

Report on Pooling level for Pension Insurance in China

1. Policies and Provisions about Provincial Pooling for Pension Insurance

There are three documents concerning provincial pooling issued by the State Council in last decade.

No. 26 in 1997, Decision on Establishing Unified Basic Pension System for Enterprises Employees, provides that county's pooling level should be improved to provincial level, or sub-provincial level authorized by respective province.

No. 28 in 1998, Notification on Issues of Improving Basic Pension Pooling Level to Province and Transferring Industrial Pooling to localities, prescribes that all provinces set up provincial adjustment fund by collecting from local pension funds with a proportion needed to cover payment claim across the province by the end of 1998. It also proposes to realize provincial pooling for basic pension by 2000 in aspects such as unifying pension contribution rate, management and usage of pension fund, and establishing top-down administration system of social insurance agencies within province.

No. 38 in 2005, Decision on Improving the Basic Social Insurance System for Enterprise Employees, stipulates that adjustment fund at provincial level should be established and improved, thus enhance the capability to share payment risk within province. It provides that municipal pooling be improved to provincial level, so as to create conditions for building unified labor market and encourage free mobility.

The three documents issued illustrate that the central government has a desire to improve pooling level. Document of No.26 in 1997 is the first document to mention provincial pooling, followed by No.28 in 1998, which even set timetable to realize provincial pooling but failed. As for No.38 in 2005, provincial pooling is once again put on agenda.

2 Current provincial pooling

2.1 Level of Pooling

(1) Provinces with provincial pooling for pension insurance before 2006

By the end of 2006, there are 13 provinces with provincial pooling, 7 provinces plus Xinjing corps implementing municipal pooling, and 11 provinces still staying at county pooling (see table 1). It is interesting to find out that there are some rules behind which provinces are among the first provinces to realize provincial pooling. (1) Due to small territory and small number of population, it's easy for four municipalities directly under the central government (referred to as provinces), Beijing, Shanghai, Tianjin and Chongqing to realize provincial pooling. (2) Fujian is the only exception in the East and comparatively affluent province (besides four municipality provinces) to

promote provincial pooling at an early time. (3) Besides the above mentioned provinces, the other 8 provinces with provincial pooling are located in the West and Northeast, which are less economically developed (especially West provinces), have fund deficits, and therefore heavily depend on central government's subsidy to pay benefits, so it is also easy for them to realize provincial pooling because it touches little interests of sub-province government, nor adds much burden on provincial government's budget.

Table 1. Pooling level of provinces at the end of 2006

| Pooling level | Provinces |
|--|--|
| Pooling at provincial level | 13 provinces including Beijing, Tianjin, Jilin, Heilongjiang, Shanghai, Fujian, Chongqing, Yunnan, Shanxi', Gansu, Qinghai, Ningxia, Xinjiang. |
| Pooling at municipal level | 7 provinces including Liaoning, Anhui, Shandong, Henan, Guangdong, Guangxi, Xizang, plus Xinjiang Construction and Production Corps. |
| Pooling at county or district level | 11 provinces: Shanxi, Inner-Mongolia, Zhejiang, Jiangsu, Jiangxi, Hunan, Hubei, Hebei, Sichuan, Guizhou, Hainan. |

Source: Bulletin of Labor and Social Security of 2006, issued by the Ministry of Labor and Social Security.

(2) Provincial pooling is accelerating

On September 22, 2007, the former Minister of Ministry of Human Resources and Social Security (MoHRSS) declared that all provinces should implement provincial pooling in two years. That means provincial pooling is accelerating.

By the end of 2007, four provinces including Henan, Hunan , Jiangxi and Xizang, and Xinjiang Construction and Production Corps had formulated methods to carry out provincial pooling. In 2008, the above mentioned four provinces are recognized by MoHRSS to achieve provincial pooling, therefore by now there is a total of 17 provinces with provincial pension pooling. Other provinces are planning to carry it out.

2.2 Features of current provincial pooling

Real provincial pooling means that pension policy, contribution rate, benefits calculation, fund use and pooling, fund budgeting, and operation procedure should be unified within province realm, in reality it is hard to do all of them. Some provinces with provincial pooling are just in the transitional stage to real provincial pooling with some unified elements and some none-unified elements. Current provincial pooling has some variation in following aspects.

