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Labour Markets in Finland and Sweden: A Swedish Perspective

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Labour market institutions in Finland and Sweden have many features in common. The many similarities have inspired a joint Finnish-Swedish research project on the effects of these institutions. Finland has experienced a prolonged economic downturn and Sweden's system of wage bargaining has been suggested as a model for Finland. Aggregate wage formation has worked well in Sweden, but relative wage formation markedly less so and the effects of local bargaining are not clear.

Labour market institutions – legislation, collective agreements and norms – and their effects have become increasingly important research areas in labour economics. The labour market institutions in Finland and Sweden have several features in common: high coverage of union contracts, minimum wages that are set in collective agreements, union-administered unemployment insurance with generous replacement rates and similar levels of stringency in overall employment protection, to name just a few. Also, there are close points of similarity between the countries in macroeconomic environments. Both Finland and Sweden are small, export-oriented economies, with fluctuations in aggregate demand to a large extent driven by changes in export demand. After the global recession, however, Finland has experienced a prolonged downturn, with important repercussions on the functioning of the labour market.

The purpose of this article is to discuss the labour markets in Finland and Sweden from an institutional perspective, but mainly from the Swedish angle (with apologies, since my knowledge and understanding of institutions on the Finnish side is fragmentary at best). My choice of focus is motivated by the ongoing discussion in Finland whether labour market institutions should be reformed in order to improve the economic situation and to what extent anything can be learned from Swedish experiences in this regard.

There are two distinct parts in the article. In the first one, I report on a joint Finnish-Swedish research project investigating the effects of labour market institutions with a novel kind of international data. The project was inspired by the many similarities between Finland and Sweden, noted above. In the second part, I discuss wage formation in Sweden, building on work of the newly established Swedish Labour Policy Council (*Arbetsmarknadsekonomiska rådet*).²

Before proceeding, it is useful to briefly consider some statistics regarding the employment situation in the two countries and the evolution of labour costs.

¹ This article is based on my keynote speech at the Finnish Economic Association XXXVIII Annual Meeting in Pori, February 5, 2016. I am grateful to Petter Danielsson for comments and to the Finnish Work Environment Fund and the Johan and Jakob Söderberg Foundation for funding of the Finnish-Swedish research project mentioned in the text.

² The council is chaired by Lars Calmfors and the other members are Ann-Sofie Kolm, Tuomas Pekkarinen and Per Skedinger. It is financed by the Confederation of Swedish Enterprise (*Svenskt Näringsliv*), but acts independently. Homepage in English: www.arbetsmarknadsekonomiskaradet.se/the-swedish-labour-policy-council/.

EMPLOYMENT AND LABOUR COSTS

Figure 1 shows that employment growth was nearly identical in the two countries from 2000 to 2012. Finland and Sweden experienced shocks to labour demand of similar magnitude during the financial crisis, due to a sharp decrease in exports. The recoveries looked very much the same, too, in the first few years after the dip in employment in 2009. However, after 2012 the picture is quite different, with diverging paths of employment growth. Evidently the labour market in Finland has performed much worse than that of Sweden in recent years.

Employment rates for those aged 15–64, by origin of birth, are displayed in Figures 2a and 2b. Employment-to-population ratios of natives have been consistently higher in Sweden than in Finland and the difference has increased since the onset of the financial crisis. In 2014, the employment rate was 77.7 per cent in Sweden and 69.2 per cent in Finland. However, employment rates among the foreign-born are rather similar in the two countries, around 60 per cent in 2014, which is considerably lower than the corresponding rates for natives. This means that the employment gap between natives and foreign-born is larger in Sweden and it has also been increasing over time. Figure 2c presents employment rates for those aged 55–64, regardless of origin of birth. Here, the differential between Sweden and Finland is even more pronounced, than for the population in working ages as a whole and amounted to 15 percentage points in 2014. The effective retirement age has been a few years lower in Finland than in Sweden (OECD, 2015). Due to Finnish reforms during the first decade of the 2000s, with the purpose of increasing the labour supply of older workers, the differential declined, though, and it is today largely associated with a higher incidence of part-time work in Sweden (KANNISTO, 2015).

