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Reducing the Coverage Gap: Lessons from Analysis and Policy

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Two Lessons

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- Taxation and Means testing:
  - Opposition to means testing based on very partial view of supporting economic policy
- Dual pension systems for rural workers
  - Exploitation of social security system expansion generates long term liabilities with long run saving and labor supply impacts

Taxation and Means Testing

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- **Targeted or means tested first pillar**
  - Less expensive
    - reduced fiscal requirement means that taxes can be lower and therefore less distortionary
  - Well targeted redistribution
    - transfers go to those in need
  - Not everyone is affected by the transfer
    - overall, distortions may be reduced
  - Monitoring required

Introduction of Labour Tax

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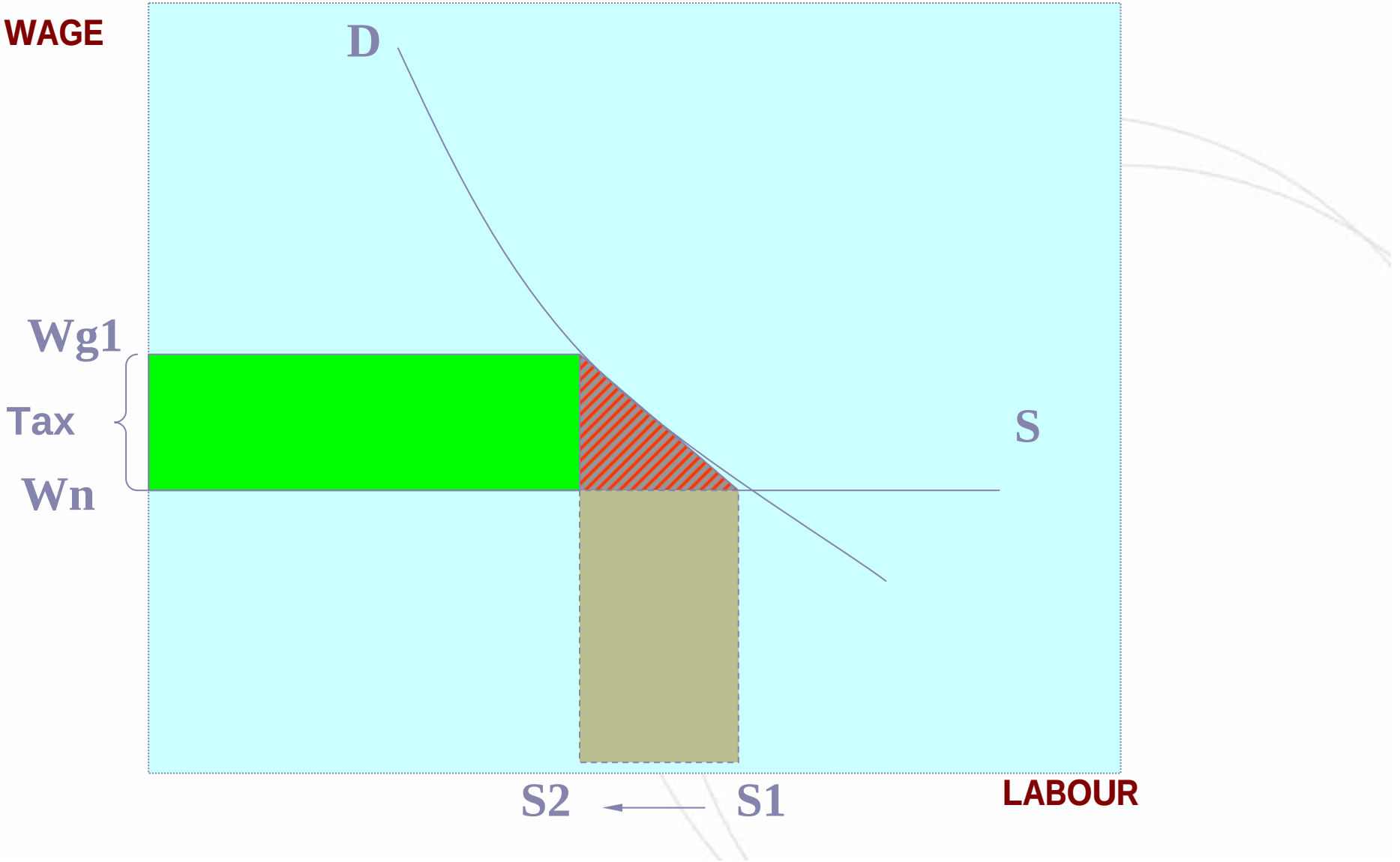

