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Institutional moral hazard in the multi-tiered regulation of unemployment in Denmark – Background paper.

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Abstract

This paper has been written in preparation of a research project funded by the European Commission (on the Feasibility and Added Value of a European Unemployment Benefit Scheme, contract VC/2015/0006). This paper adds information and detailed analysis to the following deliverable of that research project: *Institutional Moral Hazard in the Multi-tiered Regulation of Unemployment and Social Assistance Benefits and Activation - A summary of eight country case studies*; but it was not a deliverable. We use the concept ‘institutional moral hazard’ to analyse intergovernmental relations within multi-tiered welfare states, specifically in the domain of unemployment-related benefits and related activation policies (the ‘regulation of unemployment’). This paper is one of eight separate case studies, it focuses on Denmark. There are two principal actors in the Danish regulation of unemployment: the central government and municipalities, unemployment insurance funds and regional governments have a less important role. Concern for institutional moral hazard has led to several reforms of the municipal activation system, resulting in increasingly detailed monitoring and a complicated financing method. The trade-off between the complexity of central controls and the need for local flexibility is a source of ongoing reform efforts.

Keywords: *Institutional moral hazard; multi-tiered welfare states; intergovernmental relations; unemployment insurance; social assistance; Active Labour Market Policies; activation; social policy; Denmark.*

Denmark¹

List of Abbreviations

PES – Public Employment Services

SA – Social Assistance

UI – Unemployment Insurance

Introduction

The Danish case can be characterised as a fully municipalised decentralisation of activation. Due to the combination of a large municipal role in activation and the fact that the central government still bears a substantial part of the budgetary impact of both social assistance (SA) and unemployment insurance (UI), Denmark has extensive experience with performance management. Furthermore, it has undergone many changes in the regulation of unemployment; since most of these changes have been reactions to what can be seen as institutional moral hazard they are very relevant for the subject at hand.

Contrary to most of the other cases examined in this study, Denmark is not a federation. However, it has a multi-layered regulation of unemployment in which four institutional actors play a key role: the central government, the municipalities, the regions and the social partners. All these actors had, at some point or another, a major role in the design, regulation, financing, monitoring or implementing of labour market policies. Historically, the unemployment benefit regime was centralised and the SA regime was the responsibility of the municipalities. The UI regime included – and still includes to some extent – a major role for the trade unions, which administered and (co-)financed unemployment funds (*Arbejdsløshedskassen*), disbursed benefits and delivered services to the insured unemployed. It was the central government that regulated the UI scheme and monitored these funds, while the municipalities were in charge of the administration and implementation of the SA scheme. Reforms since 1994 have reshuffled some of the responsibilities, altered the size of municipalities and even introduced a new institutional player: the regional labour market councils.² Currently, the central government (co-)finances both benefit schemes and activation. Furthermore, it finances the employment regions³, sets out broad targets and has set up a monitoring and reimbursement model through which it influences the behaviour of municipalities. The municipalities have become responsible for the activation of all the unemployed and still administer the SA scheme. The employment regions are the link between the central and the municipal level, although their formal role is shrinking. The trade unions have also lost out in the reshuffling of responsibilities,

¹ We thank Bodil Damgaard, Thomas Bredgaard and Michael Rosholm for very useful exchanges on the Danish case.

² These councils are tripartite institutions in which public authorities and social partners meet to discuss both policies and the implementation thereof. These councils were introduced for other levels of government as well, cf. *infra*.

³ The employment regions are distinct from the regional labour market councils; they are levels of government that act as a transmission between the central and the municipal level. Cf. *infra* for their precise role.

although they are still responsible for the administration of UI funds and have some role to play in activation.

Landmark reforms include the 2007 resizing of municipalities and the introduction of jobcentres for UI in these new municipalities. They also include the 2009 complete municipalisation of activation services since these jobcentres became responsible for both UI and SA beneficiaries. Furthermore, these changes implemented a reimbursement model, through which the central government co-financed both activation and SA, contingent on municipal behaviour being in line with central regulation. These developments were accompanied by a very substantial monitoring system and the introduction of employment councils at *every* level of government, in which social partners and representatives of the relevant levels of government could meet, monitor performance and share information. Currently, the Danish system is undergoing new changes, which are again aimed at changing the responsibilities of these institutional actors.

1. Unemployment insurance

Danish UI replacement rates have been historically among the highest in Europe, and they currently remain at that same level of 90%.⁴ This is not to say that there have not been any changes in the (generosity of) Danish UI. It remains a politically controversial benefit scheme, and the duration of benefits has been subject to many changes. From 1994 until 2003, there was a succession of changes that shortened the eligibility period from seven to four years;⁵ in 2011, this was further reduced to a maximum of two years within a three-year period. One year of insured employment is enough to requalify. However, the entire scheme is currently under fire because the short(ened) duration, combined with a means-tested SA, results in many individuals who 'fall out' of the system: people who exhaust their UI claim suffer a great loss of income when they do not qualify for SA. In 2014, a special commission (the Dagpenge Kommissionen) was created to address this and other issues. They recently published their findings, which are now being considered by the Danish government.⁶ Shortening the duration not only held consequences for beneficiaries in the sense that they could 'fall out' of the system earlier, but it also has important consequences for the activation strategy (see section on activation of UI).

