

Budget Outlook, August 2004

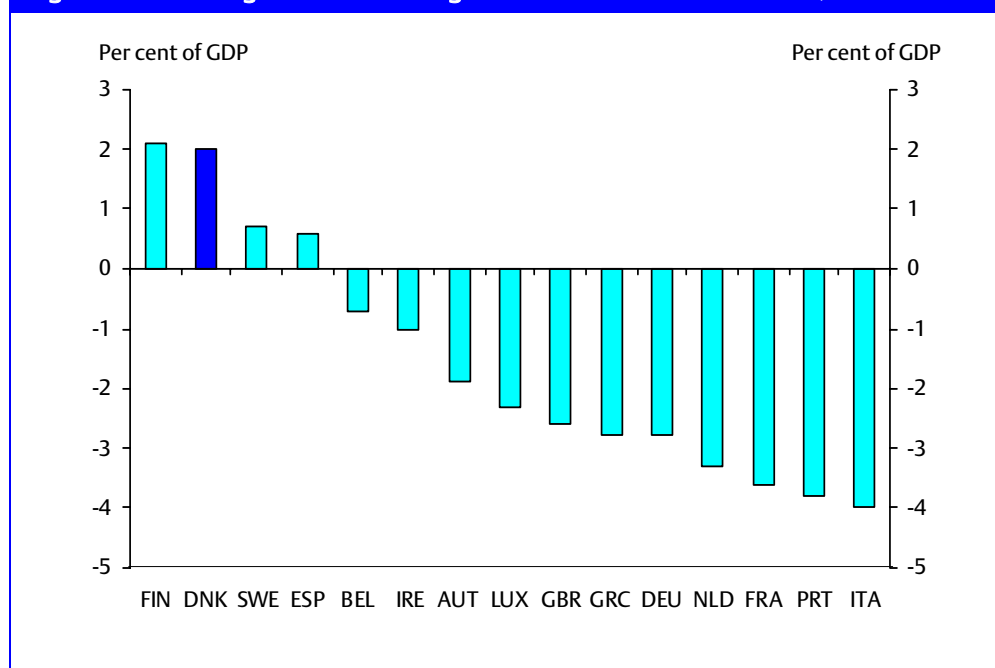
1. Introduction

Based on the short term forecast for the Danish economy, *cf. Economic Survey*, August 2004, the central government budget proposal and the agreements with local governments on the economy for 2005, both the central government current, investment and lending account, i.e. the CIL-account, and the general government finances is expected to show surpluses in 2005.

The world economy is in progress, and the expected upturn in the Danish economy is reflected in higher employment and decreasing unemployment, *cf. Economic Survey*, August 2004.

In an international perspective the general government finances are well consolidated in Denmark. Among the 15 western European EC-countries only Finland has a larger expected surplus on the general government budget balance in 2005, *cf. figure 1*.

Figure 1. General government budget balance in 15 EC-countries, 2005



Note: European Commission, *Spring 2004 Economic forecasts*, March 2004 and own estimate for Denmark.

From an overall perspective economic policy is in line with the medium term targets towards 2010, and fiscal policy is expected to be neutral to economic activity in 2005.

With the central government budget proposal for 2005 the Liberal/Conservative government gives priority several areas among them hospitals and health care, vulnerable groups, research and development, education, environmental issues, justice and integration of foreigners.

2. General government finances

The estimates of the general government finances in 2004 and 2005 are based on the most recent short term forecast for the Danish economy, *cf. Economic Survey*, August 2004. Furthermore, the estimates are based on the central and local government budgets for 2004, the Spring Package, the central government budget proposal for 2005 and the agreements with local governments on the economy in 2005.

The general government surplus is estimated at DKK 17.4bn in 2004 and DKK 29.7bn in 2005, *cf. table 1*. The surpluses correspond to 1.2 per cent of GDP in 2004 and 2.0 per cent in 2005.

