Chapter 2

Economic, Social and Social Security System

2.1 Introduction

There are several factors which affect consumer's behavior in purchasing life insurance, for a better understanding of China's consumer behavior in life insurance, In this chapter, I will review the economic, social and security system in China.

2.2 China's economic background and economic theory related to bank savings behavior

From the 1970s, economic growth spread rapidly in the Asia Pacific area, especially among the developing countries. There was an economic miracle in Asia called Four Small Dragons which refers to the growth of Hong Kong, Taiwan, Singapore, and Korea. At the beginning of the 1990s other countries in the Asia Pacific Area like China, Thailand, Indonesia also started to progress in their domestic economy during the beginning of 1990s. Following is a systematic description of the economic environment of the Chinese economic reform. In rural areas, peasants had their own land through family contracting responsibility system[7] and their income

[7] " *Regional handbooks of economic development*". The China handbook. Chicago: Fitzroy Dearborn publishers, 1997. Family contracting responsibility system ,same as " Household Responsibility System" : A contracting system that revolutionized agriculture in the early Deng period. Rather than contracting to large agricultural collectives, some local leaders began dividing up the land among work units or families and then subcontracting production quotas to these smaller units. One particularly popular method was called 'contracting everything to family' wherein families had to sell a set amount of produced goods to state officials at stipulated prices, but anything produced above these quotas could be sold at higher prices to other buyers.

increased rapidly. The average annual increase rate of industry output from 1978 to 1999 was 12% and the GNP of China in 1999 was 3.4 times of that in 1978[8].

During 1995, China's economic growth rates slowed to 10 percent, and so did the inflation rate. Reducing inflation was a priority to achieve the goal of 10% economic growth rate. In addition, the government continued its relatively tight monetary policy, while financing its fiscal deficits by issuing bonds. The growth of fixed investment decelerated from over 30 percent in 1994 to about 19 percent in 1995. The rise in retail sales showed about 10 percent in real terms over 1994. As a result, the inflation rate was reduced to about 17 percent in 1995 from 24 percent in 1994.

Losses of State-owned enterprises (SOEs) increased as their financial difficulties intensified in a restrictive macroeconomic environment. As a tight monetary policy restrained the amount of credit available to enterprises, the problem of "chain debts" (the term refers to a situation where enterprises are indebted to one another for supplies of materials and intermediate inputs) worsened. Indeed, the problems that the SOE sector posed to the overall economic efficiency and to the central government's budget remained unresolved. Recognizing the crucial role of state enterprise reforms at this juncture of China's economic development, the government identified the state-owned enterprises as the prior area that needed to be reformed[9].

All these developments were interrupted by Asia's financial crisis which

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[8] Amei, Zhang. (1995). *Economic Growth and Human Development in China* [Online]. Available: http://www.undp.org/hdro/oc28a.htm. [2000, Dec. 18].
[9] Ibid.

happened in the summer of 1997. The Financial Crisis has thrown tens of millions out of work as some corporations were forced to close, trim their payrolls or downsize for the sake of survival. In Indonesia which was one of the hardest hit countries, according to the government figures, there are approximately 13.4 millions people who lost their jobs, just a five-[f]old increase from pre-crisis levels. In Hong Kong, the provisionally adjust unemployment rate for the March-May period of 1998 rose to a 15-year high of 4.2 percent. Even labor-tight Singapore is feeling the pinch, with layoffs hitting a record quarterly high of 7,131 in the first three months of 1998[10].

China was not hit by the Financial Crisis directly and dramatically because the financial markets in China were just opened to only a small sector of outsiders and international speculators failed to attack financial markets in Hong Kong in August 1998. The Chinese government is taking a more cautious stance and is prudent about its financial policies and intends to establish a risk-preventing system.

