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## ► Multi-tier pensions in Viet Nam: Features and Options

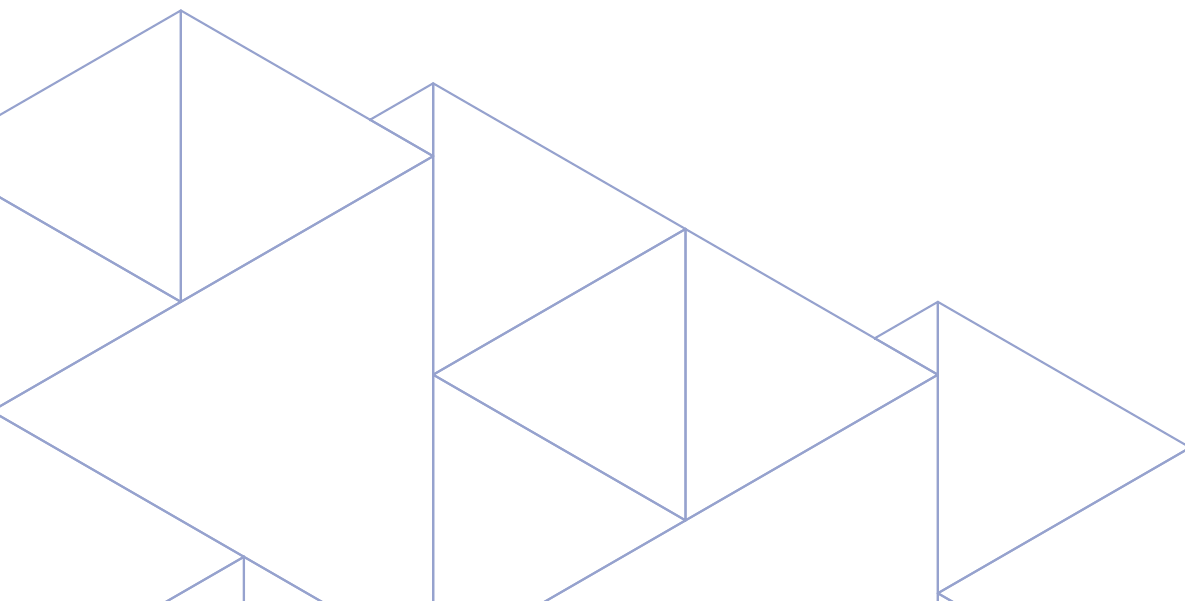






## ► Multi-tier pensions in Viet Nam: Features and Options

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# 1

## Introduction

# 1 Introduction

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**Viet Nam has set out a vision of moving towards a multi-tier social protection system.** A multi-tier system involves a combination of both contributory and non-contributory benefits which achieve social protection policy objectives in a coherent fashion. The vision to move towards a multi-tier system is stated in Resolution 28-NQ/TW and reflects a commitment to a system that provides earnings-related benefits to those with contributory capacity, but also the importance of solidarity and redistribution to ensure everyone has at least a basic level of income security.

Such a multi-tiered approach to strengthen social protection encompasses a wide range of benefits and contingencies through the life cycle, of which old-age benefits are a key component of. Specifically, a multi-tiered pension system is one that, as the broader multi-tiered social protection system, includes multiple pillars (including contributory and non-contributory benefits) with significant levels of coordination and alignment between them.

**This paper sets out key options and considerations for combining contributory and non-contributory pensions into a coherent multi-tier system in Viet Nam.** While the general policy direction in Viet Nam is clear, the country is yet to define precisely how contributory and non-contributory elements of the pension system should interact, particularly as they start to converge in future. This is important as effective design of this interaction is key to building a pension system that achieves coverage and adequacy in a way that is financially sustainable. The brief starts by setting out the basic context of the Vietnamese pension system and the rationale for a multi-tier system. It then describes some key models for building a multi-tier pension system, and key considerations for each.

**Viet Nam has made important progress in the development of its pension system, but there remain notable gaps and challenges.** Addressing them will, as is often the case in social protection, need to strike a balance between expanding coverage, improving adequacy of benefits, and ensuring the financial sustainability of the system, within the existing fiscal space.

The ILO has developed a set of principles (Box 1) which provide a useful framework for identifying some of the strengths and weaknesses of a pension system. In the case of Viet Nam these can be summarized as:

- **Coverage:** Viet Nam has made progress in extending coverage of the pension system. The proportion of the labour force contributing to the social insurance system and building pension entitlements has increased from around 23 per cent of the working labour force in 2015 to 38 per cent in 2022 (VSS 2023). Many older persons also receive a social pension or merit benefits. Nevertheless, the system is far from universal (*Principle 1*), with only around 35 per cent of the population over the retirement age estimated to receive either of these benefits (VSS 2023)). The proportion of women aged 65 and over receiving social insurance pensions (16 per cent) is significantly below that of men (27 per cent) (*Principle 5*) (ILO 2021a).

