Today's Objectives

- To discuss causes of economic insecurity
- To introduce the concepts of **social security** and **social insurance programs**
- To discuss categories of social security programs
- To discuss characteristics of social insurance programs

Recall that:

- **Economic insecurity** occurs when a person is unable to achieve a sense of well being due to a fear that present and future needs will not be satisfied

- **Social security** refers to programs established by law that insure individuals against the loss or interruption of earned income and certain expenditures as well as family allowances

- **Social insurance** is a pooling of risks by an organization, usually governmental, that is required by law to provide cash or service benefits to or on behalf of covered persons upon the occurrence of certain specified losses

Reducing Economic Insecurity:

- There are 3 components to successfully protect oneself from the potential impact of economic insecurity
  1. Individual plans/initiatives
  2. Employer benefit plans
  3. Social security programs (government)

1. Individual Plans / Initiatives

- **Examples of how individuals and families can receive protection against economic insecurity?**

2. Employer Benefit Plans

- **Examples of how employers can help protect employees against economic insecurity?**

3. Social Security Programs (Government)

- **Examples of how governments can help protect individuals and families against economic insecurity?**

Note:

- This reading refers to the Old-Age, Survivors, and Disability Insurance (OASDI) which is the US Social Insurance (SI) program when reviewing the basic principles and characteristics of SI programs
- While there may be differences in the details, the characteristics apply to other SI programs
- The Canada Pension Plan (CPP) is the Canadian counterpart of OASDI

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

1. <u>Compulsory program</u>

- Covers healthy and unhealthy people
- This allows a basic floor of income protection to be provided at a reasonable cost to the masses

- **Why is “compulsory” an important characteristic for Social Insurance?**

2. Provides Minimum Floor of Protection

- Philosophy is that individuals are primarily responsible for their own economic security (which is case in most countries)
- Only a minimum benefit should be paid if government assistance is needed
- Benefit should be set at a level that , when combined with other income or insurance, an individual should be able to maintain a reasonable standard of living

Note:

- An important SI objective is to keep people off of welfare (OASDI and CPP in Canada are both effective in this regard)

3. Emphasis on Social Adequacy vs. Individual Equity

- **Social adequacy** means benefits paid provide a certain standard of living to all contributors
  - Provides a minimum floor of income to all groups

- **Individual equity** means contributors receive benefits directly related to their contributions
  - (Actuarial) value of benefits is closely related to the (actuarial) value of contributions

3. Emphasis on Social Adequacy vs. Individual Equity (continued)

- Social adequacy results in benefits that are heavily weighted in favour of certain groups such as:
  - lower income groups
  - larger families
  - those near retirement when retirement program(s) introduced

- For these above groups of people, the concept of social adequacy means they will receive more in benefits than they put into the plan, so , relatively speaking;

  value of their benefits > value of their contributions

- With emphasis on social adequacy, this results in social insurance redistributing wealth/income from one group to another

4. Benefits Loosely Related to Earnings

- This means that some relationship exists between individual equity and social adequacy (still provides adequate benefits to lower income groups)
- Generally, the higher the worker's earnings, the greater will be the benefit for that person

- **Rationale/reasons for benefits being related to earnings?**

5. Rights to Benefits with No Means Test

- While 'need' is recognized in the program, there is no "nee"d or "means" test
  - Individuals receive benefits regardless of income needs
  - They only have to fulfill the eligibility requirements

- The right to receive benefits is a statutory right, NOT a contractual right and it is NOT an earned right
  - Note though that government can modify benefits in any direction if there are sound reasons for it

6. Self Supporting Contributory Principle

- Social insurance is financed and supported through:
  - payroll contributions of employers,
  - payroll contributions of employees,
  - payroll contributions of the self-employed,
  - interest on fund investments

6. Self Supporting Contributory Principle (continued)

- Contributory-financing principle helps establish relationship between benefits received and contributions paid, which is important because;
  - Participants have greater awareness of relation between contributions and benefits
  - Encourages a more responsible attitude from government
  - Participants feel greater psychological security in the protection provided

7. No Full Funding

- **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)
  - This was accomplished through increased contributions in anticipation of the aging baby boom generation

8. <u>Benefits Prescribed by Law</u>

- 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. <u>Plan Not Established Solely for Government Employees</u>

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