Analysis

Labour market flows run deeper: Participation has raised both employment and unemployment

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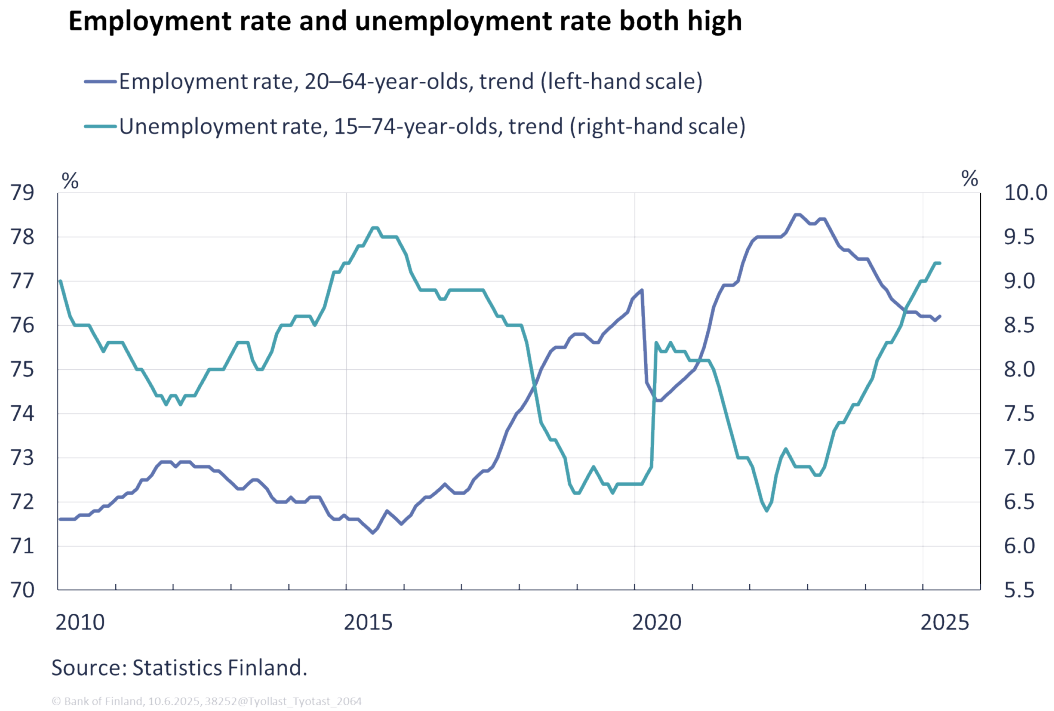
A key feature of recent developments in the labour market in Finland has been an increase in the participation rate. Inflows into the labour force have exceeded outflows. For some time already, this has been evident particularly as a rise in employment, but in recent years also as a simultaneously high rate of unemployment. The increase in the participation rate is due to people retiring later than before, the more active participation of the youngest cohorts, and the notably high proportion of people of active working age among immigrants. In the current weak economic conditions, the higher labour market participation has also contributed to a rapid rise in the unemployment rate.



Employment and unemployment rates simultaneously high

The Finnish labour market is currently in a situation where both the employment and unemployment rates are high (Chart 1). Finland's employment rate reached an all-time high in the period after the COVID-19 crisis. The labour market began to cool in spring 2023, after which employment has decreased and unemployment increased. Even though the employment rate has declined from its 2022 peak, it is still high in historical terms. Statistics Finland's seasonally-adjusted trend employment rate for people aged 20 to 64 was 76.2% in April, which is higher than the average for the past ten years. The trend unemployment rate in April was 9.2%, which is also significantly higher than the average for the past decade. When the unemployment rate last rose above 9%, in the mid-2010s, the employment rate had fallen to below 72%. The relationship between unemployment and employment has thus changed in the past ten years.

Chart 1.



Simultaneously high employment and unemployment is attributable to there being a smaller proportion of the working-age population outside the labour force than before, i.e. a smaller proportion who are neither employed nor searching for a job. This article examines what factors may have influenced the increase in labour market participation, and whether the higher participation rate is explained by changes in the behaviour of certain segments of the population, or whether this is a wider phenomenon beyond the labour market.

