

Budget Outlook, December 2005

1. Introduction

The central government budget for 2006 and the agreements with local governments on the economy for 2006 reflect the economic priorities of the Danish government in 2006.

The central government budget includes a number of new initiatives. Continued strengthening of research, education, innovation and entrepreneurship has been ensured. In addition to this care for the elderly, healthcare and better terms for families with children are areas of high priority in the budget.

The new initiatives in the budget amount to DKK 5.85bn in 2006, which are financed through changed priorities, the use of reserves and the use of the assumed growth in public consumption expenditures of DKK 2bn.

Based on the short term forecast for the Danish economy, *cf. Economic Survey*, December 2005, and the central government budget, the central government current, investment and lending account, i.e. the CIL-account, and the general government finances are expected to show large surpluses in 2005 and 2006.

The present local government budgets for 2006 exceed the agreements from June 2005. Hence, a number of measures are prepared to ensure, that local government consumption in the budgets for 2006 are reduced to the agreed level.

From an overall perspective economic policy is in line with the medium term targets towards 2010, and fiscal policy is expected to be broadly neutral to economic activity in 2005 and 2006.

2. General government finances

The estimates of the general government finances in 2005 and 2006 are based on the short term forecast for the Danish economy, *cf. Economic Survey*, December 2005. Furthermore, the estimates are based on a status for central government spending in 2005, reported accounting figures from local governments in 2005, the central government budget for 2006 and the agreements with local governments on the economy in 2006.

In 2007 the estimates of general government finances are based on technical fiscal policy assumptions in line with the 2010-projection, i.e. assumed real growth rates in public consumption of 0.5 per cent and in public investment of 1 per cent.

The general government surplus is estimated at DKK 51.3bn in 2005 and DKK 36.4bn in 2006, *cf. table 1*. The surpluses correspond to 3.3 per cent of GDP in 2005 and 2.3 per cent of GDP in 2006. In 2007 the general government surplus is estimated at DKK 35.6bn corresponding to 2.1 per cent of GDP.

Table 1							
General government budget balance, 2001-2007							
	2001	2002	2003	2004	2005	2006	2007
DKK bn, current prices							
August 2005	15.9	3.6	-3.2	16.2	38.9	30.8	-
December 2005, hereof	15.8	3.2	-1.0	24.8	51.3	36.4	35.6
Central government	2.9	3.4	5.7	29.9	50.8	35.9	35.1
Local governments	5.0	-0.1	-6.9	-5.3			
Social funds	7.9	-0.1	0.2	0.2	0.5	0.5	0.5
December 2005 (per cent of GDP)	1.2	0.2	-0.1	1.7	3.3	2.3	2.1

Note: The specification of the central and local government budget balances does not fully reflect, that the central government through transfers to local governments bears the overall risk of fluctuations in expenditures and revenues due to the business cycle. The local government deficits in the years 2003-2004 reflect among other things, that the ascertained local government tax revenues are lower than the transfers from the central government.

Since the August projection Statistics Denmark has revised the general government surplus in 2004 from DKK 16.2bn to DKK 24.8bn.

The upward revision of DKK 8.6bn in the general government finances in 2004 reflects among other things lower interest expenditure, larger revenue from pension yield taxation and an upward revision of other revenues. In 2003 the general government deficit has been revised from DKK -3.2bn to DKK -1.0bn.

The estimated increase in the general government surplus from 2004 to 2005 reflects increased estimated revenues from the North Sea oil and gas exploration activities due to higher oil-prices. Furthermore, public expenditures on income transfers are expected to decline as a result of the favorable business cycles. The estimated decline in the general government surplus from 2005 to 2006 is mainly due to expected lower revenues from the pension yield taxation.

The structural budget balance is estimated at approx. 1 per cent of GDP on average in 2005 and 2006 after correction for the effects of a suspension of Special Pension (SP) contributions for the period 2004-2007.

Compared to the August projection the general government surplus has been adjusted upwards with approx. DKK 12½bn in 2005 and DKK 5½bn in 2006, *cf. table 2*.