Marginal Increase in Labour Tax

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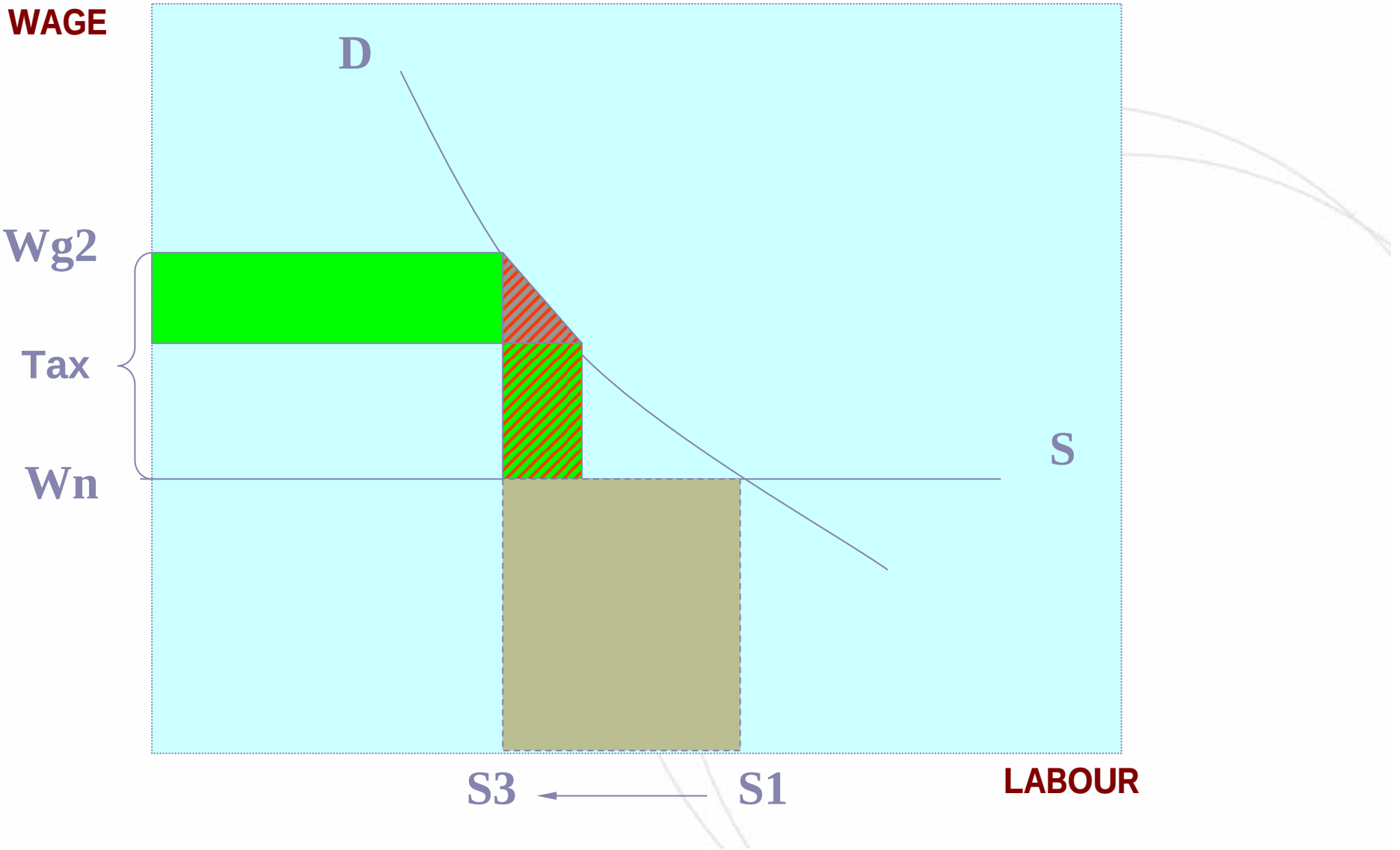

