

**Evaluation of the combination
of
Basic pension and Individual accounts**

Situation Analysis
[Topic 1.3.2]



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Evaluation of the combination of social pooling and individual accounts techniques schemes for urban employees

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Abstract

As for selection of a direction for perfection of basic pension insurance individual account system of China, arguments between shorting and full funding have always existed. Under the condition that pilot of full funding is very difficult in every move for many years, Notional Defined Contribution System(NDC) seemingly becomes a more practical solution. However, great controversies in this regard still exist in different government departments and academic circles. This report conducts theoretic analysis on the focus of arguments at present and puts forward a reasonable direction for perfection of “Social Pooling and Individual Account Combination” System (hereinafter referred to as pooling-account combination system) based on retrospective analysis of evolution of pooling-account combination system. To be specific, it is not to expand the scale of individual accounts but stick to the essential directions of fairness priority and narrowing but not expansion of initial distribution gap without any deviation. It aims to promote organic combination of social pooling and individual accounts, drive the reform of relevant supporting systems and implement nationwide pooling of basic pension insurance, so as to realize fairer and more sustainable development of system. This report puts forward two schemes for perfection of pooling-account combination system as well as relevant supporting policy measures.

Introduction

It was pointed out in the Third Plenary Session of the 18th Central Committee of the CPC that, “It is required to establish a fairer and more sustainable social insurance system, and stick to the social pooling and individual accounts combination and perfect individual account system”, which has made clear of the reform direction of basic pension insurance system. However, arguments between shorting and full funding have always existed on how to perfect individual account system design based on the adherence to “pooling-account combination” basic system model,. Under the condition that pilot of full funding is very difficult in every move for many years, NDC seemingly becomes a more practical scheme. However, great controversies over whether the scale of nominal individual accounts should be expanded still exist in different government departments and academic circles. It is thus urgently required to conduct systematic theoretic analysis of pooling-account combination system model and put forward practical and feasible policy suggestions acceptable for each party joined in the system.

This report plans to review the changes of “pooling-account combination” system of basic pension insurance of urban employees of China, analyze the main problems faced by the system and the causes, and put forward direction and policy suggestions for the perfection of “pooling-account combination” system of basic pension insurance of urban employees. The structure of this report is as follows: Part I briefly reviews the changes of pooling-account combination system of basic pension insurance of urban employees of China, highlights retrospective analysis on three argument climaxes concerning individual account system, and demonstrates that pooling-account combined partial fund system finally selected by China is a decision made based on experiment of abundant fierce theoretic arguments and policy choices; Part II analyzes the main problems faced by current pooling-account combination system and their causes, and clarifies the logical relationships among various problems; Part III puts forward a general idea for the perfection of pooling-account combination system of basic pension insurance of urban employees of China as well as basic principles to follow; Part IV conducts a comparative analysis of different viewpoints on the perfection of pooling-account combination system of basic pension insurance based on theoretic and practical inspection, and puts forward the viewpoints of this report; Part V analyzes nationwide pooling of basic pension insurance which is closely related to the perfection of pooling-account combination system and puts forward a scheme for promoting nationwide pooling of basic pension insurance; Part VI analyzes policy measures supporting the viewpoints put forward in Part IV and Part V of this report; Part VII, the final part, draws conclusions of this report.

1. Changes of Pooling-Account Combination System for Basic Pension Insurance of Urban Employees in China

China's reform and opening up started from rural reform in 1978, while urban reform was not involved. In 1984, China began to carry out urban state-owned enterprise reform focusing on enhancing enterprise vitality, which impacted the traditional retirement system in the charge of the state and monopolized by the entities under the original planned economic system. In order to cope with the challenge of aging of population and adapt to the transformation from planned economy to market economy, China's pension system was gradually changed from accounting on the cash basis to partial fund accumulation system since the middle term of the 1980s.

1.1 Primary Exploration of Pension Insurance System Reform (1984-1993)

In this stage, pension system reform was adopted as a supporting measure for state-owned enterprise reform. The state explored the implementation of pension social pooling and multi-party paying and determined the transformation from accounting on the cash basis to partial fund accumulation system combining social pooling and individual accounts.

1.1.1 Causes for Launch of Reform

In the beginning of the 1980s, pension method of "enterprise self-insurance" in the era of planned economy already caused imbalance of pension burden among enterprises. As for long-established enterprises in industries like textile, grain, salt manufacturing and moving, the retirement expenses were equal to over 50% of total amount of wages of in-service employees. The retirement expenses of some enterprise even exceeded the total amount of wages; in some emerging industries and newly established enterprise such as enterprises engaged in electronics, instrumentation and chemical engineering, the retirement expenses were even less than 5% of total amount of wages. With the increase of retirees of long-established enterprises year by year, the expenditure of pension increased greatly. The contradiction of imbalance of pension burden between long-established and old enterprises became increasingly severe. The method of paying retirement expenses by enterprises could no longer guarantee the lives of retirees especially for some enterprises suffering from serious losses. They had to reduce or stop paying of pension due to failure to pay retirement expenses. Some enterprises lowered and even canceled retirement treatment for the sake of interests of in-service employees, which triggered strong dissatisfaction from the retirees and their family members and affected social stability, which was a primary cause for launch of reform.

The second cause was that the establishment of labor contract system promoted pension security socialization. In 1986, China practiced labor contract system nationwide. The government could not monopolize employment. As for new employees, employment was no longer a lifelong hired “iron bowl” system. They began to enter into labor contracts with enterprises and they were able to select jobs and go anywhere they liked freely, which broke the lifelong stable relation of subordination. It meant that it was impossible that a certain enterprise was the only pension supply source of employees. Instead, a set of socialized pension security system matched with market employment mechanism must be established.

The third cause was that the endogenous defects of traditional pension system were gradually exposed and the system was continuously impacted. The burden of traditional pension insurance system was very sensitive to the composition structure of in-service employees and retirees of enterprises. Under normal circumstances, the aging of pension insurance system should be slow. However, in 1978, the state opened “Children Substitution” policy according to G.F. [104] Document. To be specific, when an employee retired from a state-run enterprise or public institution, one of his/her children was allowed to fill his/her shows. This policy was initiated upon the end of school graduates going to the countryside. Millions of school graduates returned to cities but the inflexible labor planning system could absorb so much surplus labor within a short time. As a result, many school graduates could not be arranged to work. In order to ensure employment of children, many employees from state-run entities chose to retire ahead of time and make room for their children in consideration of relatively stable and high-level retirement treatment commitments at that time. It directly caused the quick aging of traditional pension system. The dependence rate within labor insurance system climbed straightly and number of retirees and retirement expenses increased at a relatively fast speed.

Table 1-1: Increase of Number of Retirees and Retirement Expenses from 1978 to 1984

Unit: %

Year	Entity under ownership by the whole people		Enterprise under collective ownership	
	Number of retirees	Retirement expenses	Number of retirees	Retirement expenses
1978	100.0	100.0	100.0	100.0

1979	165.5	177.3	410.0	360.0
1980	224.6	266.3	593.3	700.0
1981	260.6	326.9	700.0	900.0
1982	304.6	380.9	826.7	1100.0
1983	357.4	453.9	923.3	1330.0
1984	374.1	519.0	1320.0	2120.0

Data source: Organized by the author according to data indicated in *China Labor and Social Security Statistical Yearbook* in relevant years.

1.1.2 Main Moves of Reform

(1) Implementation of social pooling of enterprise retirement expenses: In 1983, relevant department of the government put forward the launch of social pooling of retirement expenses of enterprises under ownership by the whole people. In 1984, social pooling of employee retirement expenses of state-owned enterprises was initially tried out in Jiangmen and Dongguan of Guangdong Province, Zigong of Sichuan Province, Taizhou and Wuxi of Jiangsu Province, Heishan of Liaoning Province, etc. and successful experience was primarily obtained. In January 1986, State Commission for Restructuring the Economic System and Ministry of Labor and Personnel jointly printed and distributed *Circular on Forwarding Retired Staff Pension Insurance Pooling System Implemented in Wuxi* which requested each place to expand pilot projects. As of May 1987, there were already 600 cities and counties in China implementing social pooling of retirement expenses. Relevant departments required that cities and counties with favorable conditions should implement social pooling of retirement expenses within two years. Social pooling of pension insurance of state-owned enterprises was an important move for the development of pension insurance from “enterprise self-insurance” to socialization, despite low pooling level and poor mutual aid degree of pooling implemented in the scope of cities and counties.

(2) Implementation of enterprise and employment individual payment and establishing of pension insurance system for employees under labor contract system. In 1986, the State Council released four regulations for reform of enterprise labor system and decided to implement labor contract system for all workers newly recruited by state-owned enterprises. In addition, measures for pension insurance of workers under labor contract system were stipulated. Enterprises paid retirement pooling pension according to approximately 15% of total amount of wages of workers under labor contract system, while workers under labor contract system paid retirement pooling pension not exceeding 3% of their standard wages.

(3) Pilot project of “pooling-account combination” system in Hainan Province and Shenzhen. In March 1989, the State Council formally approved Hainan Province and Shenzhen as comprehensive reform pilots of China’s social security system. Partial accumulated fund-raising model was adopted for the pension schemes of these two places. The difference lied in that Hainan Province adopted “Large Pooling (18%) and Small Accounts (3%)” while Shenzhen adopted small pooling and large account model. Over 2/3 of enterprise payment entered individual accounts and the scale of individual accounts was 16%. It was worth noting that these two places had very different understandings of nature of individual account. The pension scheme adopted by Hainan Province regarded that the private attribute of individual account pension was stronger than its public attribute. It should be regarded as mandatory occupational pension. However, the scheme adopted by Shenzhen regarded that individual accounts and social pooling jointly formed basic pension insurance.

The unified understanding of pooling-account combination ratio and nature of individual accounts by Hainan Province and Shenzhen revealed gaming and competition of different reform ideas during the period of reform at the back. Even after the Third Plenary Session of the 14th Central Committee of the CPC already made clear of reform principles of “pooling-account combination” in November 1993, the decision-making level still had different understandings of specific meaning of “pooling-account combination”. One opinion held that social pooling corresponded to basic pension insurance while individual accounts were established in the supplementary pension insurance. Another opinion held that “pooling-account combination” should be realized in the level of basic pension insurance while supplementary pension insurance did not belong to the category of mandatory social insurance. The opposite reform ideas of these two parties could be used to exactly explain the differences of model selection of two “pooling-account combination” policy pilots in Hainan Province and Shenzhen.

Table 1-2: Measures for Social Pension Insurance System Reform Pilot of Hainan Province and Shenzhen

System stipulation		Hainan Province	Shenzhen
Fund-raising ratio	Enterprise	18%	16%
	Individual	3%	5%—10%

	Total	21%	21%—26%
Method for determination of treatment	Social pooling	18%	5%—11%
	Individual accounts	3%	16%

Data source: Organized by the author according to relevant documentation.

The exploration in this period established “pooling-account combination” system model of basic pension insurance of urban employees of China. In 1993, the Third Plenary Session of the 14th Central Committee of the CPC approved *Decisions of the Central Committee of the Communist Party of China on Several Problems Concerning Establishing of Socialist Market Economy System* which, for the first time, made clear of “pooling-account combination” system as a reform direction of China’s social basic pension insurance system and acknowledged the public attribute of individual accounts.

