

# The Analysis of the Structure of Social Security System of China

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Key words:

Family security: the initial security to social risk, all kind of social risks had to be against by the family members.

State security: in 19 century, the state started to provide the protection for its citizens to overcome some kind of social risk.

Social security: after 1970s, the trend of multi-pillar security has been created instead of one-pillar of state security from the Eastern to Western.

## I. Factors in the Structure of Social Security System

### 1. The History of the Structure of Social Security System

Social security is dead against social risks. Every one has to be in the face of the events, which is impossible to forecast and remodel. Resisting social risk is one of necessary conditions for the human being and is the instinct of human. It has three periods to research the history of resisting social risks by human under different productive background, namely family security, state security and social security. In addition, social security and commercial insurance are hand in hand under modern life.

#### 1.1 The Period of Family Security

Families have its shoulder to foster small-fries and support elders and have the function to resist the social risk of its members, no matter what in the eastern family under the core relationship of father and son and in the western family under the core relationship of husband and wife. In the period, social risks of human were resisted by the manner of family saving and young-generation. Family security was the manner in low cost and high adaptability, which has the following characters:

- Key condition is an assurance of those who were rational personnel of dealing with present and future interests;
- Under the kinship family with two or three generations, the function of family bore all kind of social risks for its members;
- Moral cornerstone in the field was supported on traditional faithful and filial piety.

Along with the transformation of economy, polity, social cultural, law and population, state security came forth instead of family security gradually in industrial countries and areas.

### 1.2 The Period of State Security

In the time of state security, initial idea emerged from the Britain; German government enacted the first act of medical care and American government created an efficiency model linked with fairness. After War II, Welfare State, as system or policy, was popularly carried by industrial countries, especially in European Countries. Expenditure of social security reached 20-40% of GDP in the countries, which caused the heavy burden to government's financial ability. Therefore, more and more governments in above industrial countries launched the reform tidal wave in order to cast off the crisis of high cost of state security.

### 1.3 The Period of Social Security

In the time of social security, state welfare provision has been reduced in minimum. Employer and employees contribute to individual account; the public pension fund of PAYG has been being instead of full fund of individual account; in some countries, private insurance has been allowed to manage social insurance fund, e.g. the fund of pension and occupational injury under the law and government's supervision. In conclusion, the trend is to develop the multi-pillar system in the field of social security.

## 2. The History of the Structure of Social Security in European and American Countries

Family security played dominant role to against all kind of social risks before the Middle Ages. "Poor law" and "fellowship association" emerged in the Britain in 18 century. German government in the end of 19 century enacted first law of medical care, which was important event to show that state security was instead of family security. Nowadays, many poor families live on social welfare of government in European countries. In 1935, American government enacted the Law of Social Security. The development trend is that state security and social security are hand in hand since 1970s of policy reform of state welfare, but the system of social security in every country is built based on their circumstance with special characters (see table 1-1).

Table 1-1 The System of Social Security in Selected Countries

Britain	State security on health and family and individual pension account contributed by the employer and employees.
Germany	Social pension insurance of the employees financing from the employer and employee; public assistant for family and public compensation for special groups, e.g. war survivors.
America	State pension scheme for old age; social pension insurance and commercial life-insurance are hand in hand for the employees
Canada	State pension for the citizens and social pension scheme for the employees
Singapore	Individual pension account of full fund is managed by public sector
Chile	Individual pension account of full fund is managed by private sector

Conclusion is that the most efficient system of social security must be established by the contribution from the state, the employer and individuals under the condition of market,

therefore many industrial countries reduced the level of benefits as well as introduced the private insurance company to participate in the management of pension fund.

### 3 Conditions to build the System of Social Security

The system of social security in the country is composed of the conditions of economy, polity, population, law, financing, science of account and traditional culture.

- Economic background. Social security is the result of socialization production. The operation in market (taxation, insurance, re-insurance, investment, trustee, accountant, audit, etc.), the degree of public- owner and government's role in economy play an important influence to complete the system of social security in the country. On the contrary, the system will make activity and negative influence to the progress of the market.
- Population. Population's quality and quantity is basis condition to complete the system of social security in the country, because population has closed relation to the degree of poverty and the level of social welfare.
- Political background. Human thinking, democracy and legal system and pluralism are the necessary conditions to complete the system of social security. For instance, every measure to reform social security should be approbated by the Royal power.
- Theory and research. Literature on theory and research in the field of social security is the fundamental of social security system. A series of arguments are always the pre-procedure to reform old system and set up new one. For example, the ILO articles are written from a labor point of view not to protect the integrity of the financial system. And contrary views are from the World Bank, which caused great changes of social security in Chile.
- Legal Background. The experience from European and American countries has shown that social security reflects the relationship of rights and obligations between the state and her citizens (employers and employees), which should set based on the completion the system of regulation and supervision.
- Statistic data, exactitude account and computer operation is necessary conditions to make complete system of social security in modern society.
- Traditional culture and ideology. This is very popular element to influence the structure of social security in the country. For instance, de-centralized administration in European countries and high centralized administration in Singapore under their different culture and ideology.

