Anton Svensson

# The Recovery Plan in Sweden

Setting the course for a climate-neutral and digital future?

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## About this publication

The Swedish government has embarked on an expansionary budget after a long period of strict budget discipline to recover from the ongoing economic recession. The Swedish plan sets out to hinder the fall in employment and to increase the pace of transformation to a sustainable economy. The report analyses to what degree the recovery's goals for fiscal and sustainability efficiency are met and the general fallout from the recession. The conclusion finds that the expansionary budget is necessary but questions its emphasis on tax cuts and the relatively low share of support being given to sustainable sectors of the economy.

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## INTRODUCTION

The COVID-19 pandemic has struck Swedish society hard, both from a public health and economic perspective. This report will describe it's main economic implications and analyse the Swedish state's countermeasures to tackle this unique economic shock. The drop in Sweden's GDP during the second quarter in 2020 was, without doubt, historical, as it is the largest single drop in quarterly GDP since Statistics Sweden (SCB) started to measure this metric in 1980 (SCB 2020a). The decline in GDP comes from both internal and external forces. Internally, from a plunge in consumption within Sweden as social distancing restrictions and recommendations, together with decreasing incomes, have reduced household spending on, for example, the restaurant and retail business. Externally, from falling international trade, a critical component of the Swedish economy, as half of Sweden's GDP comes from export revenues (Ekonomifakta 2020). Sweden's reliance on a global market stresses that it is unlikely that it will make a full economic recovery until more favourable conditions in the international markets arise, even if temporary measures ease the most detrimental of the pandemic's economic consequences.

When it comes to facilitating recovery from the sharp drop in GDP and increased unemployment, there has been a renewed focus on fiscal policy. An emphasis not seen to this extent since the 1970s, when Sweden pursued an active Keynesian policy with the aim of bridging over its structural crisis. However, in facing the 2020 crisis, the stimulus package does not merely aim to preserve the previous business structure of the economy in the way that 1970s' Keynesian policy attempted, but also to facilitate recovery and structural transformation towards increasing the economy's renewable sectors. Expert authorities on economics, such as the Swedish National Institute of Economic Research (Konjukturinstitutet 2020) the OECD (2020) and the IMF (2020) recognise that expansionary monetary policy is already exhausted. This is because the *Riksbanken* (Swedish central bank), the European Central Bank, and the Federal Reserve have, in the wake of the financial and economic crisis of 2009, pursued zero and even negative interest rates, leaving minimal room for further expansionary monetary action.

Therefore, under current circumstances, the state is the primary agent capable of providing sizeable stabilisation policy. The Swedish government has fulfilled this role by enacting several fiscal stimulus packages, such as temporary part-time work subsidises and a substantial expansionary budget for 2021. The efficiency of individual fiscal measures, especially extensive tax cuts, is questioned in this report. Still, the overall goal of providing an economic stimulus and promoting a more sustainable economy is commendable. The report discusses trade union and Swedish think tank ideas for improving this fiscal stimulus package. These are aimed at reducing the package's tax cuts as well as increasing investment in sustainable development, public investment and consumption.

## ECONOMIC RAMIFICATIONS OF THE COVID-19 PANDEMIC IN SWEDEN

As mentioned above, the Swedish economy has seen a dramatic shrinkage in GDP, particularly during the second quarter of 2020, amounting to 8.6 per cent (SCB 2020a). The decrease primarily comes from lowered consumption due to self-isolation, decreasing income in Sweden, and plummeting international trade. In this section of the paper, the dynamic of these negative impacts on GDP will be accounted for while also laying out the effect of this drop in GDP for specific demographic groups, on the basis of age, gender, and birthplace.

### PERSONAL SERVICES ARE THE MOST AFFECTED

Consumption within Sweden has decreased by about 7.7 per cent during the second quarter of 2020 (SCB 2020a), mainly explained by social distancing and reduced incomes. From an international perspective, Sweden is viewed as an anomaly when it comes to its reliance on a high degree of restrictions and self-imposed measures for social distancing. This strategy's success is debatable; however, it is not discussed at any length in this report. Nevertheless, economic data for Sweden shows that social distancing measures have had a significant impact on consumption behaviour in Sweden. This change can mainly be seen through the plunge in revenues for the hotel and restaurant business sector which is the hardest hit sector in terms of decreasing employment. 31 per cent out of the total decrease in employment of 78,000 workers from March to June 2020, came from this sector

(Arbetsförmedlingen 2020). These layoffs have primarily impacted on younger age groups as the hotel and restaurant business is the sector with the highest share of young people – approximately 30 per cent of its employees are below 25 years old (DUA 2016). The mean age of workers in the sector is 35 years old. It also has a high share of foreign-born workers, approximately 43 per cent (SCB 2020b). The unemployment statistics from Statistics Sweden confirm that young people aged between 15 and 24 years old are worst affected (SCB 2020c).

