Pension Reform in China

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Outline

1. China’s population aging: trend and impacts on pension system
2. The reforms and evolution of China’s pension system
3. The Challenges facing China’s pension system
4. Suggestions for future reforms
China’s Population Changes, Births, Deaths and Growth, 1949-2010

- Birthrate (‰)
- Deathrate (‰)
- Natural Growth Rate (‰)
Total size and age structure of the population as reported by census

<table>
<thead>
<tr>
<th>Year</th>
<th>Total (million)</th>
<th>Aged 0-14 (%)</th>
<th>Aged 15-64 (%)</th>
<th>65 and older (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953</td>
<td>594.35</td>
<td>36.28</td>
<td>59.31</td>
<td>4.41</td>
</tr>
<tr>
<td>1964</td>
<td>694.58</td>
<td>40.69</td>
<td>55.75</td>
<td>3.56</td>
</tr>
<tr>
<td>1982</td>
<td>1008.18</td>
<td>33.59</td>
<td>61.50</td>
<td>4.91</td>
</tr>
<tr>
<td>1990</td>
<td>1133.68</td>
<td>27.69</td>
<td>66.74</td>
<td>5.57</td>
</tr>
<tr>
<td>2000</td>
<td>1265.83</td>
<td>22.89</td>
<td>70.15</td>
<td>6.96</td>
</tr>
<tr>
<td>2010</td>
<td>1339.72</td>
<td>16.60</td>
<td>74.53</td>
<td>8.87</td>
</tr>
</tbody>
</table>
Assumption on Total Fertility Rate (TFR), 2010-2100,
UN World Population Prospects (the 2010 Revision)
China’s Projected Total Population, 2010-2100 (million)
China’s Working Age Population (aged 15-64), 2010-2100 (million)
China’s Population Elderly 65+, 2010-2100 (% of total)
Impacts of Population Aging on the Pension System

the Decline of Potential Support Ratio

• Population aging implies a decline “potential support ratio”; that is, the ratio of working-age population to the elderly population

• The potential support ratio fell from 12.53 in the 1982 Census to 8.40 in the 2010 Census.

• The Medium Variant for China’s population in the UN World Population Prospects: the potential support ratio will fall to 2.38 in 2050 and to 1.83 in 2080.

• The Low Variant: the potential support ratio will fall to 2.10 in 2050 and to 1.14 in 2080.
The Decline of “System Support Ratio”

• Define “system support ratio” as the number of working employees to the number of retirees, the balance between revenues and expenditures of a pension fund requires
  replacement ratio
  = contribution rate * system support ratio
• when the system support ratio falls, to maintain the balance between revenues and expenditures requires either an increase in contribution rate or a decrease in replacement ratio, or a mixture of both.
• At the end of 2013, the system support ratio of the Pension for Urban Workers and Staff (PUWS) was about 3.0.
Impacts on Funded Pillar of the Pension System: the Shrinking Purchasing Power

- The impact of population aging on funded and DC pillars of a pension system will be milder and less obvious.
- However, as the pension benefits are in the form of financial assets, they can only be used for purchasing goods and services.
- Population aging implies a smaller working-age population relative to the elderly retirees, and hence the increased scarcity of labor, leading to the higher prices of goods and services, and the shrinking purchasing power of the pension incomes.
The Reforms and Evolution of China’s Pension System

• Prior to the mid-1990s, China’s public pension system consisted of two programs: 1) the Labor Insurance covering the employees of state-owned enterprises, and 2) the government insurance covering the employees of the governments and the public institutions, such as public universities and research institutes.

• The Labor Insurance was financed by the individual enterprises, and the Government Insurance was financed by the different level of governments.
• The two major drives of the pension reform is the economic transition and the impacts of population aging.  
• The former is more important for the earlier reforms; however, the latter is becoming more important for the recent reforms.
• In 1997, the pension for the employees of urban enterprises funded by individual enterprises was restructured into the Basic Pension for Urban Workers and Staff (PUWS), pooled and financed at the local level.
• During 1990s and 2000s, some localities initiated their own pension programs for peasant workers.
• The Social Insurance Law (2010) mandates that peasant workers participate in the PUWS.
• In 2009, the Central Government instituted the New Pension for Rural Residents, which is heavily subsidized by the governments.
• In 2011, the government instituted the Pension for (non-working) Urban Residents.
• In 2014, the pension for rural resident was merged with the pension for urban residents.
• In 2013, the government provided tax incentives to encourage the development of the third pillar of the pension system (the enterprise annuities).
• In 2015, the Government pension for the employees of the government and the public institutions was reformed to follow the same principles of the PUWS.
2. Reform Measures under Consideration

• Announce the plan for the nationwide pooling of basic pension (first pillar) of the PUWS in 2015.

