

ENGLISH SUMMARY

Chapter I: The Danish Economy

The upturn in the Danish economy has continued at an undiminished and indeed increased pace during 2005. As a result, GDP growth rate this year will reach 2¾ per cent. Next year's growth is expected to be slightly lower, but still well above normal growth rates for Denmark. The current boom is likely to lose momentum during 2007, and in 2008 growth is expected to return to a more normal pace of 1¾ per cent per year. As a result of the positive economic outlook for the current and coming years, the unemployment rate is expected to be very low during the entire forecast period.

The high Danish growth rates are primarily driven by domestic demand, especially private consumption. However, export growth also contributes to the rise in GDP, resulting from the overall positive outlook in the international economy.

The currently high rate of international growth is driven to a considerable extent by the USA and China, while growth in Europe and Japan is more modest. In the years to come international growth is expected to continue to be relatively high, although there are several uncertainties regarding the world economy.

Although the oil price has increased significantly, the impact on inflation and growth has been surprisingly small, especially in Europe. Normally, there is a time lag before higher oil prices affect overall inflation, and until now the oil price increase has only influenced European consumer prices to a small extent. Future trends in the oil price and their impact on the international economy are significant uncertainties.

Global imbalances are still present in the world economy. The imbalances show up most clearly as a large deficit on the US current account, which corresponds to current account surpluses in several Asian countries. The US external

deficit has been driven by strong domestic demand fuelled by expansionary monetary and fiscal policy. Restoration of balance may be achieved in different ways, for instance by a decrease in American consumption, by a depreciation of the dollar or by a higher US interest rate. A slow adjustment in the imbalances is assumed in the forecast. It is however uncertain how and when the adjustment will take place.

The global imbalances are related to the international interest rate, which has been surprisingly low in recent years. The low interest rate is a result of a savings surplus in Asia, particular China, as well as demographic changes in western economies and in parts of Asia. Furthermore, reduced inflation expectations caused by the stabilisation objectives of monetary policies have lowered the interest rate. Besides these factors, which will continue to keep down interest rates for several years into the future, the long interest rate is currently affected by temporary factors such as abundant liquidity in the financial markets due to expansionary monetary policy. Uncertainty regarding future changes in interest rates results in uncertainty with respect to the projection for the international economy, in part because interest rates are a key factor in determining movements in international house prices.

The low interest rates have also contributed to a steep increase in Danish house prices. Accordingly, the rise in house prices is expected to be approximately 15 per cent this year. Next year, the increase in interest rates will work towards reducing house prices. As a result, the growth rate in house prices is expected to gradually slow down, starting from 2006. There is no expectation of an actual fall in house prices during the forecast period.

Growth in private consumption will be approximately 4¼ per cent in 2005. Consumption is the main contributor to the substantial growth in domestic demand. The high growth rate in consumption is due to the increase in income resulting from lower unemployment and rising house prices. The high level of house prices also contributes to continued investment in residential housing, so that the current high level of house purchases will be maintained in the coming

year. As a result of the positive economic outlook and low interest rates, fixed business investment will grow at a reasonable rate in 2005. In 2006 the contribution from business investments to growth in domestic demand is expected to increase further.

The significant growth in domestic demand, especially consumption, will induce a considerable increase in imports. However, export growth will also be substantial, and the surplus on the current account is expected to be more or less unchanged in 2005 and 2006. During 2007 and 2008 exports are expected to resume growing at a somewhat higher rate than imports, resulting in a small increase in the current account surplus.¹

Last year employment rose only modestly, despite a high overall growth rate. During 2005 the upturn has had an indisputable positive effect on employment. The employment increase is expected to continue in the remaining part of 2005 and well into 2006. However, the upturn is expected to lose momentum after that. At the same time, the first signs of the future demographic challenges will most likely be manifested in the form of a small decrease in the labour force. Thus, a small drop in employment is predicted in 2007 and 2008.

