

Tackling Denmark's Post-Crisis Labour Market Challenges

By Frode Aasen, Joanna Leszczuk and Simona Pojar

Summary

The Danish labour market is widely known for its so-called 'flexicurity' model, combining labour market flexibility with social security and active labour market policies. The model features relatively flexible rules regarding hiring and dismissal, high income compensation in periods between work, and wide use of active labour market policies and lifelong learning. The flexicurity model appears to have served Denmark well. The Danish labour market is characterised by high employment, low structural unemployment, low long-term unemployment, high job turnover and a high degree of wage flexibility.

Yet, the work potential of some groups remains underutilised. In 2014, Denmark was recommended under the European Semester country-specific recommendations to take further measures to increase the employability of people at the margins of the labour market. Those with specific challenges include low-skilled, young and elderly people and, most vulnerable of all, migrants and disabled people, which both have low activity rates compared to the rest of the population.

The Danish economic model stands out with a high degree of equality and social mobility, a relatively generous welfare system as well as a tax system with extensive redistributive features, trade openness, and an efficient public sector. To support the model, it is important to maintain flexibility on the labour market and high activity rates. There is still scope to improve the labour market integration of immigrants and their descendants. In addition, people with reduced work capacity and disabilities should remain in the focus of the policy makers.

This economic brief investigates the resilience of the Danish labour market and the situation of those people who are at the margins. There is no quick fix for solving the labour market challenges that Denmark is facing. Tackling the challenges requires growth-friendly economic policies, which can enhance the dynamic and inclusive features of the labour market.

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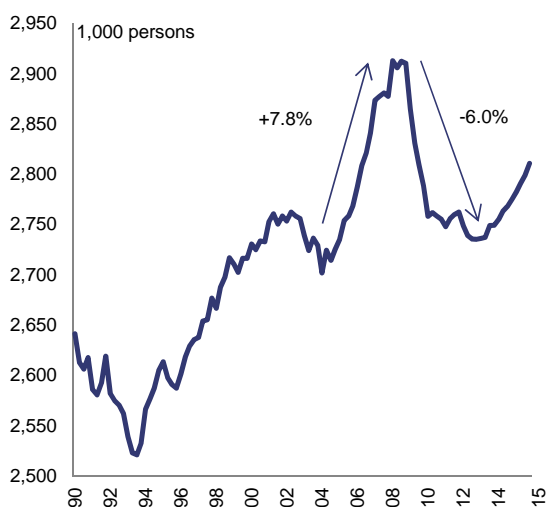
The Danish labour market took a hit during the crisis...

Even before the financial crisis escalated in the autumn of 2008, the Danish economy was slowing down after a strong cyclical upswing in 2004-2006. During that time a price bubble built up in the housing market and the economy was overheating, with observable shortages of labour supply and high wage growth. From the pre-crisis peak at the end of 2007, real GDP dropped by 7.4 % until the middle of 2009.

Recessions triggered by financial turmoil usually lead to slower recoveries. For Denmark, the recovery has also been held back by weak productivity growth, high wage growth in the years preceding the crisis, and deleveraging efforts in Danish households following the burst of the house price bubble.

The labour market responded quickly to the economic downturn. From the 4th quarter of 2008 to the 4th quarter of 2012 employment dropped by 6.0 %, with the sharpest adjustment taking place in 2009-10. Employment started growing again in the course of 2013 and employment growth has continued in 2014-15. By the end of 2015, employment was still 3.5 % below the pre-crisis peak. However, comparing the current employment level with the pre-crisis peak may be misleading, as the peak materialised during a period of overheating (Graph 1).

