

# Summary

There are several fundamental motives for striving to attain high employment. Work implies higher incomes and that more needs are satisfied. Most people of working age attach a meaning to work in itself. High employment contributes to social cohesion. Finally, high employment is important for the financing of a generous welfare state. Employment policy goals can therefore be regarded as *intermediate* goals to help achieve *final* objectives of social welfare.

## Advantages of numerical targets

Numerical employment policy targets for a government represent *commitments* that can help strengthen incentives to achieve high employment. The targets serve as benchmarks against which policy can be evaluated. The reputation cost of not reaching set targets implies more pressure on a government to deliver.

There may be several reasons for why a government may fail to attain a high sustainable employment level. Economic policy may be pursued *inefficiently*. With more efficient policy, it could be possible to raise employment without prejudice to other objectives. A government may also conclude that its overall policy, when decided in a discretionary way without commitments to employment policy targets, puts too much weight on other considerations. These other considerations might concern social policy, budget objectives or the interests of various pressure groups. Such an imbalance might be explained by too much weight being placed on *short-run* effects relative to long-run ones. As an example, the pros of more generous benefits for the unemployed in the form of higher incomes for them are immediate, whereas the cons in the form of higher unemployment are more distant in time.

Positive effects of employment policy actions may also be *less tangible* than adverse effects. The negative impact of less generous unemployment and other social benefits in the form of lower incomes for the non-employed is "certain" and easy to calculate, while the positive impact in the form of more transitions to employment is not as easy to "prove". This could give rise to a *status-quo bias* in employment policy.

### Risks with numerical targets

Numerical targets may incentivise policy towards attaining the targets for exactly those measures that have been picked, irrespective of how well they relate to the final objectives. The critique is sometimes summarised in the form of *Goodhart's law*. It says that "when a measure becomes a target, it ceases to be a good measure". The implication is that when policy tries to control a specific measure, it often loses its relationship to the final objective that one wants to reach.

My evaluation is that the advantages of numerical employment policy targets dominate the disadvantages. This holds true especially in the situation likely to arise after the corona crisis. It will likely cause a strong deterioration of the labour market situation. Hence, there will be strong reasons for strengthening the incentives for policies leading back to high employment.

### Criteria for employment policy targets

A number of criteria for employment policy targets can be defined. Targets should be *simple* so that they are easily understood by media and citizens. This requires the targets to be so well defined and transparent that goal achievement is *verifiable*. But targets should also be *adequate* so that they help achieve the final objectives. Unfortunately, there is often a conflict between, on the one hand, simplicity and verifiability and, on the other hand, adequacy. A reasonable balance between these requirements is crucial for a target's *legitimacy*, which in turn is a precondition for the existence of a reputation cost of not reaching it.

Targets must also be *enforceable*. Hence, they must be *realistic*. The *number* of targets should not be too large. Too many targets diminish each target's status and thus lower the reputation cost of not attaining it. In addition, a large number of targets could make it possible for a government to shop around among targets and always find one that is achieved. If the economy finds itself far away from the targets when formulated, it is, of course, also important to specify clearly when they are to be achieved.

## Examples of employment policy targets

Various employment policy targets have been set or proposed in Sweden.

### *Unemployment*

Targets for actual unemployment are simple, well defined and verifiable. But they are adequate only if the final objective is that "everyone who wants and can take a job should have one" and labour force participation is stable. Unemployment targets are less adequate if the final objectives are to raise incomes and consumption in the economy, to strengthen public finances, to get more people into employment because working is considered to have a value in itself or to increase social cohesion.

Targets for open unemployment of the type that applied in 1996–2006 are particularly problematic, as unemployment could be held down mechanically by increasing participation of unemployed in various labour market programmes where they are not included in the unemployment statistics. A target for unemployment as it is defined today in the labour force surveys would to some extent suffer from the same problem. Job seekers in some programmes, for example the job and development guarantee, are registered as unemployed but not potential job seekers in labour market retraining or regular education. Hence, there may be incentives to expand such programmes with the prime purpose of keeping down unemployment as it is measured. Unemployment targets may also strengthen government incentives for early retirement.

### *Employment*

If the final objectives for employment policy concern higher incomes, the value of work in itself or strong public finances, employment targets are more adequate than unemployment targets. The risk that the formulation of targets will create incentives for formal, rather than real, attainment of objectives is much smaller. Employment cannot be raised by placement of unemployed in training and education programmes that are inefficient or by early retirement (but of course through subsidised employment which may or may not be employment-enhancing in a longer time perspective).

In 2010–18, employment rose much more than unemployment fell. This is explained by a substantial increase in labour force participation. This shows that it is of great importance for the evaluation of goal achievement whether targets concern employment or unemployment.