(1) Two types of fund pooling

One is all revenue and payment is centralized to provincial level, which means all revenue is

required to put in provincial account and then allocated to social insurance agencies at sub-province level which is responsible for benefits payment based on actual amount of benefits claim. For this method, if there is a fund deficit, the gap will be filled up by provincial budget (financed by tax). This method is adopted by Beijing, Shanghai, Tianjin, Shanxi, Qinghai, etc.

The other type is that only the surplus of fund at sub-provincial level is required to put into provincial account. That means sub-province agency operates revenue and expenditure of fund within their realm but has no authority to run any surplus. In reality, the deficit occurred in sub-province agency is shared by province, municipality and county budget at a defined ratio, rather than totally borne by fund surplus gleaned from other sub-provinces, or by provincial budget if the final balance is in red. The purpose of sharing is to strengthen responsibility at various levels. Heilongjiang and Jilin adopt this method.

Generally speaking, the two modes are common in terms of unified contribution rate, and unified fund surplus management by provincial agency, but different in fund flow and the way to deal with deficit. Both modes have their own advantages and disadvantages. For the mode of centralized all revenue and payment, it helps enhance the authority of provincial pooling, but also leads sub-provincial government and social insurance agency to shy away from their responsibility and less concerned about maintaining and improving contributions in their realm, because the deficit is not their business any more. Thus overburdens provincial government if there is a deficit. In contrast, for the mode of only centralizing fund balance, if there is a deficit at sub-provinces, the responsibilities will be borne by government at various levels, which will relieve pressure on provincial government and keep local government involved in pension insurance. However, due to not all revenue put into provincial financial account, there is still a possibility that contribution collected at sub-provincial level will be misused by local government and local social insurance agency, thus lessening the function of provincial pooling.

In sum, there are some common problems happened for both modes of provincial pooling to some extent. With the responsibility of sub-province being weakened in pension insurance, local governments have a tendency to care less about compliance of contribution and benefits delivery, for example, in some places, local government lacks enthusiasm to expand coverage to enterprises and oversees their compliance. What's more, when there is limited resources for both tax and contribution, sometimes it will put tax first, contribution second, that means it tries to guarantee tax which is at its disposal, leaving the responsibility of collection and payment of pension to provincial government. It also should be noted that those problems are being addressed to some extent¹.

(3) Average wages used in pension calculation is not unified yet

It is provided that pension benefits should be unified in terms of calculation formula and benefits

¹ For example, in order to address problems resulting from centralized all revenue and payment, from 2004 on, Shanxi has adopted a method that provincial government has contracted with sub-province governments to ensure responsibilities in coverage expansion, contribution collection and compliance, and provision of service for retirees. From 2006 on, contribution collection and compliance has been taken into account of performance evaluation of local government. It has achieved comparatively desirable results.

payable by social pooling². But there is a problem whether basic pension should be calculated with provincial average wages or sub-provincial wages. In reality, for some provinces with provincial pooling, such as Shanxi³ and Xinjiang, they still use sub-provincial wages to calculate basic pension. Undoubtedly, this way means less redistribution function played by provincial social pooling. However, it should be noted that such situation gives rise to a new problem that people, especially those who are near retirement age and working in formal sector, if possible, are willing to move to big cities where have higher average wages, so that they can get higher basic pension(so for people moving to provinces with higher wages).

(3) Different pension administration agency

There are three types of pension administration among provinces with provincial pooling. One is top-down pension administration system set up with all the personnel designation and administrative cost arranged by provincial government. This is a thoroughly independent system and implemented in Heilongjiang and Shanxi⁴. The second one is semi-top down system, with administrative cost coming from provincial government but personnel designated and managed by local government, which is a moderate independent way, implemented in Fujian. The third one is to maintain original administration system, still affiliated to local labor and social security bureau in every aspect, now most of provinces with provincial pooling adopt this way.

