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## Firms and the welfare state: the emergence of new forms of unemployment

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**discussion paper**

**WZB**

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**Firms and the Welfare State:  
The Emergence of New Forms of Unemployment**

Isabela Mares

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Isabela Mares

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## **Abstract**

The goal of this paper is to provide the elements of a unitary analytical framework that incorporates the findings of two bodies of literature which, so far, have developed independently: comparative models of the political economy that distinguish between coordinated and uncoordinated market economies and comparative models of social policy. While sharing the emphasis on firm behaviour of the first models, the paper attempts to build a micro-logic into comparative models of social policy, in order to overcome the functionalist character of these analyses. By using combined insights from both models and by specifying the 'micro-regulatory' role of the welfare regimes and the impact of welfare regimes on firm adjustment, we can explain cross-national differences in the changes of the institutions situated at the interface between the welfare state and firms during the 1980's and cross-national differences in the mix between employment and non-employment.

## **Zusammenfassung**

Ziel des Papiers ist es, Elemente für einen einheitlichen Analyse-Rahmen zu entwickeln, der Ergebnisse zweier unterschiedlicher Stränge der Forschungsliteratur aufgreift, die bis jetzt unabhängig voneinander entwickelt worden sind: es geht zum einen um die vergleichenden Modelle der politischen Ökonomie, die zwischen koordinierten und unkoordinierten Marktwirtschaften unterscheiden und zum anderen um vergleichende Modelle bezogen auf Sozialpolitik. Von den erstgenannten Modellen wird die Fokussierung auf das Verhalten von Unternehmen übernommen, denn es geht um den Einbau einer „Mikro-Logik“ in die Modelle zur Analyse von Sozialpolitik. Damit soll der funktionalistische Charakter dieser Analysen überwunden werden.

Durch die Kombination von Ergebnissen beider Modelle und durch eine genaue Analyse der „mikro-regulatorischen“ Rolle wohlfahrtsstaatlicher Regelungen sowie deren Bedeutung auf Anpassungsprozesse von Unternehmen können Unterschiede zwischen verschiedenen Ländern bei der Veränderung der Institutionen an der Nahtstelle des Wohlfahrtsstaats und der Unternehmen während der achtziger Jahre und Unterschiede in der Verteilung von Beschäftigung und Arbeitslosigkeit erklärt werden.

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## 1. INTRODUCTION

The flexibility debate<sup>1</sup> which was prompted by the OECD technical labor market report entitled 'Flexibility in the Labor Market'<sup>2</sup> is almost ten years old. European dismissal laws were at the center of these debates. The social protection against the sudden termination of the employment contract enjoyed by European workers was viewed as the primary cause of the 'rigidity' and 'sclerosis' of the European labor markets and for the persistence of high unemployment in Europe, as compared to the United States. 'Deregulation' of the labor markets -- understood, in a narrow sense as the weakening of the dismissal laws and broadly as the removal of any form of 'social' protection that inhibits firms' 'flexible' use of their labor market inputs -- was viewed by employers and policy-makers alike as the all-promising cure that could remedy the unemployment ills.

After almost ten years, the debate about the possibilities of reconciliation at the firm level between the demands of social protection and economic flexibility still continues<sup>3</sup>. However, a number of empirical developments have muddled what was once considered a well-understood trade-off between economic flexibility and social policies. Consider the following facts. Despite the weakening of the dismissal laws in several European countries -- Germany, Italy, France and the UK -- European unemployment has failed to decrease.<sup>4</sup> Macroeconomic labor market prospects in Europe have failed to improve during the early 1990's: in 1994 total unemployment in Europe totaled 35 million, an increase of 10 million over the levels of unemployment of 1990<sup>5</sup>. In some countries, such as Germany, the change in employment security regulations

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<sup>1</sup> Comprehensive summaries of the debates and of the flexibility literature can be found in Rein, Martin and Friedman, B. L., 1992, Social Protection and Economic Change, Cambridge: MIT Press, Jessop, B., et. al., 1991, The politics of flexibility: Restructuring State and Industry in Britain, Germany and Scandinavia, Worcester: Billing and Sons, Rebecca M. Blank, ed., 1994, Social Protection versus economic flexibility: Is there a trade-off?, Chicago: The University of Chicago Press. For some clarifications on the concept of flexibility, see, among others, Piore Michael, 1986, Perspectives on Labor Market Flexibility, Industrial Relations, 25: 1986, pp. 146- 167

<sup>2</sup> OECD, 1986, Flexibility in the Labor Market: The Current Debate. A Technical Report, Paris: OECD. Among other influential reports advocating similar policies, see OECD, 1990, Labor Market Policies for the 1990's, Paris: OECD.

<sup>3</sup> For a summary of the positions in the debate, see Richard B. Freeman and Rebecca M. Blank, 1993, Evaluating the connection between social protection and economic flexibility, Cambridge: MA, National Bureau of Economic Research Working Paper.

<sup>4</sup> For a review of the changes to the dismissal laws see the articles in Christoph F. Büchtemann, ed., 1993, Employment Security and Labor Market Behavior: Interdisciplinary Approaches and international evidence, Ithaca: ILR Press.

<sup>5</sup> OECD, 1994, The OCED Jobs Study, Paris: OECD.

had a very low impact on the hiring and firing behavior of German firms<sup>6</sup>. The weakening of the dismissal laws has been accompanied, in many European countries by an increase of firms' use of the instruments of the welfare state: early retirement, work-sharing and part-time work (that is subsidized by unemployment insurance benefits) being the most significant examples. These policies which, based on some estimates, provide benefits to *over 20 million people* across OECD countries emerged as an unintended consequence of labor market deregulation and remain unexplained by the flexibility literature. As these empirical developments suggest, the institutional mechanisms that link employment security regulations to unemployment via firm behavior and the welfare state to firms are still insufficiently understood.

The goal of this paper is to contribute to the specification of the relationship between employment security regulations, labor market policies of firms and a number of labor market outcomes, such as patterns of labor market segmentation, labor force participation and unemployment rates. It will do so, by integrating the analysis of dismissal laws into the broader institutional environment, by making use of categories and propositions developed within institutional models of the political economy and models of the welfare state<sup>7</sup> and by focusing on the relationship between dismissal laws and other social policy instruments that are available to firms. With the use of these models, I intend to respecify the micro-regulatory function of the welfare state and the impact of welfare regimes on firm adjustment. I will attempt to distinguish among the circumstances under which deregulation of dismissal laws was successful and explain the causes of this success (by pointing out the broader macro-institutional environment that has facilitated successful labor market deregulation) and those circumstances in which attempts of employers and policy-makers towards deregulation of the labor markets had as their unintended consequences the increased use by firms of the instruments of the welfare state.

This theoretical framework will be then used to explain cross-national variation in the patterns of firm-welfare state interaction, during the 1980's. I will point to an important mechanism of institutional interaction between welfare regimes and institutions of business coordination that operates via firm behavior

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<sup>6</sup> A point repeatedly made by Christoph F. Büchtemann. See, for example, Does (De)Regulation matter? Employment Protection in West Germany, in Egon Matzner and Wolfgang Streeck, eds., 1991, Beyond Keynesianism: The Socio-Economics of Production and Full-Employment, London: Edward Elgar, pp. 111- 37; Büchtemann, Christoph and Quack, Sigrid, 1989, 'Bridges' or 'Traps'? Non-Standard Employment in the Federal Republic of Germany, in Gerry and Janine Rodgers, eds., 1989, Precarious jobs in labor market regulation: The growth of atypical employment in Western Europe, Brussels: ILO Publications.

