The Geneva Papers on Risk and Insurance Theory, 16:2 133–135(1991)

Social Insurance and Social Security: A Comment on Professor Atkinson's Lecture

AGNAR SANDMO
The Norwegian School of Economics and Business Administration, Helleveien 30, N-5035 Bergen, Norway

Professor Atkinson has provided us with a very stimulating survey of some central issues in social insurance. The exposition is very clear, and the knowledge that he displays both of theory, history and economic and social institutions is extremely impressive.

The lecture has variously been announced as "The future of social insurance" and simply "Social insurance". In the end it has turned out to be as much about the past as about the future. I am myself very sympathetic to the view that in order to make good choices for the future we must understand the past. This implies a belief not only in the importance of economic and social history as a basis for the economics of today, but also in the intellectual history of thinking about economic problems, in particular about the problems of social insurance. This belief is also very much reflected in Professor Atkinson's lecture.

In Norway issues of social insurance have become very prominent in political debate in recent years. The pensions part of the social insurance system will be coming under pressure with the aging of the population that will become particularly significant a decade into the next century. And both politicians and the general public are worried about the growth of payments under the disability insurance system. Throughout the seventies and eighties the number of disabled persons has grown much faster than the population, and the growth rate is high even when one adjusts it for the aging of the population. The empirical evidence indicates among other things that the incidence of disability varies positively with the regional incidence of unemployment, and there is some worry that doctors, who play a key role in declaring people qualified for disability insurance, have a tendency to stretch the purely medical criteria to allow for the absence of alternative employment in the region where people happen to live. If this practice becomes even more common than it is today, it will clearly become untenable. Within the context of our theory we might well take this kind of phenomenon as another piece of evidence in favour of our theories of asymmetric information and moral hazard, but it also raises some wider questions of what the social security system is for, and how social insurance in a narrow technical sense fits into the wider framework of economic and social policy.

I very much agree with Atkinson's emphasis on the employment relationship as a key to the understanding of the demand for social insurance. Preindustrial society had risks of its own, related e.g. to the connection between the natural environment and the crops, but individuals in this society had less exposure to relative price risks, which become much more important in industrialized economies with occupational specialization. The source of the demand not only for unemployment insurance, but also for pensions and disability insurance, must clearly be sought here.

Professor Atkinson discusses the reasons why firms themselves do not provide unemployment insurance as part of the labour contracts that they offer. I would personally believe that bankruptcy risks have a lot to do with this. In addition to this and the other explanations that he lists, it could be that workers would prefer public unemployment insurance for the following reason: We usually think of the incentive aspects of unemployment insurance in connection with employees—how hard they work, how intensively they search for new jobs etc. However, suppose that firms are not pure profit maximizers but have some degree of social responsibility, which is not an unrealistic assumption (contrary to the opinion expressed in Atkinson's quotation from Garraty). Social responsibility tells them that workers should not be laid off except under conditions that go beyond simple cost minimization considerations. To have unemployment insurance written into the labour contract then creates a moral hazard problem on the part of firms as well; workers would believe that the risk of being fired was greater with insurance provision than without. It might be argued that exactly the same problem arises with public unemployment insurance. But a contract between this particular firm and its workers might legitimize layoff practices in a way that is different from the situation under public insurance. There is a parallel here with the marriage contract. Most people would feel uneasy if their spouse-to-be insisted on having detailed provisions for divorce written into a personal marriage contract, even if the provisions were exactly the same as in the public law governing such contracts.

Social security is not only provided by the social insurance system.[1] Protection against relative price risks in an industrial society is also provided by transfers in kind and by the government's employment policy, regional policy, industrial policy etc., and this may have been in Beveridge's mind when he wrote the statement quoted by Atkinson at the end of his lecture. A natural economic argument is that such policies are inefficient because they involve real costs to society in a way that pure transfer policies do not. There is obviously much truth in this. But if transfer payments are made contingent on people moving, retraining etc., there are real costs involved in this too. These of course come in addition to the deadweight costs associated with the financing of the transfer payments through distortionary taxation.

Should we expect the demand for social insurance—perhaps for insurance more generally—to diminish in importance as people get richer? Theories of portfolio and insurance behaviour often imply this hypothesis, either in the form of a wealth elasticity for risky assets in excess of one (so that risky assets make up an increasing share of the portfolio as wealth increases) or as a proposition about optimal insurance coverage being lower, the larger is initial wealth.[2] The hypothesis seems to be borne out by empirical studies of portfolio behaviour, but I am less sure about the insurance part of it. The present century has seen a tremendous growth in social insurance together with considerable expansion of private insurance. If this can be taken to reflect individual preferences, it seems to go against the general hypothesis. However, there are arguments that go the other way. The increasing wealth of private individuals has come together with urbanization, occupational specialization and investment in human capital and in housing. Individuals have therefore to an increasing degree become capitalized and thereby more exposed to risks regarding relative prices, disability and unemployment. One possible explanation for the increase in social and private insurance is therefore that this capitalization effect has outweighed the wealth effect.

Whether this development will continue is of course an open question, and so is the question of the development of the relative shares of private and social insurance. In any case, the satisfaction of this demand without too large sacrifices in terms of efficiency raises interesting issues both for economic research and for public policy.

Notes

1. I have elaborated on this point in Sandmo [1991].
2. For discussions of the hypothesis in various contexts see e.g. Arrow [1974, ch. 3], Mossin [1968] and Sandmo [1969].

References

ARROW, K. J. [1974]: *Essays in the Theory of Risk-Bearing*. Amsterdam: North-Holland.
MOSSIN, J. [1968]: "Aspects of Rational Insurance Purchasing", *Journal of Political Economy*, 76, 553–568.
SANDMO, A. [1969]: "Capital Risk, Consumption and Portfolio Choice", *Econometrica*, 37, 586–599.
SANDMO, A. [1991]: "Economists and the Welfare State", *European Economic Review*, 35, 213–239.