EU-CHINA
Social Protection Reform Project
中国欧盟社会保护改革项目

EU-CHINA SOCIAL PROTECTION REFORM PROJECT

EUROPEAN BEST PRACTICES(COMPONENT 1)

FIRST CONSOLIDATED BEST PRACTICES REPORT

By: Koen Vleminckx, Senior social security specialist - December 2015

1. Introduction

The purpose of the EU-China Social protection reform project is to contribute to the improvement and inclusiveness of China's social protection system through strengthening the institutional capability for developing policies, for implementing legal and regulatory frameworks and for supervising systems of social insurances, social assistance and financial management in the area of social security. In particular, the project's purpose will be pursued through the following three components in relation to which specific Chinese government entities playing the role of partner of the consortium have been identified:

Component 1: Consolidation of institutional capacity for social protection policy development and reforms in collaboration with the National Development and Reform Commission ("NDRC");

Component 2: Enhancing of institutional capacity for financial management and supervision concerning social security funds in collaboration with the Ministry of Finance ("MoF"); and

Component 3: Improving of legal framework and policy for social assistance in collaboration with the Ministry of Civil Affairs ("MoCA" and, together with NDRC and MoF, the "Chinese Ministries").

Within the framework of the project plan of activities Component 1 (C1) for the year 2015, a European senior social security specialist was expected to perform, in close cooperation with the EU C1 Resident expert and the short-term Chinese experts working on topics related to the project C1 component, the following activities:

- collect, analyse and compile most relevant EU best practices from both Consortium and non-Consortium member states;

- collect, analyse and compile in a specific report European experience related to European response to economic crisis in the area of social security adjustment and reform;

- collect information from NDRC and other Chinese stakeholders on their updated needs for technical knowledge from European countries in topics to be covered through C1 activities, and submit relevant information and data on the said topics to the same counterparts;

- take part in technical meetings, peer reviews and other relevant meetings held in China under the auspices of the project C 1;
- act as a member of the project technical team.

The mission was planned to be conducted in two phases, corresponding to the two batches of topics to be addressed by the project during the year 2015. The topics to be considered were those listed in attached NDRC Need list of Top level design.

During the first phase of the assignment, held in July 2015, the following three topics were to be addressed:

1. Social insurance administration systems reform [contributing to the elaboration of the XIIIth National Five Year Plan (2016-2020),
2. Multi-tiered design of pension systems (public pension, enterprise annuity and individual pension),
3. Evaluation of the combination of basic pension and Individual accounts.

For the drafting of the reports on these three topics, short-term Chinese experts were recruited in consultation with NDRC:

1. Mr. TAN Zhonghe
2. Mr. DONG Keyong
3. Mr. SONG Xiaowu

During the second phase of the assignment, held in November 2015, the following two topics were to be addressed:

4. Pension reform of the public sector,
5. Strategy of integrating social security system in urban and rural context also through the portability of social insurances.

For the drafting of the reports on these two topics, short-term Chinese experts were recruited in consultation with NDRC:

1. Ms ZHANG Yinghua
2. Mr. WANG Zeying

Koen VLEMINCKX, a Belgian civil servant, was recruited as European senior social security specialist (EU S4). He obtained a doctorate in social policy from the University of Leuven (K.U. Leuven) in 2006, the thesis being: “Towards a New Certainty: A Study into the Reform of the Continental Welfare States.“ He is currently director of research and international cooperation at the Belgian Federal Ministry of Social Affairs (FPS Social Security). He prepared himself for this mission by collecting background information on social security in China and pension reform in particular. Thus, he was able to situate the activities of this mission within the context of the broader reform debate in China.

2. Method

On the basis of the reports drafted by the Chinese short-term topical experts[1], relevant issues were selected for which relevant 'best practices' in the EU member states could be found. For several topics, EU level activities and networks were also deemed to be of interest for China. Furthermore, as the topics of the authors partially overlapped, particularly as far as the reform of the second tier individual accounts system was concerned, an emphasis was put on the issues that are particularly well developed and emphasized in the respective papers. Each expert was also situated within the context of the broader pension reform debate in China.

3. The pension reform debate in China: contextual analysis

The contributions of the Chinese short-term experts can be situated in a broader context. Within China we recognize different "schools of thought" about the way the Chinese pension schemes should be adapted in response to some important challenges.

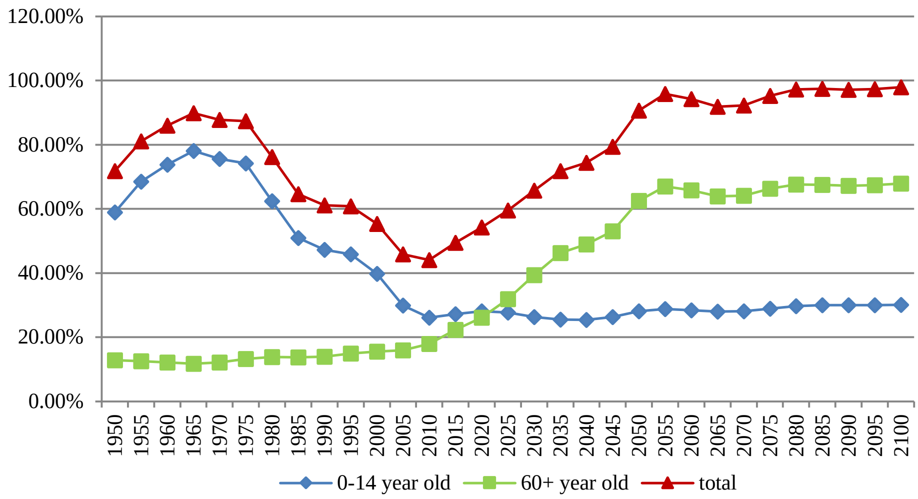
3.1. Triple challenge

The current Chinese pension system is confronted with a triple challenge:

1) Sustainability: The main medium-term threat comes from a rapidly ageing population. The main cause of this ageing problem is the imbalance that was created by the one-child policy introduced in the 1970s. Furthermore, the strong improvements in well-being have had a very positive effect on the average life-expectancy of the Chinese population. These factors have an important impact on the evolution of China's population dependency ratio (figure 1).

Figure 1. The evolution of China's population dependency ratio, 1950-2100.

[1] During the drafting process the expert also provided information to the Chinese experts on their request or, in some cases where he thought it to be useful on his own initiative, but he respected their academic freedom.



