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Social policies and activation in the Scandinavian welfare model: the case of Denmark

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Abstract:

Scandinavian countries are characterized by a generous tax-financed social safety net which provides insurance and performs a redistributive role. While contributing to lower inequality it may imply that incentives to work are low, and yet employment rates are high. How have the Scandinavian countries been able to reconcile social objectives with a high employment level? It is argued that the Scandinavian welfare model has a strong employment focus both because it is an important element in social policy based on social inclusion, but also because a collective welfare arrangement is only financially viable if (private) employment is sufficiently high. To ensure this, the social safety net includes a number of employment conditionalities (active labour market policies/workfare) to balance income protection with an employment focus. These policies are discussed using Denmark as an example and empirical evidence is presented. The criticism of workfare is also briefly discussed.

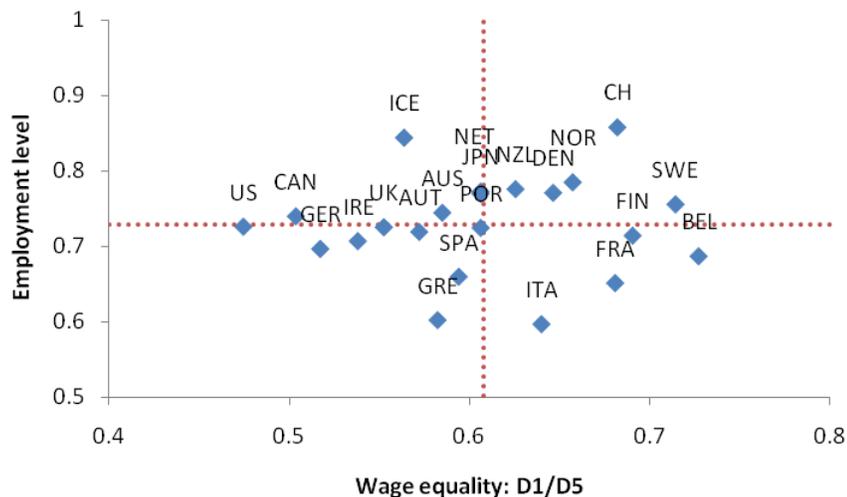
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1. Introduction

The experience of the Scandinavian countries is attracting wide attention. To some it is a puzzle how egalitarian outcome and a large public sector can be combined with a well-functioning economy with high employment and income levels. To others these characteristics are seen as capturing a model example of how to combine social and economic concerns.

The trust of the empirical facts is provided in Figure 1 in terms of a cross-country plot of employment rates and a measure of the compression of the wage structure in the lower end of the wage distribution. The Scandinavian countries stand out in comparative perspective by having both high employment rates and low wage inequality. Moreover, an extended welfare state implies a broad supply of welfare services and a generous social safety net but also a high tax burden. Similar characterizations follow by considering measures of income and income distribution after taxes and transfers (see Andersen (2011)).

Figure 1: Employment rates and wage inequality, OECD countries, 2007



Note: The employment rate is for the age group 15-64. Wage equality gives the ratio of average wages in the lowest income decile (D1) to average wages in the fifth decile (D5). The vertical and horizontal lines are the cross country averages of the respective variables.

Source: Data from www.sourceoecd.org

The poverty rate is low in international comparison. Taking Denmark as an example only 4 percent of the population are below the poverty line defined at 50 percent of median income (an annual income level of about EUR 10,100 in 2004), and 9 percent below the poverty line defined by 60 percent of the median income, cf. Danish Economic Council (2006). No full time employed individual is below the poverty line (no working poor) and individuals in basic welfare arrangements like disability pensions or ordinary pension would normally remain above the poverty line. The group with an income below the poverty line includes some young people in education, some self-employed and some individuals with only a marginal attachment to the labour market, including some immigrants. The transition

out of poverty is large, with a hazard rate out of poverty of about 75 percent the first year. However, poverty is persistent for a small group of about 10 percent.

It is interesting to contrast the presentation of the Scandinavian model in the economics and the political science literature. In the former, the puzzle of how to combine a generous social safety net and a high level of taxation with a high employment level is at the centre. In parts of the economic literature a generous social safety net is often portrayed as a "subsidy to leisure" or as "paying people for not working".

Many government spending programs implicitly provide a marginal subsidy to leisure, since they stipulate that benefits are conditional on not working, or that the benefit is reduced in response to any labour income. Relevant examples include some components of social security, unemployment insurance, traditional welfare programs, and disability (Rogerson, 2007, p 73).

The line of reasoning behind this *disincentive* interpretation identifies the composite tax rates (marginal effective tax rates) on labour market participation (i.e. the combined effect of taxes lowering the return to work and the loss of transfers) as crucial for determining labour force participation and employment. Since both benefit levels and tax rates are relatively high, it follows that the marginal effective tax rates are high in countries like the Scandinavian. Hence, there should be large disincentive effects, and yet employment rates are high, and this poses a paradox to the traditional economic approach.

In the political science literature the same issue appears but from a different angle since the focus is on the extent to which social policies lead to a *decommodification* of labour. By decommodification is understood that selling of labour¹ is not a necessity to maintain a decent standard of living.

A minimal definition must entail that citizens can freely, and without potential loss of job, income, or general welfare, opt out of work when they themselves consider it necessary (Esping-Andersen, 1990, p 23).

Decommodification of labour is seen as an integral part of the universal welfare model having entitlements based on citizenship and needs rather than performance. Since the Scandinavian countries have welfare policies which come close to the universal model², it is concluded that labour has become decommodified (see Esping-Andersen (1990)).

¹ Also expressed as "the concept refers to the degree to which individuals, or families, can uphold a socially acceptable standard of living independently of market participation" Esping-Andersen (1990, p 37).

² Various proposals on classification of welfare regimes or models have been made in the literature. Esping-Andersen (1990) made seminal a distinction between the liberal/residual, the continental/corporatist and the universal/social democratic/Scandinavian welfare model. This is used here since it is a convenient way by which to focus on the division of labour between the market, the civil society, and the state. However, no country fits perfectly into these model categories, and countries with strong universal elements are also found outside Scandinavia, e.g. the Netherlands.

Although the perspectives are different, the decommodification interpretation goes hand in hand with the disincentive view of the welfare state in the sense of implying that extended welfare arrangements are lowering labour supply and employment. In the following it is argued that neither interpretation is an appropriate characterization of the Scandinavian welfare model. It is not, and has never been, intended as a model subsidizing leisure, and it is not a model where labour has been decommodified. An important characteristic of the Scandinavian welfare model is that it is very employment focussed. This is so for two reasons. First, employment and the ability to be self-supportive is considered an objective in its own right as part of a policy focussing on social inclusion stressing the ability to participate in activities in society and control over ones life situation. Second, the financing of a generous welfare state depends critically on maintaining a high employment rate, and policies are directed at ensuring that this is consistent with a generous social safety net.

The fact that the Scandinavian welfare model combines individual rights with collective financing raises intriguing questions on how to make this model sustainable both in economic and political terms. In the traditional debate there is much focus on the redistributive nature of welfare arrangements. This is also an important element, but equally important is the implied insurance. Welfare arrangements which ex-post redistribute conditional on the state of nature (income, health etc.) will ex-ante when the future state of nature is unknown to provide insurance. Agents will know that these arrangements are there, if they end up in a situation in which they need them. Since the welfare state involves the entire population and can make transfers across time and thus generations it follows that it has a wide scope in offering insurance. Insurance has a direct welfare effect for risk averse agents but may also be conducive to a more efficiently working economy (see e.g. Andersen (2011)). Considering taxes and the social safety net solely from an incentive view leads to a focus on the disincentive effects, but including the insurance effects implies that there is a more complex interaction. The interesting question is thus how policies can be arranged such that they on the one hand support a tight social safety net and egalitarian outcomes and on the other hand ensure conditions for maintaining a high level of labour force participation and employment.