For the near future, the transition from input-driven economic growth to growth based on efficiency improvement has been identified by the Government as their logical goal. Economic reforms will be implemented to facilitate this transformation as well as financial sector reforms to strengthen the development of financial institutions and prudential supervision, along with trade liberalization. At the same time, reforms aimed at establishing a system of social security, unemployment insurance and medical insurance will continue in order to cushion the social impact of the eventual reform of state enterprises. Thus, barring major political changes, the Chinese economy can be expected to maintain its relatively high rate of growth while

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[10] Amei, Zhang. (1995). *Economic Growth and Human Development in China* [Online]. Available: http://www.undp.org/hdro/oc28a.htm. [2000, Dec. 18].

continuing to restrain the rate of inflation.

2.2.1 Economic growth in developing countries

Since the People's Republic of China's government adopted the open door policy in 1978, China has grown strongly, and people are richer. From 1950s to 1990s, China Real GDP per person and GDP growth in 1990s has increased rapidly. (See Figure 2-1 and Figure 2-2)[11]

Figure 2-1 Real GDP per person in 1990s

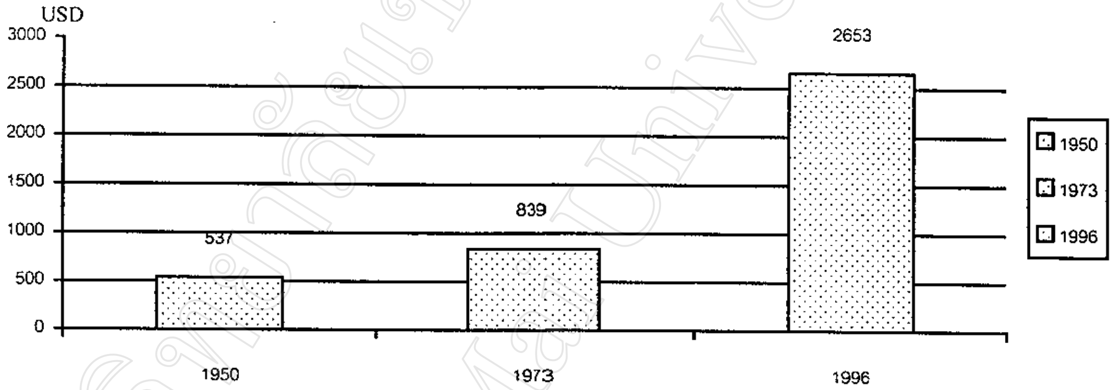
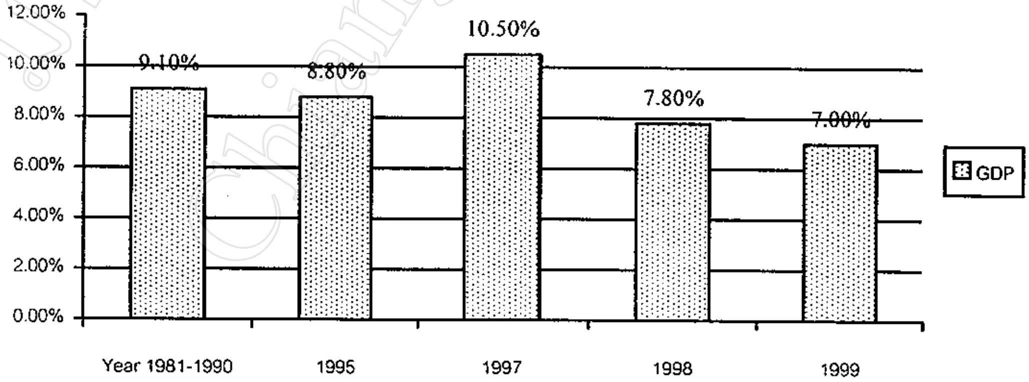


Figure 2-2 GDP growth in China from 1981 – 1999



[11] " Fortune" Vol.140, No.7, Oct.11, 1999, p76

Rising per capita output is thus not a phenomenon that is limited to China , South and East Asia also experienced rapid growth in their economies, where, in deed, almost the entire population lives in countries with rising GDP per person. The least developed countries, in particular, have made significant gains in this regard in 1995 and are expected to advance further in the future. At least 21 economies out of the 48 least developed countries, with 78 percent of the total population in the group, registered growth in per capita GDP in each of these years. This is quite an encouraging development if set against the experience of the early 1990s, when only about a dozen least developed countries, with about half their population, were in this category. (Table 2-1)[12]

