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Sharing Risks

On Social Risk Management and the Governance of Labour Market Transitions

January 2006

ISSN Nr. 1011-9523

Wissenschaftszentrum Berlin
für Sozialforschung (WZB)
Social Science Research Center Berlin

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Employment, Social Structure, and Welfare State

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Order No.: SP I 2006-101

discussion paper

This paper was also published in the lecture series of the Hugo Sinzheimer Instituut, Universiteit van Amsterdam, in January 2006 (Lecture Series, no. 9).

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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.

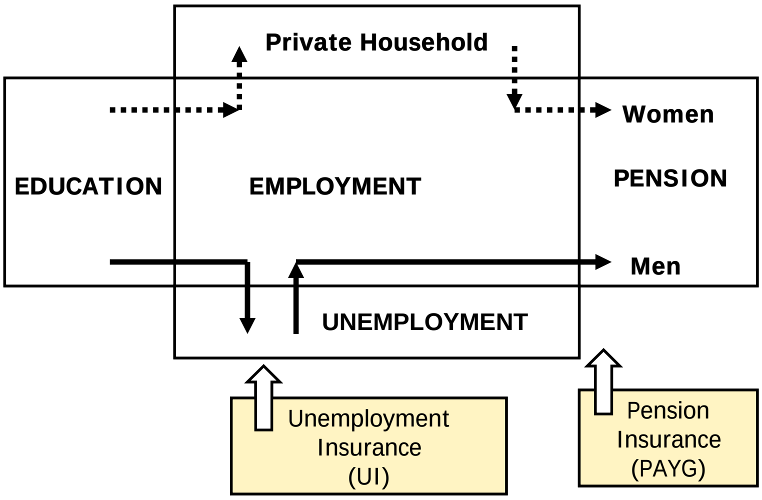
2. The Evolution of New Risks in the Modern Labour Market

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.

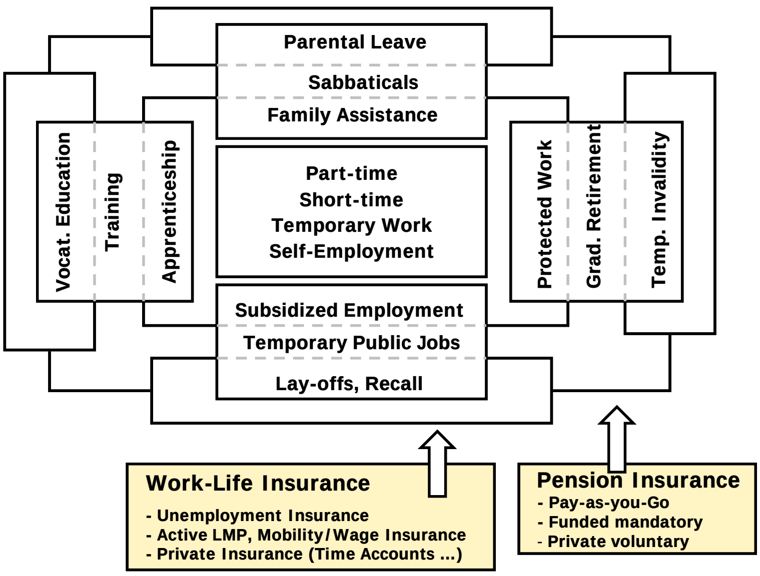
governed by the state or trade unions organised as industrial risk communities (see Figure 1).

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).

