FAMILY INSURANCE OR SOCIAL INSURANCE POLICY OPTIONS FOR CHINA'S SOCIAL SECURITY REFORM

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Abstract

The paper starts with a cost-benefit analysis of two alternative systems to provide support for the elderly: family insurance and social insurance. The conclusion is that when a nation's average income is high enough, the social benefits of a properly designed social insurance program outweigh its social costs. Based on the theory and experience of Western countries' social security systems, the paper provides a number of policy options for the on-going social security reform in China.

Introduction

In general, an economy can either solely rely on individual families to care for their elderly, a system we call family insurance, or establish some kind of social insurance program to provide income support for the elderly. With industrialization, urbanization, better education, and higher per capita income, there was an evolution from family insurance to social insurance in most developed countries. The majority of developing countries, however, still mainly rely on family insurance to support the elderly.

Currently, most of Western countries' social security programs are financed on a pay-as-you-go basis. According to the Samuelson-Aaron theory, current and future generations could maintain positive real rates of return on contribution as long as both the growth of real earnings and the growth of the population remain positive. In contrast, what have happened in Western countries is the pay-as you-go system couldn't fulfil the commitment between generations. The declining fertility rate, rising aging population and the incentive problems embodied in the social insurance system made most of social insurance systems in trouble to finance them.

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China is experiencing rapid population aging. The one-child policy and significant improvement in the living standard accelerate the aging process and make China's aging problem more serious than any other countries in the world. According to a World Bank report, China's aging population will reach the peak by 2030 (The World Bank, 1994). There will be 0.3 billion people over 60, which will account for 22 percent of the total population. Old age dependency ratio is expected to rise from currently six workers for every retired person to only two workers for a retired by 2030. China faces the greatest challenge to support the huge aging population. In reforming its social security system, China should avoid the mistakes the Western countries have made.

The purpose of this paper is to analyze the old age family insurance and social insurance from an economic and social development perspective. It provides a general analysis of the trade-off between these two systems. Based on the theory and experiences of other countries' old age insurance systems, it argues that when a nation's average income level is high enough, the social benefits of a properly designed social insurance program outweigh its social costs. So it is inevitable that a social insurance will replace the family insurance as an economy and society developed. After analyzing the current situation in China, the paper provides a number of policy options for the on-going social security reform in China.

The rest of the paper is organized as follows. Section 2 briefly reviews the history and evolution of family and social insurance for the elderly in the West. Section 3 is a comparative analysis of family insurance and social insurance. Section 4 discusses the history and current situation of China's old age insurance system. Section 5 provides policy options for China's old age insurance reform. The last section concludes the paper.

The History and Evolution of Social Insurance for the Elderly

A nation's insurance system for the elderly is determined by the nation's economic and social development. The human society started with family insurance. Taking care of the elderly has been one of the key functions of families. However, the industrialization that started in the European countries during the later 18th century fundamentally changed the landscape of the human society. Urbanization, more migration, better education, lower fertility rate, and the breakdown of traditional social norms diminished the function of extended families in supporting the aged. The poor and the unemployed among the aged became predominant social problems during that time. Politicians and social engineers began to seek alternative options to support the elderly. In 1889 Germany became the first nation in the world to enact a national compulsory old-age pension system, which was one of several social insurance programs introduced in Germany during the 1880s. In 1908 British enacted “The Old Age Pension Act.” The United State passed “The Social Security Act” in 1935. After World War II, rapid economic growth fostered further development of the social security programs. So far, most of industrial countries have established a comprehensive social insurance system for the aged. In these countries, the function of providing income security for the elderly has mostly transferred from families to the society.

In contrast to this development in industrial countries, most of developing countries still rely on family insurance for the elderly. Table 1 illustrates this point by showing the composition of different sources of income of the elderly from selected high and low income countries.

