

Budget Outlook, August 2006

1. Introduction

The central government budget proposal for 2007 and the agreements with local governments on the economy for 2007 reflect the economic priorities of the Danish government in 2007. The budget proposal also reflects the welfare agreement and the agreement on future immigration of June 2006.

The welfare agreement includes a globalization pool, labour market initiatives and a reform of the early retirement system, *cf. summaries of welfare agreement and agreement on future immigration* available on www.fm.dk. The globalization pool will enable investments in education, research and innovativeness. The labour market initiatives are expected to increase the labour force and reduce structural unemployment.

Furthermore, the budget includes increased expenditures on foreign development aid and environmental protection. The government has also prioritized improvements for families with children, the most vulnerable groups, the elderly and the health care sector.

The central government budget proposal and the agreements with local governments include new initiatives of DKK 8³/₄bn in 2007.

Large surpluses on the general government finances and central government current, investment and lending account (CIL-account) are estimated in 2006 and 2007, *cf. sections 2 and 5*.

2. General government finances

The estimates for the general government finances in 2006 and 2007 are based on the short term projections for the Danish economy, *cf. Economic Survey*, August 2006.

Furthermore, the estimates are based on the central government budget for 2006, a provisional assessment of central government spending in 2006, local governments' revised budgets for 2006, the central government budget proposal for 2007 and the agreement with local governments on the economy in 2007.

The general government surplus is estimated at approx. DKK 50bn in 2006 and DKK 47³/₄bn in 2007, *cf. table 1*. The surpluses correspond to 3.1 per cent of GDP in 2006 and 2.8 per cent of GDP in 2007.

DKK bn, current prices	2001	2002	2003	2004	2005	2006	2007
May 2006	15.8	3.2	-1.0	24.8	61.4	45.8	48.8
August 2006, hereof	15.8	3.2	-1.0	24.8	61.2	50.1	47.8
Central government	2.9	3.4	5.7	29.9	66.4	49.6	47.2
Local governments	5.0	-0.1	-6.9	-5.3	-5.6		
Social funds	7.9	-0.1	0.2	0.2	0.5	0.5	0.5
August 2006 (per cent of GDP)	1.2	0.2	-0.1	1.7	3.9	3.1	2.8

Note: The specification of the central and local governments' budget balances do not fully reflect, that central government through transfers to local governments bears the risk of fluctuations in expenditures and revenues due to the business cycles. The local government deficits in the years 2002-2004 reflect among other things that the ascertained local government tax revenues are lower than the transfers from the central government.

The estimated decline in the general government surplus from 2005 to 2006 primarily reflects estimated smaller revenues from pension yield taxation in 2006. Higher oil prices are expected to increase the central government's revenue from the North Sea oil and gas exploration activities in 2006. The surplus in 2007 is expected to be slightly smaller than in 2006 mainly due to an expected reduction in revenues from the North Sea activities in light of an anticipated decrease in oil prices.

Compared to the May projection the general government surplus has been revised up by DKK 4¼bn in 2006 and down by DKK 1bn in 2007, *cf. table 2*.

DKK bn, current prices	2006	2007
Total revision of general government budget balance	4,2	-1,0
- Income taxation etc. and labour market contributions	4,0	4,1
- VAT	3,4	4,4
- Other excise duties	2,9	2,0
- Pension yield taxation	-3,9	-4,0
- North Sea oil and gas exploration activities	-0,8	-1,3
- Public consumption expenditure	-2,6	-5,5
- Other expenditures and revenues	1,3	-0,7

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 revenue from income taxation etc. and labour market contributions has been adjusted upwards by approx. DKK 4bn in 2006 and 2007. The adjustment is mainly due to new information about 2005 which influences the 2006 and 2007 estimates. The adjustment is also due to an upward adjustment in taxable incomes.

