

162

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FINLAND:  
A NORDIC  
LILLIPUTIAN

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RESEARCH

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## THE SERVICE SECTOR IN FINLAND: A NORDIC LILLIPUTIAN

Petri Böckerman\*

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*An international comparison suggests that the share of private services in terms of output and employment is rather low in Finland. This feature raises several interesting questions. What explains this particular feature of the Finnish production structure? How has the great depression of the early 1990s influenced the structure of private services in Finland? What kind of policy measures could be implemented in order to increase the share of private services from a long-run perspective? Finnish service employment also contains a number of other interesting particularities in an international comparison. Within a corporatist framework, these include a rather large public sector employer, high female participation rate, but on the other hand a low share of part-time work.*

## 1. Recent economic development

Finland is without dispute a wealthy nation. While the economic development after the Second World War was extremely rapid in terms of growth, the economic experience of Finland in the second half of the 1980s and also the early 1990s has indeed been dramatic. In this period the Finnish economy first experienced a hectic upswing seen never before in Finnish economic history, and an overheating of the domestic economy with an asset price bubble, followed by a major slump in GDP and a very rapid rise in unemployment. In fact, real GDP collapsed in real terms by about 14% from the peak of 1990 to the trough of 1993, while the unemployment rate rose from 3.4% in 1990 to almost 20% in the beginning of 1994, which was a new record high. It is quite striking that the slump of the early 1990s in Finland was more severe than the great depression of the 1930s in terms of lost output. This has left its marks throughout the Finnish economy. Indeed, in 1990 on the eve of the great slump, Finland was wealthier than Ireland, but in 1996 the situation was the other way around.

The very reasons behind the great Finnish depression of the 1990s have been aptly described by the summary "bad luck, bad banking, bad policies" (see, for example, *Kiander & Vartia 1996; Mutikainen 1998; Koskela & Honkapohja 1999*). The collapse of trade with the former Soviet Union was not the only major external shock that shook the Finnish economy at the beginning of the 1990s off its tracks. High real interest rates due

to German unification and the heavy indebtedness of the domestic sector as a response to the liberalization of financial markets also added to severe financial disruption and credit crunch. As a consequence of these shocks, output collapsed, unemployment soared, and eventually the Finnish currency depreciated by about 30%.

Since 1994, the Finnish economy has experienced export-led recovery. Economic growth has indeed been very rapid (from 5% up to 6% annually) over the last couple of years (1996, 1997 and also in 1998), though expected to slow down to about 3% in 1999. However, in spite of the rapid GDP growth the decrease in unemployment has been slow and even at present it remains at a high level, estimated at about 10% in 1999. This reflects the fact that an export-oriented manufacturing industry is a highly capital-intensive activity. Thus, its capacity to create a great number of new jobs is limited. A recent study by *Elmeskov, Martin and Scarpetta (1998)* indicates that the rise in structural unemployment among OECD countries has been strongest in Finland during the 1990s. The slow decline in unemployment after the great depression of the 1990s has stimulated lively policy discussions in Finland about various innovative methods to combat unemployment by expanding the size of labour-intensive services in the economy. As will be seen, Finland has a sizeable public service sector, but the development of private service employment has been slow and restrained.

## 2. Finnish "corporatism"

Labour market policy in Finland is the result of a close and long-term interplay between organised agents and the government. Thus, Finland provides an example, par excellence, of a corporatist political and economic system (*Vartiainen 1998, 9-11*). The labour market parties and also other important economic and political actors are comprehensively organised and co-operate in centralised wage bargaining and dialogue on a broad range of issues related to economic and social policy. The close co-operation between the labour market parties has deep historical roots in Finland. As early as the 1930s, the management of monetary policy had already acquired some corporatist characteristics (*Vartiainen 1998, 9-11*). State-sponsored industrialisation after the Second

World War was a major stimulus to the build-up of corporatist structures in Finland.

Finnish wage bargaining is dominated by collective agreements. They usually contain a set of minimum wages at different job-complexity levels and educational levels (*Vartiainen 1998, 18-25*). Thus, there is no minimum wage legislation as such in Finland, but the minimum wages of each collective agreement set an effective floor for wages in that particular industry. However, the level of minimum wages differs across sectors and there is also some grading by age (*Santamäki-Vuori & Parviainen 1996, 42*). A number of empirical studies indicate that this tends to dampen the assumed negative effects of minimum wages on employment.

About 80% of the salaried labour force in Finland belongs to unions. The high unionisation rate is partly explained by the fact that membership fees are tax deductible; the fees are mainly collected by employers and also by the involvement of the unions in the administration of unemployment insurance benefits (*Santamäki-Vuori & Parviainen 1996, 53*). A study by *Pehkonen and Tanninen (1997)* suggests that union density would fall considerably if earnings-related unemployment allowances were cut to the level of the basic unemployment allowances. However, the coverage ratio of collective bargaining in Finland is less exceptional compared to the other countries, since the real impact of collective agreements usually tends to be stronger than would be implied by the crude unionisation rate in other OECD countries (*Vartiainen 1998, 19*). It is estimated that wage drift has accounted for about one third of all nominal wage increases in Finland since the Second World War (*Vartiainen 1998, 21*). Wage drift responds to company-specific profitability. In this respect there is an element of flexibility in Finnish wage formation.

Corporatist systems have a number of interesting features in an international comparison. *Summers, Gruber and Vergaga (1993)* have noted that labour tax burdens are higher in more corporatist nations, while nonlabour taxes are lower. This feature is due to the fact that the level of labour supply is effectively set by a small group of decisionmakers such as union leaders via binding collective agreements, and these individuals will recognize the linkage between the taxes that workers pay and the benefits they receive. Labour tax burdens are high also in Finland, and nonlabour taxes are low compared to the other OECD countries. In fact, *Koskela and Vilmunen (1996)* conclude that an increased tax progression lowers wages and is good for employment in the popular models of trade union behaviour. However, an economic analysis has also suggested that the high level of value added tax tends to discourage the expansion of private services. A study by *Alesina and Perotti (1997)* indicates that the hypothe-sis

according to which unit costs of labour are a non-linear function of the degree of corporatism does not get rejected in OECD countries. Thus, corporatist countries seem to have some advantage in terms of competitiveness. Finland also has an open economy. In fact, this is connected to the size of government. An interesting study by *Rodrik* (1998) reveals that there exists a positive correlation between the economy's exposure to international trade and the size of government. One explanation for this stylized fact is that government spending plays a key risk-reducing role in economies exposed to a significant amount of external disturbance.

