

# Life After Retirement: A Comparison of the Social Security Systems in Hong Kong, Japan and Singapore

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Most developed nations have devoted much effort to implement a social security system. In Asia, Japan and Singapore are the two pioneers in establishing a nationwide social security system. Singapore introduced the Central Provident Fund (CPF) in 1955, whereas Japan launched a national pension system in 1961. The former is a forced saving system managed by the government, whereas the latter is a PAYG (pay-as-you-go) scheme (i.e., retirees receive pension payments collected from workers' taxation). Both systems have been relatively successful, representing two different social security models in Asia. Hong Kong has chosen a different model and started its Mandatory Provident Fund (MPF) in December 2000. This article provides a critical review of the implementation and impact of the MPF in Hong Kong. It also compares the Hong Kong model with the Singapore and Japanese models to identify the characteristics of the MPF and to find clues to improve the current MPF.

## **The Pros and Cons of the MPF in Hong Kong**

The MPF is a compulsory pension system which is employment-related and privately managed. Employees aged between 18 and 65 are required by laws to participate in the MPF. The employer and the employee each contribute 5% of the employee's relevant income to the MPF. MPF members withdraw their account in a lump sum at the retirement age of 65. The MPF system provides basic financial security for working citizens in Hong Kong upon retirement.

The MPF is an important part of structural reform launched by the Hong Kong government in dealing with economic and social changes. The time was right for Hong Kong to establish a formal retirement protection scheme. Due to demographic (i.e., aging population), financial (i.e., low taxation rate) and political (i.e., non-intervention tradition) reasons, a private pension scheme is considered more suitable for Hong Kong than the PAYG and CPF schemes.

Due to globalization and economic downturn, it has become a global trend that governments downsize their bureaucracy and reduce or privatize their functions in order to cut costs. The state-controlled PAYG and CPF systems are not in line with this trend. By introducing the MPF, the Hong Kong government will save financial resources on social security. The Hong Kong government, the largest employer in Hong Kong (which employs about 5.5 % of working population or 185, 000 employees), will save about 20% of

its spending on the retirement package for civil servants. The MPF will save the government even more in the long run, because the government can gradually reduce its role in providing various forms of social security, such as the assistance for the needy (Comprehensive Social Security Assistance Scheme) and the allowance for the elderly (Social Security Allowance Scheme).

Population aging has become a serious social and economic problem in developed societies. Hong Kong is no exception. In 2011, 13.5% of its population was over 65. It is said that the proportion of people aged 65 or above will increase to 27% by 2033. Hence, without structural reforms in social security and social welfare, the Hong Kong government will be troubled by expanding welfare payments. The PAYG system is not suitable for aging societies like Hong Kong because it is unfair and unsustainable for current workforce to pay for the pensions for a larger number of retirees. The CPF is not chosen because the Hong Kong government does not want to get involved in the management of the funds. The MPF is a key measure to transfer a part of the costs for social security and social welfare from the government to the people. The government is the sure winner of the system, since it does not contribute to the premium or manage MPF funds. It is believed that in the future when the MPF system matures, most people will support themselves after retirement and thus will rely less on the government.

The MPF can benefit the working population. It provides a basic retirement protection for the workers and makes people aware of the importance of having a retirement plan. Before the introduction of the MPF, only one-third of the workforce of 3.4 million people in Hong Kong were under some kinds of retirement schemes. Now, the ratio has increased to 86% (of which 63% are MPF members). The MPF helps people save and earn when privately managed trust funds gain profits over a long period of time.

Ideally speaking, the MPF can strengthen the Hong Kong economy. The competition between trust funds and the investment of the MPF in the stock and bond markets can stimulate the local economy, in particular the financial services sector. More money is circulated in the finance market and new jobs are created. Currently, about 30,000 persons are working for MPF-related jobs.

The MPF is not a perfect system. It has its limitations and shortcomings in design and implementation.

First, the MPF is insufficient to ensure a good life after retirement. It only provides at best the most basic retirement protection for the workers. Since the contribution rate is too low (only 5% each from the employee and the employer), an average worker in Hong Kong with a monthly salary at \$10,000 HKD, after working for 30 years, will get only \$500,000 at the retirement age of 65. If he/she lives to 82, the average life expectancy in Hong Kong, he/she can only have \$2,450 a month to spend after retirement. Hence, MPF alone is definitely not enough, and it should be supplemented by personal savings and insurances as well as social security assistance schemes from the government.

Second, the MPF only provides retirement protection for the working population. The system will take twenty to thirty years to function fully (i.e., when the first group of MPF members retire), and thus it may be useful to the current young workforce but not the middle aged and the elderly. The Hong Kong government should establish a supplemental social security scheme for people excluded in the MPF. If this supplemental

scheme is not established, at least the comprehensive social security assistance scheme and the social security allowance scheme should be continued to operate.

Third, the MPF is managed by a large number of private trust funds (mostly under major banks, securities firms and insurance companies), used to invest in stocks, currencies, government bonds, equities, and bank deposits. Hence, the MPF system encourages the entire population to invest. Before the MPF, only 4% of the Hong Kong population invested in trust funds. After the MPF, almost all workers have become investors. The government seems to encourage the people to be aggressive in the MPF investment. MPF members are allowed to invest 100% on stocks. There is no way to guarantee profits in the stock market. MPF-related funds had a poor start in 2001. In 2001, 60% of them experienced negative growth. In particular, stock funds marked an unimpressive 5-8% loss. The investment performance of MPF for the first ten years (2001-2011) was a disappointing 5.5% increase, a figure lower than the inflation rate.

