China's National Rural Pension Scheme

Matching Defined Contribution Conference
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# I. Background and Motivations for Reform

Background: Evolution of Rural Pensions in China, 1980s-2009

Modest rural coverage over four phases of evolution of rural system:

- *initiation and expansion* - 1986-1998
- *contraction and stagnation* - 1999-2002
- *renewal phase* of local piloting - 2002-2009
- *2009 national rural pension pilot*

Key issues facing the <u>old</u> rural pension scheme:

- lack of incentives (no matching subsidy or minimum benefit) contributed to low participation + coverage concentrated in four coastal provinces.

- low benefits due to investment rules, lack of employer contribution, etc. and real returns volatile & strongly negative in some years

- weak governance and supervision, c. 20% of accumulations invested in non-authorized sources & mismanagement leading to collapse or cancellation of schemes of around 10% of schemes
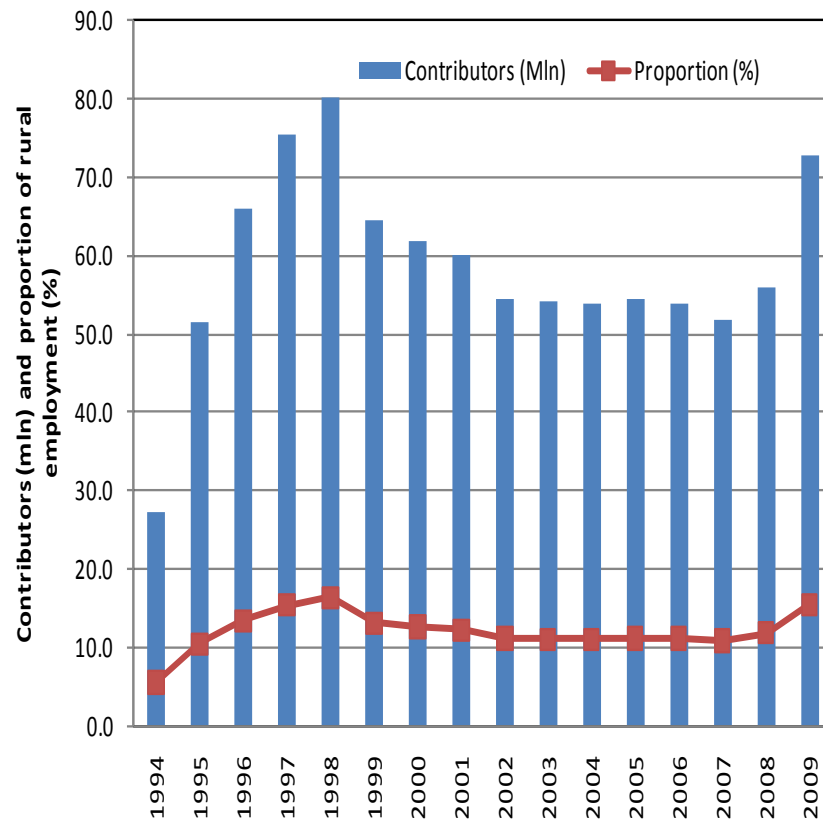
# Motivations for reform (1): Rural demographic change

- With younger adults migrating away from rural areas, elderly share of the rural population will rise sharply after 2010, much faster in rural than in urban areas.
- Declines in the support ratio in rural areas projected starting in 2011

