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SOCIAL INSURANCE: THEORETICAL BACKGROUND

By

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SCOPE OF PRESENTATION

- I. Definition of Social Security**
- II. Objectives of Social Security**
- III. Branches of Social Security Benefits**
- IV. Approaches of Social Security**
- V. Principles of Social Insurance**
- VI. Coverage**
- VII. Benefits**
- VIII. Adequacy of Benefit**
- IX. Financing Social Insurance**
- X. Developments and Trends in Asia and the Pacific**

I. Definition of Social Security

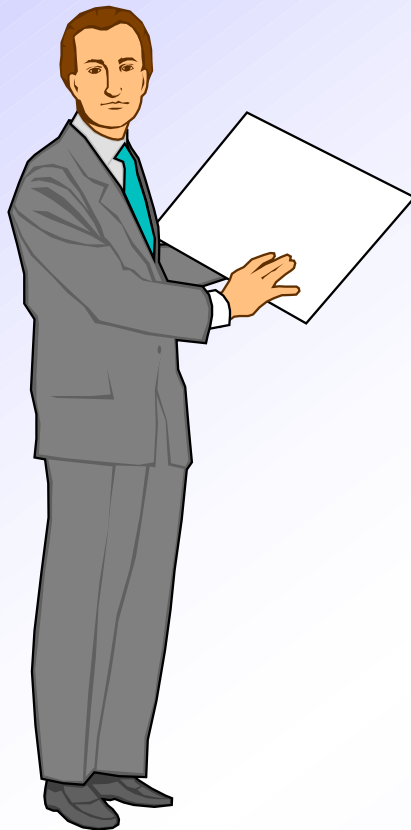
“The protection which society provides for its members, through a series of public measures, against the economic and social distress that otherwise would be caused by the stoppage or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment, invalidity, old age and death; the provision of medical care; and the provision of subsidies for families with children”. (ILO)

II. Objectives of Social Security

- ➡ provide a replacement of lost earnings
- ➡ promote health by providing medical care
- ➡ provide assistance to families raising children



III. Branches of Social Security Benefits



- ➡ old-age benefit
- ➡ disability benefit
- ➡ death benefit
- ➡ sickness benefit
- ➡ maternity benefit
- ➡ medical care benefit
- ➡ employment injury benefit
 - death
 - temporary disability
 - permanent disability
 - medical services
- ➡ unemployment benefit
- ➡ family benefit

IV. Approaches to Social Security

- A. Employer liability scheme
- B. Provident fund scheme
- C. Social assistance
- D. Social insurance

A. Employer Liability Scheme

- ❖ A system that generally places sole responsibility on employers in providing cash benefit and medical care services to their employees who suffer a work-related injury or occupational disease.
- ❖ The benefits are provided by the employers either directly or through an insurance carrier.

A. Employer Liability Scheme (continuation)

Shortcomings

- Employers or insurance carriers resist claims
- Limited medical benefit
- Modest cash benefit
- Lump-sum benefit for long-term contingencies
- Emphasizes compensation, not rehabilitation

 Many schemes converted to social insurance (Philippines).

B. Provident Fund Scheme

- ❖ A compulsory savings scheme wherein contributions from both employers and employees are accumulated in the individual account of the employees.
- ❖ It is basically an old-age protection scheme wherein the accumulated savings, plus interest, are paid in a lump-sum when the employee attains retirement age or upon his or her total disability or death prior to retirement.
- ❖ The schemes have allowed partial withdrawals from the individual accounts prior to retirement to meet certain specified needs.

B. Provident Fund Scheme (continuation)

Shortcomings

- Lump sum benefit does not meet long-term needs
- No sharing of risks among contributors
- Value of benefit vulnerable to inflation
- Partial withdrawals reduce savings intended for retirement

Due to these shortcomings, many schemes:

- converted to social insurance
- incorporated pension features (India and Singapore)

C. Social Assistance Scheme

- ❖ A non-contributory scheme which covers the entire population and is entirely financed from general tax revenue. The benefits are either universal or means-tested.
- ❖ Universal benefits are paid on a flat-rate basis.
- ❖ Means-tested benefits are paid to residents who have demonstrated their need for financial assistance.
- ❖ This type of scheme is found only in industrialized countries (Australia, New Zealand and Hong Kong).
 - expensive
 - requires well developed tax collection machinery

D. Social Insurance Scheme

- ❖ A compulsory contributory scheme wherein contributions are paid to a common fund from which the costs of benefits and administration are met.
- ❖ The contributions are paid by the employer or the employee or by both, sometimes with government contribution or subsidy.
- ❖ This type of scheme is most widely implemented by both developed and developing countries all over the world.

