Late-career Risks in Changing Welfare States
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Part I
Background
1 Introduction

Industrialized societies are undergoing dramatic demographic changes. As a result of growing life expectancy and low fertility rates, all countries are experiencing declines in the size of the working-age relative to the older population: The so-called ‘elderly dependency ratio’ is increasing. The consequences of these demographic changes extend far beyond the economic realm, but one of their most serious and best understood implications is that they threaten the solvency of public pay-as-you-go (PAYG) pension schemes. Potential labor shortages are another scenario troubling policymakers and employers alike.

Across industrialized countries, policymakers are therefore seeking to raise employment levels, and older workers in their 50s and 60s are one population group that is receiving considerable attention in this context. This is especially true in many Continental European countries which even until the 1990s actively promoted early retirement as a means of reducing labor supply and thereby unemployment (Kohli et al. 1991; Ebbinghaus 2006). While preventive policies such as health promotion and lifelong learning also have their place, at least in theory, cutbacks in (early) retirement benefits are a straightforward way of improving the sustainability of PAYG schemes. Lower retirement benefits not only directly reduce pension outlays; they should also induce individuals to postpone retirement and remain in the labor force, thereby increasing labor supply, tax revenue, and contributions to public insurance schemes.

Reforms intended to raise employment levels have not been confined to public pension schemes. Other key welfare state programs such as unemployment insurance and disability benefits also underwent major reforms in many advanced countries during recent decades, with the ‘activation’ of older workers and other groups such as single mothers and the long-term unemployed being a top priority. Generally speaking, this goal has been pursued through a combination of ‘enabling’ and ‘demanding’ policy changes (Eichhorst et al. 2008; Eichhorst and Konle-Seidel 2008): Enabling reforms include the expansion of active labor market policies such as training measures, policies facilitating the reconciliation of paid and care work, and instruments that seek to raise the net gain from working such as wage subsidies or negative income taxation. Examples of demanding reforms are the tightening of readiness-to-work requirements and suitability criteria or cuts in the level and duration of benefits.

One possible interpretation of these changes is that they reflect necessary and inevitable responses to demographic changes and other challenges
facing advanced economies. A second, less benign interpretation is that they form part of a more general trend toward a (re-)privatization of key life risks formerly covered by public provisions (Hacker 2006; Breen 1997; O’Rand 2011). In both the United States and Europe – and in academic circles as well as the general public – there is a widespread perception that workers and families are facing greater economic insecurity today than they did twenty or thirty years ago (Western et al. 2012; Lengfeld and Hirschle 2009) – and commentators on both sides of the Atlantic view changes in welfare state programs and their functional equivalents, in particular employer-based social protection, as one of the main causes of this increase in economic insecurity.

Especially in the United States, there is no shortage of bold and discomforting claims about an alleged decline of social protection and its ramifications for income security. For example, in The Great Risk Shift, his widely read book on rising economic insecurity in the United States, Yale political scientist Jacob Hacker (2006: 6ff.) writes:

Insecurity today reaches across the income spectrum, across the racial divide, across lines of geography and gender [...] By the early 1970s, it [America’s distinctive framework of economic protection, J.P.H.] worked tolerably well in insulating most middle-class Americans from the major financial risks of a capitalist economy. Today, however, it is falling apart under the weight of political attack and economic change [...] Through the cutback and restructuring of workplace benefits, employers are seeking to offload more and more of the risk once pooled under their auspices. Facing fiscal constraints and political opposition, public social programs have eroded even as the demands on them have risen.

Echoing that sentiment, Peter Gosselin (2009: 8) asserts:

[T]here is another more immediate cause for [...] insecurity [...] : an increase in the risk that Americans must bear as they provide for their families, pay for their houses, save for their retirement, and grab for the good life. The increased risk is the product of a shift of economic dangers from the broad shoulders of business and government [...] to the backs of working families. And the shift has not just affected the working poor and those in the great statistical middle, but has reached households long thought immune to dislocation [...].

Both passages contain at least three claims: First, economic insecurity has risen. Second, this rise in insecurity is not confined to lower strata or
low-income households but reaches well into the middle and perhaps even the upper classes. Third, the erosion of public and – particularly important in the American case – employer-provided income support and protection programs is a major cause of this trend towards heightened insecurity.

