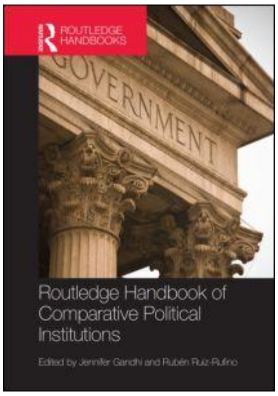

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LABOR MARKET INSTITUTIONS AND ECONOMIC PERFORMANCE

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The last few decades have seen the emergence of a large amount of literature examining the links between labor market institutions and macroeconomic outcomes. The interdisciplinary efforts of economists, political scientists and sociologists have given rise to a theoretically lively and methodologically diverse literature. This research attempts to answer a range of important questions. Some are policy related: what can governments do in the face of economic challenges? What defines a state's capacity to meet such challenges? Others are institutional: do some institutions promote lower rates of inflation and unemployment or higher rates of growth than others? What are the trade-offs? Can we expect technological change and globalization to lead to institutional convergence? And what factors are likely to affect the adjustment of a political economy in the face of such challenges?

Early research focused on understanding the relationship between specific features of collective bargaining systems and macroeconomic adjustment. Given the failings of conventional macroeconomic models of wage and price behavior to explain variation in adjustment to the macroeconomic shocks of the 1970s, social scientists began to examine the impact of alternative institutional structures of economic performance and initially concluded that so-called "corporatist" arrangements produced better macroeconomic outcomes. Spurred by the gap in employment performance between European countries and the US in the early 1990s, on the other hand, many economists endorsed the view that rigid labor market institutions were at the root of unemployment.

In turn, research by political scientists has contributed important insights by emphasizing that labor market institutions (and policies) and macroeconomic outcomes clustered in distinct welfare regimes (Esping-Andersen 1990) or varieties of capitalism (Hall and Soskice 2001). However, such studies disagree on the relative importance of different institutional and political characteristics driving differences in macroeconomic outcomes.

In this chapter, we argue that the study of labour market *dualization*, or the differential treatment of labour market insiders and outsiders, provides fertile ground for research on labour market institutions and economic outcomes. Recent research has documented distinct patterns across and within countries that need systematic explanation. First, advanced industrialized economies have not converged towards a neoliberal labor market model characterized by labor market flexibility and limited social protection systems. Rather, a trend towards structural segmentation differentiating labor market insiders and outsiders is discernible across these economies

(Emmenegger *et al.* 2012). Second, labor market dualization translates into very different economic (and social) outcomes across countries. Advanced economies exhibit strong variation in the distributive implications of policy areas (such as labor market regulation and social protection regulation). Continental European economies, for example, rely on a combination of labor market regulation to circumvent labor costs in the private service sector (Eichhorst and Marx 2012) and social protection systems that appear to *exacerbate* labor market divides (Häusermann and Schwander 2012).

These changes have important implications for the study of labor markets. To what extent can existing theories based on institutional rigidities and varieties of capitalism account for the recent transformations apparent in most OECD economies? What particular institutional features matter and why? And how can theory move beyond existing views about the role of institutions to explain differences in labour markets? In what follows, we review the major approaches underpinning the study of labour market institutions and economic performance and assess the degree to which they are able to account for new labour market developments.

The consensus view: the labor market rigidity hypothesis

Labor market institutions are the set of implicit or explicit rules, norms or contractual arrangements and organizations that govern labor transactions. These rules shape demand and supply in the labor market. Demand for labor is determined not only by conventional market elements such as output prices, productivity of labor and nominal wages, but also by regulations relating to layoffs, work time and collective wage-setting rules. In turn, the supply of labor is affected by passive labor market policies (such as unemployment benefits). Economists often argue that labor market institutions are at the root of unemployment. In this view, institutional arrangements have contributed to restricting the scope of market clearing, giving rise to "rigidities" in a number of areas that limit the freedom of employers to re-organize and adjust the size and wage of their workforce in response to market fluctuations.

