



Old Europe Goes To Work: Rising Employment Rates in the European Union

BY JOHN SCHMITT AND DEAN BAKER

Introduction

During the 1990s, many economists, international organizations, and politicians promoted U.S.-style labor-market flexibility as a solution to Europe's employment problems. Through much of that decade, the United States did have a significantly higher share of its working-age population in jobs than Europe as a whole. For example, by 2000, when the 1990s business cycle peaked in the United States, for 15-to-64 year olds, the employment gap between the United States and Europe was 10.5 percentage points.¹ During the 2000s, many European policymakers have continued to urge U.S.-style reforms, even though the employment gap between the United States and Europe has narrowed considerably. By 2005, for example, the overall employment gap had fallen to 6.1 percentage points, reflecting both declines in employment rates in the United States and increases in employment rates in Europe.²

In this brief report, we focus on employment rates for the "prime-age" population — those in the 25-to-54 age range, who have generally completed full-time schooling and are still too young to retire. Among this core population, over the last five years, Europe has nearly closed the employment gap with respect to the United States. The small remaining difference is due almost entirely to low employment rates among women in this age range in Italy and Spain, two large economies with weak welfare-state institutions and long traditions of low female employment.

Center for Economic and
Policy Research
1611 Connecticut Ave., NW
Suite 400
Washington, DC 20009
202-293-5380
www.cepr.net

John Schmitt and Dean Baker are senior economists at the Center for Economic and Policy Research. The authors would like to thank the Rockefeller Foundation for financial support of CEPR's research on labor-market issues.

¹ See OECD (2004, Table B). The data for the United States refer to 16-to-64 year olds. Europe here refers to the "European Union 15" --the first 15 member-states of the European Union. The overall employment to population rate in the United States was 74.1 percent; in Europe, it was 63.6 percent.

² See OECD (2006, Table B). The overall employment to population rate in the United States was 71.5 percent; in Europe, it was 65.4 percent. See footnote 1 for additional details.

We focus on the prime-age population because this age group represents the bulk of the working-age population in both the United States and Europe. Critics of the broad European social model,³ however, emphasize that welfare-state institutions have had the biggest — if unintended — negative impact on Europe's least-advantaged populations, including younger and older workers (and women and the less-educated). We have argued elsewhere that the employment case against the welfare state is not strong (see Howell, Baker, Glyn, and Schmitt, 2006, and Schmitt and Wadsworth, 2005). In 2005, for example, in Sweden, the quintessential welfare state, 73.5 percent of 15-to-64 year olds were working, compared to 71.5 percent in the United States. The Netherlands (72.0 percent) and Denmark (75.5 percent) are two other highly regulated European economies with larger shares of their adult population in employment than the United States has.

In this paper, we also want to emphasize that welfare-state institutions sometimes act to reduce employment of younger and older workers quite *intentionally*. Many European countries, for example, made explicit decisions to encourage early retirement, which had the intended effect of lowering employment rates for 55-to-64 year olds. In both the United States and Europe, governments have also worked to expand access to full-time higher education over the last 40 years. In Europe, these efforts have included keeping fees for post-secondary education well below those in the United States. In some countries, governments also provide student stipends and other income supports that mean students generally don't have to work while in school. The expansion of higher education took place much earlier in the United States (spurred in part by draft deferrals during the Vietnam War for college attendees), but many countries in Europe have made up the difference in the last two decades.⁴ Whether we agree or disagree with these policies, they presumably reflect Europeans' democratic choices, with electorates well aware that the impact of these decisions would be to lower employment. As a result, we believe that employment rates for the prime-age population are a reasonable test of the Europe's success in generating employment for its working-age population.

We focus below on employment rates rather than unemployment rates. While the unemployment rate continues to be a useful indicator of economic performance, capacity, and well-being, economists are increasingly emphasizing the importance of the employment rate.⁵ The employment rate has several advantages over the unemployment rate. First, the employment rate is a better measure of the success that economies have had in incorporating women into the paid workforce. Historically, many European countries had low employment rates for women, which were masked by simultaneously low female unemployment rates. Few women were doing paid work, fewer were looking for paid work, and the large majority were officially "not in the labor force." Second, the meaning of a reduction in the unemployment rate can be ambiguous. The unemployment rate can fall because workers are, on net, leaving unemployment to take jobs, or because they are, on net, giving up their job search and becoming "economically inactive."