Labour market situation in terms of labour market flows

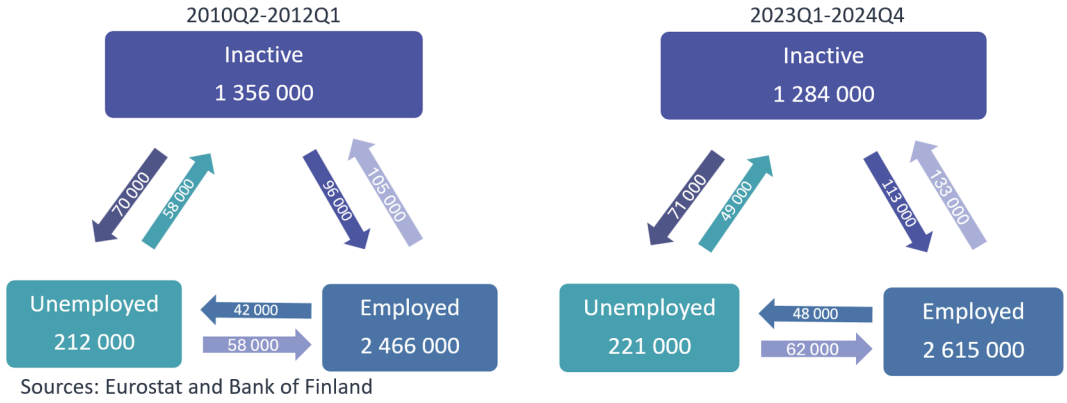
The working-age population can be divided into three groups: the employed and the unemployed, who together form the labour force, and people outside the labour force (i.e. people who are economically inactive). In 2024, the working-age population in Finland consisted of 4.2 million people, of whom 2.8 million were in the labour force. The labour force comprised 68.4% of the working-age population, and this percentage is referred to as the labour force participation rate[1]. The labour force consisted of 240,000 people who were unemployed and 2.6 million who were employed. The number of working-age people outside the labour force was 1.3 million. These economically inactive people were outside the labour force either temporarily or more permanently due to, for example, family leave, studies or retirement.

Changes in the labour market can be examined using labour market flows, which represent how people transition between unemployment, employment and economic inactivity. Changes in the number of working-age people in each of these categories will depend on the size of the flows between them.

Finland's labour market flows can be examined using statistics in the Eurostat database (Chart 2). Time series for the labour market flows are available for the second quarter of 2010 onwards. A comparison of the average of observations in 2010–2012, the first two years of the time series, and the last two years 2023–2024 shows, in particular, that the flows between economic inactivity and employment have increased. In addition, the numbers of people unemployed and employed have increased in the same period. In contrast, the number of working-age people outside the labour force has decreased. Growth in the working-age population has therefore not outpaced the flow of people into employment from outside the labour force. This means that the participation rate too has risen.

Chart 2.

Labour market flows from outside the labour force into employment have increased



Sources: Eurostat and Bank of Finland

In addition to labour market flows focusing on numbers of people, analyses often focus on transition rates that indicate the probability of an individual transitioning between the various labour market statuses, for example from economically inactive to employed. The transition rate is calculated by dividing the number of people transitioning from one status to another by the number of people in the initial category. For example, the transition rate from economic inactivity to employment is the number of persons flowing from outside the labour force into employment divided by the number of economically inactive persons. Using averages for the past two years, this transition rate is 113,000/1,284,000 = 0.088, or 8.8% (Chart 2). This means a transition rate of 8.8% from outside the labour force into employment in one quarter.

In the above, trends in the labour market have been described on the basis of flows between three

labour market statuses: employment, unemployment and economic inactivity. In the economic literature, labour market flows have usually been discussed in terms of two such categories, flows between unemployment and employment. The Bank of Finland's model of structural unemployment is also based on flows between these two labour market statuses.[2] This type of examination fails to explain the simultaneous increase in unemployment and employment, as it does not take into consideration flows from outside the labour force into unemployment and vice versa. In examining two categories, flows can be estimated from time series for unemployment and employment, whereas with three labour market statuses more detailed datasets are required, which is why this examination has been used less often.

Another reason why inflows and outflows to and from the labour force (the participation margin) have been analysed less is the assumption that these flows are steady. Students graduating from educational institutions are constantly transitioning from outside the labour force into the labour market, and retired persons are transitioning steadily out of the labour force. Cyclical fluctuations in the flows at the participation margin have thus not been considered to be as significant as cyclical fluctuations at the transition between unemployment and employment.

The flows at the participation margin are, however, significant, as a considerable number of people flow from outside the labour force into employment. In the past two years, an average of 48,000 people per quarter transitioned from employment to unemployment, and the corresponding transition from economic inactivity to unemployment was 71,000 people. Correspondingly, an average of 62,000 people per quarter transitioned from unemployment to employment, and as many as 113,000 from economic inactivity to employment. The flows at the participation margin are so large that even small changes can have a significant impact on the unemployment and employment rates and thus on the overall state of the labour market.

