The Social Safety Net : Some Basic Economics

Social Insurance

- Insurance:
  - What does insurance do? Provides transfers based on uncertain events
  - General Idea:
    - Consider Event A (e.g. Home Burning Down)
    - A group of (similar) people each pay into an insurance pool (premium)
    - Among that pool, when Event A occurs (House burns down), benefits are paid to that person

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    - Assume overhead costs are 10%, so each person has to pay and $11,000 premium. Why would they choose to do so?

Social Insurance

- Insurance:
  - Risk Aversion!
  - Most people are risk-averse, but insurance companies (or the government) is risk-neutral.
    - This difference in risk preferences is what makes insurance markets work
  - Lets walk through an example:

Social Insurance

- Other Insurance Issues:
  - Moral Hazard
    - Change in behavior
    - Costly prevention measures
  - Adverse Selection
    - Social vs. Private

Means-Tested Transfer Programs

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  - "leaky-bucket" or equity-efficiency trade-off
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  - Lets look at some example program designs:

Means-Tested Transfer Programs

- Major issue: if re-distribute income based on labor income, how does $\uparrow$ transfers change labor supply?
  - For high-earners: if re-distribution paid for by progressive taxation, do taxes lower labor supply?
  - For low-earners: does $\uparrow$ redistribution $\downarrow$ labor supply? By how much?
- Notes:
  - DWL of taxation rises with level of taxation
  - Fiscal externalities: Δ in taxes $\downarrow$ as taxes $\uparrow$