COMPETITIVE MARKETS WITH ENDOGENOUS HEALTH RISKS

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Abstract
We study an economy where agents’ productivity and labor endowment depend on their health status, and indivisible occupational choices affect individual health distributions. We show that efficiency requires cross-transfers across occupations. Moreover, workers with relatively less safe jobs must get positive transfers whenever labor supply is not very reactive to wages, a condition in line with the findings of a large empirical literature. In these instances, compensating wage differentials equalizing the utilities of ex ante identical workers in different jobs undermine ex ante efficiency. Moreover, competitive equilibria where only assets with deterministic payoffs are traded are not first-best. Finally, we show that simple transfer schemes, implemented through linear subsidies to health insurance, enhance efficiency. (JEL: D5, D61, D80)

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