Social Insurance and Economic Security

Seventh Edition

George E. Rejda

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Preface

This text deals with the nature and causes of economic insecurity in the United States. Primary emphasis is on social insurance programs aimed at reducing economic insecurity. Since the last edition of this text appeared, several unprecedented events have occurred that clearly show the destructive presence of economic insecurity in the economy. In the severe 2007–2009 downswing, the economy experienced a massive financial meltdown and a brutal stock market crash that substantially reduced the life savings of most workers; fear and panic were widespread; the economy and monetary system came terrifyingly close to a catastrophic collapse; more than 15 million workers lost their jobs; and numerous commercial banks and financial institutions failed, producing a credit crunch and a freezing of credit markets. The housing market collapsed, foreclosures increased, and millions of homeowners lost their homes or owed more than the value of their homes. The Federal Reserve intervened and implemented several unusual policies to rescue the nation from the second-worst economic downswing in its history, next only to the Great Depression of the 1930s. In addition, Congress enacted a controversial and costly federal program to stimulate the economy. Congress also engaged in a bitter and contentious debate over health care in the United States. The heated and partisan debate resulted in enactment of the historical Affordable Care Act in 2010 to reform health care and a broken health-care delivery system.

Flash forward to the present. The economy is slowly recovering, and the stock market has recovered a significant part of its losses. The unemployment rate, however, remains stubbornly high, and millions of unemployed workers have exhausted their unemployment benefits. Congress is engaged in a bitter and divisive debate on how to reduce the federal deficit and create new jobs, and the Affordable Care Act is under heavy attack by opponents who want the new law repealed. To say that we live in a fragile economy with widespread economic insecurity is an enormous understatement.

The seventh edition of *Social Insurance and Economic Security* discusses the above problems and other causes of economic insecurity as well. Like earlier editions, the seventh edition of this text is designed for a one-semester course in social insurance and income maintenance programs at either the undergraduate or graduate level.

The text can also be profitably used in labor economics courses and in courses that emphasize public assistance and welfare programs. The central thrust of the seventh edition is an up-to-date analysis of Social Security and Medicare, workers' compensation, unemployment compensation, public assistance, and the new Affordable Care Act that deals with health-care reform. The basic principles, characteristics, and public-policy issues associated with major social insurance programs and public assistance programs are discussed in considerable depth. Each major cause of economic insecurity is examined, and the appropriate social insurance program for dealing with the problem is analyzed in some detail. The new Affordable Care Act is emphasized heavily in four chapters.

KEY CONTENT CHANGES IN THE SEVENTH EDITION

The seventh edition required a considerable amount of rewriting, especially in the areas of Social Security, unemployment insurance, and health care. Key content changes include the following:

- *Completely Updated.* The seventh edition is thoroughly updated to reflect recent changes in Social Security, workers' compensation, and unemployment insurance. The new Affordable Care Act dealing with health-care reform is discussed in depth. The number of chapters has been reduced from 18 to 17.
- *Social Security Reform.* Chapter 6 discusses the various proposals for reforming Social Security. These proposals include raising the full retirement age, changing the benefit formula, reducing the cost-of-living adjustment, increasing benefits for certain vulnerable groups, and other proposals as well.
- *Economic Insecurity from Poor Health.* Chapter 8 includes an expanded discussion of the economic problem of poor health; major reasons for the historical increase in health-care expenditures; problems of the uninsured; fraud and waste; and abusive insurer practices, which led to enactment of the Affordable Care Act.
- *Affordable Care Act.* When fully implemented, the Affordable Care Act will have a profound impact on the present health-care delivery system. Chapters 8, 9, 10, and 16 discuss the basic provisions of the Affordable Care Act and its impact on individual and group health insurance coverage, as well as the Medicare and Medicaid programs.
- *Getting Your Money's Worth.* The section addressing the complex issue of whether workers receive their money's worth under the Old-Age, Survivors, and Disability Insurance (OASDI) program has been updated and expanded based on a model developed by Social Security actuaries. This model reflects the value of major Social Security benefits to individuals and families, which include retirement, survivor, and disability benefits. Earlier models tended to focus primarily on retirement benefits.
- *Financial Problems of Social Security and Medicare.* Chapter 7 discusses in considerable detail the short-range and long-range financial problems of Social

Security and Medicare. The various proposals for reducing the long-range deficit are discussed in some depth.

- *Updated Discussion of Unemployment Compensation.* Chapters 13–15 have been updated to reflect the problem of unemployment during the recent 2007–2009 recession and the present defects of unemployment compensation in reducing economic insecurity. The chapters also discuss the various proposals for improving the system.

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A successful textbook is seldom written alone. I owe a heavy intellectual debt to the following individuals and organizations, who reviewed all or selected parts of the manuscript, offered comments, answered questions, or provided technical support:

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The views expressed in the text are solely those of the author and do not necessarily reflect the viewpoints or position of the reviewers whose assistance I am gratefully acknowledging.

Finally, the fundamental objective underlying the seventh edition remains the same as in earlier editions—I have attempted to write a textbook from which students can learn and professors can teach.

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1 Economic Security and Insecurity

Student Learning Objectives

After studying this chapter, you should be able to:

- Explain the meaning of economic security.
- Explain the meaning of economic insecurity.
- Identify the major causes of economic insecurity.
- Describe the basic characteristics of social insurance programs.
- Identify major private and public programs that reduce economic insecurity.

People have always sought protection against those forces that threaten their security. Because life is full of uncertainty and pervaded by complex threatening forces, the concept of security can be analyzed from several disciplines, including economics, political science, sociology, philosophy, and national defense. A complete analysis of security, however, is a burdensome, if not impossible, task. Thus, the concept of security must be narrowed. In this text, economic security will be emphasized, with primary emphasis on social insurance programs as a major technique for combating insecurity.

