



THE RISK SOCIETY

SOCIAL DEMOCRACY IN AN UNCERTAIN WORLD

JOHN QUIGGIN, JULY 2007



CENTRE FOR POLICY DEVELOPMENT
OCCASIONAL PAPER NUMBER 2
ISSN 1835-0135

CONTENTS

Risk and the welfare state	3
The welfare state as Piggy Bank	4
Risk and the functions of the welfare state	5
Health	5
Education	6
Reframing inequality in the context of risk	6
Government as the ultimate risk manager	7
The great risk shift	8
A new case for social democracy	10

ABOUT THE AUTHOR

Professor John Quiggin is a Federation Fellow in Economics and Political Science at the University of Queensland, and a fellow with the Centre for Policy Development. He is prominent both as a research economist and as a commentator on Australian economic policy. He blogs at: <http://www.johnquiggin.com/>.

ABOUT THE CENTRE FOR POLICY DEVELOPMENT

The Centre for Policy Development is a public interest think tank.

The Centre generates creative, forward-looking ideas for fair and sustainable policy change. We are building a diverse, cross-disciplinary community of thinkers who are interested in changing Australian policy for the better. Our research and discussion papers address a diverse range of policy challenges, focusing on reimagining the public sphere and rebalancing the relationship between markets, government, society and the environment.

The CPD is a non-profit organisation, funded by a mix of donations, memberships, subscriptions and advertising. To find out more please visit <http://cpd.org.au>.

THE CPD - ECONOMICS FOR THE REAL WORLD

Much of the thinking that informs current government policy is based on outdated or oversimplified economic theory. The CPD is looking at how we can move beyond the 'small government vs big government' debate to incorporate recent research (for example in behavioural economics), environmental concerns and a broader, more balanced view of human nature into the economic principles that underpin public policy. For more information please see <http://cpd.org.au/category/all-articles/economy>.

Abstract

'Risk' may be a central idea of the early 21st century, just as 'globalisation' was the dominant idea of the 1990s. The fact that individuals and families are vulnerable to a wide range of social, economic and other risks - and that collective action is needed to help reduce and manage these risks - has long been an important theme in social-democratic thinking. The aim of this paper is to show how an improved understanding of risk can contribute to the development of a modernised social democratic model.

THE RISK SOCIETY

'Risk' and uncertainty, in a variety of forms, have become increasingly salient features of life in the early years of this century. Arguably, 'risk' will be a central idea of the early 21st century, just as 'globalisation' was the dominant idea of the 1990s.

Public discussion of uncertainty has become increasingly sophisticated. For example, weather forecasts now routinely cite probabilities for rain on a given day, whereas only a few decades ago, such concepts were considered too difficult for the general public. More significantly, the notion of a trade-off in investment decisions between risk and return is now widely understood. In public policy, risk-related concepts are increasingly discussed in quantitative terms, rather than in abstract generalities.

The fact that individuals and families are vulnerable to a wide range of social, economic and other risks - and that collective action is needed to help reduce and manage these risks - has long been an important theme in social-democratic thinking. As social-democratic ideas are reformulated in the new environment of the 21st century, the role of risk and social responses to it will need to be reconsidered.

Social democracy is built on the idea that as members of a society, we have an obligation to look out for each other. We also have a legitimate expectation of help from society when we are in need of it. In an increasingly diverse society, this kind of social solidarity cannot be assumed to exist automatically. Instead, it must be asserted through political choices, by which governments help reduce, share and manage the risks we face.

By contrast, the neoliberal alternative is based on the idea that individuals, households and businesses should manage all risks by themselves through market transactions. In practice, this means that most risk is borne by those least able to manage it.

RISK AND THE WELFARE STATE

The growing social salience of risk and uncertainty suggests the possibility of a more general reorientation of views about the welfare state, its role and significance.

