Did Active Labour Market Policies Help Sweden Rebound from the Depression of the early 1990s?

An outline

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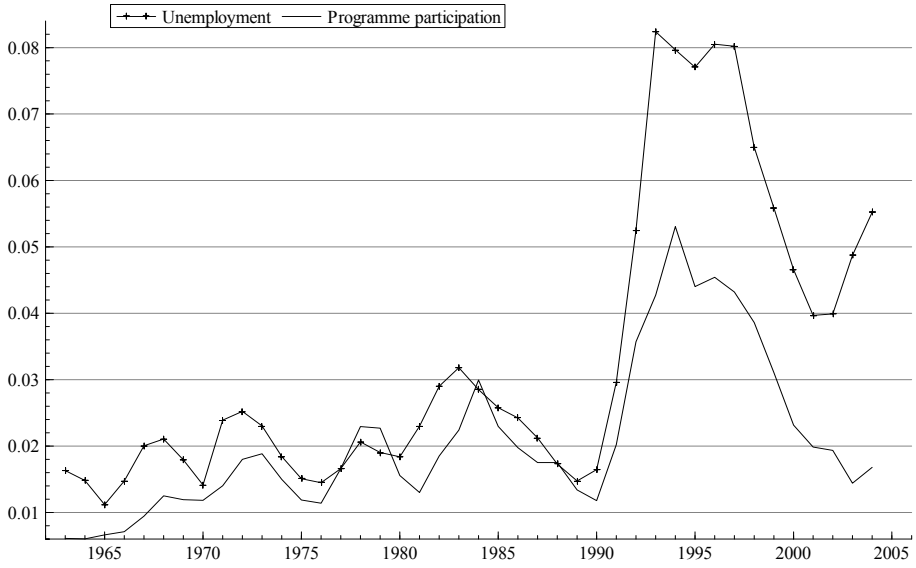
1 Introduction

2 The Swedish labour market since the early 1990s and a comparison to the US

2.1 General background description of evolution and institutional changes – a comparison with US developments

2.1.1 Development of unemployment, employment and labour force participation

During the crisis of the early 1990s the Swedish unemployment rate increased from less than 2 % to above 8 % in less than two years. Although the unemployment rate decreased in the late 1990s, it did not return to the levels of the preceding decades, and increased again during the business downturn of the early 2000s (Figure 1).



The rise in unemployment was accompanied by a rapid increase in participation in labour market programmes–in the mid 1990s, programme participation corresponded to around 5 % of the labour force (Figure 1).

Although dramatic, the increase in unemployment and programme participation actually downplays the magnitude of the shock to the Swedish labour market. This is clear from Figure 2, Figure 3 and Figure 4 where the development of labour force participation and employment are displayed.

Figure 1: Unemployment and programme participation 1963-2004 (shares of labour force)