A further illustration of the diverging paths of the two countries is provided in Figures 3a and 3b, which show relative unit labour costs (RULC), i.e., per unit produced, in manufacturing in national and common currencies, respectively, over the period 2000–2014. RULC are important measures of the competitiveness of the traded sector. The development of unit labour costs is related to an average of 21 OECD countries. Regardless of measure, RULC declined in both Finland and Sweden up to about 2006. During the rest of the period, Sweden's RULC did not change much on average, while these costs increased in Finland.

A JOINT FINNISH-SWEDISH RESEARCH PROJECT

Despite the many similarities in labour market institutions between Finland and Sweden, there are of course also some notable differences. In a joint Finnish-Swedish research project, Petri Böckerman, Roope Uusitalo and I attempt to isolate the effects of the differing institutional characteristics in an environment that is otherwise very similar. To this end, we have assembled a novel kind of international data set with information on workers in multinational firms operating in the two countries. Unlike other cross-country data sets used by researchers, it is possible to link the firms (by name and variations thereof). Thus we are able to compare outcomes for workers in the same firm in Finland and Sweden.³ The linked data set comprises around two million worker-year observations

³ In effect, we are then able to hold constant for firm characteristics like production technology, product type and personnel policy to the extent that they are time invariant.

from payroll records in 150 firms in three industries (engineering, retail, hotels and restaurants) over the period 2000-2011.

Our first research question in the Finnish-Swedish project deals with employment protection legislation (BÖCKERMAN ET AL., 2015). As already mentioned, overall stringency of the regulation is rather similar. The key difference is that seniority rules – sometimes called last-in first-out rules – are laid down by law in Sweden, but absent in Finnish legislation.⁴ The seniority rules stipulate that workers be dismissed in inverse order of seniority when firms lay off workers for economic reasons, unless unions and employers agree otherwise in firm-level bargaining. There is no comprehensive or representative documentation on departures from this optional legislation and very little is known about its effects on the functioning of the labour market. To what extent do these seniority rules provide employment protection for older workers and workers with more seniority, i.e., those with more tenure relative to other workers in the firm? Since the rules can be bargained away, the answer is not obvious.

Our econometric results, based on individual data, indicate that more senior workers are less likely to exit from employment in the firm in both Sweden and Finland, controlling for other factors that might influence mobility, like age, tenure and unobserved, but time-invariant, characteristics of the firm and industry in which the worker is employed.⁵ But the effect is stronger in Sweden than in Finland and we interpret this difference as the effect of seniority rules.⁶ We also find that the difference between the countries is striking in shrinking firms, but negligible in stable or expanding firms. This is exactly what we should expect if our results are driven by seniority rules, since they only come into play when firms downsize.

To give a rough idea of the magnitude of the effect, consider two workers with different seniority: One with a high degree of seniority, belonging to the ten per cent of workers with most seniority in the firm (worker A), and one with median seniority (worker B). In Sweden, the probability of exit from employment in a shrinking firm for worker A is about 6 percentage points lower than for worker B.⁷ The corresponding figure in Finland is about 2 percentage points, so the difference – the effect attributable to seniority rules – is 4 percentage points lower probability of exit in Sweden. These findings are in line with previous research from other countries, which suggests that worker mobility is reduced when employment protection becomes more stringent (see SKEDINGER, 2010a, for a comprehensive survey).

Our findings regarding older workers are consistent with our previous results. The probability for workers aged 50–64 to exit employment, compared to the probability for those aged 30–49, is about 3 percentage points lower in Sweden than the corresponding relation in Finland.⁸ It is thus likely that the Swedish seniority rules have contributed to the large gap in employment rates for older workers

⁴ Seniority rules are implemented in some collective agreements in Finland, notably for the engineering industry. The weight given to seniority in relation to other criteria, like the competence of the worker, is however considerably smaller than in Swedish legislation.

⁵ As is usual with payroll data, it is not possible to distinguish between voluntary and involuntary exits.

⁶ The results cannot be explained by the higher probability of early retirement in Finland, since the effect survives when we exclude workers above the age of 60.

