Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 309

Week 4: Universal Programs

I. CBA and Redistribution
   A. At first glance, redistribution automatically fails CBA. Taking money from some and giving it to others does not enrich society, and the “handling fee” is a social cost.
   B. On further thought, however, there are three main ways for CBA to recommend redistribution.
   C. Rationale #1: Redistribution as insurance. The value comes from imagining what people would pay to reduce uncertainty about their welfare.
      1. Not so philosophical: unemployment insurance
      2. Highly philosophical: low-ability insurance
   D. Rationale #2: Redistribution as altruism. The value comes because some people sincerely care about the poor, sick, etc. Even if no individual cares a lot about the poor, it adds up.
   E. Rationale #3: Redistribution as Pigovian remedy. Even if you don’t directly care about the poor, you might want to help them so they don’t commit crime, join revolutions, and so on.
   F. Don’t forget that these rationales could turn out to be SDB!
   G. Redistribution as insurance? If people really want insurance, why can’t markets just provide it? In any case, how can you call a policy “insurance” once you already know your outcome?
   H. Redistribution as altruism? People almost certainly overstate how much they really care. And if it’s altruism, how come there’s almost no international redistribution?
   I. Redistribution as Pigovian remedy for crime and revolution? Then how come there is so little money available for healthy young males?
II. The Leaky Bucket: The Deadweight Costs of Redistribution
   A. You need one of the preceding arguments to establish that redistribution has *gross* social benefits.
   B. Yet that alone does not establish that redistribution has *net* social benefits, because redistribution always has some costs, too.
   C. In addition to transferring wealth, redistribution also destroy some wealth in the process.
   D. The leaky bucket: in the process of transferring wealth, some "slips out," benefiting no one.
      1. Landsburg on "Why Taxes Are Bad.”
   E. How can wealth simply be destroyed? Many ways.
      1. Paperwork and processing.
      2. Production foregone because of taxes

3. Production foregone because of redistribution
4. Diversion of effort into less productive - but less taxed - lines of work
5. Producing things people value less (like medicine) instead of things they value more (like vacations).

F. Basic idea: A tax that can't be avoided ("lump-sum taxes" or "head taxes") merely transfers income. A tax that can be avoided will have deadweight costs because people change behavior to do so.

G. Similarly: Redistribution that you get "just because" merely transfers income. Redistribution that you get for a *reason* will have deadweight costs because people change behavior to do so.

III. Universal Versus Means-Tested Redistribution

A. The latter insight highlights a fundamental distinction between two kinds of redistribution:
1. Universal redistribution that everyone (or at least everyone in a country) gets.
2. Means-tested redistribution based on need or other criteria.

B. Standard argument for universal redistribution: Since everyone gets it automatically, no one changes their behavior in order to get it.

C. Problem: Universal redistribution is *very* expensive precisely because everyone gets it. So even if the redistribution itself does nothing to change behavior, the massive taxes required to fund the universal redistribution will!

D. Furthermore, if you're paying attention, few "universal" programs are universal in every respect, so they still change behavior. Universal health care, for example, gives more to people with poor health, which encourages poor health habits.

E. This week: universal redistribution. Next week: means-tested.

IV. Effective Altruism Versus Universality

A. A major philanthropic movement known as "Effective Altruism" (EA) tries to get donors to use CBA.

B. What's the problem?
1. Ineffective charities
2. Poorly targeted charity
3. Classic example of a cost-ineffective charity: Make a Wish Foundation.

C. Typical EA measure: Maximize lives saved per dollar.

D. EA-favored charities:
1. Deworming
2. Malaria nets
3. Payments for vaccinating kids
4. Give Directly

E. A charity almost all EAs would reject: Giving equally to every person on Earth.

F. Why is this a terrible idea? Because you waste almost all of the money on low priority problems. Using $8B to give $1 to every human is absurd.

G. The EA alternative: Focus on high-priority problems with easy logistics: war orphans, unvaccinated kids, and so on. This yields the biggest philanthropic bang per buck.

H. How is this relevant for universal government redistribution? Existing governments are spending *trillions* of dollars on wasteful philanthropy! Many, perhaps most, of the recipients could easily take care of themselves.