Revenues from value added taxes are expected to be almost DKK 3½bn higher in 2006 and DKK 4½bn higher in 2007 than estimated in May. The estimates are based on the level in 2005 which has been adjusted upwards since the May projection. Higher growth in housing construction and private consumption also imply higher VAT revenues in both years.

Other excise duties have been upward adjusted by almost DKK 3bn in 2006 and DKK 2bn in 2007. The vehicle registration fee revenues have been adjusted upwards by approx. DKK 1¼bn in 2006 and 2007 due to higher expected car sales to private households and businesses. Furthermore, the revenues from registration of property rights and excise duties related to energy and environment are expected to be higher than estimated in May.

The revenue from the pension yield tax has been adjusted downwards by approx. DKK 4bn in both 2006 and 2007 compared to the May projection. The adjustment is primarily due to a less favourable development in the stock market than expected, which also results in a tax deduction in 2007.

Revenues from the North Sea oil and gas activities are adjusted downwards by approx. DKK ¾bn in 2006 and approx. 1¼bn in 2007. The adjustment is primarily due to a downward adjustment of the US Dollar.

General government consumption expenditure has been upward adjusted by approx. DKK 2½bn in 2006 and DKK 5½bn in 2007. The upward adjustment in 2006 is based on information from the negotiations in June with local governments regarding 2007. The welfare agreement is estimated to imply an increase in consumption expenditures of DKK 2bn in 2007. The actual effect of the welfare agreement, however, will be determined in connection with the negotiations on the globalization pool in the fall. Furthermore, consumption expenditure in 2007 is adjusted upwards by approx. DKK 1bn due to new estimates on prices and wages.

Other expenditures and revenues contribute to a higher surplus in 2006 and a lower surplus in 2007 than estimated in May. In 2006 this includes an upward adjustment of the corporate tax revenue and a downward adjustment of transfer expenditures in light of lower expected unemployment. The 2007 adjustment is primarily due to a downward adjustment of government investments by DKK ¾bn.

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

The expenditure to GDP ratio, i.e. the ratio of general government expenditures to GDP, is expected to decrease by 3.6 percentage points from 2001 to 2007, *cf. table 3*. The decline is primarily due to a decrease in the interest expenditure burden of 1.9 per cent of GDP, which mainly results from a reduction of public debt.

Table 3
Expenditure, tax and revenue burden, 2000-2007

Per cent of GDP	2001	2002	2003	2004	2005	2006	2007	Change 2001- 2007
Expenditure burden ¹⁾	53.5	53.8	53.8	53.7	51.6	50.5	49.9	-3.6
Tax burden	48.6	48.0	47.8	49.0	49.7	48.0	47.5	-1.1
Revenue burden ¹⁾	54.7	54.0	53.7	55.4	55.5	53.5	52.7	-2.0

1) The specification of total public expenditures and revenues deviates from the revised specification from Statistics Denmark. Public consumption includes revenues from sales and calculated depreciation expenditure and in this light, the previous specification has been maintained. The specification of public expenditure from Statistics Denmark does not include public sales, which has been reclassified as revenue and calculated depreciation is not included in public expenditures and revenues. In light of this, the expenditure and revenue burden differ from the ascertained burdens based on the specifications according to Statistics Denmark.

The decrease in the tax burden, i.e. the ratio of aggregate tax revenues to GDP, by 1.1 percentage point over the period 2001-2007 reflects in particular a decrease in the personal income tax burden due to the tax cuts in 2004 and the tax freeze.

The revenue ratio, i.e. the ratio of general government revenues to GDP, is expected to decrease by almost 2 percentage points from 2001 to 2007. Apart from the estimated reduction in the tax burden this is due to lower estimated interest revenues.

Detailed information about the expenditure, tax and revenue burdens 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 fiscal policy changes on economic activity – measured by the estimated impact on GDP.

Based on the central government budget proposal for 2007 and the agreements with local governments on the economy in 2007 the fiscal effect is estimated at -0.1 per cent of GDP in 2007, cf. *table 4*.

