

Dominique Anxo
Harald Niklasson

The Swedish model: Revival after the turbulent 1990s?

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**Dominique Anxo
Harald Niklasson**

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International Institute for Labour Studies
Geneva

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ISBN Print: 978-92-9014-872-2

Web/pdf: 978-92-9014-873-9

First published 2008

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Requests for this publication should be sent to: ILS Publications, International Institute for Labour Studies, P.O. Box 6, CH-1211 Geneva 22 (Switzerland).

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Preface

Research on social models seeks to connect development paths, labour and social policy by analyzing complementarities and tensions between institutions in the areas of production, employment, industrial relations, skill formation and welfare within different national models. It draws on two influential bodies of literature in comparative political economy, concerned with the varieties of capitalism and of welfare regimes. Both of these literatures were initially built around OECD countries, but they are being expanded to cover developing settings as well.

The ILS Research Conference in November 2006 addressed the question of how national social models in Europe and Latin America have been changing in recent decades in response to globalization. Fifteen scholars from these two regions delivered presentations on individual national models as well as on cross-cutting issues and trends. Several of these presentations have been developed into discussion papers and articles forthcoming in the *International Labour Review*. Work is also under way to prepare two parallel edited volumes with in-depth country studies from each region.

The present discussion paper focuses on the Swedish social model, an important point of reference given that country's historical success in combining full employment with high levels of social protection, social dialogue and gender equality. The authors argue that far from being abandoned, the model has emerged from the deep crisis of the 1990s with key adaptations, which place it in a better position to continue delivering good outcomes with respect to these goals.

Dominique Anxo and Harald Niklasson are Professors of Economics at the Centre for Labour Market Policy Research (CAFO), School of Management and Economics, Växjö University, Sweden.

Gerry Rodgers
Director, International Institute for Labour Studies
August 2007

Summary

This paper analyzes the major transformations of the Swedish model, its welfare regime, employment and production systems. We argue that the current model appears to be more in line with the three core components of the original model developed during the 1950s than it did two decades ago. The changes in macroeconomic policy towards a more restrictive and anti-inflationary approach, the reorientation of active labour market policies towards supply oriented measures and the structural reforms undertaken in the tax and social protection systems during the 1990s suggest a *revival and renaissance of the traditional Swedish model*. The Swedish welfare state remains today, by international standards, clearly universal and inclusive in nature and still enjoys a high level of across-the-board political and public support. Modifications in the industrial relations system, in particular the clear tendency to a re-coordination of collective bargaining have also played a vital role in the recovery that followed the economic crisis of the early 1990s.

Introduction

The main objective of this paper is to analyse the major transformations of the Swedish model, its welfare regime, employment and production systems. Until the end of the 1980s Sweden was remarkably successful in combining low unemployment with high and growing employment rates and also with a high degree of income equality and small gender disparities. However, most economists and many policy makers were aware that the unprecedented activity level and the extreme labour market tightness during the second half of the 1980s were in the long run not sustainable. For many years inflation had been alarmingly high, and in 1990 it reached 11 per cent. In the early 1990s, the crisis became dramatic. In just three years—from 1990 to 1993—the rate of employment fell by 10.5 percentage points and the rate of open unemployment quintupled from less than two to more than 8 per cent of the labour force.¹ Furthermore, the annual government deficit reached 14 per cent of GNP, in spite of repeated ‘reform packages’ aimed at reducing public expenditure and increasing government revenues. The cutbacks in public spending, which principally took the form of lowering income replacement rates in various social insurance systems and reducing public-sector employment were considered by many citizens as a painful ‘rolling-back of the welfare state’.

It has been argued that what the country endured in the early 1990s demonstrates that the original Swedish model had become obsolete or ‘time inconsistent’ in the sense that it gave rise to developments incompatible with its long-run sustainability. However, such interpretations raise some critical questions. Is it true that the traditional model initiated during the 1950s has succumbed and that a fundamentally different, more coherent and sustainable model has emerged? What are the main differences between the current national model, the original model and the one that prevailed during the period 1975-1990?

We argue that the current model appears *to be in line* with the three core components of the original Swedish model developed during the 1950s. In our view, the period 1975-1991 represents a clear deviation from the original model, a departure that culminated in the most severe crisis that Sweden has experienced since the 1930s. After this period of turbulence, the Swedish economy has undergone a particularly favourable development. From the second half of the 1990s, GDP growth rates have returned to early 1970s levels; unemployment has been cut by half; there have been large balance-of-trade surpluses and public finances have improved substantially, posting a positive balance of 1 per cent of GDP in 2004. During the last decade, in strong contrast with the 1980s, the Swedish economy has also experienced low inflation.

The changes in economic policy towards a more restrictive and anti-inflationary macro-economic policy, the reorientation of active labour market policies towards supply-oriented measures and the structural reforms undertaken in the tax and pension systems during the 1990s suggest a *revival and renaissance of the traditional Swedish model*. The modifications in industrial relations, in particular the clear trend towards a re-coordination of collective bargaining, have also played a vital role in the recovery.

The various reforms of the social protection system undertaken during the 1990s have essentially taken the form of a temporary reduction of income replacement rates and, with the notable exception of the restructured tax and pension system, have left the welfare state almost intact. The Swedish welfare state remains, by international standards, universal and inclusive in nature and still enjoys a high level of across-the-board political and public support. The reshaping of the pension and tax systems aimed at strengthening work incentives are also clearly

¹ The data referred to in this paper are from Statistics Sweden, unless stated otherwise.

in line with the general philosophy of the original Swedish model favouring integrative transitions instead of passive support and social exclusion. In our view, these developments reinforce the coherence of the Swedish model and the robustness of its social cohesion.

1. The origin, rise and decline of the Swedish model

1.1 The 'traditional model'

From its creation in the early 1950s until the mid-1970s, the traditional Swedish model was based on three fundamental components:

(i) A restrictive fiscal and monetary policy aimed at curbing inflation in a regime of fixed exchange rates. Such an anti-inflationary policy was complemented by policy measures designed to preserve 'full and productive employment' by means of:

(ii) Wage moderation exercised by the two sides of industry, a centralized and coordinated wage bargaining system and the application of a wage norm, the so-called '*solidaristic wage policy*' based on fairness, equity (equal pay for equal work) and efficiency (i.e. fostering rationalization at company level and promoting productivity-enhancing structural changes through closure of unproductive plants); and

(iii) The implementation of an ambitious countercyclical Active Labour Market Policy (ALMP) favouring occupational and geographical mobility and enhancing employment opportunities for those with reduced work capacity.

It goes without saying that the overall macroeconomic policies, while being restrictive enough to prevent inflationary pressures, were at the same time expansionary enough to secure both employment growth and a low unemployment rate. Low unemployment was secured mainly by ALMP programmes favouring a reallocation of the labour force from the declining parts of the economy² towards the expanding ones.

Such a model or policy strategy, often referred as '*the Rehn-Meidner³ model*', presupposed the existence of powerful and autonomous workers' and employers' organizations and a high degree of consensus/cooperation between them, as well as between the two sides of industry and the government. The main reasons why the Rehn-Meidner division of tasks and responsibilities⁴ was widely accepted in the 1950s lie in the inheritance from the past. The Swedish trade union movement was strong and united. The coverage of collective agreements and union density were—by international standards—very high. The social democrats dominated the political arena, and the cooperation between them and the trade unions as represented by LO (the Swedish Trade Union Confederation, i.e. the central organization of blue-collar unions), rested firmly on egalitarian ideals. However, without the support of the Swedish Employers' Confederation, SAF, it would have been impossible for LO alone to achieve the centralized and coordinated bargaining system necessary for the successful implementation of its solidaristic wage policy and the corresponding top-down coordination of wages across industries and sectors. For the employers, a centralized and coordinated wage-setting system was a way of achieving a low degree of wage competition between firms and a cost control in industries exposed to international competition.⁵ The *solidaristic wage policy* involved not only the

² Where firms with relatively low productivity tended to disappear or reduce their labour force due to application of the solidarity wage policy.

³ The Swedish model was initially formulated by the two Swedish economists Gösta Rehn and Rudolf Meidner (1953).

⁴ The government was responsible for the conduct of the macroeconomic policy (price stability) and the implementation of the ALMP in order to ensure both an efficient allocation of resources and the preservation of full employment, while the two sides of industry were mainly responsible for regulation of the labour market and wage formation without intervention of the public authority.

⁵ It is interesting to note that LO was actually more reluctant than SAF to fully accept a system of centralized wage

application of the principle of ‘equal pay for equal work’ (irrespective of individual firms’ profitability, sectors or regions); it also became an instrument for reducing wage differentials within and between jobs, i.e. for promoting a more compressed wage structure.

