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# Employment and Skills in Finland

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**Vincent Koen**

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**by Jon Kristian Pareliussen, Christophe André, Thomas Chalaux and Vincent Koen**

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## ABSTRACT/RÉSUMÉ


### Employment and Skills in Finland

*Employment fosters equity and economic inclusiveness because those out of work face the highest risk of poverty, and it generates the tax receipts on which the social safety net depends. Further enhancing education and life-long learning would lower hurdles to employment, which are high for the low-skilled. Policies to speed up tertiary graduation, improve work incentives and activation of the unemployed and postpone labour market exit are necessary to bring the employment rate closer to the level of other Nordics. Easing employment regulations and allowing more flexible wage setting would increase both employment and productivity.*

This working paper relates to the 2016 OECD Economic Survey of Finland

(www.oecd.org/eco/surveys/economic-survey-finland.htm).



JEL Classification: I21, I28, J08, J11, J21, J24, J31, J52.

Keywords: Finland, Employment, Education, Skills, Wage bargaining, Inequality, Gender.


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### Emploi et Compétences en Finlande

*L'emploi est facteur d'équité et d'inclusion économique car ceux qui en sont exclus sont les plus exposés au risque de pauvreté ; il est également générateur de recettes dont dépend le financement du filet de protection sociale. De nouvelles mesures en faveur de l'éducation et de la formation tout au long de la vie permettraient d'abaisser les obstacles à l'emploi, plus difficiles à surmonter pour les moins qualifiés. Il faut mettre en place des mesures pour accélérer les délais d'obtention des diplômes dans l'enseignement supérieur, améliorer les incitations à travailler et l'activation des chômeurs et retarder la sortie du marché du travail pour rapprocher les taux d'emploi avec ceux des autres pays nordiques. Enfin, l'assouplissement de la législation sur l'emploi et la mise en place de procédures plus souples de fixation des salaires devraient permettre des gains en termes à la fois d'emplois et de productivité.*

Ce Document de travail se rapporte à l'Étude économique de l'OCDE de la Finlande 2016 (www.oecd.org/fr/eco/etudes/etude-economique-finlande.htm).



JEL Classification: I21, I28, J08, J11, J21, J24, J31, J52.

Keywords: Finlande, Emploi, Éducation, Compétences, Négociation salariale, Inégalité, Égalité des sexes.

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# EMPLOYMENT AND SKILLS IN FINLAND

**By Jon Kristian Pareliussen, Christophe André, Thomas Chalaux and Vincent Koen[1]**

The employment rate is lower in Finland than in all the other Nordics. The government has the ambition to increase the employment rate to 72% and reduce the unemployment rate to 5% by 2019, the end of the parliamentary term (Ministry of Finance, 2014). Higher employment increases equity and well-being in a number of ways. Raising employment increases equity directly, as those out of work face the highest risk of poverty, and indirectly, as it generates tax revenue, which can be used to finance public services and the social safety net. Well-being is also higher for the employed, who enjoy higher purchasing power, better housing conditions, better health outcomes and better opportunities to interact socially. Higher female employment can improve work-life balance for both genders, if work and domestic responsibilities are shared more equally.

There is a considerable potential to expand the labour force by speeding up the labour market entry of youth, postponing the exit of older workers, improving work incentives and activation policies for the unemployed and increasing the participation of women of childbearing age. Human capital is important in this respect, as hurdles to employment are high for the low-skilled and Finland has a comparative advantage in knowledge-intensive industries. Maintaining and further developing a world-class education system and encouraging life-long learning is essential to secure Finnish prosperity going forward.

This paper is structured as follows: The first section outlines the potential to increase employment and provides a bird's-eye view of the role of skills and education, coupled with sound labour market policies to boost employment and equity. The second section focuses on the deteriorating results in reading, mathematics and science among 15-year olds tested in the Programme for International Student Assessment (PISA) Survey, and offers recommendations to improve the education system from early childhood to upper secondary school. The third section provides analyses and recommendations on how to increase labour supply by speeding up entry, shortening unemployment spells, facilitating work immigration and increasing employment rates of women of childbearing age and older workers. The fourth section deals with the cost of labour, and how wage bargaining institutions and employment protection regulation could be reformed to boost labour demand and allocate resources more efficiently.

## Skills, employment and inequalities

Finland's low employment rate compared to the other Nordics is partly compensated in terms of total labour input by more hours worked per employee and a lower prevalence of part-time work. Even though part of the difference in employment reflects legacies from the 1990s crisis and the sluggish recovery from the Great Recession, policy settings also hold back labour supply. High employment fosters equity, but people with low education or low skills struggle to get jobs, partly because the compressed wage distribution reduces incentives to hire low-productivity staff.

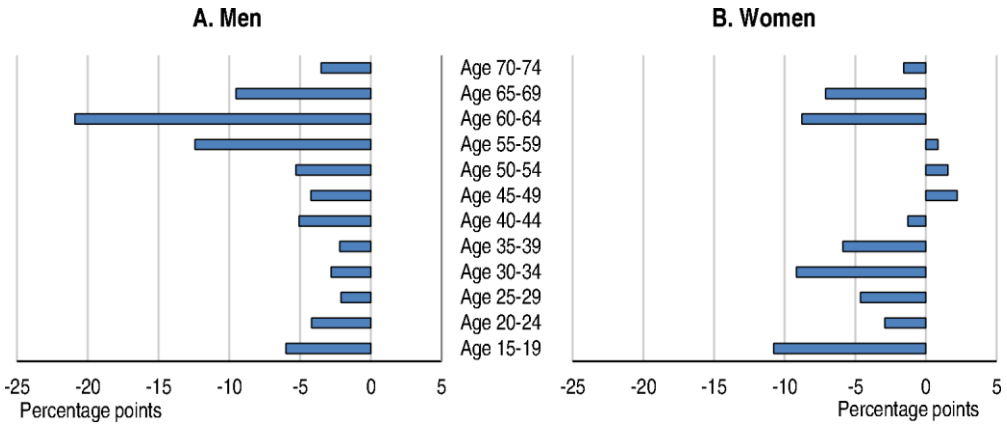
[1] The authors are from the OECD Economics Department. The authors would like to thank the Finnish authorities, as well as Robert Ford, Alvaro Pereira and members of the EDRC for helpful comments and suggestions. Mercedes Burgos and Sisse Nielsen provided excellent editing support.

***Employment is low across age, gender and skill levels compared to other Nordics***

The highest potential to increase employment is found among older workers. With an employment rate of 59% in the 55 to 64 age group, Finland fares much worse than neighbouring Sweden (74%), Norway (72%) and Denmark (63%), despite steadily increasing employment in this age group for the past two decades.

Men are less likely to be employed than in other Nordics in almost all age groups, but especially so in older cohorts (Figure 1, Panel A). Middle-aged women do relatively well, with employment rates approaching those of Sweden. In contrast, women in childbearing age are much less likely to be employed than in Sweden and Norway, despite generous parental leave and childcare arrangements in all three countries (Figure 1, Panel B). The employment rate of young adults is lower in Finland than in Norway and Denmark, despite higher tertiary enrolment in those countries. Given the high attendance in upper secondary vocational education and training (VET), Finland should target youth employment rates comparable to Norway, Germany and Denmark rather than current low levels. Indeed, individuals with a vocational education enter the Finnish labour market fairly smoothly at a young age.

**Figure 1 Employment is low compared to other Nordics1**




1. Difference in employment rates between Finland and the Nordic average (Denmark, Norway and Sweden) in 2014.

Source: OECD, Labour Force Statistics database.

Simulations of labour market participation converging towards the Nordic average (described in Box 1) illustrate that the government's target of an employment rate for the age group 15-64 of 72% in 2019 seems out of reach, given economic weakness and strong demographic headwinds in the coming years. In the baseline scenario, which already posits higher participation of women in childbearing age and older cohorts, the employment rate reaches 72% only around 2047. Achieving the employment rates of either of the two convergence scenarios would require unprecedented participation growth (Figure 2, Panel A), and would necessitate a comprehensive package of policy reforms targeting higher participation and lower structural unemployment of both genders and across age groups. The sizeable potential to boost employment of 65-74 year-olds should be harnessed further even though this age group is not included in the 72% employment target (Figure 2, Panel B).

**Box 1 Labour market participation scenarios**

Simulations based on OECD long-term scenarios set out alternative convergence paths towards Nordic average participation rates by gender and age cohort. Labour market participation is driven by two factors, the size of cohorts and changing rates of participation within each cohort. For example, overall participation falls when large cohorts age, as older individuals are less likely to be in the labour force. Higher educational attainment will postpone labour market entry of the young, but higher-educated individuals are likely to stay longer in work. The model is based on a long-term cross-country convergence scenario, where the baseline already includes significant advances, notably in the area of education attainment. The simulations for Finland assume that the gap in labour market participation between Finland and the Nordic average is reduced at a constant 2% or 5% rate within each gender and age cohort. A third scenario is constructed by identifying the highest historic five-year moving average participation growth since 1963 within each cohort and gender. Trend participation rates in the base year are then extrapolated with this past growth.

