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Sharing Risks

On Social Risk Management and the Governance of Labour Market Transitions

discussion paper

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ABSTRACT

This is a paper based on the annual lecture in honour of Hugo Sinzheimer at November 10, 2005, Hugo-Sinzheimer-Institute at the University of Amsterdam. In 1928, Sinzheimer wrote an article entitled *“Die Demokratisierung des Arbeitsverhältnisses,”* (The Democratisation of the Employment Relationship). His references to unemployment insurance that had been enacted just one year earlier went beyond the participation of trade unions and employers in administration as an essential element of democratization. Sinzheimer put even more emphasis on another aspect of democratization, namely, the enlargement of the risk-sharing community to embrace all workers, indeed, the whole economy. The argument of the paper is that sharing risks through universal and state-guaranteed unemployment insurance is still as valid as in the time of Hugo Sinzheimer. There is no reason to roll back the welfare state. On the contrary, there are strong reasons to defend the principle of social insurance. By combining a kind of work-life insurance with soft forms of governance, this principle—that of “sharing risks”—can even be extended to include the new risks related to critical events during the life course. The argument is developed by answering the following questions: First, what are the new risks to which established insurance systems have to respond? Second, what are the advantages of social insurance compared to private savings? Third, how should we share for example the risks related to parenting and to continuing education and training? Fourth, how do we overcome risk-aversion to stimulate more individual risk-taking and thereby more responsibility?

ZUSAMMENFASSUNG

Dieses Papier basiert auf der jährlichen Vorlesung zu Ehren von Hugo Sinzheimer am 10. November 2005, Hugo-Sinzheimer-Institut der Universität Amsterdam. Sinzheimer schrieb 1928 einen Artikel über "*Die Demokratisierung des Arbeitsverhältnisses"*. In diesem Artikel hob er nicht nur die Beteiligung der Sozialpartner an der Verwaltung der Arbeitslosenversicherung, die gerade ein Jahr zuvor in Kraft getreten war, als einen Fortschritt der Demokratisierung hervor. Vielmehr betonte er einen anderen Aspekt der Demokratisierung, nämlich die Erweiterung der Risikogemeinschaft auf alle Arbeiter, ja auf die gesamte Wirtschaft. Das Argument dieses Papiers ist, dass eine universelle und staatlich garantierte Arbeitslosenversicherung nach wie vor gültig ist wie zu Zeiten Hugo Sinzheimers. Es gibt keine Gründe, den Wohlfahrtsstaat zurückzufahren. Es gibt sogar Gründe, das Prinzip der Sozialversicherung auf neue Risiken des Arbeitsmarktes auszudehnen. Durch die Kombination einer Art Arbeitslebensversicherung und weicher Formen von Steuerung kann das Prinzip solidarischer Risikoteilung auch auf die Einkommensrisiken im Zusammenhang mit kritischen Ereignissen im Lebenslauf angewendet werden. Dieses Argument wird durch die Beantwortung folgender vier Fragen entwickelt: Erstens, welches sind die neuen Risiken, auf die etablierte soziale Sicherungssysteme zu reagieren haben? Zweitens, welche Vorteile hat die Sozialversicherung gegenüber privatem Sparen? Drittens, wie sollen beispielsweise die Risiken im Zusammenhang mit Elternschaft und beruflicher Weiterbildung geteilt werden? Viertens, wie kann der verbreiteten Risikoaversion begegnet werden, um individuelle Risikobereitschaft und damit verbundene Verantwortung zu stimulieren?

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1. Introduction [1]

For a political economist it is both a great honour and a great risk to give the Hugo Sinzheimer lecture. Most of my predecessors have been experts in labour law or law sociologists. Neither my discipline nor the title of my lecture seems even remotely related to the work of Sinzheimer. I hope you share this risk with me.

When I accepted the invitation, I had no idea how to refer to the exceptional man after whom this institute is named. But an earlier experience gave me confidence. When I wrote an article for the volume *Reflexive Labour Law*, which was edited at this institute by Ton Wilthagen and Ralf Rogowski,[2] I could easily refer to an important insight by Hugo Sinzheimer. He stated that the regulation of the labour market would be more efficient if parts of this complex task were delegated to the social partners, that is, governed by self-regulation. I was therefore sure that the broad range of topics that Sinzheimer had thought about would help me again. I was even persuaded that Sinzheimer would put me on the right track and enrich my story.

So, when the vague idea for my presentation became clearer, I screened Sinzheimer's impressive list of publications. It did not take long to find what I was looking for. In 1928, Sinzheimer wrote an article entitled *"Die Demokratisierung des Arbeitsverhältnisses"* (The Democratisation of the Employment Relationship) (Sinzheimer 1976 [1928]). His references to unemployment insurance that had been enacted just one year earlier went beyond the participation of the trade unions and employers in administration as an essential element of democratization. Sinzheimer put even more emphasis on another aspect of democratization,

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1 Paper based on the annual lecture in honour of Hugo Sinzheimer at November 10, 2005, Hugo-Sinzheimer-Institute at the University of Amsterdam. I am very grateful to Els Sol and Robert Knecht for giving me the chance to hold this lecture. I thank also all participants in the lecture for their interest, especially to those who provided valuable comments or asked critical questions. From the discussion it turned out that the risk perspective of the employers is not yet properly given due attention. Since I was unable to correct this deficit already in this version, it will remain as a challenge to further the improvement and extension of the concept of social risk management through transitional labour markets. I am also grateful to The Netherlands Institute for Advanced Studies (NIAS) for giving me the opportunity to write this paper, and to Anthony Atkinson, Els Sol and Ralf Mytzek-Zühlke for comments on an earlier version. Finally, many thanks go to David Antal for his meticulous way to improve my English, and last but not least to Dorit Griga and Jutta Höhne for invaluable research assistance.

2 See my article with Ralf Rogowski (1994), "Flexibilization of the Labour Market Through Law."

namely, the enlargement of the risk-sharing community to embrace all workers, indeed, the whole economy.

