

**Response to the suggestion for setting up  
a mandatory unemployment insurance system in Hong Kong**

<b>Content</b>	<b>Paragraphs</b>
<i>Summary</i>	<i>(pages i – iii)</i>
Introduction	1 - 2
Intended purposes and key features of an unemployment insurance system	3 - 11
Illustrative calculations on insurance premium and benefit pay-out	12 - 14
Purported merits	15 - 20
(a) Elevation of social welfare	15
(b) Enhancement of economic efficiency	16 - 17
(c) Caveats in the purported merits	18 - 19
(d) Relevance to Hong Kong	20
Drawbacks	21 - 33
(a) Pressure for income redistribution	21 - 27
(b) Inducement for unemployment	28 - 31
(c) Systemic risk of insolvency	32
(d) Resource wastage in checking against abuse	33
Common trends in OECD	34 - 35
Conclusion	36 - 39
Annex Tables 1-8	

## **Response to the suggestion for setting up a mandatory unemployment insurance system in Hong Kong**

### *Summary*

The primary objective of unemployment insurance (UI) is to help the unemployed persons to tide over short-term financial hardship, by providing transitory income during the spell of unemployment.

2. Advocates argue that UI could help to engender social stability and enhance efficiency of the labour market. More specifically, it is considered that UI may help ease social distress, where the social safety net is deemed financially inadequate for those who are unemployed. Also, it is considered that UI may help prevent those unemployed from being forced by short-term financial pressure into accepting unsuitable job offers or forgoing training opportunities.

3. UI commonly operates in a mandatory form and is supposed to be self-financing. Insurance premia are regularly received from employers, employees or some combination of both, so as to meet the insurance claims and cover the administration cost. The eligible claimants for UI should be involuntarily unemployed, with prior contributions to the insurance fund, and with recognised proofs on undertaking job search and/or training during the benefit period.

4. On its premium contribution, UI is tantamount to a payroll tax. Based on a hypothetical UI system for Hong Kong, it is estimated that a uniform insurance premium at 0.2 - 1.0% of labour earnings would have to be levied on both employers and employees, or 0.5 - 2.0% if the premium is to be borne by a single party. Yet the premium actually required would most likely be higher, due to possible abuse and fraud which would raise the pay-out provision, the cost of administration, and the cost of having a seed fund or buffer fund to cushion against uneven pay-outs amidst fluctuations in unemployment.

5. The purported merits of UI are considered to be of limited relevance in Hong Kong's context. A considerable proportion of lower income households do not have members who are employable or are in search of jobs. For those poor households in need of help, the existing Comprehensive Social Security Assistance (CSSA) system renders an effective cover.

6. Nor is UI an equitable system, as it tends to redistribute income from the less frequently unemployed to the more frequently unemployed. Currently around one-third of the unemployed people in Hong Kong belong to higher income households, yet under UI these people would also be at the receiving end of the cross-subsidy.

7. With a high degree of labour mobility and only modest cost on job search, the efficiency gain from better job match that is said to emanate from UI would be at best marginal, and at worst dubious. As to consumption smoothing by UI, household savings have a similar function of tiding over contingencies or temporary income shortfalls.

8. Moreover, the UI system is prone to aggravating the problem it is meant to tackle. If upon receipt of the UI benefit, the out-of-work income exceeds the in-work income, work incentive would be dampened. Higher and more protracted unemployment would then ensue. The problem could be accentuated by other possible adjustment processes on the part of employers, such as shifting to less labour-intensive production methods and having more temporary lay-offs of the fringe workers in slack times.

9. There is likely to be a practical problem in sustaining financial viability of the UI system over the longer term. As a mandatory system, it is not possible to exclude people with a higher unemployment risk from UI. Nor is it amenable to charging them added insurance premium. On the other hand, people with a lower unemployment risk can be expected to strive for exemption from the system, or else to press for reduced insurance premium. Coupled with the moral hazard problem or the tendency for abuse, this could place much strain on financial resources in the system.

10. Over the past decade or so, OECD member economies have increasingly oriented their policy emphasis towards employment enhancing measures, and away from income subsidy measures. On UI, many of them have initiated moves to tighten up the eligibility criteria and/or trim down the benefit levels. Some have set to go even further, by shifting away from the wage-linked UI system towards the means-tested social assistance system.

11. In the case of Hong Kong, the well-established CSSA system provides basic income support to those in need. Also, the retrenched workers are entitled to the statutory provisions of severance pay and long service payment. In addition, there are ample training and re-training opportunities and efficient employment services to help the people out of job to re-enter the labour market. This combination of provisions and programmes should have provided an adequate safety net, without unduly affecting the incentive to work and to hone the skills.

-----

# Response to the suggestion for setting up a mandatory unemployment insurance system in Hong Kong

## Introduction

At its meeting on 13 June 2000, the Legislative Council Panel on Welfare Services discussed the comparative study reports on unemployment-related benefits systems compiled by the Research and Library Services Division (RLSD) of the Legislative Council Secretariat<sup>(1)</sup>. During the discussion, the Panel requested the Administration to examine the feasibility of setting up an unemployment insurance system in Hong Kong. At its meeting on 10 October 2000, the Panel further requested that the issue be followed up by the Legislative Council Panel on Manpower.

2. This paper sets out the Administration's response to the suggestion, in the light of its potential implications for the labour market and the economy at large. Here the suggestion is taken to pertain to a mandatory system<sup>(2)</sup>. A broad discussion of the objectives and key features of the

- 
- (1) Published in June 2000, the comparative study reports compiled by RLSD of the Legislative Council Secretariat cover a broad comparison within the Organisation for Economic Cooperation and Development (OECD) and then more specifically amongst a number of individual economies within and outside OECD including the United States, the United Kingdom, South Korea, the mainland of China (the Mainland), Taiwan, Malaysia, Singapore and Hong Kong. The reports also cover the conventions and recommendations of the International Labour Organisation (ILO) related to unemployment benefits.

*Research and Library Services Division of the Legislative Council Secretariat, a series of study reports on "Unemployment-related Benefits Systems", June 2000. The series includes specific reports on "Overall Comparison", "the Organisation for Economic Cooperation and Development", "the International Labour Organisation's Recommendations", "the United States", "the United Kingdom", "South Korea", "the mainland of China", "Taiwan", "Malaysia", "Singapore" and "Hong Kong".*

- (2) In Hong Kong, there is no impediment by the Government to commercial insurers setting up unemployment insurance schemes. However, such schemes being run by the private sector do not appear to be forthcoming. Advocates for unemployment insurance see this as a market failure, thus requiring statutory measure by the Government to establish a broad coverage system. In the context of this paper, an unemployment insurance system as suggested for Hong Kong is therefore deemed throughout as a mandatory one.

unemployment insurance system, complemented with illustrative calculations on the insurance premium required against the corresponding benefit pay-out, precedes an assessment of purported merits against drawbacks leading to a conclusion on the suggestion.

