“Social Insurance,” Risk Spreading, and Redistribution

By James Kwak[1]

DRAFT

Record peacetime federal budget deficits, ominous projections for the growth of the national debt, and the rise of Tea Party conservatism have stimulated a national debate over the size of government, the role of government, and fiscal policy in the United States. In that debate, major domestic spending programs, beginning with Social Security[2] and Medicare, play a starring role. The common perception, at least within the Beltway, is that these programs must be brought under control: spending on Social Security and Medicare together is projected to grow from 7.9 percent of GDP in 2013 to 11.3 percent of GDP over the next twenty-five years, or from 41 percent to 47 percent of total federal spending excluding interest payments on debt (CBO 2013b).[3] Beyond the numbers, however, lies the more fundamental question of whether

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[2] When used on its own, the term “Social Security” here refers to the Social Security Old Age, Survivors, and Disability Insurance (OASDI) program.

[3] The figures in the text are from the Extended Alternative Fiscal Scenario and are net of offsetting program receipts, primarily Medicare premium payments. The Congressional Budget Office estimates gross program spending at 8.4 percent of GDP in 2013 and 12.3 percent of GDP in 2038 (CBO 2013b).

the federal government should be using these programs to shift resources among different segments of the population on such a vast scale.

The most common defense of Social Security, Medicare, unemployment insurance, and similar government policies is that they constitute "social insurance," commonly thought of as government-orchestrated protection against specific risks faced by most if not all people. This protection arguably increases social welfare for the same reasons that insurance is beneficial—that is, it increases the expected utility of risk-averse individuals. Critics, however, argue that these programs are not insurance (or not very good insurance), but instead are tax-and-transfer schemes. These attacks come mostly from conservatives, for whom one-size-fits-all government services funded by compulsory levies are usually inferior to leaving those services up to a free market. But some progressives also object to the insurance features of these programs, which sometimes mandate that high-income participants receive benefits that they seem not to need. These critics prefer means-tested public assistance to social insurance because it more efficiently transfers resources to those who need them most.

This chapter addresses the question of what role social insurance programs perform: insurance, redistribution via taxes and transfers, or something else. In the first part of this chapter, I pragmatically use the term "social insurance" to mean "those programs that are generally considered social insurance,"[4] drawing examples primarily from Social Security (including old age, survivors, and disability insurance), Medicare (including Parts A, B, and D), and unemployment insurance. I take this approach for two reasons. First, academic specialists acknowledge the slippery nature of social insurance and struggle to define it precisely. Atkinson

[4] Even people who argue that social insurance is not insurance, or is not a meaningful concept generally, still use examples from the same list of programs in making their points.

(1991, p. 113) observes, "There is indeed a lot of the proverbial elephant about social insurance: we may not be able to define an elephant, but we recognise one when we see it"; according to Graetz and Mashaw (1999, p. 25), "Social insurance has no 'essence.'" Second, my goal is to describe and analyze a major component of government social policy as it exists today—not to begin with a logically precise definition that settles every question in advance.

In this chapter, I argue that social insurance programs do play the risk-spreading role of private insurance, but they also serve an ex ante redistributive function more typical of tax-and-transfer schemes. I show that the balance between risk-spreading and redistribution varies depending on the information that participants have about their current and future circumstances, which depends in turn on the timeframe under consideration. In other words, a given program will look more or less like private insurance or public assistance depending on the time horizon chosen. Programs like Social Security appear to be simply redistributive when viewed over a short timeframe, such as one year, because we know who will be net beneficiaries and who will be net payers. Over a lifetime, however, outcomes are much harder to foresee, and so these programs spread risk over the entire pool of participants—the core function of insurance. This fundamental ambiguity is one reason why social insurance programs are always subject to debates over framing, particularly given the political interests involved.

As background, Part 1 of this chapter compares various government programs to private insurance before summarizing some of the prominent ways of conceptualizing social insurance. Part 2 proposes a new way to think about social insurance programs: as risk-spreading arrangements that are more rational or less rational for participants depending on the timeframe that they consider and the amount of information that they possess about their personal circumstances. Even under this approach, however, it remains impossible to pin down exactly where social insurance begins and ends, as shown in Section 3. Section 4 discusses alternative framings of social insurance programs to serve competing political ends—implying that we cannot ever settle the debate over what social insurance *is*.

I. Private Insurance and Social Insurance

The concept of social insurance is ambiguous because it is the product of historical contingency. Government intervention to protect the old, the young, the out-of-work, the disabled, and the sick has taken many forms, beginning, according to the conventional narrative, with the programs introduced by German Chancellor Otto von Bismarck in the late nineteenth century. Since then, observers have been struggling to bring conceptual order to this complicated history.

A. Risk Spreading and Redistribution

The core function of any insurance program is spreading risk among a pool of participants. In theory, insurance works because human beings are risk averse. If premiums are set equal to expected losses, risk-averse purchasers benefit (in utility terms) and sellers break even; even if premiums include transaction costs and a return on the capital invested in insurers, purchasers will often be made better off because of risk aversion. A private product or a government program provides insurance to the extent that it spreads the risk of uncertain future events across the people who face that risk. It is also insurance to the extent that it allows a participant to shift her resources among different future states of the world (that is, from states in which a loss does not occur to states in which it does occur).

Insurance necessarily involves redistribution in the relatively trivial sense that, seen retrospectively, cash is transferred from people who do not suffer losses to those who do. At the time people purchase insurance, however, this is not redistribution, assuming that each individual pays for her expected losses in the form of premiums.[5] In practice, insurance also redistributes resources in another, more substantive sense. Among any group of insureds, even those whom the insurer identifies as equivalent risks, some will have a higher than average risk of loss and others will have a lower than average risk. The fact that they pay the same premiums[6] means that, ex ante, there is redistribution from low-risk participants to high-risk participants (see Abraham 1986, chapter 4). One objective of insurance underwriting is to identify and price degrees of risk accurately in order to avoid undercharging high-risk people and overcharging low-risk people. When this is difficult or costly—for example, health insurers may lack the information necessary to identify individual health risks—the problem of adverse selection can arise: if insurers charge a single price to both low- and high-risk people, the former may choose not to buy insurance (since its costs outweigh its expected benefits), leaving only the latter in the pool of insureds and forcing insurers to increase their prices commensurately. The inability of insurers to identify and account for differing levels of riskiness in individual behavior can also contribute to moral hazard: the (theoretically) increased propensity of people to take on risk if they are insured against it.

In unregulated private markets, some people will buy insurance and others will not. People decline to buy insurance for several reasons. The best reason is that they simply do not need it: even risk-averse people are effectively risk-neutral with respect to small changes in wealth and thus should not insure themselves against small losses (Rabin and Thaler 2001). But there are many other, more worrisome reasons for underinsurance. Insurers may not offer needed insurance because of some market failure. Individuals may underestimate their own risk of loss.

[5] For brevity, I do not mention transaction costs and capital costs here.

[6] By "the same premiums," I mean the same premium per dollar of insured value.

They may recognize the risk they face, but may not be aware that insurance exists. They may not be able to find insurance at a fair price—one that only moderately exceeds their expected losses. Or, even given a fair price, they may not be able to afford it. As a result, people face significant risks against which they have no protection. The programs generally thought of as social insurance attempt to make insurance available to these people for one or more reasons of public policy. For example, Social Security Disability Insurance is motivated in part by the belief that people should have some protection from being physiologically or mentally unable to work, even if they are unable to buy that protection in the private market; Social Security Old Age and Survivors Insurance is motivated in part by the need to protect people from outliving their savings, a risk that is otherwise difficult to insure.

