

## Options for Extending the Coverage of Social Security to the Self-employed\*

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### INTRODUCTION

The extension of social security so that it covers the self-employed must be considered within the context of the existing system. Relevant issues include: the manner and the extent by which the self-employed are covered under the existing system, whether or not the extension of coverage should be mandatory or voluntary, how participation is to be enforced if the mandatory option is chosen, and should voluntary participation be chosen what measures should be taken to reduce adverse selection. But for either approach, a decision must be made on the benefits to be covered. Should contributions be related to risk or ability to pay? What conditions or restrictions should be imposed on the claiming of benefits in order to reduce the incidence of moral hazard?

This article will first discuss some opinions and pros and cons of some options related to these issues; afterward, steps and options to extend coverage to the self-employed will be proposed.

### SOME THOUGHTS ON THESE ISSUES

When designing a social security system, there exists a problem regarding the level of living standard which is to be maintained: should it be the minimal essential level for personal maintenance, or a normal or average living standard? To most public policy makers, governments are mandated only to protect their citizen from falling below a minimal level. Individuals aspiring to higher living standards should take it upon themselves to realize and maintain them. However, in practice, it is difficult to define a minimal essential living standard which is acceptable to all, since opinions on the subject vary from one individual to another. Hence, any scheme which provides for a uniform level of protection cannot be attractive to all; some would even prefer to opt out of the scheme and live without protection of this sort. However, if different schemes are available, persons with different needs and preference will be able to choose from those options best suited to their needs. Such a system would be more attractive to a larger percentage of the population, encouraging higher levels of participation and thus maximizing the number of those receiving some protection. This should result in higher levels of social welfare. Presently, the Ministry of Public Health offers a Poor Card, a Health Card, and Free Services (without card) which are fully or partially subsidized. All categories receive similar health care services from public providers. However, these services do not accurately reflect those generally utilized by the middle income class. Hence, the Health Card scheme, which anyone can buy voluntarily, is not popular with the middle income class.

Even though on average self-employed workers belong to the low income class, a great deal of variation within this group exists. A small, more affluent, proportion of this group relies on private insurance; those who are poor rely on social welfare programs such as Health and Poor Cards. But the middle income class of this group either does not qualify or chooses not to use the Poor or Health Cards; but if any catastrophic event happens they can always resort to the Free Service (without card) available from public providers and receive a similar treatment as if they have obtained one of the Cards. Under these circumstances, it is essential that any new program must be distinct from existing ones, especially from the Health and Poor Cards, otherwise it will not attract many users as long as the Free Service (without card) is still available from public providers. But if the program needs public subsidies, the level of subsidies must be appropriate to the maintaining of social harmony and equity. Under the existing situation, a program for the self-employed would be considered by them only as another option for obtaining security related to health care,

hence such a program should be voluntary in nature. Even if the program were to be mandatory, enforcement costs would be extremely high, unlike the private employee program for which enforcement costs are low.

If the program is voluntary, it must be designed to suit the needs of a well defined target group. An obvious target would be the middle income group among the self-employed workers, since they are currently the least protected group and they have the potential ability to pay for their own security (or with minimal subsidies). The target group is likely to be the self-employed in urban areas where private insurance is increasingly being bought.

Regarding the package of benefits which should be covered, from a 1998 survey of the self-employed in four provinces (Bangkok, Chiang Mai, Khon Kaen and Songkhla) it is evident that the most desirable benefits are those related to illnesses from general causes. A considerably high proportion of the self-employed also expressed the wish to have the same package of benefits which is offered by the Social Security Office for private employees (namely to include health insurance coverage for sickness unrelated to work, maternity, and disability benefits.) Therefore, in principle, the same benefit package should be offered to them as well as an alternative. However, some preliminary work and conditions must be fulfilled before the implementation of such a program is possible (see below). Therefore, it is recommended that implementation be divided into two phases: starting with the benefits which are urgently needed and where project implementation is feasible; only in the second phase would the full benefit package, such as that of the employee program, be offered.