This paper discusses these issues by identifying some key elements in the design of social policies in the Nordic countries and uses Denmark as an example to illustrate specific policy arrangements. The paper starts in Section 2 by a brief characterization of the Scandinavian Welfare Model, highlighting some of its key properties. The importance of the design of the social safety net is discussed in Section 3, and it is argued that the defining characteristic of the Scandinavian approach is a combination of generous benefit levels with employment conditionalities. The conditionalities (workfare) refer to various conditions with an employment focus build into the social safety net. Section 4 provides a more detailed account of the design of the social safety net and the various employment conditionalities built into the system, using Denmark as a representative example of the Scandinavian model, while Section 5 turns to the empirical evidence on the effects of workfare policies. The critique of employment conditionalities or workfare is discussed in Section 6. Section 7 offers a few concluding remarks.

2. *The Scandinavian welfare model*

The Scandinavian welfare state rests on three core principles. (i) **Entitlements** whether for services or the social safety net are not contribution dependent³ but available to all (universal) in case of need. It is crucial that contributions paid by an individual in the form of various tax payments do not determine the entitlements. Rights are not “earned”, which is a key difference to a market based system where e.g. entitlement to insurance coverage is intimately tied to previous contributions. (ii) **Provisions** offered in relation to the standard range of welfare services⁴ (education, health, child- and old age care etc), and the transfer level offered in the social safety net are to fulfil the “reasonable” requirements of most people; that is, in the case of welfare services public solutions are not second rate or a last resort to which one turns if private solutions fail, and in the case of transfers the level should be such that a decent living standard can be maintained. (iii) **Financing** is collective via various forms of taxation of which the direct and indirect taxation of labour income is the most important revenue source.

These properties of the welfare state imply that the model relies on common pool. Entitlements are individual, and financing is collective via the common pool of resources created via taxation, that is, tax payments create a common pool of resources which finances the expenditures deriving from welfare services and the social safety net. Since the ambitions of the welfare state are large, it follows that the financing requirements and thus tax rates are high. The common pool property of the welfare state is obviously closely related to the insurance and distributional aims of the welfare state; that is, certain needs should be met independently of the ability to pay. While there is no relation between entitlements and the contributions made in the form of various tax payments at the level of the individual, there is such a relation at the economy wide level. The tax revenue raised has to cover the expenses arising from the entitlements in the social safety net and the provisions of welfare services. This is the financial constraint of the welfare state. While the common pool has wide scope in diversifying risk and ensuring redistribution, it has the problem that individual incentives do not necessarily match the collective situation (tragedy of the commons), cf. below.

An important characteristic of the common pool character of the welfare model is that it is very employment focused. The strong employment focus of the Scandinavian welfare model has a dual character. First, for the individual, employment is crucial to become self-supportive. However, the aim is wider than this since it is considered as part of a policy ensuring equal opportunities and social inclusion. The latter is in policy debates related to: self-esteem, realization of abilities, social network etc. Egalitarian objectives are thus not narrowly confined to income but more widely to various capabilities of individuals.⁵

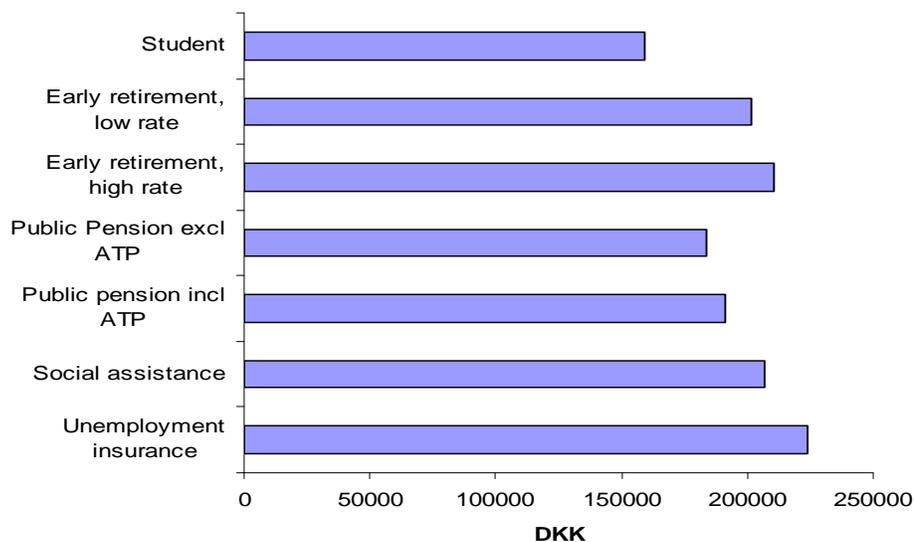
³ No rules without exception. Unemployment insurance and early retirement are examples of contribution based schemes, and thus membership based. However, both schemes are tax subsidized.

⁴ In Denmark public consumption constitutes about 25 % of GDP. Of this more than 2/3 is so-called individualized public consumption, that is, expenditures on services offered at specific individuals.

⁵ This may be justified in terms of Sen’s capability approach to poverty, cf. Sen (2009). That is, the aim is to empower individuals to provide them with sufficient capabilities to perform various functionings.

Second, the financial basis of the welfare state rests on its success in maintaining a high employment rate⁶. This is so for two reasons. First, when there are entitlements in the social safety net to all without sufficient market income, and since this is mainly financed by taxes levied on labour income, it follows that the model's financial viability depends crucially on having a sufficiently large fraction of the population in (private) employment. If too many are out of employment, expenditures rise and revenues fall. This is the flip-side of the marginal effective tax rate (METR) discussed above. When tax rates and benefit replacement rates are high it follows that the economic gain from finding a job is lowered. From a public finance perspective a high METR implies that the budgetary consequences of changes in the (private) employment rate are high since it has effects on both tax revenue and benefit expenditures⁷.

Figure 2: First year budget effect of shifting from non-work to work, for various transfer types.



Note: 200.000 DKK is approximately 26.500 euro.

Source: Danish Welfare Commission (2006).

To illustrate this, consider the sensitivity of the public budget to shifts between non-work and work which releases a double effect on the budget, namely reduced expenditures on transfers and increased tax revenue. Figure 2 shows the immediate budget effect (one year) for Denmark when a person shifts from receiving some benefits due to non-employment

⁶ This is also seen by the fact that major crises for the Scandinavian Welfare Model have all been associated with sharp decreases in employment rates.

⁷ To see this, first consider the problem from an individual perspective. The net gain from finding a job is $(1-t)w-b$, where w is wage income, t the tax rate and b the benefit level (assumed to be non-taxable). This can be written $w-wm$ where the marginal effective tax rate is given as $m=t+b/w$, i.e. the sum of the tax rate t and the replacement rate (b/w) . Next, consider the public budget focusing only on revenue from labour income taxation and expenditures on benefits. We have that the budget balance can be written $B=twL-(N-L)b$, where L is employment and N the population (all are assumed eligible for benefits if out of job). This can be written $B=wmL+bN$, i.e. the effect on the budget of a change in employment is w , i.e. the higher m , the more sensitive the budget is to changes in employment.

into employment in the private sector⁸. For an unemployed the annual amount is roughly 225,000 DKK (30,000 euro) due to the double effect of the increased tax payment and the reduced benefit expenditures. An increase in private employment of 10,000 (0,35 %) will thus improve the budget by 2.25 billion DKK (300 million euro), corresponding to a budget improvement of about 0.18 percentage points of GDP⁹.

