aer

Arbetsmarknads-
ekonomiska
rådet

# The Duality of the Swedish Labour Market – Summary of the Swedish Labour Policy Council report »Tudelningarna på arbetsmarknaden«

Arbetsmarknadsekonomiska rådet 2017

BOX 55665
102 15 STOCKHOLM
TEL. +46 8-665 45 00
WWW.ARBETSMARKNADSEKONOMISKARADET.SE
INFO@ARBETSMARKNADSEKONOMISKARADET.SE
TEXT: AER
ORIGINAL DESIGN: IRONS DESIGN & AER
STOCKHOLM 2017

# Summary

There are two key developments in the current labour market in Sweden. On the one hand, there is a strong economic upturn fuelled primarily by domestic demand. This means that the non-tradable sectors are doing better than the tradable sectors. There are labour shortages, particularly in the public sector and in the private service sectors. On the other hand, it is difficult for the low skilled, particularly those who are foreign born, to enter the labour market. Both these problems are considered in this report.

- Chapter 2 discusses *wage formation and wage negotiations*. Of particular interest is the pay bargaining norm, according to which centrally negotiated wage increases in all sectors should follow the negotiated wage increases in the sectors exposed to international competition (the tradable sectors, primarily manufacturing) – the so-called *cost mark* – in a situation where there is likely to be more room for wage increases in the former than in the latter sectors, both in the short and long term. The report also focuses on the extent to which lower collectively agreed minimum wages may be conducive to increasing the number of low-qualified jobs and thus employment for the low skilled.
- Chapter 3 discusses *fixed-term employment* and shows that this is a common form of employment among marginal groups in the labour market. It appears that hiring employees on fixed-term contracts is a way for firms to adjust to a compressed wage structure. The chapter also analyses the extent to which fixed-term employment acts as a springboard to permanent employment or locks people into insecure jobs.
- Chapter 4 provides a more comprehensive picture of the *labour market situation for the foreign born* than the traditional one that relies only on measures of employment and unemployment. The chapter takes into account the number of regular jobs (that are not subsidised), permanent employment, full-time employment and self-employment. Considering several dimensions of labour market attachment indicates a substantially weaker attachment for the foreign born than suggested by employment and unemployment figures alone.
- Chapter 5 analyses the importance of both *skills and education for the employment and pay of the foreign born*. The chapter ends with a discussion of how schools can contribute to improving the labour market prospects of the foreign born.

- Chapter 6 summarises the research findings – in both Swedish and foreign studies – on how various labour market programmes can contribute to *the employment of the foreign born*.
- Chapter 7 focuses on how employment subsidies can help both new refugee immigrants and others having difficulties entering the labour market. The chapter is based on a comprehensive survey of firms' use of employment subsidies and attitudes towards them. The principal question is why these subsidies are not used to a larger extent and what could be done to make them more attractive to employers.

## Wage formation and wage negotiations (Chapter 2)

The Swedish economy is now in an upturn. The boom is fuelled more by domestic than export demand. Labour shortages are more acute in the public sector, the private service sector and the construction sector than in manufacturing. This puts the cost mark setting by manufacturing under severe pressure. The prospects that manufacturing will maintain its role in setting the pay norm, however, look better in the 2017 wage negotiations than they did last year, because this time the blue-collar unions – i.e., the unions within the Swedish Trade Union Confederation (LO) – have presented a united front in the negotiations.

The stronger growth in domestic demand than in export demand, and therefore also stronger demand in the non-tradable sector than in the tradable sector, is however probably not only a short-term cyclical phenomenon, but also a more long-term *structural* development. Since the beginning of the 1990s, Sweden has had large current account surpluses; that is to say, the economy as a whole has had large positive net lending. This has led to a gradual improvement in the country's net financial position (claims minus debts) vis-à-vis the rest of the world. It is unlikely that Sweden will increase its net foreign claims (as a percentage of GDP) forever. An ageing population is most likely to lead to lower savings. A decrease in precautionary saving due to lower unemployment is also likely to reduce the household savings ratio. Large investments (not least in housing and infrastructure) are also needed. The demand for welfare services (health care, social services and education) will also increase when the number of both old and young people increases. All these factors indicate that in the long run, domestic demand will be high relative to export demand. There will thus be a *rebalancing* of the economy, with the size of the non-tradable sector increasing relative to the tradable sector.

A shift in demand to the non-tradable sector will lead to an increase in the

value-added price in that sector relative to the tradable sector (more than would otherwise have occurred due to slower productivity growth). This shift increases the relative ability to pay of the non-tradable sector.

*Setting of the cost mark in manufacturing*

The cost mark set by the manufacturing sector has been an important feature of the Swedish wage-bargaining model since the Industrial Agreement in 1997. The idea behind the cost mark is that the wage increase in the tradable sector (manufacturing) should serve as the norm to be followed by other sectors in subsequent wage agreements.

It may be good for employment in the economy as a whole if conditions in the sector exposed to international competition were still allowed to guide pay increases in the whole economy. Then the high domestic demand and relative price increases for the non-tradable sector may lead to a substantial increase in total employment in the economy. But this presupposes a labour supply with sufficient qualifications to meet the demand in the non-tradable sector. The large refugee immigration in recent years represents a *potential* such supply. But this potential supply of refugee immigrants must be transformed into an *actual* supply by well-functioning education and retraining measures and/or by the reorganisation of production and wage formation so that simpler job tasks can be performed by people in less skilled jobs that also pay less. Successful integration of the foreign born into the labour market is thus required for setting a cost mark based on conditions in manufacturing.

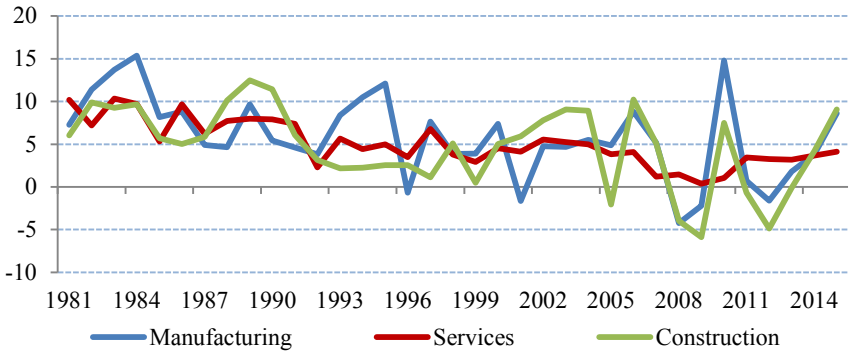
If these conditions are not met, pay increases determined by the room for wage increases in manufacturing are likely to result in significant labour shortages in the non-tradable service sector, construction and the public sector. Labour is then not allocated among the sectors in the most efficient way in a situation when labour needs to be transferred from the tradable sector to other sectors. If pay increases are not adjusted to some extent to the conditions in these sectors, there is a risk of increasing tension in the wage formation system and of an ultimate collapse of the current co-ordination with manufacturing setting the cost mark. This could make it more difficult to secure wage moderation.

