

## 8. Contracts for or against employment?

---

The labor market is a central arena for the structuring of individual life chances in modern welfare states. Social inequalities are often generated in the labor market. Not only are class-based inequalities molded and reinforced here, but inequalities based on age, gender and ethnicity have close ties to employment. It is likely true that the effectiveness of welfare states to reduce social inequalities more broadly depends on how well labor markets perform. The combination of well-functioning labor markets and effective redistribution also plays a central role for the possibility of positive-sum solutions in generational politics.

With the return of mass unemployment in the mid 1970s, the cash benefit programs legislated in the twentieth century to protect citizens from economic vagaries in the labor market, and forming an important pillar of the generational welfare contract, came under increasing criticism of being economically counterproductive in the new economy of sluggish economic growth. Although ideas about excessive social policy commitments causing labor market rigidities and poor employment outcomes remain today, it is evident that countries have reorganized their welfare states differently to serve various objectives. This variety of institutional approaches has, amongst other things, provided fertile soil for debates about the role of welfare states in relation to social investment goals and economic productivity (Cantillon, 2011; Esping-Andersen, 2002; Hemerijck, 2011; Morel et al., 2012; Vandenbroucke and Vleminckx, 2011). The social investment perspective in social policymaking very much concerns the idea of supporting people to participate fully in society and secure financial viability of welfare states well into the future. It is reasonable to assume here that positive-sum solutions in generational politics would become severely undermined if effective redistribution comes at the price of substantially raising barriers to labor market participation and employment.

The purpose of this chapter is to analyse the link between generational welfare contracts and employment. We will subject the labor market rigidity hypothesis of extensive social citizenship rights to empirical test. Are balanced generational welfare contracts – with their high levels of income

replacement in age-related social insurance – related to adverse employment outcomes? Or can greater balance in the generational structure of social citizenship be regarded as an important social investment that improves labor market performance? Although we mainly address employment outcomes from the perspective of macro-economic sustainability, it should be acknowledged that for most citizens of working age, gainful employment constitutes an important precondition for full participation in society. Thus, for the individual citizen, employment not only provides important financial rewards, but it can also be valued for broader social reasons.

As discussed in Chapter 2, balanced generational welfare contracts would partly fail to support relational equality – and people’s capacity to walk tall – if extensive social insurance schemes indeed turn out to support people’s financial security at the expense of access to contexts where they are wanted, valued and respected. Gainful employment may provide citizens with tasks and challenges that are personally rewarding, offering possibilities for friendship and social esteem by being recognized as productive contributors to society (Arneson, 1990; Gallie and Paugam, 2000; Gheaus and Herzog, 2016; Jahoda, 1982; Phelps, 1997). We should, of course, be careful not to idealize waged work, or equate employment per se with meaningful work tasks. Some jobs may be “deadening to human thought and sensibility” (Rawls, 1971, p. 529), an observation that has been central in recent debates about the freedom from toil (Goodin et al., 2008; Van Parijs, 1995), meaningless work (Paulsen, 2014) and the precarization of labor markets, including the growth of discontinuous, fragmented and insecure forms of employment (Standing, 2011). Thus, without implying that all forms of employment produce valuable social outcomes, assessing labor market and employment outcomes of social insurance is clearly important not only from the perspective of the macro-economic sustainability of generational welfare contracts, but also in our endeavor to shed new light on how generational politics may affect opportunities for relational equality and gainful participation.

This chapter is organized as follows. Next, we discuss the labor market rigidity hypothesis in greater detail and alternative perspectives on the social policy and employment nexus. Then, we empirically assess whether there is a trade-off between pursuing generational balance in social citizenship and employment. Thereafter, we present a descriptive data analysis of labor market and employment outcomes of countries that have different generational welfare contracts, and subsequently perform a more rigorous test applying statistical regression analysis.

## THE LABOR MARKET RIGIDITY PERSPECTIVE AND ITS CRITICS

It is widely acknowledged that welfare states and social policy influence labor markets in different ways, where some effects are believed to be detrimental for both the demand and supply of labor, and thereby also hampering economic growth (Bean, 1994). The assumption of core welfare state institutions causing major labor market rigidities regained influence in the 1980s, when the rise in unemployment following the oil shocks in the 1970s turned out to be more persistent than initially expected (Bruno and Sachs, 1985). Most large programs of the welfare state came under fire of such critique, but unemployment and sickness insurance benefits were often considered to be particularly problematic.

