A Universal Pension for China?

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Abstract

Since 1951, China has relied on contributory pension schemes for its citizens. The result is a fragmented, inconsistent pension scheme, providing only low coverage. The lack of an adequate pension system presents a threat to political and social stability and calls for essential change. This paper analyses whether a universal pension scheme would be a reasonable alternative to the traditional Chinese contributory system. It concludes that such a pension scheme would be feasible and meaningful for the poor rural areas, but not so for the more wealthy urban districts since the benefits of a universal pension decline while overall wealth rises.
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1 Introduction

The government of the People’s Republic of China (hereafter: China) has been trying since years to establish a sustainable pension system for its country. But still, after myriad reforms, pilot projects and other attempts to do so, China is still far away from having a proper working national pension scheme. In rural areas some 5% to 10% of the population are covered by a pension system (Williamson et al., 2009) and in urban areas, the percentage is considerably higher but the system seems to be unsustainable (Shen and Williamson, 2006).

If China was just a small inconsiderable country, then this fact would be problematic for its residents, but not that much for the whole world. But China apparently isn’t - as a matter of fact, China has the third largest economy in the world (US Census Bureau, 2011) and therefore a great impact on other countries. Moreover, as an ambitious developing nation, China is also some kind of role model for other developing countries and foreign policy makers may get inspired by China. But these external factors are not the only reason, why a sustainable pension system is very important for China: Already in 2008, some 8.3% of the population of China were at the age of 65 or even higher (National Bureau of Statistics, 2010), or in other words, more than 21% of the world’s population aged 60 and above is living in China (UN, 2009a) and this proportion will increase even further. Additionally, as shown in table 1, the population aged 65 or higher already has increased over the past years dramatically. In 1982, the fraction of people above the age of 65 in China was about 4.91%, eight years later the proportion was 5.57% and turned to 6.96% in year 2000. Moreover, China’s one-child policy enforces this development in a dramatic way.

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>0 - 14</td>
<td>36.28</td>
<td>40.69</td>
<td>33.59</td>
<td>27.69</td>
<td>22.89</td>
<td>16.87</td>
</tr>
<tr>
<td>15 - 64</td>
<td>59.31</td>
<td>55.75</td>
<td>61.50</td>
<td>66.74</td>
<td>70.15</td>
<td>73.42</td>
</tr>
<tr>
<td>65 and over</td>
<td>4.41</td>
<td>3.56</td>
<td>4.91</td>
<td>5.57</td>
<td>6.96</td>
<td>8.30</td>
</tr>
</tbody>
</table>


Therefore, China needs to establish as fast as possible a sustainable pension system, but that’s not simple at all: First, it is important to choose the right pension scheme and second, all further attempts to create such a system caused a lot of burdens in terms of debts. There is a solution needed which provides an answer to both of this points. As a
2 Non-contributory pensions

matter of fact, China is somehow between abundant burdens of the past and a ticking demographic time-bomb.

This article should provide an advice regarding a reasonable choice of an adequate pension system: It analyses the use of a universal pension scheme for China, a system that is momentary not being given serious consideration. By analysing the current Chinese pension system, the most urgent issues can be identified and this paper examines whether a universal pension would be a practical and sustainable solution for these difficulties. Moreover, by comparing other developing countries with such a universal pension to China, including an elementary financial feasibility inquiry, it can be determined that such a pension system would be highly recommendable for rural China. Contrariwise, a traditional 3-pillar-system is proposed for urban China since the actual economical situation already should be capable to bear such a system.

2 Non-contributory pensions

2.1 Definition

Common pensions cover according to estimates only a rather low part of the worlds working-age population (Willmore, 2001). Especially in low income countries with huge gaps between the rural and urban population, coverage in rural parts is sparse, because many people are unemployed, working in households or are earning just very low wages in the agricultural sector (Willmore, 2007). Even if contribution is mandatory, participation remains low, since people just aren’t able to afford the participation in such a pension system, they need all their income for everyday life.

A non-contributory pension might be a solution to this, since it covers immediately an entire or at least a large part of a population in a country. Non-contributory pensions can generally be means tested or not. If not means tested, then such a pension is called a universal pension, because it provides financial support regardless of occupation and life course in general, including all citizens of a given country or area. If such a non-contributory system is means-tested, then only people which are meeting some criteria can apply for benefits. Both versions have in common that, in contrast to a formal pension system, they are just a pure cash transfer instead of a saving scheme.

1There is no standardized notation for a universal non-contributory pension, sometimes it’s called a social pension, a demogrant or even a citizen’s pension. In this paper, for simplicity it’s just called a universal pension.
2 Non-contributory pensions

A non-contributory pension can basically take any of this three forms: (Willmore, 2001)

1. Universal non-means tested flat pension
2. Means-tested flat pension
3. Minimum pension guarantee

The universal non-means tested flat pension is the most uncommon of these three possibilities, only about nine countries in the whole world are using this system, among them Botswana, Bolivia, Brunei, Kosovo, Mauritius, Namibia, Nepal, New Zealand, Samoa and the town Mexico City (Willmore, 2007). Moreover, this model seems to be under serious consideration in Sri Lanka (Willmore and Kidd, 2008). Each citizen receives - regardless of income or fortune - a pension, the only criterion is the age.

Second possibility is a means-tested flat pension, retirees get the full or even a part of the pension only if they meet some - besides the age - criteria, like a low income or a minimum of years of residency. Several countries do have such a system, even especially for their rural population. Among them are Bangladesh, Brazil, India, Costa Rica or South Africa (Williamson et al., 2009).

The third variant, the minimum pension guarantee, is usually part of a three pillar pension scheme and thought to be some kind of top up, linked to the second mandatory contribution pillar. If the general lifetime earnings are low, a retiree might apply for the minimum pension guarantee. However, since the poorest just aren’t able to participate in the second pillar, this scheme fails to cover and protect them (Willmore, 2001). This scheme is available in several countries, in developing countries as well as in developed ones.

2.2 Financial feasibility

The costs of a non-contributory pension system are - leaving administration expenses aside - determined by the proportion of the population which is eligible and the benefit level, in general expressed as a percentage of GDP (Willmore, 2007). The lower the age of eligibility and the higher the benefit, the harder it will be to keep the pension scheme feasible. In other words, the costs for such a systems can be expressed by

\[ C = R \times B, \]

where \( C \) is the costs indicated as a percentage to a nation’s GDP, \( R \) is the percentage of eligible retirees to the total population and \( B \) is the percentage of the available benefit
3 Lessons for China from other developing countries

compared to a nation's GDP per capita for each retiree. For example, in China the average life expectancy in 2000 was around 71.4 years (National Bureau of Statistics, 2010), so it would be reasonable to set age of eligibility at 65 years. The fraction of people at the age of 65 or higher in China was estimated to be about 8.3% in 2008 (see table 1), the percentage considering only rural population was about 5.81% (Shen and Williamson, 2010).

