



Report on Panel Discussion Meeting - Component 2

Topic 2.1.1: The division on decision power and expenditure responsibilities on social security between central and local government & Topic 2.2.1: Nominal personal account reform in the basic pension insurance system

Location: No. 3 Meeting Room, Ministry of Finance
Date: 17 th September 2015, 8.30-12:00
MoF
Attendees: Mr. Fu Jinling , Deputy Director General Social Security Department of MoF; Mr. Jin Weigang , Director, The Research Institute of Social Insurance of MOHRSS; Professor Li Zhen , Renmin University of China; Mr Fuchang Zhao , Ministry of Finance Research Institute; Professor Wang Xiaojun , The Statistical Institute of REMIN University of China; Professor Hu Jiye , China University of Political Science and Law; Mr. Wang Dehua , Associate Research Fellow, National Academy of Economic Strategy of CASS; Mr. Wang Hui , Deputy Director, Social Security Department of MOF; Mr. Huang Yaodong , Consultant Social Security Department of MOF; Ms. Song Zhihua , Consultant Social Security Department of MoF.
EU
Attendees: Prof. Tito Boeri , President of the National Social Insurance Agency (INPS), Italy; Mr Stefano Patriarca , EU Resident Expert Component 2 and Team Leader; Mr Gabriele Uselli , Managing Director, Individual Account Department, National Social Insurance Agency (INPS), Italy; Ms Yi Xiaolin , Project Officer, EUD; Mr Angelo Marano , Director General in the Ministry of Labour and Social Policies, Member of the board of Auditors of the National Social Insurance Agency (INPS), Italy; Mr Koen Vlemminckx , Director of the Research and International Cooperation Department, Federal Ministry of Social Security (FPS Social Security), Belgium; Ms Valentina Pignotti , Assistant to Team Leader; Mr Giovanni Lin , Interpreter; Mr Bright , Interpreter.
Purpose: Preliminary work review on “The division on decision power and expenditure responsibilities on social security between central and local government” (topic 2.1.1); and on the “Nominal personal account reform in the basic pension insurance system” (topic 2.2.1).

The Deputy Director General of the Social Security Department of MoF, Mr. Fu Jinling, opened the meeting by stressing the importance of the EU-China Social Protection Reform Project and the need to exchange good practices between the EU and China. After introducing the agenda of the Panel and the main participants, the EU Resident Expert of Component 2 and Team Leader, Mr Stefano Patriarca, underlined that in this first phase of work, the core aim of the project is to understand and define the main needs for social security in China, aiming at identifying useful European practices and experiences in the field.

After the welcome speeches, the meeting commenced and was moderated by the Deputy Director General of the Social Security Department of MoF, Mr. Fu Jinling. During the Panel Discussion the following items have been discussed:

- Presentation of the analysis report on “Nominal personal account reform in the basic pension insurance system” (topic 2.2.1) by **Professor Li Zhen**
 - ✓ Introduction on the transformation of China’s pension system from traditional retirement system based on planned economy to modern public pension system based on market economy
 - ✓ The analysis mainly focused on the historical development, current situation and features of the first level pension system for urban employees, which is a combination of social pooling and individual account, in which the individual account was designed to be fully funded but actually in most provinces they do not have real pension fund and thus called “empty accounts”. While the second level pension scheme is a voluntary occupational pension scheme and the third level is personal saving or commercial life insurances.
 - ✓ Difficulties and challenges of the first level pension scheme
 - Coverage: many migrant workers are not included
 - High contribution burden
 - Inadequate pension benefit
 - ageing trend of the public pension system
 - Financial sustainability
 - ✓ Voluntary second level pension scheme: current situation; obstacles; policy evolution; challenges (coverage, financial sustainability, insufficient pension benefit)
 - ✓ Literature review on improvements of status quo
 - ✓ Author’ road map on improving current pension system
 - Diagnosis on problems of current individual account
 - Proposal for the design of multi-pillar pension system in China
 - Diagnosis on problems of current individual account
 - New breakthrough: form the “multi-level” pension system for urban employees to the “multi-pillar” pension system for the entire population
 - Proposal for the design of multi-pillar pension system in China
- Keynote on European NDC Models by **Prof. Tito Boeri**
 - ✓ The serious problems in collecting social security contributions faced in China cannot be solved only with controls. The collusion between employers and employees is always possible if contributions are perceived as taxes. Therefore, there is a need to explicitly link contributions to future pension claims in a PAYG system operated nationally in a transparent fashion. The Notional Defined Contribution system does it, while a fully funded public scheme does not allow for risk pooling and risk sharing (as well as portfolio diversification and opens up the possibility that local Govt appropriate the resources: empty accounts issue)
 - ✓ How the NDC operates (Italian and Swedish examples)