Scenario: Low Fertility, Medium Pace Urbanization
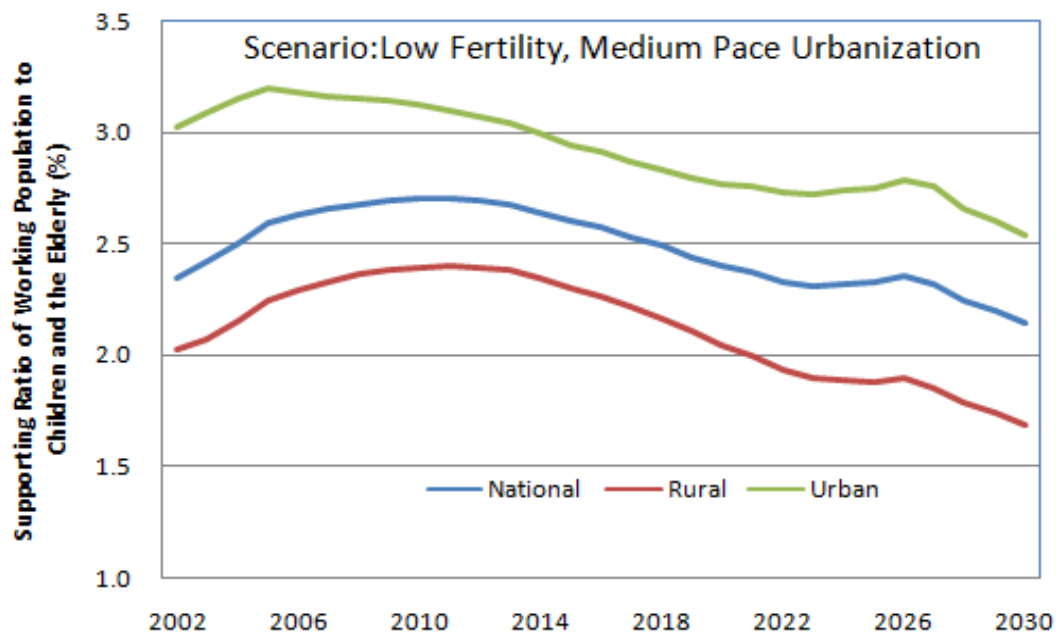
Motivations for reform (2): And rural elderly dependent upon children or family support

