CHAPTER TWELVE

West European Welfare States in Times of Crisis

David Rueda

Introduction

It is well known that relative poverty has increased dramatically in a number of industrialized democracies in recent times. In a 2008 report, before the effects of the Great Recession had been realized, the OECD observed that the period from 2003 to 2008 had seen growing inequality and poverty in two-thirds of OECD countries (OECD 2008). The report showed that in the mid-2000s, the percentage of people with an income (after taxes and transfers) below 60% of the median was higher than 20% in Australia, Ireland, Japan, New Zealand, Portugal, Spain and the USA. Decades of rapid growth, therefore, had failed to make a significant dent on relative poverty. Facing the Great Recession, these developments made Tony Atkinson ask: "If a rising tide does not lift all boats, how will they be affected by an ebbing tide?" (Atkinson 2008).

Relative poverty (and its close relation, inequality) is frequently invoked as an explanation of a number of crucial issues in political science. It is often considered a determinant of processes as diverse as the decline of electoral turnout (Verba, Nie and Kim 1978, Rosenstone and Hansen 1993), the increase in the support of extreme-right parties (Betz 1994), or the likelihood of political conflict (see, Lichbach 1989 for a review). At the same time, work by labor economists demonstrates that supply and demand factors alone cannot account for cross-national variation in inequality (Freeman and Katz 1995, Blau and Kahn 1996, and Gottschalk and Smeeding 1997). Most analysts would agree that policy influences relative poverty in significant ways.

The effects of the present economic crisis will be devastating in a number of respects. This paper will focus on the potential effects of the crisis on relative poverty. It emerges as a reaction to a general impression (in the general press as well as in academia) that the "automatic stabilizers" of the welfare state in most of Western Europe will significantly diminish the effect of unemployment on inequality. While a very public debate has taken place on the role of temporary fiscal stimulus measures during the crisis, however, much less attention has been dedicated to the effects of the automatic stabilizers in the tax and transfer system. There is, in fact, a lack of research in economics on automatic stabilization (as argued in Blanchard 2006).[1] It is true, as I will show below, that the welfare state was an effective buffer between unemployment and poverty in the past. As Atkinson has pointed out, when we look at the distributional impact of unemployment in the recent past (for example, in the mid-1980s), we see that the impact of unemployment on household living standards depended on government policy. In the mid-1980s, unemployment in Europe was around double that in the 1970s and four times that in the 1960s, but "it was not inevitable that unemployment led to mass poverty" (Atkinson 2008).

This paper explores the question of whether we should assume that the welfare state today remains a powerful buffer between unemployment and poverty. The main argument can be stated very simply. It starts from (1) the consideration that unemployment has adverse consequences for relative poverty, (2) it recognizes that the welfare state can work as a buffer between unemployment and poverty, (3) it proposes that the transformation from welfare to workfare has diminished the influence of social policy as an intermediary between unemployment and poverty, (4) it explores what the consequences of this welfare state transformation are for poverty in industrialized democracies, and (5) it analyzes the consequences of the present economic crisis on unemployment and speculates on what those consequences may be for poverty. The next section will briefly address (1) and (2), and the following sections in this paper will explore (3), (4) and (5) in more detail.

Unemployment, the Welfare State and Poverty: Argument and Previous Experience

It is not very controversial to propose that unemployment has the potential to promote relative poverty. The first reason for this is a very direct one. To the extent that the unemployed receive benefits that are lower than the wage they would receive if they were employed (or receive no benefits at all), an economy with large numbers of unemployed people will have more people in relative poverty than one with lower numbers. A majority of households rely on earnings for their income. Unemployment therefore usually represents a large decline in income that will push some people under the poverty line (this may be made worse by the higher vulnerability to unemployment of people already close to the poverty line).

The second effect of unemployment on poverty is more indirect and it works through its influence on wages. The basic insight of the literature on labor market segmentation is that unskilled, low-paid workers are more readily substitutable than more skilled, high-paid workers, and consequently that their bargaining position is more immediately and more adversely affected by unemployment (Galbraith 1998, Bradbury 2000). In this framework, the rate of unemployment can be considered a significant measure of the overall demand for labor or, in other words, the "tightness" of labor markets. Tight labor markets strengthen workers' bargaining power vis-à-vis employers. Since unskilled/low-paid workers are more readily substitutable than more skilled/high-paid workers, their bargaining position is therefore more immediately and more adversely affect by unemployment. By this logic, high unemployment causes wage dispersion which then produces relative poverty.[2]

A number of studies have produced evidence in agreement with the arguments above. Early studies of economic recessions in the US show that income inequality increased during recessions and decreased during expansions (see, for example, Thurow 1970). Using the framework developed by Blinder and Esaki (1978) to analyze the effects of unemployment and inflation on income inequality and poverty, several authors have found unemployment to be significantly inegalitarian (see, for example, Blank and Blinder 1986, Blank and Card 1993, and Romer and Romer 1999).

Taking these arguments into consideration, the importance placed on controlling unemployment for the promotion of equality is understandable. In Scandinavia, the low poverty model for the rest of industrialized democracies, politicians have been very explicit in their claims that "nothing is more important for income distribution than keeping the unemployment rate low" (Aaberge et al 2000: 79). As mentioned in the previous paragraph, however, the inegalitarian effects of unemployment are based on two essential factors: those affected by unemployment suffer significant income losses and the incidence of unemployment is concentrated on low-skill/low-pay workers.

The direct role of the welfare state in influencing the income losses of the unemployed is straightforward. A more generous welfare state will minimize these losses both by having a high replacement rate for social benefits and by covering a large amount of the population under the blanket of social protection. Social benefits provide a way to redistribute wealth to the poor and to insure them against labor market risks (Moene and Wallerstein 2003).[3] As argued by Esping-Andersen, by insuring the poor against labor market risks, welfare programs reduce people's dependence on employment as a source of income (1990). These effects are, however, more ambiguous when we consider the relationship between social policy and unemployment. In a 3-equation New Keynesian approach (IS-PC-MR) to unemployment, an increase in unemployment benefits would shift the wage-setting curve upwards and increase unemployment. Similarly, in a Beveridge curve approach to unemployment, an increase in unemployment benefits that weakens job search intensity would increase equilibrium unemployment.[4] If high reservation wages increase the income of the lowest paid but also promote higher levels of unemployment (by pricing out low-skilled workers), its effects on income inequality may not be straightforward.

While the paragraph above emphasizes the passive side of the welfare state, active policies have become an important part of the analysis of the effects of unemployment on poverty. Starting in the 1990s, arguments emphasizing the need for activation (or social investment) started to dominate the debate about the welfare state in industrialized democracies. The perception, in the words of Frank Vandenbroucke (former Minister for Social Affairs and Pensions in Belgium) was that "the traditional

welfare state is, in a sense, predominantly a passive institution. Only once there has been a bad outcome is the safety net spread. It is surely much more sensible for an active state to respond to old and new risks and needs by prevention" (2001: 4). In this view, "social policy should shift from consumption and maintenance-oriented programs to those that invest in people and enhance their capacity to participate in the productive economy" (Jenson and Saint-Martin 2003: 86). Higher levels of active labor market policy were then expected to limit the effects of unemployment on inequality and poverty.

Active labor market policy is particularly important as a part of the welfare state because it is recognized as one of the policy options still open to government in an era characterized by international openness. The effectiveness of traditional demand-management policies is questionable in increasingly open economies. In an open economy, however, some options are still available to governments. Active labor market policy belongs within the group of supply-side policies that can be used by partisan governments to promote employment, growth and equality in an environment characterized by increasing levels of internationalization (see Garrett and Lange 1991 and Boix 1998).

The effect of active policies on the relationship between unemployment and inequality is, again, not unambiguous. If activation means more and better training for those with low skills in the labor force, then it will promote higher productivity (and, consequently, lower unemployment and income inequality). If activation, on the other hand, means a reduction in the generosity of social benefits and an increase in punitive active labor market policies to push individuals into low-pay employment, then it may increase income inequality and poverty while decreasing unemployment.[5] Active measures may be inegalitarian also through their effect on wages. Successful active policy (if directed to promote low-pay jobs) may promote the entry into employment of individuals who simply underbid wage demands and increase low-wage competition (see Saint-Paul 1998 and Calmfors 1994).

The paragraphs above make clear that two things are needed when analyzing the effects of the welfare state on poverty. First, the effects of social policy on unemployment need to be explored. Second, the direct effects of social policy on relative poverty and those of unemployment (conditional on different

levels of social policy) need to be assessed. Considering the previous arguments, four scenarios are possible.

