

Problems of Unemployment in Europe and the United States

Assar Lindbeck

Productivity growth and employment

During periods of high unemployment, the specter of "technological unemployment" always seems to recur in the popular discussion. With reference to labor-saving technological advances, it is argued that less and less labor is needed in the production process. Good employment performance is therefore asserted to require that "available" work be shared. As economists have tried to explain, over and over again, such assertions lack both theoretical and empirical support. The basic reason why productivity growth does not, by itself, generate higher unemployment is, of course, that it allows higher real wages and profits, and hence increased purchasing power to match the higher capacity of the national economy to produce goods and services. Historically, productivity growth has indeed resulted in higher aggregate production, real income and consumption, rather than in reduced aggregate demand for labor. It is interesting to note that unemployment was particularly low in the 1950s and 1960s, when productivity growth was exceptionally fast. The recent rise in unemployment has taken place during a period when productivity growth was only half as rapid as during the 1950s and 1960s.

A happy outcome presupposes, of course, that basic adjustment mechanisms in the economic system are able to function -- indeed, are *allowed* to function. In particular, two types of mechanisms have to operate. First, aggregate demand for goods and services has to increase at about the same rate as real income. The importance of this point is illustrated by the successful employment performance during the first two decades after World War II, when aggregate output and aggregate demand grew by between 4 and 5 percent per year in Western Europe.

A second prerequisite for avoiding rising unemployment in connection with productivity growth is that labor and capital be gradually reallocated in response to sector-specific shifts in technology, changes in the composition of demand and new trends in international competition. In particular, labor and capital have to be reallocated from product areas with relatively weak expansion of demand, as compared to productivity growth, to product areas with relatively fast expansion of demand. This in turn requires that all major markets in the national economy function reasonably well -- the product market, the capital market and the labor market.

In particular, to avoid increased mismatches between demand and supply for workers with different skills and other abilities, it is important that education, retraining and relative wages adjust to changes in demand-supply relations. A labor market where such adjustments occur smoothly is what we usually refer to as a "flexible" labor market. Indeed, we cannot have a well-functioning market economy as long as the most important market of all, namely that for labor, is not allowed to function simply *as a market* rather than as an administratively operated system. The labor market does not, and cannot, function as an auction market, or even as a "normal" product market for consumer goods or capital goods. For instance, labor-market contracts are usually "open" in the sense that the tasks of workers are continuously adjusted during a contract period rather than determined when an initial employment contract is signed. In addition to its "technological" input-output relations in the production process labor is also involved in long-term *social relations*

with management. The labor market also comprises many more adjustment mechanisms than just changes in the price of labor. Education, training and changes in the assignment of tasks are perhaps the most obvious examples. Well-functioning labor-market exchange systems that help match vacancies and job seekers are also important. All these features can contribute to a flexible labor market, but they cannot entirely replace the need for flexible relative wages in response to shifts in demand for and supply of different types of labor.

Suppose that these requirements are fulfilled with respect to expanding aggregate demand, in proportion to increased productive capacity, and considerable flexibility in the allocation of resources. It should then be possible to avoid long periods of heavy unemployment. In other words, it is not true that "work sharing" is the only way to avoid high and persistent unemployment in societies with rapid technological advance and large structural change. The amount of available work is not given; it depends on existing institutions and policies. Properly conducted stabilization policy can also reduce cyclical fluctuations in capacity utilization and unemployment.

Increases and persistence of unemployment

The current employment situation in Western Europe should be addressed in the light of these general considerations. It should then be kept in mind, however, that the initial *rise* in unemployment in Western Europe occurred in three big leaps in conjunction with major macroeconomic shocks in the mid-1970s, the early 1980s and the early 1990s (Figure 1). I refer, of course, to the two oil-price shocks and the restrictive demand management policy that was pursued both after the second oil-price shock and in connection with attempts by governments to bring down inflation and reduce budget deficits in the late 1980s and early 1990s.

Such sudden upward shifts in unemployment occurred in both Western Europe and the United States. The basic difference between the two regions is, as we know, that high unemployment turned out to be much more prolonged in Western Europe than in the United States. As a result, the unemployment rate today is more than twice as high in Western Europe as in the United States. The difference in employment performance is even more pronounced if we look at the *employment* rates of individuals of working age. While this rate has increased from 63 to 73 percent in the United States since the mid-1970s, the corresponding figure has fallen from 65 to 60 percent in Western Europe (Figure 2).¹ More substantively, while about 45 million new jobs have been created in the United States since the 1970s, the corresponding figure for Western Europe is only 8 million, and all of these jobs are in the public sector.

