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World of Labor
Evidence-based policy making

The Danish labor market, 2000–2020

Flexicurity has proven resilient to large shocks, but low skills and employment rates are challenges, especially among youths

Keywords: flexicurity, business cycles, structural policies, youth unemployment, immigration

ELEVATOR PITCH

Denmark is often termed a "flexicurity" country with lax employment protection legislation, generous unemployment insurance, and active labor market policies. This model is not a safeguard against business cycles, but has coped with the Great Recession and the Covid-19 pandemic, avoiding large increases in long-term and structural unemployment. The pandemic has had severe effects due to restrictions and lockdowns, but the recovery and re-openings in late 2020 and spring 2021 have been strong, indicating that the labor market effects are mainly temporary. Recent reforms have boosted labor supply and employment. Real wage growth has been positive and responded—with some lag—to the developments in unemployment.

Gross unemployment rate and real wage growth, 2000–2020

Note: Gross unemployment includes individuals in activation programs. Real wage growth = growth in hourly wages in industry minus increases in the consumer price index.

Source: Statistics Denmark. Online at: http://www.statistikbanken.dk

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KEY FINDINGS

Pros

- Employment rates are high and employment increased due to cyclical factors and structural reforms.
- High job turnover rates ensure that most unemployment spells are short, which helps prevent a rise in structural unemployment.
- Resilience to crises like the Great Recession and the Covid-19 pandemic avoid sharp increases in long-term and youth unemployment.
- Wage adjustment has been flexible, preserving wage competitiveness.
- There are few working poor due to high minimum wages and a compressed wage structure.

Cons

- A large share of youths enters the labor market with low qualification levels; this is especially challenging because there are few low-skilled jobs.
- Immigrants from low-income countries have low employment rates.
- The high rate of job turnover may reduce human capital accumulation.
- Wage inequality is widening somewhat.
- Average working hours are low.

AUTHOR'S MAIN MESSAGE

Employment has been trending upward and reached record high levels. Recent reforms have contributed to this. "Flexicurity" has been tested by the Great Recession and the Covid-19 pandemic but is no safeguard against such shocks and should be evaluated against its ability to prevent temporary decreases in employment from becoming persistent due to increases in youth unemployment, long-term unemployment, and thus structural unemployment. This has not been the case as a result of the Great Recession, although Denmark experienced one of the largest GDP decreases; and evidence indicates a rather swift recovery from the setbacks caused by Covid-19-motivated restrictions and lockdowns. Turnover rates—job openings and destructions—are high, implying that many are affected by unemployment, but unemployment spells are generally short. This is critical to preventing increases in long-term unemployment and eases labor market entry for young people. Wage inequality is rising, but less than in other countries, and wage dispersion remains relatively low.

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MOTIVATION

The flexicurity model has been heralded for its ability to reconcile flexibility with social protection. The key ingredients are lax employment protection legislation, a relatively generous social safety net, and active labor market policies. This model combines employers' demand for flexibility with workers' demand for income security and maintains work incentives via active labor market policy [1]. However, the flexicurity model is no guarantee against a recession, and the critical test is whether the model can cope with a large negative shock, support reallocation of labor, and avoid persistent unemployment. The Danish experience shows that the answer is affirmative. A crucial aspect is the high job-turnover rate, which has prevented long-term unemployment from increasing significantly in the wake of the Great Recession, and preliminary evidence suggests the same regarding the Covid-19 crisis. Global trends also affect the Danish labor market, and wage inequality has been rising, although it remains low. The financial viability of the flexicurity model—and the welfare state more generally—depends critically on maintaining a high employment rate. The social safety net has, in recent years, been overhauled to strengthen labor supply and employment, including reforms targeted at the elderly, the young, the old, and immigrants. The main challenges calling for policy action are the low employment rate of immigrants and the relatively large share of youth not obtaining a labor market relevant education.

The Covid-19 crisis

Denmark has experienced two waves with a high number of people testing positive and increases in hospitalizations: in the spring of 2020 and toward the end of 2020 and the first quarter of 2021. In response to this, various restrictions and lockdowns were imposed, and although they were slightly less severe in the second round, they were enforced for a longer time period.

An important element in the Danish coronavirus strategy has been extensive testing (genome sequencing, tracing, and so on), and access to many re-opened activities was at first conditional on a negative Covid-19 test. Vaccinations are still being rolled out, but Denmark has decided not to use the AstraZeneca and the Johnson and Johnson vaccines (voluntary access to these vaccines is possible), and this has slowed down the process. Vaccination of everyone above the age of 50 was set as a political milestone for the final steps in the re-opening plan, and was reached in early September 2021.