[Table 1]

Table 1 attempts to put into a graphical form the expectations outlined in the previous paragraphs. When passive labor market policies (PLMP) and active labor market policies (ALMP) are both low, the expected negative effect of passive policy and the expected positive effect of active policy on unemployment would be muted. With regard to income inequality, unemployment was hypothesized to increase it, because (within the framework of an ungenerous welfare state) the unemployed receive benefits that are lower than their potential wages, the poor are vulnerable to more low-wage competition, and there are few active measures to benefit from. When ALMP is high but PLMP is low, it was argued that employment could grow (if activation means more and better training). Whether the combined effects of higher ALMP and lower levels of unemployment would promote less poverty is, however, unclear. The negative effects of unemployment would either be compounded by ALMP (if activation simply pushes people into low-pay jobs) or mitigated by it (if training increases the skills of low-paid workers). When ALMP is low and PLMP is high, on the other hand, unemployment could rise (if higher reservation wages priced out low-skilled workers). Whether the combined effects of higher PLMP and higher levels of unemployment would promote poverty is, again, unclear. As argued above, high replacement rates for social benefits combined with high coverage of the population would minimize the effects of unemployment on poverty. High levels of ALMP and PLMP, finally, have unclear direct effects on employment. The negative effects of passive policy could be balanced (or outweighed) by the possible positive effects of active policy. With the effects of policy on unemployment minimized, the effect of unemployment on poverty would be drastically reduced and, if social benefits are sufficiently generous, even reversed.

Welfare to Workfare[6]

The starting point for activation initiatives is the idea that passive labor market policies can produce benefit dependency and increase unemployment. Generous social policies are, in this view, associated with high reservation wages and low job search intensity (Eichhorst and Konle-Seidl 2008: 3). To combat the harmful effects of generous benefits on employment two solutions are offered through activation. First, activation is meant to push people into employment (particularly low-pay employment) by reducing the attractiveness of social benefits. Second, policies are focused on providing benefit recipients with the skills required to be successful when searching for a job.

In practical policy terms, one aspect of activation has therefore involved limiting social benefits by either reducing their generosity or making eligibility more difficult. A second aspect, what Eichhorst and Konle-Seidl (2008) call the "enabling" side of activation, attempts to develop or strengthen traditional active labor market policies like job search assistance, subsidized employment, training programs and "making work pay" initiatives designed to facilitate entry into the labor market by topping up low-pay jobs. A fundamental characteristic of activation and workfare, in any case, is the introduction of systematic links between two sides of the welfare state not necessarily connected in the past: social protection and employment promotion (Barbier 2004).

For this paper's argument, perhaps the most crucial element in activation policies has to do with their emphasis on conditionality. Receiving social benefits "increasingly depends on job search activities, acceptance of available job offers or participation in active labour market policy schemes" (Eichhorst and Konle-Seidl 2008: 3). In this respect, "the core element of activation is the removal of options for labour market exit and unconditional benefit receipt by members of the working-age population" (Eichhorst and Konle-Seidl 2008: 6). In a very real sense, therefore, the evolution towards activation and workfare has represented a move towards the re-commodification of the welfare state. Re-commodification is in this context the opposite of Esping-Andersen's celebrated concept. For Esping-Andersen (1990) the nature of the welfare state was fundamentally defined by the levels of de-commodification it accomplished. De-commodification was defined as the emancipation of the individual from market dependence by

promoting the provision of social services as a matter of right (Esping-Andersen 1990: 22). It is clear then that activation, by reducing social benefits and pushing people into work represents a re-commodification of the welfare state. Far from emancipating, its explicit objective is to make the individual more dependent on the market and to disconnect him/her from the provisions of benefits.

The increasing importance of workfare is a phenomenon common to all industrialized democracies. There are several reasons for this. There is first what Hay has called "input convergence" (2000: 514), i.e., the concurrence of a number of exogenous factors affecting all these countries. Economic changes (like the shift from manufacturing to services, the emergence of insider-outsider differences) and demographic ones (ageing of the population, decline of traditional family structures, declining birthrates) present new challenges for the welfare state while globalization and (for some countries) European integration limit the degrees of freedom enjoyed by governments.[7] At the same time, activation has been increasingly accepted as the solution against high unemployment and low employment rates. The transformation of the welfare state into a more active one has been an objective repeatedly endorsed by OECD Labor Ministers in recent years (see, for example, Larsen 2004). As Martin points out, it has also become part of the EU's official strategy to decrease unemployment since the Essen Summit in December 1994 (1998: 12), reiterated also in the 1997 European Employment Strategy.

The growing interest in activation as a way to combat unemployment is understandable. Calmfors (1994) relates it both to the disillusionment produced by demand management policies which are now perceived as measures that can increase inflation while not affecting unemployment and to the belief that other supply-side structural reforms may work too slowly or be too difficult to implement. Until the 1980s, many OECD countries had relied on policies to reduce labor supply to combat unemployment. These included early retirement initiatives and the use of incapacity and sickness benefits as valid substitutes for other social benefits. Early retirement schemes have been particularly popular in continental Europe (see Ebbinghaus 2006). In Spain in the 1980s, for example, the PSOE government attempted to reduce unemployment by promoting early retirement schemes (often supported with

intermediary unemployment benefits) (Pastor 1992).[8] In the Netherlands, in the words of Visser and Hemerijck, "generous and lenient" sickness and disability benefits had become the main subsidized exit form for older workers in the 1980s (1997: 138). They illustrate this point by explaining that in 1987 there were 262 people on disability benefits per 10,000 wage earners between the ages of 55 and 64 in Germany. In the Netherlands, this number was 980. In fact, some scholars have argued that the response to the challenges to the welfare state mentioned above (globalization, industrial decline, tertiarization, etc) in continental Europe in the 1980s involved a combination of early retirement, a rise in unemployment and the number of workers on disability benefits, discouragement of female labor force participation, and the promotion of insiders-outsiders differences (see, for example, Esping-Andersen 1999 and Rueda 2007). But, in the era of permanent fiscal austerity, solutions relying on the promotion of labor market exit have become much more difficult. Cost containment emerges as a top priority in all industrialized democracies, even if national strategies to address this goal are quite diverse (Pierson 2001b).

While the transformation of the welfare state into the workfare state has been quite significant in many OECD countries, there have been quite distinct national developments. Some of the national experiences will be outlined below but an attempt has been made by several authors to characterize national clusters of workfare. According to Barbier, for example, while activation has been a common response to the challenges faced by most industrialized democracies since the 1980s, its exact form has been shaped by Esping-Andersen's (1990) three worlds of welfare capitalism. Barbier distinguishes between a liberal and a universalistic model of activation. The UK is the country that, according to Barbier, best captures the liberal activation experience, and Denmark the one for universalistic activation. Barbier emphasizes that universalistic activation is about active labor market policy and increasing employability while liberal activation is more punitive and focused on individual self-reliance.[9]

In another attempt to distinguish among national clusters, Van Berkel and Hornemann Moller (2002) emphasize three distinct aspects of the workfare state. While they recognize that all activation policies have in common the objective of reducing social benefits, they identify three dimensions present in all countries but with very different levels of importance. First, there are policies that emphasize the

reduction of income out of work as the main incentive to increase employment. This dimension is most important in the Anglo-Saxon countries. Second, there are policies that emphasize job search requirements as a condition to receive social benefits. This dimension, according to Van Berkel and Hornemann Moller, is most important in the continental cases. And there are finally policies that emphasize the provision of resources to the unemployed to increase their chances of finding work (i.e., traditional active labor market policies). This dimension is most important in the Scandinavian cases.

While a consensus seems to be emerging in the literature about the increasing importance of activation and conditionality in all industrialized democracies, a high degree of disagreement exists about the importance of national clusters. There are several reasons for this. First, the existence of national groups seems quite dependent on what dimension of policy is emphasized by the analyst. Second, a great amount of diversity exists within groups (no matter the categorization). And third, a great amount of change through time seems to be the norm in any national case one chooses to focus on. After a very detailed and systematic analysis of a large number of national cases, Konle-Seidl and Eichhorst conclude that "ideal types may be helpful tools to structure comparative analyses, but there is significant heterogeneity to be found in the empirical activation landscape" (2008: 430). They point out that even though the UK is taken as the model for the liberal regime of activation, low benefit generosity in the British welfare state is only the case when looking at unemployment insurance benefits and not at incapacity schemes. When looking at both these policies, Germany after the Hartz reforms is a country in which more restrictive conditionality has been applied to a larger number of recipients than in the UK. They also point out that Denmark, often taken as the model for the universalistic activation regime, is in fact quite different from Sweden (also a model for universalistic activation).

It is nevertheless clear that industrialized democracies have experienced a general evolution towards workfare. The country studies in the Eichhorst et al (2008) volume "show a merger of US workfare ideas and more classical European active labour market policies" (Konle-Seidl and Eichhorst 2008: 431). From New Deal programs in the UK, to "Fördern und Fordern" in Germany, including a

variety of Dutch, Danish and Swedish activation initiatives, the new workfare state is based on a fusion of "demanding" and "enabling" policies.

Measuring the Workfare State

While, as explained above, activation happens in several dimensions of policy, the objective of this paper is to explore the influence of the workfare state on the relationship between unemployment and poverty. For this purpose, it would be convenient to create summary measures for the degree of activation experienced in any given country. I plan to do this by trying to capture the two distinct dimensions of the workfare state explicitly.

First, as mentioned above, there are two defining (and related) characteristics of the workfare stat: one is conditionality and the other is activation. Conditionality is essentially a process that makes social benefits less generous and more difficult to obtain. This "demanding" (in the terminology of Eichhorst and Konle-Seidl 2008) side of the workfare state[10] is best captured by a measure of benefit generosity. Perhaps the most straightforward way to measure whether social benefits have become more punitive is to explore the amount of resources a government dedicates to unemployment benefits.