### **Intended purposes and key features of an unemployment insurance system**

3. Unemployment insurance (UI) is primarily aimed to help the unemployed workers to tide over short-term financial hardship stemming from job losses, by providing transitory income during the spell of unemployment. From a social perspective, it is intended to help ease social distress in the community, specifically where the social safety net is deemed inadequate to protect those who are unemployed yet capable of working. From an economic perspective, it is intended to prevent the unemployed persons from being forced by short-term financial pressure into accepting unsuitable job offers or forgoing training opportunities. As such, the system is purported to engender social stability and enhance efficiency of the labour market, thus purportedly benefiting the economy in the long run.

4. UI is commonly advanced in a mandatory form, on the argument of market failure. Supply of UI schemes in the private sector is either very limited, or else at such a high insurance premium that most of the workers are unwilling to pay. This phenomenon is mostly attributable to two well-recognised problems in the insurance field.

5. There is, first, the teething problem of *adverse selection*<sup>(3)</sup>. Insurance companies generally find it difficult to gauge the probabilities of becoming unemployed for different individuals, which are heterogeneous across economic sectors, occupation categories, firms, ranks, work competence and personal background, and to charge differentiated risk-based insurance premia accordingly. A uniform insurance premium rate to all would however induce those workers with higher than average

---

(3) Adverse selection means that people faced with a higher risk are more likely than those faced with a lower risk to seek insurance protection. Faced with this inherent tendency, insurance companies will have to strive to differentiate the risk exposures amongst their customers as much as possible, so that they can differentiate the insurance premia accordingly for the sake of adequately meeting the claims. Failure to differentiate risk could lead to break down of the entire insurance scheme.

unemployment risk to join the scheme, and discourage those workers with lower than average unemployment risk from doing so. As a result, the uniform insurance premium would have to be raised, thereby putting even more of the workers with lower unemployment risk off the insurance scheme. The perverse effect would henceforth magnify to erode the structure of the scheme.

6. Another teething problem is *moral hazard*<sup>(4)</sup>. This arises from the disincentive deterring the insured workers from actively seeking jobs for so long as the insurance benefit still runs. Also, it might induce the workers still in employment to go into occasional unemployment, so as to tap the insurance benefit. As a result, work incentive is liable to be unduly distorted. So would the structure of the insurance scheme.

7. These two problems acted together would increase the possibility of claims, lengthen the benefit period, and lift the cost of insurance. The commercial insurance scheme would then be under much financial strain, with increasing pressure for upward adjustment in the insurance premium for its continued viability. The scope of the insurance scheme might also progressively narrow, to eventually falling far short of a general scheme for the entire labour force, if viable at all. Advocates of UI thus usually call for the setting up of a mandatory system, although this would only tackle adverse selection but still laying open moral hazard.

8. An UI system is supposed to be self-financing in principle, upon regular payment of insurance premium from the employers, the employees, or some combination of both. Contribution by the Government is normally not required, unless it chooses to subsidise the system. The premia received are pooled to meet the insurance claims and cover the administration cost. There may also be a buffer fund for bridging the gap between total premium receipts and total benefit pay-outs over the economic cycle. In most cases, the UI premium rate is set at a fixed proportion of an employee's wage, with or without a statutory ceiling. Yet there is no common practice as to how the premium is shared between the employer and the employee.

---

(4) Moral hazard means that people after being insured tend to have less incentive in avoiding the losses that fall within the purview of the insurance protection. Faced with this behavior, insurance companies will have to devise appropriate premium and exclusion structures that can effectively offset the incentive pitfall.

9. Insurance benefit is payable to the covered employees subject to fulfilment of three common eligibility criteria<sup>(5)</sup>. *First*, the employees should have joined the UI system and contributed to the insurance pool for at least a prescribed period immediately prior to unemployment, such as six months or a year. First-time job-seekers and re-entrants into the labour force are thus normally excluded. *Secondly*, the causes of unemployment have to be involuntary, albeit subject to the interpretations laid down by the authorities<sup>(6)</sup>. *Thirdly*, the successful claimants have to remain in the labour force and regularly produce recognised proofs on undertaking job search and/or training during the benefit period.

10. The level of UI benefit depends on the amount of monthly claim that the insured worker is entitled to and the duration of the eligible claim. The amount of monthly claim is often set as a proportion of the previous monthly earnings of the claimant, normally by reference to the average for a specified period prior to unemployment. This proportion is called the gross wage replacement ratio<sup>(7)</sup>, which broadly reflects the degree of generosity of the insurance benefit. The gross wage replacement ratio is normally uniform to all the covered employees. But in a few places such as Japan and the United Kingdom, it is set at a higher level for elderly claimants who generally have greater difficulty in getting re-employed. Amongst the OECD member economies and the East Asian economies

---

(5) These eligibility criteria differ in finer details from place to place.

(6) In accordance with ILO's recommendation, the eligible claimants for UI benefit should be involuntarily unemployed workers. They are commonly associated with setback in business causing job redundancy, and include those workers who have been laid off by their employers for reasons other than misconduct, and those who have quitted employment due to "just causes". Yet the meaning of "just causes" may be interpreted differently in different places. In the United Kingdom, for instance, it refers to any reasons other than voluntary separation from work, discharge for misconduct, refusal of suitable work, and labour dispute. In South Korea, it covers reasons related to health conditions of the employees, working conditions, terms of employment, and managerial practices of the employers.

(7) In the context of UI, the gross wage replacement ratio thus refers to the proportion of the previous earnings of the claimant that is intended or designed to be compensated for by the insurance benefit.



where the UI system is implemented<sup>(8)</sup>, the gross wage replacement ratios average at around 50%, higher than the minimum requirement of 45% recommended by ILO. However, due to less taxes payable and more social security assistance receivable during the spell of unemployment, the effective ratio of out-of-work income to in-work income, or the net wage replacement ratio<sup>(9)</sup>, is always higher than the gross wage replacement ratio, for instance by an average of around 10 percentage points in the OECD member economies.

11. As regards the maximum duration of insurance benefit, it varies widely, from 5 months to 5 years in the OECD member economies. In East Asia, it lasts for 1 - 2 years in the mainland of China (the Mainland), 6 - 16 months in Taiwan, 3 - 10 months in Japan, and 2 - 7 months in South Korea. The exact maximum duration often depends on the cumulative amount of premium that is already contributed by the claimant, or the length of time for which the claimant is already in the system.

### **Illustrative calculations on insurance premium and benefit pay-out**

12. The RLSD study reports provide some estimates on the possible amount of insurance premium and insurance benefit if an UI system is implemented in Hong Kong. This is based on an assumed gross wage replacement ratio of 45 - 60% and an assumed insurance premium equivalent to 0.5 - 2% of the wage<sup>(10)</sup>. While these estimates may serve to reflect how the insurance benefit for a typical worker would be affected by the two main parameters, they fall short of explicitly indicating the level of insurance premium required against the insurance benefit undertaken for the

---

(8) The UI system is implemented in 26 out of the 29 OECD member economies, except Australia, New Zealand and Mexico. In East Asia, the UI system is implemented in the Mainland, Taiwan, Japan and South Korea. The latter two are also OECD member economies.