Table 1. General government budget balance, 1999-2005							
DKK bn, current prices	1999	2000	2001	2002	2003	2004	2005
May 2004	38.8	32.5	37.5	21.2	16.7	18.1	26.1
August 2004, hereof:	38.8	32.5	37.5	21.2	16.9	17.4	29.7
<i>Central and local governments</i>	<i>22.1</i>	<i>13.2</i>	<i>15.5</i>	<i>7.7</i>	<i>1.4</i>	<i>6.4</i>	<i>19.1</i>
<i>Social funds</i>	<i>16.7</i>	<i>19.3</i>	<i>22.1</i>	<i>13.4</i>	<i>15.5</i>	<i>11.0</i>	<i>10.6</i>
August 2004 (per cent of GDP)	3.2	2.5	2.8	1.6	1.2	1.2	2.0

The estimated surplus in 2004 is approximately unchanged compared to the surplus in 2003, however an increase in the surplus is expected in 2005. The expected improvement of government finances from 2003 to 2005 stems from central and local government finances, whereas a decrease in the surplus is expected in the social funds.

The estimated increase in the general government surplus from 2003 to 2005 is primarily due to the expected economic recovery including lower unemployment and higher employment.

From 2003 to 2005 the structural budget balance is expected to remain constant. Fiscal policy including the tax cuts of approximately DKK 10bn reduces the structural budget surplus from 2003 to 2004. However, from 2004 to 2005 the structural budget surplus is expected to increase among other things due to decreasing net interest payments.

Compared to the May projection the general government budget surpluses have been adjusted downwards with approx. DKK ¾bn in 2004 and adjusted upwards with approx. DKK 3½bn in 2005, *cf. table 2.*

Table 2. Revisions of budget balance from May to August, 2004 and 2005		
DKK bn, current prices	2004	2005
Total revision of budget balance	-0.7	3.6
- Corporate taxes	0.8	2.3
- Profit-sharing etc. from the North Sea oil exploration activities	0.7	1.1
- VAT and other excise duties	0.5	0.6
- Pension yield taxation	-0.9	-0.1
- Income transfers	-1.0	0.6
- Public consumption	-1.7	-1.4
- Public subsidies	0.1	1.1
- Other expenditures and revenues	0.8	-0.6

Note: Negative numbers imply reductions of the surplus due to reduced revenues or increased expenditures, and positive numbers imply increases in the surplus due to increased revenues or decreased expenditures.

The downward adjustment of the surplus in 2004 is partly due to expected lower revenue from the pension yield taxation scheme in light of lower returns on shares. Moreover, the income transfers have been adjusted upwards in 2004 due to upward adjustments of unemployment and recipients of disability pension.

Public consumption is adjusted upwards by DKK 1.7bn in 2004 and DKK 1.4bn in 2005, which reduces the surplus in both years. The adjustment derives from the agreements with local governments on the economy for 2005 and a Supreme Court ruling concerning subsidised jobs.

The upward adjustments of the revenues from corporate taxes and profits from the North Sea activities in 2004 and 2005 can be referred to higher oil prices.

Revenues from VAT and other excise duties have also been adjusted upwards in 2004 and 2005, which is primarily due to the vehicle registration tax in light of an upward revision of the business sectors purchases of new cars.

A downward adjustment of public subsidies by DKK 1.1bn also contributes to the upward adjustment of the general government budget balance in 2005.

Detailed information about the general government finances, including adjustments since the May projection, can be found in *annex 1* below.

From 2001 to 2005 the expenditure burden, i.e. the ratio of general government expenditures to GDP, is expected to decrease by 1¼ percentage points, *cf. table 3*. This is mainly due to an estimated reduction of the interest expenditure burden in light of expected lower public debt and lower interest rates.

