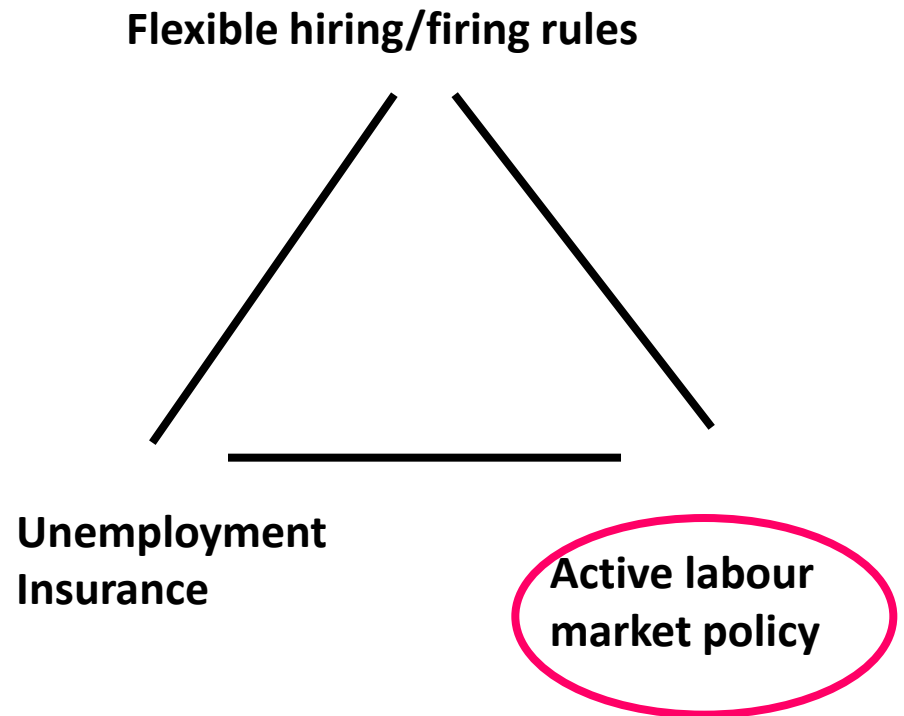# The Danish flexicurity model and the crisis

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# The Danish Flexicurity Model

**Particular – triple:**

- **Lax EPL**

- **Generous UIB**

- **Strong focus on ALMP**

**Flexible hiring/firing rules**

**Unemployment Insurance**

**Active labour market policy**

# Flexicurity and the Great Recession

- **More exposed to shocks**

- **Large employment response to be expected**

- **Higher risk of persistence – higher unemployment response and generous unemployment insurance**

- **Can the active labour market policy cope with an increase in unemployment?**

- **Eroding financial balance of the model**

# The Great Recession and the role of institutions/policies

Notion of flexibility:

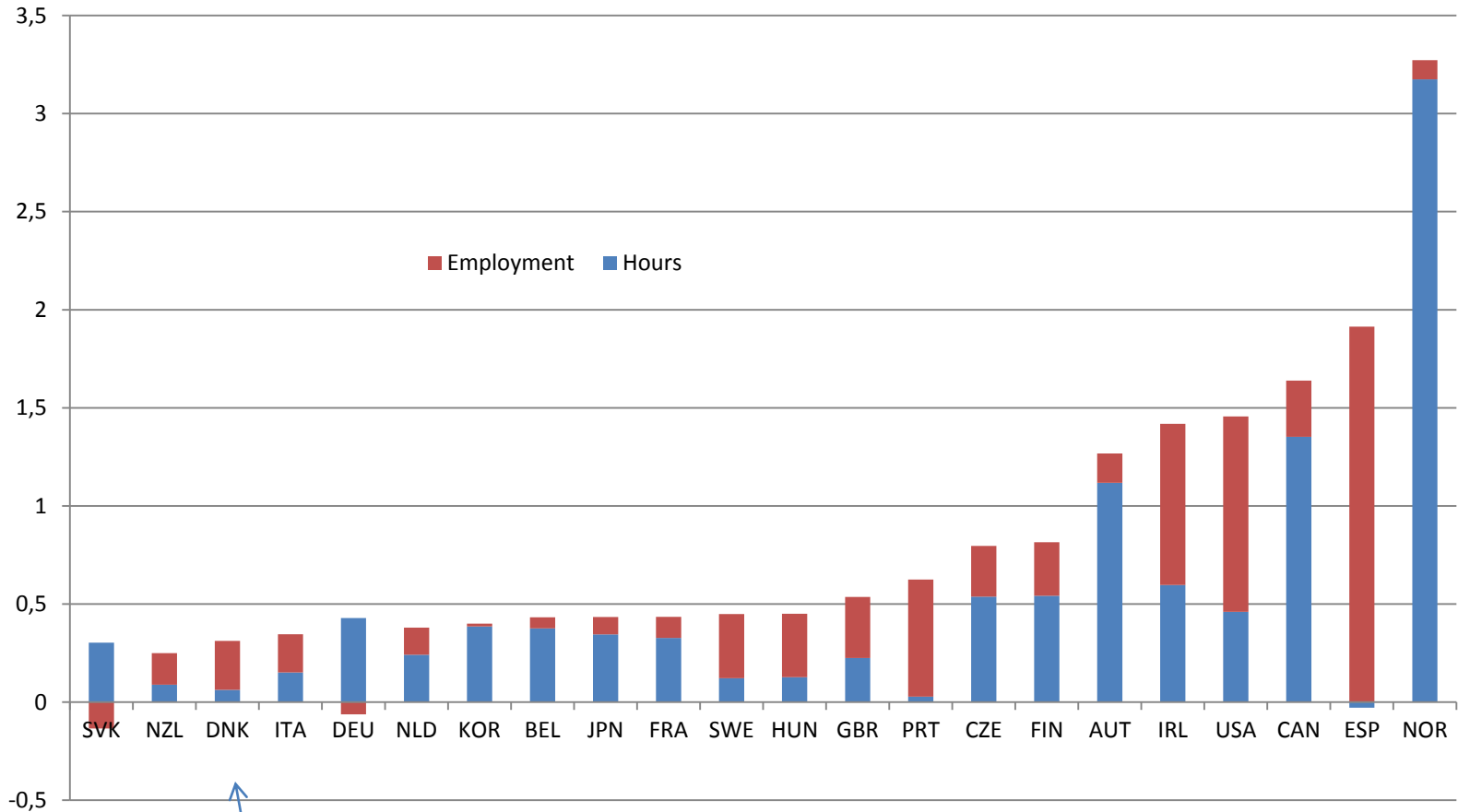| |
|---|
| |
| Adaptation of labour input to output |
| Speed of adjustment<br>(actual unemployment $\longrightarrow$ structural unemployment) |
| Avoiding path dependence<br>(change in structural unemployment) |