One way of preventing such an undesirable development may be for manufacturing, when setting the cost mark, to pay heed to the situation in the rest of the economy more than it currently does. Occasionally, there have been discussions about also having the service sectors exposed to international competition participate in setting the cost mark. The Council in its analysis has distinguished between service sectors that are *directly* exposed to international

competition (that is, sell their final output in competition with foreign producers) and those that are *indirectly* exposed to international competition (manufacturing-related services that sell a substantial part of their output to manufacturing). The Council found that the room for pay increases (the value-added price increase plus the productivity increase) in these two types of service sectors (which partially overlap) has been closely and positively correlated with the room in manufacturing. The correlation has also increased over time.

But including service sectors exposed to international competition in setting the cost mark does not solve the fundamental problem, which is that the non-tradable service sectors (and construction) are expected to do considerably better than manufacturing in the coming years. A potentially inadequate labour supply in the non-tradable sectors might necessitate more radical changes in the collective bargaining system. A retrospective analysis shows that a low correlation between the room for wage increases in manufacturing and the room in the service sector does not arise suddenly. According to Figure 1, there seems to be a trend where the correlation between the room in the service sector as a whole and in manufacturing has decreased over time.

**Figure 1 Room for wage increases, per cent**




*Note:* The room for wage increases is the sum of the changes in productivity and in the value added price.
*Source:* National Institute of Economic Research (Konjunkturinstitutet).

The difference between total and collectively agreed pay increases constitutes a *residual* that is primarily due to local pay increases over and above increases in the sectoral wage agreements. A possible scenario would be combining a low manufacturing cost mark that applies to the whole economy with higher local

pay increases. There is evidence that the size of the residual is correlated with the labour shortage. Lower collectively agreed pay increases have also led to a larger residual. But these links are quite weak. The residual as a percentage of total pay increases has also decreased over time. Thus, low collectively agreed pay increases probably at least in the short term also hold back total wage increases.

Over a longer period with better prospects for the non-tradable sectors than for tradable sectors, lower collectively agreed wage increases for manufacturing than for other sectors cannot be ruled out. This would mark a break in previous patterns: over time the wage dispersion in collectively agreed pay increases (but not in total pay increases) among different sectors has decreased, as shown in Table 1. It is not clear what more relative wage flexibility would mean for the coordination of wage negotiations. The agreement for the manufacturing sectors could still be concluded first and guide the average wage growth in the economy, even if (some) other sectors reached higher settlements. But that presumably requires a broad consensus among the social partners about what relative wage changes are justified. This may be difficult to achieve. Without this consensus, there is a high risk that a well-functioning coordination will break down and in the long run lead to pay increases that are far too high.

**Table 1 Dispersion between sectors in average centrally agreed wage increases by agreement period**

| | Total economy | Business sector | Blue-collar workers, business sector | White-collar workers, business sector |
|---|---|---|---|---|
| 2007-2009 | 0.69 | 0.95 | 0.57 | 1.22 |
| 2010-2011 | 0.42 | 0.47 | 0.44 | 0.31 |
| 2012 | 0.39 | 0.45 | 0.44 | 0.38 |
| 2013-April 2015 | 0.22 | 0.30 | 0.17 | 0.37 |

*Note:* The business sector consists of six industries: (1) manufacturing; (2) construction; (3) retail, hotels and restaurants; (4) transportation; (5) credit institutions and business services; and (6) health care and education, etc. The economy as a whole is defined as the business sector plus the central government, municipalities and county councils. The numbers are standard deviations.
*Source*: Own estimates based on data from the National Mediation Office (Medlingsinstitutet).

*Minimum wages and low-skilled jobs*

Unlike in most other countries, minimum wages in Sweden are determined in collective agreements – there is no statutory minimum wage. As noted in the

Council's previous report, Swedish minimum wages are high in international comparisons and most studies indicate that they have disemployment effects (Swedish Labour Policy Council 2016). Lower minimum wages would contribute to higher employment for both the low skilled in general and low-skilled immigrants in particular. However, such changes would lead to a conflict between employment and income distribution objectives to the extent that lower minimum wages also reduce wages for those who would have found jobs anyway and thus increase the dispersion in both the before-tax wage and disposable income.

Minimum wages can be lowered in different ways:

1. A general reduction in the minimum wages in the collective agreements with the highest minimum wages.
2. Collective agreements could define "new" types of *permanent* low-skilled jobs and introduce considerably lower minimum wages for these jobs only.
3. Negotiation by the social partners of *temporary* entry-level jobs for new labour market entrants (primarily young people and refugee immigrants) with considerably lower starting wages than current minimum wages.

Method 2 probably offers the best trade-off between the employment and income distribution objectives. On one hand, this results in permanent pay reductions for certain types of jobs. On the other hand, it hopefully limits pay reductions to these jobs only. Another advantage of the method is that according to surveys, quite large pay reductions are required to make many employers willing to employ immigrants/refugees from outside Europe. The probability that such substantial pay reductions will be accepted should be greater if it were possible to define new types of low-skilled jobs that do not currently exist and therefore have no previous job holders.

The Council's survey asked a large number of firms whether they would employ people in new types of low-skilled jobs for monthly wages of SEK 14 000-15 000 (about €1 470-1 580) and if so, what kind of jobs this would involve. About a third of the firms that answered stated that they would hire at these wages. The type of jobs and their characteristics varied. But it was consistently a matter of supporting roles: janitors, receptionists, handymen, caretakers, manual help/assistants (in construction), "pick and pack" (in warehouses) and so forth. The answers suggest a potential demand for low-skilled workers not currently being met because of high minimum wages.

Unions are concerned that new, simpler low-wage jobs would substitute for more skilled jobs and thus in the long run also reduce wages there. But it is quite possible that new jobs with low skills requirements would instead act as *complements* to existing jobs. In that case, the creation of low-qualified jobs would instead raise wages for those already employed.

Research cannot provide a general answer to the question of how increasing the number of low-skilled jobs with low wages would affect the wages of those already employed. The existing research on the effects of the immigration of low-skilled people on the wages of low-skilled workers with a non-immigrant background does, however, have some relevance. Studies for the United States and Western Europe have found that immigrants, by taking over manual routine jobs, do exert downward pressure on wages for these jobs, but at the same time wages are pushed up for the native born because they are "crowded out" to jobs with higher complexity involving more abstract and communicative responsibilities. Other studies have reached other results. But new low-paid jobs clearly do not necessarily lead to wage reductions for those already employed.

In the debate, the point has been made that new low-skilled jobs at lower wages could attract new labour immigration primarily from other EU countries in Eastern Europe with low income levels. It is difficult to know how likely this scenario is. The large housing shortage in Sweden should act as a deterrent to such immigration. To the extent that immigrants from other EU countries would be attracted, new low-wage jobs would not help solve the employment problems for refugee immigrants and other groups with a weak foothold in the Swedish labour market. One way to handle the problem would be to design the new jobs as a labour market programme (which does not have to be offered to labour migrants from other EU countries), possibly with some more or less symbolic state subsidy component. As with vocational introduction jobs (employment subsidies that combine jobs with training and/or mentoring), such a labour market programme would require sector-specific collective agreements.

A potential downside with lowering minimum wages is that workers get stuck in very low-paying jobs. There should therefore be good opportunities available for education and training. Because there is plenty of evidence indicating that employers often perceive having to take responsibility for and/or administer training as burdensome, they should not be involved. Instead, generous terms for education and training (including financial support) should be offered directly to each individual. It should then be up to the individual to decide whether to take the training during leisure time or agree on time off for studies with the employer.

