Budget Outlook, May 2005

1. Introduction

The real growth rate of GDP was 2.4 per cent in 2004 in accordance with the estimate in the December projection. In line with the December projection economic growth in 2005 is also estimated at 2.4 per cent, cf. *Economic Survey*, May 2005.

Compared to the December projection the composition of economic growth in 2004 and 2005 has shifted towards stronger domestic demand from private consumption and investments and lower growth contribution from exports.

The changed composition of economic growth is expected to generate a larger surplus on the central government account and the general government budget balance in 2005. Also, due to more extraordinary circumstances both accounts show and are expected to show larger surpluses in 2004 and 2005 than estimated in December.

The structural budget balance surplus is estimated at 2.1 per cent of GDP in 2005 and 1.8 per cent of GDP in 2006 and is thus expected to lie within the government medium target interval of 1½ to 2½ per cent of GDP. Without the effects of the temporary suspension of the special pension scheme contributions the structural budget balance surpluses are estimated at approx. 1¾ per cent of GDP per year in 2004-2006.

The improvement of central government accounts contributes to a reduction of the level of central government debt to 31.0 per cent of GDP in 2005.

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*, May 2005.

Furthermore, the estimates for 2005 are based on central and local government budgets, a preliminary evaluation of the central government spending in 2005 and a follow-up agreement between the central government and Local Government Denmark (LGDK), which aims at reducing spending in 2005. Estimates for 2006 are partly based on technical assumptions including a real growth rate in public consumption of 0.5 per cent in line with the medium term projections.

Preliminary figures from Statistics Denmark show a general government surplus of DKK 33.7bn in 2004, which corresponds to 2.3 per cent of GDP, *cf. table 1*.

Table 1. General government budget balance, 2000-2006

DKK bn, current prices	2000	2001	2002	2003	2004	2005	2006
December 2004	32.5	37.5	21.2	14.6	21.9	25.5	26.8
May 2005	32.5	37.5	21.2	14.6	33.7	38.8	36.4
Hereof: Central and local governments	*13.2*	*15.5*	*7.7*	*-0.9*	*18.4*	*25.2*	*23.0*
Social funds	*19.3*	*22.1*	*13.4*	*15.5*	*15.3*	*13.7*	*13.4*
May 2005 (per cent of GDP)	2.5	2.8	1.6	1.0	2.3	2.6	2.3

Compared to the December projection the surplus in 2004 is revised upwards by approx. DKK 11¾bn, which is primarily due to larger revenue from interests, pension yield taxation, personal income taxes and indirect taxes, *cf. annex 1*.

Among other things the preliminary figures from Statistics Denmark do not reflect local government final accounts and the final settlement of personal income taxes in 2004 and are thus subject to some uncertainty.

The general government surplus is estimated at DKK 38.8bn in 2005 and DKK 36.4bn in 2006. The surpluses correspond to 2.6 per cent of GDP in 2005 and 2.3 per cent of GDP in 2006.

The estimated increase in the general government surplus of approx. DKK 5bn from 2004 to 2005 reflects among other things the expected more favourable business cycle and lower net interest expenditure in light of expected low interest rates and reduced debt.

From 2005 to 2006 a decline in general government surplus is expected, which is mainly due to the assumed termination of the suspension of the SP-contributions in 2006, which as a consequence of tax deductions reduces tax revenues.

In the beginning of June 2005 Statistics Denmark will publish revised figures for public finances for 2004 and earlier years that will reflect methodical changes. One of the most significant changes implies, that the pension fund, ATP, is no longer a part of public finances. This causes a technical reduction of the general government surplus of ¾-1 per cent of GDP in the years 2000-2006. This revision has no impact on the sustainability of public finances, since ATP's capital is predisposed to future pension expenditures.

Compared to the December projection the estimated general government budget surpluses have been adjusted upwards with approx. DKK 13¼bn in 2005 and approx. DKK 9½bn in 2006, *cf. table 2*.

Table 2. Revisions of budget balance from December to May, 2005 and 2006

DKK bn, current prices	2005	2006
Total revision of general government budget balance	13.3	9.6
- Corporate taxes	4.2	3.0
- Profit-sharing from the North Sea oil exploration activities	0.5	1.2
- VAT and other excise duties	4.2	5.6
- Pension yield taxation	1.4	-1.7
- Income taxation etc. and labour market contributions	-2.5	-1.7
- ATP-contributions	0.1	0.8
- Income transfers	-0.2	0.2
- Public consumption	-0.1	-0.8
- Public subsidies	-0.8	-1.3
- Contributions to the EU and other transfers abroad	1.3	1.3
- Net interest payments	4.5	3.5
- Other expenditures and revenues	0.7	-0.5

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 revisions of the estimated surpluses in 2005 and 2006 are mainly due to lower net interest payments and higher revenues from corporate taxes, value added tax and other excise duties. Revenues from income taxation etc. and labour market contributions are adjusted downwards compared to the December projection.