Welfare state interference with market principles may affect labor markets and employment in various ways. By introducing moral hazards, government programs for redistribution are often considered to contribute to fraud and misuse. Unemployment benefits particularly are often claimed to reduce job search intensity and willingness of the unemployed to accept available job offers. Due to increased wage claims, redistributive policies are also thought to reduce labor demand and the willingness of employers to hire, something that may further be accentuated by taxes imposed on employers and employees to finance social policy. In this context of potential trade-offs between the goals of income protection and social inclusion, concerns have likewise been raised in connection with so-called unemployment duration or scarring effects, which refer to the deterioration of skills, motivation and well-being of the unemployed over the longer term (Darity and Goldsmith, 1993; Layard et al., 1991; Turon, 2003; Rogerson et al., 2005). Ljungqvist and Sargent (1998) have specifically linked the size of these unemployment duration or scarring effects to the generosity of out-of-work benefits.

Over the years, numerous studies using a great variety of statistical techniques claim that out-of-work benefits may be harmful for well-functioning labor markets and contribute to poor employment outcomes (Bassani and Duval, 2006; Elmeskov et al., 1998; Nickell and Layard, 1999; Nickel et al., 2005; OECD, 1994; Siebert, 1997). Some of these studies are based on micro-level data on individual behavioral outcomes, while others rely on macro-comparisons at the country level. Although critical voices have been raised concerning the robustness of cross-country evidence of supposedly employment-unfriendly welfare state institutions (Baker et al., 2005), the rigidity perspective outlined above is still figurative in contemporary debates on the employment situation of Western societies

(Messacar, 2014), To give one prominent example, in their reassessment of the 1994 Jobs Study, the OECD concluded that

changes in policies and institutions appear to explain almost two-thirds of non-cyclical unemployment changes over the past two decades. A consistent finding is that generous unemployment benefits, high tax wedges and stringent anti-competitive product market regulation increase aggregate unemployment. By contrast, highly centralized and/or coordinated wage bargaining systems reduce it. Likewise, spending on certain active labor market programs, such as labor market training, is associated with lower unemployment. Extensive sensitivity analysis shows that these findings are robust across specifications, datasets and econometric methods. (OECD, 2006, p.208)

Several studies diverge from the common view of portraying the welfare state and its institutions as a major culprit in the rise and persistence of unemployment since the mid 1970s. Besides the countercyclical effects of tax and transfer systems (Andersen and Svarer, 2011; Bougrine and Seccareccia, 1999; Darby and Melitz, 2008; Dolls et al., 2012), redistributive policies may in various ways improve labor market performance. Earnings-related benefits, for example, may strengthen work incentives via the strong link between eligibility and previous work history. Welfare states may also help to secure a workforce with suitable skills of relevance for work transitions in an era of rapid economic transformation, increasing labor market mobility and improving macro-economic performance more generally (Sjöberg, 2008).

The feminist critique of mainstream comparative welfare state research in the late 1980s and early 1990s also underscored the role of social policies for well-functioning labor markets in relation to gender-based inequalities (Fraser, 1989; Gordon, 1990; Hernes, 1987; Hobson, 1990; Leira, 1992; Lewis, 1992, 1997; O'Connor, 1993, 1996; Orloff, 1993; Pateman, 1988; Sainsbury, 1996; Shaver, 1989; Williams, 1995). One important issue concerned the emancipation of women and how welfare states could be more or less supportive of female employment and encourage gender equality, foremost through the ways in which countries have organized their family policies and reduced gender employment gaps (Crompton, 2006; Koven and Michel, 1993; O'Connor et al., 1999; Orloff, 2009). In particular, dual-earner/dual-carer models of family policy are often considered effective in promoting gender equality in paid and unpaid work (Gornick and Meyers, 2008; Korpi et al., 2013). Countries that have followed this tradition in the development of family policy combine generous earnings-related parental leave benefits and extensive public child care arrangements to enable full-time work of both parents. Although our focus is primarily on cash benefits, the overall extensiveness of gender egalitarian family benefits