The increased employment in 2005 has also led to a considerable decrease in unemployment, despite an increase in the labour force, as a result of the positive economic outlook. The number of unemployed persons is expected to be about 150,000 by the end of 2005, which translates into an unemployment rate of just over 5 per cent of the labour force (national definition). In 2006 the decrease in unemployment will continue, but at a diminished rate. Thus, it is predicted that the number of unemployed persons will approach the level of unemployment witnessed during the winter of 2001-02, which was the lowest level of unemployment seen in Denmark since the beginning of the 1970s. In addition,

1) The statistics underlying the assessment of the current account balance are presently being restructured. Thus, there is a significant degree of uncertainty concerning the balance of the current account.

the number of people participating in different labour market activation schemes has fallen since 2001-02. These people are not officially counted in the unemployment statistics, but they nonetheless constitute an extra labour reserve. In conclusion, the forecast presents a picture of a labour market under severe pressure.

Consumer prices will increase by just over 2 per cent this year. The relatively high inflation rate is primarily a result of the increase in the oil price, which has induced rising consumer prices throughout 2005. The effects of the oil price increases have been somewhat delayed, which is why the inflation rate is expected to remain above 2 per cent in 2006 as well. In the absence of any additional increases in the oil price, the inflation rate is expected to decrease to a level just below 2 per cent per annum in 2007-08.

In contrast to the increasing rate of consumer price inflation, the increases in the Danish wages have been subdued, yielding a wage rate inflation of just above 3 per cent in 2005. However, the decrease in unemployment during the current and the next year will induce greater wage increases. The prediction is that wage rate inflation will exceed 4 per cent per annum by the end of the forecast period. This is a relatively high rate of wage inflation, but it is comparable to the historical wage increases between 1998 and 2003.

Table 1 Short-term outlook for the Danish economy

	Current	Per cent	Percentage change, volume				
	prices DKK bn.	of GDP					
	2004	2004	2004	2005	2006	2007	2008
Private consumption	710.1	48.6	4.0	4.3	2.7	2.0	2.0
Public consumption	388.7	26.6	2.0	1.2	0.7	0.7	0.7
Gross fixed capital formation	284.8	19.5	3.2	3.6	5.7	2.3	1.8
consisting of:							
Residential investments	73.4	5.0	10.9	5.2	6.4	2.6	1.9
Business fixed investments	190.3	13.0	-0.4	3.9	5.9	2.2	1.7
Public investments	25.1	1.7	11.6	-3.5	2.0	2.0	2.0
Stockbuilding ^{a)}	3.5	0.2	0.1	-0.2	0.1	0.0	0.0
Total domestic demand	1,387.1	95.0	3.3	3.1	2.9	1.7	1.6
Exports of goods and services	667.3	45.7	3.3	7.5	4.4	3.4	3.3
Imports of goods and services	594.0	40.7	6.5	8.7	5.6	3.4	3.3
GDP	1,460.4	100.0	2.0	2.8	2.4	1.8	1.7
Key indicators							
Consumer prices, percentage change ^{b)}			1.5	2.1	2.2	1.8	1.9
Unemployment, per cent ^{c)}			6.1	5.5	4.9	5.0	5.1
Current account, DKK bn.			35.8	34.0	30.0	31.4	35.4
Current account, per cent of GDP			2.5	2.2	1.9	1.9	2.0
General government financial balance, DKK bn.			16.2	40.7	31.9	25.7	22.6
General government fin. balance, per cent of GDP			1.1	2.7	2.0	1.5	1.3
Hourly wage costs, percentage change			3.1	3.1	3.8	4.1	4.1
Terms of trade, percentage change			0.4	-0.3	0.3	-0.1	0.3

a) The percentage changes are calculated as real changes in stock-building relative to real GDP in the previous year.

b) Implicit private consumption deflator.

c) Percentage of the total labour force. National definition.

Note: The DKK/USD exchange rate is taken as 5.99 in 2004, 5.95 in 2005 and 6.09 in 2006-08.

Sources: Statistics Denmark, *National Accounts* and own estimates.

The housing market and the taxation of houses

Danish house prices have doubled on average in real terms since 1993. In the Copenhagen metropolitan area house prices have increased even more strongly, and the higher house prices have led to significant capital gains, which have primarily benefited the highest income groups.

