Social Insurance (finish)

Besides overcoming adverse selection problem:

(1) Externalities.

- Reduction of communicable diseases if people have health insurance

- The norm of treatment means many people will receive services whether they are insured or not. Make everyone pay for insurance seems fair. "Finance externality" because of treatment norm.

(2) Administrative costs are lower. Government don't spend $ to sort out the types since everyone buys. (Medicare has low administrative costs.

(3) Paternalism.

(Level of retirement income) a) About other people's ability to realize the goals they want.

Society won't let consumption fall below a certain level. b) About other people's consumption in the bad state.

All $\Rightarrow$ force people to buy insurance.

Moral Hazard (cont)

Because you have insurance:

(1) May fake being in the bad state (injury).

(2) Reduce precautions/take greater risks.
$\Rightarrow$ p, 1-p from before aren't independent of whether you have insurance.
(Take the free pill, eat the bad food.)

(3) Once in the bad state, spend "excessively."
(Hard to define, have insurance so you can spend on health care or whatever without reducing "C", consumption that gives you utility. Not supposed to be an opportunity cost in terms of less "C" to pay for health expenses. Excessive relative to what?
Bought "Ford" level insurance and somehow get "Mercedes" coverage when in bad state? So "C" is better preserved?)

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Private insurers limit moral hazard through threat to terminate your policy (in addition to co-pays).

Government doesn't do this.

$\Rightarrow$ Govt, high benefit (consumption smoothing) high cost.

Private, low benefit and low cost.

Social Security

- Institutional information about how it works.
- Consumption smoothing, crowding out, moral hazard.
- Financial difficulties of the program and possible reforms.

Gruber is talking about

OASDI:

"Old age, survivors, disability insurance"

Other components to "Social Security":

HI (Medicare, A): Hospitalization insurance for elderly.

SMI (Medicare, B): Supplemental medical insurance for elderly.

Medicare Plus (Part C): Private provider options, 1997

Medicare D: Prescription drug program.

SSI: "Supplemental Security Income" Supposed to provide income support to poor who don't qualify for Social Security, esp. disabled.

UI: Unemployment insurance.

OASDI is very significant part of income to many elderly (chart).

OASDI PROGRAM

Hypothetical Benefit Amounts, 2003

A covered worker who had worked continuously at low wages (45% of the national average wage) and who claimed benefits at age 62 in January 2003 would receive a monthly benefit of $572. One who had earnings at or above the maximum amount subject to Social Security taxes and who claimed benefits at age 65 would receive $1,721. Someone who claimed benefits at age 70, which maximizes the effect of the delayed retirement credit, would receive $2,045.

Hypothetical benefit (in dollars)

Earnings	Age 62	Age 65	Age 70
Low	572	701	833
Average	943	1,158	1,387
High	1,236	1,513	1,786
Maximum	1,404	1,721	2,045

SOURCE: Social Security Administration, Office of the Chief Actuary.

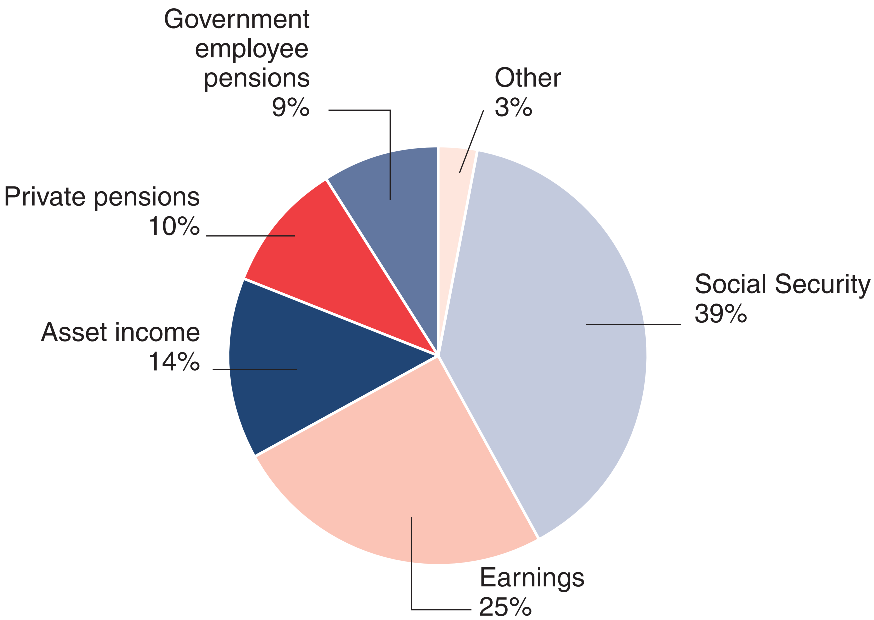
NOTE: Low earnings are defined as 45% of the national average index, average earnings are equal to the index, high earnings are 160% of the index, and maximum earnings are equal to the OASDI contribution and benefits base.

