

The Age-Orientation of Welfare

Explaining Differences in Public Spending on the Elderly in Advanced
Industrialized Democracies

by

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Date: December 13, 2010

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Thesis submitted in partial fulfillment of
the requirements for the degree of Master of Arts in the Department of
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ABSTRACT

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Abstract

Only recently have scholars begun to focus directly on one of the starkest dimensions of variation in advanced welfare states – the extent to which aggregate social spending is geared specifically to the elderly. Progress toward an understanding of these differences would be aided by scholarly debate, but this field of inquiry remains characterized by lone theories advanced in isolation. This paper seeks first to situate the question within long-standing scholarly debates by identifying implicit hypotheses within the three major branches of welfare state theory and assessing them for their empirical and logical plausibility. A new theory is then advanced linking these differences to cross-national differences in the strength of employment protection. The paper concludes with a brief discussion of potentially fertile research avenues.

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1. Introduction

1.1 *The Age-Orientation of Welfare*

As a discipline that has, at times, practically defined its subject matter as a question of redistribution,¹ contemporary political science has always quite naturally afforded the welfare state a central place in the study of advanced, capitalist democracies. As with most venerable scholarly fixations, the welfare state has sustained attention over the years not only by virtue of its inherent substantive appeal, nor even its own significant temporal variation, but also because of the creativity of researchers capable of re-framing the subject in ways that allow us to think about and make sense of facts that have long been staring us in the face. The paradigmatic arguments of Korpi (1983) and Esping-Andersen (1990) arrived decades after the eras of consolidation they illuminated, and the integration of the “hidden welfare state” of household labor and child-rearing into understandings of social support by scholars such as Orloff (1993; 1999), came still somewhat later.

Julia Lynch’s work on the “age-orientation of welfare” (2001; 2005; 2006) – essentially the degree to which the welfare state concentrates its efforts on the elderly vis-à-vis the working-aged and their young – offers one of the most recent challenges to basic understandings of redistribution and social insurance in the developed world. Emerging from a justifiable focus on the class-based struggle for economic justice, much

¹ I refer particularly to Lasswell’s (1935) timeless definition, from which Easton’s (1953) equally influential formulation is perhaps only a constructivist step removed.

of the extant work on variation in the substantive outcomes in the structure of welfare regimes has privileged questions regarding the capacity of the state to reduce income inequality and poverty among the citizenry at large. Yet Lynch's work reminds us that, as critically important as these variables are, they should not cause us to lose sight of the reality that, in terms of the sheer scope of expenditure, the welfare state's primary purpose is the *intergenerational* transfer of wealth. By Lynch's own thorough accounting, Denmark, boasting the most "youth-oriented" welfare state in Western Europe, still devotes more than five times the amount of effort to the elderly as it does adults and children (2006; p. 30).

So far so good, but it would appear that there is also very substantial variation in the degree of elderly focus amongst advanced capitalist systems, with the ratio of elderly-to-non-elderly spending exceeding twenty-five in Italy, the US, and Japan and almost half a dozen additional OECD states exhibiting ratios higher than fifteen (Figure 1). Crucially, the typologies suggested by a focus on age-based expenditure ratios confront us with a wholly untheorized world in which, on this one critical substantive dimension, the United States, Italy, and Austria are pitted against the Scandinavian states, Australia, and the United Kingdom.

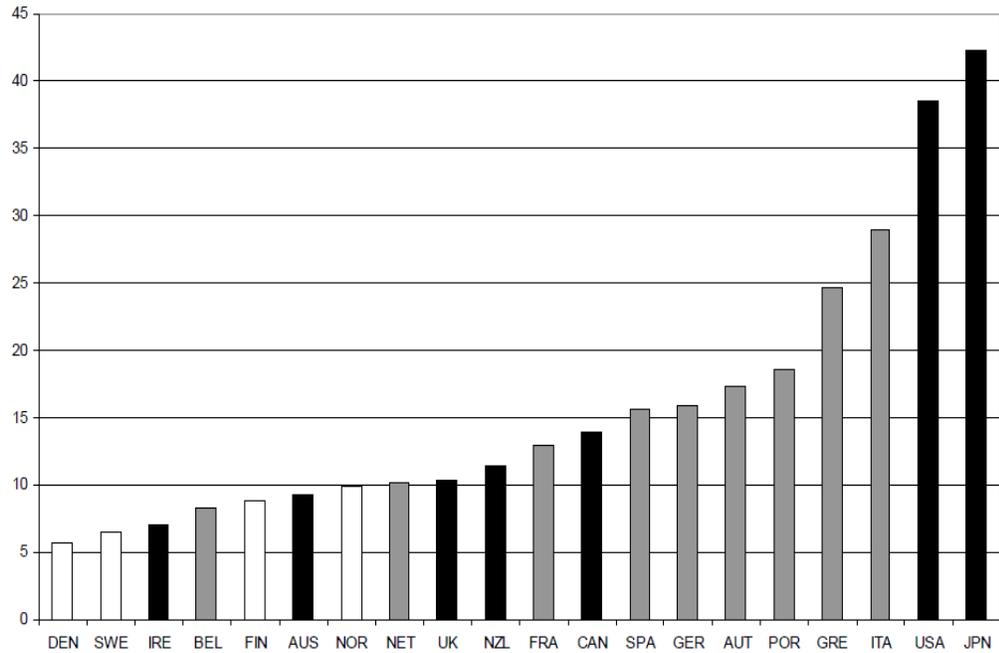


Figure 1: Lynch's (2005) Elderly-to-Non-Elderly-Spending Ratio, OECD Countries. Shadings correspond to Esping-Andersen's (1990) classificatory scheme.

