Reforming China’s social security system: Facts and perspectives

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This article overviews the social security reform started shortly after the commencement of the general economic system restructuring in China in 1978. The reform is remarkable not only for its scale in terms of population covered, territory affected and comprehensiveness sought, but also for the difficulties confronted, progress made and confidence achieved. Although there is still a long way to go to fulfil its ambitious ultimate objectives, 14 years of reforming exercises have built up a solid basis for a sound social protection system to be gradually extended to the non-covered population. China now can share its experience with other nations in a similar situation.

The significant stage of the social security system reform in China officially commenced in 1984 after a number of years of careful contemplation, study, debate and planning to meet requirements arising from the economic reform, which has switched the economy from central planning to market orientation. Although the old social security system had successfully provided an adequate and effective protection for the targeted population in the past, it failed to continue to play the same role in the new era owing to its inconsistent philosophy, principles and programme design and its narrow personal coverage. At the beginning of the reform, four political aims of the social security reform were clearly spelled out by the government:

- To support the general economic reform and, particularly, to facilitate and reinforce State-Owned Enterprise (SOE) reform, which constitutes a key aspect of the general economic reform (for explanation of abbreviations used, see list). It is intended via the SOE reform to revive the sector by having state enterprises compete on the market. Before doing so, some preconditions need to be prepared, such as granting them all necessary autonomous management rights, including recruiting and dismissing employees in line with the legislation, discharging daily operational responsibilities for the delivery of social security benefits to their personnel, and easing the related financial burden by equalizing and sharing social insurance costs among all the employers and workers covered under the same scheme.
- To provide the population with sufficient social protection provisions. The objective is twofold: universal coverage, with all main benefits provided. It is required to extend the coverage beyond the boundary
of SOEs and the public sector. Employees working in non-SOE sectors have been growing so rapidly in number over the past two decades that they now represent more than half the workforce, if one includes the 128 million workers employed by Township and Village Enterprises (TVEs). In addition, an estimated 100 million migrant workers and their families are floating from rural areas into cities, desperately looking for a job. On top of that, around 70 per cent of the total population (1,200 million) live in rural areas and to some extent need social protection as well. Eventually expanding coverage to the whole nation constitutes one of the ultimate aims of the reform. It is equally recognized that, apart from the old-age contingency, workers and employees are facing some unfamiliar and unavoidable risks stemming from the market-oriented economy, such as redundancy, unemployment and the insolvency of employer-based scheme provisions due to severe financial difficulties or even bankruptcy of their enterprises. So there is a need to redesign and restructure the social security system entirely, in order to meet these requirements.

- To facilitate the mobility of the labour force to formulate and develop a dynamic labour market, as it is regarded as essential and vital for sound and sustainable growth of the market-oriented economy. Therefore, the establishment of a regional or occupational-based social security system in the first phase, and a unified national system in the final phase, is necessary to secure the free movement of workers between various enterprises, occupational sectors and geographical areas without any punitive impact on their accumulated benefit entitlements.

- To make a contribution to the stability, perennity and sound development of the national economy, which in turn will promote the current political system and secure the affordability and continuation of the new social security system in the nation, by injecting some accumulated social security funds into the national and regional economies to speed up development. It is equally possible for the government to guide the market-oriented economy forward with a dynamic and sound structure by social security fund investment.

The necessity to restructure the existing social security system and the overall requirements and objectives have been reiterated and confirmed by the National Ten-Year Plan (1991-2000) for Economic and Social Development and the Eighth Five-Year Plan (1991-1995) of the People’s Republic of China, as well as by the epoch-making Decision on Certain Issues as to the Establishment of the Social Market Economy made by the Third Session of the 14th Plenary Conference of the Communist Party in 1993. Furthermore, they also lay specific emphasis on pension, healthcare and unemployment aspects and set out a general principle establishing a multipillar structure in line with cost and responsibility sharing between the State, enterprises and insured persons, between the central government and various levels of local government, and between formal social security provisions and traditional family and community supports.

Given how complex and comprehensive the reform is, the close linkage with and heavy dependence on the advance of the general economic reform and economic development in the nation, and the unevenness of the reform phases at which the various benefits branches stand, as well as the 9.6 million square kilometres of territory possessed and the 1,200 million
population it aims to protect, it would be impossible to attempt to give all details in this short paper. But the author will try to allow readers to have some insight into the ongoing reform, which will be mainly explained branch by branch followed by a demonstration of outstanding concerns and likely next moves. A conclusion completes the paper.

**Specific reform exercises**

The social security reform in China has experienced several stages over the past two decades of development. It might facilitate understanding to draw a rough outline of the period as follows:

• **The preparatory phase** (1978-1983). During this time, numerous studies, discussions and dialogues were carried out in the forms of international or national seminars, foreign study tours, internal policy and planning workshops, etc. In the end, policymakers started to be quite familiar with the new conceptions and principles of social insurance and obtained some basic consensus. The nation was then ready to move ahead.

• **The preliminary phase** (1984-1993). The old-age pension reform dominated this period. Pension reform started from the establishment of two separate pooling programmes for SOE workers and Urban Collective Enterprise (UCE) employees at the county level, followed by the promotion of the pooling levels. Meanwhile, certain reform efforts were also made in the rest of the social security benefits branches but with much smaller scope and scale; among these, the establishment of an unemployment insurance scheme is worth mentioning here.

• **The phase of comprehensive advancement** (1994- ). A remarkable feature of this period is that the reform continued to go substantially ahead not only in the pension branch, but also in the others, in particular in health insurance. The second remarkable feature is the official conclusions on the pension model and the unification of the pension schemes.

Now let us look more closely at each branch reform.

