CHINA

PENSION PROVISION AND PENSION ADMINISTRATION

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The general responsibility for the provision of public pension rests with the state almost everywhere. The reason for the government to be involved with providing mandatory public pensions is well-known: private annuity markets are not able to distinguish between people who are likely to be long-lived and people who are likely to be short-lived, and consequently adverse selection and moral hazard problems may plague private annuity markets, which tends to drive up annuity prices. Unlike private pension, public pension makes it possible to spread risk across the largest number of people--including the whole population in a single insurance pool or in a small number of pools, thus substantially lowering the costs of insurance and administration.[1] (Verbon 1988; Blinder 1988; Davis 1995)

If a public pension systems has to be provided by the state, then one may ask which level of government should bear the primary responsibility of pension provision and administration. This question is especially relevant to China's pension system reform, because one of the dominant features of the current system is a high degree of decentralization and fragmentation in pension provision and administration. The literature on public pension offers little help to answering the question. Since, in the West where theories of public pension are most developed, with few exceptions, the provision and administration of public pension is almost universally unified, the question is considered as extraneous and thereby negligible. Turning to the practices of other countries, we find that national pension schemes varies so widely that there seems no single model or paradigm. Of course, some schemes work better than others,[2] but we cannot expect to transplant what works elsewhere to China without adaptation, for each country has its own tradition, social structure, power distribution, or other specific characteristics that condition its choice of institution.

The focus of this paper is the administrative dimension of China's pension reform. However, the way a pension system is administered is closely related with the way pension provision is arranged. Therefore, both pension provision and pension administration will be discussed in this paper. The first section of the paper examines main variables that affect the administrative structure of public pension. The next section outlines the main characteristics of the current system. The third section describes some of China's new reform initiatives. The fourth section comments on problems associated with China's fragmented pension system. The fifth section presents some suggestions on the direction toward which China's pension reform should head. The paper ends up with a brief discussion of the politics of pension reform.

Pension Provision and Pension Administration

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[1] There is a good deal of evidence that the operating costs associated with government provision of insurance are often lower than those private schemes. (Verbon 1988)

[2] "Better" in the sense that they are more effective and efficient in alleviating poverty, redistributing income, and promoting social welfare and stability.

The term "administration" could mean either "to provide with," "to have the charge of," or "to act as executor or trustee of." In this paper, "pension administration" is narrowly defined, meaning "to have the charge of pension provision." More specifically, it involves performing the following functions:

- Enumeration
- Record keeping
- Contribution collection
- Benefit determination
- Benefit payments and other clientele services
- Regulating pension funds
- Supervising the operation of the system
- Protecting insured persons from errors and abuse (World Bank 1994b)

"Pension provision," on the other hand, means "to make pension insurance available to." Whoever provides pension insurance has the authority to specify the following essential parameters of a pension system:

<u>Type of Old-Age Protection</u> Whether a provident fund approach or a social insurance approach should be adopted in setting up the pension system (ILO 1989).[3]

<u>Range of Coverage</u> Who will be covered by the system? All citizens above the retirement age, all elderly workers, or only former workers of large establishments?

<u>Unit of Pooling</u> What is the appropriate level of pooling? An enterprise, a group of enterprises, a county, a prefecture, a province, or the whole nation?

<u>Source of Funds</u> Who will contribute? The government alone, or employers and employees as well? What will be the calculation base for pension contribution? How high will contribution rates be?

<u>Method of Financing</u> How will the system be financed? Fully funded, partially funded, or pay-as-you-go?

<u>Qualifying Conditions for Benefits</u> What requirements does one have to meet to be eligible for pension benefits? Merely attainment of a specified age? Or more conditions, such as resident status and completion of a specified period of contributions, have to be satisfied?

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[3] Asian countries are more likely to adopt the provident fund approach. Examples are Singapore, Indonesia, Malaysia, and India. See Appendix.

Benefit Formula Will the system be a defined benefit, defined contribution, or a combination of the two formulas? If defined benefit, will the benefit rate be flat or will it be related to wage levels or years of work or both? Will the benefit level be indexed? If yes, will it be indexed against price or wage or both?

Management of Pension Funds Will pension reserves be publicly or privately managed? Where and how will the pension funds be invested?

Other Pillars Will occupational pension plans and/or personal saving plans be used to supplement the public pension programs? If yes, will they be voluntary or mandatory?

Pension administration and pension provision thus are separate but related concepts. In some countries (e.g., Germany and Switzerland), pension provision is centralized but pension administration is decentralized. If local governments are allowed to make decisions about the parameters of pension provision, however, it is impracticable for the central government to administer the system. It is hard to find any country in the world in which pension provision is decentralized but pension administration is centralized (see Appendix). Unified and centralized administration is feasible only if two preconditions are met:

Standardization: All system parameters (type of system, range of coverage, source of fund, method of financing, qualifying conditions for benefits, benefit formula, funds management, supplemental tiers) are standardized throughout the country.

Integration: All local pension pools are integrated into a national pool.

When pension provision is thoroughly standardized and integrated, it can be called a unified provision. As country profiles in the Appendix shows, pension provision in the United States, Britain, Australia, Sweden is highly unified, and consequently the administrative structures of these systems are unified and centralized. In some countries, pension provision is only standardized but not integrated. Canada is an example, where two legally separated pension programs co-exist: the Canada Pension Plan and the Quebec Pension Plan. However, the two programs are so similar to each other in levels of benefits and rates of contribution that the two are usually referred to as the Canada/Quebec Pension Plan. Nevertheless, due to divided authority over public pensions, Canada has a bifurcated administrative system, in which the federal government is dominant in age-related programs, while the responsibilities and activities of provincial governments are much more extensive than their counterparts in the above-mentioned countries. There are also countries which have several nationally integrated pension programs covering different segments of the population. For instance, prior to the 1985 reform, the Japanese public pension system comprised three schemes: the Employees' Pension Insurance (EPI) was the program insuring the labor force in the private sector; the Mutual Aid Association (MAA), the employees of the public sector; and the National Pension Insurance (NPI), farmers and self-employed individuals. Their contribution formulas were not standardized and there was also wide benefit gap between these plans. Although these programs were administered by the Social Insurance Agency at the national level, the system as a whole had been criticized as being too fragmented.

These examples demonstrate that the structure of pension administration is closely related with the degrees of standardization and integration of the country's pension provision. No model of administrative arrangement is good for all kinds of systems. Centralized administration may be imperative for a unified system. But, for a system that is neither standardized nor integrated, centralized administration may be more ineffectual and costly than decentralized administration. Hence it is pointless to discuss, in abstract terms, what are the appropriate roles of central and local governments in the administration of public pension. Different pension systems place different kinds of information and resource constraints on the effectiveness of pension administration respectively by the central and local governments.[4] What is the appropriate administrative arrangement depends on the type of pension to be provided. In designing the structure of pension administration, policy-makers thus must think of what kind of arrangement could work most effectively and efficiently within the institutional constraints inherent in the pension system they are building up, rather than what ought to be in an ideal system. The ways of administering different systems ought to be different.

Pension Provision and Pension Administration in China

Compared to most of the countries that offer public pension programs, pension administration in China is extremely decentralized. Such a high degree of decentralization is not surprising given the fragmentation of pension provision in China.[5]

So far, China has not yet had a social security law that provides a coherent legal framework for public pension in the whole nation.[6] The central government, through its various ministries, issues directives concerning pension provision from time to time. But there are nearly no provisions universally applicable to workers in all regions, of all occupational status, and employed in all sectors and by enterprises of all ownership forms. Thus, provincial and local authorities are allowed to pass their own provisions in regard to pension provision. (Borchard 1993) As each local government in effect draws up its own blue-prints for pension reform, there emerges a pension system that shows considerable diversity in pension provision across regions as well as work units.

