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Pension reforms in urban China and Hong Kong

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ABSTRACT

This study of recent pension reforms in Hong Kong and urban China particularly addressed three questions. What are the causes of the pension reforms in these two economies? What are their key features? What difficulties have been faced by the Hong Kong and Beijing governments during their implementation? As well as enhancing our understanding of the pension schemes in these two countries, the paper makes a contribution to the debate on whether government welfare reforms in responses to economic globalisation are converging on one pattern, an ideal mix of pension schemes. This paper shows that both convergent and path-dependent processes explain the forms of the measures introduced by the Hong Kong and Beijing governments. They have responded not only to the challenges brought by economic globalisation but also to the legacy of previous policies. Moreover, the welfare effectiveness of the new schemes has been undermined both by the two governments' non-welfare policies, particularly to promote economic growth, and by the constraints created by the previous welfare measures. The paper also argues that to develop only a non-contributory comprehensive pension scheme is not the solution to the problem of how best to provide old-age income security, but that this welfare goal principle should be more strongly upheld in pensions reforms.

KEY WORDS – funded pensions, path-dependency, welfare reform, pension reform.

Introduction

How governments should reconstruct social welfare in an era of economic globalisation is vigorously debated. Some argue that the internationalisation of commodity markets and the need to compete for increasingly mobile private capital requires all governments to introduce similar pro-market social welfare reforms, and therefore that government responses must converge; and they advocate reforms that will open the supply and organisation of welfare to market forces and therefore reduce the role of

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the state as a welfare provider and in managing fiscal and social security transfers (Mabbett and Bolderson 1999; Palier and Sykes 2001; Erhel and Zajdela 2004). A concrete example of such proposals was the World Bank's (1994) prospectus for pension reforms, *Averting the Old Age Crisis*. This criticised pay-as-you-go programmes as financially unsustainable, and advocated pre-funded individual accounts, a lead role for the private sector and 'multi-pillar' pensions provision, which it argued would optimise distribution, insurance and savings. They recommended three pillars of provision: a mandatory state pension as a safety-net that is funded from taxes on a pay-as-you-go basis; a mandatory privately-managed pillar, in the form of personal or occupational pensions that are 'fully funded' and managed by the financial services industry; and voluntary personal savings (1994: 237).

Many social welfare analysts, however, do not believe that government responses to economic globalisation must converge, or accept that it is imperative to implement either pro-market welfare reforms or the World Bank's template. Some support a 'path dependency' model, which holds that acquired national differences in the organisation of social welfare persist even in the face of international competitive pressures (Pierson 1994; Bonoli 2000). As governments have provided social welfare in different ways in the past, they argue, it is appropriate and not surprising that their reconstructions of social welfare also differ.

There has also been a widespread view that pro-market welfare reforms undermine the role of social welfare in meeting social needs (Warnes 1996; Wilding 1997; Walker and Wong 2005). Choi (2006) and Ring (2005) noted that governments pay too much attention to macroeconomic management issues, such as the financial sustainability of public pensions and making workers meet the requirements of the increasingly flexible labour market, and pay too little attention to the capacity of pension schemes to provide income security for older people. In his paper on British pension schemes, Ring (2005: 359) raised the question: '[if] pensions are all about security, then is it too much to ask that the government begins to appreciate what security is all about?' From his analysis of the welfare implications of the Korean pension reforms, Choi (2006: 563) concluded that 'it is questionable how much the current reform options will promote or guarantee old-age security', and argued that serious consideration should be given to the introduction of a comprehensive non-contributory pension scheme. That recommendation radically differs from the World Bank's template of contribution-based and fully-funded schemes.

The recent pension reforms in Hong Kong and urban China have drawn from the World Bank's ideas and exhibited path-dependency: that is, in both cases, the implementation has been influenced in ways

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particular to the national government's previous measures of financial protection for older people. Both the Hong Kong and Beijing governments are keen to increase the attractiveness of their economies to private international capital, and this consideration has had negative impacts on the capacity of the reformed pensions to provide financial protection for older people. The pro-market reforms have not been the only factor that has increased the gap between what older people need and what the pension schemes provide, however, for the income protection role has also been undermined by the constraints of the previous measures.

