For information
on 11 November 2002

LegCo Panel On Welfare Services

Financial Assistance For Older Persons

Purpose

This paper informs Members of the present position regarding the review on the existing social security schemes for older persons.

Background

Population Ageing in Hong Kong

2. Like many other places in the world, Hong Kong's population is ageing. The proportion of the population aged 65 or above will grow from 11.2% in 2001 to 14.4% in 2016 and 24.3% in 2031. That is, by 2031, about 2.12 million, or one out of four Hong Kong people will be aged 65 or above. While the increase in the elderly population is still quite gradual from 2002 to 2016, there will be a marked growth after 2016 because the post-war baby-boomers (those born in the 1950s) will join the "old-age" group starting from that time. The elderly dependency ratio will increase from 155 in 2001 to 198 in 2016 and 380 in 2031. Although the existing social security schemes are, by and large, capable of looking after the financial needs of the elders, given the ageing trend and that the existing schemes are non contributory schemes funded from general revenue, we should carefully examine whether the existing social security schemes for elders are sustainable in the longer term, and if not, what viable options are open to us.

Existing Social Security Schemes for Elders

3. Currently, elders in Hong Kong who have financial difficulty can apply for the Comprehensive Social Security Assistance (CSSA)

Scheme for financial assistance. The CSSA Scheme is a means-tested social safety net designed to provide income support to families and individuals who suffer financial hardship for various reasons such as old age, disability, illness, unemployment, single parenthood and low earnings. Assistance under the scheme is comprehensive, covering financial assistance for basic needs, and special needs such as rent, residential home fee, dietary supplement etc. Recipients also receive free medical attention at Government hospitals and clinics. Elderly recipients can also apply for special grants to meet their special needs, such as installation and monthly fee for emergency alarm system, fares from and to clinics or hospital, costs of glasses and dental treatment and so on. Under this scheme, recipients who are aged 60 are classified as elderly recipients.

4. In addition, the Old Age Allowance (OAA) Scheme under the Social Security Allowance (SSA) Scheme is also designed to meet the special needs of the elderly. For elders aged 65-69, they receive a monthly payment of $625 subject to making an income and asset declaration, while those aged 70 or above receive $705 a month regardless of means.

5. As at September 2002, there were about one million persons aged 60 or above in Hong Kong, of whom over 167 000 were CSSA recipients while over 457 000 older persons aged 65 or above received the OAA. The Government will spend an estimated $11.8 billion in 2002/03 to provide financial assistance to elders through the CSSA and OAA schemes, representing an increase of 50% when compared to the $7.8 billion paid out in 1997/98. **Annex A** provides an overview of the financial commitment made by the Government under these schemes, and the number of elders benefiting from the schemes.

Review of Financial Support for Older Persons

Present Position

6. The Government is reviewing the existing social security schemes for the elderly in order to provide financial assistance to elders in the light of evolving needs and in a changing environment. Over the

past few months, there have been speculations that the Government would bring significant changes to the existing social security schemes, which have caused worry and anxiety among the elderly. In response, the Secretary for Health, Welfare and Food met with representatives from ten elderly concern groups in July 2002 and clarified at the meeting that there was no plan to abolish the OAA. A copy of the press release issued after the meeting is at **Annex B**. At the LegCo Q&A session held on 10 October 2002, the Chief Executive also said that the OAA would not be reduced.

7. The objective of the review is to develop a long term sustainable financial support system for needy elders.

Financial Disposition of Elders

8. In examining the provision of financial support to the elderly population, we need to take into account the financial disposition of Hong Kong's elders. In the summer of 2000, we conducted a survey on the current generation (aged 60 and above) and the next generation (aged 45 to 59) of elders in Hong Kong to obtain a better understanding of their socio-demographic profile and financial disposition. The key findings of the survey have been published by the Census and Statistics Department[1], and reported to the Panel on Welfare Services of the Legislative Council vide paper CB(2)2022/00-01(03).

Overseas Experiences

9. In addition to finding out the financial disposition of the current and future generations of elders, we have also examined overseas experiences in providing financial support to elders.

10. In brief, the old age financial protection systems fall under four basic types – namely **social insurance, social assistance, social allowance and compulsory savings**, classified according to their financing arrangements and the basis on which the benefits are determined.