Let me convey the nucleus of my story by quoting Hugo Sinzheimer:

> *„Denn die den Rechtsanspruch auf Arbeitslosenunterstützung gewährleistende Arbeitslosenversicherung hat höheren Sinn und Zweck als ausschließlich den der Bewahrung des einzelnen Arbeitslosen vor Hunger und Not. Sie schützt nicht nur den Arbeitslosen selbst, sie schützt auch den Arbeiter im Betrieb vor Verschlechterung der Arbeitsbedingungen; sie fängt die Rückschläge sinkender Konjunktur auf, weil sie die Rückzugslinie bildet, die einer wirtschaftlich geschwächten Arbeiterschaft den Widerstand gegen schrankenlose Ausnutzung des Konjunkturrückgangs ermöglicht. So schützt sie als lohnerhaltendes Element die Arbeiterschaft. Aber sie schützt auch die gesamte Volkswirtschaft vor planloser Vernichtung der Kaufkraft.“*[3]

To summarise this passage in my own words, the nucleus of the story is that sharing risks through universal and state-guaranteed unemployment insurance is still as valid as in the time of Hugo Sinzheimer. There is no reason to roll back the welfare state. On the contrary, there are strong reasons to defend the principle of social insurance. By combining a kind of work-life insurance with soft forms of governance, this principle—that of “sharing risks”—can even be extended to include the new risks related to critical events during the life course.

Defending the principle of social insurance is not fashionable these days. However, I hope to persuade you otherwise by answering the four following questions. First, what are the new risks we are talking about? Second, why do we need social insurance against these risks? Third, how should we share, say, the risks related to parenting and to continuing education and training? Fourth, how do we overcome risk aversion to stimulate more individual risk-taking and thereby more responsibility? I draw my conclusions in a summary at the end of this lecture. But first let us explore each of these questions.

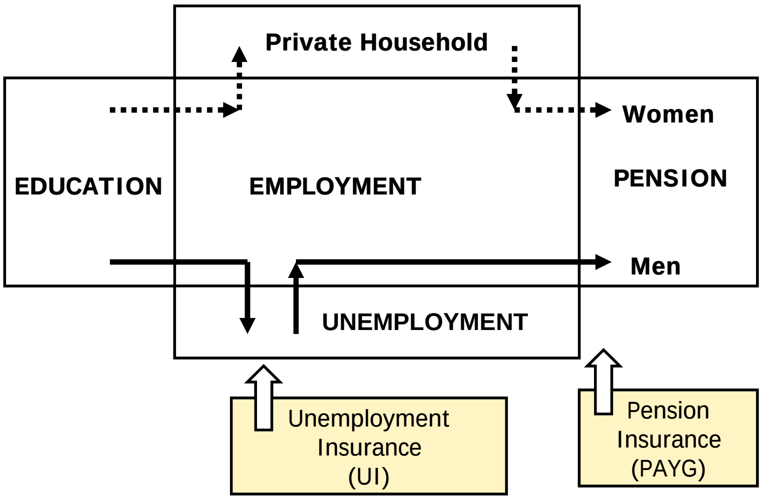
2. The Evolution of New Risks in the Modern Labour Market

In the stylised traditional labour market, women worked for a while after education, left the labour market when they got married and perhaps went back for some occasional work when their children had grown up. Men entered the labour market and worked full-time throughout their lives, possibly with the same employer; received a family wage, an income that rose steadily with age; and possibly experienced brief intervals of joblessness, which unemployment insurance covered. Labour market related risks were shared among men and

3 Sinzheimer (1928/1976), Vol. 1, p. 132.

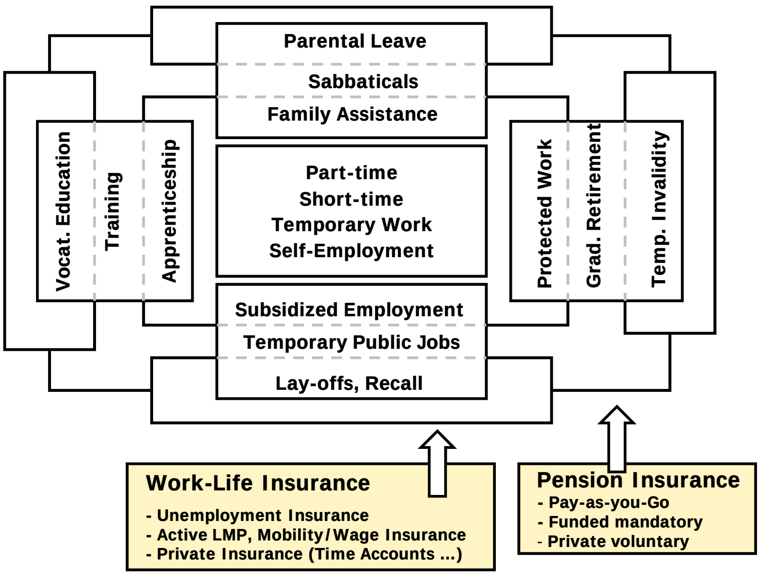
governed by the state or trade unions organised as industrial risk communities (see Figure 1).

Figure 1: The Traditional Labour Market



This picture has changed dramatically. In the modern labour market, the male breadwinner model is eroding. Work organisation predominantly based on manufactured mass production is shifting to services organised in many cases as projects pursued through changing networks. Men and especially women experience an increasing number of risky transitions between various employment statuses for which traditional insurance systems provide only incomplete social protection, if any at all. Let me briefly recapitulate the character and some evidence of the three most important new risks (Figure 2).