(9) The net wage replacement ratio is obtained by dividing net out-of-work income by net in-work income. Net out-of-work income refers to the sum of UI benefit and social security assistance less taxes and social security contribution. Net in-work income refers to the sum of employment remuneration and social security assistance less taxes and social security contribution.

(10) See the study report by RLSD of the Legislative Council Secretariat entitled "Unemployment-related benefits systems: overall comparison", published in June 2000.

UI system to break even and stay financially viable. This is considered to be a major omission, for the following reasons:

- (i) Financial viability of the UI system must be taken as a crucial constraint for determining the insurance premium against the benefit pay-out. Since the UI system is deemed to be self-financing in principle, the benefit level may only be lifted with a corresponding rise in insurance premium, and conversely the insurance premium may only be lessened with a corresponding cut in benefit level. Because of this, the gross wage replacement ratio, as a key indicator of benefit level, and the insurance premium rate, as a key indicator of cost burden, cannot be separately stipulated or assessed without regard to their linkage to each other. Also, the duration of the insurance benefit, as the other key indicator of benefit level, cannot be separately construed.
- (ii) No assumption appears to have been made in regard to the structural and systemic parameters that are likely to affect the size of the participating employees and the eligible claimants, and hence the regular contributions to and pay-outs from the UI system. These parameters include the long-term unemployment rate, substantive coverage of the system, eligibility criteria, and duration of benefit.
- (iii) In view of (i) and (ii), the RLSD estimates may not be readily taken as tenable combinations of the levels of insurance premium and benefit pay-out for an UI system for Hong Kong, even though they may seem to be broadly in line with the estimation results shown in the ensuing part of this paper.
- (iv) The wage statistics underlying the RLSD estimates have a relatively narrow coverage, including only workers at the middle and lower segments of the occupational hierarchy in selected economic sectors. Managerial and professional staff generally, and employees in the construction, storage, communications, community services and social services sectors are not included. The amounts of insurance premium and benefit pay-out so derived by RLSD would thus fall short of being generally applicable to the entire labour force in Hong Kong.

13. In the light of these limitations, some illustrative calculations are contemplated on the possible mix of insurance premium and benefit pay-out levels for a hypothetical UI system for Hong Kong (Table 1). The employment earnings data underlying the calculations are compiled from the General Household Survey conducted by the Census and Statistics Department, which covers the entire employed population. Sensitivity tests are carried out on three assumed levels of long-term unemployment rate, at 3%, 4% and 5% respectively, and on three assumed levels of gross wage replacement ratio, at 40%, 50% and 60% respectively. Other major assumptions adopted are as follows:

- (i) The UI system covers all the full-time and part-time employees as eligible claimants. Self-employed persons and employers are not covered.
- (ii) Insurance premium contributions are shared equally between the employees and their employers.
- (iii) Two scenarios are delineated in relation to the eligibility criteria and the duration of benefit, in view of possible controversies over how involuntary unemployment should be defined and for how long the benefit period should last. *Scenario I* refers to a more stringent condition under which only those employees who have lost their jobs due to dismissal or lay-off by their employers are eligible to claim insurance benefit, for a maximum duration of six months. *Scenario II* relaxes the eligibility condition to the extent that all employees with a job immediately prior to unemployment are eligible to claim insurance benefit, for a maximum duration of 18 months. For both scenarios, first-time job-seekers and re-entrants into the labour force are excluded.
- (iv) The Government gives no subsidy to the UI system.
- (v) The insurance premium which enters into the insurance fund pool, when expressed as a proportion of the employee's earnings, is uniform to all the covered employees.

14. The main estimation results are presented below:

- (i) If the gross wage replacement ratio is set at 50%, the annual benefit pay-out from the UI system would amount to \$3.2 - 5.4 billion for *Scenario I* or \$5.2 - 8.6 billion for *Scenario II*, depending on the long-term unemployment rate assumed. This represents 0.3 - 0.4% or 0.4 - 0.7% of GDP at 2000 prices for the two scenarios.
- (ii) In order to meet the respective insurance claims, the uniform insurance premium would have to be levied at 0.6 - 1.1% of the employee's earnings for *Scenario I* or 1.0 - 1.7% for *Scenario II*. Granting that the insurance premium is to be contributed equally by the employee and the employer, their respective shares in terms of the employee's earnings would be 0.3 - 0.5% for *Scenario I* or 0.5 - 0.8% for *Scenario II*.
- (iii) If the gross wage replacement ratio is lifted from 50% to 60%, the annual benefit pay-out from the UI system would rise by about 20% to \$3.9 - 6.4 billion or 0.3 - 0.5% of GDP for *Scenario I*, or \$6.2 - 10.4 billion or 0.5 - 0.8% of GDP for *Scenario II*. Correspondingly, the required insurance premium as a proportion of the employee's earnings would rise also by about 20% to 0.7 - 1.3% for *Scenario I*, or 1.2 - 2.0% for *Scenario II*. The respective shares of premium for the employee and the employer equally would be 0.4 - 0.6% of the employee's earnings for *Scenario I*, or 0.6 - 1.0% of the employee's earnings for *Scenario II*.
- (iv) On the other hand, if the gross wage replacement ratio is lowered from 50% to 40%, the annual benefit pay-out from the UI system would be reduced by about 20% to \$2.6 - 4.3 billion or 0.2 - 0.3% of GDP for *Scenario I*, or \$4.1 - 6.9 billion or 0.3 - 0.5% of GDP for *Scenario II*. Correspondingly, the required insurance premium as a proportion of the employee's earnings would be reduced also by about 20% to 0.5 - 0.8% for *Scenario I*, or 0.8 - 1.4% for *Scenario II*. The respective shares of premium for the employer and the employee equally would be 0.2 - 0.4% of the employee's earnings for *Scenario I*, or 0.4 - 0.7% of the employee's earnings for *Scenario II*.

- (v) It should be stressed that the insurance premium as estimated represents only the minimum level that is required to pay off the insurance claims in each of these scenarios. The actual premium required is most likely to be higher, partly due to possible abuse and fraud which would raise the pay-out provision. Also need to be incorporated are the cost of administration, and the cost of having a seed fund or buffer fund to cushion against fluctuations in unemployment along with changes in overall economic conditions particularly in the early years of implementation. The precise add-on to the UI premium is however difficult to quantify in this illustrative context.

## **Purported merits**

### **(a) Elevation of social welfare**

15. Advocates of the UI system view it as welfare-orienting, by providing an extra channel for the low income households to obtain welfare benefit. They regard this as more important for the less developed economies, where the social safety net is often inadequate due to government budget constraint, where savings are shallow from the already low household income, and where access to bank credit is scant. In such circumstances, the low income household is more liable to financial difficulty once its bread winner becomes unemployed, owing to lack of money to tide over the financial distress in the meantime. In the event of massive and protracted unemployment upon a major economic downturn, this distress with individual households could deteriorate into widespread tension threatening social stability. Thus a major purported merit of UI is to render a social stabiliser against the impact of economic adversities.