<sup>7</sup> A similar suggestion -- for the improvement of our understanding of the impact of social protection programs has been put forward by Richard Freeman. " There is a need to analyze the effects of specific programs within the 'general equilibrium' of social and market institutions. The impact of any program depends on the environment of institutions in which it is located. [...] Multiple and simultaneous programs can have offsetting behavioral incentives or can reinforce each other in ways that create synergies, so that the effect of several programs together may be different from any individual program alone. [...] Programs that are distortionary in isolation may not be distortionary when viewed in a broader systemic context." In Freeman, 1993, op. cit., p. 26.



and to a new political dynamics of social policy development during the 1980's that has resulted from the growing access of enterprises to the instruments of social policy. What explains cross-national variation in the mode in which firms have gained access to the resources of the welfare state and in their ability to use social policies for the purposes of enterprise reorganization? What explains differential degree in the ability of firms to shift some of the burden of adjustment and reorganization to the state? More importantly, however, what are the labor market consequences of these developments? Why have most of these policies ended up offering nothing more than a surrogate experience of work to the participants involved (part-time work, work-sharing schemes) or just a 'dignified' form of labor market non-participation (early retirement) as an alternative to unemployment? What are the mechanisms by which these social policies reinforced the institutionalized advantages of labor market insiders over labor market outsiders -- instead of overcoming some of the structural problems of European labor markets (long duration of unemployment spells, high percentage of long-term unemployment out of total unemployment, low labor force participation rates of certain labor market groups)?

By focusing on these dimensions of social policy development that are shaped by firms' use of social policies and by emphasizing this micro-macro linkage, I attempt to contribute to the growing literature that examines the institutional interaction between comparative models of the political economy and comparative models of social policy. First, this analysis attempts to build a micro-logic into existing models of welfare regimes<sup>8</sup> in order to overcome the functionalist bend of these analyses. Esping-Andersen conceptualizes the tendency of welfare regimes to maximize (universalistic) or minimize (conservative) labor force participation rates as expression of the 'latent' institutional logics of these regimes, without specifying the causes of these differences and without a consistent micro-logic<sup>9</sup>. The turn to these functionalist arguments that hypothesize differences in 'labor market logics' among the three different welfare regimes is a result of the failure of simple versions of institutional arguments to account for the vast differences in labor market outcomes: there are no major differences between Sweden and Germany in the institutional rules that specify the conditions of exit from the labor market via early retirement<sup>10</sup>, yet, in terms of labor market *outcomes*, the two countries are

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<sup>8</sup> Gøsta-Esping Andersen, 1990, Three Worlds of Welfare Capitalism, Princeton: Princeton University Press.

<sup>9</sup> *Why do universal welfare regimes maximize total labor force participation rates, while conservative welfare regimes minimize them*, Gøsta Esping Andersen would, I think, offer two answers. One is pure definitional: i.e. these differences are the characteristic attributes of these regimes. The second answer is more complex and refers to the Baumol model. The implicit institutional logic of welfare regimes is a result of the solutions to the problem of uneven growth in productivity between the manufacturing and service sector. See Gøsta Esping Andersen, 1990, op. cit., Chapter 8, p. 194.

<sup>10</sup> An observation made by Martin Kohli and Martin Rein, 1991, *The Changing Balance of Work and Retirement*, in Kohli, Martin et.al, eds., 1991, Time for Retirement: Comparative Studies of Early Exit From the Labor Force, Cambridge: Cambridge University Press, p. 9 "Countries like Sweden have almost all the supporting legislation needed to produce early exit, but nevertheless do not show the same rates as, for example, Germany, France and the Netherlands."

situated at the extreme points. Second, an analysis of firms as agents of social policy development is totally absent from comparative welfare state studies<sup>11</sup> -- a surprising omission, given the crucial role firms play in defining the terms of the employment relationship and the given the close relationship that exists between the organization of the internal labor markets<sup>12</sup> and the mode in which firms rely on the external labor markets during periods of economic downturns, between the organization of the employment relationship within firms (patterns of job tenure) and patterns of labor market exclusion. A number of recent social policy developments that the welfare regime literature has attempted to explain (such as cross-national variation in early retirement) cannot be accounted for, without an understanding of the large role played by firms in shaping these developments<sup>13</sup> and without an analysis of the growing access of firms to a number of instruments of social policy. Third, the micro-macro linkage of firms-welfare states interactions can, potentially account for some of the stratificational outcomes of coordinated market economies by linking the analysis of the variation among different forms of non-employment that the comparative welfare regimes literature has initiated to a comparative analysis of differences in the patterns of employment (cross national differences in job tenures, in security of employment etc.) that the comparative political economists have identified.

## **2. THE UNINTENDED CONSEQUENCES OF LABOR MARKET DEREGULATION: AN OVERVIEW**

A 1985 survey of employers, conducted by the international employers association (IOE) attempted to rank the significance of obstacles to the termination of employment contracts<sup>14</sup> based on assessment of employers.

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<sup>11</sup> There are, of course a few exceptions. A recent analysis that attempts to integrate an analysis of production regimes with models of welfare state development can be found in Frieder Naschold and Bert de Vroom, eds., 1994, Regulating Employment and Welfare. Company and National Policies of Labor Force Participation Rates at the End of Worklife in Industrial Countries, Berlin: Walter de Gruyter, Chapters 1 and 10.

<sup>12</sup> By internal labor markets, I refer to the specification of job classifications and seniority ladders and the benefits, wages and rights attached to each segment within these ladders. See Peter B. Doeringer and Michael Piore, 1971, Internal Labor Markets and Manpower Analysis, pp. 13- 34; Ronald G. Ehrenberg and Robert S. Smith, 1982, Modern Labor Economics: Theory and Public Policy.

<sup>13</sup> The fact that differences in early retirement cannot be explained through an analysis that focuses on social policy alone has been indirectly affirmed by Gøsta Esping Andersen and Jan Eivind Kolberg: "Cross-national variations in the scope of early retirement are increasingly large and have increased over the past decades. At present we can offer rather speculative hypotheses concerning international variations in the exit of older workers." Gøsta Esping-Andersen and Jan Eivind Kolberg, Welfare Regimes and Employment Regimes, in Kolberg, Jan Eivind, ed., 1992a, Between Work and Social Citizenship, London: Sharpe, pp. 14-15

<sup>14</sup> The results of this survey of the International Organization of Employers (Adapting the Labor Market) can be found in Emerson, Michael, 1988, Regulation or deregulation of the labor market: Policy regimes for the recruitment and Dismissal of employees in the Industrialized countries, European Economic Review, 32: 1988, pp. 775- 817.

Since dismissal laws consist of very sophisticated (and, often obscure) legal and procedural rules, cross-national comparability as well as the formulation of indexes that make possible an econometric estimation of the impact of these legal frameworks is extremely difficult<sup>15</sup>. The results of this survey can be used as a preliminary comparative assessment of the institutional impact of these rules.

**TABLE 1**

**Importance of Obstacles to the Termination of Employment Contracts<sup>16</sup>**

1. Obstacles are fundamental	France Germany Italy Netherlands Portugal Spain
2. Obstacles are Serious	Austria Belgium Ireland Norway Sweden
3. Obstacles are minor	Denmark Finland
4. Obstacles are insignificant	United Kingdom

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<sup>15</sup> On attempts to develop statistical tests, see Mosley, Hugh and Kruppe, 1992, Employment Protection and Labor Force Adjustment: A Comparative Evaluation, Discussion Paper, FS I 92-9, Wissenschaftszentrum für Sozialforschung, Berlin.

<sup>16</sup> Source: International Organization of Employers quoted in Emerson, Michael, 1988, Regulation or Deregulation of the Labor Markets, European Economic Review, 1988: 32, p. 791; Büchtemann, Christoph F., 1991, Employment Security and Labor Markets: Assumptions, International Evidence and Theoretical Implications, Discussion Paper, FS I 91- 1, April 1991, Wissenschaftszentrum für Sozialforschung, Berlin, p. 56; For similar results see Bertola, B., 1990, Job Security, Employment and Wages, European Economic Review, 1990, pp. 851- 886.

The arguments favoring more economic flexibility that would result from a weakening of the social constraints imposed by dismissal laws on the enterprises have formulated a number of empirical propositions. On the one hand, they predict that a more rapid and thorough 'deregulation' (understood as a weakening of the institutional obstacles on the hiring and firing of workers) would occur in countries with higher levels of social protection against dismissal. Second, they predict that, once these institutional barriers to the hiring and firing of workers are removed, one should observe cross-national *similarities* in the labor market adjustments of firms during economic downturns, consisting in an increase in the number of layoffs and temporary layoffs during economic downturns. As a consequence of the more rapid adjustment of firms' employment policies, economies with lower levels of employment security should be characterized by lower levels of unemployment.

