7. The Micro-Foundations of High Unemployment in Developed Countries: Are Labor Market Rigidities the Problem?[1]

David R. Howell

INTRODUCTION

By the early 1990s, unemployment throughout much of Europe had risen to unprecedented levels and concern over the economic well-being of less-skilled workers appeared at the top of the policy agenda. At about the same time, a broad consensus had been reached about the source of this decline: global forces had generated a protracted imbalance in demand and supply in the labor market, a mismatch caused mainly by computerization in the workplace (Bound and Johnson, 1992, pp. 210–32; Krueger, 1993, pp. 33–60). As Paul Krugman put it, 'the growth of earnings inequality – and quite possibly therefore much of the rise in structural unemployment in Europe – has been the result of technological changes that just happen to work against unskilled workers' (Krugman, 1994, p. 70).

Variously characterized as the 'Unified Theory' and the 'Trans-Atlantic Consensus,' this account has been enormously influential in policy circles for all the obvious reasons – the story is simple, it is consistent with the economist's supply/demand model of the labor market, and the policy implications are clear (Blank, 1977; Atkinson, 1998). In our computerized global economy, vastly higher cognitive skills are required of a large fraction of the US workforce and far greater labor market flexibility is needed in Europe. The belief in free market solutions became the orthodoxy of the 1990s.

A central plank of this orthodoxy was that high unemployment in the developed (OECD) countries could be explained largely by the labor market rigidities that follow from Welfare State regulations and institutions. This simple, textbook account of the European unemployment crisis as a labor market problem caused by government policy interventions is held by