The Danish labour market System

1. **European Commissions report 2002 on Denmark**

In 2002 the EU Commission made a joint report on adequate and sustainable pensions.
In the country summaries the description of the Danish pensions system was the following:

"The first pillar of the Danish pension system consists of the universal, residence-based and non-contributory, statutory old age pension scheme that is financed from general taxation and consists of a flat-rate benefit and an income tested element. It is designed to secure a decent minimum standard of living for all citizens from the age of 65. A full public old-age pension is conditional on 40 years' residence in Denmark. The benefit is indexed to private sector wages and is taxable. It consists of two parts, a basic amount that goes out to everybody and a supplement, which is income tested. The post-tax, net value of the two benefit elements corresponds to 47% of the average take-home pay of a worker. At present the basic pension is paid to 99% of residents above retirement age. Of these 99% receive the full basic amount and 64% the full supplement. For single pensioners the basic pension constitutes 61% of their income.
A second tier of the first pillar consists of the statutory, working time-related, fully funded ATP scheme (which is available for all economically active persons, but only offer benefits at a moderate level equivalent to 20% of the 1st pillar pension) and the statutory labour market supplementary pension scheme for recipients of anticipatory pensions (SAP). The ATP scheme provides for a substantial amount of redistribution notably in favour of the unemployed and disabled. In addition, civil servants' pension schemes, which are statutory and paid for by taxes, are included in the first pillar.
The second pillar consists mainly of occupational schemes based on collective agreements at the sectoral level which are fully funded defined-contribution schemes. These schemes have been expanded significantly since the 1980s and now cover more than 80% of the employed workforce. While based on individual accounts, these trade-union initiated schemes have important solidarity elements, in particular invalidity insurance and the absence of health criteria for qualification purposes. In addition, they do not present barriers to labour mobility, thanks to immediate vesting and transferability between schemes. The normally regressive distribution effects and public budget costs of tax incentives for supplementary pension provision are moderated by the fact that tax exemption only applies to income tax at a standard rate and that returns on investments are taxed. In 2002, the statutory Special Pension Savings scheme was redefined as a savings scheme without any redistribution objective and based on individual accounts.
The third pillar consists of individual pension savings schemes, many of which result in lump sum benefits instead of annuity payments.
Access to a number of needs- and income tested cash supplements (e.g. housing, heating and medicine allowances), to free health and long-term care and to recreational activities contribute to guaranteeing a decent minimum standard for all.

Challenges
While the Danish system currently appears to provide a solid and decent income level to all long-term residents, there appear to be weaknesses as far as the relative living standard of the elderly is concerned, although national data present a different picture from ECHP data.
In view of the fact that a significant proportion of wage earners were only covered recently

109 by occupational schemes, it can be expected that many people retiring over the next 15-20 years will have had insufficient access to schemes that allow income levels to be maintained after retirement. Over the long run the situation can be expected to improve thanks to the gradual accrual of occupational pension entitlements based on collective agreements.
However, access to income maintenance through occupational schemes for people in non-standard jobs could be improved. The increasing importance of occupational pension schemes which reflect earnings could result in a somewhat greater gap between the pension incomes of men and women.

Expenditure on public old-age pensions stands at 4.4% of GDP and is estimated to increase by 3.4% of GDP by around 2035. However, including all public pension schemes (such as disability pensions, civil servants pensions and statutory supplementary pension schemes), the total expenditure amounted to 10% of GDP in 2000 and is estimated to rise to 14.5 % by 2030 and to decrease to 13.3% by 2050 (Economic Policy Committee projections). The strategy for financial sustainability hinges upon maintaining a surplus on public finances averaging 1½-2½% of GDP up to 2010 and an increase in the labour force of 133,000 persons by 2010 also. Both of these goals are ambitious and are at the same time crucial for the strategy to succeed, given the relatively short period of time for reacting if underlying assumptions on economic developments should not hold.

Since Denmark already has one of the highest employment rates in the EU, labour reserves are small. The pension reforms undertaken during the 1990s are expected to increase the labour force participation of older workers during this decade, but only by about the amount that is needed to offset the impact of the ageing workforce. In addition, employment is to be raised through substantially improved employment rates among immigrants and an improved integration into employment of the disabled as well as by increasing the effectiveness of labour market policies.

Meeting the challenges
The Danish national strategy report expresses satisfaction with the reforms implemented over recent years and stresses that no major adjustments to the system are planned at present. The system is based on a broad consensus between the major parties about the overall structure and the relative role of its various elements. In addition, a large majority in parliament agreed in 2000 on the principle that the public old-age pension should form a sound income basis for present and future pensioners.