³ In general, we are skeptical of the usefulness of speaking of a single "European" social model. Any term that includes both Sweden and Spain, or Italy and France, is so broad that it probably loses its usefulness when making comparisons with the United States.

⁴ For a brief discussion of educational enrollment and attainment rates in OECD countries, see Schmitt and Zipperer (2006).

⁵ The European Union's "Strategy for Growth and Employment," for example, specifies a target employment rate of 70 percent for the European Union by 2010.

Employment Rates for Prime-age Population

Table 1 displays employment rates⁶ for men, women, and the total population, ages 25 to 54, in 2000 and 2005. The first year is roughly the peak of the 1990s business cycle in the United States; the second year is the most recent period for which comparable data are available. The table shows results for four separate sets of countries: the United States; the first 15 member-countries of the European Union ("Europe-15");⁷ the five largest economies in Europe (France, Germany,⁸ Italy, Spain, and the United Kingdom); and three smaller, high-performing, European economies (Denmark, the Netherlands, and Sweden).

TABLE 1
Employment Rates, 25 to 54 year olds, 2000, 2005
(percent of corresponding population)

	2000			2005		
	All	Men	Women	All	Men	Women
United States	81.5	89.0	74.2	79.3	86.9	72.0
Europe-15	76.5	87.1	65.8	78.2	86.6	69.8
France	78.3	87.1	69.6	79.6	86.6	72.7
Germany	79.3	87.2	71.2	77.4	83.7	71.0
Italy	68.0	84.9	50.9	72.2	86.6	57.9
Spain	68.4	85.6	51.0	74.4	86.9	61.5
United Kingdom	80.4	87.5	73.1	81.1	87.6	74.9
Denmark	84.3	88.3	80.4	83.9	87.7	80.0
Netherlands	81.7	92.2	70.9	81.5	88.9	74.0
Sweden	83.8	85.8	81.7	82.9	85.0	80.8

Source: OECD, Employment Outlook, 2004 and 2006, Table C. Data for Netherlands and Sweden refer to 2004.

Several aspects of the data stand out. First, Europe has made remarkable progress closing the employment gap over the 2000s. In 2000, the overall employment rate in the United States (81.5 percent) was five full percentage points higher than the corresponding rate in Europe (76.5). By 2005, the combined effect of a fall in the U.S. employment rate (to 79.3 percent) and a rise in the European employment rate (to 78.2) reduced the gap to just 1.1 percentage points. Europe made particular progress closing the employment gap for women, which fell from 8.4 percentage points in

⁶ These are employment-to-population rates — the share of the population in the 25-to-54 age range in work.

⁷ Roughly in order of accession: Belgium, France, Italy, Luxembourg, the Netherlands, Germany, Denmark, Ireland, United Kingdom, Greece, Portugal, Spain, Austria, Finland, and Sweden.

⁸ The data we present are for unified Germany. Since eastern Germany has much higher unemployment rates and much lower employment rates than western Germany and eastern Germany makes up about 20 percent of total German population, the unified German data give a more pessimistic evaluation of German economic performance than would the data for western Germany alone.

2000 to 2.2 percentage points in 2005.⁹ For men, a smaller gap of 1.9 percentage points in 2000 all but disappeared by 2005 (0.3 percentage points).¹⁰

Second, almost all of the remaining employment gap in 2005 reflects lower employment rates for women in Europe. Moreover, an important part of this difference among women is due to particularly low employment rates for women in two large countries: Italy, where only 57.9 percent of prime-age women are in paid employment, and Spain, where the figure is 61.5 percent. In 2005, the remaining three large European economies had employment rates for prime-age women that were near or above those in the United States (72.0 percent): Germany (71.0 percent), France (72.7 percent, up from 69.6 percent in 2000), and the United Kingdom (74.9 percent, up from 73.1 percent in 2000).

Third, in 2005, France had a slightly higher employment rate for prime-age workers (79.6 percent) than the United States did (79.3 percent). Remarkably, the higher overall employment rate in France was entirely due to higher employment rates among French women (72.7 percent, compared to 72.0 percent for U.S. women). The superior French employment rate in 2005 was the product of declining employment rates in the United States (down 2.2 percentage points) and rising employment rates in France (up 1.3 percentage points). France experienced particularly strong increases in female employment, which rose 3.1 percentage points in five years (from 69.6 percent in 2000 to 72.7 percent in 2005).