To reiterate, the implication of Lynch's analysis is that decades of work on the welfare state had not, prior to Lynch's own theoretical contribution, yielded the analytical tools needed to explain substantial variation in a dimension of redistribution closely related to the primary policy activity of the welfare state. The starting point of my own analysis is that an understanding of the "age-orientation" dimension of welfare is therefore critical to an understanding of the welfare state *in toto*, and demands a full exploration.

1.2 Conceptualizing the Age-Orientation of Welfare

But what, precisely, is entailed by this dimension? There are in fact at least four possible conceptualizations of welfare state age-orientation that would merit scholarly attention on substantive grounds. First, one may choose to emphasize the directly redistributive characteristics of intergenerational transfers by employing generational accounting techniques to estimate lifetime net welfare receipts (and losses) between age cohorts. Such measures are central to public policy analyses of pension system sustainability and have also been used to draw implications about the political process of pension system reform.² I choose not to directly focus on this measure because, if my theory is correct, then it should (controlling for demographics) be largely endogenous to the outcome variable that does serve as my primary focus.

Second, as in Lynch's work, "age-orientation" can be conceived as the comparative share of overall welfare spending devoted to different age groups. Here, the substantive justification for the measurement choice is least related to actual policy outcomes experienced on the consumption side of the welfare system, because a ratio-based estimate omits information regarding the overall size of the welfare state. Japan, for instance, features one of the developed world's most elderly-oriented welfare regimes by this estimate, despite the fact that its system is among the world's least

² See Auerbach et al. (1992) and Auerbach et al. (1999) for conceptual and empirical overviews.

elderly-generous in terms of per capita spending (controlling for demography and the size of the economy) (Figure 2). The substantive focus of this measure is instead the age-bias of the political process itself – given some exogenous choice regarding the overall size of the welfare “pie”, what leads to variation in how systems divvy up the servings?

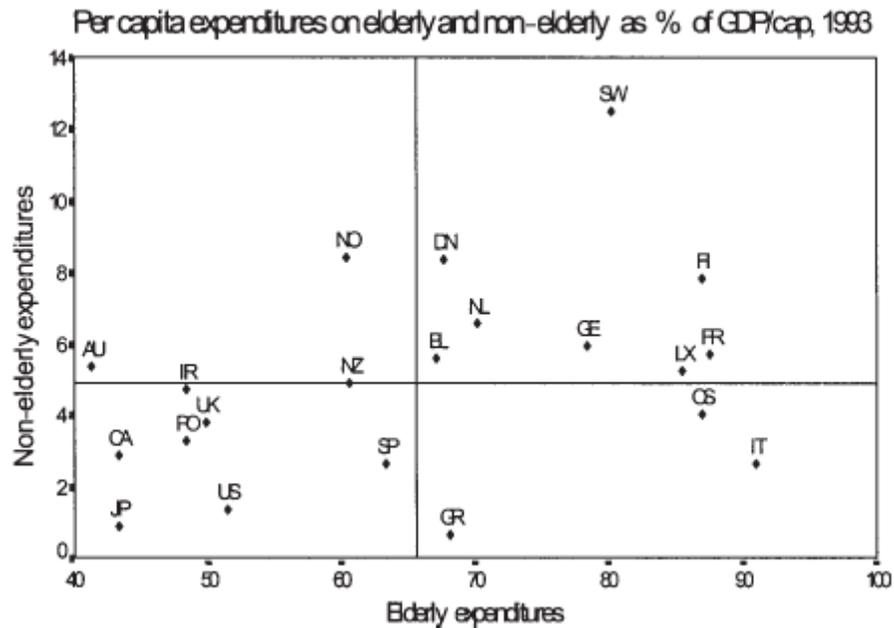


Figure 2: Elderly versus non-elderly spending. Source: Lynch (2005).

Yet, in the absence of a strong normative or theoretical anchoring suggesting what equilibrium ratios should or would be absent a given biasing mechanism, the ultimate substantive resonance of such “bias” is questionable. As a comparison of Figures 1 and 2 demonstrates, a true devotion to this measurement would call us to focus much more on differences in youth-generosity than in elderly-generosity – all of Lynch’s most elderly-oriented regimes devote comparatively small resources to the young and vice-versa, yet the ratio estimate is a weak predictor of elderly-targeted

effort. Because by far the largest *absolute* differences in spending between the two groups are driven by the elderly dimension, such an approach would seem unsatisfactory. In fact, most of what is endogenous in Lynch's own theory (discussed more fully later) relates only to the dimension of elderly spending. Only because her empirical strategy revolves around comparative case studies of Italy and the Netherlands, where differences in the numerator are not as obscured by those in the denominator, does the disjuncture between the choice of measurement and substantive focus do not post an apparent problem in Lynch's case studies.

This brings us to a third conceptualization of age-orientation, which will serve as my primary focus here. One can simply examine the dimension of elderly expenditures, acknowledging that all welfare systems devote the lion's share of welfare spending to pensioners, and thus reframing the question as to why, controlling for demographics, some systems devote more per capita spending to the elderly than others. Note that such a conceptualization does not eliminate the empirical mystery motivating the analysis. Moving away from a ratio-based approach does weaken some of the most striking typological oddities, such as the apparent likeness of the United States and Italy, but, at the same time, leaves a great deal of variation unaccounted for by the dominant perspectives on the welfare state. Using Esping-Andersen's (1990) typology as an alternative framework, why is it that Finland and Sweden devote significantly more per capita spending to the elderly than Norway and Denmark? Why are Italy and France so

different from Spain and the Netherlands on this same dimension? Why is there no apparent differentiation between Social Democratic and Conservative regimes in general?

