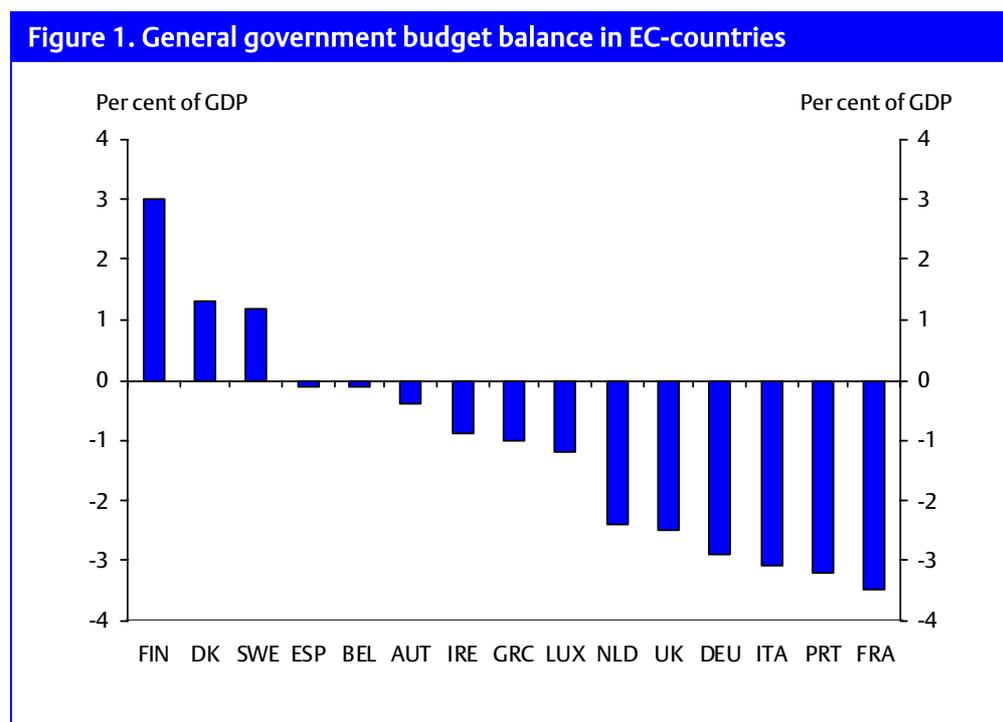


## Budget Outlook, August 2003

### 1. Introduction

In light of the short term forecast for the Danish economy, *cf. Economic Survey*, August 2003, the central government draft budget bill and the agreements with local governments on the economy for 2004, both the central government current, investment and lending account, i.e. the CIL-account and the general government finances show a continuous surplus in 2004.

In an international perspective the general government finances are at a favourable level in Denmark. Among the present EC-countries only in Finland, Denmark and Sweden surpluses on the general government budget balance are expected in 2004, *cf. figure 1*.



Note: European Commission, *Spring 2003 Economic forecasts*, April 2003.  
Own estimate for Denmark.

With the central government draft budget bill for 2004 the Liberal/Conservative government gives priority to hospitals and health care, disabled people and vulnerable groups, justice, education and research. Among the financing elements are proposed adjustments of the unemployment benefit system and reduced business subsidies.

The draft budget bill also reflects, that tax cuts on labour income are implemented from January 1<sup>st</sup> 2004 in order to improve the structures of the labour market and increase the labour supply. Furthermore, the tax cuts, which amount to DKK 5<sup>3</sup>/<sub>4</sub>bn, contribute to stimulate the economic activity and employment in 2004.

From an overall perspective the fiscal policy is expected to contribute expansively to economic activity corresponding to 0.4 per cent of GDP in 2004. The easing of fiscal policy stems from income tax cuts and other easing of revenues including reduced excise duties on tobacco and alcohol, whereas the effects of the expenditure policy are expected to be broadly neutral.

## 2. General government finances

The estimates for the general government finances are based on the most recent short term forecast for the Danish economy, *cf. Economic Survey*, August 2003. Furthermore, estimates for 2003 are based on the general government budget bill and local government budgets. In 2004 the estimates reflect the general government draft budget bill and the agreements with local governments on the economy in 2004.