## Fixed-term contracts – implications for marginal groups? (Chapter 3)

The duality of the Swedish labour market concerns not only employment and unemployment, but also the type of employment contract. Young people, people born abroad, the low skilled, those in jobs with low skills requirements, and people with low proficiency levels more often have fixed-term employment than other groups. This overrepresentation of marginal groups is larger in Sweden than in comparable countries.

After a long period of gradual liberalisation of the regulations governing fixed-term contracts in the Employment Protection Act, Sweden now has one of the least restrictive regulations of fixed-term employment in the OECD. But the regulation of permanent employment is quite strict. Recent years have seen modest re-regulation of fixed-term employment, but among OECD countries, Sweden still has one of the largest regulatory differences between permanent and fixed-term employment.

Fixed-term employment is associated with less job security, lower pay and fewer fringe benefits than permanent employment. But possibly the most important aspect is the extent to which fixed-term jobs act as a springboard to permanent jobs. Fixed-term employment should be viewed more favourably if it enhances the prospects of a permanent job rather than mainly leading to a vicious circle between this form of employment and unemployment.

A large difference in the stringency of permanent and fixed-term contract regulation may have several adverse consequences. Employers' incentives to use fixed-terms jobs instead of permanent jobs increase because it is simpler and cheaper. This leads to excessive use of fixed-term jobs. Employers are also less inclined to convert fixed-term contracts to permanent ones to avoid considerably higher dismissal costs. As a result, there are many people going back and forth between fixed-term jobs and unemployment. All these effects may lead to higher frictional unemployment and less job security. But other labour market institutions such as wage formation can also affect the number of fixed-term jobs. There has thus far been very little research in this area.

*Fixed-term employment in marginal groups*

Fixed-term employment as a percentage of total employment has not changed much in the past ten years. In 2015 the share was 17 per cent. In relation to other countries, Sweden stands out in one respect in particular: fixed-term employment is largely concentrated to marginal groups. Table 2 shows estimates of *overrisks* for fixed-term employment in various marginal groups in Sweden, Denmark, Finland,

Norway and the EU average. Overrisk refers to the ratio between the probability in a marginal group of being fixed-term employed and the corresponding probability in a selected comparison group. If the probabilities are equal, the ratio is one. A value of two, for example, means twice as high a probability of being fixed-term employed in the marginal group examined.

In 2015, the overrisks were highest in Sweden for the following groups (with ratios in parentheses): 15–24-year-olds relative to 25–64-year olds (4.95), born outside the EU28 relative to natives (1.72), employees in low-skilled occupations relative to employees in other occupations (2.19) and employees with a low proficiency level in literacy relative to employees with a higher proficiency level (2.16). For the low-educated group relative to those with more of education, the overrisks in Sweden were the second highest (1.93) among the countries under investigation.

**Table 2 Overrisks of fixed-term employment in marginal groups, 2015**

| | Sweden | Denmark | Finland | Norway | EU28 |
|---|---|---|---|---|---|
| Ages 15-24 relative to ages 25-64 | 4.95 | 3.79 | 3.62 | 4.59 | 3.91 |
| Born outside the EU28 relative to natives | 1.72 | 1.40 | 1.71 | 1.58 | 1.39 |
| Low skilled relative to not low skilled | 1.93 | 1.98 | 1.50 | 1.75 | 1.70 |
| Occupations with lower required qualifications relative to other occupations | 2.19 | 1.15 | 1.73 | 1.79 | 1.80 |
| *Low proficiency level relative to not low proficiency level* [a] | | | | | |
| Literacy | 2.16 | 1.01 | 0.95 | 1.46 | 1.22[b] |
| Numeracy | 1.79 | 1.06 | 1.08 | 1.64 | 1.27[b] |

*Note:* The overrisk for Group A in relation to Group B is equal to the ratio between the fixed-term employed as a percentage of all the employed in Group A and the corresponding percentage in Group B. The overrisks are based on individual data for those with low proficiency and data aggregated at group level for other marginal groups. Low skilled refers to people with no more than compulsory school or the equivalent. Jobs with low qualification requirements normally do not require more than a compulsory school education or the equivalent. Low proficiency level refers to people with test scores of no more than 1 on a scale of 1-5. [a] 2012; [b] EU17.
*Sources:* Own estimates based on data from Eurostat and the Programme for the International Assessment of Adult Competencies (PIAAC) for proficiency levels.

We present an econometric analysis using panel data for selected countries (that is, data that take into account the variation both among countries and over time) to examine the relationship between employment protection legislation and wage formation, on the one hand, and overrisks for fixed-term employment, on the other hand. Unsurprisingly, the estimates give support to there being a negative relationship between stringent regulation of fixed-term jobs and the overrisks. The results for the regulation of permanent employment are inconclusive.

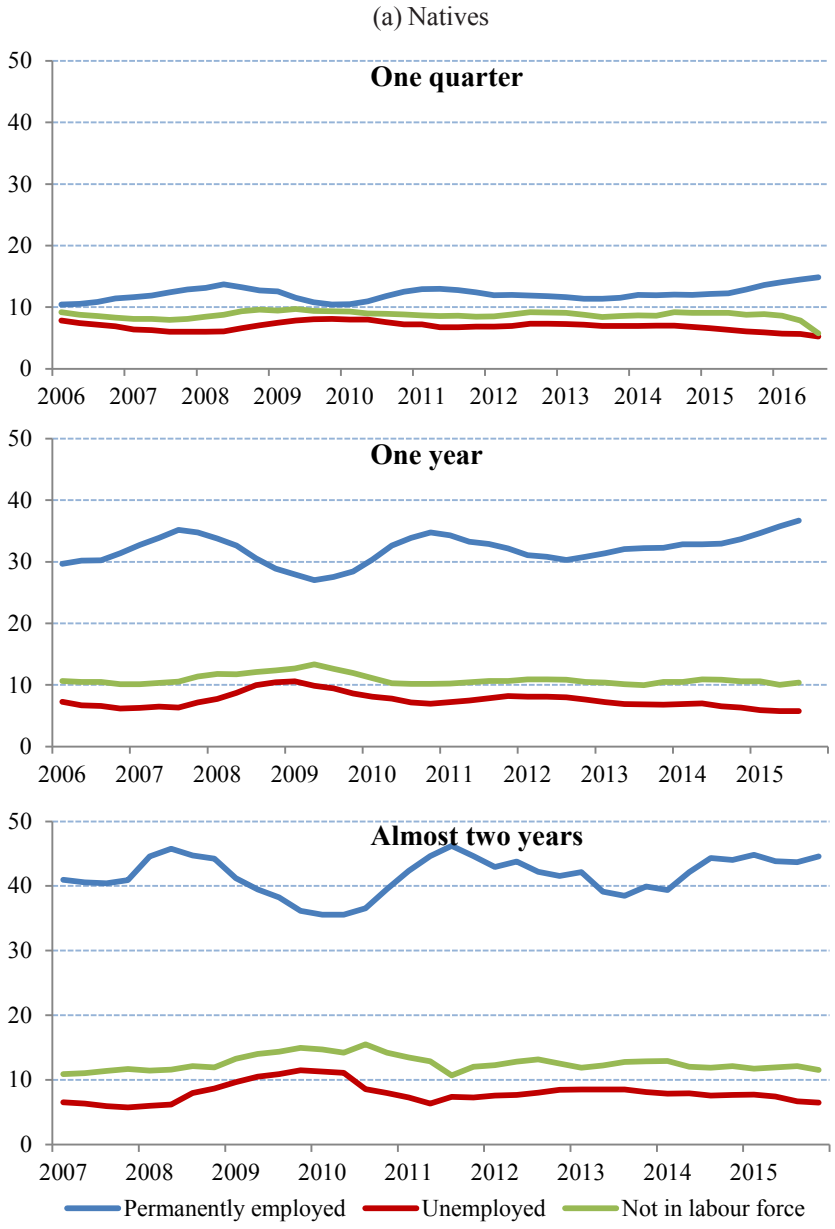
One interesting result is the clear evidence for a positive relationship between various measures of wage compression and the overrisks: smaller pay differentials are associated with higher overrisks for fixed-term employment. A likely explanation is that high wage floors make a downward adjustment of total wage costs (pay plus costs for employment protection) – as compensation for the increased uncertainty for employers associated with permanent employment – more difficult to achieve. Employers may under such circumstances be more inclined to use only fixed-term contracts, particularly for marginal groups for which uncertainty is the largest. This is an important conclusion. The high minimum wages and the small pay differentials in Sweden probably contribute not only to fewer jobs for marginal groups, but also to more insecure jobs. Not enough attention has been paid to this previously.

