

# China's Pension System Reform

Dewen Wang  
World Bank

March 26-27, 2014, Incheon, Republic of Korea

## Pension schemes are integral parts of China's social protection system

SP programs	Urban Areas	Rural Areas
Social Insurance	Urban employees: <b>Pension insurance</b> , health insurance, unemployment insurance, work injury insurance and maternity insurance Informal sectors/residents: Basic health insurance <b>Urban resident pension scheme</b>	National Cooperative Medical Scheme (NCMS) <b>Rural Resident Pension Scheme</b>
Social Assistance	Urban Dibao Special and Temporary Assistance	Rural Dibao Special and Temporary Assistance Disaster Relief
Social Welfare	<b>Welfare programs for the elderly</b> children and the disabled <b>Aged care programs</b>	<b>Wubao programs</b> <b>Aged care programs</b>

## Pension system reform has followed a gradual paradigm

- The early pension reform focused on urban areas, aiming to reduce SOEs social burden and facilitate economic transition
- The reform process follows a pattern of learning by doing—pilot first and rolling out later—for both mandatory and voluntary pension schemes
- With broad coverage achieved, the focuses of pension reform shift to a full coverage by 2020, portability, equity and financial sustainability
  - “broad coverage, basic protection, multi-layer (flexible) and sustainable” – “Full coverage, basic protection, multi-layer and sustainable”

## At present, there are four major pension schemes

- Urban worker pension scheme
  - A mandatory scheme for urban enterprise employees (equivalent to formal sector workers, but excluding public sector workers)
- Scheme for PSU employees and civil servants
  - Defined-benefit in design with a generous replacement rate financed from government revenues
- Rural and urban resident pension scheme
  - A voluntary scheme for rural residents (including rural migrant workers) and for urban residents with a local hukou who are not covered by the urban employee pension scheme
- Voluntary enterprise and individual pension savings arrangements

## Design of the urban worker pension scheme

- It has a multi-pillar framework with two accounts: social pooling account contributed by employers (20% ) **Plus** individual account contributed by individuals (8%)
- Pension benefits come from basic pension **Plus** accumulation of individual account
- Eligible conditions are 60 for men and 55 for women
- It is partial pooling at the provincial level, but aims to achieve a full pooling at the national level finally

## The urban worker pension scheme has reached over 60 percent coverage, but challenges remain

- The coverage is low for informal employment and rural migrants
- Higher labor tax from higher SI contribution is one of the factors that discourage participation
- “Empty” individual account and tremendous deficit of pension funds in the long term
- It needs both parametric and institutional reform to increase incentives and to achieve financial sustainability
  - For example, reducing employers' contribution rate, indexation mechanism, increasing retirement age, introducing NDC design, ...



## **Milestones of expanding pension coverage for rural and urban residents**

- The old rural pension scheme was introduced in 1992, but largely relied on individual contribution, and the coverage stagnated around 12 percent
- The new rural pension scheme was introduced in 2009 after locally piloting
- Similarly, a national voluntary scheme that mimic the rural one was introduced for urban informal sectors and residents in 2011
- In 2014, rural and urban resident pension schemes are integrated into one system

## **Top-level political commitment and MDC design are the forces that dramatically increase China's pension coverage...**

- Geographic institutional setting up
  - Rural areas: 10% of counties in 2009, 24 % in 2010, 60% in 2011 and 100% in 2012
  - Urban areas: 60% of cities in 2011, and 100% in 2012
- Coverage was the top priority at its initial stage, while the protection level, incentive and fiscal capacity are received attention
- The enrollment of rural and urban resident pension scheme has dramatically increased from 56 million in 2008 to 484 million in 2012, with a coverage rate more than 80 percent in 2012

