Demographic Changes and Social Security Sustainability in China

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Introduction

China's social development over the past three decades has been impressive. The country has universalized compulsory education, expanded participation in post-secondary education, sharply reduced the burden from infectious diseases, and dramatically increased social security coverage. Labor has become more mobile, and the number of rural migrants moving to cities has grown. The "iron rice bowl" social protection system based on work units has been transformed into programs that are being expanded and consolidated.

For all those efforts particularly the achievements in social security coverage, the Chinese Government won the ISSA Award for Outstanding Achievement in Social Security on 17 November 2016. Two days earlier, however, a group of Chinese fiscal experts argued that the social security system in China was not sustainable, who participated at the joint seminar "the Economic Growth under the Aging Population" held in Beijing between the Policy Research Institute of Japan and the Chinese Academy of Fiscal Sciences of China. How is the current situation of social security in China? Can it be adapted to demographic changes in the long run? This paper examines the impacts of demographic changes on major social security programs such as old-age pension and medical care. These programs not only heavily depend on demographic changes but also account for lion's share of total social security expenditures. For the detailed expenditures by program, please see Table 1.

Section 1 of this paper reviews the financial situation of major social security programs in China. The next two sections provide some preliminary explanation for the current situation and future trend in terms of demographic changes. Section 2 examines the direct impacts of demographic transition on social security, and Section 3 analyses the indirect ones through economic growth. Section 4 reviews the historical evolution of major social security programs with a special focus on those existing arrangements to address rapid aging in China. Section 5 provides some international good practices to demonstrate that a dedicated welfare system itself could be a solution for strengthening sustainability, which could strike a good balance between a welfare mix, political trust, good governance, and sustainability. Section 6 provides some further measures that China could take to mitigate the effects of demographic transition at both parameter and structure levels. The end of the paper draws some conclusion.

1 Financial situation of major social security programs in China

1.1 Current situation

According to the 2015 final accounts of social insurance funds in China, the annual revenues were 4.6 trillion RMB yuan and increased by 14.6 percent; while the annual expenditures were 3.9 trillion RMB yuan and increased by 16.5 percent. Thus, the funds had an extra surplus of 0.7 trillion RMB yuan in 2015. It seems that the social insurance programs were still in a pretty good situation.

Of the social insurance system, old-age pension program is the biggest program. At the end of 2015, the accumulated surplus was 5.9 trillion yuan, which would be sufficient for 17 months of pension expenditures nationally, according to the Minister in charge. There seems to be some grounds in the public pension program for optimism as well. The more rapid growth in expenditures than that in revenues since 2009 shown in Table 2, however, suggests that China has got to be cautious about the current situation.

Moreover, as some economists (HU, Jihua，2016；) put it, such a surplus mainly came from government subsidies. The government subsidies to both old-age insurance programs and medical insurance programs were 1.0 trillion RMB yuan in 2015. In fact, the subsidies of governments at various levels to old-age pension schemes have accounted for 16 to 19 percent of total old-age insurance revenues over the past few years. This demonstrates that the current pension programs heavily depend on state subsidies and are not financially independent.

Besides, if examining the balance sheets of individual pension funds by province, it can be see that most of pension fund surplus are accumulated in the provinces of Eastern Region such as Guangdong, Zhejiang and Jiangsu Provinces, and on the other hand, the accumulated pension funds in the provinces in Northeastern Region and Northwestern Region are very small and have been declining over the past few years because the accumulated funds in these two regions have been used to cover the annual pension expenditures.

If debates exist in China about pension fund deficits, it would be no doubt that there are no sufficient capitals reserved in personal pension accounts of individual participants. In 2007 individual accounts were introduced in the pension program for formal employees that should be real accounts by design. It can be seen from Table 3 that the accumulated funds in the public pension program have always been smaller than what have been credited into personal accounts since 2007. At the end of 2015, for example, the pension funds credited into personal accounts were 4.7 trillion RMB yuan, while the total accumulated pension funds were only 3.5 trillion yuan. Thus there was a deficit of 1.2 trillion yuan. Such a gap has been increasing over the past few years, and this trend will continue in the future. In a sense, the current personal account in the pension scheme is only a notional one.

1.2 Financial situation in the future

If the personal accounts are established as real ones, then the current deficit at the end of 2016 was about 2 trillion RMB yuan and it would increase to 8 to 10 trillion yuan in less than 10 years, according to a research group of Tsinghua University (2016). The ratio of pension deficits to GDP would have increased from less than 2.7 percent to more than 5.4 percent in 10 years.

In a much broader sense, the implicit pension debts in China were 18.3 trillion yuan in 2013 (Bank of China, 2014). This is the total obligations that public pension schemes promised to participants but without accumulation of assets. Such a debt accounted for about 1/3 of GDP in 2013. According to an estimation of Ministry of Finance and Zhejiang University (2016), the implicit pension debts in China would reach 220 trillion RMB yuan in 2050, equivalent to 31.2 percent of GDP in the same year.