It is fair to ask why, if the intent of the analysis is to explain differences in elderly spending, the language of “age-orientation” with its implicit comparisons across age-targeted segments of welfare systems, is employed. The answer revolves around the fourth conceptualization of age-orientation, which is also addressed in my analysis. As with generational accounting, this perspective on age bias focuses on effects experienced on the demand side of the welfare state, but does not attempt to track the fortunes of the citizen across time, instead examining the impact of the welfare state on different age cohorts in a given moment. In essence, this understanding of age-orientation asks nothing more or less than how the young and old fare, comparatively, between systems. My theory, outlined in the third section, suggests not only why some systems are markedly elderly-oriented in terms of elderly expenditures, but also why these same systems ought to exhibit systematic, market-based obstacles to the material objectives of young adults. Ultimately, I suggest that there is an “age-orientation” to the welfare state that privileges some cohorts over others in ways more subtle yet more substantively profound than a simple focus on spending or even welfare receipts would suggest.

As a final note, while the substantive outcomes I investigate are by no means important only to the OECD states, I follow Lynch in focusing exclusively on this case

set because it is admittedly to these countries that my theory (as well as its chief alternatives) speaks. Furthermore, I argue that the majority of difference in pension expenditures owes to differences during the era of expansion rather than retrenchment, and it is thus the expansion of retirement spending that serves as the fulcrum of analysis.

2. Insights from Past Scholarship

Surprisingly few scholars have focused explicitly on the precise question of why mature welfare states vary so substantially in levels of elderly-targeted expenditure, yet there is no shortage of implicit explanations that can be drawn from welfare state scholarship in general. The arguments largely come in one of three forms: 1) intentionalist explanations, which link the design and policy outcomes of the welfare state back to the objectives of the most powerful interest groups shaping welfare legislation, 2) political institutionalist explanations, which focus on the capacity of institutions such as the electoral system, ballot structure, the number of political veto players, and even the opportunity structure established by prior legislation to so powerfully mediate policy supply and demand as to override direct agency in importance, and 3) economic institutionalist explanations, which interpret welfare policy as a functionalist response to the policy demands of a given economic environment which must be met if the market is to continue to function properly. Additionally, there is a purely functionalist line of explanation tying elderly expenditures to variables such as the percentage of the citizenry in retirement and the capacity of the state to in fact fund them. These effects are so powerful and straightforward that they are not particularly interesting from a theoretical perspective, and the intent here is to simply control for such factors on a per capita and by-GDP basis.

2.1 Intentionalist Explanations

The three most influential intentionalist explanations of welfare state development focus on the political power of labor (Stephens 1979; Korpi 1983; Esping-Andersen 1985), the foundational influence of dominant 20th century parties (Esping-Andersen 1990), and the interests of the middle class (Baldwin 1990). The laborist, or “power resources” perspective, as outlined by Korpi (1983), argues quite simply that welfare policy is, above all, a response to the needs of blue-collar labor, and that larger and more generous welfare states are thus naturally associated with historically stronger labor power, both in terms of collective action capacity and direct political influence, by way of governing social-democratic parties during the era of welfare expansion (the latter following the former). Moving the chain of causality back a step, the collective action capacity of labor is explained as function of the historical prevalence of social cleavages (religious and ethno-linguistic in character) hampering class solidarity.¹

Certainly, there is a general and undeniable trend for the Anglo and Japanese systems, with their comparatively weak labor and social-democratic political legacies, to devote less expenditure to all segments of the welfare state, including pensions, than the rest of the developed world. In broad quantitative terms, the primary empirical obstacle to an unreconstructed power resources understanding of pension expenditures is that

¹ Alternatively, Luebbert (1991) also emphasizes the importance of political inclusiveness during late 19th century industrialization as a driving factor behind labor strength and cohesion. Here, class solidarity is understood as an ironic consequence of the initial denial of more parochial union aims.

there is no similar and apparent distinction between the allegedly solidaristic and labor-dominant countries of Scandinavia and their Continental counterparts on this particular dimension of welfare spending. As a result, pension scholars working in this tradition have implicitly abandoned the historical determinism of Korpi to explore the capacity of leftist parties to decisively shape pension development over time and regardless of political patterns during the foundational era (Esping-Andersen 1985; Garrett 1998; Hicks 1999; Huber and Stephens 2001). The most convincing work in this vein has downplayed the importance of foundational legislation in favor of a “ratchet-effect” hypothesis whereby social-democratic participation in government results in pension expansions that cannot be later undone by competitor parties, so that the ultimate variable of interest is the rate of social-democratic cabinet participation across the decades rather than their influence in the founding era (Huber and Stephens 2001). Scholars working in this vein have, moreover, emphasized the “feedback” effect of welfare expansion which, in creating constituencies for the new policies, incentivizes politicians to adopt pro-welfare stances (Hecló 1974; Skocpol 1995; Pierson 1994, 1996; Hacker 2002). Viewed in this context, it is unsurprising that the key distinction in pension expenditures should more concern the capacity of social-democratic parties to attain office in the first place than the precise degree of labor power between countries with important social-democratic partisan traditions.

