Labour market reforms in times of globalisation

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Introduction

Globalisation[1] is commonly considered to have major effects on labour market performance and outcomes in advanced industrial societies. The internationalisation of markets for goods and capital has brought about increased competition between firms on a global scale. The need for creating competitive advantage has pressured countries into creating business and investment-friendly environments. Deregulation and privatisation of labour, capital and goods markets are aimed at improving competitiveness and efficiency of the economy, but at the same time increase the vulnerability of

[1] In this chapter, when referring to "globalisation" what is meant is economic globalisation, i.e. the opening up of markets for goods and capital. Obviously, there are other forms of globalisation, such as social, cultural and technological, but these are not studied here.

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labour markets to economic shocks and increase the exposure of workers to labour market risks (Buchholz et al. 2009; Genschel 2004).

In the literature on globalisation and the welfare state, there are two main hypotheses on how governments react to these challenges of globalisation (Koster 2009; Meinhard & Potrafke 2012). The "globalist" or "efficiency" thesis, on the one hand, claims that under increasing international openness, the welfare state will contract because of pressures to reduce taxes in the world-wide competition to attract investors. With capital being more mobile, firms tend to reallocate away from regulated and unionised sectors (Potrafke 2013). The "compensation" hypothesis, on the other hand, states that globalisation and economic openness are generally expected to enhance feelings of economic insecurity among the population and will lead to increased demands for redistribution and protection (Agell 2002; Rodrik 1998). Empirical evidence has been provided for both hypotheses with no definite conclusion in favour of either (Koster 2009). In fact, Meinhard and Potrafke (2012) have interpreted this as a possibility that both effects co-exist: governments both compensate globalisation losers as well as try to improve efficiency. Given the data and methods used so far, most studies have only addressed the question of which effect offsets the other, rather than which hypothesis is true (Meinhard & Potrafke 2012, 273).

Quantitative comparative studies on the nexus of globalisation and labour market protection have used either (changes in) spending on unemployment benefits (UB) or UB replacement rates in year t as dependent variables (Allan & Scruggs 2004; Gaston & Nelson 2004; Jensen, Knill, Schulze, & Tosun 2014; Potrafke 2010; Swank 2005). Analyses of absolute levels of these indicators are, however, problematic given the path-dependency of government programmes: the absolute level of UB in t is highly correlated to its level in *t-1* (Kittel & Winner 2005, 280). Changes in expenditures and replacement rates are not necessarily policy reforms in themselves, but rather the

results of reforms. There might also be a time lag effect: a reform and a change in outcomes do not always follow each other in the same year (Green-Pedersen 2007). The net outcome of a reform can be that expenditures and replacement rates remain unchanged within a certain year, whereas actually major shifts in entitlements, eligibility, or accessibility do take place, but perhaps over a longer period.

An additional shortcoming in the empirical literature on globalisation and labour market policies is that most studies focus on changes in UB as the only indicator of social protection, ignoring that fact that other policies and institutions can perform as "functional equivalents" (Boeri, Conde-Ruiz, & Galasso 2003; Bonoli 2003). The effects of globalisation on employment protection legislation (EPL) have been especially under-researched (for exceptions, see: Fischer & Somogyi 2009; Potrafke 2010; 2013). EPL, however, performs a very different role in the labour market than UB. First, it is commonly viewed as more distorting and less efficient as a protection mechanism than UB (Blanchard, Jaumotte, & Loungani 2013; OECD 2013; Saint-Paul 2002). Second, in terms of labour market protection, EPL provides some degree of *job security* to workers, whereas UB provides a certain level of *income security*. Third, while the terms "institution" and "policy" are used interchangeably in this article, EPL resembles the concept of an "institution" more closely. Elmelund-Præstekær and Baggesen Klitgaard (2012) argued that policy retrenchment (i.e. cutting back on expenditure or benefit levels) follows a different logic than institutional retrenchment (i.e. changing programmatic rules and procedures). Taking these differences into account, there exists the additional possibility that one policy is used to offset or compensate the negative outcomes of the other in the face of globalisation (Jensen, Knill, Schulze, & Tosun 2014).

