

ARTICLE – Long-term effects of the pandemic on the Swedish economy

In a short time, the pandemic has led to a large economic crisis, but the longer-term effects of the pandemic on the economy, and their magnitude, are difficult to assess. The consequences depend on how long the pandemic continues, on the economic policy response and on how large and how permanent the changes in the behaviour of households and companies will be. There has been some recovery in the economy and on the labour market, but developments are still uncertain. In addition, all previous economic crises have led to persistent effects on economic growth potential and employment. This article describes a number of mechanisms through which the pandemic may have persistent effects on the labour market, productivity and inflation in Sweden.

Effects on the labour market

More long-term unemployed persons will reduce the employment level in the long term

Experience shows that deep or prolonged economic crises can reduce the long-term sustainable level of employment and increase long-term unemployment.¹ This is partly because deep crises can change the way the labour market functions and because long periods of high unemployment can lead to what are known as hysteresis effects. In other words, unemployment may remain at a higher level for a long time after the crisis. This is because long periods of unemployment can reduce the know-how and skills of unemployed persons and make it more difficult for them to find new jobs even when demand for labour rises again. Long-term unemployed persons also lose important contacts in working life, making it more difficult for them to find a job. Long-term unemployment rose significantly in 2020.

What might indicate less serious hysteresis effects in this crisis than in others is that the hardest-hit service sectors (retail, hotels and restaurants) are relatively dynamic, have substantial staff turnover and have relatively low educational and job-specific requirements. It may therefore be easier to re-employ people in these sectors, which could accelerate post-pandemic recovery. But it would also require labour demand in

¹ The long-term levels of employment and unemployment are the levels deemed to be achievable under the prevailing institutional conditions without the rest of the economy becoming unbalanced. These levels can vary over time.

these sectors to return to previous levels, which is uncertain as the changes in consumption patterns that have occurred during the pandemic may be long-lasting. The extensive support measures are reducing the hysteresis effects but, in a major crisis, it is usually difficult to avoid them completely, regardless of the policy measures implemented.²

Labour force participation also tends to decrease in deep recessions, but at least so far in the pandemic, it has remained on a high level. This is positive as it enables higher employment in the longer term.

The pandemic makes it more difficult to enter the labour market

Employment has decreased and unemployment has risen mostly among young people and foreign-born persons during the pandemic (see figure 1). This is because the hard-hit sectors employ many in these groups and because those with time-limited employment or who have been employed for a short time lose their jobs first in a crisis. At the same time, short-time work compensation schemes have helped many of those who are more established on the labour market to keep their jobs, which can be seen in the low unemployment rate among foreign-born persons aged 25–54 years.

The risk is that it will take longer for foreign-born persons to establish themselves on the labour market as it is more difficult to participate in, for example, language courses and labour market policy measures. Higher sickness absence and distance learning at schools and universities may have negative effects on education and on young people's future prospects.³ Young people are more flexible, however, and fare better in the longer run than older people who lose their jobs as it is easier for young people to retrain. Entering the labour market during a recession has long-term negative effects on an individual's employment and income.⁴ The effects may now be even more substantial as sectors with a large number of entry-level jobs have been hit the hardest. However, the effects will wear off after a while.

But the structural problems on the labour market that manifest themselves in terms of many low-educated and foreign-born persons having difficulty finding jobs, will remain after the pandemic and there is a risk of them being reinforced. There are few jobs on the Swedish labour market for people with no upper secondary education or knowledge of Swedish. It may become even more difficult for low-educated foreign-born persons to gain a firm foothold in the labour market as competition for jobs will become tougher when unemployment is higher.