Underlying this version of power resources theory is still the fundamental idea that, across a variety of country- and region-specific contexts, labor, or at least the “left”, will desire the same sorts of policy outputs, and that ultimate policy is therefore a function of labor/leftist political power. Thus, even if the labor-backed left has driven the expansion of Continental welfare just as much as it has in Scandinavia, power resources theory faces the additional problem that, irrespective of the size of welfare expenditures, these two regions tend to feature sizeable differences in welfare policy design, with continental regimes exerting a much smaller effect on income inequality and poverty rates. For Esping-Andersen (1990), the “politics against markets” approach to welfare expansion (which he played a considerable role in popularizing), with its emphasis on the more/less distinction in welfare effort and redistribution, obscured the reality of a case set that in every instance rejects the distributional outcomes yielded by the market alone, but in which there is no cross-national consensus as to which inequities merit political correction.

There are in fact three democratic-capitalist political philosophies on the matter of market inequities, each corresponding to a prominent party tradition. In the Social Democratic vision, very stark inequalities ought not to exist between classes and major occupational categories, either in terms of sheer wealth or the everyday power differentials arising from the commodification of the laborer. For Christian Democracy, at least prior to its centrist, catch-all incarnation, the greatest threat to justice posed by

the market was the volatility and change it introduced to the traditional male-headed nuclear family, via both female labor market participation and income insecurity for the male breadwinner. Liberalism, while the most comfortable with market outcomes, still came to embrace a role for the state in supporting those who, through no fault of their own, were incapable of providing for themselves through the labor market. What follows are emphases on class redistribution and de-commodification, income security (for males in traditional occupations), and means-tested residual provision, respectively. Employing a historical institutionalist perspective, Esping-Andersen (1990) argues that mature welfare states embody “hidden institutional logics” that harken back to the aims of the dominant party during the foundational era – logics that persist even in the face of significant programmatic adaptation by the parties in question.

The Worlds of Welfare approach would appear to speak to the unique youth-generosity of the Social Democratic world, with its emphasis on income redistribution between still active laborers, as well as the unique miserliness, on both dimensions, of the Liberal world. Yet, between the Social Democratic and Christian Democratic worlds, its logic speaks only to differences in the redistributive impact of pension schemes, and not to the overall level of expenditures. An examination of the blunt empirics of expenditure and receipt levels confirm both sizeable differences within the Worlds of Welfare on this dimension, as well as the weakness of the Social-Democratic/Christian-Democratic distinction as an explanation for expenditure levels.

Ultimately, Esping-Andersen's typology stands as a critical supplement to classic power resources theory rather than a direct competitor. In contrast, Baldwin's (1990) narrative of the rise and growth of the modern welfare state strikes at the very heart of laborism, arguing that the most significant cross-national divergences arise from the historical position of the middle-class towards labor demands. Scandinavian universalism was not, by this account, the product of a complete political victory by the left, but depended instead on the assent of crucial segments of the center (particularly agrarian interests) which stood to gain from broad-based welfare expansion. Where decisive segments of the middle-class did not face the same "high risk, low fortune" situation familiar to labor, universal welfare was perceived as direct inter-class redistribution rather than risk-pooling, and the middle class ensured that welfare would evolve in a fragmented, occupationally segmented fashion.

Again, the key policy differences under examination relate more to the type than the level of spending – Beveridgian vs. Bismarckian. The primary merits of this line of analysis do not in any case relate to its predictive power, as it is difficult to specify across historical contexts and in a non-tautological manner the conditions under which the middle class and labor will share similar risks profiles (indeed, were this the intent, Baldwin's original analysis would have been guilty of selection on the dependent variable). Rather, this approach is intended to undermine the notions that labor can

exercise decisive political power independent of the middle class and that welfare policy is, in fact, primarily reflective of labor (rather than middle-class) aims.

In summary, intentionalist theories, despite their dominant position in the scholarship on welfare state expansion, yield very few clear hypotheses regarding the specific dimension of pension expenditure levels. The most compelling argument still belongs to power resources theory, and concerns the expansionist influence of leftist cabinet participation, even after the foundational era, via a ratchet-effect mechanism. Esping-Andersen's insights tell us a great deal about differences in type but not degree of pension policy. And, to the extent that a risk-based, cross-class analysis of the welfare state yields insight on spending levels, we are faced with the challenge of providing a generalizable account of the conditions behind such alliances.

2.2 Political Institutional Explanations

Behind pure intentionalism lies, of course, the premise that social forces are powerful enough to consign institutional effects to, at best, a secondary causal role. This position may be less radical than it would initially seem to one steeped in the institutionalism of contemporary political science, for, as Benoit (2002, 2004) has suggested, the very same forces behind the social strength of labor likely have much to tell us about the choice of political institutions in the first place. Yet, if political institutions are truly secondary or purely endogenous to social forces in the shaping of welfare policy, this would be somewhat unfortunate from a scientific perspective, for the

contingency at work in purely intentionalist explanations poses an obstacle to prediction and generalization. Naturally, political scientists have explored a variety of challenges to this version of events.