The intellectual rationale for the labor market rigidity thesis is solidly rooted in neoclassical economic theory, which maintains that under perfect competition the optimizing decisions of market participants produce efficient outcomes for both individuals and society. In such models, full employment is guaranteed provided there are no rigidities. The introduction of a minimum wage above the competitive wage provides one example. Although some employees benefit from an improvement in their incomes (and labor income on aggregate may rise), for society as a whole the gain is limited. Most of the gain to labor comes from the redistribution of income from other productive inputs. Higher wages also reduce employment as employers substitute other inputs for the more expensive labor, and consumers respond to higher production prices by reducing consumption. Lastly, while producers affected by the minimum wage use too much capital, energy and other inputs relative to society's endowment, labor released from production is underutilized, being either unemployed or employed in an unregulated sector at a lower wage. Thus, a minimum wage raises costs, reduces output and results in a smaller and less desirable set of consumption goods than was otherwise available Block *et al.* (2005: 97–98).

In an influential article, Siebert (1997) identified a number of ways in which labor market institutions can influence market clearing and negatively affect employment. First, they can weaken the demand for labor, making it less attractive to hire a worker by explicitly pushing up the wage costs or by introducing a negative shadow price for labor. Second, they may distort the labor supply, for instance, by increasing the reservation wage through benefits and making the unemployed both more reluctant to actively seek work and to accept available jobs

(Nickell 1997; Holmlund 1998). Lastly, institutions can weaken the equilibrating function of the market mechanism (for instance, by influencing bargaining behavior). In short, if markets are believed to be competitive, social welfare is best attained by policies that lessen market imperfections and remove barriers to competition.

Most research in labor economics thus starts from the premise that rigidities that reduce competition increase unemployment, and goes on to ask whether labor market institutions affect unemployment directly by raising the equilibrium unemployment rate (Nickell 1997; Elmeskov *et al.* 1998) or indirectly, by magnifying the adverse consequences of exogenous shocks (Blanchard and Wolfers 2000) or by exacerbating the effects of other institutional rigidities. A first set of studies in the 1990s and early 2000s focused on the impact of union density, employment protection legislation, the amount and duration of social benefits and employment tax rates (Siebert 1997; Layard *et al.* 1991; Nickell 1997; Nickell *et al.* 2005). A longstanding literature on collective bargaining viewed unions as rent-seeking labor market cartels, whose main function is to raise wages above market-clearing levels (Johnson and Mieszkowski 1970; Johnson 1975).[1] In this view, a high share of workers belonging to unions was expected to increase unemployment, particularly in contexts of a highly elastic labor supply.[2] In turn, employment protection legislation was argued to weaken demand for labor by limiting the freedom of employers to quickly adjust to market fluctuations (Addison and Teixeira 2003). Standard neoclassical arguments claimed that employers facing high employment protection would be reluctant to hire new workers because of high potential severance costs (Van Long and Siebert 1983). However, standard theory also points out that the effects of employment protection legislation are likely to be indeterminate, as firms faced with high firing costs smooth their employment, leading to lower turnover, and lower flows in and out of employment (Bertola 1992).

A related set of arguments focused on the role of unemployment benefits in shaping wages and unemployment. An influential model incorporated the ability of unions and firms to set wages and prices, and started from the premise that unemployment benefits are always raised or lowered in line with wages, so as to keep the replacement ratio constant (Layard *et al.* 1991). In this view, unemployment benefits increased the reservation wage and made the unemployed both more reluctant to seek or accept jobs (Nickell 1997; Holmlund 1998). This disincentive, in turn, increased the bargaining power of both new job applicants and current employees. Higher wages in turn reduced labor demand and thus raised unemployment (Holmlund 1998). This framework implied that the greater the real wage rigidity, the greater the equilibrium rate of unemployment (or Non Accelerating Inflation Rate of Unemployment). Later research aimed to substantiate the view that unemployment was caused by rigid labor market institutions (OECD Jobs Study 1994; Siebert 1997; Elmeskov *et al.* 1998; Belot and van Ours 2001, 2004; Saint-Paul 2002; Nickell *et al.* 2005; Bassanini and Duval 2006). This research suggested that differences in institutional arrangements explained the increasing gap in employment performance between large European countries and the US in the 1990s (Bruno and Sachs 1985, Blanchard and Summers 1986, Lindbeck and Snower 1988).