Means testing the first pillar

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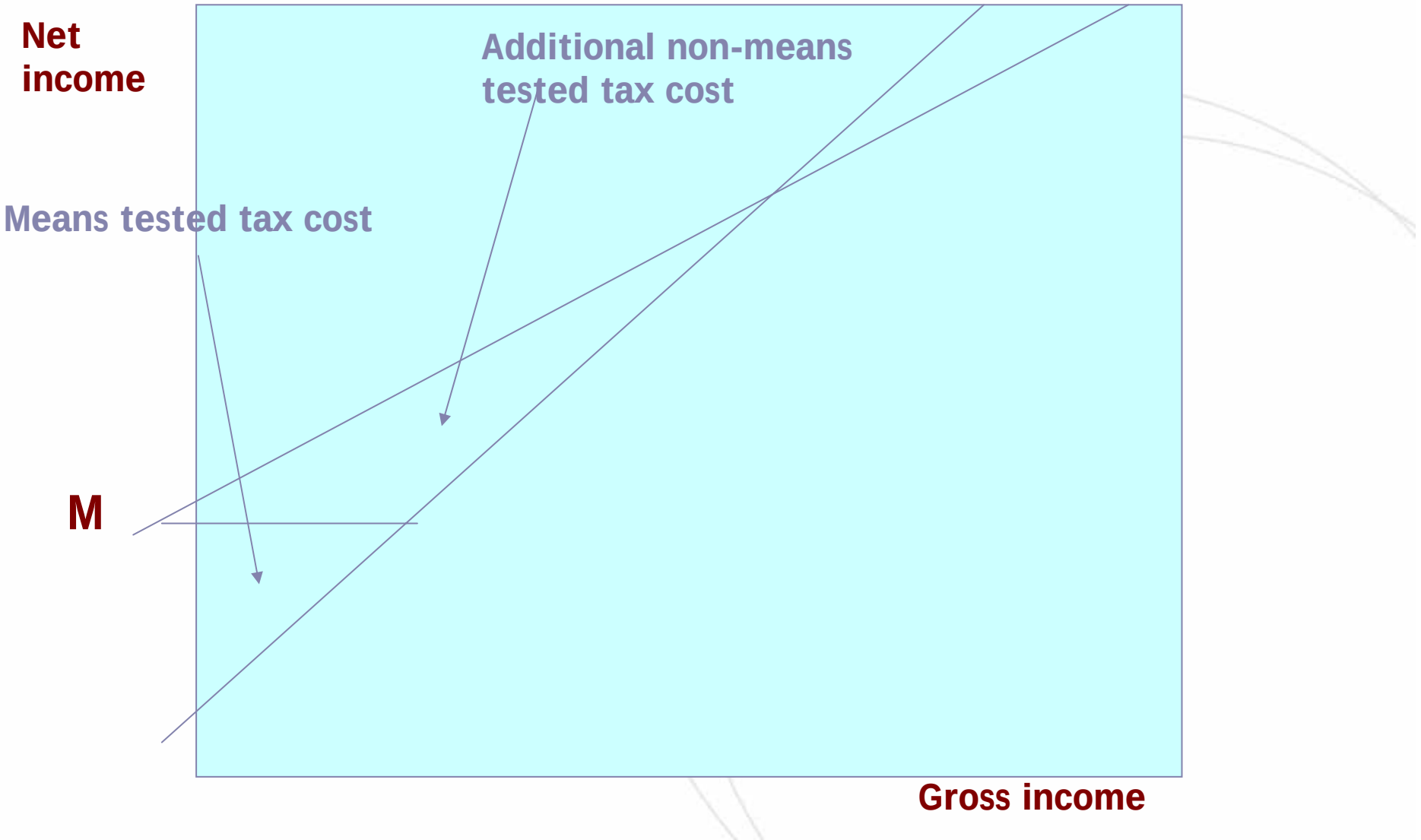