### **(b) Enhancement of economic efficiency**

16. Another purported merit of UI is efficiency-enhancing, as it is said by the advocates to be able to help promote efficiency of the labour market by reducing mismatch between available labour skills and job vacancies. By easing the plight during the spell of unemployment, the insurance benefit may allow the unemployed workers to spend more time in search of jobs that fit their skills, instead of having to accept unsuitable job offers at an early moment. Also, the unemployed workers may spend more

time to take up training and re-training programmes for improving their skills and productivity.

17. Consumption smoothing is said to be another possible source of efficiency gain. By forcing the employees to save for contingency, UI serves to mitigate the impact of a drastic loss in income for the unemployed workers and helps to support consumption of the affected households in bad times. From the macro perspective, this may help cushion the downward pressure of an economic setback on overall consumer spending and thus may help stabilise the economy. Such a cushioning effect is more desired for those economies in which the households generally do not save much and have considerable volatility in their propensity to consume.

### **(c) Caveats in the purported merits**

18. The purported merits of UI should however be viewed in their proper perspective. From a social welfare point of view, the financial relief function of UI would only be effective when the plight of the unemployed workers substantially coincides with that of the low income individuals or households. Otherwise, a large part of the insurance benefit would merely go to those unemployed workers who can support themselves anyway through their own voluntary savings. In Hong Kong, it is found that a considerable proportion of the poor households in need of help do not have members who are employable or are in search of jobs<sup>(11)</sup>. For those households, UI would be irrelevant.

19. From an economic efficiency point of view, the said advantage of UI in facilitating job match and skill development should be weighed against the tendency for abuse, whereby people go into excessively lengthy job search processes and/or go for training and re-training courses of little direct benefit. As regards the consumption smoothing aspect of UI, it should be less relevant to the middle and higher income households whose saving ratios are generally higher, so that their propensity to consume is less susceptible to income fluctuations.

---

(11) According to the General Household Survey conducted by the Census and Statistics Department, about 75% of the CSSA recipient households and 42% of the households in the lower quartile of the household income distribution do not have any economically active member.

**(d) Relevance to Hong Kong**

20. The purported merits of UI are of limited relevance to Hong Kong, for the following reasons:

- (i) A well-established Comprehensive Social Security Assistance (CSSA) system is already in place, effectively providing basic income support to those households in financial difficulties due to unemployment or other causes. Under this system, assistance is fairly determined having regard to all basic needs for livelihood, and is impartially granted through a means test on the applicant.
- (ii) Currently, 53% of the households in the lowest quintile of the household income distribution and 76% of the households in the lowest decile have no economically active members at all. Comprising mainly retirees, disabled, and single parents with children, these households are unable to benefit from the UI system.
- (iii) Around one-third (specifically 32%) of the unemployed persons currently belong to households earning more than the median household income<sup>(12)</sup> (Table 2). Conceivably, most of these unemployed persons could receive support from other family members, apart from their own savings, so that an additional source of financial support for them does not appear to be essential.
- (iv) For those workers being threatened by longer-term redundancy amidst the process of continuing structural change, it is more desirable to seek to pull them off from the tendency towards structural unemployment owing to obsolescence of or dwindling demand for their present skills. The financial support from UI could only provide a temporary relief. Appropriate training and re-training programmes to augment their skills matter much more, in

---

(12) The corresponding proportion in 1996, prior to the outbreak of the Asian financial crisis, was 42%.

the interest of re-equipping as many of them as possible to re-enter the labour market.

- (v) The retrenched workers are generally protected by that part of the labour legislation pertaining to employment rights and benefits. This covers, in particular, severance pay and long service payment<sup>(13)</sup>. The Labour Department keeps a close surveillance on compliance with these statutory provisions. In addition, the Protection of Wages on Insolvency Fund renders more immediate assistance to those employees whose employers have become insolvent, by granting ex-gratia payments to cover wages in arrears, wages in lieu of notice, and severance pay.
- (vi) The labour market in Hong Kong is highly liberal and flexible, with a high degree of labour mobility and with generally modest or often even minimal search cost<sup>(14)</sup>. An employee may start to search for another job whilst holding onto the present job, if the present one appears to become not so preferable or less secure. Thus the purported gain in efficiency from better job match that is construed to be enabled by UI is at best marginal, and at worst dubious.

---

(13) According to the Employment Ordinance, those employees under a continuous contract with an employer for not less than two years prior to retrenchment are eligible for severance pay (SP), while those employees serving an employer for not less than five years prior to termination of employment are eligible for long service payment (LSP). The SP/LSP entitlement for an employee is calculated by reference to the number of fully reckonable years of service and a pay rate at two-thirds of the last full month's wage, subject to a specified maximum payment ceiling.

Yet as the employer can offset the amount of SP/LSP to the employee from the benefit accrued under the Mandatory Provident Fund (MPF) scheme out of the employer's share of the contribution, the total accrued MPF benefit to the employee for retirement is admittedly reduced.

(14) The Employment Services, run by the Labour Department, is a free service for job search and placement available to everyone in the local labour force.



## Drawbacks

### (a) Pressure for income redistribution

21. UI in a mandatory form and operated at a uniform premium rate asserts income redistribution within the labour force, from workers with a lower unemployment risk to workers with a higher unemployment risk. A uniform insurance premium is unable to differentiate the unemployment risk exposure faced by employees in different segments of the labour force, as the pattern of unemployment rate across different economic sectors and occupation categories well illustrates ([Table 3](#)). In effect, the less frequently unemployed are made to cross-subsidise the more frequently unemployed.

22. Another way of depicting the income redistribution or cross-subsidisation is to compare the estimated amount of insurance claim with the estimated amount of insurance premium in different segments of the labour force, after taking into account the profile of unemployment and the spread of employment earnings.

23. Analysed by *economic sector*, the ratio of claim to premium is larger than unity in manufacturing, construction, the distributive and catering trades, and transport, storage and communications ([Table 4](#)). In other words, the insured workers in these sectors on average would receive more than they contribute to the UI system. This situation is consistent with the fact that the unemployment rates in most of these sectors are higher than the overall average. On the other hand, the ratio of claim to premium is smaller than unity in financing, insurance, real estate and business services and in community, social and personal services. Thus the insured workers in these two sectors on average would contribute more than they receive from the UI system. This is in line with the unemployment rates in these two sectors being below the overall average.

24. Analysed by *occupation category*, the ratio of claim to premium shows that income would be redistributed through the UI system from managers and administrators, professionals, associate professionals and clerical workers to craft and related workers, service workers and shop sales workers, plant and machine operators and assemblers, and workers in elementary occupations ([Table 5](#)). This is again in line with the pattern of unemployment rates amongst the various occupation categories being above or below the overall average.

