FEBRUARY 2008 Policy Brief

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Economic Survey of Denmark, 2008

Summary

The Danish economy has been performing well over the past decade and combines a relatively high level of GDP *per capita* with a narrow income distribution. Strong growth in recent years has brought the economy to its capacity constraints. A strong positive output gap has emerged; unemployment reached a 30 year low already by mid 2006, and it has fallen further since then. Avoiding overheating is an urgent challenge. Private-sector agreements from spring 2007 avoided unsustainable wage hikes, but local agreements now show some acceleration, and with yet higher demands in the public sector, a general wage spiral could be set in motion. Given these risks, fiscal policy should not add stimulus: priority initiatives should be offset by savings elsewhere; and excessive public-sector wage growth and continued spending slippages in municipalities and regional authorities should be avoided.

Over the past decade, an increasing share of GDP has been channelled towards public services like health, education and care for the elderly and children. But looking ahead, the room for additional spending in these areas is limited by demographic changes and early retirement. At present, more than half of those aged 60-64 leave the labour market through the voluntary early retirement scheme, and this five year scheme will be maintained even after 2019, when the general retirement age is gradually raised. Denmark faces a strategic choice: either promoting employment-oriented reforms or developing mechanisms for private funding for services that are publicly funded today. The first option is probably the best, as it goes hand-in-hand with the ambitious – but costly – priorities in Danish social and welfare policies. And effectively the government's 2015 Strategy takes this direction by positing higher structural employment and no reduction in average hours worked in a context where demographics would imply a decline in both.

Ensuring that the sound fiscal position is sustained. The targets in the 2015 Strategy are sensible, but clearer mechanisms are needed to ensure they are met. In particular, adherence to the stipulated annual growth rates for public consumption is vital, as experience shows that it is very hard to reverse overruns.

This Policy Brief presents the assessment and recommendations of the 2008 OECD Economic Survey of Denmark. The Economic and Development Review Committee, which is made up of the 30 member countries and the European Commission, reviewed this Survey. The starting point for the Survey is a draft prepared by the Economics Department which is then modified following the Committee's discussions, and issued under the responsibility of the Committee.

Helping marginal groups to secure a foothold in the labour market. Strong demand as well as activation and benefit reforms have successfully brought down unemployment, but more than one in five working age adults still live from passive income benefits – substantially more than in other countries. Activation could be more cost effective and benefits could be adjusted to give participants clearer incentives to get the most out of activation.

Promoting labour supply and skill acquisition through tax reforms. With one of the highest tax-to-GDP ratios in the OECD, Denmark should constantly consider how to refine the tax structure to reduce distortions. Social security contributions, income and consumption taxes combined create a marginal tax wedge of over 70% for four out of ten full-time employed. Reducing the top tax would help stimulate labour supply and it would cost relatively little.

Sustaining generous public insurance for healthcare is feasible if clear priorities are set and efficiency continues to be raised. The introduction of activity-based funding, along with other innovations, has ensured that the strong growth in spending has been matched by increased treatment activity. Looking ahead, spending pressures call for adoption of cost-saving technologies and mechanisms to avoid overuse. Health and employment services could be more responsive to those health problems that are part of the complex processes leading a growing number of people to be outside employment.

The occupational pension system is a success, but capital taxation needs attention. The main problem is associated with taxation of capital income outside pension funds: in some cases effective tax rates on real returns approach or exceed 100% and the gap between interest deductibility and pension tax rates encourages tax planning. ■

How has Denmark achieved reform?

