

**From the Iron Rice Bowl  
to Online Insurance:  
Implications of China's WTO Accession on  
Reform of State-Owned Enterprises and the  
Social Welfare System**

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## **I. Abstract**

As China's accession to the World Trade Organisation (WTO) is due any time this year the pressure is high on the Chinese economy to implement further reforms to make it strong enough to compete in the global arena. Ever since the post-Mao era has begun China has undergone a huge transformation from a strict Communist central-planning economy to a capitalist market economy led by a growing number of private enterprises. The old state-owned enterprises (SOEs) have lost their status of being the basis of the economy and have changed into being reminders of a stagnant past.

In the near future there will be no more protectionism of unprofitable companies. This will lead to some SOEs being dismantled for making too many losses. To a large extent the unprofitability of SOEs is due to large social welfare obligations. Reforms are taking place in this area but problems still persist.

The social welfare system used to be one of the prides of the Chinese government but in recent years it has been placed on a back seat while enterprises are let free to develop without being hindered by similar obligations as SOEs have been. However, as a result of growing numbers of uninsured and the looming threat of discontent among laid-off workers the government is now again increasing its efforts to create a better social welfare net.

With WTO membership just around the corner, problems could once again increase as globalisation and increased competition is taking its toll on China's industries.

## **II. Statement of Aims and Objectives**

I will attempt to highlight some of the issues, which have arisen recently and will occur for social security in China. As a result of the reforms during the past 20 years and in particular those happening now due to the imminent implementation of WTO compliant legislation there are big challenges facing the country's leaders.

The implementation of a social welfare system played an important role in the government's attempt to industrialise the country in the 1950s after some 30 years of war. Now 50 years later the situation has changed greatly and China is emerging onto the world scene as a major economic player. The problems the Chinese leadership are now facing are very different to those half a century ago. China is now in the transition from a communist planned economy to a capitalist market economy. Making profits and private gain are no longer the evil habits of the old bourgeois society, but part of the new modern spirit of a strong China.

Firstly, I will have a brief look at the reforms the Chinese economy has undergone in the past 20 years. During this time there has been a huge growth in privately owned enterprises coupled with a decline in state-owned enterprises (SOEs). The unprofitability of the latter has become even more evident as a result of this.

As one of the latest developments China's now imminent accession to the WTO is leading to even quicker reforms. In order to prepare for increased competition from abroad changes are taking place which could not have been expected only 10 years ago. In addition China will have adapt its legislation to work with WTO rules.

This leads me on to the next item I will look at, which is social welfare in China. I use the term social welfare in this context to describe the health security, pension and unemployment benefit systems. Social security in China has basically only been available to employees of SOEs and their dependents. The disbanding of the old agricultural collectives has led to the majority of China's rural population to live without any form of social insurance. Employees of private and joint-venture companies are also often not covered by any social security.

These problems are closely related in that the economic problems of SOEs are partly due to the fact they have heavy obligations to provide social welfare. However, should SOEs no longer provide such welfare there currently still is no proper replacement to help those workers with health or other problems. But reforms of the current system are very necessary. Looking at the future of social welfare in China I will try and discover some of the possible solutions currently being proposed. Whether there should be a national system for employees of all sectors or one, which is more, specialised be it regional, sectoral or otherwise is part of the question.

### **III. Literature Review**

#### **A. Reforming the Chinese economy**

Since the People's Republic of China's Great Helmsman Mao Zedong's death in 1976 China has undergone a great economic revolution. Under Deng Xiaoping's leadership the old communist economic planning methods were discarded in favour of a much more "capitalist" system. Much of the economy was freed up to make room for private entrepreneurs.