Table 1-3: Primary Exploration of Pension System Reform

Content of reform	Nationwide reform
Social pooling of retirement expenses	In 1984, the State began pilot projects of social pooling of retirement expenses and popularized it nationwide since 1987.
Relatively standardized social pension insurance fund management mechanism	In November 1994, the Ministry of Finance issued <i>Interim Regulation on Strengthening of Enterprise Employee Social Insurance Fund Investment Management</i> .
Pension insurance multi-party bearing mechanism	In June 1991, the State Council released <i>Decision on Reform of Enterprise Employee Basic Pension Insurance System</i> .
Establishing of pooling-account combination system structure	In November 1993, the state released <i>Decisions of the Central Committee of the Communist Party of China on Several Problems Concerning Establishing of Socialist Market Economy System</i> .

Data source: Organized by the author according to relevant documentation.

1.2 Construction of Pooling-Account Combination System Model (1993-2000)

The highlights of reform in this stage were to explore how to organically combine social pooling and individual account system as well as determine national unified pooling-account combined partial fund accumulation system.

1.2.1 Construction of National Unified Pooling-Account Combination System

On the basis of summarization of exploration experience of each place, the State Council formally issued *Circular on Deepening the Reform of the Pension System for Staff and Workers of Enterprises* (G.F. [1995] No. 6) in March 1995 and put forward two implementation measures of “pooling-account combination”. The main difference of these two measures lied in the scale of individual accounts. Each region might select either of these two measures based on actual conditions. Public proposal of competitive public policy choice schemes was very rare in the government documents of China. This move reflected openness and exploration orientation during China’s social security reform. It should be pointed out though the pension system reform scheme originally designed by former Ministry of Labor did not set up individual accounts in the basic pension insurance system. Later, according to the requirements of the State Council, the original scheme was revised and individual accounts were added.

During the subsequent reform pilot for two years, there were already 21 provinces and cities and 4 national pooling industries in China establishing “pooling-account combination” pension system. In the first half of 1996, about 150,000 employees obtained pension according got the new system or the transitional measures. However, the basic system of each region was not unified and the management was decentralized. Due to different individual accounts, employees’ flow was obstructed. A typical case was that Wuhan adopted 16% of individual accounts while Hubei Province adopted 12% of individual accounts. As a result, employee transfer between municipal enterprises of Wuhan and provincial enterprises encountered with certain difficulties.

Table 1-4: Comparison of Two Reform Schemes of Social Pension Insurance System of Urban Employees

System provision	Measure 1		Measure 2
	Startup	Final goal	

Fund-raising ratio	Enterprise	13%	8%	Generally maintain social pooling level of labor insurance.
	Individual	3%	8%	8% or smaller
	Total	16%	16%	-
Method for determination of treatment	Social pooling	5%	5%	Generally remain unchanged.
	Individual accounts	11%	11%	About 10%

Data source: Organized by the author according to relevant documentation.

In 1996, the State Council instructed former Ministry of Labor and former State Commission for Restructuring and the Economic System to take the lead and organize relevant departments to form a joint survey group which should go to each place and get to know the progress of enterprise employee basic pension insurance reform. To sum up, the survey group listened to the opinions of local leaders from 14 regions and held a series of forums and demonstration meetings. Based on the summarization of practical experience of each place and through discussion in premier work meetings in August 1996 and July 1997, the State Council released *Decision on Establishing of a Unified Enterprise Employee Basic Pension Insurance System* (G.F. [1997] No. 26) in July 1997. The core content of this document was “three unifications”: Unification of standardization of payment ratios of enterprises and employee individuals. The payment ratio of enterprises should usually not exceed 20% of total amount of wages. The specific ratio should be determined by each local government according to actual conditions. The payment ratio of individuals should not be lower than 4% of their wages in 1997. This ratio would be increased by 1% for every two years later to finally reach 8%; unification of scale of individual accounts. Each place should establish individual accounts for employees according to 11% of wages of employees of enterprises. Individual payments were all included in individual accounts and the insufficient part should be transferred from enterprise payments. With the payment ratio of individuals being gradually improved to 8%, the ratio of part transferred by enterprises should be reduced to 3% accordingly; unification of pension calculation and paying measures. Pension payment included two parts, namely, basic pension and individual account pension. The monthly standard of basic pension was 20% of monthly average wages of local employees in previous year, while the monthly paying

standard of individual account pension was accumulated deposit in individual accounts dividing 120.

1.2.2 Reasons for China to Select Pooling-Account Combination System

If viewed from the development history of world social insurance system, China’s pooling-account combination model is a system innovation. This system is neither traditional pay-as-you-go system nor fund accumulation system or partial accumulation system often discussed in the social security circles. Instead, it realizes organic integration of four key system elements, i.e. two financial balance methods (pay-as-you-go and fund accumulation) and two methods for determination of treatment (determination of payment and determination of payment) under a system framework.

As a matter of fact, Chinese decision makers didn’t finally choose pooling-account combination model only in action. As analysis in the previous part, abundant theoretic arguments and policy choices were involved. Even before the release of *Circular on Deepening the Reform of the Pension System for Staff and Workers of Enterprises* in 1995, the scheme reported by Ministry of Labor to the State Council still continuously insisted on expansion of socialized pooling coverage of labor insurance system but didn’t support establishing of individual accounts. The scheme was adjusted only with the insistence of the State Council. If viewed from the perspective of retrospective analysis, each related part finally unified the understanding of establishing “pooling-account combination” model mainly based on the following considerations:

Table 1-5: Prediction of the UN for China’s Population (2005-2050)

Year	Total population (unit: 1,000 persons)	Population aged 65 and above (unit: 1,000 persons)	Ratio of population aged 65 and above (%)
2005	1312979	100464	7.7
2010	1351512	112941	8.4
2015	1388600	133902	9.6
2020	1421260	169567	11.9
2025	1445782	197382	13.7
2030	1458421	236414	16.2
2035	1458292	285868	19.6
2040	1448355	321762	22.2

2045	1431488	328493	22.9
2050	1408846	333668	23.7

(1) Aging of population age structure decided the discontinuity of pay-as-you-go model. In the beginning of the 1990s, Chinese decision makers realized that China’s population age structure would go through radical changeover within several decades and the population age structure would be aging at a relatively quick speed and the number of retirees would continuously increased. The basis of continuity of pay-as-you-go system was relative stability of population age structure (which meant that there was enough in-service generation to supporting the retired population). Therefore, this kind of pension insurance system based on transfer of inter-generation income could not cope with the impact of financial crisis resulting from quick aging of population. The pension financing of fund accumulation system was originated from savings accumulation of individuals during work. The influence of this model on the change of population age structure was neutral and it could hedge old age crisis risk in a relatively favorable way.

(2) Relatively heavy historical burden of China decided that fund accumulation model could not be fully implemented. Although complete accumulation model had born advantages in improvement of economic efficiency and resistance of aging risk, pension transition would result in the necessity to search for extra financial sources in order to fulfill the commitments made to the treatment of retirees, so as to form transformation cost. In particular, China already had 24 million retirees back then and therefore the transformation cost was tremendous. Under the condition of heavy historical burden, realization of complete transition of pension insurance system was not feasible. System innovation was needed. Based on equal consideration to the handling of old age crisis, too heavy burden should not be imposed on the in-service generation.

(3) Advantages of pooling-account combination partial accumulation system: Partial fund accumulation model has made the respective advantages of two systems complementary to each other theoretically. It not only reflects the characteristics of social insurance, i.e. social mutual aid, risk sharing and strong guarantee in a traditional sense but also highlights employees’ self-security awareness and motivation mechanism so as to establish a new pension insurance system combining fairness with efficiency and social mutual aid with self-security.

(4) Penetration of world social security reform trends. Since the 1980s, some international organizations highly praised pension individual accounts established by countries like Singapore and Chile and recommended giving up public pension system with pay-as-you-go system as financing method and government as management subject. It proposed the provision of more

efficient economic guarantee for laborers by establishing a competitive individual accumulation pension plan. The rise of this ideological trend was exactly in a same time window with China's pension system reform. Many foreign experts were involved in the demonstration of China's pension reform scheme directly or indirectly. In 1995, with the assistance of relevant departments and research institutions of China, the World Bank completed a special research report titled as "Pension Reform in China". Through these communication activities, foreign experts directly or indirectly participated in the decision-making activities of Chinese government, and their concepts were selectively absorbed and recognized by Chinese decision makers at that time and became important theoretic foundations for promotion of the establishing of individual accounts.

1.2.3 Problems Faced in Initial Operation Stage of Pooling-Account Combination System

(1) Transformation cost: Internal digestion path contained long-term paying risk. Due to existence of a relatively mature public pension system and coverage of 24 million retirees, transformation cost for transformation of China's pension system from traditional labor insurance system to pooling-account combination model was relatively huge in scale. According to different research assumptions, scale of future pension gap estimated by different scholars differed significantly from RMB 1 trillion to RMB 12 trillion. Despite disagreement on specific figure, that the transformation cost was relatively huge as a whole already became a common understanding of decision makers and the academic circles. Since the state-owned enterprises encountered with great operation difficulties and low fiscal revenue back then, external financing was hard to realize and the pension reform had to become a closed-loop system. As a result, transformation cost had to be gradually digested inside the system. The first path selected was to overdraft individual account fund to pay the current pension. Consequently, social pooling and individual accounts were managed in a "mixed" way and "empty accounts" appeared in individual accounts; the second path was to gradually make up the increase of pension expenditure by improving payment rate. 28% of high payment rate of China's enterprise employee pension insurance was greatly related to transformation cost; the third path was to expand coverage. From a long term, this kind of "coverage expansion" transferred the current paying pressure in other stages. It made relatively high treatment commitments to the new insured but only acquired fund revenue of a limited level. When the number of paying individuals in the system grew at a relatively fast speed, this policy choice was feasible. However, once pension system realized full coverage and the economic growth became stable and the number of employed population in the system was kept stable for a long term, the pension insurance system would face a situation that the coverage couldn't be expanded any more. The treatment commitments made in the past required centralized payment but no new

paying individuals were added to provide excessive financial sources for repayment. As a result, the paying pressure of pension fund would suddenly rise. Therefore, digestion of transformation cost through expansion of coverage contained huge paying risk.

(2) The coverage of the system was still limited: It mainly covered state-owned enterprises. The pension system reform in this period was no more than a supporting measure for reform of state-owned enterprises instead of independent system arrangement. The execution of enterprise employee pension insurance system in each place mainly focused on state-owned enterprises and collective economy was gradually included in the system. At the end of the 20th century, with the decline of effectiveness of collective economy, many collective enterprise assumed relatively heavy payment burden and found it difficult to join pooling-account combination system. This problem left over by history still exists in some regions now.

(3) Low pooling level of system: Weaken risk assistance and increase labor flow cost. In 1982, after China implemented tax distribution system, each city, county and district became independent financial budget entities. Social insurance pooling was conducted with district or county as unit once. Since the economic strength and local financial level of each county and district developed in an imbalanced way, different pooling entities did not have mutual aid and allocation, the funds among them were self-balanced and closed-operated, and there was no mechanism for super-solution and adjustment of superior finance established, the risk resistance of insurance system was thus weakened. Meanwhile, fragmentation of pooling regions not only affected the risk resistance of system but also obstacle reasonable flow of labor.

(4) The method for determination of pension was unreasonable: The pension treatment continuously declined. G.F. [1997] No. 26 Document stipulated a regulation mechanism centering on growth of pension with price and referring to increase of wages. However, in the reality, the pension treatment adjustment level of “middlemen” already joining work and “old men” already retiring before system transition could not catch up regional economic development and growing range of people’s income level. Relative treatment level of retirees continuously declined. As a result, the pension level gap between enterprise employees and public institution employees kept expanding, to result in many social contradictions.

1.3 Efforts for Perfection of Pooling-Account Combination System (2000-2010)

The highlights of reform in this stage were to review pooling-account combined partial fund accumulation system, adjust and try out the full funding of individual accounts, explore the

enriching of pension insurance fund with state-owned assets, improve pooling level, expand system coverage, accelerate the development of enterprise annuity, etc..