The average Dane enjoys relatively high standards of living: GDP per capita is higher than in most other European countries, even though the gap *vis-à-vis* the United States remains at 15-20% where it has been for over three decades. A deep commitment to open trade and structural reforms in the markets for goods and services, combined with a cohesive approach to actively helping job seekers gain or regain employment, have contributed to a competitive business environment, low structural unemployment and sound public finances. Building on a consensus to sustain these good outcomes, a set of forward-looking reform agreements has been reached in recent years. The welfare agreement of 2006 – which was supported by an overwhelming majority in Parliament – will link retirement age to longevity. The globalisation strategy of 2006 implies a boost to R&D and higher education and, following tri-party negotiations, unions and employers are now incorporating the financing of life-long learning into the collective wage agreements. Moreover, a new local government structure was established in 2007 which, together with the recent quality reform and the action plan to reduce bureaucracy, will facilitate efforts to make public services more professional and efficient. By focusing on long-term issues the Danish economy will face, these reforms will allow for gradual adjustments rather than abrupt corrections. This approach and reform momentum should be continued as challenges remain in a number of policy areas. Employment rates are high, particularly for women, but average hours worked is low. Productivity growth halved in the late 1990s partly due to reallocation of resources across sectors and wider inclusion of marginal groups in the labour market. Progress in living standards has slowed, even when considering the parallel terms-of-trade gains.

With current strong fiscal revenues and recent reforms, Denmark is preparing for ageing better than most other OECD countries. As part of the 2006 welfare agreement, all age thresholds for voluntary early retirement and regular pension will move up by two years between 2019 and 2027. Thereafter, retirement age thresholds are to be raised in line with longevity, keeping average life expectancy in retirement at a constant 19½ years. Adherence to this indexation principle is vital as it forms the backbone of fiscal sustainability: without that, current standards in publicly funded services could not be maintained in the context of population ageing. However, even within the framework of the welfare agreement, it will be difficult to meet growing pressure to raise service standards in areas like healthcare simply through additional public spending. Indeed, voluntary early retirement (*efterløn*) will continue as a five year scheme also after 2019, acting as a drag on the labour supply of older workers at a high cost to public finances. Thus, meeting growing demand for public services in the long-term will hinge on a mix of further employment enhancing reforms, higher efficiency in service provision and, residually, on adjustments to the balance between public and private roles with respect to funding. ■

How can the sound fiscal position be sustained?

In August 2007, a new medium-term fiscal framework was presented by the government: the 2015 Strategy. Starting from fiscal sustainability as the overarching objective, it stipulates a set of targets that will guide fiscal policy. In line with the preceding 2010 Strategy, net lending adjusted for cyclical and other temporary factors should be in surplus by ¾ – 1¾ per cent of GDP until 2010. From 2011 to 2015, it should at least be in balance. Consequently, a small net asset position will develop while gross debt, measured according to the Maastricht definition, could be reduced to about

15% of GDP in 2015, although this is not an explicit target. The volume of public consumption spending will be allowed to increase, on average, by 1% a year. This implies a slight increase in the share of public consumption spending in cyclically adjusted GDP, although it is required not to exceed 26½ per cent in 2015. Finally, to achieve these targets, the strategy requires actions to counteract the negative demographic impact on working hours and to raise structural unsubsidised employment by 20 000 (0.7%) by 2015. These paths for the structural surplus and net debt imply a reasonable balance between pre-funding and supply-oriented reforms to tackle the fiscal consequences of ageing. The focus on employment-oriented reforms helps to make room for the ambitious – but costly – priorities in Danish social and welfare policies.

Could mechanisms be reinforced to ensure that fiscal targets are met?

