

De Økonomiske Råd 
Formandskabet

**PRODUCTIVITY
2024**
**SUMMARY AND
RECOMMENDATIONS**

SUMMARY AND RECOMMENDATIONS

The first chapter contains assessments of and recommendations for current economic policy, with particular focus on topics that effect productivity.

Chapter II shows that the share of total goods exports that does not cross the Danish border, so-called merchanting and processing, has grown over the most recent decades. The majority of these activities occur in a handful of large manufacturing companies with subsidiaries abroad. These are companies with high productivity and value-added growth.

Chapter III concludes that the contribution of merchanting and processing to the manufacturing sector's value added has grown from 2 percent in 2005 to 20 percent in 2022. Merchanting and processing have simultaneously contributed to higher productivity and a fall in the labour share.

SUMMARY AND RECOMMENDATIONS

This productivity report from the Chairmanship of the Economic Councils, which constitutes the National Productivity Board, consists of three chapters. In the following, a brief overview of the report's conclusions is given for each of the chapters.

CONTENTS OF THE PRODUCTIVITY REPORT

- Chapter I Current economic policy
- Chapter II Firms' use of merchanting and processing
- Chapter III Importance for the economy of merchanting and processing

CHAPTER I, CURRENT ECONOMIC POLICY

Chapter I comments on current economic policy proposals and broad political agreements with relevance to productivity. The discussion is focussed on five topics:

- Government support for business
- Public sector pay
- Education
- Personal tax reforms
- Climate goals

The 'DIS' Scheme should be wound up ...

The Expert Group for Future Business Support presented their first report on 19 February 2024. The report recommends that the favourable tax arrangements for employees working on ships on the Danish International Ship Register (the DIS scheme) be phased out. The Chairmanship agrees with the Expert Group's recommendations, as the scheme tends to lower the productivity of these workers, as they are retained in jobs with low pre-tax productivity and wages.

... but tonnage tax should also be changed

Contrary to the expert group, the Chairmanship is of the opinion that the so-called tonnage tax should be changed. The tonnage tax is a particularly low corporate tax on shipping companies. There are good

grounds for why corporate taxation should, as a starting point, be neutral so that the same taxation conditions apply to all industries. Although this is a principle that the Expert Group also acknowledges, it fails to follow it in this case. The Expert Group's decision not to recommend changes to the tonnage tax is based on analyses by the Ministry of Taxation that conclude that the abolition of the favourable taxation of shipping companies would result in higher tax revenues but, at the same time, would result in a loss of economic efficiency. However, this analysis is based on a number of assumptions that are debatable.

Counterpurchase agreements for defence procurement risk weakening productivity and Danish security

When purchasing defence equipment, it is possible for Denmark to require that the selling companies purchase goods or services from Danish companies. Such a requirement for counterpurchases will increase the costs of the foreign companies that to sell to the Danish market. This increases the purchase price of defence equipment, and, seen in isolation, would reduce the amount of defence equipment that can be purchased for a given budget. In itself, this would diminish Denmark's security. If there are instances where there are good arguments for such agreements, these should be made public, otherwise, as a general rule, Denmark should refrain from requiring counterpurchases when purchasing defence equipment.

Shorter master's degrees weaken productivity

In the broad political agreement on the reform of university education, it was agreed to reduce 10 percent of the master's degree programs by $\frac{3}{4}$ of a year. This in itself will reduce the average length of education, which is expected to reduce productivity in Denmark. The reform also includes measures aimed at improving the quality of education in Denmark, which could counteract the fall in productivity. However, the quality measures are economically risky, since neither their expected effect on productivity nor their degree of uncertainty can be quantified in advance.

The tripartite agreement on public sector wages does not solve the underlying problems

Public sector wage formation is characterised by the fact that virtually all employees in the public sector receive the same percentage increase in their wages. Thus, wages do not give a price signal to the wage earner that they should move to areas with a shortage of labour, and this reduces public sector productivity. The recently concluded tripartite agreement on pay and working conditions provides a one-off boost in pay for select groups of public sector workers. Therefore, the agreement does not address the underlying problem that the proportional increase in wages will tend to be the same for all public servants. Thus, the agreement does not help to prevent future labour shortages from arising again in parts of the public sector.

CHAPTER II, FIRMS' USE OF MERCHANTING AND PROCESSING

Significant increase in merchanting and processing since 2005

Danish exports have traditionally consisted of goods exported from Danish firms in Denmark to foreign firms or consumers. Since 2005, however, a significant increase has been registered in another type of goods export, where Danish-owned goods are exported from one foreign country to another without the goods crossing the Danish border. This type of goods export is called merchanting and processing, and processing, in particular, has increased in recent years, see Figure A.

FIGURE A MERCHANTING AND PROCESSING

The share of total Danish goods exports that does not cross the Danish border, so-called merchanting and processing, has increased significantly since 2005.



Notes.: Exports are calculated according to the balance of payments categories and are not seasonally adjusted. Latest observation is December 2023.

Source: Statistics Denmark, Statbank Denmark.

Another way to produce and export

Merchanting and processing are two different statistical concepts, but they usually cover the same types of activities. Merchanting, is a form of wholesale trade what occurs when Danish enterprises buy and resell goods abroad without them crossing the Danish border. Processing occurs when a Danish manufacturing company has their goods produced abroad and resells them without them crossing the Danish border. This is thus another way in which manufacturing companies can participate

in the global division of labour and export their products. Merchanting comprises the smaller part of these two activities.

