Public governance in the Dutch welfare state

The consequences of privatisation for securing public interests in the history of the Dutch welfare state

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Abstract

Since the foundation of the Dutch welfare state in the nineteenth century, the distinction between government and market has been an object of discussion. In the first welfare arrangements, the role of the government was subsidiary to that of private initiatives. The churches looked after the poor and the employers and employees developed funds to cover employment related risks. The main idea was that state regulation should not stand in the way of these private initiatives. During the twentieth century the government increased its role in the provision of welfare. The public welfare state reached its peak at the end of the twentieth century. The Dutch welfare state is currently being confronted with a process of privatisation. We are witnessing the development of a regulatory welfare state.

Discussions regarding the optimal mix between public and private elements in the welfare state have played an important role in the design of the Dutch welfare state to date. Although nowadays the government is the most important provider of social security benefits, private elements are being introduced by the privatisation of, for example, the risks associated with reintegration into the labour market and employment. The idea behind this process of privatisation is that it makes private actors more aware of the costs involved with illness and inactivity, which induces them to take preventive measures. In other words, the introduction of private elements to the welfare state is believed to increase the effectiveness and efficiency of the system. The shift in balance from government to market does, however, raise questions with regard to the extent to which other public interests are secured. For example, to what extent is the solidarity between employees with high and low health risk guaranteed?

The consequences of the development of the regulatory welfare state for the securing of public interests are the object of this research. We investigated the development of the Dutch welfare sector into a regulatory welfare state and the public interests that justified the intervention of the government. The question we want to answer is whether or not the regulatory welfare state is capable of securing these public interests.

One of the results of our research is that the development of the welfare state is based on conflicting public interests. The dominant public interest changes over the years. In the early years of the welfare state income protection was an important public interest. Nowadays the effectiveness and efficiency of public expenditure, combined with a high value being attached to labour participation, dominates government regulation.

The development of the regulatory welfare state can be regarded as a response to this shift in public interests. Although in theory the introduction of private elements to a formerly public welfare system does not necessarily have to impair the securing of a wide range of public interests, we show that the regulatory welfare state is not fully capable of correcting the perverse effects of the private market.

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1. Introduction

In the history of the Dutch welfare state, continuous reconsiderations have been made regarding the role of the government and the room for market oriented solutions. Currently, the Dutch social security sector is being confronted with a process of privatisation. With regard to the risks of illness and disability, a substantive form of privatisation has been realised by handing over the responsibility for the coverage of these risks to the employers. Since the employers have the option of insuring these risks in the market, the shift in responsibility is accompanied by the emergence of a private insurance market. In addition, with regard to the provision of reintegration services, the process of privatisation in the Dutch social security sector contains a form of formal privatisation. The government, represented by the municipalities and the Institute for Employee Benefit Schemes (UWV), hires private companies to assist unemployed people seeking paid employment rather than providing this assistance through a public employment centre.

The policy of privatisation is based on the belief that the introduction of private elements to the Dutch welfare state increases the effectiveness and efficiency of the system and therewith decreases public spending. The introduction of market forces is in line with a trend throughout Dutch society, in which market forces are introduced in former public sectors, such as, health care and public transport. In fact, we see this trend throughout the whole world.[2]

The question is, however, to what extent the introduction of market forces in public sectors such as the welfare sector, influences the securing of public interests. To answer this question we analysed the development of the Dutch welfare sector. In section two a short outline of the history of the Dutch welfare state will be given, in which we will show how the welfare state developed into a regulatory welfare state. The importance of this historical overview lies in the fact that it offers a good understanding of the link between definitions of public interests and the design of the welfare state. In section three, the definition of public interests will be discussed in detail, while section four focuses on the design of the welfare state as a way of securing public interest. In section five we describe the consequences of the development of the Dutch regulatory welfare state for securing public interests. Section six contains some concluding remarks.

2. The Dutch welfare state: the development of a regulatory welfare state

2.1. From private to public welfare

The history of the Dutch welfare state shows large similarities to the histories of other welfare states.[3] However, due to the lengthy legislative processes, the path leading to the establishment of the Dutch welfare state was relatively long in comparison with other countries such as New Zealand and Germany.[4] The Dutch welfare state therefore emerged, as Abram de Swaan calls it, with ‘a long sizzle and a late bang’.[5]

The first act related to the welfare state was established in 1854 and concerned the provision of poor relief. The act was enacted after half a century of discussion about the responsibility for the provision of poor relief. At that time the churches were important providers of poor relief. The church councils did not want to hand over their responsibility to the state, since for them it was a means of binding people to the church. Furthermore the main goal of poor relief organised by the church was to provide the opportunity for church members to do a good deed. The recipient of aid held no entitlement. He was fully dependent on the mercy of the church administrators and their benefactors. In return for receiving poor

2. This general tendency is influenced by international organisations like the European Union and the Worldbank.
3. Dupeyroux 1966.
4. Wildeboer Schut, Vrooman & De Beer 2001, p. 8.
5. Swaan 1988, p. 210.

relief, the poor had to comply with the norms of the church and their way of life was the focus of heavy monitoring. It was believed that the poor had to be educated and activated in order to become self supporting. Poverty was believed to be an individual problem and not a consequence of problems at society level.[6]

Even though over time more and more people were convinced that poor relief should not be based on concerns about the salvation of the giver, but on the possibilities that it offered for improving the position of the poor, the churches won the battle. With the enactment of the act on poor relief in 1854, the responsibility for the provision of poor relief remained at church level. The state, represented by the municipalities, was only allowed to intervene if the churches failed to provide assistance to the poor. Although very small, the act on poor relief did mark an important milestone in state intervention with regard to poor relief. For the provision of poor relief, the municipalities introduced poor relief councils. The churches were obliged to provide these councils with information regarding the number of people that were granted poor relief to prevent paupers from receiving poor relief from both the church and the poor relief council. In reality, many people, however, received poor relief from both institutions because the churches were not willing to provide information to the poor relief councils and many poor relief councils regarded the poor relief provided by the churches as insufficient.

