Social protection: From precarious to outmoded
When Western social security and healthcare programs were first established in the late 19th century, life expectancy was far lower than it is today. That meant that state pension plans had to support retirees for only a few years on average and healthcare costs were substantially lower.

Today, rising life expectancy, the increasing cost of healthcare and widening income inequality are making it increasingly difficult for governments to provide this kind of social protection.

Data from the World Bank shows that national health care costs globally have risen from 8.5% of GDP in 1995 to 9.9% of GDP in 2014. Among OECD members, that figure has increased from 9.2% in 1995 to 12.3% in 2014. Separately, OECD data shows that aggregate social welfare spending among member states has risen from 18.8% to 21.0% from 1995 to 2016.

At the same time, pension replacement rates in high-income countries, or the ratio of average pension income to average working income, have decreased for both men and women of all pay grades in the past ten years. And in the future, pension transfers as a percentage of retirement needs are forecast to decline by more than 3 percentage points between 2010 and 2030.

Rather than enforce drastic reforms, such as switching to defined contribution schemes in which pension payments are directly linked to individual contributions, most countries have chosen simpler reforms such as increasing the pensionable age or increasing tax or contribution rates. While these reforms extend the viability of pension funds in the short term, it is questionable whether they will ensure longer term sustainability.

Raising pensionable age creates its own problems. Currently, one in four people could be unable to work due to sickness, disability, or even premature death during their working life. A common response among chronically ill or disabled older workers – a sizable group, constituting half of the older segment of the workforce in the EU, for example – has been to claim for disability benefits to bridge the gap between reduced working capacity and retirement. Increasing retirement age is only going to increase the demand for disability benefits.

### Government pension transfers as a percentage of retirement needs

<table>
<thead>
<tr>
<th>Year</th>
<th>High-income countries</th>
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<tbody>
<tr>
<td>2010</td>
<td>0.79</td>
</tr>
<tr>
<td>2020</td>
<td>0.78</td>
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<tr>
<td>2035</td>
<td>0.77</td>
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Source: International Futures 7.18, Frederick S. Pardee Centre at the University of Denver
Productivity challenges

A further challenge of population aging is that countries must turn to increased productivity and increased labor participation – such as women – to assure the same levels of economic growth.

A 2015 study by the McKinsey Global Institute, Can Global Growth be Saved, suggests that while global GDP increased at a compound annual rate of 3.8% per annum between 1950 and 2014, this could slow to 2.1% per annum over the next 50 years due to slower population growth, longer life expectancy and falling productivity.

The key to offsetting this decline in productivity lies in removing disincentives to innovation, cooperation and labor-force participation.

For example, many pension scheme penalize gaps in employment history which hurt women who take time off to help raise children. Striking a balance will be increasingly important. Encouraging time off for parental care is important for the long term future of society, but too much time off decreases pension income in the retirement years.

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The gig economy

Around a quarter of the working-age population, around 162 million people, in the US and EU-15 engages in independent work. This is a larger number than reflected in government data. Many to 80 percent of those people choose to work independently, but the other 20-40 do so by necessity, usually because their jobs were eliminated. A McKinsey survey indicates that 40-to-50 percent of the working age population in the US and EU-15 would choose to be independent if they had the opportunity.

Many studies show that the gig economy will become the norm for most workers. A joint Oxford/Zurich report12 and other studies suggest that roughly half of all traditional jobs could disappear through automation13 in the next couple decades. Since robots don’t pay taxes, this will make it increasingly difficult for governments to fund pensions, healthcare and other forms of social protection. Most economists think that new types of jobs will emerge, but nobody is confident that good paying jobs will be created at the same pace as others are eliminated.

The Zurich/Oxford report shows that workers in general are not sufficiently aware of their pension and protection needs, but in the gig economy, this can be especially pronounced. Independent workers don’t typically pay into government protection schemes or public/private workplace protection schemes. Minimum wages, benefits, family leave, workers’ compensation for on-the-job injuries, income protection for disability or serious illness and retirement schemes are currently not set up to deal with independent work.
The gig economy continued

This drawback is particularly pronounced in the US where healthcare and retirement plans have traditionally been provided by employers. A more portable system of benefits would benefit ‘gig’ workers and draw more people to independent work.

There are strong economic reasons to make independent work more attractive. Independent work could encourage more workers to stay in the workforce after retirement age, thereby lessening the drop in labor participation.

Independent work is, in fact, increasingly popular with 65-to-74 year olds because of the flexible schedule it allows. For businesses, encouraging skilled employees to stay on after retirement on a part time or contract basis cushions the loss of skills that comes with large numbers of retirees leaving their workforce all at once.

Many independent workers, however, earn less, particularly when mandatory benefits are included in total compensation. This is all right if their income supplements other sources of earnings, such as pensions. For younger workers, lower income spells a smaller pension at retirement and could make it harder for governments to fund pay-as-you-go schemes.

The changing needs of businesses and individuals argues for a ‘flexi-security’ approach that provides employers with a more ‘flexible’ workforce while offering ‘whole-of-life’ security to individuals. Pension schemes may have to become more flexible, for example allowing individuals access to capital to meet other life needs such as education costs.