B. What the Government Does

This section discusses Social Security, Medicare, and unemployment insurance, which in the United States are typically thought of as canonical examples of social insurance.[7] These programs typically use one or more mechanisms to provide insurance that is considered socially beneficial but that, in the opinion of policymakers, would not be sufficiently provided or purchased in a purely private market. The principal program features include compulsory participation, underwriting constraints, and explicit subsidies. The insurance is often provided by a public entity, but may be delivered by private companies under a statutory mandate.

First, compulsory participation is a requirement that a program cover all people in a certain class. In the United States, Medicare Part A (hospital insurance) and unemployment insurance are mandatory for virtually all workers, as is Social Security with a few narrow

[7] See, for example, National Academy of Social Insurance, "Learn," http://www.nasi.org/learn.

exceptions. This means that contributions must be paid by or on behalf of workers,[8] who thereby gain a right to benefits. Compulsory participation overcomes potential adverse selection problems because low-risk individuals cannot opt out of insurance, which would drive up premiums for everyone else. Not all programs commonly thought of as social insurance are mandatory, however; Medicare Parts B (medical insurance) and D (prescription drugs) are not paid for by or on behalf of workers until they become beneficiaries, and participation is voluntary.[9]

Second, government insurance programs often place constraints on underwriting, which limit the ability of insurers to decide whom they want to insure and at what price. In a theoretical free market, insurers can use any factors to differentiate between high-risk and low-risk insureds.[10] With social insurance—especially if it is compulsory—some limits on risk underwriting may be necessary either to make insurance affordable to everyone or because of fairness concerns. Medicare does not differentiate among participants according to their health status, either during their working years or when collecting benefits; if it did charge premiums based on existing medical conditions, many people would probably not be able to afford Parts B and D. Unemployment insurance is experience rated (premiums are based in part on losses incurred in prior periods), so businesses that incur higher losses pay higher premiums. The rating system does not consider the riskiness of individual workers, however, so an employer does not

[8] Contributions can be paid by employees, employers, or both. Even if they are paid by employers, at least some of the burden probably falls on employees in the form of lower wages.

[9] Medicare Part A is financed by a payroll tax levied on current workers. Parts B and D are financed by premiums paid by current beneficiaries and by general tax revenues.

[10] In actual private insurance markets, anti-discrimination rules place constraints on underwriting.

pay higher premiums for an employee with a history of involuntary job losses.[11] Social Security does not treat people differently based on their expected longevity or their risk of disability. These constraints redistribute wealth ex ante from people with low risks to people with high risks on the dimensions along which underwriting does not occur.

Third, government programs often incorporate explicit subsidies either from "outside" or from within the pool of insureds. These subsidies are in addition to the implicit subsidy created by underwriting constraints. For example, the lack of medical underwriting in Medicare Part B is an implicit subsidy from healthy people to people with chronic illnesses that helps reduce the cost of insurance for the latter. That is not enough to make Medicare Part B affordable, however: if every beneficiary were charged the average expected losses for the entire pool, Part B would likely be too expensive for most, largely because the elderly incur high health care costs on average. Therefore, approximately 75 percent of the costs of Part B are an explicit subsidy paid out of general revenues collected from income and other taxes. Primary unemployment insurance is provided by state funds financed by employer contributions, but extended benefits during periods of high unemployment are paid for by the federal government out of general revenues. In these cases, the subsidies come from outside the insured pool in the sense that they are not funded directly by insureds. To the extent that those who pay into general revenues (which are largely comprised of individual income taxes) overlap with those in the insured pool, however, subsidies also represent redistribution among participants.

Social Security, too, provides explicit subsidies from within the pool of participants. The program's founders recognized that some degree of redistribution was necessary to provide

[11] That prior history might make an employer less willing to hire a given employee, however, because of the prospect of higher premiums in the future.

meaningful insurance to all (Hacker 2002, p. 107). Social Security accomplishes this goal by using a progressive benefit formula: low earners receive a higher percentage of their contributions as benefits than do high earners. This formula compensates for the fact that high earners make higher contributions while working. On balance, the program transfers income from high earners to low earners, at least on an expected basis (CBO 2006).

These are the main features that allow government programs to offer insurance where the unregulated private market would fail.[12] Compulsory participation overcomes adverse selection as well as behavioral frailties that might limit demand for insurance; limits on underwriting reduce price differences across participants and (from one perspective) make the system more fair; and subsidies attempt to close any remaining affordability gap. In addition, government programs are backed by a sovereign state with the power to tax, whether benefit payments are made directly by the government or by entities implicitly backstopped by it. This ability to raise money when necessary makes it possible to protect against losses that are difficult to estimate far in the future.

The examples described in this section are all government policies that intend to make insurance more available. That insurance, however, does not have to be directly provided by a government entity. Medicare Part D prescription drug plans are sold by private companies within a federal regulatory scheme that includes a risk adjustment mechanism to compensate insurers for their high-risk enrollees. In Part III I discuss additional insurance markets—including workers' compensation, auto liability insurance, and individual health insurance under the

[12] There are also ways in which social insurance programs are similar to private market products. For example, Medicare uses deductibles and copayments, and unemployment insurance imposes benefit limits, both to control costs and to mitigate moral hazard concerns.

Affordable Care Act of 2010—which bear several of the hallmarks of social insurance but are primarily sold by private companies, with considerable government regulation. In all of these cases, a regulated private market can plausibly achieve the public policy goal: universal availability at moderate cost.

C. Conceptions of Social Insurance

In practice, as described above, the programs usually thought of as social insurance are a messy, inconsistent combination of general insurance principles with statutory mandates, regulations, and subsidies. This confusion makes it possible to conceptualize social insurance in several different ways. In addition, how people think about these programs has always been influenced by political debate. In the United States, the classic, once-conventional understanding of Social Security—as an insurance policy in which payroll tax "premiums" buy a right to future benefits—was manufactured by politicians and bureaucrats eager to distinguish the program from non-contributory "welfare" alternatives and to invoke contract law in its defense (Campbell and Morgan 2005, p. 179; Simon 1986, pp. 1450–51).[13] More recently, critics of Social Security have framed it as a personal retirement savings vehicle rather than a risk-spreading mechanism—because, for many relatively affluent workers, Social Security provides lower expected returns

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[13] Social Security Old Age Insurance—the core of what we now consider "Social Security"—was created alongside a non-contributory, means-tested Old Age Assistance program, which was then more visible and popular because more people qualified for OAA than for OAI at the time (Campbell and Morgan 2005, pp. 176–77).

than, say, a personal account invested in the stock market (Campbell and Morgan 2005, p. 188).[14] In this subsection I briefly outline three influential descriptions of social insurance.

First, it is common in the United States to define social insurance by listing the idiosyncratic features of Social Security, the federal government's flagship domestic program: mandatory participation for (most) workers, self-financing through earmarked participant contributions, benefits linked to contributions, and no means testing (that is, no restricting benefits to the poor).[15] Graetz and Mashaw (1999, p. 57) describe challenge the "conventional conception" of social insurance, described (which they challenge) as "mandatory, earnings-

[14] The relatively lower returns for Social Security are a product of its somewhat progressive benefit formula and its much lower investment risk relative to the stock market; adjusted for risk, it's less clear that Social Security underperforms the stock market.