## OVERALL LABOUR MARKET EFFECTS

Unemployment (that is not seasonally adjusted) increased from 6.5 per cent in September 2019 to 8.6 per cent in September 2020. This increase corresponds to about 116,000 unemployed people (SCB 2020b). Considering the significant drop in worked hours due to furlough, individuals are only being employed part-time while being compensated by the state for lost income. Throughout the crisis, over 570,000 Swedish employees have worked part-time and received part of their pay from the state through the furlough scheme (Tillväxtverket 2020). This shows a major overall decrease in worked hours throughout the economy, both from increased layoffs and furlough. However, it is essential to note that the furlough scheme has appeared to halt the decline in the employment rate, as this has been substantially smaller than the decrease in production. This indicates that the state's capacity to bear much of the employment cost has limited the negative impact of the decrease in production. Employer expectation that the crisis will be temporary is also a central component in explaining the gap between the significant fall in production and the more limited fall in employment (Konjukturinsitutet 2020).

## DECLINE IN EXPORTS

Decreasing international trade from the global shutdown and following recession has become a major exogenous shock to the Swedish economy. It is very sensitive to these types of shocks as exports make up such a substantial part of the nation's GDP. This negative impact of decreasing exports has been worsened by the fact that Sweden's main trading partners in the EU and its free trade association have been hit exceptionally hard by the economic ramifications of the COVID-19 pandemic.

GDP in the EU has decreased by as much as 12 per cent during the second quarter of 2020 (Konjunkturinstitutet 2020). This remarkably sharp drop can be partially linked to the large tourist sector in southern Europe, disproportionately affected by the limited travel between and inside countries as a result of COVID-19 restrictions (Konjunkturinstitutet 2020). Sweden's two main trading partners within this area, Germany and Norway, have not been the worst hit. Nevertheless, the decreasing trade between these countries and its southern European neighbours might cause repercussions later on. The Swedish exporting sector has already been hampered by decreasing orders, but for now the sector has seen limited layoffs due to the previously discussed furlough schemes, which have been heavily used by the Swedish manufacturing industry. However, for the Swedish export sector to see a major recovery, further European cooperation in facilitating recovery and increased bilateral trade is needed.

## PRECARIOUSLY EMPLOYED FACE THE BRUNT

Turning to the asymmetric effects of increasing unemployment, there are limited differences between gender, with a slightly larger decrease in the male employment ratio of 2.2 percentage points to the corresponding decrease in female employment of 1.1. This trend is actually the opposite of the overall European trend which has been towards a higher decrease in the the female employment ratio (Eurostat 2020a). This can probably in part be linked to the relatively high labour market participation of 78.9 per cent of women aged between 20 and 64 years old in the Swedish labour market compared to 83.2 per cent of men in the same age bracket (SCB 2020c). These differences in employment ratios in Sweden and similar Nordic social democratic welfare regimes are in comparative terms lower than in both liberal Anglo-Saxon and continental European conservative welfare regimes which have much larger gender employment rate gaps compared to the Nordic countries (Eurostat 2020b; Korpi et al. 2013). The more equal gender division of labour (however far from entirely equal) in the Nordic countries, compared to continental Europe, stands as a plausible hypothesis for why there are only minor gender differences in layoffs in Sweden while these are larger in continental Europe.

There are clear differences in the decline of employment rates between native and foreign-born workers in Sweden. Native-born Swedes have an employment rate of 84.8 per cent among those aged 20-64 years old which decreased by one percentage points from the third quarter of 2019 to the same period in 2020. The employment rate for foreign-born Swedes in the same age group is 67.6 per cent and decreased by three percentage points between the third quarter of 2019 and the third quarter of 2020 (SCB 2020c). This highlights how foreign-born Swedes in particular have been negatively impacted by the economic downturn sparked by the COVID-19 pandemic, hurting a group with an already rather weak standing in the Swedish labour market before the crisis.

Overall, foreign-born and younger age groups have been affected disproportionately and should be at the centre of employment support programmes. However, recent indicators predict that the third quarter of 2020 seemed to see the start of a recovery, with an up to 4.9 per cent increase in Swedish GDP compared to the second quarter. This gives hope for a more optimistic outlook on the development of Swedish GDP in the longer term. This recovery is primarily driven by increased demand within Sweden (Dagens industry 2020). However, coordinating a recovery between EU member states is still essential, as they comprise Sweden's largest export market, which has still not seen a recovery in trade.

