Today’s Objectives

- To discuss reducing economic insecurity
- 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 protect themselves against economic insecurity?**
  - Purchasing insurance (life, health, property, automobile, …)
  - Private savings and investments
  - Retirement savings plans
  - Earnings of other family members
  - Education to upgrade and improve job skills
  - Assistance from children, relatives, churches, and private charity organizations

2. Employer Benefit Plans

- **Examples of how employers can help protect employees against economic insecurity?**
  - Group life and health insurance
  - Pensions and group retirement savings plans
  - Severance pay
  - Employment-stabilization techniques, e.g., work-sharing arrangements

3. <u>Social Security Programs (Government)</u>

- **Examples of how governments can help protect individuals and families against economic insecurity?**
  - Social insurance such as CPP, Employment Insurance (including parental and sick leave), Workers' Compensation
  - Public assistance (welfare)
  - Legislation to reduce economic insecurity such as provincial health care plans, standards for pensions and occupational safety and health, etc.
  - Government policies including monetary policy, fiscal policy, job training, tax subsidies
  - Other such as veteran's benefits, public housing, energy assistance, student loans, etc.

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?**
  - If it was voluntary, some individuals would elect not to be covered and the objective of providing a basic floor would not be attained
  - Large compulsory SI programs have the advantage over smaller programs that fewer random or accidental fluctuations in loss experience are likely to occur

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

对立概念

- **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. <u>Emphasis on Social Adequacy vs. Individual Equity</u> (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. <u>Benefits Loosely Related to Earnings</u>

- 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?**
  - Provides economic reward to workers earning higher income
  - Takes into consideration regional differences in standard of living

5. Rights to Benefits with No Means Test

- While 'need' is recognized in the program, there is no "need" 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

Today's Objectives

- To discuss characteristics of social insurance programs
- To compare social insurance to private insurance and public assistance

<u>Basic Principles and Characteristics of Social Insurance:</u>

1. Compulsory program
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3. Emphasis on social adequacy vs. individual equity
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7. No full funding
8. Benefits prescribed by law
9. Plan not established solely for government employees

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

Full-Funded : pension trust fund is not activately paid into its future beneficiaries .

pay-as-you-go : the benefit is directly tied to the contribution or tax paid by contributors

7. No Full Funding

- 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. 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)

<u>Comparison of Social and Private Insurance</u> (continued)

1. <u>Pooling</u>

- 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

<u>Comparison of Social and Private Insurance</u> (continued)

2. <u>Risk Transfer</u> (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

individual → insurance (private / social).

- 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**

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

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 status. (statutory right)	Benefits established by legal contract contract. (contractual right)
Government monopoly	Competition
Costs difficult to predict new → old.	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) x.
No underwriting	Individual or group underwriting 承担风险.
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 易损性.

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 有申请就会领.
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

都有，但不一定会领.

Today's Objectives

- To discuss economic objectives of social insurance programs

- To discuss the economic problem of old age

Economic Objectives of Social Insurance Programs

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

Provide Economic Security ← Prevent Poverty

Provide Stability to the Economic

Result.

Preserve Important Economic Values,

Economic Objectives of Social Insurance Programs

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

Economic Problem of Old Age

The economic problem of old age consists of the following:

1. **Growing population of older people**
   - Impact of "baby boomer" generation (those born between 1946 - 1965) entering older years
     http://publications.gc.ca/site/eng/9.847134/publication.html
   - In 2015, there were more Canadians aged 65+ than then there were dependents age 14 or less for the first time
     https://www.cbc.ca/news/business/statistics-canada-seniors-1.3248295

2. **Loss of earned income because of retirement**
   - Will be focus of Module 2
   - Mandatory retirement at 65 eliminated in Canada (by 2012)
   - Note though that many still retire at or prior to age 65

Economic Problem of Old Age (continued)

3. **Longer retirement period** as a result of:
   – People living longer (**life expectancy trends**)
   – People retiring earlier, although trend has leveled off
   – Note also that people are entering the workforce later in life (so retirement period is relatively longer in this case - i.e. shorter period of working years)

4. **Insufficient income and assets**
   – As a group the proportion of the elderly living in poverty is lower than the population proportion, but there are big differences amongst subgroups of the elderly

Economic Problem of Old Age (continued)

5. **Poor health**
   - Those in old age see doctors more, are more likely to become disabled, have longer hospital stays, need more prescription drugs
   - We will also look at this area further

6. **Long term care**
   - This deals with receiving care in a nursing home or some other health care facility (including home care)
   - We will also focus on this area

Economic Problem of Old Age (continued)

7. **Heavy property taxes**
   - Property taxes can be significant portion of income
   - Increasing rent can also be a problem (esp. those on fixed income)

8. **Inflation**
   - Cost of food, housing, clothing and other expenses

9. **Other financial problems**
   - e.g. transportation costs

10. **Abuse of the elderly**
    - Financial exploitation and scams
      https://www.bloomberg.com/news/features/2018-05-03/america-s-elderly-are-losing-37-billion-a-year-to-fraud