Table 1
Sources of Income in Old Age, Selected Countries, 1980

Percentage of persons over 65 receiving income

High income countries	Work	Family	Pension/ welfare	Saving
Australia	9	---	93	---
Canada	19	---	97	---
Germany	2	---	98	---
Sweden	0	---	100	---
U. K.	13	---	100	---
U.S.A.	20	---	94	---

Percentage of persons over 60 receiving income

Low income countries	Work	Family	Pension/ welfare	Saving
China	45	34	13	---
Urban	15	17	64	---
Rural	51	38	5	---
Indonesia	46	63	10	4
Kenya	---	88	---	---
Malaysia	34	83	14	11
Nigeria	---	95	---	---
Philippines	63	45	13	2

--- Not available
Source: The World Bank, 1994: Table 2.3, page 63.

A Comparative Analysis of the Systems of Family Insurance and Social Insurance

We compare the two alternative systems in three aspects. First, the two systems have different impact on a society's fertility rate, savings rate, and economic growth rate. Second, the two systems interact differently with different financing schemes. Third, the two systems have different impact on living arrangement, life style, inter-generation relationship and old age life quality.

In the first aspect, the major social cost of family insurance stems from the fact that it has limited resources and lacks risk pooling. The living standard and quality of life of old-aged parents directly depend on the number of children they have and the income of the children, which depends in turn on the parents human capital investment on the children. In order to hedge the risk of losing supports by children in later stages of life, parents have the incentive to have more children, which gives rise to the rapid population growth and slower accumulation of financial assets, slowing down the growth of per capita GNP. On the other hand, there is an opposite effect. That is, in order to increase their children's future income, parents have the incentive to increase human capital investment on the children, which is beneficial for the economic growth. However, most researches find that overall, the negative effect on the economic growth outweighs the positive effect of the human capital. (e.g., Zhang and Zhang, 1995).

The social benefits of old age social insurance are risk pooling and efficiency of alleviating poverty due to economies of scale. With a social insurance program, the living standard of an elderly is no longer dependent on the number of children he/she has and the children's income. Instead, his/her income depends greatly upon the aggregate income of the economy. Social insurance reduces parents' incentives to raise a large family. Meanwhile, a social insurance system implies a weak, if any, relationship between an individual's work efforts when he/she is young and his/her old age income, resulting a lower savings rate, less education investments in children, less working incentives, and earlier retirement. Hence, a social insurance program could hamper the economic growth. Another drawback of social insurance stems from politicians' short-term behavior in a democratic political system. To gain the popularity and political support, in the West, social insurance program has been over-expanded and has become too generous to finance it (Feldstein, 1998).

Regarding the second aspect of our comparison, most country's social security programs are operated as pay-as-you-go (PAYG) schemes, in which current contribution revenues pay for current pension commitment. According to the Samuelson-Aaron "social contract " model, current and future generations could maintain positive real rates of return on contribution as long as both the growth of real earnings and the growth of the population remain positive. In contrast, what have happened in western countries is that the pay-as you-go system could not fulfil the "social contract" between generations. The decline of population growth and escalating costs to support a rapidly aging population have caused serious trouble for most social insurance systems. According to estimates of the Economist magazine (September 9, 1995), under current policies, the present value of the net public pension liabilities in the U.S. amounts to 44 percent of GDP in 1994. Therefore, the Clinton administration recently announces that the priority of tapping the federal government budget surplus is to save the Social Security Program.

In light of the first two aspects of the comparison, an effective old age insurance system has to strike a balance between risk pooling, individual incentive, and promoting economic growth. The individual retirement saving accounts approach seems to be an effective approach to achieve these goals. Chile provides a successful experience in this regard. In the Chilean model, the old age insurance mainly consists of mandatory individual retirement saving accounts, while the public pension only provides a minimum income secure for the needed.

