

Social security in the People's Republic of China

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Strengthening the social security system to promote coordinated economic and social development

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To establish and improve the social security system is one of the main objectives of the development and reform process

Establishing and improving the social security system is a necessity for the full implementation of the Scientific Development Concept. In accordance with the objective and mission of building a well-off society in an all-around manner and on the basis of a comprehensive analysis of both domestic and global circumstances, the Chinese Government has adopted "the putting people first development concept that focuses on comprehensive, coordinated and sustainable development, and promoting a balanced social-economic development and all round development of the people". The government highlights the promotion of reform and development along the comprehensive and scientific development concept "in accordance with coordinated development between urban and rural areas, between different regions, between social and economic development, sound and harmonious development between mankind and the environment, and between domestic growth and opening up to the outside". The functions of the social security are to address the harmonious and common development among economy, society and environment. Therefore, to establish and improve the social security system is indispensable for thorough implementation of the Scientific Development Concept. In the course of development, China needs to balance efficiency and equity, attach equal importance to economic growth and social progress, and give priority to the overall improvement of living standard along with the growth of wealth. The development and improvement a social security system suitable to China's economic development level is an important measure to meet the above requirements. The Chinese Government has taken various measures to help the people overcome difficulties in work and daily life, including adopting active employment policies, increasing investment in education and human resources development, raising the income of residents, reducing the gap between the rich and the poor, and improving people's health. All these measures play an important role in improving the social security system and are in line with the Scientific Development Concept.

The social security system functions as a pillar for the socialist market economy system. Since the initiation of reform and opening up in China, China has witnessed a

transition from planned economy to socialist market economy. Market forces have come to play a fundamental role in allocating resources, and the national economy has been restructured in full scale and experienced rapid growth. Meanwhile, new changes have taken place in the layout of interest groups. The traditional practice where the enterprises were directly responsible for delivery of pension benefits to their employees failed to meet the new demand, and market competition highlights the urgent need to build social security for vulnerable groups. Without a proper solution to this issue, the socialist market economy can hardly function in a smooth manner. In view of this, the government has carried out the reform of the social security system along with economic restructuring, and turned the social security system into a pillar for the socialist market economy system. Experience has proven that the gradual progress of China's reform and opening up relies on the establishment and improvement of China's social security system. At present, a number of deeply rooted economic problems are yet to be resolved, and the task of economic restructuring is far from being accomplished. On the one hand, the deepening reform calls for strong support from the social security system; on the other hand, reform will create favourable conditions facilitating the progress of social security undertakings.

The establishment and improvement of the social security system provides a fundamental guarantee for maintaining stability. China has embarked on a critical stage of its modernization drive, and profound changes are taking place in economic and social structures. Therefore, it is of vital importance to properly handle relationships among various interest groups, the relationship between economic growth and social development as well as the relationship among reform, development and stability. Little can be achieved without a sound social order and enabling environment in China. In this sense, establishing and improving the social security system meets the need of not only vulnerable groups but also of the whole society. China's social security system should aim at ensuring equal opportunity of the people in participating in market competition, safeguarding the necessary human resources for development, and stimulating production and revitalizing the economy by income redistribution. Therefore, the establishment and improvement of social security suitable to the socialist market economic system will promote coordinated economic and social development and will guarantee the long-term stability of the nation.

China's social security makes progress along the development and reform process

China's economic growth has laid a solid foundation for the social security system. With reform and opening up in the past 25 years, China has attained remarkable achievements in economic and social development with a rapid growth of the national economy and increasing economic strength. In 2003, the gross domestic product (GDP) reached RMB¹1,168.98 billion with GDP per capita over USD1,000. China has experienced steady expansion in its agricultural and industrial production, constant increase in social supply, prosperous market, plenty of commodities, constant increase in people's income and gradual improvement of people's living standards. The rapid economic growth has laid a solid material foundation for the social security system.

In recent years, the Chinese Government has continuously increased investment in social security. Governments at all levels have intensified financial support and made greater efforts in their work, so as to implement job-creating measures and the policies of "two

¹ RMB = Chinese currency, Renminbi. The current exchange is approximately USD1.00 = RMB8.28 (August 2004).

guarantees" (guaranteeing basic living allowances for workers laid off from State-owned enterprises (SOE) and timely and full payment of pensions for retirees), "three security lines" (basic living allowance guarantee for laid-off workers, minimum living allowance guarantee for poor urban residents and unemployment insurance).

In-depth reforms are being implemented in the social security system. In light of the direction of the socialist market system reform, China has made a series of reform and exploration in the field of social security. Regarding pension insurance, a system has been established that combines social solidarity (through a pooling fund) with individual accounts. With regard to medical insurance, a mechanism under which the cost is shared by multiple parties has been set up. On unemployment insurance, active policies to promote employment have been adopted. In terms of social security administration, China has practiced the separation of policy making from policy implementation and gradually established an administration system with governments responsible for its organization, participants from various groups, multiple channels for fund raising, regulated operation and socialized delivery of services. After the implementation of the Pilot Project of Improving the Urban Social Security System in Liaoning Province, the Pilot Project was extended to Jilin Province and Heilongjiang Province, furthering the reform and exploration for the sustainable development of China's social security.

Relevant reforms have been unfolded along with the social security reform. To promote the construction of the social security system, the Chinese Government has actively promoted supplementary reforms. The enterprise reform has achieved progress and a large number of State-owned enterprises have pressed ahead with the construction of the modern corporate system, resulting in improved efficiency. An overwhelming majority of small and medium-sized enterprises have gradually revitalized their businesses through system transformation. The environment for enterprises to participate in social insurances has tangibly improved. Furthermore, reforms of the medical and health system and the price administration system have curbed the momentum of price hike in medical services and medicine, providing favourable conditions for the implementation of the medical insurance. Community development is also strengthened to provide a sound social basis for social security management.

The subsistence guarantee for vulnerable groups is further strengthened. The number of urban residents receiving minimum living allowance increased from 4.02 million in 2000 to 22,468 million in 2003, basically accomplishing the objective of guaranteeing benefits for all those who are qualified. The State encourages localities with ripe conditions to explore ways of providing social security to the rural residents. By end 2003, the numbers of people receiving traditional rural social relief and the minimum living allowance for rural residents had reached 10.93 million and 4.02 million respectively. The new rural cooperative medical care system has been piloted in 310 counties nationwide, covering 68.99 million people. In addition, the government also attaches great importance to employment training and wage guarantee for migrant workers, and relevant policy measures have been adopted.

Further promote the building of China's social security system

Although great progress has been achieved in China's social security reform in the process of reform and development, it should be fully realized that due to imbalance in development and system and mechanism reasons, there exists a lot of contradictions and problems in the system. There is a big gap between the security level and demands of development. The

implementation and management on social security should be enhanced in their efficiency and quality. The establishment and improvement of a social security system compatible with the economic development level is written into the Constitution, which has laid down a legal basis for the development of social security and the protection of the legitimate social security rights of the people, and set higher requirements for the building of the social security system.

At present, relevant government agencies are making great efforts to establish and improve the social security system in China, and the National Development and Reform Commission (NDRC) will continue its active participation in, and support to, the establishment and improvement of the social security system. As a macroeconomic management agency under the State Council responsible for development and reform, the NDRC will fulfill its responsibilities related to the improvement of the social security system in the following three aspects:

First, further promote development so as to build a solid foundation for social security. China is a developing country with underdeveloped economic infrastructure. Development is of overriding importance. Only by better and more rapid development can we provide a solid material basis for the development of the social security system. The first two decades of the twenty first century is a period of important strategic opportunities for China, and China must seize the opportunities to attain great achievements. In the international arena, peace and development are two themes that top the global agenda, and it is likely that we can take advantage of the favourable timing and circumstances to accelerate development. From the domestic perspective, there are also favourable conditions to accelerate development. The key issue is that we must, under the guidance of the Scientific Development Concept, dialectically understand and handle major issues related to development, grasp and make best use of the period of strategic opportunities, maintain sustained and stable economic growth and provide a solid foundation for social security. Only by maintaining the sustained and stable development of the economy can we lay down a solid basis for social security development and well settle various contradictions in economic and social life.

Second, continue the reform of social security and relevant systems and provide institutional guarantee for the improvement of the systems. The improvement of the socialist economic system and the building of a well-off society in an all-round manner requires a determined reform, while the establishment and improvement of the social security system requires a deepening reform. Under current circumstances, it is a must to increase input into social security in accordance with the real needs. However, if we fail to resolve the problems related to systems and mechanisms, it would be likely that increasing investment does not play an effective role or leads to new problems. Social security falls into social redistribution and must be compatible with the development and progress in mode of production. In the current social security system, there are problems such as low pooling level, overlapping government administration, inconsistency of policies and etc. These problems are not in line with the large-scale socialized production and market development, and therefore should be addressed through restructuring and reform in accordance with the needs of development. From the perspective of system designing, social security is subject to not only economic objectives but also social objectives. Therefore, when improving the social security system, we must coordinate demands from all the aspects of economic and social development.

All these require promoting relevant reforms in the labour and personnel system, a permanent residence registration system and an income distribution system so as to build institutional guarantee for the improvement of the social security system.

Third, strengthen studies on strategic planning of social security to build a scientific foundation for the sustainable development of social security. Against the background of a huge population, the underdeveloped economic infrastructure and imbalanced development in China, improvement of the social security system demands study on overall issues. China has indeed witnessed steady coverage expansion in social security and strengthened capacity against risks. However, seen from the perspective of a 1.3 billion population, it is evident that the achievement is far from the social demand and the due results. At present, China is stepping into an ageing society, and social security issues such as pension and medical care are closely related to ageing. For most developed market economies, population ageing comes after their urbanization and modernization, while in China it arrives during the process of urbanization and modernization. If China fails to meet population ageing in strategic and sustainable social security development perspectives, it will have to pay expensive costs in the future. The drafting of the 11th Five-Year National Plan has started, and as the general plan for national economic and social development, it will feature strategic vision, macroscopic view and policy orientation, emphasize coordinated development, focus on addressing vulnerable factors that hamper development, and guide economic and social development effectively. In light of the difficulties and priorities, the NDRC will conduct thorough studies in cooperation with relevant agencies, combine short-term and long-term consideration, underline the importance of coordination, and be practical and innovative in completing the drafting mission, so as to provide a scientific foundation and guidance to the sustainable development of social security in China.

In the course of achieving coordinated economic and social development, it is an important task to establish and improve a social security system compatible with China's current economic development level. We will stick to the putting people first development concept that focuses on comprehensive, coordinated and sustainable development, deepen reform and open up wider to the outside world, attach importance to the spirit of seeking truth from facts, draw on international experiences and continue our contribution to the sustainable development of China's social security.

Financial support for sustainable development of China's social security

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With efforts made in the past two decades, China has witnessed a transition from its traditional social security system and practice under the planned economic system to an urban social security system which is compatible with the socialist market economic system, the "Three Security Lines", and pension and medical insurance etc. as its key elements. The new system has played its important role in promoting reform, strengthening economic development and maintaining social stability. Meanwhile, the Chinese Government has been actively promoting financial system reform, and a public financial system framework commensurate with the socialist market economic system has taken shape. The functions of the State financial departments have also undergone substantial changes, with a shift towards ensuring public expenditure, promoting social justice, adjusting macro-economy, optimizing resource allocation etc. Social security has become one of the key responsibilities of the government's financial system, which has provided forceful policy and financial support for the sustainable development of China's social security.

