

Workshop – The Chinese economy

Venice International University – San Servolo Island

The historical evolution of the Chinese pension system

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In this presentation

1. The “**iron rice bowl**”, from the foundation of the Republic to the Cultural Revolution (1949-1979)
2. The transition towards a **multi-pillar system** (1980-1989)
3. The responsibility shift **from firms to local governments** (1990-1999)
4. The **latest steps** (2000-2010)
5. The development of pension system for the **rural population**

1. 1949-1979: the “*iron rice bowl*” system

- In 1951 the State Council laid down the foundation of the original social security system – “*iron rice bowl*”
 - The system covered **people living in urban areas and working in SOEs and COEs**
 - The household registration system – “*hukou*” – prevented workers’ migration from the countryside to the cities
 - The system worked on an **unfunded defined benefit, pay-as-you-go scheme**
1. It was **entirely funded by enterprises** which paid 3 per cent of the workers’ payroll as contribution
 2. **Contributions were pooled** at the national level by 30 per cent, and the remaining 70 pooled at the local level ([table 1](#))

1. 1949-1979: the “iron rice bowl” system

Tab. 1. Retirement Eligibility and Benefits: a Comparison (1951-1978)

	1951	1953	1958	1978
Retirement age				
<i>Male workers</i>	60 ✓	60	60	60
<i>Female workers</i>	50 ✓	50	50/55 (managers)	50/55 (managers)
Total working years required				
<i>Male workers</i>	25 ✓	25	20	10 ✓
<i>Female workers</i>	20 ✓	20	15	10
Years required at current work units				
<i>Male workers</i>	10 ✓	5	5	None
<i>Female workers</i>	10	5	5	None
Pension Benefits (as a percentage of the pre-retirement wage)				
	35-60	50-70	50-70	60-90

Source: Song and Chu, 1997.



1. The Cultural Revolution (1966-1976)

○ During the Cultural Revolution the “*iron rice bowl*” philosophy remained at the basis of the pension system, but

1. **trades unions** – formerly responsible for pension administration and provisions – **were dismantled**;

2. **pension fund surpluses** accumulated at both local and national levels **were spent for other purposes**

3. **enterprises** substituted the central Government and **took full responsibility for employees’ benefits** (including health housing)

4. the **cross-subsidization and risk sharing** across enterprises and regions **ceased**

○ After the Cultural Revolution ended, **the previous arrangements were not re-established**

In 1978 the State Council introduced **incentives to encourage early retirement to have room for the huge flows of younger workers** who had been sent to rural areas ([table 1](#))

2. 1980-1989: towards a multi-pillar system

○ While the **eligibility criteria** for a pension **were relaxed**

1. population began to age ([graph 1](#)) and ...

2.... pensioners and expenditure rose ([table 2](#))

○ the huge social security expenditure became an **unbearable burden** for the SOEs, that **lost competitiveness** relative to private enterprises and **faced great difficulties in downsizing their workforce**

