

A Study on China's Social Safety Institution and Income Disparity

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Abstract

Almost twenty years ago, the Chinese government recognized the importance of changing the economic development model and industrial structure, and its achievement of extraordinarily rapid economic development during the past three decades has been described as a miracle generally sustained by officials' fixed-asset investments, the state-owned sector, and exports.

China wants to shift the driving force from investment and exports to domestic private consumption, but private consumption is still too weak, despite the government's numerous announcements to realize the shift. Domestic demand has not played the expected role of driving economic growth instead of fixed-asset investment and exports.

Generally the weakness of the social safety net including pensions, health care, unemployment benefits, worker's compensation, and maternity leave has been the main factor inhibiting private sector consumption because of concerns about the future.

Traditionally, state-owned enterprises played the important role of supplying social security service under the socialist central planning era till the open door policy in 1978. Since then the government has liberalized economic control, and it is considered necessary to build a modern social security system like that in developed countries. In addition, consensus has developed that the state-owned sector cannot be expected to supply the social security service while strengthening the competitiveness in the market.

The traditional model is not sustainable. From 1998 the government started to reform state-owned enterprises, with the goal of strengthening their efficiency. The government separated and removed the function of the social safety system from the state-owned enterprises to a new platform (Social security fund) that it established. There was a slogan about the state owned reform: "Seizing the large and letting go of the small" (*Zhua Da Fang Xiao*).

Since that time the government has put in much effort to strengthen the social security function, but the capacity of the function is still very weak. One of the problems is that the system is very unfair; it is a system good for officials, but bad for workers and farmers. Basically it is not an integrated comprehensive pool. In particular, farmers are clearly discriminated against in the system. This leads to the conclusion that the weak social safety functions are the factors that led to reduced private consumption. The problem here is how to reform and build a functioning social security system to stabilize society and sustain economic development.

Keywords: Chinese economy, economic reform, economic policy, emerging economy, social security systems, income inequality

JEL Classification: G

I. Preface

In the socialist era, state-owned enterprises and collectively-owned enterprises supplied the social security services to the employees. The enterprises were called “working units” in China by the employees. Among the working units, state-owned enterprises, especially big firms, supplied much better social security service than the others. Of course, the large companies had sufficient budgets to allocate to hospitals, schools, apartments, etc. So they could supply better service than small firms. In that era, the best choice for a person was to enter a big state-owned enterprise, meaning that his or her life would be protected by the working unit. On the other hand, most of the farmers in rural areas were not protected by any social security services, not even basic medical care service. In China, farmers could only keep a small part of the harvest for themselves. They had little cash income. If they went to hospital, they would have had to pay the full fee themselves, which was too difficult for them. Of course, there was no pension system for the farmers either. In China the land itself was the pension,¹ and farmers could only rely on the land to support their lives. The right to use land played an important role in substantially supporting the farmers’ lives, but it was clearly not enough. As a result, most farmers strongly desired to move to an urban area, but they were forbidden to do so by the “*Hukou*” system (the registration system for residents). The farmers could not move their *Hukou* from the countryside to an urban area. Such kind of residential registration system was established in 1958. It is an unequal system and clearly reduced the justice of society. The system practically turned farmers into slaves in China.

Since 1978, the government enforced the open-market policy, reformed the economic system, and liberalized economic control to strengthen economic efficiency. It was necessary to remove the social security function from the working units to a new platform. The movement was part of the reform of the state-owned sector. Meanwhile, the government functions were separated from enterprise management. Since then, the state owned enterprises have still been controlled by the government, although the government announced many times that all government sessions must stop interfering with the management of state owned enterprises. The state-owned enterprises have now gained more freedom to manage themselves independently, and they operate freely. The government established a social security fund, and shifted the function to a new platform gradually. At the same time, in the rural area a basic pension system for the farmers has been established.

Regarding the reasons to establish a new social security system, there are two important points. The first point is to establish a new social protective system in order to strengthen

¹ In China farmers cannot own land; they only can use it.

private consumption. A well-managed social security system could help to strengthen private consumption. As mentioned above, the Chinese economic development model is characterized by an economy driven by fixed-asset investment and exports. However, such kind of economic development model is unsustainable and instable. To ensure economic development China needs to do make efforts to strengthen private consumption, so it is necessary to establish a well-managed social security system to protect the people's lives in retirement.

The second important point is to stabilize society, but clearly stability cannot be realized without a well-managed social security system, and countries like China need to establish well-managed social security systems. About twenty years ago, the government decided to build a public social security system, but it has not been built yet. Everybody is aware of the need for such a system, but the problem is how to establish a new platform for the ineffective system. To stabilize society China needs to strengthen the capacity of the protection and ensure that it embodies justice.

In traditional Chinese society, the most families were large and included three or four generations. The family members cared for each other; as there were many family members they only needed to depend on the public system to only a small extent, and in fact, there was not any public social protective system, traditionally. The family and the communities played the important role of protecting the people's lives. Most Chinese people didn't have any clear idea about social security systems. Even fewer people actually expected that a social security system could help them when they got old. Under the Mao Zedong era, the people expected that the government or the working unit they belonged to would care for them in retirement. This is the philosophy of socialism. From the context of the philosophy of socialism, nobody wants to pay for a service; they just want to be protected by the system. Most Chinese people considered the social safety service like a free lunch.

Here let's take a look at traditional Chinese families with three or four generations; we can find that the members cared for each other very well. This is Confucian tradition. Chinese medicine and Chinese medical theory supported the traditional care system inside the families, because the cost of Chinese medicine is much cheaper than modern western medicine. In traditional Chinese society, there was no official function to rescue the poor class, but the communities and the temples for example played a very important role in rescuing poor people. We can find the same systems in India, with Buddhist temples playing the role.

Meanwhile Chinese people had another tradition. There was no pension system in Chinese society, and the people were used to preparing for old age by saving more than consumption. Such tradition still exists in society and impacts the Chinese people. The consumption ratio was only about 35% against the GDP in 2013, but the saving ratio against the GDP had reached 50% at the same time. We cannot discuss the problem based on economic theory; this is a problem of Chinese tradition.

In 1949, socialism was established in China. Since then, Confucianism, Buddhism and other religions were considered as spiritual opium and prohibited strictly by the government. From 1966 to 1976, during the Mao Zedong era, there was a movement called the Cultural