Marginal Increase in Labour Tax

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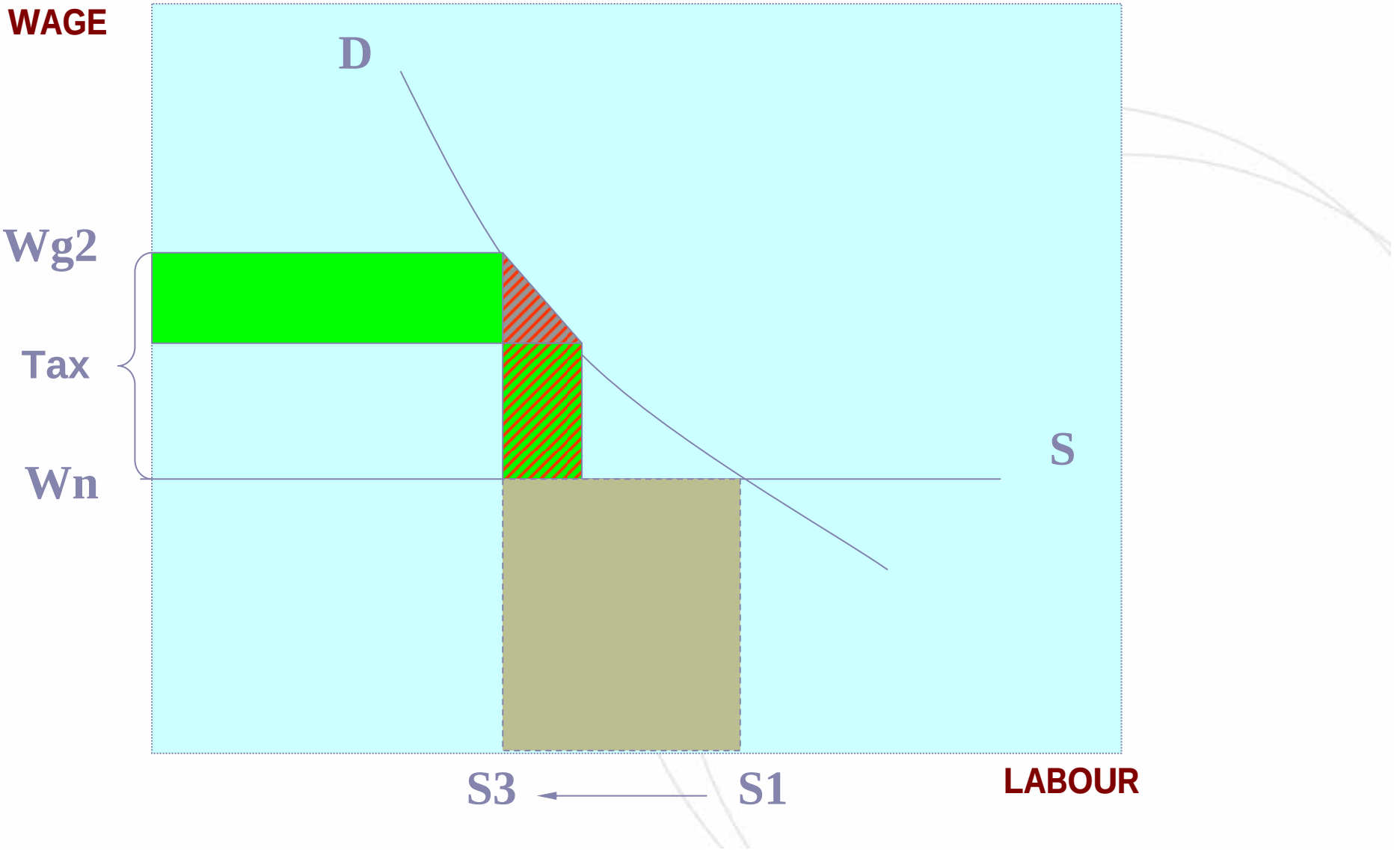

Working longer

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- Some Western experience:
  - "Phased" retirement can be bad
  - Retirement reversal very difficult:
    - Skill attrition
    - Workplace attitudes
    - Workplace infrastructure
    - Networks

