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# **“GLOBALIZATION AND THE SWEDISH LABOR MARKET”**

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## INTRODUCTION

In the last thirty years globalization has been a very wide and increasing phenomenon, especially in terms of market liberalization and integration, which has created both threats and opportunities, depending on the capacity of the countries to deal with its effects. As it has generated both positive and negative consequences in several areas, globalization has been defined as electricity: *if you put your finger in a socket, it's bad; but if you use it to plug in things that improve your well-being, it's wonderful*<sup>1</sup>.

The aim of this work is to analyze the complex relationship between globalization and the labor market, first from a theoretical point of view, and then focusing on the specific case of Sweden. The current global pressures have, in fact, a great impact on the labor market, which has to properly respond in order to adapt itself to the continuously changing conditions.

In section 1 the general phenomenon of globalization is deeply examined both as a phenomenon by itself, and in its theoretical relationship with the labor market. Its characteristic effects of relocation, outsourcing, offshoring, foreign direct investments (FDI) and job displacement are described in detail.

Section 2, instead, is dedicated to the specific relationship between globalization and the Swedish labor market. Firstly, the effects of globalization on the Swedish economy are analyzed, considering the importance of international trade, offshoring and FDI for the country. Secondly, the Swedish labor market is studied, considering its general characteristics, and the changes provoked by globalization on its employment structure and the weak categories of workers. Thirdly, the main instruments used by the labor market to respond to the global pressures are analyzed: the employment protection legislation, the unemployment benefits and the activation policies.

Section 3 suggests some solutions that, if introduced in the Swedish labor market, should improve its weaknesses. These regard the flexibility of the labor market and the labor incentives. The last section concludes the work.

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<sup>1</sup> This definition of the WHO was used to describe the relationship between globalization and health, but it can without doubt be used as a general definition of the relationship between globalization and the economic dimension (World Health Organization, (2001)).

## CHAPTER 1

# “GLOBALIZATION AND ITS EFFECTS ON THE LABOR MARKET”

### 1.1 The phenomenon of Globalization

In the last thirty years an increasing level of market liberalization and integration has characterized the world's economy. The term “Globalization” is used to identify events whose field of action covers the whole world, not remaining just at a national level. Market Globalization is just one aspect of the nowadays bigger phenomenon of intensification of social relations and international openness.

It is possible to define market Globalization<sup>2</sup> as the growth of economic interdependence between countries through the increasing level of international trade, the more and more intensive movements of capitals, labor and technology all around the world<sup>3</sup>. The borders between countries have become less relevant for goods, services and endowments that move from one side of the world to the other. Financial markets are deeply integrated thanks to a strong deregulation and the improving information technologies that permit thousand of transactions per day. The production of goods and services is increasingly fragmented into different phases that are realized in different countries, due to the phenomenon of outsourcing and offshoring, through which companies are looking for the most productive and cheapest way of production. The new international division of labor, and the increasing number of actors in the global scene have led to structural adjustments, differing from country to country, in relation to the different productive specialization.

Economists and international institutions have generally a positive opinion about globalization, as they focus on the gains that it leads to. The soaring integration has in fact contributed, together with a strong technological development, to increase wealth and income, and the major openness to international trade has a very positive influence on growth<sup>4</sup>. First of all, trade does conduct to absolute convergence to similar level of incomes among countries. Secondly, trade increases productivity as openness spreads knowledge and technologies among countries, enabling firms to determine the most efficient way of producing. This leads

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<sup>2</sup> From this point the term Globalization will be used to refer to economic globalization or market globalization.

<sup>3</sup> Quintieri B., *Tema del mese: l'era della Globalizzazione*.

<sup>4</sup> A. Berg, A. Krueger, (2003)

to a growth in productivity and, consequently, of exports, that increases the country's income. Productivity also improves thanks to the best quality of inputs that can be imported from other countries: openness and trade in fact allow specialization in relation to each country's comparative advantage. A third factor is that trade reduces corruption and monopoly power, which is a typical example of imperfect competition in closed economies. It's in fact almost impossible for just one firm to control the whole market in an open economy. Trade also encourages institutional reforms, which are fundamental prerequisites for trading relationships.

But the public opinion has often a negative position regarding globalization, arguing that it increases social inequalities<sup>5</sup>, that it is profitable only for large companies and not for citizens<sup>6</sup>, and especially that it has negative effects on the labor market<sup>7</sup>.

The effects of globalization on the labor market are surely one of the main aspects of the economical analysis of globalization. What has been happening in the last decades is that wages of the unskilled workers are falling in the developed countries and their unemployment is growing, while there is an opposite tendency in the developing countries where the exportations of labor-intensive goods are increasing, leading to a catch up of the unskilled workers wages. Western countries do in fact import an increasing quantity of goods from developing countries, characterized by a high level of unskilled labor, which decreases the demand of national unskilled labor. A consequence of this phenomenon is that unemployment has increased, and there is a larger gap between wages of skilled and unskilled workers.

It is though interesting to underline that the same effect of contraction of the demand of labor, especially in the labor-intensive sectors, where there is a high competition from the developing countries, is also caused by the continued development of technology. Improving the techniques of production reduces the demand of unskilled labor, similar to what globalization does. Thus, it is very important to separate these two phenomena in the analysis, in order to observe only the effects of globalization on the labor market, our area of interest.

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<sup>5</sup> According to the Eurobarometer (2008) 56% of the Europeans agree with this, while the 26% disagree.

<sup>6</sup> European Commission, (2008b).

<sup>7</sup> European Commission (2005).

## 1.2 Theories about Globalization and labor

In the last fifty years the volume of international trade has constantly grown at a high rate; services have become more important; foreign direct investments are increasing and constitute nowadays a fundamental step for MNCs. These are all consequences of globalization that, together with a fast improvement of innovations and technologies, has changed the international division of labor. A growing rate of unemployment is also an aspect that is characterizing the global economy in the last years. Opponents to globalization attribute this downturn in the labor market to the international integration and markets openness.

It is thus very important to analyze the mechanism that is beneath these effects and have a review of the literature about it. Traditional trade theories analyze the different factor endowments of the countries to understand the different levels of international trade. Factor endowments based on Heckscher-Ohlin theory is one of the most broadly accepted.

1- Heckscher-Ohlin theory: The H-O model is a 2x2x2 model, which means that there are two countries, two goods and two factors. The factors that are usually considered are capital and labor, or land and labor; the goods instead differ in their factor intensity, that is, at any given wage-rental ratio, production of one of the goods use a higher ratio of capital to labor than production of the other<sup>8</sup>. Thus, the H-O theorem affirms that in free trade a country will export the commodities and the services that intensively use its relative abundant factor, and it will import the commodities and the services of its relative scarce factor<sup>9</sup>. Therefore, relative endowments of the factors of production (land, labor and capital) determine a country's comparative advantage. According to this model there are winners and losers from international trade<sup>10</sup>, as the owners of a country's abundant factors gain from trade, while the owners of scarce factors lose<sup>11</sup>. So, applied to the contemporary reality, the H-O theorem highlights the reason why industrialized countries export capital-intensive goods, while they import labor-intensive goods from developing countries.

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<sup>8</sup> Krugman P.R., Obstfeld M., (2009).

<sup>9</sup> Markusen J.R., Melvin J.R., Kaempfer W.H. and Maskus K.E., (1995).

<sup>10</sup> In the Ricardian model instead, where there is just one factor of production (labor), everybody gains from trade and this leads in most cases to complete specialization (Markusen J.R., Melvin J.R., Kaempfer W.H. and Maskus K.E., (1995)).

<sup>11</sup> But there are still gains from trade in the sense that if the winners could compensate the losers everyone would be better off.

- 2- Factor-price-equalization (FPE) theorem: Related to the H-O model, the Factor-price-equalization (FPE) theorem asserts that free and competitive trade will make factor prices converge along with traded goods' prices, as long as production technologies are identical and characterized by constant returns to scale and countries are not fully specialized<sup>12</sup>. There are various economic forces that should bring factor price convergence<sup>13</sup>. The first is specialization. As the industrialized countries (capital-abundant) find new trade opportunities with the developing countries (labor-abundant), the formers stop producing labor-intensive goods and specialize in capital-intensive ones. On the contrary, the developing countries, which are rich in labor, specialize in the production of labor-intensive goods. Both specialization processes lead also to a reduction of the wage gaps, as the demand for unskilled labor in the developed countries decreases, while it rises in the developing ones. The second force is given by capital flows. Capital moves, in fact, from industrialized countries to developing countries, because of the higher rate of return offered by the last ones. Capital permits, thus, the creation of new jobs in the developing countries and makes the local labor demand grow and this raises wages. In the developed countries, instead, the opposite process takes place, making wages converge. The third force is the spill-over of technological knowledge. This is usually transferred through observation and imitation, even though there might be patents and intellectual property rights to protect it. However patents expire after some years<sup>14</sup>, and most of the technological knowledge is not protected, because it is too widespread to be patented. The fourth force of FPE is migration. People mainly migrate from low-wage developing countries to high-wage developed countries, and this makes labor scarcer in the first countries and more abundant in the second ones, reducing the international wage differences<sup>15</sup>. But all this happens only in an idealized model, as in reality complete FPE is not observed because of wide differences in resources, barriers to trade, rigid wages and international differences in technology.
- 3- Stolper-Samuelson theorem: Strictly connected to the Heckscher-Ohlin's model is the Stolper-Samuelson theorem that underlines the relationship between goods prices and factors prices. According to the Stolper-Samuelson theorem, in fact, if there are

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<sup>12</sup> Markusen J.R., Melvin J.R., Kaempfer W.H. and Maskus K.E., (1995).

<sup>13</sup> Sinn H.W., (2007).

<sup>14</sup> Usually after 30 years (Sinn H.W., (2007)).

<sup>15</sup> Sinn H.W., (2007).

constant returns to scale and both goods (the capital-intensive and the labor-intensive one that are in H-O model) continue to be produced, a relative increase in the price of a good will increase the real return to the factor used intensively in that industry and reduce the real return to the other factor<sup>16</sup>. According to the Stolper-Samuelson model the entrance of the developing countries in the international competition, due to the reduction of trade barriers and transport costs, permits to labor-intensive goods, produced in the East countries, to substitute the ones coming from the industrialized countries. As a result, the demand of unskilled labor decreases in the Western countries making unemployment grow.

### **1.3 Relocation, outsourcing and offshoring**

In the current time of greater integration and international openness, the fragmentation of the production is a phenomenon that is characterizing the majority of the MNCs. Companies can nowadays coordinate different phases of the production even though they take place in different countries, many kilometers from each others. This is indeed possible thanks to the reduction of the transport costs, to the liberalization of the markets that has put down custom duties and tariffs, and to the development of the ICT<sup>17</sup> that has made communications very easy, fast and cheap.

An important consequence of this phenomenon is that international specialization is changing: companies do not follow the production process of a good from the beginning phase to the last one, but they specialize on intermediate goods and on a specific production phase.

It is thus important to underline that this peculiarity of globalization, the fragmentation of the production into many different phases allocated across countries, is not a very recent phenomenon. What is really new is the dimension that it has acquired: relocation is not longer characterizing only traditional sectors (e.g. textile), which use a low level of technology and whose production was relocated in developing countries to take advantage of the low labor cost. Contemporary relocation, indeed, is characterizing also the service sectors and the manufacturing industry with a higher level of technology. This is changing also the kind of

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<sup>16</sup> Markusen J.R., Melvin J.R., Kaempfer W.H. and Maskus K.E., (1995).

<sup>17</sup> It is important to underline that globalization and technological development are strictly interrelated: the increase of the former does in fact stimulate the latter as a tool to be competitive, and globalization does certainly make technology circulate all around the world (Dell'Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008)).

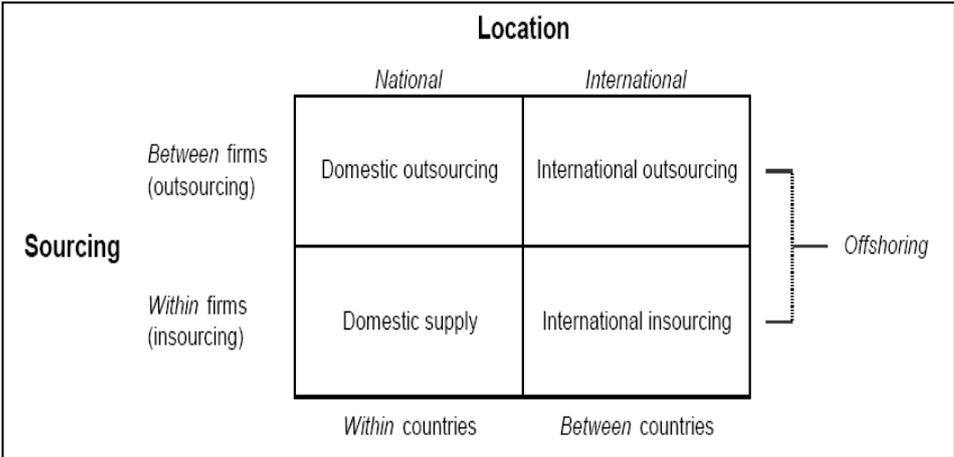
labor that is used in foreign countries: not just the unskilled one, but also the very skilled one, which is emerging from some great Asian economies, like China and India.

1.3.1 Definition of outsourcing and offshoring

Strictly implied in the concept of relocation, it is important to define the phenomena of outsourcing and offshoring. The two terms are often associated, but neither implies the other.<sup>18</sup> As Olsen K.B. (2006) states, outsourcing refers to the relocation of processes to external providers regardless of the provider’s location, while offshoring refers to the relocation of jobs and processes to any foreign country without discerning whether the provider is external or affiliated with the firm.

Outsourcing, meaning the purchase of intermediate inputs (excluding raw material) from other companies<sup>19</sup>, can thus be both domestic and international. Enterprises can in fact “outsource” one or more processes and services both in their own country and in a foreign country. Offshoring, instead, is related only to the international dimension. However, it is important to distinguish between insourcing and outsourcing. As it can be seen from Figure 1.1, offshoring can take place between firms (outsourcing) or within firms (insourcing), but both in an international dimension.

Figure 1.1 Matrix of insourcing, outsourcing and offshoring



Source: Olsen K.B., (2006).

<sup>18</sup> Olsen K.B., (2006).

<sup>19</sup> Kirkegaard J.F., (2005).

In the first case, the company commits to another company located abroad some of its activities or services, through a subcontract. In the second case, instead, the company transfers some of its activities or services to a foreign affiliate of its own group.

The company's decision to produce in-house or to outsource is traditionally related in the literature to three main theories: the theory of the firm of Coase (1937), which includes the agency theory and the transaction costs theory. According to the agency theory there is a mismatch between the interests of the firm and those of the employees and this can lead to inefficiency. Outsourcing can thus solve the problem, by committing to an external provider some activities or services of the production process and, letting the firm having the control of the output through a contract. The transaction costs theory, instead, underlines that outsourcing is suitable only if the cost advantage is higher than all the transaction costs that it causes.

### *1.3.2 Effects on the labor market*

Outsourcing and offshoring have become very important and frequent in the last twenty years, becoming also a part of all MNCs' business strategy. The decision to relocate is mainly connected to the costs of production and distribution of the firm: it should in fact permit to substitute an inefficient process with a cheaper and more efficient one. At the same time outsourcing and offshoring enable the firm to focus only on the core business, reinforcing its strengths and becoming more competitive<sup>20</sup>.

But what are the effects these two phenomena produce on the labor market both in the industrialized and in the developing countries?

The consequences they produce on employment and wages can be direct or indirect, and they depend on whether the long or the short run is considered. The main difference between the effects on employment in the short and in the long term is that the former happens to be mostly direct and negative, while the latter are often indirect and positive. Outsourcing and offshoring in fact, have been transferring the low-skill production processes from industrialized countries to developing countries, so there has been a movement of this kind of activities from North (high-skill countries) to South (low-skill countries). Relocated activities

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<sup>20</sup> It's important to underline that outsourcing and offshoring never regards the core business, as there is the risk for the firm to lose the competitive advantage, if the external provider takes the control of the process (Olsen K.B., (2006)).

are, thus, less skill-intensive than those which still remain in the industrialized countries, but more skill-intensive than the ones which were previously in the developing countries. There is therefore a movement of the demand of labor toward a more skill-intensive kind of labor in both developed and developing countries. The effects of globalization on workers can be divided into three components: the first related to the Stolper-Samuelson theorem of change in the mix of tasks performed nationally; the second connected to productivity, which increases thanks to the integration to complementary activities abroad; the third is a transformation in the world's supply of factors, linked to the entry in the international trade scenario of new countries, like China<sup>21</sup>.

