# MULTI-TIERED SOCIAL INSURANCE MODEL - ISSUES RAISED IN THE REFORM OF SOCIAL INSURANCE POLICIES

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**Abstract**

*The article studies the current situation of Vietnam social insurance system, also the challenges and requirements for reforming the social insurance system towards the goal of social security for the entire population. On that basis, the article recommends converting from a multi-pillared social insurance model to a multi-tiered pension insurance model: the first tier focuses on expanding the participants to informal workers, farmers, people outside labour force who do not have regular income; the second tier is compulsory social insurance which applies to employees with labor contracts; the third tier is voluntary social insurance which is applicable to specific occupations, high-income workers, and voluntary contributions to get increased pension benefits.*

**Keywords:** *Multi-pillared Social Insurance, Multi-tier Pension Insurance, Social security*

## 1. Introduction

The current social insurance system in Vietnam is formed under the model of "multi-pillared social insurance system". The design of the multi-pillar system has played a role in promoting the participation of formal groups in social insurance. However, the main limitation of this model is that it excludes a singnificant number of rural and informal workers who do not participate in voluntary social insurance. Thus the goal of ensuring income and stabilizing living standard for these groups still faces many difficulties, then affecting the goal of ensuring social security for the entire population.

In that context, Vietnam government is orienting to build a multi-tier social insurance model to replace the multi-pillared social insurance model.

In the Resolution No. 28-NQ/TW issued by the 7th plenum of the 12th Party Central Committee on reforming social insurance policies, it also clearly stated the viewpoints and goals are "Developing a flexible, diversified, multi-tiered social insurance system …" So, what is multi-tiered social insurance? What tiers does this model include? What are the principles and conditions required to build a multi-tiered social insurance model?

The article studies the limitations of the multi-pillared social insurance model, simultaneously based on the experience of implementing multi-tiered social insurance in order to propose orientations, model suggestions and conditions for forming multi-tiered social insurance system in Vietnam. When studying the social insurance model, the most important regime which accounts for the largest proportion and has considerable influence on social insurance is the pension scheme, therefore, the article focuses on studying the multi-tiered pension insurance model.

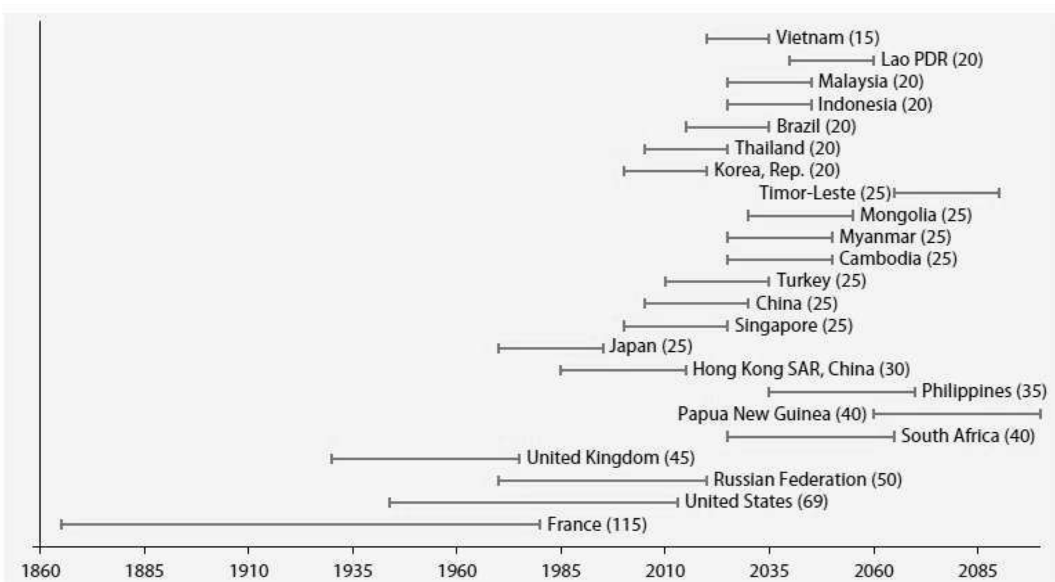
## 2. Content

### *2.1. Limiations of multil – pillared social insurance system in Vietnam*

The current social insurance system in Vietnam is built based on the model of "Multi-pillared social insurance", including (1) Social allowance for the elderly (Pillar 2), (2) Compulsory social insurance including pension and free health insurance card for pensioners (Pillar 1 and Pillar 4) and (3) Voluntary supplementary retirement insurance/ voluntary retirement Insurance (Pillar 3). Under this model, Vietnam's social insurance is facing a number of challenges, such as:

*Rapid population aging*: Vietnam is entering a period of rapid population restructuring and has a very fast aging rate when comparing to other countries. Specifically, the time required to move from the “aging phase” to the “aged phase” is much shorter in Vietnam than in other countries. For this change, Vietnam will need only 18 years, while France needs 115 years, the US needs 69 years, Japan and China need 26 years (WB, 2015). In 2015, the ratio of working age population (15-59 years old) to the elderly (over 60 years old) was 6.6:1, then it is forecasted that by 2055, this ratio will be 2.1:1. This movement becomes a challenge for Vietnam and certainly requires significant adjustment of the pension system.

Years to move from 7 to 14 percent population share 65 years and older and the start and end years of transition




*Sources:* World Bank estimates based on data from UN 2013 and Kinsella and He 2009.
*Note:* Figure shows starting and ending year for transition from 7 percent (aging) to 14 percent (aged) of population ages 65 and older. Aging and aged thresholds are based on United Nations definitions. East Asia and Pacific economies rounded to five-year increments.

**Figure 1. Population aging rate in Vietnam**

*Demographic trends require expanding retirement coverage:* Increasing life expectancy and falling birth rates will increase the number of older people who need adequate protection in old age. The risks of the working-age population are "stuck" between caring for their children and their parents, also facing the increasing financial burden of caring for three generations: their children, themselves, and their parents. This burden is exacerbated because there are fewer people of working age and fewer siblings to share the growing burden of caring for aging parents.

*Coverage expansion remains challenging*: Despite expanding legal coverage (from January 1, 2018, all workers with a contract of 1 month or more are required to register in the social insurance system, including migrant workers in Vietnam), the number of pensioners is still low. In 2017, only 25.1% of workforce paid social insurance contributions; and about 8.3 million of the 10.1 million elderlies were not entitled to a pension in, accounting for 83% of the total population who are over 60 years old. (ILO, 2018b).

The voluntary pension scheme has worked ineffectively in closing the coverage gap. The voluntary social insurance system aims to attract workers who are not required to participate, but so far this mechanism has only reached about 270,000 people in 2015 - equivalent to about 1.3% of 53,673 thousand labor force (ILO, 2018b). The experience of Vietnam as well as other countries shows the limited effectiveness of voluntary mechanisms in expanding coverage because these programs reach only a small number of workers.

A small number of elderly people are getting low pension benefits from tax source. The subsidy is currently at 5.6% of GDP per capita and among the lowest compared to other middle-income countries. The low benefit may explain the high poverty rate of people over 80 years old even when they are entitled to social pension. Furthermore, only 95,000 people aged 60-70 who live in poor households without supporters are getting pension benefit at 405,000 VND/month (Kidd et al., 2016).

The increase in participants with lump- sum withdrawal affects negatively on the expansion of social insurance coverage. Those who stop paying social insurance contributions for a period of at least one year and have not reached 20 years of contribution are allowed to withdraw. However, a lump –sum withdrawal will affect the old age income security. The number of these participants is approximately 500,000 people per year, and this number is relatively high compared to the number of people receiving monthly pension. Additionally, most young workers tend to receive lump-sum payment, thus it will impact heavily on their old-age income security.

### ***2.2. Multil – pillared social insurance model***

In order to deal with the coverage challenges, the Vietnam Government aims to gradually close the coverage gap by combining contributors and non-contributors in multi-tiered social insurance system. The solution is developing a mechanism based on the principle of pension verification to cover all elderly who are not currently receiving pensions from the contribution system. These reforming measures demonstrate Government's strong commitment to universal social security, linked to a number of key values in line with ILO Social Security’s Conventions and Recommendations.

Currently, there is no unified concept of multi-tiered social insurance. Many countries have pursued an expanded coverage approach based on a multi-tiered pension system that typically includes a tax-funded pension tier, an income-based compulsory pension tier and an additional pension tier.