In Denmark, the taxation of housing is low compared to the taxation of other sources of capital income. The imputed rent of owner-occupied houses is taxed at a nominal rate of 1 per cent of the assessed value of the house (“ejendomsværdiskatten”). However, special discounts apply to the elderly, and to people who bought their houses prior to 1998. In addition to these discounts, the so-called tax freeze means that the taxation on the imputed rent is fixed in nominal terms at its 2001 level. With increasing house prices, this causes the effective tax rate to fall. The combined effect of the tax freeze and the discounts means that the effective tax rate on housing is less than 0.6 per cent of the assessed value of the house.

The low tax on imputed rent means that investments in owner-occupied housing receive an implicit subsidy. If housing were to be taxed at par with other sources of capital income, a tax rate of around 1½ per cent should apply. The difference between the current tax rate of 0.6 per cent and this “neutral” tax rate of 1½ per cent gives rise to an implicit subsidy to owner-occupied housing of around DKK 20 billion or 1¼ per cent of GDP per year.

It is recommended that taxation on housing should be increased. This would make the tax system more neutral in relation to the taxation of the various sources of capital income, and it would make room for cuts in other more distortionary taxes, e.g. tax on labour income.

At the very least, the effective tax rate should be increased from the current 0.6 per cent to 1 per cent of the assessed value of the house. This could be done by “unfreezing” property taxes and gradually abolishing the special dis-

counts. An increase of the property tax to 1 per cent would yield extra revenue of some DKK 8 billion.

The full step to a level of taxation that does not favour investment in housing could be made either by increasing the property tax rate further to 1½ per cent or by introducing a capital gains tax to supplement the property tax of 1 per cent.

One motivation for introducing a capital gains tax is that the fluctuating house prices cause major redistributions of real income between individuals entering and exiting the housing market at different points in time. Very often the exact timing of buying or selling a house is determined by factors which are not fully controlled by the individual, e.g. births, divorces, change of jobs, etc. Favourable timing on the housing market could mean more for lifetime consumption than many years of savings out of hard-earned and taxed income. Another motivation for introducing a capital gains tax is that it could raise substantial revenue, which could be used to reduce more distortionary taxes. With an inflation rate of 2 per cent, real house price increases of 1 per cent, and a tax rate of 33 per cent (the rate at which other capital income is taxed for those in the lowest income bracket), a tax on nominal capital gains could yield some DKK 20 billion per year on average. For comparison, the revenue from the “top-skat” (a tax of 15 per cent levied on the highest income bracket) is around DKK 16 billion.

However, several arguments have been put forward against capital gains taxes on owner-occupied housing. If the capital gains tax were to be based on realization, serious locking-in effects could arise. On the other hand, if the capital gains tax were to be levied on an accrued basis, there would be serious valuation problems. Also, one could argue that a capital gains tax could increase the volatility of house prices.

This report proposes a capital gains tax scheme that avoids these drawbacks. The proposed tax scheme treats capital gains and losses symmetrically and provides an equal treatment to gains on different types of assets, e.g. housing,

stocks and bonds. The tax scheme taxes capital gains when they are transformed into consumption, whether that is after realization or if the consumption is financed by mortgaging equity. On the other hand, capital gains which are not consumed are not taxed. This means that capital gains that are realized by selling a house but reinvested in another house (or in bonds or stocks) are not taxed. Therefore, the proposed tax scheme does not lead to locking-in effects. Furthermore, the proposed tax scheme is based on actual buying and selling prices, and thus the scheme does not have the valuation problems associated with traditional capital gains taxes on an accrued basis. An additional advantage of the scheme is that the tax becomes due when people are actually holding the money in their hands. In this respect, the taxation on capital gains might be conceived as less abstract than the taxation on the imputed rent.

Policy Recommendations

The current pressure on the labour market means that the Danish economy is operating at close to full capacity. Thus, labour shortages will limit the growth potential of the economy, in both the short and the long run.