However, outsourcing and offshoring have a negative impact on wages and employment in the short run<sup>22</sup>, but the consequences in the long run are quite different. Considering a longer period, in fact, they lead to different kind of benefits<sup>23</sup>. In the developing countries there may be an increase of the wages (while in the developed countries the wage of the low-skilled workers may decrease)<sup>24</sup>, and this may increase domestic consumption, strengthening the economy and the imports from industrialized countries. In the developed countries there may also be benefits: outsourcing and offshoring may, in fact, lead to higher productivity and lower costs of production. This may conduct to lower prices of the products and therefore to higher real wages, increasing the living standards. For people who lost their job in the developed countries, there may be the benefit to find a new, more high-skilled and gratifying job, even though there may be of course some adjustment costs<sup>25</sup>.

#### **1.4 Foreign direct investments**

Foreign direct investments (FDI) are another important aspect, typical of the contemporary era of globalization. Almost 84% of the European companies had investments in different host regions in year 2008 and the trend is increasing<sup>26</sup>. Sales and production are the most internationalized functions, with respectively 46% and 41% of the companies carrying out

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<sup>21</sup> Grossman G.M., Hansberg E., (2006, cited in Dell'Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., 2008, p.10).

<sup>22</sup> This is what is underlined by the opponents to outsourcing and offshoring.

<sup>23</sup> This is the supporters' argument. The problem with the positive effects of outsourcing and offshoring is that they do not appear immediately and they do not affect the same people who have standed the negative effects. So sometimes it seems that the positive effects are not associated to the two phenomena, while the negative effects are.

<sup>24</sup> These two opponent directions of the wages should lead to the FPE.

<sup>25</sup> OECD (2005, cited in Olsen K.B., 2006, p.8).

<sup>26</sup> United Nations conference on trade and development, (2008).

more than half of these activities in a foreign country. The logistic function comes next, with a percentage of 33%.

#### *1.4.1 Definition and conditions*

FDI are investments in which the investor acquires a substantial control interest in a foreign firm or sets up a subsidiary in a foreign country<sup>27</sup>. It implies ownership and/or control of a business enterprise abroad. Usually the control means acquiring at least 10% of the ordinary shares of a company or the equivalent votes in the assembly. It is interesting to notice that contemporary international trade is increasingly developing on an intrafirm basis, rather than through export markets.

FDI differ from portfolio investments in three main ways: they don't move large amounts of capital among countries, but they often use the foreign capital market; they are not induced by the difference in the return to capital, but they rise from the opportunity to take advantage of specific business opportunities; they need a special advantage to enter in the new foreign market, otherwise they are at a disadvantage compared to the domestic firms.

FDI differ also from outsourcing and offshoring, even though they can sometimes be included in the concept of offshoring<sup>28</sup>. The demarcation between these phenomena relies on what an intermediate input is, what constitutes a final good and where products and services are sold. Kirkegaard (2005) underlines that the focus on intermediate inputs is useful to isolate outsourcing and offshoring from FDI. "Horizontal FDI" are, in fact, characterized by the production of a final product or service, which is going to be sold in the foreign market. But a firm can also carry out a "vertical FDI", when intermediate inputs are produced abroad and then imported to be used in the production process of the parent firm, and in this case FDI and offshoring overlap<sup>29</sup>.

FDI is of course done by firms in a profit perspective, but it is not always a successful strategy. There are many disadvantages of setting up MNE<sup>30</sup> operations abroad: there are costs in communication and transportation, costs due to language and cultural differences, risks related to exchange rate variations, lack of familiarity with the host country's laws,

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<sup>27</sup> Markusen J.R., Melvin J.R., Kaempfer W.H. and Maskus K.E., (1995).

<sup>28</sup> Kirkegaard J.F., (2005).

<sup>29</sup> The author makes the example of a company which builds a factory in a foreign country (e.g. China) to serve the foreign country's market. In this case it is a "horizontal FDI" and not offshoring. But if the company moves the whole domestic production to China and then imports the products back into its home country, the distinction is very difficult (Kirkegaard J.F., (2005)).

<sup>30</sup> MNE are in this case multinational enterprises that make FDI.

taxes, government procedures, and costs connected to the higher wages paid to managers and technicians abroad. The domestic firms haven't of course this kind of disadvantages, and this is the reason why MNE will enter in a foreign market only if the disadvantages are well compensated by other and larger advantages.

#### *1.4.2 Consequences for the labor market*

Foreign direct investments may broadly bring advantages both for the investor firm and for the host country. This last receives certainly benefits from the introduction of new and modern technologies, organizational structures and managerial models. This leads to positive effects on productivity and labor demand, both in the host country and in the home country. Another positive effect of FDI is clearly linked to the products price, which will decrease thanks to larger competition on the international scenario<sup>31</sup>.

Higher competition on the goods market and higher productivity can thus favor workers, compensating the adverse change in the world's labor supply. But it is important to consider also the effects that these advantages, related to FDI, may have on the labor demand elasticity, both in the host country and in the home country. FDI and international openness to trade in general, tend to make labor demand more elastic, which means that the demand for labor will be more responsive to variations in wages<sup>32</sup>. The main cause of the more elastic labor demand lies in the fact that employers can substitute very easily workers, either by investing in a foreign country or by importing the products. Thus greater foreign direct investments increase labor demand elasticity.

The increase in labor demand elasticity is important, because it can influence workers through four different channels: higher labor market volatility, lower labor standards, lower bargaining power of workers, larger difficulties for governments to apply redistributive policies<sup>33</sup>. The first aspect highlights the fact that a higher elasticity causes greater instability in the labor market results. Wages and employment become more volatile and this leads to higher skill premiums in case of long unemployment or lower wage after the displacement. With respect to the second effect, it is important to underline that the costs for labor standards are paid both by workers and by employers, depending on the labor demand elasticity. When the elasticity increases the share of costs paid by the workers will grow. Thus, it will be more

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<sup>31</sup> Dell'Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

<sup>32</sup> Rodrik D., (1997).

<sup>33</sup> World Trade Organization and International Labour Office, (2007).

difficult to maintain the same level of labor benefits, without suffering a fall of the wages. The third channel is connected to a lower bargaining power of workers, which is due to the fact that domestic workers can be substituted without problems by foreign workers. The fourth and last factor is linked to the larger difficulties for governments to apply redistributive policies. This is mainly caused by the fact that trade liberalization decreases the power of the governments to control wages and this lead to changes in the domestic welfare<sup>34</sup>.

## 1.5 Job displacement

Traditional trade models assume that there is full employment in all sectors, and when trade liberalization affects the labor market, workers move automatically into new jobs, without creating the problem of the trade-related unemployment<sup>35</sup>. But trade-related unemployment is a contemporary reality, which leads to the large phenomenon of job displacement. According to Kletzer L.G. (1998), displaced workers are persons who have been involuntarily separated from their jobs by mass layoff or plant closure, and who have little chance to be recalled to their old jobs. The Displaced Worker Survey (DWS)<sup>36</sup>, instead, considers displaced, persons who lost their job because of a plant closure, a mass layoff or the end of a business, during a period of recall of three years.

It is very difficult to measure the job displacement that derives from trade liberalization, as there are many contributing factors that generate it<sup>37</sup>. The increasing level of international trade has, of course, the main role, but there are also other important elements, which play a significant role: technological development, which changes the consumer preferences, low productivity, changes in the consumer demand, poor managerial skills, deep recessions and corporate downsizings. According to the DWS, almost 6.5 million workers were displaced every year during the period 1997-2001, with an annual incidence of 5.1% (OECD, 2005). The main question about the calculation of displaced workers is that it depends a lot on the borders around the definition of displaced worker. It is of course obvious that the job loss

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<sup>34</sup> Spector (2001, cited in World Trade Organization and International Labour Office, 2007).

<sup>35</sup> Traditional trade models state that trade liberalization influences the quality of jobs, but not the quantity, as the full employment hypothesis is assumed. Different sectors need in fact different kind of workers, and with the new global competition the relative demand for different kind of workers will change in the long term. This will affect the relative wages, making some workers be better and other be worse. (World Trade Organization and International Labour Office, (2007)).

<sup>36</sup> The DWS is a survey which collects data about national displaced workers since 1979. Other data sources are: the Trade Adjustment Assistance (TAA), the Mass Layoffs Statistics (MLS), the Business Employment Dynamics (BED), and the Job Openings and Labor Turnover Statistics (JOLTS).

<sup>37</sup> OECD, (2005).

must be permanent, and not just temporary. Nonetheless, several different methods have been used to try to understand the relationship between job displacement and international trade. In particular, it is interesting to identify the categories of workers that have been more affected by market liberalization.

To begin with, four main reasons can be identified<sup>38</sup>: slack work, plant closing, position abolished and other, which include self-operated business failed, seasonal job completed and some other reason. Job displacement, thus, takes place in different ways, in relation to several different factors: age, gender, race, education, sector and industry. Education plays a very important role, as more educated workers are much less likely to be displaced than less educated workers are. This leads to the difference between white and blue collars: the former are skilled workers, who perform professional and salaried jobs, while the latter deal with manual jobs and get hourly wages. It is underlined that blue collars workers are more damaged by job displacement than white collar ones<sup>39</sup>. Displacement rates are then much higher in manufacturing sectors than in services. Within the manufacturing sector there are not so many differences, with the exception that in high-international-competition industries ethnic minorities and women are a very large percentage of job losers<sup>40</sup>. There are also many differences within different industries: the clothing, the textile and the footwear industries have for example been more exposed to job displacement than the steel industry during the period 1979-1999 in the U.S.A<sup>41</sup>. This reflects the fact that the differences within the phenomenon of trade displacement are mainly due to the specificity of the sectors, which change continually in space and time. This is the reason why it is difficult to have solid policies for the reintroduction of displaced workers in the labor market.

However, job displacement is a very much analyzed question, as it originates many costs. It involves, in fact, the need for workers to look for a new job, and this creates high earning losses. This can be explained by the theory of specificity of human capital<sup>42</sup>: displaced workers usually earned more in their previous job, because they acquired specific skills through the training on the job (learning by doing), which is directly proportionate with task in the firm and the wage level, and when they start with a new job they have to start over learning new specific skills. Human capital can thus be divided into general, which is applicable in different firms of the same industry, and specific, which is not transferable to

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<sup>38</sup> Farber (1997, cited in Kletzer L.G., 1998).

<sup>39</sup> Kletzer L.G., (1998).

<sup>40</sup> Kletzer L.G., (2001).

<sup>41</sup> Kletzer (2001, cited in OECD, 2005).

<sup>42</sup> Petrucci A., Quintieri B., (1999).

other firms<sup>43</sup>. The difference explains why the earning loss is higher for the workers who completely changed industry, compared with the ones of the workers who remained in the same industry.

As job displacement causes a lot of earning losses, an intervention of the welfare state in each country has been considered necessary. Specific programs for reemployment and replacement have been introduced, in order to try, together with unemployment insurance system, to get a solution to the problem. Among these, retraining programs have the purpose to increase the skills of the workers, trying to positively affect their long run earnings. Job search assistance programs, instead, have produced short run positive effects, reintroducing the job losers in the labor market. However it is difficult to believe that this kind of programs will alleviate the long term earning losses<sup>44</sup>.

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<sup>43</sup> Kletzer L.G., (1998).

<sup>44</sup> Kletzer L.G., (1998).

## CHAPTER 2

### “GLOBALIZATION AND SWEDISH LABOR MARKET”

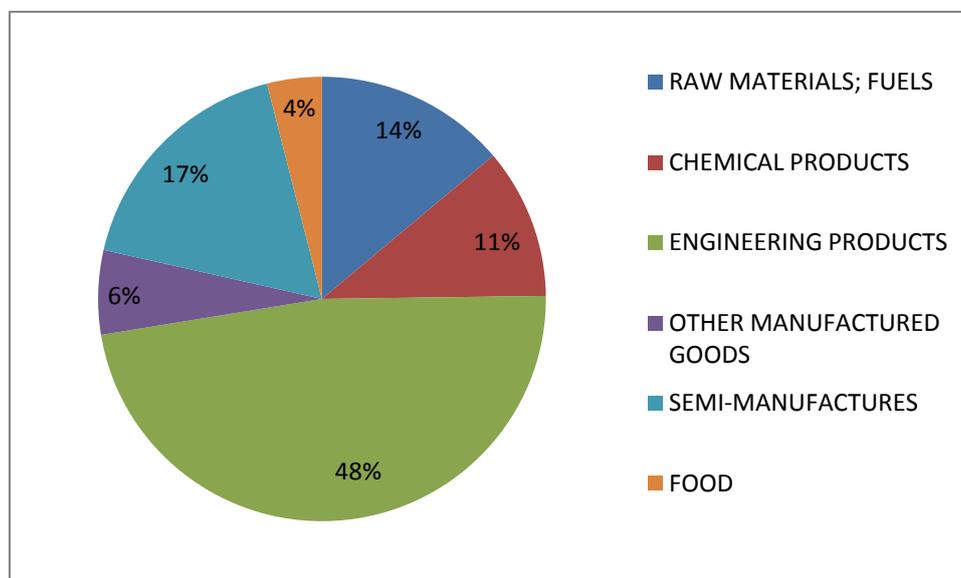
#### 2.1 The effects of Globalization on the Swedish economy

##### 2.1.1 General characteristics of the Swedish economy

Sweden is characterized by a very mixed economy, where several sectors play an important role. First of all, its traditional forestry<sup>45</sup>, iron and steel industries, which have permitted to the country to develop at the beginning of the 19<sup>th</sup> century, have still a relevant importance. In fact, raw materials and fuels (wood, paper pulp, ores and fuels), achieve a share of 14% of the total Swedish exports, and semi-manufactures (paper and board, wood manufactures, prefabricated buildings, non-ferrous metals and iron and steel) a share of 17% (Figure 2.1).

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Figure 2.1 Swedish specialization sectors



Source: Swedish Trade Council.

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<sup>45</sup> This includes the production both of timber and paper.

Thanks to the trade of these natural resources, Sweden gained the position of fourth richest country in the world in 1970<sup>46</sup>.

The following development of the country, led it to expand a competitive engineering industry, which represents 48% of the total Swedish exports. Within this sector telecommunications apparatus have a share of 14%, passenger cars 10%, parts for motor vehicles and power generating machinery 8%<sup>47</sup>. Another important sector is the chemical one (11%) which is mainly constituted by the pharmaceutical industry.

So besides traditional productions, Sweden is notable for having a large number of internationally important MNCs, which mainly represent the relevant sectors that have increasingly expanded in the country: ABB, Astra Zeneca<sup>48</sup>, Electrolux, Ericsson, H&M, IKEA, and Tetra Pak. The design and fashion industry are, instead, the new entries in the “made in Sweden” exports and they are showing a very positive trend in the last years<sup>49</sup>.

However Sweden has a really important comparative advantage in the productions which use a high-skilled labor force<sup>50</sup>. This characteristic certainly derives from the transformations due to globalization: the increasing market liberalization has, in fact, increased the demand of low-skilled labor force in the developing countries, and the one of high-skilled labor force in the developed countries.

Sweden has, thus, been very influenced by globalization, such as the other Scandinavian countries, as it can be noticed in Table 2.1. In the index for economic freedom several factors are included: the state intervention, the quality of the legal system, the system of payments, the grade of liberalization and the level of regulation. The total globalization index, instead, is calculated considering social, political and economical globalization, taking into account the trade flows, the international phone calls and the participation in international political organizations. It can be noted that the Nordic model, and especially Sweden, has gone through an increasing impact of globalization, in comparison to the other groups of countries. In particular, the Swedish economical freedom index has been calculated also removing the variable of the state intervention, and it results that the level of globalization’s influence continues to be high. This underlines that Sweden has maintained a big public sector, high taxes and a universal welfare state, but it has also increased the economical freedom through deregulations and liberalization.