**Table 1 Participation convergence scenarios**

Percentage points increase in participation rates from 2014 to 2030

| | Men | | | | Women | | | |
|---|---|---|---|---|---|---|---|---|
| **Age** | Baseline | 2% | 5% | Highest past growth | Baseline | 2% | 5% | Highest past growth |
| **15 to 19** | -2.7 | 1.4 | 7.5 | 7.9 | -2.7 | 2.0 | 9.0 | 5.3 |
| **20 to 24** | -1.0 | -0.2 | 1.0 | 3.2 | -0.8 | 0.9 | 3.5 | 2.5 |
| **25 to 29** | 1.3 | 1.6 | 1.9 | 2.6 | 2.5 | 3.4 | 4.7 | 0.0 |
| **30 to 34** | 1.5 | 2.2 | 3.3 | 3.3 | 4.4 | 5.9 | 8.3 | 0.3 |
| **35 to 39** | 1.6 | 2.4 | 3.5 | 0.4 | 3.8 | 4.8 | 6.2 | 0.0 |
| **40 to 44** | 1.4 | 2.7 | 4.5 | 0.1 | 2.3 | 2.7 | 3.3 | 0.3 |
| **45 to 49** | 0.9 | 2.4 | 4.6 | 0.5 | 0.8 | 0.8 | 0.8 | 0.3 |
| **50 to 54** | 2.4 | 4.2 | 7.0 | -0.1 | 2.0 | 2.0 | 2.0 | 0.1 |
| **55 to 59** | 2.7 | 6.7 | 12.6 | 3.6 | 2.7 | 3.0 | 3.5 | 2.6 |
| **60 to 64** | 3.7 | 9.9 | 19.2 | 7.9 | 3.9 | 7.2 | 12.3 | 5.9 |
| **65 to 69** | 4.3 | 8.7 | 15.2 | 17.8 | 3.4 | 6.7 | 11.6 | 10.3 |
| **70 to 74** | 5.2 | 5.3 | 5.6 | 37.1 | 2.9 | 3.1 | 3.4 | 20.4 |
| **75 to 99** | 0.4 | 0.4 | 0.4 | 0.0 | 0.1 | 0.2 | 0.2 | 0.0 |

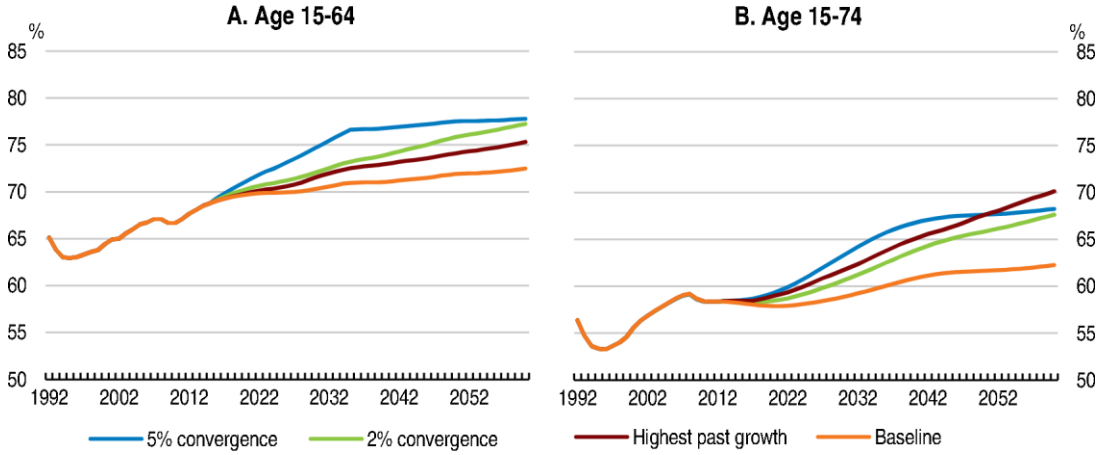
*Source*: Pareliussen, 2016

### *Drivers of skills, employment and earnings*

Inequality in Finland, as measured by the Gini coefficient of disposable income, is among the lowest in the OECD and has stayed fairly constant since the turn of the century, following a sharp increase in the 1990s. Other measures, such as the ratio of high incomes to low incomes and middle incomes to low incomes (the S90/S10 and S50/S10 decile shares), have followed similar patterns. Absolute poverty is among the lowest in the European Union, with less than 3% of the population experiencing severe material deprivation, and less than 1% experiencing severe housing deprivation in 2014. With a relatively compressed wage distribution, the main driver of income is whether or not an individual is employed. The non-employed have significantly lower average incomes despite the generous social safety net. The median income is almost 50% lower among the unemployed compared to the employed, and 35% lower among the inactive. The retired on the other hand, are less disadvantaged. Income increases with education attainment and skills proficiency, highlighting the importance of equity in access to education and the quality of teaching (Figure 3).

**Figure 2 Comprehensive reforms are needed to meet ambitious employment targets**

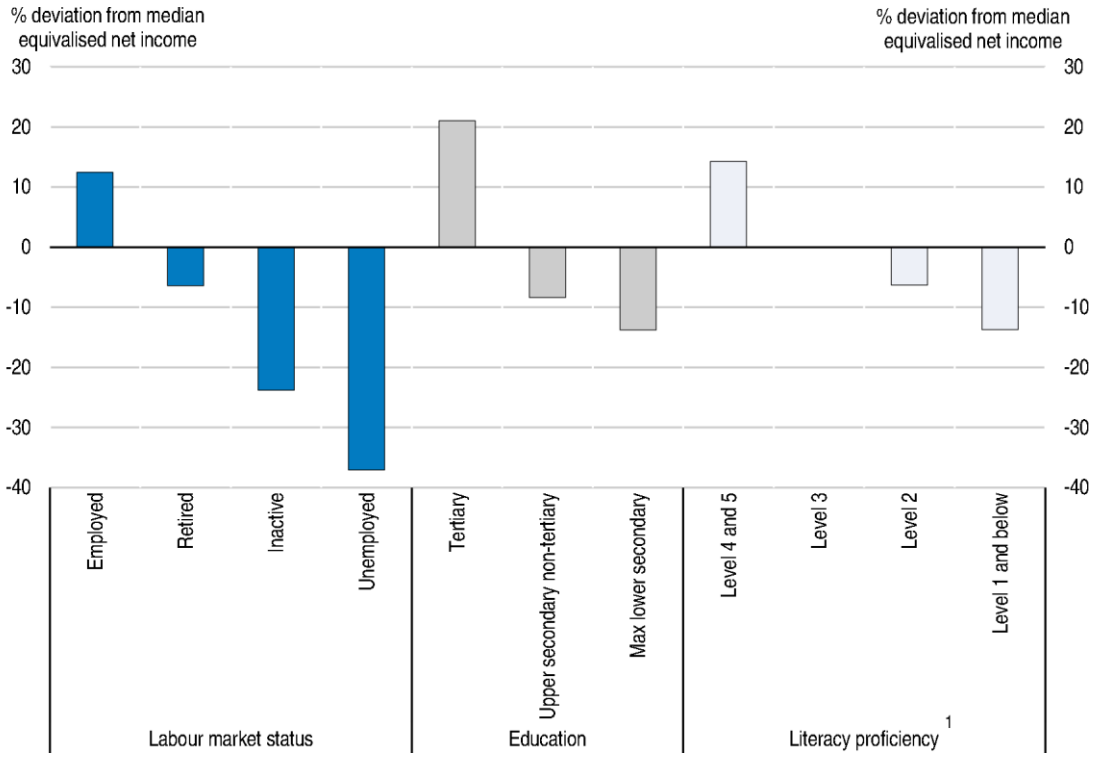
Employment rates in different scenarios1




1. See Box 2.1 for methodology.

Source: OECD calculations based on Johansson et al. (2013).

**Figure 3 Inequalities, work, education and skills in Finland**




1. Average % difference to mean hourly wages of employed persons with skill level 3, 2012.

Source: Eurostat SILC database and OECD Survey of Adult Skills (2012) database.

**Improving education further**

Finland is renowned for the good results in its compulsory schools, even though it spends slightly less than the OECD average per pupil. In the latest PISA survey it ranked sixth among OECD countries in mathematics, fifth in problem solving, third in reading and second in science (OECD, 2014a). Adult skills are also high. Both literacy and numeracy average proficiency are second highest in the OECD behind Japan, and Finland is second only to Sweden in problem solving in technology-rich environments, as measured in the PIAAC survey (Figure 4, Panel A; OECD, 2013b). Furthermore, Finland has one of the highest levels of educational attainment in the OECD, with 84% of the 25-64 year-old having at least completed upper secondary education and 39% holding a tertiary degree, against OECD averages of 75% and 32%, respectively.

