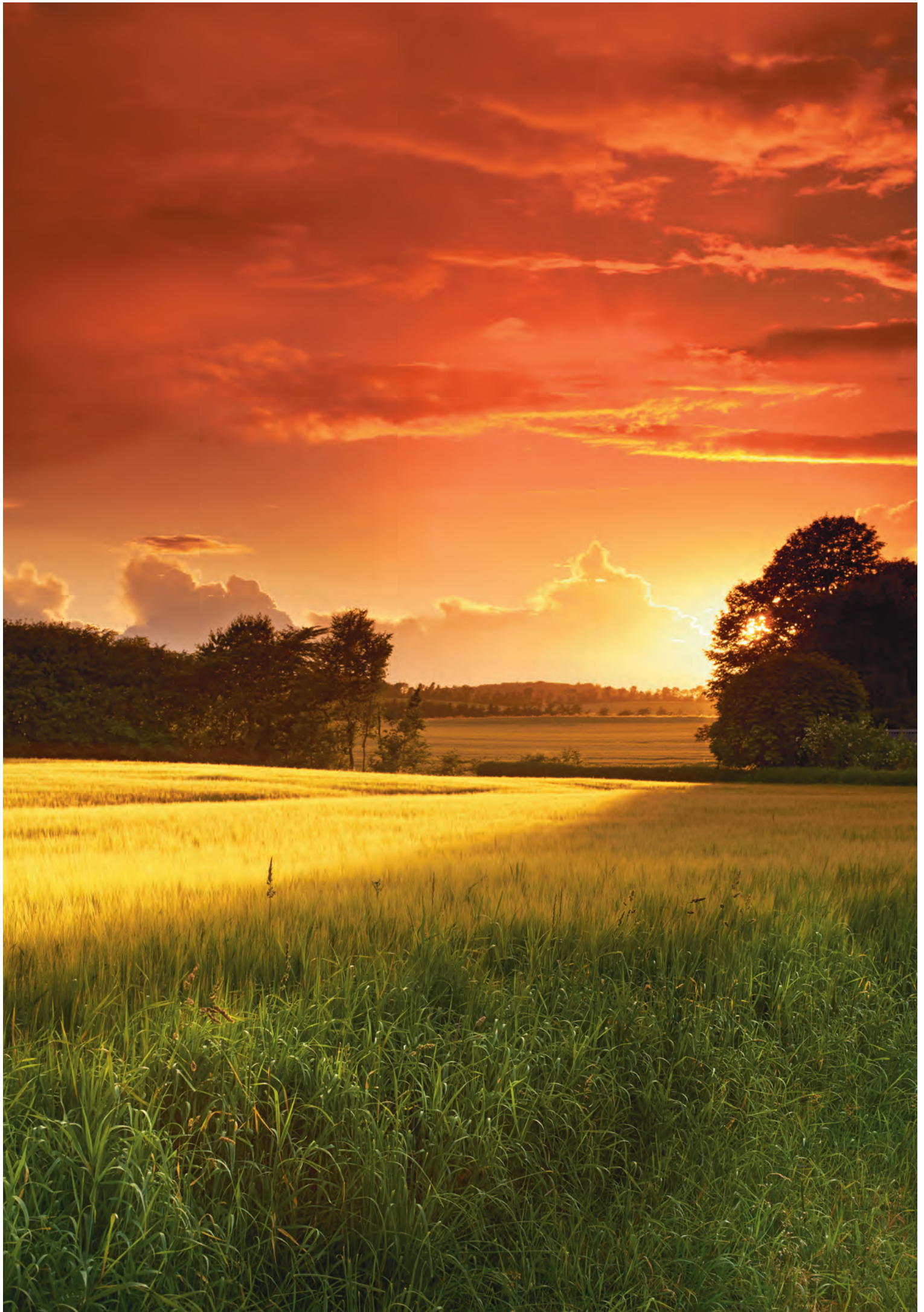




## **Small Great Nation**

Life with corona - new opportunities for the climate and the economy?

October 2020



# Preface

In the Small Great Nation project, Kraka and Deloitte collaborate on analysing long-term development perspectives of Danish society. The initiative is independent of political ideologies and of political and financial interests. The initiative uses both existing research-based knowledge and provides new independent analyses that result in evidence-based suggestions for solutions on how to create a better Denmark. This is the seventh report under the Small Great Nation project. This time, we are taking a look at life with coronavirus, and what challenges and opportunities this holds for the climate and the economy.