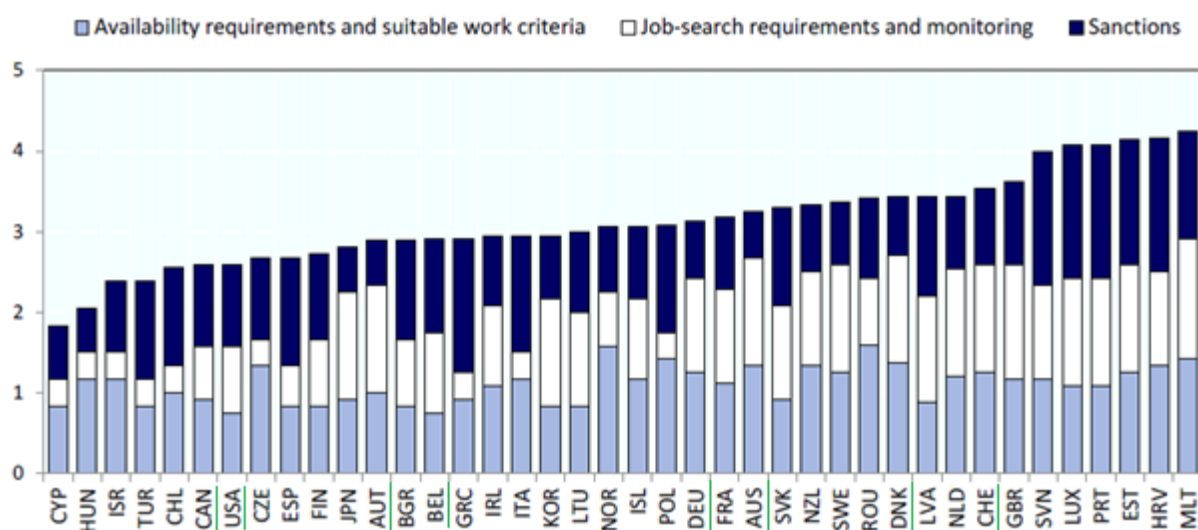
Danish UI scores higher on the eligibility criteria the average of the cases examined in this study; the strictness relates mostly to the availability criteria, monitoring requirements and sanctions for repeat offenders (see Figure 1 and **Error! Reference source not found.**). These strict eligibility criteria are most likely related to the high replacement rates of the benefits as well as the strong Danish focus on activation as a crucial part of its flexicurity model.

⁴ Capped at DKK 815 per day.

⁵ Not only was the formal duration of benefits subject to change, but also in the first period of the benefit activation was not mandatory; the 2003 reform ended this 'passive eligibility period' altogether (Andersen & Svarer, 2007, p. 12).

⁶ An interesting proposal includes greater flexibility and incentives for unemployed to take up work. Working, for even very short spells, will either extend benefit duration or create a new work record. Related to this, the commission proposes a couple of 'break' days during the benefit duration, which would be excluded from payments (Dagpengekommissionen, 2015).

Figure 1 Overall strictness of eligibility criteria. Source: Langenbucher 2015, p. 27.



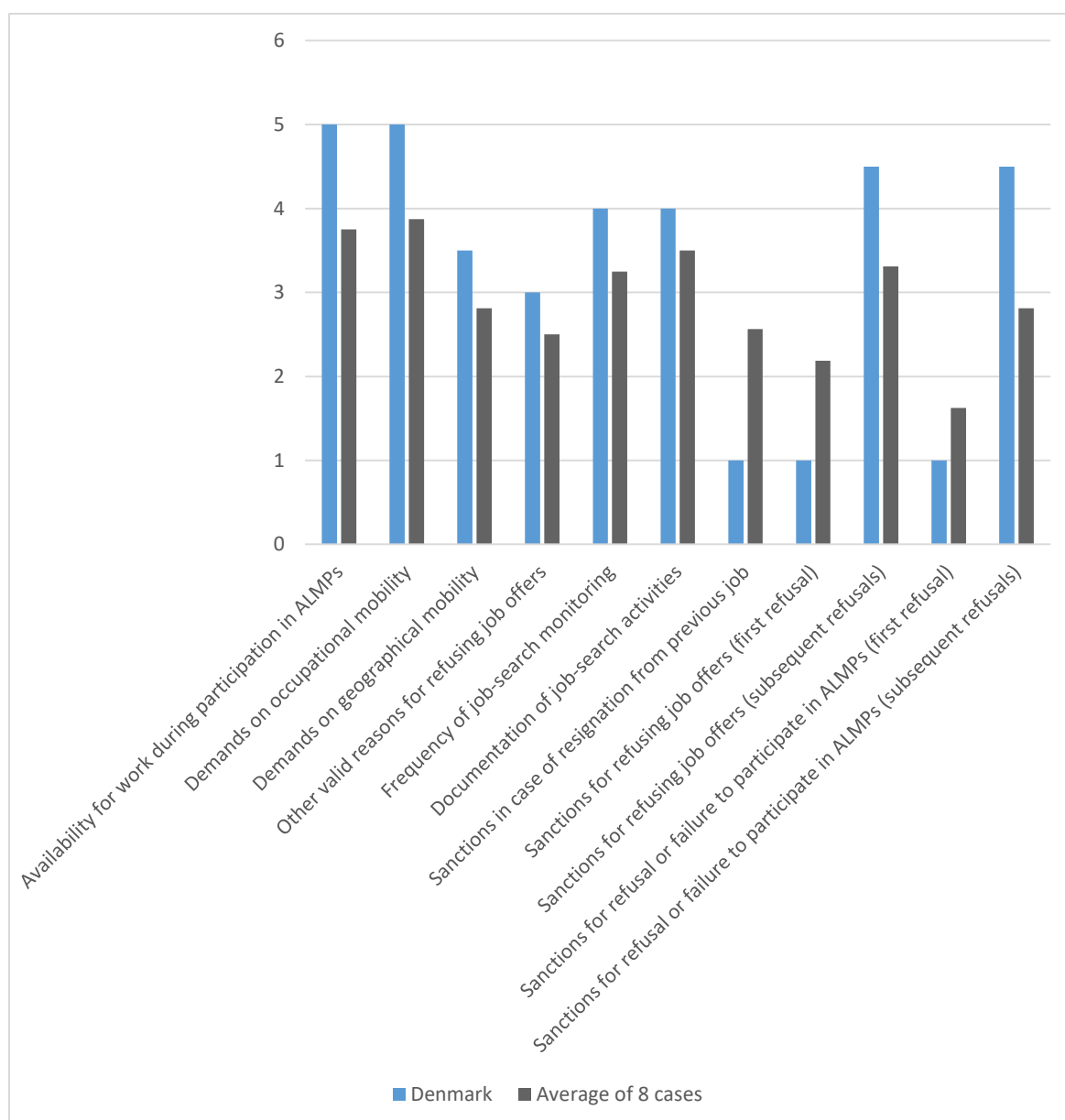
Historically, Danish UI includes major involvement of social partners, specifically trade unions. Trade unions manage UI funds (*Arbejdsløshedskassen*), which administer and disburse benefits. Workers must apply with the fund of their choice to initiate their coverage. Thus, in contrast to most other cases examined in this study (with the exception of Switzerland), the administration of Danish UI is not directly controlled by a government (agency). Yet, these funds must be formally approved by the government.⁷ It is the central level – in the form of the Ministers for Employment and Pensions – which oversees the conduct of the insurance funds.⁸ The central government is responsible for the legislation of the system, and currently the [Act on Unemployment Insurance](#) is the most important legislation governing the UI scheme.⁹ In this sense, the responsibility of governing the Danish UI scheme *sensu stricto* is centralised. However, contrary to Swiss unemployment funds, the Danish unemployment funds (and the affiliated trade unions) play an important (implementation) role in the regulation of unemployment. Their responsibilities have been subject to change throughout successive reforms. These responsibilities concern activation, which is described in sections 3 and 4. For this section it suffices to say that their role has been controversial, to say the least.

