Deconstructing the "European Unemployment Dilemma": A Case Study in the Manipulation of Statistics and Conceptual Models in the Discourse of "Eurosclerosis"

James Paterson

In an article published in 1998 in the *Journal of Political Economy*, Lars Ljungqvist of the Stockholm School of Economics (Sweden) and Thomas J. Sargent of the University of Chicago and the Hoover Institute (United States) discuss the problem they refer to as the "European unemployment dilemma". In a nutshell, the dilemma consists of the approximately two-percentage point gap between Europe's unemployment rates and the OECD average that, they say, first became apparent around 1984 (see Figure 1 on p.515). Since 1984, although the European rates and total OECD rates have risen and fallen in tandem, the discrepancy has persisted and was still evident in 1995, the last year for which they cite data (Table 1 on p.). Ljungqvist and Sargent also point out that by the late 1980s, "the European OECD countries" were all experiencing higher levels of long-term unemployment. In 1989, "more than half of all European unemployment" was "classified as long term"; however, in 1979, less than a third was. This was in contrast to the situation in the United States, where "long-term unemployment has remained low" (pp.515-17).

After completing what seems a straightforward enough presentation of the data concerning the two-point gap and the lengthening spells of unemployment, Ljungqvist and Sargent discuss the reasons for Europe's "dilemma". They instantly fasten on the welfare state, identifying two features of European welfare states - high taxes and "generous" welfare payments - as the causal factors. It is "well known", they write, "that high income taxation and generous welfare benefits distort workers' labor supply decisions" (p.517). But no sooner have high taxes been mentioned than they are abandoned and the article's focus narrows to the relationship between generous welfare payments and high unemployment.

To justify their emphasis on welfare payments, Ljungqvist and Sargent cite Layard, Nickell and Jackman, who wrote in *Unemployment: Macroeconomic Performance and the Labour Market* (1991) that

"unconditional payment of benefits for an indefinite period is clearly a major cause of high European unemployment" (cited in Ljungqvist & Sargent 1998, p.517, n.5).

Apparently taking for granted Layard, Nickell and Jackman's hypothesis that economies with generous unemployment compensation schemes cope badly with exogeneous shocks, Ljungqvist and Sargent then embark upon a technical analysis whose purpose, they say, is "to contribute to a sense of how the welfare state adversely affects the dynamic responses to economic shocks and to increasing turbulence in the economic environment" (p.517).

As the reader will have gathered from this summary, Ljungqvist's and Sargent's article is a restatement of the Eurosclerosis hypothesis that was fashionable in the early to mid-1990s, even if it does not use the word itself. Yet while other writers working in the same, supply-side tradition have managed to develop the hypothesis that there is a relationship between the European welfare state and high unemployment without ignoring the considerable number of variables that must be involved, e.g., Heitger 2002, Ljungqvist and Sargent take a highly reductionist view. They claim that the reason why, between 1984 and 1994, the European OECD countries sustained an unemployment rate that is two percent higher than the OECD average was because they paid higher unemployment benefits than non-European OECD countries. However, the aim of their article is not to *prove* that generous unemployment compensation causes high unemployment - they simply assume that it does - but to show *how* it does, by means a technical presentation that occupies the central section of the article (pp.524-27).

In this article, we contest not Ljungqvist's and Sargent's technical presentation, but their initial premise. In Part I, we show that the claim that constitutes the departure point for their article - that after 1983 there was a two-percent gap in the unemployment rates of the European welfare states and the OECD average - is wrong. The "European unemployment dilemma" is most certainly a statistical illusion. Having outlined the main reasons why the two-percent gap should be regarded as a fallacy, We turn in Part II to the authors' attempt to father the two-percent gap on generous unemployment compensation. We show that even if we accept the conventional view that unemployment is higher in the European OECD than non-European OECD, the ten European OECD countries which pay the most generous unemployment benefits had, during the period under consideration, unemployment rates which were almost exactly the same as non-European OECD rates. Generous welfare benefits cannot therefore be identified as the causal factor.

1. The Mirage of a Two-Percent Gap

Our purpose in Part I is to demonstrate beyond reasonable doubt that the two-percent gap that consitutes Ljungqvist's and Sargent's "European unemployment dilemma" is a statistical illusion. Although statistics are the lifeblood of their profession, academic economists are often uncritical when it comes to issues of data quality and comparability (Norwood 1988, p.285). Indifference to such matters is virtually ubiquitous in writing in the supply-side tradition,[4] and still far from uncommon outside it. Even those writing in the mid-1990s who pioneered the critique of the myth of Eurosclerosis like Rebecca M. Blank failed to challenge the view that the European welfare states have higher levels of unemployment than other advanced industrial nations (Blank 1997. Similar observations could be made about Herman 1998 and Pelagidis 1998).