An important issue is which age groups employment targets should apply to. It is not appropriate to include very young people – in particular 15–19-years olds – as they should go to school. Whether or not those above 65 should be included has to do with the weight attached to public-finance considerations. In the 2001–19 period, the exact age delimitation had not, however, mattered much as the correlations between the employment rates for the age groups 15–74, 16–64, 20–64 and 25–64 years were very high.

The employment rate is usually measured with data from the labour force surveys by Statistics Sweden. The requirement for an individual to be classified as employed is very low: one hour's work during the survey week is enough. It would be more appropriate to formulate an employment target using a definition of employment requiring an income from work above a certain, not too low, threshold. It would be possible to construct such a measure of the employment rate continuously during the year on the basis of employers' monthly reports on their employees' incomes to the tax authorities.

Another issue is whether a target for the employment rate should refer to the actual or the long-run sustainable level. The liberal-conservative government's employment target 2006–14 was to raise the latter. Such a formulation is adequate when low employment depends mainly on badly functioning labour and product markets,

and thus should be addressed through structural reforms. But the long-run sustainable employment rate can be calculated in many different ways: hence a target for it is complex and its attainment is difficult to verify.

Employment will probably be low during the next few years – also post the corona crisis – mainly because of insufficient aggregate demand. This speaks in favour of targets for actual employment.

### *Hours worked per person in the population*

Another option is a target for hours worked per person in the (whole or working-age) population. They depend not only on the employment rate but also on the share of employed who actually work (and are not on vacation, sick leave or absent for some other reason) and their working time.

A target for hours worked per capita is simple and verifiable. It is more adequate than the employment rate if the main final objective is to contribute to strong public finances: these are more related to total hours worked than to the number of employed persons. It is more adequate to measure hours worked relative to the *whole* population, and not to the working-age population, as fiscal outcomes are affected also by the latter group's share in total population. But a drawback of an hours target is that changes in the share of employed who actually work and in their working time affect the attainment of the target in the same way as changes in the employment rate even though the welfare effects may differ in many dimensions.

During the last 15 years, the correlation between hours worked per person in the population and the employment rate in the age group 15–74 years has been high, but not perfect. Hours worked have varied more.

## **Proposed employment targets**

If the corona crisis causes a serious deterioration in the labour market situation, it would seem appropriate, once a more definite recovery is under way, for the government and the parliament to

formulate numerical employment policy targets in order to strengthen incentives for an ambitious policy.

The crisis will cause a large rise in the government debt ratio. There will be a need to reduce it again so that fiscal buffers for both anticipated future shocks (an ageing population) and unanticipated ones (new pandemics?) are restored. Numerical fiscal targets will likely receive a lot of emphasis. This strengthens the case for targets for actual labour market developments, too. First, such targets may *balance* the fiscal targets and raise the probability that the impact of fiscal policy on aggregate demand is duly considered. Second, numerical employment targets could *support* the fiscal targets by strengthening incentives for structural reforms that help raise employment and thus improve fiscal performance.

I recommend *two main employment policy targets*. One should be the employment rate for 20–68-years old. Younger persons are not encompassed as they should go to school. 68 years is the age limit where legislated employment protection ceases to apply. A second main target should be annual *hours worked per person in the whole population*. One motive for this target is the objective of strong public finances. They are more related to total hours worked than to the number of people employed.

With the two employment policy targets discussed, the employment rate could be measured by labour-force-survey data. The hours target could be seen to compensate for the generous definition of employment according to which one hour's work in the survey week is sufficient. But a narrower employment definition, according to which labour income must exceed a reasonably high threshold, could also be contemplated. This requires that new employment statistics, based on employers' monthly reports on employees' labour incomes to the tax authorities are produced. With such a stricter definition of employment, a single main target for the employment rate might perhaps be sufficient.

The main employment policy targets (or target) could be complemented with a small number of *disaggregated sub-targets*, for example for long-term unemployment and the employment gap between natives and foreign born. This could be motivated by equity and social-cohesion considerations as well as by the fact that lower long-term unemployment and higher employment among immigrants would help raise aggregate employment.

One should, however, take the risk that numerical targets could distort policy seriously. For this reason, the follow-up of the numerical targets should be accompanied by analyses of a large number of dimensions of labour market developments to make sure that attempts to achieve the main targets do not cause adverse developments in other respects. With a target for hours worked per person in the population, changes in this variable must also be decomposed. Regular additional analyses of the type described should be done by the Ministry of Finance but also by other institutions such as the National Institute of Economic Research and the Fiscal Policy Council.

Additional analyses of various labour-market indicators will also be of great importance in the case of a drawn-out transition period after the most acute corona crisis, with variations in economic activity because of the development of the pandemic, before a more definite restart of the economy. During such a transition, normal relationships between variables such as the employment rate, hours worked, share of employed in actual work and welfare dependency may be distorted because of large variations in, for example, sickness absence and short-term work. In this situation, numerical employment targets are not meaningful. Such targets should be formulated first post corona. Only then is it meaningful to discuss actual target levels.