**Old-age benefit**

**Objectives and principles.** The Old-Age Pension Pooling represents the first effort of the social security reform. The pooling schemes were initially introduced in 1984 in a number of regions at the local county level, and the original objectives were quite simple: first, to share financial costs for pension payments among SOEs and large and medium-size UCEs in order to ease their financial difficulties through cost sharing. This initiative was particularly welcomed by longstanding enterprises with a much higher retirees-to-workers ratio, mainly established in the 1950s. Second, it equally pleased workers, especially those in SOEs that were closing down, because they would benefit a great deal from such pooling schemes detached from individual employers.

In line with the principles spelled out in two milestone regulations on pension reform, namely State Council Decrees No. 33/1991 and No. 6/1995, the basic principles for pension reform have been gradually formulated and defined as follows:

• universal coverage by the basic public pension provision, which is to be available to the whole economic population in urban areas, including workers employed in all types of enterprises and also self-employed persons;
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- financial costs shared between the State, employers and workers;
- a multiple-tier pension system which comprises a compulsory basic pension component to meet the basic subsistence needs of retirees, a top-up supplementary component stemming from a complementary employer-sponsored pension scheme, and/or additional personal savings; the last two components should be voluntary;
- the compulsory basic pension to combine a social insurance element with a funded individual account.

Progress achieved. Since its inception, significant progress has been made in this area, notably:

Promotion of the pooling level. After the green light was given to five pilot schemes, pension pooling was initially conducted as individual schemes at the county level, the lowest administrative level. With gradual liberalization and increasing labour force movement across both occupational and territorial boundaries, the government saw the necessity of promoting it right up to a situation of national unification. As an essential intermediate step, the Ministry of Labour (MOL) has made considerable efforts since the late 1980s to encourage and convince local authorities to merge their individual schemes smoothly into a single one within a specific provincial territory.

By the end of 1996, 13 provinces, municipalities and autonomous regions had claimed that they had entirely or partially achieved this primary goal: a few had completely integrated provincial schemes, while the majority had, among schemes situated within the same region, set universal criteria to be observed for contribution and benefit rates and qualification conditions for benefit entitlements, but with maintenance of the existing separate administration of individual schemes for the time being.

According to the MOL Work Plan for 1997 announced by the Minister at the Annual National Labour Conference held in Beijing in December 1996, provincial level pooling will be speeded up and eventually accomplished by the end of the year 2000 by following the momentum of the unification of the pension model, which is to be completed in the next two years.

Provision of socialized services. Until the late 1980s or early 1990s, most pension recipients still went to their formal employer prior to retirement to receive prescribed monthly pension payments exactly as usual; this made them still feel, physically and mentally, permanent members of the enterprise. This indicates that in the earlier life of pooling schemes, the term was limited to costs, risks and standards, but the day-to-day operation was excluded for one reason or another. Therefore, detaching operational responsibilities from employers and passing them on to pension agencies is another concrete task to be fulfilled.

By 1996, in more than 900 counties and cities, pension operation agencies could directly deliver pension benefits to the insured retirees; in another 615 cities and counties, their clients could receive payments from a designated bank or post office earmarked by the agencies. Meantime, in order to ease the potential tension among retirees stemming from the transfer of administrative responsibilities for pension operations, and to help retirees to settle down to a healthy rhythm of retirement life, many pensioners’ clubs, co-organized and sponsored by local governments and pension agencies, were set up and opened to retirees across the country in what is considered to be a success. Con-
sequently, employers can finally be freed from the strenuous and troublesome duties of managing pension schemes for their current or previous personnel, so that they can now concentrate on their productive business and market competition. This is therefore seen as an essential condition for advancing SOE reform. As this task has not yet been completed, it is still listed in the MOL Work Plan for 1997, particularly the essential element of making pension payments available via the banking system.

Expansion of coverage. As mentioned above, the coverage of pension pooling schemes was initially limited only to SOE workers, and shortly afterwards extended to large and middle-size collective enterprises. This was partially due to the enormous implementation task involved and limited administrative capacity obtained, and partially due to the fact that until the late 1980s, the public economic sectors still dominated the economy, although a private sector had emerged over the horizon at a miraculous speed.

As all counties (or cities and districts at the same level, amounting to about 2,849 in total in 1995) have set up a pension pooling scheme for SOE workers, and two-thirds of them have done so for UCE employees, either separately or combined by 1996, the next focus of reform in this respect is concentrated on extension to the private sector and other urban economic groups such as rural migrant workers, as only a small number of them are covered under the formal arrangements.

In summary, by the end of 1996, the pension pooling system had totally covered 87.4 million workers and retirees of all types of enterprises in the urban sector, including those under 11 separately-run industrial pension pooling schemes.

Establishment of an indexation adjustment mechanism. Over the past two decades, although the level of pensions has been increased several times in line with price or wage inflation in the form of additional premiums or bonuses, they were not based on an established indexation mechanism, so that regular adjustment in the future is not legally guaranteed for retirees. It has been decided that there should be a regular indexing mechanism to keep reasonable pace with the movements of price and/or wage inflation in order for retirees to maintain their living standards and share in social and economic achievements.

Pension formulas/models. The pension formula or model has undergone several stages since 1978 as shown below, reaching maturity just recently when it was finally determined by the State Council.

- The 1978 formula was based on State Council Decree No. 104 issued in 1978, which prescribed that the due pension benefit payable depended on the duration of employment and was calculated on the basis of the last standard wage of the insured person prior to retirement; no requirement was made for workers' contribution, and it was PAYG-financed.

- The 1986 formula was consistent with State Council Decree No. 77 of 1986, which set out a new rule for contracted workers: the overall contribution was fixed at around 18 per cent of the payroll while up to 3 per cent should be paid by the insured persons. The above contribution income constituted a cumulated individual account for contracted workers; upon retirement, their pension would depend on both the number of contribution years and the paid-in amount of total contributions prior to termination of employment. Meantime, the existing formula for the established
employees remained intact. Thus, two parallel formulas coexisted for a while.