Finally, we can compare the different impact of the two alternative systems on a society's living arrangement, people's life style, intergeneration relationship within a family, and the quality of life of the elderly. In traditional culture such as the Chinese culture, the desired life of an elderly is to live with a multigenerational extended family and enjoy his/her children's filial loyalty. Naturally, many Chinese regard the Westerners do not have filial loyalty, since they neither live with their parents and nor support of them. Those Chinese also believe that life of the elderly in the West must be miserable and blame the weakening of the function of the family in China as a result of unpleasant outcome of Westernization.

In fact, this is a vastly mis-informed perception. As aforementioned, the developed West has undergone a long evolutionary process from family insurance to social insurance, as a result of immense economic, political, and social development. Before the 20th century, the law and social norm in the United States asserted that adult children had to support their elderly parents. At that time, the elderly Americans also lived within their extended families (Smith, 1979). Table 2 lists the living arrangements of elderly American in 1900. Over years, the U.S. has developed a comprehensive old age social insurance system, consisting of federal social security program; firms' pension plans, individual's retirement savings account, with commercially oriented insurance programs providing supplemental income for old age.

Table 2
Living Arrangements of Older Americans, 1900

Age	65-69	70-74	over 75
Live with unmarried children	42 percent	30 percent	31 percent
Live with married children	21 percent	26 percent	35 percent
Live with grandchildren	27 percent	29 percent	38 percent
Live alone	4.3 percent	6.8 percent	6.5 percent

Source: Smith, 1979: Table V.

As the elderly become economic independent, they prefer to live separately from their children. The living arrangement changed rapidly. By 1960, there were only 40 percent of the elderly living with the children. The percentage decreased to 20 percent by 1984 (Smith, 1979). The similar trends also happened in other Western countries.

Although most American adult children do not live with their parents, there are a lot of communications and visits between them. Around 80 percent of parents live near one of their children within one hour driving distance. (Hu, 1995). This kind of separate living with close family relationship is the so-called modified extended family. In this arrangement, both the elderly and the young people have their own life, achieving mutual financial independence and avoiding unpleasant ideological conflicts among different generations. Old people could keep their dignity and win the respect from the young people. The young people have the freedom to choose their own life style and keep the close family ties with their parents. As the parents become sick and disabled, the adult children would take care of their parents. The highly developed markets for caring the elderly, such as those of nursing homes, also provide another choice for the elderly.

In contrast, the old age insurance system in Taiwan provides another example for evaluating different systems. Although Taiwan's economy has grown rapidly over the past several decades, the government has not established the old age social insurance yet. The elderly still rely on traditional extended family insurance. A government study illustrates that of all elderly over 65 in Taiwan, 52.3 percent depend on their children; 17.3 percent live on their own savings; only 14.8 live on pensions; and 6.6 percent live on salary. (Taiwan Government Report, 1995).

However, the rapid economic and social development in Taiwan has put increasing tension on the proper function of the traditional extended family. Surveys show that the suicide rate among the old-aged women in Taiwan is the highest in comparing with those other population group. In fact, it is more than five times higher than that of young women (age 20-24). Interestingly, this is in sharp contrast with the situation of 70 years ago, when young women were often abused by their mother-in-laws in traditional Chinese families, so at that time the suicide rate among young women was the highest in the society and was four times higher than the old women (Hu, 1995). Nowadays, daughter-in-laws and mother-in-laws switched position since their social status and relationship are completely different. Education, job opportunity, and freedom of marriage give young women in most case the same social status as men. They are no longer willing to perform the duty of a daughter-in-law of the old days. Thus, many old women are not getting the respect as they expected and are totally disillusioned.

If we use suicide rate to measure the status of psychological health, old American women are much healthier than their Taiwanese counterpart. First, the suicide rate of old American women is no higher than those of other demographic groups; second, it is only one seventh of that of Taiwan old women (Hu, 1995). Despite living alone, the life quality of the elderly women in American seems to be much better than the elderly Taiwanese women.

From the comparison of the living arrangements and old age support systems in the US and Taiwan, it is rather clear that the weakening of the family insurance system is a natural result of economic and social progress. With much economic and social development, the social benefits of a properly designed social insurance program outweigh its social costs. Eventually an old age social insurance system is needed in order to supplement the weakening family insurance system and to provide income security to the elderly.

