

# Reform Proposals



## COMPONENT TWO

### 2018 ACTIVITY PLAN

**Alternative policy measures to cope with the impact of ageing on the financial sustainability of the social security system**

**Social contribution collections: toward a unified system**

**The role of public finance and enterprise annuities funds in the Chinese social security system**



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## 1. Document Scope

The present document collects policy suggestions on the three topics tackled in 2018 by the EU-China Social Protection Reform Project- Component 2, submitted to the Social Security Department of the Chinese Ministry of Finance.

The three topics are:

2.1.3 Alternative policy measures to cope with the impact of ageing on the financial sustainability of the social security system

2.15 Social contribution collections: toward a unified system

2.3.2 The role of public finance and enterprise annuities funds in the Chinese social security system

The assessment reports on the three topics, drafted by the Chinese experts Dong Keyong, Wang Dehua and Zheng Bingwen, together with the EU best practices introduced by EU experts were presented and debated in a Panel Discussion held on 14-15th June 2018. Following, policy proposals on the three topics were presented and debated at a final Workshop, on 12th October 2018.

## Topic 2.1.4 - Dong Keyong<sup>1</sup>: Alternative Policy Measures to Cope with the Impact of Ageing on the Financial Sustainability of the Social Security System in China

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## **1. Measure 1: Unified Taxes and Fees Collection System**

After the Third Plenary Session of the 19th CPC Central Committee, the CPC Central Committee issued the "Deepening Party and State Institutional Reform Plan". It mentioned that "In order to reduce the cost of collecting, rationalize the relationship of duties, improve the efficiency of collection and management, and provide taxpayers with high quality and efficient services, the sub-national taxation agencies will be merged and responsible for the taxation and non-tax revenue collection and management in the region. In order to improve the efficiency of social insurance fund collection and management, various social insurance premiums such as basic old-age insurance premiums, basic medical insurance premiums, and unemployment insurance premiums are paid to the taxation agencies for unified collection." Then in July, the "Reform Plan of National Tax and Local Tax Collection and Management System" clarified that from January 1, 2019, basic pension insurance fees, basic medical insurance fees, unemployment insurance fees, work injury insurance fees, and maternity insurance fees will be collected by the tax authorities.

In the past, the department responsible for social security fees was determined by the local authorities at the provincial level. It could be a tax department or a social security department. There were large differences among the regions, and the abilities to collect and manage the fees were not strong enough to meet the needs. The loss of social security contribution is mainly reflected in two aspects. The first is the low compliance rate. According to the payment rate of social security insurance for urban employees issued by the Ministry of Human Resources and Social Security, the contribution rate in 2006 was 90%, and in 2015 it was 80.3%. In the decade, there was even a decrease of 10 percentage points.<sup>2</sup> In 2014, 1/5 employees in China interrupted capture to expend.<sup>3</sup> The second is the unclear contribution base. The documents promulgated by the State Council basically set 60% of the average salary of urban workers in the previous year as the lower limit of the contribution base of pension insurance for urban employees. However, even in economically developed areas like Beijing, when the contribution base of pension insurance for urban employees is calculated, the contribution base is further reduced to 40% of the average salary of urban workers in the previous year. In addition, the enthusiasm of small and medium enterprises for payment is not high, and state-owned enterprises also have deficits or arrears.

After social insurance premiums are collected by the tax authorities and the unified tax and levy system has been formed, the capability of collection and administration will be improved significantly, which is expected to fundamentally solve the two big problems—low payment rate and untrue payment base. It is assumed that after the unified collection of social insurance premiums by tax authorities, the compliance rate is 100%, and the average payment rate reaches 20% of the system design. Based on this, the fund revenues, expenditures and balance of basic pension insurance for urban employees in 2018-2050 are predicted in Figure 1-1.

The figure compares the revenues collected in the current year before and after the reform of tax and fees collection system. It can be seen that after the reform the revenues collected in 2050 will reach RMB 27.93 trillion, with 5.5 trillion more than that before the reform. The figure -2 shows that after levy reform, the balance of pension for urban employees will be positive until 2026. And the balance in 2050 is RMB -23.44 trillion, accounting for 5.71% of GDP, which is obvious lower than RMB -29 trillion balance and 7.07% before the levy reform. There will be more obvious impacts which the reform has on the accumulated balance. The accumulated balance of pension for urban employees will be positive until 2032. And the

<sup>2</sup> See "China Social Insurance Development Annual Report 2015", September, 2016.

<sup>3</sup> See "China Social Insurance Development Annual Report 2014", June, 2015.

accumulated balance in 2050 will be RMB -212 trillion (114 trillion less than that before reform), accounting for 51.58% of GDP (28% lower than that before reform).

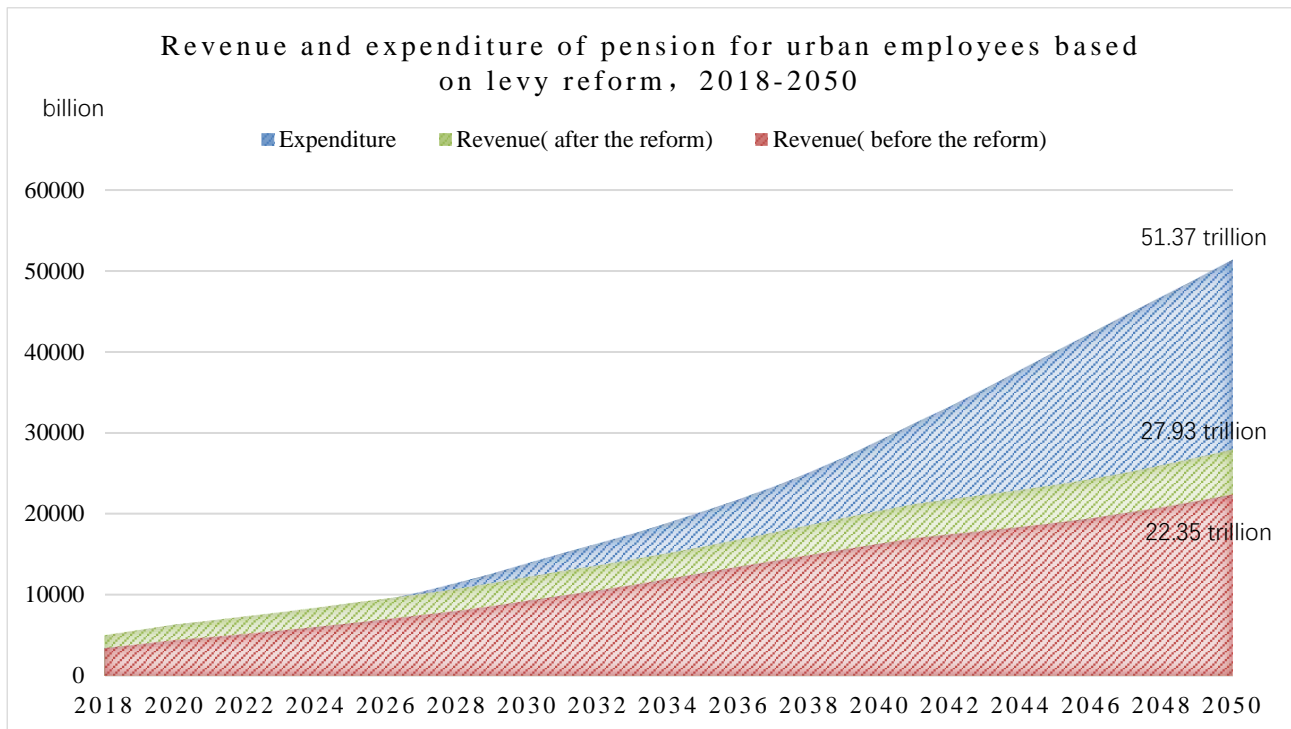


Figure 1-1 Revenue and expenditure of pension for urban employees based on levy reform, 2018-2050

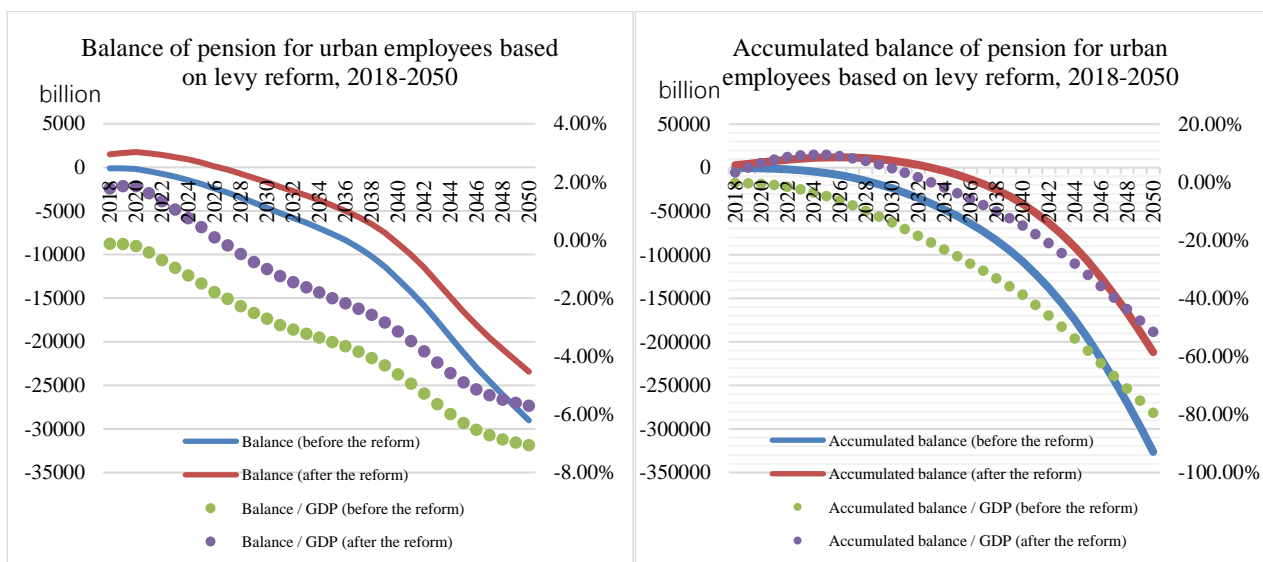


Figure 1-2 Balance of pension for urban employees based on levy reform, 2018-2050

Although the reform of the collection and management system can effectively narrow the financial gap of the social security fund, once the policy decision is announced, the reaction of the market is very significant. Since the payment base is not a universal problem, it is likely to increase the burden on enterprises and the implementation of the policy will encounter resistance. In the face of this situation, the reforms should be smooth and systematic and the suggestions are made as follow:

First, regarding national pooling of basic pension insurance as the goal at institutional level. The national pooling of the basic pension insurance is the goal that the Party Central Committee has already determined, and it is also the correct decision in line with the nature of the basic pension insurance system. The root cause of the unclear contribution base is regional separation. The fundamental solution to the problem is the national pooling.

Second, the most worrying issue in society related to the form is the burden on enterprises, which can be gradually resolved through financial subsidies. In 2016, the number of subsidies reached 651.1 billion yuan. The fund balance (4 trillion yuan) almost came from the sum of fiscal subsidies over the years, or the cumulative balance is the result of financial subsidies from the governments. Under the premise of social pooling, if it is clear that the amount of financial subsidies will continue to increase according to the growth rate of previous years, it can lift the concerns of the public. In fact, recent years is the retirement peak period of population born in the late 1950s and early 1960s. Due to the conversion cost of pension insurance system, the state financial subsidies must be increased.

Third, clarifying the reasons for collection and determining the amount of collection. At present, China's basic pension insurance adopts a social pooling and personal account system. In theory, the system is embodied in the combination of pay-as-you-go and full-accumulation. However, in practice, the two parts of funds are not managed separately, but are managed together. This led to the misappropriation of funds from individual accounts in some provinces, resulting in “empty accounts”. The government should take advantage of the timing of the reform of the collection system to achieve the separation of social pooling and individual accounts, and clarify the pay-as-you-go system of basic pension insurance. The basic pension insurance should still be paid jointly by the employer and the employee, and the collected funds are used to pay the retired people. Therefore, the funds collected in the current period plus the financial subsidies should be equal to the total amount of pensions paid to retirees.

Fourth, clarifying the relationship between contribution base and contribution rate. The total amount of pensions in the whole society minus financial subsidies will be equal to the amount of funds that should be collected from the working generation. In the case that the amount of funds to be collected has been fixed, the contribution base and the contribution rate have a trade-off relationship. A large base results in a low rate, and a small base results in a high rate. Now, China's nominal contribution rate is very high. Once the problem of unclear contribution base is resolved, the contribution rate can be truly reduced.

Fifth, clarifying the relationship between the contribution base and the benefits. On the basis of determining the contribution base and contribution rate, it is necessary to further improve the benefits calculation method, appropriately increase the proportion of individual contributions in the benefits calculation formula, and strengthen the linkage between contribution and benefits. When the public can understand and recognize the system concept of “more contribution determining more benefits”, the enthusiasm for contribution and the system compliance rate will be significantly improved.

Sixth, using preferential policies to achieve policy transitions. Through the above methods, the national unified contribution base and the national unified contribution rate can be determined. If some regions and small and medium-sized enterprises have a large gap with the above standards, it is recommended to adopt preferential policies for three to five years to gradually meet the requirements of unified standards. After understanding the system concept of “more contribution determining more benefits”, the employees will promote the employer to speed up the transition period for their own future interests.



## **2. Measure 2: Improving retirement system**

In 2013, the “Decision of the Central Committee of the Communist Party of China on Several Major Issues Concerning Comprehensively Deepening Reform” pointed out: Study and formulate the scheme of progressively raising the retirement age. Then, the Ministry of Human Resources and Social Security stated that the scheme of progressively raising the retirement age will be open to the public in 2016 and will be officially launched in 2017. Five years after the launch of the program, it will be implemented gradually. However, due to various factors, the plan has not yet been implemented.

The main reason for domestic scholars to study the issue of delayed retirement is the sustainability of pensions. In general, China's pension system for urban employees is still a pay-as-you-go system. From the current perspective, the pensions are balanced, and there are balances. However, from the perspective of development trends, the problem is more serious. According to estimates, the number of basic pension insurance contributors will decline after 2030, while retirees continue to grow. If not to change the retirement age, China will have a dependency ratio of 1:1 in 2050. For the pay-as-you-go pension system, if not to change pension system, there are three means to deal with population aging. The first is to increase the contribution rate. China's contribution rate is already high, and there is not much room for increase. The second is to reduce the benefits of retirees. The benefits of retired employees in China is not high, and there is not much room for reducing the replacement rate. The third is to delay retirement. This is also the usual way for developed countries' pay-as-you-go pension system to address the aging crisis, and it is also the most feasible reform path in China. According to the design, women will be delayed by 1 year every 3 years, and men will be extended by 1 year every 6 years, and eventually reach the legal retirement age of 65. This means that for those who retired at the age of 60, their payment period will increase by 5 years while the treatment period will be reduced by 5 years. This is beneficial for alleviating the pressure on pension funds. The incremental delaying retirement age and flexible retirement system have always been the hotspots in the field of social security. Scholars generally believe that China's retirement age is significantly lower than the international average. In the context of per capita life expectancy increasing and population aging, delayed retirement is an inevitable trend.

