

The current macroeconomic climate in Denmark

By

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Abstract

The Danish economy has recovered remarkably during the last 15 years – remarkably because the recovery does not really fit what would normally be expected from economic theory. An important explanation is the fact that the Danish economy is linked to a relatively small number of internationally high-income economies the business cycles of which are not synchronised. At the same time, the Danish economy is characterised by a highly dynamic and flexible labour market sustaining the Danish economic position. However, the current growth of the Danish economy is driven by private consumption which is not sustainable in the medium run. The future prospects of the Danish economy depend very much on the ability to increase private investments and what is going to happen in the German economy.

Background

From the end of the 1960ies to the beginning of the 1980ies, one of the first and now oldest movie production companies in the world, the Danish *Nordisk Film*¹, released 13 movies about a genius however clumsy and unfortunate criminal gang named after its leader *Olsen*. The gang portrayed the classic story about the little man fighting the big and powerful guy, mostly in terms of the honourable and decent criminal trying to steal in a non-violent fashion what the real big criminals have deprived society of. Generally, the gang never succeeded and by the end of each movie the gang leader went to prison just to be released and resume his old tricks at the beginning of the next movie. The Danes loved the gang and the movies became an integrated part of modern Danish culture and tradition, contributing to the Danish language and self-understanding. The reason was that the plans and life of the gang always were connected with basic family activities and current issues of society at the same time. During a period of 15 years, the successes and failures of the Olsen gang portrayed the current Danish debates and sentiments about such diverse themes as multinational companies, European Union membership, building society scandals, the paradoxes of the modern welfare state and vested interests in the political system, and the clash between political decisions and market forces.²

In 1979, a reputable movie³ dealt with a story that is interesting from an economic point of view. Secretly, the European parliamentary system had given up fighting unemployment, public debt, high interest rates, and trade balance deficit. In consequence, a secret agreement was being prepared by which the European governments would turn the national economies into private corporations and sell all of them to a multinational company (the European Multinational Confederation) that would run the national economies as private businesses.⁴

Even though the story was highly fictitious, it did express the general economic conditions and political sentiments at that point of time. Since the first oil crisis in 1973-74, the Danish economy had experienced increasing unemployment, excessive interest rates and inflation, public deficits and fast growing debt, and continuous trade imbalances. Even though the second oil crisis in 1978 did not strike Denmark as hard as the first one, the problems continued because the foreign economies on which a small extremely open economy as Denmark depends were depressed.

Now, more than fifteen years later, the situation has changed dramatically. Interest rates are extremely low even by historical standards, and inflation measured in terms of the annual increase of consumer prices is within the range of 1.5-2.5 %. The public deficit has turned

¹ My translation: The Nordic Film Corporation.

² The ability to combine what seemed to be a small-guy-fight-big-guy farce with current and important political themes in a seemingly non-political fashion made the movies extremely popular in the former communist East Germany as one of the subtle ways by which large parts of the population criticised the regime.

³ Movie no.11: *Olsen Banden overgiver sig aldrig* (The Olsen gang never surrenders).

⁴ In executing one of their plans, the gang stumbled over the secret policy scheme and managed to stop it from happening (for which the gang leader was imprisoned once gain, this time on a sentence of high treason).

into a surplus and consequently the public debts are gradually decreasing. The balance of trade has been positive for many years and according to the Danish Economic Council the foreign debts will disappear in 2008 (table I.1, DØR, 2004). Finally, the rate of unemployment seems to have settled at a politically acceptable level in the range of 5-6 % and is expected by most Danish commentators and analysts to fall slightly during the next 2-3 years.

Within the European Union, the countries are compelled to behave economically according to the so-called criteria of convergence, i.e. maximum levels of economic indicators that are important to primarily monetary stability. The criteria of convergence concern the rate of currency, consumer prices, interest rates, and public spending and debt. During recent years, the Danish economy has complied easily. Regarding the rate of currency, Denmark is not a member of the Euro-countries but maintain Kroner (DKR) as the national currency. DKR is expected to follow the development of the Euro within a range of +/- 2.25 %, but has actually become fixed to the Euro with only insignificant deviations.⁵ Table 1 shows the remaining criteria of convergence in 2003, i.e. the most recent year for which reliable national figures on convergence exist.