This section starts with an examination of the fragmentation in pension provision along two dimensions: the degree of integration and the degree of standardization . It then assesses the impact of the system on its administration. The fragmented provision gives rise to the decentralized administration; the decentralized administration in turn reinforces the

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[4] For instance, the information problem is more severe for the central government in a means-tested scheme than otherwise.

[5] Another example of fragmented pension provision and pension administration is Colombia. See the profile of Colombia in the Appendix.

[6] A draft of Social Security Law is at an advanced stage. For comments on the draft, see below.

fragmentation in provision. The most challenging task of China's pension reform is to reduce the fragmentation in provision, and to make the reformed system and its administration more unified.

1. Low Degree of Integration

One of the objectives of the pooling of social insurance is to spread risks among the population. To realize the full benefit of risk-spreading, the size of the basic unit of retirement pension pooling should be as large as possible. As a matter of fact, in many countries, the unit of pension financing and provision is the whole nation. However, China's pension pooling has been characterized by a low degree of integration, meaning the unit of pooling has been too small.

A national system used to exist for the financing and payment of pension benefits in China between 1953 and 1969.[7] During the Cultural Revolution (1966-1976), however, trade unions--the primary organizations responsible for administration of labor insurance--were disbanded, which brought an end to the nationally unified pension system. Consequently, pension insurance became the responsibility of individual enterprises (Ahmad & Hussain 1991).

The transition to an enterprise-based pension system did not immediately cause much concern, for the number of retired workers was still relatively small then. However, with more and more workers reaching the retirement age, pension expenditures placed an increasingly heavy burden on old state-owned and collective enterprises with a long standing, thus severely impairing the development capacity of these enterprises. After China entered an era of economic reform, the uneven distribution of pension costs also meant an unequal competitive status in the market. In order to break the direct link between the enterprise and the provision of all pension income, and to redistribute the costs of retirement programs across enterprises, the central government began, in the mid-1980s, to encourage local governments to experiment in setting up retirement pension pools (Chow 1988).

Pension pooling arrangements among enterprises have since been established throughout China. Most of the pension pooling schemes are done at the level of cities and counties. This does not necessarily mean that each city or county is covered by a single pool. Instead, as will be shown below, most cities and counties have numerous separate pooling schemes. Under these schemes, participating enterprises contribute a certain percentage of their payroll to a pool, which in turn pays the pension benefits to insured

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[7] According to the 1953 Labor Insurance Regulations, participatory enterprises were required to contribute a sum equivalent to three percent of the payroll towards a labor insurance fund. Thirty percent of this monthly contribution was transferred to a account of the All-China Federation of Trade Union so that a certain degree of redistribution could be effected between enterprises of varying financial commitments. The remainder went to the enterprise's trade union account for benefit payments. Surpluses from the monthly expenditures at the enterprise level would be submitted to municipal, provincial, or ministerial administration (depending on enterprise affiliation) for resource pooling. The central government routinely subsidized program expenditures in case of shortfall. (Chow, 20-23)

employees. The percentage of the payroll paid into the pool and the proportion of pensions the pool pays out vary between schemes but not within schemes. In other words, city or county has not yet become the basic unit of pension financing and provision. The basic unit is merely a collection of enterprises organized along various lines (Shao & Chen 1991). Compared to the old system, the scope of pension financing, of course, has been expanded. But, this is but the first step to turn the enterprise insurance into social insurance. Even if all retirement pension pools within a municipality or county were to be combined into a unified local pool, differences between local pools would still be very large. Since the ratio of the retired to the labor-force varies widely across regions, the burden of pension financing would be very unevenly distributed as long as these local pools are not integrated into a national pension system. (Hussain 1993)

2. Low Degree of Standardization

Since there are no national legislation directly addressing the question of which social groups are to be covered by the pension system, the range of coverage varies from locality to locality. For instance, it is within local governments' discretion to determine whether compulsory pooling programs should be established for private enterprises and self-employed workers, and workers in joint ventures. In some places, they are covered but in other places, they excluded.[8]

Moreover, as pointed out above, within each locality, there usually exist a variety of separate schemes covering different groups of the local population.[9] The first dividing line lies between civil servants and public institution employees on the one hand and enterprise employees on the other. Unlike schemes for other categories of people, the one for government staff and workers is directly and entirely financed by the state budget. As for enterprise employees, they are commonly placed in separate pools according to the ownership form of their work units. Workers in state and collective enterprises are likely to be put in separate pools, not to mention workers in joint ventures and private companies, if they are covered at all. Moreover, employees working in state-owned enterprises are not necessarily covered by the same program. There are 11 sectoral pension plans. For instance, the Ministries of Railways, Post, and Telecommunications, and the electricity department of the Ministry of Energy and the National Construction Company pool funds on a nationwide but sectoral basis. These programs are not only different from those for the rest of the state sector but also different from each other. Finally, even within the same sector, pools for permanent workers

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[8] For instance, in Beijing, pension pooling has been extended to all urban workers except for the self-employed (and government workers are covered in a separate system); in Yantai, pension pooling has been extended to all non-governmental urban workers including the self-employed; in Ningbo, the pension system now covers all urban enterprise workers and will expand coverage to the self-employed in 1995; and in Chengdu, pension pooling has been extended to all enterprise workers including temporary workers and the self-employed.

[9] Public pension is still largely absent in the Chinese countryside. There have recently been some innovative programs of funded individual accounts for rural pensioners are being initiated, but they are voluntary.

are often kept separate from those for contract or temporary workers (Lee 1993).

As a result of the above-mentioned divisions, it is not unusual for a locality to have multitudinous pooling schemes, each of which covers only a small segment of the urban population. In the country as a whole, there must be thousands of separate pension schemes. These schemes differ widely in their contents:

Base for Contribution In different schemes, contributions are paid on different bases. In some schemes, contribution base equals standard wages, allowances and subsidies; in others, the base is obtained by adding pension expenses from the previous year to standard wages, allowances and subsidies; and, in still others, the contribution base is the total wage bill including bonuses.

Rate of Contribution No uniform contribution rate has been established across pooling schemes, as would be needed to eliminate the distortion. Local governments, and even their subordinate agencies, have the de facto authority to determine contribution rates. For local policy-makers, the most important concern is to match contributions with pension expenditures. As a result of the different ratios of pensioners to the labor force across regions and sectors, contribution rates vary widely across regions, sector, and even across enterprises in the same sector. To reflect fluctuation in retirement pension expenses, some local policy-makers even change contribution rates year by year. (Bank, 39, 49)

Method of Financing Retirement pensions for permanent employees in state-owned enterprises are operated on a pay-as-you-go basis, while pooling for contract workers is funded. Some cities prevent the use of contract workers' pension funds to help pay retirement expenses for permanent employees, while others allow them.

Benefit Formula There is a great variation in insurers' pension benefits. Schemes for permanent employees of state-owned enterprises and government agencies generally use a defined-benefit formula that promises a specified pension to retirees, while schemes for contract workers may contain some elements of a defined contribution formula. Even within the former category of schemes, employees' benefit levels vary across regions, sectors, and enterprises. (World Bank 1990)

3. Fragmentation and Decentralization in Pension Administration

To a large extent, the fragmentation of China's pension system can be attributed to the dispensation of authority over pension provision. In China, a great number of scattered government agencies are involved in retirement pension policy formation and implementation, but none enjoys exclusive policy authority. The Ministry of Labor (MOL) oversees pension provision for state enterprise staff and workers, the Ministry of Personnel (MOP) is in charge of the same tasks for employees working in government organizations and public institutions, while pension programs for those aged people without family support in rural areas and for the retired soldiers fall under the jurisdiction of the Ministry of Civil Affairs (MOCA). In addition to these three ministries, other government agencies such as State Reform Commission (SRC), State Planning Commission (SPC), State Economic and Commercial Commission (SECC), All-China Federation of Trade Unions (ACFTU), the Ministry of Finance (MOF), China National Committee on Aging (CNCA), People's Insurance Company of China (PICC), People's Bank, and even Central Military Commission (CMC) have also, to a varying degree, contributed their efforts to the operation of the current pension system and the designing of China's future pension system. (World Bank 1990)

With so many government agencies playing in the arena of pension provision, it is imperative to define clearly the role of each agency. However, the division of labor and power between them is rather confusing. Under such an institutional environment, jurisdictional conflicts is unavoidable: when these agencies from time to time issue directives concerning pension provision, one often treads on others' toes. Each agency of course desires to protect its sphere of influence, and they all act to check one another. Infringements of authority become a persistent phenomenon, and voluntary co-operation between different agencies and levels is hard to be realized. To make the matter worse, there is no unified authoritative institution to coordinate ministerial behaviors and to exercise macro control. From the point of view of the provinces, directives from Beijing often appear to be perplexing and conflicting. The dispensation of responsibilities to various government agencies thus becomes one of the major impediments for the establishment of a unified pension system.