The general government surplus is estimated at DKK 16.6bn in 2003 and DKK 18.7bn in 2004, *cf. table 1*. The surpluses correspond to 1.2 per cent of GDP in 2003 and 1.3 per cent in 2004.

Table 1. General government budget balance, 1998-2004							
DKK bn, current prices	1998	1999	2000	2001	2002	2003	2004
May 2003	13.1	38.8	31.7	36.6	26.0	18.0	21.6
August 2003	13.1	38.8	31.7	36.6	26.6	16.6	18.7
August 2003 (per cent of GDP)	1.1	3.2	2.5	2.8	2.0	1.2	1.3

Compared to the estimate for 2002 the general government budget balance is expected to decrease in 2003 with approx. DKK 10bn or 0.8 per cent of GDP. However, new information indicates that Statistics Denmark may have overestimated the level of personal income taxes etc. in 2002<sup>1</sup>. This indicates that the general government budget balance may be overestimated with approx. 0.3 percentage points in 2002.

In light of the probable overestimation the decline in the general government budget balance from 2002 to 2003 is estimated at approx. 0.5 percentage points, which primarily stems from the economic slowdown including lower employment and higher unemployment.

<sup>1</sup> New information about the level of personal income taxes and labour market contributions in 2002 based on calculations of the tax forms by the Danish Ministry of Taxation.

The expected economic recovery in 2004 implies an increase in the general government budget surplus. The relative modest increase in the surplus from 2003 to 2004 is among other things due to the agreement on tax cuts from 2004.

Compared to the May projection the general government budget surpluses have been adjusted downwards with approx. DKK 1½bn in 2003 and DKK 3bn in 2004, *cf. table 2*.

<b>Table 2. Revisions of budget balance from May to August, 2003 and 2004</b>		
DKK bn, current prices	2003	2004
Total revision of budget balance	-1.4	-2.9
- Personal income taxes and labour market contributions	-1.7	-3.2
- VAT and other taxes	-0.5	-2.7
- Pension yield taxation	2.8	1.1
- Income transfers	-0.7	1.3
- Public subsidies	-0.5	0.4
- Public consumption	-1.0	-1.0
- Other expenditures and revenues	0.2	1.2

Note: Negative numbers imply reductions of the surplus due to reduced revenues or increased expenditures

The downward adjustment of the surplus in 2003 is primarily due to expected lower public revenues in light of the weaker economic outlook including lower employment and a more moderate growth in private consumption. The downward adjustment in 2003 is to a large extent carried over to the estimates for 2004.

An upward adjustment of unemployment in 2003 explains the expected increase in expenditures for income transfers in 2003. In 2004 the unemployment level is expected to be higher, however the increase in expenditures corresponds broadly to expected decreases in expenditures due to proposed changes in the unemployment benefit system.

In 2004 expenditures for income transfers are adjusted downwards with DKK 1.3bn compared to the May projection. Approx. DKK ¾bn of the downward adjustment is due to a lower percentage regulation of income transfers than estimated in the May. Furthermore, the estimates reflect reductions in budgeted expenditures on the central government draft budget bill, including reduced expenditures for the active labour market policies and a downward adjustment of the regulation of student grants and family and housing allowances.

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

From 2001 to 2004 the expenditure burden, i.e. the ratio of general government expenditures to GDP, is expected to decrease by 1 percentage point, *cf. table 3*. This is primarily 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, 1998-2004**

Per cent of GDP	1998	1999	2000	2001	2002	2003	2004	Change 2001-2004
Expenditure burden	56.7	55.4	53.8	54.2	54.4	54.0	53.2	-1.0
Tax burden <sup>1)</sup>	50.1	51.5	49.5	49.8	49.2	48.5	48.1	-1.7
Revenue burden	57.9	58.6	56.3	57.0	56.3	55.2	54.5	-2.4

1) The estimates for 2003 and 2004 are based on new information about the level of personal income taxes and labour market contributions in 2002, *cf. above*.