The policies pursued, based on strong political commitment to the goal of full employment and to egalitarian ideals and on the above-mentioned division of tasks and responsibilities, resulted in remarkably low unemployment. Furthermore, by international standards, Sweden was also successful in terms of labour market participation, gender equal opportunity, and egalitarian income distribution and—disregarding the period from the mid-1970s to the early 1980s—sustained economic growth. To a considerable extent the good employment record during this period was also related to the expansion of public-sector employment and the creation of a modern welfare state. This implied strong government involvement in the financing and provision of health care, social care and education.

1.2 Early warnings: The crisis of the late 1970s and deviations from the original model

The Swedish economy started to show serious signs of weakness long before the dramatic economic downturn and the employment crisis of the early 1990s. In fact, from the mid-1970s, the country’s macroeconomic performance deteriorated in the wake of the two oil crises, a restrictive economic policy in major OECD countries, and intensified competition from Japan, the Republic of Korea and the Newly Industrialized Countries (NICs). This situation was addressed by means of extraordinary policy interventions, notably devaluations of the Swedish currency, implying apparent *deviations* from the policies prescribed by the model *per se*. The repeated devaluations carried out in the late 1970s and early 1980s reflected the inability of the social partners to achieve a wage development compatible with preserving the macroeconomic balance and maintaining the international competitiveness of Swedish companies in a regime of fixed exchange rates. Given that this regime was regarded as an integral part of the model, the wage inflation during the 1970s and the use of devaluation to restore the competitiveness of Swedish enterprises and to preserve full employment can be regarded as reflecting apparent policy failures and a departure from the original model.

The severe crisis of the mid- and late 1970s did not lead, however, to major structural reforms. The successive devaluations could be justified as necessary ‘extraordinary’ policy responses to sudden and unexpected (imported) macroeconomic shocks: - the ‘oil crises’ and the international ‘stagflation’ of the 1970s. It may be that the traditional model was unable to handle the consequences of such exceptional *exogeneous* shocks, but this did not lead to the conclusion that the model *per se* had to be abandoned, or profoundly and permanently restructured.

However, for full employment to be preserved and the temporary crisis to be overcome, the model had to be supplemented, for some time, by ‘extra-ordinary’ policies, including devaluations. In the mid- and late 1970s, in the wake of international turbulence, the two sides of industry failed, in spite of the centralized bargaining system, to exercise the wage restraint required to prevent a severe cost crisis. Massive plant closures in Swedish manufacturing industry, particularly in the shipyards and textile industries, greatly unsettled the labour market and incited the policy makers to intervene to ‘rescue the jobs’ and restore ‘full employment’. In addition to ALMP programmes oriented to labour demand, such as relief work and wage subsidies, massive industrial subsidy programmes were launched, stockpiling was stimulated, and—not to be forgotten—public-sector employment was expanded. As a consequence, of course, the crisis also became a ‘deficit crisis’ involving large current account and public budget deficits. In the political arena, the social democrats lost office in 1976 after 44 years of unbroken rule. The new centre-right government devalued the Swedish currency twice in 1976 (after 25 years of constant exchange rates) and again in 1977 and 1981. It did not abandon the extensive

bargaining. It was not until the LO congress in 1961 that the LO federations unanimously supported the principle of a nationwide, coordinated wage bargaining system.

use of industrial subsidies and ALMP schemes. When the social democrats returned to power in 1982 they devalued the currency yet again, actually creating an undervalued Krona. This devaluation, together with the relative wage restraint now exercised by the two sides of industry (at that time highly crisis-conscious), gave the exposed tradable sector a major expansionary boost which was fuelled by an international economic recovery. The 'cost crisis' was overcome, and the current account and public budget deficits were eliminated by the early 1980s.

Despite the large decrease in employment in manufacturing that took place from the mid-1970s until the early 1980s, the rate of unemployment never exceeded (on a yearly basis) 3.5 per cent. The employment rate never fell below the 77 per cent reported for 1975, and from 1979 it was above 79 per cent. For men it fell from 87.2 per cent in 1975 to its minimum level at 83 per cent in 1983, but for women it increased, in the same period, from 66.5 per cent to 74.8 per cent. This reflects the destruction of jobs in manufacturing and the simultaneous creation of jobs in services, notably in the public sector. Thus, the 'cost' and 'deficit' and 'structural' crises of the late 1970s were never translated into a severe 'employment' crisis, due in particular to the massive expansion of employment in the public sector. Furthermore, the emergency policies pursued did not include any substantial 'rolling-back of the welfare state'. The social insurance systems remained intact, and the public (especially the municipal) provision of health and social care was in fact expanded.

1.3 The crisis of the early 1990s

By contrast, the crisis of the early 1990s took the form of a dramatic employment crisis. Why was this allowed to happen and what are the main factors explaining the sharp increase in unemployment? Why was the emerging cost crisis, which was clearly observable well before 1990, not met by 'over-bridging' and devaluation policies similar to those implemented during the previous decades?

The use of an accommodative monetary policy, i.e. devaluation as a means of combating excessive 'home-made' inflation (11 per cent in 1990), was unanimously rejected. The common understanding was that the country could not afford a repetition of what happened in the late 1970s and early 1980s. However, a fundamental question remains to be answered: Why did the policy makers involved fail to foresee the consequences of this consensus? Whatever the reason, the social democratic government and the central bank failed to prevent inflationary excess demand and increased labour market tightness. Then their main problem was to convince the actors on international financial markets that the devaluations of the late 1970s and early 1980s would not be repeated. The central bank's main instrument to combat speculation against the Swedish Krona, made possible by deregulation of the financial market, was to increase—sometimes very dramatically—its own interest rates, thereby influencing domestic interest rates in the same direction. The centre-right government in power from 1991 to 1994 tried to counteract the devaluation expectations by means of a restrictive fiscal policy involving substantial reductions in public spending. In this respect it was supported by the social democrats who were now in opposition after taking some steps in the same direction before losing the election in 1991. However, these policies, in combination with the original cost crisis and the high interest rates, resulted in soaring unemployment, decreasing public revenues and—in spite of the cutbacks in public expenditure—a rapidly increasing budget deficit. Apparently, many actors on the international financial markets came to the conclusion that Sweden would, as in the past, soon devalue. The attempts to defend the currency had thus resulted in reinforcing devaluation expectations! In November 1992 the central bank had to allow the Swedish Krona to float. It immediately depreciated by about 20 per cent.

Needless to say, the policy failures behind the crisis of the early 1990s were extremely costly for the Swedish people. Between 1990 and 1993 GDP decreased by 5 per cent. The consequences were especially painful for vulnerable groups hit by unemployment and/or by the reductions in social benefits and public commitments that became elements of the emergency measures carried out.

1.4 The recovery since 1994

Since 1994 the macroeconomic and labour market conditions have improved in many ways. The central bank has been, on the whole, quite successful in holding down inflation and maintaining its independence and autonomy vis-à-vis the government and the Parliament (*Riksdag*). By early 2001, the budget deficit had turned into a surplus. Between 1993 and 2000 the annual GDP growth rate was on average 3.2 per cent. This relatively rapid growth reflects a substantial increase in exports fostered by currency depreciation and wage moderation. The rate of unemployment remained above 8 per cent until 1997, but by 2002 it had declined to about 4 per cent. We believe that developments since 1990 would have been significantly more favourable if a macroeconomic strategy, consistent with the unavoidable deregulation of the financial sector, had already been established in the late 1980s, so that the futile and costly attempts to defend the currency could have been avoided. This is not to say, however, that it would have been possible to preserve the level of employment reached in the late 1980s, or to avoid reforms perceived by a majority of Swedish citizens as involving ‘rising inequality’ and ‘decreasing security’.

2. Recent transformations of the Swedish model

2.1 Reorientation of macroeconomic policy

In our view, the devaluations in the late 1970s and early 1980s, and the deep crisis of the early 1990s, demonstrate that the policies pursued, in particular the lack of an institutionalized anti-inflationary mechanism, involved strong elements of time inconsistency. According to the traditional model developed in the 1950s, restrictive macroeconomic policies should be used to keep inflation at a level consistent with a fixed foreign exchange rate regime.

The reorientation of monetary and fiscal policy started in 1993 with the establishment of an inflation target which became the main objective of the autonomous central bank.⁶ The Swedish currency has been allowed to float. Consequently, the government and the two sides of industry have to accept that the autonomous and independent central bank will react to inflationary fiscal policies or excessive wage increases by raising its interest rates. The consequences will be higher market interest rates and/or an appreciation of the Swedish Krona and thus, in the longer run, decreasing employment. This new division of roles and responsibilities between the government and the central bank means that the anti-inflationary policies prescribed by the Rehn-Meidner model have been institutionalized in a way that precludes the kind of inflation-generating policy failures observed in the late 1970s and late 1980s. These new developments represent, in our view, a *strengthening* of, rather than a deviation from, the traditional Swedish model.