Finland's labour market situation in terms of labour market flows

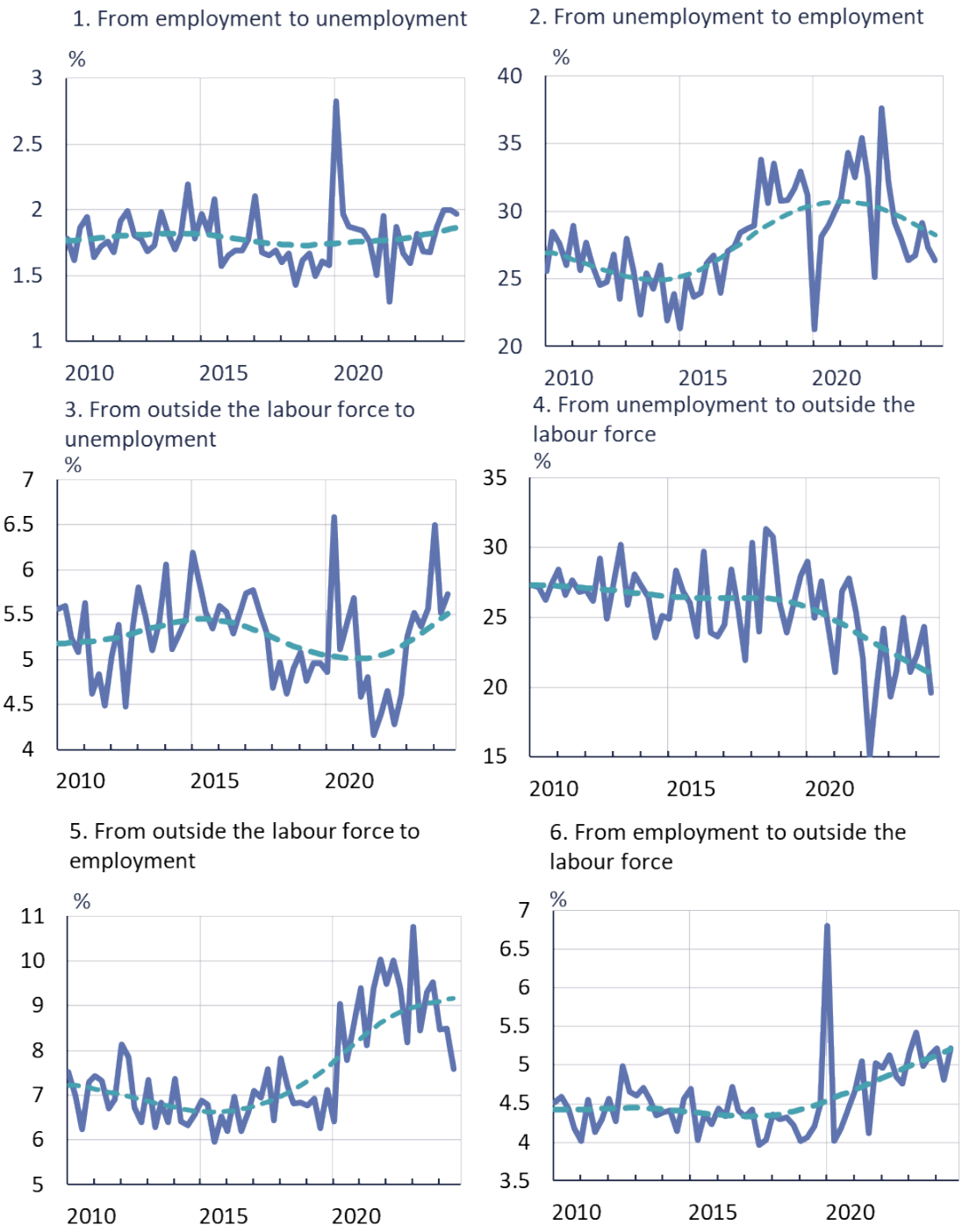
Cyclical conditions in Finland's labour market have recently been weak, as unemployment has increased and employment has decreased (Chart 1). Examining the time series of transition rates will allow us to see what kind of changes in labour market flows can explain the current situation (Chart 3).

To explain the recent growth in unemployment, we must identify four flows: two flows between employment and unemployment, and two between economic inactivity and unemployment. Looking first at the transition rate from employment to unemployment, this has increased slightly in the past 1–2 years (Chart 3, first panel). This is typical during recessions, when companies have

to make redundancies for financial reasons. Regarding the transition rate from unemployment to employment, this has decreased due to a decline in the number of job vacancies (Chart 3, second panel). As the transition rate from unemployment to employment decreases, spells of unemployment lengthen on average. Long-term unemployment has increased by some 25,000 in the past two years. A comparison of the size of the flows relative to the number of workers shows that in 2023 and 2024, a total of 382,000 people transitioned from employment to unemployment, whereas 496,000 transitioned from unemployment to employment. In other words, the number that transitioned from unemployment to employment was 114,000 higher than the number transitioning in the reverse direction. If there had been no other flows, the number of unemployed would therefore have decreased in recent years.

Chart 3.

Cyclical fluctuations and development of trends in labour market flows



Sources: Eurostat and Bank of Finland.

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The third flow identified here is the transition rate from outside the labour force to unemployment. This has increased in recent years (Chart 3, third panel). In 2023 and 2024, a total of 565,000 people transitioned from economic inactivity to unemployment. Fourthly is the transition rate from unemployment to inactivity. This rate decreased in the period 2023–2024 (Chart 3, fourth panel). The transition in these two years totalled 391,000 people. Thus, the number of people transitioning in the past two years from economic inactivity to unemployment was 174,000 more than from unemployment to inactivity. In this case, without the other flows, unemployment would have increased substantially.