Besides the pension fund deficits, some studies (Yang, 2015) suggest that the annual revenues of medical insurance schemes could not cover the annual expenditures in the near future.

2 Impacts of demographic changes on social security financing directly

2.1 change in age structure

According to the Ministry of Human Resources and Social Security (2016), number of pensioners at the end of 2015 increased 6.5 percent, while number of active contributors only increased 2.7 percent. The trend of more rapidly-growing pensioners has lasted since 2012. As a result, the ratio of active contributors to pensioners has been declined over the past 4 years. It was reduced to 2.88:1 in 2015.

East Asia and Pacific region is aging more rapidly than any region in history (World Bank East Asia and Pacific, 2016). The transition from young to old societies took 50 to more than 100 years in OECD countries, while it will take 20 to 25 years in almost all middle-income countries in the East Asian region.

China is no exception compared to both high-income countries and middle-income countries in this region. China has experienced the kind of fertility transition over the past 40 years that typically took more than 100 years in developed countries (Uhlenberg, 2009). With rising life expectancy and the dramatic drop in total fertility rate to only around 1.5. Looking ahead, the share of people age 60 and over in the total population will accelerate in coming decades, from around 12 percent in 2010 to almost 25 percent by 2030 and to more than 33 percent by 2050. By 2030, China's population share over age 60 is expected to be just under the OECD average.

Besides the share of older population, the share of working-age population is equally important for contribution-based social security programs such as old-age insurance program and medical insurance programs in China. Between 2010 and 2040, the share of the working-age population will fall by at least 10 percent in China, according to a UN projection (2005).

Compared to high-income economies, however, China is "getting older before getting rich" as many other middle-income economies in this region. As the country ages, the labor force is expected to peak around 2015, with dependency ratios rising rapidly thereafter. A projection of the Ministry of Human Resources and Social Security suggests that this ratio of pensioners to active contributors in the pension program for formal employees would decrease to 1.3:1 in 2050.

These trends put not only pressure on the social insurance programs but also put a premium on deepening human capital to enhance labor productivity, place additional demands on education and training systems, and heighten the importance of allocating labor efficiently. Aging has also transformed the disease profile toward non-communicable diseases, requiring a shift from curative to preventive care and better health education. It is not an easy job for any governments to strike a good balance between coping reactively with the immediate problems and preparing proactively for the emerging issue. As reviewed later, the Chinese Government has made some efforts in both directions.

2.2 Rapid urbanisation

The basic challenges are further complicated by rapid urbanization in China. China's urban population grew from less than 20 percent of the total population in 1980 to almost 50 percent by 2010 and is expected to grow to around two-thirds by 2030. This growth has contributed to structural transformation and higher productivity and will continue to do so, facilitated by easing of population mobility restrictions in the *hukou* system. However, the failure to address entitlement reform for migrants through incomplete reforms of *hukou* and the ongoing challenges of managing farmers who have lost their land to urban expansion has resulted in a fundamental segmentation between the local and the nonlocal *hukou* populations. The social compact with migrants in urban areas remains for the most part different from that with local urban populations. Disparities in social entitlements that the original population of “floating” migrants was willing to accept will become harder to justify to second-generation, “permanent” migrants. Deepening reform of the *hukou* system to reduce social stratification and equalize entitlements for local urban and migrant populations presents major challenges, the resolution of which will have a major bearing on the social and fiscal sustainability of further urbanization (World Bank and DRC, 2013).

Rapid ageing would be more challenging in rural areas in China than in urban areas. The old-age-dependency ratio in China will increase at an almost unprecedented rate over the coming decades, with more than one in every three residents in rural areas and more than one of every five in urban areas being 60 or older by 2030. The emerging “4-2-1” extended family pattern of four grandparents, two parents, and one child will put deepening strains on family support networks. Aging will also challenge many social security programs for informal groups, in particular pensions and health care programs for non-working population in China.

2.3 Epidemiological transition

A final demographic challenge will be sustaining a healthy and productive population in the face of epidemiological transition and the growing epidemic of non-communicable diseases. Chronic illnesses such as heart disease, diabetes, and cancer are already the number one health threat. They accounted for more than 80 percent of the 10.3 million deaths annually and contributed to 82 percent of the total disease burden (WHO, 2009). Around half of the non-communicable disease burden is among those of working age, with significant costs to the economy. Urbanization and aging will accelerate a rapid increase in the prevalence of non-communicable disease over the coming decades, implying a major increase in demand for both curative and preventive health care. It will also require reorientation of the health delivery system in the face of more complex case management needs. If not addressed, health care costs could escalate rapidly, and labor productivity could be compromised. Rapid aging will make the need for health system reforms even more urgent.

