Old-age Income Protection in Hong Kong:
Rethinking an Age Old Controversy
A Next Step in Public Engagement

A major objective of the Public Policy Initiatives at the Faculty of Social Sciences of The University of Hong Kong is to facilitate public engagement through informed discussion with a view to forging societal consensus on important public policy issues. On 10 November 2014, the Faculty organized an open public policy forum and a round-table session to discuss the controversial issue of old-age income protection in Hong Kong (previously titled as “retirement protection” in the engagement activities). For the purpose of public engagement, we published an Issue Brief that identifies common grounds and differences in the recognition of undesirable phenomena, diagnosis of the problems concerned, and possible policy tools for ameliorating the current undesirable situation. Following the engagement activities, we have identified main areas of consensus and proposed a policy framework for improving old-age income protection in our society for further engagement (Figure 1).
Old-age Income Protection in Hong Kong

Public Policy Forum

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Public Engagement on Old-age income protection

Old-age income protection is a classic public policy debate impinging upon sustainable development of our aging society, as well as the role of government in social development. For decades, the society has tried but with limited success so far to resolve the differences on this controversial issue, which involves a wide spectrum of ideas, interests and values. At the open public forum, we invited six experts representing varied intellectual perspectives on the issue (namely, Professor Nelson W S Chow, Mr. Chua Hoi Wai, Professor Wong Hung, Professor Y C Richard Wong, Dr. David Y K Wong, and Ms. Anna Wu) to share their views with about a hundred participants from various sectors (video recording of the forum is at http://www.socsc.hku.hk/pp/retirement-protection-events/). In the roundtable session that followed, around 25 stakeholders (including proponents of old-age income protection schemes, executive and legislative councilors, Mandatory Provident Fund Authority executives, scholars and representatives from business associations, NGOs, political party, etc.) engaged in serious discussion and shared their concerns and suggestions.

Policy Objectives to Address Social Needs

In the Issue Brief (Figure 1, Issue Brief), we discovered much common ground in recognizing the following Undesirable Phenomena.

- A significant proportion of the elderly people in Hong Kong do not have adequate financial resources to ensure their basic livelihood.
- The current systems of Mandatory Provident Fund (MPF), Comprehensive Social Security Assistance (CSSA), and Social Security Allowance (SSA) Scheme (that includes Old Age Allowance and the recently added Old Age Living Allowance (OALA)) have not been able to adequately address the social needs mentioned above and hence failed in many instance to prevent the elderly people from falling into poverty. Table 1 summarizes key features of the current systems.
- The problem has got worse and taken on immense urgency as our society is aging at a faster rate than many developed societies.
- The sense of a lack of old-age income security is widespread and not confined to the grassroots; many middle-class people also face the same problem because of longevity risks as a result of medical advancement and changes in social conditions (e.g. widening rich-poor gap, spiraling property prices and difficulties for families to provide support). The phenomenon has a negative impact on social solidarity and identity.

It is commonly not recommended that the policy be considered for the purpose of poverty alleviation.
Accordingly, the Policy Objectives should be to address the social needs above.

- There should be a policy to ensure that basic livelihood at old-age in Hong Kong is protected
- There should be systems in place that protects people from a lack of stable and adequate income at old age. A monthly amount of $3,000 to $4,000 is currently talked about in the community as the “basic” level.

Principles

The following principles, commonly identified across the spectrum of views, are proposed for achieving the policy objectives:

1. **Multi-pillar approach**
   It is recognized across the spectrum of views that no single policy tool is able to provide full protection of the basic livelihood at old-age, as it involves financial security as well as non-pecuniary support including housing, medical and elderly care service. A multi-pillar approach to achieving the policy objectives is agreed upon (see Figure 3 in Issue Brief); an example of the approach is the five-pillar model suggested by the World Bank. Whether all the five pillars should be put in place, in particular the proposed introduction of a new pillar of compulsory contribution to a social insurance scheme in Hong Kong, however, needs to be discussed.

2. **Personal responsibility and collective commitment**
   To protect the basic livelihood at old-age involves both personal responsibility and collective commitment. There is no question that both elements are important. There are ample policy proposals in public discourse that are said to be able to help facilitate citizens’ preparation and saving for their own retirement. Collective commitment through government intervention is embedded in the current collective schemes including SSA, OALA and MPA. Across the spectrum are ideas pertaining to improving and strengthening these policy tools, implying society’s recognition of the need for strengthening the role of collective commitment.