In order to address some of these above-mentioned shortcomings in the literature and to re-test both hypotheses on the basis of new data, in this article I identify how globalisation affects the likelihood

for different types of labour market reforms. To do so, I make use of a new dataset based on the *Social Reforms Database* that was collected by the *Fondazione Rodolfo DeBenedetti* and the *Institute for the Study of Labor* (fRDB-IZA 2010). On the basis of this data, it is possible to take into account expansion and retrenchment of unemployment benefits as well as the regulation and deregulation of employment protection for a set of 14 European countries for the period of 1980–2007. This data allows focusing on the reforms as discrete policy events, analysing the effects of globalisation on each type of reform, as well as controlling for the economic, political and institutional settings at each point in time.

Data

Dependent variables

This chapter makes several innovations in relation to the existing literature. First, it treats reforms as discrete policy events and not as changes in policy outcomes, such as expenditures and replacement rates. Second, it analyses reforms in both UB and EPL with the assumption that not all labour market policies are affected similarly by globalisation. Third, it treats expansionary and regulatory reforms as separate from retrenching and deregulatory reforms in order to identify any offsetting effects.

For operationalising the dependent variables that suit the aims of this study, I made use of the fRDB-IZA Social Reforms Database (2010) to identify the variation in reforms in UB and EPL for 14 European countries over the period of 1980–2007. This database records and describes adjustments and reforms that have been implemented in UB systems and EPL for Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

Using the descriptions and classifications in the dataset, I recoded each of the reforms in order to make quantitative analysis possible. For details on how the recoding was done, I refer to my previous work (Riekhoff 2015; 2017). The result is a series of indicators with different levels of comprehensiveness of the reforms. Distinguishing levels of comprehensiveness is important because small and corrective policy changes occur on a continuous basis, but in this study, the aim is to explain the implementation of labour market reforms that are intended to have a significant impact. Since this is a new dataset and there is no established or tested cut-off point for what makes a reform comprehensive, I create a set of dependent variables with various comprehensiveness levels for analysis.

UB expansion and EPL regulation are considered as reforms in one direction (increased compensation, decreased economic efficiency), whereas UB retrenchment and EPL deregulation deviate in the opposite direction (decreased compensation, increased efficiency). The dependent variables are dichotomous categorical variables, expressing whether, in a specific year and in a specific country, a reform took place and whether this reform classifies as 1) any reform, 2) a reform having at least one comprehensive feature, 3) having at least two comprehensive features, 4) having at least three comprehensive features or 5) having all comprehensive features. If in the same year more than one reform takes place, the more comprehensive reform is taken into account for analysis.

Independent variables

For the selection of the independent variables for the model, I largely followed Allan and Scruggs's regression specification from their 2004 study. Their article is commonly used as a benchmark of robust findings, which have been reproduced by others in related studies (Jensen et al. 2014, 537). Apart from two variables measuring the exposure to globalisation (trade and financial openness), economic

control variables include GDP growth rate, the government balance and the unemployment rate. Political and institutional control variables include a corporatism indicator (level of collective bargaining, "veto points" (the extent to which a government might face institutional obstacles in decision-making) and the percentage of left-wing cabinet seats in a given year. Table 1 describes the independent and control variables (see also Riekhoff 2015; 2017).