Important as the role played by national-level government agencies is, pension policies in China are made in effect by local governments rather than the central government. The responsibility of the central agencies is confined mainly to the drafting of basic pension regulations. In provinces and cities, a complete set of bureaus duplicate national ministries. To transmit and interpret national policy guidelines, central ministries issue "operational guidance" to their subordinate bureaus at the provincial and local levels, but implementation details are left to the latter. These bureaus are supposed to be the administrative arms of central ministries, but they in fact are absolutely obedient to the provincial, city or county government. In designing implementing procedures for enterprises to follow, these local government agencies often modify central plans to make them more compatible with what they term "local conditions." Local governments may even introduce policies that do not agree with central directives. In the last few years, we have witnessed a proliferation of the blueprints of pension reform drawn up by provincial and municipal governments. When central and local regulations conflict, unless there is strong central prohibition, the rules and regulations instituted by local governments in fact govern the actual practice (World Bank 1990). This explains why most cities and counties have been organizing local pension pools with special features varying from one place to another.

In addition to rule-setting for pension provision within their jurisdictions, local governments are responsible for supervising and administering local resource pooling and pension funds. For this purpose, special pension pooling agencies have been established throughout the country, usually at city and county level and controlled by the local labor bureaus. There is no uniform name for such agencies, and they may also take a variety of forms. The agency can operate as a section of the local labor bureau, a semi-independent organization, or even a "company." (World Bank 1990)

No matter what names and forms these agencies take, nearly all of them lack necessary resources for detailed administration of pension pooling. In general, there are only few professional staff in an agency. They may have neither the time nor the training to examine the books of participating enterprises. It is therefore difficult for them accurately to account the amount of contribution due from each enterprise and the benefit payment due to each retiree.

Moreover, local governments are not free from bureaucratic politics. The labor bureau is but one of local government agencies that are involved in the business of pension provision. Pension pooling agencies under the labor bureau therefore do not have exclusive authority in this area. They would need help from other bureaus, such as the tax bureau, to obtain better information relevant to pension provision. But such institutional connections are few or non-existent in most places. Only a handful cities have recently taken steps towards overcoming the split supervision and management of pension provision by establishing a unified "Social Security Administration."

Due to the resource constraint and the absence of necessary institutional support, with few exceptions, pension pooling agencies have limited their role mainly to acting as a clearing-house, collecting funds from surplus enterprises (whose required contribution exceeds the pension costs of its own retirees) and turning over the surpluses to deficit enterprises. Basic pension administrative functions are left to individual enterprises.

Now, records of such parameters relevant to determining pensions as age, length of services, and types of work remain kept at individual enterprises. In most places, enterprises still determine eligibility requirements and benefit levels, and disburse pension payments for their ex-employees. And they operate with limited supervision from pooling agencies or local labor bureaus at the provincial, municipal, and county levels. Only in some places, local pension pooling agencies have established branches at the district level to experiment with taking over the administration (benefit determination and payment distribution) of retirement pension for workers from enterprises participating in the pool.

The primary weakness of having individual enterprises administer pension programs is the difficulty in setting up standards of operation. The keeping of records of employment and wages by enterprises also makes it easier for them to abuse the system, and makes it more difficult for the authorities to supervise and audit eligibility requirements and benefit levels. A uniform quality of service to pensioners thus is unlikely to be realized as long as the day-to-day administration remains the responsibility of work units.

In sum, the Chinese pension administration is characterized by four features: (1) at the national level, the authority over pension policy formation is split between different government agencies, (2) whatever central directives may be, they may or may not be followed by local governments, (3) local government agencies play only limited role in program administration and supervision, (4) the day-by-day administration of pension provision rests largely with units of employment.

The highly fragmented and decentralized administration is at least partly responsible for the wide variations in pension provision across region, sector, and enterprises, as discussed above.

China's New Initiatives in Pension Reform

Prior to 1989, while the pension system had in general been very fragmented, a few provinces had tried to standardize and integrate different schemes within their jurisdictions. Shanghai was a notable example. It distinguished itself from the other provinces by instituting a single pension pool for both permanent employees and contract workers, and by unifying the contribution base and rates for these two categories of workers. Moreover, instead of pooling at county level, Shanghai, a municipality directly under the central government and with decision-making powers equal to a province, itself became the basic unit of pension financing and provision.[10] As the city unified pension schemes, it also began to unify pension administration. Shanghai was among the first provincial units to establish a unified "Social Security Administration."

In 1989 Hainan Province, China's largest special economic zone, was designated to experiment overall social security system reform at the provincial level. After three years of preparation, the new system was put into practice at the beginning of 1992. The new old-age pension system can be summarized as follows: (1) the system is compulsory, (2) all enterprises, regardless of their form of ownership, must participate in the system, (3) all employees, regardless of their occupational status, are included in the system, (4) the burden of pension insurance expenses will be borne jointly by both employers and employees through their respective contributions, (5) the pension insurance funds are divided into the public pension funds and the individual pension accounts, (6) the contribution base is the total wage bill as defined by the National Statistical Bureau; (7) contribution rates are to be standardized, (8) benefit formulas will be standardized, (9) pension pools at the city/county level will be integrated into a unified pool at provincial level, (10) individual pension accounts are transferable.

Unified pension provision needs the support of unified pension administration. In Hainan, the previous separate pension administrative units are replaced by a unified administration at the provincial level, which consists of two institutions: Social Security Committee and the Social Security Bureau. The former serves as the leading organ responsible for policy making and macro control, while the latter works as implementing organ responsible for the day-by-day operation of pension insurance. (CHIRD 1993; Krieg 1993; Zhou 1993)

Also in 1992, a new pension systems was established in Shenzhen. In 1993 and 1994, several other cities, such as Shanghai, Wuhan, and Ningpo, initiated new waves of pension reform. The systems introduced in these cities

[10] Beijing, Tienjin, and Fujian were also pooling at the provincial level at the time. (Bank, 36)

largely share the above-mentioned ten features observed in the Hainan model, but with some differences in detail.[11] (SRC 1995)

In March 1995, the State Council issued a circular (Circular No. 6) on pension reform, which was meant to point the broad directions of future reform and to provide general guidelines for local experimentation. The circular represents a milestone in the process of China's pension reform. It establishes the following principles for local governments to observe in their future experiments of pension reform:

A) A three-tier pension system will be established: The first tier consists of the national basic pension insurance program; the second tier, of occupational pensions; and the third, of personal saving.

B) The first tier will be financed by contributions from both employers and employees.

C) Separate pools will be combined into a unified one.

D) The current existing PAYG system of pension will be changed into a mixed system of PAYG and pension insurance funds. The pension insurance funds are to be divided into the public pension funds and the individual pension accounts. A retirees' pension incomes will come from his accumulated personal account. The public pension funds will be used to guarantee basic pension benefits, pay pensions to current retirees, and shoulder other obligations.