Table 2-1: Per capita GDP of developing economies, 1980-1995

	Per capita GDP (1988 dollar)			Annual growth rate of per capita GDP (percentage)		
	1981-1990	1991-1995	1995[a]	1981-1990	1991-1995	1995[a]
Developing economies	770	858	988	1.0	2.9	3.3
Latin America	2148	2008	2092	-0.9	0.8	-0.9
Africa	721	700	657	-0.9	-1.3	-0.0
West Asia	5736	3423	3328	-5.3	-0.6	0.4
South East Asia	460	674	817	3.9	4.0	5.0
China	202	411	664	7.5	10.2	9.1
Least developed countries	261	249	238	-0.5	-0.9	0.4

Another interesting development was that developing countries' growth

[12] Ibid., p76

rates were strengthened overall in 1995 despite the slower-than-expected growth of the developed countries, their primary trading partners. Actually the volume of developing countries exports was estimated to have grown more rapidly in 1995 than in 1994. This reflected the success of some developing countries in establishing markets for their goods in developed economies, taking advantage in particular of the continued strength of demand for computer-related electronics, as well as the increasing sales of developing countries to other developing countries.

During this period, Shanghai's economic growth rapidly, the economic and living condition were changing too. By the end of 2000, Shanghai had a population (with residence cards) of 16 million. In 1999, the birth rate stood at 0.5%, mortality rate 0.73% and the natural growth rate –0.23%. The city's population accounted for 1% of the nation's total. There were 4,701,100 households in the city with an average family having 2.8 members. The city's average life expectancy grew to 76.38 years for men and 80.53 years for women, it was higher than the level of the world average and that of the middle-income countries and close to that of economically advanced countries. In 1998, the city reported sustained, rapid and sound economic development. Its total GDP reached 368.82 billion RMB, up 10.1% from the previous year according to the comparable prices. In 1998, the city's average per capita GDP reached 20,240 RMB, the city's revenue stood at 114.6 billion RMB, up 7%.

The Per Capita Main Social and Economic Indicators of Shanghai were as follow: (Table 2-2)[13]

[13] 2001 IMI Consumer Behavior & Life Patterns Yearbook, p15

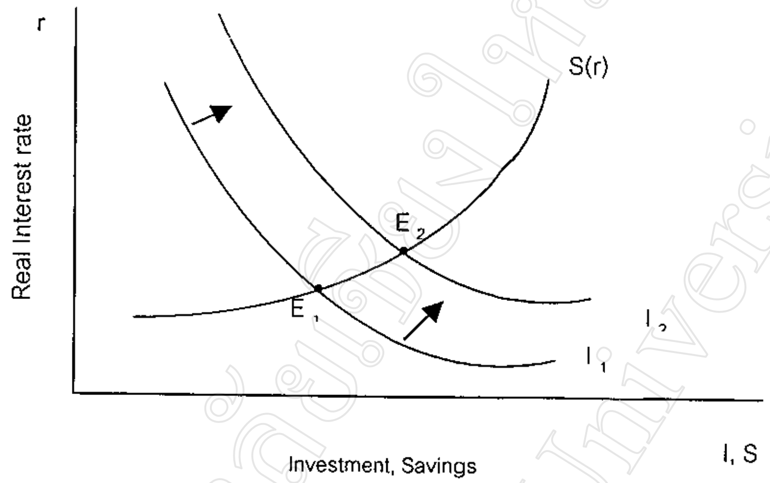
Table 2-2 Per Capita Main Social and Economic Indicators of Shanghai