In the light of the tight labour market situation and the current positive outlook for economic growth, it seems prudent to identify policy instruments which could increase the production capacity of the Danish economy. In this context it must be considered a positive development that a review of the rules governing the effective availability of unemployed labour has been announced by the government. Even if it is not possible to significantly tighten up the formal rules concerning, for example, geographic mobility, at the very least it is natural to assess whether the enforcement of the rules could be tightened up. It is essential that the municipalities and the public employment agencies fulfil their commitments concerning dialogue with the unemployed and the drawing up of job plans, etc. The requirements for active job search should always be supported by sanctions taken if an unemployed person does not fulfil those requirements. In addition, the labour market might profit from a shift in policy focus towards more direct employment counselling and increased job search requirements, and away from checking

the labour market availability of the unemployed through activation measures.

The present economic conditions with rising employment and decreasing unemployment are ideal for implementing reforms designed to increase labour market flexibility. Specifically, it is recommended that the duration of unemployment benefit payments be shortened from the existing maximum of four years to, say, three years. Another possibility is a restructuring of the unemployment benefit scheme in such a way that the longer the spell of unemployment, the lower the level of benefit. A gradual reduction in the level of unemployment benefit will increase the financial incentives for the unemployed to apply for jobs and to widen their job search criteria. This proposal would create a smoother transition from the relatively high level of unemployment benefit to the more modest level of social security benefit, which is the last resort after the discontinuation of unemployment benefits. The proposal would not jeopardize the 'flexicurity' aspect of the unemployment benefit scheme, as the compensation rate would remain unaltered during shorter spells of unemployment, e.g. spells of less than 6 months. Such additional use of financial incentives, primarily directed at individuals in stronger positions, should be supplemented by an increased effort to assist marginal groups among the unemployed. More attention should be aimed at aiding job search or suggesting relevant courses of education to these groups. Obviously, a shorter period of unemployment benefits or a reduced compensation rate of the benefits would increase the importance of speedy and effective counselling by the public employment agencies.

The present positive economic outlook is also favourable to commencing more long-term reforms to increase the size of the labour force and thereby the growth potential of the Danish economy. However, a swift implementation of some reforms may conflict with a wish to take citizens' long term planning horizons and adjustment periods into consideration. This has been stated as a case for postponing the abolition of the voluntary early retirement scheme (VERP). A sensible alternative to postponing the implementation of

reforms for several years is to initiate the reforms now and include a set of transitional schemes. The current upturn clearly makes the latter approach preferable. As an example, the abolition of the VERP could be done by gradually raising the age limit over the period 2006-15. This is preferable to announcing today a halt to entry to the scheme by 2010. A step by step rise in the age limit of the scheme starting today will encourage an increase the labour force in the near future, when demand for labour is expected to be considerable.

Reforms are necessary in order to ensure the long term fiscal sustainability of the Danish welfare state in facing the challenges of both an ageing population and a continuing process of globalization. Increasing the labour force is the best way to meet these challenges, as this will simultaneously contribute to decreasing public transfers and to raising tax revenue. At the top of the list are measures which will increase the effective retirement age, lower the graduation age for higher education, and improve the employability of immigrants and their descendents. The analyses and recommendations of the Welfare Commission are the natural starting point regarding the exact composition of such welfare reforms.

Nevertheless, ensuring long-term fiscal sustainability should not be the only motivation for economic reform. The chairmen of the Danish Economic Council have previously suggested various ways of reorganising the public sector and reforming fiscal policy in order to raise the general level of welfare. These suggestions do not necessarily focus on improving fiscal sustainability. The recommendations include changes in the education system in order to reduce the number of people without an education that qualifies them for a job (see *Danish Economy, spring 2003*). The chairmen have also recommended that increased attention be directed at research and development in order to increase the Danish potential for growth (*Danish Economy, autumn 2003*). Another area of concern is reforming the tax system in order to meet the challenges of an increasingly globalized world and to reduce existing distortions in the system (*Danish Economy, spring 2001*). A third example is the introduction of

mandatory savings accounts for social insurance. These accounts would shift a part of the financing of the public transfers from distortionary taxes to less distortionary mandatory savings (*Danish Economy, spring 2005*).

