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Economic Stabilization Measures in Denmark,
1962 and 1963

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Economic Stabilization Measures in
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During 1962, the Danish authorities adopted a series of measures to curb internal demand and correct the adverse trade balance which grew out of an excessive expansion in domestic spending. This excess demand began to appear in 1961 but accelerated in 1962 when the domestic price level rose and the balance of payments deteriorated substantially. The worsening of Denmark's external position was not fully recorded in the official reserves because of receipts from several loans placed in foreign money markets during the year.

The adoption of a wholesale turnover tax which was put in effect in August was the principal restrictive measure taken in 1962. But these measures were slow in taking effect. As prices continued to rise and reserve losses continued, the possibility of a devaluation of the Danish crown began to be generally discussed outside the country in the early months of 1963.

Finally on March 14 the Danish Parliament accepted a sweeping income stabilization program designed to restore balance in the economy. The main features of this program included:

- a. Present wage contracts have been extended for two years and a ban placed on strikes;
- b. Prices and profits are to be frozen at present levels;
- c. Farm support programs are not to be increased above present levels; and
- d. Forced savings, repayable over a five year period, have been put in effect to offset the effects of tax reductions agreed upon earlier.

To give the country a breathing space to restore a better economic balance, Parliament also recently granted legislative authority for the Government to borrow abroad 500 million Danish kroner (\$72.5 million) and some Danish loan negotiations are now in process.

Growth in domestic incomes and spending in 1961

The growth in Danish domestic demand in 1962 stemmed from the sizeable increases in industrial wages and certain other salary levels and the substantial subsidization of Danish agricultural sector which took place during 1961.

Two developments in 1961 fed the continued substantial rise in income and spending levels last year. The two-year labor agreement negotiated in March 1961 provided for an immediate increase of 8 per cent in average industrial earnings and for a 13-14 per cent increase in salaries of government employees. As a result of continued "wage drift," average hourly earnings rose by 12-13 per cent in 1961. The upward momentum continued in 1962.

On balance, industrial hourly earnings have risen much faster in Denmark than in most European countries. This reflects the continued high employment and negligible unemployment levels in the Danish labor market. Labor shortages are prevalent in some fields, notably in building and construction and in the metal working branches. Under these conditions wages tend to rise above contractual levels because of a substantial degree of upward "wage drift." Wages as well as certain transfer payments are tied to the cost of living index, and at intervals are automatically adjusted upward as prices rise.

Secondly, 1961 was a turning point in agricultural policy. After a period of several years during which Danish agriculture experienced difficulties in export markets (in large measure because of protective measures in foreign markets) and Danish farm incomes lagged behind incomes in the nonfarm sectors of the economy, the Government moved in the direction of massive subsidization. The largest single step in this policy reorientation was the passage in June 1961 of the Agricultural Marketing Act, which provided for direct payments to farmers, refunds of some taxes, and subsidization of fertilizer purchasers and export promotion activities. Amendments to this legislation adopted in August 1962 enlarged the area of direct assistance to agriculture by establishing a system of fees on most livestock products sold domestically to provide additional income to producers. This measure permitted increases in domestic prices for bacon, beef, veal, poultry and eggs.

Inflationary developments during 1962

Changes in prices and in domestic spending levels, and the deterioration in the foreign trade balance are evidence of an acceleration in the inflationary atmosphere in 1962. The principal prices affected have been at the retail level.

The Danish wholesale price level has changed little during the past year and import and export prices have been remarkably stable. The cost of living index, however, rose by 7.2 per cent through October 1962 and the end-of-year figure is expected to show a further advance. (See Table 1.) These higher prices will call for automatic adjustments in wages and also in pension and disability payments. According to an interim economic report presented to the Danish Parliament at the end of November, retail prices (excluding rents) will show an annual increase of 8-9 per cent by January 1963, as compared with the 7 per cent increase recorded in 1961.

Table 1. Denmark: Price Movements, 1961-62
(1958 = 100)

<u>Period</u>	<u>Wholesale Prices</u>	<u>Cost of Living</u>
1961 I	100	104
II	102	105
III	102	108
IV	103	109
1962 I	103	111
II	105	113
III	104	1/ 119
IV	105	n.a.

1/ October.

Source: International Financial Statistics, March, 1963.

Higher domestic spending levels are reflected in much higher levels of retail trade turnover through October 1962 than in the corresponding period in 1961. Heavier turnover in volume terms rather than price rises accounts for the higher levels of retail trade turnover shown in Table 2. Sales of some durable goods increased rather spectacularly: in the January-May period purchases of autos were 45 per cent higher in 1962 than a year earlier. Even though anticipation of imposition of the 9 per cent turnover tax which was instituted in August contributed to the jump in retail trade through July, higher levels of turnover obviously continued--at hardly changed levels--through October. It is possible that for the year 1962 retail trade turnover may be only moderately above 1961; but that would imply that sales dropped in the fourth quarter of 1962 and therefore, that the turnover tax was beginning to exert its intended effect in curbing demand.

