

# China's Social Security System —Present Status and Issues

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## 1. Introduction

Since China embarked on full-fledged reforms and market opening in 1978, the market economy has rapidly developed, while social security reforms have also been advanced. The government is pushing ahead with social security reforms as a key component of the economic reforms. There are two objectives in making social security reforms a key part of the reforms and market opening.

The first objective is to stabilize the national life. In recent years, the national life has become extremely unstable as unbalanced economic growth causes growing income disparities between coastal and inland areas. Under these conditions, as aging advanced, the social security system became an unbearable burden on companies, who were responsible for funding retirement pensions in entirety. In particular, financially troubled state-owned enterprises struggled to pay retirement benefits, and many actually stopped doing so. By forging ahead with social security reforms, the government seeks to alleviate anxieties regarding pensions and thereby stabilize the national life.

The government's second objective is to provide full support in reforming financially troubled state-owned enterprises. With state-owned enterprises crippled by social security expenses, social security reform is critical to reducing their burden and adjusting excess employment so that the reform of these enterprises can proceed smoothly.

In March 1998, the National People's Congress adopted the three major reforms for state-owned enterprises, the financial system, and government administration. Premier Zhu Ronji promised at that time to achieve the basics of the three reforms in three years. However, the reform (privatization) of state-owned enterprises has caused the demise of the lifetime employment system, creating large numbers of unemployed and laid-off persons.<sup>1</sup> Since the successful reform of state-owned enterprises rests on alleviating the

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<sup>1</sup> For information on unemployment and layoffs, see "China's Unemployment Problem and Prospects—Growth in Urban Poverty and the Prolonged High Unemployment Rate," *The Review of Comparative Social Security Research*, Spring 1999, no. 126, p. 124.

unemployment problem, observers both in China and abroad have focused on the new social security system as a solution to the unemployment problem.

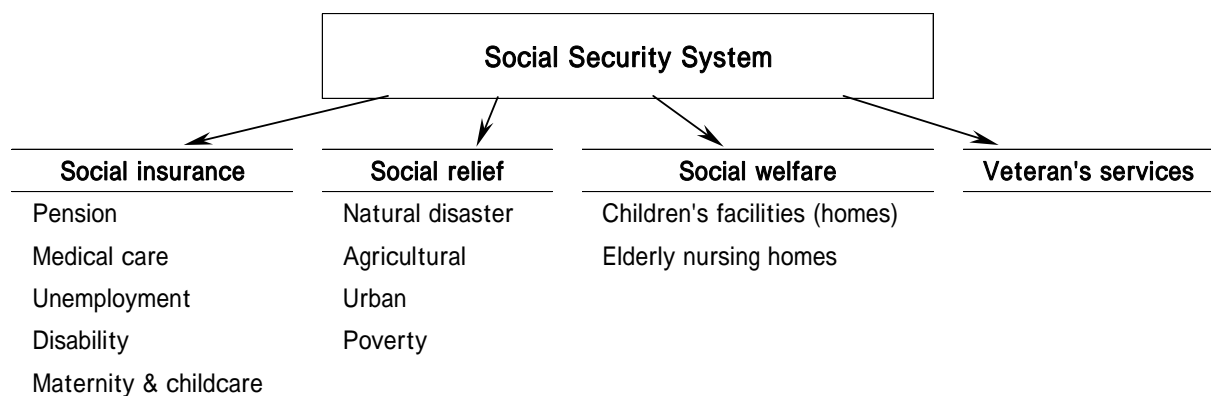
This paper first examines the development and present status of the social security system in China's urban areas, and then discusses pending issues for the future.

## 2. Reform of the Social Security System

China's social security system includes not only various types of social insurance, but also social relief and welfare for the disadvantaged, the disabled, and natural disaster victims.

The social security system was created by the labor insurance regulation of 1951, and consisted of pension insurance, medical insurance, mortality insurance, maternity and childcare insurance, natural disaster insurance, and family insurance. Initially, the system was funded solely by companies, and no contributions were made by staff and workers. Companies paid in premiums equivalent to 3% of total wages every month. Of this amount, 30% was allocated to the labor insurance general fund of the All-China Federation of Trade Unions. The remaining 70% went to the labor insurance fund of the labor union at the company, and was used to fund pensions, medical and disaster relief subsidies, funeral subsidies, and so forth. Fund shortages were financed by a higher level of the labor union (city or province level). In this way, the social security system had a uniform nationwide system of collecting premiums and paying out benefits.

**Figure 1 China's Social Security System**



Sources: Newspaper articles, government regulations

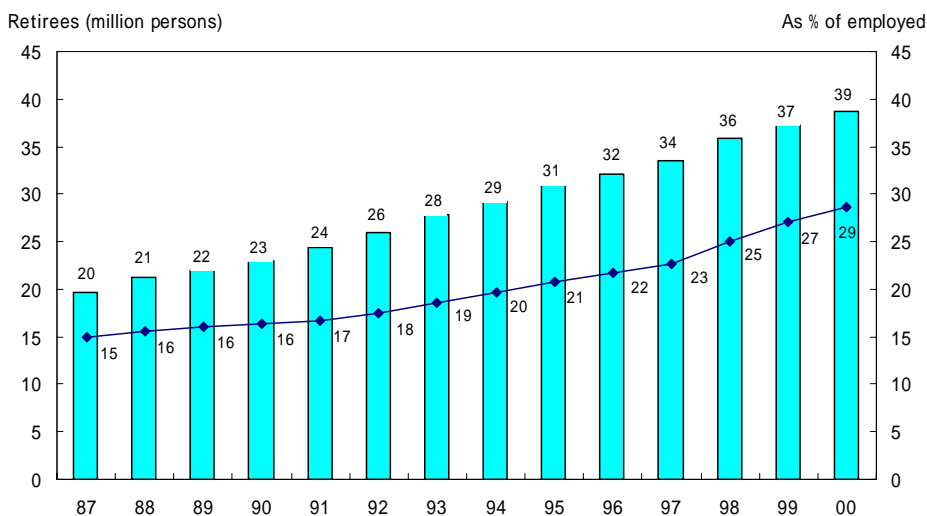
Social security coverage was not universal, but instead covered only qualified company staff

and workers, and public employees in urban areas. The agricultural population, which comprised over 70% of the total population, was excluded.

With the start of the Cultural Revolution in 1966, as the administrative capability of the Federation deteriorated, social security functions were relegated to state-owned enterprises, who no longer paid in premiums to the Federation, but rather managed the funds on their own. Under this new company-administered insurance arrangement, companies acquired the role of paying all pension and insurance benefits to recipients.