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<sup>1</sup> Resolution No. 28-NQ/TW makes reference to a multi-pillar social insurance system. The terms multi-pillar and multi-tier tend to be used interchangeably in the discussions of social protection policy. Here, multi-tier is used as it better captures the potentially overlapping nature of social protection benefits.

- **Adequacy:** Both the social insurance scheme and social pensions include strong elements of social solidarity and include mechanisms for collective financing (Principle 2). These are an important precondition for a pension system which delivers adequate and predictable benefits (Principle 3), however, in practice both schemes have shortfalls in this respect:
  - The pension formula within the social insurance scheme can be considered to comply with minimum international labour standards on social security adequacy. However, in practice, benefit adequacy may fall short due to weak contribution density<sup>2</sup> (linked to lump sum withdrawals from the scheme) and under-reporting of insurable earnings. Many workers also fall short of the minimum 20 years of contribution required to receive a pension, and instead receive lump sum payments. While the pension formula includes elements that support redistribution between men and women, in practice the value of men's pensions still exceed those of women's by an average of 20 per cent in 2019. (Principle 5) (ILO 2021a).
  - Another relevant policy questions to be considered in the future is how to progressively increase the social pension benefit level adequacy – alongside an expansion of coverage – taking account of fiscal and wider economic factors and constraints.
- **Financial sustainability (Principle 6):** The financial position of the social insurance scheme is generally assessed to be sound at present and is expected to remain as such for the coming decades. It is however advisable that regular actuarial valuations of the system continue to be undertaken to ensure that the system's financial sustainability remains sound, following both labour market and demographic changes, as well as any policy adjustments that might take place. Looking at the longer-run, adjustments might be required at some point to either to contribution rates and/or benefit levels (including age of retirement) to maintain financial sustainability.
- **Administration and governance:** Overall, the Vietnamese government has been proactive in asserting the primarily responsibility of the state in the management of the pension system (Principle 4). While there is continued room for improvement, significant progress has also been made on the management and administration of the pension system (Principle 7), while representatives of employers' and workers' organisations actively participate in the process of designing, implementing and evaluating social insurance policies (Principle 8) (Olivier 2022).

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<sup>2</sup> Contribution density is typically measured by the proportion of a given year, during which participants pay contributions to a contributory social protection scheme.



### Box 1: ILO principles for designing and reforming pension systems

Principle 1: Universality

Principle 2: Social solidarity and collective financing

Principle 3: Adequacy and predictability of benefits

Principle 4: Overall and primary responsibility of the state

Principle 5: Non-discrimination, gender equality and responsiveness to special needs

Principle 6: Financial, fiscal and economic sustainability

Principle 7: Transparent and sound financial management and administration

Principle 8: Involvement of social partners and consultations with other stakeholders.

*Source: ILO (2018)*

Within this context, the government has set out several reform directions which seek to address some of the challenges noted above. These include:

- **Extending coverage:** Resolution No. 28 sets out a roadmap to achieve 60 per cent of the working age population participating in the social insurance scheme by 2030. It also includes specific proposals to gradually reduce the age of eligibility of the social pension and increase the benefit level.
- **Adjusting the pension formula and method of indexation:** This includes measures seeking to narrow the income gap between pensioners “towards a sharing principle” which emphasises the importance of solidarity within the system. There are also proposals to move from indexation of benefits to wages towards a stronger link to the consumer price index.
- **Reducing of minimum years of contribution** for the social insurance pension from 20 years to 15, then 10 years.
- **Increasing in retirement age:** Although the governance of the retirement age falls outside of the scope of the social insurance law, this is still a policy that significantly influences the social insurance system. In particular the Labour Code has set out a gradual increase in the age of retirement with the aim of reaching 62 years (from 60 years 9 months currently) for men in 2028, and 60 years (from 56 years currently) for women in 2035. Meanwhile, there are plans to expand coverage of the social pension, including reducing the age of eligibility for the pensions-tested component from 80 to 75 years.

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## ► 2 The role of multi-tier systems

## 2 The role of multi-tier systems

The central rationale for a multi-tier system is that pension systems seek to achieve a range of objectives for people in different (and changing) circumstances (see definition in Box 2). This relates particularly to pension adequacy. At one end of the income distribution there are those with almost no contributory capacity, who will require some form of social pension to achieve basic income security in old age. At the other end of this distribution, there are those with relatively high contributory capacity that not only aspire to a basic level of income security, but to pensions that reflect their previous earnings. Greater complexity is added by the fact that many people find themselves between these extremes, and people's circumstances change over time. A multi-tier system seeks to provide a relevant level of adequacy for people in a range of circumstances. It will also seek to do this in a way that shares risks in a way that societies deem appropriate.

