

SNS Economic Policy
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Structural Transformation
of the Swedish Labor
Market: Consequences
and Policy Measures

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Summary

The labor market is in constant flux. International competition and technological progress cause employment to move towards firms with higher productivity. An effective structural transformation is a precondition for productivity gains and GDP growth.

Structural transformation typically leads to higher living standards. But it also creates winners and losers. The first part of this report examines the anatomy of structural change in Sweden. Which sectors and occupations have grown? Which have declined? How are different groups affected? How have wage and income dispersion evolved? The second part of the report deals with policy measures that may ease the process of structural change, with a focus on measures targeting groups that are negatively affected.

Over the past 40 years, the manufacturing sector's share of total employment has decreased significantly. At the same time, we observe a corresponding increase in private services, particularly financial services. These long-term trends are very similar across countries. As in other OECD countries, occupations that are easy to automate—such as office work where the education requirements are relatively low and industrial jobs—are declining in Sweden. There is growth in service occupations in general, and especially in occupations that require high education.

Projected future technological developments, such as those related to artificial intelligence (AI), are likely to affect different groups compared to recent waves of automation. For instance, AI is projected to replace white collar jobs to a greater extent, and thus may negatively affect highly educated workers, who have benefitted greatly from new technologies.

In general, we do not expect the Covid-19 pandemic to have lasting effects on the industry structure of the Swedish economy. Employees will likely work remotely to a greater extent, thus lowering demand for transport services somewhat. Online retail has grown, thereby reducing employment in regular retail stores. Overall, however, employment shares of the various industries will likely revert to previous trends, just as total employment has recovered fast after the pandemic.

The educational attainment of the Swedish population continues to rise, just as in comparable OECD countries. While wage dispersion and returns to education are still low by international standards, they have increased somewhat since 2012: The 90-10 wage ratio has increased by about 7 percent from 2012 to 2018, and the return to a college degree has increased by about one percentage point (per extra year of education) over the same period. The fact that the college premium rose, when the supply of college-educated workers grew substantially, points to a strong shift in labor demand towards this group.

The dispersion in disposable income has increased significantly since 2007 (and more strongly than the dispersion in wages), especially in the bottom part of the income distribution. This is in part because government transfers have not increased as much as wages.

Disparities in pre-tax incomes increased during the pandemic as income losses were concentrated in the lower part of the distribution. The temporary expansion of the welfare system made up for much of these losses, but a cause for concern is the high long-term unemployment rate among affected groups.

Structural changes have worsened the employment prospects mainly of low-educated workers, while the young and highly educated have benefitted. Mobility across occupations, sectors, and firms is an important adjustment mechanism. Mobility rates have remained relatively stable over time. They are lower among older workers, but do not vary much with education.

Reduced demand at the occupation level does not, on average, have large negative effects on workers. Many workers change to occupations with more favorable demand conditions, without suffering large income losses in the long run. Part of the transformation happens organically, as older workers retire and young labor market entrants avoid shrinking occupations.

The income losses from being laid off are lower in Sweden than in

many other OECD countries. The typical layoff in fact has no long-run effect on earnings. However, large layoffs, such as those caused by plant closures, are different: Earnings in the year following a mass layoff are reduced by 20 percent, and while they subsequently recover somewhat, the negative effects persist for many years.

It is relatively straightforward to predict which groups are most negatively affected by layoffs. Older, less-educated workers in the manufacturing industry who reside in rural areas tend to suffer the most. It is also relatively straightforward to predict which type of job loss events have the most negative effects: these tend to be large dismissals, in particular relative to the size of the local labor market.

Since we know well which groups are negatively affected by structural change, it should be easy to target policy measures towards those groups, and in good time—ideally at the point of receiving notice. The work of the Public Employment Service (Swedish: Arbetsförmedlingen) and the Job Security Councils (Swedish: trygghetsråden) should arguably be coordinated to a greater extent than is the case today.

Rather than trying to preserve jobs in shrinking sectors and firms, policy makers should address the negative consequences of structural change by helping workers find new jobs more quickly. During the pandemic, a subsidy for reduced-time work was introduced, and has since been made permanent. Such a subsidy may result in an unnecessary slowdown of structural change and thus contribute to lower productivity growth in the long run.