Measures of benefit generosity are not completely clear-cut. It is common to assess the importance of the welfare state by looking at the level of social policy as a percentage of GDP.[11] Although this may be a reasonable measure for some purposes, there are clear limitations in its ability to capture benefit generosity. Its most important weakness concerns the fact that it focuses exclusively on the supply of social policy and it ignores the demand side. In this respect, I agree with Clayton and Pontusson who convincingly argue that "measuring the size of the welfare state in terms of social spending as a percentage of GDP, as virtually all of the literature does, is problematic because such measures fail to take account of changes in societal welfare needs" (1998:70). This point is particularly important when trying to capture the influence of conditionality. It would be difficult to measure the effects of workfare without taking into consideration the demand for benefits. In this paper, I follow the lead of a number of other authors (see, for example, Iversen and Cusack 2000) by measuring benefit

generosity as the ratio of unemployment benefits[12] to GDP over the ratio of the unemployed to the civilian labor force. This seems a reasonable way to assess the importance of the demanding side of workfare. When unemployment transfers as a proportion of the total size of the economy rise faster than the unemployment rate, for example, this measure of benefit generosity will increase (and conditionality will decrease).

[Table 2]

Table 2 summarizes the benefit generosity data (measured as unemployment benefits as percent of GDP over percentage of unemployed) for the OECD countries in this paper's analysis. The high degree of cross-national variation in the table is best illustrated by dividing the countries into three groups (not really coinciding with the three usual varieties of capitalism, or worlds of welfare capitalism). The Mediterranean and most of the liberal economies (France, Greece, Italy and Spain; and Australia, Canada, UK and USA) belong to the group characterized by low levels of benefit generosity. All these countries spend an average of less than 0.15% of GDP per 1% of unemployed. The group characterized by intermediate levels of benefit generosity comprises a number of non-Mediterranean continental countries (Austria, Germany and Switzerland), one liberal economy (Ireland) and some Scandinavian ones (Finland, Norway and Sweden). These countries spend an average of more than 0.15% but less than 0.30% of GDP per 1% of unemployed. The final group is made up of Belgium, Luxembourg, the Netherlands and Denmark. They spend the highest average amounts on benefits per 1% of unemployed (more than 0.30% of GDP).

Although this cross-national variation is interesting, the arguments about activation presented above are also concerned with temporal variation. As explained in previous sections, conditionality is a process that has transformed the welfare state in these countries making them less decommodifying. Table 2 presents some evidence for this, but it is by no means general to all countries. In the fifth column in Table 2, a summary assessment is presented of whether these countries have experienced a move

towards more demanding workfare. In as many as 11 countries the answer is yes. A reduction in benefit generosity has been experienced in Australia, Canada, Germany, Greece, Italy, Luxembourg, Norway, Sweden, Switzerland, the UK and the US.[13] In most of these countries, the level of generosity from 2000 to 2005 is lower than the averages from 1985 to 1989 and from 1990 to 1999. In one (Luxembourg) the level in the 1990s was lower than in the 2000s and in another (Greece) there is no change from the 1990s to the 2000s. This leaves only 8 countries that have not experienced an increase in the demanding dimension of the workfare state. Belgium, Denmark, France, and Spain experience increases in generosity in each decade in the table (from the period before). Austria, Finland and the Netherlands experience increases from the 1980s to the 1990s, and a decline in the 2000s that still leaves generosity at higher levels than they started. In Ireland, generosity decreases from the 1980s to the 1990s but increases significantly in the 2000s.

The decrease in the generosity of the welfare state suggested by Table 2 is perhaps underestimated, since its general nature has been noted by a number of observers. Korpi and Palme (2003), for example, analyze net replacement rates in the public insurance systems for sickness, disability and unemployment for 18 OECD countries. They find that the welfare state underwent a change between the 1980s and 1990s. They conclude "that the long gradual increase in average benefit levels characterizing developments up to the mid-1970s has not only stopped but turned into a reverse" (Korpi and Palme 2003: 445).

The demanding side of the workfare state could also be explored by using an alternative measure developed by Scruggs and Allan (2006). Scruggs and Allan explicitly attempt to reproduce (and improve upon) Esping-Andersen's commodification index. Their decommodification index is constructed using three major social insurance programs: pensions, unemployment insurance and sickness benefits. Out of these three programs, the measure of pension generosity is the component least related to conditionality. By eliminating this component from a measure of benefit generosity and analyzing the addition of the unemployment insurance and sickness benefits indexes, a picture would emerge that is broadly consistent with the one in Table 2.[14] Since his measure includes both an unemployment and a sickness component, it

partially captures the use of sickness and disability benefits as a way to subsidize labor market exit (while officially not increasing the number of the unemployed).

The second dimension of the workfare state (activation) relates to its enabling dimension and, as mentioned above, to the traditional role of active labor market policies. In this respect, the most straightforward measure for this dimension is the ALMP one provided by the OECD. This measure contains all expenditure aimed at the improvement of an individual's chances of finding employment. It includes spending on public employment services and administration, labor market training, school-to-work youth programs, and employment programs for the disabled. I will measure the generosity of active labor market policy as the ratio of spending to GDP over the ratio of the unemployed to the civilian labor force, as I did with the previous measure of spending (and for the same reason).

[Table 3]

Table 3 presents the ALMP data for this paper's analysis. It is possible once again to divide our countries into three groups. In fact, comparing Table 3 to Table 2, it is impossible not to notice the similarities. When looking at cross-national differences, the levels of generosity in unemployment benefits in Table 2 seem highly correlated with the levels of active labor market policy in Table 3. There is once again a group characterized by low levels of ALMP generosity comprising the Mediterranean and most of the liberal economies. France, Greece, Italy, Spain, Australia, Canada, UK and the USA belong to this group. All these countries spend an average of less than 0.10% of GDP per 1% of unemployed. There is again a group characterized by intermediate levels of ALMP generosity including a number of non-Mediterranean continental countries (Austria, Belgium, and Germany), one liberal economy (Ireland) and some Scandinavian ones (Finland and Norway). These countries spend an average of more than 0.10% but less than 0.20% of GDP per 1% of unemployed.[15] The final group is made up of Denmark, Luxembourg, the Netherlands, Sweden and Switzerland. They spend the highest average amounts on ALMP per 1% of unemployed (more than 0.20% of GDP).

In Table 2, a significant number of countries had experienced an increase in the demanding side of workfare. When looking at the enabling side of workfare in Table 3, the picture is perhaps less consistent. Ten countries have experienced increases in the levels of ALMP per 1% unemployed (Australia, Austria, Belgium, Denmark, France, Ireland, Italy, the Netherlands, Spain, and the UK). Out of these countries, the changes in Australia, Spain and the UK seem too small to warrant considering them examples of activation (in Australia the level of ALMP per 1% unemployed increasing from 0.04% of GDP to 0.06, in the UK from 0.07 to 0.09, and in Spain from 0.02 to 0.06). This leaves us with 7 countries, out of 19, where activation has been significant at the enabling side.

The previous section has made clear that we should not look at the levels of enabling or demanding workfare independently. It is the combination of passive and active labor market policies which contributes to different levels of unemployment and income inequality. We can combine the data in Tables 2 and 3 to explore these different combinations.

[Figure 1]

Figure 1 present two panels depicting the decade averages for active and passive labor market policy in the countries in this paper's analysis. The first panel presents all the data, while the second focuses on those observations that are less than 0.4% of GDP per 1% unemployed. The figure makes clear than there is a general correlation between active and passive labor market policy generosity. When we look at the means for active and passive labor market policy (reflected by the red grid lines), we can also see, however, that there are cases in all quadrants within the panels. There are cases with high levels of active and passive labor market policy (Sweden in 1980s and 1990s, or Denmark in 1990s and 2000s). There are cases with low levels of active and passive labor market policy (Spain in 1980s, 1990s and 2000s). There are cases where passive labor market policy per unemployed is above average, but active labor market policy per unemployed is below average (Finland in the 1990s and 2000s). And there are cases where passive labor market policy per unemployed is below average, but active labor market policy

per unemployed is above average (Norway in the 1980s, 1990s and 2000s). And there is, finally, temporal movement over the quadrants (for example, Sweden moves from the high/high quadrant in the 1980s and 1990s, to the high active but low passive quadrant in the 2000s). This paper's claims imply that these patterns in active and passive labor market policy will be a significant determinant of the relationship between unemployment and poverty in these countries.

Exploring the Influence of Workfare on the Relationship between Unemployment and Poverty

The previous section has explained in detail the measures for both dimensions of the workfare state that will be used to explore the relationship between unemployment and poverty. In this section I will describe the measures for unemployment and poverty, the method used, the control variables introduced into the analysis, and some preliminary results.

The objective of this paper is to assess the influence of the welfare state (in either its enabling or demanding dimensions) on the relationship between unemployment and poverty. I will proceed in two steps. First, the direct effects of labor market policy on unemployment need to be considered. This can be done in a pretty straightforward way (to be explained below). Second, the effects of unemployment on poverty (conditional on different combinations of active and passive labor market policy) will be explored.

For the second step in the analysis, it is important to use a measure for poverty that takes into consideration disposable income (rather than market income). My measure for household income after taxes and transfers is taken from the Luxembourg Income Study (LIS). The measure of poverty in this paper is a commonly used one. It represents the percentage of people with household disposable income below 60% of the median. It is a measure of relative poverty and it will change as the median household income changes in any given country-year. As all relative measures of poverty, this one is itself a measure of inequality. It is one that focuses on the bottom of the distribution but, as it captures the difference between this group and the median, it will reflect to some extent whatever affects the general income distribution.