In our view, the ability of the national economy to reach and maintain full employment in the coming years will depend heavily on the functioning of the wage-setting system. According to the analysis in Iversen (1999), given a non-accommodating monetary policy pursued by an independent central bank, a bargaining system characterized by an intermediate degree of centralization and coordination (involving a remaining important role for collective agreements at industry level, but also for negotiations at local level) will be ‘optimal’ in terms of its capability to result in a relatively small ‘equilibrium unemployment’. This may give rise to some optimism, since it is in this direction that the Swedish bargaining system has moved in recent years. We will come back to this in section 2.3. Before that, however, we want to deal with another prominent element of the traditional and the current Swedish model: the extensive use of ALMP means and programmes.

⁶ The inflation target amounts to a 2 per cent per year rise in the consumer price index, within a margin of plus or minus 1 per cent.

2.2 Active labour market policies

Sweden's excellent record on employment and unemployment has often been ascribed to a particularly ambitious Active Labour Market Policy (ALMP). The ALMP has played a vital role in stabilization policies since the late 1950s and constitutes, as mentioned previously, one of the cornerstones of the Swedish model. ALMP programmes have been used not only to promote an efficient allocation of resources and to facilitate transitions from unemployment to employment but also to favour the integration of marginal workers, for example the disabled, who without public intervention would have been excluded from the labour force. The social partners' support for this policy reflects their desire to foster the integration of unemployed workers instead of relying on unemployment benefits. The Swedish labour market policy administration relies on management by objectives and not on regulations and directives. On the whole, the system is characterized by real decentralization and flexible management. In our view, this decentralized infrastructure has created a favourable institutional framework for a flexible and efficient labour market policy (see Anxo et al., 2000). Hence, two key and distinctive features of Swedish employment policy may be identified: on the one hand, the integration of unemployed workers instead of the provision of passive support (*'the job line versus the cash benefit line,' i.e. activation*); on the other hand, the key role played by the two sides of industry in ALMP programmes, thus ensuring their social legitimacy.

As already described, the early 1990s were notable for a sharp deterioration in the employment situation. The government responded by gradually putting more and more people on employment programmes, and in 1994 beneficiaries accounted for almost 6 per cent of the active population, a figure never previously reached. With the gradual improvement in the employment situation, the number of participants in ALMP programmes was gradually reduced, thereby confirming the counter-cyclical nature of Swedish labour market policy. Although labour-demand related measures (e.g. temporary public employment schemes (relief works) and recruitment subsidies) used to predominate in previous economic downturns (particularly from 1975 to 1983), these traditional instruments did not play the same role during the last employment crisis. Hence, the early 1990s saw a reorientation of the ALMP emphasizing matching efficiency and labour mobility.⁷ The number of participants on vocational training programmes and/or practical insertion courses rose quickly, while traditional measures focusing on labour demand remained at a much lower level than during previous recessions (Anxo and Erhel, 1998).⁸

The growing role of vocational training in the ALMP indicates the importance that the government and the social partners give to occupational mobility and to the development of skills over the life course. The employment crisis of the early 1990s hit the low skilled particularly hard. During the period 1993-2003 around 600 000 unskilled and low-paid jobs were lost in Sweden. The reorientation of active labour market policy towards traditional labour market training and adult education can therefore be considered as an attempt to upgrade the skill content of the labour force in face of the large restructuring that the Swedish economy experienced during the 1990s. In the same vein when the youth labour market deteriorated in the

⁷ The local employment agency provides support for job search in the form of job-broking, counseling and intensified job search programmes. It should also be noted that unemployed job seekers have the right to be enrolled in ALMP schemes after an unemployment period of 6 months (3 months for young people 20-24 years old), limiting the development of long-term unemployment.

⁸ In terms of level of expenditure, job creation measures such as relief works and recruitment subsidies have since the early 1990s been supplanted by training programmes. What stands out here is the larger emphasis in Sweden than in most other countries on labour market training: 42 per cent of expenditure on ALMPs in Sweden has been on training, compared to EU and OECD averages of 27 and 29 per cent, respectively. The measures introduced in 1992 and 1993 such as temporary trainee replacement schemes, youth training and work experience programmes are also in line with a policy of substituting mixed programmes (which combine temporary employment and training) for pure job-creation measures, such as relief works, see Anxo & Erhel, 2000.

early 1990s the educational enrolment rate was also increased, with a significant expansion in the number of university places, which had fallen continuously during the previous decade.⁹

In our view, the reorientation of ALMP in the early 1990s towards more supply-oriented programmes can be considered as a return to the initial conception of ALMP interventions designed to meet the increasing demand for skill upgrading and occupational mobility. Actually, the primacy of labour-demand oriented measures during the 1970s and early 1980s can be viewed as a deviation from the original ALMP strategy initiated during the late 1950s. Hence, the extensive and institutionalized use of ALMP remains a major component of the present Swedish model.

2.3 Recent transformations of the industrial relations and wage formation systems

While the conjunction of several factors (i.e. the reorientation of monetary, fiscal and active labour market policy) explains the ‘Swedish success story’, there is no doubt that recent changes in industrial relations, notably important changes in the regulation of collective bargaining and wage formation, have played an important role in this development.

For more than 25 years (1955-1982), the third important component of the traditional model was a wage formation process based on a centralized and coordinated bargaining system (see Anxo, 1993 and 1999). In 1983, however, the Engineering Employers’ Organization concluded a separate agreement with the Metal Workers’ Union, breaking up centralized economy-wide bargaining. The combination of the abandonment of inter-professional agreements, the erosion of the Swedish model of industrial relations (particularly the weakening of mechanisms for coordinating collective bargaining), and the resurgence of industrial disputes during the 1980s led the government and the social partners to formulate new strategies in the early 1990s. At the beginning of the last decade, the reformulation of economic policy, the sharp rise in unemployment, and Sweden’s deferred entry into the European Monetary Union had a decisive impact on the emergence of new compromises dealing with wage formation, the procedural framework of collective bargaining and the regulation of industrial disputes. After several abortive attempts in the early 1990s to set up new collective bargaining mechanisms, the prospect of further government interference in the labour market encouraged the two sides of industry to start talks aimed at reforming industrial relations. The three main trade unions¹⁰ in the sector exposed to international competition asked their employer counterparts to consider the possibility of setting up a new collective bargaining system that fostered industrial peace, and wage increases that guaranteed balanced growth and a return to full employment. These talks culminated in the signature of an agreement on Cooperation on Industrial Development and Salary Formation (*Samarbetavtal om Industriell Utveckling och Lönebildning, Industriavtal*) on 18 March 1997. This new agreement covering about 600,000 workers (approximately 17 per cent of the gainfully employed population) may justifiably be compared with the historical compromise concluded at Saltjöbaden in 1938¹¹ (Elvander, 2000).

⁹ By international standards, the educational attainment of the Swedish population is clearly higher than in most OECD countries. By the end of the century more than 50 per cent of the adult population had upper secondary education and more than 30 per cent a tertiary education. During the school year 2003-2004 almost 45 per cent of young persons aged 19-26 years were enrolled in tertiary education.

¹⁰ These were the Swedish Federation of Blue-Collar Workers in the Engineering Industry (Svenska Metallindustriarbetareförbundet, Metall), which is affiliated to the LO Confederation, the Swedish Federation of White-Collar Workers in Industry (Svenska Industritjänstemannaförbundet, SIF), which is affiliated to the TCO Confederation, and the Swedish Association of Graduate Engineers (Sveriges Civilingenjörförbundet, CF), which is affiliated to the SACO Confederation.