## II. Structure of the Social Security in China

As a developing country, China is being the initial period to develop the market economy, which is just the condition to set up the structure of Chinese social security, namely:

- 1.2 billion population;
- more than 70% population live in the countryside as farmers; nearly 6000 thousand poor population in the countryside and 2000 thousand in the city among them;
- GNP for per is only 572-582 USD in 2000, which is far lower than the 3028 USD in the middle level countries;
- imbalance of economy and culture between economic developed areas and poor areas; and
- growth of GDP rapidly in the recent years.

Thereby the structure of social security in China would be the multi-pillar of family security, state security and social security.

As concept, in China, Social Security has been used in some important documents since the 1980s. For instance, article 44 of the Chinese Constitution (1982) provides that the retirees shall enjoy benefits of social security. Article 45 provides that state shall establish the system of social insurance, social assistance and medical care for her people. Article 26 of the Decision of Establishing Socialist Market Economy by the CCPCC provides that it is very important to establish a many sided social security system for the deep reform of SOEs in a stable society and the development of market economic structure in China. The conception of Social Insurance and Welfare has been also used in Chapter IX of the CLC. The concept of social security in China is composed of the following aspects:

- **Social Insurance.** Social insurance refers to the basic (or public) insurance scheme, which is established by the state by law. The scheme provides certain benefits with materials and social services of the state, society or relevant departments for the employees and their family members who have difficulty with living on account of maternity, old age, sickness, industrial injuries, invalidity, unemployment, death, etc. Social insurance is a major part of social security system.
- **Social Assistance.** There is two kind of meaning of social assistance in broad and narrow sense. The narrow meaning refers to a material aid in limited financing by state or society for those who is older, sicknesses, disablement and orphans without support. For instance, in 1995, there were 997 thousand beds for elders and orphans in various social welfare institutions. The broad meaning includes the assistance for those who live in the area under natural disaster. Social assistance is a part of social security.
- **Social Welfare.** There is also two kind of meaning of social welfare in broad and

narrow sense. The narrow meaning includes social insurance and social assistance benefits. The broad meaning refers to some kind help to the persons in need and some public facilities to citizens except social insurance benefits and social assistance benefits. Such as some public place and facilities of sport entertainment set up in cities and towns. In China social welfare is composed of two parts: social welfare institution and collective welfare institution. Social welfare is provided by governments and collective welfare are provided by the employing units.

- Preferential Treatment and Comfort for Special Groups. As a consequence of the war, a new branch of social security was created for war veteran. The State took the responsibility upon itself of compensation for damage to health suffered by persons as a result of service offered to the State. By this way of thinking, the branch aimed to compensate war victims. Later this branch of social security was extended to cover victims of crime.
- Social Mutual Aid. Social mutual aid in China mainly refers to the collective saving and collective benefits for their members under the circumstances of old age, industrial injury, sickness, orphans and disabled under the principle of voluntary in the Chinese countryside. Besides, social mutual aid exists also in some enterprises leading by trade union under the principle of voluntary.
- Individual saving for security. Individual saving for security in China mainly refers to the family saving for security under the old age, sickness and other needs. It is a tradition that the young generation support the elder generation in China.

#### 1. Family Security

The role of family security in European and American countries has been in faintness gradually. However state security is impossible instead of family security absolutely, especially in developing countries. In Japan, 20% old generation life together with family, 50% in Latin American countries and more than 75%.

At present, the function of family security in China can not be neglected. On the contrary, it must be strengthened. In order to support social security, family security will be improved based on the following aspects:

- policy and financing supports from the local government to encourage family saving and social mutual between families. For instance, in order to develop mutual production and mutual fund to against social risks, a model of family mutual in the countryside receives the supported by Yantai county government.
- Improving the market of commercial life insurance and health insurance. Now individual and families need more good insurance products to guarantee their old age and health.
- Singaporean government advocates the thinking that citizens set up saving account for the

protection of family risks, which is great value for China to improve the protection function of family.

- Strengthening legal education to all citizen to create happy life environment for old generation.

## 2. State Security

In European and American countries, state security provided high level of social welfare to their citizens. Since 1980s their labor market was faced the challenges under the globalisation of economy. The rate of unemployment in the countries above has kept around 10%. For instance, the EU is focusing on the matters of reducing unemployment, introducing new technique, the cost of social security. The reform in some EU countries introduced profound changes in the functioning of the labor market, by shifting the focus from passive income support to active policies. The period over which the unemployment benefit is reduced and is changed as the benefit for the job-seekers. Nowadays, the function of state security in European countries is reducing instead of multi-pillar structure of social security, namely state security, the employer security and individual security (commercial insurance).