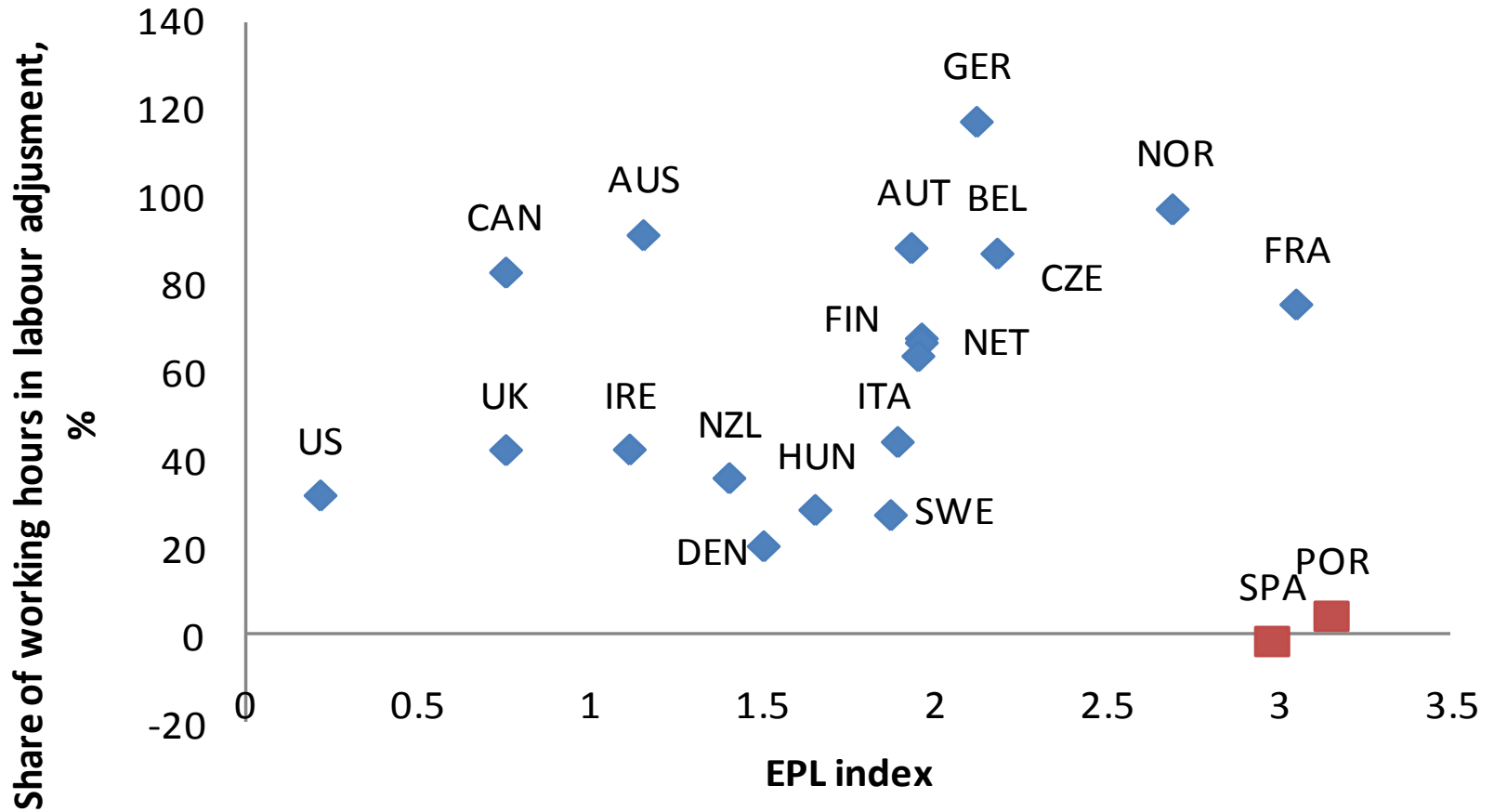# Unemployment
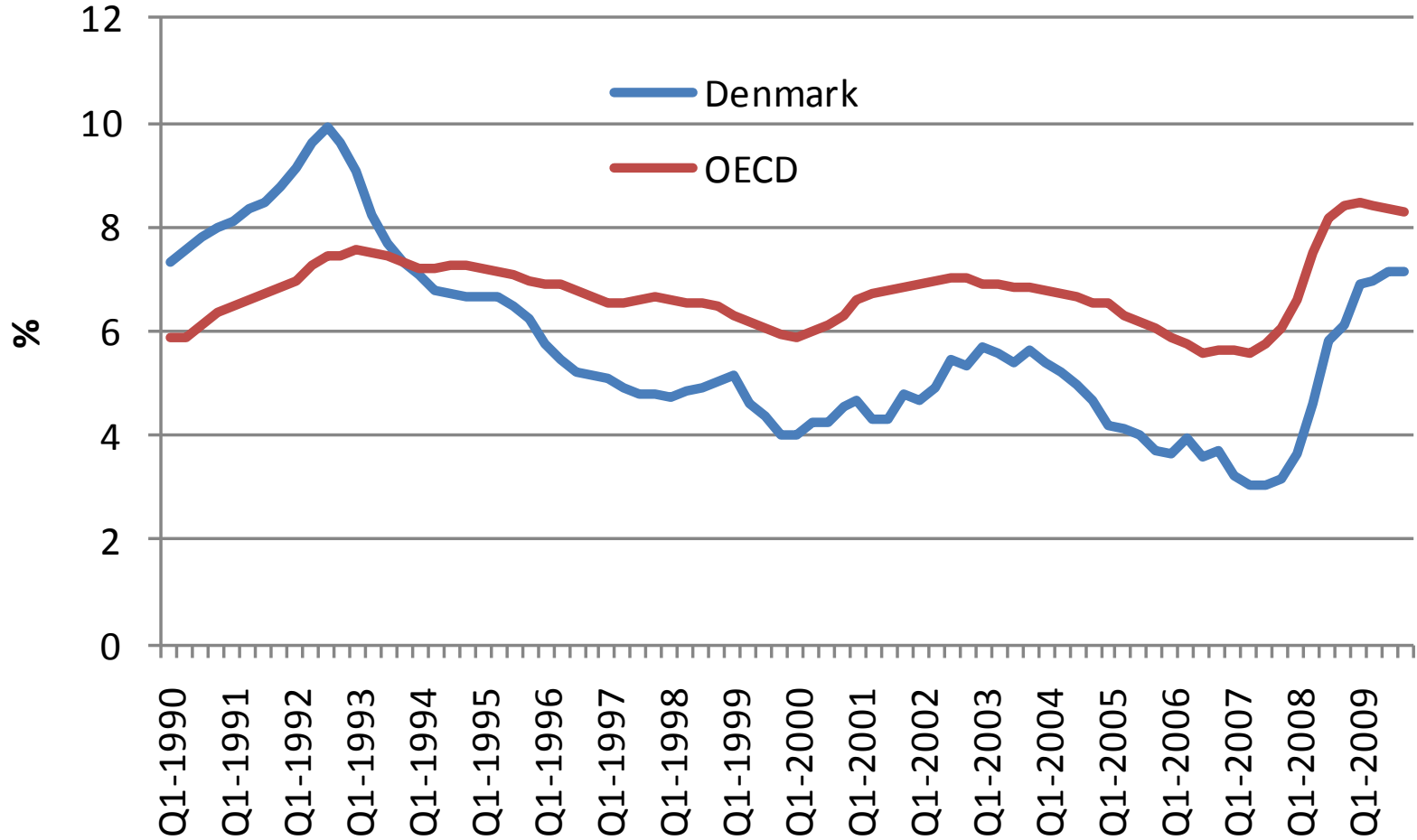
# Coping with the crisis

