Insurance Markets in China [1]

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Even though Chinese merchants have practiced risk transferring and distributing as early as 3000 BC,[2] modern insurance markets in China are still in its infancy stage relative to advanced market economies. In this article, I provide a brief description of a variety of insurance markets in China and discuss the issues in future development.

Health Insurance Market

China's current health insurance system consists of three layers: basic health insurance; employer-supplemented health insurance; and individual-supplemented health insurance.

Basic Health Insurance

The basic health insurance in China is implemented under a prefecture- or county-level planning framework, where the planning units have discretion over policy details and are responsible for balancing their own budget. It consists of three parts: the urban employee basic health insurance (UEBHI), the urban resident basic health insurance (URBHI), and the new cooperative medical scheme (NCMS) for rural populations.

The *UEBHI* is compulsory for all urban firms and non-profit organizations, and optional for township and individually-owned businesses. Usually the employee and the employer respectively contribute 2% and 6% of the employee's wage toward the premium. Benefits are subject to a cap, varying from 30 to 300 thousand yuan per year depending on the local policy. At the end of 2011, 252 million urban employees participated in UEBHI.

Urban residents not covered by the UEBHI can participate in URBHI by paying the premium themselves, which is smaller than that for the UEBHI but benefits are also significantly lower. At the end of 2010, 221 million urban residents participated in URBHI.

The *NCMS* was initiated by the State Council in 2002 to reduce illness-induced poverty in rural areas. Rural households voluntarily participate by paying an annual premium usually less than 300 yuan, more than half of which is subsidized by the central and local governments. At the end of 2011, 832 million individuals, or 97.5% of China's rural population, participated in NCMS.

Employer-supplemented health insurance

To give additional benefits for employees, employers can provide this insurance by purchasing from a commercial insurance company, establishing an account itself, or, if the employer is already in the basic health insurance program, paying additional premium to the local health insurance administrative agency. To encourage provision, funds used for supplemented health insurance are tax deductible up to a limit.

Individual-supplemented health insurance

Individuals can also purchase insurance directly from insurance companies. Commercial health insurance is a relatively small component of China's personal insurance market, making up for only 6.37% of total personal insurance revenues in 2010.[3]

An important issue is that China's basic health insurance system is financed at the prefecture or county level, where the local planning units balance their own budgets with very limited transfer from the central government. Consequently, excess demand for reimbursements relative to collected premiums often result in insufficient funds to reimburse all covered expenses. Low planning level also renders significant regional variations in policy details; for example, the caps on annual reimbursements in more developed counties can be ten times as high as those in less developed ones. Moreover, the basic health insurance in one region often cannot be used for medical expenses incurred outside region, which creates barriers to labor mobility.

Life insurance Market

At the end of 2011, there are 61 commercial life insurance companies in China, among which 25 are foreign firms. The total life insurance revenue from premium payments reached about 640 billion yuan in 2011, with the Chinese companies account for close to 95% of the market share.[4] Chinese life insurance market is highly concentrated. The largest three insurers, China Life, China Pacific Insurance (Life), and Ping An Insurance, make up more than half of total revenues, though their market share decreased in recent years.[5]

Despite the steady growth in the past decade, the Chinese life insurance market is still behind the global average in insurance penetration (ratio of total premium revenue over GDP) and density (ratio of total premium revenue over total population). In 2010, the insurance penetration in China is 2.62% and the insurance density is 783 Yuan, both well below the global average of 4.0% and US$ 364.3.[6]

The high concentration in China's life insurance market leads to limited innovation in life insurance products, and low service quality. Misleading sales tactics, frequent charges of extra fees, and complicated claim procedures are common complaints.

Property Insurance Market

As of 2011, China has 59 property insurance companies, including 21 foreign insurers. Property insurance currently accounts for about one third of total insurance revenues. The number of property insurance companies has been steadily increasing, yet the property insurance market is even more concentrated than the life insurance market. The top three companies have always been People's Insurance, China Pacific Insurance (Property), and Ping An Property Insurance, taking two thirds of total property insurance revenues. Foreign property insurers, despite their numbers, generate far smaller revenues. The payment rate for property insurance in China is fairly stable at around 50%.

The penetration and density of property insurance in China are low, both absolutely and relatively. The 2011 property insurance revenue is only 1% of GDP, while the average is 2.9% globally and 3% for emerging markets.[7] Insurance density was US$ 56.5 in 2011, much lower than the US$ 263 world average but slightly higher than the US$ 49 emerging market average.[8]

Automobile insurance is the dominant type of property insurances sold in China, largely due to the dramatic growth in the number of vehicles and the increasing participation rates in recent years. The demand is further boosted when auto liability insurance became compulsory in 2006,[9] which generates over 77% of property insurance revenues.[10] Even though China Insurance Regulatory Commission (CIRC) regulation requires that the insurance companies set the premium to just break even, it does not stop the companies from making huge profits from auto insurances.[11]

The high concentration of the Chinese property insurance market significantly hinders the competition, resulting in poor service quality and delay in reimbursement.

Agricultural insurance

There are 21 companies in China offering various agricultural insurances, the largest being PICC-Property and Casualty Company, China United Property Insurance, An-Hua Agricultural Insurance, and Sunshine Agricultural Insurance. Top three companies account for close to 80% of the market. Premium revenue of agricultural insurances amounted to 13.59 billion yuan in 2010; and total claims reached 9.60 billion, covering 129 million rural households and 680 million acres of crop, oil, or cotton.

