

David R. Howell, *Fighting Unemployment: The Limits of Free Market Orthodoxy* (with a preface by Richard Freeman), Oxford University Press.

Keywords: flexibility, unemployment, inequality, wages, earnings, labor markets, labor market regulation, deregulation, labor market institutions, welfare state, free markets

Much of Europe remains plagued by high levels of unemployment. *Fighting Unemployment* critically assesses the widely accepted view that the culprit is excessive labor market regulation and overly generous welfare state benefits. The chapters include both cross-country statistical analyses and country case studies and are authored by economists from seven North American and European countries. They challenge the standard free market prescription that lower wages for less skilled workers, weaker labor unions, greater decentralization in bargaining, less generous unemployment benefits, and much less job security are necessary for good employment performance. The cross-country chapters find that supporting evidence is surprisingly thin. There is little or no evidence of an equality-employment tradeoff: more wage equality is not found to be associated with higher unemployment (or lower employment) rates. And while some recent statistical tests of the role of protective labor market institutions across the most affluent countries have been interpreted to lend support to the orthodox view and have been highly influential in both professional and policy circles, these results are shown to vary significantly across studies and to be highly sensitive to minor changes in the way the tests are run. The case study chapters suggest that good employment performance has been achieved less by shrinking the welfare state and deregulating the labor market than by *effectively coordinating* macroeconomic and social policies with the wage bargaining system – an achievement that requires both strong employer and union associations and a relatively stable and consensual political environment. The larger message of this book is that fundamentally different labor market models are compatible with low unemployment, ranging from the free market ‘American Model’ to the much more regulated and coordinated Scandinavian systems.

Chapter 1: David R. Howell, “Introduction”

Keywords: welfare state, labor market, regulation, unemployment, employment, deregulation, labor market institutions

This introductory chapter briefly outlines the historical development of the welfare state and then provides an overview of the several dimensions of the employment problem, focusing on the pattern of unemployment and employment rates across affluent OECD countries for various demographic groups. It outlines the “OECD-IMF orthodoxy,” the widely accepted view that the main source of employment problems in affluent countries is benefit generosity and labor market regulation. The chapter compares some of the main indicators of labor market institutions and social benefits that are commonly blamed for poor employment performance and considers the justification for them on equity and efficiency grounds. Each of the remaining chapters is then summarized.

Chapter 2: David R. Howell and Friedrich Huebler, “Wage Compression and the Unemployment Crisis: Labor Market Institutions, Skills, and Inequality-Unemployment Tradeoffs”

Keywords: inequality, tradeoff, skill mix, skill distribution, welfare state, labor market, regulation, unemployment, employment, deregulation, labor market institutions

At the core of the orthodox view is the belief that policy makers face an ineluctable choice between employment and equality. With data from the OECD for the major affluent OECD countries, empirical support for a variety of tradeoffs are explored: between unemployment rates and earnings inequality; between the change in unemployment rates and the growth in earnings inequality; between unemployment inequality (high vs. low skill) and earnings inequality; and between employment rate inequality (high vs. low skill) and earnings inequality. The authors find little evidence for these predicted tradeoffs. The chapter also looks at skill distributions and finds that differences in institutions, not skill distributions, are the main source of cross-country differences in earnings inequality. They conclude that the labor market institutions that clearly compress wages do not appear to have similarly clear and substantial adverse effects on employment performance.

Chapter 3: Dean Baker, Andrew Glyn, David R. Howell, and John Schmitt, “Labor Market Institutions and Unemployment: A Critical Assessment of the Cross-Country Evidence”

Keywords: welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, unemployment benefits, employment protection

Chapter 3 takes up the question of the robustness of the cross-country evidence for the orthodox claim that labor market institutions explain the pattern of unemployment across the affluent countries. A detailed survey of the most influential cross-country statistical studies finds a wide range of results that are highly sensitive to the nature of the variables, the time period, and the econometric method employed. Simple scatter plots of unemployment against six standard measures of labor market institutions for five-year periods between 1980 and 1999 show no significant relationships. In their multivariate tests, which follow standard approaches, the authors find weak and even perverse effects of the standard institutional variables. They conclude that “the empirical case has not been made that could justify the sweeping and unconditional prescriptions for labor market deregulation which pervade much of the policy discussion.”