The first tier of the system is usually supported by the Government from public revenue sources to ensure basic old-age security for citizens. This approach has been proven to be one of the most effective ways to expand coverage in the short and medium term, including for those who have not accumulated a sufficient number of years of contributions or who have made no contributions at all. The 2nd tier is a defined – benefit mechanism (DB) that gets financial resources from pay as you go (PAYGO) or partial funding, similar to the current system of Vietnam Social Security. Finally, Tier 3 is usually the supplementary pension, with defined - contribution (DC) which allows people to get higher retirement rates.

*Tier 1: Retirement benefits are taken from tax sources*

Tier 1 aims to ensure everyone with a minimum income in retirement through a pension derived from tax sources. This is fully consistent with the ILO Social Protection Floor Recommendations. This benefit is particularly relevant for those who have little or no ability to contribute to pension scheme while working, including those with low and irregular incomes, informal and agricultural workers. Each country can choose to design its policy under the following three models: (1) Basic pension, (2) Social pension based on income verification or (3) Minimum pension.

Resolution 28-NQ/TW of Government dated issue 25/03/2018 stated that by expanding coverage, all people who do not receive a social pension will get a tax-funded retirement. It also sets targets to increase coverage by the years 2021, 2025 and 2030, where 45%, 55% and 65% of people above the normal retirement age are entitled to pension scheme, monthly social insurance and social allowance , respectively.

Tier 2: *Compulsory social insurance.*

The tax-funded program (tier 1) is aimed at poverty reduction and redistribution of the pension system, but it lacks the function of stabilizing income. The compulsory pension scheme (tier 2) is sourced from contributory sources to ensure adequate benefits for a large segment of workers, including the middle class. According to ILO standards, this tier must be designed in the form of defined - benefit (DB) managed by the state. Convention No. 102 sets a minimum replacement rate of 40% of lifetime income (after 30 years of contributions) along with Tier 1. ILO's Convention No. 128 sets higher standards that requiring a periodical payment, corresponding to at least 45% of the reference wage.

Tier 3: *Additional Private Retirement*

The occupational pension or other voluntary private pension that constitutes Tier 3 has a limited role in Asian countries as only a small number of people are able to contribute. These individual retirement plans provide a supplementary superannuation in addition to the compulsory retirement for those who want a higher rate of pension.

## 3. Results

Under the above model, there is a multi-tiered pension system in Vietnam, specifically:

- Tier 1: Social pension is based on income verification. Particularly, Decree No. 136 /2013/ND-CP is about social allowance policy for the elderly (aged 80+/60+ and the poor/60+ and disabled person). Furthermore, it is possible to add a monthly preferential allowance for people who are credited with meritorious services to the revolution.

- Tier 2: Compulsory social insurance implemented by Vietnam Social Security. Currently, there are about 14.5 million people participating in compulsory social insurance. About 1.7 million people are receiving monthly pension and social insurance from the social insurance fund and 1.3 million people are receiving monthly pension and social insurance from the state budget (retired before 1995).

- Tier 3 includes: (1) Supplemental retirement insurance according to Decree No. 88/2016/ND-CP issued by Ministry of Finance. However, it currently has not attracted participants. (2) Voluntary retirement insurance products according to Circular No. 115/2013/TT-BTC and Circular No. 150/TT-BTC issued by Ministry of Finance.