### 3. Main labour market trends

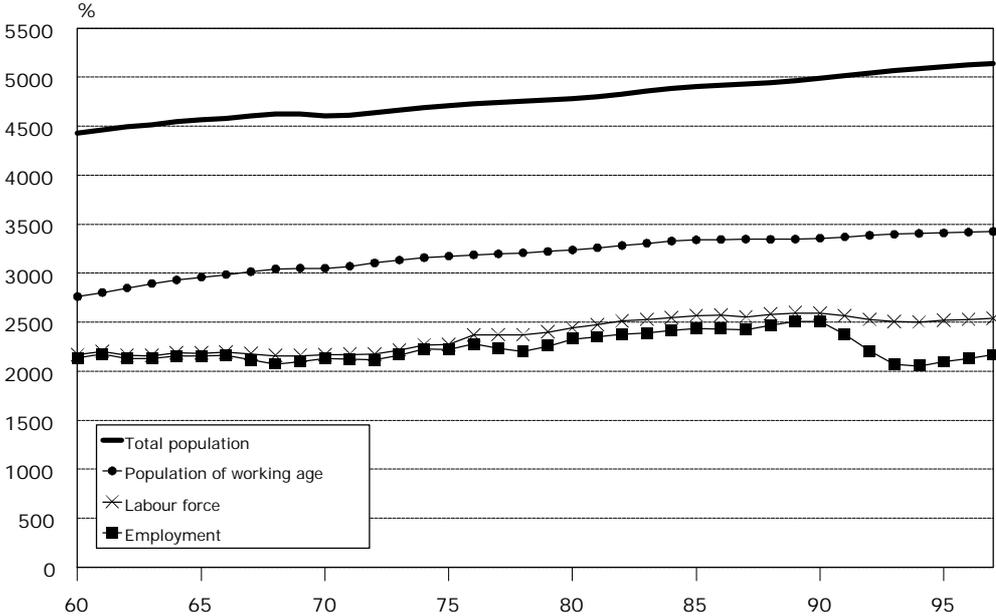
As of early 1998, the seasonally adjusted size of the labour force amounted to 2.52 million people, of whom 2.19 million were employed and about 330 000 unemployed (Fig. 1). The ratio of employed people to the working-age population has consistently been higher than the EU average, but the great depression of the 1990s led to a sharp drop in employment and to a rise in unemployment.

Population growth has mainly been attributed to natural growth, that is the excess of births over deaths by some 15 000 people annually (*Santamäki-Vuori & Parviainen 1996, 19*). The collapse of labour demand led to a major shrinkage of the labour force and a major drop in the participation rate in the early 1990s (Fig. 2). This feature is due to the so-called "discouraged worker effect", but a great number of young people were also forced to extend their education during the years of the great depression. The labour supply in 1995 was, in fact, almost 60 000 lower than at the beginning of the great depression. Owing to the rising labour supply during the recent recovery the drop in unemployment has been slower than the growth in employment would suggest. This development has been a surprise to many policy-makers and it is expected to continue in the near future.

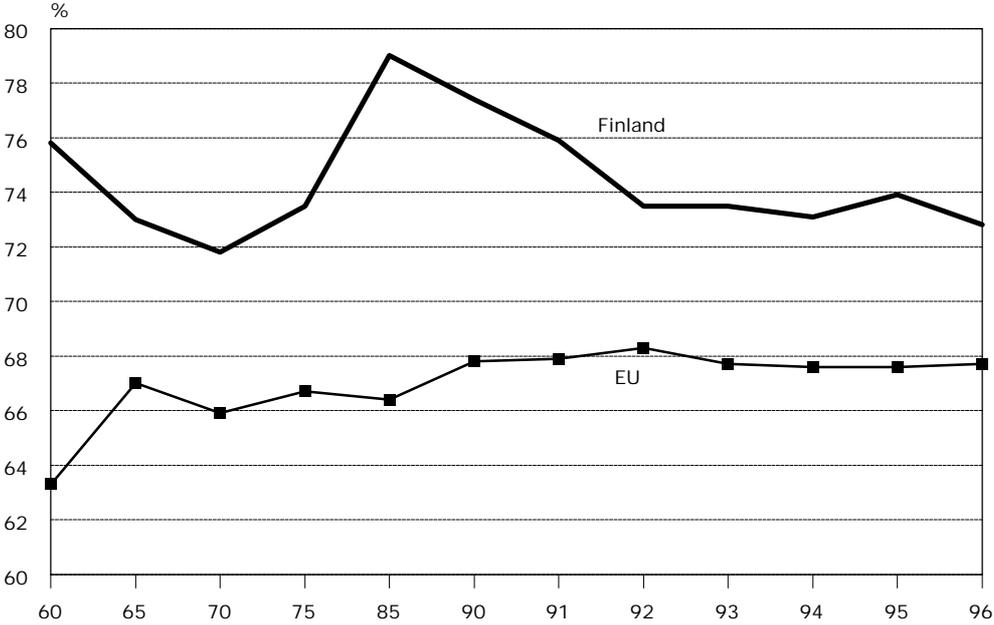
Also, the proportion of employed people in the total population aged from 15 to 64 dropped sharply during the great depression of the 1990s (Fig. 3). During the ongoing recovery these trends have been reserved, but the number of employed people is still, as

confirmed in early 1998, about 12 percent below its previous peak level of 2.47 million (namely, 1990 average). The employment rate thus dropped from about 74% in 1990 to 60% in 1994, and has only improved slowly since the great depression of the early 1990s. As a consequence, the new government, which was appointed in spring 1999, has set an ambitious target of 70% for the employment rate by the end of 2002.

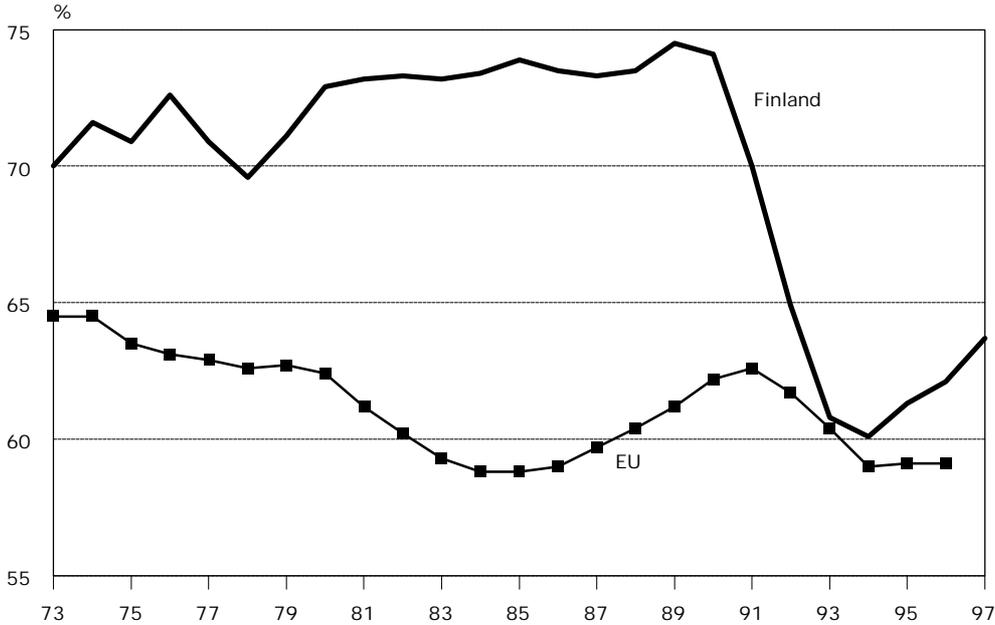
**Fig. 1.** Total population, population of working age (15-64), labour force and employment in 1960-1997, thousands (Source: *Vartiainen, 1998*)