To actively participate in and promote the social security system reform with the aim to develop a social security system suited to the financial and economic affordability levels

A sound social security system is a stabilizer for social progress, a damper for economic development, and an adjustor for social justice. Hence, establishing and improving the social security system is one of the key elements in establishing and improving China's socialist market economic system. In order to implement a series of critical reform measures and policies on the social security system, Chinese financial departments have been fulfilling their responsibilities by participating in policy making and the implementation of schemes of pension insurance, unemployment insurance, medical insurance, the basic living standard guarantee for the laid-off employees of State-owned enterprises, the minimum living standard guarantee for urban residents, medical and health services reform, and the pilot reform on improving the urban social security system etc. In collaboration with related government departments, the Ministry has determined appropriate social insurance contribution rates, and strictly monitored the level of social security benefits. Projections on the revenue and expenditure of various social security schemes and their impacts on government spending and enterprises have been made so as to enable us to come up with policy recommendations from a point of view of macro administration and balancing revenue

with expenditure, and attain the objective of making social security benefits level compatible with financial and economic development level.

Improve social insurance contribution collection and benefit payment administration and promote the development of a social insurance mechanism for fund balance

China's social insurance system reform could be dated back to 1984, when the urban employees' basic pension was funded by contributions from employers and employees. In the past years, although the coverage of social insurance was extended and the compliance rate improved, there remained a big gap between social insurance fund expenditure and revenue. This could be attributed to the following reasons: (i) the lack of effective compulsory mechanisms preventing enterprises from avoiding and defaulting social insurance contribution. In addition, some enterprises were indeed having difficulty in operating, making the phenomenon of non-compliance not uncommon; (ii) Social insurance contribution collection is not well regulated. In some regions, there were the practices of balance contribution (making up of the difference between contribution due from social insurance benefits payable to the enterprises), or negotiable contribution collection, or even reduction or exemption of enterprise contribution etc.; (iii) weak infrastructure on social insurance administration. There had been the lack of dynamic and scientific administration over contributory wages, number of participants, social insurance benefit items and formula etc. Therefore, it is not unusual to see fund abuses and frauds in the process of contribution collection and benefit payment.

In order to attend to the above issues, we have strengthened the administration over social insurance contribution collection and benefit payment. In particular, we have intensified our efforts on the collection of social insurance contribution, taking effective measures to verify the number of social insurance participants and the contributory wages to ensure full compliance. In accordance with the *Provisional Regulation on Social Insurance Contribution Collection*, we have changed the conventional contribution collection measures, such as the balance collection and negotiable contribution collection. This shift has well ensured the steady increase of the revenue of social insurance funds. By end 2003, 16 provinces (including autonomous regions, and cities directly under the central government), and some municipalities, as well as major cities, had adopted the practice whereby contributions were collected by tax authorities. In the meanwhile, efforts have been made to clear and regulate the items of social insurance benefits, benefit level and benefit formulae, by means of screening the qualification for benefits, which have kept fund abuses and benefit frauds under check.

Increase financial input and raise social security fund from multiple channels

With the accelerated ageing of population, it is expected that social security expenditure will further increase. Yet the affordability of enterprises and employees is limited, without much room for increasing social insurance contribution rates, the contradiction of social insurance fund revenue against expenditure will further sharpen. Therefore, while seeking to achieve social insurance fund balance, it is necessary to consider expanding social insurance funding channels to raise fund capacity from multiple sources.

In meeting the requirements of economic transition and maintaining social stability, the Chinese financial departments have been active in improving its public financial system, and restructuring financial spending, under the principle of taking initiatives in some fronts and not in others. They have reduced subsidies for production, and subsidies that could be otherwise compensated by markets, and increased its spending on social security year by year. In 2003, the government spending in the form of subsidies for enterprise basic pension insurance, basic living standard guarantee for laid-off employees and the minimum living guarantee for urban residents has increased six times over the figure in 1998, of which the central government injected over CNY70 billion. During the years of 1998 to 2003, the central government injected over CNY260 billion for the above three schemes.

In addition, the Chinese Government is actively exploring new financing channels to strengthen the fund capacity. In 2000, the National Council of Social Security Fund was founded by the government, with financing coming from the government budget, the proceeds of the selling of State-owned shares in newly listed companies and other resources approved by the State Council. The purpose of establishing the National Council of Social Security Fund was to make necessary fund accumulation in advance for the development of social security. By end March 2004, the fund exceeded CNY140 billion.

Improve the financial system and strengthen social security fund management and supervision

It is an important responsibility of financial departments to perform financial management and supervision over social security funds in accordance with the relevant laws and regulations. It is also a basic guarantee for the sustainable development of social security. In recent years, the Chinese financial departments have formulated a series of rules and regulations on social security financial management, regulated the allocation and management of social insurance funds, strengthened fund supervision, and enhanced fund utility. First, administration over social security financial accounts has been improved. In 1996, the Chinese Government made regulatory provisions that pension insurance, unemployment insurance and medical insurance funds should be put into special financial accounts, with separate management between their revenues and expenditures. At present, such financial special accounts have been established in all localities, which has well preserved the fund safety and integrity and ensured that the funds are used for the designated purposes. Second, the financial management system on social security has been set up and enhanced. Based on Chinese context, financial and accounting rules for the management of social insurance fund, basic living standard fund for laid-off employees of State-owned enterprises (SOE), and the re-employment promotion fund etc., were established, respectively. These have enabled an orderly administration and regulated operation of the social security fund. Third, ways of social security fund transfer payment have been further improved. In order to rationally distribute social security subsidies and reduce artificially imposed factors in the process of subsidy determination; the central government adopted the special payment transfer mechanism, making transfer payments linked with the financial capacity of localities, indicators such as their performance etc. It assures transparency, fairness, standardized practice and motivates localities to well administer social security funds and inject their own financial input. Fourth, social security fund supervision and inspection have been strengthened to ensure the integrity and safety of the social security funds. In recent years, the Chinese competent departments have carried out a number of targeted inspections on the management and administration of the fund of basic living standard for laid-off employees of State-owned enterprises, unemployment insurance fund, basic pension insurance fund and that of minimum living standard for urban

residents. Based on the findings of these inspections, measures were taken to strengthen social security fund administration.

It is well known that financial sustainability is a prerequisite for the successful running of the social security system. In accordance with the overall requirements of improving the socialist market economy and building a well-off society in an all-round way, the Chinese Government will further deepen its public financial reform and social security system reform, to improve the basic mechanisms and system, standardize administration with the aim of ensuring financial sustainability of the social security system and promoting its healthy development. Firstly, further deepen the social security system reform to improve pension insurance, unemployment insurance and medical insurance schemes, etc. and ensure that social insurance schemes have the capacity for financial balance between fund revenues and expenditures. Secondly, efforts should be made to summarize local experiences and review international good practices. We should strengthen social insurance compliance and establish a long-lasting mechanism for fund balance between revenue and expenditure. Thirdly, expedite public financial reform, further restructure financial spending, gradually increase input into social security and raise the proportion of government spending on social security to its overall spending. Fourthly, explore various channels to raise social security funds. Continuous efforts should be made to use market acceptable means to allocate State assets into the funds, undertake diversified fund investment in a prudent fashion, and promote lottery issuance etc. to enhance social security fund capacity. Fifthly, further strengthen social security financial administration and supervision. In due time, social security budgeting mechanisms should be introduced. Efforts should also be made to strengthen fund management and supervision, and dynamically oversee the collection of social insurance contribution and the payment of social security benefits, and formulate targeted policies in a timely manner.

The minimum living standard guarantee system for urban residents in China

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The minimum living standard guarantee system for urban residents in China is a new social relief and assistance system by which the government grants subsidies to the urban needy based on minimum living standard, and constitutes an important component of China's social security system. As an innovation system, it results from the central government's effort of reform on traditional social relief systems by means of combining international practices with national conditions so as to adapt to changes in social and economic development. With ten years of exploration and practice, this system has developed into one with a complete set of rules and regulations and a fairly standardized administration system. A framework with focus on determination of scope of coverage, formulation and adjustment of benefit standard, collection and management of the funds, standardized procedure for examination and approval, and perfection of management systems and operation mechanism has initially come into being.

Progress in implementation of the system

The central government attaches great importance to the work of minimum living standard guarantee for urban residents, regarding it as a cardinal task of top priority to attend to. In recent years, the central government has adopted a series of significant policies and measures, and top leaders have also given quite a few important instructions, setting higher demand on this work. In March 2003, the State Council reemphasized that each local government should pay due attention to this issue, adjust the structure of financial expenditures, and work out practical and feasible measures to secure funds for the basic subsistence of the urban needy. At the Economic Work Conference of the central government in December 2003, President Hu Jintao pointed out that "we should set up and improve social security systems commensurate with our national economic development, speed up perfecting various social security schemes, continue to do a good job in the 'two guarantees', implement in a down to earth manner the unemployment insurance and minimum living standard guarantee systems, and ensure an appropriate link among the 'three security lines'". In March 2004, in his government work report, Premier Wen Jiabao called for further defining the standard and scope of the minimum living standard guarantee system for urban residents, strengthening the social relief system, and addressing practical difficulties of the needy families in medical services, schooling of children, housing, and heating in winter, etc.

Thanks to great efforts of governments at various levels, the past several years witnessed a rapid development of the minimum living standard guarantee system for urban residents.

According to the Ministry of Civil Affairs, there were only 4.02 million urban residents receiving the minimum guarantee allowances by end 2000, but this figure rose to 22.468 million by end 2003, basically achieving the target of "extending the guarantee to all eligible people". In 2003, the governments at various levels paid out CNY15.1 billion as minimum guarantee allowances, out of which 9.2 billion were subsidies from the central government. In the same year, the minimum living standard stood at an average of CNY115 per person each month throughout the country and an average monthly allowance of CNY58 was paid to each recipient. Moreover, local governments at various levels worked out some preferential policies and provisional income supportive measures in accordance with the minimum living standard guarantee system for urban residents, providing certain discounts, reduction and exemption with regard to water, electricity and heating charges as well as medical services and children's schooling for target families. Some localities have even adopted a low-rental housing assistance programme and a medical aid system for serious illnesses.

The successful implementation of the minimum guarantee system for urban residents has effectively ensured the basic livelihood of the needy, particularly the poverty-stricken employees, promoted the smooth reform on economic system especially the State-owned enterprise (SOE) reform, and safeguarded the social stability. The roles and effects of the system are embodied in the following aspects:

- It further reflects the superiority of China's socialist economy, and gives full expression of the fundamental aim of the Chinese Government to serve the people heart and soul. That people with material difficulties are offered assistance is the right endowed by the Constitution. It is the consistent aim of the Chinese Government to care for the life of the masses and the hardships of the people. The implementation of the minimum living standard guarantee system for urban residents fully interprets the superiority of China's socialist system and the important thinking of "three represents", and it is also an important evidence that the Chinese Government values and safeguards human right.
- It further perfects China's social security system. China's social security system, besides social relief system, consists of many components including social insurance. However, in light of addressing hardships in life of residents, this minimum living standard guarantee system is the "last resort" measure and a cardinal part of the social security system, so it is often called "the last safety net" for urban residents.
- It effectively promotes social stability. The recent years saw increasing laid-offs and unemployed, widening the gap between the rich and poor and the growing needy residents, as a result of the transformation in the system and transition of the economy. This minimum living standard guarantee system for urban residents adopts the relief policy of "not to make chalk of one and cheese of the other" and treats all urban residents on the same footing. Any person, employed or not, whenever his/her average family income is lower than the local minimum living standard, can apply for the minimum living allowance, receiving assistances from the State and society in time. This system, therefore, eases social conflicts, promotes social stability, and helps safeguard the smooth implementation of China's reform and opening up policy.

Main contents of the minimum living standard security system

In 1997, the State Council released the *Circular on Establishing Nationwide Minimum Living Standard Guarantee System for Urban Residents*, making clear the contents, forms and processes of implementation for the system. In 1999, the State Council promulgated the *Regulations on Minimum Living Standard Guarantee for Urban Residents*, which provided legal basis for this system. The State Council released, in November 2001, the *Circular on Further Strengthening the Work of Minimum Living Standard Guarantee for Urban Residents*, which gave a more specific and definite explanation of some policy-related issues, and put forward the responsibilities of and work requirements on local governments in light of scope of coverage, funds, operating mechanism, etc. In the course of promoting reform on the social security system and the work of minimum living standard guarantee for urban residents, the competent departments under the State Council also released some specific policies and regulations on this issue. Meanwhile, as instructed by the central government, local governments at various levels, taking into account local conditions, worked out and promulgated detailed measures, rules and regulations on its implementation. All these policies, rules and regulations constitute the legal framework for China's minimum living standard guarantee system for urban residents.

