

From the Edge of the Abyss to Bonanza - and beyond

Danish Economy and Economic Policies 1980-2011

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1. Introduction

Between 1980 and 2010, Danish economy became renowned both for deep crises and for economic miracles. During the 1980s Denmark was the only Nordic country to suffer from enduring mass unemployment. From the mid-1990s, new active labour market policies attracted international interest (originally alongside new leave schemes and ideas about better work-life balance). Around 2000, Denmark was described as an “employment miracles” in Europe (Auer, 2000), or even as an “economic miracle” (Schwartz, 2001). A few years later, Danish “flexicurity” was referred to as a role model by the OECD and EU (OECD, 2004; 2006: 201).

However, Denmark suffered comparatively big decline in GDP and in employment during the crisis of 2008-09 which also revealed underlying problems that had started long before the crisis and precluded a quick recovery. Moreover, in the government’s attempt to reestablish budget balance, the flexicurity model was seriously undermined in 2010-11.

What explains the apparent recovery from the position as the Nordic “sick man” in the 1970s and 1980s? What policies were adopted? Did the problems reflect distortions of the Nordic welfare model – and was the Nordic welfare model modernized to fit new economic challenges? Did the Danish economy suffer from other structural problems, from which it recovered? And should the recent decline, compared to European neighbours, be attributed to underlying structural problems?

Answers to these questions are complex, but the main argument of this article is that structural problems should not be conflated with the impact of economic policy failure. As regards the Nordic welfare model, intra-Nordic comparisons warn against hasty generalizations: When the Danish economy faced its worst crisis in the early 1980s, the other Nordic economies were performing well; in the mid-1990s when the other Nordic economies suffered from severe problems the Danish economy was rapidly recovering; and the Danish economic problems before and after the crisis of 2008-09 was matched by unusually rapid growth rates in neighbouring Sweden.

Although this does not eliminate structural or even welfare state explanations of successes and failures, it indicates that the important explanations are to be found elsewhere. We suggest that the Danish crisis problems of the 1970s and 1980s – and in particular the problems revealed by the so-called “financial crisis” – are to a large extent attributable to economic policy failures. This is an important point since such failure may entail long-term problems that could easily invite to other interpretations.¹ As regards the Danish economy, some problems are identifiable with the benefit of hindsight, others were predictable. This explains why relatively much attention is devoted to short- and medium term economic policies, and somewhat less to the welfare challenges, to structural changes in the Danish economy, or to structural policies like innovation policy etc.

¹ In politics, policy-induced problems like budget problems caused by unfinanced tax relief (as the tax relief of George W. Bush in the US) may even have a strong impact on future policy paths.

At the same time it becomes a challenge to explain why governments fail. Our contention here is that dominant problem perceptions –influenced by interests as well as by ideas – sometimes make governments unattentive to emerging problems. In the Danish case, the role of ideas is underlined by the fact that the opposition appeared equally unattentive, at least to the problems that escalated after 2005. Even independent institutions like the Economic Council and the National Bank were somewhat vague in criticism and recommendations.

Economic policy has increasingly pertained to other policy fields, and from the mid-1990s, the Danish Ministry of Finance assumed the role of the “great coordinator” (Jensen, 2003). Some aspects like labour market policy and pension policy are relatively well described elsewhere (e.g. Green-Pedersen, 2007; Goul Andersen, 2011a,b; Bredgaard et al., 2008; Jørgensen, 2010, 2011), and we also find in the English language literature some general accounts of the Danish case that combines historical, cultural and political economy perspectives (Campbell et al., 2006). However, except for general overviews (Damsgaard Hansen et al., 1990; Johansen & Trier, 2010; Andersen et al., 2010) there are few recent analyses of the development in Danish economic policy over a longer time period (but see e.g. Nannestad & Green-Pedersen, 2008; Asmussen, 2007, 2010).

Even though our main focus is on 1985-2010, we include some aspects from the 1970s, partly for the sake of comparisons, partly because the 1970s was a critical juncture for the formation of policy paths that persisted for decades.

The analysis draws on several analytical frameworks. These are linked to the “independent variable problem” in policy analysis: What are the drivers of change (Goul Andersen, 2007a)? The standard list counts structural, political, ideational and institutional explanations. In principle, explaining economic policy is similar to explaining other types of policies, but there are different traditions as to what kind of factors are emphasized. There are also different traditions as regards the inclination to speak of policy failure. In economics, one would often search for main sources of policy change in “exogenous” structural factors (e.g. ageing, globalization etc.). This is a “rationalizing” type of explanations that often appear – sometimes implicitly – in economic textbooks: Because of exogenous (structural) changes there is need for new policies or policy change, and policies are adapted accordingly. So-called “open functionalist” explanations (Becker, 1988) are found in assessments of the future of the welfare state: What are the challenges, and are welfare states sustainable or efficient vis-a-vis these challenges?

Problem pressure is an important source of change, and economic policies can be interpreted *partly* as a response to problem pressure. But problems do not automatically translate into decisions, decisions do not necessarily presuppose problems – and decisions do not always solve the problems they were aimed at. In politics, there are also interests involved, and discourse about problem pressure should not always be taken at face value. It may also serve to legitimize group interests or ideological preferences. Explanations of the *emergence* of welfare states typically resort to political explanations more than to functional needs. Esping-Andersen (1990, 1999) goes as far as applying political labels to the different institutional complementarities that constitute modern welfare (state) regimes: Social Democratic, Conservative, Liberal.

However, recent years have witnessed a revival of ideational explanations of policy change (Béland & Cox, 2011), not least changes in economic policy (Hall, 1993; Blyth, 2002; Albrekt Larsen & Goul Andersen, 2009). In this study, it is the causal beliefs of decision makers that are interesting – the “elite discourse” rather than the “communication discourse” (for the people), as Schmidt (2008) expresses it. Ideas may reflect changing paradigms within economic theory (Hall, 1993). But we should also emphasize decision makers’ uncertainty about causal theory – as reflected in Hecló’s (1974: 305) classical statement that governments not only “power”; they also “puzzle”. Sometimes this “puzzling” involves transfer and translation of new ideas from neighbouring countries or from the EU (Carstensen, 2010). Sometimes it involves quite some “trial and error” – and attempts to learn from past experience. Danish politics is rich of uncertainty, small experiments, and of learning as well as mis-learning.

Finally, institutions *as such* may produce institutional change. For instance, Barth & Moene (2011) speak of an “equality multiplier” – a model explaining why equality may be self-reinforcing. More generally, policy change in Denmark is typically incremental rather than abrupt, and institutions tend to follow a path dependent course where one change breeds the next, sometimes in predictable ways, sometimes more erratic. But there is always a feedback process which may entail further changes as a consequence of an initial one.

As the 2008 financial crisis reminds us, economic policy making is uncertain. And in retrospect, some decisions can be identified as mistakes. As pointed out by scholars of economic crises, decision makers often fail to learn from experience and repeat the same mistakes – over and over again (Reinhart & Rogoff, 2009). Trying to avoid repetition of mistakes, on the other hand, decision makers may find themselves as generals fighting the last war. As pointed out by the Danish “Power project”, political decision-making processes in Denmark are faster, presumably also less well-prepared, than previously (Togeby et al., 2003: 268-281; Albrekt Larsen & Goul Andersen, 2004: 260-301; Loftager, 2004: 194-216). This contributes to innovation and overcoming resistance to change, but also increases the likelihood of mistakes. Some are reversible, others not.

In short, policy failures matter. Quite a few of Denmark’s economic problems over the last three decades have been interpreted as structural problems. As we shall try to show below, however, unlucky ideas and short-term policy failures provide a crucial part of the explanation for some of the deepest problems of the Danish economy during these three decades.

Economic policy ideas in Denmark have mostly been rather pragmatic. Unlike Sweden, Denmark has never adhered to any particular strategy. Rather, shifting problems have led to shifting priorities over time. Certainly, policy changes reflect the global ideational change from Keynesianism towards more supply-side oriented economic thinking which was introduced almost over night 1989-1992 (Albrekt Larsen & Goul Andersen, 2009; Hall, 1993). This introduced new policy concerns and problem definitions – including a broader range for economic policy – but short-term macroeconomic steering was not thrown overboard. Rather, it was complemented by dynamic equilibrium models for long-term forecasting .

As regards *structural determinants*, Denmark’s dependence on export-oriented agriculture has cast a long legacy. This is among the main reasons why Denmark has always favoured free trade and

free competition (Henriksen, 2006). It also contributes to explaining why Denmark was among the first countries in Europe to liberalize capital movements, and among the countries that most unreservedly embraced globalization. In addition to the food-industrial complex which remains important, current strongholds in Danish economy are pharmaceutical industry, renewable energy and energy-saving products, shipping, and numerous niche products. Besides, Denmark is the only net exporter of oil in the EU. Although much lower than in Norway, oil production has been quite significant since the late 1990s.

Denmark is not formally a member of the Eurozone,² but its currency (*kroner – Dkk*) is firmly pegged to the Euro. One might almost speak of a *de facto* Eurozone membership with a formal national currency.³ In combination with free capital movements this limits the range of policy instruments available, but this is in accordance with an overall ideology of liberalization which has also guided elimination of restrictions in credit policy, not least for homeowners.

The analysis below is structured chronologically. As regards periodization, we find a switch towards “sound” economic policy in the 1980s, followed by a paradigm shift towards a supply-side perspective in 1989-1992. During its last years in office the Conservative-Liberal government even gave up the idea of stimulating the economy. However, a neo-liberal strategy never really materialized. The Social Democratic governments 1993-2001 were influenced by new economic beliefs, but found other policy alternatives coupled with Keynesian macroeconomic steering. This was taken over by the Liberal-Conservative governments after 2001, with increasing carelessness with business cycle adjustments. This resulted in a bonanza 2005-2007, but also aggravated the crisis afterwards.

In the following we distinguish between four periods: (1) The oil crises and its aftermath (1973-1982); (2) Retrenchment and recovery from debt spirals (1982-1990); (3) More supply side orientation and recovery from mass unemployment (1990-2001); (4) prosperity and boom but accumulating problems before and during the economic crisis (2001-2011). This periodization almost coincides with the colour of governments (Social Democratic 1975-1982 and 1993-2001; Liberal-Conservative coalitions 1982-1993 and 2001-2011).

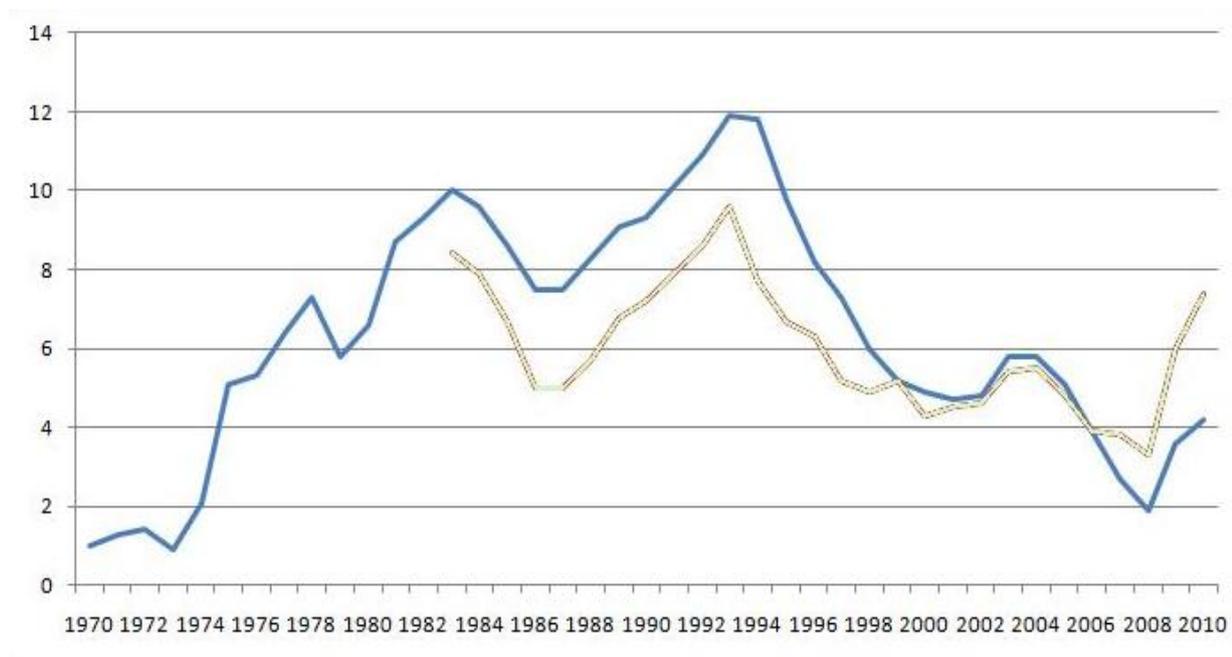
² The full Maastricht treaty was rejected in a referendum in 1992 but confirmed in a reduced version (so-called “Edinburgh agreement”) in 1993. In 2000, Euro membership was rejected in a referendum.

³ At the peak of the financial crisis in October 2008, the Danish currency suddenly came under pressure, but this was the exception confirming the rule that Danish crowns are *de facto* Euros, only with another label and another unit of measurement. Monetary policies, narrowly speaking, is just a matter of adjustments in accordance with Euroland.

2. The traumatic 1970s: Oil Crises, Social Citizenship and Keynesian Strategies

In Denmark, the first oil crisis in 1974 had a quite dramatic impact on unemployment which increased almost immediately from 1 to 5 per cent of the labour force, partly because the Liberal minority government did not want to intervene⁴. When a Social Democratic government took over after the January 1975 election, its main priority was to reestablish full employment. The government resorted to short-term Keynesian stabilization measures which, in retrospect, had a number of negative side effects as the crisis turned out to be enduring.

Figure 1. Unemployment in Denmark, 1970-2010. Per cent of labour force.



Dark curve: Registered (net) unemployment, (www.statistikbanken.dk; table AULAAR). Register based. Calculated as full-time unemployed. All unemployment benefits recipients and recipients of social assistance who are ready for employment. From 1979 recalculated according to new 2008 practice which reduced the figure by about ½ percentage point. Non-recipients and activated do not appear in this statistic even if they are job-seeking.

Light curve: Harmonized Unemployment Rate (HUR) (source: OECD/Eurostat). Survey-based. Lower figures 1983-late 1990s partly reflect “discouraged workers” who had given up looking actively for a job. Improved sampling method from 2008 may explain some of the extraordinary increase.

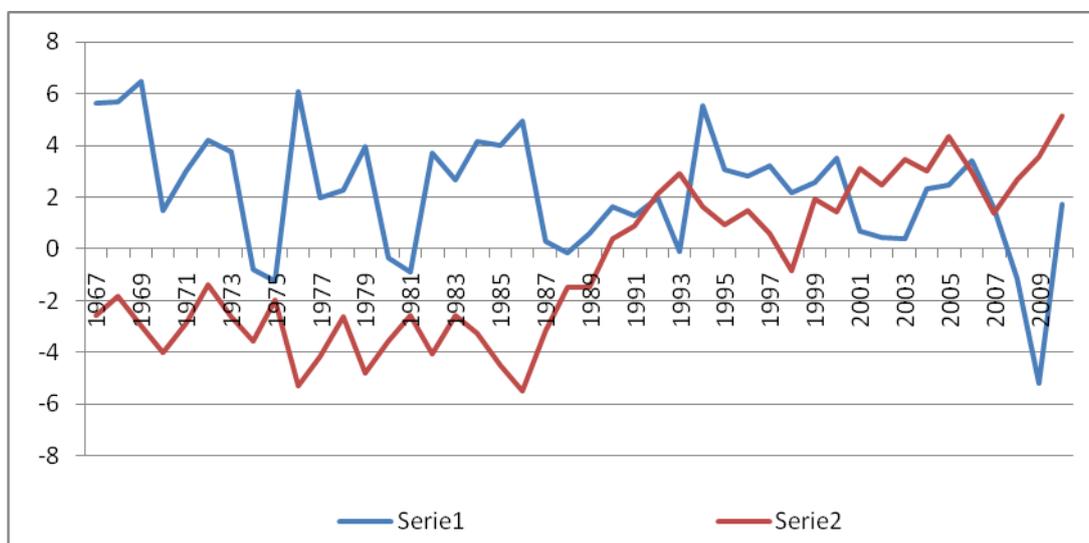
⁴ The Liberal government appointed after the Dec. 1973 “protest” election was based on only 22 of 179 seats in parliament. At first, the government misperceived the economic situation and introduced compulsory savings (by April 5, 1974) in order to constrain private consumption, actually supported by the Social Democrats. Ironically, a similar proposal was put forward in 2008 (by October, 7), but withdrawn by the government 13 days later.

2.1. Imaginative use of the Keynesian tool kit

The 7½ years from 1975 to 1982 witnessed a stop-go policy and the introduction of any imaginable instrument of the Keynesian tool kit. From the beginning, crisis initiatives included, first and foremost, the standard instrument of *stimulating aggregate demand*. The Liberal government had adopted a tax relief in 1974, but failed to reach a decision on financing. The Social Democrats eventually decided to leave it unfinanced. Later in 1975, the value added tax was temporarily reduced from 15 per cent to 9.25 per cent for five months, and the statutory savings from 1974 were paid back.

After two subsequent years of negative growth, economic growth reached 6.1 per cent in 1976 (figure 2), but the effect was short-lived and obtained at the expense of a dramatic deterioration of the balance of payment. The current account deficit reached 5.3 per cent of GDP in 1976, and from 1975 to 1977, net foreign debt increased from 11.4 per cent of GDP to 19.8 per cent (appendix table 1). In the strongly Keynesian regime at that time, the balance of payment was considered the crucial constraint among economists and decision makers, but state debt was not. However, the budget deficit gradually became recognized as a structural one. In spite of high economic growth in 1979 (4.0 per cent), the budget deficit of the state amounted to 3.7 per cent of GDP, and in the subsequent recession, the deficit increased to 10.2 per cent of GDP (Appendix table 1). From then on, the state debt increasingly became a matter of concern (Goul Andersen & Christiansen, 1991).⁵

Figure 2. Economic growth rates, and current accounts as per cent of GDP, 1967-2010.