⁷ Figure 5 in BÖCKERMAN ET AL. (2015).

⁸ Table 3 in BÖCKERMAN ET AL. (2015).

between the two countries observed in Figure 4.⁹ However, we find no difference between the two countries in this regard when instead entry into employment is examined, with firm-level data.

To the best of our knowledge, BÖCKERMAN ET AL. (2015) is the first effort investigating wage effects of seniority rules. According to our results, wages increase more with seniority in Sweden than in Finland, but this holds for blue-collar workers only. The difference between the two countries in the wage premium for the most senior blue-collar workers is around 5 per cent (calculated in the same way as for exits above).¹⁰ This finding is consistent with seniority rules increasing the bargaining power of protected workers. It remains to be explained why seniority rules are not associated with a wage premium for white-collar workers.

SHOULD FINLAND ADOPT SENIORITY RULES?

We have seen that seniority rules reduce exits among older workers. Whether the implementation of such rules is the best way of protecting this group of workers is another matter. In my opinion, there are several potential negative side effects of seniority rules that one must take seriously before reaching a conclusion.

One concern is that restricting the ability of downsizing firms to retain their most competent workers puts many firms, and especially the smaller ones, in peril and decreases employment.¹¹ Another possible side effect is locking-in: workers may be discouraged from voluntary job-to-job mobility since they would then lose their seniority capital.¹² This could have serious consequences since reallocation of labour to more productive firms is an important source of economic growth. Moreover, the wage-increasing effect for the protected group that we have established may lower total employment. The Swedish seniority rules have also been criticized for contributing to duality in the labour market, as workers on fixed-term contracts are not covered by the regulations (CAHUC, 2010). Assessing the overall importance of these concerns is however difficult since not much empirical evidence is available.

WAGE FORMATION

The prolonged crisis in Finland has sparked much discussion on how to improve wage formation. Wage negotiations are more centralized than in Sweden, but there has been considerable variation in the degree of centralization over time. When bargaining rounds have occurred at the industry level, wage increases have been higher than in rounds with central bargaining, at given unemployment rates (HONKAPOHJA ET AL., 2010).

⁹ In fact, employment rates for older workers in Sweden were high by international standards already before the enactment of the Employment Protection Act (*Lagen om anställningsskydd*) in 1974. But right-of-priority rules were widely implemented in Swedish collective agreements also prior to 1974, although the competence of the worker was given more weight than seniority (NYCANDER, 2010).

¹⁰ Figure 7 in BÖCKERMAN ET AL. (2015).

¹¹ As a response to this concern, legislation in 2001 allowed firms with up to ten workers to exempt two workers from the seniority rules when dismissing workers. According to VON BELOW & SKOGMAN THOURSIE (2010), the reform had a negligible impact on net employment in small firms, as inflow and outflow of workers increased by equal magnitudes.

¹² Our data set, being limited to three industries and multinational firms within these industries, is not suitable for exploring this issue in depth.

The Swedish system in which the traded sector sets the “mark” for wage increases, not to be exceeded by other sectors, has been suggested as a model for Finland. Upholding this norm relies heavily on the co-ordination of wage negotiations among unions and employers. In Sweden, it is widely agreed that aggregate wage formation has worked well since the implementation of the norm in the Industrial Agreement in 1997. However, the usefulness of this model for other countries is not straightforward. First, the system is under increasing pressure in the current round of wage negotiations, since co-ordination among blue-collar unions has broken down for the first time since 1997. The long-term consequences of this failure may be serious. Second, despite the similarities between Finland and Sweden, labour market institutions are complex and not easily copied from one country to another. Finland’s attempt at introducing a wage norm with bargaining at the industry level during 2007–2012 was far from successful. As it turned out, the norm defined by the traded sector acted as a floor, rather than a ceiling, for wage increases (MEDLINGSINSTITUTET, 2016).