The employment focus has an additional dimension since public service provision is intensive in labour; that is, although service provision is not market based on the financing side, it is on the provision side in the sense that the most essential input has to be acquired in the labour market. The public sector in the Scandinavian countries is therefore a significant employer employing about 1/3 of all employed.

In sum, the Scandinavian welfare model therefore has a high employment level both as an aim and as a necessity. In relation to the labour market, the Scandinavian welfare model is therefore highly market based.

3. Designing the social safety net

A generous level of social transfers affects the labour market through various routes, and challenges the possibility of maintaining a high employment level through what may be termed supply and demand mechanisms.

The basic aim of the social safety net is to cushion income and ensure that lack of job is not implying a too low living standard. But muting the income decrease in case of job loss, inevitably implies that the gain from finding a job becomes small (high METR). This is the *incentive or supply problem* referring to the problem of ensuring sufficiently strong work incentives (cf. quote by Rogerson above). The question is whether it is possible to design the social safety net such that income insurance is high, while at the same time work incentives are kept intact.

The level of social transfers¹⁰ effectively puts a floor under wages or defines an implicit minimum wage. In the Scandinavian countries there are no legal minimum wages. However, minimum wages are negotiated in the labour market and these negotiations naturally have the level of the social transfer as the outside opportunity, and hence negotiated minimum wages are somewhat higher than the lowest level of social transfers (compressed wage structure). Although minimum wages are negotiated they are a desirable outcome in accordance with distributional objectives in the sense that working poor is not an acceptable solution to the employment problem. The fact that minimum wages are not regulated by law reflects a tradition of settling major labour market issues via the labour market organizations (cooperative approach). However, at the individual level, high minimum wages create a

⁸ The orders of magnitude are the same for Sweden, see Swedish Fiscal Policy Council (2008).

⁹ Recent estimates by the OECD(2010) taking into account all indirect effects show that a one percentage decrease in employment worsens the public balance relative to GDP by 0.76 in Denmark (the highest among OECD countries), 0.63 in Sweden and 0.62 in Norway,

¹⁰ The ultimate floor set by social assistance, in Denmark: Kontanthjælp, Norge: Kontantstøtte and Sweden: Socialbidrag. The basic support can be supplemented by housing and child allowances.

locking-in effect. Individuals willing to work might not find an employer, because their productivity is below the stipulated wage level. They are involuntarily unemployed, and this may be denoted the *demand problem*.

Key objectives of the Scandinavian welfare model cause the supply and the demand mechanisms which may both be a barrier to achieving a high employment level. The following discusses this in more detail, and outlines how these problems have been solved in the Scandinavian countries.

The incentive/supply problem

The incentive or supply problem has two dimensions, namely, on the one hand the incentives of the individual to be searching for and accepting jobs, and on the other hand the problem of ensuring that the social safety net provides help in the cases it is intended for. The former is in the economic literature known as the moral hazard problem and the latter the (adverse) selection problem.

The social safety net affects work incentives via the high marginal effective tax rates. This effect does not only relate narrowly to whether people want to work or not, but more widely to how active they are in job search and which types of jobs they may be willing to accept. Jobs have numerous characteristics including wages, working hours, qualification requirements, work facilities, work environment, job task, influence on job tasks, location (transport time/costs) etc. Thus, the issue is not whether a given individual is willing to work or not, but rather which jobs one is willing to accept and how active one is searching. A generous social safety net reduces the urgency of finding a job to earn an income. This has both positive and negative effects on the labour market. On the positive side it implies that individuals have more time to search and find better matches which eventually are to the advantage not only for workers but also for firms and society at large (see e.g. Diamond (1981) and Marimon and Zilibotti (1999)). On the negative side search intensity or reservation demand may be higher than what is socially desirable, and this may reduce employment and thus imply that more people are supported by the social safety net. The problem is that the individual and social costs are not the same.

By employment conditionalities¹¹ in the social safety net is understood that transfers are conditional on not being able to find a job, but being willing to work; i.e. there is no free choice as to whether to work or to receive public transfers. The conditionalities are not requirements to qualify for the transfer, but requirements to maintain the transfer. Examples of such conditionalities include active job search, participation in job search courses, education programmes, job-training etc. (see below). The way in which these conditionalities are build into the social safety net are further discussed below, but first arguments are given why they can help overcome the incentive/supply problems.

¹¹ It is important to note the difference between *employment conditionalities* and *waiting or qualifying conditions*. The former refers to conditions associated with receiving benefits, that is, benefits are not provided unconditionally. Waiting or qualifying conditions implies that there are differentiated rights depending on whether these conditions are fulfilled or not. These issues are discussed further in section 7.

Incentives may be created by lowering benefit levels, but this will run counter to distributional objectives in the welfare state. There is an alternative route by which it is possible to strengthen incentives without reducing benefits. By building in employment conditionalities the reservation demands may be affected in a downward direction; that is, a job-seeker may reason that it is better to lower reservation requirements to enhance job-finding chances rather than having to be asked to participate in an activation programme to remain eligible for benefits. This may be phrased in the way that incentives depend on both pecuniary and non-pecuniary factors. The important point is that incentives can be strengthened without necessarily deteriorating the level of support offered by the social safety net. Economic deprivation is not necessary to create incentives, see Andersen and Svarer (2010), and Andersen (2011).

The selection problem is whether the support goes to those who are considered deserving. If the benefit level is unconditional it may be claimed by some who could be self-supportive but chooses to live on benefits rather than work. This breaches the solidarity or implicit insurance arrangement of the welfare state which presumes that the “able” not only support themselves but also via tax payments help support the “less able”. Consider a stylized example in which individuals differ along two dimensions: earning ability (high or low) and preferences for leisure (high or low), cf. table 1. Suppose the distributional objective is to provide support for those with a low earning ability since working poor are not accepted. If benefits are provided unconditionally as a possible source of income, individuals with a high earning ability but also a high preference for leisure may find benefits more attractive than work. Although claiming benefits leaves a lower income and thus consumption, it does allow more leisure which this type assesses highly.

Table 1: Typology of individuals – abilities and preferences for leisure

	Low preference for leisure	High preference for leisure
High ability	I	II
Low ability	III	IV

The design problem is now how to arrange the social safety net such that it is not attractive for type II individuals to claim benefits. Associating employment conditionalities to benefit eligibility would ensure this. Type II will not be able to enjoy as much leisure when claiming benefits and may therefore as well choose to work. Making this group work rather than claiming benefits lessens the financial constraint (fewer benefit claimants, and more tax payers) making it possible to offer a higher benefit level to those with low abilities, i.e. employment is higher, and the social safety net is more generous towards the intended group. Or to put it oppositely, a badly targeted social safety net is financially weaker and therefore has to offer a lower benefit level.

Note, that the employment conditionalities have been taken in an extreme form of time requiring activities here to make the point that it affects the incentive structure. In general,

such activities can be both productive and add to human capital which will imply that they have additional advantages (see below).

Finally, note that high employment may be sustained despite weak economic incentives to work if work norms or ethics are strong. It is sometimes argued that this is the case in the Scandinavian countries (Algan and Cahuc (2009)). While norms play a crucial role it is not obvious that they have an intrinsic cause independent of policies and institutions. If norms are not supported by policies they are unlikely to persist, and the “workline” in social policies works to strengthen strong work norms.

The demand problem

A high level of minimum wages create the problem that the demand for labour falls short of supply, or to put it differently, the value of the labour input of some workers is not sufficiently high for them to be in demand at the given wage. Individuals are willing to work, but unable to find jobs¹².