In this chapter, we examine the nature and causes of economic insecurity, the meaning of social security, and the generic characteristics of social insurance. We conclude the chapter with a discussion of the major techniques for reducing economic insecurity.

Nature of Economic Security

Total welfare for an individual or family is the sum of a large number of different parts. Although total welfare cannot be broken up in the sense that one can attribute parts of the whole to the various elements from which that welfare is obtained, it is clear that a large part of our total welfare is derived from things obtainable with money.[1] *Economic security, which is part of our total welfare, can be defined 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.* The phrase "basic needs and wants" refers to a person's desire for food, clothing, housing, medical care, and other necessities. When a person is relatively certain that both present and future needs and wants can be reasonably satisfied, then he or she may experience a sense of well-being. This sense of well-being, which results from the satisfaction of human needs and wants, depends on the use of economic goods and services. An individual must have access to sufficient goods and services to attain economic security. It is obvious, therefore, that in a highly industrialized economy, economic security is closely related to the maintenance of income. The more income a person has—whether from money wages, savings, public or private transfer payments, or the ownership of property—the greater the level of economic security that is possible.

In analyzing the preceding concept of economic security, four points must be kept in mind. First, as stated earlier, money income is a key factor in attaining economic security. The income, however, must be *continuous*. A person must have some reasonable expectation that his or her income will continue so that both present and future needs and wants will be reasonably satisfied. If money income is lost or significantly reduced, economic security is threatened.

Second, although money income is a critical factor in attaining economic security, *real income* must also be considered. Real income refers to the amount of goods and services that can be purchased with money income. If real income increases, an improvement in economic security is possible. For example, if money income increases 10 percent over time, and consumer prices increase only 5 percent, real income is increased, and greater economic security is possible. However, in recent years, the wages of millions of American workers did not keep pace with inflation. As a result, these workers experienced an erosion of economic security.

Third, for most people, economic security requires the receipt of money income that is above the poverty or subsistence level of living. *Poverty can be defined as an insufficiency of material goods and services by which the basic needs of individuals or families exceed their means to satisfy them.* Poverty can be crudely measured by various poverty thresholds established by the U.S. Census Bureau. The poverty thresholds do not vary geographically, but they are updated for inflation based on the Consumer Price Index (CPI-I). The official poverty definition is based on money income before taxes and does not include capital gains or noncash benefits such as food stamps and public housing. In 2010, the U.S. Census Bureau estimated that 46.2 million persons were living in poverty, or a poverty rate of 15.1 percent.[2] Thus, millions of Americans currently are not economically secure because their incomes are below poverty levels.

Finally, economic security is *relative to the standard of living enjoyed by others*. As the standard of living enjoyed by others changes over time, the concept of economic security will also change. The nation's rate of economic growth, social mores, educational level, cultural background, and stage of economic development has an important impact on the concept of economic security. As these factors change over time, the expectations of consumers and families will also change, which results in a changing concept of economic security.

NATURE OF ECONOMIC INSECURITY

Economic insecurity is the opposite of economic security; that is, the sense of well-being or state of mind that results from being relatively able to satisfy both present and future needs and wants is lacking. Instead, there is considerable worry, fear, anxiety, frustration, and psychological discomfort. The need for money to pay current bills is a constant problem.

Individuals can experience economic insecurity if their incomes are lost or substantially reduced, if they must assume or pay excessive or additional expenses, or if they earn an insufficient income relative to expenses. Economic insecurity may also be present if there is uncertainty concerning the continuation of future income. Thus, economic insecurity consists of one or more of the following:

- Loss of income
- Additional expenses
- Insufficient income
- Uncertainty of income

LOSS OF INCOME

A worker may lose his or her money income or may experience erosion in real income over time because money wages fail to keep up with inflation. Regardless of whether the income loss is absolute or relative, economic insecurity is present when the worker's income is lost. In such a case, unless the worker has sufficient financial assets, past savings, or other sources of replacement income, basic needs and wants cannot be satisfied. Moreover, the continuous consumption of goods and services above the poverty line may be difficult because of the income loss.

ADDITIONAL EXPENSES

Economic insecurity can also result from additional expenses that exceed the worker's ability to pay, such as catastrophic medical bills. For example, assume that a male worker with no health insurance and limited savings has prostate cancer and incurs medical bills of $200,000. In addition to the loss of earned income, he may find that payment of medical bills is financially burdensome. Likewise, assume that an uninsured motorist fails to stop at a stop sign and seriously injures a pedestrian, and that a court of law awards damages of $300,000 to the injured pedestrian. If the uninsured motorist is unable to satisfy the judgment, a lien may be placed on his or her income and financial assets. In addition, legal defense costs may be enormous if an attorney is retained. Unless the negligent motorist has sufficient auto liability insurance, adequate savings, or other sources of income from which to draw, economic insecurity is present because of the additional expenses.

INSUFFICIENT INCOME

Economic insecurity is also present if a person is employed but earns an insufficient income; that is, total income during the year is less than the amount needed to satisfy basic necessities. For example, in 2010, assume that a single mother with two children worked 40 hours weekly throughout the entire year at an hourly wage of $8. Her annual income is $16,640, which is below the federal poverty level of 18,310.[3] The family is exposed to economic insecurity because of insufficient income.

As stated earlier, millions of Americans experience economic insecurity because of poverty. The viewpoint that some people are poor because they refuse to work or cannot find employment, or because they have some mental or physical defect that makes employment difficult, is not entirely correct. Many poor workers are steadily employed and work regularly throughout the entire year, but their incomes are insufficient to satisfy their basic needs and wants.

