



Social Insurance

WHAT ARE WE TALKING ABOUT TODAY

SOCIAL SECURITY

THE NEED FOR PUBLIC INSURANCE

PUBLIC INSURANCE SYSTEMS

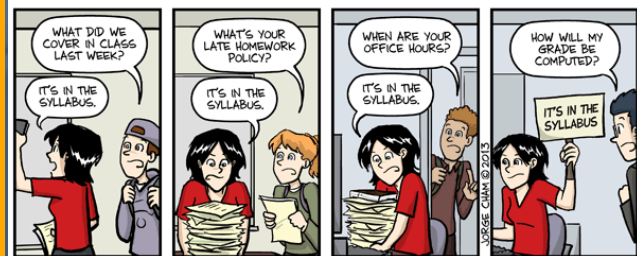
EFFECTS OF SOCIAL SECURITY

DISCLAIMER

This is a new Course, and although I have spent an awful lot of time to develop it, it has not been tested on real students - even worse on real Hult students.



Don't forget!



IT'S IN THE SYLLABUS

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Intro to Social Insurance

What is Social Insurance?

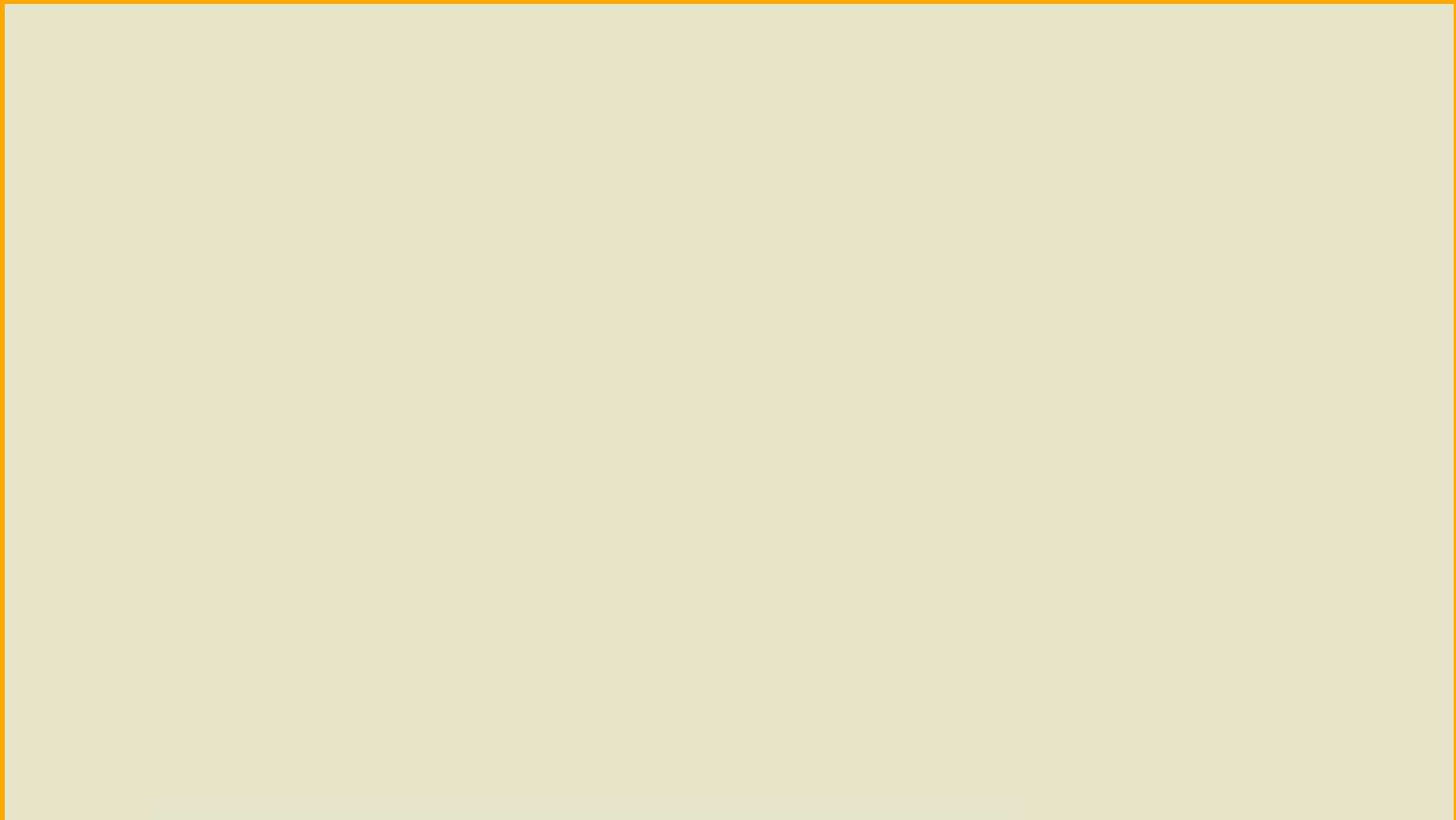
Social Insurance



Social Insurance or **Social Security** are terms to describe the actions taken by governments to provide social protection to the people, and especially to the aged, the unemployed, and the disabled.

The most important form of social insurance around the world is retirement insurance, which is provided through **pension systems**.





Private Insurance Problems

Many private insurance products are available (e.g. car insurance, life insurance, home insurance).

However there are certain issues when it comes to private provision of retirement insurance.

High Transaction Costs. Private insurance companies spend a lot of money to analyse each individual's risk and to market their products. Governments can make the purchase of social insurance compulsory.

Risk Mitigation. Inflation or poor stock market performance can be detrimental to private insurance. A government can fill the gap using public funds and can spread the cost through generations.

Adverse Selection. A private insurance would be most likely purchased by those who are more likely to use it (those in poor health or willing to retire early). Universal insurance achieves risk diversification.

Moral Hazard. Knowing that income is insured at retirement age and to an extent before that age, someone could be incentivized to quit working although he/she is capable of continuing (governments face the same problem).

Social Insurance as a Merit Good



Even if private markets were efficient in providing retirement insurance, remains a rationale for government action.