E) The basic pension insurance system should be gradually extended to cover all workers in the formal urban sector.

F) All kinds of enterprises and workers should be treated equally by unified standard, through unified management, and under unified system. The funds shall be under unified regulation.

G) Pension benefits will be indexed to wage.

H) The supervisory and administrative structures of pension funds should be separated.

Obviously, what the central government envisages is a system that is more standardized and integrated than the current one. But it will by no means be a nationally unified system. Pension pooling will be unified only at the level of prefecture,[12] and coverage, contribution rates, the way of dividing the public pension funds from the individual pension accounts, the level of minimum pension, and the degree of indexation will be determined by

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[11] The Ningpo model is less unified than those adopted in Shenzhen, Shanghai, and Wuhan, because it contains three separate pooling schemes respectively for employees of state-owned and large collective enterprises, employees of small collective enterprises, and employees of private business and self-employed.

[12] In China, prefecture is an administrative level higher than county but lower than province.

prefectural governments, not the central government and not even provincial governments (SRC 1995).

The Circular contains two implementing plans, Plan I drafted by the SRC and Plan II by the MOL. Governments at the prefectural level are given the right to select a plan from the two alternatives.[13] Although both plans are based on the idea of combining social pooling and individual accounts, their emphasis is different. Plan I stresses the significance of individual account, whereas Plan II puts more emphasis on social pooling.[14] The Plan I makes some specific suggestions on the rates of contribution from individuals, but Plan II leaves this matter to be specified by the local authorities. Both plans propose that the rates of contribution from enterprises will be determined by the local authorities. As for the division between the public pension funds and the individual pension accounts, the two plans again differ, with Plan I allowing a much larger individual account than Plan II does. Consequently, a retiree's pension income will come almost entirely from his or her individual account (basically defined contribution) under Plan I, but mainly from the public pension funds (basically defined benefit) under the Plan II.

It is clear from the above description that Plan I is basically a provident fund scheme and Plan II a social insurance scheme. The two approaches address to the issue of individual equity versus social adequacy in radically different ways. As it has been well-known, the two concepts--individual equity and social adequacy--are generally in direct conflict.[15] Which concept should serve as the principal objective of public pension is the most fundamental choice any public pension system has to make. Although public pension systems in the world usually have a benefit basis falling somewhere between complete individual equity and complete social adequacy, the general tendency is more toward social adequacy than toward individual equity. No country has, however, ever tried to promote at once two contrasting models, one based largely on individual equity considerations and the other on social adequacy considerations. We have reason to believe that if some parts of China adopt the former model and the other parts of the country choose the latter, it would be hard for the country's public pension system to become nationally unified in the future.

In fact, if Circular No. 6 is to be followed, China would find itself having many rather than just two pension schemes operating in various parts of the country, for the document permits local governments to modify the two models it proposes. Thus, at best, China would end up with hundreds separate schemes at the level of prefecture. Compared to what China has now, the new system would represent a progress, for the basic unit of pension provision is

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[13] The provincial governments have the right to approve or disapprove the selected reform designs.

[14] In fact, the MOL added the idea of individual account to its design in the last minute.

[15] Individual equity means that the contributor receives benefit protection directly related to the amount of his or her contributions. Social adequacy means that the benefits paid will provide a certain standard of living for all contributors. ( )

to be enlarged from the county level to the prefectural level. Moreover, these local schemes are likely to become more unified internally. But China would still have a long way to go to develop a nationally unified pension system.

Other than suggesting that the overall responsibility for administration of old-age pension insurance should rest with the MOL, Circular No. 6 says almost nothing about pension administration. However, the latest draft of Social Security Law gives us some idea about Chinese policy-makers' vision of the future structure of pension administration (SRC 1995).

Like Circular No. 6, the draft of Social Security Law does not pursue the goal of nationally unified provision of pension. Accordingly, the structure of pension administration it designs is, to a large extent, still very decentralized and fragmented. The structure will consist of three sorts of organizations: social insurance administrative agencies, pension institutions, and supervisory boards. The central social insurance agency is responsible for the administration of the entire pension system in the country. Local social insurance agencies, however, are not the arms of the central social insurance agency. Set up at the county level or above, a local agency is controlled by the government at the same level. Their responsibility is to administer pension schemes within their respective jurisdictions. Pension institutions will be set up wherever there are pension pools to be managed, that is, at the county level and above. These institutions (and their subordinate district offices) are responsible for the daily operation of pension schemes, including contribution collection, benefit payment, management of pension funds, and delivering clientele services. Social insurance administrative agencies are given the right to supervise and regulate the performance of the pension institutions at the same level. Finally, consisting of representatives of employees, employers, retirees, and the government, supervisory boards are to be set up anywhere there are pension institutions. Their role is to monitor and supervise pension institutions at the same level.

Clearly, this structure of pension administration is not a nationally unified one. The central social insurance agency has but a very limited role to play in such a system. Local government agencies, on the other hand, are given the green light to run their pension schemes almost independently, as long as these schemes are consistent with the very lax legal framework for old-age pension provision set forth by the Social Security Law.[16]

In sum, schemes emerging from the recent Chinese pension reform experiments and new initiatives continue to evolve at the local level.

Problems with Fragmented Pension System

[16] Principles set forth by the Social Security Law for old-age pension insurance resemble those in Circular No. 6.

The fragmentation of China's retirement pension system creates many problems. This section focuses on four of them: problems of sustainability, safety, equity, and efficiency.

1. Sustainability Problems

It is well-known that the main reason for China to reform the previous enterprise-based pension insurance system was its unsustainability. Given the fact that the ratio of pensioners to the labor force (dependency ratio) varies widely not only across regions (World Bank 1995a) but also across occupational groups, industrial sectors, and enterprises of different ownership forms, (World Bank 1990) it is doubtful that the current practice of establishing separate pooling programs for different social groups at the local level would be able to overcome the sustainability problem.

A primary objective of retirement pension pooling is to spread the risk associated with uncertain retirement ages among people. Since the average outcome for a large group of people is much more certain than that for a smaller group, the risk can be substantially reduced by pooling the pension liabilities and contributions across various segments of the labor-force, and it can be minimized by pooling across the largest number of people--including everyone in the country in a single insurance pool. Separate financing of pensions for each segment of people would fail to do either.

The separation between the pools for permanent and contract workers, for instance, obstructs the sharing of costs between the two groups. Since all new workers who join the labor force after 1986 are contract workers, the pool for permanent workers faces an insoluble problem: a declining number of active permanent employees will have to support an increasing number of retirees. In other words, the current pension program for permanent employees would eventually become unsustainable.

In general, because of the diverse retirement pension experiments in China, pooling of resources is not wide enough. Consequently, the benefits of risk pooling are not fully realized. Integrating various independent pools into a large pool would ease this problem. Shanghai is a good example. Since the late 1980s, there has been only a single pension pool for both permanent and contract workers in Shanghai. The city was compelled to do so because of its rapidly aging population. Unified pooling is a way to reduce the overall contribution rate.

Other parts of China may follow Shanghai's example to solve the problem of pension financing by instituting integrated pools. However, it needs to be noted that Shanghai is a city with a provincial status. Pension pooling in a city at the county level may not be large enough to utilize the advantages of pooling of risks and finances due to the uneven distribution of dependency ratios across regions.

2. Equity Problems

Vertical equity problems arise as long as there are separate pension schemes for different social groups, and the contribution rates and benefit levels of these schemes diverge. The state is supposed to undertake at least some redistribution from the better-off groups to the worse-off groups. The goal of this type of redistribution is to reduce inequality in the society. This goal can be achieved through either standardizing the parameters of various individual schemes or integrating these schemes into a unified one.