The difference in employment performance between Western Europe and the United States also shows up in so-called "Phillips loops" (Figures 3 and 4). Today low and constant inflation seems to require much higher unemployment in Western Europe than in the United States. Indeed, the United States has now returned to the same combination of unemployment and inflation as in the early 1960s. Long unemployment spells also pose a more serious problem in Europe than in the United States. It is well known that some 40-50 percent of the unemployed in Western

¹ This difference can only partly be explained by the rise in the number of regular students.

Europe have been jobless for more than a year, in contrast to only about ten percent in the United States.

These observations, and many others, suggest that there are strong “structural” elements in the unemployment crisis in Western Europe, in the sense that an expansion of aggregate demand is no longer enough to solve the problem. Then how do we *explain* why high levels of unemployment have continued for such a long time in Western Europe? My interpretation is that various institutions and mechanisms in the European economies tend to slow down the reversion of the unemployment rate to its initial level after unemployment-creating shocks. This, of course, is what we mean by *unemployment persistence*. Thus, even though specific institutions and mechanisms in Western Europe did not cause the initial rise in unemployment, they have contributed to making high unemployment persist. Statistically, however, it is difficult to distinguish between such unemployment persistence and changes in what is often called the “equilibrium unemployment rate”, or the “sustainable” unemployment rate.²

Needless to say unemployment performance differs considerably among West European countries. For instance, full employment did not break down in the EFTA countries until the early 1990s (Figure 1). Indeed, Switzerland and Austria have still not experienced much of an increase in their unemployment rates. Differences in macroeconomic policies seem to be one important explanation for the different time paths of unemployment in various countries. It is quite clear, for instance, that the abrupt breakdown of full employment in Sweden and Finland in the early 1990s was closely related to the overheating of their domestic economies in the late 1980s and its backlash. This overheating was evidenced by unsustainable booms in construction, financial institutions, private consumption and wage formation in the late 1980s. As we know, the global recession and the rise in international real interest rates accentuated the downturn in the early 1990s. But another important explanation for the collapse of full employment in Sweden and Finland may be found in various *transition problems* following changes in the macroeconomic policy regime in the early 1990s, i.e., a shift to an anti-inflationary, non-accommodating policy strategy.

As a result, open unemployment in Finland today is among the highest in Western Europe, and the Swedish figures are about the same as the West-European average -- 10-11 percent in terms of standardized OECD and EU statistics. For some reason, the statistical authorities in Sweden entertain the domestic population with figures that are about two percentage points lower than those which comply with internationally standardized statistics.³

Explanations of unemployment persistence

Why then is unemployment so persistent in Western Europe? The two most celebrated explanations are probably (i) behavior adjustments over time among unemployed workers; and (ii) low incentives for firms to hire workers.

The first type of explanation reflects conditions on the supply side of the labor market. In particular, it emphasizes limited search activities and “choosiness” among

² This is often defined as the rate at which labor demand is consistent with wage-setting behavior. When this definition is combined with the assumption that inflation does not tend to increase, we have the celebrated NAIRU definition of equilibrium unemployment.

³ One explanation for the difference is that students who report that they would rather work than study are not included in the labor force in Swedish national unemployment statistics.

some unemployed workers in accepting offered jobs. In some cases workers even stop searching -- the so-called "discouraged worker effect". Pockets of "unemployment cultures" may also have emerged, possibly in connection with endogenously changing social norms concerning the importance of work. High unemployment benefits, as compared to relevant after-tax wages, are often asserted to be a contributing factor. This seems to be a realistic assertion, in particular when individuals can keep their unemployment benefits for long periods of time, and when administration of the benefit system is lax.

A number of factors on the labor-demand side have also contributed to high persistence of unemployment in Western Europe. Prolonged periods of restrictive demand management policy are perhaps the most obvious example. These policies are founded partly on ambitions to make the exchange rates of European countries converge, as well as to live up to various Maastricht requirements. But it is also important to realize that restrictive demand management has partly been "forced upon" West European governments by the inflation bias in wage formation, though this bias is to some extent a result of institutions and regulations created by the governments themselves.