However, most of these propositions have been disconfirmed by the labor market developments that followed the weakening of the dismissal laws in several European countries. Germany, a country that ranks highest on the IOE index has introduced only minor changes in its employment security regulations: the most important being the change to the employment promotion act (*Arbeitsförderungsgesetz*) in 1985 allowing for fixed-term contracts.<sup>17</sup> As existing studies measuring the impact of these changes have indicated, these transformations had as a result an even more modest impact on the hiring and firing behavior of German firms.<sup>18</sup> What has accompanied these timid attempts towards labor market deregulation has been, however, a greater reliance by firms on the instruments of the welfare state and a greater use of social policy for labor market purposes: most notably being an increase in firms' use of unemployment insurance to subsidize of short-time work and the growth of early retirement.

In contrast to Germany, labor market deregulation in France has been more successful. In this case, however, employment security regulations were not linked to firms training needs and were imposed on firms externally via administrative decisions. The authorization of dismissal for economic reasons rested, after 1975, with the government (the Work Inspection Office) -- which was 'micro-managing' the labor market by monitoring, and influencing the mode of selection by enterprises of their redundant workers. This requirement of administrative authorization of dismissals (*Authorisation Administrative*) was abolished in 1986, after the Chirac II government gave in to complaints by the

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<sup>17</sup> Mückenberger, Ulrich, 1990, Zur Rolle des Normalarbeitsverhältnisses bei der Sozialstaatlichen Umverteilung von Risiken, in Christoph F. Büchtemann and Helmut Neumann, eds., 1990, Mehr Arbeit durch weniger Recht? Chancen und Risiken der Arbeitsmarktsflexibilisierung, Berlin: Sigma.

<sup>18</sup> For example, Mosley and Kruppe conclude that "the net employment effects (of the 1985 changes) were small due to substitution and dead-weight. The reform is in fact estimated to have induced only ca. 230,000 additional fixed term employment contracts. No evidence was found for the substitution of fixed-term contracts for overtime." The same study concludes that the increase in the percentage of fixed-term contracts as a total of the structure of German employment was only a modest 1.8 %, from 4% in 1984 to 5.8% in 1985. Mosley and Kruppe, op. cit., p. 85.

Conseil National du Patronat Français and eliminated all statutory regulations concerning dismissals on economic grounds<sup>19</sup>. In opposition to Germany, short-time work in France is much more limited (these programs covered only, on average, 45.000 employees per year). France shares with Germany the low labor force participation rates of males age 55-65 that has been a consequence of the development of early retirement, yet it differs in the policy instruments through which early retirement has been achieved.

The comparative analysis of this paper attempts to explain these cross-national differences and to account for these unintended consequences of labor market deregulation. None of the policy changes can be understood in isolation and without a consideration of the broader institutional environment and specifying the relationship between alternative social policies that are available to firms. Despite the tremendous variation across the national cases in the character of firm-welfare state interaction, in both cases, the increased access of firms to the instruments of social policy has been the result of the ability of the enterprises to *reinterpret* existing policy instruments of the welfare states in order to devise alternative forms of non-employment which could substitute for the reliance on the external labor market that labor market deregulation intended to achieve.

### **3. AN ALTERNATIVE MODEL OF FIRMS-WELFARE STATE INTERACTION**

What explains the cross-national differences in the mode of labor market adjustment of firms during economic downturns, i.e. their choice among alternative policies such as layoffs, early retirement policies or policies that subsidize participation in work, via work-sharing or short-time work? What explains cross-national differences in the degree of access to the institutions of the welfare state gained by firms during the 1980's ? This paper makes two general propositions. The first is the observation that cross-national differences in the mode the welfare state has been used by firms to facilitate firm-level adjustment exist. These differences can be modeled, if the institutional constraints on firms set by two macro-institutional environments are specified: the institutions of business coordination<sup>20</sup> (that influence the level of long-term

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<sup>19</sup> Maurau, Guy, Regulation, Deregulation and Labor Market Dynamics: The Case of France, in Büchtemann, C. F., ed., *op. cit.*, 1993, pp. 358- 374; Mosley, Hugh and Kruppe, Thomas, *op. cit.*, p. 72.

<sup>20</sup> In my reformulation of David Soskice's model, institutions of business coordination are institutional arenas which increase the strategic capacity of business, inducing firms to converge upon a pattern of production and trade that offers cumulative advantages that are not predetermined by preexisting factor endowments, while, simultaneously, compensating for the risks of innovative product market strategies. Characteristic of these institutional arenas is that they "provide a forum for strategic discussion and the development of common positions" and that they have both access to inside information of firms together with a sanctioning capacity against the firms that do not adhere to the strategic positions of the organization. See David Soskice, 1994, National Patterns in Company Innovation Strategies: A Comparative Institutional Advantage Approach, manuscript, Wissenschaftszentrum für Sozialforschung Berlin;

investment in human capital and the mix between general and firm-based training) and the character of the welfare regime, which can be viewed as 'repertoire' of policy instruments that are available to firms. I will attempt to distinguish among several distinct logics of firm-welfare state-interactions, i.e. broad strategies of firms use of different social policies during periods of economic adjustment. The second proposition is that these different micro-logics by which firm development has been combined with social policy development can account for different labor market outcomes across the cases, in particular for differences in labor market outcomes such as: mix between unemployment and other forms of non-employment; differences in the number of unemployment spells per worker and in the duration of unemployment spells across these economies.

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Soskice, David, 1990a, Wage Determination: The Changing Role of Institutions in Advanced Industrial Countries, *Oxford Review of Economic Policy*, 6: 4, pp. 36- 61; Soskice David, 1990b, Reinterpreting Corporatism and Explaining Unemployment: Coordinated and Non-Coordinated Market Economies, in Renato Brunetta and Carlo Dell'Ariga, eds., *Labor Relations and Economic Performance*, New York: New York University Press.

**TABLE 2**

**Hypothesized patterns of firms-welfare state interaction and social policies used by firms based on constraints imposed by the institutions of business coordination and character of welfare regime.**

	<b>Welfare Regime</b>		
<b>Organization of the Political Economy</b>	Conservative	Universal	Liberal
Coordinated	<ul style="list-style-type: none"> <li>- High Use of Early Retirement</li> <li>- Use of Unemployment Insurance to Subsidize Participation in Work (Sozialplan, work-sharing etc.)</li> <li>- Labor Market Deregulation unsuccessful.</li> </ul>	<ul style="list-style-type: none"> <li>- Low use of early retirement</li> <li>- Low levels of employment security regulations</li> </ul>	
Uncoordinated	<ul style="list-style-type: none"> <li>- High Use of Early Retirement</li> <li>-Use of Unemployment Insurance to subsidize Participation in Work</li> <li>- Labor Market deregulation successful.</li> </ul>		<ul style="list-style-type: none"> <li>- Low use of social policies by firms.</li> <li>- Firm adjustment achieved by layoffs, temporary layoffs and reliance on external labor markets.</li> <li>- Low employment security.</li> </ul>

On the one hand, in uncoordinated market economies, the low degree of business coordination has as its consequence a low level of investment in firm-level training and is associated with lower job tenures (Table 3) and a high mobility of workers across firms. Since in this institutional environment mobility of workers across firms has no adverse implications on levels of firm-based training, for employers in these economies, one expects employers in these countries to perceive dismissal laws as unnecessary barriers and 'rigidities' that inhibit a more flexible use of their manpower. Similarly, during economic downturns, one expects firms to rely on layoffs and temporary layoffs as their dominant labor market strategy and one expects a movement of workers in and out of unemployment, leading to a higher number of spells of unemployment per worker, as compared to coordinated market economies. Alternative uses of social policy to facilitate firms level adjustment, such as work-sharing or early retirement are rather exceptional for the 'average' firm in these economies. Given the 'residualist' character of the welfare regime one expects a low level of public spending on public policies that facilitate labor market adjustment, such as early retirement schemes.