Moreover, the benefit should at least be as high as the national or international poverty line. The latest estimate of the extreme international poverty line was set at 1.25$ a day (Worldbank, 2011a), so about 456$ a year. China’s GDP per capita was 22698 Yuan in 2008 (National Bureau of Statistics, 2010), or about 3500$, so parameter B would be 13.03%. The expression above then yields $0.0830 \times 0.1303 = 0.0108$, the minimal costs for such a system would be at least 1.08% of GDP, which is relatively high. If we only use the fraction of people living in rural areas, then the calculation yields $0.0581 \times 0.1303 = 0.00757$ or 0.76% of GDP. Please note that this calculation is based on the assumption that the benefit is set at the international extreme poverty line and coverage for all people over 65 is about 100% (and the pension scheme therefore universal). If using a means-tested pension, then the fraction of eligible recipients would of course be smaller and the costs therefore lower. For more information, see chapter 5.3.

3 Lessons for China from other developing countries

China is not the only developing country which is struggling with its pension system, it’s just the most popular one. During the 20th century, defined benefit contributory pension systems were common among developing countries, but almost never successful in covering a large fraction of the particular population, especially among the rural citizens (Barrientos and Lloyd-Sherlock, 2002).

However, a large number of developing and low-income countries share the characteristics of a mainly rural economy which consists of family farming. Simultaneously, most of these countries are still counting on a contributory based pension scheme and as a result, coverage in rural areas is low (Yang et al., 2010). Additionally, the small part of rural population which is working for a company, earns often a low wage and therefore it is for a contribution based pension scheme just not realistic, to cover the entire population (Willmore, 2007). These poor people in general don’t qualify for such a pension system or don’t earn enough to contribute and to make a living at the same time. The urban population instead, which is largely employed by companies, is better covered by pension schemes and this fact contributes to economic
3 Lessons for China from other developing countries

disparities and may cause social pressure (Overbye, 2005).

However, there are several developing countries which already implemented promising working non-contributory pension schemes to cover a substantial part of the rural and poor population as well, among them low-income countries such as Bangladesh, India, Lesotho, Moldova, Nepal, Tajikistan, Vietnam and middle-income countries like Argentina, Bolivia, Brazil, Chile, Costa Rica, Mauritius, Namibia and many more (HelpAge, 2007). Table 2 shows the available conditions among them. All of these countries only need a percentage between less than 0.1% (Thailand, India, Vietnam) to about 1.4% of GDP to finance their non-contributory pension, only the Kosovo and Mauritius need higher rates of GDP (HelpAge, 2007).

For example Nepal, one of the poorest countries of the world with a GDP per capita of about 465.4$ (UNSD, 2011a) offers since 1994 a universal pension to its residents. After the age of eligibility which is 75, the monthly benefit is about 500 rupees or 7$ (HelpAge, 2011) and coverage is around 80% or even higher (Palacios and Rajan, 2004). The pension benefit has been raised continuously over the years, in 2003 the monthly benefit was only about 150 rupees or 2$ (Willmore, 2007). It seems that a high age of eligibility and an at first very low pension benefit were essential for the success of Nepal’s pension scheme. By doing so, Nepal was able to afford such a system and kept costs low at a level of about 0.23% of GDP (HelpAge, 2011).

Namibia offers to its retirees as well a universal pension since 1992, available for citizens at the age of 60 or above. The benefit was about N$ 200 or 25$ in 2002, and today on a level of about N$ 450 or 59$ (HelpAge, 2011), coverage is high at a rate of about 95% of the eligible population (Yang et al., 2010). Revenues from general governmental taxes are used to fund this pension scheme and it seems that especially for the poor rural population, the universal pension enhances everyday life in a remarkable way (Yang et al., 2010).

India also does provide a non-contributory pension to its residents, however this pension is means-tested. Retirees have to be at least at the age of 65, and they must live in a family or household which falls below the poverty line. The benefit in 2000 was about 75 rupees or 1.75$ (Yang et al., 2010) and has been risen up to 200 rupees (4$) recently (HelpAge, 2011). The costs for such a pension scheme in India are less than 0.01% of GDP (HelpAge, 2007).

Countries like the above mentioned demonstrate that basically universal or mean-
tested non-contributory pension systems are feasible in low- and middle-income coun-
tries at low costs and simultaneously can cover a large part of the population.

Nonetheless it is important to analyse the differences and similarities between these
### Table 2: Non-contributory pensions in low and middle income countries 2007

<table>
<thead>
<tr>
<th>Country</th>
<th>Age</th>
<th>Means tested</th>
<th>Monthly pension benefit ($)</th>
<th>Costs in % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>70</td>
<td>yes</td>
<td>USD 88</td>
<td>0.23</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>57</td>
<td>yes</td>
<td>USD 2</td>
<td>0.03</td>
</tr>
<tr>
<td>Bolivia</td>
<td>65</td>
<td>no</td>
<td>USD 18</td>
<td>1.3</td>
</tr>
<tr>
<td>Botswana</td>
<td>65</td>
<td>no</td>
<td>USD 27</td>
<td>0.4</td>
</tr>
<tr>
<td>Brazil S**</td>
<td>67</td>
<td>yes</td>
<td>USD 140</td>
<td>0.2</td>
</tr>
<tr>
<td>Brazil A**</td>
<td>60 men, 55 women</td>
<td>yes</td>
<td>USD 140</td>
<td>0.7</td>
</tr>
<tr>
<td>Brunei</td>
<td>60</td>
<td>no</td>
<td>USD 179</td>
<td>0.4</td>
</tr>
<tr>
<td>Chile</td>
<td>65</td>
<td>yes</td>
<td>USD 75</td>
<td>0.38</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>65</td>
<td>yes</td>
<td>USD 26</td>
<td>0.18</td>
</tr>
<tr>
<td>India</td>
<td>65</td>
<td>yes</td>
<td>USD 4</td>
<td>0.01</td>
</tr>
<tr>
<td>Kosovo</td>
<td>65</td>
<td>no</td>
<td>USD 74</td>
<td>3.39</td>
</tr>
<tr>
<td>Lesotho</td>
<td>70</td>
<td>no*</td>
<td>USD 21</td>
<td>1.34</td>
</tr>
<tr>
<td>Mauritius</td>
<td>60</td>
<td>no</td>
<td>USD 60</td>
<td>2</td>
</tr>
<tr>
<td>Mexico City</td>
<td>70</td>
<td>no</td>
<td>USD 66</td>
<td>0.04</td>
</tr>
<tr>
<td>Moldova</td>
<td>62 men, 57 women</td>
<td>yes</td>
<td>USD 5</td>
<td>0.08</td>
</tr>
<tr>
<td>Namibia</td>
<td>60</td>
<td>no</td>
<td>USD 59 (2011)</td>
<td>0.8</td>
</tr>
<tr>
<td>Nepal</td>
<td>75</td>
<td>no</td>
<td>USD 7 (2011)</td>
<td>0.23</td>
</tr>
<tr>
<td>Samoa</td>
<td>65</td>
<td>no</td>
<td>USD 49</td>
<td>1.3</td>
</tr>
<tr>
<td>South Africa</td>
<td>65 men, 60 women</td>
<td>yes</td>
<td>USD 109</td>
<td>1.4</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>63 men, 58 women</td>
<td>yes</td>
<td>USD 17</td>
<td>?</td>
</tr>
<tr>
<td>Thailand</td>
<td>60</td>
<td>yes</td>
<td>USD 8</td>
<td>0.00528</td>
</tr>
<tr>
<td>Uruguay</td>
<td>70</td>
<td>yes</td>
<td>USD 100</td>
<td>0.62</td>
</tr>
<tr>
<td>Vietnam</td>
<td>60</td>
<td>yes</td>
<td>USD 6</td>
<td>0.022</td>
</tr>
<tr>
<td>Vietnam</td>
<td>90</td>
<td>no</td>
<td>USD 6</td>
<td>0.0005</td>
</tr>
</tbody>
</table>

