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Freedom and Labor

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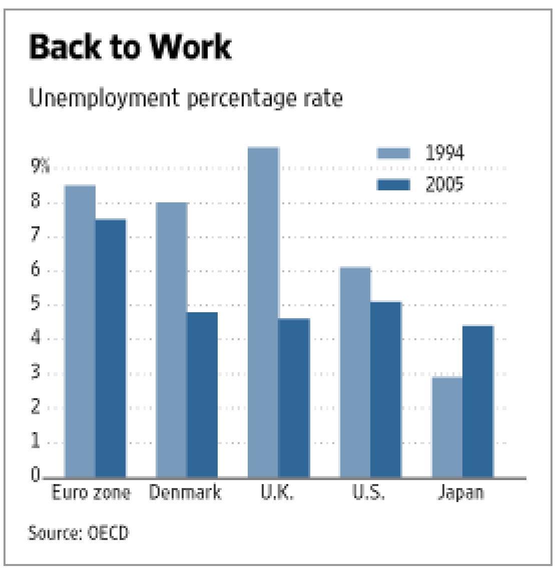
Europe just got its best jobless report in a very long time. The bad news: In a decade when record numbers of people found work in the rich world, Europe's best is an unemployment rate of 7.5%, significantly higher than America's 4.6% or that of any other developed economy.

The Old World offers a useful model of what not to do. Its largest economies -- Germany, France and Italy -- have shunned a policy mix that has enabled English-speaking and Nordic countries to reduce their jobless rolls. In its annual "Going for Growth" report released Tuesday, the OECD argues that deregulated labor and other markets are the best route to full employment. That's hardly man-bites-dog news, but the study draws on a decade's worth of empirical data to make the case.



Before a French politician gets upset, let's be clear that no one's calling for an end to the welfare state. The OECD study shows that a social safety net can coexist with strong growth and low unemployment, notwithstanding other social and economic costs. But the kind of safety net matters.

Look at the welfare-besotted Nordics, in particular Denmark, which has recently found tough love. Its "flexisecurity" system combines generous jobless benefits, strong incentives to get new work fast and lenient hiring and firing rules. This encourages Danish employers to create jobs and pushes beneficiaries back into the work pool. The result: Unemployment fell to 4.8% in 2005 from 8% in 1994 (see nearby chart).

Rigid job protection laws have the perverse effect of keeping people out of work. Germany and France are generous with benefits, lax about getting the unemployed off the dole and inflexible on hiring and firing. Such laws discourage companies from hiring and they discriminate against the jobless by raising the bar to enter the workforce; women and minorities are disproportionately hit.

In France, the overall jobless rate is a still high 8.5% today, down from 12.3% in 1994. But the youth jobless rate is three times higher. Even after its poor minority young rioted in late 2005, France did nothing to make it easier for these kids to get jobs. Unemployment in Germany rose to

10.3% in 2005, from 8.4% in 1994. After Berlin tightened eligibility rules for unemployment insurance on the margins, without touching hiring and firing rules, the rate has since gone down -- marginally -- to 9.5%. That's still a long way from Denmark or the U.S.

As the OECD study shows, countries with low jobless rates not only have the most open labor markets but also the freest product markets. These are, in descending order, the U.S., Britain, Australia, Canada, New Zealand and Denmark. Except for the U.S., all these countries abandoned statist policies and opened up their economies in the past decade or two. The result: more growth and jobs. By the way, half the one-percentage-point decrease in euro-zone unemployment in the past decade comes from Spain, where market reforms got the jobless rate down to 8.5% today from 24% in 1994.

The OECD report also points out the often-overlooked benefits of deregulation to job creation. Freer competition in product and service markets reduces prices. That in turn relaxes wage demands and lets companies hire more workers. Financial deregulation, for example, tends to bring down interest rates, enabling companies to expand. In this virtuous circle, it's then theoretically easier to fix bad labor laws in a growing economy.

New governments in Italy and Germany and a soon-to-be new president in France have a chance to catch up with other developed economies on getting their citizens into jobs. The recipe isn't complicated: Reduce taxes to reduce wage costs, tighten rules on government benefits, loosen up employment protection laws. Come to think of it, the new majority in the U.S. Congress could stand to read the OECD report, too.

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