- The 1991 formula was in line with State Council Decree No. 33 of 1991, which stipulated some very important rules: developing a multiple-tier pension system, sharing the costs among the State, employers and employees; regularly adjusting pensions in line with wage/price inflation; gradually unifying the two different contribution rates applied to the established employees and contracted workers and integrating them into one fund; and being a partially funded scheme.

- The 1993 formula was based on the instruction on the calculation of basic pension payments issued by MOL, which spelled out that the basic pension comprises two parts, namely a social pension component with a scale of flat rates, and an income-related pension component.

- The 1995 formula was in accordance with State Council Decree No. 6 of 1995, which put two options for local governments to choose in the implementation of their local schemes. Under Option 1, an accumulated individual account is established for each insured person at a contribution rate of around 16 per cent of contributable income; of this, 3 per cent is paid by the insured employee but with a 1 per cent increase every two years until the overall percentage reaches 8 per cent, while the rest is paid by the employer with a corresponding reduction until it too reaches 8 per cent; the insured worker qualifies for a monthly pension benefit fixed at A/120^2 where A is the accumulated total amount of the individual account by the time of retirement, if the worker has reached the prescribed retirement age and made contributions for a minimum of 15 years; the balance of the individual savings account (that is, the part paid by the insured person) can be inherited if the insured person dies before it is exhausted; a pooling fund is also set up to cover the benefit payments for current pensioners, for senior workers who reach their retirement age and are not able to accumulate adequate savings on their own individual accounts, and for those whose post-retirement life lasts longer than ten years so that they use up their savings account; a transition plan is also included. Under Option 2, a three-component benefit is designed to comprise a basic minimum flat-rate pension of between 20 and 25 per cent of the average regional wage, a benefit-defined component equal to 1.0-1.4 per cent of the final wage, plus a contribution-defined component equal to A/120 as defined above; an individual account is also set up for each insured person but with much less importance, because only the employee's contribution is allocated into the individual account while all the employer's contribution is devoted to a "social pooling account" which goes to finance the first two components of the prescribed benefit provisions. Contribution rates are between 18 and 25 per cent according to region, distributed between employers and employees on a similar basis to that of Option 1.

But then came the compromise Option 3 formula, which has become a widely accepted and endorsed pension model. Unexpectedly, just one year after they were promulgated, it was found that in reality only seven provinces, municipalities or autonomous regions had adopted Option 1 and five had chosen Option 2, while the majority had given birth to their own "baby" — Option 3, which is a compromise mixture of Options 1 and 2 with two remarkable characteristics: (a) a contribution of around 10-12 per cent of em-
ployees' final wages is allocated into their individual accounts, higher than under Option 1 but lower than under Option 2; (b) the benefit consists of a flat basic pension equal to 20-25 per cent of the regional average salary plus a top-up calculated on the famous formula "A/120". Given the popularity and acceptability of Option 3, the government has finally concluded that a standardized Option 3 will stand for the basic national pension model, envisaging that the share of the individual account-related benefit will be up to 60 per cent of the total basic pension income while the replacement rate is fixed at 60 per cent of the previous earnings of the insured person concerned. Meantime, some necessary transitional measures have been put in place to protect the entitlement rights of "old" workers.

Experimental pension schemes for civil servants. In addition to the pension schemes for workers as mentioned above, there are more than 500 pilot Pension Schemes for Civil Servants and Other Public Workers, run at either regional or county level within the territory of 20 provinces.

Unemployment benefit

After a long interval of 30 years, unemployment insurance was introduced for the second time by the Temporary Regulation on Unemployment Insurance for SOE Workers issued by the State Council in July 1986.

In fact, the Chinese government had set up a temporary unemployment protection scheme in 1950 to provide some income security to unemployed workers — then amounting to 4 million, equivalent to half of all workers at that time in the urban area. The programme ended in 1956, when full employment had been realized and it was widely believed it would last forever nationwide.

The second-generation unemployment scheme actually forms an inherent part of a set of regulations on SOE reform entering into force in July 1986. The other related laws are (a) Temporary Regulation on the Application of the Labour Contract Measure in SOEs; (b) Temporary Regulation on Recruiting New Employees by SOEs; (c) Temporary Regulation on Dismissing Bad-Conduct Workers by SOEs; (d) Bankruptcy Law. This new legislation brought in a number of changes to SOEs: they can now freely employ and dismiss workers as necessary; new employees are recruited under a fixed-term labour contract rather than a de facto permanent contract; like private companies, SOEs may also be closed down through financial failure; so, like workers of the private sector, SOE workers may face redundancy or unemployment. The main objective of the newly born unemployment insurance scheme, prescribed by the Temporary Regulation on Unemployment Insurance for SOE Workers, which was later amended by the Regulation on Unemployment Insurance Covering SOE Employees issued by the State Council on 12 April 1993, is subsequently defined as being to protect those unemployed workers from unemployment contingencies with an appropriate income support.

Under the newly amended unemployment legislation, personal coverage is extended from the initial four categories of workers to seven groups, comprising (a) employees of bankrupted SOEs; (b) redundant employees of quasi-bankrupted SOEs; (c) employees of SOEs closed down by the State for one reason or another; (d) redundant employees of SOEs which are in the idling and adjustment period in
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line with related state regulations; (e) employees with an expired labour contract; (f) employees dismissed by SOEs; (g) other employees as appropriate. The coverage is expected to be further expanded to private-sector workers under a new law which is currently under consideration by the government.

As regards contributions, it is stipulated that all SOEs have to contribute 0.6 per cent of their overall employee payroll to the unemployment fund. This contribution rate could be reduced somewhat or increased up to 1 per cent if surplus or deficits are excessive. Such an adjustment is subject to approval by the government in question at the provincial level.