The History of and Current Status of China's Old Age Insurance System

For thousands of years, like many other old societies, the multigenerational extended family is the core of China's traditional old age insurance system. Respecting the elderly and filial loyalty are the culture cornerstones to strengthen the system. In traditional agricultural society, raising children is a kind of investment and saving. Parents can reinforce filial loyalty through the control of property, experience-based knowledge, production and consumption decisions, marriage age and marriage partner, as well as every other aspect of the life of their children. Filial loyalty becomes a social norm and makes the intergenerational transfer reaching the equilibrium.

Since the founding of the People Republic of China, the government adopted a mixed old age insurance system. On the one hand, the traditional extended family insurance is supported by the legislation. The 1954 Constitution asserts that “parents have the duty to rear and educate their minor children; and the adult children have the duty to support and assist their parents.” The government also protects the family insurance by a tight control of out-migration from rural areas. On the other hand, portrayed as a superior advantage of the socialism system, a comprehensive old age social insurance was established in urban areas. Employees of government agencies, state-owned and collective enterprises are covered by pension and health care after they retire. Pension benefits range between 75 to 100 percent of the last basic salary before retirement. The government takes the sole financial responsibility of financing the old age social insurance expense (Li and Xu, 1997).

In rural areas, since the 1950’s, productive activities of individual households were centralized to collective farms and the people’s communes, in which the so-called production team is the basic production unit. The elderly are taken care mostly by traditional extended family and the production team.

China’s economic reform, which started in the late 1970’s, has dramatically changed the economic and social landscape. In urban areas, state-owned enterprises become independent production and accounting units and take over the responsibility to pay pensions for the retirees. The heavy pension liability burden resulting from the “pay-as-you-go” system puts those old state-owned enterprises with a high retiree-to-active-worker ratio in a financially difficult situation.

In order to build a new old age insurance system to adapt to the market economy, China has initiated various reform plans for old age insurance on an experimental basis since 1984. On June 26, 1991, the government published “Decisions Regarding Old Age Insurance System for Urban Employees.” The Decision stated that China’s new old age insurance system would be consisting of three components --- a basic old age insurance, the employer-based supplementary old age insurance, and the individual old age savings accounts. The basic old age insurance is based on the social pooled funds. The size of the pool would gradually increase from the current city-wide or county-wide to province-wide pool (Li and Xu, 1997).

Since the publication of this regulation, the number of firms and employees covered by the pooling schemes increased very rapidly. By 1997, most of state-owned and collective enterprises employees had joined various pooling schemes for basic old age insurance (Ye, 1997). However, the majority of non-state-owned enterprises have not joined the social pooling schemes.

In rural areas, after the reform, the so-called agricultural production household responsibility system replaced the collective system, which is essentially a system of private household farming. As a by-product, the collective health and old age insurance system in the rural area collapsed. Care for the elderly fell back to the traditional extended families. However, the function of family insurance is being weakened by the rapid economic growth in the countryside. Low fertility rates, rapid pace of aging and the decline family size have reduced the pool of available family resources to support the old aged. According to the Chinese Population Census of 1990, 8.2 percent of China's rural population was over the age of 60. The growth rate of this demographic group is increasing by 3 percent each year. Meanwhile, the average size of peasant's household decreased from 5.74 in 1978 to 3.96 in 1990 (Zheng, 1998).

Policy Options for the Old Age Insurance Reform in China

From the analysis in previous sections, the evolution of an old age insurance system is closely associated with a nation's economic and social development. China is a developing country, its per capita income is far below those of Western countries. Moreover, in China there is a huge income disparity between urban and rural areas. According to China Statistical Yearbook 1998, per capita annual disposable income in urban area is 5160 yuan (about 630 US dollar). In rural area, per capita annual net income is only around 2096 yuan (256 US dollar). Therefore, China's old age insurance system is and should be different from that of Western countries.