For a long period of time the role of the government was subsidiary to that of private initiatives. The churches looked after the poor and the employers and employees developed mutual funds to cover employment related risks.[7] The employees formed unions and established funds to be able to offer union members some financial compensation when confronted with a loss of income due to unemployment, sickness or industrial accidents. The union funds formed an important means of improving the working conditions of the employees. The unemployment funds, for example, prevented employees from accepting work under bad working conditions, such as low wages, in a situation of high unemployment. However, since not all employees belonged to a union and not all union members participated in the union funds, the union funds never covered more than a quarter of the labour force. Furthermore, the risk of unemployment is dependent on economic processes that are difficult to influence. This makes it almost impossible to calculate these risks and therewith the correct insurance contribution. As a result, the union funds were often insufficient for providing the required allowances. In situations of high unemployment in particular the unions were quickly confronted with financial problems.[8]

Union membership was also not widely spread since many employers did not permit their employees to become a member of the union. To prevent industrial unrest and to strengthen the relationship between employer en employees, some of the employers set up funds for professional risks, such as the loss of income due to accidents or illness. After the Industrial Revolution the employer had a special interest in strengthening the labour relation, investing in the employees' skills that were necessary to operate the machines. Private funds were established by the employers for their employees in the textile and the iron manufacturing industries in particular. Some of these funds covered the professional risks for the whole industry in a region. Other funds were only established for the employees of a specific company. Usually the funds covered the costs needed for medical treatment and the loss of income due to absence caused by an accident during work hours. If the accident caused the death of the employee, the widow would receive a small pension. The coverage of the available funds did, however, differ. Furthermore there were differences regarding to the management and the influence of employees. In some funds the board contained both representatives of the employer and employees. In other funds the firm owner was the only one who was entitled to change the contribution or the benefits. Furthermore some of the funds appeared insolvent in case of accidents, so the employee would be reduced to beggary after all.

6. Van Loo 1981.
7. Wildeboer Schut, Vrooman & De Beer 2001, p. 7.
8. Van Leeuwen 1997; Knotter, Altena & Damsma 1997.

In order to improve the situation of the employees, initiatives were taken for the introduction of a compulsory insurance against the loss of income due to industrial accidents. In 1901 the Industrial Injuries Act came into force. This act provided a compulsory insurance for the employees of a select group of companies, which increased throughout the years.[9] It was, however, not before the implementation of the new Industrial Injuries Act of 1921 that almost all employees were insured for the risk of loss of income due to industrial accidents or sickness. The new Industrial Injuries Act came into force shortly after the Invalidity Act of 1919, which covered the risk of invalidity and the loss of income caused by old age. Together, the new Industrial Injuries Act and the Invalidity Act covered both the professional and social risks of almost all employees. The acts depended on a similar administration. The boards of the funds consisted of both representatives of employees and employers as well as representatives of the government.

With regard to the coverage of the risk of unemployment, the government intervened more strongly by subsidising union funds and creating local unemployment funds. The improvement of the care for the unemployed was advocated by arguing that the unemployed differed principally from the poor. While poverty was still regarded as a consequence of individual flaws, unemployment could be attributed to economic processes. Moreover, it was in the interest of the local governments to invest in the unemployed, since their capabilities were of important value to society. In order to prevent laziness, the unemployment benefits were, however, accompanied by the obligation to search for a job and to accept employment when available. To prevent a degeneration of the work ethic of the unemployed, many local governments also created forms of artificial employment (werkverschaffing).[10]

2.2. From public welfare to the regulatory welfare state

Despite the slow start, government intervention increased rapidly during the second half of the twentieth century, during which time the Dutch welfare state transformed from a chaotic set of private initiatives to a coherent public system. Particularly the reports of the Commissie van Rhijn, with proposals based on the previous report of Beveridge, played an important role in the design of the Dutch welfare state after the Second World War. Crucial was the change in the legitimising principle. The provision of income protection for all members of society was no longer a responsibility for private actors, but was an interest for which the state should be responsible.[11] In line with this view, the principle of reciprocity was pushed into the background: the right to social security was believed to be universal and unconditional.[12]

Based on these ideas compulsory state unemployment insurance was introduced in 1952 and in 1956 the Old Age Pensions Act (AOW) came into force, providing a pension to all citizens. In 1965 the State became fully responsible for the provision of poor relief: citizens were given the statutory right to social assistance under the Social Assistance Act for poverty relief (ABW). Another important extension of the Dutch welfare state was the introduction of the Disability Insurance Act (WAO) in 1967, which covered the loss of income for employees who, for any reason, whether employment related or not, were not able to work. Finally, with the General Invalidity Benefits Act of 1975 the coverage of the risk of becoming disabled was extended to the self-employed citizens.

