

Dealing with Social Risks

James Mirrlees

Chinese University of Hong Kong

Brescia, 19 June 2014

Insurance

- There are risks, therefore insurance.
- No point in an insurance contract if not sure.
- Therefore insurance companies like independent risks.
- They do not like clients to know more about the risks than they do.
- And they limit cover when hidden behaviour affects the risk.
- Why do people not take enough of what they offer?

Why not?

- Medical insurance should be taken out at birth. Hard to do.
- Disability insurance not understood.
- Elderly-care insurance too?
- Unemployment insurance.
- Pension, which is partially insurance.
- High cost – transaction and marketing costs.
- Compulsory insurance or Government?

Improving on Private Insurance

- Government may be better at taking on correlated risk, e.g. unemployment.
- Pensions have an element of this. Public health advances make us all live longer.
- Compensation might depend on the state of the economy, or current wages.
- State insurance is better at dealing with asymmetric information: income tax.

Income risk

- Any risk deserves insurance.
- Labour income risk is insured by the labour income tax.
- That should include a basic universal subsidy – partly provided by medical cover, education, basic pension.
- Disability might attract higher compensation.

Capital risk

- Bank deposit compensation on default.
- Raises the question why the personal capital market is so imperfect.
- This assumes negligible moral hazard.
- Why not extend to other assets? Because of moral hazard. But it happens: finance.
- In these cases, partial insurance is appropriate. Regulation needed!