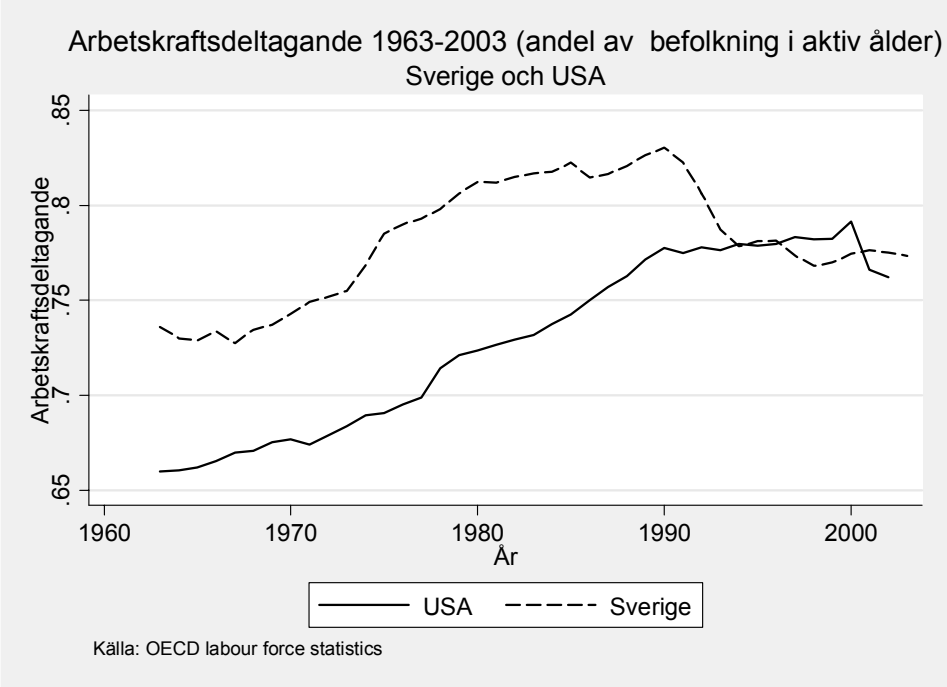


Figure 2: Labour force participation in Sweden and the US 1963—2003 (share of population in active ages)

