Jan 2015

Policy Responses to Economic Crises

Denmark, 2008-

Note: Policy background memos contain information from various sources on the political economy of a particular country and economic and social policy choices before, during, and after an economic crisis. The memos do NOT contain any original information or analyses, but rather summarize material from various sources. The material is at times quite raw – the text is often presented in bullet points and sources are often quoted verbatim. Thus, the background memos should primarily serve as an overview of 1) policy developments in a particular country, and 2) academic research on the subject.

1 Background

Economy

The overall state of the economy was quite good in the lead up to the crisis, with strong economic growth and low unemployment (OECD 2008).

Politics

A right of center minority coalition had been in power since 2001 at the onset of the crisis. Formally, the coalition was between Venstre (Liberal Party) and Det Konservative Folkeparti (Conservative People's Party), although the coalition had the semi-formalized support of Dansk Folkeparti (Danish People's Party). The last elections prior to the crisis were held in 2007.

Fiscal Policy and Welfare

Substantial fiscal surpluses were collected in the years prior to 2007, allowing Denmark to bring public debt down to 27% of GDP in 2007 (Kluth and Lynggaard 2013, 773–74). This position gave the government greater leeway to respond to the crisis by stimulating the economy, both because it had the financial capacity to do so, but also because the European Stability and Growth Pact has restrictions in place to limit budget deficits over the business cycle (Cameron 2012, 114).

2 Crisis

Using the conventional definition of a recession as two consecutive quarters of negative growth, Denmark was the first EU country to experience the recession, in the first quarter of 2007 (Cameron 2012, 96). GDP contracted by 0.9 per cent in 2008 and 4.9 per cent in 2009, with unemployment rising to 6 per cent in 2009, from a pre-crisis level of about 4 per cent (Kluth and Lynggaard 2013, 774). The financial crisis coincided with the unwinding of a massive property boom (OECD 2009c, 2009:21).

3 Policy Response and Politics

During 2008-2010, Denmark pursued a policy of fiscal stimulus, with the bulk of the stimulus coming from increases in spending (Cameron 2012, 114). Of the OECD countries, Denmark's budget is most counter-cyclical, meaning that a reduction in GDP will have the largest expansionary effect on the fiscal balance (Girouard and André 2005, 22). Thus, automatic stabilizers played a relatively large role during the recession, contributing 4.1% (of GDP) of stimulus in 2008 and 2009 (Cameron 2012, 104). Even so, the Danish government enacted a number of discretionary measures as well (OECD 2009c, 2009:45).

September 2008

Fiscal → "The budget reflected an expansionary economic policy, including increased public consumption expenditures and tax reductions" (Danish Government 2009, 47). The budget "…was designed to impart a stimulus of 0.9% of GDP in 2009 – of which about 0.5% reflect decisions taken before the crisis – and an additional 0.3% in 2010. Spending measures amounting to about 0.4% of GDP in 2009 and 0.7% in 2010.." are included (OECD 2009a, 15)

October 2008

Financial → Denmark become the second EU member state (after Ireland) to issue a full state guarantee of the domestic banking sector. From the outset, a negotiated settlement transferred much of the risk associated with a potential banking failure to the banking sector itself (Kluth and Lynggaard 2013). The scheme was voluntary, with participating institutions taking on a number of restrictions in their operations in exchange for the guarantee (OECD 2009c, 2009:38). Further discussion in IMF (2010, 19).

February 2009

Employment → Made key changes to existing schemes. 1) Increased the flexibility of a training subsidy for employers if they hire unemployed persons, and 2) increased the duration of a scheme providing up to 6 weeks of education during the first 9 months of unemployment (IMF 2010, 5).

March 2009

Taxation → The government announced a major tax reform package, referred to as the "Spring Package 2.0". The package was to be phased in from 2010 to 2019 (OECD 2009b, 16). It's main elements were: 1) a reduction in the bottom state income tax rate of 1.5 percentage points, 2) the abolition of the middle state income tax bracket, which was 6 percentage points higher than the lower bracket, 3) an increase in the income threshold for the top marginal tax rate, 4) taxes on income from shares were slightly reduced, and 5) repair and renovation scheme for private homes implemented. The tax reforms were fully financed in the long term, but financing was back loaded, such that the reforms produced a short-term expansionary effect. Financing was through a variety of specific tax increases, most noteworthy, an increase in environmental taxes paid by businesses and health promoting taxes (OECD 2009c, 2009:46). The increases were partly compensated by issuing a 'green check' to households, which was means-tested (OECD 2009b, 16). "The Social Democratic opposition was highly critical of the government's emphasis on tax cuts, especially in light of the large tax cuts the government had implemented in 2007. As in Sweden, however, the party differences over stimulus policies diminished over time, and from mid-2010 onward, again as in Sweden, the main focus of economic policy in Denmark was the reduction of the budget deficit and the consolidation of public finances." (Lindvall 2012, 252)

Employment → Introduced more flexible rules allowing companies to dismiss temporarily (up to 26 wks) employed persons with unemployment benefits (IMF 2010, 5),

September 2009

Fiscal → "Considerable easing of fiscal policy, reflecting increased expenditures in local governments (including increased public investments) and lower taxes following the phasing in of the tax reform." (Danish Government 2009, 47).

Employment → Introduced a package aimed at combating increases in youth unemployment and relaxed eligibility requirements for participating in ALMP, from six to three months (IMF 2010, 5).