The LIS data takes the form of five-year "waves" with observations pertaining to different years for different countries. This reduces the number of possible observations significantly. It also means that the number of observations per country is not constant (there are as many as 7 LIS waves in some countries, while there are only 2 in one country). The availability of inequality and generosity data reduces this paper's analysis to 86 country-year observations. The smallest number of observations per country is 2 (Germany and Greece). At the other end of the spectrum, the dataset includes 7 observations for the United States. On average, there are 4.5 observations per country and there are 19 countries in the analysis: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Norway, Spain, Sweden, Switzerland, UK and US.

Two things limit the analysis of income inequality I will present below: the relatively limited number of observations and the shortness of the time series in all countries. Given these limitation, the analysis below is necessarily preliminary. I estimate the following equations.

$$U_{it}=\beta_0+\beta_1 ALMP_{it-1}+\beta_2 PLMP_{it-1}+\beta_3 X_{1it}+\ \ldots\ +\beta_n X_{nit}+\varepsilon_{it}$$

where U_{it} is the unemployment rate (measured as percentage of the civilian labor force), β_0 represents a general intercept, $ALMP_{it-1}$ is the one-year lag of the enabling dimension of the welfare state (measured as ALMP spending as percentage of GDP per 1% unemployed), $PLMP_{it-1}$ is the one-year lag of the demanding dimension of the welfare state (measured as PLMP spending as percentage of GDP per 1% unemployed),[16] X_1 to X_n are control variables, β_1 to β_n are the slopes of the explanatory variables, and ε_{it} denotes the errors.

$$Y_{it}=\gamma_0+\gamma_1 U_{it-1}+\gamma_2 ALMP_{it-1}+\gamma_3 U_{it-1}*ALMP_{it-1}+\gamma_4 PLMP_{it-1}+\gamma_5 U_{it-1}*PLMP_{it-1}+\gamma_6 X_{1it}+\ \ldots\ +\gamma_n X_{nit}+\varepsilon_{it}$$

where Y_{it} is relative poverty, γ_0 represents a general intercept, unemployment has now also been lagged by 1 year (U_{it-1}*$ALMP_{it-1}$ and U_{it-1}*$PLMP_{it-1}$ are the interaction between unemployment and both dimensions of the welfare state, γ_1 to γ_n are the slopes of the explanatory variables, and ε_{it} denotes the errors.

In both models, I estimate random effects and Huber/White standard errors adjusted for within-country correlation. I present three sets of estimates for each equation. In the first one, the only explanatory variables are the main variables of interest (the two dimensions of the welfare state in the first equation; unemployment, the two dimensions of the welfare state, and the interactions in the second equation). In the second and third ones, an increasing number of control variables are added. The control variables follow from previous analysis of inequality in the comparative political economy literature:[17]

Female labor force participation: Higher female labor force participation has been argued to be associated with higher inequality for several reasons. There is first the influence of wage discrimination (Blau and Kahn 2000). Also, to the extent that women are on average less educated and/or have less work experience than men, an increase in the proportion of the total labor force made up of women can represent an increase in the relative supply of unskilled or less skilled labor (Topel 1994, Svensson 1995).

Private service employment: It is often argued that inequality and private service employment are associated, since the private service sector often represents an increase in the relative supply of unskilled or less skilled labor. As Iversen and Wren (1998) point out the scope for productivity growth in services is limited, pricing closely reflects labor costs, and demand for these services is highly price sensitive.

Union density: Several factors contribute to more compressed income distributions in unionized firms or sectors (see Rueda and Pontusson 2000). Among them, the fact that unions approximate the logic of democratic decision-making and that they have a strong interest in curtailing wage setting based on the subjective decisions of foremen and managers.

Wage bargaining centralization: The standard argument linking centralization to income compression asserts that centralization facilitates the reduction of inter-firm and inter-sectoral income differentials since it means that more firms and sectors are included in a single wage settlement. Additionally, it can be argued that centralization produces income compression by altering the

distribution of power among actors (as suggested by Wallerstein 1999, this would follow a median voter logic) and by making bargaining more transparent.

Left government: Governments can influence the income distribution through a number of policies (in addition to unemployment benefits and active labor market measures).[18] Left governments seem more likely to promote higher levels of minimum-wages, equal-pay legislation, incomes policy, and a variety of other measures that strengthen the competitive position of women and other disadvantaged groups (e.g., immigrants) in the labor market.

International trade openness: Wood (1994) argues that much of the trend towards increased wage inequality in the OECD countries in the 1980s can be attributed to an increase in trade with less developed countries. The basic logic of Wood's analysis is that by importing less skill-intensive goods from low-wage countries, OECD countries are essentially importing low skill labor, which puts downward pressure on the relative wages of the unskilled. I introduce a variable measuring imports plus exports as a per cent of GDP.

[Table 4]

The results for the models exploring the determinants of unemployment are presented in Table 4. The first column presents the estimates when only the two dimensions of workfare are used as explanatory variables. The second and third columns add the control variables. The estimates from all models make clear that increasing the enabling side of workfare promotes lower unemployment while the decreasing the demanding side of workfare (which means increasing the generosity of benefits) has not significant effects. Increasing the percent of GDP per 1% unemployment dedicated to active labor market policy results in significant decreases in unemployment. Decreasing the resources dedicated to passive measures, has no effect (it is therefore unclear whether, when we look at our sample, a high reservation wage is in fact associated with less willingness to search for employment).[19]

Going back to Table 1, it seems then that those quadrants characterized by higher levels of active policy are associated with lower unemployment. The costs of PLMP implied in Table 1, however, do not seem to apply. Some of the argument in the previous sections implied that increases in passive labor market policy would price out low-skilled workers. This effect does not seem to be confirmed by the preliminary analysis in Table 4.

[Table 5]

Table 5 presents the second step in this paper's argument. The determinants of relative proverty are presented in three columns. The first column presents the estimates when only unemployment, the two dimensions of workfare, and their interactions with unemployment are used as explanatory variables. The second and third columns add the control variables

The effects of the variables of interest (unemployment and the different measures of the workfare state) are difficult to interpret from Table 5. The estimates of the unemployment variable represent the effects of unemployment when both policy measures are 0. We can see from the table then that, as expected, at the lowest levels of ALMP and PLMP unemployment significantly increases the levels of poverty. I will present conditional effects in a moment, and they will tell us more about the effects of unemployment at different levels of welfare policy. For the time being, however, it can also be concluded that the three models do not produce substantially different results. In the paragraphs below I will be using the results with the highest number of control variables as the basis for my calculations. But conditional effects are mostly the same if the other columns were used.

The effect of the control variables is not of interest to the topic of this paper but I will simply report that some of them are significant. Union density has a strong egalitarian effect over disposable income (see also Rueda and Pontusson 2000). But female labor force participation (although only at the 90% confidence level) is associated with higher levels of poverty.

Turning back to the relationship between our variables of interest and poverty, testing this paper's hypotheses requires assessing the effects of unemployment at different levels of ALMP and PLMP. It is the combination of enabling and demanding policies that is expected to affect relative poverty. In Table 1, I hypothesized that the most damaging effects of unemployment on relative poverty would occur when both ALMP and PLMP generosity was low. A less enabling but more demanding welfare state would minimize the effects of social policy as a buffer between unemployment and poverty. While the effects of unemployment were ambiguous when one dimension of policy was high and the other was low, I argued that high levels of both ALMP and PLMP generosity could perhaps reverse the effects of unemployment.

I will now use the results in Table 5 to calculate the conditional effects of unemployment with different patterns of enabling and demanding workfare. When discussing Tables 2 and 3, I described the average levels of ALMP and PLMP generosity in the countries in this paper's sample. To illustrate the effects of unemployment conditional on workfare I have selected a range for each workfare variable reflecting the most common values in the sample. For unemployment benefits as per cent of GDP over the unemployment rate, around 90% of observations are between 0 and 0.4. I have selected 0 as the value for low PLMP generosity (a very demanding workfare state), 0.2 as an average value (the actual mean is 0.22), and 0.4 as the value for high PLMP generosity. For ALMP as per cent of GDP over the unemployment rate, around 90% of observations are between 0 and 0.25. I have selected 0 as the value for low ALMP generosity, 0.1 as an average value (the actual mean is 0.12), and 0.25 as the value for high ALMP generosity (a very enabling workfare state). Table 6 present the coefficients and significance levels for the effects of unemployment conditional of these different levels of workfare.

[Table 6]

Table 6 presents some preliminary evidence supporting this paper's claims. Unemployment is positive and statistically significant (at the 99% level of confidence) when ALMP and PLMP generosity is low. It is also positive and significant (but only at the 90% level of confidence) when PLMP generosity

is low but ALMP generosity is at the sample mean. The table makes clear how increasing levels of ALMP generosity (moving to the right within the same row) and increasing levels of PLMP generosity (moving down within a column) mitigate and eventually reverse the effects of unemployment on poverty. At high levels of ALMP and PLMP generosity, unemployment is associated with decreasing levels of poverty. According to Table 6, a 1% increase in unemployment when 0% of GDP per 1% unemployed is dedicated to active and passive labor market policies would be associated with a 0.35% increase in the number of people with household disposable income below 60% of the median. The same increase in unemployment would still be associated with an increase 0.16% increase in the number of people with household disposable income below 60% of the media when 0% of GDP per 1% unemployed is dedicated to PLMP and 0.1% of GDP per 1% unemployed (the sample mean) is dedicated to ALMP. To put these numbers in context, it is important to note that the mean level of relative poverty in our sample is 13.4%. The increases I have described in the previous lines are therefore substantial.