However, from the late 1970s, as the number of retirees increased sharply, the decaying state-owned enterprises became unable to finance their company-administered insurance obligations. Due to the large number of retirees, a ratio of one or two workers for every retiree was not uncommon at many companies. As a result, employees at some companies had to pay for all social security expenses of retirees, including pension and medical insurance benefits (Figure 2). For example, in Shanghai City, pension benefits (including medical insurance expenses) for retirees comprised 28.6% of total wages in 1984.

**Figure 2 Number of Retirees, and Ratio to Employed Persons**



Sources: *China Statistics Annual*; *China Labor Statistics Annual*.

In the late 1980s, many state-owned enterprises in basic industries posted persistent losses, while continuing to pay for all retirement pensions, as the number of retired persons increased, pension finances became increasingly constrained. Some state-owned enterprises failed to pay out wages to staff and workers, and at the same time also stopped making pension payments.

Medical insurance was in a similar situation. At some decaying state-owned enterprises, the

medical insurance system had become an empty shell. Citing financial difficulties, companies rejected claims from employees and retirees, and continued to disregard their obligation to pay out medical expenses under medical insurance.

Furthermore, in pursuing the reform of state-owned enterprises following the reforms and market opening of 1978, state-owned enterprises sought to improve efficiency by restructuring and reducing excess employment. For the successful reform of state-owned enterprises and maintenance of social stability, it was necessary to alleviate the anxieties of unemployed and laid-off persons by promoting re-employment and at the same time laying out the social security safety net of unemployment insurance, medical insurance, and pension insurance. However, as mentioned earlier, the former social security system became a major obstacle to the ongoing reform of state-owned enterprises. Thus there was no choice but to reform the old system and establish a new one.

The social security reform initiated in the 1990s introduced premium payments by individuals, and divided the responsibility of funding among three entities—companies, individuals, and the state. In addition, the reform seeks to eliminate local disparities by establishing a uniform system nationwide.

### **3. Characteristics of the Social Security System**

The social security reform initiated in 1992 aims to revert the company-administered insurance system into a social security system, thereby reducing the burden on companies and particularly state-owned enterprises. This reversion, however, does not represent a complete return to the social security system of the 1950s, but is rather a shift to a new kind of social security system. At present, the main components of the social security system—pension, medical, and unemployment insurance—are mostly in place, while disability insurance and maternity and childcare insurance are still in development.

The core part of the new system is called basic insurance. For basic pension insurance and basic medical insurance, minimum benefit levels have been established to guarantee minimum living standards for persons covered by social security.

The remainder of this paper examines basic insurance. Under the new system, pension and medical insurance are augmented with supplementary company insurance and individual insurance with a savings component.

The aim of reform is to establish the three-tiered structure of industrialized nations with

supplementary company insurance and individual insurance with a savings component, which correspond to Japan's company-sponsored insurance and individual insurance policy. A key feature of the social security system is that it is administered at the local government level (in addition, there is private insurance offered by private insurers).

However, these types of insurance are not widespread at present.

### **1. Introduction of Individual Premiums**

The transition from the company-administered insurance system to the new social security system entails the introduction of premium payments by individuals. During the era of company-administered insurance, funding was almost entirely the responsibility of companies. Under the new system, funding responsibilities are allocated among individuals, companies, and the state. Of greatest interest is the introduction of individual premiums. It is a fundamental characteristic of the new system, as well as a focus of the social security system reform.

### **2. Introduction of Individual Accounts**

A second characteristic of the social security system reform is the introduction of individual accounts for pension and medical insurance.

In the individual pension account, the individual and employer pay monthly premiums which are accumulated in the account and earn interest. Upon retirement, the individual receives a fixed monthly payment from the account.

A similar individual account exists for medical insurance. If medical expenses do not meet standards prescribed by the medical insurance system, they are paid out of the individual account. If the individual account has insufficient funds, the individual must pay out of pocket.

### **3. Introduction of Social Security Funds**

Smooth operation of the social security system requires the introduction of a social security fund scheme. Under this scheme, premiums that local governments collect from companies are pooled into the social security fund, and the funds are managed to ensure that pension and medical benefits can be paid to participants. By expanding the pooling function from the company level to the community level, funding burdens have become more equitable.

## **4. Outline of the Basic Insurance System**

### **1. Basic Pension Insurance for Retirement Income**

#### **(1) Funding for Basic Pension Insurance**

Funding for pension insurance is provided by the state, companies, and individuals as described below.

The state provides operating funds for labor and other administrative expenses of social security administration, as well as rescue funds in case of financial difficulty.

Corporate funding consists of pension insurance premiums paid on behalf of employees to the pension insurance fund. Under national regulations, this contribution must not exceed 20% of total wage expenses. Part of the corporate contribution is allocated to the individual accounts of employees.

The allocation to individual accounts, when combined with the individual's contribution, brings the total contribution to 11% of the individual's average wage. Assets in individual accounts earn a fixed deposit rate.

Individuals pay pension insurance premiums directly into their individual accounts. The premium rate stood at 4% of average wages in 1995, but from 1998 is being stepped up one percentage point every two years until it reaches 8%. The corporate portion decreases correspondingly by one percentage point until it reaches 3%.