**Sources:** Help Age International (2011), Willmore (2007)

* only with exceptions

** There are two schemes available in Brazil, the social security (S) pension and the social assistance pension (A)
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examples and China. All countries shown in table 2 share the characteristic of having a large and relatively poor rural population, while the urban population is better of mostly (Yang et al., 2010). However, of all of these countries, China is by far the most populous one. Several countries with a universal pension are relatively small, among them Botswana, Brunei, Mauritius, Namibia or Samoa with populations below 3 millions of people. The size of the particular population is an important factor in connection with the costs and the structure of a universal pension. These factors will be discussed in chapters 5.2 and 5.3. Beside these small countries, there is Nepal, the poor neighbour of China with a population of about 30 millions of people. However, the countries with the largest non-contributory pension programmes are Brazil and South Africa (Barrientos, 2003), both targeting particularly the rural population. Both countries are operating with means-tested pensions. India as another very populous country does have a means-tested non-contributory pension focusing mainly on rural citizens, too (Yang et al., 2010).

All these examples provide an indication that a non-contributory pension might be even possible in China, but it should be analysed whether such a system should be means-tested and if there is a restriction to certain areas (urban/rural) needed. The related discussion can be found in chapters 5.1, 5.2 and 5.4.
China and the issue of pension schemes

4.1 History of China’s pension system

In order to understand the recent pension system in China, it is important to know its history and development. Between 1951 to present, the pension system has undergone various reforms and changes, but all these measures eventually left the system fragmented.

4.1.1 1951-1984

The first pension system in China was introduced in 1951, based on the Soviet Model (Salditt et al., 2008). It was a defined benefit pay-as-you-go (PAYG) system and coverage was limited to the employees of state owned enterprises (SOE), collective owned enterprises (COE) and government authorities. The first regulations, officially promulgated by the State Council of China in early 1952, stipulated that employers had to pay a rate of 3% of the gross payroll to a governmental pool, administered on local level under the surveillance of the All China Federation of Trade Unions (Salditt et al., 2008). This amount had to be paid from the employers revenue, employees instead didn’t contribute in a direct kind of way. Male retirees were allowed to claim their pension benefits at the age of 60, however they received a full pension only when had worked for at least 25 years. Female retirees instead were able to apply for their pension benefits already at the age of 55, with a minimum working duration of 20 years. The full pension amount was set at a rate of 35 to 60 percent of prior wage and was later raised to 50 to 70 percent (Wei, 2007). Although this seems to be a very high level, wages were very low by that time (Shuanglin, 2008). Additionally, the average life expectancy at birth was also low by then, for example between 1955 and 1960, for men it was 43.1 and for women 46.2 years (Salditt et al., 2008). However it is important to notice that a lot of retirees weren’t able to claim full pension benefits: Most of the SOEs and COEs were founded in the early 1950s and since there was a minimum of service years (male 25 years, females 20 years), pensioners before 1970/1975 didn’t receive a full pension.

The cultural revolution (1966-1976) interrupted the proper working of the pension system and therefore after 1969, enterprises paid the pension benefits directly to its pensioners since the government wasn’t able to fulfill it’s obligations. Due to this fact, the pension system was shifted from a social pooling scheme to an enterprise based one (Wei, 2007).
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4.1.2 1984-1997

By the end of the year 1984, the government began with the implementation of a market economy, SOEs and COEs were suddenly allowed to quest for profits. This resulted in strong competition among enterprises. Moreover, enterprises were now also fully responsible for their financial liabilities, the government shifted the whole responsibility to them. Due to this and the fact that the former pension system was enterprise based, some enterprises became insolvent quickly or at least unable to fulfill all their pension liabilities (Farid and Cozzarin, 2008). Especially the elder SOEs and COEs had serious problems, since old enterprises in general had more retirees than the younger ones (Wei, 2007).

In 1986, the government realised that further reforms were necessary in order to cut costs for enterprises and to establish a more secure funding base (Salditt et al., 2008). Therefore it was decided to move again from an enterprise based pension system to a social pooling one. This new system was pooled on county basis and required for the first time contributions from the employees. While employees had now to pay 3% of their wage, the employers rate was raised from 3% to 15%. The pension system during that period remained a defined benefit PAYG one, and until 1996, a large fraction of SOEs, 70 to 80 % of COEs and around a third of private firm workers participated in this new system (Wei, 2007). Again in 1986, the government decided for the first time to introduce some pilot projects of pension systems in rural areas, but only in the more developed ones. After some years of experiments, in 1992 the government promulgated the “Basic Program for Rural Social Security Insurance at County Level”, which intended to set up a rural pension scheme. According to this new scheme, people had to contribute after the age of 20 and were able to receive benefits after the age of 60 (Shuanglin, 2008). Since there were no state subsidies available, most of these projects eventually collapsed or existed just on paper (Shen and Williamson, 2010). Up to now, there is still no meaningful nationwide pension system for rural areas available, even though rural citizens account for 53.4% of the overall Chinese population (National Bureau of Statistics, 2010). For more specific information about the rural pension system, see chapter 4.3.

4.1.3 1997 - present

In 1997, the government decided to move from a defined benefit PAYG system to a three-pillar system. At least the Chinese government describes it as having three pillars, but actually pillar one is split into two tiers, in a basic pension and an individual
account. Moreover, pillar 2 and 3 are only supplementary saving possibilities and rarely used by employees or not even in operation (Farid and Cozzarin, 2008), so I will handle them for simplicity as a normal three-pillar system. The conditions of this pension scheme are shown in table 3.

The 1997 introduced system bases upon the governmental document no. 26, „Establishment of an unified basic old age pension insurance system for enterprise staff and workers“. This document included mainly three important improvements (Farid and Cozzarin, 2008):

1. Expanding coverage to all urban employees, self-employed workers in urban areas included

2. Establishing of the Pension system administration on province-level, without any administrative responsibility among enterprises

3. Altering the existing defined benefit PAYG system to a three pillar pension system

The first pillar was a public pension on PAYG basis, and financed only by the employers. Enterprises had to use a rate 13% of the gross payroll for this pillar. The second pillar referred to a fully funded individual account pension, which was managed by state. Employees had to pay between 4% (1997) to 8% (2005) of their wage and employers had to contribute between 7% (1997) and 3% (2005) of the salary (Wei, 2007). The third and last pillar was a supplementary saving possibility on individual basis and was managed by commercial insurances. While pillars one and two were mandatory, the third one was just on optional basis. Additionally, pillar two and three were defined contribution accounts, while pillar one was as before a defined benefit account. The basic pension intended to replace about 20 percent of the average regional wage of the previous year (Wei, 2007).