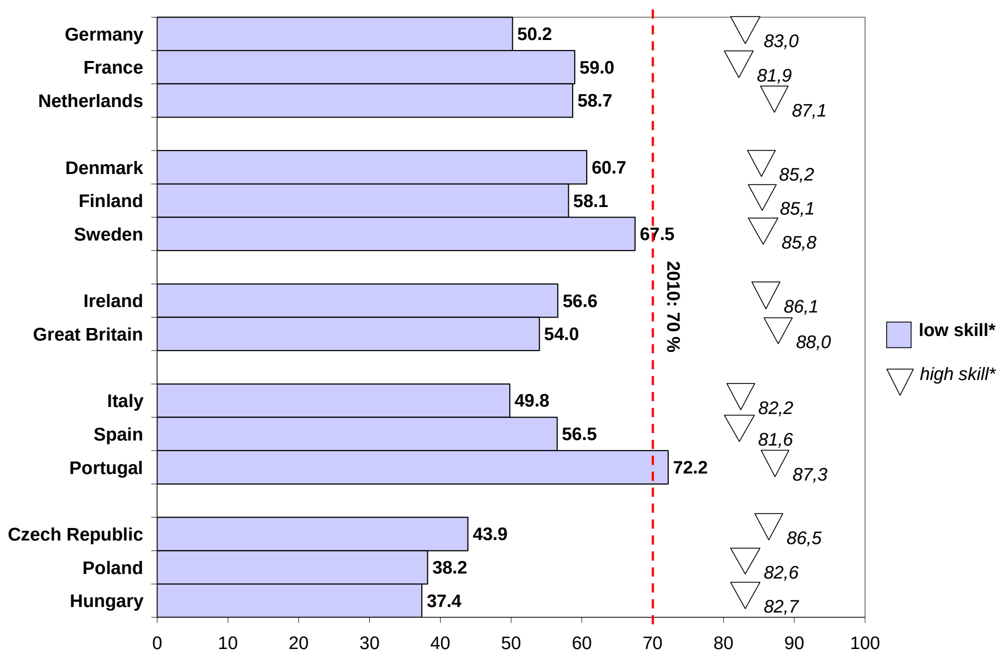
Figure 2: The Modern Labour Market



2.1 *The changing face of education and training risks*

If we take the European Employment Strategy's main goal of full employment, namely, to reach an employment rate of 70 percent by 2010, then the breakdown by qualification immediately shows where the main problem lies. Highly skilled people surpass the benchmark of 70 percent by about 15 percentage points regardless of the kind of welfare regime involved. It is the low skilled people whose opportunities for participation in the labour market are seriously compromised. In The Netherlands, for instance, the employment rate of the low skilled had fallen to 58.7 percent in 2003, more than 30 percentage points below the employment level of 87.1 percent among the highly skilled (see Figure 3). In Germany the corresponding figure was even lower, about 50 percent.

Figure 3: Employment Rates by Skill Level, 2003



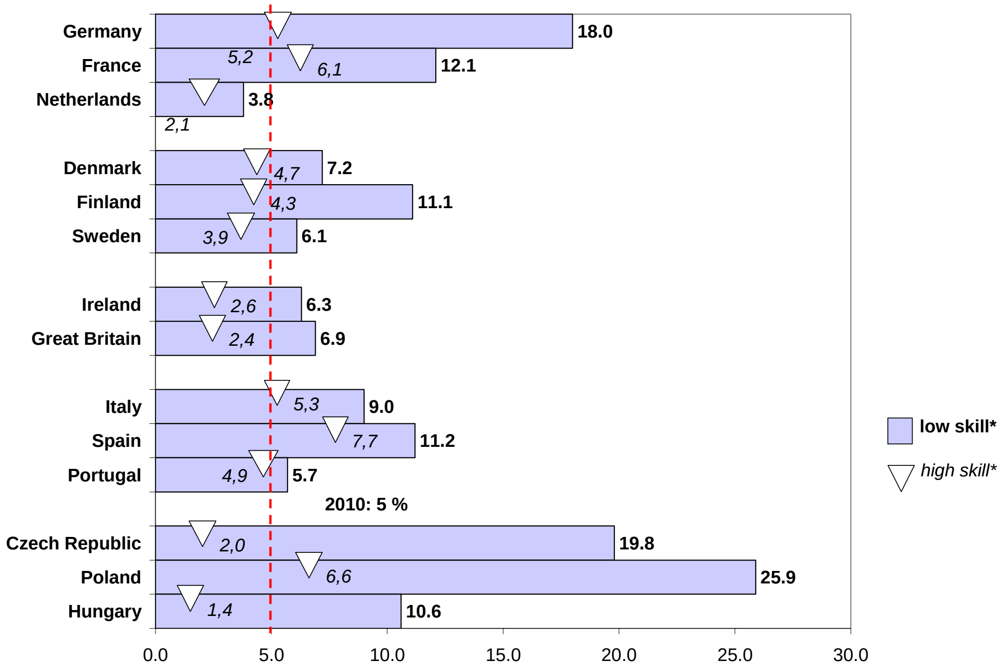
(Netherlands and Italy: 2002)

* low skill: less than upper secondary education; high skill: tertiary education

Percentage of Labour Force Aged 25 to 64 Years
Source: OECD Employment Outlook 2005, Table D.

It is also important to look at the other side of the coin, the unemployment rates, which are, unfortunately, not well reflected in the European Employment Strategy. If only the Lisbon Strategy had set the benchmark at halving the unemployment rate to about 5 percent by 2010. With a few exceptions, the statistics show that highly skilled people are already at that level or even below. The Netherlands is an example, although the recent development not shown in Figure 3 is a bit disappointing to Dutch admirers like me. The picture in Germany is much gloomier. In 2003 the unemployment rates of the low skilled averaged 18 percent (apart from huge regional differences), and those of the highly skilled hovered at exactly 5 percent. In most Member States of the European Union (EU), however, the benchmark of 5 percent unemployment is utterly out of reach for the low skilled (Figure 4).

Figure 4: Unemployment Rates by Skill Level, 2003



(Netherlands and Italy: 2002)

* low skill: less than upper secondary education; high skill: tertiary education

Percentage of Labour Force Aged 25 to 64 Years
Source: OECD Employment Outlook 2005, Table D.

Yet the times have vanished when high education was an insurance against low income or income volatility over a person's life course. The risks of proper returns from high human capital investments are multiplying but are scarcely reflected in current discussion. The high employment and low unemployment rates of the highly skilled obscure the fact that these people may also be at risk of falling into poverty or avoiding it only at the cost of displacing lower skilled people. It is not only that one's skills may become obsolete because of new technologies during one's life course, it is also the fact that uncertainty is mounting because of market globalisation. If an Indian girl in Calcutta receives higher education, she might devalue the educational investments of my son in computer science; if your daughter invests heavily in playing the violin, a Chinese boy in Beijing might do the same and win the musical competition, followed by many more engagements due to reputation. As Paul Krugman (1999, p. 203) has noted, the new economy is not only a knowledge economy but also a celebrity economy. In other words, good luck and reputation seem to be determining employment careers and life course income more and more.[4]

The impact of the escalating risks associated with human capital investment returns is twofold and ambiguous. On the hand, it feeds the tendency toward credentialing that leads to *over*investment in formal education or training. On the other hand, it encourages risk aversion that leads to *under*investment in education or training, especially among people who gravitate to the low skill labour market or among mature-aged people with short employment prospects.