UNCERTAINTY OF INCOME

Economic insecurity may also be present if employed workers are uncertain of the future continuation of their income. In the highly industrialized American economy, a chronic fear of unemployment may create considerable fear and anxiety for workers because it threatens the feeling of economic security and well-being. For example, during a severe business recession, a global corporation may issue a press release stating that 10,000 employees will be laid off. In such a case, employees of the corporation may experience considerable fear, anxiety, and psychological discomfort because of the uncertainty of losing their jobs and earned income. If workers believe that their jobs will be lost, or that hours of work will be significantly reduced, economic insecurity is present because of the uncertainty of future income.

CAUSES OF ECONOMIC INSECURITY

The major causes of economic insecurity today in the United States include the following:

- Premature death of the family head
- Old age
- Poor health
- Unemployment
- Substandard wage
- Inflation
- Natural disasters
- Children born outside of marriage
- Personal factors

PREMATURE DEATH OF THE FAMILY HEAD

Premature death can be defined as death of a family head with unfulfilled financial obligations. These obligations include dependents to support, children to educate, a mortgage to be paid off, credit card debts, and installment loans.

Premature death of the family head can cause economic insecurity because of the loss of earned income. If the surviving family members receive an insufficient amount of replacement income from other sources to meet their basic needs, or have limited savings and financial assets to replace the lost income, they will experience economic insecurity. The family may also incur substantial additional expenses because of funeral costs, uninsured medical bills, estate and death taxes, and probate costs.

Additional funds may be needed to pay off credit card and installment debts, the remaining balance on the mortgage, and funding for the children's college education. Finally, certain noneconomic costs are also incurred, including emotional grief and pain of the surviving dependents, loss of a role model, and the loss of counseling and guidance for the children.

Premature death, however, can cause economic insecurity only if the deceased individual has dependents to support or dies with unsatisfied financial obligations. Thus, the death of a child, age 7, is not regarded as being premature in the economic sense.

OLD AGE

Old age is another important cause of economic insecurity in the United States. In 2010, 40.3 million persons in the United States, or 13 percent of the resident population, were age 65 or older.[4] Although the financial position of the elderly has improved over time, many older persons are economically insecure.

Old age can cause economic insecurity because of the loss of earned income. When older workers retire, they lose their earned income. Unless they have accumulated sufficient financial assets on which to draw, or have access to adequate replacement income from other sources, such as Social Security, 401(k) plans, or individual retirement accounts (IRAs), they will be exposed to economic insecurity.

Many retired workers also experience economic insecurity because of insufficient income. Most retirees are not poor. *However, in 2010, 9 percent of people age 65 or over were living in poverty.*[5] For these persons, considerable economic insecurity was present because of insufficient income.

In addition, many retired people experience economic insecurity because of poor health and sizable medical bills. Although Medicare covers chronic illness and disease of people 65 and over, it provides only limited coverage for skilled nursing care, and custodial care is excluded altogether. Many elderly require long-term custodial care in nursing homes, and the financial burden is staggering. In many communities, annual long-term costs can easily exceed $100,000, $150,000, or some higher amount. Because of limited incomes, the majority of retired workers do not have long-term care insurance because of cost. Depending on location and age, long-term care premiums for people age 65 or older can be $3,000, $4,000, or some higher amount each year. Many retired people cannot afford these high premiums. As a result, many elderly who need nursing-home care apply for coverage under the Medicaid program, which should not be confused with Medicare. Medicaid is a state and federal welfare program with a stringent means test for eligibility. Medicaid is discussed in greater detail in Chapter 16.

In addition, some retired persons experience economic insecurity because of early retirement and inadequate income, erosion of real income because of inflation, high property taxes, exploitation, and physical abuse. These problems are discussed in greater detail in Chapter 4 when the economic problem of old age is analyzed.

POOR HEALTH

Poor health is a major cause of economic insecurity. The problem of poor health includes payment of catastrophic medical bills and the loss of earned income. Medical care is expensive. Major surgery or a serious illness or injury can easily cost $50,000, $100,000, or some higher amount. Although most Americans have some type of health insurance coverage, a large number of people are uninsured for some time during the year. *According to the 2011 Current Population Survey, 49.9 million people, or 16.3 percent of the population, had no health insurance coverage in 2010.*[6] As a result, this group was exposed to serious economic insecurity. The issue of medical care for the uninsured is a serious national problem that is discussed in greater detail in Chapter 8.

In addition, many sick or disabled people experience economic insecurity even if they have health insurance. Because of catastrophic medical bills, lifetime limits on benefits in earlier policies, various policy exclusions, denial of claims by health insurers, and abusive claims practices by insurers, many sick or disabled persons are unable to pay their medical bill and are forced to declare bankruptcy. A national study of bankruptcies by Harvard researchers concluded that medical problems contributed to 62 percent of all bankruptcies in 2007. Three-quarters of the filers had health insurance. Most filers were well educated, owned homes, and had middle-class occupations.[7]

A severe illness or injury also results in the loss of earned income. The probability of becoming disabled before retirement is much higher than is commonly believed, especially at the younger ages. According to the Social Security Administration, studies show that a 20-year-old worker has a 3 in 10 chance of becoming disabled before reaching retirement age.[8]

In cases of long-term disability, there is a substantial loss of earned income, medical expenses still continue, savings often are depleted, employee benefits may be lost or reduced, and someone must care for a permanently disabled person. Unless there is adequate replacement income from other sources during the period of disability, considerable economic insecurity is present.