- Rural elderly receive most support from their children or from their own labor.
- As the rural elderly get older, those over 65 rely less on their own labor income and more on family support. [1/]
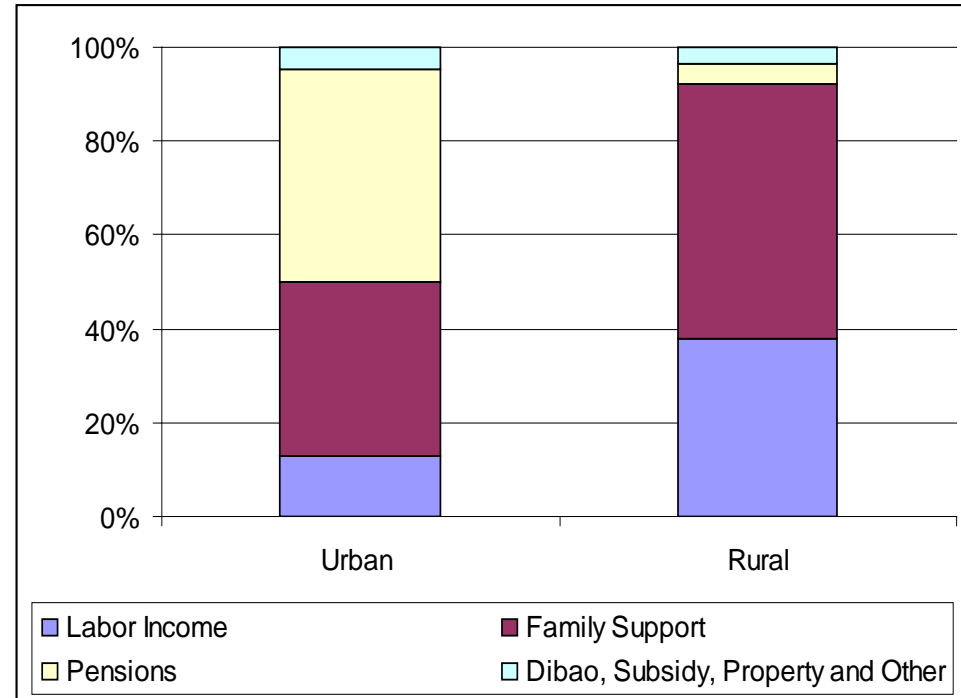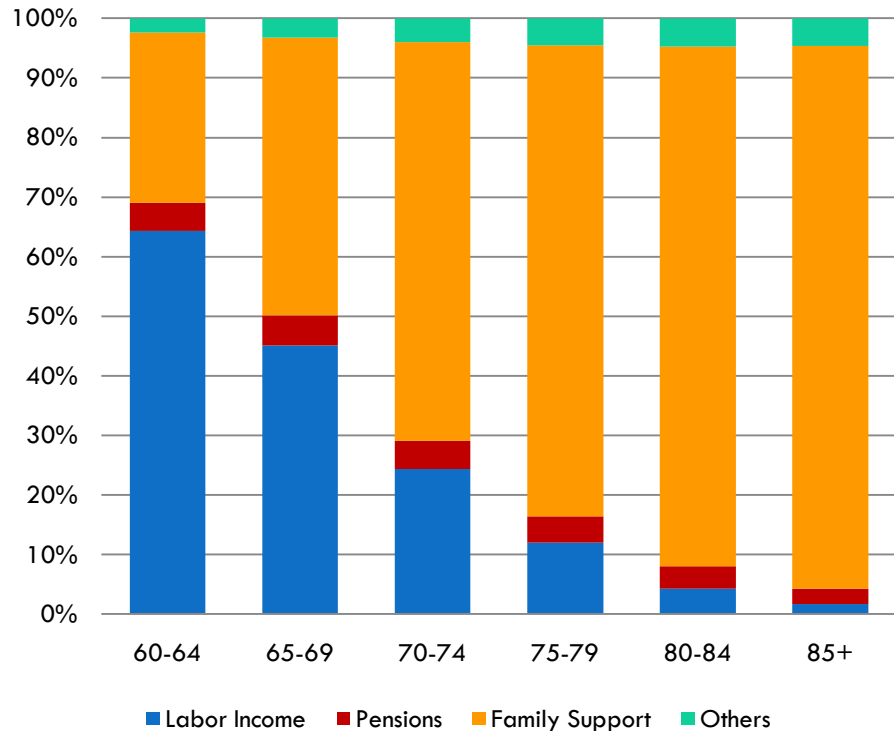
Source: National Bureau of Statistics, 2005 One Percent Population Sample Data, China Statistics Press, 2006.

See John Giles，Can China's Rural Elderly Count on Support from Adult Children? Implications of Rural-to-Urban Migration, Brown Bag Presentation, World Bank, 2010.

Motivation for Reform (3): An important share of the rural elderly are poor or vulnerable, particularly as they get very old.