The estimated drop in the tax burden, i.e. the ratio of aggregate tax revenues to GDP, of approx. 1¾ percentage points from 2001 to 2004 can among other things be referred to a decrease in the personal income tax burden due to the agreement on tax cuts in 2004, the adjustment of the special pension-scheme savings<sup>2</sup>, and to a reduction of revenues from corporate taxes, which were extraordinarily high in 2001.

A decrease of approx. 2½ percentage points in the revenue burden is expected from 2001 to 2004. 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. It measures the impact of discretionary fiscal policy changes on economic growth – measured by the effect on GDP in the year when discretionary measures are implemented.

Primarily due to income tax cuts and other easing of revenues fiscal policy is estimated to have an expansive impact on economic activity in 2004 corresponding to 0.4 per cent of GDP, *cf. table 4*.

<sup>2</sup> The special pension-scheme savings has been changed into a private/individual scheme, i.e. the previous re-distributive element is cancelled.

**Table 4. Fiscal effect, 1998-2004**

Per cent of GDP	1998	1999	2000	2001	2002	2003	2004
Expenditures	0.4	0.4	0.1	0.7	0.2	-0.3	0.0
Revenues	-0.4	-0.2	-0.2	-0.2	0.1	0.1	0.4
Total fiscal effect	0.0	0.2	-0.1	0.5	0.3	-0.1	0.4

Expenditures are estimated to have a neutral impact on economic activity in 2004. The easing stemming from the estimated growth of 0.7 pct. in public consumption is off set by the tightening of public subsidies and income transfers reflected in the central government draft budget bill for 2004.

Based on new figures of public expenditures from Statistics Denmark the fiscal effect in 2002 is estimated at 0.3 per cent of GDP. The fiscal effect is somewhat higher than expected in May, which is primarily due to Statistics Denmark's upward revision of real growth in public consumption in 2002 from 1 per cent to 2.1 per cent.

In 2003 the estimated fiscal effect is adjusted downwards to -0,1 per cent of GDP compared to 0.1 per cent of GDP in the May projection. The downward adjustment is due to a downward adjustment of the estimated real growth rate in public consumption in 2003 from 0.7 per cent in May to -0,2 per cent in the August projection as a consequence of the higher public consumption level in 2002. The estimated public consumption level in 2003 is based on the central and local government budgets for 2003.

Compared to the May projection the fiscal stance in 2002 and 2003 is unchanged, but the upward revision of public consumption growth in 2002 and the downward adjustment of the estimated public consumption growth in 2003 implies a bigger impact on economic activity in 2002, that is off set by a reduced impact on economic activity in 2003.

Fiscal policy in 2003 and 2004 is viewed to be line with the expected business cycle.

#### **4. Structural budget balance**

The structural budget balance is defined as 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 structural budget balance surplus is estimated<sup>3</sup> at 2.0 per cent of GDP in 2003 and 1.7 per cent of GDP in 2004, *cf. table 5*.

Per cent of GDP	Structural balance		----- Change due to -----				
	Level	Yearly change	Fiscal policy <sup>1)</sup>	Structural rate of unempl.	Labour force <sup>2)</sup>	Special budget items <sup>3)</sup>	Other/residual
1995	-2.0	-	-	-	-	-	-
1996	-1.9	0.1	-0.5	0.6	-0.2	-0.1	0.3
1997	-0.5	1.3	1.3	0.5	0.1	0.1	-0.6
1998	-0.2	0.3	0.4	0.6	0.3	0.1	-1.0
1999	1.5	1.7	0.5	0.5	0.1	0.7	-0.1
2000	2.1	0.6	0.1	0.3	0.0	0.1	0.1
2001	2.3	0.2	-0.3	0.2	-0.1	0.6	-0.1
2002	1.6	-0.7	-0.5	0.1	0.0	-0.2	-0.1
2003	2.0	0.4	0.1	0.0	-0.1	0.2	0.2
2004	1.7	-0.3	-0.5	0.0	0.0	0.2	0.0
Total	-	3.7	0.7	2.6	0.0	1.6	1.3

- 1) Fiscal policy is – except for some adjustments including adjustments for taxation of income transfers – measured by the direct revenue effects used in the calculation of the fiscal effect.
- 2) Measured in hours of working.
- 3) Special budget items include net interest expenditures, capital transfers etc.

