

Lessons learned:

Labour Market Reforms in Sweden 2006-10

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Introduction

Today, Sweden is one of the few countries within the European Union which can boast continued growth, diminishing unemployment, a budget surplus and decreasing public debt, at least so far.

The Swedish finance minister was named No 1 of all finance ministers in Europe by the Financial Times in November 2011 and he was even called the “Swedish witch master”. Having known him since we were young teenagers, I must say it was well deserved, but I see such a distinction not only to be about the person, but rather a tribute to the years of reforms in Sweden since 2006.

When I stepped down as the Minister for Employment in Sweden in 2010 I was the longest serving Minister for Employment of all 27 member states within the European Union. It had been four intensive years, with a packed reform agenda in order to get people back to work.

Good reforms have both short term and long term effects. Our reforms strongly contributed to a much improved functionality of the Swedish economy and a better preparedness for economic turmoil. This report is a personal description on what we did and why.

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Why Reform?

After the election in 2006 the new centre-right government embarked on reforming the Swedish economy. It implemented a long row of measures geared towards increasing labour supply, making our labour market more efficient and thus reducing unemployment and increasing labour participation.

Why?

Simply because we had a situation a decade ago where one out of every five Swedes were outside the regular labour market or were working less than he or she would like to do.

Sweden is an economy where transition and mobility within the labour market is fairly easy; over a million jobs change hands in a normal year, despite the rather small size of the labour market.

It is also a stable labour market – the Scandinavian model has delivered few strikes and conflicts. And finally, it is a labour market capable of handling the effects of globalization and change.

When Ericsson cut their staff in Sweden in half almost 10 years ago, not one day was lost to strikes and most of those laid off got new jobs in a reasonable time. The same happened in 2008 and 2009 when the car industry was especially hard hit.

But thresholds **into** the labour market are too high and thus labour market exclusion has been a real problem for a long time.

This is unacceptable – both for political and economic reasons, and was at the core of how/why we prepared for the political reforms we later implemented.

These reforms had one single and clear political focus: full employment. Our battle cry was simple: “All those who can and want to be in the labour market must have a chance to be included.”

“Full employment” is for the economist what Nirvana is for the Buddhist: a utopia that is well-nigh impossible to achieve. Instead, economists speak of “natural unemployment”, frictional unemployment and so on. And it is true, of course - full employment in its absolute sense is probably not possible to achieve.

But as a politician there is nothing else to strive for. If a politician would start to define what is “natural”, he or she would have to provide an answer as to who should be left on the platform. And if one has an ethical approach to work as tool for self-expression and participation, is it an impossible task to define away anybody.

It is my, perhaps utopian, goal: that everyone should have a job to go to, a wage to live on, a work where they feel secure and a future which they are able to influence and shape.

We tried to achieve this by a three pillar strategy: a) making it more worthwhile to work, b) making it easier and cheaper to hire people and c) improving matching in the labour market.

Under these pillars, we put forward a very long list of reforms. One of the most important was a tax reform, geared at the low and middle income earners, in some cases reducing net margin effects from over 80 percent to around 30 percent.

The result has been dramatic in terms of decreased equilibrium unemployment and increased labour supply – and has left ordinary workers with the equivalent of a month’s extra pay.

We tightened our unemployment benefit insurance system – increased premiums, reduced dividends towards the end of the period (in effect introducing an outer parenthesis), put harder demands on people to enter into the system, and finally made sure that our active labour market programs were synchronized more with the later and lower stages of benefit payouts.

We also changed our disability pension system and introduced a much improved system of rehabilitation activities, connected to financial incentives for individuals returning to the labour market.

In addition to this, we introduced reduced payroll taxes, especially geared towards the weaker groups on the labour market, effectively reducing thresholds for entering and re-entering into the labour market.

We also improved on the business climate, both by lowering taxes, abolishing wealth tax and inheritance tax, cutting red tape and improving on legislation and education.

The result

As a result of these policy changes, prior to the crisis of 2008-09, Sweden had the fastest falling unemployment rate in the entire OECD area.

We were breaking records in the numbers of hours worked, in labour participation and in employment, and had historically low unemployment. Young people, immigrants and those with disabilities were returning to the labour market faster than the average.

In the spring of 2008 one person every fourth minute left exclusion and returned to the labour market, making this policy of reducing exclusion comparable with the Clinton reform years in the 1990s.

In the Article IV Consultation in 2006, IMF wrote on Sweden: “The government has embarked on a course that is both courageous and necessary. It is courageous because it confronts some long-held beliefs and vested interests. It is necessary because it will help ensure that the much-admired Swedish model of an inclusive society thrives in the face of challenges in demographics and globalisation.”

And the OECD wrote in its Economic Outlook 2007 on Sweden: “The labour market reforms implemented this year will increase potential employment. Given the strength of the economy, it is an excellent time to pursue labour supply reforms as that will prolong the current expansion.”

The current expansion was curtailed by the crisis in 2008-09 and the one we are facing now. Both have had a major impact on a small open economy such as Sweden’s. But Sweden faces these problems from a much stronger position, due to the reforms we implemented in 2006-10.

The latest statistics show Sweden's growth at 4.6 % of GDP (year on year, Q3/2011), unemployment at 7.5 % (Oct 2011), a small budget surplus and public debt at 34.8 % of GDP.