Poverty Incidence by Age of Eldest Resident of the Household

Graphs by survey year
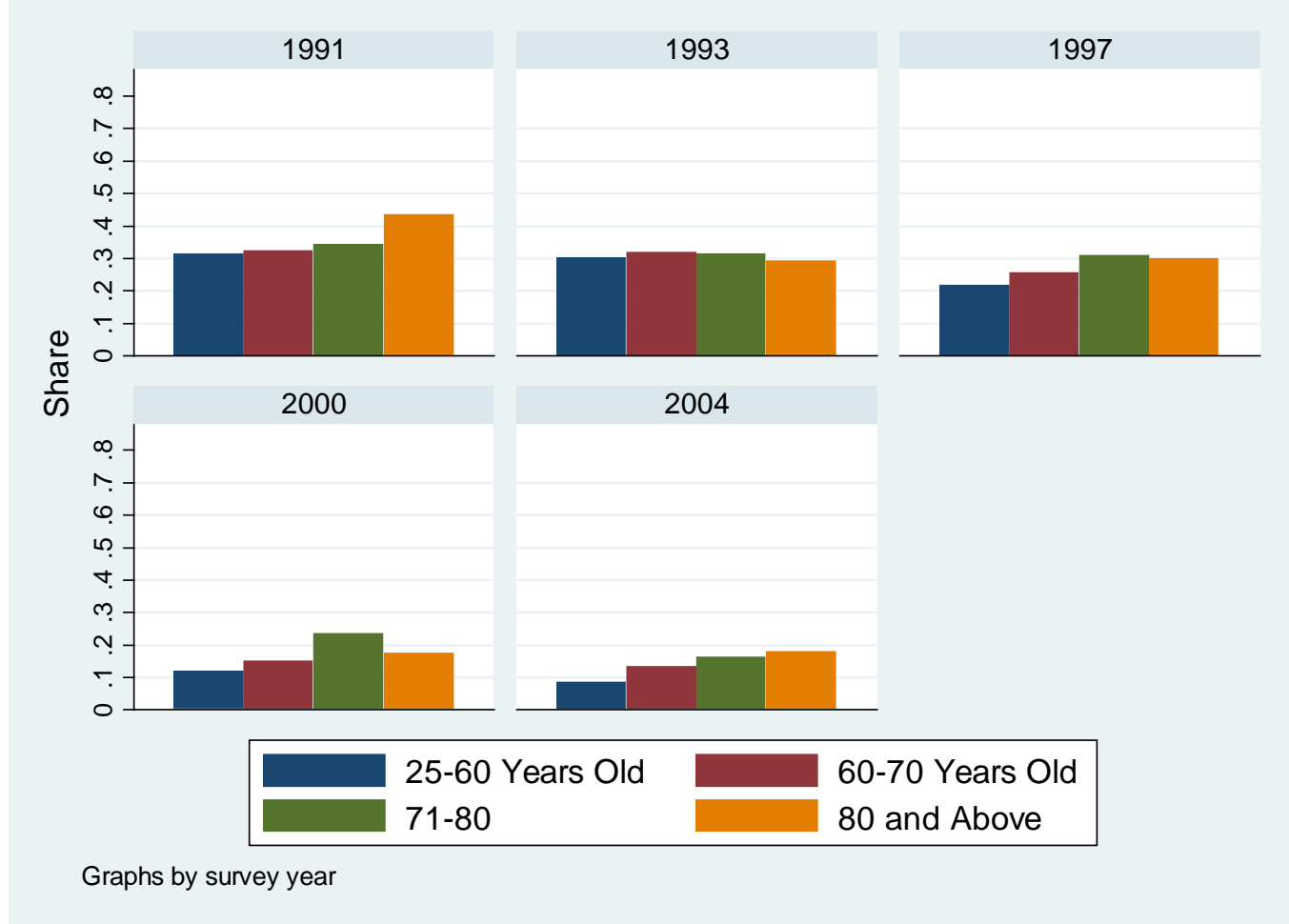
Source: CHNS, Various Years

Motivations for reform (4): Addressing broader policy concerns

- Weak rural poverty protection mechanisms.
- Growing urban/rural income disparities.
- Increasingly mobile population, often with little or no social protection.

III. Design of the National Rural Pension Scheme

Design of national rural pension scheme (1)

- Two components:
  - Individual accounts with matching contributions (MDC)
  - Basic (flat) pension at age 60 for workers who contribute 15 years.
- "Family binding" provisions for those over 60 to receive basic pension provided children are contributing. Those aged 45-59 contribute during their working lives and pay lump sum to cover shortfall on vesting contributions.
- Contributions for *dibao* beneficiaries are supposed to be covered by local governments.

Design of national rural pension scheme (2)

- **Financing** from a combination of:
  - ➢ *central subsidies* to support the basic pension (100% for central and western regions & 50% for eastern regions)
  - ➢ *individual contributions* (generally ranging from 100 to 500 Yuan per year + higher in richer areas)
  - ➢ *partial match on IA by local governments* of <u>at least</u> 30 Yuan per year
  - ➢ *collective subsidies*, encouraged but not mandated.
- **Rate of return** on IAs = one-year deposit interest rate (< wage growth and inflation)
- **Fund management** for IA accumulations at county level, with aim to shift to provincial level. Supervision of funds by local offices of MHRSS.

