

Comments on Swedish labour market reforms

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Structure of comments

1. Attempt at evaluation
2. Are complementarities important?
3. What can be done more or differently?

Evaluation

- A balanced set of reforms on both the supply side and the demand side
- Reforms in a favourable situation with cyclical job growth
- Quantitative evaluations:
 - cuts in benefit levels
 - cuts in income and payroll taxes
 - reduced volumes of ALMPs
- More difficult to evaluate:
 - changes in contributions to unemployment insurance funds
 - "new-start-up-jobs" and changes in the institutional set-up of labour market policy
 - tax deductions for household-related services
 - changes in sick insurance and early retirement requirements

Evaluation methods

1. Panel studies of the determinants of structural (un)employment in OECD countries
2. Studies of wage setting (and labour demand) for Sweden

Quick and dirty "gangster calculations"

Determinants of equilibrium unemployment

- Replacement rate and/or benefit duration
- Tax wedge
- Union density and/or coverage of collective agreements
- Co-ordination of wage bargaining
- ALMPs
- Product market deregulations
- ✓ But not employment protection

Lower unemployment benefits according to Bassanini-Duval (2006)

	5 percentage points	3 percentage points
Unemployment	-0.6	-0.4
Employment rate males 20-54	+0.9	+0.5
Employment rate females 25-54	+1.6	+1.0
Employment rate youth 20-24	+1.2	+0.7

Lower tax wedge according to Bassanini-Duval (2006)

	1.5 percentage points	
Unemployment	-0.4	
Employment rate males 25-54	+0.5	
Employment rate females 25-54	+0.8	
Youth 20-24 years (incl. reduced pay-roll tax)	6.5 percentage points	
Employment rate	+2.0	

Total effects according to Bassanini-Duval (2006)

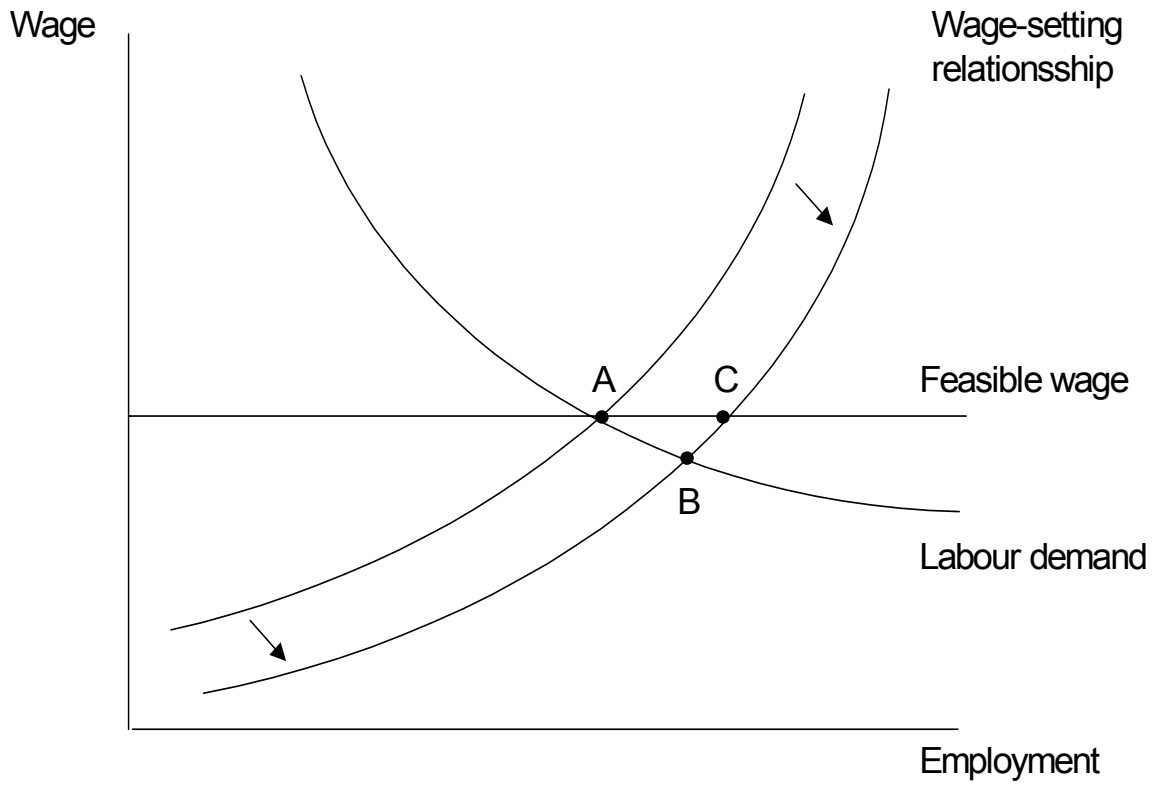
	Max	Min
Unemployment	-1.0	-0.8
Employment rate males 25-54	+1.4	+1.0
Employment rate females 25-54	+2.4	+1.8
Employment rate youth 20-24	+3.2	+2.7