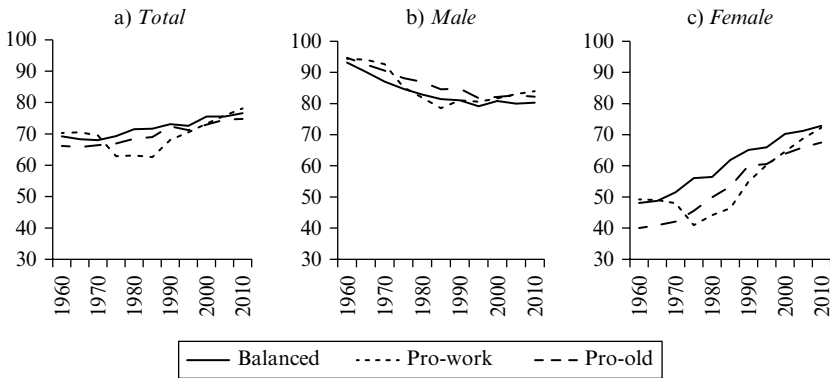
has previously been used as a proxy of countries' broader family policy models, including publicly provided child care (Ferrarini, 2006).<sup>1</sup>

In the following we will investigate employment outcomes of countries that have organized social policy and their generational welfare contracts differently. As we are mostly concerned with employment outcomes among people in economically active ages, we will not study how welfare states relate to employment of elderly people. Nor will we analyse whether welfare states support employment of young adults. Although questions about entries into and exits out of employment at these vulnerable phases in the life course are important to address in future research, we shall here restrict our focus to the particular issue of whether balanced generational welfare contracts are subject to poor employment outcomes in the whole working-age population, thereby weakening possibilities of positive-sum solutions in generational politics. Specifically, we address whether high levels of income replacement in social insurance (i.e. a typical trademark of the balanced generational welfare contract) affect employment outcomes negatively.

## EMPIRICAL ANALYSIS

Employment can be measured in different ways. In this analysis we focus on labor force participation rates and unemployment rates, both in total and disaggregated by gender. Figure 8.1 shows labor force participation rates by type of generational welfare contract in 18 OECD countries in 1960–2010. The former is calculated as the civilian labor force divided by the working-age population (15–64 years), averaged across countries for each contract type. The data is from the OECD. Countries are classified in accordance with our institutional analyses of age-related social citizenship rights in Chapter 4. Balanced generational welfare contracts are thus present in Austria, Belgium, Denmark, Finland, France, Norway and Sweden. Germany, Japan, the Netherlands and Switzerland have unbalanced contracts of the pro-work type. Unbalanced pro-old contracts characterize Australia, Canada, Ireland, Italy, New Zealand, the United Kingdom and the United States.

For large parts of the period, labor force participation rates in countries with balanced generational welfare contracts have been slightly higher or on par with those of other countries. Labor force participation has risen in most countries, particularly from the 1980s and onwards. Much of the rise in participation is due to women entering the labor market in increasing numbers, lowering the gender gap in employment. All countries have experienced a dramatic surge in female labor force