- **Boom-bust pattern**

- **Prior to crisis:**
  - **Very low level of unemployment**

  - **Clear signs of overheating**

- **Post Crisis**
  - **Adjustment to lover level of activity**
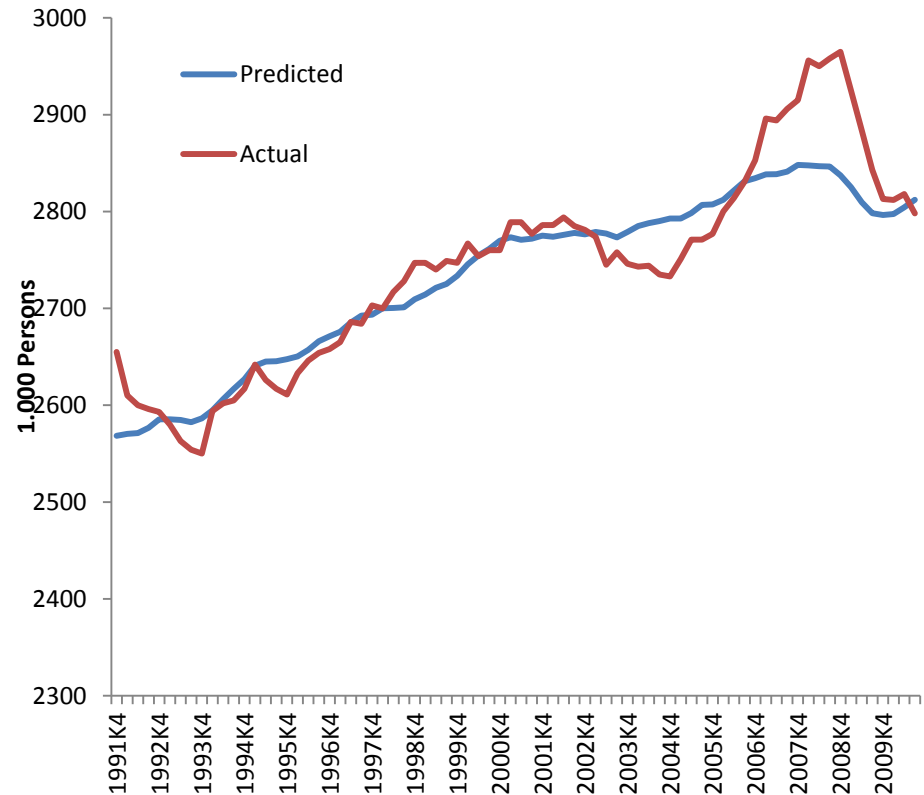
# Employment adjustment relative to output
## hours vs employees

# EPL and share of hours adjustment

Share of working hours in labour adjusment, %

EPL index

US, CAN, AUS, UK, IRE, NZL, HUN, DEN, SWE, ITA, FIN, NET, AUT, GER, BEL, CZE, NOR, FRA, SPA, POR
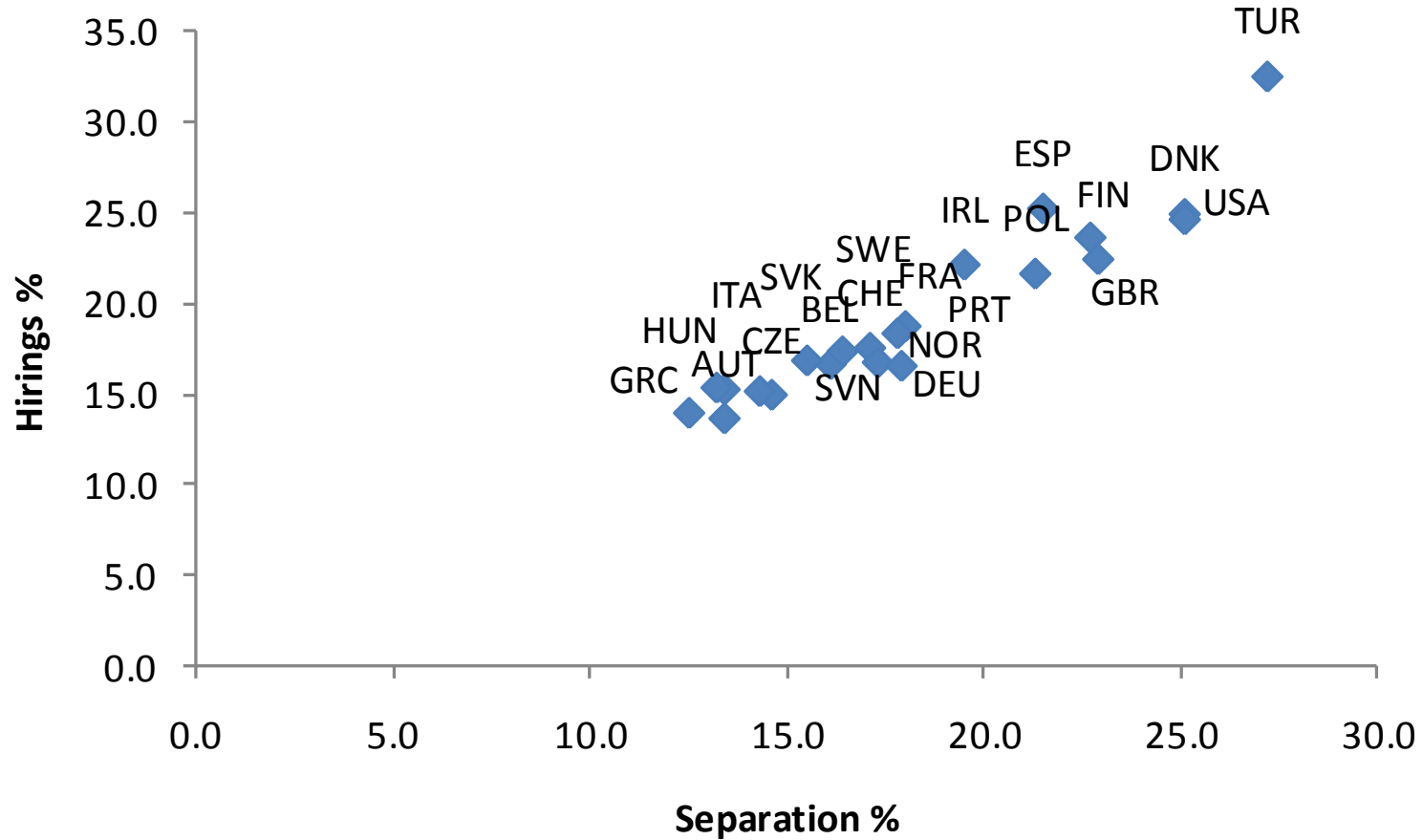
# Puzzle

