

# The Basic Situation of China's Unemployment Insurance System

*You Jun, Director-General, Institute for Labour Studies, Ministry of Human Resources and Social Security, P.R.China*

## 1. The Establishment and Development of China's Unemployment Insurance (UI) System

There have been three main phases since China's unemployment insurance system was set up in 1986.

### 1.1 Phase 1 (1986 to 1993): the basic framework established

During this period, China's economic reform focused on the cities. The goal was to boost the vitality of the state-owned enterprises (SOEs) and to reform the labour employment system of enterprises. Enterprises closed down, operations suspended, merged with others or shifted to different lines of production in line with the principle of "survival of the fittest". A new employment system was required to be set up in order to deliver the unemployment aid to those who were dismissed by the enterprises.

In 1986, the Chinese government enacted several Provisional Regulations:

- The Provisional Regulations on the Labour Contract System in State-run Enterprises (hereinafter referred to as the Provisional Regulations)
- The Provisional Regulations on State-run Enterprises' Recruiting the Workers
- The Provisional Regulations on State-run Enterprises' Dismissing the Workers who violate the Discipline.
- The Provisional Regulations on Benefits of the Employees in State-run Enterprises who are waiting to be employed were also promulgated
- This marked the official establishment of China's unemployment insurance system

### 1.2 Phase 2 (1993 to early 1999): further adjustment of the unemployment insurance system

To meet the requirements of transforming the operation mechanism of SOEs, on the basis of past experience, in May 1993 the government enacted the Regulations on the Benefits of the Employees in SOEs who are waiting to be employed (hereinafter referred to as the Regulations), which made adjustments and perfections to the coverage and the UI benefit level. During this period, the unemployment insurance system played an important role in guaranteeing the basic livelihood of the unemployed and promoting their re-employment.

### 1.3 Phase 3 (early 1999 to present): the gradual improvement of the unemployment insurance system

In the middle and late 1990s, a large number of laid-off workers and unemployed emerged. Following this, the unemployment insurance fund could not afford the cover payment of all the UI benefits. In June 1998, the Chinese government launched the Basic Livelihood Guarantee for laid-off workers from SOEs and promoted their re-employment by setting up Re-employment Service Centres. In addition, the contribution mechanism of UI fund and the contribution rate were adjusted.

Originally, only employing units were required to contribute to the UI fund at a rate of 1%. After the adjustment, both the employing units and the employees were required to contribute such that the total contribution rate rose to 3%. Furthermore, the Re-employment Service Centres received support from the UI fund to guarantee a basic livelihood for laid-off workers.

This unemployment insurance system, with Chinese characteristics, is only a transitional measure. In the long run, to implement the market-oriented employment mechanism, it is necessary that the system of basic livelihood guarantee for those laid-off be integrated into the unemployment insurance system. In early 1999, the Chinese government enacted the Unemployment Insurance Regulations (hereinafter referred to as the Regulations), which is still valid now.

## 2. The Framework and Characteristics of the Current UI System in China

The current UI system in China is mainly conducted through the Unemployment Insurance Regulations, which contains six chapters with 33 articles. The main points are summarised here:

2.1 The aim is to guarantee the basic livelihood of the unemployed and promote their re-employment. The will to be employed and the incentive to seek jobs are used as a prerequisite for receiving UI benefit.

2.2 The coverage expanded from SOEs and their employees to all urban enterprises and public institutions. Rural migrant workers who have formed stable labour relations and signed a labour contract with the enterprises are also included.

2.3 The employing units are required to contribute 2% of their total payroll to the UI fund and employees are required to contribute 1% of their personal wages. Rural migrant workers need not contribute. The provincial government can adjust the local contribution rate after receiving official approval by the State Council. The UI fund will be subsidized by the local government if a deficit should occur.

2.4 The UI fund is pooled at the prefecture-level, i.e. the level of the municipality directly under the Central Government and the cities with districts.

2.5 The UI benefit level is determined by the provincial government in accordance with the principle of being lower than the local minimum wage level and higher than the urban minimum livelihood guarantee. The period of receipt of UI benefits varies with the duration of the contribution, with the longest term of 24 months. In addition, the unemployed receiving the UI benefits are entitled to medical subsidies and pensions.