2.2 Risks related to compressed work careers

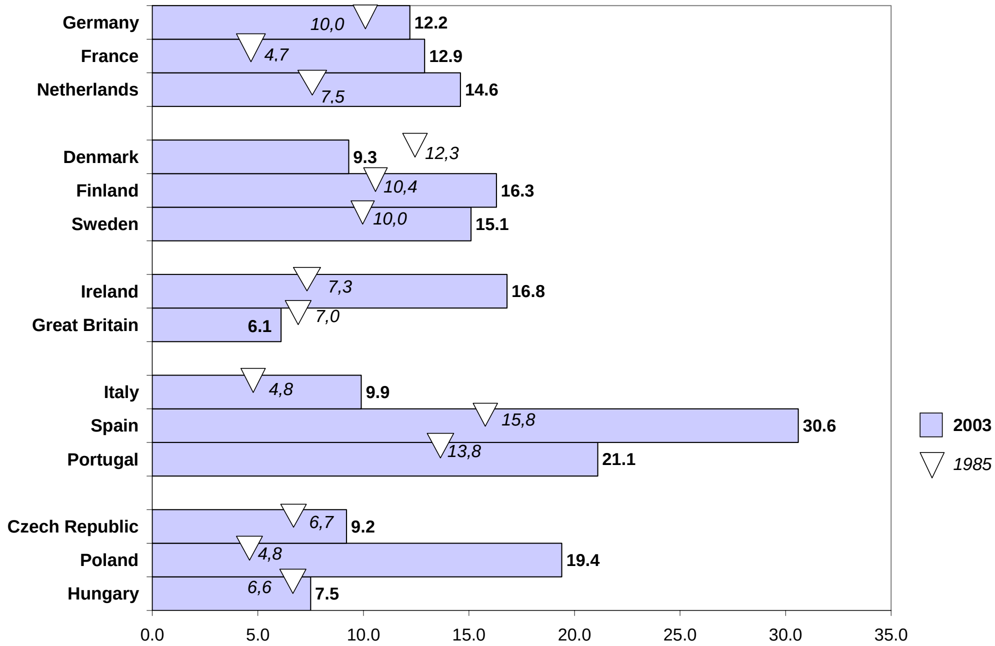
The second concern is the swelling number of precarious jobs in the form of fixed-term contracts, temp-agency work or contract work, often disguised as self-employment. Why is this trend, too, almost uniform in all European Member States? It seems that firms need added internal or external flexibility to adjust to the ever more competitive environment and new technologies. However, job protection is strong in the family-centred employment systems of southern Europe (Italy, Spain, Greece) and a bit less strong, but still important, in the conservative or corporate employment systems of other continental European countries (e.g., France, Germany, The Netherlands).

Be that as it may, the exceptions to this rule are revealing (Figure 5). In Denmark and the United Kingdom (UK), for instance, the share of fixed-term contracts has even decreased from an already low level, and dismissal protection is almost unknown. Nonetheless, Denmark compensates for the lack of job protection by granting generous unemployment transfers combined with strong activation mea-

4 There is scattered evidence for this thesis. In the United States, two thirds of the increase of inequality does not reflect widening gaps between more and less educated workers (say, college and high school graduates). Instead, it reflects bigger gaps among workers with similar education (say, college graduates). People's earnings now fluctuate more from year to year than they used to. In Germany, formal schooling explains, on average, only one third of the returns on human capital investment. Women of age 30 to 39 years have experienced a sharp decline of returns, and at an older age (50-60), the returns on education are lower for younger cohorts, particularly for women, beginning in 1994 (Lauer and Steiner 2004). A study for The Netherlands found that older workers with higher education faced declining wages compared to old workers with lower education (wage compression), and intra-group inequality increased during the 1980s but remained stable during the 1990s (Jacob 2003). Hartog (2004) comes closest to the implications of risks related to human capital investment. He and collaborators found that higher variance of wages as an indicator of higher risks is partially compensated for by higher wages. However, they also found indications that these risks are presumably "under-recompensed", as Adam Smith already noted. This circumstance might especially prevent risk-adverse would-be students with a low-income background from investing in those risky jobs.

sures, and the UK has been somewhat able to protect against precarious jobs by instituting New Deal programmes and successful job-creation machinery.[5]

Figure 5: Employees in Fixed-term Contracts as a Share of All Employees, 1985 and 2003



(Sweden 1990; Czech Republic, Poland, Hungary 1997)

Percentage of All Employees
Source: Eurostat New Cronos Databank

A growing concern is the concentration of precarious jobs among the young. The case is especially striking in Germany, where the burden of risks related to fixed-term contracts lies almost completely on 15- to 25-year olds, and on the young adults aged 25 to 35. We know from many studies that fixed-term contracts are often useful bridges to regular work. For many young people, though, and in some countries even for the majority, fixed-term contracts are, unfortunately, also traps leading to permanently disrupted job careers and often ultimately to social exclusion.

The risks that young adults run as they try to make the transition from precarious to stable jobs are often aggravated by "compressed work careers", the phenomenon of having to fulfil several social roles simultaneously within a short period of working life. It mainly affects young women between 20 and 35 years of age. Since labour market participation is becoming the norm for these women, they must cope with at least five social tasks at almost the same time: They have to acquire

5 Another factor might be the UK's successful macro-economic policy for stimulating employment growth.

a good education, look for a suitable job, plan a sustainable career, select a suitable partner and set up a family at considerable expense in housing and furnishings. The way in which work, education and welfare (including the housing market) is organised today scarcely helps them master these diverse tasks. Their transition to a sustainable career is seriously endangered.

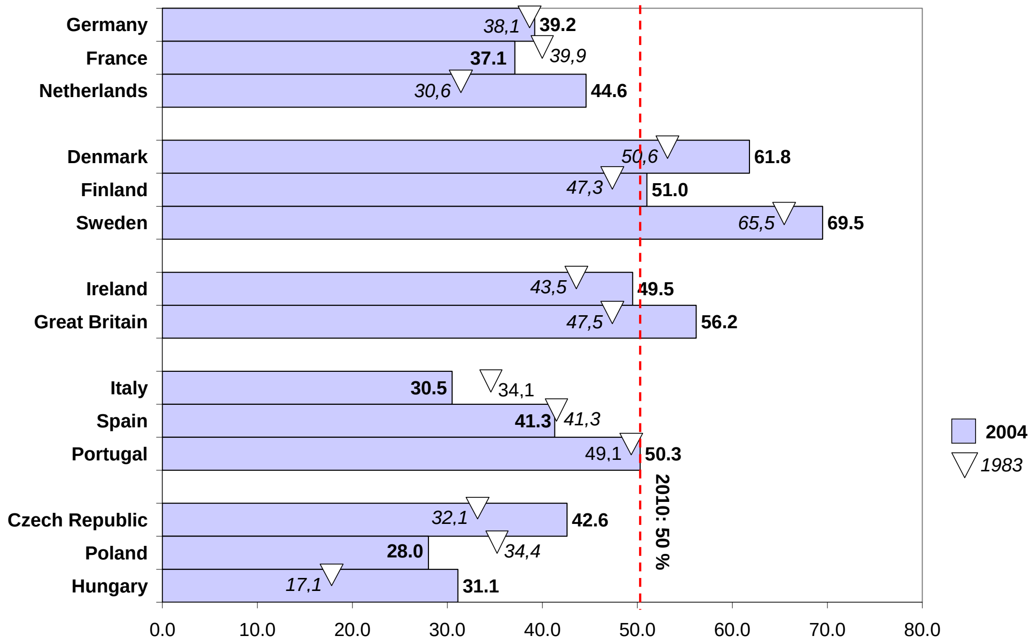
Even if a woman succeeds in these respects, the accompanying pressures can be physically or psychologically disruptive. A study carried out in The Netherlands has revealed that the incapacity to work has soared among young women, and an Australian research team even speaks of the “excluded generation”. The attention given to this problem where young adults are concerned is relatively little compared to what it receives when mature adults are at issue—a serious defect in the European Employment Strategy.