1.3.1 Further Discussion of Pooling-Account Combination System Model in 2000

Since it was required to properly solve the problem of transformation cost during transformation from pay-as-you-go system to partial accumulation system, while China expected to solve the problem by improving enterprise payments and borrowing individual account payments, problems like “mixed” pooling and “empty” individual accounts would inevitably appear. In 2000, with the proposal of former Premier Zhu Rongji of the State Council, the former Economic Restructuring Office of the State Council and the former Ministry of Labor and Social Security jointly invited first-class economists like Stiglitz and Feldstein to demonstrate *Pilot Scheme for Perfection of Urban Social Security System*. When meeting with foreign experts involved in “China Development Forum: Social Security System Reform International Seminar”, Premier Zhu Rongji put forward five major issues in the social security reform: Should China improve payment rate? Should China give up individual accounts and fund accumulation and implement pay-as-you-go system again? How could China reduce or compensate the future pension deficit? How could pension fund be managed under the capital market condition of China? How could the Central Government reduce the subsidy for each province or only subsidize provinces most needed under provincial pooling?¹ These five major problems were discussed by decision-making departments and foreign and domestic famous experts in 2000 and finally *Pilot Scheme for Perfection of Urban Social Security System* was finally formed in 2001. It determined to continuously stick to pooling-account combined partial fund accumulation system and gradually try out the full funding of individual accounts.

1.3.2 Adjustment and Pilot of Full Funding of Individual Accounts

In 2000, the State Council issued *Circular on Printing and Issuing Pilot Scheme for Perfection of Urban Social Security System* and the pilot project was conducted in Liaoning Province first. The fund-raising ratio of individual accounts was adjusted from 11% to 8%. The employees shall pay in full amount. As for gap of individual account fund resulting from reasons like history, the central finance and the local finance would subsidize at a ratio of 75:25. In addition, National Council for Social Security Fund was formed and entrusted to invest and operate individual account fund subsidized by the central finance.

¹ Refer to Human Development Bureau of World Bank: *Five Problems in China's Social Security System Reform (2001)*, forwarded from “Macro Economy” Special of www.drcnet.com.cn

In 2003, the Third Plenary Session of the 16th Central Committee of the CPC approved *Decisions of the Central Committee of the Communist Party of China on Several Problems Concerning Perfection of Socialist Market Economy System* which put forward “perfecting enterprise employee basic pension insurance system, sticking to combination of social pooling and individual accounts, and fully funding individual accounts in a gradual way”. After summarizing experience of full funding of individual accounts in Liaoning Province, the State Council expanded pilot in Heilongjiang Province and Jilin Province in 2014. The two provinces started from 5% and gradually fully funded individual accounts. The capital required for full funding was subsidized by the central finance by 3.75% and local finance by 1.25% respectively. The monthly standard of individual account pension was determined by dividing number of months for calculation and paying of pension from amount deposited in individual accounts. The number of months for calculation and paying of pension was determined according to factors like average life expectancy of urban population, retirement age of employees themselves and interest upon retirement of these employees. In 2005, the State Council released *Decision on Perfection of Enterprise Employee Basic Pension Insurance System* which put forward expansion of pilot of full funding of individual account and adjusted scale of individual accounts from 11% of wages to 8% as well as adjust the measures for calculation and paying of basic pension accordingly. In the same year, Ministry of Labor and Social Security and Ministry of Finance jointly released *Circular on Relevant Issues Concerning Expansion of Pilot of Full Funding of Individual Accounts of Enterprise Employee Basic Pension Insurance* and decided to further expand the pilot of full funding of individual accounts. The short-term goal of full funding of individual accounts was 5%. Places with favorable conditions were encouraged to realize 8%. During the pilot, principles such as separation of old, middle and new, separation of East China, Central China, and West China, activeness and reliability and gradual launch were followed. The central finance offered subsidies to Central and West China, old industrial bases and Xinjiang Production and Construction Corps. In 2007, according to the deployment of the State Council, Ministry of Labor and Social Security and Ministry of Finance issued a document concerning further expansion of pilot of full funding of individual accounts and confirmed that provinces like Jiangsu and Zhejiang might launch pilot of full funding of individual accounts relying on their own capacity.

1.3.3 Exploration of Enriching Pension Insurance Fund with State-owned Assets

In January 1996, State Commission for Restructuring the Economic System definitely stipulated in *Key Points to Implementation of Economic System Reform in 1996* that standard measures for compensation of insufficient social insurance fund by contributing a certain ratio from

existing state-owned assets and land income were explored according to actual circumstances. *Key Points to Implementation of Economic System Reform in 1997* and *Key Points to Implementation of Economic System Reform in 1998* reaffirmed this content.

In September 1999, the suggestion of transferring state-owned assets to enrich pension insurance fund was written in *Decisions of the Central Committee of the Communist Party of China on Several Problems Concerning Reform and Development of State-owned Enterprises* approved in the Fourth Plenary Session of the 15th Central Committee of the CPC. In order to implement the spirit of *Decisions*, in June 2001 the State Council issued *Interim Measures for Reducing Holding State-owned Shares to Raise Social Security Fund* which requested companies limited by shares owned by the state to sell state-owned shares according to 10% of financing amount during IPO and increase of issues. The revenue from sales would be handed over to national social security fund. After this policy was issued, strong fluctuation of stock market and certain social emotional fluctuation were triggered. Therefore, it was halted by CSRC 4 months later. In June 2002, the State Council official declared the termination of execution of state-owned shares holding reduction measures against domestic listed companies.

1.3.4 Improvement of Pooling Level of Enterprise Employee Pension Insurance System

Starting from law of large numbers of social insurance, with the higher the pooling level of pension insurance and the stronger the fund strength, pension insurance burden of different regions can be better balanced and the effect of pension insurance can become more stable and lasting. As early as 1987, the former State Commission for Restructuring the Economic System and the former Ministry of Labor mentioned in a circuit issued, “social pooling of retirement expenses shall be implemented in most cities and counties in China and places with favorable conditions can also carry out pilot of provincial pooling”. It was the first time when the concept of “provincial pooling” was used in documents of competent departments of the State Council. In 1991, the State Council released *Decision on Reform of Enterprise Employee Basic Pension Insurance System* which clearly proposed, “Favorable conditions shall be actively created to gradually transit from current municipal and county-level pooling to provincial pooling”. In 1995, the State Council printed and issued *Circular on Deepening the Reform of the Pension System for Staff and Workers of Enterprises* which presented that the highlight of reform was placed in prefecture-level cities. In 2007, the former Ministry of Labor and Social Security and Ministry of Finance jointly released *Circular on Relevant Issues Concerning Promotion of Provincial Pooling of Enterprise Employee Basic Pension Insurance* which requested acceleration of realization of provincial pooling step and

unification of basic pension insurance system model, payment mechanism, treatment standards, fund management and business flow of each place at provincial level. By the end of 2007, 13 provinces and regions in China, namely, Beijing, Tianjin, Jilin, Heilongjiang, Shanghai, Fujian, Chongqing, Yunnan, Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang realized provincial pooling, while four provinces and region, i.e. Henan, Hunan, Jiangxi and Tibet, as well as Xinjiang Production and Construction Corps issued provincial pooling measures.

1.3.5 Improvement of Pension Level of Enterprise Retirees

Since the pension insurance system reform of enterprises and government agencies and public institutions was not synchronous, the treatment calculation and paying measures and adjustment measures differed, and enterprises' pension insurance system was changed from pay-as-you-go system to partial fund accumulation system while government agencies and public institutions still used the original retirement system, the gap of treatment between retirees of enterprises and retirees of government agencies and public institutions kept increasing and the treatment level formed "three steps" from high to low, i.e. government agencies, public institutions and enterprises, consequently triggering many social contradictions. Currently, the average substitution rate of pension of government agencies and public institutions was approximately 80% which was much higher than that of enterprises (58%). In order to balance this gap, the State Council has already decided to improve the pension level of retirees of enterprises for 11 consecutive years since 2005, with an annual average growth rate of 10%.

1.4 Review and Top-level Design of Basic Pension Insurance System (2010-Now)

The pilot of full funding of individual accounts encountered with great difficulties over one decade. By the end of 2011, only RMB 270.3 billion of individual accounts was fully funded. The State Council already agreed that Liaoning Province might tentatively borrow money from fully funded individual accounts to pay the current expenditure. Later another two provinces applied not to fully fund individual accounts anymore. In 2010, the Twelfth Five-year Plan for National Economic and Social Development of the People's Republic of China definitely pointed out, "Bigger resolution and courage shall be presented to comprehensively promote the reform in each field and more attention shall be paid to reform of top-level design and general planning". Later, the discussion of top-level design of pension system reform was increasingly heated, and people began to review the pooling-account combination system again.

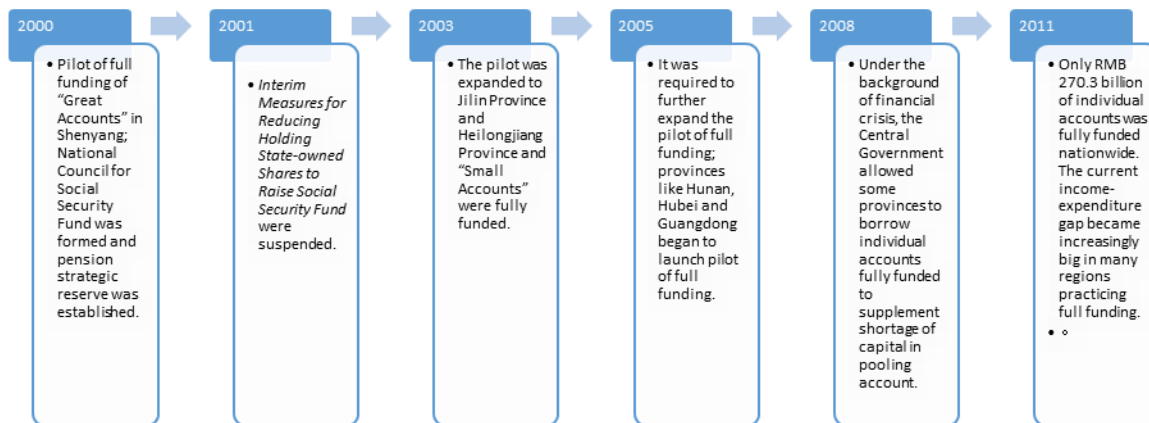


Figure 1-1: Effort and Practice of Full Funding of Individual Accounts

In 2013, the Third Plenary Session of the 18th Central Committee of the CPC put forward the idea of "Sticking to pooling-account combination system and perfecting individual account system". Under the leadership of Ministry of Human Resources and Social Security, representative organizations in China with different academic viewpoints raised six top-level design schemes for pension system reform. The implementation of Notional Defined Contribution became a more practical option. However, this scheme triggered great controversies. In addition, that how to implement different Notional Defined Contributions was presented with different viewpoints. The study of this report is exactly amidst the arguments of this round of top-level design.

2. Main Problems Faced by Pooling-Account Combination System of Basic Pension Insurance and Causes

It is undeniable that China's pension insurance system construction has obtained great progress and realized the transformation from "enterprise self-insurance" to multi-party bearing pooling-account combination system. People benefited from this system keep increasing, the security level is stably improved and the management service capacity construction is strengthened. Nevertheless, some problems during development and reform are still not properly solved, and some new problems emerged under the new situation. The basic pension insurance system of urban employees of China faces the crossroad of development once again.

