Trust and social insurance

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Jacques Drèze offers an original perspective on the interaction between subsidiarity and interpersonal solidarity. First, once we understand the importance of risk-sharing, many welfare state institutions that at first sight look purely redistributive ex post, are better seen as the reflection of an insurance contract, that is efficient ex ante. The welfare state is largely a matter of long run self-interest. Second, from an efficiency point of view, the wealth base over which risks are shared should be as large as possible. In principle, risks should be pooled and shared worldwide and over the infinite future. Decentralization remains possible through the tiered implementation of the principles of efficient risk sharing. Such tiered implementation implies (and this is Drèze's final proposition) that, in order for any form of regionalisation entailing potential transfers of public resources to be ex ante efficient, it should be accompanied with some mutual insurance of the risks affecting real regional incomes per capita in the long run. I agree.

Of course, there remains the question when and why it would be preferable to move to tiered implementation. In a first-best setting, tiered implementation (let us call it "decentralized financing") does not do better than the one-stage ("federal") approach. In a second best-setting the decentralized financing approach may do better, as it would permit to adapt policies, region by region, to local institutions and objectives, and to provide better focused incentives to local agents and decision-makers. However, it also raises specific problems and whether it actually does better is an open question, left to case-by-case empirical research. In this respect, Drèze mentions two important issues. First, with regions pursuing independent policies there may be a problem of moral hazard at the level of the public authorities. Why would a government take hard measures to stimulate real income growth if other regions will come to the rescue if things go wrong? Second, with mobile labour and capital the public policies adopted in one region will restrict the feasible sets of the other regions.

I would add two other issues to be investigated. Even if we agree (I think that everybody does), that some decentralization is useful or even necessary, it is not obvious that the relevant tiers to be considered should always be the regions and the federation respectively. The Belgian system of health insurance offers a good example: if we want to give more regulatory power to the sickness funds (a policy direction I would strongly advocate), we are faced with the issue that these sickness funds are organized beyond the regional boundaries. Second, in some cases it is possible to create room for separate policies and to introduce incentives that are more adequate without breaking the federal financing structure. This point is well illustrated by Bruno Van der Linden (2008)'s reflections on labour market policies. Like Jacques Drèze, I do not want to submit these examples as specific policy recommendations. What I suggest is that considerations like these should be taken up in the case-by-case empirical research that he is advocating.

I am more concerned about a broader (possibly non-economic) issue. While I fully agree that the interpretational move from "solidarity" to "insurance" is of essential importance, it does not remove the challenge of fostering sufficient social support for the welfare state. To set up a system of social insurance in a second-best world, trust is needed. This is true both within a one-stage and within a tiered implementation approach. People have to be confident that there will be sufficiently strong institutions to solve the commitment problem and to fight moral hazard. Moreover, perhaps even more fundamentally, they need to agree about what is moral hazard. While this may seem straightforward from the point of view of economic theory, it is much less straightforward in specific policy applications and in the eyes of the public. The examples abound. Opinions differ about whether poverty is due to circumstances beyond individual control, or whether it is due to moral hazard and laziness (Fong, Bowles and Gintis, 2006). Opinions differ about what degree of job search should be expected from the long term-unemployed. Opinions widely differ about what is moral hazard in health care, in a situation where even the medical professionals do not always (or almost never) agree about what is adequate care and what is "overconsumption" in specific cases. My point is not that these questions cannot be answered; my point is that setting up a social insurance system requires a degree of shared understanding of these issues by the citizens.

Building up such a shared understanding will most probably not be made easier by moving into the direction of tiered implementation. Let us look at the facts. As emphasized by Drèze, in the world today there are social insurance (and redistributive) systems within nation states, but at the same time the sharing of global risks among states is altogether missing, even in the EU. Why is this the case, if we know that it would be efficient to pool and share risks worldwide and over the infinite future? The answer to this question is multi-faceted, but I suggest that part of the explanation lies in the difficulty of creating a shared understanding across national boundaries. Even in an insurance setting, it is necessary that people have the feeling to participate in one overall community confronted with a shared fate. After all, some nationalistic groups would hold that a restricted definition of what is the "relevant" community is not only unavoidable, but even desirable: if they were familiar with Drèze's argumentation, they certainly would accept a loss of "long term insurance efficiency" to safeguard their own (narrowly defined) national identity.