Chapter 4: Jim Stanford, “Testing the Flexibility Paradigm: Canadian Labor Market Performance in International Context”

Keywords: flexibility, welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, unemployment benefits, wages, inequality, aggregate demand, Canada

Like most of Europe, Canada experienced high levels of unemployment from the early 1980s through the late 1990s. It responded by introducing significant labor market reforms aimed at implementing OECD-style flexibility. In Chapter 4, Jim Stanford points out that based on standard indicators of flexibility, like employment shifts across sectors, geographic mobility, and the levels of part-time work and self-employment, Canada gets high scores. He argues that the real objective of Canadian reforms has not been greater labor market flexibility per se, but greater labor market *discipline* through deregulation.

He finds that it is aggregate demand conditions, not labor market institutions, which best accounts for differences in labor market performance between the U.S. and Canada.

Chapter 5: John Schmitt and Jonathan Wadsworth, “Is the OECD Jobs Strategy behind U.S. and British Employment and Unemployment Success in the 1990s?”

Keywords: flexibility, welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, unemployment benefits, wages, wage inequality (wage dispersion), less-educated (less-skilled) workers, youth, United Kingdom, United States

The authors investigate the extent to which the logic of flexibility that underpins the OECD’s *Job Study* can explain the relative labor-market performance of the United States and the United Kingdom. Greater labor-market flexibility should be associated with relatively lower unemployment and higher employment of less-skilled workers, particularly young workers and those with lower levels of formal education: lower labor costs should “price” these workers back into jobs. Their principal findings call into question this central orthodox thesis. Labor market outcomes of both young and less-skilled workers in the flexible United States and United Kingdom are no better, and frequently far worse, than those of their counterparts in most of the rest of the OECD. Regarding the U.K., Schmitt and Wadsworth conclude that “the serious restructuring of the country’s labor market since the early 1980s appears to have produced no noticeable improvement in the labor market prospects facing less-skilled workers in the 1990s relative to the 1980s.” Indeed, they find that all of the improvement in U.K. unemployment rates is accounted for, not by workers being priced into the labor market, but by workers dropping out of the labor market.

Chapter 6: Andrew Glyn, “Labor Market Success and Labor Market Reform: Lessons from Ireland and New Zealand”

Keywords: flexibility, welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, unemployment benefits, wages, wage inequality, collective bargaining, Ireland, New Zealand

Ireland and New Zealand are often acclaimed as 1990s labor market success stories. Andrew Glyn shows that Ireland achieved this extraordinary improvement in labor

market performance without adopting the OECD's neo-liberal labor market policy prescription. Irish employment took off and unemployment collapsed without an increase in wage inequality at the bottom, without significant changes in employment protection regulations, and without major changes in the unemployment benefit system. He attributes Ireland's success not to deregulation, but to cooperative and regulated wage bargaining. In contrast, New Zealand's policy makers were early and enthusiastic converts to the OECD's labor market deregulation prescription, and the effects, particularly on labor unions, were substantial. But New Zealand's unemployment performance was quite mediocre in the 1990s, fluctuating between 7.8 and 10.3 percent between 1990 and 1994, and from 6.3 and 7.5 percent between 1995 and 1999. The lesson Glyn draws from this Ireland-New Zealand comparison is that "extensive labor market deregulation is neither a necessary nor a sufficient condition for a radical improvement in employment."

Chapter 7: Rafael Munoz de Bustillo Llorente, "Employment Performance and Labor Market Institutions: The Case of Spain"

Keywords: flexibility, welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, unemployment benefits, employment protection, wages, wage inequality, collective bargaining, Spain

From a stunning 23.9% in 1994, Spain's unemployment rate fell to 13% in 2001. In this chapter, Bustillo challenges the conventional views that the main culprits of Spain's high unemployment were overly generous and protective labor market institutions, and that the recent dramatic improvement can be explained by free market oriented institutional reforms. Benefit levels were not nearly as generous as many observers believe – about 30% of the average wage, one of the lowest in the European Union. Spain has been characterized by wage moderation, relatively low labor costs, and relatively high earnings inequality. Nor are employment protection laws particularly onerous - by the mid-1980s dismissal rates were comparable to other leading OECD countries. The author contends that the sources of much of the unemployment problem can be found elsewhere: in the rapid transformation from a highly agricultural to a service economy in a period of political upheaval in which employer-union relations were highly

charged; a rapidly growing labor force; low R&D investment; an ineffective system of job training and placement; and limited geographic mobility, due largely to high housing prices which made it risky for workers to relocate.