Between the first quarter of 2023 and the fourth quarter of 2024 the number of people unemployed grew by a total of 60,000. In other words, this is the difference between the net flow from inactivity to unemployment (unemployment rises) and the net flow from unemployment to employment (unemployment declines), i.e. 174,000 minus 114,000, using the numbers mentioned above.

In a traditional model with two labour market statuses, unemployment increases in recessions as the job-loss rate rises and the job-finding rate among the unemployed declines. In this case, the flow of employed people into unemployment is greater than the flow of unemployed people into employment. However, recent developments show that also during the period of rising unemployment, the flow from unemployment into employment has exceeded the flow in the reverse direction. The increase in unemployment is thus due to the labour market flow from outside the labour force. Fluctuations in the transitions from inactivity to employment and to unemployment and vice versa have been a key factor in explaining the fluctuations in unemployment.

The increase in the flow from inactivity to unemployment in recent years is partly explained by the low number of job vacancies. At the end of 2024, there were approximately 32,000 job vacancies, which is 45% less than a year earlier and as much as 72% less than during the highest figures in summer 2022. As the number of vacancies is so low, students graduating from educational institutions, for instance, who during their studies are still outside the labour force, are increasingly transitioning into unemployment. At the same time, the flow from unemployment into employment has decreased and the spells of unemployment have lengthened. The small number of job vacancies explains not only the decrease in the flow from unemployment into employment but also the increase in the flow from outside the labour force into unemployment.

In recent years, the increase in unemployment has been due to not only the small number of job vacancies but also the higher labour market participation of the working-age population, in other words the rise in the participation rate. The larger flow of people from inactivity to unemployment is also due to the fact that overall, the flow from inactivity into the labour force has exceeded the

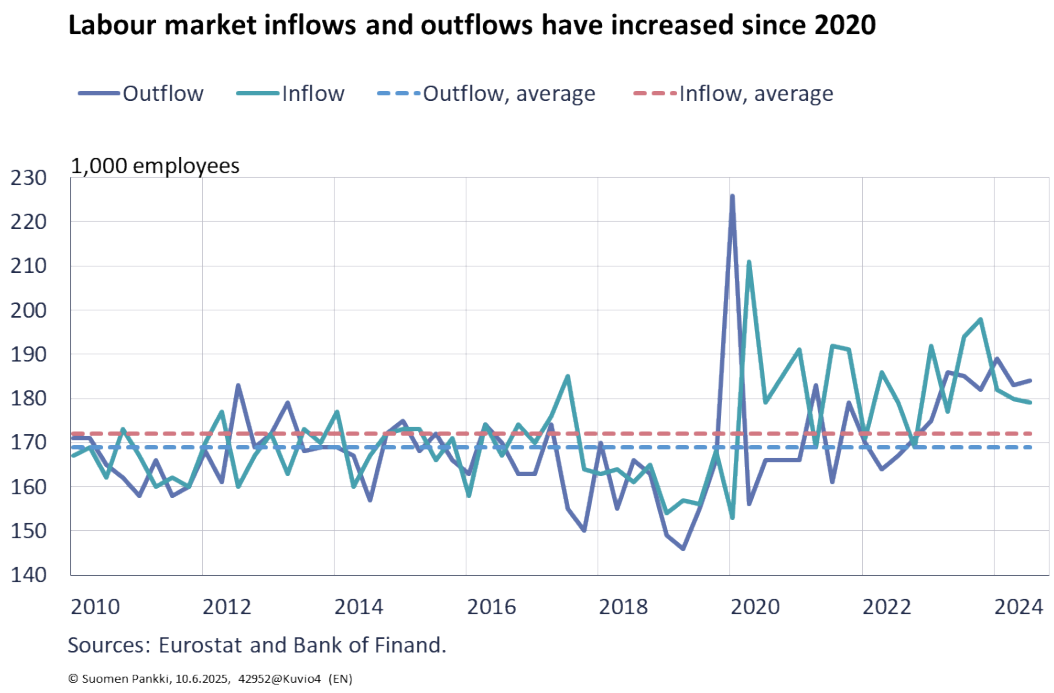
flow from the labour force into inactivity. Changes in the participation rate are discussed in more detail below.

Labour market flows in the longer term

The discussion above focused on what labour market flows tell us about the current labour market cycle. In the slightly longer term, changes in labour market flows may indicate structural changes in the labour market. Eurostat statistics on labour market flows have been available since 2010. Looking at the period 2010–2024, a change is visible in flows at the participation margin, that is, the labour market flow from economic inactivity into the labour force, over the last five years or so in relation to the 2010s (Chart 3). Overall, the flows at the participation margin, both into and out of the labour force, have increased.

