How could Finland approach flexicurity type of labour market model?

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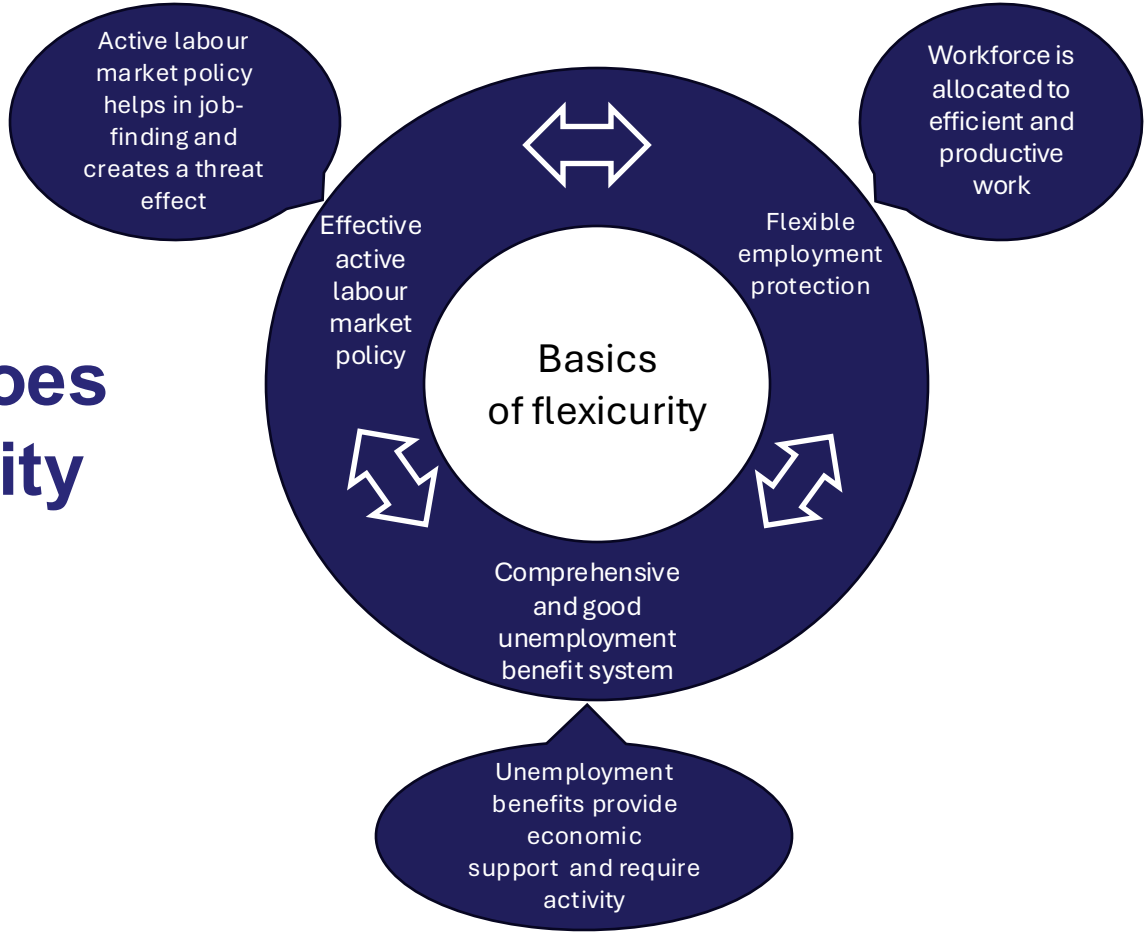
Työ- ja elinkeinoministeriö
Arbets- och näringsministeriet

Task of Senior Government advisors between February – August, 2025

- The key question of the report is how Finland could transition to a flexicurity-based labour market model
- Based on the report, the labour market model of the 2030s and 2040s can be outlined
- The main results of the report are clear - more detailed proposals serve as the basis for an impact assessment
- The report is not about legislative preparation, and the study does not address various implementation challenges

What does flexicurity mean?



Flexicurity is not a labour market theory, but a strategy

- There is a lot of empirical research on **each component** of flexicurity, but it is difficult to empirically study the **combined effects** of different elements.
- **Finland, Denmark, Sweden** and the **Netherlands** have developed different models to balance flexibility and security through employment protection, unemployment benefits and active labour market policy. Features of flexicurity in all these countries. Denmark has taken them the furthest.
- Denmark started in the 1990s by shortening very long maximum duration of unemployment benefits. However, the level of benefits was kept high. There was a strong focus on active labour market policies. Employment protection was already loose.
- Policy changes towards flexicurity in Denmark, which began in the 1990s, was not a ready-made model, but was regularly renewed. The results were systematically evaluated.
- Currently, Denmark is discussing, among other things, limiting the target group of active labour market policies and reducing interviews (those far from the open labour market); however, the high replacement ratio and significant activation rate will remain.

Loose employment protection regulation promotes total factor productivity

- Empirical studies show that loosening employment protection increases **both layoffs and recruitments** and thus the **reallocation** of workforce
- Labor market **flows increase**, but the impact on employment and unemployment is unclear and small in magnitude (sign unclear, magnitude small)
- Empirical studies show that loose regulation increases total factor **productivity**, but the magnitude of the **effect is small**
- Although the scale is small, the mechanism is important: sufficiently loose regulation enables the process of creative destruction
- However, the precondition is competition in commodity markets and other mechanisms that promote creative destruction: if these are not efficient enough, loosening the regulation of employment security will not compensate for the resulting low productivity.
- Productivity can best be promoted by a combination of competition in commodity markets and “sufficiently loose” regulation of employment security.

Unemployment benefits lead to incentive problems – unless job search activity is ensured

Good unemployment benefits extend the **duration** of unemployment:

- Increasing the **maximum duration** increases the duration of unemployment by approximately 20 percent of the change.
- Improving the **benefit level** increases the duration of unemployment. The effect is the same or lower than the change in the maximum duration.
- The effects of benefit changes are strong in Europe and the Nordic countries

Solutions to incentive problems:

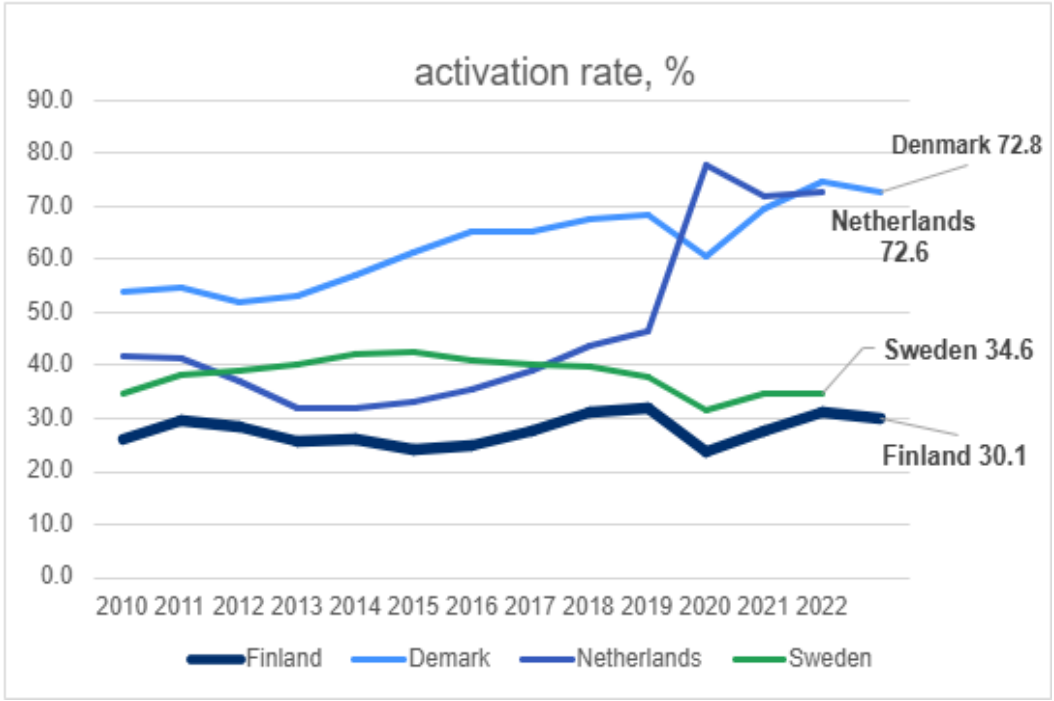
- Supporting and monitoring job search activity, including sanctions. Changes in sanctions do not always have a noticeable impact, different groups may react in different ways
- “Sufficient” investment in activation policies can shorten the duration of unemployment even if the level of unemployment security is good (threat effect)

->The combined effects of unemployment benefits and activation policies can become positive if appropriate investment is made in activation policies

Intended effects and side effects of active labour market policies

- The aim is to promote the employment of participants: the so-called **program effect** (relative to the control group)
- **Unintended side effects** may include a lock-in effect and a crowding effect
- Job search support can have a quick but not lasting impact. The impact of private sector wage subsidies and training measures can improve over several years – but there is no empirical research on the long-term effects.
- The results for Finland are mainly in line with international research evidence.
- The threat effect can be a positive side effect of activation policy; it may even be greater than the program effect.

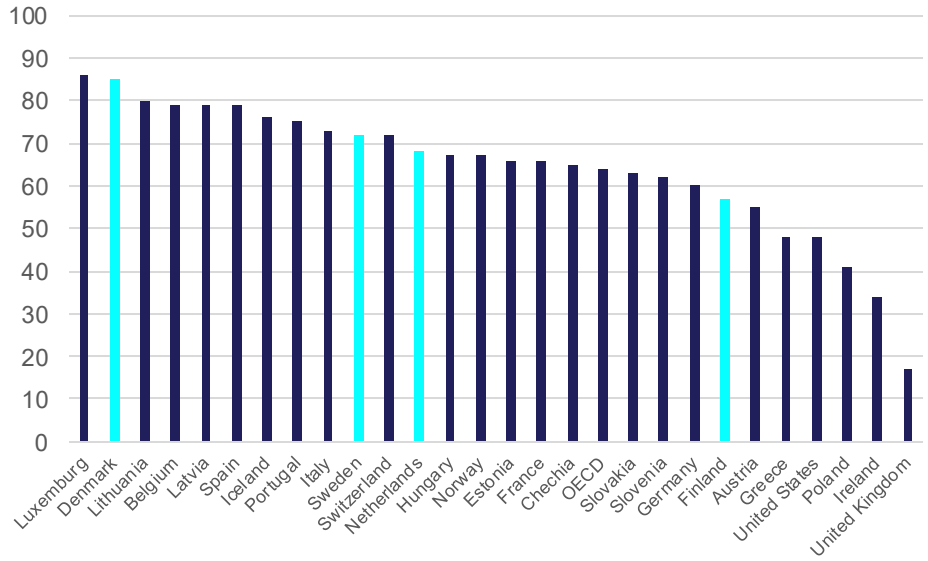
Finland's activation rate lags significantly behind Denmark and other benchmarks



- If a transition towards a flexicurity model is desired, the **greatest need for change concerns active labour market policy** (additional resourcing and reforms of ALMP measures.
- Active policy costs money, but if successful, it reduces unemployment and prevents unemployment from becoming prolonged, which is positive for public finances.

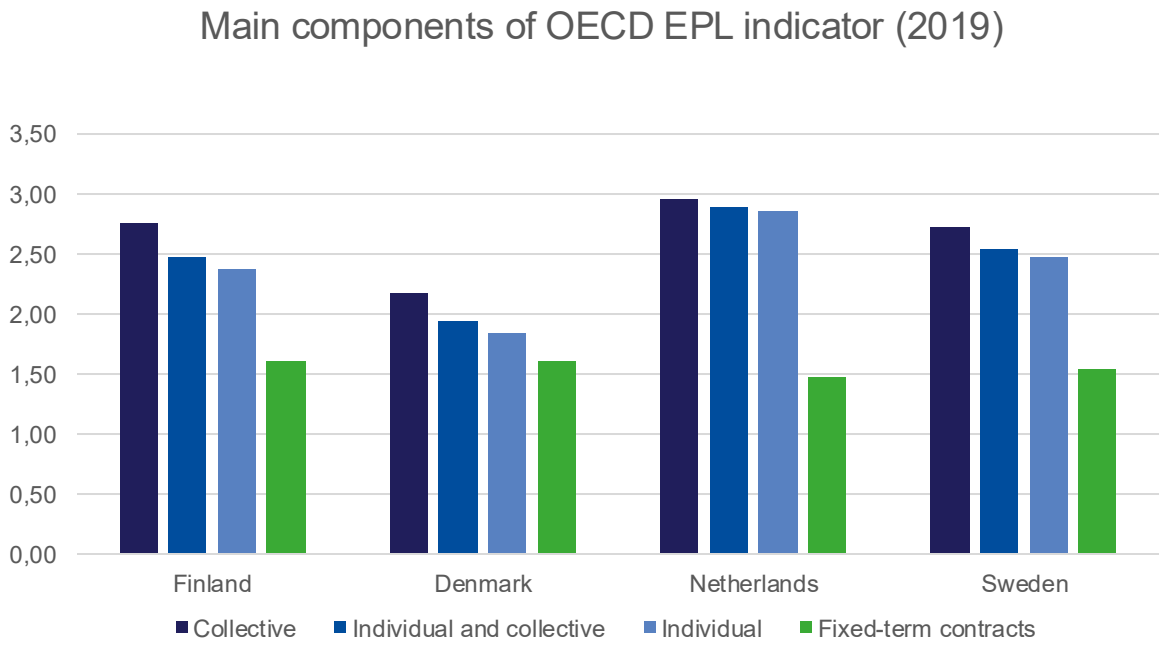
Unemployment benefit coverage in Finland is good, but the level lags behind benchmarks and does not correspond to flexicurity strategy