The lockdown restrictions were accompanied by various emergency or relief packages. From an individual and firm perspective, they offered insurance against and compensation for some direct consequences of the pandemic. From a broader perspective, the schemes aimed at protecting production capacity (job-matches, avoiding firm closure) to supporting a swift recovery when the economy is re-opened. This was essential to avoid the pandemic causing a more persistent decline in economic activity and an increase in long-term unemployment. The key elements of the emergency packages are: (i) a wage compensation scheme preventing lay-offs and maintaining job-matches such that workers receive their normal wage (up to a cap) and firms get a subsidy (75% or 90% of the wage costs), (ii) compensation for fixed costs for firms experiencing a decline in turnover of at least 30%, (iii) a support scheme for the self-employed, and (iv) liquidity and guarantee schemes for all firms (including postponement of payments of taxes and VAT). In addition, there are various other schemes, for example, for culture. These measures are a very unusual form of economic policy in a very unusual situation; they have a status quo bias, and it is therefore essential that they are temporary and phased out alongside re-openings.

These measures were essentially the same during the two rounds of lockdown. In late spring 2020, the lockdowns were lifted, and the emergency packages were subsequently phased out. During the autumn, some specific and targeted measures remained in place, and during the second round of lockdowns the general emergency packages were re-introduced. Alongside the re-opening during spring 2021, the emergency packages were phased out over a window allowing some time for adjustment.

The impact of the lockdowns was clearly most severe in the service sector, but other sectors were also affected. The wage compensation scheme protected workers, and therefore the unemployment response was muted compared to the decrease in GDP of 6.6% in the second quarter of 2020. However, unemployment did increase, and low-skilled and female workers were especially affected. The wage compensation scheme—in combination with the other measures—thus implied some hidden unemployment. At the peak in 2020, about 15% of total private employees were on the wage compensation scheme (less than half of this level at the peak during the second wave).

The Covid-19 pandemic was a large unanticipated shock. Based on historical evidence, a recovery would be gradual. However, the experience following the re-openings in 2020 and again in 2021 suggests a rather swift recovery, largely supporting the V-logic underlying the emergency packages that they would make a quick recovery possible. The lockdowns following the Covid-19 pandemic have both a supply and demand component; firms are constrained in their possibilities for selling, and demanders in their possibilities for buying. The emergency packages allowed many firms to retain valuable job-matches and production capacity (avoiding bankruptcy), but they also protected the income of workers and hence consumers, supporting consumer confidence and avoiding increases in precautionary savings. Hence, two classical persistence mechanisms, namely job-matching and decreases in aggregate demand, were muted by the policy initiatives. As noted, this should be seen in the perspective that Denmark entered the Covid-19 crisis with a well-performing economy, including low unemployment and sound public finances due to previous consolidation and reforms. Consequently, there was fiscal space to pursue rather aggressive policies in terms of emergency packages, but also more traditional fiscal policy measures. At the end of 2019, public debt was about 33% of GDP, among the lowest within the EU and well under the 60% baseline target. Despite the policy measures taken and the drop in GDP in 2020, debt will, according to the Ministry of Finance, be about 42% of GDP—still very low by any international comparison.

Following the re-openings, the economy (production, employment) has followed a clear V-pattern with a sharp drop at the onset of the pandemic and a swift recovery during the re-opening phase. As an example, about 90% of those on wage compensation in April 2020 were in employment in October 2020 [2]. This is very close to normality since there are always in- and outflows from the labor market (retirement, sickness, and so on). The decline in economic activity in Denmark in 2020 is among the lowest for OECD countries, with GDP falling 2.7% in 2020. Although many factors contribute to explaining this, the overall purpose of the emergency measures in maintaining job-matches and production capacity was borne out in reality.

Interestingly, during the second lockdown round, the decline in economic activity was smaller than during the first round, despite the lockdowns being as or perhaps even slightly more widespread than in 2020. This indicates adjustments and adaptability to the new situation via numerous channels, including more "working from home" and adaptation of sales channels (click and collect, e-commerce, virtual meetings, online teaching, and so on). A high level of digitalization is essential to resilience, making it easier to substitute virtual contacts for physical contacts, and Denmark ranks highly on a global scale on digital skills and a high-capacity network.

