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China's Social Pension Systems -problems and future challenges

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Outlines

- Review of pension systems reform
- Current systems
- Problems
- The challenges ahead

The old systems

- **The first insurance measures for SOEs and collectively owned enterprises were introduced in the 1950s and early 1960s;**
- **The system were abolished during Cultural Revolution (1966-1976), SOE became responsible for administrating and paying pensions out of current revenues;**
- **Market Economic Development with the market opening up after 1978, Social security reform were the key part of the reform and opening.**

The old system-cont.

- Separate and generous pension system for public employee including civil servants and other public institution's employee.
- The rural population did not have any formal old-age insurance schemes.

The Economic and demographic background in 1980s

- **Opening up and market Economy.**
- **Labor migration to the cities accelerated**
- **Serious Family Planning policy after 1980**
- **The pension system was unsustainable.**

Enterprise pension system reform

- Center government and State Council proclaimed a series of reform scheme for enterprise pension system in 1990s and 2000s;
- The decision on establishing a unified basic old-age insurance system in 1997(State Council document 26 of 1997);
- The decision on improving the basic social insurance system for enterprise workers in 2005(State Council document 38 of 2005)

Current pensin systems

- 1. Three pillars pension systems for workers in urban.**
 - Two systems under two documents in different regions.
 - Most provinces keep in 1997 schemes.
 - 14 provinces and municipality are making pilot under 2005 schemes.
- 2. Separate retirement system for Civil servants and other public institution's employee.**
- 3. Pension system for migration from rural to urban with urbanization.**
- 4. Pension sysetm for farmers.**

Three-pillars pension systems for workers in urban

- Pillar 1: Social pension plan
- Pillar 2: Voluntary corporate pension plan.
- Pillar 3: Voluntary individual saving plan.

Pillar III are not supported by tax incentives and the role is not significant.

Pillar 1: Social pension system

- Combining social pool (tier one) with individual account (tier two).
- In 2000, **National Social Security Fund (NSSF)** as national long-term strategic reserve fund was established by center government.

Social pension system under document 26 of 1997

- The first tier works on a PAYGO basis and financed by employers contributions.
- Contribution by employer are 20% of payroll, with a maximum base of three times the average provincial wages and at a minimum of 60% of this average.
- The second tier of pillar one is managed as individual account.
- Financed with contributions of 3% individual wage from enterprises and 8% from individuals.
- Monthly benefit is in equal installments over 120 months
- Once the account is depleted, all benefits are paid out of the pooling fund.

Benefit for “Old”, “Middle” and “New”

- *“Old” group* : retiree before 1997, retirement benefit keeps old pre-existing rules, about 80% of final salary.
- *“New” group*: entry new system after 1997.
 - ✓ 20% of last year average wage
 - ✓ IA balance at retirement/120
- *“Middle” group*: accumulated past service years, will retire after 1997.
 - ✓ "New" group benefit +compensation of past service years.

Pilot program under document 38 of 2005

- Social pooling fund with funded IA
- Basic pension benefit related with contribution and service years
- IA contribution is 8% of individual salary by employee.

Pillar 2: Voluntary enterprise pension plan

- Voluntary contribution-based, DC.
- Financed either by the company or by a mix of company and employee.
- Company has to appoint a trustee
- The trustee appoints an account administrator, a investment manager, and custodian approved by the government.
- Limited investment policy.
- Tax deductibility is limited.

Problems

- Low coverage
- Fragmentation system arrangement
- Nominal individual account
- Large difference between regions and employment.

low coverage

- In the end of 2007, Coverage of social pension system among urban employment is about 52%, among total employment is about 20%.
- Retiree with pension benefit is about 28% of total population at age 60 and more.

Fragmentation

- Decentralization lead to fragmentation between different levels of administrative hierarchy and different regions.
- Different pension systems for employee who work in public and private, formal and informal, urban and rural.
- Large difference in system parameter due to conflicting local and provincial regulations.