Although the responsibility of the government with regard to the provision of welfare expanded enormously, in the implementation of the act much room was still left for private initiatives. In particular the employers and employees remained important actors in the provision of welfare. The industrial insurance boards, with representatives from the

9. The act did not provide security for employees working on, for example, farms and working for ship-owners. These groups of employees often worked as a day labourer or without an employment agreement, which made a trustworthy administration impossible. The social needs of these employees were covered by special acts a couple of years later, such as the Shipping Injuries Act (1919) and the Agricultural Injuries Act (1922).
10. Rooy 1979.
11. Van Rhijn 1947.
12. Van Oorschot 2006.

employers and the employees, were responsible for the calculation and collection of the contributions. These private actors further designed the socio-economic system and concluded collective labour agreements, providing supplementary benefits above the minimum level laid down in acts.[13]

As a result of this strong employer and employee influence, the claims based on the Disability Insurance Act did, however, increase dramatically. Particularly older employees were driven towards claiming benefits on the basis of this act since this was beneficial for both employees and employers. If a company needed to get rid of employees because of a reorganisation, it was easier for both employer and employees to grant these employees a benefit based on the Disability Insurance Act. The unions supported this practice, knowing that the benefits based on this act were very generous. The supervision of the legitimacy of the claims was inadequate. As a result the system absorbed so much public expenditure, that the Dutch welfare state became financially untenable.[14]

In the 1980s this problem became clear resulting in the Dutch Prime Minister Lubbers declaring the welfare system to be sick and in need of restructuring. A process of privatisation was introduced, during which the task and responsibility of the state was reassessed.[15] New acts shifted some of the responsibility for the continued payment of wages to employees in the case of sickness or disability to employers, making them more aware of the costs involved with absence through illness and forcing them to take preventive measures. The task of the state is now limited to creating a safety net for those without a solvable employer. Furthermore the state has a responsibility to make sure that private actors do not misuse their regained opportunities. In other parts of the welfare state the process of privatisation has created a new institutional design. The municipalities, responsible for the reintegration of the unemployed, are for example forced to hire private companies to support unemployed persons searching for a job. Instead of supporting the benefit claimants themselves through public employment centres, the municipality's responsibilities are limited to signing a contract with an employment agency and supervising the compliance with these contracts.

At the end of the twentieth century therefore, the trend in the Dutch welfare state changed. The private sector re-entered the picture, however, this time there was no withdrawal on the part of the government. We see the development of a welfare state with room for private initiatives, but with public safeguards. This is the development of the regulatory welfare state.

3. Public interests

3.1. A general definition of public interests

The preceding section shows that in the history of the Dutch welfare state, as in so many other countries, the responsibility of the State for the provision of welfare has not always been self-evident. The question is why the provision of the welfare state should be regarded as a public responsibility. What should be considered as the inviolable part of the welfare state for which the government should take responsibility? We label this part as 'public interests'. Decisions with regard to what should be considered as public interests can be made on the basis of two definitions: a definition based on theoretic assumptions regarding market failure and a definition based on the practice of government decisions.

In public interest theories, the definition of public interests is linked to market failure.[16] In the Netherlands, market failure played a central role in discussions about public interests. In the nineteenth century, the public involvement with the until then privately organised unemployment insurance was, for example, justified by saying that 'it is the task of the government to take those measures, which are in the interest of the public, if private

13. De Gier, Henke & Vijgen 2003
14. De Gier, Henke & Vijgen 2003.
15. Zijderveld 1999.
16. Hertog 2003.

initiatives fail to provide these'.[17] In the current discussions about the development of the regulatory welfare state, government regulation is primarily geared towards correcting perverse effects of the market, therewith securing public interests.

An important contribution to the current discussions about public interests is the framework put forward by the economists Teulings, Bovenberg & Van Dalen.[18] In their study, they analyse what, in economic terms, can be considered to be public interests and how these interests should be secured.[19] According to them, public interests are related to external effects. Different forms of market failure, such as market dominance and information asymmetry, can lead to external effects. Other external effects are the results of transactions between two parties that affect a third party that is not involved in the transaction. If these external effects can be internalised, the outcome can, however, still be Pareto efficient.[20] In that case the existence of external effects does not form a public interest.

Where the market is not capable of internalising external effects, for example because there are too many parties involved and free-rider behaviour cannot be tackled, there will, however, not be a Pareto efficient outcome without government intervention. In this case a public interest is at stake, which justifies government intervention. From an economic point of view, public interests thus involve a situation in which a Pareto efficient outcome is not realised without government intervention. The redistribution of wealth is, however, also regarded as a public interest by economists. Although the redistribution of wealth cannot be argued for in terms of the realisation of Pareto efficiency, for redistribution implies that someone else will be worse off. The redistribution of wealth is nevertheless considered to be a public interest.[21] After all it is clear that the redistribution of wealth will not be realised without government intervention.[22]

Another method for defining public interests is reliance on the subjective definition of public interests by the legislator. The Dutch Advisory Council for Government Policy (WRR) adheres to this view. In their report 'Het borgen van publiek belang' (securing public interests), they define public interests as those interests that are the result of a normative debate in a country and which are laid down in regulations by the legislator.[23] The responsibility for the provision of a minimum level of social security is, for example, assigned to the Dutch government in article 20 of the Dutch Constitution and several international treaties and is therefore a public interest.[24]

When considering the different acts and treaties that apply to a country as definitions of public interests for which the government takes responsibility, a hierarchy of public interests emerges. The hierarchy that applies to the different acts and treaties influences the hierarchy of the public interests that need to be secured. At the top of the hierarchy are those public interests that need to be secured at all times, such as equality of rights for all. These fundamental basic rights are succeeded by public interests, such as the redistribution of wealth, which emerge in the specific context of the welfare state. Finally, further down the hierarchy, public interests can be defined that do not have a legal base, but which are nevertheless important to secure because they contribute to the realisation of a Pareto efficient outcome.