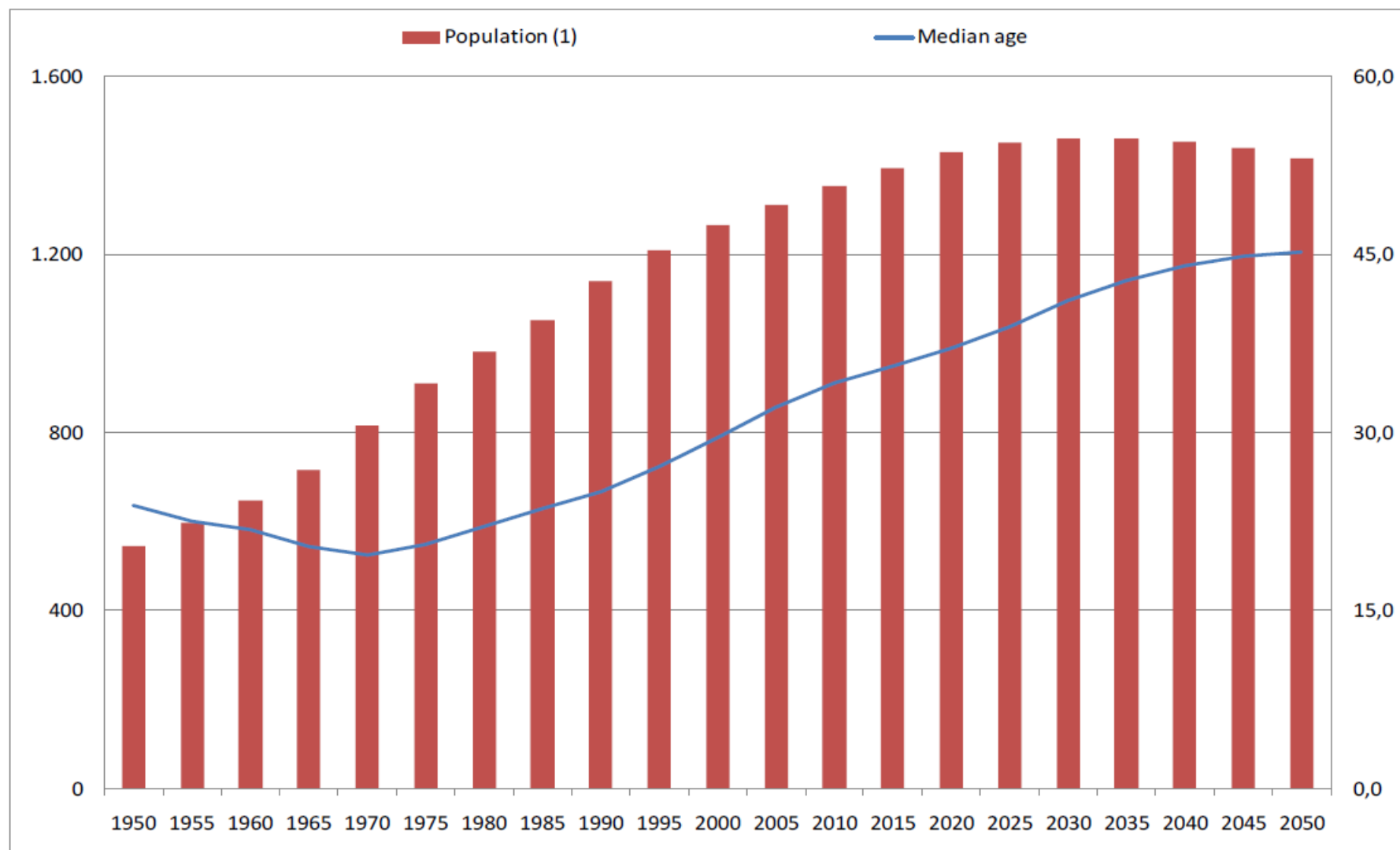
○ the **lack of pension portability** acted as a major barrier to the SOE restructuring

The enterprise-based social security system worked well **before the economic reform** – little labor mobility and the government implicitly assumed responsibility for all firms



2. 1980-1989: towards a multi-pillar system

Graph 1. *China: an Ageing Population*



Source: UN, World Population Prospects.
(1) Millions.



2. 1980-1989: towards a multi-pillar system

Table 2

Tab. 2. *Number of Retirees, Expenses, and Dependency Ratio*

Year	No. of Retirees (millions)	Expenses (1) (billion yuans)	Dependency Ratio (2) (percentage)
1978	3.14	1.73 ✓	3.30 ✓
1979	5.96	3.25	5.99
1980	8.16	5.04	7.81
1983	12.92	8.73	11.24
1984	14.78	10.61	12.50
1985	16.37	14.98	13.33
1986	18.05	19.47	14.08
1987	19.68	23.84	14.93
1988	21.20 ✓	32.06 ✓	15.63 ✓
1989	22.01	38.26	16.13
1990	23.01	47.24	16.39
1991	24.33	55.44	16.67
1992	25.98	69.52	17.54
1993	27.80	91.37	18.52

Source: 1994 Yearbook of Labor Statistics of China, pp. 463 and 478 (State Statistical Bureau, 1994).

(1) The overall price index in 1993 was 254.9 with an index of 100 for 1978.

(2) The numbers are the ratios of total retirees to total employed workers.



2. 1980-1989: towards a multi-pillar system

- In 1986 the government issued the **Provisional Regulations on Institution of a Labour Contract System in SOEs**, recognizing the **need of individual employees to contribute to their retirement**

- The Regulations required

1. **SOEs employees to contribute 3 percent of their wages**

2. **enterprises to contribute 15 percent of payroll**

- **Contributions were paid into collective funds** managed by newly established Social Insurance Agencies (SIA)

- By the end of 1991 **all counties and cities had set up their own SIA** to administer the funds – two thirds of SOEs workers were covered but ...