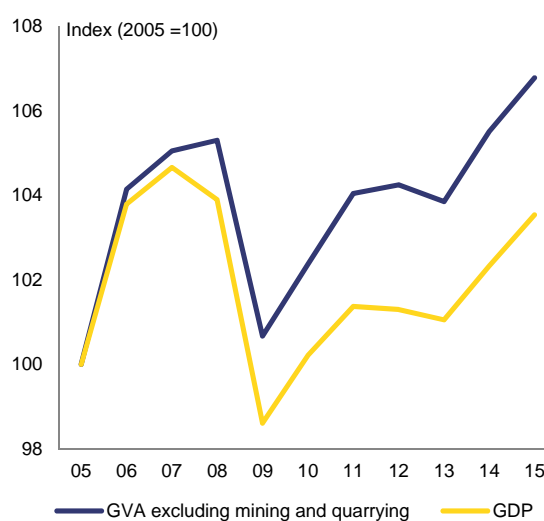
Graph 1: Employment in Denmark before and during the crisis



Source: Statistics Denmark

After six years of very slow growth, the economic recovery in Denmark started to strengthen in the course of 2014. Employment, on the other hand, started picking up already in mid-2013. This can partly be explained by a relatively stronger recovery in labour intensive sectors. At the same time, the capital intensive sector of mining and quarrying has been a drag on overall GDP growth, mostly due to a decline in oil and gas production. Thus, the production in large parts of the economy has recovered faster than overall GDP (Graph 2).

Graph 2: GDP and GVA excluding mining and quarrying

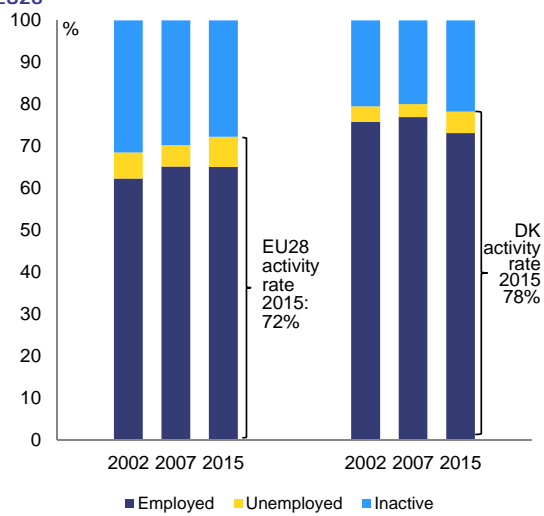


Source: Statistics Denmark and own calculations

...but performs better than most other EU member states

The Danish labour market is generally characterised by a high participation rate, low structural unemployment and a high degree of dynamism, as flows are high into and out of the labour market, as well as between jobs. Despite an increase in the inactivity rate compared to pre-crisis level, 78.5 % of the total population in Denmark between 15 and 64 years old was active in the labour market in 2015 (EU28: 72.5 %, Graph 3). Among people in working age (15-64 years old), 73.5 % of the Danes were in employment in 2015 (EU28: 65.6 %). Denmark is clearly performing well in this regard, and in 2015 the employment rate in Denmark was the fourth highest in the EU, behind only Sweden, the Netherlands and Germany.

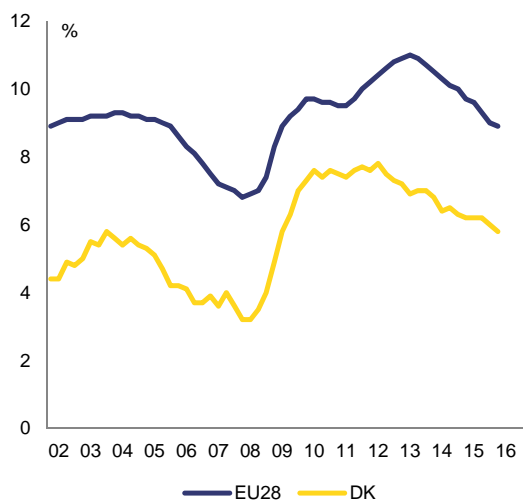
Graph 3: Activity and inactivity rate in Denmark and EU28



