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Public Policy Brief

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Is There a Trade-off between Unemployment and Inequality?

No Easy Answers: Labor Market Problems in the United States versus Europe

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Summary

High unemployment rates and increasing terms of unemployment have persisted in western European countries for the past 20 years. These problems have been explained as resulting from inflexibility in the labor market created by such policies as protective labor market regulation and generous social assistance. The lower rates and shorter duration of unemployment in the United States were thought to result from greater labor market flexibility. On the basis of this analysis, European nations enacted changes, such as weakening regulations, to increase labor market flexibility. However, labor market analysts have found not only that such efforts have been largely unsuccessful at reducing unemployment or increasing labor mobility, but also that the United States has been experiencing rising wage inequality over the same time period that unemployment problems have been occurring in Europe. In other words, both the United States and Europe face serious labor market problems. In this Public Policy Brief, Rebecca M. Blank, of Northwestern University and the Northwestern University/University of Chicago Joint Center for Policy Research, analyzes these problems to assess the extent to which they reflect different institutional responses to related economic problems.

Some researchers attempt to identify links between rising wage inequality in the United States and unemployment in Europe. According to their hypothesis, which Blank refers to as the “unified theory,” there has been a transformation in fundamental economic forces, such as technology and the pattern of international trade. These transformed forces have the same effects on labor demand in the U.S. and the European labor markets, but the ensuing changes to wages and employment are determined by the relative degree of flexibility in each market. Relatively open labor markets in the United States lead to shifts in relative wages and to greater wage inequality, while the more rigid wage structure in Europe leads to changes in hiring and firing and to greater unemployment.

Blank finds the empirical evidence to support the unified theory mixed. She concludes that although there is much that analysts do not understand about the extent to which U.S. and European labor markets are linked, similar demand shifts do appear to have affected many of the

industrialized nations, and the result of these shifts within individual labor markets appears to have depended on the structure of each nation's institutions. However, other factors (such as demographic shifts) and each country's "own unique set of economic and social forces" (such as the shape of public policy) appear to have played a role in labor market changes as well.

Blank notes that one way some governments have responded to labor market problems is to do nothing in the hope that existing imbalances will disappear. This approach has failed; the economic changes underlying these problems have not reversed themselves, nor are they likely to do so. A second response is to attempt to insulate the national economy from the economic changes. Blank comments that it is fortunate that few countries have chosen this path, because, according to prevailing economic thought, creating barriers to trade and economic change generally has larger negative long-run consequences than positive short-term effects. Blank suggests a third, and "good," response. Governments should recognize that there are no quick and easy solutions to institutionally ingrained problems; they must confront problems directly by enacting a long-term plan that will offset and reduce adverse labor market effects.

According to Blank, "good policy choices will require mixing some of the best aspects of labor market flexibility with well-run activist labor market and social protection policies." Ongoing labor market changes can be offset through (1) active labor market policies designed to subsidize or raise wages or increase employment, such as job placement and training programs, subsidies and tax incentives for hiring disadvantaged workers, and public sector employment; and (2) a reasonable social safety net that offers assistance through existing unemployment and assistance programs, such as the earned income tax credit, or through new programs, such as part-time unemployment subsidies for involuntary part-time workers.

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Preface

How much better could the economy be? This year the U.S. economy posted its 25th consecutive quarter of economic expansion, an expansion highlighted by falling unemployment, minute inflation, healthy GDP growth, and a soaring stock market. All of this rosy news appears to have masked the fact that economic participants are sharing very differently in the rewards of the robust economy. As noted by Rebecca M. Blank in this brief, between 1979 and 1993 real wages fell 12 percent among full-time male workers with a high school degree, while rising 10 percent among full-time workers with a college degree. These figures indicate that workers at the bottom of the income scale not only are faring worse relative to those at the top, but are losing in absolute terms.