2.4 Low compliance from the labour markets: more to do with state power than ageinng

While urban labour markets have seen a massive influx of migrant workers, they have also witnessed substantial declines in labour participation rates among local urban workers. Particularly, the decline among older workers has been a long term phenomenon and has continued after the main wave of state-owned-enterprise (SOE) restructuring. Even more striking is how early urban women withdraw from the labour force, with only around 30 percent labour force participation by the official retirement age of 55.

On average, people work until late in life in China, but many people in urban areas stop working relatively early, and some groups (such as urban Chinese female workers) retire very early (only about one-third are still working at age 60). Withdrawal of urban people from work is clearly correlated with access to a formal sector pension, though care-giving responsibilities for grandchildren and other elderly also play a role in the early withdrawal of urban women from formal work.

Besides, according to former Minister of Finance (2016), the average wage for social insurance contributions only accounted for 70 percent of average wage in the broad economy in 2015.

3 Impacts of demographic changes on economic growth and thus social security indirectly

The changes in age structure brought about by baby booms and ageing place new demands on national and international policy making. Transitions from high mortality and fertility to low mortality and fertility can be beneficial to economies as the large baby boom cohorts enter the workforce and save for retirement. Rising longevity, meanwhile, has perhaps increased the incentives to save for retirement. The realisation of the potential benefits associated with the demographic changes and the mitigation of the negative effects of ageing depend crucially on the policy and institutional environment in which these changes occur.

3.1 Realizing the population dividend

As Bloom and Canning (2006) put it, capturing the demographic dividend is not inevitable, however. The policy environment in which the baby boom takes place is crucial for converting it into economic growth.

In China, fertility fell quickly in the 1960s and 1970s. The boom generation in a strict sense was those born from 1962 to 1972. There were nearly 300 million newly-born babies over this period. The consequent decline in the dependency burden enabled China to begin collecting a demographic dividend in the 1980s and 1990s. China captured its demographic dividend partly because it provided a high-quality education to the baby-boom generation during the command economy. China continued to clear the path for the boom generation as it moved into the labour force. China carefully opened up to international trade, thus creating new employment opportunities for its rapidly-growing working-age population; it did not strictly enforce labour-market regulations, particularly at local levels; and it encouraged savings and investment.

The end of the demographic dividend and exhaustion of the rural labor surplus will shift labor market dynamics. A source of growth in the reform era has been an expanding labor force, rising from under 600 million people of working age (15–64) in 1980 to around 990 million in 2012. This trend will reverse starting around 2015. The decline in the working-age population will not really take hold until around 2030, when it will drop dramatically from just over 1 billion in 2026 to 850 million by 2050. The aggregate decline in the labor force is exacerbated by the rapid decline in rural surplus labor, which has until recently provided an unlimited source of cheap labor. Although the precise timing remains disputed, most researchers accept that China is at or nearing the Lewis turning point of exhaustion of the rural labor surplus, and the remaining rural working-age population may be too old, sick, or disinclined because of family obligations to migrate to urban areas. The combined impact of a declining labor force, exhaustion of the rural labor surplus, and rapid aging means that productivity growth per worker will become critical as China seeks to move up the value chain. At the same time, in the short run, low-skilled workers could benefit from the shift in supply and demand in the labor market, which might provide negative incentives to investments in human capital beyond junior high level.

3.2 Economic slowdown and "New Normal"

Just as growth is expected to slow in some emerging markets over the coming two decades, many signs point to a growth slowdown in China as well (Liu et al., 2011). Indeed, GDP growth is expected to decline gradually from an average near 8.5 percent in 2011–15 to around 5 percent in 2026–30. One reason for the slowdown is that much of the growth contribution from shifting resources from agriculture to industry has already occurred. Moreover, China is poised to go through rapid demographic change: the old age dependency ratio will double in the next two decades, reaching the current level in Norway and the Netherlands by 2030 (between 22 and 23 percent); and the size of China's labor force started shrinking in 2015. Yet workers will become more productive as physical and human capital stock per worker continues to rise. Finally, total factor productivity (TFP) growth—a measure of improvements in economic efficiency and technological progress—has also declined, in part because the economy has exhausted gains from first-generation policy reforms and the absorption of imported technologies. As a result, the distance to the technological frontier has shrunk, and second-generation policy reforms are likely to have a smaller impact on growth, which are more difficult to be pushed through.