Fourth, by far the best performers have been the three small economies in the last three rows of the table, Denmark, the Netherlands, and Sweden. Compared to the United States, these three economies have much more established welfare-state institutions, including substantial taxation, generous unemployment benefits and other income supports, employment protection legislation, and strong unions. All three countries also have substantially stronger welfare-state features than Italy, Spain, and the United Kingdom, and arguably stronger than France and Germany. In 2005, overall employment rates were higher than they were in the United States (79.3 percent) in all three countries: the Netherlands (81.5 percent), Denmark (83.9 percent), and Sweden (82.9 percent). The three small, regulated, economies did particularly well in placing women in paid employment, with the Netherlands (74.0 percent), Denmark (80.0 percent), and Sweden (80.8 percent) all surpassing the United States (72.0 percent).

Finally, between 2000 and 2005, Sweden, which already had higher employment rates than the United States did in 2000, managed to increase employment rates sharply. Overall employment increased 3.9 percentage points; employment rates for men rose 4.3 percentage points, while employment rates for women fell about 0.9 percentage points (but remained the higher than anywhere else in Europe or in the United States). Spain and Italy also saw large increases in employment rates over the same period, though from much lower levels. Between 2000 and 2005, the employment rate in Italy¹¹ rose 4.2 percentage points to 72.2 percent in 2005; over the same period, the employment rate increased 4.0 percentage points in Spain.

⁹ For 2000: 74.2 (United States) - 65.8 (Europe) = 8.4; for 2005, 72.0 (United States) - 69.8 (Europe) = 2.2.

¹⁰ For 2000: 89.0 (United States) - 87.1 (Europe) = 1.9; for 2005, 86.9 (United States) - 86.6 (Europe) = 0.3.

¹¹ In the intervening period, Italy changed its tax regulations, making it more difficult for workers to work off the books, which may have led more workers in the Italian labor-force survey to answer that they were employed.

Data Limitations

At least two features of the data in Table 1 probably mean that the comparison overstates the employment performance of the United States relative to Europe. First, high incarceration rates in the United States bias U.S. employment rates up relative to the rates in Europe. Employment rates are calculated as a share of the civilian, non-institutional population. Since incarceration rates in the United States are five to ten times higher than they are in European countries (see Schmitt and Zipperer, 2006, Table 9), the exclusion of the non-institutional population from the comparison of employment rates has a much larger effect on the U.S. employment rates than it does on those in Europe. As we have demonstrated elsewhere, the effect of excluding the non-institutional population from estimates of the employment-to-population rate raises the overall U.S. employment rate for the population 16 and over by 0.9 percentage points; the effect for men, who make up about 90 percent of the U.S. prison population, is 1.3 percentage points (see Schmitt and Baker, 2006a, Tables 2 and 3).

Second, high and rising non-coverage rates in the underlying survey used to produce the U.S. employment rates may have an even bigger impact on estimates of the U.S. employment rate than incarceration rates (Schmitt and Baker, 2006a and 2006b). The Current Population Survey (CPS), which the OECD uses to estimate employment rates in the United States for the data summarized in Table 1, has a high and rising non-coverage rate. As we have analyzed elsewhere, the portion of the U.S. population not covered by the CPS appears to have a substantially lower employment rate than the portion covered by the survey. According to our estimates, problems with non-coverage biased upward the estimates of the employment rate for the population 16 and older in the United States in 2000 by about 1.3 percentage points; by 2005, we estimate, the effect had risen to 1.7 percentage points (Schmitt and Baker, 2006b). To the extent that non-coverage rates are lower and have not risen as much in Europe as they have in the United States, this effect could further bias the comparisons in Table 1, by incorrectly boosting the relative performance of the United States.

Conclusion

For the prime-age population, the employment gap between Europe and the United States has all but disappeared in the last five years. The narrowing of the gap reflects falling employment rates in the United States in the 2000s and rising employment rates in Europe over the same period. The five-percentage-point gap between Europe and the United States in overall employment rates for 25-to-54 year olds in 2000 declined to just 1.1 percentage points in 2005. The true employment gap is almost certainly smaller since high incarceration rates in the United States boost measured employment rates by excluding a large group of men from the non-institutional employment statistics.

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