INCOME OF THE AGED POPULATION

Shares of Aggregate Income, 2003

In 1962, Social Security, private and government employee pensions, income from assets, and earnings made up only 84% of the total income of the aged, compared with 97% in 2003. Although private pensions still accounted for only a small proportion of total income in 2003, they more than tripled their share over this period—from 3% to 10%. The share from earnings declined from 28% to 25%.

Aggregate income, by source, 2003

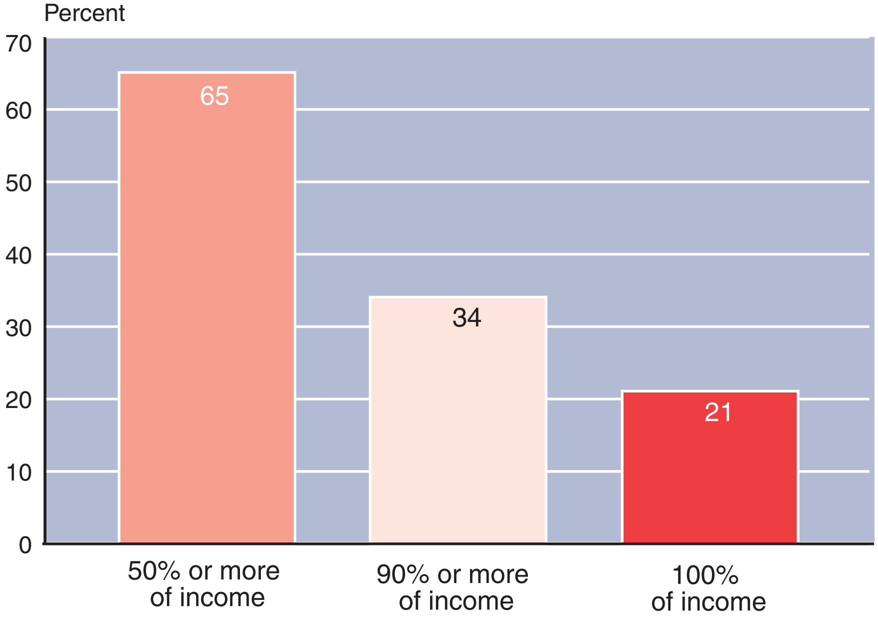


INCOME OF THE AGED POPULATION

Reliance on Social Security, 2003

In 2003, 90% of married couples and nonmarried persons (aged 65 or older) received Social Security benefits. Social Security was the major source of income (providing at least 50% of total income) for 65% of aged beneficiaries, and it was the only source of income for 21%.

Percentage of the aged receiving Social Security benefits, by relative importance of benefits to total income



Financing OASDI:

You and employer each pay 6.2% of wages and salaries, up to about $90,000. Then zero.

Qualify (necessary condition):

Have a qualifying work history (10 yrs.) or:

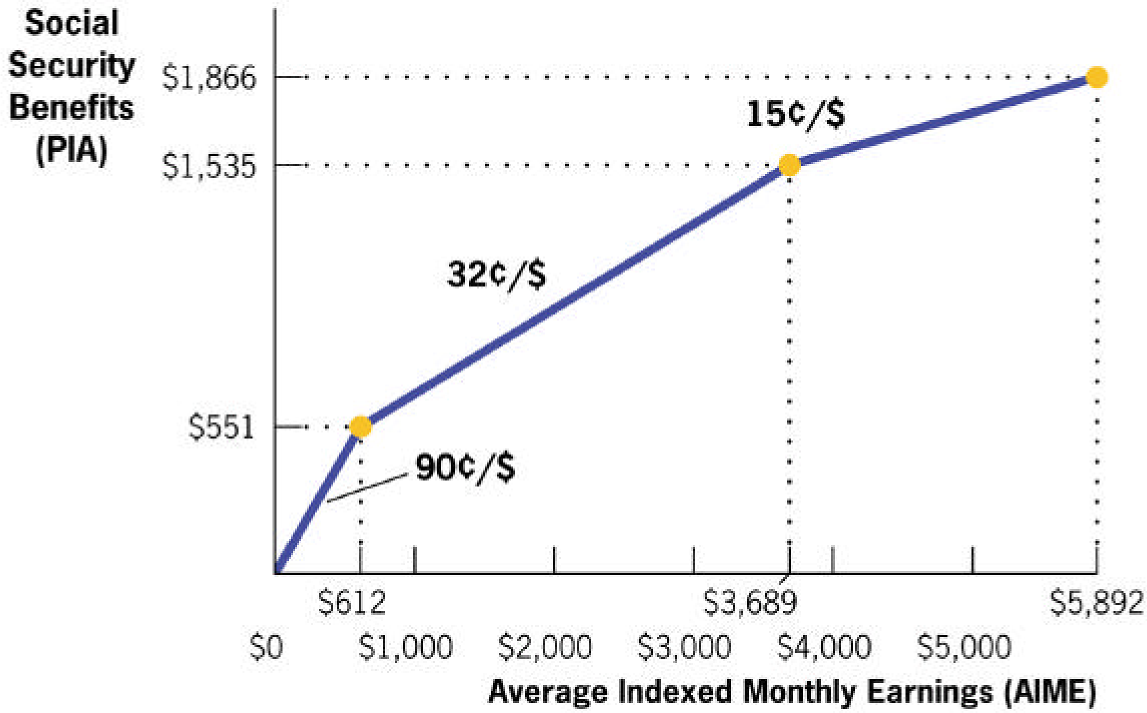
- be married to,
- the child of,
- the widow or widower of,
- the divorced spouse of,
- the surviving divorced spouse of