⁷ See [chapter 7 of the Act on Unemployment Insurance](#).

⁸ See [chapters 14-15 of the Act on Unemployment Insurance](#).

⁹ Other acts include the [Act on the Organisation and Support of Employment Efforts](#), which deals mostly with the responsibilities of different actors in the governance system, and the [Act on Active Employment Measures](#), which predominantly relates to activation of UI.

Figure 2 Strictness of eligibility in Danish UI. Source: Langenbucher 2015.



This system is financed from three sources: contributions (paid by the members of the funds), the central government and the municipalities. The contributions are mostly used to finance the administration costs of UI funds,¹⁰ while the central and municipal governments finance benefits. After the first four weeks of unemployment, the municipality starts to contribute between 50% and 100% of the benefit cost of an insured unemployed individual under its care (see Table 1).¹¹ The initial four-week period is the central government’s responsibility.

¹⁰ See [chapter 12 \(76-78\) of the Act on Unemployment Insurance](#).

¹¹ Currently, the Danish government is reforming its activation policies, which includes an adjustment of the contribution model for municipalities. See the section on activation for a more detailed discussion.

Table 1 Municipal contributions to unemployment benefits after four weeks. Source: [Chapter 12 \(82 a\) of the Act on Unemployment Insurance](#).

Default benefit cost	70%
Benefit costs of clients participating in activation (Chapters 10 and 11 of the Act on Active Employment Measures)	50%
Benefit costs of clients with a job/activation offer (Chapter 16 of the Act on Active Employment Measures) but who have not started on time	100%

As in the other cases, we present a brief overview explaining the heterogeneity of the caseloads of the constituent units in the Danish case – the municipalities. Table 2 clearly shows that there are structural differences between the caseloads of the municipalities. Historically, these differences have been the largest for SA, but UI is not far behind. Since the central government partially finances both of these benefits, the differences indicate a structural redistribution of central funds.

Table 2 Average municipal caseload for UI and social assistance (defined as the percentage of fulltime recipients as a percentage of the population), standard deviation and coefficient of variation per year. Source: own calculations made on data from <http://www.jobindsats.dk/jobindsats/>

Unemployment insurance	Average municipal rate	Standard deviation	Coefficient of Variation	Social assistance	Average municipal rate	Standard deviation	Coefficient of Variation
2004	4,604082	1,324796	28,77439	2004	3,115306	1,136262	36,47354
2005	4,064286	1,173452	28,87228	2005	2,894898	1,093335	37,76766
2006	3,083673	0,962638	31,21725	2006	2,486735	1,007283	40,50627
2007	2,05	0,782363	38,16405	2007	2,205102	0,933763	42,34555
2008	1,387755	0,560296	40,37428	2008	2,131633	0,851241	39,93377
2009	2,640816	0,672619	25,4701	2009	2,547959	0,910845	35,74802
2010	3,487755	0,737932	21,1578	2010	2,884694	0,978373	33,91603
2011	3,382653	0,713002	21,0782	2011	3,085714	1,013783	32,85406
2012	3,361224	0,674406	20,06428	2012	3,368367	1,071485	31,81023
2013	2,855102	0,507519	17,77588	2013	3,632653	1,114082	30,66855
2014	2,418367	0,435737	18,01782	2014	2,576531	0,818136	31,75341

2. Social assistance

Besides UI, the other major unemployment-related benefit scheme is SA (*Kontanthjælp*). This has historically always been a municipal competence. However, it is the central government that legislates the eligibility and levels of the SA.¹² It is a means-tested flat-rate benefit with indefinite duration, aimed at those jobseekers that have run out of UI or were not eligible in the first place. The benefit is amongst the lowest of all benefits in the Danish social safety net (Anker, Lindén, Wegner & Holch, 2009, p. 6).

As said, the scheme is legislated by the central government. The implementation, however, is the responsibility of municipalities. The municipalities assess eligibility, administer the scheme, act as the point of contact for the unemployed, and are obligated to follow up on the activation of the caseload (cf. *infra*). Furthermore, municipalities also have responsibility for other supplements as well as marginal benefits related to minimum income protection.

The municipalities are tasked with financing *Kontanthjælp*; however, the central government reimburses them for some of the benefit costs (see Table for municipal costs). The amount of reimbursement is contingent on whether the benefit claimants partake in activation and whether this happens in a timely fashion. The reimbursements are made based on the caseload and are disbursed on a monthly basis. This requires an extensive (performance) monitoring system; this monitoring system and the implications for activation policies are discussed in more detail in the next section.

