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# Social Insurance in China

## Research Summary



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## About This Report

This high-level research summary introduces the scope and principal findings of the BSR working paper, *Social Insurance in China*. The full report was written by consultants Fengyuan Wang and John Pabon of BSR. Additional guidance was provided by Jeremy Prepscius and Lin Wang of BSR, and Yun Gao of ETI.

Any errors that remain are those of the authors. Please direct comments or questions to Fengyuan Wang at [fwang@bsr.org](mailto:fwang@bsr.org).

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## THE EVOLUTION OF SOCIAL INSURANCE IN CHINA

Social insurance in China, a scheme aimed at ensuring protection for all citizens, was a key pillar of the Communist agenda when the Party came to power in the late 1940s. Since passage of its first law in 1951, however, China's rapid economic growth has necessitated sweeping changes to how the Government provides for its people. The workers that helped fuel China's dynamic growth are now at retirement age and want their payouts. Coupled with a slowing economy, drastic fluctuations in the stock market and the recent devaluation of the renminbi, tensions are understandably high. Unfortunately, in a workforce of 770 million, less than one-third have a basic pension and only half are enrolled in an insurance scheme.

A number of recent high-profile protests have centered on payment of social insurance benefits. According to the China Labour Bulletin, social unrest in China was up 33% in 2014, with 2,590 separate incidents so far this year.<sup>1</sup> The most notable of these occurred in 2014 at the Yue Yuen shoe factory in the city of Dongguan, with a two-week strike that saw 40,000 participants protesting the systematic underpayment of social insurance contributions that left many long-term employees with lower than expected pension payments.

Meanwhile, trends show a decline in private-sector contributions to the system, and public disillusionment with social insurance reforms, and confusion as to individual benefits, are leading many workers to forego enrollment entirely.

BSR and ETI sought to understand these trends, especially given the Government's recent push for full compliance of national social insurance schemes, including the 2011 Social Insurance Law. Our methodology included primary and secondary research, with surveys and interviews with buyers, suppliers, workers, regulators, and experts in the field of Chinese social insurance.

## CHALLENGES TO AN AGING SYSTEM

The social insurance system in China includes five benefit areas. Although eligibility for social insurance coverage is meant to be universal for all workers, this is not the case in practice. Each area has its own particular challenges with implementation.

- » **Statutory retirement ages are out of line with long-term sustainability of the pension fund.** Current rates were set in the 1950s and do not take into account increased life expectancies of an aging population. The Government has proposed an increase of retirement age by 5 years, but faces opposition from older workers.
- » **Unemployment benefits are required to be lower than local minimum wages and are thus often well below living wage levels.** Currently, there are 170.4 million people enrolled in the unemployment insurance scheme, up 6.3 million since last year. Of this total, 23.9% are migrant workers.
- » **Out-of-pocket medical insurance payments are common, especially for lower-paid workers.** All workers contribute 2% of their wages to an individual medical insurance account. Employers contribute an additional 30%, with the remaining 70% of employer contributions going

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<sup>1</sup> "Strike Map," China Labour Bulletin, accessed August 2015, <http://strikemap.clb.org.hk/strikes/en>.

to a public medical insurance pool. If an employee has not contributed enough to their account, they must make up the difference themselves.

- » **Work-related injury insurance is paid entirely by employers, with stop-gap measures for local governments to pick up costs if an employer refuses to pay.** Unfortunately, most local governments do not have the systems in place to do so. A survey by a legal-aid center in Beijing found only 10% of cities would "...definitely accept advance applications, and only nine cities had actually issued implementing regulations."<sup>2</sup>
- » **Even with maternal leave, some employers find ways to prevent workers from enrolling.** Some will ask prospective employees about their family plans, create contracts that forbid pregnancy, or force resignations if someone does become pregnant.

Adding to these specific complications for individual benefit areas are myriad factors influencing coverage and workers' willingness to enroll:

- » **One major factor is the workplace's status as either urban or rural.** Urban workplaces have to contribute higher premiums to the system and are entitled to the entire suite of social insurance coverage areas. Rural businesses are only entitled to retirement and medical benefit coverage.
- » **Factories are classified, regardless of location, as urban workplaces.** Over the past decade, many factories have moved from their original locations along China's east coast to more inland, rural areas. Although they may now operate in poorer provinces, employers and employees are still required to pay the urban premium for social insurance. This has led many to opt out of enrollment altogether.
- » **China's national identification system, the *hukou*, creates further problems with equitable contributions.** When employers pay into social insurance schemes, they sometimes pay less for those workers with non-local *hukou*. These non-locals will thus receive lower pension and/or medical benefits when they start to draw on their accounts.
- » **Workers must typically contribute for 15 years before they can begin to collect.** For those working several jobs in many provinces over the course of 15 years, this can create a bureaucratic headache in trying to monitor and transfer funds. As of 2014, only 0.3% of workers actually transferred their pension when moving between provinces. Many others do not envision working for 15 years, so are hesitant to begin contributing at all.
- » **Given the highly bureaucratic nature of the system, the transferability of funds is not widely understood by workers.** For many temporary migrant workers, contributing to a pool at their urban factory – one which may not be honored at banks back home – has limited appeal.

## RESPONSIBILITY VERSUS REALITY

Enforcement of social insurance regulations varies considerably from province to province. Even with the various challenges inherent to the system, our interviews with suppliers revealed a clear upward trend in the percentage of insured workers. Over the past 3-5 years, the percentage of insured has risen from

<sup>2</sup> "Local Governments Refuse Financial Aid for Uninsured Workers," China Labour Bulletin, accessed August 2015, <http://www.clb.org.hk/en/content/local-governments-refuse-financial-aid-uninsured-workers>.