**Fig. 2.** Participation rate (ratio of labour force to working-age population), Finland and the EU, 1973-1996 (Source: *Vartiainen, 1998*)

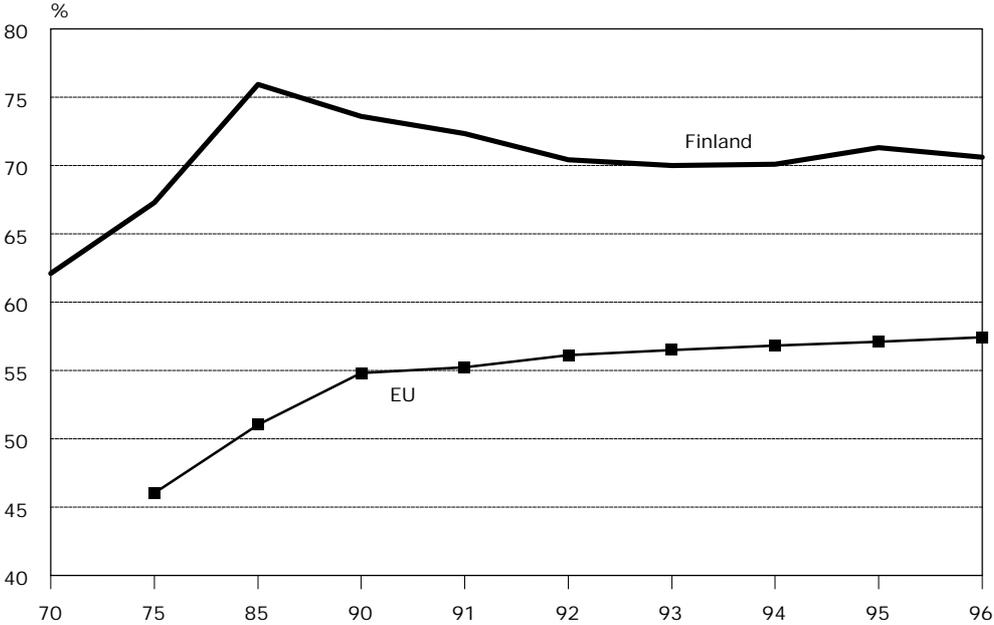


**Fig. 3.** Employment rate (ratio of employed people to working-age population), Finland and the EU, 1973-1997 (Source: *Vartiainen, 1998*)



As in other Nordic countries, the female participation rate is high in international comparison. In a typology of European welfare states suggested by the *EU* (1999) Finland belongs with Sweden and Denmark to the Nordic type, in which everyone is a breadwinner. There is also an upward sloping trend in the female participation rate (Fig. 4). In the beginning of the 1970s, especially, the female participation rate increased strongly. This development is a consequence of multiple factors. The expansion of local government services in the fields of health, education and care for the old have paved the way for women's more active participation in the labour market during the past few decades. For example, in 1995, women accounted for 75% of local government employment. Another important factor that has raised the participation rate of females in Finland is their high level of education compared to other OECD countries. The female unemployment rate has normally been lower than males' in Finland, but during the recession of the 1990s unemployment among women increased more sharply than among men (*Vartiainen* 1998, 15). As a consequence, the male and female unemployment rates have converged quite closely in recent years. But still, the employment rate of women declined less and was more stable than among males during the recession.

**Fig. 4.** Female participation rate (the ratio of the female labour force to the female population of working age), Finland and the EU average, 1970-96  
(Source: *Vartiainen*, 1998)



The number of regular annual hours is fairly low in Finland, but in other respects the intensity of working is high (*Santamäki-Vuori & Parviainen 1996, 31*). The Working Hours Act is a general law, but it is supplemented in many sectors of the Finnish economy by more specific Acts via binding collective agreements. Under the Working Hours Act, there are upper limits of 8 regular working hours per day and 40 per week (*Santamäki-Vuori & Parviainen 1996, 67-69*). As in other OECD countries, the average annual working time has declined in Finland during the past few decades. A study by *Böckerman and Kiander (1999)* reveals that both an increase in labour productivity and a widening of the tax wedge has contributed to a decline in the average working time in Finland during the past few decades.

There is plenty of overtime work, but little part-time work in Finland. Moreover, in contrast to other Scandinavian countries the share of part-time jobs in total employment has remained fairly stable during the past fifteen years. The Labour Force Survey indicates that in 1995 about 8% of all employed people and only 11% of employed women worked fewer than 30 hours per week in their main job. A major part of the pressure for increased flexibility of working hours has come from firms trying to increase the flexibility of hours of work so as to match growing variations in product demand. In particular, firms have tried to raise the share of part-time work in Finland during the 1990s.

The number of students in regular education has increased sharply during the past few decades in Finland (Table 1). In the early 1990s, enrolment rates were three or four times as high as in 1960, both in senior secondary schools, vocational and professional educational institutes and in universities (*Santamäki-Vuori & Parviainen 1996, 106-107*). At present, over 90% of young people continue in upper secondary education immediately after comprehensive school, and nearly 60% of the age group qualify for a place at university. This indicates that the build-up of human capital stock in Finland has been rapid since the Second World War.

**Table 1.** Enrolment rates in upper secondary and tertiary education

(Source: *Santamäki-Vuori & Parviainen 1996, 107*)

	Senior secondary school students as a percentage of those aged 15-19	Vocational institute students as a percentage of those aged 15-24	University students as a percentage of those aged 20-24
1960	10	8	8
1970	20	12	13
1980	30	18	22
1991	37	28	34

From 1980, real earnings for regular working hours have increased by about 30% within Finnish industries (the business sector). Relative wage differentials between the main sectors narrowed markedly in the 1970s, but since the early 1980s the wage dispersion has tended to widen again (*Santamäki-Vuori & Parviainen 1996, 40*). However, in 1994, disparities in the average hourly earnings between the main sectors were still smaller than in the early 1970s.

#### 4. The Service Sector: its scope and character

A long-run perspective indicates that the Finnish economy has undergone a deep structural transformation in terms of sectoral composition of output and employment since the Second World War. Fig. 5. displays the sectoral distribution of employment in Finland during the past few decades. It indicates that the primary sector nowadays accounts for only 7% of total employment. In 1970, the share of the primary sectors was still about 20%. The membership of the European Union has also contributed to a decline in the output of agriculture.