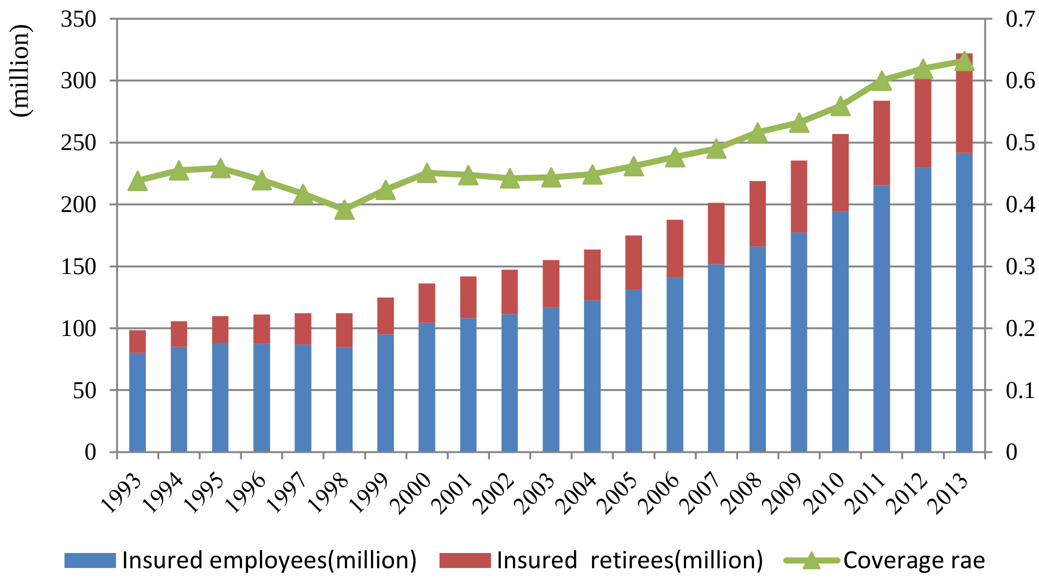
The problem of sustainability is particularly acute with regard to public sector pensions, as it is a closed system with a specific age composition. As in many countries, public sector employees are on average older than those in the private sector (see section 3.2.1).

However, spending on retirement pensions in China as a percentage of GDP is currently rather low in comparisson with OECD countries. According to OECD, public social spending in China amounted to around 7% of GDP in 2009, comparable to average social spending in the Asia/Pacific region (OECD, 2014, *Society at a Glance, Asia/Pacific*). Spending on old-age cash benefits amounted to about 2.5% of GDP with social assistance payments making up just over half a percent of GDP.

2) Adequacy: China's pension system is relatively inadequate because of both a relatively low coverage rates and a relatively low level of retirement benefits.

The current pension schemes does not realise a universal coverage of the Chinese population. The first pillar pensions only cover 63% of urban employees, while the second pillar pensions only cover 5.38%. In rural areas the coverage rate is as low as 25% (figure 2).

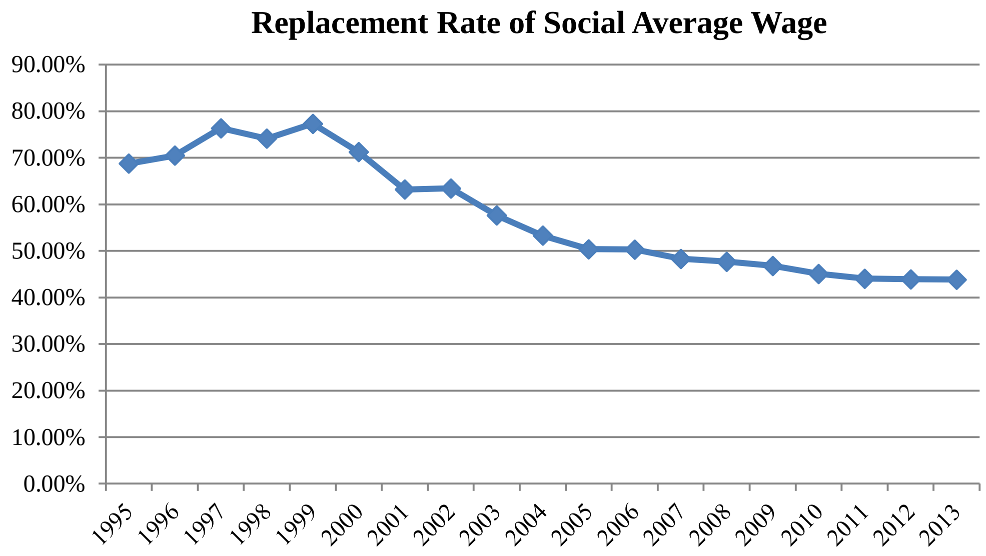
Figure 2. Coverage Rate of Public Pension for Urban Employees.



Furthermore, average retirement benefits are relatively low. The replacement rate as a percentage of social average salary of urban employees dropped sharply between 1997 (76%) and 2013 (44%), while the initial policy objective was a replacement rate of 60% (figure 3). Since the replacement rates offered by the traditional retirement system were deemed to be too high, the new system offers only basic protection to pensioners. The final-wage replacement rate of workers was replaced by a social-average-wage replacement rate. And the replacement rate was reduced from 80% to 60%. The actual target replacement rate: is 59% of the social average wage, of which 35% is to be asssured by the social pooling system and 24% by the individual account system.

Although the Chinese government has adjusted the level of pension benefit level on year by year basis, benefit levels are still too low to sustain basic living standard for some urban employees.

Figure 3. Evolution of replacement rates.



3) Regional differences: There are important regional differences in the way the pension schemes are implemented throughout China. There has always been a tension between the implementation of unified rules and the degree of autonomy and choice of regional authorities to implement pension policies. The current regulations allow for considerable differences in interpretation. This is reinforced by regional social and economic inequalities. This has led to a number of problems which appear to have a structural cause, such as the problem of the so-called "empty pension accounts": the capital invested in pension fund accounts that were reallocated by regional authorities for the payment of current pension benefits. As a result central government funding has become permanent and indispensable.

3.2. Two sensitive problems

3.2.1. Civil service pensions

As in many countries, the oldest and most generous pension system in China was the budget-funded pension scheme for civil servants and employees of public cultural, educational and scientific institutions, providing coverage for about 40 million public sector employees (about 20% civil servants and 80% other employees) and about 9 million public sector pensioners. This non-contributory public sector pension scheme provides replacement rates of up to 90 percent[2] of the salary at retirement after a career of 35 years and are indexed with the salary increase of currently active public sector employees of the same rank.

However, the generous benefits for civil servants and public servants coupled with rapidly improving life expectancy have made pensions increasingly expensive for the government. The total cost of civil service and public service pensions has increased by more than 20 times in the past two decades, and such cost relative to the wages bill has more than doubled at the same time. This is aggravated by the fact that the pension system for civil servants and public sector workers is a closed system and, as in

[2] Civil servants in general were entitled to lower replacement ratios than public servants, but given their higher base pay, they still received better pension benefits.

many other countries, China's civil servants and public sector employees are on average older than private sector employees. Over the next decade a large cohort of public sector workers will retire. As the implicit guarantee of pension for the public sector was not monetized or portable, this prohibited public sector employees to enter private sector. Furthermore, the inequality between China's public sector pension system and the urban employees' basic old-age insurance system has become a source of social dissatisfaction.

In order to streamline the scheme features between the systems for public servants and urban workers, the State Council launched a trial pension reform programme for public servants in five provinces and municipalities. In 2013 it was decided to speed up reform of pension programs for employees in government departments and public institutions. During that year public sector workers were for the first time required to pay social contributions. In January 2015 the Decision on Reforming the Old-Age Insurance Program of Civil Servants and Public Service Sector Employees was issued by the State Council, which brought all the civil servants and public service unit employees into a basic pension system similar to urban enterprise employees. In March 2015, the Notice on Circulation of the Measures on Occupational Annuity for government departments and public institutions was issued by the General Office of the State Council, which introduced an occupational system for civil servants and public service unit employees to supplement the basic old-age insurance.

3.2.2. Pensions for internal immigrants

The Regulations on *Hukou Registration of the People's Republic of China* were introduced in 1958. The *hukou* is a household registration system that restricts population mobility by binding people to their place of origin. This has important consequences for social protection coverage, as various social policies and welfare systems became attached to the household registration system. Initially China established a social security system for people with urban *hukou*, while the right of land use was considered to be sufficient as a guarantee to the basic livelihood of the rural population[3]. As a result people with urban *hukou* and those with rural *hukou* still receive different forms of social protection.