Unemployment insurance replacement rate 67% of average wage with earnings of 2 months of unemployment in 2024



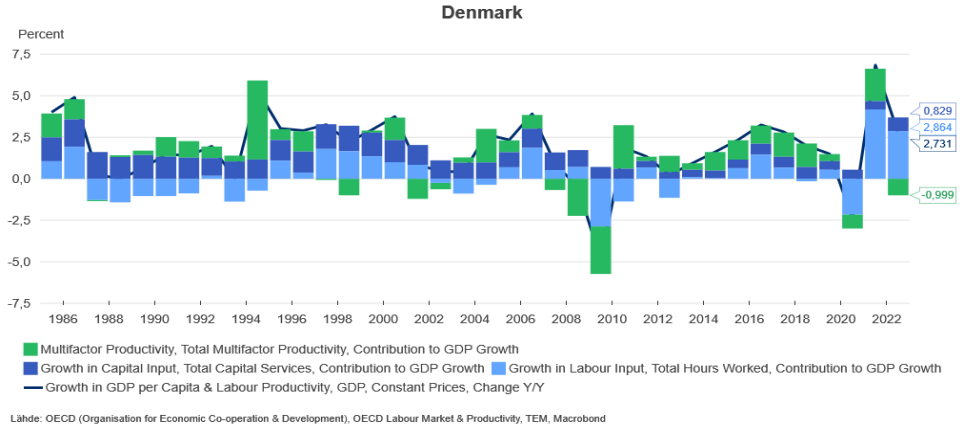
- In Denmark, unemployment benefits are particularly high for low-wage earners, while in the Netherlands, they are particularly high for middle-income earners
- In Finland, unemployment insurance is supplemented with other benefits - an increase in unemployment insurance would reduce the need for this
- Good level of unemployment benefits is one of the main flexicurity components - to avoid incentive problems, it is necessary to strongly increase active labour market policies

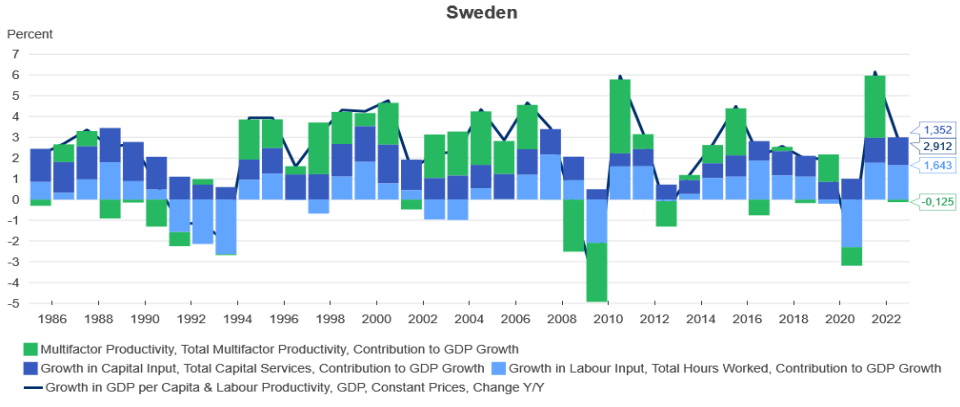
Finnish employment protection regulation is slightly stricter than average in a broader country comparison



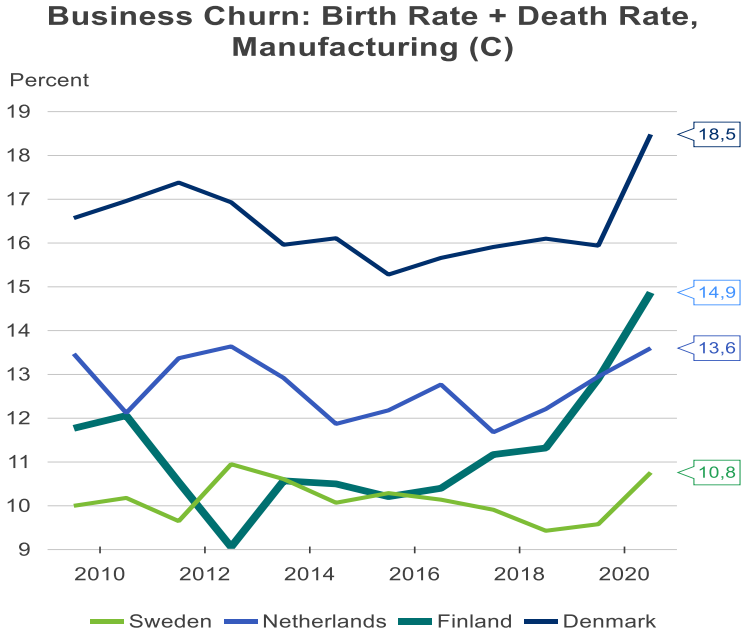
- The reforms under preparation are shifting employment protection towards flexicurity, although the overall regulation remains stricter than in Denmark
- Deregulation can support productivity growth – an important mechanism, although the magnitude of the effects is not large

Growth contributions of labor input, capital and productivity

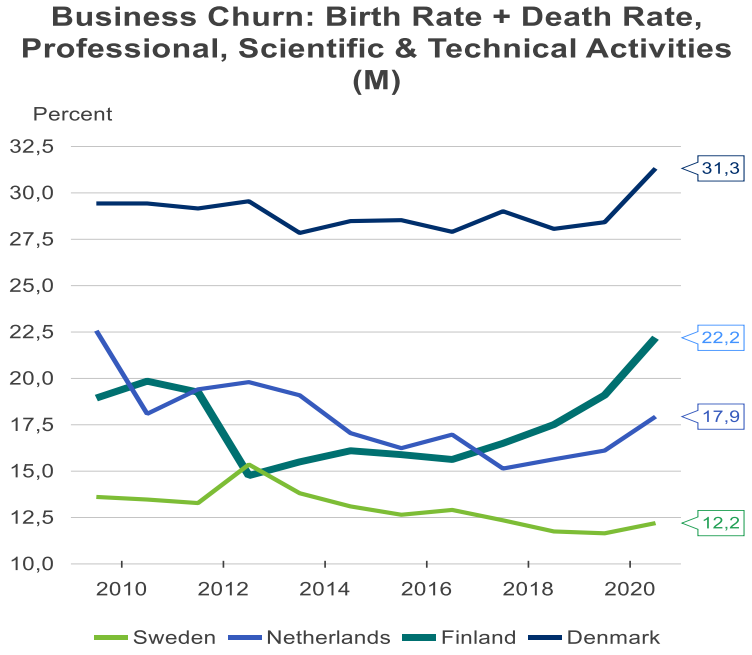




Firm churn rate (=birth + destruction rate) in two industries



Lähde: Eurostat, Structural Business Statistics, TEM, Macrobond



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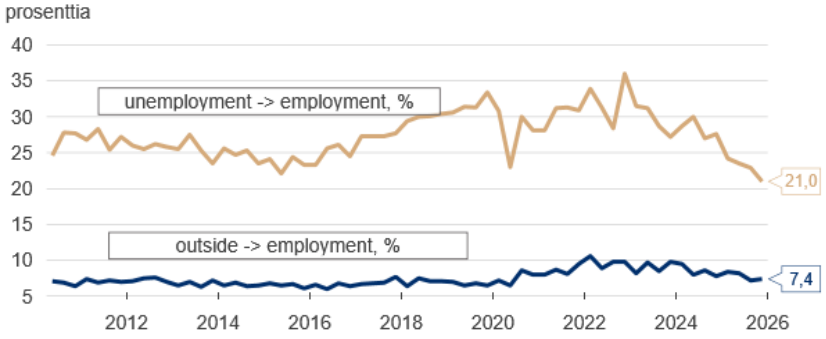
Transitions to employment