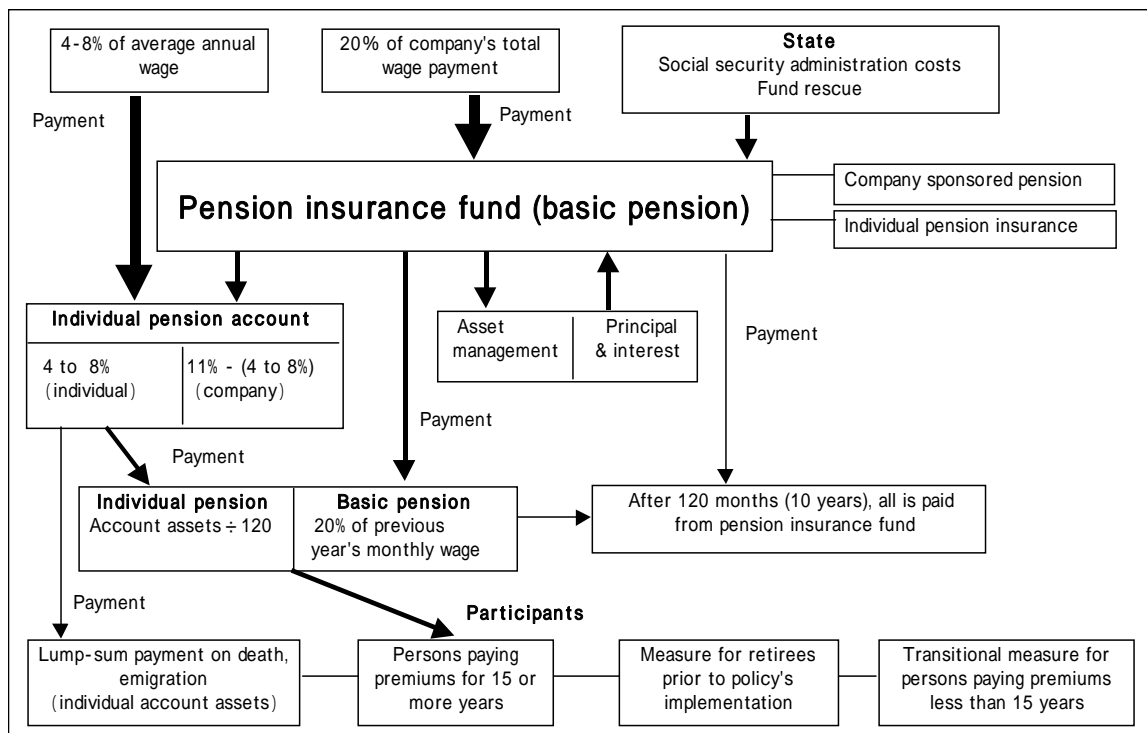
Despite the declining corporate contribution to individual accounts, companies will continue to contribute 20% of total wage expenses to the pension insurance fund.

#### **(2) Basic Pension Benefits**

Under national regulations, participants who have paid in premiums for at least 15 years are entitled to basic pension benefits upon retirement.<sup>2</sup>

Basic pension benefits consist of a basic pension component and individual account component. The basic component is paid out of the pension insurance fund, and is equivalent to 20% of the average local monthly wage in the previous year. The individual account component pays out account assets in equal installments over 120 months (10 years). Once the account is depleted, all benefits are paid out of the pension insurance fund.

**Figure 3 The Basic Pension Insurance Scheme**



Sources: Newspaper articles and administrative regulations

Since individual accounts are meant to ensure retirement income, early withdrawal prior to retirement is disallowed. If employees change jobs, the account and account assets are transferred to the new employer. However, in the event of death or emigration, not all of the remaining account assets are paid out; only that part contributed by the individual is paid out to inheritors or the individual respectively, even if the individual has already retired.

## 2. Basic Medical Insurance

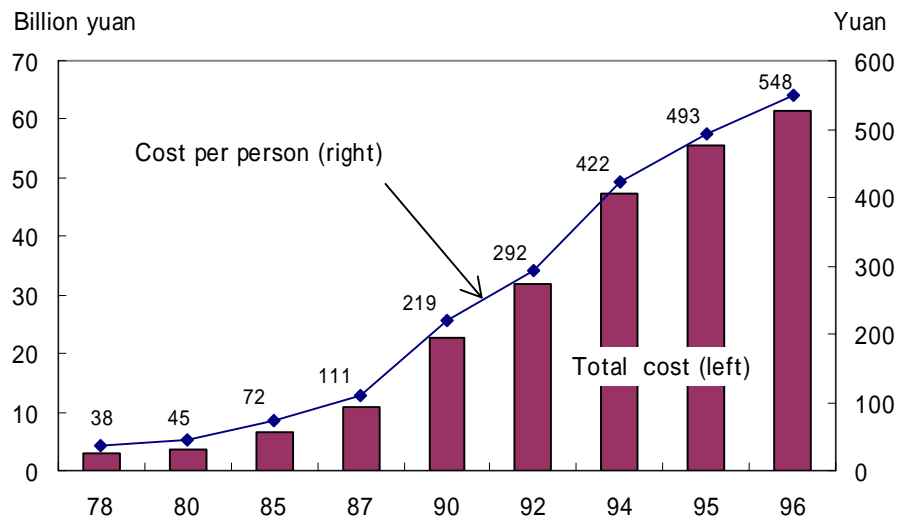
The former medical insurance system was comprised of a public medical system and labor insurance medical system, both of which offered free medical services to participants. However, after the economic reforms and market opening, state-owned enterprises accustomed to a planned economy fell into distress, and many could no longer afford to pay medical expenses.

In addition, the former medical insurance system was subject to rampant misuse. To expand profits, medical facilities provided expensive medicines, unrelated nutritional supplements, unnecessary examinations, and extended hospitalizations. Since medical treatment was free,

<sup>2</sup> Different rules apply to participants with less than 15 years of premium payments.

patients themselves often asked for such excessive treatment.

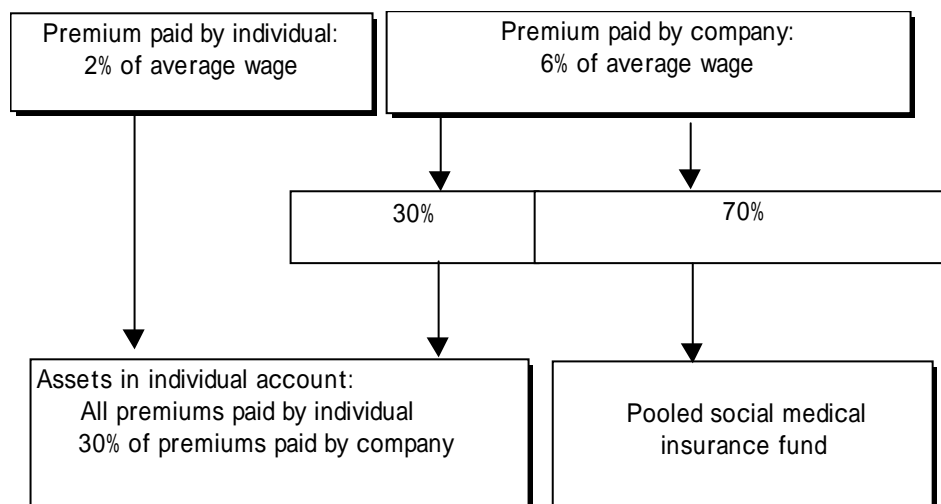
**Figure 4 Medical Expenses of State-Owned Enterprises**



Source: *China Social Security*, October 1998.

