Issue Brief: Retirement Protection in Hong Kong

Public Policy Forum
Faculty of Social Sciences, University of Hong Kong

Retirement Protection in Hong Kong: Rethinking an Age Old Controversy

Retirement protection has been a controversial issue for decades in Hong Kong. It impinges upon sustainable development of our aging society, as well as the role of government in social development. This is a classic public policy debate that involves a wide spectrum of ideas, interests and values in our society. The prospect of a consensus seems remote. This Issue Brief aims to rethink the retirement protection issue using the framework of public policy analysis, with reference to ideas and views from experts across the spectrum in the debate.

The Issue Brief focuses on problem definition as an approach to identifying common grounds and thus opportunities for consensus building. A problem is a formulation of the essence of an undesirable phenomenon that provides an anchor point for possible policy actions. In rethinking the problem, we have interviewed experts representing the wide spectrum of intellectual thinking and perspectives on the retirement protection issue in Hong Kong. They are in alphabetical order: 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. From our analysis, despite different ideologies commons grounds can be found in the way the problems are construed and defined.

Undesirable phenomena

(a) Basic livelihood at old age
A starting point is whether livelihood at old age is adequate in Hong Kong. If not, how pervasive the undesirable situation is. Figure 1 depicts graphically the common grounds and differences in opinions.

Lacking stable financial resources: All experts interviewed agreed that many elderly people in Hong Kong do not have adequate private savings and lack stable financial resources to pay for basic living expenses due to factors out of their control. The current elderly generation went through wars, economic downturns and financial market fluctuations throughout their work life. Many were low-wage earners and could barely meet their ends, not to mention savings. Longevity due to medical advancement is a mixed blessing. Even middle-income pensioners such as retired teachers do not have financial security facing rising health care and living costs. The experts either are convinced by data or by impression agreed that the undesirable phenomenon is pervasive and will aggravate as a result of an aging population.

System failures: Experts across the spectrum identified similar system failures leading to many elderly people falling through cracks. The forced saving system, Mandatory
Provident Fund (MPF), was not designed to ensure sufficient financial resources for employees or cover non-working population such as housewives. Many elderly lacking in stable income did not apply for the safety net (Comprehensive Social Security Assistance, CSSA) due to labelling effect, in particular the “bad son” statement requirement. The Old Age Allowance (OAA) and the Old Age Living Allowance (OALA) could only be supplementary support, like giving fruit money, on top of a basic living income.

(b) Constraints
The experts from across the spectrum recognized very similar undesirable phenomena in the policy context.

Aging society and longevity risks: There is a consensus that the Hong Kong society is aging and serious longevity risks exist. It is difficult for people to save enough or plan with certainty for their retirement. The scale of the issue and the drain on public finance are expected to increase tremendously in the coming years.

Macro political environment: Strong government commitment is a must for leadership in the controversial retirement protection issue. Nonetheless, the consensus is that Hong Kong SAR faces serious constraint of weak governance as a result of low public trust of the SAR government and dysfunctional politics.

Timing: It is generally agreed that the undesirable phenomenon aggravates with time. An expert suggested that demographic trends dictated urgency to introduce collective risk pooling within the next five years, after which the dependent population would start surpassing the working population and render any such schemes non-viable.

Components of basic livelihood: Experts generally agreed that the current state of housing ownership and elderly health care were undesirable, but they differed on emphasis. Some thought that difficulty in housing asset acquisition was a bigger problem than inadequate incomes. Others thought that home ownership would not be of much help to the elderly lacking in stable incomes, and they needed to spend extra on maintenance. All agreed that the increase in healthcare costs was inevitable and would be a big drain on public and private individual finance.
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Policy Formulation

Diagnosis

The experts have commonly diagnosed several intertwined factors for the undesirable phenomena, but differed on relative importance and reasoning. Figure 2 depicts graphically the common grounds and differences in views.