Table 3 Municipal financial contribution to SA benefits. Source: [Chapter 14 of the Act on Active Social Policy](#).¹³

Default benefit cost (Chapter 4 of the Act on Active Social Policy)	70%
Benefit costs of clients participating in activation (Chapter 6 of the Act on Active Social Policy , Chapter 11 of the Act on Active Employment Measures), Operating expenses for traineeships (Chapter 12 of the Act on Active Social Policy), Benefit costs of clients participating in integration scheme under Integration Act (Chapter 6 of the Act on Active Social Policy)	50%
Benefit costs of clients with a job/activation offer (Chapter 17 of the Act on Active Employment Measures) but who have not started on time	100%

¹² See the [Act on Active Social Policy](#) and specifically chapters 1, 2 and 4 for the regulation of eligibility and the rates of benefits. The Act on Active Social Policy not only legislates the scheme itself but also the activation of its beneficiaries.

¹³ This table is not exhaustive as there are many other categories of costs that can be reimbursed. However, the costs listed are the most important and most relevant to this study.

3. Activation

Besides the reforms on the (passive) eligibility period of UI (and the upcoming reforms due to the Dagpengekommision), most of the changes in Danish labour market policies have focussed on activation. Some of the reforms have changed the division of labour within unemployment regulation and often went hand in hand with reforming the actual levels of government. Our starting point for the analysis is 1994, when regional employment councils were set up while activation policies were gradually shifted towards welfare-to-work policies, both in terms of activation and in terms of reducing benefit durations (Hendeliowitz, 2003, p. 69). The 1994 changes can be seen as the start of a decentralisation effort that (counter-intuitively) has been aimed at enhancing central control – or rather enforcing central goals – over labour market policies; 20 years later, with the current government, this process might be reversing (cf. *infra*). As will become clear from this section as well as the one on concern for institutional moral hazard (cf. *infra*), the changes in the governance of activation in Denmark reflect a struggle to align municipal behaviour with central goals.

Before 2007, municipalities were responsible for the activation of SA recipients, the national PES and the UI funds for activation of UI. The 2001 government started to harmonise the central power structure by bringing these responsibilities under one ministerial roof, the newly created Ministry of Employment (Bredgaard, 2011, p. 766), and reinforced work-first policies. However, the municipalities remained responsible for the activation of SA recipients. Additionally, the increasing focus on work-first policies beginning in 2001 was hindered by the autonomy of municipal caseworkers and the duality between the UI and the SA regime (Bredgaard, 2011, p. 766). This discrepancy between central goals and institutional behaviour, what Bredgaard has called ‘compliance gaps’ and which was already present before 2001 (Bredgaard, 2011, p. 765), was a motivation for reform. The central government attempted to implement several major changes: the regional level would become responsible for the monitoring and supervision of municipalities, the local offices of the central PES would merge with municipal offices, and the role of unions would be reduced (Bredgaard, 2011, p. 767). Due to strong opposition (from the unions, the Social Democrats and the municipal workers), reforms were held back. However, the central government did successfully create a regional level that could monitor the behaviour of municipalities more closely. After pilot studies in 2005, it succeeded in implementing joint jobcentres and, next, in creating four so-called employment regions and advisory councils at every level of government. This success was in part due to the reorganisation of subnational governments: 271 municipalities were rearranged into 98, and the 14 counties were replaced by the aforementioned regions. These reforms were a window of opportunity for reshuffling labour market responsibilities (Bredgaard & Larsen, 2008, pp. 6-7).

Within the municipal jobcentres, the central PES and municipal workers would act as a one-stop shop. However, as part of the response to the opposition, the back end remained along the lines of UI and SA in terms of responsibilities and financing. This two-tiered structure was abolished abruptly in 2009. The municipalities were given the responsibility of implementing and financing activation of UI beneficiaries and became the sole responsible level of government for the jobcentres. The jobcentres are now separate from the rest of the municipal administration,¹⁴ and the municipalities

¹⁴ This is still the case; see [chapter 2 of the Act on the Organisation and Support of Employment Efforts](#).

are now politically responsible for the activation of all unemployed (through jobcentres) and are in charge of the administration and disbursement of SA benefits (through a municipal department).

Furthermore, the responsibilities of UI funds have also been subject to change. Historically, the UI funds have provided services to their clients. However, because they are voluntary associations and are affiliated with unions, the funds have been criticised in the past for being too soft on their clients. Evaluations have shown, however, that the UI fund behaviour has been in line with central regulations. Moreover, they have not been reluctant to use sanctions and have been fairly uniform in assessing readiness for the labour market (Stigaard, Sørensen, Winter, Friisberg, & Henriksen, 2006). In other words, UI-fund caseworkers have been loyal to government policies “despite the fact that most caseworkers personally disagreed with policy objectives” (Bredgaard, 2011, p. 769). Some argue that their compliance with governmental regulations is out of fear for their existence, since their role is so controversial (Bredgaard & Larsen, 2008, p. 771). Before 2007, the funds were mainly responsible for administrating payments and sanctions, advising the unemployed about their rights and obligations, and monitoring workers’ ability to return to the labour market. Additionally, the unemployment funds were active as a “third party” provider of ALMPs during a period (starting in 2003) in which the government experimented heavily with outsourcing them. However, due to increasing criticism on the outsourcing as well as the performance of private providers, the government was compelled to tighten regulations, which resulted in a strong contraction. By 2007 non-profit providers (such as educational institutions and unions, but also the funds) were all but pushed out of the market by large private companies (Bredgaard, 2011, p. 771). The reforms in 2007 included a larger role for the UI funds (cf. *infra*) and entailed a centralisation (and gradual decrease) of tendering-out ALMP delivery.