One way of approaching this reorientation is in terms of Nicholas Barr's distinction between the 'Piggy Bank' and 'Robin Hood' functions of the welfare state.¹ In Barr's terminology, the Robin Hood function refers to the redistribution of wealth (either in lump sums or as flows of transfer payments) from the 'lifetime rich' to the 'lifetime poor'. In a society where endowments of physical wealth and earning capacity were equal, the Robin Hood function would be unnecessary.

the notion of a trade-off in investment decisions between risk and return is now widely understood

By contrast, the ‘Piggy Bank’ function of the state involves the smoothing of individual consumption over time and over a range of risky outcomes. This function would be relevant even in a society where lifetime incomes were equal. It is just as relevant, (perhaps more so) for those on middle incomes as for those lower down the scale.

In traditional presentations of the case for social democracy, these ‘smoothing’ functions were commonly seen as peripheral. Advocates of a targeted welfare system saw the provision of services to households that could afford to provide for themselves as an undesirable side-effect of provision for the poor - in other words, ‘middle class welfare’. On the other hand, advocates of universal provision saw it as politically necessary to build support for redistribution.

THE WELFARE STATE AS PIGGY BANK

Traditionally, more attention has been focused on the Robin Hood function of the welfare state than its role as a Piggy Bank. Opponents of universalism have argued that ‘middle-class welfare’ constitutes wasteful churning and leads to an excessively large state that nevertheless does a poor job in equalising income. Supporters argue that universal programs build social solidarity and cement support for the Robin Hood function, even among those who are net contributors.

But Nicholas Barr persuasively argues that both sides miss the point. Consumption-smoothing and risk-pooling are valuable in themselves, and the role of the state in these activities needs to be assessed independently of distributional issues.

In fact, there is a strong case that redistribution plays a vital role because it pools risks that arise within individual lifetimes. In other words, redistribution deals with the risk of being born into a poor family instead of a rich one, possessing the wrong type of job skills for a particular labour market, or living through a sustained economic downturn. On this analysis, the primary role of the welfare state is managing risk, not redistributing income.

.....

As Anthony Giddens has observed, “the welfare state, whose development can be traced back to the Elizabethan poor laws in England, is essentially a risk management system. It is designed to protect against hazards that were once treated as at the disposition of the gods - sickness, disablement, job loss and old age.”²

.....

Given the central role of risk, we need to ask why the government should be involved in risk management. Barr argues that information-related market failures provide a more robust case for government intervention than do the traditional categories of market failure under certainty (imperfect competition, externality, natural monopoly and so on).

Barr focuses on adverse selection, moral hazard and unquantifiable uncertainty as the key issues. Embarking on a systematic treatment of the main functions of the modern welfare state, assessed in terms of risk management, he examines unemployment insurance, pensions, health care and education, in each case considering the option of private provision against a range of government interventions.

.....

Consumption-smoothing and risk-pooling are valuable in themselves, and the role of the state in these activities needs to be assessed independently of distributional issues.

RISK AND THE FUNCTIONS OF THE WELFARE STATE

The interpretation of the welfare state in terms of risk and uncertainty may be illustrated by considering some of its core functions. For some of these functions, such as various forms of social insurance, the risk management function has always been emphasised. However, concern with risk has traditionally been a subsidiary theme.

For instance, the public provision of retirement income and of services like health or education have commonly been justified with reference to notions of redistribution, public goods and the provision of basic needs. However, none of these arguments yields an immediate response to neoliberal criticisms that it would be better to redistribute money incomes, and then allow households or individuals to allocate their expenditure between health, education and other things as they see fit.

But when the argument is flipped over and examined on the basis of risk, a much stronger case for intervention emerges. We can see this by looking at the health and education sectors, where the risks associated with health care and investment in education are compelling.

Health

The problems with market provision of health care are well-known. In the absence of public intervention or insurance, health care expenses for even moderately serious illnesses and injuries are so large and uncertain as to be beyond the capacity of most individuals and households to manage through ordinary methods such as drawing on savings. In the United States, for example, an average day in hospital can cost \$US1,500 (around \$AUD2,000). Even a short stay in hospital can exhaust the liquid financial resources of the average household.