The unemployment social insurance funds, which can be used more widely than the corresponding ones in many industrialized countries, comprise (a) the unemployment benefit paid monthly to the unemployed person; (b) medical insurance benefits paid to the unemployed person when medical expenditure occurs; (c) funeral allowance, survivors' allowance and relief allowance paid to the survivors of deceased unemployed persons; (d) training allowance; (e) productive loans aiming to help in the creation of employment opportunities for the unemployed person; (f) administrative costs of operational agencies; (g) other necessary allowances approved by governments at the provincial level. The monthly unemployment benefit is fixed at 120-150 per cent of local relief allowance and is available for a period of up to 24 months, depending on the length of the previously insured employment.

According to the statistics of the Social Security Agency (SSA) (part of MOL), 95 million employees were covered by the scheme by the end of 1994, and 3.54 million unemployed persons have received benefit payments over the period 1987 to 1994. Over the same period, 2,100 unemployment insurance operating agencies with 11,000 staff members across the country have aided 2 million unemployed people to return to employment, which successfully reduced the average unemployment duration to six months in 1994.

In 1997, MOL plans to continue working on the formulation, promulgation and implementation of the new Unemployment Insurance Regulation; expand the personal coverage; improve the fund management; and combine unemployment insurance with the Reemployment Projects to promote reemployment of the unemployed and redeployment of redundant workers.

Healthcare benefit

Since the late 1980s, financial difficulties in supporting the healthcare system have drawn more and more attention from the government. Statistics show that the average annual increase in medical expenditures under the old system was about 20 per cent in the late 1980s and 30 per cent in the early 1990s.

In this context, a Lead Unit for Health Insurance Reform headed by a Deputy Secretary of the State Council was formed in March 1988. The unit members comprised senior officials of eight departments and social partners, including MOPH, MOL, MOF, SCRES and ACFTU.

Under the leadership of this Unit, separate plans for workers' and civil servants' health insurance reforms were drafted and pilot reforms were subsequently conducted in six selected localities. For the workers' healthcare, the experimental reforms aimed at pooling all medical care re-
sources and costs for retirees, while pooling serious-illness care resources and costs for employees. By the end of 1994, 357,000 retirees in 19 regions and 3,746,000 employees in 20 regions had participated in the two respective medical care pooling schemes.

For civil servants' healthcare, the pilot reforms focused on controlling the increase in medical expenditure by various incentive measures, such as giving each insured person a monthly medical allowance for meeting daily medical costs, savings going back to individual purses; and making a lump sum payment to healthcare suppliers for the insured groups for a defined period.

To consolidate and deepen the reform, the State Council decided in 1994 to conduct a further experiment in two medium-size cities in southern China, namely Zhen Jiang and Jiu Jiang. Like the compromise pension model, the basic medical insurance model was a medical insurance scheme combined with an individual medical account. It entails provisions for coverage of some members of the direct family of the insured persons. Contribution rates for employers are around 10 percent of overall wages (depending on local conditions); those for employees were initially around 1 per cent but will gradually rise until parity is reached with employers.

A new Leading Group of the State Council Responsible for Healthcare Reform, headed by a State Councillor, was set up in April 1996 to guide and supervise the second phase of the reforming exercise. Its secretariat is located in SCRES and led by a Deputy Secretary of the State Council with four other members from SCRES, MOF, MOL and MOPH, SCRES having the lead role. Under its leadership, it was decided that the reform experiment is to be expanded to another 57 selected cities in 1997, which probably implies that the medical insurance reform will become the next major combat in the field of social security over the next few years (see “Current reform difficulties” below).

Maternity benefit

Maternity insurance provisions for female workers and female civil servants and other public workers are fairly similar and their substance has not been significantly changed since the 1950s: provisions for maternity leave, maternity pay during that leave, costs of related medical care and hospitalization, special working and employment protection, etc.

However, the call for cost sharing and centralized management was being heard as early as the 1980s, particularly from female-dominant occupations and enterprises like the textile industry, where the financial burden for maintaining maternity insurance was considerably higher than in others owing to the combination of two factors: the higher proportion of women employees, and the individual employer-run scheme. This kind of pressure, combined with other financial difficulties, would easily make some employers fail to provide their female employees with all stipulated maternity benefits and other protection. So, as a first step, the reform has been conducted since 1988, but only on financing and administration aspects, which took two forms in practice: setting up a maternity insurance pooling scheme for all insured women employees, or establishing a mechanism for sharing maternity costs between both employers of the couple in question. By the end of 1994, such an experimental reform had taken place in 522 cities and counties of 20 prov-
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inces, autonomous regions and municipalities.

Employment injury benefit

Various efforts have been made:
- In 1989, the State Science and Technology Commission assigned a first scientific research project on compensation for work-related injury and the mode of raising funds, which was completed in October 1991. While the final report is not at present available, its findings are believed to have influenced subsequent reforms.
- In 1989, the State Science and Technology Commission assigned a scientific research project on the standard for appraising the degree of disability of employees resulting from a work-related accident or an occupational disease. This study was completed in 1992 and the standard (in trial form) was subsequently issued during the same year. It recognized ten progressive grades of disability.
- Experimental employment injury insurance schemes existed by the end of 1994 in nearly 900 cities and counties of 22 provinces, autonomous regions and municipalities, covering 18 million employees.
- A resolution on the scope of work-related diseases and the corresponding compensation for the employees in question was jointly issued by MOPH, MOL, MOF and ACFTU in 1987, with a standard listing of the occupational diseases including all diseases enumerated in Schedule 1 annexed to ILO Convention No. 121 on Employment Injury Benefits (1980 revision).