Back to Belgium. In the context of rethinking Belgium's foundations, we should not forget that, contrary to the EU (or the world), Belgium now has a federal financing structure in place. Moving in the direction of tiered implementation means breaking up (or at least, strongly reforming) the existing federal system. Incentive problems obviously make the present institutions far from perfect, but would the move to (an also imperfect) tiered implementation system keep us at the same overall level of insurance? I have my doubts.

The institutional reform advocated (or, better, described) by Drèze is only possible with a strong degree of social support by the population (or by the populations in all the regions). At this stage, Belgians at both sides of the linguistic border generally have a large degree of trust in the existing social security system and in the welfare state, institutions that are still organized at the federal level. At the same time, at least at the Flemish side, there is a deep lack of confidence in the French-speaking politicians. (I do no want to venture any hypothesis about the level of trust in Flemish politicians among French-speaking Belgians, but I have the strong impression that the situation is symmetric). In my view, the political debate is coloured more by concern about moral hazard at the level of public policies than by concern about the inefficiencies within the existing social security system. At the same time, strong (and credible) institutions to tackle the moral hazard and the commitment problems would be needed. While clever financial innovations may help a lot, the electorate will not necessarily understand them – and, if not, where are we going to find the politicians who will defend them? In the short run, i.e. in the present political context, I wonder what would be the outcome of negotiations on a long-run agreement between the regions.

I am afraid that the problem would only get worse in the long run. The present federal structure of social insurance leads to transparent transfers from the healthy to the sick, the rich to the poor, the young to the elderly, whatever the language they speak. Transfers between regions are a by-product. On the contrary, thinking explicitly about interregional solidarity, focuses attention on regional identities. Would this help in keeping the interregional solidarity intact? Note that in the long run, causality probably goes in both directions. Feelings of a shared fate are not only necessary for creating strong social insurance institutions, they are also influenced by the existing institutions. The remaining feelings of a common understanding in Belgium are certainly influenced by the mere fact that we now have federal social insurance institutions in place. Breaking up these institutions would bring us in the longer run in the EU or in the world situation. Are we then not (deliberately) undermining the (now still existing) common understanding of what are social risks?

As Jacques Drèze emphasizes, his purpose was to clarify some basic issues, not to voice recommendations. In my view, he fully succeeded in introducing an attractive framework to think about the interaction between subsidiarity and interpersonal solidarity. Without that framework, I could not even have formulated my concerns in the way I did. From an academic point of view, Drèze's framework suggests a rich research agenda. I mentioned already the many open empirical questions that are well in the domain of traditional second-best public economics. I suggested that there is also a host of fascinating questions on institutions, intercultural diversity and identity, a research domain that is rapidly gaining popularity within economics.

Impatient policy-makers and citizens usually hate the conclusion that there is an interesting research agenda for academics. They want to move forwards. So: should we now, given the present state of our knowledge, move in the direction of tiered implementation? This move is risky and the jury is still out on crucial empirical issues. My preference therefore would be to keep the financing structure as it stands but to look for arrangements to introduce better-focused incentives for all players, including the regional governments, within that broad structure. This search for better incentives should be taken seriously, and should not be blocked by short-sighted defence of vested interests. Even for these more limited approaches, the coherent theoretical framework offered by Drèze is extremely helpful. Moreover, in the present Belgian context, it has strategic advantages. The crucial insight that, even for the presently wealthier regions, it is optimal to have a long run insurance system in place, is an essential element, which could perhaps help to have a more detached and open discussion on subsidiarity and interpersonal solidarity. Without such an open discussion, there is a real danger that Belgium will move into the direction of decentralized implementation, but without an adequate sharing of the risks between the regions. I fully agree that this would lead to a welfare loss for all regions.

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