

# Contribution Collection

## 1 Contribution Collection agency

### 1.1 Provisions regarding contribution collection

Current contribution collection system in China is rather complicated. It is stipulated in the *Provisional Regulation on Social Insurance Contribution Collection (hereinafter referred to as the Regulation)*, issued by the State Council in 1999 that three social insurance schemes' contribution (referring to pension, medical and unemployment schemes which taking into effect at that time) should be collected in a unified way and Provincial government has the jurisdiction to choose collection agency between tax administration and social insurance agency. Before *the Regulation*, Law of Labor of 1994 provides that social insurance agency is responsible for collecting contribution. But *the Regulation* has changed the provision in Law of Labor by making a compromise with the reality that some provinces opted for tax administration to collect contribution.

### 1.2 Contribution collection agencies

As for the number of collection locations, there are 37 units including 31 provinces, 5 special cities which have higher ranking than ordinary cities<sup>1</sup>, and Xinjiang Production and Construction Corp<sup>2</sup>.

The selection of collection agency had been unchanged since 2002 until 2008 when Ningxia decided to shift to tax administration to collect contribution.

At present time, 14 provinces, plus Xinjing Construction unit and 3 special cities still insist on social insurance agency to collect contribution. 17 provinces, plus 2 special cities choose tax administration, but in reality, only 2 provinces and 2 special cities<sup>3</sup> rely solely on tax administration to collect all contribution for all group, the remainder fail to do so, they have to use social insurance agency to collect some schemes contributions for all groups or in some municipalities (or counties) or collect all contributions for some groups. Details are listed in table.

In total, half –half units choose two collection agencies respectively. In terms of contribution amount, in 2006 social insurance agency collected more than 57% of all contributions, while tax administration collecting 43%.

**Table 1 Collection Agency for Each Province (to be updated) as of Aug. 2006**

TA stands for Tax administration

SIA stands for Social Insurance Agency

<sup>1</sup> Referring to Dalian, Shenzhen, Qingdao, Xiamen, Ningbo.

<sup>2</sup> The five special cites and Xinjiang Production and Construction Corp can make their own decisions within their provinces automatically rather than authorized by provincial government.

<sup>3</sup> They are Anhui province, Ningxia province, Ningbo city and Xiamen city.

| Provinces      | Collection agency designated in documents | Reality of collection agency  | Unified                         | note   |
|----------------|---|---|---------------------------------|--|
| Anhui          | TA  | TA  | Yes                             |  |
| Xiamen city    | TA  | TA  | yes                             |  |
| Ningbo city    | TA  | TA  | yes                             |  |
| NingXia        | TA  | Pension and unemployment contribution collection has been shifted to tax administration in the beginning of 2008.<br><br>The other three schemes will be finished at the end of 2008. | Unified at the end of this year | There are 9 counties and cities where no local tax administration set up, will trust branches of national tax administration to collect contributions. |
| Hebei          | TA  | TA: for pension and unemployment insurance<br>SIA: medical, work injury, maternity insurance  |                                 |  |
| Inner Mongolia | TA  |   |                                 |  |
| Liaoning       | TA  |   |                                 |  |
| Helongjiang    | TA  | SIA for state-owned farming enterprises and foresting industry, which by affiliated-office within enterprises and industry.   |                                 |  |
| Jiangsu        | TA  | SIA for individual business, migrant works, inflexible workers  |                                 |  |
| Zhejiang       | TA  | SIA for individual business, migrant works, inflexible workers  |                                 |  |
| Fujian         | TA: pension and unemployment              | TA/SIA: The rest three items is determined by the choice of municipalities  |                                 |  |
| Hubei          | TA: Pension.                              | The other four items contribution collection is determined by municipalities  |                                 |  |
| Guangdong      | TA  |   |                                 |  |
| Hainan         | TA  | SIA for state-owned farming enterprises   |                                 |  |
| Chongqing      | TA  | SIA for individual business, migrant works, inflexible workers  |                                 |  |
| Yunan          | TA  |   |                                 |  |
| Shanxi'        | TA  | SIA in some municipalities  |                                 |  |

|               |                              |   |     |  |
|---------------|------------------------------|---|-----|--|
| Gansu         | TA: pension and unemployment | TA/ SIA for rest three items                                |     |  |
| Qinghai       | TA: pension and unemployment | SIA for medical, work injury and maternity                  |     |  |
| Hunan         | SIA                          | TA for foreign invested enterprises and private enterprises |     |  |
| Beijing       | SIA                          |   | yes |  |
| Tianjin       | SIA                          |   | yes |  |
| Shenzhen city | SIA                          |   | yes |  |
| Dalian city   | SIA                          |   | yes |  |
| Shanxi        | SIA                          |   |     |  |
| Jilin         | SIA                          |   |     |  |
| Shanghai      | SIA                          |   | yes |  |
| Jiangxi       | SIA                          |   |     |  |
| Shandong      | SIA                          |   |     |  |
| Qingdao city  | SIA                          |   | yes |  |
| Henan         | SIA                          |   |     |  |
| Guangxi       | SIA:                         |   |     |  |
| Sichuan       | SIA:                         |   |     |  |
| Guizhou       | SIA:                         |   |     |  |
| Xizang        | SIA:                         |   |     |  |
| Xinjiang      | SIA:                         |   |     |  |
| Xinjiang Corp | SIA                          |   |     |  |

Note: this table is incomplete in terms of the last three columns, just for reference.