Political institutionalist theories of welfare state development can be grouped into two categories depending on the role still reserved for interest group agency. The first family of theories seeks less to challenge intentionalist arguments than to provide an institutional explanation for the power of the relevant groups. Perhaps the most radically abstract example of this type of analysis is provided by Iversen and Soskice (2006), who begin with the empirical observation that governments in proportional representation and majoritarian electoral systems are historically dominated by the center-left and center-right respectively, with clear and substantiated implications for public spending (Persson and Tabellini 2003). This is explained as a product of utilitarian calculus by the pivotal middle class, which will support redistributive policies only when the consensual features of PR insure it against winding up as a net loser. This argument, of course, dovetails with Baldwin's focus on middle-class dominance and cross-class alliances, but the simple PR/majoritarian logic driving the explanation seems sufficient only to explain the uniquely residual character of the liberal welfare state. A similar logic is also at play in the social bargain perspective on corporatism, whereby capital backs down to welfare demands and labor agrees to wage restraint

owing to the mutual trust engendered by their institutionalized policy veto capacities (Lange and Garrett 1985).

In the second type of analysis, it is no longer possible to infer from policy outcomes the intentions of policy supporters independent of the institutional context of policy-making. The same fiscal mystery explored by Iversen and Soskice (2006) has, for example, alternatively been explained as a product of incumbent electoral calculus, insofar as the selectorate of a PR regime in principle encompasses fifty percent (plus one) of the population, while district-based majoritarianism may feature thresholds as low as twenty-five percent (half the electorate in half the districts) (Persson and Tabellini 1999; 2000). The implication is that broader (and presumably larger) public expenditures are required to sustain governmental support in proportional systems. Perhaps the most influential argument of this type is Veto Players theory, which straightforwardly suggests an inhibitory effect on all manner of public policy (including welfare state expansion, but also retrenchment) of each additional partisan veto player in a given policymaking arena (Tsebelis 2002). The great majority of veto players analysis of the welfare state has concerned political capacities for retrenchment, but quantitative analysis does in fact reveal a starkly negative impact of the number of (institutional) veto players on expansion in retirement expenditures as well (Huber and Stephens 2001, p. 68-9).

Of course, as the historical institutionalist tradition suggests, important political institutions shaping policy outcomes are often not enshrined in the constitution, but are prior policy outcomes themselves. It is a focus on policy effects that drives Lynch's argument, which is naturally the most direct of the institutionalist arguments on the specific subject of pension expenditures. Lynch begins with the exogenous given that some welfare states were founded along universalistic, citizenship-based lines and others along a more fragmented, occupational basis. Over time, these latter regimes became comparatively elderly-oriented as initial beneficiaries neared retirement age and pressed for more adequate income maintenance in their golden years. Yet, in the aftermath of WWII, a normative preference for more transparent, consistent, and Beveredgian schemes emerged across Europe. Some occupational countries managed to effect reform in this direction, while others did not.

Lynch's first causal claim is that policy fragmentation, where it was pursued, provided opportunities for targeted benefits that universal policy did not, and that policy design has therefore exerted a positive impact on pension expenditures via politically efficacious and piecemeal increases in occupationally specified categories, both before and after the post-war critical juncture. Her second causal claim is that original institutional design was nevertheless not institutionally "locked in" owing to the interaction between the particularistic effects of policy and the particularism of the political system itself. Only in countries naturally predisposed to particularistic politics

were the opportunities of fragmentation fully taken advantage of, and only in these countries did political constituencies emerge to completely block Beveredgian reform after WWII.

Leaving aside what is exogenous in Lynch's theory, we are left with an explanation relevant only to the elderly dimension of expenditures, ratio-based empirical estimates notwithstanding.² As earlier noted, Lynch's extreme-case method leaves some question as to whether the theory holds up across the case set in general, and her hypotheses merit further testing. Here, it is unnecessary to engage in process-tracing across the case set since Lynch's narrative suggests several non-contingent hypotheses that in fact resonate beyond her particular account. First, the theory suggests that more fragmented pension systems should be characterized by higher pension spending. Pension system fragmentation should in principle be amenable to operationalization across space and time, via, for instance, a Herfindahl-Hirschman measure of the fragmentation of the beneficiary pool in which distinctions are drawn between separate public benefit schemes. Since the interaction of policy and political particularism in Lynch's account occurs specifically during the late 1940s and 1950s, a contemporary examination of this measure in isolation is not unfair to the theory. Second, among the most elderly-oriented systems, it should be possible to trace levels of

² Alternatively, it may be fair to ask why similarly fragmented youth-targeted policies surrounding unemployment benefits, for example, did not follow the same logic. Whatever the answer may be, the focus here on the elderly dimension of spending in isolation renders it peripheral, as no distinction need be drawn between theories of welfare state expansion at large, and pension expenditures in particular.

expenditure back to piecemeal benefit increases rather than universalistic reforms or, certainly, original design.

Third, political particularism should be associated with higher pension expenditures. Lynch in fact takes an agnostic position on the determinants of system-wide particularism, referring instead to expert judgments from the literature as to the general character of politics, so it is not clear whether a cultural, institutional, or hybrid explanation is in play. To avoid tautology and provide for more predictive capacity, it would perhaps be most fruitful to focus on some the most prominent political institutionalist explanations. One of the most influential explanations has been Carey and Shugart's (1995) argument for the primacy of ballot structure in shaping the incentives of politicians to cultivate particularist ties with their constituents. An idea of far longer lineage which has nevertheless withstood the test of time suggests that vulnerability to electoral defeat instills accountability and impedes corruption, so that systems of low electoral turnover should be characterized by high levels of graft (Dahl 1956).