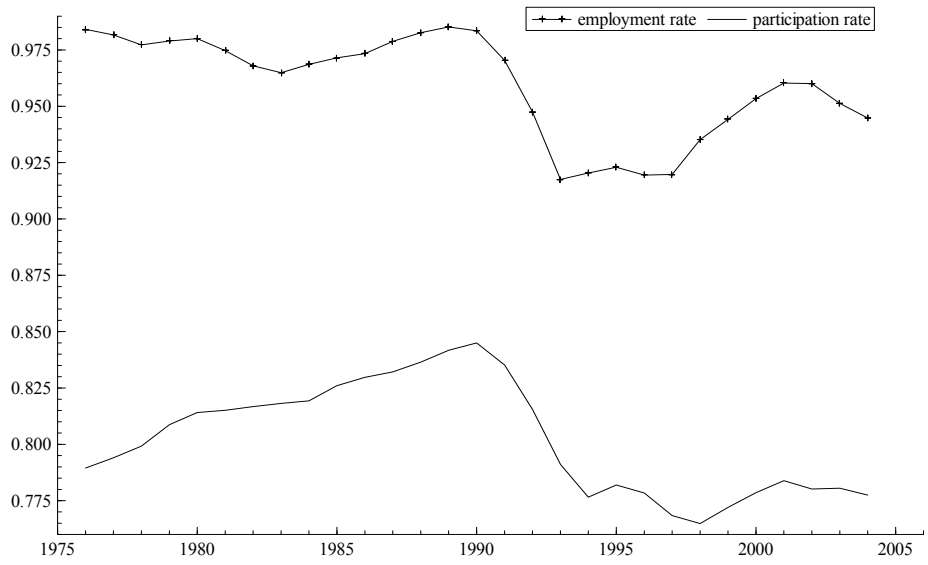


Figure 3: Employment rate and labour force participation rate 1976-2004

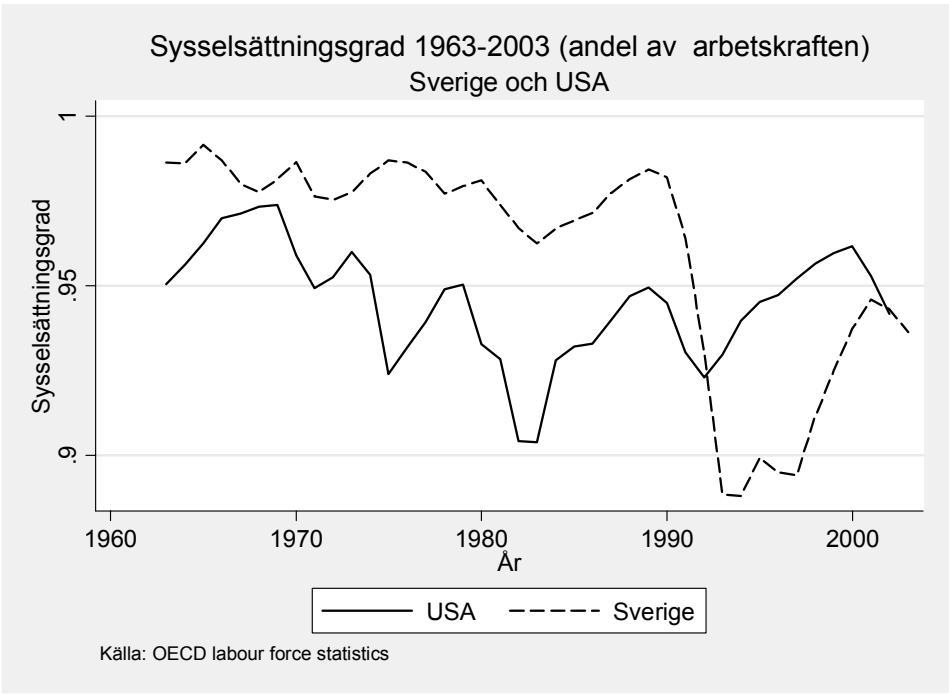


Figure 4: Employment rate 1963—93 in Sweden and the US (share of the labour force)

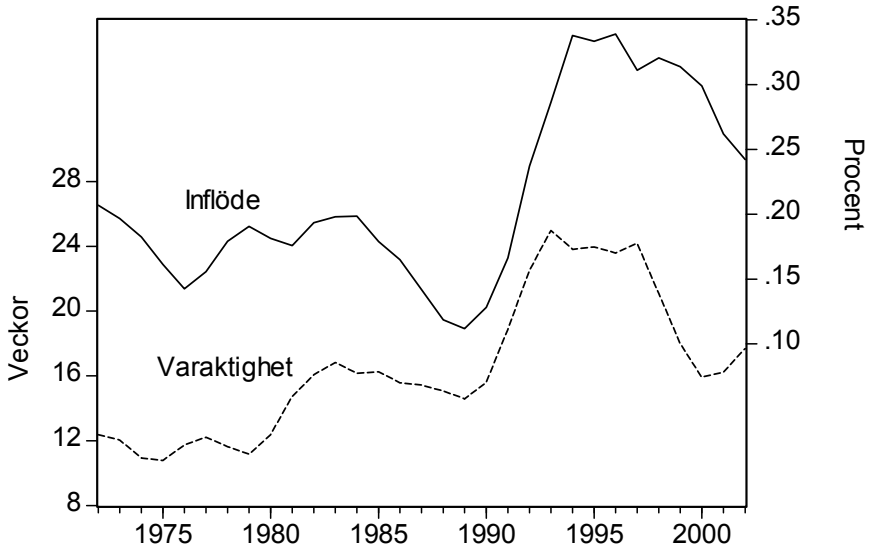


Figure 5 Inflow to unemployment (right-hand scale) and the duration of unemployment (left-hand scale), 1972-2002, 16-64 years.

Note: The inflow is given as weekly inflow as a share of the labour force (percent). The values are running three-year averages.
Source: Computations by Bertil Holmlund based on Labour Force Survey data.