In order to visualize the effect of delayed retirement schemes on pension sustainability. Based on the implementation of reformed taxes and fees collection system and the delaying retirement policy above, it is assumed that incremental delaying retirement policy will come into force in 2022. It means increasing 1 year old every four years from the current hypothesis of social average retirement age 55, that is, the retirement will get delayed three months per year, until the end of 2050. Meanwhile the average replacement rate has also risen from 35%, and will increase 1% when the retirement age is delayed 1 year.

The forecast results (Figure 2-1) show that raising the retirement age can significantly alleviate the expansion of the pension funding gap. the balance in current year, after the reform, the pension will continue to receive more than it needs to spend by 2029, and then there will be a deficit of RMB 10 trillion in 2050 (RMB 29 trillion at the beginning), accounting for 2.47% of GDP in that year (7.07% at the beginning). As to Accumulated balance, after the reform, the accumulated balance of the fund will be positive by 2038, and then there will be a cumulative deficit, which will reach RMB 71 trillion in 2050 (RMB 326 trillion at the beginning), accounting for 17.31% (80% at the beginning) of the GDP.

The extension of the retirement age can effectively alleviate the pressure on pension funds, but from an institutional perspective, it is not scientific to decide the retirement by age. The current retirement age system mainly has the following three problems.:

First, compared with developed countries, China's population life expectancy is not very different from that of developed countries, but compared with developed countries, the current legal retirement age is low. This results in a short payback period for pay-as-you-go pensions and a long period of collection. The pressure on the fund is high.

Second, according to the current method of determining pension benefits, the legal retirement age is more disadvantageous for those who have been educated for a longer period of time, or a unified retirement age is not conducive to high human capital owners. If you are retired at the age of 60, the longer the human capital investment period, the shorter the actual working life. For example, a doctoral student can get a Ph.D. at the earliest 28 years old. It's been 10 years late than a high school graduate who was working at 18 years old.

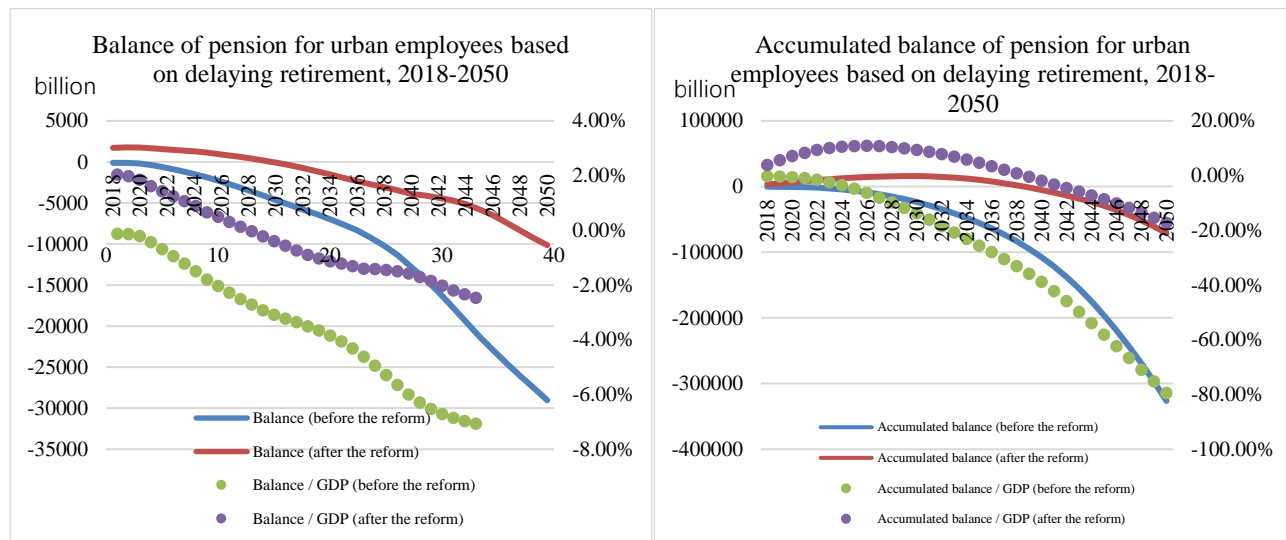


Figure 2-1 Balance of pension for urban employees based on delaying retirement, 2018-2050

Thirdly, the policy of being eligible for pensions after accumulated contributions for 15 years has been misunderstood, resulting in an increase in the interruption of payment.

Therefore, the focus of the reform should be on closely linking the retirement benefits to the payment period, and achieving the goal of “more contribution determining more benefits”. At the same time, through the strict law of collection, employees are not allowed to stop contribution during the employment period. In response, the following suggestions are proposed:

First, the pension could be divided into three categories: the minimum standard pension (equivalent to the minimum wage in the wage policy), the full pension (the pension calculated by the institutional replacement rate), and the preferential pension (policy encouragement).

Second, calculating the pension benefits based on the pension payment period. Based on the parameters such as employment, wages, contribution rate, and policy-expected replacement rate, the cumulative contribution period for receiving the minimum standard pension is determined through actuarial calculation. Generally, the cumulative contribution period for receiving the minimum standard pension should not be less than 15 years, and the collection standard should be lower than the minimum salary. It should be noted that this standard only applies to intermittent employment, or people who withdraw from the employment team in advance for various reasons.

Third, determine the period of eligibility for full pension. According to the experience of developed countries, the cumulative minimum contribution period should be determined at around 35 years. Retirees who are less

than 35 years old will permanently reduce their pension benefits based on the number of years of non-payment. In addition, according to the changes in the age structure of the population and the status of the pension fund, the standard of contribution period for full pension could be adjusted, and will gradually increase to 40 years in the future.

Fourth, formulate policies to encourage employees who have accumulated contributions for more than 35 years to receive progressive preferential pensions. At the same time, in order to balance the age structure of the workforce, the offer can be capped for 45 years.

Through the above reform, the government gives the initiative to retire to the workers. Instead of setting a statutory retirement age, the government encourages employees to delay retirement through a treatment mechanism.

### **3. Measure 3: Advancing the Development of the Third Pillar**

In April 2018, the Ministry of Finance and other five departments issued the “Notice on Launching a Pilot Program for Personal Tax Deferred Commercial Pension Insurance”, which declared that the personal tax deferred commercial pension insurance pilots would be implemented in Shanghai, Fujian (including Xiamen) and Suzhou Industrial Park in May 1, 2018. It implies that the Chinese government is actively exploring the third pillar of pension insurance, hoping to build a multi-level pension insurance system to ease fiscal pressure and ensure the long-term sustainability of the pension system.

In fact, China has not established the third pillar pension insurance for various reasons. Now we are actively exploring the construction of the third pillar of pension insurance, which mainly has the following three factors:

First, China’s first pillar of basic pension insurance has been unable to meet the needs of the elderly. Over the years, despite of the great progress made in the reform of the pension system, the basic pension insurance for urban employees is still a pay-as-you-go system in actual operation. With population aging speeding up, the proportion of China’s old-age population (60+ or 65+) expands rapidly. Correspondingly, the number of labor population has shrunk sharply. It has resulted in the decline of the number of contributors compared to the rise of the number of people receiving pension. According to the report of the 19th National Congress, the main contradiction in Chinese society has been transformed into “the contradictions between the people's ever-growing needs for a better life and the unbalanced and uneven development.” In order to alleviate the social contradictions of the "new era", there is a need for further improvement of the basic pension benefits. However, it is very difficult to raise the level of benefits considering the current conditions.

Second, from the perspective of establishing a multi-pillar pension system, the second pillar, enterprise annuity, is difficult to expand rapidly in the short term. Since the implementation of the enterprise annuity system in 2004, less than 10% of the employees have got enterprise annuities. Therefore, we cannot put our hopes of establishing a multi-pillar pension system on a large number of companies to establish enterprise annuities. The contribution rate of the first pillar basic pension is too high, and the enterprises has no enthusiasm to establish the second pillar. Therefore, there is no way for enterprise employees to enjoy tax benefits. But if there is a third pillar, employees can reserve pensions by themselves for their future.

Third, with the economic transformation, small and medium-sized enterprises have become the main force to attract labor population. There are still a large number of rural migrant workers, flexible workers and part-time workers in China. It is crucial to consider how to cover these workers. Not the second pillar but the

third pillar can allow the workers in small and medium-sized enterprises or self-employed workers to enjoy pension tax incentives.

There are three key points in advancing the establishment of the third pillar. The first is that the system model must center on “individual account”, which means to set up individual account with unique identification, rely on multiple carriers to increase the coverage of the third pillar personal pension, and rely on social security card to establish the 3rd pillar individual account information platform, etc.

The second is to design reasonable tax preference model. The tips are reasonably using the tax extension model of EET or TEE, setting a reasonable preferential tax rate or quota, and considering to open the 2nd and 3rd pillar tax incentives, etc.

The third is the diversified participation in product and investment channels. Banks, funds, insurance and other types of pension financial products should be considered into the selection range, and consider to establish a product access system and a default investment vehicle mechanism.

#### **4. Measure 4: Reasonable Control of Medical Expenditure**

Unlike the severe situation of the pension insurance system, the financial burden of the medical insurance system is still acceptable. However, while the national health expenditures and the medical insurance expenditures continue to increase, inpatient or outpatient services, total medical expenses, per capita medical expenses, and medical expenses all have increased at a high rate in recent years. Among them, there are both “reasonable growth” caused by the rise of medical technology level, and “unreasonable growth” caused by various reasons, especially the “profit-seeking mechanism” of the hospital. Therefore, to control the unreasonable growth of medical expenses is one of the important tasks of the reform and development of China's medical insurance system.

Although the government plays a pivotal role in the design of the institutional framework and the supervision and management mechanism, it does not rule out that the market and social forces play a unique role in controlling medical expenses. For the monitoring and management of medical expenses, local governments can actively explore the specific form of Public-Private Partnership (PPP), which can timely detect and process the abnormal changes in medical expenses to control moral hazard in medical needs and medical behavior with the help of third-party information platform and intelligent monitoring platform.

In addition, the function of the medical insurance system will inevitably lead to an increase in medical expenses to a certain extent. In view of the diversity and complexity of medical needs, the government should play a major role in the four aspects including legislation, planning, investment and supervision. Under this premise, the market mechanism should be introduced vigorously, which will not only improve the fairness of medical insurance but improve the quality and efficiency of medical services. In terms of macroeconomic regulation and control, medical insurance should fairly treat public and private medical institutions, public and private rehabilitation institutions, public and private nutrition institutions, and other health service institutions; should eliminate discrimination, and meet the health needs of different individuals at different levels.

In addition to the above points, it is necessary to vigorously encourage the development of commercial medical insurance. The government promotes the development of commercial medical insurance by providing tax incentives, and lays a foundation for the establishment of a multi-level medical insurance system in the future. In this respect, China still has great potential.

## **5. Measure 5: Gradually Relaxing the Family Planning Policy**

China's "two-child" policy was put forward in 2015 and implemented officially in 2016. Its purpose is to adjust the age structure of the population and meet the challenges of aging. In fact, since the implementation of the "two-child" policy, the effect is not as expected. 2017 is the second year of the implementation of the "two-child" policy. According to the hysteresis effect, it is generally judged that the number of people born in 2017 will be significantly higher than that of 2016. However, the data from the National Bureau of Statistics shows that the number of births in 2017 fell by 630,000 from 17.86 million in 2016. The birth rate in 2016 was 12.95 per thousand. It fell to 12.43 per thousand in 2017.

Health and Family Planning Commission explained in 2015: "There are about 90 million couples eligible for the policy, and the birth population is expected to exceed 20 million." But in reality, the birth population never exceeded 18 million, lower than the national health and family planning commission's forecast for 2017-2021.

The reason why the effect of the "two-child" policy is not good is that the Chinese people's fertility desires are not strong; as a result, the increase in total fertility rate is not significant. Just cancelling restrictions cannot solve this problem. There are two main factors leading to the reduction of Chinese fertility desires. Firstly, for individuals, the era when marriage and childbirth is a family obligation and responsibility has passed. With the development of urbanization, personal choice has replaced family responsibility. Secondly, China's high housing prices, high childcare costs, and fierce social competition cause a problem that having more children means more pressure.

There are many experts predicting the effects of the "two-child" policy on the future population structure of China and the pension income and expenditure. Gu Hejun & Li Qing (2017) combined the data of the fifth and sixth census data with the annual statistical yearbooks to estimate the new birth population after the implementation of the "two-child" policy. They found that the implementation of the "two-child" policy could not change the overall downward trend of the total labor population and the upward trend of the proportion of the elderly population, but only slightly reduced the rate of decline in the labor population. Gu Hejun et al. (2018) examined the impact of the "two-child" policy on China's long-term economic growth and found that this policy will not create new "demographic dividends" by the middle of the 21st century, and it is impossible to reverse the trend of increasing aging. Sui Lei (2017) established a generational overlap model to study the impact of the "two-child" policy on basic pension. He believes that the "two-child" policy can only improve the financial sustainability of the pension system to a certain extent in the future, and the effect on the growth rate of the birth rate is not significant. Some scholars further explored the effect of completely relaxing the family planning policy. Zhu Jianping (2017), based on the data from the sixth census, found that the effect of abolishing the birth restriction completely is very close to the "two-child" policy, and the elderly dependency ratio will gradually increase. Therefore, he suggested that the government not only completely abolish the birth restriction, but also encourage birth.

The birth policy has a significant lag on the adjustment of China's current population structure, it cannot be achieved immediately. Therefore, it is necessary to comprehensively consider these factors and promote to completely relax the family planning policy as soon as possible. In addition, we must learn from the practices of some developed countries, to encourage fertility, and to improve the total fertility rate.

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## Topic 2.1.4 - Linda Sokačová<sup>4</sup>: How to prepare for ageing of the society

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## **1. Population Ageing in the heart of policy making process**

China faces similar demographic trends as Europe and Czech Republic. Both countries experience so called demographic ageing. Our societies have more people 50+ and 60+ and the birth rate is not sufficient enough to secure natural renewal of the population. Therefore ageing policies are in the spotlight of policy making process. Political actors, experts and institution mainly from social and health care sector are focused on the topic of population ageing and its impacts on our society. It must be said that ageing is not just threat as it often presented, ageing of the society also indicates that the quality of life and personal well-being improves and life expectancy is getting higher. Besides increasing life expectancy we need to stress the importance of the quality of life, and health of citizens and their economic situation.

It is important that ageing policies are put to the centre of social and family policies. These policies strongly influence socie-economic position of people in the society, older people and elderly included. It is important to keep in mind that ageing is a cross-sectional issue. It involves and impacts other policies – labour market and employment policies, security or insurance measures. Ageing policies and position of older generation in the society is also strongly connected to work-life balance, position of women in the society and family policy.