These factors, together with “rebalancing” policies to emphasize domestic growth sources, will contribute to a higher share of services and consumption in the economy and a lower share of exports, savings, and investment. The challenge will be to support these growth and structural transitions while avoiding sudden slowdowns and possible crises. As countries reach middle-income levels, the underemployed rural labor force dwindles and wages rise, eroding competitiveness. Productivity growth from sectoral reallocation and technology catch-up are eventually exhausted, while rising wages make labor-intensive exports less competitive internationally. If countries cannot increase productivity through innovation (rather than continuing to rely on foreign technology), they find themselves trapped.

There is broad consensus that China’s growth is likely to slow; annual average growth over the next 20 years is expected to be one-third less than annual average growth for the past 30 years (6.6 percent versus 9.9 percent). While this will be enough to drive China into high-income status by 2030, there is no saying whether this slowdown will be smooth or not. Any sudden slowdown could expose inefficiencies and contingent liabilities in banks, enterprises, and various levels of government—heretofore hidden under the covering of rapid growth—and could precipitate a fiscal and financial crisis (World Bank and DRC, 2013). The implications for social stability in general and social security in specific would be hard to predict in such a scenario.

3.3 Mitigating the effects of ageing

As Bloom and Canning (2006) argue, market responses are likely to mitigate some of the effects of ageing. Reduced labour supply will push up wages, encouraging new entrants to the labour force. Women, older workers and even the younger elderly, for example, may be attracted into work, and inward migration is more likely to be accepted by the aged society.

These responses will only be effective, however, if they are not hindered by policy. Restrictive labour regulations are one barrier, particularly if they make hiring and firing workers, working part-time or paying market wages difficult. This is not a big issue in China. However, many existing social security programs penalise individuals who wish to work beyond a fixed retirement age through high taxation rates. This has exacerbated labour shortages in urban China. Currently, Pensions are not taxable incomes and, moreover, pensioners do not need to make contributions to medical insurance programs while enjoying higher rate of reimbursement for medical care expenses compared to working-age population.

In addition to labour market reforms, addressing the financing of retirement will be a key task. Population ageing will require increased savings. This will affect financial markets, rates of return and investment. In order to ensure adequate financing for the retirement needs of older people, methods for dealing with systemic risk in financial markets will have to be developed. In this regard, China is still in the process of learning while there is a very high risk in the stock market, which has not been mature yet.

Healthcare costs, too, are likely to increase rapidly as more people move into old age. Healthcare programs will expand and long-term care for the older people will grow in importance. These sectoral changes may have effects on economic growth – as non-tradable, labour-intensive sectors that have a low rate of technical progress, healthcare and eldercare may affect the structure of the economy, potentially slowing growth.

In general, countries which have financial institutions that best channel savings to productive investments, along with labour market institutions and policies that best facilitate domestic as well as international supply responses to labour shortages and high wages, will be well-placed to mitigate the adverse consequences of population ageing. The economic impacts of ageing, like those of a baby boom, are far from immutable. Responsive policy will help societies make the best of both processes. In the case of China, it is necessary to change the preferential social security policies for pensioners and to establish a more reliable financial market for coping with the effect of rapid aging. On the other hand, however, commercialized pension funds could arguably be an important stable factor for the fragile stock market in China.

4 Policy evolution and arrangements for coping with rapid aging in China

4.1 Pension Policy

During the command economy, old-age pension for state-owned enterprise (SOE) workers was one of the benefits covered by the 1951 Regulations on Labour Insurance. Also for the government employees, their benefits were almost the same as the SOE workers. For most peasants, however, there were no pension schemes for general population. In fact, there were only pension schemes for those peasants of "Three Withouts", which was referred to those households without family members, without living resources, and without working capacity. For this special group, local communities, together with some state subsidies, provided Five Guarantees to meet their needs of food, clothing, housing, medical expenses as well as funeral expenses.

Besides pensions for old-age, the 1951 regulations on Labour Insurance also cover many other contingencies such as birth, sickness and medical care, death, injury and disability.

Immediately after the liberation in 1949, a comprehensive labor insurance scheme was introduced both political and economic reasons. Chairman Mao Zedong had argued for this and he said that “peasants after liberation have got a piece of land, and urban workers could have labor insurance to alleviate their financial difficulties, although increase in wages is impossible for the sake of restoring production.” If wages has been immediately increased for all workers, it would have been too costly for the broad economy, which had been destroyed after roughly 30 years of consecutive wars in China. As Chairman Mao said, however, the working class needed to be mobilized. To achieve this goal, labour insurance for various contingencies was chosen as an important solution.

After the economic reform, in particular the SOE reform, pension obligations had to be decoupled from enterprises. The delinking itself, however, had caused the problem of compliance of enterprises and their employees. To address this newly-created problem, personal account had been introduced in the social insurance pension schemes. Since neither notional nor real accounts failed to motivate the contributors, the state had to turn to other instruments for help such as an incremental increase in pensionable ages. This initiative has met strong resistance from the participants of enterprise pension schemes partially because the gap in benefits between enterprise workers and government officials had been widening over the reform years. Then the government decided to merge the schemes for the two groups. Now there is a single scheme for working population.

