Nordic Countries

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The Swedish Labour Market Model in a Globalised World

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Active labor market policy has been a trademark of Swedish economic politics. Specific institutional features which go way back to the 1930ties help to explain why Sweden and the other 'Nordics' have been so relatively successful in recent years in combining high welfare with economic growth and high employment levels. A commitment to full employment and to an open economy brought about a proactive attitude towards structural change, thereby creating the famous Swedish 'work line' which aims at protecting employment as such rather than particular jobs. The institutional framework behind is strong social partners. Even though globalization puts additional pressure on the system and demands ever more skilful political and economic governance, most recent experiences suggest that the model might be sustainable. In the context of a rapidly changing economy in an aging society it might even become more important in the future.

Sweden and the Nordic countries are once again regarded as successful in trying to combine economic growth, macro-economic stability, generous welfare schemes for their citizens, equity and relatively high employment. In its Job Study for 2006 the OECD cites the Nordic "model" as a successful attempt to mix security with flexibility, successful activation on the labour market resulting in high employment. Moreover, the Swedish model is often considered a more "socially responsible" alternative to a more liberal model and could perhaps even serve as a blueprint for a future "Social Europe".

Most specifically, the Swedish and Nordic experience seems to cast doubt on a view often stated by orthodox labour market theory that there must exist a trade off between welfare and high wages, on the one hand, and high levels of employment on the other hand. According to this argument, unemployment is necessary where the levels of unemployment benefit as well as other forms of individual income security are very generous. However, Sweden and the other Nordic countries offer living proof that there is no necessary trade off involved here. Hence, Sweden as well as Denmark and Norway have one of the highest participation rates on the labour market in Europe, around 75 to 80 per

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cent. At the same time unemployment is quite low, around four per cent or even below this level. Moreover, economic growth is high in a European perspective and job and geographical mobility is among the highest in Europe. And this at the same time as up to 80 or even 90 per cent of individuals' income levels are protected during unemployment and sickness.

So, what is the trick and - perhaps an even more pertinent issue - to what extent can this model be exported also to other countries? Certainly there are no easy answers to such questions. To take the second question first, no country can serve as a simple blueprint for others. As always, the present is deeply entrenched in the past. Specific institutional features which go way back in time help to explain why Sweden as well as the other Nordic countries has been so relatively successful during recent years in combining high welfare with economic growth and high employment levels. However, this does not mean that there might not be something that other European countries could learn as well. Much of European politics is currently stalemated between a neo-liberal and a classic social democratic position which seems to offer no alternatives. However, the Swedish and Nordic models show that there might be ways to escape this logic.

The Swedish commitment to full employment.

Since the Second World War Sweden has been recognized for its commitment to a policy of full employment. Compared to most other West European countries Sweden was less severely hit by mass unemployment in the 1970s and 1980s. Without any doubt this is a major explanation behind the rather low level of inequality and quite evenly distributed incomes that still prevail in this country. It is a well known fact that more than anything else unemployment has a tendency to increase income differences in modern economies and polities. This is not only because high unemployment has a negative effect on the bargaining position of labour. Even more severe is the income loss that is suffered by the unemployed and to an even greater extent by those excluded from the labour market. Hence, when recession hit the Swedish economy in the early 1990s and unemployment figures rose dramatically incomes and wages became less evenly distributed. This economic downturn was probably the biggest since the 1920s and led to severe problems on the labour market. With unemployment figures around 10 to 12 per cent the "old" active labour market policy no longer operated efficiently. In brief, the problem was that there was no supply of jobs and therefore matching activities became increasingly costly at the same time as they were largely ineffective. Some of the effects of mass unemployment visible in Europe during the 1970s and 80s were also felt in Sweden during the 1990s. However, since the late 1990s employment has risen once again although it is not at such a high level as around 1990. Also the trend of increasing wage and income differences has been halted. Undoubtedly, increasing economic growth as well as rising employment is playing a leading role in this development.

There can be no doubt that the policy goal of what has been called "full employment" has been especially emphasised in Swedish macro-economic policies – monetary and fiscal – at least back to the 1950´s. In contrast to developments in many other countries, different Swedish governments – social democratic as well as liberal or centre-right- wing – have not simply accepted unemployment as a consequence of monetary instability and lower growth (stagflation), oil chocks or structural change. Instead, especially during the

1970s and 80s, Swedish economic policies devaluated the Swedish currency (*krona*) as a way of sustaining a policy of full employment and avoiding the consequences of structural change and rising oil prices. This policy was quite successful in the short run - but undoubtedly had a price. Many have argued that it led to an overheated economy in the 1980s with high inflation, macro economic instability and not "full" but rather "over-full" employment characterized by a shortage of labour.