The usual private market response in cases of this kind is insurance. However, health insurance faces severe problems arising from the fact that some people are more likely to suffer poor health than others. If insurers have information on the health status of their clients, they will charge higher rates for those known to be at high risk – or even refuse to cover them at all. If clients can keep this information private, those at high risk will naturally be more willing to seek coverage, and this will push up rates across the board (the problem known as ‘adverse selection’).

Despite strenuous attempts, no private market solution to this problem has been found. The US has maintained higher levels of reliance on private insurance than most other countries, but even so, almost 50 million people are uninsured. Many more are covered by the public residual insurance schemes Medicare and Medicaid, which are hugely expensive. In fact, despite offering coverage to only limited groups such as the elderly, military veterans and the very poor, the US government sector actually spends more on healthcare relative to GDP than its Australian counterpart.

The Howard government has similarly engaged in massive public expenditure combined with coercive measures applied to high income earners to maintain the private health insurance sector, without achieving much more than a partial reversal of its decline.

In other words, public financing is the only feasible response to the problems of health care.

health care expenses for even moderately serious illnesses and injuries are too large and uncertain for most individuals and households to manage

The necessity of public financing may be traced to the risks associated with health in both the short term and long term. In the short term, we can't know for sure if or when we will get sick. In the long term, markets cannot manage the risk associated with the fact that some people will have chronically worse health than others.

Although there are good grounds for a substantial element of direct public provision, public financing can also support private provision including both private medical services and community run primary health care centres. These issues are discussed further in the Centre for Policy Development's '[A Health Policy for Australia: reclaiming universal care](#)'.

Education

Similar lifetime risks arise in education. On the one hand, as children start school, or as teenagers enter university, there is a lot of uncertainty about the outcomes. Some will do well and go on to high-paying jobs, while others will do poorly and face the prospect of insecure, badly-paid work. But this uncertainty is not uniform. Students from wealthy backgrounds with highly-educated parents face much better odds than those whose parents have low incomes and less education.

As a result, any system relying primarily on private financing and provision of education is likely to be inefficient and inequitable. Students from poor backgrounds will have limited access to loans to support education, and will face less favourable terms and more limited opportunities. This can be seen quite clearly when we look at the make up of student populations in the top US universities. A 2004 study showed that, of the 146 most competitive and selective institutions, just 3 percent of students come from families whose incomes are in the lowest 25 percent. In comparison, 74 percent came from families in the top quarter. Although the situation in Australia is not as bad as this, students from working class background are less than half as likely to attend university as students from professional and managerial backgrounds. These unequal opportunities are partly due to problems at the school level, but they also reflect inadequate responses to the risks associated with education.

A related problem is that external assessment of the quality of education is quite difficult. If a school or university reduces the quality of the education it provides, for example by offering less demanding content, it will be many years before this becomes apparent. As a result, competitive market mechanisms do not work well in the education sector - if indeed they work at all.

REFRAMING INEQUALITY IN THE CONTEXT OF RISK

The issue of the distribution and redistribution of income has long been a central concern of democratic political systems. In the 20th century, particularly on the left, the issue of income distribution was viewed primarily in terms of economic and social class, usually with a focus on the organised working class. As class boundaries have blurred and unions have declined in power and influence, the effectiveness of class-based arguments for redistribution have declined.

One result has been a rethinking of the more abstract arguments for egalitarianism, such as those derived from utilitarianism and from the theory of justice developed by John Rawls. A striking feature of this new thinking is that it frames inequality in the context of

any system
relying primarily
on private
financing and
provision of
education is
likely to be
inefficient and
inequitable

the risk associated with a hypothetical process of social planning or contracting, a process in which no one can be sure what place they will fill in society.

One way to think about these abstract defences of egalitarian redistribution is as generalisations of the risk-based case for the welfare state. In a risk-based view, redistribution may be seen as providing insurance against a particular kind of risk, namely the risk of being born poor, socially dislocated and without access to human and social capital.

