Overview

Course Goals and Mechanics

Introductions

What is social insurance?

What are the rationales for social insurance?

What can and should gov’t do?
Course Goals and Mechanics
Course Overview

- Two Broad Topics
  - Social Insurance
  - Redistribution

- Two Broad Questions (central to public finance)
  - Rationale(s) for government intervention
  - Optimal form for that intervention

- Course Emphasizes:
  - Normatize as well as descriptive
  - Complementarities between theory and empirics
  - Complementarities across empirical methods
Course Goals

- Key public finance concepts
- Exposure to a range of empirical techniques
  - Including: RCTs, "reduced form" quasi-experimental work; sufficient statistics; "structural estimation"; calibrated life cycle models
- (Some of the) highlights of (some of the) literature
  - (Some of) what we know
  - Chime in if you think I’ve omitted something interesting / important!
- Help you generate research ideas
  - Will specifically try to highlight what I think are open/important areas for research
Institutional background

- Will spend minimal time on key institutional details
  - Not an efficient use of limited class time
  - Have tried to focus course around economic issues rather than programs per se
    - In practice a given economic issue has often have been studied in the context of a particular program
    - Good strategy for students: can you apply these ideas / tools to a different program?
- A deep understanding of institutional details is essential for own research
  - You should also familiarize yourself with the basics on any topic we are discussing
  - Good sources (listed on syllabus)
    - For general orientation: Gruber textbook
    - For more details: Moffit 2016
Course mechanics

- Reading list
  - Read a small number of papers carefully
    - **Read the bolded papers before class** (next class: Einav and Finkelstein JEP 2011)
    - Read actively / critically.
    - Keep a list of research ideas that occur to you!
  - Additional listing hopefully a useful reference when a topic sparks your interest
- Strongly recommended
  - Attend public finance lunch (Mondays 12 – 1)
  - Attend applied micro seminar (Mondays 4 – 5:30)
  - Don’t make attendance decisions based on whether content looks interesting, just always come.
Recitation

- Will cover some essential topics that I will assume knowledge of
  - e.g. one week will cover Rothschild-Stiglitz model (emphasizing its public finance implications)
- Will also cover (as needed / useful):
  - Review (or introduction) of techniques that I assume knowledge of in class
  - Sorting out confusions I introduce in class
- Attendance strongly advised (if time conflicts with another section we can re-optimize)
Course Requirements

- Class participation is essential
  - Pre-randomized cold calling

- Written comments – one page (10-12, more on next slide)
- One problem set
- Research proposal
  - Pose a question motivated by class and a randomized evaluation that could answer it
  - Will have section(s) to discuss aspects of design of randomized evaluation
- Final exam (closed book, 3 hours)
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"Big picture” comments 1

- Parameters
  - Two comments on paper.
  - No more than 1 page (double spaced).
  - Due: by midnight before class they are due
"Big picture" comments I

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- Examples:
  - Suggestions for future research
  - Important question related to paper that paper does not address or leave unanswered
  - Alternative interpretation for paper’s findings
  - Major substantive concern with analysis (ideally with suggestions for investigating / addressing)
What is the objective?

- Ensure you read paper carefully so we can have a more informed discussion in class
- Get you to think actively, critically, and constructively about research
"Big picture" comments II

- What is the objective?
  - Ensure you read paper carefully so we can have a more informed discussion in class
  - Get you to think actively, critically, and constructively about research

- If you have specific / narrow questions / concerns about paper please write them down and bring them up in class when we discuss the paper

- First comment due 9/14: Einav, Finkelstein and Cullen 2010
Introductions
Who am I?

• Professional
  • Political science undergraduate
  • Year at CEA convinced me to go into economics
  • Intellectual transition (likely noticeably only to me) from insurance market failures to the production of health care and health

• Personal
  • Born in NYC
  • Went to all girls’ school K-12 and now sending my daughter to one (evidence of impact?)
  • Pandemic hobby: learned to play bridge
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Introductions

- Live – Name & Program & Fun fact not obvious from resume
Introductions

• Live – Name & Program & Fun fact not obvious from resume

• Index card
  • Name
  • For credit vs auditor
  • Year in econ PhD program (or otherwise status)
  • Econ PhD courses taken to date
  • (Tentative) major fields
What is social insurance?
What is insurance?

- Insurance transfers resources from states of the world with low marginal utility of consumption to those with high MU of consumption
  - Goal: equate (smooth) marginal utility of consumption across states of the world
  - States of world: e.g. sick vs. healthy; car accident vs. not
- Key point: risk averse individual prefers to pay $10 for sure than face a one in ten thousand risk of having to pay $100,000
  - By pooling idiosyncratic risk, can make everyone better off
Insurance: A Free Lunch!

\[ \pi = \text{risk premium} \]
\[ \pi \text{ satisfies } U(\bar{y} - \pi) = E[U(\bar{y})] \]
What is Social Insurance?