Table 1. Summary statistics independent variables

Indicator	Source	Mean	SD	Min.	Max.
Trade openness	OECD: Trade-to-GDP-ratio	74.05	32.51	31	184
Financial openness	Quinn & Inclan (1997): Capital openness indicator	86.58	16.08	38	100
Unemployment rate	OECD: Annual unemployment rates	8.42	4.03	1.62	24.17
Change in unemployment rate	OECD: Change in unemployment rates (Ut-Ut-1)	0.03	1.13	-3.32	5.06
Government balance	IMF, World Economic Outlook Database: General government balance as % of GDP	-3.15	3.84	-15.70	6.90
GDP growth rate	OECD: Annual GDP growth rate	2.58	2.03	-6.00	10.92
Corporatism	Visser (2011): Level of wage coordination	3.42	1.11	1.00	5.00
Left cabinet portfolios	Armingeon et al. (2014): Percentage of left-wing cabinet seats	41.07	38.64	0	100
Veto points	Armingeon et al. (2014): Veto points composite indicator	1.23	1.26	0	4
UB replacement rates	Van Vliet & Caminada (2012): UB net replacement rates for average production worker	56.48	19.99	2	92

Methods

The likelihood of each type of reform taking place in each particular year was analysed using times-series-cross-section analysis for binary data with discrete-time logit models (Allison 1982; Beck, Katz, & Tucker 1998). Because there are recurrent events, for example, each country can have more than one reform during the period of 1980–

2007, it is likely that the occurrence of one event is dependent on the event history of a particular country. The likelihood of a reform taking place is assumed to depend on the duration of the period of non-reform. In other words, the observations are temporally related. Therefore, to prevent artificially inflated t-values, I followed Beck, Katz and Tucker's (1998) strategy of treating the data as grouped duration data and including a series of dummy variables for each of the number of years since 1980 or since the last reform occurred. In total, 15 dummies were included, taking into account the duration effects of 15 years since the start or last event. All economic independent variables (trade and financial openness, unemployment, government balance and economic growth) have been lagged with one year. Country dummies were added to all models to account for unobserved country heterogeneity.

Logit-regression analysis was applied separately for each of the reform types at varying levels of comprehensiveness, starting with the least comprehensive reform (1) and continuing to the most comprehensive type (5). This was done in order to test for the sensitivity of the models to the coding of reforms and cut-off points. Because the number of events of reform comprehensiveness 4 and 5 were so rare, these were excluded from the reporting of the findings. The likelihood of each reform type at the different comprehensiveness levels was analysed in two steps. In the first models (a), only the globalisation variables (+ time and country dummies) were entered to analyse the direct effects of trade and financial openness. In the second models (b), the economic, political and institutional control variables were entered.

Findings

Tables 2–5 show the results of the logit-regression analyses. Overall, models performed rather well, with Pearson's Chi-squared (not

reported) being significant at the $p<0.05$ level for most models apart from models for regulation 2a and 3a and deregulation 1a and 2a (significant only at a $p<0.1$ level), whereas deregulation model 2b was not significant even at a $p<0.1$ level. Hence, the models explaining reforms in EPL generally performed worse than those for UB reforms.

Trade openness was found to have a significant negative effect on the likelihood of reforms aimed at UB expansion, while no effects of financial openness were found (Table 2). This suggests that UB expansion was more likely to take place when the economy was more closed to trade. This effect is consistently significant throughout all models. These findings are not so much in support of the efficiency hypothesis, but rather a rejection of the compensation hypothesis: when more exposed to foreign trade, there is less room for expanding labour market protection in the form of UB (although not necessarily leading to retrenchment). Moreover, UB expansion was found to be more likely to occur in times of fiscal surpluses (expansion models 1b and 2b); also, the significance of this effect does not hold for the more comprehensive type of reform (3b). Hence, with more resources in their budgets, governments have more possibilities to increase spending on UB.