Why the growing disparity amidst such economic splendor? Economists have offered a number of reasons, including a mismatch between the skills needed by employers and those possessed by workers, the shift from full-time to part-time workers, and the weakening of institutional structures originally designed to protect worker interests. Blank does not discount these reasons, but offers one explanation that adds insight into why inequality in the United States is increasing and also why unemployment in Europe persists.

Blank studies labor market problems in Europe—where unemployment rates are high but disparity is low—and those in the United States—where unemployment is low but disparity is growing—and takes a different tack from those who assert that there is some form of trade-off between unemployment and equality. From her analyses of the available data, Blank hypothesizes a “unified theory” of labor markets in which changes in fundamental economic forces, such as technology and patterns of international trade, have similar effects, such as increasing the demand for more skilled workers, in all industrialized countries. The reaction to these effects within a country's labor markets, however, is dictated by that country's institutional structure (such as degree of unionization and regulations governing employee layoffs), policy goals (such as balancing the federal budget versus countercyclical spending plans), and social forces. Accordingly, in the United States the changes in economic forces lead to shifts in wages (and greater wage dispersion), while in Europe they lead to changes in hiring and firing patterns (and higher unemployment).

For growing wage disparity or persistent high unemployment to be alleviated, the effects of the fundamental forces or the structures in place that cause labor markets to react to those forces in certain ways must change. For example, if policymakers perceive that an excess demand for skilled workers is driving U.S. wage disparity, they might set up additional worker training programs to offset further dispersion. In Europe policymakers might attempt to alter reactions to fundamental forces by modifying regulations that limit the ability to lay off workers. An option suggested by Blank is to combine aspects of the two approaches: to combine the flexibility of U.S. labor markets with the social protection policies characteristic of the European markets. As Blank states, "those who favor labor market flexibility—adjusting quickly to economic changes and thereby providing the incentives for workers to invest in new skills or change jobs and relocate—must also indicate how they propose to deal with the substantial segment of the working population facing permanently lower wages and reduced incentives to participate in mainstream labor markets."

Blank's idea that conditions in the labor markets of western industrialized countries represent different responses to the same forces makes sense in the context of increasing internationalization of markets. Looking at the similarities in the experiences of European and U.S. markets can provide insights useful in developing policies aimed at allowing all Americans to share in the fruits of economic prosperity.

Dimitri B. Papadimitriou
Executive Director
August 1997

No Easy Answers: Labor Market Problems in the United States versus Europe

Over the last two decades virtually every western European nation has faced high and persistent unemployment. In frustration, many Europeans have looked to the United States, with its lower unemployment rates, as a model of labor market flexibility. The U.S. model has become less attractive, however, as analysts have come to recognize the extent of rising wage inequality in the United States over the past two decades, including sharp declines in wages among the less skilled. In short, both Europe and the United States have faced serious labor market problems in recent years.

This brief discusses some of the ways in which these labor market problems reflect different institutional responses to related economic problems. The U.S. and the European experiences demonstrate that there are no easy answers about how to operate a labor market that will generate plenty of jobs for younger and less-skilled workers and also offer workers the opportunity to earn enough to support a family. Good policy choices will require mixing some of the best aspects of labor market flexibility with well-run activist labor market and social protection policies.

The labor market problems on both sides of the Atlantic have social and political as well as economic ramifications. Changes in the labor market test a country's social cohesion and its sense of community. People who have lost economically—either because of extended unemployment or because of falling wages—are likely to be more conservative and less willing to take risks. Antagonism toward immigrants and various forms of right-wing violence are on the rise in both the United States and Europe. Many countries are having difficulties in maintaining a sense of community and civic conversation between those who are angry at their losses and those who have held onto (or gained in) relative economic status over the past decade. While there may be many sources of this discontent, and not all of them economic, certainly one important source is the employment problems faced by specific groups of workers in all these countries.