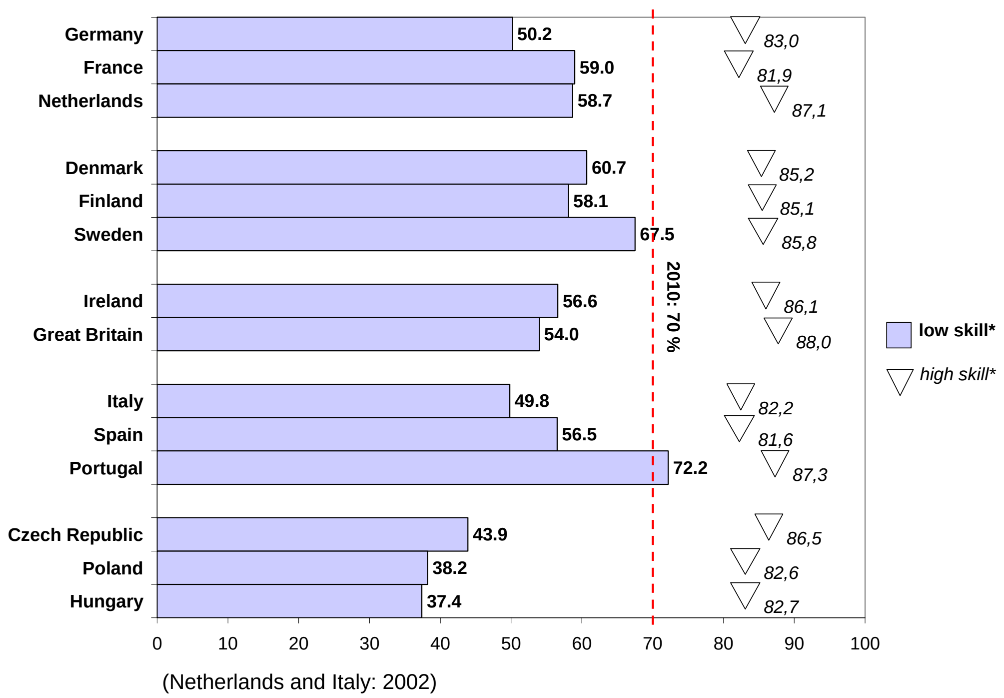
Figure 2: The Modern Labour Market



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

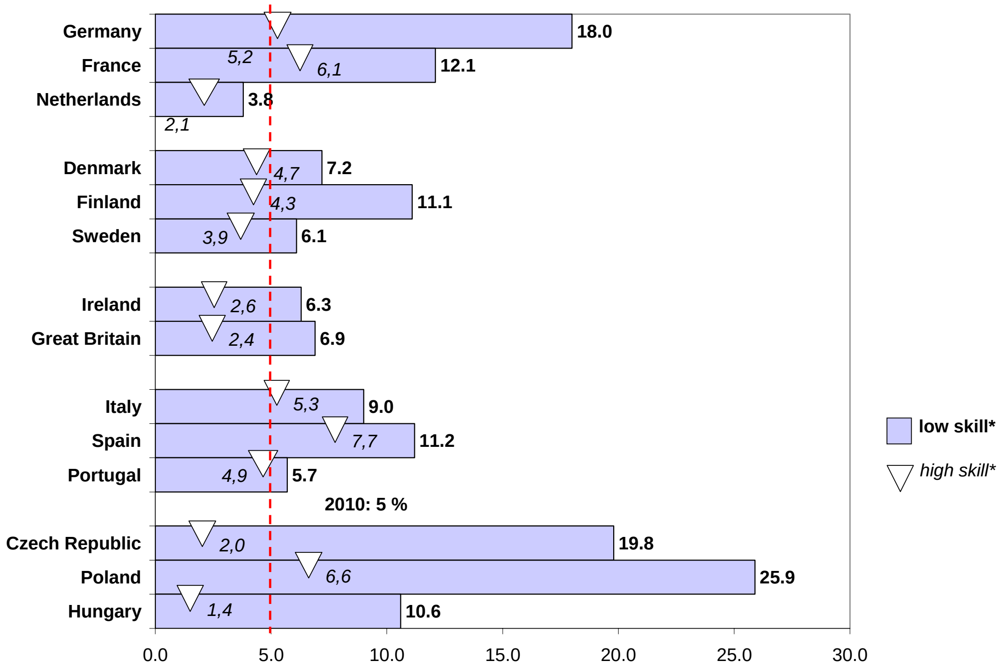


* low skill: less than upper secondary education; high skill: tertiary education

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

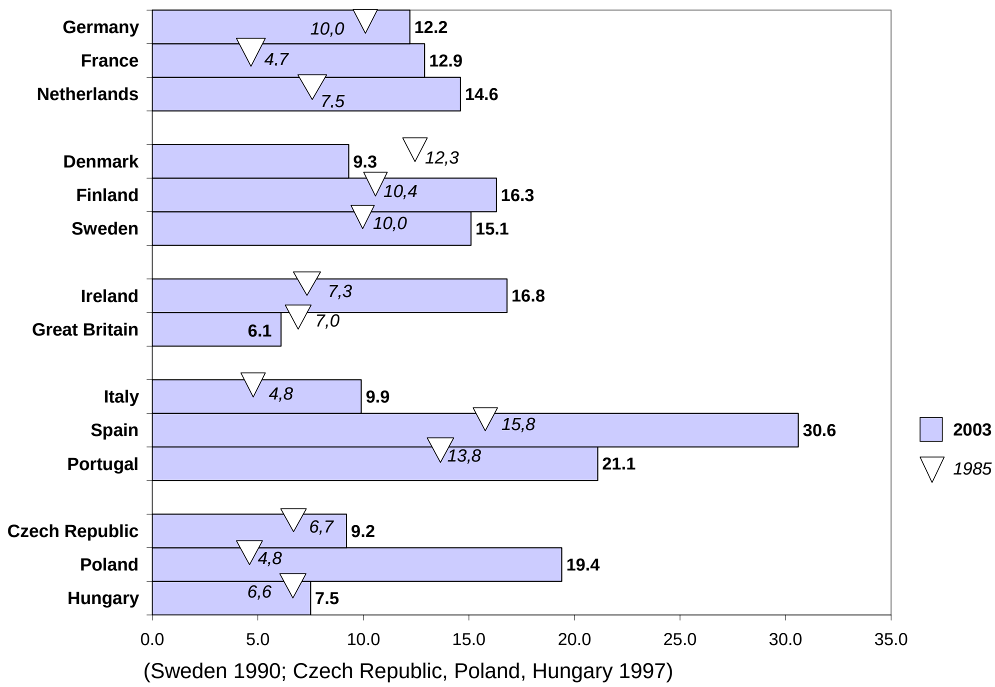
The second concern is the swelling number of precarious jobs in the form of fixed-term contracts, temp-agency work or contract work, often disguised as self-employment. Why is this trend, too, almost uniform in all European Member States? It seems that firms need added internal or external flexibility 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*



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.