(% of unemployment and % of those outside the labour market)

Finland



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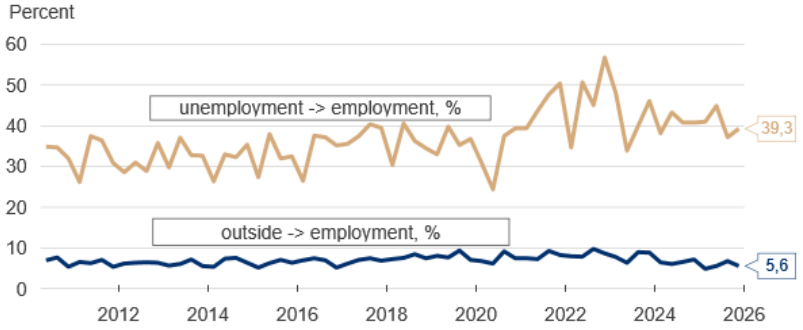
Denmark



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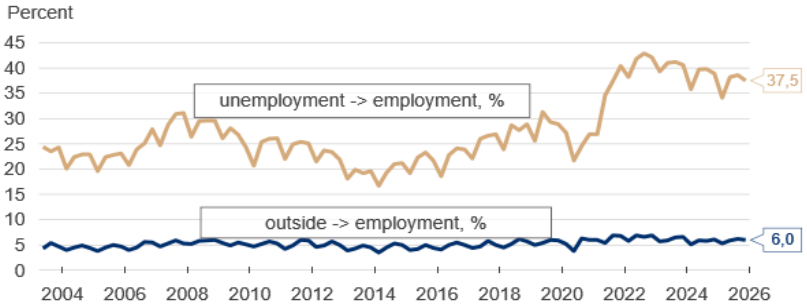
Netherlands



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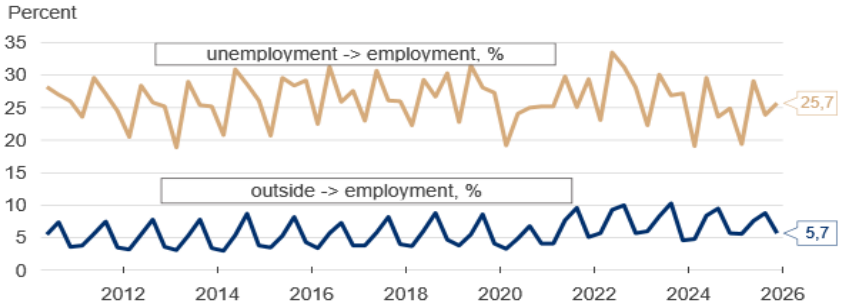
Sweden



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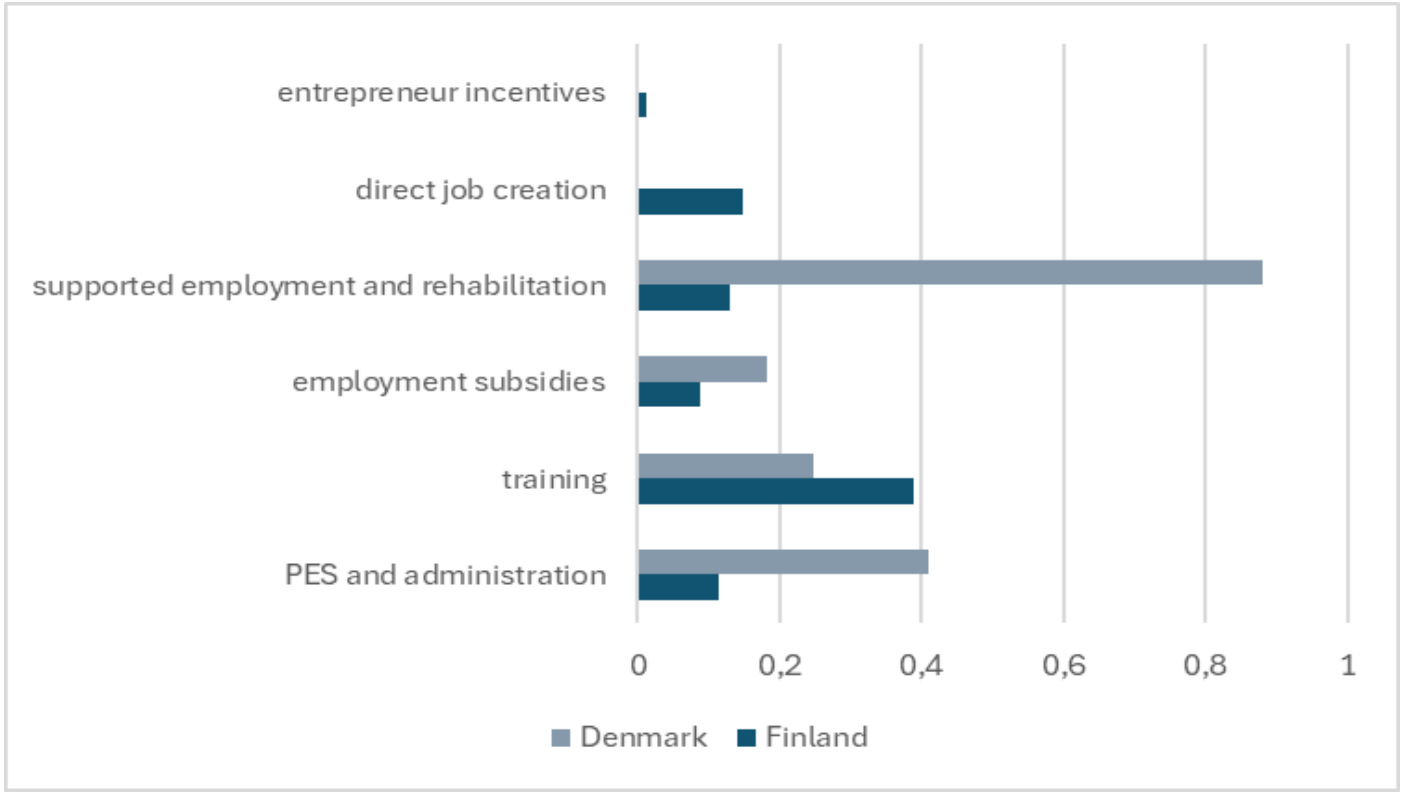
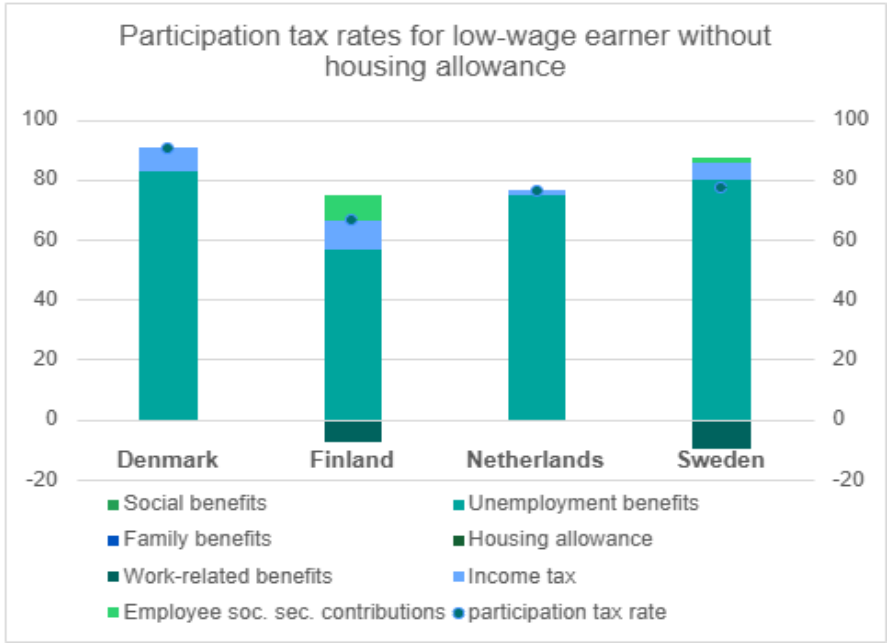
Expenditure on active programmes in Finland and Denmark, average for 2014–23, % of GDP