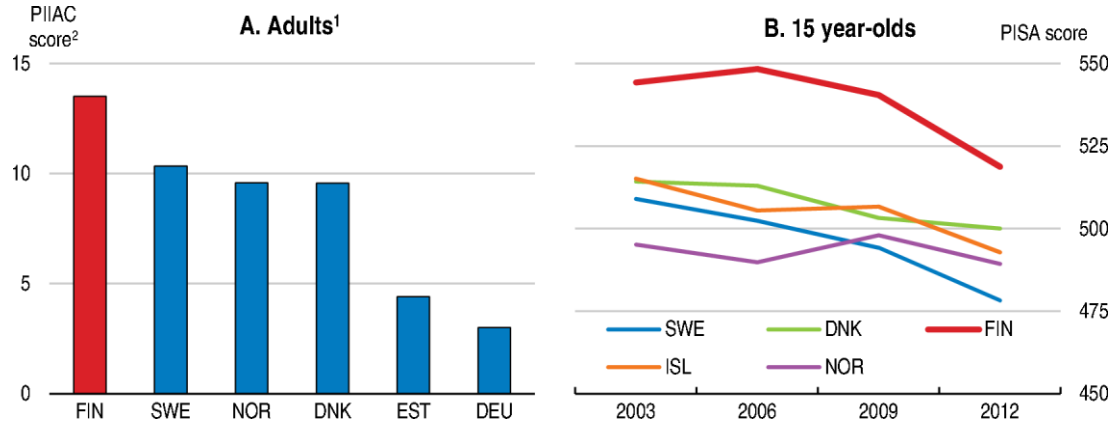
Finland's success in compulsory school is partly because teachers are valued by society and enjoy good working conditions, relatively good salaries, smaller classes and fewer teaching hours than the OECD average (OECD, 2014 b and c). Entry to the five-year teacher education programme is highly competitive, and education is rigorous, research-based and combined with supervised teaching for at least one year in schools associated with the university. The high quality of teachers is crucial to learning and it also permits the decentralised organisation of Finnish schools to function with low administrative costs and without wide variations of quality across schools and municipalities (Sahlberg, 2011; OECD, 2015a).

Another feature of Finnish schools is the well-developed system to detect pupils with special needs early and provide timely interventions. Teachers are well-trained in detecting learning difficulties and in adapting their instruction accordingly. Forty to 45% of students receive extra help during compulsory school, which reduces the stigma that may be attached to receiving such assistance. Each school has at least one special needs teacher, trained to help struggling students. The special needs teacher is tasked with early identification and intervention, helped by a multi-professional student welfare team consisting of the principal, the special needs teacher, the school nurse, the school psychologist, a social worker and the class teacher (OECD, 2015a).

***PISA results have declined, and boys fall behind***

However, PISA performance has deteriorated since its high point in 2006, which is a cause for concern (Figure 4, Panel B). PISA results are also falling in other Nordics. Even though the reasons behind the falling results are not fully understood, some hypotheses, such as the effect of rising immigration, can be ruled out. Furthermore, after having had the highest share of tertiary graduates in the OECD among 25-34 year-olds in 1991, Finland has been overtaken by other countries. Tertiary education attainment of the young is today below the OECD median.

**Figure 4 Skills are high, but school results are falling**




1. Data refer to 2012.

2. 16-65 year-olds, difference to OECD average.

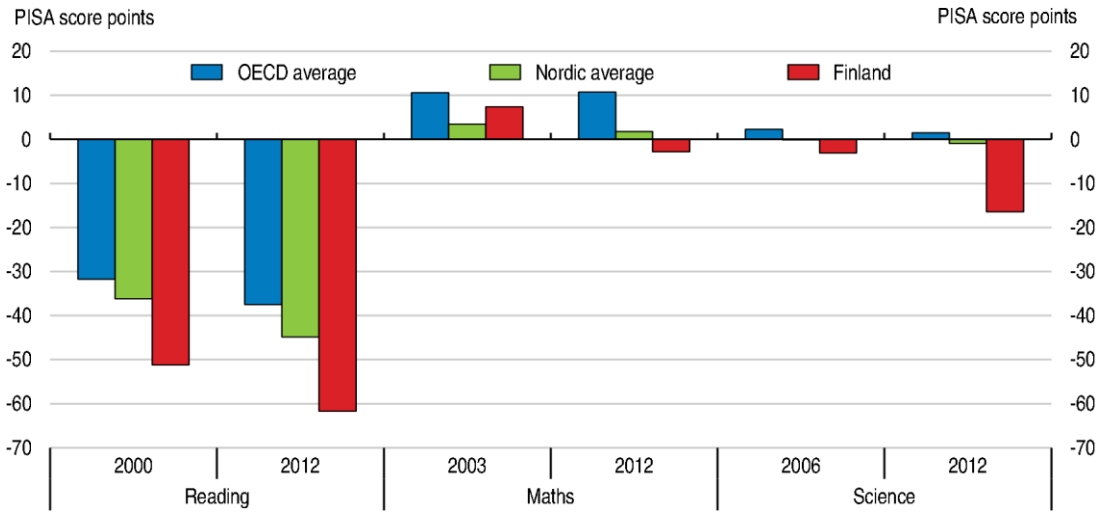
Source: OECD Survey of Adult Skills 2012 database and OECD PISA 2009 and 2012 databases.

Public spending on education remained steady at about 6.5% of GDP from 2009 to 2013. The education sector was mostly shielded from the consequences of the economic downturn. In 2015, however, the government announced cuts to education spending amounting to 4% of total education expenditure over the next four years. These savings are to come from limiting the right to early childhood education and care if one parent is not working, higher ratios of children per staff in both early childhood education and basic education and unspecified savings measures in upper secondary and tertiary education. The government assumes that cuts to tertiary education funding can be achieved by reducing administrative expenditure and increasing the share of students entering working life after completing the Bachelor's degree (Prime Minister's Office, 2015). Municipalities may cut back education spending further than expected, as around half of compulsory school funding comes from municipalities that are also subject to funding cuts. There might be room for efficiency improvement in the education sector, for example by consolidation within the tertiary education sector, but the situation should be monitored closely to avoid reduced quality.

Gender differences in school performance are evolving, and girls now perform significantly better than boys in reading and science, while results are approximately similar in mathematics, a subject where boys used to do better than girls (Figure 5). Boys and girls react differently to different instruction methods. On average, girls might do more homework and are more inclined to engage in collaborative activities, while boys are less likely to prioritize school and thus less likely to work systematically when given the responsibility to structure their own learning activities. Low-performing boys are especially likely to lose out under such teaching practices (Dalland and Klette, 2014). Causes of declining results for boys should be further investigated, and teaching practices should be adjusted to foster efficient learning for both girls and boys. "Phenomenon based learning", a teaching method that uses one overarching topic to connect instruction over several different subject areas, will be promoted as the new national curriculum takes effect in the fall of 2016. This can bring advantages as it encourages teacher co-operation as well as students' curiosity and understanding of context, and it can give gifted students the opportunity to better use their potential. The gender impact and the impact on weaker students' learning of basic skills should however be monitored.

**Figure 5 Boys are falling behind in PISA**

PISA score point difference between boys and girls1




1. Start years differ, as they refer to the last year when the subject in question was the main subject of the PISA survey.

Source: OECD (2014d).

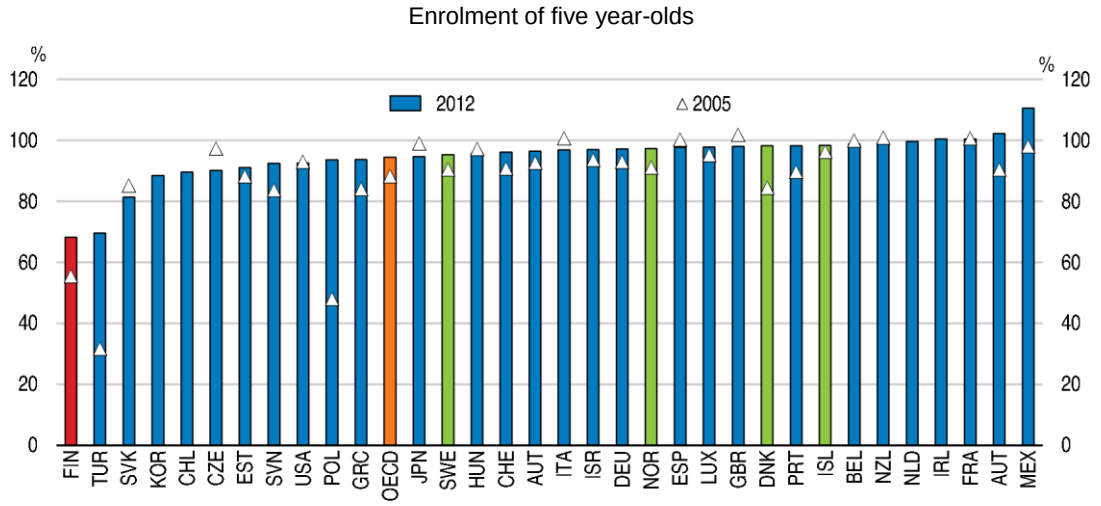
Time in the classroom is shorter by 15% than the OECD average, giving teachers better opportunities to coordinate with colleagues, cater for pupils with special needs and plan and prepare courses. Nonetheless, there may be scope for increasing instruction time – on average for countries participating in PISA one extra hour of instruction a week raises scores by about 12 points (OECD, 2015b).

