Exam winter - December 2011
"The Danish Welfare Model"

Exam question no. 1

The Danish welfare model contains a significant redistribution of income and risk between income groups

According to the OECD, the Danish Gini coefficient of 23, are among the lowest in the world. This means that measured by income, inequality in Denmark is among the lowest in the world, The public sector plays a significant role in the redistribution of incomes. Thus, the OECD in 2008 estimated that 2% of Danish families can be classified as permanent low-income families. (This is calculated from the meridian of 50%). There are significantly higher risks of poverty among younger citizens with low education and families with several children. Both groups receive permanent income replacement transfers. Without these transfers there would be 31% in the low-income group and not 2% as is the case.

The redistribution of funds in the public sector takes place through a number of channels:

- Income Taxation for several marginal rates with rising incomes (including property tax increases in the margin with rising property values). The effect is mitigated somewhat by the many opportunities for tax deductions.

- The universal Danish welfare model implies that public service is freely available to citizens regardless of income. This means that there is a significant redistribution of risks for low-income groups. Redistribution of risks occurs for example in education, childcare, health care and housing.

- Finally, there is a redistribution of income from rich and middle income groups to poor and low-income groups through income transfers such as unemployment benefits, income support, early retirement and pensions and many other transfers.

The progressive increase in marginal taxes requires that low-income groups, in principle, pay relatively less in income tax than middle income and high income groups. Because of deductions and because other taxes (VAT and excise) are added to the consumption charges, the overall effect of the progression is significantly reduced.

Statistics Denmark's total record of payment of special taxes (2008, Annex Table 6, BH11) shows that the overall taxation of income taxes and taxes on production only makes a modest difference in the percentage of taxation. Thus, the total taxes for students are 39% of the total income, for the middle-income bracket it is 43%, but high income groups pay just 46%. This is despite the fact that the marginal income tax rates have increased marginally.

For income transfers, there are significant redistributive effects. The same survey shows that cash transfers represent. 52 and 56% of the income for students and senior citizens respectively, but only 8% on average for the base income earner and 4% of the total income for the high income earner.

There is an extensive and dense safety net of transfers from middle and high income groups to low-income groups or individuals outside the labour market.
Approximately 1.7 million Danes receive cash transfers from the 2.8 million Danes in the labour market.

In 2008 the group received a total of DKK 290 billion or 32% of the total government budget. The main budget goes to people who are permanently on transfer payments, i.e. old age pensioners, disability pensioners etc. Other funds temporarily go to the recipients of unemployment benefits.

Income groups with less than DKK 300,000 in annual household income are net recipients of cash benefits from the government, less tax. Above that threshold, we are talking about net contributors on average.

Income transfers happen both over time and across generations so that children and young people receive free services or services at low prices or income transfers. Families with children receive child benefits.

Older people have paid tax with progressive marginal income tax rates throughout life, and so their taxes have funded previously retirement income transfers from the state. This means that people with high tax rates have paid more for the state pension than people with lower income tax rates.

Upon the disbursement of public pensions there is a reverse tax effect. Everybody who has an income below a certain level, receive a full or partial basic pension allowance.
Furthermore, there are significant additional pension payments to people with low income. They can obtain additional pension allowances on par with the state pension, housing allowance, health allowance, etc. and also a senior citizens check for very small incomes (approx. 10,700 DKK pr. year).

Income transfers over different stages of life (child benefit, education and pensions) therefore have a direct redistribution effect on the tax side, as well as transfers and services.
On the labor market the unemployment benefit, sick pay benefits etc. only has the effect that benefits always are redistributed between people who are employed or unemployed, and between the sick or the healthy.

Other examples can obviously be used and will give the same result that are either allocated to the different stages of life or are redistributed among individuals with high and low risks.

Question 2

In 2006 the Danish Parliament accepted a welfare accord, which changes the design of many parts of the Danish welfare system.
The reform was prepared by the welfare commission, whose analysis led to:

1. There will be a shortage in the future.
   The projections to 2040 show that the total workforce drops by 400.000 places until the year 2040.
2. The commission proposed that pensions and retirement age should be increased. That VERS should be abolished, education improved, income taxes reduced and the integration of immigrants in education and the labor market must be improved.

On that ground the Parliament agreed on a welfare accord:

1. Retirement age and VERS should be increased from 2019, with ½ a year per year.
2. Retirement age in public pensions will be increased with ½ a year per year after 2024.
3. Thereafter for both VERS and public pension programs, the retirement age will follow the increase in the life expectancy.

To analyze the impact of the 2006 accord it is important to realize, that the government can only change retirement age in the public programs. People could save money for themselves and jump much earlier.
THE PUSH, PULL, JUMP THEORY TELLS:

PULL - has to do with the conditions in the environment that makes it attractive for employees to retire. The appeal of leisure time, autonomy over one's time, or to incorporate new activities into a new life, with the prospect for most around 20 years.

PUSH - are the factors like illness, unemployment, productivity or technology that might be pushing older employees out of work.

JUMP - factor comprise action taken from ones free will and desire – to leave the labor market from social and physiological motivations.

When the 2006 accord change the retirement rules so that the retirement age change from 65 years today to 71 years in 2050, we have to look at the Pull factor. The economy "pull" to the retirement changes slowly from 65 years to 71 years, looking isolated on the public pension schemes and provided the push-impact does not change.

The exact age of the "jump" will depend on many other factors such as:

- The effect of other pension savings schemes including the rules for the start time in the pension schemes and the actuarial effect
- The effect of other savings
- And the companies' willingness to hire and retain seniors. Including unemployed seniors' opportunities to receive transfers from other schemes.