A big amount of the amazing growth rates in the 1980s and 1990s in the PRC may be due to what Olson describes as the "destruction of collusions for collective action [to undermine and resist market-oriented reforms]" (Olson 2000, p 166). Though the state still controls some of the major sectors private businesses have dramatically increased their share. By 1990 the SOEs share of China's industrial output (gross value) had fallen to 54.5 percent from 78.3 percent in 1981 (State Statistical Bureau quoted in: Nolan 1995, p 404). At the same time China's per capita real gross domestic product (GDP) grew by an average of 8 percent during 1978-96 according to official figures (World Bank 2000b), even though according to estimates by World Bank staff this is overstated by as much as 1 or 2 percentage points. However, this would still leave China in among the top 3 countries for GDP growth (World Bank 1997a, p 3). Another indicator for the private sector's rapid growth comes from statistics showing the change in employee figures in relationship to ownership status. According to the China Statistical Yearbook 1996 the numbers of

employees in non-SOE and non-collective companies grew by an average of 34.7 percent per annum from 0.4 million in 1985 to 8.9 million in 1995. At the same time the level of workers in SOEs only increased by an annual average of 2.45 percent, while employee numbers in urban collectives even declined by 1.7 percent in that period (World Bank 1997a, p 151).

The late Deng Xiaoping's idea was to develop China by "crossing the river by feeling the rocks" (The Economist 2000, et al.), ie. to introduce market economy principles on a step by step basis. In the 1980s this was still seen as a negative example by some for the reforming Eastern European countries. As Prybyla is quoted this would be like "to end up the creek to nowhere" (Nolan 1995, p403). Judging by the developments during the last decade of the century it seems to have proven more successful than the Russian "big bang" model.

During the past decade GDP growth has been slowing to around 7 percent, which according to the director of the World Bank China Program Huang should not raise concern as "the 7 percent growth rate in the future will be quite different from ... the past. It will be sustainable, it will generate more jobs, it will be more efficient, and it will be more profitable". In his speech he also appreciates the fact that growth rates are no longer targets the government wants to achieve but rather outcomes (Huang 2000).

#### B. Economic reforms ahead of and in preparation for WTO entry

Now that China's accession to the WTO is imminent more changes are necessary to abide by the rules of the global trading system. After some 13 years of negotiations a crucial step forward was made in November 1999 when the United States and China signed a bilateral agreement on WTO entry (Li 2000). Since then China has reached agreement with nearly all the other members and only some last minute details still need to be worked out.

On the one hand there will be legal and institutional changes by the government in accordance to WTO rules. In addition, enterprises will have to adapt to new competition in markets which up until recently were heavily protected.

In the face of reforms and increasing competition the number of bankruptcies has grown sharply. In the period 1991 to 1995 this jumped almost twenty-fold from 117 to 2200 (Cao quoted in: Chen 1998). And even among the remaining SOEs about half are admitting to incur losses, rising from about 10 percent in 1985 (The Economist 2000). According to World Bank figures SOEs owe some 1.3 trillion Renminbi (RMB) worth of unrepayable debt. Most of this is owed to the main state-owned banks. In a move to solve this problem of non-performing loans the State Economic and Trade Commission (SETC) has set up Asset Management Corporations (AMCs) which primarily work on appraising the assets of loss-making SOEs. The non-performing loans have been taken over by these AMCs who in the end will also have the power to basically take over and restructure or file for bankruptcy against SOEs (World Bank 2000a).

The financial sector is a good example for the reforms being made in preparation of entry to the WTO. The People's Bank of China, the central bank, is planning to gradually liberalize interest rates (World Bank 2000a, p5). Though it will still be some time until it has been completely freed from the government's influence, foreign competition is already slowly making its mark in the banking sector (World Bank 2000b).

While SOEs' bad debts with banks have been offloaded to AMCs, the SOEs have been able to show an impressive 190 percent increase in profits to 113.2 billion RMB during the first seven months of the year. To a large extent this was due to price increases and interest payment reductions (World Bank 2000a, p9). The major driving force behind recent growth in China is the private sector though. In the summer of 1999 the leadership for the first officially acknowledged its important role with a constitutional amendment (World Bank 2000b). However, this has not meant that difficulties for the private sector have been completely erased. Smaller enterprises have been charged with some 110 billion RMB in arbitrary and redundant charges (World Bank 2000a, p9).