III. Initial Results

Initial Results (1)

- **Geographic targets set for offering the scheme**: end-2010 program functioning in 24% of rural counties. End-2011 target: 60% of rural areas to offer the program (increased from 40%)

- **Participation** less clear: Age 45+ participation in areas offering the scheme believed substantial though weak incentives for those < 45.

- **Fiscal** costs for minimum benefit appear affordable while the affordability of matching contributions will vary across localities.

- **Incentives**:
  - Central financing of basic benefit addresses a fundamental shortcoming of earlier schemes creating greater confidence in benefit promises.
  - "Family binding" and purchase of service approach create contribution incentives for age 45+ though may also lead to coverage gaps.
  - Scaling up the MDC/DB scheme creates more uniform incentives across localities.

Initial results from household survey in Chengdu suggest:

- **Scale-up of the scheme can extend coverage quickly**, but challenging agenda on integrating with existing schemes covering rural workers, particularly in peri-urban areas.

- **Participation increases with age**.

- **Educated people have relatively low participation**, perhaps reflecting outflow of young migrants

- The **poorest have lower participation** rates but otherwise no clear pattern across the income distribution.

- **Pension benefits are not high:** replacement rates range between 27-31 percent of net rural per capita income.

NRPS is only part of the coverage story - Pension coverage by different schemes & by county

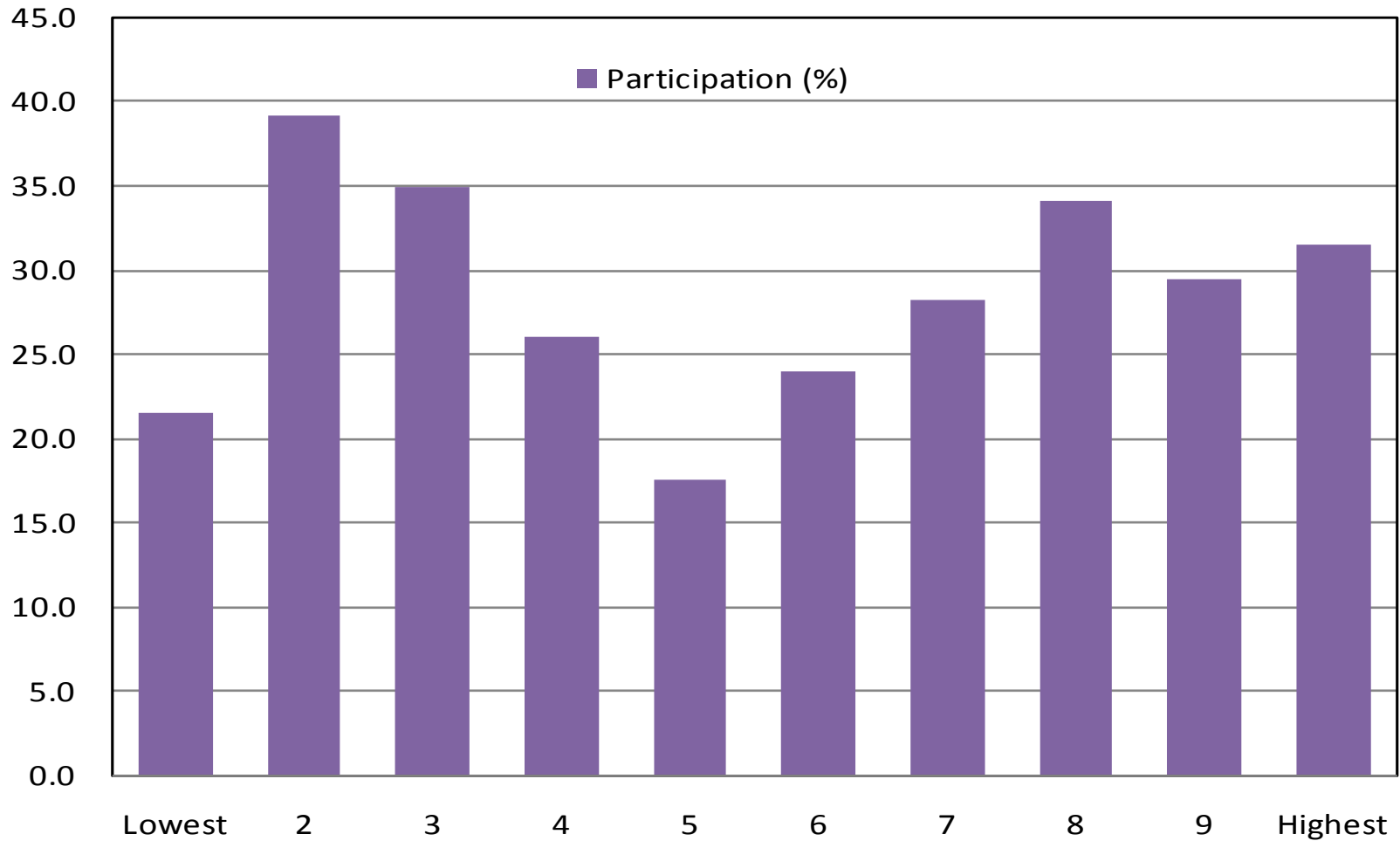| Country	Jintang	Congzhou	Shuanliu	Total
National Rural Pension Scheme	27.8	4.1	0.4	9.8
Urban Worker Pension Scheme	3.3	3.8	5.0	4.1
Landless Farmers Pension Scheme	0.4	4.5	53.6	23.6
Migrant Comprehensive Insurance	0.8	1.6	2.5	1.7
Other Schemes	0.2	0.8	0.2	0.4
Total	32.5	14.9	61.6	39.7