***Higher participation in early education can improve results and equity***

Early childhood education and care has expanded in tandem with women's labour participation in most OECD countries, yielding multiple benefits. Enrolment rates for four year-olds vary from over 95% in many OECD countries, including Denmark, Germany, Norway and Spain, to less than 60% in Finland and Turkey (OECD, 2014d). Enrolment in early childhood education and care for five year-olds in Finland is the lowest in the OECD, at 68% (Figure 6). Enrolment has increased since 2005, but remains low for all age groups below six. Enrolment reaches 98% for the six year-olds, in line with the OECD average. Pre-primary education for 6-year olds was made compulsory as of 2015, and is guided by a national core curriculum.

Pre-primary education helps pupils succeed in formal schooling. PISA analyses find that in most countries pupils who have attended at least one year of pre-primary education tend to perform better than those who have not, even after accounting for socio-economic background. Many of the inequalities in learning outcomes found in education systems are already evident when pupils enter formal schooling and persist as they progress through the school system (Downey et al., 2004). Inequalities tend to be higher when school is not compulsory, so earlier entrance into the school system may reduce these inequalities (Heckman, 2000; OECD, 2014d).

**Figure 6 Enrolment in early childhood education and care is low**




Source: OECD (2014c).

***Vocational education and training: consolidating programmes and building foundation skills***

Vocational education and training (VET) focusses on trade-specific skills, and eases the transition from school to working life. But gains in youth employment from vocational education may be offset by reduced adaptability and thus poorer employment and career prospects later in life, as rapid technological change makes occupation-specific knowledge and skills obsolete, while foundation skills like literacy, numeracy and digital skills as well as generic skills like the ability to cooperate and structure one's time facilitate such adaptability (OECD, 2013b). The youngest cohorts of VET graduates in Finland are more likely to be employed than graduates with general qualifications and similar characteristics in terms of socio-economic background and skills, but then fall behind from ages 26-35 (Hanushek et al., 2011). PIAAC data show that education is a strong driver of skills in Finland, but academic secondary and tertiary education is associated with higher literacy skills than vocational education at similar levels, reflecting on the one hand the content and quality of the education, and on the other that students make different choices based on their interests and abilities. Furthermore, education and skills strongly influence earnings among those in employment (Box 2).

Around 40% of students entering upper secondary school follow the three-year VET track, in which 119 initial study programmes lead to 53 different vocational qualifications. Following initial vocational qualifications, students can choose from 305 further and specialist qualifications, and they gain eligibility to polytechnic and university studies. Forty per cent of entrants to polytechnics, and 9% of entrants to universities held a VET degree combined with the matriculation exam in 2013 (Statistics Finland, 2015). Efforts to build foundation skills that are necessary to successfully adapt to a changing society should be increased, along with life-long development and training to improve long-term labour market outcomes. Consolidating VET programmes and specialisations could be considered as a part of this effort.

**Increasing labour supply**

Higher employment can increase equity and well-being in a number of ways, i.e. by reducing poverty directly and through taxes and transfers and by improving work-life balance for both genders if work and domestic responsibilities are shared more equally. The potential to increase labour supply is substantial in Finland, as employment is lower than in the other Nordics across skill levels, age groups and genders. To unlock this potential, the transition from secondary to tertiary education should be streamlined, tertiary

completion times shortened, work incentives for women in childbearing age and the unemployed strengthened, work immigration encouraged, and a number of policies should be implemented to prolong working lives for older workers.

**Box 2 Adult skills and labour market outcomes**

The PIAAC Survey measures what adults in the age group 15-64 know and can do within three cognitive skills, namely literacy, numeracy and problem solving in technology-rich environments. Literacy proficiency is measured on a six-level scale ranging from "Below Level 1" up to "Level 5". Individuals scoring 5 and above are highly skilled and able to search, integrate and utilise complex information on unfamiliar subjects to make high-level inferences, while those scoring at or below level 1 can at best understand short texts on familiar topics and solve simple assignments. This dataset has been used to explore skill formation, the odds of being employed, determinants of earnings and various measures of labour market mismatch in Finland. The results show that skills increase with education, but are relatively low for older cohorts and immigrants from poorer countries. Both literacy skills and education are strong drivers of employment and earnings. Furthermore, the data do not show any ethnic penalties in earnings and employment for the foreign-born when controlling for the other variables. A selection of the results of this study is presented in Table 2.2.

**Table 2 Skills formation and labour market outcomes in Finland1**

| | Literacy score (OLS) | Odds of being employed (Logit)[2] | Logarithm of earnings (OLS) |
|---|---|---|---|
| Literacy score | | 2.74 | 0.12 |
| | | [0.12]** | [0.03]** |
| Female | -1.95 | 0.89 | -0.33 |
| | [1.58] | [0.08] | [0.02]** |
| Age below 24 | 1.70 | 0.48 | -0.86 |
| | [3.16] | [0.18]** | [0.06]** |
| Age 25-34 | 4.17 | 0.74 | -0.23 |
| | [2.22] | [0.16] | [0.02]** |
| Age 45-54 | -10.72 | 0.86 | 0.11 |
| | [2.57]** | [0.17] | [0.02]** |
| Age above 55 | -28.04 | 0.24 | 0.00 |
| | [2.3]** | [0.15]** | [0.03] |
| Max lower secondary education | -13.65 | 0.69 | -0.25 |
| | [2.77]** | [0.12]** | [0.04]** |
| Upper secondary general education | 24.67 | 1.2 | -0.15 |
| | [2.69]** | [0.16] | [0.05]** |
| Post-secondary non-tertiary education | 5.74 | 1.51 | 0.14 |
| | [3.42] | [0.22] | [0.04]** |
| Tertiary vocational education | 22.29 | 1.66 | 0.06 |
| | [2.00]** | [0.12]** | [0.03]* |
| Tertiary academic education | 39.91 | 1.90 | 0.27 |
| | [1.91]** | [0.14]** | [0.03]** |
| Foreign born developed country immigrant | 6.28 | 1.38 | -0.11 |
| | [6.38] | [0.54] | [0.08] |
| Foreign born immigrants – other countries | -54.91 | 1.80 | -0.03 |
| | [8.90]** | [0.43] | [0.07] |

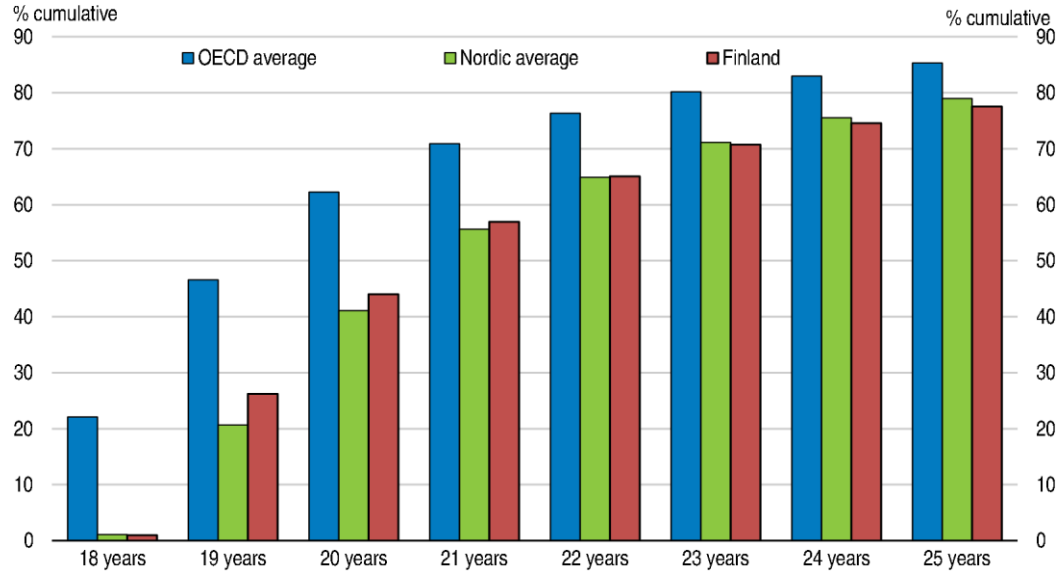
1. The reference category for all three regressions is a native born man aged 35-44 with upper secondary vocational education. Standard errors of the coefficients are included in brackets, with * and ** indicating significance at the 90 and 95% level, respectively. Further control variables, statistics and the methodology are presented in Pareliussen (2016).
2. Coefficients are odds ratios. Coefficients with a value below 1 indicate that there is less chance of an event occurring for a particular group compared to the reference group, and coefficients greater than 1 represent greater chances. The literacy score variable is scaled by its standard deviation.
*Source*: Pareliussen, 2016.

### *Speed up labour market entry of the young*

Employment prospects for tertiary graduates are good, despite recent increases in unemployment also in this group. However, the transition from upper secondary school to tertiary education could be more efficient. The transition of qualified (matriculated) students to tertiary studies is in line with the other Nordics, but slow compared to the OECD average (Figure 7), and it has slowed between 2005 and 2013 (Statistics Finland, 2015).

**Figure 7 The transition from secondary to tertiary education is slow**

Entry into tertiary education, 2012




Source: Eurostat, Database (Last accessed 8 April 2015).

