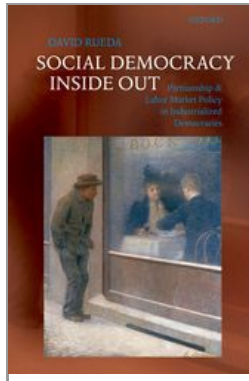


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Social Democracy Inside Out: Partisanship and Labor Market Policy in Advanced Industrialized Democracies

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Governments and Policy: The Insider–Outsider Partisanship Model

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Abstract and Keywords

This chapter analyses the transformations in party strategies that result from new voter demands and political-economic conditions. It presents a model that attempts to put together two important but often unrelated literatures: one focusing on electoral competition and the other on comparative political economy institutions. It argues that comparing and identifying social democratic governments with low unemployment and conservative ones with low inflation is not productive. This identification is based on the assumption that labour is disproportionately affected by unemployment, which is inaccurate. It is shown that labour is divided into those with secure employment (insiders) and those without (outsiders) and that the electoral goals of social democratic parties are sometimes best served by pursuing policies that benefit insiders while ignoring the interests of outsiders.

Keywords: insiders, outsiders, employment protection, corporatism, social democracy, labour market policy

In the literature on the comparative political economy of advanced democracies, there has been a widespread theoretical consensus about the goals different political parties pursue when in power. In principle, social democratic governments are assumed to defend the interests of labor and conservative ones those of what some authors¹ have defined as the ‘upscale groups’. Yet, since the early 1970s, many analysts have observed the coexistence of high levels of unemployment and social democratic government as well as a decrease in the distinctiveness of some of the policies traditionally associated with different political parties.

The analysis in this chapter focuses on the transformations in party strategies that result from new voter demands and political–economic conditions. It attempts to put together two important but often unrelated literatures: one focusing on electoral competition and the other on comparative political economy institutions. Herbert Kitschelt has accurately pointed out that the study of social democratic party strategies requires a ‘bridge across the familiar divide between students of comparative political economy and parties and elections’ (1999: 318). The model I present in the following pages attempts to do exactly that.

I argue that identifying social democratic governments with low unemployment and conservative ones with low inflation is not productive. This identification is based on the assumption that labor is disproportionately affected by unemployment. For reasons that will become clear in the following pages, I maintain that this assumption is inaccurate. The main thrust of this chapter's analysis is that labor is divided into those with secure employment (insiders) and those without (outsiders) and that the **(p.12)** electoral goals of social democratic parties are sometimes best served by pursuing policies that benefit insiders while ignoring the interests of outsiders.

Are there circumstances that make it easier for governments to promote policies that benefit outsiders? It is clear that insider–outsider differences promote the consideration of particularistic goals (more specifically the goals of insiders regardless of the consequences for outsiders) by social democrats. In the presence of insider–outsider conflict, social democratic governments will promote insider policies regardless of the consequences for outsiders. There are, however, some factors that can make the interests of insiders more similar to those of outsiders. These factors can reduce insider–outsider differences and weaken their influence on social democratic governments. Below, I will focus on the effects of two factors: employment protection and corporatism. I will show that integrating employment protection into the insider–outsider model means recognizing that insiders can become more like outsiders. In the initial model presented in this chapter, employment protection is identified as the characteristic distinguishing insiders from outsiders. It is because insiders are not as vulnerable to unemployment as outsiders that their policy objectives differ. As employment protection decreases, the distinction between insiders and outsiders weakens and so does its influence on social democracy. I will also show that corporatism has more ambiguous effects. On the one

hand, corporatist arrangements represent protection and privilege for insiders. On the other, they prevent free riding and particularistic interests. After presenting the main model, its justification and implications, the rest of this chapter will analyze in more detail the effects of these two institutional factors.

2.1. The Insider–Outsider Partisanship Model

Like much of the literature that explores the relationship between partisan government and policy, I understand political parties to have electoral objectives as well as commitments to ideology and historically meaningful groups of voters. The existence of stable ideological and historical connections between parties and some social groups ‘not only creates easily identifiable choices for citizens, it also makes it easier for parties to seek out their probable supporters and mobilize them at election time’ (Powell 1982: 116). Ideology and history, however, are not enough. Elections need to be won and they inevitably revolve around issues, like employment **(p.13)** protection or labor market policy, that give political meaning to partisan attachments and social divisions (Dalton 2002: 195). With Garrett and Lange, I assume that ‘while all governments would prefer, *ceteris paribus*, to pursue their partisan preferences, they will only do so if this does not prejudice their prospects for reelection’ (1991: 543).

The model presented in this chapter implies that party behavior is influenced by both vote-seeking and policy-seeking motivations. These two goals are not necessarily contradictory (see, e.g. Luebbert 1986) and, often, they are complementary. As Strom has pointed out, arguments in favor of the policy orientation of parties typically assume ‘that parties also pursue office at least instrumentally, as elective office is taken to be a precondition for policy influence’ (1990: 567).² Policy is then considered an instrument that molds public support and helps construct the electoral coalitions on which political parties depend (Przeworski and Sprague 1986: 125–6). Policy proposals ‘impose costs on politicians, in the form of either bargaining costs to create a supporting coalition or the opportunity cost of foregoing alternative policies’ (Alt 1985: 1,020).

Unlike most of the comparative political economy literature, however, I do not conceptualize labor as a homogeneous political actor. I share an interest in disaggregating labor with some recent works on the determinants of party strategies and individual policy preferences.³ My analysis is based on two propositions: first, that labor is divided into insiders and outsiders; and second, that the interests of insiders and outsiders are fundamentally different. I concur with the traditional partisanship approach in recognizing that parties tend to care about stable core constituencies and partisan preferences but I consider insiders (not labor as a whole) to be the core constituency of social democracy.

Two analytical frameworks directly influence the model that I propose. There is first the work of authors such as Piore (1969), Doeringer and Piore (1971), and Gordon (1972) on dual labor markets. Paying a great deal of attention to workers’ attitudes and motivations (as well as their conceptualization of work), the dual labor market literature emphasized the differences between a primary labor market composed of better and more stable jobs and a secondary one characterized by precarious employment. Some of this literature’s insights, in particular Berger and Piore’s understanding (1980) of the

emergence of the secondary sector as the **(p.14)** result of an upsurge in labor militancy, are very valuable. But the most important concepts in the approach became vague and confusing and, by the late 1970s, Piore acknowledged that market dualism had lost most of its analytical power (Berger and Piore 1980: 15).