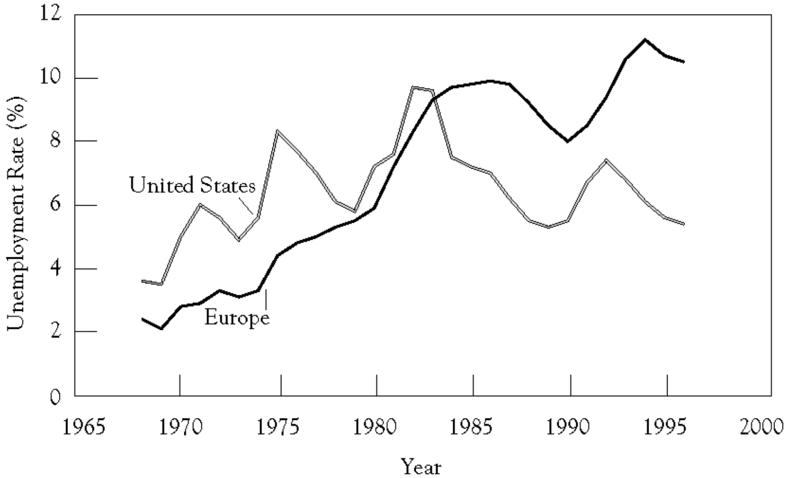
The Story in Europe

Concurrent with the OPEC oil price shocks and a worldwide recession, European nations experienced a sharp rise in unemployment and a slow-down in growth in the mid 1970s. Rather than recovering in the 1980s, in many nations things got worse. Unemployment was higher by 1990 than it had been in 1980 for most countries, and these high rates persist (see Figure 1). The rate of long-term unemployment (the share of the unemployed out of work 12 months or more) soared to 30 to 50 percent in many nations, and part-time employment also rose.[1] The problem was especially severe among younger workers.

Initial attempts to explain this high unemployment focused on the lack of labor market flexibility in Europe due to extensive labor market regulation and generous social assistance programs. Despite the uncertain economy, it was argued, wages stayed high because of protective legislation and rigid union rules. Employers refused to hire high-cost workers, especially because severance protection made it costly or impossible to lay them off. Workers, in turn, were content to remain out of the work-force because they received generous and long-term unemployment compensation and other assistance.[2]

As high unemployment continued through the 1980s, the inflexibility explanation was buttressed with other explanations that focused on the persistence of the problem. Insider/outsider models suggested that

Figure 1 Unemployment in Europe and the United States



Source: U.S. rates based on data from *Economic Report of the President* (Washington, D.C.: U.S. Government Printing Office), various years; European rates based on data from *OECD Employment Outlook* (Paris: Organization for Economic Cooperation and Development), various years.

workers who remained employed had no incentive to allow flexible wages and severance rules, hence "insiders" (the employed) kept firms from adjusting in ways that would allow them to hire "outsiders" (the unemployed). Various so-called hysteresis models suggested that the European nations had moved from a low-unemployment to a high-unemployment equilibrium because of the series of sustained economic shocks in the 1970s and early 1980s (for instance, Lindbeck and Snower 1990 and Blanchard 1990).

Throughout the 1980s many nations tried to create greater flexibility in their labor markets by weakening protective legislation, in the hope this would bring unemployment rates down. For instance, Germany, France, the United Kingdom, and Belgium weakened their dismissal laws; Spain, the United Kingdom, and the Netherlands decentralized wage bargaining; and Italy eliminated automatic wage indexation (Organization for Economic Cooperation and Development 1990).

As researchers studied these changes in labor market regulation and social protection, they found surprisingly few effects on labor market flexibility and employment. Certainly aggregate unemployment rates did not fall noticeably. A research project sponsored by the Ford Foundation and the National Bureau of Economic Research indicated that the effects of these changes were small (Blank 1994). For instance, changes in severance laws and in public sector bargaining created no bursts of job growth or worker mobility. These results are consistent with work by other researchers, who found at best only small effects from the efforts of European nations to free up labor market constraints (for instance, see Blanchflower and Freeman 1993; Atkinson and Mogensen 1993; and Buechtemann 1993).