Table 3. Expenditure, tax and revenue burden, 1999-2005								
Per cent of GDP	1999	2000	2001	2002	2003	2004	2005	Change 2001-2005
Expenditure burden	55.4	53.9	54.2	54.6	54.9	54.4	53.0	-1.3
Tax burden ¹⁾	51.5	49.6	49.9	48.9	48.9	48.9	48.4	-1.5
Revenue burden	58.6	56.5	57.1	56.1	56.1	55.6	54.9	-2.1

The estimated drop in the tax burden, i.e. the ratio of aggregate tax revenues to GDP, of 1½ percentage points from 2001 to 2005 can among other things be referred to a decrease in the personal income tax burden due to the tax cuts in 2004.

A decrease of approximately 2 percentage points in the revenue burden is expected from 2001 to 2005. Apart from the estimated reduction of the tax burden lower interest revenues are expected to contribute to the drop in the revenue burden.

Detailed information about the expenditure, tax and revenue burden can be found in *annex 2* below.

3. Fiscal stance

The *fiscal effect* is an indicator of the fiscal policy stance. The fiscal effect measures the impact of discretionary fiscal policy changes on economic activity – measured by the effect on GDP.

Based on the central government budget proposal for 2005 and the agreements with local governments on the economy for 2005 fiscal policy is expected to be neutral in 2005, *cf. table 4*.

Table 4. Fiscal effect, 1999-2005

Per cent of GDP	1999	2000	2001	2002	2003	2004	2005
Fiscal effect with higher impact on private consumption ¹⁾	0.2	-0.1	0.3	0.3	0.0	0.5	0.0
<i>Expenditures</i>	<i>0.4</i>	<i>0.1</i>	<i>0.5</i>	<i>0.2</i>	<i>-0.1</i>	<i>0.0</i>	<i>-0.1</i>
<i>Revenues</i>	<i>-0.1</i>	<i>-0.1</i>	<i>-0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.3</i>	<i>0.0</i>
Fiscal effect ²⁾	0.3	-0.1	0.3	0.2	0.0	0.3	0.0
Temporary suspension of SP ³⁾	-	-	-	-	-	0.1	-
Subsidised housing construction	-0.1	0.0	0.0	0.1	0.2	0.1	0.1

Note: The method of calculating the fiscal effect has been revised, cf. *Fiscal Survey 2004*, June 2004. The revision mainly reflects a recalculation of the model based effects of discretionary changes in expenditures and revenues on economic activity according to the latest official version of the macroeconomic model, ADAM, from Statistics Denmark. The recalculation of the model based effects shows, that the economy has become less sensitive to discretionary fiscal policy changes in the short run.

- 1) Following permanent changes in personal income taxes. The effect on private consumption from a change in personal income taxes depends on whether the change is perceived to be permanent or temporary. A change perceived as being permanent is assumed to have a larger effect than a change perceived as being temporary. It is assumed, that a change in households' disposable income of DKK 1bn following a permanent change in income taxation will affect private consumption with DKK ½bn.
- 2) Based on the official version of ADAM from Statistics Denmark, where a change in disposable income of DKK 1bn following a change in income taxation will affect private consumption with DKK ¼bn.
- 3) Special pension scheme.

Expenditures are expected to have a marginal negative impact on economic activity in 2005 partly due to a reduction of public subsidies and modest growth in income transfer payments. Primarily due to fiscal drag revenues are estimated to have a marginal positive impact on economic activity in 2005.

Publicly subsidized construction of houses, including initiatives in the Spring Package, is expected to contribute to economic activity with 0.1 per cent of GDP in 2005.

Fiscal policy in 2005 is assessed to be balanced with the expected economic activity, cf. *Economic Survey*, August 2004.

In 2004 fiscal policy is expected to stimulate economic activity corresponding to 0.5 per cent of GDP mainly due to the DKK 10bn. tax cut. The estimate is based on the assumption, that a change in disposable income due to permanent tax cuts will have a higher impact on private consumption than reflected in the official macroeconomic model, ADAM, from Statistics Denmark, cf. the discussion in *Fiscal Survey 2004*, June 2004. Based on the official version of ADAM from Statistics Denmark, the fiscal effect is estimated at 0.3 per cent of GDP in 2004.