Growth in GDP at fixed prices (2000, chained values). Source: Appendix table 1.

Increasing public employment was another means to fight unemployment, and expansion of welfare continued at a remarkable scale during the 1970s – in particular growth of services like child care and elderly care. This was a response to the explosion in employment among married women, but also reflected weak steering mechanisms. From 1977, however, the government pursued a “twist”,

⁵ These figures refer to the deficit on the central government’s budget – the so-called DAU account.

or "switch" policy, deliberately substituting private consumption with (labour-intensive and domestically produced) public consumption in order to avoid the balance of payment constraint. From 1975 to 1982, the number of full-time employed in the public sector increased from about 550.000 to 750.000 (Goul Andersen, 1993: 37). Ironically, the crisis of the 1970s completed the building of the so-called Scandinavian welfare model in Denmark by an enormous expansion in public services.

Yet another instrument was *reduction of labour supply*. *Working hours* were reduced (in collective agreements) from 41.75 hours to 40 hours by 1974. *Holidays* were extended by law from four to five weeks by 1979. The same year an "*Early Retirement Allowance*" was adopted, enabling members of unemployment insurance funds to retire at the age of 60, in order to combat youth unemployment. This scheme became more popular than anticipated (not least among women), but seemed to have rather limited impact on youth unemployment.

Altogether, these instruments were unable to prevent an increase of unemployment (figure 1) which was also affected by an enormous growth in labour force participation of women (from 1965 to 1980, housewives virtually disappeared).⁶ As a comfort, unemployment insurance was extremely inclusionary. Since 1907, Denmark had followed the Ghent model of voluntary, state-subsidized unemployment insurance. 1967-1972, shortly before the oil crisis, this (initially liberal) model had been completely transformed, with a standard replacement rate of 90 per cent (up to a ceiling) and 2½ years of duration. Access was easy, and membership more than doubled in the 1970s. With permanent mass unemployment long-term unemployment was unavoidable. In order to prevent people from dropping out to social assistance, the 2½ year limit was suspended and eventually replaced by introducing "job offer" for 7-9 months after 2½ years of unemployment. Through participation in a job offer programme, the unemployed could requalify twice for a 2½ year's eligibility. Hence, duration was stretched to nearly 9 years, and in principle, requalification for another full cycle only required 6 months of ordinary employment. These rights were obtained after one year of membership of an unemployment insurance fund and one half year of employment (Goul Andersen, 1996).

2.2. "*Heading towards the economic abyss*"

Other problems accumulated, however, and by 1979, two days after his resignation, former Social Democratic Minister of Finance Knud Heinesen warned that the country was heading "towards the economic abyss". Like the Economic Council, he was worried about competitiveness, current account problems and increasing foreign debt. A similar warning was given by the National Bank which also worried about public finances and increasing state debts (Mikkelsen, 1993: 177-78).

⁶ For details, see Goul Andersen (1992). Until 1980, this was accompanied by an increase in part-time employment. In the next two decades, part-time employment below 28 hours nearly disappeared, except among students.

Figure 3. A typology of (intentional) anti-unemployment policies in Denmark.

	STRATEGIES and substrategies	1975-1982	1982-1993	1993-2001	2001-2008
Demand/ supply strategies	1. DEMAND STRATEGY				
	(Deliberate) stimulation aggregate demand	xx		(x)	(x)
	Increasing public sector employment	xx		(x)	
	2. REDUCTION AF LABOUR SUPPLY				
	Shorter working hours/longer holidays	xx	(x)		
	Early exit	xx		(x)	
Competiti- tiveness strategies	Leave (parental, educational, sabbatical)		(x)	xx	
	3. COMPETITIVENESS/ EXPORT				
	Incomes Policy/wage moderation	xx	x	(x)	(x)
	Currency policy: Devaluations	xx	(x)		
Structural Strategies	Avoid doing anything else		xx		
	4. ACTIVATION/ QUALIFICATION				
	As qualification			xx	x
	As sanction / disincentive			(x)	xx
	5. MARKET/INCENTIVE STRATEGY				
	Lower minimum wages				
	Incentives: lower benefits		x		x
	Incentives: shorter duration			xx	
	Incentives: in work benefits				xx
	Service strategy: Subsidize household services			x	
	6. DUTIES/CONTROL/CONDITIONS				
Stronger conditionality of benefits			x	xx	
"Workfare": Duty to work in return for benefits				x	

(x) occasional; single event x : less important strategy xx : important strategy

The standard answer to current account problems was *incomes policy*, from 1979 supplemented by currency policy. Government intervention in collective negotiations became routine (Hoffmeyer, 1993: 115-121), and from 1979, incomes policy became really harsh. Disposable real incomes for ordinary workers declined by 12 per cent from 1976 to 1982 (Hoffmeyer, 1993: 91).⁷ This was also obtained via small successive devaluations – six times from 1979-1982 (Mikkelsen, 1993: 255-256, 321; Hoffmeyer, 1993: 90) – which depreciated the Danish currency by 20 per cent.⁸

More than commonly recognized, this policy did contribute significantly to higher exports and declining imports 1979-1981. As revealed by table 1,⁹ average export growth at fixed prices was 8.6 per cent 1979-1981 whereas imports declined. By contrast, the first period under the Conservative-

⁷ The decline continued by additional 6 per cent from 1982 to 1985, bringing disposable real incomes below the 1970 level. However, these figures refer to a two-earner model family with two children living in a rented apartment. For real-world families, this was compensated by higher labour supply among married women: First, housewives disappeared, and from 1980, full-time employment replaced part-time employment. By 2000, weekly working hours below 28 hours was almost eliminated except among students (Statistics Denmark, Statistiske Efterretninger, Registerbaseret Arbejdsstyrkestatistik, various issues). Besides, the huge majority of real-world families were homeowners and enjoyed falling mortgages in an inflationary economy.

⁸ There were also two adjustments in 1973 and four adjustments 1976-1978, but these were mainly released by adjustments of the German D-mark.

⁹ Average annual growth rate for exports in fixed prices was 8.5 per cent 1979-1981 whereas the average growth rate for imports was – 1.5 per cent (Statistics Denmark, Statistisk Tiårsoversigt, 1986).

Liberal government witnessed an import boom whereas exports increased at a slower pace. Even omitting the disastrous year of 1986, we find a marked difference between the two periods of 1979-1981 and 1983-1985 as regards sources of economic growth and improvement of current accounts. This is about the opposite of the collective memory—shared by political leaders from both sides.

This pattern is only revealed by a calculation based on fixed prices, however. This was hardly ever recognized since prices in the real world were anything but fixed during the oil crises. As a result of unfavourable prices for imports and exports – and because of increasing foreign debt –cumulative increase in Gross National Income (GNI) at fixed prices 1973-1982 was only 7.2 per cent as compared to 15.4 per cent for GDP. In the collective memory, all efforts of the Social Democratic governments 1975-1982 were in vain (but see Hoffmeyer, 1993; Asmussen, 2010). Actually, efforts were substantial and effective, but due to unlucky circumstances,¹⁰ benefits were not much felt. It is interesting to compare with the decade after 2000 where the very opposite took place (see below).

Table 1. Real Growth in Exports and Imports of Commodities (at 1980 prices).

	exports	imports	Difference
1975	-1.2	-5.9	-4.7
1976	2.2	15.5	-13.3
1977	4.0	-1.4	5.4
1978	2.3	-0.3	2.6
1979	9.7	5.0	4.7
1980	9.0	-6.9	15.9
1981	7.0	-2.5	9.5
1982	2.1	2.4	-0.3
1983	7.7	3.2	4.5
1984	5.5	7.1	-1.6
1985	5.4	7.8	2.4
1986	-0.5	5.2	-5.7
average 1979-81	8.6	-1.5	10.1
average 1983-85	6.2	6.0	0.2

Source: Statistics Denmark, Statistisk Tiårsoversigt (1986:115; 1991: 96; 1996: 114).

Exports/imports services omitted. By the mid-1980s, this was a small proportion of im-/exports of commodities.

Even though competitiveness improved, economic imbalances accumulated. Denmark again faced negative growth in 1980-1981, and current accounts remained negative due to oil prices and interest payments on foreign debt. Devaluations contributed to inflation which pushed interest rates up. By 1982, unemployment reached 9.3 per cent of the labour force, inflation was 10.1 per cent, long-term interest rates for homeowners exceeded 20 per cent, deficit on the state budget exceeded 10 per cent of GDP¹¹, and state debt had grown from zero in 1976 to nearly 60 per cent of GDP. Current account deficit was 4.1 per cent of GDP, and foreign debt had reached 33 per cent of GDP (appendix table 1). This remained a traumatic experience. It paved the way for the new economic policy strategies – and for a new government as the pivotal party, the Radical Liberals, withdrew its support for the Social Democrats.

¹⁰ This should not serve to eliminate blame. Appropriate action was indeed taken, but always too late.

¹¹ Deficit on central government's so-called DAU account.

3. The 1980s: Economic restoration consolidating the welfare state

In the autumn of 1982, the problems of the Social Democratic government paved the way for a new centre-right coalition of Conservatives, Liberals and two small centre parties, headed by Poul Schlüter (Cons.). The change of government took place without an election and was expected by the Social Democrats (and by observers) to be short-lived. However, Conservative-Liberal governments under Poul Schlüter¹² remained in power for 10 years until government was handed over to a Social Democratic centre-left coalition in 1993 – once again without an election.¹³

From a structural perspective, the basic problem of the Danish economy was the permanent balance of payment deficit and accumulating foreign debt. This continuously constrained growth and employment. By implication, competitiveness and low growth in public expenditures and private consumption were imperatives. The new government initially failed, but eventually managed to solve the problems of public, private and national indebtedness. Most significantly, this was obtained without institutional changes in the welfare state.¹⁴ Rather, the universal welfare state was consolidated.

The Schlüter government also introduced a paradigmatic shift in economic ideas from 1989-1993. The new problem definitions were broadly accepted, but the government was unable to find a political majority for its neoliberal solutions. In the end, it got stuck in passivity vis-a-vis increasing unemployment, because of its own problem definitions, so to speak. This is discussed in section 4.

3.1. *Competitiveness and public expenditure constraints*

The incoming government managed to exploit an extreme crisis consciousness (Petersen et al., 1987), and a “collective experience” that economic policies of the 1970s had been disastrous. The declared aim of the Schlüter government - and its justification among voters¹⁵ - was to “restore the economy”. Until 1989, the causal understanding of the economy did not change much as compared to the Social Democratic government: Increasing demand for labour power was the key to eliminate mass unemployment. Solutions differed, however: There were new priorities, and there were new instruments. Growth should be driven by exports, not by consumption. Accordingly, it was necessary to prioritize price stability and competitiveness higher than short-term reduction of unemployment.

To obtain this, a number of new instruments were introduced, among which the most important were:

- abolition of restrictions to free capital movements, and
- (return to) fixed currency policy; Danish Crown was pegged to German Mark, later to Euro

¹² The governments 1982-1988 included two small centre parties: Christian Democrats and Centre Democrats, and from 1988-1990 another centre party: the Radical Liberals.

¹³ A commission revealed the PM’s cover up of abuse of power for which the minister of justice was later impeached.

¹⁴ One institutional change was commenced in 1991: The introduction of funded labour market pensions via collective agreements for those not already covered. This developed into a multipillar pension system in the next two decades (Goul Andersen, 2011a; see also below).

¹⁵ According to “neutral” wordings in opinion polls, voters were unfavourable to the government’s proposals, but polls with a more adequate framing revealed that people strongly agreed that action was needed and were willing to make sacrifices (Goul Andersen, 2009).

Both were irreversible changes that institutionalized tight policies and deliberately constrained the room of manoeuvre for economic policy. Besides, the fixed currency attained huge symbolic importance among voters (Goul Andersen, 1988: 22-23). The fixed currency corresponded with the goal of low inflation which was to be obtained via other new instruments:

- zero growth in public expenditures and a new budgetary system with fixed budget frames, requiring expenditure increases to be accompanied by equivalent savings
- suspension in 1983 (from 1987 abolition) of the automatic price indexation of wages¹⁶
- a freeze (no price indexation at all) of maximum unemployment benefits and other transfer incomes except old age pensions (for three years, until the beginning of 1986).

Accordingly, capital movements were liberalised faster than in other Nordic countries. Fixed currency was maintained, but the government had to resort to minor depreciation of the Danish currency vis-à-vis D-mark on a few occasions (Mikkelsen, 1993: 321). Automatic price indexation of wages was abolished, and over a couple of years the rate of inflation declined from about 10 to 4 per cent – with a further decline to around 2 per cent after 1990 (appendix table 1).

Zero growth in public expenditure was not obtained, but the government was successful in its efforts to limit expenditure increases for public services – from 1982 to 1992 the cumulative growth in public consumption was as low as 6.3 per cent at fixed prices¹⁷. This is in sharp contrast to the rapid growth before and afterwards.

Transfers to households increased significantly, but mainly because of new programmes. In a budget compromise with the Social Democrats, the freeze of transfer incomes was compensated by a 10 per cent increase from 1988. Besides, increasing unemployment contributed to higher expenditures after 1988. But the government also introduced new, generous programmes. From 1986 to 1989, transfers to households increased by 20 per cent in real terms, mainly because of new programmes of universal child allowances¹⁸ and universal students' benefits, alongside improved pensions, unemployment benefits and social assistance. By 1993 when unemployment was just above the level in 1982, transfers to households had increased by 40 per cent in real terms – in spite of eleven years of “retrenchment”.

This left a widespread belief among policy elites that transfers were “uncontrollable” as they were increasing automatically as a response to exogenous changes. This belief remained highly influential in Danish politics throughout the 1990s, even though it runs counter to anything we know from political science (Goul Andersen, 2005). Recipients of transfers typically possess far less social and political resources than users of public services. Further, the latter can count on support from public employees, and the battle about budgets is fought at multiple levels, including the municipal one. The resistance against expenditure cuts (or the pressure for improvements) is not irresistible, but it is obviously

¹⁶ Indexation was a classical instrument to reduce wage differentials as compensation for inflation was the same amount for everybody, not a percentage. However, wage differentials in general does not seem to have increased.

¹⁷ Due to the “Baumol effect” (Baumol 1967) – which by definition is incorporated in the statistical calculation of production value of the public sector as there is no price mechanism – public consumption remained high as per cent of GDP. From 1987 to 1991 public consumption declined in real terms, but in current prices public consumption as per cent of GDP in fact increased (Goul Andersen, 1997b), even though there was positive economic growth.

¹⁸ Child allowances in the 1970s and early 1980s were means-tested.

stronger, generally speaking, than in the case of transfers. And in fact, the belief in “uncontrollable transfers” was misleading from the beginning. Even if we include the politically decided improvements in compromise over the 1988 budget, expenses related to unemployment, early retirement and pensions only accounted for one-half of the increase in transfers from 1982-1992 (Goul Andersen, 1997a; Green-Pedersen, 2002). The main source of increasing transfer expenditures was political decisions in Parliament,¹⁹ and the politically “controllable” costs increased by 70 per cent in fixed terms 1983-1993, as compared to 26 per cent for the so-called “uncontrollable” costs (Goul Andersen, 1997).

Two further improvements were the introduction in 1992 of free universal elderly care, and less steep means testing for pension supplements in order to avoid too high composite marginal taxes.

In a long-term perspective, the most important reform was a decision in 1990 that nearly all income transfers to households should be indexed with wages in the private sector – the so-called Rate Adjustment Scheme (“satsreguleringen”). Needless to say, wage indexation is far superior to any other indexation in the long run.²⁰ This indexation complemented an unusual coordination of incomes since wages of public employees became closely tied to the wages in the private sector by a so-called Regulation Scheme (“reguleringsordning”) introduced in the 1987 collective agreements.

More than any other decade, at least until 2010, the 1980s was a period of retrenchment. But in institutional terms, it was a decade of social reforms – towards more universalism – in spite of austerity and cost containment. Unemployment insurance and early retirement were left almost untouched. There was an abundance of neoliberal ideas, but no political majority to carry them through. The most successful liberal reform was a moderately increase in unemployment insurance contributions. This happened both directly (higher contributions) and indirectly (reduced value of tax deductions after the 1985/87 tax reform). Actually, this was carried further under the subsequent Social Democratic government. But the governments’ hope to increase contributions even further, or to privatise risk by relating contributions to the risk of unemployment for different groups, never materialised.

3.2. From “it is going incredibly well” to credit regulation in the “potato cure”

Ironically, the economic policy goals of the government were realized in the opposite order of what was planned. The main goal was a positive current account balance whereas unemployment and budget deficits had second priority. But from the very beginning in 1983 (table 1 above), an import boom built up whereas export growth was *lower* than under the Social Democratic governments 1979-1981. By 1985/1986, things went from bad to worse. The government had failed to anticipate that lower interest rates would release property gains for homeowners which, in turn, would stimulate private consumption. Unemployment declined much more than intended, and the state budget revealed an unexpected surplus by 1986. Turning vice into virtue, the government presented this as a significant economic success. Prime Minister Poul Schlüter’s statement in 1986 that “*It is going incredibly well*”

¹⁹ The biased perceptions are explainable: Universal child benefits were “forgotten” as they were introduced as compensation for lower tax deductions for interest payments of homeowners in the 1985 tax reform, and universal students’ benefits were “forgotten” because they were justified as an incentive to take an education rather than receiving “passive” support.