To cope with the rapidly-ageing population, the National Social Security Fund, and a partial-funding pension system have been established for enterprise employees in the 1990s.

For the nonworking population, there were sparse schemes for peasants in some rich villages in the period of command economy. After the economic reform, the young generations are more likely to move to urban areas, rural households would feel the negative impact of changing age structure earlier than their urban households. Therefore, rural pension initiative has been gradually brought onto the government agenda. In the 1990s the government announced pension pilots for peasants. Then the pension schemes were eventually accepted by the central government in 2007. Since rural nonworking population had got a pension, a similar scheme was also launched for urban non-working population in 2011.

4.2 Health Care Policy

During the command economy, healthcare was provided through a public health network and a work unit-based network. In terms of financing, medical services or drugs were heavily regulated. The prices could be below the production costs. Together with financial protection schemes, the patients could get the drugs or services at a very low price. For those working in urban areas, they were eligible to medical care benefits under labor insurance regulations. For those working in the rural areas, they were covered by medical cooperative schemes. On the supply side, however, there was a big shortage of professional workers and pharmaceuticals in the 1950s and 1960s. To address this problem, the system of "barefoot doctors" was created. The film of "Spring Seedlings" told the story of a barefoot doctor who learned some basic medical service knowledge and served their community members. This initiative was part of Chairman Mao's rural development programme. On 25 June 1965, Chairman Mao argued that the healthcare system should shift its priority to the rural areas. The Ministry of Public Health in the past had focused too much on the urban areas and the rural areas had lost attention for too long since the Liberation at the end of 1940s.

After the reform, the priority of health care for the first ten year from 1979 to the end of 1980s was to increase supply by liberalising the regulations on market entry, and by expanding the autonomy of public providers. Then private doctors could open clinics, and public providers in particular public hospitals were motivated to work hard. The liberalization had helped to relieve the shortage problem but at the same time created an oversupply problem or supplier-induced services.

Over the next decade from the end of 1990s to beginning of 2000s, medical costs had risen rapidly because of oversupply. Then the state had adopted a market-oriented approach to this problem by encouraging competition in the medical service sector. On the demand side, the state had established basic medical insurance schemes for urban employees by delinking medical expenses from individual enterprises in urban areas as well as attempted to restore medical cooperative schemes for peasants. When the SOEs became financially independent bodies in the 1990s, it was essential to delink all social obligations from enterprises. After the economic reform in the rural areas, particularly after the introduction of the household responsibility system, the medical cooperative schemes had lost its economic basis in the rural areas. In a changing context, many stakeholders had attempted to restore it.

Coping with the increased medical costs in the 1990s, the government is trying to introduce more market competition on the supply-side, and, on the demand side, to establish more medical insurance schemes for informal working population and non-working population.

Over the first 10 years of the new century, the government continued to consolidate the financial protection schemes for urban and rural citizens. At the same time, on the supply side, health care policy began to put emphasis on strengthening the capacity of community-based providers and regulating the pharmaceutical prices. During the command economy, there was a referral system in the health service system. But after the reform, the referral system was abolished for the sake of competition. Because the tertiary hospitals have got the strongest position in the service system and, moreover, they were motivated to provide more services, tertiary hospitals had become bigger and bigger. They had attracted better doctors and more patients. Unnecessary demand of ordinary patients at tertiary hospitals had caused accessability and affordability problems for all. Obviously, the tertiary hospitals could not do everything. Then the government attempted to strengthen the community center and also to regulate the basic drug supply and use.

In more recent years, the government has put more emphasis on supply-side reform to eradicate profit-seeking behavior of large providers, which was recognized as the dominant factor for most problems with the health care services in China. Besides, the government has begun to merge the financial protection schemes for various population groups. Now for the non-working population there would be a single financial protection scheme for everyone in the near future.

5 Learning from industrialized countries: a dedicated welfare mix itself as a facilitator for sustainability

5.1 Essential for China to study how to strengthen infrastructural powers through effective social provision

With modernization, as Mann (1984) puts it, the despotic power of a modern state should be declining while its infrastructural power should be increasing. The latter refers to the capacities of the state to interfere in daily life of the general public and to translate its decision into practice. According to the measurement of Fukuyama (2013), the infrastructural power includes the capacities of the state to register population, to collect taxes and to provide public services.

Social policy is concerned with all the key elements of the infrastructural power defined above. It must follow the target population, must mobilize resources and it provides most of public services. Therefore, there is a natural linkage between social policy and modern state-building.

