

ON THE OPTIMAL MIX OF SOCIAL INSURANCE PAYMENTS

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1. INTRODUCTION

Social insurance (and transfer) payments can be made in several different ways. They can be simple cash payments (such as old age pensions), payments in kind (medical care and job retraining programs), subsidies on specific goods (food stamp programs and bus fare subsidies) and payments in real terms, adjusted for unforeseen price level changes (the Canada pension plan).

This note attempts to provide a partial discussion of the desirability of these kinds of payments in different situations. Sociological considerations are not included, though it is recognized that they may be very important. Furthermore, paternalistic arguments are ruled out, and consistent preferences by families are assumed.

No distinction is made here between social insurance and transfer payments. Virtually all the payments that we call transfers are also a form of social insurance. Relief payments provide insurance against income loss; payments to the blind and disabled provide insurance for those born normal, and insurance for all parents. Different public programs will have different effects, however, on the distribution of lifetime income.

2. INSURANCE IN THE PERFECT MARKET

When economists admit uncertainty into their models, the number of markets necessary to guarantee "optimality"¹ expands enormously. Instead of a market for each good in each period of time and the capital market, additional insurance markets that cover every possible risk and uncertainty that people encounter are necessary. Insurance contracts would not only be against monetary losses but would provide cash payments on the occurrence of any uncertain event. If provision of the insurance market has a real cost in economic resources, then insurance should not cover all uncertainties, but only the ones in which the "benefit" exceeds the cost.²

The insurance market is, however, very poorly developed. This can be explained by several things, among them incentive effects of insurance (see below), lack of information available to insurance companies

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¹ By "optimality" we mean a Pareto optimum—a situation where a given family can be made better off only at the expense of others. There are many optimal situations, corresponding roughly to different distributions of lifetime income.

² For a more detailed discussion of these assertions see references 1, 2, 3, and 4.