Pension coverage and pension freedoms: Lessons from Hong Kong

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Abstract

Pension reforms in the UK are transforming the way that citizens, especially those who lack access to an employer funded pension scheme, save for retirement. The rollout of the Workplace Pension, rising state pension ages, and delivery of the basic State Pension have the cumulative effect of both extending pension rights to all workers and shifting risks and responsibilities from government and employers toward individuals. To see how these pension reforms play out, it is worth looking overseas to Hong Kong whose pension infrastructure is similar to the one emerging in the UK. While pension access has indeed been made universal in Hong Kong, old age poverty remains an issue with pension replacement rates lower on average than the UK. Like their UK equivalents, many Hong Kong working poor are having to delay retirement due to lack of savings and, despite Hong Kong employers complaining of skills and labour shortages, older workers are at risk of being pushed out of work before they can afford to retire. The Hong Kong experience points to the importance of employment protections for older workers to be strengthened in tandem with pension reforms so that older workers can better plan and manage their retirements.

Pension reforms in the UK and Hong Kong

The landscape of pension savings is changing in the United Kingdom (UK) as government had introduced “pension freedom”; established the basic State Pension; and started rolling out the new Workplace Pension. All of these reforms are occurring at a time when the State Pension Age is rising, with the Treasury planning to raise it to 69 by the mid-2040’s. At the same time, we have had employment regulations prohibiting workplace age discrimination for just over a decade and, since 2010, mandatory retirement is mostly unlawful. How then will these changes shape the future of retirement, particularly within the context of an ageing population and heightened concerns over economic insecurity in later life?

A glimpse into the future can be had by looking at the experience of the Hong Kong where similar pension reforms to the UK were introduced not long after the handover of the city to China. Under the “one country two systems” constitutional principle, Hong Kong maintains a relatively liberal economic system similar to the UK’s in which the welfare state provides little more than a basic safety net and the employment contractual relationship is flexible. The Hong Kong population is ageing faster than the UK’s with the 65+ population projected to rise 260% by 2041 and has one of the lowest fertility rate globally (only 1.1 births per woman of fertile age).

The Hong Kong workforce is as much age stratified as the UK’s. The manufacturing workforce is dominated by people over forty years old as jobs are exported to adjoining Shenzhen while younger workers dominate the growing finance and service industries. Moreover, while workers from mainland China can help address some of the labour shortages facing the Hong Kong economy, especially in health and social care, economic migration is as much a politically contentious issue as it is in the UK. The economic and social challenges facing the UK and Hong Kong therefore are strikingly similar.

A forerunner to the Workplace Pension?

Like the UK, Hong Kong features a residual first-tier pension. The Old Age Pension, known colloquially as “fruit money”, is less than 60% of the absolute low income threshold (similar to the UK state pension). By 1995, occupational pension coverage was limited to about one-third of the overall workforce- mainly people working for large businesses or the public sector. In response to World Bank recommendations on building a universal second tier pension system, the Hong Kong legislature passed the Mandatory Provident Fund (MPF) Ordinance establishing a compulsory defined contribution pension system for workers who lacked access to an employer provided pension. MPF is a non-redistributive defined contribution scheme in which the individuals and their employers pay into the employee’s retirement account. MPF schemes can be employer based, across industrial sectors (to provide pension access to people working for small businesses) and for self-employed workers.

MPF has a number of similarities to and differences with the UK Workplace Pension which is now being rolled out. First, both are defined contribution and non-redistributive pension schemes in which funds are managed by financial service providers overseen by a public trust. Second, although workers are auto-enrolled into the Workplace Pension, with MPF, both employers and employees are mandated to pay into the scheme. By 2018 when the Workplace Pension is fully rolled out, pension contributions will total 8% (4% employee contribution, 3% employee contribution; and 1% government contribution in the form of tax relief based on annual salaries of between £5,824 and £42,385 per year). MPF has a higher total contribution rate of 10% (5% each from employer and employee based on a salary of up to HK$20,000 or about £2000 per month). Third, both schemes have pension ages of 65 with the option of retiring as early as 60. Finally, both schemes are portable and meant to complement rather than replace occupational pension schemes which are set up and managed by employers. Also, with MPF, retirees draw down their pensions as a lump sum and have “pension freedoms” as to how they invest and/or spend their retirement incomes.

Has MPF improved retirement savings?

The answer is mixed. Yes, the scheme has succeeded in covering the vast majority of the workforce (97% of all applicable workers belong to a second tier pension scheme). However, although the OECD has found that the UK pension system has the third smallest net income replacement rate in Europe (41.8%), it is still higher than that of Hong Kong’s (36.8%). Overall household savings in Hong Kong is eight times that of the UK’s (27% versus 3.4% family income) which should be taken into account when comparing retirement income for the two sets of retirees.

Perhaps more worrisome for a UK audience is the near disappearance of employer managed pensions in Hong Kong. In 1992, over a million employees were members of an employer provided pension scheme. Now, that figure is 383,000. By 2000, final salary pension schemes were closed to new employees in the civil and public services, and today only 3.5% of Hong Kong workers contribute to a defined benefit pension. This is, for the most part, people in legacy closed pension schemes although some big employers like HSBC still offer some form of income based pensions.

The net effect of pension reforms in Hong Kong have been two-fold. On the one hand, second tier pension coverage has been made nearly universal (a primary goal of the UK government). On the other, responsibility and risk for retirement savings has shifted from employers and the State to the individual. In the UK, there are concerns that the added National Insurance contributions resulting from the phasing out of “contracting out” will persuade employers to close their occupational pension schemes to new or even existing employees, and the Workplace Pension may seem to be an administratively attractive alternative to them. However, both MPF and the Workplace Pension were only meant to provide a modest income replacement rate which is far below what is provided by most employer funded schemes in the private or public sectors.

Can older workers delay retirement?

By shifting responsibility for retirement savings onto the individual, some pressure has been removed from both employers and the State to enable workers to delay retirement. Older male employment rates are comparable: 14.3% and 13.5% of men 65+ are still in work after 65 in Hong Kong and the UK respectively, but only about a third of Hong Kong women 55-64 are in work. Like the UK, low skilled workers in Hong Kong are at risk of being pushed out of work early.

Both the Hong Kong legislature and Equal Opportunities Commission have tried three time in this millennium to introduce age discrimination regulations to complement those covering gender, disability, race and family status. Each effort has met with resistance from businesses despite the fact that the business community complains of skills and labour shortages which can be solved by older workers who are willing and able to work longer. Even the Civil Service, which last year raised its mandatory retirement age from 60 to 65 was unwilling to extend the new retirement age to existing civil servants.

Will the UK follow Hong Kong towards a more individualised retirement landscape? The UK does have stronger unions than Hong Kong and there would almost certainly be more resistance from them to closing existing occupational pension schemes, especially in the public sector. Further, age discrimination regulations and the abolition of the default retirement age have had cross party support in the UK. However, there is still relatively little support for older workers, especially those who have been displaced through redundancy or health reasons, in maintaining their employability.

The Workplace Pension was a great step forward in helping people without access to an occupational pension to save towards retirement. However, the experience of Hong Kong shows that government and employers need to actively support older workers both in terms of maintaining employability and sufficiently saving toward retirement in order to prepare them for longer work and retirements.

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