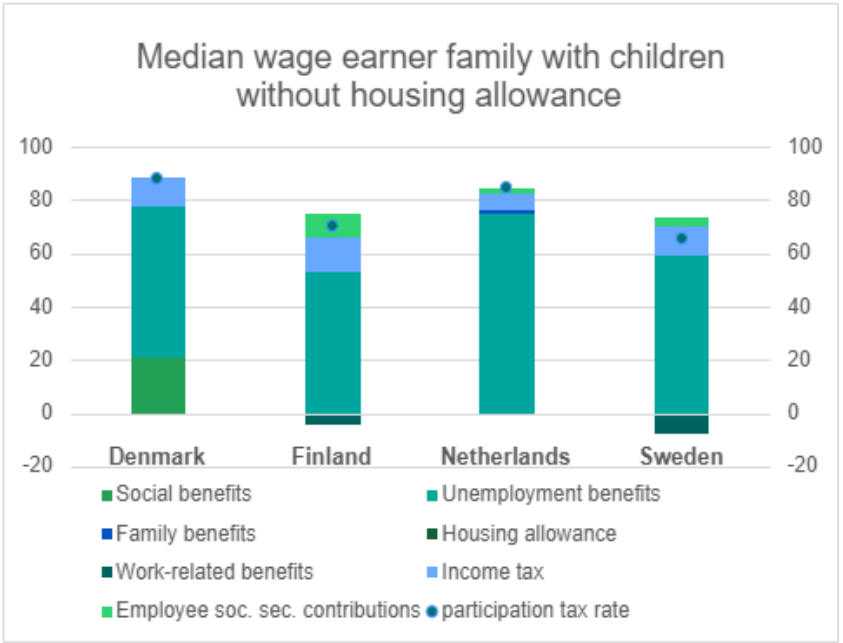


Two examples of participation tax rates

Lives alone



Family of 2 adults and 2 children



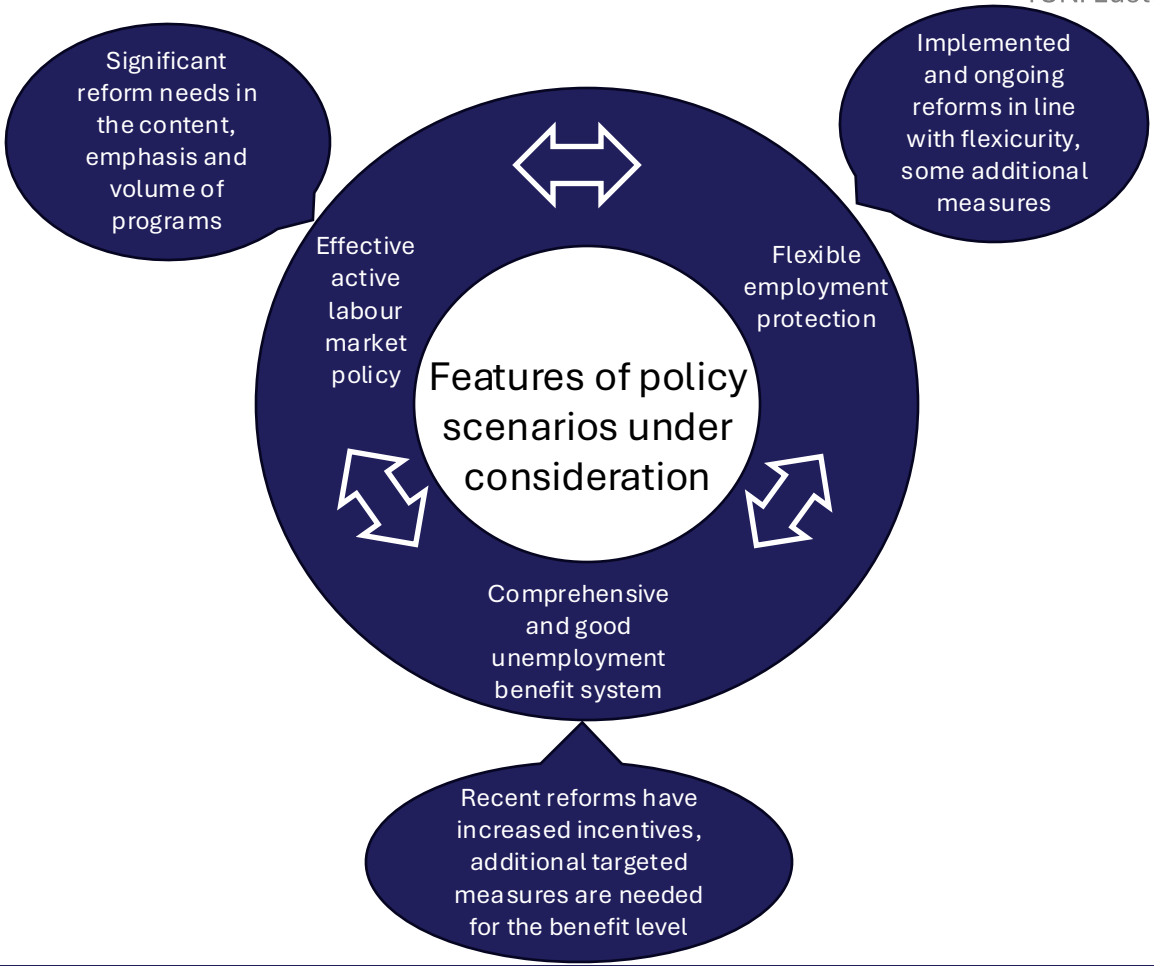
Conclusions from economic and labour market performance comparisons

- Good **business sector dynamics** require good **job dynamics**
- Effective competition in commodity markets is essential for business dynamics
- The development of Finnish business dynamics looks positive. Denmark is doing best, especially in terms of churning, and productivity growth has been good.
- Job tenure has decreased in Finland, Denmark, Sweden and the Netherlands.