Estimated wage equations

- Forslund, Gottfries and Westermarck (2005)
- EFO-model estimations on panel data for the Nordic countries
- The wage share in the long run is explained by:
 - (open) unemployment
 - unemployment benefit replacement rate

Two measures of long-term effects

1. Interaction between wages and unemployment
 - lower wages reduce unemployment which in turn affects wages etc.
2. Internationally determined rate of return to capital
 - lower wage pressure makes lower unemployment consistent with the **feasible wage**



5 percentage points lower net replacement rate

	Interaction	Given rate of return to capital
Wage	-0,9	0
Open unemployment	-0,7	-1.0

Reduction of ALMPs by 1 percentage point

	Interaction	Given return to capital
Wage	-0,8	0
Open unemployment	+0,3	0
Total unemployment	-0,7	-1,0

Total effects

	Interaction	Given return to capital
Wage	-1.7	0
Open unemployment	-0.4	-1.0
Total unemployment	-1.4	-2.0

Forslund and Kolm (2000)

- Similar long-run wage equation
- About one percentage point larger unemployment effects

Hur long is long run in Forsslund et al.?

Cumulated unemployment effects

Year 1: 28 %

Year 2: 48 %

Year 3: 65 %

Year 4: 76 %

- But the adjustment speed is likely to be overestimated, because estimations cover period of devaluations and high inflation

Caveats

- Many (most) estimated wage equations do not have benefit replacement rates and taxes as explanatory variables in the long run
- Most, but not all, find ALMPs to raise wages
- Instability of all relationships
- Lucas critique
 - unions may not behave according to past behavioural patterns when changes are part of a deliberate policy they do not like

- Nickell (2003): Net number of areas with employment-friendly reforms
- 1980-87 relative to 2000/01

**Change in unemployment = - 0, 42 –
1.24 x (net number of employment-
friendly reforms)**

$$R^2 = 0.51, N = 20$$

- For Sweden this gives $3 \times 1.24 = 3.7$ percentage points lower unemployment

Areas according to Nickell

- ✓ Replacement rate
 - Duration of benefits
- ✓ Requirements for benefits
- o Labour market policy
 - Coverage of collective agreements
- ✓ Union density
 - Co-ordination of wage bargaining
- ? Employment protection
- ✓ Labour taxes

Complementarities of reforms

- Common idea: extra effects from simultaneous reforms
 - OECD Employment Outlook (2006)
- Complementarities in the literature
 - taxes and unemployment benefits
 - taxes (benefits, union density, employment protection) and decentralised (or sector) bargaining
 - ALMPs and benefits (unclear direction)
- **Results are very unstable and can hardly be trusted**
- But they do not speak against combining reforms in several areas
 - some (weak) presumption that it may be beneficial

What can be done more or differently?

- Funding and organisation of unemployment insurance
- Payroll tax cuts for some services
- Youth measures
- New start-up jobs
- Employment protection
- Virtuous circle of higher employment and tax cuts

Funding of unemployment insurance

- Too little differentiation of contributions among funds
- At least need for clearer link between overall costs for unemployment and aggregate contributions
- Current financing proposal is a bad "halvmesy" - higher contributions from employed partly offset the employment tax credit - simpler to lower the employment tax credit and skip contribution increase now

Pay-roll tax cut for some services

- Unfortunate if this demand stimulus is postponed to 1 July 2008 for legal reasons
- Strong long-run theoretical arguments for this
 - distortion relative to untaxed home work/work in the black sector more important than distortion relative to other taxed consumption
- Why not instead cut value-added tax as a temporary measure?

Organisation of unemployment insurance

- Strong arguments for a mandatory scheme with higher contributions
- Possible organisation principles
 - as now
 - more agents and more competition
 - a state-run system
- A state-run system can be combined with differentiated contributions

Youth programmes

- "Job guarantee" after 50 days
- New start-up jobs already after six months
- Lower employer contributions

My view

- Too "generous" youth programmes
 - questionable results for individuals
 - large crowding-out effects
 - uncertainty regarding harmful effects
- "Danish alternative" instead?
 - regular education, training with low benefit or low cash benefits

New start-up jobs

- Lower subsidisation than for earlier employment subsidies ("allmänt anställningsstöd" and "förstärkt anställningsstöd") but can be for longer time period
- Broader categories
- Too early interventions?
 - "deadweight losses" and crowding out
- Why only start-up jobs in private sector?
- Important to keep large employment subsidy ("särskilt anställningsstöd") for long-term unemployed >2years)
- Widen eligible groups?
- Has labour market training been reduced too much?

