



Economic Security and Insecurity

1.1 Introduction

In March 1996 the federal government announced a proposed termination of the Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) and their replacement by the new Seniors Benefit effective in the year 2001 (this proposal was abandoned in July 1998). Then, in February 1997, Finance Minister Paul Martin announced significant amendments to the Canada Pension Plan.

This book looks at these changes to the Canadian social security system. It contends that both pieces of legislation would have moved the Canadian retirement income security systems more in the direction of a privatized system, and it shows that the proposed Seniors Benefit would have paid less in total benefits and would have been of less total value to Canadian seniors than the combination of OAS and the GIS. Similarly the reformed Canada/Quebec Pension Plans (C/QPP) will pay lower benefits, make it harder for disabled workers to collect benefits, and reshape the C/QPP to look and act much more like a private-sector pension plan.

The government has made these changes under the guise of providing more security for Canada's social security systems. In the document describing the proposed Seniors Benefit, *The Seniors Benefit: Securing the Future*, the government stated that "it is proposing a new Seniors Benefit to take effect in 2001 as part of its commitment to Canadians to ensure they have a secure and sustainable pension system now and in the future" (Canada 1996b, p. 5). Similarly, in the document describing the reforms to the Canada Pension Plan, entitled *Securing the Canada Pension Plan: Agreement on Proposed Changes to the CPP*, the government introduced the reforms by claiming that "the changes will ensure that the CPP is affordable to future generations and can

be sustained in the face of an aging population, increasing longevity, and the retirement of the baby boom generation" (Canada 1997, p. 6).

It is the contention of this book, however, that these reforms had more to do with cutting back benefits and a partial privatization of Canada's retirement income security system. Under the proposed Seniors Benefit, fewer Canadians would have received benefits, especially elderly married women. The reformed C/QPP will look, act, and feel more like private pension plans, but it is shown that they will be less progressive in terms of wealth distribution and will not be any more secure for future generations than today's C/QPP.

This book argues that social security should not be viewed as a large pension plan. Rather, it is a system of macro-economic wealth distribution. Given that it is not a large pension plan, the reforms of the Canadian retirement income security system are seen as not enhancing sustainability, even as they decrease real wealth distribution. Further, the book shows (in Chapter 4) that there will be possible competition for limited wealth-transfer capabilities between retirement income security and health care, as the population ages and applies upward pressure on the cost of both systems simultaneously.

What is needed, then, is a new model that will create a sustainable base of financing for the entire Canadian social security system, including health care. The last chapter creates a model that will guarantee sustainability of a wealth-transfer scheme (which is what social security really is) including health care, education costs, unemployment transfers, and retirement income security. The adoption of such a model would lead to long-term stability of Canada's total social security system. This chapter also discusses the public policy implications of the potential adoption of such a model.

Prior to an in-depth review of the above-mentioned reforms, the book presents several introductory chapters describing, in some detail, the context in which reform is taking place.

Chapter 2 explores why these reforms are happening at this time given shifting demographics and the political priority of fiscal conservatism. It provides further context for the announced reforms by presenting data on the present income and expenditure profiles of the elderly in Canada.

Chapter 3 provides an outline of the existing Canadian retirement income security system in total: existing government-sponsored systems, employer-sponsored schemes, and tax-favored systems available for individual savings. It also traces the interconnectedness of the various schemes; that is, any change to OAS or the C/QPP will immediately have an impact on employer-sponsored pension plans and individual Registered Retirement Savings Plans. The resulting potential for behavioral response to any reforms is an important aspect of the critique of the legislation.

Chapter 4 reviews the impact that population aging is expected to have on social security, including government-sponsored retirement income security and health care. Because cost pressures on health care will occur coincidentally to the rising costs of retirement income security, the chapter explores the potential competition for scarce government resources between these two important dimensions of economic security.

Chapter 5 reviews the amendments to the government-sponsored retirement income security schemes that the government announced. This includes the proposed Seniors Benefit and amendments to the C/QPP. Some of the public policy issues related to these announced amendments, because of their importance, are explored in detail in Chapter 6. In particular, Chapter 6 analyzes the impact that freezing the C/QPP Year's Basic Exemption will have on participants in the C/QPP. This is one very important way in which the C/QPP are being reformed to become more like private pension plans. However, this reform threatens the progressivity of the present C/QPP. Chapter 6 also discusses reforms that call for larger prefunding of the C/QPP. This will be achieved by raising the C/QPP contribution rate more rapidly than would be required under a pure pay-as-you-go financing system. This, in turn, will create a fund of around \$110 billion to be invested in the private sector. Again, this will make the C/QPP more like private pension plans. But will this make the C/QPP more secure? Chapter 6 discusses these matters in

detail. Finally, this chapter also explains that social security is not, and should not be viewed as, a large pension plan, but rather as a macro-economic wealth-transfer scheme. To achieve social security stability requires a means of achieving macro-economic wealth-transfer stability.