The aggregate numbers conceal heterogeneities. While some sectors have been in decline, others have expanded (e.g. health care and construction), and hence there has been some reallocation of labor in the process. Moreover, evidence indicates that sectors already facing declining employment prospects prior to the pandemic (including some activities prone to automatization) have been most severely hit, and the crisis may thus accelerate ongoing structural changes [3].

Pros and cons of the flexicurity model

Macroeconomic developments have generally been favorable in recent years. Based on standard macroeconomic indicators the economy was performing very well before the Covid-19 crisis. Employment was high and growing, and public finances and the current account displayed surpluses. The Covid-19 crisis differs from the Great Recession not only in the nature of the shock but also in the preexisting economic situation. The period before the Great Recession had high growth, and unemployment fell below the structural level. There were clear signs of overheating with a booming housing market and accelerating wage increases. This was an unsustainable situation. Economic growth was already fading when the Great Recession set in, thus bringing the economy into a deep recession. The recovery from the Great Recession was therefore relatively slow, although steep increases in long-term unemployment were avoided.

The cycle is clearly seen in Figure 1, displaying the developments of both employment and total working hours. Both peaked prior to the Great Recession, and subsequently plummeted to recover only more gradually. Prior to the Covid-19 pandemic, employment reached a higher level, but importantly without the same signs of overheating as before the Great Recession. The employment decrease due to the Covid-19 crisis was muted by the wage compensation scheme introduced (see above), and therefore the drop in working hours is a more accurate indicator of the effect of the crisis on economic activity.

The Danish flexicurity labor market has received considerable attention in recent years, especially for its ability to make a relatively generous social safety net compatible with a high employment rate [1]. It should be noted that employment rates—for both men and women—are among the highest within the OECD. This is in itself an interesting observation given the extended welfare state associated with the Nordic welfare model.

While the flexicurity model is no guarantee against business cycle fluctuations, the interesting question is how the model performs in a severe recession. Lax firing rules make it likely that employment will fall drastically when aggregate demand drops, and although the social safety net provides a cushion against large income losses for the unemployed, the financial viability of the model is at risk if structural employment increases. A

Figure 1. Employment and total working hours, 2000–2020

Source: Statistics Denmark. Online at: http://www.statistikbanken.dk

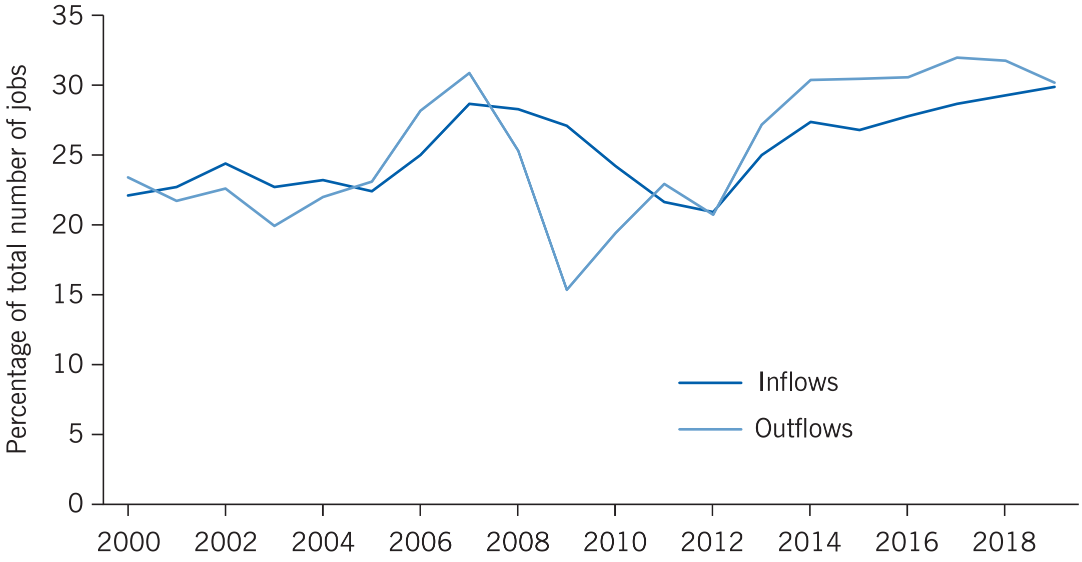
prolonged decline in employment reduces tax revenues and increases social expenditures, thus putting public finances under strain. The specifics in relation to the Great Recession are discussed in the author's previous work, and a preliminary assessment of the Covid-19 crisis was made above.