- ✓ Furthermore, a crucial issue is to make people aware of the link between the contribution they pay and their pension. Italian experience “My Pension”, a new system created by INPS which provides all citizens to access personal information on contribution records and projection of their future pension
- ✓ Retirement decision based on transformation coefficients
- ✓ Retirement incentives. NDC Systems (first pillar) could be suitable in China if well designed, in that case, the Polish, Italian and Swedish experiences are good models of reference

Question from Mr. Fu Jinling: How does Prof. Boeri think about the issue that Chinese policy makers are trying to give a new name to NDC which will be implemented in Chinese context? The new name “Registration-Delivery System” indicates to contributors that in this system their contribution will be recorded in a personal account and their benefit will be delivered in the future when they retire. The reason for this is that Chinese contributors are easily influenced by the concepts such as “notional” or “nominal”, which lead them believe that the system will be another empty account system. By giving a new name, therefore, people may accept this new system.

According to Prof. It is certainly a good idea, because the essence of NDC system is to let people be aware that their contribution is closely related to their benefit in the future.

- Presentation of the analysis report on “The division on decision power and expenditure responsibilities on social security between central and local government” (topic 2.1.1) by **Mr Fuchang Zhao**
 - ✓ Introduction on China’s pension system: history and main reforms, urban and rural residents; three type of pensioners
 - ✓ The current situation of power division
 - Central Government’s Power of Pension Management
 - Decision Power of Social Pension Shared by the Central and Local Governments
 - The Power of Deciding “to what degree”
 - Investment, Operation and Management
 - Division of the Power of Supervision
 - Local Governments’ Power in Management of Social Pension
 - ✓ Division of Expenditure responsibility of Pension
 - The Central’s Expenditure Responsibility on Pension System
 - Expenditure Responsibilities shared by both the Central and Local
 - Expenditure Responsibility in Basic Urban Employee Pension System.
 - Expenditure responsibility in Urban and Rural Citizen Pension System lies on both the central government and local governments
 - Expenditure Responsibility of Pension on Local
 - ✓ The subsidy of Public Pension Fund
 - ✓ Achievement and Challenges of Pension System
 - Problem of “the central order, while the local pays”
 - Challenges to the sustainability due to decision power and responsibility being separated
 - There are moral risks in short term behaviors of local governments
 - The level of regulation is too low and the legislation is not updated to the reality
 - Implicit debts problem is still not clearly resolved: fiscal subsidy or other method
- EU Best practices and comments on the two analysis reports by **Mr Angelo Marano**
 - ✓ Four main points raised by the papers on which the EU experience may be of interest for China:
 1. Empty accounts problem

2. Financing a Notional Defined Contribution (NDC) pension systems
 3. Coordination among central and local authorities
 4. Migrants workers and portability of pension rights
- 1) Empty accounts problem
 - Provinces are using contributions to pay current benefits
 - Underfunding
- **Compare funded systems with PAYG systems.**
No clear advantage of one system over the other
 - **EU Best Practice. The diverting of Italian public employees severance payment to private pensions funds**
- 2) Financing a Notional Defined Contribution (NDC) pension systems
 - Both papers indicate that one should make clear how to finance pension expenditure and what the options are
 - NDC system allows adding a social assistance component to social securities, in an easy and transparent way. You can do a lot of redistribution with NDC system, just it makes it transparent
 - NDC systems should be used with flexibility
 - 3) Coordination among central and local authorities
 - links and coordination procedures among different government levels still are not completely formalized;
 - the different responsibilities on policy setting, implementation and financing may cause incentive problems (moral hazard and similar) among central and local authorities.
- **EU Best Practice 1 - The EU Open Method of Coordination (OMC) in the social field**
 - **EU Best Practice 2 - Italian coordination in health care and the social field between national government, regions (provinces) and local authorities**
- 4) Migrants workers and portability of pension rights: It is difficult to give full recognition of past contributions to migrant workers (internal or foreigners). This could cause high costs for workers mobility.
- **EU Best Practice Recognition of pension rights**

Comments and open discussion involving all the experts

- **Comments by Mr. Jin Weigang**
 - ✓ China learned a lot from the international experience in the field of social security, at an early stage it was introduced a model which integrates social pooling and personal account. Nevertheless, due to the Chinese specific conditions and characteristics, it is not an easy task to apply foreign models in China.
 - ✓ With great transformation of China's society and economy, China's pension system has transformed from traditional retirement system based on planned economy to modern public pension system based on market economy. So in the very beginning China's pension system was not funded yet.
 - ✓ According to the expert, in China it is not feasible to separate personal account from PAYG system, due to the financial constraint and population ageing issue.
 - ✓ EU best practices presented at the panel represent useful examples that China could take into account, especially the EU Open Method of Coordination (OMC) in the social field and the Italian coordination in health care and the social field between national government, regions (provinces) and local authorities. In China, the local government should be responsible for social pooling, while

the central government for the final balance. In terms of migrants workers China faces many challenges in issuing clear regulation for migrant worker pension system and its implementation, however the government already tried to deal with the matter in a recent intervention.