The Danish government has announced a revision of the medium-term fiscal plan, the 2010 plan, to be renamed the 2015 plan. It is positive that the government continues to heed medium-term goals which are in accordance with the long-term goals of fiscal sustainability. On the other hand, a 2015 plan should not only contain the goals, but also outline the necessary policy measures to achieve the goals. An important limitation of the existing 2010 plan is the absence of specific policy initiatives. Increasing structural employment by 60,000 persons by 2010 is an important goal in the existing plan. Nonetheless, it is deemed unlikely that this goal will be achieved, and this is primarily due to the lack of specific policy initiatives within the plan.

In all likelihood the new 2015 plan will include new goals, e.g. an increase in the labour force. The realization of such goals will contribute to improving fiscal sustainability, and might create additional 'room for manoeuvre' for fiscal policy, i.e. scope for tax cuts or increased public expenditure on the basis of expected future revenue and expenditure. In this context, a strong warning must be issued against using expected future flexibility to implement unfinanced tax cuts or increased public expenditure today. This is particularly the case if the 2015 plan does not specify the means for achieving the goals. Even if the plan does contain specific policy measures, the potential room for manoeuvre should not be used before the measures are implemented and the effects apparent. In addition, the current economic circumstances with a very low level of unemployment do not invite unfinanced tax cuts or increased public expenditure. Not only are expansionary fiscal policies not needed in the current situation; they would be downright harmful.

In addition to goals regarding the increase in the labour force, it would seem obvious to include goals for increasing public sector productivity. Public productivity growth could

finance enhanced expenditure in selected areas within the public sector, or it could contribute to financing tax cuts.

However, if productivity growth in one area is to finance tax cuts or added expenditure in other areas, the prerequisite will generally be staff cutbacks in the branch which achieves the extra productivity growth. The health care sector is an example illustrating the difficulty of transferring the fruits of productivity growth between sectors. Productivity growth in health care typically takes the form of more effective treatments, which in turn can be cost reducing. Even so, pursuing this cost reduction with the intention of using the revenue for tax cuts, for example, also implies that at least a part of the potential for improving the general health inherent in the new treatments must be renounced. Thus, expected future productivity growth in the public sector should not in advance be transformed into tax cuts or extra expenditure in key areas.

Chapter II: Competition problems and competition policy

Effective competition is necessary for a market economy to achieve an optimal allocation of resources. The existence of a market economy, however, does not necessarily ensure the existence of sufficient competition. Companies and their owners can reduce competition and thereby increase their profits if there are only few companies in a market or if, for example, they coordinate prices. This results in a loss to society.

The best way to ensure effective competition is by ensuring free entry to the market for both domestic and foreign companies. The analyses in Chapter II indicate that international trade increases competition. Other studies indicate that the entry of new companies into the market increase productivity. It is therefore important to remove barriers that hinder the entry of new companies into a market. Such barriers can be caused by public regulation introduced for reasons not connected with competition. They can also result from dominant firms abusing their market power in order to keep

competitors out of the market. The focus of Danish competition policy is – and should also be in the future – on the removal of barriers.

The OECD finds that compared to other countries, Denmark has low barriers to entrepreneurship, a low degree of state control and average barriers for trade and investments. There are never the less significant competition problems in Denmark. The Danish Competition Authority identifies sectors with competition problems. Analyses in the chapter show that these sectors comprise more than 20 per cent of the gross value added in the private sector. Danish prices are 6 per cent higher than prices in other EU countries, and the Danish Competition Authority estimates that 2.5 percentage points of the difference stems from insufficient competition.

There is no single indicator that adequately measures the intensity of competition. The assessment of the intensity of competition must therefore be based upon several indicators. The following indicators are calculated in the chapter: excessive profit (markup), return on equity, and excessive wages (wage premium) that may be caused by insufficient competition. The results are summarized in table 2.

Table 2 *Overview of competition problems*

	Markup	Return on equity	Wage premium
Agriculture	-	•	-
Extraction of coal, oil and gas	•	++	++
Petroleum refineries	-	•	++
Electricity, gas and district heating	++	•	+
Food manufacturing	+	-	-
Beverage industry and tobacco manufacturing	++	++	-
Suppliers of construction materials	+	-	-
Manufacturing of metal Products	-	-	-
Transport equipment industry	+	-	-
Manufacturing of chemicals, etc.	+	+	+
Miscellaneous manufacturing industries	+	-	+
Construction industry	-	+	-
Trade	-	-	-
Ocean and costal water Transport	-	-	-
Miscellaneous transport	+	-	+
Banking and financial Institutions	++	+	++
Miscellaneous services	+	++	-

Note: + and - mean that the indicator points to competition problems above and below average levels respectively. ++ means that the sector is among the three sectors with the largest competition problems measured by that indicator.