...Someone with a qualifying work history.

The Benefit

1) Compute Average Indexed Monthly Earnings (AIME).

- Take 35 years of the 40 years of highest earnings from 21.
- Use a wage price index to get these numbers into current dollars.
- $\dfrac{\text{Sum up}}{(12)\times(35)}$ = Monthly figure.



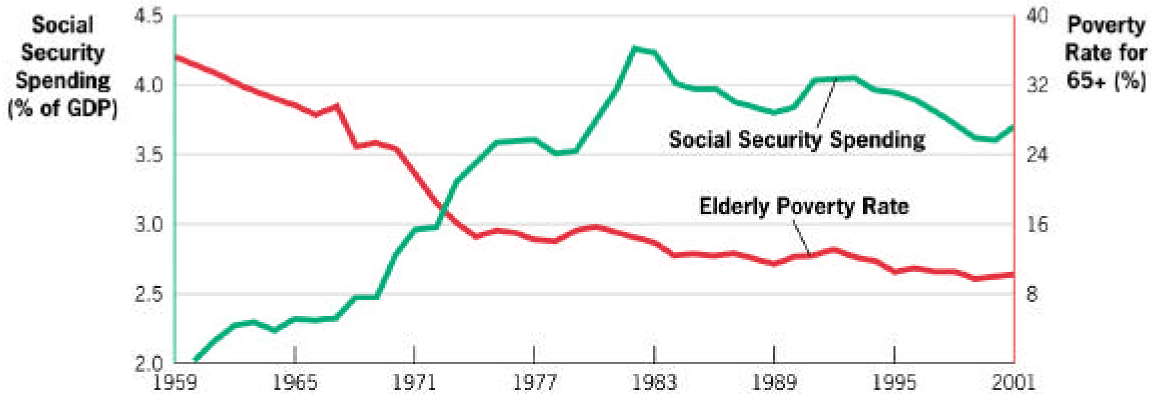
Social Security Benefits (PIA)
$1,866
$1,535
$551
15¢/$
32¢/$
90¢/$
$612
$3,689
$5,892
$0
$1,000
$2,000
$3,000
$4,000
$5,000
Average Indexed Monthly Earnings (AIME)

⇒ PIA, which is what people get who retire at the FBA (full benefit age).

Adjusted downward if retire early (62 min), adjusted upward if retire later.

Economics

- What risk is this insuring against?
  Running out of money before you pass on.
- Market failure?
  Adverse selection in market for annuities.
  (But also, paternalism/altruism toward elderly poor of 1935)
  (So, redistribution is also a basic feature/goal of the program).
- Consumption smoothing?
  Does it help people maintain "c" until they die?
  Want data on "c" over the lifecycle of the elderly.
- Redistribution? Data presented.
  As program expanded, poverty rate of elderly fell.

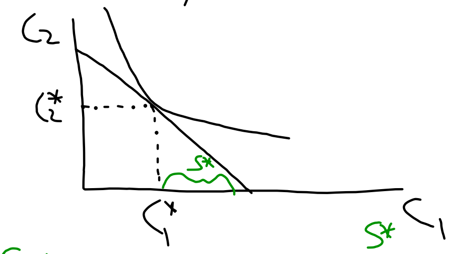


Social Security Spending (% of GDP)
4.5
4.0
3.5
3.0
2.5
2.0
Poverty Rate for 65+ (%)
40
32
24
16
8
Social Security Spending
Elderly Poverty Rate
1959
1965
1971
1977
1983
1989
1995
2001

Crowding Out.

Does the social security system reduce incentive to save?

Seems to be a big effect (Feldstein).



If the government saves S^* for you by taxing you today and giving S^* back tomorrow, you should save nothing.

