Etceteras . . .

A Tale of Two Labor Markets

The post–World War II economic history of Western Europe and the United States divides neatly into two halves, which we might call the Golden Age and the Time of Troubles, respectively. In the latter era Europe achieved only a small increase in employment and suffered a huge increase in unemployment, while the United States achieved a huge increase in employment and kept its unemployment in check.

What Has Happened?

During the Golden Age, from 1945 to 1973, the European economies recovered from the war and enjoyed high rates of economic growth. The United States, having emerged from the war with relatively little loss of human and material capital, experienced somewhat slower economic growth but remained the world's most productive and prosperous nation.

Before 1974, despite concerns about certain lagging industries and regions, unemployment did not seem to constitute a major problem in the North Atlantic economy. In the 1960s the unemployment rate ranged from 1.3 to 2.6 percent in France, from 0.3 to 1.4 percent in West Germany, from 2.4 to 3.8 percent in Italy, and from 2.0 to 3.4 percent in the United Kingdom (U.S. Council of Economic Advisers, *Report* [Washington, D.C.: U.S. Government Printing Office, 1980], p. 326). For the group of countries that eventually became the first twelve members of the European Union (EU), unemployment stood at about 2.5 percent from 1960 through 1974 (George Alogoskoufis and others, *Unemployment: Choices for Europe* [London: Center for Economic Policy Research, 1995], p. 6). In the United States the long economic expansion of the 1960s brought the jobless rate down to 3.5 percent by 1969, though it did rise thereafter, reaching 5.9 percent in 1971 (U.S. Council of Economic Advisers, 1980 *Report*, p. 326).

On both sides of the Atlantic, the recession of 1973–75 ushered in the Time of Troubles. The U.S. unemployment rate rose to 8.5 percent in 1975, the EU rate to about 4 percent. After the recession, unemployment fell during the latter half of the 1970s in the United States, but it continued to climb in Europe, and by 1979 the U.S. and the EU jobless rates had converged at about 6 percent. With the onset of another recession, the two rates rose in tandem for the next three years, reaching nearly 10 percent in 1982. After 1983, the U.S. recovery pushed unemployment down rapidly, but in Europe unemployment continued to climb until mid-decade. Though European joblessness declined a good deal in the late 1980s, it stood about 3 percentage points above the U.S. level when the recession of the early 1990s began to push it up again. In the early 1990s, just as in the early 1980s, Europe's unemployment continued to rise long after the U.S. rate had peaked and begun to fall (Alogoskoufis and others, p. 6; Alan R. Townsend, *Making a Living in Europe: Human Geographies of Economic Change* [London and New York: Routledge, 1997], pp. 27, 62; U.S. Council of Economic Advisers, *Report* [Washington, D.C.: U.S. Government Printing Office, 1997], p. 421). By 1997 the U.S. rate had dipped below 5 percent, while the EU rate remained well above 10 percent.

France, whose unemployment rate during the past quarter-century has tracked that of the entire European Union closely, can serve for a comparison with the United States (see figure 1). From the graph one gets the clear impression of a widening performance gap between the two job markets, opening in 1984 and yawning ever wider since 1992. By the latter part of 1997, France had an unemployment rate of 12.5 percent (September), the United States 4.7 percent (October). (Data plotted in figure 1 for 1970–96 are from U.S. Council of Economic Advisers, 1997 *Report*, p. 420; for September and October 1997 from *The Economist*, 29 November 1997, p. 108.)

Among the major European economies in the 1990s, only the United Kingdom seemed capable of getting a grip on its unemployment problem. By October 1997 the U.K. jobless rate had dropped to 5.2 percent, just half a percentage point above the U.S. rate.