*Transition probabilities from fixed-term employment and unemployment to permanent employment*

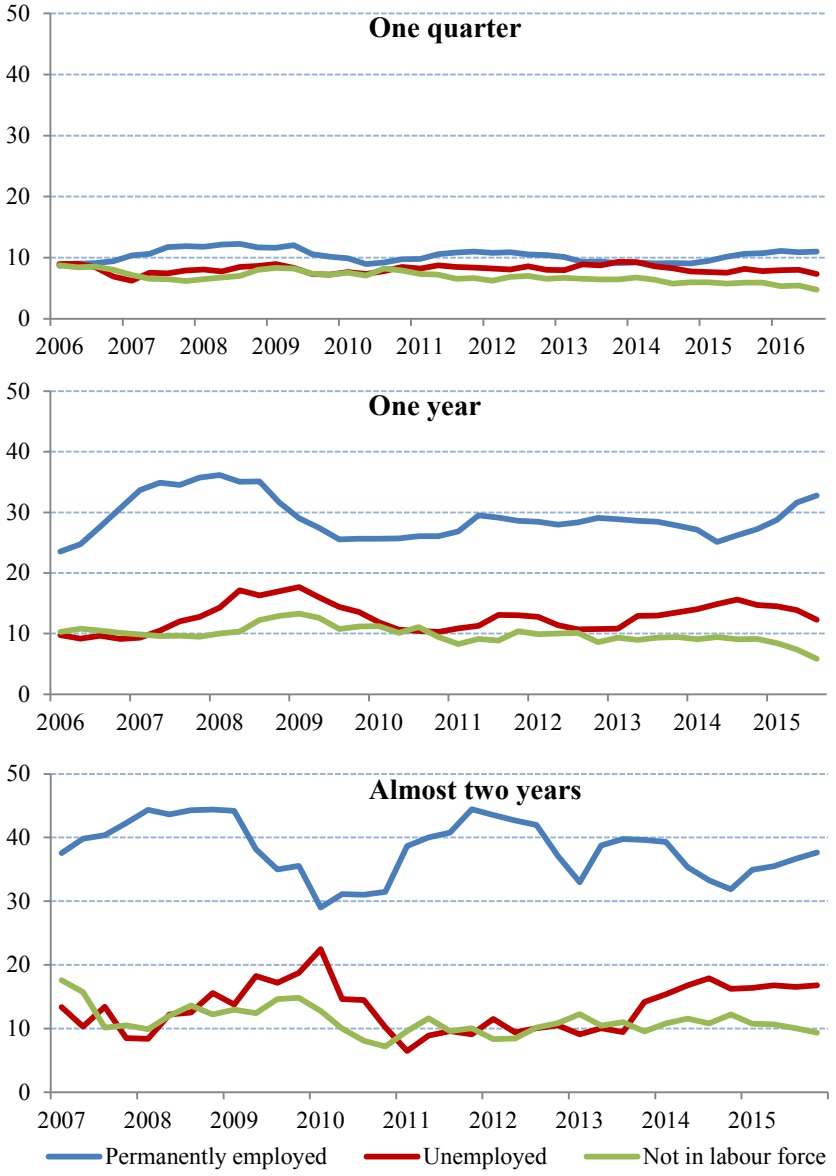
We also analyse transition probabilities between different states in the Swedish labour market. We compare transition probabilities for natives and for those born outside Europe. Figure 2 shows that probabilities for those with fixed-term jobs of transiting to permanent employment – in one quarter, a year and nearly two years – are consistently less favourable for those born outside Europe than for natives. The probabilities of leaving fixed-term for permanent employment do increase the longer the time horizon, but they are lower for people born outside Europe than for natives, while the probabilities of being unemployed are higher. In 2015, for example, the probability of transiting to permanent employment within nearly two years was 37.6 per cent for people born outside Europe compared to 44.6 per cent for natives. The gap between the two groups in the transition probabilities has also increased since the financial crisis in 2008-2009.

The analysis of transition probabilities from unemployment to fixed-term jobs and the probability of remaining unemployed shows a similar unfavourable pattern for people born outside Europe compared to natives. But it is also clear that for both groups, labour market prospects appear to be better for the fixed-term

**Figure 2 Transitions from fixed-term employment to other labour market states, per cent**



(a) Born outside Europe




*Note:* Data refer to people aged 20-64 and are moving averages over four quarters. Individuals' labour market states are observed during a reference week at two points in time (quarters). One quarter ahead compares the states in two consecutive quarters. One year ahead compares the states in one quarter with the same quarter in the following year. Almost two years ahead compares the states in one quarter with that seven quarters later. For all time horizons, individuals may have been in other states than the one finally observed in the period between observations. All differences in transition probabilities between natives and those born outside Europe (except the difference for not in the labour force after almost two years) are statistically significant at the five percent level.
*Source:* Own estimates based on data from the Labour Force Survey (LFS).

employed than for the unemployed. The probability of being unemployed at a later point in time is clearly higher if one is initially unemployed, while the probability of getting permanent employment is lower. This is consistent with the research indicating that fixed-term jobs act as a springboard into the labour market.

Fixed-term jobs appear to be more important for the labour market prospects of people born outside Europe than for natives. Admittedly, the probability of transiting from fixed-term to permanent employment is lower for people born outside Europe than for natives and the probability of being unemployed in the future is also higher. But the relative probabilities – compared to people who initially are unemployed – are consistently more beneficial for people born outside Europe. This seems to be true regardless of their length of residence in Sweden. For example, in 2015 the probability of getting a permanent job in close to two years was 25.4 percentage points higher for people born outside Europe who initially were in fixed-term jobs than among those who had been unemployed, while the corresponding figure for natives was only 19.8 percentage points.

