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# Rural pension reform in China: A critical analysis

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## Introduction

In rural China, as in rural regions of many other developing countries, prior to the mid-20th century old-age provision had been the responsibility of the family. In China this was true in both rural and urban areas. In 1951, shortly after the founding of the People's Republic of China, the first public old-age pension provision scheme was introduced. It was designed to cover workers in urban areas, primarily those working in the state owned enterprises (SOEs) that were generally located in urban areas. It was financed by employers with no contributions required from employees. For rural residents provision for old-age continued to be largely the responsibility of the family. However, there was also some additional support from the rural communes (collective farms). Rural residents who were childless were guaranteed a very modest level of support in the form of the "Five Guarantees," a social assistance program that was covered by the collective that assured at least minimal coverage with respect to food, clothing, housing, medical care, and burial expenses (Wang, Williamson, & Cansoy, 2016). But during the 1980s and the gradual shift from a command to a market economy, the rural communes generally devolved into individual family plots. This resulted in old-age provision becoming again almost entirely the responsibility of the family. During the 1980s and 1990s several other voluntary small scale old-age pension schemes were piloted in some regions of rural China. But the rural population remained largely ignored by government sponsored pension schemes.

In 2008 approximately 10% of the rural population in China was covered by one of several small-scale voluntary schemes (Fang, Giles O'Keefe, & Wang, 2012). Our focus in this article is on some very innovative recent developments in pension policy in rural China, particularly developments between 2009 and 2014. By the end of 2014 a new program called the New Rural Pension Scheme (NRPS) had been introduced and was available throughout rural China. By then almost the entire rural population that was age-eligible (over age 60) was receiving old-age pensions. Today China's NRPS (which has recently been merged with a similar scheme covering some urban residents which we will return to discuss later) is providing pensions to more rural residents than any other pension program in the world. This rapid expansion in coverage represents a major step forward for China's rural population and a potential model for rural populations in other developing countries around the world.

The main goals of our analysis are: (1) to describe the innovative structure of the NRPS, (2) to provide an assessment of what has already been achieved by this scheme, (3) to review the current challenges facing the NRPS with an emphasis on issues related to coverage, adequacy, and sustainability, (4) to discuss the three separate pension schemes that have evolved in urban areas and the recent integration of them, a similarly structured urban pension scheme with the NRPS, and (5) to review several potential reform options that some Chinese pension policy analysts are currently looking into that may play a role in future rural pension policy developments in China.

## Recent achievements and current challenges

NRPS is a two pillar scheme: (1) a noncontributory social pension component (SP) and (2) a "voluntary" funded defined contribution (FDC) component. Retirement age rural residents who meet certain conditions become eligible for a pension that combines the benefits due from both of these pillars.

The SP is currently ¥70 (US$10) per month and is available to rural residents who are already of retirement age (currently age 60) even if they have never contributed to the scheme, but this benefit is contingent on their adult children "voluntarily" enrolling in and contributing to the FDC component of NRPS. This "family-binding" policy is to our knowledge a policy innovation that is unique to China and not currently found in any other country. Given its success in China we believe that it has the potential to influence rural pension policy in many other countries around the world. This SP for those who have never contributed is entirely financed by the central government in the less affluent central and western provinces. In the more affluent eastern provinces the SP is typically financed half by the central government and half by local government (Chen & Turner, 2015).

Working age rural residents eventually become eligible for a SP benefit after they have contributed to the FDC pillar for at least 15 years and have reached retirement age. At that point they become eligible for

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a pension benefit based in part on the contributions they have made to the voluntary FDC pillar (and interest credited to these personal accounts) and in part on the noncontributory SP pillar. Working age rural adults have two voluntary decisions to make. One is whether or not to enroll and make (annual) contributions to the FDC pillar of the scheme and the other is how much to contribute. If they decide to enroll, there are a number of alternative contribution levels available that range from ¥100 to ¥2000 (US$15 to US$290) per year (Ministry of Human Resources and Social Security, 2014). Those who voluntarily elect to contribute more each year can expect a larger pension when they reach age 60. Local (county) government shares the burden of financing SP benefits with the provincial government. In addition the local government is required to contribute between ¥30 (US$4) and ¥60 (US$8) per year (depending on how much the resident elects to contribute within this range) to the enrolled participant's FDC account, but local governments in more affluent regions are urged to match a substantially larger share of the participants' contributions and many such of the local governments do contribute more.

We now turn to a discussion of three major issues that we consider particularly important in connection with an assessment of the NRPS: coverage, adequacy, and sustainability. For a discussion of other related issues that we will not be discussing see (Liu, Han, Xiao, Li, & Feldman, 2015; Liu & Sun, 2016; Wu, 2013; Shi, 2012)).

*Coverage*

The current incentives of getting a SP for one's parents and a government partial match of FDC contributions are proving to be very effective in getting rural residents to enroll despite the voluntary nature of the program (Williamson & Béland, 2016). As a result, there was a rapid increase in coverage over the past five years between 2009 and 2014. Fig. 1 shows that by the end of 2014 approximately 477 million (77%) of rural residents were covered. This figure includes 133 million recipients over age 60, almost the entire rural retirement-age population (Ministry of Human Resources and Social Security, 2015; United Nations, 2015).