Table 2. Results logit-regression for reforms aimed at UB expansion

Dependent variables / Independent variables	UB expansion					
	Expansion 1a	*Expansion 1b*	*Expansion 2a*	*Expansion 2b*	*Expansion 3a*	*Expansion 3b*
t	0.21	-0.01	-0.05	-0.08*	-0.08	-0.19*
	(0.03)	(0.03)	(0.04)	(0.04)	(0.09)	(0.10)
Trade $openness_{t-1}$	-0.03*	-0.04**	-0.04*	-0.06**	-0.16***	-0.19**
	(0.02)	(0.02)	(0.02)	(0.03)	(0.06)	(0.08)
Financial $openness_{t-1}$	0.00	0.00	0.02	0.03	0.00	0.04
	(0.02)	(0.02)	(0.02)	(0.02)	(0.03)	(0.03)
Unemployment $rate_{t-1}$		0.08		0.07		-0.11
		(0.05)		(0.07)		(0.19)
Government $balance_{t-1}$		0.18**		0.19**		0.11
		(0.07)		(0.08)		(0.17)
GDP $growth_{t-1}$		-0.03		-0.05		-0.03
		(0.08)		(0.09)		(0.87)
Corporatism		-0.12		0.12		-0.95
		(0.22)		(0.26)		(0.15)
Left cabinet share		-0.00		0.00		0.00
		(0.00)		(0.01)		(0.01)
Veto points		0.36		0.77		5.83*
		(0.48)		(0.78)		(3.29)
N	392	392	392	392	392	392
Number of events	92	92	62	62	20	20
Log likelihood	379.25	368.20	283.59	272.19	103.83	93.32

Note: Indicated are coefficients (standard errors). 15 temporal dummies and 14 country dummies not reported. * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 3 shows that financial openness has consistently significant positive effects on the likelihood of UB retrenchment. It means that when capital markets are more deregulated, governments are more likely to retrench. This is in support of the efficiency hypothesis. Trade openness was not found to have any significant effects on UB retrenchment. Higher unemployment rates did increase the likelihood of UB retrenchment. Hence, in times of growing unemployment, governments will more often cut down on UB. The fiscal situation does not directly play a role here, unlike in the case of UB expansion. Moreover, a significant effect was found for the share of left cabinet seats in the case of the least comprehensive UB retrenchment reform type

(1b), suggesting that left-wing governments did compensate more in terms of unemployment protection. This effect disappeared, however, in the models for more comprehensive reforms. The corporatism indicator had a negative effect on the likelihood of retrenchment in the case of the more comprehensive reform type (3b). This indicates that when collective bargaining structures are more centralised, more comprehensive UB retrenchments are less common.

Table 3. Results logit-regression for reforms aimed at UB retrenchment

Dependent variables / *Independent variables*	**UB retrenchment**					
	Retrench-ment 1a	*Retrench-ment 1b*	*Retrench-ment 2a*	*Retrench-ment 2b*	*Retrench-ment 3a*	*Retrench-ment 3b*
t	0.00	0.02	-0.02	-0.02	-0.01	0.00
	(0.03)	(0.03)	(0.03)	(0.04)	(0.05)	(0.99)
Trade openness$_{t-1}$	-0.01	0.00	-0.02	0.00	-0.02	-0.02
	(0.02)	(0.02)	(0.02)	(0.02)	(0.54)	(0.04)
Financial openness$_{t-1}$	0.04***	0.04**	0.06***	0.06***	0.06*	0.08**
	(0.02)	(0.02)	(0.02)	(0.02)	(0.03)	(0.04)
Unemployment rate$_{t-1}$		0.16***		0.13**		0.16
		(0.06)		(0.06)		(0.10)
Government balance$_{t-1}$		-0.03		-0.05		-0.09
		(0.07)		(0.07)		(0.11)
GDP growth$_{t-1}$		-0.10		-0.06		-0.02
		(0.09)		(0.09)		(0.15)
Corporatism		0.08		-0.25		-1.64**
		(0.25)		(0.26)		(0.78)
Left cabinet share		-0.01**		0.00		0.00
		(0.00)		(0.00)		(0.01)
Veto points		-0.14		-0.20		-1.17
		(0.50)		(0.60)		(1.09)
N	329	329	329	329	329	329
Number of events	106	106	85	85	36	36
Log likelihood	374.93	355.21	329.97	317.29	192.17	173.66

Note: Indicated are coefficients (standard errors). 15 temporal dummies and 14 country dummies not reported. * p < 0.1, ** p < 0.05, *** p < 0.01

Globalisation was not found to have any effects on the enhancement of EPL (Table 4). The relations with trade openness and financial openness were positive in all models but failed to reach any level

of significance. Hence, there is no evidence for compensation for globalisation through regulatory reforms. The only significant effect was found for the share of left cabinet seats in the government, which was relatively consistent throughout all three models. Left-wing governments are more likely to enhance EPL, hence some mechanism of compensation might be at work here.