The expansion of occupational pension schemes is expected to raise replacement rates significantly and hence to reduce the current income maintenance gap. Yet the first pillar will continue to play a lead role in provisions. By 2045, income from the basic pillar will still account for about 50% of the average income of pensioners. A potential drawback of defined-contribution occupational schemes in terms of gender equality, i.e. lower pensions for women reflecting their longer life expectancy, is avoided by calculating pension benefits on a unisex basis.

A major focus of the reforms during the 1990s was employment promotion through better work incentives and working conditions for older workers. The pre-early retirement scheme, which was a transitional allowance for people aged 50-59 years who had become unemployed and had contributed to the unemployment benefit scheme for at least 30 years, was closed for new entrants in 1996 and will be fully phased out by 2006. The voluntary early retirement scheme was made less attractive for individuals in 2001 through the obligation to contribute to the scheme if a person opts to retire early. In addition, a special tax exemption for contributions was introduced for people who postpone the take-up of a voluntary early pension. Yet, the implicit tax on working beyond the ages 60, 62 and 65 is in many instances still substantial. Regarding the disability pension scheme, rehabilitation measures have been reinforced and the focus has been switched to encouraging people to continue at work by mobilising the remaining capacity to work from those wishing to benefit from the scheme. Measures taken have already resulted in a lower number of new disability pension claimants.

An increased labour force and a further reduction in unemployment are also seen as crucial for enabling the government to face increasing expenditure while implementing its debt repayment strategy. The government aims to maintain on average a general budget surplus of 1½ to 2½% of GDP up to 2010.
The complex structure of the Danish system (means-tested elements, ATP, fined contribution schemes) can make it difficult to have a clear idea of a person's income situation after retirement. This issue is addressed by an obligation on pension schemes to disclose their administrative costs and performance records. In addition, the ATP scheme, in co-operation with almost all other pension providers, runs an internet site where individuals can have their prospective net income from various pension schemes calculated.

Conclusion
The strategy for ensuring adequacy and financial sustainability of pension provision seems appropriate. The reforms needed to achieve the adequacy and solidarity objectives have been put in place over the last decade with support from a broad majority in Parliament. A budget policy leading to quick debt reduction has already been sustained for some years and all major parties support the continuation of this policy until 2010, when the public debt will have been largely eliminated. A further rise in employment will be difficult to achieve in view of the limited labour force reserves, but it is not implausible given Denmark's proven track record in employment. In particular, the incentives for older workers to defer their retirement could be further strengthened.

In sum the pension system seems to be financially sustainable in the long term under present policies with a fairly equitable sharing of the burden between generations. Building up occupational pensions will increase replacement rates in the future and thereby alleviate potential pressure for increases in public pension rates. Yet, the sustainability calculations hinge critically on maintaining large surpluses in public finances during this decade. Further labour market reforms would seem to be needed to ensure the assumed increase in the labour supply, which in turn is needed for ensuring the debt reduction strategy necessary for financial sustainability."

2. European Commissions rapport 2005 on pensions system in Denmark

In 2005 the EU Commission made a new report on adequate and sustainable pensions.
In the country summaries the description of the Danish pensions system was the following:

“The public old age pension is a universal, residence-based and non-contributory statutory old age pension scheme financed from general taxation. A full public old-age pension is conditional on 40 years’ residence in Denmark after the age of 15. It consists of a basic amount and an income tested pension supplement. The pension depends on the pensioner's present income and martial status, but assets have no effect on the amount. The benefits are adjusted once a year based on the wage development in the private sector, and are taxable. Since 2003, in addition a supplementary pension benefit of a flat rate amount is paid once a year to the most disadvantaged pensioners (means-tested). For the 70% of older people with the lowest incomes, social pension accounts for 50% or more of the gross income for both single pensioners and couples. The statutory retirement age for both men and women is 65 years, being lowered from 67 years in July 2004.

Reforms were undertaken during the 1990s, aiming in particular at increasing labour force participation of older workers so as to offset the impact of an ageing workforce. In addition, people who postpone the take-up of a voluntary early retirement benefit beyond the age 62 are paid a tax-free bonus at the age of 65 (that increases with time worked beyond the age 62). Rules on deferred pension were introduced with effect from 1 July 2004. Persons who have reached public old-age pension age and who participate actively in the labour market (at least 1,500 hours annually) may choose to defer their public old-age pension against having later their current public old-age pension increased by a supplement for deferred pension.

Denmark has the supplementary mandatory funded **ATP** scheme, which can be considered as part of the first pillar due to the fact that it is mandatory. But it has also the characteristics of an occupational pension scheme as it is employment-related and organised in private funds, thus not burdening public finances. On average ATP offers about 10% of public old-age pensions to current pensioners. In collective agreements of 2004 covering the private labour market, the social partners agreed in raising contribution rate to ATP by 9% in 2006.