As a member state of the ILO, China established State labor security for the employees in public sector of the city areas in the early of 1951-1953, which was influenced by the model (pay as you go) of Europe. The employees did not contribute to the fund of social security and received benefits of pension, medical care, maternity and occupational injury and diseases by the way of defined benefit. State insurance in China was composed of

- Retirement pension;
- Medical care pension;
- Cash sickness benefits;
- Industrial injury and disease benefits;
- Disability pension;
- Survivor's benefits;
- Maternity benefits; and
- Social assistance for special groups, e.g. demobilization army-man.

In 1979, Chinese government launched the reform from planned economy to market economy. Old system of state labor security had to be transferred to coincide with the need of market. Unlike European and American Countries, the function of state security would not be neglected. On the contrary, it must be strengthened by the following aspects:

- In relation to the field of social assistance, state security provides in minimum level and will be grown based accompanying the economic growth;
- In relation to the field of social security, the scheme of state basic insurance has not been completed. For example,
  - The social pooling fund of pension is mainly financed from the employers. For old age

the premium is around 20% of the total wage in the enterprise; for medical care, the premium is 6% of the total wage; for unemployment insurance, the premium is 2% and others; total is 40-50% of heavy burden. Government finances only the all fee of administration of social security, which is about 5% of all premium, and gives away of taxation to the employer's premium.

- It has not find a solution to solve the hidden liability of the old man and middle man who have not saving in their account before the new scheme (before 1991-1997).
- Government has the duty to create the capital market for the return interest of pension fund to meet the need of expenditure of pension benefit during the aging period of China.
- There is a big gap between the system of social security and the system of regulation and supervision, so that premium was only collected 70% in 1998, which needs to strengthen the legislation on social security.

### 3. Social Security

How to complete the system of social security is a challenge of every country in the beginning of the 21<sup>st</sup> century. The fundamental of social security must be pluralism system and composed of the participation of state basic scheme, the employer's supplement scheme and individual's saving. The experience from European and American countries is focused on multi-pillar of structure of system and public administration linked with private administration.

China is being in the period of transformation between old system of labor security (state security) and new system of social security. As to the reform in SOEs, this requires a preliminary condition that is to decrease their burden on redundancy and the insurance expenditures. In 1984, the fund of social pooling for old-age insurance in SOEs was introduced in some big cities. After 10 years (1994) the social pooling fund of old-age insurance had been financed and managed at the level of province. Besides, the fund of social pooling for medical care was carries out in 300 cities. The similar reform on maternity was carries out in 522 cities within 19 provinces and on occupational injury and disease were carries out in 868 cities. Therefore 1995, Chinese government made the resolution to develop multi-pillar structure of social security system. The fundamental is as follows:

- efficiency and fairness are hand in hand, efficiency in priority;
- social pooling fund linked with individual account (the employee's pension and health account will be financed by the employer, employee and subsidy by the state);and
- based on state's basic insurance to set up the employer's supplement insurance and to encourage individual saving.

The argument on the present model is focused on that is it a special model of China? only a transition measure? I agree with the latter. The reason is as follows:

- In relation to basic pension scheme, the method of pay as you go plays still dominant role, which is facing the challenge of aging population. At the beginning of new scheme, the problem is that the beneficiaries are more than contributors.
- The present model of “social pooling fund linked with individual account” is the option by the Chinese government between the European model of public fund and the Chilean model. The model is called the third model of “partial fund”, by some Chinese officers and scholars, which lacks the cornerstone of theory and experience. How to linked with both funds is a perplexing problem, because public fund is operated based on the principle of re-allocation and individual account is operated based on the principle of civil saving. The obstacle is the contrary economic function in both funds. What is the gist that it is possible to realize two contrary economic functions within one scheme. By the present model, we have to pay high cost:
  - saving is involved into re-allocation and active function from DC (Defined contribution) of individual under market will be killed by DB (Defined benefit) leading to the employers’ action of fleeing pay premium;
  - Citizen’s right in their individual account has to be faced the danger of corruption and illegal administration by office, if the capital is used to fill the deficit of social pooling fund. On the other hand, under the centralized administration, it is impossible to invest the capital into market for good return interest, so that the value of private capital in the individual account can hardly to be guaranteed. Too high rate of premium by the employer, 40-50% of the total wage, has extruded the resource of supplement insurance by the employers. Individual account of the employee has been linked with social pooling fund so that it is difficult to set up another individual account for the employee.
- In relation to medical care, setting up individual account aims to control the high expenditure of medical care. In face, science and strict management is possible to realize the goal mentioned above. Individual account of beneficiary is not only and necessary measure. But the problem mentioned above and similar with pension scheme will be faced by the individual account of medical care.

