Sustainable pensions and retirement schemes in Hong Kong

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Abstract Over the next 20 years, Hong Kong will face a rapidly ageing population as the number of older adults aged 65 or above increases to approximately 2.26m by 2033 (26.8 per cent of the total population). Hong Kong has three pillars of old age income security: the Mandatory Provident Fund, personal savings and the financial support that is given to the elderly by adult children. This paper examines how these three pillars would serve their individual purposes and, as a whole, what can be done to sustain retirement protection for the older adults in Hong Kong in coming decades.

Keywords: *retirement protection; sustainable pensions; older adults; Hong Kong*

Introduction

A longer life expectancy coupled with a dramatic decline in the birth rate has resulted in a rapidly aging population in most parts of the world.¹ Hong Kong is no exception to this global population transformation. The number of people of 65 or above has increased from 150,000 in 1961 to 739,739 in 2001 (4.8 per cent and 11 per cent of total population), and they are expected to increase by over 300 per cent in the next thirty years to reach 2.26m by 2033, or 26.8 per cent of the total population.^{2,3} This rapid increase in the number of older adults presents a serious challenge to policy-makers, especially in regard to financial security in old age. This paper examines the concept of the

‘three pillars of retirement protection’ proposed by the World Bank for Hong Kong, how it would serve its purposes and what can be done to sustain retirement protection in the coming three decades.

Hong Kong, a British colony for more than 150 years, was returned to the People’s Republic of China to become a Special Administrative Region (SAR) on 1st July, 1997. Although Western practices have been prevalent in Hong Kong, especially among the young people and the better-educated, Chinese culture is still dominant among the older adults. After all, over 98 per cent of the population in Hong Kong is ethnic Chinese and most of them come from an agrarian social and economic background

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and are now the first generation to grow old in a highly industrialised city.⁴ It is not surprising to find that the majority of the older adults in Hong Kong are unprepared for their retirement, especially with regard to financial arrangements, because, according to traditional Chinese customs, relying on one's children is the most commonly accepted way of meeting economic needs in later life. Moreover, retirement is not a familiar concept to today's older adults because there was no official or mandatory retirement age for Hong Kong residents, except for a small proportion of workers who were civil servants or employees of large corporations.

Because of insufficient retirement protection, the majority of older workers strive to stay in the labour market for as long as possible, earning a living until they are forced to retire. In a recent large-scale survey of 2003 older adults in Hong Kong, it was found that, although 56.6 per cent of them had retired, only 3.4 per cent retired because they had reached the age of retirement.⁵ For almost all of them their retirement is of a forced nature, eg due to poor health status, a long period of unemployment, or no job opportunities.

Three pillars of retirement protection

According to World Bank's conceptualisation, Hong Kong has three pillars of old age income security: the mandatory publicly managed pillar, the mandatory privately managed pillar, and the voluntary private savings pillar. In Hong Kong, the social security schemes, including both the Comprehensive Social Security Assistance (CSSA) scheme and the Old Age Allowance (OAA) scheme, form the first pillar of retirement protection and they are provided by the

government, being tax-financed, flat-rated, and with redistributational elements.

The CSSA scheme is non-contributory, but means-tested, based on an individual's or a family's income and assets. Only residents who have resided in Hong Kong for at least seven years are eligible for assistance. It aims to bring the income of needy individuals and families up to a minimal level so that basic needs or special needs can be met. In 2001, the CSSA scheme for older adults (aged 60 and above, called the old age category of CSSA) included a standard rate for an able-bodied person of US\$3,931 (HK\$30,662) per year, a long-term supplement of US\$206 (HK\$ 1,607) for those who have received CSSA for more than one year and special grants such as rent and water allowance. As a result, in a typical case, an elderly recipient receives about US\$6,154 (HK\$48,001) annually from the CSSA scheme. This is equivalent to about 40 per cent of the median annual income, ie US\$15,384 (HK\$120,000) for the working population.⁶ In early 2004, there were about 180,000 older adults (aged 60 or above) under the CSSA scheme. Since the monetary assistance under the CSSA scheme is minimal, adequate only to meet the basic needs of the recipients, older adults under the CSSA scheme are among the poorest in Hong Kong.

Older adults in Hong Kong are also eligible to receive an old-age allowance (OAA), but not together with CSSA, from the government. When individuals are between 65 and 69 years of age, they are eligible to apply for one form of OAA, called Normal OAA (NOAA), but they must subject themselves to asset and income tests. When adults reach the age of 70 or above, they are eligible for another type of OAA, namely Higher OAA (HOAA), for which income and

asset tests are waived. The amount of OAA is nominal, fixed at about US\$960 (HK\$7,488) and US\$1080 (HK\$8,424) annually for the NOAA and HOAA respectively. Both forms of OAA are non-contributory. Total government expenditure for financial assistance for older adults was US\$1.51bn (HK\$11.8bn) in 2002–03, accounting for 5.4 per cent of the recurrent public expenditure, or about 1 per cent of Hong Kong's GNP.