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<sup>46</sup> Bergh A., (2009).

<sup>47</sup> Swedish Trade Council.

<sup>48</sup> This company is only partly Swedish.

<sup>49</sup> These are included in the voice “other manufactured goods” in Figure 2.1.

<sup>50</sup> Kruse A., (2009).

Table 2.1 Development of economic freedom and globalization in Sweden and other countries in 1970-2003.

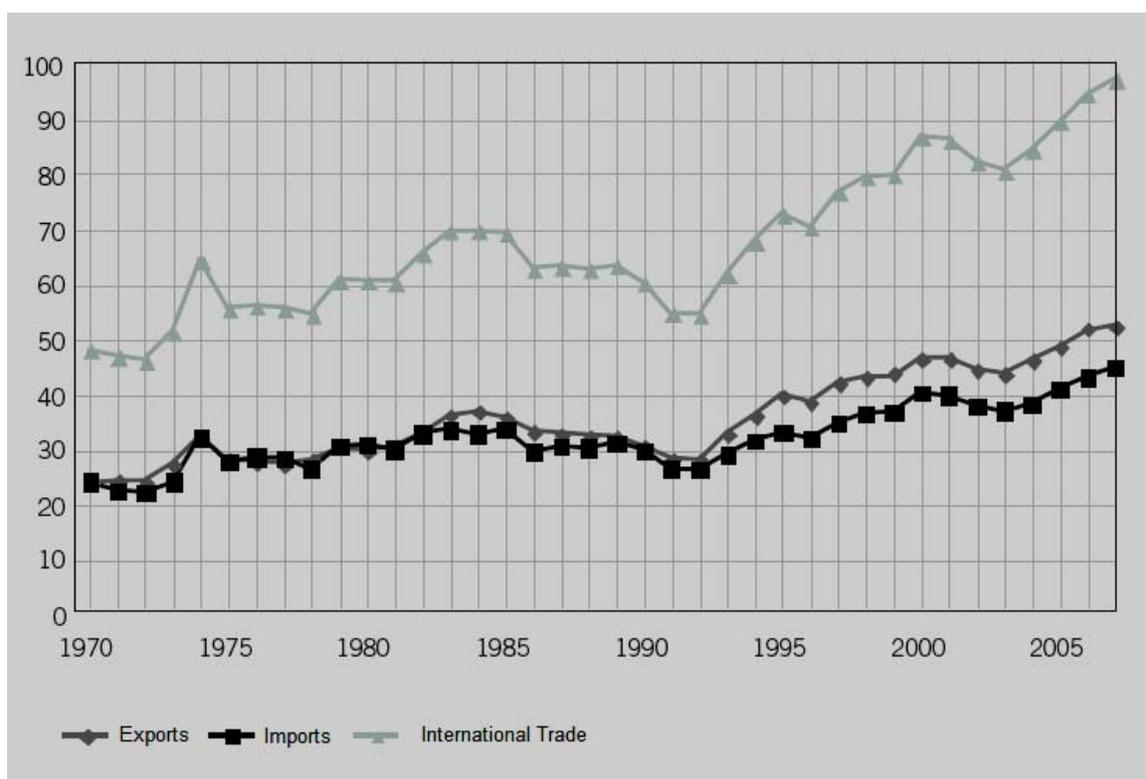
WELFARE MODEL	Economic freedom (Index 1-10)		Total globalization (Index 1-5)		Economic globalization	
	<i>Level</i>	<i>Increase</i>	<i>Level</i>	<i>Increase</i>	<i>Level</i>	<i>Increase</i>
	<i>1970</i>	<i>1970-2003</i>	<i>1970</i>	<i>1970-2003</i>	<i>1970</i>	<i>1970-2003</i>
<u>Scandinavian/Nordic</u>						
Sweden	5.3	2.03	2.79	2.19	3.84	1.21
Finland	6.58	1.07	3.57	1.60	3.74	1.37
Norway	6.58	1.34	2.46	1.45	3.79	0.90
Denmark	5.96	1.08	2.58	1.51	3.52	0.90
<b>Average</b>	<b>6.1</b>	<b>1.38</b>	<b>2.85</b>	<b>1.69</b>	<b>3.72</b>	<b>1.09</b>
<u>Continental and Mediterranean</u>						
Germany	7.33	0.12	2.49	1.43	3.60	0.76
France	6.19	0.72	2.93	1.69	3.55	1.24
Belgium	7.27	0.10	2.50	1.08	4.89	0.61
Nederland	6.99	0.75	2.18	1.25	3.97	1.60
Italy	5.82	0.76	2.74	1.07	2.88	0.76
Switzerland	7.37	0.80	2.72	1.48	3.65	1.51
<b>Average</b>	<b>6.91</b>	<b>0.54</b>	<b>2.59</b>	<b>1.33</b>	<b>3.76</b>	<b>1.08</b>
<u>Anglo-Saxon</u>						
Canada	7.37	0.66	2.48	1.63	4.13	0.56
Australia	6.61	1.24	2.43	1.83	3.11	1.23
UK	5.94	2.21	2.46	1.99	2.78	1.72
USA	6.96	1.23	3.32	1.84	4.19	0.24
<b>Average</b>	<b>6.50</b>	<b>1.33</b>	<b>2.67</b>	<b>1.82</b>	<b>3.55</b>	<b>0.94</b>

Source: Gwartney and Lawson (2003) and Dreher (2006a) cited in Bergh A., (2009).

### 2.1.2 International trade, offshoring and FDI

In the last forty years, international trade has assumed considerably more importance in the European countries, increasing from 39% of the GDP in the 1960 to 78% in 2006<sup>51</sup>. In Sweden this growth of trade has been even more relevant, passing from 45% to 94% of the GDP. It is important to underline that the process of increase of international trade has been particularly fast during the last fifteen years, in comparison to the previous decades. Figure 2.2 represents the trend of Swedish international trade during the period 1970-2007. As it can be noticed it has grown remarkably, while imports and exports have followed almost the same path of evolution, until the '90s when the share of exports on the GDP has become larger than the one of the imports.

Figure 2.2 Swedish international trade in relation to the GDP (1970-2007), percentage



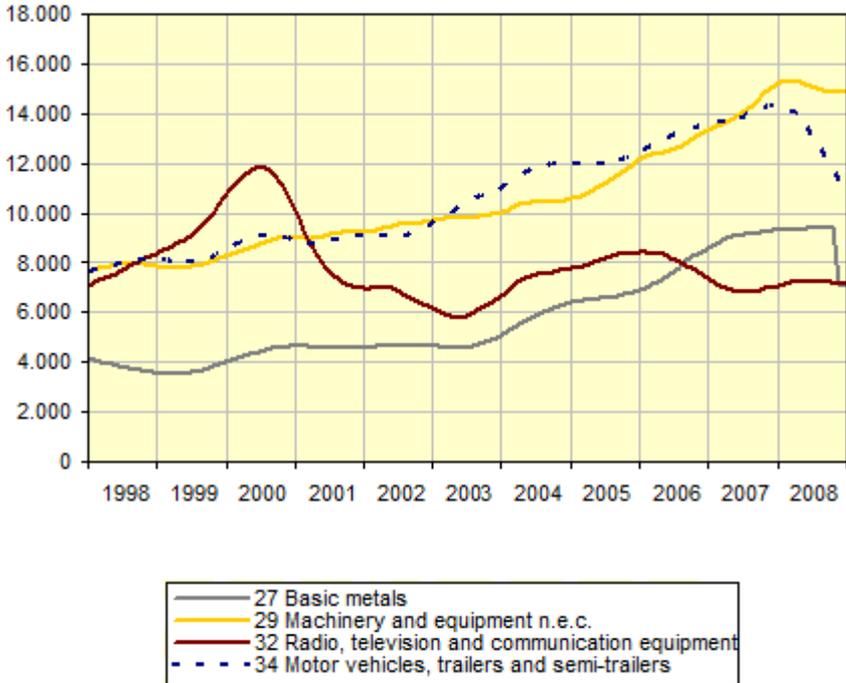
Source: SCB cited in Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

<sup>51</sup> These data are referred to EU15. For the OECD countries the variation during the period 1960-2006 was from 22% to 46% of the GDP. (Calmfors L., (2008)).

Another element which highlights the effects of globalization in the European countries is the increase of the imports of low-skilled goods from developing countries. These have grown from 2.7% of the GDP in 1990 to 4.9% in 2004 in Europe<sup>52</sup>. In Sweden the average of imports from the developing countries is lower than the European value: it passed from 1.9% of the GDP in 1990 to 3.4% in 2004.

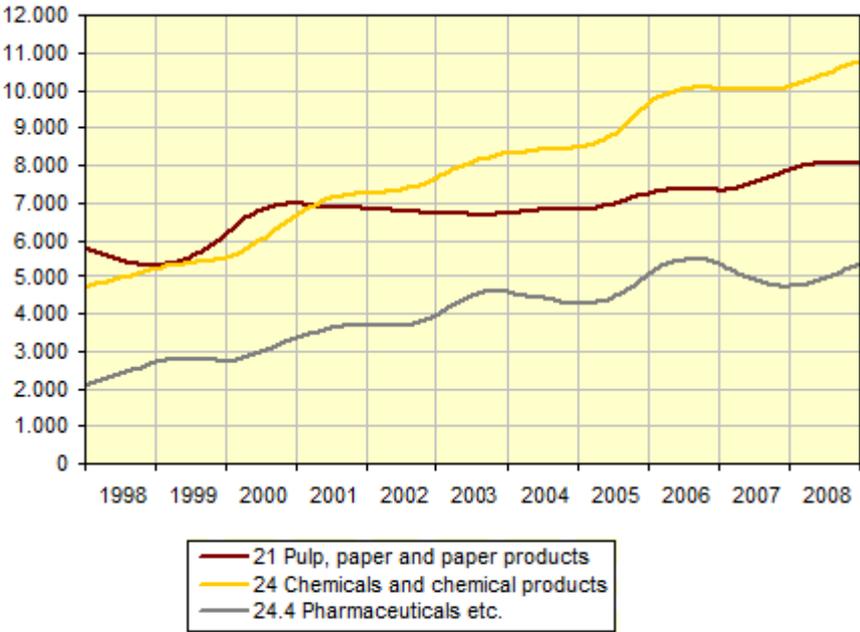
In relation to Swedish exports, instead, they are mainly constituted by natural resources, such as basic metals, pulp, paper and paper products, machinery and equipments, automotive, ICT equipments, chemical and pharmaceutical products. As it can be noted from Figure 2.3 (a) and (b) they have all increased during the period 1998-2008, with the exception of the category of radio, television and communication equipment which has remained constant. This demonstrates a strong capacity of Sweden to take advantage of the Globalization forces, and increasing its exports.

Figure 2.3 (a) Swedish exports by commodity groups



<sup>52</sup> These data refer to EU15. Considering the OECD countries, instead, the variation has been from 2.7% of the GDP in 1990 to 4.9% in 2004. (Calmfors L., (2008)).

Figure 2.3 (b) Swedish exports by commodity groups



Source: SCB

This Scandinavian country has also followed the wave of internationalization and openness through the practice of outsourcing and offshoring. In particular offshoring towards the developing countries has widely increased (from 0.4% to 1.1% during the period 1995-2003) in comparison to the one towards developed countries, which has grown from 8.8% to 9.3% during the same period, underlining a percentage of growth of 6% compared to the former of 156%<sup>53</sup>. The variation of offshoring towards developing countries is not so remarkable if the absolute value is considered, but as it started from a very low level, the percentage value is really relevant. As it can be noticed from Table 2.2, offshoring towards developed countries has decreased in some sectors, while considering the phenomenon towards developing countries, it can be noted that there has been a growth for all sectors, with the exception of the textile and the chemical one. The growth has been really significant for the clothes industry, the leather products and the tele-products.

<sup>53</sup> Offshoring for the sector *i* is calculated as the ratio between the imported inputs for the sector *i* and the total sales of the sector *i*. In this case the percentage variation for the period 1995-2003 has been calculated, but it is also possible to use an absolute value for each year. (Ekholm K., (2008)).

Table 2.2 Variation of Swedish offshoring in the period 1995-2003 (percentage)

INDUSTRY	ALL COUNTRIES	DEVELOPED COUNTRIES	DEVELOPING COUNTRIES
Alimentary	1.78	1.57	0.22
Textile	-9.85	-8.30	-1.54
Clothes	5.08	2.01	3.07
Leather prod.	4.97	2.14	2.83
Timber	1.51	0.68	0.83
Paper	1.25	1.14	0.11
Graphic prod.	-0.54	-0.57	0.03
Chemical prod.	-1.43	-1.34	-0.08
Plastic prod.	0.30	-0.09	0.39
Mineral prod.	-0.07	-0.21	0.14
Metals	2.87	2.44	0.42
Machineries	2.01	1.39	0.62
PCs	4.61	4.40	0.21
Electrical Mach.	-1.38	-2.12	0.75
Tele-products	4.86	0.81	4.05
Motors	2.91	1.74	1.17
Other transport mach.	-2.04	-3.17	1.13
Other productions	0.87	0.39	0.48
<b>Total industry production</b>	<b>1.20</b>	<b>0.53</b>	<b>0.67</b>

Source: Ekholm K., (2008).

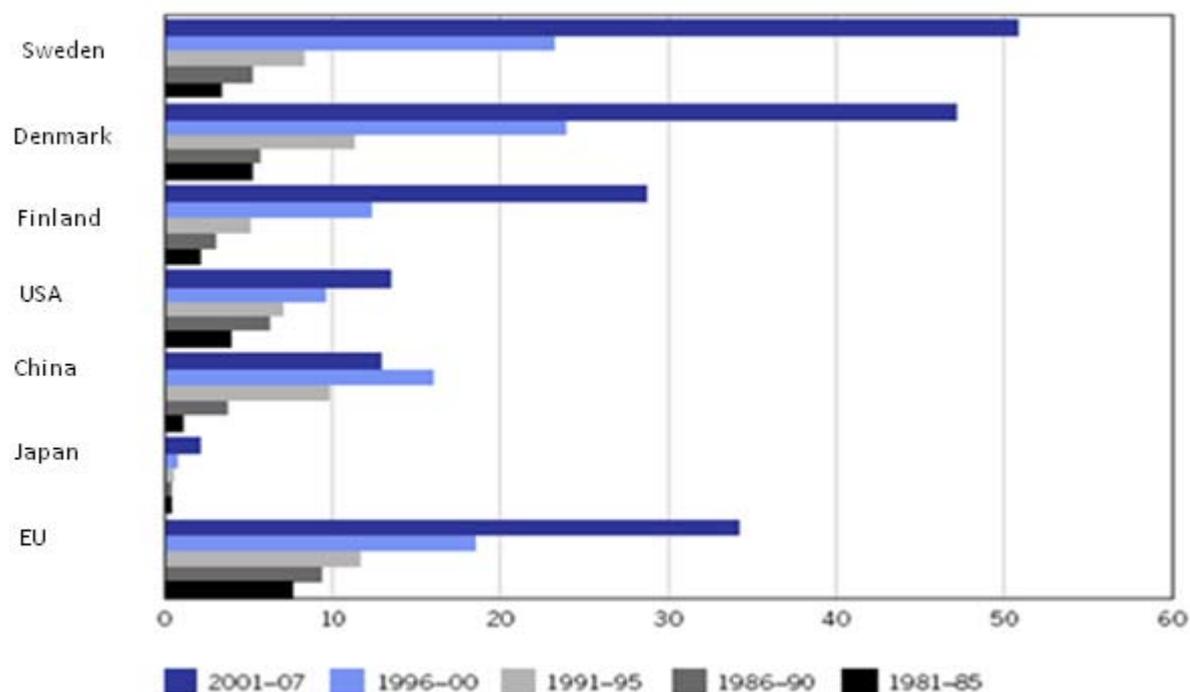
Another important characteristic of globalization is the large number of FDI. Sweden has invested very much abroad, realizing both horizontal and vertical foreign direct investments, even though the last ones play a much more important role, as it can be noted in Figure 2.4.