Since social policy is a very broad field with many policy areas, it is almost impossible for any countries to do everything ideally within the constraints of limited governance. In other words, all countries have to define their own packages of social policy programs and prioritize them. In the United Kingdom, for example, national health services have been the top priority, while benefit rates of public old-age pensions are quite limited. By contrast, social security pension program has been a higher priority than the universal coverage of health care in the United States. Other industrialized countries have also chosen their own landmark programs in the social policy field, such as social insurance in Germany, public housing in Singapore as well as equalization in basic education in both Japan and Korea.

For a generalized account of special welfare regimes, it is worthwhile to read Esping-Anderson (1990) for the three worlds of welfare capitalism in the West and to read Aspalter (2006) for the Eastern Asian Welfare models. For the more details of welfare mix including the choice of landmark programs in individual case countries, it has more to do with specific paths of individual countries.

In the Chinese history, the concept of “state” has long existed for so many years. In the long history of feudal society, however, the state was just a kind of cultural recognition and the emperor was far from the grassroots. In fact, the traditional state power had never reached effectively out to the communities at below county level (Liu, 2007). In the first thirty years after the liberation, recognition of identity was changed from clans to working units or collectives. In the second thirty years of New China after the economic reform, it was changed again from working units to localities. In many senses, there is lack of state recognition in China and the Central Government has never provided any public services directly to all the citizens.

Arguably, the Chinese state has been very strong already. This argument is partially correct. Indeed, the despotic power has been quite strong. In reality, however, its infrastructural power is very weak. The governments at various levels, in particular the Central Government, do not know the demographic changes of individual localities and individual households, do not have the information on the incomes and assets of individual households. The is the major factor for a very low compliance rate of public pensions, which has been less than 70 percent over the past decades. This has also caused inclusion and exclusion errors for minimum living standard schemes, which have been as high as 50 percent.

To address these problems, the Chinese Government has put forward recently the modernization of structure and capacities of state governance. Besides, it has also proposed to increase and equalize essential public services. What is lack in China, however, is to establish the linkage between social policy and state-building. The all selected cases have demonstrated that national welfare programs could help to establish national recognition and at the same time to consolidate the infrastructural power of the state.

5.2 A landmark program to be established to define the national character

Except those Nordic countries with very good governance, no countries could establish a comprehensive welfare system to cover all policy areas. In reality, this may not be necessary at all because the households would be in a very stronger position to deal with the remaining risks if the state could have helped them to avoid a couple of major risks in their life cycle.

As mentioned above, there is a landmark program in each of the selected countries. Compared to other social policy programs, the coverage of beneficiary would be much broader, the benefit rate would be higher, and social equity element would be stronger in the landmark program than other programs.

The selected country cases suggest that it is very hard to generalize how to single out a landmark program from a broad social policy field because the same program could be a landmark in a country but would be marginalized in the other countries. For basic education, both Japan and Korea have taken a universal approach to equalization, but most countries have taken a targeting approach to equalization. That is to say, they only guaranteed posts in the public schools for the most vulnerable groups. For health care, United Kingdom, like many other European countries, has adopted two basic principles of “universal for all” and ”free of charge at point of use of services”, while the United States has adopted a segmented approach. For social housing, almost all industrialized countries have taken a target approach, while Singapore has adopted a universal approach. For old-age pension, British public provision aims to alleviate poverty in old age, while German public provision aims to maintain living standards of older people after retirement.

Although the choice and practices are different among the country cases, there are several common principles for the selection of landmark programs. First, a country should concentrate limited fiscal and governance capacities on a couple of programs. Secondly, the selected program should not only resolve a top livelihood issue but also be helpful to strengthen the governance capacities of Central Government. Besides, it would be more sustainable to select social investment programs such as education and health care as landmark programs rather than social consumption programs such as pensions and social assistance in catch-up economies.

Following these principles, it is worthwhile for China in particular the Central Government to consider limiting its focus of social policy efforts to a few of social investment programs such as equitable basic education and health care for all. Over the past two decades, particularly in the first ten years of the new century，the Chinese Government has been quite ambitious to do everything too soon. Besides new initiatives in basic education and social housing, as a joint report between World Bank and DRC (2013, pp.336-37) suggest, China has introduced a good number of social protection programs since the late 1990s at a speed that is unprecedented internationally. Those include pension and health insurance programs for urban and rural populations; unemployment, sickness, workplace injury, and maternity insurance for urban formal sector workers; and a national social assistance scheme that now covers around 70 million people. On the other hand, however, it is up to local authorities to enforce all these programs. Due to insufficient fiscal and human resources as well as lack of willingness to enforce the related regulations in their territories for the sake of local business, the implementation has not been so good as originally planned. As a result, this has caused dissatisfaction among the general public about the slow progress and regional disparity in specific. Both the broken promise and regional disparity have in fact damaged the trust in government and the national recognition, i.e. one of the policy objectives. Now it is time for the Chinese Government to concentrate its efforts on promoting equitable basic education and health care for all, or equal opportunity for all. It should increase investment in these two areas, could establish its own local branch offices to supervise the related services, and even hire its own workforce for the service delivery. At the same time, it should retreat a little bit from all the other policy areas, or should delegate most of the related responsibilities to local authorities or the market.