Source: Eurostat

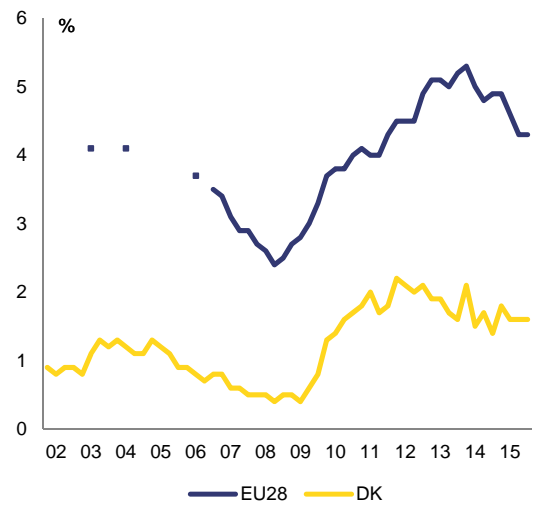
The Great Recession of 2008-09 led to a steep rise in unemployment for Danish standards, with the unemployment rate increasing from 3 % in early 2008 to 7.5 % in early 2010. Even after the increase, unemployment in Denmark has remained well below the EU average. Since spring 2012, unemployment has been edging downwards, falling from 7.9 % in May 2012 to 5.8 % in March 2016. While unemployment is clearly declining both in Denmark and in the EU as a whole, this trend started about a year earlier in Denmark (Graph 4). The long term unemployment also increased during the crisis, but from a very low level. Parallel with the overall unemployment level, long term unemployment has been decreasing since 2012 (Graph 5).

Graph 4: Unemployment rate EU28 vs DK



Source: Eurostat

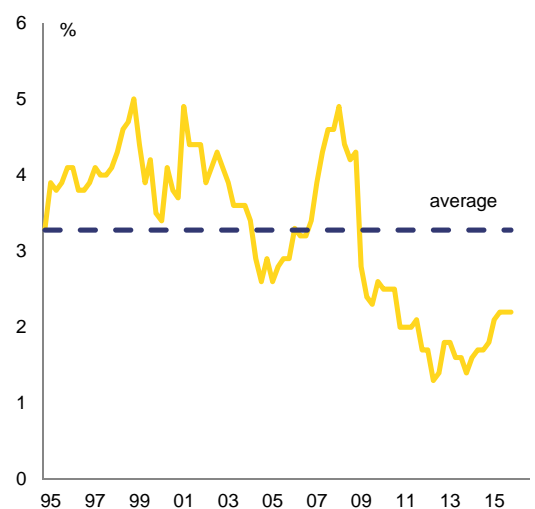
Graph 5: Long term unemployment



Note: Data for EU28 is only available for a few quarters prior to 2006.
Source: Eurostat

Danish wages reacted immediately to the crisis. Coming from a period of high wage growth in the years prior to the crisis, growth in wages has slowed down since 2009 and remains at a low level (Graph 6). The lower wage growth supports competitiveness and has helped preventing a larger fall in employment.

Graph 6: Wage growth in DK, 1995-2015

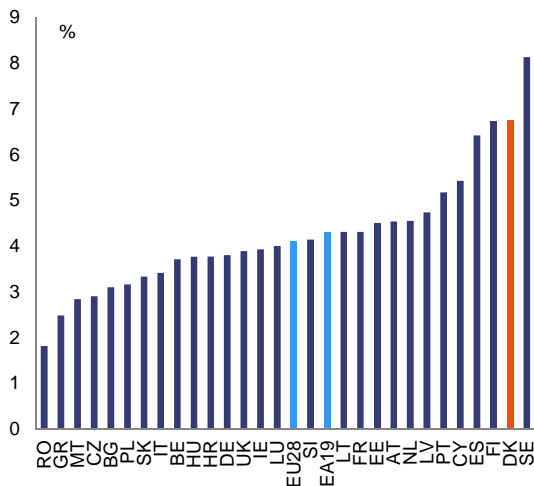


Note: Change in average earnings among workers that are employed in one of DA's more than 28,000 companies.
Source: Confederation of Danish Employers (DA)