The structural budget balance surplus is expected to be larger than the actual budget balance surplus in 2003 and 2004. This is due to the negative impact on the actual budget balance from the slowdown in economic activity including the extraordinarily low revenues from the pension yield taxation, especially in 2003.

The estimated reduction of the structural budget balance from 2003 to 2004 is primarily due to the tax cuts from 2004.

The estimated structural budget surpluses in 2003 and 2004 are in line with the targeted surpluses of 1½-2½ per cent of GDP in order to secure long-term sustainability of government finances, *cf. Economic Survey*, August 2003.

## 5. Central government finances

The general government draft budget bill for 2004 implies a surplus on the so-called CIL-account of DKK 5.3bn or 0.4 per cent of GDP, *cf. table 6*.

<sup>3</sup> The calculation of the structural budget balance is based on new information about the level of personal income taxes and labour market contributions in 2002, *cf. above*.

**Table 6 . CIL-account, 2003 and 2004**

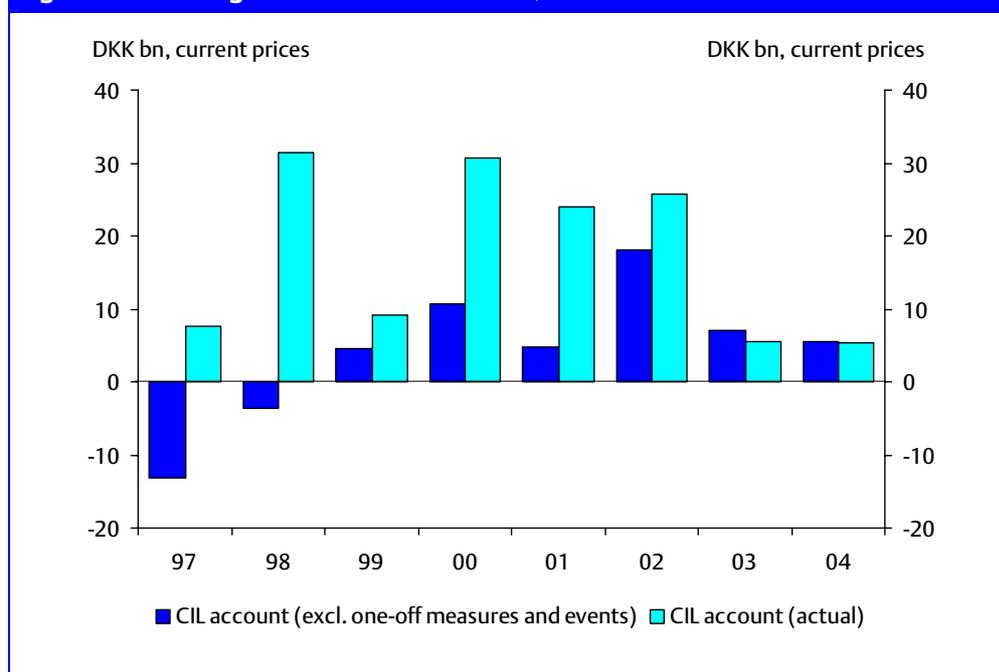
DKK bn., current prices	2003		Diff.	2004
	May	Aug.		Aug.
Total revenues	433,0	434,2	1,2	450,1
Total expenditures	427,5	428,8	1,3	444,8
CIL-account	5,5	5,5	0,0	5,3
CIL-account (per cent of GDP)	0,4	0,4	0,0	0,4

In 2003 the CIL-account is estimated at DKK 5.5bn or 0.4 per cent of GDP.

Compared to the May projection the estimate for the CIL-account is unchanged in 2003. This derives from expected higher revenues of DKK 1.2bn primarily due to an upward revision of the expected revenue from pension yield taxation and expected higher expenditures of DKK 1.3bn mainly due to the upward adjustment of unemployment.