While there are no equally influential and widely read books describing such trends for Germany, similar claims are familiar from public as well as academic debates. Recently, Lengfeld and Hirschle (2009) noted a heightened sense of economic insecurity, especially among the middle classes, and a 2008 report by Grabka and Frick stirred considerable debate as to whether the German middle class was ‘shrinking’. In addition, there is a widespread perception that Germany’s system of social protection has become considerably less generous since the 1970s and 1980s, a perception that became even more prominent after the so-called ‘Hartz reforms’ of the early 2000s, but had been widely held already before that time. The following passage from Christoph Butterwegge’s (2006: 9) book on the German welfare state (translation J.P.H.) nicely illustrates this view:

A central thesis of this book is that the welfare state is being restructured and dismantled since the middle of the 1970s [...] the neoliberal turn brings with it the end of the welfare state known from the ‘old’ Federal Republic; however, a US-style society characterized by high performance and fierce competition is not a desirable alternative for the majority of the population.¹

Not only is this passage strikingly reminiscent of Hacker’s and Gosselin’s descriptions of welfare state change in the US, it also highlights the importance of the United States as a (dystopian) reference point in German and European social policy discourse. Thus, the term ‘Americanization’ is frequently invoked as a synonym for welfare state retrenchment or a ‘race to the bottom’ (Starke et al. 2008: 981; see also Alber 2010).

Against this background, this study seeks to contribute to a well-founded empirical assessment of these claims about the direction and implications of welfare state change. It does so by focusing on the situation of workers above age 50 in Germany and the United States during the 1980s, 1990s, and 2000s.

¹ ‘Eine zentrale These des Buchs lautet, dass der Sozialstaat seit Mitte der 1970er-Jahre restrukturiert und demontiert wird [...] die neoliberalen Wendes [bringt] zwar das Ende des Wohlfahrtsstaates, wie ihn die “alte” Bundesrepublik kannte, mit sich; eine Hochleistungs-, Konkurrenz- und Ellbogengesellschaft nach US-amerikanischem Muster bietet aber für die Mehrheit der Bevölkerung keine erstrebenswerte Alternative.’
Older workers are a particularly interesting case because they are one of the groups who have arguably been most strongly affected by recent welfare state change: Besides changes in public PAYG pension schemes, reforms that have likely had a disproportionate effect on older workers include the retrenchment of long-term unemployment and disability benefits. In addition, the consequences of the shift from defined-benefit (DB) to defined-contribution (DC) plans as the predominant type of employer-provided pension plan in the US – a core element of the ‘Great Risk Shift’ according to Hacker and Gosselin – will be most directly felt by individuals near and beyond retirement age.

Recent decades have also seen rapid change in arenas other than social policy. Increasing mobility of capital and labor, rising internationalization of production, growing product market integration, and rapid technological progress are only some of the far-reaching changes that are sometimes subsumed under the umbrella term ‘globalization’ (Blossfeld et al. 2007a). In a comparative volume on Globalization, Uncertainty and Late Careers in Society Blossfeld et al. (2006) suggest that older workers are among the losers of accelerated structural change because employers may view ‘late-career employees as an increasingly expensive and inflexible burden’ (p. 3). This suggests a gloomy scenario where the labor market prospects of older workers deteriorate, while welfare state provisions that would formerly have alleviated their lot are being scaled back to promote longer working lives.

To explore the actual implications of these (alleged) trends for older workers, I will combine a detailed analysis of German-American differences and trends in key welfare state programs with an analysis of ‘how real lives are really lived’, as Goodin et al. (1999: 1) put it in their seminal book on the Real Worlds of Welfare Capitalism. In a first step, I will provide a thorough account of relevant welfare state provisions and employer-based social protection. Subsequent parts of the study will then use longitudinal data from the German Socio-Economic Panel (SOEP) and the American Panel Study of Income Dynamics (PSID) to investigate the financial consequences of two crucial ‘trigger events’ (DiPrete and McManus 2000): involuntary job loss and retirement in the sense of long-term exit from work.