Mixed System

- ❖ Not unusual for a country to adopt one approach for some benefits and another approach for other benefits.
 - **Australia:** social assistance for all benefits except work injury which is provided by employer liability schemes implemented by individual States.
 - **Japan:** social insurance for all benefits except family benefit which is provided under a dual employer liability and social assistance schemes.

Mixed System (continuation)

- **Malaysia:** provident fund for old-age and death benefits and social insurance for disability and work injury benefits.
- **Philippines:** social insurance for old-age benefit and provident fund for supplemental old-age benefit.

From hereon, our discussion will focus on social insurance.



V. Principles of Social Insurance

I. Coverage is compulsory.

☞ Voluntary coverage will result to “adverse selection” or “moral hazard” making the scheme extremely costly to operate.

2. The scheme is contributory.

☞ It is financed from contributions from employers and employees; government rarely contributes.

3. Surplus funds must be invested.

☞ Financing system requires funds not immediately needed to be invested to earn additional income.

☞ Criteria for investment:

- safety
- yield
- liquidity
- social and economic utility

4. The risks are pooled.

- ☞ Spreading of losses over the entire covered groups to enable the scheme to provide adequate benefits at low cost to the participants.

5. The scheme stresses social adequacy over individual equity.

- ☞ This makes possible more benefits than the actuarial value of the contributions of low-income earners:
 - setting minimum benefits
 - payment of dependents' supplements
 - benefit adjustments

6. Contributions and benefits are earnings-related.

- ☞ Contributions are based on earnings while benefits are based on contributions paid; hence, those paying higher contributions receive higher benefits.

VI. Coverage

- ➡ Coverage tends to be limited to workers in the formal sector
 - ineffective enforcement enables many employers/employees to evade coverage.

- ➡ Not covered by law:
 - self-employed
 - agricultural workers
 - informal sector workers
 - domestics and casuals

- ➡ Reasons for non-coverage
 - too high contributions
 - belief that they do not need the benefits offered

VII. Benefits

The following give a brief description of the 9 branches or types of social security benefits.

A. Old-age Retirement Benefit

- ➡ Lifetime pension
- ➡ Qualifying conditions
 - paid minimum no. of contributions
 - ✎ usually from 10 to 30 years
 - ✎ if not satisfied, reduced pension or lump sum
 - attainment of required age
 - ✎ usually 60 to 65 years
 - ✎ age differential for men and women, usually 5 years

B. Disability Benefit

- ➡ Lifetime pension
- ➡ Qualifying conditions
 - permanent disability
 - paid minimum no. of contributions, usually from 1-5 years
- ➡ Total disability: 2/3 disability or more
- ➡ Partial disability: depends on degree of disability
 - may be paid in lump sum if pension is low

C. Death (or Survivors') Benefit

☞ Lifetime pension, as long as qualified

☞ Qualifying conditions:

- paid minimum no. of contributions
- same as for disability benefit (1-5 years)
- death of insured person or pensioner

☞ Beneficiaries:

- widow/widower
 - ✎ often, widower not entitled unless dependent and/or disabled
- children of specified age
 - ✎ regardless of age if disabled
- others, if no widow/children
 - ✎ dependent parents
 - ✎ dependent brothers, sisters, etc.

☞ Death or funeral grant may also be paid

D. Sickness Benefit

- ➡ Cash allowance
- ➡ Qualifying conditions:
 - temporarily unable to work due to sickness
 - paid minimum no. of contributions, 1-6 months
 - recent contributions required
 - waiting period, usually 3 to 7 days
 - benefit retroacts to first day, if still sick
- ➡ Limited duration, usually 4 to 6 months
- ➡ Employer may advance allowances subject to reimbursement.