This points to a crucial link between distributional objectives concerning access to jobs and income, and the level and distribution of qualifications. If a large share of the population has very low qualifications it follows that either they will be unemployed if minimum wages are high or they will have to accept a low wage to find a job. Since the latter is implying working poor, this has not been an acceptable solution in Scandinavia. It is therefore crucial that the group of individuals with low qualifications is kept as small as possible¹³. Therefore, educational policies are important and play a key role in achieving distributional objectives.

Crucial for the possibility of making a high employment rate consistent with a compressed wage structure is thus to ensure that the level of qualifications for the workforce is high. This has also historically been a top priority in the Scandinavian countries¹⁴. Public involvement in education is extensive and education is basically fully tax financed. The implicit contract is that the public sector provides the education (equal opportunities), and it is paid back indirectly via taxes paid when obtaining jobs with decent wages based on the achieved education. It is also worth mentioning that empirical evidence shows that educational policies have been important in counteracting skill-biased effects on labour demand from technology and globalization to avoid a high unemployment rate for unskilled, see e.g. Bjørnstad et.al. (2008).

Education is also a crucial element of labour market policies. Although education as young is important, there is also a need for retraining/life-long training to cope with structural depreciation and obsolescence of knowledge etc. along side technological developments.

The system has two strands, one is an elaborate and extensive system of labour market education programmes (AMU) accessible to employed and the other is the more specific use of training and educational programmes as part of active labour market policies and thus the

¹² This problem can obviously also arise for business cycle reasons, but the present discussion is confined to structural issues.

¹³ This is also the reason why the model is challenged by immigration of unskilled.

¹⁴ Public expenditures on education are among the highest in the OECD area.

employment conditionalities in the social safety net. The latter is particularly important in overcoming the demand problems which can arise during work life¹⁵, and the purpose of the programmes is to reduce qualification barriers for employment (empowerment)

Another way to overcome the demand problem is through wage subsidies. If the problem is that the wage exceeds the productivity of the worker, this problem can in principle be overcome by offering the employer a wage subsidy. However, such subsidies are not without problems since it can be difficult to target them to the specific individuals facing such barriers, and there is thus a potentially large deadweight loss. Moreover subsidies are not a solution of the underlying problem created by lack of qualifications. Therefore, the applied schemes are usually associated with training requirements¹⁶

Designing workfare policies

The supply and demand problems can be addressed by employment conditionalities or active labour market policies including both job search and training elements. However, the design is not trivial; incentives and qualifications should both be addressed at the same time as such activities are rather costly (direct costs of active labour market policies amount to 1.3 % of GDP in Denmark). Two aspects are particularly important, namely timing and programme types. Frontloading of workfare requirements will strengthen incentives and early intervention the most, but it will also be very costly, and it would entail a large deadweight loss from programme participation for many who in any case would find a job after a short unemployment spell. This is particularly so in a labour market with a high incidence of short-term unemployment spells. Hence, workfare requirements should be imposed after some duration of an unemployment spell.

The group of unemployed is heterogeneous, spanning from some who have the qualifications and experience making them readily employable to some who lack these characteristics (e.g. due to long-term unemployment) and therefore find it very difficult to get a job. For the former group, help with job search may be sufficient, while for the latter more specific programmes may be needed to specifically address the constraints lowering their job finding rate. In some cases, it may be easy to identify these constraints (e.g. if the unemployed lacks specific skills) while in others it may be more difficult and also depend on market conditions (qualifications become obsolete due to structural changes). Avoidance of deadweight losses gives an argument for making workfare programmes duration dependent.

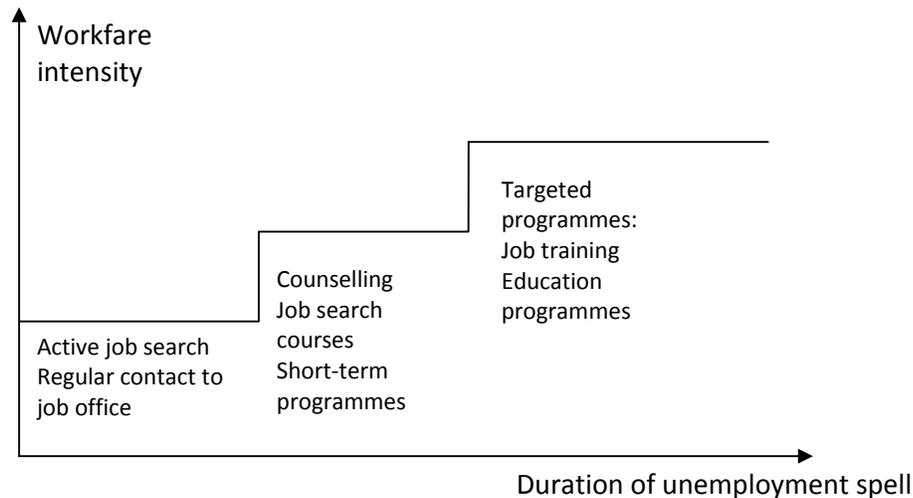
These considerations lead to an optimal profile for workfare requirements as illustrated in Figure 3 where the requirements run from general and relatively costless activities to specific and more costly activities, depending on the duration of the unemployment spell. The duration dependent sequencing works to minimize deadweight losses and programme

¹⁵ Among EU countries Scandinavian countries rank in the top according to the comparative index on life long learning (see www.elli.org) Denmark ranked one and Sweden two (Norway is not included) for 2010.

¹⁶ An example is the so-called staircase model for low-skilled immigrants which combine wage subsidies to employers with training requirements to ensure that participants eventually are qualified for "normal" jobs.

costs while maintaining the incentive effects and addressing the more specific programmes to groups for whom it may make a difference. At the same time it introduces a forward looking element into the scheme, where the stepping up of workfare requirements strengthens work incentives and help overcome barriers for employment.

Figure 3: Active labour market policy – duration dependent programme requirements



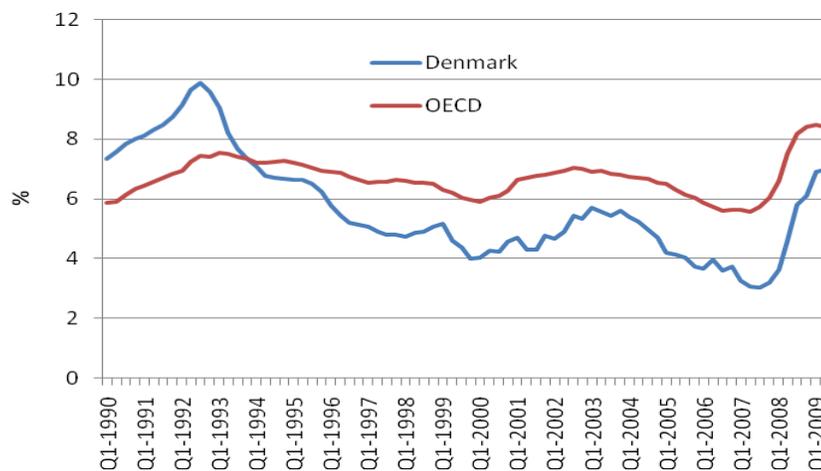
4. The design of the social safety net – Denmark

The following gives a brief overview of the social safety net in Denmark with a particular focus on employment conditionalities. The system has two basic pillars namely unemployment insurance and social assistance. The former is a voluntary contribution based system but with tax financed subsidies. The latter constitutes the basic element of the social safety net, and benefits are means-tested on a family basis. For individuals with health problems there are health-benefits and for persons with loss of work ability a disability pension. In addition there is an early retirement scheme (age group 60-65) which is a contribution based scheme.