• Announce the plan for later retirement in 2017, to be implemented in 2022.
The Challenges facing China’s pension system

1. Low Coverage of the PUWS

- By the end of 2013, PUWS covered 241.77 million working employees, accounting for 63.2% total urban employment (382.40 million); or 45.8% of total secondary and tertiary employment (528.06 million).

- Of the 268.94 million peasant workers, only 48.95 million, or less than 20%, were covered.
• Too high compulsory contribution rate tends to exclude the low-income groups from the program.

• The locality pooling (or the fragmentation) of the first pillar results in difficulties in portability of the pension entitlement, discouraging the participation of the workers with high degree of mobility.

• The weak association between pension contributions and benefits.
2. Deficits of the Pension Funds

- Population aging implies higher old-dependency ratio or lower support ratio, and higher pressure on the financing of the public pension.
- The increased government subsidies to the pension programs, the huge size of “empty” personal saving accounts, and the failure of the government efforts to re-fill or “actualize” the personal saving accounts in 13 provinces.
- Several studies on the Implicit Pension Debts (IPD) find it a heavy burden to the public finance.
3. Causes for Pension Deficits

• In addition to population aging, there are some other causes for pension deficits, such as Low coverage and the consequent low system support ratio, and locality pooling of the basic pension.

• Migration of younger laborers from rural to urban, and from inland provinces to coastal provinces, creates the transfers of pension contributions in the same direction and the inter-regional disparities in pension financing.

• The present system support ratio of PUWS is about only 3.0. If it can extend to most of the peasant workers, the ratio could easily increase to about 5.
4. The Issue of Older Peasant Workers

• The *NBS Report on the Monitoring and Survey of the Peasant workers in 2014* reveals that the country’s peasant worker amounting to 273.95 million, of which, the older peasant workers aged 50 and above accounting for 17.1% of the total (46.85 million).

• Among these older peasant workers, many contributed to the pension programs in cities, however, rarely qualified for pension benefits.

• Pension for Urban and Rural Residents is likely to be their only source of pension benefits, however, with too low replacement ratio.
5. The Slow Progress in the Development of Multi-Pillar Pension System

• Despite the government’s efforts to promote the third pillar of the pension system, the actual progress have been very slow.

• Of the 241.77 million employees covered by the PUWS, only 20.56, or 8.5% participated in the third pillar in 2013.

• The first and second pillar pension assets are not well managed and have only very low (sometimes negative) rate of return.
Suggestions for Future Reforms

1. Implement Nationwide Pooling of the First Pillar

• The Central Government is working on the plan.
• Implement nationwide pooling of the first pillar at a lower contribution rate so that to achieve universal coverage.
• The Central Government play a leading role, with local government sharing some clearly specified responsibilities.
2. Postpone the Retirement Age

- The compulsory retirement ages in China have not changed, although the life expectancy almost doubled during 1950s-2010s. The recent average retirement age is only 53.
- Retirement age should be postponed with the prolonged life expectancy in the aging society.
- The concept of “prospective age” can be adopted in the policy making.
• The Central Government will announce the plan on later retirement in 2017.

• However, the plan on later retirement needs the supportive policies, such as the policies to provide incentives for the labor participation of older workers, and the policies to encourage the employer to hire older workers.
3. Initiate the Non-Contributory (Zero Pillar) Pension

• Any contributory pensions would not be able to tackle the problem of pension for older peasant workers.

• One solution is to upgrade the current pension for urban and rural residents into a non-contributory pension, funded by the government budget, providing universal coverage to all elderly 65 and older in the country.
• If the benefits of such program is about 6% of the per-capita GDP, then the total expenditures would be about 0.6% of GDP or about 2.4 percent of the government budget.

• As the non-contributory pension could substitute some other items of public expenditures, such as the subsidies to the pension for urban and rural residents, and to the elderly poor, the net increase would be much smaller.
• A non-contributory pension with universal coverage of all elderly can improve the income distribution among the elderly, and in turn, the income distribution in the country as a whole.

• It could also expand the domestic consumption demand, and hence stimulate economic growth based on domestic demand.
4. Foster the Development of a Multi-Pillar Pension System

- Redirect the management of personal saving accounts from the local governments to the authorized pension assets management firms.
- Allow a more diversifies investment portfolio so that to enhance the return of such investments.
5. Change the Fertility Control Policy

- Allow all couples to have two children ASAP.
- Followed by elimination of any administrative control over the number of children
- Provide help to the families with difficulties in bearing and rearing children.
Thank You!