In fact the share of vertical FDI on the Swedish GDP was about 2.8% in 1980 (under the level both of the EU15, which had a percentage of 6%, and the OECD countries, which reached the 6.2% of the GDP) while in 2005 it achieved the 56.5%, which is over the average both of the EU15 countries (39.9% of the GDP) and the OECD ones (26.8%)<sup>54</sup>.

<sup>54</sup> Calmfors L., (2008).

Figure 2.4

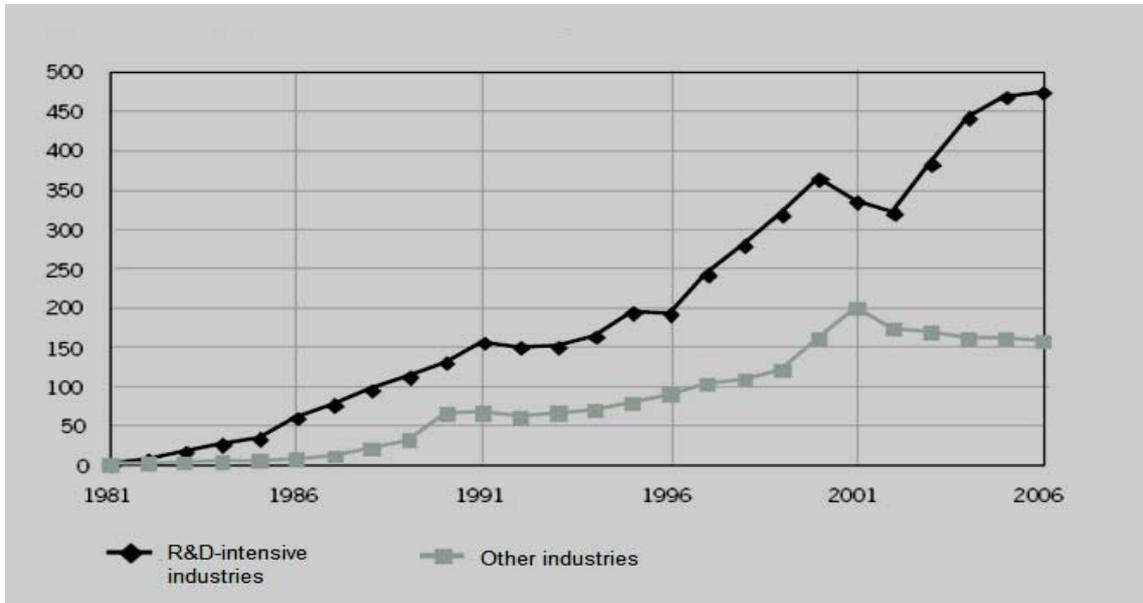
Swedish FDI as a percentage of the GDP (1981-2007)



Source: UNCTAD, World Investment Report cited in Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

In particular the Swedish FDIs in the developing countries are increasing considerably: in 1994 they were 2.7% of the total direct investments (0.7% of the GDP), while in 2003 they reached the percentage of 8.9% (4.6% of the GDP). The majority of the FDIs regards sectors with a high capital intensity that are characterized by large investments in R&D (Figure 2.5).

Figure 2.5 Swedish FDI during the period 1981-2006 (billion SEK)



Source: Riksbanken and SCB cited in Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

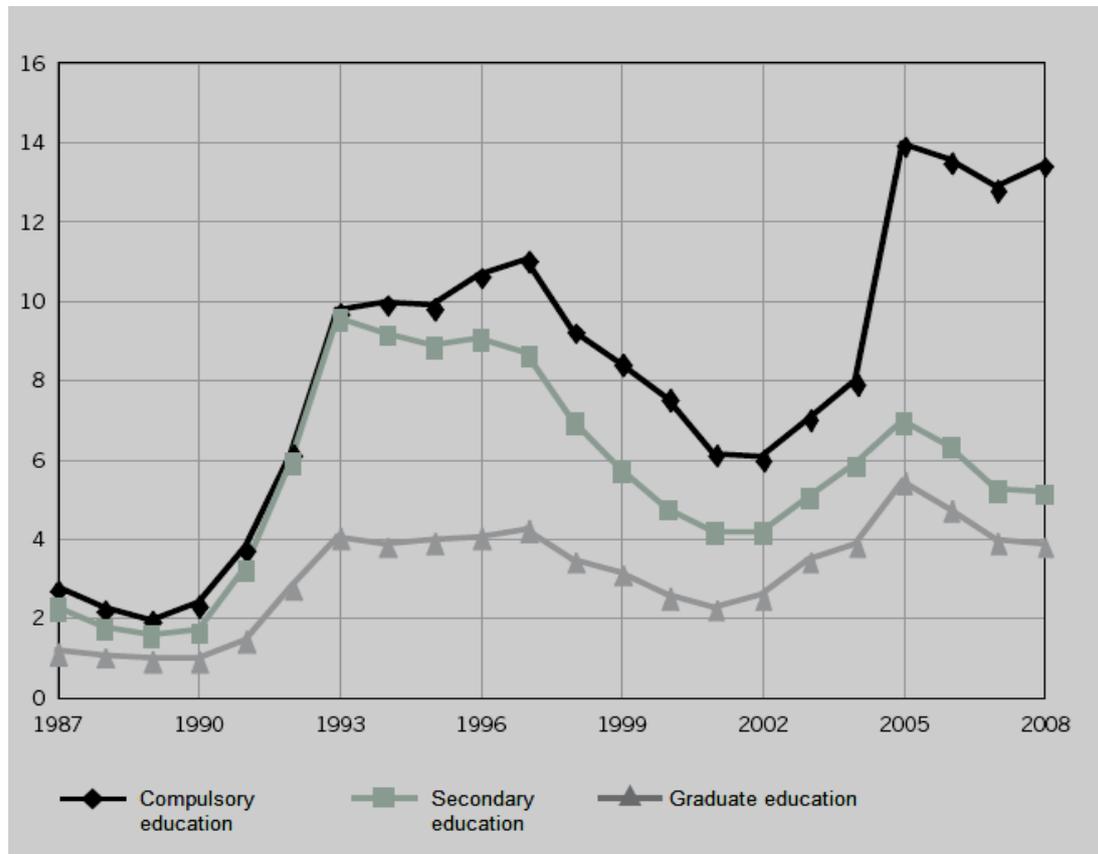
## 2.2 The labor market in Sweden

### 2.2.1 General characteristics

Globalization has considerable effects on the labor market, creating both winners and losers. In order to gain from market integration and have more winners than losers, it is important to organize it in a proper way, moving workers from stagnated sectors to expansive ones. That means that flexibility is a very important characteristic of the labor market, which seems to be a key factor of a good winning strategy in response to globalization. If it doesn't work properly, in fact, it can cause high unemployment rates and decreasing levels of welfare.

The Swedish labor market has been very influenced by global pressures. As a first effect of major openness, the demand of high-skilled workers has increased, while the one of low-skilled workers has decreased, due to the fact that Sweden is a high-skilled labor-intensive country.

Figure 2.6 Unemployed of different instruction categories in Sweden during the period 1987-2008 (percentage).



Source: AKU cited in Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

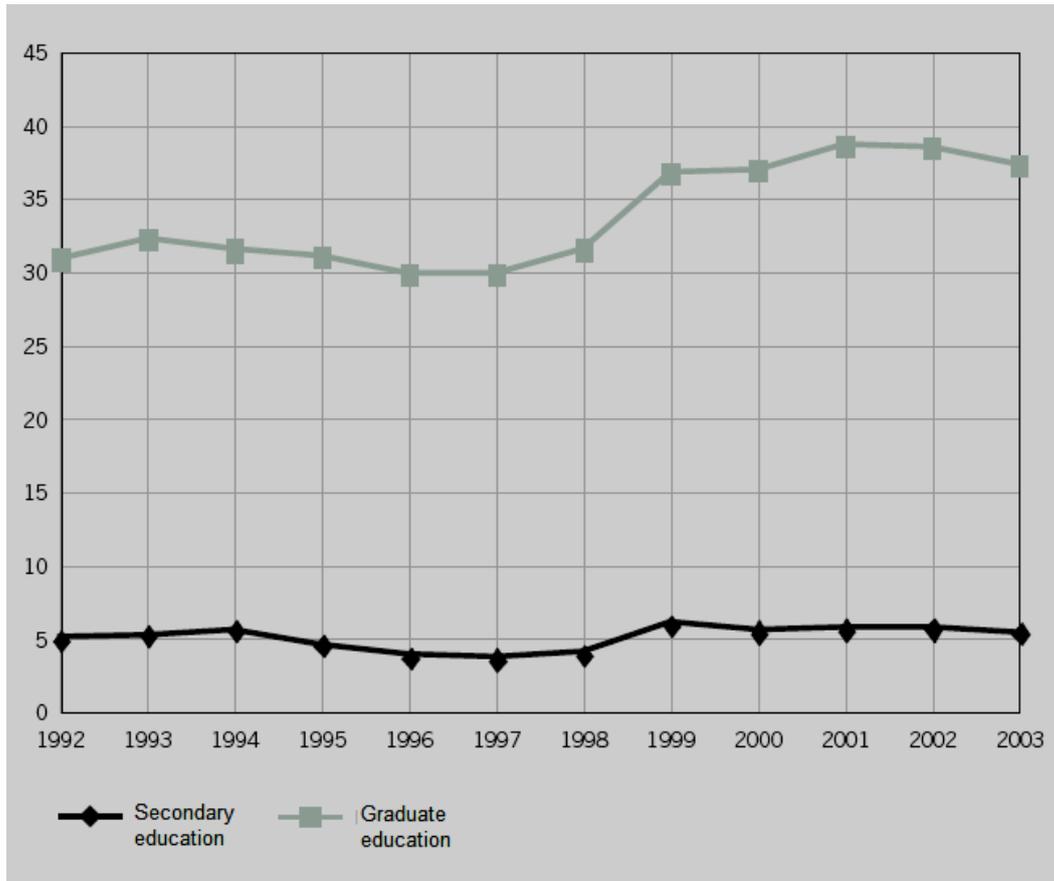
As it can be noticed in Figure 2.6, unemployment is higher among the workers with lower education, while it is lower among those with higher education. The negative effects of unemployment affect also badly those who have a shorter kind of education<sup>55</sup>. These results are completely in harmony with what has been expected in relation to the different patterns of specialization of the countries.

Another relevant effect in the Swedish labor market is constituted by the increase of the wage-gap between low-skilled workers and high-skilled ones. The gap has changed from approximately 25% in 1992 to 32.5% in 2003 (Figure 2.7). However these effects have not characterized only the Swedish economy, but almost all the developed countries during the last fifteen years<sup>56</sup>. Although it is important to underline that they can also be a result of the actual technological development, which has accompanied the phenomenon of globalization.

<sup>55</sup> Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

<sup>56</sup> OECD (2207, cited in Braunerhjelm P., Von Greiff C., Svaleryd H., (2009)).

Figure 2.7 Average wage for Swedish workers during the period 1992-2003 (percentage)

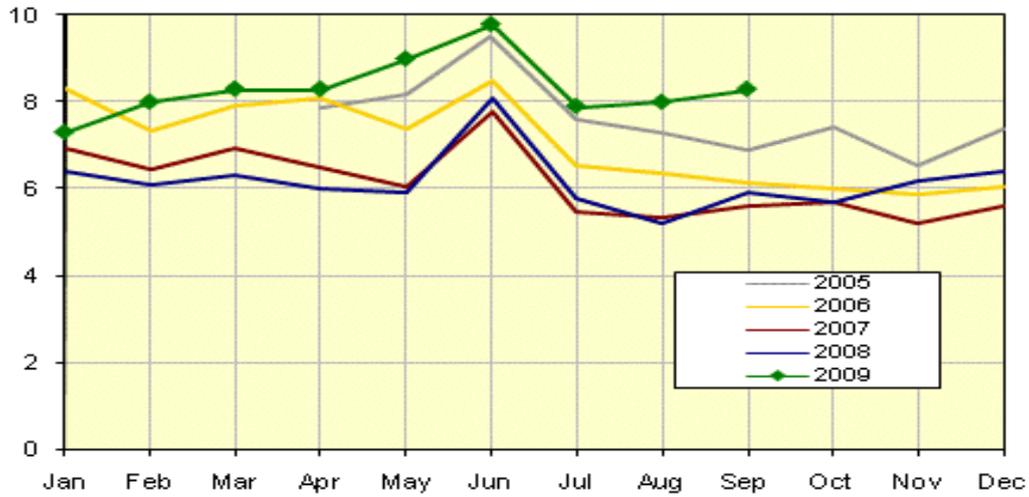


Source: LINDA cited in Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

As it is very difficult to separate their effects, these can be attributed to both of them, remembering though that globalization and technological development are strictly interrelated in sense that the former intensifies the latter as a way to be competitive and it also favors its diffusion<sup>57</sup>. However, the general unemployment rate has underlined a remarkably increasing trend in Sweden during the last years. Figure 2.8 represents the monthly trends of the unemployment rate, calculated as a percentage of the total labor force of the age group 15-74, during the period 2005-2009. Recently in September 2009, the unemployment rate was 8.3%, highlighting an increase of 2.4% units in comparison with the same month of the previous year.

<sup>57</sup> Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

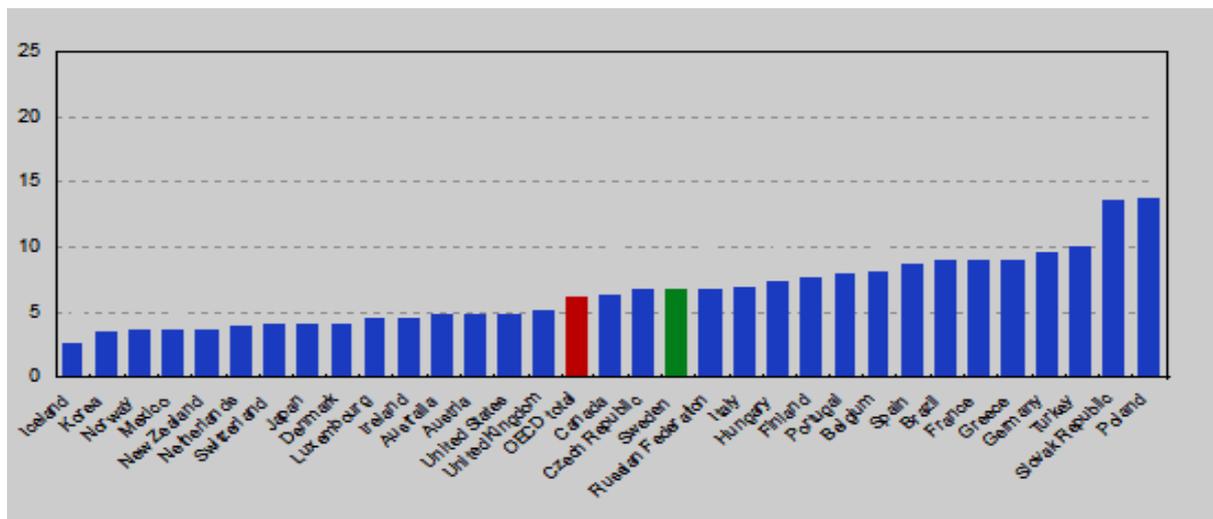
Figure 2.8 Monthly unemployment in Sweden (percentage of the labor force)



Source: SCB

Even though the majority of the countries are having increasing unemployment rates, it is interesting to analyze the reason why Sweden's rate is above the OECD countries' average (Figure 2.9) and what are the solutions the country is trying to provide to respond to the global pressures on the labor market.

Figure 2.9 Unemployment rate in the OECD countries (average 2005-2007)



Source: OECD

### 2.2.2 *The changes in the employment structure*

One of the typical effects of globalization on the labor market is, as mentioned earlier, the increasing unemployment rate for the unskilled workers. Like in many other countries, also in Sweden these have exited from the labor market, while the skilled workers continue working in more advanced segment of the same sector<sup>58</sup>. The Scandinavian country has always invested many resources in training and further education of the unemployed, but this, even if it has created positive effects, has not completely solved the problems.