25. Analysed by *age group*, cross-subsidy would occur mainly from workers aged 30 - 39 to workers aged 15 - 19 and 50 - 59 (Table 6). Teenage workers aged 15 - 19 have a particularly large ratio of claim to premium of 3.4 - 4.0, as their unemployment rate exceeds the overall average by a wide margin<sup>(15)</sup>. On the other hand, the ratio of claim to premium is distinctly smaller than unity for workers aged 30-39 and for elderly workers aged 60 and above, due to their unemployment rates being much lower than the overall average<sup>(16)</sup>.

26. Analysed by *sex*, income would generally be redistributed from female workers to male workers (Table 7). The distinctly lower unemployment rate for females than for males, at 4.0% as against 5.6% in 2000, partly bears this out.

27. Although for employees the UI premium is tantamount to levying a payroll tax, the underlying rationale and hence the effect of social transfer are rather different. The social safety net, as is funded by general revenue, redistributes income from the richer to the poorer segment of the community. On the other hand, the UI system, as is to be financed by contributions from the covered employees, would tend to redistribute income from the less frequently unemployed to the more frequently unemployed. Currently around one-third of the unemployed people in Hong Kong belong to the higher income households, yet these unemployed people would also be at the receiving end of the cross-subsidy. Part of the benefits which should better be channelled to the lower income households would thus be dissipated out.

---

(15) The rather higher unemployment rate for teenage workers is partly due to their much greater labour mobility.

(16) The lower unemployment rate for workers aged 30-39 is possibly attributable to many of them having acquired a good amount of efficiency and experience after spending some years on the job. As to the elderly workers, their lower unemployment rate is due to many of them opting out of the labour force for retirement instead of staying in as unemployed.

## **(b) Inducement for unemployment**

28. Another major drawback of UI concerns the work disincentive it tends to arouse and henceforth the longer spell of unemployment it tends to induce. Moral hazard behaviour is likely to be stimulated not only by being able to receive some pay without going into work, but also by the possibility that the net wage replacement ratio that the unemployed worker actually obtains may even be appreciably higher than the gross wage replacement ratio that the UI system obligates. This will act to lengthen the average duration of unemployment and push up the overall unemployment rate. Many empirical studies overseas have concluded that the duration and the rate of unemployment are positively related to the degree of generosity of the UI benefit, expressed in terms of the gross wage replacement ratio and the allowable ceiling on duration of benefit<sup>(17)</sup>.

29. In Hong Kong, since the low income households do not have to pay income taxes, and since many of them are eligible for CSSA, the net wage replacement ratio could exceed substantially the gross wage replacement ratio if the household concerned receives the UI benefit and CSSA payment simultaneously. Assuming that the gross wage replacement ratio is set at 50%, the net wage replacement ratio for a single-earner household comprising a married couple and one child could reach 126% if its income is half of the median household income, and 111% if its income is only one-third of the median household income (Table 8). The

---

(17) R. Barro (1990) estimated that the UI system had lifted the natural rate of unemployment by 0.5 - 1 percentage point in the United States. L. Katz and B. Meyer (1990) estimated that extension of the allowable UI benefits in the United States by one week could increase the average duration of unemployment by 0.16 - 0.2 week. They also found that new job acceptances were more apparent for the UI recipients at around the time when their UI benefits were exhausted. R. Layard, S. Nickell and R. Jackman (1991) canvassed 20 OECD member economies and estimated that a reduction in the gross wage replacement ratio by 10 percentage points could lower the average unemployment rate for those economies by 1.7 percentage points, and that a reduction in the maximum duration of UI benefits by one year could lower the average unemployment rate for those economies by 0.9 of a percentage point.

*Robert Barro, "Macroeconomics", published by John Wiley & Sons, Inc., 1990; Lawrence Katz and Bruce Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment", Journal of Public Economics, Volume 41, Issue 1, February 1990; and Richard Layard, Stephen Nickell and Richard Jackman, "Unemployment", Oxford University Press, 1991.*

corresponding figures for a singleton household at these two income levels could likewise be high, at 93% and 114%. Work incentive of these households would inevitably be dampened in consequence<sup>(18)</sup>.

30. Over-shooting of the net wage replacement ratio may be curbed by counting the UI benefit as part of the assessable income when granting the CSSA payment. However, in so doing, the net gain from the UI system for many of the low income households would be much reduced. The case for UI as an extra channel of financial support for unemployed persons especially in the low income households would then be much diluted.

31. On other possible adjustments in the labour market, there is the immediate cost impact on employers who are expected to share in the UI contributions of their employees. Faced with the cost push, though mild, employers would be induced to economise by shifting to less labour-intensive production methods and hiring fewer workers, or else to ward off the cost by incorporating it into the employees' payroll. The burden would eventually fall back on the employees' side. Also, employers of seasonal or temporary workers would be more tempted to lay off such workers in slack times, knowing that they could live on the UI claim for the time being and could be readily recalled to work as the UI benefit period is about to expire. This phenomenon is shown up by empirical studies in

---

(18) Admittedly, monetary concern is not the only factor influencing the decision of an unemployed person as to whether or not to get back to work. But if the ratio of out-of-work income to in-work income reaches an unduly high level, this could seriously undermine the employment motivation of an individual as is engendered by social posture, career aspiration, and pursuit of personal betterment.

the United States<sup>(19)</sup>. As to labour supply, the incentive of UI recipients to protract unemployment would tend to diminish the effective labour force. On the other hand, the UI system might lure some of the economically inactive people without genuine working interest to move in and out of the labour force in order to capture the UI benefit. Such intermittent addition to the labour supply is unlikely to add much to overall productive capacity of the economy, yet the cost for it is likely to be disproportionate.

### (c) Systemic risk of insolvency

32. Unlike commercial insurance schemes, a mandatory UI system is unable to exclude people with a higher unemployment risk. Nor is it amenable to charging them additional insurance premium. On the other hand, people with a lower unemployment risk can be expected to strive for exemption from the UI system. Or else, they are likely to press for reduced insurance premium. Coupled with the moral hazard problem or the tendency for abuse, this could place much strain on financial resources in the system. Yet the overall premium and benefit levels may not be easily adjusted to relieve the strain, owing to the strong vested interests involved and the political resistance thus emanating. Impeded by these institutional constraints, the UI system could run into chronic deficit cumulating in insolvency. This risk would be more apparent if the unemployment situation is worse than anticipated, or if political pressure mounts in the course of time for raising the benefit level yet lowering the overall premium level. In short, the shortfall once developed is liable to become systemic,

---

(19) M. Feldstein (1978) estimated that the UI benefits were responsible for approximately half of the temporary lay-offs in the United States. L. Katz and B. Meyer (1990) estimated that almost two-thirds of the UI recipients expected themselves to be recalled, of whom nearly half actually returned to work with their former employers. B. Meyer and D. Rosenbaum (1996) estimated that almost 40% of the UI benefits were related to repeated claims attributable to temporary lay-offs.