Current reform difficulties confronted, and the next move

The national social security reform has so far been carried out for 13 years, and during that period considerable and essential progress has been achieved. However, there is still a lot of work to be done and innumerable new challenges, issues and difficulties need to be addressed. In the years to come, the following aspects, which are obviously not exhaustive, appear most crucial and are regarded as priorities for the authorities in further advancing the reform.

Old-age pension

National unification and the new pension model. Historically, in most European countries, pension systems have evolved from fragmentation to unification. In contrast, the social security pension system in China has experienced a movement from a unified provision to a fragmented one: in its early life, pension schemes were nationally run by ACFTU; from the late 1960s, operational responsibilities were shifted to individual employers under the same rules; since the reform, on one hand the administrative level and the capacity for cost and risk sharing have been promoted, but on the other, no national rule existed any more, so that the system became more fragmented.

In full recognition of the perverse effects of the fragmented pension system, some efforts have been made in this respect by the government, such as the promotion of the pooling schemes from the lower administrative level to higher levels, and the adoption of the new compromise pension model. As a next step, MOL has deployed a new strategy to ensure that the unification of the pension system can be attained in three years. Precisely four levels of unification are expected: (a) the unified pension system covering all workers, regardless of the ownerships of their enter-

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prises or the types of working contracts and grades of salary they have; (b) the standardized criteria, including the contributable income, contribution rates and benefit rates; (c) the agency-run schemes; (d) the integration of the pension funds, i.e. all contributions collected from both established and contracted workers going to a single pooling fund.

In the implementation of the above strategy, it is anticipated that at least three types of problems will be confronted: the lack of qualified human resources for the operational agencies, the transfer of administrative responsibilities and, in particular, some uncertainty associated with the new pension model, notably:

- It is apparent that the pension formula was not based on a very well established actuarial evaluation and projection; the prescribed income replacement rate may not be able to be maintained in the long term.
- As the flat-rate basic pension component is only targeted to reach 40 per cent of the total amount provided by the public pension schemes, while the rest relies on the investment return of the individual account savings, some degree of uncertainty related to the pension benefits exists.
- Another uncertainty would come from the “blank” part of the individual accounts due to the nominal booking value of around 5 per cent which is credited into each account without the corresponding physical resources being earmarked. These uncollected contributions would accumulate for at least ten years, so resulting in a large differential or deficit between the nominal and the real balance of individual accounts, which may cause some insolvency problems in the future.
- Owing to its design, currently active workers and enterprises as contributors have to bear double financial burdens, both to meet the pension benefit payments for existing pensioners and those due to retire during the transition period, and to cover the future pension expenses for themselves. This will certainly have some impact on enterprises, particularly on those SOEs facing the risk of closedown during the reform, and in turn on the economy.

- It is doubtful that before all related investment issues are carefully regulated, the investment performance of the pension funds and then the related benefits can be reasonably guaranteed.  

Some concrete and feasible solutions to the above problems therefore need to be found.

**Extending personal coverage.** The new Labour Law, 1994, greatly expanded social security coverage to all workers employed by an economic body, regardless of its nature. In practice, MOL has initially identified about 30 million persons, equivalent to 25 per cent of the total number of urban employees, unprotected by pension pooling schemes for the time being. This mainly includes workers in private companies, foreign companies and joint ventures, self-employed persons and some SOE and UCE workers because of compliance problems.

Accordingly, MOL launched a national campaign called Planning for the Extension of the Basic Pension Coverage, in May 1995, which aims ultimately at the expansion of pension coverage to (a) all types of urban enterprises; (b) all workers of the above enterprises; (c) the self-employed and their assistants; (d) owners of private companies and members of the professions. The extension exercise is to be conducted as a geographical movement...
which will be advanced and accomplished by the end of 1997 in the Eastern Coastal Region — one of the richest areas of the country — followed by the Central Region and the Western Landlocked Region, scheduled for 1998 and 1999 respectively. To facilitate the extension in coverage, certain policy measures have been formulated by MOL.

Upon the completion of the above, relatively easy task, the government will be confronted with the toughest parts of the extension, i.e. how to cover TVE workers, rural migrant workers and the vast rural population which officially accounted for 71 per cent (859 million) of the overall population in 1995. Protection for these categories of the workforce is under consideration but has not been worked out by the competent authorities.

The first group is the most rapidly growing sector in the country since the beginning of the economic reform. It now comprises about 128 million employees. Debate mainly focuses on three aspects:

- What is the nature of this sector? It was or is still closely associated with agricultural production in terms of its human and financial resources as well as its production activities. So it was and is regarded as belonging to the agricultural sector rather than to one of the formal urban sectors. On the other hand, it is argued that this sector has a similar nature and characteristics to any formal sector in terms of the considerable size of the economic production many enterprises have reached, its quite stable workforce, the dependence of most workers on their monthly wages, etc.

- Which is the responsible government department? Just as with the previous aspect, the administrative responsibility at the ministerial level is ambiguous too, which in turn causes conflicts and some delay in planning. It is worthwhile to note that some TVE workers have participated in local farmers' voluntary schemes under the auspices of MOCA, while others are covered by mainstream protection arrangements in certain localities.

- Should it be insured by the existing formal provisions or by a specially designed one? The answer to this question has not yet been found.

Compared with the extension to TVE workers, coverage for the rural migrant population is much more difficult and arguable. It is estimated that this population group already amounted to 100 million by the end of 1996. This phenomenon resulted both from the quasi privatization of the farming lands in the agricultural sector, which made part of the labour force economically redundant, and from the economic boom in the cities, which sharply increased the demand for labour input as well as the attraction of the city life to the rural populations. No doubt this trend will remain the same for a considerable period along with the industrialization and urbanization of the country. When such a huge rural workforce surplus started suddenly to pour into the urban areas and float frequently from one city to another in a substantial fashion since the mid-1980s, the government recognized the challenge and tried to work out a plan for these people. Closer consideration has been given by MOL to this aspect but no formal plan has been released up till now.