The Mandatory Provident Fund (MPF) scheme is a system of mandatory personal savings accounts; 5 per cent of workers' salaries and an equal contribution from employers are deposited in individualised savings accounts to accumulate benefits for retirement. It is described as employment-based, contribution-defined, privately managed, and compulsory savings. Employees who join such a scheme will not normally have sufficient benefits to cover the needs of old age until they have contributed for at least thirty years. As a specific example, consider a worker who was 35 years old in 2001. If she, with her employer, contributes 10 per cent of her salary each month, then the replacement ratio will be 45 per cent (assuming a 5 per cent return on investment, a 5 per cent interest rate, 2 per cent real wage growth, a retirement age of 65, and life expectancy of 80 years).⁷ However, the MPF scheme could not provide adequate financial protection for older workers (aged 45 and above) and low income earners.^{7,8} In 2002, the scheme collected US\$2.56bn and this will increase or decrease with the salary trend.⁹

Before the implementation of the MPF scheme in late 2000, approximately 30 per cent of the 3.4 million workers at that time participated in retirement protection programmes provided by individual employers.⁷ These schemes are either Occupational Retirement Scheme

Ordinance (ORSO) schemes or the pension scheme for civil servants. The MPF scheme, the ORSO schemes and the pension scheme form the second pillar of the retirement protection system and they share a common feature in that they are all fully funded (funding of pensions for civil servants lies with the government). It was estimated that the amount of money accumulated each year by the ORSO schemes ranged between US\$1.92 to 2.56bn (HK\$15–20bn).

Other than the above two, personal savings and family financial support, especially from adult children, form the third pillar of retirement protection. In a 1995 survey, a sample of 1,106 older adults aged 60 and above was asked to report their major source of income. Three major sources of cash income were identified: contributions from family members, especially from adult children or adult children-in-law (62.3 per cent); government welfare (16.5 per cent); and employment, retirement funds or investments (21.2 per cent). Another survey conducted in 2000 found that 56.1 per cent of 2,180 older adults aged 60 and above received financial support from their children; the median monthly income was about US\$205.¹¹ Thus, almost two-thirds of older adults are supported financially by their adult children or children-in-law, indicating the strength of traditional values, such as filial piety.¹² Based on a survey of 7,200 households conducted in 2001, it was estimated that 30.1 per cent (1.68m) of people aged 15 and above had financially supported their parents in the past year.¹³ For these people who had supported their parents, the median annual amount was US\$3,205 (HK\$25,000) and US\$3,846 (HK\$30,000) respectively, in accordance with the pattern of living or not living with their parents. The

total amount of their financial support was US\$2.56bn (HK\$20bn) per year.

Resources for retirement protection

Although wealth stored in Hong Kong is known to be enormous, one has to take note of the fact that income distribution here is also highly unequal.¹⁴ The majority of Hong Kong people have little savings other than the self-occupied real estate and their MPF or ORSO contributions. The margin for savings is higher among those with steady employment. Therefore, private savings for most people would not be a significant contributor to retirement protection. In a survey conducted by the government, a sample of 1,876 middle-aged adults (between 45 and 59) were asked whether they had done anything to prepare for their future financial needs after age 60 or after retirement.¹¹ About one fifth of these middle-aged adults reported that they would rely primarily on government welfare (most likely they were referring to the CSSA scheme) when they became old or retired. Reasons given included the fact that some of them were childless; in some cases their current annual income (median = US\$5,988) was too low to enable them, even through the MPF scheme, to save enough for their retirement; and most did not have any retirement protection before the implementation of the MPF scheme.¹⁵ As a result, the authors predict that the proportion of older adults who would have to be supported by the social security schemes in the next two decades will remain at more or less the current level, ie around 20 per cent of older adults.

As mentioned above, before the implementation of the MPF in 2000, 30 per cent of the working population were members of the ORSO or other

pension schemes and they were exempted from MPF contributions. In most cases, they should be able to maintain a living equivalent to about 40 per cent of their last salaries or even higher when they retire. Therefore, it is estimated that in the next twenty to thirty years, there will be about 30 per cent of retirees who would have sufficient benefits from their ORSO or pension schemes, plus in some cases their own savings, for their retirement. When the MPF schemes begin to mature, say in about 2025 there should be more retirees who will have saved enough to support themselves.