While the restructuring of SOEs takes place China will also need to keep foreign direct investment (FDI) flows at sustained levels in order to achieve some of its development objectives. To do this China will need a stable macroeconomic environment and improved regulations (World Bank 1997b, p 19). Some 40 percent of FDI flows to developing countries currently go to

China (World Bank 1997b, p 21). In comparison to Russia, the other great transition economy, China has been able to attract enormous amounts of FDI with only limited opening while the former has opened up its markets but only little FDI (Lairson 1997, p 408).

As part of the GATT/WTO accession negotiations and also in order to improve the situation for the domestic export businesses the Chinese government has been cutting tariffs on imports, reducing the non-tariff barriers to foreign trade and restrictions on exports (World Bank 1997b, p 2). The overall industrial tariffs for instance are expected to fall from 24.6 percent in 1997 to an average of 9.4 percent after a five-year phase-in period (Economist Intelligence Unit 2000).

### C. Reforming the Chinese welfare system

The reforms in the Chinese economy have led to great changes in the way social welfare functions in China. Prior to the reforms there were three forms of health insurance coverage. The labour insurance scheme covered employees in SOEs and collectives; the public service medical care scheme covered government employees and the cooperative medical scheme covered about 90 percent of the rural population (Gu 1995, p 183). At the time there was no real need for additional protection as urban employment included housing and lifetime job security (Grogan 1995, p 1078).

The disbandment of cooperatives as of 1978 has meant that the vast majority of rural residents have been left without proper health insurance. By the late 1980s only 5 percent still received coverage (Grogan 1995, p 1074). The economic policy shifts have changed health security provisions on multiple levels. A great amount of power has been devolved to the provincial level, leading to differences in the coverage of workers. Access to health coverage now depends on the wealth of the employer and the province they live in (Grogan 1995, p 1082). The average health spending in 1993 in urban areas at 235 RMB per capita was almost four times as much as in rural areas where the average only reached 60 RMB. Some two-thirds of public spending on health was used for only half the urban population, 15 percent of the total (World Bank 1997c, p 3).

As a result of the growth in private enterprises and a growth in temporary workers the numbers of uninsured people in urban areas has risen. Since workers in private companies and joint-ventures earn more than SOE employees, the government possibly sees this an appropriate substitute for health benefits (Grogan 1995, p 1083). In addition, in 1986 China terminated lifetime employment in SOEs for new employees (Selden 1997, p 1661). In 1992 managers of SOEs were also given “14 Autonomous Management Rights”, including the right to hire and fire workers, even though implementation of these rights is uneven. (Broadman 1999, p 53). However, most still remain “obligated to provide cradle-to-grave social services to workers and their families” (Broadman 1999, p 52).

Still hundreds of thousands of workers are being laid off from loss-making companies as subsidies to SOEs are being reduced (Broadman 1999, p 54). Many others have been laid off in all but name and are no longer paid (The Economist 2000, p 113).

The pension system is also starting to experience problems as one look at Table 1 can highlight. As more and more people are being sent to early retirement and slower population growth sets in the amount of workers paying for the pensions of the retirees is falling sharply.

Table 1. Growing problems with financing pensions

| Year | Ratio of active to retired workers | Pension cost as % of wage bill |
|------|------------------------------------|--------------------------------|
| 1978 | 26.2                               | 3.4                            |
| 1982 | 9.9                                | 8.4                            |
| 1987 | 6.8                                | 13.8                           |
| 1991 | 5.8                                | 17.7                           |
| 1995 | 4.7                                | 21.3                           |

Source: State Statistical Bureau (1996), quoted in: Selden (1997)

All this has led to a need for some form of a national social welfare service, to include, in particular, health, unemployment and pensions. A national labour insurance fund did exist in the People's Republic in the 1960s but the system disintegrated at the outbreak of the Cultural Revolution (Selden 1997, p 1659).

As a survey by the China National Consumers Association shows medical and pension insurance are the most needed forms of insurance. Some 57.3 percent say they need medical insurance, while 39.2 are looking for pension insurance (ChinaOnline 2000). As part of China's accession to the WTO

foreign insurers will receive more wide-ranging and more protected entry to this growing market (European Commission 2000).