This system based on document number 26 is - with some modifications - still today in use. Another important change was the introduction of the National Social Security Fund (NSSF), introduced in 2000 (Wei, 2007). The purpose of this fund is to improve and assure financial sustainability. In case that provinces can’t fulfill their pension liabilities for pillar 1 or 2, the NSSF would be some kind of fund of last resort (Salditt et al., 2008).
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<table>
<thead>
<tr>
<th>Pillar</th>
<th>Type</th>
<th>Contribution</th>
<th>Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>I, Basic Pension</td>
<td>mandatory, DB, PAYG</td>
<td>13% Employers</td>
<td>urban</td>
</tr>
<tr>
<td>II, Individual Account</td>
<td>mandatory, DC, fully funded</td>
<td>3% Employers</td>
<td>urban</td>
</tr>
<tr>
<td>III, Suppl. saving</td>
<td>voluntary, DC, fully funded</td>
<td>8% Employees</td>
<td>members</td>
</tr>
</tbody>
</table>

Note: DB = defined benefit, DC = defined contribution

4.2 China’s current urban pension system

4.2.1 Status quo

Today China’s urban pension system is generally outlined by the State Council Decrees 26 (in 1997), 42 (in 2000), and 38 (in 2005) (Williamson and Deitelbaum, 2004), for an overview see table 3. The urban pension system covered in 2005 about 48% of the urban employees (Salditt et al., 2008) and about 57% in 2009, while coverage among urban population in 2009 was estimated to be only about 37.9%. However, it is to mention that the urban system - even if always based on the decrees above - varies from province to province and sometimes even from city to city. The central government may issue regulations, but the implementation itself is in the authority of the provinces (Williamson et al., 2009). Moreover, there are also some pilot projects which are coexistent to the above mentioned system, like the Liaoning pilot reform project (since 2001), which is available in the province of Liaoning and some other provinces (Wei, 2007). In this scheme, employers have to contribute to pillar I 20% of the gross payroll and the second pillar is only financed by the employees, paying a rate of 8% of their salary. Additionally, early retirement is unattractive in the way that the wage replacement is at first 20% of the average regional wage of last year, but after thirty years of employment, the system offers 30% of replacement (Wei, 2007). This alternative pension scheme is shown in table 4. It is no coincidence that the government first selected the province of Liaoning for such a pilot project: Liaoning has one of the highest old age dependency rations in whole China (National Bureau of Statistics, 2010), and is therefore adequate in order to test for sustainability.

Despite the fact that there is no homogeneous urban pension system, another serious problem occurred in about 75% of China’s provinces: Since local governments are facing regularly shortfalls in connection with the basic pension (which is social pooled),
4 China and the issue of pension schemes

Table 4: Liaoning pilot project, 2001 - present

<table>
<thead>
<tr>
<th>Pillar</th>
<th>Type</th>
<th>Contribution</th>
<th>Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>I, Basic Pension</td>
<td>mandatory, DB, PAYG</td>
<td>Employers 20%</td>
<td>urban</td>
</tr>
<tr>
<td>II, Individual Account</td>
<td>mandatory, DC, fully funded</td>
<td>Employees 8%</td>
<td>urban</td>
</tr>
<tr>
<td>III, Suppl. saving</td>
<td>optional, DC, fully funded</td>
<td>Individually</td>
<td>members</td>
</tr>
</tbody>
</table>

Note: DB = defined benefit, DC = defined contribution

It is common to borrow money from the funded individual accounts (Pillar II) to pay these liabilities. Governments do have a record about these misused contributions in order to pay the money later on back, but in reality it is questionable whether all contributors will finally receive their full pension amount (Wang, 2006). This fact may partially explain why coverage is low, there is just a limited trust in the system. Moreover, the expected low rates of return on the individual accounts and the complicated administrative procedures in order to apply for the pension system are obstacles, too (Salditt et al., 2008).

4.2.2 Central issues

The urban pension system has mainly two challenges:

- Overall coverage of urban population is relatively low with a percentage of only 37.9% in 2009. See also Table 5.

- The system is unsustainable in the way that contributions for the individual accounts are used for current liabilities (Williamson et al., 2009). This results in wasting trust among the population.

Coverage of the urban pension system has continually risen since 2002, for the overall urban population and as well for the urban employees only. As shown in table 5, in 1997 coverage for urban employees was 41.7% and turned to 57% in 2009. But still, the system ignores a not insignificant part of the urban population. It’s hard to estimate which population groups are concerned, but presumably those who can’t afford to participate or don’t understand how to participate, as well as the disabled and the long term unemployed. Moreover, there are also illegal migrants from rural areas which aren’t covered either. Therefore it must be an aim to augment urban coverage, in order to protect even the poorest.
4 China and the issue of pension schemes

<table>
<thead>
<tr>
<th>Year</th>
<th>Coverage total population</th>
<th>Coverage urban population</th>
<th>Coverage urban employees</th>
<th>Balance in % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>9.1%</td>
<td>28.4%</td>
<td>41.7%</td>
<td>0.9%</td>
</tr>
<tr>
<td>1998</td>
<td>9.0%</td>
<td>26.9%</td>
<td>39.2%</td>
<td>0.7%</td>
</tr>
<tr>
<td>1999</td>
<td>9.9%</td>
<td>28.5%</td>
<td>42.4%</td>
<td>0.8%</td>
</tr>
<tr>
<td>2000</td>
<td>10.7%</td>
<td>29.7%</td>
<td>45.1%</td>
<td>1.0%</td>
</tr>
<tr>
<td>2001</td>
<td>11.1%</td>
<td>29.5%</td>
<td>45.1%</td>
<td>1.0%</td>
</tr>
<tr>
<td>2002</td>
<td>11.5%</td>
<td>29.3%</td>
<td>44.9%</td>
<td>1.3%</td>
</tr>
<tr>
<td>2003</td>
<td>12.0%</td>
<td>29.6%</td>
<td>45.4%</td>
<td>1.6%</td>
</tr>
<tr>
<td>2004</td>
<td>12.6%</td>
<td>30.1%</td>
<td>46.3%</td>
<td>1.9%</td>
</tr>
<tr>
<td>2005</td>
<td>13.4%</td>
<td>31.1%</td>
<td>48.0%</td>
<td>2.2%</td>
</tr>
<tr>
<td>2006</td>
<td>14.3%</td>
<td>32.5%</td>
<td>49.9%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2007</td>
<td>15.2%</td>
<td>33.9%</td>
<td>51.7%</td>
<td>2.8%</td>
</tr>
<tr>
<td>2008</td>
<td>16.5%</td>
<td>36.1%</td>
<td>54.9%</td>
<td>3.2%</td>
</tr>
<tr>
<td>2009</td>
<td>17.6%</td>
<td>37.9%</td>
<td>57.0%</td>
<td>3.7%</td>
</tr>
</tbody>
</table>

**Sources:** National Bureau of Statistics (2010), author’s calculation

The second issue is probably partially linked to the first obstacle. As mentioned before, provincial governments are using payments intended for the mandatory individual accounts to pay current liabilities, because the change from the old PAYG pension scheme to the three pillar system in 1997 caused a lot of debts due to transitional costs: In a PAYG system, current employees are paying the annuity of current pensioners, there is no fund available. It is important to point out that in 1997, the old PAYG scheme didn’t just disappear, it’s even today still valid for pensioners retired before 1997, offering them a very high replacement rate of about 80% of prior wage (Wang, 2006). Moreover, people which were still working in 1997, participated afterwards in the new three pillar system, but they will receive when retiring almost the replacement rate of the old PAYG system (Wei, 2007). So, new employees after 1997 had to compensate for these costs caused by the old PAYG system, and simultaneously had to deposit money into their individual accounts, which resulted in high contribution rates. As a result, several enterprises and employees refused to participate in the new system (Shuanglin, 2008). Due to this fact and the maybe still to low estimated contribution rates, debts resulted and local governments apparently felt impelled to use individual account payments to pay current liabilities.
The above described practice is known in public and caused very limited trust in the system, which may also have an impact on the low coverage rate.