At the same time, job turnover has stayed high during the crisis. This indicates that the labour

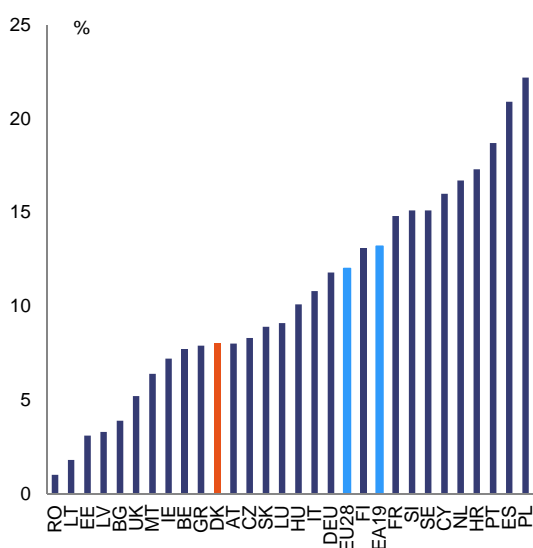
market remained dynamic, with continuous flows into and out of employment, as well as between jobs. In 2015, job turnover in Denmark was the 2nd highest in the EU (Graph 7). The high job turnover is linked to the flexicurity model, and not to widespread use of temporary contracts, which are much less used in Denmark than in most other EU countries (Graph 8).

Graph 7: Job turnover, 2015



*Note: The graph shows the percentage of total employment that has started in their current job within the last 3 months.
Source: Eurostat*

Graph 8: Percentage of employees with temporary contracts, 2015

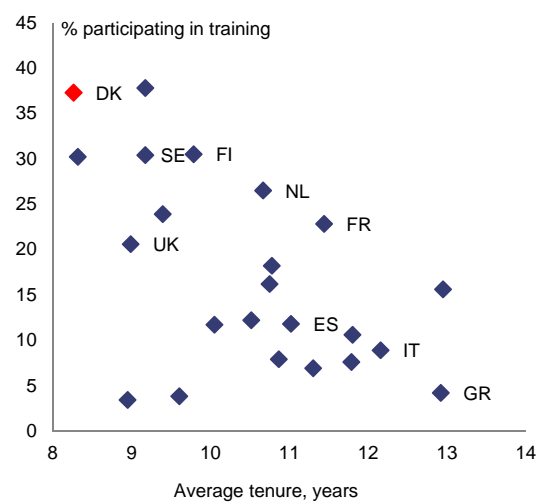


Source: OECD

The high job turnover is reflected in relatively low average job tenure in Denmark compared to other EU member states. There are no indications that the high turnover and low average job tenure lead to lower investments in employee skills or increased worries about one's future in the current job, arguments that are sometimes used against seeking to increase job turnover.

According to data from Eurostat, 37.3 % of Danish employees aged 18-74 had participated in training over the last 4 weeks. Of the 25 European countries in the dataset, this number is only slightly higher in Switzerland (Graph 9).

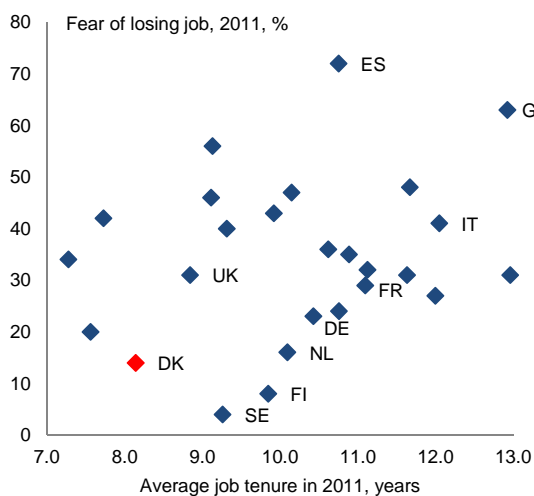
Graph 9: Job tenure versus participation in training, 2014



*Note: Participation in training measures the percentage of employees that have participated in training over the last 4 weeks. Average job tenure has been adjusted in order to take into account differences in age distribution in the different countries.
Source: Eurostat, OECD and own calculations.*

In the same vein and also linked to the flexicurity model, there is no indication that low average job tenure leads to an increased fear of losing one's job. Indeed, as in countries like Sweden and Finland, low average job tenure in Denmark is coupled with a low fear of losing employment (Graph 10).