- ... the **various sizes and levels of these funds made the pension system in China fragmented**, making it difficult to evaluate the efficiency of pension pooling and to enable supervision by the central government

3. 1990-1999: The responsibility shift from firms to LGs

○ The fragmented old-age insurance system and the high decentralization of its management caused a series of **social fallout**

1.the difficulty to transfer the individual accounts affected the formation and **completion of a unified national labor market;**

2.the basic old-age insurance **benefits in some regions remain quite high**, representing an heavy burden on the state and enterprises

3.in some regions **the system covered enterprises of different ownerships**, while in other places the coverage was limited to state-owned enterprises

○ with the aim to further expand pension schemes **combining social pooling with individual accounts to various types of enterprises and employees**, different reforms were adopted...

○ ... that **shifted the responsibility for pensions from the employees' enterprise to the local government**

3. 1990-1999: The responsibility shift from firms to LGs

○ In 1997 the State Council issued the **Decision on Establishing a Unified Pension System for Enterprise Employees** (“Document No. 26”) – a milestone for pension reform in China

1. it proposed a **unified three-pillar pension system** for the first time, **extending coverage to all enterprises**, whether they were state-owned or belonged to the private sector

2. **full funding** was emphasized ([table 3](#))

3. 1990-1999: The responsibility shift from firms to LGs Table 3

Tab. 3. *The main features of Document No. 26*

Pillar	Contribution rate %	Replacement rate %	PAYG/funded	Mandatory/ voluntary
1A	Enterprise:17 ✓ Individual:0	20 ✓	PAYG	Mandatory
1B	Enterprise:8 ✓ Individual:3 ✓	38 ✓	Funded	Mandatory
2	Enterprise: N.A. Individual: N.A.	N.A.	Funded	Not finalized
3	Individual: N.A.	N.A.	Funded	Not finalized

Source: Ministry of Labour and Social Security and Hussain (2002).



4. 2000-2010: The latest steps

○ In 2005 the pension calculating method was changed, cause “*individual account*” in the previous system did not deliver an adequate pension

1.bank deposit rate (revaluation factor) was systematically below average growth of incomes, leading to **falling replacement rate**

2. **reform reduced the weight of this component in the scheme**, allowing for a slower decline of the replacement rate at retirement

○ There have been attempts to develop a **provincial scheme to share revenue and expenditure** (“*provincial pooling*”)

1.By end-2008 38 per cent of the contributors were covered by provincial pooling – adm. and fin. arrangements vary within the same province

2.Most of the provincial pooling takes place in the west or city provinces

5. The development of pension system for the rural population

- Since the start of the rural economic reform at the end of 1978 **formal pension arrangements** were introduced without instructions from Beijing
- From 1987 **pilot schemes were promoted to establish a rural social security** system
- By 1997, **nearly all counties and half of the townships** had put in place the required administrative units
 - 1.the scheme took the form of a **voluntary savings account**, the balance converted to an annuity at age 60 at a uniform rate
 - 2.individuals were allowed **complete flexibility** in making payments
 - 3.administration investment allocation of benefits were **overseen by the county government** – structure and implementation of this pension plan varies from one county to another
- The scheme was **not popular with the public**:
 1. **administrative costs** were relative high
 2. **contributions used** to finance local economic development projects
 3. and some local governments tried to make the system **compulsory**

Conclusions

○ The **system** is fragmented, it does not work as intended and compliance with the rules is low. It **covers only half of urban employees** and a **very small part of the rural population**

○ **Urban**

1. **302 million urban employees** are supposed to be covered but ...

2. contributions are paid by or on behalf of **55 per cent of them**

3. **compliance is low** because

- the **contribution rate is relatively high** (total of employer and employee contributions typically around 28 per cent of wage)
- **people do not trust the system** (unclear rules and suspicion that the system is not sustainable and that contributions might be used for other expenditures than their declared purpose)

Conclusions

○ Rural

1. Among 473 million rural employees only **56 million** (12 per cent) are **covered by the public pension system**

2. The number of retirees was 5.1 million, who received **low pensions**

Extending coverage to the rural population is a challenge that is clearly recognized by the Chinese authorities, as demonstrated by the government plan issued in August 2009, to establish a **new system, gradually targeting universal pension coverage by 2020**

1. The benefits will be relatively modest

2. Financing will come mostly from the central government, the effort being shared with the governments of high-income provinces

There are many linkages between the urban and rural social security systems (especially through workers from rural areas working in cities), discontinuing the *hukou* system is currently under discussion, the **two systems will probably co-exist for quite some time**

Thank You for Your attention

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