The Special Savings Scheme (**SP**) was launched in 1999. All employees and self-employed contribute 1% of their income in order to receive benefits, that are paid out over a 10-year period after the retirement age is reached. A decision was however made to suspend payments to the SP plan for the years of 2004 until 2007. Almost all citizens of working age are in ATP and SP and even several groups of persons temporarily or permanently outside the labour market pay contributions to the schemes. Thus, these schemes ensure almost all future pensioners supplementary pension besides public old-age pension.

Statutory pensions are supplemented by occupational pension schemes, such as **Labour market pensions**, labour market supplement pensions (SAP) and individual pension saving. Especially labour market pension schemes expanded during the last 25 years from 30% to some 90% coverage of employees. The bulk of labour market pensions are defined contribution, i.e. the amount of the pension depends on the contributions paid. In 2004, contributions to the agreement-based labour market pension schemes were typically 7-10 per cent of the wage in the private labour market and 12-16 per cent of the wage in the public labour market. In connection with the collective bargaining in 2005, a number of increases of these contributions were agreed. The employer contributes two-thirds, while the individual person contributes one-third.

Access to a number of needs and income tested cash supplements (e.g. housing, heating and medicine allowances), as well as to free health and long-term care and to recreational activities contribute to guaranteeing a decent minimum standard for all.

Current situation

Adequacy. The relative income of all people aged 65+ relative to the complementary age group 0-64 stands at 70%, which is lower than in most of the other member states.[1] In spite of the projected significant rise of funded schemes, the first pillar will continue to play an important but decreasing role in pension provision.

The statutory pension schemes maintain the risk of poverty of the elderly people on a moderate level (21% at the 60% threshold) higher than that of the 0-64 years (10%).[2] The gender gap between men and women is one of the lowest in Europe. This is linked to the high labour market participation of women and also to prevalence of supplementary labour market pension of women as high as the one of men. In addition, pension rights in ATP and labour market pensions (since 1998) are calculated on the basis of a unisex principle. The unisex principle implies that a person's gender must not be taken into account when pension is calculated in regard to the remaining projected life expectancy.

Theoretical pension replacement rates of today are relatively low compared to almost all other member States. The current total gross replacement rate is 49%, resulting in net replacement rate of 71%. Since most Danish funded schemes are not yet fully mature (a majority of new pensioners have not yet contributed during a full working life) the level of measured income of pensioners relative to the working age population will improve gradually, in particular for people on low and average incomes. The counterpart is however that the build-up of the mandatory savings-based schemes to some degree will supersede other savings. The replacement rate ensured by the pension system must be seen in relation to the supplementary benefits targeted at pensioners and the public financed health and elderly care.

The Danish Government wishes to put self-employed persons on an equal footing with employees when it comes to the possibility for saving up for retirement. Self-employed persons can now achieve full deductions for pension contributions of up to 30 per cent of the profit for the year and can thus decide on an ongoing basis how much they wish to contribute.

Financial sustainability: Public debt has been reduced since 1998 and is below the average in EU, being 45.9% of GDP in 2003 and the State budget was in small surplus in 2002 (0.7% of GDP) and 2003 (0.3% of GDP). Government has set the operational fiscal target of upholding a structural budget surplus of 0.5 - 1.5 per cent of GDP (1.5-2.5 per cent of GDP including ATP) on average through 2010. The reduction of debt improves fiscal sustainability. To support the long-term sustainability of public finances and the pension

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[1] Accumulated wealth, which is higher for older people, should also be considered when comparing living standards across generations. Due to data limitations unfortunately this is not possible for all countries.

[2] This figure does not include as income negative capital income and imputed rent from private housing, which gives an incomplete picture of income situation, in particular for older people. When taking into account this more comprehensive definition of income, the risk of poverty in Denmark for elderly people is fairly the same as in the rest of the population (8.7% for people aged more than 65 and 10.6% for people aged more then 75, compared to 9.8% for 0-64 aged people).

system tight expenditure control and a permanent rise in employment generated from new structural policy initiatives are pursued. In relation to this, the Government has launched the integration plan that a majority of the political parties have agreed on in June 2005.

The total employment rate (75.7%) and the total female employment rate (71.6%) are currently the highest in the EU (2004), while the one of older workers (60.3%) is the second highest and far exceed the Lisbon targets. As from 1 July 2004, the age at which a person becomes eligible for public old-age pension is 65 years (before it was 67). The formal pensionable age was lowered as part of a reform of the voluntary early-retirement scheme in 1999. The lowering of the formal pensionable age is not assessed to have any significant effect on the average retirement age.

Modernisation: Reduced transfer fees for individual pensions in the 3. Pillar contracted in pension companies have improved the possibilities for transfer, and this is expected to result in intensified competition between companies and thus greater efficiency. Nevertheless, the bonus potential is not transferable between pension providers and this makes the consequences of a transfer less transparent. Frequent job/industry changes, leave, etc. could have unfavourable impact on labour market schemes, as a new employee is often subject to a waiting period before he/she becomes a member of the pension scheme.