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[1] Social data collected via the General Household Survey Special Topics Report No. 27.

11. Social insurance and compulsory savings are contributory schemes, meaning that the insured and/or their employers have to make contributions which are often pegged at a certain percentage of their earnings and payrolls respectively. Contributions to social insurance programmes are regarded as tax because they are put into a common pool for redistribution; and pensions from social insurance are in the form of defined-benefits, and are regarded as an entitlement or right by all contributors. Compulsory savings, on the other hand, is characterized by individual accounts. Only the contribution is defined, with benefits depending on contributions and investment returns.

12. Social assistance and social allowance schemes are on the other hand non-contributory schemes, and are financed through general revenue. Social allowance schemes pay a basic amount (usually modest) to those who meet the age and residency requirement regardless of their means. Social assistance, on the other hand, is characterized by the presence of means-testing to determine the level of payments and eligibility. The main advantage of a means-tested approach for targeting assistance is that resources will be focused on the needy.

13. Many countries and social security experts have now recognized that a multi-tiered system would be more capable of offering better protection for elders. In fact, the World Bank has recommended a three-pillar approach for old age financial protection: two mandatory pillars to handle retirement savings and to serve as a social safety net for needy elders respectively, together with a third pillar of a voluntary savings-annuity plan to supplement the two mandatory ones.

14. Variations of the four basic types of old age financial protection systems have been applied, in varying proportions, in Organization of Economic Cooperation and Development (OECD) countries. Their systems have evolved over time in response to changing economic, demographic and social conditions. Many countries now encourage private supplementation of public pension programmes and some have made private supplementation mandatory (e.g. Australia and Denmark).

15. An examination of the levels of personal taxes and social

expenditures in the selected OECD countries reveals that high levels of public pension payments have to be financed by high rates of personal income tax and social security taxes. Nowadays there is a well-recognized need for many OECD countries to re-engineer their Pay-As-You-Go (PAYG) systems. The debate focuses on the cost implications of an ageing population, particularly in an environment of slower economic growth in the developed economies. In addition, today's debate realizes the need to encourage greater individual responsibility and lesser system dependency. It is further recognized that individual account systems can counter-balance disincentives to work, and provide a clearer link between past contributions and future benefits.

16. Details on overseas experiences are at **Annex C**.

Suggestions from the Public

17. We have been gauging the views of the public on the review. We shall discuss the two major suggestions received, viz. increase of OAA and Old Age Pension Scheme in the following paragraphs.

Increase of OAA

18. There have been suggestions that the OAA rates should be raised. While an increase of OAA would provide more financial assistance to many elders, given the fiscal constraints, any proposal that has significant financial implications would need not only to compete for resources with other programmes but also to be justified for redeployment of resources from existing programmes. Another issue with an across the board increase in the OAA to meet the needs of the majority of older persons is that this would effectively reposition it as a universal basic pension. The overseas experience referred to in the preceding paragraphs has demonstrated that an untargeted scheme, funded from general revenue, would be difficult to sustain. Our current low and simple taxation system also cannot sustain this approach.

Old-age Pension Scheme (OPS)

19. Some quarters of the community have recently suggested the Government should re-examine the feasibility of implementing an Old-age Pension Scheme (OPS). The possibility of setting up an OPS was the subject of intensive discussions in the mid-1990s. It was the subject of a public consultation exercise in 1994 when the Government explored options to provide retirement protection for elders. There were then diverse views expressed on the proposal to set up an OPS. While some members of the public gave support to the proposal, others considered it unfair because of a lack of relationship between benefits and contributions. Some also claimed that the OPS would shift the burden of old age protection from individual/family to society. There was also concern that the OPS does not target assistance at those in need, and there is a question of inter-generational equity. Against the above background and given that the Mandatory Provident Fund scheme was intended to be one of the two mandatory pillars recommended by the World Bank, and has only been implemented for a short period of time, we consider that our priority in the next few years is to consider developing the second of the mandatory pillars, that is, a sustainable safety net for needy elders.