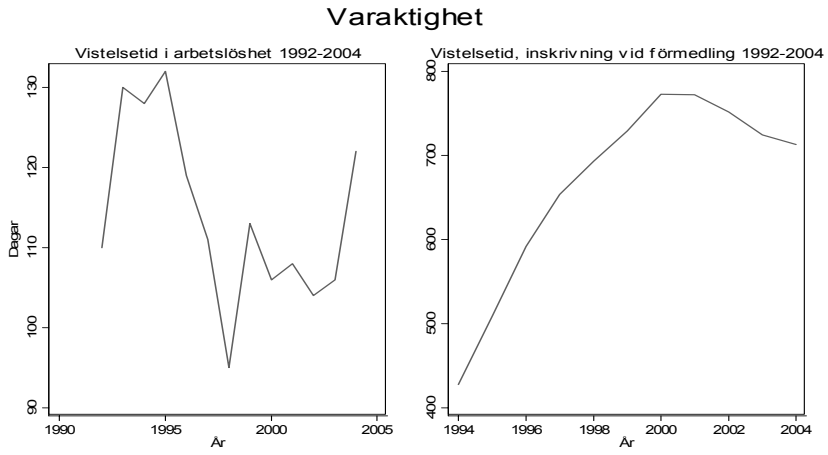


Figure 6: Duration of unemployment and register spells at the Public employment service, averages

The steep increase in unemployment reflected .both an increased inflow and a longer duration (Figure 5). Indeed, inflow and duration co-vary quite closely from the early 1990s and on. The increase in duration of the survey-based measure in Figure 5 is not that dramatic – duration goes from some 15 weeks to about 25 weeks in the mid 1990s. However, there is reason to believe that this measure understates the extent of the problem, because many spells of

open unemployment ended in a labour market programme. Hence, in Figure 6 we use information from the registers at the National Labour Market Board to compute the duration of both spells of open unemployment and spells in the registers consisting of continuous spells of open unemployment and programme participation. Using this information, the development is much more dramatic: the average length of spells increases more or less continuously from around 400 days in 1994 to around 700 days (100 weeks) around year 2000.[1]

In Figure 1 we observed that unemployment did not return to the levels of the 1970s and 1980s during the upturn of the late 1990s – it remained at around 4 %, around twice the level at business cycle peaks in the previous decades. This observed pattern is consistent with hysteresis effects in the unemployment rate. To explore this further, we use the VAR models for unemployment estimated in Forslund and Krueger (1997).

In Figure 7 we plot the actual unemployment rate 1993–2004 along with one-step ahead forecasts from the VAR and the impulse-response function. To the extent that we believe that the VAR captures unemployment dynamics over the estimation sample (1978-92)[2] the observation that the forecasts systematically under-predict the actual rate of unemployment and, especially, that it predicts the unemployment rate to fall almost five years earlier than it actually does, is clearly consistent with hysteresis (or, at least, increased persistence) in the Swedish unemployment rate. This would suggest that the extensive use of ALMPs did not protect the Swedish labour market from developing adjustment patterns typical for many European countries using much less of this medicine.

[1] To some extent this increase is an artefact reflecting the fact that the registers only date back to August, 1991. However, the level in the late 1990s is probably well measured.
[2] The VAR was estimated on regional (county-level) data.