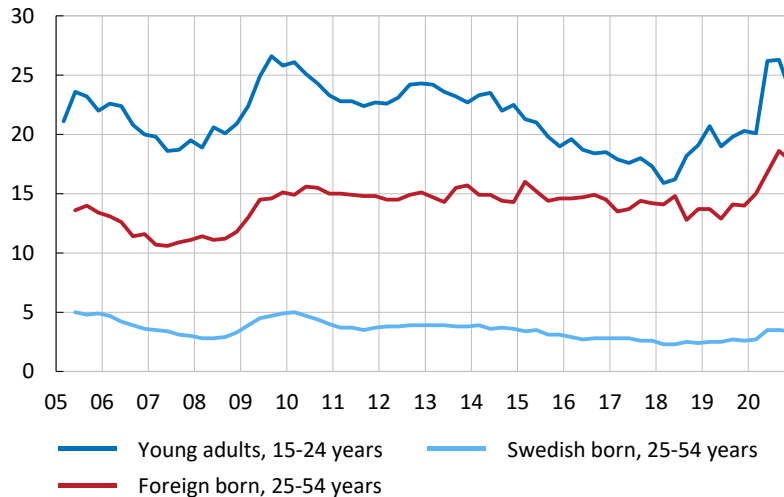
² See also I. Häkkinen Skans, "The coronavirus crisis and the labour market - effects in the short and long term", Economic Commentary no. 1, Sveriges Riksbank, 2021 and the article "The long-term effects of the pandemic on output and employment", Sveriges Riksbank, Monetary Policy Report, July 2020.

³ See, for example, A. Sjögren (ed.), Children and youth during the Corona pandemic: Lessons from research on childhood environment, schooling, education and labour market", Institute for Evaluation of Labour Market and Education Policy (IFAU) Report 2021:2.

⁴ See, for example, M. Engdahl, M. Godard and O. Nordström Skans, "Early Labor Market Prospects and Family Formation", IZA Discussion Paper 12092, 2019, D. Müller, "Lost Opportunities: Market Work during High School, Establishment Closures and the Impact on Career Prospects", in Social Networks and the School-to-Work Transition, Economic Studies 189, Uppsala University, 2020 and O. Åslund and D.-O. Rooth, "Do when and where matter? Initial labour market conditions and immigrant earnings", The Economic Journal, 117, pp 422-448, 2007.

Figure 1. Unemployment among young people, foreign-born persons and Swedish-born persons

Per cent of the labour force, seasonally adjusted data



Source: Statistics Sweden.

Faster pace of structural transformation means higher unemployment but also higher productivity

Structural transformation is normally faster during economic crises. Although this is positive for productivity and prosperity in the long term, it also causes higher unemployment for a period. Earlier crises show that this period can be long as it takes time for the labour market to adapt. The magnitude of the effect of the pandemic on structural transformation is difficult to assess and depends in part on how permanent the changes in the behaviour of households and companies will be.⁵ Demand in many sectors has recovered somewhat from the sharp fall in the spring of 2020. For example, manufacturing companies reported some recovery and an increase in new orders and production in the autumn.⁶

Services that presuppose physical proximity, gather many people together or are linked to travel have been hit hardest in the COVID crisis. Demand for many such services, for example, restaurant, hairdressing and culture services, will probably largely recover as many people are interested in and want to consume such services, but have refrained from them due to the risk of infection and the restrictions. Sectors in which structural transformation was already underway prior to the crisis will probably not recover as well. An example of this is physical retail outlets, which are being replaced by growing e-Commerce. There are also sectors where it is more difficult to predict whether behavioural changes will be permanent or not. For example, the travel sector may be affected more lastingly if digital meetings replace much of business travel.

⁵ See I. Häkkinen Skans, "The coronavirus crisis and the labour market – effects in the short and long term", Economic Commentary no. 1, Sveriges Riksbank, 2021 and the article "The long-term economic effects of the pandemic are uncertain", Sveriges Riksbank, Monetary Policy Report, November 2020.

⁶ See The Riksbank's Business Survey, December 2020, Sveriges Riksbank.

The effects of the pandemic on the labour market will be long-lasting

The assessment of the Riksbank is that the pandemic will have long-lasting negative effects on the labour market. Unemployment is expected to rise and employment and the number of hours worked are expected to fall. However, the effects will not be permanent but will wear off after a while. The magnitude of the effects is difficult to judge in the current situation as it depends on how long the pandemic goes on, how much unemployment rises during the pandemic, what measures are implemented to mitigate the effects on the labour market and the way the support measures are phased out. Reforms that promote a more inclusive labour market, greater mobility and possibilities for education and workplace training could counteract high unemployment in the long term.