Next Step

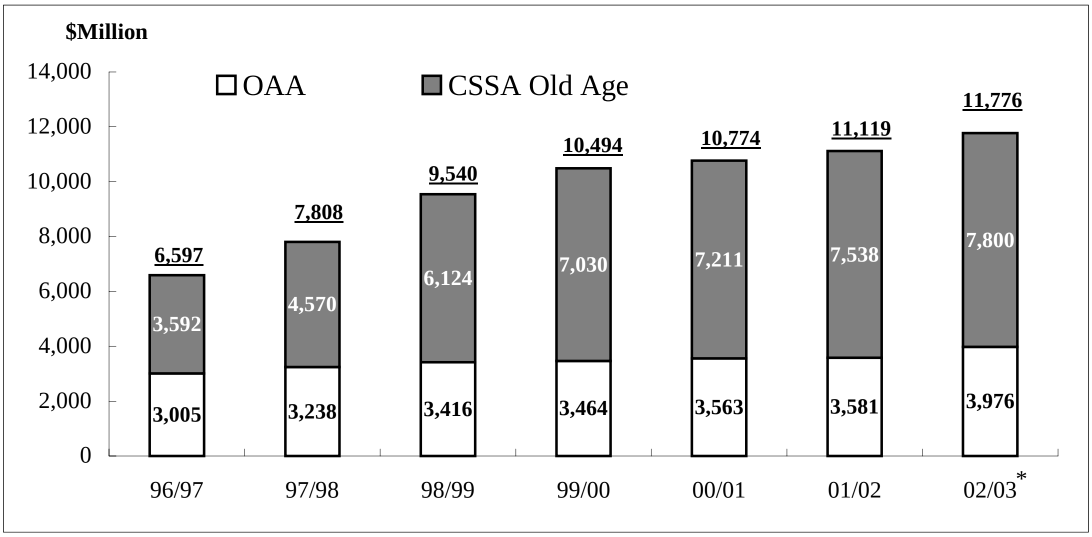
20. In considering our options in developing a sustainable safety net for needy elders, more in-depth studies need to be done. In taking the matter forward, we are sensitive to and will take into account the sentiments of the community with regard to the Higher OAA.

21. The fundamental issue of how to maintain the financial sustainability of our social security system for elders in the face of an ageing population, while maintaining our low and simple taxation system, needs to be appreciated and addressed by the community. We are still studying the issue and have yet to draw up specific proposals for the longer term system and are open to all viable options. If and when there are proposals to introduce major changes to the system, we will consult the public and the Legislative Council first. Our objective is to develop a long term sustainable financial support system that better targets resources at elders most in need.

22. In the meantime, it is envisaged that assistance to needy elders, apart from financial support, will continue to adopt a multi-pronged approach, with assistance being provided to address their needs in housing, medical and health care, community care and support and residential care services. The Government will also promote active and healthy ageing so that our elders can continue to lead productive and active lives as they age.

Health, Welfare and Food Bureau
November 2002

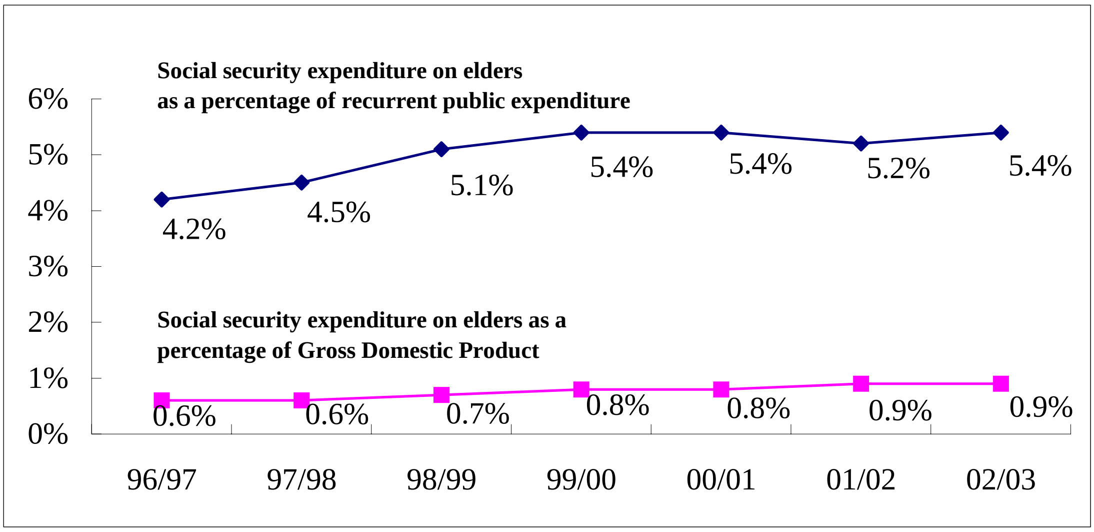
Figure A1. Expenditure on Social Security Schemes for Elders, 1996/97 to 2002/03