### **1.1. Evidence-based policy**

Evidence based policy is very important tool for conscious, responsible and on facts based policies. Without data and strict evidence we cannot prepare policies which can bring positive impacts and positive change in the field. Term evidence-based policy refers to situations in which policy decisions are framed by rigorously established objective evidence. It is hard, especially in social policies, to have strict quantitative data, but we can use also qualitative studies or outcomes from pilot programmes or knowledge from case studies. The evidence-based policy approach was popularized by the British government and at the time prime minister Tony Blair. A UK Government white paper published in 1999 ("Modernising Government") noted that government must "produce policies that really deal with problems, that are forward-looking and shaped by evidence rather than a response to short-term pressures; that tackle causes not symptoms".<sup>5</sup>

Evidence-based policy is linked also to the effective work with data and statistical evidence at the beginning of the policy preparation and implementation. It stresses the importance of monitoring statistical outcomes and results of policies and evaluation.

If we want to prepare good-quality national strategy on ageing or any other issues we need to have sufficient statistics, case studies and evidence from experts, academics or politicians. It is useful to work with official statistical data from the national statistical office, then to use robust and representative studies from academic and research institutions, qualitative studies and evidence from the institutions which work in the relevant field on everyday basis – social services, diverse various organizations, state institutions etc. This evidence should be use to describe the current situation and to elaborate future tendencies and trends under described circumstances.

Why work with data and facts, and not just with our subjective opinions and speculation:

- to describe current situation

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<sup>5</sup> [\*Department for Environment, Food and Rural Affairs\* \(21 September 2006\). \*"Evidence-based policy making"\*.](#)

Archived from [\*the original\*](#) on 14 January 2011. Retrieved 6 March 2010.



- to describe target groups in detail with regard to specific age groups, gender, health and economic situation
- to provide information about future trends and tendencies
- to provide basic insight into the cost and profit of proposed policies and programmes

## **2. Ageing and Sustainability**

As it was written above the data can be used not only for the description of the current situation but also for extrapolation of future tendencies and trends. If we consider sustainability of the society and proposed policies, we need to take into account connections of ageing to the situation on the labour market and in economy in general. We need to ask questions about the structure of key professions which we need to sustain basic societal functions.

### **Society need to have enough:**

- teachers to teach young generations
- doctors and nurses to care for people's health, especially in the ageing society
- workers for key economic sectors
- state officials to secure basic functions of the state
- social workers to secure social care, especially in the ageing society

We should elaborate the situation in defined key professions with regard to current and future situation. We may have enough teachers today, but it is important to segregate data according to age groups, gender etc. This will show us the moment in which we might have insufficient numbers of people in certain professions. It enables us to identify measures to change the trend.

## **3. Cooperation**

To gain robust and sufficient information we need to reach data from the national, regional and local level. It is important also to get knowledge from different actors in the society: hospitals, universities, public administration, providers of social care etc. It is also important to collect examples and situation descriptions from foreign countries which could be culturally similar or totally different. We need to take into account differences in legislation, political and economical context and adapt them for our own context. Foreign examples can show us dead ends which experienced other countries or can be great positive inspiration for effort in the field of population ageing.

One of the best ways to secure effective sharing of information is to set up working group on ageing. It can help us sharing experience with different key actors in the society, to discuss diverse points of views and effectively spread information.

### **The Government Council for Older Persons**

The Government Council for Older Persons (hereinafter „the Council“) was established on March 22, 2006 by Government resolution No. 1482 on implementation of the National Programme of Preparation for Ageing for the period 2003 - 2007.

The Council is a permanent advisory body to the Government of the Czech Republic on issues related to ageing and older persons.

The Council's mission is to promote conditions for healthy and active ageing, dignity in old age, and active participation of older persons in economic and social development in the context of demographic ageing. It aims to ensure equal rights for older persons in all areas of life, to protect their human rights and support development of intergenerational relationships in family and society.

The Council meets at least three times a year. The Chairperson of the Council is the Minister of Labour and Social Affairs. The secretariat of the Council is a part of the organizational structure of the Ministry of Labour and Social Affairs of the Czech Republic. The members consist of the experts from non-profit sector, social services providers, academic experts, representative from trade unions and employers and from ministries responsible for ageing of the society.



#### **4. Strategic planning: ageing and policy focus**

To prepare and implement complex and effective policies it is important to draft strategic plan for the ageing and its impact on the society. It is crucial to use statistical data and information from the analytical work and cooperation activities. Participation of different key actors provides reliability and credibility of included information and proposed policies and measures. Among other things it is important to know who will be responsible for the coordination, implementation and evaluation of the strategy. There are different approaches in national EU states. In the Czech Republic Ministry of Labour and Social Affairs is responsible for the coordination of the national plan for active ageing. It would be also possible that Office of the Government could coordinate in some extent also coordinate ageing strategy plan.

The main strategy should focus on the national level, but you can also cover regional and local level. It can also set up framework for the creation of partial strategies/ concepts for selected sectors of economy or ministries according to their importance. Every strategy should also set SMART goals and measures.

**SMART means:**

- S – Specific: all goals should be sufficiently specific and concrete
- M – Measurable. all goals should be measurable, it means you should set up transparent and realistic indicators
- A - Achievable/Acceptable: it is not clever to set up unrealistic goals, which cannot be reached
- R - Realistic/Relevant: all goals should be relevant according to the resources
- T - Time Specific/Trackable: every goal should have its time table and time milestone

If you have already started to elaborate your strategic plan on ageing you need to decide several aspects which influence the overall direction and meaning of this document. Work on your ageing strategy should follow basic instructions for strategic planning with strict time table and list of stakeholders.

**Basic questions you need to answer and solve in the process of making strategic plan:**

**1. What level do you want to address?**

Is it national, regional or local level? Do you have enough resources and tools to reach all three levels? Sometimes less is more if we consider the whole complexity and demanding character of the issue.

**2. Who do you want to address?**

It is also important to know who will be the administrators of policy areas and its aims. Is it government, ministries, regional governments, employers, institutions or citizens?

**2. What do you want to achieve?**

You should answer what should be main outcomes in the implementation process. Is it system change, change in the society or simple and easily measurable activities?

**3. What time period do you want to cover?**

To decide if you want short or longtime strategy is another important thing. One year is too short time to write strategic plan for and ten years may be too long, because it is difficult to foresee different future scenarios. Certainly it is helpful to include one year action plan in every strategic document to plan up-to-date steps and follow-ups.

**4. Start drafting main mission - vision of your strategy**

Before drafting specific aims and choosing measures to reach them you need to draft mission statement. The mission frames the whole philosophy and approach of the strategy and it determines definition of main aims, measures and areas to cover.

**5. Areas of the ageing strategy**

Based on your research and data and main vision of the strategy you need to decide what areast you need to cover. The scope of areas is influenced not only by the research and context but also by resources you have for the strategy and its implementation.

**Czech strategy on ageing covers more areas**, it starts with social services, health care, education, volunteering, but deals also with human dignity, intergeneration solidarity, provisions for families etc. It is complex roadmap for the ageing policies in the Czech Republic.

**Ageing impacts almost on all areas of the society:**

- **Employment**

The sustainable labour market needs sustainable workforce including young employees and employees with experience. Ageing population indicates shortage in numbers of people who are able to work. Thus you need to prepare society and employers on such situation by modern and inovative work tools and approaches to work. It also means that employers have to attract enough people and use talent of all members in the society, it means workplace without discrimination and age stereotypes. Modern workplace is an environment where more experienced and older workers can transfer their knowledge and experience to younger ones without fear of losing job. Younger workers on the contrary can teach the older ones in new technologies, new procedures etc. State can also balance younger and older workers on the labour market by setting the retirement age and legal conditions for work in retirement period.

- **Health care**

To stabilize national finances you need to promote healthy life style, prevention and early care. But also the health care system needs to be ready for more people who need financially more demanding care. Health care system can also be influenced by the socio-demographic composition of the medical work force. It is very important issue which need to be taken into account.

- **Transport**

Elderly people and people with disabilities require accessible transport vehicles and environment.

- **Social policies**

To stabilize national finance the society needs to have in balance family care and social services, financial support (allowances) and services. Ageing society requires higher financial costs for securing social services and care for elderly people and people with disabilities. To reflect on the direction of the whole social system and system of the social services, it is very important to decide if you want to support mainly family care or institutional care and services. Health and social care is very difficult task for famiies. If the state decides to support primarily family care, it needs to be taken into account that it affects possibilities for work. People who care on the daily basis can't be on the labour market everyday, so it is important to prepare special allowances (if you want to secure basic economic position and human dignity). Otherwise such families fall into the poverty. Family care affects in most countries particularly women, who are primary responsible for caring. Family care requires professional support from psychologists, medical experts etc. Everyday care is difficult,

it brings problems to people who are cared for and also for informal carers. Without psychological support there can be lot of problems, including in the area of domestic violence.

If the combination of family and institutional care is chosen by the state authorities, the life of family carers and whole families is easier. But this type of policy means to institutionalised social and health services on the state, regional and local level. Regions, municipalities or other bodies then provide daily/ weekly care centres or field services – social professionals support family carers in their natural environment. Social workers or professional carers can also provide care instead of family members during work week at home or in special centres. People with disabilities can be cared for in special care and senior houses. It is very important to secure very high standards in human dignity and human rights in the institutions.

Social services in the Czech context mediate assistance in the care of one's own person, providing meals, accommodation, assistance in running a household, care and assistance with bringing up a child, providing information, mediation of contact with social environments, psychotherapy and social therapy, assistance in assuring one's rights and interests. Social services help people to live a normal life - they allow them to work, shop, attend school and places of faith, participate in leisure time activities, take care of themselves, their home, etc. The services aim to maintain the highest possible quality and dignity in their lives. Social services are provided to individuals, families, as well as to groups of people. Social services are administered to people in adverse social situations if the people are permanent or long-term residents of the Czech Republic. The most numerous groups of beneficiaries are, particularly, the elderly, people with disabilities, families with children however also, people living on the fringes of society for various reasons. Social services are provided by the municipalities and regions, NGO's.

#### **The services aim amongst other things to:**

- promote development, or at least maintenance, of the existing self-sufficiency of the user, the user's return into his/her own home environment, renewal or maintenance of their original lifestyle
- enhance the user's abilities and enable them to lead an independent life where possible
- limit social and health risks associated with the users' lifestyle<sup>6</sup>

Care allowance is another important support for people with disabilities in the Czech Republic. The care allowance is provided to persons who are due to their long term unfavourable health condition dependent on another person's assistance when dealing with basic living needs: mobility, orientation, communication, self-feeding, putting on clothes and footwear, washing oneself, toileting, looking after one's health, personal activities and household tasks. The amount of care allowance corresponds to the degree of "dependence on care" which is based upon an assessment of ability to manage the above mentioned 10 basic living needs. There are 4 levels of dependence – from the slight dependence (I) to total dependence (IV).<sup>7</sup> Care allowance can be used for professional care or for family members who informally care in the household. People can decide, what type of care they want, they are not forced to use institutional care. On the other hand it is quite costly allowance, it

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<sup>6</sup> Ministry of Labour and Social Affairs, Social services, available at: <https://www.mpsv.cz/en/1613#sspa>.

<sup>7</sup> Ministry of Labour and Social Affairs, Social services, available at:  
<https://www.mpsv.cz/en/1612#sabfpwd> .

doesn't cover health and social insurance for informal/ family carers, so they are without any social security.

- **Pension system**

Sustainable pension system refers to the stability of the state finances but also possibility of retirees to live particularly well with their pension pot. The whole sustainability of the pension system is influenced by the pension age and total number of active workforce.

- **Education**

It includes whole education system for ageing workforce like longlife learning and also special education for retired people (universities of the third age) etc. The University of the Third Age is an international movement whose aims are the education and stimulation of mainly retired members of the community, for those in their third age of life. Universities of the third age are very popular in the Czech Republic, senior students attend university courses and acquire diploma. But they are not entitled to use this diploma on the labour market. It is rather prevention of social exclusion and social and network programme for seniors.

- **Safety**

Elderly people are objectively more vulnerable to criminality and subjectively they feel also less safely than younger generations. It is something what needs to be taken into account in the safety policies. In general older people make more complaints and are more sensitive towards new trends in society which they perceive very often as negative. In many European countries criminality affecting senior people is perceived as more serious criminal offence. In the Czech Republic municipalities invest into prevention programmes – special travel trips for senior people for the purpose of socializing, prevention of loneliness.

#### **4.1 Global and Strategies on Ageing**

The first WHO World Report on Ageing and Health, released in 2015, defines Healthy Ageing as “the process of developing and maintaining the functional ability that enables well-being in older age.” The overall objective of healthy ageing is well-being, which is holistic and encompasses all of the elements and components of life and living that people value. This perspective provides a new approach to frame comprehensive health policies and implement actions within and across countries. The report identifies priorities that are already shared by many of governments and stakeholders and considers further areas that are likely to be effective.<sup>8</sup>

**The WHO Global strategy and action plan on ageing and health (2016 – 2020) has two goals:**

- five years of evidence-based action to maximize functional ability that reaches every person; and

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<sup>8</sup> World Health Organization, WHO Global Strategy and Action Plan on Ageing and Health. Available at: <http://www.who.int/ageing/ageing-global-strategy-survey-report-en.pdf>.



- by 2020, establish evidence and partnerships necessary to support a Decade of Healthy Ageing from 2020 to 2030.

Specifically the Strategy focuses on five strategic objectives:

- commitment to action on Healthy Ageing in every country;
- developing age-friendly environments;
- aligning health systems to the needs of older populations;
- developing sustainable and equitable systems for providing long-term care (home, communities, institutions); and
- improving measurement, monitoring and research on Healthy Ageing.

#### **4.2 National strategies on ageing: Czech Strategy on Ageing**

Czech government approved National Action Plan Promoting Positive Ageing 2013 – 2017, which is the main national strategic document. The main aim of this strategy is to change attitude of society towards active ageing and increase interest of society in the ageing.

The Czech national strategy on ageing sets up political framework for the national policies of ageing, focuses on the preparation of the state bodies for the situation of ageing society and it marks out main priorities in this area. It is said in its introduction that: „The population ageing concerns all areas of the life of a society and is reflected in a broad spectrum of political measures. Policies responding to ageing of the population may only be effective if they are based on a comprehensive approach, coordination of all adopted measures and shall be compliant with the long-term outlook for the maximum use of the potential of older workers and seniors. Our common goal is to create individual policies able to flexibly respond to the ongoing and expected demographic changes in compliance with challenges that arise from the population ageing.“<sup>9</sup> The Czech national plan for active ageing needs to be seen in the context of the whole family policy and it is also based on the premise that prevention is better than dealing with consequences (active ageing, healthy life style).

The main stakeholders in the Czech Republic for the drafting and implementing strategic goals and measures in the area of the (active) ageing are:

- on the national level - government, ministries, Office of Ombudsman
- on the regional and local level – counties, regions, cities, towns, municipalities, other central and regional
- authorities, research institutes, academic sphere
- non-governmental organizations (NGOs) and other bodies
- specific role of the Government Council for Older People and Ageing Population a permanent advisory
- body to the government for issues related to older people and population ageing

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<sup>9</sup> National Action Plan Promoting Positive Ageing for 2013 – 2017, Ministry of Labour and Social Affairs.

Available at: [https://www.mpsv.cz/files/clanky/21727/NAP\\_EN\\_web.pdf](https://www.mpsv.cz/files/clanky/21727/NAP_EN_web.pdf).