People seeking to change residence permanently or formally are required to obtain approval for *hukou* (identity card) change from the local authorities. For urban residents, changing *hukou* residence within the same city or town is generally permitted. So are rural residents moving within rural areas along with their *hukou* because of marriage or other family reasons. However, formal or "permanent" moves, implying a *hukou* change, such as crossing city, town and township boundaries, are strictly regulated and require approval by the public security authorities. This approval is granted scarcely and only when there are good reasons for the proposed move, and if the move serves the central or local state interests and policies.

Generally speaking, it is very difficult for an ordinary person to change *hukou* from rural to urban areas, or from smaller cities to larger cities. Rural migrants are allowed to move to and work in cities under the "temporary residents" category, but they cannot have a *hukou* in the destination where they stay. Therefore, these migrants are ineligible for many local benefits and rights, which ordinary local urban residents qualify for automatically. Thus, when internal migration in China became an important part of the national industrialization strategy (Chan, 2009), the maintenance of the *hukou* created a segmented urban population.

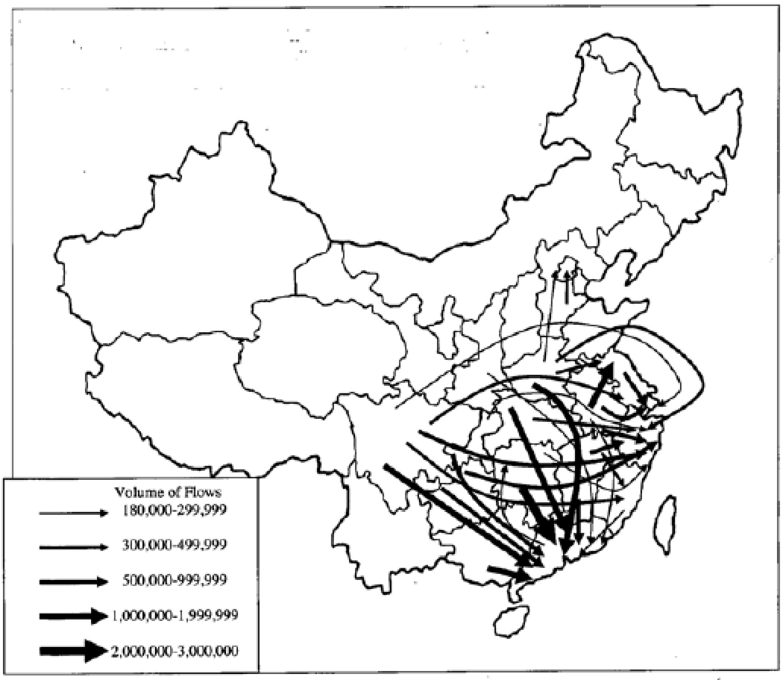
[3] The rural land system stipulated that land was collectively owned by the rural population but the peasants had rights of land use. Herd et al. (2010) and OECD (2010) provide useful insight into the complex relationships between old-age support and land ownership, especially with regard to the changes in property rights in rural areas and converting land to non-agricultural use, including new property laws issued in 2002 and 2007.

In China, officially only *hukou* migration is considered *qianyi* (“migration”). Migrants in that category are eligible for the same array of social benefits and rights other local residents have. Other types of moves are considered *renkou liudong* (population movements or "floating" population), implying a “temporary” move to a destination where the person is not supposed to, and is legally not entitled to, stay permanently.

With the deepening of market-oriented reforms, the binding force of the household register system on population mobility was de facto weakened, resulting in a lot of rural population shifting into urban areas, spurred by significant wage differentials between provinces. Thus, the so-called floating population became an important component of urban informal employment.

The volume of internal migration has expanded steadily since the early 1980s, accelerated in the first half of the 1990s and, again in the first decade of the twenty-first century. While the volume of annual *hukou* migration remained quite stable in the last 30 years, non-*hukou* migration has become more voluminous. The major constituent group of non-*hukou* migrants, the rural migrant workers, numbered about 150 million at the end of 2009. A significant portion of the rural migrant labourers are circulators. In fact, most of them are not expected to stay in the destination permanently.

Figure 5. 30 largest inter-provincial migration flows



Source: State Council and National Bureau of Statistics (2007)

It is generally estimated that by the mid-1980s about 30 million people from the rural areas population moved into the urban areas, 50 million around the mid-1990s, and 140.41 million in 2008, which means that roughly 1/3 of the rural labour force are working in the urban areas at present (Cai Fang, 2009).

Thus, the creation of a unified pension system or "an integrated pension system that is impartial to where people live or work by 2020," (China’s State Council), is a significant decision. Social pension insurance for rural residents has been rolled out gradually since 2003, to cover 240 million in 2009. A separate scheme covers urban workers that are not covered by the schemes for civil servants or private employees was introduced in 2011. Since 2014 both social pension systems are combined in the social pension system for the rural and urban nonwage population.

3.3. Three “schools of thought”

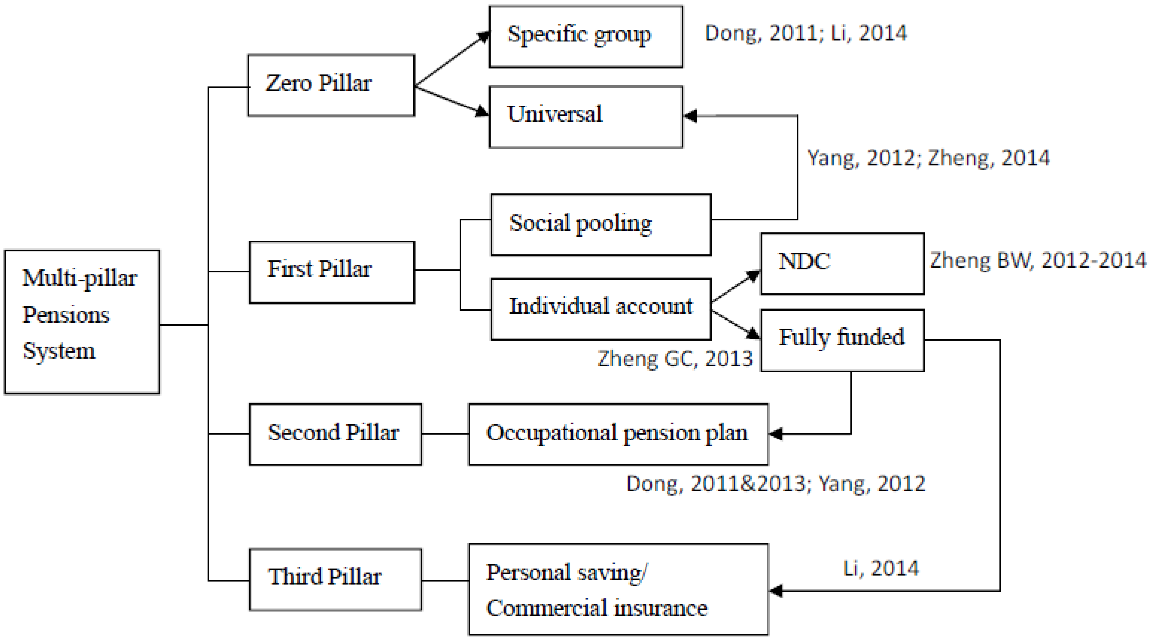
In the search for solutions for these problems various “schools of thought” emerged. Most Chinese and foreign experts agree on a number of measures. Most agree that the retirement age should be increased in order to deal with population ageing, although there is some debate about the speed of the gradual increases, the necessity to have different retirement ages for men and women, a differential treatment of various categories of workers (e.g. arduous professions). Most agree that the coverage of the pension schemes need to be enlarged, and that more coordination is needed to deal with regional differences and inequalities.