However, there are winners and losers from globalization in all the job categories, regardless of the level of education<sup>59</sup>. This derives from the fact that nowadays it is possible, thanks to modern ICTs, to move the production processes abroad, where the costs are lower. The activities which are most subject to relocation are those that are simply to codify and to realize electronically, such as data-programming or data-analysis, and routine activities which do not require personal interaction. Studies about relocation by Swedish companies have underlined that, when they relocate in developing countries, the demand of unskilled workers decrease, while the one of high-skilled workers increases. When the transfer is, instead, towards developed countries, similar to Sweden, there is an opposite effect<sup>60</sup>. So, there is a strict relationship between the categories of workers that are most affected by unemployment, and the countries where the domestic firms displace their activities. This of course derives from the different specialization patterns of the foreign relocation countries.

Job displacement is, therefore, a direct consequence of the global pressures on the Swedish labor market, and it creates high costs both for the individuals and the society. Workers do, in fact, need time to find a new job<sup>61</sup>, and this takes time and resources. In addition, they lose part of the specificity of their human capital, and for this reason, when they find a new job in another sector, their wage is clearly lower. Welfare states, such as the Swedish one, incur costs from this phenomenon, because they support the displaced workers through wage insurances. Job displacement in Sweden has been quite high in the last fifteen years, and it has caused important variations in the employment's structure.

In Figure 2.10 it is possible to analyze the changes that have taken place in the different sectors of the Swedish economy. In 1989, one third of the occupation was in manufacturing, which was the main sector of the economy. Fifteen years later, in 2004, manufacturing was

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<sup>58</sup> Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

<sup>59</sup> Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

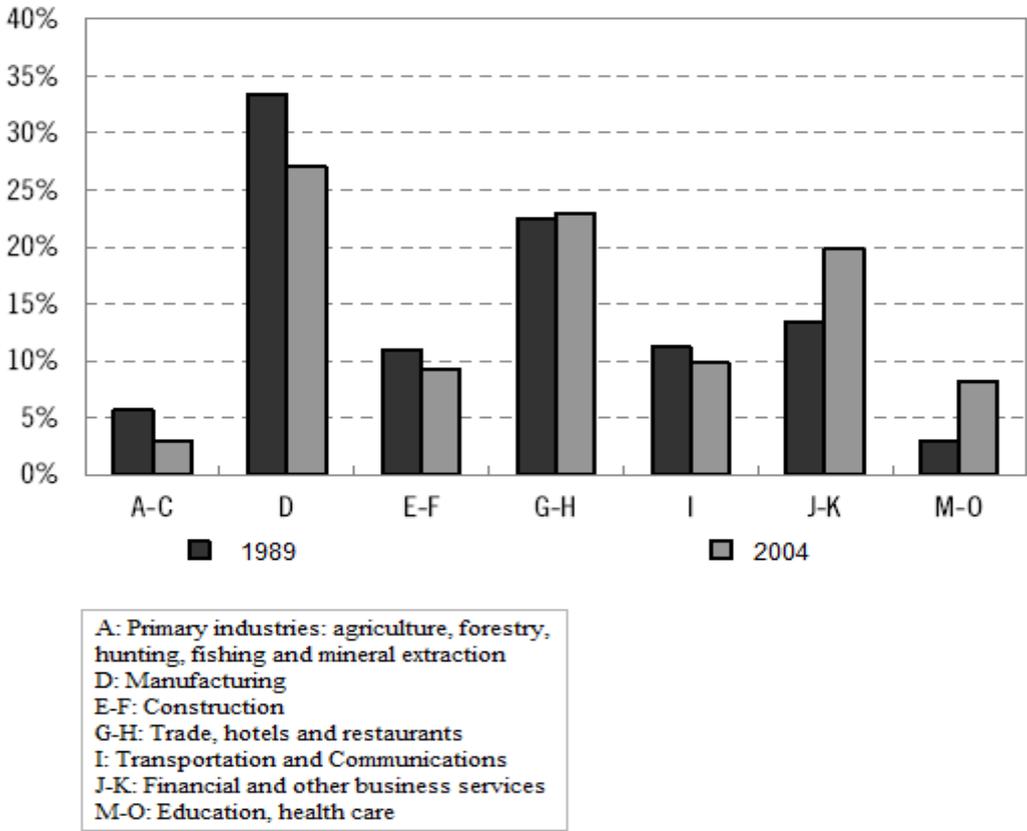
<sup>60</sup> Ekholm and Hakkala-Nilsson (2008, cited in Braunerhjelm P., Von Greiff C., Svaleryd H., (2009).

<sup>61</sup> This is the classical "matching-problem", which creates high transactional costs (SOU 2008:21).

still the main sector of the economy, but its occupation had decreased from 33% to 27%. Workers have, in fact, principally moved from manufacturing to services sectors. The most relevant increases are those in the categories of financial and other business services, trade, hotels and restaurants, and education and health care. This last has been the most significant in relative terms (from 2% to 11%), and it derives from the deregulations which have characterized the Swedish public sector during the '90s. Occupation in the primary industries, manufacturing, construction, and transportations and communications have, instead, decreased.

In conclusion, Globalization forces have demonstrated to increase the importance of services, compared to manufacturing, in all the developed countries. In the case of Sweden, this phenomenon is proved by large transformations that have occurred in the employment structure in the last fifteen years.

Figure 2.10 The Swedish employment structure (1989-2004)



Source: SOU 2008:21

### 2.2.3 Effects on the weak categories

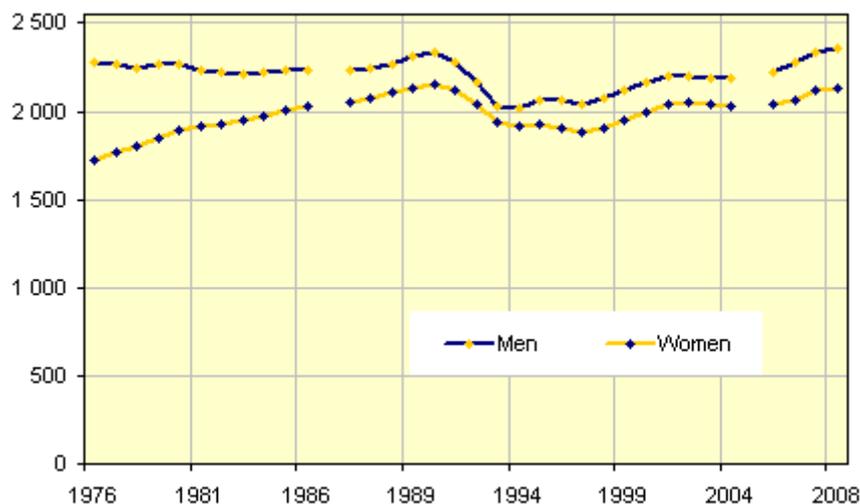
Globalization's pressures on the labor market should certainly have a stronger impact on the weak categories of workers, such as young people. This should lead to higher unemployment rates and longer displacement periods for this category.

Analyzing the data of the Swedish labor market it is possible to notice that the gap between the share of employed men and the one of employed women has been decreasing during the last thirty years (Figure 2.11). In addition, during the period 1976-2008, the level of female employment has increased more than the male employment, considering a labor force aged 15-74. Considering a labor force aged 20-64 instead, the share of women in the labor force was 60% in 1970 and 81% in 2007, while the share of men was 90% and 87% respectively, underlining a decrease of the male employment<sup>62</sup>.

This fact leads to believe that globalization has improved the conditions of the category of female workers. This is mainly due to the fact that the service sector has become more important due to the global pressures, and this is a sector where women mostly work. Thus, these results are a direct consequence of the Heckscher-Ohlin model which explains the different trends for high-skilled and low-skilled workers.

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Figure 2.11 Employed by sex (1976-2008), thousand



Source: SCB

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<sup>62</sup> SCB, (2008).

However, the current level of Swedish unemployment rate highlights a discrete difference between men and women, as the former was 5.9% in 2008 and the latter was 6.6%. Nonetheless the gap has been variable under the last ten years, so it is difficult to find a strong evidence of a global effect on women workers. This is also due to the fact that there are many social and institutional factors that push for gender equality.

Nevertheless it is very interesting to analyze the different unemployment rates both by gender and by age in Sweden. As it can be noticed in Figure 2.12, both men and women have higher unemployment rates in the younger categories: the labor force category aged 16-24 has an unemployment rate of 12% with no differences of gender. This means that the youth are actually the weakest group of workers, which is suffering the pressures of globalization, as their unemployment rate has been increasing considerably during the period 1970-2007. The other classes of workers defined by age (25-34, 35-54, 55-64) have also seen their unemployment rates increasing, but in a very lower proportion.

This is certainly due to many causes: first of all young people have less job experience, which means that they are less productive, and this has always made them a weaker group. Secondly, the high employment protection rules, that characterize the Swedish labor market, makes it more difficult for youth to respond positively to the global pressures<sup>63</sup>. Thirdly, the quality of the education system could be improved, in the sense that upper secondary school could prepare students to enter earlier in the labor market, and it could try to realize a better matching between demand and supply of labor<sup>64</sup>.

Even though the Swedish educational attainment is very high, as over 90% of the youngest categories have completed upper secondary education, youth unemployment is actually widespread in the country. In 2007 the rate was of 18.9%, which in reality constitutes a decrease compared with the rate of 22.7% in 1994<sup>65</sup>, but it is above the OECD countries' average level of 12.1%. So globalization forces seem to have put remarkable pressure on youth employment.

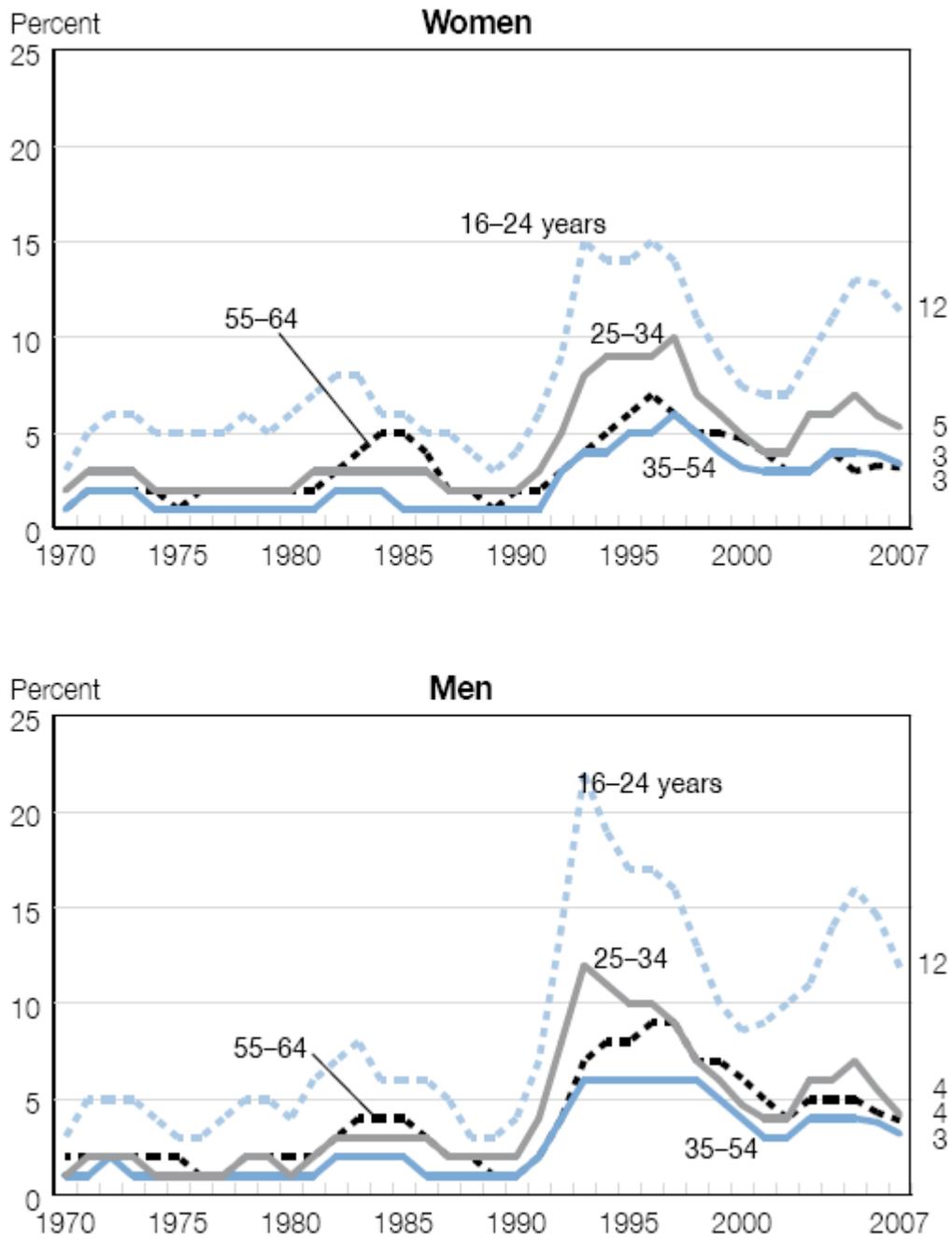
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<sup>63</sup> The question of the Swedish employment protection legislation will be analyzed later on.

<sup>64</sup> OECD, (2008).

<sup>65</sup> Skedinger P., (2008).

Figure 2.12 Unemployment rate by age 1970-2007 (percentage)



Source: Labor Force Surveys, Statistics Sweden (SCB, 2008)

However, it has to be underlined that in the Swedish labor market, the unemployment rate is particularly high among immigrant youth and youth with a low level of education. The latter reflects the demonstrated result of specialization on high-skilled activities in the developed

countries, deriving from the global stress. The question about higher unemployment among youth immigrant, instead, mainly derives from matching problems, resulting from different education systems, language and work experiences.

Another important factor that has to be considered is to analyze how safe the occupations are. This is reflected by the kind of contract that is made to the employers: a temporary contract, or a fixed-term, or a permanent one. Sweden has a very high level of temporary contracts with young employers: 57.3% in 2007 compared with the OECD average of 36.1%<sup>66</sup>. This means that security of a job is not very high for Swedish youth. This is, thus, a field where several interventions could be done, to improve the quality of the labor market, which is currently under global pressures.

### **2.3 The relationship between globalization and welfare state**

Globalization and welfare state have always been strictly related to each other. The latter has, in fact, accompanied the different phases of the world's internationalization, but the relationship between these two phenomena has widely evolved with the time. It is obviously a complicated nexus, which is still being discussed by the economists. Actually there are three different theories that underline different aspects of the globalization-welfare relationship<sup>67</sup>.

- 1- The first one is that they are in tension, in an antithetic relation, that does not allow realizing the welfare compensation anymore. According to the compensating perspective<sup>68</sup>, in fact, globalization increases economic insecurity and inequality in the industrialized countries, leading the governments to intervene with policy instruments of the welfare state, in an attempt to improve the income distribution. According to the pessimistic opinion, this mechanism is actually untenable, because of the excessive level of market internationalization that has been reached.
- 2- Another theory is that globalization and welfare state are not even related, not influencing one another<sup>69</sup>. This argument relies on doubting about some main concepts: is openness really as extensive as we think? Does globalization really lead to economic insecurity, inequality and risks? This thesis of unrelated globalization and welfare state, is then based

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<sup>66</sup> Skedinger P., (2008).

<sup>67</sup> Burgoon B., (2001).

<sup>68</sup> Garrett G., Mitchell D., (1999).

<sup>69</sup> Burgoon B., (2001).

on the idea that the policy instruments only depends on domestic questions, without interference of internationalization.

- 3- The third and more realistic theory is that globalization and welfare state are in a harmonious relationship, which means that the compensation mechanism works<sup>70</sup>, leading to responses to the global effects.

However, the way welfare states would respond to the globalization's forces depends on the view on globalization itself. It is interesting to analyze two different viewpoints of globalization and notice how the welfare policies change in relation to them.