### Box 2: Definition of an effective multi-tier system

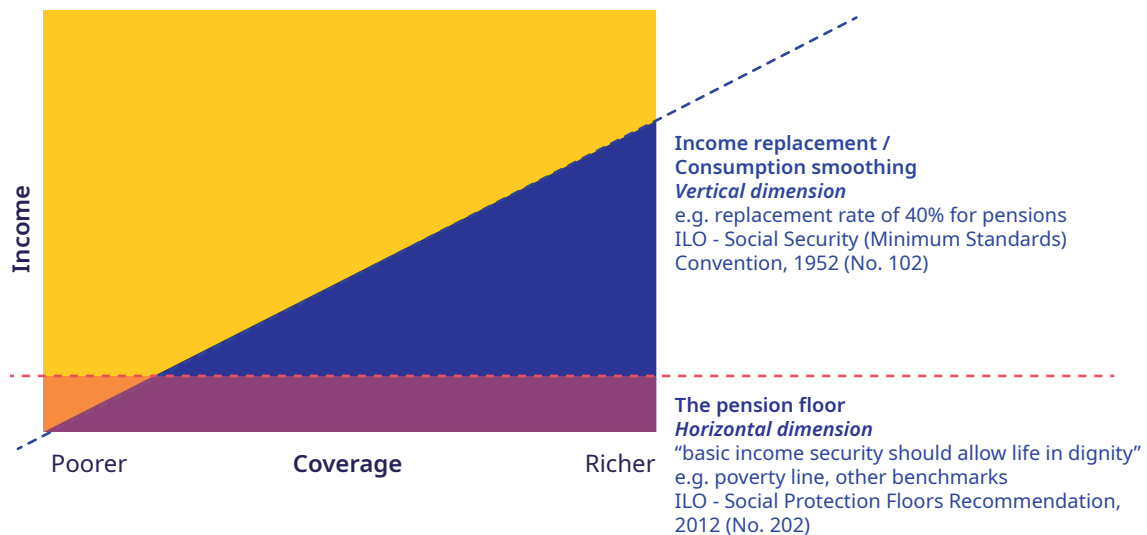
*Effective multi-tier pension systems support the achievement of the **range of system objectives for different people** (whose situation may change over time) in a way that is **coherent** and **distributes risks between individuals, enterprises and government** in an appropriate way.*

Source: ILO (2022a)

A core challenge for multi-tier systems is how contributory and non-contributory schemes should interact. This is particularly relevant for the people that find themselves between the extreme scenarios described above. Many people have some contributory capacity, but perhaps not sufficient to accumulate adequate pension entitlements under a contributory system. This group is commonly characterised as a “missing middle” within the social protection system that benefit neither from poverty-targeted social assistance, nor from social insurance. Many such workers are those found in the informal economy but who – with the right policy approaches – may be able to participate in social insurance schemes. Articulating the interaction between tiers for those in the middle is a particularly delicate process of providing subsidies and support without undermining incentives to participate in social insurance.

In considering options for multi-tier pension systems, one can consider a set of key assessment criteria:

1. **Adequacy:** A multi-tier system should seek to address two key dimensions of adequacy (Figure 1). It should provide a floor of basic income security for everybody reaching older age (horizontal dimension), while providing mechanisms for those with greater levels of contributory capacity to achieve higher levels of protection (vertical dimension). Relevant standards for both dimensions are captured in ILS (see Box 3). It is understood that achieving minimum levels of adequacy for both dimensions may be something achieved progressively over time.

**Figure 1: Two dimensions of adequacy within the pension system**

### Box 3: International Labour Standards (ILS) on old-age pension adequacy

ILO Conventions Nos 102 and 128 as well as Recommendations Nos 131 and 202 together provide an international reference framework for pensions in old age, including defining minimum standards of adequacy.

**The vertical dimension:** Earnings-related contributory pensions should ensure income maintenance by guaranteeing at least minimum replacement rates corresponding to a prescribed proportion of an individual's past earnings, or minimum benefit levels. For example, replacement rates should equal at least 40 per cent (Convention No. 102) or 45 per cent (Convention No. 128) of the reference wage after 30 years of contribution or employment.

**The horizontal dimension:** Flat-rate pensions – typically provided by non-contributory schemes – should guarantee that the provision offered is at least sufficient to maintain the family of the beneficiary in health and decency (Convention No. 102, Art. 67(c)). Relevant benchmarks for this level of basic income security include poverty lines and average wages for certain sectors of employment.<sup>3</sup>

The ILO Conventions and Recommendations listed above also state that pensions should be regularly adjusted to maintain pensioners' purchasing power until the beneficiary's death.