2.3 Risks related to diminishing earning capacities over the life course

Of course, this imbalance is not an argument for discontinuing the efforts to deal with the third new risk related to critical events during the life course. It is the risk of the mature adult’s diminishing earning capacity, a decline reflected in their employment rates below the full employment benchmark of 50 percent in most of the EU Member States. If mature adults become unemployed, they face either a high risk of long-term unemployment or the risk of drastically declining wage income. Only about 45 percent of 55- to 64-year olds are employed in The Netherlands. However, the situation in that country has improved impressively since 1983, unlike the conditions in France and Germany, for example (Figure 6).

A notable exception is Sweden, where 69 percent of the mature adults are actively participating in the labour market. Four reasons for this ‘anomaly’ already partially support my argument for complementing the social insurance system with soft forms of governance. The first reason is that Sweden included mature adults in continuing education and training (for example, through the massive “knowledge-lift programme” from 1997 to 2002). Second, all monetary incentives to retire early have been dismantled in that country. Third, soft forms of governance have been established through “work-adjustment groups” in Swedish firms with more than 50 employees. If work capacity at these firms declines, they have to start negotiation and problem-solving procedures to relocate or rehabilitate their mature adults. Finally, gender-related differences in mandatory retirement (and probably the very institution of mandatory retirement) are out of date. Women in Sweden accumulate pension rights independently from the working career of their “breadwinning” spouse, an arrangement that Sweden has in common with Switzerland, among other countries.

Figure 6: Employment Rates of Workers Aged 55 to 64 Years, 1983 and 2004



(GB 1984; Czech Republic and Poland 1994, Hungary 1995)

Percentage of Labour Force Aged 55 to 64 Years
Source: OECD Employment Outlook 1997, 2005, Table C

All three risks—education and training, job instability and reduced work capacity—must be considered against the background of eroding internal labour markets. From the perspective of risk management, the backbone of internal labour markets has been an implicit insurance contract, with the employer offering the male breadwinner a family wage, job security and earnings stability over the life course in exchange for the acceptance of wages below the productivity level at the peak of the work career. This implicit insurance contract is breaking down without a clear alternative in sight yet.

A plausible conclusion would be to extend the principle of insurance to cover these new risks at least to some extent. But why would it be suboptimal to leave people alone with these new risks and to expect solutions through private savings or private insurance? Why should we rely on social insurance rather than on private savings for these new work-life-risks?

3. On the Advantages of Social Insurance Compared to Private Savings

To answer these questions, we call to mind the basic principle of social insurance. Reflecting on this matter 80 years ago, Hugo Sinzheimer attributed a completely new principle of law to social insurance. Social insurance, in his view, is not based on private law or individual property rights but on collective law based on universal human rights to participate in the production and distribution of the society's prosperity. To ensure that people are not only "free from want" (which means having ensured access to basic necessities) but also "free to act", the state is authorised to intervene in property rights and—to put it bluntly—to redistribute between those who are lucky and those who are not lucky in the lottery of natural endowments and the whims of the market.[6]

There are also macroeconomic arguments for insurance. Let me start with some definitions. Social risks—I am not talking about tsunamis, hurricane Katrina, earthquakes, or other types of exogenous catastrophes—are likely events related to social actions that imply individual losses of calculable probability if they occur and gains if they do not occur. Each individual could insure him- or herself against these losses by means of savings or precautionary measures.

In most cases, however, insuring oneself is more costly than pooling risks. Nobody keeps his own fire brigade; we all contribute to the community fire brigade instead. Furthermore, precaution or prevention may become costly and may tie up too many resources. For instance, in former times trading ships used to be accompanied by convoys to ward off pirates; insurance proved to be cheaper. In modern times, many labour markets are heavily regulated to protect against opportunistic resignations or dismissals, but it probably turns out that generous wage and employability insurance may not only be cheaper but also more equitable. I will come back to this point later.

6 In "Wandel im Weltbild des Juristen", Sinzheimer (1928/1976, Vol. 2, pp. 42-49) asserted that the introduction of social insurance created a new type of law, one "no longer based on legal capacity to be a subject of legal rights and duties but rather also on people's capacity to make a living" (*nicht mehr an Rechtsfähigkeit, sondern auch an Existenzfähigkeit der Menschen anknüpft*). The principle of property rights is complemented by the principle inherent in the rights of humanity, which justify redistribution. "The new right intervenes in this redistribution arrangement by recognizing rights to share that derive not from property but rather from the fact that one is a human being (*Das neue Recht greift in diese Verteilungsordnung ein, indem es Anteilsberechtigungen anerkennt, die nicht aus dem Eigentum, sondern aus dem Menschsein folgt*; p. 45). Unlike private law, which is static, the new social law is dynamic. It does not aim at regulating legal relations between individuals; it is directed instead at social relationships that determine the situation of individuals (p. 48). Because the new law shapes legal relationships, it is known as reflexive law in modern terminology.

If the risks are individually unrelated and distributed equally by chance, the potential losses can be privately insured. The insurer thereby organises redistribution between those hit by the cost-causing event and those not hit by it. *Ex ante*—that is, before anyone knows who will be hit, before the veil of ignorance is lifted—insurance is a co-operative game of sharing risks. *Ex post*, after that veil has been lifted, insurance is redistribution from the lucky to the unlucky. If the insurance is effective, it establishes a win-win game.