### 1.3 Unified or Separate Collection

It is supposed to collect contribution in a unified way, but due to many reasons, up to now, there are only 11 units make it, 26 units failed. Among units with unified collection, 4 rely solely on tax administration and 7 provinces use social insurance agency. For the remainder provinces, situation varies greatly (1) As for provinces with social insurance agency collection, there are two or three or four branches collect different schemes contribution. (2) As for those using two agencies to collect contribution, some provinces authorize tax administration to collect two schemes, usually pension and unemployment insurance, while others still depend on social insurance agency and wait a ripe time to shift to tax administration. (3) Some municipalities within a province have

implemented a unified collection while some couldn't, which is totally dependent on sub-province own situation. Usually more economically developed cities pioneer in this trend. (4) In some provinces, contribution collection agency is chosen according to groups, for example, tax administration for enterprises, while social insurance agency for self employed, migrant workers, flexible workers. Another example, Hunan province provides that tax administration collects contributions of foreign-invested and private enterprises, while social insurance agency collects other employers.

## **2. Costs and Efficiency**

### **2.1 Comparison between two agencies at present time**

In fact, it is hard to compare which method is more efficient to collect contributions throughout the world. Though there is a trend towards tax administration, still in many countries, there is no sign and reason to make such a great shift, for example, in Germany, France and Poland. It is believed that if there is a law, and participants know their obligations and rights and respect law, the difference between two methods should be marginal except a little extra effort put on employers who have to deal with two agencies when paying tax to tax administration and contributions to social insurance agency.

In China's context, it seems tax administration should have been more efficient if selected as contribution collection agency for following reasons.

(1) Comparing to social insurance agency, tax administration has a long history, more experienced and better trained collectors. They have advanced computer processing system, strict control and operation procedure, therefore, the techniques required by social insurance contribution collection can be easily met by tax administration. All those are supposed to help bring down the collection cost, obviate reinvestment and save government resources. (2) It is thought tax administration has more authority. Stipulated by Tax of Management and Collection, tax administration has many ways to collect tax compulsorily, which can be applied to contribution collection. (3) If tax administration is chosen to collect both income tax and contribution, that means employers just deal with one agency rather than two, they can pay tax and contribution at a time.

But, in reality, tax administration has failed to show that likely advantages. And it is rather hard to compare which agency is more efficient in terms of compliance rate and the amount of contributions collected per participant. According to some incomplete information, social insurance agency collection is more effective. In order to figure out why, we should look at procedures and incentives of contribution collection.

For tax administration, (1) it just serves as proxy for contribution collection, gathering the amount of contributions calculated by social insurance agency, but not involved in the calculation of contributions, expansion of coverage and auditing of contributory base of employers and employees. (2) With no law on contribution collection yet, tax administration can't use the same compulsory methods to collect contributions as to tax, such as freezing bank account of

employers, and requiring employers to offer mortgage. (3) Though five schemes contributions can be collected uniformly by tax administration, employers still have to deal with two agencies, reporting the amounts of contribution to and audited by social insurance agency, so the burden on employers is not reduced a lot. What's more, in some provinces, employers have to face two agencies in the aspect of contribution collection when different schemes collected by different agency, plus paying tax to tax administration, which increases their burden. (4) In some places, the information exchange and share between social insurance agency and tax administration is not so smooth all the time, which result in low efficiency, even missing of recording. (5) Tax administration contribution collection also incurs extra input by setting up new division for contribution collection, charging a fee for contribution collection and getting a reward from government budget, the latter two are also the motivation for them to take the responsibility.

For social insurance agency, (1) Calculation, collection and auditing contribution is an integral process, that can get rid of problems happening during contracting-out of collection. (2) Now with the introduction of reward used for tax administration, it also encourages social insurance agency to improve efficiency in collection. (3) Extending coverage and ensuring the benefits payment for retirees on time and in full amount are top priorities of social insurance agency's agenda, so it has strong responsibility to collect contribution, otherwise it couldn't pay benefits. But by comparison, tax administration lacks enthusiasm to collect contributions payable by individual and flexible workers, because it is energy-consuming with a large number of people and small amount of contributions per person, thereby smaller reward per unit. That's why in some provinces with tax administration collection, such as Zhejiang, Jiangsu and Chongqing, social insurance agency has to resume and undertake contribution collection for individual business, flexible workers, which leading to parallel contribution collection systems existed in those provinces.

## 2.2 Total Cost and Efficiency

Obviously, Separate collection leads to inefficiency and huge waste in terms of system building, as well as a lot of trouble imposed on employers who have to deal with different agencies, even different branches within social insurance agency every month. That's the big failure of contribution collection in most provinces and cities (26 location units).