## OVERVIEWING THE FISCAL COUNTER-MEASURES

So far, this report has emphasised the need for economic stimulus to counter rapidly rising unemployment and declining GDP. Further expansionary monetary policy is limited, as the *Riksbank's* interest rate is already zero and gigantic quantitative easing programmes throughout the world have been able to stabilise financial markets but not keep unemployment and the decrease in GDP at bay. This has made everyone – from international expert authorities, such as the IMF and the OECD, to the Swedish government – supportive of-expansionary fiscal policy in order to accommodate the low interest rate policy.

Specifically, the Swedish government has supported a recovery plan aimed at pursuing what it has itself described as an expansionary fiscal policy, in which the Swedish state will pursue a budget deficit that will increase the deficit as a share of GDP by 5.5 percentage points. Out of the increased deficit, 2 percentage points (36 per cent out of the total deficit increase) come from the expansionary state budget for 2021 which contains expansionary measures corresponding to 105 billion *SEK*.

The deficit has also increased due to other temporary measures enacted during 2020, especially increased unemployment insurance, business support and the furlough scheme. Furthermore, the deficit is increasing due to a fall in tax revenues from the loss in hours worked and overall increased spending on unemployment insurance in particular (Ministry of Finance 2020). The NextGenerationEU initiative will also bolster the Swedish recovery with temporary measures of up to 50 billion *SEK* from 2020 to 2026 (Darvas 2020).

### NEED FOR PUBLIC SPENDING

The expansionary Swedish state budget for 2021 is primarily set to hinder the fall in employment and production. The largest individual measures in this expansionary budget are different forms of tax cuts totalling 30 billion *SEK*, aimed at reducing the cost of employing young people, providing a temporary decrease in both income tax and the cost of corporate investment. The second largest expenditure in the budget is increased welfare spending of 22.5 billion *SEK* towards the municipalities and regions which are the nation's main providers of welfare services[1]. The third largest expenditure of about 10 billion *SEK* is investment in sustainable growth and transformation. Another reform is to provide increased unemployment insurance and retraining, with the aim of facilitating an ongoing structural shift, in costing, in total, another 10 billion *SEK*. Other areas of investment are increased spending on the rule of law (police and courts) of 5 billion *SEK* and rural investments largely in the forestry industry and broadband expansion of another 5 billion *SEK*. The remaining expansionary measures in the budget are minor investments in different areas, but none of them amount to individually major sums.

### SWEDISH GOVERNMENT DEBT IN THE LONG RUN

The Swedish Ministry of Finance's strategy for financing these increases in spending is mainly designed to temporarily increase the deficit. The Swedish deficit at the start of 2020 was 35 per cent as a share of GDP, situating the Swedish national debt as one of the lowest in the OECD. As the current crisis and the expansionary budget expands, the deficit is projected to increase and peak at 42.6 per cent out of total GDP in 2021 (Finansdepartementet 2020). Thereafter, the debt to GDP ratio is projected to start to decline again due to increasingly balanced budgets, even though expansionary measures will be pursued in the 2022 budget at a lower rate to 2021. The assumption also made is that the world economy will start a major recovery phase, resulting in a lowered debt to GDP level (2020).

This means that the overall increasing debt levels of the Swedish economy will be a minor issue, as these start from low levels and are not projected to be negative over a prolonged period of time. This gives financial markets high confidence in the Swedish state's ability to meet payment obligations and, as a result, Swedish government bonds are issued with low interest rates. Therefore, temporary surges in Swedish public debt are not seen as a major issue in the foreseeable future.

## EVALUATING THE FISCAL COUNTER-MEASURES

The state budget for 2021 has been referred to as "very expansionary" by the Ministry of Finance, indicating that it wants to signal to the markets that they are ready to contribute to upholding aggregate demand. When overviewing the budget, the tax cuts stand out as the individually largest reforms of the expansionary measures, amounting to 30 billion *SEK*. These tax cuts are mainly set to encourage investment in businesses through temporarily lowered corporate taxes, hiring young people through a lowered employee tax, and increasing consumption through lowered income tax. While these reforms of 30 billion *SEK* are not a major component of the total expansionary package of 105 billion *SEK*, they are nevertheless larger than the second largest reform area which is welfare investment of approximately 22.5 billion *SEK*.