In reality, the three ways have their own problems, though top-down administration is most efficient for implementing provincial pooling, but also causes local governments to heavily depend on provincial government and decrease their participation. On the other hand, if top-down pension administration agency is not in place, it will reduce efficiency and the function of provincial pooling.

3 Advantages of provincial social pooling

As a rule, in most countries, pension insurance is pooled at national level and it is regarded as an emblem of national solidarity and fairness. But in China, pension insurance is highly fragmented, with more than one thousand of funds, which is somehow against the principle of establishing pension insurance for sharing old age risk and redistributing resources among generations and inter-generations. With the limitations of low pooling level becoming more and more obvious, it is urgent to implement provincial pooling. The advantages of provincial pooling for China are as follows.

(1)It can make best use of fund. As we all know, low pooling level means there are fund surplus in some cities while deficits in other cities. Those trapped in deficits are under great pressure to pay benefits on time. On the other hand, those with surplus just face with depreciation of their fund because there are no adequate instruments for them to invest the accumulated fund. Firstly,

² For those retired before 1997, when No. 26 was issued, the benefits items covered by social pooling includes standard pension, pension increase, subsidy for price increase and so on prescribed by Central Government and Ministry of Labor and Social Security (which is implemented by provincial government). For those retired after 1997, benefits covered by social pooling refer to basic pension, individual account pension, transitional pension, and pension increase prescribed by the State.

according to relevant policy³, pension fund can only be put in bank or used to buy state securities(national debt) which is always in short supply, since other kinds of investment are not allowed to make, the return rate is rather low, with high inflation rate in recent years, the real value of fund surplus is decreasing. Secondly, nowadays there are nine provinces which are experimenting with capitalization of individual account fund have entrusted National Council for Social Security Fund to invest their individual account fund, through which it can be invested in financial market, but only get a guaranteed return rate of 3.5% per year.

The presence of surplus fund in some cities or counties being devaluing and deficit fund in other places can't meet demands of payment and calling for subsidies from government at higher level shows that pension system is inefficient. If provincial pooling to be implemented, then fund can be pooled and best used, and benefits payment in deficit places can be ensured, that's why pension insurance is established.

(2)It can reduce fund risks resulting from operation. Current decentralization of management of fund surplus leads to low efficiency in terms of investment decision as well as brings about high possibility of misuse of fund at sub-provinces due to lack of adequate supervision. If provincial pooling is in place, then the number of funds at national level will be reduced from current more than 1000 to 31(number of provinces), which means it is easier to supervise fund and ensure its safety.

(3)It can correct current distorted subsidy mechanism, urging local governments to share its responsibility. Since 1998, the special subsidy fund for pension insurance transferred by central government is becoming a major source for pension revenue. But due to lower pooling level, this transfer is distorted into an overused mechanism by governments at lower level. What's more, some cities take advantage of this mechanism by improving pension benefits, or blindly lowering contribution rates, or making policy to encourage pre-retirement, thus creating a new fund deficit. As a result, such situation leads to unreasonable distribution of resources and heavier burden on governments at higher level. The way to remedy this dilemma is to realize provincial pooling, making subsidy fund operate in a fair and reasonable way.

(4) Improving social pooling level can promote fair competition between enterprises in different pooling areas. Due to different old age dependency in different cities and counties, the contribution rates required to cover benefits payment in localities are different, which greatly influences competition edge of enterprises, especially undermines economic development of those places with high contribution rates, because that increases labor cost and prohibits investment to some extent.

(5) Improving pension pooling level can offer a normal and reasonable environment for workers to move. Nowadays, when people move within a province with sub-provincial pooling level, they find they may suffer benefits loss from mobility, let alone moving across the provinces, especially for those migrant workers. Those leaving pooling localities don't want migrant workers to take

³ According to Document No. 60 in 1999 issued by the Ministry of Finance and Ministry of Labor and Social Security, the balance of pension fund only can be used to buy state securities and is prohibited from making any direct or indirect investment.

away all of their contributions except individual account, and insist that social pooling pension is based on pay-as-you-go principle and not portable according to current policy. While those receiving pooling places are unwilling to recognize migrant people's previous covered years because they haven't made social pooling contribution to local fund. There are a lot of such cases happened across the nation. Such conception resulting from low pooling level does harm to establish unified labor market and puts up barriers for participants to move freely. If provincial pooling is set up, then workers can move easily at least between cities within province and it also helps to resolve mobility between provinces.