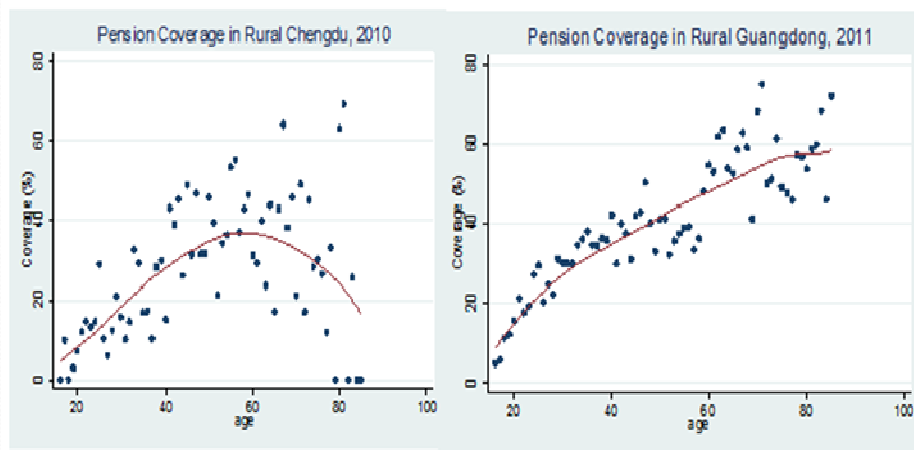
## Design features of the voluntary pension scheme

- It has a flat basic benefits (RMB 55 per month) **Plus** accumulation of individual account
- Individual account matched by local governments; and the contribution base are fixed levels for easy collection
- Basic pension benefits are financed by governments and cost-sharing is clearly defined
- Family binding is introduced to incentivize more contribution
- Pensionable ages are 60 years old for men and women; and vesting period: 15 years

## Challenges for the rural and urban resident pension scheme...

- Low target income replacement, largely flat benefits and subsidy
  - 15-year contributions of RMB 100/year (US\$15.4) yields a benefit of 73 yuan/month (US\$11.20), equivalent to 17% of rural per capita income in 2009 and 29 % of \$1.25/day
- Achieving universal elderly poverty protection will require additional minimum benefit guarantees under the current design
- Service delivery and management need to be strengthened
- Incentives for young people to participate in are weak

## Empirical results show the incentives are weak for young people

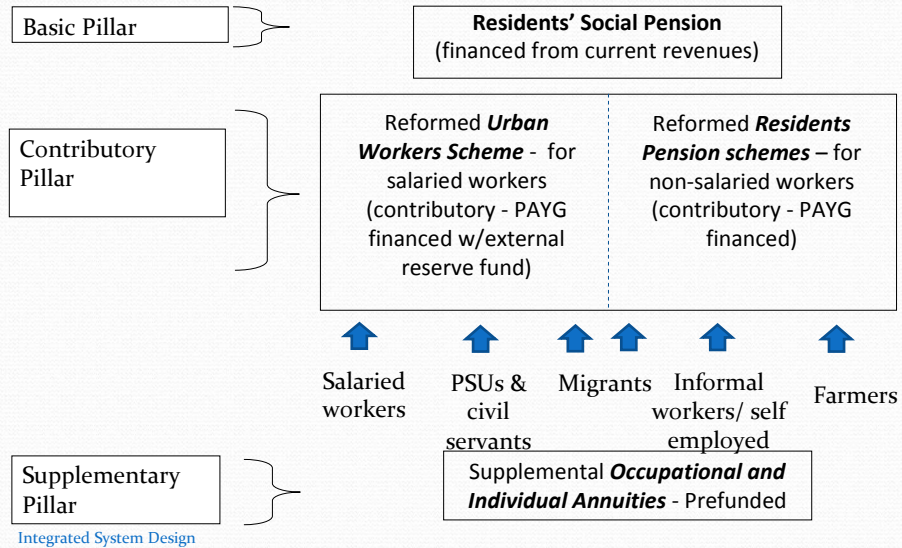


## Directions of pension policy reform in China

- Full coverage
  - Continue to incentivize participation for pension coverage
- Portability
  - Policy design has been introduced, the next step is to strengthen implementation
- Adequacy and Equity
  - Address the disparity of pension benefits between different groups and introduce the mechanism of benefit adjustment
- Financial sustainability
  - Parametric and structural reform



## A proposed reform design by World Bank for China



13

# Thank you!