It is possible that the legislative changes enacted by European nations in the 1980s were too minor to make a difference and that changes must be more dramatic to have an effect. For instance, rather than limiting severance pay and making it easier to fire workers, perhaps nations need to abolish all such regulation entirely. But the small effect of efforts by European countries to create more flexible labor markets suggests that the problems facing Europe's labor markets go beyond the institutional structures and rules that exist within these countries.

The Story in the United States

Through the mid 1980s the much less regulated labor markets in the United States appeared to provide a successful alternative model. While unemployment continued to rise in Europe, it fell dramatically in the United States. By the late 1980s it was at a low and sustained rate of around 5.5 percent (see Figure 1). The mild recession of 1990–91 pushed unemployment up, but it fell quickly to its previous low levels by the mid 1990s.

By the late 1980s, however, a number of economic observers were suggesting that focusing only on unemployment obscured an important piece of the U.S. picture. While unemployment seemed stable at fairly low levels, wage inequality was rising rapidly and real wages (wages adjusted for inflation) of less-skilled workers had fallen steadily since the early 1970s. Between 1979 and 1993 real wages among men without a high school degree who were working full-time fell 22 percent; among men with a high school degree who were working full-time wages fell 12 percent. Over these same years full-time male workers with a college degree saw their wages rise by 10 percent. Female workers also saw dramatic increases in wage inequality, although the actual declines among the least skilled are not as extreme (not a very reassuring statement given how low wages for less-skilled women have always been).[3]

The slowness with which these wage trends were recognized underscores the effect data collection and reporting have on public policy discussion. The unemployment rate is reported monthly in many countries, and it is widely discussed and accepted as a measure of economic pain. In contrast, distributional indicators are rarely measured or reported in official government statistics. Average wage and income levels are frequently reported, but distributional changes around that average are not. Hence, it was not until the early 1990s that these wage trends became known and accepted. Only after a number of studies by different researchers with different data sets all produced similar evidence of declining wages at the bottom and rising wages at the top did this rise in inequality become an accepted fact within the academic community.

By the time the wage inequality became widely accepted, the claim that flexible American labor markets were obviously superior to Eurosclerotic labor markets had become so imbedded in the public discussion that few people stopped to reassess whether that flexibility came at too high a price. While the less regulated U.S. labor markets avoided the severe rise in overall unemployment rate, they instead experienced major declines in wages for some groups of workers. In short, both the United States and Europe have faced major labor market changes and problems over the past two decades. Although the trends in U.S. wage inequality were initially less apparent, the problems they create for less-skilled workers may be as severe as the problems faced by European workers who experience long spells of unemployment.

A "Unified Theory" of Links between U.S. and European Labor Market Problems

Increasingly, researchers are looking for links between rising inequality in the United States and high unemployment in Europe. The same changing global economic forces are having an impact on both the United States and Europe. For instance, changing patterns of international trade and changing technology will increase the demand for some groups of workers (especially the more skilled), while decreasing the demand for other groups (especially the less skilled) in all industrialized nations. In the more open U.S. labor markets these changes produce shifts in wages, leading to increasing inequality. In the more regulated European labor markets, which have historically maintained more rigid wage structures, employers adjust to these economic forces by changing their hiring and firing behavior, leading to increased unemployment. *A priori*, it is not clear whether the United States or the European model is preferable. They are simply different, adjusting to international economic changes in different ways with different effects on various groups of workers.

Let's call this story the "unified theory," since it suggests both the European and U.S. labor market problems are the result of the same fundamental changes in global economic forces. The best evidence in support of this theory is simply the timing of events. Continuing high unemployment in Europe became a puzzle as the world economy started to recover in the late 1970s (Wood 1994). This is exactly the same time that wage inequality started to rise rapidly in the United States. Both sets of problems appear to have emerged at about the same time, although the wage inequality problems in the United States were not widely recognized until almost a decade later.