A major limitation underlying these studies concerned their inability to explain why the evolution of labor market institutions in continental European countries has failed to match the trajectory of unemployment. Rigid labor market institutions were already present in the 1970s and did not become more so in the 1980s (Solow 2000; Blanchard and Wolfers 2000). As succinctly put by Solow (2000: 5),

> [at] the crudest level, the timing is wrong. One of the two big increases in unemployment took place in the early eighties, although there was no change in labor-market

regulation to account for it. The large continental economies do not seem to have suffered from noticeably more rigid labor markets during the high-unemployment 1980s than they did in the low-unemployment 1970s.

A second set of arguments argued that labor market institutions have an indirect effect on unemployment by amplifying the adverse consequences of exogenous shocks. In an influential paper, Blanchard and Wolfers (2000) argued that labor market institutions affect the impact of shocks on unemployment as well as the persistence of unemployment in response to shocks, and that this could help explain why the same institutions were apparently not employment-unfriendly in previous decades. A slowdown in productivity growth could result in unemployment unless wages are adjusted downwards, and this adjustment may be more difficult in systems with strict employment protection or generous unemployment benefits. Once the adverse shocks generate an increase in unemployment, such institutions may prolong the time needed for unemployment to return to its normal level.

The evidence of a causal connection between labor market rigidities and unemployment levels, however, has been remarkably inconclusive.[3] The empirical literature has reported significant impacts for employment protection, benefit generosity and union strength, but the effects of such institutions do not appear to be robust, and exhibit widely differing coefficients and levels of significance. While there appears to be some agreement on the unemployment effects of unionization (Nickell and Layard 1999; Nickell *et al.* 2005; Baccaro and Rei 2007), the evidence on other aspects of wage determination remains unconvincing. Using a cross-section of 20 countries over the period 1983–88 and from 1961 to 1995 for OECD countries, Nickell and Layard (1999) and Nickell *et al.* (2005), respectively, find that higher union density and coverage raise unemployment, while union and employer coordination lower it. However, Baccaro and Rei (2007) look at 18 OECD countries between 1960 and 1998 and, with the exception of union density, find little support for a causal connection between labor market rigidities and negative economic outcomes.[4] The findings for employment protection legislation are equally inconsistent. While Nickell and Layard (1999) find a positive effect of employment protection legislation on unemployment, Nickell (1997) finds no effect.[5] Nickell *et al.* (2005) and Blanchard and Wolfers (2000) find a negative effect, while others tend to find no robust positive association with unemployment (Baccaro and Rei 2007).

The labor market rigidity hypothesis suffers from important theoretical and empirical limitations. One major limitation of these arguments is the absence of political mechanisms linking micro-level labor market strategies and aggregate outcomes. Specifically, such studies tend to focus on the outcome level at the expense of the *politics* of unemployment. Thus, the rigidity-cum-unemployment argument tends to focus on the micro-level strategies of labor market actors (employers responding to changed economic conditions, workers reluctant to look for work), and political processes play a minor role. However, whether micro-level responses translate into greater or lesser unemployment is contingent on the links between the micro-level, broader institutional context and the political articulation of labor market interests.

A second critique revolves around the inability of such theories to explain why countries with similar levels of institutional rigidities exhibit different levels of unemployment. Why did similar institutional reforms not lead to similar outcomes in different countries? Increases in bargaining coordination between the mid 1980s to the mid 1990s brought about wage moderation in the Netherlands (Visser and Hemerijck 1997) and Ireland (Baccaro and Simoni 2007), but had little effect on unemployment performance in Italy (Baccaro 2000; Baccaro and Rei 2007). In addition, labor markets in those countries that were able to lower unemployment rates in the 1990s (Ireland, Denmark, the Netherlands and the United Kingdom) are considerably more regulated than in the U.S. In none of these countries was unemployment accompanied by a reduction in institutional protection.