Net interest payments are expected to be lower due to higher revenues, that primarily stems from larger returns in ATP, and lower interest expenditures in light of expected lower interest rates.

The upward adjustment of the estimated revenues from corporate taxes in 2005 is related to higher actual payments in 2004 from non hydrocarbon taxable corporations, whereas the upward revision in 2006 mainly reflects the estimate for hydrocarbon taxable corporations and the hydrocarbon tax. In that light also revenues related to profit-sharing from the North Sea activities are adjusted upwards in both 2005 and 2006.

Estimated revenues from VAT and other excise duties have also been adjusted upwards in both 2005 and 2006. This is primarily due to expected higher growth in private consumption, higher expected vehicle registration and housing investments.

As the result of a more moderate growth in household incomes, which is due to lower expected wage increases, revenues from personal income taxes and labour market contributions are adjusted downwards in 2005 and 2006.

Detailed information about the general government finances, including adjustments since the December 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 1.7 percentage points from 2001 to 2006, *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, 2000-2006

Per cent of GDP	2000	2001	2002	2003	2004	2005	2006	Change 2001-2006
Expenditure burden	53.9	54.4	55.0	55.2	54.9	53.3	52.7	-1.7
Tax burden	49.6	50.0	49.3	49.0	49.7	49.1	48.5	-1.5
Revenue burden	56.5	57.2	56.5	56.2	57.2	55.9	55.0	-2.2

The estimated drop in the tax burden, i.e. the ratio of aggregate tax revenues to GDP, of 1.5 percentage points from 2001 to 2006 reflects among other things a decrease in the personal income tax burden due to the tax cuts in 2004.

A decrease of 2.2 percentage points in the revenue burden, i.e. the ratio of general government revenues to GDP, is expected from 2001 to 2006. 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 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 central government budget bill for 2005 and local government budgets for 2005 fiscal policy was expected to have a neutral impact on economic activity in 2005 in the December projection. In light of revised estimates for public expenditures and revenues the fiscal effect is now estimated at approx. 0.1 per cent of GDP in 2005, *cf. table 4*.

Table 4. Fiscal effect, 1999-2005							
Per cent of GDP	1999	2000	2001	2002	2003	2004	2005
Expenditures	*0.4*	*0.0*	*0.5*	*0.2*	*-0.1*	*0.1*	*0.0*
Revenues	*-0.2*	*-0.2*	*-0.2*	*0.1*	*0.1*	*0.4*	*0.0*
Fiscal effect	0.2	-0.1	0.3	0.2	0.0	0.5	0.1
Temporary suspension of SP[1)]	-	-	-	-	-	0.1	-

1) Special pension scheme.

The small upward revision compared to the December projection is primarily due to an increased contribution from nominal public consumption. Hence, the nominal growth rate of public consumption is slightly higher than assumed in December partly due to a downward revision in 2004. Furthermore a downward revision of private price and wage increases combined with unchanged estimates for public price and wage increases causes a slightly increased contribution from nominal public consumption to the fiscal effect in 2005.

In addition to this nominal public investment and public subsidies in 2005 contribute to the upward revision.

The fiscal policy stance for 2006 will be determined in 2005, inter alia during the preparation of the budget proposal for 2006 that is presented in August 2005.

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 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 forthcoming separation of the ATP-fund from the public finances implies a technical reduction of the interval by approx. ¾-1 per cent of GDP.

The structural budget balance surplus is estimated at 2.1 per cent of GDP in 2005 and 1.8 per cent of GDP in 2006, *cf. table 5*. The decrease from 2005 to 2006 mainly reflects the assumed termination of the suspension of payments to the special pensions scheme.

Table 5. Structural budget balance, 1995-2006

	Structural balance		---------------------------------- Change due to ----------------------------------						
Per cent of GDP	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	-0.8								
1996	-1.2	-0.4	0.0	0.4	-0.3	0.1	-0.4	-0.1	-0.1
1997	-0.2	1.0	0.7	0.3	0.1	0.2	-0.3	-0.1	0.0
1998	-0.2	0.0	0.1	0.3	-0.2	0.2	-0.4	-0.2	0.2
1999	0.9	1.1	0.5	0.1	-0.1	0.3	0.8	-0.4	-0.1
2000	1.6	0.7	-0.1	0.4	0.3	0.3	0.3	-0.8	0.3
2001	1.8	0.2	-0.2	0.3	0.3	0.3	-0.1	-0.3	-0.1
2002	1.4	-0.4	-0.3	0.2	-0.3	0.3	-0.4	0.1	0.0
2003	1.5	0.1	-0.2	-0.1	0.0	0.3	0.1	0.0	0.0
2004	2.0	0.5	-0.6	0.0	0.1	0.2	0.1	0.4	0.3
2005	2.1	0.1	-0.1	0.1	0.0	0.2	0.0	0.2	-0.3
2006	1.8	-0.3	-	-	-	-	-	-	-
Total	-	2.6	-0.3	2.0	-0.2	2.6	-0.5	-1.2	0.2

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 within the target interval in both years.

