

Redistribution versus risk-sharing in a federation: more than semantics?

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Almost all federations have systems of equalization transfers that redistribute among sub-national levels of government on the basis of some measure of fiscal capacity. Such equalization systems can be seen as devices for facilitating the decentralization of fiscal responsibilities to achieve the advantages of subsidiarity without sacrificing solidarity objectives. In many federations, equalizing transfers are a source of political tension, especially so in highly decentralized ones with significant disparities in fiscal capacity (like my home federation, Canada). This is mainly because equalization is considered to be a redistributive program. While recognizing that a risk-sharing function is served by equalization transfers, most public discourse treats the policy objective as mainly one of redistribution rather than risk-sharing.

Such political tension could be at least partly defused if the perception were changed so that the politicians, the public and the pundits all thought of equalization as being a device for achieving efficiency in risk-sharing rather than redistribution. Efficiency after all is a win-win situation, at least *ex ante*, rather than a zero-sum game like redistribution. The perspective offered by Jacques Drèze is therefore most welcome as a potential means of posing the argument of equalization in a way that might lead to general, if not unanimous, agreement.

That said, there are a number of factors that might detract from the view that equalization is essentially an efficiency-enhancing policy of interregional risk-sharing rather than a redistribution policy. They are as follows.

1. An efficient risk-sharing arrangement among regions would almost certainly take as a starting point unequal expected incomes among regions so that all regions gain in expected terms. This would seem to conflict with notions of social citizenship (and solidarity?) that characterize most nations and that require equal treatment of citizens independent of their region of residence.
2. Efficient risk-sharing schemes, as Jacques Drèze emphasizes, are long-run in nature. Indeed, one might expect that their time horizon is far in excess of the lifetime of citizens. In the shorter term, relative levels of well-being across regions are liable to be fairly stable, even if in the longer run expected per capita incomes could be close to identical. In these circumstances, it is not clear that equalization transfers can really be viewed as efficient risk-sharing schemes from the point of view of citizens, as opposed to being redistribution schemes.
3. As Jacques Drèze also emphasizes, efficient risk-sharing agreements require full commitment by the partner regions. It is inconceivable that such commitment will emerge from standard political processes. In at least some federations (e.g., Canada, Germany, South Africa), equalization commitments are enshrined in the constitution. These commitments are typically formulated in terms of redistribution, though one could give them a risk-sharing interpretation. Note, though, that constitutions implicitly treat all citizens as *ex ante* equal, so risk-sharing might be better thought of as social insurance (in the Harsanyi-Rawls sense) than insurance in the purely efficiency sense.
4. Finally, a minor observation concerns the interpretation of risk-sharing at the regional level, the so-called Stage (4b). In fact, equalization transfers among regions in practice do not attempt to equalize per capita incomes across regions. Rather, they equalize the ability of regions to provide public services, often by equalizing the ability to raise revenues. Such risk-sharing of private incomes as exists is done through inter-personal redistribution.

These caveats aside, viewing interregional transfers from the perspective of risk-sharing undoubtedly takes some of the edge off the kinds of disputes that arise in federations where such transfers are thought of as devices for redistribution. The extent to which interregional transfers in fact assume a risk-sharing rather than redistribution function probably depends upon the regional nature of the federation itself. In the case of geographically large federations such as Australia, Canada and Russia, it seems to be the case that some regions are more or less permanently better off than others so that equalization is more redistributive than risk-sharing. In smaller, geographically homogeneous federations like Belgium and Germany, there is perhaps more scope for pure luck in determining the relative fortunes of regions over time. In this case, the risk-sharing perspective makes a lot of sense.