Scope of coverage. According to the *Regulations on Minimum Living Standard Guarantee for Urban Residents*, "any urban resident with non-agricultural status whose average family income is lower than the local minimum living standard is entitled to obtain basic living materials from the local governments." In light of the present composition of target groups for minimum living standard guarantee throughout the nation, the poverty-stricken, the unemployed and their dependents account for 95.8 per cent, serving as the major part of the urban needy, while the elderly widows and widowers who are childless and have no labour capability and no income source account for merely 4.2 per cent. In perceptive of distribution, they are largely located in central and western regions, old industrial bases in north-eastern regions and areas with many depleted mineral mines.

Minimum living standard. According to *Regulations on Minimum Living Standard Guarantee for Urban Residents*, the standard is determined by the local governments "according to the costs for such necessary basic living materials like clothing, food and housing with due consideration of charges for water, electricity and fuel gas as well as compulsory education expenditures for juveniles." The major basis for determining the minimum living standard is the minimum expenditures necessary for maintaining basic livelihood, with reference in the mean time to per capita income and consumption of urban residents as well as residents' living consumption price index and other social security standards, and taking due consideration of the development level of the local economy. Information indicated that the minimum living standard for cities all over the country averaged at CNY155 per capita per month in year 2003, and the target groups were paid CNY58 per month on the average, which could largely maintain the basic livelihood.

The minimum guarantee funds. According to the *Regulations on Minimum Living Standard Guarantee for Urban Residents*, the funds "are included in the fiscal budgets of the local governments, and put under the designated social relief funds with independent management and dedicated purposes." Since the second half of 1999, the central government, on the basis of increased minimum living standard, began to grant certain amount of subsidies to the central and western regions, CNY400 million in 1999 and 800 million in 2000, respectively. Since then, the central government provided more support

for local governments, granting CNY2.3 billion in 2001, 4.6 billion in 2002, and 9.2 billion in 2003, respectively. As instructed by the central government, the minimum guarantee funds allocated by the governments at all levels are put under "the designated financial account for social relief funds" for management.

Working processes. The Regulations on Minimum Living Standard Guarantee for Urban Residents gives detailed explanation of these processes, including application, investigation, examination, approval, allowance delivery, dynamic management, administrative reconsideration and administrative lawsuit, in which investigation, examination and approval are the key processes for determining whether an applicant can be granted the minimum living allowance. The local governments at various levels have worked out specific enforcement measures and rules. In practice, by adopting democratic appraisal in communities and welcoming social supervision, the system reflects the principles of openness, impartiality and fairness.

Administration system. So far as the administration system is concerned, local governments assume full responsibility, i.e. under the overall leadership of the governments, the local civil affairs authorities are responsible for the enforcement in collaboration with other competent departments. The grass-root civil affairs authorities, sub-district offices and community neighbourhood committees undertake specific enforcement tasks. To strengthen the administration of minimum living standard guarantee work, the governments at various levels and the administrative agencies for the system follow the requirement to "exercise administration according to law", strictly observe the rules and regulations concerned, and promote the practice of socialized delivery of allowance through such facilities institutions as banks and post offices. In addition, they have also launched an information drive in an effort to attain computerized and networked administration.

Status quo and prospect

As this system has only been implemented for a short period of time, some difficulties and problems have emerged in practice. For instance, the overall relief level and administration level of the system are relatively low; the cities are confronted with serious challenges in terms of employment; and the target population of this system tends to grow in momentum, placing great pressure on relief work of the governments. The problems that the system has encountered are as follows:

- The target population of this system tends to grow, and the pressure on relief remains high for the governments. According to the investigation and analysis of the Ministry of Civil Affairs, there are five contributing factors. First of all, the new policy of calculating family incomes based on "actual incomes" for employees in trouble-ridden SOEs leads to expansion within a certain period of time. Secondly, as the basic living guarantee for laid-offs from SOEs is to be emerged with unemployment insurance, some families with members who leave "reemployment centers" and could not be reemployed, would probably apply for minimum living allowance. Thirdly, as reform on the household registration system takes place, a large amount of rural residents will become urban residents, out of which some needy will be included into the system. Fourthly, in the State-owned land-reclamation enterprises and forestry enterprises under which industry-based management is practiced, quite a number of poverty-stricken employees in certain special enterprises need to be covered by the system. Fifthly, the acceleration of industry restructuring and the efficiency enhancement effort in enterprises by laying off the redundant will

aggravate the severe employment situation in the cities by producing new needy people.

- The funds from local governments are not fully allocated. In recent years, the central government has doubled the subsidies for minimum living standard guarantee system year after year, and the provincial governments have also increased their inputs accordingly. However, the available source at the Ministry of Civil Affairs reveals that the governments below municipality level have performed poorly in ensuring the funds, particularly in some less developed regions with financial difficulties. The Ministry of Civil Affairs, along with other competent departments, is supervising and urging the due allocation of the funds from the local governments.
- Those households who are receiving the minimum living allowances and plagued by serious disease and disability need further support. At present, local minimum living allowances and subsidies can merely sustain the basic livelihood of a household, but when a family member becomes sick or a child goes to school, the expenditure will greatly increase. Some households could not afford charges for water, electricity and houses each month, some in the northern part of the country could not afford heating charges in winter, and many have poor housing conditions. All these need to be attended to by taking corresponding relief measures, with medical treatment of serious disease for targeted group of the system being the most prominent.

The Ministry of Civil Affairs, on the basis of *status quo* and issues encountered in the course of implementing the system, is endeavouring to improve rules and regulations and strengthen administration so as to ensure its effective implementation and sound development. Meanwhile, in order to deal with the actual difficulties that the needy are encountering in medical care, housing, education, employment, etc., the Ministry of Civil Affairs, by working closely with other ministries, is summing up and disseminating the successful practices and experiences of some regions, setting about to explore and establish a comprehensive social relief system with the minimum living standard guarantee system for urban residents as the mainstay, supplemented by preferential policies and interim relief measures and supported by medical relief, education relief and housing relief. In brief, as the governments and the society attach more and more importance to the minimum living standard guarantee system for urban residents, this system has a bright future and is bound to contribute more to safeguarding the rights and interests of the people, maintaining social stability and promoting economic development.

Forging ahead with China's new rural cooperative medical system

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China is a developing country with a huge population, nearly 70 per cent of whom live in the rural areas. The medical security of the farmers is an integral part of the whole social security system, having bearing on China's reform, development and stability. For a long time, the Chinese Government has been promoting a cooperative medical system in the vast rural areas as an important measure to safeguard the farmers' health. In 2002, it was further proposed to gradually establish in the whole country the new rural cooperative medical system. Localities across the country are currently forging ahead with pilot projects of the system in an active and steady manner.

Establishing the new rural cooperative medical system is a practical choice of today's Chinese rural areas

Over the past 50-odd years since the People's Republic of China was founded, governments at all levels in China have been very much committed to the health security of farmers. They have, starting almost from scratch, led all the Chinese people in gradually establishing the rural medical and healthcare service system and promoting rural cooperative medical system. As a result, great progress has been achieved in rural health. Since the 1950s and 1960s, China has effectively brought under control serious communicable diseases such as cholera, the plague and small pox, which had posed severe health threats to the people.

Since the adoption of the reform and opening up policy, in particular since the 1990s, the government has adopted the rural primary healthcare policy, strengthened the "development of three types of facilities", i.e., county centers for disease control and prevention, county maternal and child hospitals and township health centers, improved the medical and health conditions in the rural areas and promoted the "Health Education Initiative for the 900 Million Farmers". As a result, the lack of access to medical services and drugs has been greatly redressed in the rural areas and farmers' health has been improved by a large margin.

By end 2000, the objective under the rural primary healthcare policy, namely "Health for All by the Year of 2000" has been preliminarily realized in 95 per cent of the agricultural counties (cities, districts and banners). The average life expectancy for the rural population had increased from 35 to 69.6 in the year 2000. By end 2002, infant mortality rate in rural China had decreased from 2000 per thousand and in 1949 to 33.1 per thousand, maternal mortality rate in the rural areas had decreased from 1,500/100,000 to 58.2/100,000.

However, with the deepening of reform and opening up, the imbalance between economic and social development and between urban and rural development has been pronounced. In some areas, in particular the central and western areas, the rural health facilities suffer from poor infrastructure, lacking necessary testing and medical equipment and well qualified medical and nursing staff; the vast majority of farmers are still in need of basic medical security, finding it hard to afford the ever-increasing medical costs, leading to serious problems of being impoverished and being turned poor again because of diseases.

In order to solve these problems, the Chinese Government, based on the scientific development outlook of putting people first, and the overall balance of rural and urban socioeconomic development, made the decision of further strengthening rural health work. It is made clear that by the year 2010, the new rural cooperative medical system that fits in the context of socialist market economy and rural socioeconomic development be basically established in the rural areas across China. This is a significant measure adopted by the Chinese Government to practically solve the "three rural issues" (farmers, countryside and agriculture), fundamentally strengthen rural health infrastructure and improve farmer's health, with an aim to develop an all-around well-off society and balance rural and urban socioeconomic development. It is also a realistic choice for the current rural medical system.

The characteristics and basic approaches of the new rural cooperative medical system

China's rural cooperative medical system that took shape in the 1950s, had been promoted in the rural areas as a major form of farmers' health security by the government since the 1960s, and once had a coverage of over 90 per cent in the 1970s. Under the circumstances and conditions in those years, the rural cooperative medical system provided the farmers with a good amount of basic medical and healthcare service. It, together with the three-tier rural medical and preventive healthcare net and the "barefoot doctors", was known as the "three pillars" in rural health, which won appreciation from the World Health Organization and many developing countries.

In the 1980s, the economic system and social development in the rural areas have changed significantly. The rural cooperative medical system began to recede by a large margin, with a sharply decreased coverage of only 5 per cent of the rural population. Although the national government demanded again in the 1990s that the rural cooperative medical system be developed and improved, yet the work had been slow in most areas, with a lingering 10 per cent coverage of the rural population.

There are reasons for the impasse of the rural cooperative medical system. First, the funding mechanism does not fit into the new rural economic system reform. Since the household contract responsibility system was initiated in the rural areas, collective economy, the major fund source for the cooperative medical system could no longer support it. The farmers had to fund it by themselves, which obviously could not attract the farmers. Second, there were flaws in the rural cooperative medical system. On one hand, the pooling and security levels were low, covering a small population, hard to help the farmers out of serious illness. On the other hand, the management level is low. It was basically run and managed at the village or township level, not being regulated or transparent. Farmers did not have confidence in it. Third, there were different points of view between government departments with regard to whether and how the cooperative medical system should be operated in the new rural situation, resulting in policies not being coordinated, restricting the resumption and redevelopment of the rural cooperative medical system.

The Chinese Government has made the decision of establishing and improving the new rural cooperative medical system after learning all the experience and lessons of the former rural cooperative medical system and studying the current socioeconomic development in rural China. The new rural cooperative medical system is a farmers' mutual assistance medical system focusing on pooling for serious diseases, which is organized, guided and supported by the government, joined by farmers on a voluntary basis and jointly funded by individual, collective and governmental resources. Compared with the former cooperative medical system, it has the following new features and developments.

First, the government has increased its support. Governmental support for the former cooperative medical system was mainly advocacy, organizing and mobilization, while in the new system it is clearly stated that the central government subsidize an annual per capita CNY10 for farmers who participated in the new rural cooperative medical system in places other than cities in the central and western regions, the local governments subsidize the participating farmers no less than CNY10. Thus the funding mechanism of individuals paying contribution, collectives supporting and government subsidizing is further improved.