## A major bump, but not an economic disaster

When coronavirus hit Denmark in the spring, it was soon clear what the economic implications would be. Kraka and Deloitte were among the first to recognise the need for massive business aid. And even though GDP took an unprecedented dive in the first half of 2020, the government aid packages and the fiscal policy pursued so far, have averted an economic disaster.

## Light at the end of the tunnel

Regrettably, people have fallen ill and died because of coronavirus in Denmark. Yet compared to other countries, the health consequences have been limited. Even though the economic costs have been huge, many things are already now indicating that the Danish economy is recovering, that is to say, *if* the coronavirus disease can be contained.

## Fiscal policy is now the primary instrument

But the uncertainties are unprecedented, and at the time of writing a second wave of coronavirus may be on its way. Even if the coronavirus is kept down nationally and globally, the Danish economy has obviously gone from a boomlet to a major, yet hopefully short, economic downturn. Very prudently, the economic instruments used during the lockdown were direct aid to protect companies. Today, where fairly few industries are hit by restrictions, the primary instrument is fiscal stimulus. But we need to be able to respond quickly, for instance by resuming direct business aid, if the coronavirus breaks out again in Denmark.

## Green tax reform

On top of that, our national politicians are this autumn negotiating a climate action plan including a green tax reform to ensure the realisation of Denmark's ambitious climate targets. These targets have been overshadowed by the coronavirus crisis, but they will be key to the Danish economy long after the crisis has been successfully contained. Short-term fiscal policy and long-term green transition do match. But only if the fiscal stimulant has a rapid effect, and the green initiatives are to be implemented anyway as part of the green transition. Here, carbon taxes should be the mainstay from now and until fossil freedom has been achieved.

## New opportunities may emerge

Huge challenges and changes may also create opportunities: For instance, have Danish companies discovered the potential of homeworking, and, if so, might this change where in the country Danes want to live? Will the coronavirus pandemic speed up digitalisation? Can the Danish society reduce the spreading of other diseases by changing social conventions?

How Denmark is dealing with coronavirus and the green transition is the topic of this report. Happy reading!

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# 1. Executive Summary<sup>1</sup>

Things were promising at the beginning of 2020, ...

During a few weeks in the spring of 2020, the economic policy agenda was changed. The Danish economy was in fine shape before a large number of economic activities were locked down. Denmark was on or perhaps slightly above the peak of the first boom since the financial crisis, and although a certain setback was in the horizon, there was no reason to expect the setback to be abrupt.

... but coronavirus changed that

However, the Danish economy experienced a historically abrupt setback in the spring of 2020, when coronavirus led to the lockdown of various economic activities, and general uncertainty led to a significant restraint in consumption. The Danish economy was thrown into completely unknown territory. In a normal economic downturn, expansionary fiscal policies should be used to stimulate demand in order to boost the economy. But the start of the coronavirus crisis was far from a normal economic downturn.

Business aid was necessary

A large number of well-run companies, which could easily cope with a normal economic downturn, were either forced to close or suffered a massive loss of revenue due to the coronavirus restrictions. In this situation, direct business aid was needed. Kraka and Deloitte recommended a general aid model based on VAT reports and recommended that DKK 300bn be allocated to such aid. However, the Danish Parliament chose other, similar instruments and managed to protect many companies.

Now it is time for other fiscal instruments

At the time of writing, coronavirus seems to be under control in Denmark, but with considerable uncertainty about its course over the coming months. Currently, however, the vast majority of economic activities are open. Direct aid may continue to be needed for companies affected by restrictions, such as organisers of concerts and events, bars, nightclubs and restaurants, as well as airlines and travel agencies. However, in general, direct aid for the business sector should be phased out and replaced by more traditional expansionary fiscal policies.

Sound public finances

Fortunately, the Danish economy is fundamentally sound. According to the Ministry of Finance's projections, the government deficit will be on the edge of current restrictions and rules from 2025 and 30 years ahead, but in the long run, government finances are more than solid. This, however, is under the crucial assumption that the indexation of the retirement age under the welfare reform agreed upon is maintained even after 2040. On this basis, public finances are "over-sustainable", and crisis management does not change that. The sustainability of public finances is only burdened by the interest on the extraordinary government expenditure for crisis management, and the government can today borrow at a very low rate of interest. So, unless the coronavirus brings the economy to a prolonged halt, there is no reason to fear that neither the financing of the welfare state nor the standard of living of the Danes will be affected. It is therefore legitimate to consider whether, in the years of structural deficits, we should relax the requirements of the Budget Law. However, such a strategy involves risks: The calculations are uncertain and continued political support for the life expectancy indexation of the retirement age may be faltering. Therefore, the over-sustainability cannot be taken for granted.