Given that there is a large income disparity between the urban and rural regions in China, the existing old age insurance systems in urban and rural areas are very different. Inherited from the pre-reform era, Chinese retirees in urban areas have had pension and health insurance since 1950s. Table 1 shows that in urban areas around 80 percent of people over age 60 get income from pension and work, only 17 percent from family.

With income security, the urban elderly no long depend on extended families and have freedom to choose their living arrangement. According to a survey by the Chinese Academy of Social Science (CASS) on families in seven big cities, including Beijing, Shanghai, Guangzhou, Nanjing, Chengdu, Nanzhou, and Harbin, the nuclear and empty nest families are popular family structures in Chinese cities. Of all the surveyed empty nest families, more than 93.73 percent families have married children, but they choose to live separately (Sheng Chonglin, 1995). The relationship between the old and young people is similar to that in modified extended families in the US. Although the old and young don't live together, they keep very close relationship and often get together during weekends and holidays. As an important result, in Chinese urban areas, the existing old age insurance system and its resulting life style make the trend of social insurance irreversible.

In contrast to urban areas, currently, China's rural elderly mainly depend on family support. From Table 1, one can see that around 90 percent of people over 60 receive income from family and working. More than 80 percent of elderly live with their children (The World Bank, 1994). Social insurance only provides emergency relief for the so-called *five-guarantee* families (i.e., the elderly without children), which constitute only about 5 percent of rural elderly.

Demographically, the population aging is a more serious problem in rural areas than in urban areas, since the vast majority of the population in China live in rural areas. The rural population accounts for 80 percent of total population, in which the rural aging population accounts for 75 percent of total aging population in China (The World Bank, 1994). Table 3 shows the future trends of China's aging population. It shows that the pace of aging is faster in rural areas than in cities. The huge population base, one-child policy and massive young people migration to urban area speed up the aging process.

Table 3
The Projection of China's Aging Population (percentage of aged over 65)

Year	1990	2000	2010	2020	2030	2040
China	5.6	6.3	7.8	10.9	14.5	19.5
Urban	5.1	6.2	7.2	10.1	13.7	18.6
Rural	5.8	7.1	8.2	11.6	15.5	21.0

Source: Zheng, H. S. 1996, Table 3-8.

In Western countries, population aging result from industrialization, economic development, and high living standard. So before the population aging, those countries have already developed a relative comprehensive old age social insurance system. They get rich first, then get old. Aging is a natural process. Even so, Western countries still face many problems to support aging population and many of their social insurance systems need to be reformed.

Despite rapid population aging in China's rural areas, as a prudent policy, it is not advisable to establish a nation-wide old age social insurance system covering both urban and rural areas. The main reason is that in China's rural area, labor productivity is still very low. Per capital income is much lower than those of Western countries when they began to implement a social insurance system. In many rural areas, the over-riding task is still the elimination of poverty. Peasants have neither the desire nor financial capacity to join a social insurance program (Li, 1994). Moreover, with rampant corruption and bureaucracy, it is very doubtful that local governments in rural areas are capable of managing a comprehensive social insurance system. In other words, should a social insurance system be set up in rural areas in the near future, the amount of administrative inefficiency and waste are likely to be enormous and to go out of control.

The upshot of the discussion is that it is both infeasible and undesirable for the Chinese government to implement a universal social insurance system covering both urban and rural areas in China. Instead, the current situation of having two parallel systems for urban and rural areas should continue in the near future. These being said, the current old age insurance systems in urban and rural areas still leave much room to improve. In the following, we deal with them in detail.