- A) The first perspective is the "specialization view" by Sinn (2007)<sup>71</sup>, which is mainly a skill-biased vision of globalization. It stems from the H-O theory and states that, as developed countries export goods and services intensive in skilled labor and capital (which are their abundant factors), and developing countries export goods and services intensive in unskilled labor, under the pressure of globalization the demand of skilled labor increases in the developed countries, while the demand of unskilled labor decreases. For that reason, the duty of the welfare states in the developed countries is to support the unskilled workers, through employment policies, pension policies, taxes and transfer policies.
- B) The second perspective is the "great reorganization view"<sup>72</sup>, which distinguishes two recent stages of globalization. The first stage goes from the middle of the '70s to the middle of the '90s, and was characterized by the ICT development, which lead to a skill-biased process, as the specialization view asserts. The second stage, instead, started in the middle of the '90s, when globalization entered in the new current phase of great reorganization. This stage is characterized by a new bond between technology, logistic and trade opportunities, which leads to new organizations of production. There are three main features that distinguishes the reorganization: the geographic decomposition of value chains, as the different phases of the production process can be realized separately in different countries; the rising importance of personal relationships, as the only tasks that nowadays cannot be outsourced are non routine tasks where the personal relations are important; the increasing flexibility, heterogeneity and versatility of the work, which is becoming more and more multitask. According to this vision, welfare states should intervene by not supporting the unskilled workers through passive policies, which should be the wrong answer, but by increasing the flexibility and the adaptability of all workers

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<sup>70</sup> Garrett G., Mitchell D., (1999).

<sup>71</sup> Cited in Snower D.J., Brown A.J.G., Merkl C., (2009).

<sup>72</sup> Snower D.J., Brown A.J.G., Merkl C., (2009).

through active policies. The actual competition is in fact much broader than in the past, as it is not longer between sectors or industries, but it is between people at a global level<sup>73</sup>. That is the reason why welfare states should give all workers the instruments to defend themselves from the increasing global pressures, by making them more versatile and flexible<sup>74</sup>.

However, there is much more consciousness that the welfare state must intervene in response to the globalization's forces, in a virtuous and compatible connection. That is due to the fact that the contemporary phase of internationalization is clearly characterized by the centrality of human capital. The new competition is basically played on the availability of skilled, mobile and motivated workers, who supply "tasks" to the companies, transferable all over the world thanks to modern ICT. But it is important not to forget that the human capital is constituted by persons, who work better if they live in a system that helps them to ride over insecurities and risks, deriving from greater openness. As it has been demonstrated in chapter 1, globalization leads to the fall of relative wages of unskilled workers in industrialized countries and it increases their level of unemployment. In terms of welfare that means there is greater demand for forms of compensation, which can cover the lower wages of losers. This happened especially in response to the large phenomenon of trade displacement, which was faced through the support of the unemployment insurance system, and specific programs for reemployment and replacement.

However, there are two important aspects that have to be considered in the new relationship between globalization and welfare state.

- 1) First of all, welfare state is characterized by the efficiency hypothesis<sup>75</sup>, which means that it is uncompetitive and inefficient, in comparison with market solutions. In fact, there is no market for publicly provided services, and these are neither produced following the conditions of maximizing profits, or minimizing costs. Welfare states, instead, normally provide services to the citizens by trying to guarantee equality and satisfaction of the general interests. Some authors insist that this is the failure of the welfare state itself<sup>76</sup>, accompanied by the market distortions that it creates, eroding the incentives for people to work, save and invest. The tradeoff between efficiency and welfare is even stronger

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<sup>73</sup> Actually there are new patterns of winners and losers from globalization: a "polarization of work" is in fact taking place, which means that the employment shares of the high and low wages have increased at the expenses of the middle wage jobs (Snower D.J., Brown A.J.G., Merkl C., (2009)).

<sup>74</sup> According to this view the best welfare instruments are welfare accounts and benefit transfers (Snower D.J., Brown A.J.G., Merkl C., (2009)).

<sup>75</sup> Garrett G., Mitchell D., (1999).

<sup>76</sup> Esping-Andersen G., (1996).

nowadays, due to the higher level of internationalization and competition. Thus, on the one hand there is more need and demand for support from the welfare state, while on the other hand the welfare state needs to resort to retrenchment to survive. This leads to the fact that it is of great importance for the welfare state to evolve, adopting new flexible instruments, which allow responsiveness to the globalization forces.

- 2) The second aspect is that welfare policies are becoming more and more an international question, due to the increasing level of internationalization. The original Keynesian welfare state (KWS), which aimed to full employment and economic growth through policies, presupposed in fact closed national economy<sup>77</sup>. The growing level of openness has led to the fact that, even though welfare state is a national question, governments must always have an eye on the international scenario and on the consequences that can be caused.

## **2.4 Social policies for the labor market**

Nowadays Globalization has a deep impact on the labor market, and it is therefore necessary that the Welfare State intervene to react with its instruments to the global effects. In the EU, the constitution of the European single market in 1993 has led to free movement of goods, services, people and money. This has expanded the labor market, increasing the opportunities for the European workers, but it has also created the necessity for the Member States to face new needs and problems. As long as there are wage differences between the European countries, people will move to catch better job opportunities. Table 2.3 shows that, actually, there are large differences both in the per capita incomes and in the unemployment rates of the EU's countries, which leads to a sizable movement of workers<sup>78</sup>.

The welfare state, thus, is an important resource to respond to the several pressures that are characterizing the contemporary labor market, and this can be done through the use of different tools.

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<sup>77</sup> Mishra R., (1999).

<sup>78</sup> This is especially true considering the differences between the high-wage European countries and the low-wage European countries. The per capita income of the former is in fact about three times as much as the latter's (Kruse A., (2009)).

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Table 2.3 Per capita GNP and unemployment rate in EU-15, Norway and new EU-countries

<b>“Old” EU countries</b>	<b>Per capita GNP</b>	<b>Unemployment rate</b>
<b>Belgium</b>	29300	7.5
<b>Denmark</b>	30500	3.8
<b>Finland</b>	29000	6.9
<b>France</b>	27600	8.3
<b>Greece</b>	24300	8.3
<b>Ireland</b>	36300	4.6
<b>Italy</b>	25200	6.1
<b>Luxemburg</b>	68500	4.1
<b>Nederland</b>	32900	3.2
<b>Portugal</b>	18600	8.1
<b>Spain</b>	26.500	8.3
<b>Sweden</b>	31300	6.1
<b>Great Britain</b>	28700	5.3
<b>Germany</b>	28100	8.4
<b>Austria</b>	31600	4.4
<b>EU-15</b>	27700	7.0
<b>Norway</b>	45700	2.6
<b>“New” EU countries</b>		
<b>Bulgaria</b>	9500	6.9
<b>Cyprus</b>	23100	3.9
<b>Estonia</b>	17600	4.7
<b>Latvia</b>	14400	6.0
<b>Lithuania</b>	15000	4.3
<b>Malta</b>	19200	6.4
<b>Poland</b>	13300	9.6
<b>Romania</b>	10100	6.4
<b>Slovakia</b>	17000	11.1
<b>Slovenia</b>	22000	4.9
<b>Czech Republic</b>	20200	5.3
<b>Hungary</b>	15700	7.4

Source: Eurostat (2008)

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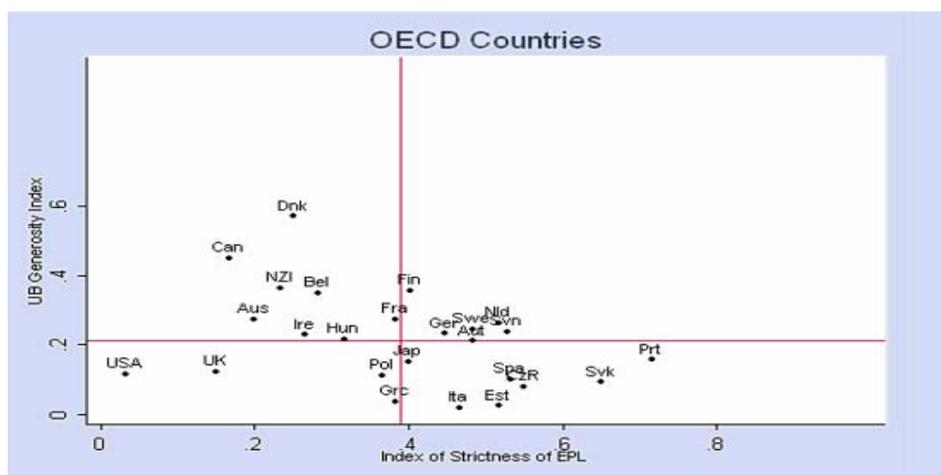
### 2.4.1 The EPL

An important tool, used by welfare states to respond to globalization's effects on the labor market, is constituted by the "rigidity" of the labor market itself<sup>79</sup>. That means having a strict legislation related to employment, or an Employment Protection Legislation (EPL). EPL is highly connected to unemployment benefits, which are another tool used to guarantee protection from labor market risks. The former protects the workers from being fired, while the latter gives support to the unemployed giving them an insurance, which is mainly financed by the fiscal system. There is a clear tradeoff between these two instruments, as having large unemployment benefits reduces the need for strict employment protection legislation and vice versa.

Nonetheless, while the unemployment benefits (UB) increase the security felt by the workers, the EPL creates two opposite effects<sup>80</sup>. On the one hand the probability to lose the job is very low in the countries with high protection, but on the other hand there is also a very low level of turnover of the employees and this leads to the fact that, if a worker loses his job it is very difficult for him to find a new one. The employment protection legislation causes unemployment problems especially for the weaker categories of workers: young people, women and old people. For these typologies of workers the employment rates are lower in the countries where the EPL is higher.

Figure 2.13

**The UB/EPL trade off**



Source: Boeri T., Conde-Ruiz J.I., Galasso V., (2004).

<sup>79</sup> Dell’Arianna C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

<sup>80</sup> Dell’Arianna C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

The different welfare state models are usually characterized by different levels of use of UB and EPL, as it can be noticed in Figure 2.13. The Nordic model<sup>81</sup>, which characterizes Denmark, Finland, Neth

erlands and Sweden, should normally distinguish itself for a low level of EPL, but large UBs. The “rigidity” of the labor market, is generally measured considering three main components: permanent contracts, temporary jobs and collective layoffs. In Table 2.4 the OECD indicators of employment protection are represented for the period 1998-2008<sup>82</sup>.

As it can be noticed, Sweden has been characterized by a constant and medium-high level of protection (2.46) in the last ten years, compared to the OECD countries’ average (2.13). However, it is neither among the countries with the highest rates of EPL in Europe, such as Spain or Italy<sup>83</sup>, nor among the ones with the most flexible labor market, such as Denmark..

Table 2.4 Strictness of employment protection (index 0-6)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Austria	2,38	2,38	2,38	2,38	2,38	2,15	2,15	2,15	2,15	2,15	2,15
Belgium	2,48	2,48	2,5	2,5	2,5	2,5	2,5	2,5	2,5	2,5	2,5
Denmark	1,9	1,9	1,9	1,9	1,9	1,9	1,9	1,9	1,77	1,77	1,77
Finland	2,18	2,18	2,18	2,12	2,12	2,12	2,12	2,12	2,12	2,12	2,03
France	2,84	2,84	2,84	2,89	2,89	2,89	2,89	2,89	2,89	2,89	2,89
Germany	2,57	2,57	2,57	2,57	2,37	2,37	2,39	2,39	2,39	2,39	2,39
Ireland	1,17	1,17	1,17	1,17	1,17	1,32	1,32	1,32	1,32	1,32	1,32
Italy	3,06	3,06	2,91	2,49	2,49	2,33	2,33	2,33	2,33	2,33	2,38
Netherlands	2,77	2,27	2,27	2,27	2,27	2,27	2,27	2,27	2,27	2,2	2,13
Norway	2,72	2,72	2,61	2,61	2,61	2,61	2,61	2,61	2,72	2,72	2,72
Portugal	3,53	3,53	3,53	3,53	3,53	3,53	3,36	3,36	3,36	3,36	2,93
Spain	2,96	2,96	2,96	3,07	3,07	3,01	3,01	3,01	3,01	3,01	3,01
Sweden	2,49	2,49	2,49	2,49	2,49	2,49	2,49	2,49	2,49	2,49	2,18
UK	0,98	0,98	1,05	1,05	1,1	1,1	1,1	1,1	1,1	1,1	1,1
OECD	2,17	2,15	2,16	2,15	2,13	2,11	2,11	2,12	2,12	2,11	2,1

Source: OECD Statistics

<sup>81</sup> According to the classification of Sapir (2005) of the welfare states, there are four main European models: the Nordic (typical of Denmark, Finland, Netherlands and Sweden), the Anglo-Saxon (Ireland and UK), the Continental (Austria, Belgium, France, Germany and Luxemburg) and the Mediterranean (Greece, Italy, Portugal and Spain). The classification that Sapir makes is mainly based on the early work of Esping-Andersen (1990).

<sup>82</sup> These are synthetic indicators of EPL, and they are weighted sums of the three temporary employment (5/12), permanent employment (5/12), and collective dismissals (2/12).

<sup>83</sup> As Sapir (2005) underlines, it is typical of the Mediterranean countries to have strict EPL and low coverage of unemployment benefits.

The Swedish level of EPL has been decreasing during the years, as its level during the '80s was around 3.5<sup>84</sup>. In fact, in 1974, a law of employment protection was introduced (lagen om anställningsskydd or LAS) which was valid for almost all occupations, both private and public ones. It mainly abolished the liberty of the employer of laying off the employees, as it was based on some main principles: the occupation should normally be permanent, lay-off was allowed only if there was an objective cause for it, and lay-off due to labor shortages has to follow the turning rule of "last in, first out".

The introduction of this law constituted an important goal for workers, and it certainly explains the following high rates of EPL in the '80s. But the LAS was reformed many times: in 1982 the possibility of temporary employment was introduced, which made possible a trial period for the workers. This was surely a step towards a more flexible labor market, but in 1984, the EPL was strengthened, as the lay-offs had to be approved by a central labor organization, with the exception of the turning rules for the lay-off due to labor shortage.

In 1996, some new important changes were introduced. Firstly, new possibilities for temporary labor were established; secondly, the law gave the opportunity to reach local deals regarding employment; thirdly, the advance notice for the lay-off was related to the occupation period. So, considering the changes in the regulation, it seems that there have been both steps forwards and backwards a higher level of flexibility in the labor market.

However, the rigidity of the Swedish labor market is quite different considering permanent and temporary occupation. The former has a very high level of protection, which has been constant on 2.86 during the last ten years, and which is above the OECD countries' current average of 2.11. The latter, instead, has maintained the value of 1.63 during the period 1998-2007, while in 2008 it has decreased to 0.88<sup>85</sup>, underlining the considerable difference between these two kinds of occupation. The fact that temporary jobs are very unsecure, while permanent ones are very well protected, makes the Swedish labor market truly segmented.

Nonetheless, temporary contracts have been more common in all the OECD countries, passing from 12% of the totality of the contracts, to 15% of them, during the period 1998-2008<sup>86</sup>. Temporary contracts increase the labor market flexibility, which is a fundamental tool to respond to the global pressures and to permit to the economy to have more winners than losers, moving workers from stagnated sectors to expansive ones.

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<sup>84</sup> OECD (2003, cited in Bergh A., 2009).

<sup>85</sup> OECD Statistics.

<sup>86</sup> OECD Statistics.

The EPL in Sweden causes negative effects for the young workers, as it is positively correlated to youth unemployment, which in Sweden is relatively high. On the contrary the elderly employment is very high in this country, mainly because of the high protection related to permanent contract.

#### 2.4.2 *Unemployment benefits*

Unemployment benefits (UB) aim to compensate the losers of globalization, in a direct way, by giving the unemployed workers a financial support (unemployment benefits in the strict sense), and in an indirect way, by compensating the lower wage a displaced worker gets in his new job (wage insurance)<sup>87</sup>. Nonetheless there are some aspects of the UB, which are not entirely positive. Firstly, subsidies decrease the incentives for unemployed workers to look for a new job, and secondly they make the reserve wage increase, which puts pressure on the average wages, creating negative effects on the labor market. It is thus clear that too generous UB, have negative effects on occupation<sup>88</sup>. The index used to describe the generosity of the benefits is the substitution rate, which is given by the ratio between the total amount of the benefit, and the wage earned by the worker before being unemployed. The higher is the substitution rate and the stronger is the disincentive to look for a new job.