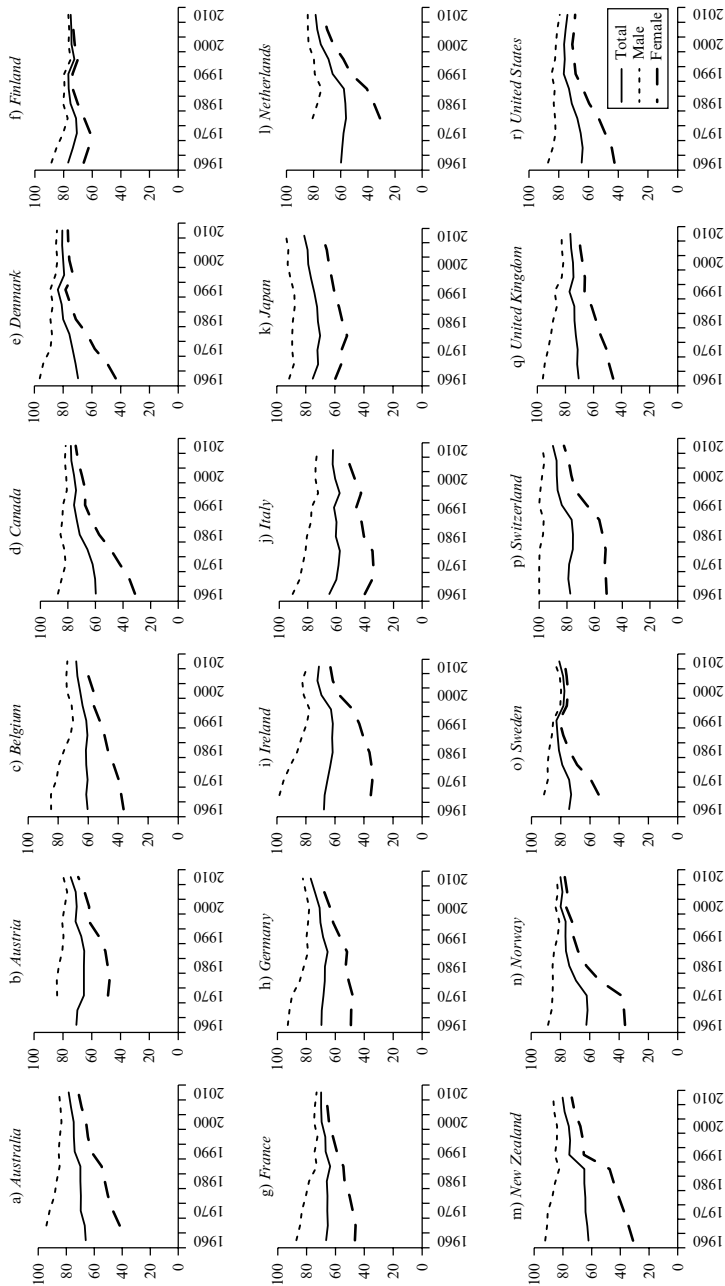
*Note:* The balanced generational welfare contract includes Austria, Belgium, Denmark, Finland, France, Sweden and Norway. The pro-work contract includes Germany, Japan, the Netherlands and Switzerland. The pro-old contract includes Australia, Canada, Ireland, Italy, New Zealand, the United Kingdom and the United States.

*Source:* OECD.Stat.

*Figure 8.1a-c Labor force participation rates by type of generational welfare contract in 18 OECD countries 1960–2010*

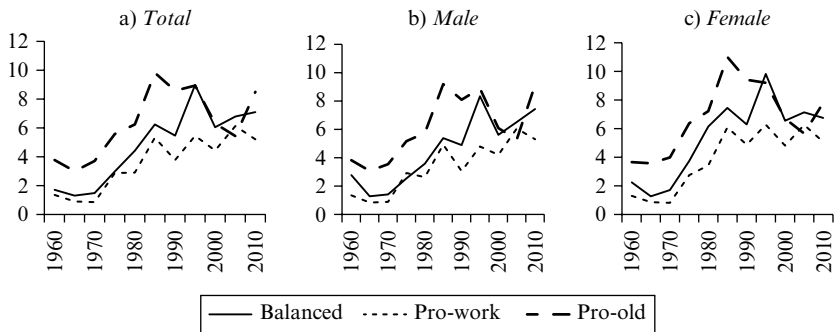
participation, but for most of the period the highest rates are found in countries with balanced generational welfare contracts. In the 1960s, it was not exceptional to find countries with female labor force participation rates of 40 percent or less. In 2010, female labor force participation is more commonly found in the range of 60 to 80 percent. Meanwhile, labor force participation has declined somewhat among men, from rates over 90 percent in the 1960s, down to rates slightly above 80 percent in the 1990s and onwards. The decline in male labor force participation, particularly in parts of Continental Europe, was to some extent driven by processes of deindustrialization and heavy reliance on pre-retirement and disability benefits to facilitate early exits from labor markets (Ebbinghaus, 2000; Esping-Andersen, 1996).

Developments deviate from the main patterns in a few countries (Figure 8.2). Finland and Italy experienced a slight but empirically noticeable decline in labor force participation between 1960 and 2010. In both countries, the rise in female labor force participation was not large enough to compensate for the downward trend in male labor force participation rates. Whereas Finland in comparison had very high female labor force participation rates in the 1960s, female labor force participation in Italy has been persistently low throughout the whole period. Since the 1960s Austria,



Source: OECD.Stat.

Figure 8.2a-r Labor force participation rates in 18 OECD countries 1960–2010



*Note:* The balanced generational welfare contract includes Austria, Belgium, Denmark, Finland, France, Sweden and Norway. The pro-work contract includes Germany, Japan, the Netherlands and Switzerland. The pro-old contract includes Australia, Canada, Ireland, Italy, New Zealand, the United Kingdom and the United States.