Table 2**Revision of the general government budget balance from August to December, 2005 and 2006**

	2005	2006
DKK bn, current prices		
Total revision of general government budget balance	12.4	5.5
- Corporate taxes	2.3	3.9
- Pension yield taxation	7.0	1.3
- Vehicle registration fee	1.5	1.3
- VAT and other excise duties	0.9	-0.7
- Income taxation etc. and labour market contributions	-0.4	-2.2
- Income transfers	1.0	2.4
- Public consumption	-1.3	-0.6
- Public subsidies	0.0	-1.2
- Net interest payments and dividends	0.8	0.9
- Other expenditures and revenues	0.6	0.4

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 upward adjustment of the general government surplus in 2005 and 2006 is mainly due to higher revenue estimates.

The revenue from pension yield taxation has been upward adjusted by DKK 7.0bn in 2005 and DKK 1.3bn in 2006 compared to the August projection. In 2005 the adjustment reflects higher expected returns on shares, while a lower estimated interest rate increase during 2006 and therefore a smaller capital loss contributes to the higher revenue in 2006.

Due to favorable business cycles and more accurate measures of the revenue in 2004, the revenue from corporate taxes have been upward adjusted by DKK 2.3bn in 2005 and DKK 3.9bn in 2006.

In light of a continued high level of vehicle purchases the revenue from the vehicle registration fee has been upward adjusted by DKK 1.5bn in 2005 and DKK 1.3bn in 2006.

Public expenditure on income transfers has been downward adjusted by DKK 1.0bn in 2005 and DKK 2.4bn in 2006 compared to the August projection. Lower estimated early retirement and pension expenditures contribute to the downward adjustment in both years, while lower estimated expenditures for unemployment benefits and cash benefits reduce income transfers in 2006.

In light of new information about local government consumption in 2005 and higher estimated medical expenditure in 2005 and 2006 public consumption expenditures

have been upward adjusted by DKK 1.3bn in 2005 and DKK 0.6bn in 2006. Estimated public consumption does not reflect local government budgets for 2006, since local government budgets exceeds the consumption agreed in June 2005. The central government is preparing a number of measures to ensure local government consumption in line the agreed 2006-level.

In 2006 public expenditures on subsidies has been upward adjusted by DKK 1.2bn. The higher estimated subsidies reflect among other things expenditures for wage subsidies regarding disabled persons and subsidies in connection with down sizing of the fishing industry.

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

The expenditure burden, i.e. the ratio of general government expenditures to GDP, is expected to decrease by 2.8 percentage points from 2001 to 2007, cf. *table 3*. The estimated decrease in the expenditure burden is mainly a consequence of a reduction of the estimated interest expenditure burden of approx. 1¾ percentage points, which results from an expected lower public debt and lower interest rates.

	2001	2002	2003	2004	2005	2006	2007	Change 2001- 2007
Per cent of GDP								
Expenditure burden ¹⁾	53.5	54.2	54.1	53.9	52.0	51.2	50.7	-2.8
Tax burden	48.6	48.3	48.1	49.2	49.6	47.8	47.5	-1.1
Revenue burden ¹⁾	54.7	54.4	54.0	55.6	55.3	53.4	52.8	-1.9

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 estimated decrease in the tax burden, i.e. the ratio of aggregate tax revenues to GDP, of approx. 1 percentage points from 2001 to 2007 reflects among other things a decrease in the personal income tax burden due to the tax cuts in 2004 and the tax freeze.

The revenue burden, i.e. the ratio of general government revenues to GDP, is expected to decrease by approx. 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 effect on GDP.

Based on the new estimated public finances a fiscal effect of approx. -0.1 per cent of GDP is projected in 2006, *cf. table 4*. Compared to the August projection the fiscal effect estimate in 2006 is unchanged.

	2000	2001	2002	2003	2004	2005	2006
Per cent of GDP							
Expenditures	-0,1	0,5	0,2	-0,4	0,5	-0,1	-0,1
Revenues	-0,2	-0,2	0,1	0,1	0,4	0,0	0,0
Fiscal effect	-0,3	0,3	0,3	-0,3	0,9	0,0	-0,1
Temporary suspension of SP ¹⁾	-	-	-	-	0,1	-	-

1) Special pension scheme.

In 2005 fiscal policy is also estimated to have a more or less neutral impact on economic activity. Compared to the August projection the fiscal effect in 2005 has been adjusted upward from -0.1 per cent of GDP to 0.0 per cent of GDP. This upward revision is mainly the result of an upward adjustment of real growth in public consumption in 2005 from 0.3 per cent in August to 0.6 per cent.

Fiscal policy is estimated to be consistent with the expected economic cycle in 2005 and 2006, *cf. Economic Survey*, December 2005.