Economic insecurity from poor health should be reduced in the future as the provisions of new health-care reform legislation become effective. In early 2010, Congress enacted controversial health-care reform legislation to reduce the defects in the present health-care delivery system. The *Patient Protection and Affordable Care Act*, amended as the *Health Care and Education Reconciliation Act of 2010*, extends health-care coverage to 32 million uninsured Americans, provides substantial subsidies to uninsured individuals and small business firms to make health insurance more affordable, contains provisions to lower health-care costs in the long run, and prohibits insurers from engaging in certain practices. The legislation also prohibits (1) medical underwriting based on health status, (2) exclusions for pre-existing conditions, (3) maximum limits on lifetime benefits and unreasonable annual limits on benefits, and (4) rescission of health insurance policies when insured people get sick. Although most provisions do not become effective until 2014, some provisions became effective immediately. Health-care reform legislation is discussed in greater detail in Chapter 8.

UNEMPLOYMENT

Unemployment is a leading cause of economic insecurity. In 2008 and 2009, the United States experienced the second worst business downswing in its history, next only to the Great Depression of the 1930s. During this period, the unemployment rate surged to 10.1 percent in October 2009, and 15.6 million workers were unemployed.

The severe recession was caused by numerous factors. A housing bubble broke, and foreclosures increased sharply; the subprime real estate market collapsed because many homebuyers with marginal credit records purchased homes they could not afford, or obtained adjustable-rate mortgages they did not understand; and financial institutions generally had lax lending standards and often made predatory and undocumented mortgage loans. Many homeowners relied heavily on home equity loans, used credit cards excessively, and defaulted on their mortgage payments. Banks and insurers sold complex credit default swaps and other derivatives in unregulated markets that resulted in billions of dollars of losses. Commercial banks generally were overleveraged and undercapitalized; numerous banks failed or were forced to merge with other banks; and credit became more difficult to obtain. Finally, lax regulatory oversight at both the state and federal level also contributed to the financial meltdown.

Regardless of the cause, extended unemployment can bring about economic insecurity in at least three ways. First, workers lose their earned income and employee benefits. Unemployed workers typically lose their group health insurance unless they exercise their right to remain in their employer's plan under the Consolidated Omnibus Budget Reconciliation Act (COBRA). However, unemployed workers generally must pay 102 percent of the group premium, which often makes the cost prohibitive.[9]

Second, during economic downswings, many firms reduce the number of hours of work or the number of work shifts. As a result, some workers can work only part-time with a substantial reduction in earned income. Also, millions of unemployed workers often become discouraged and drop out of the labor force because they believe jobs are not available. As such, economic insecurity is aggravated during spells of long-term unemployment.

Finally, if the duration of unemployment extends over a long period, past savings and unemployment compensation benefits may be exhausted. If older workers are nearing retirement and become unemployed for an extended period, the reduction or exhaustion of their savings may result in a lower standard of living during retirement.

SUBSTANDARD WAGE

A substandard wage can also cause economic insecurity. A substandard wage is any wage that is below some specified minimum necessary for workers to support themselves and their families. The wage rate paid is so low that family heads cannot adequately support themselves and their families if they are paid at that rate for any extended period. The federal minimum wage of $7.25 per hour is an example of a substandard wage. If a family head with several dependents is paid at that rate for any extended period, the worker and his or her family will be living in poverty.

INFLATION

As stated earlier, if consumer prices rise at a faster rate than money income, real income declines, and economic security is threatened. The United States at times has been plagued by severe inflation. A rapid increase in prices tends to hurt those workers whose wages lag behind the increase in prices. In particular, family heads who are paid only the federal minimum wage are severely hurt by rapid inflation. The cost of food, housing, gasoline, work expenses, medical care, utilities, and other necessities will often increase substantially. The working poor are then confronted with the unpleasant dilemma of spending more of their limited incomes on these necessities in order to survive. Considerable economic insecurity is the result.

NATURAL DISASTERS

Floods, hurricanes, earthquakes, tornadoes, forest and grass fires, and other natural disasters can result in billions of dollars in property damage, as well as numerous deaths. The increase in economic insecurity is substantial. For example, Hurricane Katrina, in August 2005, was the largest natural disaster in the history of the United States. Total property damage was estimated at $81 billion, and more than 1,800 people died.[10] Likewise, in January 2010, one of the deadliest and most devastating earthquakes in history struck Haiti. The Haitian government reported that an estimated 316,000 people died, 300,000 were injured, and 1,000,000 became homeless.[11]

Natural disasters cause economic insecurity because of the loss of human life and resulting loss of income to the stricken families; property damage losses are catastrophic; families are forced to relocate and often become homeless; property damage from floods and earthquakes is either uninsured or underinsured, causing substantial additional expenses; and the mental pain, worry, fear, and psychological discomfort experienced by affected individuals and families increase to frighteningly high levels.

CHILDREN BORN OUTSIDE OF MARRIAGE

Children born outside of marriage are another major cause of economic insecurity. The proportion of births to unmarried mothers has risen sharply over the past few decades. *According to the National Center for Health Statistics, unmarried women accounted for about 40 percent of the births in the United States in 2007.*[12] Between 1980 and 2007, the proportion of births to unmarried women has more than doubled. The substantial increase in unmarried births may be due, at least partly, to cohabitating couples who are not married. These relationships are less stable than marriage.

Many unmarried mothers with minor children experience economic insecurity because of several factors. If a cohabitating couple with children separates, the mother typically receives custody of the children. The big problem here is insufficient income. Many unmarried mothers have limited work skills, which keep them in relatively low-paying jobs. Also, as stated earlier, the financial burden of raising and educating the children falls heavily on unmarried mothers; these costs are substantial, and child-support payments from the fathers generally do not fully cover child-rearing costs. Moreover, many fathers default on their child-support payments, or the payments are late or sporadic. Many judges sentence fathers to jail for extended periods because they are behind in their child-support payments, which only aggravates the problem of insufficient income. Also, a state may revoke the driver's license of someone who is delinquent in child-support payments, which makes it more difficult for the person to work, again aggravating the problem of insufficient income.