Table 4							
Fiscal effect, 2000-2007							
	2001	2002	2003	2004	2005	2006	2007
Per cent of GDP							
Expenditures	0.4	0.2	-0.5	0.2	0.0	0.2	-0.1
Revenues	-0.2	0.1	0.1	0.4	0.1	0.1	0.0
Fiscal effect	0.3	0.3	-0.4	0.6	0.1	0.2	-0.1
Temporary suspension of SP ¹⁾	-	-	-	0.1	-	-	-

1) Special pension scheme.

Hence, fiscal policy is estimated to have a slightly dampening effect on the economic activity in 2007. The isolated fiscal effect of the welfare agreement is estimated at about 0.1 per cent in 2007, however an expected 10.0 per cent decrease in public investments reduces the estimated fiscal effect to -0.1 per cent of GDP. The decrease in public investments in 2007 is primarily due to extraordinary investments in 2006 in connection with the government structural reform.

The estimated fiscal effect in 2006 has been upward adjusted to 0.2 pct. of GDP since the May projection. The adjustment is mainly due to the upward adjustment of public consumption expenditure.

In light of the present business cycle, it is important that fiscal policy does not contribute to increase the pressure on the labour market, and that the agreements with local governments are observed.

4. Structural budget balance

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

The structural budget balance is estimated at 1¼ per cent of GDP on average over the period 2004-2007 after correction for the impact of a suspension of Special Pension (SP) contributions.

In the period 2004-2007 the estimated structural budget balance surplus is lower than the actual surplus on the general government budget balance. This reflects extraordinary large revenues from pension yield taxation in 2004 and 2005 and the North Sea activities in the period 2005-2007. The cyclical position of the economy is also expected to improve the general government budget balance in 2006 and 2007.

The structural budget balance is expected to increase by almost 2 per cent GDP from 2002 to 2007 primarily due to the lower net interest payments, *cf. table 5*.

Changes to the composition of aggregate demand have also contributed to the improved structural budget balance mainly due to strong growth in private consumption. The share of exercise duties in private consumption is relatively high compared to other components of GDP, and a strong growth in private consumption therefore tends to improve the structural budget balance

Structural balance			Change due to						
Per cent of GDP	Level	Yearly change	Fiscal policy effects ¹⁾	Structural rate of unempl.	Labour force ²⁾	Net interest	Special budget items ³⁾	Demand	Other/residual
			2002	0.0	-	-	-	-	-
2003	0.4	0.4	0.3	-0.1	-0.1	0.3	0.3	0.2	-0.5
2004	0.6	0.2	-0.9	0.1	0.1	0.2	0.2	0.4	0.1
2005	1.6	1.0	0.1	0.1	0.1	0.2	0.1	0.0	0.4
2006	1.7	0.1	-0.3	0.0	0.0	0.2	0.1	0.1	-0.3
2007	1.8	0.1	0.2	0.1	-0.1	0.2	0.0	0.0	-0.3
Total	-	1.8	-0.6	0.2	0.0	1.1	0.7	0.7	-0.3

1) Due to different methods of calculation the fiscal policy effects differ from the effects used in the calculation of the fiscal effect.
 2) Measured in hours of working.
 3) Special budget items include capital transfers etc.

Furthermore the North Sea oil and gas exploration activities are improving the structural budget balance. The structural income from the North Sea activities is calculated as a 7 year moving average of the actual revenues. The currently high oil prices are thus increasing the structural North Sea revenues and the structural budget balance.

5. Central government finances

The central government budget proposal for 2007 implies a surplus on the current, investment and lending account, i.e. the CIL-account, of DKK 60bn or 3.5 per cent of GDP in 2007, *cf. table 6*.

