End-of-chapter Questions

Chapter 12: Social Insurance: Social Security

1. Why do people demand insurance?
2. What does it mean to say that a person is risk averse? Risk neutral? How does the demand for insurance change if people are risk neutral rather than risk averse? Explain.
3. So long as insurance is actuarially fair, people receive the same expected income whether the insurance is full or partial. Why is this? Why, then, do they prefer full insurance to partial insurance?
4. Medical insurance often requires the insured either to pay a deductible before the insurance coverage takes effect or to make a co-payment for each covered event, or both. Why is this?
5. What information problems drive insurance into the public sector and why do they do so?
6. Why is the optimal amount of social insurance unlikely to be full insurance?
7. a. What is the difference between a fully funded pension plan and a pay-as-you-go pension plan? Which type of plan is Social Security?
   b. What is the difference between a defined contribution and a defined benefit pension plan? Which type of plan is Social Security? Which type of plan is the majority of private pension plans in the U.S.?
8. a. Why does the overlapping generations (OLG) model with life-cycle hypothesis (LCH) consumers predict that a pay-as-you-go pension system such as Social Security lowers national saving and investment?
   b. Why might the decrease in saving and investment not be as large as predicted in this model?
9. In what ways does the Social Security pension system redistribute income?
10. Comment on the following statement: 'From the point of view of the insurance companies, the high-risk individuals under a medical insurance plan are the low-risk individuals under a private annuity plan, and vice-versa.'
11. What are the specific moral hazard costs associated with the Social Security pension system? Do economists believe that these costs are large or small? Explain.

12. What factors contribute to making the market for private annuities in the U.S. so thin, and thus private annuities so costly?
13. What determines the rate of return that people receive on their payroll taxes under the pay-as-you-go Social Security pension system? Are the returns higher or lower than the returns to private market saving in the U.S.?
14. What is the legacy debt under the Social Security system and why did it arise?
15. What are the arguments for and against privatizing some or all of the Social Security pension system? Which set of arguments do you find the more persuasive?