*Martin Feldstein, "The Effect of Unemployment Insurance on Temporary Lay-off Unemployment", American Economic Review, Volume 68, Issue 5, December 1978; Lawrence Katz and Bruce Meyer, "Unemployment Insurance, Recall Expectations and Unemployment Outcomes", Quarterly Journal of Economics, Issue 105, November 1990; and Bruce Meyer and Dan Rosenbaum, "Repeat Use of Unemployment Insurance", US National Bureau of Economic Research, Working Paper 5421, January 1996.*

requiring public subsidy to be thrown in for the system to endure over the longer term<sup>(20)</sup>.

#### **(d) Resource wastage in checking against abuse**

33. There is a general lack of effective measures to detect and prevent the moral hazard behaviour induced by UI. In practice, it may not be straightforward to identify half-hearted job searches or lax-minded attendance at training and re-training programmes for the sake of capturing the insurance benefit. At the least, the resources thus consumed in the checking process constitute a dead-weight loss on account of the UI system.

#### **Common trends in OECD**

34. Over the past decade or so, OECD has become increasingly conscious of the adverse economic impacts brought about by excessive unemployment benefits. Thus an agreement was reached in 1994 amongst the OECD member economies to pursue more active labour market policies, with a view to helping the unemployed persons to re-enter the labour market and enhancing the overall efficiency of the labour market further<sup>(21)</sup>. In line with this, many OECD member economies have shifted the emphasis of their labour support programmes increasingly towards employment

---

(20) A case in point is the UI Trust Funds held by some of the state governments in the United States, which have reportedly come under financial strain from time to time, especially during an economic downturn. Of particular note was the insolvency of the UI Trust Fund in Kentucky in 1982, such that money had to be borrowed from the federal government in order to keep it afloat. As another case in point, fiscal subsidy to the UI system in Sweden is even more significant, with reportedly over 90% of the income of the UI system being provided by the government. This partly accounts for the high payroll tax rate at 46 - 60% in that country.

(21) This refers to the OECD Jobs Strategy as was endorsed by the OECD member economies in 1994. It comprises a wide-ranging yet balanced set of policies designed to enhance employment growth, reduce unemployment and promote prosperity. On unemployment benefits, the Jobs Strategy calls for a revamp of the system itself as well as its interactions with the tax system, so that it could impinge a lot less on the efficient functioning of the labour market.

enhancing measures, and away from income subsidy measures. This essentially involves improving access to the labour market, developing job-related skills, and promoting job creation. Concurrently, the system of unemployment benefits is to be revamped.

35. In respect of UI, a considerable number of OECD member economies have initiated moves to tighten up the eligibility criteria and/or trim down the benefit levels<sup>(22)</sup>. Some of them are set to go even further, by shifting away from the wage-linked UI system to the means-tested social assistance system<sup>(23)</sup>. This change seems to receive support from the ILO experts. In one of the ILO study reports, it has been pointed out that while

---

(22) These economies include Austria, Belgium, Canada, Denmark, Finland, Germany, the Netherlands, Spain, Sweden, Switzerland and the United Kingdom. Yet the progress in implementing such stringency measures has been rather slow in some of the economies, mainly due to domestic political resistance. This reflects the common difficulty for governments to undo the social benefits once they are put in place.

*OECD, "Implementing the OECD Jobs Strategy: Assessing Performance and Policy", June 1999.*

(23) In the United Kingdom, a new system of unemployment benefits called the Job Seeker's Allowance has been implemented since 1996, comprising both a contribution-based element and a means-tested element. In Finland, access to UI for people without working experience is restricted as from 1994, while a new means-tested benefit system has been introduced for those people not qualified for UI. In Sweden, means-tested social assistance has also become a more important measure in recent years.

UI is still deemed to supplement the social safety net particularly in the developing economies, the ultimate key objective should be to develop a means-tested social assistance programme for providing minimum income support<sup>(24)</sup>.

## **Conclusion**

36. Mandatory UI in the form as construed is thus by no means effective or equitable in serving a social security function. With its eligibility criteria mainly determined by labour force attachment and its benefit pay-outs commonly based on prior employment earnings record, the UI system in itself is unable to meet the intention of providing basic income support to all people in need, particularly those not in the labour force. The UI system would merely redistribute income from the less frequently unemployed to the more frequently unemployed. It would also channel benefit to unemployed persons in the better-off households, who otherwise could well receive family support.

37. The purported efficiency gain of UI is suspect. Rather, the UI system tends to arouse disincentive that will hamper the efficient operation of the labour market, by discouraging serious job search, lengthening the unemployment spell, and lifting labour cost. The balance between out-of-work income and in-work income that is desired for being conducive to self-reliance is liable to be distorted. Higher and more protracted unemployment is likely to ensue. The UI system is thus prone to aggravating the problem of unemployment it is meant to tackle.

---

(24) Thus a basic social safety net of broad coverage for cushioning the adversities of an economic downturn should still be augmented by means test, in the interest of greater effectiveness in helping the people really in need.

*Eddy Lee, "The Asian Financial Crisis: the Challenge for Social Policy", ILO, 1998.*



38. The case for UI is further undermined by its potentially tenuous financial viability over the longer term, in the light of conceivable political pressures for the benefit to be raised and the premium to be lowered, and more so in the light of possible further squeeze on the system to render additional welfare payments. As such, the UI system could risk not being able to be kept as self-financing, and public subsidy might be called for if the system were not let to fail.

39. In Hong Kong, the CSSA system is designed to help those in need, whether due to unemployment or due to other causes, so as to enable them to tide over the financial hardship. Also, the retrenched workers are entitled to severance pay and long service payment. In addition, there are ample training and re-training opportunities and efficient employment services to help the people out of work to re-enter the labour market. This combination of provisions and programmes aims to provide a reliable social safety net without unduly affecting the incentive to work for income and to hone the skills. Redistribution of income through broad-coverage yet non-means-tested schemes, as in the case of mandatory UI, is bound to create undue social cost.