Third, the composition is arguably as important as the aggregate level of unemployment. Countries with similar levels of unemployment vary significantly in the degree to which different subgroups in the population are affected, and often distribute labor market policy and regulations unevenly across areas of policy. The incidence of unemployment exhibits a great degree of variation within the OECD (with respect to gender, age or education). Some countries target social policy to narrow political constituencies, while others may distribute broadly across the entire population. The focus on aggregate levels of unemployment thus overlooks important information about the distributional implications of a number of labor market policies. Recent research aims to overcome this reliance on outcome-level analyses by employing measures that capture policy differences in the level of labor market regulations and social protection (Emmenegger *et al.* 2012).

How well can neoclassical arguments explain labor market developments in recent years? In their study of labor market divides in industrialized democracies, Emmenegger *et al.* (2012) find significant variation in the degree to which structural job growth in the service sector translates into economic and social divides (unemployment and inequality). Their findings emphasize inter- and intra-regime (cross-national) differences across policy areas. Continental European economies rely on different aspects of labor market regulation to circumvent labor costs in the private service sector (Eichhorst and Marx 2012). In distributional terms, social protection systems in continental European economies appear to *exacerbate* labor market divides (Häusermann and Schwander 2012). However, Howell *et al.* (2007) report unemployment rates for 2003 with OECD data in three groups of countries, and show that while corporatist economies of "high-unemployment Europe" show worse employment performance than the Liberal economies, "low-unemployment Europe" exhibits moderately good performance and comprises both corporatist and heavily regulated countries.[6] Such findings point to the need for a more nuanced theoretical approach to understand the conditions under which these effects are likely to prevail.

The role of institutions: the corporatist and partisan hypotheses

Spurred by the wave of inflation that gripped most developed economies in the 1970s, the "neo-corporatist" hypothesis explicitly sought to address the role of political mechanisms neglected by the neoclassical literature (Schmitter and Lehmbruch 1979; Goldthorpe 1984). Two conceptions of neo-corporatism emerged in the 1980s. In an influential article, Schmitter (1974) defined neo-corporatism as a form of interest representation distinct from pluralism. Subsequently, Lehmbruch (1977, 1979) defined neo-corporatism as a form of policymaking in which concertation assumed central importance. Both conceptions emphasized the structured participation of interest organizations in policymaking.

Corporatist arrangements are argued to produce implicit or explicit "social contracts" in which unions restrain wage demands in exchange for policy concessions from the government, leading to lower inflation and unemployment. This conception of corporatism is based on an Olsonian logic of collective action, proposing that institutions that are encompassing in relation to firm or industry are better able to internalize the economic effects of their wage settlements (Olson 1965; Calmfors and Drifill 1988; Golden 1993). Within this framework, features such as the centralization, concentration and density of labor and employer associations become particularly important in shaping macroeconomic outcomes (Calmfors and Drifill 1988; Golden 1993).

A first set of studies emphasized the role of the centralization of wage bargaining in shaping employment levels. In a prominent study, Calmfors and Driffill (1988) argued that good economic performance would result if wage bargaining took place either at the company or at the national level. In the first case, the actions of unions would not be powerful enough to distort efficient market outcomes. In the second, unions would be encompassing enough to act in favor of the interests of society as a whole. Poor economic performance would be associated with wage bargaining at the industry level because wage bargaining would be powerful enough to affect the market equilibrium outcome while insufficiently encompassing to take society's interests into consideration. The implications of this argument for the evolution of unemployment were subsequently explored by Rowthorn (1992) and Pekkarinen *et al.* (1992). Extending the previous framework, Rowthorn contended that there is, particularly in the early 1980s, a U-shaped relationship between the centralization of wage bargaining (i.e. centralized unions and employer associations) and employment.