²⁰ Indexation is based on annual wage increases, *less* pension savings, and *without* compensation for shorter working hours. In addition, technical details erode wage indexation by about 0.5 per cent each year (Goul Andersen, 2005).

became rather infamously reknown since the economic improvement was unsustainable. The balance of payment reached an unprecedented deficit of 5.5 per cent of GDP in 1986 (figure 2).

This required contractive policies. In particular, the government resorted to a tight credit policy. A so-called “Potato cure” package adopted in the autumn 1986 imposed heavy credit restrictions on loans for homeowners and fees on loans for private consumption²¹ in order to enforce higher private savings. Homeowners were only given access to loans with a maturity of 20 years, and only in case of buying a new house, or for renovation and enlargements. Moreover, new loans had to be so-called “mix loans” as 40 per cent had to be “series loans” with a proportional payback (5 per cent of the principal each year). 60 per cent could remain annuity loans (constant annual payment – mainly interest during the first years, payback concentrated towards the end of the maturity). This reform package did not only force homeowners to higher savings. Higher net payments also had a significant impact on housing prices. From 1992, the maximum duration of loans was increased from 20 to 30 years, and later on, complete liberalization (a “potato cure” in reverse) contributed strongly to the deep financial crisis in Denmark from 2007.

The potato cure had a strong impact. In cumulative figures at fixed prices, private consumption had increased by 18.8 per cent from 1982 to 1986. In the six year period from 1986 to 1992, the corresponding figure was only 1.4 per cent. From 1982 to 1986 exports of commodities and services had only increased by 16.3 per cent (at fixed prices) whereas imports increased by 30.0 per cent. During the potato cure 1986-1992 exports increased by 36.5 per cent, imports only by 15.8 per cent.²² These figures are indicators of economic restoration and a turn towards export-driven growth. This contributed to a significant change from a permanent current account deficit in three decades to a permanent current account surplus from 1990 onwards (figure 2).

There were other important elements behind the economic turn, however. As regards the export boom, there was a small, informal tax reform to improve competitiveness: Large wage increases in the 1987 collective negotiations were neutralized the same year by relieving employers of social contributions. These were replaced by a so-called “labour market contribution” which only applied to products and services sold in Denmark. In effect, this was a hidden VAT increase, and when declared illegal by the European Court of Justice a few years later, the *Ambi* was immediately replaced by an open VAT increase from 22 to 25 per cent. Concomitantly, a symbolically important common declaration between the government and the social partners was signed on Dec. 8 1987, stating that future wage increases should be moderate in order to ensure competitiveness. This was only a (“soft law”) declaration, but seems to have impacted on union behaviour.

In return, there was agreement to introduce almost universal, fully funded occupational pensions (labour market pensions). The unions had wanted and expected a mandatory system, but eventually had to accept pensions based on collective agreements. Employers wanted this solution to make sure that pension improvements would count as wage increases. Otherwise the “double payment problem”²³ would entail a risk of excessive wage increases. In the 1990s, this became an important

²¹ These loans could be exempted from fees if there was agreement on short payback time.

²² Annual figures are displayed in Appendix table 1.

²³ Traditionally, introduction of funded pensions in a pay-as-you-go (PAYG) system had been considered impossible because one generation would have to finance both their own pensions and the pensions of the parent generation.

measure to increase private savings. The process started when the government, in its 1984 financial report, signalled to the social partners that it would welcome an expansion of occupational pensions for the majority of wage earners who did not already have one²⁴. This happened for the remaining public employees in 1989, and for most of the private labour market in 1991. Contributions were negligible at first, but reached a minimum of 12 per cent in 2009. This amounted to a transformation of the pension system through “layering” and “differential growth” (Streeck & Thelen, 2005; Goul Andersen, 2011a) – actually carried through only by the social partners, without any legislation.

3.3. Low-growth equilibrium and consolidation of the welfare state

As public budgets remained unusually tight 1989-1992, the result was seven years (1987-1993) with an average economic growth rate of only 0.8 per cent. As the growth rate in the public sector was close to zero, however, private sector growth was higher. Altogether, the average annual growth rate in Gross Factor Income of the public sector 1983-1991 was only 0.4 per cent whereas private sector growth was 2.9 per cent. From 1974-1982, annual public sector growth was 4.7 per cent as compared to only 1.1 per cent in the private sector (Goul Andersen, 1993: 36).²⁵ In this respect, the political colour of government certainly meant a difference. But the policy did contribute to a redress of economic imbalances, and the strategy was largely accepted and continued by the Social Democrats.

From 1987 to 1993, the government maintained a rather contractive economic policy. As it did not want to “fine-tune” the economy, and as it was unable to reach agreement on neoliberal solutions,²⁶ the result was a continuous increase in unemployment culminating with an all-time high rate of 11.9 per cent in 1993.²⁷ However, seven years of recession – and political stalemate – helped to solve structural problem which had haunted the Danish economy for decades. Costs in terms of unemployment were high, but as the unemployment protection system remained intact, social consequences were alleviated. By comparative standards, the proportion of long-term unemployed remained low, and Denmark maintained a world record in avoiding social marginalization among long-term unemployed (Whelan & McGinnity, 2000; Goul Andersen, 2002).²⁸

Governments in the Nordic countries are by definition never “passive” during recessions: “Automatic stabilisers” seem to be stronger than in any other country (Olesen & Winther, 2009). Hence, budget deficits increased in the early 1990s. But unlike in the early 1980s, automatic stabilizers were not

²⁴ Ironically, it was the need to increase private savings (rather than concerns for ageing) that triggered the thorough pension reform which installed a multi-pillar system with collective, fully funded labour market pensions as the backbone (actually, the reform was carried through without legislation). Since 1964, all Danish pension reforms with one small exception were initiated because of concern for savings whereas all planned pension reforms ended without any decisions (Albrekt Larsen & Goul Andersen, 2004).

²⁵ These figures are based on the old national account system before ENS 1995. Fully updated fixed term calculations for GFI contributions are unavailable for public vs private sector.

²⁶ In 1990, the government sought to stimulate the economy by income tax relief (justified by its “dynamic effects”). But the was blocked by the opposition, and the government suffered a defeat on the issue in the 1990 election.

²⁷ Actually 12.4 per cent according to the method of counting until 2008.

²⁸ There is a much higher incidence of social problems among long-term unemployed, but the majority cope rather well, provided they have the resources. And they did at that time. Poverty rate was small, and there was rarely more than one unemployed person per family. By 1994, one half of long-term unemployed were homeowners (Goul Andersen, 1995, 2002). Still, economic hardship was widespread, and this was strongly correlated with social marginalisation.

destabilizing. The Danish economy had found a kind of *sustainable* “low growth/high unemployment equilibrium” (Goul Andersen, 1997a). State budget deficit reached 5.4 per cent of GDP by 1993, but that was only half the level in 1982-1983. State debt relative to GDP increased from 1991, but never came near the peak of 1984. Most importantly, however, the balance of payment improved from a deficit of 5.5 per cent of GDP in 1986 to a surplus of 2.1 per cent by 1992 (appendix table 1). This enabled the new centre-left government from 1993 to adopt a more expansionary economic policy.²⁹

In effect, the net impact of the 10 years of retrenchment was a consolidation of the welfare state. The Bourgeois government took over in 1982, shortly after the victories of Margaret Thatcher in the UK and Ronald Reagan in the US. Some had feared, others had hoped for a "bourgeois revolution". This did not happen. Despite hard efforts, the government “only” accomplished a strong decline in *growth rates* of public consumption. Transfers were improved. From 1982 to 1992, total public expenditure increased by 21 per cent in real terms (Goul Andersen, 1997a: 12). Relative to GDP, figures remained constant. In institutional terms, the government adopted universalistic reforms and introduced wage indexation of transfers. These were all improvements. Apart from labour market pensions, not very much happened to the welfare state in terms of institutional change.

To be sure, there was a modest, but permanent reduction of maximum unemployment benefits and a modest increase in net contributions to unemployment insurance. There were several plans to move further, but none of them were realised. The preferred method of retrenchment was proportional budget cuts which has few institutional implications. Finally, a large vocabulary of new words was invented for attempts to "modernize" the welfare state. *New Public Management* ideas were introduced, but not very much happened. Privatization was often used as "window dressing" of budgets; the idea of higher user charges was largely buried; contracting out was not carried very far (Greve 1997: 40-58). Even the use of vouchers (to be developed after 2001) did not proceed very far at that time. As regards user influence, the most important reforms were extension of *voice* opportunities through elected user boards. *Collective co-determination* won over consumer choice in the 1980s.

Taxes were not lowered, either: Corporate taxes were raised from 40 to 50 per cent by 1986 and reduced to 40, 38 and 34 per cent from 1990, 1991 and 1992, respectively. Subsequent governments reached 25 per cent by 2007, but at the same time the tax base was broadened. The uniform VAT ("moms") was raised from 22 to 25 per cent (from 1988/1992). The highest marginal income tax rate was increased from 70 to 73 per cent from 1982 and reduced to 68 per cent from 1987 alongside a broadening of the tax base. Around 1990, there was widespread concern that European integration might require a transformation of social protection schemes to become financed by contributions. A few commodity taxes were reduced in order to avoid excessive border trade, but otherwise EU adjustments were smaller than anticipated. If anything, continental welfare states switched part of the financing from social contributions to taxes like in Scandinavia (Palier, 2010).

Indeed, most programmes did become less generous, and the efforts to constrain growth in public services 1982-1993 were unprecedented. But in a long-term perspective, the 1980s represented a

²⁹ Governments were less able to steer macroeconomics than previously: With fixed currency rates and free capital movements, there was little left of monetary policy apart from regulation of credits. Incomes policy was buried and tripartite negotiations were seldom. Still, wage coordination was maintained in a more decentralized system by employer coordination and a joint concern for competitiveness in the private sector (Dølvik et al, 2011).

continuation of “Social Democratic” policies under hard economic conditions (Goul Andersen, 2000). Against this background, it is unsurprising that we find few indicators of increasing inequality. Denmark was among the countries to experience slightly *less* inequality in the 1980s (Förster, 2000; Förster & d’Ercole, 2005).³⁰

Still, parts of the welfare service apparatus was worn down, and as the government was unwilling to “fine tune” fiscal policy to the business cycle, it was stuck by its own ideas and unable to alleviate the unemployment situation which was considered unacceptable. Like in 1982, a new government was “needed” to do what was later on considered necessary.

³⁰ Most Danish figures on trends in inequality are disturbed by the fact that they include imputed rent which is highly sensitive to changes in real estate values. It is imaginable that lower imputed rent due to declining house prices 1986-1993 has served to conceal an underlying trend towards increasing inequality. But at any rate, the effect is marginal.

4. 1990s: Neoclassic problems – Social Democratic solutions.

Sustainable growth

4.1. New ideas 1989-1993: Structural unemployment & tax distortions

If the Conservative – Liberal governments left few institutional changes behind, they did leave a legacy of new economic ideas – more or less a paradigm shift – that influenced future economic policy making. The new ideas switched focus towards the supply side of the economy and defined new problems which were subsequently referred to as “structural problems” for more than a decade. As this concept was slippery and rarely defined, actors could put slightly different meanings into it, but this facilitated the introduction of the concept as a common reference point.³¹ However, most basically, “structural problems” referred to regulation that impedes on the flexibility of the market.³²

Actually, the term “structural policy” changed meaning when the new ideas were presented in 1989. In Sweden, “structural policy” had referred to state interference in structural economic development. Denmark had no tradition for this, but in his 1985 opening address to Parliament the Prime Minister announced an offensive industrial structural policy³³, and later the Minister of Industry launched his *Report on Industrial Policy* (Ministry of Industry, 1986).³⁴ This looked as opening a new path of state intervention to strengthen the position of Danish industries on future markets (Christiansen & Sidenius, 1988), but the ideas never materialized (Bertramsen, 1991; Sidenius, 1999). By 1989, the meaning of “structural policy” was reversed to distortions imposed by state regulation. In 2005-06, however, industrial structural policy resurfaced under a new headline in a *Globalization Council* (see section 5).

The new problem definitions were launched in the government’s economic “plan of the century” – *The Plan. New Growth and Progress* – and in two analytical reports: *Whitebook about structural problems on the labour market* (Arbejdsministeriet et al., 1989) and *Danish economy in the 90s* (Finansministeriet, 1989). The ambitious reform package addressed taxation and labour market policy with a strong neoliberal approach. But nothing materialized as negotiations with the Social Democrats broke down. The plan was also negatively received among voters. For the government, the new problem perceptions made it abstain from intervening against increasing unemployment.³⁵

³¹ At first, it included insufficient savings (Finansministeriet, 1989: 7-18). The authors of the 1993 programme “*New course..*” appear bewildered about what to put under the headline (Regeringen, 1993:5).

³² See Elmeskov & Macfarland (1993) for a conceptually clear delineation of structural causes of persistent unemployment.

³³ http://www.dansketaler.dk/tale.lasso?tekst_id=97

³⁴ The minister Niels Wilhjelm (1986 - 89) was former chairman of the Association of Danish Industries (1983-86). The report followed a memo on “*Growth and conversion. Requirements for Structural Policy*” (Ministry of Labour et al., 1986).

³⁵ Key ministers, not least later PM Anders Fogh Rasmussen, were convinced that Keynesian “fine tuning” would be ineffective, due to rational expectations, timing problems and lack of discipline: Rational actors would anticipate outcomes and adjust accordingly, e.g. require a risk premium to interest rates in case of uncertainty about inflation. Prognoses are uncertain, and with bad timing, fine tuning can be counterproductive. Finally, it is easy to stimulate the economy, but politically troublesome to tighten up. Putting these considerations together, the government took a very passive stand vis-à-vis unemployment. All subsequent governments, however, have used “fine tuning” to stimulate the economy. Consensus has developed towards recommending moderate uses of active financial policy whilst acknowledging uncertainty and abstaining from reacting to small imbalances (Economic Council, 2007: 109-67).

Although this could look like a simple political failure,³⁶ long-term ideational impact was considerable. The 1989 plan was a supermarket of new ideas, and several problem definitions survived and influenced policies when the Social Democrats took over – but *solutions* were quite different (Albrekt Larsen & Goul Andersen, 2009).

Structural unemployment

New ideas about *labour market problems* first surfaced in a report of the Economic Council (Det Økonomiske Råd, 1988) which pointed out that much unemployment might be structural and unlikely to disappear in case of an economic upturn. This was further developed in the Government's 1989 White Book. Based on arguments resembling the OECD (1994) Jobs Study, it focussed on all sorts of mismatch on the labour market. Some were “conventional”: Bottleneck problems caused by skill mismatch, regional imbalances in supply and demand, etc. However, attention was also on insider-outsider problems (Arbejdsministeriet et al, 1989). Later this was extended to minimum wages, incentives, poverty traps and mobility. Unless distortions were solved, unemployment could not be reduced much. Even with high unemployment, workers would have few incentives to wage moderation. In case of increasing demand, employers would compete for those already in work and release wage drift. This corresponded with the standard definition of structural unemployment as the lowest unemployment compatible with non-accelerating wage/price increases (NAWRU/ NAIRU).³⁷

If unemployment went below the structural level, wage increases would erode competitiveness and bring the economic upturn to an end. This discredited previous strategies – even the strategy of export-driven growth. With modifications, this diagnosis became accepted by all important actors, including the social partners. It was compatible with their interests, but it also made sense to experience, in particular the experience from 1987: In spite of an unemployment rate about 8 per cent, hourly wages increased by some 10 per cent, exactly as the new theories would predict (Birch Sørensen, 2008, describes this as “eye-opener” among political decision-makers). It is questionable whether the diagnosis was correct,³⁸ but it soon became an ‘institutional truth’ that structural unemployment was around 8 per cent – or even higher.³⁹

³⁶ The plan was triggered by an explosion in support for the Progress Party – originally an anti-tax party – in opinion polls. This was misinterpreted as a revival of tax protest. PM Schlüter wanted to reinvent the “spirit of 1982”, and the plan became ever more ambitious. However, the plan was strongly refused among voters who also rejected the Social Democratic alternative, and political distrust increased to unprecedented levels (Goul Andersen, 1992b).

³⁷ Non-Accelerating-Wage (Price)-Rate-of-Unemployment – as calculated on the basis of historical experiences of the relationship between unemployment rate and wage/price increases (Elmeskov & MacFarlane, 1993).

³⁸ There was a plausible alternative explanation: 1987 was an election year, the government was lagging behind, and it had given promises to public employees that raised expectations. After a humiliating government intervention in the 1985 negotiations, the unions were keen to demonstrate their *raison d'être*. Finally, wage drift in 1987 was insubstantial (Ibsen, 1992) - nearly all the wage increase came in collective negotiations, partly as compensation for shorter working hours. If we omit the year of 1987, we find little variation in wage increases after 1984 (Det Økonomiske Råd, 2007: 268). Because of theoretical expectations it seems that observers became blinded to alternative interpretations.

³⁹ As mentioned, Denmark experienced an export boom after the 1987 wage calamity. Although relief of employers from social contributions played an important role, it remains surprising.

In 1992 a corporatist Commission was appointed to elucidate the structural problems on the labour market. In its report the same year (Udredningsudvalget, 1992) the social partners agreed that unemployment was to a large extent structural. They also agreed on a regionalised active labour market policy that served as a blueprint for reforms of the new government in 1993. Otherwise preferred solutions were far apart. Employers wanted to adjust minimum wages to qualifications – and social security accordingly, to reduce reservation wages. Trade unions wanted an upgrading of skills to match high minimum wages. Later on, other government officials advocated subsidies for low-productive service work – this materialized in 1994 as subsidies for “home services”.⁴⁰ Such subsidies were introduced on a small scale, but basically the preferences of the unions prevailed.