Then there is an economic insider–outsider approach that emerged as a response to the difficulties encountered by the natural rate framework to satisfactorily explain the high European unemployment levels of the 1980s. A neoclassical interpretation of unemployment is characterized by an emphasis on the difference between the supply and the demand for labor. When the supply of labor exceeds its demand, unemployment results. In a Keynesian understanding, real factors determine a long-run equilibrium level of output and employment but wages and prices are considered to be sticky and outcomes diverge from their equilibrium values. As a consequence of price stickiness, changes in aggregate demand are considered to substantially affect the short-run level of employment (Summers 1988). Authors like Blanchard and Summers (1986), Lindbeck and Snower (1988, 1990), Lindbeck (1993), and Saint-Paul (1997, 2000) abandoned the natural rate of unemployment assumptions and developed a framework based on the differences between the employed and the unemployed. Their insider–outsider model rests on the assumption that unions primarily act in the interest of a group of insiders who are protected by labor turnover costs and more likely to secure wage gains for themselves than allow employment increases for the unemployed outsiders (Holmlund 1991: 10–11). These authors argued, therefore, that unemployment would not have a tendency to return to a natural level (an equilibrium rate defined in terms of supply-side variables) and that unemployment rates would reflect a high degree of hysteresis (see e.g. Nickell and Wadhwani 1990). Empirical analyses testing some of the theoretical claims of the model, however, have not provided unambiguous support (see Holmlund 1991 for a review).

The model that I propose takes these approaches as inspiration but significantly transforms some of their insights.⁴ As mentioned above, I divide labor into insiders and outsiders. Insiders are defined as those workers with highly protected jobs. Factors like the nature of employment protection legislation, a company's firing and job search costs, insiders' production process skills and attained levels of company investment, **(p.15)** and the behavior of unions contribute to the level of protection that characterizes 'insiderness'. Insiders are sufficiently protected by the level of security in their jobs not to feel significantly threatened by increases in unemployment. Outsiders, on the other hand, are either unemployed or hold jobs characterized by low levels of protection and employment rights, lower salaries, and precarious levels of benefits and social security regulations. I consider the unemployed, the involuntary fixed-term employed and the involuntary part-time employed to be outsiders.

Given the importance of secure employment to the definition of insiders, including the unemployed within the category of outsiders is not controversial. The classification of fixed-term and part-time employment is perhaps not as straightforward. There are two aspects to employed 'outsiderness'. The first has to do with the precarious nature of

employment. Fixed-term and part-time jobs are not simply insider contracts with flexibility added. They are in fact characterized by low wages, protection, and rights (see e.g. OECD 1998). The second has to do with the involuntary nature of outsider employment. Most outsiders would like to have access to insider jobs. This is particularly the case when looking at fixed-term employment (many workers holding fixed-term contracts in the OECD do so involuntarily). But it is also a defining factor of part-time employment. A large proportion of part-time outsiders would prefer to work full time (this is particularly the case with male outsiders, see OECD 1999).⁵

The interests of these two groups are fundamentally different and, in some circumstances, contradictory. Insiders care about their own job security much more than about the unemployment of outsiders. Outsiders, on the other hand, care about their unemployment and job precariousness much more than about the employment protection of insiders. These differences in the interests of insiders and outsiders will have dramatic consequences for the strategies of parties and the policies they are likely to pursue. The goals of both groups can be represented as two policy dimensions: employment protection and labor market policy. The first dimension captures pro-insider policy. As such, insiders strongly favor it (employment protection insulates insiders from unemployment) while outsiders do not (lowering the levels of employment protection will facilitate their exit from unemployment and precarious employment). **(p.16)** The second dimension captures pro-outsider policy. Outsiders are most vulnerable to unemployment and therefore most supportive of labor market policies directed to promote employment (or to compensate for joblessness). Insiders enjoy a high degree of job protection and are less vulnerable to unemployment. They would therefore be less likely to support labor market policy (since they are financed by taxes paid for by insiders⁶ and can promote low-wage competition by outsiders successfully entering the market).⁷

While dividing labor into insiders and outsiders has some precedents in both the economics and political science literature, trying to integrate this division into a coherent conception of partisanship and exploring its effects on policy represents a new endeavor. Other factors have received a remarkable amount of attention in the explanations of the political and economic changes experienced in the industrialized democracies since the 1970s (lower economic growth, demographic or production changes, the emergence of post-Fordism, increasing internationalization, and competition from industrializing countries are but a few). My contribution to the comparative political economy literature is to emphasize the significance of insider–outsider politics as a determinant of social democratic policy.

In this book's stylized framework, political parties are considered to have a core constituency and a more general target they wish to attract to obtain a winning and stable electoral coalition. Because of the division of labor into insiders and outsiders, social democratic governments face an important choice. In the words of Esping-Andersen, they

are caught in a severe tension between preserving loyalty to traditional working-class causes and defending the position of the new strata of social losers. Such tensions are only aggravated by the fact that the conventional worker enjoys a

menu of privileges and securities that, on one hand, are erstwhile labor movement achievements and, on the other hand, are obstacles to the social integration of the new ‘outsiders’.

(Esping-Andersen 1999: 310)

It is my contention that (because, among other things, outsiders tend to be less politically active and electorally relevant as well as economically dependent on insiders)⁸ social democratic parties will generally have **(p.17)** strong incentives to consider insiders their core constituency. In this model, therefore, the main policy objective of social democracy will be the continuation or increase of insider job security. The second implication of my insider–outsider argument, moreover, is that social democratic governments will not have an incentive to promote labor market policy (although it benefits outsiders, it is not favored by insiders).

Dividing labor into insiders and outsiders also has implications for the strategies of conservative governments. Like many other authors, I consider conservative parties to depend on a core constituency that consists of upscale groups (employers, the upper middle class, and the business and financial community). Paradoxically, the insider–outsider model implies that, in some cases, conservative governments may be able to pursue policies that are more attractive to outsiders than those promoted by social democrats. Having the upscale groups as their core constituency makes it difficult for conservative parties to promote the interests of insiders. But ignoring insiders allows conservatives to engage in some policies unavailable to social democrats. As mentioned above, outsiders favor lower levels of insider job protection legislation. By reducing insider job protection, conservative parties may attract some outsiders while reinforcing the support of their core constituency (upscale groups advantaged by flexible hiring and firing practices). While lower employment protection is favored by both outsiders and members of the upscale groups, this is not the case for labor market policies. Higher levels of labor market policies represent higher taxes and an intrusive role for government in the economy. Because of this, upscale groups (and therefore conservative governments) are not interested in the promotion of labor market policies.