[15] For example, Wikipedia defines social insurance as any "government-sponsored program" with: benefits defined by statute; an explicit financing mechanism; funding by payments by or on behalf of participants; and compulsory or near-universal participation. Wikipedia, "Social Insurance," http://en.wikipedia.org/wiki/Social_insurance. The Merriam-Webster Concise Encyclopedia defines social insurance as a "[c]ompulsory public-insurance program that protects against various economic risks," and continues, "Social-insurance contributions are normally compulsory and may be made by the insured person's employer and the state as well as by the individual. Social insurance is usually self-financing, with contributions being placed in specific funds for that purpose." Merriam-Webster, "Social Insurance," http://www.merriam-webster.com/dictionary/social insurance. The basic principles of universal participation, required contributions, and a dedicated insurance fund were also established in the Beveridge Report (1942), which outlined the principles of the postwar welfare state in the United Kingdom.

related, near-universal protection against loss of wage income and fringe benefits, provided to contributing workers and their families through a publicly administered system financed by dedicated taxes." Ball (1947, pp. 338–40), who later served as commissioner of the Social Security Administration, defined social insurance as an "earned right" available to all workers, based on contributions to a dedicated fund, whose payments "are made to individuals on the basis of a work record and are part of the reward for services rendered." When Brown (1956) attempted to describe the distinctly American "philosophy of social insurance," he essentially repeated the features of Social Security: contract-like benefits, universal coverage, benefits linked to contributions, protection for dependents, and joint contributions by employees and employers. Early advocates for Medicare consciously adopted this model because they saw the concept of earned benefits as crucial to garnering political support (Oberlander 2003, pp. 24–25). Some central "social insurance" programs, however, only loosely fit this common model. Medicare, for example, provides equal coverage to all beneficiaries, regardless of past contributions. Medicare Parts B and D are voluntary, and are funded by individual beneficiary premiums and general tax revenues, not dedicated contributions from employees or employers. As noted above, Part D is provided by private companies under a public regulatory scheme.

Second, economists have defined a more abstract model of social insurance as a rational government response to failures in private insurance markets, most notably adverse selection (Atkinson 1991, pp. 115–16; Barr 1992, pp. 749–55; Zweifel 2000, pp. 937–39). Another problem is that if the magnitude and frequency of losses are hard to estimate over the long term, worries about insurer solvency can make private insurance untenable, necessitating government regulation or provision of insurance. Arrow (1963, pp. 961–64) identifies several problems with the market for health insurance that undermine the private insurance model. Diamond (1977, pp.

279–81) justifies Social Security (or something close to it) on various grounds, including market failures that jeopardize secure retirement. In addition to the failure of markets to supply certain types of insurance, behavioral constraints may limit demand for valuable insurance products in that people do not rationally evaluate either risk or insurance benefits. Decisions to purchase annuities, for example, can be significantly influenced by the framing of the options presented (Brown et al. 2013).

Since risk-averse individuals are usually made better off by insurance at a price that reflects their expected losses (with reasonable transaction costs and insurer profits), there is a strong case that the government should make such insurance available when the private market fails to do so. Insurance against unemployment, longevity, and illness in old age were effectively unavailable to many people prior to government intervention, and so social insurance can be thought of as a response to these market failures.[16] This purely economic conception of social insurance, however, only loosely conforms to existing programs. The idea that government should limit intervention to solving market failures—therefore providing only the insurance policies that would be available under perfect market conditions and with perfectly rational consumers— inadequately describes actual policy. In the health care sector, for example, this constraint would defeat one of the core purposes of government-provided insurance, since many high-risk individuals (such as the disabled or the elderly, who are covered by Medicare) could not afford private insurance, even if fairly priced (Arrow 1963, p. 963). Indeed, Nyman (2004)

[16] It is possible that the efficiency costs of government insurance, as opposed to free market provisioning, might outweigh the welfare gains of the individuals benefiting from the insurance (Priest 2003). Much economic research focuses on the question of the optimal level of such insurance (e.g., Chetty 2006; Chetty and Finkelstein 2013).

argues that explicit health insurance subsidies (or a national health insurance program) increase social welfare.

A third conception of social insurance describes it as the set of programs dedicated to a specific policy objective: "to moderate the risks of current income loss or inadequacy by providing secure cash or near-cash entitlements on the occurrence of defined risks" (Graetz and Mashaw 1999, p. 65; see also Marmor et al. 2014, p. 10). Social insurance sets out to solve a coherent problem: "Families live almost exclusively by labor income; they therefore demand protection against circumstances and events that take them out of the workforce and cut off labor income" (Graetz and Mashaw 1999, p. 47). This problem only arose in its current form with the development of an urban, industrial economy based on wage labor, in which unemployment and retirement became discrete events; this explains why social insurance first appeared in late-nineteenth-century Europe (Atkinson 1991, pp. 120–22). On this view, social insurance includes all government policies designed to protect people from lack of access to labor income, encompassing not only government insurance programs, but also means-tested, non-contributory programs (sometimes known as "welfare"), and tax subsidies such as the exclusion for employer-provided fringe benefits (Graetz and Mashaw 1999, pp. 62–63). To the extent that other workplace policies mitigate employee risk—thus reducing the need for government involvement—they might be thought of as part of an overall public-private social insurance system.[17]

[17] According to Charny (1986, p. 1601), in the United States, "when these two forms of social insurance [private and government] are taken together, employers appear to be the entities that have been primarily responsible for workers' social welfare." In the United States, protection

None of these common conceptions of social insurance is necessarily wrong, as each describes different phenomena or implies different policy recommendations. Under each view, social insurance is not quite the same thing as private insurance, but nor is it simply a form of tax-funded public assistance. Instead, social insurance represents some hybrid of private insurance principles and government coercion. In the remainder of this chapter, I propose a new model of social insurance that focuses on this hybrid nature.

The question, here and in the broader political debate, is to what extent these government programs still constitute insurance—as opposed to tax-and-transfer schemes that redistribute resources from the affluent to the needy. From one perspective, for example, Social Security Disability Insurance is in fact insurance: all workers pay premiums, and those who suffer disability-related unemployment (the insurable event) receive payouts. From another perspective, however, it looks a lot like a public assistance program: a more or less flat tax on wage income is used to pay benefits to people with disabilities—a set of specific conditions that merit assistance. The only thing that seems out of place in a tax-and-transfer system is the fact that benefits are linked to prior contributions. Even then, however, the progressive benefit formula (under which high earners receive relatively little credit for their higher contributions) shrinks the variance in benefit payments, reducing the importance of prior payments. Social Security retirement benefits exhibit a similar duality. On the one hand, all participants make contributions while working, and those who live the longest (one of the conditions they are buying insurance against) receive the largest payouts; on the other hand, a tax on current wage income is used to fund annuities for elderly people with work histories. Again, the unusual feature is that those benefits are calculated

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against the risks of old age and ill health has largely been outsourced to the private sector, especially when compared to many European countries (Hacker 2002, p. 276).

on the basis of earlier contributions, but the benefit formula, coupled with the fact that Social Security payments are taxable only for higher-income households, smooths out the distribution of benefits considerably.

In short, many government insurance programs can be seen either as insurance products comparable to those available from the private market or as tax-and-transfer schemes akin to pubic assistance (Zweifel 2000, pp. 954–55). They combine both the risk-spreading function of insurance and a redistributive function significantly greater than that inherent in private insurance products.[18] For decades, Social Security and Medicare were conventionally regarded as contributory insurance programs that conferred on participants a right to benefits, spreading unavoidable risks across all of society. More recently, however, their fundamental ambiguity has helped fuel political and ideological debates over what these programs are and how, if at all, they should be modified (Campbell and Morgan 2005).

II. Risk, Information, and Time

The government can affect the provision of insurance in many different ways. At one end of the spectrum is competitive private insurance with no government intervention (except general-purpose rules such as anti-fraud statutes or constitutional barriers against discrimination). At the other end are public assistance programs, which provide blanket protection from risk at no explicit cost. All of the programs that are cited as examples of social insurance exist somewhere in between these two extremes. (Other regulated insurance markets that are *not* usually thought of as social insurance, such as automobile liability insurance, also sit on this spectrum, and will be discussed later.)

[18] Indeed, this may be a political strength of social insurance: the risk-spreading features partially obscure the ex ante redistribution, defusing potential opposition (Zweifel 2000, p. 944).

