

Under-coverage of Social Insurance in China's Informal Economy

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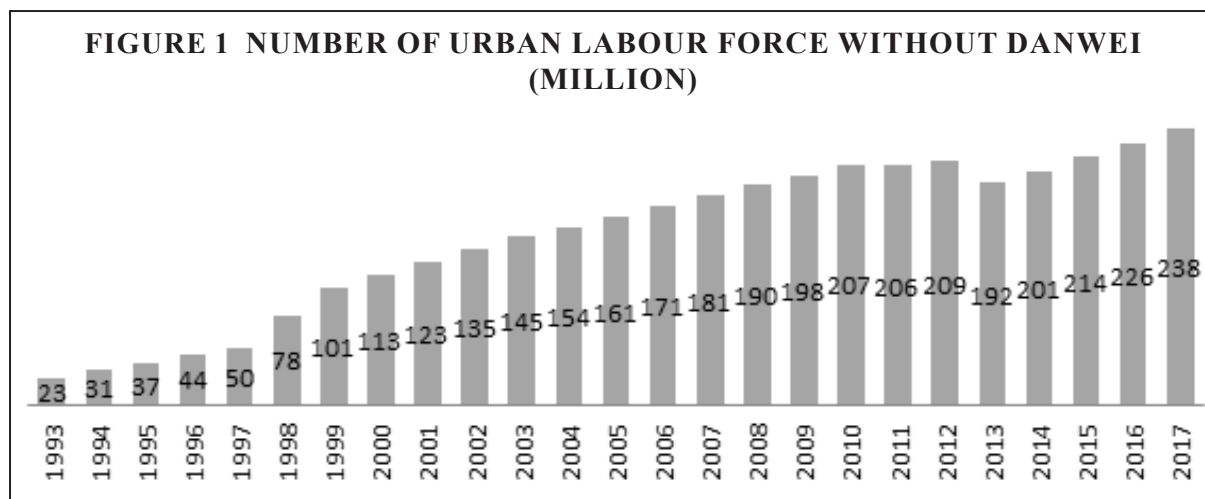
According to a 2018 report by the International Labour Organisation, about 54% of China's urban workforce in 2013 participated in the informal sector, ranging from freelancers and private contractors to migrants working without formal employment contracts and proprietors of small-scale private enterprises.¹

The size of the informal sector in China has increased dramatically since the 1990s. Informal work is well known for being less regulated, with lesser labour protection than formal employment. However as the informal sector continues to expand, the state must confront another problem: The current social insurance scheme, designed with the formal sector in mind, is not keeping pace with the needs of the country's informal workforce. This not only leaves many informal workers without a safety net, but also endangers the long-term viability of the welfare system at a time when the country's rapidly ageing population threatens to send costs soaring.

Prior to the 1990s, most urban workers in China were affiliated with a work unit, known as a danwei, which provided employees with a comprehensive set of social welfare services for health care, education and pension. When state-owned enterprises (SOEs) were the dominant economic actors, the private and informal sectors were still small enough to be ignored. It was not until the 1990s, when a significant number of SOEs had been restructured and a large portion of their workforce laid off, that the informal sector began to explode in size (Figure 1). That same decade, China initiated a new urban employee social insurance scheme comprising five elements: a pension plan, health insurance, unemployment insurance, reproductive insurance and workplace injury compensation.

* Part of this commentary is adopted from Qian (2019). "Why Informal Workers Are Opting Out of China's Welfare System", <https://www.sixthtone.com/news/1004594/why-informal-workers-are-opting-out-of-chinas-welfare-system>, accessed 31 January 2020.

¹ International Labour Organisation (ILO). (2018). *Women and Men in the Informal Economy: A Statistical Picture*, Geneva: ILO.