2.2. Why Does the Traditional Approach to Partisanship Need to Be Changed? The Emergence of Insiders and Outsiders

There are two traditional theoretical approaches to the analysis of partisan effects on policy. The first can be categorized as the party differences school. Its authors—Hibbs (1977, 1987) and Alt (1985) being the most cited examples—believe that social democratic parties will tend to promote the interests of labor while conservative parties will attempt to satisfy the demands of upscale groups. The best way to explain the assumptions that have directed much of the research of the party **(p.18)** differences school is to summarize Hibbs's initial argument. Alt provides a brief statement that is worth quoting:

Hibbs (1977) argues that the impact of unemployment varies across social classes (...). Blue-collar workers are more likely to become unemployed when

unemployment rises and thus *ceteris paribus* more likely to favor government intervention to reduce unemployment and to support parties that promise to do so. Left-wing parties (...) organize platforms to elicit this class-based support and reward their supporters by reducing unemployment while in office.

(Alt 1985: 1,017)

The right-wing constituency is then assumed to be most affected by inflation. Conservative governments, therefore, are expected to elicit the support of these groups and to reward them by reducing inflation.

I would argue that this argument lies at the heart of most comparative political economy analyses exploring the effects of partisan government on policy. The examples are legion but I will just mention that these initial partisan assumptions have been taken as the starting point of an influential literature on the welfare state (see e.g. Korpi 1978; Stephens 1979; Korpi 1983; Esping-Andersen 1985, 1990; Pierson 1994; Huber and Stephens 2001) and on the effects of social democracy (Alvarez, Garrett, and Lange 1991; Boix 1998 *a*; Garrett 1998; Hall and Franzese 1998; Swank 2002, among others).

The second approach to the partisan determinants of policy can be categorized as the electoral cycle school. Its authors argue that there is a relationship between macroeconomic policymaking and electoral cycles. The idea that incumbents have an interest in stimulating the economy right before elections regardless of the long-term economic consequences of such economic policy maneuvering has been put forward by Nordhaus (1975) and Tufte (1978), among others. Williams summarizes the starting point of this school as follows:

the ‘political business cycle proposes that politicians find their self-interest best served by manipulating the economy in a way that maximizes votes. Longer-term policy concerns, such as price stability, are mortgaged in order to ensure that the public is satisfied with short-term macroeconomic performance when an election occurs’.

(Williams 1990: 767)

These two alternative approaches to the influence of politics on policy need not be contradictory. As Williams has argued, there is not an inescapable discrepancy between a partisan model of policy and an electoral one (1990: 768). In fact, they can be complementary. It is not unreasonable to accept that different parties have distinct macroeconomic **(p.19)**

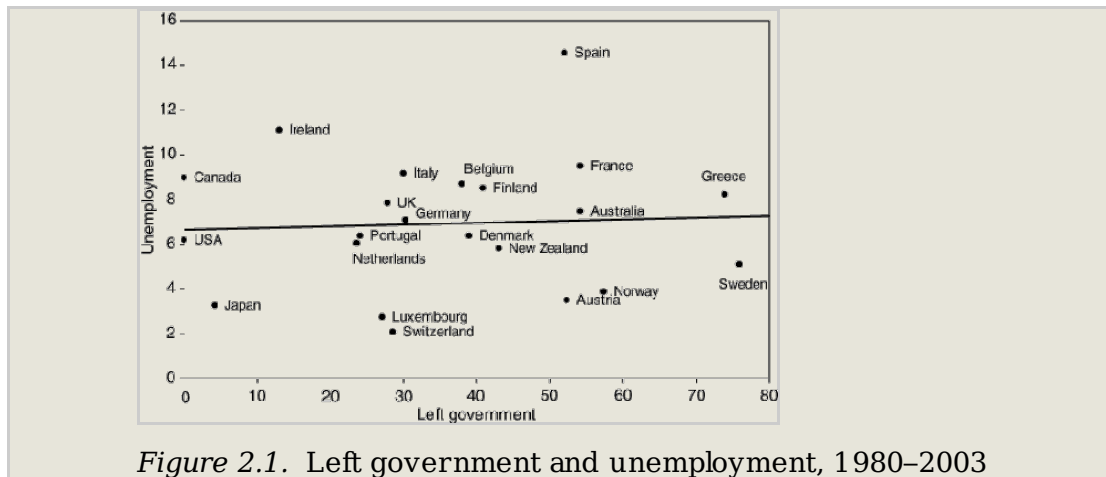


Figure 2.1. Left government and unemployment, 1980–2003

strategies designed to attract different electoral groups and that, at the same time, there may be electoral temptations to develop short-term policies that please a chosen electoral core.⁹ This discussion is relevant to this chapter's discussion because my model is essentially a transformation of the partisan differences approach. Like the authors mentioned above, I consider parties to have distinct interests as well as policy goals fundamentally related to those of their core constituencies. My insider–outsider analysis departs from this framework in its consideration of the core constituencies social democratic parties aim to attract.

Why is it necessary then to transform the initial assumptions of the traditional partisanship approach? The original impetus for the arguments developed in this book emerged as a consequence of an empirical puzzle. The traditional view of partisan differences rests on the assumption that labor is disproportionately affected by unemployment and that social democratic governments will therefore promote policies that promote higher employment. There is, however, very little evidence to indicate that this is the case.

Figure 2.1 presents the relationship between social democracy and unemployment. The figure plots social democracy (measured here as the **(p.20)** percentage of cabinet seats held by Left parties)¹⁰ against unemployment rates.¹¹ The figures represent averages for the 1980–2003 period. The almost completely flat trendline makes clear that the influence of government partisanship on unemployment has been terribly weak over this period. There is no clear pattern: countries with widely divergent partisanship averages (like Canada, Italy, Belgium, France, and Greece) exhibit similar unemployment rates while countries with very similar partisanship averages (like Spain, France, Australia, and Norway) have widely divergent unemployment rates. The association between social democracy and low unemployment proposed by the traditional partisanship approach does not seem to hold.