**TABLE 3**  
**JOB TENURES IN OECD COUNTRIES<sup>21</sup>**

	1979	1979	1985	1985	1989	1989	1991	1991
	Tenur e<1	Avera ge	Tenur e<1	Avera ge	Tenur e<1	Avera ge	Tenur e<1	Avera ge
<b>Australia</b>	22.3	6.5	22.9	6.6	27.9	6.5	21.4	6.8
<b>Canada</b>	26.2	7.3	26.6	7.6	27.3	7.4	23.5	7.8
<b>Finland</b>	17.0	7.8	18.4	8.4	22.2	8.0	11.9	9.0
<b>France</b>	...	...	13.1	10.7	...	...	15.7	10.1
<b>Germany</b>	...	...	8.5	11.1	18.2	10.3	12.8	10.4
<b>Japan</b>	10.6	8.9	9.4	10.3	9.4	10.8	9.8	10.9
<b>Netherlands</b>	...	...	11.7	8.9	...	...	24.0	7.0
<b>Spain</b>	...	...	15.2	11.2	...	...	23.9	9.8
<b>UK</b>	...	...	18.0	8.3	21.5	7.8	18.6	7.9
<b>US</b>	29.3	6.4	28.9	6.7	29.7	6.8	28.8	6.7

<sup>21</sup>Source, OECD, *The Jobs Study*, 1994, Paris: OECD.



A vast amount of econometric evidence has been accumulated to point that the labor market adjustment of firms in non-coordinated market economies with liberal welfare regimes such as the US and the UK can be approximated by the simple empirical predictions of this model, which parallels, in its broad characteristics the standard description of labor market found in economics textbooks. By using dynamic labor market demand model that estimates the change in labor inputs by firms (across the same industries) but in different institutional environments, it has been estimated that American firms adjust more rapidly *their employment levels* than European firms, despite the existence of tax disincentives for US employers to lay off workers, whereas European firms (in particular German and French firms) adjust the *average hours per worker*<sup>22</sup>. But the situation encountered in uncoordinated market economies with liberal welfare regimes is rather exceptional. For most other European economies, we can identify several different patterns of welfare state-labor market interaction during the 1980's.

Coordinated market economies are characterized by a combination of high levels of training of the workforce (consisting of both general training provided by the institutions of vocational training and firm-level training). If linked to the policies of firm-level training, dismissal laws are viewed by employers as a part of the institutional environment that prevents the mobility of workers across firms. During periods of economic downturns, enterprises will attempt to decrease the movement in and out of unemployment that may potentially undermine the investment of employers in the skills of their employees. Thus, one expects to find in these economies higher job tenures associated with a lower number of spells of unemployment per worker, but one expects the duration of the unemployment spell to be longer than in uncoordinated market economies. (Table 4) Rather than relying on a mixture of layoffs and temporary layoffs as the dominant labor market strategy, enterprises in these economies turn to the welfare states in search for labor market instruments that are alternatives to layoffs: these 'strategies', in turn, lead to significant changes in the character of social policy itself.

But firms adjustment strategies during periods of economic downturns are conditioned by the character of the welfare regime, as well. Prior economic models have assumed that the level of unemployment benefits is the most significant variable that determines the levels of unemployment<sup>23</sup>. These

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<sup>22</sup> Susan N. Houseman and Katherine L. Abraham, 1993a, Labor Adjustment under different Institutional Structures: A case study of Germany and the United States, NBER Working Paper no. 4548; Katherine G. Abraham and Susan N. Houseman, 1993 b, Does Employment Protection Inhibit Labor Market Flexibility? Lessons from Germany, France and Belgium, NBER Working Paper no. 4390; Abraham, K. and S. N. Houseman, 1993, Job Security in America: Lessons from Germany, Washington: Brookings Institution; Houseman, S. N., 1991, Industrial Restructuring with job security: The case of European Steel, Cambridge: Harvard University Press.

<sup>23</sup> A representative text is Layard, R., et. al., 1991, Unemployment, Macroeconomic Performance and the Labor Market, Oxford: Oxford University Press. Elements of a critique can be found in Atkinson, Anthony B., and Micklewright, John, 1991, Unemployment Compensation and Labor Market Transitions: A Critical Review, Journal of Economic Literature, 29: 1991, pp. 1679- 1727.

models, however, fail to account for alternative forms of non-employment (totaling almost 20 million people in OECD countries), which are, paradoxically, important in economies with very high levels of unemployment benefits, such as Germany or the Netherlands. One needs to identify a different variable of the welfare regime that accounts for the differences in the mix between unemployment and non-employment across OECD countries. My analysis will focus on different structural variables of the welfare regime in order to account for these differences in labor market outcomes: (a) the mode of financing of the social benefits and (b) structural relationship between social policies, in particular the relationship between sickness and invalidity benefits and unemployment benefits. Both influence the relative costs between unemployment and alternative forms of non-employment faced by firms.

First, the mode of financing of social benefits (i.e. contributory or financed through general taxation) influences the costs of open unemployment (that is a consequence of layoffs) faced by firms. In contributory systems of insurance (or conservative welfare regimes) the cost of open unemployment to firms is higher than in non-contributory systems of social policy (universalistic welfare states). This increase in the cost of unemployment to firms reinforces the tendency of firms in these economies not to rely on the external labor markets during periods of economic downturns.

The second structural variable of welfare regimes, which influences the choices between unemployment and other forms of non-employment available to firms are, as Blondal and Pearson have pointed out, the level (and conditions) of invalidity and sickness benefits and the relationship of invalidity and sickness benefits to unemployment benefits. If high sickness and invalidity benefits exist, firms will turn to these policy instruments in order to develop the early retirement 'pathway'<sup>24</sup> as an alternative to layoffs and will prefer to use social policy instruments to subsidize different forms of non-employment as functional equivalents of unemployment. The growth in the use of firms of sickness and invalidity benefits in a large number of conservative welfare regimes (such as Germany and the Netherlands) will lower the level of unemployment and will lead to a higher level of early retirement and a different mix in the level of labor force participation rates/unemployment rates.<sup>25</sup> In

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<sup>24</sup> The concept of pathway was developed by the authors of the comparative study of early retirement. Kohli et al., eds., 1991, Time for Retirement: Comparative Studies of Early Exit from the Labor Force, Cambridge: Cambridge University Press. "A pathway is an institutional arrangement or in most cases a combination of different institutional arrangements that are sequentially linked to manage the transition process, that is the period between exit from work and entry into the normal old-age pension system. [...] Pathways consist of sequences of institutional programs, with rule providing by a specific program to be followed by a specific second, and third etc." p. 6

<sup>25</sup> Blondal, Sveinbjorn and Pearson, Mark, Unemployment and other non-employment benefits, Oxford Review of Economic Policy, 1995, 11:1, p. 136.

France, on the other hand, given the low levels of disability benefits as compared to unemployment benefits, early retirement has been achieved through the use of unemployment compensation.

Given these constraints faced by firms in coordinated market economies with conservative welfare regimes, one expects to find in this institutional environment the most innovative use by firms of different social policies that represent alternatives to reliance on the external labor market during periods of structural decline of industries or for the purpose of enterprise adjustment. Flexibility during periods of economic downturns is achieved by the use of a number of the instruments of the welfare state: (1) early retirement policies are used by firms to achieve flexibility financed by general taxation; (2) unemployment benefits are paid directly to firms who use it to subsidize short-term work; (3) employment security of employees can be maintained if employment security regulations are linked to firms' training practices.

Empirical evidence for the propositions developed above will be provided in the next section. First, this institutional explanation that specifies the differential constraints imposed on firms by the welfare state and the institutions of business coordination can explain the widespread cross-national variation in the success of employers' attempts to weaken statutory provisions against unfair dismissals. The variation in the success of labor market deregulation can be understood, if the institutional logics of dismissal laws is disaggregated. From the perspective of employees, employment security regulations serve a 'decommodifying'<sup>26</sup> role: they undo some of the power inequality of the employment contract, by weakening the possibility of an unjust termination of the labor contract. From the perspective of employers, dismissal laws are an instrument that decrease turnover rate and that protect their investment in skills: a necessary institutional prerequisite for long-term investment in the skills of employees. The fact that in non-coordinated market economies these two logics are not linked increases the likelihood of employers' success in weakening of dismissal laws in these economies; in coordinated market economies, given that a linkage between the 'decommodifying' and 'economic' functions of dismissal laws exists, employers will be less successful in weakening the social constraints on their enterprises<sup>27</sup>.