The CIL-account is affected by one-off measures and extraordinary events of varying size from year to year. E.g. the very large surplus in 1998 reflected the central government sale of shares in TeleDanmark. Likewise, the CIL-surpluses in both 2000 and 2001 were affected by a shortening of the fixed time of credit with respect to VAT payments, *cf. figure 2*.

In 2004 the sum of one-off measures and extraordinary events is approximately zero, while the sum is negative in 2003 especially because of extraordinary low expected revenue from pension yield taxation. Thus, corrected for one-off measures and extraordinary events there is a decline in the CIL-account from 2003 to 2004 in light of the agreement on tax cuts from January 1<sup>st</sup> 2004.

**Figure 2. Central government CIL-account, 1997-2003**

## 6. Central government financing requirement and debt

In 2004 central government debt as per cent of GDP is expected to continue to decrease, *cf. table 7*.

**Table 7. Central government debt, 2001-2004**

End of year, nominal value	2001	2002	2003	2004
Central government debt, per cent of GDP	38.8	38.1	37.5	36.4
Central government debt, DKK bn	514.1	520.6	529.2	536.3
Re-lending to infrastructure entities <sup>1)</sup>	5.8	12.8	18.3	24.9
Central government debt, adjusted for re-lending	508.3	507.8	510.9	511.4

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

In nominal terms, however, central government debt in 2004 is expected to increase by approximately DKK 7bn due to a net financing requirement of DKK 5.4bn. The net financing requirement is anticipated in spite of a surplus on the CIL-account. This is primarily due to factors such as re-lending to government owned infrastructure entities – approximately DKK 6½bn – and technical factors relating to periodizing of tax incomes etc. In 2004 central government debt adjusted for re-lending is expected to increase from DKK 510.9bn to DKK 511.4bn.

At the end of 2003, central government debt is expected to amount to 37.5 per cent of GDP. In nominal terms, central government debt is foreseen to increase to DKK 529,2bn despite the surplus on the CIL-account.

Again, the increase in debt can be attributed to technical factors relating to periodizing of tax incomes etc. and re-lending.

<b>Table 8. Central government borrowing, 2003-2004</b>		
DKK bn	2003	2004
CIL-account	5.5	5.3
Total re-lending <sup>1)</sup>	-6.5	-7.6
Periodizing etc.	-7.5	-3.2
Net financing requirement (-net balance)	8.6	5.4
Redemption of central government debt	100.9	123.8
Gross financing requirement	109.5	129.2
Gross financing <sup>2)</sup>		
- Domestic borrowing	75.7	113.2
- Foreign borrowing	17.1	16.0
- Drawing on the central government's account in Danmarks Nationalbank	16.7	0.0

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.

In 2004 the gross financing requirement is estimated at DKK 129.2bn, *cf. table 8*. This is a consequence of a net financing requirement equal to DKK 5.4bn, DKK 107.8bn in redemption on domestic debt and DKK 16.0bn in redemption on foreign debt. The gross financing requirement is covered by domestic borrowing equal to DKK 113.2 and foreign borrowing of DKK 16.0bn.

In 2003 the gross financing requirement is forecasted at DKK 109.5bn. The financing is split between DKK 75.7bn in domestic borrowing, DKK 17.1bn in foreign borrowing and a reduction of the central government capital balance at the Danmarks Nationalbank equal to DKK 16.7bn. The significant reduction of the capital balance at Danmarks Nationalbank in 2003 is the result of an initiative aiming at better cash management within the central government.