Table 6				
CIL-account, 2006 and 2007				
DKK bn, current prices	May	2006		2007
		August	Diff.	Budget proposal
Total revenues	527.8	541.1	13.3	620.8
Total expenditures	465.4	464.8	-0.6	560.8
CIL-account	62.4	76.2	13.8	60.0
CIL-account (per cent of GDP)	3.8	4.7	0.8	3.5

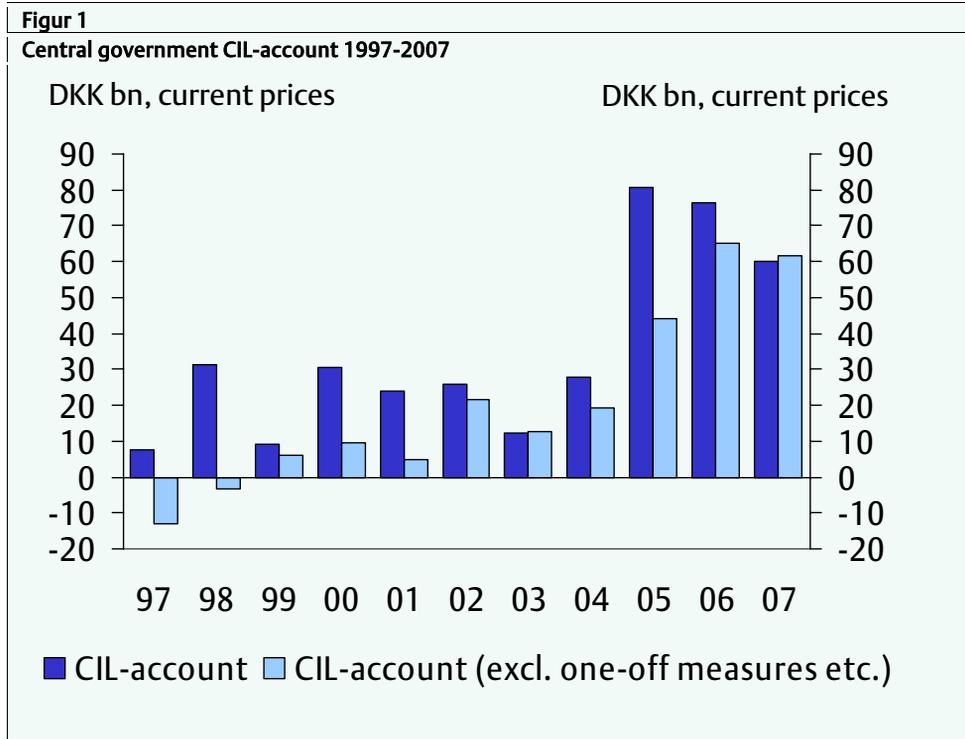
The CIL-account in 2006 is estimated at approx. DKK 76¼bn which corresponds to 4.7 per cent of GDP. The estimated surpluses in 2006 and 2007 are influenced by extraordinary large revenues from the North Sea oil and gas activities, which imply a temporary strengthening of the CIL-account. The CIL-account is also improved due to the cyclical position of the economy and the temporary suspension of the special pension scheme, which increases the income tax revenues.

The CIL-account surplus is upward adjusted by approx. DKK 13¾bn in 2006 compared to the May projection. The adjustment is primarily due to higher expected revenues from income taxes, VAT and other excise duties.