Table 6 also presents some interesting evidence in favor of the egalitarian effects of unemployment. Low or averages levels of ALMP and average or high levels of PLMP succeed in muting the effects of unemployment on poverty. When one of the policies in high and the other is average or higher, moreover, a reversal of unemployment effects can be perceived. These effects (concentrated in lower right corner of Table 6) suggest that increases in unemployment in very generous welfare state move households out of poverty. A 1% increase in unemployment when both policies are high (0.4% of GDP per 1% unemployed is dedicated to PLMP, and 0.25% to ALMP) would be associated with a 0.66% decrease in the number of people with household disposable income below 60% of the median. These effects, as suggested in previous sections, may reflect the better (i.e., high pay) employment promoted by generous passive benefits and active measures. But it is also a natural consequence of the way that welfare states are financed. In many ways social policies, whether active or passive, are paid by the rich to pay/insure the poor. As unemployment grows, the number of those in need of benefits increases and so do the demands on the taxes of those who remain employed. A generous welfare state facing

unemployment therefore automatically brings down the top half of the distribution while attempting to keep the bottom half stable (which would decrease the levels of relative poverty).

More importantly for this paper's analysis, Table 6 makes clear that workfare has the potential to make unemployment very damaging for poverty. Increasingly demanding workfare policies move welfare states up in the vertical dimension in Table 6 and therefore makes the effect of unemployment increasingly inegalitarian. Enabling workfare would move welfares states to the right in the horizontal dimension in Table 6 and therefore help limit the effects of unemployment on poverty even if PLMP is low but, as shown in Table 3, the move towards more effective active policies has been less general than the move towards more demanding passive policies. The figures clearly illustrate that the best way to control or even reverse the effects of unemployment on poverty is for welfare states to increase the generosity of their unemployment benefits at the same time that they increase their levels of ALMP. This is not a prescription of the workfare/social investment framework and, more importantly, it is not a prescription that is easy to implement in times of crisis.

Economic Crisis, Unemployment and Inequality: Some Predictions

It is an uncontested fact that the present economic crisis has had and will have dramatic effects on unemployment in most OECD countries. A look at recent news stories, even if superficial, leaves no doubt about the extraordinary dimensions of the problem. Table 7 presents data on unemployment rates (not harmonized) for the countries in our sample from 2007 to 2010. The table makes clear the significance of the problem. All countries except Germany experience an increase in unemployment during this period. The increases range from the moderate (in Australia, Austria, Norway and Switzerland the rate increases by 1% or less) to the spectacular (Greece, Ireland, Spain, the UK and the US experience the largest increases).

[Table 7]

It is also possible to present some preliminary data of what kinds of workers have been most affected by the Great Recession. Two economic processes have been associated with the recent economic crisis in OECD countries: the bursting of the housing price bubble and an extraordinary decline in international trade. As a consequence, the two sectors most dramatically affected by the Great Recession regarding employment have been construction and manufacturing. The OECD calculates that the construction sector is historically 70% more vulnerable to the vagaries of the economic cycle than the average across all sectors (2010a: 52). In the present crisis, Ireland and Spain are particularly dramatic examples, with declines in construction employment of 37% and 25% respectively over the twelve months concluding in the second quarter of 2009 (OECD 2010a: 52). Durable goods manufacturing is similarly vulnerable to the economic cycle (according to the OECD, 40% more than the average across all sectors).

The employment impact of the Great Recession has also varied across different types of workers. While gender has not been a good predictor of the likelihood of losing one's job in this economic crisis (perhaps because of the concentration of male workers in construction), unemployment has concentrated on what we could call outsiders: immigrants, the young, unskilled and precariously employed (OECD 2010a). The data are perhaps most telling when looking at youth and skills. In 2009, the OECD average unemployment rate for young people (15-24 years of age) was 16.4% while it was a much lower 7.3% for "prime age" workers (25-54 years of age).[20] In 2008 (the last year that we have data for), the OECD average unemployment rate for people with less than an upper secondary education was 8.7% but it was only 3.2% for those with a tertiary education.[21] The effects of the crisis on those who were precariously employed are more difficult to assess systematically. But it is clear that in countries like Spain and Italy, the unemployment consequences of the Great Recession have been concentrated on those with temporary employment.[22]

In previous sections, I argued that unemployment would promote inequality if those affected by it suffered significant income losses and the incidence of unemployment was concentrated on low-skill/low-pay workers. Given the less than complete generosity and coverage of replacement rates in the OECD

countries and the data presented above about the incidence of unemployment since 2007, both hypotheses seem justified when analyzing the consequences of the Great Recession.

How have the countries in our sample reacted to these increases in unemployment? The results in Table 6 suggest that high ALMP generosity combined with high PLMP generosity limit the damaging effects of unemployment on relative poverty. Have OECD countries reacted to the crisis by increasing (or at least maintaining) the levels of PLMP and ALMP? The limited nature of market policy data (only available until 2008) does not allow us to answer these questions systematically. But we can look at the immediate reactions to the crisis.

[Table 8]

In Table 8, we have calculated the levels of ALMP and PLMP generosity with the latest data available. The years 2006 and 2007 serve as a before-the-crisis baseline. The early reaction to the crisis is captured by the 2008 data. The most remarkable characteristic of the numbers in Table 8 is their stability. It is not clear that there has been any reaction to the crisis in these countries. Both ALMP and PLMP generosity stays more or less the same in 2008. In some countries it goes up slightly, in some countries it goes down slightly. But all changes are marginal (less than 0.05% of GDP per 1% unemployed). The only exception is the USA, where PLMP generosity goes up significantly from around 0.05% of GDP per 1% unemployed in 2006 and 2007 to 0.14% in 2008. In the rest of the countries, whatever combination of enabling and demanding workfare was reached before the crisis remains in 2008.

A less systematic exploration of the policy reactions to the crisis would suggest that, if anything, the welfare state has become less generous (both in its demanding and enabling dimensions). In the countries of the European periphery, the crisis has reached dramatic proportions and social policy is just one of the areas that have been the subject of draconian cuts directed to reduce debt. But even in OECD countries that have not been affected so radically by the crisis, this decrease in generosity has been clear. I will focus on two significant examples: the UK and Germany.

In the UK, reducing the generosity of the welfare state seems to have been an objective of recent governments not affected by partisan changes. In the midst of the crisis (July 2008), the then Secretary for

Work and Pensions, Labour's James Purnell, published a Green Paper emphasizing the expansion of compulsory work for the unemployed, targeting in particular the over two and a half million claimants of incapacity benefit and those unemployed for over two years. This policy thrust informed the 2009 welfare reform bill. It promised to abolish income support, to implement a new sanctions regime for those not attending Jobcentres and to require non working mothers whose youngest child has reached 7 to sign on. The arrival of the Conservative-Liberal Democrat coalition to power in 2010 reaffirmed this austerity-dominated direction for labor market policy in the UK. It is difficult to get exact data on budget priorities (for example, there was no explicit mention of welfare policy in the speech by Chancellor of the Exchequer George Osborne's announcement of the 2011 budget). But it seems clear that the Conservatives' fiscal plans involve significant cuts in social spending to accomplish the 6 per cent of GDP reduction in total spending from 2011 to 2015 they are aiming for.

In Germany, a significant effort towards workfare was undertaken right before the economic crisis. In March 2003, the German Chancellor, Gerhard Schröder, presented to parliament an ambitious set of reform policies, known as *Agenda 2010*. An important part of Agenda 2010 was a decrease in dismissal costs and a significant reform of social security to increase work incentives and to lower labor costs. With the arrival of the economic crisis, and now with Angela Merkel as Chancellor, Germany was initially one of the countries most affected by the downturn (in 2009 the International Monetary Fund considered Germany and Japan to be the worst performing economies in the OECD). This initial shock was confronted with temporary measures like *short-time working* policies (the government partly financing private sector wages in the hope that employers would retain workers with skills that would be needed after the recovery). But these policies coexisted with a continuation of the emphasis on workfare that emerged before the crisis. As in the case of the UK, the decrease in the generosity of the welfare state has been generally justified by the need for austerity. This way, in June 2010, Merkel announced drastic public spending cuts totalling more than $96bn over four years. This was part of a sweeping austerity strategy meant to address Germany's budget deficit (which was planned to exceed 5 per cent of GDP in 2010). The plan particularly focused on reducing social security and unemployment benefits (increasing

their means-tested nature in a workfare-influenced effort explicitly directed to reduce long-term unemployment and raise the rate of employment). While Merkel's cabinet also approved in November of 2010 a plan to increase the basic welfare payments (Hartz IV) by 5 Euros, this minimal increase was done again in a context emphasizing workfare. In the words of Merkel, "Hartz IV is not a way of life" and the benefits, even in times of crisis, are "meant as a bridge back to employment."