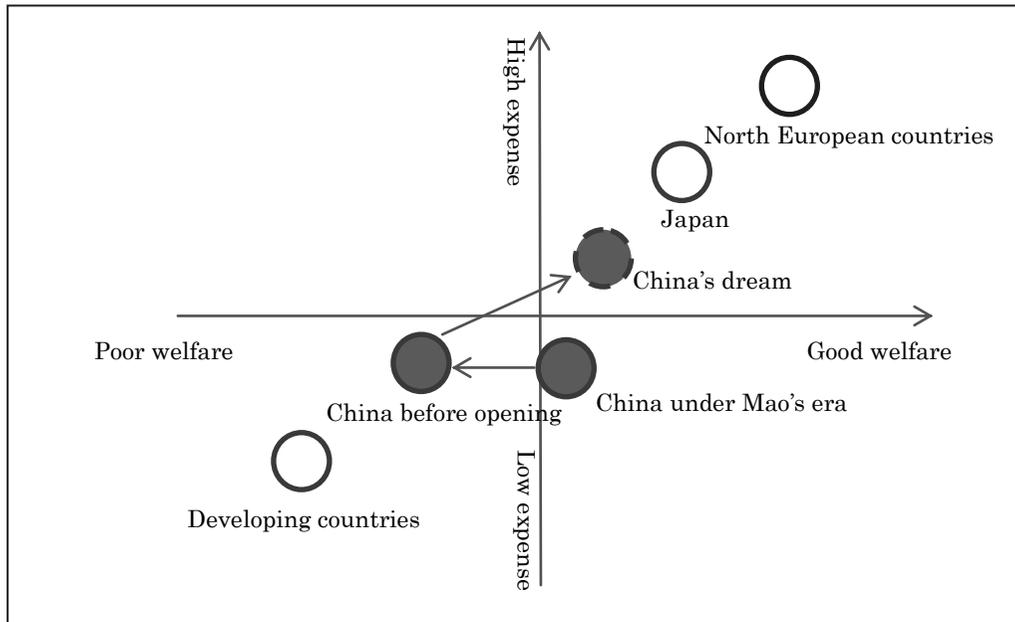
Revolution, during which, most of the staffs of temples and churches were banished, and many temples and churches were destroyed by young people who were called the “Red Guards” and were encouraged by the government to smash historic objects. Meanwhile, the traditional Chinese families changed from big families to nuclear families. The security function inside the family was gradually broken, but the one-child policy then speeded up the change.

From the 1950s, the government took over almost all private companies, integrating the companies into state-run enterprises or collectively-owned ones. This initiative was called *Gong Si He Ying*. The enterprises supplied medical care service and pension service to the employees. Chinese society changed dramatically, but the government planning system was not sustainable. Finally the system failed, and socialism also eventually failed.

In 1976, Mao Zedong died. Meanwhile Deng Xiaoping came back to be the real leader in the party and the government. Deng was characterized as a realist and a liberalist. He changed the country’s closed central planning system into an open market oriented system. The goal of the open-market policy was basically to strengthen economic efficiency. To reform the agricultural industry the government improved the contract system with farmers in order to make the responsibility clear and strengthen the productivity of agricultural production. The government promised the farmers that they could keep or sell any agriculture products in excess of the quotas freely. To reform the manufacturing and service industries the government separated the administrative function from the state owned enterprises management function. Meanwhile the function of education and medical care inside state-owned enterprises were separated and shifted to a public pool later. Under the government planning system, the enterprises controlled by the government directly were called “state-run enterprises,” meaning that the managers of the enterprises had no freedom or independence in the management. Since the reform, they have been called “state-owned enterprises.” The change here is that the managers gained freedom and independence to decide what and how to do the management, but even so, the government still kept control of the enterprises indirectly with the personnel affairs.

Basically, we can consider that China is trying to realize a western-style market-oriented economy. The problem is how to realize the goal. Of course there is no unique standard social security system that can function in every country. The social security system must be designed to work specifically for and under a nation’s culture and customs. To make the security system match the culture of a country is very important. There are several types of social security systems in the world (Figure 1). From the citizen’s view, a good welfare system could be better, but most people request to pay little. This leads to the dilemma of trying to realize a system which is very cheap but very protective. The systems in north European countries are characterized as good welfare with high cost. In Japan the system is middle cost and middle welfare, but it is quite difficult to sustain. The Japanese government is redesigning the system to create a more effective and functioning “middle welfare and middle pay” system, otherwise the country’s fiscal system will head to bankruptcy. Based on the situation, Japan’s system could be a good example for experimentation in China. Of

Figure 1. The social security systems in China and other countries



Source: FRI

course there is a long way to go for China to establish such kind of functioning system.

II. Economic development, the *Hukou* system, and urbanization

As mentioned above, the necessity to create a well-managed social security system for China includes two points: to strengthen private consumption and stabilize society. Nobody can deny the necessity and the importance of creating a social security system, but regarding whether it is the initial condition for strengthening private consumption, there are still many arguments. China is a country with a huge population, so it will take a very long time for China to create an ideal social security system. If it is the initial condition for China's strengthening of private consumption, it would mean that the Chinese economy has to depend on fixed asset investment, and in fact, a well-managed social security system can definitely support household consumption, but the real initial condition for helping private consumption is not the social security system, it is the growth of households' disposable income.

For today's China the strong necessity to create a well-managed social security system can contribute to the stability of society. The Chinese government still characterizes the social system as socialism, calling it "Chinese socialism." Economically, the Chinese government accepted elements of capitalism, but politically, it refuses democracy. Regardless of whether capitalism or socialism, society must be equal and the people must be supported by a social safety net, otherwise society will not be stable.

It is true that Chinese society is not stable. There are many reasons for the instability, and the poor social security system is one of the main ones. China needs to create a well-managed social security system as soon as possible.

This paper predominantly focuses on the pension system and medical care system in China. About forty years ago, China enforced the “One-child policy” to restrict the population increase because of a food shortage. At that time the government used coupons to allocate food in urban areas. But there were no coupons for farmers. Under Mao’s era, the population increased too rapidly and led to the food shortage. Toward the end of Mao’s era the government changed the policy to control the birthrate and population in order to match the supply and demand of food. The one-child policy succeeded in controlling the birthrate and population, but society aged faster than the leaders expected. Of course there are merits and demerits to the one-child policy. Actually, the legacy is clearly too huge, because the policy changed the dynamism of the population. In the coming decades it is expected that the young generation will not be able to support society because the elderly generation will come to account for over 50% of the total population between 2025 and 2030. In 2013, the Chinese Communist Party held the third meeting of the central committee. At the meeting, the central committee decided to deepen the market oriented economic system reform. The party decided at the meeting on an agenda and roadmap for the country’s economic reform till 2020. Inside the agenda, Chinese government decided to partially deregulate the one-child policy, allowing couples to have a second child if either spouse is an only child, but this is not enough to help the county overcome the aging. The deregulation seems to have come too late. The deregulation cannot change the dynamism of the population. It is important to complementarily create a well-managed social security system as soon as possible.

II-1. The economic development model

During the past thirty-five years China realized 10% GDP growth annually on average. From the demand side, investment and exports formed the main engine that drove the economic growth in the period, with private consumption being quite weak as a driving force in comparison. Most ordinary Chinese households are used to saving much more money than they spend. The propensity to save in China is very high, meaning that the propensity to consume is too low. During the same period, for most low-income households in China the real growth of disposable income was lower than the real growth of GDP. If the growth of disposable income of the households was almost the same as the growth of GDP, then the private consumption could be expected to strengthen.

Asian countries experienced currency crises in 1997. To overcome the crises, former Premier Zhu Rongji persuaded to the government to strengthen the domestic demand to drive economic development. He pointed out that China could not just depend on exports to US and EU. It is true that Asian countries including China cannot sustain economic development only depending on exports to developed countries. This is the lesson of the currency crises. Such kind of thinking about the policy enforcement is basically correct, but the goal is

difficult to realize because of the rationality of the current economic development model. It has been seventeen years since then, but the economic development model has not changed.