3. **Role of government in collective schemes**
   Diverged from the traditional “small government” governance philosophy, there is a common appeal to strengthening the role of government in ensuring the basic livelihood and improving income security of the elderly people in the current and new collective schemes.

4. **Fairness and Equity**
   The principle of observing fairness and equity to different stakeholders concerned, in
particular relating to the allocation of funding responsibility, is important. However, a consensus over interpretation of fairness and equity needs to be further discussed.

5. **Public acceptance**
The level of public acceptance determines to a large extent whether policy reforms or a new policy tool can be introduced. However, different stakeholders often hold different perspectives in their assessment of public acceptance of various policy tools. Hence, this is an area for further engagement in search for a consensus of an objective assessment of public acceptance.

6. **Timing**
It is agreed that in view of the aging demographics, the government should act fast. Any delays will likely attenuate the problem and leave the society with fewer policy options.

7. **Sustainability**
Any new policy in ensuring old-age income security needs to be tested objectively on its sustainability, in particular the financial sustainability.

**Scenarios of Policy Tools**

Under the policy principles, the community may move forward quickly to discuss what combinations of policy tools may be formulated to achieve the policy objectives. The following scenarios of policy reforms / new policies are mapped out for public engagement. The scenarios are not mutually exclusive. Table 2 summarizes the policy imperatives under each scenario.

**Scenario 1: SSA Reforms**

The first scenario is to substantially expand the scope and benefits of the SSA, which provide non-contributory benefits defined by the World Bank as the Pillar 0 of retirement income protection. In Scenario 1, Pillar 0 serves not only as a measure of poverty alleviation but also the provision of basic income security to all (or almost all). SSA is a suitable tool for Scenario 1 reforms. SSA is a scheme for supplementing livelihood of two targeted beneficiary groups, namely people with disabilities and the elderly in need of financial support, and is regarded by the government as separate from the CSSA that serves as a safety net. The SSA is funded by government general revenues. Please see Table 1 for the details of SSA (comprising OAA and OALA).

Scenario 1 of Pillar 0 reforms may be achieved by way of an expansion of OAA or the newer OALA scheme. For example, the threshold of OALA could be substantially lowered in order to cover a far higher proportion (up to all) of the elderly population.
Old-age Income Protection in Hong Kong

Public Policy Forum

Faculty of Social Sciences, University of Hong Kong

above the age of 65; alternatively, the level of benefits could be increased by a large amount, say of $3,000 to $4,000. Another possibility is that the age limit for OAA could be reduced and the level of benefits increased. The asset and income limits in the means-tests (if preserved for OALA or introduced for OAA) could also be set at levels to exclude the very rich.

The financial implications on the government’s general revenue in Scenario 1 will be substantial. As estimated in Professor Nelson Chow’s report\(^1\), increases in the social security schemes will not be sustainable given the government’s current revenue structure. New funding will be needed. Since the Pillar 0 scheme is non-contributory, new funding must be in the form of increases in current taxes (e.g. incomes tax, profit tax) or the introduction of new taxes, e.g. capital gains tax, goods and services tax, dividend tax. In Scenario 1, the government will take up the sole role in managing the Pillar 0 schemes and be responsible for seeking new general revenue sources.

Arguably, an advantage to pursuing Scenario 1 is that the government may afford, given the huge fiscal reserve, to implement reforms to benefit the elderly population (for some years) immediately, before seeking new funding or public contribution later. As such, public resistance to introduce Pillar 0 reforms may be relatively lower. However, the public will need to foot the bill via (probably drastic) tax reforms eventually. Securing public acceptance to new taxes is likely to be difficult.

Scenario 2: Pillar 2 reform

The second scenario is to significantly expand and reform the MPF, a mandatory and contributory Pillar 2 pension scheme. In order to leverage on the MPF to ensure basic income protection at old-age in Hong Kong, the following imperatives are proposed.

- To expand the MPF’s scope to cover non-working population, for example by setting a public fund with government contributions.
- To increase the provident fund amount, for example, by increasing the mandatory contribution rate, removing caps on contribution amount, encouraging voluntary contribution, and cancelling the setting-off arrangement for severance pay etc..
- To significantly improve the rate of return so as to increase the provident fund amount and encourage voluntary contribution.
- To significantly reduce management fees, for example, through setting a government management platform, regulatory reforms, simplifying fund choices, etc..
- To consider changing the lump sum provident fund wholly or in part to annuities.