The eight areas of the National Action Plan:

- Implementation of the Ageing Policy in the Czech Republic
- Securing and Protecting the Human Rights of Older People
- Life-long learning
- Employment of older workers
- Quality life environment for seniors
- Volunteering and intergenerational cooperation
- Healthy ageing
- Care for the elderly

The main Objectives of the national strategy:

- Coordination and cooperation at national and local levels
- Funding and personnel strengthening of ageing policy
- Role of Focal Point Contacts
- Role of Family
- Intergenerational Relations
- Informal Care

## **5. Final conclusions**

Population ageing is a global trend, challenge and problem in one. The problems and challenges in this area can be resolved only by the pro-active and systematic approach by governments and transnational bodies and networks. To prepare complex, sustainable and effective strategy on ageing it is important to involve all important stakeholders like public bodies, municipalities, regions, universities etc. Ageing policy need to be linked to the family policy and work-life balance strategies. Ageing of the society can be slowed down by the effective family policies which support families with children and prevent barriers for them. It is also very important to strengthen intergeneration relations and solidarity. And always remember prevention is easier and less costly than elimination of negative impacts.



## **Topic 2.1.5 – Wang Dehua: The proposals on Promoting Social Contribution Collections toward a unified system in China**

### **Executive Summary**

At present, China has made it clear that since 2019, the social security contributions should be collected by the tax authorities uniformly. In order to carry out the reform direction proposed in The Deepening Reform of The Party and State Institutions Plan, the report puts forward five suggestions that should be paid close attention to in the next step. Firstly, the transitional policy should be clarified, the duty of collecting social security contributions should be transferred steadily to the tax departments, so as to avoid excessively increasing the burden of social security contributions in the short term.

Secondly, we should confirm the order in which the reform is put into practice in each social insurance items and give priority to basic endowment insurance system reform for urban residents. Thirdly, we should establish a platform for information exchange and cooperation among social security, taxation and finance, solve the problem of coordination between tax departments and social security agencies, and promote the governance of "Tax collection, Fiscal co-ordination, Social security expenditure, Public supervision". Fourthly, we should strengthen the study and training of the tax departments on social security policies. Fifthly, we should make use of the favorable conditions created by the reform of tax collection and management system to start the reform of lowering social security contributions and raising the level of overall planning.

**Keywords:** social security contributions, a unified collection system by tax departments, small and medium-sized enterprises

## The proposals on Promoting Social Contribution Collections toward a unified system in China

*The Deepening Reform of the Party and State Institutions Plan* released in 2018 clearly points out that “in order to improve the efficiency of social insurance funds collection and management, various social security contributions such as basic endowment insurance premiums, basic medical insurance premiums, and unemployment insurance premiums will be uniformly levied by tax departments.” This plan has been approved by the National People's Congress of China and has legal effect, which resolves a lasting dispute for nearly two decades that which would be better between tax authorities and social security agencies to collect social security premiums for the development of social insurance, the reform direction is toward a unified collection by the tax authorities.

*The Deepening Party and State Institutional Reform Plan* also required that the separate national and local taxation systems by integrating their offices should be realized in 2018. Therefore, in 2018, the Chinese tax departments faced two major institutional reform tasks. First, the merger of the separate national and local taxation systems at all levels to form a new tax authority; Second, the tax departments should undertake the task of uniformly collecting social security contributions in most regions.

The recently released *The National and Local tax Collection System Reform Plan* clarified the order of key reform tasks: Firstly, the new tax institutions were listed, followed by *The Three decisions plan* for the new tax authorities. Thirdly, develop the transfer of social security contributions and non-tax revenues collections. Fourthly, promote the integration and optimization of tax and fee business as well as information system, and the fifth is to strengthen the funds safeguard and asset management, and revise relevant laws and regulations, from which the integration of national and local tax offices and the implementation of the unified collection system are intertwined and need to be systematically promoted.

The reform plan requires that the social security contributions shall be collected uniformly by tax departments as of January 1st, 2019. The reform plan has aroused widespread attention from Chinese enterprises and the public, and even caused some panic concerns. Some people even believe that the unified collection of social security contributions will greatly increase the social security burden and labor costs of enterprises, which may lead to large-scale business failures and unemployment.

In response to the public concerns, the State Administration of Taxation and the State Council timely announced some policy considerations following the social security premiums collection system reform. In August 2018, Director Wang Jun of the State Administration of Taxation pointed out at the mobilization and deployment meeting of the transfer of social security contributions and non-tax revenue collection, set up social security contributions collection system with well-defined duties, smooth process flow, standardized administration, strong collaboration, convenient and efficient, which is helpful to lay a good foundation for raising overall plan level of social security contributions, promoting timely improvement of the payment rate and deepening “delegate power, improve regulation and optimize services” reform and further stimulating the vitality of market mainstay.<sup>10</sup> In September 2018, the State Council executive meeting further clarified: We must promptly study and reduce the social security rate appropriately, ensure that enterprises’ burden is not increased as a whole to invigorate the market and guide a good social expectation.<sup>11</sup> These information

<sup>10</sup> <http://www.chinatax.gov.cn/n810219/n810724/c3675977/content.html>.

<sup>11</sup> [http://www.gov.cn/premier/2018-09/06/content\\_5319849.htm](http://www.gov.cn/premier/2018-09/06/content_5319849.htm).

indicates that with the changes of the social security collection system, the social insurance related policies will also be adjusted.

On the views of recent advances, China's social security contributions collection with the existence of the double-track system will become a thing of the past, and enter a new era of uniformly collected by the tax departments since 2019. However, there are still many problems to be studied in how to promote the reform of the unified collection of social security contributions by tax authorities and the subsequent adjustment of social insurance policies. First of all, as the public feared, the degree of tax administration of social security contributions may be increased drastically. How to balance the interests of enterprises and insurers in a short term and achieve a smooth transition? Secondly, the collection of social security contributions is relatively special. It is closely linked with the provision of social insurance benefits. For this reason, how do various social insurance projects promote reforms step by step? How to coordinate the division of responsibilities between the tax departments and social security agencies? Finally, China's social insurance system still has some problems of policy design such as "fragmentation" and "high rates". How to use favorable conditions of the tax authority full responsibility model to further promote social insurance system? This paper preliminarily analyzes of these problems and puts forward the following recommendations.

## **1. Clarify transitional policies and steadily transfer the responsibility for collecting social security contributions to tax authorities**

Social security contributions will be uniformly collected by the tax departments in 2019, which lead to the enterprises' great concerns about the social contribution collections reform in China. The reason is that the current situation of social contribution collection is far from the ideal state of "Participate in social security according to law". The tax authorities' ability of collection and administration can quickly achieve "Participate in social security according to law". According to *The White Book Of China Enterprise Social Security System 2017*, The proportion of enterprises with social security payment base according to law continued to decline in 2017, and only 24.1% of enterprises were fully compliant. 75.9% of the enterprises fail to verify the payment base according to the actual wages of employees, of which 22.9% of the enterprises uniformly paid the minimum base.<sup>12</sup> The author's interviews with some entrepreneurs also found that many labor-intensive enterprises, the proportion of employees participating in social security according to regulations is only 20% to 30%, and some even only 5% to 10%. As the tax authorities have more sufficient information on the enterprises, they are qualified to require the enterprise to pay 100% for all employees who participate in social security according to law. It means that the enterprises with 100 employees, which used to have 20-30 employees participated in social security, now have to have 100 people insured, and 75.9% of the enterprises had inaccurate payment base originally, and now all have to make the payment base solid. Fully achieving 'Participate in social security according to law' will lead to an increase of the number of participants in social security and the payment base, a rough estimate of labor costs has risen by about 30%. Moreover, assuming that an enterprise's costs for labor account for 30% of the total cost, the total cost rises by about 10%. At present, the gross profit margin of entity enterprises is relatively small, so the rise of cost is naturally unbearable.

From the current situation that enterprises are not optimistic about participating in social security to the ideal state of "participating in insurance according to law", we should consider the endurance of enterprises and pay attention to the ways and means. When you come down to it, good operation of enterprises is the foundation for the sustainable development of social insurance and the improvement of the welfare benefits of the insured. But in recent years, entity enterprises are under various pressures. Externally, the growing

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<sup>12</sup> The relevant data are from the information provided by Guangzhou and Beijing local taxation bureaus.

trade war between China and the United States has brought more uncertainty and great pressure on the export and sales of enterprises. Internally, the improvement of environmental standards has also increased the operating costs of enterprises. To avoid greatly increasing the social security burden of non-compliant enterprises in the past due to tax authorities uniformly collected social security contributions has become the last straw to crush enterprises.

Therefore, we should follow the idea of ‘making progress while remaining stability’, define the transitional policies, and do a good job in the reform of social contribution collection.

Firstly, practical measures should be taken to avoid a sharp rise of enterprises’ social security payment after collecting by tax authorities, and to stabilize the actual social security payment burden of enterprises. Relevant policies can be issued by the State Council, and a transitional period of 3-5 years can be set up, clarify the phased promotion target of enterprises’ participation in social security after collecting by tax authorities. The principle stipulates that the annual growth rate of social security payment of every enterprise shall not exceed 15% during the transition period. Tax authorities at a higher level should avoid blind view of political achievements and put forward excessively high growth target when issuing the plan of social contribution collection.

Secondly, to stabilize the reform of social insurance payment policies by enterprises and realize the expectation that the efficiency of tax collection and management will not lead to the rapid rise of actual burden. It should be acknowledged that the setting of the statutory rate of social security contributions in China in the middle 1990s is characterized by " budget liberally and spend sparingly ", which is relatively high from the international comparison. With the rapid improvement of the efficiency of collection and management, China has the conditions to change the policies of the base and the statutory rate of social security contributions. The central government should release information on the implementation of relevant reforms as soon as possible to stabilize the expectation of enterprises on social security payment burden and avoid wrong decisions of enterprises.

Thirdly, we will steadily advance the element tasks, such as the reform of social contribution collection and the integration of information related to enterprise social security, making it a solid foundation for improving the efficiency of social security collection. Improving the efficiency of tax collection and management does not mean that the burden on enterprises must be increased. In the case that the target of social security collections is set, improving the efficiency of collection and management means the enterprise social security burden is lower and fairer.

## **2. Establishing the implementation of social security projects in accordance with Tax authorities full responsibility model**

The tax departments will begin to levy social security contributions uniformly in 2019. However, given the uneven development of different regions in China, it may not be realistic to implement Tax authority full responsibility model for all social security projects at one go. To this end, we can consider promoting the transfer of duties according to the regulations, but we must clarify the sequence. Some of the business links can be entrusted to the social security agency by the tax departments, and finally realize all social security projects according to Tax authority full responsibility model.

Enterprises have statutory obligations to pay the premiums of the basic endowment insurance, basic medical insurance, unemployment insurance, employment injury insurance and maternity insurance of urban workers.

The work of social security collection is characterized by income discrimination, that is, the actual income of the insured as the payment base, pay at a fixed rate. Starting from the goal of improving the efficiency of collection and management mentioned in the deepening reform of the party and state institutions plan, it is more urgent to implement the Tax authority full responsibility model in such social security projects for workers. Taking into account the pains and social risks that may be brought about by the promotion of reforms, the specific reform plan can be implemented step by step: the province as a unit, the areas implemented the tax agents authorized collection model at present should be fully realized the “Tax authorities full responsibility model” in the early 2019, the areas currently charged by the social security branch may be delayed appropriately and meet the requirement that implement Tax authority full responsibility model in 2019. The areas that have taken the Tax authority full responsibility model, whose relevant systems should be further improved, especially strengthen coordination with the social security departments. In areas where the different types of insurance are under the responsibility of the tax and social security agencies, the basic endowment insurance and basic medical insurance may be considered as the reference system. The two types of insurance that have been levied by tax authorities are deemed to they have been collected according to the Tax authority full responsibility model. Other types of insurance also changed to the Tax authority full responsibility model.

Social security projects that are voluntarily insured or do not involve income screening mainly refer to the the basic endowment insurance and basic medical insurance for the residents. The main features of these types of insurance or participation in social security is that meet the requirement of voluntarily participating in social security from the view of laws and rules, the amount of contributions paid by the insured is generally fixed, and no income screening is required. Therefore, whether people are willing to participate in social security depends mainly on policy designing, services and whether the policy is beneficial to their own judgment. The ability to income screening of the departments of social security collections has little effect on improving the efficiency of collection and management. As analyzed earlier, due to the strength of the tax department's information system, they can also provide convenient services for the insured voluntarily. In addition, the tax department is responsible for the social security collection, which can realize the integration of all types of insurance registration information and facilitate the information flow between the tax departments and the social security branches. Based on these considerations, the final reform direction of the residents' social insurance projects that are voluntarily insured should be levied by the Tax authority full responsibility model, but the transition period can be specified by the provinces.

### **3. Establish an information exchange and cooperation platform for social security, taxation and finance, and promote the governance model of “tax collection, fiscal pooling, social security expenditure and public scrutiny”.**

Social security business is a complete chain from the registration of insurance, the approval of payment base to the payment of treatment. Some people worry about handing over some of these links to the tax authorities cuts them apart and adds to the cost of the cost of co-ordination between departments. When both revenue and expenditure are handled by social security agencies, the internal incentive and restraint mechanisms will encourage social security departments to work harder to increase revenue and spend more prudently, while social security collection charged by tax authorities will weaken the incentive and restraint mechanisms. The author believes that the coordination costs between departments is inevitable for the public sectors, which should be mitigated by institution and technology. Internal incentive restraint mechanisms are important, while external regulatory constraints are more important. The solutions to these problems lie in establishing a platform for information exchange and cooperation among social security, taxation and finance, and

promoting a governance model of ‘tax collection, fiscal pooling, social security expenditure and public scrutiny’.

First of all, a consultation mechanism (led by the government and have a leader in charge of it) for major decision-making should be established, a regular mechanism for department communication should be established, the policies of social security collection should be timely passed, joint meetings should be organized regularly to report the work progress, the difficulties of collection should be discussed together, and reasonable suggestions for improvement of collection should be proposed. Especially, the determination of the payment base and other key parameters should be coordinated by social security, finance and taxation to establish the corresponding leadership system.

Second, we should strengthen the construction of informatization, learn from Guangdong province, rely on the core collection and management system of "Golden Tax-III " of tax departments, accelerate the promotion of provincial, municipal and county-level comprehensive treatment information platform, improve the data exchange rate, improve the abnormal information screening mechanism, and realize the reconciliation of three-party data of PICC, finance and local tax in real time.

Third, we should jointly formulate measures for collection, and clarify the payment period and types of tickets. After collection, we should push relevant information to the people's insurance departments in real time. For the application for refund of overpaid social security contributions, it shall be handled in accordance with the corresponding procedures for tax refund and promote the streamlined and standardized management of the social security collection business.

Fourth, establish the governance model of ‘tax collection, fiscal pooling, social security expenditure and public scrutiny’, supplemented by the support of modern information technology, which can achieve departmental communication and separation of powers based on information flow without technical barriers. In addition to the tax and social security departments, it is necessary to give full play to the role of fiscal pooling and the public supervision of auditing and other departments. Strengthening external supervision and restraint is beneficial for the tax departments to realize “full collection according to law”, and the social security departments carefully manage the expenditure according to law. After promoting the Tax authority full responsibility model, the tax authorities are responsible for collection, the social security departments are responsible for expenditure management, and the division of responsibilities is relatively clear. Under the constraint of this decentralized system of checks and balances, it can not only ensure the security of funds, but also lay the institutional and technical foundation for good communication between departments.