To be efficient and equitable, however, insurance has to meet some conditions. The three most important ones are well known: no moral hazard, no adverse selection, and no correlation of the risks. If risks are correlated or even infectious, as with unemployment, no private insurance can guarantee liquidity high enough to compensate for the losses. If risks are unequally distributed, bad risks would tend to overcrowd and good risks would tend to opt out. As a consequence, either bad risks would have to pay deterrent high premiums, or private insurance will not be established. If moral hazard exists and is difficult to detect for informational asymmetries, then control has to be exercised by legitimate power over which private insurers normally do not dispose.

These are the reasons why no civilised country has private unemployment insurance that sufficiently covers the risk of involuntary unemployment. Only the state can guarantee liquidity in the event of correlated risks. Only the state can force good risks to participate in the insurance or alleviate the burden of premiums for the bad risks. Only the state can ultimately exercise legitimate control over moral hazard.

However, if we argue for a wider application of the insurance principle, we have to go beyond the risk of unemployment. We have to ask why the welfare state in effect provides or organises risk-sharing for many more life-course risks than it does for involuntary unemployment. Even liberal welfare states have some kinds of mandatory social insurance—such as those against the risks of low income (poverty), illness, disability, work accidents, and old age. They at least play a strong regulatory role in supervising or supporting various kinds of private insurance.

The few mainstream economists who dare to deal with this question agree that the welfare state plays an indispensable role as a risk-sharing institution.[7] Why? First, social insurance can enhance efficiency by stimulating otherwise risk-averse people to engage in prosperity-enhancing activities. Historical examples abound. In fact, Peter Bernstein argues in his stimulating book *Against the Gods* (1996) that it was the invention of insurance that propelled modern capitalism. The rise of Venice to become the world's richest city in the 14th and 15th centuries would have been inconceivable without the invention of a modern insurance sys-

7 The best references, in my view, are Agell (1999, 2002), Atkinson (1991, 1999), Barr (2001) and Sinn (1995, 1996).

tem. Henry Ford once said that New York would not have been built without the help of the insurance system.

Apart from traditional arguments concerning market failure, political economists provide additional important reasons for universal and at least publicly ensured risk-sharing institutions. Hans-Werner Sinn (1996, pp. 263–264) especially stresses the timing problem related to risks over the life course. Typically, private insurance companies deal only with contingent risks that affect clearly distinguishable groups of people. Such risks include the risk of fire, theft, or traffic accidents. They are not correlated with a person's lifetime. Social insurance, by contrast, is an all-inclusive insurance that protects against multiple and interdependent risks of lifetime careers. The insurance provided by the public tax and transfer system is an insurance against the randomness of career opportunities and in nature's lottery of innate abilities. Because of time dependencies, private insurance contracts would have to start right at the beginning of human life, maybe even with conception. How should a private insurer determine the premiums and the indemnities for such complex and interrelated risks? Only public social insurance can deal with this time problem, and it will probably be much cheaper than private insurance given that a system of fiscal taxation is considered inevitable anyway.

Tony Atkinson (1991) hints at another important reason for the advent of social insurance, one that cannot be explained by the traditional economic focus on information asymmetries and adverse selection. It is the distinction between risk and uncertainty, which harks back to the classic work by Frank Knight (1921). When social risks cannot be calculated, no private insurance can do the job of compensating for severe and irreversible damages. Faced with uncertainties such as wars, riots, epidemics, demographic imbalances, large-scale accidents, and other unforeseeable challenges, social insurance contracts have to be flexible enough to mobilise quickly the resources to mitigate such risks and cope with them.[8]

Jonas Agell (2002) adds another important argument. Proponents of rolling back the welfare state should be aware that social insurance did not develop mainly as a rent-seeking behaviour of interest groups but as substitution for the erosion, weakness or even disappearance of traditional self-insurance institutions such as the extended family, the "hinterland" of small farms providing economic subsistence, the neighbourhoods, and the communities or trade unions organising mutual self-help. The shift to universal social insurance systems occurred especially in countries exposed to rapid structural change and characterised by a relatively homogeneous population.

8 The Contergan case at the end of the 50s and the beginning of the 60s (also known as the scandal caused by Thalidomide) might serve as an instructive example of such internal social risks that cannot be calculated.

Agell (2002) also suggests functional equivalents as second- or third-best solutions if tax-financed universal social insurance is not feasible. In addition to insuring against the hazards of volatile wages directly through minimum-wage laws or unemployment insurance, there are also indirect ways narrowing and stabilising wage distribution by means of centralised wage bargaining.[9] He uses a formal model to show that the insurance benefits from a small compression of the wage structure will outweigh any costs in terms of unemployment and reduced output. Furthermore, surveys persistently report that the state and collective social insurance systems are politically accepted, even strongly supported. The representative worker is willing to accept a lower expected wage in exchange for a wage structure that offers insurance against the uncertainty of who will be in the wage distribution.

Of course, there is a trade-off. On the one hand, people protected by the welfare state engage in risky and profitable activities that they otherwise would not have dared to undertake. Risky occupations might not be chosen without the protection of the welfare state, and it would be difficult to find entrepreneurs willing to undertake risky investment if debtor's prison were all that society provides should the venture fail. On the other hand, the welfare state may, in fact, make people too eager to jump, to become careless, and to take excessively dangerous short-cuts in the mountainous paths of life (Sinn 1996). This is the moral hazard to which an overwhelming majority of policy advisors call attention.

How to balance productive risk-taking by avoiding careless risk-taking and its moral hazard in a way that maximises efficiency and equity is an old conundrum of welfare state theory. In any case, risk-taking has important repercussions for the observable degree of inequality in the economy. If people choose more risks *ex ante*, they will typically be more unequal *ex post*. Risk-averse societies may exhibit relatively little inequality but also little economic dynamism. By contrast, risk-taking societies may indeed exhibit high economic income on the costs of high inequality, as the liberal U.S. regime seems to show. Denmark, however, has recently received increasing applause for its achievement of high risk-taking and low inequality both before and after taxes—the "flexicurity" model par excellence.[10] It therefore does not seem that social insurance necessarily drives the "big trade off between equality and efficiency" (Okun 1975); under certain circumstances it may well also drive a "virtuous marriage between equality and efficiency" (Schmid 1994). The question of how such a complementary relationship might work shall be tackled in the next step.

9 In addition, totally flexible wages would aggravate cobweb-like (and therefore quite instable and costly) adjustments to external shocks (see Arrow 1971, for example).