Sources: ILO (2021b; 2018; 2012) and James and McClanahan (2019)

<sup>3</sup> For example, ILO Conventions Nos 102 and 128 set minimum replacement rates for tax-financed pension levels at 40 and 45 per cent, respectively, of the prevailing wage of a male manual labourer.

**2. Incentives:** An important idea of multi-tier systems is that there should be a financial incentive for workers to participate in contributory social insurance. This does not necessarily mean that the level of contributions and benefits should be perfectly aligned, especially given the importance of redistribution within a pension system. Nevertheless, there are two key principles that are important:

- Those who contribute to a social insurance scheme should achieve higher benefits than those who have not.
- Those who contribute more (and longer) should receive higher benefits than those who have contributed less (and for shorter periods).

Future reforms that consider reducing the minimum years of contribution required for a pension, and/or increasing the social pension benefit, are likely to make the question of incentives more relevant, as they may result in benefit levels from the social pension and the social insurance system being similar.

**3. Simplicity and flexibility:** Some level of complexity is inevitable within the pension system, but every effort should be made to ensure that the system is as clear and easy to navigate as possible. Systems where rules are extremely complex – or uncertain – create a difficult landscape for workers and enterprises to navigate, which in turn may undermine participation, and thus the coverage, adequacy and sustainability of the system. As well as good scheme design, this process can be supported by good communication and by efforts to strengthen financial literacy. Pension systems should ideally not be designed too rigidly around factors such as the current demographic context, income distribution or configuration or the labour market. At best, they should be able to adapt to changes over time.



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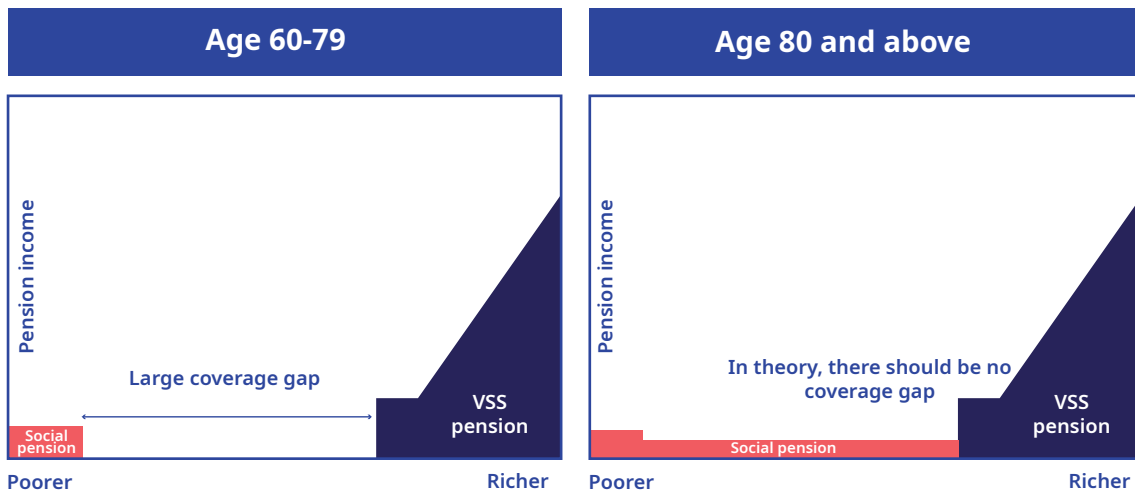
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## Options for multi-tier pension systems

### 3 Options for multi-tier pension systems

Before setting out options for a multi-tier pension system, it is useful to summarise the current multi-tier configuration in Viet Nam (Figure 2). Between the age of 60 and 79, older people can either receive a social insurance pension (depending on their contribution record and reaching the prescribed retirement age) or one of a variety of social pensions, allowances and merit benefits. These include the social pension for older people aged 60-79 assessed as needy, and living alone without family support, and allowances for those with severe levels of disability. However, many older people aged 60-79 receive no benefit at all. From age 80, all those not entitled to a social insurance pension benefit are eligible for a social pension. Those assessed as needy, and living alone without family support and/or with disability can receive higher benefit levels.