¹¹ The Saltjöbaden Agreement, which was signed by the LO-S General Confederation of Labour and the Swedish employers’ confederation, the SAF, put an end to the frequent labour disputes during the 1930s and had a decisive influence on the development of peaceful industrial relations. It also established a series of regulations covering the roles of the various actors on the labour market, and accorded the social partners considerable maneuvering room in respect of wage policy. The Saltjöbaden Agreement also influenced the organization and functioning of negotiations and regulated industrial disputes by demanding prior agreement with the Confederations in the case of disputes

The main innovatory element of the Agreement on Industry, apart from the tendency to re-coordinate collective bargaining, is the establishment of explicit rules concerning the regulation of negotiations and the resolution of disputes. The main objectives of the Negotiating Agreement are to create a constructive climate that is favourable to the conclusion of collective agreements compatible with balanced growth, and to avoid industrial disputes (see Anxo and Niklasson, 2006). Retrospectively, we can say that the last rounds of negotiations passed off without industrial disputes. By and large, negotiated wage increases kept pace with the rest of the European Union. The negotiated pay rises within the industrial agreement affected other bargaining areas, thereby *re-establishing the normative pacesetting role* of the sector exposed to international competition. Also worth noticing is that the agreement led to a sensible increase of real wages, contrasting with the situation in the 1980s, characterized by stagnation in real wages.¹²

As has already been stressed, the period 1980-1995 was characterized by a clear tendency towards the decentralization of collective bargaining and a weakening of coordination mechanisms. Following the abandonment of inter-professional national agreements in 1983, collective bargaining was carried out at two levels: industry and enterprise. This decentralization was also accompanied by a marked tendency towards a differentiation and individualization of wages and terms and conditions of employment. In wage policy terms, the questioning of egalitarian *solidaristic* wage policy both by the employers and by some trade unions—including the Engineering Federation (*Metall*)—that were influential inside the Swedish Confederation of Trade Unions (LO) led to a wider dispersion of the wage distribution, and to an acceptance of a more individualized type of wage formation based on individual skills and performance, and no longer only on job characteristics. Several reasons may be advanced for this shift. Firstly, solidarity mechanisms and the general raising of low pay that characterized the LO wage strategy during the 1970s ran out of steam as growth slackened and imbalances linked to economic recession in the late 1970s increased (Anxo, 1993). The second reason concerns major changes in work organization and the gradual abandonment of Taylorian modes of production. The acceptance of greater wage differentiation by the trade union federations also responded to a fear of LO affiliates that they might lose members to the white-collar confederations, which were traditionally more prone to accept wage differentiation.

The employers' more recent change of attitude regarding the strategy that was initiated during the 1980s of decentralizing collective bargaining to enterprise level, and therefore their acceptance of a re-coordination of collective bargaining at industry level, is certainly linked to an awareness of the cost incurred by the resurgence of industrial disputes, and to the transaction costs associated with the absence of coordination mechanisms. These developments since the mid 1990s may therefore be interpreted as the emergence of a new type of agreement in which the employers accept a degree of coordination in exchange for a guarantee of industrial peace. Clearly, in a situation marked by high trade union density¹³ and limited government interference in the field of pay determination, coordination of negotiations at industry level ensures a certain degree of industrial peace (Sheldon and Thornthwaite, 1999).

Given the structural changes that Sweden has undergone in the last two decades, the recent developments in industrial relations augur well for a revival of the Swedish model of industrial relations. Although these new developments show that the two sides of industry are nowadays prone to accept a re-coordination of industry-wide agreements and give the traded goods sector a leadership role in wage determination, and although they may be interpreted as a reorientation of employers' strategies as regards the decentralization of collective bargaining, it would be erroneous to interpret these new tendencies as a weakening of enterprise-level bargaining. In

affecting more than 3 per cent of the workforce, thus guaranteeing industrial peace as soon as the collective agreements were concluded.

¹² During the 1980s nominal wages rose by approximately 8 per cent, whereas real wages remained unchanged throughout the whole period.

¹³ The average union density in Sweden is above 80 per cent while the coverage rate of collective agreements is around 90 per cent. It must also be stressed that the union density has not declined during the last decade.

fact, industry-wide agreements leave ample scope for enterprise-level negotiations, particularly regarding the distribution of the individualized part of the wage increase negotiated and concluded at industry level. Strong trade union organization and high union density at company level ensure the implementation of negotiated forms of individualization and differentiation. In our view, this two-tier system provides an institutional and legal framework that is favourable to the emergence of *negotiated flexibility*.

These new developments, therefore, appear to respond to a three-pronged objective: ensuring industrial peace; limiting the impact of transaction costs and of negative externalities on employment and firm competitiveness of uncontrolled wage drift; and finally guaranteeing a *principle of subsidiarity*, making it possible to adopt the provisions contained in industry-wide agreements to the productive and competitive constraints of Swedish companies.

The recent developments in industrial relations in Sweden may justifiably be seen as the emergence of a *new historic compromise* combining employers' demands for greater productive flexibility with the trade union movement's desire for sustained growth in employment and in household real incomes. In other words, these developments confirm the impact that changes in the conditions of competition and production have on the system of industrial relations. They also indicate that the Swedish model of industrial relations has adapted to the new challenges posed by post-industrial societies.

3. Institutional and structural reforms

3.1 Main characteristic of the Swedish welfare state and employment regimes

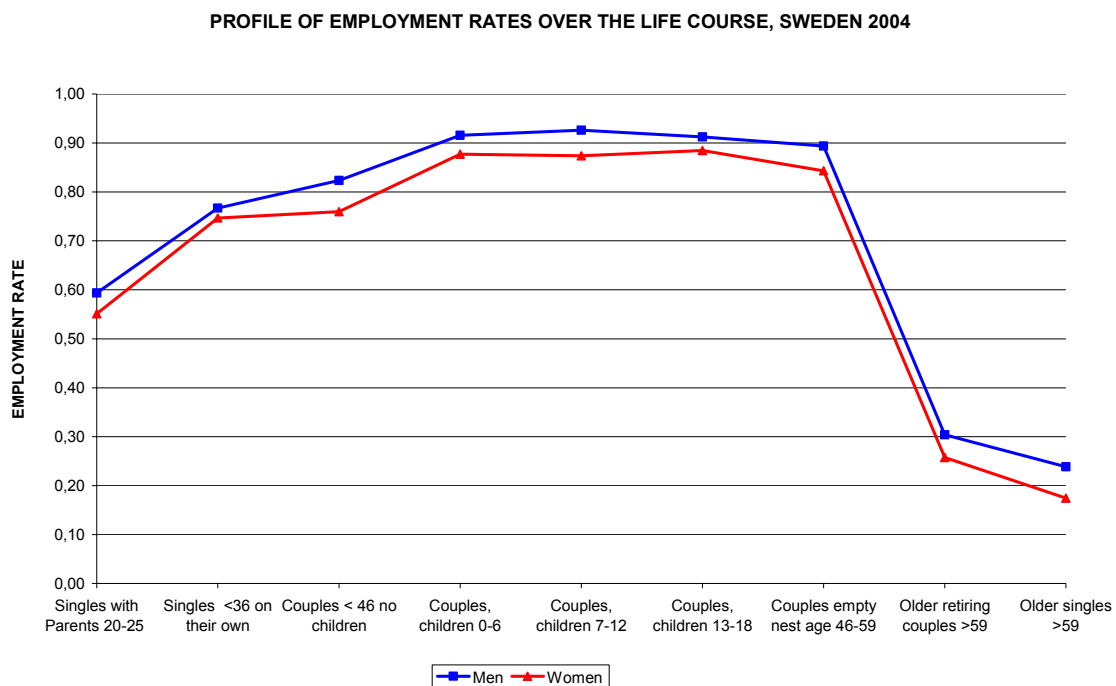
The Swedish model is based on a strong political commitment to the goals of full employment and price stability and also to egalitarian ideals. Presented often as the ideal type of the Nordic social democratic regime, the Swedish welfare state emphasizes the principles of egalitarianism, de-commodification and individualization. In the whole spectrum of social policies, individualization has been a key part of the Swedish universal welfare state. The basic principle of the institutional model is entitlement based on citizenship/residence. The individual, and not the family, has for many years been the unit not only of taxation but also of social benefits as social rights. The individualization of Swedish social policy is strikingly illustrated by the lack of social benefits awarded to women on the basis of their status as wives.