Chapter 7 looks at ways of achieving financing stability for Canada's total social security system (including not only retirement income security but also health care, education, and employment insurance). The chapter begins by exploring some demographic variables (fertility rates, immigration rates, and mortality rates) that might have an impact on future funding requirements. It then explores in detail a wealth-transfer model that could be used to create long-term funding stability for Canada's total social security system. The chapter closes with a presentation of some of the potential public policy issues associated with the wealth-transfer model.

The goal is to achieve financing stability for Canada's social security systems. This, in turn, would provide Canadians with economic security. The remainder of this introductory chapter looks at what economic security and economic insecurity are, how they arise, and how economic security can be achieved in Canada today.

1.2 What Is Economic Security?

Rejda defines economic security as "a state of mind or sense of well-being by which an individual is relatively certain that he or she can satisfy basic needs and wants, both present and future" (1994, p. 2). The definition, which is used throughout this book, is dependent upon the individual: what provides economic security to one individual may not to another. A person who is wealthy may have different criteria for economic security than someone who is poor. Someone who grew up during the Depression may require less material wealth for a sense of well-being than someone from the post-World War II era. Hence, one's personal perception is an important part of economic security. In other words, economic security is relative. The requirements for economic security will vary from time to time, place to place, culture to culture, and person to person. According to Rejda (1999), for any individual there are two key criteria for economic security. First, one must be assured of some basic level of support to satisfy the needs and wants common to all. Second, one hopes that one's standard of living will not be changed drastically by the normal events of life.

Hence, a legitimate goal of a modern social security system is to provide a certain replacement ratio of previous income so as to create this aspect of economic security. Of course, one need not be poor to feel economically insecure.

Ways to attain economic security can change with time and the environment. In an agricultural society, one's basic needs and wants could be satisfied by being part of a family unit with young members willing to provide support in one's old age. In such a society, economic security is assured as each active generation "contracts" to support the two adjacent dependent generations. Security could be achieved within the family unit, with minimal societal involvement. This model for the provision of economic security still exists in many developing nations.

In a modern industrial or postindustrial society, the key to economic security is income maintenance. This income must be continuous. If it is temporary, or if it can be significantly reduced, economic security will not be achieved. Real income and purchasing power are what matters. Thus, one must be protected from the effects of inflation to feel economically secure. To know that one's future needs and wants will be satisfied requires a knowledge that the real value (purchasing power) of one's income will be maintained.

The 1982 *Green Paper on Pensions* defined three basic principles, consistent with the goals of achieving economic security, that became the basis for pension reform:

1. Elderly Canadians should be guaranteed a reasonable minimum income
2. The opportunities and arrangements for Canadians to provide for their retirement should be fair, and
3. Canadians should be able to avoid serious disruptions of their preretirement living standards upon retirement (Health and Welfare Canada 1982, p. 11).

As noted, in an agrarian society one's needs for economic security could be met within the family and community. While this basic assumed contract still exists, achieving full economic security is not expected to be satisfied within each family unit. Instead financial intermediaries are used to administer this implied contract, the most important being the government. Recent government amendments to the social contract are the focus of this book.

1.3 What Is Economic Insecurity?

If economic security is a sense of well-being about the relative certainty of one's ability to satisfy basic

needs and wants, both present and future, then economic insecurity must be a parallel sense of uncertainty. Uncertainty, in an economic sense, has been defined as an individual's subjective view of risk, where risk is defined as the economic consequence of an event that can vary from the expected. Kulp and Hall (1968, pp. 3–14) maintain that risk is objective and can be analyzed mathematically, similar to statistical variance. Uncertainty, on the other hand, is subjective, and each individual can have his or her own attitudes as to the uncertainty of an event.

For any income maintenance program, one can calculate expected benefit values given certain assumptions as to rates of earnings, investment income, inflation, labor force participation, mortality, divorce, and so on. However, any of these parameters can vary, for any individual, from what has been assumed. This variance logically results in uncertainty for the individual and is a source of economic insecurity. As discussed in later chapters, the fact that our population is aging (see Section 2.1) tends to magnify this feeling of insecurity. A recent Gallop Poll illustrates the existence of uncertainty among Canadians. The poll, conducted in October 1994, found that six out of ten Canadians do not think that government programs such as the OAS or C/QPP will be there for them when they retire (Prince 1996, p. 65).