Although a hierarchy of public interests is helpful in decisions regarding conflicting public interests, the fact remains that a definition of public interest that is dependent on acts and treaties is not absolute, but differs both between governments in different countries as well as

17. Raaymakers 1895.
18. Teulings, Bovenberg & Van Dalen 2003.
19. See Ministry of Economic Affairs 2004 for a summary.
20. An outcome is Pareto efficient if no one can be made better off without making someone else worse off. The Coase theorema shows how internalised external effects can result in a Pareto efficient outcome (Coase 1960).
21. See Spicker 2000; Fleischacker 2004 for an extensive discussion of the development of the argument.
22. Barr 2004 argues that poverty entails negative external effects for society. The redistribution of wealth can therefore be regarded as the internalisation of these external effects. See also De Mooij 2006, p. 51.
23. WRR 2000.
24. See Vonk 2003, Kulke 2007.

over time.[25] Moreover, the decision of what is considered to be a public interest might be arbitrary. In order to have a full understanding of the public interests that need to be secured in a regulatory welfare state, it is therefore important to investigate the matter from the point of view of both theory (of market failure) and practice (public interests defined in regulations). In section 4 we will address the issue of market failure: to what extent market failure can be overcome by government regulation. That is, to what extent we can rely on government regulation for securing public interests. Before doing that we will, however, take a closer look at what the Dutch legislator has defined as public interests throughout the years.[26]

3.2. The definition of public interests in the Dutch welfare state

The history of the Dutch welfare state shows us that the task for which the government assumes responsibility and the definition of public interests change throughout the years. The involvement of the government in the Dutch welfare state in the early twentieth century was justified by arguing that the Dutch citizens should be provided with income protection. Income protection was deemed necessary to prevent paupers from dying from starvation or laying violent hands on society and to hold on to skilled employees. It was considered to be a government task, because the private initiatives failed in providing it.

Overseeing the first acts on poverty relief and disability insurance, the reason for the government to interfere in the private market, was twofold. The first reason involved the *inequalities in the provision of private welfare*. Before the implementation of the acts, poor relief was depended on the membership of the religious community or a union, and insurances against disability depended on whether or not the employer had set up insurance funds. For the people that did not belong to these groups, income protection was not realised. Moreover, not only did differences exist between the groups of people that could and could not rely on welfare provisions, but there were also large differences within the groups of beneficiaries. The provision of welfare varied widely between churches and unions and the disability funds in the region of Twente provided more care than the funds in the region of Brabant. The implementation of the first acts on poverty relief and disability insurance should also be regarded as a first attempt to reduce these unreasonable inequalities.

The second reason the government intervened was the *weak institutional capacity of the private insurance market*. Neither unions nor employers succeeded in establishing a solvable fund. The funds were often unable to pay the employees in the case of unemployment or an industrial accident. Another element of the lack of institutional capacity involved the pool of insured persons. An elementary rule of a working insurance market is that the pool of insured persons has to be large enough to proportionally divide the risk of becoming unemployed or disabled. Without the intervention of the government, there is the threat of the known market failure of ‘cherry picking’, as a result of adverse selection. The group that carries the risk of a member will allow only the persons with a low risk to enter the group. However, only people with high risks will try to share this risk with others, for people with low risk will not want to participate in an insurance fund since their contribution will be higher than their calculated risk. Consequently, without enforcement of the government, people with high risks will not be insured and established insurance funds will often be unable to carry the full risks of all the members.

A final flaw in the institutional capacity of the privately organised employer insurance funds concerned the dependent position of the employee in a liability procedure in case of an accident. Problematic in this procedure was that the employee carried the burden of proof. Moreover, the liability procedure interfered in a – normally – long-term relationship between

25. In fact, Schubert 1960, p. 220 points out that ‘American writers in the field of political science have evolved neither a unified nor a consistent theory to describe how the public interest is defined in governmental decision-making’.

26. For a full understanding of public interests, it is important to take a closer look at the definitions of public interest brought forwards by other governments too. Although the scope of this paper does not give us the opportunity to do that here, in our research we will look into this matter.

employee and employer. The risk of winning the battle (win the liability procedure) but loosing the war (getting fired after all), was reasonable. The employer could further slow down the legal procedure, knowing the employee was in urgent need of money. The first legislating activities started because of these known problems. The problems of institutional capacity could be overcome or diminished through government intervention, improving the realisation of income protection. The increasing role of the government in the provision of welfare thus shows the weaknesses in the institutional capacities of private actors and, hence, the importance of the institutional capacity of the state.[27]

During the development of the public welfare state, more and more emphasis was given to the institutional design of the welfare state. Especially the *legitimacy* by the stakeholders, in particular the employees and employers, was very important. The realisation of *income protection* remained, however, the main goal for a long period of time. In fact, it was broadened in such a way that it offered a higher level of income protection and covered all members of society. Moreover, the universal entitlement to such a level of income protection, was no longer advocated because of the positive effects for society, but because it was regarded as a goal in itself, as an indispensable element of a public welfare state.

The peak of the public welfare state was reached with the enactments of several acts after the Second World War. These acts were based on the idea of *solidarity with every member of society to keep a certain wealth*. Contributions and benefits were not depending on risks but on income.[28] In addition to the *redistribution of wealth* and the promotion of solidarity, *equality of rights* (the entitlements should cover and be equal for all members of society) and *legal certainty* (people ought to receive what is rightfully theirs) were important goals to realise.

As mentioned before, the increase in scope and level of social security entitlements raised the costs of the public welfare state dramatically. The next generation of acts therefore showed a reaction to the extensiveness of the framework of the welfare state. The legislator tried to reduce the intake of new social security recipients, by making the employer responsible for the paid benefits. The employer had to pay a higher insurance premium depending on the number of employees that became occupationally disabled. With the implementation of the Act on the Enlargement of Wage Payment during Sickness (WULBZ) in 1996, the legislator transferred the public risk of sickness absence by making the employers responsible for paying the wage of sick employees for the first year of sickness absence. A new orientation of the role of the government and the room for private interests thus emerged. Part of the responsibility for the provision of welfare was handed back to the private sector.