The fiscal effect in 2007 has not yet been determined. The economic priorities for 2007 will be decided during 2006 and presented with the government's budget proposal for 2007 in August 2006.

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. 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 labor force.

The target interval for the structural budget balance implies average surpluses of ½-1½ per cent of GDP.

The structural budget balance surplus is estimated at 1.6 per cent of GDP in 2005 and 1.3 per cent of GDP in 2006, *cf. table 5*. Corrected for the effect of the suspension of SP-contributions the structural budget balance is estimated at 1.3 per cent of GDP in 2005 and 1.1 per cent of GDP in 2006. The structural budget balance is thus expected to be within the target interval in both years.

Table 5									
Structural budget balance, 2002-2006									
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	0,4	-	-	-	-	-
2003	0,7	0,3	0,2	-0,1	-0,3	0,3	0,2	0,1	-0,1
2004	0,8	0,1	-0,9	0,0	0,1	0,2	0,1	0,4	0,2
2005	1,6	0,8	0,1	0,0	0,1	0,2	0,1	0,2	0,1
2006	1,3	-0,3	0,1	0,0	-0,1	0,2	0,0	0,0	-0,5
Total	-	0,9	-0,5	-0,1	-0,2	0,9	0,4	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.									

In the years 2004-2006 the estimated structural budget balance surplus is lower than the estimated surplus on the general government budget balance. This reflects extraordinary large revenues from pension yield taxation in 2004 and 2005 and from corporate taxes in 2005 and 2006. Moreover, favorable business cycles in 2005 and 2006 are expected to contribute to a larger general government surplus.

The estimated increase in the structural budget balance surplus of approx. 1 percentage points from 2002 to 2006 mainly reflects reduced net interest expenditures. In addition to this the impact of the composition of aggregate demand contributes to a higher structural budget balance mainly due to the relatively strong growth in private consumption. The share of excise duties in private consumption is relatively high compared to other components of GDP, and a strong growth in private consumption therefore tends to increase the structural budget balance. Fiscal policy and the labor force development, on the other hand, contribute to a reduction of the structural budget balance from 2002 to 2006.

5. Central government finances

The central government budget for 2006 implies a surplus on the current, investment and lending account, i.e. the CIL-account, of approx. DKK 47½bn or 2.9 per cent of GDP in 2006, *cf. table 6*.

Tabel 6						
CIL-account, 2005 and 2006						
	2005			2006		
	Aug.	Dec.	Diff.	FFL	FL	Diff.
DKK bn, current prices						
Total revenues	505.1	524.5	19.4	507.4	515.4	8.0
Total expenditures	455.0	456.3	1.3	467.6	468.1	0.5
CIL-account	50.1	68.2	18.1	39.9	47.4	7.5
CIL-account (per cent of GDP)	3.3	4.4	1.1	2.5	2.9	0.4

The expected CIL-account surplus in 2006 is thus approx. DKK 7½bn larger than estimated in August based on the budget proposal.

In 2005 the surplus on the CIL-account is estimated at approx. DKK 68bn or 4.4 per cent of GDP. Compared to the August projection the surplus on the CIL-account in 2005 has been upward adjusted by approx. DKK 18bn.

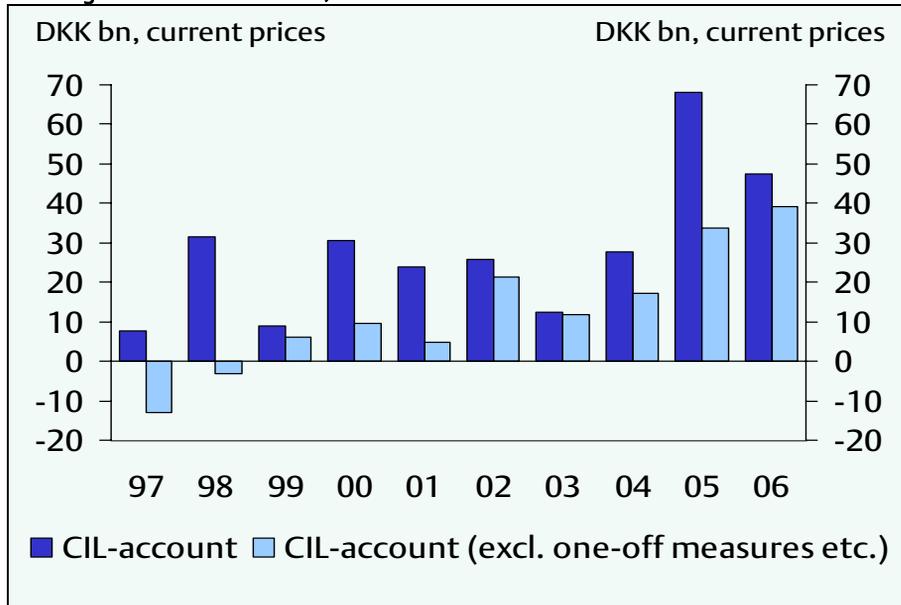
The estimated surpluses in 2005 and 2006 are to a great extent due to revenues from the pension yield taxation in 2005 and the North Sea oil and gas activities in 2005 and 2006, which imply a temporary strengthening of the CIL-account. Also the suspension of the SP-contributions, which has been continued in 2006 (and 2007), contribute to the large surplus on the CIL-account in 2005 and 2006.