NRPS Participation by Age and Education in Chengdu
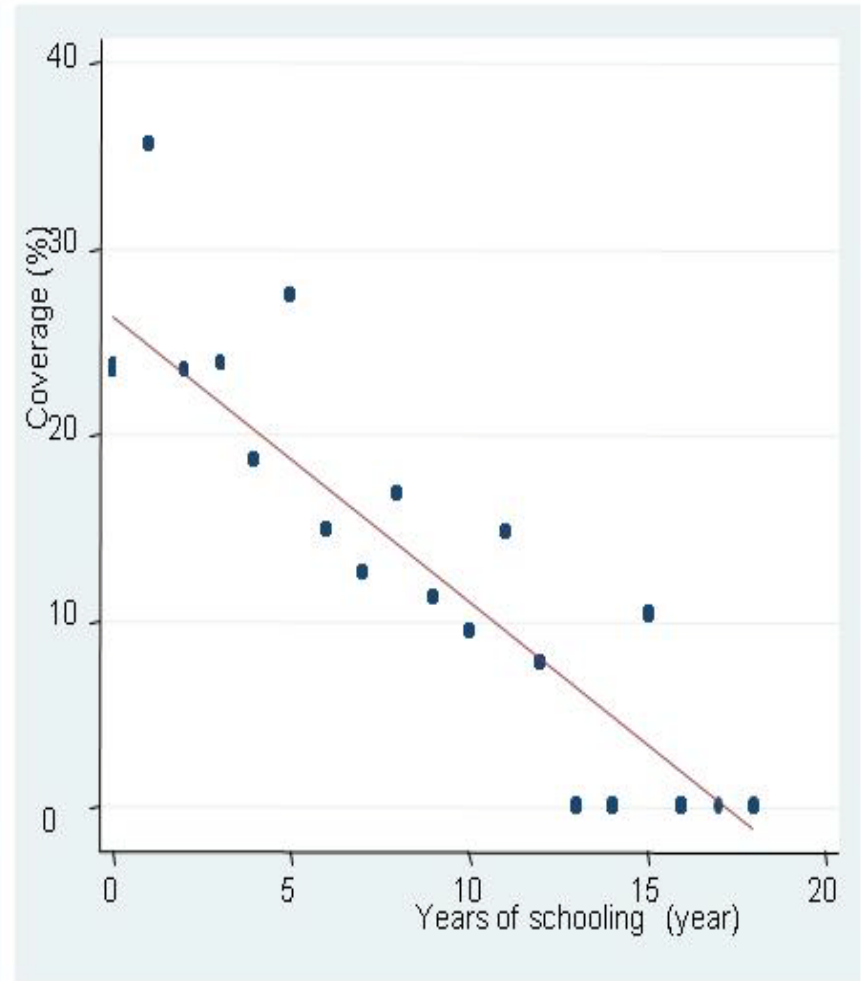