In the OECD survey of Sweden in 2011, the conclusion is clear:

“Sweden has weathered the recent global financial and economic crisis well thanks to strong economic institutions and fundamentals, not least a sound fiscal position. The main challenge going forward is to strengthen institutions and fundamentals even further so as to keep enhancing resilience and sustainable long-term growth. (...) Past reforms and measures taken during the crisis have limited the fall in employment and exits from the labour market.”

The lessons learned seem to be that reforms are both necessary and good, both in the short term and the long term.

The Fight Against Exclusion

First and foremost, exclusion has a purely human cost. If one, just as I do, has an ethical approach to work, it is unethical to organize society so that a large proportion of the population are denied opportunities to participate, be denied the right to work and support themselves, to be able to feel needed.

Secondly, it is incredibly costly. Any person who is depending on the government for their livelihood costs thousands each day, money that obviously could be used for other important things: school, health care, a functioning juridical system and so on.

And thirdly, each person in isolation corresponds to a dropped opportunity. Every single person who goes from being excluded to being a taxpayer represents a person that is included and contributes to the common good, for growth and prosperity. And it also means that we become better equipped to help those who really need our collective support.

One should also have our demographic challenges in mind. At a conference that Sweden held as presidency country of the Nordic Council of Ministers in October 2008 one of the starting points was that Swedish labour supply

needs to increase by an equivalent of 300 000 people in coming decades if we are to maintain economic standard.

The practical conclusion is that more people have to work harder and longer, the entry into working life must occur earlier than it does today, that withdrawal should take place later in life, and that participation must increase if we are to be able to afford the same or better level of economic standard that we have today.

In order to do something about these problems, one must of course first know what has caused the present situation. While analyzing the situation, we found several reasons that explain the large amount of people whom have been excluded from the workplace: the great number of early retirements, sick leave, taxes and the marginal effects, the design of the unemployment insurance, a persistent mismatch in the labour market and a poor business climate were some of the problems we wanted to try to solve.

Our main efforts had to be focused on the supply-side to try and lower the threshold into the labour market. In the end it was and still is mostly about the ways of making it profitable to work, reducing the so-called marginal effects, so that especially low and middle income earners will get more money left in their pockets.

It may sound as if we only focus on the financial incentives, but that is certainly not true in my opinion. However, at the same time it is quite natural to start there. If it for larger groups in the Swedish labour market was worth very little, if even worth anything at all, to leave exclusion and unemployment, it is natural that fewer in these groups choose to do so.

And the other way around: when it pays off to work, more people will take the jobs that actually exist today. And when that happens, more people leave benefit dependence and become taxpayers instead. That will in turn, viewed in a simplified way, lead to an increased demand that will create opportunities for more companies to grow and hire.

It is also about the importance of getting a foothold in the labour market. Even if the first job may not be a dream job with a dream salary, it is by having a job one more easily get to the next one. It is always better to have a job than not having it.

If one intends to increase labour supply, it is not unreasonable to begin from where you are. So we needed to look at the composition of outsiders and see what political actions that might increase people's willingness and ability to work.

During the Social Democrats last term of office (2002-06) about 140 people went into early retirement or disability pension every day. What previously had been a last resort for the permanently incapacitated had become a long-term car park for failed labour market policies.

This trend started after the financial crisis Sweden experienced in the 1990's. To give early retirement to thousands of people who belonged in the labour force was a way for the government of the time to cover up high open unemployment, and suddenly we had over 12 percent of the workforce in early retirement - among the highest rates in the world. At its peak, Sweden had over 550,000 people on disability pension.

At the same time the number of people on sick leave had increased substantially for several years. The Swedes – a people who are one of the healthiest in the world - was also one on sick leave. It was mostly the diffuse disease diagnoses that increased the most: burnout, back problems and stress symptoms. It seemed as if people were increasingly unhappy at their workplace, and increasingly unhappy with their lives.

One of the reasons reason for this large exclusion in society is to be found in high marginal effects in the economy. These marginal effects are about the combined effects of wages, taxes, benefits, entitlements and other things that affect individuals' finances. The recognition of the high marginal effects came to be the basis for many of the reforms that were implemented from 2006 and onwards. The earned income tax credit and the changes in the unemployment insurance are the two clearest examples.

A study that was published in DN Debatt (a daily paper op-ed), on 10 February 2005, showed that nine out of ten Swedish women lost money when working. Compared to the sickness benefit women employed in the health care sector lost close to 1000 SEK per month after taxes. Reality cannot be described any clearer than that. There was so little difference between living on ones working wage and living of benefits of various kinds that it was not worth being employed for large groups in society. Some individuals even lost money.

Starting Points

When we in the Moderate party started our analysis of economic policies after the elections in 2002, it was obvious that the labour market had undergone drastic changes. As recently as in the 1970s it had appeared that the labour market was the crown jewel of the Swedish model. While unemployment rose in the majority of other industrialized countries during the 1980s it continued to be at lower levels in Sweden.

The Swedish model, with a comparatively high degree of centralized wage setting and active labour market policies, appeared to be very successful from an international perspective. In retrospect, it was found that wage formation was not working and that labour market policies were unable to improve the employability of the unemployed. In order to curb unemployment it was required to have recurring devaluations and an expanding public sector that took care of the potentially unemployed.

In the beginning of the 1990s the Swedish economy crashed. Several years of excessively high cost development in relation to the world led to a dramatic cost crisis and interest rate shock. The domestic economy was pushed hard by rising real interest rates, prices for real estate dropping and the crisis in the banking system. We reached a debt-deflation spiral in the financial economy and an unemployment spiral in the real economy.