Old Age Insurance in Urban Area

In urban areas, from the above discussion, the existence of a social insurance program and its resulting expectation and life-style dictate China has no choice but continuing an old age social insurance system. Then, what kind of social insurance system China should choose? Regarding the pay-as-you-go system, Aaron (1966), Samuelson (1975) , and Feldstein (1974) raised the question whether this system could sustain in an aging population. Their studies suggest that a declining population growth rate make pay-as-you-go system less attractive. The lessons from Western countries also show that a national social security program with pay-as-you-go system cannot sustain the growing costs as fertility rate decline and population aging. As a result, in many Western countries governments have to raise tax rates in order to keep their pay-as-you-go programs solvent , causing lower savings rates, less working incentive, and lower economic growth rate. In addition to these problems, China has much lower per capita income and larger aging population than Western countries. Certainly, China should not adopt this system.

A fully funded social security system is widely regarded as being more efficient than that of pay-as-you-go. Martin Feldstein (1998) argues that the marginal product of capital is greater than the growth rate of aggregate wage. According to his theory, the cost of a funded pension system is much lower than the costs with a pay-as-you-go system. In other words, the saving deposits in a funded system are less than the tax required in a pay-as-you-go system in order to provide the same level of benefits. Chilean's experience have proved that the fully funded accumulated saving system is more efficient than the pay-as-you-go alternative and is a better option for an aging society.

Despite the potentially higher efficiency of a fully-funded system over that of a pay-as-you-go system, there are insurmountable difficulties preventing China from adopting a Chilean type system in the near future. First, the transition from China's old pay-as-you-go system to a fully funded system will exacerbate the dependency burden for the current working generation, who have to bear the cost of supporting the current retirees and the cost of creating a fund for their own future pension. Given China's per capita annual income of urban household around $630, it is virtually impossible to ask the current workers to bear the double burden.

Second, the success of Chilean's new system depends on the existence of a reasonably large and efficient financial market. In China, the overwhelming majority of investments are channeled through the five state-owned banks. The two stock markets are still very small in capitalization and corporate or municipal bond markets are even more limited. Therefore, running a Chilean type pension program in China is equivalent to maintaining household saving accounts in state banks, which are under reforms themselves and cannot play the role of increase the value of the saving accounts as Feldstein has argued.

Finally, the success of a Chilean type system depends greatly upon that the private pension fund investments are tightly regulated in order to minimize the risk for the pensioners. However, in China the set of regulations on financial institutions and financial markets are merely emerging at best and are taking time to shape up. Meanwhile, a hasty implementation of the Chilean system would expose individuals to unnecessarily great risk.

So far, China has chosen a rather prudent and appropriate approach to reforming its social security system. The intended new system relies on integrating individual savings accounts with pension pooling funds which are managed by municipalities and are intended to provide basic retirement benefits. There are a few advantages of this system. First, it departs from the pay-as-you-go system to a partially funded system based on individual account and therefore has a lower burden for current workers. Government study shows that this system will reduce total pension cost under 28 percent of GDP by 2033, while the pay-as-you-go system could push the pension cost up to 39.27 percent of GDP. A fully funded system could increase the cost to 37 percent of GDP (China Economic Reform Committee, 1995). Second, it combines the benefit of risk pooling with that of individual incentives, avoiding many problems embodied in the pay-as-you-go system. Third, the system has more flexibility to evolve in order to fit future development. For example, as China's economy grows and per capita income rises, the share of the individual savings account will increase, and the share in the social pooling fund will shrink. Then gradually, China could move to a fully funded pension system like the Chilean model, in which social pooling will only provide the minimum old age insurance for the needed.

Although the on-going old age insurance reform in urban area is on the right direction, there are a lot to be improved regarding the government old age policies, legislation and pension fund management. Specifically, government should pay attention to the following issues.

First, the government should extend the pooling fund program to all workers in urban areas. The current scheme only covers workers in the state and collective enterprises. The majority of workers in private sector, such as from town-village, Sino-foreign joint venture enterprises as well as contract-based short-term employees and the self-employed are not involved and covered in the pooling scheme. As the private sectors play a more and more important role in the economy, which already account two thirds of China's GNP, it is necessary to include all the workers into the pooling scheme and to increase the scope of risk sharing. In doing so, the Chinese government should develop a unified social insurance for all the workers in urban area, in which the employees in state and non-state enterprises should be treated equally in term of the basic pension contribution rate and pension benefit.