- In terms of **labor market performance**, **Denmark outperforms Finland** on 26 factors, with Finland on five, where there is no difference on four factors compared to the situation in recent years. **In Denmark, almost all factors of employment and unemployment are better**, as is the level of earnings.
  - Finland is ahead of Denmark only in net immigration, full-time equivalent employment, the share of low-wage workers, the transition of those outside the labour market, and the employment of women aged 55-64.

What kind of “flexicurity” is there in different countries?

- In **Denmark**, the balance between flexicurity components include loose employment protection, good unemployment security and a high activation rate.
- The **Netherlands** appears more like a country of “security” than “flexibility”: strict employment protection and good unemployment security, plus a high activation rate
- **Sweden** is close to Finland in many ways, the biggest difference is perhaps the resources on employment services?
- **Finland** could be a little more flexible, offer better financial security and be a much more activating country


Significant reform needs in the content, emphasis and volume of programs
Implemented and ongoing reforms in line with flexicurity, some additional measures
Effective active labour market policy
Flexible employment protection
Features of policy scenarios under consideration
Comprehensive and good unemployment benefit system
Recent reforms have increased incentives, additional targeted measures are needed for the benefit level

Two scenarios for calculating the impact scale

Scenario 1

- Reforms in preparation:
  - Changes to employment protection
  - Changes to unemployment benefit sanctions
  - Changes to employment services
- Increase in the lowest earnings-related unemployment benefits
- Employment incentive for long-term unemployed people receiving labour market support
- Wage subsidy reforms (increase in companies, short recruitment support, will be discontinued in the public sector)
- Stricter labour market policy consideration of self-motivated studies while receiving unemployment benefits
- Duration changes for activation actions

Scenario 2

- Reforms in preparation
  - As in scenario 1
- Increase in the level and limitation of the duration of earnings-related allowances
- Employment incentive (as in scenario 1)
- Temporary protected part of unemployment benefits for those who have completed rehabilitation measures
- Reform of rehabilitation measures
- **Increase in the stock for activation activities**
- Activation actions otherwise as in scenario 1

Impact assessment in the study

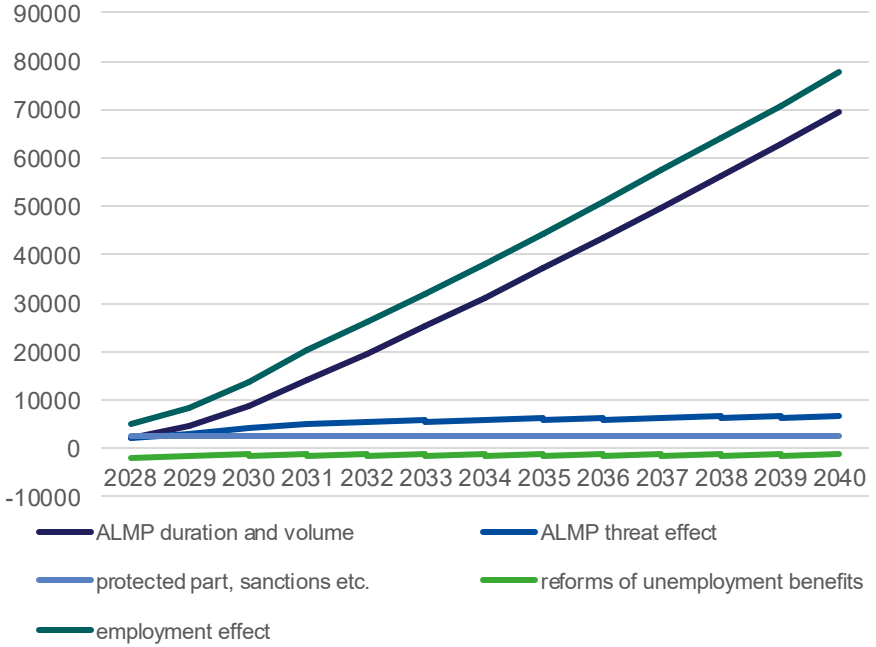
- Ministry of Finance's **microsimulation calculations** on unemployment benefits changes

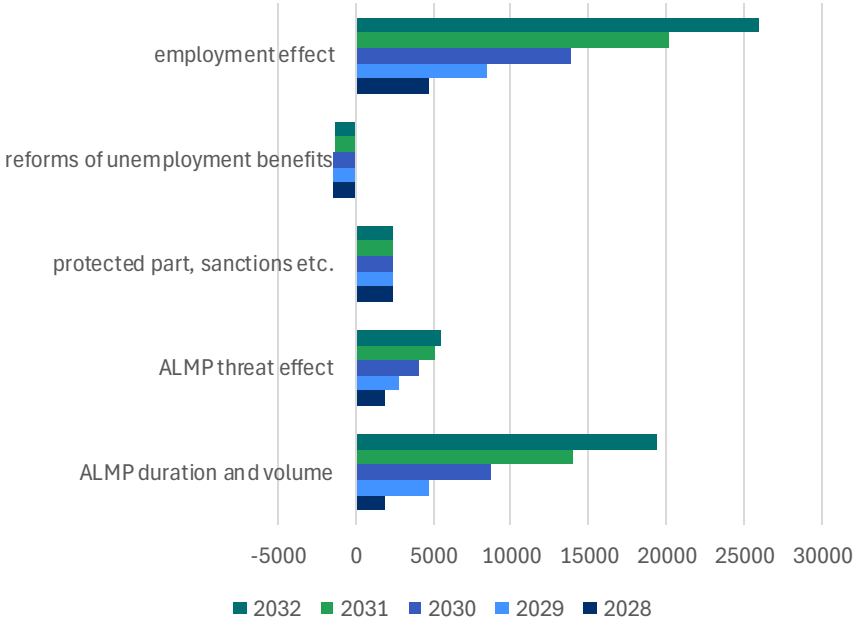
- Our own **static calculations** of the public finance and employment impacts for the years 2028-2040 for both scenarios
- Unemployment benefits in the starting year, according to the Ministry of Finance's microsimulation calculations
- The calculation utilized **impact research and impact assessments of government legislation proposals** under preparation

- **GEM model calculations** of the national economic impacts 2028-2040
  - Static calculations serve as the input data for the GEM calculation
  - A sensitivity analysis of productivity
  - GEM model calculations were commissioned from independent researcher