Nominal individual account

- Social pooling and individual account mixture together;
- Even 14 provinces which making fully funding individual account pilot, still managed by social security agents.
- Lack of financial support under huge legacy debt.
- Lack of clear regulations guiding the operations.
- Investment limitation for IA fund.

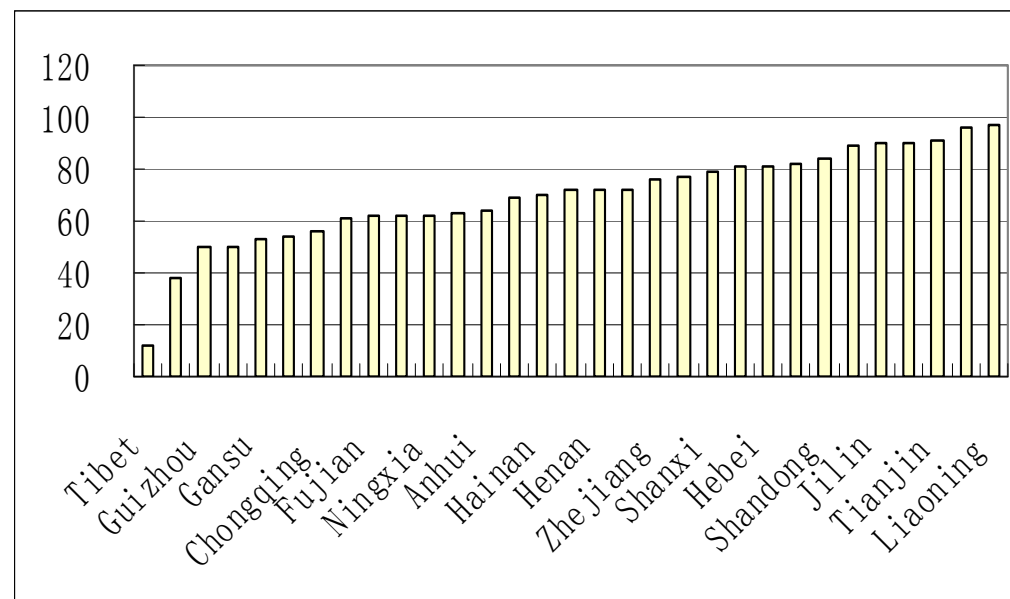
Large difference between regions

- Coverage
- Dependency ratio
- Historical liability
- Fund balance

Coverage rate in different provinces in 2007

(Ten thousands, %)

Region	Active population	Urban employee	Coverage rate
total	15183	29350	52
Tibet	5	41	12
Yunnan	191	504	38
Guizhou	149	300	50
Guangxi	243	483	50
Gansu	148	279	53
Jilin	354	395	90
Shanghai	592	658	90
Tianjin	226	249	91
Guangdong	1970	2057	96
Liaoning	892	918	97

