

# Diagnosis & Baseline Data

## Project Component 1

Support to strengthen NDRC institutional capacity

for the development and implementation of Social Protection reforms

(Macro-activity 0.1)



Social Protection Reform Project  
中国-欧盟社会保护改革项目

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# Diagnosis & Baseline Report on China's Pension System

The EU-China Social protection project Grant application form provides that “ After the setting up of the Office in Beijing, the Resident Experts, in collaboration with the three Component Coordinators and the Project Leader, will (...) establish a brief diagnosis of the situation and define the baseline”. The present document responds to this requirement as far as Component 1 is concerned. The topics to be covered under Component 1 of the project are almost exclusively related to pension schemes – hence the focus on such schemes in the Diagnosis and Baseline hereafter provided.

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## 1. Introduction

In contrast to the developed countries that introduced the social security system as early as the 19th century, China began to develop its modern social security system in the mid-1990s as one of the essential elements in a market-oriented economic reform. In the past two decades, the social insurance programs for pension, health care, unemployment, work injury and maternity were progressively implemented and expanded rapidly both in rural and urban areas. These five social insurances, combined with a dozen of social assistance programmes developed in rural and urban areas, constitute the social protection framework in China. At the end of 2013, it was estimated that there were 322 million pension participants, 573 million medical insured, 164 million unemployment insured, 199 million work injury insured and 164 million maternity insured covered by urban social insurance system, and 497 pension participants were covered by the rural system (see figure 1). The great achievement in expanding coverage in the past 20 years has made China enjoy the world largest social security system in terms of covered population.

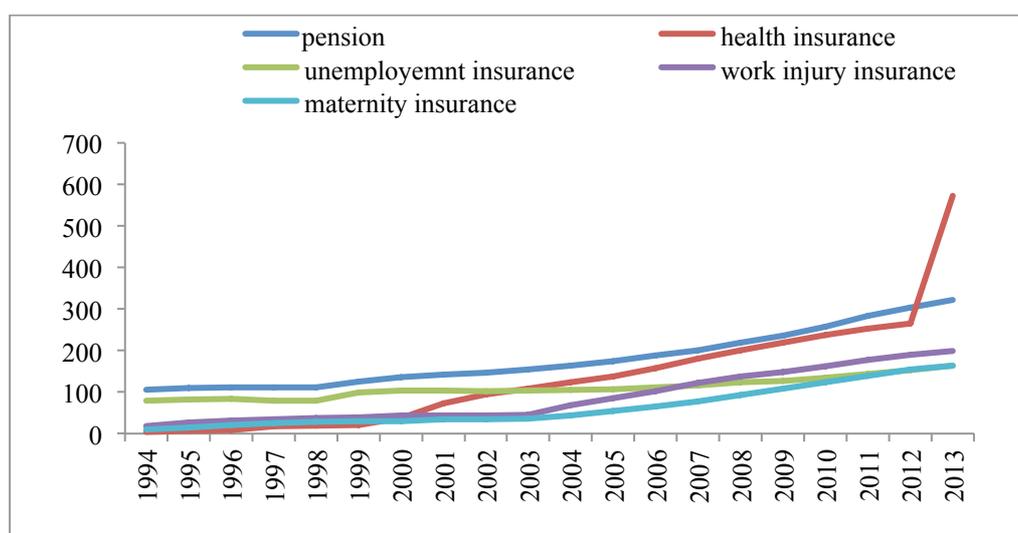


Figure 1 Covered Population in China's Urban Social Insurance System 1994-2013 (in millions)

Source: 1994-2014 MOHRSS Bulletins on Social Security Development.

However, there is also evidence suggesting that while China's social security system represents a major step forward, it is also very much a work in progress that will be facing big challenges in the years ahead. The current social security benefits are still insufficient to meet with social needs, effectual coverage needs to be improved, and this system is suffered from a series of difficulties like system fragmentation, low level of social pooling, inefficient coordination between regions and different regimes, and so on. Looking ahead, in the next coming five years, comprehensive reforms on social security are needed to construct a sound, adequate, affordable and sustainable social protection system under the "New Norm" of economy-social development circumstance.

This baseline paper will focus on China's pension system, providing a benchmark introduction on the reform history of major pension schemes, the framework of multi-pillars, the three public pension programs, and making a brief analysis on its development achievements and challenges ahead.