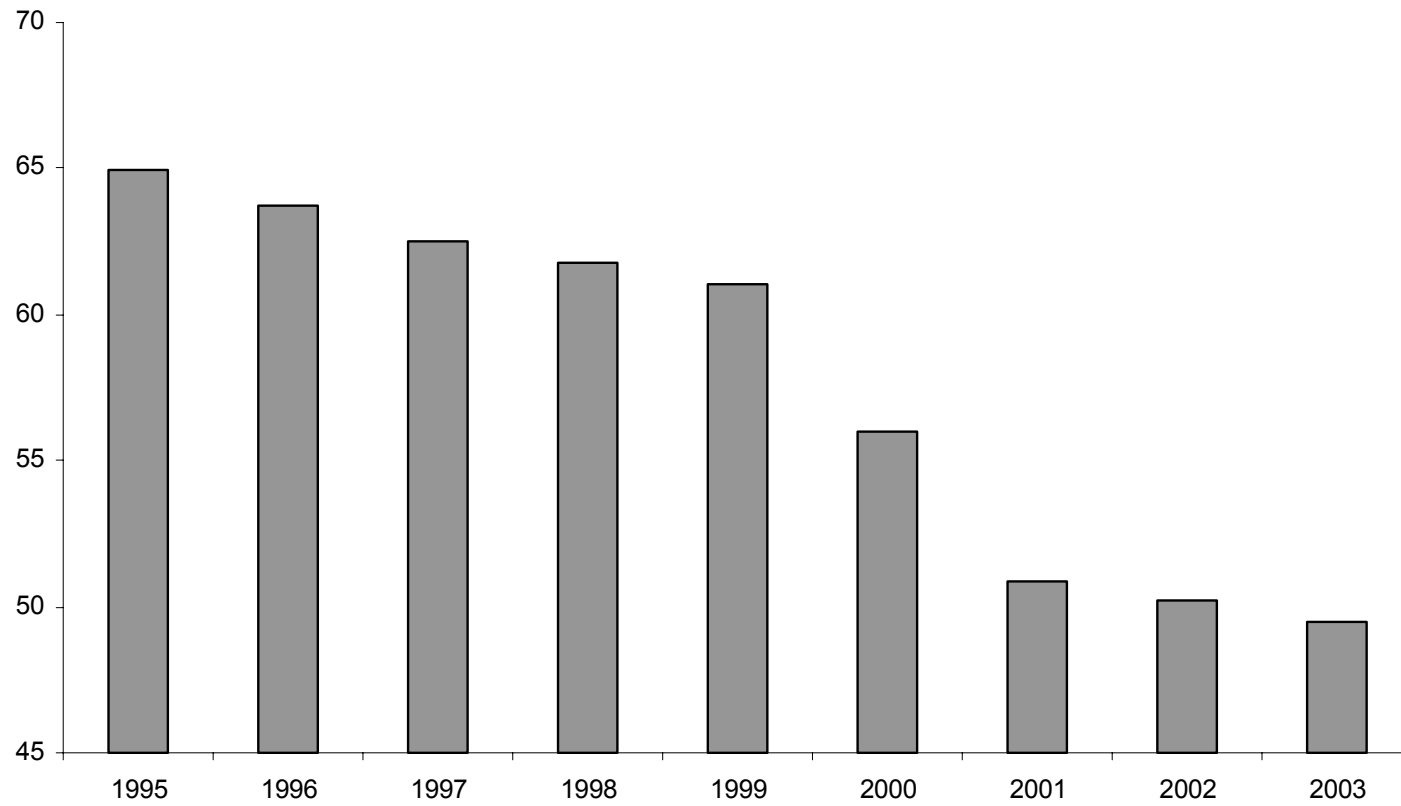
Employment protection (flexicurity)

- Danish flexicurity is a myth
- Employment protection is usually insignificant in panel data regressions
- Denmark
 - marginal changes in employment protection
 - large cuts in unemployment benefits
 - stricter requirements on the unemployed
 - for youth in particular
 - “threat effects” of ALMPs

Reform intensity in Denmark 1994-2004

Active labour market policy	55,8
Unemployment insurance	42,3
Wage setting	27,3
Pensions	25,0
Working time	16,7
Taxes	12,5
Employment protection	10,0

Denmark: average unemployment benefit replacement rate (%)



The **long-run** effect of labour market reforms

- 0.5-1 percentage point reduction in open unemployment?
- 1.5-2 percentage point increase in regular employment?

Potential of reforms

- Virtuous circle of higher employment – tax cuts – higher employment etc?
- Favourable time to do reforms both from economic and politico-economic point of view

Risks

- Trade-off between speed and preparation
- Union militancy in next wage round?
- Budget discipline?