➔ SOCIAL SECURITY ELIGIBILITY AGE SHOULD BE GRADUALLY INCREASED

China's urban – rural income disparity

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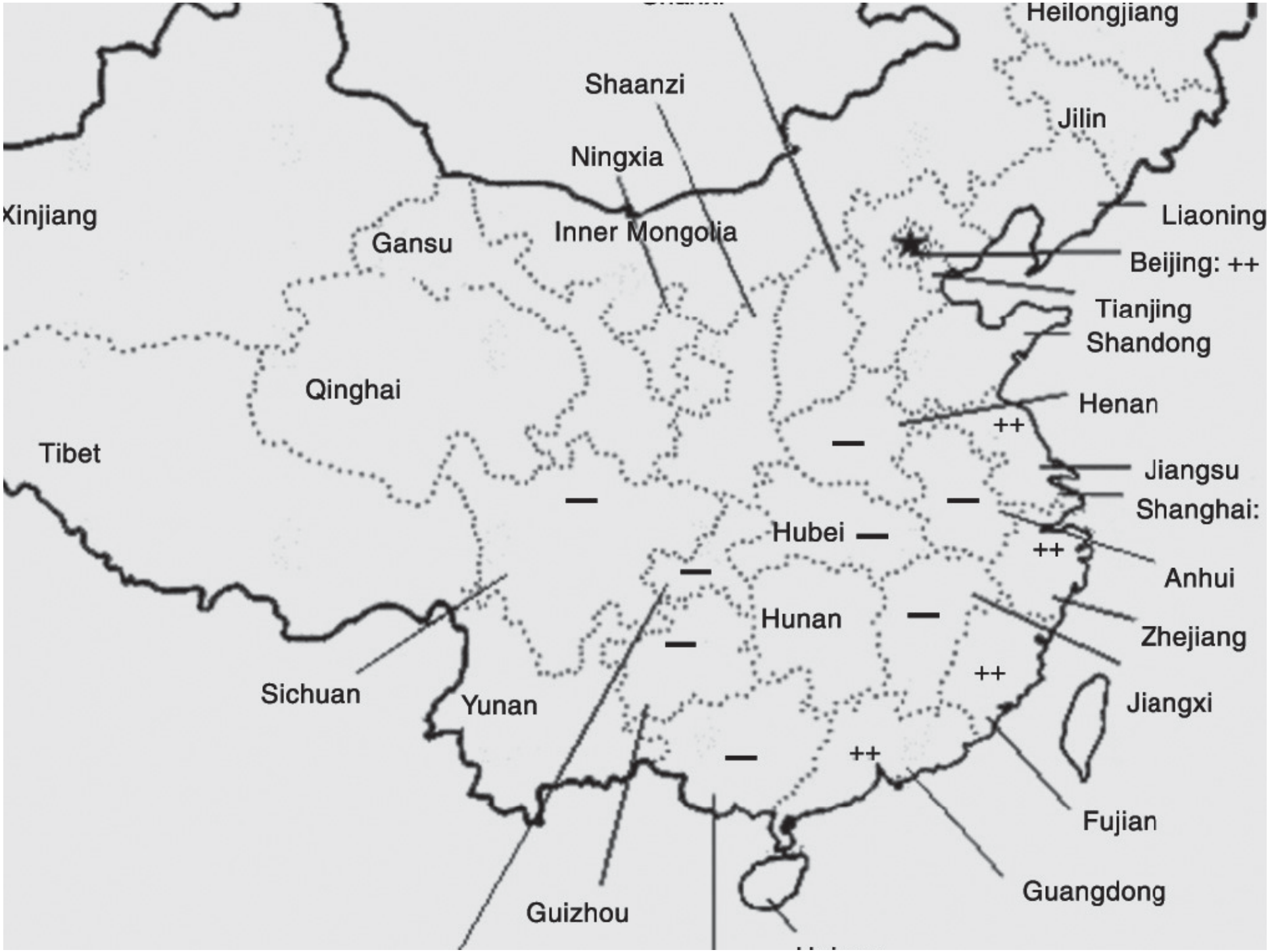
"The income of urban residents in 2006 was 3.28 times that of rural ones, up from 3.22 in 2005 and 3.21 in 2004"

Vice Minister for Agriculture, October 2007


Heilongjiang
Shaanzi
Jilin
Ningxia
Xinjiang
Liaoning
Gansu
Inner Mongolia
Beijing: ++
Tianjing
Shandong
Qinghai
Henan
++
Tibet
Jiangsu
Shanghai:
Hubei
++
Anhui
Hunan
Zhejiang
++
Sichuan
Yunan
Jiangxi
++
Fujian
Guangdong
Guizhou