Year	Gross Domestic Products (RMB)	Retail Sales of Consumer Goods (RMB)	Average Annual Wages of Staff and Workers (RMB)	Annual Living Income of Urban Residence	Living Expenditure of Urban Residence
1979	2568	612	784	-	-
1980	2738	706	873	560	553
1981	2813	768	870	589	585
1982	2877	766	883	606	576
1983	2963	848	897	641	615
1984	3259	1032	1110	787	726
1985	3855	1432	1416	1012	992
1986	4008	1608	1689	1215	1170
1987	4396	1815	1893	1347	1282
1988	5161	2355	2277	1616	1648
1989	5489	2610	2608	1860	1812
1990	5910	2608	2917	2050	1936
1991	6955	2973	3375	2334	2167
1992	8652	3608	4273	2842	2509
1993	11700	4814	5650	4057	3530
1994	15204	5944	7401	5566	4669
1995	18943	7461	9279	6822	5868
1996	22275	8913	10663	7721	6763
1997	25750	10155	11425	8439	6820
1998	28240	11263	12059	8773	6866
1999	30805	12111	14147	10931	8247

2.2.2 Economic theory related to bank savings behavior

This study employs the General equilibrium model to explain the relationships between savings, investment and interest rates. Since the interest rate is the return to saving, a higher interest rate might reduce investment and increase saving. The higher interest rate induces people to increase savings and reduce consumption, which in turn allows investment to increase. (See Figure 2-3)[14]

Figure 2-3 General equilibrium model



With an upward-sloping saving schedule, an increase in investment demand would increase both the equilibrium interest rate and equilibrium quantity of investment. Figure 2-3 illustrates such a change. The increase in the interest rate causes households to consume less and save more. In addition, the decrease in consumption free resources for investment. E_1 is the old equilibrium point, E_2 is the new equilibrium point, I_1 is the old investment curve, I_2 is the new investment curve, S(r) is a curve showed that savings as a function of the interest rate. Savings are positively related to the interest rate. A positive relation occurs if a higher interest rate induces people to consume less and save more. In short, if the interest rate reduces, the other personal investment will increase(e.g. buying life insurance). Then, the economic curve moves from I_1 to I_2.

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[14] N. Gregory, Mankiw. Macroeconomics. Harvard University. Worth publishers, 1992, p71-75.

2.3 Social changes in China

During the period of economic transformation, Chinese society was influenced deeply. Chinese central government decided to adjust the industrial structure in the whole economic system. Some industries like textile industry, instrumentation industry were downsized. The first direct impact was the problems of laid-off workers. In Shanghai, there were millions of workers who lost their previous jobs and entered re-employment training center. Influenced by the effect of Asian Financial Crisis, this problem worsen more than what people had been expecting. If there was no relevant social security system, these jobless people could not support their life and afford their families till they are re-employed. This will cause serious social problems and hinder the further reform process. It's very urgent to set up a complete social security system to protect the person who needs help and offer help to tide them over during these difficulties. Only in this way, can the Chinese economy continue to grow steadily.

Another change to the social aspect related to Chinese reform is the family planing policy. As we know, China has the largest population in the world. The target of economic reform is to optimize the limited natural resources and to improve the living conditions of Chinese people. It's necessary to control the increasing population while the economy is growing. Otherwise the increasing GDP will be offset by the expansion of the population. If China had not pursued family planing and had continued with its population birth rate of the early 1970s, it would have a population of more than 1.5 billion now and the consequence would be disastrous. Nevertheless, this policy also brings lots of social problems, such as aging of the population, family education of a single child, and the population pressure on pension funds, etc.

Aging of the population means the proportion of senior people (dependent population) in the total becomes larger and larger because the amount of aging people increases faster than the amount of younger people. The childbirth policy of allowing a couple to have one child will lead to the reverse pyramid structure of population. This means that the amount of young people is decreasing while the people aging increases to a larger quantity. Obviously, this structure is not stable and drives the problem of aging to a worse and worse situation. Working people of young ages can not bear the pressure to support such huge numbers of the aged in the future. How to handle this problem depends on what kind of pension plan the Chinese people will choose to protect their future and try not to add economic pressure on their descendants. All these problems are a reflection of the main changes in China's society and they have the same solution; which is to establish a social security system that is compatible with the Chinese characteristics.