2.1 Main Problems Faced by Pooling-Account Combination System of Basic Pension Insurance

The primary problem of China's pension insurance system to solve lies in fairness and sustainability. Requirements of fairness: 1. As an important part of social security system and also an important approach for national income redistribution, pension insurance system is an important content of China's basic public service system. The function of income redistribution shall be properly developed; 2. It shall be ensured that pension fund realizes mutual aid among different generations, different groups of people and different regions; 3. More groups of people the system can cover shall be included in the system. Sustainability refers to long-term financial balance of pension level given relatively stable conditions under the scheduled condition of population age structure and a bearable rate, which requires that: 1. Pension payment rate is bearable for different types of enterprises and employees, and the expenditure used by each financial department of the state in each level for pension insurance is also bearable; 2. Pension substitution rate can not only ensure certain living standards of retirees but also squeeze and supplement the development space of pension insurance due to the substitution rate being too high; 3. Pension can not only ensure payment in current period but also realize long-term financial balance. While ensuring fairness priority, basic pension insurance system shall also give equal consideration to efficiency which mainly refers to two aspects: One is motivation mechanism which links individual payments with pension treatment level. More people are motivated to take part in the system and actively pay relevant expenses; the other is to compress management cost and improve management efficiency. Therefore, the main problems faced by China's pension system include:

2.1.1 Long-term Financial Sustainability of System Confronted with Challenges

China began to step into the stage of aging of population since 1999. It is expected that the aged population will increase to 350 million to 450 million during "the Thirteenth Five-year" period. In the peak of aging of population, i.e. 2053, the ratio of total number of senior citizens aged 60 and above in total population will reach 35%. Meanwhile, the working-age population will continuously decline, the dependence coefficient of aged people will substantially increase and pension expenditure will quickly increase. If viewed from current fund income-expenditure operation condition, the current surplus of basic pension insurance fund of urban employees of China was RMB 420.994 billion in 2013. After deduction of financial subsidies, the current surplus was only RMB 16.317 billion. Some regions already faced the condition that income is less than expenditure in current period. If viewed from the accumulated surplus, there was no region with

negative accumulated surplus. However, the growth rate declined to a certain extent and the regional differences were still significant. For example, the number of months of provision of accumulated surplus was 53.41 while that of Xinjiang Production and Construction Corps was only 2.85.

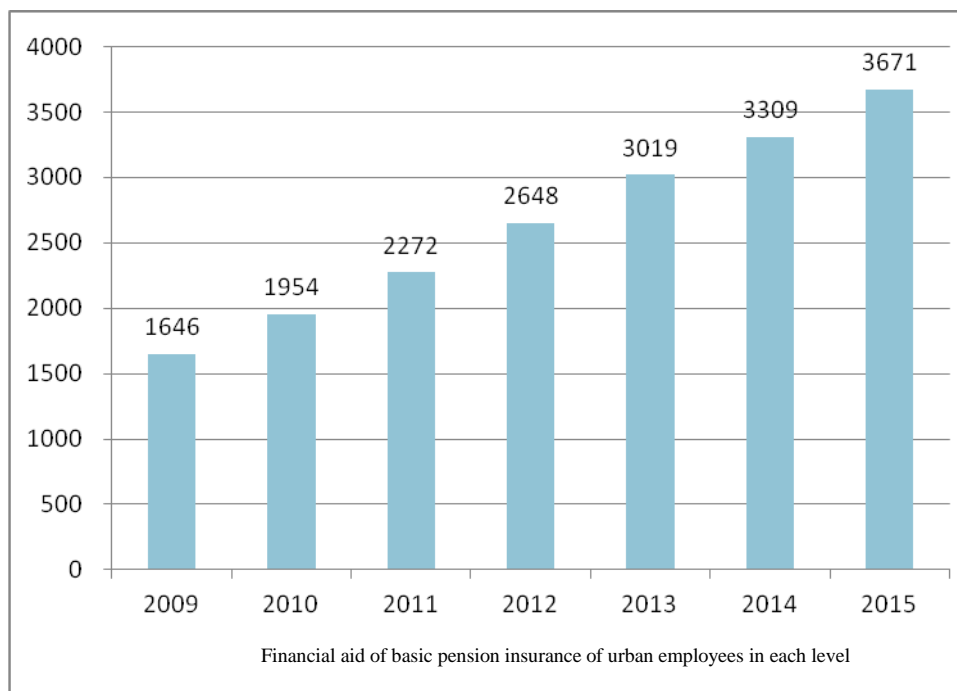
Table 2-1: Surplus Conditions of Income Collection Minus Total Expenditure of Basic Pension Insurance of Urban Employees in Each Province in 2013

Province	Surplus	Province	Surplus	Province	Surplus
Guangdong	697.76	Tibet	2.67	Chongqing	-81.54
Beijing	396.36	Agricultural Development Bank of China	2.08	Xinjiang Corps	-82.81
Jiangsu	218.37	Yunnan	-0.3	Tianjin	-85.58
Zhejiang	215.15	Sichuan	-6.14	Guangxi	-88.68
Shanghai	208.38	Ningxia	-14.4	Henan	-88.73
Shandong	101.5	Qinghai	-16.08	Hunan	-111.8
Fujian	48.24	Gansu	-25.63	Jilin	-127.15
Shanxi	18.66	Hainan	-30.63	Hebei	-134.96
Xinjiang	15.84	Shaanxi	-50.02	Hubei	-174.47
Anhui	13.42	Inner Mongolia	-63.94	Liaoning	-233.82
Guizhou	6.4	Jiangxi	-66.17	Heilongjiang	-298.8

Data source: Zheng Bingwen: *China Pension Report 2014-Transformation to Notional Defined Contribution*. Beijing: Economy & Management Publishing House, 2014.

It should be recognized that the current condition in some regions including Northeast China that the income was less than the expenditure was related to unreasonableness of regional splitting of system at present. This problem could be solved through inter-regional pooling and mutual aid.

However, the development of aging of population would increase the pressure of financial expenditure under the condition that China was currently lack of fund-raising channels beyond the system and also effective solutions to transformation cost.



Note: The amount in 2015 is a budget amount; data source: Financial Statistical Yearbook in relevant years

Figure 2-1: Expenditure of Financial Aid of Basic Pension Insurance of Urban Employees in Each Level

2.1.2 Poor Adaptability to Mobility

The transfer and renewing of pension insurance relation are unimpeded, it is inconvenient for the insured to transfer and new pension insurance relation in different pooling regions and among different systems, the formalities for transfer and renewing of pension insurance relation are complicated and overloaded and take a long time. Actually, the technologies and policies of transfer and renewing are basically completed. The primary cause of not ideal execution in reality lies in decentralized fund management and low pooling level. The power of property and the power of office of each level of government among different pooling levels are unclear. This problem can be gradually solved through nationwide pooling of basic pension.

2.1.3 Overall Falsely High Payment Rate and Obvious Regional Differences

Currently, the sum of rates of five social insurances paid by Chinese enterprises and individuals is around 40%. Among these five social insurances, the rate of pension insurance is

mainly relatively high (it is 28% in most regions). Since a relatively big gap exists between actual payment base number and wage income, and the calculation of payment base number is based on social average wages, while only statistics of enterprises above designated size are gathered to calculate social average wages, two problems will be therefore caused: 1. The real payment rate is lower than nominal payment rate. According to relevant researches, the real payment rate of enterprise employee basic pension insurance of China is approximately 14%; 2. Some enterprises especially many SMEs and labor-intensive enterprises indicate that the payment burden is too heavy, the employee wages are lower than social average wages and the payment rate is relatively high. Furthermore, the payment rate differs greatly in different regions, to result in unequal development opportunities in these regions. China actually executes 16 standards of enterprise basic pension insurance payment rate. The highest payment rate is 22% while the lowest is 10%. 8 provinces still fail to realize unified payment rate in the provinces, and some provinces even adopt as many as 12 standards.

2.1.4 Incomplete Pension Treatment Determination and Adjustment

If viewed from the perspective of treatment determination mechanism, in order to fulfill the requirements of extensive and full coverage, the threshold for obtaining of pension qualification is set relatively low and the sustainability of system becomes worse. It is mainly reflected in the following aspects: 1. Low payment term: Chinese people paying 15 years of insurance expenses are qualified to obtain pension in China's basic pension insurance, while the minimum payment term of most OECD countries reaches 40 years; 2. Low retirement age: Relevant researches indicate that the average retirement age of urban employees of China is 56.1, while the average retirement age of OECD countries is 64 for males and 63 for females. Under the condition that the life expectancy of Chinese population keeps growing, the retirement age stipulated is too early. The retirement age is not linked with life expectancy per capita. Therefore, it fails to dilute supporting rate to improve financial sustainability of pension insurance; 3. The number of months for calculation and paying of pension is not timely revised. The calculation and paying of individual account pension is based on nominal accumulated amount of individual accounts by dividing number of months for calculation and paying of pension. Currently, China still follows the table of number of months for calculation and paying of pension to individual accounts released in 2005 and thus it fails to fully reflect the changing conditions like life expectancy of population and retirement age. The number of months for calculation and paying of pension to individual accounts under current system is only about half of actual remaining life.

If viewed from the perspective of treatment adjustment mechanism, administrative adjustment makes adjustment rigid and the income-expenditure restriction of pension fund is softened. Since the reform of pension system of enterprises and government agencies and public institutions is not synchronous, system model, treatment calculation and paying methods and adjustment methods all differ. The treatment gap between these two systems kept expanding since 2001, thus triggering many social contradictions. Currently, the average substitution rate of pension of government agencies and public institutions was approximately 80% which was much higher than that of enterprise employees (approximately 50%). In order to balance this gap, the State Council has already decided to improve the pension level of retirees of enterprises for many consecutive years since 2005, with an annual average growth rate of 10%. This kind of administrative instruction “adjustment” method had a positive effect within a short term. However, it results in unclear expectation of society for pension treatment adjustment, splits income association designed in original system, and also forces the government to carry out rigid improvement of treatment, which significantly increases its financial pressure. The calculation method for adjustment of treatment standards is not scientific, which has already caused the problem of reverse linking of wages of in-service employees and pension treatment. It is required to establish a scientific adjustment mechanism on the basis of actuary to conduct adjustments according to economic and social development conditions and stabilize people’s expectations.

Besides the four problems mentioned above, many viewpoints regard that the fairness of basic pension insurance pooling-account combination system of urban employee of China is still questionable. It is regarded in this report that the problem of fairness exists in China’s basic pension insurance system including basic pension insurance of urban employees, basic pension insurance of government agencies and public institutions, and basic pension insurance of urban and rural residents. However, basic pension insurance system of urban employees has reflected fairness in a relatively favorable way. 20% of social pooling ratio of current system is beneficial to the adjustment of income redistribution. Relevant research findings also indicate the pension insurance has an obvious effect on income redistribution amount people with high and low income. However, its effect on income redistribution among people of different employment types is not clear, thus reflecting the unfairness of system². Some scholars put forward an issue that the insufficient coverage of employee basic pension system has an adverse influence on fairness. It mainly refers to that a considerable number of migrant workers and flexible employees are not included in the

²Wang Xiaojun & Kang Bowei. Analysis of Income Redistribution Effect of China’s Social Pension Insurance System. *Statistical Research*, 2009 (11).

system. It is regarded in this report that extensive coverage is more beneficial to mutual aid and sustainability of system. But it is currently not necessary to forcefully include in all migrant workers and flexible employees in basic pension insurance system of urban employees, for employment market needs certain flexibility while employment is the best guarantee. If all employees are forcefully included in pension insurance system, the labor cost of irregular employment will be increased, which is not beneficial to promotion of employment. It will not only increase management cost but also make some irregular employees to reject and cancel insurance. The total number of migrant workers of China is about 270 million, and the number of migrant workers flowing cross provinces is around 160 million. In order to solve a series of problems concerning urban social security, education, and medical treatment and public health available by migrant workers, the essential way out is to promote citizenization of migrant workers. It is very difficult to solve this problem only relying on social insurance. It also depends on the reform of household registration system developed along with urbanization. In 2014, China already began to implement *National New Urbanization Planning (2014-2020)* and the promotion of reform of household registration system featuring citizenization of employed population from rural area to urban area was an important content of this planning.