### FISCAL EFFECTS ON AGGREGATE DEMAND AND EMPLOYMENT

The Swedish National Institute of Economic Research (NIER) has evaluated which fiscal measures have had the largest effect on aggregate demand and employment. Their research finds that expansionary measures in times of reces-

1 Municipalities provide schools and elderly care and regions provide hospitals and public transport.

sion, but also under other circumstances, can be effective for Sweden. The NIER finds that expansionary measures in public investment and consumption are the most efficient in providing an increase in employment during a recession. In their model, a one per cent expansionary increase as a share of GDP to public investment provides an increase to employment of 0.6 per cent, and the same increase to public consumption increases employment by 0.4 per cent (Konjunkturinstitutet 2017). The NIER also finds that public transfers, such as cash benefits to parents with school age children, can have a considerable effect on employment of 0.4 per cent. The fiscal measure they find to have the least effect on employment is tax cuts with a multiplier of only 0.2-0.1 depending on the type of tax cut, where, for example, lowered income tax has a higher multiplier than lowered value-added taxes (Konjunkturinstitutet 2017).

The Swedish Fiscal Policy Council (SFPC) explains the effect of tax cuts on lowering employment as being due to a large proportion of those in receipt of tax cuts saving their increased income (SFPC, 2020), while municipalities and regions have a higher probability of consuming or investing that income directly, especially during slumps when tax revenues are declining, and it is hard to sustain the quality of welfare services. Therefore, the SFPC (*finanspolitiska rådet*) and the NIER stress that increased public consumption should be directed to labour intensive sectors of the welfare state, such as elderly care, as this appears to be more effective in increasing employment than increasing the consumption of products needed for elderly care (Konjunkturinstitutet 2017, Finanspolitiska rådet 2020). This research pinpoints the need to carefully choose which actions should be taken in order to most efficiently stimulate demand and employment during a crisis. Some international research conducting similar analysis for the entire OECD (Coenen et al. 2012) confirms the results of the Swedish NIER study (Konjnkturinstitutet 2020), pointing out that public investment and consumption in particular are the most efficient countermeasures to a recession.

However, such research lacks consensus on how to measure these effects and the precision of their methodologies is uncertain. Therefore, different studies obtain different results depending on the method and dataset employed. Meta-studies of the field of fiscal stimulus effects confirm the uncertainty in the strength of their results. One of the few increasingly undisputed results is that austerity (contraction in fiscal policy), in particular during recessions, creates a significant shrinking of GDP and employment, the effect of which fiscal policies are the most efficient is still highly debated (Ramey 2019).

### INCREASED DECARBONISATION

Another critique of the recovery plan has been to question the degree of sustainability, as a majority of the fiscal stimulus goes to non-renewable sectors of the economy (Volturius/Rylander 2020). This is mainly because policies designed to save existing businesses, are automatically predominantly helping fossil driven businesses as they comprise the majority of the Swedish economy. To not save the current economic structure is difficult as it would result in a destruction of existing businesses. In the current circumstances, it is hard to see how new renewable businesses are able to spring up and replace previous work at a rate which keeps pace with environmental destruction. Increasing the rate of transformation to a fossil free economy must be investigated more thoroughly, while, at the same time, bearing in mind the need for new employment opportunities and unemployment benefits that support job searching.

To facilitate this economic transformation will be a difficult balance between faster transformation of the economy and providing new opportunities and security. This topic is too large to initiate an in-depth analysis in this brief report – that would be to downplay the existential threat from climate change. Nevertheless, it is painstakingly clear that there is a need for a public inquiry in Sweden and a broader European debate to analyse how to facilitate a transformation while providing new job opportunities in sustainable business sectors and without leaving behind workers with a lifelong career in what will become obsolete fossil industries.

Both the Swedish recovery plan and the NextGenerationEU project (Europeiska kommissionen 2020) touch on this issue but are far from sufficient. Without new policies being implemented to smooth the transformation, such as increased unemployment insurance, re-training and new employment opportunities, there is likely to be strong resistance towards transformation to lowered carbon dioxide emissions.

## ALTERNATIVE PROPOSALS FOR RECOVERY

While Swedish and international macroeconomic research has found that public investment and consumption are the most efficient measures to slow down the fall in employment, the trade union affiliated think tank Katalys (Gerin/Svensson 2020a;2020b) and the largest Swedish trade union LO (Bergström et al. 2020) have questioned the expansionary budget's focus on tax cuts. The welfare investment of 22.5 billion *SEK* comes out in a more favourable light in the macroeconomic research but is insufficient to halt much of the fall in employment.