2.4 The Exploratory Stage of Social Security System

The social security system for a nation and the current situation of the Chinese social security scheme. The functions of commercial life insurance in China's reform of social security system and the influence of the information of the social security system are as follow. Before economic reform in China , the burden of social security was supported by state-owned enterprises. At that time, the Chinese word "Unit", which referred to the corporation people who worked, means everything to employees. The enterprises which people worked for took the responsibilities of their retirement, disability compensation, child education, and housing, including the job provision to the employee's children. These became heavy burdens for the state-owned enterprises.

After China had changed their central planned economy to the market economy, all these government supports were transferred to social institutions: social insurance bureau, medical insurance bureau, and housing fund administration center. Drawing upon the experience of Chile, the social security system was transferred from government control to commercialized management. All these protection functions which were afforded by "Unit " previously, would be transferred to social institutions and enterprises have the unique goal for profit and development. That is to say, these protection functions should be involved in including a social security scheme now and be socialized. Because Shanghai is where China's sole opened insurance market is located, it has therefore been a forerunner in the development of the life insurance industry.

Before China design its own social security scheme, China learned the experiences from Chilean reform[15]. In 1981, Chile introduced radical reforms in its old-age pension system, moving from a publicly managed benefits-determined scheme to an individually capitalized contributions-determined system which was privately administered. Employees were given the option to choose between the public and the private systems and for those who opted for the private one, a premium, based on their past contributions to the old system, was paid in the form of treasury bonds (bonos de reconocimiento). New entrants into the labor market are obliged to subscribe to the private system, to which they contribute 10 percent of their

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[15] "Privatization of pensions Latin America", *International Review of labor*, vol.133, No.1 (1994), p.134-141.

gross earnings. Additional contributions of 2.5-3.7 percent of their salaries are paid for disability and survivors' benefits. The law does not require employers to contribute. Benefits depend on the contributions made and the income those contributions generate. At retirement, the accumulated capital and earnings can be used to provide a pension or to buy an indexed annuity.

The State guarantees a minimum pension for those with a qualifying period of contributions (20 years), if by the time they reach retirement (65 years of age for men, 60 years of age for women), their accounts do not contain adequate resources to provide a predetermined minimum benefit (22-25 percent of the average wage). The State also pays a pension for those who are qualified under its social assistance program, but the number of beneficiaries is restricted to 300,000.

The accumulating resources are managed by private funds administrators (Administradoras de Fondos de Pensiones (AFPs)), under government regulation. The AFPs are expected to compete among themselves, by offering low commissions and high returns, for contributors who are allowed to move freely from one administrator to another.

The system has been considered a success in many respects. Pensions currently offered are 40 percent higher than those obtained in the public schemes. Coverage is universal: 93.4 percent of the workforce belonged to AFP at the end of 1993; less than 7 percent of the active population remained in the old system. By the end of 1994, the AFPs had accumulated funds equivalent to 45 percent of GDP (the figure was less than 1 percent of GDP in 1981) and real returns on investment averaged 13.7 percent annually during the period 1981-1994[16].

The Chilean example is being followed in other Latin American countries and reforms similar to those adopted by Chile are being implemented elsewhere in the region. However, there are factors particular to the Chilean situation. Chile has long had a social security system covering a large extent of its working population, most of it engaged in the formal sector. The fact that the informal sector activities in Chile is limited and has contributed to the universalization of the system. Privatization of pension funds does not increase coverage because it is a formal channel that employees will be able to enroll in the private pension funds. In the informal, sector workers will remain excluded. Voluntary schemes may be offered but there is no guarantee that there will be contribution.

