Reply

by Jacques H. Drèze

Comments on the texts of my discussants

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1. First of all, I feel deeply gratified and grateful that a number of distinguished scientists have taken the trouble to read and complement my modest note, and this in spite of being given a very short notice. Beyond the response to a challenging topic, there are expressions of friendship, which I duly appreciate. Also, I wish to thank and congratulate the "moderator" André Decoster who did a perfect job of arranging this varied and constructive discussion.

A major benefit of the discussion is that it has brought in specialists of public choice, federalism or justice, who are much better equipped than myself to deal with some of the complexities of our subject. As mentioned at the outset, my own contribution is limited to spelling out the implications of risk-sharing theory for our topic. My comments on further issues are mostly meant to bring out the *limitations* of the risk-sharing approach. Thanks to the discussants, these limitations have received more, well-deserved attention.

Rather than reacting to each discussant in turn, I shall limit myself to a few comments on *issues* under discussion, without giving each discussant explicit credit for every issue raised. There is indeed much convergence in the independent contributions – a positive feature in its own rights – and separate reactions would be repetitive. Also, reacting to issues provides an opportunity to *clarify* some points treated too concisely in my note. My global reactions will be followed by natural conclusions about where to go from here.

2. Bringing in the risk-sharing viewpoint automatically raises the difficult problem of **disentangling risk-sharing from redistribution**, a problem recognised by most commentators and discussed by Philippe, Pierre, Robin, Jean, Christian… In my view, *a clear distinction is possible when looking forward* – though not when assessing the current situation. Indeed, when looking forward, one can *separate logically expectations of a variable and its deviations from expectations*. (Easier said than done – but the logical distinction is clear). One then regards mutualisation of the deviations from expectations as a pure risk-sharing operation; this automatically relegates to expectations any redistributive consideration. And the expectations are related to *initial conditions*, which offer scope for redistributive transfers. In contrast, when assessing the current situation, the risk-sharing aspect is *implicit* in the observed allocation. To "disentangle" it from redistributive transfers, one is led to bring in the "veil of ignorance". Philippe and Pierre remind us meaningfully of the limits of that concept.

Thus, I do not plead guilty to "collapsing" the distinction between redistribution and insurance into the distinction between static and dynamic solidarity, as suggested by Philippe. It is *only when looking forward* that the two distinctions coincide; when assessing the current situation, the distinction between static and dynamic solidarity looses its edge, and only remains helpful if it helps to disentangle redistribution from the impact of *earlier insurance.* Also, the framework within which I have separated the static/dynamic dimensions is unidimensional: "real disposable incomes per capita". I would not claim that the distinction remains clear-cut in higher-dimensional frameworks.

I have used as an illustration the possible regionalisation of Belgium's public pensions, pointing to the need for initial transfers corresponding to the present value of entitlements linked to past contributions. *Looking forward*, the different regions would face different evolutions, linked both to demography and to revenues. *For given levels of working-life* *contributions, retirement ages and post-retirement incomes*, one can attempt to define expected values of net financial balances. These expected values are apt to differ across regions. *Solidarity among all Belgian citizens* would militate in favour of additional initial transfers correcting the unequal burden of pensions across the regions. These additional transfers would be *redistributive*; what is more, they would permit any degree of redistribution across the regions. At the same time, an efficient risk-sharing arrangement calls for mutualising the deviations of actual net balances from expectations. I maintain that *the logical distinction is clear-cut* – while fully recognising that implementing this two-tiered approach is overloaded with practical difficulties.

My illustration invites three further comments. First, the previous paragraph singles out the *interregional dimension*. It fails to bring in, for instance, the *intergenerational dimension*, which is at the heart of today's ageing problem. Taking that other dimension into account, as suggested more generally by Erik, reveals that mixing interregional with intergenerational solidarity opens prospects that the two-tier approach eliminates (Philippe should like this…).

Second, regionalising pensions opens the way to different regimes in the different regions. As Robin and others note, this violates "equal treatment of citizens independent of their region of residence". I have labelled that violation "a natural implication of subsidiarity", while acknowledging the scope for differences of opinion… The differences are indeed with us!

Third, Philippe raises the issue of a possible difference between concepts of justice applied to interpersonal redistribution versus concepts of justice applied to interregional or international redistribution. I side with him in longing for a global approach to justice. More modestly, I note (under **5.**) that we are about as far from global risk-sharing as we are from global justice…

3. The other contribution of risk-sharing analysis consists in bringing out the long-run nature of our problem. There seems to be general agreement on this point. It brings in the issue of **long-run commitment**, which receives a lot of attention from Johannes, Christian, Jean... I was thereby led to formulate (more explicitly than in a preliminary draft) my *illustrative scheme* of debt exchange. This area is wide open for further exploration. All the more so that several discussants contrast this long run with the short-run horizon of politicians – or even, as Robin notes, with the lifetime of citizens…

Regarding more general problems of implementation, there is again much agreement, and several additional themes are introduced. For instance, Philippe mentions explicitly the potential role of *economies of scale* (which I have left implicit under the broad umbrella of "externalities"). He is also right in spelling out that "mobility" includes *commuting as well as migrating*. Referring to Brussels and its periphery, he concludes that migration and commuting rule out regionalisation of social security. The experience elsewhere (Washington, Monaco…) might suggest otherwise – but these areas are unilingual!

There are some interesting variations on the theme of *incentives versus moral hazard*, with Philippe seeing in local incentives "a way of tracking collective moral hazard" not available under centralisation.

The issue of *trust*, aptly brought in by Erik, is important. Erik writes: "..at the Flemish side, there is a deep lack of confidence in the French-speaking politicians". I am not surprised! He contrasts this with "..a large degree of trust in the existing social security system" – and concludes with a preference to "keep the financing structure as it stands". Definitely instructive – also for someone like me who thought that "trust in autonomous Flemish institutions *alone*" was the underpinning of separatist tendencies…

4. To conclude, the need for **case-by-case empirical investigation** of the many issues raised in the discussion is largely confirmed – all the more so that few if any references to such investigation with Belgian data are offered here.

But there also remain **theoretical issues** deserving continued attention. The list includes the distinction between risk-sharing and redistribution or the role of local incentives in containing public moral hazard.

On both fronts, the Re-Bel initiative stands positively encouraged!

At this stage, some of us (including Erik and Philippe, two Re-Bel founding fathers...) conclude that regionalisation of social security in Belgium would be premature, to say the least. While others stress that pressures in that direction will not abate. Listing interregional risk-sharing as a prerequisite of efficient regionalisation may or may not prove convincing. But failure to stress the point would be irresponsible.