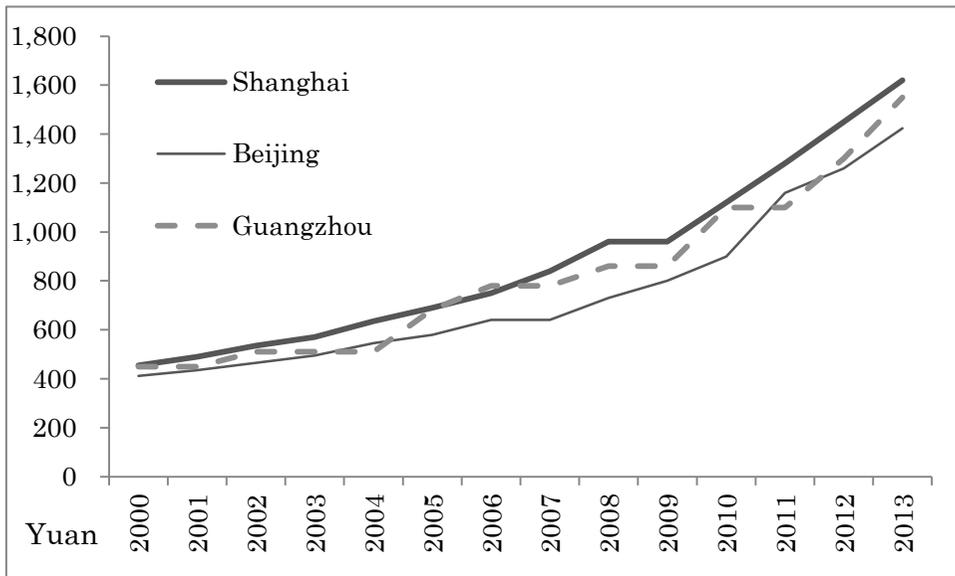
First of all, the government, especially local governments, felt comfortable about the then-current economic development model, which made it is easy for them to control the scale of investment. To maintain the competitiveness of exports by Chinese firms, the government controlled wages, fixing them at a low level for workers. The labor intensive industries played a very important role in exports. Most laborers came from the countryside. It is difficult for farmers to earn cash income, but by working in urban areas they can do so. Although the work in the factories in urban areas is hard, tiring and dirty, the cash income cash is a big incentive for and attracts laborers from rural areas.

In the 1980s more than 70% of Chinese people lived in rural areas. There is a “*Hukou*” system to control the movement of the farmers. *Hukou* is a kind of residential registration system. Every person in China must be registered with the government. Nobody can move his or her *Hukou* residence freely. Since the 1980s, Chinese government has partially deregulated the *Hukou* system. The government allowed the people in rural areas to go to urban areas to work in factories temporarily. In this case, the laborers still cannot be registered in urban areas, but they can obtain permission to stay in urban areas temporarily. The inflow of people from rural to urban areas led to the fixed wages of the workers at a low level. Generally, the wage level increases with economic development. But in China it was fixed at the original level. The workers have no ideal to make the factories raise the wage level. This is why the government felt comfortable about the current economic development model.

But the Chinese market started changing about ten years ago, after thirty years of the generation of workers coming to urban areas, most of whom were farmers originally. They were satisfied with earning cash income in the factories, but ten years ago most of the second generation rural workers were born in an urban area. They are basically the same as other young people in urban areas, and they hope to have the same life as them, refusing to work in the dirty factories. The local governments cannot attract the young generation to work in the urban areas with low wages. Although the young workers still have a rural area *Hukou*, they will never be satisfied with earning a low cash income. All of them dream of enjoying the same life as other young people in urban areas. In recent years, strikes happening in factories are very often against low wages. To stabilize society local governments had to start to increase the lowest wages for laborers from rural areas (Figure 1), which, of course, is an insufficient action; it is necessary to raise the average wage, otherwise society will not be stabilized.

To stabilize society it is important for the Chinese government to increase the middle income classes. A society is very unlikely to be stable and develop sustainably without a middle class. The government needs to arrange a mechanism to increase the salary following the growth of GDP, meaning that the government needs to allow unions to work under the rule of law. Meanwhile, farmers must be allowed to organize associations themselves to protect their benefits.

Figure 2. Big cities raise wages for laborers



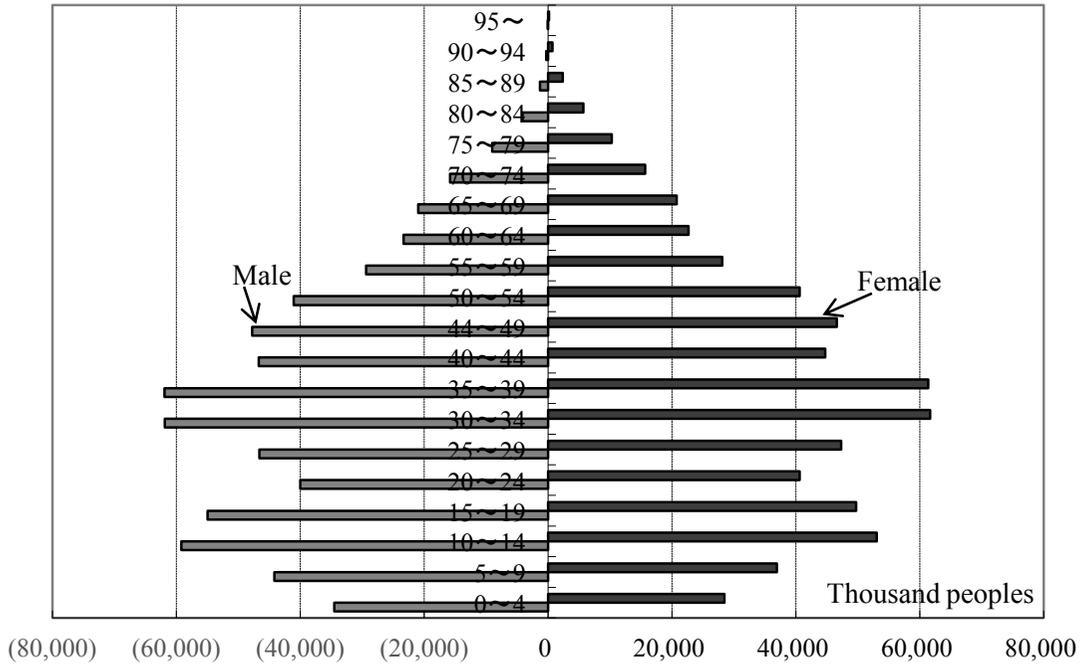
Source: Local governments of Shanghai, Beijing and Guangzhou

II-2. *The demerits of the one-child policy*

About forty years ago, China enforced the one-child policy to lower the birth rate and to restrict the increase of the population. Such kind of policy not only changed the structure of the population, but also influenced the economic development model. Figure 3 shows us the dynamism of the population in China. It is clear that Chinese society is aging rapidly. One of the main reasons is the one-child policy. Under Mao's era the population increased very rapidly; in fact, it was encouraged by the government. The baby boom contributed to the shortage of the food supply in the 1960s and 1970s. China was facing the pressure of social instability because of the increasing population and the shortage of the food supply. Since the one-child policy was enforced forty years ago, each couple was only permitted to have one child. Such kind of policy not only helped China to control the population but also stimulated the consumption of the young generation, because the expenses of education and living in a nuclear family are so much less compared with big families.