*Source:* OECD.Stat.

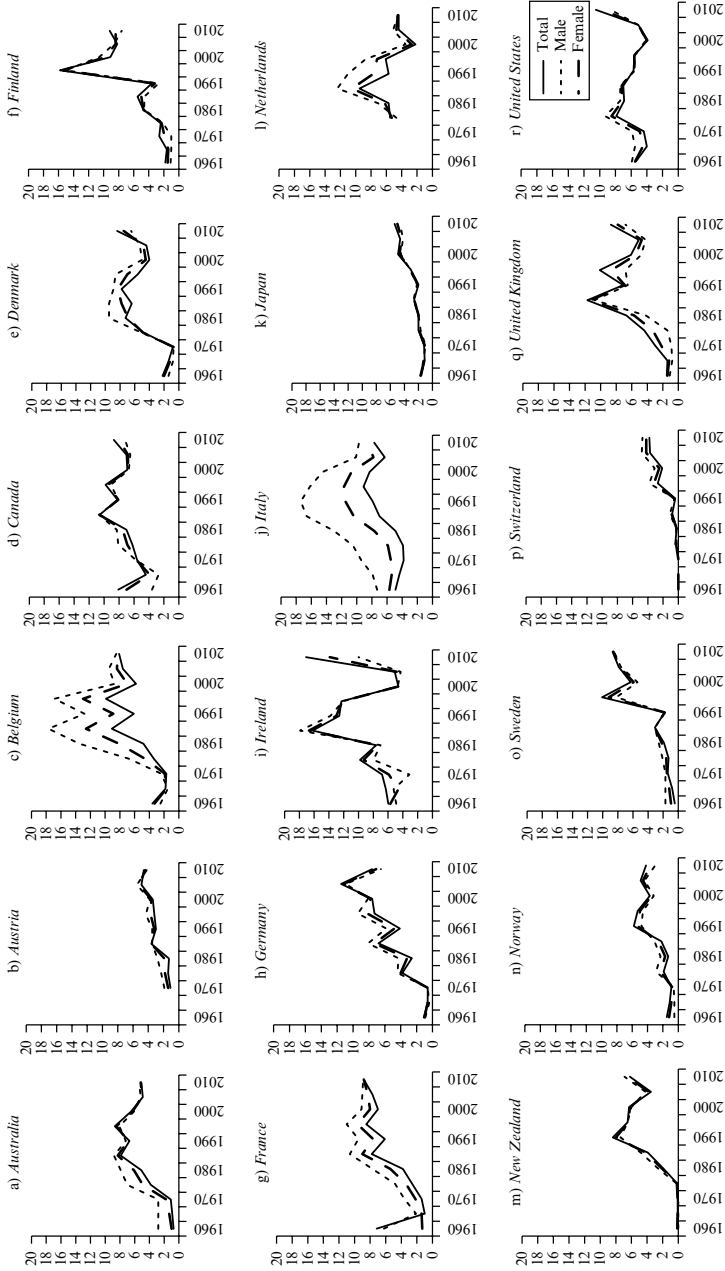
*Figure 8.3a–c Unemployment rates by type of generational welfare contract in 18 OECD countries 1960–2010*

Japan, Norway and Switzerland stand out in terms of maintaining levels of male labor force participation (in Japan even a slight increase).

Figure 8.3 shows unemployment rates by type of generational welfare contract in 18 OECD countries in 1960–2010. The unemployment rate is calculated as the ratio of the unemployed to the labor force (the total number employed plus all unemployed people). This data is also from the OECD. As may be expected, unemployment shows more of a cyclical roller coaster pattern than our previous figures on labor force participation. However, a few general trends are discernable. The return of mass unemployment in the 1970s is clearly visible in the data, in many countries followed by reduced unemployment rates in the 1990s and up to the great recession of 2008, when unemployment typically rose again.

For most of the period, the highest unemployment rates are observed in countries with unbalanced generational welfare contracts of the pro-old type. One exception to this pattern is in the mid 2000s, when unemployment declined in several countries that we categorize as pro-old, including Australia, Italy, New Zealand and the United Kingdom (Figure 8.4). During the most recent decades, female unemployment rates have sometimes been slightly higher than those of men in several countries. The gender gap in unemployment is not that well studied, especially in comparative research where most analyses have focused on differences in activity rates of men and women. However, a few studies indicate that





Source: OECD.Stat.