Whether the contribution should be related to risk or ability to pay is a normative question which depends on the underlying philosophy adopted. If the program is merely a risk sharing device, contributions should vary according to risk; but if cross subsidies among members of the program are needed, contributions should be related to ability to pay. Normally, the premium in private insurance is risk related; and the program automatically excludes those with high risk and low ability to pay. Therefore, if the objective is to increase coverage and improve equity within society, premiums based on ability to pay seem more desirable, and even subsidization cannot be ruled out. However, premiums which are related to ability to pay and unrelated to risk can pose serious problems for any voluntary program because it is likely that only those with high risk and low ability to pay will join the program. If premium is related to ability to pay, benefits should also be related to premiums paid to make the program more attractive. This is because if benefits are unrelated to contributions/premiums, not only will those with high risk join the program but everyone will also try to pay the least amount required to keep the entitlement. Both will lead to serious problem in the program. Thus, on the one hand, in order to improve equity contributions should be related to ability to pay and benefits to need; but such a program will encounter practical difficulties if participation is voluntary. On the other hand, in order to increase coverage through voluntary participation, benefits should be related to contributions. There is no clear answer on how to reconcile this dilemma between achieving equity and overcoming practical problems.

## IMPLEMENTATION OPTIONS

### Implementation Phases

As mentioned earlier, in principle, the same benefit package of the private employee's scheme should be included in the scheme for the self-employed. However, due to difficulties in assessing their income, which is usually irregular in nature, calculations of contributions (and benefits) based on income may not be possible. Attempts have been made to assess their income based on other characteristics such as age, sex, educational attainment, location, and occupation. However, these variables can account for only a small proportion of the variations in their income. Therefore, until a satisfactory method to classify self-employed workers by income has been developed, contributions cannot be based on income; and only a few of the options of those benefit packages that are urgently needed by the self-employed can be made available.

Based on such limitations, it is proposed that the extension of coverage to self-employed workers be divided into two phases:

*Phase I.* Contributions are unrelated to ability to pay. Benefits should be designed to fit the needs of some well defined target groups. During this phase, emphasis should not be on increasing the coverage as

extensively as possible, but more on strengthening the administrative organization and on learning and gathering information regarding methods needed to access the target groups, the incidence of adverse selection and moral hazard, and measures to deal with these problems. This will lay a strong foundation for the second phase expansion. If the targets are based on some existing organized bodies, such as occupational associations or saving co-operatives, access might be easier, thereby reducing administrative costs. However, except for some professional self-employed associations, most self-employed do not have any organization which they are or can be attached to. Hence, if the program will only allow participation through existing organized bodies, only a low level of coverage for the self-employed can be expected. Criteria to allow the self-employed to form into groups and participate in programs which will increase coverage without serious adverse selection problems are worth further investigating. However, as more experience is gained, coverage should be widened in the later phase. This is usually the pattern followed when extending coverage to the hard to cover groups in most countries.

*Phase II.* After a method to assess the self-employed workers' income based on their occupations and other measurable characteristics has been developed, contributions could be set that are more closely related to ability to pay and benefits made to reflect contributions made in addition to need. Between phase I and II, it is desirable that each of the existing schemes be modified so as to be better suited to each particular group, and make them more compatible with one another. By that period in development, mandatory universal coverage, with some freedom of choice as to which scheme one would like to participate in according to one's needs, might be possible.

### **A Proposed Scheme for Phase I**

(a) *The benefit package.* According to the Self-employed Survey, benefits should include medical care, maternity, disability, and funeral expenses, but should exclude all types of compensation for lost income during the period covered. Difficulties in assessing the self-employed workers' incomes is the first reason for excluding income based compensation in the benefit package. If it is to be included, it must be calculated based on other criterion beside their income.<sup>1</sup> The second reason is related to the problem of moral hazard, as it is difficult to check whether self-employed workers have actually lost income while claiming compensation from the program. Finally, the rationale to include first the benefits which protect one from unexpected large expenditures rather than compensation for normal income is because they are the most urgently needed benefits, according to most self-employed workers.