Second, focusing on pooling for serious diseases. In the former rural cooperative medical system, except for a small number of areas, the focus was on out-patient clinic or mild illnesses, i.e. "cost pooling for ailments rather than serious diseases", while in the new rural cooperative medical system, the priority is the urgent need to address the problem of farmers being impoverished by serious diseases, and high or in-patient medical costs are reimbursed. The medical security is obviously improved.

Third, the pooling level is increased. The former approach of pooling at townships and village level is replaced by pooling at county level as required, where conditions are not ripe, to start from township pooling and gradually move to county pooling. Thus the capacity of risk management and supervision is strengthened.

Fourth, the principle of voluntary participation by farmers is defined, and farmers are given the right to information and right to supervision, so that the system is made more open, equitable and fair.

Fifth, the government is responsible to provide guidance to establishing coordination, operation, supervision and management institutions and to intensify leadership, management and supervision.

Sixth, the medical aid system is established at the same time. Impoverished farmers can participate in the new rural cooperative medical system with financial assistance from civil affairs and poverty alleviation agencies.

To avoid blind and roundabout development and ensure the healthy development of the new rural cooperative medical system, the central government has clearly demanded that pilot projects be implemented in localities with the leadership of provincial governments in the principle of adjusting measures to local conditions, providing guidance in different categories and tangibly benefiting the people. Experience shall be drawn from the pilot projects before they are scaled up gradually. The system aims at covering most of the rural residents by 2010.

An overview of the pilot projects shows that all the pilot counties (cities) share the same guideline although they have different implementing schemes. As to the reimbursement approach, in most pilot counties (cities) the reimbursement covers mainly in-patient costs

(large sum) and part of out-patient costs (small sum). There are two major modes for the reimbursement of outpatient medical costs. In one mode, household accounts are established with part of the premium paid by individuals. The insured seek treatment in designated medical institutions and their out-patient costs are decreased or exempted (reimbursed) in accordance with a certain quota or ratio prescribed, with the total amount of annual reimbursement no higher than the amount in the household account. In the other mode, no out-patient account is established. Out-patient and in-patient funds are bound together and utilized in a uniform way. The farmers participating in the cooperative medical system seek medical service in a county with designated medical facilities and their costs are directly decreased or exempted (reimbursed) according to a certain ratio, while the accumulated annual reimbursement must not exceed a pre-defined quota.

The reimbursement for in-patient medical costs also falls into two major categories. In one mode, a threshold and ceiling for reimbursement are defined. Farmers are hospitalized in designated medical facilities at different levels and their medical costs above the threshold can be reimbursed according to different ratios for different cost scales; the total annual reimbursement shall not exceed the ceiling. In the other mode, only the ceiling is defined with no threshold. Hospitalization is sought in designated medical institutions at different levels with the medical costs reimbursed according to different percentage for cost scales.

Households in difficulty such as destitute households and those enjoying the five guarantees (childless and infirm old persons who are guaranteed food, clothing, medical care, housing and funeral expenses) are subsidized by the medical aid fund provided by the central and local governments.

Major progress and problems

So far 310 pilot projects have been launched in 30 provinces, autonomous regions and municipalities in China, involving 95.04 million agricultural population, while 68.99 million farmers have participated in the new rural cooperative medical system, or a participation rate of 72.6 per cent. Among them in the 22 central and western provinces (municipalities and autonomous regions) there are 233 pilot counties (cities), involving 63.31 million agricultural population with 45.24 million farmers participating in the schemes, or a participation rate of 71.5 per cent. RMB3.021 billion has been pooled in the whole country, CNY1.088 billion of which is contributed by farmers. CNY1.471 billion has been pooled in the central and western regions, CNY513 million of which is paid by farmers, CNY393 million subsidized by the central government, CNY504 million subsidized by local governments. By June this year, 41.94 million persons (time) were reimbursed for their medical costs, amounting to RMB1.39 billion, in 30 provinces, autonomous regions and municipalities across the country.

Generally speaking, pilot projects in the new rural cooperative medical system have been operating steadily and progressively. Farmers in pilot localities have benefited from the system,. The burden of medical costs has been lessened and the issue of illness-induced poverty has been readdressed to some extent. Yet we have noticed that quite a few problems still exist in the pilot sites.

Inadequate awareness of and knowledge about the system. Some local people are not fully aware that it is a long-term, difficult and complicated task to establish and improve the new rural cooperative medical system. They do not have a thorough understanding of relevant policies, do not work carefully and do not carry out outreaching advocacy and mobilization. The management is careless and some policies and measures have not been very well followed up. Some farmers still have doubts about the new rural cooperative medical

system. They are concerned that: the fund from the government might not be put in place; the cooperative medical funds might be embezzled; the medical costs might not be reimbursed in a reasonable, timely and convenient manner; or the medical costs might be raised with bad service and they might not get tangible benefits, etc.

The implementation plans of the pilot projects have not been developed scientifically and soundly. In some counties (cities, districts) with similar economic and regional conditions and funding levels, the thresholds, ceilings and reimbursement ratios are different, so that the number of participating farmers who benefit from the system and the extent to which they benefit are greatly differentiated. In some pilot counties, there are too many limitations on the reimbursement, high threshold and low ceiling as well as low reimbursement ratio, resulting in large fund surplus, therefore affecting the number of beneficiaries and their benefit level.

There exists difficulty in the staffing and funding of the implementing agencies, and management is backward. Up to now the implementing agencies in some pilot counties (cities) have not been adequately staffed or sufficiently funded. In a large number of agencies in the central and western regions, computers have not been installed. With manual operation, a high management cost is incurred with low efficiency.

There is not yet an effective measure to supervise medical institutions and control costs. In the designated medical facilities of some pilot counties (cities), prescription drugs far exceed the Essential Drug List or there are too many medical check items, some of which are not to be reimbursed. It not only increases farmers' burden of cost but also the expenditure of the cooperative medical fund. What is more, the supervision over rural pharmaceutical market needs to be strengthened.

The cost of fund pooling is high. For the time being, in most pilot counties (cities), contributions are collected by township or village officials and village doctors who advocate the cooperative medical system and visit every households. As a result, contribution collection is costly and difficult.

Strategies and recommendations

To intensify education and awareness raising efforts. In light of doubts and concerns on the new medical cooperative system, efforts should be on in-depth, tailor made and well-presented education about the significance and benefits of the new rural cooperative medical system so that the vast majority of farmers will alleviate their scepticism and reluctance and take the initiative to participate in the new system. Meanwhile, education efforts targeting the grass-root officials should also be intensified to enable them fully realize the long-term nature, difficulty and complexity of constructing the new rural cooperative medical system so that they will push forward the pilot work in a down to earth manner.

To conscientiously enhance guidance to the pilot work. Various forms of fact-finding and investigation must be employed to solicit opinions from the farmers and to identify issues that need to be addressed. The expert panel should play a due role in guiding the fine-tuning of the pilot plan, ensuring both the safety of the cooperative medical fund and the increased benefit level for the beneficiaries.

To strengthen the capacity building of the implementing agencies. In compliance with the stipulations and requirements of the central government on establishing the new rural cooperative medical system, the staff and fund for the implementing medical institutions in the pilot counties (or cities) should be put in place to ensure staff and money are available while

needed. In the meantime, efforts should be made to standardize and regulate the implementing agencies. Necessary computing equipment shall be provided.

To improve conditions for rural medical and health service delivery facilities and to strengthen supervision. In parallel to pushing forward the construction of a new rural cooperative medical system, construction and reform of rural health service delivery system should be developed in order to provide farmers with proper medical service. Medical service behavior and centralized purchase of drugs should be strictly regulated with an aim to contain the unreasonable increase of cost on medication and to lessen the burden of the farmers.

To strengthen policy research and explore convenient and effective model of funding and management. As the establishment of a new rural cooperative medical system is an innovation, there is a shortage of readily available experience to learn from. Therefore, it needs active research and improvement. We should organize and encourage relevant organizations and experts to study the important and difficult issues that arise from the pilot work in close cooperation with the pilot counties to further improve our policy and regulate the system and implementation.

To strengthen international exchange and cooperation. Many countries and international organizations have a lot of good practices and experiences in establishing health insurance systems. China will further strengthen its cooperation with them to draw on their good experience to facilitate the development of the rural cooperative medical system in China.

As China's new rural cooperative medical system has just started, it still faces some difficulties and problems. However, we are convinced that with the strong leadership of the Chinese Government, we can do a good job in the pilot work and realize our target to cover most of the vast rural areas by the year 2010. We also believe that along with the economic development and the increase of national public spending and farmers' income, the scope of coverage of the new rural cooperative medical system will continue to expand and it will join hands with the urban medical insurance system to form a universal medical insurance system.

China's pilot reform programme to improve its urban social security system

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The State Council pilot programme to improve the urban social security system in Liaoning province was basically completed by the end of last year. The pilot programme of this year is expected to include two more provinces of Jilin and Heilongjiang, in the light of the strategy to revitalize China's north-eastern old industrial base. The pilot programme of Jilin and Heilongjiang got officially kicked off last May and is expected to conclude by the end of 2005.

Objectives, principles and main tasks of the pilot programme

The Chinese Government has been reforming the country's social security system in line with the requirements of the socialist market economy system since the 1990s. The basic framework of urban social security system, which was initially put in place by the end of 1999, mainly includes the pension system, the basic living standard security system for laid-offs from State-owned enterprises (SOE) and unemployment insurance, the medical insurance system, the work injury insurance system and the system of minimum living standard security for urban residents. The gradual establishment and improvement of China's social security system has helped maintain social justice and harmony of the society and bring tangible benefits to the general public, giving them a sense of security while creating favourable conditions for the economic reform and restructuring in China. However, there still remains a large room for improvement as the social security system in China is still in a very early phase. More intensive reforms are called for to address the deep-seated problems in accordance with the comprehensive and coordinated development of the economy and the society.

A long-term mechanism of sustainable development is yet to be established for the pension system. The establishment of a basic pension scheme has ensured that the retirees from the enterprises receive their basic pension on time and in full. However, with the aging of the Chinese population, the increase of more than 3 million retirees annually poses a huge payment pressure on the pension scheme. At present, the central government appropriates an average of RMB47 billion annually to fill in the gap in localities. Starting from the mid 1990s, China introduced the system of combining social pooling with individual accounts. 11 per cent of the employee's wage is put into his individual account. However, as a result of the lack of pension fund accumulation in the past, individual accounts and pooling fund are used to pay for the current pension, which resulted in the empty individual accounts. A gap

of nearly RMB100 billion has been formed each year since 2000. The future pension system will hardly sustain itself if the pay-as-you-go financing model is not changed completely.

The basic living standard security for laid-offs from State-owned enterprises is a major measure to address the question of redundant workers of SOEs in the process of economic restructuring. It has played a major role since its introduction in 1998. However, given its nature of a transitional policy in the context of an incomplete social security system, the system itself does not offer a long-term solution. With the establishment and gradual improvement of the unemployment system in the process of economic restructuring, it is imperative that a systematic arrangement for laid-offs be in place that will offer a more long-term oriented and stable solution in compliance with market rules, i.e., to integrate the basic living standard security system for SOE laid-offs into a regular unemployment insurance scheme.

Compared with the requirements of a socialist market economy, the current social security system has some institutional impediments and policy deficiencies, such as regional segmentation, low level of social security pooling, inadequate fund adjustment ability, and difficulty in portability. Diversified forms of employment have also posed new challenge to the previous social security scheme that was mainly targeting urban employees with permanent employment. Moreover, the loose link between one's length of contribution and the benefits one is entitled to under the current pension policy does not provide much incentive for people to work longer, because the basic pension a person with a 15-year contribution history receives is exactly the same with those who have a 35-year contribution length. Such policy deflection leads to the tendency of people wanting to retire early and aggravates the payment pressure on pension fund.

In order to tackle all these problems, the State Council organized a large-scale investigation study in 2000, involving competent departments and agencies. On the basis of drawing on the best practices worldwide and careful argumentation, *the Pilot Programme to Improve Urban Social Security System* was formulated and saw its implementation in limited number of places on a trial basis.