Additionally, a stimulus to activity in 2004 is expected from the temporary suspension of payments to the special pension scheme, SP, and from subsidized housing construction.

4. Structural budget balance

The structural budget balance the general government budget balance adjusted for the estimated positive or negative impact on the budget from the cyclical position of the economy. Thus, the development in the structural budget balance is mainly determined by fiscal policy, differences between the actual and structural rate of unemployment and the underlying growth in the labour force.

The medium-term strategy towards 2010 presupposes yearly structural budget balance surpluses in the range of 1½ and 2½ per cent of GDP in order to secure debt reduction and hence the sustainability of public finances in light of the ageing of the population

The structural budget balance surplus is estimated at 1.2 per cent of GDP in 2004 and 1.5 per cent of GDP in 2005, *cf. table 5*.

Table 5. Structural budget balance, 1995-2005									
Per cent of GDP	Structural balance		Change due to						
	Level	Yearly change	Revenue effects, fiscal policy ¹⁾	Structural rate of unempl .	Labour force ²⁾	Net interest	Special budget items ³⁾	Demand	Other/residual
1995	-0.9								
1996	-1.6	-0.7	0.1	0.3	-0.5	0.2	-0.5	-0.2	-0.1
1997	-0.8	0.8	0.8	0.3	-0.2	0.1	-0.1	-0.2	0.1
1998	-0.7	0.1	0.1	0.4	-0.2	0.3	-0.5	-0.2	0.2
1999	0.4	1.1	0.5	0.3	-0.1	0.3	0.7	-0.3	-0.3
2000	1.4	1.0	-0.1	0.4	0.3	0.3	0.4	-0.7	0.4
2001	1.8	0.4	-0.2	0.1	0.3	0.3	0.2	-0.4	0.1
2002	1.1	-0.7	-0.3	0.1	-0.3	0.3	-0.6	0.0	0.1
2003	1.5	0.4	0.0	0.0	0.1	0.2	0.0	0.0	0.1
2004	1.2	-0.3	-0.8	0.0	0.0	0.2	0.1	0.3	-0.1
2005	1.5	0.3	0.3	0.0	-0.2	0.2	0.0	0.1	-0.1
I alt	-	2.4	0.4	1.9	-0.8	2.4	-0.3	-1.6	0.4

1) Due to different methods of calculation the revenue effects differs from the direct revenue effects used in the calculation of the fiscal effect.

2) Measured in hours of working.

3) Special budget items include capital transfers etc.

The structural budget balance is thus expected to be in the lower edge of the targeted interval in 2004 and 2005.

Mainly due to the DKK 10bn tax cuts a reduction of the structural budget balance of 0.3 percentage points of GDP is expected from 2003 to 2004. The estimated increase in the structural budget balance from 2004 to 2005 is partly due to falling net interest payments.

The increase in the structural budget balance surplus of approximately 2.5 percentage points of GDP since 1995 is mainly due to a reduction of the structural rate of unemployment and falling net interest payments.

The impact of the composition of aggregate demand pulls in the other direction. Since 1995 a moderate growth in private consumption relative to GDP has contributed to a reduction of the structural budget balance through a slower growth in indirect tax revenues. The share of excise duties in private consumption is relatively high compared to other components of GDP, and a slower growth in private consumption therefore tends to reduce the structural budget balance.

5. Central government finances

The central government budget proposal for 2005 implies a surplus on the CIL-account of DKK 20.5bn or 1.3 per cent of GDP, *cf. table 6*.