E. Maternity Benefit

- ➡ Cash allowance
- ➡ Qualifying conditions:
 - unable to work due to pregnancy
 - paid minimum no. of contributions, 1-6 months
- ➡ Limited duration, usually 1-2 months
 - employer may advance allowance subject to reimbursement.

F. Medical Care Benefit

- ➡ Medical services of curative nature
(no cash payment)
- ➡ Qualifying conditions:
 - either covered or paid required contributions
 - usually, more liberal than sickness
- ➡ Usually available to dependents
- ➡ Usually with cost sharing feature
- ➡ System of delivery
 - direct
 - indirect
 - “fee for service”
 - “capitation”

G. Employment Injury Benefit

- ➡ Cash payment and medical services
- ➡ Qualifying conditions:
 - immediate coverage upon employment
 - work-related injury or occupational diseases
- ➡ Cash payment for:
 - temporary disability (sickness)
 - payable in allowances
 - duration may be limited, until recovery or permanent disability
 - permanent disability
 - may be total or partial
 - payable in pension

G. Employment injury benefit (continuation)

- death (survivors')
 - payable in pension
 - payable to specified beneficiaries

Medical services

- comprehensive
 - includes rehabilitation
 - no limit on duration

Occupational disease determined by:

- list of diseases deemed occupational
- legal definition
- mixed system

Systems of contribution rating:

- uniform rating
- industry rating
- experience rating

H. Unemployment Benefit

- ➡ Cash payment
- ➡ Qualifying conditions
 - temporary unemployment of regularly employed person
 - paid required contributions, say, 6 months to 1 year
 - usually with waiting period, 3-7 days
 - registration with an employment office
- ➡ Disqualifications
 - dismissed for cause
 - left job voluntarily
 - refused training opportunities
- ➡ Limited duration: 8 to 6 weeks
- ➡ Available in developed countries, rarely in developing ones.

I. Family Benefit

- ➡ Cash allowances and sometimes, benefits in kind.
- ➡ Payable to families for each child of specified age, usually from 14 to 18 years old.
- ➡ Usually financed either by the state (social assistance) or by employer (employment-related).
- ➡ Social insurance may be inappropriate in delivering family benefit.
- ➡ Exists in practically all developed countries and nil in developing countries.

I. Family Benefit (continuation)

Payment methods:

- uniform amount for each eligible child
- amount per child is adjusted as the number of children increases
- limit to number of eligible children

VIII. Adequacy of Benefit

- ➡ Social insurance is effective if it provides adequate benefits.
- ➡ To achieve adequacy, social insurance may provide :
 - minimum benefits
 - dependents' supplement
 - constant attendance supplement
- ➡ Benefits may be adjusted
 - automatic adjustment
 - ad hoc adjustments
- ➡ Basis for adjustments
 - wage increases
 - price increases

ILO Standards

SCHEDULE OF PERIODICAL PAYMENTS TO STANDARD BENEFICIARIES ILO CONVENTION NO. 102 (1952)

Part	Contingency	Standard Beneficiary	Percentage
III	Sickness	Man with wife and two children	45
IV	Unemployment	Man with wife and two children	45
V	Old age	Man of pensionable age with wife	40
VI	Employment injury:		
	Incapacity for work	Man with wife and two children	50
	Invalidity	Man with wife and two children	50
	Survivors	Widow and two children	40
VIII	Maternity	Woman	45
IX	Invalidity	Man with wife and two children	40
X	Survivors	Widow and two children	40

IX. Financing Social Insurance

- ➡ A financial system provides for the method in which a social insurance scheme generates, administers, invests, and disburses income.
- ➡ The financial system is established based on actuarial studies.
- ➡ Any changes affecting benefits (especially pension) and the reserves require actuarial analysis of their impact on the scheme's solvency or financial soundness.

Major Types of Financial Systems for Social Insurance

- A. “Pay-as-you-go” system (annual assessment system)
- B. Fully funded system (general average premium system)
- C. Partially funded system (scaled premium system)

A. Pay-As-You-Go System

- ➡ The yearly resources should balance the expected yearly costs for benefits and administration.
- ➡ Small reserve fund provided to meet unforeseen increase in expenditure or reduction in income.
- ➡ Most appropriate for financing short-term benefits.
 - However, many industrialized countries have adopted this system for long-term benefits.