The Danish decentralisation of activation policies is a good example of the possible counter-intuitive effects of devolution: on one hand, it does entail more autonomy for the municipalities, but on the other hand, it created tools for the central level to enforce its will. The central goals are voiced through ministerial targets, which are set (bi)annually (see Table).¹⁵ The municipality is required to adopt and translate these targets into a municipal employment plan that is audited on the basis of performance according to these goals.¹⁶ Audits go beyond the formal ministerial goals and include:

“(1) Baseline data about the number of unemployed persons according to type of income support and the type of activation programme they participate in. (2) Output data showing how well each Job Centre conforms to centrally defined goals. (3) Process data showing the performance of each Job Centre in meeting legally defined activation goals, such as making job plans, writing CVs and offering training activities. (4) Fiscal data showing how much money a given Job Centre may save, or is saving, by matching the average performer in its group” (Triantafillou, 2012, p. 63).

¹⁵ For the current legislation on these goals, see [chapter 3 of the Act on the Organisation and Support of Employment Efforts](#).

¹⁶ For the current legislation on these goals, see [chapter 2 of the Act on the Organisation and Support of Employment Efforts](#).

Table 4 Current and previous ministerial labour market goals to be adopted and translated by municipalities into their employment plans. Source: <http://www.jobindsats.dk/jobindsats/>.

Current goals	Reducing inflow into early retirement
	Reducing the number of long-term unemployed
	Stronger cooperation between jobcentres and businesses
	More youth beginning an education
	Increase the share of long-term unemployed with firm-based activation
Previous goals	Increase the labour force
	Reduce caseloads of pensions (non-activated permanent benefit schemes)
	Reduce the number of benefit claimants under 30
	Reduce the number of immigrants on benefits

To align municipal and central interests, a comprehensive reimbursement model (and contribution model in the context of UI) was created, which linked activation to the municipal costs for payments (cf. supra), while another reimbursement model was created for the costs of activation (cf. infra). Furthermore, “as the extended arm of the central administration, the [then] four employment regions are entrusted to monitor the performance of local jobcentres through a sophisticated benchmarking system” (Bredgaard, 2011, p. 768).¹⁷ Another limiting factor for the leeway of the municipalities can be found in central legislation, which prescribes a list of types of policies that the jobcentres are allowed to utilise.¹⁸ The list does allow for some flexibility in the design (and content) of these policies; however, central legislation does dictate formal requirements and conditions per policy (see Table 5).¹⁹ A final avenue for central control over municipal behaviour was the introduction of minimum requirements, a cadence of mandatory actions to be taken by the jobcentres at set intervals (see **Error! Reference source not found.** for the current list of minimum requirements).²⁰ “The organizational reform can thus be seen as an attempt of central government to regain control and strengthen the accountability structures in labour market policies” (Jantz & Jann, 2013, p. 238).

Table 5 Prescribed activation policies to be delivered by jobcentres to UI and SA clients, plus centrally legislated requirements for these policies. Source: [Chapters 8-12a of the Act on Active Employment Measures](#).²¹

Type of policies	Requirements
Elective training	Maximum and minimum duration, type of education, cap on costs, waiting period before start, limitations on eligibility
Mentoring	Outline of mandatory mentoring agreement, additional rules on mentoring conducted by third parties
Guidance and upskilling	Limitations on eligibility, limitations on content, minimum and maximum duration
Internships	Limitations on eligibility, limitations on content, minimum and maximum duration
Subsidised employment	Limitations on eligibility, limitations on content, minimum and maximum duration, additional rules on wages, working conditions and level of hourly subsidies to be paid
Resource progress	Strict eligibility requirements (only for persons unable to achieve employability through regular services), requirement of a single caseworker per client and establishment of a holistic plan
All categories	Offers must be in accordance with individual job plan, offers must take into account: both local employment conditions and individual conditions, offers cannot distort labour market

¹⁷ Also see (Mploy, 2011, pp. 14, 22).

¹⁸ See [chapter 8 of the Act on Active Employment Measures](#).

¹⁹ Furthermore, the minister always retains the prerogative to lay down additional rules and guidelines for each type of policy.

²⁰ The list presented in Table 6 is the current amended 2014 version, which leaves more room for the municipalities than the previous version.

²¹ This list is not exhaustive but covers the main types of programmes; other programmes include measures to support self-employment and schemes for the reintegration of the disadvantaged.

Table 6 Centrally legislated minimum requirements for the actions of jobcentres. Source: [chapter 7 \(15-21e\) of the Act on Active Employment](#)

Assess job readiness and classify clients in 2 groups: employment-ready and activation-ready
The creation of an individual job plan and minimum substance thereof, per benefit
The timeframe for the first meeting and the amount of follow up meetings within a year, per benefit
Instructions for content and goals for meetings with clients, per benefit
The provision of a single caseworker for certain social assistance clients
Mandatory action & follow up when doubts arise concerning availability of clients
A time frame and mandatory minimum actions for job referrals

The developments in the Danish regulation of unemployment have shown that decentralisation is not a zero-sum power game where the local government automatically wins out (Triantafillou, 2012). Rather, the system incorporates many ways for the central government to try and enforce the type of municipal conduct that is in compliance with their goals. On the other hand, municipal autonomy and municipal decisions remain important and they still maintain the ability to achieve central goals and even go beyond them (Triantafillou, 2012); however, this system is not without perverse incentives (see section on institutional moral hazard).

The labour market governance system described above is undergoing new changes that started in the summer of 2014; some of them still await implementation. These changes seem to entail a break in the trend of increasing central control over municipal activation, since the link between (1) reimbursements and contributions to benefit costs and (2) activation as a policy output will be severed. The rate of reimbursements and contributions will depend on a 'counter' per unemployed: the longer an individual is unemployed, the higher the costs for the municipality, regardless of the benefit and type of activation offered to him/her. Furthermore, reimbursements for activation services will be simplified, limiting the perverse incentives (cf. *infra*). In essence, the relationship between reimbursement and activation becomes reconceptualised, from a more complicated and strict system in which (different rates of) reimbursement were dependent on activation as an output, to an outcome-based system where reimbursement is linked to successful activation due to increasing costs throughout the period of benefit dependency. In other words, reimbursement is no longer linked to the delivery of activation in and of itself, but to the outcome of activation policies.