Table 6 . CIL-account, 2004 and 2005				
DKK bn., current prices	May	2004		2005
		Aug.	Diff.	Aug.
Total revenues	450.0	450.7	0.6	476.5
Total expenditures	449.0	447.9	-1.1	456.1
CIL-account	1.1	2.8	1.7	20.5
CIL-account (per cent of GDP)	0.1	0.2	0.1	1.3

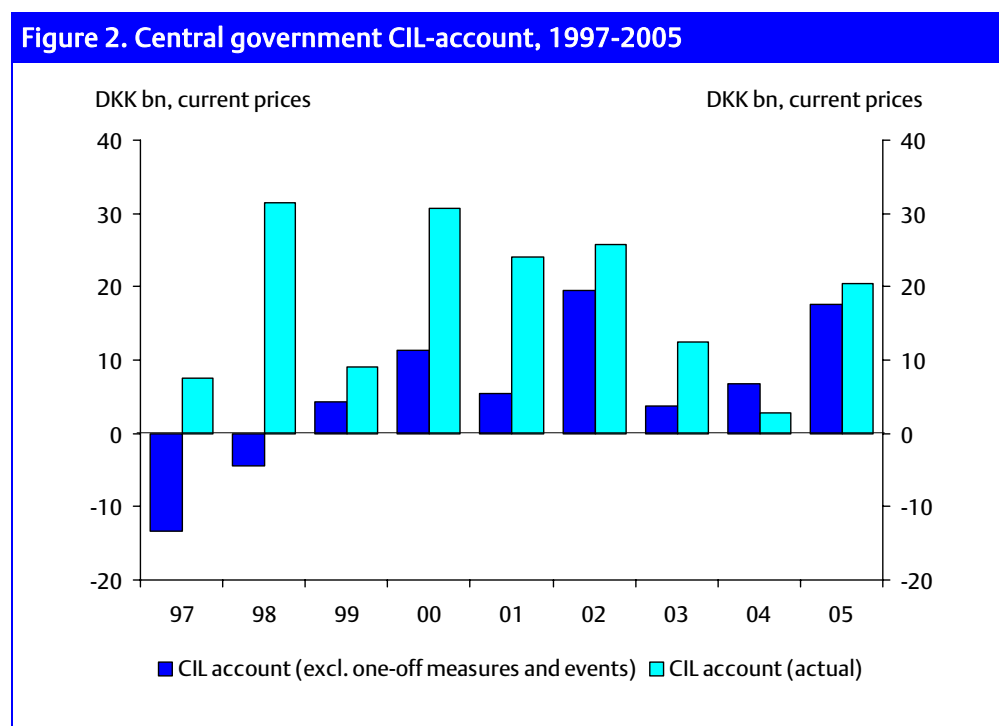
In 2004 the CIL-account is estimated at DKK 2.8bn or 0.2 per cent of GDP.

The improvement of the CIL-account from 2004 to 2005 is mainly due to partly the expected economic recovery and higher oil prices. Furthermore, the CIL-account is especially low in 2004 because of one-off measures and extraordinary events.

Compared to the May projection the estimate for the 2004 CIL-account is DKK 1.7bn higher. This derives partly from expected higher revenues primarily from corporate taxes. In addition, a surplus on the EU budget in 2003 has caused repayments of EU-contributions in 2004.

In 2005 one-off measures contribute to the CIL-account with approximately DKK 3bn. This is primarily due to sale of and shift in central government assets in connection with the capital build up of a new High Technology Fund.

The CIL-account in 2004 is negatively affected by one-off measures as a result of shifts in payments of corporate taxes between 2003 and 2004. Hence, corrected for one-off measures the increase in the CIL-account from 2004 to 2005 is less than the increase in the actual CIL-account, *cf. figure 2.*



6. Central government financing requirement and debt

In 2005 central government debt as per cent of GDP is expected to continue to decrease to 33.6 per cent of GDP, *cf. table 7.*

Table 7. Central government debt, 2002-2005

End of year, nominal value	2002	2003	2004	2005
Central government debt, per cent of GDP	38.3	36.8	35.9	33.6
Central government debt, DKK bn	521.3	515.3	522.8	511.4
Re-lending to infrastructure entities etc ¹⁾	12.5	14.7	17.2	20.6
Central government debt, adjusted for re-lending	508.8	500.6	505.5	490.8

1) Ørestadsselskabet, A/S Storebælt, Øresundsforbindelsen A/S and Danmarks Skibskreditfond.

