

**Comment on Lars Calmfors, Anders Forslund and
Maria Hemström: Does active labour market policy
work? Lessons from the Swedish experience**

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This well-written paper summarises evidence from micro-econometric and macroeconomic evaluation studies on employment effects of Swedish active labour market policy (henceforth denoted ALMP). The authors interpret the overall evidence of employment effects rather pessimistically and even find a negative employment effect of Swedish ALMP in the 1990s. The “costs” of the policy in terms of displacement and locking-in effects exceed its “revenues” in terms of a more efficient matching process, more efficient labour supply etc. In fact, there are few evaluation studies indicating positive employment effects of ALMP while there are many indicating negative effects. The large-scale programmes of ALMP in the 1990s have not promoted regular employment and the overall conclusion is: “The policies that were pursued are likely to have reduced open unemployment at the cost of also reducing regular employment.”

In the following, I argue that this conclusion is exaggerated and need not necessarily be valid for the 1990s as a whole. First, the conclusion is based on a period when the necessary conditions for evaluating ALMP were lacking, as the large-scale volumes of measures in the first half of the 1990s were not due to policy objectives. Second, a somewhat modified conclusion is implied if separating the evidence on the influence of ALMP on employment during the first half of the 1990s from other periods.

1. The objective of ALMP and large-scale volumes of measures

It is reasonable that any evaluation of the effects and/or efficiency of an activity such as ALMP is based on its objective(s). The authors’ point of departure is that “employment generation is widely consid-

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ered to be the primary aim of active labour market policy”... and is “...explained by generally rising ambition in employment policy”. This formulation of the objective deviates considerably from that found in official documents, where the stated objective for ALMP is to be a complement to general economic policy by promoting labour market adjustment.¹ The implication of this objective is that in downturns, the unemployed are temporarily employed and retrained to satisfy the demands of the regular labour market in the next upturn, i.e. the unemployed are kept employable. It is of crucial importance, however, that ALMP cannot directly generate new and permanent regular jobs but rather encourages general job creation in an indirect fashion.² On the other hand, ALMP may be expected to indirectly have a positive effect on regular employment by e.g. the positive externalities implied by increased matching efficiency, also a main theme in the paper.

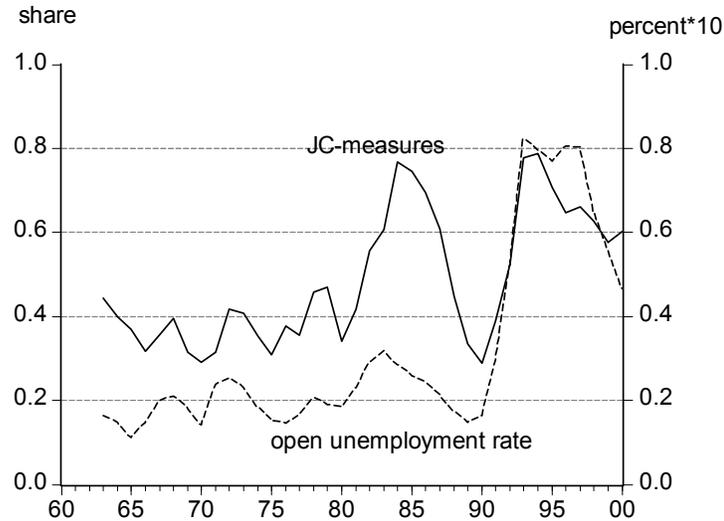
However, it cannot be excluded that officially stated policy objectives might differ from actual implemented policy. Studying the composition of its measures gives a basic idea of the actual goals pursued by ALMP. Let measures for labour market training (LMT) represent measures for promoting labour market adjustment and mobility while job-creating measures (JC)—which consist of several different kinds of measures over time—represent the discretionary part of ALMP. Figure 1 displays the evolution of the shares of these measures in the period 1963-2000.³ In the 1960s and 1970s, the composition of measures showed a stable pattern. The policy was largely in accordance with the ideas of the Rehn-Meidner model, with a focus on labour market training. However, since the beginning of the 1980s, there has been a pronounced countercyclical pattern in the evolution of the share of job creation measures. Relatively large increases in unemployment implied relatively larger volumes of job creation measures, whereas the evolution of labour market training measures remained stable (with the exception of a certain expansion in 1991-92).

¹ An exception is the 1970s when the general economic policy aimed at increasing the employment rate and also involved direct measures to firms intended to prevent unemployment. But in the following decades, it has once more been stressed that the aim of the ALMP is to promote labour market adjustment, with the additional motivation that this is of importance for a growth-oriented economic policy. Compare Zetterberg (1997).