4.3 China’s current rural pension system

4.3.1 Status quo

Almost all previous pension reforms in China targeted the urban population, so in rural China coverage is humble, estimates are around 5% to 10% of the rural population, varying among provinces (Williamson et al., 2009). According to official sources, coverage in rural China in 2009 was estimated to be about 10.2% of the rural population (National Bureau of Statistics, 2010). There are mainly two small pension schemes in some provinces available, one is an old age insurance with voluntary contributions (Yang et al., 2010) the other a non-contributory social assistance, called the “Rural Five Guarantees” (food, clothing, housing, medical care and burial costs) (Salditt et al., 2008). The old age insurance exists since the late 1980s, was first only available in one province and then in 1992 extended to other provinces (Yang et al., 2010). However, participation is optional and contributions in general are only made by rural residents, there is no support from the government.

The “Rural Five Guarantees” instead isn’t a pension system in a common sense. Recipients are the poorest retirees who aren’t able to work and don’t have any assets or family members who can support them. Pensioners are either collective accommodated in a home for the aged, or individually in another family (Yang et al., 2010).

Recent research has also shown that since 2009 the government of China is in the process of establishing a new experimental pension scheme for rural China, which consists of a basic pension financed by the state as well as by local government and additionally offers an individual contributory saving possibility (Shen and Williamson, 2010). However, there aren’t a lot of information about this issue and it’s questionable whether this system will be generally available in the near future.

4.3.2 Central issues

Traditionally and still today, rural retirees relied on family support as soon as they were unable to work anymore (Salditt et al., 2008). The pensioners were in charge of the family until they died and were able to pass their evening of life in dignity. However, this kind of family support has worsened since numerous young people migrated to urban areas, in order to find work and have a better life. In 2006, about 132 millions of such migrants were - legal or illegal - employed in urban areas (China Labour Bulletin,
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This development is not a coincidence, since the urban - rural income disparity has increased over the years. In 1991, the urban-rural income ratio was about 2.4, eighteen years later in 2009, the same ratio was about 3.33. The development over the past eighteen years is shown in table 6.

### Table 6: Urban and rural annual income

<table>
<thead>
<tr>
<th>Year</th>
<th>Urban annual income per capita*</th>
<th>Rural annual income per capita*</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>1700.6</td>
<td>708.6</td>
<td>2.4</td>
</tr>
<tr>
<td>1995</td>
<td>4283</td>
<td>1577.7</td>
<td>2.71</td>
</tr>
<tr>
<td>2000</td>
<td>6280</td>
<td>2253.4</td>
<td>2.79</td>
</tr>
<tr>
<td>2005</td>
<td>10493</td>
<td>3254.9</td>
<td>3.22</td>
</tr>
<tr>
<td>2006</td>
<td>11759.5</td>
<td>3587</td>
<td>3.28</td>
</tr>
<tr>
<td>2007</td>
<td>13785.8</td>
<td>4140.4</td>
<td>3.33</td>
</tr>
<tr>
<td>2008</td>
<td>15780.8</td>
<td>4760.6</td>
<td>3.31</td>
</tr>
<tr>
<td>2009</td>
<td>17.174.7</td>
<td>5153.2</td>
<td>3.33</td>
</tr>
</tbody>
</table>

**Sources:** National Bureau of Statistics (2010), author’s calculation

* in Yuan

Additionally, there isn’t just an income and wealth discrepancy between the urban and rural areas, large wealth income differences are even observable among rural provinces. Recent research has shown, that the official poverty rate in coastal provinces was less than 1% (among them Zhejiang, Jiangsu, Fujiam and Guangdong), but in the more remote mountainous provinces (Yunnan, Guizhou, Henan, Shanxi, Shaanxi and Gansu), this rate was as high as 6% (Shen and Williamson, 2006). However this six provinces are accounting for about 21.1% of China’s population (National Bureau of Statistics, 2010). Nationwide instead, the poverty rate in 2005 was about 2.5% of the population (UNSD, 2011c).

Another issue in connection with family support is China’s one-child policy. Nowadays, married couples often have to support four elder parents, since there are no other brothers and sisters (Shen and Williamson, 2006). This constitutes a huge financial burden for these families.

The rural pension system has therefore the subsequent challenges:

- Overall rural coverage is low, estimated to be about 10.2% of the rural population in 2009, the coverage needs to be augmented in a meaningful way.
- The traditional family network for pensioners is weakening, since more and more young people migrate to urban areas, leaving parents behind.
4 China and the issue of pension schemes

- There is a growing income disparity between the urban and rural population. This causes migration and may eventually result in disturbances.

- Beside the urban-rural disparity, there is also a discrepancy among rural provinces. This points out that the requirements, regarding a rural pension system may be very different among provinces.
5 A universal pension for China?

Up to the present, China has relied on contributory pension systems and focused mainly on the urban areas. The systematic change from a PAYG to a 3-pillar system in 1997 resulted in huge transitional costs and the government was never able to lower these burdens in a meaningful way. The result is a fragmented, unsound pension system which is in general available only in urban areas, while rural pensioners have to rely either on family support or - if even available - on a very small-scaled rural pension system.

However, the analysis in chapters 4.2 and 4.3 shows that the situation of retirees differs substantially from region to region. People in urban areas have completely different needs than those of rural areas, especially with regard to income disparities. As long as there are such huge discrepancies inside of China, it is questionable whether it is feasible to set up one pension scheme for the country as a whole. Additionally, common pension systems are designed to cover a the more or less homogeneous population, homogeneous in the way that at least a substantial part of a population has similar standards of living. If not, then contributory systems will eventually suffer from low coverage and financial shortfalls, since the poor can’t afford to participate. Contrariwise, non-contributory systems may then offer a sufficient support for poor people, but the same amount of assistance would be to low for the middle and high class population. Additionally, if the amount paid to the more affluent people would be substantially higher, then it is questionable whether such a system would be even financially feasible.

Therefore, it is absolutely necessary to analyse the meaning of a universal pension separately regarding the urban areas and the rural areas.

5.1 A universal pension system for the urban areas

The urban areas of China are accounting for more than 60% of GDP and about 85% of GDP growth (Worldbank, 2011b). Compared to other countries with similar levels of GDP and standards of living, China’s actual three-pillar system seems to be a fungible solution. However, the issues described in chapter 4.2.2 are serious obstacles for the actual system.