#### **4. Strengthen capacity building of the unified collection system**

Social insurance business is an organic and unified whole, and the payment link is closely related to the insured's post-insurance payment. The payment link is closely related to treatment and payment of the insured after participating in social security. There is a significant difference between social security collection and the general tax collection. Therefore, the taxation departments should strengthen the learning and training of social security policies.



First of all, the tax system should establish a special collection agency for social security contributions, responsible for processing the social security policy information and insurance information and should be inclined to the social security profession in the recruitment of new personnel. Social security premiums collection takes the measure of “co-collection and co-management” of taxes and premiums. However, the collection of social security premiums involves too many social insurance policies, timely transmission and check of insurance information, as well as the handling of abnormal situations, and so on. It is more policy-oriented and sensitive, so it needs special agencies and personnel responsible for management.

Secondly, the tax system should carry out special actions for social security policy learning and training, the participation of leaders, and collectively improve understanding of social security policies. The social security departments and the tax departments should pull together for mutual goal of doing a good job in social insurance business and provide convenience for the tax departments to study and promote social insurance policies. This not only conforms to the current direction of supply-side structural reform, but also can improve the compliance degree of insured persons. In fact, it is possible to increase the total amount of payment income, which is conducive to the sustainable development of social insurance industry.

## **5. Based on actuarialism, launch policies to reduce social security contributions and the enterprises’ social security burden**

In terms of international comparison, China's various social insurance premium rates are relatively high, and more are borne by enterprises. This is also the main reason why the World Bank's accounting for Chinese corporate tax burden is high in countries around the world. In practice, the current actual contribution rates vary widely across China; the determination of the lower limit of the contribution base depends on the actual social average wage, which is unreasonable. It can be expected that after the Tax authority full responsibility model, especially proceed with the expansion of the number of insurers and make the base of payment solid, which is helpful to effectively improve the actual collection effect. This will substantially increase the enterprises’ burden, given the same rate and contribution base policy. The change of the collection system should be linked with the adjustment of the social insurance payment policies to balance the interests of the insured, the government's financial pressure and the corporate burden. It not only conforms to the direction of supply-side structural reform, but also improves the compliance of insurers, which actually can increase the total amount of payment income, thus contributing to the sustainable development of social insurance business.

First of all, after the reform of the collection system, the central government can enforce the executive ability, and the actual rates of different areas can be gradually converged and improved. On the basis of actuarial balance, the supporting system can reduce the statutory rate of social security contributions to ensure that the social insurance total payment income grows normally rather than excessively.

Secondly, the national social insurance contribution base policy can be gradually unified, and the lower limit of the payment base should be set to 60% of the social average wage including private sector. At present, the lower limit of the payment base set by different areas is generally based on the average salary of the employees on the job ruling out the private sector published by the Bureau of Statistics, so it was separated from the real social average wage.

Finally, in view of the low participation rate of SMEs and the fact that most of them are migrant workers, special policies can be considered to avoid overburdening the social security contributions of SMEs. For example, small and medium-sized enterprises may be allowed to employ urban migrant workers to choose to participate in resident endowment insurance or medical insurance. For those who choose to participate in residential social insurance, they get subsidies by the government and enterprises to actually improve their social insurance benefits.

## **6. Utilize the favorable conditions of unified tax collection to improve the social insurance overall planning level to break the "fragmentation" pattern**

A prominent feature and drawback of China's social insurance system is “fragmentation”. Including endowment insurance, the overall level of most types of insurance is only at the county level or at the prefecture level. This situation is not only not conducive to the development of a unified fair market across the country, but also seriously undermines the sustainability of the social insurance system. Breaking the "fragmentation" problem of the social insurance system and upgrading the overall level of the social insurance system is the primary direction for China's social insurance system reform. However, upgrading the overall level of various social insurance projects requires a high level of cooperation between lower levels of government and various departments. Under the circumstances that all kinds of information are under the control of lower-level governments, the promotion of reforms may face a situation where the number of bottoms is unclear, and the lower levels do not cooperate.

From this perspective, the tax departments are fully responsible for collecting social security contributions, which is conducive to improving the overall level of the social insurance system. The tax departments are responsible for the full collection of social security contributions. It at least has been achieved the provincial pooling in two key links for the collection of income and insurance participation information. With the promotion of the combination reform of national and local tax systems, the national pooling will be realized. For this reason, if the Tax authority full responsibility model has the yielded results, it should promptly promote the unified collection policies across the country, including the payment rate and payment base policies and so on. Finally, we should seize the opportunity to promote basic pension insurance and worker injury insurance for employees on the national pooling and carry out medical insurance (including maternity insurance), unemployment insurance at the provincial or municipal level pooling.



## **Topic 2.1.5 – Mel Cousins<sup>13</sup>: Social contribution collections: toward a unified system – policy recommendations**

### Contents

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## Abbreviations

<b>ESSPROS</b>	<b>European System of Integrated Social Protection Statistics</b>
<b>EU</b>	<b>European Union</b>
<b>IMF</b>	<b>International Monetary Fund</b>
<b>ISSA</b>	<b>International Social Security Association</b>
<b>MISSOC</b>	Mutual Information System on Social Protection
<b>NPC</b>	<b>National People's Congress (China)</b>
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>SOCX</b>	<b>Social expenditure database</b>
<b>SPC</b>	Social Protection Committee (EU)
<b>SSA</b>	Social security agency

## Introduction

This report forms part of 2.1.5 *Social contribution collections: toward a unified system, experiences from the EU*.

As set out in the terms of reference, the report is to provide policy recommendation reports on the topic 2.1.5 based on the best practices from the EU and the Chinese background situation. This work draws on the workshop (and background reports) held in June 2018. As identified at that workshop, a pension system must be based on a reliable revenue collection that establishes a strong financial base. The issue has been crucial to many countries, especially those in a transition phase, which have been struggling to reach an effective strategy of contributions collection in line with the characteristics of their pension system. In addition, an effective system of collection is important to the legitimacy of a national social protection system while, conversely, an inequitable or ineffective system can tend to undermine legitimacy if contributors feel that others do not pay their fair share.

The main challenges to implement a more integrated and efficient approach include the overall administrative structure of the pensions and revenue institutions; more specifically, a pivotal role is played by the coordination among different institutions in charge of contributions collection.

According to IMF (Barrand et al., 2004) three broad approaches can be outlined:

- Full-service pension institutions that handle all major functions, including collection;
- Arrangements involving closer coordination between tax administration and pension institutions, including data sharing and joint audit operations;
- Collection responsibility is concentrated in a single administration.

It was noted in the background report on this topic (Cousins, 2018) that EU countries have been facing the problem of contribution collection for long time and can provide valuable insights for the Chinese context. The methodologies of contribution collection usually depend on the historical circumstances of a specific country. In some European countries, such as France and Germany, a parallel collection system emerged, while in the countries in which social insurance institutions developed later, such as in Australia and in the United States, an integrated collection system prevails. To achieve greater efficiency, some countries, like Ireland, the UK, and Sweden have converted parallel systems into an integrated collection system.

The table below shows the approach adopted in some EU countries. Verbeke (2012) points out that the choice of collection method has been determined both by practical considerations and by the historical and political context. A number of these countries have moved from collection by SSA to an integrated approach (see Bakirtzi, 2011). In section 2 we look at the lessons from these transformations.

Integrated in tax agency	Social security/pension agency
New Member States – Bulgaria, Estonia, Hungary, Slovenia	Central European - Austria, Belgium, France, Germany, Italy
Nordic countries – Denmark, Norway, Sweden	New Member States – Czech Republic, Poland
Tax-based – Ireland, Netherlands, UK (also USA, Canada)	

In China, the situation of contributions collection varies among provinces where different agencies oversee the collection of social contributions. In some provinces, the agencies are administrative centres of social security, while in others the agencies are tax authorities. In some provinces, the two agencies are responsible for different sorts of contributions. Therefore, as highlighted by the Social Security Department of the Chinese Ministry of Finance, the current collection regime is affected by problems related mainly to effective coverage and adequacy of benefits; more specifically:

- the collection method has confused the rights and obligations of the employer;
- the contributory base is not realistic, limiting the growth of the contribution fund;
- the nominal contribution is high, which impacts on the compliance of employers;
- the coverage of social security schemes is not sufficient to protect the rights of insured employees;
- the advantages of the tax authorities in collecting contribution cannot be fully applied.

However, the Chinese government has recently decided to adopt a fully integrated approach. In early 2018, the CPC Central Committee issued an Institutional Reform Plan which proposed that in order to increase the efficiency of social insurance fund collection and administration, all social insurance premiums such as basic old-age insurance premiums, basic medical insurance premiums, and unemployment insurance premiums shall be levied by the tax department. This plan has been adopted by the National People's Congress. This means that a decision has been taken that the tax department should be responsible for the collection of social insurance premiums at provincial level. Therefore this report focusses on EU experience insofar as it can assist in the transformation of collection from separate to fully integrated collection. The main starting point is to improve the efficiency of social insurance fund collection and management.

This report (section 1) identifies the main rationales for using an integrated approach.

Section 2 looks at the experience of EU countries in moving to an integrated approach drawing on a number of detailed country studies (see references).

Section 3 sets out a number of policy recommendations drawing on international and EU best practice.

## **1. Rationales for an integrated approach**

In this section we outline the rationale for an integrated approach as adopted in some EU and other countries.

### **Functions involved in social contribution collection**

Collection of social contributions involves a number of different and inter-related functions. These include

- a registration process;
- a process for determining the liability of insured persons and their employers, and what contributions are due;
- a validation process to ensure the correctness of the contributions paid;
- a process to collect these contributions;
- a process for recording contributions paid by a contributor over their lifetime, which can then be used by the benefit-paying authority to determine the amount of social security benefit due;
- an approach for monitoring compliance and controlling fraud within these processes;
- a debt management process for pursuing contributions where liabilities have not been met; and
- an enforcement process including law courts for collecting contributions due where the contributor or employer refuses to pay (ISSA, 2013a).

### **Rationale for an integrated approach**

The reasons for adopting this approach include

- Commonality of core processes
- Efficient use of resources/efficiency savings
- Compliance cost reduction – reduce burden on employers/self-employed
- Better compliance – reduced evasion.

First, the IMF (Barrand et al., 2004) has argued that one of the main arguments for unifying the collection of tax and social contribution collections is based on the commonality of the core processes involved in collection of both tax (especially income tax) and social contributions. Both processes involve the need to: (1) identify and register contributors and taxpayers using a unique registration number; (2) have systems to collect information in the form of returns from employers and the self-employed, usually based on similar definitions of income; (3) for employers, withhold tax and contributions from the income of their employees and pay this to the agencies (usually through the banking system); (4) have effective collection systems to follow up those employers who do not file, or do not account for payments; and (5) verify the accuracy of the information shown on returns using modern risk-based audit methods.

Second, studies indicate that the marginal costs of expanding systems used for tax administration to include social security contributions are relatively minor. Conversely, the integration of two existing systems can lead to efficiency savings. This can include fewer staff (so that existing staff can be reallocated to other work) and economies of scale in human resource management and training; lower infrastructure costs in office accommodation, telecommunications networks, and related functions; and the elimination of duplicated IT development costs and less risk in system development and maintenance.

Third, various studies of the integration of tax and social contribution collection have indicated that this can lead to a reduction in compliance costs and in the burden on employers and self-employed payers (see, e.g. Bakirtzi, 2011). This arises as a result of common forms and record-keeping systems, and a common audit program covering both taxes, and social contributions. The increasing use of internet based electronic filing and payment systems within the tax administration also lowers taxpayer and contributor compliance costs.

This simplification can also help improve the accuracy of the calculations made by employers, and therefore compliance levels.

Fourth, the integration can lead to reduced evasion of contribution payments and increased compliance.

It might be suggested that EU experience implies that countries which rely more heavily on social insurance do not adopt an integrated approach. A recent EU Commission study (Social Protection Committee, 2015) indicates that in 12 Member States (Austria, Belgium, Estonia, Croatia, Czech, France, Germany, Lithuania, Netherlands, Poland, Slovakia and Slovenia), more than 60% of all receipts came from social contributions (EU average = 56%). In fact, four of these countries *have* adopted an integrated approach. Conversely, several countries which rely on SSAs for collection (such as Italy and Spain) depend more heavily on general government contributions. The approach in EU countries appears to depend more on institutional politics whereby (Bismarckian) countries with long-established SSAs (often involving employers and trade unions representatives in management) have not adopted an integrated approach to date.

## **2. Experience of integration in EU countries**

This section looks at the experience of integration in a number of EU countries

### **Issues and risks involved**

Studies indicate that there are a range of issues and risks involved in such a reform (e.g. Barrand et al., 2004). These include

- ▶ Readiness of tax administration to implement – it is important that the tax administration should have the capacity to take on this new role in terms of organisational structure, IT capacity, etc.
- ▶ Need for political leadership – given that integration involves a number of different agencies across government and that there is likely to be some resistance to the change process, it is important to have strong political leadership throughout the change process.
- ▶ Need for clear understanding by all key partners – again given the complexity of the process, it is important that all the key agencies have a clear understanding of how the process will work and the end goals
- ▶ Plan and Implementation timetables – part of this involves having a clear plan and a timetable by which different stages in the process will be achieved., this will include identifying the information needs of the SSA
- ▶ Legal harmonisation – it may also be necessary to carry out legal changes in advance of or in parallel with the implementation, for example, it may be necessary to specific the new functions of the tax agency in relation to social contributions.<sup>14</sup>

### **Key design features**

In order to address these issues, studies of existing reforms in EU countries indicate a number of key design factors. These include

- ▶ Cross government approach & political leadership - as above
- ▶ Clear plan with timelines – as above
- ▶ Clear delineation of roles – an important part of the plan will be to decide clearly on which tasks will be carried out by which agency in relation to registration, assessment of liability, validation, etc.
- ▶ Performance standards – standards should be agreed between the SSA and tax agency in relation to issues such as provision of information, transfer of resources, etc.
- ▶ Adequate resourcing – while the implementation of an integrated approach should provide administrative savings in the mid-term, it is essential to recognise that investment in human resources, IT, etc. will be needed in the short-term to allow for implementation of new responsibilities.
- ▶ Strong project management & interagency coordination – for example, it will normally be necessary to establish a working group to plan and implement the reform led by somebody at sufficiently senior level and including all key stakeholders.

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<sup>14</sup> In some countries the opportunity has also been taken to make some harmonisation between definitions, time requirements for submitting reports and payments, etc. for tax and social security contributions.

- Common ID number – in many countries, a single ID number has been established for both tax and social insurance purposes to simplify exchange of data.

Although it has been suggested that the Chinese authorities should reduce the headline level of social insurance contribution as part of the integration of social insurance contribution collection, it does not appear from the studies reviewed in the background report (Cousins, 2018) that this approach was adopted in EU countries.

## Case studies

There have been a number of case studies of completed and ongoing integration of social contribution collection (Barrand et al., 2004; Bakirtzi, 2011). Here we provide an overview of the integration process in the Netherlands (drawing on Bakirtzi, 2011).