Why is this the case? The insider–outsider partisanship model explained above is an important part of the answer to this question. According to the traditional partisanship approach, workers feel threatened by unemployment. They vote for social democratic parties because they believe these parties will promote policies that decrease unemployment when they are in power. Disaggregating labor into insiders and outsiders

corrects a critical weakness in this approach. It is misleading to categorize all labor as vulnerable to unemployment. High levels of employment protection effectively guard a group within labor (the insiders) against unemployment. Social democratic governments become more tolerant to unemployment in a way that is directly related to the emergence of ‘insiderness’. In the insider–outsider model, the acceptance of higher levels of unemployment by social democracy in Figure 2.1 results from the decreasing vulnerability of insiders.

Two parallel historical processes can be identified as significant in the emergence of insiders and outsiders. First, starting in the late 1960s, firms accepted highly restrictive tenure and severance pay arrangements—see Blanchard et al. (1986) and Bentolila and Bertola (1990). It could be argued that, in many respects, the creation of a significant degree of ‘insiderness’ starts at this point in most OECD countries. Most employment protection legislation was enacted during the late 1960s and in many cases it was strengthened during the early 1970s. Commenting on the initial wave of legislation in the late 1960s, Blanchard et al. (1986) argue that this process was influenced by a pattern of stability and growth which allowed firms to consider employment protection as relatively costless. Excessive hiring was judged an error that could be easily corrected in, **(p.21)** at most, a few months. Bentolila and Bertola point out that the post-Oil Shock crises contributed to a further reinforcement of legislation in France and the UK, among other countries, around 1975 (1990: 394). Most analysts also agree that these later developments were influenced, to a considerable degree, by social unrest and the actions of unions. It is in any case clear that during the period of interest to this book's analysis, a considerable proportion of labor became significantly insulated from unemployment by restrictive legislation that did not exist before.

The second factor affecting the vulnerability of some members of labor to unemployment was that, as ‘insiderness’ increased, so did ‘outsiderness’. The emergence of outsiders as a significant segment of the labor market was a complex process with several causes. The increase in unemployment experienced by many OECD countries during the post-Oil Shock crises is very significant. But, simultaneously, in a number of countries labor supply shocks caused by larger numbers of women entering the labor force applied further pressure on the labor market. A number of authors have argued that since the mid-1970s there has also been a production change in certain sectors of the economy caused by ‘firms using “working time” variations as an instrument of gaining flexibility and higher productivity’ (Maier 1994: 151). As Dore explains, until the 1970s, ‘growing oligopoly’ had ‘made it possible for more and more managers to “afford the luxury of a contented and loyal workforce” ’ but the ‘intensification of international competition’ and the ‘change in the nature of work’ altered this (1994: 21–2). The need for flexibility to achieve international competitiveness, however, did not result in the lowering of employment protection in most OECD countries. Rather, the flexibilization of labor market legislation that took place in the 1980s affected in most cases entry into (not exit from) the labor market (see e.g. Bentolila and Bertola 1990). One of the consequences of this process was a dramatic increase in part-time work and temporary contracts to the point that, Maier argues, ‘whole sectors of national economies have reorganized their

employment/working-time patterns around various forms of part-time work' (1994: 152). As mentioned above, however, the great majority of part-time work and temporary contracts pay poorly, are concentrated in low-skilled activities, and offer a precarious level of benefits, social security regulations, and employment rights.¹² Moreover, the precariously employed and the unemployed are the main, if not only, group to suffer **(p.22)** the consequences of economic fluctuations (being hired in good times and fired in downturns).¹³

To assume that unemployment disproportionately harms labor as a whole is, therefore, clearly misleading when analyzing OECD countries from the early 1970s. When we divide labor into insiders and outsiders, it is reasonable to assume instead that insiders do not feel particularly concerned about unemployment. Outsiders are the main victims of increasing levels of unemployment and precarious employment. Since insiders do not feel threatened by unemployment to the same degree that they did in the pre-1970s period, social democratic parties do not need to organize political platforms that focus on the problem of unemployment and they do not have to reward their insider supporters with policies designed to reduce unemployment. Unless social democratic parties make outsiders, in addition to insiders, their core constituency, the traditional partisan framework is of very limited use.

2.3. Partisanship and Policy

While the previous sections have been pretty explicit about the preferences of insiders, outsiders, and upscale groups, it is important to turn to the theoretical justification for the connection between parties and policies in a little more detail.

2.3.1. Employment Protection

Within the context of this book's partisanship model, it is clear that lowering employment protection directly attacks the interests of insiders. Because the immediate result of decreasing protection legislation is that firing insiders becomes easier, and since insiders care about their employment stability most of all, it is reasonable to assume that any proposal for such change would produce the strongest insider opposition.¹⁴ For **(p.23)** outsiders, on the other hand, it is easy to believe that high levels of insider protection impede employment growth. The reasons why employment protection may negatively affect employment can be summarized briefly. Employment protection, it is feared, limits 'the flexibility required for firms and national economies to prosper' (OECD 1999: 49). This limitation mainly results from the increase in labor costs that employment protection implies. In the words of the OECD, employment protection 'is, in effect, a tax on work-force adjustments' (1999: 68). As such it may inhibit firms from shedding labor in economic downturns but also from hiring in periods characterized by good performance.¹⁵

My partisanship hypotheses derive directly from this analysis. Social democratic governments that give preference to the interests of insiders over those of outsiders will clearly support greater levels of employment protection. Conservative parties, on the other hand, have important reasons to promote lower levels of employment protection.

First, inasmuch as employers and managers are a very influential portion of the upscale groups, the lowering of employment protection will be positively received by the conservative party's core constituency. But a lowering of employment protection will also be perceived by some outsiders as helping their chances for employment and will therefore represent a widening of the conservative electoral appeal. The insider–outsider model consequently implies the existence of marked partisan differences regarding employment protection.

2.3.2. Labor Market Policy

There are two kinds of labor market policies that are relevant to the insider–outsider partisanship model: passive labor market policies (PLMPs) provide unemployment compensation whereas active labor market policies (ALMPs) are aimed at reducing unemployment by shaping the supply, demand, and mobility of labor.