(a) Systemic disparity: The consensus is that serious disparity between the have-nots and deteriorating social mobility are the root causes to poverty and financial insecurity. The undesirable situation discussed is aggravated by the aging population. Some particularly pointed out spiraling property prices as the main culprit, drawing most private assets for home purchase, leaving minimal savings for old age. Others thought that it was not equitable that housewives and homemakers were not covered by any retirement scheme.
(b) **Market failure:** It is agreed that the market fails in many instances to ensure that people can save enough for themselves. Some attributed such market failure to the perverse incentives posed by CSSA and MPF, and believed that the situation could be fixed. Others thought that, in addition to the MPF issue, the market lacked incentives to pool risks collectively to address the inadequacy of financial resources for old age.

(c) **Policy failure:** The market failure is often induced by policy distortions. Some highlighted and others agreed that the MPF was badly designed and biased towards the banking sector and employers such that the MPF was costly yet produced low returns and inadequate pensions. Other experts added the policy failure to cover a significant proportion of population in either the MPF or the CSSA.

(d) **Government inertia and inadequate incentives in policy making:** The government has failed to address the market and policy failures for a long time. The issue is vested with diversified interests and extremely difficult to build consensus and galvanize support. Funding for retirement protection could create an immense burden on public finance. There is an apparent lack of political incentives for politicians, policy makers and the administration to take on the issue when finding a solution demands too much effort. Inaction however leads to further deterioration.

![Figure 2: Diagnosis](image-url)
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Parameters and policy levers

There are two schools of thought on solutions. One school suggests that the forced saving system should be reformed to strengthen the role of personal responsibility, and that a policy be in place to facilitate home ownership among low income elderly and families to enhance the individual and family capacity to save for old age. The other school calls for a new compulsory contributory scheme that pools risks collectively and distributes pension to all, or almost all, in line with World Bank’s recommended Pillar 1 (a mandatory and contributory scheme) of old age income support. On surface, the two schools contrast greatly. Nonetheless, it is possible to unpack different policy formulations into parameters and policy levers, and to identify room for dialogue. Figure 3 depicts graphically the common grounds and differences in opinions regarding each pillar in retirement protection policy.

(a) Holistic approach / Multi-pillar Model: All experts across the spectrum agreed that the retirement protection policy must adopt a holistic approach or multi-pillar model. Many of the experts interviewed referred to the World Bank’s 5-pillar model: Pillar 0 - non-contributory social assistance scheme (CSSA, OAA, OALA in Hong Kong), Pillar 1 - mandatory and contributory scheme which is typically pay-as-you-go (no such pillar in Hong Kong at present), Pillar 2 - mandatory individual savings scheme (MPF in Hong Kong), Pillar 3 - voluntary saving scheme, and Pillar 4 - non-financial support for home ownership, health, and other services. Currently, Pillar 1 is absent in Hong Kong.

(b) MPF reforms: The consensus is that MPF may be reformed to improve Pillar 2 protection. Commonly agreed reform areas include: the government’s role (to take back the MPF platform) to improve its economies of scale so as to reduce management costs and simplify fund choices for employees, the setting off arrangement against severance pay, contribution rates and regulation. It is also agreed that it will not be fair to existing MPF contributors if part or whole of their MPF lump-sum entitlement is transferred to building a Pillar 1 scheme. Some experts thought the society may discuss whether the MPF of new contributions should be reformed to be a policy lever for building a new pillar, e.g. by providing an annuity option. Some thought that Government should consider other MPF reforms to expand its coverage, to increase contribution, or to introduce a new option of receiving annuities.

(c) Safety net and public finance: The experts differed on whether Hong Kong should or can rely on the CSSA alone to cope with the aggravating undesirable phenomena, and whether the assets criteria should be relaxed to cover more people. Some experts suggested that even if the cut-off point were lowered there would still be gaps in the safety net. Regardless of their positions on CSSA, all the experts
interviewed recognized that financial burden would increase given the ageing trend. Since the safety net is funded by general revenues, experts agreed that tax increases (e.g. profits tax) and / or new taxes (e.g. GST, capital gain tax) should unavoidably be considered.

(d) A new pillar? Some opposed to any pay-as-you-go scheme that would give universal benefits, and believed that such schemes would not be sustainable due to the population projection. Others called for introducing a new pension scheme to cover increasing elderly population and this is more equitable.

