Dualization and Labor Market Inequality during the Great Recession

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Abstract

European countries during the Great Recession had to deal with massive economic shocks, leading to a surge in employment insecurity. How was this increase in employment risk distributed across societal groups? The prominent dualization hypothesis posits that outsiders, characterized by low labor market attachment, grow particularly vulnerable to a deterioration of employment prospects during recessions, while insiders remain comparatively sheltered from economic fluctuations. Using panel and cross-sectional data from France, Italy and Spain for the pre-crisis, crisis and immediate post-crisis period, we show that this theory did not hold during the Great Recession. Instead, employment prospects deteriorated more rapidly for insiders than for outsiders leading to convergence in labor market conditions of the two groups. We suggest potential explanations for this finding and highlight that the dualization literature needs to be expanded to account for instances of major economic shocks.

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1 Introduction

The combined effects of the 2008 financial crisis and the euro crisis that followed suit caused more lasting economic damage in Europe than the Great Depression of the 1930s (Crafts 2014). Upon the onset of crisis, Eurozone countries hasted to implement large bailout programs to stabilize their financial sectors, in attempts to prevent the crisis from spilling over to the real economy (e.g. Lane 2012; Obstfeld 2013), but in later stages of the crisis, governments were forced to implement tough austerity measures, by retrenching welfare state provision and cutting public spending (Blyth 2013; Frieden and Walter 2017). These policy responses and their effects on aggregate social outcomes such as unemployment and poverty risks have been analyzed in a number of publications. In contrast, we know very little of how the Great Recession affected the distribution of labor market risks within national populations.

A highly prominent account in political science emphasizes that economic downturns result in increased labor market dualization; that is, a strengthened division of the workforce into well-protected insiders in stable employment, and marginally employed outsiders that enjoy a much lower level of social and economic protection. Dualization theory leads us to expect that outsiders bear the brunt of the crisis while protected insiders remain shielded from the vagaries of post-industrial labor markets and that, in extension, the gap in labor market risk exposure widens between insiders and outsiders.

In this letter we show that the Great Recession has provided limited evidence, at best, of increasing labor market dualization. Rather we observe a convergence of risk exposure between insiders and outsiders, as insiders’ employment prospects deteriorate faster than the employment prospects of outsiders. This observation is based on the analysis of panel and cross-sectional data from three strongly dualized economies that were all severely affected by the recession: France, Italy and Spain. We highlight potential mechanisms that may explain the empirical pattern that we uncover and emphasize the need for further research in this field.

2 Theoretical Background

Dualization refers to the existence of segmented labor markets, characterized by the co-existence of primary labor markets offering stable, ‘good’ employment for labor market insiders and secondary labor market with instable and flexible forms of employment for labor market outsiders (e.g. Lindbeck and Snower 1986; Lindbeck and Snower 2001). The divide manifests as structural inequality in the labor market — when employment and career prospects vary systematically across different social groups — but it can also take an institutional form when labor markets are divided by regulatory means (employment protection, wage coordination rules), or when social rights are increasingly differentiated depending on worker employment status.

Within Europe, scholars largely agree that dualization is most pronounced in Continental and

1See for example Bermeo and Pontusson 2012; Greve 2012; Pontusson and Rues 2015; Dovvik and 2014.
2See for example Emmenegger et al. 2012; Häusermann and Schwander 2012; Rueda 2007; Rueda 2005; Palier and Thelen 2010; Lindbeck and Snower 2001; Lindbeck and Snower 1986; Saint-Paul 2002; Saint-Paul 1998.
Southern Europe. While historical trajectories towards dualization vary between these two political economies, cross-class alliances between unions, employers and the state are the driving force of dualization in both cases. In Continental Europe, dualization was the outcome of such an alliance to save industrial core production, in response to recessions in the 1980s and 1990s (Palier and Thelen 2010). High non-wage labor costs in continental Europe increased employer demand for a flexible labor force in an increasingly globalized context (Esping-Andersen 1999). Trade unions — as representatives of insider labor — then traded employment security in favor of economic productivity, allowing for the emergence of a secondary labor market that consisted mainly of cheap and atypical employment (Palier and Thelen 2010).