Politicians and unions have recently acquired a greater understanding of the fact that rapidly rising real wages threaten employment prospects -- particularly in a medium- and long-term perspective. So far, however, it is the role of the *average* wage level that has been emphasized. But what is of *direct* importance for the labor demand of individual firms is *not* the average wage but the wage rates for specific jobs and specific workers. In other words, *relative wages*, and not just the average wage, matter. This means, of course, that compression of relative wages -- via government intervention or centralized wage bargaining -- will influence the employment situation. The effects depend, however, on the initial position of relative wages as well as a number of other factors. Wage compression may, indeed, improve the functioning of the labor market if market forces happen to "ask" for smaller wage differentials. Such a situation may have existed in several countries during the first two or three decades after World War II. The consequences of wage compression are different if market forces instead "ask" for a widening of wage dispersion. This may well be the situation today, as an increase in the demand for skilled labor seems to have taken place at the expense of unskilled labor. In this situation, a "forced" compression of relative wages, or even an attempt to prevent a widening of wage differentials, will result in excess supply, i.e., unemployment, for low-skilled workers and excess demand, i.e. vacancies, for high-skilled workers. The result would be "structural unemployment".

The *strength* of the effects of shifts in relative labor demand differs, of course, among countries depending on many factors. For instance, policies that encourage retraining and labor mobility would be expected to mitigate the effects on both relative wages and relative employment rates for different types of workers. Some authors have also hypothesized, quite realistically I think, that these effects will be relatively weak in countries with a rather even *initial* distribution of the stock of human capital. Germany has been mentioned as an example (Nickell and Bell, 1996). More specifically, the apprenticeship system in Germany seems to have produced a large stock of workers who are fairly good substitutes for highly skilled ones. This means that a rise in the demand for skilled workers does not necessarily have to result in very large changes in either relative wages or relative employment rates. The same

reasoning helps explain why recent shifts in the composition of demand for different types of labor have reduced both relative wages and relative employment rates of low-skilled workers in the United States, where the distribution of human capital is very uneven in the lower tail of the distribution.

These considerations suggest that many countries, including Sweden, have much to learn from *both* the United States *and* Germany. A positive lesson from the United States is that a flexible labor market allows brisk expansion of aggregate employment and helps its recovery after strong unemployment-creating shocks. A positive lesson from Germany is that broad-based education and training programs tend to mitigate tendencies towards a wider distribution of wages and employment opportunities when labor demand shifts to the disadvantage of low-skilled workers.

The present-day reorganization of work within firms may also have important consequences for the functioning of the labor market. Tasks and responsibilities are being increasingly decentralized to the shop floor, often reflected in work rotation and multi-tasking among workers. A shift is underway from a Tayloristic organization of work to what may be called a "holistic" organization. This development probably renders centralized wage bargaining more distortionary than before. The reason is that it has become increasingly difficult to classify jobs and skills; individual workers increasingly perform different combinations of tasks, which differ among firms. As a result, people outside firms, including individuals engaged in central bargaining, find it more and more difficult to be informed about appropriate wage structures within individual firm (Lindbeck and Snower, 1997). It is only within the firms, indeed perhaps only at the individual plant level, that such information is available. This is likely to result in more wage bargaining being decentralized often at the initiative of firms. In countries where centralized bargaining has contributed to squeezing wage differentials, we would then predict a wider dispersion of wages.

Wages are, obviously, not the only factor behind labor costs. High payroll taxes are often singled out as another important explanation for persistently high unemployment in Western Europe. There is some truth in this assertion, but the issue is much more complex than is usually reflected in the popular discussion. It is true that a sudden rise in payroll taxes tends to raise labor costs and hence reduce labor demand, in particular during a period when negotiated wages are fixed. But in a long-term perspective, we would expect most workers to carry the burden of higher payroll taxes, in the same way as they have to carry the burden of ordinary income taxes. A basic reason why payroll taxes would be expected to be shifted onto workers, in the form of correspondingly lower wages, is that capital is internationally mobile. This means that the rate of return on capital in the long run has to adjust to the return abroad. This shifting of higher payroll taxes onto correspondingly lower wages also mitigates, though not necessarily completely eliminates, the negative effects of higher payroll taxes on labor demand.⁴ Since it may take several years, however, for payroll taxes to be shifted in the form of lower wages, a temporary rise in wage costs will occur in the meantime. If the tendencies towards unemployment persistence are strong, a rise in payroll taxes may, therefore, reduce aggregate employment for a considerable period of time.