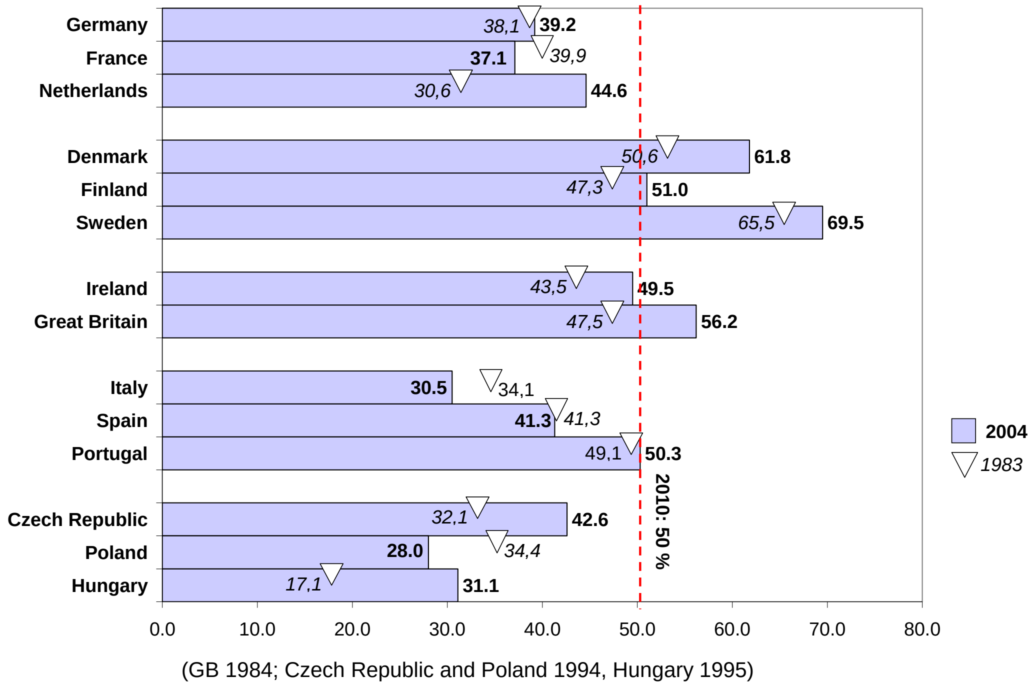
Even if a woman succeeds in these respects, the accompanying pressures can be physically or psychologically disruptive. A study carried out in The Netherlands has revealed that the incapacity to work has soared among young women, and an Australian research team even speaks of the “excluded generation”. 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



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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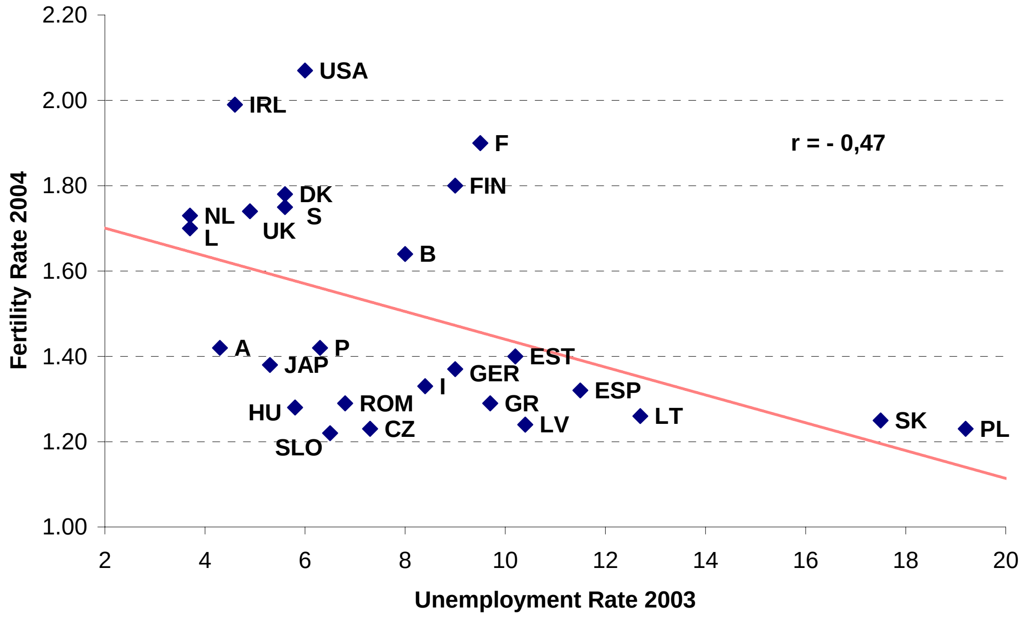
higher specific human capital investment, the effect being that the wage penalty of employment interruptions is higher than in liberal regimes, where firms do not invest much in specific human capital. Correspondingly, wage penalties are generally higher for the highly skilled than for the low skilled, 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).

