

Sweden

Weak Government Likely to Present a Budget without Major Reforms

- Economic Forecast
- Fiscal Policy
- Politics

- The general election ended without a majority for either side. But with the Social Democrats (SDP) gaining the most votes, the party is now trying to form a minority government with the Green Party. However, as the SDP-Greens only will have 137 seats in parliament (out of 349 in total, of which the four Alliance parties hold 142), the minority government in many cases will have to rely on support from the (ex-communist) Left Party (gained 19 seats). However, even with support from the Left Party, the government will still lack an absolute majority, and will, hence, have to seek support from some of the smaller Alliance parties.
- The first critical point for the government will be to get approval in parliament for its 2015 budget. To limit the extent of potential defeats, we reckon the SDP-Green government will be careful about submitting proposals that the opposition parties dislike. Therefore, we believe the 2015 budget only will include a slim version of the tax hikes discussed by the red-green parties in the run-up to the elections. For example, we expect the controversial reforms of higher pay-roll taxes for young people, higher VAT on restaurant services and large tax hikes on fuel to be left out. We note that by excluding these measures, this could be viewed as an invitation for future cooperation with other parties. Increased revenues will likely be used to raise unemployment benefits and spending on health care and education, in-line with the proposals from the two Alliance parties, the Center Party and the Liberals.
- Although, Social Democratic leader, Stefan Löfven, will need to take the strong leftist indications in the election outcome into account, we still reckon that more formal cross-block cooperation with one or two of the small Alliance parties could happen over time; the Social Democrats are in many ways a closer related politically to the Alliance parties than to the Green and Left parties. Moreover, we reckon the alliance parties should have an interest in trying to steer policymaking towards the middle of the policy spectrum. Such cooperation will probably also become easier once new Alliance party leaders have been appointed.

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Budget without Major Reforms

The general election ended without a majority for either side. But with the Social Democrats (SDP) gaining the most votes, the party is now trying to form a minority government with the Green Party. However, as the SDP-Greens only will have 137 seats in parliament (out of 349 in total, of which the four Alliance parties hold 142), the minority government in many cases will have to rely on support from the (ex-communist) Left Party (gained 19 seats). However, even with support from the Left Party, the government will still lack an absolute majority, and will, hence, have to seek support from some of the smaller Alliance parties. In turn, the government will likely find adoption of aggressive left-wing policies very difficult and economic policy is likely to be characterised by compromises during coming years. In other words, economic and other policies in Sweden are unlikely to change dramatically ahead, in our view.

Formation of government

Social Democratic leader Stefan Löfven and the Green Party have started talks on how to form a new coalition government. Mr Löfven and Green Party's spokespersons Åsa Romson and Gustav Fridolin will focus on drawing up their joint political agenda for the next four years of the government and discuss the allocation of ministers' portfolios. As the Green Party has never formed part of a government in its 33 year history (was formed 20 September 1981), it is eager to take power, in our view. Mr. Löfven has, meanwhile, concluded that the Left party must be kept outside the government since the parliamentary support for the leftwing parties is not sufficient to gain a majority in the parliament. Furthermore, we believe, the Left Party's hard line on privatisation complicates the inclusion of the party in the government. The Left Party has also indicated that it is happy to stay outside a government in exchange for other opportunities to get influence on government policy. Mr. Löfven must report back to the Speaker of Parliament by noon on Friday 26th September on the result of the talks and a new government must be formed by 13th October.

The Moderate Party has accepted its defeat; Prime Minister and party leader Fredrik Reinfeldt, Finance Minister Anders Borg and Financial Markets Minister Peter Norman have all resigned, stating that they are leaving politics. Earlier this week, the Moderate Party's executive committee announced that the party will hold an extraordinary conference on 7 March 2015, at which time a new party leader will be appointed. In the meantime, we reckon the Party will be pre-occupied in finding a successor for Mr. Reinfeldt and adopting a new strategy.¹ There has also been speculation that some of the other Alliance parties may be changing their leaders given poor election results. Thus, we believe the Alliance probably is not interested in assuming government responsibilities at present.