The general introduction of a universal pension system for the urban areas would call for another fundamental change of the system. But the changes in the past, connected with the arisen transitional costs and the disability to fulfill all pension liabilities caused very limited trust into the system and another huge change certainly would not
improve trust. Consistency and the development and advancement of public trust is needed. Instead of changing the actual system again completely, there is a need to implement only one three-pillar system in urban areas, which requires the abandonment of experimental urban pension systems. This “one urban pension system for all” policy would signal consistency, transparency and same conditions for everyone. Of course, contribution rates could be adjusted in each urban province, but the main regulations have to be identical.

Another important point regarding public trust is the fully funded individual pillar II, which is often not fully funded at all since local governments need these contributions to pay current liabilities. The reason are the already mentioned transitional costs, which arose as a result of the change from the PAYG to the three-pillar system. Research has shown that a solution to this issue might be the change from a fully funded defined contribution pillar (FDC) to a notional defined contribution (NDC) pillar (Williamson et al., 2009). The main difference between these two possibilities is that the NDC-pillar isn’t fully funded. There are individual accounts as well, but the contributions from employees can be officially used for current liabilities, since the balance in each individual account is just notional. With such a system, the government may lower the financial deficits and fulfill all pension liabilities as well. Moreover, the actual handling of using individual accounts for current liabilities would then be officially allowed, formalised and the system therefore more transparent.

All these measures together will lower the main problems of the current system, and improvements in consistency and trust will eventually result in higher coverage.

As a conclusion, it can be determined that a renewed changed of the urban pension system doesn’t seem to be a wise idea at the moment, regardless of possible advantages of a universal pension system. But what about the future? In past years China had always a growth rate of around 9% of GDP (UNSD, 2011b), which is rather high. The standards of living in urban China will move up quickly and the higher these standards, the lower the benefits of a universal pension, since research has shown, that especially the very poor people benefit from a universal pension in a meaningful way (Yang et al., 2010). In the whole world, there is only one high-income country which provides a universal pension, it is New Zealand. This indicates that universal pension might not be an optimal choice for developed countries and as time goes by, a universal pension becomes decreasingly useful in urban China.
5.2 A universal pension system for the rural areas

China’s lack of an adequate nationwide rural pension scheme has left many rural retirees dependent on family support or left them to their own devices. However, family support has been weakened since a lot of young people migrate to urban areas in order to get employment. A new dimension of elderly support is urgently needed, since the very small-scaled contributory pensions schemes which are available only in some parts of rural areas are ways to small to protect people in a meaningful way. Additionally, such contributory schemes call for a broad administrative capacity in order to collect and keep records over several years for each participant and even to distribute benefits. However such administrative capacity is low in China’s rural districts (Yang et al., 2010), contributory schemes don’t seem to be an adequate choice for many years.

A universal pension could be a adequate solution for all these concerns, since it can cover a large rural population in a little while and support especially the poorest in a very meaningful way.

However, universal pension schemes call for administrative capacity too, but the overall effort is much lower compared to a contributory system. Information has to be collected about place of residence, personal situation and the age has to be verified, but there are no long-time records about income and wealth of people needed. Verifying the age in rural China might be an obstacle, since it is unlikely that the majority of rural citizens do have a birth records. However, there are ways to deal with this issue. For example in Nepal, the 1995 introduced universal pension system first excluded many retirees from benefits since they weren’t able to proof their age. Nowadays, they are allowed to use election identity cards and horoscopes as a proof of age. Bolivia, which provides for its citizens a universal pension too, solved this issue in a similar way: As long as retirees were able to provide witnesses in order to proof age, they were eligible for benefits (Gorman, 2004).

One main administrative challenge regarding universal pensions is to deliver pension benefits in a timely manner. If available, benefits can be managed and distributed by networks of banks or post offices. If such networks are weak or not available at all, then other solutions are needed. Nepal uses rural village development committees which are responsible for all administrative issues. Retirees have to hand in their application forms to the local committee and after verification, benefits are paid in cash (Palacios and Rajan, 2004). If such administrative issues are solved, then coverage for a universal pension system can emerge very fast, providing support for each pensioner.

However the most important factor about a universal pension scheme for rural China
is the impact on standards of living. In rural China, poverty is still a major issue. In 2006, about 26 million rural residents had to get by with an income below the national poverty line (Yang et al., 2010), which is considerable below the international poverty line of 1.25$ a day. A universal pension scheme can lift a large fraction of people out of poverty. Moreover, this includes not only retirees, but their whole family too. If a pensioner is living together with his family, then it is very likely that the pension benefit will improve the living conditions of all household members. Additionally, older people then shift from being a burden to an important resource and income contribution, which advances even their status within the family (Shen and Williamson, 2006). Prove for this can also be found in other countries: Nepal’s pension benefits seem to be a very important source of income for many retirees and their relatives (Gorman, 2004), even though Nepal is offering a very small pension amount of 7$ a day. In 1998, Bolivia stopped its universal pension scheme which offered less than one dollar a day. This resulted in serious protests among population and the scheme had to be reinstated quickly (Willmore, 2001).

Such advancements in living conditions have large overall impacts on other categories, like on health status or educational benefits. The health status of pensioners or the whole family as well can be improved since medical attendance isn’t an unaffordable issue anymore. Additionally, children can attend school and therefore improve their future career opportunities. Without a pension benefit, they might drop out of school since their families just can’t afford the fees for schooling (Shen and Williamson, 2006).

Moreover it is important to point out that such benefits will not only improve the conditions within a family, it will also reduce disparities among population, especially between the rural and urban population. By reducing the poverty rate in rural areas and hence lowering the gap between wealthy urban and poor rural residents, the government can achieve higher political and social stability.

### 5.3 About the ability to afford a universal pension system

A common concern regarding universal pensions is that they are too expensive and many analysts claim that China has at present not the needed financial resources for such a pension scheme (Williamson et al., 2009). Regardless of these concerns, it has to be mentioned that a noteworthy number of countries with similar or even lower levels of GDP per capita than China do have such a universal pension. Nepal, a neighbour of China and one of the poorest countries in the world with an estimated poverty rate of about 55% of the population (HelpAge, 2011) does have a universal pension system.
5 A universal pension for China?

The pension benefit was during the first years quite low with about 2$ a month, but citizens reported that the amount was very meaningful in everyday life (Palacios and Rajan, 2004). Recently, this amount has been augmented to 7$ a month and age of eligibility has been lowered from 75 to 70 years (Williamson et al., 2009).

Other low-income countries with a universal pension like Bolivia or Botswana offer their citizens a monthly pension benefit of 18$ respectively 27$ with average costs of 1.3% and 0.4% of GDP (see also table 2).

Research has shown that universal pension schemes are administratively simpler and less expensive than the contributory ones. Additionally, there is evidence that the overall costs of such a system are relatively low. Moreover, most of the nations which do have a universal pension system introduced it with lower levels of GDP per capita than China does have at the moment (Shen and Williamson, 2006).