A key property of the flexicurity model is a high level of job turnover, implying that the unemployed (including youths entering the labor market) can find jobs fairly easily, and that most unemployment spells are short. Indeed, the data bear this out, as the general level of job inflows and outflows is high. Although job inflows plummeted as a consequence of the Great Recession crisis, they soon recovered, and the gross in- and outflow rates quickly returned to pre-crisis levels or even higher (Figure 2). Data for the Covid-19 period are not yet available, but indicators—including indicators of job openings—strongly suggest that turnover rates have recovered.

The resilience of the labor market can be illustrated by looking at the duration of unemployment spells (Figure 3). In a normal year, for example 2007, 30% of unemployment spells are shorter than four weeks, and about 50% are shorter than three months. During crisis periods with increasing unemployment, exit from unemployment is lower, as illustrated by the 2009 numbers in the figure. But still most durations are rather short. Following those becoming unemployed in late 2019, the path is normal in the first weeks, but then exit rates are lower than during a normal year due to the Covid-19 pandemic.

This high level of turnover in the labor market is also the driving force behind Denmark's comparably low levels of youth and long-term unemployment. Both were about half the EU average during the crisis years and at other times too. High turnover rates thus effectively work as an implicit work-sharing mechanism. Equal burden sharing is important from a distributional perspective, but it is also of structural importance. The alternative would be longer unemployment spells concentrated among a smaller group of individuals, more long-term unemployed and a corresponding depreciation of human and social

Figure 2. Job inflows and outflows, 2000–2019



Note: In- and outflows as a percentage of total employment for blue collar and white collar workers for the area covered by the Confederation of Danish Employers. Shifts in job for the same employer (work place) are not included.

Source: The Confederation of Danish Employers. Online at: https://www.da.dk/en/

capital. In short, the high turnover rates reduce the negative structural potential of high unemployment.

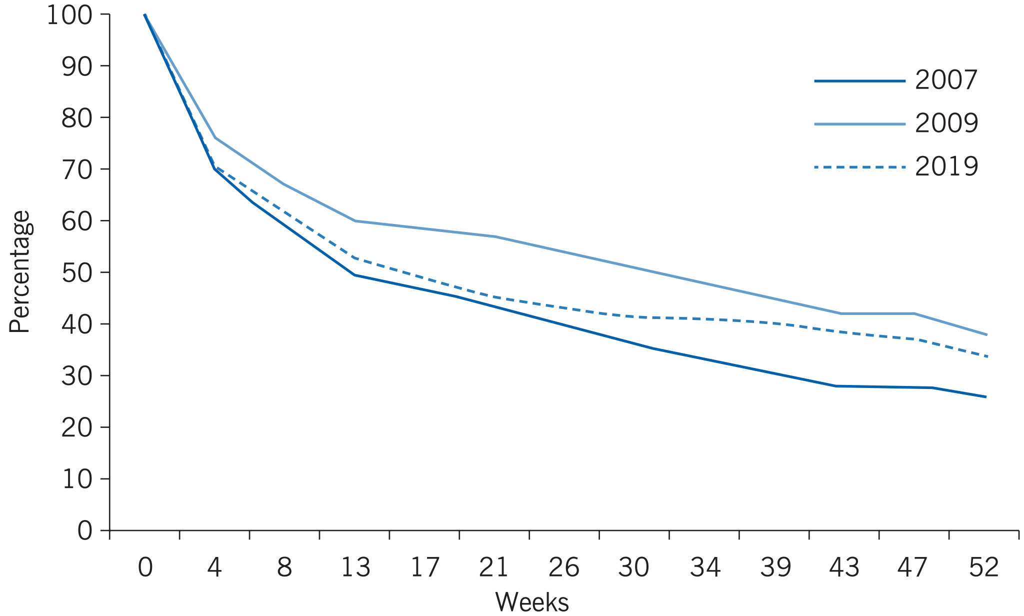
A possible downside of high job turnover is that it may be detrimental to firm-specific worker training. It makes it difficult for firms to protect investments in their workers' human capital if the training is useful in other firms too. This may lead to a suboptimal level of investment in human capital with negative effects on productivity growth.