In addition to current debates about economic insecurity and the direction of recent welfare state change, this study also speaks to broader questions about the relationship between (macro-level) institutions and individual life courses. Until the 1980s or even the 1990s, life course sociology was preoccupied with identifying secular and universal trends in overall life course patterns, as captured by the distinction among traditional, industrial, Fordist, and Post-Fordist life courses (Mayer 2005). Since then,
and due in part to the growing availability of longitudinal micro data, research has increasingly focused on the extent and institutional sources of variability beyond these highly stylized distinctions (e.g., Mayer 1997, 2005; DiPrete 2002; Leisering 2003; Diewald 2010). Much of this research, however, has analyzed midlife or early career trajectories such as the transition from school to work. Comparative research on the later life course has so far predominantly focused on the timing of retirement (e.g., Kohli et al. 1991; Maltby et al. 2004; Blossfeld et al. 2006; Schils 2008; Radl 2010). There is much less comparative research on the income trajectories of older workers and retirees, even though household income mobility undoubtedly is a crucial life course outcome (DiPrete 2002; Mayer 2005). This study directly addresses this research gap.

On a very general level, the primary research questions of this study can thus be summarized as follows:

1. How do the financial consequences of exit from work and late-career job loss differ between the United States and Germany?
2. Have the financial consequences of these events changed over time? In particular: Are they increasingly associated with declines in economic well-being?
3. To what extent can country and period differences be attributed to differences in welfare state provisions?

The remainder of this introduction is divided into three sections. In the next section, I further elaborate why I selected Germany and the United States as country cases. In Section 1.2, I sketch the rationale for studying the real-life consequences of (changing) welfare state arrangements by focusing on income mobility around potentially adverse life events. Section 1.3 concludes with a brief overview of the study.

1.1 Why compare Germany and the United States?

A primary reason for selecting Germany and the United States is that they are important and paradigmatic reference points in two of the most influential accounts of institutional variability across industrialized countries: the welfare regimes approach associated with the work of Gøsta Esping-Andersen (1990) and the varieties of capitalism (voc) approach set out in an edited volume by Peter Hall and David Soskice (Hall and Soskice 2001b).

Welfare state scholars consider Germany the prime example of a conservative (or corporatist) welfare state. Conservative welfare states feature
high contribution-based and earnings-related public benefits that serve the goal of status maintenance (Esping-Andersen 1990). Labor markets tend to be regulated with relatively strong employment protection, which reduces labor market turnover and stabilizes careers, possibly resulting in a marked divide between ‘labor market insiders’ with secure jobs and ‘outsiders’ such as low-skilled workers or labor-market entrants and re-entrants (Blossfeld et al. 2007b; Gießelmann 2009).

The US, by contrast, epitomize the so-called liberal (or residual) welfare state that emphasizes individual responsibility. Public benefits tend to be meagre and of limited duration. They are often means-tested and/or restricted to certain (‘deserving’) population subgroups such as families with children or the disabled and the elderly. The flip side of limited public benefits is a greater salience of private and employer-provided benefits in pensions and health care. The labor market is relatively unregulated and turnover is high. Social services are even less developed than in the ideal typical conservative welfare state, but the private service sector is larger due to (downwardly) flexible wages and a large immigrant workforce.

While some authors have drawn on the VOC approach to explain country differences in systems of social protection (Estevez-Abe et al. 2001; Iversen 2005), it is primarily a typology of different production systems characterized by distinctive configurations of economic governance mechanisms, skill (and skill formation) regimes, and product market strategies. The basic distinction put forward by the VOC approach is between ‘coordinated’ and ‘liberal’ market economies – with Germany exemplifying the former and the US the latter type of economy. In fact, Germany and the United States are the two countries Hall and Soskice use to illustrate the coordinated-liberal distinction in their introduction to the 2001 volume (Hall and Soskice 2001a).