\(^1\) The University of Hong Kong Department of Social Work and Social Administration, 2014, Research Report on Future Development of Retirement Protection in Hong Kong, 20 August 2014.
or providing options of annuities.

In contrast to Scenario 1, new funding sources under Scenario 2 are characterized by putting new monies into designated accounts rather than the general revenues. The new funding may come from three parties: government contribution to a public fund, increased contributions from employers and employees (including non-working population) respectively.

There are two main gaps in Scenario 2 that policy makers should find ways to fill. First, the current population of elderly / retirees (of about 1 million) will not benefit from a strengthened MPF. To fully cover the current and future generations, Scenario 2 needs to be either supplemented by a strengthened Pillar 0, or to designate part of the public fund in the MPF framework to better protect the elderly population today. Second, the MPF is a currently defined contribution scheme. Benefits to individual participants are subject to financial market risks; and this is one of the undesirable social phenomena identified. Consideration may be given to if certain part of the MPF could be changed into a secured defined benefit protection floor, under the auspices of a basic default scheme for all.

The reform imperatives above imply a much stronger role of government in the MPF. The government roles will include:

- Contributing government funding to the provident fund for non-working population;
- Providing a central platform to reduce provident fund management cost, facilitate portability of individuals’ pension accounts, and / or manage investment risks collectively;
- Strengthening regulation of MPF service providers, employers and employees; and
- Encouraging voluntary contribution, for example, by giving tax incentives.

Since the public contributions will go to designated individual accounts, the criticism of welfarism against Pillar 2 reforms is expected to be less forceful. However, resistance to increasing mandatory contribution will likely come from employers and employees. The cancellation of setting off against severance pay is likely opposed by business sector.

**Scenario 3: A new pillar**

Scenario 3 is to implement a new Pillar 1 which is defined by World Bank as “a mandatory first pillar with contributions linked, to varying degrees, to earnings with the objective of replacing some portion of lifetime pre-paid retirement income or savings.”

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Old-age Income Protection in Hong Kong

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The first pillar aims to address the many undesirable social phenomena that Hong Kong is facing --- risks of individual myopia, low earnings, inappropriate planning horizons due to the uncertainty of life expectancies, the risks of financial markets and the labelling effect of means-tested anti-poverty handouts. Although typically financed as pay-as-you-go, World Bank has not suggested if pay-as-you-go is the only possible financing model for the first pillars.

The imperatives of the new pillar 1 in Hong Kong should be as follows.

- **Benefits:** The new pillar would provide monthly income of say, $3,000 - $4,000; the level of benefits may be linked to individuals’ contribution amounts.
- **Scope and threshold:** The new pillar would cover all or almost all of the elderly population above a certain age to be agreed upon (say, 65). Means test would not be ruled out and if any, it would be mainly used as a mechanism to screen out the very rich.
- **New funding:** Contribution from multiple parties would be needed for designated account(s) for the scheme but not for general revenue. Government would need to contribute seed money and / or periodic contributions. Employers and employees may be mandated to pay a new tax or contribute specifically for the new pillar.
- **Risk pooling:** First pillar schemes would serve the objective of risk pooling collectively. The scheme might take the form of a social insurance with fixed benefit or defined benefit. A cross generational pre-paid fixed benefit scheme is similar to pay-as-you-go old-age pension schemes proposed by Professor Nelson Chow or advocates for universal pensions. A defined benefit plan determines retirement benefits using a formula incorporating number of working years, contribution, age of retirement, etc.) regardless of investment returns so as to manage risks in financial volatility.

The role of government in Scenario 3 will be equally strong if not stronger when compared to the first two scenarios. The government will need to initiate and manage a new scheme, provide seed money and / or periodic contributions, collect contribution and distribute benefits, and manage risks.

Given government inertia (p.4, Issue Brief), politically scenario 3 is likely to be the most difficult to achieve among the three scenarios. The financial sustainability of such a scheme is subject to demographic and political risks.
Conclusion

The title of this paper has been retitled to “old-age income protection” from the previous title of “retirement protection” so as to more accurately describe the policy issue. It is a consensus from the first round of public engagement activities that the undesirable social phenomena concerns not only the working population but the entire elderly population, and that the inadequate income protection to ensure basic livelihood at old-age is the core issue. In this paper, we recommend the three scenarios for reforming old-age income protection for the purpose of further public engagement. The recommendation is on the basis of a number of common grounds obtained from the previous round of engagement.