Table 4. Results logit-regression for reforms aimed at EPL regulation

Dependent variables / *Independent variables*	**EPL regulation**					
	Regulation 1a	*Regulation 1b*	*Regulation 2a*	*Regulation 2b*	*Regulation 3a*	*Regulation 3b*
t	0.04	0.03	-0.01	-0.06	-0.01	-0.08
	(0.03)	(0.04)	(0.04)	(0.05)	(0.05)	(0.06)
Trade openness$_{t-1}$	0.01	0.02	0.02	0.01	0.02	0.00
	(0.02)	(0.02)	(0.02)	(0.03)	(0.02)	(0.03)
Financial openness$_{t-1}$	0.00	0.01	0.01	0.03	0.02	0.03
	(0.02)	(0.02)	(0.02)	(0.03)	(0.03)	(0.03)
Unemployment rate$_{t-1}$		-0.02		-0.13		-0.15
		(0.06)		(0.09)		(0.11)
Government balance$_{t-1}$		0.01		0.06		0.10
		(0.08)		(0.11)		(0.13)
GDP growth$_{t-1}$		0.03		-0.02		-0.02
		(0.10)		(0.13)		(0.15)
Corporatism		-0.39		0.00		0.40
		(0.25)		(0.33)		(0.45)
Left cabinet share		0.01*		0.02***		0.02**
		(0.00)		(0.01)		(0.01)
Veto points		-0.27		-0.28		-0.79
		(0.51)		(0.73)		(0.86)
N	329	329	329	329	329	329
Number of events	74	74	39	39	26	26
Log likelihood	330.33	324.41	211.67	197.05	149.52	137.75

Note: Indicated are coefficients (standard errors). 15 temporal dummies and 14 country dummies not reported. * p < 0.1, ** p < 0.05, *** p < 0.01

Increased financial openness was found to have a positive significant effect on the likelihood of EPL deregulation (Table 5: models 1a, 2a and 2b). This is in support of the efficiency hypothesis: greater openness to international capital forces governments to deregulate labour markets

in order to attract investors. No effects of the openness to trade were found. Other indirect economic, political and institutional variables also did not show any significant effects, apart from a positive effect of unemployment rates on the least comprehensive deregulatory reform (1b). This means there is some evidence that governments are more likely to deregulate in times of higher unemployment.

Table 5. Results logit-regression for reforms aimed at EPL deregulation

Dependent variables / *Independent variables*	**EPL deregulation**					
	Deregulation 1a	*Deregulation 1b*	*Deregulation 2a*	*Deregulation 2b*	*Deregulation 3a*	*Deregulation 3b*
t	-0.01	0.00	-0.02	-0.02	-0.06	-0.05
	(0.03)	(0.03)	(0.03)	(0.04)	(0.04)	(0.05)
Trade openness $_{t-1}$	0.01	0.02	0.00	0.00	0.02	0.02
	(0.02)	(0.02)	(0.02)	(0.02)	(0.03)	(0.03)
Financial openness $_{t-1}$	0.03**	0.03	0.03**	0.03*	0.03	0.02
	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)
Unemployment rate $_{t-1}$		0.12**		0.07		0.03
		(0.06)		(0.06)		(0.07)
Government balance $_{t-1}$		-0.04		0.02		0.00
		(0.06)		(0.07)		(0.08)
GDP growth $_{t-1}$		0.00		-0.03		-0.01
		(0.08)		(0.09)		(0.11)
Corporatism		0.27		-0.10		-0.01
		(0.24)		(0.30)		(0.34)
Left cabinet share		0.00		0.00		0.00
		(0.00)		(0.00)		(0.01)
Veto points		0.85		1.18		0.89
		(0.53)		(0.77)		(1.15)
N	329	329	329	329	329	329
Number of events	95	95	66	66	49	49
Log likelihood	390.91	379.87	313.81	307.98	237.55	237.93