The new system will most likely entail higher costs for municipalities. This is due to the amount of municipal contribution rates, which will increase to a maximum of 80% of the benefits after a certain period of benefit dependency. The increase in these rates is dependent upon the duration of benefit dependency and will be the same for all benefits. In exchange for higher costs, the municipalities get more leeway in the implementation of activation policies and the strategy thereof, since the system of minimum requirements and the ways in which central goals can be achieved will be relaxed. Additionally, the regions, which have increased to eight total, are no longer responsible for the continuous monitoring of municipalities. The current responsibilities of the regions have been relegated to coordination and facilitating cooperation.²² Instead, the audit of municipal performance on the employment plan is now performed annually by the ministry.

²² See [chapter 5 of the Act on the Organisation and Support of Employment Efforts](#).

4. Activation of two benefit schemes under one roof

Contrary to some other cases examined in this study,²³ the analysis of the specific division of labour concerning activation of different benefit schemes will not be distinguished as Denmark currently has a fully integrated activation system. There are, however, some differences between the activation regimes of the two benefits, which are related to the pre-2007 dichotomy.

The dichotomy between what the (then central) PES was doing for the insured unemployed and for the municipalities for SA was already somewhat addressed before the integration of services in the jobcentres. Insured and non-insured jobseekers were afforded the same rights (in principle) and were both subjected to an individual job plan (Hendeliowitz, 2003, p. 70). Furthermore, as already stated, central responsibility for both schemes was harmonised, which emphasised the continued difference on the ground. The municipalities were seen to be overprotective of their caseloads and not willing to sanction or discipline when needed. This was especially due to the fact that municipalities were responsible for both activation and providing social services. These responsibilities were separated when the pilot programmes with new jobcentres were introduced. During the pilot period and between 2007 and 2009, jobcentres were only allowed to provide activation services; social services were delivered through a purely municipal department. Frontline workers tended to perceive this as an attack on their autonomy and as counterproductive to a coherent activation strategy (Bredgaard, 2011, p. 767). Even after the full municipalisation, the two types of services were kept separated. With the recent changes in 2014, the separation will most likely fade, since some of the more problematic cases in the SA caseload now have the right to a single caseworker for both activation and social services, as well as the opportunity to engage in a holistic programme that goes beyond activation alone.²⁴

On the other hand is the UI regime, which also continues to carry over characteristics from the period before full municipalisation. This is mainly due to the role of unions. As described in the previous section (cf. supra), the role of the UI funds in activation intensified after the 2007 reforms. They not only handle the initial contact with the insured unemployed, but can also make referrals to job vacancies and provide services; they have also intensified their responsibilities for monitoring availability (Bredgaard, 2011, p. 771; Mploy, 2011, p. 31). The insured unemployed are obligated to make initial contact with the UI funds, and they can also receive services from their UI fund.²⁵ Furthermore, some of the mandatory follow-up meetings will not only be held with the jobcentre but jointly with the UI funds. This might seem inefficient, but it is a testament to the dedication of UI funds to stay relevant and involved in the regulation of unemployment. The role of the UI funds, therefore, cannot be discounted. This is in contrast to the Swiss UI funds, which are not able to influence policy in any way.

A final difference between the development of activation policies for UI and SA beneficiaries has been the reduction of UI benefit duration. Labour market reforms in the early 2000s shortened the benefit period from seven years to four years and also eliminated the initial 'passive' portion. In

²³ And indeed most other European and OECD countries (Jantz & Jann, 2013).

²⁴ See [chapter 7 \(18 a\)](#) and [chapter 12 a of the Act on Active Employment Measures](#) for the special programme for this client group.

²⁵ See [chapter 3 \(5\) of the Act on Active Employment Measures](#).

2011, the duration was further shortened to a maximum of two years within a three-year period. This requires a change in the activation regime for policies to become more 'front-loaded'. This means, in turn, a change in incentives in order to target early policies more, since municipal caseworkers have to adjust their practices.

So even though there are fully integrated municipal jobcentres, the regimes for the different benefit schemes do still differ. Moreover, the central requirement for services to be delivered by the jobcentres (see Table 5) can specify for which target group these services are eligible and under which circumstances. The Act on Active Employment Measures covers activation, but the Act on Active Social Policy not only includes regulations on SA but also codifies some of the specifics for activation of that benefit scheme. Differences not only include the types of services available, but also the fact that SA beneficiaries must be divided into two categories: employment ready and activation ready; this further determines which services are available to which individuals. Finally, there are differences in the way services are reimbursed.

As stated above, the municipal contributions for UI benefit costs and the central reimbursements to municipalities of SA benefit costs are contingent upon individuals participating in activation (see Table 1 and Table). The reimbursement of municipal activation costs is more complicated. Generally speaking, the central government reimburses the municipalities for 50%, 65% or 100% of their costs, if the municipalities have incurred such costs in accordance with prescriptions.²⁶ Furthermore, if municipalities do not comply with the minimum requirements, reimbursements can be withheld. Due to time and space limitations, it is not feasible to present the full rules and regulations concerning the reimbursement model, especially as there are many clauses and specific regulations functioning as conditions for reimbursement. It is safe to say that the model is very complicated and requires an elaborate IT system in order to function. The IT system through which municipalities and the UI funds disclose their actions and the applicable details of their caseloads (but also their budgetary information) is open to the public via the online portal www.jobindsats.dk.

One of the elements of the very recent reforms that is still underway is the adjustment of this reimbursement model. Most likely it would feature the same municipal contributions for every unemployment-related benefit and would not be contingent on activation. The reimbursement of activation will most likely be simplified and not include the many stipulations and rates that are still currently applicable under chapter 23 of the Act on Active Employment Measures. It is to be expected that these and other changes will incentivise the jobcentres to focus on early activation. It is, however, too early to assess these recent changes thoroughly, as some are not yet even in effect at the moment.