(p.24) As an important element of the welfare state, PLMPs have received quite a lot of attention in the comparative political economy literature. Regarding these policies, my insider–outsider partisanship model represents a challenge to the ‘political class struggle’ or ‘power resources’ approach to the relationship between parties and policy. This framework emphasizes the role played by two main actors: the working-class and socialist parties (especially when in power). The strength of social democratic parties and the power of working-class mobilization are understood to be the main influences affecting the evolution of the welfare state. Several authors can be identified as strong proponents of this approach¹⁶ but perhaps the clearest description of the core of this argument is provided by Shalev. He notes,

The essential argument of this perspective on the welfare state, is that the growth of reformist labor unions and parties which reflect the class divisions of capitalist society, and in particular the ascension of labor parties to executive power, have been the preeminent forces in the initiation and development of public policies for furthering justice and equality between the classes.

(Shalev 1983: 317)

More recently, the influence of international forces has been integrated into these analyses. The conventional wisdom about this topic has been that increasing international openness results in a blurring of partisan differences caused by the inability of social democratic parties to produce policies that do not conform to market forces (see e.g. Scharpf 1991; Scharpf and Schmidt 2000). Some authors have argued, however, that international forces do not affect some partisan differences (like Boix 1998 *a*; Garrett and Lange 1991) or that they actually have strengthened the influence of partisanship on policy because of some groups' need for compensation (Garrett 1998).

It is clear that my insider–outsider partisanship model does not share the optimism of the power resources approach regarding the interests of labor. Like Esping-Andersen (1990), I believe it is problematic to assume that there is a linear relationship between social democracy and the development of welfare policies. The solution for Esping-

Andersen is to integrate a class-coalition logic into the theory of welfare development.¹⁷

(p.25) In my model, it is the insider–outsider distinction which helps us understand the policy effects of partisan differences. I argue that, to the degree that they are protected from unemployment, insiders have little incentive to support PLMPs. The insider–outsider model therefore challenges the power resources framework by exploring the possibility that social democrats will be less interested in PLMPs than we have traditionally expected.

The traditional partisanship literature has paid much less attention to ALMPs. In many respects, however, ALMP levels are an optimal measure for testing the accuracy of the insider–outsider model. First, they are, in Janoski's words, 'preponderantly discretionary' and can 'be either a major recipient of fiscal resources (...) or relatively ignored by politicians and budget makers' (1994: 54). Second, the unambiguous objective of ALMPs is to benefit outsiders. Unlike other policies whose goals may be difficult to distinguish in insider–outsider terms, ALMPs are designed to produce stable employment for those who do not possess it. Finally, the economics literature provides some evidence that higher levels of ALMP do promote lower levels of unemployment indeed.¹⁸ But the existence of scholarly analyses demonstrating the beneficial effects of ALMPs is not as relevant as the general acceptance of ALMP as a tool against unemployment by policymakers. And this acceptance has been quite general. Transferring public resources into ALMPs has been an objective repeatedly endorsed by OECD Labor Ministers in recent years. As Martin points out, it has also become part of the EU's official strategy to decrease unemployment since the Essen Summit in December 1994 (1998: 12).

The growing interest in ALMPs as a way to combat increasing levels of unemployment and precarious employment is understandable. Calmfors (1994) relates it both to the disillusionment produced by demand management policies which are now perceived as measures that can increase inflation while not affecting unemployment and to the belief that other supply-side structural reforms may work too slowly or be too difficult to implement. In spite of both the recent popularity and the perceived importance of ALMPs, however, the relationship between these policies and government partisanship has not received enough attention in political science. The economics literature has been largely concerned about the economic effects of ALMPs and has generally ignored the role of government partisanship. We know comparatively little about the politics **(p.26)** that determine ALMPs (unlike other government policies such as demand management or the welfare state).¹⁹

This is all the more surprising when we consider that ALMPs are recognized as one of the policy options still open to social democrats in the era of internationalization. Increasingly international capital is identified as the main limitation facing social democratic governments since the early 1970s. Highly mobile capital, it is argued, powerfully constrains the ability of social democratic governments to promote policies that are significantly different from those implemented by conservative ones. In an open economy, however, some options are still open to social democratic governments. ALMP belongs

within the group of supply-side policies that can be used by partisan governments to promote employment, growth, and equality in an environment characterized by increasing levels of internationalization (see Garrett and Lange 1991; Boix 1998 *a*). In spite of their modest presence in national budgets, ALMP levels have become one of the clearest signals of a government's political choices in industrialized democracies greatly influenced by international forces (including European integration).²⁰

In the framework proposed in this book, outsiders are the unambiguous beneficiaries of ALMPs while insider interests may actually be hurt by the policies' effects on taxes and labor market competition.²¹ As mentioned above, the immediate effect of an increase in the level of ALMPs is a higher tax burden for insiders. In the long run, insider taxes may decrease if ALMPs are successful at bringing new workers into employment but at least in the short run, insiders bear the brunt of the policies' costs. Additionally, ALMPs will, if successful, promote the entry into employment of individuals who can underbid insiders' wage demands. From an insider perspective, dedicating public resources to ALMPs may in fact result in low-wage competition. When insiders feel protected enough not to significantly fear unemployment, lack of support for these policies may result from what Saint-Paul has called insiders' 'interest in being sheltered from competition' (1998: 162).

As was the case with PLMPs, there is then a convincing logic for social democratic governments not to favor ALMPs if their objective is to satisfy the interests of insiders. The insiders' lack of concern for unemployment (**p.27**) as well as their perception of the costs of ALMPs contribute to this outcome. Conservative governments, on the other hand, are also expected to be uninterested in pursuing ALMPs. This is because upscale groups do not favor them (since they represent higher taxes and an increase in the government's participation in the economy) and because conservative parties consider the reduction of employment protection a more attractive way to appeal to outsiders.

2.4. Factors that Mitigate Insider–Outsider Differences: Unemployment Vulnerability and Corporatism

This book's partisanship model is based on a fundamental difference in insiders' and outsiders' vulnerability to unemployment. Since the early 1970s, two factors had effectively insulated insiders from the threat of unemployment: the establishment of restrictive severance legislation and the emergence of 'outsiderness'. To the extent that insiders are protected from unemployment, their interests will be significantly different from those of outsiders. The potential benefits for insiders of policies to promote employment, for example, are small while the actual costs (in terms of taxes and low-wage competition) are high.

Factors that increase the insiders' vulnerability to unemployment, however, will align their interests with those of outsiders. The analysis developed in the following pages will focus on two aspects of the labor market: the levels of employment protection and the presence of corporatist arrangements.