One of the most damaging consequences of such dramatic increases in unemployment (if not mitigated by labor market policy) is their effect on poverty. It is, however, impossible to assess this effect at this point. Data on poverty (much less the LIS data on disposable income poverty) are not available at this early stage. Given the impossibility of exploring the real effects of these increases in unemployment on relative poverty, we must engage in an exercise of prediction in this section of the paper. I will assume that the previous section has produced an accurate picture of the relationship between unemployment and poverty conditional on different levels of labor market policy. I will then use the estimates from these models to predict the potential levels of relative poverty in a couple of different scenarios involving varying degrees of workfare.

I am focusing on two different countries in this section. In 2007, The UK is an example of a country with low PLMP generosity and low ALMP generosity (see Table 8). It is therefore an example of a country where the demanding side of workfare is significant, but activation in the enabling side is not. Our second example is Sweden, which in 2007 has high unemployment benefit generosity and high ALMP generosity. This is our example of a country where the demanding side of workfare has not been very significant, but activation in the enabling side has been.

I will simulate two different scenarios. In one of them the generosity of the welfare state increase (this means more generous unemployment benefits or more generous ALMP) while in the other it decreases (more generous unemployment benefits or less generous ALMP).

To calculate these effects we face a few difficulties. First, we don't have data on disposable income for 2007 (the year before the crisis starts). To set up the baseline for the comparison, I will simply take the values for inequality for the last year we have available. In the case of the UK, this is 2004 (when

19% of the population had household disposable incomes below 60% of the median) and in the case of Sweden it was 2005 (where only 12% of the population did). Second, we have data on benefit generosity in 2006 (since we use a one-year lag in our calculations) and can simulate an increase in generosity equal to 0.07% of GDP or a decrease in generosity equal to 0.07% of GDP. These are not extreme changes in ALMP or PLMP generosity (a standard deviation change would be closer to 1.2% in both cases). Third, I take the unemployment rate in 2007 and the projected rate in 2010 from Table 7 (for the UK unemployment in 2007 was 5.4 and it is predicted to reach 8.1 in 2010, for Sweden it was 6.1 in 2007 and it is predicted to be 8.8 in 2010). Finally, we use the estimates from column 3 in Table 5 (with all the control variables).

These simulations present us with a clear picture. In the UK, an increase in the generosity of PLMPs and ALMPs would significantly reduce the impact of the predicted unemployment increase on relative poverty. If the generosity of ALMP and PLMP was to increase by a modest 0.07% of GDP per 1% unemployed as a reaction to the crisis, the number of those in poverty would only increase from 19.20% to 19.96% of the population. If benefits were to be reduced by 0.07% of GDP per 1% unemployed (a more realistic possibility as explained in the conclusions),[23] relative poverty would increase to a more dramatic 20.39% of the population.

Sweden in 2006 was much more generous than the UK. It dedicated 0.14% of GDP per 1% unemployed to unemployment benefits and 0.19% of GDP to ALMP. The simulated increase in unemployment benefit and ALMP generosity would, as was the case in the UK, reduce the impact of the predicted unemployment increase on relative poverty. If unemployment benefits and ALMPs were increased by 0.7% of GDP per 1% unemployed, the number of those in poverty would only increase from 11.97% to a still modest 12.73% of the population. If benefits were to be reduced by 0.07% of GDP per 1% unemployed, on the other hand, relative poverty would increase to a higher 13.10% of the population.

Conclusions

In September of 2009, OECD employment and labor ministers met in Paris to discuss how the job crisis resulting from the Great Recession should be tackled. They agreed that "the severity of the recession called for decisive and comprehensive actions and endorsed a set of broad guidelines for the labour market and social policy responses that are intended to limit the social costs of the recession while also promoting a return to sound economic growth" (OECD 2010b: 16). Already in 2010, the OECD report analyzing the concrete labor market reactions to the crisis produced mixed conclusions. Many governments hoped to expand or at least hold constant the resources devoted to PLMP and ALMP compared to those in 2009. But "countries facing especially large government budget deficits or where an already high unemployment rate is projected to remain stable or decline are more likely to envisage beginning to trim back some of the increases in spending that were taken in response to the crisis" (OECD 201b0: 18). In 2011, the commitment to mitigate the effects of the crisis on unemployment and the effects of unemployment on poverty seems to have grown weaker still. Budgetary concerns and fiscal discipline have replaced unemployment as the main concern in the media (and most academic analyses).

This paper is meant to make two main points to try to reverse this increasing apathy towards the implications of the crisis with regards to unemployment. The first one is that, without the buffering effects of the welfare state, unemployment has a significant effect on relative poverty. We ignore the political costs of potential increases in poverty and inequality (in terms of electoral turnout, support for anti-system parties, or political conflict) at our peril. The second one is that thinking in terms of relative increases in social policy from the levels reached in 2007 misses the point. By the mid-2000s, the welfare state in most OECD countries had gone through a profound change. Conditionality had transformed social benefits and welfare policies had become more demanding. An emphasis on enabling activation, on the other hand, had not been adopted equally throughout the OECD. To evaluate the policy responses to the crisis, as the OECD seems to do,[24] by assessing whether unemployment benefits or active labor market measures grow approximately in proportion with the number of new unemployed persons produced by the crisis seems to ignore the nature of the starting point in our analysis.

Table 1

Effects of welfare state

		ALMP	
		Low	High
PLMP	Low	Unemployment increases poverty (no buffer between unemployment and poverty)	Ambiguous effect of unemployment on poverty (ambiguous effect of ALMP on low pay)
	High	Ambiguous effect of unemployment on poverty (negative effect of PLMP on employment, but buffer between unemployment and poverty)	Positive effect of unemployment on poverty (limited effect of policy on employment and social benefits that are more generous than low pay employment)?

Table 2

Demanding Workfare
(unemployment benefits as % of GDP over unemployment rate as % of civilian labor force)

	1985-1989	1990-1999	2000-2005	Demanding Workfare?
Australia	0.14	0.15	0.12	Yes
Austria	0.23	0.29	0.25	No
Belgium	0.27	0.28	0.41	No
Canada	0.19	0.15	0.10	Yes
Denmark	0.57	0.56	0.60	No
Finland	0.23	0.28	0.23	No
France	0.10	0.15	0.17	No
Germany		0.20	0.18	Yes
Greece	0.05	0.04	0.04	Yes
Ireland	0.19	0.14	0.20	No
Italy	0.11	0.06	0.05	Yes
Luxembourg	0.48	0.26	0.32	Yes
Netherlands	0.30	0.41	0.38	No
Norway	0.19	0.19	0.14	Yes
Spain	0.13	0.16	0.20	No
Sweden	0.27	0.30	0.20	Yes
Switzerland	0.31	0.29	0.22	Yes
U. K.	0.17	0.10	0.06	Yes
U.S.A.	0.08	0.07	0.07	Yes

Table 3

Enabling Workfare
(active labor market policy as % of GDP over unemployment rate as % of civilian labor force)

	1985-1989	1990-1999	2000-2005	Enabling Workfare?
Australia	0.04	0.05	0.06	Yes
Austria	0.09	0.10	0.14	Yes
Belgium	0.11	0.10	0.14	Yes
Canada	0.06	0.05	0.05	No
Denmark	0.12	0.21	0.38	Yes
Finland	0.17	0.13	0.10	No
France	0.07	0.10	0.11	Yes
Germany		0.16	0.13	No
Greece	0.02	0.03	0.02	No
Ireland	0.07	0.10	0.18	Yes
Italy		0.03	0.07	Yes
Luxembourg	0.37	0.08	0.15	No
Netherlands	0.10	0.24	0.41	Yes
Norway	0.18	0.20	0.17	No
Spain	0.02	0.03	0.06	Yes
Sweden	0.80	0.39	0.25	No
Switzerland	0.29	0.18	0.19	No
U. K.	0.07	0.06	0.09	Yes
U.S.A.	0.04	0.03	0.03	No

Table 4

The determinants of unemployment in the OECD

	(1)	(2)	(3)
Demanding Workfare	**5.047**	**-0.018**	**0.432**
(Lag of PLMP)	*4.770*	*3.363*	*2.823*
	0.290	0.996	0.878
Enabling Workfare	**-13.295**	**-7.423**	**-6.949**
(Lag of ALMP)	*3.749*	*1.496*	*1.767*
	0.000	0.000	0.000
Service		**0.328**	**0.424**
Employment		*0.073*	*0.064*
		0.000	0.000
Female		**-0.750**	**-0.580**
Employment		*0.236*	*0.239*
		0.002	0.015
Wage		**-0.590**	**-0.344**
Bargaining		*0.371*	*0.353*
Coordination		0.112	0.329
Union		**0.190**	**0.169**
Density		*0.058*	*0.058*
		0.001	0.004
Left		**-0.002**	**-0.002**
Government		*0.007*	*0.007*
		0.765	0.748
International			**-0.044**
Openness			*0.007*
			0.000
Intercept	**8.515**	**13.008**	**3.271**
	1.247	*8.151*	*9.201*
	0.000	0.110	0.722
R^2	0.175	0.005	0.034
N	389	389	389

The estimates are FGLS and contain standard errors adjusted for within-country correlation. Numbers in bold are estimated coefficients; numbers in italics are their standard errors; third row of numbers are p-values from two-sided t-tests.