*Should the regulation of fixed-term employment be strengthened or loosened?*
Experiences in other countries indicate that reforms that one-sidedly focus on making fixed-term hiring more difficult – either with more restrictive regulation or through special taxation similar to that introduced in recent years in some countries – are ineffective in creating more jobs and more secure jobs. With these one-sided measures, there is a risk that fewer fixed-term jobs will be created, leading to a reduction in total employment. Effects on income distribution from these measures may also be problematic because our analysis shows that fixed-term jobs seem to be more important for people born outside Europe, acting as a springboard to their permanent establishment in the labour market.

A large difference in the stringency of regulation for permanent and for fixed-term jobs – as in Sweden – may affect employers' incentives in two ways. First, their likelihood of hiring on fixed-term contracts rather than permanent ones increases because it is simpler and less costly. Second, employers are less likely to convert fixed-term contracts to permanent jobs because high dismissal costs can then be avoided.

We also find a positive relationship between a compressed wage structure and the overrisks of fixed-term employment among marginal groups. Therefore, a combination of measures may be the most effective way to reduce the large overrisks of fixed-term jobs in marginal groups. It may be desirable to reduce the difference in the stringency of regulation of permanent and fixed-term jobs from "both sides" as well as to increase the wage dispersion in the lower part of the wage distribution.

## Labour market attachment of the foreign born (Chapter 4)

It is well known that people born abroad exhibit higher unemployment and lower employment rates than natives. Those born abroad also participate in the labour force to a lesser extent and are more apt to be long-term unemployed. This is particularly true for immigrants from Africa and Asia. However, the differences between natives and the foreign born decrease with the length of residence in Sweden of those born abroad. The convergence process takes a long time, though, and most immigrant groups have not reached the same employment rates as natives even after a long time in Sweden.

*Labour market attachment for the foreign born employed*

Unemployment and employment figures provide an incomplete picture of the labour market attachment of people born abroad. They have a weaker attachment than natives even when employed. For example, the foreign born are much more often hired on fixed-term contracts or with employment subsidies instead of on a permanent basis than natives. Those from the former group are also more likely to be employed part-time rather than full-time. Thus the differences solely in unemployment and employment between natives and people born abroad understate the true differences in labour market attachment.

To get an idea of labour market attachment among the *employed*, the Council calculates the percentage of those with permanent full-time jobs in various groups. Employed Asian and African immigrants have a considerably weaker labour market attachment than employed natives. This is primarily due to the greater incidence of fixed-term employment in these immigrant groups compared with natives. Another contributing factor is that people born in Africa and Asia are employed part-time rather than full-time to a greater extent than natives. However, the differences are smaller when comparing the foreign born who have resided in Sweden for a long time with natives. The high incidence of fixed-term jobs among people born abroad with short residency is not surprising. Fixed-term employment is common in all groups that are new entrants in the labour market.

*Self-employment*

Self-employment is another form of employment that must be taken into account when discussing labour market attachment. Self-employment is often put forward as a solution to the employment problems of people born abroad. But there are differences in the self-employment of natives and the foreign born. According to the research, the self-employed who were born abroad are more likely than natives to be engaged in labour intensive sectors with low profit margins. Self-

employment among the foreign born also less frequently takes the form of limited liability companies and is more often motivated by necessity – lack of employment alternatives – rather than opportunity. Self-employment also generally involves more risk than regular employment. These arguments support the idea that self-employment in many cases represents weaker labour market attachment for those born abroad than for natives.

*Overall labour market attachment for the foreign born*

To get an overall measure of the attachment to the labour market, we have in Table 3 calculated the incidence of permanent full-time employment in various groups. Of those born outside Europe, only 35 per cent are permanently employed full-time, compared to 61 per cent for natives. This means that the degree of labour market attachment of those born outside Europe is only 57 per cent of that of natives. The most important factor in explaining this difference is that the employment rate of those born outside Europe is only just over 70 per cent of that for natives. Another contributing factor is that people born outside Europe who are in employment are employed on a fixed term or with employment subsidies to a far greater extent than natives. The share with permanent jobs is only 83 per cent of that for natives. The percentage of those with permanent employment who work full-time is of less importance in explaining the difference in the degree of labour market attachment between the entire group born outside Europe and natives.

The foreign born from Africa are the group with the weakest attachment to the labour market. Only a little over a quarter in this group have permanent full-time employment, which is only 42 per cent of the figure for natives. The most important factor in explaining the difference here is that the employment rate is considerably higher for natives. The second most important factor is a higher percentage of the employed who have permanent jobs. Natives with a permanent contract work full-time to a greater extent than the foreign born from Africa and this also helps explain the difference.

Women have a lower degree of labour market attachment than men, regardless of where they were born. The main reason for this is that fewer women than men work full-time. As to the share with permanent full-time employment, the differences between natives and the foreign-born are even larger for women than for men. This is primarily due to a larger difference in the employment rate. However, labour market attachment for those born abroad is consistently stronger in groups who have resided in Sweden longer.

**Table 3 Total labour market attachment by place of birth, ages 20-64, 2015**

| | *Permanently employed full-time* / *Population* | *Permanently employed full-time* / *Permanently employed* | *Permanently employed* / *Employed* | *Employed* / *Population* |
|---|---|---|---|---|
| Natives | 0.61 | 0.82 | 0.88 | 0.84 |
| Born outside Europe | 0.35 (0.57) | 0.79 (0.96) | 0.73 (0.83) | 0.60 (0.71) |
| Born in Africa | 0.26 (0.43) | 0.74 (0.90) | 0.65 (0.74) | 0.53 (0.63) |
| Born in Asia | 0.34 (0.56) | 0.80 (0.98) | 0.73 (0.83) | 0.59 (0.70) |

*Note:* The self-employed are defined as permanently employed. Full-time refers to those who work more than 35 hours a week. The ratio between the entry for those born abroad and the entry for natives is given in parentheses.
*Source:* Own estimates based on data from the Labour Force Survey (LFS).

Table 4 shows the percentage of permanent full-time employed for native women and for different groups of women born abroad by length of residency. The differences between natives and those born abroad with short residency (0-5 years) are quite large. Only 3 per cent of women from Africa with a short residency have permanent full-time jobs. For women from Asia, the corresponding figure is 7 per cent. In contrast, more than half of all native women are in full-time employment. The labour market attachment for women from Africa with short residency (0-5 years) is less than 6 per cent of that for native women. The degree of attachment for women from Asia is just below 14 per cent of that for native women. The shares with permanent full-time employment are only slightly higher for women born outside Europe who have lived in Sweden 5-10 years: 10 per cent for those from Africa and 16 per cent for those from Asia.

The single most important explanation for these differences is the gap in the employment rate. But the smaller share with permanent jobs among the employed is also of relevance in explaining the differences in the degree of labour market attachment between groups of women. However, the differences in this degree are much smaller when comparing women born abroad who have resided in Sweden for more than ten years with native women. This is largely due to the share in fixed-term jobs decreasing with longer residency.

The main conclusion is that labour market attachment is seriously underestimated if only the differences in the employment rate are examined. Our measure of attachment – the share of permanent full-time employed in the population group – shows that people born abroad, particularly from Africa and Asia, have a much more vulnerable position in the labour market than is suggested by employment and unemployment figures alone.