Economic Analysis Division  
Financial Services Bureau  
Government Secretariat  
10 August 2001

**Table 1**  
**Estimation of unemployment insurance (UI) premium and pay-out**  
**(at 2000 prices)**

Pay-out from the UI system	Long-term unemployment rate :					
	3%		4%		5%	
	Scenario I	Scenario II	Scenario I	Scenario II	Scenario I	Scenario II
(a) Number of unemployed persons in a month <sup>(1)</sup>	101 000	101 000	135 000	135 000	169 000	169 000
(b) Number of eligible UI claimants <sup>(2)</sup>	49 000	75 000	66 000	101 000	82 000	126 000
(c) Sum of previous monthly employment earnings of all eligible claimants (\$Mn) <sup>(3)</sup>	536	864	715	1 151	894	1 439
(d) Annual pay-out from the UI system (\$Mn) subject to gross wage replacement ratio (GWRR) at :						
- 40%	2,574	4,145	3,432	5,527	4,290	6,908
- 50%	3,218	5,181	4,290	6,908	5,363	8,635
- 60%	3,861	6,217	5,148	8,290	6,436	10,362
((d) = (c)*GWRR*12 months)						
<u>Insurance premium required to meet pay-out</u>						
(e) Number of employees in work <sup>(4)</sup>	2 938 000	2 938 000	2 908 000	2 908 000	2 878 000	2 878 000
(f) Annual employment earnings of all employees in work (\$Mn)	519,939	519,939	514,579	514,579	509,219	509,219
(g) Insurance premium expressed as a proportion of employment earnings subject to GWRR at :						
- 40%	0.5	0.8	0.7	1.1	0.8	1.4
- 50%	0.6	1.0	0.8	1.3	1.1	1.7
- 60%	0.7	1.2	1.0	1.6	1.3	2.0
((g) = (d) / (f) * 100%)						
(h) Insurance premium shared equally by employers and employees subject to GWRR at :						
- 40%	0.2	0.4	0.3	0.5	0.4	0.7
- 50%	0.3	0.5	0.4	0.7	0.5	0.8
- 60%	0.4	0.6	0.5	0.8	0.6	1.0
((h) = (g) / 2)						

Notes : (1) Based on total labour force of 3 383 000 in 2000.

(2) For Scenario I, eligible claimants refer to those employees who have become unemployed due to dismissal or lay-off and have been unemployed for less than six months. Those who have left their previous jobs for other causes or for a longer duration, first-time job-seekers, re-entrants into the labour force, and self-employed persons are excluded. For Scenario II, eligible claimants refer to all the employees who have become unemployed for whatever cause for less than 18 months. First-time job-seekers, re-entrants into the labour force, and self-employed persons are again excluded.

(3) Data on the previous employment earnings level of the unemployed population are not available. The figures shown in this table are proxied from the distribution of eligible claimants and the average employment earnings of employees across different occupation categories in different economic sectors.

**Table 2**

**Distribution of employed and unemployed population in domestic households by household income in 2000**

	<u>Number of employed persons</u> (000)	<u>% share in total</u> (%)	<u>Number of unemployed persons</u> (000)	<u>% share in total</u> (%)
All domestic households	3 213	100.0	168	100.0
<i>Of which :</i>				
With household income > median*	2 213	68.9	53	31.7
With household income ≤ median	1 000	31.1	115	68.3
<i>Of which :</i>				
With household income below the lower quartile	325	10.1	68	40.6

Note : (\*) Median household income amounted to \$18,000 a month in 2000.

**Table 3****Unemployment rate by major economic sector and by major occupation category in 2000**

<u>Economic sector/ occupation category</u>	<u>Managers and administrators (%)</u>	<u>Professionals (%)</u>	<u>Associate professionals (%)</u>	<u>Clerks (%)</u>	<u>Services workers and shop sales workers (%)</u>	<u>Craft and related workers (%)</u>	<u>Plant and machine operators and assemblers (%)</u>	<u>Elementary occupations (%)</u>	<u>All occupation categories (%)</u>
Manufacturing	2.1	2.6	3.8	4.0	8.2	7.1	6.3	8.5	5.5
Construction	1.0	1.4	2.9	3.4	12.1	11.7	6.2	15.6	10.3
Wholesale, retail and import/export trades, restaurants and hotels	1.9	2.1	2.8	4.2	8.0	3.6	5.6	6.1	5.3
Transport, storage and communications	1.9	1.3	2.3	2.9	4.9	2.3	2.7	10.7	4.0
Financing, insurance, real estate and business services	1.3	1.1	2.6	3.2	13.0	3.3	1.8	3.6	2.6
Community, social and personal services	0.8	0.8	1.1	1.9	3.6	4.6	4.9	1.4	1.8
All economic sectors	1.7	1.2	2.4	3.5	6.9	8.9	4.2	4.9	5.0

**Table 4**  
**Ratio of UI claim to premium by major economic sector**  
**(subject to gross wage replacement ratio at 50% and long-term unemployment rate at 4%)**

Economic sector	Unemployment rate in 2000 (%)	Amount of annual insurance claim received <sup>(1)</sup> (\$Mn)	Scenario I <sup>(1)</sup>		Scenario II <sup>(1)</sup>		Ratio of claim to premium <sup>(4)</sup>
			Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	Ratio of claim to premium <sup>(4)</sup>	Amount of annual insurance claim received <sup>(2)</sup> (\$Mn)	Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	
Manufacturing	5.5	455	392	1.16	794	631	1.26
Construction	10.3	1,314	345	3.80	1,474	556	2.65
Wholesale, retail and import/export trades, restaurants and hotels	5.3	1,239	1,033	1.20	2,291	1,663	1.38
Transport, storage and communications	4.0	454	430	1.06	699	692	1.01
Financing, insurance, real estate and business services	2.6	326	885	0.37	805	1,424	0.57
Community, social and personal services	1.8	486	1,165	0.42	822	1,875	0.44
Other sectors	1.7	17	41	0.41	23	66	0.34
All economic sectors	5.0	4,290	4,290	1.00	6,908	6,908	1.00

Notes: (1) For delineation of Scenario I and Scenario II, see the respective footnote in Table 1.

(2) Weighted by the estimates on the number of eligible claimants and their previous employment earnings in each of the economic sectors in 2000, and constrained by the estimated amount of annual insurance claims received by all claimants.

(3) Weighted by the number of employees and their average employment earnings in each of the economic sectors in 2000, and constrained by the estimated amount of annual insurance premia paid by all employees.

(4) The ratio being more than 1 means that the people in the economic sector concerned receive more than they contribute to the UI system, while the ratio being less than 1 means the reverse.

**Table 5**

**Ratio of UI claim to premium by major occupation category  
(subject to gross wage replacement ratio at 50% and long-term unemployment rate at 4%)**

Occupation category	Unemployment rate in 2000 (%)	Scenario I <sup>(1)</sup>			Scenario II <sup>(1)</sup>		
		Amount of annual insurance claim received <sup>(2)</sup> (\$Mn)	Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	Ratio of claim to premium <sup>(4)</sup>	Amount of annual insurance claim received <sup>(2)</sup> (\$Mn)	Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	Ratio of claim to premium <sup>(4)</sup>
Managers and administrators	1.7	276	653	0.42	568	1,052	0.54
Professionals	1.2	158	669	0.24	316	1,077	0.29
Associate professionals	2.4	460	937	0.49	992	1,509	0.66
Clerks	3.5	511	664	0.77	941	1,068	0.88
Service workers and shop sales workers	6.9	752	438	1.72	1,371	706	1.94
Craft and related workers	8.9	1,177	334	3.53	1,397	537	2.60
Plant and machine operators and assemblers	4.2	314	220	1.43	461	354	1.30
Elementary occupations	4.9	637	373	1.71	855	601	1.42
Other occupations	2.8	4	2	1.65	8	4	1.92
All occupation categories	5.0	4,290	4,290	1.00	6,908	6,908	1.00

Notes: (1) For delineation of Scenario I and Scenario II, see the respective footnote in Table 1.