To avoid the negative effects of the UB, there are several conditions and prerequisites that are used to regulate them<sup>89</sup>. Firstly, there are some “eligibility” conditions, which means that not all the unemployed can benefit from the subsidies. Young people who are looking for the first job are, for example, excluded. Secondly, there is a maximal duration of the entitlement, which differs from country to country. These conditions are of course checked, and if they are not respected there can be some sanctions<sup>90</sup>. The third aspect is constituted by the phenomenon of “workfare”. The term, which is a mix of the words “work” and the “welfare”, describes a model that is increasingly developing, in which the recipients have to participate to work programs to receive the welfare benefits. It is an alternative model to the traditional welfare state model (mainly based on assistance), which requires an active participation of the unemployed.

Sweden has a generous unemployment benefits system, which confirms the main features of the Nordic welfare state model.

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<sup>87</sup> Calmfors L., (2008).

<sup>88</sup> Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

<sup>89</sup> Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

<sup>90</sup> Kruse A., (2009).

The current system is characterized by several preconditions that have to be fulfilled to get the benefits<sup>91</sup>.

- First of all, the unemployed worker has to be willing to work at least three hours per day and seventeen hours per week, to accept any appropriate job, and he has to be registered in the employment services as seeker for a job.
- Secondly, the worker has to have worked at least six months, eighty hours per month, during twelve months, to be considered “unemployed” and get the UB.
- Thirdly, the compensation can cover a maximum of five days per week for a total of 300 days, with the exception of parents with children under 18 years, who get the compensation for a maximum of 450 days.

In addition, there are two kinds of unemployment insurance: a general basic insurance and a voluntary insurance in case of loss of income (wage insurance). In order to get the latter, the worker has to be a member of an unemployment insurance (arbetslöshetskassa or a-kassa) during a consecutive period of at least twelve months, and he has to be over 20 years of age. The former is, instead, guaranteed to the worker who is not a member of an a-kassa, or who does not fulfill the related requirements. The basic insurance guarantees 320 SEK for every covered day of unemployment. The wage insurance, instead, pays a compensation of 80% of the previous income, which cannot exceed 680 SEK per day, for the first 200 days; then it pays 70% of the previous income for the following 100 days, for a total of 300 days<sup>92</sup>.

However, the actual unemployment benefits system<sup>93</sup> is the result of several reforms that have mainly characterized the wage insurance. These have changed time after time the average replacement rate, which is given by the statutory replacement rate (the current percentage of 80% of the previous income) and the ceiling (the maximum coverage of 300 days)<sup>94</sup>.

These adjustments can be considered both a cause of the variations in the Swedish unemployment rate during the last fifty years, and an instrument that has been used to respond to macroeconomic shocks that have characterized the labor market. The former is related to the fact that UB often reduces the incentives for unemployed workers to find a new job, so it is important to reach a good equilibrium between supporting the unemployed and creating incentives to seek a new job, in this kind of system. The latter is, instead, related to the main function of welfare states to react to global pressures on the labor market, by giving workers a support, which should allow to gain from globalization.

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<sup>91</sup> Kruse A., (2009).

<sup>92</sup> Kruse A., (2009).

<sup>93</sup> From now on we will refer to the UB system as the wage insurance system.

<sup>94</sup> Holmlund B., (2003).

From the '60s to the '80s, the average replacement rates showed an increasing trend, which led to a statutory replacement rate of 90% in the late '80s. This increasing trend of the UB is certainly an explanation of the increase in the duration of unemployment between the '60s and the '80s<sup>95</sup>.

However, the unemployment rate in Sweden during the '80s was exceptionally low compared to the international standards, reaching a level of 1.5% at the end of the decade, which was a very successful result. These positive outcomes were realized thanks to a combination of active labor market policies, which facilitated the matching between demand and supply of labor, and a wage moderation, obtained with a coordinated wage bargaining<sup>96</sup>.

Nevertheless during the '90s the unemployment rate increased remarkably, reaching the 8% in 1993, which became the average rate for about five years<sup>97</sup>. The crisis of the '90s in Sweden was caused by many factors<sup>98</sup>, among which we certainly include the increasing pressures deriving from globalization, but an important role is clearly played by the unemployment insurance. A series of reforms made, in fact, the unemployment benefits system less generous and less expensive during this period. In 1993, both the ceiling and the statutory replacement were decreased, with this last falling from 90% to 80%.

Empirical studies indicate, that the result of these cuts was a considerable fall in the duration of unemployment (Harkman, 1997 cited in Holmlund, 2003) and positive effects on job finding (Carling et al, 2001, cited in Holmlund, 2003).

In 2001 and 2002, there were further reforms, which changed the UB system. Firstly, it was established that an unemployed worker can restrict the job search in his specific labor market for the first 100 days; then he has to search in the general labor market. This was certainly an "increase of generosity", as in the previous system the worker had not the possibility of a restrict search at the beginning. Secondly, the reform set a maximum of 300 days for all workers of all ages, while the previous system guaranteed 450 days for older workers. Thirdly, the sanctions for an unemployed who does not pursue active search were softened, as they passed from the complete withdrawal of UB for a certain period to the reduction of the

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<sup>95</sup> Holmlund B., (2003).

<sup>96</sup> Layard et al, (1991, cited in Holmlund B., 2003).

<sup>97</sup> In 2001 the situation improved, as the unemployment rate decreased until 4%, remaining constant for two years (Holmlund B., (2003)). But in the last five years the rate has increased again, and actually in Sweden there is 8.3% of unemployment.

<sup>98</sup> According to Holmlund (2003) the crisis broke down because of : 1) shocks that hit the economy, such as the stabilization policy, the climbing real interest rates, the falling public sector employment; 2) problems related to the labor market, such as work hours, absenteeism, and cyclical unemployment; 3) other factors, such as unions and wage bargaining, unemployment insurance, taxes, matching and demographic changes.

UB of 25% or 50%. The idea of this change was to apply softer sanctions, but more frequently.

An interesting empirical study<sup>99</sup> has shown that the reforms of the period 2001-2002 have lead to different results among men and women. It seems, in fact, that they have decreased the expected duration of unemployment among women, but they increased the one among men.

However, it is clear that the unemployment benefits system plays a very important role in the labor market, and it has been used in Sweden to lower unemployment duration, but it has also itself been a tool to reduce unemployment. In fact, UB, if used in the proper way, leads to many positive results. Besides being an important tool to respond to globalization's pressures on the labor market, having positive effects from a social point of view, they are also very useful to realize a better match between demand and supply of labor. Thanks to the benefits, in fact, workers have the opportunity to look for a job that is more proper for their abilities and preferences.

Finally, it is important to underline a significant problem related to the UB system in Sweden. This system, in fact, creates a very low incentive for low-wage workers, who are unemployed and receive the benefits, to search a new job. Indeed, when the UB recipient starts working again, getting certainly a worse wage compared with the previous job, he receives the same income as when he did not work. That is because the benefits will be reduced by the further incomes, and as they provides 80% of the previous wage, which is almost always a higher amount than the new wage, only high-wage workers will gain from finding a new job in this system<sup>100</sup>.

This is certainly a relevant problem that should be solved, because labor incentives are the most important thing, both for the functioning of the UB system, and for the struggle against current high unemployment rates, which are two aspects that are very much related to each other.

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<sup>99</sup> Bennmarker H., Carling K., and Holmlund B., (2005).

<sup>100</sup> Bergh A., (2009).

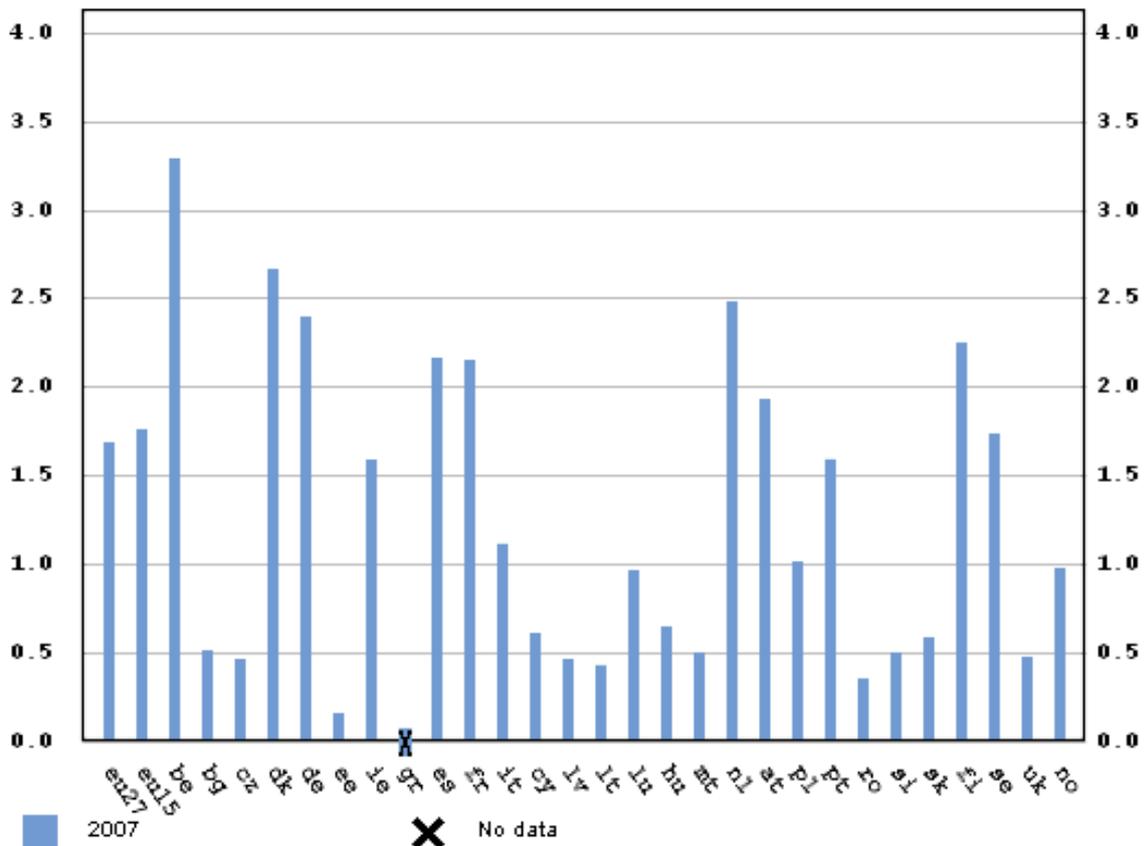
### 2.4.3 Activation policies

Labor market policies are growing in importance in all the countries, because of the pressures of globalization, and especially in EU they are reaching high levels of public expenditure, as it can be noticed in figure 2.14. The total expenditure is given by:

- Labor market policy (LMP) services, which includes public employment services and other publicly funded services for jobseekers.
- LMP measures, which embodies activation measures for the unemployed and other target groups, such as training, job sharing, direct job creation, job rotation, supported employment and rehabilitation, employment incentives and start-up incentives.
- LMP supports, which covers early retirement benefits, out-of-work income maintenance and support.

Figure 2.14

**Public expenditure on labor market policies (% of GDP)**



Source: Eurostat, (2007).

The activation policies are certainly one of the main and appropriate tools to respond to global challenges in the labor market, and their share within the LMP is increasing. Activation measures are strictly related to passive policies, such as unemployment benefits, because, if well designed, they neutralize the negative effects of the subsidies. But their purpose is to increase the flexibility of the workers, their skills, their adaptability and their versatility, so that they can actively react to the changes in the labor market. “Activation” as a labor market policy is a broad term, referred to different measures which aim is to support people excluded from the labor market. The main forms of activation policies are active labor market policy (ALMP) and workfare<sup>101</sup>.

ALMP is characterized by universal tools, like general economic policy, and by selective tools, such as policies towards specific regions, sectors, industries or groups. There are different measures that can be used within the ALMP: training and educational programs, creation of new jobs in the public sector, incentives for new entrepreneurial ideas, youth measures and programs for disabled<sup>102</sup>. Even though the participation to these programs is usually an opportunity, and not a duty, it becomes compulsory if it is connected to unemployment benefits. The entitlement to benefit of the subsidizes is, in fact, often related to the participation in training programs, or the availability to accept different kinds of job, or the commitment in seeking a new occupation. The participation, the availability or the commitment are, thus, monitored, and in case of lack of the prerequisites, there may be some sanctions. The sanction system seems to increase the efficiency both of the passive and the active measures, creating higher benefits than costs<sup>103</sup>. There are both “ex ante” and “ex post” benefits<sup>104</sup>. The former is given by the change in the recipient’s behavior, which becomes much more virtuous, before there can be a bad behavior. The latter is related to the sanction itself, which consists in revoking the benefit, and this increases thus the intensity of the job research, after the bad behavior. It is though necessary that the sanction system is credible, in order that it works properly.

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<sup>101</sup> Kildal N., (2001).

<sup>102</sup> Eurostat (2006, cited in Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008)).

<sup>103</sup> Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

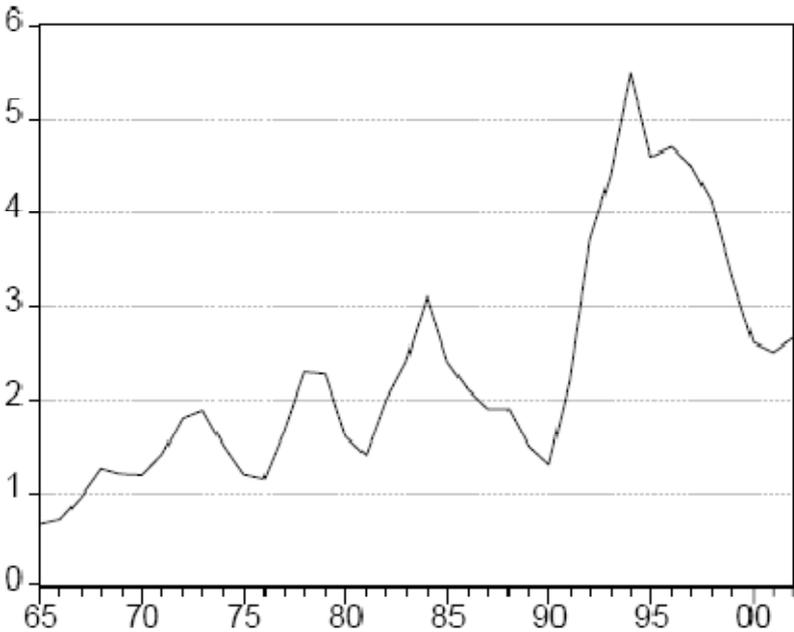
<sup>104</sup> Boone *et al.*, (2004, cited in Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008)).

Sweden has always been a country that spends many resources for ALMP, and this dates back to two trade union economists, Rudolf Meidner and Gösta Rehn, who introduced ALMP as an integral part of their program of full employment in the 1940s<sup>105</sup>. The aim of the active policies was to allow structural change and labor reallocation.

However, there have been many variations in the volumes of participation to ALMP, as it can be noticed in Figure 2.15, where rising trends in recession phases have followed falling trends in boom phases, underlining countercyclical patterns<sup>106</sup>. In the last 60 years, though, there has been an increase of the role of this kind of labor policies.

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Figure 2.15 Number of participants in ALMP, percentage relative to the labor force (1965-2002)



Source: The National Labor Market Board and Statistics Sweden (cited in Holmlund B., (2005)).

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In the 1990s, the participation has increased remarkably, especially because many new programs were introduced. These were mainly characterized by youth programs, training programs and forms of subsidized employment. The first were very important, because youth unemployment was a considerable problem that had to be faced.

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<sup>105</sup> Holmlund B., (2005).

<sup>106</sup> Holmlund B., (2005).

Other traditional tools were also increased, such as the “relief jobs” (temporary public jobs), the subsidies to hire long-term unemployed and the subsidies to the unemployed who want to start their own business.

Unfortunately, it is very difficult to determine if ALMP have contributed to decrease unemployment rates. The 1990s, which were a period a large growth of the activation policies, were also a period of deep crisis and high unemployment. We can suppose that larger use of ALMP was exactly an instrument used to react to these negative global pressures, but it is not possible to establish the measure of this effect.