According to the VOC account, German firms pursue a strategy of incremental innovation or ‘diversified quality production’ (Sorge and Streeck 1988) that relies heavily on workers’ industry/occupation as well as firm-specific skills. In this ‘specific skills regime’ both firms and workers have strong incentives to enter into long-term relationships: Because they are difficult and costly to replace, employers want to hold on to workers who are equipped with the necessary industry-, occupation-, and firm-specific skills. Well-matched workers, too, have high stakes in their jobs, as they allow them to reap the returns on their investment in non-portable skills. From this point of view, Germany’s more generous early retirement or ‘welfare-sustaining employment exit policies’ (DiPrete et al. 1997: 328) are not simply the outcome of a stronger labor movement. They can also be seen as devices that ‘allow firms that operate production regimes requiring
employee loyalty to release labor without violating implicit contracts’ (Hall and Soskice 2001a: 50).

The typical American firm, by contrast, follows a strategy of ‘radical innovation’ (Hall and Soskice 2001a: 39) that relies more on general skills which are portable across firms and even industries. Labor market turnover is higher than in coordinated market economies. This may partly be due to lower levels of employment protection, but the voc approach argues that there will also be less demand for such protection on the part of workers in liberal market economies, because greater emphasis on portable general skills makes job loss less costly.

The welfare regimes and voc approaches have provided important cues for attempts to identify systematic cross-national variability in life course patterns (see, for example, Mayer 1997, 2005; DiPrete 2002; Diewald 2010) and according to Mayer (2005: 35) ‘a plausible argument can be made that major institutions and a series of life course outcomes do in fact cluster to a considerable extent’. This study contributes to these ongoing debates about the identifiability of distinct life course regimes by focusing on one aspect of the life course that has so far received only limited attention – changes in economic well-being during the late career and at the transition to retirement – and by doing so in two countries that figure as important reference points in both the welfare regimes and voc literatures.

Yet, while the findings of this study are certainly relevant to these debates, I opt for an in-depth comparison of two countries rather than a broader comparison of multiple countries from different regimes. This approach is in the spirit of Mayer (2005: 36) who opines that regime-style typologies are too coarse for ‘establishing credible links’ between institutions and individual life course outcomes and goes on to argue that there is ‘no alternative than to resort to the level of particular countries and particular institutions’ (ibid.). The implicit hope here is that intimate knowledge of institutional configurations – as opposed to abstract and stylized regime-style classifications – will shorten the ‘inferential leap’ involved in (causally) attributing country differences in life course outcomes to country differences in institutions. Equipped with such detailed institutional knowledge, a researcher may be able to rule out some explanations that are plausible from a welfare regimes perspective. In a related vein, Alber (2010) argues that at least some widely held beliefs about differences between the American and European welfare states turn out to be exaggerated when confronted with institutional realities.

It is also important to stress that in this study the country comparison is only one of two axes of comparison, the second being the within-country
comparison across time. As later parts of the study will show in more detail, Germany and the United States are interesting cases for such a within-country comparison because both countries have seen considerable, albeit quite different, changes in their systems of social protection over the last three decades. As Chapter 3 will explore in greater detail, public pension replacement rates in both countries have fallen modestly over the course of observation period. In Germany, a perhaps even more consequential development has been the retrenchment of generous early retirement options in the public pension pillar and their functional equivalents in other welfare state programs. As noted above, such programs are often seen as a key functional requirement of a labor market that emphasizes non-transferable skills and is characterized by marked occupational boundaries that constrain displaced older workers’ opportunities for reemployment. This suggests the possibility of an ‘institutional mismatch’ where displaced older workers are faced with increasing pressures to return to work, while other institutional factors restrict their opportunities for actually doing so. In the United States, the most consequential changes have arguably occurred in the sphere of employer-provided pensions, where DB pension plans have increasingly been replaced by DC pension plans, which has shifted investment risks from employers to workers.

1.2 Why study income mobility around job loss and retirement?

There are many possible ways to study how the ‘real lives’ of citizens vary across countries and over time. The approach taken in this study is to examine how the income situation of workers and their families changes around two (potentially) adverse ‘trigger events’: late-career job loss and exit from work. This approach entails two general commitments: to focus on the income situation of individuals (as opposed to other outcomes such as subjective well-being) and to focus on changes around major life events (as opposed to, say, cross-sectional inequalities).