Aims and scope

This paper analyses the recent pension reforms in Hong Kong and urban China, not only to enhance our understanding of the welfare role of pensions in these two economies, but also to contribute to the debate on the applicability of the convergence and path-dependency models of welfare reform. The paper appraises the negative impacts of pro-market reforms on old-age welfare, and is a contribution to the search for an 'ideal mix' of pensions schemes. The paper begins by explaining the concept of path-dependency, the alternative to the convergence view of governments' responses to economic globalisation. This is followed by an account of the causes and features of the pension reforms in Hong Kong and urban China, and of the difficulties faced by decision-makers in carrying out these reforms.

The path dependency of welfare reform

The retrenchment of social welfare has been undertaken by many governments during the current era of economic globalisation, although the precise form has varied considerably (Kennett 2001). As one example, the structural and institutional welfare reforms launched after 1979 by the British Prime Minister, Margaret Thatcher, were inspired by supply-side economics and promoted individual responsibility, and were more far reaching than the concurrent welfare reforms in Germany (Lash and Urry 1987). It has been suggested that different countries do not reform social welfare in the same ways because the starting points and economic and social trajectories differ, that is, reforms are 'path dependent'. This concept has been used by economists to explain the persistence of inefficient technologies despite the availability of better alternatives (North 1990).

In applying this concept to the analysis of pension reforms, Pierson (1994) discussed the 'lock-in effects' that greatly increased the cost of a

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reform and inhibited exit from a current policy-path. One example is the difficulty of replacing a pay-as-you-go pension scheme with a funded scheme: if a government proposes this change, it will be strongly resisted by current workers, for to finance their own retirement and the pensions that are currently being paid they will be required to pay double pension contributions (Bonoli 2000). As far as welfare reforms are concerned, the concept of path dependency conveys two important messages. First, governments should not necessarily follow a single template when reconstructing social welfare, but rather should respond to economic globalisation in ways that are consistent with the national historical background and current needs and capacities. Given that reforms will vary, studying whether and how governments follow the World Bank's suggestions on pension reforms requires a comparative framework.

The underlying causes of pension reforms

The pension reforms in Hong Kong and urban China have important similarities and differences. Both the Hong Kong and Beijing governments face demographic challenges and have sought pension policies and arrangements that accommodate both the development of social welfare and the promotion of the private sector in the economy. On the other hand, the problems that they had to tackle have been quite different, largely because of the different previous forms of organised social welfare. The strategies used by the Beijing government to expand the market economy have seriously undermined the previous mode of welfare provision that was dominated by state-owned enterprises. To create a more attractive investment environment, to help workers in urban China cope with income insecurity, and to strengthen social stability, it has developed a new form of social insurance (including for pensions) that reflects the changes in social and economic conditions that are being shaped by market reforms. In Hong Kong, the poor performance of the economy since the Asian financial crisis in 1997 has made it difficult for the government to raise sufficient revenues to fulfil its commitments to social welfare and has raised its awareness of the problem of the long-term sustainability of providing financial support to older people. Hence it is safe to say that the immediate concern of the Hong Kong government is to search for a new source of finance for welfare.

The background to the pension reforms in urban China

Since coming to power in 1949, the Chinese Communist Party has been keen to persuade the population of the importance of realising socialist

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goals through their participation in economic activities. This had led to full-employment policies and the provision of comprehensive welfare for workers and their families in urban China (Fung 2001). In 1957, the Beijing government set up the first nationwide pension system and gave the management responsibility to the National Trades Union (Huang 2003). This system provided comprehensive occupational welfare but mainly covered workers in state-owned enterprises. Revenues from the enterprises were used to fund retirees' benefits on a pay-as-you-go principle (Zhu 2002). According to Leckie (2003), the system was very generous. Male factory workers received their pension at 60 years of age and females at 55 or 50 years, while workers were not required to make contributions but received benefits equal to about 80 per cent of their final annual earnings. At the beginning of the Cultural Revolution, the national pension system was split into numerous pension schemes for individual enterprises (James 2002). Those state-owned enterprises that were unable to meet their pensions obligations were compensated directly out of state revenue (Huang 2003).

The market reforms launched since the late 1970s have seriously undermined the ability of state-owned enterprises to provide income protection for their retired workers (Song and Chu 1997; Beland and Yu 2004). To expand the market economy, the Beijing government encouraged the establishment of private companies that would compete with state-owned enterprises (Tang and Ngan 2001). This competition, together with poor management and the heavy welfare and pensions-funding responsibilities, made one-half of the state-owned enterprises either loss-making or bankrupt (Saunders and Shang 2001; James 2002). Not surprisingly, the proportion of the workforce in state-owned enterprises has decreased significantly – from 76.2 per cent in 1980 to 25.3 per cent in 2004 (Republic of China, State Statistical Bureau 2005*a*).