Entrance exams commonly differ between universities and faculties in Finland, especially at the undergraduate level. Candidates who fail the entrance exams to their preferred faculty may have to take a break of two to three years before obtaining a place in tertiary education (OECD, 2013c). The implementation of a joint national application process in 2014 is a step in the direction of facilitating faster entry and better resource utilisation. However, the new system still relies on entrance exams. A system where applications are assessed using matriculation results only would facilitate the entry into tertiary education in the year in which students matriculate. The Open University and polytechnics could be strengthened as alternative routes to university for those with poor matriculation results (OECD, 2010).

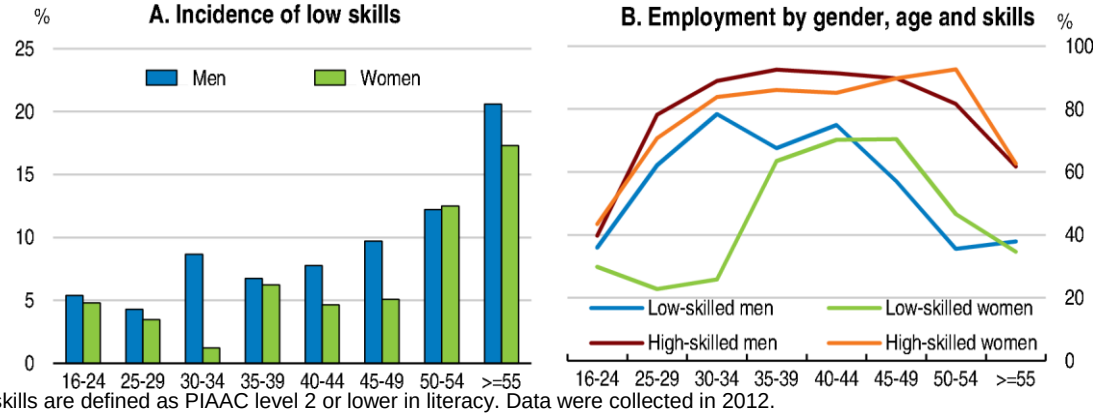
Those who enter tertiary education tend to stay in studies for a long time. The average duration of tertiary education is 6.5 years, considerably higher than the OECD average of 5.0 and the Nordic average of 4.8 years. Moreover, one in ten university entrants in 2013 already held a university degree in another field (Statistics Finland, 2015). Long completion times may to some extent reflect preferences and add value to society. Around half of students work part time, which may both give young people useful experience and fill needs in the labour market. Some may take sabbaticals and develop personal skills, and individuals with complementary double degrees are valuable in the labour market. Nonetheless, timelier graduation would in general increase Finland's growth potential. Furthermore, slowly progressing students occupy study places that could have been made available to others, slowing transition into tertiary education. Student aid and university financing were reformed in recent years to encourage faster completion, and the government plans to go further in this direction (Ministry of Finance, 2014; Prime Minister's Office, 2015).

***Encouraging female participation***

The employment rate of Finnish women (68%) is close to that of men (69%) but considerably lower than in the other Nordics. Despite a second place in the Global Gender Gap Report, only 24% of science, technology, engineering and mathematics students are female. Furthermore, the Finnish labour market is sharply gender-segregated. Just 30% of legislators, senior officials and managers are female, and women are 70% more likely than men to be in part-time work (WEF, 2014), contributing to a gender wage gap of 19% (Eurostat, 2015).

Women are less likely to show low literacy proficiency, defined as scoring at or below level 2 in literacy in the PIAAC Survey (Figure 8, Panel A). But women of childbearing age with low literacy proficiency are significantly less likely to be employed than men with the same level of proficiency (Figure 8, Panel B). Furthermore, the employment gap between women with secondary and those with tertiary education is also markedly higher for women in childbearing age than for men. Older women are on the other hand more likely to be employed than men across skill levels except in the oldest age group.

**Figure 8 Low-skilled young women are unlikely to be employed1**




1. Low skills are defined as PIAAC level 2 or lower in literacy. Data were collected in 2012.

Source: OECD Survey of Adult Skills, 2012.

Gender differences are also reflected in rates of youth who are neither in employment, education or training (NEET). The NEET rate for individuals aged 20 to 34 with lower secondary education is 37% for women and 33% for men. 15 % of women with upper secondary education or higher are NEET, 5 percentage points higher than the NEET rate for men with a similar education level.

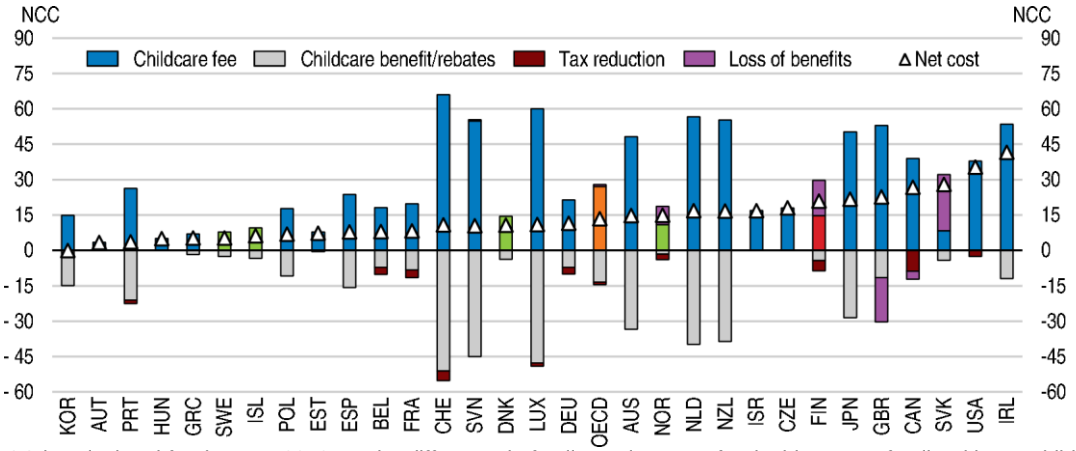
Labour force participation among Finnish mothers with children below three years of age is the lowest in the Nordics, some 20 percentage points below that of Sweden and Denmark despite the legal entitlement to public day-care at rates capped below 10% of average monthly wages. One reason for low participation among mothers is the home-care allowance, a benefit which follows parental leave and is available for up to two years per child not attending public day-care. The benefit is especially attractive to persons with relatively low potential earnings, a group in which immigrants are over-represented, since it offers a flat rate subsidy for staying at home. However, the bulk of recipients are natives. The basic allowance is comparable in generosity to similar allowances in Norway and Sweden, but take-up rates among parents of two- and three-year olds are higher (50%) in Finland than in Norway (25%) and in Sweden (5%), where it is available only in some municipalities. High take-up reflects the multiple supplements available. There is a supplement for older siblings and a means-tested supplement. Furthermore, 46 out of 320 municipalities, covering more than half of Finnish pre-school children, offered top-ups to the allowance as of March 2015, partly because encouraging women to stay at home can be less expensive for municipalities than offering

day-care (Ellingsaeter, 2012; Kela, 2015). As with parental leave, the home-care allowance can be combined with the right to return to one's previous workplace.

Childcare is available to all, and free of charge for very low income households. However, the combined economic incentive of the benefit and foregone childcare fees amounts to € 626 per month for one child and € 984 for two children, not taking into account municipal or other supplements, which may be substantial. The loss of the benefit results in the highest net cost of childcare in the Nordics (Figure 9). By comparison, the average monthly earnings for women are around € 3000. The participation tax rate – i.e. the extent to which taxes and benefits reduce the financial gain of moving into work including childcare costs and loss of the allowance – exceeds 70% for low-earning lone parents and women in low-earning couples who receive the home care allowance for two children. Facing such strong incentives, four in ten women with children aged below seven receive the home-care subsidy rather than making use of public day-care. Kosonen (2013) finds that increasing the allowance by € 100 per month reduces maternal labour supply by 3%. Female employment rates in a panel of OECD countries fall sharply if combined parental- and home-care leave entitlements exceed two years (Thévenon and Solaz, 2013).

**Figure 9 The home care allowance doubles the cost of childcare in Finland**

Net cost of childcare (NCC) in % of the national average wage1




1. The NCC is calculated for the year 2012, as the difference in family net income of a double-earner family with two children, aged two and three, who uses centre-based childcare and an otherwise identical family who does not. Family net income is the sum of gross earnings plus cash benefits minus income taxes and social contributions paid by workers for a family with two earners, earning 67% and 50% of the national average wage, respectively.
Source: OECD Tax-Benefit Models, www.oecd.org/els/social/workincentives (last accessed 27 July 2015).