Table 2. Denmark: Index of Retail Trade Turnover
(1961 = 100)

<u>Period</u>	<u>All consumer goods</u>	<u>Food, beverages and tobacco</u>	<u>Clothing</u>	<u>Other</u>
January-October 1961	95	96	93	94
January-October 1962	107	108	102	107

Source: Den Danske Landmandsbank, Monthly Review of the Economic Situation in Denmark, January 15, 1963.

Finally, rising income levels in 1962 helped sustain a real estate boom and contributed to an increase in building activity. Despite some limitations on new starts on public construction and housing projects, projects under construction increased by 10 per cent between July 1961 and July 1962.

Domestic demand pressures increase trade deficit

The principal evidence of the pace of Danish inflationary experience in 1962 lies in the development of foreign trade. Higher levels of domestic demand spilled over into imports, which rose by almost 14 per cent, while exports increased by only 7.6 per cent. As a result, Denmark's trade deficit rose by almost 1 billion kroner (about 40 per cent)--or from DKr. 2,437 million in 1961 to DKr. 3,403 million in 1962. (See Table 3.)

Table 3. Denmark: Foreign Trade, 1961-62

<u>Period</u>	<u>Imports</u>	<u>Exports</u>	<u>Trade Deficit</u>
	(Monthly averages, million Danish kroner)		
1961 I	1,069.5	834.7	- 234.8
II	1,011.3	822.6	- 188.7
III	1,014.8	849.9	- 164.9
IV	1,202.6	978.7	- 223.9
Year	1,074.6	871.5	- 203.1
1962 I	1,171.1	899.6	- 271.5
II	1,172.1	903.5	- 268.6
III	1,272.7	892.0	- 380.7
IV	1,270.2	1,053.6	- 216.6
Year	1,221.5	938.0	- 283.5
<u>Total values:</u>			
1961	12,894.7	10,457.7	-2,437.0
1962	14,658.4	11,255.9	-3,402.5

Source: Vareomsaetningen med udlandet, December 1962.

Note: Data are unadjusted, and exclude Danish trade with Faroes Islands and Greenland.

Imports rose fairly steadily throughout 1962 except for a 35 per cent rise in Danish purchases abroad in July when consumers rushed to stock goods before imposition of the turnover tax. With import prices little changed during the year, the import rise was almost wholly a volume increase. (See Table 4.)

Table 4. Denmark: Indices of Foreign Trade, 1961-62

<u>Period</u>	<u>Volume Indices</u>		<u>Price Indices</u>	
	<u>Exports</u>	<u>Imports</u>	<u>Exports</u>	<u>Imports</u>
1961 I	115	143	98	97
II	114	133	100	98
III	119	132	99	98
IV	136	157	98	97
1962 I	126	156	99	97
II	123	155	99	98
III	124	164	99	99
IV	n.a.	n.a.	n.a.	n.a.

Source: International Financial Statistics, March 1963.

The rather substantial increase in imports and in the trade deficit in 1962 tends to obscure the comparatively satisfactory development of Danish exports. (See Table 5.) Because of marketing difficulties caused by import restrictions in neighboring countries, Denmark's traditional agricultural exports rose by only 2 per cent in 1962 but industrial exports rose by 12 per cent. Exports of machinery increased by roughly 16 per cent; even though machinery is only about 16 per cent of total Danish exports, this performance is encouraging as evidence of a shift into new industrial export lines. Total exports in 1962 were also adversely affected to some extent by a drop in sales of newly built ships, a Danish specialty, in 1962.

Table 5. Denmark: Exports, by Branch of Production, 1961-62

<u>Item</u>	<u>1961</u> (Million Danish Kroner)	<u>1962</u> (Million Danish Kroner)	<u>Index of Change</u> (1961=100)
Agricultural exports, total	4,476	4,572	102.1
Animal products	(4,162)	(4,210)	101.2
Vegetable products	(314)	(363)	115.6
Industrial exports, total	4,597	5,149	112.0
Machinery	(1,563)	(1,820)	116.4
Other industrial exports	(3,034)	(3,329)	109.7
All other exports, total	<u>1,385</u>	<u>1,535</u>	<u>110.8</u>
Total exports	10,458	11,256	107.6

Note: Details may not add to totals due to rounding.

Source: Vareomsaetningen med udlandet, December 1962.