The Chilean Government has had an enviable record of delivering on its promises. Some other Latin American countries cannot lay claim to such a record. Moreover, the Chilean reforms were introduced during the Pinochet region, whereas democracy is the dominant form of government nowadays. In 1992, the Uruguayan Government failed to have a much less radical reform approved by congress. The proposal comprised, among other things, an increase in the retirement age and changes in the formula that established benefits. These proposals aimed at reducing

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[16] UNCTAD, "Consideration of the country presentation in the light of a cross-country review by the Secretariat of the design, implementation and results of privatization programs. Issues related to (a) privatization of the environment and (b) the privatization of pension funds" (document TB/D/WG.3/7/Rev.2/Add.1), 24 January 1994; and C. Mesa-Lago, "Economic reform, institutional change and social security policy in Latin America", summary of the presentation made at the International Seminar on Economic Restructuring and Social Policy, United Nations, New York, 11-13 January 1995 (mimeo).

the deficit of the social security system[17]. In Argentina, it took a long time for pension reforms to be adopted as they met fierce opposition. The original proposal that is compulsory for all insured persons over the age of 45 to enroll in private funds was dropped and the Government had to settle on a mixed system.

The lack of updated information is a major problem in many countries, especially in those that contemplate giving employees in the public system an incentive to move to the private one. Like those in Chile, the Peruvian reforms included bonos de reconnocimiento, which were based on the value and the number of past contributions. However, given inadequate records, the length of the contributory working life of the employee had to be estimated by other means. For instance, the value of past contributions was obtained through sworn statement of employees. Given widespread evasion in terms of contributions, the State probably recognized higher contributions than it had actually been paid[18]. The high real rates of returns obtained by the Chilean AFPs may be attributed in part to relatively well-developed financial and capital markets and the availability of attractive opportunities. The program of privatization of state-owned enterprises during 1985-1988 was one such opportunity. Other countries may not have mature capital markets or equally attractive investment opportunities. The reforms in Bolivia have many of the same characteristics as Chile's. However, with very limited capital markets and undiversified financial instruments, it is not clear how these resources will be invested. There is the option to invest these funds abroad; however, this option needs

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[17] Economist Intelligence Unit, Uruguay, Country report, No. 3 (1992), p.9.

[18] For those who had paid for longer periods than estimated, there was the option to prove their having done so. Work Bank, Peru: Public Expenditure Review, report, No. 13190-PE (Washington D.C., World Bank, 31 October 1994), p.68.

to be examined carefully, for it will not raise investment in the domestic economy. The failure among the 12 member States of the European Union in 1994 is to agree to the inherent difficulties.

To support a replacement ratio of 70 percent of earnings with a contribution of 10 percent of earnings, as in Bolivia and Peru, it is necessary to earn real rates of return at 4.5 percent per year for a period of 45 years. Such rates of return may not be sustainable in the long run[19].

The reforms are costly and require intense state involvement in regulating, supervising and providing the necessary guarantees. There are a series of guarantees and benefits that the State has to honor (minimum pensions, social assistance, bonos de reconomiento and others), without corresponding revenues, as employees transfer their contributions to the private sector. In the eve of reforms in Chile, social security funds ran a deficit equivalent to 1.9 percent of GDP. During the first four years of the reform, the deficit widened, reaching more than 6 percent of GDP in 1984. It has been slowly narrowing since then[20]. These costs had to be absorbed by the government budget.

A worrisome feature is the high degree of delinquency in Chile. Although 94 percent of the working population are members of an AFP, over 40 percent default on their payments. It is not known if this lack of compliance is due to sickness and unemployment or to evasion. Employees might evade payment because they place a higher value on current consumption than on future consumption. They may also lack

[19] C. Gillion and Bonilla, loc. Cit., p.211-212

[20] The cost of transitional measures was estimated at 4.8 percent of GDP in 1992 and is expected to halve by 2010. UNCTAD, "Consideration of the country presentations", p.11.

confidence in the system, despite government guarantees. The minimum pension guaranteed by government (although requiring 20 years of contribution) may act as a disincentive to the orderly payment of contributions. A parallel problem is the value of the minimum pension itself. At 22-25 percent of the average wage, it may place low-wage workers well below the poverty line in retirement. Continuous delinquency puts the value of future pensions in jeopardy, even if the system succeeds in maintaining the present high rates of return. These factors raise the contingent liability of government entailing eventual financial burdens and renewed social problems within the country.