The share of the manufacturing industry has also shrunk over time as in many other OECD countries. As people get richer, they demand more services (i.e. income elasticity of demand for most of the private services is more than one). In fact, from 1960 to 1973 the average growth rate of real value added in services in Finland was 5.6% (the EU15

average was 5.1%). It is a well-known fact that services dominate most of the EU economies (on average market services are about 50% of GDP) (*Eurostat 1998a*). In contrast, market services today account only for 40% of GDP in Finland. The situation in Finland is, in this respect, similar to Switzerland. However, a measure of the service sectors based on employment reveals that Finland, in fact, is quite close to the OECD average (*Ministry of Trade & Industry 1998, 20*). This is partly a reflection of the high share of employment in public services. An international comparison with the other OECD countries reveals also that the share of services in total employment is highest in Canada, the United States and the Netherlands.

Despite the rise in the share of the service sector in the long run, the growth rate of private services employment from 1980 to 1994 was about -0.2% (*Koistinen 1997, 10*). The number of employment in services was highest (1.5 million) in 1990. A study by *Kurjenoja (1998)* suggests that a high level of taxation encourages formation of the black economy in the fields of private services in Finland. Indeed, a popular view is that a high level of public services and taxation has crowded out the volume of private services in Finland. This point will be elaborated more closely later in the context of the economic policy issues.

The employed share of public services was 28.5% in 1996 (*Ilmakunnas 1998, 11*). In recent years the employment of public services has been stagnant due to the continuous efforts to balance the government budget. On the other hand, during the depression the employment of public services worked as a kind of stabilizer, because it did not drop in response to a violent decline in GDP.

During the late 1980s there was a lively debate about deindustrialisation of the Finnish economy connected to overheating of the domestic sectors during the years of boom. A further expansion of private service sectors was widely held as counterproductive for the future development of the Finnish economy. This is at least partly a reflection of the popular view that the expansion of low-skilled private services (so-called "McJobs") does not support the build-up of human capital stock in Finland. Also, the indebtedness of the domestic economy in the late 1980s indicated the need to increase the share of manufacturing exports in the near future.

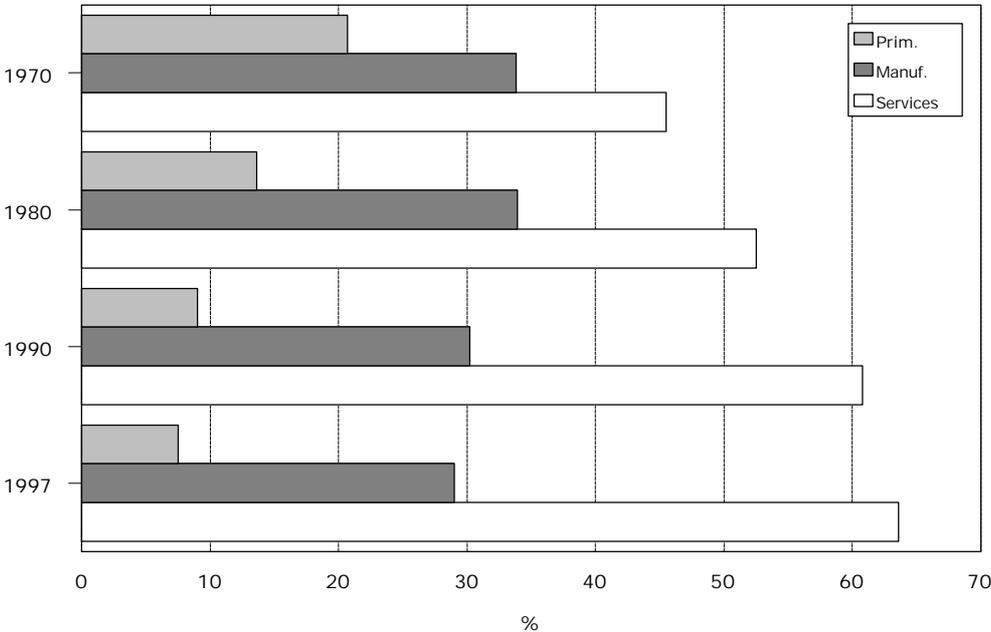
Of course, this scheme is certainly not a comprehensive account of the modern private service sector in Finland (*Kasanko & Tiilikka 1999*). In fact, an interesting new feature of the 1990s is that Finland has the largest employment share (2.2%) of communications

services in the EU (*Eurostat 1998a*). Another important and also well-known feature of the service sector is that the majority of workers are women. For example, in financial intermediation about 80% of all workers are women in Finland.

As an implication of the structural transformation of the Finnish economy employment in the so-called tertiary sector (such as education and research) has also expanded during the past few decades. However, almost one-third of the Finnish workforce is still employed in manufacturing industries. This figure is somewhat higher than the EU average, but lower than those of other Nordic countries (except Norway).

The share of services in total Finnish exports is only 16.9% (*Ministry of Trade and Industry 1998, 25*). In this respect Finland is far behind the EU15 average, in which the proportion of service exports of total export activity is about 25%. The low share of services in Finnish exports is, at least partly, a reflection of the low share of intra-industry trade in Finnish exports. Internationally tradable services are almost always business-to-business services.

**Fig. 5.** Percentual employment in primary production, manufacturing and service sector, years 1970, 1980, 1990 and 1997 (Source: *Vartiainen 1998*)



There is also a distinct regional aspect of the service sector in Finland. *Ilmakunnas (1998, 29-31)* has noted that the role of services in the economic structure is more important in

urban areas, notably in Southern Finland. In contrast, the economic structure of Eastern and Northern Finland is characterized more by primary production (such as agriculture).

Table 2 gives a set of more detailed information about the development of employment across major sub-sectors in the private service sectors from 1989 to 1994 and also from 1994 to 1996. The effects of the great depression in the 1990s are heavily present in these numbers. As the income elasticity of demand for private services tends to be high (i. e. more than one), the sharp decline in real earnings of households in the early 1990s led to a substantial drop in demand for private services. Hence, a great number of jobs were also destroyed during the years of the slump. From 1990 to 1995 the number of firms in the private service sector declined by about 11 000. It is also a well-known fact that the size of firms is small in private service sectors. In Finland almost 90% of all firms in the private service sector have less than five employees. The number of really big firms is very limited. In fact, only 0.2% of all firms in private service sector have more than 250 employees.

Available empirical evidence indicates that all sub-sectors of services lost jobs from 1989 to 1994. Finance and financial services, and health and social welfare services have lost more jobs than the other sub-sectors. During the recent recovery the creation of new jobs within private services has contributed significantly to the decline in unemployment in Finland. Employment has increased most rapidly in wholesale trade, and restaurants and hotels, while finance and financial services have continued to lose a great number of jobs ever since 1994, reflecting the ongoing restructuring of the banking sector. Hence, the unemployment rate in selected private services sectors was still very high in 1996 (in the case of wholesale and retail trade 12.3%, transportation 9.6%, and finance and insurance 11.8%).