2.2 Primary Causes for Great Difficulties Encountered by Pooling-Account Combination System

The main problems faced by existing pooling-account combination system are not isolated. These problems connect and influence each other and present relatively strong logical casual relationship. For example, in regions where individual accounts cannot be fully funded, the income-expenditure gap of the pension fund is relatively big, the aging of population is serious and the payment rate is relatively high. Since improvement of pooling level is a precondition for obtaining of transfer payment from the central finance, the pooling level in these regions is also relatively high; in regions where individual accounts are fully funded, the payment rate is relatively low, the pooling level is relatively low and the value preservation and increase pressure of pension fund is huge. The primary causes resulting in these problems mainly lie in:

2.2.1 Problem of Transformation Cost Unsolved

During the transformation progress from pay-as-you-go system to pooling-account combined employee basic pension insurance, China has always failed to solve the problem of transformation cost. Although some relevant documents put forward the idea of appropriating a part of assets of state-owned enterprises to supplement pension fund, it was not implemented for many years.

During the actual operation, this problem was solved by improving enterprise payments and borrowing individual account payments, which would inevitably result in mixed and empty accounts. The in-service generation has not only to support the retired generation through inter-generation transfer payment but also to prepare for their retirement, while the pension level of the retiring generation also slightly declines, thus paying a cost for system transformation.

2.2.2 Pooling Level Too Low

Pooling level being too low leads to a phenomenon that regions with relatively high supporting rate of aging population have to overdraft fund accumulated in individual accounts and maintain a relatively high payment rate, while regions with relatively low supporting rate of aging population are able to lower payment rate. Regional gap of payment rate results in unfairness of development opportunities in different regions. Developed regions obtain development “dividends”. Since nationwide pooling of pension is still not realized yet, balance of pension of developed regions cannot be transferred to regions failing to make both ends meet. As a result, the central finance has to appropriate over RMB 200 billion to subsidize these regions in order to realize balance of payments. Therefore, the central finance is supporting the operation of split pension system. In fact, the subsidy from the central finance stays in a minority of surplus provinces. Besides, due to the individual account fund torn to pieces, it is impossible to establish an investment and operation mechanism of individual account fund and it is difficult to effectively appreciate the accumulated fund.

3. Overall Idea for Perfection of Pooling-Account Combination System of Basic Pension Insurance

3.1 Main Idea

Implement the requirements of the Third Plenary Session of the 18th Central Committee of the CPC for establishing of a fairer and more sustainable social security system, base on the general situation of new normality of China’s economy and the changing trend of population age structure, stick to the guideline of full coverage, basic insurance preservation, multiple levels and sustainability, the essential direction of fairness priority and the essential direction of narrowing but not expansion of initial distribution gap without any deviation, actively promote structural reform of basic pension insurance of urban enterprise employees and perfect and give equal consideration to relevant supporting measures, and promote the development of basic pension insurance system in a fairer and more sustainable way.

3.2 Basic Principles

-Fairness priority and equal consideration to efficiency: Basic pension insurance system is not only an important project of China's social security system but also an important part of the national basic public service system. The functions of mutual aid and income redistribution of basic pension insurance system shall be emphasized. On this basis, motivation mechanism and supply efficiency of the system shall be improved, and people's initiative to take part in insurance and pay insurance expenses shall be enhanced.

-Sharing by three parties and guarantee of basic insurance: Stick to the sharing of basic pension insurance expenses by three parties, i.e. the state, enterprises and individuals. Realize social pooling and mutual aid of basic pension insurance expenses at a relatively high level and within a relatively big scope. Stick to the principle of basic insurance preservation, provide more groups of people with certain level of basic insurance, and gradually expand insurance scope and improve standards according to the economic and social development and changes of demands.

-Revealing of all the details by the government and assurance of actuary balance: It means actuary balance based on the revealing of all the details by the government. Strengthen the dominant position and leading role of government in provision of basic pension insurance, perfect government input guarantee mechanism, pursue "actuary balance" of system as much as possible, conduct actuary balance analysis of income-expenditure condition of pension insurance account fund within a certain period, and make the national finance reveal all the details when necessary.

-Supporting and comprehensively advancing reform: The construction of basic pension insurance system shall adapt to the economic development situation of the state and the changing trend of population age structure. In addition, it is required to continuously perfect relevant supporting measures, establish scientific treatment determination and adjustment mechanism, link the indexation of basic pension with equilibrium factor of the system, and improve system insurance level and operation efficiency.

3.3 Proper Handling of Several Major Relations

3.3.1 Relation between Mutual Aid and Motivation

Motivation and mutual aid of basic pension insurance are trade-off to a certain extent. The stronger the motivation and the weaker the mutual aid would become. Mutual aid emphasizes fairness and mutual assistance, while motivation stresses correspondence between rights and obligations. The legal basic pension insurance of the state shall cover the whole people and promote

social fairness. Therefore, the basic function of mutual aid shall be emphasized. Linking of treatment with payment can be enhanced and honest and diligent labor can be promoted only on this basis.

3.3.2 Relation between Present and Long Term

Pension system is an income-consumption smoothness system between generations and among different stages of individual life cycle. It is often affected by long-term factors like degree of aging of population, retirement term, and return on investment. It has to go through a long test and cannot bear the influence of short-term factors like policy regulations and administrative assessment. The goal of reform of pooling-account combination system of pension insurance of urban employees is not only to preserve current rigid payment but also to benefit long-term sustainable development of system and give equal consideration to present and long term.

3.3.3 Relation between Government and Market

In the pension system, properly handling relation between government and market is actually to properly handle the relation between basic pension insurance and supplementary pension insurance and make clear of the functions of these two insurances. An important content of reform of pooling-account combination system is to clearly define security responsibility and level of basic pension sponsored by the government and properly release market acting space.

3.3.4 Relation between Central Government and Local Governments

Basic pension insurance is the common power of office of central government and local government. Relationship of power of office shall be gradually smoothed and decentralized authority of central government and local government shall be emphasized. The central government shall not only break local protectionism, conduct pooling, adjustment and use of pension in a bigger scope and turn over the reverse transfer tendency of expansion of initial distribution gap of inter-region basic pension insurance project, but also fully mobilize local initiative and encourage mutual competition and learning among different places. Under the condition that the regional development gap of China is relatively significant, it can be considered that the central government shall take charge of nationwide pooling of basic pension and enough acting space shall be given to local governments on the basis of guarantee of basic pension demand.

4. Pooling-Account Combination System Model of Basic Pension Insurance

4.1 Arguments of Different Viewpoints on Perfection of Basic Pension Insurance

Arguments between “shorting” and “full funding” have always existed as for selection of direction for perfection of pooling-account combination.

4.1.1 Shorting of Individual Accounts and Implementation of Notional Defined Contribution

Based on the reality that full funding of individual accounts is very difficult over many years and referring to experience of establishing of nominal accounts by some countries, certain sectors and scholars put forward transformation as Notional Defined Contribution³ and come up with three schemes: 1. Implement full nominal accounts (28%). Include individual and enterprise payments to nominal accounts. They belong to individuals. National unified account-keeping interest rate is released every year with clear individual payment records. In addition, calculation and paying formula featuring more payment for more gain is adopted. Pooling account and individual account fund are used in a mixed way and all of them are used for current payment. The surplus fund is used for investment and operation; 2. Implement lager nominal accounts (16%) to enhance payment motivation; 3. Implement small nominal accounts (8%) and do not change the current situation of enterprise payment as 20% and individual payment as 8%. The three schemes mentioned above are to strengthen payment motivation mechanism and request using individual wage income as payment base number. The balance of individual accounts is not inherited.

The main reason for supporting of Notional Defined Contribution lies in its motivational effect. It is regarded that Notional Defined Contribution implements DC system with payment determined as for payment of treatment. The individual payment is directly linked with pension treatment level. Therefore, it has relatively strong payment motivational effect theoretically, which is mainly reflected in the following aspects: 1. Motivation of individual payments benefit expansion of coverage and improvement of collection level; 2. Payment is directly linked with pension treatment. The concept of more payment for more gain helps increase payment term and encourage postponed retirement; 3. It is convenient to manage nominal individual accounts and it is easily to transfer and renew. Therefore, this system adapts to population mobility; 4. Nominal individual

³Zheng Bingwen: *China Pension Report 2014-Transformation to Notional Defined Contribution*. Beijing: Economy & Management Publishing House, 2014.

accounts can realize long-term financial sustainability of the system through actuary relation between treatment and payment.

4.1.2 Full Funding of Individual Accounts to Conduct Structural Adjustment

Scholars holding this viewpoint think that pooling-account combination system is an innovation of China's pension system and it has well integrated the advantages of pay-as-you-go system and fund accumulation system and fully reflected the principle of equal consideration to fairness and efficiency. Besides, it experienced major theoretic and decision-making discussion in the 1990s. The future development direction is to establish national basic pension system through system integration to overcome poverty of senior citizens; build functions of savings of individual accounts and market financing to improve senior citizens' lives. It requires the full funding of individual accounts as soon as possible. There are two different viewpoints concerning how to fully fund individual accounts and how to manage individual accounts after full funding: 1. Individual accounts fully funded are still a part of basic pension insurance and they shall go through market-oriented investment and operation. It insists on original intention of system design and claim gradual implementation of full funding. It can start from full funding of small accounts (5%). New and old accounts shall be separated. Old accounts shall be fully funded by other means including appropriation of income of state-owned capital and increase of fiscal revenue; 2. Change individual accounts to supplementary pension insurance. Scholars with this viewpoint think that individual accounts do not increase efficiency or solve the problem of retirement income guarantee under the condition of aging of population. Instead, it brings many realistic challenges. Therefore, these scholars recommend separation of social pooling from individual accounts and inclusion of individual accounts to voluntary enterprise annuity or personal savings insurance⁴.

The important reasons for supporting of full funding of accounts are aging of population and system recognition. It is regarded that Notional Defined Contribution is not sustainable under the background of aging of population. Besides, the economic advantage and motivational effect of Notional Defined Contribution are not obvious, and it directly damages the function of income redistribution and substantially lowers the safe expectations of the insured. The reasons why individual accounts cannot be fully funded shall be treated in an objective way, and it shall be clarified that that the individual accounts cannot be fully funded cannot deny the correctness of decision-making of pooling-account combined partial fund accumulation system.

⁴Li Zhen. *Analysis and Evaluation of Basic Pension Insurance System*. Beijing: People's Publishing House, 2013.

4.2 Theoretic Analysis Based on Cross Matrix

A cross matrix indicating relationship between mutual aid and motivation and between present and long term is established for analysis. Mutual aid and motivation of pension system has a trade-off relationship. If viewed from the perspective of the entire economic aggregate, capital available for basic pension insurance system is limited. If the mutual aid of the system is improved, its motivation will be inevitably weakened. If the motivation is improved, its mutual aid will be inevitably weakened. The relationship between present and long term is often considered from the perspective of financial balance. The long-term sustainability of the system refers to long-term financial balance under a bearable rate and relatively stable condition of pension level with given population age structure.