The pilot programme started with the purpose of improving social security system and touched upon areas such as basic pension for urban employees, basic medical, unemployment and other social insurance systems, and minimum living standard security for urban residents. The overall objective of the programme was to establish a social security system independent from the enterprises and institutions with multi-sourced funding, standardized insurance schemes and socialized management and service-delivery.

The principles of the pilot project were: gradual improvement from close proximity to more remote places; consistency in the social security policy and improvement of people's psychological expectation of reform; combination of unified national decision-making with multi-level management, subordination of local interests to national ones; commensuration of social security standards with the national situation and the affordability of the various parties, combination of fairness with efficiency, corresponding rights to obligations; giving incentive to all parties by a clear definition of social security rights to push for the establishment of a multi-level social security system.

The main tasks of the pilot programmes were: to adjust and improve the basic pension scheme for urban employees; to accelerate the establishment of a basic medical insurance system for urban employees; to push for the integration of basic living standard security for SOE laid-offs into unemployment insurance (referred to as the integration hereafter); to

strengthen and improve the system guaranteeing the minimum living standards of urban residents; to adopt socialized social security management and service-delivery; and to enhance the fund raising and management. The integration and the capitalization of individual accounts are the two key targets of the programmes.

The Pilot Programme in Liaoning Province

Liaoning province is an old industrial base in China. Its big urban population and the large number of old enterprises suffering difficulties make it extremely difficult to implement the reform and restructuring plans for the improvement of the social security scheme. It is thus of great significance for the whole country to draw on the experiences of the pilot programme in Liaoning. The State Council decided to choose Liaoning as the pilot province in 2001. Over the past three years, Liaoning province has been carefully following the State Council approved plans in carrying out the reform and made important breakthroughs on the two key issues of the integration and capitalization of individual accounts, basically fulfilling the major tasks of the programme with remarkable results as expected.

The task of integrating the basic living standard security of SOE laid-offs into unemployment insurance was basically achieved, realizing the strategic transfer of more than a million SOE employees and facilitating SOE reform and economic restructuring. Beginning from the start of the pilot programme, SOEs in Liaoning province no longer establish their own reemployment service centers, newly laid off workers from enterprises stop entering into reemployment service centers in principle and those laid-offs already in the centers begin to leave the center once the agreed period is over. The employees who terminate their labour relations with the enterprises according to law enjoy the benefits of either unemployment insurance or minimum living standard security for urban residents in accordance with law. Preferential policies are provided to laid-off workers seeking reemployment. For laid-off women above 40 and men above 50, who have less than 5 years to reach legal retirement age and whose length of service is more than 30 years (these people are called the 40/50 group for short), if they experience difficulty in finding new jobs, they are entitled to the internal retirement privilege from their respective enterprises which will continue to pay for their living allowances as well as social security contributions.

The pilot programme concerning the integration issue opened new outlets for SOE employees. Liaoning province closed down all the reemployment service centers affiliated to its enterprises in June 2003. More than 1.75 million SOE laid-offs terminated their service with their respective enterprises, the majority of whom have found new jobs and all the people who meet the requirements get incorporated into the unemployment insurance scheme. The completion of the integration greatly facilitated SOE reform. More than 1,400 SOEs were restructured smoothly and 256 SOEs suffering extreme operation difficulties withdrew from the market. Many enterprises previously experiencing business problems gradually regained vigor and vitality. SOE per capita productivity almost doubled. A better social security regime provided the guarantee for the rational flow of labour and market-based employment, and facilitated labour structure adjustment commensurate with economic restructuring. A large number of SOE laid-offs shifted to private businesses and the service sector and more than half of the laid-off workers found new jobs of their own choice. By the end of 2003, more than 3.45 million urban population in Liaoning province were employed by the private sector, an increase of 1.01 million compared to the figure of 2000.

The capitalization of the basic pension individual accounts improved the system of combining social pooling with individual accounts, making institutional transition

possible. Starting from 1 July 2001, contribution rate by individual workers for basic pension in Liaoning province was uniformly adjusted to 8 per cent of their wages. The size of individual accounts was also adjusted to 8 per cent from the previous 11 per cent of a worker's wages. The previously unfunded accounts with only personal information in them were substantiated into funded account with both fund accumulation and account information. The gap resulting from the account capitalization in current pension payment was subsidized by both the central and local financial budgets. By the end of June 2004, individual accounts in Liaoning province got a total fund of RMB11.1billion. The basic pension financing model transition from the previous pay-as-you-go to the present partial funding addressed the issue of unfunded accounts and accumulated fund for the aging population, thus laying a foundation for the improvement and sustainable development of the pension scheme while enhancing the social insurance awareness of its participants and the level of pension management. The funding of individual accounts and that of social pooling are managed in strict separation, with the former no longer being used to pay for the current pension. The fund of individual accounts enjoys uniform management and accounting from the provincial-level social security agencies and value maintenance and appreciation from the purchase of treasury bonds or bank deposit on an agreement basis. On the part of social pooling fund, a provincial-level fund adjustment system is established to guarantee the payment of pension on time with the support from the central and local financial budgets, creating favourable conditions for the provincial-level pooling of the basic pension costs.

A social security information network was set up by and large to initially achieve socialized management and service-delivery. During the pilot programme, Liaoning province established a basic social security information network with a centralized and connected data base, incorporating all the information such as contribution, recording, accounting, payment, inquiry service into the computerized system. Thanks to such a network, Liaoning province saw an enhancement of its social security management, which was more efficient, and of a higher level. The network also provides timely and accurate data support to the macro decision-making of the government.

The pilot programme of Liaoning province also helped to build a social security working platform, with the establishment of social security agencies at all communities and neighborhoods, realizing the transition to a socialized management of the unemployed. Retirees and urban population receiving minimum living standard allowances all get their service from the community-based agencies which are also providing services concerning daily life, health and culture to their clients. It shows that social security management and service has become community-based at an initial stage.

The basic living of employees living in difficulty was guaranteed to maintain social stability. During the pilot programme, all workers from the integration who meet the requirements receive unemployment insurance benefits, all the eligible urban citizens receive the minimum living standard allowances and the pension for retirees are paid out on time and in full, all of which helped a lot to maintain social stability. By the end of 2003, 670 thousand people in Liaoning province received unemployment insurance benefits, 1.6 million urban population received minimum living standard allowances and 2.88 million retirees enjoyed an increase of their pension which has been paid out on time and in full.

At the same time, the urban basic medical insurance continued to expand its coverage while trying to establish a multi-tier scheme. Participants of the basic medical insurance scheme in the whole province increased from 1.05 million in 2000 to 6.99 million in 2003 while 280 thousand people took part in the supplementary medical insurance plans.

Pilot Programmes in the Provinces of Jilin and Heilongjiang

While the Liaoning pilot programme achieved remarkable results and accumulated many successful experiences, it has also exposed some problems. In the process of the integration, the unemployment insurance fund of some places failed to make both ends meet as a result of the sudden surge of the number of the unemployed. After the integration, some people with alternative means of employment didn't continue their participation in the social insurance scheme, which led to a plunge of the number of people paying contributions. As for the funded individual accounts, they suffer a low rate of return as a consequence of limited channels of investment.

In order to continue to search for the way to improve the social security system and accumulate more successful experiences for its implementation on a national scale, the State Council, on the basis of the Liaoning experience, decided in 2003 to expand the pilot programme to cover the other two provinces in Northeastern China of Jilin and Heilongjiang in coordination with the national strategy to rejuvenate the old industrial bases in China's northeast.

The pilot programmes of Jilin and Heilongjiang provinces were conducted in accordance with those contents in the *Pilot Programme Plan* that have been proven feasible in the Liaoning programme. The integration and capitalization of individual accounts remained the two most import issues. Some of the policy adjustments made in the Jilin and Heilongjiang programmes include: closer link between the integration and reemployment with an eye on controlling the surge of unemployment rate; capitalization of individual accounts in a more incremental way to look for ways of value maintenance and appreciation; expanded social security coverage and improved formulae for pension; and regulating social insurance policies for people who work in the private sector or are in flexible forms of employment in order to gradually phase in a mechanism encouraging people's participation and contribution.

The integration. The integration has to take into consideration the question of reemployment and affordability of the government, enterprises and the employees so as to avoid driving out the laid-offs in a simplistic way. The purpose is to promote reemployment, effectively control unemployment rate, establish an interrelated regime of unemployment insurance, minimum living standard security and reemployment in order to address the basic livelihood problems for urban residents who got laid off from the labour force. For those of the 40/50 groups who find alternative ways of employment after the integration, the government provides them with an employment subsidy that is no more than 30 per cent of the basic pension contributions they have paid in the previous year as an incentive to encourage more employment among the laid off workers.

Capitalization of individual accounts. Individual accounts of the basic pension scheme got funded first at 5 per cent and then at 8 per cent in 2004. The fund of the funded individual accounts is managed by the provincial-level social insurance agency under a designated social insurance financial account. Under the prerequisite of fund security, more channels of investment are allowed for to increase the yields of the fund. The investment and operation of the part subsidized by the central budget is entrusted to the National Council for Social Security Fund for its management.

Further improve the formulae of the basic pension. The old practice of a basic pension equivalent to 20 per cent of the average social wage of the previous year once the length of contribution reaches 15 years is changed into the new formulae where an equivalent to 1 per cent of the average of the local average monthly wages and the individual contributory wages is paid for each year of contribution once the length of contribution reaches 1 year. By so doing, the longer the contribution history, the more pension one will receive. In the past, individual account pension is calculated at 1/120 of the accumulated amount of the individual account. Now, it is calculated at different ratios based on such facts as the person's retirement age, the average life expectancy for the urban population and the interest rates (for those who retire at 50, the figure stands at 1/195, 60 at 1/139 and 70 at 1/56). Workers will thus get the incentives to retire at a later age.

Standardize policies for social security participation and paying contribution. In order to cope with the diversified forms of employment, a pension contribution base for urban citizens who work in the private sector or are flexibly employed was unified to be at 20 per cent of the average local wage as compared to the previous floating spectrum ranging from 60 per cent to 300 per cent of the average wage.

Raise the pooling level. The provincial-level adjustment fund will be further improved to enhance the fund capacity. City-level and county-level pooling will be gradually phased out during the pilot programme to be replaced by the provincial level pooling.

Promote corporate pension plans. Those enterprises where conditions allow are encouraged to set up corporate pension plans for their employees which will be jointly financed by both the enterprise and its staff. The part of enterprise contribution that is less than 4 per cent of the total payroll can be listed as cost. Corporate pension fund will be managed by individual accounts and operated under market conditions together with government supervision.

The Chinese Government will continue to be committed to the development of a social security system. All the successful experiences found to be useful and effective in pilot programmes will be introduced to the whole country so that the social security regime will keep abreast with the requirements of the socialist market economy to provide an even more powerful guarantee to China's reform and modernization drive.

Management of investments and operation of the National Social Security Fund

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National Council for Social Security Fund
The People's Republic of China

China's economic growth and social progress have been remarkable over the past twenty odd years of reform and opening up. The basic framework of a socialist market economy has been established. Over these years, the government has been paying a lot of attention to the establishment of a social security system. As a result, social security undertakings have experienced a major development, especially over the past ten years. In urban areas, a social security network is basically set up, focusing upon pension, medical insurance, and minimum living standard guarantee. Social security has become an important component of China's socialist market economy, and is an important part of a well-off society for which we are pressing ahead. As an important measure to improve and perfect China's social security system, the Chinese Government established the National Council for the Social Security Fund (SSF) in September 2000. Since then, SSF has witnessed a remarkable growth in fund size, a transition from a single investment instrument to multiple investment instruments, a development of investment from domestic market into offshore markets.

This paper first gives some brief background information about the SSF and its mission. Then it describes its present status, ways of further development and strategies.