This shift in responsibilities coincided with a redefinition of public interests. The *efficiency and effectiveness* of the provision of welfare as well as an increase in *labour participation* became central goals of the welfare state. The enactment of the Work and Social Assistance Act (WWB) in 2004 forms a good example of the increase in focus on labour participation. Since this act came into force, social assistance recipients are obliged to accept almost every job that is offered to them, while before they needed to accept only those jobs that matched their qualification. Although the provision of income protection has remained an important public interest up until now, nowadays, a high level of efficiency as well as the notion that every citizen should have the opportunity to develop him- or herself (by participation on the labour market), can be regarded as the most important public interests.[29]

27. In that way the development of the Dutch welfare state shows similarities with the current development of welfare states in developing countries; McKinnon 2007.
28. Van Oorschot 2006.
29. Klosse 2003; Noordam 2006.

4. Securing public interests

4.1. Public versus private securing of public interests

When public interests are defined, whether by theory due to market failure or in practice by governments, the question is how these public interests can be secured. Both the public and the private sector exhibit their own mechanisms for securing public interests. In the public sector the government can, for example, secure public interests by law, while competition forms an important mechanism that contributes to the safeguarding of public interests in the private sector. The mechanisms inherent in the public and private sector do, however, differ with regard to the extent to which they are suitable for securing certain public interests. As a consequence, the public and private sector differ with regard to the extent to which certain public interests are intrinsically secured.

In the public sector the law functions as a safeguard for securing the public interests of equality of rights, legal certainty and legitimacy. The legal framework does, however, also influence the way in which decisions are implemented within the public domain. In order to be able to secure the public interests of equality of rights, legal certainty and legitimacy, some form of bureaucratic organisation is inevitable. Although bureaucracy prevents arbitrary decision making, it does so at the expense of efficiency. The competition that is inherent in the private sector, on the other hand, does promote efficiency and effectiveness. In the private sector market failure might, however, stand in the way of securing other public interests.

In the case of private welfare provision, market failure due to asymmetrical information forms an important issue. One of the problems that is associated with asymmetrical information, and which we addressed in the preceding section, is adverse selection. Adverse selection occurs on a private insurance market when risks are spread widely within a group of insurants and the information regarding these risks differs between insurer and insurant. On the one hand, when the risks are not known to the insurer, no insurance market will be established. This is because the insurer will have to create an insurance based on average risks, which will only attract the people with high risks and will therefore not be profitable for the insurer. On the other hand, when the insurer does know the risks, not the insurant but the insurer will apply adverse selection. The insurer may select insurants on the basis of the risks they are bearing, which means that sick people can be refused or offered insurance under less favourable conditions than healthy people. In this case, public interests such as equality of rights and the provision of a fair income distribution will be harmed.

In a situation of private welfare provision, asymmetrical information may also result in moral hazard.[30] On a private insurance market, all persons insured may be inclined to run more risks than they would have done without the insurance, because they are not confronted with the costs of insurance claims. In the same respect, having an insurance covering illness may result in unintentional use of the insurance, since it makes it attractive for employees to call in sick when they are in fact capable of working. Moral hazard may, however, not only appear on the level of the insurant but also on the level of the provider. In a private reintegration market, the providers of reintegration services may, for example, display moral hazard. Since the quality of reintegration services is difficult to measure, suppliers of reintegration services do not have an incentive to offer high quality and therefore may not provide the tasks they are paid for.

All in all, it may be clear that the realisation of a welfare state that is able to secure a large range of public interests is not easy. On the one hand, a publicly organised welfare state is capable of securing public interests such as equality of rights, legal certainty and legitimacy, however, the bureaucratic organisation is accompanied by inefficiency. A private welfare state, on the other hand, promotes efficiency due to the presence of competition, but does not offer a sufficient safeguard for securing public interests such as equality of rights and legal

30. Moral hazard may not only form a problem in a private welfare state. In fact, the Dutch welfare state is characterized by an example of moral hazard in a public setting, that is, the misuse of the disability status by the social partners during the 1980s.

certainty due to market failures. In order to be able to secure the full range of public interests, neither a public nor a private welfare state will do. Instead we need the best of both worlds.

4.2. Public and private securing of public interests: the regulatory welfare state

The development of a regulatory welfare state is an attempt to combine the advantages of both the public and private sector and is currently being adopted throughout the world. By introducing private elements to a formerly public welfare system, the role of the government shifts from that of a public provider to that of a regulator of the private market and the welfare state develops into a state-regulated welfare market: the regulatory welfare state.[31]

In a regulatory welfare state both government regulation and incentives play an important role in safeguarding public interests. The introduction of private elements in a formerly public welfare system, therefore, does not go hand in hand with less, but rather with more regulation.[32] Characteristic of the regulatory welfare state is the tension between market forces on the one hand and the safeguarding of public interests through government regulation on the other hand. Although the market is given the freedom to do its work, the government stays in control by correcting the perverse effects of the market. The corrections lead to a regulated market: a market in which market relations are subject to public law regulations and accompanying supervision. For the functioning of the regulatory welfare state, adequate government regulation is therefore essential.[33]

The functioning of the market is addressed in two respects by government regulation. In the first place, government regulation is geared towards creating a competitive market. By creating the conditions for competitiveness, through the use of competition policies, government regulation may prevent monopoly power and enhance efficiency. Secondly, governments can set the boundaries in which markets may operate, therewith preventing the perverse effects of the markets. Adverse selection may, for example, be prevented by introducing a compulsory insurance. In this case, the government sets the boundaries in which the private insurance market may operate, which induces insurants and insurers to behave according to the public interest.

