

WHY ARE THE NORDIC COUNTRIES DOING SO WELL?

The case of Denmark and Sweden

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The Nordic countries are on many parameters performing rather well. This goes in particular for Denmark and Sweden who are among the most prosperous and most equal countries in the world. Despite the crisis and rather generous unemployment benefits, employment rates in the two countries continue to be among the highest in the EU. Although Denmark and Sweden seem to have done well during the crisis there are also differences in the outcome, with, for example, a far more significant fall in employment in Denmark than Sweden.

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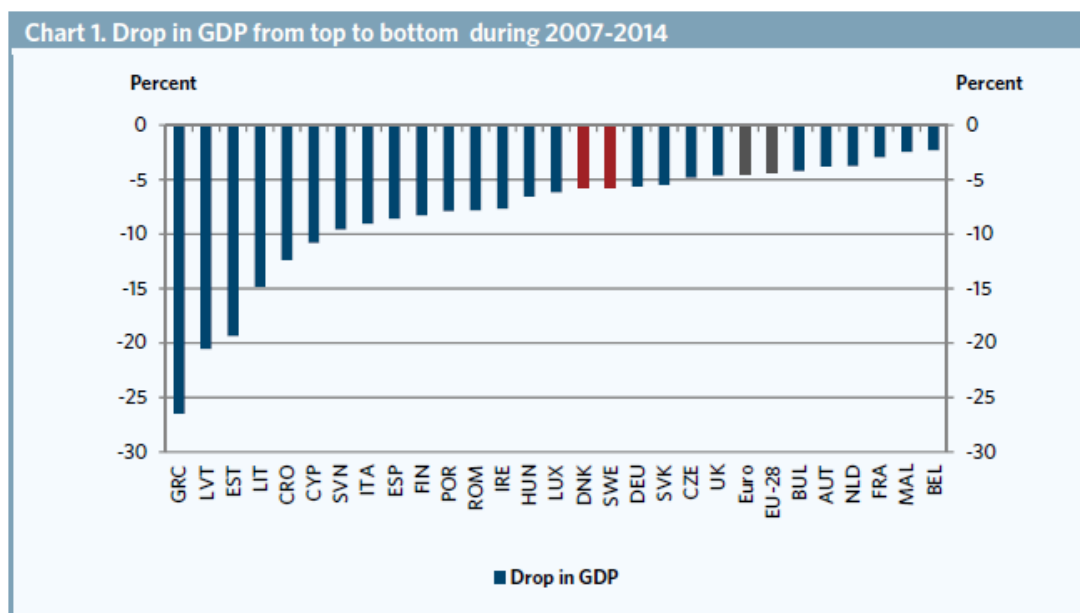
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The Nordic countries have been affected by the crisis

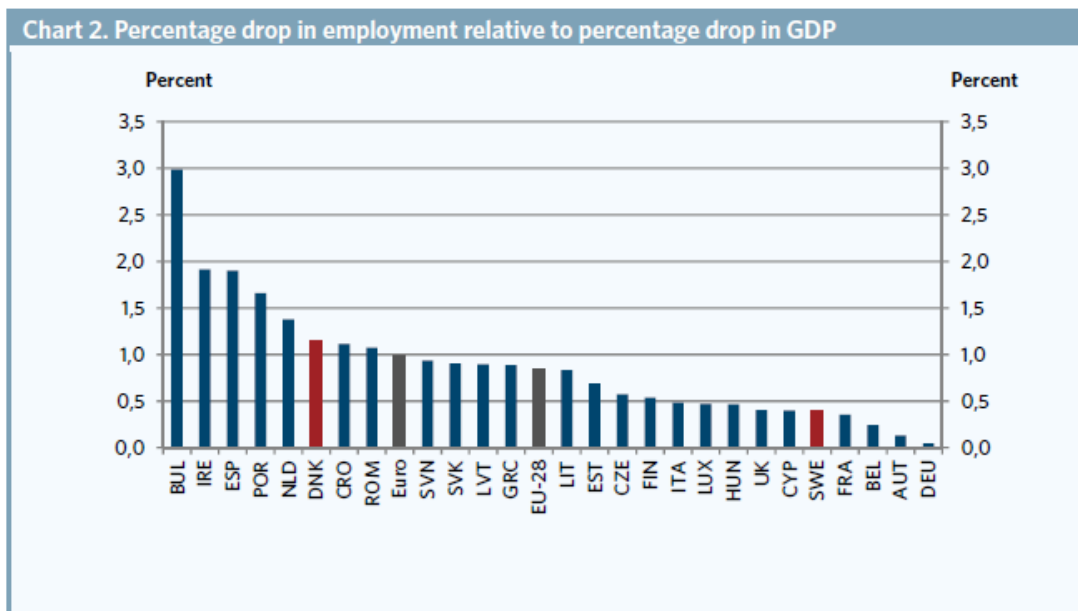
The Nordic countries are on many parameters performing rather well. This goes in particular for Denmark and Sweden who are among the most prosperous and most equal countries in the world. Despite the crisis and rather generous unemployment benefits, employment rates in the two countries continue to be among the highest in the EU. Although Denmark and Sweden seem to have done well during the crisis there are also differences in the outcome, with, for example, a far more significant fall in employment in Denmark than Sweden. Nevertheless both countries have performed well and have undertaken great labour market reforms that will help to ensure the Nordic models in the future. However lack of skilled labour and poorer public service could prove to damage the prospects of the Nordic economies.