⁴ If wage earners try to protect their after-tax wage rates, they will react to higher payroll taxes by demanding higher wage costs than earlier at any given rate of unemployment. However, as wage costs are constrained in the long run by international factors, unemployment might rise somewhat also in a long-term perspective.

High payroll taxes, and indeed wide tax wedges in general, are particularly problematic for low-productivity workers. It is impossible to shift higher payroll taxes to the worker in the form of correspondingly lower wages onto those who are already employed at minimum wages (determined by legislation or collective bargaining). As a result, these workers will experience higher wage costs and reduced demand for their services also in a long-term perspective. In some countries, however, there is no (formal or informal) minimum wage. Higher payroll taxes can then be shifted onto lower wages. But if the wage falls below the reservation wage of the worker, he will withdraw from the labor force. Thus, for some low-skilled workers, high payroll taxes tend to create either unemployment or withdrawal from the labor force -- also in a long-term perspective.⁵

My basic message about the role of relative wage costs in Western Europe is that millions of jobs are likely to have been wiped out by a combination of high minimum wages and wide tax wedges. These employment effects are particularly important for household services, as home production is a close substitute for purchases in the market. Obvious examples are visits to restaurants, gardening, cleaning, repairs on homes and durable consumer goods, child care and old-age care. It is important to realize, however, that it is the entire tax wedge, and not just the payroll tax, that is the problem.

The political discussion has recently become more and more aware of these problems. There have also been some policy experiments to mitigate their consequences, either by reducing payroll taxes in general (as in the Netherlands) or by reducing tax wedges selectively for specific types of services (as in Belgium and France). In the United States, poor education and training, as well as "social exclusion", have instead kept many individuals out of gainful employment.

Restrictive job-security legislation in several European countries has also raised the costs of hiring workers. This tends to stabilize employment at the initial level, whatever it happens to be. If we start from a level with high employment, this is fine. But if the initial situation is high unemployment, as in Western Europe during the last two decades, large hiring and firing costs instead tend to stabilize high *unemployment* (Lindbeck, 1996).

High costs of hiring and firing labor also tend to strengthen the bargaining power of those who already have a job, the "insiders" in the labor market, at the expense of those who do not have jobs, the "outsiders". Therefore, particularly in business upswings, insiders can push up their wages to the detriment of outsiders' chances of getting jobs. These powers of insiders are reinforced both by legislation that extends the domain of collective bargaining agreements to non-organized workers and by legislation that facilitates strikes or blockades against firms which are not directly involved in labor-market conflicts. High minimum wages and strict job-security legislation can be expected to be particularly problematic for low-skilled workers in the service sector, where the demand for final output is often highly unpredictable for individual firms.

Much empirical research remains to be done before we can be confident about these asserted mechanisms of unemployment persistence. Experience has also shown that one and the same institutional feature may have quite different effects on

⁵ As we can see from the United States, such withdrawals from the labor force by low-skilled workers may also occur in connection with a dramatic widening of wage dispersion, without any rise in payroll taxes.

unemployment persistence depending on other features of the national economy, including the exact construction of various labor market regulations and welfare-state arrangements. Several authors have observed that the “fine structure” of such regulations and arrangements is important for their economic consequences.

Obstacles to employment growth in Europe depend, not only on deficient aggregate demand and on various distortions in the labor market. Defects in the functioning of product and capital markets also have a bearing on unemployment persistence. A potentially important example is the presence of various obstacles to the entry of firms: cartels, various types of government-created entry regulations and difficulties for small and medium-sized firms to get equity capital and loan capital. This means that it is complicated to quantify to what extent the high persistence of unemployment in Western Europe is due to distortions in the labor market, the product market or the capital market, respectively.

Policy options

Against this background, it is useful to distinguish between three strategies for dealing, more or less realistically, with the West European unemployment problem.

(i) The first policy strategy, which is currently very popular among European governments, is to manipulate unemployment *statistics*. With only slight exaggeration, we may say that unemployment statistics themselves have become a policy target for some governments, rather than the social conditions which unemployment statistics were originally designed to highlight. For instance, unemployment could in principle be eliminated in one stroke by putting a book in the hands of every unemployed worker, calling him a “student”, and hence removing him from the labor force.⁶

(ii) A second attempted policy strategy is to reduce the labor supply, for instance by permanently shortening the work week, sabbatical leave for workers and early retirement for employment reasons. Indeed, as mentioned earlier, advocates of the “technological unemployment” approach often, though incorrectly, assert that such “work sharing” is the only way to bring down open unemployment.