In Southern Europe, dualization is a structural legacy of the 1960s and 1970s, when demand-led growth models allowed organized labor and capital to engage in competition limitation (Rueda, Wibbels and Altamirano 2015). Unionized workers benefitted from this rent-seeking strategy through higher wages and strong employment protection legislation. While this pacification of the radical labor movement resulted in additional costs for employers, these costs were comparatively easy for them to shoulder given the regularity of currency devaluations (Iversen and Soskice 2018; Rueda, Wibbels and Altamirano 2015). Since then, globalization has shortened business cycles, increasing the necessity of a flexible workforce in Southern Europe too. Policy reforms aiming at liberalizing labor markets have however only done so ‘selectively’ and ‘at the margins’ — thus facilitating atypical forms of employment such as temporary or part-time work, while leaving the privileges of insiders untouched (Toharia and Malo 2000; Regini 2000).

During economic recessions, dualization accounts argue that employment protection legislation and union power largely shelters insiders from economic fluctuations. Firms are however still able to adjust to changing macroeconomic conditions as outsiders are subject to much weaker employment protection and function as employment buffer (Rueda 2007; Rueda 2006). Empirically, these theories thus expect outsiders to bear the brunt of employment crises, as they are the first to be made redundant — partly by means of dismissals, but also via employers reducing work hours and/or relying more heavily on fixed time workers (Eichhorst, Feil and Marx, 2010). Additionally, employment protection reduces the ability of those outside the labor force to (re-)enter the labor market (Emmenegger 2009). Consequently, dualization accounts predict outsiders to be faced with ever stronger labor market risks while the employment prospects of the sheltered insiders remain largely intact.

3 Method

Both Continental and Southern European labor market regimes were characterized by strong dualization at the onset of economic crisis in 2008 — this held across all three country cases that we analyze in this letter: France, Italy and Spain. In contrast, the three countries were effected to varying degrees by the Eurozone financial crisis and also undertook different reform trajectories throughout the recession, thus allowing us to taking these factors into account. Our case selection is therefore particularly well-suited to examine developments of insider-outsider divides throughout
the Great Recession and to explore the possible causes thereof.

The literature has developed two different conceptualizations of insiders and outsiders: a first one based on the current employment status of individuals and a second one focusing on the exposure of individuals to different forms of employment risk. Consequently, we study the employment trajectories of insiders and outsiders for different operationalizations to rule out that our results are driven by specific measurement decisions. We base our analysis on data from the European Survey on Income and Living Conditions (EU-SILC). The sample coverage of this survey is unrivalled per country wave, covering an average of roughly 13,000 (FR), 26,000 (IT) and 18,000 (ES) respondents per country-year across our selected cases. We also specifically leverage the rotating panel of the survey to measure the trajectories of individual labor market prospects during nine years spanning 2005 to 2013, covering thus both the pre-crisis, the crisis and the first post-crisis years.

3.0.1 Status-based operationalization

This first conceptualization classifies individuals as insiders or outsiders on the basis of their labor market contracts. Following Rueda, we code individuals with permanent employment contracts, as well as voluntary part-time workers working at least 20h per week as insiders (Rueda 2006; Lindvall and Rueda 2014). Conversely, we consider individuals as outsiders if they work under atypical conditions (i.e. if they hold fixed term contracts, involuntary part-time contracts, or part-time contracts limiting them to work less than 20h per week, within-family employment). We categorize self-employed individuals as insiders if they have employees working for them and outsiders if they do not. Based on these measurements, we track individuals across three consecutive years, comparing their labor market status between time points t and t-1. We then compare the capacity of insiders to remain in insider employment with the ability of outsiders to attain an insider position. Aggregating these transitions enables us to analyze group-level probabilities of attaining or sustaining insider-status, over time. This measurement in itself represents a strong test of dualization theory, for in all likelihood, one would expect it to be substantially harder for outsiders to gain entry to primary labor markets, than it is for insiders to remain in their current labor market situation — particularly during times of economic downturn.

As an even stricter version of this operationalization, we also employ a ‘prolonged status’ measurement that considers individuals to be insiders only if they sustain their insider position over two consecutive years. As the results of both operationalizations look broadly similar, we include the