A related line of argument suggested that the degree of wage coordination is more relevant to macroeconomic outcomes than the level of wage bargaining (Soskice 1990; Golden 1993; Hall and Franzese 1998). In this view, increasing levels of union concentration (a small number of unions that do not compete) are associated with better employment outcomes. The concentration logic stresses collective action by considering that fewer actors reduce coordination problems and that unions that do not compete "have fewer incentives to engage in wage militancy" (Golden 1993: 441). Although this approach emphasizes a different factor, the analysis is compatible with the centralization argument and the conclusions are similar (the main difference being the suggestion by the concentration framework that a linear relationship may be more accurate than a U-shaped one).

Empirically, many studies found support for the beneficial effects of corporatist institutions. Exploring macroeconomic responses in the wake of economic crisis in the 1970s, most authors concluded that a positive relationship existed between the degree of corporatism and macroeconomic performance (Flanagan *et al.* 1983; Pekkarinen *et al.* 1992; Scharpf 1997). Corporatist countries were found to be more successful at controlling inflation and adjusting in periods of crisis than less corporatist or noncorporatist ones (Western 1991; Crepaz 1992). However, others have found that corporatist institutions do not make much of a difference. Analyzing eight small countries, Woldendorp (1997) showed that countries ranking higher in the neo-corporatist scale do not perform better than countries ranking lower. Finally, exploring differences in macroeconomic outcomes in contexts of low monetary autonomy, other scholars have explored how institutions interact with monetary regimes (Hall and Franzese 1998; Iversen *et al.* 2000). These studies emphasize the relationship between coordinated bargaining and central banks, and argue that "the key to effective wage and labor-cost setting is coordination among actors and an emphasis on cost containment rather than on centralization and elaborate redistributive goals" (Molina and Rhodes 2002: 311–312).

The neo-corporatist approach addresses previously neglected and important issues, but suffers from a number of theoretical limitations. While accounts emphasizing changes in economic context may help identify the presence of new incentives for governments, employers and unions to engage in concertation, they do not explain how or why attempts at concertation achieved greater or lesser degrees of success in different countries. Scholars have noted that many countries that successfully coordinated policies of wage restraint could not rely on the strong, centralized interest associations prevalent in the 1970s (Hemerijck and Schludi 2000). In other words, such accounts failed to address the mechanisms or processes that linked institutional structures with macroeconomic outcomes. Subsequent research has focused on corporatism as a policymaking process and explored the goals and strategic behavior of actors rather than institutional features (Molina and Rhodes 2002).

A prominent literature stresses the importance of political parties in shaping outcomes such as unemployment and inflation. The traditional partisanship school emphasized that political parties promote the interests of their core constituencies. In this view, labor is assumed to be more affected by unemployment than capital owners, and social democratic governments are expected to design economic policies that promote employment. In turn, inflation is assumed to disproportionately influence upscale groups, so conservative governments are expected to promote policies that reduce price increases (Hibbs 1977; Alt 1985). Stressing the capacity of left power to mobilize resources to promote full employment, Esping-Andersen (1990) claimed that a strong presence of labor interests—including high union density, centralization of wage bargaining and a high share of seats held by social democratic parties—in Nordic welfare regimes would result in higher levels of employment relative to Liberal and Continental welfare regimes. The former were more likely to create employment through the welfare state and the public sector. In Continental welfare regimes, the existence of a high social wage and centralized industrial relations were expected to hinder the development of a large low-wage service sector. However, this would likely come at the expense of a large "outsider surplus population" with no access to the labor market. In contrast, the minimalist nature of the welfare state together with decentralized industrial relations in Liberal countries was expected to facilitate the emergence of a large, low-wage service sector segment. In the absence of comprehensive employment and training programs, these workers were likely to remain in such low-wage service sectors. A related view emphasizes the role of social democratic governments in promoting active labor market policies to attain both equality and economic efficiency in contexts where orthodox left policies are considered unfeasible (Boix 1998; Huo *et al.* 2008).