2.4.1. Employment Protection Legislation

The reasons why we need to consider the level of employment protection as a factor that

can make insiders more like outsiders are very straightforward. Employment protection legislation affects ‘the rules governing unfair dismissal, lay-offs for economic reasons, severance payments, minimum notice periods, administrative authorization for dismissals, and prior discussion with labor representatives’ (OECD 1994: 69). As was explained in great detail above, it is clear that decreasing levels of employment protection directly increase the vulnerability of insiders to unemployment. If firing insiders becomes easier, it is reasonable to assume that the interests of insiders and those of outsiders will become more similar. The benefits of policies directed to promote employment will then **(p.28)** become more attractive to insiders as they themselves become more likely to need them. The insider–outsider model therefore implies that decreasing levels of employment protection should be associated with increasing levels of pro-outsider policy when social democratic governments are in power. As insiders become more vulnerable to unemployment, they will pressure social democratic parties to promote labor market policies.

The arguments in previous sections make clear that employment security is a fundamental part of the definition of ‘insiderness’. It is therefore necessary to understand employment protection not only as a defining characteristic of insiders, but also as a policy outcome that they pressure social democratic governments to promote. The relationship between insider–outsider differences and employment protection can be best understood as a reinforcing loop playing itself out in industrialized democracies since the early 1970s. Once employment protection exists, it divides insiders and outsiders. Insiders then use their influence to make social democratic governments increase or maintain high levels of employment protection. The degree of their success in securing high levels of employment protection, finally, feeds back into the existence of insider–outsider differences and their subsequent influence on partisanship.

2.4.2. The Role of Corporatism

Like social democratic parties, unions face a host of choices that range from pro-insider (maximizing the job security levels of insiders while not pressuring governing parties to promote employment) to pro-outsider (pressuring governing parties to minimize unemployment while sacrificing job security). In a more significant way than social democratic parties (since upscale groups are of no importance to unions that depend primarily on insiders), they have strong incentives to defend the interests of insiders. The decision of a union will be influenced by consideration of two goals: fulfilling the aspirations of existing members and increasing the number of members. Since insiders tend to be both more unionized and a more influential constituency than outsiders, the first goal is a strong reason for unions to side with insiders. The second contributes to making the interests of outsiders a relative objective of a union's strategies but it is a weaker goal with a more uncertain payoff. After all, nonunionized insiders (or, in contexts of competitive labor representation, insiders affiliated to other unions) are a more attractive target for unions trying to expand membership. It is also questionable whether outsiders who benefit from **(p.29)** union strategies will become members. It is likely that as soon as outsiders become insiders they will be satisfied with particularistic union policies. As insiders, even those who were recently outsiders will be more likely to support unions

that deliver on their promises about job security.

Both because of their direct involvement in industrial relations (negotiations covering work regulations and wages being the most clear examples) and because of their capacity to influence political parties, the behavior of unions is a relevant factor in a government's policy orientation. I expect social democratic governments to be more likely to produce pro-insider policies when they are subjected to pro-insider pressure from unions. I logically also expect social democratic governments to be more likely to produce pro-outsider policies when unions exert pro-outsider pressure. The dependence of social democrats on insider support would imply that the influence of unions would be greater when social democratic parties are in power, but there is no reason to assume that unions will not significantly affect the strategies of conservative governments to some degree. Strongly pro-insider unions may limit the ability of conservative governments to develop their preferred anti-insider measures. It is my contention that the existence of corporatist arrangements will affect whether unions make insider goals their main priority and, in turn, the impact of union strategies on governments.

The influence of institutions on political processes has been emphasized by a great number of scholars.²² Regarding labor market policy, I argue that the effects of insider–outsider divisions on parties and the effects of government partisanship on policy are contingent on institutions. I focus on a set of interrelated labor market institutions that have been grouped often under the name of corporatism. The effects of corporatism on labor market policy can be interpreted in two very different ways: there is an economic insider–outsider approach that emphasizes corporatism as a representation of the privileges of insiders, and an Olsonian one that emphasizes the effects of institutional encompassment in promoting common goals.

2.4.2.1. THE ECONOMIC INSIDER–OUTSIDER APPROACH TO CORPORATISM

Most mainstream economists regard trade unions as rent-seeking labor market cartels. The economic insider–outsider model shares this starting **(p.30)** point and goes on to argue that unions have no incentives to take into consideration anyone's interests but those of their employed members, the insiders. In this framework, corporatism is simply the reflection of insider power. Corporatism would then represent a variety of coordinated capitalism in which interest organizations, especially those representing insiders, play an important role in political processes and labor market outcomes. It may be the case that in the golden age of social democracy, before insider–outsider divisions become significant, a central feature of corporatism was its nonexclusive and egalitarian nature (see e.g. Pekkarinen, Pohjola, and Rowthorn 1992: 3). As outsiders become more numerous, however, corporatist arrangements serve to protect insiders, rather than facilitate the integration of outsiders.

It is not complicated to see that there is a relationship between the economic interpretation of corporatism and the arguments about unemployment vulnerability explained above. If corporatism is understood as an extension of insider privileges, its effects are in fact very similar to those of higher employment protection levels. When corporatist arrangements protect insiders and are not extended to outsiders, they

insulate insiders against unemployment and make the consideration of outsider interests by social democratic parties extremely difficult.

This interpretation of the influence of corporatism seems to be supported by, for example, Kunkel and Pontusson (1998) and Notermans (2000). Although Kunkel and Pontusson's argument distinguishes between Swedish and Austrian varieties of corporatism, they argue that corporatism in Austria has reinforced the dominant position of male industrial workers within the union movement and constrained the ability of Austrian unions to mobilize new categories of wage earners. Notermans's analysis of social democratic economic policy since 1918, on the other hand, makes clear that a regime that required workers to abstain from fully exploiting their market strength (i.e. corporatism) was very difficult to sustain in unfavorable economic circumstances. Notermans argues this to be the case starting as early as the 1960s and even in countries like Sweden (the paragon of social democracy).²³ In line with this argument, the analysis in Mares (2006) can also be interpreted as supportive of an economic insider–outsider approach to corporatism. Before the end of the golden age of social democracy, corporatism was based on a deal between unions and governments whereby governments provided an **(p.31)** ever-increasing welfare state and unions committed to wage moderation (see Cameron 1984; Crouch 1994; Beramendi and Rueda 2007). According to Mares, different political circumstances since the 1970s (welfare state maturation, the changing composition of social policy, increasing taxes) have made corporatism unsuccessful in promoting wage moderation and employment.