The preceding 2010 Strategy has been successful at building consensus for maintaining budget surpluses in good times. The boost to revenues from pension taxation and North Sea oil and gas production in recent years has, to a large extent, been channelled into faster-than-planned debt reduction. This is a remarkable achievement. Meanwhile, the volume of public consumption has grown almost twice as much as envisaged in the original 2010 Strategy, and this tension is set to continue: under the 2015 Strategy, the target for public consumption growth is 1¾ per cent in 2008, but thereafter falls to 1% per year until 2012 and ¾ per cent in 2013-15. The strength of the consensus-based framework to withstand pressures in difficult times might, therefore, need to be enhanced by clearer mechanisms to ensure that the targets are met. In particular, the expenditure ceiling should be applied each year in the sense that if actual and projected spending indicates that the limit on public consumption spending in 2015 may be breached, action should be taken to redress excess spending up front. Indeed Danish experience shows that it is extremely difficult to reverse any accumulated excesses in public consumption growth. Strict adherence to the annual spending targets is vital. It will also promote clearer prioritisation of government expenditures. As much of the spending overrun has traditionally occurred in local and regional authorities, these would need to be better controlled, not least to prevent municipal tax hikes. Transparency could be improved with more accurate and up-to-date statistics on budget execution coupled with clearer consequences for overspending to break the pattern where aggregate public consumption spending drifts above the annual targets. If recent labour market reforms do not raise structural employment by as much as assumed, the requirement for new reforms would be commensurately higher. In this context, it is important that the new labour market commission presents specific measures going well beyond the labour supply requirements of the 2015 Strategy.

Should the government buy assets or repay debt?

Unless the government has more costly liabilities than government bonds, debt repayment should continue. The fixed exchange rate and closeness to the euro area means that euro-denominated government bonds can substitute for kroner bonds in many roles, such as pricing benchmarks and instruments for managing maturity-related interest risks. But re-entry may be associated with higher interest cost after a period of zero debt issuance. Being an oil producer, Denmark faces large fluctuations in revenue: for example, revenue from North Sea oil and gas production has risen by 1½ percentage point of GDP since 2003. If high oil prices continue, purchases of financial assets may then be required. It would then be important to have a clear framework for the prudent and efficient management of the assets. The framework should also ensure that the funds are used in a fiscally sustainable way consistent with the 2015 Strategy. ■

Can the employment gains be made durable?

Following strong economic growth during 2005 and 2006, unemployment reached a 30 year low in mid 2006 and has fallen further since then. Private-sector agreements concluded in early 2007 implied relatively moderate wage growth of 4 to 4.5% a year, but local agreements now have started to react to the labour shortages. GDP growth has slowed recently, but with a large positive output gap, capacity constraints are set to continue. Inflationary pressures are strengthening, and there is a real risk that the achievement of low unemployment could be spoiled in the coming years. Marginal groups, such as immigrants from non-western countries, have benefitted most from the recent strength of the labour market, but to secure a foothold in employment, these groups will need time and stability. It is therefore vital to avoid policies that put the current expansion at risk. Crucial in this respect is to reach a reasonable settlement during the renewal of public-sector wage agreements in early 2008. Demands are currently aired for wages to grow considerably faster than in the private sector, but if met, these wage increases might well spill over into an economy-wide wage spiral with increased inflation to follow.

Why has the record low unemployment not generated inflationary pressure until recently?

These potential risks have to be assessed against changes in the structural rate of unemployment, the NAIRU, and changes in the structure of employment. There is growing evidence that the NAIRU – the rate of unemployment consistent with a non-accelerating inflation – has fallen in Denmark as a result of a combination of factors: benefit reforms and active labour market policies, including greater efforts to mobilise people outside the labour market; hysteresis, as the length of the expansion provides opportunities for the former unemployed to develop work skills; increased supply of low wage workers from the new EU member states; and possibly more decentralised wage bargaining.

However, the decline in the NAIRU cannot fully explain the wage moderation observed until recently. Indeed, actual unemployment has been below any empirically-based estimate of the NAIRU for a while, and the unemployment gap is currently large. The observed wage moderation at the aggregate level can also be partially explained by significant changes in the industry structure towards sectors with relatively low labour intensity. Indeed, wage settlements have already begun to outrun productivity gains in some sectors, but this has not yet emerged at the aggregate level in part because changes in industry structure have helped to contain the overall development in wages relative to labour productivity. In the absence of further major changes in the industry mix, it is likely that the current very tight labour market conditions will strengthen the upside risks to wages and prices.

Have monetary conditions helped to contain demand?