2.6 The UI fund can be used to subsidize the vocational training and career service for the unemployed to promote their re-employment.

2.7 The management and supervision of the UI fund was standardized and rationalised. The fund must be deposited to special accounts in the state-owned commercial banks and fund expenditure and collection are conducted separately and subject to fiscal supervision.

Since 2006, in order to further promote the re-employment of the unemployed, some developed regions in China are piloting to expand the items for the expenditure of the UI fund. The UI fund is also used for subsidisation of social insurances on re-employment and the interests accrued from any of their micro-credit loans apart from their vocational training and provision of career services.

During the past ten-years, since the Regulations was enacted, China's UI System has generally met the requirements for the development of a market-oriented economy and has promoted the establishment and perfection of a social security system with a market-oriented employment mechanism.

### 3. The Achievements of China's Unemployment Insurance System

Setting up the unemployment insurance system was a historic choice for China.

3.1 It guaranteed the basic livelihood of the unemployed, promoted their re-employment, and effectively maintained the social stability.

From the day of its establishment, China's unemployment insurance system has taken on the role of both guaranteeing the basic livelihood of the unemployed and promoting their re-employment. From 1999 to 2007, the beneficiaries of UI benefits totalled 27.02 million. Vocational training and career service for the unemployed are also covered by the UI fund. The UI fund is always a major source for the public employment agencies to launch initiatives to promote the re-employment of the unemployed. The "one-stop" services including UI benefits, career counselling and vocational training are a combination of guaranteeing the basic livelihood of the unemployed and promoting their re-employment, which has played an important role in maintaining the social stability.

Currently, China's unemployment insurance system has become "the safety valve" and "shock absorber" for the smooth operation of the labour market in China. By the end of 2007, the number of UI participants reached 116.45 million. In 2007, the revenue of the UI fund was as high as 47,200 million yuan with 5.385 million beneficiaries who had different durations of benefits. 0.874 million eligible rural migrant workers also received lump-sum living subsidies.

3.2 It effectively pushed forward the reform of SOEs and promoted the establishment of market-oriented economy system

The unemployment insurance system set up in mid-1980s promoted the reform of the employment system in SOEs and helped to ensure the implementation of the labour contract system. It therefore laid a foundation for the market-oriented employment mechanism. The Regulations on Benefits of the Employees in SOEs who are waiting to be employed effective as of 1993 created favourable conditions for the large-scale structural adjustment of SOEs and further promoted the establishment of the market mechanism. The Unemployment Insurance Regulations effective from 1999 made it possible for the transitional system of the basic livelihood guarantee for laid-off workers and unemployed to be shifted to unemployment insurance system. From 1998 to 2006, the basic livelihood guarantee for the laid-off workers drawn from the UI fund totalled 26,900 million yuan. The unemployment insurance system has played an active role in smoothly transforming the planned economy into market economy in China.

3.3 Optimised the employment structure and rationalized the distribution of labour resources

The adjustment of the economic structure and the change of direction in the economic development pattern led to the migration of the labour force and brought about changes in the distribution of labour among different sectors and the enterprises of various ownerships. Unemployment is an unavoidable phenomenon during the transitional period. The unemployment insurance system has guaranteed the basic livelihood of the unemployed and promoted their re-employment, which relieved the social conflict and pressure that may be caused by unemployment and migration of the labour force, and provided the conditions to enable the improvement of labour quality and their sound distribution.

During the period from 1998 to 2005, more than 19 million laid-off and unemployed workers from SOEs were re-employed through many channels and at the same time maintained their basic livelihood. A great number of the labour force was transferred from SOEs to non-public sectors. There was a steady growth in the total number in employment, and the employment structure was also being optimized. The distribution of the labour force among different industries also changed: the tertiary sector has become the main channel to absorb the increased labour force, and the emergence of various ownership models has turned into the new sources for employment creation.