Inflow into the labour force is obtained by adding up the flows from economic inactivity into unemployment and employment. Correspondingly, outflow is the sum of the flows from unemployment and employment to economic inactivity. The analysis based on two labour market statuses makes the assumption that labour force inflows and outflows are considered to be relatively stable across cyclical fluctuations. This was, to some extent, the case before the 2020s (Chart 4), but short-term fluctuations in flows have since increased and the volume of flows has risen overall.

Chart 4.

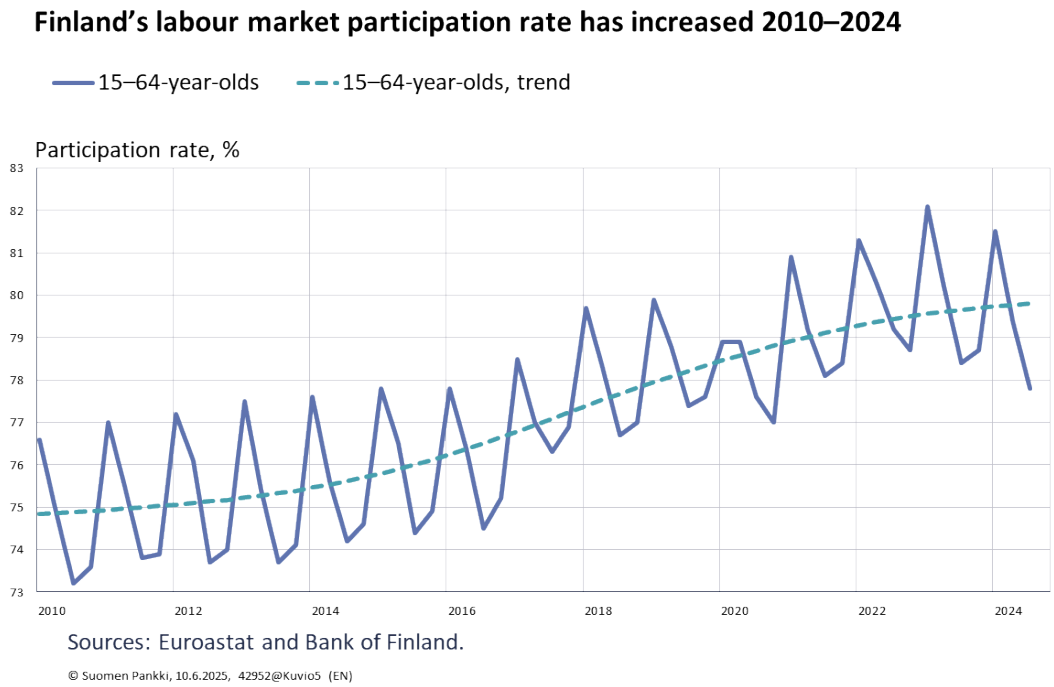


Both labour force inflows and outflows have increased over the past five years or so. The average inflow per quarter for the available time series is approximately 3,000 higher than the average outflow. From the beginning of 2020 to the end of 2024, the difference between these averages was already around 5,400 people (Chart 4). Since more people have transitioned into the labour force than out of it, the labour force participation rate in the Finnish labour market has increased (Chart 5). The growth in the participation rate has occurred particularly since the mid-2010s. In the years 2017–2020, the reason seems to have been a greater decline in the outflow, whereas following this both flows have increased, although the inflow has increased more than the outflow.

Trends in individual labour market flows show a few distinct changes that occurred at the very start of the 2020s (Chart 3). The transition rate from outside the labour force into employment has increased by around 2 percentage points and the transition rate in the opposite direction by around 0.5 percentage points. At least at the moment, this appears to be a kind of readjustment, in which the averages of both flows have risen from the lower level of the 2010s to a new, higher level.

The flow from unemployment to economic inactivity has declined. This trend is rather strong, as it continues until the end of the review period, although the weak labour market conditions have increased the number of unemployed people in recent years. No such clear trend is evident in the reverse flow from inactivity to unemployment. This flow has been clearly declining since 2016, but over the last two years it has started to increase again. This is presumably due to the poor cyclical conditions, which have redirected the inactivity flow away from employment and towards unemployment.

Chart 5.