The moderate inflationary pressures observed until recently probably also reflect the fact that inflation expectations have been firmly anchored at a level in line with the European Central Bank's definition of price stability, thanks to the highly credible fixed exchange rate between the kroner and the euro. Meanwhile, interest rates have often been somewhat out of line with the levels suggested by the cyclical position of the Danish economy. In spite of the short-term interest rate increases during 2006 and early 2007, monetary conditions are likely to remain too expansionary for Denmark in the near future, leaving the necessary adjustments to fiscal and structural policies.

Could a fiscal stimulus derail the expansion?

A soft landing would imply a gradual increase of unemployment towards structural levels with an easing of labour shortages. A less benign scenario would emerge if demand growth is not contained in the short run. In this context, it is unfortunate that fiscal policy is set to be eased in 2008 with clear increases in public consumption and tax cuts that are not financed in the short run. Additional demand stimulus will only add to inflationary pressure, leading to a loss of competitiveness and potentially undermining inflation expectations; a major hike in unemployment going well above structural levels could then follow. With house prices above what interest rates and other fundamental factors would justify, such a development could trigger a harsh correction with forced sales and strong house price falls, suppressing investment and adding to the direct effect of higher unemployment on consumption. In the worst case, this chain of events could lead to a prolonged recession. Tackling this risk is an urgent challenge. The government's priority initiatives should be offset by savings elsewhere and other measures so that fiscal policy as a whole does not stimulate aggregate demand. It is vital to avoid excessive public-sector wage increases and overspending by municipal and regional authorities during the year.

How can further gains in employment be promoted?

With the recent strength in job growth, actual employment is well above the structural targets envisaged in the 2015 Strategy. However, this cyclical rise will only be sustained if it is supported by measures to increase durably the labour supply and further reduce structural unemployment. The government's recent job plan recognises this, proposing measures to enhance activation as well as measures to reduce reliance on disability and sickness benefits. A number of these measures could be implemented quickly. Others may require more time, for example those aimed at strengthening the capacity of job centres to implement stronger activation requirements. Rather, measures should be pursued in ways that also help the long-run challenge of fiscal sustainability. These include:

- Focus on job search early in the unemployment spell. This includes immediate assessment of job readiness and referral to available positions.
- Refine activation programmes to make them more cost effective. Ensuring more counselling with job-centre staff and better matching of activation programmes to individual needs should be considered, while putting less time and resources into training which has proven not to be cost effective. In cases where it is cost-effective, compulsory activation could be brought forward to speed up the transition back to employment. Also, training programmes should be structured so that they ensure continued jobs search. Continued evaluation of labour-market programmes is essential given their high cost.

- Activation programmes should focus more on older workers close to moving into early retirement. A special focus on such workers in activation policies, as is the case for young people, might reduce unemployment amongst older workers and possibly even reduce the flow into early retirement.
- Ensure that unemployment benefits support activation. It is important to have benefits early on so that the unemployed can spend time on job search. At the same time, it is important that if the unemployment spell is prolonged, eligibility to benefits becomes gradually tighter with requirements to search for jobs in other areas or to consider changing profession. In particular, for full-time unemployment benefit recipients who had low income and so face a very high replacement rate (up to 90%) for four years, the incentives to consider moving to another part of the country for work are quite limited, since such a move would leave the person with less disposable income than if they stayed unemployed where they are. Reducing the unemployment benefit replacement rate during the period of unemployment should be considered, as has recently been introduced in Sweden. In addition, shortening the duration of part-time unemployment benefits would help promote search for full-time work.

Policies to promote immigration of workers, which is also a focus of the government's job plan, should contribute to easing the current labour shortages. However, Denmark does not have a good track record of integrating immigrants, especially from non-western countries, into the labour market. The gap between the employment rates of native born and foreign born individuals is the largest in the OECD, partly reflecting immigrant characteristics, including their country of origin. Weak integration and the redistributive features of taxes, benefits and publicly funded services imply that low-skilled immigration does not generally improve fiscal sustainability. High-skilled workers may also be discouraged from staying for long in Denmark by the high income tax rates. Accompanying reforms would therefore be needed to ensure also long term benefits from higher migration flows, including policies to encourage high skilled immigrants to stay in Denmark and policies to enhance the skills and employment prospects of low skilled immigrants. ■

What tax reforms could boost labour supply?

