

China's Health Care and Pension Challenges

Testimony before the U.S.-China Security and Economic Review Commission
Hearing on

Major Internal Challenges Facing the Chinese Leadership

February 2 and 3, 2006

Room 1310 Longworth House Office Building

Independence & New Jersey Avenues, SE

Washington, D.C. 20515

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Introduction

Let me begin by thanking the Chairman of the Commission and the Co-Chairmen for this hearing for inviting me to provide my views this morning. I commend the Commission for taking up issues related to China's domestic political, economic and social challenges. The China we will face in 10 years' time will be profoundly shaped – for better or for worse – by the enormous domestic challenges unfolding in the country. Our political leadership and policy community needs to be better prepared to assess and respond to these developments, and our work here can make a contribution to that process.

As China's socioeconomic system moves increasingly toward the market and the role of the state diminishes as a provider of social services and public goods, the country's social safety net systems – traditionally core aspects of Chinese socialism – have suffered and declined. Moreover, the central government is cutting back on financial support to localities, and increasingly expects provincial and local governments to generate their own revenues to support social services in their jurisdictions. Poorer parts of China – where governments are less innovative, economic development lags, and tax revenues are scarce, and where the vast majority of Chinese citizens reside – are particularly hard-pressed to provide decent health care, pensions and other social benefits.

In response to the Commission's request, I have divided the remainder of this testimony into five parts, covering:

- China's overall health situation
- China's health care funding and medical insurance
- China's aging challenge
- China's retirement pension situation
- U.S.-China cooperation and assistance programs in these areas

Health Care Situation

Compared to 50 years ago in the early years of the People's Republic of China, health conditions have improved dramatically. According to statistics from the World Health Organization (WHO), the average life expectancy of people in China has been raised from 35 in the 1950s to 71 in 2003. The mortality rate of Chinese infants declined from as high as 20 percent during periods in the 20th century to 2.5 percent at present. There are more than 300,000 hospitals and other medical institutions across the country.¹ For the most part, China's overall improved health situation is attributable to its rapid economic development and its past public-financed disease prevention strategy.

Despite remarkable gains in key health indicators, however, China's health situation faces many problems. With an ailing public healthcare system and social safety net (discussed below), China is increasingly vulnerable to the spread of emerging and re-emerging infectious diseases. For example, China is facing a considerable HIV/AIDS epidemic. China had approximately 141,241 cumulative known cases of HIV infection by the end of November 2005, a more than 50 percent increase from 89,067 cases reported the year before.² Importantly, China estimates there are approximately 650,000 HIV/AIDS cases in China, meaning that about 80 percent of those infected with HIV in China do not know it, and health authorities do not know where and who they are.

*“Almost 200 people are infected [with HIV] every day in China. The situation is grave.”
-- Wang Longde,
China's Vice
Minister of Health,
New York Times,
January 25, 2006.*

Although the new estimate of 650,000 cases is lower than the previously believed, the rate of infection is rising at rate of at least 70,000 new cases per year as of 2005.³ In 2004, the United Nations projected that, if the epidemic is left unchecked, the number of people living with HIV/AIDS in China could exceed 10 million by 2010.⁴ The epidemic clusters among several marginalized groups that live outside mainstream society, such as commercial sex workers and intravenous drug users (IDUs) in several regions. However, several emerging factors – increase in China's sex trade, increasing pre-marital and extra-marital sex, greater social tolerance for homosexuality and men having sex with men, and risky behavior in the “floating population” of migrant workers – could serve as a bridge to spread the epidemic into the general population.⁵ In some provinces, such as Yunnan, Henan, and Xinjiang, HIV prevalence rates exceed 1 percent among pregnant women, and among persons who receive premarital and clinical HIV testing. This meets the criteria of the United Nations Joint Program on HIV/AIDS (UNAIDS) for a “generalized epidemic.”⁶

¹ “Chinese People's Health Condition Advanced in Developing Nations,” *People's Daily*, November 21, 2005.

² “Epidemiological Fact Sheets on HIV/AIDS and Sexually Transmitted Infections, 2004 Update China,” United Nations Joint Programme on HIV/AIDS, 2004.

³ *2005 Update on the HIV/AIDS Epidemic and Response in China*, Chinese Ministry of Health, United Nations Joint Program on HIV/AIDS, and the World Health Organization, January 24, 2006.

⁴ “Epidemiological Fact Sheets on HIV/AIDS and Sexually Transmitted Infections, 2004 Update China,” United Nations Joint Programme on HIV/AIDS, 2004.