Yet there is good reason to question this prevalent assumption, and this is because over the last twenty-five years the governments of many OECD countries have artificially reduced their countries' official unemployment statistics by periodically redefining unemployment and making administrative decisions that generate lower figures. Although one might think that such behaviour would be indulged in by politicians and bureaucrats almost everywhere, such efforts appear to be routine in the U.S., the U.K., Japan, and Australia, but rare in Europe, with the exception of the Netherlands, which is probably not coincidentally the European country that has done the most to reconfigure its welfare state in accordance with neoliberal prescriptions.

In the aforementioned countries, four basic strategies have been used to lever official unemployment rates downward. First, a person is apt not to be counted as unemployed if his or her jobsearch techniques do not meet specific criteria. Not only do counts based upon current jobsearch activity automatically exclude discouraged jobseekers, they can also exclude unemployed persons because their jobsearch activity does not conform to the bureaucracy's precise specifications. In Japan, for example, a person needs to have looked for work in the week immediately prior to the survey to be counted as unemployed. If he or she did not look for work in that week, s/he will not be counted

[4] On the rare occasions that a supply-side economist expresses reservations about unemployment statistics, it is in relation to the performance of a European country, not the U.S. or any other country identified with welfare restructuring and/or hardline labor policies. Siebert 1997, pp.41-42, for example, questions whether unemployment really has fallen in Belgium. It would be no exaggeration to say that for most supply-siders, the notion that unemployment could ever fall in a country which has a highly-developed welfare state is inherently implausible.

as unemployed, no matter how intense his or her jobseeking efforts were in previous weeks (Ostrom 1999).

That the bureaucracy's criteria can be virtually arbitrary was discovered by Ohio State University researcher Jay Zagorsky (Zagorsky 1996). Until Zagorsky conducted his research, it was generally believed that there were no significant differences in the manner in which unemployment is measured in Canada and the U.S. However, his study "found that persons not employed who responded that their only job search method was looking at job ads in newspapers were classified as in the labour force and unemployed in Canada while they were treated as out of the labour force in the United States". This factor alone makes the U.S. figures look better than Canada's. When such persons were removed from Canada's unemployment figures, the Canadian rate fell "0.7 percentage points, reducing the gap with the U.S. rate by 17 per cent" (Riddell & Sharpe 1998).

A variation on this approach exists in the Netherlands, where, since 1983, unemployed persons aged over 57 have no longer been required to actively search for work in order to qualify for unemployment benefits. This has given rise to a curious situation in which more people receive unemployment benefits than are officially unemployed (Webster 2000). By exempting unemployed persons from jobsearch obligations, the Dutch system ensures that they are not counted at all and that the country's unemployment figures – especially its *long-term* figures - end up looking healthier than they are.

Second, large numbers of people have been moved from the category of the unemployed to categories that are less politically volatile, such as disability. The most dramatic instance of this occurring is in the Netherlands since the late 1970s (Aarts, Burkhauer & De Jong 1992). By the mid-1990s, there were actually more people receiving disability than unemployment benefits (Vidal 1997).[5] In 1997, the country had an official unemployment rate of just 5.3%. But, commented the *Financial Times*, "[i]f one adds together the unemployed and those on sickness, disability and other welfare lists, the Netherlands has a non-employment rate of well over 20 per cent, one of the worst in the whole of the EU" (Munchau 1997, p.9).

A similar shift has taken place in the U.K. Since the late 1970s, some 1.6 million Britons have moved from unemployment to sickness benefits. The country now has 2.3 million people on sickness benefits,

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[5] However, according to Vidal, the number of persons in receipt of disability benefits began to fall after 1994.

the highest working age sickness in the EU (7%). Since at least one-third of those on sickness benefits would would prefer to have a job - a figure that is certainly a serious underestimate - the real unemployment figures are far higher than government statistics indicate (Webster 2000). In a recent article, Beatty and Fothergill studied the diversion from unemployment to sickness benefits in depth. They established that less healthy workers, because they find themselves at the back of the queue for jobs, end up on the Incapacity Benefit (IB) - rather than the more onerous Jobseekers' Allowance - when they are able to meet its criteria (Beatty & Fothergill 2004). By the end of the 1980s, the U.S. had also come down with a case of "Dutch disease". According to Austan Goulsbee of the University of Chicago Graduate School of Business, "record" numbers of unemployed shifted to the disability rolls after Congress loosened qualifications for disability payments in the late 1980s and early 1990s (Goulsbee 2003). It is estimated that "this has reduced the measured aggregate unemployment rate by at least 0.65 of a percentage point" (Webster 2000).