In a short-term perspective, fewer working hours per person may, no doubt, reduce open unemployment, in particular if hourly wage rates are not increased in proportion to a shorter work week. This makes a case for varying hours of work over the business cycle. It is unlikely, however, that a *permanent* reduction in hours of work will lower the unemployment rate in a long-term perspective. We would not expect a country with a smaller work force, in terms of total hours supplied, to have a lower unemployment rate in the long run than a country with a larger work force. Thus, in a long-run perspective, there is hardly any reason to abandon the traditional normative principle that hours of work per employee should be decided in a trade-off between the utility of income and leisure, according to the individual’s own preferences, rather than in an attempt to keep down the aggregate unemployment rate. It is worth noting that the two countries which lead in technological development, and which also report the most hours of work per employee, i.e., the United States and Japan, also have relatively low unemployment rates.

⁶ Education and retraining programs are sometimes designed more to keep people out of the unemployment statistics than to provide training that increases their chances of getting jobs later on. An additional example is “make-believe work” in the public sector simply to improve open unemployment statistics.

Similar reasoning holds for early retirement. There is a case for allowing individuals considerable freedom of choice regarding their pension age -- in conformity with their own evaluation of income versus leisure. There is also a humanitarian case for facilitating early retirement for health reasons, as an element of the social insurance system. But the case for implementing early retirement primarily to reduce aggregate unemployment is much weaker, in particular if it implies a permanent reduction in the retirement age. Indeed, in the long run, there is no reason why early retirement would reduce the unemployment rate, as such policies simply shrink the workforce. It is also important to realize that both fewer working hours and early retirement tend to undermine the economic foundations of the welfare state. The reason is that entitlement schemes are often based on previous full-time work.

(iii) So far, I have talked about policies designed either to manipulate unemployment statistics or to reduce the labor supply. During the early postwar period, neither of these strategies was relied on to any large extent. The idea generally accepted among politicians at the time was that unemployment should be kept low via high aggregate employment. With such an *employment strategy*, it does not make much sense to formulate the basic employment target in terms of a reduction in statistically recorded open unemployment. A more natural formulation would be in terms of the total unemployment rate or the total employment rate. The obvious policy strategy would then be to combine appropriate aggregate demand management with structural policies that revitalize entrepreneurship, facilitate reallocations of resources (including labor), encourage workers to search and accept offered jobs, provide relevant education and retraining, reduce the market powers of insiders, keep various types of government-provided benefits below relevant after-tax wages, etc. It would probably also be helpful if a considerable part of the financing of unemployment benefits could be paid by workers and unions that actually influence wage setting, rather than by the general taxpayers. Mismatches between supply of and demand for different types of workers could also be mitigated if relative wages were allowed to adjust more freely, which I believe would be facilitated by much more decentralized wage bargaining.⁷ Tax reductions or employment subsidies to low-skilled workers are also an obvious, and often suggested, policy option. To prevent such subsidies from discouraging investment in human capital, it would be useful to combine them with programs for education and training of the unskilled.

Both demand management policies and supply-side reforms are, of course, standard recommendations today. What I want to emphasize is the *complementarity* between different types of policy actions. For instance, not much is likely to be gained by stimulating labor supply, job search and job acceptance by workers if firms are not anxious to hire them in the first place. The hiring of labor may, in turn, be facilitated not only by expansion of aggregate demand for goods and services but also by maintaining appropriate real wage costs and relative wages, low hiring and firing costs and stable rules including property rights. Vice versa, aggregate demand management is more useful if structural reforms help reduce the inflationary bias in wage formation, and if search intensity and willingness to accept offered jobs are increased.

⁷ While post World War II Keynesianism emphasized the importance of letting aggregate demand grow at the same rate as full-capacity output, the functioning of the supply side of the economy was largely neglected. Demand was assumed to create its own supply -- in fact, turning Say's law upside down. More specifically, the importance of flexible markets was hardly recognized.

For reasons given above, however, freer wage formation would most likely widen the dispersion of wages. This does not mean that a wider dispersion of wages should be seen as a *method* to reduce unemployment. The proper way to look at this issue is rather that freer wage formation in Europe today is likely to result in *both* lower unemployment *and* a wider dispersion of wages, if other policy actions are not undertaken at the same time to counteract the distributional effects.