Three main “schools of thought” can be identified:

1) Social Insurance Defined Benefit – PAYG: This “school of thought” promotes social insurance based pay-as-you go pension schemes (defined benefit). This school adheres to the view that the government remains the broker of intergenerational solidarity and other forms of solidarity between various social categories of the population (lower income groups, immigrants …) and should protect the population against market failure. Related to this viewpoint is the idea of the so-called “pension promise”: the government guarantees security in old age to its citizens, even if this guarantee can be conditional. This viewpoint is challenged by population ageing and the lain challenges are rigidities, such as fixed retirement ages and fixed replacement rates. However, various adjustments have been proposed to deal with these issues.
2) Defined contribution – partially or fully funded: This “school of thought” is associated with the pillar approach promoted by the World Bank during the nineties. This school of thought is centred on the idea that a more differentiated way of financing reinforces pension systems and protects them to a variety of shocks. Pay-as-you-go systems are better adapted to economic instabilities, but are challenged by population ageing. Funded defined-contribution pension schemes are better adapted to the challenge of population ageing, but are challenged by market risks. Funded defined-contribution pension schemes depend on the rate of return, minimally above wage growth and require regulations with respect to financial management.
3) Notional Defined Contribution – PAYG: The third “school of thought” emerged during the second half of the last decade and has been strongly promoted by the World Bank (Holzman, Wang Dewen, 2013). The main feature of this school is that NDC systems can protect pension schemes against the consequences of population ageing. Benefits are automatically adjusted for ageing risks (balance + longevity) and can be made self-sustaining in a “steady state” situation. They also promote a strong link between the payment of contributions and the level of pension benefits. Due to this strong link NDC systems have less room for social corrections. Moreover, if the population does not respond well to these behavioural incentives, average replacement rates can be sharply reduced. Thus, NDC systems give priority to sustainability over adequacy.

Figure 4 gives an overview of the main characteristics of the various “school of thought” in the Chinese pension reform debate and situates the proposals of the three short-term experts within this broader context. Professor Dong Keyong has been a strong promoter of the pillar approach, with an important role for funded ‘second pillar’ occupational pension plans. Professor Song Xiaowu is in favour of a strong first pillar, based on social pooling, complemented by reinforced individual accounts (funded or notional). Professor Tan Zhonghe’s preference with respect to this broader pension reform debate is less explicit.

Figure 4. Overview of the main reform proposals in the Chinese pension reform debate.



4. The topical reports

<u>Research Report I: "Development of China's Old-age Insurance for the 13th Five Year Plan Period", by Professor Tan Zhonghe[4]</u>

From the onset of the 12th Five Year Plan period, a social security system covering urban and rural residents has been tentatively established, with expanding coverage, growing participants, and enhanced the social security. Significant stride has been made in the undertaking of social security, which laid a solid foundation for the development of social security during the 13th Five Year Plan period. The 13th Five Year Plan period is a critical stage in reforming the Chinese social security system, and a key period in integrating social security systems for urban and rural residents. Old-age insurance scheme is one of the most important components of China's social security system, and was among the earliest for reform among China's social security programs during China's transition from planned economy to socialist market economy. Although an old-age insurance scheme covering urban and rural areas has been basically established, there are still prominent problems, such as unsound policies and mechanisms, unbalanced development, and unsustainability. Mr. Tan's report puts forward the development targets, reform tasks, measures and suggestions for the development of old-age insurance scheme, on the basis of the achievements of reform and development during the 12th Five Year Plan period, analysing the situation and major existing problems.

Professor Tan Zhonghe particularly stressed the need to:

[4] Professor Tan also drafted a Research Report on "Social Insurance Administration System Reform".

- enhance the governance of China's social security system and its pension system in particular;
- to improve China's legal and regulatory framework of social security, its management and servicing system;
- to improve communication and training of employers and employees;
- To improve the contribution base and compliance, He also stressed the need to improve the actuarial system, modelling, and enhancing social security research.

Best practices related to Research Report I:

Improving management and servicing system	
New scientific tools for managing social security administrations and networks (e.g. performance agreements)	Belgium, …
Systematic use of electronic data to improve administrative performance and for strategic policy support	Belgium, Spain, …
Improve actuarial system, modelling, enhance social security research	
Best practices identified by European working groups on actuarial modelling	EPC's Subgroup on Pensions
Actuarial expertise and pension modelling	Belgium, Czech republic, France, …
Economic and budgetary projections	Spain, …
Improve communication towards employers and employees	
Communication strategy to increase pension awareness	Poland, Spain, Estonia, Ireland, Sweden, …
Improve contribution base compliance	
Improvement of contribution base and the monitoring of compliance	France, Belgium, …
Anti-fraud strategy based on data-mining	Belgium, …

Research Report II: "The Chinese Pension System in Transition: Current Challenges and Reform Path", by Professor Dong Keyong

In its current set-up the Urban employees' pension system has difficulties in coping with the challenge of China's ageing crisis. Hence the reform proposals for the establishment of China's three-pillar pension model. In Mr. Dong's view, on the basis of combination of social pooling and individual accounts, the separation of existing social pool and personal accounts are to be converted into first and second pillar. The first pillar basic pension would be based on an actuarial basis PAYG system related to the collection of contributions based on individual workers salary base with tax collection and national coordination, paying attention to the burden on enterprises. Benefits should in a way be linked to contributions but at the same time should avoid regressive redistribution mechanism and establish normal pension adjustment mechanisms in order to achieve the basic functions in the first pillar. To turn the personal account into the second pillar, the fact that individual workers currently pay 8% into the funds forms a solid basis for the establishment of this pillar, investment returns leading to improve pension income replacement rate. Mixed ownership economic reform provides the opportunity, through the reduction of state-owned assets, to replenish the currently empty personal accounts and to reduce the implicit pension debt. To accelerate the enterprise annuity system while achieving a fair *system, organizations and institutions should be subject to mandatory occupational pension system, while annuity coverage rate is only about 7% currently. The introduction of preferential policies to accelerate the construction of enterprise annuity is therefore necessary. To achieve the implementation of voluntary private savings system, tax incentives should be developed to speed up the trial of voluntary private savings policies. The system should focus on solving the pension issues for those who are not covered by employer pension or occupational pension. According to Mr. Dong the considered mechanisms to improve pension operations represented an opportunity to promote the construction of China's capital market.*

Professor Dong Keyong's main proposal is to merge the second tier individual accounts with the second pillar occupational pension plans that are currently underdeveloped in China. The second pillar would become mandatory and tax subsidized. The first pillar's basic pension would be reserved for social pooling. This structure reminds us of the Dutch pension system. Professor Dong also suggests to further develop the third pillar as these are more individual and flexible and could thus provide a solution for covering freelance workers etc. that could not be covered by the second pillar. The development of the third pillar would be supported by tax incentives.