Because economic policy had to be rearranged and focused on fighting inflation, while the public finances were decontaminated, weak international demands could not be met in the customary manner with adjustment policies by the state. The underlying problems in the labour market were now visible, with all their might. The unemployment rate quadrupled in a couple of years from just below two percent to almost eight percent.

It was during the second half of the 1990's that the development of the labour market became more favourable. The shift in economic policy during the early years of the 1990s had begun to bear fruit. Deregulations that improved the functioning of a number of markets had been implemented and economic recovery was boosted by a strong global economic upswing.

Towards the end of the 1990's employment rebounded and the unemployment rate fell to around four percent. But a series of political decisions were taken that in the long run would contribute to higher unemployment.

Among other things, the reimbursement rates in both unemployment insurance and health insurance were increased.

In the beginning of the 2000s the IT bubble burst, asset prices fell and real activity in the economy slowed. After that it took several years of very weak growth in the labour market, even when overall economic growth began to increase again. Many economists talked about "jobless growth", i.e. that the economy grew, but without any creation of new jobs.

Many analysts argued that the economic situation in the 2006 election should have favoured the then incumbent Social Democratic government. However, voters did not have as great reasons to vote for Social Democrats in the 2006 election as they had had before. Although growth was very strong in 2006, it had been weak during the first half of the term and had not recovered until 2004.

In addition growth did not generate any employment and instead unemployment rose throughout the whole period of 2002-2006. Between 1998 and 2002, unemployment fell, as measured by Eurostat, from 8.6 to 4.9 Percent of the workforce. From September 2002 to August 2006 it rose to 7.5 percent.

It was particularly troublesome for the Social Democrats and its supporting parties that unemployment declined in many other countries at the same time. Between 1998 and 2002, unemployment had fallen in Sweden at about the same rate as in other OECD countries.

During the period 2002 to 2006 there were many countries that had lower unemployment than Sweden. In 2006, Denmark, Norway, the UK, the US, Ireland, New Zealand, Canada and Austria, for example, had lower unemployment than Sweden.

No actions were taken to seriously reduce long-term unemployment during the last Social Democratic term. On the contrary, there came a series of decisions during the term of office which would contribute to a higher long-term unemployment.

In the election campaign in 2006 the Social Democrats misjudged the situation and argued that unemployment was low, when everyone in the electorate could feel the effects of the large exclusion. The key for the incoming

government was to focus on total exclusion rather than just open unemployment.

The economic deterioration during, and after, the 1990's crisis put a great deal of pressure on the Employment Service. These services were not designed for the influx of unemployed, at the same time as a new structure of the labour market emerged in which new skills were required. The sluggishness in the labour market resulted in vacancies not being filled to an extent greater than any time since the crisis in the 1990's.

This can be illustrated with a Beveridge curve, showing the relationship between vacancies and unemployment, including labour market programmes. Total unemployment in 2006 was nearly as high as in 1992, although the number of vacancies in relation to the workforce was more than twice as many. This means that the matching between vacancies and job seekers was worse in 2006 than it did nearly 20 years earlier.

Employment also showed poor development. It remained at levels well below those at the end of the 1980's. The number of people outside of employment had also continually increased. In the 2006 election there were just over 300,000 more people than average in the 1980s that were outside of employment. Those who were in labour were not fully employed. In addition to nearly a quarter of a million people that were unemployed, there were about the same amount who worked less than they would like to.

Those who were outside of the labour force, but who were both willing and able to work made up an untapped labour supply, which accounted for about 400,000 full-time jobs. There was a lot to do for a new government.

Problems with the Old Policies

Labour market policy must primarily affect labour supply. The high unemployment in the middle of the 2000's was explained by both a weak demand and an unutilized labour supply.

To enable the unemployment rate to decrease to a reasonable level it was therefore required to take measures on both the demand and supply side.

Demand is determined by monetary policy, through stabilization policy which - for good reasons - is delegated to the Swedish Central Bank. While fiscal policy can stimulate demand through tax cuts, the space is limited to

the extent that inflationary pressures arise. If the inflation target might be exceeded, the central bank will raise rates and tighten the economy.

It is therefore important that the supply side of the economy keeps pace with the demand. Measures to stimulate the supply side enables a less tight monetary policy and lower interest rates.

One of the main reasons for the high unemployment Sweden experienced was that the economic incentives were not strong enough to work. Another important reason that led to the rise in unemployment 2002-2006, despite economic recovery, was that the unemployment insurance system was not designed to help people back to work.

A third reason was that the Employment Service was not able to bring together jobseekers with the vacancies. Job seekers need not only the financial incentives in place, but also a comprehensive and effective support from a well-functioning Employment Service.

The high unemployment rate at the end of the 2002-06 term was also explained by the fact that labour market programmes were unable to increase the employability of job seekers on a sufficiently large scale.

Clear Targets for Labour Market Policy

Labour market policies are an integral part of overall economic policy. The general objectives of economic policy can be formulated in terms of structural objectives, stabilization policy objectives and distributional goals. The first goal mentioned can be expressed in terms of increasing the economy's long-term production capacity. For labour market policy that means that it should focus on measures to enable that unemployment is kept at a low level without generating a higher inflation.

The second objective means that labour market policies can be used to smoothen out business cycles. The third case concerns the groups that have a weaker foothold in the labour market, such as the occupationally disabled, immigrants or long-term unemployed.