Several trends have combined to reduce the coverage and value of public-sector pension schemes. First, the ratio of benefit claimants to workers rose rapidly (see Table 1). From 1985 to 2004, the number of retirees of the state-owned enterprises more than doubled and the ratio of workers to each retiree decreased from 7.5 to 2.3. As a result, an increasing number of state-owned enterprises have insufficient revenue to honour their pension commitments. Over the same period, the average wage-replacement rate of the pensions offered by state-owned enterprises decreased from 86 to 48.3 per cent (Table 1). The dilution of income protection has created serious social conflicts. For example, in 2002 in Guizhou province, more than 1,000 retired workers blocked the roads and protested against the inadequacy of their retirement benefits. In the same

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TABLE 1. *Key statistics of the state employees pension scheme, People's Republic of China, 1985–2004*

Year	Millions of SOE retirees	Ratio of SOE retirees to workers	Expenditure on pensions (billion RMB)	Average annual pension (RMB)	Average annual SOE wage (RMB)	Average wage replacement rate (%)[1]
1985	11.7	1:7.5	11.2	1043	1213	86.0
1990	17.2	1:6.1	30.6	1868	2284	81.8
1991	18.3	1:6.0	36.5	2096	2477	84.6
1992	19.7	1:5.7	45.7	2448	2878	85.1
1993	21.4	1:5.4	60.1	2979	3532	84.3
1994	22.5	1:5.1	84.4	3923	4797	81.8
1995	24.0	1:4.8	105.5	4620	5625	82.1
1996	25.2	1:4.6	126.5	5229	6280	83.3
1997	26.4	1:4.4	149.3	5890	6747	87.3
1998	27.8	1:4.0	172.6	6369	7668	83.1
1999	20.2	1:3.7	186.6	6614	8543	77.4
2000	21.1	1:3.5	184.7	6318	9552	66.1
2001	21.6	1:3.2	198.9	6573	11 178	58.8
2002	22.6	1:3.0	241.7	7633	12 869	59.3
2003	23.9	1:2.7	268.5	7957	14 577	54.6
2004	24.0	1:2.3	286.7	8081	16 729	48.3

Notes: 1. Average wage replacement rate is the ratio of average pensions to average wage level. SOE state-owned enterprise. The exchange value of one US dollar is eight RMB.
Sources: *China Labour and Social Security Yearbook*, 2000; *China Labour Statistical Yearbook*, various years (1998, 2000, 2001, 2002, 2003, 2004, 2005*a*).

year, thousands of retired workers in Henan launched street protests for the same reason.

Private-sector employers are not compelled to provide pension schemes for their workers. The consequence is that an increasing number of urban workers do not have adequate retirement pensions, partly because many employees of state-owned enterprises are unwilling to move to the private sector and there has been strong resistance to the redundancy programmes implemented by state-owned enterprises (*China News Digest*, January 23, 2002; *China Labour Bulletin*, November 25, 2005). The resulting immobility of labour has retarded the modernisation of the economy and decreased labour productivity. It is commonly believed that the social conflicts and instability discourage investors, although this is not apparent from the data on inward capital flows. From 1994 to 2004, foreign direct investments in China increased steadily from US$ 33.7 billion to 60.6 billion, and they increased again to US$ 66 billion in 2005 (*Asian Wall Street Journal*, 30 September, 2005; Republic of China, State Statistical Bureau 2005*b*). Nonetheless, the Chinese leadership is still worried about the negative effect of workplace conflicts on social stability and the economy. Some Chinese leaders, notably Jiang Zemin, have repeatedly proclaimed

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the importance of providing social support to marginal groups (Chau and Yu 2005). His successor, Hu Jintao, also openly instructed officials to put 'building a harmonious society' at the top of the government's agenda. The Beijing government has sought to balance the interests of different social groups, to avoid conflicts, and to strengthen stability through the provision of social welfare such as pension schemes (*China Daily*, 4 March, 2005; Xinhua News Agency, 5 March, 2005 and 28 June, 2005).