• Government intervention in provision of insurance
  • E.g: unemployment, disability, health, death
  • Motivation: share risk of idiosyncratic shocks to individuals
    • Consumption smoothing value to risk averse individuals (recall graph: free lunch!!)
• Is it different from means-tested redistribution (e.g. cash welfare, food stamps, subsidized housing, subsidized health insurance)?
  • Yes: Redistribution based on “permanent” differences (vs smoothing shocks)
  • Note: Redistribution can be thought of as insurance behind the Rawlsian veil of ignorance
  • Some programs explicitly involve both insurance and redistribution (e.g. Social Security / public pensions)
Social Insurance: The changing function of government

- SI share of federal expenditures has increased from ~9% (1953) to ~55% (2014)
- “Loosely speaking, the post-cold-war federal government is a big pension fund that also happens to have an army” (Peter Fisher, undersecretary of Treasury 2002)
The changing function of government

**Figure 12-1**

Government Spending by Function, 1953 and 2014 • Government today devotes a much larger portion of its budget to social insurance than it did 50 years ago.

Data from: Office of Budget and Management (2014); Bureau of Economic Analysis, nIPA Table 3.16.
## Main Social Insurance & Redistribution Programs in the US

<table>
<thead>
<tr>
<th>Program</th>
<th>People Receiving Benefits (Millions)</th>
<th>Annual Federal Spending (Billion $)</th>
<th>Year</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Medical Care</strong></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Medicare</td>
<td>57</td>
<td>583</td>
<td>2016</td>
<td>HHS 2016 budget-in-brief</td>
</tr>
<tr>
<td>Medicaid</td>
<td>72.6</td>
<td>344</td>
<td>2016</td>
<td>HHS 2016 budget-in-brief</td>
</tr>
<tr>
<td><strong>Old Age Assistance</strong></td>
<td>50</td>
<td>765.6</td>
<td>2016</td>
<td>SSA monthly statistical snapshot, June 2016</td>
</tr>
<tr>
<td><strong>Workplace Insurance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployment Compensation</td>
<td>?</td>
<td>32.3</td>
<td>2016</td>
<td>Congressional Research Service Report 33362</td>
</tr>
<tr>
<td>Workers Compensation</td>
<td>?</td>
<td>61.9</td>
<td>2015</td>
<td>Congressional Research Service Report 44580</td>
</tr>
<tr>
<td>Disability Insurance</td>
<td>10.7</td>
<td>132</td>
<td>2016</td>
<td>SSA monthly statistical snapshot, June 2016</td>
</tr>
<tr>
<td><strong>EITC</strong></td>
<td>62.9</td>
<td>54.9</td>
<td>2012</td>
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</tr>
<tr>
<td><strong>Welfare</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>SSI</td>
<td>8.3</td>
<td>56.4</td>
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<td>TANF</td>
<td>5.8</td>
<td>6.7</td>
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<tr>
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<tr>
<td>WIC</td>
<td>8.1</td>
<td>7.2</td>
<td>2012</td>
<td>Congressional Research Service Report 44327</td>
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<tr>
<td>Housing Assistance</td>
<td>10.8</td>
<td>33.4</td>
<td>2012</td>
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Main Social Insurance Programs in US

- Prior slide gives (crude) sense of relative magnitudes (in terms of $ and "beneficiaries") of different programs (c. 2016)
  - Note: actual “beneficiaries” exceed those who receive benefits ex post (insurance value ex ante; incidence of costs to uninsured)
- In terms of $ and people, Old Age Assistance and Medical Insurance dominate
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- Meta question: How to think about optimal allocation of $$ across programs (including those with potentially with different goals - eg insurance vs redistribution)?
  - Stay tuned for Hendren's "Marginal Value of Public Funds" (MVPF) and Hendren and Sprung-Keyser (2020)
What are the rationales for social insurance?
Rationales for social insurance

- Thus far: insurance can be very valuable and government is very involved
- Now: why would government be involved?

1. Private market failures
Rationales for social insurance

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  1. Private market failures
  2. Redistribution
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1. Private market failures
2. Redistribution
3. Individual failures of rationality / optimization
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1. Private market failures
2. Redistribution
3. Individual failures of rationality / optimization
4. Paternalism
Private market failures

- Imperfect Competition [go take IO]
- Asymmetric Information
- Aggregate Shocks
- Externalities
Asymmetric Information

- Selection markets: consumers vary not only in their WTP but in how costly they are to the seller
- Main applications:
  - insurance markets
  - credit / loan markets
- Other applications:
  - education
  - labor markets
Two Types of Asymmetric Information

- Adverse selection
  - Individuals have private information about their costs
  - My favorite private market failure

- Moral hazard
  - Individuals take hidden actions in response to contract

In general not something the government has a comparative advantage in addressing. Critical though for optimal policy design.
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Aggregate Shocks

- Economic downturn (UI), natural disasters, terrorist attacks

No one will have the endurance to collect on his insurance, Lloyd's of London will be loaded when they go - Tom Lehrer "We Will All Go Together When We Go"

- Private insurance markets can diversify idiosyncratic risk cross sectionally but if want to smooth intergenerationally, government may have comparative advantage.

