Danish Welfare Model – Fall 2012

Question 1:

The Danish Flexicurity model consists of three components flexible hiring and dismissal rules ensuring a high mobility of the Danish labor, active labor market policies that contribute to a rapid return to work for the unemployed and a generous unemployment benefit, which gives relatively good social security during unemployment.

This implies a relatively high "Job turnover" - (job creation and job rotation). At the same time, the Danish Flexicurity model the most expensive in the world. Unemployment Support and activation is rated among the highest spending in the OECD circuit goal percentage of GDP.

The model is not designed as a master plan, but is grown from laws, initiatives in companies and organizations and was in 1990 known in the world under the name Flexicuritry.

Thus, the European Council asked the European Commission to look at the Danish model in 2006 and a report was published in 2007.

Most people in Denmark are employed in the service sector where education and high skills in labor productivity is crucial to competitiveness. During the development of and trimming of labor market policy from the 1990s to the 2000s (by reducing the benefit period) structural unemployment dropped significantly. During the economic crisis, the economic effect was strongest in 2009 in Denmark compared to many other countries; unemployment did not increase dramatically (from 4 to 7%). However, there is still a risk of financial disincentives especially for low-income area where (replacement rates) is particularly high in unemployment benefits.

However, in these crisis times there are particular problems, immigrants have particularly high unemployment and groups such as young people between 25 and 29 years and later in the crisis phase seniors experienced an employment marginalization.

The "Golden Triangle" in Flexicuruty may be stretched or disrupted if one or more assumptions burst. A deterioration of the unemployment benefit, as happened in 2010, from 4 to 2 years, may cause pressure on the notice period in contracts. A General agreement between the politicians and the labor market. After the financial crisis the weight of the longer notices period occurred. In that way it reached 3 months in the "blue collar market", against the 6 months that already existed on the "white collar market". This somewhat weakened the flexicurity model.

The models response to the financial crisis was first and foremost the unemployment benefits, etc. that served as one of many automatic "economy stabilizers", stabilizers, restricting consumption to fall further. The high mobility of labor combined with incentives in the short-term benefit period has certainly stopped raise in wages and thus contributed to a competitive improvement / less competition deterioration.

On the other hand it strained public spending, as applicable public resources for transfers and servicing of labor market policy.

This part of the effects has helped to build a bridge over the poverty trap many could have fallen into at a time when unemployment is rising.

The Flexicurity model is sought introduced in France and Germany, but without result.

Question 2

A welfare state design depends not only on the sources it uses to finance the costs, but in as much of the objectives of the welfare state enforces. The welfare and economic strategies can range from wanting to fight poverty, to increase equality in society, but also the strict financial requirements: to create the best possible incentives to supply labor, economic growth, and balance in the economy, such as fight the inflation and improve competitiveness.

In recent years, the welfare state design is reconsidered with a view to sustainability in relation to future challenges. Here is the question of the welfare model is sustainable to the development in the future demographics, or to the increasing globalization and the increasing individualization. It is ultimately a question of economics of the public sector in the very long term. Is it a durability problem, then the deficit of public budgets increased over time relative to GDP (English GDP). Therefore it is crucial the political economic instruments to be installed. The individual instruments have different effects on the components of the macro economy.

The tax-funded model also known as: *Defined Benefit* implies that the services are politically determined and financed not certain but from the general taxes. This instrument enables the redistribution of income from rich to poor. This is done for example through progressive income taxes combined with higher benefits and subsidies for low incomes. It can increase consumption and smallest savings for those redistributed from those with a high savings rate for those with low quota. The strength is also the model hedge against inflation, in the sense that if inflation increased adjusts transfer payments and services often the case is that there is compensation. Finally, there remain in Denmark many groups that are poorly covered with old age pension, so that the state pension as may pose a safety net that brings pensioners above the poverty line.

Conversely, a demographic with more retirees and fewer people in the labor mean that the economic is viability undermined. In Denmark, politicians through large consensual settlement secured the *Defined Benefit* model's interim survival by increasing the retirement age in pension systems. But there are still issues to rise. Labor taxes can distort the incentive structure of labor supply, just as through wage effects may impair the country's competitiveness. Finally, pensions do not secure. They are like all other public expenditure subject to political risk. A future policy decision could fundamentally change the basis for pension increase, although pension goes under the concept of defined benefit.

The situation is different with funded (Defined Contributions) built systems.

On the one hand it implies a funding that each generation saves for themselves, thus. On the other hand, the pension market dependent, but not completely independent of politics as politicians at any time may change as: fiscal environment. The model seems quite durable to demographic changes. It will in principle also contribute to an increase in savings. However, it is difficult to apply funded schemes for redistribution between rich and poor. In addition, fiscal instrument involved. It is a significant risk that the fund dependent pensioners referred to market risks, and must leave their dependents made through riskier return on equities, real estate and bonds, than the more secure tax-financed pension. Fund savings are not guaranteed against strong fluctuations in inflation.

On the other hand, the fund savings by virtue of its actuarial management significantly better incentive structure in the labor market. When you decide to leave the labor market later than the established retirement age you will be favored with an enhanced pension economy (several years more savings at a higher rate, either for life or in installments and capital pensions)

How a welfare society puts together its instruments depends on its objectives. From Singapore which fully finance their welfare measures through a government fund forced membership and contribution funding to the Nordic and Dutch model that much more is earned based on tax financing. But even in Denmark we see a softening through a complex financing of both defined benefit and defined Contributions schemes. The welfare state involves many objectives, many of them conflicting. It requires the use of many instruments, including a combination of both securities and tax plans.