In addition, unmarried teenage mothers generally lack marketable skills that would enable them to obtain high-paying jobs and often do not receive child-support payments from the fathers. Many unmarried teenage mothers apply for aid from the Temporary Assistance for Needy Families (TANF) program, a welfare program that has a stringent means test and provides only a subsistence level of income. As a result, unmarried teenage mothers often seek additional financial help from parents, relatives, and other sources.

Finally, the burden and stress of caring for a baby makes it difficult for some unmarried teenagers to complete their high school education. As a result, they drop out of school without graduating, which almost guarantees a life of poverty. *The poverty rate for female householders with children under age 18 and no husband present was 37.2 percent in 2008.*[13] Unmarried teenage mothers are an important part of this group.

PERSONAL FACTORS

In some cases, individuals are primarily responsible for their own economic insecurity. Some people are poorly motivated and have little desire to improve themselves. Others have personal problems that interfere with their relationships with other people. Still others are spendthrifts, fail to save for contingencies, and are often late paying their bills and debts or ignore them altogether. In addition, many people have addictive habits, such as alcohol, substance abuse, or gambling, that result in economic insecurity. Finally, some people are greedy, imprudent, and make unwise investments, which often result in substantial financial losses and financial insecurity.

Personal factors are especially important in certain major social problems that cause economic insecurity in individuals and families. Some timely causes of economic insecurity include divorce, alcohol and drug addiction, gambling, domestic violence, and bankruptcy.

Divorce

Divorce is widespread in the United States and is an important cause of economic insecurity for many divorced women. As stated earlier, the poverty rate for female householders with children under age 18 and no husband present was 37.2 percent in 2008. Divorced women with minor children are an important part of this group.

Economic insecurity may result from several factors. First, research studies generally show that many divorced women experience a significant decline in money income after the divorce occurs. Many divorced women are in the labor force, where women typically are paid less than men.

Second, many fathers default on their child-support payments, or the payments are habitually late; the result is insufficient income for the family. Also, some older women who get a divorce do not have access to their ex-husband's retirement plan.

Third, in the majority of cases, the mother is awarded custody of minor children. As stated earlier, the financial cost of raising minor children to adulthood is substantial, and falls heavily on the mother. Also, because of child-rearing responsibilities, many divorced mothers can work only part time, thus reducing earned income. In addition, many divorced mothers do not have health insurance and can be faced with substantial uninsured medical bills if a major sickness or injury occurs. The problem of additional expenses is relevant here.

Finally, divorce can have a severe emotional impact on children. Research studies show that children of divorced parents are often hurt and bewildered, experience considerable anger, underachieve in school, and have problems with relationships years after the divorce occurred.

Alcohol and Drug Addiction

Substance abuse is another important cause of economic insecurity. *The National Council on Alcoholism and Drug Dependence estimates that about 18 million Americans have serious alcohol problems, and another 5 to 6 million people have severe drug problems.*[14] Substance abuse can cause serious health problems and is an important causal factor in domestic violence, suicide, auto accidents, homicides, and child abuse.

In addition, drug addiction is rampant in the United States. Millions of Americans habitually use marijuana, cocaine, crack, heroin, and other drugs. In particular, methamphetamine is a powerful drug that is widely used. Supporting a serious drug habit can cost thousands of dollars weekly, and addicts pay the high price of damaged health, dysfunctional families, loss of career opportunities, and incarceration in jail and prison.

In particular, addiction to alcohol or drugs can cause severe economic insecurity because of (1) loss of earned income to the family, (2) poor health from excessive drinking or habitual drug use, (3) loss of a job or inability to work at a steady job, (4) an increase in broken or dysfunctional families, and (5) an increase in crime and overall deterioration in the quality of life in many neighborhoods.

Gambling

Gambling problems also cause economic insecurity. Most adults who gamble do not have a gambling problem. *However, the National Council on Problem Gambling estimates that 2 million (1 percent) of the adults in the United States meet the criteria for pathological gambling in a given year. Another 4 to 6 million (2 to 3 percent) are considered problem gamblers because although they do not meet the full diagnostic criteria for pathological gambling, they meet one or more of the criteria and are experiencing problems from their gambling behavior.*[15] Pathological gamblers are often deeply in debt and suffer disproportionately from insomnia, depression, and other stress-related diseases. Pathological gamblers often commit crimes of forgery, fraud, embezzlement, or theft. Because of their addiction, pathological gamblers may lose their jobs, their careers may be altered, and they may serve time in jail and prison. The loss of a job, high gambling-related debts, and illegal acts can result in great economic insecurity for pathological gamblers and their families.

Domestic Violence

Domestic violence is another important cause of economic insecurity. Domestic violence is a leading cause of injury to women. *One in three women reports being physically or sexually abused by her husband or boyfriend sometime during her life, and more than 32 million Americans are affected by domestic violence each year.*[16] Many battered women have low self-esteem and find it difficult to work. Since they lack the income to be self-supporting, they often remain in an abusive relationship and are exposed to great physical harm.

Many battered women apply for admittance to homes or shelters that provide protection and specialized services. The home or shelter, however, may have a time limit on the length of stay. Many battered women are unemployed, and finding a job that pays a living wage to live independently can be difficult if the community is experiencing high unemployment. Also, many battered women do not have furniture and other household goods to live independently in a house or apartment, so the problem of additional expenses is also present.