Source: Own calculations.

On the basis of these indicators, there seem to be competition problems in several sectors. There are substantial problems in extraction of energy, in electricity, gas and district heating, and in the financial sector, in which there are ex-

cessive earnings and excessive wages.² A high markup is also found in the beverages industry and tobacco manufacturing sector, though the wage premium is limited in this case.

The economic benefits of increasing the level of competition in Denmark can be calculated using a new economic simulation model developed by the IMF. The calculations show that there would be benefits of around 2 per cent of GDP in the long term from improving competition in the product markets. In the analysis, the calculated Danish markups are reduced a level corresponding to that prevailing in the United States. The benefits to Denmark would comprise approximately 5½ per cent of GDP if all EU countries improved competition and increased flexibility in the labour market to the levels prevailing in the United States.

Table 3 Changes in Danish GDP following increased competition and increased labour market flexibility

	5 years	10 years	Long term
	----- Per cent change -----		
Danish product market reforms in isolation			
GDP	0.9	1.6	2.2
Employment ^{a)}	0.7	1.0	1.2
Product and labour market reforms in Denmark and the EU			
GDP	1.9	3.7	5.6
Employment ^{a)}	1.5	2.2	2.8

a) Measured by total working hours.

Source: IMF simulations using the Global Economy Model (GEM).

2) In extraction of energy, the problem may be captured resource rent rather than lack of competition.

Reforms of competition policy carried out by Denmark independently would increase the total of working hours by approximately one per cent within the next 10 years. This corresponds to around half of the increase in employment that is necessary to ensure a sustainable fiscal policy according to the 2010 plan.

Public regulation

Several kinds of regulation create barriers to competition. The regulation may involve, for example, public ownership, sole rights and other public limitations on the number of suppliers or authorisation licenses. There are exceptions from the competition law, e.g. resale price maintenance, or other kinds of regulation such as regulation of advertising. Resale price maintenance should in general not be allowed, but other kinds of regulation may in specific cases be necessary, for example to ensure consumer safety.

The Danish authorities should examine public regulations such as authorisation licenses, limitations on numbers of suppliers and sole rights in order to assess whether they are still necessary or whether they could be reformed in order to hamper competition less.

Limitations on the numbers of suppliers, e.g. for taxis, comprise significant barriers to entry. They can often be substituted by other types of regulation that limit competition less. The granting of sole rights should be avoided; it can, however, be necessary to accept sole rights in cases of natural monopolies, such as shuttle busses. It is in such a situation crucial to create competition in the allocation of the sole rights agreements. Authorisation licenses may be acceptable, but each situation should be examined carefully, especially when licences are combined with limitations on the number of suppliers.

As a part of the Lisbon strategy, the EU Commission has proposed a “Services Directive”. The purpose of the directive is to remove barriers to international trade in services and to the establishment of service providers in other EU countries. The directive simplifies access to markets in

other EU countries, and significant socio-economic gains can be expected in Denmark if the directive is enacted.

The Services Directive is connected to the Posting of Workers Directive ((96/71/EC). The Posting of Workers Directive states that it is the rules of the country in which the work is carried out that apply with respect to working hours, statutory minimum wages, job security, equal treatment, etc. This is not changed by the Services Directive.

There is no statutory minimum wage in Denmark. The Services Directive could therefore cause pressure for wage reduction in certain branches. This might be a disadvantage to specific groups of employees, but the total real income to society would increase, as several services would be cheaper. It must be expected that the increased competition created by the Services Directive would build up only slowly. In the longer term, it is expected that the wages in the new EU countries will increase towards the level of the old EU countries. This process will be speeded up if the Services Directive is enacted.

