

**Information Paper for
Legislative Council Panel on Public Service**

Pensions Adjustment Policy and Mechanism

Purpose

This paper briefs Members on the review of the pension adjustment policy and mechanism as prescribed in the pension increase legislation¹, and the Administration's views that the current policy and mechanism should be maintained and re-affirmed.

Existing Pension Increase Policy and Mechanism

2. The current pension increase policy and mechanism are prescribed in the pension increase legislation, which provides that the pensions paid to pensioners under pension schemes for civil servants and judicial officers and their dependants shall be subject to **annual increase** according to inflation. The **pension increase** shall be calculated by reference to the **increase in the annual average monthly Consumer Price Index (A) (CPI(A))** of the last financial year over that of the immediately preceding financial year. It has been a practice that pension increase is awarded with effect from 1 April each year.

3. In the event of deflation, i.e. the annual average monthly CPI(A) in one financial year is lower than that of the immediately preceding financial year, the existing pension increase legislation would have the following effects -

- (a) there would be no pension increase immediately following the financial year of deflation. Pensions would be frozen but not reduced; and
- (b) subsequent to the freeze in pension level after the year of deflation, pension increase would be made in accordance with the increase in annual average monthly CPI(A) in the last financial year compared with that of the financial year immediately before. No account can be given to the previous deflation and hence the freeze of pension level in the year(s) beforehand.

¹ Specifically the Pensions (Increase) Ordinance [P(I)O] and the Widows and Orphans Pension (Increase Ordinance) [WOP(I)O]. Relevant extract at Annex. The P(I)O governs the increase of pensions granted under the Pensions Ordinance, Pension Benefits Ordinance, Pension Benefits (Judicial Officers) Ordinance and Surviving Spouses' and Children's Pensions Ordinance. The WOP(I)O governs the increase of pensions granted under the Widows and Orphans Pension Ordinance.

4. To illustrate, assuming annual average monthly CPI(A) dropped by 4% in 1999-2000 over 1998-99 and then picked up by 2.5% in 2000-01 over 1999-2000, pensions would be frozen in the financial year of 2000-01 and a pension increase of 2.5% would be made in 2001-02.

Development of Pension Increase Policy and Mechanism

5. It is Government's long-established policy since 1947 to grant increases to the pensions of civil service pensioners to catch up with increases in the cost of living. Prior to 1975, there was no established criteria for pension increases in Hong Kong. The general practice was to review pensions immediately following a salary award, taking into account the increase in the cost of living and any salary increases during the review period. Increases to pensions were granted on an ad hoc and ex-gratia basis at irregular intervals subject to approval by the Finance Committee.

6. The Pensions (Increase) Ordinance (Cap 305) and Widows and Orphans Pension (Increase) Ordinance (Cap 205) were enacted in 1975 and 1976 respectively to ensure the continued validity of previous pension increases granted for their respective periods and to clarify eligibility for pension increases. The Ordinances then did not prescribe how the increases should be made.

7. Since 1975, the Administration has established the criteria for pension increase having regard to the pension review systems in the UK and other Commonwealth countries (notably Australia, New Zealand and Canada). In particular, the policy aims to ensure that the original purchasing power of pensions in Hong Kong is maintained by granting increase annually to pensions according to changes in purchasing power measured by the CPI(A) and independently of increases in salaries.

8. In 1990, the Administration decided that the CPI(A) should continue to be used as the indicator of price inflation for pension increase purposes and that the **pension increase against price inflation should be granted as of right and the existing method of adjustment be statutorily provided for** in the pension increase legislation. The pension increase legislation was thus amended in 1993 to prescribe the pension increase policy and mechanism into the statute.

Pension Increase Policy and Deflation

9. In the pension increase legislation enacted in 1993, deflation was not featured. We believe there were strong policy reasons for not featuring deflation in the **pension increase** policy -

- (a) it had been the well-established administrative practices and policy that despite the then discretionary nature of pensions increases prior to 1975, no pension reduction was made even on occasions of reduction in Retail Price Index (the predecessor of the CPIs) in the 1950s and early 1960s;
- (b) as the Government deliberated on the pension increase policy which led to the enactment of the P(I)O in 1975, the Administration had laid down the criteria for pension increase. One of the key considerations underlining the criteria was to accord priority to protect pensioners even when compared with those in employment as the former are generally elderly and less able to fend for themselves; and
- (c) it was and remains a common design among the pension increase mechanisms in the Commonwealth governments (e.g. UK, Canada, Australia and New Zealand) that only pension increase on account of inflation is allowed. Pensions would be frozen on deflation. In Canada subsequent increase would not take into account previous deflation, though in Australia and New Zealand subsequent increase would take into account previous deflation. In UK, subsequent pension increase would be up to the government to decide.