The complex structure of the Danish system (means-tested elements, ATP, defined-contribution schemes) can make it difficult to have a clear idea of a person's income situation after retirement. This issue is addressed by an obligation on pension schemes to disclose their administrative costs and performance records. In addition, a common database, *PensionsInfo*, has been established in cooperation between pension funds, life-insurance companies, banks and public authorities. *PensionsInfo* gives the individual pension saver access to information from almost all pension suppliers, thus enabling him/her to get a total overview of his/her pension savings.

Outlook, reform measures and policy debates

Denmark is projected to face similar demographic trends to most EU15 Member States in until 2030 and then experience more favourable trends. According to the latest projections of Eurostat, ageing would be slower than the average EU. Indeed, the elderly dependency ratio will increase from the present 23% (2004) to 38% in 2030 and 42% in 2050, staying significantly below the EU25 average of 52% in 2050.

Since persons are now entitled to higher pensions compared to previous rules, supplements for deferred public old-age pension for people who wish to work beyond the retirement age of now 65 will not necessarily improve fiscal sustainability. Nevertheless the aim is to increase the average retirement age by six months to the age of 61.5.

The expansion of occupational pension schemes (SP and labour market schemes) is expected to raise replacement rates significantly and hence to reduce the current gap. Theoretical total gross replacement rate for a worker retiring at 65 after 40 years at the average wage is expected to increase from 49% in 2005 to 64% 2050 because of an expected increase of the gross replacement rate in the second pillar from today 4% to 25% in 2050 and despite a slight decrease of the gross replacement rate for the first pillar (including ATP) from 45% today to 39% in 2050. Because of taxation of the pensions, the increase in total net replacement rate is significant lower, starting from 71% in 2005 to 76% in 2050.

Denmark's national strategy report highlights that the budgetary pressure from ageing is not only related to public old-age pension, but also to health and elderly care expenditures, and that the sustainability of the public pension system cannot be assessed independently of other public expenditures and the overall assessment of the long-term sustainability of public finances because public pensions are financed by general tax revenues. Latest available national budgetary projections included in 2004 in the context of the assessment of the long-term sustainability of public finances indicate that public pension spending will grow by 2.3 p.p. of GDP between 2004 and 2050, while total age-related expenditure by 6.0 p.p. between 2004 and 2050. [*Paragraph to be updated with latest AWG projections*]

ATP and SAP savings-based schemes, pension rights are earned on the basis of a unisex principle. SP is a purely saving-based scheme without re-distribution. The unisex principle, which implies that a person's gender must not be taken into account when pension is calculated, became statutory for labour market pensions in 1998. The principle will only take full effect for pensions paid out from 2040. As regards maternity leave without wage, the social partners in the central, local and regional government area agreed in connection with the collective bargaining in 2005 that pension contributions will be paid in the maternity leave periods in which no wage is paid.

The system is based on a broad consensus between the major parties about the overall structure and the relative role of its various elements. In addition, a large majority in parliament agreed in 2000 on the principle that the public old-age pension should form a sound income basis for present and future pensioners. The government has set up a Welfare Commission charged with submitting specific proposals before the end of 2005 for reforming the Danish welfare model, including social pensions. In the light of the analyses from the Welfare Commission and with a view to maintaining the long-term targets of economic policies, the Government will in spring 2006 present a new economic multi-year plan for Denmark, covering at least the period up to 2015.

Conclusion

The strategy for ensuring adequacy and financial sustainability of public pension provision seems appropriate. A budget policy leading to quick debt reduction has already been sustained for some years and all major parties support the continuation of this policy until 2010, when the public debt is expected to be substantially reduced.

In sum, the pension system seems to be financially sustainable in the long term under present policies with a fairly equitable sharing of the burden between generations. Denmark reports not only one of the lowest gender gap between men and women in the risk of poverty in Europe but also a very small gender gap in the pension entitlements of the current pensioners. While relative living standards of older people are moderate, building up private pensions is expected to increase replacement rates in the future and thereby alleviate potential pressure for increases in public pension rates. Nevertheless, the future contribution of private pensions to adequate pensions would benefit from periodic reviewing.

Yet, the sustainability calculations hinge critically on maintaining large surpluses in public finances. Furthermore, ambitious targets have been set to increase employment by 60.000 persons by 2010. Given Denmark's proven record in employment, further rises in employment rates will be difficult to achieve and will require further measures, especially to slow the outflow of older workers through early retirement scheme.

In the light of the proposals for welfare system reforms from the Welfare Commission and with a view to maintaining the long-term targets of economic policies, the Government will in spring 2006 present a new economic multi-year plan for Denmark, covering at least the period up to 2015.”