**Table 2.** Employment development in major sub-sectors of private services, from 1989 to 1994 and from 1994 to 1996 (Source: *Ilmakunnas* 1998, 21)

Subsector	1989*	1996*	Change (1989-1994), %	Change (1994-1996), %
<i>Wholesale and retail trade</i>	326.7	257.5	-24.2	4.0
Wholesale trade	102.3	91.2	-18.0	8.7
Retail trade	173.0	130.5	-24.9	0.4
Hotels and restaurants	67.6	55.6	-24.1	8.4
Transport	176.9	150.8	-16.4	2.0
<i>Finance and insurance</i>	69.2	43.4	-26.7	-14.3
Finance and financial services	57.4	32.5	-30.3	-18.8
Insurance	10.9	10.3	-7.3	2.0
Education and research	2.7	2.5	-8.0	8.7
Health and social welfare services	38.0	27.4	-31.8	5.8

\*Thousands

The private service sector is by its nature a very heterogenous entity. For example, the requirements of physical and human capital tend to vary considerably within the private service sector in Finland as well as the labour intensity. One way of comparing the labour-intensity of a given sector is to calculate its ratio of employment contribution relative to its value added contribution of the whole economy. In fact, this measure reveals interesting differences. The ratio of retail trade (1.43), and hotels and restaurants (1.71) is higher than one (see, for example, *Lankinen* 1999). This means that these sectors are relatively labour-intensive by their nature compared to the other sectors of the economy. In contrast, the labour-intensity of finance and insurance is well below one (0.52). The variation suggests that policies to promote employment in private services should be highly targeted in order to achieve maximum efficiency in terms of employment creation.

It is a typical feature also in Finland that the prices of services have tended to rise more rapidly than other goods during the past few decades (*Ilmakunnas* 1998, 16). This

reflects that the very nature of the service sector is such that the opportunities for productivity enhancements are limited compared to the production sector. A possible, but not an inevitable, consequence is the so-called Baumol cost disease (see, for example, *Leslie 1993, 33-57*). That is not to say that there are no possibilities for productivity enhancements in the service sector. For example, in banking, the use of automated cash dispensers is a recent and important productivity innovation. In retailing, the changes to supermarkets and self-service petrol stations are longer-standing productivity enhancements that have also proved widely popular with consumers.

There was also a major tax reform in Finland in 1994, namely the introduction of value added tax as a consequence of EU membership. According to a survey, the introduction of the value added tax in June 1994 had raised consumer prices by around 0.54 percent by October 1994 (*Lehtinen 1994*). In the middle of the great depression of the 1990s the reform was particularly problematic for the private service sector. The main impact of the new tax was felt in private services, which had not been liable to sales tax in the old system and the resulting increase of prices contributed to a decline in demand for private services and employment.

The productivity of an economic activity is obviously an important issue. *Bernard and Jones (1996)* have investigated the issue of productivity across the OECD countries. They conclude that manufacturing shows little evidence of either labour productivity or multifactor productivity convergence across countries, while other sectors, especially services, are driving the observed aggregate convergence result. A study of productivity growth rates in the service sectors reveals that, in the case of Finland, the growth rate in both labour and multifactor productivity has been more rapid than the OECD average (Table 3). This observation is in contrast with the popular view that the service sector in Finland has been somewhat stagnant in terms of productivity growth.

**Table 3.** Productivity growth rates in services, 1970-1987

(Source: *Bernard & Jones 1996, 1222*)

	Labour productivity	Multifactor productivity
Finland	0.027	0.013
OECD average	0.015	0.008

One peculiarity in the structure of Finnish employers' associations compared to other Nordic countries (except Norway and Denmark) is that there are two federations in the private sector. As pay levels are relatively low in the service sectors, the service employers' have not wished to be in the same federation as manufactures (*Lilja 1992, 201-202*). Service sector employers are represented by the Employers' Confederation of Service Industries (PT), comprising about 7 300 member firms with a combined total of about 280 000 employees.

The representation of private service employees in Finland is much more diverse than the representation of employers. A major part of the most important organisations of employees in the service sector belongs to the Central Organisation of Finnish Trade Unions (SAK), which at present represents about 1.1 million blue-collar workers. The membership of private service unions is about a third (327 000 persons) of the total membership of SAK. The largest member unions of SAK are the metalworkers' and local government workers' unions. As a consequence of this, the representation of the interests of private service sectors' unions in SAK is underdeveloped. Another important union in the private service sector is the Finnish Financial Branch Employees' Union (SUORA). It belongs to the Finnish Confederation of Salaried Employees (STTK).

A popular view is that private services are characterized by a high share of non-permanent contracts due to the need for flexibility in the production of services, where storage is not often an option. However, this widely held view is not consistent with empirical observations in the case of Finland. According to the latest surveys conducted by the employers, about 90% of all contracts are, in fact, permanent in private services (*Koponen 1999*).

There are also some interesting differences across private services. Available empirical evidence indicates that the share of permanent contracts is highest in banking and insurance, despite the fact that banking and insurance have been a subject of a major restructuring during the 1990s. An explanation for this particular observation is that in banking and insurance the role of new entrants into the sectors has been very limited during the past years. As a consequence, the pressures for changes in the contract structure have not been achieved results as in the case of other sectors (such as the manufacturing industry).

It is clear, however, that hours of work are more flexible in the private service sector than in other industries (*Ministry of Trade & Industry* 1998, 58). As a major part of this flexibility, the share of the part-time workers is higher in services (13.9%) than in manufacturing industry (3.6%). This feature is partly due to the strong seasonal fluctuations in the provision of private services (for example, tourism). Approximately 70% of the part-time employees are women. These two stylized facts are in line with each other, because the majority of workers in the service sector in Finland are women.

## 5. Case studies

In this section we try to shed some light into a few interesting sub-sectors of private services in Finland. These sub-sectors are chosen in order to deliver an international comparison (i. e. banking and retail), and also to pick out two specific sub-sectors (i. e. hotels and restaurants, and communications), which have been subject to major structural changes during the 1990s and feature Finnish particularities.

### 5.1. Banking

The Finnish banking sector has gone through major restructuring process during the 1990s. This can be seen in an extremely rapid drop in the number of branch offices (Table 4). This development is, at least partly, a consequence of mergers and acquisitions. The service network of retail banks has traditionally been exceptionally dense in Finland. This was a reflection of the fact that, as a result of tight government regulation after the Second World War, the quality of service was also the only way for commercial banks to compete with each other.

**Table 4.** The number of branch offices in Finland

1980	1985	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
654	631	585	546	502	425	361	355	352	347	346	342

The most important factor behind the rapid drop in the number of branch offices is the deep depression of the early 1990s, and technology and the opening of markets stemming from economic integration, together with the European monetary union, has also played a role. In particular, the European Commission has made an effort to deregulate and promote free competition in financial services. *Andersen, Niskanen and Yläoutinen (1999)* note that increasing competition for market shares in the euro area might incline some individual banks toward excessive risk-taking and in turn lead to even larger losses than those experienced in Finland during the great depression of the 1990s.