Effects on production and productivity growth

During the coronavirus pandemic, some companies have experienced disruptions in global supply and production chains, which may lead to “re-shoring”, that is companies reorganising their value chains so that some production is moved from abroad to Sweden or more adjacent countries.⁷ Productivity growth is expected to be affected negatively in such a scenario, as companies will no longer be able to take full advantage of the specialisation of work tasks in global value chains. The negative effects on productivity growth of re-shoring may to a certain extent be countered by increased digitalisation making it easier to disseminate knowledge and new technology globally even though production takes place more locally. More local production also makes labour more expensive, but this may lead to companies investing more in labour-saving technology in the longer term, which will cause productivity growth to increase again.

In a short time, the pandemic has forced companies to come up with more efficient solutions, such as more flexible workplaces and new digital tools, which can increase productivity growth. Increased digitalisation of the retail sector is another example of how the pandemic can reinforce a structural transformation that is already underway. Faster structural transformation usually leads to higher productivity growth.

But it is normal for deep economic crises to lead to reduced risk appetite and reduced investment and thus have long-term negative effects on productivity growth. Although investment has not yet decreased as much as feared, it is too early to say whether the pandemic is affecting the long-term investment of companies. In addition, prolonged high unemployment leads to the labour force becoming less productive. Furthermore, the increased sickness absence in schools may harm the abilities and skills of students, which will also have negative effects on the productivity of the labour force in the long term.

Greater digitalisation and faster structural transformation as a result of the pandemic will increase long-term productivity growth. At the same time, however, reduced globalisation, reduced investment and long-term high unemployment tend to reduce

⁷ See The Riksbank's Business Survey, May 2020, Sveriges Riksbank.

productivity growth. In the Riksbank's view, therefore, it is not currently possible to assess whether total long-term productivity growth will be higher or lower as a result of the pandemic.

Effects on inflation

The pandemic has contributed to low inflation in 2020 but its effects on inflation in the slightly longer term are difficult to assess.⁸ High unemployment and low resource utilisation cause companies' costs to increase more slowly and dampen price growth. This would suggest that inflation will be low over the next few years. The key question is to what extent this will spill over to potential productivity or to long-term inflation expectations. In the very long term, however, the weak development in the real economy, which is nevertheless assessed as temporary, should not affect inflation and the Riksbank's ability to uphold the inflation target.

There is also a risk that the pandemic will lead to higher inflation in the longer run. Concerns over the potential of the powerful monetary and fiscal policy measures the world over to cause higher inflation due to the increase in liquidity and indebtedness have been highlighted in the debate. There are several examples of such sequences in history. Re-shoring can also cause inflation to rise as a result of increased production costs and subdued productivity. Finally, lower growth in the labour force, due to an ageing population, could lead to poorer public finances and higher inflation, a development possibly hastened by the pandemic.⁹

The Riksbank's overall assessment is that the weak demand and low resource utilisation in Sweden and abroad indicate dampened inflationary pressures in the years to come. But there are also of factors that may lead to higher price growth in the longer term.

Appropriately designed economic policy measures can support the recovery

The comprehensive economic policy measures introduced during the pandemic have mitigated the negative effects on the economy. How such crisis measures are designed is important since it will often lead to lower costs in the long run if they manage to help companies survive the crisis and keep unemployment down.

Appropriately designed economic policy measures can also support the economic recovery. The monetary policy measures are keeping interest rates low for households and companies and thereby support general economic development. Expansionary monetary policy also contributes to higher employment and lower unemployment. A

⁸ See, for instance, the article "Inflation outlook during the corona crisis", Sveriges Riksbank, Monetary Policy Report, July 2020.

⁹ See the discussion in C. Goodhart and M. Pradhan, "The great economic reversal: Ageing societies, waning inequality and an inflation revival", Palgrave Macmillan, 2020. This book's main message is that the previously highly favourable demographic conditions, particularly in China, and rising degree of globalisation are in the process of changing. In this case, the labour force's opportunities to negotiate conditions will improve, leading to higher wage growth, higher inflation and greater equality.

combination of expansionary fiscal policy that stimulates investment and structural reforms, in part to improve the job-finding rate for low-educated and foreign-born persons, could lead to higher employment, higher productivity and higher growth in the longer run.