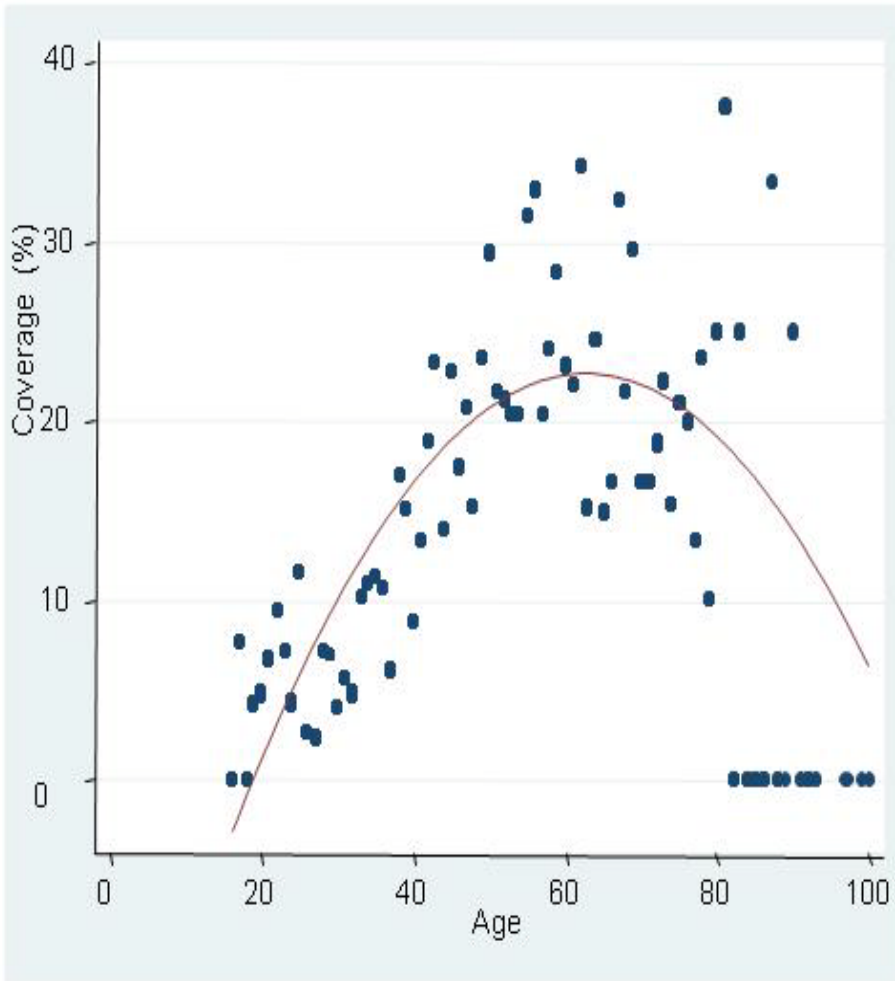
NRPS Participation by per capita income in Chengdu