**Table 4 Labour market attachment by place of birth and length of residence, women, ages 20-64, 2015**

| | *Permanently employed full-time* / *Population* | *Permanently employed full-time* / *Permanently employed* | *Permanently employed* / *Employed* | *Employed* / *Population* |
|---|---|---|---|---|
| *Length of residence: <5 years (immigration year 2011-2015)* | | | | |
| Natives | 0.51 | 0.72 | 0.86 | 0.83 |
| Africa | 0.03 | 0.69 | 0.28 | 0.18 |
| Asia | 0.07 | 0.47 | 0.51 | 0.31 |
| Europe | 0.28 | 0.67 | 0.63 | 0.66 |
| *Length of residence: 5-10 years (immigration year 2006-2010)* | | | | |
| Natives | 0.51 | 0.72 | 0.86 | 0.83 |
| Africa | 0.10 | 0.63 | 0.40 | 0.40 |
| Asia | 0.16 | 0.68 | 0.53 | 0.42 |
| Europe | 0.35 | 0.69 | 0.73 | 0.69 |
| *Length of residence: >10 years (immigration year -2005)* | | | | |
| Natives | 0.51 | 0.72 | 0.86 | 0.83 |
| Africa | 0.34 | 0.64 | 0.76 | 0.70 |
| Asia | 0.39 | 0.72 | 0.79 | 0.68 |
| Europe | 0.49 | 0.74 | 0.90 | 0.74 |

*Sources:* Own estimates based on data from the LFS data and the Total Population Registry (Registret över totalbefolkningen) for length of residence.

## Improving education and proficiency among immigrants: what can schools do? (Chapter 5)

There are substantial differences in skills between those with non-immigrant and those with foreign backgrounds. First and second generation immigrants have a lower education level than people with a non-immigrant background and perform worse in international proficiency tests such as the OECD's study of the adult population, the Programme for the International Assessment of Adult Competencies (PIAAC). This is also true when education is controlled for. The tests measure proficiency in literacy, numeracy and problem-solving in technology-rich environments.

We show that the labour market rewards proficiency equally well, regardless of whether people have a non-immigrant or a foreign background. For those at the same proficiency level in PIAAC, there generally are no differences in labour market outcomes between the two groups. Rather, the analysis indicates that the return

to proficiency, for example literacy, in the form of pay and employment rates is slightly higher for people with an immigrant background than for people with a non-immigrant background.

If immigrants have the right skills, they also get jobs. This pattern is clear in Table 5, which shows the employment rates for people with an immigrant versus a non-immigrant background by proficiency level in literacy in selected countries. A foreign (immigrant) background is defined as being born abroad or having parents that were both born abroad. In Sweden, the employment rate for people with a foreign background and high proficiency levels is even slightly higher than for people with a non-immigrant background at the same proficiency levels. In an international comparison, the employment rate for people with a foreign background at these proficiency levels is also high. For example, it is higher than in the United States and the United Kingdom. People with an immigrant background and good skills clearly do not have difficulty finding employment in Sweden. But low-skilled immigrants do have difficulty. They also do relatively worse than comparable people in other high-income countries, where the employment rate for immigrants at low proficiency levels is higher or at the same level as for people with a non-immigrant background.

The differences in labour market outcomes between those with a non-immigrant background and those with a foreign background thus depend mainly on differences in skills. Education is the most important means of improving proficiency levels. It is thus natural to examine the extent to which the Swedish school system succeeds in raising the proficiency levels of students of foreign origin.

The connection between length of residency in the country and the skills gap compared to students with a non-immigrant background can serve as an indicator of the Swedish school system's ability to impart skills to immigrant students. The earlier immigrant children have come to Sweden, the longer the time they have spent in the Swedish school system. Therefore, the Swedish school system has a greater effect on the proficiency level of immigrant children with a long residency than on that of immigrant children with a short residency.

We use data from the recently published PISA assessment for 2015 to map the proficiency differences between first and second-generation immigrants. The new PISA study shows that Sweden has managed to reverse its earlier downward trend and that the average results have improved for all three proficiencies studied (literacy, mathematics and science). The differences in proficiency between students with a non-immigrant background and students born abroad have declined slightly compared to the previous PISA study. However, Sweden still has one of the largest gaps in the OECD.

**Table 5 Employment rate for those with a native background and those with a foreign background by literacy proficiency, 2012, per cent of the population group**

| | Proficiency level 1 | | Proficiency level 2 | | Proficiency level 3 | | Proficiency level 4 | |
|---|---|---|---|---|---|---|---|---|
| | Native back-ground | Foreign back-ground | Native back-ground | Foreign back-ground | Native back-ground | Foreign back-ground | Native back-ground | Foreign back-ground |
| Austria | 63 | 59 | 71 | 67 | 80 | 74 | 82 | 76 |
| Denmark | 57 | 54 | 72 | 65 | 80 | 71 | 85 | 75 |
| Finland | 47 | 47 | 64 | 73 | 75 | 76 | 79 | 71 |
| France | 56 | 52 | 65 | 57 | 68 | 63 | 72 | 65 |
| Germany | 62 | 64 | 76 | 69 | 81 | 77 | 83 | 77 |
| Ireland | 44 | 56 | 58 | 59 | 68 | 63 | 77 | 75 |
| Italy | 49 | 69 | 53 | 59 | 62 | 57 | 71 | 76 |
| Netherlands | 62 | 50 | 72 | 60 | 82 | 72 | 86 | 73 |
| Norway | 60 | 66 | 74 | 74 | 83 | 81 | 90 | 91 |
| Spain | 46 | 50 | 58 | 58 | 67 | 66 | 75 | 73 |
| **Sweden** | **57** | **47** | **70** | **70** | **78** | **81** | **85** | **90** |
| United Kingdom | 54 | 57 | 68 | 68 | 77 | 75 | 84 | 81 |
| US | 59 | 74 | 68 | 70 | 80 | 74 | 83 | 81 |
| OECD | 57 | 69 | 66 | 67 | 77 | 73 | 82 | 79 |

*Note*: Proficiency level 4 includes proficiency levels 4 and 5 in PIAAC.
*Source*: Own estimates based on data from the 2012 PIAAC survey.

We divided first-generation immigrants into children who arrived before and after the age of six. Although test scores for the children who immigrated before they were six are lower than in most comparison countries, children seem to acquire skills relatively quickly with the length of residence in Sweden. The difference in test results, adjusted for family background, between students who immigrated before and after the age of six is one of the largest among the countries studied. This indicates that the Swedish school system is nevertheless succeeding quite well in improving the proficiency levels of children of foreign origin, even though there are still significant differences compared to students with a non-immigrant background.

Unfortunately there is very little research into what specific education measures are effective in reducing the differences in skills between students with a non-immigrant background and students with foreign backgrounds. This is primarily due to the difficulty in finding data that make it possible to differentiate between causal and spurious relationships. Most earlier research has thus been limited to

documenting simple correlations between different types of education measures and differences in the size of the proficiency gap in various countries. The results indicate that extra language training and preschool education are correlated with a smaller proficiency gap.

As in other Nordic countries, Sweden has an extensive preschool system. New research has emphasised the importance of the preschool for skills acquisition. Several studies from English-speaking countries have shown that children from vulnerable groups benefit especially from attending preschool. It is thus likely an effective means of improving the proficiency level of children with an immigrant background.