As far as the rural population is concerned, the government is reluctant to take any formal action for the time being. It is considered that the conditions necessary for the inclusion of this sector are not in place, because its capacity to make the required contribution payments is still very low, while the size of the formal sector and
the level of industrialization in the country are not yet enough to absorb such groups according to social security experience internationally. Meantime, traditional family and community support is still very strong in the rural sector.

Health insurance

The pilot reform was conducted as early as the late 1980s under two separate Leading Groups of the State Council Responsible for Healthcare Reform, but it appears to be still at an initial experimental stage. This may be partially due to its complexity and sensitivity, the close linkage with other sectors and the deep and wide implications for every family and individual and their daily life. Consequently, for the Chinese government it has become the most difficult part of social security to be restructured. In summary, the following aspects require careful study and further consideration.

Efficiency and social equity. As stated in a ministerial document, “Instruction on experimenting with healthcare reform for workers and public employees”, which was jointly submitted by SCRES, MOF, MOL and MOPH to the State Council on 22 April 1996 and subsequently endorsed as official guidance for health insurance reform, the health insurance system will consist of a health insurance component combined with an individual medical account, apparently cloned from the new pension model. Accordingly, contribution revenues are to be allocated into two accounts: the social pooling funds, and the individual accounts. It is prescribed that all workers' contributions plus at least 50 per cent of the overall employers' contributions should go to the individual accounts distributed by age scales, i.e., more resources will be allocated for older and less for younger workers (for rates, see “Healthcare benefit” above). Once medical expenses occur, they will first be charged against the balance of the individual medical account until it runs out. Then the insured person has entirely to cover medical costs until they exceed 5 per cent of his or her annual wages in the year concerned. Only starting from that point, the pooling funds will pick up the rest of the medical bills while the individual concerned has to bear a prescribed percentage, at scaled rates again, of the remaining medical expenses. The purpose of such a design is quite clear: try to control the rapid and continuing increase in medical care expenditure by creating a direct linkage between the volume of individual medical care consumption and the insured person's revenue and outlay. However, two deep concerns have arisen from this design.

First, can it effectively protect the insured persons, particularly those in the older population group, those with disabilities and those with continuing health problems, as promised? The costs of medical care are really unpredictable at the individual level, so when the system places heavy emphasis on individual medical care accounts (more than half of the resources available are allocated to them), it may easily expose many workers and their families, especially those who are older, those who have a history of serious or chronic illness, and those on low incomes, to severe financial hardship.

Second, and on the other hand, would it bring costs down as expected? There are some doubts about this. It may be true that such a design would discourage overconsumption of medical care resources, but it would also discourage insured people in
many cases from seeking medical treatment in a timely manner, owing to the personal costs involved. This is likely in turn to lead to complications, to higher treatment costs and to a less satisfactory outcome. Furthermore, it may result in an increase of the contribution rate in the end, as there will always remain positive balances in numerous individual accounts which the pooling funds are not able to mobilize as in the past, when group insurance funds existed.

Reforms in the healthcare provider and medication supply sectors. Under the old healthcare insurance system, the two sectors were included in the global public health programme and functioned as service supports. This will no longer be congruent with the new scheme. The reforms will jointly affect several aspects of these sectors, for instance the medical service and medication price-determining mechanisms; government subsidy and budget arrangements; staff recruitment; determination of salary and other welfare benefits; separation of the two services; relationship between the healthcare insurance schemes, the insured, and the suppliers; how to control the quality, quantity and price of those services provided from the insurance fund side; and permanence of and access to enterprises’ and privately owned medical services and hospitals. All these are fairly new issues to the Chinese authorities and require close cooperation and coordination among various government departments.

Healthcare insurance for the rural population. No doubt the question constitutes a very important policy in terms of the vast population affected and the high priority attached to it by rural residents (who usually rank it above pension needs). However, it is more or less beyond the current boundary of the reform, or is at least not a priority.

In the countryside, a public healthcare system has existed since the earliest days of the planned economy. From it, the rural population can get certain basic free or subsidized health services. In the past, this system worked fairly efficiently when it was cooperating with a semi-insurance scheme called “Barefoot Doctor Programmes”, which were collectively financed by local village communities and farmers. But when the latter was gradually ended once the privatization of farming lands began in the rural areas after the late 1970s, medical care insurance for rural people became crucial. The government now encourages rural communities to set up voluntary medical insurance schemes, but that has proved to be very inefficient until now, mainly because of the scarcity and poor quality of available medical facilities in the countryside on one hand, and the inability of the rural population in general to afford to seek qualified medical services in cities on the other.

Generally, even if the need for medical care is huge in the rural areas, no formal government plan can be drawn up for them before the mainstream system focusing on the urban sectors has been worked out.

Unemployment

The unemployment scheme was quite relaxed during its early stage, as the coverage was restricted to SOEs, which were not free in practice to claim bankruptcy. The tension has come and is increasing with extension and further expansion of coverage.
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First, what will be the impact if a large proportion of SOEs are finally allowed to be closed down like any other economic entities in the market? It was recently said that the government has decided to give the green light in this direction in order to advance the enterprise reform. One immediate consequence would be an imbalance between the income and outlay of the scheme.

Second, should the rural migrant workers be covered? How? Separately or under the same provisions? With what resources? The financial impact would be more significant than the above.

Third, is it appropriate to use part of the funds for the promotion of employment opportunity? How much should be spent on training? What would be the impact on long-term unemployment and the necessary coherence and linkage with the social relief system?

Related general issues

Investment of social security funds. Following the advance of the reform, the amount of resources accumulated under social security funds is huge. For instance, the pension pooling schemes alone had accumulated a reserve of 28 billion yuan (approximately US$3.5 billion) by the end of 1994. It is estimated that the accumulation will continue to speed up since the adoption and implementation of the partially/fully funded pension model nationwide. This also implies that the actual pension benefit level payable in the future will largely depend on investment performance and returns.