The government expects a rapid recovery

The government expects the autumn of 2020 to see a considerable pick-up, and by 2021 the economy is expected to be back at the 2019 level. This would be a historically rapid recovery – in comparison, it took seven years after the financial crisis before the economy was back at the pre-crisis level. In the period up to the financial crisis, fiscal policy was far too expansionary, bank

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<sup>1</sup> This document serves as a summary in English of the full report titled "Livet med corona – nye muligheder for klimaet og økonomien?". The full report (Danish only) is available at [www.sgnation.dk](http://www.sgnation.dk).

lending was lax, and financial regulation was inadequate. This meant that significant economic structures had to be changed. Today there is not the same kind of "disease" in the economic structures. If the fiscal policy – as seems probable – becomes sufficiently expansive, and *if* the coronavirus is kept down, a rapid recovery is likely.

**The uncertainties are considerable**

But the uncertainties are considerable: At the time of writing, coronavirus is flaring up again in several EU countries, and the Danish Ministry of Foreign Affairs is therefore again advising Danes to restrict their travelling. This creates a risk for Danish exporters. Coronavirus is also flaring up again in most of Denmark, and new restrictions have been introduced. It is quite uncertain whether the current flare-ups will remain manageable or whether more extensive restrictions are necessary. This will result in further economic and fiscal losses and an even stronger fiscal stimulant will be necessary.

**Fiscal policies must stimulate activity and be timed correctly**

Even if the government's relatively optimistic forecast is realised, there is a need for expansionary fiscal policies. At the same time, there is considerable political zeal to link fiscal policy to other political objectives. The general recommendation is to choose fiscal instruments that have a strong impact on activity per government-funded krone. And it is crucial that the impact on activity is not too late in relation to needs.

**Paying out holiday pay is a wise choice**

The government has wisely chosen to pay out some of the frozen holiday pay, which can produce a rapid impact on activity virtually without burdening public finances in the long term. And there is still more holiday pay to take from. In addition, the government has transferred an additional DKK 2bn to many people on social benefits. Analyses in the report show that the impact on activity is almost the same, whether you increase, for example, state education grants, pensions or standard tax deductions. If we focus solely on stabilisation, it is virtually as effective to accommodate one group as the other. If additional fiscal stimulus is necessary, it would be obvious to pay out more of the frozen holiday pay, as these payments only burden public finances a little, but a new portion of additional transfer payments may also become relevant. However, this should, of course, be aligned with the need for fiscal stabilisation.

**Infrastructure investments are difficult to time**

If fiscal policy is not timed correctly, the intended cyclical stabilising effect will be lost. For infrastructure investments in particular, timing can cause problems. The planning horizon for stabilisation policy measures is typically not more than a couple of years, and currently probably even shorter, while infrastructure investments usually don't start until three to five years after they have been decided. Historically, these investments have not affected the economy in a counter-cyclical way either. Therefore, increasing infrastructure investments should not be seen as a fiscal stabilisation instrument but as a structural instrument that can improve mobility in Denmark in the long run.

**Wise to concentrate on the small investments**

The government has temporarily relaxed the municipalities' ceiling on expenditure but has abstained from initiating major infrastructure investment projects. Both are wise: Small investments in, for example, the municipalities can be initiated quickly and thereby stimulate the economy in time. However, the planning horizon for large capital investments is too long for them to be timed according to the stabilisation policy needs.

**The green transition framework**

There is a significant political demand for a "green" recovery. This is not impossible, but you have to watch your step: The green transition is a long-term structural challenge, which above all is about reducing greenhouse gas emissions by 70% by 2030. In a previous Small Great Nation report, we have drawn up a tax-based system that minimises transition costs, is distributionally neutral, and takes leakage into consideration so that Danish emission reductions are not at the expense of increases in emissions abroad. However, the need to recover from the coronavirus crisis is acute, and it is essential that the stimulation of the economy has a rapid impact.

**Green transition: Timing and long-term needs**

A green recovery must therefore be both timely and take the green transition into consideration. It must therefore be based on investments which can be implemented quickly, and which in any case should be carried out as part of the green transition. These can be investments in increased electrification, such as electric vehicle charging stations, replacing oil-fired boilers with heat pumps

or similar equipment, which can be carried out from as early as 2021. A key instrument for combining short-term stimulants with long-term climate considerations would be to let a green tax reform, which is necessary anyway to achieve the target of reducing greenhouse gas emissions by 70% by 2030, be underfunded in the first few years while there is a need for fiscal stimulus. This could be done, for example, by removing the electric heating tax.