The fact that agricultural insurance in China is a policy-driven public service requires complicated coordination among several government departments including those in the CIRC, the Ministry of Agriculture, the Ministry of Finance, and the National Development and Reform Commission; and among different levels of governments -- the state, the province, and the prefecture or county -- because all three levels of the government contribute to some of the premium subsidies to the farmers. Since local governments are required to match central government subsidies for some insurance, they are sometimes unwilling to promote agricultural insurances. Even with considerable government subsidies, some farmers do not trust the insurance companies and thus are reluctant to purchase insurance.[12] Due to its voluntary participation nature, there are also widespread adverse selection and moral hazard problems, and sometimes even fraud, in agricultural insurance.

Social Insurance Programs

Chinese social insurance system consists of five basic insurances: pension, unemployment insurance, health insurance, work injury insurance, and maternity insurance. The first two and the other three are usually combined as two bundles. The pension system and the health insurance are the two pillars of

China's social insurance program. The basic health insurance program is already discussed in detail in Section 1. In this section we will focus on China's pension system.

China's current pension system is planned at the province level and administered at the prefecture level. Policies are kept uniform within each province, but the detailed figures may vary across prefectures. All firms are compulsory participants. The firm pays 20% of an employee's wage income as the monthly premium that goes into the social pension fund, which is run as a pay-as-you-go system. The employee pays another 8% that goes into his/her personal account (at least in principle).[13] The expected national average replacement rate is 70%. By the end of 2011, 216 million urban employees participated in the pension program.[14] Similar to the basic health insurance system, there are also employer-supplemented and individual-supplemented pension programs. These are provided by commercial insurance companies or industrial associations and are not part of China's social insurance system.

Many of the designed features of the pension system were not implemented in practice. For example, funds in the personal accounts (8% paid by the employee) of working participants were often used to pay for pensions of retirees. The system also faces significant financial stress as Chinese population is expected to decline and enter an ageing period in 2030. The social pension fund in China is sponsored by central government budgets. A recent study projects that with low mortality and low fertility, China's pension deficit rate will amount to 59.9% if the retirement age remains constant.[15] Several measures have been taken to prevent huge deficits in future: In 2001, the central government used the sale of state shares to supplement social pension funds.

Another problem with China's current pension system is inequality among participants because benefits and costs for participants differ greatly across types of employers and regions. Government employees enjoy more generous pension plans supported by local fiscal budgets. Because the system is planned at the province level and managed locally, policies and rules may vary even within the same province, The regional variations in the pension system add to China's already severe regional inequalities.

Conclusion

Despite the rapid growth in recent years, there are still many areas for Chinese insurance markets to further develop. The existing markets are dominated by few large majority state-owned insurance companies, leading to limited product innovation and poor customer services. While CIRC has attempted to reduce many forms of malpractices committed by the insurance companies, more competition from the entry of financially strong private companies is needed to drive down the abnormally high profit margin in Chinese insurance markets. There are also several important insurance markets that are non-existing or tiny in China. For example, private annuity insurance market in China is very small. Homeowners' insurance, which is huge in other countries, is also small. Commercial insurance used frequently in other market economies to hedge against price risks is also only at the early stages of development in China.

1 Prepared for *The Oxford Companion to the Economics of China* (Oxford University Press) edited by Shenggen Fan, Ravi Kanbur, Shang-Jin Wei and Xiaobo Zhang. I am grateful to Qing Gong for excellent research assistance in the preparation of this article.

2 See, e.g., Vaughan, E. J., 1997, Risk Management, New York: Wiley.

3 See China Insurance Yearbook 2011.

4 See China Insurance Yearbook 2011 and China Insurance Regulatory Commission (http://www.circ.gov.cn/web/site0/tab61/i191553.htm).

5 Author's calculation using China Insurance Regulatory Commission statistics.

6 World Insurance in 2010: Premium Back to Growth -- Capital Increases. Swiss Re Sigma Report, No.2/2011, pp. 20.

7 Source: Author's calculation using figures in Table 4 and GDP and population data from China Statistical Yearbook 2011. 2011 figures are from The People's Republic of China Economic and Social Development Statistics Report for 2011 (February, 2012), see http://www.stats.gov.cn/tjgb/ndtjgb/qgndtjgb/t20120222_402786440.htm

8 World Insurance in 2010: Premium Back to Growth -- Capital Increases. Swiss Re Sigma Report, No.2/2011, pp.37.

9 Auto liability insurance is the first compulsory insurance in China as required by the Road Traffic Safety Law enacted in 2006.

10 Wang, Xujin (2011). *Property Insurance*, Peking University Press, Beijing, pp.34.

11 The Provision on Mandatory Motor Vehicle Traffic Accident Liability Insurance, Chapter 2, Section 6. http://www.gov.cn/zwgk/2012-04/30/content_2125893.htm

12 See Cai, Hongbin, Yuyu Chen, Hanming Fang and Li-An Zhou (2012): The Effect of Microinsurance on Economic Activities: Evidence from a Randomized Natural Field Experiment". Working Paper, University of Pennsylvania.

13 Monthly contributions into pension funds are subject to a ceiling: individuals and firms shall, respectively, pay no more than 8% and 20% of *three* times the local average wage for each participant.

14 Employees working for non-profit organizations and some government agencies (in Chinese, *Shi Ye Dan Wei*) have their own more generous pension system.

15 Yi Zheng, 2011. Effects of Demographic and Retirement-Age Policies on Future Pension Deficits, with an Application to China, Population and Development Review 37 (3), pp. 553-569.