One of the government’s intentions was to change the financing of unemployment benefits – an element from the 1989 plan. After voters’ rejection of tax cuts (another element from 1989) in the 1990 election, the government assigned top priority to such a reform which was written into the mandate of the Commission. It should provide an incentive for wage moderation by “privatizing” the costs of unemployment: If wage increases were too high for a particular group, they should carry the costs of excessive unemployment. This would give an incentive to flexible wages and to wage moderation.⁴¹

This was unacceptable to the unions and was rejected by the Commission. But the underlying idea survived. It only had to be realized at a higher level of aggregation. The proposal resurfaced in the idea of a “labour market contribution” to a fund financing unemployment costs and other labour market policies. If wage increases were too high, unemployment would increase, and wage earners would pay more; if wage increases were low enough to reduce unemployment, they would have a tax relief. This was included in the proposals of a Tax Commission (Personskatteudvalget, 1992) and in the 1993 tax reform.

Now in opposition, the Liberal party won the game of *naming* the new tax which it called “gross tax” rather than “labour market contribution”. Actually, “gross tax” became the appropriate label. A few years later, unemployment declined sufficiently to generate a surplus in the labour market contribution funds. According to the logic of incentives, workers should be rewarded by lower contributions. Not surprisingly, however, this happened at a time when the economy was overheating. Contractive measures were needed, and policy makers realized that they had created a pro-cyclical tax.⁴² Still, it illustrates the impact of the 1989 Plan. In this case, the original idea underwent a metamorphosis and survived for a decade, but was eventually abandoned. None the less, it brought about an institutional change in the tax system which has survived.

It is difficult to determine whether actors were convinced by the structural unemployment diagnosis. More importantly, they could live with it as it was compatible with different solutions (reflecting

⁴⁰ Finding low-paid job opportunities for low-skilled workers has often been presented as necessary response to globalization and de-industrialization. In Denmark, the problem did not emerge because of the generational replacement of low-skilled generations by high-skilled generations.

⁴¹ This “privatization” was later carried through in the reforms of unemployment insurance in Sweden after 2006.

⁴² Needless to say, rules were changed, but the case illustrates how an instrument which could appear logical from a micro-economic supply side perspective was disastrous from a classical macroeconomic demand side perspective.

different actor interests). This was an indispensable precondition.⁴³ Whatever the motives were, however, there is a path dependency associated with new ideas. And as soon as the new diagnosis was accepted, this had significant agenda-setting effects.

Not only was attention directed to supply-side solutions to unemployment. The ideas also implied an “explosion” of economic policy as e.g. labour market policy became a central component. This provided the Ministry of Finance with a broader role in the 1990s as *coordinator* of the policy fields which affected economic incentives (Jensen, 2003), maybe at the cost of its traditional role as “guardian of the budget” (Jensen, 2008). Maybe preoccupation with structural problems also detracted attention from “traditional” economic challenges and problems before the financial crisis.

At an operational level, however, the important short-term effect of the preoccupation with “structural problems” was that the Labour Market Commission (Udredningsudvalget, 1992) left a blueprint for an active labour market policy to be carried out by the new government in 1993.

Taxation

Much the same could be said about *taxation* which was the other main concern of the 1989 plan. At that time decision makers were worried about impact of the single European market and prepared for adjustments of indirect taxes and for introduction of social contributions.⁴⁴ But the government also proposed a significant reduction of marginal taxes in order to stimulate labour supply, arguing that this would by itself reduce wage increases, improve competitiveness and contribute to solve the unemployment problem. Besides, the “Laffer curve” was for the first time introduced to argue that lower taxes might be self-financing (Finansministeriet, 1989: 108-17).

As perceptions about EU adaptation proved exaggerated, future discussions focussed on labour supply effects. In the 1990 election campaign, the government proposed income tax cut, but suffered a defeat even though the proposal was not linked to retrenchment.⁴⁵ The ideas about labour supply effects did not disappear, however, and this issue was soon to be coupled to the issue of globalization and the risk of tax emigration.⁴⁶ After the 1990 election which the government barely survived, it felt no incentive to reinvent the tax issue. However, because of a joint initiative by the Social Democrats and Radical Liberals, an expert committee on personal taxes was appointed and delivered a report the same year (Personskatteudvalget, 1992). In this committee, members agreed

⁴³ Undoubtedly, ideas did have an impact of its own that goes beyond interest. The Social Democrats changed its preferences regarding labour market policy and taxation policy significantly in 1993, as compared to the party’s plan in 1989 (Albrekt Larsen & Goul Andersen, 2009).

⁴⁴ This was probably another motive for introducing the labour market contribution/gross tax referred to above. It did not have much in common with mandatory social insurance, but it might be used as a stepping-stone. Few sources are found, however, on the motives.

⁴⁵ The 1990 tax proposal was later carried through as a prelude to the 2007 election campaign, following a simple political logic: Voters might not appreciate tax relief – but would they cancel lower taxes already decided?

⁴⁶ Apparently, many decision makers did not fully understand the subtle differences, and the media never got it right: Marginal taxes are (theoretically) important for labour supply, but not for migration. If decision to live in the country is determined by economic incentives, average taxes rather than marginal taxes count. Furthermore, average taxes includes all taxes levied on persons, not just income taxes. Moreover, a calculus would include necessary social expenditures, regardless of financing (taxes, contributions, private). Finally, it is incentives for young people that count. Middle aged are not very mobile (Goul Andersen, 2006a).

both on problem definitions and on policy proposals. It elaborated and expanded on ideas that were already contained in the 1989 plan. Most importantly, the committee advocated substitution of “green” taxes for income taxes, and substitution of lower tax rates for tax deductions (i.e., a broadening of the tax base). This was another blueprint for reform left to the new government.

The new government headed by Poul Nyrup Rasmussen was a coalition between the Social Democratic party and three small centre parties (two of which later left the government, leaving the Radical Liberals as permanent coalition partner until 2001). At the time of its appointment, it was one of the very few majority governments in recent Danish history⁴⁷, and as it could rely on support from left-wing parties in critical situations, the government seemed invincible. For 75 years there had never been a majority to the right without support from centre parties. None the less, the government lost the election in 2001, but this required innovative strategies from the parties to the right – in particular mobilization on the issue of immigration. By 1993, however, the government was free to act. Its major concern was to break the curve of unemployment before the 1994 election. It introduced a giant package already in May 1993, consisting of a labour market reform, a tax reform, and an economic stimulus to “kick-start” the economy.

4.2 Kickstarting the economy – and stable growth

The “kick-start” element in 1993 was traditional Keynesian policy. It included an expenditure increase and a temporary deficit financing of the tax reform (altogether 12.3 bill. DkK, or 1.3 per cent of GDP in 1994). Perhaps even more important for the economic turn (Hansen & Pedersen, 2003) it included a liberalisation of credit opportunities for homeowners. This could not only reverse falling prices, but also make it attractive to take additional loans or switch to new loans with less repayment and lower interest rates (Knudsen & Sand, 2004).⁴⁸ Stimulating consumption via capital gains and consumption for homeowners was equivalent to what happened in 1982-85, only this time the government was prepared, and the effect was intended. The combined effect of deficit financing, capital gains, credit opportunities, and postponed consumption was strong: 1994 witnessed an economic growth of 5.5 per cent, and the annual growth rate remained around 3 per cent for the next three years. Until 2001, economic growth did not fall below 2.1 per cent.

This contributed to a decline in unemployment far beyond expectations. From 1993 to 1999, unemployment declined from 11.9 to 5.2 per cent (national data; figure 1) – the lowest level since 1976. What seemed to be permanent mass unemployment revolving around 10 per cent had almost evaporated – in spite of warnings by OECD that unemployment could only be reduced slowly (B.T., 22. Sep. 1993). At first, critics claimed (with some justification) that declining unemployment was “window dressing” as unemployed people were just transferred to other categories that did not

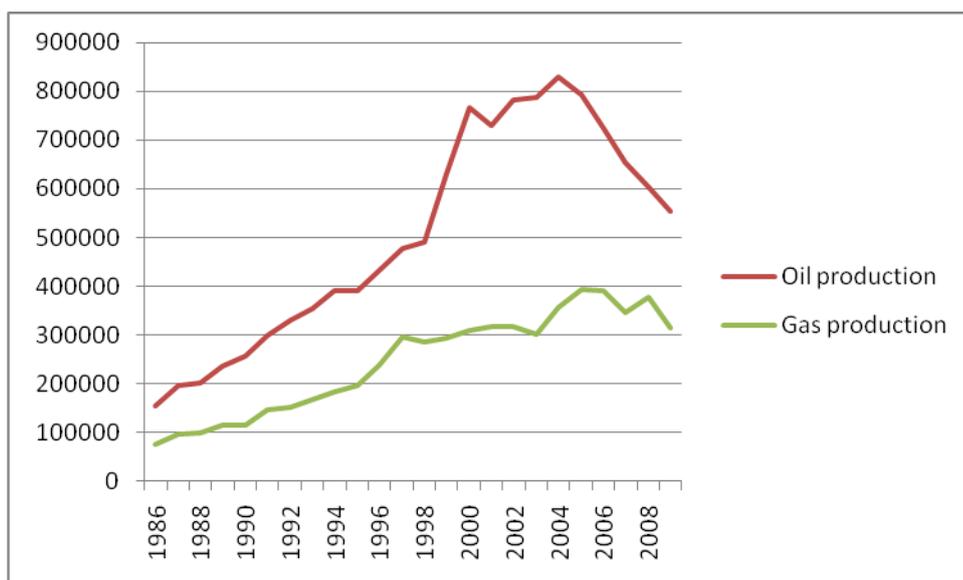
⁴⁷ There was a majority government 1968-1971 (Radical Liberals, Liberals, Conservatives) and a short interlude 1978-1979 when the Social Democrats invited the Liberals to enter government in an unhappy marriage.

⁴⁸ The Conservative-Liberal government had abandoned the 20 year restriction in 1992 and re-introduced free access to loans with a currency of 30 years, but still based on a 60-40 mix between annuity loans and series loans. In the summer of 1993, annuity loans with a 30 year currency was reintroduced, with the “classical” restriction that has never been dropped: that it should remain within 80 per cent of the property value. Moreover, loans could be paid as so-called “cash loans” where the depreciation (due to bond value below 100) is transformed to a tax-deductible interest payment.

count as unemployed. From 1995, however, the main driving force was a genuine increase in employment, primarily in the private sector.

It remains disputed what were the decisive factors behind the upturn in the 1990s (Schwartz, 2001). The kick start was a trigger, but there were underlying causes. Traditional macroeconomic policies, including the cure of the balance of payment deficit via credit restrictions, falling house prices, and other factors enforcing increased savings in 1986-1993, certainly played an important role. Labour market pensions started to pull in the same direction. And exports were booming, stimulated by German unification, by moderate wage increases, and – perhaps – by crumbling domestic markets forcing enterprises to search for new markets abroad. Gradually, oil also became an important factor in the Danish economy (figure 4). From around 2000, Denmark became the only net exporter of oil in the EU, after an increase of 56 per cent 1998-2000. Oil production peaked in 2004, but remained above the 1999 level, and the state enjoyed increasing revenues because of strongly increasing oil prices. Oil played a minor role in the upturn until 1999/2000.

Figure 4. Production of Oil and Gas. Denmark 1986-2009. TeraJoule.



Source: Statistics Denmark (www.statistikbanken.dk. Table ENE7).

During the long recession 1986-1993, the centre-right government had actually realised its economic programme that had failed in 1982. Basically, the Social Democrats continued along this path, but with more emphasis on employment and welfare. Fiscal policy was fine tuned to stimulate in 1993/94 –and tightened in 1998, but as compared to the 1970s, this was “Keynes light”. Public consumption was allowed to grow at a much faster speed – and more than intended –typically 2 per cent or more in real terms. Still, the state budget moved towards a surplus in 1997 which was maintained for 12 years. From 2005 to 2007, the surplus averaged more than 5 per cent of GDP.

However, labour market policy and tax policy were much emphasized in explaining the past, and in planning the future.

4.3. From labour shedding to activation

The most important new element in the policies from 1993 onwards was the introduction of a new regionalized, corporatist active labour market policy (ALMP). Later, it became common to speak of a reform in three stages: 1993, 1995 and 1998 – which was continued in 2002 and 2006 (section 5). The first stage in 1993/94, however, also contained a number of measures that could be seen as a continuation, indeed a radicalization, of the social citizenship path of the 1970s and 1980s. However, *labour shedding* became a more widely used and somewhat pejorative term to describe this path. At any rate, the government aimed at a lower unemployment rate by any means, including short-term reduction of labour supply. This included a *pre-early retirement* allowance with eligibility for long-term unemployed from the age of 50, and three (almost) new leave arrangements: *Sabbatical leave*, *educational leave* and *parental leave*⁴⁹. All these elements were phased out within few years. Pre-early retirement and sabbaticals were terminated from 1996. Educational leave was abandoned in 2000, and parental leave was replaced by a prolonged maternity/paternity leave in 2002 (Goul Andersen, 2011b).

The new ALMP was based on the idea of matching demand and supply in regional labour markets. The social partners were assigned influence via regional labour market boards that should supervise and prioritize efforts. The actual engagement of unions and employer representatives was different from one county to another, but at least they had a considerable potential influence that could be mobilized whenever necessary. For the long-term unemployed, the 1993 reform introduced “individual action plans” based on a signed agreement between the unemployed and the case worker, jointly designing a path to employment based on the preferences of the individual, the regional demand for labour power, and the activation opportunities in terms of job training and education (including the option of educational leave).

From the mid-1990s, all reforms were aimed at stimulating labour supply rather than reducing it. In the labour market reform in three stages (1993/94, 1995 and 1998), tighter conditions were introduced successively:

- Duration of unemployment benefits was reduced to 7 years in 1993, 5 years in 1995, and 4 years in 1998 (fully implemented by 2001).
- More tight formal requirements regarding geographical mobility and duty to take any job⁵⁰
- “Right *and duty*” to activation after 4 years in 1994 was pushed forward to 2 and 1 year of unemployment, respectively, in 1995 and 1998.
- After the termination of pre-early retirement, there were measures to protect unemployed in their 50’s from losing unemployment benefits. These exceptions were gradually narrowed and completely abolished in 2006.

These reforms initiated a gradual change from a human resource approach towards a more disciplinary approach that came to characterize the subsequent decade (Larsen, 2009; Goul Andersen, 2010; Jørgensen, 2011). “Right and duty” of activation was introduced at a successively

⁴⁹ More restrictive leave programmes and pre-early retirement had been introduced in 1992, but take-up was negligible.

⁵⁰ There is an unknown but probably big discrepancy between formal requirements and actual practice in the 1990s.

earlier stage during the unemployment spell. At least it was supposed to – from the end of the 1990s a huge gap developed between the prescribed and the actual intensity of activation.⁵¹

Contradicting anything we know about “retrenchment” (Pierson, 1994), prosperity rather than austerity was the main driver of “retrenchment” in labour market policy – like in other countries with low unemployment (Eichhorst et al., 2008). Besides, activation was nourished by increasing concern for the long-term impact of ageing. Apart from tax incentives (to be described below), the dominant trends were tighter conditions of entitlements –increasing *conditionality* in Clasen’s (2005) terms – coupled with gradual extension of employment efforts to the not-so-easily employable among the non-employed.

Although conditionality was a break with policies of the 1970s and 1980s, unemployment insurance remained generous, especially in terms of duration. Compensation rates were unfavourable for high incomes, but generous for low-income groups. The compensation rate of 90 per cent was formally maintained, but as the ceiling was rather low and minimum wages high, virtually everybody received maximum benefits. As regards conditionality, there was no widespread protest, and strict work requirement is not at odds with the Scandinavian Social Democratic tradition. The most important trait, linked to long duration, was the inclusiveness of unemployment insurance. There was no increase in the proportion of unemployed receiving social assistance – only 10-20 per cent among those registered as unemployed (Goul Andersen, 2011b).⁵² Finally, having considerable control over implementation via the corporatist regional labour market system, the Social Democrats were confident that tighter rules would not be administered unduly strictly.

Unlike in the “good old days”, the reforms were not the result of tripartite negotiations with the social partners. Nearly all reforms after 1993 were carried through as part of the annual budget negotiations between the (minority) government and other parties. This forms part of a broader de-corporatization in Danish society – and fast-moving political decision making processes (Albrekt Larsen & Goul Andersen, 2004; Munk Christiansen & Nørgaard, 2003). Organisations are included if there is time, and if legitimacy is necessary. This was carried even further under the subsequent centre-right government (Jørgensen & Schulze, 2011).

On one occasion, the by-passing of the unions had significant effects on legitimacy. In 1998 the Minister of Finance secretly negotiated a reform of early retirement allowance with the leader of the Liberal party over a long time span.⁵³ Nothing was known to the public until a big package deal was announced. Early retirement allowance became reduced by nine per cent for those resigning before the age of 62, alongside a deduction for private pension assets.⁵⁴ Besides, a new contribution for early retirement was introduced, compensated by a minor decline in contribution to unemployment insurance. Although the reform was modest and might have enjoyed public support, it generated

⁵¹ Because of capacity problems it was agreed in the 2002 package that unemployed with “right and duty” to activation should be activated maximum six months since the completion of the last activation,

⁵² Social assistance recipients are counted as unemployed if they are considered employable. From 2005, they were classified according to matching groups (originally five, from 2010 three groups). Earlier, the delineation was based on registration at the employment office which rests more openly on discretion.

⁵³ Ironically, the social partners were invited to discuss another aspect of the 1998 reform: the cut in duration from 5 to 4 years. However, the social partners were informed that duration was not negotiable.

⁵⁴ Regardless of age, there are deductions by 55 per cent for labour market pension payments.

widespread protests and nearly halved the support for Social Democrats in the polls, as compared to the election in March (Goul Andersen, 2009a). The reform was interpreted as a break of a very explicit promise in the 1998 election campaign.