Second, old age social insurance legislations should be enacted. As of today, there is no social insurance law in China. The implementation of the on-going pooling scheme and individual saving accounts is administrated by the government. Often times, local governments have hard time collecting pension contributions, especially for many non-state enterprises, since they are relatively independent and are not controlled by the government. So Chinese government should enact an old age social insurance law, in which the participation of old age social insurance is compulsory, also the benefits for old age as an “earned right” will be protected by the law.

Third, the management of pension funds need be improved. The basic pension pooling funds and individual saving accounts are administrated by the social security commissions of local governments, who are responsible for collecting pension contributions, paying for pension benefits and managing the pension funds. The pension funds can only be deposited in banks or be used to buy governmental bonds.

The advantage of depositing the pension-pooling funds into banks or buying bonds is low risk. But the disadvantage is its low return rate, which, due to the high inflation in recent years, is often negative in real terms. In these situations, Feldstein’s theory that a funded pension system is more efficient than the system with pay-as you-go is invalid, since the marginal product of capital is smaller than the growth rate of aggregate wage. To make the old age social insurance program viable in the long run, it is important to preserve and increase the value of the funds. A portion of the pension funds could be invested in purchasing stocks and certain development projects such as highway, bridge, real estate, electricity and energy related projects. Once these projects are completed, the funds would have a stable income source. Based on the U.S. financial market experience, these investments could generate much higher return rates than depositing money in the bank. Although there are risks in these investments, the enormous size of the funds would make the risk to a manageable level. Also since these are long term investment, the impact of governmental investment on the fluctuation of the stock market is minimized. The Singaporean government has been very successful in managing pension investments in this fashion.

Of course, the downside of investing pension funds in development projects and the stock market is rather prominent. That is, the decisions on which projects to investment can be subject to political rather than financial considerations. Moreover, once an investment is made in a project or a stock, the pension fund becomes a large stakeholder of a business entity. Thus, the pension fund managers, influenced by the government, may exercise their control rights on the business entity based on political rather than financial considerations, potentially reducing the efficiency of the business. In order to minimize the downside of the investment strategy, the management of the pension fund should be appointed on a long term basis and should be given enough autonomy and incentive to fend off government interference.

The government should also consider introducing mechanisms of market competition to ensure efficient management of the pension funds. If a single governmental agency controls the funds, it is difficult to avoid bureaucracy and inefficiency. Many cases of abuses of the pension funds by the local government officials have been reported (Hua Sheng Monthly, 1997). The possible solution is to let the management of the funds be delegated to independent trustees, who are regulated by the government. Those trustees should have the economy of scale (adequate size), and also should face sufficient competition among them. The competition will force trustees to reduce management costs, provide good quality services and high funds return rate to attract customers.

In summary, in urban areas, the Chinese government should consider enacting a social insurance law, expanding the pooling scheme to all urban workers, and improving the pension funds management towards scientific, systematic and institutionalized system.

Old Age Insurance in Rural Areas

How to solve old age insurance for the vast rural elderly is the biggest challenge for China. As argued above, due to the limited social and economic development in China's rural areas, family insurance continues to be an effective way to insure the old age. More specifically, the following factors are also arguing for the case of continuing the current family insurance system in the rural areas. First, caring for parents is not only deeply rooted in the Confucius-centered Chinese culture but also written by the Chinese law. Chinese Constitution asserts that the adult children have the duty to support and assist their parents. Those abuse and abandon their parents will be punished by the law and could be sentenced up to five years in jail (Chinese Constitution, 1996). Second, due to the tradition fashion of agricultural production, which is still widely practiced in rural China, the extended family could pool the limited resources together and use it efficiently. Also the family insurance could avoid transaction and administration costs incurred in social insurance system. Third, the majority of old people in rural areas actively contribute to the family by using their knowledge to help production, taking care of grandchildren, and doing housework, etc. In this way, the costs of old age care is minimized. Fourth, currently, among today's Chinese peasants, the traditional perception that "raising kids in order to have a well-supported retirement" is still very popular. Emotionally and psychologically, the elderly would get more satisfaction living with and being supported by the extended family.