Thus from the 1990s, the medical insurance system underwent fundamental reform. A national uniform medical insurance system was promulgated in 1998, at which point a new system was finally developed. Medical insurance premiums are described in Figure 5.

**Figure 5 The Basic Medical Insurance System**



Sources: Newspaper articles and administrative regulations

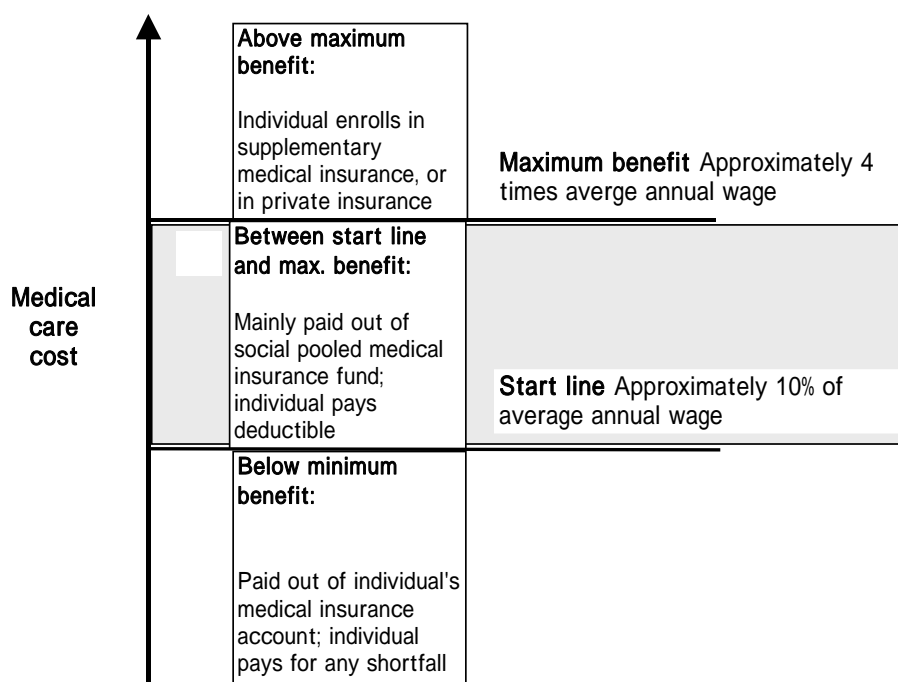
As with pension insurance, medical insurance premiums are paid by both individuals and companies. For individuals, the premium rate is 2% of their average wage (including bonuses), and premiums are contributed to their individual medical insurance accounts.

Companies contribute 6% of the total average wage expense as medical insurance premiums. Of this amount, 70% is allocated to the medical insurance fund, and the other 30% to individual medical insurance accounts.

Medical insurance benefits are determined by comparing actual medical expenses against a schedule of benefits. Benefits start when medical expenses reach the provision start line of approximately 10% of local average annual wages, and peak out when medical expenses exceed the ceiling of approximately four times the average annual wage. Specific benefit levels are determined by the local government.

1. For medical expenses below the start line, no benefits are paid out of the medical insurance fund. Expenses are paid from the individual account or out of pocket.
2. For medical expenses between the start line and maximum, benefits are paid out of the medical insurance fund, but the individual must also pay a deductible.
3. For medical expenses above the maximum, the individual must pay the full amount. Alternatively, the individual can enroll in supplementary company insurance, individual insurance with a savings component, or other private insurance. If the employer is in good condition, the company may also voluntarily offer assistance.

**Figure 6 Medical Insurance Benefits**



Sources: Newspaper articles and administrative regulations

As with pension insurance, the pooled medical insurance fund and individual accounts

represent a fundamental reform from the previous system.

### **3. Unemployment Insurance and Relief for Layoffs**

#### (1) Unemployment Insurance

The reform of state-owned enterprises has generated a sharp increase in unemployment and layoffs. In China, since laid-off persons are seldom called back to work, they must find new jobs as well.

Prior to the reforms, China's labor system was modeled on the former Soviet model, and since job separations were rare, unemployment was not a major social problem. Thus unemployment insurance was also unnecessary.

However, after the labor system reform of state-owned enterprises began in 1978, unemployment surfaced due to collapse of the lifetime employment system, introduction of free occupational choice, and failure of companies. From the late 1980s to 1990s, the number of unemployed and laid-off persons gradually increased.

To promote social stability, the central government required state-owned enterprises to provide relief to laid-off persons, and pressed ahead with the development of an unemployment insurance system. In 1999, the State Council (China's cabinet) enacted unemployment insurance regulations, and local governments complied by providing social relief to unemployed persons, thus formally establishing the unemployment insurance system.

Under the unemployment insurance system, companies must contribute 2% of total wage expenses, and individuals 1% of their average wage.

Unemployment benefits are determined by local governments, and fall somewhere above subsistence but below local minimum wages. The benefit eligibility period is based on length of participation prior to becoming unemployed.

The reform principles of social security system—expanded coverage, and low guaranteed benefits—are reflected in unemployment insurance. Coverage has been expanded from employees of some state-owned enterprises to other workers in urban areas, and benefits have been kept somewhere between minimum local wages and the subsistence level. Given the small size of the unemployment insurance fund and massive number of unemployed

persons, this is the most effective approach.

**Figure 7 Unemployment Benefits**

Years of premium payment	Maximum duration of benefits
1 to 4 years	12 months
5 to 9 years	18 months
10 or more years	24 months

Sources: Newspaper articles and administrative regulations

## (2) Layoff Relief

In 1998, to ensure basic livelihood and promote the re-employment of laid-off persons, the State Council ordered local governments to create re-employment service centers. The Ministry of Finance, Ministry of Education, National Bureau of Statistics, and the All China Federation of Trade Unions complied by issuing detailed regulations to create the centers.

The centers are temporary administrative departments created by each industry. If an industry does not create a center, a center is created within companies.

### *1. Roles of Center*

- To train and develop persons for re-employment
- To assist in finding re-employment
- To pay living allowance to laid-off persons
- To collect social security premiums from laid-off persons

### *2. Joining and Leaving the Center*

Although laid-off persons must stay at home, they are still employees of the company as long as the labor contract remains in force. Thus they must follow their company's instructions and enroll at the center. If they refuse to do so, under the regulations of the State Council, the company can cancel the labor contract.