**Figure 2: The current configuration of Viet Nam’s multi-tier pension system**

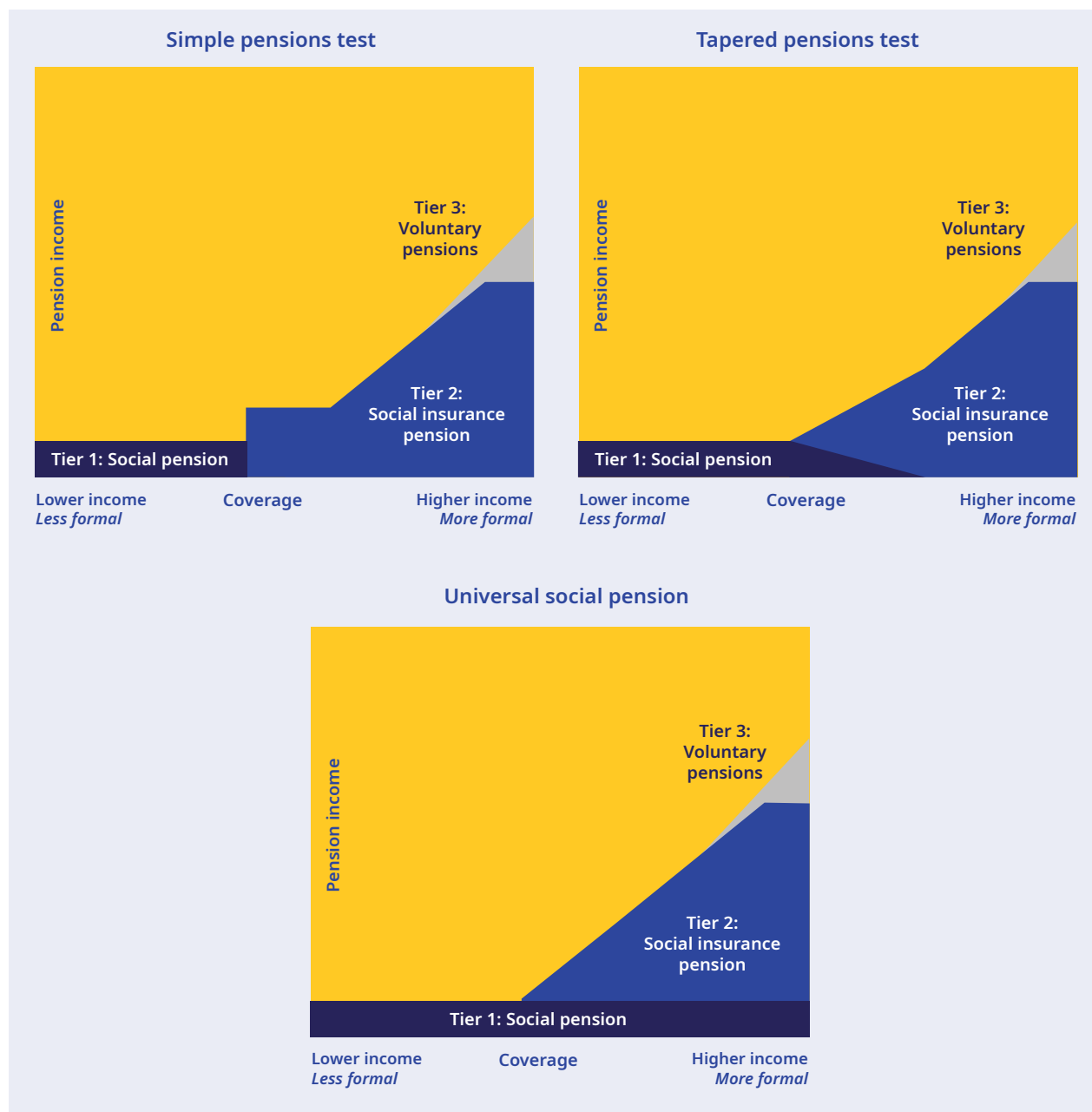


Source: Kidd et al, 2019

This section describes options for the design of a multi-tier pension system. The different options are visualised in Figure 2, and then described and discussed in detail in the following subsections. The focus of the section is on the interaction between non-contributory social pensions (Tier 1) and contributory social insurance pensions (Tier 2), given that voluntary savings (Tier 3) are unlikely to be a priority for providing adequate pensions to the majority of the population.<sup>4</sup>

<sup>4</sup> Within multi-tier pension typologies, voluntary pensions are usually conceived as being supplementary to mandatory schemes (including both social insurance and social pension approaches). This implies that in that framework, workers can contribute to and benefit from both compulsory and voluntary tiers simultaneously. This is distinct from the voluntary social insurance scheme in Viet Nam which is provided as an alternative to the compulsory scheme, and therefore cannot be combined with it.



**Figure 3: Scenarios for multi-tier pension arrangements****a. Universal social pension floor**

This scenario entails providing a non-contributory benefit provided to all older persons (Tier 1). This benefit would be supplemented by pension entitlements from the social insurance (Tier 2). This approach exists in countries including Bolivia, Mexico, New Zealand, Timor-Leste, Thailand (for private sector workers<sup>5</sup>) and various Pacific Island Countries.

<sup>5</sup> Thailand's universal social pension only excludes recipients of civil servant pensions, but pensioners under the Social Security Fund are eligible for the social pension (ILO 2022b).



This approach has particular **advantages** in terms of incentives and simplicity. Given that pensioners would receive their full social insurance entitlement in addition to the social pension, there would be strong incentives to participate in social insurance. With eligibility only based on age and citizenship/residency, universal pensions are relatively simple to implement, and the entitlement is easily understood by the population.