But other empirical evidence for the unified theory is admittedly mixed. The careful cross-national research needed to explore this issue fully is only beginning. The theory implies a trade-off between wage inequality and high unemployment, with countries with the most inflexible labor markets experiencing the highest unemployment rates but showing little evidence of rising wage inequality and vice versa. The United States has experienced the strongest increase in wage inequality and little long-term increase in unemployment rates over the past 15 years, consistent with the theory. Similarly, some European countries with high unemployment show no change in wage inequality. However, this reverse correlation between the two problems appears at best mild. Some European countries, most notably the United Kingdom,[4] have experienced both problems.

Further evidence might be found by determining which group of workers is experiencing the biggest decline in relative wages in the United States and asking whether this same group is most affected by rising unemployment in European countries. In the United States it is clearly the less skilled who have seen the biggest wage declines, although wage inequality is rising within skill categories as well. In Europe unemployment rates are highest among the less skilled, but it is not clear that the relative unemployment rate of less-skilled workers has risen over time. In fact, only France, Italy, and Norway show big rises in unemployment among the least-skilled relative to more-skilled workers (Nickell and Bell 1995). In other countries unemployment among all groups has risen, so relative unemployment rates by skill remain largely constant. In general, European unemployment seems more focused by age than by skill level. Younger workers have experienced the biggest increases in unemployment. But this does not necessarily contradict the unified theory. Labor market protections that make it hard to fire older workers in Europe may have pushed an undue burden of unemployment onto younger workers of all skill levels as companies try to cope with changing competition and changing demand.

Finally, researchers have tried to test directly the extent to which direct changes in trade and technology feed through to the labor market.[5] At present, this literature is more extensive for the United States than for Europe, and more cross-national studies on these topics need to be done. The evidence seems to suggest that changing technology has played a larger role than changing trade, although there remain serious problems in correctly characterizing technological change and in developing a fully satisfactory model of how trade changes flow through the entire labor market.

While there is much we still do not understand about the extent to which U.S. and European labor market changes are linked together, there appears to have been a series of demand shifts that have affected many of the most industrialized nations. Differences in how labor markets in these nations have responded depend upon the nations' institutional structure. Less regulated labor markets, particularly the United States and the United Kingdom, have experienced much greater changes in relative wages (Freeman and Katz 1994). (It is worth noting that *only* in the United States have there been actual declines in real wages among workers. In other countries where inequality has grown, it is because the wages of more-skilled workers have risen faster than the wages of those at the bottom of the wage distribution.) Countries with centralized labor bargaining have been most effective in maintaining an unchanged relative wage structure, but a number of these economies have instead faced high and sustained unemployment problems.

The demographics of different nations also appear to matter for these labor market changes. Some of the labor market differences across countries can be explained by different age patterns in the population and by different patterns of labor force entry and exit among younger, older, and female workers.

Social protection programs have played a key role in offsetting the effect of labor market changes on workers' income and well-being. Countries with more redistributive programs have spread the economic costs of these changes more broadly within the economy. In fact, there is some evidence that countries with more extensive social assistance programs are exactly those countries where the increases in unemployment are also spread more broadly across workers of different skill levels. This suggests that countries may have distributional norms that affect corporate and public behavior beyond the explicit transfer systems that are in place. (One small piece of evidence in support of this is that the rising level of CEO salaries relative to other workers within U.S. firms over the 1980s is a pattern not mirrored in European firms.) In the United States the costs of these economic changes have been much more highly concentrated on a particular group of workers, with less relief provided by public transfer programs.

I don't want to oversell the "unified theory" approach to understanding the unemployment or wage situation in any one country. Every industrialized country has clearly faced its own unique set of economic and social forces over the past two decades, and those forces, combined with the country's response to them, have shaped the economic reality of its workers. For instance, some countries have chosen to pursue strong macroeconomic and monetary policies to fight inflation, and this has affected their unemployment and wage rates. Other countries have faced significant immigration issues, and this has affected unemployment and changed the distribution of jobs and wages. However, although each country has its own peculiar history, it remains a useful exercise to stop asking what is *different* about the U.S. and the various European experiences and instead to ask what is *similar* about them. When this question is asked, it becomes clear that related labor market problems face both U.S. and European policymakers.

