Country Report

Denmark

Current pension system: first assessment of reform outcomes and output

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DENMARK

The Institutional Architecture

Denmark is one of the few countries in the world that copes well with the challenge of providing its citizens with both a flexible labour market and with socially adequate old age pensions that are also fiscally sustainable. The complex mix of Danish *flexicurity* and old age security has developed over the last two decades as an incremental process, leading to the so-called Danish employment miracle. This brought the unemployment level form over 12% in the early 1990s to a nadir of 1.7% in 2008, while securing reasonable income replacement to the vast majority of the population.
Denmark is often described as one of the first that adopted a multipillar pension system consisting of both Beveridgean (a flat-rate residence-based national pension) and various Bismarckian elements, of which private occupational pensions based on collective agreements have the lion's share. The universal character of basic income security in old age, coupled with quasi-mandatory supplementary pension savings means that most of the elderly are not at risk of social exclusion during retirement.
The main problem with regards to occupational pensions is directly related to their linkage to collective agreements. Contributions are precluded to people who are temporarily outside the labour market, due to parental leave, unemployment or sickness. This is amended by augmented contributions to the funded components of the first pillar, which, however, do not compensate entirely for the loss of income.
In sum, improvements to the system are of course possible, however, the Danish social security system's defects are negligible in comparative perspective.
The **first (state and mandatory) pillar** consists of two tiers and it is universal in coverage.
The *first tier* is a residence-based national pension (*folkepension*), which is composed of two different elements: i) the basic amount, which is flat-rate and tied to length of residence; and ii) the income-tested pension supplement
The *folkepension* is PAYG and tax-financed from general budget revenues, where the central government reimburses municipalities for their pension expenditures. The normal retirement age is currently 65 for men/women but will increase to 67 during the period 2024-2027 by half year each year. The minimum qualifying period for Danish citizens is 3 years of residence between the age of 15 and 65/67 and 10 for non-Danish citizens (including the last 5 before retirement).
The full basic amount is earned after 40 years of residence and is reduced pro-rata by the number of years of residence missing to 40. The maximum monthly rate of the basic amount before tax for 2009 was DKK 5,254 (in 2008 DKK 5,096, i.e. circa 17.5% of average earnings). The basic amount is subject to means-testing based on income from work only (other pensions are not taken into account). In 2008, the basic amount was reduced for annual earnings greater than DKK 259,700 (if living with a partner, DKK 179,400).
The maximum monthly rate of the pension supplement before tax for 2009 was DKK 5,289 for singles and DKK 2,470 for couples (in 2008, DKK 5,130 and DKK 2,396, respectively). The actual amounts are tested against all sources of personal income (including ATP, SP and occupational pensions) apart from the public pension. Hence, in 2008, for yearly individual earnings greater than DKK 57,300, the targeted pension supplement was reduced by 30% of the excess income. For couples this income test was calculated on income beyond DKK 115,000 at a rate of 15%.

Early retirement is possible through various arrangements. The *anticipatory pension*, which may be awarded to persons aged 18 to 65. Eligibility depends on the applicant's working capacity, in case it is permanently reduced or to such an extent that the applicant is unable to provide for himself or herself by means of a remunerated job. At 65 the recipients of an anticipatory pension are transferred to the *folkepension*. The maximum monthly benefit granted by the anticipatory pension for 2009 (before tax) was DKK 15,704 for singles and DKK 13,348 for married or cohabiting couples.

Partial early retirement is also an option, but is being phased out and is currently available only to people born before 1959. Eligible are people aged 60-65, residing in Denmark, employed full-time for at least 10 of the last 20 years, and continuing to work for 12 to 30 hours a week. Employees must have participated in the ATP scheme for at least 10 of the last 20 years and worked at least 18 of the last 24 months in Denmark. A self-employed person must have worked full-time during the last 5 years, been self-employed in Denmark for at least 4 of the last 5 years (including 9 of the last 12 months), and must reduce working hours on average to 18.5 hours a week. In 2008, the maximum annual partial pension was DKK 98,392 (work reduced to 12 hours p.w.). The minimum annual pension for a self-employed person was DKK 27,555.

Finally, there is a *voluntary early retirement programme* linked with unemployment insurance, which pays benefits between ages 60 (increasing to 62 during 2019-22) until the normal pension age. To qualify, individuals must have been members of the unemployment insurance fund for 25 years within the last 30 years and have paid voluntary early-retirement contributions. The benefit amount corresponds to the rate of unemployment benefits, subject to a limit of 91% of the maximum rate of unemployment benefit (differentiated for full- or part-time workers). Combining voluntary early-retirement benefits with the *folkepension* is disallowed. Hence, beneficiaries revert to the standard old-age pension once they reach the normal retirement age of 65.