If viewed from the perspective of financial model, pension insurance system can be classified into pay-as-you-go system and fund accumulation system. Pay-as-you-go system determines income based on expenditure, combines expenditure with withdrawal and implements inter-generation income redistribution. It features strong mutual aid and ensures current expenditure; fund system features withholding accumulation and future payment and implements income redistribution within individual life cycle. It has weak mutual aid but ensures long-term financial balance. If viewed from the perspective of treatment payment model, pension insurance system can be classified into treatment determined DB model and payment determined DC model. DB system can be linked with payment. However, more importantly, it guarantees a certain pension level to prevent poverty of senior citizens; DC system is directly linked with payment. The treatment level is related to payment and investment and operation conditions. But it does not ensure treatment level under certain substitution rate. Both fund system and pay-as-you-go system can be designated as DB or DC model.

Partial fund accumulation system determined by China in 1997 was expected to combine the advantages of comprehensive pay-as-you-go system and fund accumulation system. Pay-as-you-go system was implemented for 20% of social pooling to reflect mutual aid. It was mainly used to pay basic pension of DB model. Fund accumulation system was implemented for 8% of individual accounts to reflect motivation. In addition, it was used accumulate partial fund for long-term payment. It was mainly used to pay individual account pension of DC model.

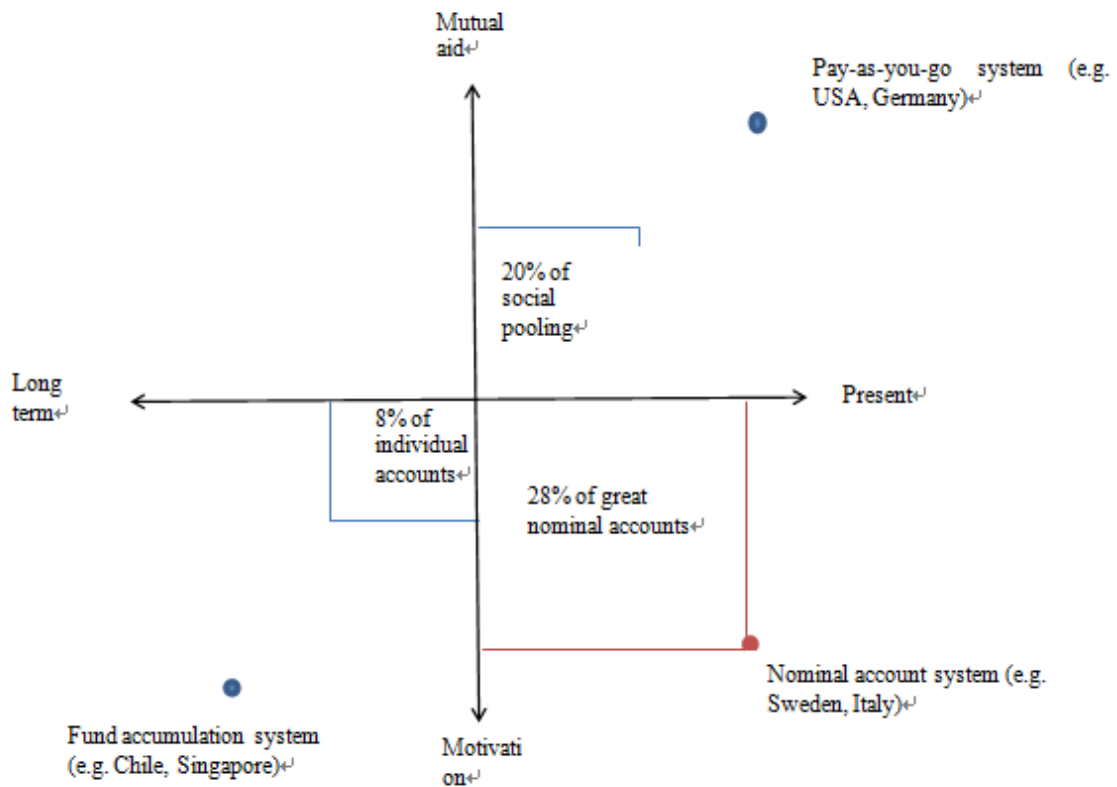


Figure 4-1: System Design and Full Notional Defined Contribution Reform Scheme in 1997

Notional Defined Contribution refers to “nominal payment determination system”. It is a pay-as-you-go system in terms of financial operation. It is another bookkeeping method of pay-as-you-go system instead of innovative form of fund accumulation system. The Notional Defined Contribution itself has no fund accumulation and its financial balance depends on the national financial situation. The capacity of the system for handling of aging of population is relatively low.

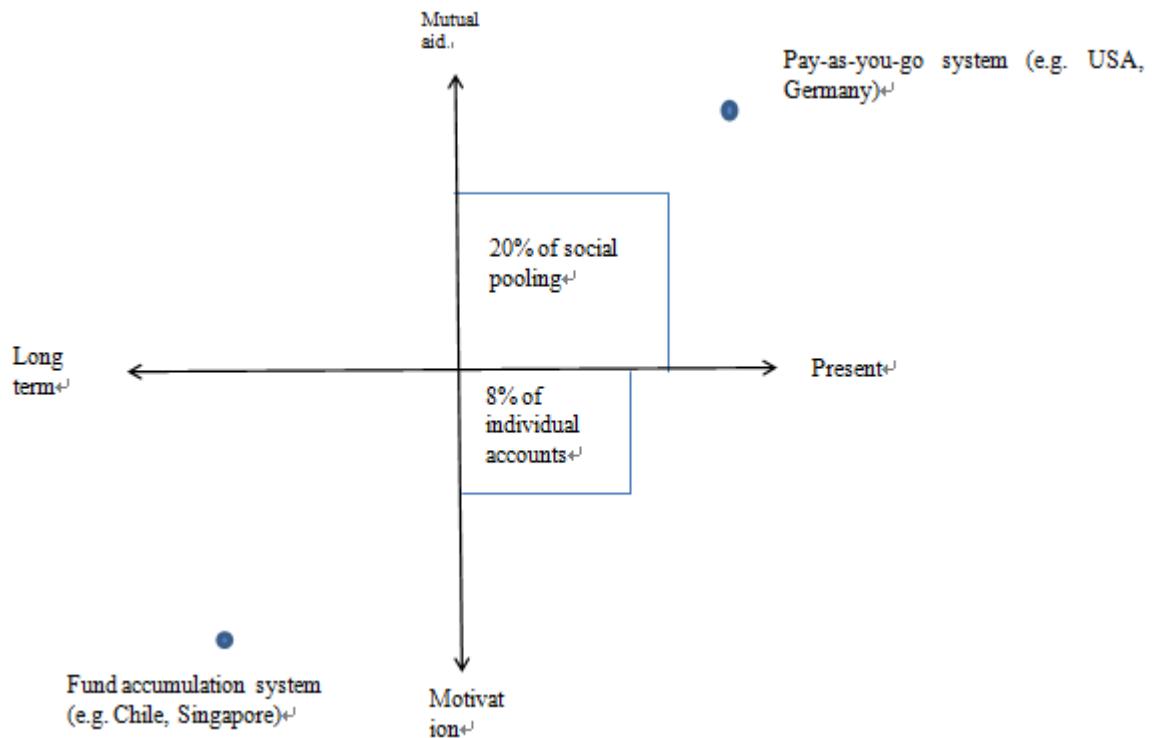


Figure 4-2: 8% Notional Defined Contribution Reform Scheme

4.3 Practical Inspection of Focus of Contradiction

There are two focuses of contradictions of different viewpoints: 1. Whether Notional Defined Contribution can realize long-term sustainable development through actuary balance; 2. How big the motivational effect of Notional Defined Contribution is.

4.3.1 Is Notional Defined Contribution sustainable?

Long-term sustainability of the system refers to long-term financial balance under a bearable rate and relatively stable condition of pension level with given population age structure. The preconditions of two viewpoints (i.e. sticking to full funding of individual accounts and implementing fund accumulation system & shorting individual accounts and implementing Notional Defined Contribution) differ concerning the issue of sustainability. Scholars who support full funding of individual accounts predict that pension fund has self-balanced income and expenditure. If large-scale financial imbalance takes place in the peak of aging of population, this system will fail. Scholars opposing full funding believe that the younger generation always has to create material wealth to support the elderly generation under all financial systems if viewed from the perspective of physical form, and the full funding of individual accounts is also exposed to the fund investment and operation risks. Therefore, it is unnecessary to fully fund individual accounts

in this regard. The pension system needs to satisfy rigid payment and financial support from the government is also an important source of pension fund income. Therefore, when payment gap appears in the pension, the financial department of the government may conduct current transfer payment.

The precondition of sustainability of Notional Defined Contribution is unlimited support and warranty from the finance. For example, relevant law of German stipulates that about 20% of income of pension comes from fiscal appropriation of the state. The debt condition of Germany exceeded the red line established by the Eurozone every year from 2002 to 2005, while 30% of public expenditure of Germany was spent on the subsidy of pension. China's retirees rely on basic pension insurance too much and they have relatively high expectations for basic pension insurance and also relatively high requirements for fairness. If pay-as-you-go system is implemented, it must join hands with multilevel supplementary pension insurance system for mutual support. Otherwise, the pay-as-you-go system which takes on all things is not sustainable.

Under the background of aging of population, Notional Defined Contribution cannot change the continuously deteriorated supporting rate of aging population faced. If principle of "actuary balance" is introduced to Notional Defined Contribution itself and no capital investment outside the system such as finance is provided, the payment burden of the in-service generation will be increased, or the substitution rate of pension treatment will decline. Sweden began to implement Notional Defined Contribution since 1994. The pessimistic prediction during financial crisis in 2008 was that the condition that debts outperformed assets would occur only in 2020. However, the actual situation was that the responsibilities of individual account system of Sweden began to exceed assets in 2008. Therefore, it was required to lower interest calculation rate of individual accounts (i.e. lower retirement treatment level) in order to keep the system balanced. In 2010, Sweden launched automatic balance mechanism. As a result, the growth rate of pension in current year dropped from 4.6% in previous year to -3%. This figure even declined to -4.3% in 2011. In 2012, the automatic balance mechanism stopped. The growth rate of pension in 2012 recovered to 3.6%. The huge fluctuation could not provide the insured with stable and safe expectations.

4.3.2 How big is the motivational effect of Notional Defined Contribution?

Firstly, it is about the relation between nominal accounts and system coverage: Some viewpoints hold that Notional Defined Contribution motivates individuals to pay and participate in insurance. Since individuals can clearly supervise enterprise payments and individual payments are linked with pension treatment, the possibility that enterprises and individuals collude to lower

payments. Certain practice already indicate that the coverage rate of pension system is irrelevant to individual account system and size of individual accounts, while coverage rate is related to pension insurance payment rate, enterprise operation condition, condition of labor supply of private sectors and intensity and capacity of policy execution. As for the collusion of enterprises and individuals for reduction of payment, it is irrelevant to scale of individual accounts. The occurrence of this phenomenon will not be avoided due to expansion of scale of individual accounts. *Social Insurance Law of the People's Republic of China* stipulates mandatory paying obligation of enterprises and individuals. Management institutions may discover the problem of fee avoidance through labor supervision.

Secondly, it is about the relation between nominal accounts and payment: Some viewpoints hold that Notional Defined Contribution motivates individuals to increase payments and postpone retirement. This viewpoint is not checked by practice. Sweden implements Notional Defined Contribution and stipulates mandatory age for retirement as 65. The system allows individuals to choose to retire ahead of time or postpone retirement. Certainly, pension level is closely related to mandatory age for retirement. The earlier the people retire, the lower the pension level would be (vice versa). The system designers think that the beneficiaries would intend to choose to postpone retirement. However, things go athwart. Relevant figures indicate that more and more people intend to choose to retire ahead of time instead of postponement. With the retrocession of year of birth, the ratio of people choosing to retire ahead of time becomes increasingly big. Besides, the age for retirement becomes increasingly early. Among newly increased retirees every year, the ratio of population aged from 61-64 increased from 9.4% in 2002 to 21.8% in 2008, which obviously ran countering to the initial intention of establishing of nominal individual accounts⁵.