The Swedish move towards more of local bargaining has also been suggested as something that Finland should emulate. But the development has not been uniform across sectors and occupational categories (see KAUKANEN, 2015, for more details). Today all employees in the public sector in Sweden are subject to some form of local bargaining, but only 28 per cent in the private sector (MEDLINGSINSTITUTET, 2016). This holds also for the majority of white-collar workers (78 per cent), but merely for a tiny fraction of blue-collar workers (5 per cent). In the most far-reaching form of local bargaining, there are no wage increases whatsoever specified at the central level in the so-called number-less agreements (*sifferlösa avtal*). This is left entirely to the local parties and such agreements cover some large white-collar worker categories in the public sector, like teachers and nurses. Today 50 per cent of all white-collar workers are subject to number-less agreements, up from 40 per cent in 2014.

It is a reasonable hypothesis that local bargaining leads to wages becoming more responsive to market forces and to greater wage dispersion. But it should be noted that local bargaining does not necessarily imply that wages are set on an individual basis. There is still room for the unions to influence wage setting at the firm level, which could result in little wage dispersion if they have strong egalitarian preferences. Unfortunately, there is not much empirical evidence on the effects of wage decentralization, and of numberless-agreements in particular, in the Swedish context.¹³ This of course does not preclude that local bargaining is important for wage setting. However, despite number-less agreements neither teachers nor nurses, two occupations with chronic labour shortages, have so far managed to counteract a secular decline in relative wages, as noted in ARBETSMARKNADSEKONOMISKA RÅDET (2016). Another relevant observation is that average teacher salaries under centralized bargaining in Finland are higher than the average for the labour market as a whole, whereas the corresponding relative wage in Sweden is considerably lower.¹⁴ The seriousness of the situation in Sweden has prompted the government to intervene in the current round of wage bargaining, awarding selected teachers wage increases over and above the negotiated ones.

¹³ In our view, the linked data set in BÖCKERMAN ET AL. (2015) holds promise for investigating this issue as well as several other questions related to the effects of labour market institutions.

¹⁴ In 2013, the relative wage for teachers was 104.2 per cent in Finland and 93.5 per cent in Sweden (ARBETSMARKNADSEKONOMISKA RÅDET, 2016).

We saw in Figure 3 that RULC in manufacturing have developed more favourably in Sweden than in Finland. The mechanical explanation behind the observed pattern for Sweden up to 2006 is that productivity increases were larger than in the comparison countries and larger than wage increases (ARBETSMARKNADSEKONOMISKA RÅDET, 2015). From 2006 and onwards both productivity and wages have developed in much the same way as in the 21 OECD countries. The more fundamental explanation for Sweden's performance is the implementation of the wage norm in the Industrial Agreement in 1997. Decentralization of wage bargaining in Sweden has probably not been important for the evolution of its RULC.

Arguably, relative wage formation in Sweden has worked less well than aggregate wage formation. ARBETSMARKNADSEKONOMISKA RÅDET (2016) has identified a dual problem with relative wages. On the one hand, and as discussed above, there are chronic labour shortages and falling relative wages of important groups of skilled workers, like teachers, nurses and civil engineers. Apparently, the bargaining system has had great difficulties in achieving higher relative wages for these groups, as this could trigger compensatory wage claims from other groups and thus threaten the wage norm. On the other hand, high minimum wages by international standards have clearly hampered the employment prospects of unskilled workers.¹⁵

Of the six available studies on the union-bargained minimum wages in Sweden, all find that employment decreases or that total employment is not affected but the employment of marginal groups is diminished.¹⁶ These findings are in line with theoretical predictions in various models – the competitive model, monopsony and the more realistic search and matching models – all of which suggesting that minimum wages, if high enough, cause disemployment (CAHUC ET AL., 2014). The effects in the Swedish studies are in most cases not large. But there is reason to believe that the research underestimates long-term effects associated with the adjustment of production technology and the emergence of new firms and industries.

Empirical results from other countries are more mixed, but this is likely to reflect the considerably lower levels of minimum wages in most of these countries. As documented in SKEDINGER (2010b), minimum wages in relation to average wages in Finland are about ten percentage points lower than in Sweden, and BÖCKERMAN & UUSITALO (2009) failed to find any effects on employment following a temporary reduction of the minimum wage in the retail industry.