²⁶ See [chapter 23 of the Act on Active Employment Measures](#).

5. Concern for institutional moral hazard

Institutional moral hazard has played a very prominent role in Danish regulation of unemployment. Much of these reforms have centred on aligning municipal behaviour with central goals. Due to the high replacement rates, and especially the long duration of benefits, activation in Denmark previously focussed on improving human capital. The shift in focus towards work-first policies, by both reducing benefit periods and changing the nature of activation, created ‘compliance gaps’ because municipal caseworkers did not view such goals as very legitimate (Bredgaard, 2011). The result was a dichotomy between the UI and the SA regime. This is where the changes in the mid-2000s come into play: as the central government tried to end these compliance gaps and reverse the dichotomy, it also harmonised the activation system. Eventually, the activation for both types of benefits was brought together under one roof in 2007 and was fully municipalised in 2009.

There have also been many concerns regarding the role of UI funds. As explained earlier, the assumption was that they would be too soft on their clients when assessing work-readiness. However, research shows that the UI funds have been loyal to government policies. Starting in 2007, the role of the UI funds was expanded. Besides the federal legislation surrounding the UI funds and ALMPs, the UI funds seem to have an intrinsic motivation to comply with government policies. Because their role is so controversial, any sign of structural sheltering of UI clients from government policies would surely lead to a revision of their role and, thereby, endanger their continued existence.

Just as in the Swiss case, the Danish UI replacement rate is high. However, contrary to the Swiss case, the Danish subnational level contributes substantially to the costs of unemployment-related benefits. Therefore, the moral hazard has had a different impact in Denmark, not only for UI but also for SA. The co-financing of benefits and activation by municipalities has been crucial in dealing with issues of moral hazard. Even though the municipalities can manipulate their insured risk – the costs of unemployment – they still bear a substantial burden if they would do so. Moreover, if municipalities were to manipulate their insured risk by not providing enough activation services, their costs would increase due to the higher contribution/lower reimbursement rate for benefits of clients who are not participating in activation. Notwithstanding the fact that municipalities contribute to the costs of benefits, such a constellation could still create incentives for parking. However, incentives to park clients in programmes which have little or no substance are (partially) counteracted by the system of minimum requirements: on one hand, there are strict stipulations on the activation costs that can be reimbursed and, on the other hand, non-compliance with the minimum requirements by municipalities can result in reimbursements being denied or retrieved. In other words, the municipal jobcentres do have incentives to actually engage in the behaviour prescribed in the minimum requirements (see **Error! Reference source not found.**) and to not create any meaningless programmes.

This system is not without downsides. First of all, the reimbursement model, the minimum requirements for contact with the unemployed and the requirements for programmes necessitate a comprehensive monitoring tool. All actors – the jobcentres, municipalities, UI funds, the regions, the councils and the central government – are obligated to use ‘Jobnet’ as the way to communicate,

administer and register data on the unemployed.²⁷ The information of this database is even (partially) open to the public via the aforementioned link (cf. supra). Furthermore, the level of detail of the data is necessarily high. In all, this requires a very complex and elaborate system, which needs very detailed and substantial monitoring and reporting. According to an OECD survey in 2011, 93% of all the Danish jobcentre managers indicated that the 'level of bureaucracy dealt with as part of accountability procedures' was 'high' (Froy, Giguère, Pyne, & Wood, 2011, p. 42).²⁸

An additional downside is that this strict system has a heavy impact on the flexibility of the jobcentres and municipalities. Especially during times of crisis, there were signs of difficulty for municipalities to enforce the minimum requirements due to high costs, but they are still forced to comply since costs would otherwise increase even further (Mploy, 2011, p. 48). Perhaps even more poignant, the method of financing and minimum requirements does not ensure that jobcentres and municipalities will work towards the annual overarching ministerial goals – which are often broad and outcome-based. Instead, the reimbursement model emphasises output goals. In concrete terms, this means that jobcentres are more focussed on providing every unemployed individual with services and programmes that attract the highest reimbursement, even though such programmes might not be in the best interests of those unemployed. Monitoring, reimbursement and possible sanctions are not related to the ministerial goals, and they are therefore more symbolic in meaning. Municipalities have little incentives to translate the ministerial goals to their local context as precisely as possible, and even if they do, the jobcentres would still react more to the financial output-based incentives. Moreover, jobcentres have the incentive, within the formal requirements, to relabel their programmes to those programmes that attract the highest reimbursement.

These downsides of encroaching on municipal flexibility seem to have been recognised in the latest (and still ongoing) reforms. By simplifying the reimbursement model for activation services, the incentive for relabelling will be addressed. More importantly, by severing out the municipal costs for benefits with activation as a policy in favour of activation outcomes, municipalities will have more leeway to implement policies as they see fit rather than applying the highest paying programmes to as much unemployed as possible – regardless of the effects. The incentive for jobcentres to be as effective as possible – in terms of work-first policies – will still remain due to the 'counter' per unemployed, which increases municipal costs as the duration of benefit dependency continues. However, since not all elements of these reforms are in place and the effects are not yet clear, it is too early to analyse the impact.

²⁷ See [chapters 6-9 of the Act on the Organisation and Support of Employment Efforts](#).

²⁸ This is not an inherent feature of jobcentre work, as caseworkers from other countries noted lower scores in the same category for their work: New Brunswick (Canada) less than 10%, Flanders (Belgium) 20%, Alberta (Canada) 50%, Dutch central PES workers just over 60% and Dutch municipal workers around 80%.

6. Analytical grid

Table 7 Analytical grid Denmark. Source: own compilation.