20%-30% to over 80% in many cities. Costs associated with social insurance have also risen during this same period, averaging 10% year-on-year.

These costs are clearly defined. For employers they include: pension payments to all staff of around 20% of wages, with regional variations; unemployment payments of 2% of the total workforce salary; medical insurance payments of between 6% and 12% of the total workforce salary; work-related injury payments of between 5% and 2% of total payroll; maternity rates determined by local governments; and, ad-hoc housing fund payments as set by local governments.

Though responsibilities are well defined, social insurance implementation across a geographically dispersed supply chain becomes quite complicated. Individual provinces have different requirements and expectations, with regulations sometimes varying within a single province. In addition, some local governments provide official waivers that allow companies to operate while not in full compliance with national law.

All buyers interviewed have social insurance requirements embedded in their supplier codes of conduct, including through third-party audit mechanisms. However, we found that non-compliance remains common in the electronics and apparel supply chains in China, varying between 80% and 99%. There are several factors contributing to this.

- » **Generally, social insurance costs are not fully reflected in current purchasing prices.** In order for a factory to compete, they will sometimes reduce costs at the expense of worker benefits. While many buyers have added social insurance costs into pricing equations, they are largely unable to ensure their suppliers are purchasing appropriate social insurance for their workers.
- » **Even if a factory has achieved full compliance in an audit, that doesn't necessarily mean that they consistently maintain compliance year round.** Some will hire temporary workers or interns during peak seasons but do not contribute to their social insurance premiums; some won't contribute to a new hire's social insurance premium until after a probationary period is complete.
- » **Corrective action for non-compliance is not standardized.** Buyer expectations for improvement vary, with priority often given to work-related injury insurance. Social insurance violations typically do not lead to supplier termination, which reduces the perceived importance of importance of improvement.

BSR also conducted interviews with 62 workers through a series of focus group discussions. Overall, there were four main issues found during the worker interviews.

- » **Knowledge of the social insurance system is generally low.** The four main sources of information on social insurance were factory human resources personnel, onboarding orientation sessions, the Internet, and family or friends. Most interviewees said they bought social insurance simply because it is a benefit provided by the employer. Few felt any incentive to learn more about the system they are paying into.
- » **Workers had varying levels of understanding about benefits.** Generally, focus group participants thought medical insurance and pension payments were most useful, with tangible benefits such as access to health care and medicine. Perceptions of pension scheme

understanding varied with age. Workers approaching retirement were more aware of and likely to participate in pension schemes. Those in their 40s or 50s mentioned recent enrollment in the program and were concerned about the 15-year minimum contribution period. Younger workers generally felt they were too young to need the benefits a pension scheme could provide.

- » **Policy limitations impact migrant workers differently in different places.** For example, rural migrant workers in Shanghai are not entitled to unemployment or maternity benefits. In Chengdu, migrant workers from outside Sichuan Province cannot claim outpatient fees as part of the medical insurance scheme.
- » **There is a general reluctance to transfer or withdraw the money in social insurance account.** It is highly unlikely that a migrant worker would manage to merge 15 years of separate provincial pension accounts into one before retirement. The process is burdensome and costly, with in-person certification required in each city of employment. Participants in the working groups also reported difficulties in claiming pension funds in rural areas. A retiree may need to make periodic withdrawal claims at their local social security administrative office but then withdraw the actual funds at a local bank branch, both of which may be far from their home.

## A MULTIFACETED APPROACH TO IMPLEMENTATION

Labor costs in China, especially those associated with social insurance schemes, are continuing to evolve. While we were able to glean several findings from our interviews across China's supply chain, several questions still remain.

- » **How can companies achieve social insurance compliance while maintaining market competitiveness?** One approach is to improve efficiency while reducing waste. The International Labour Organization (ILO), however, has warned against lean manufacturing as a one-stop solution to address changes in labor issues.
- » **Will consumers pay the cost of social insurance?** Our research found that even if all increased costs associated with social insurance were passed to consumers, this would only result in a nominal increase in retail prices. Many retailers claim, however, that consumers are highly sensitive to price fluctuations, making it a difficult business decision to increase prices unless absolutely necessary.
- » **What factors can influence social insurance compliance among factory workers themselves?** Through our research, the key factor is education. Current education efforts do not always reach the level of workers. Although all factories interviewed provide new staff orientation, including on social insurance, often the trainers do not fully understand the material. This partially illustrates why workers may lack the knowledge necessary on the topic.

Given these questions, as well as varying supplier understanding of the social insurance system, BSR recommends a tailored approach when discussing the subject of implementation.

- » For factories taking a **proactive approach** to social insurance implementation: Develop case studies and quantitative data on the positive impacts of compliance. Additionally, work with employees on advanced subjects such as financial planning.

- » For factories that **mostly respond** to audit findings: Acknowledge their work, reinforce the value of continuing to invest in social insurance education, and provide them with incentives to do so.
- » For **lagging factories**, including those blatantly ignoring social insurance regulations: Try to better understand their needs and concerns. In particular, do they see the positive business case for social insurance compliance, understand the system, or need more training than they are currently receiving?

The goal with each of these approaches is to maintain open dialogue between buyers and suppliers and move steadily towards compliance. Both sides should work collaboratively to understand, adapt, and comply with changing labor laws and social insurance mandates. China remains an important part of the global supply chain, and a key market for meeting sourcing needs. As such, keeping sourcing economically viable – through maintaining productivity and competitiveness, improving buyer/supplier and employer/employee relations, education, and communication – is in the best interest of all.

## About BSR

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