FINANCIAL SUSTAINABILITY OF THE BASIC PENSION SYSTEM IN CHINA

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Executive Summary

1. By end 2012, the accumulated surpluses for the Basic Pension System (BPS) for enterprise workers in China's urban areas accounted for about 4.5% of the country's GDP. Enrollees reached over 304 million in 2012.

2. Although contributions to the basic pension system have increased in tandem with the coverage and wage rate in the last one and a half decade, financial risks for the BPS are still eminent. Deficits for BPS in 2013 are expected to amount to RMB90 billion.

3. The financial stability of social security funds depends on firstly, the share of people over 60 years old in the country's total population. In China, the figure is on an upward trend until 2050 when it will hit over 30%, compared to about 12% in 2010.

4. Secondly, contribution evasion is another source of financial risks. It is estimated that the amount of tax avoidance for pension contribution can be as high as 80% of actual contributions to pension fund.

5. Thirdly, annual returns for accumulated surpluses of basic pension system are significantly lagging behind that of wage growth. To meet living standard and cater for inflation, the government has increased pension benefits for nine years since 2005, broadening the outlay of the BPS further.

6. Fourthly, the fragmentedly managed social security fund is not financially robust as there is no risk diversification.

7. Financial deficits of social security fund are covered by diverting funds from individual accounts to social pooling account. However, unfunded individual accounts have weakened the credibility of the system.

8. To reduce financial risks of basic pension system, government budget could be used to cover deficits. In 2012, government subsidy for the BPS amounted to over RMB264.8 billion, or about 0.5% of GDP.

9. A social insurance law laying the general rules of contribution, coverage and benefits of BPS was released in 2010. A new round of pension reform is expected in 2013.

10. A pension reform would have to provide incentives for local government to integrate the fragmented social security plans, improve its fiscal capacity to fund individual accounts and further develop its supplementary pension schemes.