Having one of the highest tax-to-GDP ratios among OECD countries makes it very important for Denmark to constantly consider how to refine the tax structure in order to reduce distortions to the supply and allocation of production factors, not least labour. Indeed, the co-existence of high employment rates and low average hours worked also reflects the income tax schedule as labour market contributions, income and consumption taxes combine to create a marginal tax wedge of over 70% from just above average full time earnings. In 2008, the in-work tax credit will be enlarged but, to compensate those not working, there will also be a one-off increase in the level of all income benefits, attenuating the incentive effect of the larger in-work tax credit. To strengthen employment incentives, the in-work tax credit should rather be combined with benefit reductions, as done in Sweden. In 2009, the threshold from where the middle tax is paid will be moved up to be exactly the same as for the top tax, thus improving work incentives for a fifth of the labour force.

Meanwhile, the 15% top tax, which generates a 70% marginal tax wedge for four out of ten full-time employed, has not been cut despite bringing only modest revenue worth 1% of GDP. Estimates of dynamic effects from cutting the highest marginal tax wedge indicate that the rise in the tax base from a less distorted choice of hours worked at the margin would bring back over half of the initial revenue loss. The degree of self-financing could in fact be even higher in the long run when considering the full range of dynamic gains in terms of greater effort, better skill formation, young people starting studies and work earlier, less difficulty in attracting and retaining talented staff from abroad, less do-it-yourself activity, less artificial fringe benefits and the associated possibilities for making capital taxation more neutral. Consequently, if focused on bringing down the high marginal rates, then a financed tax reform is capable of enhancing individual economic welfare, by reducing distortions, as well as contributing to fiscal sustainability and thereby helping to finance public consumption growth in the long run. Given the uncertainty about the size and timing of the dynamic gains, a prudent approach to financing should be adopted. Reducing the high top marginal income tax rate or, as a second-best option, raising the threshold from where it is paid should therefore have priority – but unless cuts are fully financed also in the short run, then it should wait until the risk of macroeconomic overheating has subsided. ■

Can Denmark afford tax-financed healthcare in the long run?

Life expectancy, while relatively low from an international perspective, has been improving in recent years and the gap with the other Nordic countries had narrowed to 2½ years for women and 2 years for men in 2005. Still, cancers result in premature deaths more often than in other countries, and this could partly reflect previous inadequacies in healthcare attention or quality. The government's increased focus on earlier diagnosis and access to treatment, notably for cancer, is therefore welcome. However, having a healthy lifestyle is the key determinant of longevity, and the coming prevention strategy should therefore be welcomed: the stated objective is to raise average life expectancy by three years over a ten-year period. With half of the adult population smoking on a daily basis back in 1980, Denmark was a clear outlier, but now the share has come down to a quarter, just marginally above the OECD average. Meanwhile, obesity is rising, as in other countries, and excessive alcohol consumption, notably among youth, remains problematic. The government's increased focus on nutrition and physical exercise is therefore well chosen, but promoting moderate and sensible use of alcohol should also be a priority for public health policy.

Who should pay for growing healthcare costs?

At close to 8% of GDP, Danish public spending on health and long-term care is only surpassed by France, Iceland and Germany. Indeed, public consumption growth has given healthcare particular priority with the number of physicians employed in public hospitals rising almost 3% annually over the past five years. Nevertheless, as private spending is rather limited, total healthcare spending is close to the OECD average and well below that in the United States or Switzerland. Looking ahead, continued technological advances enlarging the range of effective treatments might intensify spending pressures. Consequently, public funding must be prioritized for where it is most needed.