## Annex 1.

Table 1. General government finances. 2002-2004									
DKK bn., current prices	----- 2002 -----			----- 2003 -----			----- 2004 -----		
	May	Aug.	Diff.	May	Aug.	Diff.	May	Aug.	Diff.
Consumption	355.0	358.7	3.7	368.0	369.0	1.0	381.2	382.2	1.0
Income transfers	238.5	239.0	0.5	250.7	251.4	0.7	259.4	258.1	-1.3
Investment	23.3	24.2	0.8	23.8	23.8	0.0	24.8	24.7	-0.1
Interest expenditures	50.6	49.8	-0.8	47.3	47.2	-0.1	47.1	46.2	-1.0
Other expenditures <sup>1)</sup>	70.7	70.5	-0.3	71.0	71.5	0.5	73.7	72.3	-1.4
Total expenditure	738.2	742.2	4.0	760.8	762.9	2.1	786.2	783.4	-2.8
Personal income taxes <sup>2)</sup>	304.9	306.7	1.8	315.1	313.7	-1.4	322.5	319.6	-2.9
Labour market contrib.	61.7	62.0	0.3	63.6	63.3	-0.3	66.2	65.9	-0.3
Corporate taxes	38.9	38.6	-0.3	37.6	37.6	0.1	38.0	38.1	0.0
Pension yield taxation	0.3	0.8	0.5	0.3	3.1	2.8	7.6	8.7	1.1
Value added tax	132.3	132.6	0.3	136.7	136.5	-0.2	142.8	142.3	-0.5
Vehicle registration fee	15.1	15.1	0.0	14.1	14.1	0.0	15.4	15.1	-0.3
Excise duties	90.8	90.4	-0.4	91.5	91.2	-0.3	93.8	91.9	-1.9
Other taxes <sup>3)</sup>	22.7	22.7	0.0	23.4	23.1	-0.3	24.0	23.9	0.0
Interest revenues	31.7	31.4	-0.3	31.3	31.4	0.1	32.2	31.4	-0.8
Gross operating surplus	26.7	26.7	0.0	27.1	27.1	-0.1	27.6	27.5	-0.1
Other revenues <sup>4)</sup>	39.2	41.9	2.7	38.1	38.4	0.3	37.7	37.6	-0.1
Total revenue	764.2	768.8	4.6	778.8	779.5	0.7	807.8	802.1	-5.7
General government budget balance	26.0	26.6	0.6	18.0	16.6	-1.4	21.6	18.7	-2.9
Net interest expenditure	19.0	18.4	-0.5	16.0	15.8	-0.2	14.9	14.8	-0.2
General government primary balace <sup>5)</sup>	45.0	45.1	0.1	34.1	32.5	-1.6	36.5	33.4	-3.1

- 1) Other expenditures include subsidies, 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 and tax burden. 1998-2004								
Per cent of GDP	1998	1999	2000	2001	2002	2003	2004	Diff. 2001- 2004
Consumption	26.0	25.8	25.3	25.9	26.3	26.1	26.0	0.1
Income transfers	18.3	17.8	17.3	17.3	17.5	17.8	17.5	0.2
Investments	1.7	1.7	1.7	1.9	1.8	1.7	1.7	-0.2
Interest expenditures	5.3	4.8	4.3	4.0	3.7	3.3	3.1	-0.9
Other expenditures	5.4	5.4	5.2	5.1	5.2	5.1	4.9	-0.2
Expenditure burden	56.7	55.4	53.8	54.2	54.4	54.0	53.2	-1.0
Personal income taxes	22.0	22.3	22.3	22.5	22.5	22.2	21.7	-0.8
Labour market contributions	4.5	4.5	4.4	4.5	4.5	4.5	4.5	0.0
Pension yield taxation	0.8	1.2	0.7	0.0	0.1	0.2	0.6	0.6
Corporate tax	2.8	3.0	2.4	3.1	2.8	2.7	2.6	-0.5
Value added tax	9.9	9.9	9.7	9.7	9.7	9.7	9.7	0.0
Other duties	8.6	8.5	7.7	7.8	7.9	7.6	7.4	-0.4
Other taxes	1.6	2.1	2.3	2.2	1.7	1.6	1.6	-0.6
Tax burden	50.1	51.5	49.5	49.8	49.2	48.5	48.1	-1.7
Interest revenue	3.0	2.5	2.5	2.6	2.3	2.2	2.1	-0.5
Other non-tax revenue	5.0	4.9	4.6	4.7	5.0	4.6	4.4	-0.3
Tariffs etc. to EU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0
Revenue burden	57.9	58.6	56.3	57.0	56.3	55.2	54.5	-2.4