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3 For detailed discussions on the different approaches, see Rovny and Rovny 2017; Schwander and Hausermann 2013; Marx and Picot 2018.
4 Both year-specific panel samples are designed to be representative of national working age populations. The number of observations included in the panel data ranges from 8,000 to 11,000 per country-year.
5 Results are robust to the exclusion of self-employed workers.
6 Our argument focuses on the active part of national labor market pools. As such, we restrict our sample to those in working age (20-65 years) and exclude individuals that are inactive on the labor market: i.e. individuals unable to work due to sickness and/or disability, homemakers, pensioners, students and people pursuing military or social service. Importantly, we also conceptualize the unemployed as a separate labor market group and exclude them from our analysis, while acknowledging that jobseekers among the unemployed could also be defined as labor market outsiders. Our decision to examine employed outsiders in isolation is based on our desire to establish an appropriate comparison between insider and outsider groups. As jobseekers may of course be highly employable, there is reason to believe that they are less so than workers with atypical contracts.
7 The rotating panel of the EU-SILC data tracks the labor market status of each individual over three years, allowing us to analyze two transitions per survey respondent. We opt for including both transitions in this letter as this minimizes the risk of potential composition effects of our sample. We also perform separate tests excluding the first or second transition of each respondent. Doing this does not substantially affect our findings and the results of this exercise are included in our appendix.
findings of the latter in our appendix.

3.0.2 Risk-based operationalization

For the risk-based operationalizations, we draw mainly on work by Schwander and Häusermann (2013). They classify individuals on the basis of their prospective risk exposure, which is determined by them belonging to an occupational group with an above-average rate of vulnerable employment i.e. an above-average risk of atypical employment/unemployment. We use the dichotomized version of this measure, which identifies individuals as ‘low risk insiders if they belong to an occupational group with below-average rates of atypical work or unemployment prior to the outbreak of the crisis (baseline year is 2007). Schwander and Häusermann’s measurement is based on multiple forms of vulnerable employment, i.e. involuntary part-time employment, temporary employment, within-family employment and unemployment. Given that unemployment is arguably the most severe form of ‘outsiderness, and in line with a political economy literature focusing specifically on unemployment risks (most importantly Rehm 2011; Rehm 2016) we additionally test the robustness of our findings by defining insiders and outsiders solely based on their pre-crisis unemployment risks (see appendix, figure 4).

4 Results

4.1 Employment prospects deteriorate more substantially for insiders

The top facet of figure 1 displays the percentage of insiders that were able to sustain their labor market status (dark line) and the percentage of outsiders that upgraded to insider status (lighter line) in the following year for the time period 2005-2013. The lower facet conversely shows the development of risk exposure for ‘low-risk’ insiders and ‘high-risk’ outsiders (darker and lighter lines, respectively). Contrary to the predictions of the dualization literature, the analyses reveal that outsiders are not disproportionally affected by the downturn in any of the three countries examined. For one, we clearly see that sustaining or attaining insider employment grows more difficult for both groups over time (upper facet of figure 1). In fact, we find that insiders’ employment prospects deteriorated more strongly than those of outsiders, particularly in the direct aftermath of economic shocks. Our analysis also uncovers in all countries a convergence of risk exposures between insiders and outsiders over time (lower facet).

Figure 1 also displays country-specific differences. Our analyses confirm the dualized nature of labor markets in all three countries at the onset of the crisis, albeit more strongly in the Italian and Spanish cases than in France. French insiders faced an 11% decrease in their ability to sustain their status between the years 2008 and 2009 (compared to a 9% decrease experienced by French outsiders). Effects were markedly stronger in Italy. Italian insiders grew 26% less likely to sustain their insider status in the same time period, while Italian outsiders grew 18% less likely to transition into insider contracts. In Spain too, employment prospects for insiders declined at a more rapid pace than those of outsiders: between the 2008 and 2013, Spanish insiders grew 22% less likely of sustaining their insider status, while outsiders’ prospects of job upgrading declined by 18%. In

For a more comprehensive discussion about this, see Picot and Tassarini 2017; Jessoula et al. 2010.
Spain, we also find evidence of risk flips. Risk flips occur when insiders grow more vulnerable to labor market risks than outsiders in not only relative, but also absolute terms – most typically on account of economic depressions.9 Our findings suggest this to take place at two separate instances. In the years prior to the collapse of the Spanish housing market in 2009, Spanish outsiders’ prospects of attaining an insider position gradually improved, likely due to the housing boom. In 2006, 59% of outsiders managed to upgrade into insider status, while the same figure in 2008 was roughly 65%. Conversely, the ability of insiders to retain their contracts remained stable as the initially flat line for insiders shows. The collapse of the housing bubble in 2009, however, led to a drastic deterioration of outsiders’ employment prospects thus reversing this initial risk flip. We find evidence of another risk flip, with more persistent effects, taking place in 2012.