**Think through green recovery instruments**

The green recovery instruments could also be temporary direct support for selected technologies or a period in which the same technologies are given particularly attractive depreciation conditions. However, whatever the instrument, experts should decide which technologies should be included. This is not an easy task and not at all something that should be decided by way of political compromise in a night session.

**Hope springs eternal, but ...**

A large number of coronavirus vaccines are under development and the test results are positive, but the first vaccines will hardly be ready for wide use until sometime in 2021. In that case, we will "only" have to deal with the global economic setback after 2021.

**... without a vaccine, permanent changes are in store**

If there is no vaccine, coronavirus will not be fully under control until herd immunity has been achieved from the spreading of the infectious disease, and this can take a very long time and have significant health consequences. In this case, we can expect permanent changes, such as shorter value chains in international trade, industrial shifts – for example, a permanent decline in international tourism – and new social conventions.

**Denmark is dependent on the faraway markets**

If a consequence of the coronavirus pandemic becomes a regionalisation of world trade, i.e. that the value chains are geographically centred, this creates a great risk for the Danish business sector. Today, Danish companies export mostly to Sweden and Germany. But the US is actually Denmark's most important importer, when you look not only at where exports go at first, but at their final destination. The importance of Asia and the Middle East is also increasing when looking at final destination of exports. So, when all is considered, Danish companies are more exposed to fluctuations in demand in the faraway markets, and a possible regionalisation may have major consequences for Danish foreign trade.

**Agriculture and pharma are most vulnerable**

Not surprisingly, it is the large export sectors such as pharmaceuticals and agriculture that are most vulnerable in the event of a regionalisation of world trade, while the spillover effects on other Danish industries are more limited. This is also true when their role as subcontractors is taken into account.

**Politics and consumption can force companies to regionalise**

In recent years, there have been a number of examples of trade restrictions which could lead to increased regionalisation. As a consequence of coronavirus, almost half of Danish consumers believe that Danish companies should have their focus more regionally rather than globally. Both consumer desires and political tensions can force companies to focus their trade more regionally. Seen in isolation from an enterprise perspective, shorter supply chains can be an advantage as the overall risk of supplier failure or a sudden drop in sales is thereby reduced. But it will also involve a loss, as the costs of companies and therefore consumer prices will go up.

**It is an ill wind that blows no good**

However, the coronavirus pandemic can also have positive effects. Specifically, it appears that the restrictions have reduced the spread of other infectious diseases, and it is possible that the involuntary experiences from working from home during the lockdown have opened people's eyes to new opportunities.

**Digital opportunities are gaining ground**

Many have been forced to contact, for example, authorities and doctors online to a greater extent. This may lead to greater openness towards the digital opportunities. In the same way, more people have gained experience with online shopping, and it will be interesting to see if this accelerates the increase in online shopping or whether consumers will go back to the familiar physical stores.

**Potentially major benefits from better hygiene**

Hand hygiene has improved during the corona crisis, and fewer kisses and hugs are given. If these very changes in habit continue as many expect, this can reduce the spread of other infectious

diseases such as influenza. This will improve welfare and increase effective supply of labour. But will the somewhat awkward elbow greeting become standard over time?

#### Experiences with working from home

During the coronavirus pandemic, many working people have been forced to work from home. Although it turned out to be a good solution for many people, working from home also has certain limitations. After all, it is not possible for a carpenter to build a house from home. In order to uncover the potential of working from home, we combine a study that analyses who has the opportunity of working from home with an assessment of Danes' expectations of working more at home in the future. So far, working from home has been done mostly by people with a long commute to work, and perhaps one might even imagine that the practical testing of working from home could in the long run lead to changed settlement patterns in favour of the remote areas. Similarly, working from home can increase the return per hour of total time spent on transport and work, thereby increasing the supply of labour. This elevates working from home from being a matter between the employer and the employee to being a social one as well.

#### Taxes should be key elements in the green transition

Before we all learned to say "coronavirus", the key economic policy discussion point was the realisation of the Danish goal of reducing greenhouse gas emissions by 70% in 2030 compared to the 1990 level. If a vaccine allows Denmark to leave the coronavirus behind in a few years, the green transition will return as the most important challenge for the Danish economy, and carbon taxes should be the mainstay here. Previously, we in Kraka-Deloitte have presented a comprehensive and thoroughly calculated proposal for a green tax reform that reaches the target, minimises costs, is distributionally neutral, and takes significant account of leakage and competitiveness. The negotiations on a green tax reform this autumn will show whether the politicians are going that way, or if they are choosing more expensive detailed regulation.

