

CHAPTER 16

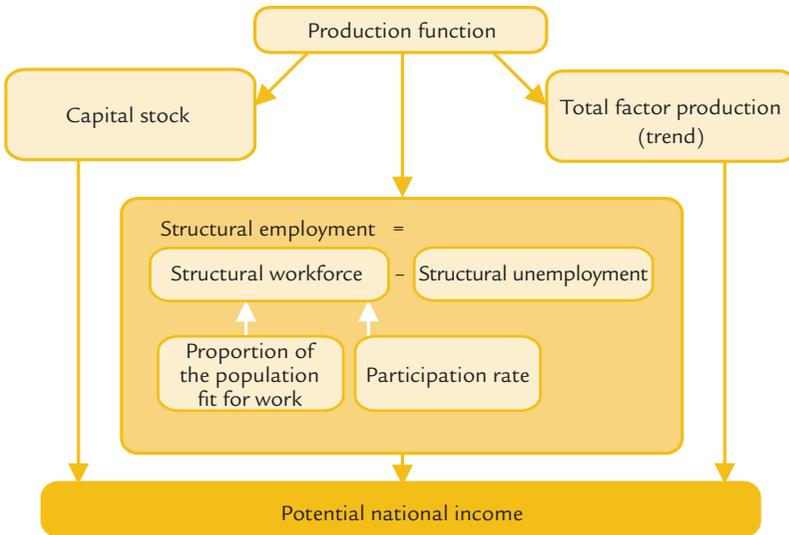
# Long-term economic potential and structural policy

As seen in Chapter 11, **potential** national income can be considered the pivot point around which the economy revolves in the long run. This chapter looks at the factors that determine **potential** national income and at how governments seek to boost it, mainly via structural policy.

## 16.1 Determining **potential** national income

Figure 16.1 shows the factors that determine **potential** national income, and forms the basis for this entire chapter.

Figure 16.1 *Potential national income*



Based on Winther 2011 and The Economic Council, The Danish Economy, Autumn 2010

The starting point for the analysis is the production function, a well-known concept in microeconomic theory. The production function shows the relationship between input (amount of each of the different available factors of production) and the output (**potential** national income).

As the figure shows, the input consists of capital equipment (machines, buildings, etc.) and labour. The size of the **potential** national income is therefore determined by:

- the volume and the quality of the capital equipment in the long term
- employment in the long term, also called the structural employment, and the quality of it
- total factor productivity (TFP), which shows how well the capital equipment and the workforce have been deployed, and how the two factors interact.<sup>133</sup>

This chapter looks first at structural employment, then capital equipment and, finally, productivity.

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## 16.2 Structural employment

Structural employment is the employment rate in the long term. As shown in Figure 16.1, structural employment is calculated as structural workforce minus structural unemployment, both of which will now be examined in turn.

### 16.2.1 The structural workforce

The structural workforce depends on the proportion of the population who are of working age and on how many of them are available for work (the participation rate).

The Danish population of working age is approx. 5.6 million people. As shown in Figure 16.2, this is just under a half million more than 30 years ago, and it is expected to rise by another 700,000 to approx. 6.2 million by 2050.

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<sup>133</sup> Permanent improvement of a country's terms of trade also depends on its **potential** national income. The terms of trade show the prices of export goods in relation to import goods. However, this relationship is not covered in this chapter.