Here, let's turn back to take a look at Chinese society in Mao's era. During the period from the 1950s to 1970s, the Chinese population increased very rapidly, but the share against the world's total population was constantly kept at 22%. The problem during the same period was not the increasing population, but that the Chinese economy declined sharply due to political movements, for example, the Cultural Revolution from 1966 to 1976. The workers stopped production activity to participate in political revolutionary activities to guard Chairman Mao. They felt it necessary to do so, as most of them believed there were some

Figure 3. Dynamism of the Chinese population (2010)



Source: World Population Prospect, 2012

groups in the government and the party who opposed their leader, Mao Zedong. Meanwhile, the students in the schools and universities stopped their studies. They were the main players of the movement. They punished their teachers because they believed that most of the teachers were anti-revolutionary activists. As a result, China was confronted with a serious situation of a shortage of food and daily necessities. It was not a problem of demand, but a problem of supply. The former premier, Zhou Enlai, requested the government to change the population policy. In 1971 the state council transmitted a report to strengthen the plan of child birth. From 1973 the government improved the situation of late marriage and birth control. But the strict one-child policy continued to be enforced. In 1980, Song Jian, a professor in the state science committee, reported that the Chinese population would reach 4 billion in 2050 if China did not enforce the one-child policy immediately. Actually this report is the key background that directly pushed the government to enforce the strict birth control policy. But earlier, in the 1950s and 1960s, Mao expected to increase the human resources to make the Chinese economy catch up with the UK and U.S. This tragedy happened in China and still influences Chinese society now.

In 1998 the national family planning commission stated that the one-child policy reduced the number of child births by 400 million from 1980 to 2005. How should we consider this effect? In rural areas, local governments' village committees implemented compulsory contraceptive operations on young women—this is not social policy, it is violence without

humanity. The families in rural areas usually hope to have a boy rather than a girl, because boys are considered as precious human resources that can support the family. In Chinese tradition, society is mainly for men, not women. Even so, many families face the dilemma of whether to have a boy or girl, because they can only have one child. Some of the families in rural areas decide to abort girls. Whatever the effect of the policy is, the process of the policy enforcement is serious violence.

Recently, some scholars (Wang Feng in Fudan University, Cai Yonghe in North Carolina University, Yi Fuxian in Wisconsin University) examined the effects of the one-child policy announced by the national family planning commission. They doubt the result of 400 million less children due to the policy. They point out that the number of births was reduced by only 200 million during the period, of which, only 100 million were the result of the policies, while the other 100 million were due to urbanization and industrialization. The movement of industrialization and expenses of education and living is the real reason for the lower number of child births. The situation is almost the same as what happens in developed countries.

From the studies on population dynamism in China we can reach the conclusion that it was not necessary for China to enforce the one-child policy so strictly. The population control policy could have been designed to allow couples to have two children each. The dynamism of industrialization and economic development is estimated to slow down population increase. Such kind of movement has been proven in Japan and other developed countries. The legacy of the one-child policy is an unforeseeable aging problem and a lack of laborers in China.

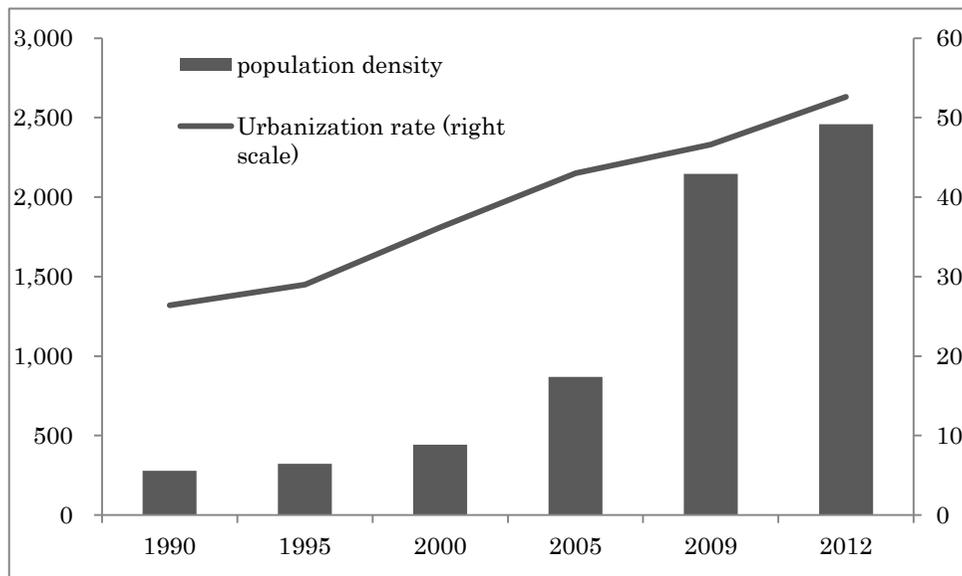
The structure of Chinese families changed to a “4-2-1” style, referring to one child, two parents, and four grandparents. The only child in the family becomes the king or queen. These facts cause concern about health care inside the family: one child cannot physically care for six people (father, mother, two grandfathers, and two grandmothers).

In November 2013, the Chinese communist party decided to relax the one-child policy. If either the husband or wife is an only child, they can apply to have a second child. However, the national family planning commission emphasized that the decision did not mean the abolition of the policy. Some of the specialists in China pointed out that the deregulation of the policy is not sufficient as it can neither change the dynamism of the population nor increase the population to overcome the aging problem.

II-3. The meaning of the urbanization policy

Under the Xi Jinping administration, Premier Li Keqiang is improving the policy of urbanization. In an agricultural society, the economy usually develops less than in an industrialized society, and urbanization would be very slow. Under the Mao Zedong era, the urbanization rate (the share of the population living in urban areas against the total) was only about 10%. Since the open-market policy was introduced, the urbanization rate has increased, reaching 50% in 2012 (Figure 4). But we can consider that, although half of the population still lives in rural areas, agriculture only creates 10% of the GDP. This is the background to

Figure 4. Chinese population density and urbanization rate



Source: Chinese statistical bureau

the income disparity in China. Clearly, China needs to increase urbanization, but the problem is how to do so.

Actually, many farmers want to move to an urban area, but the residential registration system (*Hukou*) has prevented such movement in the past decades. Everybody knows that the *Hukou* system is irrational and needs to be removed so that farmers can move to urban areas freely, from the viewpoint that in a just society free movement is possible. It seems that the government is just concerned that free movement would cause social disruption. In this respect, liberalization is necessary, but gradual improvement is necessary. There is no doubt that the Chinese government needs to design the reform and show the people the roadmap of the liberalization of *Hukou*. There is no option to postpone the reform.

The metropolitan centers in China, for example, Beijing, Shanghai, and Guangzhou, have huge populations of over 20 million, including the rural workers who do not have *Hukou* registration in the cities. The population density in urban areas has reached 2500 people/km² (Figure 4). Meanwhile environment pollution is very serious in these areas. Under these conditions, it is difficult to imagine that more farmers will move to the existing cities. One meaningful choice for the policy makers is to construct small cities, to which it will be feasible to allow farmers to move.