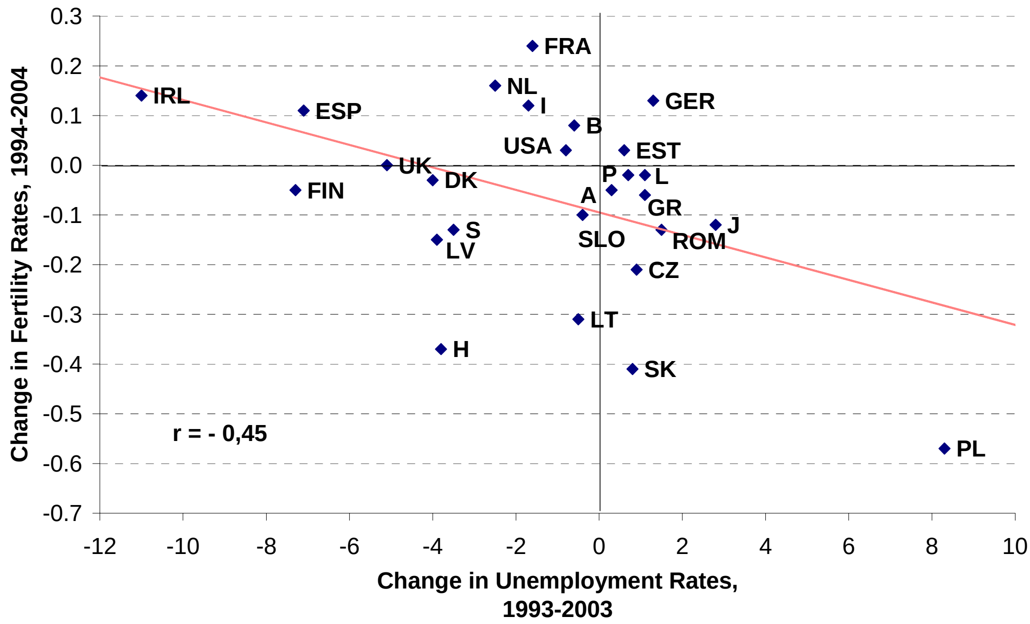
14 This arrangement means paying a generous wage replacement of, say, 80 percent for up to two years instead of only a small lump sum, which usually leads to parental leave being taken by low-income women.

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?

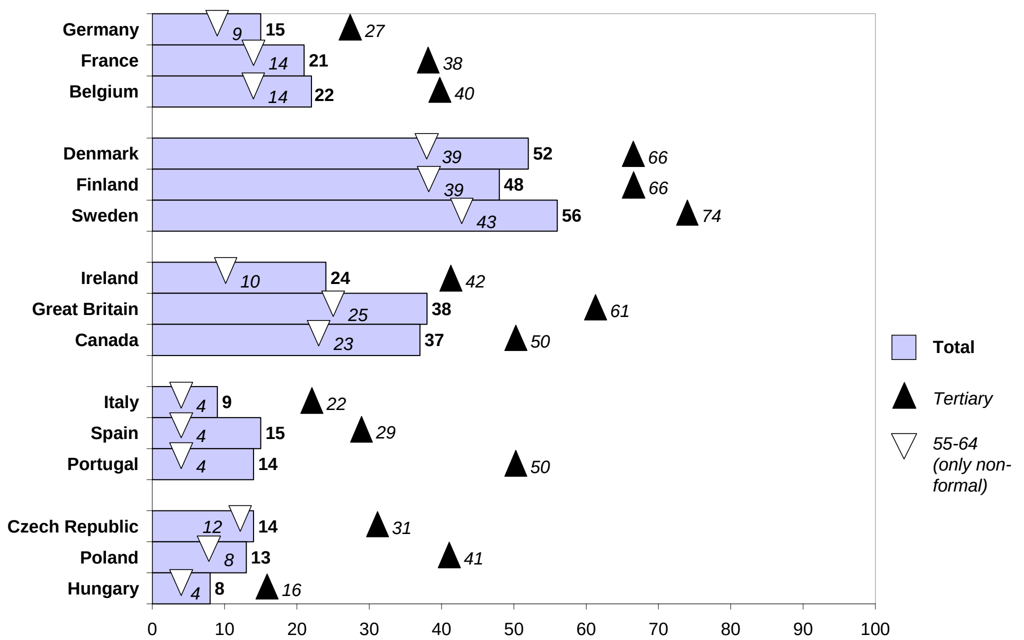
The first reason why the state should involve itself is *savings restrictions*: The people who need continuing education and training most lack the necessary financial resources. Numerous studies have shown that the people with the greatest need for continuing education and training are especially the 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).

The second reason why the state should help shoulder the risks related to education and training argument is capital market failure. The market does not loan to those who most need credit for continuing education and training.[17] Problems associated with default make banks reluctant to grant such loans to young or mature adults. Unlike a housing loan, an education or training loan has no collateral for the bank to sell if the loan recipient defaults on repayment. The implication is that banks will not be interested in underwriting human capital investments unless at least one of two conditions are met: (a) high interest rates with deterrent effects on would-be loaners, or (b) securities from assets other than human capital, a demand many candidates for loans cannot fulfil. Prospective investors without sufficient financial resources or real estate will not be able to invest in continuing education and training. This foreclosure has four important implications: a loss of talent and, hence, a cost to the whole society; a loss of opportunity for individuals; a cementing of inequalities resulting from previous disadvantages related to family background and education; and the perpetuation of inter-generational inequality.

Figure 8: Participation Rates in Formal and Non-formal Continuing Education and Training, 2003 in Percentages



Labour Force Aged 25–65 Years
Source: OECD Education at a Glance, 2005, Tables C 6.1a, C 6.4.