The Social Security Fund's important mission

Background information about the establishment of SSF

At present, aging population is a common challenge for all the countries in the world. China is not spared from the impact of this so-called "graying wave". Indeed it is faced with a much bigger challenge than other countries as it has a large population with a peculiar structure and a unique population policy that it has been implementing. In 2000, China had its fifth national population census. The result indicated that people over 60 years of age accounted for 10 per cent of the total population and those over 65 accounted for 7 per cent. This showed that China was already moving into an aging society. According to the population forecast of the United Nations (UN) for China, by 2030 the proportion of people over 60 and over 65 will be 23.3 per cent and 15.7 per cent of the total population respectively. By 2035 the proportion of people over 60 and over 65 will be 26.2 per cent and 19 per cent of the total population respectively. It should be noted that the aging population emerges in China at a time when our economy is not well developed and the social security system is not mature. In addition, the large population base and rapid population growth make this issue much more difficult to deal with than other countries.

China's social security system, established rather late, suffers from a low coverage, heavy burden, a large historical overdue amount and shortfall of funds. China began to reform the basic pension system in 1980s. As of now, the new pension system principally covers employees in urban areas who work for State-owned enterprises (SOE) and collectively owned business and enterprises. It is now slowly being extended to other types of employees. The new pension system gives a very heavy burden to businesses, which are required to make a contribution equivalent to at least 20 per cent of their payrolls. On top of that, the huge hidden debt issue has to be gradually resolved; an issue resulting from the shift from the pay-as-you-go system to the partially funded one. This itself will certainly affect the operation of the new pension system.

Faced with the increasing pressure from social security expenditure, the usual practice is to either increase the contribution rate or lower the benefit level. However, the situation in China is a peculiar one. On the one hand, SOEs have a gigantic task of structural reform, making it impossible for them to afford an increased contribution rate. On the other hand, it is not politically feasible to lower the benefit level. And to do that would not be in line with the economic growth trend either. It is under this background that the Chinese Government made an important decision to use other ways to finance the establishment of the National Social Security Fund while maintaining the normal operation of pay-as-you-go system and capitalizing the full individual accounts. This will enable China to have sufficient funds to deal with the expenditures when the peak of aging population arrives.

The important mission of the National Social Security Fund

A sound social security system has to be backed with strong funding. The important mission of the National Social Security Fund as an important component of China's social security system, is as follows: raise funds through various channels, accumulate funds through investment activities, provide an important financial reserve for various social security provisions and guarantee the sustainable development of social security in China.

Social security fund investment activity is a brand new undertaking in China. We need to learn from the international best practices, management know-how and expertise so as to improve our own capacity and establish a system of management and operation suitable to China's context. The management model and operation experience of the Social Security Fund will be conducive to the learning process of similar organizations in China.

The National Council for Social Security Fund

The National Council for Social Security Fund (SSF), established at the same time as the National Social Security Fund, is a specialized organization responsible for managing and operating the Fund. The Council is composed of a chairman, several vice chairmen and council members. All of them are appointed by the State Council.

Here are the responsibilities of the Council:

- Management of the National Social Security Fund.
- Formulation of investment strategies and their implementation.
- Appropriation of funds as laid down in the decrees of departments as designated by the State Council.
- Regular publication of annual financial reports of the Fund.

The present status of the National Social Security Fund

The Ministry of Finance and the Ministry of Labour and Social Security jointly issued the *Provisional Methods on the Management of the Investment by the National Social Security Fund* (the Provisional Methods), which is the main legal framework for managing the Social Security Fund and its investment operation at the present stage.

The funding sources of the National Social Security Fund

According to the Provisional Methods, the National Social Security Fund has the following main funding sources: appropriation from the central treasury, revenue and equities from reduction of State-owned shares, revenues raised through other channels as approved by the State Council, and proceeds of fund investment.

As of end June 2004, the total equity of the National Social Security Fund was CNY143.2 billion. The breakdown is as follows: CNY104.8 billion from the central appropriation, accounting for 73.19 per cent of the total; CNY21.9 billion from the reduction of SOE equities, 15.33 per cent of the total; CNY7.5 billion from other channels, 5.23 per cent of the total; and CNY9 billion from proceeds, 6.25 per cent of the total.

The investment operation model of the National Social Security Fund

A successful international practice for managing the pension fund is in-house investment for low-risk activities and out-source investment, or investment through fund management institutions, for high-risk activities. It helps spread risk and makes use of the advantages of specialized investment organizations. While learning from international best practices, China's context was looked into in carrying out investment activities according to the Provisional Methods. Therefore in-house investment is made by the Council in bank deposits and primary-market government securities and out-source investment is made in equities, corporate bonds and financial notes, meaning these activities are carried out by entrusting specialized investment managers. The National Social Security Council chose, through a rigorous assessment procedure, six fund management companies as its investment managers, and two banks as its custodian banks. The Fund formally began to invest in the stock market in June 2003.

As of end June 2004, 24.4 per cent of the Council's investment was out-sourced investment.

Investment policies and risk control

The Fund has some unique features different from other funds. Firstly, the Fund is closely linked with the livelihood of the people and therefore is an important guarantee for social equity and stability. This nature of the Fund will prohibit it from being engaged in investment with high risk. Secondly, the Fund has a feature of long-term horizon and stability, which means it is suitable for long-term investment for higher rate of return.

While the capital market was not mature and similar investment experience not available, many countries make explicit restrictions on the components of the investment portfolio of their social security funds and their respective share. The purpose of that was to control risk through investment restrictions. The Provisional Methods makes it clear that the scope of the National Fund investment is limited to bank deposits, government bonds, corporate bonds,

financial notes, security investment funds and equities. The proportion of the last two items should not go beyond 40 per cent of the portfolio and corporate bonds and financial notes should not be higher than 10 per cent.

The SSF adopts a prudent attitude towards investment operations, with the safety of investment as its top priority. It has a target rate of return for the coming five years higher than the inflation rate for the corresponding period. Its risk control target will be that no loss will occur in its annual average return for five years to come.

In line with the requirement of a high starting point, standardization and specialization, following the international standard of risk control, the SSF has formed a sophisticated risk control system. It has a Risk Control Committee and an Investment Decision Committee. To make an investment, first, the Risk Control Committee has to make an assessment of risk and then a report is submitted to the Investment Decision Committee for a final decision. Different functions are allocated to front desk, middle desk and back end office, which are independent from one another, and form an effective check and balance mechanism. At the same time, through analyzing different components of the business, control measures are proposed to deal with each and every part of the risk, taking into account their respective risk profile, thus guaranteeing the safety of the Fund.

The asset portfolio as of end June 2004: regular bank deposits, negotiated deposits, and T bonds repo contracts, account for 51.85 per cent of the total assets; bonds investment, 32.76 per cent of the total; stock investment, 7.75 per cent of the total; and long-term equity investment, 6.75 per cent of the total. In the first half of the year 2004, the return of equity is 3.7 per cent based on capitalized returns.

The future development of the Fund

The Chinese Government attaches great attention to social security. In 2004, the National People's Congress put the concept of "Establishing a sound social security system appropriate to the level of economic development" into the Constitution. The development of the Fund is indeed a focus of attention of people from national leaders down to the general public. The Fund is indeed embracing a good opportunity of rapid development.

Our target is to raise the value of the Fund to one trillion Yuan in five or more years and to achieve a modernization of social security fund management, and build the Council into a world-class organization of social security fund management.

For that purpose, we must have a stable source of funding, sound legal framework and a management system relevant to our needs.

We will mainly focus on the following three areas in the near future.

Improve the legal framework for the National Social Security Fund

China has established the strategy of rule of the law and the State Council has also laid down the principle of administration governed by law. A sound legal framework is the *sine qua non* for sustainable and healthy development of the Fund. At present, the Council is working actively with the regulators to revise the "the Provisional Methods". In line with the practical needs and looking into the future development, there will be fewer restrictions on investment.

The next step to be taken will be working with legislative departments to try to come up with a high-level administrative regulation or law, in which such important issues as the nature of the National Social Security Fund, the funding sources, and ways of outlay, will be clearly defined.

To increase the size of the Fund and establish a stable source of funding

As one of the most important measures of enhancing the financial strength of the National Social Security Fund, the Chinese Government has decided to transfer some State-owned assets to the Fund. This idea has been integrated into the major documents for national economic and social development. Huge State assets are important resources in the hands of the nation. The State-owned assets result from excessive accumulation since the days when older generation of SOE employees were paid with low wages. To use these State assets in social security undertaking means to use resources for the people who have created them and is an opportunity to further accelerate the development of the Fund. At present, the Council is working with relevant government departments to try to start the transfer process at an early date.

Fiscal budget appropriation is the main source of funding for the National Social Security Fund. The Council has submitted a suggestion to the central government to ask for institutionalization of fiscal appropriation to the Fund.

In order to have more sources of funding, the Council, drawing on international experience and taking into account China's national circumstances, is exploring the possibility of financing from public source revenues. For instance, it may procure funding through revenues of auctioning telecommunications licenses, land lease revenues, etc.

Broaden investment channels and develop new investment instruments

Investment return from the security market of a country is closely linked with its political situation, economic cycle, prevailing economic growth rate, monetary policy, and maturity of the capital market. These elements may vary significantly from country to country. Therefore, international investment becomes an important means of getting high return with low risk. In February 2004, the application by the Council to carry out overseas investment was approved by the State Council. Legal formalities and early stage preparation are under way at the moment.

The development of new investment instruments and investment through a variety of channels are conducive to the diversification of risks, and good for a stable growth of investment return. Since the beginning of investment activities of the Fund, while maintaining safety as a precondition, a whole series of investment activities through multiple channels have been explored. Bond repo, conducive to improving cash management with good return, was initiated. As a strategic investor, the Council has tried to subscribe promising initial public offering shares from the primary market. As is planned, the Council will further broaden its channel in project investment and industrial investment funds. Compared to securities investment, these activities have different reactions to the cycles of inflation and deflation and are effective investment products for risk diversification. They tend to have a longer-term horizon with a stable source of income, which is in line with the risk income profile of the Fund. At the moment, the Council is engaged in studying relevant issues,

hearing advices, and getting support from regulators. We are making efforts to complete legal formalities as soon as possible.

Stressing human resource development.

Market competition in its final analysis is a competition for talents. The development of highly qualified staff equipped with theoretical knowledge about social security fund investment management, knowing international best practices, and having participated in practical exercise is the only way to develop a successful national social security fund. The Council is taking measures to encourage its staff to improve themselves via internal incentives and check and balance mechanisms, providing a sound human resource development environment and policy.

Exploration of a mechanism to invest money in individual accounts to maintain and grow their value

At present, Liaoning, Jilin and Heilongjiang provinces are implementing a pilot project intended to improve urban social security system. In this exercise, the part of the money needed to fill in individual accounts as injected from the central fiscal subsidies, are managed by the National Council for Social Security Fund. After some time of preparation, this work is already under way.

The establishment of individual accounts is one of the effective means to deal with the impact of aging population. The success of individual account programme depends to a large extent upon the result of the underlying investment activities. With individual accounts gradually getting filled in, the amount of money in these accounts will grow bigger, making it more important for investment operations. It is a heavy responsibility and a great significance for the Council to manage this part of the money from the individual accounts. We will make efforts to identify an investment approach for individual accounts in line with our national context so as to better contribute to the improvement of China's national social security system.

Commercial insurance investment in China under modern economic conditions

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In essence, insurance mechanism is a social mechanism. Risk transfer, damage mitigation and economic compensation rely on pooling of social forces. The social nature of insurance puts commercial insurance in a position to join and supplement social security schemes run by the government, reducing the concerns of the whole society, and exercising its function as a “social stabilizer”. Meanwhile, as an important component of the financial system, through fund raising and circulation, commercial insurance can not only increase profit margins of the insurance companies, and lower the prices of insurance products, so as to be in a better position to provide and participate in social security schemes on pension, medical care, education and unemployment; it can also effectively promote financial stability and economic prosperity. At present, China has by and large put in place its social security system framework. The basic system of China’s social security is one dominated by government-administered basic pension insurance, basic medical insurance, unemployment insurance, work injury insurance, maternity insurance, and a minimum living standard guarantee system for urban residents. Enterprise supplementary pension insurance and supplementary medical insurance provide addition to the first tier insurance benefits. Personal savings and commercial insurance further enhance the level of security. Therefore, a multi-layer and multi-product commercial insurance constitutes a supplement to the basic social security system, and is playing an ever-increasing role in improving the social security system.