It is also important to note that developing a pension system may increase rather than reduce the workers' discontent, because a new scheme may require them to make financial contributions and thus reduces their disposable income, despite the long-run benefit of a better pension. Improved income protection is particularly important in China given the demographic trends: the proportion of people aged 60 or more years will increase from 10 to 22 per cent during 2000 to 2030 (Song 2001; Zhang 2003). The financial implications are already clear: expenditure on pensions for the retirees of state-owned enterprises increased from 11.2 billion RMB (*renminbi* or *yuan*) to 286.7 billion RMB during 1985 to 2004 (see Table 1).

The background to the pension reforms in Hong Kong

To attract private investment, the Hong Kong government has long stressed the importance of the private market in the creation of wealth, and has maintained low tax and balanced budget policies. Chris Patten (1999), the last governor of the British colonial administration, remarked that the Hong Kong economy was the closest to the classic free market in Asia, because government intervention was generally viewed as blunting the competitiveness of the private-sector. From 1949 to 1997, in only six financial years did the colonial administration have deficits, and both the standard rate of income tax and the tax on corporate profits were seldom higher than 20 per cent. After 1997, Hong Kong was reintegrated into China as a special administrative region (SAR). With the blessing of the Beijing government, the new SAR administration is as enthusiastic as the former colonial administration to promote the private sector, and equally champions low taxation and balanced budgets. Articles 5, 107 and 108 of the SAR Basic Laws require it to maintain Hong Kong as a capitalist economy, with low taxes and a fiscal balance (Chau and Yu 2003).

In the light of their economic priorities, both the colonial administration and the Hong Kong SAR government have been concerned about the negative effects of social-welfare spending on private-sector investment. Both openly worried that social welfare generates a dependency culture and a heavy economic burden (Chiu and Wong 1998). Nevertheless, both

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administrations have committed to one of the most comprehensive welfare systems in Asia. More than one-third of the population lives in public-rental housing, and about 94 per cent of hospital services were provided by the public sector in 2000 (Hong Kong, Health, Welfare and Food Bureau 2000). A means-tested non-contributory financial assistance scheme, the *Comprehensive Social Security Assistance Scheme* (CSSA), provides income benefits for the poor and has an important role in providing financial protection for older people. In 2005, over 50 per cent of CSSA users were aged 60 or more years (Social Welfare Department 2006).

The gap between what the colonial administration and the Hong Kong SAR government have professed about the provision of social welfare and what they practise has attracted the attention of social analysts. As well as attributing the development of social welfare to the demands of pressure groups and political parties, and the state's role in assisting capital accumulation, analysts have noted that the government promotes social stability through the provision of social welfare (Castells 1998; Chau and Yu 2005). In fact, there is a widespread consensus that the riots in 1966 and 1967 prompted major developments in social welfare. During the 1967 riot, 8,000 suspected bombs were reported and 47 people were killed. To reduce the discontent, from the late 1960s the colonial administration introduced several social services, including school social-work, outreach youth-work, a 10-year housing programme, and the CSSA. Although the colonial administration occasionally expressed its concern about the potential financial strains of its commitment to social welfare, it seldom put meeting these financial responsibilities high on its agenda. Because of the impressive performance of the economy during most of the second half of the last century, the colonial administration comfortably drew increasing revenue from the economy and had no need to revise its low tax or surplus budget policies.

The recent changes in economic conditions have however made the Hong Kong SAR government increasingly aware that its commitment to social welfare severely strains its finances. Since 1997, Hong Kong has experienced serious economic problems, and between 1998 and 2005 most years saw recession or negative economic growth. Moreover, the unemployment rate increased from 2.2 per cent in 1997 to 5.7 per cent in 2005 – the rate was as high as 8.5 per cent in 2003. These economic problems have not only made it difficult for the Hong Kong SAR government to raise enough revenue but also led to increasing demands for social services and social-security payments. The number of CSSA cases increased from 289,694 in November 2003 to 298,011 in December 2005.

As with China, Hong Kong faces the challenges of an ageing population. From 1980 to 2005, the proportion of the population aged 65 or more

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years doubled, from 6.7 to 12.1 per cent (Census and Statistics Department 2005). It is estimated that the proportion will increase to 17.2 per cent by 2021 and 24.3 per cent by 2031. Most commentators agree that the rising number of older people will increase demands on the CSSA (Chau and Yu 2005). Ho (2005) estimated that the number of elderly CSSA recipients will increase by more than 300 per cent from 2004 to 2034.