- Substantial variation in the employment to output adjustment

- Not clearly related to labour market policies/institutions

- Not even for the relative share of employment and hours

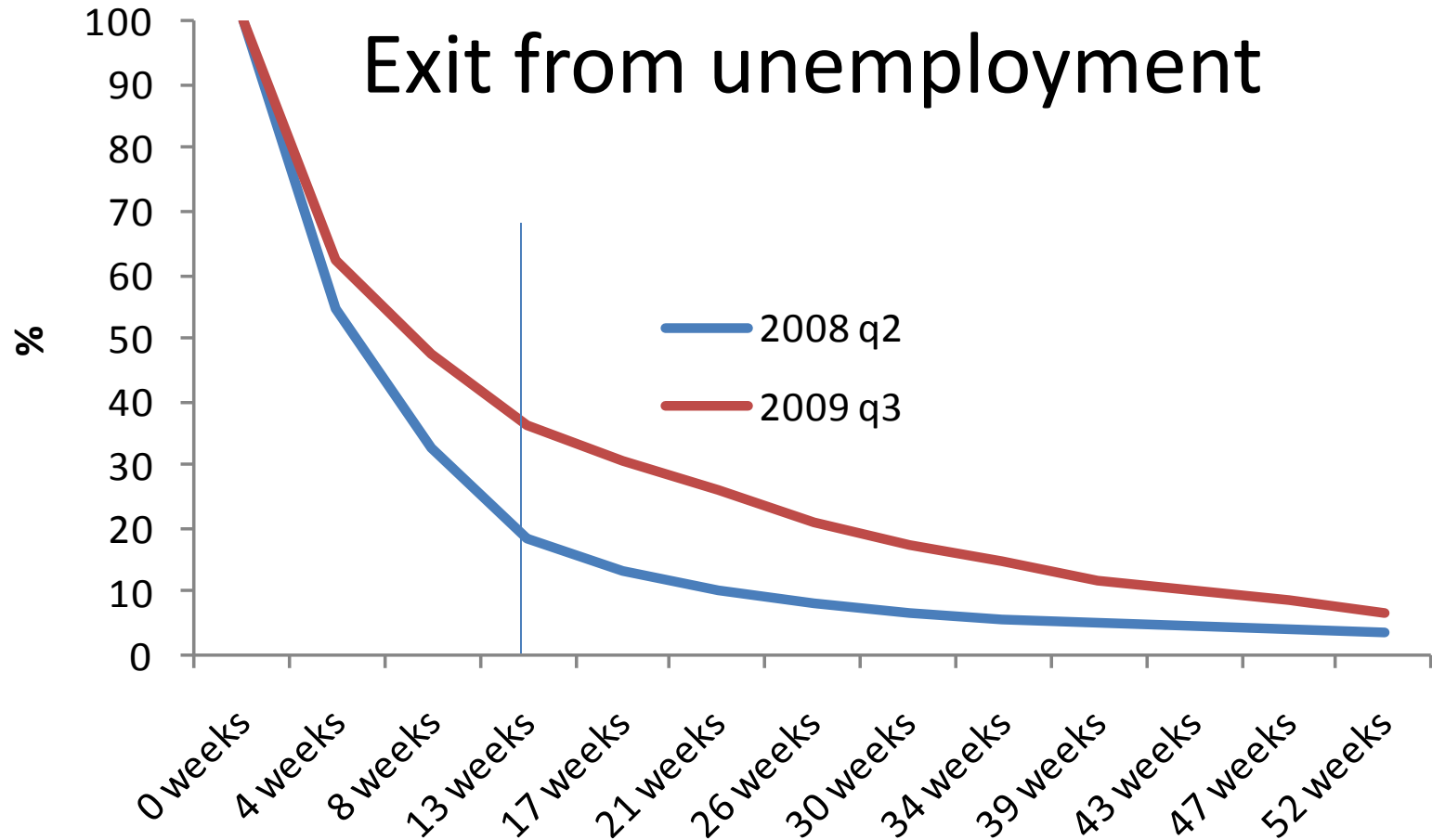Table 2: Share of hours in labour adjustment

| EPL | UIB | ALMP | Output change | Constant | $R^2$ |
|---|---|---|---|---|---|
| 0.20 | -0.02 | -0.11 | NI | 4.07 | 0.05 |
| (0.27) | (0.92) | (0.37) | | (3.36) | |
| 0.24 | -0.31 | 0.07 | -0.15 | 5.55 | 0.18 |
| (0.26) | (0.91) | (0.39) | (0.11) | (3.41) | |