However, in the Swedish model established after WWII the commitment to full employment was part of a more general strategy of growth and increasing productivity by means of structural economic adjustments, including high labour mobility. One given precondition for this model has been the awareness of the reality that Sweden is a small open economy with strong external trade relationships. In this respect, economic internationalization and globalization is nothing new in Swedish economic history and we will come back to this point.

Growth and the labour market model

Probably the most important part of the Swedish model has been the emphasis of the labour market on growth and employment. During the early 1950s two Swedish economists, Gösta Rehn and Rudolf Meidner, - with strong ties to the labour movement - developed a comprehensive model which emphasised the crucial role of labour market policy – including activation - for growth and full employment. **Firstly**, Rehn and Meidner insisted upon the need for a balanced economy with low inflation. Excess demand must be combated through fiscal policy while admitting quite high structural or frictional unemployment. **Secondly**, the trade unions should implement solidaristic wage policies, within but also between sectors, which meant that firms with low profitability were forced out of the market. By the same token, sectors of the economy with a low capacity to withstand international competition had to face downsizing. The kernel of the model was that employment as such should be defended – by means of increased growth and rising productivity - rather than particular jobs. Ironically, what one of the founders of liberal Austrian economics, Joseph Schumpeter, called "creative destruction" was a very important part of the growth and employment model of the Swedish social democrats Rehn and Meidner. Thus macro-economic policies in Sweden have combined promoting structural change with standard Keynesian anti-cyclical stabilisation measures.
However, such a policy necessarily leads to unemployment in the short run. This then, **thirdly**, allowed scope for an active labour market policy which admitted the possibilities of mismatch in a situation with structural change. Hence the Rehn and Meidner model emphasised the role of public authorities in taking over responsibility for reintegrating people into the open labour market by providing help to be more mobile, further training and education, guidance and other measures. The general proposition behind this line of thought was that it is essential to develop the productive capacities of the wage earners because they are central to productivity and adaptation processes. Labour market schemes had to be implemented that would support the individual worker and reallocate labour and investment from less to more productive parts of the economy. Innovative, expanding enterprises and mobile workers should be helped and rewarded, thereby promoting competitiveness, adaptation and social equality. At the same time the employees would feel safe if they played by the rules and joined the public activation

schemes for which the labour market authorities (AMS, The Swedish Labour Market Board) provided funding. Without doubt such programmes were expensive and over the years Sweden, together with the Nordic countries, has spent more public resources on an active labour market policy than any other country. By and large this is the essence of the famous so called **“**work line**”** which has served as a corner stone in Swedish labour market policies since at least the 1950s. In general, it has been defended by both social partners, which has not of course meant that it has also escaped stringent criticism from time to time. The social partners have also tended to stress different policy measures in order to activate the unemployed. Hence the employer organisation have placed greater emphasis on the role of work fare strategies, including cuts in welfare and introducing more private incentives to take jobs, while the trade unions have advocated the role of training and re-education. In 2006 the controversy over the interpretation and practical application of the “work line” policy was an important factor behind the victory and the subsequent establishment of the new centre-right coalition as a result of the general elections in Sweden.

Strong social partners

The commitment to full employment must also be understood as a backdrop to unusually strong social partners. Nor would it have been possible for an active labour market policy or, for that matter, a solidaristic wage policy to have been developed, implemented and accepted unless the social partners had applauded it. Since the 1930s a matrix of relations between the central organisations on the labour market was developed which led to the creation of a platform for institutionalised collaboration. Swedish historians talk about the so called “Saltsjöbadsandan”(Saltsjöbaden Agreements) as a cornerstone of the high growth era after WWII and the establishment of the Swedish model.

However, strong social partners cannot in themselves explain why a policy of growth through means of structural adjustment and active labour market policy was chosen. In other countries in Europe, bipartite or tripartite systems of social partnership have often led to quite different results, for example to alliances in order to defend particular jobs and enterprises rather than employment in general or even the joint development of protectionist devices in order to hinder competition. Why the social partners in Sweden have chosen another road is not easy to say. However, once again the clear understanding among strategic actors – including the social partners - that Sweden was and is a small economy which has more to gain from openness than protection must have played a pivotal role in this context.

The Swedish model facing globalisation

Some might argue that so far the Swedish (and the Nordic) model has been a success. But for how long? Will not the present process of intensified global competition necessarily mean the loss by countries of the kind that Sweden represents of their competitive position? Can really high welfare and a high level of equity be retained in this era of globalisation?