## 2. A brief history

In 1997, to support the jobless workers laid off by SOEs, a public pension scheme called "social pooling + individual account" model was set up. At the beginning, this programme mainly covered urban workers in formal sectors, and gradually extended to cover urban workers in the private economy, including those in flexible employment and self-employment. With the arrival of the 21st century, the pace of pension system development accelerated. In 2006, the goal of "Universal coverage for urban and rural residents by 2020" was put forward by the central government. In 2009 and 2010, the new rural pension programme and urban resident pension scheme were introduced respectively, providing pensions for the non-wage residents. In 2010, The *Social Insurance Law* come into force, providing a regulation framework on pension system in China. In 2012, the government announced the realization of the goal of "institutional universal coverage". In 2014, the originally separated pension schemes for urban residents and rural residents were merged. In January 2015, the State Council released the decision to establish the pension plan for civil servants and employees of public institutions.

### 2.1 Current multi-pillars

Currently, pension systems in China consist of three pillars:

- ◆ First pillar: public pension schemes for urban workers, rural and urban residents and employees in public sectors (see below).
- ◆ Second pillar: supplemental pension schemes sponsored by employers, including those for urban workers (called Enterprise Annuity, EA) and those for public sector employees (called occupational pension). The voluntary EA plans started its market-oriented investment in 2006 and enjoyed the EET tax treatment both for employees and employers since 2014. However, the EA scheme is still underdeveloped. By the end of 2014, there are 66,000 plan sponsors, with 20.56 million employees, participate in EA, with 603.5

billion Yuan pension fund accumulated. The occupational pension schemes for public employees just launched in 2015.

- ◆ Third pillar: individual pension plans. There are some kinds of saving plans, annuities, as well as commercial pension insurance plans for individuals. Tax favour policies are expected to be introduced in 2015 to encourage the development of those plans.

## 2.2 Three public pension schemes

China's public old-age pension system consists of the following three schemes:

The *Pension Scheme for Urban Workers* is one the key programmes in the pension systems. It mainly targets urban workers and the self-employed are also encouraged to participate in this scheme. It is mandatory and divided into two tiers. The first is a PAYG-DB plan financed entirely by employers, with a maximum contribution of 20 per cent of the payroll (in most areas). The second is a Funded Defined Contribution (FDC) plan based on mandatory individual accounts. These accounts are entirely financed by employees, who must contribute 8 per cent of their earnings. Upon retirement, covered workers receive monthly benefits derived from both tiers of this scheme. The Ministry of Human Resources and Social Security (MOHRSS) supervises the system, while local agencies in provinces are responsible for collection of contributions, benefit payments and fund administration. According to MOHRSS, by the end of 2014, a total of 341.2 million people participated in the urban pension programme.<sup>1</sup>

The *Pension Scheme for Rural and Urban Residents* covers residents who are outside of the *Pension Scheme for Urban Workers*. It is a voluntary system with two components: a basic pension financed by local and central government and a personal account for saving contributions from enrolled individuals.<sup>2</sup> A flat-rate basic pension of 70 Yuan per month is the minimum benefit. In terms of the annual contribution to the personal account, participating residents select one of 12 contribution levels ranging from 100-2000 Yuan, and local governments are encouraged to match workers' contributions. In order to qualify, a resident must be at least 60 (for males) or 55 (for females) and have contributed for at least 15 years. The over 60s receive the flat-rate pension if their adult children join the scheme. Currently, county social security agencies are responsible for setting up personal accounts, managing local pension funds and distributing the benefits for retirees within the county. According to the official statistics of MOHRSS, it is estimated that this programme has covered 501.1 million of the rural and urban residents.<sup>3</sup>

In addition to these two major schemes, there is the *pension scheme for civil servants and employees of public institutions*. Traditionally, the pensions of civil servants and employees of public institutions are regarded as "final salary" after retirement, with generous benefit provisions financed entirely by public revenue. Since 1992, a number of pilot reform

<sup>1</sup> Ministry of Human Resource and Social Security (2015), <http://www.mohrss.gov.cn/SYrlzyhshbzb/zwgk/szrs/>

<sup>2</sup> For western provinces, the central government will pay the total cost of the basic pension component; for eastern provinces, the central government will pay 50 per cent and local governments will cover the remaining 50 per cent.

<sup>3</sup> Ministry of Human Resource and Social Security (2015), <http://www.mohrss.gov.cn/SYrlzyhshbzb/zwgk/szrs/>

projects have been implemented in some provinces with the intention of introducing a system with responsibilities shared between the state, private companies and individuals. At the beginning of 2015, the State Council released the decision to establish the pension scheme for public sectors which might include about 7 million civil servants and 30 million employees of public institutions. The contribution structure is the same as the *Pension Scheme for Urban Workers*. The supplemental occupational plans for the civil servants and the employees of public institutions will be established. The contribution plan is 8% from the payroll and 4% from individuals.