The so-called transition agreements (Swedish: omställningsavtalen) are a unique feature of the Swedish labor market. These agreements provide employees access to job search assistance and retraining. The possibility to take such measures already during the notice period has been highlighted by the OECD as a recipe for success. Additional measures should be taken to induce higher take-up of such assistance among the low-educated and older workers. These groups tend to overestimate the probability of finding a new job, so that they may not exert sufficient search effort during the notice period.

Notice requirements increase predictability for employees while reducing flexibility for employers. They force employers to take on some of the social costs associated with layoffs: A longer notice period reduces the time spent unemployed and reduces the earnings loss of

being laid off. However, excessively long notice periods can be a problem if employees are locked into unproductive activities. Overall, it is good that Swedish law stipulates notice periods rather than severance payments, and the latter are also rare in the collective agreements.

Employees on permanent contracts enjoy much stronger employment protection than those on temporary contracts. At the same time, the possibility to negotiate firm-level agreements makes the system more flexible than appears at first glance. Recent reforms may have changed the scope for such agreements. The so-called LAS agreement (Swedish: lag om anställningsskydd, employment protection law) implies that more people can be excluded from the last-in-first-out rule. However, the scope to negotiate exceptions to the rule seems to have decreased.

Unemployment insurance (UI) protects people from earnings losses. Benefit levels decreased continuously from 2002 to 2016 due to a nominally fixed income ceiling. This was partially reversed in 2016 and during the pandemic. In 2021, a median wage earner had a UI replacement ratio of 80 percent.

While structural change requires insurance, generous unemployment benefits tend to increase time spent in unemployment. This does not seem to result in better jobs upon exiting unemployment, however. Membership in unemployment insurance funds is voluntary in Sweden. Membership rates dropped due to a reform in 2007 mandating higher fees. This is worrying as it decreases insurance among vulnerable groups. Among low-educated workers, aged 40 or above, who were notified of a layoff, membership decreased from 97 to 92 percent as a result of the reform.

General education and training are not effective policy measures for those suffering from structural change: low-educated and older workers. These groups are less willing to participate in training and have a short period to recoup the skill investment. Retraining for them should consist of short courses closely linked to occupations that remain in demand. Recent evaluations of such programs provide evidence of their effectiveness.

The LAS agreement introduced very generous conditions for retraining, covering all employees who have been employed for at least eight years, regardless of type of contract. Subject to a ceiling, the government pays 80 percent of the previous wage. Such support is

unlikely to reach those who are most in need of retraining. It should be replaced by a much better targeted policy.

The Public Employment Service eases the adjustment to structural change by helping the unemployed to find new jobs faster, as case workers assist them in identifying suitable job vacancies (they sometimes even mandate job applications). The Public Employment Service is undergoing some changes which may affect this function. First, it increasingly uses AI-based job recommendations and online search tools. It is unclear whether these innovations reach the groups most in need of assistance. Second, it has become less present in rural areas. This means a reduction in support for some of the most vulnerable groups.

Mobility across occupations, sectors, firms, or regions helps people avoid income losses due to structural change. However, some groups face high mobility costs, which suggests an argument in favor of place-based policies. Investments in regional infrastructure are worthwhile because, among other reasons, they enable local firms to remain competitive. In contrast, using subsidies to attract new firms to shrinking regions risks prolonging an inevitable adjustment process. Evaluations of regional cuts in employer contributions suggest that these are ineffective in raising employment.

Some of the key institutions and policies meant to help workers adjust to structural change have not been studied as much as they should. For instance, there is only one study evaluating the activities of the Job Security Councils, finding no evidence of an effect on unemployment duration, but a positive effect on the duration of the subsequent job (which is consistent with better match quality). The activities of the Job Security Councils have not yet been evaluated. Better conditions—both in terms of data and research design—are needed to enable research on the role these Councils play in the Swedish labor market in general, and in particular to what extent they ease the process of structural change.

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