Sweden introduced an earned income tax credit (EITC) in 2007 and the reform was expanded upon in several steps in subsequent years. ARBETSMARKNADSEKONOMISKA RÅDET (2016) shows that the real take-home pay for a worker on the minimum wage in retail or the hotels and restaurants industry increased by 70 per cent between 1997 and 2014, while the real before-tax wage increased by 50 per cent. The difference, 20 per cent, is attributable to EITC. Despite this very large increase in net-of-tax wages, which was larger than for the average wage earner, the negotiating parties apparently saw little reason for moderation of minimum wage increases.

¹⁵ In 2014, the minimum wage relative to the median wage in the three most important low-wage industries (retail, hotels and restaurants, municipal services) stood at 60–68 per cent, which is higher than in any of 23 comparison countries with statutory minimum wages (ARBETSMARKNADSEKONOMISKA RÅDET, 2016).

¹⁶ EDIN & HOLMLUND (1994), ELIASSON & NORDSTRÖM SKANS (2014), FORSLUND ET AL. (2014), LUNDBORG & SKEDINGER (2014), SKEDINGER (2006, 2015).

A REFORM PROPOSAL

According to ARBETSMARKNADSEKONOMISKA RÅDET (2016), there are reasons related to both the supply and the demand of labour why high minimum wages are likely to increasingly impede the employment of low-skilled workers in Sweden. On the supply side, following the refugee crisis there is a very large influx of mostly low-skilled asylum seekers – 160,000 in 2015. When these individuals enter the labour market in a couple of years, the employment gap between natives and foreign-born observed in Figure 2 is likely to widen even further. There has also been a well-documented decline in PISA results – the largest among OECD countries – and the poor student performance in previous years is now also showing up in the PIAAC tests directed at adults. On the demand side, there is a global trend of skill-biased technological change, implying a shift in labour demand from low-skilled towards high-skilled workers. Furthermore, globalization has facilitated off-shoring and international outsourcing of low-skilled jobs to other countries.

ARBETSMARKNADSEKONOMISKA RÅDET (2016) has proposed the creation of “entry jobs” for newcomers on the labour market who have failed to find regular employment, regardless of ethnicity. These jobs should have wages considerably lower than the going minimum rates, no training requirements on part of the employer (to avoid low take-up rates) and last a maximum of three years (to avoid low-wage traps). “Entry jobs” should also be subject to an extra EITC, intended to safeguard a reasonable standard of living and keep up the supply of labour of the workers concerned. While a reduction of minimum wages is important, it is not a miracle cure. Hence “entry jobs” should be complemented with other measures already in existence, like subsidized employment and the tax deduction for cleaning, maintenance and laundry services (RUT).

The proposal of “entry jobs” has received much attention in the media. But the main blue-collar union (the Swedish Trade Union Confederation, LO) and the governing coalition (Social Democrats and the Green Party) have rejected the proposal. Partly because of skepticism regarding the potential for creating many more jobs with lower wages, but also out of fear of spill-over effects to wages in regular jobs. These two arguments seem logically inconsistent. Also, with the massive influx of low-skilled labour, low-wage jobs are likely to pop up anyway, but in unregulated sectors like the black market and various forms of self-employment.

