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Commentary

THE BUFFIN FOUNDATION SOCIAL AND ECONOMIC DEVELOPMENT ISSUES

Social Protection and Personal Thrift

The French Institute of Actuaries will host an international actuarial colloquium in Paris in May with the theme *Individual Choices facing Societal Changes*. The organizers of this international colloquium have posed a question that represents a direct challenge to the global actuarial profession: *"Can actuarial science bridge the gap between individual and collective choices?"* At the heart of this issue is a concern to address the needs of the general population for social protection, such as old-age income support and healthcare provision, while considering the appropriate role for individual choice regarding thrift and self-sufficiency. It is generally acknowledged that thrift is applauded as an economic virtue and is associated with independence and self-esteem. The challenge also extends to other areas of public concern, including climate change, legislation that disproportionally benefits the wealthy, and economic policies that result in certain groups within a population being "left behind". Environment, Social and Governance issues provide opportunities for the global actuarial profession to influence the decision-making process through risk analysis and quantitative assessment.

The Washington Post published an article by Professor Lawrence H. Summers on this theme recently with the title: *Do Americans really need to be more thrifty?* Larry Summers is a highly-regarded economist who served as the United States Secretary of the Treasury from 1999 to 2001 and is a past president of Harvard University. In 2018 he launched a *Task Force on Fiscal Policy for Health* with former New York City Mayor Michael Bloomberg. This initiative was lauded by the UN Secretary-General who noted that it "will bring more than health; it will bring equity, and contribute to a life of dignity for all".

In his *Washington Post* article, Summers identifies two major financial challenges for families today as the need for adequate retirement income and the effects of economic dislocation, including unemployment. To address these economic issues, he believes that the federal government should expand social insurance coverage and benefits, resulting in reduced inequality, a more secure middle class, and a stronger economy. Expansion of social insurance programs would entail broadening the scope of coverage to more individuals as well as increasing the type and level of benefits provided. According to Summers, a well-functioning society should include Social Security to meet retirement needs, unemployment and wage replacement programs to cushion economic shocks, and adequate public funding to provide healthcare coverage. These social insurance programs would greatly reduce the need for households to save through individual thrift for these contingencies. It is inefficient to rely on individual saving rather than universal public programs to deal with these contingencies. Social Security in the United States, for example, pays out about 99 percent of the revenue it collects in the form of benefits. By contrast, individuals saving for retirement, may, over a lifetime, dissipate as much as 20 percent of their savings in commission and other expense payments to financial institutions. Similar efficiencies are associated with government provision for other social insurance programs. Summers makes a key point in explaining that self-reliance is an implausible way to deal with catastrophes such as disability or the loss of a good-paying job without the availability of an alternative; preparing for such contingencies by building up financial reserves involves a substantial cost in terms of current consumption. Meanwhile, the feared adverse contingencies may never materialize for most people; accordingly pooling risk through social insurance programs is the best strategy.

Summers believes that now is a propitious time to expand government-provided social insurance in the current macroeconomic environment where, after adjusting for inflation, the interest rate on the safest debt securities is essentially zero. According to Summers reasoning, if the government expands Social Security by raising taxes on payrolls by, say, two percentage points and pays the proceeds to the retired generation, and then continues this policy indefinitely, the generation currently retired would earn a return on the taxes it pays equal to the economy's growth rate, which is well above the prevailing rates of interest. The combination of the economies available from having the government provide social insurance services, plus the return premium made available by such pay-as-you-go finance, makes public programs the right way to strengthen the middle class. This becomes even truer once it is recognized that, as long as initiatives are financed at least in substantial part from highly progressive taxes, the result will be to reduce inequality. And finally, there is the observation that more social insurance, even if fully paid for by contributions, will raise demand in the national economy by reducing households' need to save. Summers concludes that increasing normal interest rates will push the economy forward and contribute to financial stability. His clear verdict regarding the debate over social insurance and individual thrift is that we need more social insurance for the middle class.

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