Figure 8.4a-r Unemployment rates in 18 OECD countries 1960–2010

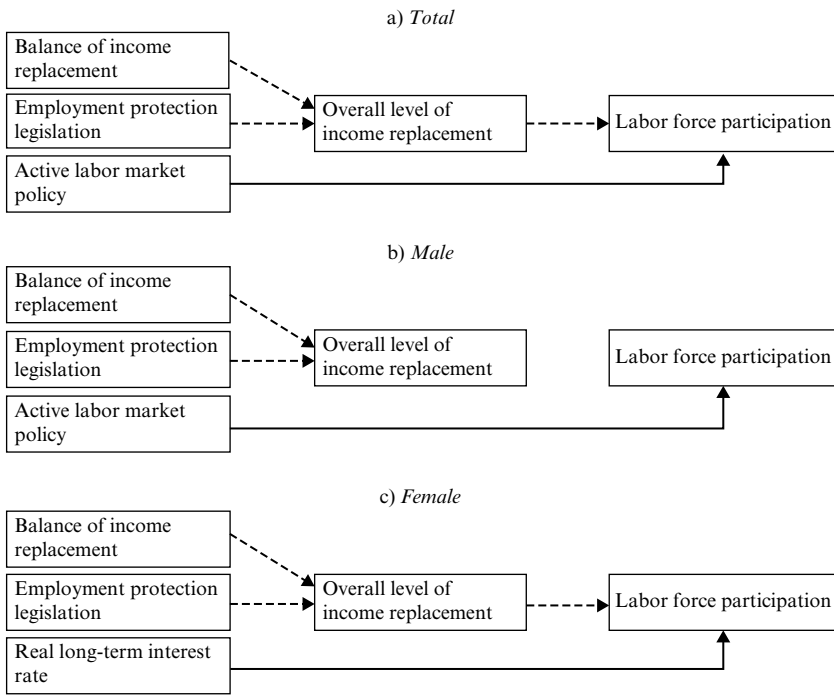
gender differences in industry composition during recessions are the main explanatory factors for sudden shifts in unemployment between men and women (Albanesi and Sahin, 2013).

The country averages fail to provide any conclusive evidence of extensive labor market rigidities in countries that have more balanced age-related social citizenship rights. Labor force participation rates are not consistently lower in countries with balanced generational welfare contracts, and considering unemployment these countries seem to take an intermediate position. For large parts of the period, unemployment rates in countries with balanced generational welfare contracts are somewhat higher than in countries with pro-work contracts, but lower than in countries that we categorize as pro-old. Thus, in terms of labor force participation and unemployment it is not possible to observe strong evidence of countries with balanced generational welfare contracts performing substantially worse, although individual countries may deviate from this pattern.

### **Regression Analysis**

In order to subject the labor market rigidity hypothesis to further empirical tests and assess the extent to which generational balance in social citizenship can be regarded as an important social investment, we next perform a series of structural equation models examining possible links between income replacement in social insurance and employment outcomes. As labor market performance is affected by numerous factors besides the organization of social policies, we adjust our estimates for confounding factors typically used in macro-comparisons of labor market outcomes, including macro-economic (monetary) policy (Baccaro and Rei, 2007; Howell, 2005; Schettkat, 2005), globalization (Rhodes, 1997; Wood, 1998), labor costs (Hemerijck and Schludi, 2000; OECD, 1994), employment protection (Bentolila and Bertola, 1990; Bertola, 1990) and active labor market policy (Heckman et al., 1999; Kluve, 2010; Nickel, 1997; Scarpetta, 1996). Among these factors, employment protection legislation and active labor market policy in particular are often considered to have ambiguous effects on labor market performance.

In order to measure how countries use macro-economic and monetary policies to affect employment performance we use the real long-term interest rate. The real long-term interest rate includes government bonds that mature in ten years, adjusted for inflation. Globalization is tricky to conceptualize and measure (Carroll, 2003). We follow Kenworthy (2008) and use imports in percent of GDP. Labor costs are calculated per unit of output. For employment protection we use an index capturing procedures involved in dismissing workers and hiring people on fixed-term or



*Note:* Country-fixed effects and cluster robust standard errors. All models include a full specification of confounding effects, including employment protection legislation, active labor market policy, unit labor costs, the real interest rate and imports. Only statistically significant paths are shown. Solid arrows indicate negative associations, dashed arrows positive ones.

