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Something's got to give

by Peter C. Hirst

Canada's social programs are coming under increasing pressure.

Our social security system, i.e., old age benefits, comprises three main elements:

1) The Canada and Quebec Pension Plans (C/QPP) is an employment earnings-related plan to which both employees and employers contribute. It is "funded" on a modified pay-as-you-go basis.
2) Old Age Security (OAS) is a flat benefit program available to all Canadians on attaining age 65, subject to certain residency requirements. Benefits are simply paid out of general tax revenues.
3) Guaranteed Income Supplements (GIS) is a system of income-tested payments to people age 65 or over. This was originally intended to be a short-term measure that would virtually disappear as the C/QPP grew and matured. This has not happened, and GIS has become a sizable program, also paid out of general tax revenues.

Supplementing these programs are, of course, private pensions comprising primarily registered (i.e., qualified) pension plans and Registered Retirement Savings Plans (RRSPs). (U.S. IRAs were modelled on Canadian RRSPs.)

Our health care system also may be described as a two-tier system, the largest tier being the universal hospital and medical program. Supplementary programs insuring items not covered by the universal program, such as drugs, are provided through private contracts, usually employer-sponsored.

The costs of national health care and social security have been increasing steadily over the last few years. For example, national health expenditures increased from 7.5% of GNP in 1980 to about 10% in 1991. This is still well below the comparable figure of 14% in the United States, but the worst is yet to come.

Consider the following facts:

Fact No. 1 — Health care costs increase dramatically with age. A 1987 study by the Economic Council of Canada found that 77% of total medical costs occur in the last six months of the life of an average Canadian.

Fact No. 2 — Canada has a rapidly aging population. The population aged over 65 as a percentage of those age 20-64 is expected to increase from about 20% currently to about 33.3% by 2025. Furthermore, in the 25 years between 1961 and 1986, life expectancy at age 65 increased from 13.5 to 14.9 for males and 16.1 to 19.1 for females.

Fact No. 3 — According to the Organization for Economic Cooperation and Development, Canada is near the top of the "Debtors' League," well ahead of the United States. Canada's debt is currently equal to about 100% of its GDP, and its current year federal deficit is running about 5% of GDP. Corresponding U.S. percentages are reported to be about 65% and 3%. GDP in Canada is approximately $750 billion (Canadian).

The new Liberal government in Ottawa has already set out to get the deficit down and the debt under control. The finance minister has declared that no program is immune from cuts, and tax increases are possible, although the room to increase taxes is very limited. (Canada's tax rates are significantly higher than U.S. rates.)

The situation can only become exacerbated in the future as the population ages and the costs of social security and health care start to go through the roof. The spectre of future conflicts between generations has been described as a "ticking societal time bomb."

Eventually, something's got to give. In speculating what will happen, remember that, while Canadians in general don't have too much faith in the long-term viability of Social Security, their culture and values are somewhat different from those in the United States, and they tend to accommodate social programs more readily. However, "universality" is not as sacred a cow as it used to be in Canada. Talk is now of more efficient targeting of the welfare dollar.

Nevertheless, Canadians like their national health system. A 1990 Harvard/Harris poll showed people's satisfaction levels in well-developed nations compared to the amounts spent on their systems. There tended to be a correlation between satisfaction levels and costs. The United States stood out as the real exception, with the highest cost by far yet the lowest satisfaction level. Canada's system had relatively high cost but the highest satisfaction level.

Canada will have national health care in the future, but with fewer hospitals and greater efficiencies imposed on health care institutions. They will have to be more accountable to the public, e.g., hospitals coming under community councils made up of representatives from the public, government, and medical professions.

Other changes will include greater use of out-patient facilities; shorter stays in hospitals; increased emphasis on prevention versus treatment; and user fees, not simply as a revenue raiser but to discourage overuse of the system. More emphasis will be placed on maintaining quality of life and providing dignity in death, versus prolonging life at all costs. Nurses will do more of what doctors currently do.

Some costs will be shifted to the private sector, representing a shift from "universal access" to "ability/willingness to pay."

A shift away from fee-for-service will provide greater control on physician

(continued on page 19)

Something's got to give (continued from page 9)

expenditures/incomes. However, regardless of all of the above, we can expect higher costs.

Turning to Social Security, we can speculate that OAS will be rolled into GIS, i.e., a fully income-tested system. It is already on the way there, thanks to the "clawback," which imposes a special 15% tax on any OAS recipient whose income exceeds a certain threshold level.

As proposed in a Canadian Institute of Actuaries' Task Force Report that has received considerable publicity in Canada, the normal retirement age of 65 for C/QPP, OAS, and GIS benefits will be steadily increased to age 70. The CPP chief actuary has estimated that, if this were done over 20 years, the combined costs of CPP, OAS and GIS would be about 25% less.

Regardless, costs of these programs will increase along with health care cost. How will we pay for this? As our aging population retires, their private pensions and withdrawals from RRSPs will be added to the tax base. However, unless significant measures are taken to get things under control, that is not likely to be enough. We could see Canada eventually follow New Zealand in moving from an EET private pension system to a TTE system. (EET = Tax deductible going in, tax exempt while there, taxed when withdrawn; TTE = not tax deductible going in, taxable while there, tax exempt when withdrawn.)

Ironically, one way to help avoid this could be to take a very small step toward it. There is about $600 billion in tax-sheltered pension plans and RRSPs, and this figure is growing rapidly. The government could "go after" these funds (and Deferred Profit Sharing Plans) to help reduce the deficit. The substantial tax incentives currently provided to these plans and their role in capital markets would not need to be diminished significantly.

Ultimately, our whole system of social programs depends on a strong economy. From my perspective preparing this article in January 1995, if deficit reduction leads to a stronger economy, from which RRSPs will benefit, it is hard to see how the minister can logically exclude them from his deficit reduction plans. After all, something's got to give.

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Research grants competiton

The SOA Committee on Knowledge Extension Research (CKER) announces its first grants competition to fund new research in actuarial science. The key selection criterion is that proposed research subjects have the potential of contributing significantly to the advancement of knowledge of actuarial science. Sponsored research projects are expected to result in papers published in appropriate journals. CKER expects to award several grants each year.

For information and application forms, call the SOA's Research Department, 708/706-3574. Applications are due in the SOA office before April 15, 1995.

Corrections to *Directory*

Please mark this correction in your 1995 *Directory of Actuarial Memberships*: the fax number for the American Academy of Actuaries is 202/872-1948. A sticker imprinted with the correct Academy fax number will be mailed with the April issue of *The Actuary*.

Please note these other corrections:

- The area code for individuals at Coopers & Lybrand LLP in Philadelphia listed in Section A (Membership Directory) should be "215," not "610."
- In Section C (E-Mail Listings), the e-mail address for Patricia Scahill should be 73462, 77@compuserve.com

IN MEMORIAM

Milton F. Chauner
FSA 1953, MAAA 1965, FCA 1980

Frank D. Cubello,
FSA 1949, MAAA 1965

A. Allan Gruson
ASA 1948, MAAA 1971

William R. Williamson
ASA 1950, MAAA 1966