Given the importance and essence of the investment returns, the question has been placed by all related government departments on the top of their agenda for 1997. Some relevant principles have been worked out. For example, MOL attempts to reinforce the management of the investments of social security funds by three specific measures, namely (a) limiting the investment to special government bonds; (b) gradually releasing such a restriction and allowing individual members freely to choose trusted agencies; (c) setting up a supervisory mechanism to monitor and guarantee the security of pension funds.

Limiting investment to bonds sounds realistic. Taking into account the early and unstable stage of the development of the domestic investment market in the nation, it would be feasible and indeed indispensable to impose such a restriction in the transition period. When the domestic financial and investment markets are very well formulated, developed and regulated, however, there will be no reason to keep such strict constraints and the funds can invest in multiple market stocks, bonds, real estate, etc. to have a balanced investment portfolio and gain high yields at given and acceptable risks. It is widely acknowledged that too heavy investment in government bonds would lead to an increasing repayment burden on the government, which, in turn, would have to increase taxes, or reduce other public expenditure, or increase the public debt to meet obligations. In effect, lending reserves to the government simply means, in the best case, partial “time-lagged tax financing” and, in the worst case, deteriorating benefit levels.

As regards granting freedom to choose investment agencies, it may pose some potential problems and indeed dangers. It is generally accepted that such a decision usually results in high administrative, advertising and marketing costs, difficulties in making a wise choice due to insufficient
information, unpredictable future returns, persuasive and possibly misleading sales propaganda, the offering of "free gifts" as inducements, etc.

Equally, the following issues absorb the attention of the government:
- The legal framework for the investment of social insurance funds should first be formulated and entered into force. This should include clear regulatory provisions on the investment portfolio, selected stocks and securities, selected trustees and the minimum rate of return. This legal framework should be consistent with the general legal framework for investment but with far more precaution and control.
- Compensation funds for safeguarding the minimum pension level of the basic public scheme should be in place to protect the pension rights of members whenever an investment failure and subsequent insolvency of benefit payments occur.
- Domestic financial and investment markets need regulating to prepare a sound environment for social security fund investment.
- The investment capacity of responsible agencies must be strengthened and their professional expertise improved.
- Good use should be made of the social security funds both for the economy and for society.

**Overdue contributions arising from SOEs’ financial difficulties.** A Chinese dilemma is that, on one hand, a large proportion (one estimate is about one third) of SOEs are on the verge of economic bankruptcy but, for one reason or another, the government cannot close them down, or at least cannot afford to let them all go bankrupt together, despite the existence of the Bankruptcy Law which came into force several years ago; on the other, because of their financial difficulty, no or only part of due contributions for the various social security branches can tangibly be collected from these impecunious SOEs, and this consequently transfers their financial burden to the schemes, which thus may in turn face bankruptcy. The situation becomes worse when those SOEs' financial deficits rise to 50-60 per cent in a city where schemes are individually independent.

**Governance and management.** The Chinese concentrated a large part of their attention on the management issue from the very beginning of the reform and tried very hard to find out whether and how a responsibility line should be drawn between the responsible departments, the social security operational agencies and investment agencies, between the various government departments, and between central and local managements. In effect, this is an issue of secondary concern within the overall framework of social security governance, which embraces the levels of national policy, national management and the management and administration of individual schemes. The actual form of administration of the scheme should adapt to national circumstances, which is why no specific structure of administration is stipulated in the related International Labour Conventions. What the relevant Conventions require on this matter is a commitment to overall responsibility on the part of governments and the adoption of a tripartite structure (government, workers and employers) for the governing boards of funds in the case of autonomous management of the schemes.

Tripartism actually is not entirely new to the Chinese because, under the law, each Social Security Board should com-
The absence of employers' representatives was partially due to the dominance of the SOEs and UCEs in the economy in the past, whereby the government could also assume the role of employers. However, there is now a need for full representation of the employers' organizations, as non-public sectors are growing. Moreover, the role of trade union representatives also needs to be strengthened, so as to protect workers' interests.

As far as the administrative structure is concerned, the need now to formulate a national administrative network for pension, employment injury, health insurance and unemployment insurance schemes appears urgent from the point of view of MOL/SSA. It is apparent that, for example, the current fragmented management cannot fully meet the requirement of realizing the unification of the pension system in two to three years. In this respect, MOL identifies some aspects that need to be addressed, such as the lack of a systematic and regular training programme for operating staff; and the absence of a nationwide computer network for the overall social security system.

Formulation and establishment of the regulatory framework. Although some very important amendments have been made over the past five decades, the regulatory framework for social security in China is still based on that established in the early 1950s. Therefore, it is more or less out of date and neither consistent nor coherent between its various parts. Obviously, there is a need to formulate a new legal framework for social security so as to provide better protection for the population.

Accordingly, an attempt to establish a new pattern of social security legislation, including a Social Insurance General Act and several individual subsidiary regulations, has been made by the government in the past four years. A basic consensus has been reached among government departments concerned some years ago with technical assistance provided by the ILO via a UNDP-funded project. By the time of completion of the project in the summer of 1996, the drafts of the Social Insurance General Act and Regulations on Unemployment and Employment Injury Insurance were ready for submission to the State Council for finalization. For one reason or another, the Bills are still waiting.

Within the legal context, social security adjudication (appeals) is another essential aspect. But for the moment, this has not drawn much government attention. This may be partly because the old adjudication mechanism is still working for the moment; partly because it is difficult to reinforce compliance, for example in the case of SOEs that are not paying contributions, through the adjudication system alone, as the concern may have been more a political one in the first place; and partly because ordinary insured people are still not used to protecting themselves with legal instruments.