The main **disadvantage** of this approach is that it would have a higher cost to the state budget relative to other social pension options discussed below. It could also be questioned whether the additional support from the social pension is necessary for social insurance pensioners – in particular those with higher pension benefits – given that many should already achieve minimum standards of income replacement as set out by international labour standards.

## **b. Simple pensions test**

**This scenario would entail social insurance pensioners (Tier 2) being excluded from the social pension (Tier 1).** This is the current situation with the social pension provided for older persons aged 80 and over. Such an approach exists in countries including **Portugal, Argentina and various countries in Central Asia**. Some countries include a simple pensions test as part of a broader means test, as in **Italy and Mongolia**.

The main **advantage** of this approach is that it would entail lower expenditure from the state budget than a fully universal pension, while still being a relatively simple approach to implement.

The main **disadvantage** of this approach is that, if not designed carefully, it could create disincentives to participate in social insurance, or create questions around the fairness of the pension system. This is particularly likely to be the case where pension benefits provided by the social insurance system are at a similar level to those provided by the social pension. This may be the case for workers within the social insurance systems with lower incomes and shorter contribution histories.

One approach to address the issue of incentives is to provide minimum pensions for social insurance pensioners that are above those of a social pension. A minimum pension already exists for workers under the compulsory scheme reaching the minimum 20 years of contribution, currently 1,800,000 Vietnamese dong (dong).<sup>6</sup> This is more than five times higher than the current social pensions 360,000 dong, which implies that most people would have strong incentives to contribute to social insurance.

An important consideration for the minimum pension approach is how it should adapt to other planned and necessary reforms within the pension system. This relates particularly to the reduction in minimum years of contribution required for a pension and the increase in the social pension, both of which are important to strengthen benefit adequacy. Box 4 provides some options and considerations.

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6 The minimum pension is set from 1,490,000 dong to increase to 1,800,000 dong per month from 1<sup>st</sup> July 2023.

#### Box 4: Adapting minimum pension to wider pension reforms

With regards to **the reduction of minimum years of contribution required for a pension** (to 15 and then 10 years), the government would have one of three choices of how to adapt a minimum pension for those with less than 20 years of contribution:

- **Provide pensions simply based on the pro rata accrual rate relevant to years of contribution.** The result may be that some workers receive very low pensions which are similar to (or below) the social pension benefit.
- **Extend the current minimum pension to those with fewer years of contribution (at the same level).** The main issue with this approach would be that many workers (with varying durations and levels of contribution) would receive the same minimum pension benefit. This may incentivise workers to stop contribution once they have accumulated a minimum level of contribution, by leaving employment or the formal economy. It could also incentivise under-reporting of wages.
- **Create lower levels of minimum pensions for fewer years of contribution.** For example, a pro rata approach could be adopted where the minimum pension could be reduced to 75 per cent of the current level for 15 years contribution, 50 per cent for 10 years contribution, and so on.

**A second issue is the fact that the government may seek to address the currently low level of adequacy of the social pension.** Increases to the social pension to bring it more in line with national and international standards of basic income security would bring it closer to the minimum benefits of the social insurance system, regardless of the approach used above.

**Another associated approach to increase the minimum adequacy of the social insurance system would be the introduction of a grandfathering rule.** This would respond to the fact that many workers close to retirement may not have sufficient time to reach the minimum contribution requirements to receive a pension. A grandfathering rule would provide credits (years of contribution) for those close to the retirement age and with gaps in contribution histories, that could provide incentives for them to complete their contribution record. For example, a 47-year-old woman with less than one year of contribution could be provided a credit of 2 years, which would allow her to reach a minimum 15 years with 13 years of contribution before retirement at age 60.

#### c. Tapered pensions test

**Given the potential issues with a simple pensions test, an alternative is to provide a social pension with a “tapered” pensions test.** This entails social pension (Tier 1) benefits only gradually being reduced based on the level of social insurance pension entitlement (Tier 2). For example, the social pension might be reduced by 10,000 dong for every 20,000 dong of social insurance pension. A consequence is that social insurance pensioners with low benefit entitlements would also receive a supplement from the social pension. Variations of this approach exist in countries including **Canada, Denmark, Chile, Finland, the Maldives and Sweden**. While the specific design of tapered pensions-tests vary, they all share common features (see Box 5).

### Box 5: What is a tapered pensions test?

The basic idea of a tapered pensions test is that social insurance pensioners with lower pensions could also receive some level of social pension. To achieve this, the social pension benefit is reduced according to the level of earnings-related pension benefit. This is articulated as a taper rate. For example, a 50 per cent taper rate would reduce a social pension by 50 per cent of the value of an earnings-related pension, until the social pension reaches zero. Taper rates vary across countries from 50 per cent in Chile, Finland and the Maldives to between 31 and 32 per cent in Denmark. Table 1 provides an illustration of what social pension individuals might receive depending on their level of social insurance pension benefit, where the maximum social pension is 500,000 dong per month.