The enrollment procedure requires that individuals sign a contract with the center called the "Basic Livelihood Assurance and Re-employment Agreement." This consists of two parts. First, the employment provisions in the present labor contract are replaced by the center,

who assumes the responsibilities of the company. This consists of paying basic living allowances to the individual, and shouldering social security premiums that the individual is supposed to pay while employed. Second, the individual must accept the center's training and engage in job searching. When a new job is found, the agreement is automatically canceled. The duration of the contract is less than three years in principle.

Acceptance of the center's contract is mandatory for enrollment. Under the State Council's regulations, if the individual refuses, the employment contract with the company will be canceled.

Upon enrollment, a "layoff certificate" is issued, enabling the individual to receive a basic living allowance and other welfare measures.

**Figure 8 Enrollment Rate at Job Placement Centers (end of 1998)**

	Laid-off persons (A)	Participants (B)	Enrollment rate (B/A)	1997 enrollment rate
Beijing	67,487	67,487	100.0%	39.6%
Shanghai	162,926	162,926	100.0%	62.0%
Tianjin	80,491	80,491	100.0%	0.0%
Chongqing	123,800	110,800	89.5%	6.6%
Heilongjian	830,800	528,000	63.6%	9.8%
Liaoning	1,035,147	527,000	50.9%	15.5%
Jiangsu	411,554	411,554	100.0%	12.7%
Sichuang	435,451	352,121	80.9%	7.9%
Henan	417,120	259,495	62.2%	4.5%
China total	8,769,314	6,827,000	77.9%	11.1%

Sources: China Statistics Press, *China Labour Statistical Yearbook*, 1998 and 1999.

### *3. Funding of Re-Employment Centers*

Operating funds for the centers are provided by the state, society, and companies. The state provides one-third of the total funds to local government finances. Local administrative agencies fund another one-third from independently procured funds. While local disparities exist, part of these funds are procured from the unemployment insurance fund, and part from local public finances. In the case of Shanghai City, the social security and labor administration bureau draws from the administrative expenses of migrant workers. Companies provide the remainder.

#### *4. Status of Job Placement Centers*

Although enrollment rates were not very high in 1997, according to fiscal 1998 data, enrollment in coastal areas was almost 100%, but still low in inland areas. These results do not coincide with the government's expectations.<sup>3</sup>

### **5. Issues Confronting the Social Security System**

#### **1. Fiscal Crisis of the Social Security Fund**

With the rapid advance of aging, the pension insurance system must confront the sharp growth in number of retired persons. Given its limited resources, the pension insurance fund faces a difficult situation, with little prospect for improvement.

The medical insurance system, still in the process of reform, is already ailing, and may lapse into financial distress unless rampant abuses are checked.

The unemployment insurance fund also faces a grim financial outlook. The reform of state-owned enterprises is exacerbating urban unemployment (including layoffs). Unemployment stood at 19.34 million in 1998,<sup>4</sup> and is predicted to exceed 23.94 million in 1999. By 2020, the total of urban unemployment and excess rural employment is predicted to reach 300 million.<sup>5</sup>

Due to the above factors and difficulties in collecting social security premiums, the financial condition of the social security fund has started to deteriorate. As local social security funds confront the risk of failure, the system has entered a precarious phase.

#### **2. Difficulty of Premium Collection**

Difficulty in collecting social security premiums is a major obstacle to social security reform. More companies either neglect or fall behind in paying their share of social security premiums, which affects not only the collection of pension insurance premiums (old-age insurance in China) but the social security fund and medical insurance premiums. In addition, they often delay the payment of medical insurance benefits to staff and workers for extended periods.

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<sup>3</sup> See note 1, page 130.

<sup>4</sup> State Development Planning Commission, as cited in "Unemployment Next Year to Reach 23 Million," (in Chinese) *Hong Kong Economic Times*, November 25, 1998.

<sup>5</sup> See note 1, p. 130.

In August 1999, Japan's National Institute of Population and Social Security Research conducted a survey of social security systems at 100 present or former state-owned enterprises (consisting of an equal number of large, medium and small enterprises) in the coastal province of Jiangsu and inland province of Sichuan.<sup>6</sup> According to the results, 49 state-owned enterprises report having failed at some time to pay social security premiums or to disburse pension or medical benefits to recipients, with the unpaid amount totaling 64.82 million yuan (approximately 970 million yen).<sup>7</sup> This amount is equivalent to 48.0% of the total annual premiums owed by the 49 companies, and 18.7% of the amount owed by all 100 companies. Only three companies report having paid all premiums and benefits, and the remaining 48 companies who did not respond are assumed to be largely delinquent. By type of social security, 62.2% of the unpaid premiums and benefits pertain to pensions, 8.0% to medical insurance, and 7.1% to unemployment insurance premiums.

The survey reveals that despite social security reforms implemented over the past few years, almost all state-owned and privatized enterprises for various reasons remain delinquent in paying part of their social security premiums and benefits. This obviously hinders the operation of social security funds. Below we examine five reasons companies do not meet their social security obligations.

#### (1) Undeveloped Legal System

Since laws regulating social security still do not exist, the social security system is regulated by administrative ordinances and notifications issued by the State Council and administrative agencies. As a result, legal enforcement measures for premium collection are weak and ineffective.

To correct this problem, local governments established their own ordinances and provisional regulations for social security premium collection, and called on companies in their jurisdiction to pay premiums as required. However, the results have not been encouraging.<sup>8</sup> Some companies are unable to pay premiums due to their poor financial. However, the problem is that even successful companies who can afford to build modern office buildings and procure a fleet of expensive cars are refusing to pay premiums. Bill collectors from social security administration agencies cannot even get past the receptionist at these companies.

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<sup>6</sup> The survey sample consisted of 60 state-owned enterprises, 23 privatized companies, 2 Sino-foreign equity joint venture or cooperative venture companies, and 15 other companies.

<sup>7</sup> Unlike Japan, where pension and medical benefits are paid directly to recipients, China's social security system pays benefits to companies, who then pay recipients.

<sup>8</sup> See Li Pei Fu, "Che hao shan lu nan chi pin," *China Social Security*, 1999.

This problem relates to the lack of a social security law. Under the Labor Law, companies and individuals are required to pay social security premiums, and should perform their obligation completely. While the law requires staff and workers to pay social security premiums and also stipulates their right to receive benefits, this right is not legally guaranteed. If companies fail to pay social security premiums or disburse benefits, the local social security administration has no legal basis for imposing penalties.<sup>9</sup>

Since companies receive the same treatment regardless of whether they pay premiums, and companies that do not pay premiums are not disciplined, the present legal system actually encourages the tendency to not pay premiums.