Partisan and power resources theories have provided key insights to explain differences in macroeconomic outcomes, but suffer from a number of shortcomings. First, at the root of both approaches is a zero-sum conflict among workers and employers (Carnes and Mares 2007: 873). Workers are assumed to demand employment friendly policies to offset their disadvantaged position in the labor market. In contrast, employers are expected to resist all policies that weaken their absolute authority over workers (Esping-Andersen 1990). Second, both assume that labor and social democratic parties are internally homogeneous and relatively context insensitive. Yet both labor and parties have been shown to vary greatly over time and across countries, and can be divided internally. These studies also overlook the electoral constraints under which parties operate. Rueda (2005) stresses the electoral dilemmas faced by social democratic parties, who have to cater to the interests of insiders (at the expense of outsiders), and have thus not been univocal in implementing measures to reduce unemployment for all workers.[7]

The literatures on neo-corporatism and power resources offer limited guidance in understanding the development of labor markets across and within the universe of institutional regimes. Recent scholarship has identified considerable variation in the degree to which continental European economies are capable of integrating low-skill labor in what was claimed to be an adverse institutional scenario. Research shows that while these economies are constrained by institutional barriers to hire at low wage levels, they have developed different strategies to overcome such obstacles (Eichhorst and Marx 2012). It also provides little guidance to understand the preferences and strategies pursued by labor-based parties in OECD countries. How do social democratic parties weigh ideological concerns and electoral calculations (Carnes and Mares 2007: 874)? Given heterogeneity in the support base of many of these parties, what role does labor market policy play in crafting together such heterogeneous coalitions?

The dualization hypothesis

Recent scholarship on the evolution of labor market institutions in advanced industrialized economies offers a number of insights into such questions. It challenges the theoretical assumptions and empirical results of both neoclassical and welfare regimes scholarship, and explores the conditions under which different labor market actors can be expected to support greater or lesser flexibility. A first set of studies seeks to identify the interests of actors other than (insider) workers in labor market policy.

Recent work by political economists and political scientists has focused on insider-outsider politics in an attempt to highlight the mechanisms leading to the emergence of outsiders and the translation of such cleavages into economic and political outcomes (Emmenegger 2009; Rueda 2005, 2007). In his study of labor market policy in industrialized democracies, Rueda (2007) provides a strong critique of the thesis that social democratic governments care more about high employment than low inflation. He examines the extent to which social democratic governments promote policies that further employment for the unemployed as opposed to job security for the employed insiders. He finds that social democratic parties have become staunch supporters of insider interests—at the expense of outsiders demanding active labor market policies, the relaxing of employment protection legislation and training programs.

This approach draws on insights from non-neoclassical segmentation economic theories that emphasize heterogeneity among labor market actors. Partly in response to the failings of neoclassical theory to account for the workings of labor markets in advanced democracies, dual labor market theory argues that labor markets are composed of a primary sector with well paid, stable and secure jobs and a secondary sector marked by poorly paid, unstable employment from which workers would find it difficult to escape due to the intermittent nature of employment (Piore 1979; Döringer and Piore 1971). The economic insider-outsider approach developed such insights and stressed that labor market insiders and outsiders have partly conflicting interests and that a potential for cross-class coalitions exists between insiders and employers (Lindbeck and Snower 1988; Blanchard and Summers 1986). Rueda's (2007) conceptualization of labor as a heterogeneous labor market actor has important theoretical implications. In this account, conflict over labor market policy and outcomes does not pit a disadvantaged labor force against employers.

Building on these insights, a second set of studies questions the assumption of zero-sum conflict between employers and workers over the introduction of flexibility in labor market policy. In their study of the causes and consequences of dualization, Emmenegger *et al.* (2012) document the extensive variation in labor market divides that characterizes the labor markets of advanced industrialized democracies. The authors argue that while structural trends such as globalization and de-industrialization are common to most countries, the resulting insider-outsider divides vary considerably across welfare regimes (Häusermann and Schwander 2012) and within welfare regimes (Eichhorst and Marx 2012). Eichhorst and Marx (2012) identify five different ways ("transformative pathways") used by continental European regimes to circumvent existing rules and costs associated with standard employment. They find that (1) defection from permanent contracts plays a role in labor market dualization in France and the Netherlands; (2) defection from full-time jobs is particularly pronounced in the Netherlands but also in Austria and Germany; (3) defection from dependent employment in the form of precarious self-employment is common in Belgium and France; (4) increasing wage dispersion to integrate low-skilled workers into the labor market is prominent in Austria and Germany; and (5) large government-sponsored labor-subsidizing schemes are prominent in France and Belgium. The heterogeneity in the type of labor divides within welfare regimes emphasizes the degree to which both labor market policies and outcomes are likely to be country-specific, and has given rise to two questions. A first question concerns the specification of preferences of labor market actors. A second question concerns the coalitional dynamics that are likely to emerge.