Personal Bankruptcy

Personal bankruptcy also causes economic insecurity. More than one million persons declare bankruptcy each year. Personal bankruptcy is due to a number of factors. First, as stated earlier, poor health is a major contributing factor: unpaid medical bills contributed to 62 percent of the personal bankruptcies in the United States in 2007.

Second, the abuse of credit is a major factor in personal bankruptcy; many consumers use multiple credit cards, spend recklessly, rack up enormous debt, and often declare bankruptcy to avoid repayment. Harassment from bill collectors adds to the problem.

Third, during the severe recession in 2008 and 2009, the housing market collapsed and foreclosures increased sharply. Many homeowners declared bankruptcy because the market value of their homes was less than the mortgage balance; other homeowners with marginal credit records declared bankruptcy because they had purchased homes they could not afford.

Finally, unforeseen events can result in personal bankruptcy. Examples include the unexpected death or disability of a family head, unanticipated loss of a job during a business downswing, failure of a small business firm to survive during a severe business recession, and substantial loss of financial assets during a severe stock market decline by workers nearing retirement, which delays retirement or results in a reduced standard of living in retirement.

CONCEPT OF SOCIAL SECURITY

Many of the preceding causes of economic insecurity are addressed by social security programs in many countries. The Social Security Administration periodically publishes a four-volume series on social security programs throughout the world.[17] In that report, the term "social security" refers to programs established by law that insure individuals against the loss or interruption of their earned income, and for certain expenditures arising from marriage, birth, or death. This concept also includes family allowances that some countries provide for the support of children.

Individuals and families that have lost income as a result of death, disability, and old age; work-related injuries; unemployment; and sickness and maternity receive cash payments that at least partially replace the income. Programs that provide this money are called income-maintenance programs. Some countries also finance or provide direct services for hospitalization, medical care, and rehabilitation. These programs are referred to as benefits in kind.

The Social Security Administration classifies the income-maintenance programs in different countries into three broad categories: (1) employment-related programs, (2) universal programs, and (3) means-tested programs.[18] Under the first two categories, cash benefits are paid as a matter of right. Under the means-tested approach, benefits are based on a comparison of the individual's income with some standard measure of need.

EMPLOYMENT-RELATED PROGRAMS

Employment-related programs are social insurance programs (discussed later) that generally base eligibility for pensions and other periodic cash payments on the length of employment and self-employment. In the case of work-related injuries and family allowances, eligibility is established based on an employment relationship. As will be pointed out later, social insurance programs pay benefits based on the worker's covered earnings and are typically financed by specific contributions from covered workers, employers, or both.

UNIVERSAL PROGRAMS

Universal programs provide flat-rate cash benefits to citizens and residents. There is no consideration of income, employment, or satisfaction of a means test. Universal programs generally are financed by general revenues, and benefits are paid to all persons that meet the residency requirement. In some countries, however, benefits are partly financed by contributions from workers and employers. Finally, most countries with universal programs provide a second tier of benefits that are based on the worker's earned income.

MEANS-TESTED PROGRAMS

In addition to social security programs, most countries have means-tested programs. These programs establish eligibility for benefits by measuring the individual's or family's financial resources against some standard measure of need, which is typically based on a subsistence level of income. Applicants must meet a *means test* (also called a needs test) and show that their income and financial resources are below the standard of need established for the program.

Although means-tested programs vary among countries, they have certain common features. Benefits are usually limited to low-income or poor recipients; benefits are normally approved only after an investigation of the applicant's financial resources and needs; the benefit amount is typically adjusted to the recipient's financial resources and needs; and the benefits are typically financed out of general revenues of government.

In the United States, public assistance programs (also called welfare programs) are means-tested programs that provide cash income and other benefits to poor people who are not covered under social insurance programs. Public assistance programs are also used to supplement social insurance benefits that are inadequate for people whose financial resources are small or nonexistent, or for people with special needs. Public assistance programs are discussed in greater detail in Chapter 16.

MEANING OF SOCIAL INSURANCE

Social insurance programs are part of the overall structure of social security. Social insurance programs have distinct characteristics that distinguish them from other government programs. The following section discusses the generic characteristics of social insurance.

GENERAL CHARACTERISTICS

Social insurance programs have certain generic characteristics. First, they are not financed primarily out of the general revenues of government, but are financed in large part by specific contributions from covered employees, employers, or both. These contributions are usually earmarked for special funds, and the benefits, in turn, are paid from these funds. Second, the right to benefits is derived from or linked to the recipient's past contributions or coverage under the program. The benefits and contributions generally vary among the beneficiaries based on their prior earnings. Third, most social insurance programs are compulsory: certain categories of workers and employers are required by law to pay contributions and participate in the program. Finally, eligibility requirements and benefits are usually prescribed by statute.

DEFINITION OF SOCIAL INSURANCE

After careful study, the Committee on Social Insurance Terminology of the American Risk and Insurance Association defined social insurance as a device for the pooling of risks by their transfer to 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. To be called social insurance, the program must meet all of the following conditions:[19]

- Coverage is compulsory by law in virtually all instances.
- Except during a transition period following its introduction, eligibility for benefits is derived, in fact or in effect, from contributions made to the program by or on behalf of the claimant, or the person as to whom the claimant is a dependent; there is no requirement that the individual demonstrate inadequate financial resources, although a dependency status may have to be established.
- The method for determining benefits is prescribed by law.
- The benefits for any individual are not usually directly related to contributions made by or on behalf of the individual, but instead redistribute income to certain groups such as those with low wages or a large number of dependents.
- There is a definite plan for financing the benefits that is designed to be adequate in terms of long-range considerations.
- The cost is borne primarily by contributions, which are usually made by covered persons, their employers, or both.
- The plan is administered or at least supervised by government.
- The plan is not established by the government solely for its present or former employees; social insurance programs must cover some persons other than government employees.