#### 4. The Problems in Current System

In general, the current unemployment insurance system is running smoothly with an increasing fund, which plays a more and more important role in guaranteeing the basic livelihood of the unemployed and promoting their re-employment. In recent years, however, due to the changing situation, the unemployment insurance system cannot meet the current problems, which can be summarized as follows:

##### 4.1 The narrow coverage of the unemployment insurance system

Initially, the main groups participating in the unemployment insurance were the employees in SOEs and urban collectively-owned units. Since 1990s, the number of employees in SOEs and urban collectively-owned units has been declining dramatically. From 1999 to 2005, the share of the urban workers had dropped from 46.7% to 28.7%, a decline of 18 percentage points, which resulted in an enormous loss of participants in the unemployment insurance scheme. Meanwhile, the number of new groups vulnerable to unemployment rose greatly: the laid-off and unemployed who were re-employed and the youth as well as the rural migrants are rather vulnerable to unemployment. At the end of 2007, the urban employment totalled 293.5 million<sup>1</sup>. The number of the participants in unemployment insurance, however, was only 116.446 million, which is less than half of those in urban employment.

##### 4.2 The low benefit level and incomplete items for UI fund expenditure

According to the current regulations, the UI benefits generally account for 60-80% of the minimum wage, without taking into consideration the family conditions of the unemployed. Also, during the period of receipt of UI benefits, the unemployed are entitled to receive not medical insurance, but medical subsidies. There is also no subsidy for their transportation cost when seeking jobs in different cities and moving.

##### 4.3 The weak role in promoting re-employment

When the current regulations were initially enacted, in light of the great number unemployed, the main function of unemployment insurance was to guarantee the basic livelihood of the unemployed and to keep the expenditure on UI benefits around 90% of the total expenditure of UI fund. However, the items for promoting re-employment are confined to the subsidies on the vocational training and career service of the unemployed when they are UI beneficiaries. Neither the unemployed whose duration of receiving UI benefits expires nor those who have never contributed to the UI fund are entitled to the subsidies on vocational training and career service.

With the rising UI fund, it is fairly feasible to cover the expenditures for re-employment promotion. The above-mentioned situation is far from meeting the requirements of the current labour market changes, and it doesn't conform to the international trend of supporting the re-employment by unemployment insurance system.

##### 4.4 UI lacks the role of stabilising employment and preventing unemployment

Being exposed to fierce competition, some enterprises in some regions or sectors are becoming more vulnerable to unemployment. Both the enterprises and their employees need the support to pull through. The current unemployment insurance system however lacks items of expenditure which could be used to support the enterprises to stabilise employment and prevent unemployment. Indeed, some of the enterprises which make full contributions into the UI fund on time need financial support for training on adapting their business. However, there are no relevant regulations on encouraging the enterprises to absorb employment and take more social responsibility in the current Unemployment Insurance Regulations. There are also no emergency items for the expenditure of the UI fund. Therefore, if regional or industrial economic risks or natural disasters occur, the current unemployment insurance system lacks the capacity to promote and stabilise the employment so as to effectively maintain the social stability.

##### 4.5 The current system cannot meet the requirements of regional differences

Under the current system, the same national regulations and fund pooling at the prefecture level are adopted. Owing to the unbalanced regional development in China, there is a great surplus of the UI fund in some developed regions but a deficit in some under-developed regions. It is not permitted for the developed regions to allocate some funds from their UI fund to support the employment according to local conditions.

##### 4.6 Huge balance of UI fund

Up to the end of 2007, the total national balance in the UI fund reached 97,910 million yuan, which is 4.5 times total expenditure in the year of 2007. The surplus of UI fund is mainly concentrated in the developed regions and large and medium-sized cities.

Because the "Pay-as-You-Go" system is adopted, it is necessary to keep some surplus to guarantee the smooth operation and cope with the economic fluctuations. However, the huge surplus also hints that the UI fund has not played an adequate role and that the coverage of the target, benefit level and expenditure items is too narrow. This has led to the case where some labourers cannot obtain appropriate unemployment protection.

Further, the expenditure on promoting the re-employment is far from enough. In 2007, the total expenditure of the UI fund was 21,760 million yuan. The expenditure on vocational training and career service, however, was 3,200 million yuan, only accounting for 14.7% of the total expenditure.