- There is timeliness of a solution; otherwise the population window for action will dwindle quickly.
- The coverage of people being protected should be increased.
- The income protection level should guarantee basic livelihood.
- Means-tests may be used to screen off the very rich and as an administrative procedure to ward off abuse.
- There is a need for risk pooling as that is beyond individuals’ and family’s ability to manage.

The way forward for old-age income protection policy hinges on three inter-related factors: whether stakeholders may reach a consensus (that can be built upon the basis of the common grounds proposed here), whether the government has the political will to push ahead, and how a financially sustainable proposal will be made.
### Table 1 Current Pillars for Old-age Income Protection

<table>
<thead>
<tr>
<th>Pillar 0: Non-contributory retirement income protection</th>
<th>Pillar 2: Mandatory and contributory pension</th>
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<tbody>
<tr>
<td><strong>CSSA</strong></td>
<td><strong>MPF</strong></td>
</tr>
<tr>
<td>▪ Objective: Safety net to alleviate poverty. Cover singles, families and elderly</td>
<td>▪ Launched in December 2000, the MPF now covers 2.71 million employees (including those self-employed).</td>
</tr>
<tr>
<td>▪ Means-tested (more stringent)</td>
<td>▪ Cover only working population. Housewives, homemakers are not covered</td>
</tr>
<tr>
<td>▪ $3,055 per month as a basic allowance of a single elderly aged 60 or above plus other supplemental allowances</td>
<td>▪ One-off lump sum of provident fund</td>
</tr>
<tr>
<td>▪ Labelling effect (e.g. ‘bad son’ requirement)</td>
<td>▪ Mandatory level of contribution is relatively low (5%) plus cap on mandatory contribution at $1,500 per month</td>
</tr>
<tr>
<td>▪ Fully funded by government’s general revenue</td>
<td>▪ High fees. Insufficient returns</td>
</tr>
</tbody>
</table>

**Social Security Allowance (SSA)**

Four types of SSA for people with severe disabilities or people aged 65 or above. For able-bodied elderly people, the two types of SSA are Old Age Allowance (OAA) and Old Age Living Allowance (OALA). Fully funded by government’s general revenue

**OAA**

- $1,180 per month
- Formerly known as Higher OAA. Not means-tested for all aged above 70. Notably, it is a kind of ‘universal’ benefit albeit offering a token amount and for senior elderly people.

**OALA**

- Introduced in 2013
- $2,285 per month
- Means-tested for people aged 65 or above (lower criteria than CSSA)
### Table 2  
#### Three Scenarios

<table>
<thead>
<tr>
<th></th>
<th>Scenario 1: Pillar 0 Reforms</th>
<th>Scenario 2: Pillar 2 Reforms</th>
<th>Scenario 3: A New Pillar</th>
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<tbody>
<tr>
<td><strong>Imperatives:</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Level of benefits</strong></td>
<td>Needs substantial increases in the existing benefit levels</td>
<td>Returns to provident fund need to be raised. Annuities may be considered</td>
<td>Say, $3,000 - $4,000. Maybe defined benefits and be linked to contribution amounts</td>
</tr>
<tr>
<td><strong>Scope and target beneficiaries</strong></td>
<td>Substantially lower the threshold of means test (if preserved) so as to exclude only the very rich</td>
<td>Set up a public provident fund to cover non-working population</td>
<td>For all or almost all of the elderly above an age to be agreed upon</td>
</tr>
<tr>
<td><strong>New funding sources</strong></td>
<td>Tax increases or new taxes to increase government’s recurrent general revenues</td>
<td>Government contribution to the public fund. Remove contribution caps. Increase mandatory contribution rates. Encourage incentives for voluntary contributions</td>
<td>Contribution from multiple parties: Government contribution, tax-like contribution from employers, employees New funding will go to designated account(s)</td>
</tr>
<tr>
<td><strong>Role of government</strong></td>
<td>Sole responsibility of management and in tax reforms</td>
<td>Government contribution for the public fund. Manage platform for MPF operators. Strengthen regulation, reduce admin fees</td>
<td>Initiate and manage a new scheme and risks. Government’s financial contribution. Collect contribution and distribute benefits</td>
</tr>
<tr>
<td><strong>Public acceptance</strong></td>
<td>Public resistance of Pillar 0 reforms is less if tax reform will only be considered later</td>
<td>Resistance to increasing mandatory contribution is likely from employers and employees. Canceling setting off against severance pay is likely opposed by business</td>
<td>Introducing a new pillar that requires public contribution to a new pension scheme will likely face a lot of public opposition</td>
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