Bureau of the Census
International Brief

Old Age Security Reform in China

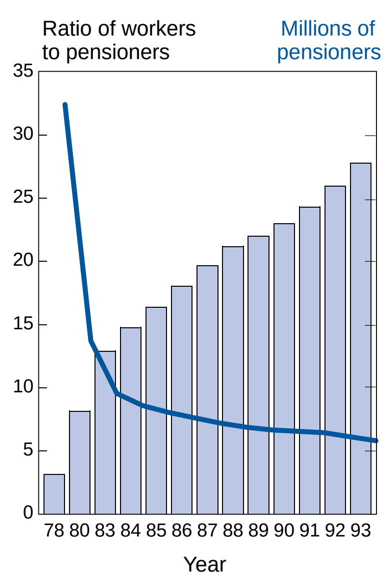
China is undertaking a major revamping of its old age security system because it is faced with a falling proportion of workers to pensioners, declining income replacement levels, precarious funding, and diminishing coverage of the labor force under the current system. China is reforming its urban old age security system and introducing a new system for the rural population.

Reforming the Urban System

Reform of the urban old age pension system, while still evolving, addresses both funding and benefits.

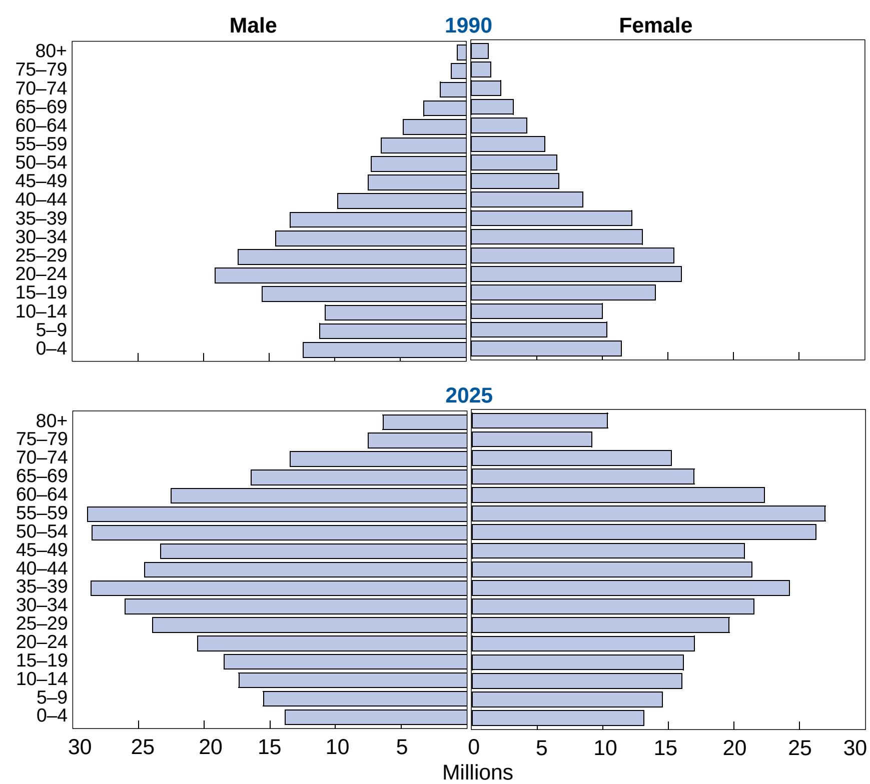
A regionally-based pension pool system is replacing the work unit as the focal point of the old age security system. Until recently, each enterprise provided benefits to its retirees, covering the costs from current operating funds. Now, pension pools are being formed for administrative areas (usually counties or cities; a few at the higher prefecture or province level). Work units contribute to the pools on the basis of their total wage bills, and the pools assume responsibility for

China faces a declining ratio of workers to pensioners as number of pensioners increases



China's large cohort of young urban workers will be at or near retirement by 2025

Urban population by age and sex



Note: China's urban population is growing through natural population increase, in-migration, and reclassification of rural places as urban.

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payment of benefits. By the end of 1994, about two-thirds (19 million) of pensioners and half (83 million) the urban work force were covered by the new pools.

A network of social security offices is being established to administer the reformed system. These offices, which will service retirees from a large number of enterprises, are expected to be more efficient than the former decentralized system.