Note: Indicated are coefficients (standard errors). 15 temporal dummies and 14 country dummies not reported. * p < 0.1, ** p < 0.05, *** p < 0.01

Conclusions

By looking at the effects of globalisation on the likelihood of specific labour market reforms taking place, this article has cast some new light on the compensation and efficiency hypotheses of globalisation. The findings partly supported the efficiency hypothesis: greater openness to international capital has led governments to retrench and deregulate more. Greater openness to trade has reduced the likelihood for UB to be expanded. There is no direct evidence for a "race to the bottom", but greater exposure to globalisation does seem to lead to a deterioration of labour market protection. The particular effect of financial openness might be on the one hand explained by the influence of international capital over national governments. On the other hand, it should be noted that the financial openness indicator measures the degree to which capital flows are regulated (Quinn & Inclán 1997). It might be that deregulation of capital and labour markets are both the result of a third factor, such as the political party in power or the "variety of capitalism" in a certain country. The latter would be in line with Swank's (2002) findings that the effects of globalisation depend on national institutional features, where decentralised "liberal" economies have chosen a pathway of deregulation and retrenchment, whereas more "coordinated" economies are more likely to keep existing market regulations and welfare structures intact.

In addition, this study confirmed the importance of domestic economic, political and institutional factors, serving either as links between globalisation and reforms or as independent determinants. Conform with earlier studies, high unemployment rates increase the need for UB retrenchment (Allan & Scruggs 2004; Gaston & Rajaguru 2008; Hicks & Zorn 2005; Saint-Paul 1996). Budget deficits did not necessarily trigger retrenchments (Hicks & Zorn 2005; Gaston & Nelson 2004) but did put a brake on further UB expansions. There was also some evidence that left-wing parties will reinforce job

security for their key constituencies (Emmenegger 2009) and in some cases will halt UB retrenchment (Allan & Scruggs 2004; Jensen et al. 2014; Swank 2005). More centralised collective bargaining was found to be an institutional obstacle to the most comprehensive type of UB retrenchment only.

As with other studies using panel data methods in comparative political economy, results are still sensitive to the definition of the dependent variables and the selection of methods and data (see for example Kittel & Winner 2005; Wenzelburger, Zohlnhöfer, & Wolf 2013). This study aimed to address the "dependent variable problem" by analysing reforms as discrete policy events and applying discrete-time logit models. As a first attempt to use this new dataset, these innovations are obviously not free from concerns about validity and reliability, especially regarding the coding of the reforms and choices of cut-off points. To address such concerns, the sensitivity of the models to dependent variables with various cut-off points was explored. In spite of all caution, the models still yielded some robust results.

This study differed from previous studies in the way the dependent variables and methods were selected. First, treating reforms as discrete policy events enabled establishing a more direct link between globalisation and the moment of the implementation of the reform. Using this method, the models performed well in explaining UB reforms, but less so in explaining reforms of EPL. It is not unlikely that it takes a longer time for an economic shock to be felt before governments decide to reform legislation, whereas the need to cut spending on benefits is often a more urgent and automatic policy response. Second, by distinguishing between reforms in UB and EPL, it was possible to scrutinise a "variety of reforms" in the face of globalisation and other economic shocks, taking place against a background of varying political and institutional settings. Third, this article shows that there is no single labour market policy response

to globalisation. In a complex globalised economy and political environment, governments can both compensate as well as enhance efficiency in the labour market, even simultaneously.

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