Such questions are difficult to answer as we lack the skill to look into the future. However, there are at least some caveats that can be raised against such pessimistic arguments. **First**, as we have seen, openness and fierce international competition are not new phenomena with regard to Sweden. Moreover, it can be argued that since the 19th century Sweden has been a classic example of a small country using an active export strategy in order to bolster growth and employment. The historical record shows that it is especially during periods of rapid economic internationalisation – in the two decades before WWI as well as during the 1960s and since the middle of the 1990s - that Sweden's growth achievement has been particularly strong. So far today there is no evidence to indicate that jobs are leaving Sweden on a large scale due to off-shoring or other processes. Without doubt, jobs in the industrial sector are currently being exported to distant countries, but so far this has been compensated for by the creation of new jobs both in the service and knowledge-based sectors of the economy. Neither now nor in the future should international trade be regarded as a zero-sum game. However, globalisation in the form of off-shoring is a major force behind the current structural transformation of the Swedish economy leading to a more service and knowledge based society.

Secondly, more than anything else globalisation means innovation and the restructuring of economic activities. In Sweden as elsewhere we can detect in the labour market that structural adjustments taking place in the form of a mismatch between demand and supply – a far from perfect matching between the skills and competences needed in the labour market and those currently on offer. In this there is nothing novel as periods of "creative destruction" always seem to be closely followed by mismatch problems on the labour market. Perhaps in contrast to periods with radically rising unemployment caused by demand shocks (of the kind Sweden experienced in the beginning of the 1990s) it can surely be argued that activation and productive investments in human capital is of particularly great importance during periods of structural mis-match. An active labour market policy which can lead to the transfer of labour and capital into more highly productive sectors is most possibly a very effective counter-strategy in this context. However, a transfer to the service sector, which has to provide much of the demand in a high-income economy, must be stimulated through active measures.

The crucial issue is of course how to bring about the upgrading of human capital and acquisition of new skills during periods of mismatch. So far the standard answer to such questions by orthodox labour market search theory has been that better incentives must be developed in order that people upgrade their skills and become more mobile on the labour market. In clear language this implies cuts in welfare and income insurance coverage. However, increased "employment friendliness" can also be achieved by other means. So far at least, the Swedish and Nordic experience has shown that it is possible to maintain employment and a high mobility despite generous levels of welfare benefits, for example during unemployment. Without doubt, increased mobility and a willingness to upgrade individual competences require a certain basic degree of income and social security. People must be willing and able to make decisions without fearing a radical loss of welfare and income. Social and income insecurity definitely leads to lock-in problems in the form of long-term unemployment, early retirement and - most probably - also long periods of illness. Both Denmark as well as the other Nordic countries show that it is possible to achieve high growth and high employment levels in a situation with strong trade unions and with a high degree if collective agreement coverage. In this instance, the currently highly lauded Danish model is mainly a modernised version of a much longer Nordic tradition of active labour market policies. It seems that the Danish model with its de-centralized structure and the involvement of social partners at the local level is a highly successful attempt to create employment friendliness without destroying social security. It is, moreover, clear that greater mobility and a better functioning labour market can be achieved through modernising collective agreements to include such aspects as well. For example, the collective agreement on adjustments signed quite recently (2005) protects many wage-earners from the most dire consequences of job-loss and creates a more secure platform for future job seeking, vocational training or other forms of skill enhancement.

Challenges to the picture

Our analysis above does not preclude the possibility that problems may arise which threaten the Swedish model. In conclusion we will depict a number of such scenarios which in this era of intensified global competition might lead to problems and strong pressure for economic and political change.

Firstly, it must be spelled out that too much success can lead to failure over a longer time perspective. On the whole, so far the Swedish model has been characterized by an open attitude to change and development. As we noted, the attitude that Sweden is a small economy which is highly vulnerable to the outer world has been mainly beneficial for the model so far. However, as partly occurred in the beginning of the 1970s, we cannot sit back and believe that our resources and possibilities are endless. New welfare reforms cannot be inaugurated which threaten the principle of sound public finances or with no regard for their effects, for example, regarding output of labour. Moreover, the model must be open enough to adapt to new circumstances. This also includes the social partners. The employers' side should understand that there is more to be gained by cooperation than by opting out – a little more "voice" instead of "exit" would be welcome. On the other hand the trade unions must also be able to adapt to new circumstances. So far the system of collective agreements has served the Swedish model well. It is highly possible that it will also do so in the future. Collective agreements with a high coverage can serve both social partners well and create "rules for the game" which reduce transaction costs and enhance calculability. However, it is important that the system does not hinder the necessary transfer of jobs from the "old" sectors to the new and growing sectors of the economy. At the same time it is important that both social partners protect the legitimacy of the collective agreement system in the eyes of the public. It must be flexible enough to admit to changing circumstances and not serve to create the feeling that it only protects the "insiders" on the labour market and excludes "outsiders". This would be highly detrimental to the collective agreement system in the long run and would in fact invite the state to introduce harder laws in order to protect the right of "outsiders".