10 See Auer (2000) and Madsen (2005), for instance.

4. Application of Risk-sharing to New Social Risks

These general foundations of the "traditional" welfare state are not yet sufficient to argue for a further extension of social insurance simply because new risks are emerging. What is it that leads me to say that the new risks I have mentioned are best covered through an extension of the social insurance principle or, as a second-best solution, through a revitalisation of self-insuring organisations such as collective wage bargaining? The argument shall be developed for two critical transitions over the life course: first, for the risks related to parental leave or to the combination of parenting and labour market work; and, second, for the risks related to educational or training leaves or to models for combining them.

4.1 Sharing risks related to parenting

What are the social risks related to parenting? The social construction of risks is clear in this area. The time problem already mentioned is best understood from the perspective of parents-to-be because for them the veil of ignorance has not yet been lifted. These parents do not know which abilities their children will be endowed with. They may fear that their children will suffer from illness and injuries. They may worry about bad teachers and friends. They are concerned about missing job opportunities and bad choices. They are afraid that their children may become unemployed, and they hope, but cannot be sure, that a successful marriage will be possible.

It is inconceivable that private insurers could cover these risks. They could do this only under the condition of contracts that would come close to bondage—as Hans-Werner Sinn (1996, p. 263) starkly put it. It would have to be acceptable for parents to allocate substantial portions of their children's future incomes to private institutions without their offspring having the chance to nullify or even modify the decision when they become adults. Private insurance contracts would therefore have to wait until a person comes of age, but by then most of the veil of ignorance would have been lifted. When both the insurer and the insured have the same knowledge about the inequalities then existing they will not be able to find mutually agreeable redistribution contracts. And when the insured person has superior knowledge, the typical adverse selection problem will exist.

In fact, the solution may be even simpler than this overly sophisticated economic talk. Children are wonderful. Their risks cannot be calculated, and uncertainty cannot be insured privately. The solution for the lifetime risks of children can only be the family as an insurance device, or—if families are poor or family relationships become unstable—the state. The welfare state cannot eliminate these risks. But by offering a redistributive social contract between successful and unlucky children, it can help mitigate the consequences. All welfare states therefore offer more or less social protection against child poverty, equal access to primary and secondary education, and health and disability insurance. However, new risks arise, and that circumstance has much to do with endogenous changes related to values, families and labour markets.

Let us examine value changes first. As long as the role (that is, the responsibility) of parenting is socially ascribed to women, child-bearing and child-rearing is not a risk that goes beyond the boundary of the family. However, as soon as it is accepted that both men and women should have the free choice of engaging in this task and that both should have the opportunity to earn their own income, caring for children involves a career risk as well as an income risk for both parents. A science fiction novel even went so far as to imagine conception being randomly distributed between men and women. In a way, of course, this idea is seriously misplaced, for most children are consciously planned. However, if you accept the thought experiment and imagine that men can also become pregnant, then you would probably agree that the debate about the compatibility of family work and labour market work would change drastically. Men would certainly be much more open for the concept of social risk-sharing related to parenting.[11]

I now turn to family and labour market changes. When children enter the world, not every one of them is hit by the related risks in the same way as all the others. Whether and how much men or women are affected depends on the employer, the occupation, the working tasks, the neighbourhood and so on. All these factors are ones that individuals normally cannot determine or predict. Some people, such as academics and people living in intact families or functioning neighbourhoods, can manage to combine market work and family work more easily than others. Some of these others, such as those who cannot work at home, those who must live in broken families, or those who are not integrated into a functioning neighbourhood, are less fortunate. Furthermore, the number of single-parent families is climbing in almost all modern welfare states and thereby exacerbating the vulnerability of children and single parents alike.

The lack of social insurance against these new risks will lead to two kinds of penalties: wage and career penalties on the one hand and social penalties on the other. The calculated average risk of wage penalty incurred by, say, five years of full-time leave amounts to 1.5 to 2 percentage points yearly. The wage penalty declines to 0.5 percentage points if only part-time leave is taken, and it differs from one employment regime to the next. The wage penalty for interrupting full-time work is 7 percentage points in conservative regimes (e.g., Germany) compared to liberal regimes with medium public support for employment during the family phase (e.g., Canada). This kind of difference likewise emerges in a comparison with social democratic regimes enjoying high public support (such as Sweden).[12] Such large wage penalties for complete employment interruptions

11 The topic of the “pregnant man” goes far back in history and mythology (see Zapperi 1991).

12 See Gustafsson et al. (2002) and Stier et al. (2001). Complementary results come from the varieties-of-capitalism approach. Coordinated regimes are characterized by

can be taken as an argument in favour of publicly financed or publicly provided institutions for child care during pre-school and elementary school. They would not only broaden the occupational choices of parents (especially women) but would pay off economically as well. One must also figure in the risks of status loss and restricted occupational choice after expiration of the parental leave.[13]

The social penalties of inadequate social insurance are no less severe. Whenever children's lifetime risks are not properly provided for, the lapse will have repercussions on the decision to establish a family with children. From this perspective it becomes plausible that the welfare regimes with the largest drop in fertility rates are those in which life-course securities for children are not properly covered. If parents or would-be parents are highly uncertain about how to protect against these risks, they will decide against children. The desire to have children—an important aspect in the quality of life—will continue to be blocked if the future of the would-be parents themselves becomes insecure. Unemployment of the parents or of people in their immediate environment is one of the most important predictors of low fertility. One piece of evidence for the damaging impact of unemployment on family formation, although not a causal relationship in a strict sense, is the negative relationship between fertility rates and unemployment across OECD countries, in both cross-section and dynamic form (Figure 7).

Summing up, if we accept the abolishment of traditional role ascription of who shall take care of children, we shroud ourselves in the veil of ignorance as described by John Rawls (1990, 2001). Would-be parents do not know where they will end up in the lottery of their own careers and that of their children's careers. Hence, the structural situation for risk-sharing through social insurance is given, and it legitimates redistribution between fortunate and less fortunate parents and their children. To the extent that societies value their children, there are strong arguments for inter-generational redistribution and intra-generational redistribution. In the inter-generational contract, this would be a generous lump sum to cover some of the immediate costs for children (a non-means-tested child allowance). In the intra- generational contract, this would be wage insurance to compensate for the risk of reduced earning capacities due to child care.[14]