All variables in logs

# High turnover in the labour market

# Job finding rates remain high – but are pro-cyclical



Exit from unemployment

2008 q2
2009 q3
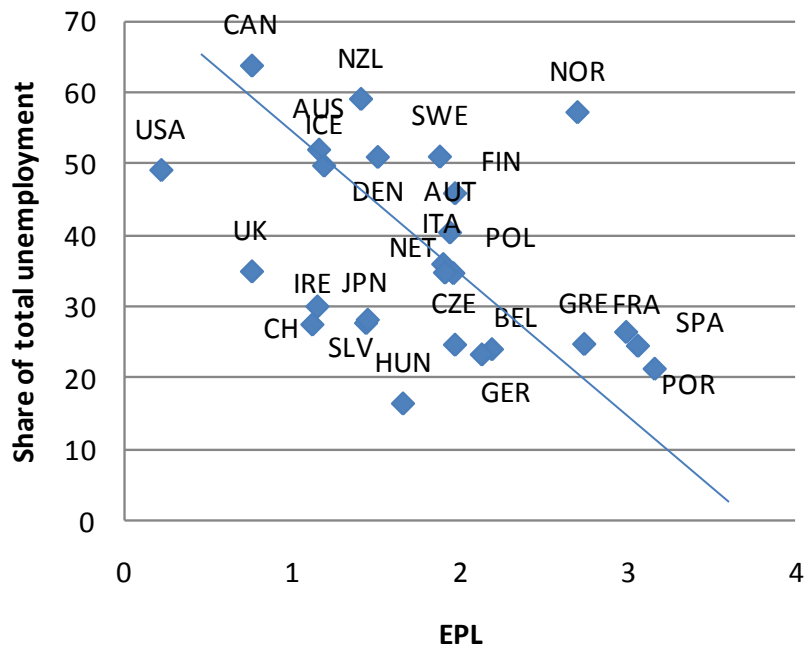
# High incidence of short-term unemployment
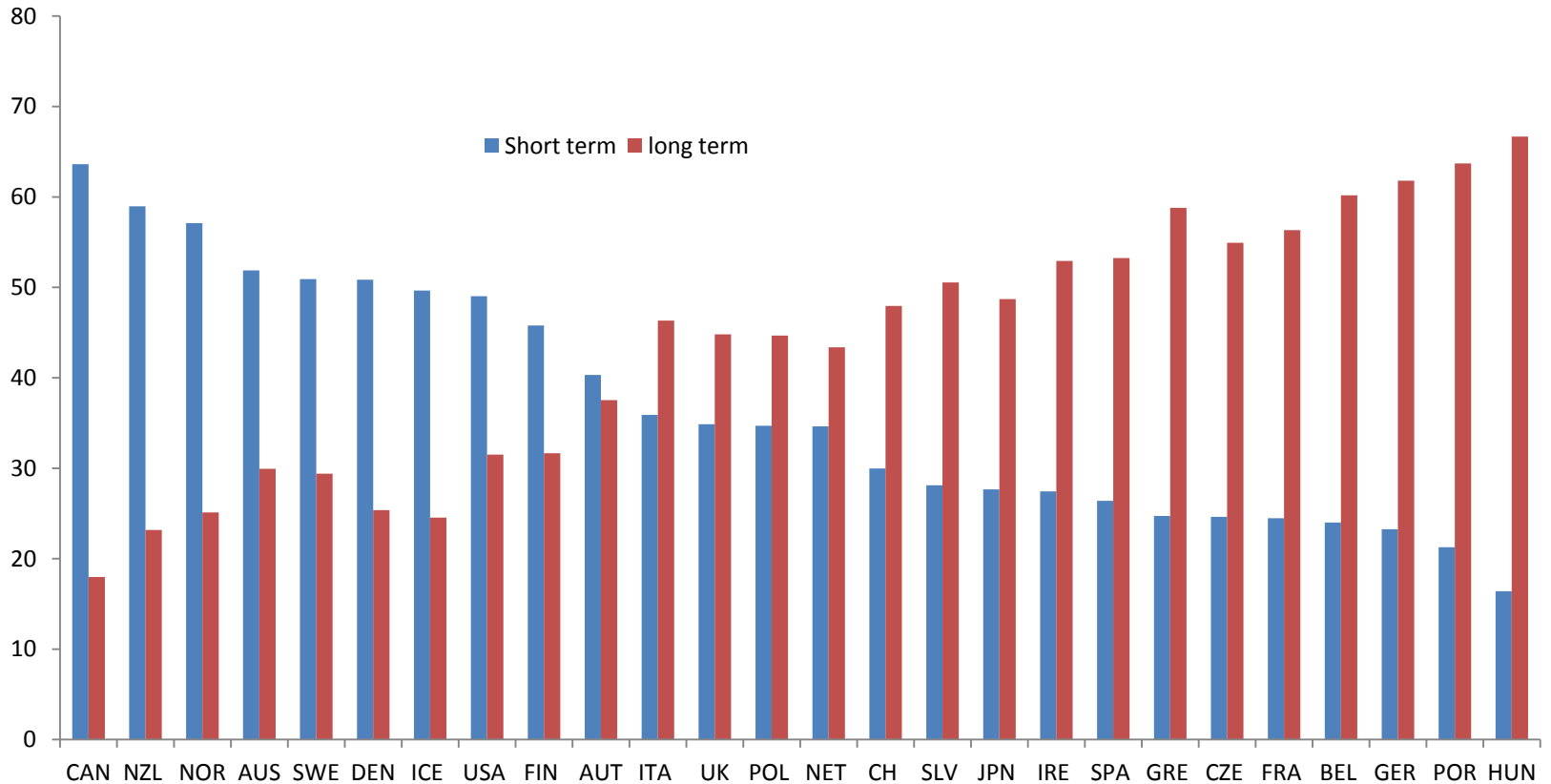
# Burden of unemployment falling on youth
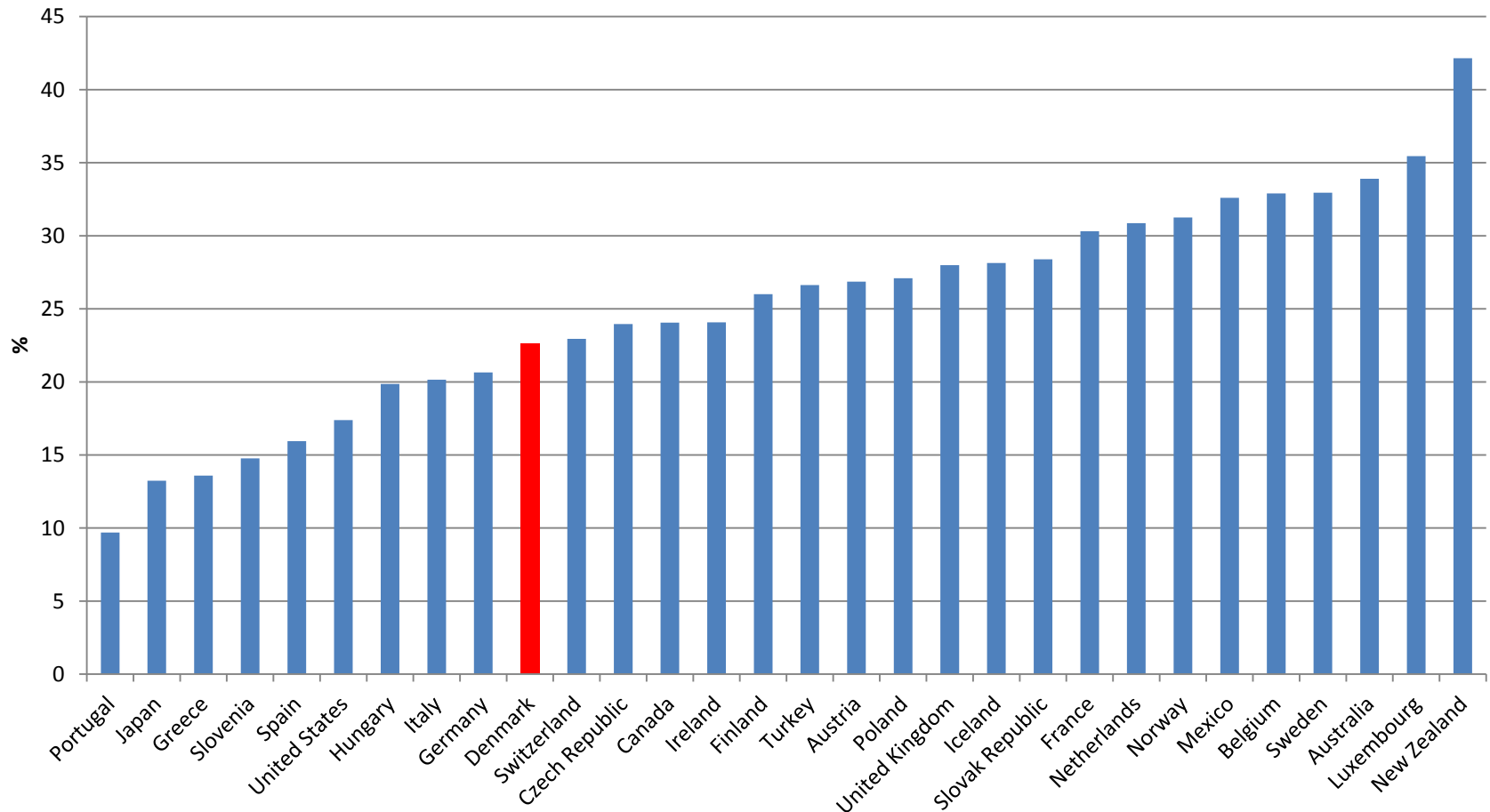
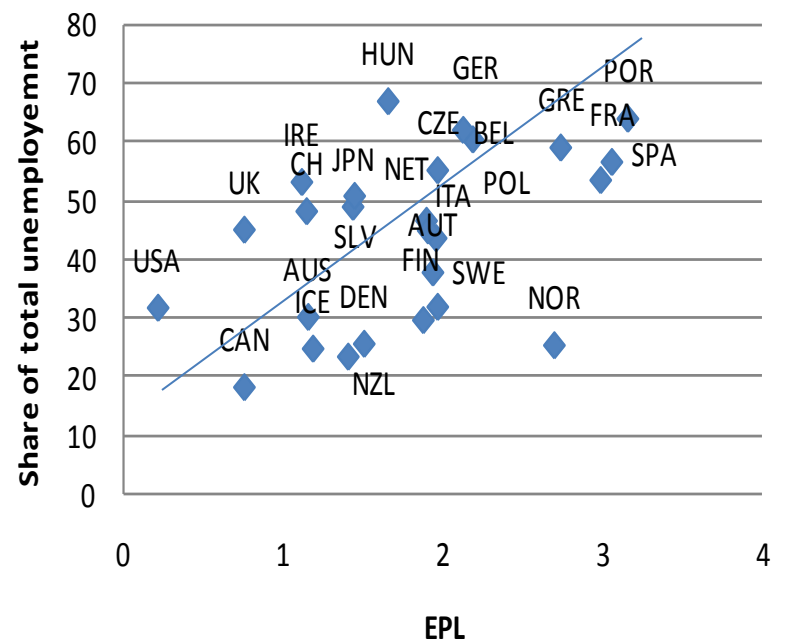**(a) Short term unemployment**