(b) *Contributions.* As discussed earlier, ideally contributions should be related to the ability to pay. However, due to difficulties in assessing the income of the self-employed, it has been suggested that during the first phase contributions should be at a flat rate (or at most varied by some broad age groups as in the case of private insurance) for everyone who chooses the same benefit package.

(c) *Options between individual and family insurance.* In the Thai context, self-employed workers should include both the own-account and unpaid family workers. Both groups are equally excluded by the existing system, hence both should be targets of expanded coverage. However, since own-account workers and unpaid family workers are likely to be present in the same household, inclusion via family insurance seems desirable—because having access to the first group will lead to having access to the second group, and family insurance should also help reduce the problem of adverse selection. (This is the approach used in the Health Card Scheme.) A maximum number of members included should be imposed (for example, to cover spouses and at most 3 children). But family insurance may not be attractive to self-employed workers who are single or have some household members already covered under the existing system. Therefore, in order to achieve a better coverage, individual insurance may also made available, but adverse selection could be very high and premiums (or subsidies) must be high to cover the true cost of the program.

(d) *Some problems with implementation.* The rationale for supporting the introduction of another scheme in the social security system is that the existing schemes do not seem to suit the needs of the self-employed. Thus a new scheme must be designed according to their needs. This does not only mean that the contributions and benefits should be appropriate, but also that implementation must be convenient for them. The following practical considerations have been suggested: (1) The opportunity cost of time of the self-employed seems to be very high, hence they attach high value for convenience in obtaining health care services; this is evident by a high use rate in private clinics. Therefore, in order to make the program attractive to them, using services in private clinics must be an option. (2) Incomes of self-employed workers tend to be irregular, hence the collection of contributions should not be on monthly basis (administrative

costs would be too high), but at most once or twice a year. (3) If individual insurance is available, access to the self-employed workers through existing organized groups (such as saving co-operatives, occupational or professional associations, etc.) is advisable because it helps reduce adverse selection. It is also recommended that further study on the incidence of adverse selection and moral hazard, which is essential in determining contributions (and subsidies) and preventive measures, should be undertaken.

## FINANCIAL VIABILITY OF A SOCIAL SECURITY PROGRAM FOR THE SELF-EMPLOYED

Analyzing the financial viability of extending the coverage of social security to the self-employed will be limited to the scope proposed for phase I. The analysis consists of comparing costs and willingness to pay, i.e., the actual cost to self-employed workers paid out-of-their pockets for the benefit package proposed, their willingness to pay which is a fixed amount paid for having a guaranteed access to those benefits, and the estimated cost of a program that covers those benefits. If the cost of the program is higher than the willingness to pay, such program would not be feasible without subsidies from external sources. Moreover, if the fixed amount they are willing to pay is lower than the average cost paid out of their pockets, this implies that self-employed workers are not risk averse. If this is the case, it will be more difficult to design a program which is financially viable and yet attractive enough for them to voluntarily join the program. However, if the fixed amount they are willing to pay is higher than the average cost they actually paid, it implies that self-employed workers are risk averse. Then it is possible to design an insurance program which is financially viable without external support, provided that the amount is greater than the costs of services provided.

### Financial Viability of Health Insurance

This section will compare the costs of the benefit package that includes only health care related benefits. Actual expenditures other than health care (expenditure on child delivery, rehabilitation, and funeral costs) are not available, hence the analysis for other benefit packages in the following section will compare only the willingness to pay with the cost of the program.

From the Self-employed Survey, the average amount that they are willing to pay for health care related benefits (health care for illness, child delivery and disability) is 885 Baht per person per year. If household members are also covered (spouse and no more than 3 children), their willingness to pay is 2,632 Baht per household per year. The majority of the respondents expressed a willingness to pay 20 percent more than the figure they gave initially; hence the maximum willingness to pay would be about 3,158 Baht per household per year ([Table 1](#)).