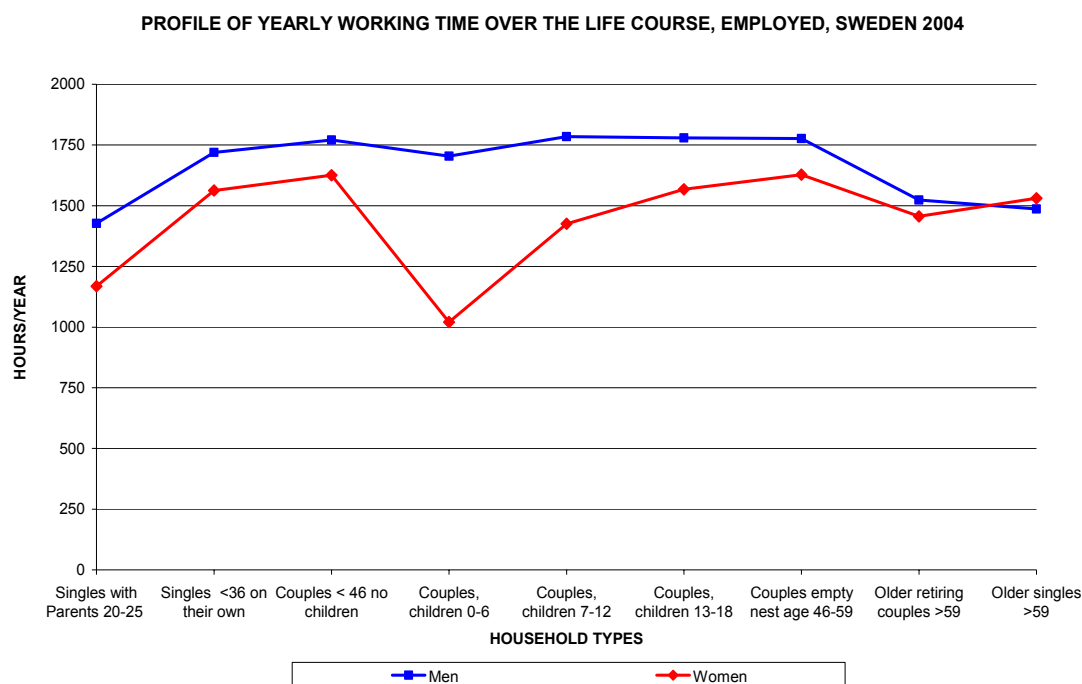
Sweden stands out as providing one type of societal system based on a high incidence of two-earner households, high employment rates at the two ends of the age distribution with a small gender gap, extensive and generous family policy, strong welfare support systems both for child care and parental leave and egalitarian wage structures, including low gender wage inequality. To a considerable extent the good employment records experienced by the Swedish economy during the last decades are clearly related to the creation of a modern welfare state, strong public involvement in the financing and provision of health care, social care and education and the related expansion of public-sector employment. As far as working time is concerned, the high union density and the relatively high degree of centralization and coordination of collective bargaining produce a rather low dispersion of working time and a high concentration of dependent employees around the standard full time norm (40 hours). Some gender differences persist with a relatively large share of women working part time, but in contrast to other EU member states with high part-time rates such as the United Kingdom or the Netherlands, many women in Sweden work long part-time hours and receive income compensation for working less than full time. The development of part-time work among Swedish women that started in the early 1970s is symptomatic: 47 per cent of Swedish women worked part-time in 1981, compared to 35 per cent in 2005. Part-time work in Sweden must be considered more as a historical transition from married women's inactivity towards a strategy,

largely initiated by labour market and political institutions, to strengthen women's labour market commitments. The parental leave system allows for an income-compensated temporary reduction of working time, thereby reinforcing women's bargaining power and status as significant breadwinners even when they are temporarily not participating on a full-time basis in the labour market. The overall political context characterized by gender mainstreaming and high female involvement in the political process (government bodies, parliament, and labour market organizations) creates a favourable institutional context for a more balanced gender division of labour and responsibilities over the life course.

As already mentioned, Sweden is characterized by high employment continuity over the life course, and relatively low gender disparities in labour market integration (see figure 1 upper panel). Neither union nor family formation affects women's employment rates. Family formation is even positively related to female labour market participation. It is also interesting to note that having children has, compared to other EU member states, no lasting effects on the female labour supply. The main impact is a temporary reduction of working hours to long part-time hours while children are of pre-school age (see figure 1 lower panel). Women's working time then increases smoothly as the children grow up and attains a level similar to their male counterparts at the end of working life.

Figure 1: Employment and working time patterns over the life course, Sweden





Source: LINDA (2005) and own calculation (see, Anxo 2006). LINDA is a longitudinal data base produced by Statistics Sweden.

3.2 Social protection system: Structure and evolution

Sweden's institutional structures and the policy reforms undertaken during recent decades are crucial to an understanding of the country's employment system, particularly the high employment rates and gender employment profiles over the life course. These reforms explicitly aimed to encourage high and continuous labour force participation of men and women, to narrow the gender employment gap and ensure similar patterns of employment over the life course. The following institutional features appear to be determinant: the generous and flexible leave of absence; the expansion of subsidized and high quality child care; and the reforms of the benefits, taxation and pension system.

3.2.1 Parental leave

The Swedish parental leave programme, introduced in 1974 (replacing the maternity leave legislation), has obviously sustained the growth of female labour participation and contributed to the changes in women's behaviour in the labour market. Since 1974 women withdraw from the labour market much less frequently than they did during the 1960s and the employment rate of mothers of children under seven is among the highest in the OECD countries. The change of name also reflects a desire to influence the division of labour between men and women and to favour gender equal opportunities.

The length of parental leave was initially six months and was gradually extended to 16 months (480 days) in the 1990s with full job security on return.¹⁴ The level of compensation is 80 per cent of gross earnings for the first 390 days. For the remaining 90 days parents receive a flat rate of 60 SEK.¹⁵ Parental leave offers considerable flexibility in that part of the time can be taken over a longer period by working a shorter week with wage compensation. Generally

¹⁴ The parent leave system is associated with full employment guarantee and the employment contract is not suspended during the work absence.

¹⁵ Parents not in employment before the birth or adoption of their child are entitled to a flat rate of 180 SEK for the first 390 days and the same flat rate of 60 SEK for the remaining 60 days. (1 SEK=0,107 Euro, 1 Euro=9,38 SEK)

speaking, the parental leave schemes offer considerable scope for re-arranging working time. Parents may use their leave at any time from the child's birth or adoption until its eighth birthday. It is interesting to note that the system is one of the few social rights that is not fully individualized.¹⁶ In order to favour a more equal gender distribution of absence a first non-transferable month for each parent was introduced in 1993 and a second in 2002. This rule constitutes, therefore, a strong incentive for the father to use his right to parental leave for at least 60 days. The gender division of parental leave remains, however, unevenly distributed since in 2005, 81 per cent of the total number of compensated days were taken by the mothers.¹⁷

Even though the extent of universalism and the degree of de-commodification of the Swedish welfare state is high, the level of income compensation in the parental leave system is not independent of the individual work history and job experience.¹⁸ The amount of income-related benefit is based on earnings during the six months immediately preceding the birth of the first child; this constitutes a strong economic incentive for parents to be gainfully employed and to work full-time prior to childbirth. The benefit system has therefore had a great influence on working time patterns for prospective parents. Typically, Swedish women work full-time before childbirth, take parental leave, come back to employment on a part-time basis and increase working time when the children grow up (see figure 1 above).

Parents are also legally entitled to paid care leave for sick children (60 days per year and per child, up to the child's twelfth birthday¹⁹ compensated at the same replacement rate as sickness benefit, i.e. 80 per cent of previous earnings). Employees are also entitled to leave of absence or reduction of working time to care for a relative (spouse, parent, sibling or child) who is seriously ill (60 days). The loss of income is compensated in accordance with the replacement rate for sickness benefit. Another law of 1998 allows employees to take unpaid leave for pressing family reasons.

3.2.2 Training leave

Statutory leave of absence is not confined to parental leave. Since 1974, employees have been able to take career breaks to pursue training or study. The legislation on training leave is particularly flexible and gives individuals considerable leeway in their choice of studies. Access to training leave is promoted by public loans with highly subsidized interest rates and favourable repayment terms. The Individual Training Leave Act (1974) had two aims; to encourage social and occupational mobility and to facilitate access to education for employees with the lowest levels of compulsory education. The Act is exceptionally liberal in allowing all workers with at least six months' service to follow training of their choice, with no restriction on either the type or length of training which may, therefore, be in a field completely unconnected with the worker's job. The arrangements for taking leave are also very flexible: absence may be hourly

¹⁶ The current policy and political debate focuses on the advantages and disadvantages of fully individualizing the system of leave of absence.

¹⁷ The incidence of fathers' parental leave and the average duration of fathers' absence have continuously increased during the last decades, from 1 per cent of compensated days in the mid 1970s to almost 20 per cent in 2004 (about 50 days of absence).

¹⁸ To be entitled to the 80 per cent level of income compensation, a period of employment during the 34 weeks before the birth of the child is required. The unemployment insurance system is also related to previous job experience. Unemployment benefits (80 per cent of previous earnings up to a ceiling) require that the individual has belonged to a certified unemployment insurance fund for at least 12 months - the *membership requirement*. In addition, the unemployed must have worked for at least 5 months during the previous 12 month period before the unemployment spell - the *work requirement*. This makes it difficult for new entrants (like youth and recent immigrants) to qualify for this level of compensation. According to Swedish law all persons with an income below a threshold are eligible for social assistance. The social benefit is equal to the difference between the threshold and income before assistance. Unemployed persons who are not entitled to receive wage-replacement benefits or have a low level of compensation may, therefore, apply for social assistance benefits. Social assistance is provided at the social welfare offices who decide, on behalf of the local authorities, who is entitled to receive such benefits. The newly elected centre-right government (October 2006) has recently announced a reform of the unemployment benefit system aiming to strengthen work incentive and intensify job search activity.