Fundamentally, any product or program along this spectrum effects both risk spreading and redistribution. It is not simply the case that social insurance programs spread risk "less" and redistribute "more" than private insurance, while spreading risk "more" and redistributing "less" than public assistance. Risk necessarily involves some probability distribution over potential outcomes. For any insurance product or government program, as we shorten the timeframe under consideration, we gain more information about what outcomes are likely to occur: risk decreases, the likely outcomes become more clear, and as a result the program looks more like redistribution. Conversely, as our time horizon lengthens, risk increases; with less certainty about who will end up with which outcome, ex ante redistribution diminishes. Social insurance programs may appear to be primarily redistributive when assessed over a short timeframe, for which we have relatively good information, but function more like insurance over many decades or a lifetime (see Sinn 1996).

Private insurance policies typically have a term of one year. Even insurance that both seller and purchaser intend to remain in force for decades, such as life insurance or long-term care insurance, is priced on an annual basis and can be canceled at the end of the policy-year or with shorter notice (by the purchaser, if not the seller).[19] For a product such as personal automobile insurance, the insurer uses its underwriting model to estimate the expected losses for each applicant and then charges an appropriate price. Ideally, from the insurer's perspective, insureds pay their expected losses (plus transaction costs and profits), so there is little or no ex

[19] The insurer may guarantee an annual premium for a certain number of years, as in level term life insurance. Alternatively, the insurer may state an annual premium for the life of the policy but reserve the right to apply for changes to its overall pricing model, as in some long-term care insurance.

ante redistribution, and the product simply spreads the risk of accidents among all drivers. In practice, since insureds often have private information about their riskiness and since efficient underwriting systems don't perfectly assess risk, there is typically some redistribution from people who have higher risk than predicted by the insurer's underwriting model to those who have lower risk (Abraham 1986, p. 78).

Applying a short-term perspective to government insurance programs often makes them appear to be simple tax-and-transfer schemes. At the limit, consider the current cash flows of the principal social insurance programs. At this moment, workers are transferring money to the elderly and the disabled via payroll taxes and to the unemployed via unemployment insurance contributions paid by their employers. All taxpayers are transferring money to the elderly via the general revenues that subsidize Medicare Parts B and D. Given a short enough time horizon, the insurable events (disability, injury, etc.) have already occurred, and we know for whom. All that is left is to transfer the cash. In this respect, there is no difference between insurance and public assistance. This very-short-term perspective is not particularly informative, however, because the same observation can be made of private insurance. Although I pay for automobile insurance with the expectation of coverage for future losses, my monthly premiums are being used, in part, to compensate other people for accidents they suffered last month.

More significant differences appear when we widen the timeframe to one year. In general, my risk of an auto accident in the coming year is largely independent of whether or not I suffered an accident in the previous year.[20] With many government-sponsored programs, by contrast, the

[20] People who were in involved in accidents in the previous year, on average, are probably more likely to be in accidents in the coming year, but this is generally the result of some underlying factors (eyesight, miles driven, etc.), *not* the fact of having been in an accident.

insurable event triggers compensation for a period of years or even the rest of the insured's lifetime. At the beginning of any year, many people face a very low risk of disability, while some face a risk that approximates 100 percent.[21] In some cases, the insurable event is also highly predictable over the short term. This is true of Social Security's old age insurance, for example: most participants have no chance of receiving benefits over the next year, while some are certain to.

From the one-year perspective, then, there is a very clear difference between personal automobile insurance and Social Security or Medicare: if the market functions effectively, the former is a plausible bargain for any risk-averse driver, while the latter is either a very good deal (for current beneficiaries) or a very bad deal (for other workers). Put another way, if Social Security were only going to operate for one more year, most current workers would opt out if they could. Social Security and Medicare do little to spread risk over a short time period, since the predictability of outcomes means that there is little risk to spread. This is the perspective taken by the many commentators who assert that Social Security and Medicare transfer resources from working-age people to the elderly (e.g., Cogan 2011). A similar, though weaker argument can be made about unemployment insurance. Although firms pay contributions based on their past losses (claims paid to their former employees), most workers know that they do not face the average risk of unemployment, even within their company. People with more secure jobs at the beginning of the year, perhaps because of seniority or specific skills, get a bad deal from unemployment insurance, while those with less secure jobs get a good deal.

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[21] From the insurer's perspective, the risk is never 100 percent because there is some chance that the insured (and any dependents qualifying for benefits) will die during the next year.

This is clearly an incomplete perspective, however. Social Security and Medicare would probably not be as popular as they are if they simply transferred wealth from a majority of the population to a minority. While automobile insurance makes sense as a risk-spreading device over a one-year policy period, many social insurance programs only make economic sense over a longer timeframe—and do indeed operate over one. From a lifetime perspective, Social Security looks like this: an individual entering the workforce in her early twenties expects that she will pay a percentage of her wage income throughout her career; in exchange, she expects to receive an annuity beginning around age sixty-seven that insures her against longevity risk, as well as coverage in case of disability and protection for her dependents should she die prematurely. Considering her cohort, we know that some members will earn high average incomes, some will earn low average incomes, some will become disabled, some will die young, and some will live long past the time they retire. The risks they face include low earnings, disability, dying young with dependents, and outliving their savings. Social Security protects all participants by paying more in benefits to those who suffer these insurable events, thereby spreading these risks across the entire group.

From a lifetime perspective, Social Security does spread risk across individuals, and is attractive to a much larger proportion of participants than from a one-year perspective. At age twenty-two, most people have only a vague notion of how much they will earn over the next half-century, how healthy they will be, how many dependents they will have, and how long they will live.[22] At that point, it is highly plausible that many would choose to participate in Social

[22] While it is possible that people might be able to use private information to estimate their future income, there is little evidence that they actually do so effectively (Krueger and Bowen 1993, Siegelman 2004).

Security (or vote in its favor), precisely because they lack information about their futures. Some might regret that choice four decades later—corporate executives and law firm partners, for example—but that is because of information that was not available to them when entering the workforce. The same principle holds true for unemployment insurance. In their early twenties, people do not know if they are likely to hold secure or insecure jobs for most of their careers, and therefore should be more supportive of the existence of an unemployment insurance program that, on an expected basis, transfers wealth from the secure to the insecure.

As discussed previously, insurance can also be thought of as a way for a person to shift resources between future states of the world. Again, whether a given insurance product performs this function depends on the timeframe chosen. Private automobile insurance shifts money between the states of the world in which you do not cause an accident to those in which you do; this is meaningful over a one-year timeframe because you generally face some risk of an accident over the next twelve months. Considering Social Security Old Age Insurance and Medicare Part A, most working-age people face only one possible state of the world over the next year—the state in which they pay contributions but do not receive benefits.[23] For a person in her early twenties, however, these programs do shift resources between future states: from futures in which she has high earnings, is healthy, and dies shortly after retirement, to futures in which she has low earnings, has poor health in retirement, and outlives her savings.

This is not to say that a lifetime perspective is necessarily correct for all purposes. For a program like Social Security or Medicare, there is always the risk that the rules will change. For

[23] This is a slight simplification: a worker could stop working and therefore stop paying payroll taxes, but in that case there is still no shifting of resources from the state of the world in which she continues working.

example, Congress could legislate higher Social Security payroll taxes or lower benefits, making the bargain worse than it initially seems. If a young person believes that Social Security is unlikely to be around when she retires, then she should evaluate the program using a shorter time horizon, in which case she might prefer not to participate. If she is confident that the political coalition sustaining Social Security will survive, then she should apply a longer time horizon.