Of course, even for the delivery of the landmark programs, the Central Government could purchase services from civil society organizations or market providers in medium and large cities where competition could be more effective than that in small towns and remote rural areas and alternative organizations are available. In the German case, for example, social insurance was subject to the federal legislation and the related adjustment funds have been established to even the risks among industrial groups. Its management and delivery has been the responsibility of self-governance bodies incorporating the representatives of employers and employees. In the case of

Korean basic education, for another example, the leveling policy has been legislated at the central level, but even a private school can get the funding from the central government if it follows the leveling rules.

6 Towards a more sustainable social security system adapted to a changing demographic context

6.1 Policy changes in program parameters to mitigate the effects of aging

China will need to mitigate the labor supply and fiscal effects of rapid aging through ongoing reforms of pension and health systems and labor policies to extend the working lives of urban formal sector workers during the process of rapid urbanization.

As a World Bank report (World Bank East Asia and Pacific, 2016) suggests, channels for mitigating the effects of aging on the labor force include the following:

• Extending productive working lives through labor market and social security policies. China could gradually raise retirement ages and reverse incentives for early retirement; incentivize workplace adjustments to accommodate older workers (through, for example, flexible and part-time work arrangements and midcareer skill upgrading); and promote attitudinal change among employers. China could also reform labor market institutions such as seniority wage systems, which create barriers to productive employment of older workers.

• Raising female labor force participation, with an emphasis on making child care available and providing subsidies to make it affordable. The experience of richer East Asian and Pacific economies that adopted measures to promote female labor force participation demonstrates the challenges of shifting strong gender norms in the region. Besides phrasing in gender equalization of retirement ages, China could learn from good practices in both childcare and eldercare in this region.

6.2 Further structural reforms to mitigate the effects of aging

In response to these challenges, this paper argues that in the coming decades China needs to prioritise social policies that promote equality of opportunity with security. Social policy will need to focus on human capital development, assisted with basic social welfare without welfare dependency. Simply stated, all citizens should have equality of opportunity in education, health, employment, and entrepreneurship; and security from deprivation through a moderate but sustainable social protection system, together with care services for the aging population.

To achieve these objectives, China needs to develop a vision, core values, and guiding principles for social policy development and social harmony. The paper argues that China could benefit from its particular blend of social and economic characteristics.

China could choose the “active welfare society” (also called “developmental welfare”) model. Underpinning such a model would be the need to develop consensus on a common set of underlying values. These include social equity and justice for all; acceptance that society should help to meet basic needs for all, especially for the poor and vulnerable; respect and care for family members; maintenance of a strong work ethic and avoidance of welfare dependency; development of the professional ethics of service providers; and the sharing of responsibilities among the state, communities, families, social organizations, and the private sector.

In moving toward such a model, an overarching question will be what level of social services and protection the state should aim to finance. International experience suggests that social spending accounts for the bulk of incremental public expenditure as countries grow wealthier. At the same time, additional government-financed social services and social protection should be undertaken with considerable caution and with a strong focus on efficient public spending. In striking this balance, China will need to avoid the difficult situation that many advanced countries face from unsustainable entitlement programs. The key elements of such a social policy model—some of which are already emerging—are:

- Equitable and effective social services that build human capital for a healthy and productive population.
- Flexible and secure labor and entitlement policies and institutions that not only promote an internationally competitive workforce but also ensure that workers share in growth and maintain basic protections.
- A basic but secure social protection system that provides for a moderate level of security for all while respecting fiscal constraints. By 2030, China would have full coverage of sustainable pension and health insurance systems, with more reliable security from all schemes and greater integration of all subsystems. In addition, China would have a well-developed system of aged and long-term care services that draws upon the human and financial resources of all stakeholders and provides a minimum level of service for the poor. Finally, the safety net for the poorest and most vulnerable would have greater coherence between different parts of the social protection system, providing acceptable coverage of benefits for poor households without at the same time creating “poverty traps” for the near poor.

Conclusion

The major social security programs in China such as old-age pension and health care have already been confronted or will confront with sustainability problems. With almost highest overall contribution rates for major social security programs, they are not currently self-financed and, in fact, have become increasingly depended on government subsidies. Moreover, financial protection of older people in urban areas has been heavily depended on the government alone. In the future, the implicit pension debts could account for as high as 1/3 of national GDP, and maintaining the balance for health care would also be a big concern very soon.