To guarantee that market players display behaviour that is in accordance with the public interest, it is important that government regulation is enforced. Enforcement, for example through forms of supervision, does not mean that the responsibility is handed over to the government. Supervision is always supplementary to the primary responsibility of the agent that is under supervision and is focused on supervising whether the agents under supervision fulfil their responsibility and act according to the rules.[34]

Enforcement is necessary when it is not likely that the agents under supervision will spontaneously comply with the rules, which is the case when it is not in the private interest of the agents to behave according to the public interest. When the behaviour of market players does not result in an outcome that is in accordance with the public interest, one is confronted with external effects which the market is not capable of internalising. Government regulation, when enforced, forces market players to internalise the external effects, therewith correcting the perverse effects of the market and resulting in a public interest outcome.[35]

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31. Leisering 2003.
32. Vogel 1996; Leisering 2003.
33. That is not to say that all government regulation is applauded. We acknowledge that government failure can sometimes be even worse than market failure. Moreover, we have argued that government regulation is not necessary in the cases where the market is able to find a solution on its own (by internalizing external effects). Adequate government regulation therefore entails the demonstration of a market failure, a good analysis of correcting this market failure (which entails, as we will demonstrate, the possibility of not using government regulation but incentives as a correcting device), and an analysis of the costs and benefits of the correction of the market failure.
34. De Ridder 2004.
35. Teulings, Bovenberg & Van Dalen 2003. We do acknowledge that, due to possible adverse effects of government regulation, in practice the realization of a public interest outcome is not always that clear cut. See Van den Bergh 2000 for adverse effects of government regulation.

The perverse effects of the market can, however, not only be corrected by government regulation, but also through the use of incentives. Unintentional use of insurances can, for example, be discouraged by introducing financial contributions like the no-claim in the Dutch healthcare insurance system, while adverse selection can be prevented by financially stimulating employers to employ occupationally disabled employees. An important advantage of the use of incentives is that supervision is not necessary, since the financial incentives create a situation in which it is in the private interest of the market players to behave in accordance with the public interest. Due to the incentives the market players will thus spontaneously internalise external effects.[36]

In a regulatory welfare state, the nature of law changes from substantive law to more instrumental regulation, providing incentives to private actors, accompanying public supervision. Especially in a private setting, securing of public interests through the use of incentives is important. While in a public setting the supervising authority can annul decisions of agents under supervision and therewith take away the legal force, the supervising authority does not have these powers in a private setting. Therefore, in this case, supervision needs to be guided by derivative incentives, such as penalties and fines. In a private setting, the task of the supervising authority consists first and foremost of guarding against typical threats of the market, such as monopolisation and adverse selection. Another important task for the supervising authority involves the provision of information in order to increase the transparency of the market and therewith enhance competition and efficiency. In fact, pre-emptive supervision (by giving advice) is regarded by some as a more effective and efficient form of supervision than repressive supervision (through sanctioning).[37] Although supervision involves the collection of information, as well the formation of a judgement and intervention, in a private setting the importance of supervision is reduced to the element of information collection, while judgement and intervention are, when possible, left to the market.

5. Securing public interests in the development of the Dutch regulatory welfare state

From the foregoing it is clear that in theory a welfare state that exhibits both public and private elements is capable of securing a wide range of public interests. It is this idea that has prompted many to introduce private elements to a formerly public welfare system.[38] The transformation from a welfare state, in which the government fulfils the role of a public provider, to the regulatory welfare state, where the government becomes the regulator of the private market, can, however, not be regarded as an isolated decision. In fact, it is the shift in definition of public interests that forms the underlying motive for the change in the organisation of the welfare state.

As we showed in section 3, at any one point in time, several public interests might be at stake, one of which dominates the other. Moreover, within this set of public interests, one is often confronted with interests that are conflicting. In the welfare state, two public interests are obviously conflicting: on the one hand there is the interest of providing income protection and on the other hand there is the interest of labour participation. Since generous welfare provisions are believed to provide disincentives to work, promoting both public interests at the same time might not work out well.[39] In fact, as explained, for a long period of time the primary goal of the Dutch welfare state was the provision of income protection, which resulted in a huge number of people depending on welfare benefits and which changed the focus in the welfare state from a system of passive income support towards a system of activating benefit claimants. Where welfare states used to be primarily aimed at the provision of income protection, we are currently witnessing the transformation of the welfare state into

36. It is important to realise that financial incentives also have a drawback: that is, the possibility of crowding-out intrinsic norms or motivation. See Frey 1997 for examples of crowding-out effects.
37. Hampton 2005, Risseeuw & Leenheer 2007.
38. See for example Considine 2001; Taylor-Gooby 2001; Taylor-Gooby 2004; Sol & Westerveld 2005.
39. This view may, however, be questioned. See Esping-Andersen & Gallie 2002.

a workfare state or enabling state, where the promotion of labour participation is the principal aim.[40]

By introducing a process of privatisation to the Dutch welfare state, the Netherlands is thus not unique. According to Gilbert (2004) all Western countries 'push in the same direction, that is, away from the conventional welfare state model based on government delivery of an expanding range of social benefits under a system of broad-based entitlements. The United States is probably furthest along the course that has veered away from social rights to welfare and toward social responsibilities to work'.[41] A negative aspect of the transformation of the welfare state into a workfare state or enabling state is, however, that the promotion of labour participation might be accompanied by a decline in the entitlements to social welfare and therewith a decrease in levels of income protection.[42] The question is, therefore, to what extent the regulatory welfare state is capable, in practice, of securing a wide range of public interests, and which role government regulation and incentives play in the safeguarding of public interests. In this section we will address these questions, on the basis of the development of the Dutch regulatory welfare state.

In the development of the Dutch regulatory welfare state we can distinguish two types of privatisation. With regard to the risks of illness and disability, a substantive form of privatisation is realised, by handing over the responsibility for the coverage of these risks to the employers. Since the employers have the opportunity to choose for reinsurance of these risks, the shift in responsibility is accompanied by the emergence of a private insurance market. In addition, the process of privatisation in the Dutch welfare state contains a form of formal privatisation, with regard to the provision of reintegration services. Both types of privatisation are believed to increase the effectiveness and efficiency of the system.[43]

The privatisation of the risks of illness and disability dates back to 1994 and was finalised through the implementation of the Work and Income According to Work Capacity Act (WIA) in 2006. Under this law employers are obliged to continue the payment of employees' wages in the case of illness and partial disability. The idea is that employers will become more aware of the costs involved with absence through illness or disability, which induces them to take preventive measures. With regard to the safeguarding of public interests, this form of privatisation does, however, involve at least three threats.