What are the conditions under which unions are driven to support flexible labor market policies? When do the benefits of such policies outweigh the costs of flexibility, among which is severing the employment relationship at the root of union power? The dualization literature provides a number of answers. One set of arguments focuses on unions' need for political survival. The expansion of private service sector employment together with the growth of non-standard employment in many industrialized democracies contributed to the erosion of the traditional base of unions in manufacturing. In the context of state-led industrial adjustment, unions traded workforce reductions leading to greater productivity for greater job security (Palier and Thelen 2012). Focusing on France and Germany, Palier and Thelen (2012: 203) argue that "[early] responses to the economic crisis of the 1970s and 1980s were organized around saving the core manufacturing economy, which was the foundation for both the economic and the social model." However, this insider-centered mode of adjustment came at the expense of outsiders. Focusing on corporate unions in East Asian economies, Peng (2012) also documents the "consenting" role of unions. In these cases, labor market flexibility was a strategy of union survival.

Other studies have argued that encompassing labor unions facilitate the consideration of general goals by actors that may be tempted not to act solidaristically (Obinger *et al.* 2012). Corporatism in this view is expected to promote pro-outsider policies through two channels. First, corporatist arrangements promote solidaristic preferences for individuals. Second, they may promote solidaristic behavior by the social partners (Rueda 2007). Corporatism facilitates the consideration of general goals through, for example, the existence of tripartite institutions. The Olsonian view implies that when matters of general economic or political interest are debated in fora characterized by an ongoing dialogue among relatively cooperative social partners, the possible future costs of particularistic behavior become clearer and more widely known. This affects both individuals (insiders become more likely to understand the negative implications of demanding high employment protection at all costs) and social partners (unions would become more likely to understand the negative implications of acquiescing to the particularistic demands of insiders).

The dualization literature has also provided new insights into the political coalitions underlying the introduction of labor market policy. A number of studies emphasize the strategic alliances or coalitions of various actors driving policy. In their study of Sweden in the period 1994–2006, Lindvall and Rueda (2014) show that insider-outsider divisions are relevant even in a proto-corporatist country such as Sweden. Looking at how political party strategies shape the political behavior of insiders and outsiders, they find that mainstream left parties that focus on issues primarily relevant to insiders are punished by outsiders. They also find that social democratic parties may face an "insider-outsider dilemma": tailoring their message to one group may alienate the other. This suggests that failure to reconcile insider-outsider interests may lead to new coalitional dynamics, with centre-right parties tailoring to insider interests (as appeared to be the case in 2006).

In other accounts, dualization stems from complex cross-class coalitions. Some studies emphasize that such cross-class coalitions have often involved manufacturing unions and the state. Palier and Thelen (2012: 202) conclude that "current trends point to a more durable new pattern based on cross-class coalitions, progressively institutionalized across successive policy domains and underwritten by state policy." Other studies have focused on the conditions under which firms are more likely to support labor market protection. Acknowledging that employers exhibit considerable heterogeneity in their preferences over labor market policy, the Varieties of Capitalism (VoC) literature conceived of production regimes as institutional complementarities that reinforce one another in addition to reinforcing particular ways of producing and competing in the international economy (Kitschelt *et al.* 1999; Hall and Soskice 2001). In this view, regulated labor markets have beneficial employment effects in production regimes where institutionalized job security and unemployment insurance constitute institutional complementarities (as in coordinated market economies). Strong job protection encourages investments in training and may enhance productivity performance (Estevez-Abe *et al.* 2001; Mares 2003), but may increase dualization. In his study of labor market policy in Sweden, however, Swenson (2002) argued that the adoption of active labor market policies specifically targeted to outsiders in the 1950s was strongly supported by firms keen to address labor market shortages. Admittedly a unique feature of Swedish economic history, this nonetheless points to the possibility that under some conditions employers may support outsider-friendly policies.