Disposable income is an interesting outcome because of its presumably close relationship to individual (economic) well-being, particularly if certain corrections are made for differences in household needs. As I will further discuss at the beginning of Chapter 2, there is a long-standing debate in social philosophy and welfare economics about the nature of individual welfare (or well-being). Even though many authors convincingly argue that well-being must ultimately be conceptualized in terms of ends that are
valuable in themselves (such as ‘utility’ or ‘capabilities’), few would dispute the claim that, at least in advanced economies, income is a crucial resource for achieving such ends.

For good reasons, income maintenance and prevention of income poverty are therefore typically seen as important objectives of welfare state policy (Goodin et al. 1999). Welfare states broadly construed do many things other than promoting income security (e.g., provide social services), yet programs whose primary function is to provide (partial) protection against the adverse economic consequences of ‘life course risks’ (DiPrete 2002) arguably form the core of the welfare state. Thus, many of the major welfare state programs operate on the ‘principle of causality’ (Kausalprinzip; Alber 1982: 27) whereby eligibility for a certain type of benefit is contingent on the occurrence of a specific life course risk. For example, unemployment benefits are intended to cover workers who have (involuntarily) lost their job. Other programs such as means-tested programs that provide basic income support are not clearly targeted at those who have experienced a specific event, but their contribution, too, may be most clearly visible after the occurrence of adverse events with the potential to trigger downward income mobility. In other words, welfare state programs are the prototypical set of ‘societal institutions’ that ‘mitigate the consequences of […] events [with the potential to change a household’s life conditions]’ (DiPrete 2002: 267).

Job loss is a paradigmatic life course risk: It often strikes unexpectedly and is usually accompanied by an episode of unemployment without any labor income. In addition, research on so-called ‘scar effects’ suggests that earnings losses may persist long after reemployment (Arulampalam 2001; Gangl 2004a; Farber 2005). Retirement (in the sense of exit from work) is a more ambiguous event. It also entails economic risks, as it is associated with a decline in labor income. However, it is often a long-anticipated transition that households financially prepare for in various ways, some of them mandatory such as participation in public PAYG schemes, some of them voluntary such as most forms of individual or employer-subsidized saving. Given that retirement is often anticipated, it might be considered an abuse of terminology to call it a ‘risk’. Yet, as I will argue in more detail in later chapters, there are many reasons why public pension schemes and (the regulation of) second- and third-pillar pensions can be expected to influence how well-prepared different kinds of workers are for their retirement – and thus how their income situation changes in the course of that transition.

In addition, not all late careers unfold as planned. In particular, previous research suggests that retirement often occurs rather unexpectedly:
A non-negligible number of workers retire earlier than planned due to unforeseen adverse events, with job displacement and health problems being the primary triggers of such ‘involuntary early retirement’ (Szinovacz and Davey 2005; Lachance and Seligman 2010). The two events examined in this study – job loss and retirement in the sense of exit from work – are thus interrelated. I take this interrelationship into account by making a basic distinction between involuntary retirees who retire after suffering an involuntary job loss or a sudden decline in health and voluntary retirees whose retirement choices are not immediately constrained by these events. More concretely, my analysis of retirement will focus on income dynamics among voluntary retirees. The analysis of late-career job loss then complements this analysis by looking at employment/retirement and income trajectories around one crucial trigger of involuntary early retirement. Accounting for differences in control over retirement is crucial when it comes to assessing the consequences of recent welfare state change: Workers whose late careers are interrupted by job loss or health problems likely find it more difficult to comply with the new paradigm of late retirement than workers whose late careers run smoothly.

1.3 Overview of the study

The study consists of nine chapters, which are divided into four parts.

Part I places the study in the recent empirical literature on income mobility and develops a general analytical framework. It also provides a detailed account of relevant institutional differences between Germany and the United States and of recent changes in key welfare state programs. More specifically, Part I contains three chapters in addition to this introduction.