In fact, China’s insurance industry has become an assistant for the government in its social administration and control and adjustment of macro economy; commercial insurance is becoming an increasingly important pillar in the social security system. In recent years, China’s commercial insurance has maintained a good momentum of development, with more than 30 per cent of an annual growth rate. Commercial pension insurance and health insurance have also witnessed rapid development in China. In 2003, commercial insurance companies had more than 110 pension insurance products, and more than 300 health insurance products. Premium income from commercial pension schemes amounted to CNY43.043 billion, a year-on-year increase of 12.74 per cent; premium income to health insurance schemes amounted to CNY24.192 billion, a year-on-year increase of 97.58 per cent. China’s insurance industry has CNY912.284 billion of total assets, with CNY873.9 billion of insurance premium investment. The corporate bonds owned by insurance companies account for around 50 per cent of the total corporate bonds; insurance

companies owned 26.3 per cent of the funds in securities markets. Insurance companies are becoming the principal institutional investor in China's capital market; and the performance and management of insurance funds are attracting more and more attention from all quarters of society.

Historical review: Commercial insurance investment in China

With social development and progress, insurance needs are experiencing profound change worldwide. On the one hand, with the advancement of science and technology, people have far less fear of the damages caused by natural disasters and life threats; on the contrary, they pay far more attention to the livelihood risks associated with old-age pension, health and unemployment. On the other hand, people are becoming increasingly aware that the essence of insurance mechanism is a financial mechanism. Insurance in effect is a type of preventive saving for the main purposes of mitigating the risks arising from aging and illness. More and more people are making arrangement of financial assets to insurance. They demand not only economic compensation for their damages from insurance mechanism but also their share of the benefits from efficient utilization of the financial assets. In 2003, of the CNY388 billion of insurance premium income in China, 58 per cent were investment-oriented products like dividend products, investment-linked products and all-purpose products. They demand a higher yield of insurance investment. Propelled by such market force, China's insurance industry will see further strengthening of its functions of fund circulation and savings allocation.

In theory, the circulation and savings allocation functions of insurance fund are mainly executed through insurance investment systems, which is closely linked with economic development and the mature degree of financial markets. In retrospect of China's commercial insurance investment, traditionally, China's insurance industry for a long time depended on insurance operations for its profits. There wasn't an urgent need for investment of insurance funds. Insurance funds were put into a saving and custodian state, namely in banks, as a saving medium. According to some statistics, for a long time, the amount of bank savings in China's commercial insurance fund accounted for over 50 per cent of the premium investment. However, in countries with developed insurance industry, like the United States, in 2001, 83 per cent of the fund was invested in bonds, securities, and mutual funds; 72 per cent in the United Kingdom. Their bank savings had a very low proportion in the premium investment.

Such traditional concept of insurance investment to some extent helped maintain the safety of insurance funds. However, with the rapid growth of insurance business, insurance industry is facing more and more challenges. First, with structural change of life insurance products, the products with dual functions of insurance and investment have become the leading products in the insurance markets. The direct linkage between investment gain of insurance funds and a client's policy dividend or investment account makes insurance investment an important backbone of insurance business. Second, with increasing competition, property insurance companies see a gradual decline of profits from insurance operations; consequently, fund investment gradually becomes the principal source of profits. Third, with repeated interest cuts from the central bank, the problem of interest loss in life insurance companies becomes increasingly evident. The fundamental means to mitigate the interest loss is to create conditions and increase investment gains under the prerequisite of safety.

However, any new investment instrument contains new risks. With the pressure from the current situation, we can only choose to manage risks, and cannot avoid them all the time. Indeed, risks exist in all situations and can be in no way eliminated. Risk should not become the pretext for not making investment. It is the same as all types of risks that we face in our daily life, like traffic accidents, unemployment, or investment failure; we won't end our life to avoid such risks. The important thing is that we know how to identify these risks, and assess whether we are able to tolerate them, and know what measures to take to manage these risks, so as to safeguard our interests. It is under such concept that in recent years, China's commercial insurance investment is endowed with more open regulatory policies, and more and more channels are available for insurance investment. For instance, in addition to bank accounts, State bonds and financial bonds, insurance companies are allowed access to nationwide inter-bank borrowing markets, engaging in bond trade business; they are allowed to purchase corporate bonds issued by companies graded AA and above; they are allowed to purchase securities investment funds. We are confident that with the deepening of the reform and the opening up, and the development and improvement of the financial market, there will be more and more investment tools and financial products available for insurance companies.

Pragmatic choice: Operation and regulation of China's commercial insurance fund

As insurance funds are an important component of social security funds, insurance investment needs to underline safety, liquidity and profitability, and ensure value maintenance and appreciation of the funds. Therefore, operation and management of insurance funds should have good regulation, be undertaken in a cautious and professional way, and follow market principles in order to prevent and avoid all types of risks, increase its strength and fulfill the functions of social security.

There are different operating modes of insurance funds because of the differences in the national system, management mechanism, type of corporation, size of fund, and capacity of risk control. At present, there are three fund operating modes in the world: first, an insurance company setting upon investment management center or investment department, especially discharged with the responsibility for insurance fund investment and utilization; second: an insurance company entrusting other agencies like securities companies or fund management companies for management; third: an insurance company setting up a specialized insurance asset management company to take charge of the operation and management. There is no absolute good or bad among the three modes. Different companies at different times can select different operating modes, or a combination of the operating modes.

As for China's commercial insurance fund operating mode, in the past, it used to take the form of an investment department established in the company responsible for investment and utilization. However, with the rapid increase of China's insurance funds and the rapid expansion of fund size, and increased competition in the insurance industry and the change of the investment environment, the single management mode cannot meet the needs of further development of insurance funds in terms of both organizational structure and specialized investment services. Therefore, we need to introduce innovations to the operating mode of insurance investment, and allow those insurance companies that have met certain conditions to set up insurance asset management companies. The establishment of insurance asset management companies will ensure management of the insurance investment be placed in the hands of professionals, which will effectively lead to

specialized handling of insurance operation business and investment business. Meanwhile, a fund firewall is put in place between different legal persons so as to minimize and evade risks, raise returns of insurance investment, and promote insurance industry to become stronger. At present, the People's Insurance Company of China and China Life have set up insurance asset management companies. The China Insurance Regulatory Commission and other pertinent departments will approve the proposals in succession from other insurance companies to ensure that they have met the qualifying conditions to set up their insurance asset management companies.

As insurance companies are financial institutions with large liabilities, their investment policies particularly stress safety of the investment and long-term matching of assets and liabilities. In a sense, insurance investment is the backbone of modern insurance industry. The concept of modern insurance supervision and administration is to enhance the capacity of insurance companies to increase their returns with due regard to the principle of safety. Starting from that concept, drawing on international regulatory experiences and taking into account China's current situations, we have gradually formed a regulatory mode with Chinese characteristics.

The regulation of insurance investment is to achieve four goals: first, protecting the interests of the policyholders; second, guiding the flow of insurance funds; third, preventing over-density of investment; and fourth, maintaining the matching between assets and liabilities. The regulatory approaches adopted in the operating process are primarily limitation of investment channels and control of investment ratio to regulate insurance investment. Given that China's capital market is not yet mature, insurance companies lack experiences in investment, and some other factors, in order to lower investment risk, and ensure safety of the funds, the Insurance Law of China provides limitation to the investment channels of the insurance funds. In order to avoid a general over-concentration of risks, we have worked out provisions concerning the maximum percentages to be invested in various funds so as to control the percentages of different risks in the total assets. Meanwhile, in order to avoid any insurance company concentrating its assets on a single category of product, scatter the risks, ensure its professional business operation by preventing it from holding too many equities to engage in other relevant businesses, we exercise control of the share invested to a single category of products, and monitor the investment of insurance funds to various assets and set a maximum percentage for each category.

Future regulation: Putting in place a risk control model

To provide better services for economic development and social progress, insurance industry needs to not only exercise its traditional function of economic compensation, but more importantly, make full use of the unique function of modern insurance industry of fund raising and circulation, and optimize allocation of financial resources. At the end of last year, the Standing Meeting of the State Council adopted in principle *the Reform Plan of Investment System*, which encourages and promotes insurance funds to invest in basic infrastructure indirectly. *Opinions concerning Promoting Capital Market Reform and Opening up and its Stable Development* as promulgated by the State Council clearly states supporting direct access of insurance funds into capital markets in various forms, and gradually increasing the share of commercial insurance funds invested in capital markets, and making institutional investors like insurance companies as the leading force in capital markets. We will implement the principle laid down by the State Council, explore the concrete approaches to widen insurance investment channels, organize work to put them into practice, and further promote professional, regulated, and modernized insurance investment. When conditions are mature, the business scope of insurance asset

management companies will be further expanded to create favourable conditions for the healthy development of insurance asset management companies. Allowing insurance companies to set up insurance fund management companies falls in line with the development trend of insurance asset management business and international practices.

However, with the opening of investment channels and widening of insurance management business scope, new problems and new risks keep emerging. Insurance fund regulation has to constantly adapt to the needs of new situations, progress with time, and explore the regulatory approaches suitable to insurance investment channels. China's commercial insurance investment regulation will be performed with safety guarantee as the principle, industry development as the prerequisite, risk monitor and control as the core, and technological means as the medium to achieve the purpose of effective regulation. While we continue to promote widening of insurance investment channels, we promote assets and liabilities management at all fronts, vigorously enforce monitoring of solvency capacity, establish and strengthen in real terms risk management and control of insurance investment. The work in the following aspects needs to be done well in the process of establishing a risk control model at all fronts:

First, setting up an instant and dynamic insurance investment risk advance warning system, and formulating a unified risk assessment standard. Efforts have to be made to ensure that data provided by insurance companies is accurate, with correlated verification approach. Follow-up auditing approach will be used to avoid uncovered risks. Insurance companies will be required to set up designated departments to take the charge of risk management of insurance investment, set up a department independent of insurance investment business to be responsible for inspection, evaluation and report of insurance investment risk control compliance. An insurance company shall submit its assets and liabilities matching report to the China Insurance Regulatory Commission every year, which should include strategic allocation, deficit management, VaR analysis, scenario analysis, and pressure test.

Second, improving insurance companies' internal control system of investment, and setting up a high-standard insurance investment firewall system. For instance, establishing strategic allocation of insurance funds, separation of investment trade and assets guardianship, effective human resource management system, graded authorization system of insurance investment.

Third, putting in place a scientific performance evaluation system and public disclosure system. A comprehensive, equitable and comparable investment performance evaluation system will be established to assess the investment performance of insurance companies. The scientific performance evaluation system includes equitable performance calculation, way of expression and the scientific evaluation approach based on the former aspects. Meanwhile, minimum disclosure requirements should be provided for insurance companies concerning their investment performance. In this connection, effective public overlook should be used to achieve transparent operations, so as to promote effective utilization of the insurance funds.

Through our efforts to put in place a risk control model, we will formulate a professional layout and dynamic regulatory framework focusing on risk monitor and control index system, industry investment plan, and insurance investment accounting, in an effort to promote insurance companies to set up effective insurance investment risk management system, improve their solvency and competitiveness, and upgrade their capacities to mitigate and defend against insurance risks, so as to achieve the sound and exceptional development of China's insurance industry.