Table 1. *Convergence criteria and the Danish situation in 2003*

	Inflation (Increase of consumer prices)	Interest rate (10 year state bonds)	Balance of public spending (% of GDP)	Public debt (% of GDP)
Denmark	2.0 %	4.3 %	0.3 %	45.9 %
EU-25	1.9 %	4.2 %	- 2.8 %	63.2 %
Basic criteria	2.7 %	6.1 %	- 3.0 %	60.0 %

Source: Finansministeriet (2004a, table 2.1) and DØR (2004, table I.3)

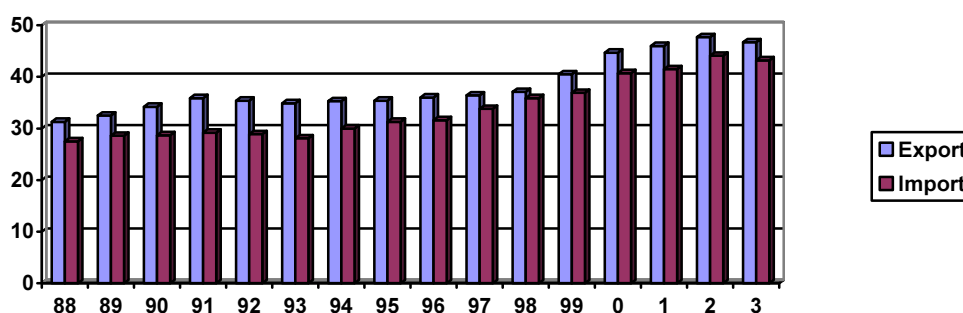
Table 1 reveals that the Danish inflation and interest rates are similar to what characterises the European Union on average (EU-25) and comply easily with the basic criteria of convergence. Regarding the public budget, Denmark is characterised by a surplus (as mentioned earlier) while the common situation in the EU is a relatively large deficit. Similarly, Denmark has been rather good at decreasing public debt measured as a proportion of GDP.

⁵ In practice, Denmark is a member of the Euro community since the national currency is almost locked to the Euro. This is an important part of the Danish national program for how to comply to the criteria of convergence (Finansministeriet, 2004a).

The peculiar openness of the Danish economy

The remarkable success of the Danish economy after the oil crises is a recent phenomenon. The economic problems of the 1970ies continued during the 1980ies and Denmark did not turn into a low-inflation stable-growth economy until the beginning of the 1990ies. Restrictive financial policy was applied during the 1980ies (which in Denmark became known as the “poor eighties”) followed by an expansive economic policy during the 1990ies when the international business cycle contributed to the positive renewal of the Danish business cycle. The gradual change of the Danish macroeconomic conditions took place as part of a process by which the Danish economy, although being a relatively open economy, became even more open, as illustrated by figure 1.

Figure 1. Total export and total import as proportion of GDP, 1988-2003



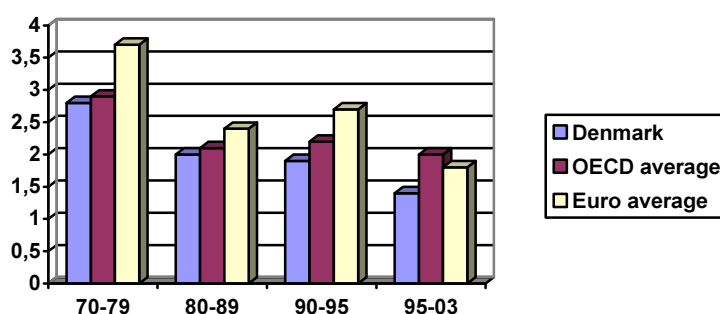
Source: Statistics Denmark and own calculations

The trade balance surplus that appeared during the 1980ies was a main factor contributing to the positive economic development of the Danish economy. In previous decades, continuous impulses of stop and go policy combined with depreciation of the Danish currency had been applied in order to protect the balance of trade that normally ran at a deficit. In consequence, the Danish economy was subjected to balance-of-payments constraints of growth. At the beginning of the 1990ies, the balance-of-payments constraints disappeared as export had been growing faster than import during the end of the 1980ies.