When discussing distributional aspects it is important, however, not to limit considerations to the distribution of *money income*. Unemployment is a serious distribution problem in other respects besides the consequences for the distribution of money income. There is strong empirical evidence that unemployed workers suffer much more than indicated by their low money incomes. Though some workers seem to adjust, or even accept, long-term unemployment, both everyday observations and systematic studies suggest the many individuals suffer gravely from being out of work and not just from having low income. Well-known examples are a deprivation of social relations with fellow workers, a decline in self-confidence, a loss of skills, a deterioration in mental and physical health, and even a sense of desperation. This means that large gains in the *distribution of welfare*, in a wide sense of the term, may be achieved in Western Europe by a reduction in unemployment even if it were accompanied by a widening of the distribution of wages.

There is, of course, also a considerable potential for mitigating tendencies towards a wider dispersion of disposable money income. In a long-run perspective, education and retraining are perhaps the most promising methods, as suggested, for instance, by the apprenticeship system in Germany. Other policy instruments should also be relied on, in particular in a short-term and medium-term perspective. The international literature is full of suggestions, and various experiments have also been carried out in different countries: lower income taxes or higher income transfers to the working poor, employment subsidies either to low-wage workers or to the long-term unemployed, smaller tax wedges for household services, etc. The basic idea of all such suggestions is, of course, to reduce firms' costs of employing low-skilled and inexperienced workers, without forcing them to accept extremely low disposable income.

To the extent that citizens desire higher consumption of social services rather than more consumption of private goods, there is also a case for increased employment in the production of such services. It should be kept in mind, however, that these services do not necessarily have to be *produced* by public-sector agencies, even if the services would be financed by taxes to a considerable extent. Moreover, in accordance with an efficient allocation of resources in society, the quantity and quality of consumption -- also of such services -- should reflect the preferences of individuals. This traditional and sensible principle is violated if increased public-sector employment is used *solely* to reduce unemployment -- provided other policies to reduce unemployment are available, which as I have tried to show there are.

The upshot

In this lecture I have argued that the employment and poverty problems now faced by many countries reflect failures of institutions, mechanisms and policies. In the United States, the basic employment problem seems to be poor education and training among actual and potential low-income earners. It is bound to take a long time to correct previous policy failures in this sphere. Problems of poverty and non-

employment among the low-skilled in the United States will, therefore be difficult to solve without much more reliance on employment subsidies to this group of citizens and higher transfers both to "the working poor" and (the small group of) individuals who are physically or mentally unable to work.

I have never quite understood why politicians, and the general public, in the United States offer and do so little to mitigate problems of poverty and "social exclusion", which have been well documented in the literature. The explanation has to be sought, of course, in the political process. A reasonable, though perhaps rather tautological, hypothesis is that a large middle class is simply not willing to finance policies that may improve conditions for the underclass, even if such policies are also likely to have a number of favorable indirect effects in the long run on middle-class individuals themselves.

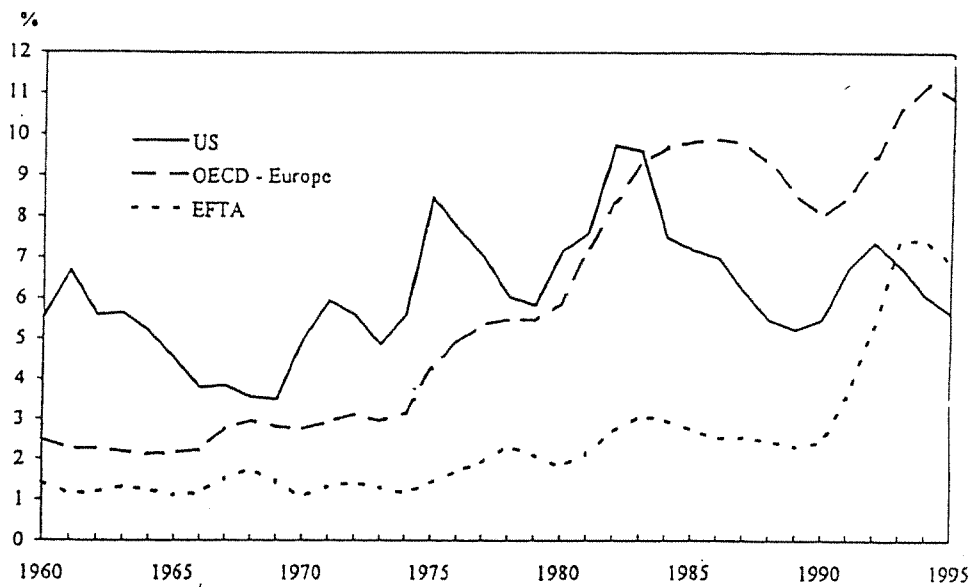
In Western Europe, the main problem is, in my judgment, that the national economies are not flexible enough to deal successfully with recent disturbances, such as international and domestic macroeconomic shocks, technological developments and changes in international competition. I have on several occasions used the metaphor that the economic and social system in Western Europe is better adapted for "fair weather" than for a "storm".