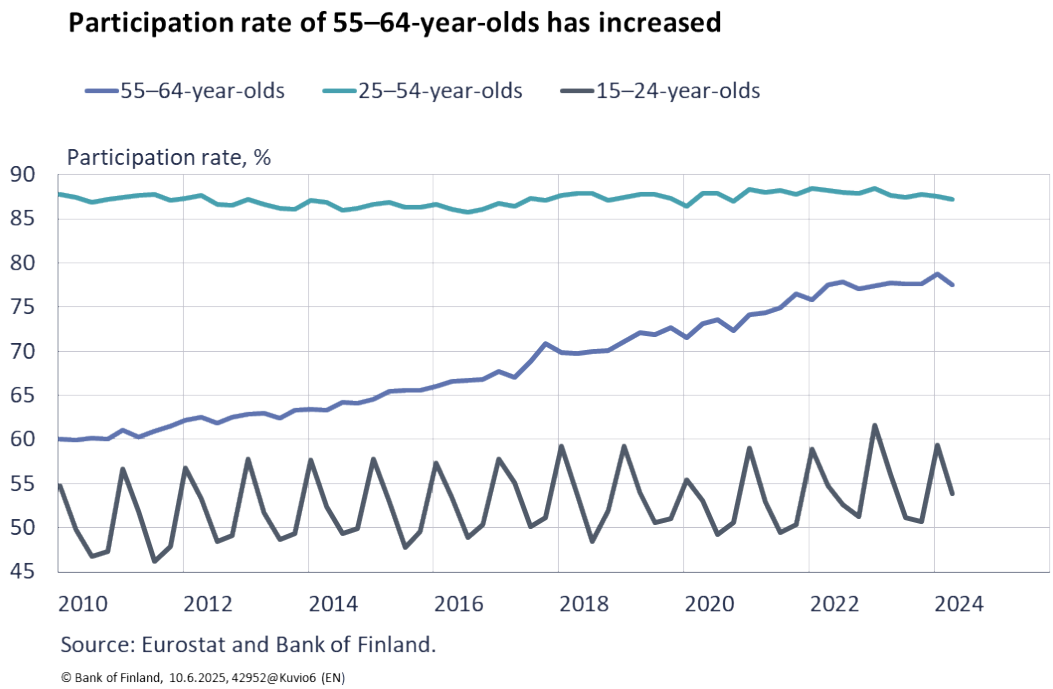


The trend employment rate for the 15–64-year-old labour force has increased by around 5 percentage points since 2010 (Chart 5). The pace of growth has also increased in the latter half of the review period. This is due to an increase in inflows and outflows, especially because the difference between these two flows has increased (Chart 4).

Growth in participation rate explained by later retirement, increase in young peoples' participation and immigration

The reasons for the increase in the participation rate can be examined by categorising the labour force according to different factors. The first and most important explanation for the increase is that people are retiring later than before. Looking at the participation rate divided into three different age groups (15–24, 25–54 and 55–64-year-olds), it can be seen that the participation rate of the oldest group, the 55–64-year-olds, has risen steadily throughout the entire time series starting from 2010 (Chart 6). A slight increase can also be seen in the participation rate of the youngest group, whereas the participation rate of the largest group (aged 25–54) has remained steadily high throughout the review period.

Chart 6.



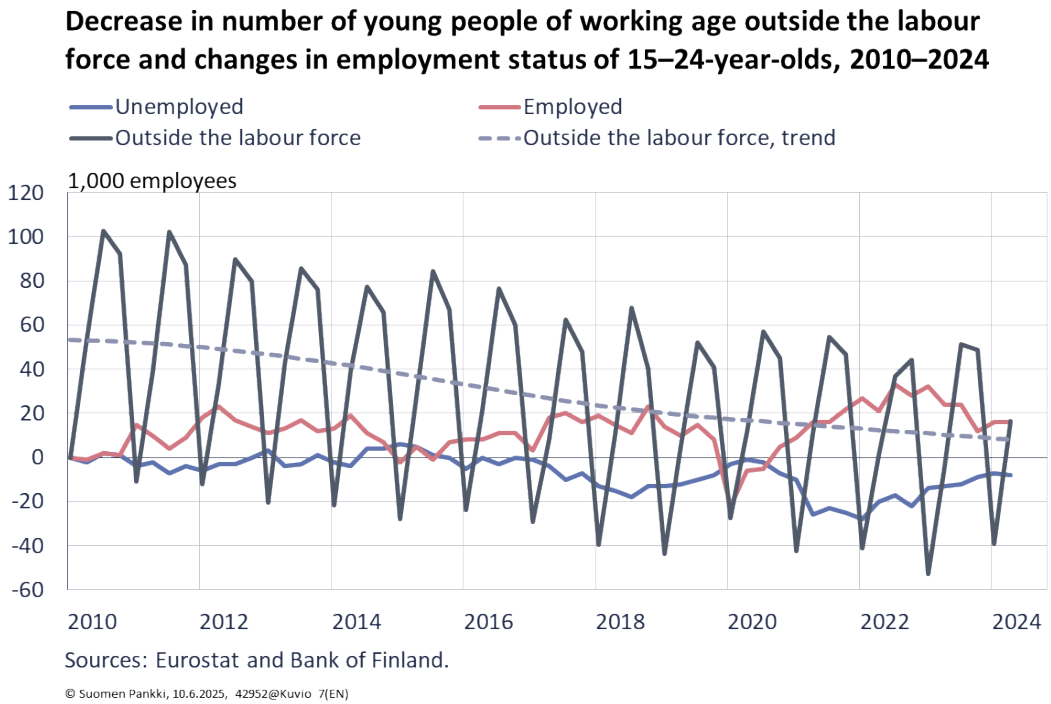
A steady increase in the participation rate of 55–64-year-olds is the most pronounced long-term change. This is attributable to various pension system reforms and also global megatrends. Regarding the latter, working life can continue for longer than in previous generations due to, for example, the increase in life expectancy and an improvement in the health of older people. On the other hand, the type of work done has also changed over time and hard physical labour has been automated, enabling employees to work efficiently even at an older age. Reforms to the pension system have also been carried out, partly because of longer life expectancy and because employees are able to continue working until an older age. Indeed, a survey by the Finnish Centre for Pensions showed that the extensive pension reform in 2005 lengthened the working lives of older people.[3] This reform affected 55–60-year-olds, in particular.