The estimated surpluses on the CIL-account in 2005 and 2006 are subject to uncertainty because of the sensitivity to changes in the oil price and financial market developments.

The upward adjustment of the CIL-account surplus in 2005 and 2006 is primarily due to an upward adjustment of central government revenues. The larger revenue is mainly a result of an upward adjustment of revenues from pension yield taxation in 2005 and corporate taxes in 2005 and 2006, i.e. revenues characterized by a certain volatility.

Corrected for one-off measures etc. the CIL-account surplus is estimated at approx. DKK 33½bn in 2005 and DKK 39bn in 2006, *cf. figure 1*. The relatively large corrections in 2005 and 2006 are primarily due to revenues from pension yield taxation and the North Sea oil and gas activities.

Figure 1.
Central government CIL-account, 1997-2006



6. Central government financing requirement and debt

Central government debt measured as a percentage of GDP is estimated to decrease by approx. 5¾ percentage points in 2005 and by additional 3½ percentage points in 2006, cf. table 7. From 2003 to 2006 the total decrease in central government debt is estimated at approx. 12 percentage points.

Table 7

Central government debt, 2003-2006

	2003	2004	2005	2006
End of year, nominal value				
Central government debt, DKK bn	515.7	493.6	432.5	397.0
Relending to infrastructure entities etc. ¹⁾	14.7	18.5	21.2	23.8
Central government debt, adjusted for relending	501.0	475.1	411.3	373.3
Central government debt, per cent of GDP	36.8	33.8	28.1	24.7
Central government debt, adjusted for relending, per cent of GDP	35.7	32.5	26.7	23.2

1) Ørestadsselskabet I/S, A/S Storebælt og Øresundsforbindelsen A/S.

Measured in nominal terms central government debt is estimated at DKK 397.0bn in 2006 and DKK 432.5bn in 2005 compared to a level of DKK 493.6bn in 2004.

The estimated reduction of central government debt is thus approx. DKK 35½bn from 2005 to 2006 due to a net balance amounting to approx. DKK 37½bn in 2006, cf. table 8.

Table 8		
Central government borrowing, 2005-2006		
	2005	2006
		Budget
DKK bn		
CIL-account	68.2	47.4
Total relending ¹⁾	-4.1	-6.9
Differences between posted revenues and expenditures and cash flow	0.0	-2.9
Net financing requirement (-net balance)	-64.1	-37.6
Redemption of central government debt	121.7	94.2
Gross financing requirement	57.5	56.7
Gross financing ²⁾		
- Domestic borrowing	35.8	23.5
- Foreign borrowing	15.5	11.4
- Drawing on the central government's account in Danmarks Nationalbank	6.2	21.8
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.	

While the CIL-account is expected to show a surplus of approx. DKK 47½bn in 2006, the net balance is somewhat lower primarily due to on-lending to government guaranteed infrastructure entities etc. amounting to approx. DKK 7bn.

Central government debt adjusted for on-lending is expected to decrease by approx. DKK 38bn to DKK 373.3bn in 2006.

In 2005 the net balance is estimated at approx. DKK 64bn. Compared to the August projection the net balance in 2005 has been adjusted upward by approx. DKK 18½bn, primarily as a consequence of a higher estimated surplus on the CIL-account.