Third, people without jobs find it increasingly difficult to qualify for benefits. Activity tests are introduced and periodically tightened, while genuinely unemployed people are removed for minor infractions such as undeclared income or administrative breaches. Every time the bar is raised in this way, the disqualified population grows without their employment status changing. The bar was raised a few notches in the U.K. in the course of a radical overhaul of the social security system in 1986, a few notches in New Zealand in 1991, and a notch at a time in Australia during the 1980s and 1990s (Vournas 1999; Maloney 2002; Harris 2001, pp.17-19).

Fourth, the definition of employment has been broadened so unreasonably that in most OECD countries a person who worked as little as one hour in the week prior to the labour force survey is counted as employed. This novel approach, which was enshrined in the Labour Statistics Convention of 1985, seems to have been applied fairly unevenly, however. In the case of Austria, for example, the Austrian Statistical Office (ÖSTAT) used, until 1994, a more realistic figure of 12 hours, "while all those questioned who described themselves as unemployed were classed as such" (European Foundation). Although ÖSTAT shifted to the ILO measure after Austria joined the European Union in 1995, Austria's unemployment rate for the preceding period would presumably have been higher than if the ILO measure of an hour had been insisted upon. According to a 1997 ILO report, the Netherlands defined a person as unemployed if he or she worked less than 12 hours during the reference week (O'Higgins

1997, p.1), while the same definition is still in force in Finland. It is by no means clear, therefore, that the ILO definition has been so consistently applied that it has not contributed to significant differences between national unemployment rates.

In addition to the above four factors, there are circumstances specific to Japan, the U.K. and the U.S. that significantly reduce their respective unemployment rates. In Japan, gender conventions apparently inhibit women from registering as unemployed. "Rather than being counted as unemployed, Japanese women who lose their jobs tend to leave the labor force altogether. This is manifested in the remarkably high proportions of discouraged workers in Japan, the vast majority of them women. Thus the Japanese unemployment rate as well as unemployment volatility are deceptively low, much more so than for the other advanced economies" (Kucera 1998, p.1).

In the U.K., statistics count only persons drawing unemployment compensation, not people who would like to find work and would accept a job if one was offered to them. The shift from a count based on those who were registered as unemployed to one based on those receiving benefits took place in 1983, drastically reducing the unemployment figures (Vournas 1999). Conveniently for Ljungqvist's and Sargent's purposes, the British shift to a claimant regime occurred immediately prior to the decade that is the subject of their article.

The U.S. engages in two forms of extra-market labor allocation that significantly reduce the country's unemployment rate. First, the U.S. has an exceptionally large number of military personnel. Recognizing the nonmarket nature of military employment, statisticians do not normally count military personnel among the employed population. But in 1983, President Reagan decided to move the military, previously classed as "not in the workforce", into the ranks of the employed, giving American employment figures an instant boost (Furfero 2000). Since no European country counts its military among the ranks of the employed, this decision would have fostered the misperception that from the mid-1980s there was a large jobs gap between the U.S. and Europe. Although the practice was discontinued by the Clinton administration in 1994, it was in force for the exact duration of Ljungqvist's and Sargent's study (1984-94).

Second, the U.S. has incarceration rates which are about six times those of Europe (Downes 2001, pp.74-75). The fact that, by 1996, America's prison population was three times what it had been in 1980 certainly contributed to a significant reduction in the country's unemployment rate (Beckett & Western 1999, p.1031). In 1995, state

Beckett and Western, "prison and jail inmates added 1.9 points to the usual unemployment rate" (Beckett & Western 1999, p.1040). While it cannot be assumed that all current inmates would remain unemployed if freed from prison, most probably would. After all, American prisons are full of young, undereducated males - disproportionately black - at least a third of whom actually *were* unemployed at the time of their arrest (Beckett & Western 1999, p.1038; Wray 2000).