If we look further at the participation rates of specific age groups, we see that since 2010, the participation rate of those aged 60–64 and 65+, in particular, has increased. The employment rate is a measure that refers to the 20–64-year-old labour force. Based on this commonly used labour market indicator, the sharp increase in the participation rate of people aged 60–64 is especially marked. The participation rate of this group has risen from 43% in 2010 to 71% in 2024. An even greater increase in relative terms can be seen in the participation rate of those aged over 65, which was just over 4% in 2010, but had risen to nearly 10% by the end of 2024. Moreover, in quantitative terms this is also considerable, as the number of people in this age group is high

because there is no upper age limit. In 2024, 80,000 more people aged 65 or over participated in the labour market compared to 2010. The quantitative increase in the age group 60–64 is of the same magnitude. The increased participation of these two groups, i.e. an increase of more than 160,000 employees, has therefore been the most significant factor boosting the overall participation rate.

The pension reforms have quite clearly increased the employment rate of older people.[4] The pension system reforms have removed opportunities for early retirement and created incentives to continue working longer voluntarily. As a result of the current reforms, the retirement age is going to rise to 65 in the future. This means that the participation rate of 60–64-year-olds would rise at least close to the level of the current 55–59-year-olds (85%). This could lead to a further increase in the participation rate and a considerable increase in the employment rate, which measures the proportion of employed people among 20–64-year-olds. This may weaken the usability of the employment rate as a labour market indicator, as it would no longer be meaningful to compare its level with previous statistics. In addition, the pension system reforms (removal of the 'fast track to retirement') have reduced the transition from unemployment to retirement, which has reduced the flow from unemployment to economic inactivity.[5] On the other hand, people who have already reached their retirement age will be transitioning from employment to inactivity but may even return to employment, although will most likely no longer transition to unemployment. These changes are likely to increase the flows between employment and inactivity.

Chart 7.