⁵ Bates Gill, J. Stephen Morrison, and Andrew Thompson, *Defusing China's Time Bomb: Sustaining the Momentum of China's HIV/AIDS Response*, CSIS HIV/AIDS Task Force Report, June 2004.

⁶ *2005 Update on the HIV/AIDS Epidemic and Response in China*, Chinese Ministry of Health, United Nations Joint Program on HIV/AIDS, and the World Health Organization, January 24, 2006.

Avian influenza, or “bird flu”, is another concern. Since China first acknowledged that it had identified one case of bird flu in July 2004, the virus has spread among chickens in numerous villages in southern and western China. In 2005, Chinese agriculture authorities reported 32 outbreaks in poultry in 12 provinces, resulting in the culling of more than 24 million birds.⁷ The government announced China’s first confirmed human cases at the end of 2005. As of January 25, 2006, Chinese MOH has announced 10 confirmed human cases, seven of which have been fatal. The cases have occurred in 7 provinces and regions: Anhui, Guangxi, Liaoning, Jiangxi, Fujian, Hunan and Sichuan.⁸ With a potential human pandemic at hand, China faces grave challenges due to the large size of both its human and poultry populations. The central government has candidly expressed its determination to fight HIV/AIDS, bird flu, and other infectious diseases, however, local-level implementation remains a big problem.

Chronic and non-communicable diseases are also continuing to increase in China. According to the WHO, chronic diseases are projected to account for 79 percent of all deaths in China in 2005. A WHO projection in 2005 estimates that over the next 10 years, over 80 million people will die from chronic diseases in China, a remarkable increase of 19 percent over the previous 10 years.⁹ In large measure, this trend reflects China’s transition to an aging society (discussed in more detail below). The continuing increase of chronic disease cases will result in an increasingly heavier burden on the healthcare system and affect overall GDP. It is projected that China will lose US\$558 billion over the next 10 years from premature deaths due to heart disease, stroke and diabetes.¹⁰

Other lagging health-related factors contribute to increasing chronic and communicable disease as well. According to the United Nations Development Program, for example, only 44 percent of China’s population had “sustainable access to improved sanitation” in 2002 (though that is double the percentage in 1990), and some 23 percent of the population in 2002 did not have “sustainable access to improved water sources”, down only 7 percent from 1990.¹¹

The Chinese central government is increasingly open in recognizing the problems posed by its public health situation. Chinese news has reported experts’ concerns on health care and pension issues. For instance, in 2002, Xinhua reported that among the top ten mass concerns was the need to “set up a sound social security system”, and noted that “the current pension insurance fund system of payments from current accounts can hardly be maintained over the long term.” *People’s Daily* reported in 2004 on the top ten challenges facing China, including “AIDS and public health.” In the past year, a State Council researcher, Ge Yanfeng, issued a highly critical report on China’s health care reform efforts, and in July 2005, Chinese Minister of Health Gao

⁷ “Avian influenza – situation in China – update 2,” World Health Organization, January 25, 2006. accessed at: www.who.int.

⁸ “Avian influenza – situation in China – update 2,” World Health Organization, January 25, 2006. accessed at: www.who.int.

⁹ *The Impact of Chronic Disease in China*, World Health Organization, 2005, accessed at: www.who.int/chp/chronic_disease-report/en/.

¹⁰ *The Impact of Chronic Disease in China*, World Health Organization, 2005, accessed at: www.who.int/chp/chronic_disease-report/en/.

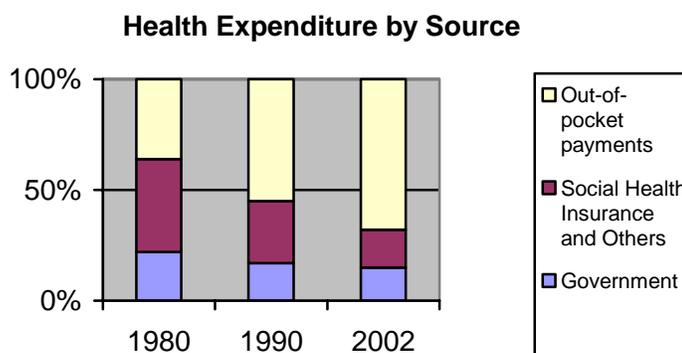
¹¹ See the *Human Development Report 2005* (New York: United Nations Development Programme, 2005), p. 241, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.

