Economics 681b: Social Insurance

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This is an introduction to the economic analysis of Social Insurance. It will not be possible to provide an in depth treatment of all aspects of this complex subject in a single semester. In particular, we will deal only tangentially with a very important aspect of social insurance -- health care. A full treatment of issues connected with public provision of health care requires a separate course. Students who are interested in health care are referred to XXXXXXX. This course will also not be able to provide in depth coverage of the larger literatures on optimal taxation and public income transfer programs such as welfare. In view of current public concern over the world wide demographic transition and its effect on the financial solvency and long run viability of pay as you go Social Security systems, the main focus of this course will be on old age and disability components of social insurance. We will also consider unemployment insurance and workers compensation, especially since they are important "exit routes" from the labor force in European countries. After comparing and constrasting the key features of existing social insurance institutions around the world, we will consider the history of social insurance in order to understand the main forces affecting the evolution of these institutions. An important question is the extent to which we can explain some of the idiosyncratic features we observe in different systems throughout the world as a result of nearly optimal adaptations to heterogeneity in local environments (e.g. differences in endowments, technologies, markets, and preferences) versus being a result of a series "historical accidents" in a more or less trial and error process of sequential policy "blunders" and reforms. We consider the main explanations of why government should be in the "social insurance business" in the first place including a) paternalism, b) market failure, and c) redistribution of income. The first motive for government involvement depends on the extent to which individuals are rational, far-sighted decision makers. So a significant part of the course will be devoted to theoretical and empirical analyses of individual retirement behavior -- particularly with regard to the extent to social insurance institutions affect or "distort" labor/leisure and consumption/savings decisions. Assuming individual rationality (and thus temporarily dismissing the paternalist motive for government intervention in social insurnace), we will study theories of "optimal" and "efficient" social insurance institutions using results from dynamic extensions of the literature on mechanism design. However we will find that this theory is a bit too abstract to say much about the particular details of efficient social insurance institutions. Instead, more progress is being made via a less systematic approach to policy analysis, using increasingly realistic computational models to evaluate the welfare gaings and losses from alternative schemes for financing and providing social insurance benefits such as various types of fully funded and "privatized" Social Security systems (such as the system adopted in Chile). A large share of the course will be devoted to evaluations of various trade-offs involved in setting social insurance policy, including balancing the efficiency costs of implementing social insurance systems (e.g. its potential "moral hazard" or disincentive effects in crowding out private insurance markets, reducing private saving, and reducing labor supply) against the welfare gains provided by the intragenerational and intergenerational risk sharing features of social insurance institutions.

Note about reading list: I have produced a long reading list for benefit of students who which to explore topics covered in this course in further detail. The actual readings covered in lectures will be only a small subset of what is included below. Key readings will be highlighted in advance of lecture.

I. Social Insurance in a Time of Demographic Transition: Will the Baby Boomers Usher in an "Old Age Crisis"?
II. Survey of Social Insurance Institutions Around the World


III. Historical Overview of Social Insurance and Retirement Systems


IV. Why is the Government in the Social Insurance Business?


V. Review of Moral Hazard and Adverse Selection Reasons for Failure of Competitive Insurance Markets


VI. Overview of Policy Issues in Social Insurance


VII. Neutrality Results for Social Insurance and Government Transfer Programs


VIII. Modeling Individual Retirement Behavior

VIII-A: Theoretical Literature

VIII-B: Empirical Literature


Blinder, A.S. R.H. Gordon and Donald E. Wise (1980) "Reconsidering the Work Disincentive

**IX. Effect of Health Care on Retirement/Savings Behavior**


**X. Intergenerational Transfers and Capital Accumulation**


**XI. Political Economy of Social Insurance**

Northwestern University.
Conesa, J. and D. Krueger (1998) ``Voting on Social Security Reform with Heterogeneous Agents'' manuscript, University of Minnesota.

XII. Mechanism Design and ``Optimal'' Social Insurance


XIII. Endogenous Incomplete Markets and ``Crowding Out'' of Private Insurance Markets


XIV. Social Security Reform and the Debate over Privatizing Social Security


XIV-A. Effect of Reform on Annuities and Financial Markets

XV. Overlapping Generations Models of Social Security


XVI. Disability Insurance


Mashaw, J.L. (1988) "Disability Insurance in an Age of Retrenchment: The Politics of


**XVII. Unemployment Insurance**

Hopenhayn, H. and J.P. Nicolini (1997) "Optimal Unemployment Insurance" *Journal of Political Economy*