*Figure 8.5a–c Pathways between balance and overall level of income replacement in age-related social insurance and labor force participation after confounding adjustment. Structural equation models of 18 OECD countries 1985–2010*

temporary work contracts. Active labor market policy is measured as total expenditure in percent of GDP. All of the data is from the OECD, including the index of employment protection legislation.

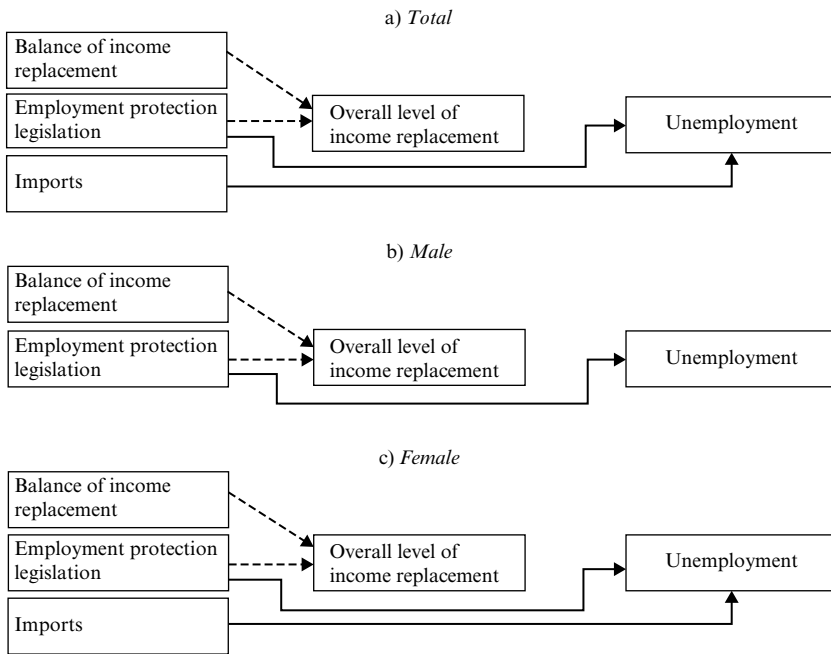
Figure 8.5 shows structural equation models of pathways between income replacement in social insurance and labor force participation in 18 OECD countries after confounding adjustment (for further description of the statistical method, see Chapter 5). Solid arrows indicate negative associations, dashed arrows positive ones. Social insurance is measured as previously in this book, with the overall level of income replacement in

age-related social insurance as the mediating variable. The degree to which levels of income replacement in social insurance is evenly distributed across age-related risks (childhood, working age and old age) is our main independent variable. Full models with all estimates are found in the Appendix, Table A.5. We analyse labor force participation in the total population as well as that of men and women separately. Due to the structural shifts in employment outcomes noted above and availability of data for some of the confounding variables, we restrict the analysis to the period 1985–2010.<sup>2</sup>

In a regression framework, we also do not find any strong evidence of labor market rigidities caused by extensive age-related social citizenship rights. To the contrary, a higher overall level of income replacement in age-related social insurance appears to increase labor force participation. Much of this increase is explained by positive impacts in relation to female labor force participation. Among men, there is no association between income replacement and labor force participation. The generational structure of social citizenship is not directly related to labor force participation. Instead, the association is indirect. In countries where income replacement in age-related social insurance is more balanced, the overall level of income replacement tends to be higher, with consequent increases in labor force participation foremost among women.

Only a few confounding factors have statistically significant effects. Active labor market policy somewhat surprisingly appears to reduce labor force participation, but only among men. This association may appear for various reasons. One issue that often is raised in analyses based on statistical regression concerns endogeneity in the variables of interest. In many countries, increased spending on active labor market policy implies that more people are getting into training, thus leaving the labor force. It is reasonable to assume that this type of endogeneity is pronounced in fixed-effects regressions, where the focus is on short-term rather than long-term effects or cross-country differences (see our discussion of fixed effects in Chapter 4). In fact, in a random effects model, the negative association between active labor market policy and labor force participation among men changes and becomes positive (results not shown).<sup>3</sup> Higher real long-term interest rates also seem to reduce labor force participation, but only among women. We also observe an indirect (goes through income replacement) positive effect of employment protection. We must be cautious not to interpret this mediating effect of social insurance in causal terms (i.e. that employment protection increases income replacement).