In any case, unconsciously conflating different time horizons is a common error. The idea that the individual health insurance mandate of the Affordable Care Act is bad for young, healthy people (e.g., Hederman and Winfree 2010) overlooks the fact that people age and health deteriorates. (It also overlooks the possibility that the individual mandate, by bringing everyone into the market, causes insurers to lower prices to a point where most people want to buy insurance (Boleslavsky and Campos 2013).) The idea that Social Security is a money-losing proposition for high-income, middle-aged people is based on information that has become available over the course of their working careers; while they might have been able to estimate their future income when entering the workforce (based on their education, parents' income, test scores, etc.), that estimate would have still have carried risk—precisely the risk that Social Security provides insurance against. In both of these examples, the program in question looks like a bad deal only because there is little risk over the chosen timeframe or because enough time has passed that the need for insurance has greatly diminished.

Many analyses that purport to measure the "returns" on payroll tax contributions to government insurance programs suffer a similar flaw: ignoring the existence of risk, which is tantamount to assuming unavailable information. For example, one argument for Social Security privatization is based on comparing a hypothetical worker's eventual retirement benefits with the amount she would accumulate by investing her payroll taxes in the securities markets (e.g., Shipman 1995). This comparison ignores the very significant risk that any person's actual income will vary significantly from the hypothetical level, as will her risk of disability.[24] In short, this approach assumes away risk and in doing so ignores the risk-spreading function of Social Security. The same no-risk assumption, of course, also makes private market insurance a money-losing proposition: if people were sure to experience average outcomes, there would be no reason to buy insurance. A compulsory government program may have a negative expected value for a given participant—just like private insurance has a negative expected value if premiums are priced accurately. To conclude that the program is a bad deal for that participant is to assume that she will actually experience her expected outcome—information that we never have in advance.

Distributional studies that measure the relative fortunes of income groups often take a similar approach, comparing the experience of hypothetical average people in each category (e.g., CBO 2006). This analysis is useful in showing the ex post redistribution accomplished by a given program, but it does not reveal whether that program is good ex ante for any given person in any income group, because that person cannot assume that her position in the income distribution will remain fixed for the rest of her life.

[24] It also ignores the risk that stock market returns will deviate from whatever benchmark is selected, the risk that an annuity comparable to Social Security retirement benefits will not be available when the worker retires, and the risk that the annuity provider will go bankrupt. For a fuller analysis, see, e.g., Geanakoplos et al. (1999), Furman (2005). On the other hand, the calculation of Social Security's future benefits ignores the risks that Congress may change the terms of those benefits and that future payroll taxes may not be sufficient to cover currently scheduled benefits.

These examples show the importance of information about likely outcomes in assessing the government income and health insurance programs that are often described as social insurance. These programs, like private insurance, spread risk to the extent that we do not know who will suffer losses over the relevant timeframe. With common forms of private insurance, such as automobile insurance, we cannot predict who will file claims and receive payouts over the one-year policy period. The difference with social insurance is that for the next year, we often *do* know who will receive benefits, or at least who is more likely to, which makes these programs seem redistributive over a short timeframe. Because we know the short-term winners and losers, many programs like Social Security and Medicare could not be sustained on a purely voluntary basis, at least not in anything close to their current form. As our time horizon expands, however, we have less information about who will suffer losses, and these programs perform more of a risk-spreading role and less of a redistributive role.

What Social Security, Medicare, unemployment insurance, and similar programs share is that, although many people are clearly made worse off by them in the short term, they offer insurance that most people should rationally buy if the policy period were each person's entire lifetime (and the administrative costs were not unreasonably high). I consider this timeframe dependence a central feature of social insurance—more central than how a given program is financed, or whether it is solely administered by a government agency. Social insurance is valuable when we have little information about our lives; once we accumulate the relevant information, its risk-spreading function is diminished, and individuals become either the sources or the beneficiaries of redistribution.

Government provision of social insurance then makes sense for more fundamental political reasons than the simple fact that some degree of administrative coordination is required to make a program work. After all, a group of private individuals could theoretically choose to enter into a social insurance scheme and hire an insurance company to administer it. First, a sovereign government with the power to tax (and, more importantly, to borrow) has a considerable advantage over private companies when it comes to insuring risks that may not materialize for several decades, especially when the magnitudes of those risks are difficult to estimate far in advance (as with health care costs, for example).[25] Second, a government can enforce continued participation, including payment of premiums or contributions, past the point where an individual would rationally want to cancel her insurance "policy."[26] Third, and most important, a democratic government at least theoretically has the power to enact an insurance scheme that benefits a majority of citizens and then compel participation by the remaining minority. This is crucial because, even if we make the strong assumption that everyone would opt into a given program at age twenty-two, at any given moment there are many older people who have more information about their lives and, on that basis, would prefer to opt out. Social

[25] The federal government's minimal solvency risk is a major reason why private catastrophe insurance markets tend to be replaced or backstopped by government insurance programs (Jaffee 2015). Government catastrophe insurance shares some features of social insurance. One major difference is that, in general, catastrophe insurance spreads risk even over a relatively short timeframe, since the incidence of catastrophes is difficult to predict even in the short term.

[26] A private insurer can achieve a similar result by charging premiums that exceed expected losses for several years and premiums that are less than expected losses for successive years, so that it becomes increasingly irrational for the insured to cancel the policy. In effect, the insured will only buy the policy if she evaluates it over a long time horizon.

insurance can be seen as a mechanism by which a society composed of multiple generations commits itself to a bargain that is beneficial to most people, but only over the very long term.[27]

III. Blurry Lines

The previous part argued that social insurance is redistributive when viewed over a short timeframe but spreads risk over a longer timeframe, and that therefore it can make sense for people to collectively commit themselves to a social insurance scheme via democratic mechanisms. Even if this is true in principle, however, it is not entirely clear where social insurance begins and ends, for three reasons discussed in this section. First, government intervention imports redistributive principles into seemingly private insurance markets. Second, means-tested public assistance programs might be thought of as risk-spreading schemes given sufficient uncertainty about the future. Finally, at the limit posed by the Rawlsian veil of ignorance, almost any government program funded by a progressive tax system could be seen as a form of risk sharing.

A. Private Insurance

As discussed above, private insurance spreads risk among participants over a one-year time horizon, while social insurance generally requires a longer timeframe to make sense as a

[27] Government provision or price regulation of insurance also suffers from several problems, notably the difficulty of pricing risk on an actuarially fair basis in a political environment (Jaffee 2015; Brown 2010, chapters 1–2, 5–6). The welfare benefits of social insurance should be evaluated against these costs. The efficiency costs of inaccurate pricing, however, may be less relevant depending on the policy motivation for a specific program. For example, if the goal of Medicare is to ensure equal access to affordable health care for the elderly, then the incentive effects of underpricing are less of a policy concern.

risk-spreading mechanism. On closer inspection, however, it can be difficult to differentiate clearly between the two. It is true that there are some insurance markets that operate more or less independently of government intervention—say, kidnap and ransom insurance for companies doing business overseas. But the government does play a role in several of the largest and most important insurance markets in ways that reflect some basic principles of social insurance.

Workers' compensation insurance, which is often considered a type of social insurance (e.g., Graetz and Mashaw 1999, Moss 2002), illustrates the difficulty of determining where the private market ends and where government intervention begins. In most states, workers' compensation insurance is provided by private companies that behave in a more or less competitive manner: insurers segment the universe of possible customers, target the customer groups they want to serve, market to them (often via insurance brokers), and use underwriting to filter out risks they do not want to take.[28] Alternatively, companies can choose to self-insure. Workers' compensation is similar to social insurance, however, in that it is mandatory for all employers. Because some companies might not be able to find insurance in a completely free market—for example, because their operations present new types of risk that no insurer has experience with—most states operate a state insurance fund that will sell insurance to any company. In addition, because insurance companies can fail, states administer guaranty associations that will pay claims on behalf of insolvent insurers. Many states also closely regulate the rates that insurers are allowed to charge to their customers, essentially as a matter of public policy.