On the basis of the analyses of public regulation, it is recommended that:

- The Services Directive should be enacted in a version close to that proposed by the EU Commission.
- Limitations of numbers, sole rights and authorisation licenses should be examined in order to assess whether they are still necessary or whether they could be reformed to hamper competition less.

The electricity market has been liberalised, and the reform has largely been successful. The Energy Agreement (March 29. 2004) has further improved the situation with respect to regulation. There is, however, still heavy regulation in the sector. Regulation is necessary, but the level of competition is still insufficient and there are signs of abuse of market power. Regulation could thus still be improved upon.

The major Danish state-owned natural gas provider DONG is proposing to merge with the electricity producer Elsam. The merger will turn DONG into a dominant electricity

producer, and the concentration of suppliers in the electricity market will become very high. The merger is a disadvantage to society and should be blocked. The high concentration of suppliers will create competition problems, and the merger will create vertical integration which will contribute further to those competition problems. The problems will increase even more if DONG is privatised. The Competition Authorities should accept the merger only if electricity production, gas production and electricity distribution are separated into different companies. This would have the added advantage of facilitating a future privatisation of the companies.

The capacity for international electricity transmission should be increased to secure effective competition. It may be necessary to establish transmission capacity that would not be considered cost-effective on a private market basis.

The regulation of heat production in small-scale combined heat and power plants is still not fully effective, and specific improvements are suggested in the chapter. The regulation of the distribution companies has been improved, but it is still unnecessarily complicated and could be improved further.

The liberalisation of the electricity market has largely been a success but it is recommended that:

- Sufficient international transmission capacity to ensure competition in electricity production should be established.
- DONG should be separated into different companies for production of natural gas, electricity production and electricity distribution. This should be required by the competition authorities in order for them to accept the proposed merger.
- The regulation of small-scale combined heat and power plants and distribution companies should be further improved.

The competition law

The most recent change to the competition law was in early 2005. There is, however, still room for improvement. The institutional setup of the Competition Authorities should also be changed.

Today, the membership of the Competition Council includes representatives from industry and other interested groups. The Competition Council should only include independent legal and economic experts with specific knowledge about competition and insight into the businesses with which the Council is concerned. The Competition Authorities and the section of the office of the Public Prosecutor for Serious Economic Crime that deals with violations of the competition law should be merged. This would make the enforcement of the competition law more effective, as investigations would not be duplicated by different authorities. Consideration should be given to establishing a special court for competition, as in Great Britain. This court would be able to build up sufficient expertise to deal with complicated competition cases.

It is recommended that a leniency programme be introduced for members of cartels who cooperate with the Competition Authorities in revealing and documenting the existence of a cartel. Denmark is among the few EU countries that have not introduced a leniency programme. A leniency programme would improve the chances of proving the existence of cartels and prosecuting them. It could also prevent establishment of new cartels. The punishment reduction would have to be substantial – probably full exemption from punishment.

The threshold values in the Danish merger rules are still higher than in most other EU countries. The fines for abusing the competition law are significantly below the levels in several other EU countries. The latest change to the Danish competition law increased the Danish penalty limits, but developments in court practice should be monitored and a further increase considered. Higher fines would also make the leniency programme more effective.

Further, consideration should be given to the introduction of the possibility for class actions, where a person or a public institution can act as a party in an action for damages on behalf of other persons or institutions.

The competition authorities have increased the use of economic and statistical analyses during the past 10-20 years. This use should be further increased, as economic and statistical methods can be used as circumstantial evidence in legal competition cases and can set guidelines for the authorities' conduct. This can facilitate international cooperation among national competition authorities that may have very different legal traditions.

The competition law has been improved, but the improvements are not sufficient. It is recommended that:

- The Competition Council only should consist of independent legal and economic experts with specific knowledge about competition and insight into the businesses concerned.
- The Danish Competition Authorities should be merged with the section of the office of the Public Prosecutor for Serious Economic Crime that deals with competition cases
- A special court should be established for competition cases
- A leniency programme should be introduced for cartel members who reveal the existence of a cartel to the authorities
- Economic and statistical material should be used more widely as circumstantial evidence in legal competition cases.