It is very difficult for the Hong Kong government to supervise these MPF-related funds (more than a hundred). If bankruptcy or illegal conduct occurs, it will bring loss to MPF members. An indemnity insurance and compensation fund have been set up to protect MPF members. In the worst-case scenario, as the final guarantor, the government has no choice but to step in and even use public money to restore confidence.

Fourth, the MPF benefits mostly the government, financial services sector and big companies but not necessarily the general public. It saves the government and big companies millions of dollars. Before the MPF, the government and big companies offered more generous pension schemes for their employees. Usually, the employers contributed an extra 10-20% of employees' salary as premium. Now, their contribution rate was cut down to only 5%. It creates business opportunities for the financial services sector. Win or loss, MPF-related funds charge their members 1-2% of their account as management fee that is enormous, considering the size of the funds.

On the contrary, workers and small and middle-sized companies feel that they gain little in the MPF. Before the workers enjoy positive results of the system, many have already suffered. Many workers have lost their more attractive retirement schemes and benefits. Some employers cut their employees' salary to make up for the 5% contribution or force their employees to become self-employed (self-employed workers pay their own 5% and enjoy no public holidays or medical benefits). Small and middle-sized companies (constitute more than 90% of all companies in Hong Kong) suffer. Many did not offer any pension schemes for their employees and now they have to increase their labor costs by 5%. In times of the economic downturn, this 5% has made life more difficult for small and middle-sized companies. Hence, the reception of the MPF in Hong Kong has been relatively critical among general public and mass media.

### **A Comparison of the MPF with the Social Security Systems in Japan and Singapore**

In the first place, compared with the MPF, Singapore's CPF and Japan's national pension system are relatively large-scale and sophisticated. Like the MPF, the CPF is also a scheme for workers. It is, however, much larger in scale and more comprehensive in functions. The CPF is a mandatory saving system. The contribution rate for employees under 55 and their employers is 20% each which is four times higher than that in the

MPF. The CPF is multi-functional. It not only takes care of member's retirement, but also home purchase, education as well as medical and life insurances.

The national pension system in Japan is even more ambitious than its Singapore and Hong Kong counterparts. It puts every Japanese, not only the working class, under social security protection. All Japanese citizens over 20 (including the unemployed, self-employed and students) have to pay the premium for the basic national pension (kokumin nenkin). On the top of the basic pension, workers join an income-related supplementary pension scheme, employee's pension (kosei nenkin). The premiums are shared by employees and employers on a fifty-fifty basis. This two-tier system makes sure that everyone will be entitled to acquire pension payments at the age of 65. The national pension system also includes medical and life insurances.

Second, MPF in Hong Kong is managed by private firms (20 trustees that run more than a hundred MPF-related funds) endorsed and supervised by the Hong Kong government through the MPF Schemes Authority (MPFA). This practice is in agreement with the *lassie-faire* (non-intervention) tradition championed by the Hong Kong government. This is cost-effective. Competition among private firms increases efficiency and reduces costs. The Hong Kong government does not have to spend money on the management of the MPF. Its jobs are to supervise private firms that manage MPF-related funds and to regulate and monitor the operation of the MPF system.

In Singapore and Japan, social security funds are under tighter control from the governments. In Singapore, the CPF Board manages the funds and delegates part of the management responsibility to a number of private and semi-official firms (29 insurances /trust funds companies and five banks). Interest (2.5% to 3.75%) is guaranteed and the management fee is low. Almost all CPF funds are used to purchase Singapore government bonds. Thus, the return is secure but modest. The government has full control of the CPF and uses it for whatever purposes it wants. In Japan, the Social Insurance Agency under the Ministry of Health, Labor and Welfare is put in charge of national pension. Premiums (or taxes) collected are not used for investment but to pay for the retirees. In other words, the working generation is paying for the retiring generation. Although in both Singapore and Japan, the governments do not directly contribute to the premiums, they have to maintain a huge workforce to manage, regulate, monitor or supervise social security funds. They do gain political credits. Since Singaporeans and Japanese contribute so much on national social security schemes, they tend to be politically conservative and support the existing political system lest any dramatic political change will jeopardize their retirement schemes.

The Singapore and Japanese models provide good references for Hong Kong to reform the current MPF. First, the MPF should increase its functions beyond retirement protection, but also includes medical and life insurances. Second, to make the MPF works as a sufficient social security mechanism, the contribution rate should be increased substantially (at least to 10% each from the employee and the employer as in the case of Chile). Some flexibility should be added. For instance, the contribution rate can be lowered in bad economic years. Third, the MPF should not be allowed to invest solely in stocks and other high-risk items. A minimum return and interest should be guaranteed.

To conclude, the MPF is a new experiment in Hong Kong and it is far from being

perfect at the present stage. It does provide a basic framework for retirement protection and seems to be the best option for Hong Kong. The Japanese and Singapore models provide clues for Hong Kong to make the MPF more comprehensive, flexible, fair and sustainable.

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