On the basis of these priorities best cases were selected on the regulation of investments by pension funds, on tax incentives for occupational pension plans, on the portability of occupational pension plans, and on tax incentives for individual pension plans.

Best practices related to Research Report II:

Investment regulation of pension funds	
Belgium, Czech republic, France, Italy, Poland, … (Dutch case is particularly interesting)	
Other sources	OECD regularly reviews regulations, UNJSPF
Tax incentives for occupational pension plans	
Most EU Countries: In EU 90% of 140 occupational pension plans catalogued by EIOPA benefited from tax incentives, mostly EET system (Italy: ETT)[5]	
Cross-national information	EIOPA
Portability of Occupational Pension Plans	
European Commission	EU Directive 98/49/EC and new "Portability Directive
	Pan European Pension Plans (EU Directive 2003/41/EC)
Tax incentives for third pillar individual pension plans (deductibility of premiums, taxation of benefits, …)	
Belgium, Italy, Spain (both premiums and benefits), France (benefits)	

<u>Research Report III: "Evaluation of the combination of social pooling and individual accounts techniques schemes for urban employees", by Professor Song Xiaowu</u>

In his report Prof. Song's argues that in order to further improve the basic old-age insurance system, solidarity mechanisms should be reinforced, while the size of individual accounts cannot be expanded to the detriment of the pooled part of the system. With regard to the personal accounts, the main question remains whether they should remain funded ("real) or become "notional". Professor prefers the first option and argues that the conditions should be created to gradually reinforce the funded individual pension accounts. But he acknowledges that there may be some practical problems that may justify small NDC accounts, his second option.

Thus, Professor Song Xiaowu wants to maintain the current pension structure for urban workers, including the repartition of funding (20/8), but he wants to improve and modernize the individual accounts system, for which he identifies two options:

1) Reinforcing the funding of the individual accounts, or

2) Replacing the funded individual accounts with notional individual accounts, in line with the NDC model. Professor Song prefers the first option and motivated his choice in his report.

Thus, European best practices decided to select European best practices for both options. Furthermore, best practices on pension calibration and indexation were provided on Professor Song's request.

[5] EET: a system that exempts contributions from tax, does not tax fund income, but does tax the pension in payment. ETT exempts contributions, taxes fund income and pensions.

Best practices related to Research Report III:

Option 1: funded individual accounts as 2nd tier	
Clearing house model	Poland Sweden, …
Creation of pension fund regulatory authority	Italy, Czech Republic, …
	EIOPA (European Insurance and Occupational Pensions Authority)
Relationship Basic Pension and supplementary pensions	France, …
Option 2: introducing notional individual accounts (NDC type or mimicked)	
NDC practices	Italy, Poland, Sweden, …
Mimicked within PAYG	Germany (point system)
Calibration of pensions	
Retirement (dis)incentives - NDC	Italy, Poland, Sweden, …
Retirement (dis)incentives – PAYG DB	Belgium
Adjusting to longevity	
Within NDC	Italy, Poland, Sweden
Within PAYG DB or altered PAYG DB with NDC characteristics	Germany, Czech Republic
Taking into account specific circumstances (e.g. arduous occupations)	Czech Republic, France
Indexation of pensions	
Inflation+wage -> CPI	Czech Republic

Research Report IV: "Public Sector Pension Reform in China", by Dr. Zhang Yinghua

The public sector pension reform in 2015 established a two-pillar mandatory social insurance pension system for China's public sector, with a basic pension pillar and an occupational DC pension pillar similar to the Urban employees' pension system. Public employers are expected to contribute 20 percent of total wage expenditure to the basic pension system and a 'notional' 8 percent to occupational pension system. Public employees are expected to contribute 8 percent of individual wage to the basic pension system and an additional 4 percent to the occupational pension system.

According to Dr. Zhang the new civil service sector pension faced two potential risks. The first is financial sustainability risk, mainly because the pension divisor of the new public sector pension system is too low. The second risk is the lack of persistent contribution abilities in some local governments. As a result, expenditures of local governments will have to depend largely on central government transfer payments.

The author recommends:

- The need to set a reasonable contribution base.
- The implementation of measures to facilitate the mobility of employees between different public sector employers and between private and public sector employers.
- The implementation of measures to improve the sustainability of the new public sector system:
    i. Implementation of long-term actuarial technology
    ii. Enlarge investment capacity of pension fund
    iii. Enlarge the social pooling

    iv. Encourage deferred retirement

- The need to improve investment performance of the pension fund:
    i. Keep fiduciary independent from government
    ii. Evaluate investment performance
    iii. Establish personal limited investment option for occupational pension funds
    iv. Set guaranteed return rates

Best practices related to Research Report IV:

Portability of Pension Rights (between public sector and public sector/private sector)	
France (separate civil sector scheme), Sweden, Netherlands (both separate but similar)	
Deferred retirement in the public sector	
Belgium (experience with bonus system to promote deferred retirement among public sector employees)	
Public Sector Occupational Pension Fund Management	
France (ERAFP - French public service additional pension scheme)	
Investment regulation of pension funds	
Belgium, Czech republic, France, Italy, Poland, … (Dutch case is particularly interesting)	
Other sources	OECD regularly reviews regulations, UNJSPF
Creation of pension fund regulatory authority	
Italy, Czech Republic, …	
EIOPA (European Insurance and Occupational Pensions Authority)	

Research Report V: "Research Report on the Integration of Urban and Rural Pension Insurance System", by Mr. Wang Zeying

Mr. Wang identifies a number of elements in China's pension system that complicate the portability of pension rights. Most basic pension systems for urban and rural residents are planned at the county level or the prefecture or municipal level. Provincial-level planning, where the funds of basic pension insurance for urban enterprise employees are charged and paid uniformly, has been realized in only a few provinces, such as Shaanxi and Jilin. Budget and fund management are situated at a regional level. Regional economic differences complicate the introduction of provincial budget management. Without nationwide planning funds cannot be pooled and enterprises in different regions are faced with unfair investment environment and competition due to the different rates[6]. But the large number of planning entities also increases the cost and workload associated with the implementation of the portability of pension rights, while differences in local regulations makes it the portability of pension rights hard to implement. Current regulations also create a number of injustices.

Furthermore, there are prominent contradictions and problems regarding the system and mechanism of operation management service. The management system is not smooth because of various inconsistencies, while service capability and infrastructure is inadequate. Procedures need to be made more efficient and standardized. The use of information technology in the pension

[6] In 2012, the average rate of Tibet, Shanghai, Jiangsu, Liaoning and Heilongjiang was above 20% and that of Sichuan, Chongqing, Shandong, Fujian and Zhejiang was below 20%. The highest rate of Tibet was 23%, the lowest rate of Guangdong was 12%, the rate of Zhejiang was 13% and that of Fujian was 16%.

insurance system needs to be improved. Firstly, the operation management information system for every basic pension insurance systems is established independently, so the information can hardly be shared fully, in real time and accurately. Secondly, the information network platform construction is to be improved. Some underdeveloped regions and some basic-level communities and villages are not covered by network and manual operation is adopted mainly in some areas. Thirdly, the software system of the management information system is to be improved. Fourthly, computerisation is not following the rapidly growing operational need.