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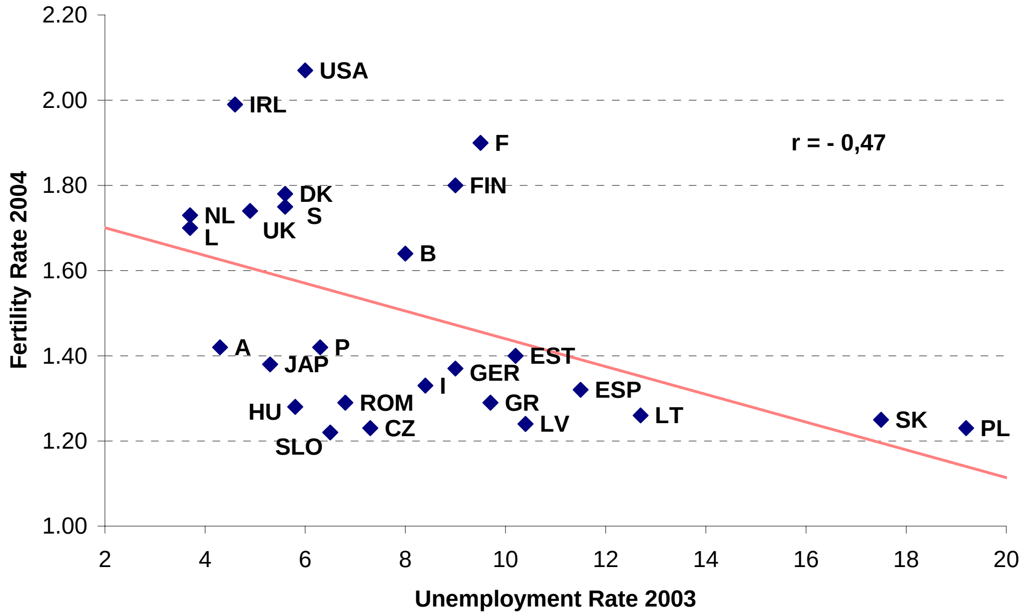
higher specific human capital investment, the effect being that the wage penalty of employment interruptions is higher than in liberal regimes, where firms do not invest much in specific human capital. Correspondingly, wage penalties are generally higher for the highly skilled than for the low skilled, whereby the regime types, again, compound the differences (Estevez-Abe 2001, Rosenbluth et al. 2002).

13 Of the vast literature on The Netherlands, see Vlasblom and Schippers (2005).

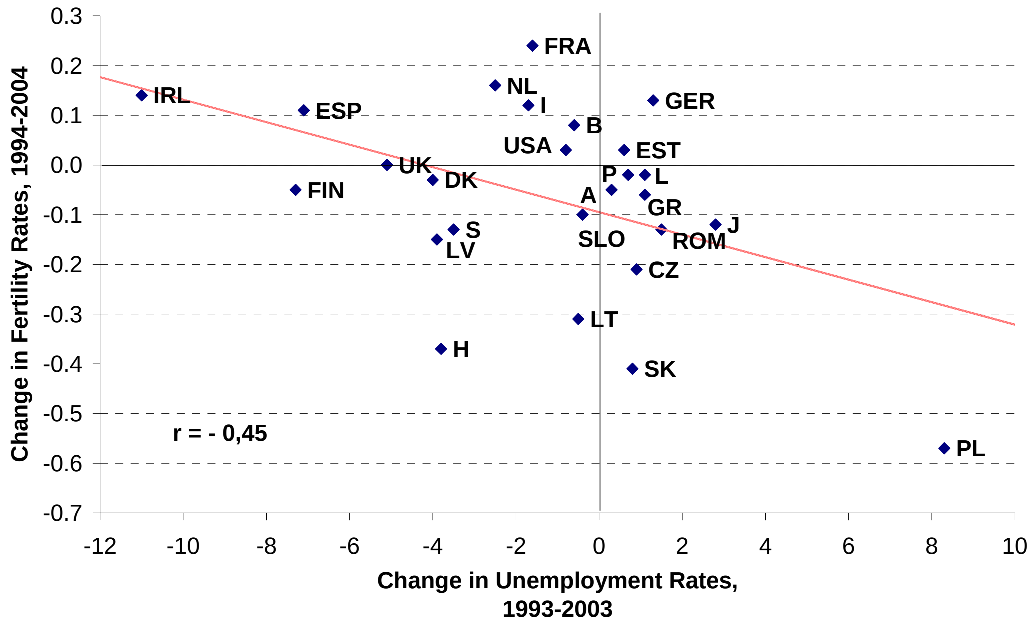
14 This arrangement means paying a generous wage replacement of, say, 80 percent for up to two years instead of only a small lump sum, which usually leads to parental leave being taken by low-income women.

Figure 7: Fertility Rates and Unemployment in OECD Countries:

a) Cross Section



b) Change in Percentage Points



Source: Eurostat

In terms of governance, parental risk-sharing as social insurance would have the advantage of reducing the fragmented, intransparent and often contradictory child-care subsidies that have mushroomed over the decades.[15] There are further strong arguments for providing tax financed public child-care facilities or at least for ensuring affordable public or private child-care services through tax premiums. Finally, there are even strong arguments for introducing take-it-or-leave-it paternity leaves to share the risks between men and women equally, as already introduced on a small scale in Scandinavia. The other side of the coin, however, would be the acceptance of co-financing and the willingness to negotiate solutions to complicated problems of co-ordination between employers and employees.

4.2 Sharing risks related to continuing education and training

A case for social insurance can also be pressed when it comes to sharing risks related to education and training. Take continuing education and training, for example. Why should the state become involved in sharing risks related to deteriorating skills over the life course, to skills lacked by a person who must change jobs, or to the uncertainty of returns on investments in human capital? Why should these matters not be left solely to individual savings or precautionary measures taken by the employers or employees?

The first reason why the state should involve itself is *savings restrictions*: The people who need continuing education and training most lack the necessary financial resources. Numerous studies have shown that the people with the greatest need for continuing education and training are especially the ones who will not be able to save enough for substantial investments. Apart from the fact that participation in continuing education and training varies across OECD countries between 10 and 40 percent of the labour force on average, the participation of highly skilled persons is an average of 26 percentage points higher than for people with low or only upper secondary skills (see Figure 8). Multivariate studies using industry, educational attainment, gender and age to explain participation produces a fairly stable result. In most countries, the only significantly positive variables are the level of educational attainment and the upper tier of the service industry. In a few countries the age group of 55-to-64-year-olds is significantly negative (OECD 2005, p. 314). Studies about the reason for non-participation on the supply side emphasise financial bottlenecks as important determinants especially for the low skilled. On the demand side, education and training costs decrease for the employers as employee skills improve through higher learning capacities and lower risks of failing at training courses.[16]

15 Germany has about 150 such child-care subsidies.
16 For facts and figures related to participation and investment in continuing education and training, see OECD (2003, 2004, 2005).