Flexible wages facilitate labor market adjustments

Real wage growth has been rather steady over the years, but with variations reflecting the business cycle. Most clear is the spike in wage increases, and the associated deterioration in wage competitiveness, as a consequence of the overheating prior to the Great Recession. Subsequently, wage developments have been more moderate, and real wage growth has gradually increased in response to the declining unemployment rate. Wage flexibility—both upward and downward—has thus been relatively high by international comparison, and sluggish wage adjustment is thus not a key issue. This differs from labor market responses in the 1980s and 1990s and can partly be attributed to a move from a highly centralized wage-setting system toward a model of so-called "centralized decentralization." Collective arrangements retain their role as regulators of labor market conditions, while wage determination has become more decentralized [4]. The recent rise in employment has increased real wages, but only moderately.

As in most OECD countries, wage inequality has followed an upward trend (Figure 4), although wage dispersion remains low by international comparison. There are few working

Figure 3. Gross unemployment—Survival function, selected years



Note: The graph shows the share of those who become unemployed (among those with unemployment insurance) in the third quarter of each year and who remain unemployed after a given number of weeks (the survival function). Individuals are included as unemployed irrespective of the social benefit they receive. 2007 represents a normal year, 2009 a crisis period, and 2019 the onset of the Covid-19 pandemic.

Source: Jobindstats. Online at: http://www.jobindsats.dk

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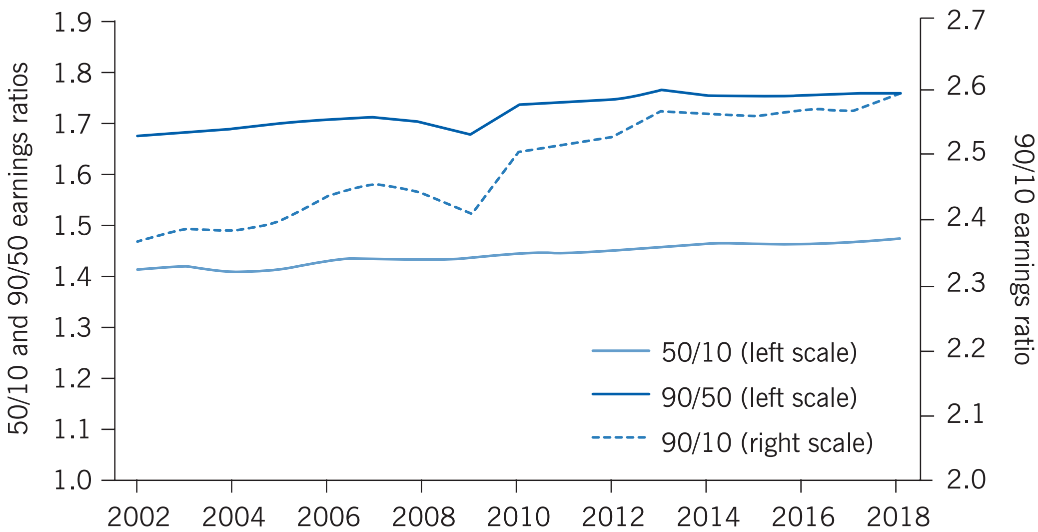
poor, and the number did not increase much during the crisis. It is noteworthy that the wage share (wages as a share of value added) has remained fairly stable for decades, and there has not been a shift between labor and capital income, as experienced in many other countries.

Figure 4. Earnings inequality, 2002–2018



Note: Decile ratios are computed based on gross earnings. 90–95 earnings ratio = earnings at 90th percentile divided by earnings at the 50th percentile; other ratios analog. Data available only for the period 2002–2015.

Source: OECD iLibrary. http://www.oecd-ilibrary.org

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High employment rates and high share of population receiving transfers

The labor market situation can be assessed from two angles: one is the share of the working-age population in employment (as in Figure 1), and the other is the share receiving some form of public income support. The employment rate in Denmark is high by international standards, but so is the share of the working-age population receiving public transfers. The latter reflects more extended welfare arrangements, implying that most who are unable to support themselves are entitled to some form of public support. It is an immediate corollary that public finances are very sensitive to the employment rate; higher employment increases tax revenues and reduces social expenditures, and vice versa. In recent years, there has been much focus on reducing the share of the working-age population receiving social transfers. All types of social transfers have been overhauled in order to strengthen labor supply and employment. These changes cover both eligibility criteria and conditions as well as benefit levels. Several aspects of these changes are of particular interest, most notably those involving youths, the elderly, and immigrants.