**(b) Long term unemployment**

## Table 3: Short and long term unemployment and labour market characteristics

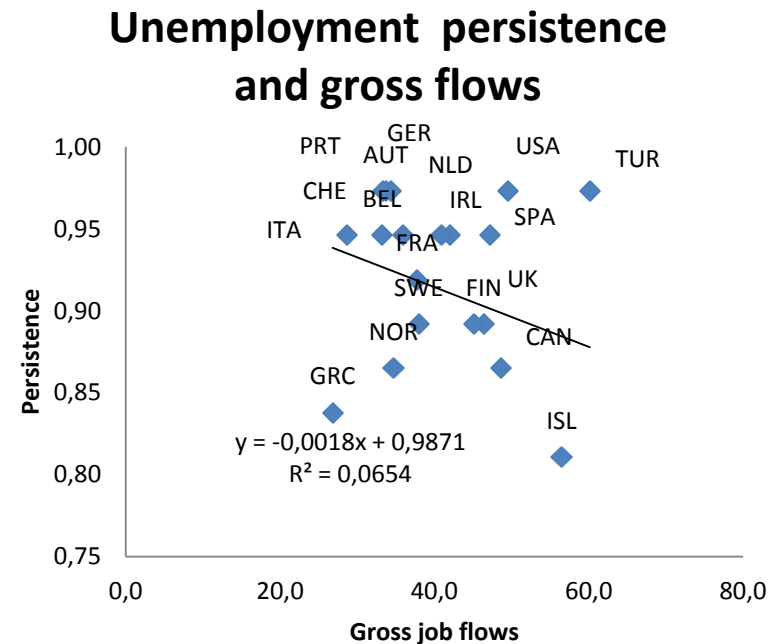|  | EPL | UIB | ALMP | Constant | $R^2$ |
|---|---|---|---|---|---|
| Short term unemployment | -0.31 (0.13) | 0.28 (0.47) | 0.07 (0.19) | 2.64 (1.72) | 0.27 |
| Long term unemployment | 0.36 (0.14) | -0.57 (0.49) | 0.02 (0.20) | 5.70 (1.80) | 0.29 |

# Persistence in the labour market

- **Difficult to measure**
- **How to separate**
  - **Exogenous sources (shock)**
  - **Endogenous sources (policy, institutions etc.)**

- **Different measures indicate relatively strong persistence**
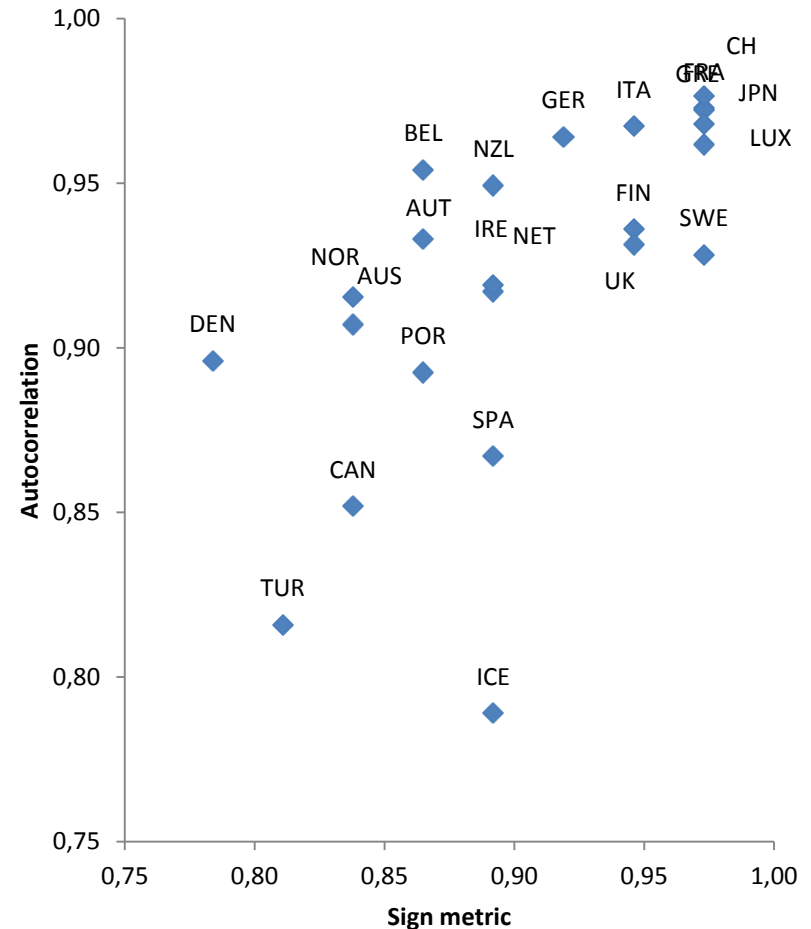
- **Trade-off: Volatility vs. persistence**

- **Less volatile markets = more persistence?**

- **Very weak evidence – also for the opposite**

### Unemployment persistence and gross flows

# Social insurance a source of persistence?

- **Insurance= lack of flexibility= strong persistence**

  - Incentives
  - Reservation wages
  - Norms

- **No clear evidence supporting this BUT persistence is crucial**
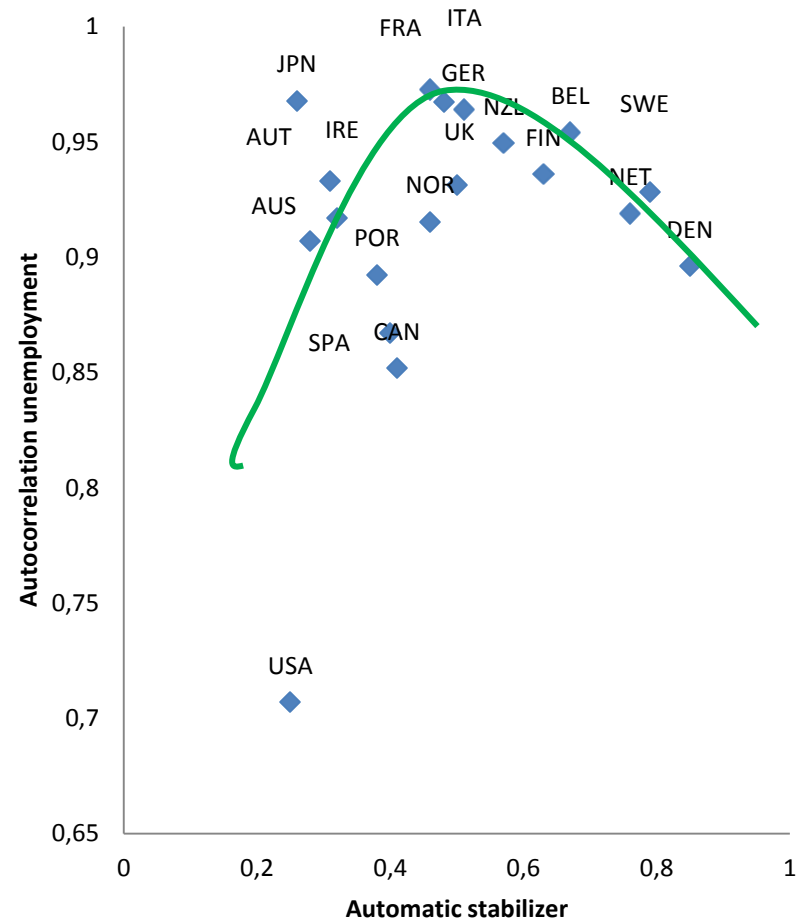
| Measure of persistence | EPL | UIB | ALMP | Constant | $R^2$ |
|---|---|---|---|---|---|
| Autocorrelation | 0.10 (0.02) | -0.06 (0.05) | -0.01 (0.02) | 0.08 (0.18) | 0.66 |
| HP-autocorrelation | 0.14 (0.05) | -0.13 (0.14) | 0.02 (0.06) | 0.03 (0.51) | 0.31 |
| Sign metic | 0.07 (0.02) | -0.03 (0.06) | -0.04 (0.02) | -0.02 (0.21) | 0.47 |