- Comments by **Professor Hu Jiye**,
 - ✓ The previous EU-China Social Protection Reform Project has been a great opportunity for China to learn from EU experience.
 - ✓ Regarding the first pillar pension scheme, how to apply a NDC system, which has been implemented just in relatively small countries such Italy and Sweden, in a large country like China, which is facing tremendous aging population issues? In fact, the USA and other large countries never adopted such system.
 - ✓ Regarding the second pillar pension scheme, we cannot use it because the public sector in China is much larger than in other European countries
 - ✓ The third pillar can be perceived as a kind of life insurance.

- Comments by **Mr Koen Vleminckx**
 - ✓ China faces three main challenges: population ageing; adequacy of pension (coverage); regional inequalities.
 - ✓ To cope with population aging, NDC (Italy, Sweden) or similar models (Germany) have been introduced in Europe. As an example, the NDC model and the German mixed system have the main objective of fiscal and financial sustainability. Nevertheless, we cannot tell if the NDC is a good system in the case of China, as the population aging is increasing very fast, also considering the issue of the empty accounts.
 - ✓ A suggestion could be either to reinforce the funded system or to change into a NDC system. If China chooses this path, the EU experience has many examples China could learn from.
 - ✓ Governance of the system. Attention must be paid to the implementation of the system at a national and local level. The regulation on national level sometimes results on being too vague; at a local level it needs more coordination among different provinces. On this regard, the EU Open Method of Coordination (OMC) in the social field may not be the proper practices to be implemented in China; rather something stricter is needed in China. Maybe a similar method, such as the EU performance agreement among regional agencies could be useful in China, as once an agreement is established, at the local level there is a follow up, where the main aim is to meet the final objective.

- Comments by **Mr. Wang Dehua**
 - ✓ The transparency is the real benefit of a NDC system. Actually, transparency is the focus of many problems in China. People do not really know what are the benefits and good incentives of the pension system.
 - ✓ There are different views on whether to adopt or not a NDC system in China. There are good aspects of NDC model, as people will know how much they pay and how much they will get when they retire. The expert supports a NDC system reform in China. Nevertheless any reform will meet some obstacles, as it did in the EU, such as:
 - Social fairness of NDC system for vulnerable groups.
 - Lower pension benefits
 - ✓ How can the Chinese government respond to these obstacles? The EU experience can give good advice on this regard.

- Conclusion and final remarks by **Mr. Fu Jinling** and **Mr Stefano Patriarca**

- ✓ It is important to underline that the analysis made by the Chinese experts represents their personal view in the field and can in no way be taken to reflect the views of the Chinese Ministry of Finance. Nevertheless, the analysis are meaningful to understand the different advices and views in the field as well as to gather useful EU experiences that could help China operate and enhance its pension system in a healthy way.
- ✓ Mr. Fu Jinling expressed his gratitude for the work performed and thanks to the EU experts, and hoped to enhance the cooperation between Mof and C2 in the upcoming work plan of next year.

Valentina Pignotti / Stefano Patriarca, 21st September 2015 (v.1)

ANNEX I – AGENDA OF THE PANEL DISCUSSION

08.30-08.40	Welcome speeches Mr Fu Jinling, Duputy Director, Department of Social Security, MoF Mr Stefano Patriarca, EU-SPRP, Team Leader
Introduction to Analysis Report on Topic 2.2.1 – “Nominal personal account reform in the basic pension insurance system”	
08.40-9.10	Keynote on EU NDC Models Mr Tito Boeri, President of INPS
9.10-9.30	Analysis Report Presented by Ms. Li Zhen, Chinese Expert
Introduction to Analysis Report on Topic 2.1.1 – “Division of decision power and expenditure responsibilities on social security between central and local government” –European Best Practices on the Topics and Discussion	
09.30-09.50	Analysis Report Presented by Mr. Fuchang Zhao, Chinese Expert
Open discussion involving all the experts	
09.50-10.30	EU best practices and comments on the two Topics submitted by Mr Fabio Angelo Marano, EU Expert
10.30-11.30	Comments on the two Topics by other Chinese and EU experts and specialists
11.30-11.45	Conclusion and final remarks Fu Jinling, Deputy Director, Department of Social Security, MoF Stefano Patriarca, EU Resident Expert Component 2 Yi Xiaolin, Project Officer, EUD