Voters who feel secure in their own jobs are probably not very eager, however, to give up privileges simply to make it easier for the unemployed to get jobs. Many citizens have, in fact, adjusted their lives to existing regulations and welfare-state arrangements, which means that reforms of these arrangements may create severe transition problems. The popularity of various welfare-state arrangements also means that it is difficult for governments to fiddle with these arrangements without risking a heavy loss of votes.

But it is also my impression that many politicians in Europe simply do not share the views expressed in this lecture about the causes of the European employment problem. Indeed, many European politicians, and even some economists, are fully occupied downplaying various deficiencies in the functioning of the economic and social systems in Europe, including the labor market.

These are probably some of the reasons why European politicians have largely "capitulated" in their attempts to reform institutions, mechanisms and policies. Instead, they are working hard to manipulate unemployment statistics and restrict the supply of labor. This is certainly not the most promising route back to full employment in Europe. Successful employment policies should, in my view, rely heavily on a *combination* of three types of policy measures -- (i) education and training of actual and potential low-skilled workers; (ii) liberalization of markets including the labor market; and (iii) tax reductions or employment subsidies to people who would otherwise be "working poor", unemployed or wind up outside the labor force. In this short lecture I have only been able to give a few concrete examples of how such a broad policy strategy can be furnished with substantive content.

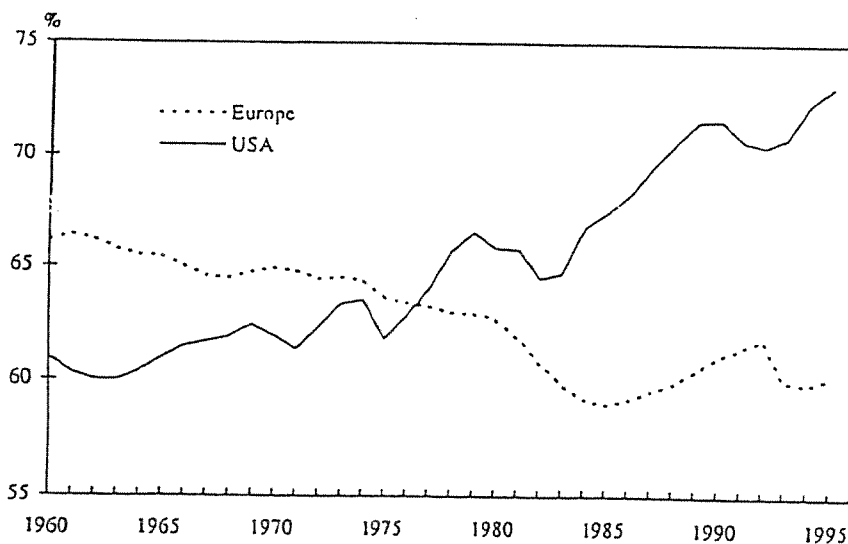
Figure 1 – Unemployment Rates, 1960-1995



Note: Country weights (for OECD Europe and EFTA) are the relative share of the labor force. Countries included in EFTA are Austria, Finland, Norway, Sweden and Switzerland.