However, the rapid economic and social development is changing the traditional way of agricultural production, consumption, and living arrangement, especially for the young people in rural areas. The young people have more opportunities to migrate to urban areas, to have more education, and to seek a modern life style and freedom. They tend to ignore the traditional value of filial loyalty and social norm and neglect their obligations to support their elderly parents and grand parents. All these changes put the elderly in a vulnerable position. According to a survey in a village in Hubei province, 141 out of 352 elderly were abused or abandoned by their families (Zheng, 1998). Data from the Superior Court of Shandong Province shows that during the recent 10 years, the lawsuits related to the elderly being abused and abandoned have increased more than 10 times (Ma and Pu, 1996). For the problems exist in the family insurance, government should use the media and the law to protect old people's legal rights.

Therefore, the current family insurance is only an expedient measure to provide old age support. In the long run, the family insurance function will further deteriorate as more young people migrate to urban and aging population increase. So on one hand, government should continue to strength the family insurance for the elderly; on the other hand, government should start to establish a social insurance system to insure the future elderly in rural China.

There are a few specific policy implication from the above analysis. First, based on the existing *five-guarantee* social insurance program (i.e., the social insurance program in rural areas for the elderly who do not have children), government needs to increase the funds and expands the coverage of the program. Since the first generation of couples who first followed the one-child-per-family policy will need old age support by the beginning of the next century, when the typically family structure will be two young persons (a couple) having four old parents (two couples), half of the single-child parents will become *five-guarantee* families. Apparently, the *five-guarantee* insurance program needs to be expanded.

Second, the Chinese government may want to consider tax-deduction policies to encourage the current young rural people to join an old age pooling fund and to set up their own individual old age saving accounts. Generally, peasants' income is low and unstable. Thus, contributions to a pooling fund are often regarded as pure taxation. According to this analysis, social insurance in rural area should mainly depend on individual saving accounts, let social pooling be a supplement and only provide minimum income for the elderly. In this way, as the rural economy develops, the old age insurance system will gradually move from the current family insurance to a system where individual savings accounts are the main source of old age insurance and pooling funds are supplement old age insurance.

Conclusion

The paper reviews the evolution of modern societies from family insurance to social insurance as two alternative systems of providing support for a society's elderly and provides a cost-benefits analysis of various aspects of these two systems by drawing on the experience of the developed West, Taiwan, and China. In the second half of the paper, we analyze the history and current status of China's old age insurance system and provide a number of policy options for the on-going social security reform in China.

Economic history of the developed West has shown that with social and economic development, industrialization, urbanization, decline in fertility rate, rural-urban migration, and better education, the traditional family insurance system is invariably weakened. Eventually, a kind of social insurance system becomes the main component of old age insurance.

China is reforming its old age insurance system. Due to the significant difference in social and economic development between the urban and urban areas, we argue that China needs to establish separate old age insurance systems for these areas. In the urban area, a social insurance system should be adopted. To avoid repeating the mistakes of the social insurance programs in the West, China's new urban old age insurance system needs to integrate a basic pension program based on pooling funds with individual savings accounts. This way, a balance is maintained between pooling risk and providing individual incentive. Also, since such an old age insurance system is partially funded by individual accounts, it has higher returns and lower costs than the pay-as-you-go system (Feldstein, 1998). In the rural area, due to low per capita income and limited resources, family insurance continues to be an efficient way to support the current generation of the elderly. The government should further strengthen the function of the family in supporting the old aged. However, at the same time, government should start to establish a social insurance system to support the future generations of old people. Based on the situation in the rural area, a system of self-insurance based on individual savings combined with pooling funds will be an effective way to replace the current family insurance system.

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