Given the economic problems and the rising demand for social security payments, the Hong Kong SAR government had no choice but to run six deficit budgets from 1998 to 2005. Early in 2002, it made a pessimistic forecast that if the budget deficits continued the fiscal reserve of HK$ 369 billion would be wiped out by 2008–09. To strengthen its image as an effective government and to reduce the discontent of corporations and investors, in 2003 the government announced that the budget deficits would be significantly reduced by 2008. One way in which it seeks to achieve this is by tapping new financial sources. It set up research teams to study the feasibility of a compulsory social insurance scheme, the *Mandatory Provident Fund* (MPF), and implemented the scheme in 2000.

The main features of the pension reforms

Two features of the pension reforms in urban China and Hong Kong are shared and follow the World Bank's recommendations. Multi-pillar pension provision has been introduced, and the funded scheme will make a large contribution to future pensions financing. The World Bank provided intellectual and technical support to the Beijing government during the preparation of the pension reforms, and prepared the reports that analysed pension needs (Leckie 2003; Leung 2005). In Hong Kong, the SAR government justified the main reform measure, the MPF, by stressing the two assessment criteria for old-aged programmes advocated by the World Bank: protection of older people and the promotion of economic growth (MPFA 2005).

There have also, however, been significant differences between the two reforms. The main measure in Hong Kong was the creation of a mandatory saving scheme (the MPF) to supplement the CSSA in providing old-age income security. All the contributions from both the employees and employers to the MPF are credited to employees' individual accounts. The MPF is thus not designed to redistribute resources between employers or employees. The Beijing government's aims have been more complicated: both to provide financial protection for retirees and to help enterprises share the risks of their pension commitments. The contributions from enterprises go not only to employees' individual accounts

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but also to a risk-pooling fund, which will redistribute resources between enterprises.

Pension reforms in urban China

For over two decades, the Beijing government has attempted to develop a uniform framework for co-ordinating and consolidating the previously unco-ordinated pension schemes. The basic ideas were first put forward in a series of State Council decrees (Republic of China 1991, 1995, 1997, 2005). During the Cultural Revolution, each state enterprise managed an independent pension scheme, but from the early 1980s the Beijing government encouraged experiments with pooling these funds. The State Council decrees of 1991 and 1995 emphasised three points: that the state, the enterprises and individual workers had to share the financial responsibility for the new pension schemes; that private enterprises should provide pension schemes for their workers; and that most of the accumulated pension fund should be invested at state banks or in government bonds.

By the mid 1990s, several important issues remained unresolved, including how to co-ordinate the risk-pooling fund with the individual account, whether it was necessary to standardise the contribution rates of the various enterprises' pension schemes, and whether there should be maximum contributions. To deal with these issues, the 1997 State Council decree set the following requirements:

1. Part of the basic insurance premiums from enterprises are deposited in the risk-pooling fund, and the rest goes to individual accounts.
2. An enterprise's contribution is uniformly capped at 20 per cent of the total wage bill, and three per cent of workers' wages goes to individual accounts.
3. Individual workers pay eight per cent of their wages in contributions and the amount is credited in full to their individual accounts.
4. The basic old-age pension has two parts: a basic monthly retirement pension and a monthly pension from the individual account.
5. The basic monthly retirement pension is covered by the risk-pooling fund, the sum amounting to 20 per cent of the average social wage of the employees, and the monthly pension from individual accounts is set at 1/120th of the accumulated amount in the individual accounts.

At the same time as unifying the pension schemes, the Beijing government attempted to deal with the problem of empty individual accounts. To fulfil pension payments, local governments not uncommonly had used money from the individual accounts to pay current pensioners (Zhao and

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Xu 2002). To rectify this inappropriate use of the individual account funds, the Beijing government tried pilot projects in Liaoning, Jilin and Heilongjiang provinces (*China Daily*, 26 October, 2005). Their two aims were to recapitalise individual accounts and to strengthen the incentive for workers to contribute to the pension schemes. The first objective was achieved by separating the individual-account funds from the risk-pool fund. At the same time, individual contributions were reduced from 11 to eight per cent of earnings and the contribution basis changed to solely from employees. The second objective was achieved by giving one per cent more annually if workers continued to pay into personal accounts after they had paid the premium for 15 years. The success of these trials was evident in the 2005 State Council decree which made them mandatory.