The third argument in favour of risk-sharing by the state is lack of equity. The people who greatly prefer investment in continuing education and training may have the weakest position in private household bargaining, even where govern-

17 The following reasoning is inspired, among others, by Chapman and Ryan (2005).

ment-assisted bank loans are concerned. Government assistance would have to depend on means testing. This approach rests on the assumption that the individuals involved have equal access to household income, which might not hold for young dependent family members or women in a weak bargaining position. This condition would, in turn, restrict loan access for those family members who value human capital investments more highly than the co-determining family members.

The greatest problem, however, is default. The risk of inability to repay a loan is highest among those with a background of poor income. Experience has shown that default rates among such people are very high.[18] If government guarantee is unlimited, investors will put little care into their choice of investment, and banks will put little effort into debt recovery. Default and moral hazard problems can make government assistance very expensive for taxpayers. Thus, governments will assist only if quite restrictive guarantees are agreed to. In other words, bank loans will have to be repaid under normal circumstances. This condition has serious implications for would-be borrowers. For fear of not meeting future repayment obligations, some eligible investors will not be prepared to take bank loans. They would also fear damage to their credit reputation and, hence, to their future borrowing ability, say, for a house. Consequently, some eligible borrowers will not be prepared to take out bank loans. Risk aversion is intensified by the fact that returns on continuing education and training investments are particularly uncertain.[19]

What are the alternatives? Some countries have experimented with various forms of state subsidised individual training accounts, such as individual development accounts (IDA), individual learning accounts (ILA) and long-term time-saving accounts (TSA) especially earmarked for education and training. It is too early to assess these experiments, but most of them have been failures. Moral hazard or even fraud terminated some of them (e.g., the British ILA) in the middle of their implementation. Other types of state subsidised individual training accounts were even not introduced despite long preparations, as happened in Sweden for fear of unbalanced social consequences favouring people who were already well-off. Even a panel of experts in the United States came to an ambivalent result after studying the idea of complementing social insurance with individual accounts.

The strongest arguments in favour of such accounts were that they

- counter-balance the political discretion of purely publicly administrated social insurance,
- encourage individual responsibility,

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18 Chapman and Ryan (2005, footnote 10) quote literature reporting 15 to 30 percent average default rates for student loans in Australia and 50 percent in U.S. Propriety Colleges.

19 First, it is unsure that the complex web of factors that influence the returns on continuing education and training can be analytically disentangled. Second, returns can materialise quite late in a person's career, as shown by most of the recent evaluation

- allow individual ownership and individual choice, and
- perhaps discourage tax evasion and increase incentives to participate.

The strongest arguments against state subsidised individual training accounts were that they

- escalate administrative costs,
- expose workers to market risks and the risk of poor investment choices,
- erode the benefit level provided to those with low earnings,
- undercut the sense of community responsibility and shared concerns embodied in Social Security,
- entail undesirably large variation in benefits between members of different cohorts employing the same investment strategy, and
- restore actuarial balance in the existing system, an effect that might revive worker's confidence in the future of Social Security. By diverting revenues and introducing new risks, individual accounts might not improve confidence in either the remaining defined-benefit portion of Social Security or in the overall system.

In fact, the balance of the pros and cons reflected a fair degree of scepticism about individual accounts.[20] This finding raises the question as to whether combining social insurance and elements of individual choice and responsibility would be more promising than state subsidised individual training accounts. A worthy example is the Australia's Higher Education Contribution Scheme (HECS). This income-contingent loan, introduced in 1989 and amended in 1997, goes beyond risk pooling, which would be possible to organise privately. It is a public-private risk-sharing device for financing higher education. All students are entitled to a loan regardless of family income. The debts must be repaid only if a stated income threshold is exceeded.[21] The issues of default and moral hazard are effectively resolved by a government guarantee if default occurs and by repayment through the effective governmental tax authorities. New Zealand (1991) and the UK (2005) have introduced this kind of scheme, and Thailand follows in 2006.

The Australian scheme seems to have been accepted. It does have flaws, however. Although HECS was introduced explicitly to improve the share of university students from poor family backgrounds, it had no discernible effect on this target group. It may have helped expand overall university attendance, but it made only the middle class (and perhaps women) better off without making the poor worse

research on this subject quite late in a career (see Heckman et al. 2002).

20 Diamond (1999, pp. 21–24); see also for differentiated view and dampening high expectations of private social insurance Pearson and Martin (2005).

21 For a description and evaluation of the HECS, see especially Chapman (2005) and Chapman and Ryan (2005).

off.[22] Another problem of the Australian scheme is the political discretion of fixing the earnings threshold beyond which the debts must be repaid. After a relatively generous threshold set by the labour government in 1988, the conservative government lowered the threshold considerably, slashing the implicit subsidy of the loans. This discretion is probably the main reason for the mediocre success of the programme, for it has created uncertainties that deter the most risk-averse students—those from poor backgrounds—from taking out these income-contingent loans.