Although the Nordic countries are doing well on many parameters they have not been unaffected by the crisis, and both Denmark and Sweden actually suffered a quite significant drop in GDP from 2008 to 2014 (chart 1), which actually exceeded that one of the Euro Zone. Only Eastern European countries and the troubled countries in Southern Europe experienced a more severe drop in GDP.



Note: We are looking at the decline in GDP from top to bottom in the period 2007-2014.
Source: Eurostat.

As a result of the drop in GDP employment fell significantly around Europe. Compared with the drop in GDP, the drop in employment in Sweden however remained rather low while in Denmark it was rather high (chart 2).



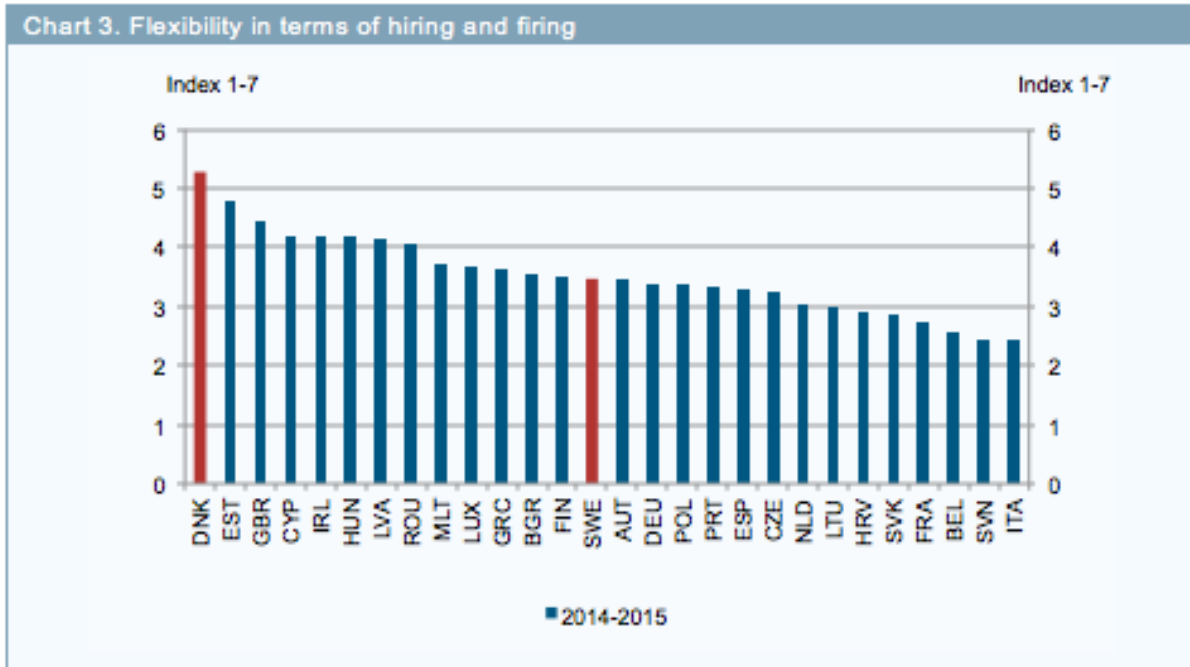
Note: We are looking at the percentage drop in employment relative to the percentage decline in GDP from top to bottom in the period 2007-2014.