- Or perhaps the capital markets ("act of god" bonds)

- Relatively little work here.
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- Examples: Infectious disease, thirdy party damages from driving; pollution
- Policies:
  - Mandates (e.g. vaccines; liability insurance for drivers)
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- Policies:
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- Inter-temporal externalities: Samaritan’s dilemma
Samaritan’s dilemma

- People are altruistic (Parable of the Good Samaritan)
- Lack of commitment creates a time inconsistency problem (Buchanan 1975)
- Scope of welfare-improving government intervention (Coate AER 1995)
  - rich altruists, and rich averse poor who face some probability of loss
    - public finance perspective: altruism provides an efficiency rationale for public provision of transfers to the poor (a public good; free-riding / underprovision of private charity; welfare improvement through government provision)
    - Coate insight: altruism also affects form of transfers - reason for in-kind transfers of insurance or investments (eg education or job training)
  - With unconditional cash transfers the poor may forgo insurance and rely on private (or publicly-funded) charity to bail them out
    - We can’t commit not to take care of people in certain circumstances, which will lead them to under self-insure (e.g. food pantries; rebuilding after a flood; hospital charity care)
    - Even if government can commit, the fact that private actors cannot creates role for public policy
Samaritan’s dilemma

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Traditionally, externalities have gotten relatively little attention as motivation for social insurance. But are potentially important in some contexts. Spoiler Alert: Samaritan's dilemma may be crux to health insurance policy/reform. Will return to later in course—a great area for work.
Externalities: comment

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Redistribution

- Want to redistribute based on hidden information ("ability", "well being")
  - Social Insurance as Akerlovan tag (Akerlof 1978)
  - lifetime earnings (SS); health insurance (poor are sicker).
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- Questions
  - Do we want this type of redistribution (who are the winners?)
  - Is this the most efficient way to do redistribution (vs. e.g. progressive income tax)
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- Note many models of redistribution share features w models of asymmetric information / adverse selection (e.g. Diamond-Mirlees and other screening models)
Behavioral Biases

• In purchasing insurance
  • Overconfidence / don’t understand probabilities (young think they’re invincible)
  • Overweight low probability events (buy flight insurance)
  • Inattention / inertia / confusion...
Behavioral Biases

- In purchasing insurance
  - Overconfidence / don’t understand probabilities (young think they’re invincible)
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  - Inattention / inertia / confusion...

- In consumption decisions
  - e.g. Myopia: too little savings; under-investment in preventive care
Paternalism

- Social planner wants to encourage behavior individuals would not choose
  - "We as a society don’t want access to health care to depend on income" (even if poor would prefer the cash equivalent)
Paternalism

• Social planner wants to encourage behavior individuals would not choose
  • ”We as a society don’t want access to health care to depend on income” (even if poor would prefer the cash equivalent)

• Why?
  • Non-individualistic social welfare function
    • Consumption of that particular good enters SWF not through individual utilities
  • ”Consumption Externalities” My utility depends on your consumption
What can and should gov’t do?
What can government do?

- Power to change prices
  - tax/subsidize
  - regulate pricing (levels, formulas)
What can government do?

- Power to change prices
  - tax/subsidize
  - regulate pricing (levels, formulas)
- Power to change quantities
  - Mandate individuals to purchase or firms to offer product
  - Publicly provide
  - Regulate (e.g. minimum standards)
Choice of Instrument

- SI takes many different forms:
  - Public provision of insurance (Medicare, Social Security)
  - Mandate that firms provide insurance (Worker’s Comp, health insurance)
    - UI is publicly-provided, but financing is close to firm provision

- Subsidize / Regulate private insurance markets
  - Tax subsidy to employer provided health insurance
  - Regulate pricing and contracts in health insurance exchanges
  - Provide “public option” (Traditional Medicare or Medicare Advantage) or not (Medicare Part D)

- Choice of Instrument = understudied question
- Conditional on intervening, what form should it take?
- Lamppost problem!
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  - What is the rationale:
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  - How large is welfare gain from a given (or optimal policy) intervention?
  - What are costs from policy intervention?
  - What is the optimal policy intervention? (choice of instrument)