Chapter 2 begins with a discussion of the study’s main outcome variable: household income mobility. I then situate my approach within the context of recent mobility research. Following DiPrete (2002) and others, I argue that the analysis of household income mobility around ‘trigger events’ is a promising approach for understanding how (changes in) welfare state provisions and institutional context more generally affect the lives of ordinary citizens. My review of the trigger events framework suggests three general questions to be addressed in the subsequent analysis: What are the key welfare state programs for cushioning the impact of retirement and late-career job loss and how have these programs changed over time? How do institutions shape the rates of countermobility conditional on the
occurrence of an event – for example, how do displaced older workers’ reemployment chances differ between Germany and the US and over time? And: How does the scope for ‘family buffering’ through the incomes of other household members vary across countries and periods? The chapter concludes with a discussion of the relationship between late-career job loss and exit from work. As discussed above, I argue that it is sensible to adopt a basic distinction between voluntary retirees whose retirement choices are not constrained by job loss or the onset of health problems and between workers whose late careers are interrupted by these events, as the latter may find it more difficult to comply with the ‘new paradigm’ of late retirement.

Chapter 3 focuses on institutional factors that are relevant to the three questions identified in the previous chapter. I first discuss a set of interrelated factors (strength of labor market boundaries and employment protection legislation, continuing training participation, statistical age discrimination) that are often argued to influence the demand for older workers and the reemployment chances of displaced older workers in particular. My review suggests that the reemployment opportunities of displaced older workers are more limited in Germany. I then provide an in-depth analysis of German-American differences and recent trends in relevant welfare state programs. In addition to public and complementary pensions (i.e., employer-sponsored and individual private pensions), I examine earnings-related unemployment benefits and disability benefits, which often serve as temporary bridges for early retirees who are not yet eligible for standard retirement benefits. I also briefly discuss means-tested assistance/welfare benefits and progressive income taxation. I then explore country and period differences in household earnings arrangements that are likely to influence the extent of family buffering. The chapter concludes with a summary of key differences and trends in the two systems of social protection.

In Chapter 4, I describe my empirical approach for investigating the consequences of late-career job loss and voluntary retirement. I introduce the so-called counterfactual account of causality and discuss when and why the construction of an appropriate control or comparison group is essential for identifying the effect of an event. I argue that comparisons to a control group are not required for voluntary retirees because the relevant counterfactual is not well-defined, but that such comparisons are indispensable when investigating the impact of job loss. I also review difference-in-differences matching (DID matching) as a promising empirical strategy for identifying the effects of events and elaborate my own implementation of this approach. I conclude with a few essential technical details of empirical analysis.
Part II contains the empirical analysis of income mobility around retirement in the sense of exit from work.

Chapter 5 lays the ground for the empirical analysis of income dynamics around retirement. Drawing on research in psychology, behavioral economics, and sociology, I argue that – contrary to the predictions of neoclassical economics – even voluntary retirement may be associated with substantial declines in economic well-being. I then combine this account with the institutional information provided in Chapter 3 to formulate expectations for the empirical analysis. I conclude with a review of previous longitudinal research on income changes at retirement.

Chapter 6 confronts the hypotheses from Chapter 5 with an empirical analysis of income trajectories around exit from work. I examine average income changes relative to preretirement levels, the prevalence of poverty entries, and the proportion of workers with large declines in disposable income (i.e., declines of more than a third and more than half). I compare losses before and after taxes and transfer and changes in different income components to get a better sense of country and period differences in the importance of public and complementary pensions. The chapter concludes with an analysis of differences by level of education and retirement age.

Part III presents the empirical analysis of employment/retirement and income trajectories around late-career job loss.

Chapter 7 again prepares the empirical analysis. Based on standard theories of job search I provide a stylized account of how supply- and demand-side factors influence the likelihood that displaced older workers return to work. I then draw on the institutional information provided in Chapter 3 to formulate a set of hypotheses and research questions for the empirical analysis. The chapter concludes with a brief review of relevant previous research.

Chapter 8 provides an empirical analysis of employment patterns, income trajectories, and changes in spousal labor supply around late-career job loss. Throughout the chapter, I provide DID matching estimates of the impact of late-career job loss as well as simple non-differenced estimates of employment/income trajectories among displaced workers. I begin with an analysis of employment and income changes for displaced workers as a whole. I then analyze changes in spousal labor supply around late-career job loss and conclude with a disaggregated analysis that differentiates between ‘involuntary retirees’ who leave employment after late-career job loss and ‘returners’ who become reemployed.
Part IV consists of only one chapter, Chapter 9, which summarizes the main findings of the study and relates them to the research questions and broader debates highlighted above. I close with a short discussion of open questions and directions for future research.