B. Fully Funded System

- ☞ A constant rate of resources, as a percentage of the insured earnings, is determined at the outset to adequately meet future disbursements for an indefinite period.
- ☞ Unsatisfactory in financing social insurance schemes:
 - the contribution will be too high for workers and employers to afford.
 - the sizable capital generated may exceed capacity of national economy to absorb productively.
 - such large capital offers great temptation to misuse or abuse it.
- ☞ Normally applied to private insurance or occupational pension schemes
 - to protect the rights of workers/policy holders to promised benefits.

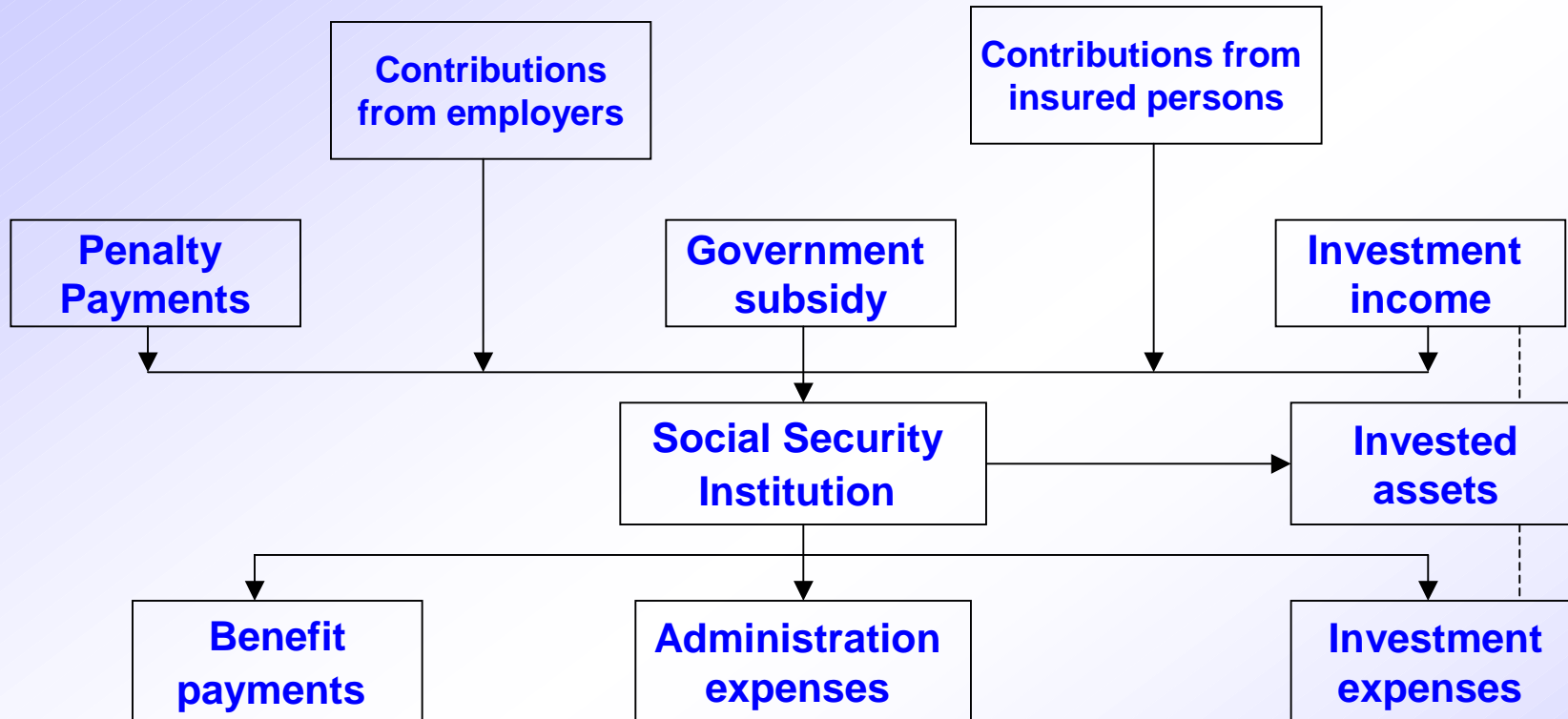
C. Partially Funded System (scaled premium system)