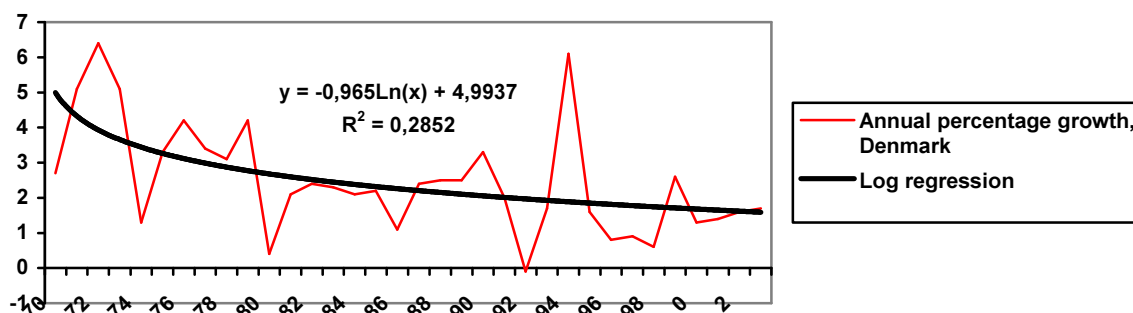
The disappearance of balance-of-payments constraints (which is normally associated with Thirlwall, 1979) may be explained by changes in the composition of country and product markets, superior technical changes, improvements of relative wages, and productivity growth above the international average, to some extent associated with a process of catching-up on the leading international players (see e.g. Abramovitz, 1986 and Fagerberg et al., 1994). However, none of these factors have really been at play in the Danish case (see e.g. Andersen et al., 2001). The composition of the Danish export remained relatively stable and Denmark

did not achieve superior technical changes. Relative wages tended to increase faster than the OECD average, and productivity growth seemed to lag behind. Actually, the Danish economy experienced severe problems of creating productivity growth during the 1980ies despite of intensive investment in technological upgrading (Gjerding et al., 1992), and recent figures seem to indicate that the productivity problems continued during the 1990ies (OECD, 2005), cf. figure 2. Even though the development of Danish productivity growth reflects an overall international long term decline in the OECD and EURO countries, Denmark is continuously lagging behind the industrialised international averages.

Figure 2. Labour productivity (GDP/working hour) 1970-2003



Source: OECD (2005), table 1.2



Source: Statistics Denmark

In a case where an economy is becoming more open while relative wages continue to be larger than the international average with which the country competes and productivity growth is not able to compensate for weak wage competitiveness, it would normally be expected that the economy would encounter economic problems. It is unclear why Denmark does not fit the basic case. However, two observations may suggest a partial explanation. First, the Danish business cycle has always been smooth because Denmark has been dependent on countries the business cycles of which have not been synchronised. In effect, Denmark has never experi-

enced the full blow of major international crises. Second, Denmark has maintained its primary economic relations with relatively stable high-income economies. Thus, it seems that if a small, extremely open economy is able to maintain major long term economic relations with stable high-income economies the business cycles of which are not synchronised, then the economy in question is able to prosper despite of long term productivity lags.