Mr. Wang formulates a number of policy recommendations:

1) Integrate basic pension insurance systems further
2) Improve the policies regarding basic pension insurance
    a. Promulgate policies to encourage urban and rural residents to voluntarily participate in the basic pension insurance for urban enterprise employees
    b. Improve the policies on the integration of urban and rural pension insurance systems
    c. Improve the policies on transfer and continuation of credentials of basic pension insurance for urban employees
3) Rise the overall planning level of basic pension insurance
4) Improve the capacity of pension insurance operation management service
5) Strengthen the promotion of information technology

Best practices related to Research Report V:

Portability of Pension Rights
EU Social Security Coordination, Regulation (EEC) No 1408/71, Regulation (EC) No 883/2004
The Mobility Network of legal and statistical experts on free movement of workers and social security coordination
Coordination agreements
Portability of Occupational Pension Plans
EU Directive 98/49/EC and new “Portability Directive
Pan European Pension Plans (EU Directive 2003/41/EC)
Systematic use of electronic data to improve administrative performance
Belgium, Spain, …

5. Best practices

In this section we elaborate more on the various priorities and the selection of the best practices. Furthermore, we discuss the importance of the proposed best practices within the context of the planned Chinese pension reform. We also discuss the possibilities for technical cooperation on these best practices.

5.1. Improving the management and servicing system

Professor Tan Zhonghe stressed the need to enhance the governance of China's social security system and its pension system in particular. He specifies the need to improve China's legal and regulatory framework of social security, its management and servicing system. Most experts agree that more coordination and supervision of various pension administrations is needed.

During the last decade Belgium has introduced new scientific tools for managing social security administrations and networks. In order to improve coordination and supervision, while respecting the autonomy of administrations performance agreements were introduced between the central government and decentralized agencies and administrations. These performance agreements specify the SMART management objectives to be realized within the time-framework of the performance agreements, while the resources needed are specified in pluriannual budgets. The supervising authorities' commitments are also specified. The decentralized and administration in return receive a certain degree of autonomy, but are accountable for achieving the specified objectives. Examples of management objectives are:

- Optimising the tools for analysing the social fraud
- Building up internal audit & control and efficiency measures
- Seeking collaboration with other organisations for common managements problems
- improve the delivering of HR data to central databanks
- ...

Furthermore, most experts agree on the need for systematic use of electronic data to improve administrative performance and to improve the Chinese government's capacity for strategic policy support. During the recent decade China's social security administration have greatly improved the construction of computerized administrative data sources and streams, which could be used both for monitoring and the improvement of bureaucratic efficiency. An example is the Crossroads Bank of Social Security in Belgium, a best practice within the European Union, which dramatically improved bureaucratic efficiency and constructed a Data warehouse that made anonym administrative data accessible for scientific research and ex-ante policy evaluation.

Spain has introduced a new way to manage the collection of contributions "Direct System Incomes"

- The new direct system of payment of social contributions will allow to take an active role in the collecting process to the enterprises, moving from a model of self-settlement to a new billing model.

- The priorities are to minimize the mistakes in the implementation of the contribution rules, to compare the data in advance and to facilitate the payment of the contributions through telematics means.

- The system will automatically apply the price increases and/or reductions, achieving greater legal security, and will give an individual calculation for each worker contribution. In conclusion, the system will be guarantee against possible irregular situations in the collection of quotas.
- The system apply to 12,314,519 companies with 1,420,412 employees, and more than 3,000,000 self-employed workers.

This system is aimed to simplify the duty of collecting contributions by the companies and to reduce administrative burdens to the employers, communicating less data than before.

5.2. Improve actuarial systems, modelling, enhance social security research

While the Ministry of Human Resources and Social Security has constructed an actuarial model, the Chinese administration could improve its capacity for ex-ante population by getting inspiration from best practices identified by European working groups on actuarial modelling. Furthermore, several countries within the consortium (Belgium, Czech Republic, France …) have considerable experience with actuarial expertise and experience with pension modelling. Spain has relevant experience with economic and budgetary projections.

This capacity is crucial for policy makers in order to calculate the medium- and long-term budgetary and social-economic impact of pension reform proposals and could be used to fine-tune planned policy measures. Thus, costly mistakes could be avoided by avoiding that faulty measures are implemented in the first place. One faulty measures have been implemented they become very difficult to adjust or retract. This is particularly the case for a large country such as China. The use of simulation models in addition to standard actuarial modelling could also supplement Chinese policymakers' strategy of testing reforms measures on a more limited scale in selected regions.

5.3. Improve communication towards employers and employees

Several European countries have benefited from the implementation of a communication strategy to increase pension awareness. Defined Contributions in particular, demand a greater awareness of individual citizens as the risks are borne directly by the individual, who is required to make a variety of complex financial decisions (how much to save, in which funds, which retirement income product to choose, which pay-out solution to select, etc.). National Pension Communication Campaigns are also important to inform citizens when important pension reforms are introduced.

National Pension Communication Campaigns are usually designed and delivered by a government department or agency, often in collaboration with key stakeholders, such as regulators, private providers, and employers and unions. The design of the National Pension Communication Campaigns depends on its goals and target audience. The objectives of each NPCC reflect the relevant stage of reform reached, for example advance announcement, phased implementation and post-implementation changes. National Pension Communication Campaigns can be largely informative (e.g. setting out the individual's rights, responsibilities and choices), they may seek to change individual views (e.g. support a pension reform) or they may be aimed at changing individual behaviour and engagement (e.g. to increase contributions to pension plans).

Poland and Spain, both consortium members, have experience with National Pension Communication campaigns. Furthermore, National Pension Communication Campaigns in Estonia, Ireland and Sweden are considered to represent best practices. Furthermore, OECD organized an International Network on Financial Education (INFE) in order to facilitate information sharing, research and the development of policy instruments and analytical tools.

5.4. Improve contribution base compliance

During the mission the need to improve China's contribution base and the monitoring of compliance was identified as an important issue, a fact that was acknowledged by the Chinese topical experts as well as by representatives of the Ministry for Human Resources and Social Security. Evidence indicates that many employers do not or do not fully contribute. Contributions are paid on fixed wages, but not on variable wages, etc... One of the reasons is a prohibitively high contribution rate, but a reduction of the contribution rate could be realized when a successful campaign to improve compliance is implemented. For this the monitoring of compliance needs to be improved and a more effective anti-fraud strategy needs to be implemented. France has recently improved the monitoring of compliance.

In Belgium a very successful anti-fraud strategy based on data-mining was implemented recently. To inform this anti-fraud strategy electronic administrative data from various sources were matched, as this allowed the identification of anomalies in various declarations by both employers and individual beneficiaries. Simply said, it is very difficult for a fraudster to lie consistently to all administrations. Data-mining strategies are used to identify individual fraudsters but also to identify risk groups. This strategy has led to the discovery of many fraudsters, while potential fraud was discouraged by the awareness that the administration had become much more effective in identifying fraud.

5.5. Investment regulation of pension funds

Investment regulations of Chinese pension funds need to be improved, especially when the government decides to reinforce funded individual accounts. Various forms of quantitative portfolio restrictions (minima and maxima) can apply to pension funds at different legal levels (law, regulation, guidelines, etc.). Regulations can also vary depending on the type of plan (occupational, personal, mandatory, voluntary, DB, DC, etc.).

Most countries impose a ceiling on investments by pension funds by type of asset class (among consortium countries only Belgium does not). Investments in equities, in particular in unlisted equities, are capped in most countries regulating pension funds' investments. Countries regulating investments in bonds often reduce or remove the limit on government bonds. Investment in real estate is not allowed in Italy and Poland.