Annex 1

Table 1									
General government finances, 2004-2006									
	2004			2005			2006		
	Aug.	Dec.	Diff.	Aug.	Dec.	Diff.	Aug.	Dec.	Diff.
DKK bn, current prices									
Public consumption	388.7	388.3	-0.4	398.6	399.9	1.3	411.6	412.2	0.6
Income transfers	251.9	251.7	-0.2	258.0	257.0	-1.0	266.3	263.9	-2.4
Investment	25.8	25.8	0.0	27.1	27.1	0.0	27.9	27.9	0.0
Interest expenditure	46.5	45.2	-1.3	42.5	41.9	-0.6	37.7	37.5	-0.2
Subsidies	34.4	33.8	-0.6	35.4	35.4	0.0	36.7	37.9	1.2
Other expenditure ¹⁾	43.5	42.7	-0.8	41.1	40.5	-0.7	43.6	43.4	-0.2
Total expenditure	790.8	787.5	-3.2	802.7	801.7	-1.1	823.8	822.8	-1.0
Personal income taxes ²⁾	310.6	308.8	-1.8	323.8	323.2	-0.6	337.6	335.3	-2.3
Labour market contributions	64.1	64.8	0.7	67.0	67.2	0.2	69.8	70.0	0.1
Corporate taxes	46.0	46.6	0.6	54.3	56.6	2.3	52.8	56.7	3.9
Pension yield taxation	21.1	22.9	1.8	19.5	26.4	7.0	6.8	8.1	1.3
VAT	143.5	143.3	-0.2	151.1	151.4	0.3	158.3	157.3	-1.0
Vehicle registration fee	17.9	17.9	0.0	20.7	22.1	1.5	21.6	22.9	1.3
Other duties	94.0	94.0	0.0	96.4	97.1	0.7	97.6	97.9	0.3
Other taxes ³⁾	17.1	17.1	0.0	17.3	17.4	0.1	17.4	17.4	0.0
Interest revenues	22.1	22.3	0.2	22.1	22.3	0.2	21.0	21.7	0.7
Gross operating surplus	28.0	28.0	0.0	28.2	28.2	0.0	28.8	28.8	0.0
Other revenue ⁴⁾	42.4	46.6	4.2	41.4	41.1	-0.3	42.8	43.1	0.3
Total revenue	806.9	812.3	5.4	841.7	853.0	11.3	854.6	859.2	4.6
General government budget balance	16.2	24.8	8.6	38.9	51.3	12.4	30.8	36.4	5.5
Net interest expenditure	24.4	23.0	-1.4	20.3	19.6	-0.8	16.7	15.8	-0.9
General government primary balance ⁵⁾	40.6	47.8	7.2	59.3	70.9	11.6	47.6	52.2	4.6

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	26.4	26.5	26.6	25.9	25.6	25.4	-0.3
Income transfers	16.5	16.8	17.3	17.2	16.7	16.4	16.3	-0.2
Investment	1.9	1.8	1.6	1.8	1.8	1.7	1.7	-0.2
Interest expenditure	4.0	3.8	3.4	3.1	2.7	2.3	2.2	-1.8
Other expenditure	5.3	5.4	5.2	5.2	4.9	5.1	5.0	-0.3
Expenditure burden¹⁾	53.5	54.2	54.1	53.9	52.0	51.2	50.7	-2.8
Personal income taxes	22.2	22.0	21.7	21.1	21.0	20.8	20.8	-1.3
Labour market contributions	4.4	4.5	4.4	4.4	4.4	4.4	4.4	-0.1
Pension yield taxation	0.1	0.1	0.4	1.6	1.7	0.5	0.8	0.7
Corporate taxes	2.8	2.9	2.9	3.2	3.7	3.5	3.1	0.3
Value added tax	9.6	9.7	9.6	9.8	9.8	9.8	9.8	0.1
Other duties	7.8	8.0	7.8	7.9	7.9	7.7	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	48.3	48.1	49.2	49.6	47.8	47.5	-1.1
Interest revenue	1.8	1.5	1.4	1.5	1.4	1.4	1.3	-0.5
Other non-tax revenue	4.5	4.7	4.6	5.1	4.5	4.5	4.3	-0.2
Tariffs etc. to the EU	-0.2	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	0.0
Revenue burden¹⁾	54.7	54.4	54.0	55.6	55.3	53.4	52.8	-1.9

- 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.