Youths

The share of youths neither in employment, education, or training (NEET) in Denmark is below the OECD average, but it has been on an upward trend. While much has been said about the Danish flexicurity model's ability to attain a low unemployment rate, the issue of youth entering the labor market with weak qualifications is a challenge [5].

The share of cohorts without education relevant for the labor market is a particular challenge. A key welfare state objective is to reconcile high employment with decent wages (i.e. no working poor). The wage structure is compressed, and minimum wages are high by international comparison, thus creating a situation in which the qualification requirements to find jobs are also high. This is important for maintaining a relatively equal distribution of income, but it is also a precondition for the financial viability of the welfare model.

The social safety net has recently been reformed to strengthen the incentive for all youth to acquire relevant qualifications. For individuals below the age of 30 (previously the critical age was 25) without an education yielding labor market qualifications, the social assistance benefit level has been reduced such that it does not provide better compensation than study grants. Eligibility for support requires commencing education, or, alternatively, participating in an activation program.

These changes are aimed at reducing the number of NEETs. The experience so far is mixed. On the one hand, some evidence points to positive effects on employment and, in particular, on enrolment in education among the targeted groups. On the other hand, there is no noticeable decline in the share of youth depending on social benefits.

One criticism of the reform is that educational deficiencies should be targeted much earlier than when people are above the age of 20. Most people in the target groups have been enrolled in education before—without completing it—which points to the importance of early intervention (primary school or earlier) as a more effective tool in overcoming educational barriers.

The unemployment insurance scheme has also been reformed, affecting everyone in the labor market. Most important is a reduction in the maximum benefit duration from four to two years. Since this reform was implemented during the crisis, it has been very controversial. The reform also strengthened incentives to accept short-term jobs.

The elderly

While the overall employment rate is high, it has been low for age groups above 55 in the past. This has changed in recent years. A number of reforms have tightened the possibilities for early retirement and increased the statutory pension age, and it is now indexed to longevity. These changes have been motivated by increasing longevity and healthy aging as well as the need to ensure fiscal sustainability by increasing the relative share of a lifetime that people are working and thus contributing to the welfare state. One of the arguments against these changes has been that the job possibilities for the elderly are few. In a business cycle perspective, elderly workers are not more exposed to unemployment risks than young cohorts, but they may have a hard time returning to jobs. However, that does not preclude a high structural employment rate for the elderly, which was true in Denmark even during the crisis years. The employment rate for the age group 60–64 has increased greatly, from 47% for men and 28% for women in 2008, to 68% and 53%, respectively, in 2019. A more challenging aspect alongside increasing statutory retirement ages is the exit possibilities for individuals with reduced working capability (high morbidity).