In the first place, the privatisation of the risks of illness and partial disability might impair the position of the employees when they wish to execute their financial claims due to illness or disability. For in a private market, it can be the case that an insurance company or an employer will not be able to live up to its obligations. It is the question to what extent government regulation will be able to cover this risk. Another consequence of a privately organised insurance market is the fact that liability conflicts will no longer be covered by public law, but will fall under the heading of private law. The employer may, for example, appeal against a claim made by an employee, because the claim may have consequences for the social insurance premium the employer has to pay. A third consequence that needs consideration, involves the extent to which the employer will apply adverse selection, resulting in exclusion from employment for those employees that have a higher than average risk of becoming ill or occupationally disabled. On the basis of these arguments, the European Committee of Social Rights concludes that the process of privatisation is a violation of the European Social Charter.[44]

Although in theory, the introduction of private elements to the provision of insurances to cover the risks of illness and partial disability does not have to impair the securing of a wide range of public interests, in order to be able to safeguard these public interests, the threats that are inherent to a process of privatisation necessitate additional safeguards. The government, for example, needs to provide a safety net to cover the possibility that employees will not be

40. See for example Considine 2001; Gilbert 2004.
41. Gilbert 2004, p. 42.
42. See Gilbert 2004 for an extensive discussion.
43. See Walsh 1995; Nyfer 1998; Van Berkel & Van der Aa 2005.
44. See the conclusions regarding article 12, paragraph 1 of the European Social Charter (European Committee of Social Rights 2006).

able to execute their financial claims when confronted with illness or disability, while the transition of liability conflicts from public to private law necessitates an extensive framework for regulating financial markets. Furthermore, adverse selection needs to be prevented, for example, by forbidding employers to select employees on the basis of health aspects or by encouraging employers, through the use of financial incentives, to employ this group. For the safeguarding of public interests, government regulation and incentives thus play an important role.

While the privatisation of the risks of illness and partial disability affects the insiders, the other form of privatisation in the Dutch welfare state, the privatisation of the reintegration services, affects the outsiders of the labour market. Given the differences in groups, for this group other public interests might be under pressure due to the introduction of the process of privatisation.

Since the implementation of the Work and Income Implementation Structure Act (SUWI) in 2002, municipalities and the Institute for Employee Benefit Schemes (UWV) are obliged to purchase reintegration services for their clients on the market through the use of tender procedures.[45] The process of privatisation is further enhanced by the introduction of financial incentives both municipality and employer level, via the implementation of the Work and Social Assistance Act (WWB) in 2004 and the Work and Income According to Work Capacity Act (WIA) in 2006. By introducing financial incentives, it is expected that the municipalities and employers will become more aware of the costs involved with inactivity, inducing them to introduce an active reintegration policy. The introduction of an active reintegration policy might, however, involve some important drawbacks.

In the first place, the introduction of an active reintegration policy at municipality level is accompanied by the implementation of work first projects. In work first projects, social assistance recipients are obliged to work in return for receiving social assistance. The goal of the work first projects is twofold. On the one hand it is intended as a deterrent to claiming social assistance; on the other hand it is a reintegration tool. The participants of work first projects gain work experience, which helps them in finding a job.[46] Although work first projects are successful in lowering the number of social assistance recipients, especially because due to the projects many people refrain from claiming social assistance, a drawback of the work first projects is that the participants of the projects often have to work under poor working conditions. The work is often very unskilled, takes place within an imitated work setting, and it is not rewarded with a proper wage.[47] The obligation to work under these poor working conditions raises the question whether work first projects are in conformity with the European Social Charter, since it states that 'with a view to ensuring the effective exercise of the right to work, the parties undertake to protect effectively the right of the worker to earn his living in an occupation freely entered upon'.[48] Furthermore, due to the demands of work first, some people refrain from claiming social assistance.[49] For this group, income protection is not guaranteed, which also is not in conformity with the European Social Charter given that the European Committee of Social Rights states that 'reducing or suspending social assistance benefits is only compatible with the Charter if this does not deprive the individual concerned of means of subsistence'.[50]

The second drawback of the introduction of an active reintegration policy at municipality level is that it promotes adverse selection. Because the municipalities bear the full financial responsibility for the provision of social assistance, it is profitable for them to focus their reintegration policy on those groups that are easiest to reintegrate. The reason for this is that it is unlikely that the costs of the reintegration services for social assistance claimants with a

45. Sol & Westerveld 2005.
46. Sol and others 2007.
47. Due to these aspects some draw similarities between work first projects and forms of artificial employment (werkverschaffing) created in the history of the Dutch welfare state.
48. European Social Charter (revised), article 1, paragraph 2, Council of Europe: Strasbourg, 3.V.1996.
49. Sol and others 2007.
50. See the conclusions regarding article 13, paragraph 1 of the European Social Charter (European Committee of Social Rights 2006).

low chance of entering the labour market will be recovered by a decrease in social assistance claims. As a result, the municipalities will pay less attention to this group and will focus more on groups with a higher chance of entering the labour market.[51]