Qiang went on record in a public speech on the need to dramatically improve China's health care conditions. In drawing up the 11th Five Year plan, central authorities pointed out the need to "accelerate the pace of perfecting the social security system." According to the plan, "the basic pension, medical care, unemployment, workplace injury, and birth insurance systems for urban workers should be perfected. Fiscal investment in social security should be increased; social security funds should be raised through multiple channels; and personal accounts should be established gradually." It also emphasized the issue of social security for migrant workers in the cities.¹²

Health Care System and Funding

China's health care and medical insurance system face a number of challenges. China's once admired public health care system has degenerated considerably since privatization began in the 1980s. Prior to 1980, China adopted a collective health care financing system, relying heavily on public subsidies. In the course of rapidly developing its market economy in the past two decades, the old health care system has been abolished as China has attempted to switch to a market-oriented health system. In so doing, the government has failed to establish a viable substitute for the old health care system.

Today, private, out-of-pocket spending on health care in China represents almost twice as much as public health care spending as a percentage of GDP.¹³ The United Nations also estimates that, as a share of total health expenditure, such private health-spending rose from 36 percent in 1980 to 68 percent in 2002. In contrast, the government's share declined from 32 percent in 1978 to 15 percent in 2002.¹⁴



Source: *A Health Situation Assessment of the People's Republic of China*, United Nations, July 2005

As a result, according to recent report released by China's State Council Development Research Center, the country's medical insurance system currently covers less than half of urban residents (approximately 100 million people) and only 10 percent of the rural population. The same report

¹² "CPC Central Committee Proposal on Formulating the 11th Five-Year Program for National Economic and Social Development," *Xinhua*, October 18, 2005.

¹³ *Human Development Report 2005* (New York: United Nations Development Programme, 2005), p. 241, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.

¹⁴ *A Health Situation Assessment of the People's Republic of China*, United Nations, July 2005.

also notes that “China’s medical reform has been unsuccessful because it has become unbearably expensive to patients and many dare not go to the hospital when they fall ill.”¹⁵

In addition, the disparity in government health care spending between urban and rural areas is stark and increasing. United Nations’ data show that in 2002 the average level of per-capita health spending in urban area was more than twice the national average and 3.5 times the average health spending level in rural areas. China’s medical resources have been mostly allocated to benefit urban areas and to government departments or state-owned units. Meanwhile, the lack of funding in rural areas means poor and declining health services over time.

Population vs. Health Expenditures in Rural and Urban China, 2002

	Population (million)	Health Expenditure (RMB billion)
Rural	800	190
Urban	500	280

Source: *A Health Situation Assessment of the People’s Republic of China*, United Nations, July 2005

China’s urban social health insurance, named as the Urban Employee Basic Medical Insurance System (UEBMIS) was launched in 1998. Employees of the non-state sector have recently been urged to join the scheme as well. UEBMIS enables urban employees to use private medical saving accounts and social-risk pooling funds. However, it sets a ceiling, above which medical expenses should be covered by supplementary insurance or out-of-pocket money.

In the countryside, the new Rural Cooperative Medical Scheme (RCMS) was started in 2002, which aims to pool funds for catastrophic illness and in-patient medical services. Nevertheless, the participation rate of rural individuals is very low, as mostly those at higher health risk are interested in the scheme. As mentioned above, more than 90 percent of the rural population still does not have any medical insurance.

China’s Aging Challenge

China’s age wave is crashing upon the country at an exceptionally fast pace. Unlike the experience in the West and other developed economies which became “rich” before they became “old”, China will be the first major country to become “old” *before* it becomes “rich.”¹⁶

There are two fundamental forces behind China’s aging population – falling fertility and rising longevity. The total fertility rate (TFR) of Chinese women has decreased dramatically from 6.1 in 1949 to 1.8 in 2002, reaching below the replacement level of 2.1 children per mother, a birthrate required to keep the population steady.¹⁷ Within only a short period of time, China’s TFR pattern matches that of

Unlike in the West and other developed economies, China will grow “old” before it becomes “rich.” – Richard Jackson and Neil Howe, The Graying of the Middle Kingdom

¹⁵ “The Medical Reform Controversy,” *Beijing Review*, vol. 48, no. 38, September 22, 2005.

¹⁶ Richard Jackson and Neil Howe. *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China* (Washington, D.C.: Center for Strategic and International Studies, April 2004). p. 3.