From the 1996 Socio-economic Survey (SES), the average health care expenditure of households headed by an own account worker in the 4 provinces (Bangkok, Chiang Mai, Khon Kaen, and Songkhla) was 5,627 Baht (in 1998 value) per household (Table 1). Actual expenditures are higher than the willingness to pay for health insurance expressed by the self-employed. This implies that the self-employed are not risk averse and will not pay to exchange uncertainty for certainty. This also means that it is difficult to design an insurance scheme that is attractive enough to them which does not have external support, unless the existence of an insurance scheme somehow induces efficiency improvements in the health care service industries (e.g., health care providers manage to reduce the cost of production without reducing quality, and consumers choose more efficiently). Since such improvements in efficiency are unlikely, subsidies will no doubt be needed to induce the self-employed to take up the program.

The cost of the program for private employees (data are taken from the Planning Division, Social Security Office) in 1997, could be summarized as follows. The costs of providing health care benefits due to (1) any illness unrelated to work, (2) maternity benefits (excluding income compensation), and (3) disability benefits (including both the cost of rehabilitation and income compensation because these are not separable) were, respectively, 708.12, 126.48, and 78.15 Baht per insuree per year. Thus total cost for providing health care benefits (regardless of cause) was 912.75 Baht per insured person per year. The cost of providing health care benefits that extended to household members was estimated to be 3,295 Baht (912.75 Baht \* 3.61 average household members = 3,295 Baht); in 1998 prices, the figure would be 3,559 Baht. Thus, the cost is higher than the amount they are willing to pay for health insurance. Hence, a program that is attractive enough for them is almost certain to require subsidies from external sources. Since the self-employed are, on average, older and their morbidity incidence is about 2.5 percent higher than private employee, it is expected that the cost of a program which covers them with health care benefits would be higher. But if

household members, which include grown up children who tend to have lower morbidity incidence, are covered, one might expect that the cost would be lower. Hence, it is not clear in which direction the bias lies. However, if adverse selection incidence is high, the cost estimate given above is likely to be an underestimation.

### Financial Viability for Other Benefit Packages

The willingness to pay for other combinations of benefits and the cost are compared in [Table 2](#). (These figures refer to individual insurance; for household insurance, it could be roughly estimated by multiplying the figures by the average household size). Caution must be taken in using the cost figures which are calculated from the costs incurred by the private employee scheme in 1997. It is likely that the cost figures were under-estimated because adverse selection is expected to be higher in a voluntary scheme.

All the benefit packages shown in Table 2 include health care benefits for illnesses from general causes, which are the benefits most urgently needed by the majority of self-employed workers. The benefit packages are designed as a combination of health care benefits with options to include other types of benefits. It should be noted that the only type of benefit whose cost is lower than willingness to pay is that of paying 30,000 Baht as funeral cost to the funeral organizer; the opposite holds true for all other types of benefits. This implies that the self-employed place a high value on receiving a lump sum payment for funeral costs in the case of death. The reason given by the respondents is that they want to relieve their children of that financial burden. Hence, it seems reasonable to include funeral costs in the benefit package, but with some qualifying period. Likewise, a reasonable qualifying period must be imposed in covering benefits for events which are more likely to happen, such as maternity benefits. Although 7 benefit packages are given in Table 2 only a few are recommended. In order to reduce administrative costs and adverse selection, package I is the most highly recommended (including 4 types of benefits as covered by the private employee scheme, but without income compensation). Even this package needs subsidies from the government because the cost figure excludes administrative costs.

### Subsidies and Equity

Extending the coverage of social security is desirable in all societies. A good social security system should be efficient, effective, and allow people to have some freedom of choice regarding the level of protection they receive while maintaining some degree of harmony within society. This is difficult to achieve, especially when the system is composed of several programs which were not initially designed to achieve all these objectives. Usually, the government plays an important role in these programs, as operator, financial supporter, or monitor of the programs. In order to reduce inequities within society, the principle of financial support should be based according to need, i.e., full support for the most destitute and none or minimal support for those who can provide for themselves. This section compares the level of government subsidies in existing programs with the estimated subsidy level needed for the proposed self-employed program, in order to check whether the existing system follows such principles in practice.