- ➡ Scaled premium system is just one example of infinite number of partially funded system.
- ➡ The contribution income and investment earnings received in a year will be sufficient to meet expenditures for that year.
- ➡ The contribution rate is established for a specified “period of equilibrium” say, 10, 15 or 20 years.
- ➡ When current income is no longer sufficient to meet current expenditures, the contribution rate is increased for a **new** period of equilibrium ... and so on.
- ➡ Hence, there is need for periodic actuarial review.
- ➡ Usually applied by most developing countries with social insurance schemes.

Separation of Accounts

- ➡ A social insurance scheme may provide combination of short-term and long-term benefits, each with different financial systems.
- ➡ Separate account of income and expenditure for each benefit.
- ➡ A deficit in one benefit should not be met from funds allocated to the other benefits, especially long-term benefits.
- ➡ If this is done, there must be recognition of this action and need to replenish the long-term reserve.
- ➡ Meeting deficit of a benefit branch or financing a new one from funds of long-term branches could endanger viability of those branches.

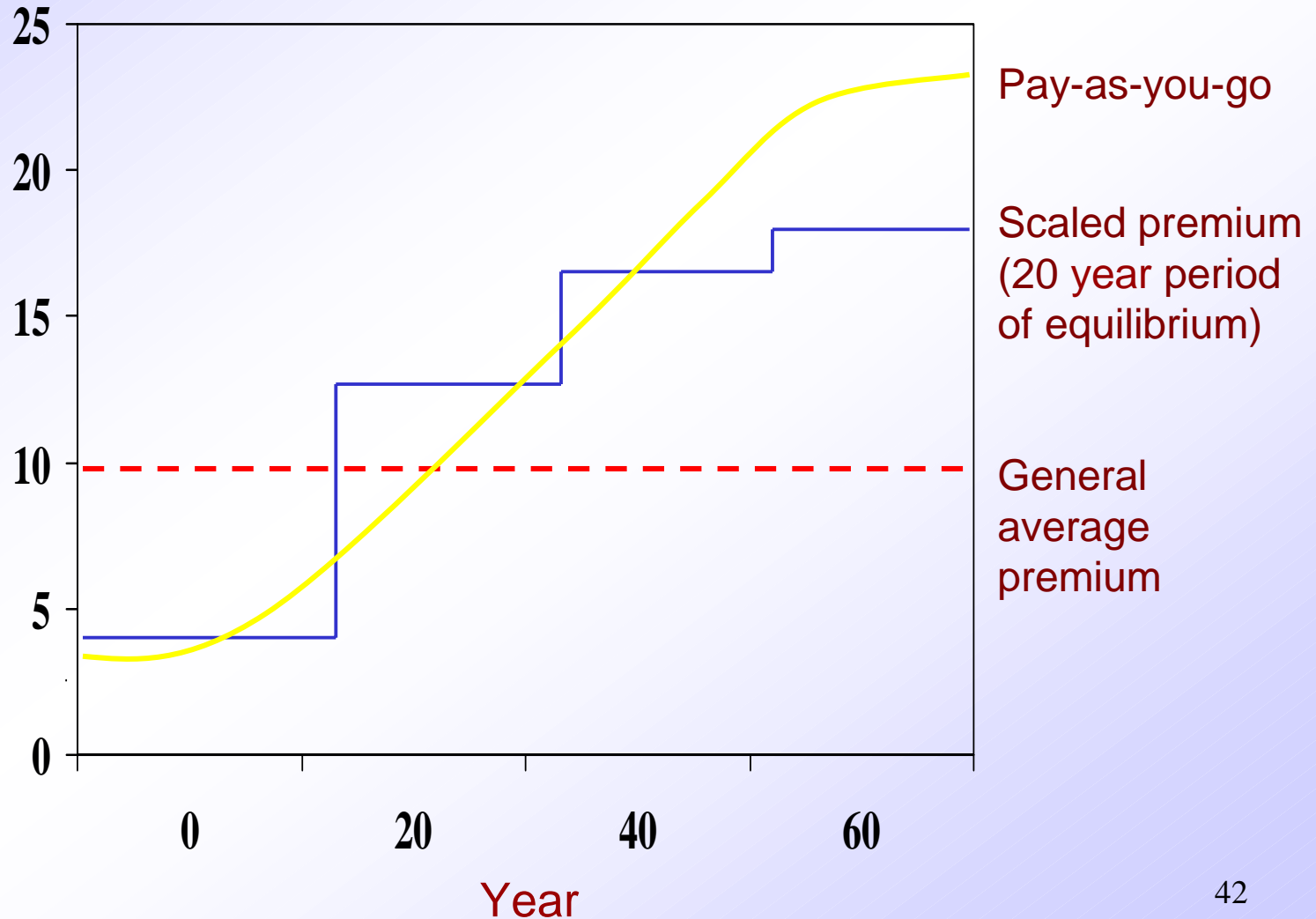
FLOW OF FUNDS IN A SOCIAL SECURITY SYSTEM