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January 2010

Employment → Established training program in vocation skills for low-skilled adult workers, increased funding for unemployment assistance programs, established a national job alert system to offer support as quickly as possible, and increased monitoring of labor market developments (IMF 2010, 5)

May 2010

Fiscal → Government and main opposition party agreed on measures to consolidate public finances during 2011-13, in an aim to bring the deficit to below 3 percent by 2013. Spending measures included capping public consumption growth, sanctions on municipalities that overspend, and spending cuts in culture, education, and development aid, with funds prioritized toward social spending. Revenue measures included suspending the automatic indexation of income tax thresholds (i.e. allowing bracket creep), and defer the planned increase in the top-bracket of the personal income tax for three years (IMF 2010, 17).

Family → The annual amount of total child allowances limited and child allowances gradually reduced by 5% until 2013 (European Commission 2015). Note: Potentially 5% per year for 3 years (ILO 2014, 23).

July 2010

Unemployment → Included in the May 2010 fiscal consolidation package, a shortening of unemployment benefits from four to two years (van Kersbergen, Vis, and Hemerijck 2014, 900).

May 2011

Old age → "…a drastic reduction, if not outright abolition, of the popular early retirement scheme (allowing people to retire at the age of 60 rather than 65, although with a lower pension for the first five years) […]The proposal met with fierce resistance by the trade unions and three of the four opposition parties" (Stubager 2012, 862). The scheme took effect in January 2012. "Increase in eligibility age from 60 to 64 during 2014-23; reducing pay-out period from five to three years; during 2012, choice between early-retirement benefits and a tax-free lump sum at eligibility age of DKK 143 300" (OECD 2013, 29).

September 2011

Politics → Elections were held in mid-September, with sharp lines drawn between the incumbent right-of-center government and the opposition left-of-center bloc. The left bloc campaigned on investing in welfare without increasing income taxes on low and middle income, while the right-bloc campaigned on balancing the budget by reducing welfare spending (Stubager 2012, 862). Although the opposition parties had a comfortable lead in the run up to the elections, the elections were quite close and the opposition just barely managed to secure a majority. The Social Democrats formed a three party minority government with the Social Liberals and Socialist People's Party, with the support of the Red-Green alliance. Since the Social Liberals had supported many measures taken by the previous government (including changes in the retirement scheme), as well as opposing increasing taxes to fund welfare programs, the government agreement between the parties was quite moderate, with the other two parties abandoning some of their biggest campaign promises. This caused considerable loss of support for those parties (Stubager 2012, 863).

February 2012

Social assistance → "Abolishment of ceiling on social assistance + tougher activation for social assistance recipients" (van Kersbergen, Vis, and Hemerijck 2014, 900)

Disability → "Abolishment of early retirement scheme for (partly) disabled individuals under 40" (van Kersbergen, Vis, and Hemerijck 2014, 900)

Disability → "Claimants >40 of early retirement benefits for (partly) disabled need to participate in special labour market programmes aimed at labour market integration" (van Kersbergen, Vis, and Hemerijck 2014, 900)

July 2012

Unemployment → Entry criteria were tightened from 26 weeks of employment to re-qualify for unemployment benefits to 52 weeks. (IMF 2014, 30).

August 2012

Unemployment → "Reform package for younger unemployed and social assistance recipients, consisting of various labour market programmes (worth €8.7 million) to secure apprenticeships, education, (re)training and stimulation of public–private partnerships to foster youth employment" (van Kersbergen, Vis, and Hemerijck 2014, 900)

September 2012 (?)

Taxation → Tax reform package introduced, which is to be phased in between 2013 and 2023. The reform is focused on the personal income tax and its stated aim is to increase labor supply. The reform raises the threshold for the top income tax rate and increases the employment allowance. The reform is partly financed by indexing certain excise duties, and partly by cutting public expenditure, e.g. on defense and social transfers (European Commission 2013, 29).

September 2012

Taxes → "Decreasing taxes on labour for low and middle incomes, and strengthen incentives for welfare benefit recipients to take on employment, e.g. tax fee for single parents when taking up" (van Kersbergen, Vis, and Hemerijck 2014, 900).

Taxes → "Higher tax rate for highest incomes" (van Kersbergen, Vis, and Hemerijck 2014, 900)

Unemployment → "Recipients receiving maximum unemployment benefits will lose about €900 per year after the reforms have been passed" (van Kersbergen, Vis, and Hemerijck 2014, 900)

Social assistance → "Postponement of indexation of a number of benefits" (van Kersbergen, Vis, and Hemerijck 2014, 900)

January 2013

Disability → "The criteria for receiving a disability pension were tightened but options and support for rehabilitation were added. In particular, disability pension is discontinued for persons under the age of 40 (with very few exceptions), and access to disability pension in general requires prior participation in at least one rehabilitation program. Instead of a disability pension, persons with substantially reduced work capacity will be offered individually-tailored rehabilitation and support measures for up to 5 years. In addition, the new flex-job scheme (the special employment program for persons with disabilities) allows for part-time work at the normal wage (paid by the employer) plus unemployment benefit-level pay for the rest of the working week." (IMF 2014, 30).

June 2013

Taxation → Parliament adopted a growth package, which included a measure to gradually reduce the corporate income tax from 25% to 22% over a three year period (European Commission 2013, 29)

January 2014

Social assistance → "A reform that establishes a requirement for education for people below the age of 30 who do not have training or education but have sufficient basic skills. Social assistance for this group is also lowered to the same level as education support. Those who have received training/education will be required to get a job. More vulnerable groups (e.g., people with a range of challenges, single parents) will receive additional assistance in the form of mentoring and a coordinating caseworker." (IMF 2014, 30)

July 2014

Sickness benefits → "A reform of the sickness benefit scheme reduced the maximum sickness benefit period from 12 to 5 months (with various exemptions), but provides for additional support including potential access to a rehabilitation scheme (for up to several years), at a lower level of assistance than the sickness benefits" (IMF 2014, 30)

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