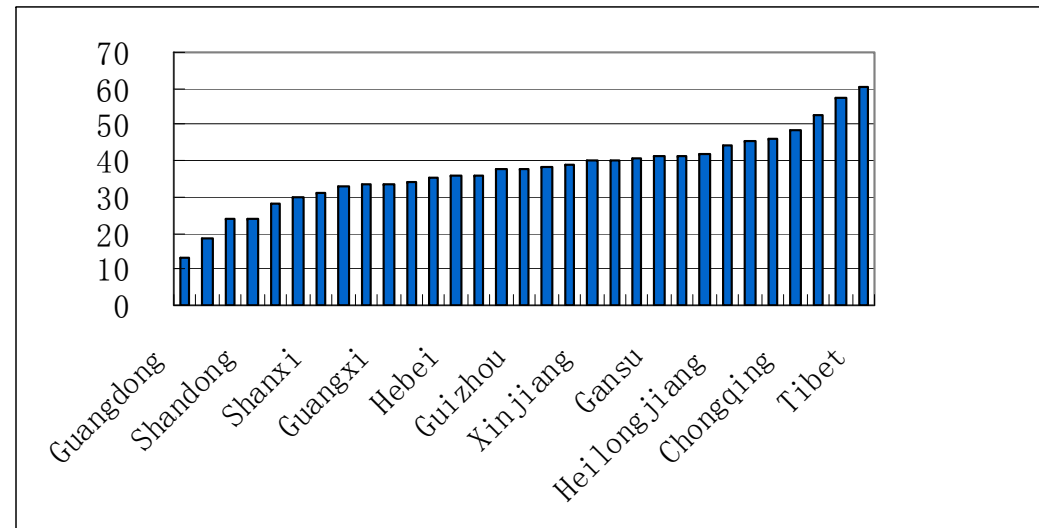


Source: China Statistical Yearbook

Dependency ratio in provinces in 2007

(Ten thousands, %)

Region	Active population	Retirement	Depend-ratio
Total	15183	4954	38
Guangdon	1970	257	13
Zhejiang	985	182	19
Fujian	415	98	24
Shandon	1175	282	24
Jiangsu	1249	353	28
Liaoning	892	408	46
Chongqin	232	113	49
Tianjin	226	119	53
Shanghai	592	341	58
Tibet	5	3	60



Source: China Statistical Yearbook

Pension liability in some provinces in 2000

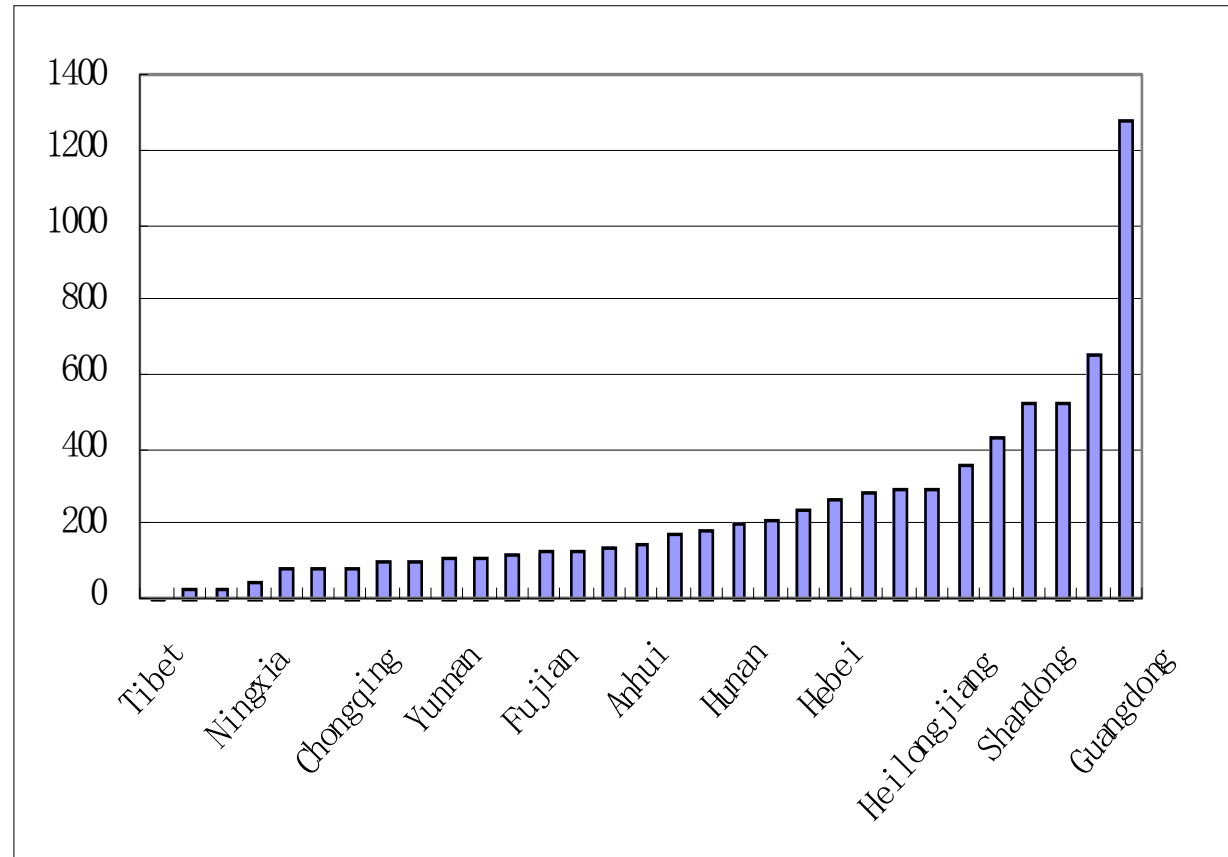
Region	Historical liability (trillion yuan)	Ratio of liability to GDP (%)	Liability Per capita (ten thousands)
Fujian	913.1	23.3	3.2
Hebei	1808.9	35.5	3.6
Anhui	1130.1	37.2	3.3
Henan	2006.9	39.1	3.5
Hunan	1448.3	39.2	3.1
Tibet	56.9	48.4	12.9
Qinhai	217.1	82.4	5.4
Liaoning	3943.5	84.5	5.2
Tianjin	1549.4	94.5	8.3
Beijing	2844.2	114.7	9.3
Shanghai	6179.9	135.8	13.4