It is a feasible policy to urbanize society; however, there one problem remains: who will be allowed to move to an urban area? It is a problem of rule. Most farmers want to leave their village and live in a city, but as the capacity is limited, the cities cannot accept an enormous amount of farmers. Another point is whether the government can pay for infrastructure

construction in new cities. For example the government needs to construct many apartments, hospitals, schools, etc. Such kind of public service is definitely necessary and important, but the problem is who will pay for it. Finally, consider the fact that if most of the young farmers leave their villages and move to urban areas, Chinese agriculture will become unsustainable. The food security problem would threaten Chinese society.

To improve economic development, China needs to realize industrialization. A big country with a population of 1.36 billion cannot achieve economic development only depending on agriculture. The Chinese government set up the goal for the agriculture policy to maintain the self-sufficiency rate (total consumption-import/total consumption) for food at 95%; however, in 2013 the self-sufficient rate decreased to 88%. Professor Lester Russell Brown (founder of World Watch Institute) warned about that problem in his book, “Who will feed China?” In response, Chinese official analysts denied the possibility of such problem and concern. But in 2013, the Chinese Ministry of Agriculture announced that China would import more rice than it would export. China is currently facing the problem of how to balance industrialization and agricultural development.

The conclusion here is that moving some farmers to urban areas is not the only problem. How to sustain the agricultural development, stabilize society, and lower the income disparity to realize equality and justice in Chinese society, is also a major issue.

III. Construction of the social security system

In the socialism central planning era (1949–1978) there was no need to construct a social security system. The workers in the state-run enterprises or collectively-owned enterprises were able to go to hospitals belonging to the enterprises and only needed to pay a little for it. The enterprises supplied apartments to the employees freely at that time, although they were small and very old. There was no property market in China. The workers were able to receive a retirement allowance called “retirement salary,” and they did not need to return their apartment to the enterprises after retiring. As a result, the enterprises guaranteed the workers’ lives from birth to death. But the business of the enterprises was not beneficial enough to cover the expenses of the social security service. Under the central planning economy the government covered the expenses with the fiscal budget instead of the enterprises. But such kind of social security service was not sustainable.

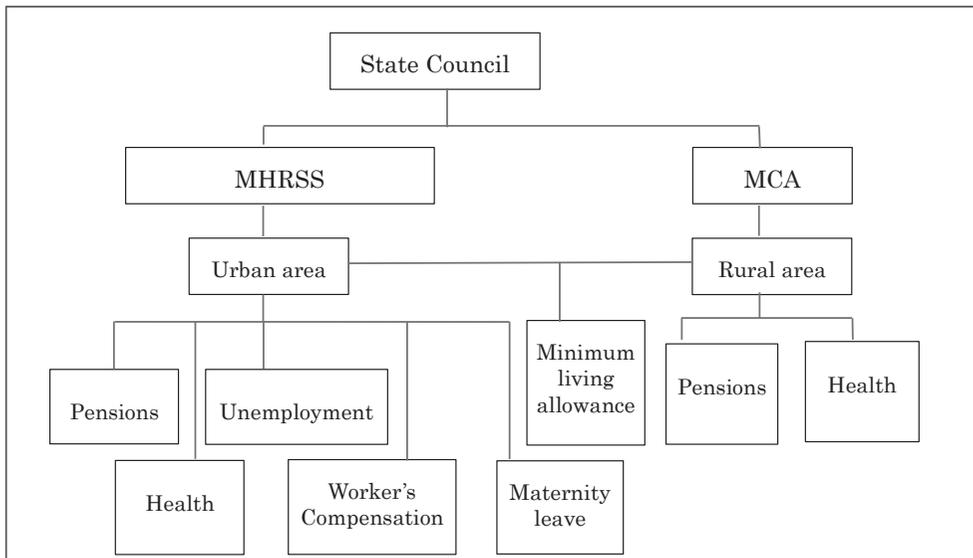
Since 1979, when the open-market policy was enforced, the economic system was gradually transformed into a market-oriented system. All enterprises, whether state-run or collectively-owned, had to participate in market competition. The social security service became the reason for the deficit of business. The state-run enterprises and collectively-owned enterprises requested to separate the social security service from the core business. In 1998, Premier Zhu Rongji improved the reform of state-run enterprises, and since then, state-owned enterprises have become collectively-owned enterprises. The social security service was separated and changed to a public social security fund. This is the first step of the reform of the social security system.

Here, let's take a look at the relationship between the reform of the state-run enterprises and the separation of the social security service function. There was a consideration in China that the social security service caused inefficiency in the enterprises, and it became necessary to separate it from core business. It is true that the companies under the market oriented economy just do a lot of efforts to maximize the benefit. After separating the function of the social security, the business was originally able to be beneficial, but it turned out that they are actually not beneficial. The government sold all of the small state-owned enterprises in 1998, only maintaining major ones. To benefit the big companies the government permits monopolies in the electricity, aviation, railway, shipment distribution, oil, and other industries. The conclusion here is that the separation of the social security service is necessary, but it is not enough to improve the state-owned enterprises to maximize profit. China needs to privatize state-owned enterprises to improve competition.

III-1. Overview of the social security management system

I mentioned the necessity and the process of separation of the function of the social security system in China since 1998 above. At the same time the Ministry of Human Resources and Social Security was established. In 2010, the function of personnel was incorporated into the ministry (Figure 5).

Figure 5. Overview of the Chinese social security system



Note: MHRSS is the Ministry of Human Resources and Social Security of China. MCA is the Ministry of Civil Affairs.

Source: FRI

According to the State council, the role of the Ministry of Human Resources and Social Security is as below:

- (1) To enforce the policies which are decided relative to the laborers and social security by the government;
- (2) To recommend and plan the policies, rules and standards relative to the laborers and social security, while enforcing the policies and monitoring the process of the enforcement;
- (3) To standardize the human resource market, increase employment, and strengthen support for the unemployed;
- (4) To manage and monitor laborers' contracts, and especially strengthen the management of female and minority employees;
- (5) To arbitrate labor disputes;
- (6) To strengthen professional training and reemployment;
- (7) To manage the salary system of enterprises and optimize the minimum wage;
- (8) To enact standards on pensions, health care, unemployment, workers' accidents, and childbirth;
- (9) To collect social security premiums and operate social security funds;
- (10) To care for pensioners and the unemployed.

The matters concerning social security in China are planned by the Ministry of Human Resources and Social Security under the management of the State Council, and enforcement is managed and monitored by the Ministry. Since the reform of the state-owned enterprises in 1998, the right of approval was shifted to the National Development and Reform Commission, and the assets of the state-owned enterprises came to be managed under the State-Owned Assets Supervision and Administration Commission. The function of social security was transferred to the Ministry of Human Resources and Social Security.

Besides the Ministry of Human Resources and Social Security, there is another ministry related to social security, which is the Ministry of Civil Affairs. The function of the Ministry of Civil Affairs is to manage administrative affairs and construct democratic policy at the minimum level, strengthen the safety-net function, and supply various services to the armed forces. To put it simply, according to the Ministry of Civil Affairs, it works for the minimum living allowance of the people, human rights, and the benefit of the people. Of course the problem here is how to fulfill these roles.