Short-term benefits	Long-term benefits	Employment injury benefits	Unemployment benefits	Family benefits
Medical Sickness Maternity Death grant	Invalidity pension Old age pension Survivors' pensions	Medical Temporary incapacity Permanent incapacity Dependents' benefits		

PENSION SCHEME CONTRIBUTION RATES UNDER DIFFERENT FINANCIAL SYSTEMS

Contribution rate %

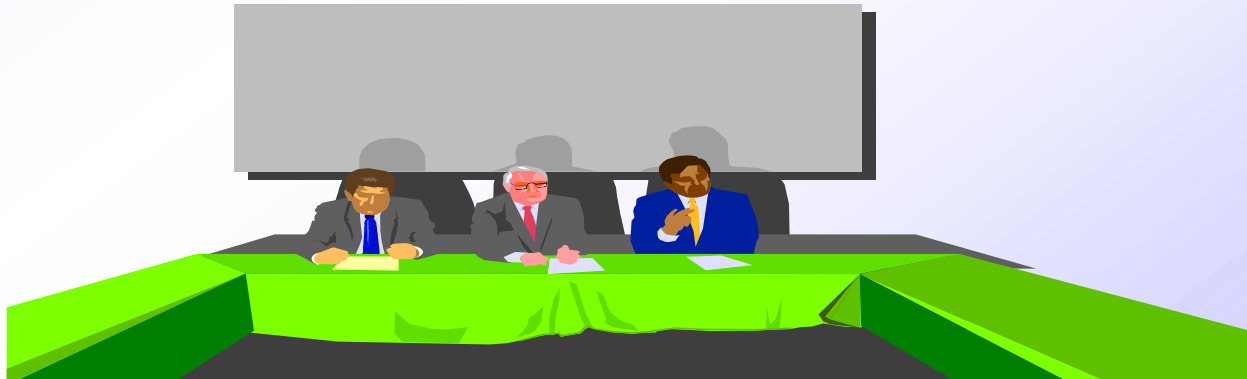


X. Developments and Trends in Asia and the Pacific

A. On types of schemes

B. On coverage

C. On benefits



A. On Types of Schemes

- ➡ Majority of countries have adopted the social insurance scheme.
- ➡ A number of countries, former British colonies, adopted the provident fund scheme.
- ➡ Only Australia, New Zealand and Hong Kong implement social assistance schemes.

B. On Coverage

- ➡ Generally limited to formal sector workers
- ➡ Usually excluded from coverage are:
 - self-employed persons
 - rural and agricultural workers
 - domestic, casual, temporary workers
 - workers in small establishments
 - workers in the informal sector
- ➡ Reasons for exclusion: administrative difficulty/
non-affordability
- ➡ Australia, New Zealand and Hong Kong cover their entire populations.

C. On Social Security Benefits

- ➡ Most countries in the region provide old-age, disability, death and work injury benefits.
- ➡ Only half of the countries have sickness, maternity and medical care benefits.
- ➡ Unemployment and family allowance benefits available only in industrialized countries, except Thailand.

Thank You!