

## **Comment on Richard Jackman: What Can Active Labour Market Policy Do?**

Anders Björklund\*

Richard Jackman has as usual written a very stimulating paper with clear policy recommendations that are based on solid economic analysis. He has two basic policy conclusions. The first is that the provision of reasonably generous unemployment benefits calls for active labour market policies to counteract the disincentives to seek work and to acquire new skills. By offering temporary jobs and training programs to unemployed persons, potential misuse of benefits can be prevented. (I admit though that this general statement does not do full justice to his very insightful and innovative discussion of the role of labour market policy.)

The second conclusion is that the European countries in general and Sweden in particular ought to retreat, at least partially, from their previous wage policy and allow greater wage inequality in order to cope with the structural change that is taking place in the labour market.

I will comment on both these policy recommendations, but pay more attention to the second one that, in my view, needs to be reformulated somewhat.

### **I. Preventing misuse of unemployment benefits**

I think the first recommendation is quite correct and very important. From a Swedish perspective it might seem trivial. After all, we have had an arsenal of active labour market policy programmes for a long time. Further, these programs are implemented by the employment exchange

*\*The discussant is Professor of Economics at the Swedish Institute for Social Research, Stockholm University.*

offices, which also enforce the "work test" of the unemployment benefit system. The offices can offer both temporary jobs in programmes and training to the benefit claimants. A person who does not accept such job or training offers can be denied benefits. Hence, it seems as though Sweden is following Jackman's recommendation. To some extent we probably do, but I think that this important objective of active labour market policy is not emphasised very much in practice.

I have followed Swedish labour market policy for about 20 years and have had at least reasonably close contacts with officers at various levels of the National Labour Market Board (*Arbetsmarknadsverket*). Nonetheless, I have never heard an officer publicly say, or read any public document from the Board which states, that an important objective of active policies is to prevent the misuse of unemployment benefits. Actually, it is my impression that it is taboo to address this issue.

In my view, the National Labour Market Board should pay much more attention to this objective in the future. It is not a trivial one because it involves many difficult decisions and trade-offs, but that is also the reason why it needs much more emphasis within the organisation.

## **2. Greater wage inequality or more wage flexibility?**

I have some objections to the second policy recommendation. At least I think it must be reformulated somewhat. Jackman's conclusion is that more wage inequality is called for, whereas I would argue that it is more wage flexibility he has in mind. By more wage flexibility I mean that wages should become more sensitive to short- and medium-term changes in demand and supply. More wage flexibility does not necessarily mean widening wage differentials, in particular not in Sweden during the rest of the 1990s.

To begin with, it helps the discussion to imagine what changes in the Swedish wage setting mechanisms Jackman has in mind. He probably does not want more direct government involvement in wage negotiations. Rather he suggests that wages in a single industry, occupation, or even a single firm shall become more sensitive to market conditions, i.e., to the excess demand or supply that is prevailing in their segment of the labour market. This would probably come about if wage negotiations become less centralised than before.

Suppose now that this will happen. Would widening of wage differentials immediately take place? I am not at all certain about this. There are

at least two reasons why this may not happen, at least not during the next few years. Indeed one can point to some rather strong mechanisms that will tend to equalise wages during the rest of the decade. Further, these mechanisms will probably be reinforced if wage formation becomes more sensitive to market conditions. I will present some simple empirical facts in favour of this view.

A first argument is that industries that have been most severely hit by the crisis during the first years of the 1990s are high-wage industries with rather skilled workers. Therefore Jackman's model of structural change is too simple to describe accurately what is happening in Sweden. The industries I have in mind are construction and banking and finance. In particular, the former industry has very bad prospects for several reasons. It has been badly hit by the general recession, and some very high explicit and implicit subsidies that the industry has gained from in the past have now been eliminated or reduced.

These two industries, where wages are likely to lag behind in case of the proposed changes in wage formation, have had wages far above the average. In Table 1, I present very simple micro-data wage regressions with dummy variables for these two industries on data from the first half of 1991. It appears that workers in the construction industry had 10 percent ( $1 - \exp(0.095) = 0.10$ ) higher wages than workers of the same gender and age in the rest of the labour market. After controlling also for the human capital variables work experience and years of schooling, the "industry premium" for construction was as high as 14 percent ( $1 - \exp(0.131) = 0.14$ ). The corresponding numbers for banking and finance are 18 and 16 percent.