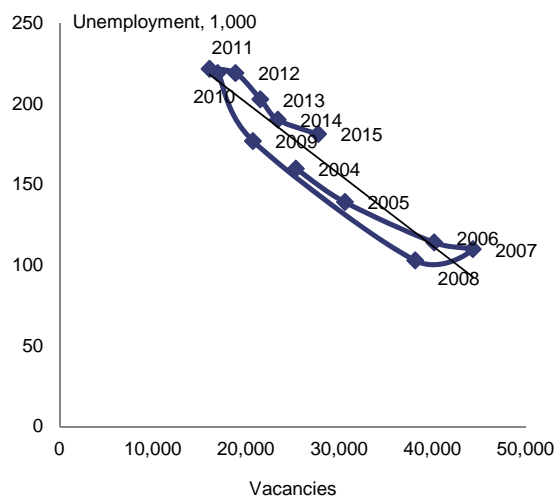
Graph 10: Job tenure and fear of losing job



Note: Average job tenure has been adjusted in order to take into account differences in age distribution in the different countries.

Source: OECD, Eurobarometer 2011 and own calculations.

Graph 11: Beveridge curve, 2004-2014



Note: Beveridge curve (unemployment versus vacancies), ILO unemployment (y-axis) and vacancies (x-axis). First and last observations are marked in red.

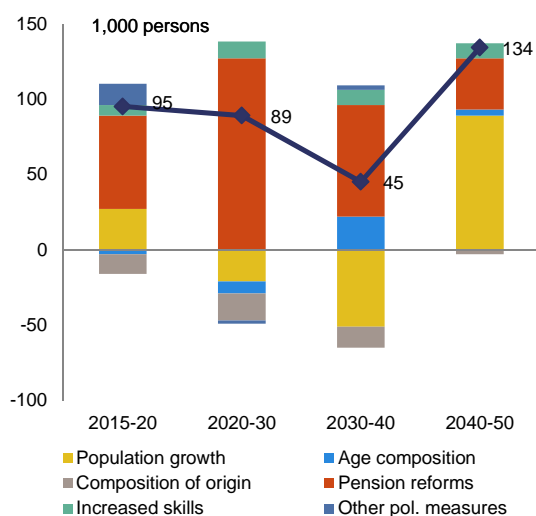
Source: Eurostat and jobindsats.dk

An analysis made by the European Commission in 2013¹, showed an upward trend in indicators of skills mismatch and sectoral mismatch, suggesting that the Danish labour market's matching efficiency could have worsened during the crisis. Looking at the Beveridge curve, which illustrates the labour market's ability to match the number of unemployed with the number of vacant positions, indicate that currently the same number of unemployed as some 10 years ago is observed in correspondence with more vacancies. However, data for the whole period do not seem to indicate a systematic outward shift of the Beveridge curve. The last couple of observations might show a lagged adjustment to negative demand shocks rather than a significant change in the matching performance of the Danish labour market compared to the situation ten years ago, before the start of the overheating of the economy (Graph 11). This calls for further monitoring.²

Challenges of the Danish labour market

In the context of demographic ageing, a key challenge is to increase the long-term labour supply. A number of reforms have been introduced in order to tackle this challenge, including the 2011 pension reform and reforms of taxation, early retirement, flexi-jobs, social transfers and student grants. According to the latest projection from DREAM³ made in August 2015, labour supply is projected to increase by 95,000 persons (3.5%) in 2015-2020. The main part of this increase would come from an increased activity rate (Graph 12), due to reform efforts (as explained further below).