With no explicit legal provisions to enforce the payment of premiums, enforcement is very weak because the administrative regulations and notifications that now exist amount to little more than administrative guidance. In addition, there are no provisions regarding administrative discipline for late payment or nonpayment of social security premiums. Thus the enactment of laws pertaining to social security is an urgent priority.

## (2) Poor Business Condition of Companies

Poor business condition and loss-making management are the primary reason for late or nonpayment of social security premiums.

Following the implementation of the reforms and market opening, some state-owned enterprises were privatized, while others remained state-owned. The problem with security reform lies with the latter group. In retaining their state-owned production and management methods, they fell behind the rapidly changing market economy and are in dismal condition: they have unsellable products, lack working capital, are entwined in nonperforming debt called “third-party loans” (*san jiao zhai*), carry massive debt, have no bank credit, cannot pay wages or pension benefits, and are delinquent in paying social security premiums.

For example, in 1997, 172 companies in Dongtai, Jiangsu province failed to pay a total of 37.0575 million yuan (approximately 550 million yen) in social security premiums. In Zhuzhou, Hunan province, the collection rate for social security premiums stood at 88.0% in fiscal 1997, and fell to 78.2% in fiscal 1998.<sup>10</sup> According to China’s official statistics, the

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<sup>9</sup> Peng Shu Sheng stresses the urgent need to enact a social security law in “Company Reform and the Problem of Social Security Liabilities,” (in Chinese) in *Shanghai lao dong bao zhang*, May 1998.

<sup>10</sup> See Zhou Guangyao, “Qian nan wan nan bao shou jiao,” in *China Social Security*, May 1999.

collection rate in fiscal 1997 and 1998 averaged around 80%. Moreover, in Hainan province, from January to April 2000, 2,760 companies failed to pay a total of 294.42 million yuan (approximately 4.6 billion yen) in social security premiums.<sup>11</sup> As these statistics show, late or nonpayment of social security premiums is a very serious problem.<sup>12</sup>

### (3) Deficiencies in Social Security Administration

Three major problems plague the administrative organization of social security. First, administrative systems for social security are in disarray. As is typical in China, administrative systems vary significantly by area because they are tailored to local circumstances. Even the names of administrative organizations differ—the social security bureau might be a center, commission, or office. In addition, a variety of affiliated agencies may be involved, including the labor bureau, personnel bureau, welfare bureau, or health bureau.<sup>13</sup>

For example, in Yunan province, pension insurance, disability insurance, and maternity and childcare insurance are managed by the social security bureau, while unemployment insurance is managed by the employment bureau, and medical insurance by the medical insurance center. In Shanghai, pension insurance, unemployment insurance, disability insurance, and maternity and childcare insurance are managed by the labor and social security administration bureau, while medical insurance is managed by the medical insurance administration bureau.

Under these conditions, administrative disarray is inevitable. For example, if staff or workers should move to another area, it is doubtful whether appropriate administrative measures would be taken due to the lack of uniformity.

Second, the administrative structure consists of multiple layers. In Shanghai, for instance, besides the local insurance administration that actually carries out operations, there are three to four layers of upper management including the Shanghai People's Government, Shanghai Social Security Commission, Shanghai Insurance Administration and Labor Bureau, Medical Health Bureau and Shanghai Social Security Administration Center.

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<sup>11</sup> Let us put this in perspective using the latest available data from fiscal 1996 and 1998. Since Hainan province had 19,888 companies in 1998, the 2,760 delinquent companies represent approximately 13.9% of the total. Using fiscal 1996 data for social security premiums due of 980.6 million yuan, unpaid premiums in the first quarter of fiscal 2000 comprise 32% of the total. (*China Statistical Yearbook 1999*, and *China Social Security Yearbook 1997*)

<sup>12</sup> See *Shenzhen Special Zone Daily*, May 31, 2000.

<sup>13</sup> The social security bureau is an administrative unit of the government. The social security center is not a government agency, but rather a public corporation or foundation. The commission and office are both

The more administrative layers that exist, the lower the system's operating efficiency, and the larger the ratio of administrative expenses. If left alone, there is genuine concern that the inefficiencies of the present system will overburden the companies and individuals who must pay premiums.<sup>14</sup>

Third, there are too few staff personnel at the working level. As with other government agencies, organizations are top heavy, with too many managers and too few staffers. Moreover, compared to management, the staffers are significantly less educated and experienced. To sum up the situation, there are too many new graduates and older persons, and too few specialists and front line staff.

#### (4) Inefficient Premium Collection Method

The social security administration currently relies on banks to collect premiums from companies. This arrangement has the following flaws.

First, banks have no legal enforcement measures in collecting premiums. Thus if a company can simply refuse to pay, the bank has no recourse.

Second, some social security administrations use a method of collecting the difference between premiums owed and benefits due (*chae nafu*). If a company owes more in premiums than it expects to receive in benefits, it is likely to delay or evade premium payment. To see why, consider the arrangements for premium and benefit payments (Figure 9). The company regularly pays the required premiums to the social security administration. Every month, the social security administration allocates funds to the company, which the company disburses as pension and medical insurance benefits.

Collecting the difference means, for instance, that if a company owes more in annual premiums than it receives from the social security administration as benefit allocation, it need only pay the excess premium rather than the full amount. On the other hand, if the difference is negative, no premium payment is required, and the company simply receives the difference in benefits.

The problem is that if companies owe more in premiums than they will receive in benefits, they will seldom volunteer to pay the difference. Of course, if benefits exceed premiums, companies are unlikely to be delinquent.

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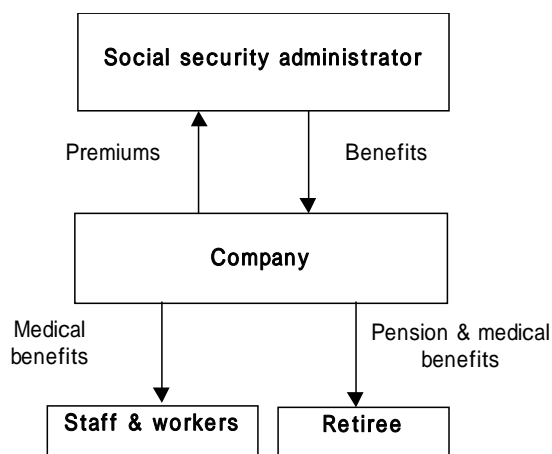
units of the government, with the commission being higher in stature.