After several years of ambitious expansion, NRPS coverage seems to be reaching an upper limit, but the "full coverage" goal still has not been fully realized, particularly for young adults. The term "full coverage" is sometimes used by the Chinese government to mean that this program has been implemented in all rural counties and every rural resident is being given the opportunity to participate in the new system. But it does not mean all rural residents are enrolled in NRPS as either contributors or pension recipients. Some younger residents elect not to participate, particularly when they are poor and more than 15 years from the pension eligibility age.

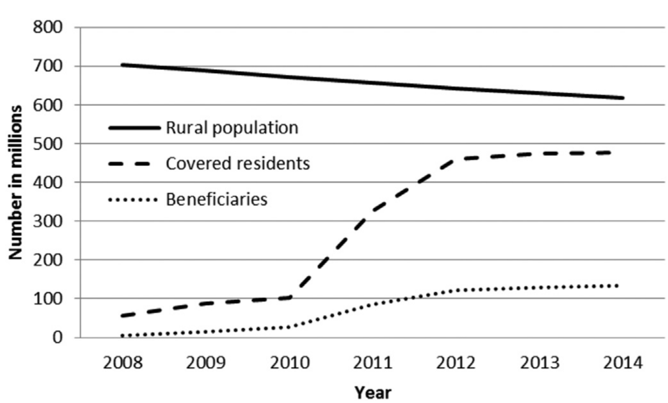


**Fig. 1.** Trends in Rural Population and Coverage of NRPS in China*Notes*: Adapted from Ministry of Human Resource and Social Security (2015). The number of beneficiaries for 2012 and 2014 were estimated by the authors. Our data for "covered residents" includes both participants that are not currently receiving benefits and beneficiaries. A few small scale pension programs were available in some provinces during the years prior to the introduction of the NRPS that began in 2009.

While poor coverage in rural areas is not currently a major issue, this could change in the years ahead if an increasing proportion of younger adult rural residents elect not to participate, for example, when they are more than 15 years below the pension eligibility age. Many analysts argue that the attractiveness of the NRPS currently comes mainly from the SP for elder parents financed by the government without any prior contribution to the NRPS. In contrast, rural residents, especially young adults without retirement age parents, generally have much less incentive to participate (Lei, Zhang, & Zhao, 2013; Zhang, 2010). Because the influence of the family-binding incentive is likely to gradually decline in the decades ahead, it may be necessary to replace this incentive with others, if current high coverage rates are to be maintained.

Other aspects in the design of the FDC component contribute to this incentive problem. Many rural residents are very poor and face considerable pressure to spend what limited funds they have on a host of pressing short-term needs such as medical emergencies. Personal pension accounts are established to keep a record of these contributions, but they do not get access to these funds until they reach retirement age. Rural residents are understandably skeptical as to how adequate the eventual compensation will be. The contributions must be deposited in government owned banks paying interest rates set by the government with yields that in some years provide a negative real rate of return and are consistently far below the rate of increase in rural incomes (People's Bank of China, 2017). This adverse incentive problem gets worse, because the modest fixed government match translates into a lower rate of match for those electing to contribute at more than the minimal level allowed for those who enroll. In sum, in the years ahead low rates of return for the FDC pillar may adversely impact coverage rates as the family-binding incentive weakens.

*Adequacy*

Benefit adequacy will be adversely affected if workers continue to opt for making the lowest allowable annual contribution levels to the FDC pillar ¥100 (US$15) for 15 years, the resulting supplement to the pension benefit based on the SP pillar will at best be very modest. Even if the interest earned on contributions to the FDC pillar were to keep up with or slightly exceed the rate of inflation, which is quite possible, the supplement to the SP benefit would still be modest, particularly for the many rural residents who are electing to contribute at the lowest allowable levels.

The current monthly SP benefit of ¥70 (US$10) used in many areas is clearly very low, making voluntary participation in the NRPS of little interest to affluent rural residents. In 2014, the benefit was about 36.5% of the official poverty line in rural areas, 8.5% of the average income in rural areas, and 3.5% of the average pension benefit of urban retirees (National Bureau of Statistics, 2015). The bottom line is that the NRPS as currently structured may provide a good starting point, but it is not a model likely to continue to attract attention from around the world unless progress is made with respect to the adequacy of these pensions.

Is there reason to believe that it should be possible for China to fund these rural pensions at a level that will yield pension benefits viewed as attractive when comparisions are made with the pensions available to the rural population in other developing countries? Based on strong evidence from Latin America and the Caribbean countries that we will be presenting, we believe this is possible. As the pension benefits in China associated with the NRPS are currently highly dependent on the level of the SP pillar, a particulary appropriate comparision is with the SP schemes currently available in many Latin American and Caribbean countries. Latin America has been a region of the world with many countries that have introduced multi-pillar pension schemes that include SP and DC pillars (Calvo, Bertranou, & Bertranou, 2010). It is also a region that includes some countries at China's level of economic