The Great Recession's real labor market legacy

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There is something stirring in the world of labor market punditry. The Great Recession is showing some unexpected results on the unemployment front. The irresistible job machine that used to be the US labor market continues to sputter. Job creation remains disappointing. A decidedly un-American unemployment rate of close to 10% keeps almost 15 million Americans unemployed. And that is not counting the millions more who are underemployed, or the equally numerous jobs that are officially and artificially "saved or created" by stimulus spending.

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Across the pond, on a European continent traditionally lambasted for its outdated and stifling labor rigidities, the picture is surprisingly less bleak. For sure, European countries have had their fair share of the massive employment hemorrhaging and the frosty hiring slump that has been the crisis fallout throughout most of the developed world's labor markets. But in relation to their economic contraction, many European countries have registered less unemployment increase than the US. The list covers almost the entire Old Europe, including such otherwise notorious labor market underperformers as Italy, France, and Belgium.[1]

It used to be different. For decades, Europeans have been told that they need to become more American if they want more growth and more jobs. That conviction eventually morphed into an official European Union agenda for so-called "Flexicurity", seeking to combine flexible labor markets with supportive policies for personal employability. Whatever its merits, Flexicurity was always more a hype among policy wonks than a reality on the European work floor.

The recent change in labor market fortunes has now brought a number of observers to question the mantra altogether. European politicians did not go on a Keynesian spending spree and instead claim credit for their country's built-in protections. Union experts have joined the chorus, labeling Flexicurity a fair-weather friend and reclaiming old-fashioned restrictions as the guarantors of stability.[2] This particular observer finds the

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transatlantic labor market comparison premature. There is simply no quick labor market fix for an economic recession, whatever your policy persuasion may be. Economic differences come a long way in explaining today's differences in labor market outcomes among countries. Some countries have been hit more by the Great Recession than others, some have had a major domestic real estate crisis to add to the global contraction, and some have been able to take better advantage of the rebounding economy in the developing world. Germany's ability as an export economy towards Asia helps its domestic employment. A real estate crisis weighs heavily on unemployment in Ireland and Spain alike, notwithstanding big differences in their respective labor market models. Beyond the economy there is demography. Aging and immigration affect different countries differently, with ramifications for their respective labor force and – consequently – unemployment figures.

Nothing of the above relates to labor market policies per se, but all of it heavily impacts labor market outcomes. Moreover, the traditional assumption of inflexible European labor markets is really outdated. Virtually all of the European countries that typically have rigid and inflexible labor regulations at their core, have also grown a wide penumbra of often extremely flexible a-typical work. Companies in Europe thus have layers of flexible temporary workers that can be employed, re-employed, and laid off as a matter of course. Such is the legacy of rigid labor markets whose beneficiaries have never accepted overall modernization: a multitier market where insiders enjoy cushy stability for most of their careers, at the expense of incoming outsiders. Predictably, the brunt of any labor market contraction then falls on the outsiders, who either loose temporary work or enter the labor market with very limited job perspectives.

The labor market lesson of the Great Recession so far lies not in the vagaries of unemployment statistics, but in the worsening of the divide between insiders and outsiders. For the responses of virtually all European governments to the current jobs crisis have primarily been aimed at protecting existing jobs even more. Across the continent, subsidy mechanisms and regulatory measures have sought to avoid redundancies through working time reduction, temporary unemployment systems, cash-for-clunkers programs, and the like. As a result, the chasm between the haves and the have-nots on the labor market has only deepened further.[3]

By entrenching existing employment, European politicians and employers have not demonstrated the uselessness of flexible labor markets in times of crisis. They have instead undermined the potential of job transitions in a period of profound economic change. Europe's internal market rules did prevent the repeat of wholesale

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state support as a crisis policy. But its light-version on the labor market has similar consequences. Time will tell whether Europe is – once again – only slowing inevitable transitions and therefore undermining future growth and productivity to the detriment of all, or whether its job shielding will be a jump board and allow companies to grow anew with lower redundancy and recruitment costs.

Whatever the outcome, the bottom line is a labor market preference for the incumbent at the expense of newcomer. This goes beyond reduced job opportunities to the price tag as such. The niceties of increased employment protection and automatic stabilizers translate into deficits that will have to be paid by future workers. The same generational arithmetic obviously holds for deficit spending on expanded unemployment insurance and Keynesian job creation in the US. Labor market realities on both sides of the Atlantic thus share what is becoming an overall tendency of our crisis epoch: our generation's unwillingness or inability to pay for its collective mistakes.

The Great Recession does not demonstrate the failings of any particular labor market model, at least not yet. But the recuperation of the crisis for political purposes is clearly spilling over into labor market territory. The renewed foundational EU-Treaty already advocates a "social market economy" aimed at "full employment". Europe 2020, the EU's new flagship program, similarly seeks to steer economic development towards "smart, sustainable, and inclusive growth", including an industrial strategy for "green jobs". Keynesian dreams of a more politically managed labor market are gaining political traction. If this tendency becomes a trend, it will be the Great Recession's real labor market legacy.

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Full version of an opinion article in the Wall Street Journal Europe, August 24, 2010.

[1] *P. Gregg and J. Wadsworth, Jobs in the recession, London School of Economics, CenterPiece, Summer 2010.*
[2] *A. Tangian, Not for bad weather: flexicurity challenged by the crisis, ETUI Policy Brief 3/2010.*
[3] *See W. Eichhorst et al., Crisis, What Crisis? Patterns of Adaptation in European Labour Markets, IZA Discussion Paper 5045, July 2010; European Commission, Labour market and wage developments in 2009, European Economy, 5/2010.*

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