If society does not want its senior members suffering due to their poor saving choices, retirement insurance is seen as a merit good and government can enforce a system where everyone must purchase a minimum amount of it.



Fully funded vs Pay-as-you-go system

"State"

Pay-as-you-go

- current employees contributions cover the current benefits of pensioners

DB (Defined Benefit)

- Pensioners benefits are defined by law

Mostly managed by state



"Private"

Fully funded

- each participant accumulates capital, and the capital plus capital gains (interest, price) backs his/her pension

DC (Defined Contribution)

- Pensioners benefits are defined by the amount invested

Mostly managed by private pension funds



A pension system in which each age group's pension is supported by its own contributions is called a **fully funded system**.

Private pension systems are usually fully funded. Individuals contribute to a fund that is used to provide for their pensions in retirement.



A pension system in which the payroll taxes of those in employment today pay for the benefits of those retired today is called a pay-as-you-go system.

Most countries in continental Europe have a pure or (most likely) a modified pay-as-you-go system.



Pay-as-you-go advantages and problems

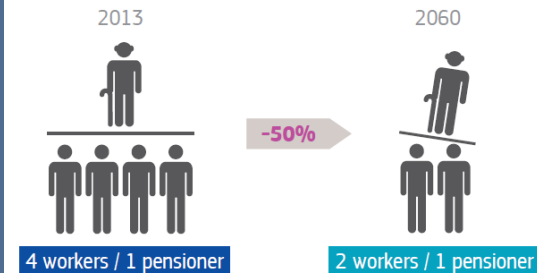
Advantages

- Low initial cost
- Less affected by market fluctuations

But...

- People live longer
- People in developed world have less children
- More people go to higher education

The ratio of workers to pensioners will decrease



Source: European Commission, Ageing Report 2015

Global Life Expectancy

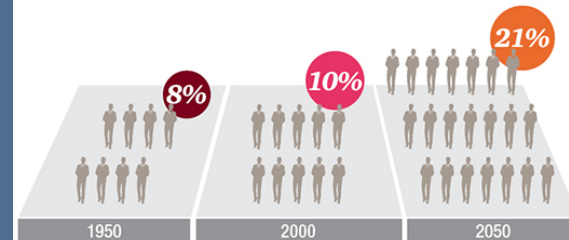
Projected global life expectancy at birth*



Source: United Nations Department of Economic and Social Affairs, Population Division, World Population Prospects: The 2017 Revision
Produced for: United Nations, Department of Public Information
*Life expectancy data from the World Population Prospects are average values referring to five-year periods.