Among the smaller European economies, some did better, some worse, relative to the three big problem children, Germany, France, and Italy. By the latter part of 1997 (September or October), jobless rates stood at 7.7 percent in Denmark, 7.1 percent in Austria, 6.8 percent in Sweden, 5.3 percent in the Netherlands, and 4.8 percent in Switzerland. At the other extreme, in 1997 Belgium reported 13.4 percent of its labor force unemployed for October and Spain 20.8 percent for the second quarter, though informal reports indicate that many of the Spaniards reported as without jobs are actually working in the underground economy—a phenomenon obviously occurring elsewhere in Europe as well. (All 1997 unemployment data in this section are from the Organization for Economic Cooperation and Development, as reported in *The Economist*, 29 November 1997, p. 108.)

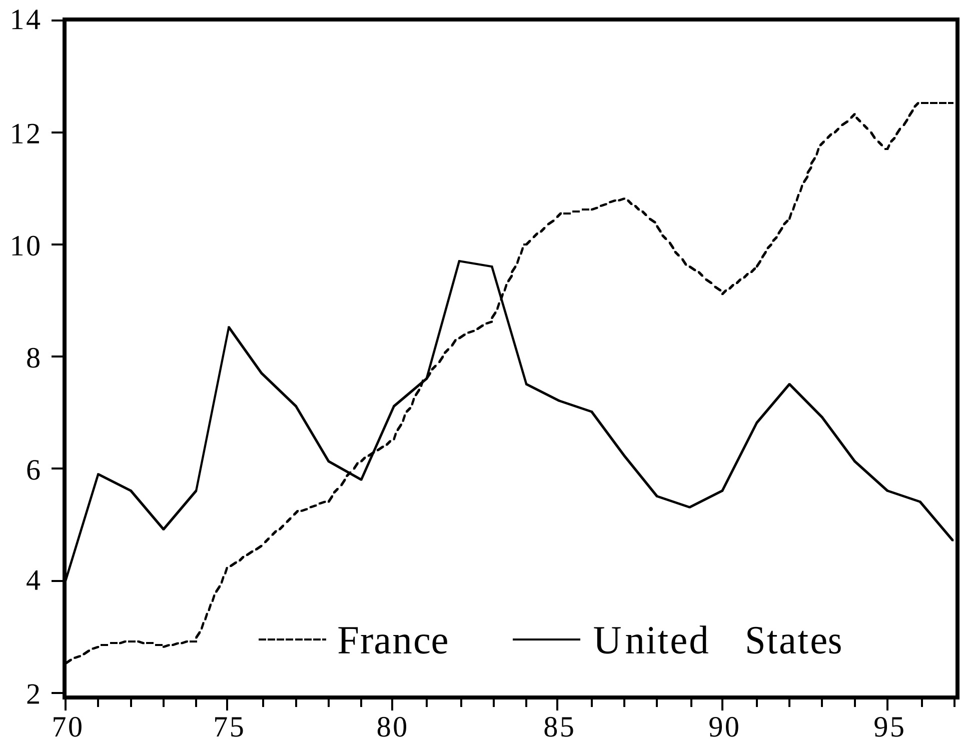
Whence the Trouble?

Why the high, persistent, rising levels of unemployment in Europe? The question has a short answer, a long answer, and a fundamental answer. The short answer is: the cost of labor is too high. The long answer, which explains why the cost of labor remains too high to clear the market, pertains for the most part to government policies and their consequences. The fundamental answer, which brings us to politics, has to do with how the political process has given rise to the adoption and maintenance of policies that entail high, persistent, rising levels of unemployment.

As figure 1 illustrates, since 1970 the U.S. unemployment rate has varied mainly with the course of macroeconomic fluctuations, although the peaks and troughs of the unemployment-rate cycle did tend to rise until the early 1980s and to fall thereafter. For the period from 1970 through 1997, the mean rate was 6.5, the range from 4.0 to 9.7. Of the year-to-year changes, nine were positive, eighteen negative.

