skill-biased technological change), while 'cross-country variation' in unemployment rates is accounted for by 'employment-unfriendly' labor market institutions. In the language of mainstream economics, the European welfare state 'adversely affects the dynamic responses to economic shocks and to increasing turbulence in the economic environment' (Lungqvist and Sargent, 1998, p. 517).

Given the focus of this chapter, I only note here that the 'shocks' part of this conventional wisdom is not entirely convincing. Perhaps the biggest problem concerns timing. Why did productivity and energy price shocks that took place in the 1970s not translate into a US–Europe unemployment gap until the late 1980s and early 1990s? Indeed, German and Swedish unemployment rates were below the US rate until well after German unification and the Swedish macroeconomic crisis of the early 1990s.

Taking into account a variety of shocks to the developed world, has the case been made that differences in employment performance since the early 1980s are attributable to institutions that interfere with competitive market processes? Not only should these adverse labor market institutions account for the cross-national pattern of unemployment, but they should do so over the course of the last two decades of high unemployment, including the late 1990s convergence (see Figure 7.5). The conventional wisdom answers this in the affirmative. As a major OECD report puts it, 'Developments in structural unemployment over the 1990s to a large extent reflect the progress made in implementing the OECD Jobs Strategy' (OECD, 1997a, p. 12). At the core of the Jobs Strategy is the adoption of the 'American model' of highly competitive labor markets.

Absent a prior belief in the labor market rigidity story, the empirical case against 'employment-unfriendly' labor market institutions as the source of the unemployment problem seems remarkably unconvincing. As noted above, Figures 7.1a and 7.1b show a number of central and northern European nations with highly developed welfare states (Sweden, Austria, Switzerland, West Germany, and Norway) with lower average unemployment rates than the US in both the 1983–88 and the 1989–94 periods. And Figure 7.2 shows the US improved its position in the mid-1990s, but by 2001 Sweden, the Netherlands, Austria, and Denmark again had similar or lower unemployment levels than the United States. This comparable or superior employment performance in these European welfare states took place despite collective bargaining coverage rates between 77 to 90 per cent in the early 1990s (the US had an 18 per cent rate), unemployment benefit duration rates between 1.2 to 4 years (US: 0.5 year), and employment protection scores that ranged from 11 to 16 on a scale of 20 (US score: 1).[5] To take just one example, apart from four years in the mid-

1990s, the US has consistently shown higher unemployment levels than the Netherlands.

There is an extensive literature that has attempted to link unemployment levels statistically with measures of various labor market institutions. The results appear quite impressive, with nearly all variables statistically significant with the right signs (effects are in the correct direction). For example, in a recent paper, Fitoussi et al. are able to account for 65 per cent of the variation in unemployment (1983–88) across 19 developed countries with the following variables (coefficient and t-statistic in parentheses): unemployment benefits replacement ratio (.12, 2.95), duration of unemployment benefits (.79, 2.13), union density and coverage (.08, 1.68), union coordination (-3.06, 2.35), employer coordination (-3.95, 3.46), and labor market expenditure (-.09, 2.14) (Fitoussi et al., 2000, table 6). While other measures, such as employment protection and taxation have been employed in some studies, both the theoretical justification and the empirical results for them are rather weak.[6]

It is worth noting that these kinds of tests are used in the literature to support the position that once the shocks pushed unemployment up, the persistence of high rates has been accounted for by 'adverse' labor market institutions. But in fact, much of the strength of these regressions – their explanatory power – is due to institutions that *reduce* unemployment. This can be seen above in the last three variables listed above. Institutions that promote coordination and help train workers and provide job search assistance are costly interventions in the labor market, but they tend to *lower* unemployment. The literature that uses empirical tests of this sort tend to conclude that welfare state institutions can provide a good explanation for observed cross-country patterns of employment performance on the grounds that 'bad' institutions explain the persistence of high unemployment, but do not distinguish the 'good' from the 'bad' institutions! For example, in the Fitoussi et al. test reported above, only the results for the two unemployment benefits measures lend support to the conventional institution-as-culprit story.

Second, the key measure of wage rigidity – union density and coverage – is not statistically significant, a common result. According to an OECD study, 'evidence presented in this chapter does not show many statistically significant relationships between most measures of economic performance and collective bargaining' (OECD, 1997a, p. 64). Other institutions can compress wages (reduce wage inequality) but there is little evidence that they have detrimental impacts on employment. For example, in cross-country tests, OECD researchers have concluded that minimum wage levels appear to have no effect on young adult employment, and while they find small negative effects on teenage employment, there is no evidence of any