In a survey conducted by the government, 60 per cent of middle-aged adults expected their children to financially support them when they retired.¹¹ It is reasonable to predict that, in comparison with the present cohort, a similar proportion of the future cohort of older adults might also find it necessary to financially rely on their adult children. It should be noted, however, that Hong Kong's middle-aged adults have fewer children than their parents.¹¹ Slightly more than two thirds (67.3 per cent) of middle-aged adults have two children or less, whereas only slightly less than half of today's older adults (49.5 per cent) do. This means that the adult children of present middle-aged adults, as they are fewer in number, might find it more difficult to financially support their parents when they retire. As a result, we do expect children's financial support for older adults to decline in future, though the need might still be there.

Future strategies for sustainable retirement protection

Due to the recent economic downturn, the Hong Kong SAR government is now facing persistent and structural fiscal deficits; its intention is to restore the

balance as soon as feasible. Because of the fiscal deficits, it is very unlikely that the government would allocate more resources to support the needy older adults. Therefore, the immediate question is how to utilise the current annual welfare expenditure (US\$1.51bn or HK\$11.8bn) now spent on older adults in a more effective manner. One feasible solution is to combine the financial resources put in the CSSA and OAA schemes, with only the needy as the target for assistance. To ensure that older adults who are in need have enough to support them, the authors propose that the new scheme be means tested, but non-contributory. The authors further suggest that the income and asset limits allowed by this new scheme be raised — ie they must at least be higher than the existing levels of the current CSSA scheme. It is estimated that a further 30 per cent of the current number of elderly CSSA recipients would benefit, as about 25 per cent of the total expenditure for financial assistance (CSSA and OAA schemes) was accounted for by the OAA scheme.²²

This proposal may be controversial, but it is one practical way to make the existing public assistance system more effective in resource allocation and keep it financially sustainable. The strongest resistance will come from those who view receiving the OAA as a right — a value widely held by the public.¹⁶ Another survey, however, revealed that both older and middle-aged adults agree that needy older adults should have a priority in receiving OAA, especially when new resources are not forthcoming.¹⁷ By using a new name and a more generous means test, opposition might not be as great as some expect.

As mentioned above, until 2000, Hong Kong was one of the few industrialised societies without a retirement protection scheme for its

senior citizens. Even with the introduction of MPF, the majority of the future older adults will still be unable to adequately support themselves, due to the low MPF contribution rates. Since the MPF scheme in Hong Kong is still in its infancy, there is room for improvement and the authors suggest slowly adjusting the contribution rates upward in future. Furthermore, products like annuities developed by financial institutions should be provided to retirees with MPF benefits in order to ensure that they will have stable and sufficient financial support in old age.⁷

Finally, the Hong Kong SAR government must encourage people to save for their own retirement protection and maintain the filial support for elders. One way to do this is to facilitate the development of insurance schemes for health care and long-term care services in later life. To date, most of the health care and long-term care services provided for older adults in Hong Kong have their finance, directly or indirectly, coming from public revenue.¹⁷ Although the government has pledged to provide older adults with better and more adequate health care and long-term care services, it has also indicated that it has almost stretched its financial resources to the limit. Further expansion and improvement of these services for older adults must rely on a more diversified financing system. When the Working Group on Care for the Elderly produced its report in 1994, it suggested the introduction of services on a self-financing basis, with the government only assisting with capital expenses and part of the initial operating costs. Similar recommendations have been made for health services,¹⁸ and the fees for public medical and health services are also expected to increase in coming years.¹⁹

Therefore, the authors recommend that the government should make it clear

to the current cohort of middle-aged adults that it is not capable of continuing to support all older adults for their health care and long-term care services and only the needy ones will be covered by those heavily subsidised health care and long term care services. Therefore, those who are able to support themselves should prepare for their future needs in health care and long term care by paying premiums to insurance schemes as a form of private saving. Adult children of future older adults might also fulfill their filial obligations by paying premiums to their parents' health care or long-term care insurance policies and contributions should be tax-exempted as an incentive. These insurance products will not flourish if the government's policy on these issues is not made known clear and loud.

Conclusion

This paper has discussed the three pillars for retirement protection in Hong Kong in the coming three decades. Based on their observations and projections, the authors believe that the present arrangements for retirement protection in Hong Kong can be sustainable. However, modifications have to be made, which include the concentration of public social security resources on the needy older adults, the gradual continued improvement of the MPF scheme, and the promotion of preparation for self support in old age, especially with the demise of the practice of filial piety.

Finally, the authors believe that no single system will be able to provide sufficient retirement protection to all older adults in Hong Kong; they will have to find their own individual mix.²⁰ It is further believed that these discussions about the Hong Kong situation, the concept of 'the three pillars of retirement protection' as proposed by

the World Bank, will provide useful lessons for countries that have their own mix of arrangements for retirement protection but are uncertain of their sustainability.

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