This definition clearly shows that social insurance programs have unique characteristics that are usually not found in private insurance. Failure to recognize these differences has led to considerable confusion regarding the desirability of economic security programs. The unique characteristics of social insurance are analyzed in greater detail in Chapter 2.

The following programs are considered social insurance because they meet the preceding definition:

- Old-Age, Survivors, and Disability Insurance (also called Social Security or OASDI)
- Medicare
- Unemployment Compensation

- Workers' Compensation
- Compulsory Temporary Disability Insurance
- Railroad Retirement System
- Railroad Unemployment and Temporary Disability Insurance

The following programs are not considered social insurance because they do not meet the above definition:

- *Federal Employees Retirement System.* This program is not social insurance because it was established solely for government employees.
- *Civil Service Retirement System.* The plan was established by the government solely for its employees.
- *National Flood Insurance Program.* The plan is not compulsory.
- *Federal Crop Insurance.* The various plans are not compulsory.
- *Public Assistance.* This is welfare, not social insurance. A stringent means test must be satisfied; benefits paid are based on need; and the cost is not borne directly by employees and their employers.
- *Veterans' Benefits.* The various benefits generally are financed out of general revenues; the government established the plans primarily for military personnel and ex-service members; and some benefits require that the applicant's income be below a specified level.

REDUCING ECONOMIC INSECURITY

Numerous public and private techniques are used in the United States to reduce economic insecurity. Some techniques aim at preventing economic insecurity by reducing or eliminating its cause. Other approaches alleviate the financial consequences after a loss occurs. Table 1.1 presents a list of selected programs and techniques that are currently used in the United States to reduce economic insecurity.

PRIVATE ECONOMIC SECURITY PROGRAMS

Individuals and families can receive protection against economic insecurity by purchasing life, health, homeowners', and auto insurance, as well as other types of individual insurance. Savings can be accumulated for contingencies; individual retirement accounts (IRAs) can provide additional income at retirement; the earnings of other family members may be available to offset the loss of earned income, such as the earnings of an employed spouse; and individuals may return to school to upgrade their work skills to obtain a higher-paying job. Finally, financial assistance is often available from churches and private charity organizations.

Individuals and families also receive protection against economic insecurity from employer-sponsored group life and health insurance plans, employer contributions to tax-advantaged retirement or 401(k) plans, and severance pay and other benefits when there is a major reduction in employment. In addition, a corporation may use certain employment-stabilization techniques, such as work-sharing arrangements. Finally,

Table 1.1

Selected Programs and Techniques to Combat Economic Insecurity in the United States

Private Programs and Techniques

I. Individual	II. Employer
A. Private Insurance 1. Life insurance and annuities 2. Health insurance and disability income 3. Homeowners' insurance 4. Auto insurance B. Private savings and investments C. Individual retirement accounts (IRAs) D. Earnings of other family members E. Education to upgrade and improve job skills F. Assistance from children, relatives, churches, and private charity organizations	A. Qualified retirement and profit-sharing plans B. Defined-benefit pension plans C. Section 401(k) plans D. Group life insurance E. Group health insurance (including disability income and paid sick leave) F. Severance pay and unemployment benefits G. Private employment stabilization H. Retirement plans for the self-employed

Public Programs and Techniques

A. Social insurance
1. Old-Age, Survivors, and Disability Insurance (OASDI)
2. Medicare
3. Unemployment insurance and extended unemployment benefits
4. Workers' compensation
5. Compulsory Temporary Disability Insurance
6. Railroad Retirement Act
7. Railroad Unemployment Insurance Act

B. Public assistance
1. Supplemental Security Income (SSI) for the Aged, Blind, and Disabled
2. Temporary Assistance for Needy Families (formerly AFDC)
3. Medicaid
4. General Assistance

C. Selected federal legislation to reduce economic insecurity
1. Patient Protection and Affordable Care Act
2. Health Care and Education Reconciliation Act
3. American Recovery and Reinvestment Act of 2009
4. Children's Health Insurance Program (CHIP)
5. Pension Protection Act of 2006
6. Health Insurance Accountability and Portability Act of 1996
7. National Flood Insurance Program
8. Occupational Safety and Health Act of 1970

D. Government policies
1. Monetary policy to stabilize the economy and promote full employment
2. Fiscal policy to reduce unemployment and promote economic growth
3. Job-training programs for displaced persons
4. Tax subsidies to expand employment

E. Other programs
1. Veterans' benefits
2. Civil Service Retirement System
3. Federal Employees' Retirement System
4. Services for children
5. Food stamps
6. Public housing
7. Mental health programs
8. Vocational rehabilitation
9. Crime compensation plans
10. Energy assistance programs
11. Subsidized student loans
12. Pell grants

self-employed individuals have access to several retirement plans with favorable tax treatment, including Keogh plans, individual 401(k) plans, simplified employee pensions (SEP), and a SIMPLE retirement plan.

PUBLIC ECONOMIC SECURITY PLANS

Government combats economic insecurity in the public sector in several ways. First, social insurance and public assistance programs are used to alleviate the economic insecurity from the social risks described earlier. Second, the government may enact specific legislation to reduce economic insecurity from specific risks. Examples include enactment of Medicare in 1965 to meet the economic problem of high and uninsured medical expenses for the aged, and the Patient Protection and Affordable Care Act in 2010 to deal with the large number of uninsured in the United States and serious problems with the current health-care delivery system. Finally, government policies can be adopted to stabilize the economy and expand employment, including monetary and fiscal policies to reduce employment and stimulate economic growth, and job-training programs and tax subsidies to reduce unemployment.