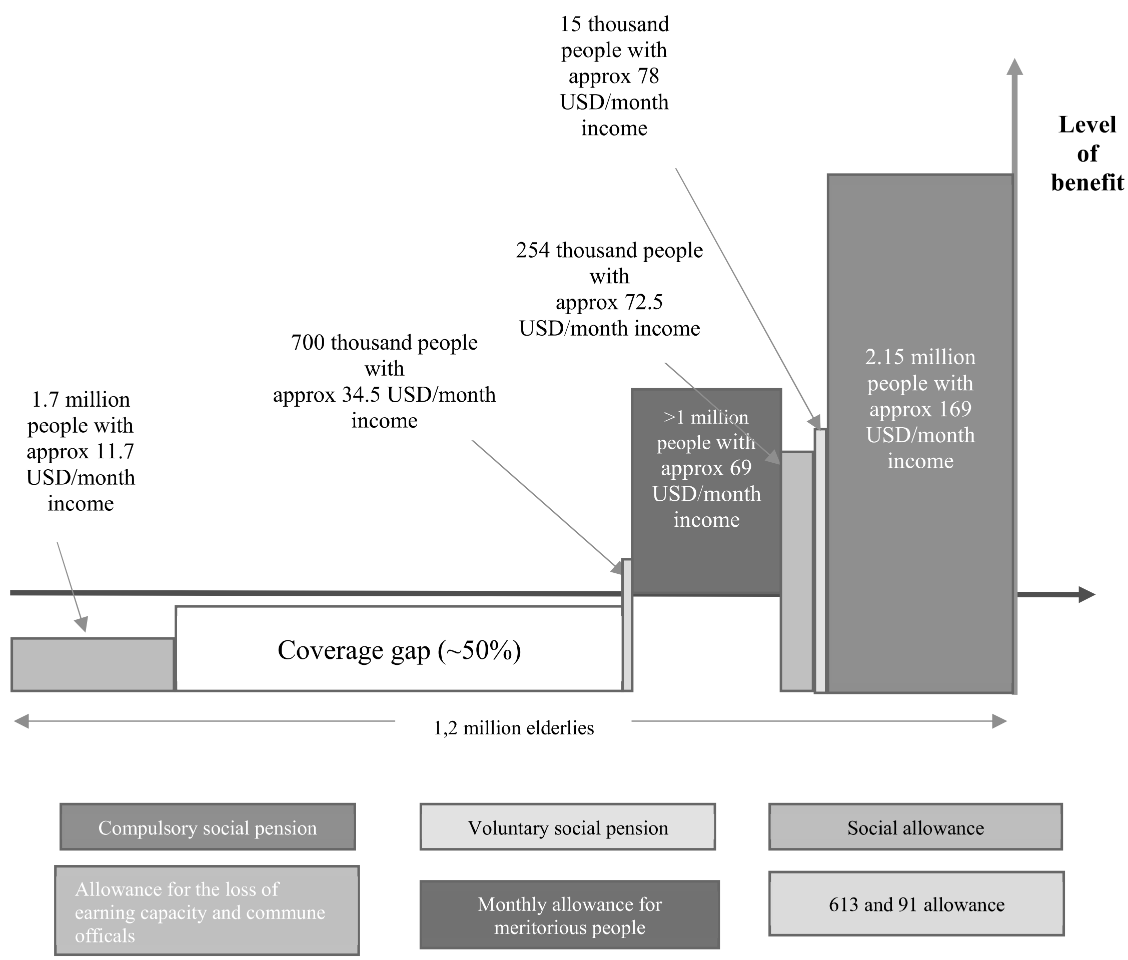



***Figure 2: Rate of elderly receiving pensions***

Presently, only about 47% of elderly have monthly pensions, social insurance, social allowances and preferential allowances for those with meritorious services.

In order to set up a multi-tiered model for Vietnam social insurance which contains different methods dealing with risks and resources needed to ensure people's health and income.

It can be divided into three groups: children, the workforce and the elderly from a demographic perspective. In which, the labor force is the force that creates material wealth, mainly contributes resources (both taxes and social insurance contributions) to ensure social security for themselves (illness, maternity, unemployment, occupational accidents - occupational diseases), as well as for their children (nutrition, education, medical care...) and their parents (income, medical care). Thus, the system should encourage employees to improve labor productivity, actively contribute to social insurance and savings to take care of their old age; encourage the elderly to partially participate in the production process with suitable jobs to generate additional income; creating conditions for children to have good nutrition, good medical care, good education and training.

Social security policies should be formed under a general and human-centered design. Social security policies should be diverse but not overlapping. Social security policy is designed based on the risks that each person may face. In order to help people overcome their life risks, only one social security policy (single tier) or multiple social security policies (multi - tier) may be needed. For example, an elderly person can have 3 sources of pension: (i) social protection allowance; (ii) social insurance pension and (iii) supplementary pension/ pension from voluntary retirement schemes. A woman giving birth can receive two financial sources: (i) the maternity benefit of the compulsory social insurance and (ii) the payment when giving birth from a life insurance product. A sick worker migh be paid (i) medical expenses from the health insurance fund and (ii) sick benefits from the social insurance fund.

## 4. Discussion and Conclussion

In the future, social insurance policy should be designed to reach 100% of elderly people having a pension with the following notes:

- Formalizing informal jobs to increase the percentage of employees participating in social insurance, thereby increasing the number of elderly people receiving social insurance pensions (tier 2). The minimum contribution conditions to receive monthly pensions should be reduced to 10-15 years instead of the current 20 years (Korea 10 years, Indonesia 15 years) to encourage employees to join, lower lump-sum withdrawal.