Source: Own calculations based on data from Eurostat.

Several reasons can explain the difference between employment performance in Denmark and Sweden. First, the crisis in Denmark also featured a burst in the housing bubble which may have impacted severely not only on construction workers but also had severe negative effects on employment within the private service sector which provides a wide range of services for the construction sector. Also the burst bubble had a significant negative impact on confidence and domestic demand which in Denmark is more important for employment than exports. In Sweden on the other hand domestic demand was faster to recover. Second, while Sweden chose to stimulate the economy through fiscal policies, Denmark embarked in austerity already in the spring of 2010 which may have caused a larger impact on employment. Similarly, Sweden has had some benefit from their currency not being fixed to the Euro which gave Sweden more room for maneuver. The Swedish Kronor actually depreciated in the beginning of the crisis and thereby strengthened Swedish competitiveness. A third reason for the rather significant drop in employment in Denmark compared to both Sweden and the Eurozone has to do with the structure of the labour market.

Flexible rules for hiring and firing

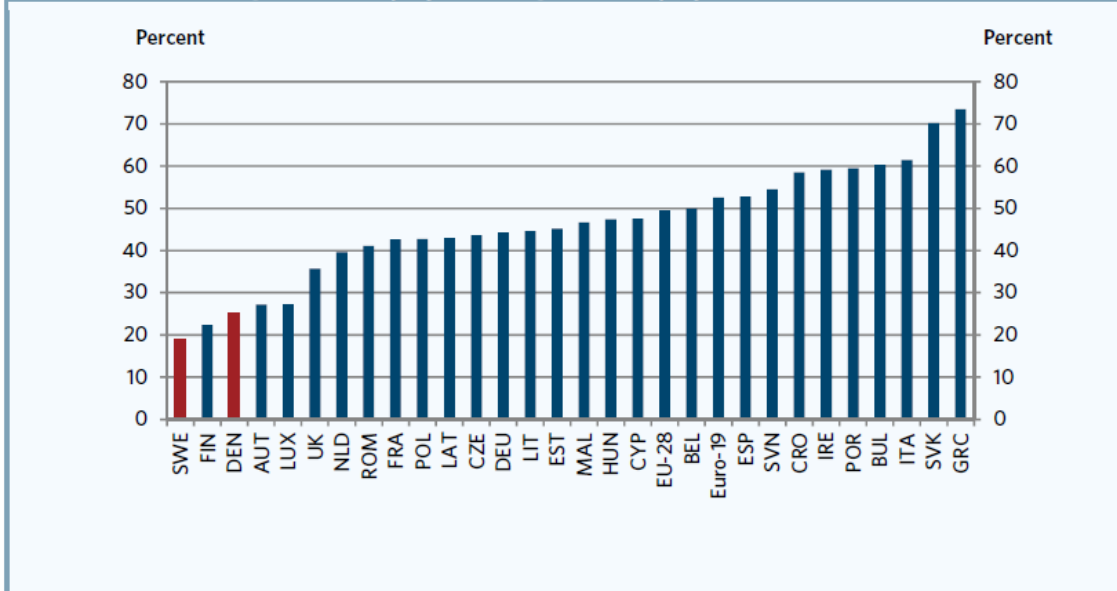
Denmark is characterized by having very flexible hiring and firing rules. According to the World Economic Forum, Denmark has the sixth most flexible labour market in terms of hiring and firing in the world and the most flexible labour market in the EU (chart 3). This can help to explain the rather large drop in employment.



Source World Economic Forum's "Global Competitiveness Report 2015-2016"