Notes: The underlined figure represents the sum of expenditure on CSSA old age case plus that on OAA.

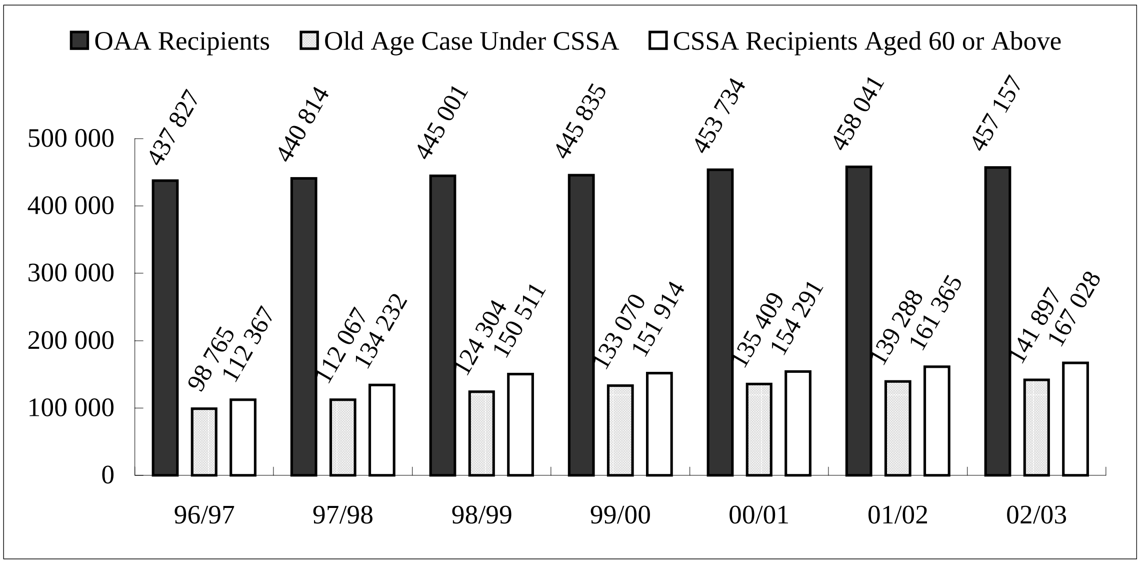
* Approved estimates.

Figure A2. Social Security Expenditure on Elders as a Percentage of Recurrent Public Expenditure and Gross Domestic Product, 1996/97 to 2002/03



Notes: The social security expenditure on elders refers to the sum of expenditure on CSSA old age case plus that on OAA. Public expenditure in 2001/02 refers to the revised estimate and that in 2002/03 to the approved estimate.

Figure A3. Elderly Recipients of Social Security Schemes, 1996/97 to 2002/03



Note: All figures refer to the caseloads or number of recipients as at the end of the financial year, except for 2002/03 which shows the number of recipients and caseloads as <u>at the end of September 2002</u>.

Annex B

Press Release issued after SHWF's Meeting with Ten Elderly Concern Groups

The Government is reviewing the existing social security schemes for the elderly in order to provide better assistance to elders in light of changing needs, the Secretary for Health, Welfare and Food, Dr Yeoh Eng-kiong, said today (July 26).

"We have yet to draw up specific proposals to introduce changes to the existing system. There is no plan to abolish the OAA," he said. Dr Yeoh also assured representatives from 10 elderly concern groups at a meeting this afternoon that existing OAA recipients would not be affected.

Dr Yeoh noted the meeting was a useful and constructive exchange. "We are sensitive to concerns of elders. We welcome their views, which will all be studied carefully in the course of the review. Being an open, caring and responsible government, we shall continue to listen to views from the community in our policy formulating process," he said.

