The Political Economy of Ageing Labour Markets

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In its earliest stage it referred to studies about the creation of wealth by nation-states (Adam Smith, David Ricardo, Karl Marx).

Currently it identifies studies that focus on:

- How economic policies are adopted (Downs, 1957)
- Impact of political institutions on economic outcomes (Roubini, 1990)
- Origins and change of political institutions (Esping-Andersen, 1990; Pierson, 2000)

Purpose of the Lecture:

- To understand how demographic ageing might impact on the nature and shape of labour market institutions, i.e. on how labour markets are regulated.
Debate on the impact of demographic ageing on nature and extent of the Welfare-State

This debate has overly focused on the distributive function of the Welfare-State

- Distributive function – Promoting equality (Education, Health, Pensions)

- Productive function – Regulating relation between capital and labour in the production of wealth
  - How much workers get (minimum wage regulations; wage-setting systems)
  - How secure they are in their jobs (employment protection legislation)
  - How much protection do they get when out of work (unemployment benefits, active labour market polices)

This later function is important, as the way we regulate our labour markets impacts on our economic performance (see Nickell and Layard 1999)
The political economy of ageing labour markets

- **Structure of the lecture**
  - Main standpoints on political economy of labour markets
    - Power-Resources Theory
    - Asset-Based Theory of Preferences / Varieties of Capitalism Approach
    - Insider/Outsider Model
  - Elements of a political economy of ageing labour markets
    - How will demographic ageing impact on the distribution of labour market risks?
      - Looking at employers hiring/firing decisions
      - Taking a broader view
    - What are the age-based trade-offs associated to labour market institutions?
      - Wage-setting systems
      - Employment protection legislation
    - How will age impact on actor’s preferences for labour market regulation? Some theoretical and empirical notes
  - Summing-up & research agenda for the future
**Power-Resource Theory**

- Departs on two key assumptions about market-based societies
  - Preference for social protection reflect the class-based nature of how life-course risks are distributed
    - Workers, as they are more exposed to life-course risks would like to insure against these risks
    - Employers will oppose any kind of redistribution
  - The end result of distributive conflicts is the product of the balance of ‘power resources’ held by actors

- In capitalist societies there is an imbalance in the ‘power resources’ owned by employers (capital, means of production) and labour (human capital)
  - Labour then tries to organise into trade unions, and left-wing parties to, counteract this imbalance
  - Universal suffrage, social citizenship policies, Neo-Corporativist institutions to regulate working conditions

- Welfare development depends on the strength of labour movement and on hold of left-wing parties over government
Political Economy of Labour Markets

- Asset Theory of Social Policy Preferences / Varieties of Capitalism Approach

- Iversen and Soskice (2001)
  - Preferences for redistribution do not reflect class, but nature of skills
    - General skills - Skills that are portable across all firms
    - Asset-Specific skills - skills are valuable only to a single firm or a group of firms (whether an industry or a sector)
  - Workers depending on specific skills are more exposed to labour market risks, and therefore more supportive of policies that protect them against those risks

- Hall and Gingerich (2001)
  - Firms are key in shaping model of labour market regulation
    - They are interested in protecting workers investments in specific skills
  - Two types of capitalist regimes
    - Liberal Market Economies
      - Production based on general skills
      - Market regulates employment relations
    - Coordinated Market Economies
      - Production based on specific skills
      - Unemployment insurance, employment protection and coordinated wage-bargaining
Political Economy of Labour Markets

- Insider/Outsider Model (Rueda, 2005)

  - Labour is divided between insiders and outsiders
    - Insiders - Less exposed to labour market risks (permanent contracts, voluntary part-time or fixed-term)
    - Outsiders - More exposed to labour market risks (unemployed, involuntary part-time or fixed-term, students)
    - Employment security explains the distribution of labour market risks

  - This changes the distribution of preferences for labour market regulation...
    - Insiders – Oppose UB and ALMP (tax burden, low wage competition). Strongly in favour of employment protection
    - Outsiders – More supportive of UB and ALMP. Less supportive of employment protection (easier entry in the labour market)
    - Up-Scalers – Oppose UB and ALMP (tax burden, fear of regulation) and employment protection (reduces flexibility and economic performance of firms)

  - ... And how political parties position themselves
    - Social Democratic – Have insiders as core constituency. Less able to follow policies to support outsiders.
    - Conservative parties - Have up-scallers as core constituency. But are able to follow policies for outsiders, namely lower employment protection.
What we have discussed so far:

- There is a number of key institutions in regulating the functioning of the labour market:
  - Wage-Setting Systems; Employment Protection Legislation; Unemployment benefits; Active Labour Market Policies
- These institutions imply a redistribution of gains and costs across social groups
- Individuals preferences with regards these institutions reflect their exposure to labour market risks, which in turn might reflect one’s
  - Socio-economic class
  - Skills
  - The level of employment security

The political economy of ageing labour markets*

- How will demographic ageing reshape the distribution of labour market risks?
- What are the age-based trade-offs associated to labour market institutions?
- How will the distribution of preferences change by reference to this?