The size of the equilibrium rate of unemployment is central to how high the growth can be in the long run. However, there is no exact measure of how high the equilibrium unemployment rate is; different calculation methods have their advantages and disadvantages. The difference between actual un-

employment and the long-term equilibrium unemployment is called cyclical unemployment. This varies with the business cycle and may be affected by stabilization policy.

The primary goal of labour policy should be to reduce the long-term, structural, unemployment. The task of conducting stabilization policy has for very good reasons been delegated to The Swedish Central Bank. In a situation when one has the deepest economic downturn since the 1930's, the focus must be changed to be more cyclical - for obvious reasons. This would then ensure that unemployment does not become entrenched and that as many unemployed as possible participate in activation measures.

Unemployment Insurance as an Insurance

After the change of government in the early October 2006, the government had ten working days to introduce a finished state budget for 2007. I have no space here to go into a constitutional debate, but I note that today's Swedish Constitution is not made to endure a change of government. It was a completely absurd situation – that in such a short time produce an entire state budget with announcements of a long series of reforms. Still, we managed, thanks to extremely good preparation and highly skilled civil servants.

One of the structural reforms focused on the restoration of unemployment insurance as an adjustment insurance. The reform was presented in the budget on the 16th of October 2006 and on the 2nd of November the Council on Legislation had reacted with their comments. On 16th of November 2006, we presented the bill to Parliament, and as of 1st of January 2007, the act was in force.

It became, to say the least, an awful row. I had to receive protest lists and organized demonstrations, op-eds were written, there were additional parliamentary debates and a I had to take part in an excessive number of media interviews and talk shows on radio and on television. Seldom has any political reform, so clearly presented before an election, come to be perceived as so unexpected.

But we sustained throughout the debate and implemented one of our main reforms which together with the tax reform were essential in reducing equilibrium unemployment and increase the return flow into the labour market.

Let me briefly describe our motives and our reasoning.

Unemployment insurance affects behaviour

Unemployment insurance affects, like all systems of insurance, the behaviour of those affected. Companies who are reconstructing their businesses know that the unemployed people's income is secure if the compensation is large. The social partners do not need to take the unemployed into as much consideration in contract negotiations when the terms for the unemployment insurance is generous and when they do not have to bear the cost of insurance themselves. The jobseeker knows that he or she need not accept a job if coverage is high and regulations are less strict.

It is well established in research, both theoretically and empirically, that the tendency to seek and accept offers, even if it involves a geographical relocation, increases if unemployment benefits are lower. Empirical studies also show that unemployed search more intensively for work when the benefit period is coming to an end.

A more generous unemployment insurance may also affect the way unions operate in wage formation. It is less costly in terms of unemployment for a union to enforce wage demands may mean that more members face unemployment when unemployment insurance is generous. Thus, wages can rise and unemployment will be higher in comparison to if the compensation is low.

Both Swedish and international studies show that a reduction in unemployment benefits reduces the number of unemployed and shortens periods of unemployment. While studies use different methods and the different countries in different time periods, the results are relatively stable. It is found in a rigorous compilation by the American researchers Krueger and Meyer from 2002 that decreasing unemployment benefits by ten percent reduces both the number of unemployed and the average period of unemployment by ten percent.

A Swedish study, by Bertil Holmlund (et. al.) in *The Economic Journal* in 2001, shows that reduction of the compensation rate in unemployment insurance from 80 to 75 percent expected to increase the proportion of people who move from unemployment to employment by about ten percent. It

should be noted that there also are studies showing weaker effects and connections. Given that research shows that a generous benefit in the unemployment contributes to higher unemployment, it was worrying that Sweden, in comparison with other industrialized countries, had one of the most generous unemployment insurance systems.

The financing of unemployment insurance is important

The Swedish unemployment insurance system is neither public nor is it compulsory. It is a private system (run by the trade unions for the most part) and subsidized by the government.

Despite the system being voluntary, about three-quarters of workers have coverage through unemployment insurance.

A high degree of self contribution in the system decreases the risk of over exploitation of the insurance. In a system where the state, through general taxes, pays almost all unemployment benefits, there is no mechanism to hold back wage demands, with the result that labour costs increase and employment rates decrease.

The unionization rate is high in Sweden, even if union membership varies over time and is cyclical. Somewhere over 80 percent of wage earners tend to be organized in a union, which means that the majority also has unemployment insurance coverage. Of course it is possible to remain outside a union and only be a member of an unemployment insurance fund. There is also, since 1998 an unemployment insurance fund, which has no direct connection to a labour union, nor is tied to a particular occupational group.

When we faced the problem of the financing of the unemployment insurance system in 2006, members' contributions to the unemployment insurance system covered basically only the cost of administration, in other words, only a few percent of the total cost of unemployment insurance. At the margin, the state subsidy was total, i.e.100 percent.

This means that the insurance was not affected by changes in unemployment. That meant, by extension, that collective bargaining on wages and other employment conditions could be concluded without taking unemployment into account. The cost of an unfavourable contract with respect to employment affected all taxpayers. In other words, if unemployment rose,

all were to pay, through higher taxes or reduced spending, all else equal. Put it another way, the actuarial element of the insurance was very weak.

One conclusion we drew was that increasing the individual premium paid to the unemployment insurance would likely contribute to lower unemployment and higher employment and, in addition, reduce the economy's inflation propensity.