European unemployment, in contrast, tended to rise almost relentlessly and displayed only a muted relation to the course of macroeconomic expansion and

Figure 1. Unemployment Rate (percent), 1970-1997



contraction. In France, for example, from 1970 through 1997 the mean rate of unemployment was 7.9, the range from 2.5 to 12.5. Of the year-to-year changes, twenty-one were positive, five negative, and one approximately zero. Again, figure 1 tells the story: a horizontal trend in the United States; a steeply rising trend in France, as in Western Europe as a whole.

The figure does not reveal an even more startling fact: for the past twenty-five years, European labor markets have expanded employment by only a tiny amount. Between 1972 and 1992, when U.S. employment rose by 36.4 million persons (44 percent), EU employment rose by just 5.9 million persons (4.8 percent), even though simultaneously the EU population aged 15–64 increased by 18.9 million (9.7 percent) (U.S. Council of Economic Advisers, 1997 *Report*, p. 340; Townsend, p. 34).

Why has Western Europe virtually lost its capacity to generate new employment? We can place the causes under two headings: those that deter employers from offering jobs and those that discourage would-be workers from seeking or accepting offers.

Over time, European governments have mandated an extensive list of employment benefits—for instance, a month or more of paid vacation annually and a year of maternity leave with 75 percent of pay—that elevate the costs of employing permanent workers. "Mandated severance pay and the required period of notice before dismissals can occur are generally greater in Europe than in the United States, and furthermore in some countries these have tended to become more stringent over time" (Charles R. Bean, "European Unemployment: A Survey," *Journal of Economic Literature* 32 [June 1994]: 595; see also the data presented by Alogoskoufis and others, p. 63). Payroll taxes have reached extraordinary levels—more than 50 percent in France and Italy (U.S. Bureau of the Census, *Statistical Abstract*, 116th edition [Washington, D.C.: U.S. Government Printing Office, 1996], p. 841). Wilfried Prewo reports that "indirect labor costs in Germany [which recently amounted to about 46 percent of total labor compensation] have increased about twice as fast as gross wages since 1966, and this increase is closely correlated with the rise in the unemployment rate" (*From Welfare State to Social State: Empowerment, Individual Responsibility, and Effective Compassion* [Zellik, Belgium: Centre for the New Europe, 1996], pp. 8–9). Given the high costs of employing and firing workers, employers are loath to add workers unless they are sure that they will have a long-term need for those workers and confident that the new workers will prove sufficiently productive to warrant the costs and risks of employing them.

Labor unions receive greater privileges in Europe than in the United States, and the European labor force is much more heavily unionized. Unions represent more than 40 percent of European employees, in contrast to fewer than 15 percent in the United States (Bean, p. 586). By pushing wages and benefits above competitive levels, unions discourage hiring and encourage plant closures and the relocation of production to lower-cost venues. European unemployment is especially high among heavily unionized manual workers such as miners and shipbuilders (Bean, p. 590; Townsend, p. 21).

Minimum-wage laws, which are relatively generous in Western Europe, diminish the prospects of unskilled and inexperienced job seekers, especially young people. The French minimum wage, for example, rose from 40 percent of average earnings in the 1960s to 50 percent in the 1980s, whereas the U.S. minimum wage fell relative to the average wage (Bean, p. 595). The socialist government that assumed power in 1997 in France raised the minimum wage further, to 39.4 francs (about $6.20) per hour. This government's plans also included raising corporate taxes, cutting the workweek from 39 to 35 hours with no cut in pay, and putting an additional 350,000 persons into make-work at taxpayer expense (Douglas Lavin, "Socialists Sweep to Victory in French Vote," *Wall Street Journal,* 2 June 1997; Douglas Lavin, "Tale of Two Job Markets: Why England Works, France Doesn't," *Wall Street Journal,* 7 August 1997).