Our politicians are telling us we face serious problems. For example, Garth Turner, previous Minister of National Revenue, states, "Given the population make up, the CPP is cooked. Any serious retirement planning should include no public pension income" (1996, p. 39). Here an ex-minister of the crown is counseling Canadians that they should not count on any future social security benefits.

Some employers are adding to this concern. For example, an employee benefits booklet entitled *Financial Planning for Retirement* (Cooperators Insurance Group, undated) provided by a large insurance company states, "Although we are dealing primarily with long range financial planning and since the government programs could change or not be there when you retire, we will outline at this time the present funds available from each plan and possible future availability." Later in the booklet, the various government-sponsored plans are described in more detail, but in each case the booklet indicates that there is no guarantee that the benefit will be available in the long run. It concludes, "it is up to you to decide whether or not you include it in your retirement income plans."

Recent amendments to Canada's social security systems have reinforced in the minds of Canadians the risk associated with government-sponsored social security benefits.

1.4 Causes of Economic Insecurity

As noted in the previous section, to be able to calculate with certainty one's future income maintenance, one would need to know the exact future values of variables such as rates of earnings, investment income, inflation, labor force participation (or unemployment), mortality, and divorce. Some of the factors that may in part create feelings of insecurity include the following:

A. Mortality

- If I die prematurely, will my dependents be economically secure?
- If I, or my spouse, live to a very old age, will our resources be exhausted?
- If my spouse dies, will I face financial difficulties?

B. Health

- If my health, or the health of my dependents, deteriorates, what are the financial consequences to me, and to my dependents?
- Do I have sufficient resources to pay for health care costs not otherwise covered?
- What happens if the government continues to cut back on health care benefits?
- Will I stay healthy enough to enjoy my retirement, or should I take early retirement?

C. Job security

- What effect would a job change have on my income maintenance programs (such as my pension plan)?
- Could I withstand the financial consequences of an extended period of unemployment?
- What happens if the government continues to cut back on unemployment benefits?
- What are the financial consequences of early retirement, either voluntary or forced?
- Can I withstand the job technology revolution?

D. Inflation

- What effect will inflation have on the real value (purchasing power) of my income maintenance programs? Which sources are indexed to inflation—fully, partially, automatically, ad hoc?
- Do I have the financial resources to withstand a prolonged period of high inflation?
- What effect will inflation have on the real value of my assets?

E. Retirement

- Will I have enough income from my various sources to retire in an economically secure manner?
- Will I receive the government-sponsored benefits now being promised?
- Will I be able to work after retirement should I so wish?
- What form of payout can I choose for my retirement income?
- What form of payout will optimize economic security for both me and my dependents?
- Will I be forced to retire early?

F. Divorce

- What are the financial implications of divorce?
- Do I have the financial resources to ensure economic security if I divorce?

G. Dependents

- Have I enough wealth to support my dependents in the case of my untimely death?
- Can I afford to pay for my children's education?
- What happens if the government continues to cut back on their support of education?

This is a subjective list of questions relating to economic security. Different individuals would compile different lists and would place different emphasis on the importance of various questions.

A recent poll by Towers/Perrin (1992, p. 6) found that less than one-third of pension plan members (30%) and less than one-quarter of nonmembers (23%) think that they are doing enough retirement planning. Most say they are not doing enough.

As Schulz states,

The problems involved in preretirement planning are very complex. Most people seem to have a natural inclination to live for today and avoid thinking about old age and death. Hence, they give very little systematic thought to the financial issues of old age until they come face to face with them—when it usually too late. The flood of criticism about the adequacy, financial viability, and equity of social security and private pensions (regardless of their merits) creates confusion and distrust among workers—further discouraging early thinking about retirement preparation. (1995, p. 114)

1.5 Summary

This chapter has defined economic security and looked at sources of economic insecurity. It presents the philosophical theme for the remainder of the book, namely, what is economic security and how can it be achieved? Conversely, what is economic insecurity, and why might it exist?

Canada has developed a tripartite system of retirement income security in that workers derive retirement income from the government, from employers, and from individual savings. These systems are reviewed briefly in Chapter 3.

Recent reforms to these systems will change the mix of responsibility. In particular, this book shows that the support provided by the government will decrease. This

means that more has to be done by the employer or the individual, or else economic security for the worker will decrease.

The focus of this book is to review and critique the recent government reforms and to present alternatives to these proposals that, I argue, would provide Canadians with a higher level of economic security.