Table 2. *The major country customers and competitors of Denmark, 2003*

Country	Share of Danish exports	Competition weight
Germany	19	23
Sweden	11	6
UK	8	7
USA	7	8
Norway	6	4
France	5	7
Netherlands	4	3
China	4	n.a.
Spain	4	2
Finland	3	3
Belgium	2	3
Japan	2	6
Ireland	2	1
Total	$\frac{3}{4}$ of Danish export	

Source: DØR (2004, pp.112-13) and own calculations

Note: Rounded figures. Competition weight reflects the importance of the country as a buyer of Danish export combined with its importance as a competitor on other markets. The table reflects only manufacturing export. The countries marked by red have, traditionally, received about half of total Danish exports

Table 2 illustrates the Danish position by showing the 2003-composition of Danish manufacturing exports. Apart from China that have entered the top-8 of Denmark's trading partners recently, the countries in table 2 have for several decades been the most important Danish trading partners. They are, at the same time, the most important Danish competitors.

Prospects and the current Danish economic debate

The stability of the Danish economy appears to continue, however at a lower rate of growth. There is widespread agreement on this prognosis that appears in most of the recent forecasts whether they are made by the government, various labour market organisations, private banks, or the Economic Council. However, there are disagreements and signals of danger as to whether the stability can be maintained. Three points may be emphasised.

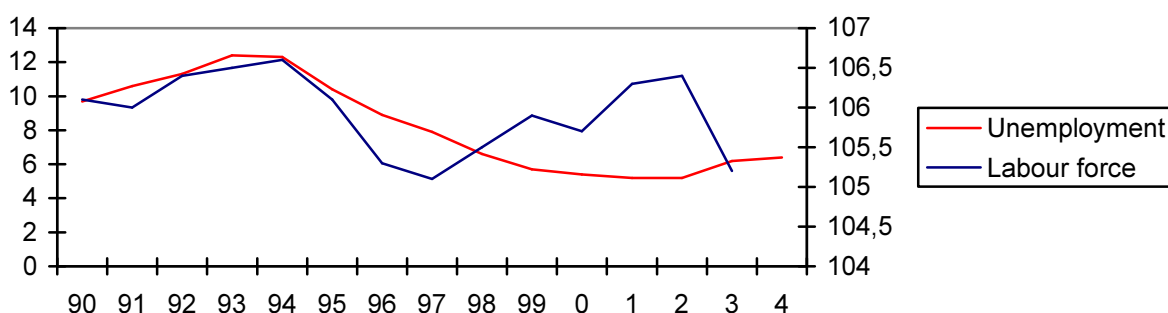
First, in order to sustain the current financial stability the Danish government needs to avoid large public budget cuts. However, maintaining the tax stop implies a need to cut down on public expenses in the medium term. Avoiding this scenario requires that employment increase in order to contribute to the value creation in society and the savings of public expenditure on unemployment. There is no agreement on how much the employment needs to increase, but the government anticipates an increase of some 60,000 jobs in its economic plan for 2005-2010. However, there is a widespread agreement among labour market organisations (whether representing employers or employees) that this will be hard to achieve without a new national plan for upgrading the qualifications of the labour force and for employing those who have been unemployed for a long time.

During recent years, about 260,000 Danish jobs have disappeared annually (DØR, 2003). Still, the Danish economy has been able to decrease unemployment, cf. figure 3. These movements reflect that the Danish labour market is, already, highly dynamic and flexible. At the same time the size of the Danish labour force is decreasing, cf. figure 3. In effect, creating 60,000 new jobs at a dynamic labour market characterised by a decreasing labour force may be far from trivial.

Part of the debate on future job creation has focused on the threats posed by the outsourcing of jobs to foreign countries.⁶ While employee labour market organisations have been very worried about these threats, research seems to indicate that the threats have been overrated. The Danish Social Research Institute has shown that the amount of outsourcing of jobs has been quite small during recent years (Geerdsen et al., 2004). Estimates indicate that only 3,500-5,000 jobs annually outsource (see e.g. DØR, 2004, and Økonomi- og Erhvervsministeriet, 2004). Even though some estimates have argued that as much as 10,000 jobs annually may outsource, it is still a small number compared to the number of new jobs created each year. It appears that there is a widespread agreement that at least 2,000,000 Danish jobs are not able to outsource and of the remaining 700,000 jobs only some may actually outsource (cf. DØR, 2004, pp.132-133). However, maintaining most of the 700,000 jobs require, of course, that the qualifications of Danish labour force is continuously upgraded.