Table 5

The determinants of poverty in the OECD

	(1)	(2)	(3)
Lag of Unemployment	**0.283**	**0.328**	**0.351**
	0.109	*0.104*	*0.100*
	0.009	0.002	0.000
Demanding Workfare	**6.327**	**8.148**	**8.282**
(Lag of PLMP)	*6.302*	*5.140*	*5.291*
	0.315	0.113	0.117
Workfare(Lag of PLMP)*	**-1.849**	**-1.322**	**-1.318**
Lag of Unemployment	*0.607*	*0.482*	*0.446*
	0.002	0.006	0.003
Enabling Workfare	**-2.047**	**-2.270**	**-2.162**
(Lag of ALMP)	*3.926*	*3.132*	*3.318*
	0.602	0.469	0.515
Workfare(Lag of ALMP)*	**-1.168**	**-1.806**	**-1.918**
Lag of Unemployment	*1.064*	*0.551*	*0.566*
	0.272	0.001	0.001
Service		**-0.071**	**-0.118**
Employment		*0.111*	*0.098*
		0.521	0.227
Female		**0.423**	**0.430**
Employment		*0.230*	*0.232*
		0.066	0.064
Wage		**0.333**	**0.296**
Bargaining		*0.272*	*0.256*
Coordination		0.221	0.248
Union		**-0.070**	**-0.069**
Density		*0.024*	*0.023*
		0.003	0.003
Left		**-0.002**	**-0.002**
Government		*0.005*	*0.004*
		0.663	0.608
International			**0.012**
Openness			*0.010*
			0.245
Intercept	**16.684**	**4.306**	**6.157**
	1.527	*6.082*	*5.889*
	0.000	0.479	0.296
R^2	0.371	0.390	0.375
N	86	86	86

The estimates are FGLS and contain standard errors adjusted for within-country correlation. Numbers in bold are estimated coefficients; numbers in italics are their standard errors; third row of numbers are p-values from two-sided t-tests.

Table 6

Unemployment Effects Conditional of Workfare Patterns

		Enabling Workfare (ALMP as % of GDP per 1% Unemployed)		
		Low	Average	High
Demanding Workfare (PLMP as % of GDP per 1% Unemployed)	Low	0.351***	0.159*	-0.129
	Average	0.087	-0.104	-0.392***
	High	-0.176	-0.368***	-0.656***

Conditional effects from estimating FGLS and standard errors adjusted for within-country correlation. Numbers are estimated coefficients of unemployment variable. * if statistically significant at 90% level of confidence, ** if statistically significant at 95% level of confidence.

Table 7

Unemployment during the Crisis

	2007	2008	2009	2010
Australia	4.4	4.2	5.5	5.2
Austria	4.4	3.8	4.8	4.9
Belgium	7.5	7.0	7.9	8.2
Canada	6.0	6.2	8.3	7.9
Denmark	3.6	3.2	5.9	7.2
Finland	6.9	6.4	8.3	9.4
France	8.0	7.4	9.1	9.8
Germany	8.3	7.2	7.4	7.6
Greece	8.3	7.7	9.5	12.1
Ireland	4.6	6.0	11.7	13.7
Italy	6.2	6.8	7.8	8.7
Luxembourg	4.4	4.4	5.7	6.0
Netherlands	3.1	2.7	3.4	4.6
Norway	2.5	2.6	3.2	3.3
Spain	8.3	11.3	18.0	19.1
Sweden	6.1	6.2	8.3	8.8
Switzerland	3.6	3.5	4.4	4.6
U. K.	5.4	5.7	7.6	8.1
U.S.A.	4.6	5.8	9.3	9.7

Unemployment as % of labor force (not harmonized). Source: OECD 2010b.