Put together, all these aspects give evidence to us that the unemployment insurance system did not work well at all. The impression was rather that unemployment insurance in many cases acted as a permanent income insurance for those who had managed to enter the labour market.

Decreasing reimbursement rates in three steps

As long as the jobseeker himself can affect his ability to get a job, a gradual reduction in unemployment compensation is preferable. At the beginning of a period of unemployment, the jobseeker searches more intensively - trying to find a job before the payment will be reduced.

It was important to us that the de-escalating reimbursement rates were part of a package of measures which aimed to support the unemployed in their search for work. There had to be clear demands on the Employment Service to establish and continuously maintain personal contact with the individual unemployed.

The compensation introduced in 2007 was 80 percent of previous income (to a maximum of 680 SEK per day) during the first 200 days of unemployment and then reduced to 70 percent for 100 days. This created an incentive for those seeking employment at an early stage to search more intensively for jobs.

The total remuneration of unemployment insurance compensation would exist for 300 days. After that, the unemployed would receive “activity support” at a 65 percent level - provided that the unemployed participate in the job and development guarantee.

For adolescents under the age of 26 the time-limits are different. If a person has not signed unemployment insurance, but still has worked full time, he or she is entitled to a maximum of 320 SEK a day.

The Employment Services needs to focus on Jobs

It is not only pure economic incentives that determine how well the labour market functions. Also important is of course how we organize our efforts and how flexibility and adjustment in the labour market works.

It cannot be that our way of organizing the state becomes a stumbling block on the weakest persons' path back to a job. Instead, our task - the state's task - is to facilitate each individual's ability to enter, or return to, employment.

Thus, the question of how we organize our policy measures, our agencies, how we manage by objectives, becomes decisive. It became one of our major tasks after the change of government in 2006.

The starting point was a significant problem with matching in the labour market, problems that were accentuated by how the old employment service was organized. This often led to a feeling of abandonment. The agency itself had become more important than the people they were to serve.

Prior to 2007 the Employment Service in Sweden was part of a complex organizational structure. The Parliamentary Auditors, the Treasury and the Financial Management Authority had all directed strong criticism towards the structure contributing to a lower efficiency in overall labour market policy.

The Employment Services was organized both as a national agency and some 20 individual regional agencies directly reporting to the government. These bodies were led by boards which were made out of politicians and representatives of trade unions and employers confederations.

The political control of these agencies was a major problem which risked leading to an over-expansion of operations which could not be justified by economic trends. This was particularly clear at the end of the Social Democrats' last term when unemployment programmes were used frequently, despite a strong economy.

There was also a risk that politicians at the regional and municipal level influenced the distribution of resources in a sub-optimal way, from a national economic standpoint. The far-reaching influence of the unions ultimately

risked to lead to that the labour market policies became designed to mitigate the effects of unemployment that arose as a result of contract negotiations.

Additional problems with the previous system were that the parliament and the government did not define clear targets for employment policy. There were a number of different target levels, and a large number of different targets used in previous budgets, instructions and directions.

Many obscure and sometimes conflicting goals made it impossible to determine what and how many labour market programmes that needed to be initiated.

If one includes the overall goal of full employment, targets of 80 percent of employment and 4 percent in open unemployment, the aim for labour market policies to improve labour market performance, the six different business aims, operational aims of the agencies, data to make it easier for people with weak position in the labour market, to prevent segregation, integration, regional policy and EU objectives, we could observe four to five different target levels, and a total of up to 15-20 different goals. It was hopeless.

In the middle of this maze of agencies, aims, levels, and rules stood the unemployed person who to the best of his/hers ability had to attempt to weave a way through and get the help he or she needed. It was neither effective nor humane.

A complex hierarchy of objectives risks leading to conflicting objectives. It can also be difficult to understand the relations between different goals and levels of objectives as well as what different objectives are supposed to affect. Nor is it possible to evaluate the outcome from the impact of the taken policies.

It can also be questioned whether the old and unclear goals had been formulated based on a realistic idea of what actually could be achieved by using different measures, something that especially the Parliamentary Auditors noted.

In preparation for the 2006 election, it was obvious for us that it was natural to convert the Employment Service to a single agency and that the regional labour boards would be abolished. Decisions about how activities in the various regional labour markets should be designed should be a national

priority, especially since the old regional bodies did not correspond with regional labour markets.

On the 1st of January 2008 the reorganization was completed. It meant that the old National Labour Board was converted into one coherent body, the Employment Service.

The Employment Service's overall task today is to help job seekers find jobs, effectively bring together those seeking employment with those looking to employ.

The purpose of the change in structure was to achieve a more effective and uniform operation. The reorganization aimed at creating a better adaptation to local and regional labour markets, resources were to be optimized and the organization more flexible. The responsibilities would be clearer and greater credibility would be achieved because decision making would be based on the objectives and assessments of the labour market situation.

Politicians and representatives from unions or employers organisations were excluded from the board of the new Employment Service. A new management was hired. New policy documents were written with a focus on reducing excessive details. The aim was to clarify, streamline and focus the Employment Service's main tasks.

We also opened up for private procurement of active labour market programs. Today, over a third of all the activities in the active programmes are procured from private partners.

Labour Market Policies must be Effective

Sweden is, together with Denmark, one of the countries who spend the most on active labour market programmes. The effectiveness of these programmes has always been debated. There was no strong evidence that the old programmes did improve matching between job seekers and job opportunities.