ANNEX II – MOST RELEVANT EU BEST PRACTICES- SUBMITTED BY MR ANGELO MARANO

(Note: tentative and incomplete. This integrates INPS+Formez contribution with what emerged from discussions with Chinese experts, other projects Components and Chinese partners during my mission to Beijing from 18 to 29 July 2015. It is a tentative listing, which may be integrated and further elaborated in view of the panel discussions and thereafter, in order to decide on which best practices to focus the following work.)

Topic 2.1.1 Division of decision power and expenditure responsibilities on social security between central and local government

- 1) **The EU Open Method of Coordination (OMC) in the social field** as offering a soft method of coordinating “central” and “local” governments, based on the formal identification of common objectives, common indicators, reports by “local” governments and reviews of them, to check the coherence with, and the progress towards, the common objectives.
 - a. This could be suitable for China, that already has in place national planning linked to local level planning, although it appears that formal planning is barely applied to the social field.
 - i. Indeed, the OMC, has been told by the EU representative, was already considered among the EU best practices in the previous EU-China program, although, it seems, in another framework than that of managing central-local relationships.
 - b. Clearly, the OMC may be applied with different levels of tightness, which should be considered in a centralized system like China.
 - i. For example, the role that the setting of formal targets could play should be considered, which makes the OMC more tight and effective.
 - ii. Further tightening the coordination process, one could also come to present best practices as the Italian one below, concerning the setting of minimum service or essential service levels.
- 2) **Italian experience on regulation of central-local relationship in the social field.**
 - a. Formally set minimum standards, minimum service levels, essential service levels imposed by the central to the local authorities, which, on their side, have the power to choose policies, as long as they fulfill the minimums.
 - b. This holds particularly on health, where essential levels have actually been set, but the method applies in theory to the entire social field and beyond.
 - i. Also INPS-Formez identify health care as a possible topic for scrutiny: “Implementation of regional autonomy in health care at the level of resources allocated and the services provided locally; this autonomy is based on specific regulations and of relationships encoded between regions and the central government”.
 - c. The difference between different concepts of minimums (minimum standards, minimum service levels, essential levels, standard costs) could be presented, which has strong implications both for the budget and for the level of public provision of the services, as shown by the Italian experience.
 - d. Tools for the monitoring and evaluation of local policies could also be presented, as well as monitoring of local costs based on standard costs.
 - e. Possibility of conditioning the transfer of resources from the central to local authorities to full respect of local duties in terms of minimums and data reporting should also be discussed.

- i. In China while expenditure responsibilities on pensions lies in the local governments and should be financed through contributions, the balance is such that transfers are needed from both other parts of the local budget and the central government budget.
- f. Setting minimum standards and minimum levels of service it not, however, an only Italian experience, and the formal arrangement and practice in other countries could be analyzed too.
- 3) **INPS-Formez** have identified 4 further areas of work, which could also be considered for work:
 - a. **Programming and budgeting procedure of INPS.** “It optimizes the operating costs and makes more efficient the work of central and local structures, which are directly responsible for the resources allocated. This also impacts on financial budget of INPS and, consequently, on the total value of social security within the State budget”.
 - b. **Tools and policies at the central level on the disabled.** “They help to unify the local standards, which used to be very different from one region to the other before, causing functional inefficiencies and unequal treatment across the country”.
 - c. **Extension and flexibility of active and passive work policies at the regional level.** “This especially with regards to the instruments of income protection and income support for people at risk of losing their job, such as non-ordinary social safety benefits in situations of severe economic crisis”.
 - d. **Regions and municipalities autonomous measures of financial support to the households.** “As family and maternity allowances, such as the *baby bonus*, in case of inadequate insurance coverage. Often such benefits are paid centrally by INPS of behalf of local governments”.

Topic 2.2.1 Nominal personal account reform in the basic pension insurance system

- 1) **Portability of pension rights**¹. It appears that mobility of Chinese workers is negatively affected by the rules of the pension systems, with internal migrant workers not being recognized their pension rights or having difficulties with their insurance position, which is managed at the local (provincial) level.
 - a. The Italian experience on this could be useful from two different points of view:
 - i. On one side, NDC, with its individual account and homogenous pension calculation rules, allows for full portability of pension rights, both in a central administered pension system and in a decentralized framework.
 - ii. On the other side, the issue of portability has been dealt with through several legislative interventions, dealing either with the reunion of one’s different contribution in one single individual account (so called “ricongiunzione”) or with the recognition of pension benefits by different public administrations on a per-quota base (so called “totalizzazione”).
 - b. More in general, portability of pension rights is an issue dealt with also at the EU level, the Lisbon Treaty, as the previous EU treaties, putting freedom of circulation of citizens and workers among the fundamental rights.