The sharing of financial burdens between the beneficiaries and the government (out of general tax revenue) in each of the existing health insurance/welfare programs is given in [Table 3](#). The health care program for government officials could be considered as a kind of occupational fringe benefit, hence the government picks up all the cost of the program. The government officials, pensioners, and their family members who are beneficiaries of the program do not contribute monetarily to the cost of the program. The cost per government official, pensioner (per beneficiary) was estimated to be 6,618 (2,000) Baht per year. In the welfare program for the poor, the government also pays all costs by allocating about 231 Baht per card to the Ministry of Public Health to provide free service to the poor. However, actual cost per card is expected to be higher; and public providers cover the extra cost by cross subsidization between the several programs they are involved with. The subsidy for the Health Card is 500 Baht each, while the insured pay another 500 Baht. Again, actual subsidization is expected to be higher and public providers cover the cost by cross subsidization. In the social insurance program for private employees, the government subsidizes about one third of total contributions, which is equivalent to 774 Baht per employee per year.

The beneficiary bears all of the costs in private insurance. These health insurance/welfare programs could be ranked according to the average income of their (implicit or explicit) target groups, in ascending order, as follows: The Poor Card, Health Card, social security program for private employees, and private insurance; and the percentage of subsidization in each of these programs is 100, 50+, 33.33, and 0,

respectively. Hence, with the exception of the welfare program for government officials, the percentage of subsidization seems to follow the principle mentioned above. That is, the percentage of subsidies for persons likely to be in low income groups is higher than that for persons likely to be in high income groups. However, in terms of absolute subsidies, the criterion does not hold. The subsidies per card (Poor Card and Health Card), which covers about 4 household members, are 231 and 500 Baht respectively, while the subsidy per person in the social security program for private employee is 774 Baht per year. This implies that the subsidy for persons likely to be in higher income groups is greater than that for persons likely to be in low income groups.

From previous discussion, it is clear that a program for self-employed workers is not possible without subsidization from the government. The socio-economic status of self-employed workers is comparable to that of private employees. Since the government substantially subsidizes the private employee program, it can be argued that the subsidization of the self-employed program is also justified. If the program charges premiums according to willingness to pay, the level of subsidization per household is estimated to be 401 Baht per year (estimated from the difference between the cost of the program at 3,559 Baht and their willingness to pay for health insurance at 3,158 Baht). Both the absolute (401 Baht) and percentage (11.3%) of subsidization are lower than those in the private employee program. In individual insurance, the willingness to pay is 1,210 baht (Table 3). The level of subsidy would depend on the true cost of the program, which is not known. The true cost depends greatly on the degree of adverse selection in the program. In order to allow for some adverse selection, suppose that the cost is 50–100 percent higher than that of the employee program, then the subsidy would be around 349–869 Baht per person, or about 22.4–41.8 percent. This level of subsidization, both in absolute and percentage terms, is comparable to that for the employee program. This level of subsidization is calculated on the assumption that premiums are charged according to the willingness to pay. However, both the premiums/subsidies are policy variables; and hence can be based on other criteria. But if the premium charged is higher than the willingness to pay, the program will not be attractive enough to induce the self-employed to join. Therefore, one possible criterion is to charge according to the minimum between the willingness to pay and the cost of the program. Thus, the level of subsidization estimated in this section should be viewed as the minimum level of subsidization that would make the program attractive to the self-employed.