On the technological side, the emergence of information technology has had a notable effect on banking business. The intensive use of computers has reduced the need for human intervention in transactions and also opened new opportunities for distant on-line services. As the financial markets have become truly global, the financial services have become more concentrated and dominated by large enterprises.

The financial sector produces slightly over 3% of total value added and approximately 2% of employment in Finland. The share of financial services of the EU countries is highest in Luxembourg (9%) (*Eurostat 1998b*). Employment in the banking sector in Finland has declined sharply during the 1990s (Table 5). In order to reduce costs and improve their profits during and after the depression the banks have cut staff and shed almost half of the workforce. The heavy reduction in the number of workers in banking did give a substantial boost to productivity in the early 1990s (Fig. 6). There was indeed a major shift in the productivity to the new higher level. This was needed in order to meet the challenges of increasing competition. The process of restructuring is still underway. A study by *Lilja (1999)* reveals that women and men adjusted quite differently to these changes. To keep their jobs women seem to have accepted more often than men changes in the quality of their jobs.

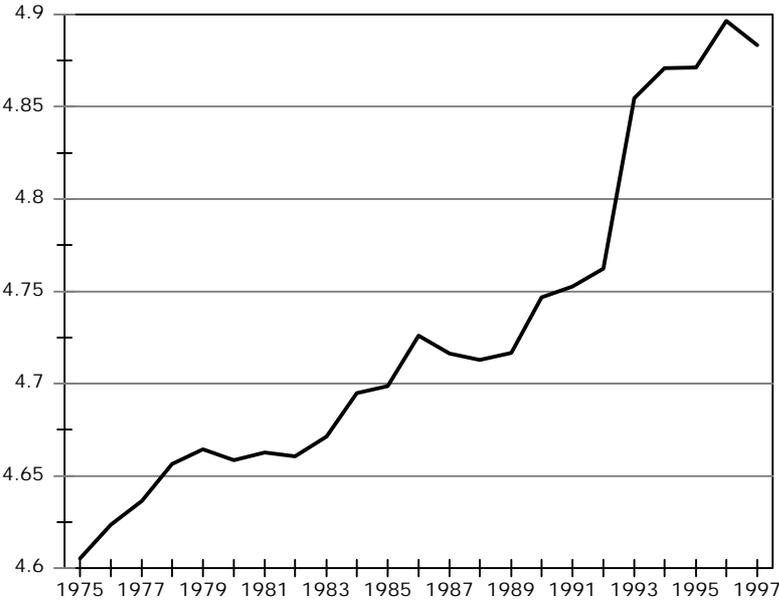
The unionisation rate is very high in banking. In fact, it is about 90%. The sector is also female-dominated. About 80% of all employees are women. Despite this fact, banking is a high-wage sector in Finland compared to other private service sectors. In line with this the education level of banking employees is on average higher than in other sub-sectors of private services. The share of part-time workers in banking is very low compared to

other private services. It is only about 10% of total workers.

**Table 5.** Employment in the banking sector (thousand persons)

1989	1990	1991	1992	1993	1994	1995	1996	1997
110	104	96	86	79	74	66	60	56

**Fig. 6.** A log of value added per hours of work by employees in banking from 1975 to 1997 (Source: *Statistics Finland*)



After the boom had given a substantial boost to wage growth in the banking sector in the late 1980s (Table 6), wage growth almost came to a halt during the years of the deepest depression. It is clear that the collective mechanism of bargaining responded to the depression with wage moderation, but this did not prevent a great loss of jobs. One of the key issues on the agenda of banking is the upgrading of workers' skills in order to meet the demands for more specific services. These more tailored services include pension planning and also general asset management. Traditional retail banks have indeed had serious problems in competition with new investment banks in this high

value-added market segment during recent years.

**Table 6.** Wage growth in banking (nominal change)

1989	1990	1991	1992	1993	1994	1995	1996	1997
8.4	7.9	8.5	1.5	1.0	3.1	5.8	5.5	1.0

## 5.2. Retail

A study by *Santasalo* and *Kontio* (1995) reveals that there are two major trends in retail trade in Europe and also in Finland. The first major trend concerns the retail trade of daily products, in which the number of establishments and partly of the personnel is declining, while the relative significance of sales has changed very little. Thus, the main changes concern shifts in the market shares of companies engaged in the retail trade of daily products.

The second major trend is related to the specialized retail trade, whose significance in the retail trade is increasing overall. The number of speciality shops is on the rise in relative terms, and as employers in the retail sector they are already dominant in many EU countries. In an economic sense, the specialized retail trade has been overshadowed by the retail trade of daily products, although it has steadily increased its market share. Speciality shops are not so efficient as convenience stores, and their social significance is apparent not in cash flows but in employment and in the number of service outlets. The speciality shops satisfy the consumers preference for variety. The trend is likely to continue in the future, too.

A study by *Alatalo* and *Alho* (1998) has used a computable general equilibrium model in order to investigate some recent trends in the productivity of the retail trade in Finland. An international comparison shows that there is indeed some room for raising productivity in the Finnish retail trade. However, according to the results, the rise in total productivity of the branch resulting from the continued tendency toward bigger units has been rather limited. The biggest units (so-called hypermarkets) make up only a fairly

limited share of total sales (15%) and irrespective of their higher efficiency in input use, 15-20% above, the overall figures of the branch are influenced only in a limited magnitude. Differentials in productivity growth caused by this tendency are fairly small, of the order of a few tenths of the percentage point per year. The recent proposed merger of two leading Finnish supermarket chains, Kesko and Tuko, was prevented by the European Commission on the grounds that it would create a dominant position and significantly impede effective competition (*Dobson & Waterson 1999, 153-154*). The Commission rejected Keskos offers to divest certain wholesaling and cash-carry outlets, together with the creation of a new block.

Due to the collapse in domestic demand in the early 1990s, employment in the retail sector has almost continuously decreased from 1989 to 1997 and fell in total by more than 40 % (Table 7). During the recovery there has been a small increase in employment, but the number of retail workers is still much lower than before the great depression of the 1990s. Retail is also highly female-dominated (almost 70% of all workers are women) and is low-wage sub-sector compared to banking. Most of the full-time workers in retail have only had some vocational training.

**Table 7.** Employment in the retail trade (thousand persons) (Source: *Lehtonen 1998*)

1989	1990	1991	1992	1993	1994	1995	1996	1997
140	141	128	115	106	98	98	101	104

The number of part-time workers has traditionally been quite high in retail compared to the other sectors of the Finnish economy (Table 8). Since a small increase in the number of part-time workers during the depression of the early 1990s, an interesting observation is that the share of part-time workers has increased significantly during the recent recovery. This development is presumably a reflection of firms' uncertainty about their ability to generate enough output and profits to create full-time jobs, and new cost-oriented optimization of shifting in view of rush-hours. Also, the role of temporary workers (such as students) in retail is higher than in other sectors of private services.