It is difficult to calculate compliance rate and draw a comparison between two kinds of collection methods. First, the definition of coverage differs across provinces, especially when it comes to informal sector, some provinces provide that it should be compulsorily covered while other provinces not. Second, the contributory base is different across provinces, some provinces provides employers contribution base is the sum of individual wages, while some provinces is the total payrolls. What's more, contribution rate is different across provinces, for example, Guangdong has the lowest employers' rate for pension at 12 %, most provinces is about 20%. In theory, low contribution leading to high compliance. Lastly, the reality is also complicated, Sichuan province, Jilin province and Guiyang city and Changsha city once depended on Tax administration to collect contribution, but with low compliance rate, they had to give up and return to social insurance agency, while Ningxia, is the recent case of shifting from Social insurance to tax administration. In fact, many factors rather than compliance consideration have been involved

in the choice of collection agency, for example, the lobbying of tax administration is effective in some provinces.

Generally speaking, under current situation, there is always compliance problem for both collection agencies. It is easy to blame that on the absence of Law concerning contribution, which leads to low contribution compliance for both collection agencies. But that is just one reason for low efficiency. The deep-seated problems are related to the economic situation and system design. When economy is on the rise, both collection agencies can obtain better results because higher wages and more employment, vice versa. In China, due to the government's shying away from implicit debt incurring from pension system transforming from social pooling to the combination of social pooling and individual account, double burden is put on current employers and employees, which leading to high contribution, thereby high cost to keep compliance. So if implicit debt is not resolved, just the law is made and put into effect, high contribution-induced compliance problem is very likely to exist, and partly reflected in other forms, such as lower wages, and reduced employment.

### **3. Discussion about contribution collection agency**

In China, with half- half provinces choosing respective two methods at present time, it is rather hard to unify collection agency, because both agencies have their own advantages and disadvantages.

#### **(1) Social insurance agency.**

Firstly, it suits the features of combination of social pooling and individual accounts for pension. Individual account is intended to be funded, which means there is a huge amount of bookkeeping, i.e. recording its contributions and investment return. Since individuals have no right to choose investment tools by themselves and their account can't be trusted to financial organization, it is the main responsibility of social insurance agency to take care of individual accounts, and not appropriate for tax administration to undertake because whose job is based on one fiscal year rather than life-time recording.

Secondly, collection by social insurance agency meets the requirements arising from varied employment patterns and different kinds of employees. In China, social insurance is now extending coverage to individual business and those working in a flexible way, especially to migrant workers, urban and rural residents, who have no tax registration number and with a small amount of contributions to make. Therefore, it would be hard for tax administration to track these people and realize full coverage at present time. As we know, in welfare states such as UK and Sweden, everyone has a tax number, so it's easy and natural for them to rely on tax administration to collect contribution.

Thirdly, labour and social insurance bureau is more familiar with labour policy and wage composition at enterprise level, so they have some advantages to collect contributions over tax

administration.

The disadvantages are also obvious, compared with tax administration, social insurance agency lacks compulsory collection means and necessary authority to collect contribution which tax administration has already had in their field. Meanwhile, a new system collecting contributions, parallel to tax system, means reinvestment to some extent.

(2) Tax administration. Relying on tax administration also has many advantages, which are mentioned before. In addition, it can help to form a built-in evasion prevention system. Tax administration to collect contribution is conducive to reduce non-compliance for both tax and contribution collection, because social insurance contribution can be deducted from taxable income, so enterprises have the incentive to report a larger amount of contributions to tax administration to get more tax deduction while pay a smaller amount of contribution to social insurance agency. If one agency is used to collect both tax and contribution, then such thing can be avoided to some extent.

The disadvantage is if tax administration just collects contributions without engaged in calculating and checking contributory base and keeping records of employers and employees, many problems facing China today will continue to exist in the future. Especially, the information exchange between social insurance agency and tax administration is huge, which maybe trade off some of the efficiency gained from collection through tax administration. But if all the responsibilities of calculating and checking contributory base and recording individual account shift to tax administration, even it is not regarded as a tax, just like that in UK, it comes new problems, one is about the separation of management of social pooling and individual accounts suggested by some experts, which also brings about a lot of inefficiency. The other is about downsizing social insurance agency resulted from a large proportion of responsibilities transferred to tax administration, which will incur transitional cost in terms of laying off personnel and wasting previous investment in social insurance agency, undoubtedly, that will entail expansion of tax administration. In fact, tax administration has the highest administrative cost compared to other public organizations in China as well as its counterparts in the world<sup>4</sup>. It also needs improving efficiency in its own field.

To sum up, it is a critical decision to choose collection agency, many things should take into account, such as policy design, transition cost and so on. For the time being, the most important thing is to extend coverage while lower contribution rate by emphasizing government budget responsibilities for implicit debt of pension.

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<sup>4</sup> The administrative cost for tax administration in China is about 5-6% of total amount of tax, which is in contrast with 0.58% in USA, 0.95% in Singapore, 1.13% in Japan, 1.76% in UK of 1992.