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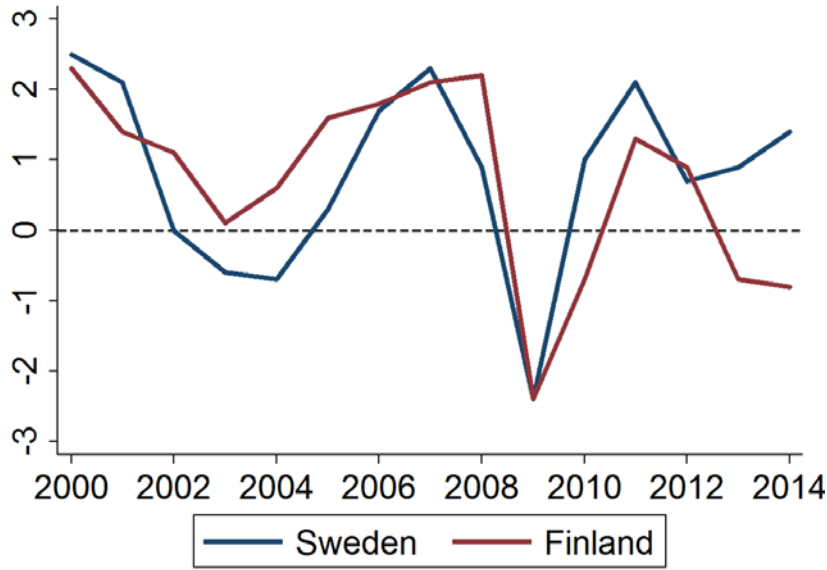
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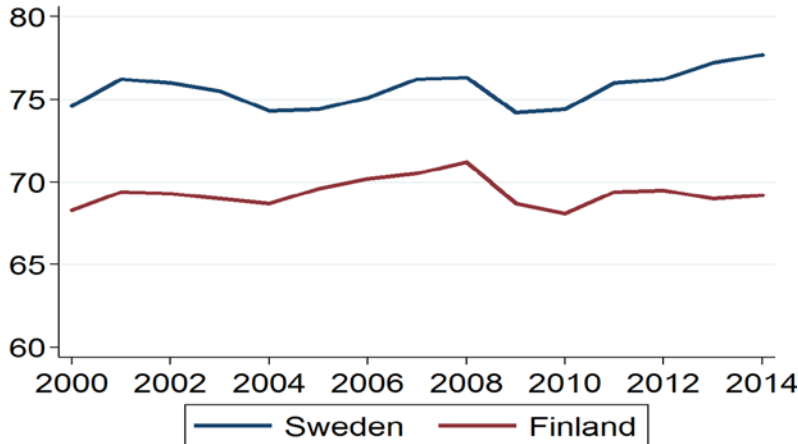
Figure 1. Employment growth