The active role of the Chinese Trade Unions in building and improving the social security system

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The Chinese Trade Unions have always played a key role in the process of establishing and perfecting the country's social security system. During the special period of more than one decade immediately after the founding of New China, the Trade Unions were entrusted to be directly responsible for the management and administration of social security affairs. Out of the total five members of the Drafting Committee of the first legal document concerning social security, namely the *Regulations on Labour Insurance*, three were representatives of the All China Federations of Trade Unions (ACFTU). On 26 February 1951, the Government Administrative Council (later replaced by the State Council) of the People's Republic of China promulgated the *Regulations on Labour Insurance*, which expressly provides that "the ACFTU is the highest leading organ of the labour insurance undertakings of the nation and the grassroots trade union committees as organizations at the grassroots level to see to the implementation of labour insurance operation. The ACFTU shall make overall planning for the running of labour insurance undertakings across the country while taking a variety of relevant elements into consideration, supervise and direct its affiliates at locality and industries to carry out labour insurance endeavours." Although the Trade Unions were no longer directly involved in the administration of social security issues since reform and opening up, laws and regulations concerning different aspects of social security such as the *Labour Law* and the *Trade Union Law*, all contain clear-cut provisions regarding status and responsibilities of the Trade Unions in social security system. In other words, the Trade Unions have, as always, been playing an irreplaceable role in pushing forward the improvement of China's social security system.

To participate in investigation and formulation of relevant laws and regulations as well as policies

The Trade Unions have taken an active part in the process of research and formulation of laws, regulations and policies on social security and put forward propositions from the perspective of workers. It is particularly true since mid 1980s when China started to reform the social security system and came out with a series of policies and regulations. The Trade Unions have involved in the entire process of the reforms ranging from the formulation of the *Labour Law* and the *Social Insurance Law (Draft)* to various specific regulations, from the "two guarantees" (namely to guarantee full and in-time payment of pension for the retirees

and the basic living allowance for the lay-offs), the "three security lines" (namely basic living guarantee for the lay-offs, unemployment insurance, and the minimum living guarantee for poor urban residents), the five major insurance schemes including pension, medical care, unemployment, industrial injuries and maternity, to the experiment of urban social security system in a few selected places. Through active participation, the unions have expressed voices and opinions on behalf of the broad masses of the workers and staff members, raised suggestions and propositions, most of which have been accepted, and effectively protected workers' rights and interests at source. In the meantime, the unions have taken note of the fact that with a vast geographical size, China is of great diversity and disparity in terms of economic development level in different regions. Whereas the government works hard to come out with national policies and regulations, different provinces are advised to have implementation plans that are compatible with local conditions. For this purpose, the trade union organizations at provincial and city level have actively participated into studying and formulation of local policies and regulations and proposed various constructive suggestions. Participation of the Trade Unions at source has provided a mass foundation for local governments in formulating relevant policies and regulations, helped the governments to make scientific and democratic decisions, safeguarded economic interests of the workers and staff members, politically materialized their democratic participation in decision-making and effectively enhanced their social status.

To strengthen supervision and inspection of relevant policies and laws

On the one hand, the Chinese Trade Unions constantly urge the governments to establish supervision institutions made up of representatives from relevant government departments, employers and Trade Unions. By end 2003, social insurance supervision committees were set up in 19 provinces and fund supervision institutions set up in 239 cities at prefectural level. Hotlines for reporting complaints and disclosing violation on social insurance fund supervision were opened in 30 provinces and 205 cities at prefectural level. On the other hand, a number of local Trade Unions have formed mass supervision organizations within the unions so as to strengthen supervision and monitoring of the revenue and outlay, management and operation of social security funds and the implementation of relevant laws and policies. At the same time, the Trade Unions at various levels have actively carried out supervision regarding the implementation of laws and regulations through representation in the joint inspection taskforces composed of representatives from the National People's Congress (NPC), the Chinese People's Political Consultative Conference (CPPCC) and the government, and through a variety of other channels such as Workers' Representative Congress, corporate transparency initiatives and the joint meeting mechanism between the Trade Unions and the governments. In recent years, focus of the supervision work has shifted to misconducts by employers, individuals and social insurance agencies, which has scored effective results. All the activities have contributed to the smooth implementation of policies, laws and regulations on social security.

To assist workers and staff members to enjoy due social security benefits

Given the fact that social security policies demand for technical knowledge, the Chinese Trade Unions have actively promoted education and explanation on relevant policies among the broad masses of workers so as to enable them a better understanding about their social security rights and interests by giving full play to the organizational advantage of the Trade

Unions as being closely connected with the workers. In recent years, Trade Unions at different levels have paid special attention to assisting the lay-offs and unemployed to maintain their relationship of social insurances, claim for basic living allowance and unemployment benefit, and helping the retired to get their pension. They also help workers in poverty and their families to apply for minimum living allowance, and urge poor performance enterprises and needy workers to participate in medical insurance schemes and ensure that they will enjoy their entitled benefit. They render their support to other departments concerned with regards to employment accident prevention, injury and disability evaluation and vocational rehabilitation. Unions have actively helped the injured workers and their families with timely application for work injury insurance compensation. All these efforts are aimed at safeguarding workers' social security rights and benefits.

To build up the workers' mutual-aid security programme and develop it into a component of the multi-level social security system

The Trade Unions have actively carried on the fine tradition of the Chinese working class to help each other and initiated the workers' mutual aid security programme. The mutual aid security programme is on voluntary basis and funded by contributions paid by individual workers. It is an external programme out of the State statutory social security system and aims to provide material assistance to workers in difficulties in case of old age, sickness, death, injuries, disabilities and other unforeseen disasters. As a supplement to the State statutory social security system, the workers' mutual-aid security programme mainly includes mutual aid security on medical care and a series of comprehensive mutual aid benefits. The programme is run by local Trade Unions mostly operated at enterprise, industrial wide and city or county level with only a few at provincial level. Most of the programmes above grassroots level have set up specialized organizations. Those at enterprise level have to follow relevant constitutions, measures and regulations discussed and approved at Workers' Representative Congress before their actual implementation. At present, the workers' mutual-aid security programme has turned out to be a component part of the multi-level social security system with Chinese characteristics. By the end of 2003, the Chinese Trade Unions have established 18,000 mutual-aid security organizations, covering 7.23 million workers and staff members. The number of grassroots Trade Unions running mutual-aid security programmes has amounted to 1839 with 14.58 million participants, with a total fund of several billion RMB. More than 6 million persons (times) had received all kinds of benefits. The development of the workers' mutual-aid security undertakings has contributed to the increase of the overall social security benefit level for the Chinese workers and relaxed contradictions between benefit level under the statutory schemes and the practical needs of the workers, constituting another security line for the workers against social risks and well received by the broad masses of the workers.

To implement the Warmth Delivery Project and establish help-support centers for the needy workers and make them an important part of the social mutual-aid system

The ACFTU and its affiliates at various levels, in collaboration with the Party and the government, launched the well-known Warmth Delivery Project in 1992, to extend care towards the needy workers and helping them out of difficulties around the New Year's Day and the Spring Festival across the country. From 1992 to 2004, the Trade Unions at various

levels by joining hands with the Party Committees and governments at corresponding levels have mobilized and delivered a total amount of RMB18.18 billion as relief funds to the needy. They have visited more than 823,000 enterprises in red and over 55.778 million families of needy workers and staff members. Moreover, 447 local Trade Unions, the majority of Trade Unions at county and district levels and 180,000 grassroots Trade Unions have set up files and data for workers in extreme difficulty. In the meantime, more than 1 million officials from the Party Committees, the governments and Trade Unions have formed links with nearly 1 million poverty-stricken families to help them get rid of poverty. Furthermore, to regularize, systematize and socialize the Warmth Delivery Project and better help needy workers and staff members, Trade Unions at various levels have taken the initiative to set up help-support centers since January 2002. By the end of 2003, 11 Trade Unions at provincial level, 307 Trade Unions at prefectural level, 1,202 at county level and 342 at industrial and grassroots level have established their help-support centers. At the same time, assistance network for needy workers with participation of both Trade Unions at upper levels and those at grassroots level have also taken shape in many places. Statistics indicates that in 2003, the help-support centers across the country have extended either living or medical care assistance to more than 2.569 million workers (living assistance to 589,000 and medical care to 133,000), and handed out about CNY319 million of relief funds to meet workers' needs in subsistence (157 million), health care (45.36 million) or their children's education (59.83 million). They have effectively helped the needy workers and their families to safeguard their basic living standard.

In order to further improve the social security system, the Chinese Trade Unions stand for greater efforts to be made to perfect and regularize the existing social security system in line with the operational laws of social security in the market so as to adapt to demands of the socialist market economic system. At present and for a certain period to come, efforts should focus on the following aspects:

First, speed up the legislative process regarding social security. The government should speed up legislation on social security, utilize the binding force of laws to require all their employers and enterprise management to pay social insurance contributions for employees, and clearly define workers' rights and interests to social security in the form of law. In drafting relevant laws and regulations, principles of comprehensive planning, breakthrough in priority areas and step-by-step implementation shall be carefully observed. Currently, emphasis should be on the drafting of *Social Insurance Law* and related rules and regulations and on such basis, to push forward drafting up of other laws and regulations with respect to social security. Laws on social insurance should explicitly provide that any enterprise in operation or employing workers has to participate in social insurance schemes, honour legal obligations and in turn enjoy relevant rights and interests.

Secondly, strive to expand the coverage of social insurance schemes. Efforts should be given to extending the existing basic pension insurance scheme to all workers in urban areas and expanding the coverage of basic medical insurance by improving the basic medical insurance system for urban workers and simultaneous reform in pharmaceutical production and circulation systems. Special attention should be paid to the study and formulation of workable measures to enable the enterprises of poor performance and their employees being covered by the medical insurance schemes. The basic living allowance guarantee system should be emerged into the unemployment insurance in a steady manner. Efforts should also be given to the earnest implementation of the *Regulations on Work Injury Insurance* and expanding its coverage. Furthermore, emphasis should be on formulation of flexible forms of contribution collection and benefit calculation as well as improved social security management and service delivery so as to enable workers in flexible forms of

employment to be covered by the social insurance schemes. At the same time, special emphasis should be placed on feasible measures to enable the rural migrant workers to be covered by social insurance schemes with priority on their participation in the work injury insurance schemes and medical insurance for serious illness. In short, the aim should be to extend social insurance coverage to all employing units and their workers as well as migrant workers and ensure them to enjoy social insurance benefits.

Thirdly, intensify the work on contribution collection, fund raising, fund management and operation. The labour departments should, in close cooperation with authorities for business administration, taxation, auditing and accounting, intensify contribution collection to ensue "full collection of all contributions due". Fiscal spending should be restructured with more financial input and steadily increased proportions of fiscal spending on social security. Proactive and prudent measures should be adopted to liquidate some State assets and put them into the social security funds. More funding channels should be opened by such measures as tax revenues and bonds issuance. Moreover, strict measures should be adopted to control early retirement, clear up special trades and work posts that are qualified for earlier retirement, extend retirement age where necessary and conduct strict assessment on benefit items payable and wages bases for contribution calculation. On this basis, strengthen management of social security funds, promote their investment and operation and ensure the value maintenance and appreciation of the funds.

Fourthly, strengthen the construction of the supervision mechanism of social security. Priorities of the supervision work are as follows: i) Administrative supervision. Strengthen daily supervision work by the governmental departments over operation of social security systems and enhance capacity building in labour and social security inspection and severely deal with malpractices and misconducts; ii) Legal supervision. It mainly refers to People's Congresses at various levels should strengthen inspection on the enforcement of laws and regulations concerning social security; iii) To set up social insurance supervision commissions with the participation of representatives of the three parties, namely, the government, employers and labour (or Trade Unions) and examine, at regular intervals, the implementation of social insurance policies, revenues and expenditures as well as operation of social insurance funds; iv) Social supervision. The Trade Unions should fully exploit such avenues as Workers' Representative Congress, corporate transparency initiatives, negotiation and collective bargaining on equal footing to urge the employers to honour their obligation of paying contributions. Meanwhile, efforts should also be on public awareness raising and social supervision by the mass media (newspapers, TV, magazines and the internets etc.) and hotlines to expose malpractice and misconduct in social security.