Some authors, on the contrary, believe that activation policies, and especially youth programs, had negative effects on the unemployment levels. They underline, in fact, that at the end of the ‘90s the unemployment rate fell, in parallel with the fall of the participation to ALMP<sup>107</sup>.

Other authors, on the other hand, demonstrated that the labor policies had positive effects on the labor market, increasing the participation of the labor force, but they could not establish the extent of this relationship<sup>108</sup>.

The other instrument of the activation policies, beside ALMP, is constituted by workfare. The term was originated in the US in the ‘60s, but it became an important phenomenon in 1981 when the US Federal Legislation allowed introducing workfare programs<sup>109</sup>. Actually it has been developing also in EU, where it is becoming an important measure for activation policies in the labor market. Workfare is the combination of paying welfare benefits and demanding a work effort in exchange for them<sup>110</sup>.

The main features of workfare programs are, in fact, that they are compulsory for the able-bodied recipients, they oblige recipients to work in return for their benefits, and they oblige to accept also an inferior job<sup>111</sup>. This kind of system leads to a sort of “auto-funding” of the social benefits by the unemployed, and from a dynamic perspective their lower wages create also an incentive to acquire human capital, giving a push to the labor market.

In Sweden workfare measures have been largely introduced in the 1990s. As said earlier, the Swedish economy was characterized by a deep crisis in that period, and the government responded introducing both ALMP and workfare measures. The latter are related to a shift of responsibility from the state to the municipalities, as a labor market agent for the unemployed

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<sup>107</sup> Holmlund B., (2005).

<sup>108</sup> Johansson (2001, cited in Holmlund B., (2005)).

<sup>109</sup> Nathan (1993, cited in Kildal N., (2001)).

<sup>110</sup> Holzner C., Meier V., Werding M., (2006).

<sup>111</sup> Kildal N., (2001).

aged under 25<sup>112</sup>. As the special feature of workfare is exactly that the authorities can require unemployed to work to receive their benefits, the Social Service Act from 1998, established that the recipients were obligated to participate in training projects and municipal work, and those who refuse to participate may suffer a reduction of the assistance<sup>113</sup>.

This measure was followed by the “Development Guarantee Program” from 1998, which established the responsibility of the municipalities for young people between 20 and 24 years old. The program planned that after the first 90 days of unemployment, during which the young unemployed were a responsibility of the local labor office, they became the responsibility of the municipalities, that should offer them a development program or a work according to the municipality’s needs, for the following 12 months. The beneficiaries are, though, obliged to accept any offer, otherwise they will lose their benefits<sup>114</sup>.

The workfare measures are different from the unemployment benefits, firstly because of the stricter conditions they require<sup>115</sup>, secondly because of the different incomes they guarantee. In fact, while the beneficiaries of UB get 80% of their previous wage, workfare policies beneficiaries receive around 2000 SEK per month. The compensation levels are, indeed, related, not to the wages on the labor market, but to the replacement levels in the social assistance system<sup>116</sup>.

Again, it is difficult to measure the impact of the workfare activities on the labor market, and especially to analyze whether the new legislation has made the young unemployed more employable. However, during the late 1990s, Sweden experienced a remarkable improvement in the labor market, which reduced both the unemployment rate and the participation to labor market policies, and this can probably be seen as a positive effect of the workfare measures. In fact, according to the evaluations of the “Development Guarantee Program”, the program has been a success, leading to very positive results on the labor market<sup>117</sup>.

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<sup>112</sup> Kildal N., (2001).

<sup>113</sup> Salonen & Johansson (1999, cited in Kildal N., (2001)).

<sup>114</sup> Johansson, (2001, cited in Kildal N., (2001)).

<sup>115</sup> The unemployment benefits only require that the recipients actively seek a work and accept reasonable offers.

<sup>116</sup> Kildal N., (2001).

<sup>117</sup> Angelin & Salonen, (2000, cited in Kildal N., (2001)).

## 2.5 Discussion

After all these data and statistic analysis, it is important to outline the situation about the effects of globalization on the Swedish labor market, to underline which areas are to improve, and to suggest some eventual solutions.

As it has been demonstrated at the beginning of the chapter, the Swedish economy has widely been influenced by the global forces, which is highlighted by the increasing of its share of international trade, of offshoring and FDI, which are all positive factors for the economical growth of the country. Concentrating, instead, on the specific effects on the Swedish labor market, the situation is quite variable.

At the question “has globalization influenced the Swedish labor market?” I would certainly answer yes. This because, even though it is not at all easy to separate the globalization effects from other kinds of effects, many countries have been characterized by similar phenomena, different for developed and developing countries. In addition, it is always more true that the economies of many countries are more and more linked to each other, which is an important aspect of globalization, and this creates consequences on the single economies.

However, it is very difficult to give an answer about how much globalization has influenced the labor market in Sweden, so in this work some hypothesis have been made to try to answer to this question. I firmly believe that globalization should not been considered as a residual category, used to justify phenomena that we cannot explain with other factors. It is certainly true that it is a wide concept, often confused by common people, which therefore should be specified and analyzed as a separate factor, as it really constitutes a current reality and it will certainly increase in the next future.

Regarding the Swedish labor market, I would underline three main areas, where the country is acting worse because of the strong effects of globalization.

The first one is the education system. Sweden is characterized by a comparative advantage in the productions which use high-skill labor force, which is the result of the new specialization patterns, consequence of globalization. The data have, thus, shown that there is an increasing unemployment rate among the low-skilled workers, that the wage gap between high-skilled and low-skilled workers is increasing, and in the weak category of young workers the worse off are the less educated. This leads to the fact that the education system has, nowadays, a central role. Educational attainment in Sweden is high, as over 90% of the youth have completed upper secondary education, which is one of the highest levels among the OECD

countries<sup>118</sup>. Nonetheless, youth unemployment is widespread. Therefore, what has to be reformed is not the education system itself, but its capacity to connect to the labor market. There should be more communication and exchange between these two “actors”, as they are strictly related the one to another, and they can both benefit from the other.

The second area of the Swedish labor market that has shown negative results is the flexibility of the labor market itself. This is a very important characteristic, in order to be able to react to a more and more changing and competitive environment, but not much has been done in this field<sup>119</sup>. There is a very high level of EPL, especially in the permanent jobs, and this causes negative effects especially for the youth employment, and it does not permit to respond to the global pressures by moving workers and resources from the stagnated sectors to the expanding ones. The flexicurity model is proposed as a solution to this problem in the next chapter.

The third and last area is related to the mechanism of the unemployment benefits. This, in fact, does not give to the low-wage workers any incentive to look for a new job, because they do not gain from it. This derives from the fact that the Swedish system is based on the combination of high taxation also of the low wages, and high wage insurances, which are reduced by further incomes. A reform, is therefore needed, even though there have been already many changes in this area, to increase the incentives to work.

However, looking at the overall Swedish picture, the areas that have shown negative results as a consequence of globalization are certainly areas that can be improved with targeted programs and effort by the government. Sweden does not have structural problems, which are difficult to come out from, but it have to rethink the mechanism of some of its basic systems. And this, to reach the best international positions and to be considered a benchmark for the other countries. It is important not to forget that the results are different in relation to the term of comparison, and thus, Sweden, if compared with its past positive results, has of course worsened its performances, and also comparing it with the most successful countries in this area, such as Denmark; but using as a term of comparison worse off countries, such as Italy or Spain, Sweden’s labor market situation seems to be really successful. Therefore I would collocate Sweden in the medium-high band of European countries in relation to the labor market performances, which is a position that certainly has to been improved, but which is neither totally dark.

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<sup>118</sup> OECD, (2008).

<sup>119</sup> Bergh A., (2009).

## CHAPTER 3

### “FUTURE CHALLENGES”

#### 3.1 Flexicurity

Flexicurity is a quite recent term that describes a welfare state model which tries to guarantee both “flexibility” and “security” in the labor market. It was originated in the ‘90s<sup>120</sup>, when the positive performances of the Dutch<sup>121</sup> and the Danish economy convinced the economists that employment flexibility improved firms’ competitiveness, stimulating both production and labor markets<sup>122</sup>.

A good conceptual definition is given by Wilthagen and Tros (2004) which state that *“flexicurity is a policy strategy that attempts, synchronically and in a deliberate way, to enhance the flexibility of labor markets, work organization and labor relations on the one hand, and to enhance security – employment security and social security – notably for weak groups in and outside the labor market on the other hand”*<sup>123</sup>.

Both the flexibility and the security dimension include many factors. Flexibility refers to “external numerical flexibility”, which is the possibility for the employer to move (“hiring and firing”) the employees according to their need (external job turnover); “internal numerical flexibility”, which is the employers’ ability to change the distribution of the working hours, without changing the number of employees; “functional flexibility”, that is the possibility for the employer to modify the content of the employees’ work, moving them from a department to another; “wage flexibility”, which permits to the employers to change the wages in relation to the variation of the labor market conditions; “externalization flexibility”, that enables the employers to use workers from external providers, with commercial contract, instead of employment contract (for example teleworking, distance working or virtual organizations)<sup>124</sup>. Security, instead, can refer to “job security”, meaning the protection of workers from dismissals and important changes in the working conditions; “employment/employability

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<sup>120</sup> The advantages of the flexibility of the labor market were analyzed both by the *Job Study* by the OECD (1994), and by Esping-Andersen (2000). They both underlined evidence in favor of less employment protection (Tangian A., (2007)).

<sup>121</sup> The deregulation of the labor market in Netherlands lead to the “Dutch miracle”.

<sup>122</sup> Tangian A., (2007).

<sup>123</sup> Wilthagen and Tros (2004, cited in Tangian A., (2006)).

<sup>124</sup> OECD (1989, cited in Tangian A., (2006)).

security”, which is the security of remaining at work and/or of finding a job (availability of jobs); “income security”, that is the income protection given in the case the work ends<sup>125</sup>.

Flexicurity has thus been recognized as an important issue to be reached, and this is demonstrated by the fact that the EU referred to this concept during the Lisbon summit of 2000 and in 2006 it has been the main subject of the Green Paper.

But, if flexicurity seems to be the perfect answer to the continued global pressures on the labor markets, why aren't all the European countries developing it? The main problem of this model is that it requires a high level of “public spiritedness”<sup>126</sup>, that means a high level of civic sense, which is not present in many countries. As it is characterized by high asymmetric information, the problem of moral hazard becomes very serious in the countries where people lie just to get the social benefit.

Sweden could certainly improve its labor market situation by introducing this kind of system, which would surely be successful in relation to the high civic spirit, characterizing the Northern European countries, and so Sweden, in comparison with the Southern countries. The flexicurity model has been winning especially in Denmark, leading the country to positive results within the labor market. This could definitely be taken as a benchmark model by Sweden to improve its performances, allowing the country to maintain its characteristic of medium-high protection in the labor market, and increasing in the meanwhile the flexibility of the system, which is a fundamental aspect that has to be improved. The model could certainly be developed in Sweden, by defining a program of improvement in this direction through specific objectives and control of the results, as the country has all the requirements to realize a good labor market system.

### **3.2 Labor incentives**

The problem of the lack of incentives for the low-wage workers is a very complicated issue, as it is related to the difficult question of finding a good equilibrium between unemployment benefits and incentives for work. This is a problem that characterizes all the welfare models, which make use of unemployment benefits systems. It is, in fact, embedded in their mechanism that there is a tradeoff between benefits and incentives.

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<sup>125</sup> Wilthagen, Tros and van Lieshout (2003, cited in Tangian A., (2006)).

<sup>126</sup> Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008).

However, what differentiates Sweden is the fact that the mentioned tradeoff problem has a strong influence on a specific labor class: the low-wage workers. It follows that an eventual reform should intervene not on the whole mechanism, but on the specific effect on this working category. And this is certainly not an easy question.

In general, the methods used to solve the problem of low incentives are based on the introduction of prerequisites to receive the benefits, eligibility conditions, limits of the benefits themselves, and sanctions to make the rules respected. These seem to be functional in the limit that the underlined problem derives from an objective high marginal effect<sup>127</sup>, which hit the low-wage classes.

Thus, generally the tools used to avoid the low labor incentives are very useful, especially if they are used in parallel with active labor policies, which can, on one hand, condition the receipt of the benefits to an “active behavior”, such as to the participation in a training program or to a working activity (workfare programs), and on the other hand, create positive effects by increasing the skills of the workers.

In fact, the solution that the most efficient welfare states are trying to reach is to use a low level of EPL, which means having a flexible labor market, and to have high levels of unemployment benefits, whose negative effects are neutralized by the parallel use of appropriate active labor policies<sup>128</sup>.

However, regarding the specific problem of the Swedish unemployment benefits system, a reform related to its mechanism should certainly be made, introducing a proper differentiation between different wage-categories. Of course, if the government has not done anything to change this situation, it means that it is not considered a serious problem or a necessary question to solve. But the aim of this work was to underline all the effects of globalization on the Swedish labor market and to suggest a solution to reach the best performance in all the areas.

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<sup>127</sup> Bergh A., (2009).

<sup>128</sup> This is especially what the Nordic and the Anglo-Saxon welfare models are trying to do. (Dell’Arringa C., Giovannetti G., Padoan P.C., Quintieri B., Rodano L., Sestito P., (2008)).

## CONCLUSIONS

Globalization is an increasing phenomenon that has a very deep impact on the modern society from several points of view. The economic dimension of globalization, or market globalization, can in fact lead both to positive and negative results, depending on the capacity of the countries to deal with the global effects.

In this work the relationship between globalization and the labor market has been analyzed in detail, highlighting not only the effects that the former has generally on the latter, but also the instruments in possession of the governments to answer to the increasing challenges in the labor market, such as the increasing unemployment rate, deriving from globalization.

The Swedish labor market has been examined to find out how globalization has affected it and what effects it has provoked. As in many developed countries, also in Sweden there has been an increase of the demand of the high-skilled workers, in comparison to the low-skilled ones, as the comparative advantage of the country relies in the high-skilled labor intensive goods and services. This has led also to the expected increase of the wage gap between these two categories of workers.

Moreover, these variations have been influenced by the phenomenon of relocation (outsourcing and offshoring) which is a typical feature of globalization. In fact, when the Swedish firms relocate their activities in developing countries the demand of unskilled workers decreases, while the one of high-skilled workers increases. When the transfer is, instead, towards developed countries, similar to Sweden, there is an opposite effect.

However, the unemployment rate has been quite high in the last decade in Sweden, especially if compared with the past rates. This is especially true considering youth unemployment, which is actually a serious problem for the Swedish labour market.

Another consequence deriving from globalization is the considerable transformation that has taken place in the employment structure, leading to an increasing importance of the services in comparison to the manufacturing.

The main tools that a government can use to influence the performances of the labour market are principally three: the employment protection legislation (EPL), the unemployment benefits and the active labour market policies. The Swedish labour market is essentially characterized by a medium-high level of EPL, which on one hand protects the workers from being fired, while on the other hand does not guarantee the necessary level of flexibility,

which is a fundamental prerequisite to adapt to the changing conditions, and thus to globalization, and to struggle against the youth unemployment problem. The unemployment benefits play also an important role in the Swedish system, which has always been generous in supporting the job seekers, beside the active labour market policies, which aim to supply training and education programs to the unemployed to enrich their skills and in that way reduce unemployment.

The Swedish labour market has, thus, been considerably influenced by globalization, which has led both to positive and negative consequences. On one side, in fact, Sweden's specialization on high-skilled labour intensive goods and services, whose exports have been increasing in the last years, has led the country to very positive economic results. But on the other side, there are some problems, such as the youth unemployment, which have really to be solved.

Three areas of improvement of the Swedish labour market have been underlined: the education system, which should create a better matching between the students and the needs of the labour market; the unemployment benefits system, which should create more incentives, especially for the low-wage workers to find a new job when unemployed; the flexibility of the labour market itself, which should be increased, especially with regards to the entrance in the market.

In conclusion, Sweden can be considered in the actual days both a winner and a loser, in this complex globalization – labor market relationship, as, even though it has reached positive economic results, there are still some questions that have to be worked out to be a complete winner.

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