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SYMPOSIUM INTRODUCTION

Risk pooling, reciprocity, and voluntary association

Michael Otsuka

Department of Philosophy, Rutgers University, New Brunswick, NJ 08901, USA
Email: michael.otsuka@rutgers.edu

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What follows is a sketch of three of the main claims of *How to Pool Risks across Generations: The Case for Collective Pensions* (Otsuka 2023) with which my symposium commentators critically engage: namely, that (1) by efficiently pooling risks across as well as within generations, (2) collective pensions can realize a form of Rawlsian reciprocity involving fair terms of cooperation for mutual advantage, (3) through the voluntary binding agreements of individuals to join a mutual association that provides social insurance. I respond to their challenges to these claims in my replies that follow their contributions.

1. Risk Pooling

Otsuka (2023) opens with an investigation of the longevity and investment risk that lone individuals face in providing for their old age. From this atomistic starting point, it builds up, within and across the chapters, to increasingly collective forms of pension provision. With defined contribution retirement savings plans involving the drawing down in old age of the income they have saved during their working years, individuals bear the risk on their own of living so long that they end up in poverty by outliving their savings. One can address this problem by means of a life-cycle de-risking of the assets in one's pension pot from equities into bonds during the years leading up to retirement, to facilitate the purchase of an annuity from an insurance company to provide a guaranteed stream of income for as long as one lives in retirement. Such de-risking and annuity purchase involves the considerable sacrifice of the higher expected returns of remaining fully invested in equities.

The mutual association of collective pensions provide various means to avoid this sacrifice. By joining together into an arrangement known as a tontine, whereby the assets of those of a similar age who die earlier are redistributed to those who manage to outlive them, we can more efficiently tame the risks we face as individuals, each with our own private pension pot. The tontine's pooling of longevity risk eliminates the need for an annuity and therefore to expensively de-risk assets in the lead up to its purchase at point of retirement. To manage the investment risk that remains, the entire age cohort can de-risk their assets from equities to bonds as they collectively draw them down during retirement. The delaying of de-risking to retirement years increases, to the entire span of their working lives, the period during which people can remain fully invested in higher-return equities.

The need to de-risk assets during the retirements of individuals can be eliminated by pooling risks across different age cohorts. Such pooling is made possible by the creation of the enduring corporate body of a collective pension scheme that spans multiple generations. Even though all individuals age and die, such a collective remains evergreen, as the average age of members is stabilized through the influx of new members to replace those who retire. These new members provide a steady stream of incoming contributions out of savings from the income of their productive labour. Such constant replenishment of the funding of the scheme obviates the need to collectively draw down its assets to any significant degree, to pay promised pensions as they fall due. By thereby avoiding the risks of disinvestment, the scheme can safely remain fully invested in higher-risk assets with higher expected returns, to provide each of the individuals who constitute this collective a much better pension than she could expect to generate through her own private pension pot.

2. Reciprocity

As I have spelled out in the previous section, collective pensions provide a solution to the problem we would otherwise face of living so long that we find ourselves lacking sufficient resources to sustain ourselves and prosper throughout retirement. This solution is realized through the continual transfer of the fruits of the labour of those who are relatively young, healthy and able-bodied to those who are elderly, no longer in work, and often infirm, in a manner that involves cooperation over the life cycles of overlapping generations. Rather than as the redistribution of resources between distinct individuals to eliminate unchosen misfortune, these transfers can be conceived and defended as fair terms of social cooperation in the division of the fruits of the labour of workers which is to the expected benefit of each. Such terms involve a form of reciprocity, which Rawls (1993: 17) describes as 'a relation between citizens expressed by principles of justice that regulate a social world in which everyone benefits judged with respect to an appropriate benchmark of equality'.

A collective pension can be justified as a 'social union of social unions', formed by reciprocal agreements to pool risks. Each first-order social union is created by a set of covenants that unites the members of a cohort who will retire at the same time into the mutual association of a tontine arrangement. Such covenants are to the mutual benefit of each, as they pool and tame the longevity and investment risks that each faces as an individual. The different cohorts in turn will find it rational to enter into covenants with one another in order to pool the investment risks that remain. They agree to transfer from those cohorts whose invested contributions exceed the expected growth rate to those cohorts whose investments fall short.

3. Voluntary Association

To pool investment risks across generations, it will be necessary to take steps to ensure that the collective pension scheme remains stable on an ongoing basis, with a steady influx of new members. This is incompatible with the freedom of scheme members to opt out without financial penalty whenever collectivization would be less advantageous than what they could reap if they remove their per capita share from the collective and invest it on their own. I maintain that steps can be taken to stabilize a collective scheme without the need for a requirement of compulsory, permanent enrolment into it.

Without undermining risk pooling, workers could be provided with the freedom to choose or decline a pension on the following terms. They could be provided with the choice of entering into a collective risk-pooling arrangement when and only when they *join* a pension scheme at the outset of their working lives upon reaching the age of majority. Having signed up, they would need to remain collectively invested from that point onward, or else pay a heavy penalty for withdrawing. At the outset, but *only* at the outset, they would also have the choice to invest entirely in their own private pension pot, which provides them with complete freedom to cash in, or draw down, etc., when they retire. All this would be consistent with individual freedom, assuming, as one should, that freedom encompasses the right to bind oneself. The non-paternalistic point of such binding would be to prevent rational defections from a pension scheme that would destroy the cooperative benefits of risk pooling. Such binding therefore makes a valuable option possible which would not otherwise exist and thereby enhances the range of available options among which people can freely choose.

I maintain in Otsuka (2023: Ch. 4) that, at point of entry at the beginning of one's adult working life, each will be choosing under a fairly thick natural veil of ignorance regarding his or her own prospects for a long life and for a retirement when the stock market is bullish rather than bearish. In large part because known longevity and investment risks are both significant and roughly equal at an early point of entry into the scheme, most will have compelling reasons of self-interest to damp down these risks, by means of their pooling of risks in a collective pension scheme, rather than going it alone. It would be rational for them to enter into an agreement with others, who also do not yet know their fates, that, if one turns out to be among the unfortunate whose private pension pots would not have yielded enough for one's retirement, one will receive much more in retirement, whereas those whose pension pots would have overflowed their retirements will receive somewhat less. It would be rational for them to agree to share one another's fates by pooling risks across both space and time, on fair terms of social cooperation for mutual advantage.

Competing interests. None.

References

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Michael Otsuka is a Professor of Philosophy at Rutgers University–New Brunswick. Prior to his arrival in Rutgers in 2022, he taught in the Philosophy Departments at UCLA, University College London, and the London School of Economics. *How to Pool Risks across Generations* is a revision and expansion of a series of Oxford Uehiro Lectures in Practical Ethics that he delivered in 2020.

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