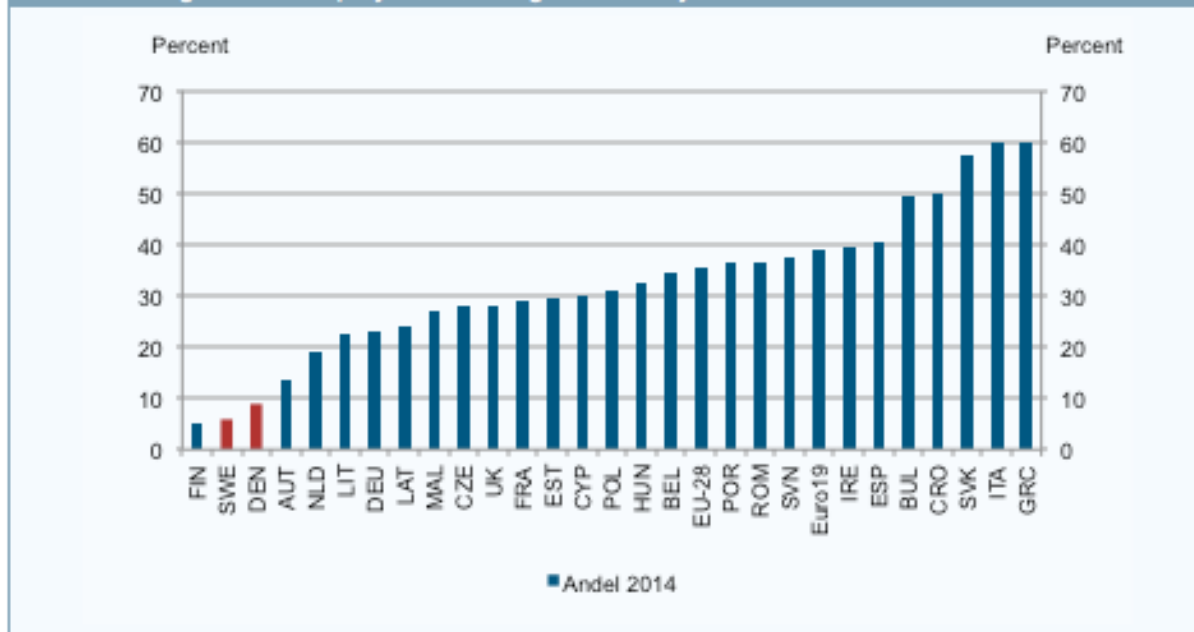
Despite the large drop in employment, Denmark continues to do well in terms of unemployment. Especially in terms of long term unemployment Denmark along with Sweden continues to be at the top of the league with a very low share of long term unemployed among the unemployed (chart 4). In the Eurozone about 50 percent of the unemployed have been unemployed for more than a year; but in Denmark and Sweden only around 20 percent and 25 percent respectively of the unemployed are long term unemployed. Even Germany despite having a very low unemployment rate has a rather high share of long term unemployed, of about 45 percent). Looking at long term unemployment among the youths, Denmark despite the significant loss of jobs, also continues to have a low share of long term unemployed (chart 5). Among the 15-24 year old, less than 10 percent are long term unemployed in Denmark and Sweden while the share in the Eurozone is around 40 percent. Among the 25-29 year old, the share of long term unemployed in Denmark and Sweden is less than 20 percent while it is 46 percent in the Eurozone (chart 6).

Chart 4. Share of long term unemployed among the unemployed



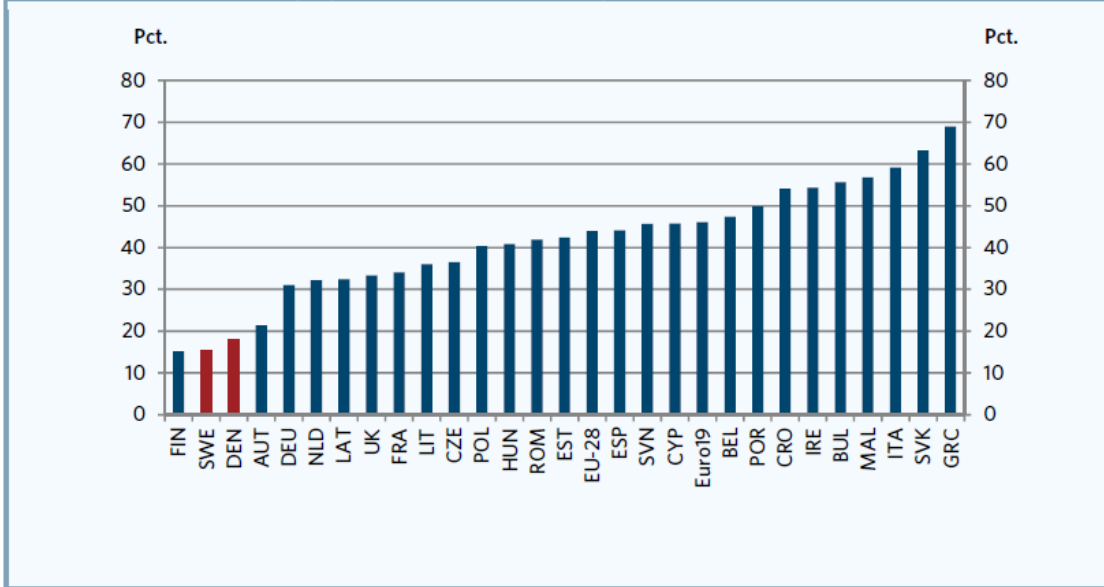
Source: Eurostat.