#### R&D and government agreements with private actors

In addition to the central decision on an efficient tax-based system, the government should support the green transition by several means: There is a need for publicly funded research and development of green technologies, and this may also include demonstration facilities, where the government, together with private companies for example, develops and tests CCS or PtX plants.<sup>2</sup> The government should also contribute to the development of green markets, for example by ensuring sufficient transmission capacity in the grid, the possibility of delivering green fuel to large single CO<sub>2</sub> emitters or a sufficient number of electric vehicle charging stations. Even if the government takes the initiative, it is not given that it should bear the cost. For example, it would be natural that electricity consumers should pay for new transmission capacity via their electricity bill, as is the case today.

#### The government can promote the development of green markets

However, government costs may be necessary in other areas: A PtX factory or a stronger transmission connection to the rest of the world can compensate for the varied supply of, for example, wind turbine power. This ensures higher prices for wind turbine power, improves turbine profitability, and means that investors can safely build wind turbines. However, the PtX factory or connection will only become profitable once the turbines have been established. In view of the fact that the green transition is to be carried out in a short time, the government can actively make or contribute to investments in order to facilitate development, knowing that they will initially be loss-making.

#### If carbon taxes are not applied, consumers will lose

If carbon taxes are not chosen in the political process, or if only insufficient taxes are to be introduced, there will be a considerable need for government investments in the green transition. In addition to straining public finances, the result will also be a major socio-economic cost – a loss that will certainly end up with the consumers in the form of higher taxes, higher commodity prices or poorer public service.

#### Are passenger charges on air traffic a good instrument?

According to the Danish Climate Act, attention must also be focused on Denmark's international climate action. One of the challenges here is international air and ship traffic, which is not covered

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<sup>2</sup> CSS stands for carbon capture and storage, i.e. a facility that collects CO<sub>2</sub> from the atmosphere or from a CO<sub>2</sub> discharge point and stores it in, for example, an exhausted oil field. PtX stands for 'Power to X' and refers to a process in which fuels are generated by the use of electricity. For example, these fuels can partially replace fossil aviation fuels, and if the electricity used is produced using green technologies, the CO<sub>2</sub> emissions from aircrafts can be reduced.



by the national targets. We analyse the effects of and Danes' views on passenger charges, which is one of the most controversial instruments for regulating air traffic.

#### Sustainable fuels are obvious for aircraft

Adding green fuels can be a solution to reduce emissions of greenhouse gases by air traffic. The technology to produce green aviation fuels using electricity is well known. Passenger charges, on the other hand, are a weak instrument because passengers do not respond much to them and because they do not encourage the development of new climate-friendly technology.

#### Smart passenger charges

The airlines will be able to avoid a unilaterally Danish addition requirement by simply avoiding refuelling in Denmark. It is therefore appropriate to introduce a passenger charge equal to the CO<sub>2</sub> emissions in the flight and to allow companies to escape the tax by adding green fuels. This ensures that air traffic contributes to the green transition at the same cost as the rest of the economy. At the same time, Denmark may be in favour of a common EU requirement to add green fuels.

#### Can a "green change of attitude" contribute to a green transition?

Although taxes have been proven time and time again as an effective tool for regulating behaviour, a change of attitude and personal desires to live climate-friendly are also crucial. Taxes make the socio-economically necessary choice the private-economically sound choice, but do not in themselves change people's desire for a better climate. At the end of the report, we focus on how much people try to influence others into more climate-friendly consumption. Such a change of attitude may mean that part of the green transition "arises of itself".

## 1.1 Key analytical results

The key analytical results of the report are:

#### State of the union

- Denmark experienced a significant economic downturn when coronavirus hit in the first half of 2020. Things are already going better, and the government expects the Danish economy to be back at the 2019 level by 2021. Since there is nothing structurally wrong in the economy, this scenario is likely if the coronavirus can be kept at bay with restrictions and ultimately a vaccine.
- The sustainability of government finances is not significantly affected by the crisis, and they are still more than sustainable, provided that the indexation of the retirement age under the welfare reform is maintained even after 2040. During the crisis, the public sector has obtained considerable loans, but despite this, the net debt is expected to be around zero in the next few years, and the sustainability is only affected by the interest rate on the loans, which is currently very low. The crisis therefore does not significantly alter the options under the economic policy.
- According to the government's calculations, the Danish government finances are oversustainable because of a structural surplus in the very long run. However, demographic headwinds mean that Denmark can expect government deficits of up to 1.5% of GDP from 2025 to 2055, according to the same calculations. If we are to meet the requirements of the Budget Law during this period, we need to either increase government revenue or to reduce expenditure. It is, however, a legitimate discussion whether the requirements of the Budget Law should be relaxed. Alternatively, it is a possibility to bring forward the taxation of pensions. However, neither of these solutions are simple and both have far-reaching consequences.