<sup>14</sup> See Sa Ginka, "On the Reform of China's Social Security System," (in Japanese) in *Chosa Geppo*, NLI Research Institute, November 1995, p. 21-22.

To resolve these problems, in the second half of 1999, Shanghai took measures to enforce the collection of social security premiums, and set up a single office for direct payment (*she hui fa fang*) of pension and other social security benefits to recipients instead of through companies. Beijing implemented similar measures on June 1, 2000.

However, smaller cities and towns have difficulty adopting these measures, and thus confront the likelihood of encountering delinquent payment problems and operating losses when they set up a social security fund. As long as such funding uncertainties exist, prospects for setting up a fund are dim. This problem is likely to persist.

**Figure 9 Flow of Premiums and Benefits**



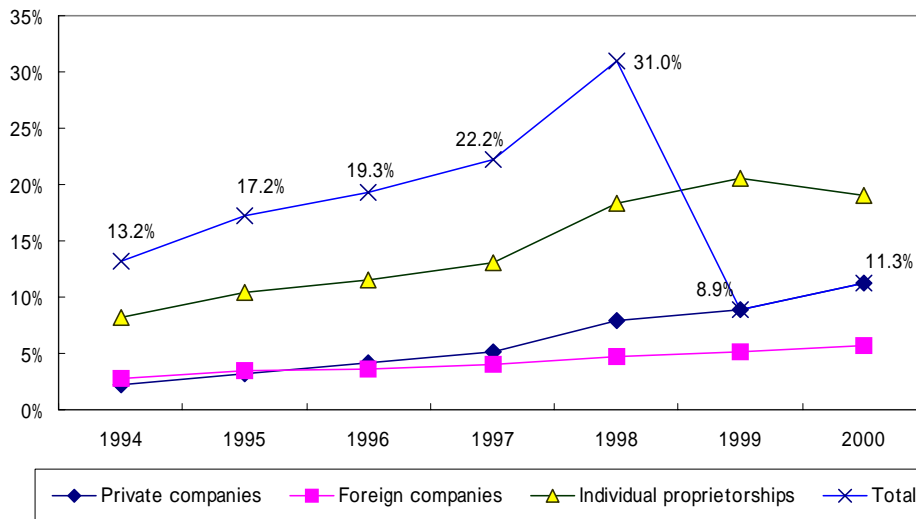
Source: Newspaper articles and administrative ordinances

### 3. Social Security Participation Rate

#### (1) Participation Rate is Low Outside of State Enterprises

In recent years, the number of employees and workers at private companies, individual proprietors, and foreign companies has increased sharply, comprising approximately 31% of the total in 1998 (Figure 10). However, compared to state-owned enterprises and collective enterprises, the social security participation rate is extremely low. Below we examine the situation at private companies and foreign companies.

**Figure 10 Employment Ratio of Private & Foreign Companies, and Proprietorships**



Note: Foreign companies include those from Taiwan, Hong Kong, and Macao.  
Source: *China Labor Yearbook*.

### 1. Private Companies

Across the country, private companies are preventing their staff and workers from participating in social security. This is a very serious problem. Below we examine the regions in which the situation is most serious.

In Ningxiahui autonomous region, located far inland, economic development lags behind the coastal region. Private companies are slow to participate in social security compared to other areas. With regard to individual proprietorships, the latest available statistics (March 2000) indicate that there are 45,548 individual proprietorships with 79,967 employees, but only 745 persons participating in pension insurance—a participation rate of only 0.93%—and practically no participants in medical insurance. As for private companies, 4,180 private companies and 52,835 employees are registered at the State Administration for Industry and Commerce (the equivalent of the legal affairs bureau in Japan), but only 1,176 persons participate in old-age pension insurance. The number of participants in medical insurance is also practically zero.<sup>15</sup>

Conditions are also grim in Anhui province, located in central China. As of March 2000, out of two million person eligible persons for basic medical insurance, only 360,000 are participants, for a 24% participation rate.

This can be explained by four factors. First, due to intense competition in the labor market,

<sup>15</sup> See “Social Security Participation Rates of Individual Proprietors and Private Companies are Very Low,” (in Chinese) *Ninxia Daily*, May 29, 2000.

staff and workers have little clout in requesting social security benefits from employers. Many temporary employees at private companies are migrants from agricultural villages. Due to the instability of business conditions at private companies, employee turnover is high. And since supply greatly exceeds demand in the labor market for temporary staff and workers, those fortunate enough to be hired seldom dare to negotiate their social security participation with employers. Stated differently, employees know when they are hired not to expect any social security coverage.

Second, in most private companies, since labor unions or staff and workers' congresses do not exist, employees seldom have the opportunity to negotiate with employers.

Third, some private companies have practically no work regulations, and do not offer labor contracts. As a result, employees have no legal means of protecting their rights. In 1989, the Ministry of Labor and Social Security issued provisional regulations for labor management at private companies. The regulations stipulated that if employees become ill or incur injuries off the job, the private company must provide a paid recuperation period of three to six months depending on length of service, with the wage being at least 60% of the employee's regular wage. However, no provisions were made regarding pension and medical insurance for employees of private companies.

Fourth, private companies refrain from participating in social security to contain costs.

In light of these conditions, the lack of participation in social security by private companies deserves special attention. Unless compulsory measures are established, little improvement can be expected.

## *2. Foreign Companies*

The status of social security participation among foreign companies is better than at domestic private companies. In particular, participation rates at Japanese, U.S. and European companies are higher than at companies from Taiwan, Hong Kong and Macao.

In August 1999, Japan's National Institute for Population and Social Security Research conducted a survey of 200 Japanese companies with a presence in China, receiving 159 valid responses. In the survey, only four companies admitted to being delinquent in paying social security premiums.

According to the results, while there appears to be full participation in pension insurance, the situation with medical insurance is different—134 companies are participating, for a

participation rate of 84%.

With regard to why companies participate in social security, 127 companies responded. The top two reasons are: to comply with a government request (114 companies), and to alleviate uncertainty among employees (55 companies, multiple response).

In the survey, 12 companies cited the second reason of alleviating employees' uncertainty, while 31 companies cited both responses. The overwhelming majority, however, cited only the first response. These companies complied with the government's administrative order to participate in medical insurance. This, no doubt, is the main reason Japanese companies participate in social security.

However, even with the government's forceful request, 16% of Japanese companies still refuse to participate in medical insurance. It will be interesting to see how this situation develops in the future.