Chart 5. Long term unemployment among the 15-24 year old



Source: Eurostat

Chart 6. Long term unemployment among the 25-29 year old



Source: Eurostat.

From the evidence reported, it is not surprising that Sweden has been able to dampen the increase in long term unemployment given limited job losses in the country. In Denmark however the drop in employment has been rather significant so why is it that long term unemployment in Denmark is still among the lowest in Europe? To answer this question one must again look at the flexibility of the labour market. The low protection employees have against being fired in Denmark may certainly have its down sides but on the other hand such flexibility ensures that even during a severe crises the unemployed can still find a lot of job openings. Evidence in fact shows that despite the crisis there have been many newly employed persons in Denmark (chart 7), as about 23 percent of the employed have been employed for less than a year.

Chart 7. Newly employed among the employed



Source: Eurostat.

Also if one looks at the speed of which unemployed get back into work both Denmark and Sweden are doing very well. Of those that were unemployed in the first quarter of 2015 in Denmark almost 38½ percent had found a job the next quarter and in Sweden almost 30 percent, which brings Denmark and Sweden right at the top in the EU (chart 8). In the lower end we find some of the troubled countries in southern Europe where the flexibility of the labour market is not as pronounced as for instance in Denmark.



Note: We are looking at the share of unemployed in the first quarter of 2015 that found a job in the next quarter.
Source: Eurostat.

Generous unemployment benefits are essential for accepting flexible rules for firing..

While workers in Denmark dare changing jobs during times of an economic crisis and accept a poor protection against being fired?

The reason is that Denmark offers rather generous unemployment benefits. Generous unemployment benefits are traditionally viewed as reducing the motivation of the unemployed to search for work but in the Nordic model unemployment benefits and social assistance is an essential insurance in case of unemployment which can ensure workers income during times of unemployment and guarantee a certain standard of living.

..but combined with Active Labour Market Policies

The potential negative effect on employment from generous unemployment benefits can be reduced by means of Active Labour Market Policies (ALMP). A study performed by the OECD in 2006 indicates that, contrary to other countries, the generous unemployment benefits in Denmark do not have a statistically significant effect on unemployment.¹ The reason for this is exactly because Denmark has high spending on ALMP. In countries where a large share of GDP is used on ALMP, the negative effect

¹ OECD, Employment Outlook 2006.

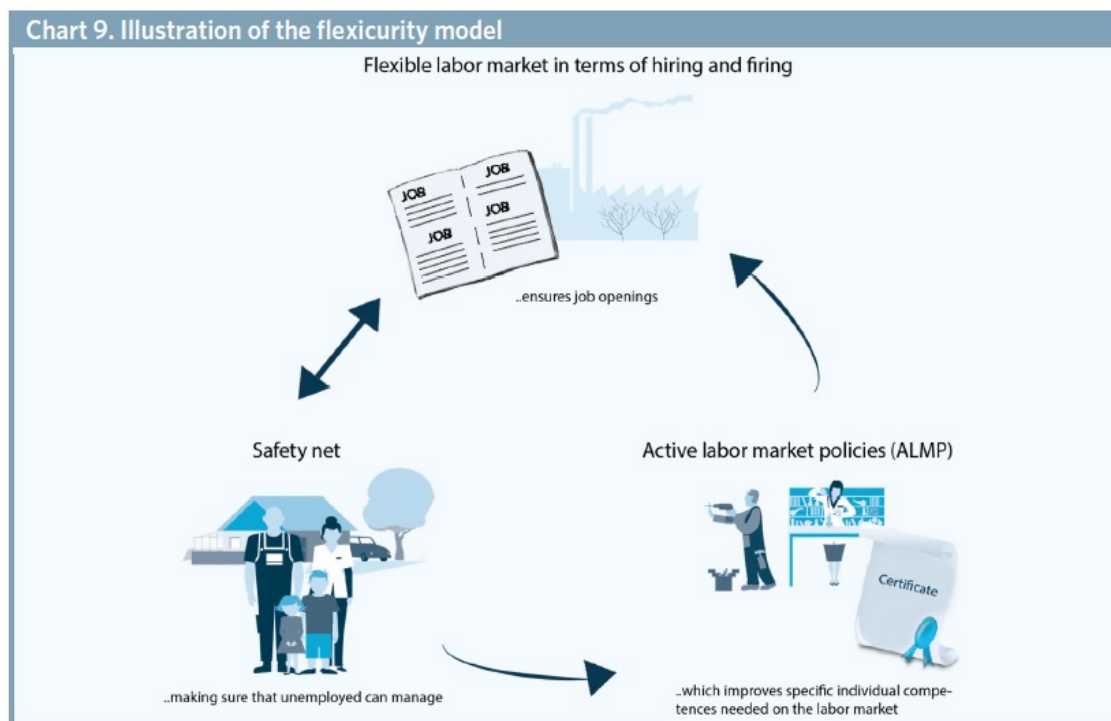
² Veje til Job – en arbejdsmarkedsindsats med mening, Februar 2014, Koch (2014).