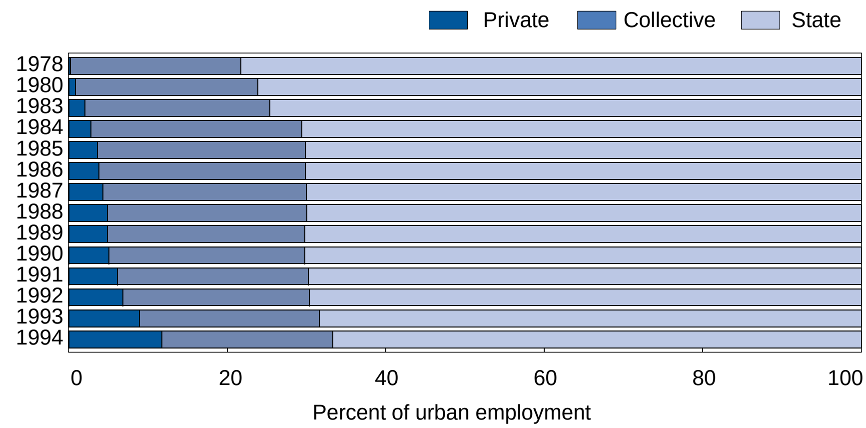
Pension financing is being diversified, with the employer (work unit) no longer the sole contributor to the pension fund. Employees now also make contributions, and the government is to contribute as needed in its role as pension guarantor. Presently, employers contribute 15 percent or more of total payroll. Employees are now contributing only 1 to 3 percent of wage income, but the rate is gradually increasing by 1 percent every 2 years. As the employee contribution rate rises, the employer's rate is to fall until each is contributing roughly 50 percent of total premium costs.

The system of benefits also is changing, as multiple plans replace the single defined benefit plan. The multiple plans seek a balance between incentives for participation and social equity. The specifics of each type of plan and the combination of plans available to workers vary across regions. In general, three types of plans are emerging:

- The basic pension plan pays benefits based on the average local wage (an equalizing characteristic of the benefit formula) and years of qualified service (an incentive aspect of the plan). Retirees receive a percentage of the local average wage prevailing in the year prior to retirement.

- The supplementary pension plan is similar to occupational pension plans in developed countries. This defined benefit plan takes into consideration

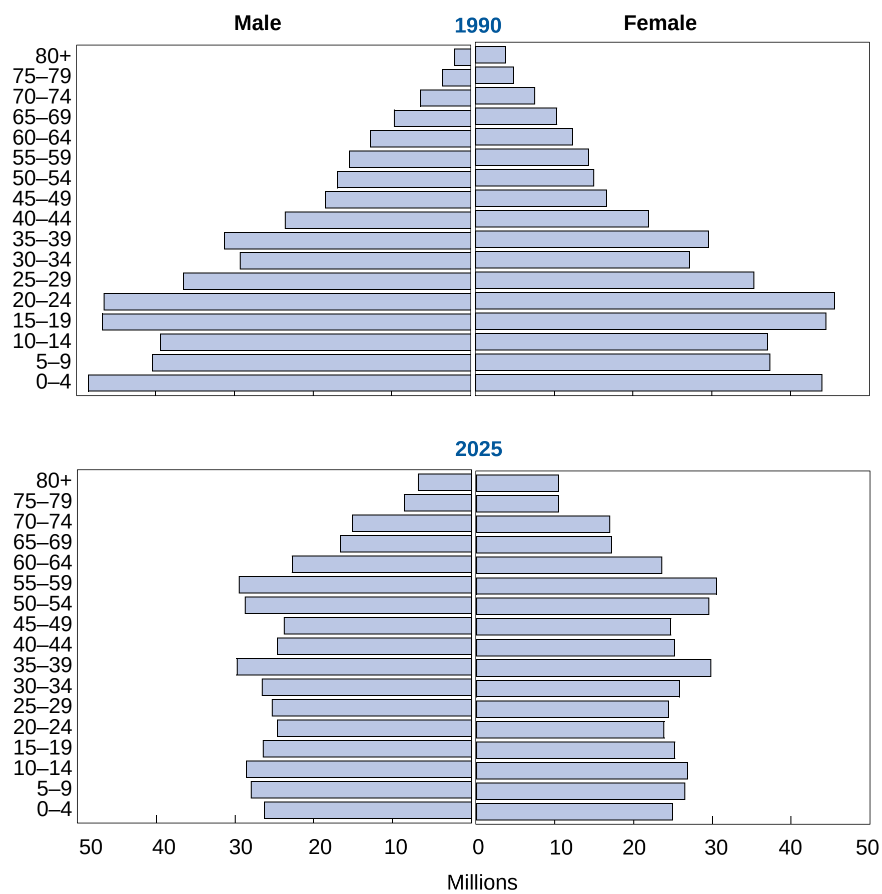
Employment in the private sector is growing in urban China



Note: Private includes foreign invested and self-employed.