However, even if local governments completely unify pension schemes in their respective jurisdictions, horizontal equity problems may arise if these locally unified pools are independent from each other. Horizontal equity holds that people in equal circumstances ought to be treated equally. According to this principle, people with equal levels of economic well-being should pay equal amounts of taxes and receive equal levels of benefits regardless of where they live. (Steuerle 1994)

China's municipality-based pooling system, whether at the county level or the prefectural level, is unlikely to attain this goal, even if local pools were financially sustainable. Because dependency ratio varies across regions, in such a system regions that happen to have high dependency ratios would be discriminated against in comparison with regions with lower dependency ratios. The former consistently face the following two choices. The first is to raise contribution rates so that the level of pension benefits would be comparable with that in the latter. The second choice is to lower the level of pension benefits so that contribution rates would be equal to the level in the latter. Either way, people living in regions with high dependency ratios would be hurt. Since the uneven distribution of dependency ratios across regions is something unavoidable, China is unlikely to be able to overcome such horizontal equity problems as long as pension provision remains done at one of subnational levels. Of course, the higher the level, the less serious the problems.

During the last sixteen years, the progress of economic reforms in China has been accompanied by an increasing divergence in development between regions, as can be seen in income disparity. (Hu & Wang forthcoming) A growing gap in matters of pension provision will exacerbate the tendency of widening regional inequalities. China should take effective measures, including reforms necessary for enlarging the size of the basic unit of pension provision, to tackle this problem before it becomes explosive.

3. Efficiency Problems

An economy would be most efficient if factors of production move freely, economic agents compete with each other on an equal footing, and transaction costs are low. However, a fragmented pension system tends to obstruct factor mobility, hinder competition, and augment transaction costs.

Pension insurance programs may help the economy to be efficient when they treat all the insured equally. When uniform contribution rates and benefit levels apply to all the insured, other things being equal, it does not matter much where one works. Thus, working people can be readily redeployed according to their preferences and the demands for their talents and abilities. The economy works best when people are free to move to meet the needs of a changing situation.

Vertical and horizontal inequity resulting from the fragmentation of pension system, however, may have the side effect of impeding labor mobility within a locality and between localities. The status division between social groups and differences in contributions and benefits, for instance, tend to inhibit the mobility of labor across enterprises. Workers would not willingly leave a job covered by a good pension insurance scheme to another job if their benefits are to be reduced or lost altogether. Moreover, if there are gaps between schemes in different localities and especially when there are no portability arrangements for allowing workers to transfer from one locality to another without losing some of their pension benefits, the free movement of labor across regions would be impeded. In any case, the fragmentation of pension system creates a disincentive for people to move and adapt as economic efficiency would dictate.

Differences in pension contributions may also influence competitiveness of companies and regions, because employers' pension contributions raise labor costs. If the rates of contribution are higher in a scheme than in another, the enterprises participating the former scheme will be put in an inferior position in their competition with the enterprises participating the latter scheme. Similarly, regions with high contributions would find themselves less competitive in attracting investments than regions with lower contributions. The reason is simple: for companies with interregional market, other things being equal, a region with costly pension program would place their firms at a competitive disadvantage in relation to firms operating in regions with less advanced, and therefore less costly programs.

Competition of course is not always desirable. If local governments vie with each other in reducing pension benefits in order to obtain an advantageous position in interregional competition, there is a danger that the overall level of pension benefits in the country will spiral down to a point that makes the system of pension insurance meaningless. To avoid such an undesirable interregional competition, at least some uniform minimum standards of pension provision should be instituted on the nationwide basis, or at least at the provincial level.

Finally, a fragmented pension system tends to have the following negative effects: legal confusion, administrative complexity, lack of coordination, high operating costs, and difficulty in establishing a single register, and ineffective control of evasion. In one word, the fragmentation of pension provision is likely to result in high transaction costs. The unification of pension provision would lower transaction costs. Likewise, efficiency gains can be attained by the vertical and horizontal integration of pension administration. For instance, the transfer of the day-by-day administration of pension provision from individual enterprises to specialized local pension agencies would significantly reduce the operating costs of the system. Similarly, merging all the sections related to pension provision in various central ministries, such as MOL, MOP, and MOCA, into a single ministry would pool scarce human resources together and give full play to their expertise. (World Bank 1995a) Economies of scale can further exploited by integrating pension administrative agencies at all levels into a unified network.[17]

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[17] In Latin American countries where there are multiple pension institutions (e.g., Bolivia, Colombia), the percentages for administrative expenditures tend to be higher than in countries that either began in a relatively unified

4. Safety Problems

To the extent China's future pension system is going to be partially funded, every effort has to be made to guarantee that the investment of pension funds would be safe and profitable. However, if the administration and utilization of pension funds are decentralized to lower levels of local government, as it is in China today, the safety of such funds would be severely compromised.

Chinese local governments have shown a great interest in pension funds. Two reasons may explain why. First, they regard pension funds as cheap money for local investment projects. Second, they expect the central government, as the ultimate guarantor for the pension insurance funds, to bail them out, if their projects fall through (a moral hazard problem). For the first reason, they have strong incentives to keep the pension funds within their localities and are reluctant to relinquish control over these potentially large funds. For the second reason, they are inclined to invest the pension funds only in their jurisdictions, even if investing elsewhere may be more profitable. If the two reasons sound plausible, one may expect that the control of the pension funds by local governments might reduce the rates of return to pension funds and increase the risk faced by pension funds. The danger is particularly severe when there are no effective supervisory mechanisms for such funds, which may leaving them open for misuse and abuse. Indeed, examples of questionable investments, misappropriation, and illegal use of these funds by local governments have been abundant in China.[18] (World Bank 1990, 1995b)

Recommendations on the Directions of Reform

The discussion in the previous section suggests that the current fragmented system is neither financially viable nor efficient nor equitable nor safe. Reform is inevitable. Now the important question is how to distinguish between appropriate and inappropriate options. Before making specific recommendations on what China should do, it is useful first to lay out some principles that may provide a helpful framework for thinking about what option is appropriate for China's pension system reform. In my view, a good pension system should be built on the following five principles:

A) Social Adequacy. The basic idea of public pension is to use social means to prevent deprivation and vulnerability to deprivation associated with old-age. Therefore, a pension system should assure that the insured are able to meet certain basic needs regardless of the amounts of their individual contributions.

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manner or underwent unification and standardization (e.g., Argentina, Brazil, Chile, Costa Rica, Uruguay, and Panama) (Mesa-Lago 1994)

[18] For example, although the central government requires that 80% of all accumulated pension funds be invested in government bonds, but some local governments do not follow this rule and invest the pension funds on local projects directly.

B) Individual Equity. An individual's insurance protection beyond the basic pension should be somehow related to the premium s/he has paid, and vice versa.

C) Equality. Legal conditions for entitlement should be standardized and unjustifiable inequalities between social groups and between regions eliminated.

D) Economic Efficiency. The operation of pension system should avoid any adverse impact on labor market.

E) Sustainability. Whatever pension system is chosen, it should be financially sustainable from not only a short term but also a long-term point of view.

Based on these five principles and also in view of other countries' experience, the paper recommends the following measures be taken.

1. The Extension of Coverage

In principle, the larger the proportion of the population is covered, the more efficiently a pension insurance system would operate. In practice, however, most countries have extended coverage gradually, first to public employees (including military personnel and civil servants, teachers, and employees of public utilities), and then to workers in large private sector firms. Some countries (e.g., the United States) have further extended coverage to all salaried employees and wage earners in the urban areas (employees of small firms and the self-employed), and a small number of industrial countries (e.g., Sweden) even provide coverage for the entire population. But, coverage of public pension systems in economically developing nations (e.g., India) is still largely limited to a small proportion of the working population. Two related factors are most crucial for explaining the variation: one is the level of economic development and the other is government tax and administrative capabilities. Coverage expansion usually takes place after the economic growth has enables a country to bear the financial burden of pension insurance, and the enhancement of state capacity has facilitated rule enforcement and thus lowered transaction costs in the operation of the pension system. (World Bank 1994a) The Appendix contains an enlightening case in this aspect, the case of Korea.