SUSTAINABLE DEVELOPMENT GOALS

Proportion of the world population aged 60 years or more



Source: UN report World Population Ageing 1950-2050

Pay-as-you-go Challenges

What can be done?

- Reduce the number of pensioners
- Reduce benefits
- Increase contributions
- Increase workforce



Fully funded



Advantages




- No direct negative impact on public debt or deficit.
- Individual responsibility

But...

- Market fluctuations (e.g. stock market) and inflation might be detrimental to pensions
- High transition cost

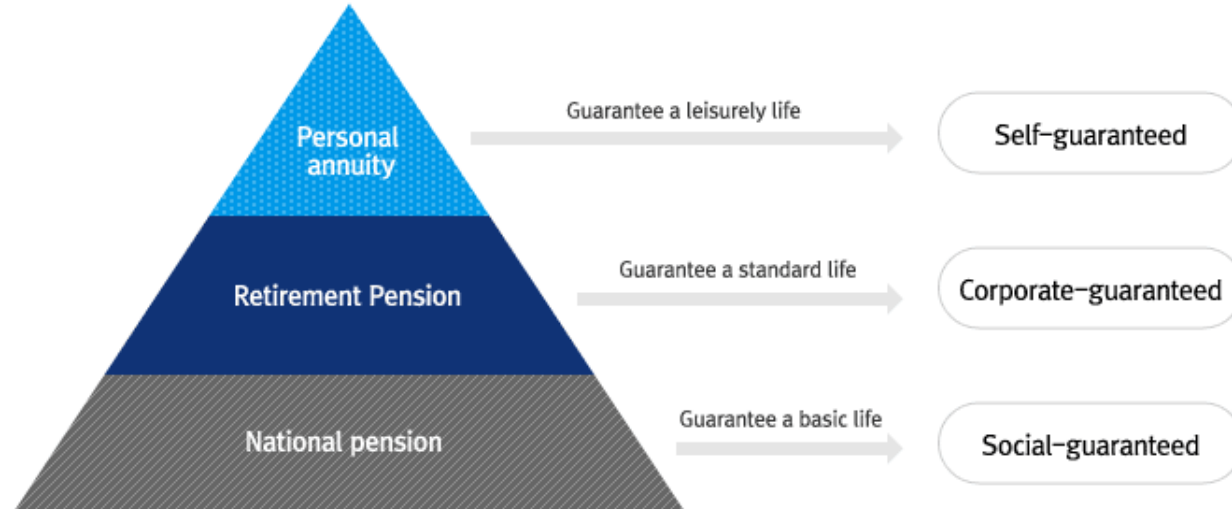
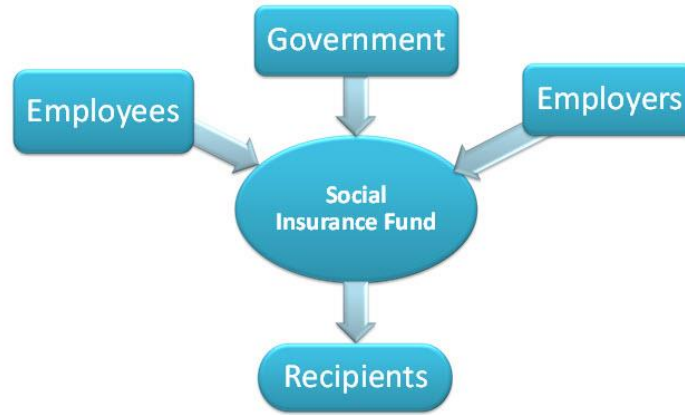
The three pillars/tiers

Contributions from 6 April 2019: £40 extra 'free' money

-  You'll get tax relief £10
-  Your employer contributes £30
-  You contribute £40



= £80



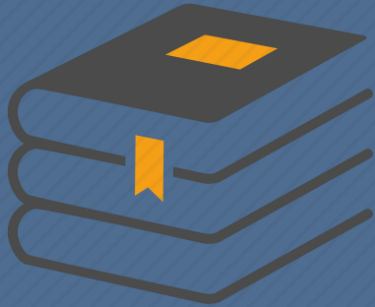
The 3-tier structure of guaranteeing one's later life recommended by OECD and World Bank



Thanks!

Any questions?

Bibliography



Stiglitz, J. and J. Rosengard (2015) *Economics of the Public Sector* (4th ed.), W.W. Norton & Company