The sustainability problems could be partially attributed to rapid ageing in China. Most of these problems, however, have been caused by other factors including pro-pensioner policy design, and low compliance from the labour markets due to weak state power. Good practices from selected modern countries demonstrate that the latter could be strengthened by a well-defined welfare mix with a good choice of landmark program.

To improve the sustainability of major social security programs in China, this paper thus recommends that China take a new approach to welfare development, which should different from the approach over the past 30 years.

While China's social policies have achieved some measure of success in the past 30 years, simply doing more of the same is unlikely to be sufficient as the country faces new challenges. The more complex challenges require greater collective action across regions and social groups in situations where interests diverge. They also require shifting emphasis from welfare expansion to prioritization, from quantity to quality of services, from input to outcomes of programs, and from government dominance to co-governance arrangements for social services that are complex to achieve and monitor. In this process, public resources need to be used more efficiently, along with structural shifts in policies and delivery systems; the country must recognize that the state cannot "do it all." Implementing the necessary social policy reforms will need strong and sustained commitment to manage vested interests within the social sectors and beyond.

This paper argues that China could spend more money for those areas with more nature of social investment, and could also put greater emphasis on equity in those areas to integrate more equity elements or factors. But for remaining areas, like pensions, the qualifying conditions for benefits could be much stricter. The government could take a bottom-line approach to this. If the government could really spend more money to equalize education, and healthcare, then individual households would have the capacity to help themselves on pensions, old-age pension support and also on the minimum living standards, and other needs with more nature of social consumption. More importantly, growing human capital stock and ebabling participation in labour markets would be a fundamental solution to addressing rapid-ageing in China, which has been growing old before growing rich.

Table 1:
Revenues and Expenditures of Social Security Programs in China, 2015
(billion yuan)

Social security programs	Revenues		Expenditures	Surplus
	Total	State subsidies		
1 social insurance programs	**4635.4**	**1014.9**	**3911.8**	**723.6**
old-age insurance for employees	2655.4	389.3	2309.2	346.2
old-age insurance for residents	287.9	204.4	213.5	74.4
medical insurance for employees	892.6		738.6	154
medical insurance for residents	540.5	421.2	478.5	62
work-injury insurance for employees	72.9		57.6	15.3
unemployment insurance for employees	136.5		73.7	62.8
maternity insurance for employees	49.6		40.7	8.9
2 social assistance programs	**186.1**	**186.1**	**186.1**	
urban minimum living standard	71.9	71.9	71.9	
rural minimum living standard	93.2	93.2	93.2	
social support for special groups	21	21	21	
3 Social housing programs	**1454.9**		**1108.3**	**346.6**
housing provident funds	1454.9		1108.3	346.6

Sources: 1. Ministry of Finance (2016): The 2015 final accounts of social insurance funds in China; 2. Ministry of Civil Affairs (2016): The 2015 statistical report on social service development; 3. Ministry of Housing and Construction (2016): The 2015 statistical report on housing provident funds.

Table 2: Differences in Growth between Annual Revenues and Expenditures of Public Pension Programs in China

Year	Revenues		Expenditures		Gap in growth (R%-E%)
	Yuan(b yuan)	Growth(%)	Yuan(b yuan)	Growth(%)	
2000	227.8	15.9	211.5	9.9	6.0
2001	248.9	8.8	232.1	9.7	-0.9
2002	317.2	27.4	284.3	22.4	5.0
2003	368.0	16.0	312.2	9.8	6.2
2004	425.8	17.8	350.2	12.2	5.6
2005	509.3	19.6	404	15.4	4.2
2006	631	23.9	489.7	21.2	2.7
2007	783.4	24.2	596.5	21.8	2.4
2008	874	24.3	739	23.9	0.4
2009	1149.1	18.0	889.4	20.4	-2.4
2010	1342	16.8	1055.5	18.7	-1.9
2011	1689.5	25.9	1276.5	20.9	5.0
2012	2000.1	18.4	1556.2	21.9	-3.5
2013	2473.3	13.3	1981.9	18.6	-5.3
2014	2762	11.7	2332.6	17.7	-6.0
2015	3219.5	16.6	2792.9	19.7	-3.1
2016	3799.1	18.0	3400.4	21.8	-3.8

Sources: Ministry of Human Resources and Social Security, various years.

Table 3: Growing Gap in Funds between credited and actually accumulated in the Chinese public pension programs

Year	Funds credited into personal accounts (Trillion yuan)	Actually accumulated funds (Trillion yuan)
2007	1.1	0.7
2008	1.3	0.9
2009	1.5	1.3
2010	1.8	1.5
2011	2.2	1.9
2012	2.6	2.4
2013	3.1	2.8
2014	3.6	3.1
2015	4.7	3.5

Sources: Ministry of Human Resources and Social Security, various years.

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