Children with a non-immigrant background and children with a foreign background have attended preschool about equally often. But the PISA data show that the time spent in preschools is shorter for children with an immigrant background. For example, second-generation immigrant children are underrepresented among children attending preschool for more than one year. The relationship between preschool attendance and test scores in PISA is stronger for children with a foreign background than for children with a non-immigrant background. This indicates that measures encouraging immigrant families to let their children attend preschool is an effective way of reducing proficiency differences. For the same reason, the allowance for childcare at home is a subsidy that probably contributes to increasing the proficiency differences.

Good language skills are a prerequisite for success in all kinds of education and training. Schools can improve immigrant children's language skills through extra resources for language training. One indicator of the amount of extra resources is the number of training hours. Earlier research has shown that the number of training hours has a positive effect on the skills measured in PISA. When the number of training hours for children with a non-immigrant background is compared with the number for children with a foreign background, it is clear that schools are investing in extra language training for immigrant children. In particular, first-generation immigrants who came to Sweden after the age of six appear to be a high priority. The ratio between the number of hours of language training for immigrant children and the number of hours for children with a non-immigrant background is one of the highest among the countries studied. There is also extensive extra language training outside ordinary school hours in Sweden. But in Sweden the number of school hours in Swedish for immigrant children is still small compared to other countries (and their native languages). This is primarily due to the generally short school day in Sweden. This may justify putting even more effort into extra training for immigrant children in order to provide sufficient allocation of time.

Private schools and, in particular, the voucher system distinguish the school

system in Sweden from that in other OECD countries. Earlier Swedish studies have shown that the independent schools reform had a small, but positive, effect on students' results. However, segregation of students with different backgrounds has increased. It seems that families with a non-immigrant background tend to exploit the opportunity to switch to better-performing schools to a greater extent than families with an immigrant background.

PISA data show that there is more segregation in schools according to immigrant status in Sweden than in many other countries. Moreover, school segregation – as in many other countries – is increasing. However, the level of segregation is still lower than in for example the United Kingdom and the United States. Increased segregation is a cause for concern if it results in a concentration of children with a foreign background in less well-performing schools. Earlier American studies show that children from vulnerable groups are more adversely affected by low-performing schools than children from other backgrounds.

Although the Swedish school has succeeded relatively well in improving immigrant children's proficiency, it is unrealistic to expect schools to succeed in completely bridging the proficiency gap between people with a non-immigrant background and people with a foreign background. A large share of new refugee immigrants are too old to attend Swedish schools and those who are of school age are also socio-economically and linguistically disadvantaged. A substantial proficiency gap between people with a non-immigrant and people with a foreign background will therefore probably persist in Sweden.

## Active labour market policy and labour market prospects of the foreign born (Chapter 6)

The labour market in Sweden has little wage dispersion and relatively few low-skilled jobs. Active labour market policy has played an important role by retraining low-skilled workers in stagnating sectors with low productivity and enabling them to move to expanding sectors with higher productivity.

In the past, this model has worked quite well, but the large differences in skills between natives and many of those born abroad currently put considerable strain on the system. Of those registered at the Swedish Public Employment Service (*Arbetsförmedlingen*), the share of people born abroad has increased from about 20 per cent in 2005 to almost 55 per cent today. An even larger share of the participants in some active labour market programmes are born abroad. In October 2016, 62 per cent of those in a work experience placement (*arbetspraktik*) were born abroad. Similarly, the corresponding figures for labour market training (*arbets-*

*marknadsutbildning*) and new start jobs (*nystartsjobb*) – the largest employment subsidy – were 60 per cent and 63 per cent respectively.

The growing share of foreign-born participants in active labour market programmes is primarily due to measures for newly arrived refugee immigrants. Labour market and integration policies have in practice merged. This follows not least from the Public Employment Service's assumption of responsibility in 2010 for establishing refugee immigrants in Sweden.

Both Swedish and foreign research indicates that employment subsidies are important for immigrants' integration into the labour market. As the employment gap between foreign born and natives seems to be due largely to differences in productivity, this is a reasonable conclusion. One risk associated with large employment subsidies, however, is that they displace regular jobs – either for those people who receive the subsidy or for other workers.

An alternative to compensating for low productivity with wage subsidies provided by the government is labour market training to improve qualifications. This involves less risk of displacement than most other labour market programmes. But labour market training currently seems to work poorly for all groups. Nor is there any strong evidence in Swedish or foreign research that it would be a particularly suitable measure for newly arrived refugee immigrants and others born abroad.

Work experience placement appears to be a more effective programme than labour market training and also should have smaller deadweight effects than employment subsidies. The magnitude of the employment effects for the individual of the work experience placement has, however, diminished over time and appears to be smaller than that of employment subsidies. Employment subsidies thus remain the labour market programme apparently most capable of tackling the integration challenges despite their deadweight effects. However, if people with a stronger position in the labour market are displaced, this is not a serious problem.

There is also strong evidence of significant positive effects from expanding placement services, particularly for newly arrived refugee immigrants. With intensified placement services, labour market policy can compensate both for refugee immigrants' lack of a social network and exposure to discrimination. But reforms to improve the Public Employment Service's job matching have already been carried out and the question is how many low-hanging fruits there still are.

There is scant knowledge about the employment effects of the validation of immigrants' earlier qualifications. However, research in Germany indicates that improved validation procedures are likely to have positive effects. But because the Swedish labour market already seems to reward the skills of the foreign born relatively well, better validation procedures will probably not have large effects.

Finally, there is very little evidence to indicate that the Government's new

employment subsidies, known as extra jobs (*extratjänster*) and trainee jobs (*traineejobb*) in the public sector will lead to more regular employment in the long term.[1] Findings from both Swedish and foreign research generally suggest negative employment effects from work practice and employment subsidies in the public sector.

## Employers' use of employment subsidies and attitudes towards them (Chapter 7)

According to Chapter 6, there is reason to believe that employment subsidies for newly arrived refugee immigrants, others born abroad and the long-term unemployed are more effective than other labour market measures in increasing employment in these groups.

*Types of employment subsidies*

Figure 3 shows that the total number of subsidised jobs have fluctuated between 50 000 and 60 000 per month since 2011. Those in new start jobs form by far the largest category, about 50 000, while those in step-in jobs (*instegsjobb*), less than 3 000, form the smallest.[2] About 10 000 people have special employment subsidy jobs (*särskilt anställningsstöd*).[3] In addition to the three employment subsidies described above, vocational introduction employment (*yrkesintroduktionsanställningar*), trainee jobs (*traineejobb*) and extra jobs (*extratjänster*) have been introduced. In December 2016, these had a total volume of about 2 900 employees.