In principle, income-contingent loans could also be used for continuing education and training. Apart from the critical points already mentioned, however, practical problems exist. Most continuing education and training is piecemeal and ad hoc, a characteristic that makes it difficult to attribute rising income to these kinds of fuzzy investments. And unlike higher education, which generates overwhelmingly general and transferable skills, continuing education and training produces more company-specific, less transferable and therefore riskier skills. Thus, one can expect employers and employees to share risk or the firm to shoulder all of it. In fact, however, we are again confronted with the "Matthew" principle that the people who profit most from company-specific training are those who already have a strong position within the company or who enjoy overall employability on the labour market. In addition, recent literature shows that company-financed training has many more general traits than is usually assumed.[23]

What about other alternatives to state subsidised individual training accounts? It should be clear by now that one-size-fits-all solutions are impossible in this complicated area of continuing education and training. The case for sharing risks through social insurance does not seem as strong. After all, the externalities related to continuing education and training might not be as major as those related to primary, secondary and higher education. Market failures related to continuing education and training might not be as strong. And risk-sharing between employers and employees should be assumed in many instances. Nonetheless, untapped qualification potentials, looming shortages of skilled labour, and disadvantaged groups legitimate state involvement. The involvement of the state can take different forms, and there are still second-best solutions through other forms of collective insurance. Examples illustrating the range of possibilities shall end this section.

22 In economic terms the scheme thus met the Pareto efficiency criterion but not the Rawls criterion. The justice theory by John Rawls (1990, 2001) would recommend the contrary approach instead: making the poor better off without to making the rich worse off. In Rawls terms, HECS would be justifiable only if the remaining inequality lifts everyone's lot through greater efficiency, which in the present context means improved growth rates. It may be that HECS meet this criterion, provided that the increasing participation in higher education was due to HECS and that it contributed to growth.

23 There is even evidence that firms use general training as an insurance device. See Acemoglu and Pischke (1998) and Feuer et al. (1991).

First, the state can use its redistributive capacity of taxation to ensure a second chance for those who were unlucky on the education and training market. This reprieve could be a form of financing periodically targeted programmes for lifting the overall level of knowledge and competence of the disadvantaged.[24] An instructive example is the Swedish "Knowledge Lift" (*kunshaftsliftet*) programme, which spent an annual sum of about €350 million on upgrading the knowledge and competence of low-skilled employees or unemployed persons from 1997 to 2002. Applied to The Netherlands, this would amount to a yearly investment of about €700 million and 200,000 additional participants in continuing education and training.

Second, the entitlements to unemployment benefits can be "activated" as "social drawing rights" in the form of training vouchers or job subsidies. The concept of active labour market policy has already extended the insurance principle to those unemployed who need education or training in order to find a new job. Job subsidies for the unskilled can thereby be interpreted as employability measures because learning on a matched job in a firm is a functional equivalent of formal training for this target group.[25] The spiralling need for continuing education and training would suggest extending the entitlement to vouchers to low skilled employees as well if they have accumulated unemployment benefit entitlements for a number of years. Denmark and Sweden have long practised this transformation of unemployment benefits into education-and-training benefits.[26]

A third alternative to state subsidised individual training accounts is the idea of stimulating continuing education and training by means of tax deductibles, including tax credits for those who pay little or no tax. Austria, for instance, provides 120 percent deductibles for firms investing in the employability of their

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24 This approach corresponds to Dworkin's (2001) theory of justice in which he recommended periodic redistribution to correct for random inequalities in order to make access of resources equal. One way of doing so is to impose heavy taxes on non-invested inherited assets. On the normative foundation of social risk management, see also Schmid (2005).

25 For the unskilled, Dustmann and Meghir (2005) found substantial positive returns related only to firm tenure. They concluded that programmes designed to improve the employability of the unskilled by means of general work experience are likely to be less successful, at least in Germany, than programmes attempting to match a worker with a firm, say, during an initial job subsidy.

26 For arguments in favor of vouchers and drawing-right systems, see Supiot (2000, 2001) and Wilthagen and Rogowski (2002), Both sources provide examples of good practice in this area. Supiot defines such drawing rights exactly in the tradition of Hugo Sinzheimer—as rights built on the notion of people's civil status. However, these rights relate to rights to exercise liberty, so their use simultaneously implies individual responsibility, including the acknowledgment of quantitative (financial) and qualitative (social) limits. The quantitative limit in extended risk communities of this sort implies the acceptance of fair co-financing. The qualitative limit implies the acceptance of coordination in using the drawing rights, usually by way of negotiation and mutual agreements, that is, through soft forms of governance.

employees. Another example is deferred taxation of savings accounts related to continuing education and training.

Fourth, collective agreements can include individual training or time-saving accounts, with the state guaranteeing transferability and liquidity of such entitlements and funds. Yet another possibility is an agreement on “working time reductions” in the form of investment. In this arrangement, employees agree to use reduced working time for education and training and thereby share the costs with the employers. The state can enter the game—as is often the case in The Netherlands—and enlarge the risk community by mandatory extension of such collective agreements to prevent cut-throat price competition between companies.[27]

Covenants are a fifth alternative to state subsidised individual training accounts. As a soft form of governance, covenants seem especially well suited to managing the risks of continuing education and training.[28] As previously noted, the situation surrounding the decision about investing in education or training is characterised by great uncertainties. First, there is the uncertainty about the required skills in the future training market. Second, the players of the game—employers, employees and the state as the representative of externalities—do not know beforehand where gains are going to accrue and where losses must be incurred. This observation holds true at the micro- and macro-levels alike. The veil of ignorance—the insurance situation—is a given.