Source: Wang Xiaojun (2006)

Pension fund balance in 2007

100 million yuan

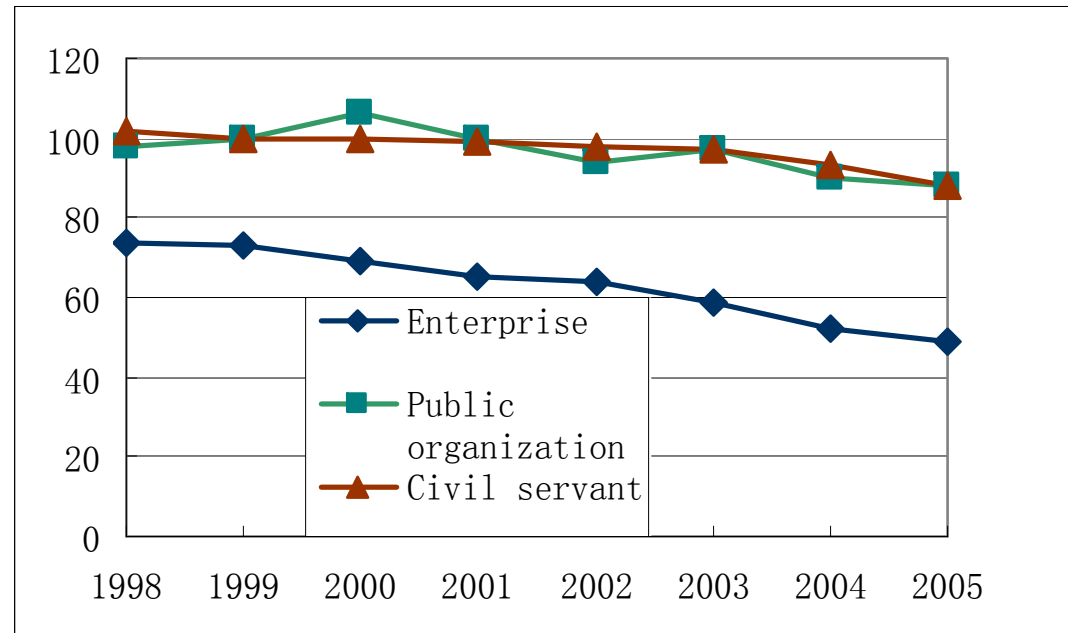
Region	Balance
Tibet	1
Qinghai	25
Hainan	30
Ningxia	46
Shandong	523
Jiangsu	530
Zhejiang	652
Guangdong	1283



Source: China Statistical Yearbook

Average replacement rate for difference employment from 1998 to 2005

Year	Enterprise	Public organization	Civil servant
1998	74	98	102
1999	73	100	100
2000	69	106	100
2001	65	100	99
2002	64	94	98
2003	59	97	97
2004	52	90	93
2005	49	88	88