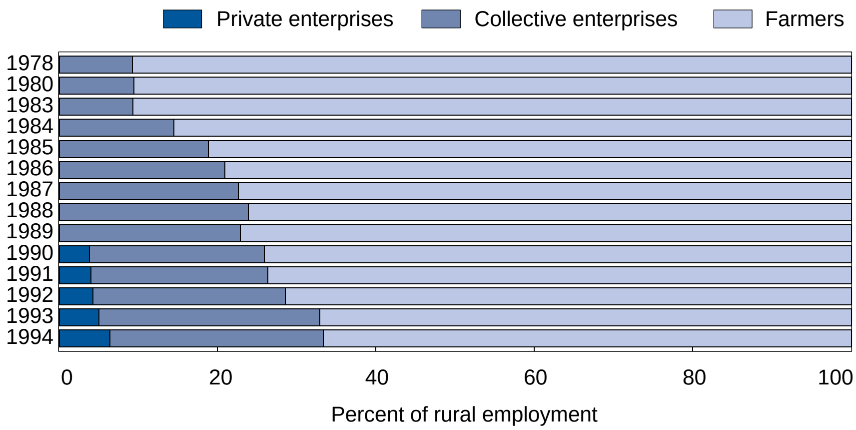
Rural China is aging less rapidly but has more old people than urban areas

Rural population by age and sex



Note: China's rural population is declining through out-migration and reclassification of rural places as urban.

Off farm employment in collective and private enterprises is expanding in rural China



the individual worker's earnings and the number of years of qualified service. In most cases, maximum and minimum wage levels are imposed to introduce an equalizing element to this pension as well.

The basic and supplementary pensions are adjusted annually for inflation. In addition, pensions are raised as labor productivity increases.

- The third type of plan is a compulsory savings plan. Contributions go into a special individual bank account. At retirement, monthly payments are disbursed from the principal and interest built up in this account with payments based on the accumulation and average life expectancy at retirement.

Pools vary in the distinction made between those who retired under the old system, workers hired under the old system, and workers hired under the new system. Nevertheless, all pools are required to honor previous obligations to existing retirees.

Worker coverage is more comprehensive under the new system. Unlike the old system which covered only State workers and employees of some urban collectives, the new system is slowly being opened up to workers in other rapidly growing urban sectors—foreign-funded enterprises, private enterprises and the self-employed.

The new system is partially funded, replacing the former pay-as-you-go system. The current contribution rates are intended to generate an annual surplus equivalent to about 10 percent of benefit payments in anticipation of rising costs as the reformed system matures and China's population ages.

Expanding the Rural Old Age Security System

In rural areas, only local government employees, including State teachers and employees of State farms, are eligible for the pension programs described above.

In an attempt to redress the imbalance in the provision of old age insurance between urban and rural workers, the central government has designed and is promoting a special pension insurance program for rural areas. The program is a voluntary savings plan (defined contribution and fully funded) targeted at individuals with rural household registration (farmers, employees of rural enterprises, and the rural self-employed) between 20 and 60 years of age. Individuals may contribute between 2 and 20 yuan per month to be placed in a special bank account. Local governments and rural enterprises have the option of matching a percentage of the participant's contribution. Pension payments begin at age 60 based on contributions and accrued interest.

Sustainability of the Reformed Urban System

The reformed urban system offers generous benefits with high income replacement ratios and with retirement at age 50 for women (age 55 for some women) and age 60 for men. As China's population ages, the working population supporting the system will be shrinking proportionately to retirees: the ratio of population ages 20-59 to those 60 and over is projected to decline from the current 6.7 to 5.0 in 2010 and 2.7 in 2025. The pension system will be paying benefits to more people for longer periods of time as life expectancy continues to increase. By the year 2025, life expectancy at age 60 will increase by over 4 years. Despite these demographics, Chinese officials have steered clear of any discussion of reduction in benefits.

For the new system to remain financially sound, it is imperative that all participants meet their obligations and that funds are profitably invested. Some firms and individuals are reluctant to join the new compulsory pension pools because of concerns over the adequacy of funding for current and future obligations. Currently, nearly one out of four participating enterprises, primarily loss-making state enterprises, needs government assistance in paying premiums.

Also serving to undermine confidence in the system are reported instances where local governments have invested pension funds under their control in risky development projects or used them to cover budgetary shortfalls. Given the underdevelopment of financial markets in China, safe and profitable investments are few.

What Next?

Several government leaders advocate moving pools up from the lower levels to the province and eventually the national level in order to maximize the benefits of risk sharing and facilitate the development of labor markets. However, substantial regional variation in salary levels and in the inherited obligations and relative burden under the former system hinder expansion of pools.

While the reformed pension system embraces more workers, it is still largely limited to the urban labor force, which comprises just 27 percent of China's total labor force. The remaining 73 percent only have the option of contributing to the voluntary savings plan. Some regions are considering expanding coverage to the growing number of laborers employed in rural enterprises and to migrant laborers in urban areas that lack urban residency status (currently excluded from most urban pension pools).

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Workers per Retiree for Provinces of China: 1993