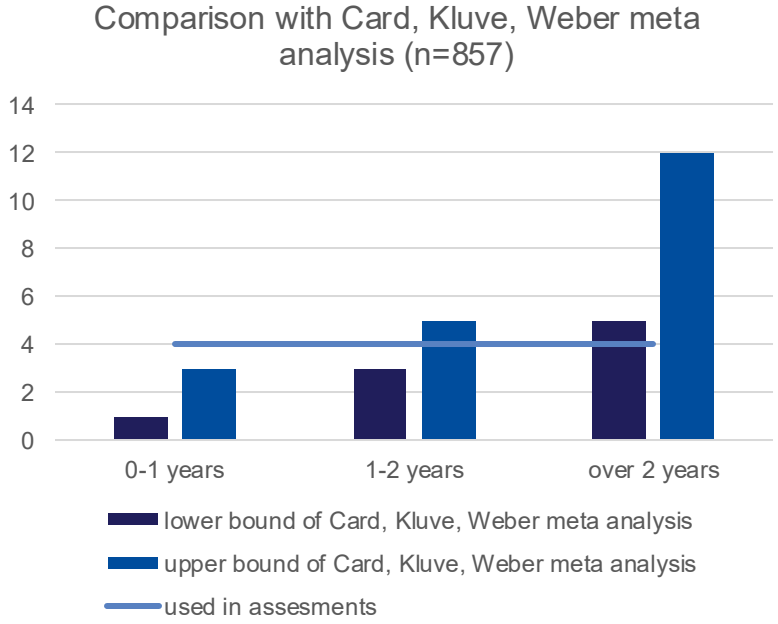
- The calculations include **several assumptions and uncertainties**, which we have attempted to describe.

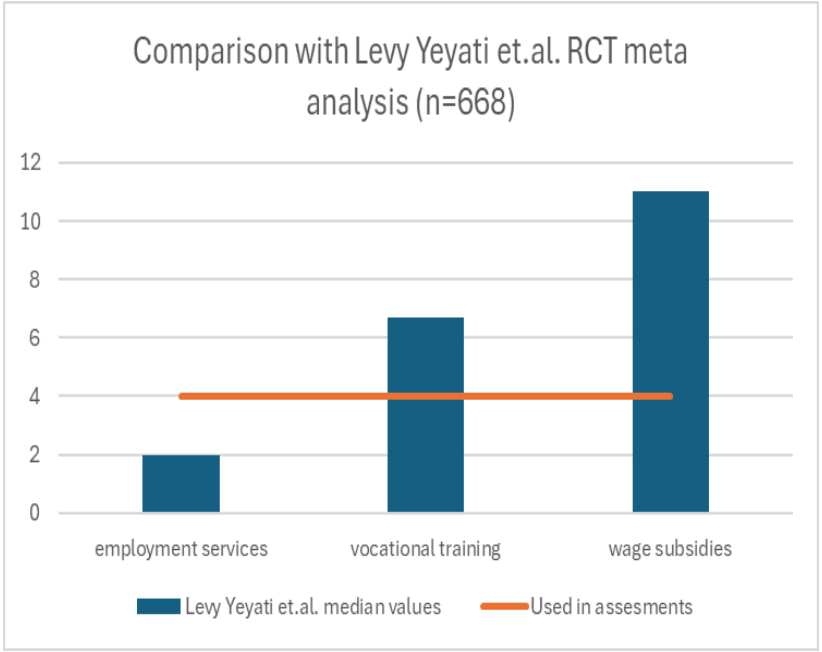
Total employment impact of Scenario 2 and its main components in 2028–40 and over the first five years





Comparison of the impact of active labour market policies with key meta-evaluations