The point is that people's lifetime incomes are inevitably affected by their family backgrounds. Children from dysfunctional families do face greater risks of unemployment, poverty and so on than those from stable, socially integrated families. From a risk perspective, the fact that there is no inevitability about this relationship (people from poor and unstable family backgrounds can prosper, and those with a more favourable start in life may fail) does not alter the fundamental injustice of a society where people face radically different life chances. This issue has commonly been framed in terms of a contrast between equality of opportunity (the idea that everyone should have an equal chance at the prizes society has to offer, regardless of family background) and equality of outcome (the idea that society should not be divided into groups of winners and losers, even if the contest for those positions is in some sense fair).

In reality, no such distinction persists in the long run, due to the fact that without active intervention, inequality is inherently accumulative in nature. In a society with highly unequal outcomes, those who do well in an initially equal race will have the resources to ensure a head start for their children, in the form of private schooling, capital for business investment, richer social networks and so on. Hence, equal opportunity cannot be sustained for long in the presence of highly unequal outcomes.

This point is illustrated by the experience of the United States. In the 19th century the US genuinely was a land of opportunity, with rates of social mobility far greater than those in Europe. By the late 20th, Americans born into low-income families were less likely to escape poverty than their counterparts in other developed countries.

GOVERNMENT AS THE ULTIMATE RISK MANAGER

The past is inevitably viewed through the prism of the present and the imagined future. Just as happened with globalisation a decade ago, it is necessary to reassess the experience of the 19th and 20th centuries in the light of new ways of thinking about the present.

Moss (2002) surveys two centuries of American history, in which he presents the state as 'the ultimate risk manager'.³ Moss distinguishes three phases of public risk management in the United States. Although the United States is atypical in important respects, Moss' three-phase model provides a useful framework for discussion.

Moss' first phase, 'security for business', encompasses innovations such as limited liability and bankruptcy laws, introduced in the period before 1900. The institutions of bankruptcy and limited liability have been established for so long now that they seem like a natural part of the capitalist order of things. Yet, as Moss shows, before their introduction they were vigorously opposed by defenders of the free market, who saw them as undermining the principle of individual responsibility and promoting what is now called moral hazard.

in a society with highly unequal outcomes, those who do well in an initially equal race will have the resources to ensure a head start for their children

risks of environmental degradation and natural disaster are inherently social in their nature, and the success or failure of a society in responding to these risks is a measure of the capacity and responsiveness of its government

Moss' second phase, 'security for workers,' was produced by the shift from an economy dominated by agricultural smallholdings to a manufacturing-based economy in which most households depended on wage employment. In this phase, workers received systematic protection from the impact of industrial accidents, through workers' compensation, and from the risk of unemployment, the natural counterpart of wage employment. Historically the phase includes Progressive initiatives such as workers' compensation and the core programs of the New Deal like unemployment insurance and social security.

These developments were less extensive in the United States than in most other developed countries. Although European countries developed the welfare state further, it is arguable that Australia, with its 'wage-earners' welfare state' fits Moss' model even better.

The third phase, 'security for all', is still underway and includes such diverse initiatives as consumer protection laws, environmental protection and public disaster relief. These may be seen as responses to the 'risk society'. Risks of environmental degradation and natural disaster are inherently social in their nature, and the success or failure of a society in responding to these risks is a measure of the capacity and responsiveness of its government. Both the failure of Japanese authorities to respond adequately to the Kobe earthquake and the even more catastrophic failure of the US government in the aftermath of Hurricane Katrina prompted fundamental questioning of the nature of social arrangements and the adequacy of social protection.

THE GREAT RISK SHIFT

In the last quarter of the 20th century, there was a strong reaction against the welfare state, associated with the movements variously known as 'Thatcherism' in the United Kingdom, 'Reaganism' in the United States, 'economic rationalism' in Australian and neoliberalism more generally. The neoliberal movement criticised the welfare state as a costly, inefficient and ultimately inequitable drag on economic performance.

One influential way of framing this critique was the claim that by socialising the risks faced by individuals and households, the welfare state necessarily reduced incentives to pursue risky opportunities. Hence, it was argued that reductions in welfare benefits would reduce welfare dependence and create a more enterprising society. This is far from obvious, particularly once we look beyond the sphere of for-profit business enterprise. Social innovations of all kinds flourished in the 1960s, a time of full employment and a strong welfare state. Fear of poverty tends to encourage conformity to existing social norms and established career paths rather than a willingness to experiment.

