China's Social Security: Current Status and Future Direction (U.S.-China Relations Study Group Commentary No.15)

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It has been announced that the total population in China in 2022 has decreased. With the declining birthrate, aging population, and increasingly severe fiscal constraints, how is China planning to make its social security system, including old-age security, sustainable in the future? In the following, we examine this issue from the perspectives of population, finances related to social security, and the use of the private insurance market.

1. Around 2035, one out of every three people will be the elderly

In January 2023, National Bureau of Statistics of China announced that the total population at the end of 2022 decreased from the previous year. The total population decreased by 850,000 from the end of 2021 to 1.41175 billion, as the number of deaths (10.41 million, up 270,000 from the previous year) exceeded the number of births (9.56 million). China is facing a "declining birthrate cliff," in which the number of births is declining rapidly, and a "low fertility trap," a situation in which it is difficult for a society with a prolonged low fertility rate to make the transition to an improved fertility rate.

Furthermore, National Health Commission of the People's Republic of China, in the Communist Party newspaper, *Qiushi*, published in August 2022, mentions that around 2035, society will be made up of more than 30% of the population aged 60 years or older. China is expected to reach a society in which one in three people will be elderly in just the next decade or so.

Meanwhile, life expectancy in China is increasing. According to the United Nations World Population Prospects 2022, life expectancy in 2021 is 78.2 years (75.5 years for men and 81.2 years for women), an increase of 5.6 years (5.3 years for men and 5.9 years for women) from 2001, 20 years ago. In addition, life expectancy (e.g., at age 65) has increased by 2.0 years (1.5 years for men and 2.4 years for women) compared to 2001. This means that longer life in old age poses a "longevity risk," exceeding assumptions regarding insurance and pension funds.

In addition, around 2022, men of the baby boom generation (age 60), whose birth rate peaked in 1963, will have reached retirement age. Thereafter, mass retirement will continue for about 10 years, and the Chinese authorities estimate that 40 million people will transition to the elderly population between 2021 and 2025. The number of elderly people is expected to increase rapidly, which will increase the pressure on old-age security and pension benefits.

2. Largest national expenditure is for social security

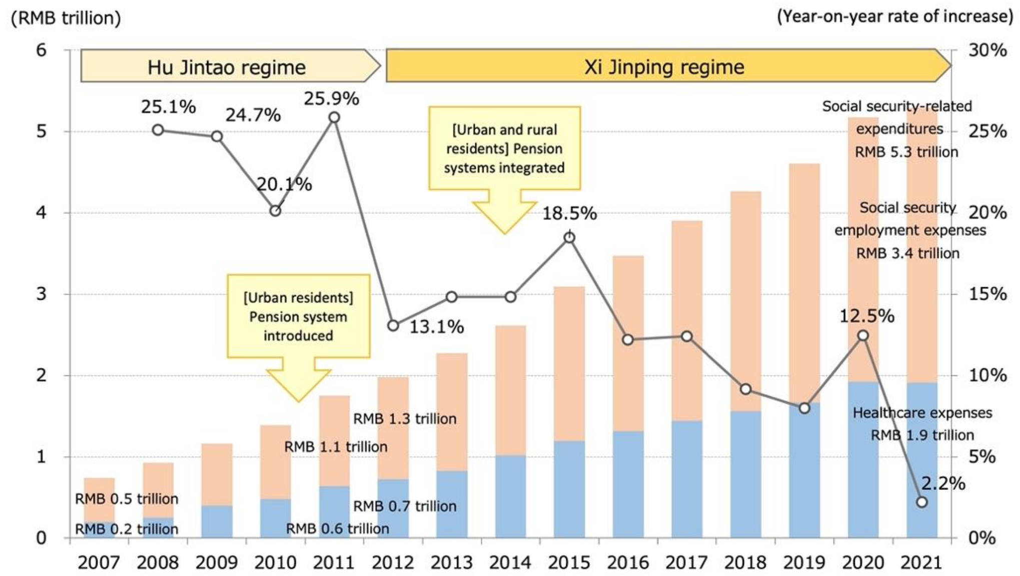
The Social Insurance Law of the People's Republic of China stipulates that the social insurance system, the core of the social security system, "follows the principle of (1) wide coverage, (2) modest benefits, (3) multi-tiered programmes, and (4) a sustainable system" (Social Insurance Law of the People's Republic of China, Article 3, 2011). In other words, the law states that a sustainable social security system will be built by establishing a multi-layered social security system consisting of public, private, and family coverage, in which all citizens can enroll, and benefits are limited to the basics.

The 1990s, when the current social insurance system was established in China, was a time of crisis and restructuring of the welfare state in Europe. China studied and developed its current system while keeping a close eye on global trends. In addition, the country as a whole had little financial freedom at the time, given the still low income level of the population, and it was financially difficult to establish a welfare state system. Deng Xiaoping himself pointed out in his 1992 southern tour that the European welfare states had become financially unsustainable, and he stressed the importance of home and family support, particularly with regard to the issue of old-age security for the elderly in China.