## CONCLUSION

With government subsidization at a level comparable to that given to the private employees' program, the extension of social security to the self-employed is highly probable. However, it is recommended that implementation should be divided into two phases. The types of benefit covered during phase I should be limited to what is urgently needed and implementable, namely health care benefits, with options to include funeral benefits, but without income compensation. Extending coverage to other kinds of benefits, especially income compensation, should be delayed until a more satisfactory method to classify the self-employed into income classes for the purpose of calculating their contributions has been developed. Immediate problems regarding the administration of the program are important and need to be addressed. The program must be able to attract a large enough number of self-employed workers to ensure economies of scale in risk sharing and to reduce adverse selection. Access to the self-employed via existing organizations, such as occupational associations or saving co-operatives, etc., which are set up for other purposes is suggested. In order to reduce moral hazard, some measures (e.g., appropriate qualifying periods, co-payment, setting limits on the maximum number of claims per time period, etc.) should be implemented.

On the basis of the foregoing information and conclusions, it might be useful to lay out the next steps necessary for implementing the extension of social security to the self-employed. The decisions needed to complete preparations for phase I are as follows:-

1. What will be the benefit package offered to the self-employed? This paper suggests having health care benefits with options to include maternity, health care related to disability, and funeral costs for the funeral organizer; but all compensation due to income loss would be excluded.
2. What size of flat contribution will be charged and how often and how will it be collected? This paper suggests charging premiums according to the minimum between the willingness to pay and the cost of the program. For example, the premium will be approximately 3,200 Baht per household per year for all health care benefits (calculated according to the willingness to pay), or 4,500 Baht per

household per year if funeral costs are included (calculated for the cost of the program).

3. What size of subsidy (i.e., to cover administrative costs and differences between contribution and likely cost per worker) will be offered and how will it be financed? If premiums are charged according to willingness to pay, the subsidies would be about  $400 + 356 = 756$  Baht per household per year, (400 Baht to cover the differences between contributions and likely costs per worker, and 10 percent of true actuary costs for administration); this is approximately the amount the government uses to subsidize each private employee per year. If the benefit package includes funeral costs, subsidies would be 375 Baht per household per year. The estimated subsidy is lower in this case because the contribution covers the actuary cost of the program, hence subsidies are needed to cover administrative costs only.
4. Will contributions be indexed to cover inflation in costs (e.g., social security contributions that are indexed to wages) and what will it be indexed to?
5. Whether insurance should be offered only at a household level, or also at an individual level, and how to define a household and what will be the maximum number of household members covered? This study suggests offering insurance at both levels and covering a maximum of 5 household members. Eligible members should reside in the same household and be related either by blood or by marriage.
6. If insurance for individuals is offered, will membership by the self-employed be allowed only to those organized into groups and what groups would qualify? This study suggests that individual insurance should start only with organized groups. However, since it is expected that only a minority of the self-employed are attached to the existing organized groups, some criteria should be clearly specified to allow the self-employed to form into groups which would qualify their members to join the program.
7. Will there be pre-conditions for group members (e.g., medical examinations, exclusion of coverage for existing conditions, restrictions on coverage)? and if so, what exactly would they be? About one third of the sampled self-employed agreed to have medical examination before joining the program.
8. How would a health service provider be compensated (e.g., capitation fee or fee-for-service) and how big would such compensation be? Capitation seems to be the most likely criterion. If this is the case, health service providers would be the risk bearer and their willingness to join the program must be explored before determining capitation fees.

In order to proceed further, a task force should be set up by the Social Security Office to decide on the above questions. Implementation of Phase I should be able to begin within 12 months following the setting up of such a task force.

*Implementation of Phase II depends upon:-*

1. Completion of further survey work on how to assess the self-employed's income in order to move from a flat rate system to one based on income ; and
2. Completion of further review work on how to reduce problems arising from adverse selection and moral hazard.

However, the success of the program also depends on the conditions and practices in other programs as well. Free services which are available at public providers without pre-arrangement or condition will surely reduce the incentive to join this program. It is also a barrier to improve the quality of existing welfare programs which are known to be under serious budget constraints. Hence, although introducing a program for the self-employed is an important step to increase the coverage of social security, a wider scope of reform in the whole system is also needed.

## REFERENCES

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