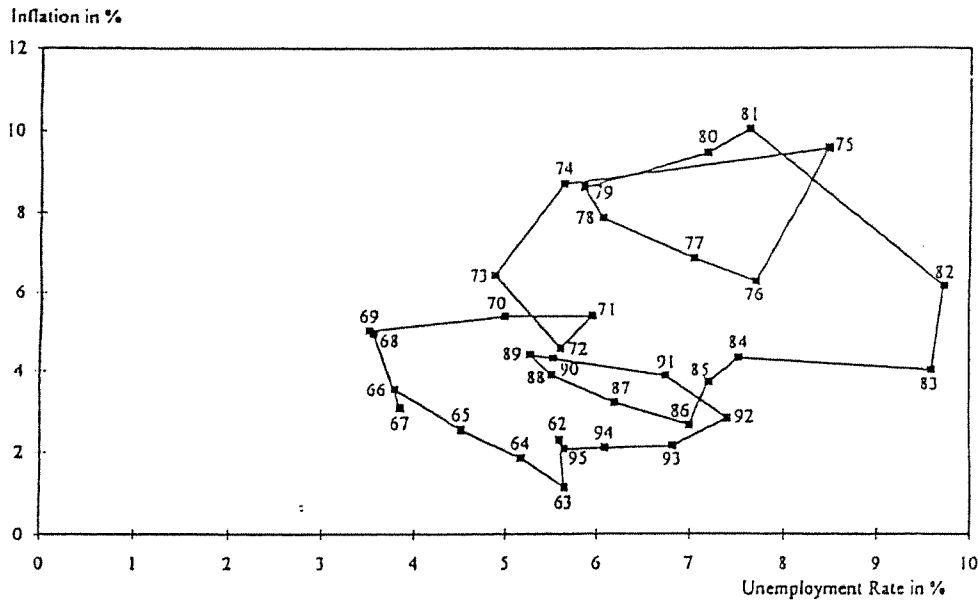
Source: OECD, *Economic Outlook*, December 1995.

Figure 2 – Total Employment as a Percentage of Population, aged 15-64, 1960-1995



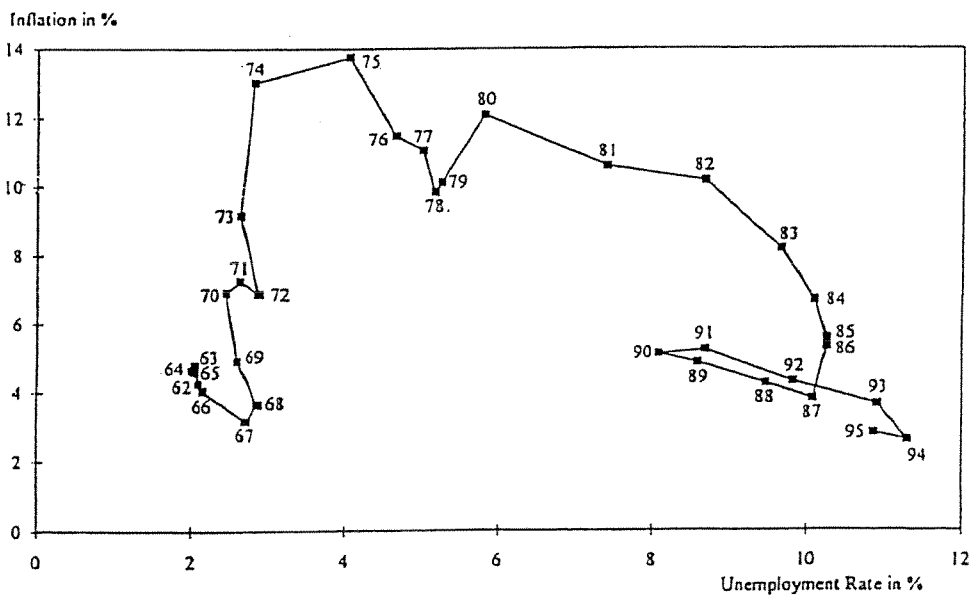
Source: OECD, *Economic Outlook*, June 1995; OECD, *Employment Outlook*, July 1996.

Figure 3 – Price-Phillips Loops for the United States, 1962-1995



Note: Inflation is defined as the percentage change in the GDP deflator.
 Source: OECD, *Economic Outlook*, June 1995.

Figure 4 – Price-Phillips Loops for the EU, 1962-1995



Note: Inflation in each country is defined as the percentage change in the GDP deflator. The weights used for aggregate inflation are the countries' relative share of total GDP at 1990 prices and US dollars. The weights used for aggregate unemployment are the countries' relative share of total employment.
 Source: See Figure 3.

References

- Lindbeck, Assar (1996), "The West European Employment Problem", The Bernhard-Harms Price Lecture, *Weltwirtschaftliches Archiv*, 132(4), pp. 609-637.
- Lindbeck, Assar and Snower, Dennis, J. (1997), "Centralized Bargaining, Multi-tasking and Work Incentives", CEPR Discussion Paper no. 1563.
- Nickell, Steve and Bell, Brian (1996), "Changes in the Distribution of Wages and Unemployment in OECD Countries", *American Economic Review*, 6(2), Papers and Proceedings, May, pp. 302-308.