But if the U.S.'s harsh penal policies have given it a mandate to lock up a not insignificant part of its population which would otherwise suffer extensive, and probably long-term unemployment, this is not true of Europe, where "including prison inmates in the jobless count only changes the unemployment rate by a few tenths of a percentage point" (Beckett & Western 1999, p.1038). If the U.S. does not experience as high levels of long-term unemployment as Europe - and, in fact, it never can be proved that it does not, because long-term unemployment is as apt to resolve itself in hidden unemployment as in a return to employment - it certainly has something to do with the fact that many of those most at risk of long-term unemployment are behind bars for offenses that would not lead to imprisonment in any European country.

The U.S. is also one of only three OECD countries which excludes 15 year olds from unemployment meaures. The U.S. unemployment rate therefore understates the extent of unemployment in comparison to all other OECD countries except Spain and the U.K. (Carlson 2001, p.11). It is not clear which country is the worst offender when it comes to "massaging" the figures, but it would be hard to beat the U.K., whose definition of unemployment has, according to *The Economist*, been revised 33 times since 1979 (Mészáros 2000). There is no doubt that the process has benefited political incumbents by suppressing the true dimensions of the country's unemployment problem. Since 1981, every change has led to a reduction in the official figure, and most reductions have been significant. More and more people have simply vanished from the officials statistics who would meet any reasonable definition of unemployment.

In the period between 1983 and 1994, when to combat the spectre of "welfare dependency" most English-speaking countries adopted policies intended to force as many people off unemployment benefits as possible, the result was a shift was from a situation in which most unemployed persons received unemployment benefits to one in which most either received none at all or had been diverted to other benefit regimes. In this respect, the pace was set by the U.S., where, by the 1990s, only one in three unemployed persons actually received

unemployment benefits (Vroman & Brusentsev 2002, p.366). This process would heighten the contrast with Europe, where the tendency has been to reduce the size and/or duration of benefits rather than to prevent unemployed persons from gaining access to them altogether.

The reality is that in countries like the U.K. that cook the books the real unemployment figures are well above official figures. As we saw, the *Financial Times* indicated that the non-employment rate in the Netherlands stood at "well over" 20%. If we subtract from this a few percentage points for those who are genuinely unable to work through illness or disability, we would still be looking at a figure about four times the official rate. In the English-speaking world, real unemployment rates seem to be at least three times the official figures. In the U.S., a recent survey in Lawrence County, Ohio, found that a real unemployment rate of 17.9%, which was three times the official rate (Malloy 2004). Although Lawrence County has an unemployment rate slightly above than the national average, there is no reason to believe that a similar finding would not result if a survey along the same lines were conducted nationally. In Australia in March 2005, the real rate (obtained by including an estimated 1.2 million "hidden" unemployed) was in the region of 14.8%, or very nearly three times the official rate of 5.1% (Garnaut 2005). For Canada, adding in the hidden unemployed yields a similar figure of 15% for 2002 (Agbola 2003, p.9, Figure 3).

Such estimates of real unemployment rates are usually obtained by adding in the hidden unemployed. They usually do not include – although they almost certainly should – at least 50% of people in contingent employment. Although it is commonly suggested that most people working in casual, part-time and temporary jobs do so because they prefer them to traditional full-time employment, the reality is that at least half the people so employed are simply making do with contingent employment because they have no alternative. The resulting lifestyle flexibility is real enough, but for most a poor substitute for income that could enable them to have children, take a holiday, buy a house or contribute to a health or retirement plan.

Viewed in this light, such econocratic fads as the "American job machine" and the "Dutch miracle" ought to be dismissed as the neoliberal propaganda exercises they really are.[6] Indeed, the massaging of the unemployment figures in countries like the U.S. and the Netherlands conceals the reality that unemployment levels are significantly higher throughout the OECD than they were in the

[6] For a critique of the "American job machine", see Heise 1997 and Navarro 1998. For an expose of the Dutch "miracle", see Vidal 1997.

1970s. Mainstream economists would have us believe that the countries which have most zealously applied neoliberal policy desiderata constitute exceptions. In fact, the so-called "laissez-faire economies" have performed no better than the European welfare states on the employment front, and they may well have done worse, at least until 1993. They have merely concealed the extent of their decline by flagrantly misrepresenting their unemployment statistics.

