The Long-Term Survey 2008

Main report

Summary of SOU 2008:105 by the Long-Term Survey 2008

Summary

The aim of the Long-Term Survey is to provide a basis for economic policy and initiate a debate about economic policy formulation. It should also provide an overall picture of economic developments in the long term. The Survey is prepared by officials at the Ministry of Finance and the political leadership of the Ministry has not taken a position on the contents. The Long-Term Survey 2008 consists of a main report and eight separate appendices.

The main conclusions in the Long-Term Survey 2008 are that in order to create good conditions for growth, economic policy should focus on the following:

- *Encouraging a longer working life.* Efforts should focus on making the educational system more effective and promoting a later exit age from the labour market, in addition to the work already being conducted to reduce exclusion.
- *Working for good adaptability in the economy and more competition*. The policy should take a broad approach to improve adaptability. Competition, not least international competition, should be fostered. This is particularly important in those parts of the service sector where competition is currently limited.
- *Exploring possible arrangements for more private financing of welfare services.* An increased demand for better quality in the welfare services cannot be met within the framework of the existing system. A broad-based inquiry should be appointed to submit proposals for a long-term, stable system for financing welfare services.
- *Working for an international climate policy based on cost-effective policy instruments*. Making use of the opportunities that exist within the framework of the Kyoto Protocol with its flexible mechanisms and working at the international level for an extension of the system.

Trends affecting growth

The central theme of the Long-Term Survey 2008 is the possibilities for promoting healthy growth and a good standard of living. There are a number of trends that can be expected to characterise growth over the next 15–20 years. In particular, the Survey thinks that *the changes in the composition of the population* with an ageing population, *changes in demand patterns* in the direction of greater service content and *continued internationalisation* will influence economic development and policy formulation in the years ahead. To differing extents, these trends have an impact on various parts of the report.

The Survey identifies a number of core areas on which policy should focus in order to better equip Sweden to meet the future. The following need to be achieved:

- A plentiful labour supply
- Strong productivity growth
- A good ability to adapt and change
- A cost-effective climate policy
- Stable welfare systems.

Long-term economic development

Economic development up to 2030 is described in a base scenario, which in principle is based on the continuation of the development patterns of recent decades. The aim of the estimates in the Long-Term Survey 2008 is not to try to forecast the development of the Swedish economy in the long term but rather to illustrate one possible path in a structured way. The base scenario serves as a starting point for analysing and discussing the effects of policy and external changes.

The basic factors for growth to take place are labour supply and productivity. The Survey's starting point for assessing labour supply development is Statistic Sweden's latest population forecast, according to which the number of people of working age increases weakly until 2030. In the base scenario, there is also a weak increase in the number of hours worked, due in part to the assumption that in principle, employment patterns do not change. At the same time the labour force becomes increasingly well educated, which means

an increase in the share of hours worked by people with a postsecondary education.

The scenario also assumes that productivity growth in the business sector continues to be strong even though it is somewhat lower than the average rate of growth between 1980 and 2005 and considerably lower than the relatively rapid growth since 1990. In addition, climate policy is assumed to be cost-effective.

The basis of the scenario is that tax rates are unchanged in relation to the respective tax base, which is sufficient to finance an unchanged standard in public sector activities.

The main results of the estimates are:

- Gross domestic product (GDP) grows an average of 2.2 per cent a year between 2005 and 2030. This is the same as the average rate of growth between 1980 and 2005.
- The structural change calculated in the base scenario, where the importance of the service sector in particular increases, has a dampening effect on total productivity growth in the business sector.
- Household private consumption expenditure grows more rapidly than GDP, at 3.1 per cent annually. Public consumption grows weakly during this period, at not quite 0.7 per cent a year.
- Public finances are sustainable in the long term under the base scenario. One prerequisite for this to be realised is that the estimate's assumption of unchanged coverage and quality in public sector activities is fulfilled.

Higher labour supply

Favourable developments in the labour supply create the conditions for economic growth. Development of the labour supply is also key for financing the public welfare systems. In the Survey, the discussion on the number of hours worked in the economy centres on how labour market entry and exit ages have developed and how they can be influenced. Relatively small changes in the entry age and the exit age would have a substantial impact on the labour supply.

Labour market entry today takes place late. This is largely due to more people getting a longer education, but it is also due to the

long time it takes to go through the education system and to more young people's postponement of their university studies.

The Survey draws the following conclusions on the level of education among young people and how student throughput in the education system can be improved:

- There are two divergent trends in young people's level of education. The percentage of young people with a higher education is growing but at the same time the percentage of young people with less than an upper secondary education is persistently high. More than a quarter of the nation's twenty year olds have not completed upper secondary school and just over a third lack basic entrance requirements for university studies.
- Information needs to be improved on such matters as average income and risk of unemployment after various education alternatives so that people choosing an education can make a well considered decision.
- Greater economic incentives for more rapid throughput to getting a degree or diploma should be considered, for example, via fees for university studies and premiums in the study support system. Currently just over a half of Swedish university entrants get their degree within seven years.