During the 1990s, it was widely argued that the transformations of economic and social structures associated with the increased importance of risk rendered social democracy obsolete. It would inevitably be replaced, it was argued, by the emergence of a new global turbo-capitalism. But in the 21st century, it seems that social democracy has proved more resilient than its critics expected, and than some of its supporters feared. In the English-speaking world, where the neoliberal push has been most vigorous, the main institutions of the welfare state, including public health, education and social security systems, remain intact - despite continuous pressure.

The persistence of the welfare state has surprised many observers, given the decline of many of the mass institutions that supported it (most obviously trade unions) and the emergence of an increasingly diverse and individualistic society. A focus on shared risk may help to explain this resilience. Many discussions of social democracy focus on notions of community that derive ultimately from membership of some specific group, and therefore appear vulnerable to social change that breaks down the boundaries between groups.

By contrast, consideration of the risks we all face, and a view of society as a set of institutions through which we jointly manage those risks, may have less immediate emotional appeal than specific claims about community. But it can be supported by reasoned ethical judgements that are consistent with diversity and individualism. Neoliberalism affected not only the explicit institutions of the welfare state like social welfare benefits, but also the implicit contracts between workers and employers, under which employers would seek to preserve jobs, except in circumstances where the viability of their business was threatened, and to reward the loyalty of long-term employees through the maintenance of career paths. From the 1980s onwards, businesses routinely dismissed employees in large numbers, not as a last resort, but as a preferred method of making already substantial profits even larger.

With the advantage of hindsight, it is evident that the transfer of risk from government and business to households has been one of the most significant outcomes of the neoliberal era, referred to by Jacob Hacker as *The Great Risk Shift*.⁴

A particularly striking feature of this transfer has been the extent to which business and political leaders have been insulated from it. Top managers are protected by increasingly generous 'golden parachutes', ensuring that even if they lose their jobs for poor performance they are still entitled to large payouts. Although this has been accompanied by the expanded use of devices like payment in share options, which appear to expose senior managers to risk, these are largely shams. Options that fail to deliver the expected benefits, because the price of the company concerned falls below expectations, are routinely repriced or reissued by company boards. Likewise politicians, so long as they have not offended business interests, can expect to enhance their generous superannuation with lucrative jobs in the private sector, many of which appear so undemanding as to be virtual sinecures.

Meanwhile, households are exposed to increasing levels of financial risk. The results are most evident in the United States, where bankruptcy has become more and more common. By 2005, more Americans experienced bankruptcy than divorce. A 'reform' introduced in that year made bankruptcy much harder, but this merely shifted the form of financial distress. Because the new laws made it harder to refinance housing debt in bankruptcy, they contributed to a wave of foreclosures on 'sub-prime' loans made to high-risk borrowers. Rapid growth of household debt means that Australians are vulnerable to similar risks in the event of an economic downturn.

The transfer of risk has been symbolised in Australia by the misleadingly named *WorkChoices* laws, likely to be experienced by the average Australian worker in the form of a take-it-or-leave-it individual contract. Not surprisingly, there has been a resurgence of support for the traditional role of the state in protecting individuals and families from the risks of a market economy, particularly in relation to employment.

the transfer of risk from government and business to households has been one of the most significant outcomes of the neoliberal era

Moreover, the claims made on behalf of unfettered capitalism in the 1990s have increasingly come under question. The dot-com boom, ending in the crash of 2000, cast doubt on the idea that the growth of an information-based economy was best directed by speculative investors. And it has become increasingly apparent that the main effect of neoliberal reform has been to shift risk from business and governments to workers and consumers.

As a result, voters seem disinclined to abandon social democracy in practice. Even John Howard observed in the lead up to the 2004 Federal election that “There is a desire on the part of the community for an investment in infrastructure and human resources and I think there has been a shift in attitude in the community on this, even among the most ardent economic rationalists.” More recently, Howard has conceded the need for action on other risks such as climate change.