Review

10. Hong Kong has not experienced any decrease in annual average monthly CPI since 1962. However, in 1999, Composite CPI has declined by 4%. It is forecast that inflation would remain minimal in the year 2000 and that consumer prices are expected to pick up in 2001 and gradually rise further in the ensuing years. The Composite CPI is forecast to increase by an order of 2.5% per annum during 2000-03. In view of the prospect of deflation, the Administration has reviewed the existing pension increase policy and mechanism.

11. While it can be argued that reducing pension on deflation or taking into account previous deflation in pension increase subsequent to deflation would not contravene the aim of maintaining the purchasing power of pensions, we see strong arguments in principle to maintain the present pension increase policy and mechanism -

- (a) the long-established policy since 1947 is that **pension increases are awarded on top of pensions granted to pensioners to adjust pensions upward to maintain their purchasing power.** Reduction of pensions on deflation would involve a fundamental change to the pension increase policy;

- (b) it is also the long-established pension increase mechanism since 1976 that pension increase is made on the basis of increase of CPI(A) from one year to the next. Taking into account the cumulative effect of movements in consumer price index in subsequent pension increase involves a fundamental change to the existing pension increase mechanism prescribed in statute since 1993;
- (c) pensions, including the pension increase mechanism prescribed in statute since 1993 as a conscious policy of the Administration, are regarded by pensioners and serving civil servants as part and parcel of their accrued rights. Any attempt to alter the pension adjustment mechanism would likely be perceived as erosion of accrued statutory rights and give rise to strong objection and challenges;
- (d) among the 56,000 pensioners, more than 30,000 or 50% of which are receiving monthly pensions of less than \$5,000. The monthly pension is in many cases the sole or main source of income to support the living of these pensioners; and
- (e) the current outlook is that deflation is likely to be short-term.

12. In addition to these issues of principle, there are also practical difficulties in introducing changes to the current pension increase mechanism, namely -

- (a) reducing pension on deflation will give rise to disparity in treatment between early retirees and normal retirees. Early retirees are not subject to pension adjustment until they reach normal retirement age and would thus be treated differently on deflation when compared with normal retirees if we are to reduce the latter's pensions;
- (b) freezing pension on deflation and reducing subsequent pension increase across-the-board taking into account the previous deflation will also give rise to disparity in treatment between officers who retire before and after the deflation. In particular, civil servants who retire after the deflation may argue that their pension increases are suppressed instead of being maintained in line with the purchasing power; and
- (c) on the other hand, applying index-linked pension adjustment on the basis of individual retirees would be undesirable and administratively cumbersome. It may invite criticisms from old pensioners for being treated less favourably than new pensioners, particularly from those retired in the early years whose pensions are much smaller, even with

pension increases, compared to pensioners retired recently who have enjoyed salary increases over and above inflation.

Investigation by Director of Audit

13. The pension adjustment mechanism has been a subject of investigation by the Director of Audit, who has published a report of investigation for submission to the Public Accounts Committee on 29 March 2000. The Director of Audit notes the effect of the current pension adjustment mechanism which does not provide for reduction of pensions on deflation or reduction of subsequent pension increase to take account of previous deflation. The Director of Audit has also estimated that there would be savings in pension expenditure if the current pension adjustment mechanism were to be revised to provide for reduction of pension on deflation. The Director of Audit has urged the Administration to review the matter and make an early decision.

The Administration's Views

14. The Administration notes the Director of Audit's observations and has reviewed the current pension increase policy and mechanism which has been prescribed into the statute since 1993. Having regard to the review and considerations as set out above, the Administration is of the view that the current pension increase policy and mechanism as prescribed in the pension increase legislation should be maintained and reaffirmed.