of generous unemployment benefits becomes smaller and in some countries – among them Denmark – the negative effect on employment is not even statistically significant according to the OECD.

ALMP can also be an important tool in getting the unemployed back into work. However not all kinds of ALMP have positive effects on the unemployed’s chances of getting a job. Studies show that ALMP have to be targeted towards the labour market and specific jobs. If ALMP for instance just aim at improving some basic general skills within say math or language the chances of getting a job is not improved. But if specific skills for specific jobs are gained through ALMP, ALMP can improve chances of getting a job.² Also providing vocational education for low skilled workers without education can increase the chances of getting a job. ALMP are also recommended to be initiated fast – the longer the unemployed wait for help the more difficult to get them back into work, as the unemployed might lose faith and risk getting caught in long term unemployment if they are not quickly offered help and guidance. Finally frequent meetings between unemployed workers and the job center can also help getting unemployed into work.

The flexicurity model

Flexibility in terms of hiring and firing, generous unemployment benefits/social assistance and ALMP are the three key ingredients in the flexicurity model as illustrated in chart 9. The flexibility of the labour market in terms of hiring and firing ensures that even during bad times there will be job openings. To compensate for the low protection against being fired, a strong safety net is needed securing income during spells of unemployment. Finally to neutralize any potential risk of moral hazard problems arising from generous unemployment benefits, active labour market policies are needed to ensure that unemployed search actively for a job and provide the unemployed with help and guidance.