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<sup>26</sup> On a similar interpretation of the decommodifying function of dismissal laws, see Mosley and Kruppe, 1992, op. cit., p. 11. "The principal historical rationale for unfair dismissal and related regulations creating quasi 'property-rights' in employment relationships has been equity considerations -- within the context of the post-World War II social contract with its partial 'decommodification' of the factor labor."

<sup>27</sup> Also, existing surveys of employers in coordinated market economies (in particular Germany) have found that employers are less likely to regard employment security regulations as a major constraint. For example, the largest study on the impact of employment security commissioned by the German Federal Ministry of Economic and Social Affairs during the early 1980's found that "most German firms do not regard employment protection regulations as a major constraint." Falke, et. al., eds., 1981, Kündigungspraxis und Kündigungsschutz in der Bundesrepublik, Forschungsbericht no. 47, Bonn. A wave of interviews conducted among German employers during the late 1980's found that "77% of managers interviewed asserted that employment protection regulations were not a major obstacle to workforce reduction." Büchtemann and Höland, 1989, Befristete Arbeitsverträge nach dem

The second broad strategy of reliance on social policies available to enterprises in coordinated market economies have been general policies that subsidize 'participation in work'. Known as 'work-sharing' or short-time work, most of these policies use unemployment benefits to subsidize participation in work and to affect changes in the working hours of their employees, instead of relying on layoffs. In Germany, the use of short-time work as a social policy instrument used by firms has risen dramatically during the 1980's, but has slowly decreased during the 1990's, an outcome made possible by the numerous changes in the regulations concerning the conditions under which firms can make use of these unemployment benefits. Among these changes, which I will describe in the empirical part, the most significant is a decision of the Federal Social Court (*Bundessozialgericht*) in 1986 that allowed firms to make use of short-time work benefits, even if the majority of jobs could not be saved as a result of the reorganization of the enterprise.

The third alternative social policy instrument is early retirement. My analysis will focus on the mechanisms through which early retirement was achieved by firms, with a particular emphasis on the political process of redefinition of existing policy instruments and of old age as risk. The availability of this early retirement option has allowed firms in these economies to shift the burden of adjustment and restructuring to the state. This explanation of the rapid growth in early retirement that focuses on the active role played by firms in explaining this dramatic social policy innovation during the 1980's differs in several respects from the welfare regime explanation that hypothesized an abstract institutional logic of welfare regimes<sup>28</sup>. According to Gøsta Esping Andersen, early retirement should be highest in conservative welfare regimes, *because* these regimes do not aim at maximizing total labor force participation. These analyses, while convincing for the purpose of broad macro-comparisons fails to identify the *political* dynamics behind this rapid increase in early retirement: unions acceptance of the new trade-off wage demands/early retirement; the acceptance by the state of its role to subsidize firm-level adjustment through a reinterpretation of some of the institutions that were created to guarantee full employment and fails to distinguish among the different policies (pathways) through which early retirement was achieved (sickness and disability pensions, unemployment insurance and disability benefits).

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Beschäftigungsförderungsgesetz 1985, Forschungsberichte no. 183, results quoted in Mosley and Kruppe, *op. cit.*, p. 87.

<sup>28</sup> On this position, see Gøsta Esping Andersen, 1990, *op. cit.*, p. 148; Gøsta Esping Andersen and Jon Eivind Kolberg, *Welfare States and Employment Regimes*, pp. 14-15, in Kolberg, Jan Eivind, ed., 1992a, *Between Work and Social Citizenship*, London: Sharpe; Kolberg, Jon Eivind, ed., 1992b, *The Study of Welfare State Regimes*, London: Sharpe.

## 4. APPLYING THE MODEL: A COMPARISON OF GERMANY AND FRANCE

In the next part, I will present evidence supporting the theoretical propositions outlined above that predict differential adjustment of firms, based on differences in the access to the instruments of the welfare state. While in this paper, the focus will be on the 'institutional evidence' tracing the changes in three policy areas: dismissal laws, short-time work, early retirement, the statistical evidence that assesses the impact of these labor market frameworks on employment patterns and labor market adjustment -- and that analyzes the stratificational outcomes within the different institutional environments -- will be presented elsewhere.

### 4. 1. Labor Market deregulation: differential success.

During the 1980's, in both France and Germany, dismissal laws came under strong attacks of organized employers. The prescriptions of the OECD 'flexibility' reports were widely embraced<sup>29</sup> and the social policy principles embodied in the statutory dismissal regulations came under attacks that critiqued the high social constraints imposed by the existing labor legislation on the adjustment process of enterprises. However, the success of the attempts of employers and policy-makers to weaken dismissal laws varied across the two national contexts: while French employers succeeded in abolishing the administrative authorization of dismissals, German employers were unable to influence a major change in the legislation of employment protection. The explanation of this differential success that I will propose is based on the different mode in which the 'social' (decommodifying) and 'economic' functions of dismissal laws were linked in the two different institutional contexts.

First, differences in the historical evolution of social protection against dismissal in both countries sheds some light on the different mode in which employment protection laws mediated between the needs of enterprises to retain skilled employees and the 'decommodifying' demands of employees for protection against the risk of sudden termination of the employment contract. In Germany, regulations against unfair dismissal originated during the 1920's, as a

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<sup>29</sup> See, for example, the collection of articles edited by Christoph F. Büchtemann and Helmut Neumann, 1990, Mehr Arbeit durch weniger Recht? Chancen und Risiken der Arbeitsmarktflexibilisierung, Berlin: Sigma, especially the contributions by Schellhaas, Neumann, Muckenberger etc. For France, see the study undertaken by the Conseil National du Patronat Français in 1984, concluding that "through the abolition of certain regulatory constraints and parafiscal taxes, additional 471,000 jobs could be created in the following year." Study is quoted in Maurau, op. cit., p. 360.

result of a cross-class alliance<sup>30</sup> between employers and employees.<sup>31</sup> Tight labor markets and fear of loss of high-skilled workers were the most important considerations that led employers accept a number of progressive social policy principles, embodied in a number of legislative decrees of the period, among others the Works Council Act of 1920 and the Labor Tribunal Act of 1926. The harshness of 'social' constraints on German enterprises is remarkable from a comparative viewpoint: a dismissal could be found as justified only if it represented a "necessary hardship (*Härte*) that was not caused by the behavior of the employers or by the conditions of the enterprise."<sup>32</sup>

In France, on the other hand, statutory provisions against unfair dismissals were enacted as a consequence of the strike-waves of 1968 and they do not share the long history of cross-class alliance between employers and employees that has characterized German employment security legislation. The 1973 unfair dismissal regulations required 'well-founded and serious causes' of initiation of dismissals by employers and the obligation of employers to offer employees (that had been employed for a period longer than two years) the possibility of retraining (*Convention de Conversion*) if dismissed for reasons of redundancy. Employers were required to pay the dismissed workers compensation equal to six months earnings and pay to the Unemployment Insurance Fund (ASSEDIC) for the benefits drawn by the employee for a period of six months. In case of collective redundancies, consultation with works councils (*comité d'entreprise*) defined the selection criteria for dismissals (such as job tenure, family conditions, age etc.) and if dismissals affect more than ten employees the negotiation of 'social plans' was mandatory.

The second difference between dismissal laws across the two cases consists in the character of the public intervention in the labor market. The degree of discretionary authority of the French state was much higher than in Germany, and is one of the major causes of the frustration of the Conseil National du Patronat Français (CNPF) with the existing system of employment protection. In France, a requirement of public authorization of all redundancies (*Authorization Administrative*) was introduced by the conservative government of Chirac in 1975, a measure by which the government attempted to exert a significant degree of public control over the pace, scope and selection of different redundancies. Germany, avoided the pitfalls of this ad-hoc and random public intervention in the operation of the labor market and over firms'

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<sup>30</sup> The cross-class alliance explanation which was developed to account for the origin of centralized wage-bargaining, is, certainly applicable to a number of other institutions that emerged during the inter-war period. See Swenson, Peter, 1991, Bringing Capital Back In or Social Democracy Reconsidered, *World Politics*, 23:4.