In summary, political institutionalism provides an array of hypotheses concerning the level of public expenditure that should apply equally to the question of public retirement spending. Theories in the vein of Iversen and Soskice (2006) that provide an institutional context for intentionalist accounts should perhaps be set aside at this juncture insofar as the ability of intentionalist theory to explain pension spending is

itself in question. Simple binary distinctions between majoritarian and proportional electoral systems or between presidential and parliamentary ones seem better suited toward explanations of the uniqueness of the liberal welfare world than to variation across the entire case set. Yet veto players theory seems to exert a significant impact on welfare state expansion, and the possibility that the number of systemic veto players drives much of the variation in pension expenditures merits exploration. Lynch's suggestion that pension spending is a function of particularism also yields several plausible hypotheses.

2.3 Economic Institutional Explanations

Economic institutionalist explanations of the welfare state revolve around the idea that a confrontational view of the relationship between politics and the marketplace is only valid up to the point that a denial of political demands threatens to unravel the successful functioning of the economy. Much of the contemporary literature in this tradition is framed by empirical questions regarding the impact of international economic competition and globalization. According to one school of thought, the expansion of social insurance was a necessary tradeoff to ensure political stability in the context of a post-WWII international liberalism that threatened to expose the laborer to otherwise intolerable levels of market volatility (Cameron 1978). It follows that variation in the size of public expenditures may reflect variation in the degree of

international market exposure, which can in turn be tied to variables such as country size (Katzenstein 1985).

More recently, Northern concerns about the impact of trade with the developing world on the value of labor have popularized the reverse hypothesis – that globalization induces advanced capitalist systems to dismantle social policy thereby reducing international competitive disadvantages in the cost-efficiency of production in tradable goods (Gill and Law 1989; Cerny 1990; Summers and Thomas 1993; Andrews 1994) . Yet many would argue that such a sweeping dismantling of the welfare state has not occurred, and that instead what we have witnessed is a bifurcated trajectory of welfare state retrenchment, with the more comprehensive welfare regimes ironically proving to be the most resilient against international market pressures (Kitschelt et al 1999; Pierson 2000; Huber and Stephens 2001).

The economic institutionalist explanation for this finding comes by way of Varieties of Capitalism theory, which begins with the basic recognition that international trade competitiveness is a function not just of price, but of supply; certain welfare policies may in fact increase the capacity of firms to produce certain goods.³ Specifically, goods differ in the specificity of skills required to produce them so that, in certain firms, laborers may be called upon to master skill sets that do not transfer easily across the labor market. Absent state intervention, the marketplace in such goods finds itself

³ For an overview of the perspective, see Hall and Soskice (2001).

under attack, not from politics, but from the quiet decision-making of laborers seeking to avoid unnecessary levels of risk exposure. It follows that robust unemployment insurance and strong employment guarantees can assist the market in such goods by substantially reducing the disincentives of laborers to invest in specific skill sets. There is, in fact, a feedback effect, insofar as firms operating under these welfare policies would indeed find themselves at a production-cost disadvantage in the trade of general-skill commodities.

The Varieties of Capitalism perspective has sometimes been crudely read as a skill-based argument about differences in overall welfare effort, but this ignores the rather narrow set of welfare policies to which the logic applies. An argument about public retirement spending, for instance, does not follow automatically since all workers, regardless of occupational category, must eventually retire and any insecurity in income used to fund retirement savings plans are, as the theory goes, dealt with at the level of active labor market intervention.

This is not to say that Varieties of Capitalism remains silent on pensions. In Isabela Mares' (2003) influential account, firms stand to benefit from the provision of employer-based private retirement policies, which can be manipulated to influence the demographics and size of the workforce in accordance with production needs. At the same time, such policies obviously carry their own significant and direct costs to the firm. Quite simply, firms that can afford these costs will prefer such second-tier

retirement schemes, and those that cannot will instead prefer the state to handle these matters. Affordability of second-tier pensions is in turn a function of firm size and “risk” (the older the present workforce, the costlier and “riskier” the retirement program). Through this lens, Mares examines the strategic coalitions that emerged around early retirement programs in Germany and France.

Mares’ account provides a crucial outline of the political process behind the potentially functionalist Varieties of Capitalism perspective. But, as in Baldwin (1990), the intent is not truly predictive of ultimate welfare state outcomes, and instead concerns the preferences of relevant social actors and the prospects (contra laborism) for strategic alliances across class. Firms can be shown to support the policies the theory expects them to, but there is no generalizable account for which preferences will ultimately prevail in the policy arena.

In summary, economic institutionalist accounts of the welfare state have not provided a direct account of retirement effort to complement their contributions to understandings of active labor market policies. My argument, developed below, is that this brand of economic institutionalism can in fact provide great leverage over the question of retirement policy once we account for the negative macroeconomic externalities of active labor market policies.

3. Theory

This work hypothesizes that a significant amount of the variation between mature welfare states in retirement expenditure comes about as a response to labor market rigidities introduced by employment protection. In the simplest, most functionalist terms, the expansion of public retirement benefits is in many cases a strategy to increase retirement rates and labor market turnover, thereby satisfying employer desires for greater workforce flexibility.¹ Among the most elderly-oriented systems, a labor-flexibility hypothesis can be applied to Italy's reforms of 1968 (Law 238) and 1969 (Law 153), France's expansions of 1971 (the *Boulin* law) and 1973, the Finnish reform of 1971 (TEL), Luxembourg's reforms of 1969 and 1974, Sweden's 1971 establishment of the ATP, and Germany's *Occupational Old-Age Protection Act* of 1974. Austria is something of a special case in that it had already developed, at the latest by 1957, a pension structure with many of the ease-of-exit features of these other cases. By the estimates of Estevez-Abe et al. (2001; p. 173), Austria, Germany, Sweden and Italy comprise four out of the five of the most rigid countries by employment protection, though Belgium, not terribly remarkable by elderly-generosity standards is the fifth. It

¹ Differences in employment protection strength are, in turn, explained by Varieties of Capitalism as an outcome of extreme (firm-based) skill-specificity, insofar as even unemployment insurance will not provide sufficient risk-hedging for the worker yoked to a single employer. I do not intend here to conduct an empirical investigation of this hypothesis.

should be further noted that the labor-rigidity hypothesis would also predict substantially great elderly expenditures by Japan.