Most European countries have quantitative limits on the investments of pension funds. All consortium members (Belgium, Czech Republic, France, Italy, and Poland) have implemented such regulations, as well as many non-consortium members. The Dutch case is particularly interesting, as the country has a long experience in mandatory DB schemes, while DC systems have recently become more prominent. Furthermore, OECD regularly reviews quantitative limits on the investments of pension funds.

5.6. Tax incentives for occupational pension plans

Occupational pension plans in China are still underdeveloped. In order to promote occupational pension plans several tax incentives could be considered. Within the European Union 90% of 140 occupational pension plans catalogued by EIOPA benefited from tax incentives, mostly EET system (Italy: ETT). Thus, most consortium members could report on their experiences with their tax incentives for the promotion of occupational pension schemes. Furthermore, very useful cross-national information can be provided by EIOPA, the European Insurance and Occupational Pension Plan Authority, an independent advisory body to the European Parliament, the Council of the European Union and the European Commission.

Interesting is Belgium's experience with the Law on Supplementary Pensions. This Law provides for important tax incentives for occupational pension plans on both a sectorial and company level, but these tax incentives are made conditional on the introduction of specific elements within these occupational pension plans. The most important characteristic is the "democratic character" of the occupational pension plan. This clause was introduced because in the past occupational plans were mainly provided to male, white collar workers, and was far less common for blue collar workers and female workers. This Law, which was introduced in 2001 led to a great expansion of occupational pension plans (most sectors have a sectorial plan) and the coverage of blue collar workers by these plans.

5.7. Portability of occupational pension plans

The portability of occupational pension plans is an important issue in China as internal regional migration is of considerable importance. European experience in portability issued is situated on a European level (e.g. EU Directive 98/49/EC). A lot of information has been produced by the European Commission within the context of the preparation of the new portability directive. Furthermore there is an interesting EU directive on Pan European Pension Plans (EU Directive 2003/41/EC).

5.8. Tax incentives for third pillar individual pension plans

Professor Dong Keyong also wants to promote the development of third pillar occupational pension plans. In order to promote occupational pension plans several tax incentives could be considered, such as the deductibility of premiums, partial taxation of benefits, etc...

Most consortium members have experience with these measures. Belgium, Italy and Spain have tax incentives for both premiums and benefits, France for benefits.

5.9. Option 1: funded individual accounts as 2nd tier

Professor Song Xiaowu prefers a reinforcement of the funded individual accounts, although this would require some important improvements in the management and organisation of pension funds.

Some European member states, including Poland and Sweden, have introduced an organisational innovation that could be interesting to consider from a Chinese perspective: the Clearing House Model. With the Clearing House Model the public authorities remain responsible for the collection of contributions and payments, but the pension funds are managed by the private sector. However, they do so under strict regulations. This allows the government to make use of the considerable experience of the private sector in investing funds, while retaining the oversight.

Another important element is the creation of pension fund regulatory authority? Such regulatory authorities exist in many European member states, including Italy, Czech Republic, Belgium, …. More information could also be provided by EIOPA, the European Insurance and Occupational Pensions Authority.

Furthermore, the modernisation of the funded individual accounts would require and adjustment of the relationship between basic zero pillar (or first pillar) pensions and supplementary pensions. This experience could be provided by France.

5.10. Option 2: introducing notional individual accounts (NDC type or mimicked)

According to Professor Song Xiaowu, the second best solution for the personal accounts would be the introduction of notional accounts (NDC). Different European Member States introduced NDC systems, including Italy, Poland, and Sweden. However, Sweden was a pioneer with regard to the introduction of the NDC system and has recently evaluated the results of its introduction. As a result they have also introduced some adjustments to the system. Therefore, I consider the Swedish system to represent a best practice.

Furthermore, some European member states have introduced features of the NDC system in their PAYG Pay as You Go system, thus mimicking to some extent the NDC system. An important example is the German point system. Belgium's pension reform commission has also proposed the introduction of a point system, although this system has not yet been implemented. These adjustments are mainly focussed on protecting the PAYG pension system from the consequences of population ageing.

5.11. Calibration of pensions aimed at fostering longer professional careers and later retirement

Professor Song Xiaowu was also very interested in different built-in calibration methods within the pension system to stimulate longer professional careers and later retirement. Several methods exist in the European member states. Here we should distinguish between countries with NDC systems (Italy, Poland and Sweden) and countries with PAYG systems.

Belgium has experimented during the last decades with adjustments within its PAYG system aimed at delaying the retirement of individuals. A so-called "pension bonus" was introduced, which provided a pension supplement for individual pensioners for every year that they had delayed their retirement after the minimum retirement age. This bonus was evaluated in 2013 and the introduction of a malus system was proposed instead.

In 2013 Spain introduced a number of pension reforms aimed at fostering longer careers and later retirement:

1) Persons who reach the pensionable age and have met the contribution period required for entitlement to 100% of the pension may combine a pension with work, either on a self-employed or employed basis. In this case, and for the duration of such a situation, the pensioner will receive 50% of the pension. Once the work has concluded, the pension will be restored in full amount, with any revaluations that may have been made. Furthermore, Act 27/2011 allows the old-age pension to be

combined with self-employed activities if the total annual income received does not exceed the national minimum wage calculated on an annual basis, with no Social Security contributions being payable on such income.

2) Another incentive introduced within the Spanish system was the introduction of a bonus, which increased pensions by between 2% and 4% for each full additional year of work after pensionable age is reached, depending on the number of years of contributions previously made.

5.12. Adjusting to longevity

Chinese is facing an accelerated ageing of its population, not only due to the consequences of the one-child policy, but also because the increases in longevity, no doubt a consequence of the social and economic transformation of the last 30 years. However, longevity also leads to longer pension careers, which can be unsustainable unless some changes to the system are introduced. One such change is the gradual increase of the legal retirement age for both men and women. However, other measures could be considered too.

Notional Defined Contribution systems are equipped with automatic adjustments to deal with the consequences of longevity. Per cohort, pension benefits are actuarially adjusted to take longevity into account. This leads to lower pension benefits for these cohorts unless they delay their retirement. As we mentioned before, Italy, Poland, and Sweden have an NDC system with this kind of built-in actuarial corrections.

Social insurance based PAYG DB systems can also be adjusted to take into account the consequences of increases in longevity. This can be done on an ad hoc basis, for instance by gradually increasing the legal retirement age in order to compensate the increases in longevity. This can also be done in a more structural way, as was done in Germany, by introducing a point system with actuarial corrections for longevity. The Czech Republic, which has a more traditional PAYG system, has a strong correlation between the increase in retirement age and prolongation of working life.

In 2013 Spain introduced a “sustainability factor” in its pension system, which will come into force in 2019 and will be applicable to the new retirement pension amounts. This factor takes into account the growth of the life expectancy of the new pensioners.

Most experts agree that elements of pension formula to account for average increase in longevity should take into account the special requirements of categories working in arduous occupations, which life expectancy may be shorter. In that regard, the experience of countries like the Czech Republic or France – where individual “hardness accounts” will be introduced from 2015 – is worth studying further.