- **Criteria of coverage and means test:** Some experts considered means-testing as a must to set criteria that only people in need should receive welfare. Other experts suggested means tests for screening out the richest so that 80%-90% of the population would be covered. An expert suggested that alternatives could be developed to replace costly means tests, e.g. a social solidarity fund to encourage rich people to donate their entitlements.

- **Funding structure:** Experts agreed that there could be many different funding combinations. Opinions differ on who should bear how much – the business sector, the middle class or the grassroots – for any new retirement protection initiative. Some were in favour of redistribution of income so that the business and richest should pay more, e.g. a progressive profits tax. Some proposed a fixed percentage of payroll tax that would eventually place relatively more burden on the middle class. Some suggested that the government should bite the bullet to commit a bigger share using its reserve and general revenue. Different proposals reflect experts’ different assessment on what funding structure is more equitable and more politically acceptable.

- **Risk-pooling and pay-as-you-go:** Some opposed to pay-as-you-go schemes as a matter of principle. They believed that such schemes lead to perverse incentives and would not be sustainable. Other experts, however, thought that collective risk pooling would be needed to provide retirement income security in order to ease out the risks from financial market volatility and uncertainty over lifespan.

(e) Housing assets: Some suggested focusing more on facilitating asset acquisition (so as to strengthen Pillar 4) and proposed to giveaway public housing units to tenants. When elderly and families own housing assets, they may do reverse mortgage to obtain incomes. Others, however, believed that home ownership would not reduce the undesirable phenomenon of lacking stable incomes at old age.

(f) Public acceptance and engagement: The experts agreed that it is a divisive topic, but they assessed differently how various stakeholders would respond. Some thought that the banking and financial sector had vested interests and would hinder MPF reforms. Some considered the business sector as the main opposing force to any new contributory schemes or tax increases. Some found the community’s general mindset against welfare a stumbling block to any new schemes with income redistribution. The public’s dissatisfaction about the MPF would also be an obstacle if any new contribution is to be proposed. An expert pointed out that engagement is
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therefore a must in the new policy making.

Figure 3: Policy Tools

Value Choice

The experts interviewed represent the spectrum of ideologies in Hong Kong. One end of the spectrum puts the primary value on personal responsibility and market. The government’s role should be minimal and limited to providing public good and should intervene only when the market fails. Any policy of “universal benefit” will produce perverse incentives leading to more market failures. On the other end is the belief that society should ensure dignified livelihood for all and strengthen social identity, social solidarity and social harmony. (It is also noted that there is an opinion in society that a
basic income guarantee at old age is citizens’ right). In between the spectrum, there is a belief that public policy making should be evidence based and pragmatic, and address equity issues rather than following purity of any ideology. “Equity” is another question subject to a debate on different interpretations and values, in particular on whether (or how much) there should be income redistribution and/or inter-generational redistribution. Indeed, the beliefs in the role of government and the basis of policy making are contrasting across the spectrum. Yet, they may not be totally contradictory if we unpack the problems into specific policy parameters for examination as suggested in this Issue Brief.

**Way Forward**

Across the intellectual spectrum on the issue of retirement protection, we have identified common grounds in

- Recognizing the undesirable phenomenon that many people lack adequate stable financial resources at old age; and
- Identifying constraints including ageing society, longevity risks, low trust in government, and that the current state of home ownership and elderly health care is also undesirable; there is an urgency in timing for action.

There is a unison that the government must act sooner. The experts share some common thoughts about the diagnosis, in particular the consensus in the root causes of disparity between the haves and have-nots, social immobility, the undesirable MPF design and inadequate incentives in the policy making and administrative system. There are, however, differences over relative focus in the diagnosis, and how the problems should be fixed. The most prominent difference is on whether there should be a pay-as-you-go scheme that gives benefits to everyone. Nonetheless, the differences may not be as uncompromising as they first appear if we unbundle the analysis into parameters and policy tools. We look forward to examining at the Forum possible ways to build consensus:

- to set boundaries of policy parameters (e.g. criteria of coverage, annuity or lump sum, funding options),
- to explore policy windows, and
- to obtain public acceptance in the light of varying interests and views of different sectors,

with the ultimate objectives of ameliorating the undesirabilities of the current state of retirement protection and improving the basic quality of livelihood at old age in Hong Kong.