**Table 1: Illustration of a possible tapered pensions test for social pension of 500 000 dong per month**

Social insurance pension	Taper rate: 50%		Taper rate: 30%	
	Social pension	Total pension	Social pension	Total pension
0	500 000	500 000	500 000	500 000
500 000	250 000	750 000	350 000	850 000
1 000 000	0	1 000 000	200 000	1 200 000
1 500 000	0	1 500 000	50 000	1 550 000
2 000 000	0	2 000 000	0	2 000 000

*Note: All values are monthly. In this case, it is assumed that social insurance benefits are calculated based on a pro rata accrual rate.*

A taper may also include an **allowance** for the earnings-related pension, which is unaffected by the taper rate. This exists for tapers in countries such as Chile, Denmark and Finland.<sup>7</sup>

Some countries, such as Canada and Denmark, include a **tapered benefit as a supplement to a universal social pension**. In both countries, virtually all older persons receive the universal pension, while only some receive the tapered supplementary benefit.

*Source: Chile Atiende (2023), Kela (2023), OECD (2022) and Maldives Pension Office (2023)*

The main **advantage** of this approach is that it would require lower expenditure from the state budget than a universal pension, while providing clear incentives to contribute. A taper should ensure that longer duration and higher levels of contribution will always result in higher benefits. For a given benefit level, a tapered pension would be lower cost than a universal pension. Whether or not a tapered arrangement is lower or higher cost than a minimum pension arrangement will depend on the specific design of each. Tapered pensions-tests usually apply to non-contributory benefits, but there is a case for Viet Nam to use a similar approach to define a minimum pension within the social insurance scheme (Box 6).

<sup>7</sup> For example, in Chile, the first 702,101 pesos (US\$ 884) of monthly earnings-related pension benefit is not affected by the taper (Chile Atiende 2023).

### Box 6: Tapering a minimum social insurance pension?

In countries where they exist, tapered pensions tests are typically used to reduce a non-contributory benefit financed by general revenues, according to the level of contributory benefits. This tends to be part of a system that guarantees a minimum pension benefit to all older persons. However, the evolving nature of Viet Nam's pension system presents a distinct context. The social pension is in a process of gradual expansion of coverage, but only provides a universal guarantee above the age of 80 (with proposals to reduce this to the age of 75). In the meantime, there is a policy ambition to improve the minimum level of adequacy within the social insurance system, including for retirees below these ages.

One solution could be to introduce a minimum pension arrangement within the social insurance system that follows the logic of a tapered pensions test. For example, a minimum pension could be defined at 500,000 dong for all workers with fewer than 20 years of contribution history, but with a tapered approach. This approach would differ from the flat-rate approach of the minimum pension, that could remain in place for those with 20 years or more of contributory history. Notably, this would apply from the existing retirement age within the social insurance scheme, unlike the social pension which only applies from age 80+.

For the time being, this tapered minimum pension could be financed by the social insurance fund. However, as the Vietnamese pension system evolves (and the social pension expands in coverage), the government could review whether to maintain this arrangement or shift the financing to general revenues.

A potential **challenge** of a tapered approach is its greater administrative complexity. The fact that the social pension benefit level will depend on the level of social insurance benefit requires the administration of both schemes to be unified. Nevertheless, unifying the administration and policy planning is something which is likely to have broader benefits. A taper also makes the benefit calculation slightly more complex for participants in the system to understand, although it is questionable whether most workers have a precise understanding of the benefit calculation of the existing system. Tools such as the existing app for workers to check their pension entitlements can also be updated to reflect the role of the tapered pensions test.

**One important consideration with a tapered scheme would be rules around the withdrawal of lump sum payments at retirement.** A tapered pensions test could only be applied to periodic pension benefits and not to lump sum payments which are paid to those not reaching the minimum years of contribution to receive a pension. This could create a scenario where some individuals might consider themselves better off by contributing just below the minimum years required for a pension (for example, 19 years, where the minimum is 20 years), then taking the lump sum benefit and full social pension benefit. One solution to this issue would be to eliminate the option to take lump sum benefits upon retirement, or limiting it only to those with very short contribution histories (for example, less than 5 years). Providing such small benefits is often considered administratively impractical but this would be feasible where the social pension and social insurance pension were paid as a single benefit.