In spite of protests the reform was carried through, and it formed part of an emerging trend to maximize labour supply and limit exit from the labour market. Inclusion of ever more marginalized groups under activation forms part of the same trend, and the same year, the government announced an “inclusive labour market”. This was accompanied by a stricter approach to disability benefit assessment and introduction of “flexible jobs”, leaving disability pension as the last resort. After 2001, this approach was extended even further.

In short, one could speak not only of activation, but of activation of social protection more generally (Barbier, 2005; Barbier & Ludwig-Mayerhofer, 2004) – a trend that was also found in other Nordic and European countries (Dølvik et al., 2011).

4.4. Tax reforms

Tax reforms could also be included under the “activation” headline – at least this increasingly became the declared purpose, although especially after 2001. Again, one could speak of a tax reform in three stages (1985, 1993 and 1998), the first being adopted in a broad compromise, the others with narrow majorities. This was also the case for two minor and a big tax reform under the subsequent government (2004, 2007 and 2009).⁵⁵

Even though most reforms were adopted with narrow majorities, the common denominator was lower marginal taxes and a broader tax base, i.e., fewer deductions, and/or less tax value of deductions. Deduction of interest for homeowners was limited from a tax value up to 73 per cent in the early 1980s to 52 per cent from 1987, 44 per cent from 1994 and 33 per cent from 1998. Hence, the tax subsidy disappeared. From 2003 real property taxes exceeded the tax value of interest deductions for homeowners (Albrekt Larsen & Goul Andersen, 2004: 132).

As mentioned, a tax commission (Personskatteudvalget, 1992) had almost delivered a blueprint for the big 1993 reform. Alongside the introduction of a gross tax (called Labour Market Contribution) and the reduction of the value of tax deductions, a major element was the introduction of “green taxes” and a significant increase in existing taxes on energy. The highest marginal tax rates were reduced from 73 per cent to 68 per cent (in 1987) and 62 per cent (in 1998). With the exception of two largely unfinanced tax reforms in 2004 and 2007 (see below), all reforms followed the principle of revenue neutrality, in spite of various attempts to mobilize the idea that tax reforms could be self-financing because of labour supply effects. Unlike in Sweden, there were few attempts to measure whether the tax reforms *did* have such effects.⁵⁶ But there was a significant change in Social

⁵⁵ For a thorough analysis of tax reforms 1985-2004, see Albrekt Larsen & Goul Andersen (2004: 130-198).

⁵⁶ There were a lot of arguments, and a kind of consensus developed after 2000, at least among most economists appearing in the public debate, that the so-called substitution effect (inducing people to work more, or to work harder) was probably stronger than the income effect (with lower taxes, people had to work less to maintain the same income), that is, there would be a positive labour supply effect. A small, survey-based test conducted before and after the 2004

Democratic preferences for lower marginal taxes between 1989 and 1993, indicating that the supply-side discussion had left an impact (Albrekt Larsen & Goul Andersen, 2004: 155; 2009).

4.5. Medium-term planning and industrial structural policy

As mentioned, labour market policy and social policy (pensions, disability pensions), as well as tax policy became a more integral part of economic policy from the 1990s. This was not entirely new, but it reflected the change in economic paradigms towards emphasis on supply-side problems, i.e. on labour supply, and on the mechanisms that could impede the smooth functioning of markets and increase the level of structural unemployment. Further, the focus on labour supply also reflected increasing concern globally with the impact of ageing. Partly as a consequence of this change in focus, partly as an effect of new public management, the 1990s was a period where the Ministry of Finance assumed a much stronger coordinating role than previously (Jensen, 2003).

The Social Democratic government did not officially pursue any industrial structural policy. But at least in two ways, it did contribute. Towards the end of its incumbency, the government terminated the educational leave scheme, but it was concerned with expanding life-long learning for people with a short education. These ideas were not really institutionalised before the 2001 election. Due to improved employment, and because of political preferences, this was given less priority by the following government. But future governments might resume such ideas.

Further, the government actively supported the development of green technologies – wind power and others. This effort was for a while entirely reversed by the subsequent government, but the weight of this sector (crossing the conventional branch categories in statistics) had passed a point of no return, and it currently constitutes a very important segment of Danish business life.

As an enduring new instrument in economic policy, the government introduced medium-term economic planning, first as a “2005 plan”, later as a “2010 plan” which was taken over by the subsequent government. Originally, a basic idea was to find the necessary means for the costs of ageing by reducing interest payments on the state debt accordingly. Besides, it was a disciplinary device to ensure that decision makers were aware of the long-term *structural* budget situation, cleaned from business cycle fluctuations. This served to underline that the budget surplus would not last forever. Somewhat counter-productively, it might also tempt governments to “cash in” on projected savings in the future since expectations reduce current requirements to the state balance. This opportunity was occasionally used by the subsequent government to justify that it had obtained a larger “room of manoeuvre” by means of expected future savings. The medium term budgeting also set up targets for annual growth in public consumption. Not surprisingly, the government was seldom able to reach these targets. In fixed prices, public consumption increased by more than 45 per cent cent from 1992 to 2010.⁵⁷

reform indicated that the effect was very small. It also indicated that only a minority had an opportunity to work fewer or more hours (Goul Andersen, 2006b).

⁵⁷ Calculating fixed prices for public consumption is always troublesome. But considering increasing outsourcing and the large share of public consumption spent for commodities, alternative measures like the number of public employees appear even more uncertain.

5. 2001-2010: Continuity, Bonanza, and Crisis

At first, there was much continuity in economic policy after the 2001 election. The incoming Liberal-Conservative government took over the medium-term “2010 Plan” without any changes. It promised a “tax stop” which lasted – at least for citizens – until the 2009 tax reform. And as public support for the welfare state reached the highest level ever measured, there was little retrenchment until the crisis.⁵⁸ Besides, the government’s coalition partner, the Danish People’s Party, defined itself as a pro-welfare (although welfare chauvinist) party, and Denmark seemed to avoid all the problems that has often been associated with globalization and de-industrialization, such as the choice between structural unemployment among the unskilled, or larger wage differentials, perhaps even a dualization of the labour market. Like the Nordic countries, Denmark maintained small skill differences in unemployment levels (Goul Andersen, 2006a). There was a steady loss of unskilled jobs, but due to the generational replacement, there was even larger loss of unskilled labourers (Andersen, 2006).

None the less, there were also significant changes, some of which could have long-term impacts. We put particular emphasis on the policies that contributed to the economic crisis in 2008-09, to the impact of the crisis, and to institutional changes in the wake of the crisis.

As regards the crisis, it is generally agreed that in Denmark, this was not only an exogenous shock; it had a strong national component (Det Økonomiske Råd, 2009b; Birch Sørensen, 2010a; Bernstein, 2010; Goul Andersen, 2009b). This explains why the economic downturn was more profound than in most other countries. The cumulative economic decline in 2008-2009 was minus 6.3 per cent of GDP (minus 4.1 per cent for the three years 2008-2010 taken together). Such a decline had not been experienced in peacetime for nearly 200 years, not even in the 1930s, or in 1856/57.⁵⁹ Recovery was slower than usual, and 5-6 years with cumulative zero growth had to be envisaged. Moreover, economic growth in Denmark had also been comparatively low in the years before the crisis, in spite of increasing oil production. To quite a large extent, the crisis can be attributed to short-term economic policy decisions during the years 2004-2007 (and with less certainty to the handling of the crisis), but it may leave a long-lasting impact on the economy and the welfare state.

5.1. Tax Policy

Even though the new government in 2001 spoke about “time for change”, continuity was a more appropriate label for its economic policy in the first years. As regards taxes, emphasis on stability was even stronger. The government did not promise any tax relief, but declared a strict “tax stop” which would rule out any new tax increases. Hence, the only possibility of tax reform was genuine tax cuts which were promised to be fully financed. However, the operationalisation of “fully

⁵⁸ Despite this constraint, there remained an ideological room of manoeuvre: The government carried through a municipal reform and introduced a large array of market-inspired New Public Management initiatives (in particular separation of buyers and providers, competition between providers, free choice for users/consumers).

⁵⁹ The careful calculation of economic growth by economic historian S.Aa.Hansen (1974) begins from 1820.

financed” gradually changed from “crown to crown” into “room of manoeuvre”, and the tax cuts of 2003 and 2007 (effective from 2004 and 2009, respectively), were partly or wholly unfinanced. The 2003 tax cut was announced as a stimulus to the economy, and to employment. The 2007 tax cut which was adopted in an over-heated economy just before the election campaign, was aimed at increasing labour supply, but ended up being reported as part of the government’s economic stimulus in the wake of the 2008 financial crisis.⁶⁰

The 2003 reform (partly financed by the 2002 labour market reform) was a novelty as it was targeted to people in employment and contained a new “employment deduction”.⁶¹ Besides, the income bracket for the middle-level tax rate was raised. In 2007, the bracket was de facto removed as it became the same as for top level tax. Removing the middle level tax rate was an old Conservative dream and equivalent to the proposal that was rejected in the 1990 election.

The 2009 tax reform suspended the tax stop and was more in continuation of previous reforms. Ironically, this reform, with emphasis on reducing marginal taxes for high incomes, had been suggested by the Social Democrats in the party’s negotiations with the government after the 2007 election. The government accepted the invitation with some surprise and appointed a tax commission which put forward its proposals in 2009 (Skattekommissionen, 2009). It is difficult to guess the motives, but neither the Social Democrats nor the government appeared interested in a broad compromise, and in a fast decision making process, the government reached a compromise with the Danish People’s Party in March 2009.

In broad terms, the government followed the proposals of the tax commission.⁶² The maximum marginal tax was reduced to 56 per cent. People with high incomes enjoyed a substantial net tax relief, but financed primarily by tighter taxes for business. For the rest, it was a matter of churning around as income taxes were reduced, making it more attractive to work, while green taxes and other taxes were increased correspondingly. The reform (gradually phased in 2010-2019) was fully financed, but with a deficit for the first years. Actually, the economic crisis turned it into a virtue that the reform was under-financed in the beginning. Once again, tax cuts ended up being justified by the need to stimulate the economy. On the other hand, timing was perhaps less optimal for transferring money from business to employees with high wages.

Actually, Danish marginal taxes were below most Western European countries already before the reform, except for high incomes, and with the reform, even the highest marginal taxes came close to the EU average (Goul Andersen, 2006a). The reform was basically designed for a full employment situation, but came to be implemented in a quite different context.

⁶⁰ Ironically, Fogh Rasmussen came to demonstrate himself very convincingly the timing problem which had made him argue so fiercely against “fine tuning” of fiscal policy during the last years of the Schlüter administration (1988-1992).

⁶¹ This was a universal deduction with a ceiling, different from targeted tax credit schemes of the US and the UK, but not so different from a traditional Danish “wage earner’s deduction” that had been abolished in 1993.

⁶² The commission was headed by former Social Democratic tax minister Carsten Koch who had tried to find proposals that could enable a broad compromise. In the end, however, the reform was adopted by a narrow majority.

5.2. From bonanza to crisis – economic policy failure

As Denmark entered the new century with a very prosperous economy, the crisis did not bring the country into big trouble. But the *decline* was severe, and the cumulative negative growth 2008-2009 or 2008-2010 was among the worst decile in the world. More specifically, the national component of the crisis emerged from the following factors:

- liberalization of credit policy that got out of control
- pro-cyclical credit policy and fiscal policy
- housing bubble stimulated by government policy
- decline in competitiveness

“...we can buy the whole world”

Until 2007, Danish economic performance had appeared convincing. From 2005, unemployment declined to a lower level than anyone had anticipated, and shortage of labour power became widespread. By July 2008, registered (net) unemployment reached a low point of 1.6 per cent. According to internationally comparable figures it was just above 3 per cent (figure 1). Even though unemployment was assumed to be below its structural level, wage increases were not considered disastrous. Moreover, the classical Danish overheating indicator, balance of payment deficits during boom periods, did not reveal any problems.⁶³ And from 2005-2007, the state budget revealed an average surplus of about 5 per cent of GDP. In 2006, the minister of finance Thor Petersen became reknown for the quote: “...we can buy the whole world”.

This was (largely) a joke, but the boom generated a sense of economic optimism unknown for decades. As pointed out by the PM in his 2008 new year’s speech, the only remaining economic concern was the risk of over-heating and shortage of labour power. Throughout the boom, one economic concern had survived, namely the risk of wage inflation. There were warnings against expansive fiscal policy by the Economic Council, and against too low unemployment by the National Bank, but nothing was expected to shake economic stability as there was only moderate wage drift and inflation. Decision makers were concerned not to repeat the perceived errors of the mid-1980s, but as indicated above, the interpretation of the wage explosion in 1987 is contested, and concern for this problem detracted attention from other problems which might otherwise have been discovered. Some of them were typical of an emerging crisis.

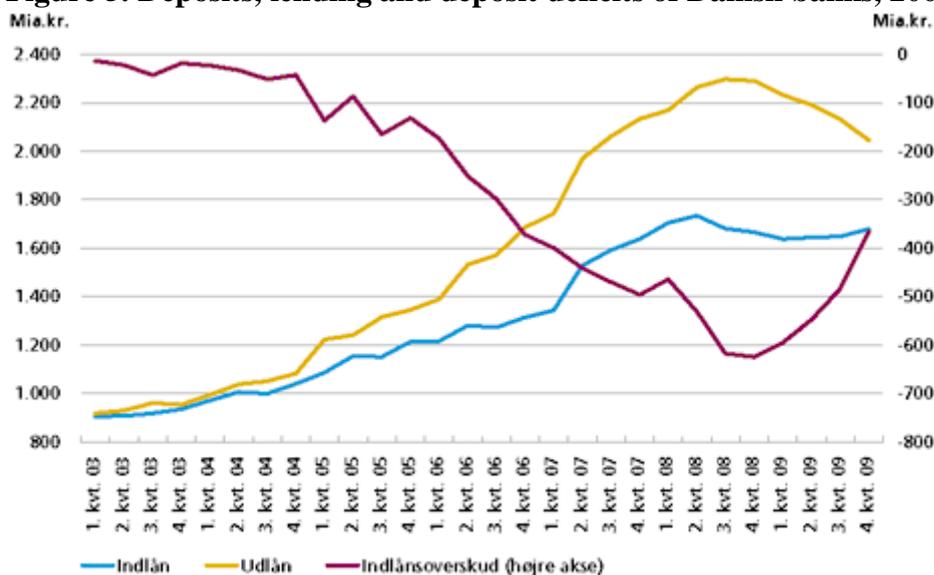
What went wrong? – Credit liberalization of the financial sector

Like in the US and some other countries (with Iceland as an extreme), the banking sector had exploited the liberalization of credit policies and of capital movements to embark on a rapid and profitable, but also increasingly dangerous, credit expansion. From 2003 to 2008, Danish banks

⁶³ Due to permanent current account surplus there was less attention to a long-term relative deterioration of unit labour costs by some 25 per cent from 2000-2009, as compared to a weighted index of other countries (Det Økonomiske Råd, 2009b), even though this became a matter of great concern during the crisis. Oil revenues contributed to a positive balance (due to a large mercantile marine current accounts does not benefit from higher oil prices, however).

built up a rather large deposit deficit of some 625 bill DkK, or some 40 per cent of GDP. In relative terms, this was a small figure as compared to Iceland, but the banks were none the less depending on continuous re-financing of short-term loans. The National Bank (Danmarks Nationalbank, 2008) officially estimated the banking sector to be solid, but seems to have used other opportunities to warn representatives of the banking sector, showing them the curve in figure 4 below. When the international financial sector panicked in the wake of Lehman Brothers' collapse Sep.15, 2008, there was reason to be worried. Four weeks later, the state set up an enormous guarantee covering all lending and deposits in Danish banks (Rangvid, 2011). Besides, a new state organisation "Financial Stability" was established to take over banks heading towards bankruptcy. Whereas the banks had previously been

Figure 5. Deposits, lending and deposit deficits of Danish banks, 2003-2009. Bill.DKK.



Source: Nationalbanken (2010) Balance- og strømstatistik for MFI-sektoren, dec 2009, published 26. Jan 2010

eager to expand as much as possible, they over night became cautious as they had to reduce the deposit deficit as fast as possible. This seems to have constrained lending of money to firms for a while – detrimental to investments, or accelerating collapse – although it remained a controversial issue to what extent this was the case.

What went wrong? – Liberalization of credit for homeowners: A potato cure in reverse

As regards households and housing prices, much of what went wrong from 2004-2007 could be characterized as a “potato cure in reverse” as indebtedness and a housing bubble was actively (although unintentionally) promoted by state policies. This was diametrically opposite to what happened from 1986-1992.

A comprehensive liberalization of credit policies for homeowners took its beginning already in the 1990s (figure 6). At first, temporary restrictions from the 1970s and 1980s on currency (20 years), annuity loans and so-called cash loans were abandoned (1992-93). In short, the requirement of very fast repayment was softened.

More importantly for the future, homeowners were granted unrestricted access to supplementary loans (up to the sacred limit of 80 per cent of current value). Such money could be spent for any purpose, and Denmark became one of the countries with the strongest connection between housing prices and consumption possibilities (Cardarelli et al., 2008). Accordingly, Denmark experienced an unusually large decline of 4.5 per cent in private consumption in 2009), in spite of an almost unprecedented growth in disposable incomes that year (see below).

Figure 6. Liberalization of credit policies for homeowners.