The social security system in the Netherlands is mainly financed by income-related social security contributions paid by the insured persons and the employers (66.5% in 2011). The Dutch tax authority (*Belastingdienst*) has been responsible for the collection of social security contribution since 2006. The merger of the administrations of social security contribution and tax collection began in 1990 and it was completed in 2006.<sup>15</sup> Originally a range of different SSAs were responsible for collection but over time this was transferred to the tax authority. Staff were transferred from the SSA to the tax authority and overall staff numbers dealing with collection were reduced as part of the integration process.

More than 30,000 staff members of the Dutch tax authority are responsible for levying and collecting taxes and social security contributions. The tax administration processes the tax returns of 6 million private individuals and 1.1 million entrepreneurs as well as pays out provisional refunds and benefits that are available to households towards the costs of childcare, rent or health care.

Social security contributions in the Netherlands are calculated on the basis of income deriving from employment and home ownership and they are separate from personal or corporate income taxes. They are collected as a single sum with the wages tax. The identification of contributors is done through a unified personal identification number (*Burgerservicenummer*). The concept of wage in the law on social security has been harmonized with the definition of wage in the taxation law in order to facilitate the merged collection system.

The employer declares and pays each month to the tax authority the social security contributions which are directly withheld from the salary of the employee. Both the levies upon collection are kept together until the Ministry of Finance transfers them directly to the social security funds. The Dutch tax authority does not charge any kind of fee for the collection of the social security contributions.<sup>16</sup>

The data on the payments are interchanged freely between the tax and social security agencies. This includes information required for the determination of the right to benefits of the social insurance schemes. However, there is appropriate data protection as only authorised persons within the agencies can access and process this information. The control of the payments is performed by the tax authority with the cooperation of the Dutch Social Insurance Agency. All these agencies can declare a person liable for not paying his/her contributions.

The only obstacles reported during and after the merger in the Netherlands were that some practices of the tax administration did not fully take into account the nature and purpose of the social security contributions collected.

Some disadvantages of the merged collection system in the Netherlands were:

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<sup>15</sup> An exception to this is that *voluntary* social security contributions are still collected by the Dutch Social Insurance Agency (*Sociale Verzekeringsbank*).

<sup>16</sup> In other EU countries, e.g. Ireland, the tax agency is paid an agreed fee by the SSA for its collection services.



- the vulnerability of the operation system due to the massive processes, the large flows of information, the transfer of data and the transfer of personnel, and
- data failures in the insurance file administration, such as lack of data or incorrect data.

Overall, the study concluded that the merger of social security contribution and tax collection resulted in a simplification of levying and collecting social security contributions, a reduction of the administrative burdens on employers, a reduction of the implementation cost for the government, a higher level of efficiency in the collection process, the harmonization to a certain extent of rules and the decrease of the contradictory decisions within the public administration. From a general point of view, the transition to the merged collection system was welcomed positively in the Netherlands. The taxation and social security rules were harmonized and the collection procedure became more efficient.

### **Summary of the merged administrative arrangements for social security contribution and tax collection in the Netherlands**

Issue	Outcome
Collecting authority	The Dutch Tax and Customs Administration. Collection of voluntary social security contributions by the Social Insurance Agency
Collecting method	Social security contributions are collected as a single sum with the wage tax
Applicability of taxation rules	Yes
Relationship of social security contributions with taxes	Social security contributions are distinguished from personal or corporate income taxes
Declaration and payments of social security contributions and taxes	Performed by insured persons and their employers as well as self-employed persons
Records' maintenance	By the employer for each individual employee
Identification of insured persons for payment purposes	Via a personal identification number called <i>Burgerservicenummer</i>
Electronic declaration of payments	Use of e-forms
Calculation basis for social security contributions	Taxable income deriving from employment and home ownership
Deductibility of contributions for corporate income purposes	Not reported
Transfer of funds collected	<ul style="list-style-type: none"> <li>• Transfer of Exceptional Medical Expenses and health care contributions to the fund of the Health Insurance Board</li> <li>• Transfer of employee insurance scheme contributions to the Employee Insurance Implementing Body</li> <li>• Transfer of the national insurance scheme contributions to the Social Insurance Agency</li> </ul>
Control and recovery of overdue payments	<ul style="list-style-type: none"> <li>• General supervision of contributions by the Inspection Service for Work and Income</li> <li>• Special supervision on social security fraud by the Social Intelligence and Investigation Service</li> </ul>
Levels of record keeping	<ul style="list-style-type: none"> <li>• Records kept by the employer for each individual employee</li> <li>• Records maintained by the tax authority</li> <li>• Records kept by the competent social security administrations</li> </ul>
Data exchange between tax and social security administration	Free data exchange of social security contribution payment and information on the right to benefits, the duration and type of employment and wages
Obstacles during and after the merger	Performance practices of the tax administration did not take into account the nature and purpose of the social security contributions
Disadvantages of the merged collection	<ul style="list-style-type: none"> <li>• Vulnerability of the operation system due to the massive processes, the large flows of information, the transfer of data and the transfer of personnel</li> <li>• Data failures in the insurance file administration</li> </ul>
Benefits of the merger	<ul style="list-style-type: none"> <li>• Simplification of levying and collecting social security contributions</li> <li>• Reduction of administrative burdens on employers</li> <li>• Reduction of implementation costs for the government</li> <li>• Higher level of efficiency in the collection process</li> </ul>

	<ul style="list-style-type: none"><li>• Harmonization of rules</li><li>• Decrease of contradictory decisions within the administrative bodies</li></ul>
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## Overview of integration

Bakirtzi (2011) carried out a study of a number of EU countries<sup>17</sup> which have carried out integration. Based on the practical experience in these countries, the study concluded that

- the merging of the administration of social security contribution and taxation can be a cost-effective and efficient system,
- the administrative burdens on the administration and the employers or insured persons can be greatly reduced,
- the collection procedure can be facilitated by the use of new technologies, and
- the stricter control and enforcement procedures will result in higher contribution compliance which will safeguard the sustainability of the social security systems.

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<sup>17</sup> This includes both countries which have long-term experience of integration such as the Netherlands and the UK and more recent experience in Estonia and Hungary,

### 3. Policy recommendations

This section sets out a number of policy recommendations for the Chinese authorities, drawing on the EU experience.

#### Policy recommendation 1

The Chinese authorities at national level should **set a clear timetable** for the move to full integration of social insurance contribution collection at provincial level. This should be realistic taking account of the issues involved in such as transition and the other challenges facing tax agencies (e.g. merger of national and provincial tax agencies). As part of this assessment, the national authorities should **assess if any legal changes are required to national social security and/or tax law** and should make the necessary changes in order to facilitate integration.

#### Policy recommendation 2

**Working mechanisms (e.g. project team) should be established at provincial level** involving all the key stakeholders (in particular the social security and tax agencies) in order to plan and implement the integration.

#### Policy recommendation 3

A **strategic implementation plan** should be developed at provincial level setting out a detailed plan for the implementation of the integration of social insurance collection. This should specify the actions required, agencies responsible, timing, resources required (including human resources and IT, future co-ordination mechanisms between key agencies, etc.

#### Policy recommendation 4

As part of the strategic implementation plan, the future **IT platform should be identified and developed** (drawing insofar as possible on existing systems such as Golden Tax Phase III). As we discussed IT can act as a motor for improved processes. Many countries provide for electronic data submission by the payer. IT systems also allow electronic exchange of data with other key stakeholders. This, for example, facilitates timely exchange of information between tax agency and SSA, e.g. in relation to contribution records. It also allows real-time exchange of data with key agencies to assist in control activities. IT can also facilitate the use of management information systems (MIS) and business intelligence systems (BIS) which can improve the effectiveness and efficiency of collection processes (see ISSA, 2013b).

#### Policy recommendation 5

The strategic implementation plan, should provide for active policies to support compliance, e.g. offering client-oriented facilities through call-centres and help desks; electronic data submission; soft-measures, such as individualised follow-up,<sup>18</sup> etc. It should also provide for simplification of collection process, e.g. by offering e.g. electronic interactive record keeping and payment management.

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<sup>18</sup> For example, establishing a direct contact with the contribution payer providing for prompt solutions to resolve payment problems where a deadline for payment has been missed.

## Policy recommendation 6

In the future collection of social insurance contributions, **a risk-based approach should be adopted**. This involves the use of automated detection tools that employ data matching and crosschecking of files. The data are obtained predominantly internal but agencies also exchange data with other key stakeholders. Integrated systems have an advantage here since they gather both tax and social contribution data. Risk analysis is also widely used as an instrument to guide audits and inspection activities. Risk analysis helps to identify high-risk sectors and activities so that investigation resources can be targeted at these areas. Some Chinese tax authorities are already using technology to tackle tax evasion. For example, the tax authorities in Shenzhen are working with Tencent to develop an intelligent tax system which uses block-chain, cloud computing, artificial intelligence and big data to combat tax evasion.<sup>19</sup>

## Policy recommendation 7

The implementation plan should include a **communications plan** which would keep key stakeholders (including employers and employees) informed as to planned and actual progress on implementation and the implications for the different stakeholders and any mitigation measures being planned to offset the perceived impact of higher actual payment of contributions.

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<sup>19</sup> China Daily, June 15, 2018.

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### **Topic 2.3.1 - Zheng Bingwen, Liu Guilian: The Role of Enterprise Annuity Funds in Chinese Social Security**

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At present, there are four important opportunity windows for Chinese enterprise annuity reform. Firstly, decreasing social insurance contribution rate helps to expand the participation rate of enterprise annuity system. Second, the law of “enterprise annuity trial method” has been implemented for 13 years. It is imperative to revise and upgrade the enterprise annuity policy in the new period. Third, China now begins to improve the commercial insurance system. It is the right time to open a channel between the enterprise annuity system and commercial insurance system. Forth, the GOPI pension system reform has just started. It is necessary to set up many regulations to ensure labor mobility between the public and private sector. China should seize these four opportunities to promote the reform of enterprise annuity system.

## **1. Introduce automatic enrollment mechanism**

Now the low participation rate of enterprise annuity system in China is a major problem. It is partly due to the strict requirements of establishing the enterprise annuity. The “enterprise annuity trial method” was issued in 2004, which has made some specific provisions for employers to establish the enterprise annuity system. Firstly, enterprises must participate in the basic old age insurance by law and must pay contributions on time and in full. Second, a collective bargaining mechanism must be established. Third, enterprise should strive to make profits. Now in China, more and more state-owned enterprises have established enterprise annuity. Many small and medium-size enterprises are unable to participate in the enterprise annuity due to their weak economic ability. Besides, small and medium-sized enterprises have high labor mobility. Most small and medium-sized enterprises cannot meet these requirements. Thus, in order to increase the participation rate, it is necessary to establish automatic enrollment mechanism.

## **2. Appropriate release of individual investment options**

Since Chinese enterprise annuity system was established in 2004, only several enterprises’ employees have personal investment options, such as in the financial industry, foreign banks industry and IT industry. Many enterprises have established the single plan, that is, all the employees in the same plan enjoy the average rate of return. The enterprises and trustee are responsible for formulating the investment strategy and asset allocation. In China, the individuals have no investment options. All the investment option decisions are made by the enterprise. There are historical reasons for China to establish the single plan. Firstly, the single plan is easy and there is no competition among workers. Every employee enjoys the same rate of return. Secondly, employees have insufficient understanding in enterprise annuity. They have no strong motivation and ability to invest their pension funds. Until now, the investment goal of enterprise annuity system is to ensure safety.

State-owned enterprises are the first founders and beneficiaries of enterprise annuity system. In order to solve the benefit gap between different groups and to make sure convenient management, China chooses to adopt the unified investment of enterprise annuity system. The unified plan will limit the personal choices. Under the conditions of enterprise unified investment policy and the absence of workers’ individual investment options, the only investment target is to maintain the value of pension fund assets. The investment goal of enterprise annuity fund is to pursue preservation rather than appreciation.

Now Enterprise annuity system in China is Defined Contribution. As we all know, China adopts the unified investment mode for the enterprise pension fund. That is, the different risk preference and employees with different age groups are covered by a unified plan. The asset allocation is the same whether employees are young or old. Thus, all employees in the plan enjoy a relatively low rate of return. This is not good for the young employees.



It is advised that appropriate release of individual investment option is a good solution. It helps to allocate assets according to employees' risk preference. Besides, it is also helpful to receive a relatively high rate of return by investing into the capital market.

### **3. Establish qualified default investment alternatives**

It is necessary to introduce the qualified default investment alternatives (QDIAs). The introduction of QDIAs will simplify individual decision making, helping to solve the problems caused by unreasonable asset allocation.

Broadly, QDIAs include target-date funds (life cycle fund) and target-risk funds. The target-risk funds have played an important role in enlarging the investment choice. The life-cycle fund helps to solve some existing problems of Chinese enterprise annuity funds. Firstly, it helps to make the long-term investment for enterprise annuity funds. Secondly, it helps to solve the problem that the single fund asset allocation is unable to meet the entire employee's needs. Finally, the problem of inefficient fund investment can be solved. Employees may enjoy a higher rate of return by investing the QDIAs. If the life cycle funds are introduced in China, the enterprise annuity funds will become an important long-term investment fund. The long-term investment fund is helpful for improving the Chinese capital market. In all, the introduction of life cycle fund helps to reduce the investment loss caused by personal investment decisions.

### **4. Improve the tax incentive policy**

Enterprises annuity system in China was established in 2004. Only the employer's contributions enjoy the tax treatment. The Notice on the individual income tax related problems in the enterprise annuity and occupational pension promulgated in 2013 states that employees' contribution rate can enjoy 4% tax preferential policies. Until now, the full EET model was formally established. The tax treatment has a demonstrative effect on promoting the development of enterprise annuity system. In order to ensure the EET model systematic, supplementary policies should be formulated as soon as possible.

Firstly, design tax threshold when retirees begin to receive pension benefits. After workers retire, personal tax exemption should be deducted when they receive the pension benefits.

Second, it is prudent to tax the investment income in the stage of receiving benefit. Now China does not levy a tax on capital gains. If China begins to tax on investment income of enterprise annuity, it is obviously not conducive to expand the participation rate. Therefore, it is not wise to tax on the investment income in China. Third, if retirees use their enterprise annuity to purchase commercial annuity products, the preferential tax policy should be considered. Because many commercial insurance products provide lifetime pension benefits, it is necessary to offer certain tax support.

Forth, raise the contribution rate which enjoys the tax preference. In order to expand the participation rate, it is necessary to increase tax preference. It is proposed to increase the preferential tax rate from 5% to 8%.

### **5. Cancel or Shorten the vesting period of enterprises' contributions**

The previous related documents on enterprise annuity do not specify the vesting period of employers' contributions. Some companies provide that the employers' contributions will belong to employees when they retire. It is not helpful for the labor flow. It may become an obstacle to reduce the flexibility of the labor market. In 2017, China has provided that employers' contributions and its investment income in the individual account can belong to employees when they participate in the enterprise annuity system.

Otherwise, employers' contributions can also belong to individuals gradually with the increase of their working period. They completely belong to the individual not exceeding the time limit for 8 years.

It is helpful to cancel or shorten the vesting period of employers' contributions. If the employers' contributions belong to employees immediately, it is helpful for employees to participate in the enterprise annuity system.