In 1993 the Central Committee called for a “multitier social welfare system to provide both urban and rural people with a degree of security” (People’s Daily quoted in: Selden 1997, p 1663). More than half of urban employees were participating in unified pension plans by the end of 1993 (Selden 1997, p 1663). The State Council in 1995 outlined its proposals for a national insurance programme. However, the system is made complicated by the fact that prefectural authorities will have the say over the amounts individuals and enterprises will have to contribute (Selden 1997, p 1664).

#### D. Problems with reforms

Many difficulties arise when looking at the recent changes. In order to survive the challenges of a liberalised market economy, China’s SOEs have to become profitable and competitive.

However, as the vice minister of the SETC has said there are still big problems awaiting the government, such as poor enterprise management and an inadequate response to market forces. SOEs have also been burdened with the costs of social welfare reform, which makes it even harder for them to climb out of debt (ChinaOnline 2001).

Due to social security cash-flow deficits in certain provinces and cities the Central Government had to transfer some 17 billion RMB in 1997 to support pension deficits which could not be covered either by local government or SOEs. As this problem is likely to increase the State Council has set out regulations including new penalties for companies which fail to make required contributions (World Bank 2000a, p 13).

In order to maintain social stability it will be necessary for the government to establish a general social security system which can allay fears caused by the major economic shifts in recent years and in the near future (Chi 2000).

According to the deputy director of the National People's Congress finance and economy committee "WTO accession will bring a shock to many sectors of the economy". Should this shock of foreign competition be felt strongly in China there seems to be a danger of a "new left" emerging which is opposed to the opening up and sees more disadvantages in WTO membership. The government's request for a delay in tariff cuts were rejected (ChinaOnline 2000).

#### **IV. Formulation of Hypotheses**

As shown in the paragraphs above China is facing some great challenges at the moment. It is obvious that problems will arise but it depends on the actions of the government whether they will cause any problems as such. In addition the adaptability of SOEs and also private enterprises will be tested.

When confronted with the reform of social security how is the government attempting to solve the problem of so many people being uninsured. Are there legal attempts being made to introduce a system with which all the citizens could be provided with social insurance. Or does the government want to implement a private insurance system whereby everyone is responsible for themselves to use their income to fund a safety net.

If there is to be a national insurance system who will be administering it? As part of the national government's decentralization efforts this could be done by the provinces who already are the main level of taxation. However, current efforts have also seen a handing down to the prefecture/municipality level.

Various countries have developed social security systems which work on different levels and use differing means to gain the funds to provide it. Be it through the national income taxation system, in individual enterprise funds or regional funds. Will there be a differentiation between employees in different sectors and would the level of insurance then not be the same due to varying

amounts of money available. The government could attempt to help equalise the differential by distributing funds according to where they are most needed.

## **V. Discussion of Research Methods and Data Sources**

The importance of the Chinese economy has led to great amounts of work being published on the reforms occurring there. A wide variety of sources is available from traditional academic journals and media to modern internet-based sources, such as online databases of institutions and specialist websites. These modern sources make access to official statistics much easier.

One part of possible research on the reform of the economy and social security would be to find out exactly what the financial situation of the SOEs is. For this it would be necessary to have reliable accounting standards which as part of accession to WTO and China's gradual entry to the global capital system can be expected to be implemented soon. Without this it would surely be near impossible to get accurate figures. This then could be used to distinguish between different industries and the implications their status has on the situation of their employees.

When looking at the employees it would be a good idea to find out about growth in wages. Due to the high level of regionalisation in the Chinese economy it would also be important to put some of the focus of research on the huge income gap which is growing between the eastern coastal provinces and the inland areas.

Coming to the social welfare system I would look at how private insurance is growing and also look at whether the state system covers the majority of the population or is even attempting to achieve that. A large amount of social insurance already has to be paid out of the insured person's pocket. I would also look at whether foreign insurers will attempt to move into the market as a result of the government's failure to create a workable system.

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