If wages in these industries lag behind those in other industries, the immediate effect is obviously a more equal wage structure. Of course, it cannot be ruled out that after a couple of years, wages will fall so far below the national average that overall wage dispersion will rise. My point is just that higher wage flexibility is not *necessarily* the same thing as wider wage differentials.

The second reason for my doubts is that the supply side of the Swedish labour market is not taken into account in Jackman's analysis. I think the Swedish labour market is facing two rather marked structural changes from the supply side that most likely will reduce wage differentials, or at least counteract the forces from the demand side that might take us in the same direction as the United States went during the 1980s.

First, I believe that a continuous equalisation of the educational level of the Swedish labour force is taking place and will be magnified during

**Table 1. Coefficients for construction and banking and finance industries in micro wage equations from 1991**

Dependent variable: log of hourly earnings  
Standard errors in parentheses

Industry	Regression with age, age squared and gender	Regression with age, age squared, gender, work experience, work experience squared and years of schooling
Construction	+0.095 (0.019)	+0.131 (0.017)
Banking and finance	+0.175 (0.023)	+0.158 (0.021)

*Source:* Own estimates based on Swedish Level of Living Surveys

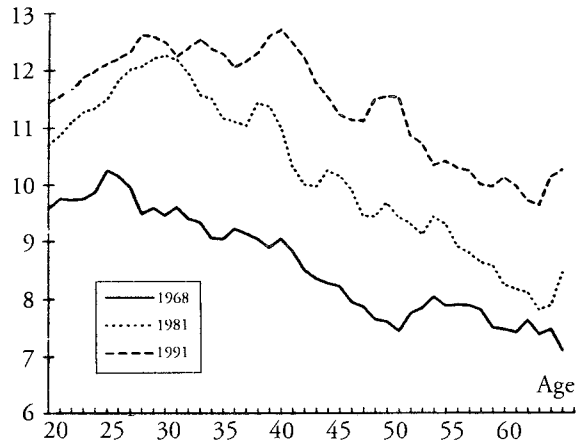
the 1990s. The reason for this equalisation is that the reforms of the educational system during most of the postwar period have tended to make schooling more equally distributed among the labour force. During the 1950s and 1960s the minimum length of schooling was increased from six or seven to nine years, during the 1980s it was (in practice) increased to eleven years and in the early 1990s it was further increased to 12 years. Over the same period the length of study for typical academic occupations like lawyers, advanced engineers and doctors hardly changed at all.

The effects of these reforms on the dispersion of years of schooling can be seen in Figure 1, where I show the average years of schooling and the dispersion of schooling by age of the Swedish employed labour force for 1968, 1981 and 1991. Panel A illustrates the gradual increase of the level of schooling from 1968 to 1991. The negative slope of the curves from the age of 30 and onwards captures the fact that more recent cohorts have received longer education than the older ones.

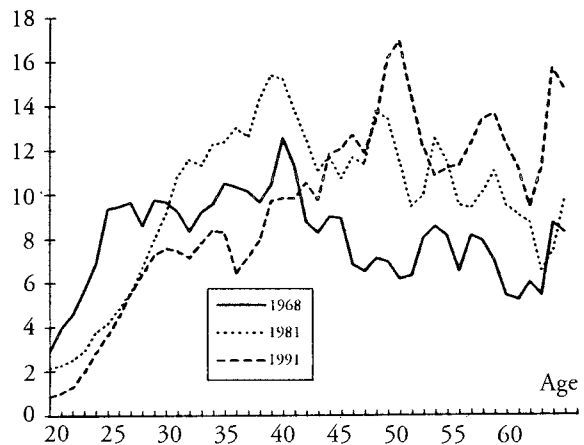
When looking at the dispersion of schooling it must be noted that the variance, which is used in the middle panel, is an absolute measure of dispersion that tends to increase when the level of the variable increases. The variance of the logarithm of schooling, on the other hand, is a relative measure and is not affected by the level. The situation in 1991 is particularly striking: whatever measure of dispersion we use, the level of dispersion for those between 30 and 40 years of age in 1991 was much lower than during previous years. These persons have completed most of their schooling and the rather low dispersion will most likely continue for these cohorts until retirement. Further, the dispersion for those above 55