A long-term objective of China's pension reform is the extension of coverage to the entire working population. But, at the present, the possibility of extending old-age pensions to the rural population is still beyond the country's economic power. What China should and is able to do is to extent pension coverage to all workers (regardless of their occupational status, including permanent workers, contract workers and temporary workers) of all enterprises (regardless of their form of ownership, including state-owned enterprises, large collective enterprises, small collective enterprises, private enterprises, and Chinese staff of foreign joint ventures and foreign enterprises). By covering new categories of workers who have been growing in number as a result of economic reform, such extension would help achieve the important objective of broadening the base of the pension system.(World Bank 1990)

2. Standardization

From the draft of Social Security Law and Circular No. 6, it is clear that China is determined to establish a three-tiered pension system.[19] The first tier would provide only an adequate basic pension. The second tier would consist of occupational pension programs provided by individual enterprises or groups of enterprises. And individual saving plans would make up the third tier. The first tier itself comprises two layers. The defined benefit component would guarantee some minimum level of pension to all who fulfill eligibility conditions. The defined contribution component would be actuarially fair, for it allows each individual to get the value of his/her own contributions and the investment returns earned.[20]

The transition to such a three-tier system provides a unique opportunity for China to replace numerous separate pension schemes for different social groups with a uniform pension provision for all workers covered by the system. Since the first tier is supposed to guarantee only a basic living standard and the other tiers to supplement it with retirement income in excess of a minimum, pension benefits for certain groups, such as permanent workers in state-owned enterprises, could be reduced in terms of replacement rate.[21] Thus, it is possible for the first tier to standardize pension provision at a low but adequate level for all the insured. Japan's far-reaching 1985 pension reform provides an instructive example of such a transition. (see Appendix)

Standardization calls for at least four changes. (1) The range of coverage should be uniformly specified. (2) The contribution base should be uniformly defined. (3) The contribution rates should be some uniform percentages of the contribution base (2) Uniform benefit formulas should apply to all the insured.

Standardization could be realized without combining all separate pension pools into a single pool; it requires only uniform standards be used in all pools. However, if all the key parameters of different schemes are to be standardized, it makes no sense to keep the standardized pools separated. Otherwise unnecessary administrative costs would ensue. Therefore, it is wise to combine the pools that are subject to the same set of standards.[22]

While pools are standardized and combined, the special pension program for the employees of government and nonprofit institutions may remain separate from the general program. There is nothing unusual for a country to have a special pension program for government workers. The United States, Germany,

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[19] Many countries have multi-tiered pension system. Examples are Israel, France, Sweden, Switzerland, Canada, Japan, and the United Kingdom. See Appendix.

[20] The relative size of each component differs between Plan I and Plan II of Circular No. 6.

[21] When benefits from occupational pension plans are added, however, the overall level of retirement income may not be lower.

[22] Latin American countries in general, and Chile in particular are interesting cases in this regard. See the profiles of "Latin America" and "Chile" in the Appendix.

Japan, and Korea are some examples (see Appendix). Nevertheless, arrangements should be made so that the pension plan for the special group would be compatible with the general pension plan. Such compatibility will help labor mobility between this special sector and the rest of the urban economy.

3. Integration

Standardization has a spatial dimension. It may be executed by government either at the county, prefectural, provincial, or national level. Then a question arises: which level of government should be entrusted the authority to specify the details of standardization? Obviously, if only county governments are assigned the power, the pension system would certainly not be seen as unified from the provincial point of view, even if schemes are thoroughly standardized in individual counties. In general, as long as the details of standardization are left within the discretion of subnational governments, a country's pension system would remain a fragmented one, even though the fragmentation may have been largely removed at the subnational levels. Only when the central government commits itself to the cause of standardization, does a nationally unified pension system become possible.

There is a consensus in China that within a city or county, pension pooling should be fully integrated.[23] In fact, that is what China has been doing since the mid-1980s. Moreover, few would object the idea that when conditions permit, local pension pools should be gradually integrated into larger regional pools, then provincial pools, and eventually, a unified national pool. By pooling across the largest possible number of people, a nationally unified pension system has the advantage of minimizing risks associated with old-age. After all, this is the way most countries in the world organize their pension systems.[24] (World Bank 1994a)

In designing its future pension system, China must decide whether to centralize pension provision further to a higher level of government. If the answer is negative, the currently existing disparity in pension provision across cities and counties would continue to prevail. If the answer is positive, then the next question is which level of pooling, prefectural, provincial, or national, is most appropriate under present circumstances. Essentially, this is an issue of decentralization versus centralization.

A decentralized approach to pension reform, of course, is not without redeeming features, especially in a large country like China.

A) Given the vast size of China, a decentralized system is more adaptable to the wide regional differences in standard of living and labor market conditions. The locally selected designs tend to fit local situations better.

[23] There are 2,183 counties in China. On average, each county has only about a half million population. Since the number of people who are covered by pension schemes are just a fraction of the population, pension pools at the county level tend to be very small.

[24] Even in most of federalist countries, such as Australia, Austria, Mexico, and the United States, public pension is provided by the central governments. See Appendix.

B) Decentralization allows room for experimentation. Indeed, due to the decentralized nature of China's pension reform, a variety of pension schemes have been experimented in the country. Such experiments may help the country to make better choices.

C) Decentralization makes implementation relatively easier, for local governments are more willing to implement schemes designed by themselves than one imposed from the top.

D) Due to the foregoing three advantages, the decentralized approach to reform may help to speed up the pace of reforms.

On the disadvantage side, a decentralized pension system is by nature not able to provide equal old-age protection across localities, thus violating the equality principle discussed above. Moreover, when a pension system is too fragmented, it may even lose the advantages of risk-spreading which is essential for any social insurance program. Consequently, the system may become financially unsustainable.

The problems of inequality and unsustainability are evident in China's current county-based pension system. Change therefore is imperative. However, the mere extension of the size of the basic unit of pension pooling from county to prefecture, as indicated by Circular No. 6, may not be a good idea for two reasons. First, prefectural-level schemes may still not be large enough to utilize the advantage of risk pooling, because the dependency ratio varies very widely across prefectural units.[25] Second and more important, positioned between the provincial and county governments, the prefectural government's power is less substantive than either's. Accordingly, the structure of the prefectural government tends to be less elaborate. Without necessary human-resources, this level of government's ability to administer pension pooling is questionable.

A unified pension system for the whole country is ultimately desirable in order to achieve the widest possible risk spreading and an even distribution of pension contributions and benefits across the land. But such a system may not be feasible at present, given that China's economic decision-making is highly decentralized. For the central government to assume the financial responsibility for providing pension benefits to the entire urban working population, it has to be able to collect contributions from employers and employees scattering all over the country. However, it is doubtful that the central government has such administrative capacity. In fact, tax collection has for years been a constant headache that troubles China's central government. (Wang & Hu, 1994) In 1994, its tax revenue accounted for only 5.1 percent of GDP, probably the lowest in the whole world. The collection of pension contributions may very well be more demanding than tax collection.

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[25] There are altogether 336 administrative units at the prefecture level, among which 185 are municipalities. The dependency ratio differ greatly between these municipalities and other ordinary prefectures.

Since the central government's administrative capacity and fiscal position are too weak to pool sufficient resources for providing pension benefit on the nationwide basis, an attainable option in the short term would be a pension system organized at the provincial level. Usually ten times as large as prefectures, Chinese provinces are akin to large- or medium-sized nations in terms of population (see Table 1), and therefore large enough for reaping the "economies due to pooling" if all pension pools are to be combined at the provincial level. Such provincial pools should be able provide a stable source of finance for the first tier of the pension system within individual provinces. For this reason, provincial pooling appears to be a good compromise between centralization and decentralization (Study Group 1989) Of course, the ultimate goal of national pooling should not be abandoned.