2.4.2.2. THE OLSONIAN APPROACH TO CORPORATISM

Is it the case that after the 1970s corporatism only promotes the interests of insiders? Proponents of the Olsonian interpretation of corporatism would disagree. Mancur Olson (1982) argued that institutions for collective action that are encompassing in relation to firm or industry have a strong incentive to contribute to the prosperity and expansion of the host firm or industry. Aware of the possibility of an emergence of monopoly power and its consequences over inefficiency, Olson believed that sufficiently encompassing organizations would 'internalize much of the cost of inefficient policies and accordingly have an incentive to redistribute income to themselves with the least possible social cost, and to give some weight to economic growth and to the interests of society as a whole' (1982: 90). Following a similar logic, Calmfors and Driffill (1988) considered the macroeconomic effects of three levels of wage bargaining by unions and employers. They argued that good economic performance would result if wage bargaining took place either at the company or at the national level. In the first case, the actions of unions would not be powerful enough to distort efficient market outcomes. In the second, unions would be encompassing enough to act in favor of the interests of society as a whole. Poor economic performance would be associated with wage bargaining at the industry level because wage bargaining would be powerful enough to affect the market equilibrium outcome while insufficiently encompassing to take society's interests into consideration. This argument's implications for the evolution of unemployment have subsequently been emphasized by Rowthorn (1992) and Pohjola (1992). Extending the previous framework, Rowthorn contends that there is, particularly in the early 1980s, a U-shaped relationship

between the centralization of wage bargaining (i.e. centralized unions and employer associations) and employment.

In analyzing the effects of labor market organization over macroeconomic outcomes, other authors have suggested that the level of wage bargaining centralization is not as important as ‘the degree to which bargaining is coordinated across the economy’ (Hall 1994: 4). Soskice (1990), **(p.32)** Golden (1993), Hall (1994), and Hall and Franzese (1998) have argued that the degree of wage coordination is more relevant to macroeconomic outcomes than the level of wage bargaining. In this view, increasing levels of union concentration (a small number of unions that do not compete) are associated with better employment outcomes. The concentration logic stresses collective action by considering that fewer actors reduce coordination problems and that unions which do not compete ‘have fewer incentives to engage in wage militancy’ (Golden 1993: 441). Although this approach emphasizes a different factor, the analysis is compatible with the centralization argument and the conclusions are similar (the main difference being the suggestion by the concentration framework that a linear relationship may be more accurate than a U-shaped one).

The behavior of unions and their influence over policymaking is also affected by the degree of union density. The encompassing nature of unions significantly depends on whether union members are a high or a low proportion of the labor force. Once the effects of the centralization/coordination of wage bargaining have been taken into consideration, unions that represent a larger proportion of the labor force are more likely to favor pro-employment policies. Following the Olsonian framework outlined above, unions that have a larger constituency should be more aware of, and concerned about, the consequences of their actions over the economy as a whole and more able to internalize the costs of nonparticularistic strategies.

Teulings and Hartog provide a good explanation of the encompassment logic contained in the union density and centralization/coordination arguments I have presented. They point out that ‘(w)ith sufficiently high membership and sufficient spread across firms, the union can withstand pressures from its members to let idiosyncratic shocks [like particularistic demands by insiders] be the dominant factor in its wage demands’ (1998: 279). They have to play a strategy of being both *representative* and *reasonable*. A centralized union with a high number of members

will care less about its membership, as firms have little incentive to get rid of the union. Instead, it will invest in being an encompassing union that is able to negotiate a large number of contracts and is not sensitive to the pressure of small groups within its membership. As soon as any small group had an overwhelming influence on the policy of the union, this would make the union *unreasonable*, and firms would no longer be prepared to accept the union as a party to which the power to renegotiate can be delegated safely. As the union has not invested in a large membership in a few firms, it will have difficulty in countering this attack. There are therefore considerable incentives to maintaining the reputation of being **(p.33)** *reasonable*. Clearly, a union must always be *representative* because otherwise the

workers will not be prepared to delegate renegotiation power to it.

(Teulings and Hartog 1998: 279)

Following a similar logic, an employer association faced with an encompassing union will also have strong incentives to be both representative and reasonable.

The centralization/coordination of wage bargaining and the level of union density, however, are not the only factors that can affect the influence of insider–outsider differences on social democracy. Many comparative analyses in political economy distinguish among clusters of countries that share a number of relevant characteristics—Katzenstein (1985), Hall (1986), Esping-Andersen (1990), Soskice (1990), and Hall and Soskice (2001) being some notable examples. Most authors would agree that these clusters represent institutional configurations that cannot easily be reduced to the values of a couple of labor market variables. I will emphasize the difference between corporatist and noncorporatist countries. Like Katzenstein (1985), I understand that the most important distinguishing feature of corporatism is the formation of government policy through bargaining among centralized interest groups and the ideology of social partnership.²⁴ Corporatism encompasses the labor market factors that I have mentioned above (centralization/coordination of wage bargaining and union density). But it is more than that. In Katzenstein's words, three traits define corporatism:

an ideology of social partnership expressed at the national level; a relatively centralized and concentrated system of interest groups; and voluntary and informal coordination of conflicting objectives through continuous political bargaining between interest groups, state bureaucracies and political parties.

(Katzenstein 1985: 32)

As argued by Rueda and Pontusson (2000), a fourth trait could be added: a high degree of institutionalization of collective bargaining and coordination of wage formation.²⁵

(p.34) The reasons why, in the Olsonian approach, corporatism should affect the policy outcomes that I am interested in analyzing are pretty straightforward. Corporatist arrangements are considered to facilitate the consideration of general goals by actors that may be tempted not to act solidaristically. The expectation therefore is that corporatism would promote pro-outsider policies through two channels. First, they promote solidaristic preferences for individuals and, second, they promote solidaristic behavior by the social partners. Corporatism would facilitate the consideration of general goals through, for example, the existence of tripartite institutions. The Olsonian view would imply that when matters of general economic or political interest are debated in fora characterized by an ongoing dialogue among relatively cooperative social partners, the possible future costs of particularistic behavior become clearer and more widely known. This affects the individuals (insiders would become more likely to understand the negative implications of demanding high employment protection at all costs) and the social partners (unions would become more likely to understand the negative implications of

acquiescing to the particularistic demands of insiders).