⁶ DØR (2004, ch.2) gives an excellent account of the debate and the real life consequences.

Figure 3. *The rate of unemployment and the size of the Danish labour force, 1990-2004*



Source: Statistics Denmark and own calculations

Note: Unemployment is measured on the left axis as percentage of the labour force. The size of the labour force is measured at the right axis as an index number where 1981 = 100

Second, the growth of the Danish economy through recent years has been driven by private consumption, to some extent stimulated by decreasing taxes as part of the tax stop policy scheme. Even though private investments are expected to grow at a faster rate than private consumption⁷, cf. table 3, the rate of private investments as compared to the rate of consumption is still too small to take the role as the driver of growth. In the long run, the situation will be non-sustainable because low rates of investment means that it becomes increasingly difficult to maintain international market shares. Growth will gradually depend more and more on the domestic market, thus creating a balance-of-payments constraint on growth. This scenario is especially relevant in the Danish case where GDP per capita seems to have been growing at a comparatively low rate, cf. table 4. However, GDP per capita is still comparatively high (table 4), so the crisis scenario may be postponed a little bit.

Table 3. *Annual growth of private consumption and private investments 2004-2007*

Two forecasts	2004	2005	2006	2007
<i>Finansministeriet (2004b)</i>				
Consumption	3,5	3,2	2,0	
Investments	4,0	4,8	4,4	
<i>DØR (2004)</i>				
Consumption	3,4	2,8	2,1	2,1
Investments	2,6	4,1	2,5	2,2

Source: Finansministeriet (2004b, p.30) and DØR (2004, p.35)

Table 4. Danish GDP per capita

Average annual growth	1970ies	1980ies	1990-1995	1995-2003
Denmark	1.5	1.5	1.6	1.7
OECD average	2.7	2.4	1.4	2.3
EURO average	3.0	2.3	1.5	2.4
EU-15 = 100	2000	2001	2002	2003
Denmark	115	115	112	112
UK	102	105	108	109
Sweden	109	106	105	106
Japan	105	104	103	105

Source: OECD (2005, table 1.2) and Statistics Denmark

Third, as shown by table 2, the Danish economy is internationally linked to a relatively small number of countries, notably Germany, Sweden, UK, USA and Norway. While the economies of Sweden, Norway and UK are generally expected to grow annually at a rate of 2-2.5 % (DØR, 2004), there is no real anticipation of the American growth. Some argue that previous annual growth rates in the range of 3.5-4.5 % will continue due to the expansive financial policy of the Bush administration. Others fear that the American growth will come to a standstill because the increasing deficit of the balance-of-payments may lead to restrictive financial policies supported by an increase in interest rates. However, for the time being the economic situation in the countries most important to Denmark seems to favour the Danish economy.

One exception may be Germany, the economy that is by far the most important one to Denmark. Germany has experienced economic setbacks, and the rate of unemployment has now reached a historically high level quite uncommon to what is normally seen in Germany. In Denmark, the general expectation is that the German economy will grow by no more than 1-1.5 % annually during the next 3-4 years, thus depressing the rate of growth of the Danish

⁷ Partially because the rate of consumption in private disposable income during the last five years has decreased from the traditional Danish level of 95 % to 90 %, leading to an increase in the rate of saving from 5 % to 10 % (approximate figures).

economy. However, signs of growth may be appearing (e.g. *The Economist*, 2005): The formation of wages and private business rationalisation has improved the international competitiveness of Germany. Actually, Germany is the only G7 country that has increased its international market share during recent years. Furthermore, investments seem to improve. The main problem in Germany now is that the rate of consumption is too low (and the rate of saving too high), thus depressing domestic growth that could have stimulated the general business climate and thus exports. Which scenario that turns out to be the right one for Germany is quite important to the future prospects of the Danish economy.

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