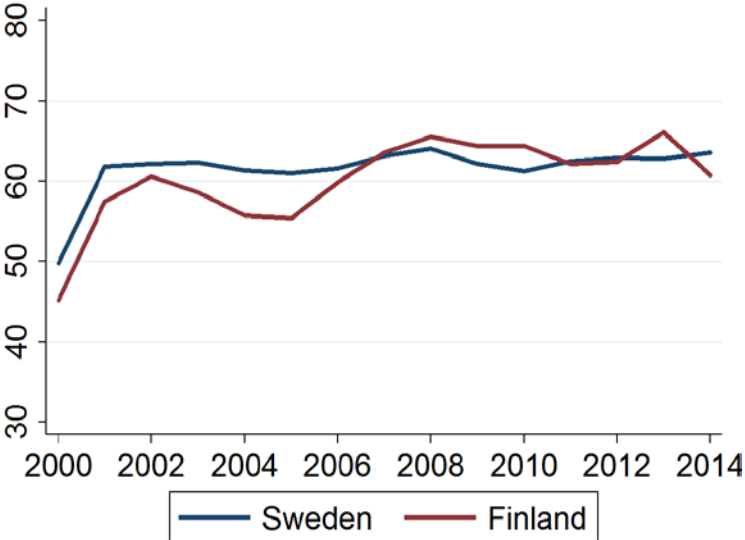
Source: Eurostat

Figure 2. Employment rates

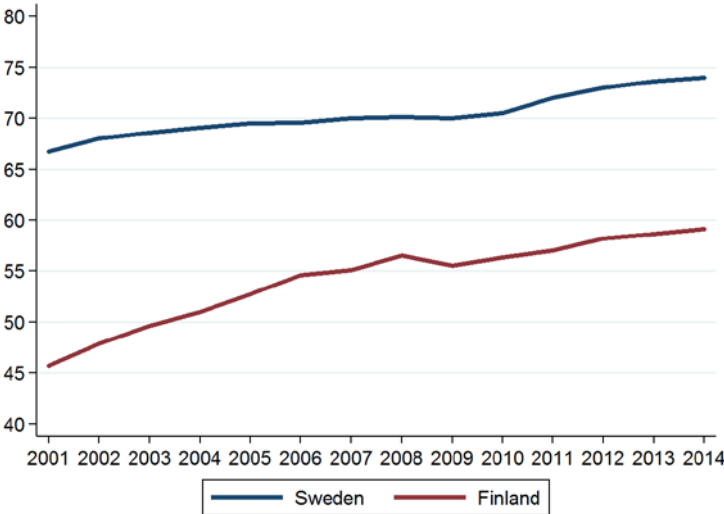
a) Natives



b) Foreign-born



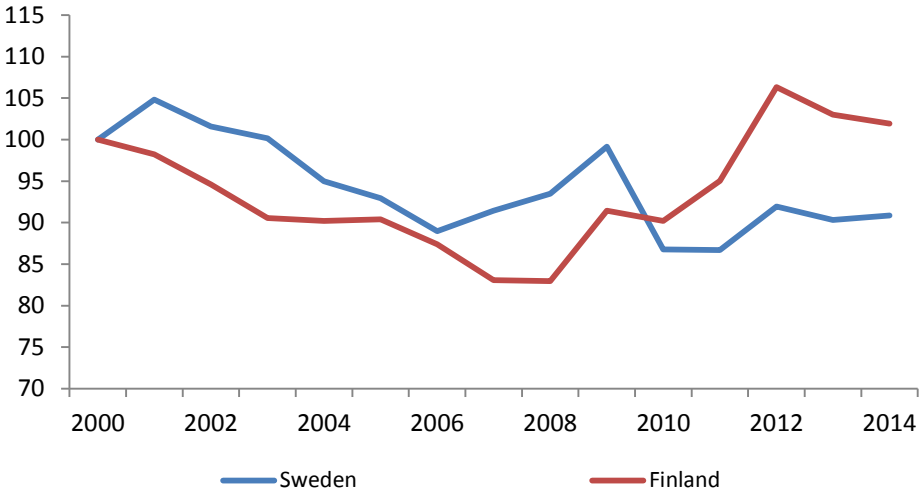
c) Ages 55-64



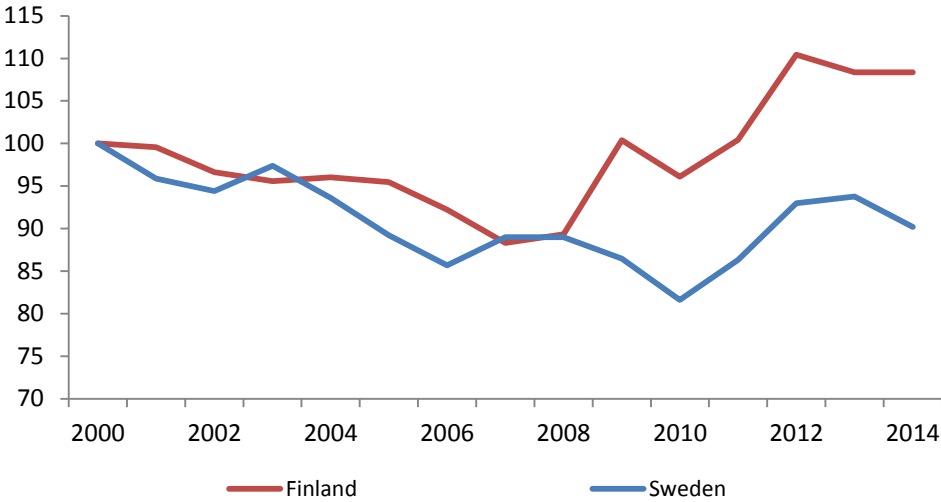
Source: OECD.

Figure 3. Relative unit labour costs in manufacturing, against 21 OECD countries. Index 2000=100

a) National currencies



b) Common currencies



Sources: Konjunkturinstitutet, Medlingsinstitutet, Conference Board, Bank of International Settlements and own calculations.
 Note: OECD countries are Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Japan, Korea, Netherlands, Norway, Poland, Portugal, Spain, Sweden, United Kingdom and United States. The group of comparison countries for Finland excludes Sweden and vice versa, and is weighted with exchange rate indices: KIX index for Sweden and BIS effective exchange rate index for Finland.