Note: First order autocorrelation coefficient for unemployment rate, HP-filtered unemployment rate, and the sign metric for persistence. Data for 21 OECD countries for the period xx EPL, UIB and ALMP measured as in Table 1. Standard deviations on paranthesis
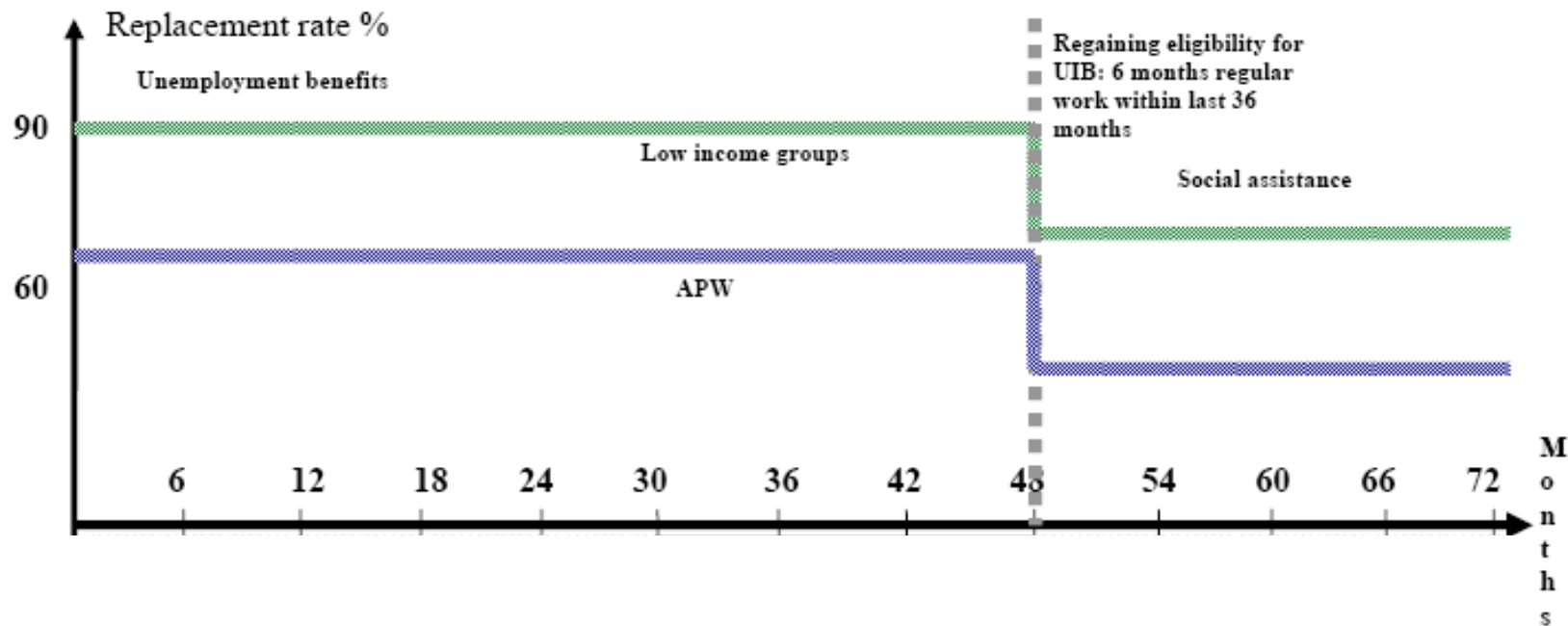
# High level of activation
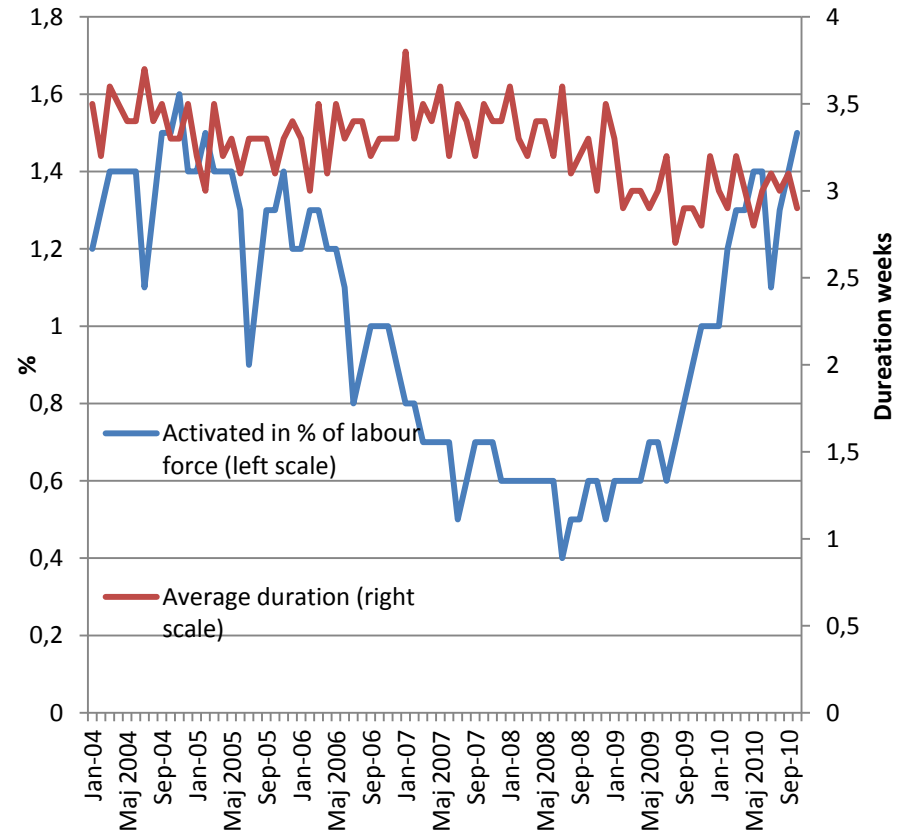
**Share of unemployed in activation**
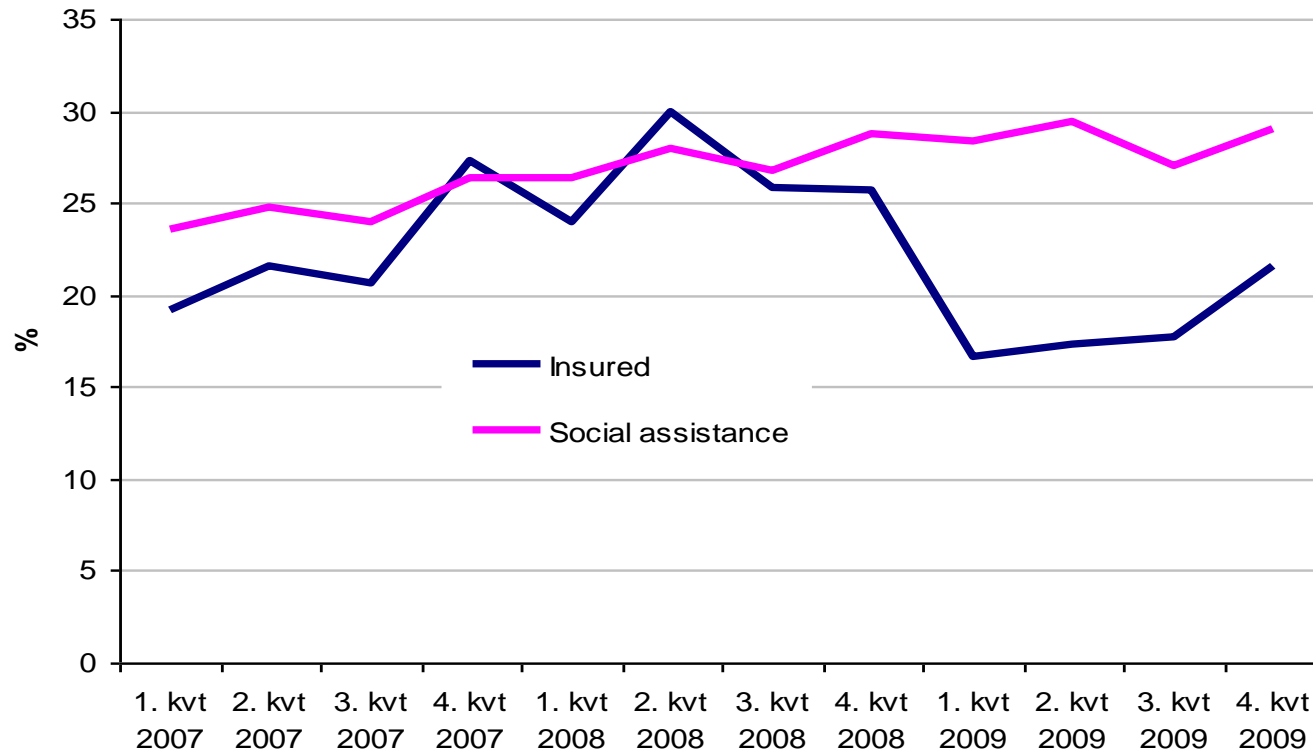
# Benefits and activation requirements:



Danish social safety net in case of unemployment

# Maintaining efficiency of active labour market policies?

- **Larger inflow**

- **Different composition (more core workers – deadweightloss)**

- **Programmes less effective?**

- **More difficult to screen participants**

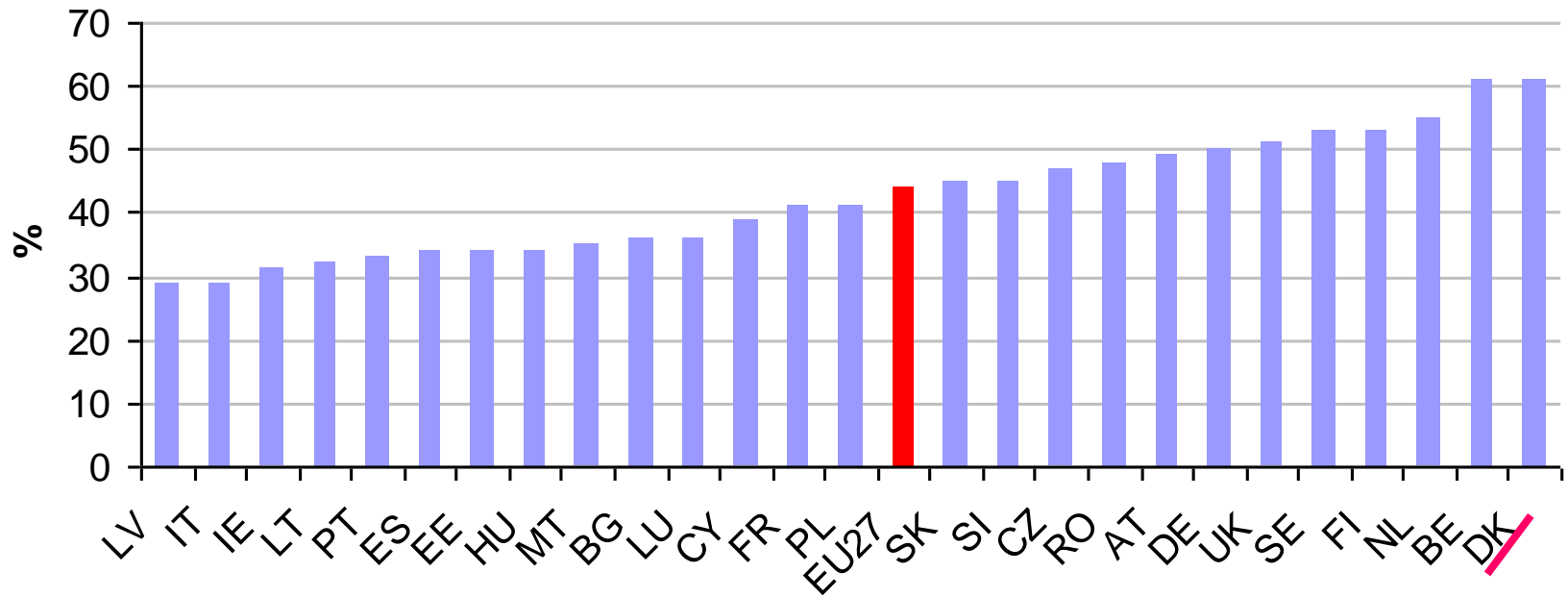# Main challenge – preventing long-term unemployment

- **Overload in ALMP?**

- **Larger risk of long-term unemployment**

- **Can the system cope with this??**

Post activation – employment effect
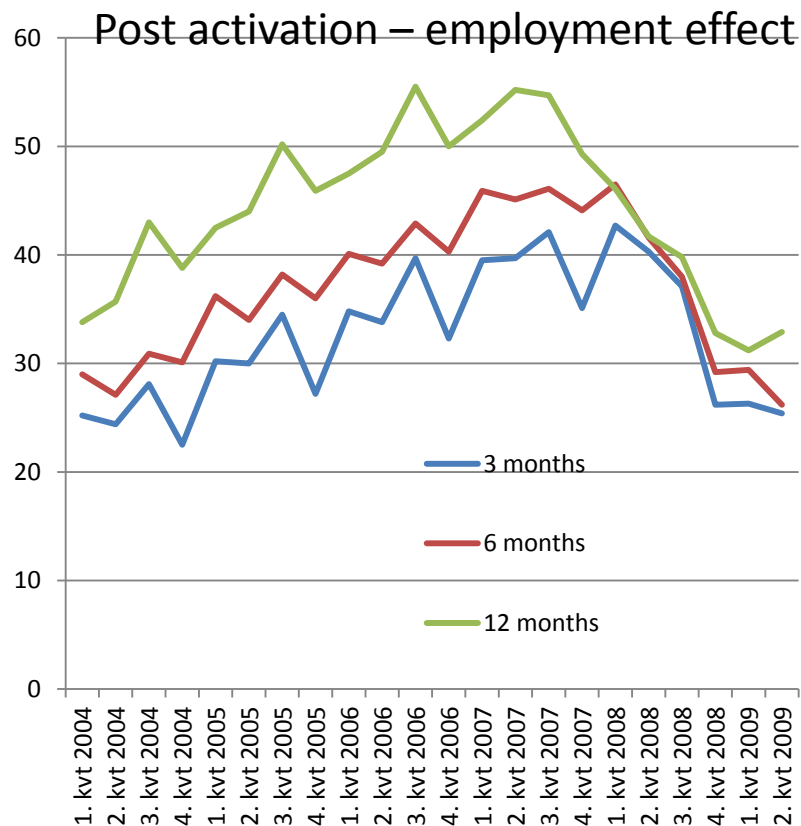
# Strong perceived job security

**Eurobarometer 2010**

**Perceived likelihood of respondens being able to find a job (after being laid off)**

# Conclusion

- Large change in (un)employment – but not relative to output change

- High gross flows remain despite crisis
  - Most unemployment spells are short
  - Low risk of long-term unemployment
  - Relatively easy entry for youth

- So far: weak signs of marginalization and increase in long-term unemployment compared to other countries

- Active labour market policy – can it also work in a deep recession?

- Financial viability of the model – crucial to maintain a high employment level!