The number of hours worked in the economy can also increase by a later exit age from working life. Even though the exit age from the labour market has risen somewhat in recent years, average life expectancy has increased more than working life has, i.e. retirement time has increased. The new pension system may have a positive effect on the labour supply but it also includes an option to retire earlier if desired. The old-age pension system, at least for large groups, rewards staying in the labour force. However, the system gives certain groups weaker economic incentives to keep on working when they are older. This is the case for people with high incomes, as incomes over 7.5 base amounts do not give public pension rights even though pension contributions are deducted. This is also the case for people with low incomes as the guarantee pension, often combined with the housing supplement for pensioners, does not create incentives to continue working.

The average exit age is still under 65 years and exit generally takes place via benefit systems other than the state old-age pension. It takes place foremost via supplementary pension schemes and via sickness and activity compensation.

The chapter in which this is discussed concludes that there is no simple solution for bringing about a later exit age. Some conclusions are:

- The starting time for taking the old age pension varies increasingly. More people are taking the state old age pension later, but there are also more who are taking it earlier. It may be a sign that the norm of a pension at age 65 is beginning to loosen.
- A later exit age would require tightening the different available exit options for leaving working life.
- Consideration needs to be given to how the age limits in the old age pension system can be tailored to the change in life expectancy. This also applies to private and collective pension savings, which often have a substantially lower age limit for retirement than the state old age pension system.

Strong productivity growth:

There has been strong productivity growth in the Swedish business sector since the beginning of the 1990s, which an international comparison also shows. The recent slowdown in productivity does not affect this assessment. The increase in total factor productivity explains a substantial part of the productivity growth in the economy during this period. Total factor productivity can be described as the contribution from technological developments in a broad sense. The contribution of total factor productivity from telecommunications products in particular has been substantial in the latter part of the 1990s.

It is difficult to estimate precisely how much a particular factor affects productivity development. Structural changes – greater macroeconomic stability, training programmes, deregulation and developments in information technology – are important general factors that may help explain the strong productivity growth in recent decades.

Productivity differs considerably from sector to sector. The increased demand for services has led to a shift in employment to the service sector, a sector that has historically had a lower productivity growth than manufacturing. The service sector's growing role as an input factor in manufacturing is the main explanation for the growth of the service sector, although demand by the end-user has also increased somewhat. With a growing service sector, productivity development in the sector is clearly of increasing importance to the whole economy.

Competition, not least international competition, in the service sector is currently limited to a considerable extent by regulatory regimes in Sweden and other countries. To some extent, the low level of competition can be attributed to the nature of services; for example, some services have to be consumed in connection with production. But technological developments also make it possible to purchase a greater percentage of the production of services internationally.

In the chapter on productivity developments we come to the following conclusions:

- The impact of the increased service input in production on productivity developments in the economy as a whole is not obvious. A greater use of services in a sector may lead to productivity improvements.
- Measures promoting competition in the economy are urgent since they can contribute to better productivity development. Such measures are particularly urgent in the service sector, where competition is limited compared with competition in the production of goods.
- A policy aimed at promoting strong productivity growth must take a broad approach and have a general orientation. The policy should focus on creating good and equal conditions for enterprise and entrepreneurs in all sectors. This is important since productivity developments are decided by a number of different factors, which in addition, often interact.

Transformation and adaptability of the economy

From a long-term perspective, there has been a substantial transformation of the Swedish economy. As the internationalisa-

tion of the economy has spread, it is often asserted that the pace of change in the economy has increased. The concept of change has no clear-cut definition and it is relevant to study changes both *between* sectors and *within* sectors. There are therefore a number of different measures of change.

Both companies and workers must constantly adapt to new conditions. Workers adapt to change primarily by changing occupation or employer, while geographic mobility is less common. To increase individual adaptability, both geographic and occupational mobility need to increase.

The effects of change on the Swedish economy are difficult to foresee. The adjustment of production in recent decades has not meant a change in Sweden's areas of specialisation. Likewise in the future Sweden will still have the natural resources and the relatively well educated labour force on which current comparative advantages are based. But technological development now makes it more possible to separate stages in the production process and thus increases the possibilities of moving more parts of the production to other countries.

The chapter's main conclusions are that:

- The pace of change has no clear-cut definition and thus change can be measured in various ways. There are many indications that the pace of structural change has been higher, but has not been increasing, in the 1990s and 2000s compared with the 1980s.
- A well-functioning policy for improving adaptability in the economy must take a broad approach and include several policy areas: the labour market, housing, research, infrastructure, taxes, education, etc. There is no simple individual measure that improves adaptability in the economy.
- The policy neither can nor should aim at preventing job opportunities from disappearing but rather at creating conditions for new job opportunities.