¹⁹ In case of child disability, this right is extended up to 16 years old.

(several hours a week combined with normal work) or taken in a block. As with the other forms of statutory leave of absence, the right to training leave is backed by a full employment guarantee; employees are reinstated in their job with the same working conditions and the same pay. While the Act affords employees considerable leeway, the employer is nevertheless entitled to decide when the training shall start. However, training may not be deferred for more than six months without the express agreement of the trade union representatives. The employee may also abandon the course before completion and be reinstated in the job subject to varying periods of notice depending on the length of the course (two weeks to a month).

3.2.3 Public child care

The public child care system has substantially improved during the last three decades. In 1995, the legislation was modified and the municipalities were made responsible for providing pre-school programmes and leisure-time activities for school children without unreasonable delay. The responsibility applies to children from one to 12, whose parents are gainfully employed or are studying. The number of places in community child care centres or community sponsored homes has increased from about 12 per cent of children between one and six in 1972 to almost 85 per cent in 2004. The Swedish system is specially designed to help working parents. The day care centres provide meals for the children and are open until 6 p.m. Between 2001 and 2003 several reforms were introduced to extend child care facilities. Local authorities were required to provide pre-school or family day-care openings to children aged one to five, for job seekers and also for parents taking leave to care for a sibling. Pre-school care, free of charge, was introduced for all four and five year-olds for at least three hours a day during the school term. Furthermore a maximum fee, i.e. a ceiling on the amount parents were required to pay for state child care was also introduced. The main objective of these reforms, besides labour supply considerations, is to make child care part of the general welfare system, available to all. The basic principle is that all children should have access to child care and that no child should be excluded because of cost.

3.2.4 Tax system

The tax policy has also contributed to the sharp increase in female labour force participation. The shift in 1972 from family-based to individual income tax treatment encouraged married women to enter the labour force. The development of public-sector employment during this period, together with generous social benefits and transfer systems for income redistribution, increased government spending leading to increased tax pressures and a sharp increase of marginal tax. The system of individualized taxation in a context of high average and marginal tax rates has also reinforced the dual breadwinner model.

Many Swedish economists have stressed the detrimental impact of high taxes on work incentives, on investment in human capital (educational attendance and attainment), and on entrepreneurship. To a considerable extent, however, there are reasons to believe that these negative effects are determined by the tax (and transfer) structure rather than by the overall tax rate. Such considerations led to a comprehensive tax reform in 1991, not aimed primarily at reducing the total tax level but at reforming the tax *structure*. The measures reduced marginal tax rates on earned income, widened the tax base and introduced a more uniform taxation of capital.²⁰ Despite this reform Sweden remains a high-tax country and the reduction of total tax pressures in terms of GNP has been limited.²¹ The tax reforms during the 1980s and early 1990s

²⁰ The current income tax is composed of a municipal tax rate ranging from 26 to 35 per cent depending on the municipality and a national income tax of 20 per cent for income between 252 000 SEK and 390 000 SEK and a 25 per cent tax rate for income above 390 000 SEK (1 SEK=0,107 Euro). The highest marginal tax is therefore 55 per cent compared to over 80 per cent during the 1990s. All capital income is taxed at 30 per cent regardless of the amount.

²¹ According to OECD, in 2002 Swedish tax revenues amounted to 50.6 per cent of GDP. The corresponding figure for the 15 EU member countries, the OECD countries, and the United States were 40.5, 36.9 and 28.9 per cent, respectively. The newly elected centre-right government (October 2006) has recently announced further reductions of the income tax especially for low and median income groups.

might also be a factor explaining the increase of average working time, particularly for women, during the last decade.²²

3.2.5 The reform of the pension system

There is a large consensus on the need to increase the working population in order to guarantee the long-run sustainability of the social protection system. The proportion of the population aged 65 or more is expected to increase from 17 per cent today to around 23 per cent per cent in 2030. The number of people aged 80 or more is expected to exceed 7 per cent by the same date. The share of the working age population (20 to 64 years) is expected to decrease from around 59 per cent to 54 per cent in 2030.²³ The continued expansion of higher education, as well as the increasing need for recurrent education caused by rapid technological and structural changes, will raise the number of participants in different kinds of educational programmes, thus reducing the total labour supply.

Like many other industrialized countries during the last 30 years, Sweden has experienced a clear shortening of working life due principally to the conjunction of later entry into the labour market (lengthening of education), earlier exit from the labour market and increased longevity. To illustrate: during the 1970 until the mid-1980s, 56 per cent of older workers left the labour market before the retirement age of 65 and the average drop-out age was 63. During the late 1980s up to the mid 1990s, 76 per cent of older workers anticipated their exit from the labour market and the average drop-out age fell to 61.3 years old (Sjögren, 2004).²⁴

The old benefit-defined “pay as you go” pension system introduced in the early 1960s combined a flat universal benefit (*Folkpension*) with a supplement based on previous earnings (ATP). A full earnings-related benefit could be obtained with 30 years of employment at age 65 and calculated on an average of the best 15 years, the so called 15-30 years rule (Palmer, 2000). During the 1980s this system became increasingly under-financed and it was clear that the problem would grow more serious. Many observers considered that the required increase in contributions or the reduction in benefits necessary to sustain the old system were not practicable.

In June 1994 parliament passed legislation replacing the old benefit-defined system (DB) with a mandatory defined contribution (DC) scheme. The old state pension system was converted into two defined contribution pillars: *a pay as you go notional defined contribution system* (NDC) and *a financial defined (FD) contribution system*. These two earnings-related components are both based on contributions from lifetime earnings and the total contribution amounts to 18.5 per cent of earnings.²⁵ The two mandatory defined contribution schemes were also supplemented by a *guaranteed minimum pension* for those with a low income or no income from work and designed to protect the lifetime poor.

This new system is the result of a broad political consensus²⁶ and the awareness among all politicians of the urgency of reshaping the pension system in order to secure its long-run sustainability and therefore to ensure intergenerational fairness. Intra-generational fairness also

²² The gender gap in working hours has narrowed over the past three decades (from nine hours in 1963 to less than 5 hours in 2004).

²³ According to projections made by Statistics Sweden in 2003, from 2002 to 2020 Sweden’s population will increase by about 836 thousand to about 9.7 million people. The main part of this increase, about 70 per cent, will take place in age groups outside the working age population (0-19 years and more than 64 years). Furthermore, about 62 per cent of the increase of the working age population will occur in the group 55-65 years, where the rate of labour market participation is relatively low. Thus, the demographic developments will hardly contribute to an increase of the labour supply.

²⁴ Despite this trend, employment rates among older workers (55-64 years old) are still above the Lisbon Target of 50 per cent, namely 72 per cent for Swedish men and 67 per cent for Swedish women.

²⁵ Half is an employer contribution, half an employee contribution. For people covered fully by the new rules 16 percentage points will go to the NDC pay as you go component of the system and 2.5 percentage points to the mandatory funded component (FD).

²⁶ The new system is the result of a broad political consensus among five of the seven parties in Parliament in 1994, representing 80 per cent of voters.

played an important role since the old system based on the 15-30 years rule favoured people with a shorter contribution history and/or steeper lifetime earning profiles.

The pension reform introduced in 1994 has been implemented gradually, starting with the earmarking of funds for the mandatory financial account system (FD) in 1995 and with full implementation in 2003. The new legislation also allows a gradual transition to the new system beginning with people born in 1938 and ending with those born in 1953. People born in 1938 receive 20 per cent of the pension benefits from the new system and 80 per cent from the old system. These proportions change gradually with increments of 5 per cent per year for each younger cohort, so that people born in 1954 and later are completely covered by the new system.

As previously mentioned, the new pension system comprises three main components: *a pay as you go notional defined contribution system* (NDC), *a pre-funded pension* (FD), and *a guaranteed minimum pension*.²⁷

The first and most important component, the *notional defined contribution pay as you go system* is based on life earnings and is also linked to national economic growth and demographic development. This contribution based component means that the “pay as you go” character of the pension system is maintained since its financing is based on the working age population. The 16 per cent contribution is registered in an individual account with interest at 1.6 per cent. The annuities of pensioners are calculated by dividing notional capital by a unisex life expectancy at retirement (see Palmer and Wadensjö, 2004).

The initiators of the reform were aware that the life income principle could affect individuals’ earning during retirement quite differently depending on the distribution of risks concerning career and employment disruptions between socio-economic groups. Hence, the reform of the pension system had to consider the diversity in the patterns of labour market integration over the life course and the uneven distribution of risks by limiting the cost of necessary work interruptions linked to parenting, care activities, or involuntary employment disruptions such as unemployment, disability or sickness. While one important motive in the pension reform was to increase the labour supply and lengthen the time devoted to paid work over the life course, the time that workers devote to higher education, to small children or to national military service, as well as absence due to unemployment and sickness, also gives rise to pension rights. In other words, future entitlements to a pension are currently not only related to work history and earnings but are also linked to other forms of income such as parental, unemployment, sickness and partial disability benefits.