At this stage, the objection could be raised that the official unemployment rates in the European welfare states might also drastically understate the extent of unemployment. However, with the exception of the Netherlands, such deceptions have apparently not been resorted to on the continent. Let us look at the cases of France and Germany, continental Europe's two largest economies. One way to gain a sense of the greater fidelity of the European statistics is to look at these two countries' figures for sickness benefits. In contrast to the U.K.'s disability recipiency rate of 7%, Germany, has only 2.1% of its working age population on sickness benefits, while France has a negligible 0.3% (Webster 2000). Diversion of unemployment to sickness benefits is seems to be a feature not of the European welfare state so much as of countries like the U.S., the U.K. and the Netherlands which have proven most receptive to neoliberal economic policy.[7]

France is an interesting case, because it has long ranked among the OECD countries with the highest official unemployment rate. France therefore has as least as much incentive as the U.S. or the Netherlands to massage its figures downwards. Yet there is no evidence to suggest that it has tried to do so. According to David Webster, who uses the WWR ("Work Wanted Rate"), France counts as unemployed 91% of those seeking work; in the U.K., on the other hand, the equivalent figure is only 44%. This is a huge difference – showing how very much scope France would have to reduce its unemployment figures if it followed in the U.K's footsteps. Interestingly, French president Jacques Chirac is the only European leader who seems to to have cottoned on to the neoliberal scam described in this paper. "[I]f unemployment is lower in Britain than in France, it owes no thanks to the virtues of economic liberalism but because the English fiddle their figures", he declared in 1998 (cited in Nickell & van Ours 1999, p.4).

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[7] Government work-training programmes usually play a similar function of hiding unemployment. In the U.K. and Australia a person enrolled in a government work-training programme is not counted among the unemployed, even though the person needs to be unemployed to qualify for the programme.

In recent years, Germany's unemployment problem has caused the country's prime minister, Gerhardt Schroeder, considerable grief, leading to the implementation of a controversial economic reform package in 2004-5. Yet Germany could have spared itself much trouble if it had only adopted the OECD's unemployment measure as its own. According to Ostrom 1999, "the officially reported German unemployment rate in 1996 of 10.3 percent was much higher than the OECD standardized measure of 8.9 percent. In fact, in recent years, the OECD rate consistently has been more than a percentage point lower than Bonn's number". Further reductions enabling Germany to shed its current image as the "sick man of Europe" would easily be achieved if the German government simply adopted the U.K.'s official measure of unemployment.

It would seem, therefore, that higher levels of unemployment in the major European economies are a product of the fact that, with the exception of the Netherlands, politicians in these countries have not been playing the same statistical games as the arguably more ideological, less scrupulous Anglophones.[8] Although Webster's figures are for more recent years than those cited by Ljungqvist and Sargent, his data are sufficient to establish the role that statistical manipulation has played in reducing official unemployment rates in precisely the countries with the best reputations for reducing unemployment.

Once due account is taken of such manipulations, an entirely reasonable conclusion to draw is that most OECD countries have similar unemployment rates. Although I know of no satisfactory method of determining "real" unemployment rates and am therefore not in a position to assert what the real rates were for the 1984-94 period, it is striking that when attempts are made to come up with more accurate figures the results can be greatly contrary to the received wisdom. Agbola, for example, calculated hidden employment for eleven different OECD countries for the period 1980-2001 and found that, after Spain, whose figure of 22 percent is hardly

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[8] A factor that cannot be examined here but which may well contribute to significant differences between official unemployment rates in European and non-European OECD countries is that, in the latter, they are derived from population samples. As Ostrom 1999 writes, "Japanese, British (since 1992), Canadian, Australian and American practices [with regard to the collection of unemployment statistics] generally are quite close", and "differ from those of other industrial nations. For example, the United States, Japan and Canada long have derived unemployment figures by sampling the population, while some European countries traditionally have used data from job centers and unemployment offices supplemented by surveys". If sampling yields substantially lower figures than are obtained by others methods, it is possibly because sampling techniques would seem to leave considerably more scope for the construction of results.

unexpected, the highest rate was 18.4 percent for Canada (Agbola 2003).