Appointments Division
Civil Service Bureau
29 March 2000

**Extract from Pensions (Increase) Ordinance (Cap. 305) and
Widows and Orphans Pension (Increase) Ordinance (Cap. 205)**

Pensions (Increase) Ordinance, Cap. 305

Section 4 Authorized increases

- (1) A basic pension to which this Ordinance applies shall, in respect of any period beginning on or after the commencement of this Ordinance, be increased in accordance with such Part of Schedule 2 as is applicable in the particular case. (Amended 36 of 1987 s. 38)
- (1A) A basic pension to which this Ordinance applies (including any adjusted pension) shall, in respect of any period beginning on or after 1 April 1993, be increased or further increased, as the case may be, by such percentage ("percentage of increase") declared by the Chief Executive under subsection (1B) from time to time after the period in which the salary in force is the salary on which the pension is based. (Added 3 of 1993 s. 58. Amended 63 of 1999 s. 3)
- (1B) If, in any year after 1992 ("the succeeding year"), the average monthly Consumer Price Index (A) of the period of 12 months beginning on 1 April of the previous year and ending on 31 March of the succeeding year, exceeds the average monthly Consumer Price Index (A) of the period of 12 months immediately preceding that first mentioned period by an amount which when expressed as a percentage exceeds 0.1%, the Chief Executive shall, for the purpose of subsection (1A), declare a percentage of increase equal to the excess expressed as a percentage. (Added 3 of 1993 s. 58. Amended 63 of 1999 s. 3)
- (1C) A declaration under subsection (1B) shall be made as soon as practicable by notice in the Gazette and shall take effect on a date specified in such notice, which date shall not be later than the date of the notice. (Added 3 of 1993 s. 58)
- (2) Subsections (1) and (1A) shall apply to a basic pension which is a deferred pension under the Pension Benefits Ordinance (Cap 99) or the Pension Benefits (Judicial Officers) Ordinance (Cap 401) with effect from the date the deferred pension is granted and shall apply to the commuted pension gratuity of a deferred pension under the Pension Benefits Ordinance (Cap 99) or the Pension Benefits (Judicial Officers) Ordinance (Cap 401) in the same manner as a "basic pension as regards the period from the date the deferred pension is granted to the date when the commuted pension gratuity is paid. (Added 36 of 1987 s. 38. Amended 85 of 1988 s. 54; 3 of 1993 s. 58)
- (3) Subsections (1) and (1A) shall apply to a basic pension which is an additional pension granted under regulation 31 of the Pensions Regulations (Cap 89 sub. leg.) or section 15 of either the Pension Benefits Ordinance (Cap 89) or the Pension Benefits (Judicial Officers) Ordinance (Cap 401). (Added 36 of 1987 s. 38. Amended 85 of 1988 s. 54; 3 of 1993 s. 58)
- (4) Where an officer is granted a pension under section 6(2) of the Pensions Ordinance (Cap 89) and opts under regulation 23 of the Pensions Regulations (Cap 89 sub. leg.) to receive a gratuity (in lieu of part of his pension), then as regards the period beginning on the date on which the pension is granted and ending on -
 - (a) the day immediately preceding the day on and from which, assuming he does not sooner die, he could, subject to the provisions of this Ordinance, expect payment of the pension to be made; or
 - (b) in case he so dies, the day on which he dies, subsections (1) and (1A) shall apply to the gratuity in the same manner as they apply, as regards that period, to a basic pension mentioned in those subsections. (Added 36 of 1987 s. 38. Amended 3 of 1993 s. 58)

Widows and Orphans Pension (Increase) Ordinance, Cap. 205

Section 3 Increase in pension

- (1) A pension may, in any period ending not later than the date from which the first increase under subsection (2) becomes effective, be increased in accordance with one or more paragraphs of the Schedule as are applicable in any particular case. (Amended 3 of 1993 s. 54)
- (2) If, in any year after 1992 ("the succeeding year"), the average monthly Consumer Price Index (A) of the period of 12 months beginning on 1 April of the previous year and ending on 31 March of the succeeding year, exceeds the average monthly Consumer Price Index (A) of the 12 months immediately preceding that first-mentioned period by an amount which when expressed as a percentage exceeds 0.1%, the pensions described in subsection (4) shall be increased by a percentage equal to the excess expressed as a percentage with effect from the date specified under subsection (3)(a) in respect of such increase. (Added 3 of 1993 s. 54)
- (3) Where, pursuant to subsection (2), any pension becomes subject to an increase, the Chief Executive shall, as soon as practicable, by notice published in the Gazette specify-(Amended 63 of 1999 s. 3)
 - (a) the date, which shall not be later than the date of the notice, from which such increase shall be effective; and
 - (b) the percentage of the increase as determined in accordance with subsection (2). (Added 3 of 1993 s. 54)
- (4) The pensions referred to in subsection (2) are-
 - (a) in the case of the first increase under that subsection-
 - (i) any pension calculated on the total contributions up to 31 March 1992 together with the total increases in pension; and
 - (ii) any pension calculated on the contributions from 1 April 1992, up to the date immediately preceding the specified date of such first increase; and
 - (b) in the case of any subsequent increase under subsection (2)-
 - (i) any pension calculated on the contributions up to the date immediately preceding the specified date of the last increase under that subsection together with the total increases in pension; and
 - (ii) any pension calculated on the contributions from the specified date of the last increase under that subsection, up to the date immediately preceding the specified date of such subsequent increase. (Added 3 of 1993 s. 54)
- (5) In subsection (4) "specified date" (指定日期), in relation to an increase under subsection (2), means the date specified under subsection (3)(a) as the date from which that increase shall be effective. (Added 3 of 1993 s. 54)