Pension reforms in Hong Kong

As mentioned, before 2000 the Hong Kong government provided financial assistance for retirees mainly through the CSSA, and this scheme emphasised helping the poorest rather than all retirees. During the early 1990s, the colonial administration proposed an old-age pension scheme (OPS) on the pay-as-you-go principle. It was designed to give HK$ 2,300 to all eligible senior citizens (aged 65 or more years), and the funds would come from compulsory employer and employee contributions. In the event and after serious opposition from business interests and the Beijing government, the colonial administration dropped the proposal. Some critics suspected that the British government had persuaded the colonial administration to offer a more generous scheme than its successor could sustain, and some were worried that the OPS was in effect a pay-roll tax. In 1995, the feasibility of a compulsory individual saving scheme was examined (Tan 1998), and in 1998 the colonial administration established the *Mandatory Provident Fund Schemes Authority* (MPFA). It was fully implemented in 2000.

The MPF is a privately-managed, employment-based, defined-contribution scheme to protect the entire workforce (Siu 2002). The MPF Ordinance requires employers to arrange that all full-time employees aged 18–65 years contribute each month five per cent of their earnings to a recognised private provident fund. Employees earning less than HK$ 5,000 a month do not need to contribute, but their employers have to contribute five per cent of the employees' earnings. For employees earning more than HK$ 20,000 a month, the mandatory contributions are capped at HK$ 1,000. The self-employed are required to contribute five per cent of relevant income up to a maximum of HK$ 1,000 per month (MPFA 2005). Trusts with approved trustees were appointed to run the MPF

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schemes (Asher and Newman 2001). In 2004, there were 19 MPF trusts. The trusts are required to appoint investment managers to manage the long-term investment of the funds (BNP Asset Management Limited 1998). Employers select from the approved trusts and must provide at least one. Each trust generally includes several investment portfolios for its members, the employees, from which they have the right to choose and to form their own investment portfolios. When the members of the MPF reach the normal retirement age of 65 years, they can withdraw all the accrued benefits in a tax-free lump sum (Siu 2002).

The problem of raising sufficient resources

Both the Hong Kong and Beijing reformed schemes have found it difficult to raise sufficient funds to provide older people with reasonable financial protection, but the difficulties have not been the same. The pension schemes in urban China suffer from a high non-compliance rate, while the problem in Hong Kong has been the unwillingness of many people to contribute to the MPF at a higher rate. Many employers in urban China have evaded making contributions to the schemes: their strategies have included employing temporary rather than permanent staff, under-reporting the number of staff, and under-reporting the wage bill (Zhao and Xu 2002; Leung 2003). During the 1997, 1998 and 2000 financial years, the number of workers taking part in the pension programmes decreased. Leung (2003) believed that this was only partly because of the reduced number of state-owned enterprises and also reflected the unwillingness of private companies to participate in the programmes. Zhao and Xu (2002) showed that while over 90 per cent of state-owned enterprises had established a pension programme, only 53.8 per cent of the urban collectives and 32 per cent of other enterprises participated.

The high non-compliance rate can be seen as a result of both the problems of the pension schemes and flaws in the design of the risk-pooling fund. The pension schemes have two serious problems, one being the lack of both transparency and accountability. As mentioned, many local government authorities have taken money from the individual accounts to meet other expenditures and thereby created 'empty accounts'. The other problem is that investment decisions have been taken by the government, and employees lack the right to decide how to invest their contributions or to choose their own financial advisers and agents (Zhao and Xu 2002; Dorn 2004). Because of the absence of competition, those officials who are responsible for managing the pension funds lack incentives to maximise the returns.

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Apart from the management problems, the cross-subsidisation role of the risk-pooling funds has caused a high non-compliance rate. Many enterprises that are losing money cannot afford to contribute to the risk-pooling funds, while profitable enterprises are unwilling to do so (Lin 1996; Zhu 2002). From the perspective of the profit-making employers, the pension schemes and particularly the risk-pooling funds reduce their competitiveness in the private market (Smyth 2000; Duckett 2001; Dorn 2004). The refusals to contribute have resulted in financial problems. Dorn (2004) predicted that the deficit of the pension schemes would be US$ 6 billion in 2005, and that it would increase to US$ 76 billion by 2030 and to US$ 181 billion by 2050. The financial problems are so serious that the Beijing government has ordered the enterprises with large unpaid contributions to sign payment agreements, and it has established reserve funds to meet the pension deficits (Zhao and Xu 2002).