**Figure 1. Years of schooling 1968, 1981 and 1991  
by age, means and variances**  
Employed workers, self-employed excluded

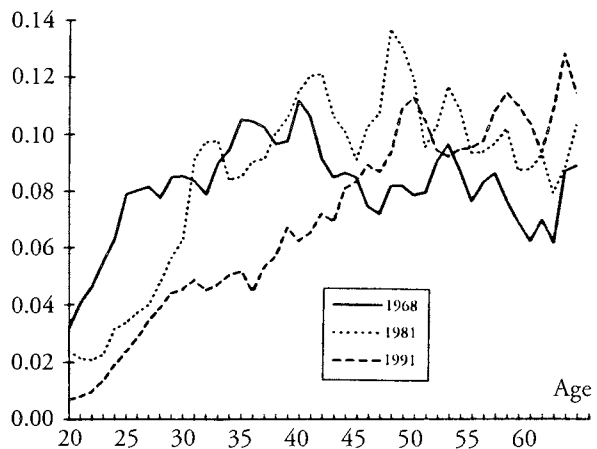
A. Average years of schooling by age in 1968, 1981 and 1991. 3-year moving averages.



B. Variance of years of schooling by age in 1968, 1981 and 1991. 3-year moving averages.



C. Variance of the logarithm of years of schooling by age in 1968, 1981 and 1991. 3-year moving averages.



Source: Swedish Level of Living Surveys

**Table 2. Inflow and stock of university students**  
Thousands and fractions of youth population

Year	Beginners at universities	Fraction of 20–24 year-olds in population	Full time (equivalent) students	Fraction of 20–29 year-olds in population
1986/87	41	6.8	125	10.8
1987/88	42	6.9	128	10.8
1988/89	44	7.1	129	10.8
1989/90	47	7.7	133	11.1
1990/91	50	8.4	143	11.7
1991/92	54	9.3	159	13.1
1992/93	58	9.9	178	14.5

Source: Verket för högskoleservice and labour force surveys

years, i.e., those who were born during the late 1920s and the 1930s, is very high. This is not surprising since typical schooling lengths for these cohorts range from six to sixteen years.

During the rest of the 1990s, these “high-dispersion cohorts” will gradually be replaced by “low-dispersion cohorts”. The consequence will be much lower inequality of schooling in the labour force; the relative inequality might even be reduced to half after the turn of the century. We know from estimated micro-wage equations that years of schooling is one of the strongest predictors of wages and hence an equalisation of years of schooling will most likely tend to equalise wages.

The second change on the supply-side of the labour market that is taking place is due to the quick expansion of the number of students during the first years of the 1990s. In particular, the increase in the number of study places at the universities will increase the supply of high-skilled labour during the second half of the 1990s. Table 2 shows some facts. The number of beginners at universities and full-time equivalent students was quite stable during the second half of the 1980s, both in absolute numbers and as fractions of the youth population. The first years of the 1990s, however, mark a significant increase in both absolute and relative magnitudes. Preliminary data suggest that the increase continued during 1993/94 and will do so also in 1994/95. It is hard to know how strong this increase is in a historical perspective. The only longer time series that I know of suffer from a structural shift in data in the late 1970s (Fredriksson, 1994). A glance at his series, however, suggest that the increase in the early 1990s is both strong and rapid in a long-run perspective.

If the demand for labour will be technologically biased in favour of

high-skilled jobs, as Jackman and many other economists predict, it will be quite interesting to study the race between supply and demand for university trained labour during the coming years. I am not sure that the speed of the change on the demand side will be highest. Actually, we might get a surplus of young academics during the second half of the 1990s with strong downward pressure on their wages as a consequence. That was exactly what happened in the early 1970s when the supply of university trained workers increased markedly (see Edin and Holmlund, 1992). As a consequence the return to schooling declined and so did the dispersion of wages. This is another case where traditional market forces tended to reduce wage differentials.

### References

- Edin P.-A. and B. Holmlund (1992), The Swedish Wage Structure: The Rise and Fall of Solidarity Wage Policy?, in R. Freeman and L. Katz, eds., *Differences and Changes in Wage Structures*, University of Chicago Press, Chicago, forthcoming.
- Fredriksson P. (1994), *Efterfrågan på högre utbildning i Sverige*, Ekonomiska Rådets Årsbok 1993, Stockholm.