In nominal terms central government debt in 2005 is expected to decrease by approximately DKK 11½bn due to a net balance of approximately DKK 16½bn, *cf. table 8.* While the CIL-account is expected to show a surplus of DKK 20½bn, the net balance is somewhat lower due to re-lending to government owned infrastructure entities etc. amounting to approximately DKK 4bn and differences between accrued revenues/expenditures on the CIL-account and actual cash flow, including

net due interest and distributed capital losses on issue. Central government debt adjusted for re-lending is expected to decrease by close to DKK 15bn to DKK 490.8bn in 2005.

Table 8. Central government borrowing, 2004-2005		
DKK bn	2004	2005
CIL-account	2.8	20.5
Total re-lending ¹⁾	-3.5	-4.2
Differences between accrued revenues/expenditures and cash flow	-2.8	0.3
Net financing requirement (-net balance)	3.4	-16.6
Redemption of central government debt	108.6	102.3
Gross financing requirement	112.1	85.6
Gross financing ²⁾		
- Domestic borrowing	85.0	75.2
- Foreign borrowing	16.1	10.5
- Drawing on the central government's account in Danmarks Nationalbank	10.9	-

Note: The numbers are rounded. Hence, the sum of the components does not necessarily equal the total.

1) Including re-lending to infrastructure entities.

2) Market value.

Central government debt is expected to amount to 35.9 per cent of GDP in 2004. Despite a surplus on the CIL-account, the net financing requirement is estimated at DKK 3.4bn. Again, the difference can be attributed to re-lending and differences between accrued revenues/expenditures and cash flow. Central government debt in nominal terms is expected to increase by DKK 7½bn to DKK 522.8bn.

In 2005 the gross financing requirement is estimated at DKK 85.6bn, stemming from a net balance of DKK 16.6bn, DKK 94.2bn in redemptions on domestic debt and DKK 8.1bn in redemptions on foreign debt. Financing is expected to come from domestic borrowing equal to DKK 75.2 and foreign borrowing of DKK 10.5bn. Usually gross foreign borrowing equals the redemption on foreign debt. In 2005 there is a difference amounting to app. DKK 2½bn due to expected re-lending to Danmarks Skibskreditfond denominated in US-dollars.

In 2004 the gross financing requirement is estimated at DKK 112.1bn. The financing is split between DKK 85.0bn in domestic borrowing, DKK 16.1bn in foreign borrowing and a DKK 10.9bn reduction of the central government account in Danmarks Nationalbank. The significant reduction of the account in Danmarks Nationalbank in 2004 following a DKK 5.5bn reduction in 2003 is the result of improved cash management within the central government.

Annex 1.