² Cf Löfgren (1995).

³ Note that as the sum of the shares is equal to one.

Figure 1 **The share of job creation (JC) measures
and unemployment rate in Sweden 1960-2000**



Note: Share of job creation (JC) measure is defined as the ratio of job creation measures to the sum of job creation measures and labour market training (LMT).

Source: Participation in ALMPs: The National Labour Market Board. Unemployment and the Labour Force: Statistics Sweden.

These volume increases in job creation measures during the 1980s and the 1990s thus indicate an increase in the discretionary part of ALMP. Consistent with the authors' view, this might be interpreted as a growing ambition of ALMP that is shown by an increased endeavour to reduce the open unemployment rate when exceeding a certain level. An alternative interpretation is that the larger volumes of ALMP-measures were due to the fact that the labour market was exposed to relatively larger shocks than in previous periods and thereby, a larger risk of increased open unemployment. Indeed, these interpretations imply two different hypotheses on the reasons behind the large volumes of ALMP-measures at the beginning of the 1990s.

The first hypothesis is that if the primary objective of ALMP is to generate employment, as suggested by the authors, then "the unique Swedish experiment in the 1990s of using large-scale ALMPs "is part

of a planned strategy to increase regular employment.⁴ The second hypothesis is that since policy alternatives were lacking, the large-scale volume of ALMP-measures was the result of an adjustment to an unexpectedly rapid increase in the open unemployment rate that was “unacceptable” for political reasons. Instead of a complementary role, the ALMP was assigned a substitutive role in the general economic policy, i.e. a stabilisation policy role it was neither intended for nor had the capacity to tackle.

The two hypotheses have different implications for the interpretation of empirical evidence on employment effects of ALMP. According to the first hypothesis, the large-scale volumes are a result of an active and planned expansion of ALMP, with the aim of increasing regular employment. Evaluation should therefore be done on the basis of this target. According to the second hypothesis, the large-scale volumes are a pure anomaly where ALMP was not used in accordance with the real objectives of the policy, and thereby implying that the conditions for evaluating ALMP are lacking.

It is, of course, difficult to empirically test and discriminate between these hypotheses but, in my opinion, little support is found for the first. The large-scale volumes were not part of any long-term economic policy, but were rapidly introduced in a period when unemployment increased dramatically. Furthermore, the volumes were, to a large extent, implemented by a government consisting of liberal-conservative parties which are traditionally sceptical to ALMP-measures.

2. Different conditions for ALMP during the 1990s

In the light of the above observations, it is therefore reasonable to separate the evidence of the employment effects of ALMP for the first half of the 1990s from other periods. This provides a somewhat different picture of the evidence for the 1990s as a whole than that given by the authors. In contrast to the first half of the 1990s, the Swedish labour market displayed a considerably more favourable evolution in its second half. The unemployment rate and the volume of ALMP were strongly reduced, with a simultaneous increase in regular

⁴ Here, I disregard the case of generating temporary employment with the sole objective of reducing the open unemployment rate. If this were the objective, it would be rational to let the unemployed participate in the most inexpensive measures possible. But there is no support in the data for this case.

employment and the state of the labour market grew closer to that of the pre 1990 period.

It is thus not astonishing to find that the evidence from microeconomic studies based on data from various periods of the 1990s also differs. Studies based on data from the first half of the 1990s yield results indicating that the probability of becoming employed for program participants was similar to or worse than for non-participants. This implies that the combination of recession and rapidly increasing volumes of ALMP renders the measures inefficient. On the other hand, studies using data from the second half of the 1990s indicate more positive effects of program participation, particularly for job creation measures. The latter results are, to a large extent, similar to those reported in studies using data covering the period before 1990 which reflect an economic situation with normal levels of ALMP-measures. Thus, it is the evidence from studies covering the first part of the 1990s that considerably deviate from other periods. This should be taken into consideration when general conclusions are drawn on the employment effects of ALMP. At the same time, it should be pointed out that results from microeconomic studies do not contain as much information about the total effects of policy on regular employment levels as macroeconomic studies.

The macroeconomic studies are typically based on time-series data beginning in the early 1960s and, at best, including a few years in the 1990s. Among the few panel-data studies that investigate direct displacement, there are a couple of studies using data from the first half of the 1990s. To some extent, this is also true for cross-country comparison studies, even though the results from such studies are probably independent of specific Swedish labour market conditions at that time. In other words, with the exception of some panel-data studies, the evidence from macroeconomic studies mainly reflect the labour market conditions prevailing during the period before 1990.