The Hu Jintao regime, which achieved rapid economic growth in which income inequality became a social problem, emphasized the importance of people's livelihoods and introduced a new social insurance system to cover people who had previously been outside the scope of social insurance coverage. Examples include a medical insurance system and a pension system for rural residents and those not working in urban areas. It was during this period (late 2000s) that China was finally able to shift to a social security system that covers all citizens (shift from selective to universal coverage). However, because the newly introduced system relied on the national treasury's contribution, the financial input for the purpose of social security increased rapidly during this period.

Meanwhile, the Xi Jinping regime, which took over amid slowing economic growth and an aging society with a declining birthrate, has been under significant fiscal pressure from expenses related to social security. Social security-related expenditures, including natural increases due to the aging of the population and benefit increases, have consistently increased, with a 1.5-fold increase over the last five years (Figure 1). In addition, social security-related expenditures account for 21.6% of national expenditures (national general public budget), making it the largest expenditure. It should be noted, however, that these social security-related expenditures do not include those related to public long-term care insurance and childcare support, which are currently undergoing trial.

Figure 1: Changes in Social Security Expenditures in China



Note: In China, "social security-related expenditure" has not been clearly defined, and here the total of two expenses related to social security (social security employment expenses and healthcare expenses) is defined as social security-related expenditure.

Source: Prepared from financial data of the Ministry of Finance of the People's Republic of China.

3. Pensions account for 70% of the financial supplementation of social security: limits to the income redistribution function

In China, in administering social insurance, financial resources are managed in the social insurance funds, a fund separate from the budget. Looking at the fund revenues and expenditures, in 2021, revenues recovered to RMB 9.6877 trillion, up 26.9% from the previous year, while expenditures rose 10.6% from the previous year to RMB 8.6694 trillion. In 2020, on the other hand, due to the impact of the Novel Coronavirus pandemic, fund revenues declined significantly (revenues fell 8.2% from the previous year to RMB7.6364 trillion and expenditures rose 4.9% from the previous year to RMB7.8372 trillion), and, even with financial supplementation, expenditures (benefits) were not covered. The single-year balance showed a deficit of RMB200.8 billion. The main cause was the measures to reduce the corporate burden of social insurance premiums. Premium income fell 17.9% from the previous year to RMB4.9225 trillion, particularly for pensions with high premium rates. While premium income from pension funds covering urban residents and company employees fell sharply by 30.4% from the previous year (RMB2.0887 trillion), expenditures also increased, with the government requesting a 5% increase in pension benefits over the previous year. Thus, in 2021, 71.1% of the RMB2.3 trillion in social insurance-related fiscal expenditures was pension-related, making the issue of old-age security a major fiscal challenge.

On the other hand, as for medical care, although the medical insurance system remained stable in the black during the 2022 and 2021 pandemic, for urban and rural residents it remained difficult to operate without financial supplementation. During the Coronavirus pandemic, original benefits were suppressed as patients refrained from medical treatment and surgery. In addition, the structure of the system limits the amount of benefits provided by public medical insurance, limiting the benefits themselves. Furthermore, medical insurance for urban and rural residents has a limited redistribution function, as premiums are collected based on risk (age) rather than income.

The effects of the redistributive function of social security were analyzed by Li Shi (2016)[1] using 2013 household survey data (CHIPs Data 2013) from China Institute of Income Distribution, Beijing Normal University. According to the report, China's social security had a limited improvement effect on the Gini coefficient, which indicates inequality, compared to Western countries. While the average improvement effect for Europe as a whole was 30%, in China it was only 8%. For Japan, according to the Survey on the Redistribution of Income (2017) by the Ministry of Health, Labour, and Welfare, the Gini coefficient for initial income before redistribution was 0.5594, and after redistribution was 0.3721, a 33.5% improvement due to redistribution. Of 33.5%, the degree of the improvement due to social security was 30.1%.

4. The growing use of the private insurance market

Amid a rapidly aging society with a declining birthrate, the budget deficit is widening and expenses related to social security are increasing, making public finances more difficult. In addition, local governments that administer the social security system are facing tighter finances than before due to the pandemic, the real estate recession, and land-use fee regulations. As a result, the government is forced to rely heavily on private financial markets, including private provision.

Insurance products for old-age security have been particularly strengthened in recent years. In addition to the previously available general individual annuities, annuities with deferred personal income taxation were introduced in 2018. In addition, 36 cities began experimenting with the introduction of simple individual pensions for gig workers and other non-regular workers in 2021 and "endowment insurance," the equivalent of Japan's iDeCo (individual-type Defined Contribution pension plan), in 2022. For endowment insurance, people open a dedicated account at a bank and contribute funds, purchase products, receive benefits, and pay taxes. In China, although the birthrate is declining and the population is aging, no government bonds have been issued for the purpose of social security. By strengthening the private insurance market and private security, which is positioned as one of the multi-layered social security systems, the government aims to supplement social security and make the system sustainable.

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1 Li Shi (2016) "Redistributive effects of social security system in China," EU-CHINA Social Protection Reform Project [http://www.sprp-cn.eu/HLE2016/Reports/LiShiEn.pdf].