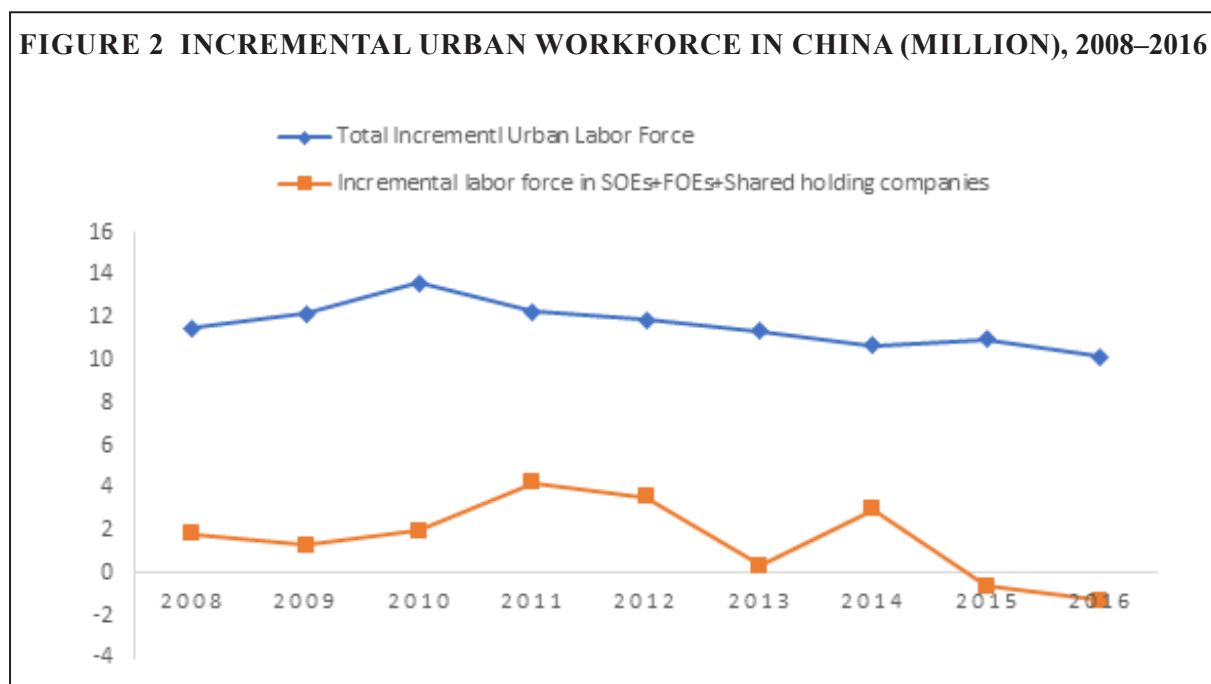


Source: *China Statistical Yearbook*, various years. Registered unemployed are not included.

Yet this new scheme continued to target formal employees only, requiring contributions from both enterprises and individual employees in proportion to their payrolls and wages, respectively. Even though informal sector workers and rural migrants were theoretically allowed to sign up for urban residence-based social insurance from the mid-2000s, many opted not to do so, as benefits for residents not enrolled in the full urban employee scheme were much lower.

As a result, though recent statistical data suggests that the informal sector rather than state owned enterprises or foreign-owned enterprises has provided the majority of new urban jobs in China since 2010 (Figure 2), most of these workers are not enrolled in or protected by the country's social insurance scheme. Nationwide survey data show that, among workers in the informal sector, the pension enrolment rate is below 47%. In contrast, 90% of formal sector workers have enrolled in the state pension scheme.

With many workers lacking health and unemployment insurance, they are in real danger of falling into poverty if they are laid off or experience a serious medical emergency. Indeed, the problem of urban poverty is attracting increasing attention from policymakers as more urban workers are left exposed to these risks.



Source: CEIC. SOEs and FOEs refer to state-owned enterprises and foreign-owned enterprises respectively.

Interestingly, however, many informal sector workers have opted out of social insurance schemes largely because of low benefit payouts and continued difficulties in accessing local welfare services.

China's welfare programmes are run at the prefectural level, and in smaller, poorer regions, as well as those with larger informal sectors, benefit payouts are generally lower than in richer areas. This incentivises workers from poor areas to risk going without insurance.

At the official level, some recent studies show that economic performance as a criterion for an official's promotion has presided over social programme provision. Local officials may want to spend more on infrastructure building to attract investors than to spend on social programme to protect the informal sector workers. More equal access to the labour market for informal sector workers is likely to increase costs for investors in the manufacturing sector, which may discourage the entry of investors and in turn impact on local economic growth.

Another factor is the country's *hukou* system of household registration which poses a problem for many informal sector workers. For individual workers and the self-employed, enrolment in the social insurance system is not a very attractive option since in many cases they can only claim benefits from the city or region where their *hukou* is registered, and payouts there may be lower than in their city of residence.

The scheme's payment structure could also be a deterrent. Many high-earning members of the informal sector — including some self-employed workers and those who run small, private companies — expressly choose not to enrol in social insurance schemes. Although contribution rates are progressive and tied to income, the benefits of some social insurance programmes, such as unemployment insurance, are fixed and not income-related. Hence, high-income workers sometimes prefer to simply buy private insurance instead.

Low social insurance enrolment rates among the informal labour force not only leave many workers without a safety net, but also pose a long-term threat to the viability of the entire welfare system. Broad-based enrolment in social insurance is especially crucial as China's population continues to age. The share of those aged 65 and above had increased from less than 6% in 1994 to over 10.9% in 2018, according to the World Bank.² In provinces where the population is starting to grey, local authorities have already been forced to plug holes in pension funding by transferring funds from their general budgets. In 2017, these transfers accounted for roughly 15% of the RMB3.35 trillion the country spent on urban employee pensions that year.

Looking forward, it is important to increase informal sector participation in social insurance. One possible option is for policymakers to reduce the high compliance costs of China's welfare system, including optimising its management and reducing the burden on users.

In particular, the government would do well to consider upgrading the management, control, and disbursement of pension funds from the prefectural level to the provincial level. This would equalise benefit payouts across a given province and assuage the concerns of workers who are still registered as living in poorer areas even though they have migrated to the provincial capital or another major city.

Policymakers should also give thought to adjusting payouts for unemployment insurance to take into account either total contributions or income brackets. This could potentially bring more high-earners back into the system and boost overall contributions.

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² <https://data.worldbank.org/indicator/SP.POP.65UP.TO.ZS>, accessed 21 October 2019.