Source: China Statistical Yearbook

Average replacement rate for different income group in system of 2005

Income group	Basic benefit	IA benefit	Total
Lowest	53.6	8.8	62.5
Lower	46.2	8.8	55.0
low	40.1	8.8	48.9
Median	35.2	8.8	44.1
High	31.2	8.8	40.0
Higher	28.2	8.8	37.0
Highest	24.6	8.8	33.5

Source: Wang Xiaojun (2009)

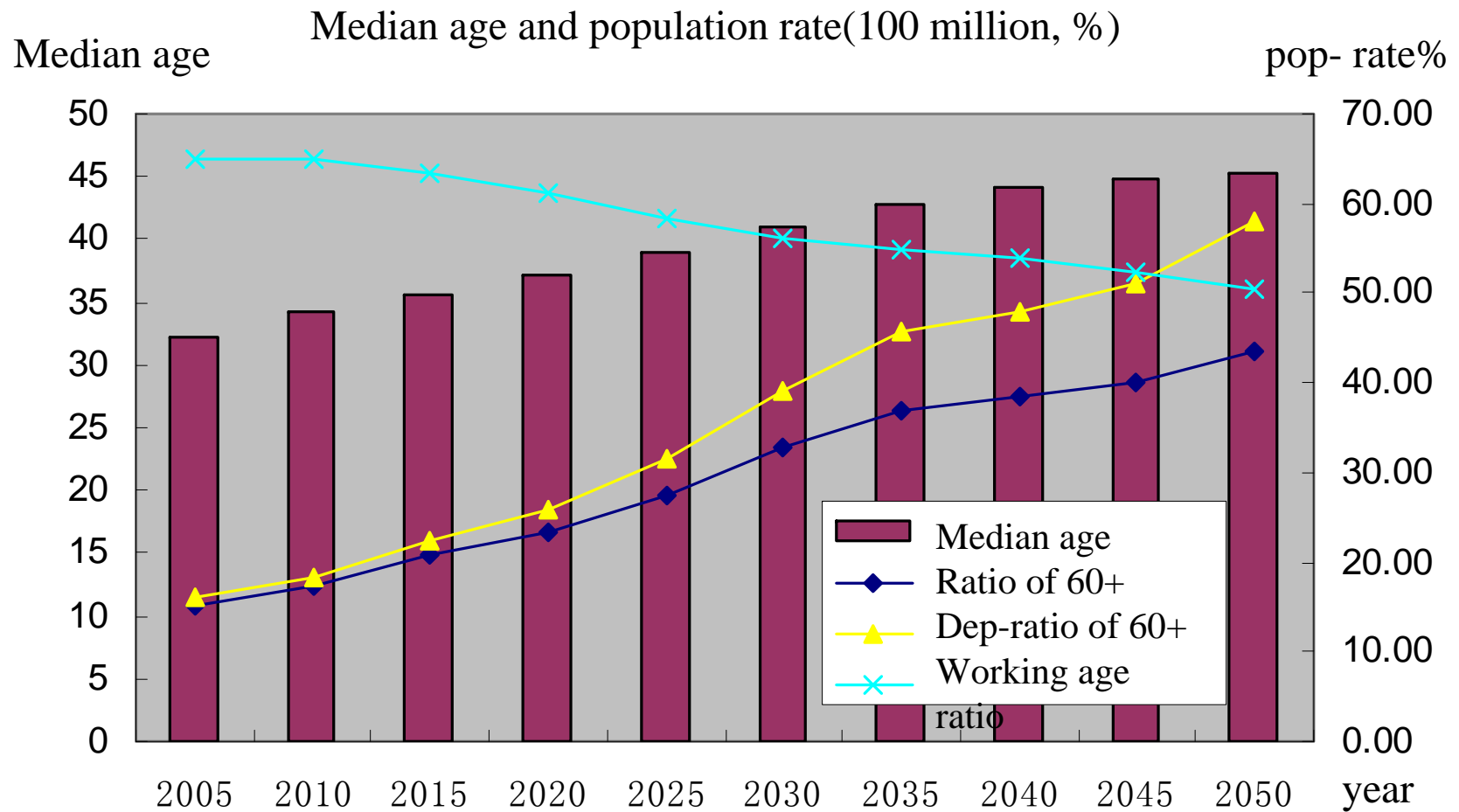
Average replacement rate for male and female in system of 2005