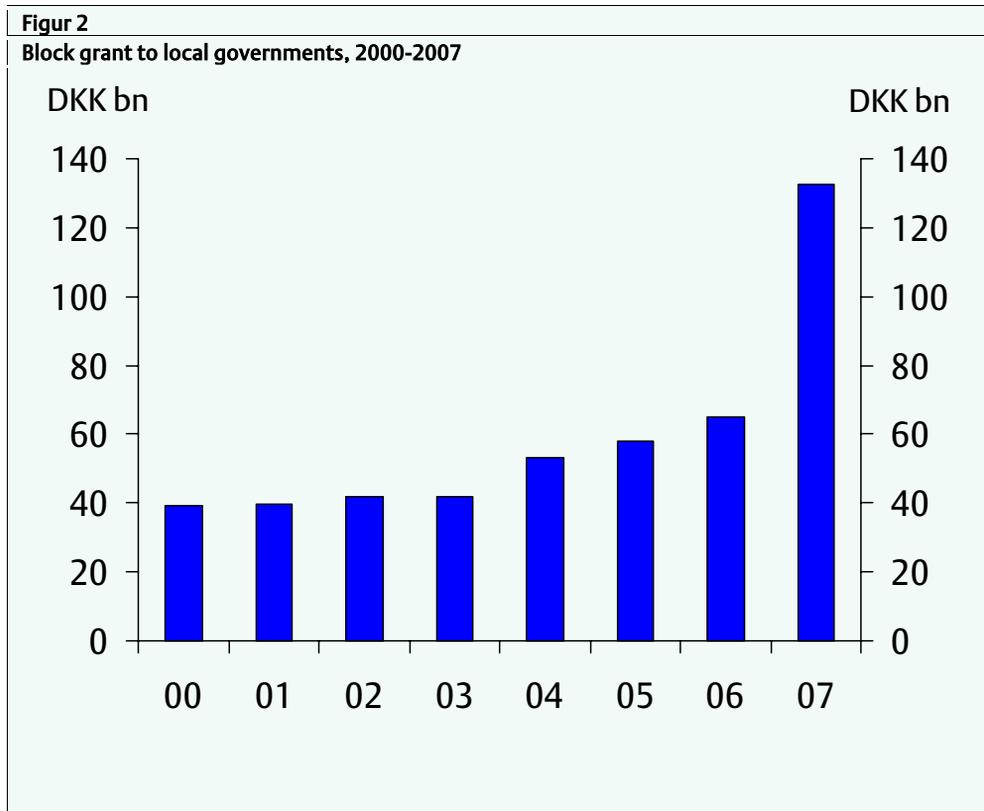
The central government revenues and expenditures are expected to increase significantly from 2006 to 2007. This is due to technical changes as a consequence of the government structural reform. As part of the reform the financing responsibility of the public hospitals are transferred from the local government level to the central government thus increasing both the central government revenues and expenditures.

Furthermore, the revenues from some taxes are transferred from the local government level to the central government. The local governments are compensated for the transfer of revenues by an increase in the block grant, cf. below.

Excluding one-off measures the CIL-account surplus is estimated at DKK 65bn in 2006 and approx. 61½bn in 2007, cf. *figure 1*. In both years there is a downward correction for extraordinarily high revenues from the North Sea activities, which in 2007 is more or less off set by a correction for relatively low revenues from the pension yield taxation.



The block grant to local governments will increase from approx. DKK 64³/₄bn in 2006 to approx. DKK 132¹/₂bn in 2007, *cf. figure 2*. This extraordinary increase in the block grant is primarily due to the government structural reform. From 2007 the new regions, that replaces the counties, will be financed primarily by the block grant from the central government, and a new central government health care contribution tax will replace the income tax collected by the counties.



The central government compensates the local governments for changes in their expenses due to business cycle fluctuations. In order to ensure overall balance in the local government economy the block grant is adjusted, so that local government revenues correspond to the negotiated local government expenditures.

6. Central government financing requirement and debt

Central government debt measured as a percentage of GDP is estimated to decrease by approx. 5 percentage points from 2005 to 2006 and by more than 3½ percentage points from 2006 to 2007, cf. table 7. From 2004 to 2007 the total decrease in central government debt is estimated at approx. 15½ percentage points.

End of year, nominal value	2004	2005	2006	2007
Central government debt, DKK bn	494.8	417.8	357.8	310.9
Relending to infrastructure entities etc. ¹⁾	18.5	20.3	25.0	28.0
Central government debt, adjusted for relending	475.1	397.5	332.9	282.9
Central government debt, per cent of GDP	33.7	26.9	21.9	18.2
Central government debt, adjusted for relending, per cent of GDP	32.5	25.6	20.4	16.6

1) Primarily Ørestadsselskabet I/S, A/S Storebælt and Øresundsforbindelsen A/S.