"I understand that there have been speculations that the Government would bring significant changes to the existing social security schemes, which have caused worry and anxiety among the elderly.

"I can assure you that the review is at an initial stage and we are open to all viable options which will better help those in need. If and when there are proposals to introduce major changes to the system, we will consult the public and the Legislative Council first.

In exchanges with representatives at the meeting, Dr Yeoh said that over the past five years, the Government has enhanced the home and community care and support services for elders to meet their preference to age at home. Today, about 29 000 elders have used these services, up by 60 per cent over five years ago. Also, about 26 000 subsidised residential care places to elders who cannot be adequately taken care of at home have been provided, up by 62 per cent over five years ago. Expenditure on elderly services in this financial year amounts to $3.5 billion, more than double the expenditure five years ago.

"The objective of our elderly services and measures is to improve the quality of life of our elders. We had all along been promoting the community's respect and caring for elders and to provide opportunities for the elders to continue to contribute to the society.

"When the OAA was first introduced in 1973, the objective was to help families to look after their older members. In view of the ageing population and the need to address the fiscal challenges, we have to develop a long term sustainable financial support system for needy elders. "We will take all relevant factors into account in developing any new proposals," Dr Yeoh said.

Speaking after the meeting, Dr Yeoh welcomed the direct dialogue with representatives on a number of issues of common concern including medical services, social and recreational services and other support services for the elders.

As at June 2002, there were about one million persons aged 60 or above in Hong Kong, of whom some 164 200 were CSSA recipients while over 457 000 people received OAA.

The Government will spend an estimated $11.8 billion to provide financial assistance to elders through CSSA and OAA schemes, which are both non-contributory, representing an increase of 50 per cent when compared to the $7.8 billion payout in 1997/98.

According to the latest population projections, the proportion of the population aged 65 or above will grow from 11.2 per cent in 2001 to 24.3 per cent in 2031, or one in four persons in Hong Kong will then be 65 years of age or older.

Annex C

Financial Support for Older Persons – Overseas Experiences

Pension Systems of OECD Countries

The pension systems of OECD countries are very diverse, but all characterized by a strong public component. While most of the public pension schemes are defined-benefits social insurance financed by pay-as-you-go (PAYG) contributions, many are also financed through transfers from the general revenue. **Table C1** sets out the major old age financial protection programmes of Australia, New Zealand, UK, USA, Canada, Denmark, and Japan. All of them offer a first-pillar pension, many of which are means-tested. Japan, UK and Denmark also have a contributory flat-rate pension scheme as a first-pillar protection – the income redistribution effect is very high for such programmes as a flat rate is paid out to all eligible individuals regardless of their prior earnings and contributions. Australia, Denmark and the UK have large funded second-pillar pension schemes, which are privately managed occupational pension schemes characterized by defined contributions. New Zealand is the only country relying entirely on a social allowance pension scheme. On the other hand, Denmark has the most comprehensive pension systems, and its public pensions are generally financed by general revenue.

2. Variations of the four basic types of old age financial protection systems have been applied, in varying proportions, in OECD countries. Their systems have evolved over time in response to changing economic, demographic and social conditions. Many countries now encourage private supplementation of public pension programmes and some have made private supplementation mandatory (e.g. Australia and Denmark).

3. **Table C2** shows the levels of personal taxes and social expenditures in the selected OECD countries. It is evident that public pension is an important part of social spending in all these countries; and high levels of public pension payments have to be financed by high rates of taxation, particularly through personal income tax and social security taxes. It has been a concern that high levels of public pension

expenditure may lower the tax revenue available for other social benefits and developmental programmes such as education, health and infrastructure.

Table C1. Major Old Age Financial Protection Programs in Selected OECD Countries

Major Programs	Australia	New Zealand	UK	Canada	USA	Denmark	Japan
Means-tested universal pension	✓						
Means-tested income supplement (social assistance)			✓	✓	✓	✓	
Universal flat-rate minimum pension (social allowance)		✓		✓		✓	
Universal flat-rate social insurance pension			✓			✓	✓
Supplementary earnings-related social insurance pension			✓				
Compulsory earnings-related social insurance pension				✓	✓		✓
Mandatory private pensions (Mandatory occupational pension)	✓		✓[b]			✓	
Voluntary private pensions[a]			✓		✓	✓	

First pillar of basic protection

Second pillar of retirement savings

(a) Only voluntary schemes subsidized by the government, such as through tax breaks, are included.