1992	Loans with a <u>currency of up to 30 years</u> (previously 20 years)
1993	<u>Annuity loans</u> (no restriction that 40 per cent should be series loans). <u>Reintroduction of “cash loans”</u> (depreciation due to bond value below 100 transformed to tax-deductible interest payment). <u>Unrestricted access to supplementary loans</u> (up to 80 per cent of current value)
1996	<u>Flexible loans:</u> Loans with flexible interest rate to be changed each year or within a few years (following the short-term interest rate). ⁶⁴ Low short-term interest rates reduced mortgage payments and contributed to rising house prices. It gradually removed the stabilizing nature of the Danish mortgage system. Technically, the loan must be refinanced every year.
2003	<u>Interest only – loans:</u> Loans without repayments for 10 years

Another novelty was the introduction of “flexible loans” in 1996 enabling homeowners to exploit the advantage of unusually low short-term interest rates in the years to come – the risk being, of course, that interest rates could increase unexpectedly. This sensitivity to fluctuations in the short-term interest rates may erode the traditional stabilizing influence of the Danish building societies credit system (see below).

Finally, interest-only loans were introduced in the autumn of 2003. It was argued by the building societies and accepted by the government that this would not affect prices. This has remained an issue of dispute, but on average, real estate prices increased very dramatically 2004-06 (see below).

⁶⁴ The loan can be up to 30 years but is based on short-term bonds that are renewed each year (a variety of time horizons have been introduced, however). Further, new products have been invented where the interest rate can move downwards, but not upwards (needless to say, initial interest rates are somewhat higher on these loans).

Altogether, this was a 180 degree reversal of the credit policy from 1986 to 1992. Not surprisingly, it also meant an enormous increase in loans, and in private consumption among homeowners: Current consumption could be financed cheaply by housing loans – with or without repayment. The motive for the liberalization in 1993 was to stimulate the economy after a very long recession. From 1997 onwards, this motive would typically have pulled in the opposite direction, but liberalization of credit policy was in accordance with the global turn towards deregulation of mortgage markets.⁶⁵

At first, the use of flexible loans was limited, but as short-term interest rates remained unusually low (reflecting decisions of FED and ECB), even conservative and cautious homeowners switched. At the peak in the second quarter of 2009, about 90 per cent of all new loans were flexible loans.⁶⁶ This served to alleviate falling house prices, but the stabilizing influence of the traditional Danish mortgage system (fixed interest rates throughout the currency of the loan) was seriously damaged. What remained was the limitation that loans can "only" cover 80 per cent of current value.⁶⁷ The rest must be financed through savings or through ordinary bank loans.^{68,69}

Not surprisingly, the liberalized credit policy created a housing bubble (Figure 7) – further supported by the tax stop for (most) real property taxes.⁷⁰ Following the introduction of interest-only loans, prices went up by additional 60 per cent on average 2004-06. From the take off in 1995 to the burst of the bubble in the end of 2006, prices tripled for houses and quadrupled for owner-occupied apartments. The consumer price index 1995-2006 only went up by 28 per cent.⁷¹ This bears quite some resemblance to the housing and credit bubbles of the other Nordic countries in the early 1990s. This was also linked to liberalization that got out of control.

⁶⁵ From 1989, deregulation also involved a transformation of building societies to shareholding companies.

⁶⁶ Press release, Realkreditrådet 31.07.2009 (<http://www.realkreditraadet.dk>). 80 per cent of new loans in the second quarter of 2009 were taken for "other reasons" than change of ownership, rebuilding, etc., that is, for consumption, or for "financial management" reasons. Until 1993 this was impossible.

⁶⁷ This loan-to-value (LTV) ratio is rather high by comparative standards (Cardarelli, 2008: Table 3.1).

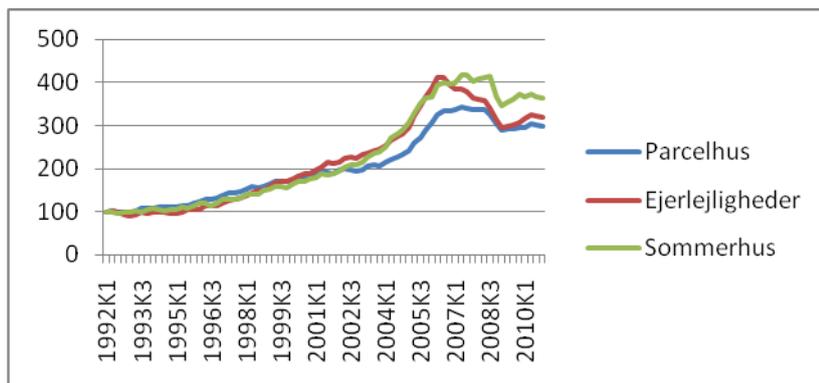
⁶⁸ Technically speaking, these bank loans are "sub-prime" loans. But they are ordinary bank loans, granted on the basis of an ordinary credit (risk) assessment; risk remains with the bank and is not transferred. In the Danish system, homeowners remain personally responsible for their debt for an indefinite period.

⁶⁹ Homeowners with fixed interest rates had other opportunities. With fluctuating interest rates, they could convert their loans. For ordinary loans, it is always possible to prepay the entire loan, either by paying the nominal debt, or by buying corresponding bonds. If the interest rate goes up, bond prices go down, and loans can be refinanced at a higher interest rate but with lower nominal debt. If the interest rate subsequently goes down, it is possible to prepay the expensive loan at a maximum bond price of 100 (=nominal debt; no fee) and refinance at a lower interest rate. This was a widespread practice among those who maintained loans at fixed interest rates (Hansen & Pedersen, 2003).

⁷⁰ There are two taxes on real property: Land value taxes and property value tax. Land value taxes were not included under the tax stop, but increased with a considerable delay since there is a ceiling to maximum annual increases.

⁷¹ The index is based on prices per square meter and does not take account of renovation and quality improvement.

Figure 7. Housing prices in Denmark, 1992-2010 (1992=100).

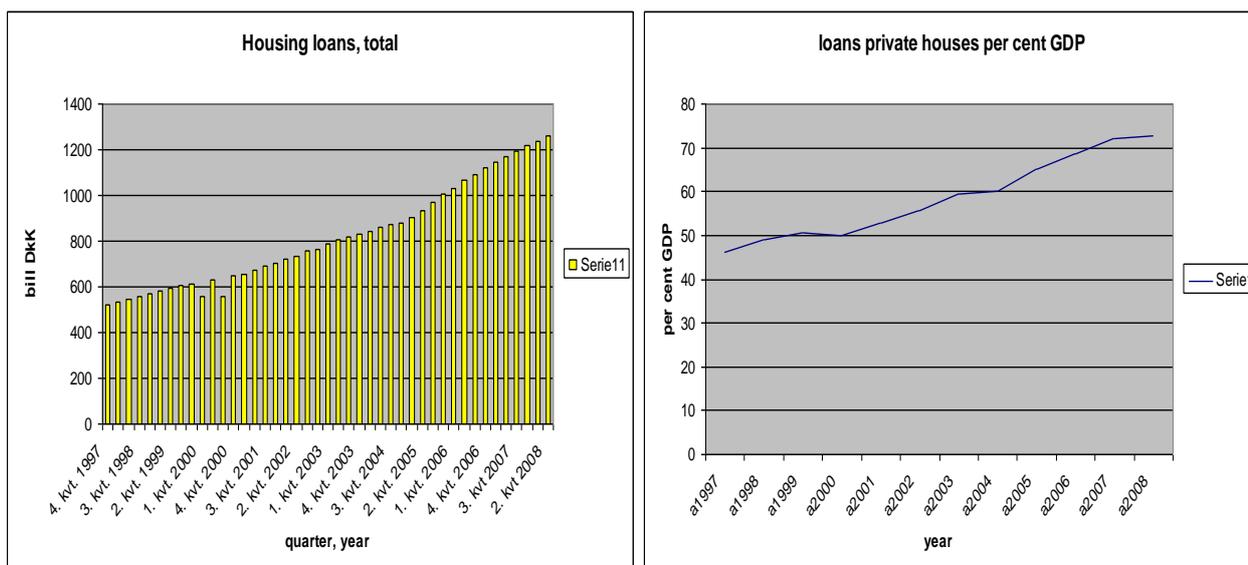


Source: Realkreditrådet. Boligprisstatistikken

From 2000, Danish homeowners became financial experts. Opportunities were exploited creatively. It was different from the subprime excesses in the US: In Denmark, loan management was a middle class privilege. Loan expansion was huge, but among people in a good financial situation. Hence, the burst did not release avalanches of bankruptcies or accumulation of "dodgy" loans. It only meant that people had to adjust consumption to current incomes (Hede et al., 2009).

It should be repeated that flexible loans and interest-only loans also served to modify the decline in prices after the burst. As seen from figure 7, the decline only brought prices back to the 2004/2005 level (at least until the autumn 2010 when a new decline started). In the short run, the loans had a stabilizing impact as interest rates came close to zero. Cheap loans enabled people to get rid of other, expensive loans, and lower interest payments enabled homeowners to consolidate.

Figure 8. Loans from building societies, 1997-2008. (A) Bill Dkk. (B) As per cent of GDP.



Source: Realkreditrådet homepage: statistics. <http://www.realkreditraadet.dk/>. Including ordinary houses, owner-occupied apartments and summer houses. Figure B calculated on basis of www.statistikbanken.dk (table NAT01). Due to an announced revision in statistics, data are only available until 2. quarter of 2008. [becomes available now]

Long-term impact could leave Danish economy on a volcano, however. Homeowners' indebtedness increased, absolutely and relative to GDP, as revealed by figure 8. From 1997 to 2008, loans went up from 46 per cent to 73 per cent of GDP. By the end of 2010, the figure was 79 per cent of GDP, and 65 per cent of all loans were flexible loans with variable interest rates (up from 60 per cent by the end of 2009). 54 per cent were interest-only loans (up from 52 per cent), 43 per cent were a combination: Variable interest rates, no repayment (up from 38 per cent). This explains why the National Bank Director warned in 2011 that interest-only loans destabilized the economy and had contributed to the housing bubble (Danmarks Nationalbank, 2011).⁷² A few months earlier, financial experts had warned against massive use of flexible loans. The Economic Council (Det Økonomiske Råd, 2011) joined the latter, but had no reservations with interest-only loans.

A volcano eruption would look like this: The housing market has become sensitive to fluctuations in short-term interest rates, and sharp increases could affect housing prices dramatically. With high indebtedness, widespread insolvency could occur. Finally, to take the worst case scenario, the massive need for annual refinancing of flexible loans – nearly 50 per cent of GDP – bears resemblance to the refinancing needs of the banks when they suffered the large deposit deficit in 2008. In case of financial unrest there might be sudden increases in interest rates on Danish bonds (as it happened in 2008). Briefly, this was the risk scenario in 2011.

What went wrong? Pro-cyclical credit policy

In retrospect, liberalization of credit policy looks like a big policy risk. In addition, the timing of interest-only loans was unlucky as it contributed even further to the housing bubble where the tax stop had already weakened the brakes. This also contributed to the general overheating of the economy in 2005-07. To explain this policy course seems relatively simple, however. Needless to say, incentives for lobbying were strong since credit liberalization implied a large increase in activity and profits of the financial sector. The government was not only ideologically favourable to the financial sector, and to liberalization; it also saw liberalization as an inevitable trend. Nobody had strong incentives to go against deregulation. Even the Social Democrats supported it with some reservations. The Economic Council (Det Økonomiske Råd, 2006: 1, 3, 30, 52-54) considered the impact on consumption, over-heating, and housing prices, but apart from a few economists warning about excessive increases, nobody seemed seriously worried about a collapse.⁷³

By 2006-2007, the predominant view among experts was that price increases would not continue, but that there would be a “soft landing”. From the fourth quarter of 2006, however, housing prices were falling in Copenhagen, and a few months later in the whole country, beginning with the large urban centres. In 2008-2009, prices plummeted all over the country. From the first quarter of 2008

⁷². Not surprisingly, the Association of Danish Mortgage Banks (Realkredittædet) argued from the very beginning that this was not the case; the Ministry of Economics and Business (Økonomi- og Erhvervsministeriet, 2007) had concluded that it only contributed by some 4 percentage point of the increase (the analysis left a huge variance unexplained).

⁷³ The Political-Economic Committee of Parliament elaborated a small report in 2006. In a report to the Committee (Økonomigruppen, 2006) it was estimated that these capital gains only contributed to an increase in private consumption by 4½ bill Dkk in 2005 and 2006, and about half that amount on average in 1995-2005.

to the first quarter of 2009, house prices declined country-wide by 15.0 per cent. In the Copenhagen metropolitan region prices had declined by 30 per cent in 1st quarter of 2009, as compared to 2006 average. For owner-occupied apartments, the decline was 36 per cent.

Alongside lower consumer confidence, this released a sharp cut in private consumption. Asset inflation had contributed to higher consumption in the preceding period as it was easy to expand debt and consume capital gains without bringing oneself in a vulnerable economic position. But in the first quarter of 2009, savings as per cent of disposable income for households increased to 14.2 per cent, from a 2008 average of 5.7 per cent. Throughout 2009-11, consumption propensity was much lower than expected, and this also deprived the economy of a growth trigger.

What went wrong? – Pro-cyclical fiscal policy

Normally, fiscal policy is contractive under a booming economy, but in the mid-2000s, this was not the case. On the contrary, fiscal policy was also largely pro-cyclical, as criticized by the National Bank and by the Economic Council (Det Økonomiske Råd, 2006: 3, 111; 2009a: 115-116). On average, the annual fiscal effect (effect on GDP as compared to a “neutral policy”) was about 0.5 per cent.

As mentioned, the government had promised that any tax cut should be fully financed, but this was gradually modified to “room of manoeuvre”. Like its predecessors, the new government found it difficult to constrain public consumption; this left little room for tax cuts. The 2003 package was legitimized as an anti-recession stimulus after the IT bubble, but had its impact during the boom 2004-2007 when the 1 per cent SP (Special Pensions Savings) contribution remained suspended. In short, both the tax cut and SP suspension served as pro-cyclical measures. So did the high public consumption growth, and on average, there was a positive stimulus of fiscal policy by some ½ per cent per year 2005-2007, with a peak in 2006 (Det Økonomiske Råd, 2009b: 138). It actually turned out that there had been a positive stimulus *every* year 2001-2010.

This was criticized by the National Bank and by the Economic Council, even though there was a fierce debate about whether these institutions were critical enough until the very strong critique in the Autumn 2009 report of the Economic Council (Det Økonomiske Råd, 2009b; Sørensen, 2010; Birch Sørensen, 2010a, 2010b). The opposition and the media largely remained silent. Perhaps the opposition felt little incentive to criticize as it might backfire on social spending ambitions, and without political conflict, the media seem unable to function as a watchdog (Goul Andersen, 2010).

As regards credit policy, uncertainty may be part of the explanation. But financial policy is routine, and actors should know what they are doing. None the less, in both fields government, opposition and the media seemingly failed, and independent actors like the National Bank and the Economic Council failed to voice their criticism loudly enough. This contributes to explaining why the Danish economy could suffer an extraordinary, partly self-inflicted decline, almost without warning.

Deliberate Crisis policies 2008-2010

Ironically, the tax cut adopted in the heydays of prosperity right before the 2007 election came in force during the recession in 2009. *Post hoc*, it was presented by the government as part of its stimulus efforts. This was of course turning vice into virtue, but it remains that it had an expansive effect.⁷⁴ The 2009 tax reform was also designed to increase labour supply during an economic boom, but due to the recession, it was legitimized much as a stimulus – which coincided nicely with fact that the reform was under-financed for the first years.

Expansionary fiscal policy was uncontroversial in 2009. The controversial issues were about size, about timing, and in particular about means. The government argued (with justification) that automatic stabilizers in Denmark are unusually strong, and that the 2009 tax reform would also provide a stimulus in 2010. Besides, people were unexpectedly allowed to withdraw their savings from the SP pension scheme in 2009 with a reduced rate of taxation. As virtually everybody took out their money, the entire scheme was terminated by the end of the year.

The timing was unlucky as the administrator of the SP fund (ATP) was forced to sell the underlying assets at a time when average value of shares was little more than one-half the value one year earlier or one to two years later.⁷⁵ The termination also affected the long-term sustainability of the welfare state which was the original justification of the scheme. But this concern was hardly uttered in public at that time, not even by independent economists, due to the short-term crisis problems.

The Economic Council criticized, however, that effects were unpredictable as regards impact on consumption (Det Økonomiske Råd, 2009a: 132). In addition to uncertainty about propensity to withdraw, it was uncertain how the money would be handled. If people acted rationally, the impact would be small.⁷⁶ Apparently people did not act rationally. But they did not seem to increase spending much, either. An unexpected increase in cheap tourist travels indicates that people with small savings did spend the money for consumption, and later survey evidence also indicates a significant effect. On the other hand, it remains a puzzle why private consumption declined by 4.5 per cent in 2009, in spite of a large increase in disposable incomes.⁷⁷

It is difficult to guess the government's motives. Certainly, it had not been planned for a long time. In his opening speech to parliament on the 7th October 2008, the Prime Minister had announced that

⁷⁴ A Labour Market Commission had been appointed in the spring 2008 to find equivalent revenues by proposals to increase labour supply. Unexpectedly, the commission was asked already in August 2008 to come up with proposals to be carried through in the autumn. However, negotiations took place at the peak of the financial crisis and soon broke down. When the Commission came up with its final report in August 2009, it was shelved by the Minister of Finance even before it was published since the economic agenda had changed so radically.

⁷⁵ Depending on age (investment in shares being highest among the young), people suffered big losses, but ironically, this was never really discussed in the media, nor was it questioned by the opposition.

⁷⁶ People with the highest marginal tax rate could withdraw 15.000 DkK with a reduced tax rate of 35 per cent and transfer the money to an *identical* pension scheme with a tax deduction of 59 per cent. That was tantamount to a 60 per cent increase of the savings account without any cost and without any change in conditions. For the part of the pension beyond 15.000 DkK, the tax subsidy was smaller, but still substantial. People with low tax rates could also enjoy a subsidy, but it might be more attractive to get rid of expensive debts and build a buffer to face the recession.