Covenants are written agreements between two or more parties or partners and signed by each of them with the understanding that they are committed to cooperation for an overarching common goal. In many cases, the state is involved as an initiating and co-signing partner. Unlike private or public contracts, covenants are voluntary and require no legal framework. Partners thus retain an exit option if the risk-taking appears excessive. On the other hand, the agreements also contain voice options regulating procedures to solve problems step by step as they arise. Because the balance of costs and benefits for the partners involved might change at each step, there must be trust that corrective measures are taken in pursuit of the common goal. Such “induced decision-making” through learning-by-doing, muddling through step by step, and learning-by-monitoring are the essence of covenants to establish such trust relationships.[29]

Covenants as public-private partnerships have become rather popular as a policy instrument, particularly in The Netherlands. There are two reasons for this

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27 Such extension of collective bargaining agreements (related to continuing education and training in this context) is also practised in Germany in the construction industry.

28 On this point and in the following passages, I rely heavily on the excellent and stimulating papers by Korver and Oeij (2004, 2005).

29 On the concepts of induced decision-making, learning-by-monitoring and policy learning, see also Hirschman (1967, 1995), Sabel (1994, 1995) and Hemerijck and Visser (2003).

development: (a) to overcome state failures in regulating complex issues, and (b) to close the gaps of inadequate laws that are either not followed properly or even circumvented. There are reportedly several hundred such covenants in The Netherlands. These agreements pertain to environmental issues, energy-saving, educational matters, health care, traffic and transport, housing, and especially working conditions. Best practice in continuing education and training is not common knowledge yet, but it probably already exists and may be the secret of successful local or regional labour markets. It is also likely to evolve, for the urgency of this overarching common goal at all levels of governance is pressing, not least in relation to the Lisbon goal of the European Employment Strategy.[30]

However, it would be a mistake to consider risk aversion only in economic terms. Prospect theory, or the psychological theory of intuitive beliefs and choices, teaches us that risk aversion is not only a matter of rational choice that can be resolved with the right economic incentives.[31] The way that people perceive risks greatly determines their daily choices, and utility is not only a matter of income maximisation but also of cognitive and emotional relationships. The consequences of these insights for the management of new social risks will be explored in the next section.

5. Sharing and Governing Risks under the Lens of Risk Perception

How can risk aversion be overcome in order to induce people to accept more risks and the increased responsibility that goes with them? Prospect theory provides interesting insights to this question. Most people tend toward myopic risk perceptions. They overestimate small-scale risks in the foreseeable future, and they underestimate large-scale risks that seem to lie far ahead. Most people are therefore more apt to buy travel insurance than disability insurance. Most people also underestimate the risk of unemployment or the risk of large income loss due to the erosion or lack of skills over the life course.

Another important psychological insight is that losses loom larger than gains in risk perception. Most people prefer small certain gains over large uncertain gains. That is, they prefer a bird in the hand to two in the bush. Yet most people are extremely averse to loss. They do not like to give things away even if the prospect of gain is bright. Psychologists have found that the loss-gain ratio is about two to one. It thus makes a difference in perception whether you frame a risk in terms of loss alternatives or gain alternatives.

30 See Ferrera (2005) and Kok (2004), among many others.
31 See especially Kahnemann and Tversky (2000) and Gigerenzer (2002). For an application to labour market policy, see Schmid (2005).

Important conclusions for the design of risk-sharing policy can be drawn from these insights. Daniel Bernoulli (1700-1792), one of the founders of probability theory and risk management, gives us a clue. As he pointed out, a beggar will not give up begging for a workfare job, for he would lose his ability to beg. He has to be offered something more.[32]

This "more"—what could it be? The concept of transitional labour markets (TLM) suggests a specific solution to this psychological problem: the extension of the expectation horizon through a set of opportunity structures available in the most critical events during the life course.[33]

(1) The first pillar in an extension of the expectation horizon would be the establishment of new social rights that go beyond employment. I am sure it would be in the spirit of Hugo Sinzheimer to extend the employment contract to an employability contract that includes income and employment risks related to transitions between various employment statuses.

As forcefully presented in the Supiot Report already, these social rights are new in content, scope and nature (Supiot 2001). They are new in that they cover subjects unfamiliar to industrial wage-earners: rights to education and training, to appropriate working hours, to a family life and to occupational redeployment, retraining or vocational rehabilitation. Their scope is also new since they would cover not only "regular" wage-earners but also the self-employed; the semi-self-employed; and temp-agency, contract and marginal workers. They are new in nature because they often take the form of vouchers or social drawing rights, which allow workers to rely on solidarity within defined and perhaps collectively bargained limits when exercising their new freedoms.

These new securities can no longer be seen as being given in exchange for subordination (as in the old employment contract), but as the foundations of a new freedom to act. They can be considered as active social securities, which go hand-in-hand with worker's initiatives to shoulder the risks of flexible employment relationships instead of restricting them.