(6) It goes without saying that provincial pooling is the first step towards national pooling. Only all provinces can realize provincial pooling is national pooling possible.

4. Problems Facing the Establishment of Provincial Pooling

Though improving pooling level is in right direction, it is difficult to carry out for following reasons.

(1) It shifts responsibilities to provincial government. The level of pooling determines which level of government is responsible for fund deficit. For provincial governments, if they make up their mind to improve pooling level, that means they have to undertake the shortfall of fund. Those affluent provinces can't expect to get subsidy from central government, therefore have to use their own budget to pay pension if there is a deficit, which is otherwise undertaken by sub-provincial governments. It is the fiscal structure-induced government interest impedes the implementation of provincial pooling. Therefore, if it is not a compulsory mandate by central government, provincial government is reluctant to take the initiative to realize provincial pooling level.

(2) It influences the interest of cities and enterprises with low contribution rate. Long-term fragmentation of pension system has spawned local governments' and enterprises' interest which have low dependency ratio and low contribution rate. Since the first prerequisite for provincial pooling is unification in terms of contribution rate, those advantageous cities and enterprises have to increase contribution rate while their employees' pension benefits may not or less increase, undoubtedly, they will resist such change at the outset.

(3) It may increase fund deficit. If benefits items are to be unified, then those with low benefits will increase their level and benefit most from provincial pooling, because at any time high benefits level is rigid and can't be reduced right way, with low benefits level improved, that will produce or enlarge fund gap to some extent, and may increase provincial government burden.

(4) It may create reversed fund flow and worsen the situation of disadvantageous places. Due to great disparity in local development, there is a possibility that provincial pooling may produce reversed fund flow. Though in theory, provincial pooling can enhance fund capability to share risk, in reality, fund may be flew from small town to big city, underdeveloped areas to developed areas, agriculture area to industrial area. Because some big old cities have high dependency ratio and fund deficit while some small towns are underdeveloped and young with fund surplus, under such

situation, if improving pooling level, fund flow will be in favor of big industrialized cities and help them to lower contribution rate and reduce old age risk but put small cities at a disadvantage with high contribution rates. This is hard to be understood and accepted by ordinary people.

5. Discussion on how to improve to provincial pooling

Essentially, improving pooling level from sub-province to province is a political decision, if it is compulsorily enforced by central government, it can be achieved. **But** there are some points should be taken into consideration when carrying out provincial pooling.

(1) Emphasizing the responsibility of local governments

It is clear if provincial government is totally responsible for revenue, payment and shortfall, then sub-province governments have no incentive to engage in pension insurance process, that will put great pressure on provincial government, so the best practice is to let all governments share the responsibilities, such as put coverage expansion, contribution collection and compliance on their agenda, if they can finish their task on time or ahead of time, they can get some benefits from provincial government, if they fail to do so and there is a gap in due collection amount and actual amount, they should fill up part of the gap through their budget. In the long run, if all employers and employees are to be covered, and a powerful collection agency is set up, and high compliance rate is ensured, it should consider letting sub-province government shake off this responsibility. But at present time, co-responsibility between governments at all levels is necessary.

(2) Setting up top down management system

If social insurance agency is affiliated to governments and labor and social security bureau at lower level, it couldn't remain neutral to implement policies stipulated by provinces when there is interest conflict between province and sub-provinces, such as the transferring of fund surplus which is always thought to be an asset of localities. In order to efficiently and successfully implement policies made by provinces, top-down management system is indispensable, because there is no interest conflict.

(3) At preliminary stage, permitting social pooling pension to be calculated based on local average wages. Because there may be a big gap in wages between different cities within one province, in order to avoid resistance from advantageous cities and enterprises, benefits regulation can be put last, but in the long run, with transitional pension is chased out, and individual account pension is playing its full role, basic pension should be calculated on provincial average wages, so that to realize real provincial pooling and redistribution function.