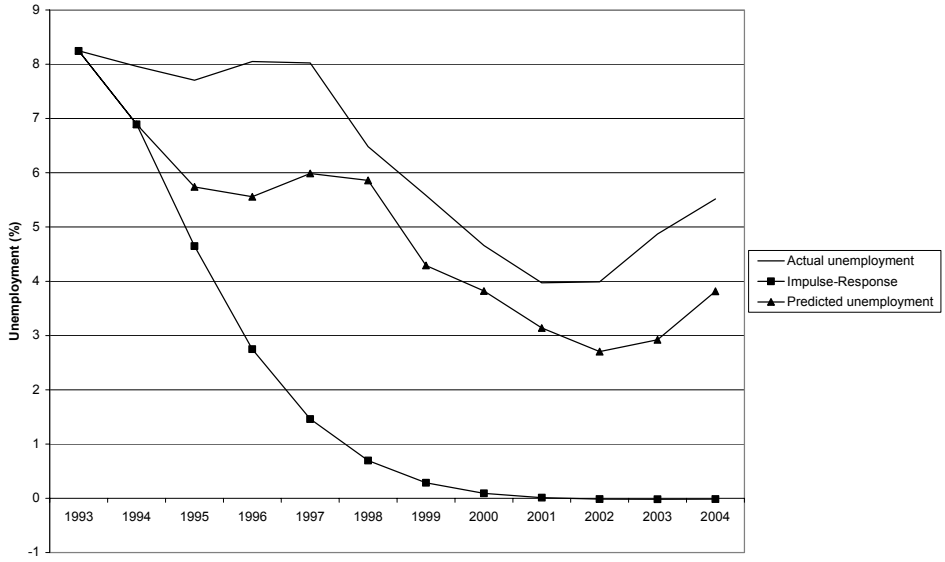


Figure 7:

2.1.2 Changes in wage-setting institutions

Trend towards more "low-level" bargaining and industry-level contracts without precise agreements on wages. Implications not totally clear and, to my knowledge, very little empirical evidence. Probably harder to argue now than it was before that (central) wage policies effectively raise the wages for (potential) low-wage earners. This will be discussed more thoroughly by Fredriksson & Topel.

2.2 Beveridge curves and other matching indicators

Review possible changes since previous paper – possibly an outward shift of the Beveridge curve (see Figure 8 and Figure 9) probably reflecting an increased inflow into unemployment rather than deteriorating matching efficiency.[3]

[3] There is clear evidence in the labour force surveys that the inflow rate into unemployment increased during the 1990s, see Figure 5.