Measured in nominal terms central government debt is estimated to be reduced by approx. DKK 60bn in 2006 to a level of approx. DKK 357³/₄bn. The expected surplus on the CIL-account is higher than DKK 60bn, and the difference is due to differences between the CIL-account and cash flows, on-lending to government guaranteed infrastructure entities, bond price fluctuations and other technicalities. The debt is estimated to be reduced by approx. DKK 47bn in 2007 to a level of approx. DKK 311bn.

In 2006 the increase in liquidity, measured as net balance, is estimated to be approx. DKK 62³/₄bn, cf. table 8. The estimate is adjusted upward compared to the May projection in which a net balance of DKK 51¹/₂bn was estimated. The adjustment is primarily due to the expected increase in the CIL-account in 2006. The net balance is estimated to be approx. DKK 49¹/₂bn in 2007.

	2006	2007 Budget proposal
DKK bn		
CIL-account	76.2	60.0
Total relending ¹⁾	-11.6	-7.5
Differences between posted revenues and expenditures and cash flow	-2.0	-3.1
Net financing requirement (-net balance)	-62.7	-49.4
Redemption of central government debt	92.7	77.5
Gross financing requirement	30.0	28.1
Gross financing ²⁾		
- Domestic borrowing	20.5	6.7
- Foreign borrowing	3.3	19.5
- Drawing on the central government's account in Danmarks Nationalbank	6.3	1.9

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

1) Including on lending to infrastructure entities.

2) Market value.

The central governments gross financing requirement is expected to be DKK 30bn in 2006. DKK 20¹/₂bn is expected to be covered by domestic borrowing and approx.

DKK 3¹/₄bn by foreign borrowing. The rest will be drawn from the central government account in the Danish central bank.

In 2007 the gross financing requirement is expected to be approx. DKK 28bn of which DKK 19¹/₂bn is expected to be covered by foreign borrowing. Approx. DKK 6³/₄bn is expected to be covered by domestic borrowing and the rest will be drawn from the account in the central bank.

Annex 1

Table 1									
General government finances, 2005-2007									
	2005			2006			2007		
	May	Aug.	Diff.	May	Aug.	Diff.	May	Aug.	Diff.
DKK bn, current prices									
Public consumption	401.9	402.0	0.1	415.2	417.8	2.6	427.6	433.1	5.5
Income transfers	256.2	255.5	-0.7	260.3	259.5	-0.8	267.6	268.6	1.0
Investment	27.2	27.6	0.3	30.4	30.4	0.0	28.7	27.9	-0.8
Interest expenditure	42.1	40.0	-2.1	37.0	37.3	0.3	35.5	36.5	1.0
Subsidies	34.0	35.1	1.1	36.3	36.3	0.0	37.3	37.9	0.6
Other expenditure ¹⁾	42.8	41.3	-1.5	43.2	43.3	0.1	46.5	45.8	-0.7
Total expenditure	804.3	801.5	-2.8	822.4	824.6	2.2	843.2	849.9	6.7
Personal income taxes ²⁾	328.0	323.6	-4.3	335.0	338.5	3.5	348.0	351.5	3.5
Labour market contributions	67.2	66.8	-0.4	70.5	71.1	0.5	73.3	73.9	0.6
Corporate taxes	56.6	56.1	-0.4	62.7	62.8	0.2	59.0	59.0	0.0
Pension yield taxation	31.7	31.5	-0.2	4.9	1.0	-3.9	10.5	6.5	-4.0
VAT	153.9	155.6	1.6	162.4	165.8	3.4	168.4	172.8	4.4
Vehicle registration fee	21.9	21.9	0.1	22.6	24.5	1.8	23.0	24.7	1.7
Other duties	97.8	97.1	-0.7	97.9	99.0	1.1	98.7	98.9	0.3
Other taxes ³⁾	17.4	17.1	-0.2	17.5	17.5	0.0	17.8	18.0	0.2
Interest revenues	21.4	20.5	-0.8	20.6	20.7	0.2	20.4	21.1	0.6
Gross operating surplus	28.2	28.2	0.0	28.8	28.8	0.0	29.5	29.2	-0.3