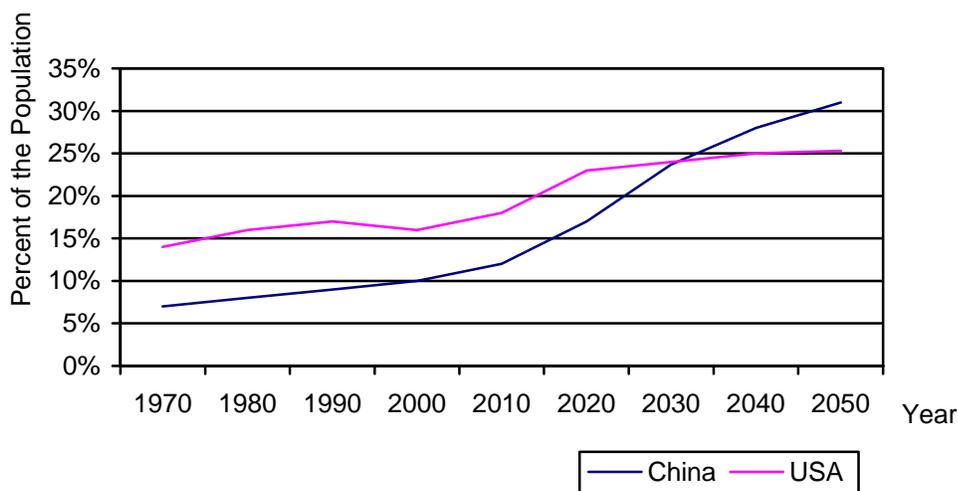
¹⁷ Data from National Population and Family Planning Commission, accessed at: www.npfpc.gov.cn.

more developed countries and China now has one of the lowest fertility rates in the world. This is partly the result of the Chinese government’s one-child policy, introduced in 1979 in order to strictly control its growing population. A more important factor is China’s overall socioeconomic modernization, which, as shown across the world, results in significantly reduced birthrates.

Along with a remarkable decline in birthrates, China’s rapid socioeconomic development has also lead to noticeable improvements in public hygiene, nutrition, healthcare and hence people’s life expectancy in recent decades. As noted above, life expectancy has risen to over 71 years in 2003, making China one of the world’s longest-lived, low-income nations.¹⁸ Socioeconomic modernization, together with the implementation of strict population control policy measure has caused China to age faster than any major country in history.

As a result, despite the fact that China’s present population is relatively “young” with only 11 percent considered elderly (those aged 60 and over), the United Nations projects that the proportion of elderly will increase to about 28 percent in 2040, by which time over a quarter of the world’s elderly population will live in China. The projected share of elderly in the population will begin to exceed that of the United States in 2030 (see chart below). Furthermore, the very old, those aged 80 and over, will increase from about 8 million in 2000 to 50 million in 2040.¹⁹ In terms of absolute numbers, China has the world’s largest elderly population, with 134 million people over 60 years old, a figure that is likely to hit about 397 million by the middle of this century, assuming current demographic trends continue.²⁰

Percentage of the Elderly (Aged 60 & Over) in China and the U.S.,



Source: U.N. (2003)

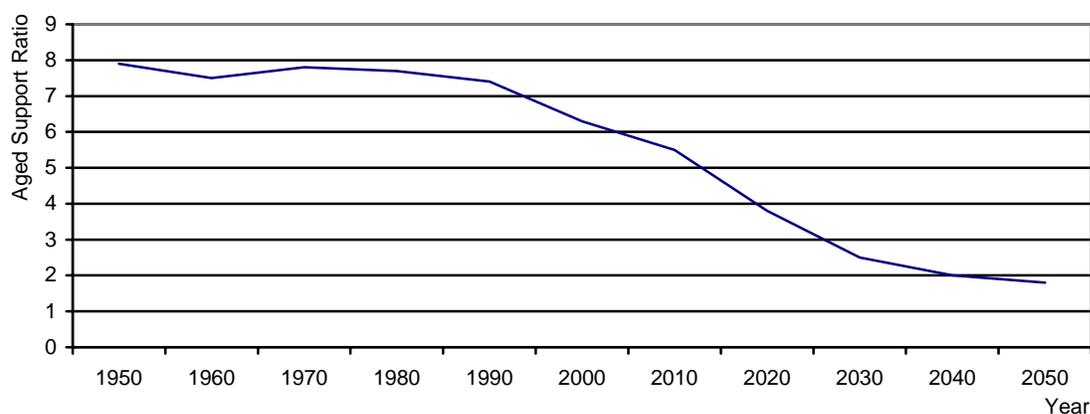
¹⁸ *Human Development Report 2005*, United Nations Development Program, 2005, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.