In order to analyse more closely the role of social insurance, we also estimated a series of structural equations where female labor force participation was regressed on income replacement for each age-related social risk (childhood, working age and old age). Only income replacement for



*Note:* Country-fixed effects and cluster robust standard errors. All models include a full specification of confounding effects, including employment protection legislation, active labor market policy, unit labor costs, the real interest rate and imports. Only statistically significant paths are shown. Solid arrows indicate negative associations, dashed arrows positive ones.

*Figure 8.6a–c Pathways between balance and overall level of income replacement in age-related social insurance and unemployment after confounding adjustment. Structural equation models of 18 OECD countries 1985–2010*

childhood-related risks showed a statistically significant relationship, which in a broader sense can be expected to capture the extent of work and family reconciliation policy (see Table A.6 in the Appendix). Thus, we here specified the link between age-related social insurance and labor force participation, which largely seems to be driven by effects of family benefits on female labor force participation.<sup>4</sup>

Figure 8.6 shows structural equation models of pathways between income replacement in social insurance and unemployment in 18 OECD countries in 1985–2010, after confounding adjustment. We do not find any effects of income replacement. Thus, social citizenship rights seem to be unrelated to unemployment at aggregate level. Employment protection

legislation is negatively associated with, and reduces, unemployment, both in total as well as among men and women separately. Several factors may contribute to this negative relationship. A general reduction in arbitrary dismissals and early warnings that allow employees to engage in job search prior to being laid off are two mechanisms previously noted in the literature (OECD, 1994). Finally, we find that the size of imports in the overall economy reduces unemployment among women. This effect most likely reflects gender differences in sectorial composition and the multifaceted effects of globalization on different parts of the economy.

## CONCLUSION

In this chapter we have analysed links between generational welfare contracts and employment outcomes in 18 OECD countries. Poorly functioning labor markets pose serious threats to positive-sum solutions in generational politics. The dominating view in mainstream behavioral economics has come to portray comprehensive welfare states as causing major obstacles for labor market performance and employment growth, thus indirectly raising concerns about the long-term sustainability of balanced generational welfare contracts. The empirical results presented in this chapter strongly challenge such ideas and rather indicate that balanced generational welfare contracts may be considered an important social investment.

Unemployment appears to be largely unrelated to the ways in which countries have organized their generational welfare contracts. However, in terms of labor force participation we find some interesting results. Labor force participation tends to be higher in countries where income replacement in social insurance is more extensive, as in countries with balanced generational welfare contracts. Much of the observed increase in labor force participation is due to changes in the economic behavior of women and the ways in which countries have come to organize income replacement in relation to work-family reconciliation, which is an important element of the generational welfare contract.

## NOTES

1. According to the family policy models developed by Korpi et al. (2013), Austria, Belgium, France, Germany, Italy and the Netherlands rely heavily on various forms of programs encouraging traditional family structures, including child allowances for minor children, part-time public daycare for children three years up to school age, home care allowances and marriage subsidies. By comparison, Denmark, Finland, Norway

and Sweden emphasize more dual-earner policies, which include public daycare for the youngest children and full-time public daycare for children over three years, and clearly earnings-related parental insurances. Family policies are less developed in Australia, Canada, Ireland, Japan, New Zealand, Switzerland, the United Kingdom and the United States, where market principles have dominated policymaking. Typically, these more liberal-oriented countries score low on both traditional family policy and earner-carer dimensions.

2. Due to missing data for some variables and years in a few countries, the empirical analyses in this section are based on unbalanced panel data with at least 80 observations unequally divided across time and space.
3. Random effects models capture long-term effects and cross-country differences in levels, but also increase the likelihood of omitted variable bias. To recapitulate our discussion of fixed effects in Chapter 4, bias is the difference between the expected value of an estimate and the true value of the parameter being estimated.
4. These sensitivity analyses also show that the indirect association between employment protection legislation and labor force participation observed above appears to be largely influenced by developments in income replacement for working-age risks. It is only for protection against working-age risks that we observe an association with employment protection legislation. Again, we should not interpret this mediating effect of employment protection legislation on income replacement causally.