Conclusion

China has had, over more than 30 years, a comprehensive social security system for its urban population with a similar scope to that provided in the industrialized world. It is interesting to note that the social security provisions available under the old system could meet most of the minimum requirements as to the coverage of the workforce, contingencies covered, and
the benefit levels which are set out in International Labour Convention No. 102 on social security (minimum standards).

However, it has been demonstrated since the beginning of the economic restructuring that the old system could not continue to play the same role in the reforming, market-driven economy, owing to its planned-economy system design and limited personal coverage. There is an inevitable need for reform and expansion.

The reform of social security has been under way for more than 14 years, not counting several years of contemplation and planning prior to that exercise. The progress made so far is quite encouraging:

- Old-age pension, the most important part of the social security system, has been shifted from individual employer-based schemes to institutionalized schemes based on social insurance principles; a new national model has been invented and finally determined; the scope of coverage in terms of population is redefined and prescribed under the new Labour Law, and practical expansion is under way.

- Regarding unemployment, a national scheme was set up for SOEs in 1986 and some extension of the coverage has been subsequently achieved.

- Concerning health insurance, some experiments were carried out as early as the 1980s and a nationwide reform experiment on a large scale is now going ahead.

- The reform of maternity insurance, work-related injury, etc., has equally achieved some objectives.

After so many years concentrating on social security reform, the Chinese have not only built up a basis for the new social security system, but also have a clear overall view of the type of programmes that they want and that are suitable for the economy and society.

Nevertheless, there is still a long way to go before the Chinese achieve their ultimate goals. On the way, they will continue to confront numerous obstacles and difficulties, but these will mainly be administrative and operational issues rather than system and programme designs or planning ones. With the experience and knowledge they have gained, it is believed that they can well handle whatever issues may emerge.

For reform to go smoothly in the next stage, international experience and assistance will still be essential for the Chinese. On the other hand, possessing half a century of experience in social security that delivered comprehensive protection provisions to a population amounting to nearly a quarter of the world’s total, including 14 years of non-stop restructuring practices, the Chinese people are now not only confident about their future but also in a position to be able to discuss, engage in dialogue and exchange ideas and experience with their colleagues abroad, particularly in Asian countries and central and eastern European ones in economic transition, so that they may make a real contribution to the development of the social protection system in the world.

Abbreviations

ACFTU: All-China Federation of Trade Unions
MOCA: Ministry of Civil Affairs
MOF: Ministry of Finance
MOL: Ministry of Labour
MOPH: Ministry of Public Health
SCRES: State Commission for Restructuring the State-Owned Enterprise
SSA: Social Security Administration
TVE: Township and Village Enterprise
UCE: Urban Collective Enterprise
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Notes

As this article is mainly a factual presentation of the situation prevailing in China, its contents do not therefore imply that the author or the ILO or its Social Security Department endorses or, indeed, disagrees with the approach followed in this field by the Chinese authorities, even when no specific comments are expressed in the article regarding one or the other measure.

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1. In China, the most significant classification of non-agricultural economic entities (enterprises) is by types of ownership as shown below: (a) entirely state-owned; (b) urban-collective-owned, which is usually subdivided into two classes: county level or above, normally medium size to large; and lower level, normally small; (c) jointly owned by public and private sectors; (d) private enterprises, having more than eight workers; (e) urban self-employed, employing up to eight workers; (f) cooperatives; (g) foreign entities, including joint ventures, foreign-funded companies and overseas Chinese; (h) village and township enterprises and cooperatives, which are usually excluded from the category of the urban population.

2. This “120 factor” is supposed to represent ten years of life expectancy at retirement. In fact, it is based apparently on life expectancy at birth, and therefore underestimates the average number of years during which a pension will have actually to be paid. The proposal did not, however, foresee that payments would be stopped upon the exhaustion of the individual account. Specific mechanisms were also foreseen for the adjustment of pension benefits and the payment of minimum pensions. Concern is thus raised about the continuing soundness and the validity of the actuarial evaluation on the basis of which contribution and benefit rates were established.

3. The experience of other developing countries in this field, including Chile, is not very encouraging. The volatility of financial markets is a very negative factor for the sound development of funded or partially funded pension schemes.

4. One difficulty is certainly to be found in the lack of a very strict legal definition of Township and Village Enterprises, due to their complex and short history. These entities mushroomed either on the initiative of the local authorities in rural areas, at an early stage in most cases, or on that of local village communities, or out of entirely individual motivations in the case of the increasing number of economic entities set up later. But one common feature is that their normal financing and functioning are the direct responsibility of individual shareholders. Some circles in China therefore argued that TVEs were in fact close to cooperatives, but this is not legally true. Some are actually private entities. Another common feature is that they were, in the first instance, established between the rural and urban sectors. In other words, TVEs were initially financed by mobilized local rural residents, were situated in their home town and on their land, and recruited existing farmers for their workforce, apart from highly technical positions; but they were no longer a part of the agricultural economy.

5. By the prescription of State Council Decree No. 33/1991, such a Social Security Pension Board should be made up of representatives at the same administrative level from MOL, MOF, the State Planning Commission, the State Audit Bureau, the Central Bank and ACFTU or their local offices, and chaired by a governmental head, such as a deputy mayor, at the same level. It is clear that it is not a tripartite structure as it includes no direct representative of employers’ organizations. This is perhaps due to two facts: (a) employer bodies are not very active in society, particularly in the field of social security, because, on the one hand, entrepreneurs of state-owned enterprises and even large or medium-size collective enterprises are usually appointed by the government, mostly of them having a civil servant’s status, and on the other hand, the formation of employers’ organizations for those newly established private entrepreneurs has not yet been completed, so that they have very little influence on the development of the social security system for the moment; (b) responsible social security operational agencies have not yet become autonomous organizations.
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