Many of these programmes risked instead leading to a lower intensity of job search. We found that participants of these programmes were actually seeking fewer jobs during the time they were in the programmes.

However, there are other studies that suggest that labour market programmes can have positive effects in terms of labour supply, although results in some of the studies can be difficult to interpret. The increase in the workforce as these studies reported could partly be due to that more used participation in measures to qualify for a new period of compensation from unemployment insurance, an option that was removed in 2000.

I would still argue that the benefits of active labour market programmes clearly outweigh the disadvantages. It is not the labour market programmes in themselves that are the problem; the problem is how they are designed. There is also a tendency for these programmes to become more widespread during a recession than the economic situation requires. Similarly is down-scaling in an economical recovery often slower than warranted by economic development.

It was therefore necessary to reorganize the labour market programmes to support work-first principle fully and reduce the long-term equilibrium unemployment.

I am convinced that we need active labour market programmes, especially for those who are most excluded – not to rectify past mistakes in educational policy, but to rehabilitate individuals who are in isolation to enable them to more quickly get back to work.

Labour market programmes must therefore be structural and individual. They should build on what each individual actually can do - not on what he or she can't do.

This is why the Government reduced labour market programmes for those unemployed who were close to the labour market in the boom period of 2006-2007. These unemployed should not be stuck in year-long training programmes, but should rather be encouraged to take the jobs available.

We started focused our resources instead on those who were far away from the labour market. As part of the “Job- and Development Guarantee”, which we introduced in 2007 and is offered to all after a year of unemployment, the resources are allocated to individual coaching, job training, job internship, and in some difficult cases subsidized employment.

We opened a new route back, through this Job- and Development Guarantee, for the long-term unemployed. For adolescents, we introduced a job

guarantee for young people which supports and activates the young people after just three months of unemployment.

The government has since lowered the threshold into the labour market for several groups who traditionally had difficulties in entering.

“New-start jobs” is an example. Under this programme, the employer need not pay payroll tax for a period equal to the time a long-term unemployed person has been absent from the labour market. A new-start job is not a benefit or an entitlement, but a right that you can exercise if you meet the criteria.

A new-start job is a job like any other, just that the government refrains from levying the payroll tax for a limited time. There is no cap in terms of salary - each and every job counts. Since its inception in 2007 every fifth new-start job has been granted to a person under the age of 24, nearly a third have gone to a person of a foreign origin and a quarter to people with disabilities.

Every other new-start job has been given to people who have been absent from employment for more than two years, a tenth to people who have been away for over five years.

Adaptability, Mobility and Flexibility

In 2007, 830 000 jobs changed hands in Sweden through the Employment Service. During the crisis year of 2009, 409 000 job vacancies were reported to the Employment Service. We know that about half of all jobs in Sweden are provided through the Employment Service which means that in a good year at least 1.5 million jobs in Sweden are exchanged and in a bad year, it is perhaps up to 800 000 jobs.

These numbers show the Swedish labour market is quite flexible and good at adapting to changing circumstances, at least for those who are already in the labour market.

I am absolutely convinced that the Swedish economy's flexibility is crucial to our future in an increasingly globalized world. It is a great quality in a globalized world, but also a result of a deliberate effort in a small, open, market economy country.

Adaptability and mobility of the work force is a counterweight against protectionism and stagnation, a kind of consensus on the need to allow Schumpeter's creative destruction to work through the economy because it eventually creates rising prosperity based on the conclusion that we cannot guarantee every single job, but we can and will strengthen the individual's ability to quickly regain employment.

Adaptability must be viewed in a larger perspective. The starting point is probably the traditional Swedish pragmatism to change, our ability to handle new events, our capacity to take advantage of development and make us more attractive as a country.

Swedish economic history shows us rapid change - but also very peaceful change. The Industrial Revolution during the second half of the 19th century, took Sweden from being one of poorest nations in Europe to becoming one of the worlds richest in a period of just 70 years. Much was based on liberal reforms; a public school reform, freedom of trade, credit laws, railway expansion, the Cobden-Chevalier Treaty on free trade.

These reforms, the Swedish engineering tradition and the emergence of what came to be world leading companies, all lead to an extremely powerful urbanization and industrialization.

Agriculture's share of the economy fell from 95 per cent to under 50 per cent in just a few decades. That is a huge shift, which occurred almost entirely without social unrest.

In more recent times, there are also plenty of examples of flexibility and adaptability in a peaceful labour market. When Ericsson cut its workforce by half in the early 21st century they did not lose a single day in strike or conflict. When Electrolux shut down its operations in Västervik in the early 21st century, the situation was similar. Only a handful of years later, lots of small businesses made Västervik into a model community where there are more employees in private firms than when Electrolux shut down.

The road to more and better jobs is not through protectionism but through using and embracing the opportunities that globalization offers.

Globalization and Change

International competition and interdependencies between countries increase over time. When country after country opens its market to international trade, worldwide growth is boosted.

In this respect, it is important to recognize that globalization is not a zero-sum game, in which the gains in one country are offset by losses in another.

Everyone can be a winner, both globally and nationally. More jobs and higher growth in Asia do not necessarily mean less jobs and lower growth in Europe for example.

Historically, Sweden has faced many of the same challenges that are today being created by the forces of globalization.

Being a small country building its wealth on the ability to export goods to the rest of the world, the Swedish economy has over the last century relied on open markets, free trade and the ability to adapt to changes to maintain competitiveness.