Since official unemployment statistics are suspect, especially in the case of the more market-oriented economies that have apparently done the most to tamper with them, the best way to obtain an impression of the reality is probably by dispensing with them altogether. A more reliable impression can actually be gained from looking at employment rates. If you work out the civilian employment rates as a percentage of a given country's population (all ages), you have a figure that has not been manipulated for political purposes to anywhere near the same extent as unemployment figures. In the case of Sweden, Europe's premier welfare state, the figure for 2001 is actually 48.2%, scarcely less than the equivalent figure for the OECD's most "laissez-faire" country, the U.S., which is 48.56%. However, since the U.S. has a higher proportion of its population of working age (15 to 64) than Sweden, it is only fair that the difference be taken into account.[9] Adjusted accordingly, the employment rate actually works out in Sweden's favour - 75.6% to 73.1% (Nickell 1997, p.58, Table 2). In another leading welfare state, Denmark, the working age (15 to 64) employment rate was - in 1997/98 - the second highest in the OECD – 75.8% (Scharpf 2000, p.202, Table 4).[10]

Such high employment rates contrast greatly with the Netherlands, where the so-called Polder model stands revealed as a dismal failure. In the Netherlands, the working age employment rate was, in 1994, only 50.7%, "very much below the nearly 60% of 1970 and even further below the European average of 67%" (Vidal 1997).[11] But while on account of its reduction in its official unemployment rate it has been common to praise the "Dutch miracle", few voices are raised in praise of Sweden and Denmark, the OECD countries with the highest employment rates.

Of course, employment statistics are not entirely free from manipulation or distortion. Their most serious failing is that they do not reveal the distribution of contingent (casual, part-time and temporary) and "proper", full-time employment. The "Dutch miracle",

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[9] According to *OECD in Figures 2002*, 64.3% of Swedes are aged 15 to 64 and 66.1% of Americans.

[10] Since the legal working age in Denmark is 16, the figure would actually be higher if 15 year-olds were excluded.

[11] Admittedly, the situation in the Netherlands may be much less dire than Vidal's figures indicate. According to Scharpf 2000, p.202, Table 4, the Dutch employment rate was, in 1997/98, 61.8% - which is fully 11% higher than in Italy and a few percentage points higher than Belgium, France and Germany. However, 61.8% was still significantly below the OECD 18 average of 66.5%. The Netherlands' relatively low employment rates are due chiefly to low female employment rates. See Bruyn-Hundt 1990.

such as it was, was largely based on the growth of part-time and temporary jobs. Wim Schoutendorp, economic editor of the Amsterdam daily *Trouw*, explained in 1997 that the number of part-time jobs in the Netherlands had "increased from 15% to 36% of the total in twenty years". According to Amsterdam University sociologist Jelle Visser, nine out of ten jobs created in the previous ten years were between 12 and 36 hours a week. Furthermore, temporary work had expanded in the same period to occupy 3.5% of the labour market. It is largely due to the unusually high proportion of the population engaged in contingent employment that Professor Lammert van der Laan of Erasmus University regards the official Dutch unemployment statistics as meaningless, especially for the purposes of international comparisons (Vidal 1997).

In the above discussion, I have shown that there are good reasons to doubt that unemployment rates are as low in the non-European OECD countries as the official statistics indicate. If so, then the OECD average is considerably lower than it ought to be, and the two-percent gap that inspired Ljungqvist's and Sargent's notion of a "European unemployment dilemma" is considerably exaggerated. Two further factors reinforce the conclusion that it is much too high. First of all, it is unlikely that the extent of the gap for the 1984-94 period was of the order of 2% percent to begin with. In the above discussion, we accepted Ljungqvist's and Sargent's claim that the gap was "around" 2%. However, Heitger's re-presentation of Nickell's 1997 data shows that for 1983 to 1988, the European OECD countries had an average unemployment rate of 8.2% compared to 6.6% in the non-European OECD, while from 1989 to 1994 they had an average unemployment rate of 8.3% compared to 7.2% in the non-European OECD (Nickell 1997, p.56; Heitger 2002. p.334). This means that between 1983 and 1988, the employment gap was 1.6%, while between 1989 and 1994, it was 1.1% - an average gap for the entire period (1983-94) of only 1.35%. Not only is this significantly less than 2%, it suggests that the gap was actually narrowing. If we accept my contention that the OECD average for 1984-94 is lower than it ought to be, we are almost certainly looking at a situation in which the European rate may even have been below the OECD average.