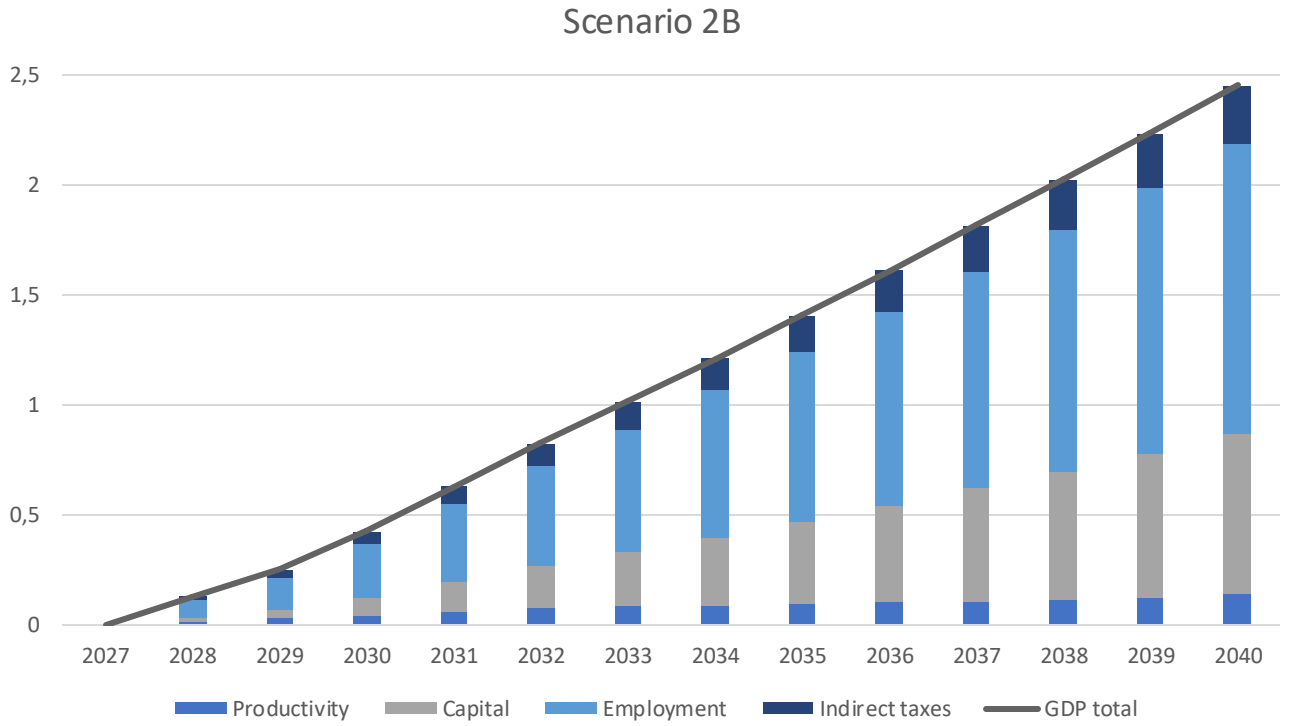


Sensitivity analyses of employment impacts

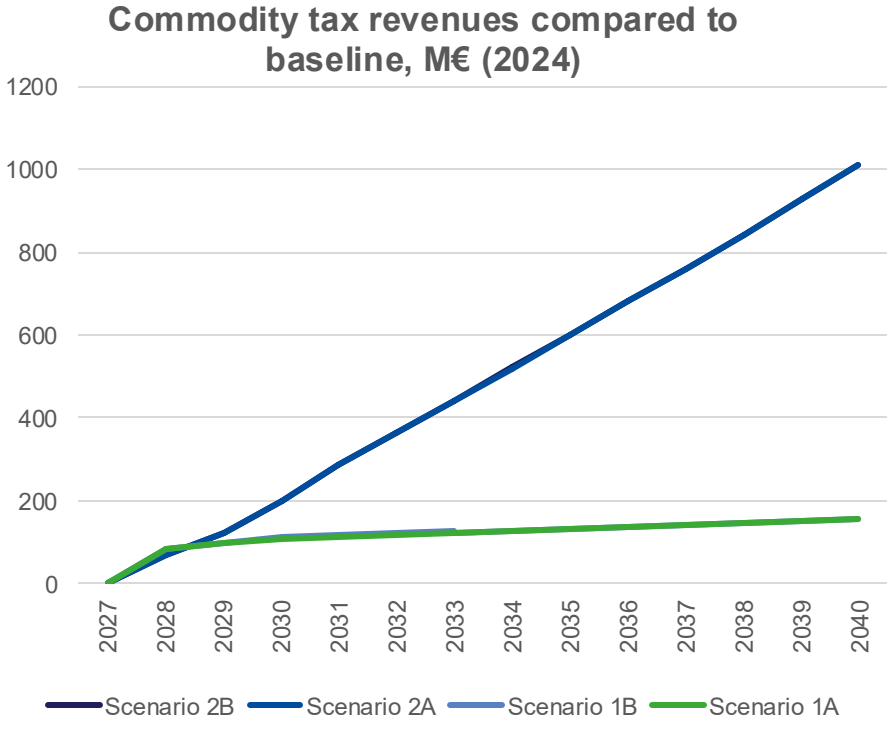
The key factor for the impact is the permanent employment impact of **active labour market policy** estimated at a **4% effectiveness level**. This is 69,000 people in 2040.

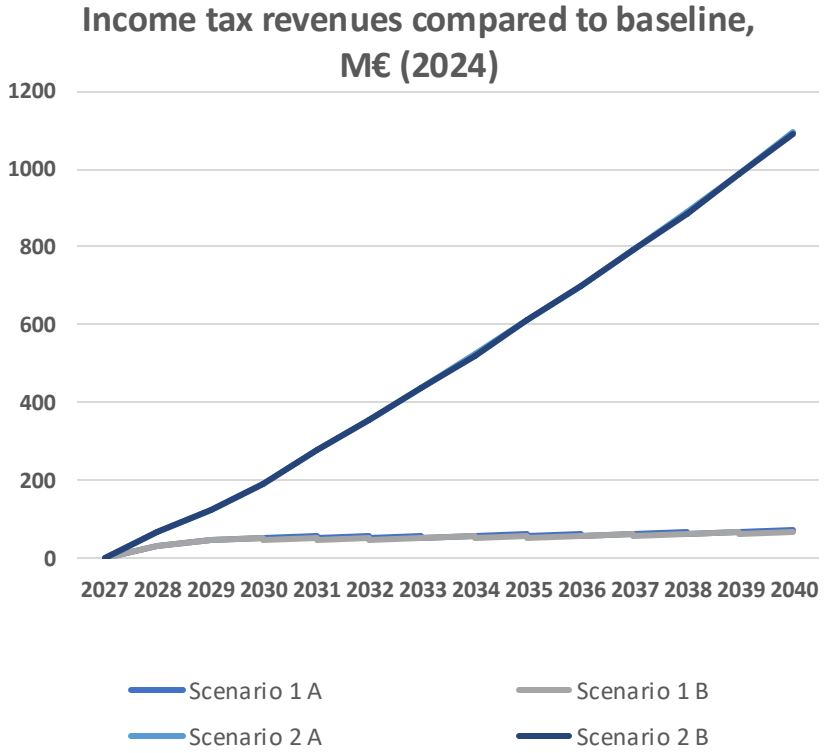
- Sensitivity analyses
  - Variation of the impact estimate: 3% -> 52,000, 5% -> 87,000 people
  - Variation of permanence:
    - Smoothly to zero in year t+6 -> 22,800
    - Smoothly to a third in year t+4, this part permanent -> 34,200
    - Smoothly to a half in year t+4, this part permanent -> 43,100
    - Smoothly to two-thirds in year t+4, this part permanent -> 51,600

Growth impact of supply components of GDP in scenario 2



Cumulative commodity and income tax revenues in scenarios





Cumulative costs and benefits in 2028-40

- **Spending increases:**
  - Active labour market policy €1.65 billion
  - Increases in unemployment benefits €1.8 billion (net €1.1 billion)

- **Benefits**
  - Income tax revenue €1.1 billion
  - Commodity tax revenue €1 billion
  - Unemployment benefit savings from reduced unemployment €3.8 billion

- Expenditures €3.45 billion, benefits €5.9 billion
- Public finance benefits sensitive to employment impact

What would a transition to flexicurity require?

- Active labour market policy should be **significantly increased**
- The level of unemployment benefits should be **improved**
- The pending reforms of employment protection should be **implemented**
-

➔How this happens in detail is not that significant

Exemplary proposals from investigators

1. Increase in funding for active labour market policy (funding level €180 million higher in 2040)
2. The average duration of ATP actions is shortened -> additional activation
3. Wage subsidies will be directed to the corporate sector and the 3rd sector, public sector wage subsidies will be discontinued.
4. Rehabilitation measures will be renewed; rehabilitative work activities will be discontinued
5. Labour market policy considerations for voluntary studies will be tightened
6. The reforms of employment services that are being prepared will be implemented
7. Active labour market policy cyclical buffer created for the Employment Fund (max. 300 M€)
8. Increase in earnings-related unemployment benefit (the coefficient for the earnings component will be increased, the increase will end at 300 benefit days)
9. The proposed sanctions for unemployment benefits being prepared will be implemented.
10. Unemployment insurance protected part for those who have completed rehabilitation measures (€400 for 8 months)
11. Reforms to the Cooperation Act (in force from 1 July 2025)
12. Individual dismissal relief will be implemented
13. Waiving take-back obligations and shortening the time limits for actions to 1 year

Finally

- The **proposals lead towards flexicurity**, but even after them, Finland is not at the same level as Denmark in any dimension.
- A **systematic assessment** of flexicurity as a whole and individual policy measures is needed
- Flexicurity **policy** must also be **reformulated** if the nature of the structural problems in the labour market changes over time.

- If flexicurity is the answer, what are the challenges?
  - Can a good employment rate be achieved otherwise?
  - Does not help to eliminate structural unemployment, but can prevent the formation of new structural unemployment
  - Can prevent unemployment from becoming prolonged and help keep unemployment low
  - Can improve labour market dynamics
  - Is not the answer to challenges resulting from cyclical fluctuations
  - Breaks the trade-off between income and incentive of unemployment security

Link to the publication: https://julkaisut.valtioneuvosto.fi/handle/10024/166491