### 2.3 Major progress in the past five years

The past 5 years has witnessed great achievements in expanding pension coverage in China. Figure 2 illustrates the numbers of participants under the two major pension schemes for urban workers and rural and residents during 2009-2014. In 2009, less than 322 million people in China, including both the insured and the pensioners, had pension protection. At the end of 2014, 842 million people were covered by the old age pension scheme. This number has increased by 1.6 times in only five years.

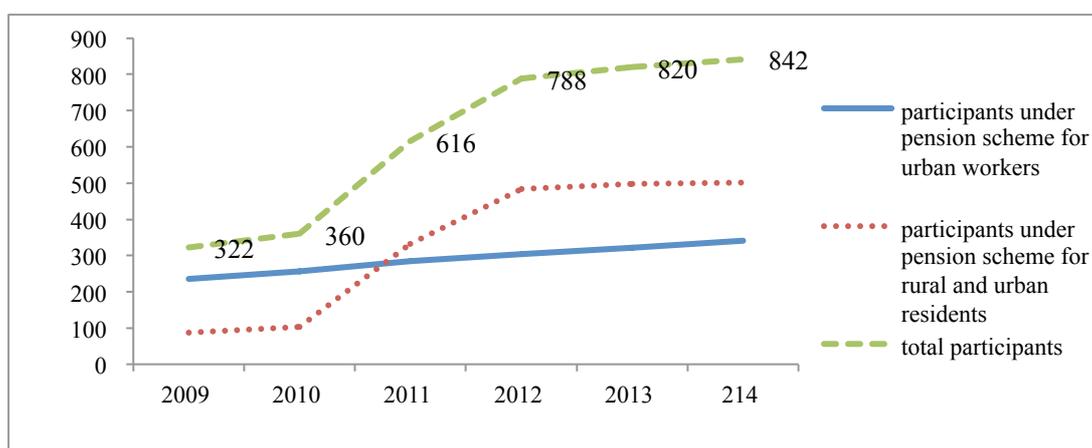
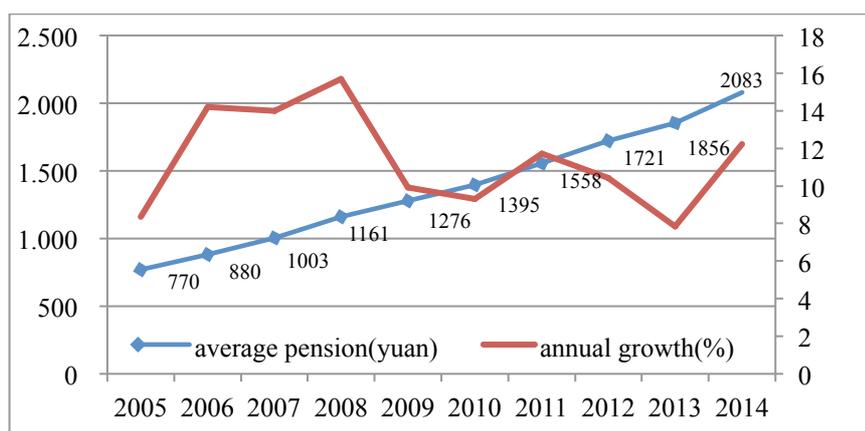


Figure 2 Covered Population in China's Urban Social Insurance Systems 1994-2013 (in millions)

Source: MOHRSS (2009-2014), Annual Statistical Communiqué, <http://www.mohrss.gov.cn/SYrlzyhshbzb/zwgk/szrs/>.