<sup>31</sup> My account of the origin and development of German dismissal law is primarily based on a number of legal interpretations. I have primarily relied on Weller, Bernhard, 1969, *Arbeitslosigkeit und Arbeitsrecht*, Stuttgart: Gustav Fischer, pp. 62- 74; Preis, Ulrich, 1987, *Prinzipien des Kündigungsrechtes bei Arbeitsverhältnissen*, München: Beck, Birk, Rolf, 1994, *Protection against unfair dismissal in Germany: Historical Evolution and Legal Regulation*, in Buchtemann, Christoph, ed., 1994, *op. cit.*

<sup>32</sup> Paragraph 84, Absatz 1 of Betriebsratsgesetz of 1920, quoted in Preis, *op. cit.*, p. 15.

employment practices through the high degree of ‘juridification’ of employment laws, which paradoxically, rendered the social criteria which restructuring enterprises had to consider as more transparent.

The third difference among employment protection laws results from their different relationships to the environment of skill formation that supported different strategies of firm level training. In the German context, a strong institutional linkage exists between the institutions of skill formation and dismissal laws. Given the fact that the German system of vocational training leads to the acquisition of general skills, that were transferable across firms<sup>33</sup>, employers were reluctant to dismantle the protective regulatory environment that prevented mobility of workers across firms. In France, on the other hand, the absence of a system of training providing workers with general, transferable skills similar to the German dual system, had as its consequence a large percentage of semi-skilled workers (*ouvrier spécialisé*) as percentage of total industrial workforce (based on some estimations, the semi-skilled workers account for 60 % of all manufacturing workers)<sup>34</sup>. Vast differences between the French and German understanding of skill exist: in France “multi-skilled workers are workers with experience in several jobs, not workers with a relatively abstract understanding of the production process, most of them would qualified as semi-skilled in Germany.”<sup>35</sup> As a result of the different understandings of skills in the two contexts, the possibility of an increase in turnover rates and inter-firm mobility of workers, the predictable consequence of the weakening of dismissal laws was less of a threat to French employers.

The weakening of the dismissal laws proceeded with different degrees of speed and intensity during the 1980’s. In Germany, the changes introduced to the employment protection act were minimal and with no major consequences. A first change, introduced in 1985 relaxed the restrictions on firms’ use of fixed contracts. Until 1985, Federal Labor Courts had ruled out ‘economic uncertainty’ as a legitimate justification for the use of fixed-term contracts<sup>36</sup>; these legislative changes introduced in 1985 intended to undermine these rulings with the hope “that firms would be induced to hire additional workers rather than paying overtime work to their core work forces.”<sup>37</sup> The second

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<sup>33</sup> Franz, Wolfgang and Soskice, David, 1994, The German Apprenticeship System, mimeo, Soskice, David, 1993, Innovation Strategies of Companies: A comparative institutional explanation of cross-country differences, Paper Presented at the Seminar on State and Capitalism since 1800, Harvard University, November 8th, 1993.

<sup>34</sup> Hancke, Bob and Soskice, David, 1994, Market, State and Business Networks: Coordination in French Industry, Paper presented at the seminar on European Political Economy and Institutional Analysis, Center for European Studies, Harvard University, p. 8; Lane, Christel, 1989, Management and Labor In Europe, London: Edward Elgar. D’Iribarne, A., 1995, The French Educational system: Regulatory Reform and Institutional Setting, in Buechtemann, C., ed., 1995, Human Capital Investment and Economic Performance, NewYork: Praeger.

<sup>35</sup> Hancke, Bob and Soskice, David, 1994, op. cit., p. 8 This particular illustration is borrowed from Maurice M. et.al, 1986, The Social Foundations of Industrial Power, Cambridge: MIT Press.

<sup>36</sup> Buchtemann, Christoph F., op. cit., 1993, p. 286.

<sup>37</sup> ibid., p. 287.

change has weakened the procedures which required the negotiation of 'social plans' between works councils and employers<sup>38</sup>.

In opposition to the incremental character of labor market deregulation in Germany, all existing accounts of changes in French dismissal laws indicate that "French labor market regulation of employment contract underwent a fundamental transformation to relatively liberal"<sup>39</sup> and that "the dominant theory has shifted from being protective to being more transactional."<sup>40</sup> Several developments need to be highlighted. The most significant policy change abolished the requirement of administrative approval of dismissals. The Chirac II government, gave in to the vocal complaints of the Conseil National du Patronat Français and removed the *Authorisation Administrative* in 1986. Second, regulations allowing the use of part-time work by firms were further liberalized in 1986, by an Ordinance and a Presidential Decree of the same year<sup>41</sup>. In this case, liberalization consisted in an 'expansion' of the justifications employers can legally use in order to hire temporary workers and in the lengthening of the maximum duration for part-time work from 12 to 24 months. Third, regulations facilitating adjustment in working hours, in particular 'flexibility' in working time were introduced in 1987<sup>42</sup>.

While Germany and France have started from a position of comparable degree of stringency in their dismissal laws (see Table 1), the reforms of the employment protection legislation, initiated by policy-makers as a response to similar pressures exerted by organized employers, have varied in their scope and degree of success during the 1980's. As I have argued, the explanation of this variation lies in the absence of link between the social and economic functions of dismissal laws in France, which has permitted labor market deregulation to be more far-reaching in the France. I will now turn to the analysis of the labor market adjustment of firms and to an analysis of firms' reliance on the welfare state for adjustment.

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<sup>38</sup> Based on the old regulations, if at least 5% of the employees within one firm were affected, social plans had to be negotiated in cases of redundancies due to rationalization. The new threshold have been raised for redundancies affecting 20% of all firms' employees. Source, Mosley and Kruppe, *op.cit.*, 1992, p. 85.

<sup>39</sup> Mosley and Kruppe, *op.cit.*, p. 72.

<sup>40</sup> Maurau, Guy *op. cit.*, p. 359.

<sup>41</sup> Ordinance of August 11, 1986 and Presidential Decree no. 85-399 of April 3, 1986.

<sup>42</sup> June 19, 1987.



## 4. 2. The development of short-time work during the 1980's.

The low degree of success of labor market deregulation in the German case has left the employment practices of German firms, which are characterized by long job tenures, low inter-firm mobility of workers and low reliance on the external labor market during periods of economic downturns, fundamentally unaltered. However, the continuation of these employment practices has been facilitated by firms' reliance on the instruments of the welfare state: in order to avoid the reliance on the external labor market during periods of business cycles downturns or periods of industry adjustment, firms have, increasingly, turned to existing instruments of social policy and, by the reinterpretation of existing provisions and by the legal reformulation of older policies, firms adjustment has contributed to changes in social policy itself. .

An important policy instrument increasingly used by German firms during the 1980's as a substitute for relying on the external labor markets during periods of economic downturns was short-time work. The policy instrument of short-time work consists of firms' use of subsidies paid by the Federal Employment Office (*Bundesanstalt für Arbeit*) -- from a fund to which both employers and employees contribute -- during periods of adjustment and reorganization. Under this program, an employee whose working-time has been reduced can collect unemployment insurance benefits to which the would have been entitled if unemployed<sup>43</sup>. Although the limited character of this policy instrument was recognized by unions and works-councils, short-time work became, nevertheless, a widely accepted policy instrument, offering employees with very specific firm-level skills the possibility of retraining prior to dismissals and it postponed dismissals as a labor-market option of enterprises, facilitating internal adjustment. For employers, short-time work lowered the transaction costs associated with job searches and permitted the continuation of employment relationships for employees with high specific firm-level training. A number of existing estimations of the costs of short-time work to the relevant actors, have pointed out that by financing short-time benefits the Federal Employment Service (*Bundesanstalt für Arbeit*) has incurred lower costs per employee receiving short-time benefits, than it would have incurred if would have financed full unemployment benefits<sup>44</sup>.

Short-time work as a social policy instrument used by firms has risen dramatically during the 1980's and leveled off during the 1990's. Its use shows a strong variation by industry and is affected by the structural adjustment of the

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<sup>43</sup> For an overview of the system, see Flechsenhar, 1980, *Kurzarbeit als Maßnahme der betrieblichen Anpassung*, Frankfurt: Harri Deutsch; Neumann, Manfred, 1984, *Arbeitszeitverkürzung gegen Arbeitslosigkeit*; Berlin: Duncker & Humblot, Wirtschaftspolitische Kolloquien der Adolf Weber Stiftung.