[28] In North Dakota, Ohio, Washington, and Wyoming, workers' compensation insurance is provided solely by state insurance funds, although companies can self-insure in some cases.

In summary, although most workers' compensation polices are sold by private parties, the net effect is that all employees are guaranteed the same state-mandated benefits at prices overseen by the state. From the employer's perspective, the difference between a required insurance premium and a tax is relatively small.[29] Experience rating imperfectly limits the degree of cross-subsidization within the pool of insured firms, but rate regulation can effectively subsidize the entire employer sector by suppressing insurance premiums. The resulting system is broadly similar to unemployment insurance, although the latter is administered by the state rather than by private insurers. As with other social insurance programs, there are certainly people who are made worse off by workers' compensation insurance and would rationally opt out: wealthy executives with good health plans, for example, who do not need insurance and would prefer to get their workers' compensation premiums (that is, the premiums their employers pay to insure them) in cash. For many people entering the workforce, however, the workers' compensation requirement is a good thing because they may value the insurance now or in the future, but might not be able to negotiate for it in the labor market or buy it in the private insurance market.[30]

[29] The major difference is that the employer has some ability to look for a lower premium in the market.

[30] In theory, one could imagine a world in which some firms carry workers' compensation insurance, others do not and pay slightly higher wages, and employees sort themselves between the two. Historically, however, workers' compensation insurance did not become widely available until after state laws made it mandatory. Workers' only remedy in case of injury on the job lay in tort claims against employers, which were rarely successful. Reliance on tort liability also posed the risk of large judgments for employers and arguably did not create the appropriate incentives to prevent accidents (Moss 2002, pp. 162–69).

These similarities should be no surprise, since universal workers' compensation insurance was established as a result of political pressure and for reasons of public policy, not by market forces (Moss 2002, pp. 162–69). The historical difference between workers' compensation and unemployment insurance is that the former was enacted in the 1910s, when government-run insurance was an anomaly, and the latter in the 1930s, when the Great Depression and the New Deal made the idea of government administration politically acceptable.

Even automobile liability insurance, however, bears several of the traits of social insurance. Although most people purchase personal auto insurance from private companies in a competitive market, they are required to carry minimum liability coverage by state law. Liability insurance protects drivers from having to pay for the losses they cause to third parties. If those losses exceed the driver's assets, any insurance benefits the injured party and not the driver; therefore, people will tend to undervalue liability insurance, buying too little of it or even none at all (Smith and Wright 1992). Mandatory liability insurance ensures that victims of automobile accidents are not forced to absorb all of the losses caused by uninsured drivers.[31] This spreads the risk of accidents more widely than would be the case in a purely free market, as does typical social insurance: drivers with few assets, who face little financial risk and might prefer not to buy insurance, cannot escape sharing at least some of the aggregate risk. Because they are forced to buy insurance that does not benefit them, there is some redistribution from them to everyone else (the prospective victims of the accidents that they cause). In addition, with mandatory insurance, there must be some mechanism to provide coverage to people who would otherwise be uninsurable, such as a young driver with a record of multiple serious accidents. Some states

[31] This protection can be secured by buying uninsured motorist coverage, but this essentially forces the insured to pay ex ante for accidents caused both by her and by uninsured drivers.

place uninsurable drivers in an assigned risk pool and essentially force insurers to sell them policies at regulated rates. To the extent that these policies are priced below their actuarially fair value, drivers in the assigned risk pool are subsidized by other drivers.[32]

Minimum liability insurance requirements cause risk to be spread more broadly than it would be in a purely private market; people who would rationally prefer not to have insurance are forced to bear some of the collective risk. In addition, states regulate auto insurance rates both because of perceptions that certain rating factors are unfair or inappropriate (credit score, for example) and because of voters’ desire for lower premiums (Jaffee and Russell 1998). In addition to their efficiency costs, underwriting restrictions and price constraints have redistributive effects that are justified either on fairness or affordability grounds. The net effect of these government interventions in the auto insurance market is to cause some drivers to pay more than their expected losses for insurance while others pay less. From a longer-term perspective, however, those who do not know to which category they will belong several years in the future could plausibly support the existence of such a system.

The health insurance regime established by the Affordable Care Act is another hybrid of private insurance and social insurance principles. Private companies compete by offering health

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[32] No-fault insurance goes further by limiting the extent to which people who cause accidents suffer the consequences of liability, since one driver ordinarily cannot hold another liable for damages (although there are frequent exceptions). While mandatory liability insurance is based on the premise that automobile accidents are an inherent risk of modern living against which everyone should be protected, no-fault insurance is based on the additional premise that accidents are somewhat random events and the people who cause them (according to common law tort rules) should not bear a disproportionate share of their costs.

plans to individuals and small businesses on exchanges run by states or by the federal government, but are subject to underwriting constraints to ensure that poor risks are not priced out of the market. Individual and employer mandates require most people to purchase insurance or pay a penalty, which is meant to ensure near-universal coverage. Like workers' compensation, this health insurance system seems like social insurance administered through private companies. In the short term, many people can estimate whether the Affordable Care Act makes them better or worse off; but in the long term, the Act's mandates and underwriting restrictions provide valuable insurance against the possibility of developing expensive, chronic illnesses.[33]

I do not claim that there are no real differences between private insurance and social insurance. There are, however, many different forms of government intervention in insurance markets that increase the population over which risk is spread, redistribute resources among groups in the short term (typically by forcing people to buy insurance they may not want), and arguably provide legitimate insurance benefits to most people over the long term. These interventions make private insurance function more like what we typically call social insurance.

B. Public Assistance

Earlier I described Social Security, Medicare, and unemployment insurance as programs that do little to shift risk in the short term but make sense as insurance when viewed over a longer timeframe. These observations can also apply to other programs such as Medicaid that are

[33] Even before the Affordable Care Act, however, health insurance for the non-elderly was not a simple free market. Most notably, the tax exclusion for employer-provided health plans represents a major subsidy to employees with such plans—paid for by taxpayers, whether or not they benefit from the subsidy. This constitutes a perverse kind of risk spreading: people with employer-based health coverage can offload some of their health risk onto the population at large.

generally considered public assistance rather than social insurance. With unemployment insurance, the bargain is that contributions today are exchanged for benefits in case of involuntary job loss in the future. With Medicaid, the bargain is that individual income taxes (and relatively small amounts of other taxes) today are exchanged for health benefits in case of poverty in the future. The same distributional characteristics apply: rich people who pay high taxes and have little chance of becoming poor are likely to be net losers, while young people with uncertain prospects are more likely to benefit from the insurance.

In these respects, there is no clear difference of kind between Medicaid and unemployment insurance or any other social insurance program. Medicaid does depart from the textbook social insurance paradigm in that it is not financed directly by contributions paid by or on behalf of employees. But this is arguably a difference more of framing than of substance. On the front end, Social Security contributions are 12.4 percent of wage income up to a cap ($117,000 in 2014). There is no dedicated Medicaid tax. Congress, however, could create a Medicaid payroll tax equal to 4.4 percent of wage income up to the same cap and simultaneously create a refundable income tax credit of exactly the same amount.[34] This would have no economic effect on anyone, yet it would give Medicaid the dedicated financing mechanism

[34] In 2012, total Social Security payroll tax receipts were $589.5 billion, at a rate of 10.4 percent (reduced from 12.4 percent for two years only by the December 2010 tax cut) (*The 2013 Annual Report of the Board of Trustees of the* Federal *Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, p. 6). Total federal Medicaid spending was $251 billion, or 4.4 percent of the Social Security payroll tax base (CBO 2013a). This analysis ignores a couple of loose ends, such as state Medicaid spending and the fact that the level of the Medicaid payroll tax would have to be set every year, but the basic principle is the same.

supposedly typical of social insurance. On the back end, a dedicated trust fund is only distinguishable from general revenues if the trust fund imposes a hard constraint on program spending. In the past, however, Congress increased funding for the Social Security trust funds when their solvency was threatened;[35] it remains politically likely that Congress will take corrective action before letting the trust funds run dry.[36] In effect, the trust fund mechanism is simply a means of documenting a preference for a certain relationship between taxes and benefits—a preference that can and almost certainly will be revisited when necessary.