Graph 12: Expected increase in labour supply from 2014-2050



Source: DREAM

Demographics, the sum of population growth, age composition and composition of origin, are expected to give a relatively neutral contribution to labour supply in the years up to 2020, but are projected to become a drag on labour supply in the period 2020-2040. The contribution from changes in the age composition is expected to turn positive in the long run. Meanwhile, the composition of origin – covering the increasing share of immigrants and descendants in the population – is expected to be a drag on labour supply until 2050, but its impact is expected to diminish gradually after 2030.

There is a potential to increase labour supply even further by strengthening the labour market participation among several groups. In this vein, the European Commission recommended in 2014 that Denmark takes steps to improve employability of people at the margins of the labour market. Among them are immigrants, low-skilled workers and the disabled. The activity rate among elderly people is expected to increase in the coming years, due to the implemented retirement reforms.

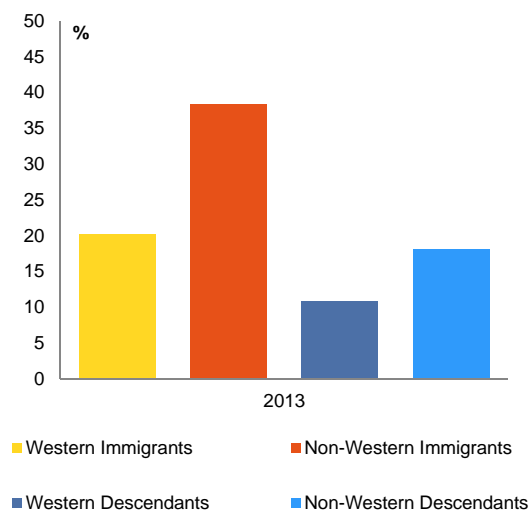
Labour market participation among immigrants needs to increase

At 10.1 % in 2014, the share of foreign born in the Danish population is in line with the EU28 average (10.4 %). In Denmark, 6.7 % of the population was born in a country outside EU28, which is also in line with the European average (6.6 %), but somewhat

lower than in countries like Sweden (10.6 %), Norway (7.6 %) and Germany (7.4 %). The population of immigrants in Denmark is quite heterogeneous, reflecting years of refugee reception, former waves of labour migration from non-EU countries and, to a lesser extent, open access for workers from other EU countries.

According to data from Statistics Denmark, the underemployment⁴ of 16-64 year old non-Western⁵ immigrants⁶ stood at 38.4 % in 2013 compared to people of Danish origin⁷ (Graph 13). Smaller, but yet significant underemployment also exists among immigrants from Western countries and among descendants. The underutilisation of immigrants' labour market potential – which can to some degree be explained by educational disadvantages and language barriers - remains a considerable loss of human capital and a social inclusion challenge. Employment in Denmark would be close to 100.000 persons higher in 2013 if employment rates of immigrants and descendants were fully in line with the employment rates of people with Danish origin⁸. This challenge has become even more important with the recent inflow of migrants.

Graph 13: Underemployment of immigrants and descendants (age 16-64) in Denmark in 2013



Source: Statistics Denmark

People who have been granted refugee status in Denmark benefit from a three-year integration programme. Other immigrants fall under the normal active labour market policy (ALMP) measures. Danish authorities have, however, taken steps in order to improve the employability of immigrants. A new integration initiative was presented by the previous government on 15 March 2015, aiming at promoting employment among refugees and

immigrants through a combination of job search assistance, training and language classes. The initiative did not make it to Parliament before the handover of power following the elections in June 2015.