Active labour market policies or employment conditionalities have a long history in Denmark. However, a major reorientation of the system was enacted through a sequence of reforms in the 1990s. Prior to these reforms workfare elements were passive in nature in the sense that they were mainly seen as a way to regain eligibility of unemployment benefits. With the steep increase in unemployment following the crisis in the mid 1970s there was an increase in long-term unemployment. To prevent individuals from losing their entitlement to unemployment benefits both extension of the duration period (reaching a maximum of 7 years in 1994) and the use of active labour market policies was introduced. A new benefit period could be regained if a certain employment condition (e.g. 6 months work within the last 36 months) is met, and participation in an active labour market programme was used to ensure that this criterion was met. Therefore, the role of workfare was mainly income maintenance.

The reforms of the active labour market policy during the 1990s meant a change in a more active direction in the sense of strengthening the focus on bringing people back into regular non-subsidized jobs (for details see e.g. Andersen and Svarer (2007), Jørgensen and Kongshøj Madsen (2007), and Strøby-Jensen (2008)). This shift reflected the failure of past policies and the untenable situation – both socially and economically – of the high unemployment level, and in particular a high level of marginalization in the labour market. The reforms included a shortening of the benefit period, changed eligibility conditions implying that the employment criteria can only be met by holding non-subsidized jobs, and a use of the instruments in the active labour market policy in bringing people into regular jobs. This was a sequential process initially supported by an expansionary fiscal policy, and gradually strengthened and fine-tuned along with the observed fall in the unemployment rate. An important part of the development during this period was also an explicit policy of unions to aim for “jobs rather than wage increases”, and thus wage competitiveness was significantly improved during this period. It is noteworthy that benefit levels as such were not reduced to strengthen incentives during this period with the exception of the youth-package, see below.

Figure 4: Unemployment : Denmark and OECD-average 1990-2010



Source: www.sourceoecd.org

The development over this period resulted in a low unemployment rate and a record high employment rate up to the financial crisis. All of this attracted international attention under the label of flexicurity. As is well-known, this label captures that employers are offered flexibility via rather lax employment protection, and workers security via a relatively generous social safety net. However, these elements were also in place during the high unemployment period, and hence it is not obvious that a flexicurity labour market automatically delivers a low unemployment rate. It is hard to explain the Danish experience since the mid 1990s without attributing a significant role to the reorientation of the active labour market policy (Andersen and Svarer (2007)).

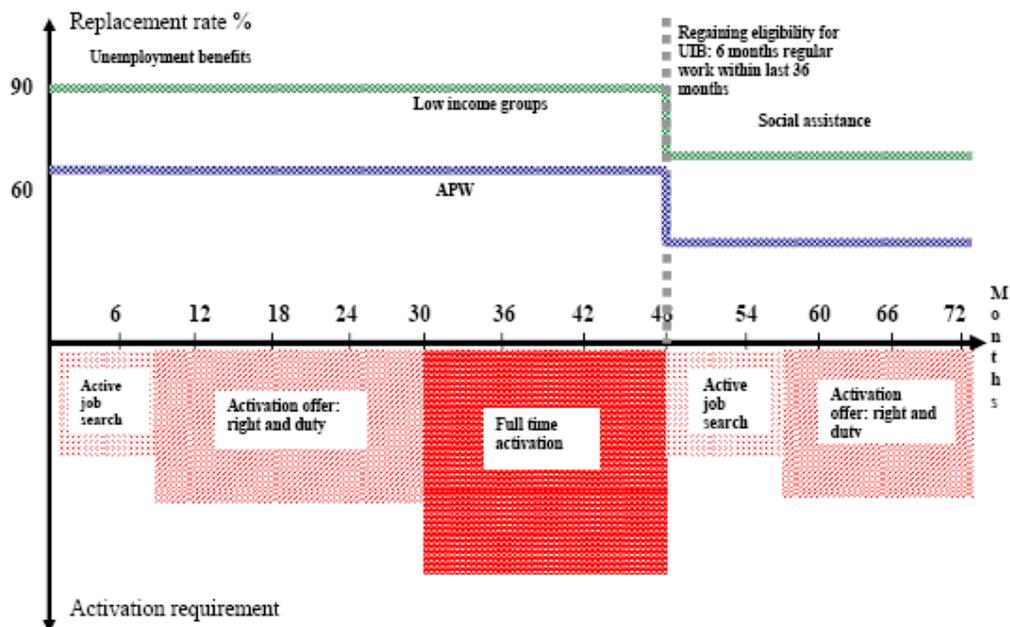
Important is also the 1998 reform which introduced employment conditionalities in the social assistance scheme. This should be seen in the perspective of the fact that

unemployment insurance is voluntary (68 % of the labour force was member of an unemployment insurance fund in 2009). The basic aim was thus to have workfare requirements for individuals for whom the main problem was lack of job. For other groups with other barriers for employment (social problems, abuse etc) the requirements are different.

A crucial question is whether some can fall outside the social safety net due to the employment conditionalities. The law stipulates sanctions of individuals who do not comply with the activation requirements. The sanctions are regulated via a system requiring that the welfare recipient when applying for aid is informed about the consequences of not complying to the criteria. There is an elaborate system of making complaints about decisions on sanctions. The sanctions are proportional in the sense that the support is reduced proportional by the days for which requirements are not fulfilled, and entitlement is immediately regained when fulfilling the requirements.

Table 2 gives in summary form some key properties of the social safety net in Denmark. An important implication is the time profile during an unemployment spell which is illustrated in figure 5 for a person eligible for unemployment benefits. Thus, there is duration dependence in both the benefit level and the activation requirements. While the duration dependence in benefits is weak (long duration of unemployment benefits), the effective profile displays more time dependence due to a stepping-up of the activation requirement with duration of an unemployment spell.

Figure 5: Danish social safety net in case of unemployment



Note: Diagram drawn for an individual fulfilling the requirements for unemployment at the moment of becoming unemployed. Social assistance is calculated on the basis of benefits for a single person. The activation requirements are for those above the age of 30. More strict conditions apply for individuals below 30. APW refers to the replacement rate for an average production worker. The replacement rate is lower because the system has an absolute cap.

Table 2: Summary indicators of conditionalities in unemployment insurance, social assistance, and early retirement - Denmark

	Eligibility	Conditions	Job search	Activation requirements ¹
Unemployment benefits	Voluntary, contribution based, tax subsidized	Membership: relevant education or employment in 12 months. Renewed benefit period: regular work in 6 out of the last 36 months. Duration: max 4 years	Mandatory registration in job centre (to be renewed weekly) CV on jobnet Individual job-plan/regular contact to job-centre Active job search (monitored and sanctioned)	Age below 30: after 6 months Age between 30 and 60: after 9 months Age above 60: after 6 months Repeated offers After 2 ½ years full time activation
Social Assistance	Universal, but depends on age, and means tested for married based on family income	Social event precluding self-support	For recipients of social assistance who are assessed to have lack of job as their main problem – the same requirements as for unemployment insured	Age between 25 and 30 and no education: education offers after 6 months (alternatively lower benefits) Age between 25 and 30: after 5 weeks an offer of 8 weeks duration, after 13 weeks an offer of 18 months duration Above 30: after 9 months
Early retirement	Voluntary but based on previous employment, contribution based, tax subsidized	Age 60-65.	None	None