However, before national pooling becomes feasible, provincial pooling is a choice better than any other alternatives.

Many countries experienced a shift from dependence on local financing of pension provision to the assumption of a substantial portion of the cost by the central government. The United States is an example (see Appendix)

4. Harmonization

If provincial pooling is to be instituted, China would end up with 30 different pension schemes. These schemes may be financially sustainable, but the co-existence of 30 independent pension schemes in a country would result in inequality and inefficiency. To minimize undesirable effects of provincial pooling, the central government should make efforts to harmonize these provincial schemes.

Harmonization can be realized by the introduction of uniform legal regulation in different provinces either by provincial legislative decisions or by national law. The former option involves less central intervention and coercion, but is probably more costly and tardy, because it is difficult to coordinate multilateral legislative activities so as to adapt individual provincial schemes in a desired manner. If the latter option is chosen, national regulations must be uniform and applicable to all the provinces. And individual provinces must adapt their pension schemes to these national regulations.

Harmonization would certainly require the provinces to make some changes of their pension schemes. But how much change is required depends on the content of uniform regulations. If harmonization applies to the entire old-age pension, a uniform system would have to be created and pension provision would have to be equal in all the provinces. If harmonization applies to the structure of the systems, only partial but not complete harmonization is needed. If harmonization applies to individual elements of the system, such as the retirement age, the method of financing, or benefit level, only marginal changes are necessary. (Schmahl 1993)

Harmonization in China should start with some key parameters of pension system, then apply to the overall structure of the system, and finally to the entire system. Thus, before China builds up a unified pension system, provincial old-age pension schemes will operate under a set of national guidelines. Since these schemes are administered by provincial governments, variations are allowed. But their legal framework is laid down in national laws, and thereby a certain degree of unity is achieved.

This paper recommends to harmonize the following parameters in the next stage of pension reform:

- Coverage
- Retirement age
- Contribution base
- Vesting period

The harmonization of these parameters will help overcome the transferability problem. As long as there are workers who move between provinces that adopt different pension schemes, there is a transferability problem. Without transferability, a person might lose some of his/her pension benefits when s/he moves across provinces. Interregional labor mobility thus would be discouraged. To achieve the aim of increasing labor mobility on a nationwide basis, pension insurance has to be transferable from one province to another. To facilitate such transfer, the central government should require provincial pension schemes to make portability arrangements which allows the transfer of either accumulated personal pension account (under a defined contribution plan) or pension benefits (under a defined benefit plan) from one province to another. While portability in theory can be arranged between different provincial pension plans, there are numerous technical difficulties arising from the valuation of contributions or benefits, differing benefit formulas, the division of contributions into the public funds and individual accounts, actuarial assumptions, and funding ratios between "importing" and "exporting" pension plans. Resolving the transferability problem therefore would require the central government to lay out certain guidelines for portability.[26]

5. Unified Administration

The way in which a pension system is administered, to a large extent, depends on the degree of disparity in pension provision. The unified pension administration usually goes together with uniformity and fragmented with disparity. (Hussain 1993) If, as suggested by this paper, the province will become the basic unit of pension financing, and pension provision will become standardized within each and every province, there will certainly be a greater degree of uniformity in China's pension system. Accordingly, the new pension

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[26] In Switzerland and Canada, there is complete portability between different pension schemes. See Appendix.

system may need to be supported by a more unified pension administration than before. Because of the co-existence of 30 independent provincial pension schemes, however, a highly centralized pension administration may not be appropriate and practicable.

A) Supervisory Structure

The supervisory structure should be unified.

In the past, a great number of central ministries were responsible for different aspects of pension provision in China, and friction between them often led to confusion and waste. The state of incongruity must be ended. Circular No. 6 assigned the overall responsibility of pension administration to the Ministry of Labor. This is an applaudable move. The paper recommends either to change the name of MOL into Ministry of Labor and Social Security (MLSS) so as to make clear its task or establish an independent Ministry of Social Security (MSS). In any case, China needs a specialized and authoritative central ministry to oversee the whole pension system, just as many countries in the world have done.[27]

The MLSS or MSS will be responsible for policy making and the coordination of the entire system. More specifically, its functions include:

- Overall planning.
- Making proposals to the People's Congress in regard to the legal framework for pension insurance.
- Issuing decrees and regulations delineating coverage, retirement age, contribution base, vesting period, and other matters to be carried out nationwide.
- Unifying the structure of administrative organizations throughout the nation.
- Introducing standard administrative procedures.
- Setting national standard of practice in accounting and auditing.
- Designing a basic set of forms for records and reports.

[27] In many countries, the overall responsibility of pension administration often falls within the purview of Ministry of Labor, the Ministry of Social Security, the Ministry of Health, or even the Ministries of Finance or the Interior. See Appendix for examples.

- Supervising the law enforcement in the provinces.

- Coordinating transferability arrangements between the provinces.

By playing these roles, the MLSS or MSS will be able guarantee the reformed pubic pension system to be more unified than before.

Each province should establish its own bureau of labor and social security (BLSS) or bureau of social security (BSS). Subject to the leadership of the provincial government, the bureau is not a subordinate unit of the central MLSS or MSS.[28] But it does have the responsibility to see to it that the operation of the provincial pension scheme is consistent with the central guidance. The bureau may set up branches in municipalities, prefectures, and counties to implement provincial policies under its unified administration.

Keeping pension provision unified within the province is the main task of the provincial bureau. For this reason, it should be allowed to perform all the functions MLSS or MSS performs, though at the provincial level. The bureau should also be given the responsibility for supervising contribution collection, pension payment, and the investment of pension funds. In addition, it should be responsible for coordinating the activities of its branches at lower levels.

Although the central and provincial supervisory mechanisms are separated, each is more unified at its own level than before. Together they will help to make the whole pension insurance system more unified.

B) Administrative Structure

Since the basic unit of pension financing and provision is province, the administrative structure should be centralized only within the province. Each province is fully responsible for administering its own pension pool. From the national point of view, the administrative structure thus is rather decentralized.

A provincial pension scheme may be operated either by a special division of the provincial BLSS (or BSS) or a semi-autonomous pension institution. Unlike the supervisory structure which always falls within the purview of the state, the administrative organization of national pension schemes varies widely. As Appendix shows, in many countries (Australia, Canada, Denmark, New Zealand, the United Kingdom, and the United States), public pension is directly administered by the state, whereas in others (Brazil, France, Germany, India, Indonesia, Malaysia Mexico, Pakistan, Singapore), the administration of schemes is delegated to autonomous or semi-autonomous (non-profit-making) institutions. (DHHS 1993) Therefore, there is no single model for China to follow. Whatever type of administrative structure is used, the chosen agency and its branches are responsible for:

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[28] The State Council has decided that "vertical leadership" (chuizhi lingdao) does not apply to social security institutions. (SRC, 44)

- Registration

- Record keeping

- Contribution collection

- Benefit determination

- Benefit payments and other clientele services

- Management of pension funds

It is important to note that except Canada and the former Yugoslavia, almost no country in the world allows its local governments to mess up with pension funds, and for good reasons. As pointed out in the previous section, if the local governments are given the authority to manage pension funds, they are inclined to invest the financial resources within their jurisdictions without much concern about the rates of return. Such a proclivity may expose the interests of insured persons to excessive risks. To avoid this danger, China is better to have its provincial pension schemes administered by semi-autonomous institutions.

To insulate the operation of pension schemes from the political influences that come from provincial governments, such institution should be managed by tripartite governing commission, including representatives of retirees, employees and employers alongside civil servants from the provincial BLSS or BSS. The bureau's participation allows it to monitor the institution from within, but it is no longer able to avail the provincial government of monies earmarked for old-age pensions.