(2) The second pillar in an extension of the expectation horizon would actually consist of stepping stones and bridges for overcoming critical events during the life course. The tendency to overestimate immediate small risks and underestimating distant large risks leads people to perceive the risk of being stuck in the low-wage sector to be greater than the risk of long-term unemployment resulting, say, from being too choosy about the jobs they will accept. Active labour market policies, therefore, should not be confined solely to offering jobs and

32 Quoted in Bernstein (1996, p. 119f).
33 On the concept and applications of TLM, see O'Reilly et al. (2000), de Koning and Mosley (2001), Schmid and Gazier (2002), Schömann and O'Connell (2002), and Mosley et al. (2002). For The Netherlands, see especially Wilthagen (2002), Muffels et al. (2003) and van den Heuvel et al. (2004).

placing individuals in work. Follow-up measures are required for transforming sheer workfare measures into stepping stones to a sustainable job career.

(3) The third pillar in any extension of the expectation horizon would be psychological bridges for overcoming asymmetric risk perception. Acceptance of a risky new job often requires abandonment of familiar certainties, such as confidence in one's own productive capacities or the reliability of social assistance benefits possibly supplemented by a small amount of clandestine employment.

Among people from a relatively poor background, the psychological dimension of risk aversion is compounded by the financial dimension, with the former paradoxically sometimes being even more important than the latter, as Bernoulli's beggar has already suggested. Motivation studies have shown that poor people are especially dependent on the sociability of their peer groups. But training and education often imply a change of peer group, particularly when job mobility is required. Hence, it might be advisable to arrange group measures instead of individualised measures in such cases.

The financial implication for programme design is to ensure that fall-back positions are always plainly available. It is therefore important for people from financially insecure backgrounds to have the opportunity to try out several jobs without benefits being withdrawn immediately if one option does not immediately lead to success. Trust in such sets of opportunities rules out workfare strategies that rigidly preclude trial and error as a productive job search strategy. For the same reason, the implementation of training measures for these target groups should also avoid the creation of exaggerated expectations, which can be nurtured, say, when a job candidate is required to pass formal examinations.

(4) The fourth pillar in an extension of the expectation horizon would be the establishment and reinforcement of learning communities. Coping with the risks of parenting and of education and training have demonstrated the importance of uncertainty, including that of family timing, of the needs to care for children, of the skills required by the future training market and of one's position in the wage distribution after investment. These kinds of uncertainty defy precise advance calculation of financial contributions and benefits, for the risks occur only in the process of doing. It is therefore necessary to design forms of social contracts that make constant revisions possible in order to recalibrate the balance of costs and benefits. Social insurance against new risks thus requires soft forms of governance that allow learning in the process of implementation.

In reality, we already know many forms of such learning communities based on soft law governance. Collective bargaining agreements are relatively traditional examples. But looking more closely, we discover that they tend to develop into framework agreements that open ways to negotiate flexibilities into their implementation. The social dialogue and the open method of co-ordination at the European level are modern forms of such learning communities. And as previously mentioned, two Dutch researchers have recently drawn attention to *covenants* as a promising form of learning-by-monitoring (Korver and Oeij 2004, 2005).

6. Summary and Conclusions

What has come out of this long lecture? There are a number of points to keep in mind. First, new social risks have evolved from familiar risks not yet well covered by unemployment insurance or other insurance devices. They include increasing social risks related to human capital investment; increasing risks of job instability related to family, care and life-long learning obligations; and increasing earning capacity risks due to ageing and new ways of organising work.

Second, compared to private insurance, social insurance has the great advantage of keeping the rules of the game flexible. In addition, democratically legitimate governments can redistribute *ex ante* on the basis of social criteria or, to use an outmoded term, solidarity. Solidarity is fundamental to social insurance, as expressed in spirit by Lord Beveridge in his famous 1942 report entitled *Social Insurance and Allied Services*: “The term social insurance”, he wrote, “implies both that it is compulsory and that men stand together with their fellows.” This notion, of course, is precisely the reason for the fierce opposition to social insurance from neo-liberal quarters.

Third, if we accept that the practice of ascribing the role of child care solely to women has been abolished, we cloak ourselves in the veil of ignorance described by John Rawls. Would-be parents don’t know where they will end up in the lottery of their own careers and that of their children’s careers. In other words, the structural situation for risk-sharing through social insurance is given, which legitimates redistribution between fortunate and less fortunate parents and children. That redistribution could take place, for instance, through generous non-means-tested children allowances and wage insurance during parental leave.

Fourth, sharing risks by applying social insurance principles could also stimulate low-skilled young and mature adults alike to increase their participation in continuing education and training so as to enhance their employability. With proper incentives, employers and other regional actors can be brought into the boat through, say, income-contingent loans, periodic governmental second-chance programmes, tax deductibles or deferred taxes on educational or time-saving accounts.

Fifth, it would be a mistake to consider risk aversion only in economic terms. This stance is supported by Sinzheimer’s view of social insurance quoted at the beginning of this lecture. Prospect theory, or the theory of intuitive beliefs and choices, teaches us that risk aversion is not a matter of rational choice only. It is also a matter of cognitive and emotional relationships. Active or activating labour market policy still has a long way to go to exploit these insights in an effective recalibration of social risk management, especially when it comes to the need for new forms of governance through which to implement these policies capably. I have argued for a combination of new social rights, such as training leaves and training vouchers, and for soft forms of governance, such as negotiated flexibility, covenants and open methods of co-ordination.

The concept of TLM makes suggestions in this direction, and there is some reason for hope that it is receiving more and more attention, especially through the ingenious help of my Dutch colleagues and the bold experimental spirit of Dutch politics.

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