SUMMARY

- Economic security can be defined as a state of mind or sense of well-being in which an individual is relatively certain that he or she can satisfy basic needs and wants, both present and future.
- Economic insecurity is the opposite of economic security; the sense of well-being or state of mind that results from being relatively able to satisfy both present and future needs and wants is lacking. Instead, there is considerable worry, fear, anxiety, frustration, and psychological discomfort. The need for money is constant.
- Economic insecurity is associated with the loss of income, additional expenses, insufficient income, and uncertainty of income.
- The major causes of economic insecurity include premature death of the family head, old age, poor health, unemployment, substandard wage, inflation, natural disasters, children born outside of marriage, and personal factors.
- Personal factors that cause economic insecurity include divorce, alcohol and drug addiction, gambling problems, domestic violence, and bankruptcy.
- In the broad sense, the term "social security" refers to programs established by law that insure individuals against the loss or interruption of their earned income, and for certain expenditures arising from marriage, birth, or death; this concept also includes family allowances that some countries provide for the support of children.
- In the United States, the Old-Age, Survivors, and Disability Income program (OASDI) is also called Social Security.
- The Social Security Administration classifies the income-maintenance programs in the different countries into three broad categories: employment-related programs, universal programs, and means-tested programs.
- Means-tested programs establish eligibility for benefits by measuring the indi-

vidual's or family's financial resources against some standard measure, which typically is based on subsistence needs. Applicants for benefits must show that their income or financial assets are below the standard of need established for the programs.

- Social insurance can be defined as a device for the pooling of risks by their transfer to 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.
- Social insurance programs have certain generic characteristics to distinguish them from other government programs. Social insurance programs are not financed primarily out of the general revenues of government, but are financed in large part by specific contributions from covered employees, employers, or both; the right to benefits is derived from or is linked to the recipient's past contributions or coverage under the program; benefits and contributions generally vary among the beneficiaries based on their prior earnings; most social insurance programs are compulsory; and eligibility requirements and benefits are usually prescribed by statute.
- Private techniques that reduce economic insecurity include private insurance; savings and investments; individual retirement accounts (IRAs); earnings of other family members; education to upgrade and improve job skills; and assistance from children and other relatives, churches, and private charities.
- Public programs and techniques to reduce economic insecurity include specific federal legislation to deal with a certain problem, monetary and fiscal policies, job-training programs, and tax subsidies.

REVIEW QUESTIONS

1. Explain the meaning of economic security.
2. Briefly explain the nature of economic insecurity.
3. Identify the major causes of economic insecurity.
4. Identify the important social problems that result in economic insecurity from personal factors.
5. What is the meaning of "social security"?
6. Describe the generic characteristics of social insurance programs.
7. What is a means-tested program?
8. Identify the major programs that are considered to be social insurance.
9. Identify several private programs and techniques that can reduce economic insecurity.
10. Identify several public programs and techniques that can reduce economic security.

APPLICATION QUESTIONS

1. Chris and Karen are married and own a three-bedroom home in a large midwestern city. Their son, Ken, age 20, is attending college and lives in a fra-

ternity house. He has a part-time job to help pay for his tuition. Chris owns a local construction firm that employs five people. Karen is a statistical analyst for a large public relations firm and is often away from home several days at a time. Based on the preceding information, answer the following questions:

a. Identify the major causes of economic insecurity to which Chris is exposed.
b. Identify the major causes of economic insecurity to which Karen is exposed.
c. Identify the major causes of economic insecurity to which Ken is exposed.

2. For each of the following events, identify a private technique or public program that could reduce economic insecurity that might result from the event:
   a. A male construction worker, age 28, with three dependents, is seriously injured when a gust of wind blows him off the roof of the house he was working on.
   b. A single parent, age 28, with two minor children, is killed by a drunk driver while walking across a street to pick her children up at a local day-care center.
   c. A worker, age 45, loses his job when the manufacturing plant where he is employed is closed because the company outsourced his department to China.
   d. A female college student, age 25, incurs medical bills of $100,000 when she is treated for breast cancer.
   e. A home with a market value of $250,000 is damaged when a tornado destroys a large part of the city where the home is located.

INTERNET RESOURCES

- The **Center on Budget and Policy Priorities** provides considerable information on the effectiveness of federal legislation dealing with the fiscal stimulus program, tax policies, unemployment compensation, and other areas that impact economic security. Visit the site at www.cbpp.org
- The **Centers for Medicare & Medicaid Services (CMS)** administers the Medicare program. The site provides timely information and data on the Medicare program to consumers, health-care professionals, and the media. The site also provides actuarial cost estimates for Medicare. Visit the site at www.cms.gov
- The **Employment and Training Administration (ETA)** in the U.S. Department of Labor provides detailed information and statistics on state unemployment compensation programs. Visit the site at www.dol.gov
- The **Insurance Information Institute (III)** provides a considerable amount of information and statistical data on earthquakes, floods, brush fires, and other natural disasters. Visit the site at www.iii.org
- **Medicare.gov** is the official government site for people on Medicare. The site provides timely information on Medicare, nursing homes, participating physicians, Medicare publications, and prescription drug assistance programs. Visit the site at www.medicare.gov
- **The National Academy of Social Insurance** publishes timely and important research studies and key facts on Social Security and Medicare on its Web site. Visit the site at www.nasi.org

- The **Social Security Administration** administers the Social Security (OASDI) program in the United States. The site provides updated information on retirement, survivor, and disability benefits and recent changes in the program. Visit the site at www.socialsecurity.gov
- The **Social Security Advisory Board** advises the president and Congress on issues relating to the Social Security Program in the United States. The site provides timely and relevant information dealing with Social Security. Visit the site at www.ssab.gov

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