Merchanting and processing mainly occur in large manufacturing companies ...

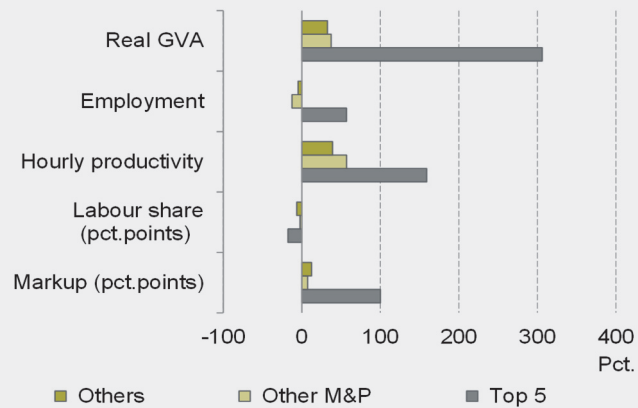
The majority of merchanting and processing occurs in large manufacturing companies with subsidiaries abroad. Furthermore, these activities are concentrated in relatively few companies, with five companies accounting for almost 60 percent of the total value added from merchanting and processing activities, as approximated by the gross profit from these activities.

... with a large increase in productivity and markups

These five companies have had strong growth in their value added, productivity and markups (i.e., the difference between selling prices and costs), see Figure B. At the same time, they have had a large decline in the labour share.

FIGURE B GROWTH OF THE COMPANIES WITH THE MOST MERCHANTING AND PROCESSING COMPARED TO OTHER COMPANIES

The five manufacturing companies with the highest turnover from merchanting and processing have had significantly higher growth in real gross value added, productivity and markups and a decrease in the labour share compared to other manufacturing companies over the period 2001-20.



Notes: *Top 5* is the five manufacturing companies with the most merchanting and processing in 2019. GVA is gross value added.

Source: Own calculations based on data from Statistics Denmark, StatBank Denmark and Danish register data.

Have the same characteristics as superstars

The five manufacturing enterprises with the most merchandising and processing thus have many of the characteristics that distinguish the so-called superstar firms that, according to the academic literature, increasingly seem to dominate the economy in the USA and Europe. Superstar firms are thus characterised by high growth, high productivity, low wage rates and high markups that reflect very high earnings.

Increased concentration may reflect economies of scale and specialisation in R&D

The literature points to a number of possible explanations for the increased prevalence of superstars. For example, economies of scale may play a more important role in some companies, and this makes it possible for them to grow and market their goods globally. For the Danish superstar firms, globalisation results from, among other things, increased use of merchandising and processing, where production occurs in foreign subsidiaries. The parent companies in Denmark increasingly contribute the research, development and administration with a view to developing patents and designs for the goods that the foreign subsidiaries produce and sell abroad, without them physically crossing the Danish border. This pattern is supported by the fact that companies with merchandising and processing have a high proportion of intangible capital and, to a greater extent, make use of highly specialised labour, e.g., workers with a Ph.D., compared to other manufacturing companies.

CHAPTER III, THE IMPORTANCE FOR THE ECONOMY OF MERCHANDISING AND PROCESSING

Merchandising and processing have contributed to high productivity and growth ...

Chapter III examines the importance for the economy of merchandising and processing. Overall, merchandising and processing are of great importance for the trends in value added, productivity and the labour share in the manufacturing sector. Thus, the value added linked to merchandising and processing has increased from 2 percent of the total value added of manufacturing companies in 2005 to 20 percent in 2022. From 2005 to 2019, productivity per hour worked in manufacturing increased by 60 percent. Of this, 16 percentage points can be attributed to merchandising and processing.

... and a lower labour share

As mentioned above, the labour share is significantly lower in companies that use merchandising and processing. The labour share in the entire manufacturing sector was 54 percent in 2019, but if merchandising and processing are excluded, the labour share would be 59 percent.

Structural change in the way of producing

The shift towards large M&P companies implies an underlying (structural) change in the way in which production takes place in the Danish economy, as physical production is increasingly shifted abroad, while

Danish companies are increasingly responsible for research, development and administration.

Weaker link between production and Danish employment

This shift has implications for how the economy functions. For instance, there has traditionally been a close connection between production and employment in the manufacturing sector. However, this connection weakens when a larger share of company earnings is connected to production abroad. For companies that make extensive use of merchandising and processing, this weakens the link between wage competitiveness and exports.

Danish superstars contribute to high productivity, ...

In a world which increasingly seems to be dominated by superstar companies, it may seem positive that there are also Danish superstars. They have contributed to high productivity and increased prosperity overall. However, this trend may have had distributional consequences, as the lower labour share implies that a higher proportion of the value added goes to the company owners.

... but reduced competition

An unfortunate consequence of the increased dominance of the superstars is that competition decreases. Viewed in isolation, the superstars' high markups mean that prices are higher than in a situation with stronger competition. Since the Danish superstars also sell their goods abroad, the negative consequences of the high markups are also felt by foreign consumers. On the other hand, Danish consumers are affected by the weakened competition as a result of superstars in the USA and other countries. This speaks in favour of international coordination of competition policy, where the negative consequences of the general rise of superstars are reduced. The EU's so-called Digital Markets Act is a step in this direction in the digital area.