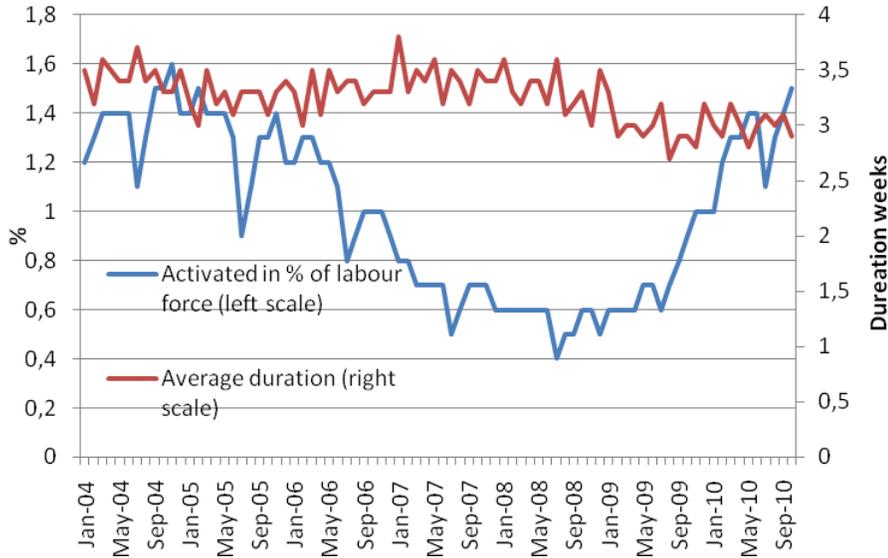
Note: (1) the actual activity and duration vary across the different groups

Source: LBK nr 1074, 07/09/2007, Ministry of labour, Denmark

The activation offer can be in one of three forms which all have specific rules on duration: I) counselling and requalification. This includes short counselling and assessment programmes as well as special projects and education in the ordinary educational system, II) job-training (virksomhedspraktik), this may be in the public sector or a private company, and is used for persons where there is a need to clarify the possible job prospects, or for persons who due to lack of qualifications may have difficulties in finding a job on normal conditions, III) employment with wage subsidy, this may be at a public or private employer and is used for retraining to upgrade the qualifications (specific skills, language or social skills) of

unemployed. About 2/3 of all activation offers are of type I, and the other two types constitute about 1/6 each. As seen from figure 6 the number of people in activation programmes has varied over time with the business cycle. The average duration of activation programmes is rather short (3 weeks) which reflect a significant variation with a large number of very short programmes and a few long programmes.

Figure 6: Activation degree and average duration

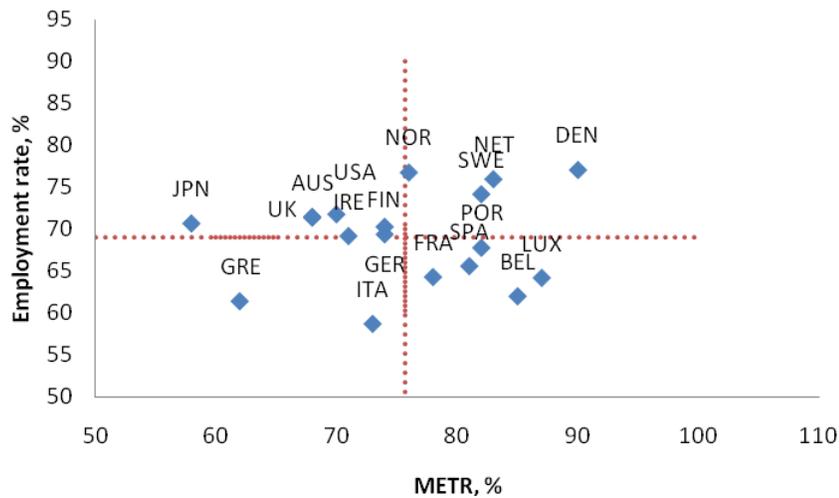


Source: www.jobindsats.dk

5. Some empirical evidence

The Scandinavian countries stand out, as noted in the introduction, by having a high employment rate as well as a generous tax financed welfare state. The latter in itself suggests that incentives to work are low, and yet employment rates are high. In this respect the Scandinavian countries are outliers as illustrated in Figure 7 showing a cross-country plot of the work incentives measured by the marginal effective tax rate (METR) and the employment rate. While most countries are on the diagonal suggesting that a high METR reduces work incentives and thus employment, the Scandinavian countries both have a high METR and a high employment rate.

Figure 7: Employment and marginal effective tax rate, selected countries



Note: Data applies to 2007. The marginal effective tax rate (METR) is the total net tax burden (taxes net of transfers) of going from receiving unemployment benefits to employment. This structural indicator covers single persons without children earning, when in work, 67 % of the average earnings. The employment rate is for the age group 16-64. The vertical and horizontal lines are the cross country averages of the respective variables. Source: Data from Eurostat

As argued above, these facts can be reconciled when taking into account the way in which the social safety net is designed and in particular the employment conditionalities built into the system. Table 3 presents the results of a stylized regression model of labour force participation and the economic incentives to be active in the labour market in the form of the marginal effective tax rate and a measure of the active orientation of social and welfare policies in terms of active labour market policies and measures to facilitate labour supply activities (particularly for females) like child and old-age care.

It is seen that a simple regression of labour force participation on the METR leaves a wrongly signed effect (though not significant), i.e. a higher METR is associated with a higher employment rate. This is however driven by the Scandinavian countries being outliers. Including the active measure improves the regression, the marginal effective tax rate obtains the theoretically expected sign, but the active measure is also found to have a significant positive effect on labour force participation, especially for females. In short, the disincentive effects caused by high marginal effective tax rates are countered by the active orientation of key elements on labour and welfare policies. In this way it has been possible to reconcile a high METR with a high employment rate.

Table 3: Estimated labour force participation equation, European countries

	Total		Males		Females	
Constant	3.31 (3.62)	5.29 (6.27)	4.24 (6.87)	4.94 (6.34)	2.19 (1.46)	5.70 (4.62)
Metr	0.23 1.07	-0.26 (-1.29)	0.03 (0.22)	-0.18 (-0.76)	0.46 (1.34)	-0.39 (-1.36)
Active	NI	0.13 (3.64)	NI	0.05 (1.39)	NI	0.29 (4.40)
R ²	0.09	0.59	0.01	0.15	0.13	0.68

Note: Based on a cross-section estimation for 15 European countries (EU 15 minus Luxembourg and plus Norway) data applies to 2005, except the service component of the active measure which is from 2003. All variables are in logs. The metr is the marginal effective tax rate applying to labour force participation (Source: Eurostat), and active is the sum of expenditures on active labour market policies and in-kind benefits for old age and child care in % of GDP (source: www.sourceoecd.org). NI denotes variable not-included in regression. The regression equation is: $\ln(p) = \text{constant} + a_1 \ln(\text{metr}) + a_2 \ln(\text{active})$, where p is the labour force participation rate. Numbers in parenthesis give the numerical value of the t-statistic.

A large number of more micro-oriented empirical analyses of active labour market policies exist. While yielding important information they suffer from the problem that they tend to focus on the individual effect on the margin, leaving open how the system-wide (equilibrium) effects are. Most studies tend to focus on the direct effect in terms of locking-in effects and post-programme effects in terms of employment. While these are important elements, activation also has crucial interaction (general equilibrium) effects, see Andersen and Svarer (2010)). Activation is part of the eligibility conditions for social transfers (unemployment benefits and social assistance) and thus serves to attach stronger requirements to receiving benefits, cf. figure 3. This may in turn have an incentive effect lowering the reservation requirements to jobs (type of job, location, employer, wage etc). This is sometimes termed a threat or motivation effect. However, there is also a negative locking-in effect since participants in activation programmes usually do not search as much for regular jobs. This is countered by a possible post programme effect in terms of changed qualifications. Related to the above there may also be a wage effect, since activation not only has a direct effect on participants but also affects the fall back position of employed if they become unemployed. Under standard assumptions this leads to wage moderation. Hence, a proper assessment of the effects of activation is very difficult and care should be taken in making conclusions from partial analysis. The empirical literature has traditionally focussed most on the locking-in and post programme effect, but more recent studies have also considered the threat/motivation effect.