¹⁹ Data from United Nations China webpage, accessed at www.unchina.org/about_china/html/population.shtml.

²⁰ “Warning over China’s Aging Populace,” *China Daily*, June 12, 2004.

With the continuation of the one-child policy, demographers predict a “4-2-1 problem” among individual Chinese families in an aging society. Ten years from now, as China’s baby boomers begin to retire, the first single-child generation will assume the burden of caring for the elderly. Specifically, in many Chinese families, two elderly parents and four grandparents who can expect to live longer in the future, will have to depend on one child in their old age. This informal safety net will come under increasing pressure as the population ages. Looking beyond individual families, there is also a decline in working-age adults aged 15 to 59 in China for every elder aged 60 and over. According to United Nations projections, the number will fall from six at present to just two in 35 years (see chart below).

**Ratio of Working-Age Chinese (Aged 15-59)
to Elderly Chinese (Aged 60 & Over)**



Source: U.N. (2003)

An increasingly elderly population will become an obstacle to China’s overall development if measures are not implemented in a timely manner to address this problem. China is currently poorly prepared for the coming age wave. Chinese financial markets are also poorly-structured and risky investment vehicles, closing that avenue for nest-egg building at present. Improving China’s social safety net and pension system to care for its elderly and alleviate the burden on the country’s working population will be critical to assuring China’s continued economic, political, and social development. If millions of Chinese continue to grow old with no pensions or other forms of social security, the stability of the political regime and economic prosperity could come under threat.

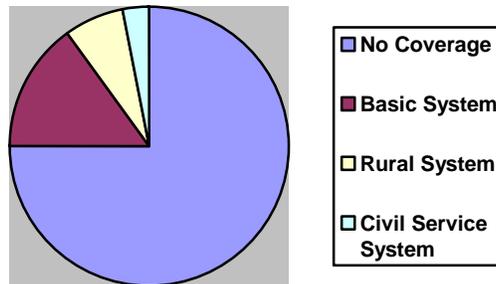
China’s Broken Pension System

China’s pension system is poorly prepared to care for a rapidly aging population. Pension coverage in China is largely limited to urban workers in the state-owned sector, and, as SOEs downsize and put more persons on the retirement roles, the overall pension system is running into financial trouble.

China’s pension system consists of three parts – a basic pension system for urban workforce (mostly employees of SOEs and collectively owned enterprises), a civil service pension system for civil servants, and a voluntary rural pension system. According to the United Nations, at the

end of 2004, the number of people covered by the basic pension scheme was 163.53 million, including 122.50 million workers and 41.03 million retirees, and very few rural migrant workers.²¹ China's public pension system leaves nearly half of the workforce uncovered in the cities, and the coverage in the countryside is merely 11 percent of the rural workforce. In addition to the large discrepancy between urban and rural coverage, the overall coverage is alarmingly low: about three out of four Chinese workers have no pension at all.²²

China's Pension Coverage in 2002



Source: Chinese Ministry of Labor and Social Security and Richard Jackson and Neil Howe, *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China* (Washington, D.C.: Center for Strategic and International Studies, April 2005).

In the meantime, as many SOEs started to downsize in the 1990s, the State Council launched a national pension system reform effort in 1997 to extend coverage under the basic pension system to private sector workers. The reform replaced the former “pay-as-you-go” system with a scaled-back pay-as-you-go system plus personal retirement accounts. However, due to the high contribution rates (24 percent of the payroll with regional variations) in order to pay off the unfunded liabilities, the 1997 reform has faced serious problems. In particular, it fails to bring in new contributors to the social pools. As local authorities use account contributions to cover current cash shortfalls, the overall system is gradually running out of money.

Estimates of the size of China's unfunded pension liabilities, or implicit pension debt (IPD), vary. Several calculations made in recent years reach a figure by making the theoretical assumption that the unfunded system is to be terminated immediately and that all pensioners and workers must be compensated for their future pensions and accrued rights.²³ A World Bank report in 1997, citing a rough Chinese government calculation, said the IPD could be three to four times GDP.²⁴ The Bank stated that these high estimates have discouraged the authorities from explicitly recognizing the debts and reforming the system. Instead, Chinese authorities have

²¹ *Human Development Report 2005*, United Nations Development Program, 2005, accessed at: http://hdr.undp.org/reports/global/2005/pdf/HDR05_HDI.pdf.