Chapter 8: Ronald Schettkat, "Is Labor Market Regulation at the Root of European Unemployment? The Case of Germany and the Netherlands"

Keywords: flexibility, welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, unemployment benefits, wages, wage inequality, labor costs, collective bargaining, Germany, unification, Netherlands

While the Netherlands experienced high unemployment in the late 1980s, it outperformed the U.S. in the early 1990s and has done so since 1997. Germany's high unemployment is entirely a post-unification phenomenon - it was not until 1993 that Germany's unemployment rate was higher than that of the United States. The author argues that despite Dutch reforms, by the late 1990s their regulations still tended to be stronger, and social protection spending more generous, than Germany's. Wage and skill dispersion are quite similar, as are the unemployment benefit systems. The answer lies elsewhere. The Netherlands has been distinguished by high levels of part-time employment, particularly among women, and has experienced substantially slower wage growth (partially compensated for by tax cuts), which contributed to an export boom. The key to the Dutch success has been a consistent mix of monetary, fiscal and wage policies. In contrast, in Germany the politics of the unification process helped produce both large public debts and substantial growth in real wages. The response was fiscal austerity, tight monetary policy, and a rise in social security payments levied on both employers and employees. The chapter concludes that the policy debate has greatly overemphasized the role of supply-side work incentives (regulations and benefits) and neglected the role of consistent wage bargaining, tax, and macroeconomic policies.

Chapter 9: Peter Plougmann and Per Kongshoj Madsen, "Labor Market Policy, Flexibility, and Employment Performance in Denmark and Sweden in the 1990s"

Keywords: flexibility, welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, active labor market policies, Denmark, Sweden

Chapter 9 considers Denmark and Sweden, two countries that exemplify the universalistic welfare state. Denmark's unemployment rate was similar to that of the U.S. in the 1980s, rose above it in the 1990s, but by 2002 was again well below it; Sweden's unemployment rate was far below the U.S. rate until the early 1990s, and although unemployment shot up to almost 10 percent in the middle of the decade, by 2002 Sweden was again outperforming the U.S.. This impressive employment performance has been achieved without changing the fundamentals of the Scandinavian Model: high tax rates, a comprehensive social security system, and among the lowest levels of wage and income inequality in the developed world. The authors argue that much of the explanation can be found in a strong commitment of both countries to active labor market policies, such as job placement and work-related education and training programs. Danish and Swedish government interventions have acted to facilitate both labor market flexibility and the transition to the "new economy" of services and high technology. These state policies have helped promote a flexible and innovative "high-road" economy without abandoning the universalistic welfare state.

Chapter 10: David R. Howell, "Labor Market Institutions and Unemployment: An Assessment"

Keywords: flexibility, welfare state, labor market, regulation, deregulation, unemployment, employment, labor market institutions, unemployment benefits, wages, wage inequality, labor costs, collective bargaining

This concluding chapter makes use of evidence from the earlier chapters in this volume, from other recent country case studies, and from additional data on selected country "success stories" and "failures" to sum up the empirical case against the orthodox view – that labor market rigidities explain high unemployment and that free market reforms are required for good employment performance. Some dimensions of the French, Italian, Belgian, and Austrian experiences not covered in the earlier chapters are briefly discussed. The country case study evidence suggests an alternative to the orthodox rigidity account: employment performance across affluent countries appears to be related to the ability to effectively coordinate macroeconomic and social policies with the wage bargaining system, and that this in turn seems to require both strong employer and union associations and a relatively stable and consensual political environment. In any case, it is

evident that fundamentally different labor market models are compatible with low unemployment, ranging from the free market 'American Model' to the much more regulated and coordinated Scandinavian systems. The policy discourse should move beyond free market orthodoxy.