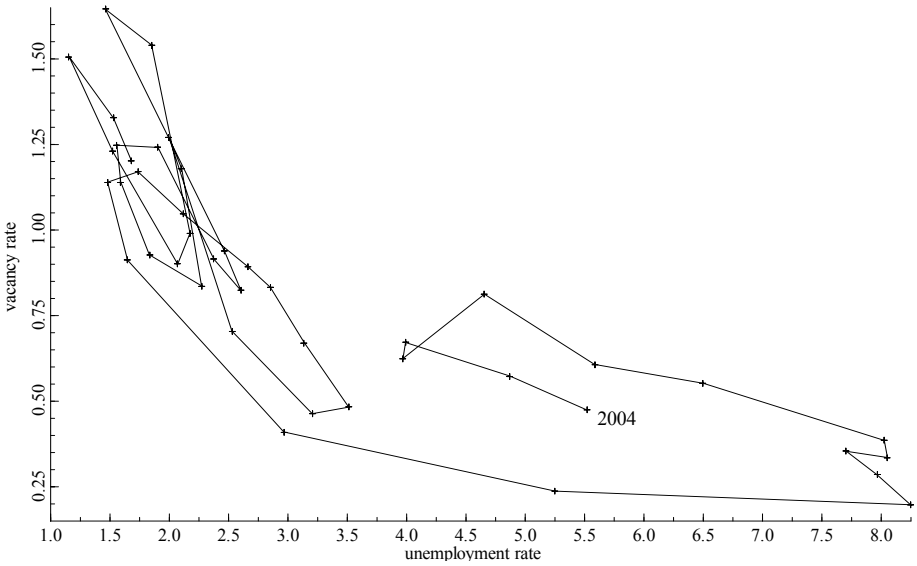


Figure 8: The Swedish Beveridge curve 1963-2004

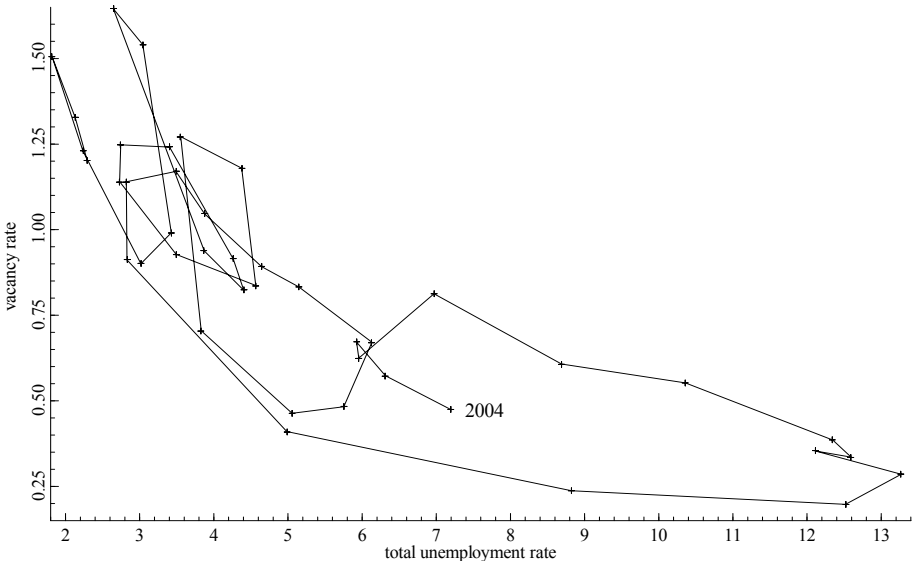


Figure 9: The Swedish Beveridge curve 1963-2004 in terms of "total unemployment"

2.3 Regional adjustments

Some new evidence to review: no new evidence suggesting lower geographical mobility, but also no evidence that ALMPs have contributed to higher mobility – the opposite seems more likely given the evidence.

3 Swedish ALMPs since the early 1990s

3.1 The programme menu – new stuff and old

A review of existing programmes and important changes during the last decade. Two important trends: more focus on the long-term unemployed and on job-search assistance.

3.2 A quantitative description

Figure 10: Different ALMPs 1963-2004 (shares of labour force)

3.3 Interactions between UI and ALMPs

A generous[4] unemployment insurance (UI) creates incentives which are likely to cause long unemployment spells. A number of recent reforms in the Swedish UI system have facilitated an analysis of the effects of changes in the level of compensation on the flow from (insured) unemployment to employment.

Carling, Holmlund and Vejsiu (2001) studied a change in the replacement rate from 80 % to 75 % that was introduced on January 1, 1996. This reform only

[4] In terms of compensation levels and duration as well as in terms of the level of control that the unemployed receiving benefits actually is actively looking for a job. We described the basics of the Swedish system in Forslund and Krueger (1997).

affected a sub-sample of the unemployed. The authors estimated the effect of the reform by comparing job-finding rates before and after the reform of those affected and unaffected. The estimates suggest that the cut in the replacement rate resulted in an increase in the job-finding rate by about 10 %.

Bennmarker, Carling and Holmlund (2005) investigated the effects of several changes in the unemployment insurance system introduced in 2001 and 2002. In 2001, a two-tiered benefit system was introduced. The new system entails a higher compensation during the first 20 weeks of an unemployment spell. In 2002, compensations were raised both for spells exceeding 20 weeks and for the first 20 weeks of spells. The changes applied, as was the case in the 1996 reform, only to sub-samples of the unemployed. Once again, this was used to identify effects on job-finding rates. Somewhat surprisingly, there is a striking difference between the results for males and females. The female job-finding rate was increased whereas the male job-finding rate (in accordance with what should be expected from theory) was reduced. There was no significant effect on the aggregate job- finding rate. The authors speculate that the difference between males and females were due to a reform in child-care taking place simultaneously. The expected effect of this reform was to increase female labour supply.

A peculiarity of Swedish labour market policies in the 1990s was the possibility to renew UI benefit eligibility through participation in labour market programmes.[5] Given the generous Swedish UI system, this feature is likely to have affected both the treatment effects of programme participation and the work disincentives associated with the combined system of UI and labour market programmes. There is, indeed, evidence suggesting that the system led to cycling between unemployment and programme participation and that this affected the results of programme participation.[6]

[5] Provided that the programme lasted long enough, participation in any programme counted as "employment and, hence, gave renewed benefit eligibility. Before 1986, only participation in "job-like" programmes, such as relief jobs, qualified.