Benefits arising form both components of the *folkepension* as well as from the anticipatory and partial pensions are indexed once a year to the growth of average wages (based on an index of wage increases during the two preceding years). However, if the increase exceeds 2%, then 0.3% is transferred to a fund used for the improvement of other cash benefit schemes.

The Danish first pillar's *second tier* consists of a number of fully funded supplementary schemes (and a smaller PAYG one), with varying purposes and operational structures.

The Supplementary Labour Market Pension Fund (*Arbejdsmarkedets Tillaegspension*, ATP) is meant for all employees between 16 and 67 if working time exceeds 9 hours a week. ATP was introduced already in the 1960s. It is financed through fixed-sum contributions (decided by social partners as part of collective agreements) paid by both employers (2/3 of total) and employees (1/3). Contributions depend on the number of hours worked, e.g. for a full time employee with 37 hours per week contribution was in 2009 DKR 3,240 (approx 1% of the average national wage). Their valorization changed in 2008 and is based on swap interest rates as opposed to a fixed nominal interest rate.

The ATP has the same age requirements as the *folkepension*, hence one has to retire at 65 (67 since 2027), and there is no minimum qualifying period. However, deferred retirement is also possible, until 70 before 2009 and currently at 75. From 2010 employers must pay ATP contributions for employees even if one defers retirement and also in the case she is already a pension recipient. Before 2010, contributions were not compulsory after the statutory retirement age. Deferral guarantees a much higher ATP pension, guideline increase percentages range from 8% for 1-year deferral to 130% for 10 years.

ATP pays its benefits depending on the size of the pension at 67. A monthly benefit is paid out if the benefit is greater than DKK 2,480 a year; as a yearly annuity if the benefit amounts to between DKK 1,240 and DKK 2,480; and as a lump sum if the benefit is lower than DKK 1,240 a year.

The ATP has an important social function, which is not fulfilled by the occupational private schemes due to their employment-related nature. In fact, people on maternity leave or recipients of unemployment benefits have their contributions to the second pillar discontinued. To compensate for that, the ATP contribution is doubled with respect to the parental or unemployment benefit.

Maternity, paternity and parental benefits are granted for up to 52 weeks in total. During this period, beneficiaries pay 1/3 of the contribution, while 2/3 are paid by the respective municipality. Those caring for children beyond the maternity period and who are not employed, typically switch to another scheme, which also carries an ATP contribution.

During unemployment (which can be up to 2 and half years long), an unemployment insurance fund (or municipality if the recipient is uninsured) takes over the payment of ATP contributions. The government pays 2/3 of the contributions when unemployment insurance is exhausted and the individual is still unemployed.

On average, a full ATP benefit after 40 years of employment grants a replacement rate of 7%. Even though the amount seems negligible, it is of crucial importance for low-income workers.

The Special Pension Savings scheme (*Særlig Pensionsopsparing*, SP) is a fully funded scheme for employees, self-employed and recipients of unemployment and sickness benefits. The contribution rate is 1% of earnings (no ceiling is applied) and investments are managed centrally. As from 2005, members choose their manager and portfolio. Benefits are paid out as a lump sum or over 10 years (depending on the accumulated amount). Contributions to the SP scheme have been suspended since 2004 and the scheme is officially closing down in April 2010. Those who are currently insured must either withdraw now or transfer the accumulated sums into another fund.

The Supplementary Labour Market Pension Scheme for Disability Pensioners (*Supplerende arbejdsmarkedspension*, SUPP) was introduced in 2003 and is a voluntary funded scheme to top up disability pensions. SUPP contributions equal 2.8% of the disability pension, whereof 2/3 are paid by the government. SUPP benefits are either paid out as an annuity, if the accumulated sum exceeds DKK 17,813.23 (as of 2009), or as a lump sum if it does not.

Finally, for some groups of civil servants, there is a special earnings-related pensions (*tjenestemænd*), whose participation is, however, very restricted – in fact most members are either high-ranking officials and priests. It is the only purely PAYG scheme in the *second tier*. The minimum qualifying period is 3 years. Benefits are service-related and calculated according to a final-salary formula. Full benefits amount to 57% of the last wage if the person has 37 years of employment and are reduced for early retirement or less than 37 years of qualifying period. Benefits are indexed according to the growth of civil servants' average wages.