<sup>44</sup> Bruche, G., Reissert, B., 1985, *Die Finanzierung der Arbeitsmarktpolitik, System, Effektivität, Reformansätze*, Frankfurt: Campus, p. 107.

particular industry. This change has been facilitated by a dynamic transformation of a number of social policy regulations (in particular, the Employment Protection Act) concerning the conditions of access of particular industries to this social policy instrument, the length of its use, and the relationship between short-time work and standard employment.

One trend in the changes of the regulatory environment has been the lengthening of the time during which firms can make use of short-time work, leading to a maximal period of 36 months in 1983. Second, following a decision of the Federal Social Court (*Bundessozialgericht*) of 1986, the broad terms under which firms can make use of short-time work have changed. This decision allowed firms to make use of short-time work, even if the majority of jobs could not be saved and the interruption in the contributions of employers and employees to the social security system were not temporary. The third broad tendency was a sectoral expansion of short-term benefits, from severely affected sectors (such as steel) and sectors affected by strong seasonal variations (constructions) to all sectors, if appropriate training measures are offered by the employers.

**TABLE 4**

**Selected Changes of Legislation affecting short-time work in Germany<sup>45</sup>**

1981 Consolidation-Law of Employment Protection Act. Restriction upon the use of short-time work by enterprises which use overtime in other sections.

1983 As a complement to EU measures that attempt to compensate for the crisis of the steel industry, enterprises in the steel industry are given the possibility to make use of short-time work up to 36 months.

1983 Restriction on the use of short-time work by *Mittelstand*- and *Handwerk* firms (which claimed short-time benefits for their trainees).

1987 Enterprises in steel and mining can claim short-time benefits (steel industry for up to 36 months during 1987-1989). The preservation of the job of short-time workers is no longer necessary as a precondition for the receipt of short-time benefits. Extension of short-time benefits to sectors that undergo strong seasonal variations in employment levels (such as construction).

1988 Change of Employment Promotion Act facilitating a 'flexible transition towards retirement'. Employers cannot claim short-time work benefits for employees older than 63.

1989 Possibility of long-term use of short-time benefits is extended to other industries, besides steel and mining, if these measures avoid the notification of dismissals, but employers are required to undertake appropriate retraining measures for employees receiving these benefits.

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<sup>45</sup> Source: Niesel, Klaus, et.al, eds, 1995, Kommentar zum Arbeitsförderungsgesetz, München: Beck; Knigge, Arnold, ed., 1984, Kommentar zum Arbeitsförderungsgesetz, Baden-Baden: Nomos; Holzmayr, Werner, 1989, Kurzarbeitergeld und Schlechtwettergeld: ein entwicklungsgeschichtlicher Vergleich, Rheinfelden: Schauble; Linke, Lothar, 1993, Kurzarbeit im Strukturwandel, Discussion Paper FS I-93- 206, Wissenschaftszentrum für Sozialforschung Berlin.

In opposition to Germany, in France short-time work has been a more limited policy instrument. This difference can be, in part explained as a consequence of a greater reliance of French firms on fixed-term contracts<sup>46</sup> than German firms. French labor market programs have emphasized 'external' adjustment of firms, as opposed to the internal adjustment facilitated by German social policies. The *congé de conversion*<sup>47</sup> (introduced in 1980 for adjustment of firms in steel and ship-building and extended later to all large firms which initiate collective dismissals) is a policy instrument that requires employers to provide for training for redundant workers who remain employees of the firm during the period of training<sup>48</sup>.

#### 4. 3. The Development of Early Retirement.

The availability of early retirement to restructuring firms (in fact, firms' active role in devising new possibilities of exit for older workers, by 'recombining' available policy instruments) and the radical changes in male labor force participation rates in several European countries during the past years are social policy developments that have allowed enterprises to shift some of the burden of adjustment and restructuring to the state. In this brief overview of the development of early retirement in France and Germany, I will focus on two distinct policy mechanisms: (1) policy instruments which have complemented the 'traditional' old age pensions as compensation for retiring older employees and (2) the changing arena where the definition of the boundary between working age and retirement took place: by shifting back and forth between the state and the social actors it had as its consequence the acceleration of the 'downward spiral' in the exit age from the labor force.

In terms of labor market outcomes -- male labor force participation rates age 55-65 -- Germany and France are comparable. In comparative terms, both countries are situated at an extreme point with respect to the other OECD countries, where a similar, but less dramatic decline has also been in place. Male labor force participation rates (age 55-64) have declined in both countries, more dramatically in France than in Germany: from 75.4% in 1970 to 50.1% in 1985 in France and from 80.1% in 1970 to 57.0% in 1985 in Germany.<sup>49</sup> If one

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<sup>46</sup> Based on European Labor Force Survey Results, existing studies have attempted to compute cross-national indexes measuring the incidence of fixed-term contracts. France, Spain and Portugal are above the European average, while Germany, Belgium and the UK are well below. Source, Mosley and Kruppe, 1992, *op. cit.*, p. 35.

<sup>47</sup> The *convention de conversion* (mentioned above) is a different program, requiring training in the case of individual redundancies. The degree of involvement of the state is much greater, however, in the case of the *congé de conversion*. Mosley and Kruppe, *op. cit.*, p. 76.

<sup>48</sup> For an evaluation of these policies see, for example Lessons in restructuring: the French experience, 1992, US Congress: Washington, D.C.

<sup>49</sup> Source: OECD Employment Outlook, Paris: OECD, various years.

disaggregates these figures by age groups, the decline in labor force participation rates is particular sharp for the 60-64 age group, where the decline was from 68.0% in 1970 to 25.4% in 1988 in France and from 71.8% in 1970 to 31.5% in 1988 in Germany<sup>50</sup>.

The policy instruments through which early retirement was achieved in France and Germany differed, and, are a consequence of the different relationship that exists between unemployment and disability benefits in the two welfare states. In France, exit of older workers from the labor market was achieved primarily via the unemployment insurance 'subsystem' of the welfare state, while in Germany exit was made possible through a combination of disability and unemployment benefits.

In France an Unemployment Compensation Fund, based on contributions of employers and employees, was set up as early as 1972, providing for guaranteed income benefits for older workers who had been dismissed prior to the retirement age of 65. A change introduced in 1977 made possible for resigned workers to receive guaranteed income benefits, called *garantie de ressources démission*. These administrative changes led to a vast decrease in the labor force participation rates of males age 60-65 and to "the emergence of a new phase of life, called pre-retirement (*préretraite*) between the time they stopped working and the time they received an old-age pension."<sup>51</sup> The expectations of 'pre-retirement benefits' affected, however the labor market status of workers in the 54-59 age group, among which unemployment rose dramatically. To compensate for this situation, in 1980, the National Employment Fund established a special allocation (*allocation speciale*) for pre-retirement at age 56 or 55.<sup>52</sup>

A new early retirement-package targeted at the age group 55-59 was established in 1982. As part of this program, the state agreed to pay a large proportion of the benefits to pre-retired workers (called *allocation conventionnelle de solidarité*) if the firm would, in return, hire a new worker to replaced the retired employee. While the intention of the state was to regain control over the process of early retirement which had 'drifted' beyond the state's control and had become part of a series of ad-hoc, case-by-case negotiations among the social partners, the effect of the 'Pre-retirement' policy was that the state took over a large amount of the costs associated with early retirement, further overburdening its finances.

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<sup>50</sup> Source, Jacobs et. al., 1991, The evolution of early exit: A comparative Analysis of labor force participation patterns, p. 56. in Kohli, et.al., op. cit., 1991.

<sup>51</sup> Guillemard, 1991, op. cit., p. 139.

<sup>52</sup> Guillemard, 1991, op.cit., p. 141.

In Germany, disability pensions were a significant policy instrument contributing to early retirement. A number of decisions of the Federal Social Court<sup>53</sup> have changed the notion of 'disability' as an administrative category<sup>54</sup> and have widened the understanding of disability beyond the strict medical definition, facilitating the use of disability pensions by older workers. The decision of the court made it possible for older workers to receive full disability pensions, if no part-time jobs were available and has, in particular, affected the population in the age-group 55-59<sup>55</sup> (whose proportion classified as disabled doubled). In addition, the age limit of pensions for handicapped persons was lowered to 60 years in 1980.