As to the risk-based measurement of insiders and outsiders, in 2005 French workers in low-risk insider groups were 2.0 times more likely to hold desirable labor market contracts in the following year than those in outsider groups. By year 2013 this ratio had diminished to 1.3. Similar patterns of convergence are also detectable in Italy and Spain: Italian and Spanish insiders went from being 2.2 and 2.5 times more likely of remaining insiders, respectively, to being less than 1.5 more likely in both cases.

9See Rehm 2016.
Thus, while broad trends look similar across all three cases, our findings also point to country differences that point to the relevance of country-specific factors. Importantly, crisis trajectories varied notably between the three cases. All three countries experienced large negative demand shocks in the aftermath of the Great Recession, resulting in negative GDP growth rates in 2009. But while the French economy was quick to recover (the country returned to persistent growth already by 2010 despite persistently high unemployment), the Italian and Spanish recovery remained sluggish. This might explain why employment prospects improve again for French outsiders in 2012 (see figure 1), as French employers start expanding their pool of permanent workers after the immediate shock is over. In Italy, growth returned briefly in 2010/2011, only to turn negative again in 2012 when fears of a banking crisis resurfaced. In Spain, growth was hemmed by the eruption of a substantial banking crisis in 2010 that spilled over to the real economy, despite the governments efforts to contain it. The resulting insolvencies in finance, housing and construction sectors — all insider-dominated sectors with a high share of male employment — affected insiders particularly strongly, likely contributing to the first Spanish risk flip detected in figure 1. The strong vulnerability of these sectors to the crisis has been highlighted by some scholars who dub the recession a ‘mancession’ (Perry 2010). Furthermore, in an effort to combat the crisis, the Spanish government implemented comprehensive labor market reforms in 2010 and 2012 (Pavolini et al. 2015; Picot and Tassarini 2017). These reforms aimed at reshaping the overall efficiency of the labor market and, especially, to reduce the privileges of insiders by smoothening differences in dismissal costs between temporary and permanent contracts (Wöll and Mora-Sanguinetti 2011). Notably, the second risk flip when insider employment prospects deteriorate to below those of outsiders occurred directly after the enactment of these structural reforms. We conjecture that this risk flip is thus likely caused by reform implementation and the sector-specific pattern of the mancession.

5 Avenues for further research

In closing this letter, we discuss potential explanations for the patterns that our analysis has uncovered, as well as how our findings may spur further research and advance our theoretical reflections on labor market dualization. Our findings point to two possible causes for convergence between insiders and outsider employment prospects. First, the Great Recession substantially differs from previous crises upon which dualization theory is based. The magnitude of the economic shock during the time period by far exceeded that of any shock described by existing dualization accounts. More specifically, the crisis strongly affected domestic banking sectors, draining access to credit and causing unemployment to surge as a result of firm insolvencies. Economic shocks that lead to an increase in insolvency rates, rather than a decrease in aggregate demand, do not allow employers to engage in strategic labor shedding. Essentially, when a firm goes bankrupt, all workers become redundant regardless of their employment contract. As such, we suggest that shocks leading to banking crises likely lead to a symmetric increase in unemployment risk for insiders and outsiders.

Second, the Great Recession hit already strongly dualized labor markets. This conditions possible responses as selective flexibilization was no longer a viable path to economic adjustment. It was rather considered part of the problem, as wages and employment prospects did not correspond to
productivity levels. Countries such as Spain were therefore accordingly pressured to lower protection legislation for standard employment and to flexibilize the domestic wage bargaining system (Wöllfl and Mora-Sanguinetti 2011; Pavolini et al. 2015). In other words, the crisis had short-term cyclical effects but affected also more persistent institutional arrangements in ways that directly disadvantaged labor market insiders. This suggests that if crisis persists in highly dualized contexts demands for structural reforms increase. Depending on whether these demands translate into government action or not, we expect to see evidence of risk flips between insiders and outsiders as the short-term effects of flexibilization asymmetrically hit insiders.10

More broadly, our findings challenge conventional dualization theory that considers institutional dualization as a gradual process. During major shocks, crucial actors such as the state, trade unions or employer might act differently than during times of economic normalcy. If employers for instance consider shocks as persistent, their incentive to retain surplus labor throughout the recessionary spell decreases, as the cost of labor hoarding becomes larger than the cost of rehiring workers upon the end of the recession. Simultaneously, the bargaining power of organized labor, as main representatives of insiders, is substantially weakened in the aftermath of crises (Culpepper and Regan 2014) — in particular if countries are pressured into reforms by supranational institutions. These combined factors, we argue, should diminish the probability of increased dualization in event of large-scale economic shocks.