The Olsonian analysis predicts then that encompassing corporatist arrangements will limit the power of insiders. There is some evidence in favor of this argument (see Holmlund and Zetterberg 1991; Teulings and Hartog 1998). It is, however, not uncontroversial. Going back to their emphasis on representativeness and reasonableness, Teulings and Hartog recognize that

(i)n practice, unions can get into very difficult situations as their *representativeness* sometimes requires them to stand for the demands of insider groups, although that goes against their peace duty [the peace clause that obligates unions to not get involved in any actions undermining collective agreements] and against the reputation of *reasonableness*.

(Teulings and Hartog 1998: 285)

They show that this has been the case, for example, in the Netherlands with particularly influential workers, like those in domestic transport and computer services.

We have now a clear set **(p.35)** of hypotheses about the preferences of insiders, outsiders, and upscale groups. We also have an equally clear set of hypotheses about the influence of these preferences on parties and, in turn, on the relationship between parties and policy. Finally, I have analyzed two intervening variables expected to potentially transform the effects of government partisanship on policy: employment protection and corporatism. The rest of the book is dedicated to testing these claims.

Notes:

(1) See e.g. Keech (1995: 70).

(2) For a unifying argument specifying the conditions under which different models of party behavior apply, see Strom (1990).

(3) See e.g. Kitschelt (1994), Iversen and Soskice (2001), and Estevez-Abe, Iversen, and Soskice (2001).

(4) In addition to the dual labor market and the economic insider–outsider literature, the arguments in this book have also been influenced by a number of other works. My analysis of the relationship between labor and social democracy is related to points made by Swenson (1989), Pontusson (1992), King (1995), and Western (1997), among others.

(5) It is often argued that some part-time workers, in particular women, do so voluntarily but, as Maier points out, the fact that many working women do not want to work full time does not imply that they prefer part-time jobs with precarious levels of protection and benefits (1994: 180). See also Asplund and Persson (2000) for an analysis of the overrepresentation of women in low-pay employment.

(6) On this point, Lindert (2004) and Cusack and Beramendi (2006) have shown that taxes

to support the welfare state are paid disproportionately by one class (labor).

(7) See Saint Paul (1998) and Calmfors (1994). I provide a more extensive explanation of the preferences implied in my insider–outsider model, as well as a set of empirical tests, in Chapter 3.

(8) As argued by Esping-Andersen, the crystallization of outsiders into a coherent and influential electoral constituency is complicated. ‘It is difficult to imagine’, he observes, ‘an alliance of housewives, early retirees, excluded youth, and a variety of groups with a more or less irregular connection to the labor market’ (1999: 304–5).

(9) Alesina, Roubini, and Cohen (1997) is a good example of this approach.

(10) See Armingeon et al. (2005).

(11) The unemployment rate is measured according to the Eurostat definition. See European Commission (2006).

(12) See e.g. Maier (1994) for an analysis of part-time legislation and Mosley (1994) for a description of temporary employment in Europe. See also the contributions in Gregory, Salverda, and Bazen (2000).

(13) Immigration also plays an important role in buffering insiders. In fact, it could easily be argued that immigrants are the ultimate outsiders. Immigrant labor is not emphasized in this book, but see King and Rueda (2006) for a more detailed analysis of this issue taking the insider–outsider model as its starting point.

(14) In this section I concentrate my analysis on what we could call labor market exit flexibility. Increasing labor market entry flexibility (particularly if high labor market exit costs remain untouched) may be beneficial to insiders. This may have been the case in some European countries (like Spain, Italy, Portugal, France, Germany, and the Netherlands) where fixed-term contracts and temporary work (overwhelmingly directed to women and young people) have been increasingly common since the early 1980s (see Maier 1994; Mosley 1994).

(15) Although a relative consensus exists regarding the theorized effects of employment protection, the empirical evidence has not been conclusive. Most authors attempting to assess these effects have concluded that employment protection influences employment dynamics more significantly than the average level of employment (see Bentolila and Bertola 1990; Bertola 1990, 1992; Booth 1997). Lazear (1990), however, finds support for the argument linking severance pay and unemployment (Lazear's findings have been questioned by Addison and Grosso (1998) and Addison and Teixeira (1999)). More recently, Risager and Sørensen (1999) have shown that in an open economy, where unions do not reduce their wage demands and the domestic industry bears the cost of employment legislation, firing costs may result in higher long-term unemployment.

(16) For example, Cameron (1978), Stephens (1979), Korpi (1983), and Alvarez, Garrett,

and Lange (1991). More recently, Huber and Stephens (2001) support, but also amend, this power resource approach to the welfare state.

(17) For Esping-Andersen, the existence of alliances with farmers and white-collar workers is a very significant factor in determining welfare policy.

(18) See Jackman, Pissarides, and Savouri (1990), OECD (1993), OECD (1994), and Martin (1998).

(19) Notable exceptions are Janoski (1990, 1994), Garrett and Lange (1991), Boix (1998), Swank and Martin (2001), and Rueda (2005, 2006).

(20) For a more detailed analysis of the choices available to (and the constraints faced by) partisan governments in the open economy, see Scharpf and Schmidt (2000).

(21) These observations about the effects of ALMPs follow Calmfors (1994) and Saint-Paul (1998).

(22) See Steinmo, Thelen, and Longstreth (1992), Pontusson (1992), and Hall and Taylor (1996) for an analysis.

(23) See Notermans (2000: ch. 5). For a different but related argument about the failure of corporatism as an explanation of national responses to the 1974–85 unemployment crisis, see Therborn (1988).

(24) Corporatism has been defined in many ways. As Therborn notes, corporatism ‘has become a bit like God. Many people believe it is an important phenomenon, crucially affecting social life. But nobody really knows what it looks like, so disagreement persists, apparently forever, about what it is and about what it does’ (1992: 24).

(25) This factor may appear to be too closely related to the centralization of wage bargaining and union density. Rueda and Pontusson (2000) argue convincingly that the institutionalization of collective bargaining is conceptually different from the other two variables (whether, practically, they coincide or not in some countries). While union density and centralization represent the two most important characteristics of the formal organization of the wage bargaining process, the institutionalization of collective bargaining is meant to capture the influence of collectively bargained conditions over the circumstances of workers across the entire economy. In other words, the level of collective bargaining institutionalization (most easily represented by the percentage of the labor force covered by collective bargaining agreements) indicates the extent to which nonunion workers are affected by the employment terms achieved by unions through collective bargaining.



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