Changes in the conditions governing the receipt of unemployment benefits affected the labor force participation rates of older employees. Given that the risk of unemployment was heavily concentrated among elderly workers (the length of unemployment spells and the percentage of long-term unemployment of total unemployment was higher in these age groups), special rules governing the receipt of unemployment benefits were developed for this age group. First, the maximum length of benefits of the contributory unemployment benefits (*Arbeitslosengeld*) was extended for elderly workers from 12 to 18 months (for the unemployed older than 49) and, in 1986, to 32 months for unemployed over the age of 54. Pension benefits are available at age 60, if unemployment had persisted for at least one year.

Third, early retirement was achieved as a result of the introduction of supplementary legislation which required, for its implementation, institutional support through collective agreements among the social partners. In particular, the *Vorruhestandsgesetz* (Pre-Retirement Act) that was in effect starting with 1984<sup>56</sup> provided a 'pre-retirement' pension starting with the age of 58. Part of the pension benefits were subsidized by the *Bundesanstalt*, if the employer replaced the older employee with an unemployed. The similarity between the German Pre-Retirement Act and the French 'Solidarity Contract' is based on the fact that the deliberate use by the state of social policy with the goal of stimulating the hiring behavior of firms (by paying significant contributions to enterprises, 'in exchange' for the latter's 'separation' from older workers) -- a

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<sup>53</sup>See *Berufsunfähigkeit bei Teilzeitarbeit*, in *Entscheidungen des Bundessozialgerichtes*, Band 30, Köln: Carl Heymans, pp. 166- 209.

<sup>54</sup> On the construction of disability as an administrative category in the German welfare state, see Deborah Stone, 1984, *The Disabled State*, Philadelphia: Temple University Press; pp. 29-89; Florian Tennstedt, 1972, *Berufsunfähigkeit im Sozialrecht*, Frankfurt: Europäische Verlagsanstalt.

<sup>55</sup> Jacobs, *et.al.*, op. cit., p. 188.

<sup>56</sup> See *Gesetz zur Erleichterung des Übergangs vom Arbeitsleben in den Ruhestand*, 13. April 1984, in *Das Deutsh Bundesrecht*, 519. Lieferung, Mai 1984. On the preretirement act, see Kohli, Martin et.al., 1989, *Je früher - desto besser? Die Verkürzung des Erwerbelebens am Beispiel des Vorruhestandes in der chemischen Industrie*, Berlin: Sigma, pp. 10-25 for overview of the legal framework; Naegele, Gerhard, ed., 1987, *Theorie und Praxis des Vorruhestandsgesetzes: Ergebnisse einer empirischen Wirkungsstudie*, Augsburg: Maro-Verlag, 1987; pp. 7-67.

'new' usage of social policy which blurs the institutionalized distinction between the 'social policy' and the 'labor market' policy functions of the welfare state<sup>57</sup>.

#### 4. 3. 1. Control over boundary between work and retirement: Welfare State or Firms?

The second significant policy development that has contributed to the sharp decline in labor force participation rates of older employees was the changing arena of definition of 'retirement' age. The shift the place where the boundary between work and retirement is 'defined' --away from the social security system (and the general pension system) -- has further increased the ability of firms to use the welfare state for the purposes of enterprise rationalization.

Based on the social security systems in France and Germany, the 'official' retirement age was age 65 in both France<sup>58</sup> and Germany<sup>59</sup>. The unchallenged premise of the postwar settlement was that this function remained an uncontested prerogative of the welfare state was undermined by firms' active involvement in social policy development.

In Germany, a reform of the pension system introduced as early as 1957 made retirement at age 60 instead of 65 possible for older workers, if prior to this period, unemployment had persisted for at least one year. Given the favorable labor market situation, for most of the post-war period, neither employers, nor employees had incentives to make use of this provision. Once the labor market began to deteriorate (in the aftermath of the second oil shock) this policy instrument was 'discovered' by firms as a very attractive alternative to the brutality of dismissals for older and 'expensive' workers who had spent most of their lives within the same enterprise. Given that unemployment assistance was available for 36 months, the use of this provision had the effect of further lowering the retirement age to 57 years<sup>60</sup>.

In France, an unintended consequence of the establishment of the Unemployment Fund in was that it rendered the 'official' retirement age of the

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<sup>57</sup> On the importance of this distinction within the German welfare state ('Sozialpolitik' and 'Arbeitsmarktpolitik') and on the effects of the blurring of these boundaries, see Schön Donald A. and Rein, Martin, 1994, Frame Reflection: Towards the Resolution of Intractable Policy Controversies, New York: Basic Books, p. 65. "The most striking characteristic of the first stage of the early retirement-story was a blurring of the lines between social protection and labor market policies. [...] As a recent OECD report has noted, "the deterioration of the labor market itself played an important role in increasing the importance of the 'alien' claims upon the pension system."

<sup>58</sup> For overviews of the French pension system, see Guillemard, Anne Marie, 1980, La vieillesse et l'Etat, Paris: PUF.

<sup>59</sup> For overviews of the structure of the German pension system, see inter alia, Nullmeier, Frank and Rub, Friedbert, 1993, Die Transformation der Sozialpolitik: Vom Sozialstaat zum Sicherheitsstaat, Frankfurt: Campus, Ch. 2.2. Die Policy-Prinzipien der Gesetzlichen Rentenversicherung, pp. 93- 117.

<sup>60</sup> The workers could claim unemployment benefits for three years, and then claim this supplementary pension for five years, until they became eligible for the social-security benefits.

social security system (age 65) ineffectual as a boundary between working life and old age and shifted the locus of negotiation of the boundary to the social actors: employers, unions, enterprises. In 1983, the socialist government attempted to respond to these developments and recapture the prerogative to define old age. It 'reestablished' the retirement age at 60, for workers that had contributed to the Social Security Old-Age fund for at least 37.5 years, without realizing that the pre-retirement program (Contrat de solidarité) that had been established in 1982 had precisely the consequence of undermining this policy.

## 5. CONCLUSIONS

This paper has attempted to analyze the dynamics of institutional and social policy development in three arenas of social policy: early retirement, short-time work and regulations guaranteeing employment security, by arguing for the need to view the institutional interdependence between these policy areas. Neither economic arguments that have characterized these developments as a form of 'labor market deregulation' nor welfare state models that *hypothesize* invisible logics of welfare state-labor market interactions can adequately capture the political dynamics behind these social policy developments. I have argued that one needs to construct a unitary model that specifies the complex interactions that exist between the institutions of skill formation and the welfare regimes and the constraints that these institutions place on the adjustment strategies of firms<sup>61</sup> in a particular political economy.

The analysis of this paper provides, simultaneously, an explanation for the problems of labor market segmentation and labor market dualisms which have become the most problematic labor market issues facing European economies during the 1980's. By focusing on firms' involvement in social policy development, I highlight additional political mechanisms through which these labor market dualisms and the new forms of 'non-employment' and labor market non-participation came about. The ability of firms to use the welfare state for the purpose of enterprise reorganization and to 'reinterpret' some of the traditional provisions of the welfare state is a development with wider implications which has, in part, undermined a number of the 'assumptions' of

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<sup>61</sup> This follows the research program outlined in Hall, Peter, A., 1994, The Comparative Political Economy of Europe in an Era of Interdependence, Paper presented at Seminar on State and Capitalism since 1800, Harvard University. Peter Hall suggests that the problem of 'adjustment', broadly encompassing 'cyclical adjustment' (understood as 'the adjustment of the economy to exogenous shocks'), 'sectoral adjustment' ('transfer of resources from sectors that are relatively uncompetitive in international terms to those where a comparative adjustment can be exploited') and 'structural adjustment' (understood as 'adjustment to new ways of organizing productive activity so as to take advantage of rapid technological change and more flexible ways of organizing work and economic transactions.') should be the focus ('dependent variable') of political economists and replace the existing 'static' dependent variables of current studies that have focused on rates of inflation, growth or unemployment. pp. 27-28.



the post-war consensus -- in particular the assumption of an institutionalized boundary between social and labor market policies.

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