A further observation readers of "The European Unemployment Dilemma" should take into account is that the graph for the period 1961-94, displayed in Figure 1 (p.515), is derived from two separate sources, one for the period 1961-77 (U.S. Government *Labor Force Statistics*, 1984) and the other for 1978-94 (OECD *Employment Outlook*, 1995). By stitching together data sets that were calculated using different measures of unemployment, the authors leave themselves open to the objection that the gap could be partly an

artefactual illusion. Although the gap begins to yawn from about 1984, it first becomes evident around 1977-78, which just happens to be when the change from one data source to another occurs. Admittedly, the gap between about 1977 and 1983 is not the gulf it becomes thereafter, but the fact that it is where the stitch occurs that the gap first appears suggests the possibility that at least part of the subsequent gap is due to the use of a different measure from 1978 onwards.

If one adds together the three main points made above - that the official unemployment statistics generated by the non-European OECD countries drastically underestimate the extent of their own unemployment problems, that the two-percent figure was far too high to begin with, and that the switch to the OECD unemployment measure in 1978 contributes an artefactual distortion to the mix - the conclusion must be that not only were unemployment rates in the European OECD countries no higher than in the non-European OECD countries in the 1984-94 period, they may even have been lower. Insofar as it postulated an employment gap to make its case, the discourse of Eurosclerosis appears to lack real foundations.

2. The Welfare State/Laissez-faire Dichotomy

As Charles Kindleberger recently pointed out (1999), academic economists engaging in comparative economics often take "Manichaean" positions which are rarely applicable to real world situations. Ljungqvist's and Sargent's article is based on a dualism which is not only insufficiently rigorously drawn to permit the conclusions they use it for but is also profoundly at odds with reality. When talking about the two-percentage point gap, they rely upon a distinction between "the European OECD countries" and the OECD average (Figure 1 on p.515). This distinction would not be a problem, perhaps, if it were employed consistently throughout the paper. However, Ljungqvist and Sargent subsequently ditch the term "European OECD countries" in favour of an ideologically-loaded expression "welfare states". Then, to complicate matters, they contrast the welfare states not with the OECD average but with the "laissez-faire economies". This semantic transfer – made most explicit in Table 4, which contrasts "Welfare-State Economy" with "Laissez-Faire Economy" - presents a serious problem, because it is not the case that to avoid repetition the authors have merely introduced alternative expressions that mean the same thing. They mean very different things.

The problem here is that it is extremely hard to see which OECD countries, if any, would fall in the class of "laissez-faire economies". Ljungqvist and Sargent apparently understand the term to refer to

countries "in which there is no government intervention whatsoever" (p.529). Yet there are, within the OECD, no countries which, by such standards, could be described as "laissez-faire economies", only a spectrum of welfare states ranging from those usually considered the most generous (those in northern Europe) to the meanest (usually, the English-speaking countries plus Japan). The countries Ljungqvist and Sargent probably have in mind when they refer to laissez-faire economies - Japan, the U.K., Ireland, Canada, Australia, New Zealand and the U.S. - are actually all welfare states of one kind or another.

Even the U.S., which is commonly identified in economic literature as the paradigmatic laissez-faire economy, is actually a welfare state, albeit one of a quite different kind than other comparable countries (Howard 1999; Katz 2001; Alesina, Glaeser & Sacerdote 2001). "International commentary often takes the USA to be some kind of ultracapitalist lost cause in terms of welfare spending", observes David Downes. "But this is a travesty. In 1993, even after a decade of Reaganomic tax cuts for the rich and welfare cuts for the poor, US spending on welfare services still amounted to some 21 percent of GDP, compared to 26 percent in the UK and 29 percent in Germany" (Downes 2001, p.72). With its extraordinarily high spending on the military, moreover, it could be maintained that the U.S. actually has the most extensive welfare ("make work") programme of any OECD country.

A further problem is that, like Layard, Nickell and Jackman, Ljungqvist and Sargent identify the welfare state with "unconditional payment of benefits for an indefinite period". (As was mentioned above, they mentioned high taxes initially but ignored them thereafter.) But if "payment of benefits for an indefinite period" is the defining feature of the welfare state, then only one European country – Belgium – fits the bill. In "all EU countries except Belgium there is a limited duration to unemployment insurance" (Atkinson 1998, p.12).[12] In some European countries, the maximum duration of unemployment benefits is actually shorter than in some American states. For example, in Germany it is only 32 months, while it is 33 months in France. In some American states, however, it is 39 months (Siebert 1997, p.50). Furthermore, if the "unconditional payment of benefits" is a defining feature of the welfare state, then no welfare states exist in Europe - or anywhere else. Indeed, the very suggestion that there are such countries in Europe entitles one to suspect that Ljungqvist and Sargent know very little about the European welfare state.

