



Denmark: Reform aimed at raising the effective retirement age and removing disincentives to private retirement savings

ESPN Flash Report 2017/48

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JUNE 2017

The new Danish pension reform improves incentives for postponing retirement and for pension savings for persons in the later years of their career while also strengthening residence as a basis for entitlement to the universal national old-age pension.

Description

Albeit praised for its integrated multi-pillar character, the Danish pension system has two widely-acknowledged problems in pension provision resulting from the interaction between the public and private pension pillars. The “coverage problem” refers to the fact that the 20-25% of the working age population who are not covered by the system of occupational pensions tend to have much smaller supplementary retirement savings, if any at all. The “savings disincentive problem” means that low to middle income workers, covered by occupational pensions, reap little to no benefits from the savings they accumulate during their last decade on the labour market because the extra private pension entitlements accruing result in a reduction of the pension income-tested part of the universal national old-age pension (the non-contributory old-age pension which any resident is entitled to). This second problem may have adverse effects on work and retirement decisions.

On 20 June, the government and the Danish People’s Party reached agreement on various changes related to pensions and retirement, including measures to address the savings disincentive problem.

To reduce savings disincentives for workers in later life and to postpone retirement and prolong working lives, the agreement sets the annual maximum contribution that can be paid

into old-age savings (Aldersopsparing) without leading to reduction in the pension income-tested part of the national pension at €670 for individuals with more than five years until the pensionable age (of particular relevance for people on a low income) and at €6,700 for individuals with less than five years to retirement and individuals already claiming a national old-age pension, as long as they have not already begun to draw down their pension savings. Today the annual maximum contribution is €4,000 irrespective of time to retirement.

The parties have, furthermore, agreed to set aside a sum of €33,600,000 to reduce taxation of contributions to retirement saving schemes.

To increase incentives to continue working, the earliest date at which one can begin to draw on tax-subsidised retirement savings was reduced from five to three years prior to the pensionable age for the national old-age pension.

In line with the growth in life expectancy, the maximum duration of annuity pensions will be increased from 25 years to 30 years.

To entice insured persons to give up their entitlement to early retirement with a Voluntary Early Retirement Pension, it will now be possible to get a tax-free refund of the tax-deductible contributions paid.

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The agreement introduces greater flexibility of financial incentives to postpone the claiming of a pension till after the ordinary pensionable age. Persons who retire later than the ordinary pensionable age receive a permanent supplement to the pension when in retirement. In addition the agreement introduces the possibility of getting this supplement paid as a 10 year annuity or a lump sum. The agreement allows persons to choose between the supplement paid as a permanent benefit, a 10 year annuity, a lump sum, or a mix of an annuity and a lump sum.

The use of residence as a principle for calculating pension entitlement is extended from the national old-age pension to include the cheque for the elderly (an annual lump sum) and the disability pension.

Moreover, the benefit formula has been changed. Since 1973, each year of residence in Denmark between the age of 15 and the pensionable age has entitled a person to 1/40 of the national basic pension. The new formula will require people to have resided in Denmark for a minimum of 9/10 of the years between the age of 15 and the pensionable age to become entitled to a full national old-age pension, full cheque for the elderly or full disability pension.

The agreement also brings rules for refugees' disability pension entitlement into line with the new benefit formula.

The measures to promote longer working lives and later retirement also include the establishment of a new think tank (for three years), more intensive information about postponed retirement options and a review of the special rules and employment policies for older workers.

Because the agreement did not address the "coverage problem", the parties decided to discuss it as

part of a planned Phase II of the so-called Job Reform in the Autumn of 2017.

The agreement is part of the Government's repeated attempts to increase labour supply and reduce taxes, which formed part of its now shelved plan for budget developments until 2025 (see also ESPN Flash Report 2016/66).

Most changes will come into force either on 1 January 2018 or on 1 July 2018.

Outlook & commentary

Reception of this pension reform agreement has been mixed. Trade Unions find it "unclear and expensive for the insured" (HK), "not sufficient and in need of additional measures" (FTF), and "too small and socially unjust" (LO). Employers say the agreement is a "good start but not enough" (Federation of Employers, DA). Some pension funds find it "hits those who work the most and earn the least which is not fair" (Pensam) and the association of insurance companies and pension funds finds the reform "inadequate and overly complicated" (Forsikring & Pension). The opposition is against the pension reform. For example, the Social Democrats made a statement saying "the government has not solved the problems for ordinary hardworking people". Moreover the opposition points out that in the longer term the reform is unfinanced.

Indeed, low income groups would benefit more from a long period with medium sized contributions to old-age savings (Aldersopsparing) than from five years with high contributions and many years with low contributions. Within the low and middle-income groups, many persons will not have the funds to benefit fully, just as a minority will

not be working five years prior to the official pensionable age.

However, the negotiations on addressing the "coverage problem" in the pension system in the Autumn of 2017 are likely to become even more difficult, due to widespread opposition to mandatory savings, as described in the ESPN Flash Report 2016/66.

Further reading

Government and Danish People's Party (2017): Flere år på arbejdsmarkedet (Agreement on more years on the labour market), Copenhagen 20 June 2017: <https://www.fm.dk/nyheder/press/meddelelser/2017/06/ny-aftale-om-flere-aar-paa-arbejdsmarkedet>

Kvist, J. (2016): Danish government proposes mandatory savings, ESPN Flash Report 2016/66.

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