Social Pension	Male	Female
Basic	32.62	28.89
IA	9.82	7.26
Total	42.44	36.15

Source: Wang Xiaojun (2009)

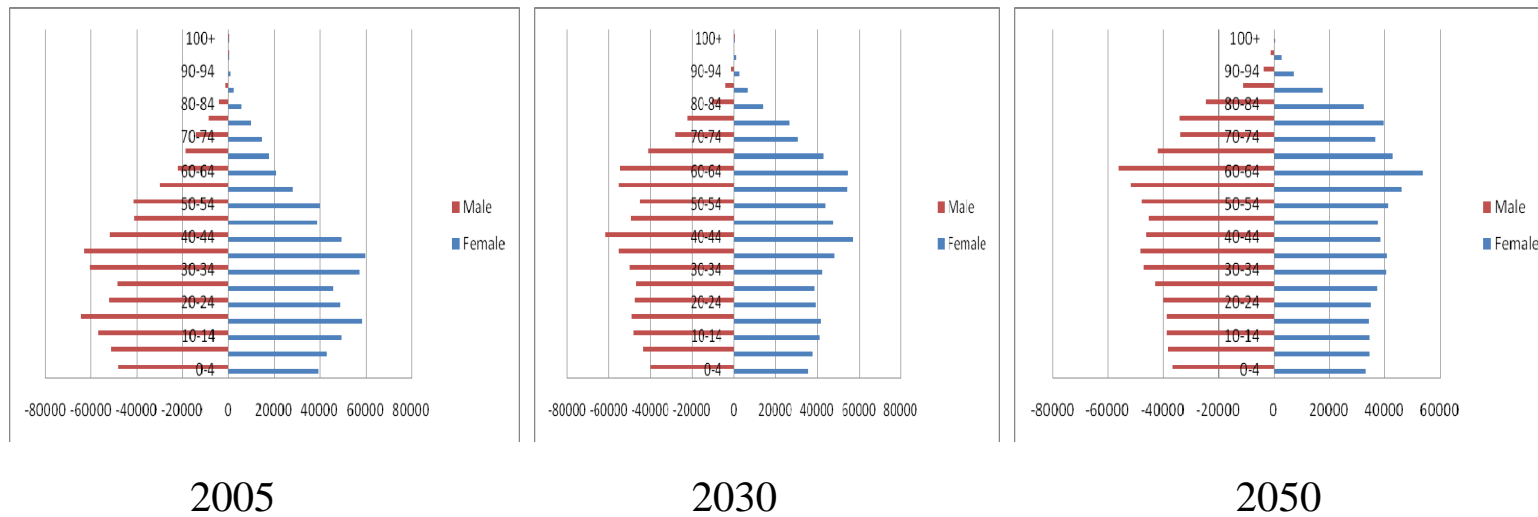
Challenges Ahead

- Population aging.
- A large amount of legacy debt.
- Immature capital markets.
- long-term sustainable development.