[6] In Forslund and Krueger (1997) we presented some evidence consistent with these results, but we concluded that there was no direct conclusive evidence.

First, Ackum Agell, Björklund and Harkman (1995) showed that long spells in the registers of the National Labour Market Board (including both UI and programme periods) were common in the early 1990s. Carling, Edin, Harkman and Holmlund (1996) showed that UI compensated unemployment spells close to benefit exhaustion were significantly more likely to lead to programme participation than were uncompensated unemployment spells. Sianesi (2001) found that programme participation increased the probability of future benefit-compensated unemployment as well as subsequent programme participation. This effect was both of a non-trivial size and long-lasting. Finally, Hägglund (2000) found that both employment durations and the length of programme spells were affected by changes in UI eligibility criteria.

Second, Sianesi (2001) found that the treatment effect (in terms of a number of different outcomes) of programmes was among the worst for those individuals joining the programmes around the time of benefit exhaustion. This is consistent with the finding in Regnér (1997) that unemployed job seekers often entered programmes just to renew UI benefit eligibility.

Hence, the evidence suggests that the system promoted cycling between periods of (UI compensated) unemployment and programme participation.

The possibility to renew benefit eligibility was removed in August, 2000, when the *Activity guarantee*[7] was introduced. Apart from other possible effects of the activity guarantee, this reform should be expected to improve the results of the active labour market programmes.

We could also discuss whether we Granger caused the benefits to decline.

3.4 Research results on Swedish ALMPs – a survey

[7] See Section 3.1 for a description of the activity guarantee.

3.4.1 Training programmes

New evidence available. Should we revise the conclusions drawn in previous paper? No! Training seems not to work in bad labour market states. Evidence on the Adult education initiative (kunskapslyftet) should be included here.

3.4.2 Other micro evaluation results

Much more evidence available now than 10 years ago. Generally, few examples of positive effects for participants. The exceptions are different forms of wage subsidies. Generally, the closer the programmes are to ordinary jobs, the more favourable the results. Most evaluations of programmes targeted at youth suggest that those programmes do not work.

We should also review the evidence of the "sabbatical year" (friåret).

The generally disappointing results of programme participation may suggest that the alternative, job search supported by the Public employment service, is a productive use of time and that an increased policy focus on job search could be warranted.

3.4.3 Direct displacement effects

Direct displacement takes place if employers substitute programme participants for ordinary employment. In Forslund & Krueger (1997) we estimated displacement effects of relief jobs, and found displacement to be high in building and construction but not significantly different from zero in health and welfare. Since then, much new evidence has accumulated. This evidence is surveyed in Calmfors, Forslund and Hemström (2001), on which we base the following brief summary of results.

In a fairly large number of surveys, employers, programme participants and employment officers have been asked whether they believe that the tasks performed by programme participant(s) would have been performed also in the absence of the programme.

The results in the survey studies, almost without exception, suggest that all programmes are associated with substantial displacement effects. Another main result in these studies is that displacement effects are larger the closer the programme resembles an ordinary job.

There is also a number of econometric studies of displacement. In most cases these studies do not look at displacement effects for single programmes. The results indicate larger displacement effects than those found in the survey studies – typically displacement effects well above 50 % are found in the econometric studies, whereas the estimated effects in the survey studies inly in a few cases exceed 50 %.

3.4.4 Other macro evaluation results

Some new evidence to review. The only "positive" result: ALMPs seem to contribute to higher labour force participation.

3.4.5 International evidence on ALMPs

Some new evidence since previous paper. Briefly, the evidence indicates that ALMPs contribute to lower open unemployment rates, but not to lower total unemployment rates (including ALMP participation). This means that ALMPs reduce regular employment.

3.5 Have policy changes been consistent with the evidence?