## **6. Enlarge the investment choice of enterprise annuity funds**

Ministry of Human Resources and Social Security has adopted several laws to expand the investment choices of enterprise annuity funds from the year 2011 to 2013. It is an important reform since the establishment of enterprise annuity system in 2004. Overall, there are still few investment choices for Chinese enterprise annuity in China.

At present, China's enterprise annuity fund investment is still in its initial stage. Higher proportion of enterprise annuity funds are invested in the fixed income products. Recently, more and more enterprise annuity funds are accumulated, it is necessary to expand the investment choices.

Firstly, the fund investment choices of enterprise annuity should be expanded. More enterprise annuity fund investment choices, such as equity investment and real estate investment, should be expanded.

Second, enterprises annuity funds should be allowed to invest in financial derivatives, such as the stock index. As we know, the stock index is useful to avoid the investment risk of stock market. It is necessary to implement the diversified investment strategy for the enterprise annuity.

Third, increase the proportion of enterprise annuity fund investment on equity assets. In China, it is provided that the proportion of enterprise annuity funds invested in equity will not exceed 30 percent of total investment assets. We suggest that it is necessary to raise the proportion of enterprise annuity fund investment on equity assets.

Forth, expand the fund investment regions and conduct overseas investment. In the near future, it is possible to invest overseas. In the initial stage, we can invest in Hong Kong equity market.

## **7. Establish a free conversion mechanism between the second and the third pillar**

It is necessary to establish a free conversion mechanism between the second and the third pillar, allowing the fund assets in the accounts to be transferred between them. A large number of employees change many jobs in their life. Building the free conversion mechanism between the second and the third pillar contributes to meet the needs of personnel flows. If employees in the small and medium-size enterprises leave the company, their annuity funds in their account can be changed into their commercial insurance accounts. The translation channel mechanism can enhance the attractiveness of enterprise annuity system and will help to expand the participation rate.

## **8. The regulatory system of pension management companies needs to be optimized**

China has established the first professional pension management company in 2015. The name is CCB Pension Management Co LTD. One of the goals of establishing the pension management companies is to provide retail annuity products for the small and medium-sized enterprises. It is helpful to expand the participation rate. There are some systemic obstacles to be solved in the operation of pension management companies.

Firstly, the pension management companies should be listed as an independent financial industry. The nature of pension Management Company is to manage the fund asset. It needs to be regulated by different parties.

Second, more professional pension management companies should be established, which help to compete in the market. Therefore, it is helpful to establish unified and independent regulatory systems in China.

Third, the professional pension management company should be a chartered asset management company. Its special regulatory framework and regulations should be defined by the law.

## **9. Establish an enterprise annuity IT system platform with Chinese characteristics**

It is necessary to establish a nationwide IT system to support the development of enterprise annuity system. There are three options for establishing a nationwide IT account system platform in China. Firstly, establish a new IT system. The funds are provided entirely by the government. Second, China can use the existing IT platform and make some relevant modifications to the platform. We can make use of the securities registration and settlement system and insurance information technology management system, which have the ready-made platform. Third, we can select one effective account management systems from the market by government purchase.

In all, it is important to set up a nationwide IT platform for managing enterprise annuity system. In the future, the “cloud service” should be used, which is help to provide cost- effective service.

## **10. Establish TEE tax exemption account**

At present, many account holders choose to receive their enterprise annuity benefit in installments, which helps to avoid tax. Therefore, it is not good for employers to establish the enterprise annuity system.

In order to expand the participation rate, it is useful to establish the tax-free account. It is important to establish TEE tax exemption account in the future. The main reforms are as follows.

Firstly, China needs to tax on the capital gains. If the capital gains tax of security investment is absent, the TEE tax account of enterprise annuity and individual commercial old age insurance will be difficult to play the due role.

Second, the indirect tax in China should change into the direct tax. China adopts the indirect tax system at present. Personal income tax revenue accounts for a very low proportion of fiscal revenue. The number of taxpayers is small. Therefore, if China implements the direct tax, there may be more taxpayers. More people will enjoy the tax preference policy. Under the current tax system in China, it is difficult to establish TEE tax exemption account. In all, the reform of tax system in China is very important.

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## Abbreviations

<b>CADES</b>	Caisse d’amortissement de la dette sociale [French Social Security Debt Fund]
<b>ESSPROS</b>	<b>European System of Integrated Social Protection Statistics</b>
<b>EU</b>	<b>European Union</b>
<b>MISSOC</b>	Mutual Information System on Social Protection
<b>MoF</b>	Ministry of Finance (PRC)
<b>MoHRSS</b>	Ministry of Human Resources and Social Security (PRC)
<b>NPRF</b>	National Pension Reserve Fund
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>SOCX</b>	<b>Social expenditure database</b>
<b>SPC</b>	Social Protection Committee (EU)



## Introduction

This report forms part of Topic 2.3.2 - *The role of public finance and enterprise annuities funds in the Chinese social security system*. It focuses on the issue of the role of public finance.

As set out in the terms of reference, the report to provide policy recommendation reports on the topic 2.3.2 based on the best practices from the EU and the Chinese background situation. This report draws on the background report prepared for the June workshop which sets out examples of EU practice to help inform the future development of policy recommendations for the Chinese situation. It also looks at the limited studies available on this issue including studies from other relevant countries.

In general, as identified in the terms of reference, EU practice varies very widely on this issue and the approach which has been adopted in EU member states is not simply an outcome of technical analysis but is also a result of political considerations and compromises.

In section 1, we outline the Chinese context looking at the current levels of public subsidy and likely future trends.

Section 2 looks more specifically at the role of public finance in supporting social insurance funds in EU countries.

Finally, section 3 sets out policy recommendations.

## Chinese context

National studies indicate that there is currently a high level of subsidy to the social insurance system. For example, Professor Dong (2018) in his presentation to the June workshop reported the following levels of subsidy under the urban and urban and rural residents pensions schemes.

Year	Basic Pension Insurance for the Urban Employees (billion)				Basic Pension Insurance for Urban and Rural Residents (billion)			
	Revenue	Expenditure	Balance	Subsidies	Revenue	Expenditure	Balance	Subsidies
2002	317	284	161	41				
2003	368	312	221	53				
2004	426	350	298	61				
2005	509	404	404	65				
2006	631	490	549	97				
2007	783	596	739	116				
2008	974	739	993	144				
2009	1149	889	1253	165				
2010	1342	1055	1537	195	45	20	42	22
2011	1689	1276	1950	227	111	60	123	69
2012	2000	1556	2394	265	183	115	230	124
2013	2268	1847	2827	302	205	135	301	142
2014	2531	2175	3180	355	231	157	384	164
2015	2934	2581	3534	472	285	212	459	216
2016	3506	3185	3858	651	293	215	539	220

Professor Dong concluded that the urban pension fund balance mainly came from the sum of fiscal subsidies over the years and that financial subsidies have accounted for more than 70% of urban & rural residents pension income in the long term.

The Chinese Statistical Yearbook 2017 indicates that, currently, a number of provinces are spending more on urban pensions than they receive or are close to a negative balance. It is understood that, at least in part, this is because some provincial administrations take a short-term approach to pension funding, focusing on ensuring that revenues are sufficient to cover current expenditure and not giving full attention to the long-term implications of pension funding. This suggests a need for awareness raising by MoF and MoHRSS.

Provinces with expenses higher than revenue	Provinces close to negative balance
Hebei	Tianjin
Neimenggu	Henan
Liaoning	Hunan
Jilin	Guangxi
Heilongjiang	Sichuan
Hubei	Shanxi
Qinghai	Gansu

Source: Chinese Statistical Yearbook, 2017, table 24:30<sup>21</sup>

As has been discussed in a number of papers prepared for the EU-China SPRP, including Bruni (2017), the cost of pensions and other social security benefits is likely to rise significantly in coming years due to the ageing of the population (higher proportion of older people and increased longevity) and conversely a fall in the working population paying contributions to fund pension costs. This means that, in the absence of alternative policy measures, the demand for public subsidies is likely to rise further in the coming decades.

<sup>21</sup> Available at <http://www.stats.gov.cn/tjsj/ndsj/2017/indexeh.htm>

## **The role of public finance**

### **Overview**

EU countries adopt very different approaches in terms of the amount they spend on social protection and how they fund this. As set out in the terms of reference, these can basically be summarised into four approaches:

- 1) Pre-subsidising social funds
- 2) Post-subsidising the deficit (if any) arising
- 3) Subsidising a minimum benefit/pension<sup>22</sup>
- 4) Funding transitional costs, e.g. where there is a reform of the pensions system.

We look in more detail below at these different measures but we should first point out that countries use a mix of these different policies measures. In addition, while we have categorised these different approaches under these four headings, in practice there may not be much difference between, for examples, countries which pre-subsidise a certain proportion of a social insurance fund's annual expenditure (e.g. Japan) and a country which post-subsidises any annual deficit arising (e.g. UK). Countries often combine a variety of approaches. For example, in relation to pensions, Germany provides a general Federal State subsidy for statutory pensions which varies according to the development of the gross salary and wages per employee and the contribution rate. Germany also provides targeted pre-subsidies, for example, by paying contributions during child-raising periods. It also provides some transitional funding in relation to pensions costs arising from the unification of Germany. All the federal expenses mentioned (almost one third of the total expenses in statutory pension insurance) are tax financed.

The available evaluations of different approaches were discussed in the background report (Cousins, 2018) and are summarised in section 3 (below).

### **Pre-subsidising social funds**

A wide range of different approaches are adopted in *ex-ante* subsidisation of social insurance funds. In general, countries provide subsidies for specific groups, e.g. low paid workers or people taking up employment (to encourage the creation of employment); and to parents to assist such persons (especially mothers) to qualify for benefits given that statistically women generally have lower contribution records than men (largely due to parental responsibilities).

In theory, countries might pay a more general subsidy to pay a proportion of social contributions which would otherwise have to be paid to the employers and/or employees. However, this is more often done by way of post-deficit subsidy (see below). Alternatively, a number of countries reduce contributions below a level which would be actuarially necessary to meet projected costs. The rationale for this may be to avoid high contribution levels so as to encourage employment or for more pragmatic political reasons that, in many countries, there is resistance to high levels of social contributions.

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<sup>22</sup> In some cases, as in Sweden, these pensions are residence based non-contributory pensions rather than social insurance pensions. Nonetheless, they are also closely linked to the social insurance system and it seems appropriate to take them into account.

### *Subsidies to specific groups*

One example of this approach (albeit not one to be recommended) is in Bulgaria where the state budget pays contributions on behalf of state employees including civil servants and soldiers.

Examples of subsidies focussed on *people who need support to take up employment* include:

Bulgaria where the State Budget covers 50% of the contributions paid for people with disabilities working for certain employers, i.e. specialised enterprises, associations of people with disabilities and. units for occupational therapy of disabled persons set up in specialised social care institutions.

Romania: Contributions for unemployed persons participating in training are paid from the unemployment insurance budget.

Examples of support to *parents* include

Germany: the State pays contributions for pension insurance during child-raising periods.

Slovakia: the state contributions on behalf of persons taking care of children up to the age of 6 (up to the age of 18 whose health status is considered negative in the long-term)

An alternative to this pre-subsidisation approach is that some countries chose to post-fund specific schemes such as maternity (see below).

It should be noted that, rather than providing direct subsidies, many EU countries have chosen to reduce contributions for specific groups (e.g. low paid workers or unemployed people). Insofar as this does not affect entitlement to benefits, this involves an indirect subsidy, either from other contributors or, where a scheme deficit is funded by the state, from the public purse.

### *General subsidies*

A limited number of countries provide general subsidies of social contributions. For example, Luxembourg pays 40% of the contributions to sickness and maternity; and one-third of contributions to old age and other long-term pensions.

## **Post-subsidising**

### *Deficit*

A number of countries subsidise any deficit arising in the social insurance fund. In the context of PAYG schemes, this means that the public finances are obliged to meet an annual deficit where the outgoings (benefit payments and administrative expenses, etc.) are less than the income to the fund (mainly social contributions) and any balance in the fund. Again there is variation in this approaches. In some countries, e.g. Ireland and the UK, there is a general responsibility to subsidise deficits across all (or almost all) social protection schemes. In other countries, the public finances fund only deficits in specific schemes. These differences are largely for historical reasons rather than having a clear policy rationale.

On the basis of the information provided in MISSOC and elsewhere, these type of provisions can be found in Austria (invalidity and old age/survivors pensions; unemployment benefits); Belgium (sickness benefits); Bulgaria (pensions); Germany (state loan covers possible deficits of the federal unemployment scheme; pensions); Hungary (except unemployment); Ireland; Poland; Romania (only in the case of unemployment benefits); Slovakia (occupational accidents, invalidity and old age pensions, unemployment) and the UK.<sup>23</sup>

### *Targeted*

Some countries chose to fund a proportion of the expenses of specific schemes such as maternity. An example is in Austria where 70% of the expenses of maternity benefit are reimbursed by the families compensation fund. Similarly in Slovenia, the state finances the bulk of the maternity benefit costs (92%) with only 8% being funded from contributions.

### **Subsidising a minimum benefit/pension**

In these cases, the State pays the cost of a minimum benefit or pension level. This type of approach is found, in particular, in the Nordic countries and ensures that the costs of a minimum payment fall on taxpayers generally rather than on individual insured persons and their employers. Examples include:

Finland: the state pays the costs of minimum sickness allowances and of the guaranteed old age pension

Spain: the state finances the guaranteed minimum pension amount of the contributory pension system

Sweden: The state funds the guarantee pension. Those who have not earned any national income-based pension at all receive a full guarantee pension. To those who receive a low income-based pension, the guarantee pension is a top-up.<sup>24</sup>

The intention of the guaranteed or minimum pension is generally to provide a basic level of income. This approach can be seen as involving an *ex post* individual transfer in contrast to the *ex ante* transfer involved in subsidising contributions.

### **Funding transitional costs**

The issue of funding transitional costs should perhaps be seen separately to the above examples of pre and post-subsidisation. In theory the above examples are on an ongoing basis while funding of transition costs is to address a once-off issue (even though in practice the transition period may run over many years). Countries which use pre or post subsidisation (or which chose not to subsidise social insurance generally) may or may not decide to fund transition costs. Examples of the state funding transition costs include in Germany where the state funded costs arising from pensions reforms associated with the unification of the

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<sup>23</sup> In the case of the UK, there are very limited exceptions in relation to sickness benefits, Statutory Maternity Pay, Statutory Paternity Pay, and Statutory Adoption Pay where the state meets some or most of the costs.

<sup>24</sup> The Swedish guarantee pension is a non-contributory pension but forms part of a social insurance-based pensions system. Almost half (42%) of all pensioners currently receive a guarantee pension and, therefore, it seems appropriate to take it into account here.

country and in a number of eastern European countries where the costs of pensions reform after the fall of the Soviet Union were also funded from general taxation (PRAXIS, 2008).