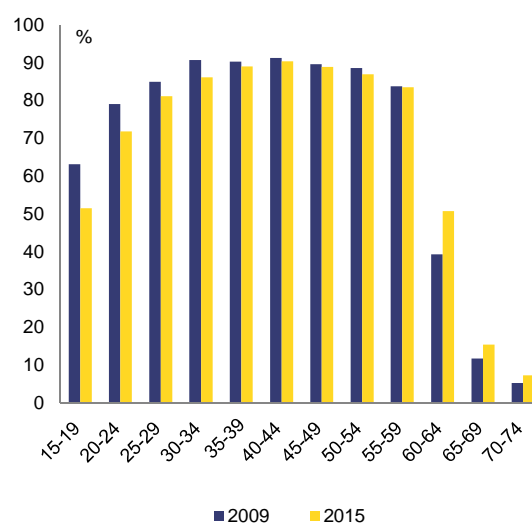
In August, the Danish parliament passed a so-called ‘integration benefit’, replacing ordinary social transfers for those who have not had residence in Denmark for a minimum of seven out of the last eight years (exception for those classified as mobile workers under EU-legislation). Some Danish nationals who have worked or studied abroad will be affected by this, but recently arrived immigrants/refugees are the main target group. The new model will effectively cut the amount of money a newly arrived refugee has available for consumption and saving by between 13 to 57 %, depending on the refugee's civil status and number of children⁹. With the new model, which is planned to be introduced by September 2015, refugees have the opportunity to increase their social transfers by passing an exam proving a basic knowledge of Danish, as this will trigger a monthly bonus.

The low skilled, the young and the elderly are targeted by reforms

The largest decrease in the activity rate in the aftermath of the crisis has been among young people (Graph 14). This reflects partly that more young people have started an education, as illustrated by historically high intakes to higher education, but also that some students may have given up looking for part time-jobs.¹⁰

It is a challenge to prevent young people from getting lost in the transition between school, education and employment. Recent reforms of labour market and educational policies therefore appear to be warranted. The 2013 cash benefits reform introduced more conditionality of professional training as a precondition for public income support recipients, in particular for young people under 30 years. The 2014 Active Labour Market Policy reform focuses on individual needs of the unemployed. It follows the recommendations of the expert committee chaired by the former taxation minister, Carsten Koch. The reform has been implemented gradually in the course of 2015.

Graph 14: Activity rates in different age groups in Denmark, 2009 and 2015

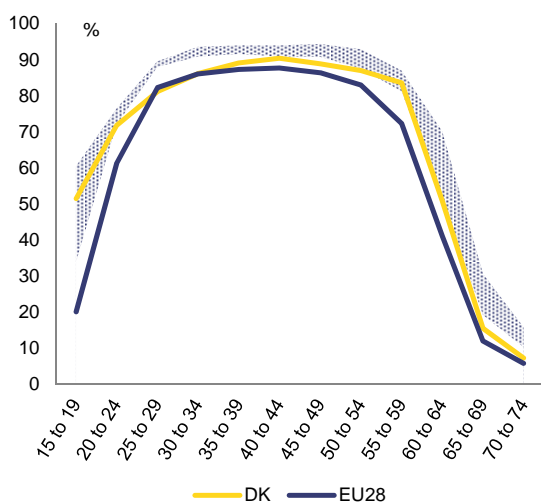


Source: Eurostat, Commission services

There is a risk that Denmark will face an increasing surplus of unskilled labour by 2020.¹¹ Training and education are crucial for the improvement of the skill levels of unskilled workers. To this end, the 2013 reform of vocational education and training is expected to provide an educational boost by making vocational education more attractive and of better quality. While its objectives seem well-targeted, it is too early to assess the full impact of the reform.

For the elderly, labour market participation remains above the EU average, but below the top five performers in the EU (Graph 15). Activity rates have increased from 2009 to 2015 in these age groups, (Graph 14). This likely reflects the 2011 pension reform, which is gradually phased-in up to 2023. The reform increases the statutory retirement age from 65 to 69 years and thereafter links it to life expectancy. The statutory age for early retirement (efterløn) will be increased from 60 to 64 years and linked to life expectancy. The measures aim to improve the sustainability of public finances in the long term and are an important step in view of the challenges posed by an ageing society.