5.13. Indexation of pensions

Old-age pension beneficiaries depend on their benefit for the rest of their life. This means that their benefits should be adjusted to take into account the rise in consumer prices and, if possible, wage increases. Retirement pensions is China are currently corrected for both increases in consumption prices and average wage increases. However, the correction for wage increases is deemed to be unsustainable, especially if the current coverage and benefit levels of the current pension system are to be increased. Therefore, experts have suggested limiting indexation to adjustments for increases in consumer prices. The Czech Republic also has indexation based on a CPI and wage increase, but altered the indexation formula in 2012 and 2015.

In 2013 Spain introduced a new pension revalorization index which eliminates the compulsory indexation to the evolution of price index. Pensions will be indexed according to a mathematical formula that considers the evolution of the systems incomes and expenses, searching to reach the equilibrium in the middle and long term. There is a minimum revalorization limit, 0,25%, and a maximum revalorization limit, price index + 0,50.

5.14 Portability of pension rights between schemes

Various EU Member States have specific social security schemes for different professional categories. Most EU Member States, with the notable exception of the Central European Member States, have separate pension scheme for employees and civil servants. Some (e.g. Belgium, France, Germany, Italy, Spain, …) have separate pension schemes for (various categories of) self-employed.

However, as lifetime careers have become rare, more people move between various professional categories and, thus, social security schemes. Self-employment is promoted as part of business innovation strategies or as part of re-employment strategies offered to unemployed workers. Cross-fertilization between the public and private sectors is also increasingly promoted, while employees can move between both sector due to privatisation or contracting out.

5.15. Portability of pension rights between regions

European Social Security Coordination: The EU provides common rules to protect social security rights of people legally residing in a European member state (+ Iceland, Liechtenstein, Norway and Switzerland) when moving within Europe. EU provisions on the coordination of social security schemes have existed since Regulations No 3 and 4 of 1958. During the seventies a major reform was introduced as Regulation (EEC) No 1408/71 was introduced (Implementation: Regulation (EEC) No 574/72). As from 1 May 2010, new Regulations on modernized coordination (Implementation: Regulations 883/2004 and 987/2009) apply.

<u>Four basic principles</u>:

1. EU residents are covered by the legislation of one country at a time and only pay contributions in one country at a time. The decision on which country's legislation applies to you will be made by the social security institutions.
2. Migrating EU residents have the same rights and obligations as the nationals of the country where they are covered. This is known as the principle of equal treatment or non-discrimination.
3. When EU residents claim a benefit, their previous periods of insurance, work or residence in other countries are taken into account if necessary.
4. If EU residents are entitled to a cash benefit from one country, they may generally receive it even if they are living in a different country. This is known as the principle of exportability.

The following information can be interesting for the Chinese administrations working on interregional portability of pension rights:

- EU legislation and agreements
- Provides an overview of EU legislation on social security coordination and its agreements with third countries. Includes links to download regulations and find further information.
- Official documents
- Provides access to updated versions of Structured Electronic Documents (SEDs) and Portable Documents (PDs) as well as all the decisions, recommendations and other documents agreed on by the Administrative Commission for Social Security Coordination.
- EESSI
  Provides an overview of the Electronic Exchange of Social Security Information system. Includes access to technical and other useful documents and to software downloads.
- The Mobility Network of legal and statistical experts on free movement of workers and social security coordination is a network of independent legal and statistical experts on these topics. It provides the Commission with legal and statistical expertise via reports and ad hoc analytical support. The network is composed of a Network of legal experts (FreSsco) and a Network of experts on statistics.

Furthermore, individual Member States conclude bilateral social security coordination agreements with third countries. These agreements set up a system of coordination rules for persons moving between the two countries. Most agreements with third countries typically contain rules on applicable legislation, equal treatment and pensions. The pension provisions protect migrants' acquired rights when they leave the national territory and allow payment of the pension in the other territory. In some cases, provision is made for aggregating insurance, employment or residence periods. The applicable legislation rules generally include 'posting' provisions. These enable workers who fulfil certain conditions to remain subject to the social security legislation of the sending country and exempt them from paying social security contributions in their country of work. The principle of equal treatment guarantees migrant workers the same treatment as nationals of the country of work.

EU migration rules have imposed standards that national social security legislation must meet in the case of third-country nationals who reside in a Member State. For example, after five years' legal residence in an EU Member State, and assuming certain conditions are met, third-country nationals acquire the same rights as nationals in respect of social security, social assistance and social protection as defined by national law. In addition, there are three EU migration directives, the so-called "Single Permit" Directive, the so-called "Blue Card" Directive and a Directive dealing with third-country researchers, which guarantee third-country nationals admitted to Member States – subject to certain limited exceptions - equal treatment in social security with nationals of the state where they reside. This guarantee includes equal treatment as regards the transfer of their state pensions to a third country and is not dependent on the existence of bilateral agreements.

The introduction of a new instrument, an EU social security agreement, is currently under active consideration. Such an instrument would allow EU Member States to act jointly on social security coordination in respect of a given third country on an ad hoc basis.

Annex I. Summary table on selected topics and best practices.

1	**Improving management and servicing system**	
	New scientific tools for managing social security administrations and networks (e.g. performance agreements)	Belgium, …
	Systematic use of electronic data to improve administrative performance and for strategic policy support	Belgium, Spain, …
2	**Improve actuarial system, modelling, enhance social security research**	
	Best practices identified by European working groups on actuarial modelling	EPC's Subgroup on Pensions
	Actuarial expertise and pension modelling	Belgium, Czech republic, France, …
	Economic and budgetary projections	Spain, …
3	**Improve communication towards employers and employees**	
	Communication strategy to increase pension awareness	Poland, Spain, Estonia, Ireland, Sweden, …
4	**Improve contribution base compliance**	
	Improvement of contribution base and the monitoring of compliance	France, Belgium, …
	Anti-fraud strategy based on data-mining	Belgium, …
5	**Investment regulation of pension funds**	
	Belgium, Czech republic, France, Italy, Poland, … (Dutch case is particularly interesting)	
	Other sources	OECD regularly reviews regulations, UNJSPF
6	**Tax incentives for occupational pension plans**	
	Most EU Countries: In EU 90% of 140 occupational pension plans catalogued by EIOPA benefited from tax incentives, mostly EET system (Italy: ETT)	
	Cross-national information	EIOPA
7	**Portability of Occupational Pension Plans**	
	European Union initiatives	EU Directive 98/49/EC and new "Portability Directive
		Pan European Pension Plans (EU Directive 2003/41/EC)
8	**Tax incentives for third pillar individual pension plans**	
	Deductibility of premiums, taxation of benefits, …	Belgium, Italy, Spain (both premiums and benefits), France (benefits)
9	**Option 1: funded individual accounts as 2nd tier**	
	Clearing house model	Poland Sweden, …
	Creation of pension fund regulatory authority	Italy, Czech Republic, …
		EIOPA (European Insurance and Occupational Pensions Authority)
	Relationship Basic Pension and supplementary pensions	France, …
10	**Option 2: introducing notional individual accounts (NDC type or mimicked)**	
	NDC practices	Italy, Poland, Sweden, …
	Mimicked within PAYG	Germany (point system)

11	**Calibration of pensions**	
	Retirement (dis)incentives - NDC	Italy, Poland, Sweden, …
	Retirement (dis)incentives – PAYG DB	Belgium
12	**Adjusting to longevity**	
	Within NDC	Italy, Poland, Sweden
	Within PAYG DB	Germany, Czech Republic
	Adjusting for arduous occupation	France, Czech Republic
13	**Indexation of pensions**	
	Inflation+wages -> CPI	Czech Republic