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[12] However, according to Nickell 1997, p.61, Table 4, unemployment benefits in Belgium have a maximum duration of 4 years, the same as in the U.K., Ireland, Switzerland and former West Germany.

The underlying purpose of Ljungqvist's and Sargent's article seems to be to foster receptivity to supply-side solutions for Europe's unemployment problem by suggesting that the problem is most usefully viewed through the lens of a welfare state/laissez-faire dichotomy. Although the fact that that there are no laissez-faire economies in the OECD raises questions about the value of taking an ideological approach, what is being considered here is only the fact that, like so much literature of its kind, Ljungqvist's and Sargent's article invites the conclusion that there is a causal relationship between the welfare state and high unemployment rates. Yet Ljungqvist and Sargent are only able to establish their case by creating a straw man – the European welfare state which offers "unconditional payment of benefits for an indefinite period". Certainly, it would be hard to see why unemployment would not rise if unemployment compensation was really so generous and given so freely. But such a case falls apart the instant it is recognized that no such European welfare state exists. Since no European country offers "unconditional payment of benefits for an indefinite period", there is no country in which high unemployment can be attributed to it.

Even if we were to do Ljungqvist and Sargent's work for them by constructing a more viable image of the European welfare state – one in which it was identified with high net replacement rates – it is not the case that the European countries which offer the highest net replacement rates are also those with the highest unemployment rates. Indeed, in 1983-96, three of Europe's most generous welfare states ranked among the five OECD countries with the *lowest* unemployment rates - Austria (3.8%), Norway (4.2%) and Sweden (4.3%) (Nickell 1997, p.56, Table 1).[13] The reality that Ljungqvist and Sargent fail to confront is that none of the European countries which historically have had the most serious unemployment problems are countries which offer generous unemployment benefits. In 1983-96, to return to Nickell's figures, the two OECD countries with the highest unemployment rates were Spain (19.7%) and Ireland (15.1%). Neither were generous welfare states.

The case of Spain is particularly important to review, because, between 1983 and 1996, it was the European country with by far the

[13] The figure for Sweden is noteworthy, as it includes the extremely high level of unemployment the country experienced during the recession of the early 1990s. It is probably also worth the noting that the European country which has today the lowest official unemployment rate, Switzerland, is also the country which offers the highest net replacement rates. It is striking that the country which is actually the most generous to the unemployed is invariably missing from literature purporting to address the relationship between unemployment compensation and unemployment.

highest official unemployment rate – nearly 20% (Nickell 1997, p.56, Table 1).[14] The problem is that, while certainly a European OECD country, Spain is not a country characterized by generosity to the unemployed. Between 1976 and 1988, gross and net rates of financial assistance for the unemployed actually fell.[15] Although there was a major improvement in 1989, this was a strategic manoeuvre by the government to win support from the unions for its employment strategy. [16] Benefits began to be rolled back from 1992 onwards and have been under siege ever since. With the possible exception of the period 1989-92, therefore, Spain has never been a country in which unemployment compensation has ever been considered adequate, let alone generous. The same is true of Ireland, where net replacement rates have long ranked among the lowest in the OECD.

The unemployment rates for these two countries - Spain and Ireland – are so high in fact that their inclusion significantly inflates the European OECD average. Minus Spain and Ireland, the average unemployment rate for the European OECD (13 countries) was 7% for the period 1983-96. But once these two countries are added in, the average rises to 8.4%. If we restrict ourselves to the ten European OECD countries *which offer the most generous unemployment benefits* – the four Scandinavian countries, the Netherlands, Belgium, France, Germany, Switzerland and Austria – the average falls to 6.8%, or.1% below the non-European OECD average of 6.9% (Heitger 2002. p.334). In other words, the European countries which offer the most generous unemployment benefits had unemployment rates which were about the same as the non-European OECD average, not well above it. If we accept that the non-European OECD countries' official unemployment figures significantly understate the extent of their own unemployment problems, the position argued at some length in Part I, the inescapable conclusion is that the European countries which offer generous unemployment benefits did appreciably better in the period under the microscope than the non-European OECD countries. The critics of the European welfare state seem to have matters exactly the wrong way around.

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[14] It has since been supplanted by Finland.
[15] http://www.fr.eurofound.eu.int/emire/SPAIN/UNEMPLOYMENTCOVER-ES.html
[16] http://www.cepr.org/pubs/Bulletin/dps/dp1184.htm

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James Paterson

jimjamtwo@yahoo.com