The second component of the new pension system, the *financial defined (FD) contribution system* is a mandatory premium pension which individuals save in funds of their own choice. The FD component is, as previously mentioned, based on a contribution rate of 2.5 per cent and the individual accounts are administrated by a government agency (PPM) which is part of the social insurance administration. This agency manages fund shares on behalf of participants during the saving phase and is the sole supplier of annuities. Like the NDC pillar, the annuity in the financial defined contribution scheme is calculated by dividing the accumulated capital by the estimated life expectancy at retirement (see Palmer and Wadensjö, 2004).

As stressed by Joakim Palme (2003) this second component illustrates:

the changing boundaries of public and private in the system of old age security. It opens up the possibility for private fund management to act within a public framework, where public authorities both collect contributions and pay out the pension. Moreover it introduces individual risk sharing within the

²⁷ As stressed by Palmer and Wadensjö (2004), around 80 per cent of the Swedish workforce is also covered by contractual pension benefit schemes in the four main bargaining areas (blue collar, white collar, state and municipal employees). The contractual schemes supplement the public pension system, since the replacement rates in the public pension applies up to a ceiling. The contractual schemes partly compensate for the share of earnings above the income ceiling (see Palmer and Wadensjö, 2004 for details.)

social insurance system, where programmes are usually designed for collective risk sharing.

The third component, the *guaranteed minimum* pension is a universal basic pension for those who have had a low income or no income; it is a way to fulfil the traditional social policy goal of preventing poverty in old age. The minimum pension can be drawn at 65 and is subject to income tax. Since the *guaranteed minimum pension* might not be sufficient to meet the minimum subsistence level, it may be supplemented by a rent and means-tested housing allowance and/or if necessary by social assistance benefits.

Even though the new pension system does not include a fixed retirement age, the pension cannot be drawn before the age of 61 and there is no legal right for employees to work after the age of 67.²⁸ It is also worth noticing that the new system is flexible since the annuities for both the NDC and the FD can be claimed partially or fully at age 61, whether the beneficiary leaves the labour force or not. If the individual decides to continue to work while claiming a partial or full annuity, the pension benefits will be recalculated given the additional work contribution (see Palmer and Wadensjö, 2004). The new pension system makes it possible and financially advantageous to gradually withdraw from the workforce after the age of 65 and therefore to postpone the retirement decision.

One crucial issue is to assess whether the new pension system will mean that people choose to retire later. The average exit age from the labour market in Sweden is one of the highest in the EU and recent data from Statistics Sweden show that the average age of retirement rose by one year between 2001 and 2004, from 61,8 to 62,8 years (62,4 per cent for women and 63,2 per cent for men).

The system also gives the right to early retirement through the disability pension scheme (*Förtidspension*). Individuals are entitled to a full or partial disability pension depending on work invalidity. Originally, eligibility was based on a concept of incapacity based on medical factors. From the early 1970s, a disability pension could be obtained “for labour market reasons” for those over 60 years of age; in practice it was often extended to those below this age. These schemes were widely utilized in the seventies and early eighties. Due to the expected demographic developments and increasing public budget constraints early retirement for labour market reasons was abolished in 1991. It cannot be ruled out, however, that in practice the labour market situation is still a factor, even if in principle the pension decision is based solely on medical considerations.

3.2.6 Adjustments to sickness pay

Health insurance was extended to all in Sweden in 1955. The system is not directly linked to working life and there are no legal thresholds concerning working time which affect coverage. All gainfully employed people with an annual income of at least SEK 6,000 (640 Euro) are also entitled to cash benefits for loss of income while ill. Although it is paid for an unlimited period and is subject to income tax the level of benefit is related to actual income.

From 1997 to 2003, spending on sickness benefits increased from less than SEK15 milliards to more than SEK43 milliards!²⁹ Since then sick leave has decreased somewhat, but it remains at a high level, and the number of individuals who take early retirement for medical reasons has continued to increase. The rate of sick leave and the average number of days taken is significantly higher for women than for men (and for low-income earners). The factors behind these developments are still a matter of debate and research. A common diagnosis is that the structural reforms undertaken in the 1990s in the wake of the economic crisis have involved harder and more demanding working conditions for many individuals, in particular in the female-dominated and relatively low-paid state care sector.

²⁸ In other words, employees aged 67 can still work and accumulate capital on their individual account and get a higher pension, however, employers have the right to terminate their employment when they reach 67 years old.

²⁹ 1 SEK=0,107 Euro, 1 Euro=9,38 SEK

In order to curb the rapid growth of sick leave, the health insurance system has been successively reformed. In the early nineties, in conjunction with the effort to curb the increasing deficit in public spending, sickness benefits were lowered from 90 per cent to a replacement rate of 80 per cent of previous income and one waiting day was introduced. Payment for the first 21 days of sickness was shifted to the employer. From the 22nd day of sickness the state health insurance system takes over and pays sickness benefit (80 per cent of 97 per cent of the previous wage).³⁰ In order to further reduce sick leave, especially long-term absenteeism and early exit from the labour market due to illness (disability pensions or work-injury benefits) various rehabilitation and “return to work” programmes have been launched during the last decade.

4. The Swedish production system

Sweden entered the post-war period with an undamaged production apparatus, and up to the early 1970s its rate of economic growth was among the highest in the world. From the mid-1970s to the early 1990s, however, the annual growth of *industrial production* averaged about one percentage point lower for Sweden than for EU-15. The beginning as well as the end of that period was marked by deep economic crises involving significant decreases in industrial employment and production. In the following period from 1993 to 2001 the rate of growth in industrial production reached on average about 5 per cent per year, well above the OECD average. After the recession of 2001-2002 it is again among the highest in the European Union. The continuous structural transformation of manufacturing industry towards more knowledge-intensive and less labour-intensive production has in recent years manifested itself in rapid productivity growth. For example, in 1990 the rather knowledge intensive electronics and telecommunications industry accounted for 6 per cent and in 2006 for about 20 per cent of manufacturing industry's total value added.

From 1965 to 2005 manufacturing's *share of total employment* fell from 30 to 16 per cent. In the period 1992 to 2000 it was fairly stable at the 20 per cent level. The subsequent decline reflects remarkably large increases in industrial productivity. In 1965, *the public sector* (excluding state-owned companies) accounted for 15 per cent and private *services* for 43 per cent of total employment. In 2005 the corresponding figures were 34 and 48 per cent, respectively. Since the early 1990s the public sector's share has been fairly stable at the 33-34 per cent level while the private service share increased from 42 to 48 per cent in 2005. It should be remembered, however, that an increasingly large number of employees in the service sector are providing services to manufacturing companies ('business to business services'). In the period considered many industrial companies have undergone reorganizations meaning, among other things, an *outsourcing* of service activities— such as consulting, marketing, computer and IT support, financial and insurance services, etc.— many of them quite knowledge-intensive.

Only 1 per cent of companies or corporate groups in Sweden have more than 200 employees, but together they account for 60 per cent of total employment in the private sector. This makes Sweden one of the countries with the heaviest *dependence on large companies*. However, the share of all employees working in SMEs (small and medium-sized enterprises) has gradually increased over the past decade. The larger companies are to an increasing extent focusing on their core activities, and as a consequence many service units have been transformed into—outsourced to—formally separate companies.

For their long-term survival the large enterprises depend on their ability to continuously develop their products and methods of production. This is one of the main factors behind the relatively high level of R&D spending in Sweden. Swedish multinationals are among the most R&D-intensive in the world. Since 1989 average R&D investments have increased by more than

³⁰ Compensation from the state system is commonly supplemented by additional payments from contractual insurance and special provisions in collective agreements.

10 per cent per year and in 2001 they corresponded to almost 4 per cent of GNP. This share seems to be larger for Sweden than for any other industrialized country. Private industrial companies—mainly multinationals in the pharmaceutical, heavy engineering, automotive, aerospace and IT sectors—account for about 75 per cent of these investments. Between 1990 and 2002, the average annual growth of knowledge-intensive production was 6 per cent. The service share of Swedish exports has also increased notably in recent decades. In 1980, it was 14 per cent and in 2003 about 23 per cent.

Concerning *corporate ownership and control*, the present Swedish model has emerged from the close interaction that was developed some decades ago between ‘high finance’, the government, and the trade unions. This makes it possible for owners to exercise control on the basis of a limited capital stake. As a consequence of a law instituted in 1973 unions may appoint two members to the boards of directors of most companies with at least 25 employees and three members to the boards of companies with at least 1000 employees. Employee participation in company decision making is institutionalized through the Act on Codetermination at Work (MBL) instituted in 1977. According to this law, an employer is obliged to consult with local unions before implementing decisions that involve a major change for the employees in general or an individual union member.

