Why did Sweden change government?

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In recent years, the Swedish economy has come to be seen in many countries in Europe as a role model to follow. A common interpretation has been that it is an alternative to the Anglo-Saxon model, able to combine social protection with flexibility.
During the last decade, the average annual growth rate in GDP per capita in Sweden has been almost one percentage point higher than in the euro area. The employment rate exceeds that of all the eurozone countries. Inflation is low and public finances are stable with substantial government budget surpluses. A sustainable pension system is in place and product markets are more deregulated and open to competition than in most continental European countries.
Also short-term economic prospects appear bright in Sweden. There is a strong cyclical upswing with GDP growth this year likely to exceed four percent and a large increase in employment. Against this background, it may appear surprising that the social democrats, who have governed Sweden for 65 of the last 74 years, were just voted out of power. Instead, a new government has been formed by a liberal-conservative alliance of four parties.
The main reason for the change in government was voter dissatisfaction with the inability of the earlier government to create enough jobs. Swedes were used to very low unemployment as long as until the early 1990s. A deep recession then caused a drastic fall in employment. Although output growth has been high from 1995, there has been no return to earlier low unemployment rates. Open unemployment at the end of this year is likely to be around 7 per cent, measured in the same way as in other EU countries.
In general, the Swedish model has been much more successful in generating high measured employment rates than seeing to it that the employed actually work. The fraction of working-age population (20-64 years) actually working is 13 percentage points lower than the official employment rate (65 per cent versus 78). Important reasons are high rates of absence due to sickness, parental leave and study leave. It seems clear that a substantial fraction of those registered as sick represents concealed unemployment. This comes on top of large labour market programmes (around 3 per cent of the labour force).
The social democrats have traditionally been regarded as “guarantors” of jobs in Sweden. But they obviously failed to communicate this image to the electorate. The social democrats seem to have fallen in exactly the trap they themselves warned against in the early 1990s when unemployment started to increase in Sweden. A recurrent theme among social democrats then was the risk that society would become accustomed to high unemployment once it had been allowed to increase. This in fact happened to the social democratic election campaign, which sought consistently to downplay the jobs issue, which was the main election theme of the liberal-conservative parties.
Many outside observers have emphasised the small differences in programmes between the liberal-conservative parties and the social democrats. This is true with respect to the overall size of the welfare state. But it is not true for employment policies. Here, the social democratic election programme was very short of new ideas. In contrast, the new government has opted for substantial labour market reforms. Unemployment benefits will be cut for long-term unemployed and an earned income tax credit introduced. Payroll taxes will be reduced for young people in general and for all employees in parts of the private service sector. In addition, there will be large tax rebates for household-related services. Labour market programmes will be scaled

down and there will be more of general employment subsidies for those earlier out of work rather than subsidised jobs in the public sector. At the same time, tax deductions for union membership dues will be abolished and government subsidies to the unemployment insurance system – which is in effect administered by trade unions – reduced.

The employment programme of the liberal-conservative parties reads more or less like the standard recommendations of many economists. Normally, it should be almost impossible to win an election on such a programme in a business cycle upswing as in Sweden. Experience tells that significant labour market reforms are usually only politically feasible in deep downturns when deteriorating public finances put pressure on politicians to cut costs. The fact that the labour market reform programme appealed to voters testifies to the importance attached to job creation in Sweden. An important contributing factor was in all probability that the social democratic government was regarded as "tired" and void of new ideas after twelve years in office.

What are the chances for the new government to succeed with their labour market reforms? Quite good in my view. The best time economically to make such reforms is a situation with buoyant aggregate demand, as this will speed up the effects of supply-side measures. The employment effects will take much longer time to materialise if there is only low labour demand to match a larger effective supply of labour.

Compared with earlier liberal-conservative governments in Sweden, the current one has much better prospects. The liberal-conservative governments that took office in 1976 and 1991 had to deal with very deep economic crises (the oil crises of the 1970s and the financial and exchange-rate crisis of the early 1990s). This locked them into acute crisis management and never offered the opportunity to tackle basic structural issues. This time, the more favourable economic situation gives the liberal-conservative parties the chance to do this. Apart from jobs, these issues include school reform (raising the status of vocational education and reducing drop-out rates), more focus on quality rather than quantity in tertiary education, more private provision of government-financed services (such as health care), and privatisation of state enterprises.

What could go wrong for the new government? I see two main risks. One is that the next round of wage negotiations would produce high wage increases at the same time as there might be a sharp downturn in the world economy. Another risk is that the new government would not – like many other coalition governments – prove able to keep public finances under control. But I do not regard any of these scenarios as very likely.

However, liberal-conservative governments in Sweden have a history of taking office at the wrong time. This has made many voters associate them with bad times. It would certainly be good for democracy in Sweden to break this trend. And it would be very good for the country if the social democrats could use their time in opposition to embrace labour market reforms in much the same way as they did in the early 1990s with product market reforms.

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