Finally, research on labor markets in developing countries shows that insider-outsider dynamics are not specific to OECD countries. A longstanding literature in development economics emphasizes the strong income gaps in dual economies (Ray 2010). More specifically, research on the development of labor markets in Latin America shows that the increase in labor market flexibility in the wake of economic reform in the 1980s brought about rising levels of unemployment (Weller 2001) and atypical employment (Marshall 1996; CEPAL 2000). Labor market economists trace the rise in unemployment to the sharp increase in female participation triggered by reform (Ocampo *et al.* 2001). In turn, scholars of structural reform in Latin America have emphasized that by empowering unions and business groups, import-substitution industrialization benefitted the interests of formal sector workers and powerful capital owners (Murillo 2001, 2009; Etchemendy 2011), exacerbating labor market segmentation. Drawing on an insurance framework, recent work in comparative political economy argues that inward-looking industrialization increased incentives to protect labor market actors through generous labor market protections that address labor market risk. This dramatically increased dualization in many developing countries (Rueda *et al.* forthcoming).

Conclusion

The study of labor market institutions and economic outcomes constitutes a rich field of research marked by great interdisciplinary efforts to understand the causes of an eminently economic and political outcome. Extant efforts to emphasize the preferences of key actors and explore the political consequences of existing institutional configurations have greatly expanded our understanding of the drivers of macroeconomic performance.

In this chapter, we have argued that interesting opportunities lie in the study of labor market dualization. Building on rigorous microeconomic foundations, the dualization literature bridges economic and political insights and provides an exciting and worthy opportunity to analyze the variety of labor market outcomes prevalent in industrialized democracies. Equally important, this literature also offers an attractive framework to make sense of labor market dynamics in developing countries.

Notes

1 In the monopoly view, unions reduce output in three ways. First, union-won wage increases above competitive levels lead to too little labor being hired relative to capital in unionized firms, causing a misallocation of resources. Second, union-influenced work rules or contract provisions (such as limits on the load handled by workers, restrictions on tasks performed or requirements that unnecessary work

be done) reduce productivity. Third, strikes to force management to accept union demands cause a substantial reduction in gross national product (Freeman and Medoff 1979).

2 Subsequent work on insider-outsider politics shared this starting point and stressed differences between the employed and the unemployed. These authors argued that labor market insiders face incentives to seek higher wages at the cost of jobs for outsiders (Blanchard and Summers 1986; Lindbeck and Snower 1988; Saint-Paul 2002).

3 For a thorough review of the empirical evidence, see Howell *et al.* 2007.

4 Earlier cross-national studies find inconsistent results. While Scarpetta (1996) finds a significant effect, Elmeskov *et al.* (1998) does not. In addition, the size of the estimated effects varies considerably. Scarpetta (1996) and Elmeskov *et al.* (1998) both find significant effects for bargaining coordination, but the effect in Scarpetta (1996) is twice as large.

5 Baker *et al.* (2005) replicated Nickell's analysis with newer versions of institutional variables and found that only union coverage is significant, and three of the remaining seven institutional variables have the wrong sign (in contrast to the Nickell 1997 results in which 7 out of 8—except EPL—were significant).

6 The English-speaking Liberal market economies are Australia, Canada, Ireland, New Zealand, UK, USA. High unemployment continental European countries are Belgium, Finland, France, Germany, Italy, Spain and the low unemployment European countries are Austria, Denmark, Netherlands, Norway, Switzerland, Sweden.

7 Kitschelt (2000) also shows that the closeness of the political competition and the identity of the challenger of left-wing parties affect both the timing and the character of policy adoption.

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