In recent decades (since the late 1980s) large parts of the service sector in the Swedish economy have been subject to different forms of *deregulation and/or privatization*. Prominent examples are the deregulation of the financial markets (in the mid- and late 1980s), railways (1988), taxi services (1990), domestic aviation (1992), postal services (1993), telecommunications (1993), and electricity (1996). The implementation of these and other reforms has involved the dismantling of detailed, although not overall, public governance. The recognition of competition as promoting economic efficiency and growth has also led to intensified efforts on the part of the governmental Competition Authority to prevent illegal competition and to enforce EU directives and rules on competition.

Household-related services accounting for a large share of female labour market participation—notably schooling, higher education, child care, health care and social care for the elderly and the disabled—are still mainly provided by the public sector. In recent years, however, tendering and outsourcing to private providers have gained some ground, although on the basis of *retained overall public governance and financing*. In 2002 private entrepreneurs took care of about 12 per cent of all children enrolled in day care or pre-school activities organized and supervised by the municipalities. In elder care the corresponding share was about the same, but in schooling significantly smaller, about 6-7 per cent. In the health care sector the provision of private hospital services has been held back by existing regulations.

5. Maintaining full employment?

Considering the quite favourable developments in the Swedish economy since the mid-1990s, including the high level of R&D investment, it is paradoxical that these improvements have not yet involved more substantial changes in total *employment*. Regarding R&D and the switch to more knowledge-intensive production, it should be observed, however, that while the *development* of new products and methods of production offers new job opportunities, the *implementation* of such innovations in large-scale production often requires a rather limited amount of labour per unit produced. As for labour-intensive production, a more profitable alternative might be to relocate mass production to countries where labour costs are considerably lower than in Sweden. Up to now, direct *re-localization* from Sweden to other countries has been limited, but the preservation of internationally competitive industry in Sweden has largely been based on labour-saving rationalization. Furthermore, the total *number* of job opportunities in R&D intensive activities will probably remain limited, and many of these jobs require highly educated workers.

In the aftermath of the crisis of the early 1990s, the scope for *countercyclical variations* in public investment and employment has become rather narrow. Since a significant further increase in the already high regular public employment is unattainable, the reestablishment of the 1980s levels of employment and unemployment might imply the creation of new job opportunities primarily *in the private service sector*.

The reduction of wage dispersion during the 1970s combined with a growing tax wedge may explain the comparatively low employment growth in the labour-intensive part of the private service sector, particularly household-related services. For the twenty-first century Sweden stands at a crossroads: *either* pursue its high-road strategy based on low wage dispersion, a continuous upgrading of skills (ALMP and lifelong learning), high investment in R&D and the development of a knowledge based service economy, together with employment-promoting structural and institutional reforms *or* conduct policies aimed at increasing wage dispersion and earnings inequality, at drastically reducing the tax wedge and the provision of public services and favouring the development of a low skill/low paid labour-intensive private service sector. Even though recent political developments indicate that the second scenario seems to be favoured, at least to some extent, by the new centre-right government, it is too early to say whether the recent measures will profoundly alter the Swedish model.³¹

Conclusion

As shown earlier, the present Swedish model appears today more in line with the three core components of the original model developed and implemented during the 1950s and 1960s. In our view, the period 1975-1991 represents a clear deviation from the original Swedish model, a departure that culminated in the most severe crisis that the country has experienced since the 1930s. The recent changes in economic policy towards a more restrictive and anti-inflationary macroeconomic policy, the re-orientation of active labour market policies towards supply-oriented measures and the structural reforms undertaken in the wage formation, tax and social protection systems suggest a revival and renaissance of the traditional Swedish model.

After a period of turbulence in the early 1990s, during the last decade the economy has undergone particularly favourable development. Unemployment has been cut by half, inflation has been curbed and the country appears to have recovered from the deep economic crisis of the early 1990s. Besides the reorientation of macroeconomic and employment policy, the recent modifications in industrial relations, in particular the clear tendency to a re-coordination of wage bargaining, have without doubt played a vital role in the Swedish recovery. These new developments reflect a desire on the two sides of industry to re-coordinate collective bargaining at industry level, and to restore the leading role of the traded good sectors in wage formation.

Hence, the tendency towards a re-coordination of collective bargaining co-exists with a marked tendency to a decentralization, differentiation and individualization of wage setting and working conditions. Although contradictory at first sight, these tendencies should not be interpreted as a weakening of the Swedish collective bargaining tradition, but rather be considered as a recomposition and adaptation of the industrial relations system in face of the major transformations in work organization and production processes during recent decades. In our view, these developments do not question the basic foundation of the Swedish model, namely a strong contractual tradition based on the existence of powerful social partners who

³¹ The new coalition Government has recently undertaken a tax reform, the so called *job deduction*, with an emphasis on reducing threshold and marginal effects for low and medium earners. The average tax rate for labour income will decrease by 1.5 percentage points. The marginal tax rate will be reduced significantly for low earners and by about 3 percentage points for labour income between EUR 10,800 and EUR 32,400. The Government proposes also to discontinue employers' contributions for parts of the service sector. In particular, it will reduce the tax on household-related services in order to favour the development of domestic services; this tax reduction is planned to take effect in July 2007.

enjoy considerable autonomy from the public authorities. Instead they reflect a transition and adjustment of the Swedish model to the new challenges posed by post-industrial societies. Sweden's various bipartite cooperation agreements concluded during the late 1990s may be interpreted as a new historic compromise combining employers' demands for greater flexibility with a desire on the part of the trade union movement to restore full employment and sustained income growth.

The various reforms of the Swedish social protection system undertaken during recent decades have essentially taken the form of a temporary reduction in the level of income compensation. With the notable exception of the fundamental restructuring of the tax and pension system, the reforms have left the welfare state almost intact. The social protection system is still clearly universal and inclusive in nature and it still enjoys a high level of across-the-board political and public support. Important structural reforms were undertaken in the tax and benefit system, particularly the reshaping of the pension system and the tax reform initiated of the early 1990s aimed at strengthening work incentives and fostering investment in human capital. These measures were also clearly in line with the general philosophy of the original Swedish model favouring integrative transitions instead of passive support and social exclusion. In our view, the social protection system constitutes an integrated and coherent system of time and income management over the life course. Actually, the large palette of individual reversible working time options in Sweden backed with a complete employment guarantee, generous income replacement rates and extended child care facilities gives large opportunities for households to adapt their labour supply to various situations and commitments over the life course without large income loss. In spite of the significant reduction of the gender employment gap over recent years, gender inequalities in time allocation and income over the life course persist. Actually, the bulk of unpaid housework and care activities are still predominately carried out by women, even though the male share of household and caring tasks has increased. Further efforts have to be made in order to reduce the gender gap in the division of unpaid work in order to favour a more even distribution of time and income over the life course. A gradual individualization of the parental leave system, further reduction of the prevailing gender wage gap and gender occupational segregation appear to be good policy instruments to cope with the remaining disparities and foster gender equal opportunity.

Last but not least, the third main element of the Rehn-Meidner model, the extensive use of ALMPs, i.e. the overall *policy of activation* still occupies a central role in Swedish stabilization policy and its reorientation towards supply-oriented measures (occupational and geographical mobility, active search programmes etc) in many respects stands out as well in accordance with the strategy initiated in the 1950s.

Overall, the recent modifications of the Swedish model constitute an interesting advance, creating an institutional framework favourable to the emergence of negotiated flexibility and a return towards balanced economic and employment growth. In our view, these developments reinforce the coherence of the Swedish model and the robustness of its social cohesion.

Several policy implications might be drawn from the Swedish experience. Reconciling employment with changing family commitments and other considerations such as lifelong learning, health aspects etc, requires policies which support a more flexible adaptation of time and income over the life course. Hence, more reversible time options which secure individual entitlements to make labour supply adjustments over the life course appear to be a good policy instrument for conciliating employment with other responsibilities, events and risks over the life course. The Swedish experience also shows that an increased range of statutory and/or collectively negotiated options for individual working-time adjustments over the life course have to be combined with income transfer mechanisms to prevent serious income reductions at particular life phases and limit their negative impact on subsequent earnings (such as pension claims). The Swedish experience highlights not only the role of legal provisions and empowerment (civil rights) but also the importance of their conditions of implementation: employment guarantee, income compensation, maintenance of social protection. In this sense

they illustrate the linkages and interrelated effects of various institutions such as the educational and care system, labour market, and social protection systems in shaping individual life trajectories and limiting social exclusion.

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