Thirdly, the management cost of nominal accounts is low and it is convenient for transfer and renewing. Nominal accounts are pay-as-you-go. The management cost is indeed low. However, transfer and renewing are more related to division of power of property and power of office and are irrelevant to that whether actual capital transfer exists in individual accounts. If power of property and power of office of pension payment belong to local governments, nominal accounts will not benefit transfer and renewing and the receiving places will choose to reject.

Fourthly, it is about the relation between nominal accounts and fund value preservation and increase. Fund value preservation and increase under pay-as-you-go system are only limited to

⁵Li Zhen & Zhou Yimeng. "Swedish Model" of Social Pension Insurance System: What Swedish Notional Defined Contribution System Solve? *Economic Perspectives*, 2010 (8).

surplus fund. Interest rate is objective result of market and it shall not be established as planned. “old peasant insurance” of China once implemented bookkeeping interest rate higher than market interest rate in order to motivate payments, which unexpectedly attracted other market capital to the system, indicating that the bookkeeping interest rate of nominal individual accounts should never be higher than market interest rate, and the motivational effect of Notional Defined Contribution was limited.

It is thus clear that Notional Defined Contribution especially full Notional Defined Contribution is not a cure-all medicine solving the problem of employee basic pension insurance as what some scholars worship and its motivational effect was not checked through practice. In addition, it does not indicate that this system is superior to system before reform in terms of solving of financial sustainability issue and labor market efficiency losses. Besides, basic pension insurance system is a major system construction project. It shall not be constructed only based on a motivational mechanism. Basic pension insurance system must stick to the principle of fairness priority and principle of efficiency shall be mainly applied in multi-pillar supplementary insurance system.

4.4 Viewpoint of This Report

Following the basic principles for perfection of pooling-account combination system of basic pension insurance mentioned above, this report regards that Notional Defined Contribution can be implemented when it is indeed difficult to fully fund individual accounts, but only small nominal individual accounts can be implemented. Nominal individual accounts shall not be expanded. In particular, 28% of full Notional Defined Contribution shall not be implemented. Zero social pooling would make the system lose inter-generation mutual aid mechanism, which is a fundamental overturn of pooling-account combination system. It shall be clearly defined that Notional Defined Contribution is pay-as-you-go system. If the government input is not provided, the paying pressure of future aging of population cannot be eased through “actuary balance”. Therefore, this report puts forward two schemes:

4.4.1 Scheme 1: Encouraging Fund Accumulation and Fully Funding Individual Accounts in a Gradual and Flexible Manner

It is an optimized scheme. Respect and prudently treat the common understanding formed during previous three discussions concerning individual accounts, review pooling-account combined partial fund accumulation system established by China (equal consideration to fairness

and efficiency and present and long term), objectively treat the reality and causes of failure to fully fund individual accounts, and make clear that failure to fully fund individual accounts cannot deny the correctness of pooling-account combined partial fund accumulation system.

Organically combine social pooling with individual accounts, keep existing payment ratio unchanged, manage pooling accounts and individual accounts in a mixed way, and ensure paying of pension insurance in current period. Reform pension investment management system and encourage each place to accumulate pension fund. Individual account fund and its investment and operation management are in the charge of provincial government. Promote individual account pension investment and management system reform, introduce market-oriented investment operation and competition mechanism, enhance dynamic power of each place to accumulate pension fund and ensure value preservation and increase of pension fund. Pension fund accumulation, investment return and investment risks are in the charge of provincial governments. Meanwhile, separate administrative affair management, investment management and supervision management of pension insurance, strengthen pension investment and operation supervision of the central government, establish pension fund investment risk control system, and formulate specific investment objects, investment rules, procedures, etc..

As for cross-region employee flow, it can be stipulated that it is only required to transfer pension insurance relation but not required to transfer individual bookkeeping accumulation fund due to different inter-region accumulation fund scale and scale of individual accounts fully funded. Relevant individual account expenditure of pension of transferred population is solved by the central government using collection adjustment payment based on realization of nationwide pooling of basic pension and according to ratios of population transferred out and transferred in among different areas.

4.4.2 Scheme 2: Implementing Lager Social Pooling + 8% Small Notional Defined Contribution

It is a secondary optimized scheme. Ensure that pooling-account combined basic system model remains unchanged and payment ratios of social pooling and individual accounts remain unchanged. Social pooling is formed by enterprise payments as 20% of total amount of wages. Pay-as-you-go system with payment determined is implemented; individual accounts are formed by individuals as 8% of their wages. Bookkeeping method of Notional Defined Contribution with payment determined is implemented. Individual account pension payment and treatment are strictly corresponding, i.e. more payment for more gain. Pooling fund and individual account fund are

managed and used in a “mixed” way to ensure paying in current period. The surplus can be invested and operated.

The central government is responsible for nationwide pooling of basic pension as well as relevant basic pension and transitional pension. The paying standards of basic pension are determined according to living standards of different areas. The central government stipulates national unified individual account bookkeeping interest rate and ensures that the investment return of pooling and individual account fund already accumulated by local governments is used to ensure employee pension insurance level of local regions before nationwide pooling of basic pension.

As for cross-region employee flow, since most regions adopt nominal individual accounts, it is only required to transfer pension insurance relation and record individual bookkeeping accumulation fund to place of movement. During cross-region transfer of employees in regions with individual accounts already fully funded, it is not only required to transfer pension insurance relation but also needed to transfer individual account accumulation fund. Individual account fund fully funded can be operated and management by entrusting National Council for Social Security Fund. Provincial governments are responsible for individual account fund accumulation, investment return and investment risks in regions with individual accounts fully funded.

5. Nationwide Pooling of Basic Pension

5.1 Arguments of Different Viewpoints

5.1.1 Unified Collection and Allocation of Funds by the State

Unify payment base number calculation specification, unify enterprise payment rate, unify collection revenue, unify treatment payment, unify system operation specification and supervision and unify handling mechanism and information system. The local governments shall pay all pooling funds to the central agreement, the central government is responsible for implementing national unified collection and unified expenditure of employee basic pension, and the local governments are responsible for individual account pension. On the basis of actuary balance analysis of income-expenditure condition of pooling accounts within a certain period, unified enterprise payment rate is determined. The central government is clearly defined as responsible subject to implement full-amount budget management. When social pooling accounts formed by payments are not enough for current payment, the central finance will subsidize to solve the problem.

5.1.2 Implementation of Nationwide Pooling for Part of Basic Pension

Divide basic pension borne by the central government and local pension responsibility borne by local governments. The central government and the local finance shall reveal all the details respectively. On the basis of provincial pooling, the subsidy of the central finance and pooling adjustment payment paid by each province are applied to bear a part of basic pension of each province, while the remaining pension demand is borne by the local governments.

5.2 Analysis of Advantages and Disadvantages of Different Viewpoints

If viewed from the perspective of linking with realistic pooling level and responsibility sharing of the central government and the local governments, the abovementioned viewpoints completely hand over the control power of pooling fund to the central government and the central government is completely responsible for paying of basic pension. The advantages include clear fund income and expenditure and simple operation; the disadvantage includes full responsibility exemption of local governments. The central government is in comprehensive charge of basic pension of each place and big problems exist as how to balance gap of each place. Besides, the pressure and responsibility of the central finance can be greatly increased. Viewpoint 1 also requests unification of payment rate nationwide. However, since regional differences concerning current payment rate already exist, if unification is forced, dissatisfaction of enterprises and individuals in surplus regions can be easily caused and the system will face excessive strengthening of risks. Besides, the local governments are exempted from liability and they are only income-expenditure institutions. Income and expenditure can be socialized and thus the local governments do not have initiative, thus possibly resulting in moral risks and adverse selection. Currently, the provincial pooling realized is adjustment payment system without unified income and expenditure. The pension fund is still in the charge of governments of each prefecture-level cities and counties, which is relatively far away from the comprehensive realization of unified income and expenditure.

Viewpoint 2 requests provincial governments to undertake partial responsibility for basic pension. To be specific, a part of social pooling fund is preserved in local governments, while a part of social pooling fund is paid to the central government. Then, pooling fund paid to the central government and the central finance form the sources of basic pension. The key problems faced include: 1. The responsibilities of the central government and the local governments shall be clearly defined. Otherwise, it will easily cause dependence of local governments on the central government or dissatisfaction of local governments; 2. As for determination of ratio of social pooling fund paid

by provincial governments, the initiative of local governments shall be protected and the capital demand for smooth implementation of schemes shall be satisfied.

5.3 Viewpoint of This Report

It was put forward in the Third Plenary Session of the 18th Central Committee of the CPC that a system suitable for power of office and expenditure responsibility should be established and the power of office and expenditure responsibility of the central government should be properly strengthened. Nationwide public products and products with regional overflow effect shall be included in the power of office of the central government. The central government can collect a part of power of office according to factors like beneficiary scope, information availability and scale economy. Since basic pension insurance is a common power of office of the central governments and the local governments, the relation of power of office shall be gradually smoothed. This report thinks it necessary to fully mobilize initiative of the central government and the local governments and implement central-provincial two-level basic pooling architecture. The central government and the provincial governments shall jointly undertake responsibilities for pension. Since the rate in regions with relatively low enterprise payment rate is only 11%, the payment rate shall not be forcefully improved without exception. During start-up stage, 10% of social pooling fund of each place can be handed over to the central government and forms central pooling fund with current financial aid of the central finance. The central pooling fund shall be adjusted and used nationwide. Some of pooling fund and individual account fund are preserved in local governments. Each province and district shall comprehensively implement provincial pooling of fund. The provincial governments shall take charge of investing and operating pension surplus fund. In the future, enterprise payment rate of each place shall be adjusted in proper timing based on regional coordinated development of the whole country in the future to finally realize nationwide unification.

The central government and the local governments are jointly responsible for payment demand of basic pension. The payment is based on the principle of equality of citizens. The appropriated amount per capita is determined by dividing the number of retirees taking part in insurance of China from central pooling fund. The central pooling fund is used to determine the amount appropriated to each province according to number of retirees taking part in insurance and appropriated amount per capital as verified by each province. The payment demand of basic pension exceeding the appropriated amount of central pooling fund shall be in the charge of the local governments in each level. Strengthen actuary balance of two-level pooling fund and offer certain autonomous right to local governments under the precondition that the payment demand of basic pension is guaranteed.

It shall be clarified as how to determine the payment demand of basic pension. Pension substitution rate is involved. In 1952, it was put forward in *C102 - Social Security (Minimum Standards) Convention* released by International Labour Organization that the substitution rate of pension of common grown-up male labor paying pension insurance expenses for 30 years should not be lower than 40%; in 1967, *C-128-Convention for Security Treatment of the Aged, the Handicapped and the Members of the Deceased's Family* released by International Labour Organization improved this substitution rate to 45%. According to *China Social Insurance Development Annual Report 2014*, the enterprise employee pension substitution rate of China from 2009 to 2014 fluctuated around 66%, presenting a general stable operation. The substitution rate calculated in this report is based on wages for payment. Researches based on social average wages regarded that the pension substitution rate of China decline gradually and reaches about 45% at present, which basically reaches the standard stipulated in international society security convention.