Table 1. General government finances , 2003-2005									
DKK bn., current prices	----- 2003 -----			----- 2004 -----			----- 2005 -----		
	May	Aug.	Diff.	May	Aug.	Diff.	May	Aug.	Diff.
Consumption	369.2	371.8	2.6	382.5	384.2	1.7	393.5	394.9	1.4
Income transfers	252.8	252.6	-0.2	262.0	262.9	1.0	266.9	266.3	-0.6
Investment	22.9	23.8	0.9	25.2	25.2	0.0	26.2	26.2	0.0
Interest expenditure	48.1	47.9	-0.2	45.7	45.6	-0.1	43.0	42.7	-0.3
Subsidies	31.0	30.0	-1.0	31.5	31.4	-0.1	32.5	31.4	-1.1
Other expenditure ¹⁾	41.4	41.1	-0.3	42.4	42.4	0.0	43.8	43.6	-0.2
Total expenditure	765.5	767.1	1.6	789.2	791.7	2.5	805.8	805.1	-0.7
Personal income taxes ²⁾	310.2	309.5	-0.6	316.8	316.7	-0.1	328.6	328.3	-0.3
Labour market contrib.	62.9	63.0	0.1	65.1	65.2	0.0	67.8	67.9	0.1
Corporate taxes	39.9	39.1	-0.8	43.3	44.1	0.8	42.5	44.8	2.3
Pension yield taxation	6.1	5.2	-0.9	9.9	9.0	-0.9	10.1	10.0	-0.1
VAT	135.3	135.4	0.1	141.3	140.6	-0.7	146.9	146.3	-0.6
Vehicle registration fee	13.2	13.5	0.4	14.3	15.3	0.9	15.3	16.4	1.1
Other duties	91.8	92.3	0.6	93.1	93.3	0.3	95.9	96.1	0.2
Other taxes ³⁾	23.5	23.4	-0.1	23.9	23.8	0.0	24.0	23.9	-0.1
Interest revenues	35.3	35.3	-0.1	32.5	32.6	0.0	32.4	32.8	0.4
Gross operating surplus	27.1	27.1	0.0	27.4	27.4	0.0	27.7	28.0	0.3
Other revenues ⁴⁾	36.9	40.0	3.2	39.6	41.1	1.4	40.5	40.3	-0.2
Total revenue	782.1	784.0	1.8	807.3	809.1	1.8	831.9	834.8	2.9
General government budget balance	16.7	16.9	0.2	18.1	17.4	-0.7	26.1	29.7	3.6
Net interest expenditure	12.8	12.6	-0.2	13.1	13.0	-0.1	10.6	9.9	-0.7
General government primary balance ⁵⁾	29.5	29.5	0.0	31.2	30.4	-0.8	36.7	39.6	2.9

- 1) Other expenditures include, capital transfers, transfers to the Faroe Islands and Greenland and Danish EU-contributions.
- 2) Personal income taxes include withholding taxes, tax on imputed income from owner-occupied dwellings, specific taxes from households, tax on estates of deceased persons and other personal taxes.
- 3) Other taxes include social security contributions (labour market supplementary pension scheme contributions, unemployment insurance contributions and early retirement contributions).
- 4) Other revenues include profits from public enterprises, current and capital transfers from other domestic sectors and EU, and imputed (calculated) revenues such as contributions to civil servants' earned pension.
- 5) The general government primary balance states the balance of the general government finances before net interest expenditures.

Annex 2.

Table 2. Expenditure, tax and revenue burden . 1999-2005								
Pct. af BNP	1999	2000	2001	2002	2003	2004	2005	Diff. 2001- 2005
Consumption	25.8	25.3	25.9	26.3	26.6	26.4	26.0	0.1
Income transfers	17.8	17.3	17.3	17.5	18.1	18.1	17.5	0.2
Investments	1.7	1.7	1.9	1.8	1.7	1.7	1.7	-0.2
Interest expenditures	4.8	4.3	4.0	3.7	3.4	3.1	2.8	-1.2
Other expenditures	5.3	5.3	5.1	5.2	5.1	5.1	4.9	-0.2
Expenditure burden	55.4	53.9	54.2	54.6	54.9	54.4	53.0	-1.3
Personal income taxes	22.3	22.3	22.5	22.1	22.1	21.8	21.6	-0.9
Labour market contributions	4.5	4.4	4.5	4.5	4.5	4.5	4.5	0.0
Pension yield taxation	1.2	0.8	0.1	0.1	0.4	0.6	0.7	0.6
Corporate tax	3.0	2.4	3.1	2.9	2.8	3.0	2.9	-0.2
Value added tax	9.9	9.7	9.7	9.7	9.7	9.7	9.6	-0.1
Other duties	8.5	7.7	7.8	7.9	7.7	7.6	7.6	-0.2
Other taxes	2.1	2.3	2.2	1.7	1.7	1.6	1.6	-0.6
Tax burden	51.5	49.6	49.9	48.9	48.9	48.9	48.4	-1.5
Interest revenue	2.5	2.5	2.6	2.3	2.5	2.2	2.2	-0.4
Other non-tax revenue	4.9	4.5	4.7	5.1	4.8	4.7	4.5	-0.2
Tariffs etc. to EU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0
Revenue burden	58.6	56.5	57.1	56.1	56.1	55.6	54.9	-2.1