In particular, great hopes have been attached to employment subsidies combining jobs with training and/or mentoring – vocational introduction employment, trainee jobs and step-in jobs – because these subsidies are likely to be especially effective in improving participants' employment prospects, not only in the short term but also in the long term. However, it has proven remarkably difficult to achieve any large volumes for these programmes. This is especially true for vocational introduction employment. One explanation seems to be the complexity of this type of employment: it assumes sector-specific collective agreements that may be difficult for the employment services staff to understand. There are also many administrative demands on employers to draw up training plans and follow them up. Another factor adding to the complexity is that the jobs must also be app-

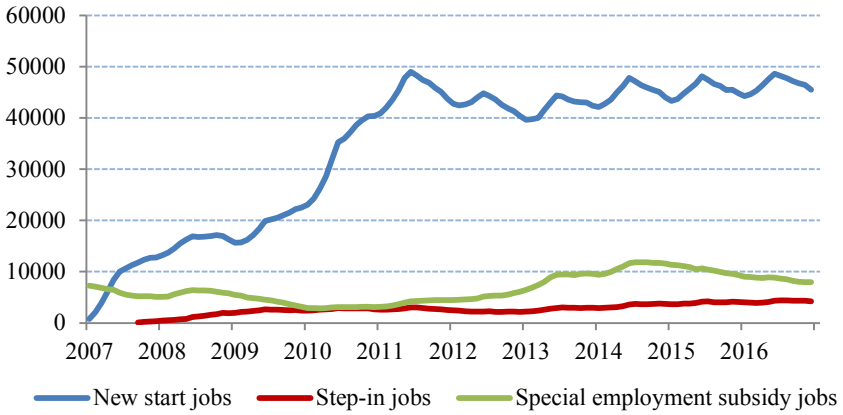
[1] The Public Employment Service translates "extratjänster" as "special employment subsidies."

[2] The Public Employment Service translates "instegsjobb" as "entry recruitment incentive" jobs.

[3] The Public Employment Service translates "särskilt anställningsstöd" as "special recruitment incentive."

roved both by the Public Employment Service and by trade councils composed of the social partners.

**Figure 3 Participants in new start jobs (*nystartsjobb*), step-in jobs (*instegsjobb*) and special employment subsidy jobs (*särskilt anställningsstöd*) at the end of the month**




*Source:* The Swedish Public Employment Service.

*Our survey of employers*

One pertinent issue is why employers do not make greater use of employment subsidies. One reason may be that employment subsidies themselves may have a stigmatising effect by labelling potential participants as problem cases. Another possible explanation is that the subsidies and contacts with the Public Employment Service are seen as complicated. It has also been argued that the many different forms of employment subsidies make it difficult for everyone – employers, public employment service officers, and jobseekers – to keep tabs on what currently applies. Other explanations are that the subsidies are only temporary and thus cannot compensate for permanent low productivity on the part of those hired. Finally, some employers may have an unfavourable view of subsidies as a matter of principle.

However, not so much is known about why employers do or do not use existing subsidies. To shed light on this issue, the Council conducted a survey of a large number of firms about the use of employment subsidies and attitudes towards them.

The following are the survey's most important findings:

- According to firms that have used employment subsidies, the deadweight effects (employing the same people one would have without subsidies) and substitution effects (employing a person eligible for a subsidy instead of another person) are quite small. As much as 55 per cent of the companies that use employment subsidies state that they have hired people they otherwise would not have employed. This figure is significantly higher when employees have been hired with the help of the special employment subsidy rather than with other forms of support.
- More than two thirds of the firms using subsidised employment state that they have done so for reasons of social responsibility. This is particularly true when the special employment subsidy has been used. Firms may possibly exaggerate their altruistic motives. But the figure is nevertheless so high that it may be an argument for trying to encourage firms to use subsidised employment specifically for social reasons.
- The most common reason for not using the subsidy was firms' belief that those eligible for support did not have the required skills.
- A surprisingly large number of firms that have not used the subsidies – 23 per cent – say that they were unaware of the possibility. The figure appears credible as other surveys report similar results. They provide a strong argument for more information initiatives and possibly a simplification of the subsidies to help communicating them easier.
- Remarkably few of the firms that have used employment subsidies – only about 12 per cent – think that contacts with the authorities were too demanding. In contrast, almost a quarter of the firms who have not used the subsidies think that the contacts would require too much work. Here, improved information could also increase willingness to hire using subsidies.
- On almost all points, firms that have not used employment subsidies have more negative expectations than firms that have used them. This applies not only to contacts with authorities, but also to the likelihood of finding suitable staff among those eligible for subsidies, the need for mentoring, administrative difficulties in arranging education and training, and adverse effects on workplace dynamics. It is difficult to know whether this is due to self-selection; that is, the firms where subsidised employment would work best are the firms that have used it, or whether firms who have not used employment subsidies have misjudged them. The latter interpretation appears to be valid because differences in attitudes persist even when controlling for observable firm characteris-

tics and because firms who have used employment subsidies have generally become more disposed to do so again than they were beforehand.

- Both actual and anticipated language problems appear to be the biggest obstacle to the employment of immigrants, significantly more important than inadequate job skills or insufficient knowledge about norms in the Swedish labour market. Hence, the primary focus should probably be on language training.
- According to the survey, the most important factor in getting firms that have not used employment subsidies to do so would be the opportunity of having a trial period before the agreement on a "normal" employment subsidy takes effect. The firms that have used employment subsidies also consider this important. The firms that have already employed people with subsidies say that they would expand their use of subsidised employment if the subsidies were larger and available for a longer time. The latter possibly indicates that permanent low productivity on the part of employees from weak groups is a problem (that temporary employment subsidies cannot compensate for). This interpretation is supported by the significant percentage of both the firms that have used subsidies and the firms that have not (15 and 12 per cent respectively) that say that lower gross salaries (which are likely to be more permanent than temporary subsidies) would make them more disposed to use subsidised employment.
- Both firms that have used subsidised employment and firms that have not would be more willing to use it in the future if the Public Employment Service took on responsibility as employer (over 20 per cent). Eleven per cent of the firms that have not used employment subsidies can envisage doing so if temporary employment agencies assumed employer responsibility while this percentage is only about 4 per cent among firms that have previously used employment subsidies. In view of the criticism often directed at the Public Employment Service for its poor contacts with employers, the figures for temporary employment agencies are surprisingly low.
- Less labour-intensive contacts with the authorities would make about 23 per cent of the firms who have not hired employees with subsidies willing to do so compared with about 16 per cent of those that have already done so. Having both no requirements for mentoring/training and better mentoring support would make about 20 per cent of firms in both groups more willing to use employment subsidies in the future.

One possible policy conclusion is that the Government and the Public Employment Service in cooperation with the social partners should initiate a broadly based campaign so that firms, recognising their social responsibility "in a unique situation when many new refugee immigrants will be entering the labour market", will undertake subsidised employment. Because the willingness to employ people with subsidies in the future seems to increase when firms have experience using employment subsidies, a successful one-off measure like this could have positive long-term effects on the willingness to employ people in marginal groups. There also appears to be much to gain having the Public Employment Service or temporary staffing agencies take employer responsibility in cases of subsidised employment, by enabling a trial period prior to ordinary employment with a subsidy, by reducing the requirements for firms to be responsible for mentoring and training plans and by simplifying contacts with the authorities. Better information on employment subsidies and the contacts required with authorities – which would probably be greatly facilitated by a reduction in the number of types of subsidies and the standardisation of the entire subsidy system – is also likely to make firms more favourably disposed to the use of employment subsidies.

## Reference:

Swedish Labour Policy Council (2016). Time for larger wage dispersion? – Summary of its report *Dags för större lönespridning?* Stockholm