There is an additional supplement for low-wage civil servants to compensate them for a decline in the pension benefit as a result of the new calculation system. The supplement will be phased out in 2022.

All pension benefits above are taxed as income from work or by using specific tax rates.

The **second pillar** consists of quasi-mandatory, privately managed fully funded occupational schemes. These are based on collective agreements stipulated by social partners. Their coverage has increased exponentially during the 1990s, when the private sector was formally included. Collective agreements provide supplementary pensions to an astounding 93% of Danish wage-earners aged 30-60 (some 80% of total), which is even more than in the Netherlands, the other country coping well with occupational pension coverage. Even more impressive is the fact that the remaining 20% does not pose a particularly pressing problem for the future social adequacy of Danish pension arrangement. In fact, only two categories of workers are currently not covered by collective agreements: i) young, precarious workers, which under the Danish provisions for flexicurity will with high probability land with a job

providing occupational pensions; ii) high-income private employees, usually employed as middle management or above, who do not require this type of arrangement and usually resort to other, individual forms of supplementary savings.
The retirement age is the same as in the first pillar, i.e. 65 increasing to 67, but there are possibilities to retire already at 60. Contributions to occupational pensions range between 9% and 17% of gross wages, and are to a large extent tax deductible. In 2006, the percentage for the majority of Danish workers has been raised to 10.8%. During accumulation there are quantitative restrictions to investment, but at the same time, the law specifies a minimum interest rate of 2%.
Benefits are calculated using actuarial principles, thereby basing the end value on the contributions paid in, the interest rate, average life expectancy and the risk profile of the individual fund. Since 2000, the annuity calculation must use unisex mortality tables. Occupational pensions are Exempt Taxed Taxed, meaning that pension benefits are subject to income tax at the time of payment and annual interest gains are taxed during accumulation. Annuitisation is not compulsory, as many schemes allow lump sum withdrawals. There is no guaranteed indexation of occupational pension benefits.
As already mentioned in the introduction, the main problem with regards to occupational pensions is that they do not cover other labour market risks. Periods outside of employment do not entitle to the payment of any contributions, hence, compensation is delegated to other parts of the pension system (the ATP scheme in most occasions).
Finally, the **third pillar** consists of voluntary, supplementary pension schemes, managed by banks or insurance companies. Investment is regulated, indexation is not mandatory. Contributions are tax deductible but interest and benefits are taxed. Enrolment is very high, circa 1 million people.

The Administrative Structure

Due to the multi-tiered nature of the Danish pension system, its management is performed at multiple administrative levels. The national pension is administered by municipalities, under the supervision of the Ministry of the Interior and Social Affairs (*Indenrigs- og Socialministeriet*). The central government finances national pension expenditures and municipalities have no influence over the nature and amount of pension benefits.
ATP and SP are administered by ATP, which is a private organization set up by law and governed by the social partners under the supervision of the Ministry of Employment (*Beskæftigelsesministeriet*). As for the SP, since 2005 it is possible to move contributions to private insurance companies and since 2010 it is compulsory (so this part of the system becomes *de facto* the third tier of the first pillar). Either the ATP or a private provider, such as a bank or life insurance company, administers the SUPP scheme for recipients of disability pensions.
The Ministry of Finance manages the civil servants' pension for those working for the institutions of central government. Local governments, instead, set up a special institution, the *Kommunernes Pensionsforsikring*, which manages pensions for their employees.
As for occupational pension schemes that are part of collective agreements, there is usually one pension fund per agreement. All funds' boards are composed of employee and employer representatives. Often, employee representatives have the majority of seats. As for individual supplementary schemes, these are rather fragmented. Two associations cover private insurers: one for insurance companies (*Forsikring og pension*) and one for banks (*Finansrådet*). Both second and third pillar funds are monitored by the Danish Financial Supervisory Authority (*Finanstilsynet*) under the supervision of the Ministry of Economic and Business Affairs (*Økonomi- og Erhvervsministeriets*).