This is also why we so strongly oppose views that globalization should be met with protectionism and obstacles to trade.

A very colourful example of this point is the debate in Europe a few years ago concerning import-quotas on clothing made in China as a means of protecting European manufacturers.

When looking at how many hundreds of millions of Chinese shirts it would take to equal in value the export of a single Airbus airplane it is – to my mind – easy to make the case that the future for Europe lies in the Airbus end of the market – not in protecting an industry that has a hard time competing on its own merits.

Sweden is well placed to take advantage of the benefits of globalization. In comparison to many other countries, Sweden occupies a prominent position in many areas that are considered important in an internationalized economy.

One of the reasons is that being a small country we realized very early on that we needed and depended on the rest of the world for trade, know-how and peaceful development.

The share of export production is one measure of how internationalized a country is. Over the last ten years, Sweden has increased its exports from below 40 to almost 50 per cent of GDP.

Globalization is something that affects people's everyday lives in a very real sense. Of course, structural adjustments, which ultimately lead to more efficient division of labour and faster growth, can give rise to periods of unemployment and insecurity.

These situations require the provision of adjustment assistance to facilitate the acceptance of change. It is all about seizing the opportunities offered by globalization while combating any associated threats.

The direction of Swedish policy is therefore to promote competitiveness, while at the same time limiting insecurities for the individual.

This is best safeguarded by sustainable systems that can handle change – it is about protecting the employability of the work-force, not the protection of every single job.

But change for me is not just about enabling transitions for those already in work or those at risk of becoming unemployed, but also for those who are unemployed, absent from work because of long term illness and for those who are entirely outside labour market.

To me, therefore, primarily adaptability, or flexicurity as it is sometimes called in the EU context, is a concept that must be expanded to those who currently remain outside, mainly through lowering thresholds into the labour market, particularly for those furthest away.

If one should be blunt, one can say that we have good flexibility, adaptability and security for those already *in* the labour market.

But for those who are outside it seems as if the flexibility in recent decades mostly seemed about to go from open unemployment through various employment programmes and into early retirement or disability pensions. Such a model is not at all one of security in a changing world. It's about insecurity in isolation.

Experiences from Crises

In 2008 we faced the worst financial crisis the world had experienced in a long time. Swedish exports fell by 13 percent in one year. Banks were shaking, creditors worried and lots of people were laid off in just a few months.

But Sweden regained momentum rather quickly: the reforms we put in place did not hinder the effects of an international crisis, but it did make it shorter and less painful than it would have been otherwise.

It now looks like we are in for a double dip. The crisis of 2008-09 seems to be followed by one of 2011-12.

It is easy to be a bit worried. The future of the European economy is at stake and several of our member states have been in, or are in, deep trouble. Our financial systems are shaking and the effect on the real economy can be felt around our nations: growth is again coming to a halt and we risk going into yet another recession.

Our citizens are low on hope. Our businesses are low on confidence. And our politicians seem low on solutions.

There are quite a few Doomsday prophets around, and it is only fitting that the Mayan calendar, and indeed the world itself, is said to end on December 21, 2012.

But let us not overdo it. Let us remember that we have been through hard times before. We have prevailed before, and we shall do so again.

Winston Churchill once said that “success is going from failure to failure without loss of enthusiasm.” I believe that to be very true. We may fail and stumble, but the entire history of the human race shows us that we have been extremely adaptable and ingenious. We know how to handle change and we know how to get through it.

In my native Sweden, this was our seventh financial crisis since 1880. We not only survived the other six, but actually, eventually, came out of them stronger than before.

When I was the Minister of Employment during the crisis of 2008-09, I was obviously asked a lot of questions on the immediate crisis and the govern-

ment response. But I was also asked a lot of questions about the long-term future.

What are we going to work with in this country? Aren't low-cost countries threatening our production base? How can we renew ourselves to be able to compete in the future?

Again: we have the answer in history. We have done it before and we will do it again. As late as in the mid 1800's, Sweden was one of Europe's poorest countries. Yes, we were so poor that other nations gave foreign aid to Sweden.

Let me just give you one example: After a devastating fire in the city of Sundsvall in 1888, Uruguay felt compelled to send emergency aid to us. Just fifty years later, Sweden had turned into one of Europe's richest countries.

Uruguay has taken the other route. In the 1930's it was called the Switzerland of South America and was the world's fifth richest nation. Now it is muddling through, trying to keep its place in the middle.

My point is basically two:

Take no misery for given. And take no wealth for granted.

The Need for Reform

We now have two major problems: In the shorter term, the nations of the world need to gain control of their budget deficits and they need to stabilise their economies and financial markets. In the longer term, we need to get Europe competitive again, and we need to get people back to work.

Governments and international bodies around the world now focus on short term crisis management. That is what they are there for.

I was at the Ministry of Finance in Stockholm in the early 1990's, when we had a similar financial crisis. A housing bubble burst and banks collapsed. We came into a financial crisis and later a debt-deflation spiral, much as the one we see in the rest of Europe now.

By doing what was absolutely necessary – budget discipline, internal reform and joining the EU – Sweden eventually bounced back. Our budget deficit was closed and our foreign debt was slowly but steadily reduced.

The problem that remained, and still remains, is that previous governments used disability pensions or early retirement as “permanent parking lots” in the labour market. That was a huge mistake that we must never do again – and a great lesson for all of us.