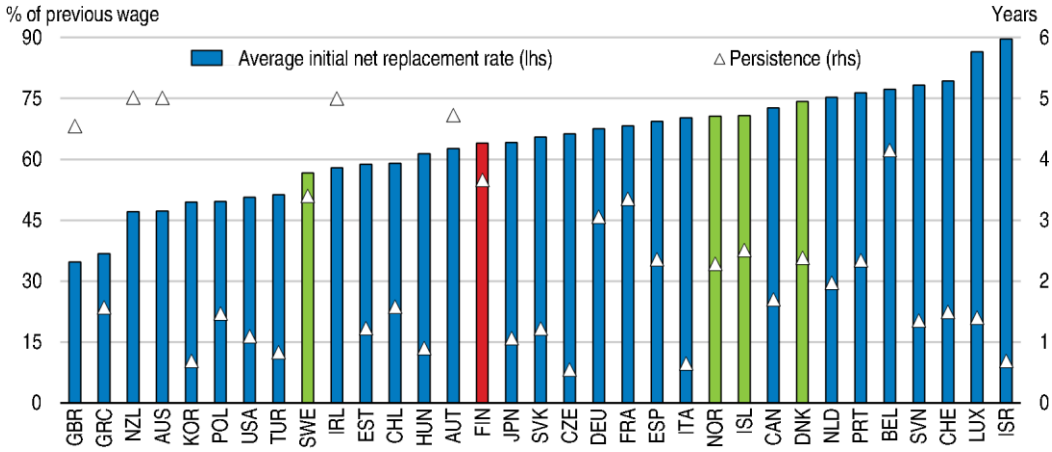
A longitudinal study of Swedish women shows that women taking 16 months leave or more are less likely to progress in their careers once back on the job (Evertsson and Duvander, 2011). Lower participation and earnings imply lower pensions. Limiting the combined duration of parental leave and the home-care allowance to between one and two years would likely generate significant gains in children's enrolment and mothers' employment, which would increase childcare expenditure, but also boost tax receipts.

### *Shortening unemployment spells*

The unemployment rate stands at 9.4%, which is high compared to Denmark (6.0%), Sweden (6.8%) and Norway (4.6%). Unemployment was already higher than in the other Nordics before the recession but the difference with Sweden has widened since. The combination of slow tapering of benefits and late activation of the unemployed distinguishes Finland from the other Nordics, as it reduces job search intensity and prolongs unemployment spells. The unemployment benefit replacement rate is only slightly higher than the OECD average and close to the Nordic average, but contrary to most OECD countries with

generous replacement rates, the benefit is tapered only slowly in Finland. Belgium is the only OECD country with both higher replacement rates and slower tapering (Figure 10). The 2015 government programme includes a € 200 million cut to the unemployment insurance which among other things will imply reducing the maximum duration of unemployment benefits by 100 days to 400 days for those with at least three years of work history, and to 300 days for those with a shorter work history. Those aged 58 or above would retain the current 500 days. Introducing a reduction of replacement rates in steps over the unemployment spell could strike a balance between income security and improved work incentives, and may increase job search intensity as a behavioural response to benefit reductions (Pang *et al*., 2014).

**Figure 10 Relatively generous unemployment benefits are tapered slowly1**




*How to read this figure:* The initial net replacement rate refers to benefits received during the first 12 months of unemployment as a percentage of the previous wage. Persistence is calculated as the sum of replacement rates over five years divided by the initial replacement rate. A low value means that the initial benefit is tapered relatively quickly.

1. Replacement rates are calculated for four family types; single, lone parent, couple and couple with children. Rates are from 2013.

Source: OECD, Tax-Benefit Models.

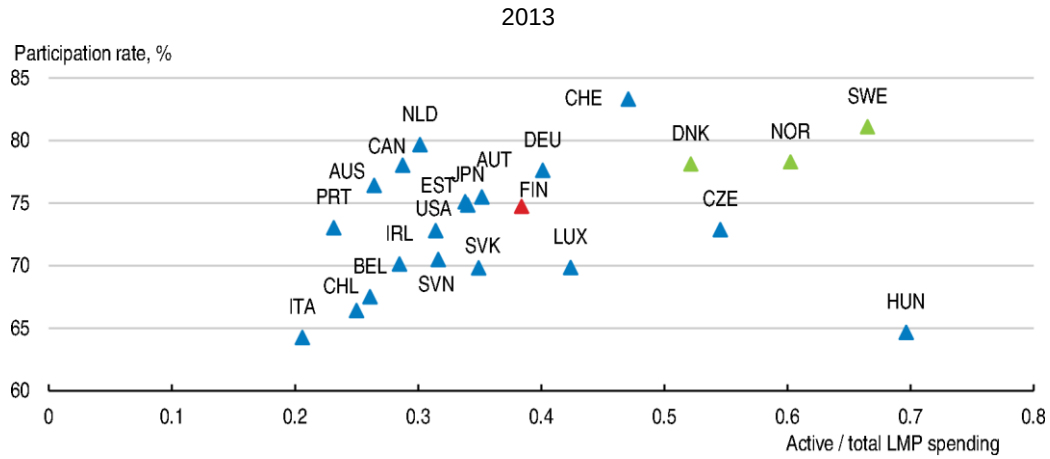
However, for low-income households, the means-tested Basic Income Support (BIS) may still reduce work incentives. While BIS covers only a fraction of the original wage, it covers 100% of housing expenditures up to a threshold. For households and individuals who expect wages close to the minimum levels and who have high housing costs, replacement rates can be close to 100% (OECD, 2010). The government has announced a reduction in labour taxation and coordination of tax and social security measures to remove inactivity traps. As part of these measures, work incentives should be safeguarded by better coordinating different benefits. One option to achieve such coordination is to pool working-age benefits into one single benefit that is progressively tapered off as income increases, as has been done in the United Kingdom. Pooling benefits also holds the potential to reduce administrative costs, fraud and error (Pareliussen, 2013).

Efficient activation policies early in the unemployment spell hold the potential to mitigate the negative effect on job search intensity from high benefits that are tapered slowly. Despite major improvements to the Finnish activation regime since the 1990s, notably by better aligning financial incentives to the decentralized structure of employment offices and abolishing a job placement guarantee that cemented high unemployment levels (OECD, 2013a), there is room for further improvements.

Finland spends a smaller share of labour market policy expenditure on active measures than the other Nordics, and activation generally comes late in the unemployment spell, compounding the negative effects of generous replacement rates and slow tapering (Figure 11). Local Public Employment Service (PES) offices enjoy a high degree of flexibility. Job search requirements can be set in an individual action plan,

which is formulated within the first weeks of unemployment, and there are rules for continued contact if unemployment persists. But mandatory activation requirements are systematically implemented only after 100 weeks. A notable exception is youth below 25 and recent graduates below 30 who are offered a study, work trial or workshop place or a job within three months of registration as unemployed under the youth guarantee (Ministry of Finance, 2014). Facing resource constraints, employment offices tend to prioritise activation of persons covered by the guarantee at the detriment of other unemployed. The PES, municipalities and the Social Insurance Institution (Kela) are responsible for helping the individuals who are the hardest to employ under single Employment Service Centres. This should improve coordination and better align the level of service provision and financing.

**Figure 11 Strengthened activation could boost labour market participation**




Source: OECD Labour Market Statistics, Database.

New Public Employment Service guidelines, which came into force in late 2013, toughened requirements on the unemployed to accept job offers and widened the geographical search area. An amendment to the Unemployment Security Act took effect in the beginning of 2015, further increasing the search area (Ministry of Finance, 2014). Job referrals are widely used, but job-search requirements are not sufficiently enforced early in the unemployment spell. Introducing mandatory job search and reporting from the beginning of the unemployment spell, combined with an improved sanction regime would be an effective and low-cost way to shorten unemployment spells for those who are relatively close to the labour market (Martin, 2014). Finland has a profiling tool that categorizes the unemployed according to their risk of long-term unemployment, but its use is not mandatory, and the impact of the tool has been limited. Improving the profiling tool, and making its use mandatory holds the potential to give quicker and more targeted support to those who are further away from the labour market (OECD, 2013a).

Failure to carry out an activation plan, refusal of suitable work or refusing or quitting an activation activity is normally sanctioned by two months of benefit suspension. This sanction may be too strict for minor infractions, such as late submission of an activity report or first-time failure to document job search, for two reasons. First, experience from Sweden shows that severe sanctions lead Public Employment Service (PES) staff to side with clients and under-report minor infractions (OECD, 2015a). Second, those who lose unemployment benefits for an extended period of time are entitled to Basic Income Support (BIS) subject to a means test, reducing incentives to comply. Reforming the sanctions regime in the direction of more gradual but consistently applied sanctions would therefore facilitate the introduction of a universal job-search requirement. The job-search requirement and sanctions regime should be made fully operational also for those BIS recipients who are subject to labour market conditionality.

Expanding the application of activation policies to groups of benefit claimants who are less intensively targeted in the current system holds some potential, especially for older workers and lone parents. OECD experience with expanding activation to people on disability and long-term sickness benefits are mixed, as it is challenging to develop and apply criteria that successfully re-classify and direct resources towards those who are capable of working. Tightening inflows to such benefits is less controversial, but these groups are nonetheless harder to activate, and their activation should not come at the expense of more easily employable groups (OECD, 2013a).

***Encouraging work immigration***

Work immigration could help address Finland's demographic challenges. Only 5% of the population is foreign-born and gross inflows are 0.3% a year, of which half is work immigration, almost exclusively from other EU countries. But immigrants fare worse than natives in the labour market on average. They have 8 percentage points lower employment rates than natives, rising to 14 percentage points for immigrants with tertiary education. Unemployment rates are double that of natives, and particularly high for women (OECD, 2014e).