#### Fiscal stimulants

- There is a very large difference in the speed at which different types of fiscal policy measures stimulate the economy, and if the timing is not correct, the economic downturn is not being mitigated. In the current situation, the economy needs to be stimulated by autumn 2020 and perhaps one and a half to two years ahead, so instruments that work quickly should be chosen. For example, tax relief or higher transfer payments typically only give a small total delay.
- Government transfers targeted at specific households, such as additional state education grant or state pension, increased standard allowances or the release of the frozen holiday

pay, can all stimulate the economy at short notice. The effect on activity is similar, regardless of the instrument that is used. The release of the frozen holiday pay has the considerable advantage for public finances that it is people's own savings that are paid out. Although the government has to use bridge financing for these payments, this does not increase the government debt permanently. If further fiscal policy stimulus is needed, it is therefore natural to pay out the rest of the frozen holiday pay.

- Public investment in infrastructure over the past 25 years has not smoothed out the economic cycles. Public infrastructure investments have a high impact on activity once the first sod has been cut, and they are targeted at the cyclically sensitive construction sector. But particularly large projects require a long planning process, often at least three to five years for, for example, infrastructure investments, i.e. much longer than what is within the time frame of a stabilisation policy.
- Municipal construction projects are generally smaller than government projects and can thus be initiated at shorter notice. The temporary easing of the municipal expenditure ceiling can therefore contribute effectively to fiscal stabilisation.
- The economic recovery after the coronavirus crisis and the green transition can be linked if climate action has an impact on activity within a few years and if it also brings forward measures which are required anyway for the green transition. Otherwise, either the fiscal policy will be ineffective, or the green transition will be unnecessarily expensive. Suitable measures may be grants for the replacement of oil-fired boilers, bringing forward the roll-out of electric vehicle charging stations, temporarily underfunding a green tax reform, for example by a lower electric heating tax or other measures to cost-effectively phase out fossil fuels.
- When focus is on the final destination of Danish products, the US is Denmark's largest export market. The importance of Asia, the Middle East and Russia is also greater than in the traditional reports on exports. Denmark is therefore more vulnerable to faraway markets than the impression normally created. This is because traditional reports focus on the immediate exporting country, which is often Germany or Sweden, and do not consider the fact that most Danish-produced intermediate inputs are further exported.
- Many Danish consumers want more regionalisation. Almost 45% of all Danes believe that the Danish business sector should become less dependent on regions outside the EU as a result of the coronavirus crisis. This share is stable across education groups. Almost 25% disagree, and these are particularly people with long education.
- New trade policy uncertainties such as the US trade wars, the security policy challenges with Russia, and the risk of armed conflict can reduce the profits of companies in global trade. Danish companies risk having relatively high costs from regionalisation, but it depends very much on whether such regionalisation is general or covers only certain sectors.
- Particularly important export industries such as agriculture and the pharmaceutical industry will lose out by increasing regionalisation. Conversely, domestically oriented industries such as IT and information services or consultants can boost sales as a result of growing demand from companies in the same region.
- 42% of Danes have become more positive towards the digitalisation of certain public services as a result of the coronavirus crisis. The majority want more digitalisation of higher education while few want more digitalisation of the primary school.
- The coronavirus crisis made 6% of Danes buy groceries online for the first time. But virtually none of these people expect to continue shopping online after the crisis. Although the people who already did their grocery shopping online will increase demand a little, there is no indication that the boom in online grocery shopping will continue after the coronavirus crisis.
- Coronavirus can also change the way people interact with each other and their hygiene habits. Approximately 80% of the respondents state that, after the coronavirus crisis, they will be more mindful of hand hygiene and keep a safe distance from others in public spaces. Around 40% state that they will reduce their use of hugs and handshakes when greeting other people

#### New economic structures and new social conventions

after the coronavirus crisis is over. If this continues, it can reduce the spread of other infectious diseases.