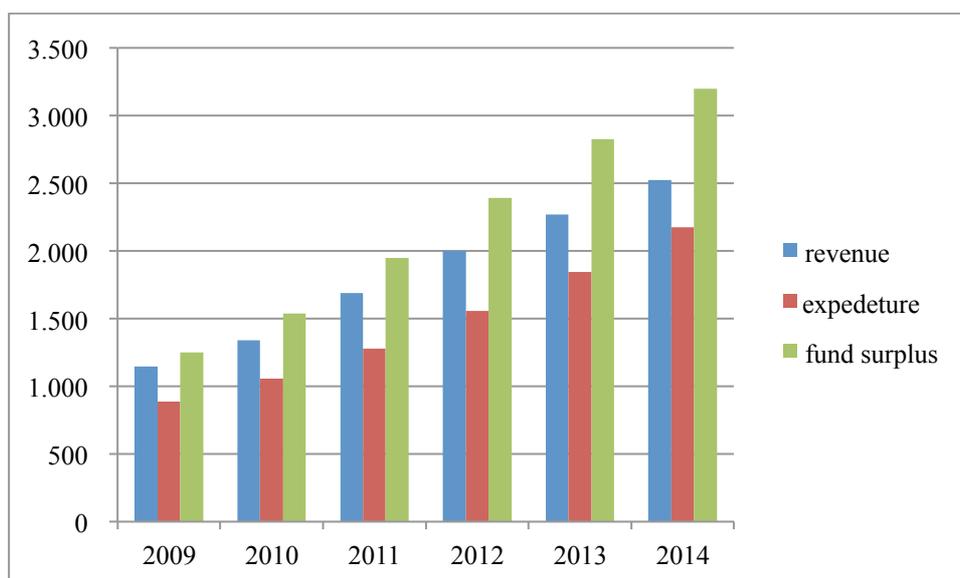
In terms of the level of pension benefits, the average monthly pension for urban workers has increased from 700 Yuan in 2005 to 2083 Yuan in 2014 as the authority has implemented the policy of pension benefit adjustment in the past 11 years (as shown in Figure 3).



**Figure 3 Growth of the Average Pension for Urban Workers**

**Source:** updated based on the data from Annual Report on Chinese Labour and Social Security Industry (2014)

As coverage extended rapidly in recent years, the overall funding status of public pension system has been improved. As figure 4 shows, aggregate accumulated surpluses under urban pension have increased rapidly during 2009-2014 with a yearly growth ratio of 20.6%.



**Figure 4 Pension Fund of Urban Worker Scheme (in billions Yuan)**

Source: MOHRSS (2010-2014), Annual Statistical Communiqué, <http://www.mohrss.gov.cn/SYrlzyhshbzb/zwgk/szrs/>.

### 3. Challenges in the 13<sup>th</sup> Five-year period

With the prospect of a slower economic growth and a fast aging population in the next 20-30 years, the 13<sup>th</sup> Five-year period will be the strategic time for China to develop a universal, equitable, adequate and sustainable pension system. The challenge of aging population, new type of urbanization, the need to redress income inequality, as well as the transition for a consumption driven economic growth mode will have great implications for the pension reform in china. *The 3rd Plenary Session of 18th CPC Central Committee* had put forward a series of pension reform measures. Major tasks on pension reform in the next five years

include:

***To improve the quality of universal coverage.*** To realize the goal of universal coverage in 2020, it is estimated that around 200 million people are to be covered by the public pension system<sup>4</sup>. In extending the coverage, one of the main challenges is the low compliance in the private sectors. Besides, the quality of pension coverage in formal sectors should be improved by introducing in the incentive mechanism which based on the principal of “contributing more, getting more; and contributing longer, getting more”.

***To promote equity and adequacy.*** For the pension scheme for urban workers, the actual replacement rate (average pension/social wage) has been declining in recent years although the benefit level has been adjusted annually by the central government. For urban and rural resident pensions, the basic benefit is 70 Yuan which is far away to be sufficient for pension protection. There is also a gap between the average pension under *Pension Scheme for Urban Workers* and the pension of civil servants.

***To integrate the fragmented schemes.*** The three public pension schemes cover different population groups, facing portability difficulties among migrant workers in labour market. The future challenge shall be to gradually harmonize these separate schemes in terms of contribution rate, benefits level and quality of service.

***To strengthen the sustainability of pension finance.*** Currently, weak incentives on contributions, low level of social pooling and a lack of investment policy on pension funds, and will have implications on the long-term sustainability. Thus, regular actuarial testing and analysis is indispensable for the long-term financial equilibrium. Based on solid actuarial assessment, a closer link between social insurance contributions and benefit levels could be established to encourage participation and more contribution. In addition, the early formulation of rules and regulations on the investment of pension funds is required to maintain and increase the value of the pension fund.

***To improve administration efficiency.*** Currently, most of pension funds are managed at provincial levels, and some even at city/county level. The fragmentation of the system not only makes benefits portability a major issue but also constrains risk-sharing among the provinces. In addition, the social security administration agencies both at central and local authorities are not well developed to undertake the increasing workloads on public pension services.

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<sup>4</sup> [http://www.gov.cn/jrzq/2013-09/17/content\\_2490397.htm](http://www.gov.cn/jrzq/2013-09/17/content_2490397.htm)