**Table 8.** Proportion of part-time workers in retail (%) (Source: *Lehtonen 1998*)

1990	1991	1992	1993	1994	1995	1996	1997
24.7	26.7	25.3	29.1	32.4	32.9	33.7	37.3

Traditionally the unionisation rate has been somewhat lower in private services than in manufacturing industry in Finland, too. It is interesting to note that the unionisation rate has not decreased as a consequence of the slump in the early 1990s. Indeed as in other sectors, it has continuously increased as a consequence of the rise in unemployment in Finland (Table 9). It is evident that the main reason for this rise in unionisation is the involvement of the unions in the administration of unemployment insurance benefits. Another reason is perhaps that the job cuts during the depression hit the marginal workforce hardest, so that the core members of the unions remained in the workforce. According to *Oswald (1993)* trade unions do not care about employment at all, because the senior people who decide do not face the risk of unemployment.

**Table 9.** Unionisation rate in retail (%) (Source: *Lehtonen 1998*)

1991	1992	1993	1994	1995	1996	1997
54.7	68.2	68.9	76.2	71.0	70.0	70.6

### 5.3. Hotels and restaurants

The sector encompassing the activities of hotels, restaurants and cafes is sometimes known by its acronym: Horeca. In the classification of economic activities, it is defined as the provision of drinks, meals and accommodation from specialist outlets (*Eurostat 1998b*). This sector is often associated with the tourism industry, but tourism is, in fact, a demand-side concept involving a much wider range of industries and services, which is hence better viewed as a market rather than as a sector.

In view of the bleak unemployment situation in Finland, it is important to note that the Horeca sector is a highly labour-intensive activity. This means that an increase in value

added in hotels and restaurants is quite directly channelled into new jobs. In the long run the share of value added of hotels and restaurants in Finland has increased from about 1.3% of GDP (in 1970) to about 1.8% of GDP (in 1998). The share of hotels and restaurants was highest in 1990 at the end of the hectic boom in the 1980s (i. e. the value added was about 2% of GDP) (*Lankinen 1999*). This is an indication of the high income elasticity of demand for hotel and restaurant services.

The sector is also dominated by small enterprises in Finland, covering 9 500 enterprises in 1995 with 41 000 persons employed (*Eurostat 1998b*). Hence, on average, Horeca enterprises in Europe employ between three and six persons. Spain is the EU member state in which the Horeca sector contributes most to the national total value added, with a share of 7.5%. The contribution of the Horeca sector to the Finnish national total value added is about 1.7%, significantly below the EU average. The share of employment in hotels and restaurants of the total economy is slightly below 3%, also lower than the EU average. Austria and Spain have the largest share of people employed in Horeca in their economy (6.5%). However, the employment gap with the other countries is much smaller than in the case of gross value added.

Also, in hotels and restaurants the great depression of the 1990s led to a substantial decline in employment (Table 10). From 1989 to 1994 about a quarter of all jobs in hotels and restaurants were lost. However, the ongoing recovery has helped to raise employment somewhat. In particular, the rise of household earnings and consumption has been important for hotels and restaurants. From 1994 to 1996 employment rose 8.4%, but still the number of employed persons in hotels and restaurants is much lower than in the late 1980s. As a consequence of the shift in consumers' preferences and company strategies there has also been a major structural change within hotels and restaurants. In particular, the number of various fastfood outlets has increased rapidly during the 1990s.

**Table 10.** Employment in hotels and restaurants (thousand persons)

1989	1990	1991	1992	1993	1994
53	57	50	46	40	37

The unionisation rate in hotels and restaurants is about 75-80% and the share of women is about 80% of total employment. One of the interesting particularities of hotels and restaurants is that a great number of employees are fairly young compared to the other sub-sectors of private services in Finland. There has also been some up-grading of formal education in hotels and restaurants. Most of the employees nowadays have had vocational training. The share of part-time workers in hotels and restaurants is about 30%, which is slightly less than in retail. The issue of part-time workers has been a major question in collective bargaining during the 1990s.

#### 5.4. Communications

The communications services sector covers the enterprises engaged in postal and telecommunication activities. In Europe this sector has a long tradition of state monopoly. However, this situation is changing fast, and national public operators are preparing themselves to tackle new competitors in opening markets. In fact, Finland has been in the forefront of liberalisation, which has, together with a high-level of education, supported the development of communications services in Finland.

Postal services are facing increased competition from private operators in non-reserved services (i.e. parcel and express deliveries). These operators are mainly active in high value-added services, such as express business-to-business services. In the future, they could also enter the business-to-private market segment.

The communications services sector is characterised by very high concentration: 97% of the persons employed work in companies with more than 250 people (*Eurostat* 1998b). This is a reflection of the former national monopolies in this sector of economic activity. However, during the 1980s, the number of enterprises has rapidly been expanding as a consequence of the increasing number of small businesses taking advantage of the opening markets.

The number of enterprises in communications in Finland is about 550 and the number of persons employed is about 74 000 (*Eurostat* 1998b). The share of communications of total value added in the Finnish economy is slightly over 2%. This is in line with the EU average. The share is highest in Luxembourg and Greece at 3.5% and 3.4%. However, the share of employed persons in communications of the total economy is highest (2.2%) in Finland of all EU countries. It is clear that the unionisation rate is lower in

communications than in the other sub-sectors of private services, but it is almost impossible to give precise numbers because of dynamic character of sector. Communications are also characterized by other interesting features. It is definitely a high-wage sector, most of the workers are young and the turnover of workers also tends to be high in the communications enterprises. There is substantial variation in the education levels among workers in communications. Available evidence suggests that the hours of work are longer in communications than in other key sectors of economic activity.

During the 1990s there has been a rapid development of a telecommunications cluster around Nokia in Finland. Compared to communications, telecommunications is a highly male-dominated sector. It is important to note that active government policy played a substantial role in the early stage of the development of the telecommunications industry (*Palmberg* 1998). A particular feature of Finnish technology policy, especially in the 1990s, has been the quantitative upgrading of the R&D system through a continuous increase in R&D investments. Behind these investments has been an explicit policy of supporting industrial restructuring and transformation away from the traditional pulp and paper industry towards industries with higher technology content and value added, as well as fostering the creation of innovations.

## 6. Economic policy issues

The issue of bringing more private competition to the provision of the municipal services has been intensively debated in Finland during 1990s. The reason is that local authorities have intensively sought to "out-source" or "sub-contract" their non-core activities to various service sector enterprises (see, for example, *Böckerman* 1997). The main aim of these reforms is to cut costs in the provision of municipal services. In other words, local authorities are transforming their traditional position from being the actual producers to becoming the providers of municipal services. Examples of this phenomenon include cleaning services.

