Summary

Background

Since the adoption of the New Economic Mechanism (NEM) in 1986, Lao People's Democratic Republic (Lao PDR) has been undertaking a major reform with a view to transforming its economic system from a centrally-planned system to an open market system.

At present, only workers in the public sector are covered by the existing social security scheme. There is no social security provision for employees in the private sector, which has been growing rapidly. In 1994, the Government passed the Labour Law, which provides a basic outline of the social security for workers in the private sector. In order to formulate the policy options for the implementation of the scheme, a Social Security Reform Steering Committee was established in 1996. The Committee has approved a draft Social Security Decree, which envisages a phased implementation of a fully-fledged social security system. The scheme is planned to start within one year of the approval of the Decree by the Prime Minister. The draft Decree stipulates the introduction of short-term benefits (health care, sickness, maternity, birth grant, death grant, and employment injury) and pension benefits (old-age, survivors' and invalidity). The Government also intends to reform the existing social security scheme in the context of the current policy for restructuring the public sector. The reform focuses on measures to restore the long-term financial equilibrium, in particular, by reinforcing the financial basis and by reviewing the current high benefit level. The Social Security Steering Committee has agreed that both private and public sector schemes be integrated into a unified scheme in the future.

The purpose of the present report is, first, to study the financing issues of the proposed scheme for the private sector, and second, to analyse the financial status of the existing scheme for the public sector workers and examine the financial implications of some reform options. Actuarial projections have been made under two sets of economic assumptions, namely the base case assumption and the high growth assumption.

Actuarial analysis of the private sector scheme

Actuarial valuation of the short-term benefits

- Under both the base case and the high growth assumptions, the PAYG cost rate is expected to increase gradually from about 6.2% in 2000 to 6.4% in 2005. This increase is mainly due to the gradual accumulation of periodical payments of the employment injury benefits

- The following contribution rates are recommended for the short-term benefits:

<table>
<thead>
<tr>
<th>Fund</th>
<th>Worker (%)</th>
<th>Employer (%)</th>
<th>Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health care fund</td>
<td>1.65</td>
<td>1.65</td>
<td>3.30</td>
</tr>
<tr>
<td>Cash benefit fund</td>
<td>1.20</td>
<td>1.20</td>
<td>2.40</td>
</tr>
<tr>
<td>Employment injury fund</td>
<td>-</td>
<td>0.70</td>
<td>0.70</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2.85</strong></td>
<td><strong>3.55</strong></td>
<td><strong>6.40</strong></td>
</tr>
</tbody>
</table>

Actuarial valuation of the long-term pension benefits

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1. Sickness and maternity benefit, birth and death grant.
2. To be gradually raised to phase in with the future increase in expenditure.
• Under the base case assumption, the PAYG cost rate of pension benefits (including administrative expenses) is expected to increase continuously by about 0.3 %-points every year, and reach 7.0% by 2020 and 17.4% by 2050.

• To determine the future contribution rates, the following three schedules have been investigated:

<table>
<thead>
<tr>
<th>Schedule</th>
<th>Initial contribution rate (1999)</th>
<th>Increase in the contribution rate</th>
<th>Final contribution rate (2049)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>2.0%</td>
<td>by 1.5%-points (every 5 years)</td>
<td>15.5%</td>
</tr>
<tr>
<td>B</td>
<td>3.0%</td>
<td>by 3.0%-points (every 10 years)</td>
<td>15.0%</td>
</tr>
<tr>
<td>C</td>
<td>10.0%</td>
<td>none</td>
<td>10.0%</td>
</tr>
</tbody>
</table>

(i) Under Schedule A, the balance of the fund is expected to be in surplus throughout the projection period, and the expected amount of reserves would be less than 1% of the GDP, or about 1-2 years’ expenditure.

(ii) Under Schedule B, as compared with Schedule A, the higher contribution rates in the early years will result in a higher level of reserves.

(iii) Under Schedule C, a rapid accumulation of the reserves is expected in the early years. After attaining its peak at about 3.5% of GDP by 2025, the relative level of the reserve is estimated to decline. By 2035 the expenditure is not covered solely by contribution income; by 2045 the fund is estimated to be in deficit; and, by 2049 the reserve is expected to be depleted.

• In view of the not fully developed capital market in Lao PDR, and the gradual cost increase due to moderate ageing of the population, it is suggested that the contribution rate should be increased gradually with a relatively low level of funding.

• The projection results suggest that an initial contribution rate should be at least 2.0% and this rate should be increased by 1.5%-points every five years. Alternatively, with an initial contribution rate of 3.0% which would ensure the financial equilibrium for the next ten years, this rate would then have to be increased by 3.0%-points every ten years. Taking into consideration the long-term increase in the pension expenditure, the optimal schedule of contribution rates should be set out. In order to ensure the long-term financial viability of the scheme under economic changes, the actuarial valuation should be conducted at least every five years.

Actuarial analysis of the public sector scheme

Problems in the financing of the current scheme

• The current contribution rate of 6% (paid by the workers), which was determined without proper actuarial evaluation, does not adequately meet the expenditure of the scheme. In fact, the scheme has been in a growing deficit, which has been covered by the government budget.
• Contributions are collected only from the basic salaries. However, there are various forms of additional allowances from which contributions and taxes are not collected.

• The benefits covered by the Social Security Fund and the Government are not clearly separated. Although the Fund was initially intended to finance only pension benefits, the Fund has been covering various other benefits.

• The scheme provides various generous provisions, like high replacement rates, early retirement opportunity at 55 for women and war veterans. In addition there are no provisions to restrict the entitlement of two or more benefits (i.e. old age pension and invalidity pension).

Actuarial valuation of the long-term pension benefits

• In 1997, the PAYG cost rate for the pension benefits stood at 12.8%. The status quo projections under the base case assumption indicate that this rate could stay below 14.5% till 2020. After this, due to the ageing of the population, the PAYG cost rate is estimated to increase to about 25% by 2050. Under the high growth assumption, with a higher growth of the number of civil servants, the PAYG rate of the pensions would increase to 13.2% in 2020 and to 16.3% in 2050.

• The financial implication of main proposals to restore the financial equilibrium has been examined:

  (i) The reform projections under the base case assumption indicate that the PAYG cost rate is estimated to be 12.7% in 2020, and 20.6% in 2050. Under the high growth assumption, the PAYG rate would be lower, at 11.0% in 2020 and at 13.5% in 2050.

  (ii) The extension of the retirement age for female workers to 60 leads to the savings of the PAYG cost rate of old-age pensions by 1.5% in 2020 and by 3.7% in 2050, although the cost of the invalidity pensions is expected to increase slightly.

  (iii) The reduction of the entitlement of two or more pensions for new pensioners will result in a reduction of PAYG cost rate by 0.2% in 2020 and 0.6% in 2050.

  (iv) The introduction of widow(er)s' pensions would increase the PAYG cost rate by 2%-3% in the long-term.

Evaluation of the accrued liabilities of the workers in formerly state-owned enterprises

In addition to the valuation of the existing scheme, the accrued liabilities of the workers in formerly state-owned workers have been estimated. The present value of the accrued liabilities is estimated to be 28 billion Kip, which is 4.7 times the annual expenditure of the Social Security Fund. The average amount per worker is about 1 million Kip, which is almost equivalent to 2 times the average annual basic salary.