## **Reserve Funds**

It should be noted here that a number of EU countries have created reserve funds with a view to putting aside resources in order to fund future projected pension deficits. In some cases, such as the Spanish Social Security Reserve Fund, these were made up of surpluses from social security contributions. However, in others such as the Irish National Pension Reserve Fund, the state agreed to put aside a proportion of national income. The Exchequer contributed an amount equal to 1% of GNP annually into the NPRF. The investment mandate required the Fund to secure the optimal total financial return provided the level of risk was acceptable to the Commission. The Commission implemented its investment strategy through a globally diversified portfolio that included quoted equities, bonds, property, private equity, commodities and absolute return funds. The objective of the fund was to meet as much as possible of the costs of social welfare and public service pensions from 2025 until at least 2055. Sweden also established a series of national pension funds (Severinson and Stewart, 2012). Japan and Korea and a number of other OECD countries have also established similar funds.

The 2008 recession had a negative impact on the reserves of some such funds and much of the Spanish fund (which at one time contained EURO66 billion) has now been drawn down while the Irish fund has been transformed into a broader Strategic Investment Fund. However, the Swedish funds play a continuing role in the Swedish pensions system.

## **Debt funds**

The impact of social security funds on the general government debt in most EU countries is relatively small: contributions of less than 5% of total general government debt were recorded in most countries (see Table A1). However, three countries had higher ratios of debt for social security funds: Lithuania (20.3%), France (10.3%) and the Netherlands (6.6%). France has established a specific fund (the Social Security Debt Fund - CADES) to repay the social debt, i.e. the accumulated deficits of the social security organizations. This is funded by a specific tax (the Social Debt Repayment Contribution) and other sources of income including other transfers from the public finances. The task of CADES is to pay down the accumulated debt by 2025 (extended from 2009). The approach adopted includes transforming ongoing short-term debt into longer-term debt and adopting a phased plan for amortizing this debt by 2025.

## **Discussion**

The issue raised by MoF is a very interesting one and it is perhaps surprising that there is very limited international literature on the topic. Insofar as issues concerning public subsidies for social insurance have been considered, they have tended to be considered separately. In relation to pre-subsidies, for example, the World Bank (2013) recently published a report on the effectiveness of matching contributions (although this looks mainly at defined contribution pensions schemes). This covers a wide range of countries including Germany, UK (and also China). Similarly, there have been some evaluations (e.g. Turkey, Korea) of the effectiveness of subsidising social insurance contributions to support employment. The conclusions of these studies are discussed below. However, there do not seem to be international studies of the effectiveness of pre-subsidising social insurance schemes more generally. Not do there appear to be such studies of post-subsidisation.

Data is also lacking at EU level as to the extent to which individual countries fund social insurance from contributions as opposed to subsidies. While ESSPROS makes available extensive data as to the overall



funding of social protection schemes, this includes non-insurance benefits and data is not readily available as to social insurance schemes separately. While MISSOC provides information on the approaches adopted by member states this is descriptive only and does not provide any quantitative data.

## Discussion and Recommendations

### Summary of approaches

In this section we summarise the findings of the report and discuss the advantages and disadvantages of different approaches and set out four key recommendations for the Chinese authorities.

In relation to the findings, the main conclusion from the international experience has to be that there is a great variation in EU countries in how they finance social protection benefits. While EU countries (on average) fund a majority of social protection costs from social contributions, there is an enormous variation amongst countries with many relying heavily on general taxation. Similarly, general (average) trends in relation to the balance between social contributions and taxation hide a wide variation among EU member states. Countries which are often categorised as having into the same welfare state group (such as Denmark and Sweden) adopt quite different approaches to funding social protection.

The mechanisms adopted by member states to fund social insurance benefits and pensions include:

- 1) Pre-subsidising social funds
- 2) Post-subsidising the deficit (if any) arising
- 3) Subsidising a minimum benefit/pension
- 4) Funding transitional costs, e.g. where there is a reform of the pensions system.

However, once again there is little clear pattern. Many countries use a number of these methods but comparable quantitative data as to the extent to which different countries rely on different approaches is lacking. Unfortunately there is very little quantitative information as to the extent to which member states fund their social insurance schemes either on an ongoing basis or as to the debts (explicit and implicit) involved.

The different approaches appear to have arisen largely for historical reasons and represent political and policy compromises. Perhaps surprisingly there has been little academic discussion about the pros and cons of different options.

### Pros and cons of different subsidy approaches

In terms of the pros and cons of different subsidy approaches we can look at the possible objectives for these approaches including work incentives, labour costs, affordability (of contributions), assisting target groups to qualify for benefits, increasing participation in insurance, reduction in informality, and fiscal efficiency (see Annex). We do not include transitional funding here as the impact would depend on how the transitional costs are funded.

As discussed in previous sections, there is limited empirical evidence on the impact of subsidies. In principle (and supported by the limited evidence which is available) targeted pre-subsidies seem most likely to have a positive impact assuming they are well designed and operate in a context where contribution collection is reasonably effective. Such approaches can create positive work incentives for specific groups (see EU, 2012) and reduce labour costs. They are also likely to have a positive impact on participation in social insurance and to assist targeted groups in qualifying for benefits. In principle they should help in reducing informality but studies of actually existing subsidies do not find such an impact in practice perhaps due to poor design or ineffective enforcement. In principle, such targeted approaches are likely to be most fiscally efficient. Of course, poorly targeted subsidies (e.g. to public servants as in some EU countries) will have none of these positive outcomes.

The World Bank (2013) suggests that post-subsidisation by way of minimum pensions is likely to be less fiscally efficient than targeted pre-subsidisation. However, minimum (or guarantee) pensions form part of the overall design of the pensions system in countries such as Sweden and need to be evaluated in that context. It seems very unlikely that targeted pre-subsidisation of contributions could achieve the same effect as a minimum guarantee (i.e. assuring a minimum pension for all residents).

Targeted post-subsidisation (such as paying a proportion of the costs of a maternity scheme) is more closely linked to specific objectives and the design of such an approach can be more narrowly focussed so as to encourage participation and make it more affordable, thereby assisting persons to qualify for benefits without adding to work disincentives. However, this all depends of the specific design.

Finally, in principle, post-subsidisation of deficits would appear to have limited advantages from an economic perspective. In principle, such post-subsidisation may lower contributions and might, therefore, have some positive impact on work incentives and affordability of contributions, etc. However, any such impact is indirect and likely to be difficult to measure. In general, because this approach does not have clearly defined objectives, it seems likely that governments will have difficulty in achieving positive outcomes from deficit funding. Such an approach also seems to be likely to be of limited fiscal efficiency but it must be emphasised that there do not appear to be any evaluation of deficit subsidisation in EU countries and the outcome of any evaluation would, of course, depend on the specific design. However, given the extent to which such an approach is operated in practice, there are clearly political and administrative advantages to post-deficit subsidisation.

## **Recommendations**

### **Policy recommendation 1**

The first recommendation is that the Chinese authorities should develop explicit estimates of the cost of pension and social insurance schemes at both the national and provincial levels. This involves both estimating the likely actuarial cost of pensions schemes in total but also isolating the likely cost in public subsidies based on best estimates as to likely economic and demographic trends. This exercise would also help to increase awareness of the policy challenge at provincial and municipal levels of government.

In doing so, the Chinese authorities could draw on the work carried out by the EU Commission in its ‘Ageing Report’ (2018) which looks at the long-run economic and fiscal implications of Europe's ageing population.<sup>25</sup> This report estimates the costs of pensions and other benefits at a national level.

### **Policy recommendation 2**

A second recommendation is that the Chinese authorities should analyse the full extent of existing subsidies. These includes not only direct payments from central and/or local government funds but also implicit subsidies such as those arising from the fact that pension payments are normally calculated by dividing the

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<sup>25</sup> See [https://ec.europa.eu/info/publications/economy-finance/2018-ageing-report-economic-and-budgetary-projections-eu-member-states-2016-2070\\_en](https://ec.europa.eu/info/publications/economy-finance/2018-ageing-report-economic-and-budgetary-projections-eu-member-states-2016-2070_en)

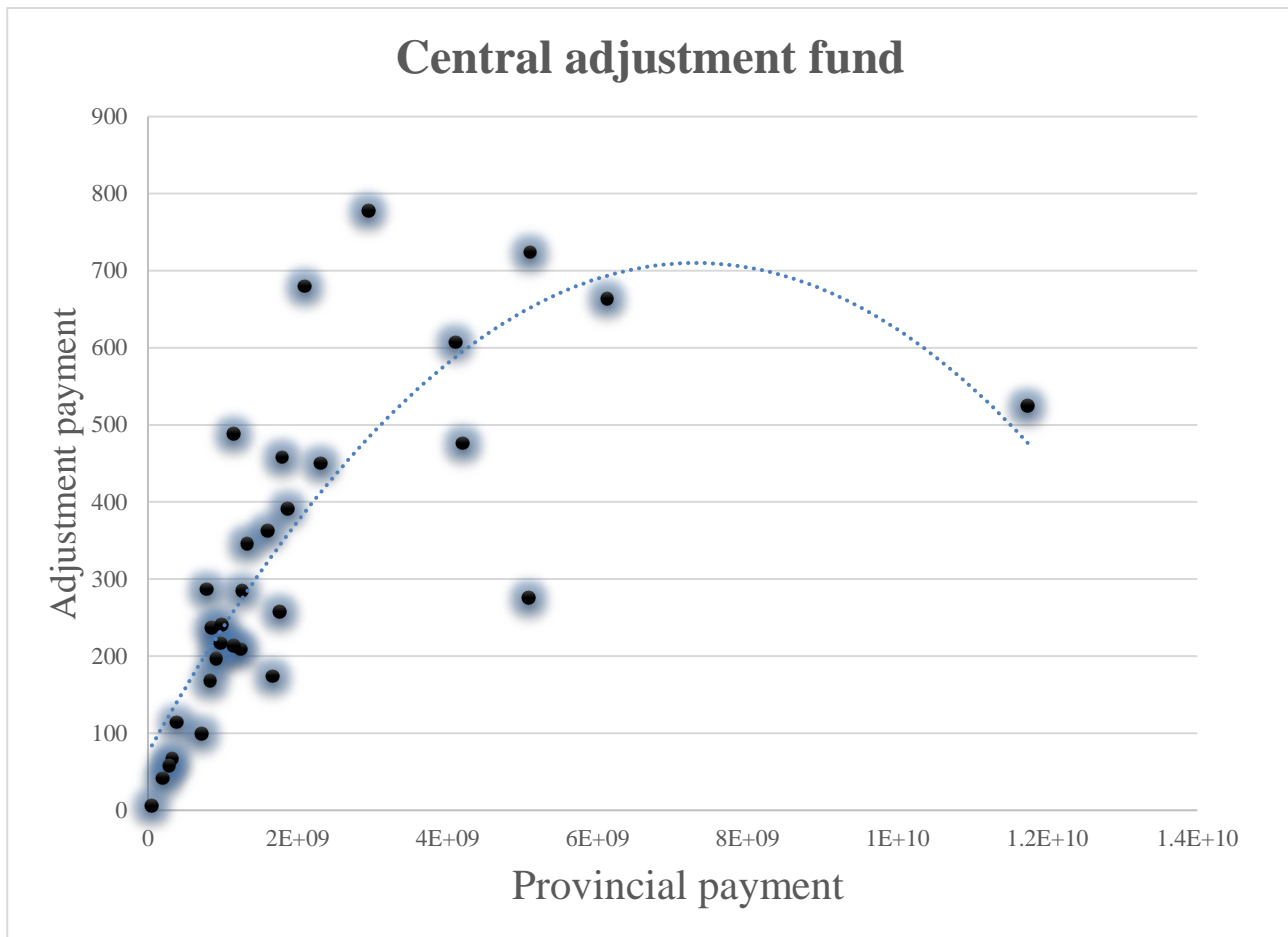
pension account by a set number of months whereas the actual pension payment period is likely to be significantly longer than this.

As part of this analysis, the study should identify the rationale for the existing subsidies. It may be that, as in many EU countries, subsidies have been introduced on an ad hoc basis and without a very clear policy analysis. Therefore, it would be important to consider whether these objectives are still relevant and whether the subsidies are achieving their objectives in the most cost-effective manner. Alternatively, the study should look at whether there are more cost-effective approaches for the future such as more targeted subsidies and/or pre-subsidisation rather than deficit funding. For example, the implications of moving to a more geographically targeted approach to funding (providing high levels of subsidy to poor areas) might be examined.

### **Policy recommendation 3**

It is clear that the challenges caused by an ageing population will affect different Chinese provinces to a different extent. It is recommended that the Chinese authorities should use funds and experiences (both good and bad) from Chinese provinces to inform policy and support financial resources. It is noted that there have been a number of previous attempts to restore financial sustainability in North-eastern provinces. These received rather positive evaluations at the time (World Bank, 2006; Zheng, 2006). However, it is noteworthy that all 3 provinces are currently in negative balance in terms of urban pensions funding.

One interesting innovation is the central adjustment fund recently established by the government (Guó fā (2018) 18). This is to be funded by provinces with payments *in* based on provincial average wage and number of covered employees and payments *out* based on number of pensioners in the province.



It is too early to know how this will work in practice. However, an estimate of the impact of the fund based on data published in the Chinese statistical yearbook would suggest that most provinces (with the exception of Guangzhou – the outlier in the figure above - which will pay much more than it will receive based on these estimates) will pay in broadly what they will receive which would suggest that the fund would have a limited impact. Of course this is just an estimate and it may be that the operation in practice will be different. However, this highlights the need to monitor the impact of the fund and to revise the formulae for payments in and out where necessary. It will also be important to provide positive incentives to provinces. For example, payments in to the fund should be based on what provinces should collect rather than any lower actual figure to avoid giving provinces incentives for ineffective collection.

## Policy recommendation 4

Finally, although it is not directly related to public subsidies, it will be important to improve the financial management skills of social security authorities at both national and local levels. The level of finances involved in pension funds is enormous and expertise is required to manage both funds and deficits. We have described in section 2 of this report the examples of different pensions and debt funds which have been established in EU countries with specific financial management expertise (investment, debt management, etc.).

More effective and efficient use of funds (and management of debts where this is relevant) will increase the resources available to social security funds and conversely reduce the level of public subsidy which is required. A greater focus on good financial management should also help to ensure that public subsidies are used most efficiently and are not treated as ‘free money’.

	Work incentives	Labour costs	Affordability of contributions	Participation in social insurance	Assisting to qualify benefits	Reduction in informality	Fiscal efficiency
<b>Pre-subsidisation (targeted)</b>	Can reduce disincentives for specific groups	Reduces labour costs for specific groups	Positive	Positive	Positive	Limited	Positive depending on scheme design
<b>Pre-subsidisation (general)</b>	Limited impact	Reduces labour costs more generally	Positive but high deadweight	Limited and high deadweight	Limited and high deadweight	No impact	Not likely to be efficient
<b>Post-subsidisation (deficit)</b>	May reduce disincentives but only indirectly	May reduce labour costs but only indirectly	Indirect	No direct impact	No impact	No direct impact	Not likely to be efficient
<b>Post-subsidisation (targeted)</b>	May reduce disincentives but only indirectly	May reduce labour costs but only indirectly	Direct	Positive	Positive	No direct impact	Potentially positive depending on scheme design
<b>Post-subsidisation - Minimum benefit/pension</b>	No direct impact	No direct impact	Indirect	No direct impact	Positive	No direct impact	Depends on scheme design

Source: Author.

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