Energy, climate and economic growth

A well-functioning energy supply is essential for the economy. According to estimates, total energy use is expected to increase sharply, both in Sweden and in other countries. There is a clear

connection between energy use and economic growth that has not changed appreciably in the last few decades. Energy intensity, i.e. energy use in relation to GDP, does indeed decline continuously, but any reversal of the trend in the form of a more rapid reduction has not been established.

Energy use in the form of burning fossil fuels gives rise to carbon dioxide and other emissions that are probably a strong contributing factor to climate change. The Survey looks at the connection between carbon dioxide emissions and economic growth. In the 1970s and 1980s, emissions of carbon dioxide in relation to GDP (carbon dioxide intensity) declined more rapidly in Sweden than in the rest of the world. This was due to a change in the composition of energy rather than to more efficient use of energy. Since 1990, carbon dioxide intensity has declined at approximately the same pace in Sweden as in OECD countries in general. The reduction has been largely the result of ongoing structural change in the economy.

In order to achieve national commitments on emission limitations in the most cost-effective manner possible, flexible mechanisms have been established under the Kyoto Protocol. When countries have the opportunity to participate in emissions trading or implement measures to reduce emissions in joint projects with other countries, emission reductions can be accomplished at a lower cost. The Survey's base scenario assumes that this policy will extend over an increasingly large part of the economy between now and 2030. If Sweden chooses to make full use of international emissions trading possibilities, the cost of reducing emissions affecting the environment to a level equivalent to about 70 per cent of 2005 emissions by 2030 would be relatively limited. In an alternative scenario, the Survey calculates the costs of a climate policy that instead focuses solely on national emissions, and limits the possibility of using flexible mechanisms. This policy results in substantially higher costs to achieve the same climate goals.

It is the Survey's opinion that climate policy should take the following into consideration:

- The climate policy should focus on international and flexible solutions. Poorly designed policy instruments result in substantial additional costs to achieve a given effect on the climate. This may in turn limit the possibilities of achieving the

target of an increase in global mean temperature of no more than two degrees.

- The relatively strong correlation between energy use and economic growth indicates that there are greater risks associated with a policy focusing on energy use instead of on the fundamental problem. Given that it is lower greenhouse gas emissions that are to be achieved, policy instruments should first concentrate on this very problem.
- By effectively limiting global emissions, funds can be freed up for other purposes such as research and development, other environmental problems and welfare initiatives.

Welfare systems renewal

The Survey analyses the requirements for financing the welfare systems based on the long-term scenarios for economic development. The proportion of elderly in the population will increase in the years ahead. Even if the elderly gradually enjoy better health, the greater proportion of elderly can be expected to lead to an increase in the need for health care and social services.

Public sector consumption growth is based on the assumptions that the quality of the welfare services, i.e. health care, social services and education, and tax rates remain unchanged. That being so, there is no scope for developing welfare services beyond today's level. An unchanged standard in public sector services will scarcely meet the public's expectations when the overall standard of living increases. The increase in the cost of welfare services has historically been greater than that warranted by population growth and composition.

It is also characteristic of welfare services that the cost of many of these often labour intensive activities can be expected to rise more than the cost of other goods and services. Technological developments in health care are also more likely to increase total costs than to yield lower costs as a result of higher productivity. As new treatments become available, demand for them will increase. Since the provision of welfare services is heavily subsidised, the price does not keep demand for these services in check.

The Survey presents the following message on the possibilities available for developing welfare services in the future:

- The problem of generations of varying size can be handled by the surplus in general government finances. But in the longer term, the welfare systems need to be reformed. The reasons are that life expectancy is increasing and the demand for welfare services rises when the standard of living increases.
- More private financing makes it possible to develop welfare services beyond the current level. A cross-party inquiry should be appointed with the remit to examine how greater private financing can be designed at the same time that the welfare systems contribute to security for everyone in society. Postponing measures in this area may end in undermining confidence in the public welfare systems and their legitimacy.
- A more precise formulation of what society and the individual should be responsible for in the area of welfare services makes it possible for market solutions to emerge under orderly conditions.

A policy for the future

The three trends –changes in the composition of the population, changes in demand patterns and continued internationalisation – affect future development in different respects. Changed conditions make it necessary to adjust the policy in order to make better use of new possibilities that arise and to meet new challenges.

The Long-Term Survey 2008 has found that it is particularly important to encourage a longer working life, work for good adaptability and for more competition in the economy, investigate forms for more private financing of welfare services and work for a global climate policy based on effective policy instruments.