### PRECISION IN THE SUBSIDIES INSTEAD OF GENERAL TAX CUTS

Enacting a lowered employer's tax on young people aged between 19 and 23 years old, as the Swedish government has done during the crisis, might seem like an appropriate tax cut considering this is the age group hardest hit by the economic crisis. However, this also creates significant deadweight costs, as those already employed in this age group are also subsidised, thereby reducing the reform's precision (IFAU 2013). Previous evaluations of similar reforms have pointed out that it would be far more efficient to increase employment among young people through subsidising the long-term unemployed in this age group instead of lowering taxes for everyone in that cohort (Seim 2019). The individual centralised measure with the most efficiency at this stage is the furlough scheme, making it possible for employers to keep employees on part-time while the state pays most of the lost income from fewer hours worked.

## INCREASED WELFARE SPENDING

Trade unions and aligned think tanks have proposed increasing the employment effect of the fiscal stimulus by increasing spending on the welfare sector and investment in infrastructure. This is in line with research findings that estimate which fiscal measures have the largest effect on employment. Infrastructure investment needs to be directed towards measures which can be enacted within a short timeframe and that will enable the fiscal stimulus to be implemented more quickly, such as repairing current infrastructure. However, it is essential that these measures to stimulate the economy also bring value to society.

Increasing investment in the elderly would definitely have such a value. Firstly, elderly care has seen major cuts in provision of 20 billion *SEK* in the past twenty years alone. Since 1980, the number of domiciliary care home visits has tripled (Plesner 2020). Secondly, the underfinancing of elderly care has been attributed as a major factor in the high per capita death rates from COVID-19 in Sweden. Therefore, an increase in employment in this sector would provide much needed investment in a critical welfare service which is in dire straits.

## INCREASED INFRASTRUCTURE INVESTMENTS

Increased spending on repairing existing infrastructure would also be essential as the Swedish authority responsible for the country's roads and railway warns that it is currently unable to maintain the existing infrastructure (SvD 2020). Furthermore, focusing on advancing already planned railway building could be an important step in reducing emissions in the transport sector. Therefore, increased spending on infrastructure projects with a short planning period might be a key element in ensuring the Swedish recovery plan both generates a larger positive employment effect and results in reduced emissions from more reliable and sustainable transportation.

## CONCLUSION

In conclusion, Swedish GDP has seen a major negative shock in 2020, especially during the first half of the year. While there seems to have been an upswing in GDP during the third quarter, most forecasts estimate that Swedish GDP in total dropped by 3 per cent for the entire year (Ekonomifakta 2021). A prolonged drop in international trade is a fundamental barrier to long-term recovery in Sweden, highlighting the need for EU cooperation to stabilise joint markets. The crisis has affected demographic groups differently on the basis of income and employment. Young and foreign-born workers have seen a major drop in employment. To tackle this crisis, the Swedish government has enacted a recovery plan set to stimulate the economy and thereby hinder the fall in employment and GDP, aided by a joint EU recovery plan. The Swedish plan is primarily to lower taxes, increase spending on welfare provisions and facilitate a sustainable transformation, financed through increased lending. This plan may be criticised on the basis of limited evidence that the enacted tax cuts would generate much of an increase to employment and that the share of investment in sustainable sectors of the economy is too small. Swedish trade unions and aligned think tanks have responded to the recovery plan with proposals to refocus its priorities to include increased investment in generating employment in the care sector and in repairing existing infrastructure.

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The Friedrich-Ebert-Stiftung (FES) is the oldest political foundation in Germany with a rich tradition dating back to its establishment in 1925. Today, it remains loyal to the legacy of its namesake and campaigns for the core ideas and values of social democracy: freedom, justice and solidarity. It has a close connection to social democracy and free trade unions.

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## EUROPA

### Recovery strategies in Europe

The restrictions imposed to combat the COVID-19 pandemic have led to a pronounced drop in production, a steep rise in unemployment and public debt. As a result, profound social distortions have arisen. Further, the pandemic has also revealed the strong dependence of Europe's economy on the production of vital products beyond the continent. Accordingly, national governments and the EU have had to devise wide-ranging programmes to support and revive the economy.

The development of these "recovery" programmes is taking place at a point in time when the European economies are at a crossroads. They are faced with meeting the immediate challenges stemming from social and ecological transformation and digitilisation. As a result, there is significant pressure to ensure that measures to implement economic revival do not lead to a return to the pre-pandemic status quo. Instead these countries should seize the opportunity massive public spending programmes to start the transformation of the economy and society towards climate neutrality and social equality.

A series of reports form several European countries analyse their respective national recovery plans and assess them in view of meeting the complex challenges. A synopsis offers a comparative perspective by interpreting and classifying the events and individual measures introduced in the individual countries. The aim is to develop policy recommendations that not only meet the long-term structural challenges faced by EU-member states, but also combat the immediate effects of the pandemic.

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