The suggestion here is not that the “state” unilaterally initiated reforms to functionally redress market shortcomings, nor, certainly, am I suggesting that labor market flexibility served as a chief focus for either the occupational interest groups backing reform or their government champions. What I do claim is that strong employment protection provides cyclical opportunities for cross-class alliances between labor and employers easing the passage of retirement expansion. For employers, the benefits of an appropriately skilled labor pool associated with strong employment protection come attached to certain costs related to a gradually increasing disjuncture between the productive competencies of the workforce and the productive needs of the enterprise.

This disjuncture and its temporally positive trajectory owe first to the eventual obsolescence of previously valuable skills and the emergence of new production skill requirements. While the gradual evolution of a firm’s production process is unlikely to pose any sizeable difficulties to employers that, as Varieties of Capitalism theory suggests, are especially suited to incremental retraining, even skill-specific regimes are not immunized against rapid technological and market changes, which can quickly present the firm with sizeable opportunity costs relating to workforce rigidity. Numerous studies have identified the late 1960s and early 1970s as a critical juncture in

the development of Continental production regimes, as economic liberalizations initiated in earnest at the end of the 1950s deepened significantly – this period witnessed a marked increase in European trade exposure (Ben-David 1993; Alvarez-Cuadrado and Pinteá 2009; Jacks et al. 2009), total factor productivity (Iversen 2001), international R&D partnerships and foreign direct investment (Patel and Pavitt 1998; Hagedoorn 2002), along with major technological change in the electronics (Rothwell 1991) and automotive industries (McLaughlin and Maloney 1999; Freyssenet et al. 1998).

In this scenario, opportunity costs will of course arise whenever it is more expensive to retrain tenured workers than to train new ones or hire new pre-trained employees, and whenever the returns on investment in tenured workers are expected to be lower than for new ones. Such will be the case if new skill requirements are expected to have a particularly long window of usefulness, if ingrained work practices pose an obstacle to the acquisition of new skills, or if the costs of training new hires are shared with other actors, as in the case of deferred salary apprenticeship or non-company-subsidized vocational training.

Employment protection is a matter of both law (legislative and judicial) and collective labor contracting. In practice, it is less frequently the case that firms are strictly barred from the dismissal of workers, but a robust employment protection regime will raise the costs of such dismissals, typically via severance and compensation requirements (Bertola et al. 2000). Thus, it is in fact within the legal purview of the firm

to handle exogenous skill shocks without state intervention. The potential usefulness of the state lies in its ability to share such costs with the employer. As in Mares' framework, "risk" is thus an important motivator for the delegation of retirement policy to the state. What I suggest is that, under a scenario of high employment protection, risk itself can be endogenous.

Does this impact only early retirement policies? Ultimately, the firm seeks an attenuated labor contract, and early retirement provisions are a direct means to this end. But they are not the only policy instruments available. States may subsidize early-exit severance packages, either directly or via other segments of the welfare state such as unemployment insurance. It is also important to note that states may, by taking on a larger burden of the overall retirement package, free up industry to provide for earlier retirements, and more generous and enticing early retirement benefits. Moreover, the contradiction between the firm's desire for higher retirement rates and its need to preserve the reputational bargain places labor in a strong negotiating position from which to demand generosity in the level of benefits as well as their timing.

Why does the state acquiesce in these claims? The general assumption in the cross-class alliance literature has been that strategic solidarity between interest groups comprising major constituencies of the political right and left should be of sufficient strength to serve as an explanation in and of itself, and this logic is not terribly far from my own. But, as Mares reminds us, and as this analysis suggests, the starkest cleavages

in welfare policy may often be sectoral in character. In this scenario, an expansion of retirement benefits should of course roughly pit skill-specific, labor-market-rigid sectors against others who will be called on to partially fund the subsidies.

However, several factors can politically privilege the would-be beneficiaries. First, when considering the full range of employment protection measures, industrial laborers are typically subject to stronger protection owing to contractual (i.e., non-legislative) protection (Doldado et al. 2004). In this context, cross-class coalitions should preserve much of the unity of the socioeconomic left while dividing the center and right between industrial employers and others. Second, along with the party system, corporatism can lend institutional weight to industrial segments of the workforce beyond even what would obtain given its inherent power resources. Third, intersectoral transfers need not be entirely immediate and direct, but can be diffused across segments of the fiscal apparatus and, more importantly, can be effectively delayed via deficit spending. There are, in fact, incentives for employers to discount the future in the negotiation of retirement policy insofar as the long-term sustainability of the pension structure is unrelated to the primary objective of a short-term increase in labor turnover. Union preferences on this point are less clear, but to the extent that the burden of non-sustainability can be devolved to the state, and to the extent that extra weight attaches to seniority in intra-union decision-making, it can be expected that a short-term, if

unsustainable improvement in the status quo will be preferred over maintenance of the status quo.

