Today’s Objectives

- To discuss characteristics of social insurance programs

Basic Principles and Characteristics of Social Insurance:

1. Compulsory program
2. Provides minimum floor of protection
3. Emphasis on social adequacy vs. individual equity
4. Benefits loosely related to earnings
5. Rights to benefits with no means test
6. Self supporting contributory principle
7. No full funding
8. Benefits prescribed by law
9. Plan not established solely for government employees

7. <u>No Full Funding</u>

- **Full funding** is when "*the value of the accumulated assets under the plan is sufficient to pay out all liabilities for the benefit rights accrued to date under the plan*"

- Full funding is not practical for social programs as it would be quite difficult to determine benefits accrued to date

- Full funding is not necessary for social programs because;
  - programs are expected to operate indefinitely
  - program is compulsory, so always has new people entering
  - government can always use its taxing powers to raise additional money

7. <u>No Full Funding</u>

- Full funding is not desirable- would be detrimental costs

- Many social insurance programs are funded on a "pay-as-you-go" basis whereas private insurance programs are fully funded
  - Instead of a "pay-as-you-go" structure, the CPP was expected to be 20% funded by 2014, increasing to 30% by 2075 (i.e., the CPP Reserve Fund will equal 30% of the "liabilities" - or accrued pension obligations by 2075)

    Canada pension plan.
  - This was accomplished through increased contributions in anticipation of the aging baby boom generation

8. Benefits Prescribed by Law

- OASDI or CPP in Canada are both programs with benefits and eligibility requirements prescribed by law, and with the administration of the plan done (or supervised) by government

9. Plan Not Established Solely for Government Employees

- A plan established by a government for its own employees only would be comparable to group benefits offered by employers

Comparison of Social and Private Insurance

- OASDI is a form of social insurance that contains both (1) a strong welfare element and (2) private insurance elements
- To understand why, will first look at 2 of the **key characteristics of private insurance** (that are also found in SI)

1. Pooling (one of the key characteristics of private insurance)

- Pooling is a technique by which a large number of exposure units are combined or grouped
  - then the law of large numbers can be used to provide a reasonably accurate prediction of future payouts
  - it allows the spreading of these payouts over the entire group (i.e., payouts of individuals exposed to certain risks are pooled with all other individuals)

Comparison of Social and Private Insurance (continued)

1. Pooling

- The law of large numbers is of little practical value in predicting long run social insurance experience
  - difficult to predict future experience due to complex social, economic and demographic variables

- BUT pooling does occur in some sense with SI
  - OASDI example: those not yet retired are making contributions, the cost of retirement payments being made is being spread out and at least partly paid for by individuals who have not yet retired and are still making OASDI contributions

Comparison of Social and Private Insurance (continued)

2. Risk Transfer (also a key characteristics of private insurance)

- A pure risk is transferred to the private insurance company (for a price…), which is in a stronger financial position to pay losses than the individual

- Similarly in a Social Insurance (SI) program, the financial risk is transferred to the government

- There are also several **other similarities between Social Insurance (SI) and private insurance**

Other Similarities between SI and Private Insurance

3. Both provide specific and complete descriptions of all conditions relating to coverage, benefits and financing
4. Both require contributions or premiums that are sufficient to meet estimated costs of the program/insurance
5. Both require precise mathematical calculations of benefit eligibility and amounts
6. Both provide pre-determined benefits that are not based on demonstrated need
7. Both benefit society as a whole in providing economic security

- There are, however, also **major differences between social and private insurance**

Differences between Social Insurance and Private Insurance

Social Insurance	Private Insurance
Compulsory	Voluntary
Minimum floor of Income Protection	Large amounts available, depending on individual desires and ability to pay
Emphasis on social adequacy	Emphasis on individual equity
Benefits established by law that can be changed (statutory right)	Benefits established by legal contract (contractual right)
Government monopoly	Competition pooling
Costs difficult to predict	Costs more readily predictable
Full funding not needed because of compulsory contrib'ns from new entrants & program assumed to last indefinitely	Fully funded basis (no reliance on new entrants' contributions)
No underwriting	Individual or group underwriting
Diverse opinions regarding program objectives and results	Opinions generally more uniform regarding objectives and results
Investments are generally in obligations of federal government	Investments in different but mainly private channels
Taxing power readily available to combat erosion by inflation	Generally a greater vulnerability to inflation

Module 1 – Financial Security and Insecurity
→ Basic Principles of Social Insurance (Ch 2 of *Social Ins. & Economic Security*)

Comparison of Social Insurance and Public Assistance

Social Insurance	Public Assistance
No means test: Individuals receive benefits regardless of income needs	Always involves a means test: Applicants must show that their income and financial assets are below the standard of need established for the program May be needed to supplement social insurance benefits
Benefit amounts are generally predictable - loosely related to participant's earnings	Benefits are based on extent of recipient's need and may vary by state/province
All participants are insured but only a small percentage are receiving benefits	All participants are receiving benefits, therefore less participants than SI
No stigma or shame attached to receipt of benefits, so relatively few eligible participants refuse to make a claim	Many eligible individuals find the means test demeaning and as a result may not apply for benefits

Economic Objectives of Social Insurance Programs

economic insecurity.

1. Provide Basic Economic Security to Population
   - Primary objective is to provide protection against risks of premature death, old age, sickness and disability
   - Should provide a base layer of income protection, which when combined with other sources should be sufficiently high to provide a minimum standard of living

2. Prevent Poverty
   - Effective in reducing the number of beneficiaries who sink into poverty

<u>Economic Objectives of Social Insurance Programs</u>

3. Provide Stability to the Economy
   - Contributes to nation's economic stability by influencing consumption of goods, saving and investment (including during downturns in the business cycle)
   - Financing programs should also contribute to economic stability
   - Note: Economic stability should not overshadow primary objective of providing basic economic security

Economic Objectives of Social Insurance Programs

4. Preserve Important Economic Values
   - Promote personal incentives, initiative and thrift
   - Promote concept that a person's economic security should result from work and that benefits should be related to earnings
   - Benefits are paid regardless of income from private pensions, savings and investments, therefore workers are encouraged to supplement the basic layer of protection