The results from these studies are, as a whole, mixed and ambiguous as concerns the employment effects of ALMP. This conclusion does not change when the results from the few studies covering the latter part of the 1990s are considered.⁵ In addition, this picture is strengthened by my estimation results of the influence of ALMP on the Swedish Beveridge curve, using data including the 1990s. The

⁵ These studies are Forslund and Kolm (2000), Johansson et al. (1999), Johansson (2001) and Thomas (2001).

findings reported in Table 1 cover the periods of 1964-1990 and 1964-2000, respectively, and coincide with the result reported in Calmfors (1993). He estimates the corresponding equation for the years 1964-89. The estimates indicate that the presence of ALMP-measures do not seem to influence the efficiency of matching vacancies with the total number of unemployed.

Table 1. Estimates of the influence of ALMP on the Swedish Beveridge curve. Dependent variable: $\ln(r+u)$

Period	Constant	$\ln(r+u)_{-1}$	$\ln v$	$\ln \gamma$	LM(1)	LM(2)	R^2_{adj}
1964-1990	-4.29** (5.20)	0.570** (5.02)	-0.505** (5.89)	0.098 (0.63)	2.80	1.48	0.912
1964-2000	-4.47** (8.27)	0.568** (10.95)	0.531** (13.05)	0.096 (0.80)	2.43	1.69	0.980

Note: Absolute t-values in parentheses. ** and * indicate statistical significant at 5 per cent and 10 per cent, respectively. r , u and v are labour market programmes, open unemployment and stock of vacancies as a percentage of the labour force. The measure of ALMP is defined as $\gamma = [r/(r+u)]_{-1}$. Trend variables are included in the estimations.

Sources: Participation in ALMP-measures and stock of vacancies: The National Labour Market Board. Unemployment and the Labour Force: Statistics Sweden.

Thus, findings from macroeconomic studies—with the exception of studies on direct displacement—suggest that there is genuine uncertainty about the effect of ALMP on regular employment. The overall conclusion of the authors—that ALMP has probably decreased regular employment in the 1990s—is therefore based solely on the results from studies of direct displacement. The findings from the econometric studies based on data from the first half of the 1990s, however, suggest that only the use of youth programmes has large displacement effects in the long run.

There are not only considerable econometric problems in estimating displacement effects, but one may also question how “displacement” should be interpreted. Certainly, a displacement effect is a negative externality and should therefore be considered as a cost of an ALMP-measure. However, it might be misleading to merely mechanically report estimations of the displacement effect of a measure without closely defining the nature of the displacement that is, in turn, conditional on the objective function of the ALMP. If a measure

gives rise to displacement, that is, less competitive unemployed (low-educated youth or immigrants) become employed at the cost of more competitive unemployed, then it seems reasonable that its economic value of this should be considered. Consistent with this view, the authors also note that there is displacement that can contribute to positive employment effects “to the extent that employment of long-term unemployed (outsiders) crowds out employment of insiders”.

This means that it is difficult to estimate the economic cost of displacement effects without a closer specification of the objective function for ALMP, since an ALMP-measure entailing the risk of a high degree of displacement does not necessarily imply a high *net* cost. Accordingly, it is not evident how the displacement effects of youth programmes should be interpreted.

3. Conclusions

My main objection to the paper is that the overall conclusion drawn on the employment effects of ALMPs is primarily based on the existing evidence of the effects of increases in the volume of ALMP made in a state of panic at the beginning of the 1990s. The relevance of referring to evidence from a period when necessary conditions were lacking in evaluating ALMP in accordance with the objectives of that policy might be questioned. Whether long-term large-scale volumes of ALMP measures would be effective means to fight high and persistent unemployment, can therefore hardly be estimated on basis of the Swedish example and still, to a large extent, remains an unanswered issue. The focus on the ALMP-measures in the first half of the 1990s also implies that the authors more or less ignore the more relevant issue of which conclusions can be drawn from the employment effects of ALMP in an economic situation with more normal levels of such measures. After all, these are the underlying conditions valid for the greater part of the evidence on employment effects reported in the paper. The overall conclusion implied from this evidence is similar to that in previous reviews of ALMP, namely that there is genuine uncertainty as to its employment effects. In my opinion, it is of sufficient concern for ALMP that evaluation studies have difficulties in establishing unambiguous positive effects.

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