<table>
<thead>
<tr>
<th>Age of eligibility</th>
<th>Benefit</th>
<th>Aggr. population</th>
<th>Rural population only***</th>
</tr>
</thead>
<tbody>
<tr>
<td>65</td>
<td>107$*</td>
<td>0.25%</td>
<td>0.18%</td>
</tr>
<tr>
<td>65</td>
<td>456$**</td>
<td>1.08%</td>
<td>0.76%</td>
</tr>
<tr>
<td>70</td>
<td>107$</td>
<td>0.19%</td>
<td>0.133%</td>
</tr>
<tr>
<td>70</td>
<td>456$</td>
<td>0.81%</td>
<td>0.57%</td>
</tr>
<tr>
<td>75</td>
<td>107$</td>
<td>0.10%</td>
<td>0.073%</td>
</tr>
<tr>
<td>75</td>
<td>456$</td>
<td>0.44%</td>
<td>0.31%</td>
</tr>
</tbody>
</table>

Sources: National Bureau of Statistics (2010), Yang et al. (2009), author’s calculation
*national annual poverty line 2007
** international poverty line 2008 (1.25$ / day)
*** Shen and Williamson (2010) assume that 70% of China’s elderly live in rural areas

A great advantage of a universal pension regarding financial concerns is the possibility to adjust them very closely to the resources of a country. Costs can be regulated by keeping the age of eligibility high and the benefits low. Afterwards, when a universal pension system is once successfully implemented and enough resources are available, then both age of eligibility and benefits can be slowly adjusted.

Table 7 shows actual estimated costs of a universal pension in China, the calculation method is shown in chapter 2.2. Considering only the rural population after the age of 65, the minimum costs would be 0.18% of GDP with respect to the national poverty line respectively 0.76% regarding the international poverty line. Costs can be significantly reduced by raising the age of eligibility to 70 years with costs of 0.133% respectively.
0.57% of GDP. A raise to 75 years for eligibility would lower the costs again, but it is questionable whether such a high minimum age would be reasonable since the average life expectancy is about 71.4 years (National Bureau of Statistics, 2010).

In connection with financial issues, it is important to consider possible future developments. Table 8 shows estimated data for the period until 2035 as a medium variant. The total population is predicted to grow further for about twenty years, though an overall deceleration is expected. After the year 2030, also as a result of China’s one-child policy, a decline of the population size is expected to arrive (UN, 2009b).

However while total population is expected to grow further, the rural population growth rate is as shown in table 8 already negative with -1.01% a year today and predicted to be about -1.82% a year in 2035 (UN, 2009b). This development can be potentially positive for a universal pension in rural areas with regard to financial burdens. Contrariwise, even China is facing an aging society: While the fraction of people over the age of 65 nowadays is about 8.3%, this rate is going to scale up to 20.2% in 2035 (UN, 2009b). The exact future allocation of this population group between urban and rural areas is hard to estimate, today about 70% of all elderly people are living in rural areas (Shen and Williamson, 2010).

Estimated future calculations can be found in table 9. If we fix the benefit level at the actual level of 13.03% of GDP per capita and take into consideration the annual rate of change of percentage rural (see table 8), then we can determine that the costs of a universal pension for the whole population would result in very high rates of GDP, while the costs of such a pension for the rural population only would stay sustainable, even though a rise in costs can be expected.

Besides already estimated population projections it has to be considered that the introduction of a universal pension in rural areas only (see discussion in chapter 5.1 and 5.2) may have an impact on the future demographic development of China. First of all, a so-called pensioner-tourism might occur and second, the extent of migration from rural to urban areas as estimated above could be lowered since rural areas suddenly offer more prospects to its citizens. These two arguments should therefore be analysed.

Living conditions for retirees in rural areas could become more attractive than those in the urban ones and incentives might arise to change the place of residence at pension age. Such a pensioner-tourism would be a potential a financial threat to the universal pension scheme as well as to the whole country in demographic terms. In order to control costs and keep them low, it is necessary to restrict eligibility to “true” rural citizens. For example, this can be achieved by the compelling requirement that pensioners have lived in rural areas at least since they were at the age of 50. It might also be possible
Table 8: China population projection 2010 - 2030

<table>
<thead>
<tr>
<th>Year</th>
<th>Total population*</th>
<th>Percentage urban %</th>
<th>Percentage rural %</th>
<th>Urban annual growth rate %**</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>1354146</td>
<td>47.0</td>
<td>53.0</td>
<td>2.29</td>
</tr>
<tr>
<td>2015</td>
<td>1395998</td>
<td>51.1</td>
<td>48.9</td>
<td>1.97</td>
</tr>
<tr>
<td>2020</td>
<td>1431155</td>
<td>55.0</td>
<td>45.0</td>
<td>1.58</td>
</tr>
<tr>
<td>2025</td>
<td>1453140</td>
<td>58.6</td>
<td>41.4</td>
<td>1.23</td>
</tr>
<tr>
<td>2030</td>
<td>1462468</td>
<td>61.9</td>
<td>38.1</td>
<td>0.96</td>
</tr>
<tr>
<td>2035</td>
<td>1462351</td>
<td>64.9</td>
<td>35.1</td>
<td>0.77</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Rural annual growth rate %**</th>
<th>Population aged 65+ in %</th>
<th>Annual rate of change of percentage rural**</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>-1.01</td>
<td>8.3</td>
<td>-1.62</td>
</tr>
<tr>
<td>2015</td>
<td>-1.16</td>
<td>9.5</td>
<td>-1.66</td>
</tr>
<tr>
<td>2020</td>
<td>-1.37</td>
<td>12.0</td>
<td>-1.68</td>
</tr>
<tr>
<td>2025</td>
<td>-1.54</td>
<td>14.0</td>
<td>-1.67</td>
</tr>
<tr>
<td>2030</td>
<td>-1.66</td>
<td>16.5</td>
<td>-1.66</td>
</tr>
<tr>
<td>2035</td>
<td>-1.82</td>
<td>20.2</td>
<td>-1.72</td>
</tr>
</tbody>
</table>

Source: UN (2009b)

* in thousands

** rates valid for the subsequent 5 years
Table 9: Estimated future costs of a universal pension in China in % of GDP*  

<table>
<thead>
<tr>
<th>Year</th>
<th>Benefit</th>
<th>Aggr. population</th>
<th>Rural population only**</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>13.03%</td>
<td>1.24%</td>
<td>0.80%</td>
</tr>
<tr>
<td>2020</td>
<td>13.03%</td>
<td>1.56%</td>
<td>0.93%</td>
</tr>
<tr>
<td>2025</td>
<td>13.03%</td>
<td>1.82%</td>
<td>0.99%</td>
</tr>
<tr>
<td>2030</td>
<td>13.03%</td>
<td>2.15%</td>
<td>1.08%</td>
</tr>
<tr>
<td>2035</td>
<td>13.03%</td>
<td>2.63%</td>
<td>1.21%</td>
</tr>
</tbody>
</table>

Source: UN (2009b), author’s calculation  
* Age of eligibility is 65  
** With respect to the annual rate of change of percentage rural from table 8

to restrict eligibility to people who passed a specified number of years (e.g. 20 years) in rural China. However, the therefore necessary verification would be complex and expensive. Additionally, if a person passed this specified number of years in rural China all in his early life only, then it is questionable whether such a person should be still eligible for a rural pension benefit when retiring.