¹ This issue, as well as the closely related next one, deals with an aspect which should also be dealt with in the Italian best practice suggested by INPS for topic 5.1 of Component 1, namely “*improvement of the individual account Component in public pension system for urban workers*”, where the Italian law on this is explicitly referred to, as well as the EU guidelines on portability. Also Component 1 5.3 topic “*strategy of integrating social security system in urban and rural context also through the portability of social insurance*”, for which no Italian best practices have been suggested, clearly relates to this.

- ii. In particular, the possibility to integrate the NDC model with such corrections, financed thru fiscal revenues, could be shown, so to correct what it seems to be a too abstract view of the working of pension systems based on NDC.
- 4) **The diverting of the Italian public employees' TFR to private pension funds. An example of solving the problem of funding part of the pension system.**³
- a. Although this doesn't directly relates to NDC systems, virtually all the papers submitted by Chinese experts, both in Component 1 and 2, suggest that the so called "empty account problem" is perceived as a critical one in China.
 - i. Such problem refers to the fact that public pension system individual accounts, which were envisaged as fully funded, are in most provinces financed PAYG instead, as resources are pooled and used to finance the overall pension expenditure.
 - ii. All papers seem to claim that fully funding levels on such individual accounts should be restored, instead of the PAYG financing (which, however, seems the system envisaged by the MOF, probably for budget reasons).
 - b. One could argue whether fully funding individual accounts would be the best option in the Chinese framework, rather than, say, the adoption of NDC accounts, who replicate individual account features, while maintaining a PAYG financing structure.
 - c. Nevertheless, also given the overall limited dimension of the resources that would be involved, one could offer the example of the solution identified by the Italian government to make the private pension funds for public employees take-off.
 - i. Private pension system is envisaged in the Italian pension system to be financed through individual and enterprise contributions (1%-2% of wage each) which would add to the Italian deferred compensation Component, called TFR, which is 6,91% of the wage base and would be transferred to private pension funds.
 - 1. However, for public employees, such component is financed PAYG, being paid only at the moment of one's retirement. Its diverting to private pension funds would thus have implied that, for each worker signing in a pension fund, the government should have liquidated to such fund the entire TFR matured till that moment, which would have implied for a certain period an unbearable extra-burden for the government budget.
 - ii. In practice, the problem can be viewed as one of passing from a PAYG funding (the TFR) to a fully funded system (the diverting of TFR to private funds).
 - 1. The government budget should have disbursed the resources needed to the funding immediately (at least for those willing to enter a pension fund) while in the budget only the resources needed to pay the entire TFR to those that are expected retiring in the year are allocated.
 - iii. The solution found consists of splitting in two the contribution to the public employees private pension funds.
 - 1. The contribution corresponding to the TFR will be paid by the government to a pension fund only at the moment of retirement of the worker, with (notional) annual contributions uprated³ in line with the pension fund actual performances;
 - 2. instead, the additional contributions paid by the public employer and the public employee are actually paid to the pension fund monthly.

³ This issue is similar, although with a different emphasis, to the Italian best practice suggested by INPS for topic 4.5 of Component 1, namely "occupational pension plan for public sector and private pension plan".

- iv. In this way, the additional burden for the public pursue is limited to the employer contribution to pension funds, while the TFR part continue to be financed PAYG, without affecting the workers, although this implies lower funds to be invested by the pension funds and some additional risk taken over by the public budget, who sees part of its liabilities indexes to financial market performances.
- 5) **INPS-Formez** have identified 2 further areas of work, which could also be considered for work, although the first is very general, while the second may be of limited interest in the current Chinese framework:
- a. “Analysis of the **reform of the Italian pension system** and of the current rules concerning the requirements for access to the basic pension, the methods of calculation used and the system of funding adopted by the different funds operating the compulsory pension insurance”.
 - b. **“INPS "my pension" initiative**. This allows all insured persons to simulate the amount of their future pension on the basis of the information present in their unified individual account statement and to verify the length of contribution that is still missing to reach retirement age; calculations use appropriate projections of life expectancy, from which minimum retirement age depends, and different future macroeconomic and individual career scenarios”.



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