⁷⁷ Certainly people did not act as rational investors (some could have their savings by switching to an identical private pension and investing in shares at random in order to protect their pension savings). Maybe they followed another rationale by using the money for consolidation.

contributions to SP would be resumed after 5 years suspension. On the 20th October, the Minister of Finance recalled that statement: There would be *no* contributions in 2009. And on the 1st March, 2009, the scheme was *de facto* terminated. As the manoeuvre provided short-term tax revenues to the state, one could guess that blame avoidance was a motive. However, this probably builds on too rational assumptions regarding motives: It was hardly intended to eradicate the scheme, and the government only made calculations for moderate withdrawals.

The government resisted proposals from the opposition and (until 2010) from the Economic Council to introduce large growth packages. It advanced some investments and adopted some guarantees and subsidies for business (like postponement of VAT payments). Another major initiative which was supported by all parties except one was a renovation subsidy (of 1½ bill Dkk) for homeowners, adopted the next month. This was evaluated (Erhvervs- og Byggestyrelsen, 2009). Deadweight losses were extremely large. Net employment effect was estimated to 700-1.000, but as some projects were not carried out, the net impact was close to zero (Politiken, 23.11.2010).⁷⁸

5.3. Labour market reforms and dismantling flexicurity

Not surprisingly, Denmark was among the OECD countries that experienced the largest *increase* in unemployment and the largest decline in employment 2008-2010. From a long-term perspective, this is important for the impact of labour market reforms. Under full employment, one might speak of policy continuity as the reforms would entail little risk of social marginalization. In a context of deep economic crisis, it is another matter. Besides, rather than adapting reforms to the deteriorating employment situation as in the 1970s, the radical policy changes in 2010 and 2011 moved in the opposite direction. This is tantamount to path breaking. Arguably, it involves a dismantling of the Danish “flexicurity” model of institutional complementarity between generous social protection, liberal EPL, and ALMP bringing people back to work.

If we take the economic situation into consideration, there was continuity in the major labour market reforms launched under the Liberal-Conservative government. Following the three stages in the 1990s, a fourth stage of labour market reform was a reform package in 2002 (“*More people to work*”, Regeringen, 2002). Besides, a *Welfare Reform* in 2006 could be considered a fifth stage. Both of these reforms were adopted in broad compromises between all parties except the left wing⁷⁹.

Conditionality and “work first”

Much more than in the 1990s, the Liberal-Conservative government emphasized conditionality, and work first strategies rather than education. Symbolically, the “individual action plan” was renamed “Job plan” in 2002: The shortest possible road to a job. According to evaluations most activation measures only had small employment effects; in particular the effect of education was disappointing (e.g. Arbejdsministeriet, 2000; Det Økonomiske Råd, 2002, 2007). Even though these conclusions

⁷⁸ www.politiken.dk/tjek/penge/ECE842061/danskerne-dropper-renovering-for-millioner.

⁷⁹ Social Democrats and Radical Liberals later regretted their participation in certain elements of the package, in particular a ceiling for social assistance.

have occasionally been questioned, this was the lesson drawn among policy makers. Accordingly, education was given less priority, without being completely eliminated.

Apart from specific measures for certain categories of social assistance recipients – sometimes explicitly targeted at non-western immigrants – there were no cuts in benefits or duration until 2010, and the indexation by wage increases was continued without questioning. In return, duties were tightened. Within one month, the unemployed must have a job interview and agree on a plan for job search. The unemployed must document active job search, upload CV on the internet, confirm availability every week and respond to any employer contact. Availability means ability to take a job immediately without notice, and it is to be reconsidered by the unemployment insurance fund every three months. Much of this was decided already in 2002. For a while active job seeking was operationalized as sending at least four applications per week, but that was given up in 2009.

The duty to be actively job seeking was also applied to people on activation – and until the autumn 2010 it even applied to people who had already signed a contract for a new job. Sanctions of all sorts were introduced and more frequently used (Det Økonomiske Råd, 2007: 187-189; Arbejdsdirektoratet, 2010). There was duty to short term activation any time, and “right and duty” to activation after 9 months according to the job plan. For unemployed under 30, right and duty applied after 13 weeks. Altogether, conditions were substantially tightened, and the rules were applied in practice. Alongside continuity, one could speak of a *conversion* of the system (Streeck & Thelen, 2005) to a more disciplinary approach. However, formal rules were also changed. Danish rules used to be the most lenient, but already before the 2006 agreements, Denmark was classified among the “toughest” (Ministry of Finance, 1998; Hasselpflug, 2005). As regards activation, it is rather well-documented that tight conditionality works (Rosholm & Svarer, 2008; Konle-Seidl & Eichhorst, 2008). This is also considered preferable to the use of economic incentives by reducing the level of benefits which was largely avoided, except for immigrants.

Targeted cuts for immigrants

For immigrants, the situation was different. In 2002, the government and the Danish People’s Party agreed on an immigration package which included a much reduced “start assistance” for newly arrived immigrants from non-EU countries (Goul Andersen, 2007b). In 2005 the same parties adopted a package entitled “*There is need for everybody*”. This was labelled an “integration package” and was targeted at immigrants⁸⁰, but the rules formally applied to everybody.⁸¹ The most significant element was a requirement that married couples receiving social assistance should have 300 hours of ordinary (not subsidized) employment within two years in order to maintain social

⁸⁰ *De facto*, this holds also for most of the cutbacks in the 2002 *More People to Work* package (Goul Andersen, 2007b).

⁸¹ The Social Democrats exited from a preliminary agreement when it was to be specified. Social assistance recipients were divided into five “matching groups” according to employability. The government only wanted to exempt the totally unemployable group five from the work requirement whereas the Social Democrats wanted to exempt the two lowest groups. Even though the exit was politically motivated, the disagreement was more than a detail. “Matching group four” was the largest one (44 per cent of those allocated by 2006, see Det Økonomiske Råd, 2007: 191), and was officially described as “having so substantial limitations in competences and resources” so that “job functions compatible with the person’s competences and resources are only to be found to a very limited degree on the ordinary labour market” (<http://www.folketinget.dk/samling/20051/almdel/AMU/spm/8/svar/endeligt/20051130/225352.PDF>).

assistance. In 2008 when a decision from the European Court of Justice (the so-called Metock case) revealed that Danish immigration requirements would be at odds with EU regulation, the Danish People's Party was compensated by extending the work requirement for social assistance recipients to 450 hours (Regeringen, 2008a). Besides, it was made explicit that this requirement applied to all married social assistance recipients, regardless of spouse's employment.⁸² It remains to be seen if those affected will be able, in a context of economic crisis, to meet these requirements. The rules apply to the huge majority of social assistance recipients, exempting only the completely unemployable group (the lowest among five – from 2010 three – “matching groups”).

Administrative reform and financial reform

Until 2010 the most important institutional change was a transformation of the administrative structure, including a reform of financing unemployment benefits. Supported by the Danish People's Party, the government decided in 2004 (as part of a municipal reform) to move towards a one-string Job Centre system for people receiving unemployment benefits (UB), social assistance, and other income transfers (Regeringen, 2004: 39-43). This meant a transfer of responsibility for UB recipients from the regional to the municipal level. It was initially a hybrid since two separate administrations were maintained within the Job Centre (Christiansen & Klitgaard, 2008, 2009; Breidahl & Seemann, 2009).

The future was to be decided after an evaluation of the reform 2007-2010 (Regeringen, 2004: 43), but as an unexpected element in the annual budget negotiations, it was decided by the same parties in November 2008 to make a full municipal one-string system (Regeringen, 2008b: 25, 57-60).⁸³ Furthermore, the agreement included a financial reform: Municipalities should co-finance unemployment benefits according to rules resembling the rules for social assistance, disability benefits etc. This was specified in a law adopted by May, 2009 (L184/2009) – against strong resistance from the social partners and the opposition.

The reform was followed in April 2010 by an administrative division of all working-age recipients of income replacement (unemployment benefits, social assistance, sickness benefits etc.) into three matching groups: (1) Ready for employment; (2) ready for employment efforts; and (3) “temporarily passive”. This illustrates the gradual extension of employment efforts from the

- most employable UB recipients, to the
- not-so-employable UB recipients, and the
- not-so-employable SA recipients, and the
- not-so-employable people receiving other benefits (sickness, or on the way to disability pension)

⁸² The Ministry of Labour had tried to impose this interpretation already on the 2005 package, but this was declared illegal by Ankestyrelsen (25.January 2008).

⁸³ According to a participant observer, the issue was never discussed during the negotiations (Breidahl & Seemann, 2009: 190-196). In the parliamentary debate, the minister of employment appeared surprisingly little equipped with analyses or arguments to deal with critique from the opposition, but used the acceptance from the Association of Danish municipalities as the only justification.

This reform was paralleled by similar efforts in other countries (Clasen & Clegg, 2011). The reforms are sometimes criticized for being too little “recession-proof”. Until now, this remains to be seen, but problems are highly imaginable in a situation of enduring high unemployment.⁸⁴ In Denmark, all experts and the social partners criticized the model of financing according to which the municipalities should be reimbursed according to performance. Performance measures include unemployment (as compared to regional average), and activation (higher reimbursement during activation). As municipalities have little control over the level of unemployment, the rational strategy is to maximize reimbursement through activation. Municipalities have a strong incentive to develop (or to buy) the cheapest possible activation measures (Nørgaard, 2009), and unsurprisingly, newspaper reports throughout 2010 indicated that this was exactly what municipalities were doing. The Minister of Employment took action in 2010/11 to reduce such behaviour, but the system was not designed for a recession and is insensitive to fluctuations in the business cycle.

Transforming the Ghent model to a liberal model

The Ghent model of unemployment insurance was originally a liberal institution that was tacitly converted to a Social Democratic one by increasing state responsibility for financing. Like in Sweden, there has been a hidden transformation in the opposite direction – in Denmark since the 1980s. In addition to higher contributions, the most important means has been a reduction of tax deduction. In Denmark this proceeded slowly over three decades. From 1982 to 1987, tax deduction was up to 73 per cent. Through tax reforms, this was gradually reduced to 33 per cent from 1999, and according to the 2009 tax reform it is reduced further to 25 per cent. In the late 1970s, the government paid more than 90 per cent of the costs. In 2008 when there was full employment, unemployment insurance even provided a small profit for the state.

Apart from social assistance, there has been no attempt since the 1980s to improve economic incentives to work via reduced benefits. However, the instrument of incentives has been used inversely, by introducing tax relief exclusively for employed people in the 2003 tax reform, more specifically by an employment deduction in income taxes. As a universal deduction, however, this is different from tax credits in the Anglo Saxon countries, and to some extent it simply represented a revival of a classical deduction that disappeared in previous tax reforms.

Rediscovery and erosion of Flexicurity

Until 2008, the government showed no inclination to cut the long duration of unemployment benefits which had been four years since 1998. There were obvious political reasons to abstain from this as it could spoil the “winning formula” of the Liberal-Conservative government after 2001. Since 1920, it had never been possible to gain a majority to the right without the support of the Radical Liberals, and as this party was allied with the Social Democrats, the only road to power for the bourgeois parties was to attract Social Democratic working class voters. This segment could be

⁸⁴ The formation of job centres was justified by the small differences between UB and SA recipients. However, exactly this difference was much larger when the reform was adopted than it had ever been previously.

attracted because it was dissatisfied with liberal immigration policies, but only if the bourgeois parties could also provide acceptable social policies. Hence, the government should not expose itself to criticism for an unfair distributional profile. This was indeed a successful formula: In the elections 2001, 2005 and 2007, the governing majority including the Danish People's Party attracted more than 50 per cent of working class voters (Goul Andersen, 2003).

This strategy generated unrest among hard-core liberals, but the winning formula matched very well with the new ideas of "flexicurity": Since 2005 (Regeringen, 2005), the government argued strongly in favour of the Danish "flexicurity" model that combines (1) a flexible labour market where it is easy to hire and fire (liberal employment protection) with (2) generous protection for those who happen to be unemployed, and (3) an active labour market policy (ALMP) that brings people back to work.

In Denmark, flexicurity was not invented by the government; it was hardly even a case of deliberate institutional design. True, ALMP was strongly expanded in the 1990s, but the two other elements had been present for decades. It was not coined "flexicurity" until around 2000, however (Kongshøj Madsen, 1999). Generous unemployment benefits date back to 1967-1972, and to around 1980 as far as duration is concerned. Employment protection legislation (EPL) has always been liberal in Denmark, and attempts from the unions to strengthen EPL in the 1970s largely failed. The reasons are mixed, and it is uncertain what counted the most: perhaps the predominance of small and medium-sized enterprises made it unfeasible, perhaps there was too little pressure from members due to generous benefits. Or perhaps the unions were too preoccupied by another reform project: Economic Democracy. At any rate, not much happened.

The institutional complementarity between generous benefits and liberal EPL was largely ignored at that time, however. Inspired by Piore & Sabel (1984) and others, Denmark was rather referred to as an old-fashioned "numerical flexibility" system, in contrast to the more advanced "functional" flexibility of countries like Japan and Germany. Others noted in passing that there might be a positive match with Danish industrial structure (Jensen, 1987; Goul Andersen & Munk Christiansen, 1991). But there was little attention to the issue until economists turned interest towards the issue of flexibility in the 1990s. When the concept of flexicurity was coined in Dutch politics and in Dutch research, scholars began describing the Danish system as a model of institutional complementarity. This attracted international interest after EU's Lisbon summit 2000, both among scholars and among policy makers all over Europe, as well as in the OECD (Kongshøj Madsen, 2002).

Unions, preferring a relatively generous UB system eventually declared themselves in favour of maintaining a liberal EPL. And the concept of flexicurity fitted perfectly with the winning formula of the Liberal-Conservative government. The government largely remained loyal to the idea of flexicurity, with the exception of two proposals that were given up: A proposal in 2003 to introduce a long waiting period for UB for people with high wages (seemingly a simple mistake), and a proposal of shorter duration in 2008.

Generosity has two components: duration and level of benefits, and in the optimistic economic climate that lasted until mid-2008, the labour movement did not completely refuse to change the

balance between the two dimensions as there were few long-term unemployed anyway.⁸⁵ The Danish model was unusually generous in terms of duration, but for people with average incomes or higher, compensation rates are relatively low since UB has *de facto* become a flat-rate benefit (Clasen et al., 2001; Goul Andersen, 2011b). Due to the financial crisis, however, negotiations in the autumn 2008 ended without results, and in 2009 the government itself shelved the proposals of its Labour Market Commission even before they were published.

Thus, it was a big surprise when, as a response to government proposals for large public savings in May, 2010, the Danish People's Party suddenly came up with the proposal to reduce duration to two years. Moreover, negotiations were completed within less than a week.

It is questionable how much remains of the Danish flexicurity model after the 2010 reform. At least it has been eroded. Since the 1980s the most important "security" component always was long duration, and in addition to the cut of duration to one half, requalification requirement was doubled from 26 to 52 weeks of employment. This combination is likely to exclude vulnerable groups from unemployment benefits.

Moreover, in accordance with the idea of institutional complementarity, unions negotiated a protection against dismissal in the 2010 collective agreements – a compensation in cash that is related to tenure, normally reaching a maximum after eight years. This sort of employment protection, whether adopted by law, or by collective agreements, always protects people with long tenure, that is, the insiders (in this case typically full compensation after eight years). As an important side effect, this protection also provides an incentive to remain in current job and not give up tenure. In short, one could envisage longer tenure, less flexibility and increasing polarization between insiders and outsiders after the demise of flexicurity. So far, the settings of the instrument may not have a dramatic impact, but it is a remarkable adjustment.

Flexicurity and early retirement allowance

Early Retirement Allowance could be considered yet another component of flexicurity. Providing an opportunity to exit the labour market at relatively favourable conditions, this allowance has made targeted protection schemes less necessary. In May 2011, the government reached a compromise that formally maintained the scheme as a three year scheme, but *de facto* abandoned it for a large proportion, possibly a majority. According to the agreement that has to be implemented after the 2011 election, those who have contributed to the scheme can have their contributions repaid with a small interest, but tax-free. As early retirement allowance *de facto* became a sort of state subsidized pension scheme already in the 1998 reform, but with much lower tax deductions for contributions, people with high incomes can buy (or make) an equally attractive private scheme themselves, and insurance companies are ready to offer such private replacement after the 2011 election.

⁸⁵ Long-term unemployment has always been comparatively low in the Scandinavian countries, including Denmark. This holds even during the period of mass unemployment when a very large proportion of the labour force – up to 30 per cent – was affected by unemployment within a calendar year (Goul Andersen & Jensen, 2002: 41). By the same token, Denmark has not really had much experience of "precarious jobs" as compared to Continental European countries (Goul Andersen & Jensen, 2002: 45-52).

As retirement age was raised in the 2006 welfare reform, the combined impact is quite dramatic. For people born until the mid-1950s, the earliest retirement age is 60 years. For those born 1971 or later, the earliest retirement age is 70 years or more, following the change in life expectancy at 60. On average, people are supposed to enjoy some 14½-15 years as pensioners. As social class inequality in life expectancy is increasing very significantly, the 2011 reform will be pretty tough to the lower classes on the labour market. They are offered a new “senior disability pension scheme”. In principle the criteria are the same as for ordinary disability pension, but with less effort to find alternatives, and the compromise was accompanied by signals that it was expected to be applied somewhat more leniently, although there are no judicial obligations in these signals. At any rate, some protection against dismissals for elderly workers would seem required.