It is difficult to estimate the effective dimension of such a pensioner-tourism, there are no projections available. Nevertheless the extent should be relatively small: First of all, people in urban areas are relatively more wealthy than the rural citizens. It is therefore likely that urban residents perceive the available rural pension benefit as being very small and unattractive. Moreover, a move to rural areas is not a simple undertaking, besides administrative difficulties and additional costs it is also necessary to leave friends and relatives behind.

The second mentioned issue is the phenomenon that the extent of migration from rural to urban areas might decline since rural areas with a universal pension will offer better prospects to its citizens than before. Table 8 would then show a too strong decline in rural population. However, these emigrants are mainly young people (Shen and Williamson, 2006) and it is questionable whether they will consider a small pension benefit available in the distant future when thinking about emigration. Research has shown that people consider financial benefits the fewer the further they are available in the future. This phenomenon is the so-called hyperbolic discounting (Laibson, 1997).

Even if the impact of these two demographic phenomenons tends to be relatively small, it is necessary to emphasize that all calculated costs above are estimated lower limit costs and therefore only a guideline. The real costs will be, not only because of demographic issues, higher.
5.4 Means tested or not?

In general, a non-contributory pension can be available as a means tested or a universal pension scheme. Means-tested pension systems offer support only to those who meet certain criteria, like being below a specified level of lifetime-income. Universal pensions instead are available to all, the only criterion is the age of eligibility and the place of residence.

A major advantage of means-tested pension is the idea, that only people who are really in need of support receive such a pension. Local or central public authorities can check whether a citizen is eligible for a pension and therefore no money is wasted for unnecessary payments. In such a way, financial support can be distributed more precisely and as a higher amount to the needy instead of providing lower benefits to the whole population.

However, such an administrative organization is always costly and it is likely that the benefits of such a means-tested scheme are fully compensated by the high administration costs (Johnson and Williamson, 2006). Research has also shown, that even when means tested, pensions might target not only the poor: In Costa Rica, about 40% of its means-tested support reaches people who are not needy at all (Willmore, 2001).

Additionally, especially in rural areas public authorities are often rare and the overall administrative capacity therefore too low (Overbye, 2005), due to a lack of available trained personal and the general often weak environmental structures. The result are interminable and inert administrative proceedings. Such slow administrative processes may discourage people even from applying and the poorest among the population just don’t have the financial resources to wait for a long time. Such issues can present huge obstacles to developing nations. For example, Namibia which does have a universal pension, considered more than once to switch to a means-tested pension scheme, but eventually it has been determined that this was not going to be feasible due to the lack of available data, concerning income or wages and administrative capacity (Schleberger, 2002).

Another issue regarding such administrative proceedings is corruption. Research has shown, that corruption in China is still a severe issue. The “corruption perceptions index” of 3.6 from 2008 (72nd out of 180 checked countries) attests China still widespread corruption, in the public sector as well as in the private sector (Transparency International, 2009). Willmore (2006) reported that in Mauritius, means-tested pensions were terminated because they were prone to corruption.

Beside administrative concerns, there are also problems regarding potential recip-
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As shown above, especially the poor rural areas of China are in need of a sustainable and meaningful pension scheme, while the urban areas already can at least partially count on a three-pillar-system which needs to be improved and not be changed completely. It is therefore proposed to establish a universal pension scheme in rural China only. This system should be province-specific since the standards of living differ from province to province. In such a way, the conditions can be adjusted to the particular economic and social situation of each province. It is important to point out that China should first implement the new pension scheme in the poorest western areas. These provinces are the most in need of support and in such a way, the government can lower income disparities in a meaningful way.

Since the administrative capacity in rural China tends to be low, means-tested pension aren’t a reasonable alternative at the moment. Research has shown, that the government of China at present does not have reliable information about individual or even family income of rural citizens (Shen and Williamson, 2006). This is a momentary conclusion, if the administrative situation becomes improved in the future, then this should be analysed again.

Therefore, eligibility in rural areas should only be dependent on age and place of residency and the age of eligibility should be chosen with regard to the financial situation of the local population. In the remote mountainous western provinces of China, where unemployment and poverty are relatively high, the age of eligibility might be lower, as example around 60 years, while in the more wealthy coastal regions the minimum age can be set at 70 years. However, in order to prevent the rural universal pension
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system from exploitation through pensioner-tourism it is also important to restrict the availability of the pension scheme to true rural retirees by law.

The benefits themselves should be at least at the beginning very small, but nevertheless meaningful to the poorest. If it turns afterwards out that the pension scheme is feasible even if augmenting the benefits, then the provincial governments can do so. The contrary would be much more delicate and might be interpreted as the unsustainability of the whole system.

Moreover, keeping the benefits low and the age of eligibility high is the key for a successful introduction of a universal pension scheme. Benefits can be specified as a percentage of the GDP per capita level or as a percentage of the provincial poverty line, adjusting them every year. By doing so, benefits are always appropriate to a province’s economical situation.

Financing could be carried out by local and central governments, for example with revenues from government shares of enterprises (Gorman, 2004) or regional taxes. Financing over general nationwide taxes might be a precarious approach, since not all contributors will be eventually able to benefit from the pension scheme. Beside the way of financing, future population developments should also be considered and it should be emphasized that all financial forecasts have to be regarded as lower limit cost calculations.
6 Conclusion

Chinese policy makers should take universal pension systems into consideration. Universal pension schemes can offer valuable support for the elderly, especially in rural areas. Because no means tests are necessary, a smaller administrative capacity is needed and coverage can quickly emerge, providing retirees with social security, better health and higher life expectancy. Additionally, the positive effects on pensioners even take influence on other family members, since the financial situation of the whole family can be improved. All these influences contribute to social and political stability and can lower the gap between the rural and urban population.

There are often concerns about the financial feasibility of such a scheme. Nevertheless, research has shown that even very poor nations can afford a universal pension. By keeping the benefits low and the age of eligibility high, at least at first, costs can be kept very low. If the scheme then turns out to be feasible, the government can improve conditions.

The analysis has shown that a universal pension, especially with regard to future population development, might be too expensive for the urban parts of China. Additionally as examined in chapter 5.1, another change of the urban system would assist the existing incertitude towards the pension system among urban citizens and it is recommended to improve, not to change the available scheme. Beside these circumstances, the value of a universal pension comes best into its own in poor areas, where it can lift a large fraction of people out of poverty.

Therefore, this article recommends to implement a universal pension in China’s rural areas, beginning with the implementation in its poorest provinces. Such an implementation is difficult and a challenge to the government, but it eventually result in a rural society which can rely on public support, too. It is important to point out that such a scenario is not only meaningful for poor rural retirees and their relatives, it is also important regarding social peace within China.

Sometimes Chinese policy makers express the apprehension that it might be too early (in economic terms) for rural China to implement an extensive pension system (Shen and Williamson, 2010), especially due to large regional disparities. However, several European countries introduced pensions for their poor rural population at lower or at least similar levels of economic development than rural China does have at the moment (Leisering et al., 2002), which also presents a hint, that a universal pension for rural areas might be feasible and meaningful.
References


References


References