Various assessments have been made of ALMP in Denmark and the general findings are matching findings from studies for other countries, see e.g. Kluve (2006) and Card et.al. (2010). In Rosholm and Svarer (2008) it is shown that, in general, activation has a locking-in effect. However, private job training and education improves qualifications, while there is no statistical significant effect from public job training and other forms of activation. This study also finds a threat/motivation effect from all forms of activation which tends to shorten the duration of unemployment spells. Overall it is assessed that activation, when taking into account the locking-in, the qualification and the motivation effect contributes to higher job finding rates and thus lower duration of average unemployment spells. Positive long-run

employment effects from private job-training are also found in Jespersen et.al. (2008), while there is no such effect from public job-training or educational activation programmes.

Danish Economic Council (2007) considers the motivation, locking-in and qualification effect of all forms of activation. In general, activation has a locking-in effect. There is a positive employment effect due to improved qualifications from private job-training but a negative effect from other forms of activation. In addition a positive motivation effect is found. The study is not able to find any positive effects of educational activation, not even after 5-6 years after participation.

Educational activation programmes are analysed in Christensen and Jacobsen (2009) with particular focus on the locking-in and motivation effect. There is no short- or long-run (5 years) positive employment effect from ordinary education for persons becoming unemployed in 2002. However, positive effects are found for persons who became unemployed in 1995. For both groups there are positive effects of private job training. It is also found that the effects of all forms of activation are better when unemployment is low (less locking-in), but the direct effect of the programme is not different across business cycle situations¹⁷.

The program "Early start" (Hurtigt i gang) has made it possible to make an experimental design of the effects of active labour market policy. In this programme half the participants received the activation offers as prescribed by existing rules while the other received an early and more intensive intervention. The program was first launched in 2005-06 and later repeated 2008-09 to allow for a more specific evaluation of the applied activities. The general finding is that the early intervention has contributed to enhance employment prospects, corresponding to a shortening of unemployment duration spells by 3 weeks (see Graversen et.al. (2007), Rosholm (2008), and Rosholm and Svarer (2009)). Cost benefit analyses show that the increased employment can cover the costs of running the programme.

6. The critique of workfare: Duality – rights and duties

The Scandinavian welfare model is, as argued above, crucially relying on a high employment rate both for its financial viability and its ability to offer a range of welfare services to the population. In this sense it does not fit into the theoretical perception of a model with labour being decommodified and with politics oriented against market. Whether such a model is feasible is another issue beyond this paper.

¹⁷ For Sweden the effects of educational programmes are more favourable for the 1980s with lower unemployment than the 1990s with high unemployment (see Calmfors m.fl.(2004)), which may suggest a business cycle dependency in the effectiveness of the programmes. More recent studies for the years 2002-04 with low unemployment also suggest favourable effects (se de Luna et.al. (2008)). In the latter study it has been possible to differentiate between different types of educational programmes. A possible business cycle effect can depend on a volume effect which lowers effectiveness in periods with high unemployment and thus many in activation programmes. Moreover, with low unemployment it may be easier to target activities to areas with good job prospects.

Considering specific social and labour market policies over time it is noteworthy that these are characterized by recurrent changes. It is thus not appropriate to discuss these issues based on a perception that there was a given set of policies or master plan at some point in time, and simply conclude that policy changes are tantamount to a change in the welfare model. It is important to distinguish between the underlying policy objectives and the specific instruments. The former have been rather steady and define the model, but the means to achieve these have changed over time in response to changes in the economic structure in general and the development in the labour market in particular.

It has been argued that employment contingencies are a new element in the welfare state and that it represents a reorientation of the welfare state representing so-called neo-liberal views. This has been interpreted as reflecting an individualization of the welfare state and the responsibility concerning self support. This is very much open for discussion. In the Scandinavian countries there is a very strong tradition for focussing on active labour market policies, and in labour market and social policies there is a recurrent reference to the work orientation of policies (“workpolicy”; “arbejdslinjen”). This is perhaps most clearly illustrated by the so-called Rehn-Maidner model which was based on i) solidaristic wage policy, ii) restrictive demand management policy, and iii) an active labour market policy (see e.g. Wadensjö (2007) and Erixon (2008)) to combine full employment and equity with price stability and economic growth

It has been argued that focus on employment conditionalities and workfare reflects an individualisation of the unemployment problem in contrast to alleged previous views that the problem was at the level of society (see e.g. Handler (2001) and Pascual (2007)). The latter is sometimes taken to be equivalent to a Keynesian orientation of economic policies.

Historically it is the case that Scandinavian countries are characterised by a Keynesian focus in economic policy in a quest for full employment. There are several remarks to be made in the context. The Keynesian perspective to income support runs via employment. Hence, the basic idea is that the government has the responsibility to ensure enough jobs for those willing and able to work. This is definitely not a passive regime but a very employment focussed perspective on how to solve social problems. Note also that it is not always easy to make a sharp distinction between an active fiscal policy and workfare programmes. If the government decides to proceed with a huge infrastructure project targeted to create jobs for unemployed building workers, how is this to be classified?

It is the case that the optimism of the potential of aggregate demand management policies is less strong today than it was in the 1960s and early 1970s. Though, the Keynesian logic is still important in Scandinavia, and Denmark and Sweden were among the countries with the most active fiscal policy after the financial crisis¹⁸ (see e.g. OECD(2010)).

¹⁸ Comparisons based on discretionary policy initiatives often overlook that automatic stabilizers are much stronger in the Scandinavian countries which in turn reduces the need for discretionary policy measures.

The more moderate expectations concerning the potential of fiscal policy in generating full employment has several explanations. The most obvious is the failure to generate full employment in the 1970s and 1980s despite an active use of aggregate demand management policies. In accordance with basic Keynesian theory fiscal policy becomes less effective the tighter economies are internationally integrated via trade and capital links. Moreover, specialization in production also implies that labour becomes more specialized, and the original Keynesian assumption of labour being homogeneous is decreasingly accurate. This implies that unemployment not only depends on the aggregate level of demand but also its composition. Different sectors and thus type of labour are affected depending on whether a business cycle downturn is generated by say a fall in private consumption, investment, or exports. It may be difficult to target these groups via aggregate demand management policies. Finally, empirical facts show that the Keynesian perception of the labour market in terms of employed vs. unemployed is inaccurate. In- and outflows of unemployment are large, and accordingly a large group is only affected by short unemployment spells. The key problem in the labour market is those at risk of marginalization and long-term unemployment, and it is difficult to target those groups via aggregate demand management policies. Creating more aggregate demand and this labour demand would not necessarily be to the benefit for those at the back of the job queue!

In particular in the sociological and political science literature the current emphasis on active labour market policies and workfare is interpreted as a new welfare regime implying a new definition of citizenship (Paz-Fuchs (2008), Pascual (2007), Handler (2001)). The arguments are both that there is a trend towards more focus on individual responsibility and an implied lower responsibility for society, and also a stronger focus on reciprocity and deservedness. It is thus argued that the welfare state is changing from a political/social contract to a moral contract with stronger focus on reciprocity norms, deservingness, status to be deserved, and responsible behaviour.

Concerning the social contract it is important to stress that the employment conditionalities are phrased in terms of rights and duties in a dual sense¹⁹. The individual has rights in the social safety net as a citizen, but at the same time a duty to do what is in the power of the individual to be self-supportive. Society on its part has the duty to offer a decent social safety net and a right to ask that (realistic) conditions are fulfilled. Clearly this builds on reciprocity and it has deep roots in the Scandinavian welfare model. To give just two examples hereof, the Danish constitution (from 1849) stipulates in paragraph 75 that (own translation)^{20,21}:

In order to promote the common good one should aim at ensuring that any citizen who is fit for work has the opportunity to work under conditions that safeguard his existence.