Graph 15: Comparison of activity rates in different age groups in 2015



*Note: The blue shaded area shows the interval of the top-5 performing countries in the EU.
Source: Eurostat, Commission services*

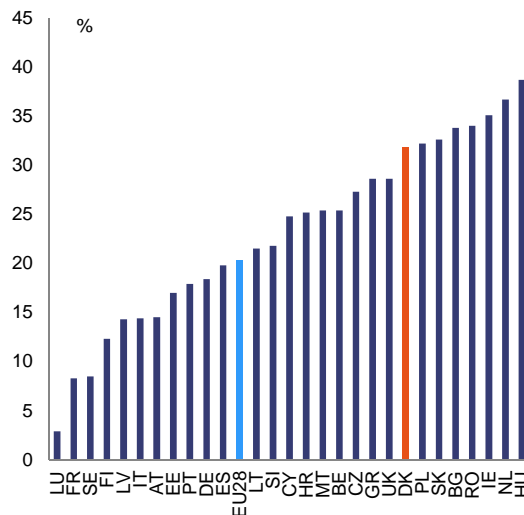
Disabled people need individual solutions

People with disabilities and reduced work capacity are at a higher risk of being at the margins of the labour market. According to an ad-hoc survey of the access to the labour market for disabled people, made by the Labour Force Survey in 2011, the share of disabled persons in the total population in Denmark is in line with comparable countries and the EU average. However, the gap in the employment rate for disabled persons is much higher than in Germany, Sweden and EU28 (Graph 16). Caution is necessary when interpreting these numbers, partly given that the definition of disability and the criteria for eligibility may vary in different Member States.

A reform of the disability pension and flexi-jobs scheme has been in force since the beginning of 2013, and it aims to bring as many people as possible to work. The target group of the reform is people with complex problems, who need individual support. Entry into interdisciplinary rehabilitation programmes has been increasing since the reform came into force and entry into the disability pension scheme has declined by half. The implementation of the rehabilitation teams might not be fully perfected yet. Moving towards more active efforts through the

flexi-job system seems more desirable than passive income support and seems to be the policy focus in Denmark.

Graph 16: Gap in employment rate among people with and without disabilities (15-64 years, 2011)



*Note: The graph shows the difference in employment rate between people with "Difficulty in basic activities" and people with no such difficulties.
Source: Eurostat, Commission services*

Conclusion

The Danish labour market was hit hard by the Great Recession and employment fell sharply in the course of 2009. The healthy structures of the labour market have, however, remained intact and the Danish model has proven its flexibility.

As for most Western countries, the demographic development will pose challenges for Denmark in the coming years. Reform measures have already been taken to deal with the challenges posed by demographic ageing with respect to fiscal sustainability issues. However, there are still groups in the population that are not fully integrated in the labour market. This is a broader challenge, involving a loss of human capital and insufficient social inclusion.

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¹ European Commission (2013).

² On labour market matching, see also E. Bjørsted et al. (2016)

³ The DREAM group is an independent institution with the main purpose of developing, maintaining and performing economic analyses of the Danish economy using the economic model Danish Rational Economic Agents Model, DREAM, www.dreammodel.dk. Some of its projections are used as input by the Danish Ministry of Finance.

⁴ Underemployment means the difference in employment compared to the population of Danish origin, corrected for differences in age structures between the groups.

⁵ Non-Western countries here comprises all countries except EU member states, Andorra, Australia, Canada, Iceland, Liechtenstein, Monaco, New Zealand, Norway, San Marino, Switzerland, USA and the Vatican State.

⁶ An immigrant is here defined as a person born abroad, where none of the parents are both Danish citizens and born in Denmark.

⁷ A person with Danish origin is defined as a person where at least one of the parents is a Danish citizen, born in Denmark.

⁸ Statistics Denmark (2014).

⁹ Danish Ministry of Foreigners, Integration and Housing (2015a).

¹⁰ According to ILO definitions, a person holding or looking for a part-time job is given equal weight to a person holding or looking for a full-time job.

¹¹ Economic Council of the Labour Movement (2014).