From 1990s, the Chinese Government started to consider how to design a social security scheme according to the society and economic situation in China after almost ten-years of economical reforms. Since Shanghai is the economical and financial center in China and possesses a developed corresponding facilities which is more readily available than in other Chinese cities, it became the first experimental city to establish the social security system.

2.4.1 An outline of the structure of the social security system in Shanghai

China started to experiment with the social security system in Shanghai because the industrial and commercial foundation were quite solid in Shanghai. Compare to other big cities in China, Shanghai has a relatively more advanced economy, a higher individual income level, a more stable market mechanism and higher insurance awareness of its citizens. After 1990, Shanghai became the most attractive market in China and more international giants like General Motors, NEC, etc. invested in Pudong, a new area that is in the eastern part of Shanghai. All these facts show clearly that Shanghai, as the window of China started to play a very important role in the world economy. The first step to strengthen competitive advantages of Chinese businesses is that the Chinese state-owned corporations should begin to release their employees from social protection. To implement the designed social security system scheme, Shanghai municipality tried several schedules based on the experiences of other developing countries and opinion of professional consultants. After all, the final decision is transferring all these social security functions to several independent institutions.

There are several relevant institutions which are in charge of the social security affairs: Social Insurance Bureau, Medical Insurance Bureau, and Housing Fund Administration Center.

- Social Insurance Bureau

This institution is established for pension fund plan control and operation. In Shanghai, the working force in different industries should contribute almost 6% of their monthly salary as one part of the pension fund together with another part of 25.5% of total monthly salary which should be submitted by the employer. Both parts will be organized and operated as the pension fund to cover the basic living expenditure for retired people. The idea of this plan is to leverage the covered pension fund for the whole society, which means that amount of income earned by an individual, is the protection range for different contributors are the same. If a person who earns a higher income is not satisfied with the basic coverage, he/she could purchase some commercial life insurance as supplemental protection. However, this institution is limited to administrate only to employees in urban areas. Meanwhile the pension plan in suburban areas are controlled by another institution called the Department of Civil Affairs.

- Medical Insurance Bureau

This organization was built up in 1995 and most of the staff was separated from the Health Bureau. This is the supporting measure of medical protection system reform. All the medical expenditure of employees in urban areas were taken care of by the enterprises or government in the past. It was a very huge figure and increased rapidly every year along with the increase of people aging. The goal of the medical insurance system reform is to lower the whole national medical cost. The plan is that individuals will pay medical insurance premiums from their monthly salary and this will become the Medical Insurance Fund which is run by the Medical Insurance Bureau. Each individual will payout about 10 percent of hospital expenditures if he/she has an illness that is not serious and other costs will be paid by the Medical Fund. If the individual who takes part in this medical social security plan suffers from a very serious disease and the costs are very high, the medical insurance fund will pay all expenditure for him/her.

- Shanghai Provident Fund Management Center

When the employee pays the basic pension fund to his/her own account in the Social Insurance Bureau and the medical premium to the Medical Insurance Bureau, they should also be paying at the same time to a housing fund in another account of the Shanghai Provident Fund Management Center. This fund also contains two parts: one is paid by individual and the other part is paid by the enterprise. This fund, was started in May of 1991 and now reaches RMB 24,313 billion. The fund can be used to purchase or repair a house or borrow for purchasing a house as a loaner pledge. If the individual reaches retirement age, the housing fund which accumulated for many years can be withdrawen for use as a retirement package.

These institutions have to take the responsibilities of a social security scheme and provides sufficient experiences to benefit other regions in China when the social security system reform starts.

After three years of operation, there following existing problems are apparent:

- Administration of social security funds can not be highly socialized.

Some of the insurance funds were established at society level but it is still operated by enterprise themselves. It is very costly for the human resource department in the enterprise to take the responsibility of fund collection and payment. Another disadvantage is that the social plans are divided into different parts according to enterprises and can not be optimized to investment.

- The responsibilities for each institution are not clarified.