The final way in which Medicaid does not conform to more traditional social insurance programs is that there is no explicit work requirement to qualify for benefits. Again, this is less of a difference than it may seem. For example, Medicare actually does not have a work requirement. Any U.S. citizen or permanent resident over the age of 65 can buy Part A by paying a monthly premium (which is waived for people who have sufficient work credits), and can buy Part B simply by paying the same monthly premium as people with work records.[37]

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[35] Social Security Amendments of 1983, Pub. L. 98-21, 97 Stat. 65.

[36] Federal backstop entities with "dedicated" funding mechanisms have often bailed out by general revenues when faced with the prospect of insolvency, including the Federal Savings and Loan Insurance Corporation during the savings and loan crisis of the 1980s and the National Flood Insurance Program after Hurricane Katrina. The federal government even bailed out non-governmental backstop entities Fannie Mae and Freddie Mac in 2008 during the financial crisis.

[37] Centers for Medicare & Medicaid Services, "Original Medicare (Part A and B) Eligibility and Enrollment," http://www.cms.gov/Medicare/Eligibility-and-Enrollment/OrigMedicarePartABEligEnrol/.

There are some Medicaid recipients who neither have worked nor are the spouse or dependent of someone who has worked. These individuals arguably have never paid into the system at all (outside of the state sales taxes that partly fund Medicaid)—something that could never happen with Medicare. But for most people, Medicaid is functionally similar to Social Security, Medicare, or unemployment insurance: you pay taxes in one period and collect benefits in another in certain states of the world. Most importantly, Medicaid shares with typical social insurance programs the feature that it looks like a tax-and-transfer scheme from a one-year perspective but spreads risk among participants (all residents) over a longer time horizon. In the short term, there are clear winners and losers; in the long term, as the risk-spreading function becomes more significant and the value of the insurance increases, more people are made better off by the program's existence. It is plausible that fewer people would choose to participate in Medicaid than in Social Security or unemployment insurance, if given the option, because Medicaid's stringent eligibility thresholds make it less likely that a given person will benefit from it in the future—but this is a difference of degree, not of kind. Medicaid still has insurance value for people who are not current beneficiaries, which may help explain the program's enduring popularity.[38]

This is one reason why it is difficult to draw clear lines that distinguish social insurance from other public policies that spread risk. Whether a program spreads risk and among whom depends on the time horizon chosen. Over a long enough timeframe, programs like Medicaid,

[38] For example, a 2011 survey found 69 percent of respondents opposed to reducing spending on Medicaid, even in the context of reducing the national debt. *Washington Post-ABC News Poll*, April 14–17, 2011, http://www.washingtonpost.com/wp-srv/politics/polls/postpoll_04172011.html.

Supplemental Nutrition Assistance Program (food stamps), and Temporary Assistance for Needy Families provide valuable insurance even to people who do not currently receive benefits and are unlikely to receive benefits in the next several years. Of course, there are many people who are unlikely ever to qualify for benefits and for whom the marginal tax burden is large enough that any insurance they receive is vastly overpriced. But this is equally true of classic social insurance programs like Social Security and unemployment insurance.

C. Government Programs and Progressive Taxation

There will always be some groups of people who do not currently benefit from social insurance programs. The extremely wealthy, for example, are probably not risk-averse over the range of losses against which social insurance protects; in addition, under most plausible financing schemes, the very wealthy are sure to be net contributors ex ante. Earlier I discussed the perspective of a young person entering the workforce with limited information about her future. But even among people whose working lives have not yet unfolded, some should still rationally oppose Social Security and Medicare based on the information they already possess about themselves and the risks they face. In particular, the very rich know that they are unlikely to need insurance at any point in their lifetimes.

But what if people had to consider public policy choices with no information about themselves? This is the situation behind the veil of ignorance posited by philosopher John Rawls (1971). If people did not know their positions in the income distribution, would they support Social Security, Medicare, and even Medicaid? Rawls seems to have thought so: he argued that one principle that would emerge behind the veil of ignorance is that any inequalities of treatment should be "to the greatest benefit of the least advantaged" (p. 302). That is, to the extent that government policy benefits some people at the expense of others, it should benefit the less-advantaged at the expense of the more-advantaged, which is precisely what both social insurance and public assistance aim to do. People who are alive today need insurance against risks that may materialize during the rest of their lives; people behind a veil of ignorance need insurance against discovering that they have few assets and low incomes, lack valuable job skills, have poor health, and so on. Medicaid and food stamps are examples of that kind of insurance. They generally tend to benefit the least advantaged because they are largely paid for by taxpayers with moderate or high incomes while supporting people with low incomes.[39]

The veil of ignorance can be thought of as the outer limit as we extend our timeframe outward from the typical one-year policy. As the time horizon expands, people have less information about their personal circumstances and therefore face more risk. This decreased information and increased risk make social insurance programs, which may seem like simple transfers in the short term, appear more and more like valuable insurance. At the limit, behind the veil of ignorance, any such program has no ex ante redistributive component because everyone faces the same risks equally (see Sinn 1996, pp. 261–62; Barr 1992, p. 795). From this perspective, public assistance or tax-and-transfer programs can be thought of as a kind of insurance because they effectively spread risk (the risk of poverty) across the entire population. Varian (1980) argues that redistributive taxation can be justified as a form of social insurance because it protects people against variance in their future income streams. Although the veil of ignorance is a purely theoretical construct, it is perhaps most closely approached in the real world by the perspective of parents considering the future welfare of their children. As Sinn (1996, p. 259) argues, "The risk of not having a successful career is substantial for young, and even more so for unborn, children. Knowing these risks, parents may well opt for a program of

[39] On Rawls and insurance, see also Abraham 1986 (pp. 26–29).

income redistribution to insure their children against bad luck in terms of missed opportunities, illness, injuries and an unfavourable endowment of innate abilities."

The programs we think of as social insurance share certain key features: they behave like redistributive tax-and-transfer schemes given short timeframes and full information, and like risk-spreading insurance policies given longer timeframes and less information. This dual nature is characteristic of a broad spectrum of government policies, ranging from tax subsidies for purchasing insurance on the one hand to public assistance programs on the other. At the extremes, free market insurance has (in theory) no ex ante redistributive component, and a pure tax-and-transfer program (e.g., a wealth tax combined with a flat cash grant to all citizens) has no risk-spreading component except behind the veil of ignorance. Between those endpoints, however, there are no clear boundaries where social insurance begins or ends. The crucial function of social insurance, on this view, is using government power to spread risk in ways that very well might fail in the free market (because too many people might rationally decline to participate), but that most people would choose when evaluated over a long timeframe. A wide range of public policies serve this function, to varying degrees.

IV. Labels and Politics

Large federal budget deficits in the wake of the recent financial crisis, coupled with projections of increasing government outlays due to an aging population and increasing health care costs, have made controlling the growth of the national debt a major political issue (see Johnson and Kwak 2012). As the most expensive domestic spending programs other than national defense, Social Security, Medicare, and Medicaid sit at the center of this discussion, and framing plays a crucial role.