Percent 65+, 2000

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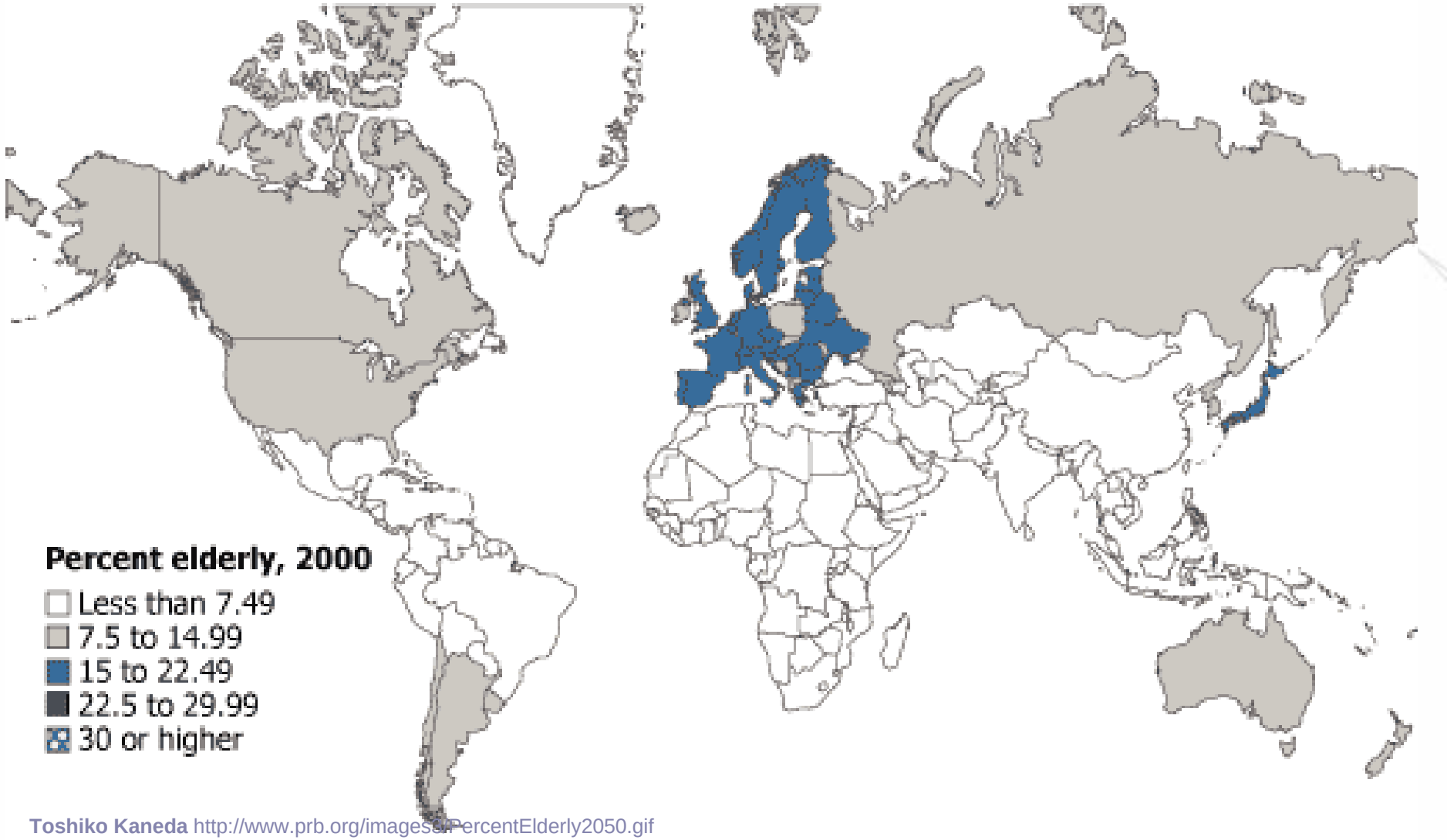