A NEW CASE FOR SOCIAL DEMOCRACY

The resilience of social-democratic institutions and values in the face of a concerted neoliberal attack has been striking. It is not sufficient however to defend the existing institutions of the social-democratic welfare state. Rather the case for social democracy must be formulated in a way that provides a response to current circumstances and challenges.

The idea that we have the capacity to share and manage risks more effectively as a society than as individuals may provide the basis for such a reformulation. The set of policies traditionally associated with social democracy may be regarded as responses to a range of risks facing individuals, from health risks to uncertain life chances.

Equally importantly, an emphasis on facing and managing risk collectively, through social institutions supported by government, is relevant to many of the challenges we will face in the future. Moss’s emphasis on the role of the state in providing protection against disasters looks particularly prescient in the light of the failure of the Bush Administration to provide a coherent response to the destruction of much of New Orleans by Hurricane Katrina. The damaging effect of that failure on the credibility of the Bush Administration and on support for the Republican Party in general, has been large and durable.

An even bigger source of risk today is climate change. In this case, the failure of neoliberals to respond has been complete. Until very recently, the vast majority of commentators on the political right either ignored the problem or sought to discredit the scientific evidence that established its existence and severity. Even now that attempts to delude the public on the scientific facts have generally been abandoned, neither the Bush Administration in the US, nor the Howard Government in Australia has any coherent response to the problem.

Finally, there is the question of national security. National security is traditionally seen as the trump card of political conservatives, yet neither historical nor recent experience suggests that this perception is strongly based in reality. Rather than treating security against foreign enemies or terrorist attacks as one of the risks faced by our community, to be minimised as far as possible and managed like other risks, the conservative approach has been to treat such risks as existential threats to the nation and to respond with military force, even though this is usually not the best response and commonly a counterproductive

choice. From a social-democratic perspective, the nation-state is not an end in itself, but a set of institutions designed to serve the collective interests of its members. This view of the state suggests a more realistic approach to national security, based on careful assessments of costs and benefits, in contrast to outdated militarism.

Treating national security as a problem of risk management has two big benefits. First, it means that the security implications of global risks such as climate change and financial instability can be taken into account as an inherent part of the process of policy formation - rather than as an afterthought. Second, it ensures that the use of military power is considered as one of a number of policy options, rather than being the default response to particular risks.

The time is ripe, then, for a shift from the defensive position of the last quarter-century, in which social democrats struggled mainly to protect the achievements of the past. The risks and uncertainties we all face, from economic insecurity to climate change, require a shared response. At present, individuals are carrying the burden of risks that can only be faced by society as a whole, while society is bearing the costs of our failure to equip individuals to manage the increased risks they have been exposed to.

We can reduce anxiety and suffering for individuals, and put our economy and society back on a sustainable footing, by putting a coherent, consistent approach to risk management at the centre of public policy. Acting together, we can reduce and manage risk for everyone, and protect those who suffer the adverse outcomes of the risks that are an inevitable part of modern life.

The risks and uncertainties we all face, from economic insecurity to climate change, require a response from society as a whole.

ENDNOTES

¹ Barr, N. (2001) *The Welfare State as Piggy Bank: Information, Risk, Uncertainty, and the Role of the State*, Oxford University Press, Oxford.

² Giddens, A. (1999) *Runaway World*, BBC Reith lectures, http://news.bbc.co.uk/1/hi/english/static/events/reith_99/week2/week2.htm

³ Moss, D. (2002) *When All Else Fails: Government as the Ultimate Risk Manager*, Harvard University Press, Cambridge, Massachusetts.

⁴ Hacker, J. (2006) *The Great Risk Shift: The Assault on American Jobs, Families, Health Care, and Retirement*, Oxford University Press, Oxford, <http://www.greatriskshift.com/>.

Beck, Ulrich (1992) *Risk Society: Towards a New Modernity*, Sage, London.

PUBLISHED BY THE CENTRE FOR POLICY DEVELOPMENT, JULY 2007
MAY BE REPRODUCED PROVIDED ACKNOWLEDGEMENT IS GIVEN

THIS DOCUMENT CAN BE DOWNLOADED FROM

http://cpd.org.au/policy_papers