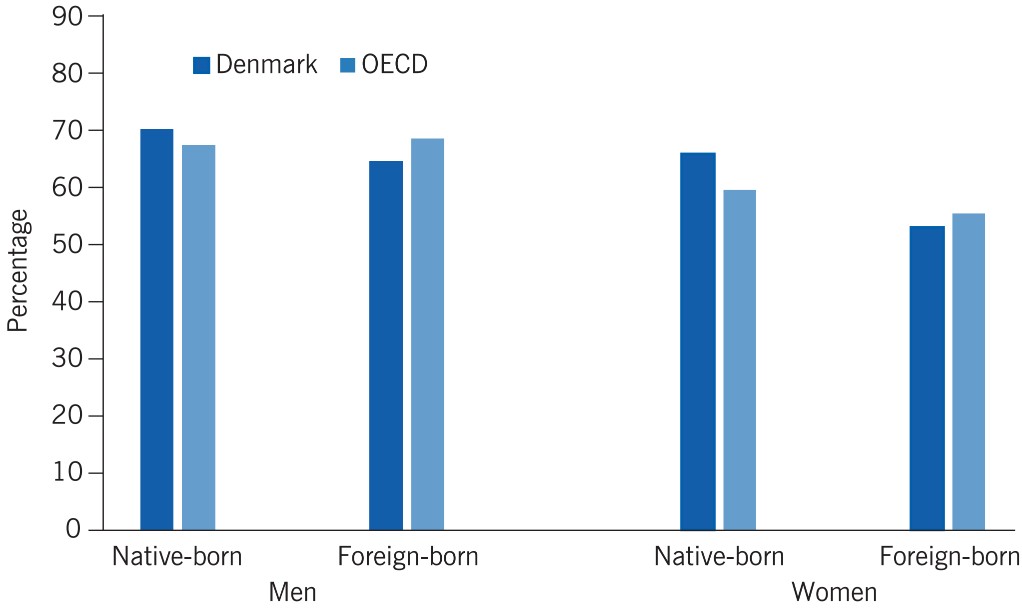
Immigrants

Employment rates for immigrants vary considerably depending on the individual's reason for immigrating (study, work, refugee, family unification) and country of origin [6]. Employment rates for immigrants from low-income countries (mostly refugees and family unifications) can be viewed in two ways—by comparing either levels or gaps relative to other OECD countries, as in Figure 5. The level of employment rates for immigrants is not much different from what it is on average in OECD countries. The gap—the difference in the employment rate relative to natives—however, is large, especially for women. This reflects, of course, that employment rates are high in Denmark, so that it is more difficult for immigrant employment to reach this level.

The differences in employment rates between natives and immigrants may have numerous explanations. An important question is whether the design of the welfare model is an impediment to labor market entry for some immigrants. As noted, the Danish labor market is characterized by relatively high minimum wages and a compressed wage structure, which essentially eliminates working and being poor as an option. Consequently, the qualifications required to find a job are relatively high, and low-skilled jobs are in short supply. Different cultures and norms for some immigrants with respect to gender roles may also play a role, especially for female employment rates. These effects may be compounded by language barriers, problems related to recognizing foreign educational qualifications, and possibly discrimination in the labor market.

The policy debate on immigration has been intense in Denmark, and various policy initiatives have been undertaken, including the tightening of immigration rules. Moreover, some changes in the social safety net have been prompted by immigration issues. The ultimate floor in the social safety net is the so-called social assistance, which provides economic support to those unable to support themselves and their family. A residence principle for eligibility was introduced in 2002, implying that eligibility for social assistance

Figure 5. Employment rates by place of birth, Denmark and OECD, 2019



Source: OECD iLibrary. Online at: http://www.oecd-ilibrary.org

requires residence in Denmark for nine out of the last ten years. In addition, there is an employment criterion requiring ordinary employment for an accumulated period of at least two and a half years within the last eight years. (A further employment criterion has been added to target couples.) Individuals not fulfilling these requirements are entitled to a different transfer (start aid/introduction benefit), equivalent to roughly half the value of social assistance. While these conditions did affect some Danes returning home after extended periods abroad, they had the largest effect on groups of immigrants with low employment rates, who were very likely to receive social assistance. These initiatives have been debated heatedly. They were introduced in 2002, abolished in 2012, and reintroduced in 2015 (and strengthened in 2019). The frequent policy changes reflect the sensitivity of the issue and the divided political views. However, the trend in recent years has been toward a tightening of the rules on both immigration and access to the social safety net.

LIMITATIONS AND GAPS

Looking forward, the Danish labor market is affected by various structural changes, including automation, that have been accelerated by the Covid-19 crisis. This requires adjustment; a particularly worrisome aspect is the large share of young cohorts not possessing labor market relevant qualifications. Since most youth do enroll in upper secondary, post-secondary non-tertiary, or tertiary education, the main challenge is to increase completion rates, and earlier intervention may be called for to ensure that the educational objectives can be reached. Ensuring high employment rates for immigrants also remains an important challenge.

Although employment rates are high, average working hours are low due to the prevalence of part-time work. It is easier to regulate labor market participation (the extensive margin) via entitlement conditions than it is to regulate working hours (the intensive margin). However, working hour restrictions have been included in the entitlement conditions for social benefits, and tax reforms have been implemented to target working hours.

SUMMARY AND POLICY ADVICE

The Danish experience shows that the flexicurity model has been able to cope with deep crises. Despite recent global and national challenges, the balance between flexibility and security has been retained. The model ultimately rests on its financial viability. Thus, even during the crisis, Denmark succeeded in launching forward-looking reforms to support high labor supply and employment. However, challenges remain. Ensuring that a high employment rate coexists with relatively low wage dispersion is difficult, particularly considering the problems arising from youths and immigrants entering the labor market with weak qualifications. Policymakers are working to address these issues via changes in the social safety net and education programs, but more action may be needed to reach the objectives.

Acknowledgments

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Competing interests

The IZA World of Labor project is committed to the IZA Code of Conduct. The author declares to have observed the principles outlined in the code.

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