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Implications for risk management

The Zurich Risk Room (ZRR) is a global risk analysis tool, designed to help illustrate the impact of multivariate risks on individual countries and regions. The tool has the ability to look at risks in single dimensions as well as show the complex interactions between many different types of risk.

Find out more here »

At a country level, the ZRR identified five indicators that increased or decreased social vulnerability. On the other side, five factors increased or decreased states’ capacity to provide continued levels of social protection.

The Zurich Risk Room features a range of risk categories that fall within the scope of social vulnerability and austerity risk, as shown below:

Social vulnerability
- Employment of working-age population
- Demographic shifts
- Income inequality
- Social mobility
- Social safety net protection

Austerity risk
- State failure
- Fiscal austerity risk
- Government effectiveness
- Sovereign debt risk
- Wastefulness of government spending

Using the Zurich Risk Room to map a variety of countries across these risk categories shows which present higher and lower levels of social vulnerability and austerity risk. Here are some examples of higher- and lower-risk countries:

Lower-risk countries
- Australia
- Germany
- Hong Kong SAR
- Malaysia
- Switzerland
- U.A.E.
- United Kingdom
- United States

Higher-risk countries
- Brazil
- Italy
- Mexico
- Spain

Social protection
Social vulnerability and austerity risk

Risk measurement: Each risk indicator/position on the graph and aggregated risk measure in the tool is normalised between 0 and 1, where 1 represents high risk and 0 absolute no risk.
Implications for risk management continued

Mapping social vulnerability against austerity risks shows which countries are best positioned to provide social protection. Not surprisingly, the Gulf countries are currently among the least risky. The UAE has benefited from oil revenues and its social programs only have to cover the 1 million UAE nationals, approximately 11% of the total population. UAE benefits are very generous, going not only to workers and their spouses and children, but brothers, sisters, parents and even grandchildren in some cases. Unmarried daughters, sisters and granddaughters can also be beneficiaries with the annuity continuing for the rest of their lives.15

The income replacement ratio is 80% for the United Arab Emirates (UAE) as compared to the OECD average of 63%.16 UAE workers can retire at age 45 with a full pension after 25 years of work. Normal retirement is 60 years for men and 55 for women. Given lowering energy revenues and rapid increases in life expectancy, it remains to be seen whether this generosity will remain sustainable.17

Asian countries have historically taken a different approach, putting the emphasis on self-reliance. Benefits levels in Hong Kong and Malaysia are low. Malaysia spends about 1% of its GDP on pensions19 whereas high income countries expend 8% on average.20 The Malaysian government has called for families to help more with aged relatives. A similar philosophy exists in Hong Kong where authorities believe low taxes and high savings levels allow for less generous social welfare programs. But Asian authorities are facing growing social pressures to expand social benefits, which fits a historical pattern. Typically, as countries develop, they start increasing outlays on pensions, healthcare and education.

With over a fifth of its population 65 or older, Italy has one of the oldest populations of any high-income nation. Less than 10% of spending goes to the bottom fifth of earners, one of the smallest shares among the OECD21 states. Low growth and high debt add to the difficulty of sustaining current benefit levels.

Mexico trails other OECD members with total social spending at just 7.5% of GDP versus 21% on average for OECD countries. With a large informal sector, its coverage is much more limited. Compared to other OECD countries, Mexico has some of the lowest safety-net benefits and the highest elderly poverty rates.22

Brazil has used its social programs to cut back on inequality and lower the poverty rate. The federal government extended, for example, the pension coverage of the private sector insurance fund to informal workers in agriculture, mining and fishing even when those workers are unable to contribute.23 Among Latin American countries, Brazil has the highest proportion of people older than 65 in receipt of a pension.24 With lower growth in recent years and large government deficits, the future affordability of Brazil’s social protection system is unclear.

Highest proportion of people older than 65 in receipt of a pension

Brazil

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<th>20%</th>
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20

65+

65 or older

80%
Any changes in social protection are politically painful so political leaders need to be persuaded that putting off the inevitable won’t solve the problem. Most OECD countries have made some progress in cutting back the future cost, but Estonia, Greece, Hungary, Iceland, Mexico, Slovenia, Turkey and the US did not make any reforms between 2013 and 2015, according to the OECD.25

Reforming social protection schemes need to involve educating publics about how social protection programs are funded. Firms can play a critical role in encouraging employees to save early in their careers for retirement. Some US employers, for example, are automatically enrolling their workers in 401(K) supplemental retirement plans and deducting contributions from employees’ pay. Employees can always reverse that decision, but tend not to.

Businesses will be at the forefront of rapidly changes in the nature of work. As a result, they can help develop new types of benefits, particularly for independent workers who often lack the knowledge of financial tools that would help them save for retirement. Given many firms’ increasingly dependence on independent workers, it’s in the interest of companies to help.

Re-training people whose job have been eliminated will be critical. Many experts believe our whole notion of education – focusing on the first twenty or so years of life – is out-of-date and lifelong learning will increasingly become the norm. Governments may have the primary role in restructuring education to fit with changing nature of work, but firms can improve their capacity by retraining their employees to keep pace with technological change.

There’s no better way to protect our democracies than through more solidly grounded social protection programs.

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