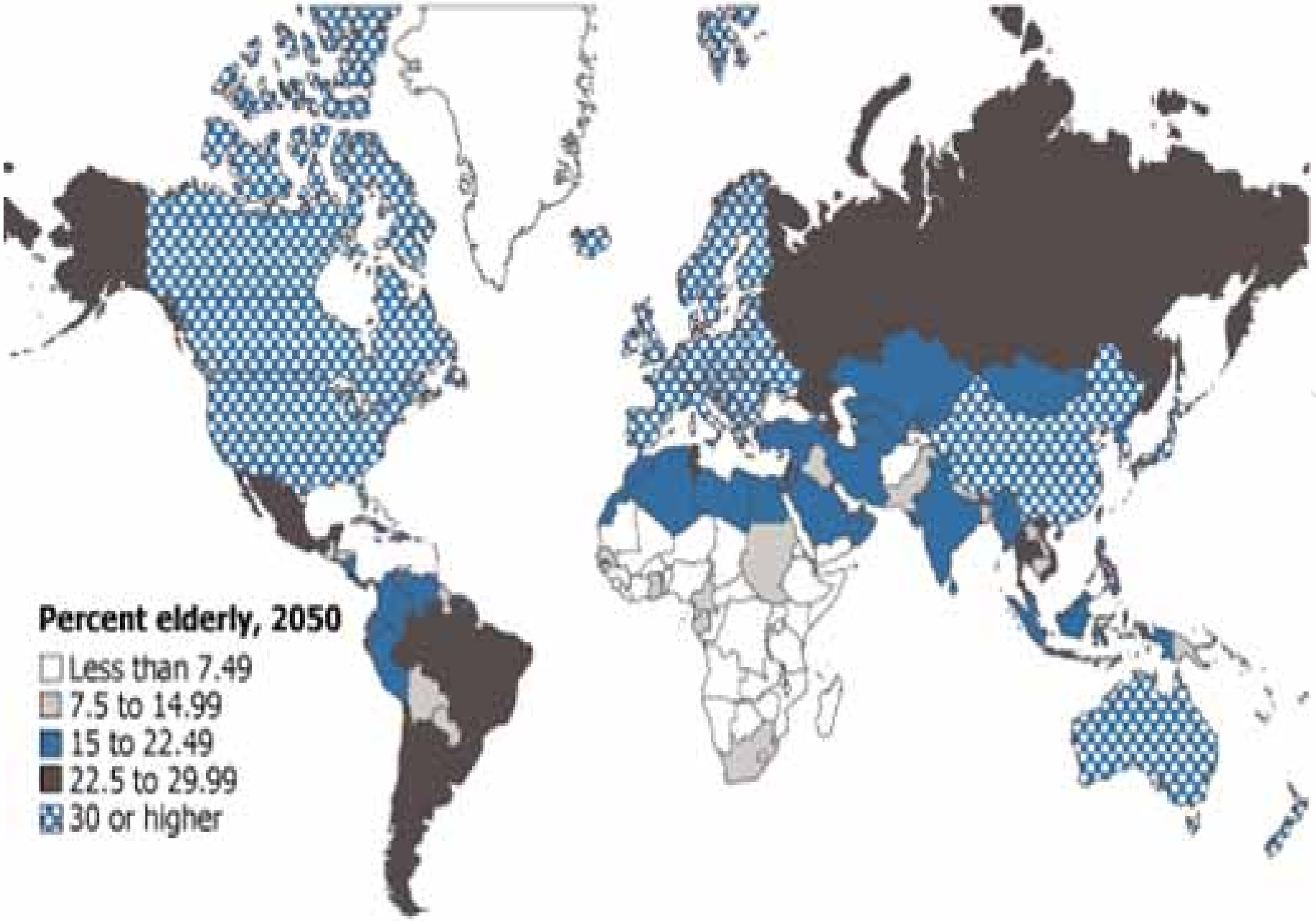
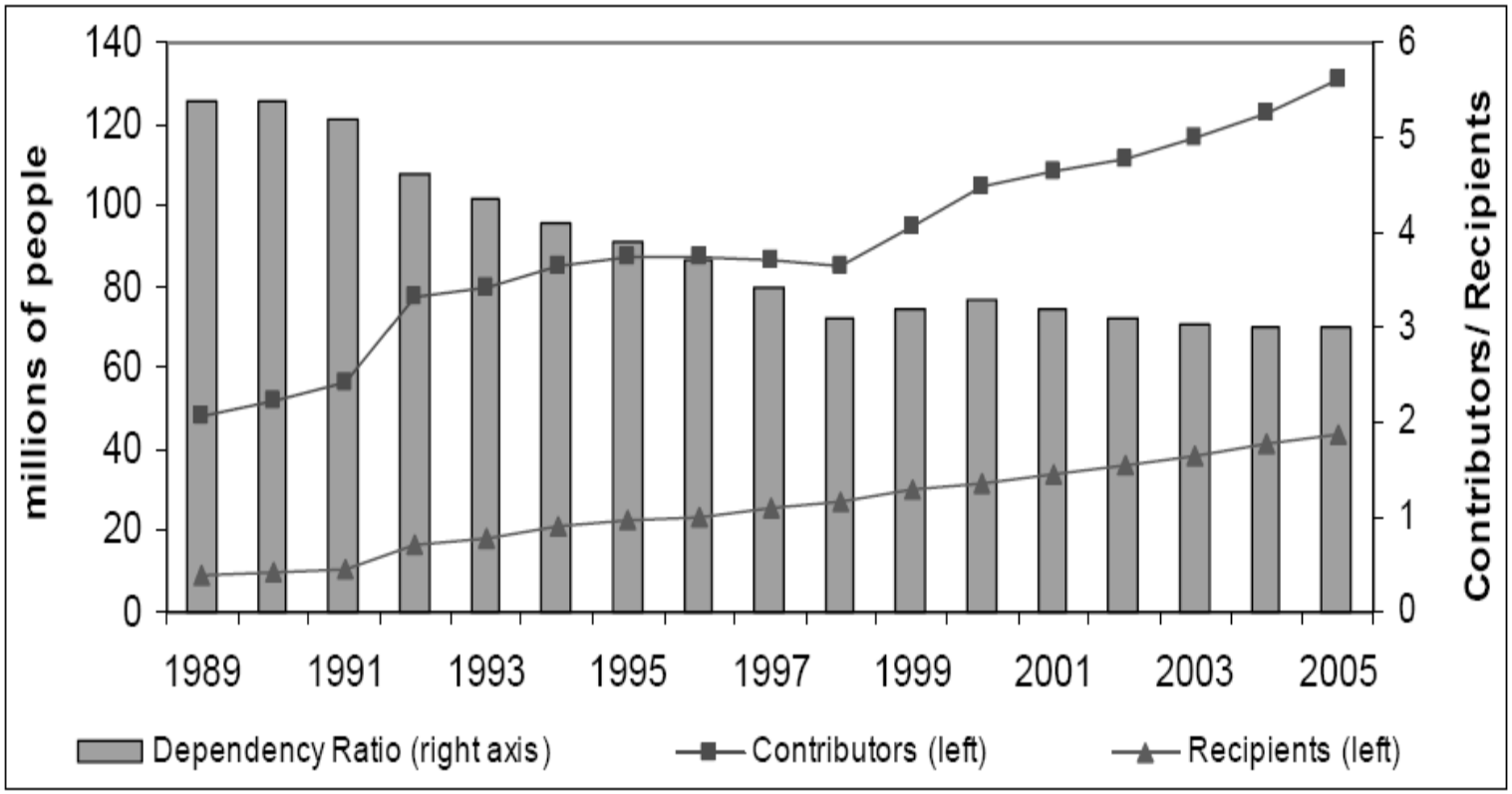