III-2. Building a market-oriented economy and constructing a social security system

The Chinese communist party decided to construct a socialist, market-oriented economy instead of a centrally planned economy in the fourteenth congress of party representatives in 1992, and the decision was written into the constitution. Since then the government started to reform the financial system, fiscal system, state-owned enterprises, etc. Concerning the reform of state-owned enterprises, the government decided to maintain the big SOEs and released small-sized enterprises. In the Jiangzemin era, Premier Zhu Rongji started preparations to join the World Trade Organization (WTO) from 1996. To join the WTO China had to promise to open the market to the world, meaning that market competition would become fiercer. For state-owned enterprises, the social security system had been a hindrance

to the competitiveness of the companies. It was considered that the social security function must be separated in order to strengthen the competitiveness.

China succeeded in joining the WTO in 2001. China indeed promised to open its markets to foreign companies. Market opening was obviously a big challenge to China and meanwhile it was also a strong driving force to push the country to reform the economic system. Relating to the social security system, the goal of the reform is to build a public social security system instead of the old system inside SOEs. The context of the reform is not only to stabilize society but also to strengthen the competitiveness of the SOEs. This is a reform like killing two birds with one stone.

But the reform is not easy to carry out; the government had to build a new system from scratch. There are many difficulties, for example, the population is ageing, there are several millions of retired workers who cannot pay the cost of the social protection system, and the young generation cannot fully support the aged generation. The government is planning to build a compulsory insurance system. The problem, again, is who will pay the cost. It will obviously take a long time for China to build an effective social security system.

In China the residential registration system has separated the urban residents and rural residents since 1958. For the people in urban area, a new social security system has been arranged, including a pension system, medical care system, worker's compensation, and maternity leave, although the care provided by the system cannot compare with that provided in developed countries. On the other hand, for people in rural areas, a very basic and minimum pension system and medical care system is arranged, but it is clearly not at all sufficient. The Minister of Human Resources and Social Security announced how to rebuild a new social security system in 2013. First, to build a compulsory insurance system, the focus is on the fundamental pension system and fundamental medical system. Second, is to integrate the system for the employees in the government, including the central government and local government, and the system for the employees in companies including state-owned enterprises and private companies. Third, is to unify the systems for the residents in urban areas and the systems for rural areas. Fourth, is to transfer from the old system to the new system gradually in order to overcome the stress from the transformation.

Here, let's review the problems with the current social security system. The trend of ageing of the population means there is strong demand for the social security system, but the capability of the system is limited. The social security system in urban and rural areas was separated, but it is necessary to integrate the two systems to realize a just and equal society.

III-3. Fundamental endowment insurance

Comparing the social security system in the socialist era (1949–1977) and market economy era (1978–) we find the difference that the people were cared for by the government or the companies they belonged to, but nobody took responsibility to pay for the system. Under the market-oriented system, the responsibilities of the government, companies and individuals are clear. The people are the monitors of governance over the social security

fund. The clear responsibility and the monitoring will guarantee the sustainability and health of the system.

Figure 6 illustrates the fundamental endowment insurance system in China. Till 1990 the companies played the important role of supplying the service of insurance in China. The government reformed the old system and started to build a new social security system. Sha Yinhua pointed out that companies paid the expenses for the insurance under the old system in his paper. Under the newly-built social security system, the government, companies and individuals share the expenses. In the era of a socialist, central-planned economy it was difficult to request individuals to pay for insurance, whereas in the era of a market economy it is very natural to ask individuals to share a part of the expenses for social insurance. Now, every individual member in the system has his or her own account, in which he or she needs to make a monthly deposit. After retiring from a company he or she will receive payments from the account under this system.

The government established a Social Security Fund (SSF) in order to strengthen the social protection function. The headquarters of the fund is administrated and monitored by

Figure 6. Chinese fundamental endowment insurance system (million people)

	Total	Incumbents	Retirees
1989	57.10	48.17	8.93
1990	61.66	52.01	9.65
1991	67.40	56.54	10.87
1992	94.56	77.75	16.82
1993	98.48	80.08	18.39
1994	105.74	84.94	20.79
1995	109.79	87.38	22.41
1996	111.17	87.58	23.58
1997	112.04	86.71	25.33
1998	112.03	84.76	27.27
1999	124.85	95.02	29.84
2000	136.17	104.48	31.70
2001	141.83	108.02	33.81
2002	147.37	111.29	36.08
2003	155.07	116.47	38.60
2004	163.53	122.50	41.03
2005	174.88	131.20	43.68
2006	187.66	141.31	46.35
2007	201.37	151.83	49.54
2008	218.91	165.88	53.04
2009	235.50	177.43	58.07
2010	257.07	194.02	63.05
2011	283.91	215.65	68.26
2012	304.27	229.81	74.46

Source: China state statistical bureau

the central government. The real operation of the fund is at the local level, mainly at the city level. The local social security funds request companies to pay a part of the expenses for the employees instead of the individuals. The pools of the funds at the local level are administrated by the local governments, which also pay a part of the expense in the form of a subsidy.

According to the law, every company must pay an amount equivalent to 20% of the employee's total wages of the previous year. The individuals must pay expenses of 8% of the wages of the previous year as social insurance expenses. The individuals need to be in the system for 15 continuous years. Men can receive the pension from 60 years old, while women can receive it from 50 years old. The pension that the employees receive is only about 20% of their current wages. But it must be emphasized that the system here is only for the employees working at companies. Unemployed people are not protected by any social security system, not even *dibao*, the minimum protection system.

Government employees are protected by a completely different system. They do not need to pay expenses for their social security, as the government pays the entire amount for them. They will receive an amount equivalent to 70–90% of their wages as a pension after retiring. Compared with the employees working at companies it is clearly an unfair system.

Another problem here is the lack of transparency in the operation the funds. It will damage the capability of the function of the funds because of the shortage of liquidity in the near future. Of course for China, the establishment of a social security fund is progress compared with the old system. However, it needs to strengthen the management and administration of the fund operation. The corruption of the government officials could damage and weaken the capability of the funds. It is also possible that the corruption could lower the motivation of individuals. To construct a functioning social security system it is necessary to strengthen the management and monitoring of the operation and maintain the transparency.

III-4. Health care system

In the era of a centrally planned economy the Chinese health care system included the state-run public medical care system and the workers' medical care system. Both of the health care systems were almost free, or the members needed only to pay a little. In that era the government ran the private hospital establishment, so theoretically all of the hospitals were publicly state-run entities—some of them belonged to state-run enterprises, and the others belonged to the local governments. In urban areas the hospitals belonging to state-run enterprises played the important role of supplying medical care services. However, the quality of the medical care of the hospitals run by the local governments was the best in China. Such kinds of hospitals supplied services to officials first. The employees in state-run enterprises had to go to their enterprise's hospital or clinic first, and if the hospital or clinic could not supply the service, he or she could move to a bigger hospital belonging to the local government, if introduced by a doctor.

A big part of the medical care system could not be sustained after the open-market

liberalization policy began, in 1978. Sha Yinhua pointed out the reasons in his paper: “The enterprises faced serious market competition. Many of them could not support the medical care system with profit because of the difficulties of management sustainability. Another problem is the lack of governance. The employees usually requested doctors to write a prescription including some medicines which were very expensive, but not necessary. The balance sheets of the hospitals were not sustainable.” The SOEs could not strengthen the management because they were run by the government. The low profitability and efficiency constrained the SOEs to hold hospitals to supply the medical care service to their employees. Meanwhile the moral hazard of the employees and the hospitals was also a problem that damaged the sustainability of the medical care system.