For costly healthcare needs that arrive unpredictably, there is a clear case for insurance, and the Danish model with tax-financed healthcare may be a relatively well-functioning and simple solution. In this light, the structure of co-payments for Danish healthcare is understandable: it mainly applies to pharmaceuticals, dentists and some treatments, such as physiotherapy. Yet, the share of private spending has fallen in recent years. Consideration could be given to co-payments for general practitioner visits, as exist in other Nordic countries. Annual ceilings, as currently used for pharmaceutical co-payments would maintain equal access and avoid disadvantaging chronically ill and low-income groups. The hardest element to justify from a social insurance perspective, however, is that a quarter of the population aged 65 or over receives publicly funded long-term care, including help with practical tasks like housekeeping for a few hours a week. Norway is the only other OECD country coming close to having such wide coverage. Sweden offers long-term care to considerably fewer older persons – but the presumption of informal care obligations does not prevent 45-64 year old Swedish women from having considerably higher employment rates than their Danish peers. Targeting public funding for practical home help to cases with substantial needs would free considerable resources without undermining equity considerations. It would be a less complicated alternative than having to move part of the funding for core healthcare services over to private insurance or develop individual health savings accounts. The rapid expansion of employer-paid private health insurance should therefore not be favoured with complete exemption from income taxation. Funding diversity helps nurture innovation in healthcare provision, but the tax exemption may create incentives to cover a wide array of wellness services for which insurance is not needed, thereby magnifying the loss of tax revenue.

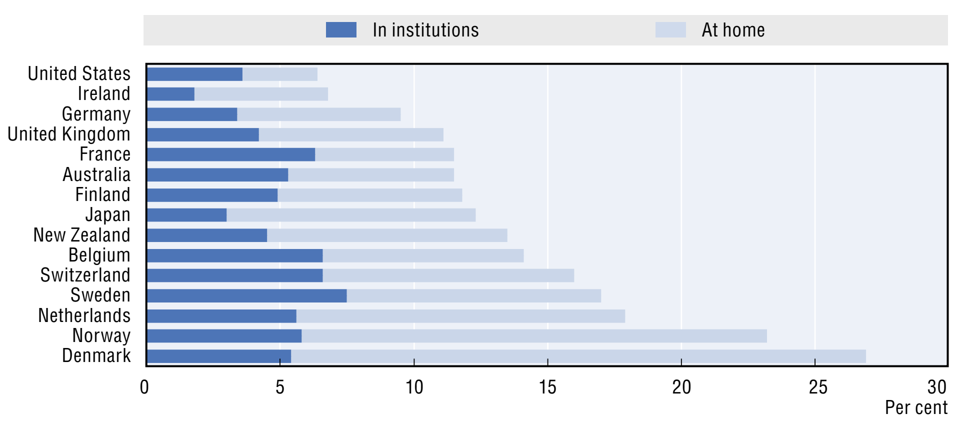
How can healthcare provision be made more efficient?

Following a doubling of the student numbers admitted to medical school in the 1990s, the number of graduates has risen to 4% of the physician workforce in 2005. This is relatively high in international comparison, implying that the physician workforce is set to grow along a path above what can be expected for most other OECD countries. For nurses, current shortages and growing demand could be eased if more worked full time, as currently 6 out 10 work part time. There is also scope for reallocation of tasks among health professions to improve efficiency, technology adoption and accommodate staff shortages.

Figure 1.

OLDER PERSONS RECEIVING LONG-TERM CARE

Share of population aged 65 or more



Note: Only formal/paid care is included; 2004 or latest available year. Institutions include also adapted living facilities with 24 hour care provision at nursing-home level.

Source: OECD Health Data 2007, October 07.

Increased use of activity-based funding mechanisms appears to be a key factor behind strong productivity improvements in hospitals. Indeed, the ample spending growth of recent years has been more than matched by increased treatment activity. Waiting times have shortened by 6 weeks (20%) from 2002 to 2006. Activity-based funding can still be refined, but the strength of incentives might be maintained broadly as it is today. Meanwhile, the role of private-sector healthcare providers could be expanded via both contracting and choice to ensure contestability and spur innovation. Choice in home care introduced five years ago has successfully created contestability *vis-à-vis* public agencies, even though the effect is still limited in areas where the market share held by private providers is small. Finally, public health sector pay schemes might be developed more in line with the private sector with elements of team-level and individual pay flexibility to make it easier to nurture skill development and effort.