In Hong Kong the compliance rate with the MPF has never been lower than 80 per cent, which reflects the advantages of the scheme and the fact that it does not affect all employers and employees in the same way. First, the MPF has a high degree of transparency and accountability. If an employer fails to pay the contributions, the trustees of the MPF are legally required to report this problem to the MPFA, which may impose a surcharge or imprisonment (Ho 2005). Secondly, the implementation of the MPF is marked by competition and choices. As mentioned, 19 MPF trusts competed with each other in 2004. Employers have the freedom to choose among the approved trusts, and employees have the right to choose their own investment portfolios in their employer's scheme.

Undeniably the provision of MPF implies costs for employers, but not all believe that the scheme has raised net employee costs. Before the MPF, some employers provided pension schemes, and in 1999 one-third of the workforce (1.1 million people) were covered by employer-managed schemes (Ho 2005). These employers can apply for exemption from the MPF for the members of existing occupational pension schemes or replace their scheme with the MPF. In these cases, the implementation of the MPF may not have increased the costs. It is also important to note that different employees see the consequences of the MPF differently. The five per cent contribution is a large commitment for low-income employees, but others pay not only the standard contributions but also additional voluntary payments. Voluntary contributions comprised nine per cent of the total monthly revenue of the MPF in 2005 (*South China Morning Post*, 1 December, 2005: 3). In response to the demands for supplementary retirement-income insurance, some companies, including the Hong Kong Shanghai Bank Corporation, have marketed special voluntary contribution schemes (*South China Morning Post*, 15 December, 2005: 2).

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The high compliance rate does not necessarily mean that the MPF provides sufficient old-age financial security. Lui (1998) pointed out that, for those who start contributions to the MPF at age 45 years or older, it is difficult for those earning less than the median wage to accumulate enough contributions to fund a 'decent' retirement standard of living, partly because the annual rate of return on their contributions is no more than four per cent. Ngan and Cheung (2000) argued that workers with low salaries and a contributions record of less than 15 years could not fund a decent standard of living in old age. In theory, the Hong Kong SAR government could require such people to make higher contributions to the MPF, but it hesitates for good reasons. It should be remembered that most employers and particularly small companies did not provide any pension or group insurance schemes for their employees before 2000 and that, according to Kwun (1998), in 1998 only 15 per cent of small companies had group medical insurance for their employees. To them, the MPF means extra costs.

Given that the tax rate in Hong Kong is low, it is not surprising that resistance to the MPF was not great while the contribution rate was low and the economy booming, but it is a different story during recession or if businesses believe that the government plans to raise the contribution rate. In 2002, when the Hong Kong economy was seriously affected by the Severe Acute Respiratory Syndrome, some industry sectors, notably tourism and convention-hospitality, pressured the Hong Kong SAR government to suspend the MPF for one year (Mackay 2003). A government study showed that the public were unwilling to contribute more to the compulsory saving schemes before the economy recovered (Hong Kong Health, Welfare and Food Bureau 2004). Without strong support from the public and a clear sign that the economy is recovering, it is very unlikely that the Hong Kong SAR government will be willing to propose a substantial rise in the MPF contribution rate.

Conclusions

This paper has discussed the causes and main features of the pension reforms in urban China and Hong Kong, and the difficulties faced by decision-makers in carrying out these reforms. The discussion has shown that the implemented reforms reflect international competitive pressures and the continuing influence of both previous welfare arrangements and of time and place-specific economic features – in other words, of both global convergence and path dependency in welfare reform. Pro-market reforms have been an element of the reforms in the two administrations,

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and each of them has been searching for an ideal mix of pension schemes in their particular circumstances. Both the Hong Kong and Beijing governments have to respond to demographic challenges and to find a compatible relationship between policies that promote economic development and the development of social welfare, particularly old-age income protection. The pension reforms in both Hong Kong and urban China share similar features of the World Bank's reform proposals, notably the stress on multi-pillar provision and on funded schemes.

The two pension reforms have also differed in significant ways, some of which are related to previous social welfare policies and arrangements. The Hong Kong SAR government has concentrated on establishing a funded system for employees, while the Beijing government has been more ambitious. Besides introducing funded schemes, it has established a risk-pooling fund. The second major difference has been that raising adequate resources to deliver old-age income protection has been made difficult by distinctive problems. The newly-reformed pension schemes in urban China suffer from a high non-compliance rate, while the problem confronting the Hong Kong government is the unwillingness of many people to contribute to the MPF at a higher rate.