### Working from home

- 50% of the people who themselves believe they can do some of their work from home would like to work more at home as a result of the coronavirus crisis. Approximately 40% want no change, while 10% want less working from home. For just under 60% of those who can work from home, their wishes are consistent with their expectations for the future.
- If working from home gains currency, for example because many companies have invested in supporting IT equipment during the coronavirus crisis, it can lead to a significant socio-economic benefit. This benefit arises mainly from less transportation time and fewer transportation costs, but also from less congestion, less pollution, and a greater supply of labour. Our estimates show that the labour supply will increase by 2,200 full-time employees if all employees who are able to work from home have one more homeworking day every two weeks.
- There are great differences in the potential for working from home in the Danish labour market depending on the level of education, income, and residence. The potential for working from home for people with long education is five times the potential for unskilled workers. And, on average, the potential for homeworking among the 10% of Danes with the highest income is almost four times the average of the 10% with the lowest income. In general, the potential for homeworking is clearly greatest in the municipalities around the large cities, where the concentration of highly educated people is also greatest.
- On average, employees who can work from home live more than five kilometres further away from their workplace than comparable employees without that opportunity. If the ability to work from home determines where you choose to live, better opportunities to work from home can lead to reduced urbanisation for the benefit of remote areas without necessarily leading to more congestion on the roads.

### Climate

- Uniform taxes on greenhouse gases should be a cornerstone of the overall climate plan to meet the Danish Climate Act's objective of cost effectiveness. With a precise design of the tax system, leakage and politically undesirable distribution effects can be counteracted. In addition, the government should contribute to funding research, development, and demonstration of new technologies. For example, the authorities should also ensure that a "green infrastructure" is established, such as the availability of biogas for heavy industry, facilities for storing collected CO<sub>2</sub> or adequate distribution of electric vehicle charging stations. As a high pace in the green transition is necessary, it may also be necessary for the government to initiate investments which are not private-economically viable in the short term, in order to drive developments.
- The number of flights in Denmark, Sweden and Norway stagnated before the coronavirus crisis. Sweden and Norway have introduced passenger charges on air travel in recent years, but since airfares have not increased significantly more than in Denmark, these charges are hardly the main reason for the slowdown in Sweden and Norway. It may be explained by greater awareness of the climate change impact from aviation.
- International air traffic to and from Danish airports is a large contributor to the CO<sub>2</sub>-emissions in Denmark but does not count towards the official climate accounts and the 70% target in 2030. An isolated Danish tax on aviation fuel would be against international rules and agreements and would not be appropriate either, as aircraft can just refuel outside Denmark. An effective and internationally coordinated levy or quota system would be highly appropriate, but may, at best, have long prospects. However, like Sweden, Norway and Germany, Denmark could introduce a passenger charge on air travel.
- According to an analysis in this report, consumer demand for air travel is less price-sensitive than previously estimated. This means that the climate effect of introducing a passenger charge in Denmark is likely to be lower than previously estimated. But there are opportunities for starting to produce and add so-called electrofuels, also known as Power-to-X. It would therefore be appropriate to impose a passenger charge on the airlines equivalent to what they would have to pay on average if air travel were included in our proposal for CO<sub>2</sub>e-taxes.

The charge may then fall in proportion to the addition of green fuels, in order to increase the incentive for a green transition.

- More than half of the Danes want higher air travel taxes. However, the majority only want air travel taxes if they are coordinated in the EU. Elderly people are more likely to want an air travel tax. Less than half of people between 18 and 39 want to introduce an air travel tax, while this is the case for about two-thirds of people who are over 60.
- Almost half of the young people under 30 and a fourth of all respondents have tried to influence friends or family in a greener direction in the last year. 50% of those who have tried to influence friends and family indicate that they are trying more now than two years ago. If the attempts to influence others work, it can promote green consumer awareness. Greener consumer behaviour can encourage companies to produce greener, which can also contribute to the green transition.