Could the system focus more on the health problems that matter most for labour market attachment?

Wide labour-market participation is necessary for fiscal sustainability and thereby for good-quality healthcare to continue to be affordable for society. The healthcare system itself has a role to play here, by helping people with health problems maintaining, if possible, a foothold in the labour market. From 2001 to 2007, the share of 15-64 year olds receiving some form of sickness or disability-related income benefit increased from 9.6% to 11.2%. Meanwhile health care provision has grown mainly for persons aged 65 or older. Better coordination between the health and employment services could help to address, early on, health problems that are part of the complex set of factors that can lead to prolonged detachment from the labour market. Several measures could be taken:

- Establish a national strategy to identify and prioritize the preventive and curative measures that will help maintain labour market attachment. Give the new coordination committees, involving all municipalities within each regional authority, a clear responsibility for the cooperation between healthcare providers and municipal job centres administering benefits and activation for persons with sickness or disability.
- Adjust funding incentives to advance these priorities: municipalities could carry more of the costs for benefits and flexjob subsidies, combined with clearer instruments to guide the availability of vocational healthcare services.
- Develop the use of models – like the so-called round table for dialogue between the employer, job-centre caseworkers, physicians and the employee – to ensure early action when sickness absence reaches a duration that implies the risk of drifting into long-term absence and loss of labour market attachment. Consider differentiated employer co-financing of sickness benefits depending on participation in roundtables or similar dialogue.

Part of the sickness- and disability-related benefits would also need adjustment to make sure that it pays to remain in, or return to, unsubsidised employment. This concerns, in particular, the flexjob scheme where the public subsidy currently offers complete coverage of the income loss associated with reduced work capacity. Consequently, employers, as well as the persons concerned, have a clear incentive to seek a flexjob, rather than taking another job that might be easier to manage but pays less. As health conditions are sometimes hard to assess objectively, some element of self-insurance might be warranted to prevent overuse of the scheme: the salary under a flexjob should be lower than for a normal unsubsidised job. For example, flexjobs could pay a wage for the hours worked and an unemployment benefit for the hours not worked. In general, the maximum flexjob wage subsidy should be scaled down further to be equal to, or less than, the disability benefits. ■

Could capital tax rates be harmonised?

The occupational pension framework reached wide coverage in the early 1990s. Building on agreements between unions and employers, the system aims at supplementing the public pension. Contribution rates have now reached their initially intended levels, so it is a natural time to take stock and assess the system and its outcomes. Combined with the basic and income tested elements of the public pension, the occupational framework has generated pension assets, replacement rates and wealth projections that are now amongst the highest in the OECD. The overall pension system is comprehensive and almost unique in achieving high levels of private pension provision without much legal compulsion. However, people who are marginally attached to the labour market are at risk of missing out on these gains. The best solution to this problem might be found in labour market policies to increase employment amongst these groups. At the same time, low income workers with strong attachment to the labour market may end up with more income in retirement than they do from work. As such, there is a case for reducing the amount of special concessions and non-pension benefits for seniors. There may also be scope to consider increased choice and flexibility in a range of dimensions of the pension system, notably for the profile of pension contributions and the extent of insurance coverage.

There are significant differences between the taxes levied on different types of capital income, with pension fund income taxed much more lightly than income from assets held outside the pension system. Also, the combination of pension tax concessions and generous tax deductibility of interest expenditure may nurture tax planning, for example through the use of new flexible mortgage products. Reducing the tax rates on capital income outside the pension system, as well as the tax value of negative capital income, would effectively reduce the tax concession towards pensions and at the same time reduce incentives for tax planning. ■

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More information about this publication can be found on the OECD's website at *www.oecd.org/eco/Economic_Outlook*.

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10 2008 02 1 P4