Our results also run counter to accounts that attribute developments in insider/outsider inequality mainly to changes in national employment protection legislation. For we find evidence of convergence between the two labor market groups, even in cases such as France and Italy, where employment protection for regular workers remained largely unaltered throughout the period analyzed in this letter.11 Theory derived from previous European recessions of the 1980s and 1990s, may not hold during the Great Recession as substantial depressions seemingly represent a ‘force majeur’ during which employment protection can no longer sufficiently shelter core workers. We therefore suggest that key assumptions of the insider-outsider model do not hold in the context of the Great Recession and probe the dualization literature to expand its theoretical framework to incorporate events as the Great Recession.

The looming question in our view is whether the deviation from the structural pattern of dualization that we uncover is persistent or transitory: in other words, whether insiders and outsiders’ employment trajectories will continue to converge or if labor markets will grow more unequal again once the turmoil is over. We highlight this as a fruitful avenue for future research. The fact that many countries have implemented structural reform leaves us hopeful for a continued narrowing of the insider-outsider gap. Worryingly, this convergence is however mainly downward convergence – insiders now face more substantial risks than before and employment prospects for outsiders have advanced far from satisfactorily. This, combined with prolonged under-investment in social investment policies such as education, childcare and active labor market policies in the Eurozone South

10Empirically, this pattern has been discussed by Rehm, who argues that uncertainty in the aftermath of the Great Depression led to more homogenous exposure of individuals towards employment risks (Rehm 2016).
11See figure five, included in appendix
(Bonoli 2013), prevents us from closing this letter with an optimistic outlook on future European labor market developments.
References


Appendix

Alternative Operationalizations of Insider/Outsider Divide

In order to increase our confidence in our findings, we undertook a number of robustness checks employing alternative definitions of the insider/outsider divide. Below we present the results of additional analyses.

Status-based Operationalizations

The rotating panel of the EU-SILC data tracks the labor market status of each individual over three years, meaning that we track two labor transitions per survey respondent. Given this, we also run separate tests excluding the first or second transition of each respondent. Doing this does not fundamentally affect our findings, as the overall rate at which insiders transition out of insider employment conditions remains higher than the rate at which outsiders transition into insider employment. In examining individual-level change and continuity over a singular annual threshold, group trends become more volatile. As per-year respondent samples are designed to be nationally representative, this increased volatility is likely caused by the fact that respondent pools grow more biased when we subset our data to look only at the first/last transition of each individual.

Figure 2: Status-based operationalization: Only First/Last Transition
Dashed lines demarkate start of the Great Recession (year 2008).
As a stricter version of our status operationalization, we performed analysis by employing a prolonged status definition of insiders and outsiders. This definition considers individuals to be insiders only if they sustain their insider position over two consecutive years prior to our year of interest (i.e. at t-1 and t-2), and, similarly, individuals to be outsiders only if they remain in atypical employment over two consecutive years prior to our year of interest.

Employing this operationalization alters our findings in two main ways. First, in France the convergence trend between insiders and outsiders no longer holds after 2010. Still, French outsiders do not seemingly bear the brunt of employment shock in the aftermath of the crisis, as employment prospects deteriorate more strongly for insiders after 2008. Second, we can no longer find as evidence of a clear risk-flip in Spain in 2008 — nonetheless, the employment prospects for insiders do deteriorate between 2007 and 2008, while they conversely improve for outsiders during the same period.

![Status-based Operationalization: Prolonged Status](image)

**Figure 3: Status-based operationalization: Prolonged Labor Market Status**
Risk-based Operationalization

Given that unemployment might be the most severe form of outsidership, and in line with a political economy literature focusing specifically on unemployment risks, we additionally test the robustness of our findings by defining insiders and outsiders solely based on their pre-crisis unemployment risk exposure. Overall, employing this alternative operationalization does very little to change our findings.

Figure 4: Risk-based operationalization: Only Unemployment Risk
Development of Employment Protection Legislation

Figure 5: Employment Protection Legislation of Regular Contracts: 2004-2013. Based on OECD EP strictness indicator of regular contracts (individual & collective dismissals, version 1), scaled 0-5.