Abstract

This paper studies the effects of social insurance policies on efficiency and distribution of resources in a general equilibrium model of a closed economy with heterogeneous agents and repeated moral hazard. I compare optimal allocations in stationary recursive equilibria for economies with different guaranteed minimum consumption levels (social insurance). I show that the efficiency–equality trade-off associated with social insurance does not hold: Efficiency and inequality decrease as the minimum guaranteed consumption increases to around one third of the average consumption. However, if social insurance expands even further, the efficiency loss becomes very high and inequality increases.

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