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<sup>1</sup> From "2007 National Economic and Social Development Statistical Bulletin", the National Bureau of Statistics, February 28, 2008

## 5. The Issues to Be Solved

To reform and improve the current unemployment insurance system requires China's government to take into account the changes in China's social and economic development, and adjust the goal of the UI system accordingly. International experience should also be used to help improve the UI role and function. From the international trend in unemployment insurance system, a prominent direction is to change the passive livelihood guarantee to an active re-employment promotion. Many countries are not only transferring their work priority towards this direction, but also focusing on the role of unemployment insurance in promoting employment through the expenditure arrangements of the UI fund.

In theory, China's current unemployment insurance system was initially established based on the two major roles of guaranteeing the basic livelihood of the unemployed and promoting their employment. However, the system mainly focuses on the role of guaranteeing the basic livelihood of the unemployed from the point of social stability, as the initial design and set up of the system was for the reform of SOEs. This system therefore is transitional and with economic development and social transformation, it is inevitable that the current system be adjusted and improved.

The greatest challenge facing the current system is the tremendous employment pressure and diversification of employment patterns. Under such a context, the only way to reform the system is to further enhance its role in promoting re-employment whilst raising its function of guaranteeing the basic livelihood of the unemployed. Unemployment prevention should also be strengthened to reduce the likelihood of unemployment and stabilise the employment situation.

In view of the problems in China's unemployment insurance system and using international experience, the following issues should be studied in improving China's unemployment insurance system.

### 5.1 The coverage

The aim of the unemployment insurance system is to pool the social funds, disperse the risk of unemployment, and guarantee the basic livelihood of the labourers who are temporarily unemployed. The unemployment insurance system, in theory, should cover all categories of employing units and all labourers including the newly increased labour force. The real coverage in practice however, is only part of this group. How should coverage be determined? Should the public servants be covered? For those not covered how should their livelihood be addressed in the case of their unemployment? Should the employees in small enterprises, the self-employed and the flexible (informal) employment be covered? If an individual is covered, how can you identify whether they are employed or unemployed? Should the policies and management for them be consistent with others? If not covered, what measures should be taken to handle their livelihood if they are unemployed?

### 5.2 The UI benefit level

The level of UI benefit should be moderate. It is temporary and short-term because the UI system guarantees the basic livelihood of the unemployed. It cannot afford to take on the responsibility of eliminating poverty. Both over-protection and under-protection should be avoided to encourage the unemployed to seek jobs. Therefore, the determination of a scientific and reasonable UI benefit level is of vital importance.

What items should be covered by the UI benefits? How to handle the medical treatment and endowment insurance of the unemployed? How to determine the UI benefit level? What is its relationship with minimum wage and social relief? In determining the UI benefits, should family conditions be taken into account? How to determine the duration of the UI benefits? Under what circumstances can the duration be extended? How to adjust the UI benefits? For example, should benefits vary with the prices?

### 5.3 The relationship between UI and employment promotion

Generally, the UI system is regarded as passive labour market policy, and employment promotion is seen as active labour market policy. They are closely related. Providing the basic livelihood guarantee for the unemployed is temporary and the ultimate goal is to promote their employment. Therefore, should the employment promotion mechanism be considered in designing the UI system? What items should be available to promote employment and what measures should be taken? How to encourage the unemployed to become employed as soon as possible? What are the financial sources for employment promotion? And how should the fund be operated and managed?

### 5.4 The unemployment prevention

How to reduce the unemployment? How to encourage and support the enterprises so that their employees are not dismissed when they are faced with crisis? Can the UI fund be used to provide the enterprises with some wage subsidies or training subsidies for a particular duration? Can the UI fund be used to reduce the contribution rate when the enterprises are in crisis?

### 5.5 The management of UI

How to determine and adjust the contribution rate? How to manage the UI fund? How to cope with when deficit occurs? How to set and arrange the UI agencies to be more rational and efficient? What is its relationship with employment management agencies and other social insurance agencies?