The Chinese government started to reform the SOEs in 1998, separating the social security system from the management. The social security functions were removed to a new platform of social security funds under the local governments. The purpose of the reform was to strengthen the management and competitiveness of SOEs and to build a universal social security system to comprehensively cover the entire social protection service, including pensions and health care. However, the current pension system and health care system still treats the officials favorably; for example, most of the officials in the governments don’t need to pay for medical expenses, while the employees in SOEs are treated poorly. Under the system, the people who do not belong to any enterprise need to pay all of the expenses themselves. This system treats workers and farmers very poorly.

On the other hand, the new health care system is facing the problem of the aging population. The fund is facing difficulty in paying the continuously increasing cost because of the aging population. The problem is how to strengthen the capability and capacity of the health care system as soon as possible. For the government, it is important to first find sources for revenue, while it is also necessary to cut expenses. It is clear that China needs to integrate the social protection systems for government officials and for workers and farmers to create a fair system. A fair system would be an efficient system that can contribute to the stability of society. Of course it is likely that the officials would oppose the reform. If President Xi Jinping and Premier Li Keqiang are to implement such reform, they need to employ stronger leadership; otherwise social stability could not be expected.

Here the conclusion is that the existing health care system is not sustainable. The limited medical care resources are not allocated efficiently or equally. The health care system is expected to play the role of stabilizing society and realizing justice. China is the second largest economy in the World, but the per capita GDP is still at the low level of about U.S. \$7000; China is still an emerging economy. The traditional health care system was maintained depending on the government fiscal expenses. The government fiscal resources are limited, and the moral hazard of the government, hospitals and the members makes the system unsustainable. SOE management is also unsustainable. It is not likely that the SOEs can support the health care function for their employees.

In China, there is no class system like that in India, but there is a residential registration system which is used to limit the movement of farmers from rural areas to urban areas. In

China, farmers are treated as second-grade citizens under an unequal system. In some respects farmers are treated as slaves in China. The problem of the health care system is how to realize justice in Chinese society.

IV. The social structure and the residential registration system

Here it is necessary to make clarify the Chinese social structure and residential registration. In China the government usually emphasizes that everybody is equal because the social system is socialism, but actually Chinese society is separated into at least two parts: rural areas and urban areas. Farmers are discriminated against in Chinese society. In 1950, China experienced a mighty famine because of Mao Zedong's failure to improve economic development, but at that time the government prevented the movement of the refugees (farmers) from the countryside to the cities.

Till the mid-1980s China faced a serious shortage of food supply. The residents in urban areas needed to pay for food with coupons and money. The coupon system was to guarantee the food supply to the residents in urban areas. But the government never guaranteed the food supply to the residents in rural areas. It is clear that the residents in rural areas were treated unequally compared with the residents in urban areas. The residential registration system in China means that, in effect, a class system exists in modern China.

IV-1. The residential registration system in China

Under the Mao Zedong era, the government started a residential registration system to limit farmers' movement from rural areas to urban areas. Since then, Chinese society has become a dual system consisting of residents in rural areas and residents in urban areas. At first the government wanted to support heavy industry development by limiting the movement of people from rural areas to urban areas. It was a kind of subsidy for heavy industries. As a result, however, the income gap became bigger and bigger.

The communist party was a political party of the proletariat. The leader of the party was made up of the workers. In Chinese society farmers are usually put in a weak position. Since 1949, Mao Zedong decided to start the residential registration system to restrict farmers' immigration to urban areas in order to enable the heavy industries to catch up with those of the U.S. and the UK. In actual fact, the residential registration not only limited farmers' movement to urban areas, but also limited residents' movement between cities. For example, if a resident living in Xian, in inland China, had wanted to move to Beijing, it would not be permitted under such system. People were only permitted to move to different city if they could find somebody to take their place in their current city. The reason why the government managed the movement of the residents so strictly is that it needed to control the food supply because of the serious shortage.

There were, however, some unique cases in which farmers were able to move to an urban area. First of all, if a farmer was able to enter the army, he or she could be allowed to reside

in an urban area after retiring from the army. Second, if a farmer could pass the examination to enter a university, he or she could enter an enterprise in an urban area and get permission to live in the city. Third, since the open door policy began, in 1978, farmers have been allowed to inaugurate companies. There are many village and township enterprises in China, and the owners are allowed to register as an urban area resident. Of course, most farmers are still not permitted to move to an urban area. The farmers hope the government will deregulate the residential registration under the situation that China has overcome the shortage of food supply. The situation has changed, but the government still wants to continue the regulation, because it does not guarantee the same social security for farmers as it does for residents in urban areas.

Under the Mao Zedong era, there was no social security service for farmers, who had to dedicate all of their harvests to the government. In practical terms, the farmers were slaves living in the hell of no health care, no pension system, and no justice. Since the open door policy started in 1978 many farmers have rushed to the big cities in the coastal area without permission, to work in very dirty factories. Life in that situation was still better than that in the countryside.

From the 1960s to 1970s thousands of students graduated from high schools but could not find a job, because the economy sharply deteriorated because of the cultural revolution. Mao told the students to go to the countryside and learn everything from farmers. The real purpose of Mao's instruction was to resolve the unemployment problem. Mao was like an emperor in China—nobody could say no to him. As a result, most students went to the countryside in line with Mao's instruction. The only merit of the movement was that the young students played a role in caring for farmers' health. They were called "bare feet doctors" at that time. After Mao died in 1976 and the open door policy started in 1978, most of the young people returned to the cities. The open door policy started with the reform of agriculture. The farmers were allowed to keep a part of the harvest for themselves. Some of them went to work in the big cities in coastal areas, but the government refused to deregulate the residential registration.

In 2006, Premier Wen Jiabao decided to stop collecting agriculture tax from farmers. As an expert on the issue of agriculture and farmers Wen recognized how important it was for China to boost the countryside and farmers. It was helpful to increase the income of the farmers by stopping the collection of agriculture tax, but it was not enough. The best solution for China to overcome the income gap between the rural area and urban area is to deregulate the residential registration.

IV-2. Income gap inside an area and across areas

China is a large country with a huge population. In the past three decades the Chinese economy developed dramatically. Meanwhile, the income gap between inland China and the coastal become larger and larger. The income gap would damage the social stability and economic efficiency.

The Chinese open door policy started in Guangdong province near Hong Kong and

Macao. The leading industries at the time were the labor-intensive textile and home electronics manufacturing industries. The government constructed some special zones in coastal areas, and the companies that invested there could enjoy special favorable policies. Guangdong province and Fujian province developed into large manufacturing industrial clusters supported by cheap labor from inland areas such as Sichuan and Hunan. In fact, the attraction of laborers and elite, well-educated elite students from inland China is one reason for the income gap, and even led to a shortage of human resources in inland areas.

Another factor in the obstacle to economic growth is the location of natural resources. In China the natural resources are located inland, but the economic centers are in coastal areas, meaning that it is necessary to move the resources from inland areas to coastal areas. To support industrial development the government lowers resource prices to shift the benefit from inland areas to coastal areas. The price of coal is a typical example.