It is important to note that the two governments' previous policies on social welfare contributed to these different problems. A key function of the risk-pooling fund in China is to enable loss making state-owned enterprises to fulfil their welfare commitments to their workers. This indicates that the Beijing government, despite its enthusiasm for market reforms, has no intention of giving up the earlier policy of making state-owned enterprises provide social welfare for their retirees. Its focus on developing the risk-pooling funds has made it difficult to implement the new social-insurance measures, because they have aroused discontent and resistance from more successful and profitable enterprises.

In Hong Kong, the colonial administration during its last years could comfortably draw sufficient revenue from the economy to finance social welfare without high taxation or without obliging the majority of the population to join contributory schemes. This long-established practice has affected the SAR government's search for new sources of social-welfare funding. Its attempts to raise tax rates and to oblige people to join contributory schemes inevitably required some groups to give up disposable income, and therefore aroused their discontent. In implementing the pre-pay system, both the colonial administration and the SAR government have taken great care to minimise this reaction. The colonial administration dropped the proposal to set up an employer-funded old-age pension scheme, partly because business saw it as a pay-roll tax. To prevent the MPF being seen as a threat to the quality of

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life, the Hong Kong SAR government set the contribution level too low to fund effective retirement pensions. While the concession increased the political acceptability of the MPF, it has seriously undermined its ability to provide income protection and to reduce the population's reliance on the CSSA.

The reform experiences in Hong Kong and urban China provide examples of the negative impacts of pro-market reforms on the development of pension schemes. The lessons are that welfare reform should not be exclusively driven by macroeconomic considerations, such as how to reconstruct the economy and attract private capital, but should also pay close attention to the likely impacts on older people's quality of life. The market reforms conducted by the Beijing government have seriously undermined the role of state-owned enterprises in securing the financial protection of their retirees. One of the reasons why the Hong Kong government abandoned the old-age pension scheme (OPS) was to serve and placate business interests: this strengthened the government's image as a defender of the capitalist interest, but deprived poor older people of a reasonable standard of living in retirement. The welfare ineffectiveness of the two reformed pension schemes arose from the undue attention to the demands of private capital *and* the legacy of previous policies and measures. In pre-reform China, central government and state-owned enterprises provided generous pension schemes regardless of whether the schemes were adequately funded. This heavy welfare commitment seriously weakened the ability of collective-welfare era enterprises to compete with those formed after 1979. In Hong Kong, the long-established practice of upholding low taxes and relying on the non-contributory CSSA to meet the financial needs of older people made it difficult for the SAR government to raise the level of personal contributions to the MPF without arousing serious political discontent.

The pensions reform experiences in Hong Kong and urban China can usefully be compared with those of other countries that have responded to economic globalisation. They provide concrete examples of the difficulties faced by decision-makers and of the different types of pension schemes that can be provided. The departures from the recommendations made by the World Bank provide insights into the complexities and case specificities of replacing existing schemes with better alternatives. From his analysis of the pensions reforms in South Korea, Choi (2006) argued that serious consideration should be given to the introduction of a comprehensive non-contributory pension scheme, contrary to the recommendations of the World Bank. The reform experiences in Hong Kong and urban China provide useful insights into the merits and limitations of this approach and of abandoning funded schemes. The experience of the

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MPF in Hong Kong has indeed been that the funded scheme does not effectively meet the needs of marginal labour-market groups, such as those on low incomes and part-time workers, because it only weakly redistributes resources from the rich to the poor. But while the Beijing government's pension reform has retained the pay-as-you-go principle for the risk-pooling fund and a basic monthly retirement pension alongside funded individual pension accounts, there is no guarantee that retirees have more income protection than in Hong Kong. Because of the lack of transparency and accountability, the money credited to the pension schemes has been misused.

Even if the Beijing government introduced a comprehensive non-contributory pension scheme, without more protection of pension scheme assets, there is no guarantee that retirees will have improved financial protection. It is safe to say that while a funded scheme has problems in helping poor people achieve a decent retirement life, simply providing a comprehensive non-contributory pension scheme does not solve the problem. Governments must actively uphold the principles of transparency and accountability in managing and regulating pension scheme assets. This suggests that, to provide financial protection for older people, the good management of pensions assets is more important than finding the best types and ideal mix of pension schemes.

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