Reforms in the labour market are needed not only in the short term, but more importantly in the long term. If they are done right, they will speed up recovery and will prevent us from falling deeper into recession in the next crisis.

Our problem in Europe is that our starting point was less than brilliant.

A hundred million Europeans were outside the regular labour market, even before the crisis. Of course that is not feasible. And there are three good reasons for it.

First, the cost of supporting a hundred million people excluded from the labour market is staggering. With budget deficits all over Europe, it is obvious that this cannot stand. Something has to be done.

Second, the opportunity cost is also staggering. We need these people in the labour force if we are going to be able to cope with pensions, health care and education in the future. It is such a waste, that these individuals are not able to contribute to growth and wealth.

But most importantly, having such a large share of our populations excluded from the core of society has an excessive ethic cost. Let me explain what I mean.

I believe there is an intrinsic value to work itself. Work is both good and right. It is right to fend for oneself and to contribute to the welfare of our families, our neighbourhoods and indeed our countries. But it is also good for you: we know for a fact that people who are working have better health, happier lives and live longer than those who don't.

It is rather simple actually: through work, we make it possible for ourselves to live off the fruits of our labour, we feel needed, a part of society, we gain

colleagues and friends and we make it possible to strive for our dreams and hopes.

Of course every job isn't fun and easy all the time, but that is another issue. There is no other way to personal fulfilment and empowerment than through having a job and being a part of working society. Or as Lebanese-American poet Kahlil Gibran wrote in the Prophet: "Work is love made visible."

So why aren't more people a part of the labour market?

First of all, I don't believe for a second that people are lazy or don't want to work. There might be one or two bad apples in the basket but the vast majority of people want a job. So what do we do about it?

I believe that increase in labour supply is the most relevant way to go. This means making sure students come out of school earlier, people retire later, and people work more, when they do work.

It may sound like an exceptionally difficult political proposition, and it is. But it is the one thing we know that actually works! When more people are entering into the labour market, more people will step by step have more money to spend. This creates an upward pressure on overall demand in the economy, and it's a demand that is economically sound. In the terms of 19th century French economist Jean-Baptist Say: "Supply creates its own demand."

I have heard a lot of people say to me: "Why don't we get older people off the labour market now, so the younger ones can have their jobs instead." I think that would be the worst possible thing to do.

All experience and research show that older and younger people in the labour force are not substitutes, they are complements. A labour market with lots of older people active will also have lots of younger people employed.

The alternative view is that there are a set number of jobs in the economy, a set number that politicians' should somehow hand out to people. Nothing can be further from the truth.

Jobs are created by entrepreneurs through innovation.

I spent the spring of 2011 as a visiting scholar at Stanford University in California looking into the links between innovation and jobs. It is obvious that innovation is the driving force for about three quarters of growth over the longer period. Whether innovation will turn into jobs is up to the policies we put in place, but the opposite is extremely true: economies that are less innovative will have fewer new jobs.

So a recommendation for every government would be to look into what could be done to foster and enhance innovation, and turning innovation into new jobs and new companies. Everybody is doing it, so the country that does not will definitely lose out in international competitiveness.

I think it is evident that such a strategy needs to start much earlier than we normally think. What is innovation really? Well, to put it simply it is creativity with customer value.

And creativity must be fostered from early on. I believe the next large area in need of real reform is the educational sector. We need to get away from looking at education as just teaching. It is much more about learning, and there is a big difference in that perspective.

Look at the ordinary school system. It's conservative, it's fragmented, it's deprived of price and choice as factors for performance, it's lacking in innovation and it's frankly not producing students who are innovative or even adaptable to change.

I believe there is no other sector today in greater need of a Steve Jobs than education. Someone needs to turn our schools inside out and make them into temples of learning and creativity, where children and students have ownership of their own educational challenge, where we stimulate our children to learn over time, to be innovative.

We have to stop letting schools just teach for the tests, and instead focus on helping children learn to for life.

Make no mistake: I'm not an educational hippie. I do believe in knowledge and grading and homework. But I also believe that no sector can survive and produce the right thing without changing with its times and needs.

A class room experience today is the same more or less as in 1912: 25 students and a teacher. The school year is still agrarian: arranged the way it was when 95 percent of children grew up on farms.

And it seems that money is not a solution. In the UK, the government has vastly increased its spending on the educational system in 10 years, and it is still not better off compared to the other OECD countries.

If we do nothing, we will see more and more students leave schools with no hope and no future. They will have an increasingly hard time finding jobs, and they will not have the ability to start their own companies or take charge of their own lives. This has to change for the future of our children.

So, to sum up: I believe there are four major reform areas that any government have to look into:

1. Fiscal prudence and **getting public finances in order** is a foundation for everything else. Göran Persson, former Social Democrite Prime Minister put it this way: “He who is in debt is not free.” Very true!
2. **Labour market reforms** in order to get more people back to the labour market. We would all rather have a lot of tax payers than a lot of recipients of benefits. There is a lot to do in this area, and a lot we can learn from each other.
3. **Innovation.** An innovative economy creates more jobs than a stagnant economy. Creating an innovative environment and support mechanisms are one of the most important things for long term growth.
4. **Education.** Innovation is not about gadgets or trinkets. It’s about creativity and adaptability to change. And that has to start early on in our schools. A true educational reform is key to making this happen.

If we manage to address these four areas, I am quite positive about Europe’s and indeed the world economy’s long term perspectives.