# 4 Conclusion

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**Building a coherent multi-tier pension system will be key for Viet Nam to build a universal and adequate pension system that is financially sustainable in the context of demographic ageing.** A key implication of moves towards a multi-tier system is the creation of new pension arrangements for workers in the “missing middle” that combine different financing sources (contributions and the state budget). A wide array of different design options exists, with a key consideration being how to combine a contributory principle (that those who contribute more receive higher pensions) and strong elements of solidarity and redistribution. These approaches should be considered carefully in light of other priority policy commitments in Viet Nam including:

- **Expanding coverage** of both social insurance pensions (by increasing the portion of workers contributing, and reducing the minimum contribution years required for a pension) and of the social pension (by reducing the age of eligibility).
- **Improving adequacy**, by bringing the social pension more in line with national and international benchmarks of minimum income security. It also involves addressing factors that reduce social insurance pension adequacy including the gap between insurable earnings and workers’ wages, and the widespread early-career lump sum withdrawals that limit pension entitlements.

**Despite the urgency to strengthen the pension system in the context of demographic change, building a multi-tier pension system in Viet Nam is likely to be an incremental process** that responds to wider economic, social and demographic developments. Some key actions would support this process:

- **Work to bring both social insurance pensions and the social pension under the same overarching management.** This can support policy planning that considers the design of both schemes together, as well as providing opportunities to integrate administration.
- **Seek to design a multi-tier system in a way that can easily adapt to changes in the context that the pension system is operating within.** This includes designing minimum guarantees within the social insurance system in a way that can easily “connect” with a social pension as it expands in coverage.
- **Undertake research to assess the relative cost of different options for multi-tier arrangements.** This requires actuarial analysis to weigh up the costs of different scenarios for minimum pensions and social pensions (including different approaches to pensions testing). Once any given design is put in place, there is a need for monitoring through periodical actuarial valuations.

Following this overall direction, analysing and identifying what the most suitable design for a multi-tiered pension system in Viet Nam, while staying true to the fundamental principles put forth by ILS will be the only way for Viet Nam to stay in course to reach the goals set forth by Party Resolution 28 of reaching 60 per cent of pension coverage for workers above the retirement age by 2030, and to reach the long-term goal of providing social protection for all.

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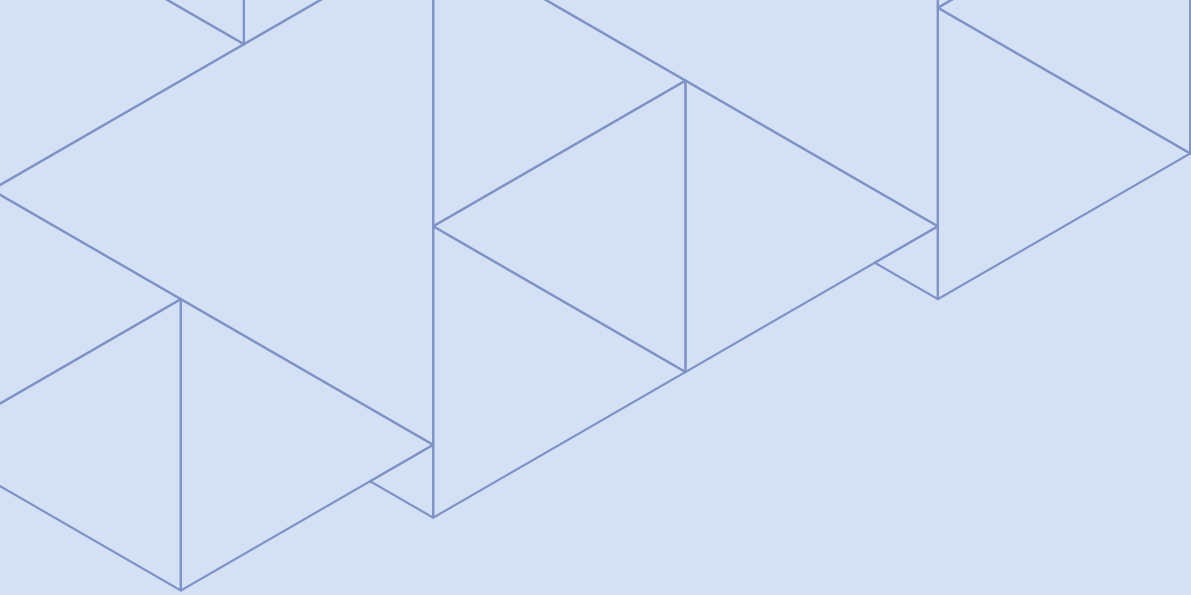
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**ILO Country Office for Viet Nam**

- 📍 Green One UN House  
304 Kim Ma Street, Ba Dinh, Ha Noi
- ☎ Tel: +84 24 38 500 100
- ✉ Email: [hanoi@ilo.org](mailto:hanoi@ilo.org)
- 🌐 [www.ilo.org/hanoi](http://www.ilo.org/hanoi)
- 📘 [www.facebook.com/Vietnam.ILO](https://www.facebook.com/Vietnam.ILO)