The administrative control is layer after layer. For instance, pension funds in Shanghai are separated into three parts. Employee pension fund in urban areas is in the charge of Social Insurance Bureau in Shanghai, farmers in the suburb areas take part in the pension plan held by Department of Civil Affairs and last, the pension fund of government officials will be managed by the Personnel Department of Shanghai Municipality.

- The social security scheme is not managed as a whole plan and the efficiency of management facilities is low with high costs. Nowadays, every individual in Shanghai has three different accounts to contain the different funds: pension fund, medical fund and housing fund. The investment of these funds does not generate high expected return because the fund administration lacks systematic and economic scale. With the aging problem and high inflation rate, the social security system experiment will become worse.

At present, the Chinese Social Security system is still strongly controlled by government planning. From looking at the experience from other countries, bureaucratic apparatus drives the management of system costly and can not optimize resources with efficient feedback mechanism. To solve this problem, lots of countries tried to implement the commercialization transitions of their social security system. For example, Chile has already began to experiment with this type of transition.

2.4.2 The transition of social security scheme in Shanghai

Drawing on the experience of Chile, the social system should be transferred from government control into commercialized management. Because Shanghai is where China's sole open insurance market is located, it has therefore been a forerunner in the development of the life insurance industry. However, this resource could be used to contribute to the management basis for the social security project. Through our research on the Chilean example, we extracted some experiences:

1) Governments should push the enterprise and individual to take part in the security system and pay the risk premium by law;

2) The security fund is operated by private company;

3) The premium payers have the right to choose the fund operator;

4) Government has the responsibility to control instead of operating funds.

Although we could not transfer these experiences directly to the Chinese social security reform, the Chinese government could absorb some good ideas through this research. As mentioned before, China has the largest population in the world and the aging problem will get worse and worse after the family planning policy is implemented.. The current pension fund will not be sufficient to cover all the old people in the Chinese population in the future. Until now, the Chinese central government treated employees in urban area and farmers in countryside with different methods. Firstly, pension fund administration centers were established in cities to insure employees who worked in state-owned enterprises, joint venture, foreign companies and so on; then government encouraged people in suburban to take part in Suburban Pension Project which was organized by Ministry of Civil Affairs. The pension fund for urban employees is formed by three parts: percentage of monthly salary from employees themselves, same amount from enterprise where the employee worked, and a certain amount from government. Although the pension fund has several sources, it can only cover the basic living standard for each employee when he/she retires.

Shanghai's local government has also shared these experiences and implemented some steps of forming their pension fund. The pension fund of urban employees is operated by the Social Insurance Bureau and the Pension Fund Settlement Center of Shanghai is in charge of fund collection and distribution. The Chinese State Council also announced several provisions about pension funds of urban employees. The main problem influencing the implementation will be: there is no efficient operation merchant of pension value-added that could afford the aging problem in China for the future; functions of pension fund operation and supervision were still mixed together at the present time.

Through the study of the Chilean style, the direction for the Chinese social security reform should be the commercialization of pension fund operation. This means that the government could involve some developed insurance companies, which are operating smoothly, to entrust to them the pension fund operation. This should be based on maturity of the insurance market. It is also the reason that the Chinese insurance market started to open to the foreign investors with regulations of PBOC and the local insurance companies could gain valuable practical experiences from their competitors. With the basic coverage from the social pension plan, some employees with high-income level who demand further protection could purchase additional insurance contracts to assure for his or her own future life. All these requirements come to the same result: the development of the Chinese insurance market.

Since Shanghai insurance market opened to the world, many foreign insurance groups established representative office in Shanghai and also planned to implement their Asia investment plan in Shanghai. Shanghai became the experiment city in China known as a place to get some good ideas about the development of the insurance market. To study the insurance market in Shanghai will provide lots of helpful experiences for the Chinese social security reform.

2.5 Summary

At the beginning we made a systematic description of the economic environment of the Chinese economic reform, social changes and then elaborated on what is the social security system for a nation and what is the current situation concerns about the social security system. Then we explained the experimental pattern of social security scheme in Shanghai.

In chapter 3, we will review Chinese life insurance business and analyze consumer behavior and household savings in Shanghai.