Other revenues ⁹⁾	41.8	44.2	2.4	45.3	45.1	-0.2	43.4	42.1	-1.3
Total revenue	865.7	862.7	-3.0	868.2	874.7	6.5	892.0	897.7	5.7
General government budget balance	61.4	61.2	-0.2	45.8	50.1	4.2	48.8	47.8	-1.0
Net interest expenditure	20.7	19.5	-1.2	16.5	16.5	0.1	15.1	15.4	0.4
General government primary balance⁹⁾	82.1	80.7	-1.4	62.3	66.6	4.3	63.8	63.2	-0.6

Note: The specification of total public expenditures and revenues deviates from the revised specification from Statistics Denmark. Public consumption includes revenues from sales and calculated depreciation expenditure and in this light, the previous specification has been maintained. The specification of public expenditure from Statistics Denmark does not include public sales, which has been reclassified as revenue and calculated depreciation is not included in public expenditures and revenues. In light of this, the expenditures and revenues differ from the specifications according to Statistics Denmark.

- 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

	2001	2002	2003	2004	2005	2006	2007	Diff. 2001- 2007
Per cent of GDP								
Public consumption	25.7	26.2	26.3	26.5	25.9	25.6	25.4	-0.3
Income transfers	16.5	16.7	17.3	17.2	16.4	15.9	15.8	-0.8
Investment	1.9	1.8	1.6	1.8	1.8	1.9	1.6	-0.3
Interest expenditure	4.0	3.8	3.4	3.1	2.6	2.3	2.1	-1.9
Other expenditure	5.3	5.3	5.2	5.2	4.9	4.9	4.9	-0.4
Expenditure burden¹⁾	53.5	53.8	53.8	53.7	51.6	50.5	49.9	-3.6
Personal income taxes	22.2	21.9	21.6	21.1	20.8	20.7	20.6	-1.6
Labour market contributions	4.4	4.5	4.4	4.4	4.3	4.3	4.3	-0.1
Pension yield taxation	0.1	0.1	0.4	1.6	2.0	0.1	0.4	0.3
Corporate taxes	2.8	2.9	2.8	3.1	3.6	3.8	3.5	0.7
Value added tax	9.6	9.6	9.6	9.8	10.0	10.1	10.1	0.5
Other duties	7.8	7.9	7.7	7.8	7.9	7.8	7.5	-0.3

Other taxes	1.7	1.2	1.2	1.2	1.1	1.1	1.1	-0.7
Tax burden	48.6	48.0	47.8	49.0	49.7	48.0	47.5	-1.1
Interest revenue	1.8	1.5	1.4	1.5	1.3	1.3	1.2	-0.5
Other non-tax revenue	4.5	4.7	4.6	5.1	4.7	4.5	4.2	-0.3
Tariffs etc. to the EU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0
Revenue burden¹⁾	54.7	54.0	53.7	55.4	55.5	53.5	52.7	-2.0

- 1) The specification of total public expenditures and revenues deviates from the revised specification from Statistics Denmark. Public consumption includes revenues from sales and calculated depreciation expenditure and in this light, the previous specification has been maintained. The specification of public expenditure from Statistics Denmark does not include public sales, which has been reclassified as revenue and calculated depreciation is not included in public expenditures and revenues. In light of this, the expenditure and revenue burden differ from the ascertained burdens based on the specifications according to Statistics Denmark.