(b) In the UK, employers and workers may opt out of the public earnings-related social insurance pension scheme by participating in occupational or private pension schemes.

Table C2. Personal Income Tax and Social Expenditures in Selected OECD countries

Selected countries	Average personal income tax and social security contributions, 2001[a]	Gross public social expenditure, 1997 [c][d]	Public pensions (old age and survivors) expenditure, 1997[c]
	% of gross wage earnings[b]	% of GDP	
Australia	23.1 (48.5)	17.4	4.4
New Zealand	19.5 (39.0)	20.7	5.6
UK	23.3 (40.0)	21.2	7.0
Canada	25.3 (43.2)	17.9	5.6
USA	24.6 (47.5)	14.7	6.0
Denmark	43.8 (63.3)	30.7	7.0
Japan	16.2 (49.5)	14.0	6.4

(a) Source: OECD, Tax Database 2000-2002.
(b) 'Gross wage earnings' refer to average annual gross wage earnings of adult, full-time workers in the manufacturing sector. Figures in parentheses are top marginal tax rates, which are derived on the basis of a unit increase in gross wage earnings.
(c) Source: OECD, 2001, Net Social Expenditure, 2nd Edition, Paris.
(d) Public social expenditures are government spending on health and welfare, which include pensions (old age and survivor benefits), disability benefits, sickness benefits, unemployment benefits and other cash benefits such as family allowances, as well as public healthcare and social services financed by the government.

Lessons from OECD Experiences

4. Public old-age pensions were originally introduced in industrialized countries to reduce poverty in old age by providing coverage for the entire working population and their survivors. However, public defined-benefit systems with generous rules started to emerge after the war in the 1950s. Some systems disregarded the contributory principle of social insurance and extended the benefits to all residents regardless of their work status, often with large infusion of government funding. The number of covered years needed for a full benefit was in some cases set lower (e.g. 20-30 years) than the normal male working careers. In addition, the benefit itself may have been based on the participants' best years or the final years of earnings. These types of benefit formula are designed to provide better benefits to persons retiring in the initial decades after the war. However, it has

turned out to be a hidden problem in the long run. For example, there is an unfair redistribution from those with longer and relative flat earnings careers to persons with shorter working careers and steep increases in their earnings profiles. In addition, these systems typically offer a full-benefit at a specific age, and often also allow early retirement.

5. Over the years, workers have been retiring earlier under the generous rules, and the workforce participation of males has declined in all OECD countries except Japan. Pensioners are also drawing on the public pension for an increasingly longer period of time. It is now generally recognized that the actual retirement age has to be increased, and actuarial neutrality has to be established with regard to the timing of retirement and life expectancy at retirement. This realization has led countries to move in the direction of lifetime accounts by tying benefits to lifetime contributions.

6. When the economy grew rapidly and with a young society, it was possible to transfer higher percentages of GDP from workers to pensioners. Improved benefits were affordable in the initial decades after the war because people spent more of their adult lives working, and less in retirement. However, **population ageing, lower fertility rates and increasing life expectancy mean that a smaller number of future workers have to support a higher number of retirees who also live longer**. In other words, the existing old age financial support systems may have succeeded in transferring growing prosperity to older persons, but their design and tax rules are working against their financial sustainability. There is now a well-recognized need for many OECD countries to re-engineer their PAYG systems.

International Debates on Public Pension

7. Public policy debates on pension plans have focused on a wide variety of issues over the years. In the past, the debate focused on finding the best way of assuring adequate incomes for retirees. Nowadays, the debate focuses on the cost implications of an ageing population, particularly in an environment of slower economic growth in the developed economies. In addition, the current debate recognizes the need to encourage greater individual responsibility and less system

dependency. It is further recognized that it is no longer feasible to advocate the use of pensions to promote social stability since the fiscal pressure of PAYG systems may in fact heighten intergenerational tension, and that individual account systems can counterbalance disincentives to work, and provide a clearer link between past contributions and future benefits.