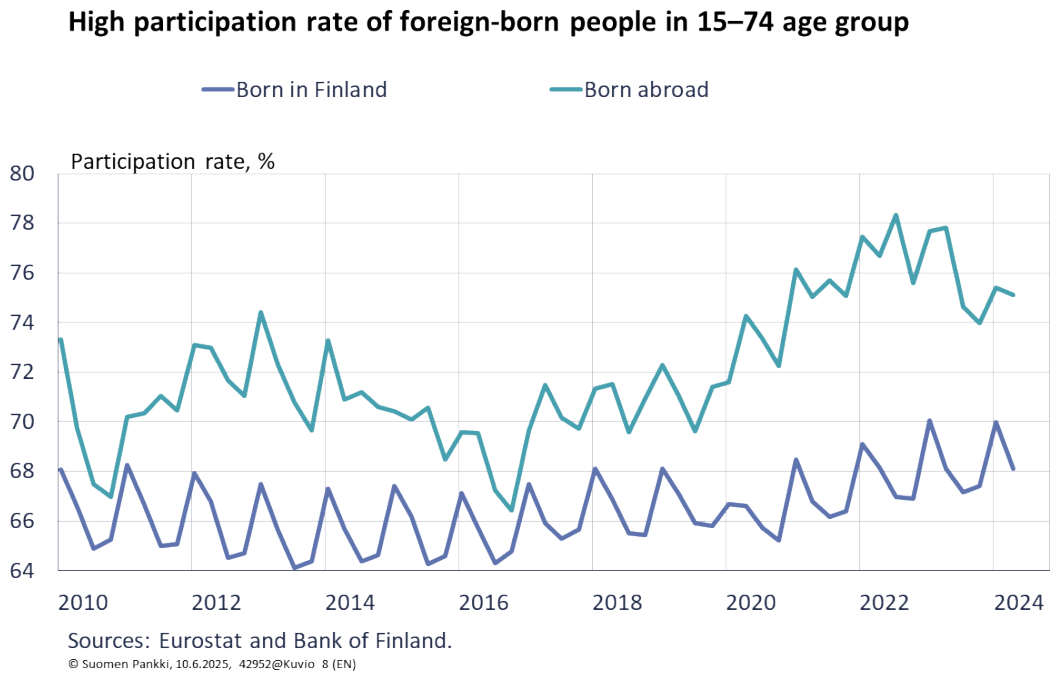


The overall increase in the participation rate is attributable in part to the participation of older employees but also to the increased participation of younger people in the labour market. There has been a downward trend since 2010 in the proportion of people in the 15–24 age group outside the labour force (Chart 7). At the same time, there has been no trend change in the number of employed and unemployed people in this age group, but only cyclical fluctuations. This indicates that the age groups have become smaller, but the number of labour force participants has remained the same. This means an increase in the relative share of people participating in the labour force, i.e. the participation rate. It is possible that the demand in the labour market for students, in particular, has remained unchanged and that this demand is being met by a smaller number of young people of working age. The impact of young people's participation is nevertheless quite small compared to the large increase in the number of older people in the labour force.

A third reason for the increase in participation rate is immigration. A growing number of foreign-born workers have entered the Finnish labour market in recent years. At the beginning of 2018, foreign-born working-age people accounted for about 6% of the total labour force, whereas in 2024 their number had already increased to around 11%.[6] The participation rate of foreign-born workers is quite high (Chart 8). This is because a majority of those born abroad are of active working age. In Finland, there are very few foreign-born people outside the labour force,

especially of retirement age. Immigration has therefore increased the number of people in the most active working-age group (25–54-year-olds) without correspondingly increasing the number of people outside the labour force. This has somewhat counterbalanced the exit of older Finnish-born employees from the labour market.

Chart 8.



In less than ten years, the participation rate of those born abroad has risen more quickly than those born in Finland, which has contributed to an increase in the total participation rate. The labour force participation rate of foreign-born women aged 25–54, in particular, has risen fairly steadily and is already around 75%. The participation rate of Finnish-born women of the same age is about 10 percentage points higher. The participation rate of foreign-born men has fluctuated quite a lot with the economic cycle. At its highest, it was over 90% in 2022 in a robust labour market but has since declined to about 84%.

The foreign-born population includes immigrants who may have moved to Finland already as children and studied in the Finnish education system all their lives, and who have reached active working age during the period under review. Such foreign-born individuals who grew up in Finland are assumed to find employment fairly smoothly, boosting the rise in the participation rate of those born abroad. The significant increase in the number of foreign-born workers in recent years also indicates the relatively high labour market participation of new immigrants.

In conclusion

This article has examined labour market developments in Finland using statistics that describe the transitioning between different labour market statuses. At the moment, both the unemployment rate and the employment rate are simultaneously high compared to the past decade. This can be explained by the rise in the participation rate. Inflows into the labour force have exceeded outflows.

The rise in the participation rate can be explained particularly by the more active participation of older people in the labour market. A further rise in the average age at which employees retire is foreseeable, which will increase the participation rate of those aged over 60. Immigration has also supported a rise in the participation rate by maintaining the number of people in active working age at a time when the Finnish-born age cohorts have declined. The participation rate of the youngest age groups has also risen slightly, and despite the declining age cohorts, the number of people under 25 participating in the labour market is similar to previous years.

The rise in the participation rate over the last ten years appears to be a structural phenomenon. Therefore, it is likely that the employment rate will remain higher in the future, even during weak economic cycles.

The past two years have seen a strong surge in unemployment. The rise in unemployment has been due to weak economic conditions, but another significant factor at work has been the increase in the labour force participation rate. The flow from outside the labour force into unemployment has increased. During weak cyclical conditions, this has occurred because people entering the labour force have ended up in unemployment instead of employment. This appears to have been a more significant factor in the rise in unemployment than the flow from employment to unemployment. Without increased labour force participation by working-age people, the increase in unemployment would probably have been more subdued, but, on the other hand, employment growth would also have been weaker in the 2020s.

An examination of Finland's labour market shows how important the participation rate is, not only for describing the long-term situation in the labour market but also in analysing economic conditions. In economic monitoring and forecasting, it is therefore useful to consider the participation rate as one indicator of the labour market cycle.

Notes

1. The term activity rate is also used. The figures in this paragraph are based on the broadest definition of the working-age population: 15–74-year-olds. The same definition is also used subsequently in this article unless specified otherwise. ↑

2. See Juvonen and Obstbaum (2017). ↑
3. See: Pension Reform in 2005, etk.fi/en. ↑
4. For more about the impacts of the pension reform, see e.g. Impacts of 2017 and 2005 pension reforms (etk.fi/en), Kyyrä (2014), Nivalainen and Ilmakunnas (2023), Nivalainen (2022), Nivalainen and Uusitalo (2013). ↑
5. For more about the 'fast track to retirement', see Kyyrä and Pesola (2020). ↑
6. See: Every tenth employed person was of foreign origin in 2024 | Statistics Finland. ↑

Keywords

employment, labour markets, unemployment