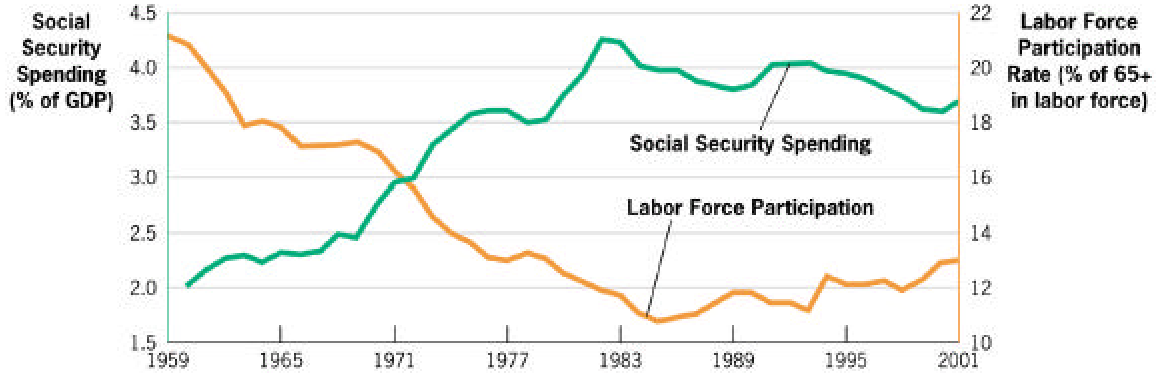
$\Longrightarrow$ Macroeconomic issues, reduced capital formation.

- Moral Hazard

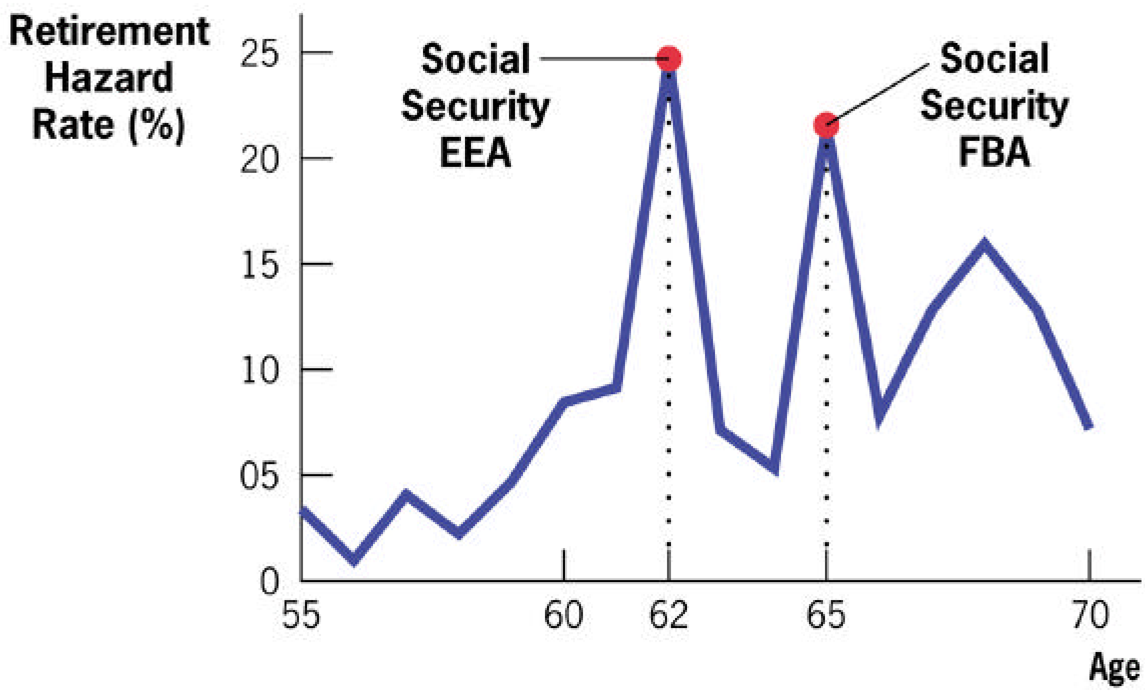
Two forms:

* quit smoking, take better care.
* retire earlier than you would have otherwise.

Big effect.



Social Security Spending (% of GDP)
Labor Force Participation Rate (% of 65+ in labor force)
Social Security Spending
Labor Force Participation
4.5
4.0
3.5
3.0
2.5
2.0
1.5
22
20
18
16
14
12
10
1959
1965
1971
1977
1983
1989
1995
2001



Retirement Hazard Rate (%)
Social Security EEA
Social Security FBA
25
20
15
10
05
0
55
60
62
65
70
Age