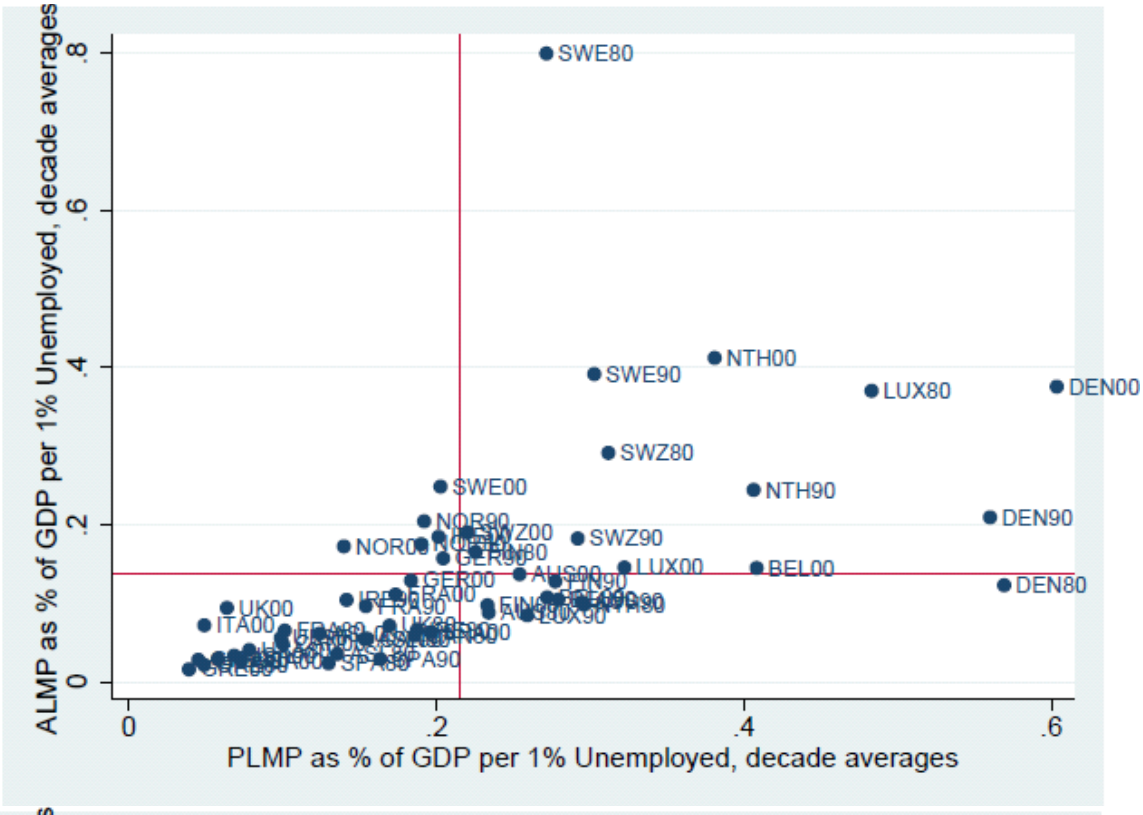
Table 8

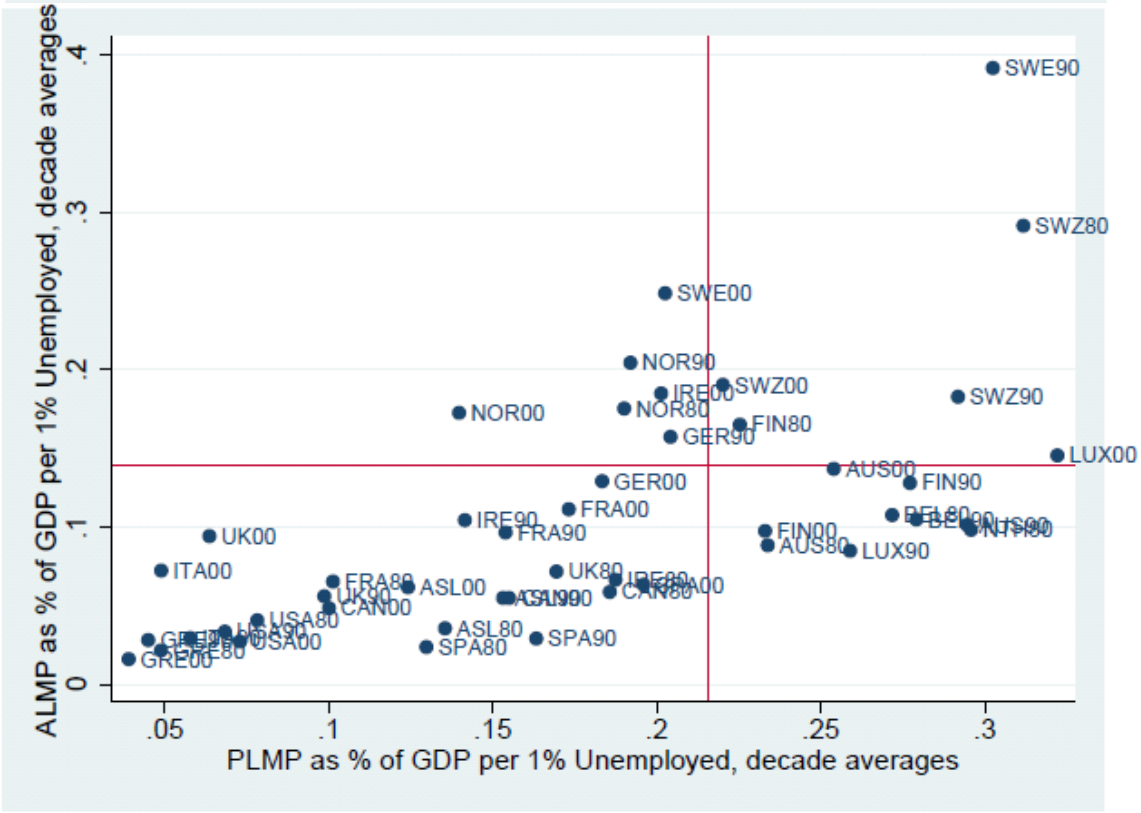
Workfare during the Crisis

	ALMP Generosity (ALMP/GDP/Unemployment)			PLMP Generosity (PLMP/GDP/Unemployment)		
	2006	2007	2008	2006	2007	2008
Australia	0.07	0.07	0.07	0.10	0.09	0.11
Austria	0.15	0.15	0.17	0.29	0.28	0.30
Belgium	0.14	0.16	0.18	0.27	0.27	0.29
Canada	0.05	0.05	0.05	0.09	0.09	0.11
Denmark	0.39	0.35	0.41	0.47	0.40	0.37
Finland	0.12	0.13	0.13	0.22	0.21	0.21
France	0.10	0.11	0.10	0.15	0.15	0.15
Germany	0.09	0.09	0.11	0.18	0.16	0.15
Greece	0.02	0.02	0.02	0.04	0.04	0.06
Ireland	0.14	0.14	0.11	0.19	0.20	0.21
Italy	0.07	0.07	0.07	0.12	0.11	0.12
Luxembourg	0.10	0.11	0.09	0.13	0.12	0.11
Netherlands	0.30	0.34	0.38	0.43	0.44	0.46
Norway	0.17	0.22		0.15	0.17	0.13
Spain	0.09	0.09	0.06	0.17	0.17	0.17
Sweden	0.19	0.18	0.16	0.14	0.11	0.07
Switzerland	0.17	0.16	0.13	0.19	0.16	0.15
U. K.	0.06	0.06		0.04	0.03	0.04
U.S.A.	0.03	0.03	0.03	0.05	0.06	0.14

Harmonized unemployment rate as % of civilian labor force. For the definitions of active and passive policies, see text. Source: OECD 2010b.

Figure 1


ALMP as % of GDP per 1% Unemployed, decade averages
0
.2
.4
.6
.8
PLMP as % of GDP per 1% Unemployed, decade averages
0
.2
.4
.6
SWE80
NTH00
SWE90
LUX80
DEN00
SWZ80
SWE00
NTH90
DEN90
SWZ90
LUX00
BEL00
DEN80
UK00
ITA00
SPA90


ALMP as % of GDP per 1% Unemployed, decade averages
0
.1
.2
.3
.4
PLMP as % of GDP per 1% Unemployed, decade averages
.05
.1
.15
.2
.25
.3
SWE90
SWZ80
SWE00
NOR90
SWZ00
IRE00
SWZ90
NOR00
NOR80
FIN80
GER90
LUX00
AUS00
FIN90
GER00
FRA00
IRE90
FRA90
FIN00
AUS80
LUX90
UK00
ITA00
UK80
FRA80
ASL00
UK90
CAN00
USA80
ASL80
SPA90
SPA80
GRE00

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Appendix: Variables Used in the Analysis

Variable	Definition	Source
Relative Poverty	Percentage of the population earning less than 60 percent of the median disposable household income.	LIS
Unemployment	Unemployment rate (% of civilian labor force)	QoG, OECD.
Unemployment Benefits	Unemployment expenditure, public, total as % of GDP.	QoG, OECD Social Expenditure Database.
ALMP	Active labour market programs total, % GDP.	QoG, OECD Social Expenditure Database.
Service Employment	Civilian employment in services as % of civilian employment.	OECD, Labour Force Statistics.
Female Employment	Female labor force participation as % of civilian employment.	OECD, Labour Force Statistics.
Wage Bargaining Coordination	Coordination of wage bargaining: 5 = economy-wide bargaining, based on a) enforceable agreements between the central organisations of unions and employers affecting the entire economy or entire private sector, or on b) government imposition of a wage schedule, freeze, or ceiling; 4 = mixed industry and economy-wide bargaining: a) central organisations negotiate non-enforceable central agreements (guidelines) and/or b) key unions and employers associations set pattern for the entire economy; 3 = industry bargaining with no or irregular pattern setting, limited involvement of central organizations and limited freedoms for company bargaining; 2 = mixed industry- and firm level bargaining, with weak enforceability of industry agreement; 1 = none of the above, fragmented bargaining, mostly at company level.	ICTWSS (2009).
Union Density	Trade union density, the % of wage and salary earners that are trade union members, divided by the total number of wage and salary earners – calculated using survey data, wherever possible, and administrative data adjusted for non-active and self-employed members otherwise.	OECD, Labour Force Statistics.
Left Government	Cabinet composition: social democratic and other left-wing parties as a percentage of total cabinet posts, weighted by the number of days the government was in office in a given year.	CPDS (2009).
International Openness	Openness to Trade (imports plus exports) as % of GDP, Constant 1990 Prices	QoG, UN Except Germany, OECD, Economic Outlook

ENDNOTES

[1] For an exception, see Dolls, Fuest and Peichl 2010.

[2] It could also be argued that the causal relationship between unemployment and wages outlined above could in fact be reversed. A number of studies suggest that employers are more likely to lay off unskilled workers than skilled workers during economic downturns, and to the extent that an increase of unemployment entails a disproportionate loss of low-paid jobs, it should be associated with less

wage inequality. See Rueda and Pontusson (2000) for some evidence. Even if this was the case, however, the effect on unemployment on household disposable income inequality and relative poverty (as it will be explained below, this is the measure of interest for this paper) would still be positive.

3 To the degree that social benefits, whether active or passive, are paid by the rich to pay/insure the poor they may also promote equality in a different way: as a result of unemployment they may automatically bring down the top half of the distribution (who have to pay higher taxes) to protect an increasing number of unemployed people at the bottom. I will return to this idea when discussing the results.

4 For details on the effects of unemployment benefits, see, for example, Carlin and Soskice (2007).

5 There is a more detailed analysis of this possibility in the next section.

6 The terms welfare-to-work and workfare are often employed to describe a particular aspect of activation policies commonly identified with the "Anglo-saxon" model. In this section, I use it to encompass a more general set of activation policies.

7 See, for example, Ferrera and Hemerijck (2003) and the contributions in Pierson (2001a).

8 For the case of France, see Barbier and Kaufmann (2008), for the Netherlands, see Aarts and De Jong (1996).

9 The continental cases, in Barbier's view, are characterized by heterogeneity and it is difficult to find any common trends.

10 In some of the literature on activation, this punitive side of policy is often simply described as "workfare." See Serrano Pascual (2007).

11 See, for example, Huber and Stephens (2001).

12 This measure of unemployment benefits includes all public cash expenditures to the unemployed. It includes redundancy payments out of the public budget as well as some early-retirement "pension" expenditure (to unemployed beneficiaries before they reach the standard pensionable age).

13 Even leaving aside Australia, France, Greece, and the US, where the decreases have not been substantial, we still have 7 countries where benefit generosity has decreased significantly.

14 Cross-nationally, this measure is highly correlated with the one in Table 2. When looking at temporal variation, however, the correlation is lower. Figures available from the author.

15 The exceptions when comparing with Table 1 are Belgium, which has high levels of unemployment generosity but intermediate ones of ALMP; and Switzerland and Sweden, which have intermediate levels of unemployment generosity but belong to the more generous group when looking at ALMP.

16 The policy variables are lagged in both equations because of concerns about endogeneity. If not lagged, the results of the policy variables could be suspected to be themselves the result of unemployment (in the first equation) or poverty (in the second). For similar reasons I also lag unemployment in the second equation. By lagging these variables, I am trying to capture their causal effect over time on contemporary unemployment (first equation) and contemporary poverty (second equation). The results I present are robust to the estimation of lags of different duration (as well as of 5-year moving averages).

17 See Appendix for details and sources for all these control variables.

18 See Rueda (2008).

19 Although not the focus of this paper, the results in Table 4 also show that higher level of service employment, lower levels of female labor force participation, higher union density and less international openness all promote higher unemployment levels.

20 These OECD averages hide a high degree of national variation. In 2009, countries like Spain exhibit particularly dramatic youth unemployment rates (37.9% unemployment for young people, compared to 16.5% for prime age workers). But even in the case of Sweden, where "last-in first-out" rules are followed for layoffs, the numbers are significant (25.0% unemployment for young people versus 6.2% for prime age workers). See OECD 2010b.

21 In terms of education effects, the USA is a particular unequal country. The unemployment rate for people with less than an upper secondary education there was 10.1% while it was only 2.4% for those with a tertiary education.

22 In Spain 85% of job losses affected people with temporary employment (OECD 2010a:54).

[23] This is not as significant a change as in simulation for Sweden. In Sweden, the decrease is 0.07%. But in 2006 data, the UK only spent 0.04% of GDP per1 % unemployed on unemployment benefits and 0.06 of GDP on ALMPs. The simulated decreases simply take the values to 0.

[24] See OECD (2010b:18-19).