Policy Implications

Changing labor markets have presented major challenges to policymakers in all countries. All countries have faced increasing demands on their public assistance programs from workers facing either deteriorating wages or long-term unemployment. This means greater demands on public budgets. Countries that offer extensive social protection have been the most challenged, because the burden of supporting generous redistributive programs rises when the number of people participating in those programs grows. Sweden is only the most dramatic example of a European country that is being forced to make significant cuts in it social assistance programs because of its inability to provide traditional levels of support to a large number of unemployed workers.

The initial approach taken by many nations to both the labor market problems and the public budget problems was simply to hope that they would go away and things would return to "normal." Unfortunately, but not surprisingly, this approach has failed. The fundamental economic changes underlying these problems—changing patterns of international trade and changing technology—are unlikely to reverse themselves and will probably continue into the foreseeable future. Growing global economic competition (particularly increasing competition from rapidly developing nations) will continue and may even accelerate in certain markets. The growth of "smart" technologies, which give an advantage to more-skilled workers, is still underway in most industries.

Another possible approach is to try to insulate a country from these economic changes by imposing higher trade barriers, trying to regulate labor market changes, or trying to slow down the adoption of new technologies. Fortunately, few countries have chosen this route, although a vocal political minority in all industrialized countries continues to advocate it. As economists are famous for pointing out (often with annoying frequency), creating barriers to trade and economic change can produce negative long-run effects, limiting economic growth and job creation and creating long-run costs that are much greater than the benefits such policies might produce in the short run.

To respond effectively to these problems, governments must confront the problems head-on, recognize that they have no quick and easy solution, and make long-run plans to offset and reduce their labor market effects. There is no "magic bullet" to do this and no single remedy that will work for all countries; each country must find a solution that works within its own set of political and economic institutions. The best approach, I believe, lies in utilizing a mix of ideas from both the U.S. and European experiences.

On the one hand, those who admire the flexibility of the U.S. labor market have some good arguments in their favor. Extensive limits on employee hiring and firing can seriously limit an economy's ability to adapt to changing economic forces. In economies with historically extensive labor regulation, easing severance restrictions and increasing the ability of firms to hire part-time or temporary labor are almost surely necessary changes. On the other hand, along with flexibility must come a greater willingness to redistribute the costs of that flexibility throughout the economy, rather than forcing it to be borne by particular groups of workers facing extended unemployment or falling wages. U.S. policymakers have been far too ready to shrug and say “That’s just the result of the market” in the face of massive loss of earning power among less-skilled workers.

There are two ways in which countries should offset the costs of ongoing labor market changes: active labor market policies to raise wages and to bring unemployed workers into jobs and some form of ongoing redistribution of income to act as a social safety net. Many countries have at least experimented with a variety of active labor market policies such as job placement and training programs, subsidies and tax incentives for hiring disadvantaged workers, and public sector job creation, particularly for the long-term unemployed and younger workers who may have dropped out of the labor market entirely. These programs directly address some of the problems of low skills and inadequate access to jobs. Thus, they promise to “right” that which is wrong. They also operate to redistribute some of the gains by the “winners” (those who maintain their jobs or have rising wages) to the “losers” (those who become unemployed or face declining wages.) There is plenty of evidence that these programs can have positive effects.[6]

But it is important to recognize that such effects are typically small. Rarely do training or job placement programs lead to large increases in future income, according to most evaluations of these programs. In addition, such programs make significant demands on the public sector. Not only are they typically quite costly per participant served, but they also require substantial management expertise. Someone must actually run these programs, locating jobs, monitoring employers’ use of tax credits, identifying public sector job placements, and so on. Many such programs may be best operated by the government in conjunction with substantial private sector involvement (where management expertise is often greater). Traditionally, such programs have worked best when run on a small scale for targeted groups.