However, it must be realized that this model cannot solve all problems. With increased labour mobility in Europe and in the world this system must be altered to take into consideration new challenges. Especially the challenges from globalisation and increased work-force mobility in Europe after the enlargements must be handled with care so that any accusations of protectionism can be avoided. In fact discrimination against immigrants seeking work goes totally against the historical tradition of Sweden and its social partners.

Secondly, as a small open economy Sweden is always at risk of being severely punished by international market forces and by external economic shocks. Such a shock can be imported from outside as a consequence of a radical downturn of international business cycles, or through a drastic decline in international trade. However, it can also be created by internal factors, such as less skilful economic governance and policies or through internally constructed wage and price inflationary spirals, etc. The latter was very much what happened during the 1980s and which led to the drastic recession at the beginning of the 1990s.

Against this backdrop it might be a good suggestion to start a process of reconsidering the Swedish decision to stay out of the Euro zone. Joining might involve both gains – mainly in the long run - as well as perhaps losses in the short run. So far countries that have stayed out have been more successful economically than those that joined (with the clear exception of Finland and Ireland). However, this might change and such changes can happen very rapidly given the present unstable world economic order. Hence it is necessary for Sweden to consider seriously the pros and cons of joining the EMU in a not too distant future. As a small economy it is of course vulnerable to external shocks of different kinds. Besides, it is highly probable that belonging to the Euro-zone can lead to better calculability over time which can promote sustainable economic growth in a longer time perspective

Thirdly, it is very important for the active labour market policy to be effective at high-quality matching and really increase jobs and geographical mobility. It is also necessary for social security systems to be generally "employment friendly" to the extent that they stimulate the individual to become more mobile and move from sectors with a low expectancy of survival to more vigorous and thriving ones. As orthodox labour economics show, there is a clear positive correlation between "employment friendliness" and the willingness to move and become more mobile. However, as we have already argued "employment friendliness" does not automatically imply lower unemployment benefits and a loss of welfare. The employment friendly character of labour market policies seems to be specifically important during periods of rapid structural change and mis-match problems. The experience from the 1990s was that such policies did not always work optimally. Hence the unemployment crisis of the early 1990s was turned into a renewed crisis involving a massive increase in sick-leave and early retirements. This must be avoided in the future. It is very important for the unemployed to be seen as individuals with individual needs and prospects. Such individual matching schemes are expensive but massive evidence shows that they are highly effective. In particular, the Danish experience during recent years clearly show that job mobility and the ability to find a new job can very well be combined with quite generously designed insurance systems for coping with unemployment and sickness. Also adjustment agreements between the social partners that make it easier for the individual to go from one job to another seem to be a highly fruitful strategy for the future.

Conclusions

There is a great deal of interest today in the Swedish and Nordic "model ". In recent years the Nordic countries have been recognised for their successful growth, stable finances, relatively high job mobility and the modern profile of their economies with new thriving high-tech sectors – and at the same time for high welfare, generous unemployment and sickness benefits as well as high taxes and strong social partners. No country can serve as a simple blueprint for others. But it is without any doubt possible to learn at least something from the Swedish case presented here

A highly pertinent question is of course whether this model can retain its attractiveness also in the future. It is not unusual to argue that the current threats from globalisation and increased economic internationalisation will result in the weaknesses of the model – i. e. high welfare and high wages leading to off-shoring, etc - becoming increasingly apparent. As we have argued here, at the moment there seems to be nothing to say that such a change for the worse is necessarily inevitable. On the contrary all the available evidence makes it more plausible that today, as earlier, Sweden will gain from more intensified globalisation rather than lose.

However, at the same time there are certain threats that need to be taken seriously. First, success can lead to its own failure. So far the Swedish model has been able to adapt successfully to changing circumstances. This adaptiveness is crucial if the model is to be able to survive. Secondly, as a small and open economy Sweden is vulnerable to external shocks of different sorts. The extent to which Swedish politicians and other leading actors can cope with such threats skilfully will also determine the outcome of the Swedish model. This is in fact a highly decisive factor for the future. It is perhaps not to be expected that the pragmatism and skilful engineering – which have so far, on many occasions, “rescued” Sweden - can last forever. To this extent increased institutional embedded ness within a larger Europe might perhaps be a wise strategy for a small country like Sweden. Third and lastly, we also stress the specific importance of an active labour market policy that can do even better than in the past in meeting the demands of a rapidly changing economy. With the prospects of an ageing society with more people to support, an effective labour market policy for matching and mobility will become even more important in the future.