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Pension fairness in China

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ABSTRACT

The most populous country in the world, China faces immense socio-economic challenges providing adequate pensions to its growing elderly population. In that country, pensions available to older people vary considerably across the country's various pension schemes. This paper calculates the fairness coefficients of these pensions based on pension income, contributions, demand, and generational gap. The analysis shows that the pension fairness coefficients are 0.53, 0.38, 0.95, and 0.82, respectively. Synthesizing pension income, contributions, demand, and generational gap, the paper suggests that, in China, old-age pensions across different schemes are absolutely unfair. Finally, it analyzes the superficial and deeper factors behind pension unfairness in China before providing policy recommendations for improving the fairness of the country's pension system.

1. Introduction

Since the market reforms beginning in 1978, China has accomplished much in terms of economic development. For instance, between 1978 and 2011, GDP (Gross Domestic Product) increased by 15.88% a year on average based on current prices (or 9.89% based on comparable prices).[1] Meanwhile, in real terms, the per capita disposable income of urban residents rose by a yearly average of 13.41%, and the per capita net income of rural residents by 12.72%. Yet, from a social standpoint, China faces major challenges. For instance, an outstanding problem is that social wealth is increasingly concentrated in the hands of a few and income inequality is becoming more and more apparent. There are many different ways to assess the fairness or unfairness of income differences among Chinese workers. From an international standpoint, ‘China's Gini coefficients range from 0.45 to 0.49 in recent years,’ which allegedly points to the unfair nature of primary distribution in the country (Wolf, 2012), a conclusion reached by a number of studies (Gustafsson & Shi, 2001; Jiang, Shi, Zhang, & Ji, 2011).

For retirees, whose number is rising in a context of accelerated demographic aging, the two major sources of income are national pensions and support from family members. With China's unequal primary distribution of pensions in a climate of ever-increasing need for economic support for the elderly, it is more important than ever to evaluate the fairness of the various provisions available through the country's fragmented and stratified pension system. Considering this, the following study evaluates pension fairness across different schemes, to offer a broad overview of pension fairness in China.

Most of the international studies on pension fairness have emerged from the field of public policy research. Early on, socio-economic disparities among individuals from different social classes, labor-market positions, income levels, genders, and ethnic and racial groups were the focus of the policy research on fairness (Andrews, 1975; Hermkens, 1986; Rickne, 2013; Tinari, 1987). Since the 1970s, authors like Atkinson and Brandolini (2009) and Sen (1976) have extended the research on fairness and public policy by focusing on the allocation of social welfare benefits. What the literature shows is that assessing pension disparities is as much

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about value judgments as about factual judgments (Brunner, 1996). While factual judgments focus on making accurate statements of fact, value judgments focus on norms and codes of conduct (Friedman, 1966). In the international pension literature, both factual and normative assessments of pension schemes are now common (Le Garrec, 2011). The most common factual assessments involve indexes looking at average pension benefits per person, pension substitution rates (the relationships between average pension benefits and average wages), and relative pension level (Van Duijn et al., 2013; Fors, Modin, & Koupi, 2012; Haberman & Wong, 1997). In addition, as researchers recently analyzed defined-benefit (DB) and defined-contribution (DC) pension schemes (Exley, Mehta, & Smith, 1997; Zelinsky, 2004), they emphasized the reciprocity and coherence of rights and obligations, and assessed pension fairness through the relationship between pension contributions and benefits (Devesa Carpio, Carpio, & Meneu Gaya, 2012). Zhang S. and his colleagues (2013) constructed an analytic model about the fairness of the distribution results from three perspectives (income, income and contributions, income and demand), before undertaking a comparison of income and demand ratio of basic pension from horizontal and longitudinal perspectives; and thus drawing conclusions regarding China's pension fairness (Yong & Zhang, 2013), but they did not conduct empirical research regarding income or income and contributions. Their conclusions and methods of the research on pension fairness can be used as a reference point for this paper.

This paper formulates a pension fairness framework and fairness models based on pension income, contributions, demand, and generational gap, respectively. Then, it presents data about the five types of pension schemes defined below: the basic old-age insurance system for enterprise employees, the basic old-age insurance system for public institution employees, the old-age insurance system for urban residents, the new type of rural social endowment insurance, and the pension system for civil servants. Based on this data, the paper calculates pension fairness indexes in view of pension income, pension income and contributions, pension income and demand, and pension income and generational gap. Finally, the paper analyzes the factors behind pension unfairness in China before providing policy advice about how to improve the fairness of that country's pension system.

2. China's pension schemes

The institutional fragmentation of pension schemes in China is a well-known reality. There are five types of pension schemes in China. The first type is the basic old-age insurance system for enterprise employees. All enterprise staff (self-employed people and individuals in flexible employment) must participate in this type of pension scheme. This pension scheme combines a pooled social trust fund with individual accounts. In the pooled social trust fund component, employers pay the basic 20% old-age insurance contribution for employees required by the state. In the individual contributions component, employees pay 8%, which is funneled to their individual account. When individuals participating in this scheme reach the statutory retirement age (60 years old for men, 55 for female civil servants, and 50 for female employees) and have over 15 years' worth of contributions in total, they shall receive a monthly pension. The pension includes the general basic pension and the individual account pension. The value of the general basic pension, which is financed through the pooled social fund and (when needed) general government revenues, is the product of the average wage of local employees and the number of contribution years divided by 100. The value of the individual account pension is the quotient of the total amount of money in their account and 139.[2]

The second type of pension scheme is a recently-created basic old-age insurance system for public institutions employees. In March 2008, the State Council issued a pilot project for a basic old-age insurance system for public institutions employees, and selected Shanxi, Shanghai, Zhejiang, Guangdong and Chongqing as the five pilot regions. This pension system is very similar to the basic old-age insurance system for enterprise employees described above.

The third scheme is an old-age insurance system for urban residents. In June 2011, the State Council issued guidance to carry out the old-age insurance system pilot project for urban residents. Urban residents who are non-students aged 16 and older and who do not qualify to join the basic old-age insurance system for enterprise employees can voluntarily participate in an old-age insurance system for urban residents (the exception to this scheme is urban residents who are already 60 or older, as they do not contribute). In this scheme, individual contributions are set between 100 and 1000 Yuan a year and local governments can set up additional contributions based on their specific needs. Yearly local government subsidies for pension contributory benefits cannot be lower than 30 Yuan per person. The individual's contribution and local government's subsidies are automatically added to each individual pension account. Furthermore, the central government provides a basic monthly pension of 55 Yuan per person, and local governments can increase that basic amount at will. As for the individual pension amount, it is calculated by dividing the total value of the account by 139.

A fourth type of pension scheme in China is the recently created rural social endowment insurance. In September 2009, the State Council issued the guidance to carry out the new type of rural social endowment insurance, and the guidance shows that non-student rural residents aged 16 and older not eligible to enroll in any other old-age pension scheme can join this new rural scheme voluntarily. Currently, individual contributions vary from 100 to 500 Yuan a year, and other aspects of this pension scheme are identical to the old-age insurance system for urban residents described above.

Finally, the fifth pension system in China is designed for civil servants. Civil servants and most public institution employees do not participate in old-age insurance and they receive a pension financed through the state's general budget. The amount of the monthly pension depends on the number of working years and the civil servant or public institution employee's pre-retirement salary.

[2] 'Considering the average life expectancy and statutory retirement age in China, the mean residual lifetime of retirees aged 60 was around 139 months in 2005. Therefore, in 2006, the State Council determined that the number of months used to calculate the individual account pension was 139. However, if the insured person opts for early or late retirement, this number is changed.'