²² Richard Jackson and Neil Howe, *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China*. CSIS and Prudential Foundation, April 2004.

²³ Wang, et al., *Implicit Pension Debt, Transition Cost, Options and Impact of China's Pension Reform*, paper prepared for the World Bank Policy Research Working Paper series, and also presented at the conference on Developing through Globalization: China's Opportunities and Challenges in the New Century, held in July 5-7, 2000, in Shanghai, China.

²⁴ *Old Age Security: Pension Reform in China* (Washington, D.C.: World Bank, 1997).

been looking at other options to reduce costs, including continuing to increase the contribution rates and expand the coverage. As a matter of fact, these measures are not sustainable and have led to widespread evasion.

The World Bank has since conducted more careful IPD research and generated better estimates. It calculated in 1997 that China's IPD ranged from 46 to 69 percent of the GDP in 1994.²⁵ Some experts from the World Bank provided a more recent estimate that IPD in China accounted for 94 percent of the GDP in 1998.²⁶ Another frequently cited estimate is based on a more quantitatively sophisticated model and puts the IPD at around 71 percent of GDP in 2000.²⁷ There are also some higher, non-Bank estimates that China's unfunded pension liabilities are fast approaching \$1 trillion.²⁸ It is reasonable to view China's IPD at the higher end of the range, given the increasing number of laid-off employees from the SOE reforms.

The World Bank also concludes that, compared with the pension debt ranges from 100 to 200 percent of GDP in most OECD countries, China's IPD is relatively low. This is because of the small coverage of current China's pension system. The low estimate from the Bank means that it is still easy for China to reform its pension system if decisive measures are undertaken soon enough. However, the Bank also warns that as coverage expands and workers age, in combination with the upcoming wave of SOE layoffs, the pension liability will grow by leaps and bounds over the next few years in China.

U.S.-China Cooperation and Assistance

Health care, social security, and pension-related issues offer a potentially rich set of cooperative avenues for U.S.-China relations, providing untapped opportunities for U.S. businesses, scientists, and policy analysts, and opening a new window to understand China's economic and security future. A number of current and potential future areas of cooperation include:

- U.S.-China Health Care Forum (*baojian luntan*): The Forum was jointly held by the Chinese Ministry of Health (MOH), Ministry of Commerce (MOC), and the U.S. Department of Commerce (DOC) and Department of Health and Human Services (HHS) in July 2005. It covered four areas: medicare system, medical insurance system, health care products and services, and R&D for health care products and services.
- U.S.-China cooperation on emerging and re-emerging infectious diseases: Chinese Health Minister Gao Qiang and HHS Secretary Leavitt signed a MOU in October 2005. It aims to increase official bilateral collaboration and technical assistance related to emerging and re-emerging diseases such as SARS, influenza, West Nile virus and plague.
- U.S.-China cooperation on HIV/AIDS: HHS and MOH signed a MOU in June 2002 aimed at promoting enhanced U.S.-China cooperation on HIV/AIDS prevention and

²⁵ *Old Age Security: Pension Reform in China*, (Washington, D.C.: World Bank, 1997).

²⁶ M. Dorfman and Y. Sin, *China: Social Security Reform – Technical Analysis of Strategic Options*, Human Development Network, World Bank, December 13, 2000.

²⁷ Wang, et al., *Implicit Pension Debt, Transition Cost, Options and Impact of China's Pension Reform*, paper prepared for the World Bank Policy Research Working Paper series, and also presented at the conference on Developing through Globalization: China's Opportunities and Challenges in the New Century, held in July 5-7, 2000, in Shanghai, China.

²⁸ A. Newton and R. Subbaraman, *China: Gigantic Possibilities, Present Realities*, (New York: Lehman Brothers, January 21, 2002).

research. The MOU calls for increased collaboration in the development of effective intervention strategies to prevent HIV transmission, including new strategies to improve blood safety. The two sides will also focus on upgrading HIV/AIDS epidemiology and surveillance in China, and provide more opportunities for training and exchange of scientists and health care professionals.

- Looking ahead, there are opportunities for U.S. firms and nongovernmental organizations, as well as U.S. government agencies and research institutions to intensify cooperation with China in such areas as pension financing, including through the development of viable investment vehicles in China; health care insurance and financing; aging and elderly health care; drug pricing and availability; chronic disease; occupational health and safety; and environmental health.