Mounting trade deficit leads to foreign exchange drain

The worsening trade deficit was accompanied by a foreign exchange drain in 1962. (See Table 6.) However, the recorded decline in Danish reserves does not measure the deterioration in Denmark's external position because reserves were bolstered at intervals during the year by proceeds from a variety of foreign loans. In the first half of 1962, reserves declined by about DKr. 200 million, (\$29.0 million) in the face of a current account deficit estimated at more than DKr. 500 million (\$72.5 million). Loans amounting to about \$43 million were raised in the U.S. and in Switzerland. In the second half of 1962, reserves declined by DKr. 390 million (\$56.5 million) and loan proceeds totalled less than DKr. 100 million (\$14.5 million).

Table 6. Denmark: Gold and Foreign Exchange Reserves, 1960-62
(Millions of U.S. dollars)

<u>End of period</u>	<u>Reserves</u>
1960 - December	255.1
1961 - March	265.8
June	245.2
September	219.8
December	252.2
1962 - March	242.6
June	245.7
September	212.4
December	225.4
1963 - January	190.0

Source: International Financial Statistics, March 1963.

The sharp increase in Denmark's trade deficit in 1962 overstates somewhat the deterioration in Denmark's external position. Denmark regularly earns surpluses on shipping, travel and other non-trade components of the current account. In addition, it is quite likely that the relatively high Danish interest rate structure during the period under review has encouraged some short-term trade borrowing abroad, contributing to the development of the familiar pattern of "leads and lags." Because of these factors, neither the trade deficit nor the recorded decline in foreign exchange reserves adequately measures the state of Denmark's over-all balance of payments. (See Table 7.)

Table 7. Denmark: Exchange Reserves, Capital Imports
and Trade Balance, 1961-62

<u>Period</u>	<u>Recorded reserve change</u>	<u>Net capital receipts</u>	<u>Adjusted reserve change</u>	<u>Foreign trade deficit</u>
	(In millions of Danish kroner)			
1961 I	+ 8	+141	-133	-704
II	-193	+165	-358	-567
III	- 83	+ 56	-139	-494
IV	+ 79	+182	-103	-672
1962 I	- 60	+165	-225	-808
II	-141	+333	-474	-814
July	- 77	+ 3	- 80	-625
Aug.	- 77	+ 91	-168	-265
Sept.	- 48	n.a.	n.a.	-261

Source: Danmarks Nationalbank, Monetary Review, November 1962.

Austerity measures taken in 1962 prove insufficient

The Danish authorities recognized the dangers of mounting inflationary pressures; but the coalition position of the Government, requiring compromise among political parties, meant some delay in mounting an effective anti-inflationary program.

The austerity program which emerged in June 1962 from a political compromise solution combined a number of fiscal policy measures, the most important of which was a 9 per cent wholesale turnover tax which became effective on August 1. The authorities also adopted a policy of retrenchment of public works and a ceiling on government expenditures. In the private sector, a ban was imposed on construction of garages and summer cottages--a feature of the real estate boom accompanying the rather spectacular push outward to suburban areas around Copenhagen and other Danish cities in recent years--and limits were set for both new housing starts and private reconstruction projects. The objective was a 15 per cent reduction in building activities. The June political compromise also included some scheduled tax cuts to take effect in 1963.

It became apparent that some time would have to elapse before these austerity measures could take effect, particularly in the case of the turnover tax. At the outset, the original proposal for a retail tax had to be abandoned in favor of the tax on wholesale turnover which would have a delayed effect. Then, in addition, the date of introduction was delayed for about two months for reasons of political expediency.

By the end of 1962, however, evidence began to accumulate that the impact of the Government's program was finally being felt. Based on returns for August and September, the first two months of operation, it is now estimated that, with the turnover tax, tax receipts will reach DKr. 900 million for 1962-63 as intended and will be substantially more next fiscal year, even allowing for the tax cuts provided under the June 1962 political compromise. There is also every indication that the authorities are holding to their ceiling on budget expenditures.

As a result, the tendency for the budget to weaken in 1961 and early 1962 has been reversed. The Treasury accounts for the year ending on March 31, 1962 closed with a deficit of DKr. 538 million, interrupting a succession of budget surpluses in recent years. It now seems likely that the Treasury's cash surplus for the fiscal year ending on March 31, 1963 will exceed the estimate of DKr. 500 million. Furthermore, the surplus for fiscal year 1963-64 may even be double this figure.

Monetary policy did not play a dominant role in the original restrictive program although some steps to tighten credit were taken. In May 1961, the central bank issued a warning against a continuation of the then rapid rate of credit expansion, and cautioned that money would be made "scarce and expensive." On May 23, 1961, the discount rate was raised to 6-1/2 per cent--its highest level in 37 years.

On February 12, 1962, the central bank announced the imposition in two stages--effective on March 21 and May 21--of reductions in the eligible loan values of bonds pledged as collateral against central bank advances.