In the Jiang Zemin era, the government improved a western development program to help the economy in the western area catch up. The Jiang Zemin administration requested the provinces in coastal areas to help the provinces in inland areas one by one. The provinces in coastal areas were obliged to help the provinces in inland China, which are usually under developed, one by one. The provinces in coastal areas provided help to develop education, industries, medical services, and other infrastructure. But in 2002 Chairman Jiang retired, and since then the western development program has dwindled. During the Jiang Zemin era, the central government invested many millions of Yuan in inland areas to help them construct infrastructure, but the development gap is still enormous.

From 2003, under Hu Jintao administration, Premier Wen Jiabao improved the “the Rise of Central Area Plan” and “Revitalization of Northeast Project.” The central area and northeast area are where industrial structures are very old and under developed. The Chinese government wants to revitalize the industries by innovation. The central government planned to revitalize the central area and northeast area economic development through investment. However, investment driven by the government won’t be sustainable, and it is difficult to boost inland areas’ economy.

From 1994, Chinese government enforced a shared-tax system. This is a policy arrangement between the central government and local governments on collecting and spending of different taxes. But the shared-tax system only gave the definition of the taxes shared between the central government and provincial government. The administration units under the provinces, like city, county, town and village don’t know how to share the tax with the central government in the system. The policy arrangement of the shared-tax system strengthened the central government revenue, but it could not lower the regional income gap. The key point here is how to reallocate the income efficiently in order to strengthen local governments’ economic power; otherwise it is not likely that the local government will be able to build a meaningful social security system to cover the area it administers. In China we can find some strange phenomena. The government office buildings in poor areas are usually very modern, large, and luxurious, like a five star hotel. The problem here is the weakness of governance.

Premier Li Keqiang decided to improve urbanization to sustain economic development. Such plan was decided in the 3rd Plenary Session of the 18th CPC Central Committee. The government decided to partially deregulate the residential registration. That means the government will allow some farmers to move to small cities and towns, where they will be covered by the same social security system as people in the big cities, as expected. But it is not clear who will be allowed to move to the small cities and towns. One possibility is that the government will allow workers from rural areas who are working in the cities to become residents in such urban areas.

Generally the momentum of urbanization is considered to contribute to private consumption and to lowering the income gap. According to the National Statistics Bureau, the Chinese population reached 1.36 billion at the end of 2013. There are about 800 million farmers, and 153 million of them are working in the cities. They are called *Nongmingong* (rural workers). In addition, there are another 89 million farmers working in areas near their villages. About 242 million farmers need to become urban residents. According to official data, only 33 million farmers are covered by the basic pension system, 46 million farmers are covered by the medical care system, and 63 million farmers are covered by accident insurance. It is a big project for the Chinese government to rebuild the social security system to cover all farmers. There is still a long way to go.

Actually, when we discuss urbanization policies we cannot only consider the merits and benefits, we need to also pay attention to the demerits. One demerit is that urbanization could damage the natural environment, because, if so many farmers move to urban areas, life lines such as the water supply system will not be built in the short term. Another problem is that as the young generations move to urban areas, agriculture will face the problem of a shortage of farmers. This means that urbanization could damage food security from a long-term view. China needs to redesign its plan for urbanization. Of course the goal of the policy is to realize balanced economic development.

IV-3. Income gap and the social security problem

The argument for economic growth and a social security system shows that it is necessary to build an efficient social security system to strengthen private consumption. As the initial condition to sustain economic growth, the social security system would play a very important role. For China, however, the economy is still in the transition from a centrally planned system to a market-oriented system, and it will take China a long time to build an efficient social security system.

As mentioned above, under the central-planning era the SOEs and collective-ownership enterprises played the important role of supplying social security services. In China, each SOE was really a small society to supply various services to employees, including health care, education, and pensions. Such community definitely contributed to the stabilization of society. Of course there was no pension fund in the era; the enterprises supplied pensions to their employees after retirement instead of the government. Theoretically nobody in an SOE

needed to be concerned about life after retirement, but the system was not sustainable because of the shortage of resources.

It is necessary to separate the social security function from the SOEs and collective-ownership enterprises in order to strengthen the efficiency. This is why the government tries to reform the social security system actively. In 1998, the Chinese government established a social security fund to supply the social security service. In 2009 the government decided to reform the social security system for farmers, when the test of the new pension system for people in rural areas was carried out. The experiment of the pension system for residents in urban areas was carried out in 2011. The Chinese government appears to be trying to establish a universal insurance system. According to official data, there were 370 million employees in urban areas as of the end of 2012. About 150 million employees are covered by unemployment insurance, and about 200 million employees are covered by health care insurance. From the data we know that at least 40% of the employees are not covered by the social security systems (Figure 3 and 4).

The question is why have so many people not joined the social security programs? First of all, the employees at SOEs never think it is necessary to join such kind of social security program, because they believe that their company will care for them in the future. Therefore, this mindset of the employees must be addressed. Second, the social security fund established by the government is not trusted by the people because of the lack of the transparency in the operation.

V. Conclusion

Nowadays the biggest concern for ordinary Chinese people is life after retirement. It is clear that the social protection capability of the social security system is limited. The population of China is aging very rapidly. The government emphasized to need to accelerate the reform of the social security system, but gives it low priority in the official agenda, because the government wants to improve economic growth to prove the greatness of the government and the party.

The Xi Jinping administration announced that it will create a comprehensive protection system for the whole nation. It is a Chinese dream. However, the financial resources are limited, and from a short-term view, such reform is a zero-sum game. The government needs to equalize the protection functions for the government officials and for ordinary people. Of course, there is no option for China to postpone the reform, because the population will continue to age rapidly. To create a fair social protection system the government needs to force the officials to share financial resources and services with ordinary people.

The Chinese government still insists that China is a socialist country. The concept of socialist equality and justice is propaganda. Dr. Schumpeter believed that capitalism would collapse and be replaced by socialism, but despite the many problems that true capitalism entails, the experience of the cold war has shown us that socialism was not a dream, but a nightmare. Now, the problem is how to combine the traditional social system with a

democratic system, otherwise a fair and just system will not be possible. How to create an effective social protection system in China is not only a social economic issue, it is a political issue. The government recognizes the importance of stabilizing society, but as the leaders belong to the privileged class, they do not appear to be interested in sharing social benefits with the people.

It is a major challenge for the Xi administration to create a new social protection system, because it could diminish the benefit for the privileged class. It really is a dilemma. Premier Li Keqiang seems to want to reform the social protection system and lower the income disparity through urbanization, and urbanization is a correct policy option. The *Hukou* residence registration system has made the farmers slaves in China, because they do not have citizenship under the system. Chinese society has been classified into different classes in the past decades. To integrate society is important. In the past ten years the government has made efforts to establish social security funds and gather payments from individuals. However, such funds may actually be a factor in official corruption because the governance of the funds' operation is too weak. The operation should fundamentally be transparent, but most of the funds' operators never disclose information to the public. The government can arrest some leaders and staff members within the funds' organization, and such kind of activities could contribute to strengthening the capability of social protection.

China announced that it was going to create a socialist market economy. We don't what a socialist market economy is, but an effective social security system is important to stabilize society. The conclusion here is that the Chinese government needs to start to enforce political system reform.

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