The nature of immigration has a strong bearing on labour market performance. Developed country immigrants, who are to a large extent work immigrants, are generally skilled, as measured by the PIAAC Survey, and their labour market performance is not significantly different from natives when accounting for skills, education and other relevant factors (Pareliussen, 2016). Abolishing the "work test", that stipulates that non-EU work immigrants can only immigrate if their job offer is in an occupation where there is a lack of supply from the Finnish workforce, as stipulated by the public employment service, would allow for somewhat higher work immigration. Effective integration of work immigrants depends on good systems for recognition of foreign qualifications and bridging courses, as well as systems to accept and integrate their families.

Immigrants from poorer countries, who often immigrate for humanitarian reasons or family reunion, tend to come from less advantaged socio-economic backgrounds than natives, to be less educated and to have lower literacy for each educational level, and are hence disadvantaged in the labour market (Pareliussen, 2016). Furthermore, they are more likely to be overqualified for their jobs, more likely to be poor, and more likely to live in overcrowded accommodation (OECD/European Union, 2015). The number of asylum seekers has increased drastically during 2015, notably from Iraq, Somalia and Afghanistan. Tailored integration plans increase the efficiency of integration and improve labour market outcomes (Sarvimäki and Hämäläinen, forthcoming; Musset, 2015). An integration centre of expertise has been founded in association with the Ministry of Employment and the Economy. The centre supports the expertise of local actors to promote integration and employment. Furthermore, the centre assembles and disseminates information and good practices, and supports the work of NGOs (Ministry of Finance, 2014).

Finland does fairly well in up-skilling immigrants. The literacy proficiency of newly arrived immigrants is low, but the mean score level of foreign-born adults who have lived more than five years in the country is higher than the OECD average (Bussi and Pareliussen, 2015). However, the scale of current inflows is at an unprecedented level, and scaling up the integration apparatus while maintaining high quality will be a challenge. Furthermore, second generation immigrant youth score lower than natives on the PISA test, and only at par with first generation immigrants (NAO, 2015). Lower enrolment than natives in early education, encouraged by the home-care allowance, may partially explain their low performance, but more research is needed to identify causes and secure that these children are given a fair treatment and the support they need to succeed in school.

***Postponing retirement***

As discussed in the *OECD Economic Survey of Finland* 2014, the population is ageing more rapidly in Finland than in most OECD countries. Ageing carries with it significant fiscal challenges related to increased pension and health care expenditure, but also opportunities connected to lengthening working careers and developing a competitive edge in age-related goods and services. Labour participation among people aged 55-64 has increased during the past decade, but is still significantly lower than in the other Nordics. As the share of older workers, whose labour participation is low, grows, the overall participation rate tends to decline (OECD, 2014f; Box 1).

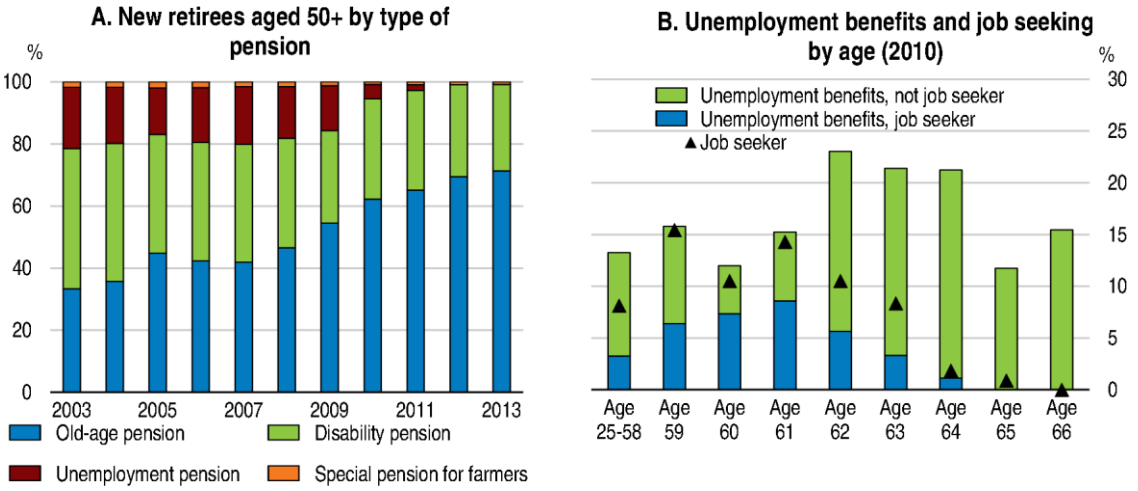
Aside from labour demand and working conditions, the employment rate for older workers depends fundamentally on the design of the pension system and pathways to early retirement. The social partners agreed on a pension reform in September 2014. Key elements of the reform include gradually raising the lower pension age limit from 63 to 65 years and linking it to longevity thereafter. The expected benefits of the reform are substantial, with pension expenditure reduced by around 6% and the budget balance strengthened by approximately 1% of GDP when the reform has been fully implemented (Economic Policy Council, 2015).

However, the two-year increase in the pension age limit is expected to raise the effective retirement age by only one year, and time in employment by less than five months. This is because individuals are expected to use early retirement options more and more. The incentives to seek early retirement increase significantly with the reform, both because accrual rates for workers over 53 are reduced, and because the value of bypassing the extended accrual period by opting for early retirement increases. Disability benefits and the extended unemployment benefit ("the unemployment tunnel") are the two main routes to early retirement today. A third route, a years-of-service pension, to be introduced as part of the reform, will provide an option to retire at the age of 63 after a working career of 38 years in mentally or physically demanding jobs (Economic Policy Council, 2015).

Inflows into disability have been on a downward trend since 2008 (Figure 12, Panel A). Disability benefit recipients continue to earn pension rights as if they had continued in work. The attractiveness of the disability benefit therefore increases as accrual rates are reduced and the accrual period for pensions rights increases with the reform. The unemployment pension was completely phased out during 2012, but is replaced by the extended unemployment benefit ("the unemployment tunnel"), where the unemployed who pass the age of 61 can continue on unemployment benefits until pension age. Many use this option, and the unemployment rate peaks around the age of 62. The rate of unemployment benefit claimants who actively search for jobs peaks for the age groups 59-61. High rates of active job search may partly indicate a strong incentive to comply with activation requirements set by the PES in order to extend their benefit spell until the 61 year limit (Figure 12, Panel B). The eligibility age for the unemployment tunnel will only increase by one year (to 62 years) under the new pension reform. Time in employment is expected to rise by only three months if the minimum age for the unemployment tunnel is not raised by one year as foreseen (Economic Policy Council, 2015).

In order to reap the full benefits of the reform, the definition of mentally or physically demanding jobs in the years-of-service pension should be narrow, the 63 year age limit and the 38 year career limit should be adjusted to longevity, the unemployment tunnel should be closed, and access to disability pensions should be limited to medical reasons only.

**Figure 12 Disability and unemployment benefits are the main routes to early retirement**

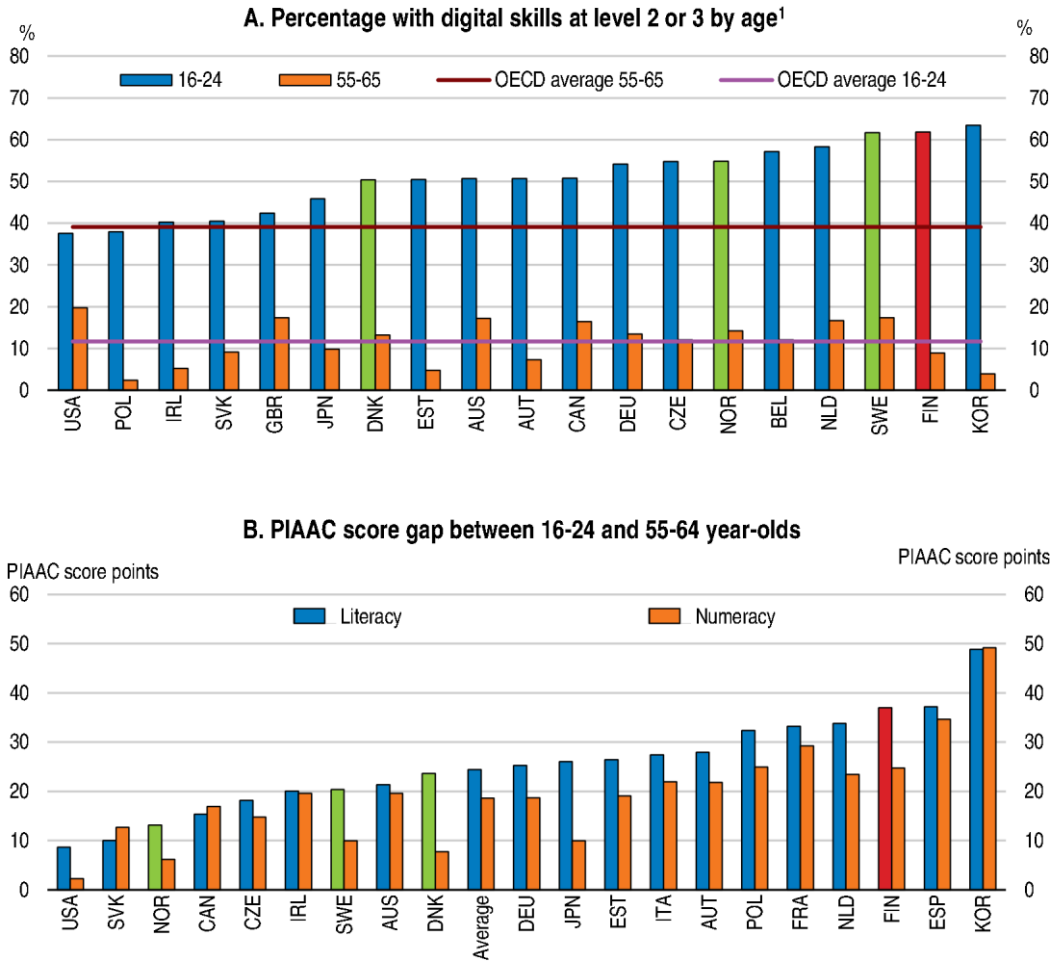



Source: Finnish Centre for Pensions, Database (accessed 29 July 2015), LIS Data Centre, fi10p, Database (accessed 29 June 2015).