* For this lecture we will not discuss how demographic ageing impacts on preferences of capital/employers, and on the strategies of political parties and trade unions.
How will demographic ageing reshape the distribution of labour market risks?

- Looking at employers hiring/firing decisions

**Human capital theories**

- Becker, 1971; Hutchens, 1988

**Delayed Compensation Contracts**

- Lazear, 1979

- No clear incentive for firing older workers
- No incentive to hire older workers / Incentive to offer lower wages to older workers.
- Transfers between age-groups in firms
Taking a broader view

Generation crowding models (Mosca, 2009)

- These theories look at whether the size of one’s cohort has repercussions on the level and shape of one’s earnings and employment opportunities

- Three key assumptions:
  - Workers of different cohorts are different factors of production, as compared to the more homogeneous factor capital;
  - Workers of different ages are imperfect substitutes in production, especially in high skilled occupations.
  - Increase in the supply of an input, its price and utilization rate will decline

- Demographic ageing will mean that the older cohort will become more abundant, which can mean lower wages or higher unemployment (or lower employment rates)

- The type of impact on older workers will depend on degree of substitutivity between younger and older workers and the level of regulation in the labour market
  - No regulation – adjustment is done through the increase of wages of younger cohort
  - Labour market regulation – adjustment made through higher unemployment/lower employment of older generation.
What are the age-based trade-offs associated to labour market institutions?

- **Wage-Setting Systems**
  - Aubert (2005) - Reports a negative correlation between the employment share of older workers and their wages relative to younger workers. A similar negative correlation exists for hiring, except in the case of highly qualified workers.
  - OECD (2006) - Employers are more likely to hire and retain older (male) workers in countries where wages rise less steeply with age

- **Employment Protection Legislation**
  - Bassanini and Duval (2006) - Positive relation between the level of employment protection legislation and the employment rate of workers aged 55 to 64, in OECD countries
  - OECD (2006) - Negative relation between employment protection and the hiring rate of men aged 50 to 64
  - Behagel, Crepon and Sedillot (2008) found that a higher tax penalty on the laying-off of older workers reduces the probability of being fired for male older workers
  - Krugler, Jimeno and Hernanz (2002) - Reduction of dismissal costs approved in 1997 increased the probability of making the transition from permanent employment to unemployment – which practically cancels out any increases in hirings (2002: 19-21).
How does age impact on actor’s preferences for labour market regulation?

- Age emerges as an important variable in the formation of social cleavages around the regulation of the labour market
  - Young workers vs. older workers
    - Conflict over level of employment protection
    - Conflict over pay-system (productivity based vs. seniority based)
  - Active vs. Retired
    - Conflict over level of protection to be given to the unemployed
    - Conflict over the level of investment in ALMP

- Understanding the role of age in the formation of preferences
  - Age vs. Skills vs. Income/Class
  - Economic-Life Cycle vs. Demographic Life-Cycle (Wilkoszewski, 2009)
    - Self-Interest vs. Dynastic altruism vs. Societal Altruism
  - Cohort effects
How does age impact on actor’s preferences for labour market regulation?

- **Example: age-based support for cuts in unemployment benefits**

  - Bonoli and Häuserman (2009) - People over 65 are more likely to support a reduction of unemployment protection than those aged 18 to 39 (Voting behavior in referendums)

  - Bursemeyer et al (2009) Age effects are generally low (except in Sweden and Norway, Japan and the USA)

  - Fraile and Ferrer (2005) - support for cuts in the level of unemployment benefits spending actually decreases with age

  - Blekesaume and Quadagno (2003) - Positive relation between age and support for welfare policies towards the unemployed
There is a number of key institutions in regulating the functioning of the labour market (Wage-Setting Systems; Employment Protection Legislation; Unemployment Benefits; Active Labour Market Policies).

These institutions imply a redistribution of gains and costs across social groups.

Individuals’ preferences with regards these institutions reflect their exposure to labour market risks, which in turn might reflect their socio-economic class, skills or employment security.

Demographic ageing impact on the distribution of labour market risks, with older workers being more exposed to unemployment/inactivity, lower hiring opportunities and the prospect of lower wages upon recruitment.

Certain labour market institutions (wage-setting systems, employment protection legislation) imply a redistribution of gains and costs between age-groups.

We can expect that that age will play a more important role in the formation of preferences for labour market regulation...

... But we need to have a comprehensive approach to the role of age in the formation of policy-preferences.
In order to understand how demographic ageing will shape the political economy of labour markets, we need to look at:

- How age and skills interact in the way labour market risks are distributed?
- How age will shape individuals’ preferences for labour market regulation?
- How will trade unions adapt to changes in preferences and possible age-based conflicts within the labour force?
- How will employers adapt to changing preferences in the labour force? What kind of cross-class alliances can they engender?
- How will political parties position themselves in the face of a change in the distribution of preferences in society?
Thank you for your attention!!!

And I hope you've enjoyed it! 😊