While European public policies discourage employers from offering jobs, they also deter potential workers from actively seeking or accepting offers. Unemployment benefits replace nearly 60 percent of average earnings and in many countries extend virtually indefinitely (Bean, p. 586). Researchers have found "a very significant relationship between the length of time for which unemployed workers are eligible for benefits (generally much longer in the European Community than elsewhere) and the degree of persistence in the unemployment process across countries" (Bean, p. 610). Taking a job means sacrificing the dole and becoming subject to heavy income and employment taxes, so the jobless, especially those whose earnings would be relatively low, have little incentive to seek or accept work. In 1993 in the European Union, 43.3 percent of the unemployed had been out of work for more than a year, in contrast to just 11.7 percent in the United States (Alogoskoufis and others, p. 12). Although workers who endure prolonged unemployment may get by on the dole, family assistance, and erratic earnings in the underground economy, they tend to lose skills and productive work habits and forgo valuable on-the-job training and experience. Employers look askance at job applicants who have not worked for a long time, so long-term joblessness tends to be self-perpetuating (Bean, pp. 608–10).

As a summary of the long answer to the European unemployment question, Martin Feldstein's 1997 statement serves nicely:

> Unemployment rates have been rising for two decades and remain high today because high unemployment benefits and other transfer payments discourage working, high minimum wages and the nonwage costs of employment (like payroll taxes, mandated fringe benefits and work rules) reduce the demand for labor, excessive regulations impede the creation of service jobs, and high income taxes induce the substitution of home production for market services. ("The Political Economy of the European Economic and Monetary Union: Political Sources of an Economic Liability," *Journal of Economic Perspectives* 11 [Fall 1997]: 40)

Why These Policies?

Identifying the causes of the high, persistent, and rising levels of unemployment in Western Europe does not require rocket science, just basic economics. But the fundamental question remains: If Europe's unemployment problem results from its public policies and their consequences, why do the European countries maintain and even augment these pernicious policies? Answering this question requires a much deeper and wider analysis. It calls for an explication of the political actions taken in more than a dozen countries over a span of several decades. No short answer can suffice, and I am not so presumptuous as to offer one here.

Some clues, however, should not be ignored. Many observers have noted that Europe's unemployed tend to fall disproportionately into certain classes: younger adults (say, under 25); older adults (say, over 50), especially those who have been laid off because of plant closures or workforce reductions in declining industries; the unskilled; and women. In 1995 the average EU unemployment rate was 9.5 percent for men, 12.5 percent for women (Townsend, p. 28). In most European countries the unemployment rate for young adults recently has stood much higher than the rate for older persons, often more than twice as high. In France, Italy, and Spain the rate for younger adults has exceeded 25 percent. Persons aged 15–24 accounted for 27.6 percent of all EU unemployment in 1994 (Townsend, p. 29).

One sees the significance of these data by reflecting on how much political power young people, women, and older unskilled men tend to wield in European politics—in general, relatively little. In Western Europe's interest-group democracies, as elsewhere, people with the most political muscle control the instruments of government in the service of their own interests. Of course, the Europeans would never simply throw the unemployed to the wolves, as they fancy the Americans do. In Europe governments shower the unemployed with an array of "protections" that—as economic analysis demonstrates and empirical evidence corroborates—contribute to the perpetuation and exacerbation of the unemployment problem.

Obviously, the foregoing discussion only sketches Europe's unemployment problem. Readers who wish to learn more will find an ample, if not always astute, literature by economists and other social scientists. Charles R. Bean's 1994 survey article, on which I have drawn, provides a good place to start. Anyone who wishes to contribute further to a detailed understanding of this problem will discover that many questions remain open.

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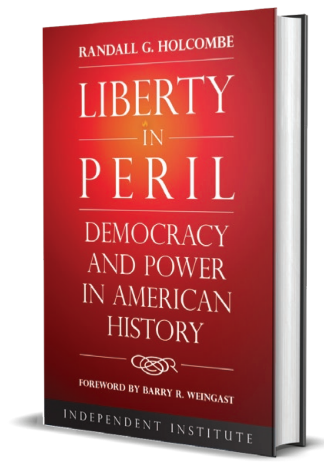

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