## (2) Special Groups not Covered by Social Security

### *1. Medical Insurance for Temporary Staff and Workers*

Following the reforms and market opening, there has been a sharp increase in temporary staff and workers in urban areas. These people are migrant workers, or surplus labor spilling out of agricultural villages. Major metropolitan areas on the coast have several million such persons on average, while smaller cities and towns average several tens of thousands of people. The jobs available to migrant workers are characterized by severe working conditions—for example, construction sites, municipal construction projects, ports, steel factories, processing plants, and production lines in heavy industry. One company employs 87 regular employees and 132 temporary employees. In a more extreme case, a construction firm fired all regular employees and replaced them with temporary workers. In recent years, jobs for women have been growing to include janitorial work and unskilled patient care at hospitals, housekeeping, and production line work in hi-tech industries.

Because of these conditions, the problem of social security participation among temporary employees is receiving greater attention from society. In the survey of Japanese companies cited above, 44 out of 159 companies (27.7%) make their temporary employees participate in medical insurance. The employment status of these companies is shown in Figure 11.

**Figure 11 Medical Insurance Participation Rate (Japanese Companies in China)**

Company	Regular staff & workers (A)	Temporary staff & workers (B)	(B/A)	Medical insurance participants (C)	(C/B)
A	150	130	86.7%	0	0%
B	245	229	93.5%	229	100%
C	153	278	181.7%	0	0%
D	191	449	235.1%	0	0%
E	795	608	76.5%	0	0%
F	120	878	731.7%	0	0%
G	1,927	1,131	58.7%	1,131	100%
H	1,000	1,500	150.0%	0	0%
I	2,659	1,562	58.7%	0	0%

Source: National Institute of Population and Social Security Research, *Survey of Japanese Companies*.

Why do companies that perform labor intensive operations prefer to use temporary staff and workers? While ease of hiring and firing is one reason, the main reason is the significant cost savings. Below we analyze two facets of these cost savings.

First, companies that hire temporary staff and workers seldom use labor contracts, while labor regulations have no provisions regarding employment problems of temporary staff and workers. Thus as long as employers pay above minimum wages, they can hire temporary staff and workers for substantially less than regular employees.

Second, since temporary staff and workers have their family registries in rural areas, they are not eligible for the company-oriented social security system in urban areas. Thus employers do not need to pay social security premiums.

It is an important social problem that despite their large contribution to urban construction, temporary staff and workers have no social security coverage should they become ill and unable to afford proper medical care. Authorities are at a loss as to how to provide relief.

In light of their reliance on temporary staff and workers, cities have no choice but to find ways to provide some form of social security coverage.

## *2. Medical Insurance for Unemployed and Laid-Off Persons*

As China underwent full-fledged economic reforms in the 1990s, the collapse of the bubble economy caused economic conditions to deteriorate. The lifetime employment system at

state-owned enterprises became unsustainable, generating massive unemployment and layoffs. For these unemployed and laid-off persons, a key concern has been whether they can continue to receive medical insurance coverage.<sup>16</sup>

The greatest concern among unemployed and laid-off persons is that job severance can result in the loss of pension and medical insurance coverage. This happens because some companies stop paying premiums for these persons, thereby voiding the insurance coverage. Moreover, companies often refuse to pay former employees medical benefits to which they are entitled. Thus in many cases, people who are severed from the workplace lose all social security coverage.

Under these circumstances, at least three problems arise regarding medical insurance coverage for unemployed and laid-off persons. First, without medical insurance coverage during the unemployment or layoff period, if the person becomes ill, no other relief measures may be available. Second, if the person is re-employed at a private company or other non-state enterprise, the new employer may not continue the medical insurance coverage from the former employer. Third, if the person decides to become an individual proprietor, they may not be eligible for medical insurance coverage.

In the case of Shanghai, these problems are addressed with the following three measures. First, job placement centers (affiliated with the government's labor and social security bureau) distribute a special medical insurance certificate to unemployed and laid-off persons, which is valid only during the period of unemployment, and carries the same coverage as ordinary medical insurance. In addition, premiums are waived.

Second, if these persons are re-employed at a private company or other non-state enterprise, the new employer is required to enroll them in medical insurance. Employers are supervised by the government's medical insurance administrative agency.

Third, if these persons become individual proprietors, they can enroll in medical insurance in the same way as staff and workers at ordinary companies. In this case, the government's labor and social security administration bureau administers medical insurance, and collects individual premiums on behalf of the medical insurance administration.

However, such measures to provide medical insurance for unemployed and laid-off workers have been implemented in only a few cities, and are tentative rather than fundamental

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<sup>16</sup> Regarding the problems of unemployed and laid-off persons, see Sa Ginka, "China's Unemployment Problem and Prospects—The Growth of Urban Poverty and Persistence of High Unemployment Rates," (in Japanese) *The Review of Comparative Social Security Research*, no. 126, April 1, 1999.

reforms. For a fundamental solution, a national health insurance system with universal participation needs to be established similar to the system in Japan. In addition, in many areas, no action has been taken. Further developments will be followed with keen interest.

## 6. Conclusion

China's social security system is now in the process of reform. Meanwhile, the aging of society is creating new pressures on society over the long term.

In the 21<sup>st</sup> century, as China's population continues to grow, aging is predicted to impose a substantial burden on the labor force.<sup>17</sup> By the middle of the century, the total population is predicted to reach 1.5 billion, while the elderly population will exceed 300 million and the labor force will easily top one billion. Due to the one-child policy, aging and the decline in birthrate are advancing most rapidly in urban areas. As a result, the number of retirees will continue to rise (excluding elderly in agricultural areas), eventually resulting in a two-to-one ratio of working to retired persons in urban areas.<sup>18</sup>

To ensure a stable life for the 300 million elderly persons, action must be taken now to ensure pension and medical insurance benefits without overburdening younger generations. As for the labor force of one billion persons, measures need to be implemented to provide unemployment benefits and social relief to the extent possible for unemployed and laid-off persons. Unless necessary measures are taken, China will struggle merely to survive, much less develop in the 21<sup>st</sup> century. The response to these difficult problems will be followed with keen interest.

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<sup>17</sup> See Hu An Gang and Wang Yi, *Survival and Development*, (in Japanese) edited by the Center for China Studies, Science Publisher, October 1989, p. 20.

<sup>18</sup> See the Development Research Center of the State Council of the People's Republic of China, ed., "Forecast of Old-Age Insurance Costs for Nationwide Urban Staff and Workers," 1995.