Negative attitudes towards older workers are more prevalent in Finland than in the other Nordic countries, and older workers are perceived as having low technological skills and lacking openness to new ideas (OECD, 2014f). Indeed, the skills gap between the young and the old is high, as the latter have not benefitted from the rise to excellence of Finnish compulsory school and rising educational attainment (Figure 13). The PIAAC Survey shows a pattern of qualification mismatches, where the oldest tend to be under-qualified while the youngest tend to be over-qualified. Furthermore, workers in the age group 55 to 64 have more than six times higher odds of being under-skilled, and six times lower odds of being over-skilled, than 35-44 year-olds (Pareliussen, 2016). These findings reflect to a certain extent the accumulation of job specific skills that are neither reflected in educational attainment nor in the generic skills measured by the PIAAC Survey. It is therefore a pattern that many countries have in common, but it is particularly strong for Finland. Life-long learning to acquire new skills and upgrade existing ones can prevent workers from falling behind as they age. Life-long learning is already well developed in Finland, the OECD country where job-related training is most widespread (OECD, 2015c).. The introduction of financial incentives in 2014, where the government covers up to half of the cost to employers who provide their employees with up to three days of training per year (Ministry of Finance, 2014) is a step in the right direction.

**Figure 13 The skills gap between young and old is high**

2012




1. Skills in problem solving in technology-rich environments ("digital skills") are assigned to four levels, ranging from "below level 1" to "Level 3", where those scoring at or below level one are at best able to solve well-defined problems involving only one function within a generic interface to meet one explicit criterion without any categorical or inferential reasoning or transformation of information.

Source: OECD (2013b).

## Increasing labour demand

In Finland, as in the other Nordics, the wage structure is compressed, reflecting egalitarian values and the high coordination of wage bargaining (OECD, 2015a). High minimum wages makes jobs attractive for the low-skilled, but they also create a wedge between the remuneration low-productivity workers are entitled to and the value they add for their employer. High taxes on labour income widen this wedge. The employment impact of the wedge is compounded by regulations which reduce the flexibility for employers to adjust their labour force as a consequence of a changing external environment or to dismiss inefficient workers, limiting employment growth (OECD, 2015d; Blanchard *et al*., 2013). Low-skilled young individuals are especially at risk of unemployment as a result of high minimum wages (OECD, 2010). Youth unemployment, which includes a significant share of students searching for summer- or part-time jobs, is nonetheless on the rise and stood at 21.3% in July 2015, 3.4 percentage points higher than one year previously.

A compressed wage structure makes it attractive to hire high-skilled workers, whose productivity does not fully translate into higher wages. The low-skilled are relatively well paid if they find employment, but high minimum wages make employers reluctant to hire them, and their probability of employment is therefore drastically lower. The 11% of the adult population at level 1 or below on literacy in the OECD Survey of Adult Skills (PIAAC) and the 27% at level 2, have higher wages, but lower employment rates than the PIAAC average (Figure 14).

**Figure 14 High wages hold back employment of the low-skilled1**




1. Hourly wages among employed individuals, PPP adjusted USD, 2012.

Source: OECD (2013b).

### *Strengthen wage bargaining institutions*

The tradition of centralised negotiations between union and employer confederations and the government often leads to equal wage increases for 90% of workers covered by a central agreement. This model has contributed to macro-level wage flexibility, but little microeconomic flexibility (OECD, 2010; Böckerman et al., 2010). The wage bargaining model is contested, especially by employers, but attempts to decentralise in the period 2007-10 contributed to eroding competitiveness, as the coordination between the exporting industries and other sectors broke down. Furthermore, allocations to bargain locally were used in a fairly mechanical way, contributing little to aligning wages with local productivity conditions. The parties went back to the centralised model in 2011 to secure wage moderation. The government that took office in May 2015 proposed a social contract which included an increase of 5% in working time for the same pay. This would have improved cost competitiveness, but the social partners failed to reach an agreement. The government is now pushing forward measures to shorten annual leave, convert two public holidays into unpaid holidays, reduce sick-leave benefits and cut employer social security contributions.

A "two-tier" collective bargaining framework in which a centrally coordinated framework is combined with firm-level flexibility can secure both macroeconomic coordination and some flexibility to adjust relative wages to better reflect productivity developments in different industries and local circumstances. Such a framework has been followed successfully for a long time in Sweden, Denmark and Norway, where coordinated industry-level bargaining is combined with substantial local wage flexibility.

To avoid industries breaking out of the two-tier model, with loss of competitiveness as a consequence, core institutions must be in place and functioning. Firstly, employers and unions should agree on underlying facts and analyses about the economic situation and on a reasonable overall wage outcome in line with economic fundamentals. The price and incomes working group with members from unions and employers, chaired by the Ministry of Finance, plays a key role in this process in Finland. Secondly, negotiations should be sequenced such that trade-exposed industries settle before the others. Mediation is compulsory in Finland following the announcement of industrial action from either of the parties, but there is no mechanism to impose an agreement on the parties if mediation fails and industrial action threatens vital society interests. Such a system exists in Norway for example and may give the parties an added incentive to reach a reasonable agreement. Finally, the local wage setting process with negotiations between the employer and local union representatives needs to be institutionalised. The tradition of central settlements has left local wage setting institutions and employer-employee co-operation underdeveloped in Finland compared to other Nordics. However, the government plans to improve conditions for local agreement on issues like pay, working hours, flexible working hours and well-being at work by means of legislative changes to strengthen the employees' position in companies' decision making (Prime Minister's Office, 2015).

***Loosening employment protection***

Employment protection legislation (EPL) for regular workers in Finland is at a similar level as in the other Nordics, which in itself is not a great cause for concern. Additional regulation on temporary workers and collective dismissals is fairly modest, and well below the OECD average (OECD, 2015e). However, the current regulations give employers little opportunity to test the capabilities of new employees before taking a final decision on keeping them on the payroll, since the trial period is fairly short (four months) and the use of fixed-term contracts and workers employed through temporary work agencies are restricted. Lengthening the trial period and loosening restrictions on fixed-term contracts for assignments shorter than a year, as proposed by the government (Prime Minister's Office, 2015) would help.

While collective dismissals connected to larger reorganisations or company-specific difficulties are fairly straightforward in Finland, individual dismissals are more strictly regulated. A definition of unfair dismissal that leaves considerable room for judgement, combined with fairly high compensations, the possibility to post claims up to two years after dismissal and settlement of such cases in ordinary courts increase the uncertainty related to dismissal. This may in turn increase the reluctance to hire, harming employment and productivity growth not only within firms that need to shed workers, but also in companies that need these competencies, and are reluctant to hire when operating in an uncertain environment. Young businesses' reluctance to hire is a particular concern, as their growth is important to boost productivity (OECD, 2013d; OECD, 2013e). The government has pledged to ease a requirement to offer employment to earlier laid-off employees, and ought to go further in easing restrictions on individual dismissals.

**Box 3 Recommendations to increase employment and enhance skills**

**Key recommendations**

- Reduce the combined duration of parental leave and the home-care allowance to encourage female labour market participation.
- Shorten the duration of the unemployment benefit and reduce benefits over the unemployment spell. Systematically enforce mandatory job-search and reporting requirements starting early in the unemployment spell.
- Extend working lives by phasing out the option to extend unemployment benefits until retirement, by limiting rights to disability pensions to medical reasons only, and by adjusting the new years-of-service pension to life expectancy.
- Strengthen the roles of the state mediator and of the local level of unions in the wage setting process to raise local flexibility without compromising competitiveness.
- Strengthen foundation skills in vocational education and training.

**Other recommendations**

- Continue to streamline admission procedures to tertiary education and to tilt incentives towards faster graduation.
- Encourage work immigration by streamlining the recognition of foreign qualifications and the provision of bridging courses, phasing out the work test for non-EU immigrants and streamlining systems to accept and integrate their families.
- Increase the trial period for new hires, ease regulations on individual dismissals and remove the obligation to re-hire laid-off employees.

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