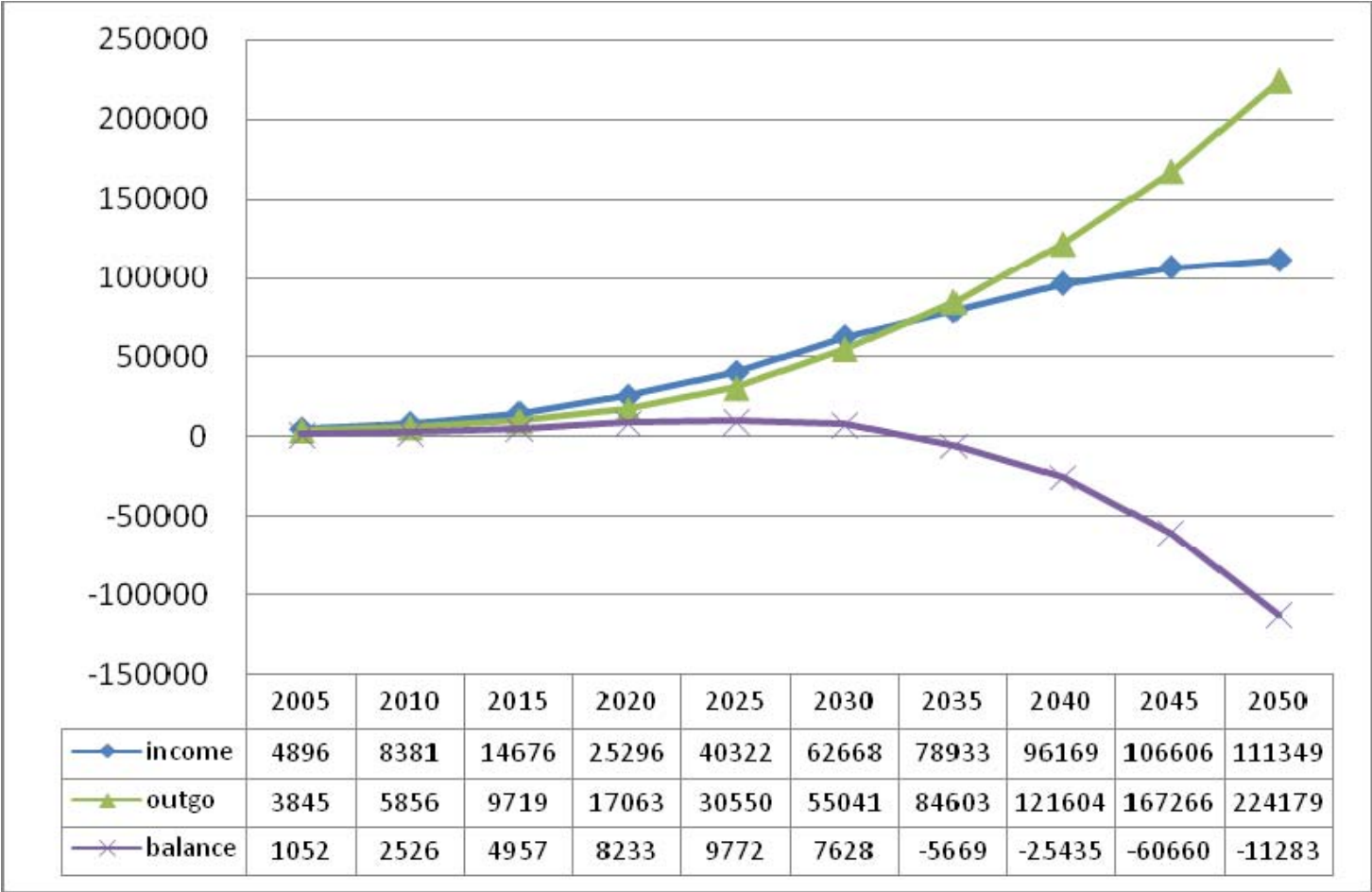
Source: the United Nations, World Population Prospects, middle assumption

Age Pyramid in China



Source: the United Nations, World Population Prospects, middle assumption

Income and expenditure under current replacement ratio (hundred million)



Source: Wang Xiaojun (2009)

Assumptions

year	2005	2010	2015	2020	2025	2030	2035	2040	2045	2050
Urban share	0.456	0.494	0.533	0.571	0.61	0.648	0.647	0.647	0.646	0.645
Empolyment rate	0.698	0.698	0.698	0.698	0.698	0.698	0.698	0.698	0.698	0.698
coverage rete	0.48	0.534	0.588	0.642	0.696	0.75	0.75	0.75	0.75	0.75