## 1.2 The way forward

The purpose of the work of Small Great Nation is to map Denmark's strengths and weaknesses and to point to expert-based suggestions for solutions. Based on the analytical results, we here present a number of questions and possible answers to the issues raised:

### Where do we stand?

- It is quite clear that most of the direct business aid in connection with coronavirus should be phased out and replaced by general fiscal instruments. In the most likely scenario, the fiscal policy is appropriately planned, but there are significant risks. Does the absence of a specific plan for handling a flare-up of coronavirus in Denmark or with Denmark's trading partners create unnecessary uncertainty for the business community? Is it even possible to make such a plan?
- Should the established oversustainability of the Danish economy lead to, for example, a relaxation from 2040 of the current budgetary discipline in order to overcome the demographically triggered, yet temporary pressure on the government budget? The oversustainability presupposes that the life expectancy indexation of the retirement age is maintained, but the political support for this seems to be faltering at times. How should this uncertainty be addressed?
- The structural fiscal challenge is the "hammock", i.e. an expected budget deficit from around 2025 to around 2060. However, provided that the current indexation of the retirement age is maintained, a budget surplus is expected from around 2060 onwards. The limit for structural deficits is currently 0.5%, but should this limit be increased to 1%, corresponding to the EU's requirements, given that the fiscal policy is considered to be oversustainable? How do we balance the need for a responsible and credible fiscal policy on the one hand and, on the other, for the different generations to have a similar public service, tax burden and so on? Can we expect continued political support for the indexation of the retirement age?

### Fiscal policy

- Stabilisation policies should work quickly and have a high impact per government krone spent. Green initiatives, on the other hand, should primarily support a cost-effective green transition. These considerations can be aligned, for example, by letting a green tax reform be underfunded in the first few years, for example by lowering the electric heating tax. Temporary subsidies for the replacement of oil-fired boilers and insulation, and the advance deployment of electric vehicle charging stations are also relevant. The budget bill has - rightly - been criticised for not being very green. Does this reflect that the coronavirus has shoved the climate debate into the background?
- If further fiscal stimulus is needed, it would be natural to pay out more of the frozen holiday pay, as the public budgets will not be permanently burdened. Direct government payments to people place a burden on public finances, but also stimulate consumption effectively for many different groups of people. Should direct payments be used again and to which groups of people?

## New structures in Danish economy?

- Public infrastructure investments are a bad instrument as a counter-cyclical means and has historically almost intensified cyclical fluctuations. What could the potential instead be of a long-term and broadly agreed infrastructure plan?
- Consumer desires and global uncertainty about free trade and the risk of supplier failures can lead to shorter supply chains, which, all other things being equal, will lead to more expensive products. Is consumer demand and the question of security of supply just a temporary coronavirus phenomenon, and will the US presidential elections improve international interaction in favour of free trade? Danish politicians have no direct influence on these matters, but what is the significance of Danish participation in international organisations such as the EU and NATO?
- The Danes have become more positive about the fact that some public services can be more digitalised as a result of the coronavirus crisis. Can the public sector step up the digitalisation of some of its services in the coming years?

## Working from home

- Working from home can potentially increase labour supply, improve welfare, reduce congestion on the roads, and perhaps even affect settlement patterns. Should employers and employees together try to make greater use of the opportunities that homeworking can offer? And when does the cost of reduced professional back-and-forth and social interaction between colleagues exceed the potential benefits?
- Two out of five working people who can work from home do not think that the amount of working from home after the coronavirus meets their requirements. Does this reflect that the employees have the benefits of working from home, while the employer bears the cost, or do employers just not have enough confidence in their employees?

## Climate

- Denmark has adopted an ambitious climate act and is busy if the goal is to be achieved by 2030. However, it is not globally appropriate that the Danish green transition just moves emission-intensive production abroad. How do we align the considerations of cost minimisation, distributional effects, and greenhouse gas leakage?
- Kraka-Deloitte has previously presented a comprehensive proposal to reach Denmark's climate targets with uniform greenhouse gas taxes as a key instrument. With a precise design, it will minimise costs, prevent leakage, and be distributionally neutral. But politicians are wavering. Are they perhaps afraid that taxes make it clear that a green transition will unavoidably involve a certain economic cost? Is the political desire to have a green transition real at all?
- Although taxes should be the key instrument in the green transition, public expenditure will continue to be needed for research, development, and the provision of green infrastructure in the broad sense. How is this expenditure prioritised in relation to other public expenditure and revenue, and across generations? Is it responsible and reasonable to use debt financing for this expenditure when future generations will benefit from the green transition?
- Our neighbouring countries have relatively high passenger charges on aircraft, and there is popular support for higher charges if coordinated within the EU. However, passenger charges have in themselves a limited climate effect. We therefore recommend passenger charges which are reduced as companies add green fuels. Can this effectively secure the green transition of air traffic?
- Can it have an effect if the authorities support the growing green awareness of the population and their mutual green influence? Do Danish consumers have sufficient insight to act climate-friendly? For example, is a climate labelling of foods a negotiable road, or will it drown in the large number of labels that already exist?