In summary, variance in the overall level of retirement expenditures is expected to be significantly influenced by variance in labor market rigidity. This hypothesis is not intended to wholly supplant intentionalist or political institutionalist arguments, but it is argued that, particularly among Social Democratic and Conservative welfare regimes, this variable serves as a Lakatosian improvement over the chief alternative hypotheses in the degree of variance explained and the scarcity of major anomalies. Other important implications also follow from this hypothesis. First, systems of high employment rigidity should also be characterized by very high literal intergenerational transfers, in the form of unrealizable retirement investments on the part of younger individuals via the public-private contributory scheme. This in part follows directly and obviously from the simple outcome of higher retirement expenditures in a context of worsening demographic trends. But it also owes to the precise nature of spending increases, which are designed to shorten the average lifetime tenure of the worker. And certainly, to the extent that such reform discounts the importance of sustainability, high literal intergenerational transfers will eventually ensue.

Second, there are implications of labor-rigid systems for the actual welfare outcomes experienced by both old and young. For the elderly, such systems should, again, lower the average age of retirement but can also raise average replacement rates

via the enhanced bargaining position of labor in negotiating retirement policy. For the young, outcomes follow not from pension policy, but from the labor market effects of employment protection. While there is significant disagreement over whether or not employment protection serves to increase societal unemployment rates (the difficulty of entry being potentially outweighed by lower rates of exit), it is well accepted that the share of unemployment in such systems is uniquely borne by the young, along with women and minority groups (Addison and Texiera 2003). Such systems are thus doubly elderly-oriented – in terms of both welfare receipts of the elderly and market effects experienced by the young (both from unemployment and wage suppression resulting from competition for jobs outside of the organized labor sector).

Third, there is a temporal aspect to these effects. Major institutional features of the welfare state such as retirement policy and employment protection are naturally difficult to alter in a wholesale fashion, and it is on this basis of institutional persistence that expansions during the 1960s and 1970s can still account for significant variation in contemporary retirement spending. Yet we should also predict: 1) inter-temporal variation in youth market outcomes, with a temporary lowering in unemployment rates and increase in average wages following major retirement expansion, followed by a gradual return to previous levels, 2) a flagging of employer interest in supporting retirement policy subsequent to passage, with potential implications for the long-term political sustainability of the arrangement. Furthermore, the entire argument is premised

on two sets of variables – employment protection legislation and the strength of blue-collar sectoral coalitions vis-à-vis other societal interest groups – that are themselves variable, not only across cases, but across time.

4. Future Research

Despite a large and impressive body of scholarship on advanced capitalist welfare systems, insight into variation on the crucial dimension of elderly spending levels remains limited, in large part because, prior to Lynch, few researchers had posed this direct question. Fortunately, several compelling hypotheses have already been elucidated, and significant progress is available to any researcher with the time and resources to test their comparative merits. In my review of the literature, I have identified as particularly compelling the “ratchet-effect” hypothesis, whereby left-party cabinet participation across the decades produces incremental but resilient increases in elderly spending, the veto players hypothesis, whereby multiple checks and balances have the potential to hold such increases at bay, and the “particularism” hypothesis, whereby spending increases are a function of a systemic propensity towards clientilism. To these intentionalist and political institutionalist explanations, I have formulated an economic institutionalist rebuttal which might be termed the “labor-rigidity” hypothesis, whereby the expansion of elderly spending is tied to a cross-class strategy to induce labor market turnover, and the ultimate source of spending is the strength of employment protection.

While a simple quantitative test of the four hypotheses would be inadvisable given the small set of cases, the analysis of causal mechanisms can allow for more fine-

grained and satisfactory analysis. With regard to the labor-rigidity hypothesis, there are five such mechanisms that would serve as interesting research questions in their own right, and which could be addressed through a mixture of quantitative and qualitative analysis:

- Robust employment protection does, in fact, pose a sizeable barrier to hiring. Analysis of this conjecture would not only go far towards confirming or refuting the overarching hypothesis that European firms during the late 1960s and early 1970s faced variable costs in achieving labor turnover, but would shed empirical light on an assumption often made in the industrial labor literature.
- The late 1960s and early 1970s were a period of unusual market and technological change for European firms.
- Firms with high labor turnover costs related to employment protection and subject to rapid market and/or technological change were in fact supportive of an expansion of public retirement expenditures.
- Retirement expansion under high employment protection in fact served to ease labor turnover for firms.

Confirmation of these hypotheses would significantly bolster a qualitative comparison across the case-set aimed at testing the overall claims that 1) expansionary era of the 1960s and early 1970s produced inherently more costly pension systems when a major intent of reform was to increase rates of retirement, and 2) subsequent retirement expenditure levels, extending to the last two decades, are more influenced by the differences arising from this time period than by earlier or later reforms.

Alternatively, if left-party government is a prerequisite for major pension expansion, as predicted by the ratchet-effect hypothesis, then it would truly seem that the cross-class alliances emphasized by economic institutionalist explanations are not central to the explanation. Similarly, insofar as veto players theory emphasizes the number of *partisan* veto points as the decisive independent variable, the number of constitutional checkpoints ought only to exert a meaningful impact among cases without incentives for cooperation between firms and workers (i.e., those without rigid employment protection). Finally, as the labor-rigidity hypothesis predicts expansions targeted especially toward sectors with the strongest employment protection, the particularism hypothesis predicts no clear pattern to the beneficiaries of increases, allowing for comparative analysis.

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