Sum up, the structure of social security of China, especially for pension scheme, has to be re-structured, in order to separate the different economic function of re-allocation by the government and of saving by individuals. The new model should be composed of three pillars:

- Based on public tax, government set up the system of state (basic) security, which must be wide coverage and in low level of 20-25% of the replacement of wage.
- According to law, the employer must set up the employee’s individual account of pension and medical care and the employee also contribute to his/her account, which will be at 30-40% the wage by the agreement. The capital in the account may to invest into capital market under the state regulation, which is supervised by the committee of government, experts and contributors.
- Encouraging individual buy the commercial life and health insurance to improve their life.

#### 4. Supplement Role of Commercial Insurance



Well known, the market of commercial insurance (life insurance and health insurance) is large one in the world due to the system of social security of China in minimum. The question is how big and how to run?

#### 4.1 Life insurance and social pension scheme

Social security aims to guarantee the income in minimum for the stable social order and commercial insurance will be highness to improve the life quality of people. In fact, social security and commercial insurance are in closed relationship of supplement each other. Because of

- The former is in minimum coverage and the latter is in wide coverage based on the former;
- The former is in minimum benefit and the latter receive high benefit based on the former;
- The former creates a stable income basis to product the need of market for the latter;

Today, more and more persons find they need the more insurance for their old age, due to:

- Social pension scheme aims to cover all employees in the country, which will be realized from the city to the town in a long time. Population live in the city is only 16% of total population in China. Besides, a large numbers of population who is non-employees need the protection for old age.
- Most family live on wage and pension without other income, e.g. heritage and stock, due to Chinese people live under socialist public and planned economic system, such as high employment linked with low wage, for a long period.
- Pension benefit from basic scheme maintains minimum income of family. Pension benefit will be replacement of the wage 20% from social fund and around 40% from the individual account, total is around 60% of his/her wage. But the wage in China is still low than industrial countries and lacks rising index system. The Chinese family is facing the challenge of price and medical fee, so that they need more protection for their old age.

#### 4.2 Health Insurance and Social Medicare

The same analysis with the market of life insurance, the market of health insurance in China is also large one. Social medical care and health insurance also have a closed relationship of supplement each other. The key elements to develop the market of health insurance are as follows:

- The gap of population. Social scheme of medical care aims to cover all employees in the country, which will be realized from the city to the town in a long time. Besides, a large numbers of population who is non-employees need the protection for old age.
- The gap of payment. Social scheme of medical care pays only under the 4 times of average wage of the local level. The data from the research of more than 40 cities in 1997, 0.5% of

employees need protection for the medical fee which was more than the payment level mentioned above.

- The gap of item. Now the related Departments of Chinese government are making the insurance item of medical treatment and medicine. That is to say, besides this legal item, there is a big gap of medical treatment and medicine, which needs the commercial health insurance products to fill. Hence, many companies have bought the kind of health insurance for their employees as supplement protection.

#### 4.3 Improvement of Commercial Insurance Market

Insurance industry in China stopped from 1959 to 1979 and has re-developed since 1980s. The average growth has been at 39.6% during the period of 1980 – 1998. But the deep and density of insurance market of China lag behind the world. For instance, in 1998, premium gross income in China was 1.5% of GDP, which was lower than the average level of the world of 7.28% and presents 55<sup>th</sup> of the world. Per premium in China was USD 12, which is far lower than the average level of USD 431 and presents 60<sup>th</sup> of the world<sup>1</sup>. At the same time, it emerges imbalance situation between the supply of insurance products and the demand of citizen. Therefore we have to pay more attention to the following aspects in order to improve the commercial insurance market in China:

- increasing the supply of insurance products inside and outside, to shape the competitive insurance market;
- researching the market regular and setting up the science market rules of premium-making instead of governmental action;
- giving equal taxation rules to all kind of insurance companies; and carrying out different tax rate to different kind of insurance products;
- according to the local circumstance to sign the insurance products to meet the need of Chinese people;
- introducing active resort of sales promotion to create sound visualize of company and to change the preconception of citizens to commercial insurance products;
- training a numbers of personnel with ability in high quality to meet the demand of risk evaluation, extract account, accept insurance, managing compensation and agency;
- cultivating the agency market to create efficiency service in the market;
- government must carry out active financing policy and supervision system to promote and guarantee the insurance market in order;
- opening the Chinese insurance market to foreign insurance company step by step and strengthening the competition ability of Chinese insurance company in the open market; and
- completing the legislation system of insurance market in accordance with the Insurance Law of China.

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<sup>1</sup> Li Yousheng, *Report of Problems in the Chinese Insurance Market*, Shengyang Publishers, 1998, P 29-30.