Toshiko Kaneda http://www.prb.org/images/PercentElderly2050.gif



Toshiko Kaneda http://www.prb.org/images3/PercentElderly2050.gif

China pension: trends of system members



Source: CSY 2006.

Special policy in Zhejiang during 2000-2003 and its consequences

- Double – low policy was introduced
- Changed the ratio of contributors to pensioners
- Rapid coverage increase of the system
- Convergence of the two systems in due time with flexible policy guidelines

Survey Results: Retirement Planning

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	Number of people	*Percentage*
From savings	767	22.89%
Family support	187	5.58%
Government pension	1756	52.4%
Other means	232	6.92%
Multiple sources	409	12.2%

Implications for Pensions and Safety Nets

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- Chinese social security can continue to be financed from the contributions of rural immigrants if they become contributors to the pension system, because of rapid urbanisation.
- If this policy (of taking contributions from rural migrants) is pursued, its credibility will depend upon fair treatment on vesting and payouts
- The rural elderly will then be most at risk, because urbanisation leads to family fracture.

Implications for Pensions and Safety Nets

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- In the long term, China will then face an enormous unfunded liability, because of increasing longevity and an increasing aged dependency ratio.
- Yet even now, only about half urban workers are covered by social security.
- Increasing coverage must be important, not only to the rural sector, but also to uncovered urban workers

Implications for Pensions and Safety Nets

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- A safety-net payment to the rural elderly of 1/3 the average urban pension would cost 4.5% of GDP.
- Payment could be targeted to the poor
- Australia has had a targeted safety net for 100 years

Take aways

- Targeted social pensions are a relatively cheap way of closing the coverage gap
- Targeted structures may have less impact on saving and labor supply than universal structures
- Reducing the coverage gap can lead to an explosion in unfunded promises
- Targeting may be a way of controlling the burgeoning potential legacy costs

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Thank you

Questions?

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