¹⁹ The reciprocity may also be crucial for the political support to welfare arrangements. Work on the political economy of welfare arrangements support that reciprocity arguments are important, see e.g. Fong et al (2004).

²⁰ www.grundloven.dk

²¹ A supreme court decision in 2005 made clear that activation requires associated with social assistance is in accordance with the constitution.

A person who is unable to support himself or his dependants, and who is not to be supported by someone else, is entitled to public support, conditional upon accepting the obligations imposed by the Act on this subject

The active focus is also explicitly stated in the law on social assistance (Lov om aktiv sosialpolitik) which in paragraph two states that the purpose of providing the aid is to make the recipient able to become self-supporting.

Also among unions the slogan “Do your duty, demand your right” (“Gjør din plikt, kræv din ret”) (used since 1872) underpins the understanding that collective arrangements yields individual rights but also collective responsibilities.

Conditionalities in welfare policies have been discussed from a judicial perspective by e.g. Paz-Fuchs (2008). It is argued that “rights ‘have the quality of unconditionality’, where ‘unconditionality’ implies that *access* to the rights is not conditional upon fulfilment of responsibilities” (p 61-62). In particular, the conditionality on behavioural responses like “to search for jobs” is considered problematic and an expression of a trend towards individualisation and therefore leads to “the personalisation of risk rather than the collective assumption by the state”. Likewise, the focus on contractual relations and reciprocity is dismissed as being irrelevant to the fundamental rights which are unconditional and lead to a de-commodification of labour. Finally, these conditionalities are considered a new trend in welfare policies undermining earlier more universalistic approaches.

At a more philosophical level it may be asked whether there can be rights without duties (Edmundson (2004)). The welfare state is a common pool arrangement defined in terms of individual rights and collective financing. There is thus an ultimate relationship between all individuals as in any common pool arrangement. Therefore, a statement that welfare rights should be understood simply as a contract between the state and the citizen (Paz-Fuchs p 63) overlooks the fundamental factor that the state in this context is all other citizens. Hence, the right of someone to claim benefits depends on the duty of someone else to contribute to the common resource pool financing these benefits. As a consequence social rights are associated with duties. If the person unable to work has a right to benefits, the one able to work has the duty of contributing to the common pool (usually via some form of tax payment). Hence, relating duties to rights are not tantamount to an individualization of risk or a requirement that entitlement should correspond to contribution. On the contrary it recognizes that social or collective insurance, and therefore social citizenship, relies on the “common pool”. It is well known from the “tragedy of the commons” that such common pools create incentive problems, that is, individual behaviour is not necessarily consistent with collective rationality. Therefore, either economic mechanisms or norms are required to ensure that a tragedy of the commons does not develop. This is what economists would term incentive problems related to moral hazard and adverse selection problems of any insurance mechanism (they are all collective but differ in the extent to which entitlement and payments are related).

Goodin (2004) makes a distinction between moral permissible and impermissible conditions defined in terms of whether the condition is consonant with the purpose of the policy. Hence, it is argued that if a purpose with a policy is to combat poverty it is morally impermissible to attach work conditionalities to the scheme. It is argued that “needy people are needy, regardless of how they became needy” (Goodin (2004), p304).

This raises two important aspects. First there is an important difference between workfare or active labour market policies in the North American²² and the Scandinavian tradition. In Scandinavia the social safety net is a premise to ensure that all have the means needed to attain a socially acceptable standard of living, and then subsequent the issue arises as to the necessary steps to ensure that this is consistent with both opportunities for all to work, but also to ensure that all able do actually work. Therefore, education and active labour market policies have been in much focus. In the North American tradition the basic principle is that help is only directed to those who are willing to work, that is “work first and then help” implying that work becomes a kind of entry condition for help. This is also why earned income tax credits (EITC) have been more in focus in the US than in Scandinavia²³. The workfare conditions in the Scandinavian model should also be seen in the context of the option-out possibilities for people with health problems or loss of work capabilities. The Scandinavian model does not give an option for the individual to work or not to work, but “not to work at any price or pain”. Labour market and social institutions support a relatively high minimum wage, working poor is not a policy option. Hence, even if work could be found at the lower wage, the implied living standard for the worker would not be acceptable. Likewise if work capability is temporary (sickness) or permanently lowered (disability) the social safety net gives an opting out possibility. Note, that this opting out is clearly defining in terms of individual conditions. The rights/coverages in these dimensions are universal.

Finally, the criticism of workfare based on utilitarian approaches should be mentioned. The argument is that the consequences should be evaluated in terms of utility (consequentialistic approach) and although workfare allows a higher level of transfers other things being equal, it leaves recipients worse off due to the loss of utility. Accordingly, workfare does not improve the scope for redistribution (see e.g. Besley and Coate (1992)). However, a number of criticisms may be levied against the utilitarian approach to redistribution, primarily because it only consider end-states, redistributes according to marginal utility, and do not take into account social interactions (see e.g. Sen (2009) on capability approach). Actual distribution policies focus on income, both because it is measurable and thus comparable across individuals (in contrast to utility) and because a minimum level of income is one of the necessary conditions for social inclusion

7. Concluding remarks

The Scandinavian model is employment focussed, and it has accordingly been a permanent policy aim to ensure that a high employment rate is consistent with an extended welfare

²² For an overview of workfare in US and Canada see e.g. Crisp and Fletcher (2008)

²³ They have recently been introduced in both Denmark and Sweden, but mainly as a way to lower tax burdens for low income groups.

state. The key element has been employment conditionalities associated with the social safety net. Such conditionalities are not new, although their specific form and focus has changed over time.

The employment conditionalities both serve to strengthen incentives for job search and employment but also to overcome the barriers for employment in terms of qualifications or other factors reducing job finding possibilities. It is thus an important element of these policies that they are not conditions which should be satisfied before receiving support, but requirements to remain eligible for the support. The system is thus not earnings based, but builds on a reciprocity principle.

In a “work-first” scheme certain employment conditions have to be fulfilled before earning the entitlement. The same logic applies to earned income tax credits, where the support is explicitly tied to work. There is a noteworthy difference in the perspective between work-first conditions and the employment conditionalities discussed above. In the universal model with employment conditionalities, the perspective is to ensure that all have a decent living standard, and subsequent take steps to ensure that most are self-supporting. Under the work first condition the perspective is to provide special treatment to those who meet the requirement to work. Inherent in the choice between the two strategies is a question of type I and II errors. The universal scheme has the risk of providing support to non-deserving, while the work-first model has the risk of not offering help to some deserving individuals and families.

Finally, a recent more qualitative change in the welfare arrangement in Denmark should be mentioned. Recent reforms have introduced both stricter waiting periods but also work first conditions. An important example of a residence requirement specifically related to immigration in Denmark is the differentiation of social rights for all immigrations from outside the Nordic countries and EU where full rights in the social system requires residence in 7 out of the preceding 8 years (effective as of July 1st 2002). If this condition is not met there is no right for the basic social assistance (kontanthjælp) but only for an alternative and lower transfer denoted "start aid". The level of the start aid is approximately 40 % lower than normal social assistance (kontanthjælp). The requirement for full rights has later been strengthened by adding the requirement (since 2006) to have been in full time employment for 2 1/2 year within the qualifying residence period. The introduction of an employment criterion for basic rights in the social safety net is a new policy direction which implies a qualitative change in the welfare model.

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