		Unemployment benefits	Activation of individuals with unemployment benefits	Unemployment-related SA benefits	Activation of individuals with SA benefits
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: <ul style="list-style-type: none"> - Formal regulation - Policy goals 	No decentralisation	Low decentralisation Central regulation of types of policies and minimum requirements The central level also formulates broad policy goals. The local level translates these goals into targets.	Low decentralisation The central level regulates SA, and the municipal level formulates policy goals.	Low decentralisation Central regulation of types of policies and minimum requirements The central level also formulates broad policy goals. The local level translates these goals into targets.
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	No decentralisation UI is implemented according to the Ghent system: private (social partners) parties create UI funds which disburse benefits, but they have no policy autonomy concerning UI.	Medium decentralisation Municipalities are completely responsible through one-stop shops, with some responsibilities for UI funds. The degree of decentralisation is limited by exacting central legislation, minimum requirements and monitoring.	High decentralisation Municipalities are completely responsible through municipal department.	Medium decentralisation Municipalities are completely responsible through one-stop shops. The degree of decentralisation is hampered by strict central legislation, minimum requirements and monitoring.
3	Budgetary responsibility	Shared between the central and the municipal level The UI funds fund their own administration through contributions of members.	Shared between the central and the municipal level The municipalities fund activation and the central level partially reimburses them. The UI funds fund their own administration through contributions of members.	Shared between the central and the municipal level The municipalities fund SA and the central level partially reimburses them.	Shared between the central and the municipal level The municipalities fund activation and the central level partially reimburses them.
4	Budgetary transfers between levels of government?	Yes From the municipal to the central level	Yes From the central to the municipal level	Yes From the central to the municipal level	Yes From the central to the municipal level
5	Structural redistribution? (measured on a per capita basis)	Yes Structural	Yes Structural	Yes Structural	Yes Structural

		differences in caseloads	differences in caseloads	differences in caseloads	differences in caseloads
6	Political or managerial decentralisation/ delegation?	n.a.	Political decentralisation	Political decentralisation	Political decentralisation
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	Output	Input, output and outcome Very elaborate monitoring system which focusses on inputs and outputs. Ministerial goals are mostly outcome-based.	Output	Input, output and outcome Very elaborate monitoring system which focusses on inputs and outputs
8	Is a system of 'minimum requirements' applied?	n.a. The legislation concerning UI and the implementation thereof is tightly regulated at the central level.	Yes Relatively strict set of minimum requirements, including minimum amount of meetings and mandatory work processes	No The legislation concerning UI and the implementation thereof is tightly regulated at the central level.	Yes Relatively strict set of minimum requirements, including minimum amount of meetings and mandatory work processes
9	Are performance-based sanctions/rewards applied by the higher level at the lower level?	n.a. There is no lower level of government involved in the implementation. The funds receive no performance-based rewards or sanctions.	The reimbursement model entails financial incentives for the municipalities. Municipal costs are contingent on activation (measured in output indicators).	The reimbursement model entails financial incentives for the municipalities. Municipal costs are contingent on activation (measured in output indicators).	The reimbursement model entails financial incentives for the municipalities. Municipal costs are contingent on activation (measured in output indicators).
10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	Institutional moral hazard exists, there is much awareness and the responses have been numerous. Municipalities are subject to very detailed monitoring. This monitoring system is tied to a reimbursement and contribution model. The mandatory municipal contributions to central UI funding and the central reimbursement of municipal activation efforts are contingent on the compliance and efforts of the municipalities. A strict system of minimum requirements is applied. Reform is underway to simplify the financial system and to address the strictness of minimum requirements. There has been much concern for the role of UI funds in the past. But besides the measures described above, the UI funds have been intrinsically loyal to government policies, to ensure their continued existence.	Institutional moral hazard exists, there is much awareness and the responses have been numerous. Municipalities are subject to a very detailed monitoring system, which is tied to a reimbursement model. The central reimbursement of municipal activation efforts and SA costs are contingent on the compliance and efforts of the municipalities. There was also a strict system of minimum requirements applied. Reform is underway to simplify the financial system and address the strictness of minimum requirements.		
11	Conclusion from 5-6-7: approach to principal-agent issues?	There are no obvious principal-agent problems concerning the implementation of the passive part of UI by private funds. The central government has tightly regulated these funds.	n.a. (due to the political nature of decentralisation, we do not apply the principal-agent concept here).		

		Principal-agent concept is not applicable to the active part of UI (due to the political nature of decentralisation)	
12	Contribution to macroeconomic stabilisation by the benefit system	Very important (Dolls <i>et al</i>)	

7. Conclusion

Denmark, with its municipalised activation system and its high replacement rates, has proven to be very relevant for the subject at hand. Contrary to most of the other cases, Denmark is not a federation. However, the relationship between the central government, which legislates and (co-)finances the unemployment-related benefits, as well as the municipalities, which are responsible for activation, is indicative of several issues concerning moral hazard.

The early situation in which the two labour-related benefit schemes were separated, combined with the refocus towards work-first policies, led to compliance gaps on the side of municipalities. By harmonising the two systems, the Danish central government tried to close these compliance gaps. This has resulted in a completely municipalised system of activation in which jobcentres play a pivotal role. But as time went on, it became clear that to reduce perverse incentives and to align municipal behaviour with central goals, an intricate interplay between strict minimum requirements, a complicated financing method and an elaborated monitoring system was required. This constellation, in turn, reduced flexibility at the local level and did not necessarily lead to compliance with the ministerial goals. The oncoming reforms will address these issues, but as of yet it is too early to tell what the impact will be.

The Danish case has shown that a central government can be successful in steering the behaviour of lower levels of government. The reimbursement model combined with the monitoring via Jobnet led to a strong adaptation on the municipal side. Simultaneously, Denmark also illustrates the downsides of such a constellation – albeit that the output-based financing method had more impact than the outcome-based overarching annual ministerial goals. It seems to remain a tough balancing act between the strictness of control and the effectiveness of local flexibility.

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