These attempts to make financing more expensive did not prove to be an obstacle to continued bank credit expansion in 1961 and 1962. Total loans and advances of Danish commercial and savings banks increased by 10.8 per cent in 1961 and, owing to a rather sharp rise in the fourth quarter of 1962, by 12.4 per cent last year. (See Table 8.) Through April of 1962, there was a reduction in the annual rate of credit expansion, by comparison with the two previous years. but the rate of expansion subsequently accelerated.

The continued expansion of bank lending reflects, of course, the accommodation of high levels of activity, especially imports and exports, during a period of rising prices. It would appear that the central bank has felt obliged to permit this process to continue, perhaps in anticipation of the restrictive effects of the Government's fiscal measures. In any event, the bank has offset the liquidity-reducing effects of the foreign exchange drain by supplying reserves to the banking system through open market operations. Despite rather massive bond purchases, however, Danish bond prices have remained depressed; yields have risen in part under the influence of a heavy volume of new mortgage financing, but sluggishness in bond prices also has reflected an air of uncertainty about international as well as domestic trends.

Table 8. Denmark: Trends in Bank Credit, 1961-62

Period	Commercial bank loans		Savings bank loans		Total loans	
	Amount (mill. kr.)	Index a/	Amount (mill. kr.)	Index a/	Amount (mill. kr.)	Index a/
1961 I	10,784	103.6	5,913	102.2	16,697	103.1
II	11,266	104.5	6,025	101.9	17,291	103.6
III	11,297	100.3	6,143	102.0	17,440	100.9
IV	11,716	103.7	6,232	101.4	17,948	102.9
1962 I	12,051	102.9	6,402	102.7	18,453	102.8
II	12,456	103.4	6,536	102.1	18,992	102.9
III	12,583	102.0	6,729	103.0	19,312	101.7
IV	13,376	106.0	6,801	101.0	20,177	104.5

a/ Previous quarter = 100.

Sources: Data through third quarter, 1962, from Danmarks Nationalbank, Monetary Review, November, 1962; data for fourth quarter, 1962, from Statistiske Efterretninger, 1963, No. 6.

New measures adopted in March 1963

The Minister of Economics underlined the seriousness of the Danish economic situation in an interim economic survey to the Danish Parliament at the end of November 1962. He stressed the continued unfavorable balance of payments position and the fact that demand pressures had not yet been sufficiently reduced. Success of the restrictive economic policy measures adopted in the summer of 1962 hinged, he said, on efforts of private sectors of the economy to reduce their future demands. Otherwise, the Minister indicated, the Government would have to counter new wage and price increases and farm subsidies with higher indirect taxation.

By the beginning of 1963, the situation had become more serious. Continued inflationary pressures was followed by talk that some basic deterioration in Denmark's competitive position has been produced by upward price and wage movements. Rumors began to circulate that the Government might resort to quantitative restrictions or devalue the currency. It does not appear that, in fact, either of these alternatives was seriously considered.

On March 14, however, the Parliament adopted a series of measures which comprised a comprehensive program, embodied in 12 bills outlining a general effort to stabilize prices and to limit all Danish incomes during 1963 and 1964. Although details are not available, the principal features of the Government's proposals were apparently included in the recent Parliamentary action. These include:

1. Extension of the existing wage agreements for two years, with strikes prohibited during this period, but with special arrangements to improve wages of low paid workers;
2. Modification of cost-of-living bonus arrangements by excluding taxation from the index calculation;
3. Limitation of dividend payments and prohibition on bonus share issues, for the next two years;
4. Authority for the Danish Monopoly Board to administer a price and profit freeze in accordance with tighter regulations regarding the types of costs (including wage costs) to be passed on in prices;
5. Continuation of agricultural subsidies at present levels; in part, subsidies are to be replaced by arrangements designed specifically to promote exports, partly in the form of interest-free loans to support rationalization of the dairy industry;
6. In addition to arrangements for higher pay for low paid workers, increases in sickness insurance benefits and in pensions, financed in part by higher contribution from participants; and
7. Adoption of a system of forced savings to offset the increased cost of tax relief (under the June 1962 program) and of income supplements envisaged under the proposed legislative program.

Finally, the Government's proposals include the easing of restrictions on foreign borrowing by residents and on purchases of Danish Government bonds (within certain limits) by non-residents.

These relaxations, together with recent legislative authority to raise foreign loans to DKr. 500 million (\$72.5 million) in 1963, should provide a breathing spell for the restoration of economic balance in the Danish economy. In the meantime, the effects of the 1962 measures and the impact of the March 1963 income stabilization program can gradually bring under control the excessive demand pressures responsible for Denmark's recent external payments problems.