(2) Weighted by the estimates on the number of eligible claimants and their previous employment earnings in each of the occupation categories in 2000, and constrained by the estimated amount of annual insurance claims received by all claimants.

(3) Weighted by the number of employees and their average employment earnings in each of the occupation categories in 2000, and constrained by the estimated amount of annual insurance premia paid by all employees.

(4) The ratio being more than 1 means that the people in the occupation category concerned receive more than they contribute to the UI system, while the ratio being less than 1 means the reverse.

**Table 6**  
**Ratio of UI claim to premium by age group**  
**(subject to gross wage replacement ratio at 50% and long-term unemployment rate at 4%)**

Age group	Unemployment rate in 2000 (%)	Scenario I <sup>(1)</sup>			Scenario II <sup>(1)</sup>		
		Amount of annual insurance claim received (\$Mn)	Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	Ratio of claim to premium <sup>(4)</sup>	Amount of annual insurance claim received <sup>(2)</sup> (\$Mn)	Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	Ratio of claim to premium <sup>(4)</sup>
15 - 19	23.7	120	35	3.39	226	57	3.99
20 - 29	5.9	810	819	0.99	1,502	1,319	1.14
30 - 39	3.3	1,126	1,608	0.70	1,889	2,590	0.73
40 - 49	4.3	1,403	1,256	1.12	2,052	2,023	1.01
50 - 59	6.0	759	487	1.56	1,138	784	1.45
≥ 60	2.9	73	84	0.87	101	136	0.74
All age groups	5.0	4,290	4,290	1.00	6,908	6,908	1.00

Notes : (1) For delineation of Scenario I and Scenario II, see the respective footnote in Table 1.

(2) Weighted by the estimates on the number of eligible claimants and their previous employment earnings in each of the age groups in 2000, and constrained by the estimated amount of annual insurance claims received by all claimants.

(3) Weighted by the number of employees and their average employment earnings in each of the age groups in 2000, and constrained by the estimated amount of annual insurance premia paid by all employees.

(4) The ratio being more than 1 means that the people in the age group concerned receive more than they contribute to the UI system, while the ratio being less than 1 means the reverse.

**Table 7**  
**Ratio of UI claim to premium by sex**  
**(subject to gross wage replacement ratio at 50% and long-term unemployment rate at 4%)**

Sex	Unemployment rate in 2000 (%)	Amount of annual insurance claim received <sup>(2)</sup> (\$Mn)	Scenario I <sup>(1)</sup>		Scenario II <sup>(1)</sup>		Ratio of claim to premium <sup>(4)</sup>
			Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	Ratio of claim to premium <sup>(4)</sup>	Amount of annual insurance claim received <sup>(2)</sup> (\$Mn)	Amount of annual insurance premium paid <sup>(3)</sup> (\$Mn)	
Male	5.6	3,387	2,684	1.26	5,120	4,322	1.18
Female	4.0	904	1,607	0.56	1,788	2,587	0.69
Total	5.0	4,290	4,290	1.00	6,908	6,908	1.00

Notes: (1) For delineation of Scenario I and Scenario II, see the respective footnote in Table 1.

(2) Weighted by the estimates on the number of eligible claimants and their previous employment earnings in each sex in 2000, and constrained by the estimated amount of annual insurance claims received by all claimants.

(3) Weighted by the number of employees and their average employment earnings in each sex in 2000, and constrained by the estimated amount of annual insurance premia paid by all employees.

(4) The ratio being more than 1 means that the people in the sex concerned receive more than they contribute to the UI system, while the ratio being less than 1 means the reverse.



**Table 8**  
**Net wage replacement ratio for a single-earner household<sup>(1)</sup>**  
**(subject to gross wage replacement ratio of 50%)**

For ratio of monthly household income against median monthly household income of \$18,000 in 2000 :

	200%		100%		50%		33%	
	Singleton household (\$)	Household with a married couple and one child (\$)	Singleton household (\$)	Household with a married couple and one child (\$)	Singleton household (\$)	Household with a married couple and one child (\$)	Singleton household (\$)	Household with a married couple and one child (\$)
(a) Monthly employment earnings as single source of household income	36,000	36,000	18,000	18,000	9,000	9,000	6,000	6,000
(b) Income taxes, reckoned on a monthly basis <sup>(2)</sup>	3,715	1,760	655	0	0	0	0	0
(c) Monthly UI claim received upon unemployment (c) = (a) * (i)	18,000	18,000	9,000	9,000	4,500	4,500	3,000	3,000
(d) Monthly receipt from the CSSA Scheme <sup>(3)</sup>	3,850	8,590	3,850	8,390	3,850	8,590	3,850	8,590
(e) Portion of the CSSA Scheme payment for encouraging employment, reckoned on a monthly basis (if applicable) <sup>(4)</sup> (e) = excess of (d) over (a) - \$1,805, if any	0	0	0	0	0	1,395	0	4,395
(f) Net monthly in-work income (f) = (a) - (b) + (e)	32,285	34,240	17,345	18,000	9,000	10,395	6,000	10,395
(g) Net monthly out-of-work income (with both UI and CSSA benefits) (g) = (c) + (d)	21,850	26,590	12,850	17,390	8,350	13,090	6,850	11,590
(h) Net monthly out-of-work income (with UI benefits counted in CSSA means test) (h) = (c) + excess of (d) over (c), if any	18,000	18,000	9,000	9,000	4,500	8,590	3,850	8,590
(i) Gross wage replacement ratio (%) (as assumed for the present calculation)	50	50	50	50	50	50	50	50
(j) Net wage replacement ratio (%) (with both UI and CSSA benefits) (j) = (g) / (f) * 100%	67.7	77.7	74.1	97.7	92.8	125.9	114.2	111.5
(k) Net wage replacement ratio (%) (with UI benefits counted in CSSA means test) (k) = (h) / (f) * 100%	55.8	52.6	51.9	50.0	50.0	82.6	64.2	82.6

Notes : (1) This implies that all of the household income will be lost upon unemployment of the single earner.

(2) Based on the current salaries tax allowance of \$108,000 per annum for a single person, \$216,000 per annum for a married couple, and \$30,000 per annum for the first child of a couple. The tax payable for the year is then divided by 12 to obtain the tax payable on a monthly basis.

(3) Based on the average monthly recognised needs of CSSA in 2000/01, including standard payment, rent allowance, and other special grants and supplements, for households with nil income comprising one person and three persons respectively.

(4) Households with employment income may be eligible for assistance from the CSSA Scheme, in the amount by which the recognised need as determined by means test exceeds the assessable employment income net of the disregarded portion (up to \$1,805 a month), if any.