If the supervisory and administrative structures were to be built as suggested here, China's future system of pension administration would be very close to the decentralized model used by Germany and Switzerland (see Appendix).

C) Pension Reform Institution

The fragmentation of China's current pension system is at least in part due to the fact that a great number of government agencies have been involved in the process of pension reform, all designing their own pension plans with very little effective coordination. This situation has to be changed if China hopes to make its new pension system standardized, integrated, and harmonized to the degree it desires.

Changes are taking place at some subnational levels. While instituting province-based or municipality-based pension schemes, a number of provinces and municipalities (e.g., Hainan, Shanghai, Wuhan, and Ningpo) have recently established social security commissions[29] to coordinate pension reform efforts in their respective jurisdictions. Headed usually by a deputy governor or a

[29] Their actual names may be different.

deputy mayor, the commission customarily consist of the heads of all relevant government agencies, such as system reform commission, planning commission, economic commission, people's bank, federation of trade unions, and bureaus of labor, personnel, public health, civil affairs, finance, taxation, auditing, statistics and the like. Such a composition enables the commission to discuss major issues in pension reform, build consensus, and make decisions. Moreover, with the establishment of the social security commission, no other government agency is allowed to introduce pension reform measures without sanction of the commission. Thus, the uniformity of the local pension scheme may be attainable even when the system is undergoing relatively rapid changes. (SRC 1995)

At the central level, a similar institution is also urgently needed. Although Circular No. 6 entrusts the MOL with the task of promoting pension reform in the country, it, in the meantime, authorizes the SRC to engage itself in some "in-depth experiments of pension reform." In addition, the SPC, SECC, MOF, People's Bank, and other "relevant" central ministries are encouraged to "play supporting roles" in the reform. Since these ministries are equal in terms of their official ranking, such an arrangement may help to lessen, but is unlikely to eliminate, bureaucratic friction concerning pension provision between them. The way Circular No. 6 has come out without reconciling MOL and SRC visions of pension reform is an illuminating example in this regard.

To remove the fragmentation in designing the reform, the Chinese central government may need to set up a Leading Group of Pension Reform comprising the heads of all relevant central ministries. Such a powerful central body will not only give a high profile to the task of pension reform, but also help to build consensus over main issues in the reform and to hammer out policies that are concordant with each other.

Conclusion: The Politics of Pension Reform

China's present pension system is too fragmented so that it needs to be reformed. In the long term, there is little doubt that China will be better off with a single and unified pension insurance system covering the whole country, just as most of other countries do. In the short term, however, it is feasible for China to establish only a province-based pension system, a system that is more unified than the enterprise-based and county-based alternatives, but nevertheless retains a degree of fragmentation. In order to make transition from here to there less painstaking, China's current pension reform should start with designs that are not only consistent with its short-term goal but also helpful to eventually accomplishing its long-term goal. More important, policy-makers need to be sober-minded about what may constitute main obstructions to forward movement.

In our view, as in the past, the main obstructions standing in the way of future pension reform will be of political rather than economic nature. If we conceive of the pension reform as a process of redistributing costs and benefits, then the reform inevitably imposes costs on some groups and brings benefits to others. For obviously reasons, those whose interests are damaged in the process resist changes, while those whose interests are advanced support changes. Conflicts between the losers and gainers would affect the outcome of the reform in one way or another. Three categories of such conflicts have been observed.

Conflicts between Individual Workers

Since an elaborate pension insurance system has been in existence for permanent workers of state-owned enterprises, anything less favorable would arouse resistance from them. However, the benefit level of permanent workers cannot be maintained unless funds collected from contract workers and others may be tapped to help pay retirement expenses for this group, which would certainly make contract workers and others unhappy. Permanent workers would favor a unified pooling and contract workers and others a separate pooling. Because contract workers and others are still small in number and weak in political influence, this kind of conflicts are relatively easy to be overcome.

Conflicts between Enterprises

With a high ratio of pensioners to the labor force and thereby high retirement costs, long standing state-owned enterprises naturally have an incentive to join a unified pool. But new state-owned enterprises, and enterprises in the non-state sector such as private companies, joint ventures and foreign firms, tend to have relatively young workforce and low retirement costs. If they join pools with enterprises with high pension burdens, they would have become net contributors in the short run. Therefore they are reluctant to join.

For years, this kind of resistance has been one of the most important obstacles to the formation of city-based pooling. Local governments often have to make concessions to enterprises with few older workers. Some such enterprises have been exempt from participating in the pool. If they do join the pool, it is often because local governments allow them tax advantages or reduce their contributions. It appears more difficult to overcome resistance by a group of enterprises than resistance by individual contract workers.

Conflicts between Regions

Here "region" can refer to county, prefecture, or province. "New" regions with low dependency ratios have no incentive to share the pension insurance costs of "old" regions with high ratios. Little wonder that they generally oppose the idea of setting up larger regional, provincial, or national scheme. To justify their position, they sometimes resort to the following lines of reasoning: there is a direct relation between the aging of the population and the level of economic development. Economically more developed regions are likely to enter the phase of an aging society earlier than relatively backward regions. In other words, the pension burden of well-off areas tends to be higher than of backward ones. Thus, a transition to the provincial or national pooling would require the latter to pay for the pensions of the former, which is considered unfair. (CHIRD 1993)

From the point of view of "old" regions, however, what is unfair is the system that keeps the flows of pension contributions from "old" and "new" regions separate. The implicit pension contributions of the retirees in the "old" regions have been an important source of capital for "new" regions' economic take-off. There therefore is nothing wrong for them to get compensated by the beneficiaries of their contributions in "new" regions. (WORLD Bank 1995b)

What interests us here is not whose argument is more plausible, but their contrasting attitude toward the provincial or national pension scheme that would involve a large redistribution across regions. Resistance by a group of regions is certainly much more difficult to be subdued than resistance by a group of enterprises, which is perhaps the principal reason why the provincial pooling is still rare and the national pooling at the moment is not even on the reform agenda.

Among the three types of resistance, the first type has been largely mollified, the second type is being abated, and the third type is still mighty. China has to break all types of resistance before it can establish a truly unified pension system in the country. A country cannot mould its pension insurance system according to doctrine. It can only achieve what is possible and feasible in a given situation.

Table 1: Population in the Chinese Provinces and Selected Countries (10,000 persons)

Province	Total Population	Comparable Case
Beijing	1112	Hungary (1032)
Tianjin	928	Bulgaria (896)
Hebei	6334	Philippines (6426)
Shanxi	3012	Argentina (3310)
Inner Mongolia	2232	Romania (2275)
Liaoning	4042	South Korea (4366)
Jilin	2555	Canada (2744)
Heilongjiang	3640	Poland (3836)
Shanghai	1349	Czechoslovakia (1573)
Jiangsu	6967	Vietnam (6948)
Zhejiang	4266	Myanmar (4367)
Anhui	5897	Turkey (5878)
Fujian	3150	Argentina
Jiangxi	3966	Poland
Shandong	8642	Germany (8057)
Henan	8949	Mexico (8954)
Hubei	5653	France (5737)
Hunan	6311	Philippines
Guangdong	6607	Philippines
Guangxi	4438	Myanmar
Hainan	701	Bulgaria
Sichuan	11104	Pakistan (11911)
Guizhou	3409	Argentina
Yunnan	3885	Poland
Tibet	232	Mongolia (231)
Shaanxi	3443	Argentina
Gansu	2345	North Korea (2292)
Qinghai	467	New Zealand (341)
Ningxia	495	New Zealand
Xingjiang	1605	Australia (1753)

Source: State Statistical Bureau. 1994. Statistical Yearbook of China, 1994. Beijing: China Statistical Publishing House, pp. 60, 735.