The nationalist Sweden Democrats, who gained a king-maker role at the general election, are also unlikely to want to jeopardize this position by creating a political turbulence and a potential re-election, in our view.

In sum, we believe the SDP and Green party will succeed in forming a minority government, as failure to do so is against everyone's interest, at least in the near-term.

¹ A post-election commission has been set up with the task of analysing why the Moderates lost almost 7pp, most of them to the Sweden Democrats, compared to the 2010 election. The commission will present its conclusions in the near future, according to party secretary Kent Persson.

Budget process

The first critical point will be the new budget for 2015. After being appointed the Prime Minister, Mr. Löfven (the PM candidate) will have two months to submit a budget bill (15th November being the deadline). With a likely weak governing constellation, the SDP-Green government will have to gain an advance backing from the Left Party for its budget. Under the Swedish system, each party can present its own budget proposition. The Alliance has said it will present a joint budget. Since the Sweden Democrats hold the balance of power between the two blocks with its 13% voter support, the party may choose to vote for the Alliance's budget (has voted with the Alliance in up to 80% of votes).² Meanwhile, there are reasons to believe that this will not happen this time. In our view, the SD has no sway over the right-wing coalition budget, which is expected to include measures that are in direct contrast to key issues for the party (such as large increases in spending on asylum). However, in an unlikely event that an Alliance budget does gain SD's support, it would likely defeat Mr. Löfven's budget, potentially leading to a collapse of the government, in our view.

Opposition could well block single budget items ahead. We believe, a more likely scenario, especially in the medium term is the legal possibility that the parliament may strip out individual proposals from a budget bill already passed and by doing so it strengthens the overall budget balance. The SDP made use of this possibility when it blocked a proposed tax cut for high income earners in outgoing Prime Minister Reinfeldt's latest budget (it was the first time that this had been done). As both the Sweden Democrats and the Alliance parties agree on many issues regarding the economy, this will possibly be a constant threat to the potentially costly SDP-Green reforms, in our view. The Moderate party has also indicated that it will not hesitate to block parts of the SDP-Green budget. To limit the extent of such potential defeats, we reckon the government will likely be careful about submitting proposals that the opposition parties may dislike.

A watered-down first budget. Hence, in our view, in order to get its first budget approved, the government is unlikely to include controversial reforms such as higher pay-roll taxes for young people, higher VAT on restaurant services or large tax hikes on fuel. In other words, it will only include a small share of the tax hikes discussed by the Red-Green parties in the run-up to the election. We note that by excluding these measures, this could be viewed as an invitation for future cooperation with other parties. Increased revenues will likely be used to raise unemployment benefits and spending on health care and education, in-line with proposals from the two Alliance parties, the Center Party and the Liberals.

Cross-block cooperation a possibility over time: Although, Social Democratic leader, Stefan Löfven, will need to take the strong leftist indications in the election outcome into account, we still reckon that more formal cross-block cooperation with one or two of the small Alliance parties could happen over time (historically, the Social Democratic Party has cooperated with both the Center Party and the Liberals); the Social Democrats are in many ways a closer related politically to the Alliance parties than to the Green and Left parties. Moreover, we reckon the alliance parties should have an interest in trying to steer policymaking towards the middle of the policy spectrum. Such cooperation will probably also become easier once new Alliance party leaders have been appointed.

² According to the Swedish daily, *The Local*.

Conclusion

We reckon economic policy is likely to be characterised by compromises during the coming years, and it will probably be difficult for the SDP-Green government to implement any major structural reforms. A re-election cannot be ruled out, but we perceive it as unlikely in the near term. Historically, early elections are extremely rare in Sweden (the last time it happened was in 1958 after the defeat of the SocDem government's proposals for a new pension system in a parliamentary vote) – and government crisis in the past have tended to be resolved by a reshuffling within the government.

Appendix A-1

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