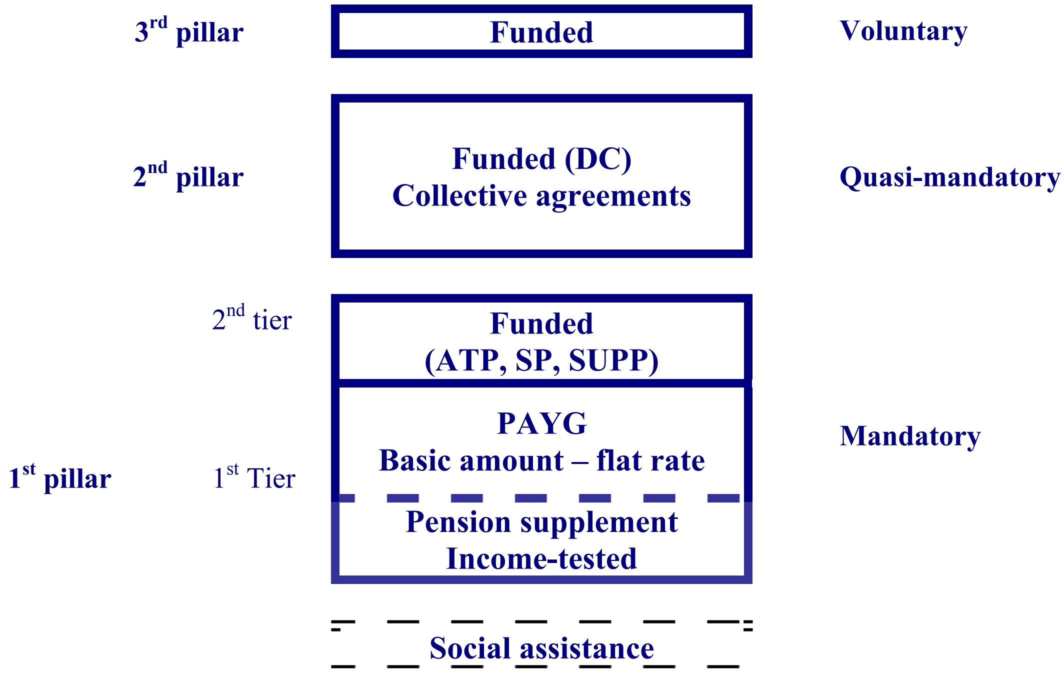
Assessment and Future Challenges

Danish retirement is sometimes described as a World Bank pension scheme due to its multi-tiered nature. If compared to the original recommendations of ‘Averting the Old-Age Crisis’, this seems to be a crude approximation. Danish retirement has been shaped by incremental reforms that lasted more than two decades, which have little to do with the clean slate approach advocated by the Bretton Woods institution.

In general, it can be stated that Denmark, alongside a very small number of other countries, e.g. the Netherlands, successfully combines the fiscal sustainability of its retirement system with quasi-universal social adequacy. There are very few categories of people (and almost no one among Danish citizens) who fall out of the system or do not receive socially inclusive benefits. This is, however, not only the merit of a complex, yet very articulated pension legislation, which provides coverage to advantaged and disadvantaged groups alike, but also to the flexicurity model that Denmark built up since the 1990s.

Hence, the example of Denmark illustrates that the old age problem has to be tackled both from the pension as well as the labour market side in order to secure satisfactory results. Whether the overall Danish employment-retirement system is replicable abroad is, however, questionable due to its contingent character and incremental evolution.

Figure 1 The Main Pillars in the Danish Pension System



1st Pillar, universal coverage (residence-based);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Denmark

Contribution rates	**2009**
Folkepension	**None**
ATP	**fixed amounts, circa 1% of gross wages**
SP	**1% of gross wages, but closing down**

Supplementary schemes	
Contribution rates (2006)	**between 9% and 17% of gross wages, 10.8% on average**
Coverage (of employees)	**93% of wage-earners aged 30-60 (80% of total)**
Assets in EUR bln (2007)	**185.1**
Taxation	**Exempt Taxed Taxed**
Investment principles	**Quantitative Restrictions**

Theoretical replacement rates	**Gross**			**Net**
	1st pillar	**2nd pillar**	**Total**	**Total**
2005	**45.1%**	**3.6%**	**48.7%**	**71.3%**
2050	**39.2%**	**24.8%**	**64.0%**	**76.1%**

SILC income 2004	**Total**	**Male**	**Female**
Relative income of 65+	**0.700**	**0.718**	**0.695**
Aggregate rep. ratio	**0.353**	**0.325**	**0.388**

Eligibility retirement age	
Old age	**65 for women/men (will increase to 67 during 2024-2027)**
Early retirement	**various schemes, usually not before 60**
Deferred retirement	**in ATP, up to 75**

Indexation	**to average wage growth, if this exceeds 2%, 0.3% is being transferred to a special fund financing other cash benefits**

Public pension spending (as % of GDP)	**2004**	**2020**	**2050**
	9.5%	**-**	**12.8%**

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