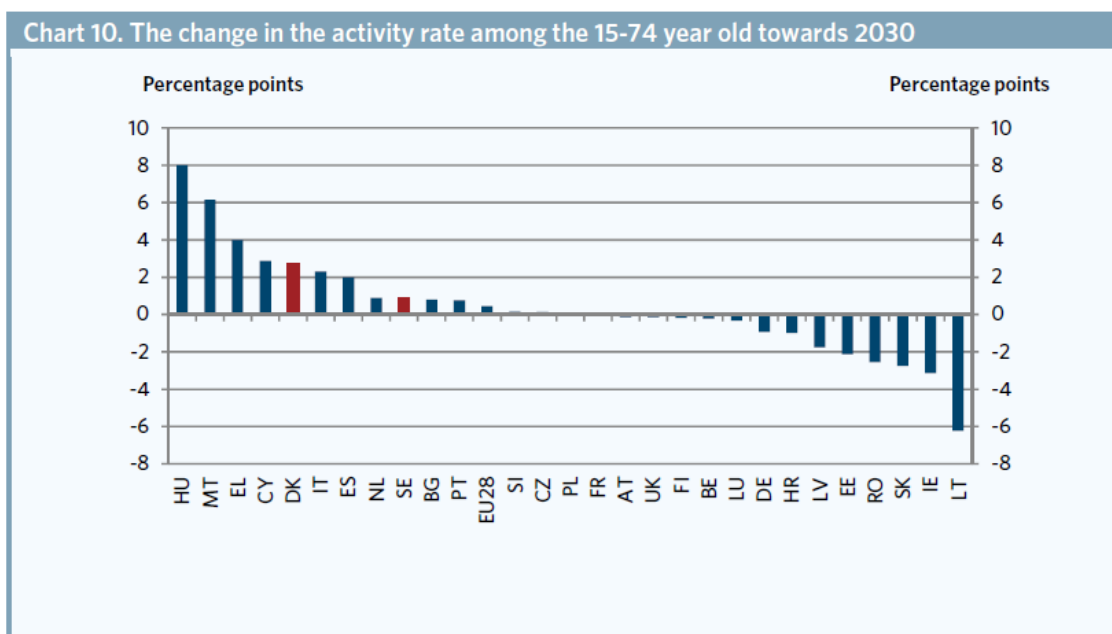


² Veje til Job – en arbejdsmarkedsindsats med mening, Februar 2014, Koch (2014).

How does the future look for the Nordic economies?

The outlook for the Nordic economies is looking bright. Both Denmark and Sweden have managed to avoid a large increase in long term unemployment. A large increase in long term unemployment could have resulted in higher structural unemployment which would damage growth potential and public budgets but this has successfully been avoided. In Sweden damage has been avoided due to expansive fiscal policies and healthy labour market structures and in Denmark thanks to its flexicurity model. At the same time both Denmark and Sweden have undertaken great labour market reforms, that will increase the labour force significantly over the coming years and will help to support growth and prosperity in the two countries. Thus both Denmark and Sweden are still expected to be among the most prosperous countries in the OECD in the future. The main contribution to the increase in the labour force in Denmark comes from reforms on the retirement age. In Denmark the retirement age will be lifted gradually over the coming years and the retirement age will be indexed with the life expectancy age. Thus in 2075 for instance the retirement age in Denmark is expected to be 75 years. In Sweden the main contribution to the increase in the labour force comes from an increase in the tax allowance concerning income from work (Jobbskatteavdrag).

Even though both Denmark and Sweden already are in the top 5 in the EU, in terms of the activity rate and the employment rate, both rates are expected to increase even further for the 15-74 year olds towards 2030 (chart 10). In many other countries – in Germany for instance - the activity rate is actually expected to fall towards 2030, which can seriously damage the long run growth potential of these countries.



Note: We are looking at the change in the activity rate for the 15-74 year olds from 2013 to 2030.
Source: The EU-commission, The 2015-Ageing Report.

Despite these steps to ensure sustainability of the Nordic model, some problems are looming. In Denmark there is a growing fear that even though the labour force will increase in the coming years the skills of the labour force might not be sufficient and forecasts point out that firms will lack employees with vocational and higher education. This lack of qualified labour can dampen productivity growth and hence prosperity. Furthermore reforms in Denmark have reduced the safety

net. This could in turn result in a less flexible labour market with fewer job openings making it more difficult for unemployed to get a job and more difficult for young people to enter the labour market. The reforms include the reform on the unemployment benefits in 2010 as part of the austerity measures taken in “Genopretningspakken” where the benefit duration was lowered from 4 to 2 years and the recent reform on social assistance where a ceiling on the total of social benefits a family can receive has been introduced (Kontanthjælpsloftet). The latter will also contribute to increase poverty and inequality in Denmark. In Sweden the replacement rates of several social benefits were lowered during the 90’ies including unemployment benefits which has contributed to increase inequality. The new government however has chosen to increase unemployment benefits again.

Public spending in Denmark is being lowered, compared to what was originally planned, in order to give room for tax cuts. If the service provided by the public sector becomes poorer this might in fact damage the growth potential of the economy. In the Nordic countries it has traditionally been the view that public consumption and investments can have positive effects on the growth potential of the economy. Education can for instance increase productivity and ensure workers a stronger and tighter attachment to the labour market, child care facilities makes it possible for both mom and dad to be active on the labour market, public spending on research and development can stimulate private investments in this direction which raises productivity and benefits innovation etc.

These positive effects of public spending are unfortunately now being ignored by many to give room for tax cuts - That could damage future growth potential of the Nordic countries. Reducing public spending is not a free lunch and that the safety net (unemployment benefits, social assistance etc.) play an important role in the Nordic models and ensure a dynamic labour market with many job openings. What policy makers in the Nordic countries really should focus on is education and training so to avoid scarcity of qualified labour and to increase productivity. Finally the Nordic countries need to define new policies on how to include the groups that today are outside the labour market - particularly immigrants.