The economic implications of the reform are uncertain. According to government expectations the huge majority of potential early retirement recipients will remain in the labour force in the future. If the government’s assumptions are true, this would provide Denmark with far the highest employment rate among 60-64 years old in Europe, in spite of short life expectancy. If we assume that Denmark may reach the top-three level (Sweden, Norway and Switzerland), only some 60 per cent will remain in the labour force. As a particular problem, Denmark is expected to face a surplus supply of unskilled workers in the near future; as people receiving early retirement allowance are recruited mainly among the less skilled, this surplus of low skilled labour power is likely to increase. By implication, there is likely to be structural unemployment problems among the unskilled in the future – or wage differentials are likely to increase as minimum wages will come under pressure.

5.4. Economic Crisis, Cost Containment, and Institutional Change

The erosion of flexicurity is perhaps the most significant institutional change that has resulted from the economic crisis. The changes were not discussed very much in these terms, however. Rather, the word flexicurity seems to disappear from government discourse, and it was not brought very much forward in the criticism of the government. Further, as job losses were severe and rapid in the Danish case, the blessings of flexicurity have been questioned, e.g. by previous members of the Economic Council (Kærgård et al., 2011), but as pointed out by Jørgensen (2011), this is an inevitable side effect.

Whether there will be another life for flexicurity after the crisis remains to be seen. But it is an illustration that unlike the crisis in the 1980s which – also under a Bourgeois government – brought cost containment without institutional change, the current crisis has brought both. As regards cost containment, the switch of the government was quite abrupt. Whereas the government’s economic reports in 2008 and 2009 systematically underestimated the crisis and its budgetary implications, at least the budgetary implications were exaggerated systematically in 2010 and 2011. This had the political purpose of presenting the government as the economically responsible political alternative to the voters, and to legitimize budget cuts. Moreover, EU budgetary requirements could be used as blame avoidance for the efforts to restore budget balance, even though the Danish budget deficit remained below slightly below the 3 per cent level in 2009 and 2010.

In 2008 and 2009, the growth in public expenditure continued, not only as regards employment-related expenditures, but also public consumption. In the May 2010 compromise, the government declared a zero growth target for public consumption, including strong sanctions for municipalities, individually and collectively, if they failed to comply. From the last quarter of 2010, this appears effective. Rejecting traditional logic about the “political business cycle” (advising cuts shortly after the election, and generous policies in the last year before the election), the government pursued a die-hard cost containment before the 2011 election, hoping to maintain and reinforce an image of “economic responsibility”.

Figure 9. GDP (a), private consumption (b), and public consumption (c) at fixed prices, and (d) public consumption as per cent of GDP, 2000-2010.

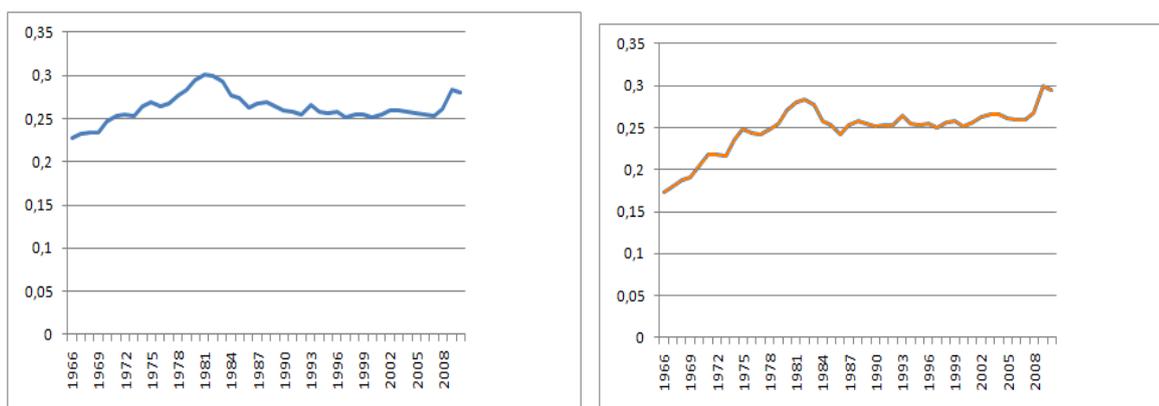


This represents a change away from the predominantly pro-welfare centrist policy conducted by the government 2001-2009. However, cost containment does not as such constitute path breaking. After all, the development of GDP and public consumption in figure 9 reveals an imbalance building up between the significant decline in GDP and the growth in public expenditures which continued until 2010, increasing the proportion of GDP spent for public consumption significantly – in addition to the “natural” increase in transfer expenditures during the economic crisis.

One could ask how this looks in a long-term perspective. As mentioned, the Danish record of public spending is quite impressive as public consumption grew with more than 45 per cent from 1992 to 2010⁸⁶ - even in a period where there was virtually no demographic pressure on expenditures.

It is also interesting to compare the figures with the economic crisis in the 1980s (figure 10). In fixed prices, public consumption as per cent of GDP was actually lower in 2010 than in 1982, but, in current prices the 2010 level was the highest ever recorded. The difference reveals the so-called “Baumol effect” that reflects the difference in productivity and relative prices between services and

Figure 10. Public consumption as per cent of GDP, in fixed prices and in current prices, 1966-2010.



industrial products, services becoming ever more expensive in current prices. As current prices are the prices that counts – fixed prices is just a calculation – it is difficult to picture the government’s cost containment in 2010 only as a matter of ideological preferences. When the denominator in the calculation of public consumption as per cent of GDP declines so radically, and when economic recovery is so delayed and uncertain, it will inevitably have consequences for the counter. Any government would face a cleaning up problem after the crisis, even if it would prioritize a restoration of growth. The question is whether the cleaning up includes institutional change or is only a matter of cost containment.

5.5. Industrial structure and the challenge of growth

Focussing one-sidedly on the budget deficit, the Liberal-Conservative government followed the recipe of the 1980s, even in its vocabulary. However, the situation is much different around 2012. In the 1980s, Denmark had a problem of over-consumption and exploding state debt and national debt. Unlike Norway, Denmark did not build any oil funds. But since the 1980s, Denmark has built pension funds of roughly the same size as the Norwegian oil funds – some 3.000 bill. DKK or more

⁸⁶ Methodologically, there is some uncertainty regarding long-term calculations of public consumption in fixed prices. Alternatively, one might look at the number of public employees that reveals a much lower increase. However, in a time of outsourcing, and regarding the substantial amount of money spent for purchase of goods and services, the number of public employees is an even less reliable measure. Even though there remains some reservations regarding the calculation, however, the overall trend is highly significant.

than 150 per cent of GDP. About one half of this is postponed taxes. In other words, the financial situation of the state is unusually solid. Next, foreign debt has turned into a surplus. Together with higher oil prices, this means that growth of gross national income (GNI) 2001-2010 is more than twice as high as growth of GDP. This is exactly the opposite situation of the early 1980s when GNI growth was lagging much behind growth in GDP.

Until the financial crisis, Denmark took a very self-conscious approach to the challenge of globalization. Denmark has always welcomed globalization with few reservations. A Globalization Council was established in 2005 and served to provide the government with advice about the tackling of the globalization challenge, in a close dialogue with the Prime Minister. The answer was large investments in education, research and infrastructure from 2006 onwards.

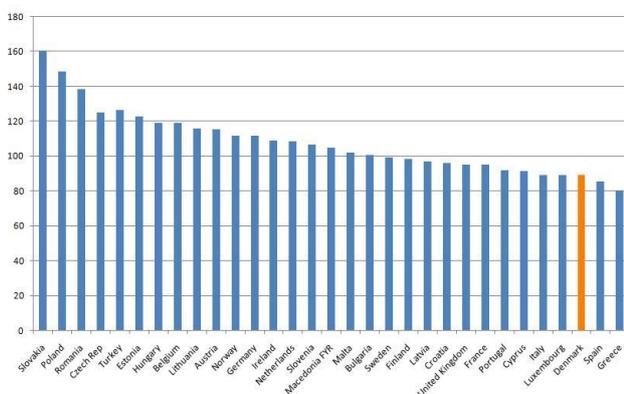


Figure 11. Production index of manufacture, feb 2011 (2005=100)

This had a little resemblance to the aborted industrial structural policy in the 1980s. Simultaneously and afterwards there has been a mapping of the various industrial complexes in the Danish economy. This is quite different from many other countries. Consumer durables only play a minor role. This also made Denmark less vulnerable to exogeneous shocks as the financial crisis. Exports declined dramatically, but not as much as in Sweden and Finland (Goul Andersen, 2011c). There remains a huge industrial complex around foodstuffs, there is a very large medico-industrial complex headed by some of the largest companies in the world in this field, and cutting across traditional branches there is a large green complex centered on production of alternative energy, and (not least) on energy saving. It would seem an obvious task to facilitate the further development of such complexes, and this was to quite some extent what followed after the work of the Globalization Council.

Denmark did experience a serious decline in productivity and wage competitiveness during the 2000s, and this corresponds with a comparatively very disappointing growth rate in manufacture (figure 11). Still, productivity and competitiveness are somewhat difficult to measure, and it may change quite rapidly. In 2010, overall productivity increased by nearly six per cent as compared to

2009, and for manufacture, the increase was 11 per cent.⁸⁷ This is highly unusual, even in the wake of an economic crisis. But it is in accordance with the flexicurity model (Jørgensen, 2011) which would predict large job losses during a crisis (even if Danish industries are substantially less exposed than most countries due to product composition), but at the same time rapid and substantial adjustment in favour of the most competitive sectors and companies.

At the time of writing, signs of recovery of the export industry are only slowly emerging, but the great leap in productivity leaves some hope that exports might be a driver of growth in spite of somewhat excessive wage increases 2000-2010. As regards public consumption, this is an inexhaustible driver of growth in the short run, but regardless of government, a considerably slower growth is to be expected here. Due to the indebtedness of private households, it is not surprising that Denmark has experienced an unusually large decline in private consumption, and as long as house prices decline, it is likely to expect a continued consolidation, perhaps exacerbated by the government signals of less welfare. It is questionable what the government could or should do to compensate for a housing and credit bubble burst – except that it should have prevented the bubble (if possible) in the first place.

In short, the situation is completely different from the 1980s, and copying the policies from that period appears inadequate – even for a government that is favourable to liberalization. Rather, the most uncontroversial tasks would be to facilitate research and development to the benefit of the export sector, perhaps support the building of new markets – followed by availability of cheap credits. As regards the latter, Denmark was a little too fast to abandon its bank packages in 2010/2011. The government had hoped to put pressure on the private banks to solve remaining problems in the sector themselves, but this strategy failed. In two instances in the spring 2011, private banks have gone bankrupt (Amagerbanken, Fjordbank Mors – the first mentioned was among the 10 largest banks), and not only shareholders but also loan-givers have lost money. This has generated some international unrest, it has led to a collective downgrading of credit-worthiness of Danish banks, and it could pave the way for further crashes at worst, or higher interest rates at best. It seems that in 2011, the power game between the banks and the government (supported by the opposition) about where to place the economic responsibility has led to a collectively sub-optimal outcome.

All of this also reflects uncertainty about how to deal with the situation, and it could appear that the generals are fighting the last war as regards the handling of the credit market situation and the one-sided emphasis on restoring budget balance. What could or should be done to promote growth, however, is controversial. It is uncontroversial that anything should be done to promote export-driven growth. It is (almost) uncontroversial that expansion of public consumption cannot proceed at the same speed as previously. But it is highly controversial whether there is need for more public investments, or for more public subsidies to renovation or similar tasks (with the risk of large deadweight losses). And it is equally controversial whether the government should stimulate private consumption – another big driver of growth. As an alternative to tax cuts (which would appear politically suicidal after harsh savings in 2010 and 2011), one could imagine opportunities to

⁸⁷ Statistics Denmark, *Nyt fra Danmarks Statistik*, no. 246 (30. May). Annual productivity increase 2010.

withdraw money from pension funds, or avoid the postponement of taxation involved in the huge pension savings in the future. The latter measures would be beneficial in the short run, but they would also hurt long-term sustainability.

Again, this illustrates how short-term carelessness with economic policies, and with credit liberalization generate unforeseen dilemmas with choice opportunities – including interference with the pension system – that could have considerable long-term institutional impact. This could also affect the long-term future of the welfare state, even though the "welfare state" is relatively "innocent" in the current crisis, and even though it is not particularly challenged by globalization, ageing or some of the other exogenous factors that are usually considered when assessing the future prospects of the welfare state.

6. Conclusion

The story of Danish economy and economic policy from the 1980s to 2010 at the time of writing could look a bit as a fairy tale with an unhappy ending. However, whereas institutional changes should be taken seriously, one should not conflate short-term and long-term problems. Escaping from a credit- and housing bubble is more than a short-term problem, and a larger problem than often recognized, but it does not last forever.

A little bit miraculously, Denmark recovered from a long period of severe economic imbalances with permanent current account deficit, mass unemployment, increasing state debt and foreign debt, and high inflation. It is impossible to point out one single factor as the explanation. But it does seem that the stop for public and private over-consumption from 1986 to 1992 formed an important part of the cure. The side effects of this medicine were (perhaps unnecessarily) severe, but the government succeeded in avoiding widespread social marginalization, and the institutions of the welfare state were maintained.

In the 1990s, a carefully balanced growth policy coupled with activation, increasing conditionality and emphasis on employment managed to escape from the seemingly permanent high employment levels. Aided by increasing savings in labour market pensions, and by increasing revenues from oil production, at least to the national economy (state revenues were small at that time), the country escaped permanently from the balance of payment problem that had bedevilled the Danish economy for three decades. Eventually, even a public budget surplus was obtained, and throughout the 1980s and 1990s Denmark experienced a growth in the export-oriented part of the economy.

The state also contributed to the development of "green" technologies in that period, but that is a (after all) a minor part of the story. More significantly, there were also strong efforts to activate social protection and the tax system in order to promote growth, and these efforts continued with even more intensity under the centre-right governments after 2001. As regards marginal taxes, corporate taxes, activation and postponement of retirement, the efforts have been huge indeed. To

what extent they have had any impact, is difficult to tell. Probably the answer is yes. But activation was celebrated in the 1990s as explanation of the employment miracle, until micro-level analyses indicated that there could be quite some doubt about the impact. Apart from quite some evidence about activation (not least about activation as deterrent, e.g. Rosholm & Svarer, 2008) our knowledge is rather limited.

Clearly, the 1990s was the happy period of Danish economy, but the solution of macroeconomic imbalances in the 1980s is perhaps a more plausible explanation than the (Social Democratic) supply-side solutions that were pursued. The exchange of government in 2001 did not at first mean a substantial change in economic policy. This was also the period when dramatically increasing oil production brought prosperity to the economy and quite substantial revenues to the state. However, the liberalization of credit policies that started already in the 1990s got an increasing impact as the new opportunities were exploited, and the introduction of loans without repayment contributed further to a housing bubble that was among the most significant in Europe. Indebtedness of Danish homeowners became the highest in the world, and a combination of expansive fiscal policy and expansive credit policy contributed to a bonanza period 2005-2007 when everything seemed possible, and the Danish economy appeared unshakeable.

As compared to the past, this was a miracle, but miracles seldom last forever. It is quite fascinating how late the problems were realized. Signs of emerging problems were ignored, in particular by the traditional "watchdogs": The political opposition and the media. Apparently the media can do very little (as regards important issues) without support from party conflict. Independent actors like the Economic Council and the National Bank did criticize, but not really loudly enough. In retrospect, warnings were rather vague, and they sometimes came to late.

But perhaps most importantly, actors were "anderswo engagierte", and the usual indicators of emerging crisis were not functioning: Previously, emerging problems always surfaced in excessive inflation and current account problems. However, the balance of payment remained positive alongside full employment, and during the crisis it actually reached the highest level ever recorded. Indicators like the development of productivity and economic growth are less reliable, especially in the short run, and even though these indicators signalled problems, they were not given very much attention.

At least it remains that economic policies during the bonanza were rather irresponsible, and that the economic crisis in Denmark was partly self-inflicted. Denmark was not hit by an exogenous shock as Sweden or Finland. Rather, it was one of the epicentres of the economic crisis, a little bit like Iceland, although not to nearly the same extent, of course.

Short-term prospects of recovery at the time of writing (2011) are not very encouraging. Competitiveness seems damaged, and until now, Denmark has not benefited as much as could be expected from the upswing in Germany and Sweden. Domestic consumption seems constrained by too large credits and falling housing prices, and there even is a (small) risk of collapse as the housing market has become extremely sensitive to fluctuations in short-term interest rates.

Still, despite some similarities, the Danish crisis is quite different from the crisis of the so-called PIGS countries: State debt is moderate, and it one were to include (as ordinary accounting would)

the value of postponed taxes in pension funds, there would be no debt at all: Accumulated pension fortunes amount to 160 per cent of GDP by the end of 2009, and almost one half of that is expected as tax revenues for the state. This is so to speak the Danish equivalent of the Norwegian oil fund. Moreover, the balance of payment is more positive than ever, and oil resources in the North Sea are not yet exhausted.

Basically, the Danish economic problems around 2011 are attributable to short-term economic failure. But the impact may be long-term; after the oil crisis in 1973 it took 25 years to restore full employment. This happened without much detriment to the welfare state; in this respect, the current situation is more uncertain, but at least there have been transformative changes in the field of labour market policy that will have significant consequences for social marginalization if unemployment remains at a high level.

Besides, there is a very basic challenge to economic policy, namely to improve the level of education. The proportion of young people who do not fulfill any education after basic school was supposed to decline radically to five per cent, but it has increased to above 20 per cent. This will most likely cause structural unemployment among the low-skilled, or increasing wage differentials and increase in precarious jobs, or both. It has often been a saying in Danish politics that "the answer is education – what is the problem?". But there has never been more relevant guidance in this saying than now. Besides, in the global competition ahead, outsourcing will not only affect unskilled jobs, but also highly skilled jobs, and the very high Danish wages may not be balanced by equivalent advantages in qualifications and productivity.

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