Some mix of active labor market policies is an important policy component in most countries, but such policies are rarely adequate by themselves. They must be combined with some ongoing redistribution of income, supplementing the wages of low-wage workers and providing income support for those who remain unemployed. Active labor market policies must be the first line of attack—workers should be pushed into job training, job search, and public job programs as quickly as the size of these programs will allow. But given the realistic limits on the effects of active labor market policies, a reasonable social safety net needs to remain in place. If this does not happen, countries will face serious long-term consequences, such as increases in underground economic activity, crime, drug use, family fragmentation, civic disconnection, and civic disorder—frequent outcomes when a share of the population is excluded from mainstream labor markets.

Income supplementation can occur through traditional unemployment and public assistance subsidies or in more novel ways. The earned income tax credit in the United States subsidizes wages of low-wage workers and has been shown to increase labor market participation among those initially out of the labor market (Eissa and Lehman 1995). Public sector job programs are a way of supplementing income while still encouraging labor market activity. Partial unemployment payments are used in some European countries to subsidize involuntary part-time workers.

The appropriate level of such subsidies is always a contentious issue. Because of perceived overwhelming demand on their unemployment and public assistance budgets, most industrialized countries have cut income transfers to some extent in recent years. The United States has been in the midst of a debate about whether its social assistance programs are too generous (particularly in the face of high and sustained caseloads over the early 1990s) for several years. European countries have made major changes in some of their social assistance programs and in their unemployment benefit systems (which traditionally have provided far more income support and redistribution than similar programs and systems in the United States).

Setting limits on access to cash support may be a fiscal necessity, but if at all possible, setting limits should coincide with active labor market policies. Limiting time on unemployment insurance should coincide with providing job search and training services. A time limit on public assistance with no guarantee of employment, as has been recently enacted in the United States, amounts to no more than wishful-thinking public policy. Given the realities of low-wage labor markets, many less-skilled parents will face unemployment and low wages that make economic survival extremely difficult without some ongoing external support.

There is no reason to believe that the economic changes creating problems of wage inequality and unemployment in U.S. and European labor markets will reverse in the foreseeable future. Nations will continue to face difficult choices between active labor market policies, redistributive programs, and government budget costs. The United States currently appears to be choosing, in the name of deficit reduction and budget balancing, a route whereby low-income families are being cut off from government assistance. The recent welfare reforms emphasize that the labor market is the only way out of poverty, even as falling wages make full-time work less and less useful as an escape from poverty. Although the long-term consequences of such policy changes, when combined with the trends in wages, are unknown, they do have the potential to lead to increases in poverty and class conflict. While many European countries are cutting their safety nets, most still maintain far greater assistance and redistribution than the United States. Given their longer and stronger commitment to social protection in the past, how far they will follow the United States in cutting back in the long term is unclear.

There are no obvious solutions to the problems of unemployment and wage declines in the short run, only ways to soften their effects. Europe has found no effective ways to lower youth unemployment rates, just as the United States has found no effective ways to prevent wage declines among the less skilled. Those who favor labor market flexibility—adjusting quickly to economic changes and thereby providing the incentives for workers to invest in new skills or change jobs and relocate—must also indicate how they propose to deal with the substantial segment of the working population facing permanently lower wages and reduced incentives to participate in mainstream labor markets. Those who favor labor market regulation and redistribution—providing more job protection and greater wage equality—must indicate how they propose to deal with the large number of long-term unemployed. A better response is not to view policy as a choice between two opposing models, but to try to meld the best parts of a flexible private labor market with an effective set of active labor market and social protection policies.

Notes

1. See Blank (1995, Table 2).
2. For example, see the collection of articles in Bean, Layard, and Nickell (1987) or Lawrence and Schultze (1987).
3. The data on wage changes are from Blank (1997). For discussion of the changes in wage inequality, see Levy and Murnane (1992) or Danziger and Gottschalk (1995).
4. For evidence on comparative changes in wage inequality within the OECD, see Freeman and Katz (1995).
5. Recent contributions to this literature include Allen (1996) and Berman, Bound, and Griliches (1994).
6. For a summary of the U.S. evidence, see U.S. Department of Labor (1995).

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