At employer level the drawback to the introduction of an active reintegration policy is the threat that it will induce employers to fire employees with a partial occupational disability. Since the implementation of the Work and Income According to Work Capacity Act (WIA), the employer is responsible for the reintegration of the employees that are found to be occupationally disabled for less than 35%. For this group, the employer is obliged to search for possibilities to reintegrate the employee within the company, or when that is not possible outside the company. Since the employer will try to minimize the personnel costs, this will prevent him from hiring someone with a higher risk of becoming ill or disabled. Furthermore, it is likely, that in case the employer does not see any possibilities for reintegration, he will fire the employee in order to save reintegration costs. Research shows that small companies in particular have few possibilities for reintegrating employees with a partial occupational disability within the company and that they therefore opt for dismissal.[52]

A final drawback to the privatisation of reintegration services is the danger of opportunistic behaviour on the part of private reintegration companies. Two forms of opportunistic behaviour can be expected: reintegration companies can be expected to do less than they are contracted for (moral hazard) and reintegration companies can be expected to focus on those clients that are easiest to reintegrate (adverse selection). Both forms of opportunistic behaviour can be attributed to the fact that the quality of reintegration services is difficult to measure and the reputation mechanism does not (yet) work in the Dutch reintegration market.[53] Although opportunistic behaviour is addressed by using contracts based on pay for performance, both types of opportunistic behaviour are present on the Dutch reintegration market. Clients of reintegration services complain that the reintegration companies make little effort to help them find a job.[54] And research shows that reintegration companies do indeed focus on those clients that are easiest to reintegrate, which results in little attention being given to the reintegration of social benefit claimants with a low chance of entering the labour market (due to creaming and parking).[55]

All in all, it may be clear that in a private reintegration market additional safeguards are necessary for securing public interests. Adverse selection at municipality level can, for example, be prevented by not focusing on labour participation only, but also on social participation as an outflow instrument (and by compensating the municipalities in this case for the costs of social assistance).[56] Equal opportunities for development can, furthermore, be promoted by stimulating employers, through the use of financial incentives, to hire employees with an occupational disability and/or long-term unemployed people, such as is being done in the Dutch welfare state, or to use government regulation to oblige employers to reserve a certain percent of their staff for people with an occupational disability.[57] Government regulation and financial incentives can also be used to tackle the opportunistic behaviour of reintegration companies.

The opportunistic behaviour of reintegration companies can, in the first place, be prevented by improving the reputation mechanism. The reputation mechanism can, for example, be improved by renewing the contracts concluded with reintegration companies that have good performance ratings without a competitive tender procedure and/or by including quality criteria in the tender procedure.[58] Another possibility is to increase the transparency of

51. Raad voor Werk en Inkomen 2006.
52. Regioplan 2007; Carpenter 1998; Wynne & McAnaney 2004.
53. Groot and others 2006.
54. Wit, Ulenbelt & Visser 2004.
55. See for example Van Berkel & Van der Aa 2005; Struyven & Steurs 2005.
56. Raad voor Werk en Inkomen 2006.
57. This system is administered in Germany, based on the Sozialgezetsbuch (Book 9, § 71). Other countries, like Italy (under Law 68/99) have a similar system to enforce employment of disabled persons: Wynne & McAnaney 2004, p. 73.
58. These aspects are, for example, present in the tender procedures in Australia. See for example Zwinkels, Van Genabeek & Groot 2004; Sol & Westerveld 2005.

the reintegration sector. To this end, the Dutch government has developed several initiatives. Information about the working of the reintegration market is collected and published through research reports and via websites.[59] Furthermore, the emergence of a quality mark for the reintegration market is being promoted.[60] A final possibility to tackle the opportunistic behaviour of reintegration companies is through the use of contracting. By including conditions in the contract with regard to, for example, differentiation in target groups and ways of financing the reintegration services, such as no cure no pay or no cure less pay, creaming and parking can be prevented and reintegration companies can be forced to live up to their contract.[61]

6. Concluding remarks

Although in theory, the introduction of private elements in a formerly public welfare system does not have to impair the securing of a wide range of public interests, in order to be able to safeguard public these interests, the threats that are inherent to a process of privatisation necessitate additional safeguards. As we have shown, in the safeguarding of public interests both government regulation and financial incentives play an important role.

From the previous section it is clear that the introduction of a process of privatisation to the Dutch welfare state, despite the use of government regulation and financial incentives, did not go hand in hand with an adequate securing of a wide range of public interests. The largest problem manifest in the private insurance and reintegration market is that of adverse selection. There are indications that the introduction of privatisation in both markets has induced employers to apply adverse selection in the hiring and firing process and reintegration companies to display behaviour of creaming and parking. The Dutch government is endeavouring to prevent these forms of adverse selection by formulating government regulation and using financial incentives, however, the evidence shows that these safeguards are not adequate. The current mechanisms for securing public interests are not fully capable of correcting the perverse effects of the private market.

The finding that in the Dutch regulatory welfare state the perverse effects of the private market, such as adverse selection, are not fully prevented by government regulation, does, however, not lead to the conclusion that the process of privatisation should be reversed. Before drawing such a conclusion, it is important to obtain a good overview of the public interests that are under pressure due to the privatisation of the Dutch welfare state. In addition, it is important to analyse why the adopted mechanisms fail in securing these public interests. Is the regulation insufficient, does the supervision fail, do financial incentives not work as they are supposed to, or is there a combination of factors at work? Finally, it is important to gain an insight into the measures that need to be undertaken, in terms of government regulation and accompanying supervision, in order to form a sufficient safeguard for the public interests under pressure. Within our research project these questions will be addressed in two doctoral theses. In the first project, the securing of public interests in the privatisation of the risks of illness and partial disability will be central, while the other project will focus on the consequences of the privatisation of the reintegration market for the safeguarding of public interests.

59. The improvement of the transparency and quality of the reintegration market is the task of the Council for Work and Income (Raad voor Werk en Inkomen).
60. See the quality mark website: www.blikopwerk.nl.
61. See for example Struyven 2002, Groot and others 2006.

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