China’s Pension System Reforms: Hybrid MDC and Social Pensions

Pensions Core Course
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1. Demographic & economic context & description of current schemes.
2. Background, description and evaluation of National Rural Pension Scheme.
3. Pilot program for Urban Citizens
4. Lessons for other countries.
Demographic & economic context - Aging population

- Drop in fertility rates and increasing longevity leading to rapid growth in old age dependency and a flat working age population.
- Substantial labor mobility and urbanization.

Figure 1: Projected Size and Composition of the Working Age Population

Figure 2: China Population Projections – Growth in the Aged and Dependency Ratios

Source: Staff estimates.

## Description of Current Schemes

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Target Group</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Urban Pension Insurance Scheme</strong></td>
<td>Urban workers with employment contracts</td>
<td>Mandatory contributory scheme, PAYG DB &amp; FDC layers (about 45% RR)</td>
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<tr>
<td><strong>Enterprise Annuity</strong></td>
<td>Salaried employees, medium-large companies</td>
<td>Supplemental voluntary occupational scheme for salaried employees</td>
</tr>
<tr>
<td><strong>Public Institutions Scheme</strong></td>
<td>PIU workers</td>
<td>Cont. Defined Benefit (88+% RR)</td>
</tr>
<tr>
<td><strong>Civil Servants Scheme</strong></td>
<td>Public servants at all levels</td>
<td>Non-contributory Defined Benefit</td>
</tr>
<tr>
<td><strong>Migrants pilot scheme</strong></td>
<td>Migrants in urban areas</td>
<td>Voluntary contributory <em>Pension Insurance Scheme</em></td>
</tr>
<tr>
<td><strong>Pilot Program for Urban Citizens</strong></td>
<td>Urban workers and retirees without other sources of old age poverty protection.</td>
<td>Voluntary contributions with local matching subsidy. Basic benefit and FDC layers</td>
</tr>
<tr>
<td><strong>National Rural Pension Scheme</strong></td>
<td>Rural workers and retirees without other sources of old age poverty protection.</td>
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</tbody>
</table>
Description - Multi-tiered Urban Social Insurance Design

- Urban Enterprise Contributors: 21.5%
- Rural Contributors: 6.7%
- PSUs: 3.7%
- Civil Servants: 1.5%
- Migrants: 9.0%
- Urban Uncovered: 55.2%
- Rural Uncovered: 2.4%

Voluntary personal Pillar III
Voluntary employer Pillar III
Mandatory social insurance Pillar I
Government provided Pillar 0

Individual Savings
Enterprise Annuity/Supplementary pension plan
Tier 1 Social Pool
Tier 2 Individual Accounts
Dibao (Minimum Living Standard Guarantee)
National Rural Pension Scheme – Description and Evaluation
Modest rural coverage over four phases of evolution of rural system:

- **initiation and expansion** - 1986-1998
- **contraction and stagnation** - 1999-2002
- **renewal phase of local piloting** - 2002-2009
- **2009 national rural pension pilot**

**Key issues** facing the old rural pension scheme:

- **lack of incentives** (no matching subsidy or minimum benefit) contributed to low participation + coverage concentrated in four coastal provinces.
- **low benefits** due to investment rules, lack of employer contribution, etc. and real returns volatile & strongly negative in some years
- **weak governance and supervision**, accumulations invested in non-authorized sources & mismanagement leading to collapse or cancellation of schemes of around 10% of schemes
Motivations for reform: Changing demographics and rural elderly dependent upon children or family support

• Rural elderly receive most support from their children or from their own labor.
• As the rural elderly get older, they rely more on family support.
• An important share of the rural elderly are poor or vulnerable, particularly as they get very old.


Two components:
- Funded individual accounts with matching contributions.
- Basic (flat) pension at age 60 for workers who contribute 15 years.
- “Family binding” and buyback provisions – benefits provided children are contributing.
- Contributions for *dibao* beneficiaries to be covered by local governments.
Financing from a combination of:

- *central subsidies* to support the basic pension (100% for central and western regions & 50% for eastern regions)
- *individual contributions* (generally ranging from 100 to 500 Yuan (US$15.80-US$79.00 - per year + higher in richer areas)
- *partial match on IA by local governments* of at least 30 Yuan per year
- *collective subsidies*, encouraged but not mandated.

Rate of return on IAs = one-year deposit interest rate (< wage growth and inflation)

Fund management for IA accumulations at county level, with aim to shift to provincial level. Supervision of funds by local offices of MHRSS.
National Rural Pension Scheme - Initial Results

- Geographic targets set for offering the scheme: 2011 target: offered in 60% of rural areas.
- Participation less clear: Age 45+ participation in areas offering the scheme believed substantial but weak incentives for those < 45.
- Fiscal costs for minimum benefit appear affordable while affordability of matching contributions will vary across localities.
- Incentives:
  - Central financing of basic benefit creates greater confidence in benefit promises.
  - “Family binding” and purchase of service approach create contribution incentives for age 45+ though may also lead to coverage gaps.
  - Scaling up the MDC/DB scheme creates more uniform incentives across localities.
Will a benefit of 73 yuan (US$11.20) per month be adequate to protect the rural elderly from poverty?

- 27-31% of net rural per capita income (2009)
- 29% of $1.25/day
- 73% of national poverty line & dibao threshold (2009)

- Benefit amount depends upon amount of supplementary financing provided by the locality.
- Further reducing income disparities may require committing to a higher minimum income target centrally financed.

Will combined subsidies and the basic benefit be sufficient invite widespread participation?

- Likely yes for those age 45+. Overall returns on contributions make for a very high 16% IRR on contributions
- Minimum contributions affordable for most rural citizens.
Does the design suit the objectives? Is it worth the effort?

- Designed as largely a contributory flat defined-benefit social insurance scheme.
- Yet low target income replacement subsidy structure suggests elderly poverty protection is the core objective.
- Achieving universal elderly poverty protection will require additional minimum benefit guarantees.

- Alternatively, a non-contributory social pension (pensions tested with a low benefit target) might better achieve the objective of poverty protection with greater economic efficiency.
- An MDC arrangement with greater matching contributions could provide basic income support, + serve as a stronger savings vehicle for smoothing consumption and adding up entitlements for China’s mobile workforce.
Pilot Program for Urban Citizens
Pilot Program for Urban Citizens

- Announced June 2011
- Objective to guarantee the basic living of the aged in urban areas – extending basic income protection to all urban citizens (addressing coverage gaps in basic protection)
- Design similar to National Rural Pension Scheme.
- Family binding processes left to local regulations.
- Questions of adequacy even stronger than for NRPS and concern over link between objective and instruments as per the NRPS.
Lessons for Others
Lessons

- Basic design framework with regional variation useful in large countries with diverse conditions and decentralized existing programs.
- Substantial participation in rural areas possible through the hybrid incentives, but incentives greatest for older workers; some characteristics of rural China are country-specific.
- Tension between fiscal cost and benefit adequacy.
References