The most common label for these programs (as well as TANF, food stamps, and so on) in contemporary discourse is "entitlements." On the one hand, this seems like a reasonable word to use: most of these programs pay benefits to anyone who meets prescribed eligibility criteria and is therefore entitled to them.[40] The idea that participants are entitled to benefits is also consistent with the analogy between social insurance and private insurance contracts (Simon 1986) and may help protect those benefits as inviolate. In the context of federal government programs, however, "entitlement" has had a decidedly negative connotation at least since the 1970s, when it became shorthand for government benefits (Liberman 2012; see also Bernstein 2012). That pejorative tone is related to the usage of the term in popular psychology, as in a "sense of entitlement." Today, "entitlement" is the term of choice among many conservatives to denote government benefits that people expect but do not deserve in some usually unspecified moralistic sense. For example, in his notorious "47 percent" remarks, Republican presidential candidate Mitt Romney said (Corn 2012),

> [T]here are 47 percent who are with [Obama], who are dependent upon government, who believe that they are victims, who believe that government has a responsibility to care for them, who believe that they are entitled to health care, to food, to housing, to you-name-it. That that's an entitlement. And the government should give it to them.

In this context, "entitlements" seem not like insurance benefits earned by prior premium payments, but instead like transfers paid for by someone else. (A few sentences later, Romney added, "These are people who pay no income tax.")

Having recognized the importance of framing, some progressives prefer to use "social insurance" as the umbrella term at least for Social Security and Medicare (e.g., Hertzberg 2013).

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[40] Technically speaking, recipients have a legal right to benefits even in the absence of annual appropriations by Congress (Schick 2007, pp. 209–12).

"Insurance" implies a contractual system in which benefits are earned by paying premiums in a prior period; "social" evokes the notion of social solidarity, while also serving as a vague explanation for all the differences between social insurance and private insurance. I have argued in this chapter that "social insurance" is a plausible label not only for Social Security and Medicare, but also for public assistance programs such as Medicaid; while they differ from private insurance and have clear winners and losers in the short term, they all spread risk when viewed over a sufficiently long timeframe. At the same time, any government program that possesses the key features of social insurance can also be described as a tax-and-transfer scheme, since in the short term certain people are almost certain to pay higher taxes and other people are almost certain to receive benefits. This latter characterization of social insurance as a form of tax-funded welfare programs (Wilkinson 2005; Samuelson 2011) is implied by the conservative rhetoric of entitlements, which contrasts one group of contributors with another group of recipients. At the other end of the political spectrum, proposals to make Social Security more progressive are rooted in a discomfort with the "insurance" aspect of social insurance. If we are willing to jettison the idea of actuarial fairness (that is, the idea that there should be some relationship between contributions and benefits), we could explicitly make the system more redistributive by reducing or eliminating benefits for high earners and raising benefits for low earners.

This debate over labels can never be definitively settled, and not just because of the political stakes involved. It is not clear what evaluative timeframe is appropriate for programs that redistribute wealth in the short term but spread risk over the long term. We might make better policy choices behind the veil of ignorance, but of course it does not exist. Since Social Security is a program that most people pay into for decades before receiving benefits, it makes conceptual sense to think of it as a compact among people entering the workforce at different times with little information about their futures. In a practical sense, however, any working democracy has to take into account the preferences of the entire population, which includes people of all ages. Asking people to vote as if they were entering the workforce (or behind the veil of ignorance) is a thought experiment, not a practical option in a democracy. Social insurance programs will only succeed politically if they can muster the support of a majority of the electorate at a single moment.

As programs that transfer resources primarily to the elderly, Social Security and Medicare enjoy a structural advantage, and not just because people tend to think fondly of their grandparents. As people age, they gain information about their life circumstances. Those who earn high incomes and amass personal savings may, by middle age, wish they had never had to pay payroll taxes for Social Security and Medicare Part A as well as higher income taxes to subsidize Medicare Parts B and D. But by that point, with much of their contributions in the past and all of their benefits in the future, these programs may be a good deal for them on a prospective basis. In other words, by the time people realize that they *would have* been better off without Social Security and Medicare, they will in fact be better off if these programs continue to exist. Politically, these programs can be sustained by a coalition of young people who value the insurance they provide and old people who are currently receiving benefits. (The same could be true of Medicaid because a large proportion of benefits are paid to the elderly, primarily in the form of long-term care coverage (Bernstein 2012b).) Cash assistance is in the opposite political situation. The former Aid to Families with Dependent Children program, for example, was portrayed as welfare for young, single mothers, so it had little perceived insurance value for much of the population.

It is also important to remember that major American social insurance programs do not provide a true contractual commitment to pay benefits in the future in exchange for contributions made today, since the government has the power to change those benefits in the interim—as Congress has done periodically with both Social Security and Medicare. As discussed in Part II, the discretionary nature of benefits weakens the case for applying a long time horizon to such programs because there is no certainty that those programs will exist decades in the future. If we discount future benefits at a high enough rate to account for political risk, then we are left with little more than the short term—and in the short term, social insurance looks a lot like redistribution through taxes and transfers. This is a central reason why opponents of social insurance programs often highlight their long-term solvency risks. If young people can be made to believe that Social Security will collapse, they will evaluate the program over a short time horizon and may rationally oppose it—making that belief self-fulfilling. Conversely, social insurance supporters tend to argue that these programs can be made sustainable with relatively modest modifications (Johnson and Kwak 2012, chapter 7), which should make young people value them more highly and support their continued existence.

Another factor that affects political support for social insurance is rising inequality. Social insurance provides protection against certain risks—most notably the financial risks due to low lifetime earnings, disability, unemployment, or living for a long time after retirement. The greater the perceived risk, the more people value insurance, even if it has a negative expected value for them. Increasing wealth inequality, however, means that there are more very rich people who are unlikely to ever need social insurance benefits and are therefore almost certain to lose money through participation. Perhaps more importantly, low levels of social mobility in the United States (compared to other advanced industrialized countries) mean that people born into the top echelons of the income distribution are relatively likely to stay there (DeParle 2012); lower risk of becoming poor should rationally translate into a lower valuation of social insurance. Together, high inequality and low social mobility could help explain the fact that U.S. social insurance programs tend to be weaker than those of most societies with similar economic characteristics.

Fundamentally, the hybrid nature of social insurance means that any program can always be framed either as risk spreading or as redistribution. Because there is no single correct timeframe over which to evaluate these programs, the debate over whether, say, Social Security is a zero-sum transfer from young to old or a positive-sum insurance scheme can never be definitively resolved. In a democracy, individuals have the right to apply their personal time horizons when making political choices. For example, senior executives with golden parachutes and for-cause termination clauses are perfectly justified in evaluating unemployment insurance from their current situations—and forming a super PAC to campaign against it. The fact that social insurance is itself subject to the political process—for all the rhetoric of contractual commitments, there is no actual enforceable contract—only highlights these basic ambiguities.

In this context, social insurance programs could indeed benefit most people over the course of their lives, but still fail to gain or maintain majority support because people cannot be required to adopt a lifetime perspective in making voting decisions today. It is comparatively easier to explain to someone how a given program is costing her money today than to explain how its insurance features increase her long-term expected utility. It is harder still to convince someone who no longer needs insurance that she should adopt the perspective of unborn strangers when evaluating current programs. The “makers versus takers” rhetoric recently adopted by some conservatives is designed, among other things, to highlight the immediate-term redistributive impact of social insurance as well as other government programs. Defending social insurance programs requires a coalition between people who, at this point, are likely to benefit from redistribution (current Social Security and Medicare recipients, for example[41]) and other people who value the insurance that the programs provide. This, in turn, requires a clear understanding of the long-term risk-spreading function of social insurance programs. This contest between alternative labels may have a significant impact on the evolution of these programs and the degree to which risk is actually shared within advanced industrial societies.

[41] Proponents of restructuring Medicare (for example, converting it to a voucher system) routinely promise to exempt anyone age 55 or higher in order to split this coalition.

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