I. This is even clearer once you realize that this money could have been spent on absolutely poor foreigners instead of relatively poor natives.

V. Government Retirement Programs

A. Almost all countries have a universal government retirement program. *Every* citizen gets money from the government once they reach the right age.

B. This is hard to justify with CBA. Taxing everyone to help everyone is futile at best. Further downsides:

1. Extra taxes to fund these massive programs disincentivize work throughout people's careers.
2. Government pensions encourage earlier retirement as well.

C. Why not just have a much smaller program for helping the very poor elderly?

D. Justifications?

1. Insurance. Very weak. Everyone knows they'll be old one day.
2. Altruism. Why care so much about "everyone"?
3. Pigovian remedy. Will the elderly really turn to crime?

E. SDB diagnosis: "Guaranteeing a dignified retirement to every American" sounds great, and the political system barely cares about cost or collateral damage.

VI. The Universal Basic Income

A. Retirement programs are, by definition, limited to the elderly. Many reformers are pushing a much more expansive universal program, the Universal Basic Income (UBI).

B. Key idea: Everyone (or sometimes just every adult) gets automatic free cash from the government if they have $0 income. Every dollar you earn reduces this grant.

C. The cost for any substantial UBI is off-the-charts. The U.S. spent $1.2T on SS in 2022. To give $15k to every American would cost more than 4x that - almost $5T.

D. Who would pay for it? UBI would effectively put the whole tax on a sliver of the population. Exercise:

1. How much money should each person get if they earn $0? Call this M.
2. What fraction of your earnings should you lose if you make an extra $1? Call this T.

        3. Family of four remains a net recipient until family income hits 4*M/T. M=$15,000, T=25% means families over $240k pay for everyone else. That's the 94^{th} percentile of the 2022 family income distribution.
        4. This ignores taxes required to fund all *other* government spending!
    E. Couldn't you fund the UBI by getting rid of all other redistribution? According to the one economist I know of who calculated the maximum annual UBI you could get by eliminating all other non-medical programs: In 2022 dollars, less than $5000.
    F. Got a better idea? UBI is worse than the status quo.

VII. Gratis Health Care Versus CBA
    A. Almost all governments, including the U.S., spend heavily on health care.
    B. The U.S. has two main programs:
        1. Medicare, a universal program for the elderly.
        2. Medicaid, a means-tested program for the poor.
    C. Global aspiration: To make health care totally free. Not just for contagious disease, but for everything.
    D. "Free health care for all" badly fails CBA for standard EA reasons. Giving free health care to people who can pay for it themselves is very wasteful.
    E. Furthermore, giving people medicine instead of cash is also very wasteful. Why? Because people value marginal medicine at less than cost – and the cost is exorbitant.
    F. Remember the diagram: Gratis is not great.

VIII. Free Markets Versus Moral Hazard and Adverse Selection
    A. When economists want to defend government funding of health care, they routinely invoke two textbook arguments: moral hazard and adverse selection.
    B. The idea of moral hazard: Health care is expensive, so people naturally want insurance. Once insured, however, people adopt higher-risk lifestyles.
    C. The idea of adverse selection: For any insurance deal, the most eager customers will be the least healthy. This encourages healthy people to refuse to buy insurance, which amplifies the problem.
    D. These are weird arguments for government funding.
    E. First, there are obvious market remedies for both problems:
        1. To mitigate moral hazard: Limit coverage, and impose punishments for violation. E.g. Refuse to cover smokers, and fine smokers who claim to be non-smokers.
        2. To mitigate adverse selection: Adjust premiums for risk.
    F. Second, while free health care for all does solve the adverse selection problem, it *maximizes* moral hazard!
    G. Third, while some regulations make a minor effect to mitigate moral hazard (e.g. require seat belts), other regulations *greatly* amplify

adverse selection.

1. Limits on risk-adjusted premiums; ban on pre-existing conditions clauses.

H. The best explanation for the status quo, as usual, is just SDB. A free market would charge sick people more, which sounds bad. So governments pass a law saying that everyone has to be treated equally, which leads to high premiums, which in turn fosters demand for universal coverage.