NRPS Pension Benefits and Replacement Rates in Chengdu

Year	Pension Benefits (Yuan/month)	No.of Pensioners Person	Per Capita Income (Yuan/Year)	Replacement Rates (%)
2007	103	23	4754	26
2008	120	8	5333	27
2009	143	18	5720	30
2010	172	17	6658	31

- Establishing adequate service delivery networks at county level & below.
- Developing fund/budgetary management systems at a local level to monitor the revenue streams from multiple parties and avoid the urban problem of "empty" accounts.
- Linking up information systems to ensure necessary communication between and across levels of government.
- Establishing a viable approach to portability of rights and linkages with urban pension arrangements.

IV. Reflections on the Design and Remaining Challenges

Does the design suit the objectives? Should alternatives be considered?

- Low target income replacement, largely flat benefits and subsidy structure suggests *elderly poverty protection* is the core objective.
- Yet design largely a contributory flat defined-benefit social insurance scheme.
- Achieving universal elderly poverty protection will require additional minimum benefit guarantees under the current design.

➤ Alternatively, establishing a non-contributory social pension (pensions tested with a low benefit target) might better achieve the objective of poverty protection with greater economic and operational efficiency.

➤ An MDC arrangement with greater matching contributions and an annuitized benefit could provide basic income support, serve as a savings vehicle for smoothing consumption in retirement (and a stronger savings incentive for those <45), and provide a basis for adding up entitlements for China's mobile workforce.

Will combined subsidies and the basic benefit be sufficient invite widespread participation?

- **Likely yes for those age 45+.** Overall returns on contributions make for a very high 16% IRR on contributions (with low direct matching subsidies, low rates of return on individual accounts, basic benefits, generous annuity factors and survivors' benefits). [2]

- Minimum contributions affordable for most rural citizens.

- Overall, 15 years of contributions of 8.33 yuan/month (US$1.28) yields a benefit of 73 yuan/month (US$11.20) for 19.2 years (+ survivorship benefits) … *a good deal for those who can afford it.*

- **While those under age 45 may only contribute on behalf of parents.**

- [2] See Larry Thompson, Guangdong Pension System Development, Preliminary Draft, 2011.

Will contribution incentives lead to coverage gaps for those with lowest incomes or inability to meet the family binding/purchase of service requirements?

- Fiscal capacity to support contributions on behalf of *dibao* recipients limited, but *dibao* recipients only about 6% of rural population.
- Local fiscal capacity for 30% match may be difficult in poorest localities.
- Migration may prove a barrier to meeting family binding requirements.
- Uncovered elderly beneficiaries may or may not receive *dibao* benefits.

- Will a benefit of 73 yuan (US$11.20) per month be <u>adequate</u> to protect the rural elderly from poverty? Adequacy low by most measures though depends upon the benchmark.
  - 17% of rural per capital income (2009)
  - 29% of $1.25/day
  - 73% of national poverty line & *dibao* threshold (2009)
- Effectiveness of the NRPS in achieving elderly poverty protection will depend upon the amount of supplementary financing provided by the locality. Additional financing and benefit guarantees likely needed in most of China.
- Further reducing income disparities may require committing to a higher minimum income target which is centrally financed.

- How can policies and systems develop to ensure full portability of pension rights across space and occupation as the system matures?
- What is the potential to move from "rural" to "informal sector" pensions through parallel expansion of urban resident pensions and integration of rural and urban schemes for those outside the formal sector? How will the NRPS be integrated with the recently announced national expansion of the urban resident pensions?

V. Lessons for Other Countries

Lessons for Other Countries

- Linking social pension eligibility with MDC contributions
  - ➤ Can positively impact incentives through vesting req. & "family binding" provisions.
  - ➤ But poses institutional challenges & can come at the expense of coverage gaps
  - ➤ While the same effect could be achieved by a much larger match which also provides stronger incentives for younger workers.
- Strong rural coverage through the NRPS compared with countries of comparable income and economic composition.
  - ➤ A strong fiscal position and central fiscal transfers which guarantee a minimum benefit can encourage participation and credibility.
  - ➤ Yet need a unified institutional infrastructure is needed for mobilizing, managing and disbursing pension savings in rural areas.
- Portability – An MDC design can form the foundation for consolidating acquired rights in a rapidly urbanizing economy where labor mobility is key to growth.

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