6. Supporting Measures for Perfection of Pooling-Account Combination System of Basic Pension Insurance

6.1 Expansion of Capital Sources beyond System

Gradually improve the payment ratio of capital income of state-owned enterprises to supplement the gap of pension insurance fund and balance and adjust the payment of pension insurance fund. The capital income of state-owned enterprises is a part of fiscal revenue of the government. Therefore, using it as a capital source of social insurance fund is not only reasonable but also feasible. It is recommended that the capital income of central enterprises should be transferred to the central finance, while capital income from local state-owned enterprises should be transferred to local finance for filling the gap of pension insurance fund at this level. Meanwhile, establish and perfect multichannel social fund-raising mechanism (e.g. issuing of social security welfare lottery, charity stamps, charity IC cards and commemorative coins, establishing of social security donation capital, etc., in order to expand fund-raising channels and enrich pension insurance fund. In addition, it should be clarified that National Council for Social Security Fund should have the function of balancing and adjusting payments of social security projects.

6.2 Progressive Postponement of Retirement Age

Postponement of retirement age is a feasible approach to ease financial pressure of pension. Facing the problem of aging of population, western developed countries usually handle it by postponing retirement age. Progressive postponement of retirement age can motivate payment,

lower current expenditure and benefit the lightening of expenditure pressure. Good timing shall be selected to postpone retirement age. Retirement age shall be standardized first and equal consideration shall be given to special conditions. Then, it shall be gradually advanced in small steps. Firstly, the selection of timing for postponement of retirement age shall be made clear of. Relevant researches indicate that the stage combining quick growth of scale of aging population and quick withering of working age population shall be the crucial stage for implementation of postponement of retirement⁶; 2. Difference of retirement age of males and females shall be narrowed and flexible retirement system shall be implemented first. As long as the employers and the laborers agree, they may continuously sign labor contracts; 3. Differentiated retirement age policies shall be adopted for different types of laborers (different types of work, levels of education, and genders). The retirement age of heavy workers shall be properly reduced, and manual workers with big labor intensity shall be allowed to retire ahead of time; 4. Practice of progressive adjustment is suitable. The retirement age may be postponed for 2-6 months every year so as to finally gradually postpone retirement age; 5. A motivation mechanism shall be established for in-service labors beyond mandatory age for retirement, and the pension part paid by enterprises for them shall be transferred into individual accounts.

6.3 Full Funding of Pension Insurance Payment Base Number

Since the pension insurance system reform of China accompanied with the process of wages monetization, the total amount of wages for payment was deviated from actual labor income. Compared with other countries, the total amount of wages of urban employees of China took up a relatively low ratio in GDP (continuously declined from 15.77% in 1990 to 11.30% in 1998). Later, this ratio was fluctuated and declined to 11.09% in 2007. In recent years, it was continuously improved to approximately 20%. The ratio of total amount of wages of main developed countries in GDP was basically around 50%. Therefore, in order to fully fund pension insurance payment base number, the gap between wage income and labor income shall be solved first. In addition, allowance subsidy system shall be standardized and management of total amount of wages shall be strengthened. Secondly, stick to social average wages as payment base number. The enterprise payment base number of urban employee pension insurance of China is social average wages, while the individual payment base number is 60%-300% of social average wages. This provision itself has the function of adjustment of income distribution. A certain viewpoint proposes to cancel concept

⁶Tang Ruida & Guo Xiuyun. Dynamic Study of Retirement Age Based on Reasonable Supporting Ratio: Model and Simulation. *Social Security Studies*, 2014 (1).

of social average wages and fully use individual wage income as payment base number. Enterprise payments are also included in individual accounts according to ratios of individual wages of employees, which make the accumulated amount of individual accounts closely related to individual wage income. If 28% of full account system is implemented, it will undoubtedly further expand the gap of wages preliminarily distributed to redistribution field of social insurance. Therefore, enterprise payment base number shall still be social average wages. However, the statistical caliber of social average wages shall be perfected. The wage income of employees of private enterprises shall be included in the statistical category of social average wages; thirdly, under the condition of nationwide pooling of basic pension, payment rate shall be gradually lowered. Reduction of payment rate is closely related to individual accounts. If nominal accounts are implemented, the space for reduction of current payment rate will be increased. However, under the background of aging of population, long-term rate will increase without fund-raising beyond the system; if individual accounts are fully funded, the space for reduction of current payment rate will not be big, but a relatively stable rate can be maintained in a long term.

6.4 Institutionalization of Treatment Adjustment Mechanism

Establish a “three links” adjustment mechanism from system supply and demand to replace administrative adjustment. Firstly, basic pension insurance shall ensure the basic life of the insured. The pension shall be adjusted according to growth rate of consumer price index (CPI); secondly, it shall be ensured that the retirees properly share economic and social development achievements. Treatment gap among systems and groups of people shall be adjusted based on growth rate of CPI and according to the principle that the growth speed of pension shall be generally lower than growth speed of social average wages; thirdly, principle of actuary balance shall be introduced to basic pension insurance system to make the system rely on its financial balance more. If the fund paying capacity or financial paying capacity is greater than or equal to adjusted amount, the adjustment capacity can be fully provided, and full-amount adjustment is available as demanded; fourthly, “guaranteed index” ensuring certain pension substitution rate level shall be established. It can be linked with investment return of national social security fund. It can be used as a supporting policy for principle of pension actuary balance to make up the risk of decline of pension payment level resulting from adjustment of indexation; fifthly, the number of months for calculation and paying of pension in individual accounts released in 2005 shall be timely revised. The life expectancy of population shall be calculated in a scientific way according to remaining life expectancy per capita

after retirement. In addition, the changing conditions of life expectancy of population and retirement age shall be fully reflected.

6.5 Enhancing of Openness and Transparency of Pension Insurance System

Degree of familiarity of social public with basic pension insurance system is an important factor influencing the initiative of individual to take part in pension insurance. Therefore, the openness and the degree of transparency of relevant policies and knowledge concerning basic pension insurance shall be enhanced. Clear and simple individual pension treatment actuary formula shall be established and released to enable the insured residents to conveniently learn the relation between individual payment and treatment and make clear of ratio of individual payments used for pooling and accumulation. The annual appropriated amount per capita in the charge of pooling fund of the central government shall be clarified according to nationwide pooling scheme of basic pension, which has made clear of responsibilities of the central government and the local governments for determination of pension of single insured resident so as to provide clear basis for pension transfer and renewing, effectively supervise the governments and prevent corruption of micro powers like social insurance.

7. Several Conclusions

Basic pension insurance is an important project of social security system. The process of establishment and perfection of basic pension insurance shall adapt to economic and social development stage and development level of a country. During the transition of China from planned economy to socialist market economy, a basic pension insurance system combining individual accounts and social pooling was discussed and established in the 1990s. During the initial stage of reform, the total Gini coefficient of urban and rural areas does not exceed 0.3. Therefore, reform of distribution system in the 1980s and also the beginning of the 1990s emphasized the breaking of equalitarianism. Under this grand background, it was proposed to introduce the efficiency principle of initial distribution to secondary distribution. A typical example was that individual accounts were introduced to basic pension insurance system, for individual accounts were paid according to certain ratio of wages of employees during work and it reflected the principle of more payment for more gain. In the beginning of the 1990s, comrades claiming the reflection of motivation principle in basic pension insurance designated 16% of individual accounts. After fierce arguments and summarization of practice of different provinces for exploration of individual accounts, the State Council unified employee basic pension insurance system in 1997.

Employees of enterprises in China established individual accounts as 11% in a unified way. Individuals should pay 8% while enterprises should pay 3% of wages of employees. Later, this system was gradually corrected. The ratio of individual accounts declined to 8% and it was fully paid by the employees themselves. Meanwhile, the ratio of social pooling of pension calculation and paying was improved.

After over 30 years of reform and opening up, China's social and economic lives already changed greatly. Despite creation of miracle of high-speed economic development, China also gradually accumulated many problems. An outstanding problem was the growing gap in income distribution. The total Gini coefficient of urban and rural areas of China exceeded the international warning line of 0.4 over 10 years ago, and it approached 0.5. What was more unreasonable, the redistribution system including basic pension insurance did not narrow the gap of initial distribution. Instead, they further expanded this gap. In the new economic and social development stage, facing the growing gap in income distribution, basic social security projects shall have fairness and mutual aid improved so as to stabilize the gap of initial distribution. As one of the most important projects of basic social security, the direction of basic pension insurance system for improvement of fairness and mutual aid shall be clear and definite.

In the current stage, expansion of scale of individual accounts of employee basic pension insurance went against the improvement of fairness of social security. It was pointed out in the Third Plenary Session of the 18th Central Committee of the CPC that, "It is demanded to establish a fairer and more sustainable social insurance system, stick to the social pooling and individual accounts combination and perfect individual account system", which made clear of the reform direction of basic pension insurance system. However, for perfection of individual account, arguments between "shorting" and "full funding" have always existed. Under the condition that pilot of "full funding" stood still for many years, Notional Defined Contribution seemingly becomes a more practical scheme. However, great controversies concerning as how to design nominal accounts still exist. After release of scheme of mergence of basic pension system of government agencies and public institutions and enterprises, the discussion of perfection of individual account system becomes increasingly fierce. Some scholars proposed the inclusion of payments of entities (20% of total amount of wages) and individuals (8% of wage income) into individual accounts to implement 28% of zero-pooling "full account" employee basic pension insurance system. Later, some proposed the expansion of individual accounts to 16% (8% for entities and 8% for employees respectively). Recently, it was proposed to expand individual

accounts to a ratio of 24%. During this system design, employers would pay the pension insurance at an amount approaching 2.5 times or 1 time of individual wages of employees. Therefore, the gap of initial distribution was further expanded to the redistribution field of basic pension insurance, which goes against fairness and mutual aid of basic social security that should be improved in the current stage.

It is not suitable to excessively stress the motivational effect of more payment for more gain in social insurance projects. Social insurance is enforced by the state according to law. During specific scheme design, certain motivation factor can be considered, which has different nature with commercial insurance which completely relies on the participation of the insured. Scholars designing “full accounts” and “lager accounts” publicized the motivational effect of “full accounts” on employees but opposed inheritance of individual accounts on the other hand, for retirees beyond average remaining life expectancy will become very heavy burden of finance if such huge nominal individual accounts are inherited but without actual account accumulation. However, the motivational effect of establishing of “full accounts” and “lager accounts” is completely self-contradictory with the negative motivation of “no inheritance of balance of individual accounts”. If a system design requests that nearly one third of accumulated amount of income of employees in their lives cannot be inherited, so why wouldn't people deposit this amount in bank, or use it to purchase commercial insurance? Moreover, motivational effect of expansion of scale of individual accounts is not checked through practice.

Conclusions of this report: Under the condition that the gap of initial distribution of China is already too big, China has to perfect its employee basic pension insurance system and stick to the principles of fairness and mutual aid and narrowing but not expansion of initial distribution gap without any deviation. The effective solving of specific problems currently existing in employee basic pension insurance system can be further discussed only on this basis. This report thinks the optimized scheme is still to remain the existing pooling-account combination system unchanged, encourage fund accumulation and fully fund individual accounts in a gradual and flexible manner. Based on the restriction of realistic difficulties for funding of individual accounts, a stable transition effect can be reached by changing 8% of individual accounts paid by employees to nominal accounts. In addition, the social mutual aid of the system shall be guaranteed. Meanwhile, it is required to firmly implement nationwide pooling of basic pension, expand capital sources beyond the system, promote postponement of retirement age step by step, accelerate citizenization of migrant

workers to expand payment base number, fully fund pension insurance payment base number, institutionalize treatment adjustment mechanism and enhance fairness and transparency of the system. In the current stage, it is absolutely unnecessary to make a big fuss of expanding the scale of individual accounts, for it not only lowers the mutual aid of employee basic pension insurance but also makes it extremely difficult to link with the existing system. Therefore, it is absolutely not allowed to implement zero pooling of “full accounts” without any social mutual aid.

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