Unions in the municipal sector, especially KTV, have opposed this development, because it often causes a reduction in the total wage bill of employees and it also tends to increase the share of part-time workers. Disputes at the local level have even led to some

strikes. However, *Vickers and Yarrow (1991)* conclude that the evidence indicates that private ownership has efficiency advantages in competitive conditions, but does not show either public or private ownership to be generally superior when market power is present. A survey of relevant econometric studies by *Nickell (1999)* indicates that competition is good for the level of productivity. These two important views are often forgotten in public debates about the provision of municipal services.

As noted earlier, there seems to be a kind of gap in the volume of the private service sector in Finland compared to the EU average, even if the volume of public services is taken into account. *Ilmakunnas (1998)* recently elaborated some main economic reasons for the low share of the private service sector in the Finnish economy among OECD countries. She found with panel data regressions that the so-called tax wedge plays a key role. In particular, the high level of commodity taxes and social security contributions seems to be an important factor behind the low share of private services in Finnish economy. According to the same study, the high level of income taxation is not an important issue in this respect.

There has been a lively debate about ways to stimulate the development of the private service sector in Finland. A very popular measure to improve conditions for job-creation within private services is to reform the payments of social security contributions. It is assumed that by reducing the social security contributions of firms it is possible to decrease total labour costs. According to the conventional wisdom, this policy measure should improve employment, because services are very labour-intensive by nature. It is a fact that the proportion of social security contributions of total labour costs is lower in the manufacturing industry than in the provision of private services. An elementary economic analysis suggests that the case for a reduction of social security contributions in order to increase the number of jobs is not that simple, because a decline in social security contributions can lead to a rise in real wages demanded by workers via unions.

According to a recent survey among employers about 90% of all employers in the private service sector think that the reduction of social security contributions of firms is the most important single policy measure to improve employment in Finland (*Martikainen 1999*). Only 4% of employers' think that social security contributions have no role at all in the determination of employment. In addition, in the hotels and restaurants sub-sector a targeted reduction of value added tax is more popular than in the other sub-sectors of private services. On the other hand, the employers' assume that the level of income taxation has no particular role in the determination of employment in the service sector. A

recent econometric study by *Honkapohja, Koskela and Uusitalo (1999)* is in line with these casual observations. However, the adopted tax policy in Finland in the 1990s has been in sharp contrast with these suggestions from current empirical evidence, because the very focus of tax reductions has been as a reduction of income taxation.

Available empirical evidence suggests that there are interesting differences in the elasticity of employment with respect to total labour costs within private services in Finland (Table 11). The elasticity of employment with respect to total labour costs is highest in finance and insurance, and health and social welfare services. This suggests that, in principle, a targeted reduction of social security contributions within those sub-sectors of private services could be effective in promoting the maximum employment pay-off of the reform. However, such a targeted scheme is very difficult to implement by political parties. In particular, employers (and also employees) within the manufacturing industry do not accept selective reductions of social security contributions, because it would weaken their relative bargaining position in a long-run perspective.

**Table 11.** The elasticity of employment with respect to total labour costs in major sub-sectors of private services (Source: *Ministry of Trade & Industry 1998, 46*)

Sub-sector	Elasticity
Wholesale and retail trade	-0.47
Hotels and restaurants	-0.47
Finance and insurance	-0.92
Health and social welfare services	-0.89

Another topical mechanism to improve conditions for employment growth in private services is a selective reduction of value added tax in order to increase the demand of services. This proposition is connected to the introduction of value added tax in 1994, which, without a doubt, weakened the relative position of private services in Finland. From a comparative perspective it is also easy to argue for this reform, because the general value added tax is higher (22%) in Finland than the EU average. It is essential to

note that the reduction of the value added tax is also a part of the EU employment strategy for Finland (*Ministry of Labour* 1998, 29). Indeed, according to the official estimates made by the Government Institute for Economic Research, a reduction of the value added tax from 22% to 8% in labour-intensive service sectors would reduce government revenues by about 3 mrd marks per year and it would bring about 1 500-6 500 working years. In addition, due to the various dynamic effects the eventual reduction in government revenues would be only 2 mrd marks per year. These include the fact that a rise in employment implies an increase in government revenues via progressive income taxation.

In fact, *Santamäki-Vuori* (1998) has recently proposed that a major part of the revenues generated by the ongoing privatization program should be earmarked for the reduction of value added tax in the private service sector. The proposition has not received much support, because a reduction of income taxation seems to be a much more popular measure among policy-makers.

There has also been a public debate about the "flexibility" of labour markets during the 1990s. The main problem of this particular discussion is that there is hardly no solid empirical evidence to support the various positions taken. However, a recent empirical study by *Holm and Tuomala* (1998) reveals that low-wage and temporary, so-called "entry jobs", which are often found in private services, indeed tend to provide a pathway to more permanent positions in the Finnish labour markets. In a sense, it seems that even a temporary low-wage job is a much better option than no job at all from a long-run perspective.

## 7. Conclusions

An international comparison indicates that Finland is characterized by a lower share of private services in terms of output and employment than most other EU countries. According to current empirical studies, the main reason for this structural feature of the Finnish economy seems to be a high level of commodity taxes and social security contributions, which tend to discourage the expansion of employment within private services in Finland. Empirical studies also tend to support the view that the high level of income taxation is not as harmful as a high level of commodity taxes and social security

contributions for the expansion of the private service sector. From a long-run perspective, it is clear that the state-sponsored industrialisation after the Second World War was a restraint to the development of the private service sector in Finland.

The violent depression of the early 1990s led to a major restructuring in many sub-sectors of private services. As a consequence of the deep slump, the demand for private services declined sharply compared to the years of hectic boom in the late 1980s. This is due to the fact that the income elasticity of private services tends to be high. For example, in banking and retail a great number of jobs (up to 40-50%) have been lost during the 1990s. During the recent recovery the number of private service jobs has increased somewhat, but the restructuring process is still underway in many sub-sectors.

During the 1990s various programs - including a targeted reduction of value added tax and social security contributions - have been put forward in order to improve the conditions of private services in Finland, but the adopted policy measures have been incomplete. A reduction of income taxation has been much more popular among policy-makers. It is evident that the rapid ageing of population in Finland in the early decades of the new millenium means that in the future there will be an urgent need to broaden the scope of private services in all major sub-sectors. This will be a major challenge.

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## Abbreviations

KTV	Kunta-alan Ammattiliitto - Trade Union for Municipal Sector
PT	Palvelutyönantajat - Employers' Confederation of Service Industries
SAK	Suomen Ammattiliittojen Keskusjärjestö - Central Organization of Finnish Trade Unions
STTK	Toimihenkilökeskusjärjestö - Finnish Confederation of Salaried Employees

SUORA Suomen Rahoitusalan Ammattiliitto - The Finnish Financial Branch  
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