- Encouraging people to participate in other types of insurance in tier 3 so they can also get an additional (higher) pension benefits in.

- Gradually lowering the age of receiving pension allowance from 80 to retirement age according to the labor law and the law on social insurance (65 years old), thus,  hose who have no opportunity or cannot participate in social insurance will be supported with basic/minimum pension.

- Separating the contributions of employees and employers into 2 funds. The employer's contribution (14%) is formed into the Paygo-DB fund, which is a risk-sharing fund that demonstrates the nature of insurance. The purpose is promoting employees with monthly pensions, so it is not allowed for employees to withdraw lump-sum pensions, and shortening the period for minimum pension payment to 15 years, then 10 years.

The employee's contribution (8%) should be put into an account and managed under the DC fund. This is not a risk-sharing fund but only for the savings of the employees. If employees pay more, they will benefit more and vice versa

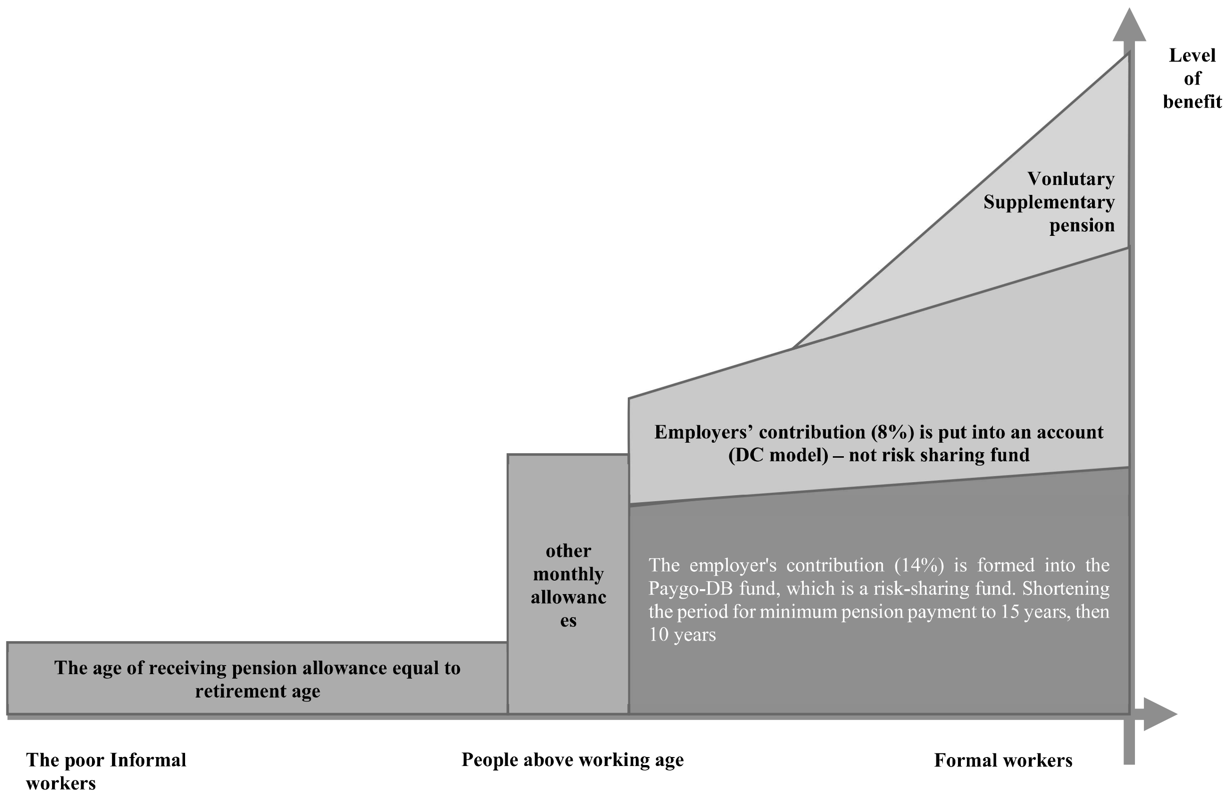



**Figure 3: Multi – tiered pension model in Vietnam**

The employer's contribution (14%) is formed into the Paygo-DB fund, which is a risk-sharing fund. Shortening the period for minimum pension payment to 15 years, then 10 years

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