The increase in the structural budget balance surplus of approx. 2½ 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 – especially in the years 1996-2001. A relatively 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. The relative strong growth in private consumption in 2004 and 2005 tends to ameliorate the structural budget balance.

5. Central government finances

The central government accounts for 2004 imply a surplus on the current, investment and lending account, i.e. the CIL-account, of approx. DKK 27¾bn or 1.9 per cent of GDP, *cf. table 6*.

Table 6. CIL-account, 2004 and 2005						
		2004			2005	
DKK bn., current prices	Dec.	Final	Diff.	FL	May	Diff.
Total revenues	457.7	471.7	14.1	480.4	487.3	6.9
Total expenditures	447.1	444.0	-3.1	457.0	456.6	-0.4
CIL-account	10.6	27.7	17.1	23.4	30.7	7.3
CIL-account (per cent of GDP)	0.7	1.9	1.2	1.5	2.0	0.5

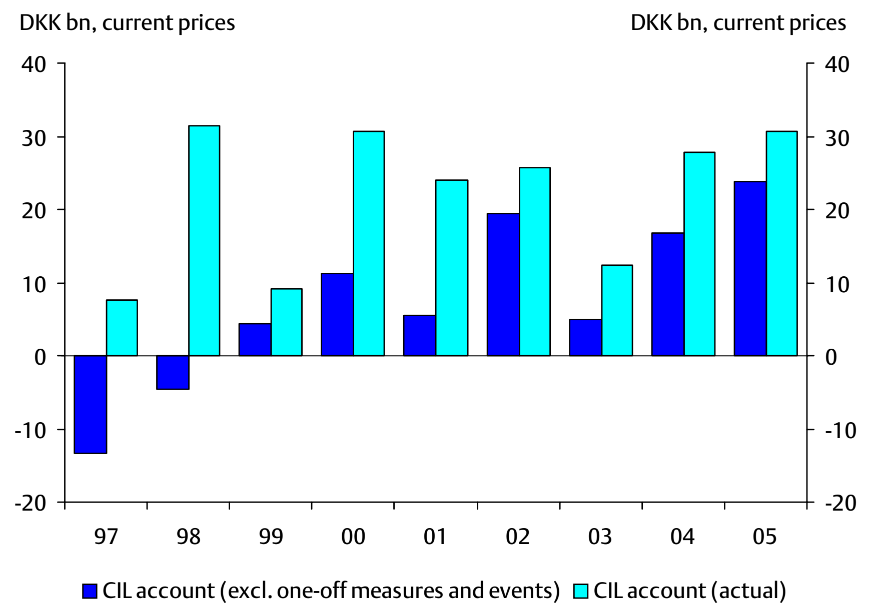
The surplus in 2004 is considerably higher than expected in the December projection, which is primarily due to larger revenues from pension yield taxation and corporate taxes. In addition to this revenues from personal income taxes and indirect taxes are higher than expected in December.

The reduction of total expenditures compared to the December projection reflects among other things a reduction in transfer payments related to active labour market policy, unemployment benefits etc. Furthermore, expenditures are lower than expected in December due to some accounting technicalities regarding the revenues from TV2/DANMARK and lower expenditures for publicly subsidized housing construction and international programs.

Compared to the assessment in the December projection, which was based on the budget bill for 2005, the estimate for the CIL-account surplus in 2005 is approx. DKK 7¼bn higher. This follows from an upward revision of revenues of almost DKK 7bn due to larger estimated revenues from pension yield taxation, VAT and other excise duties and a downward revision of expenditures of almost DKK ½bn. The downward revision of central government expenditures reflects lower expected interest payments and a smaller contribution to the EU.

Corrected for one-off measures etc. the CIL-account surplus is estimated at approximately DKK 17bn in 2004 and DKK 24bn in 2005, *cf. figure 1*. In 2004 the CIL-account is adjusted for an extraordinarily large revenue from the pension yield taxation, whereas in 2005 corporate taxes are expected to contribute to a temporarily higher actual CIL-account.

Figure 1. Central government CIL-account, 1997-2005



6. Central government financing requirement and debt

In 2004 central government debt amounted to DKK 493.6bn or 34.1 per cent of GDP, *cf. table 7*. The reduction of central government debt from 2003 was thus larger than expected in the December projection.

Table 7. Central government debt, 2002-2005

End of year, nominal value	2002	2003	2004	2005
Central government debt, DKK bn	521.3	515.7	493.6	468.7
On lending to infrastructure entities etc.[1)]	12.5	14.7	18.5	19.5
Central government debt, adjusted for on lending	508.8	501.0	475.1	449.2
Central government debt, per cent of GDP	38.6	37.1	34.1	31.0
Central government debt, adjusted for on lending, per cent of GDP	37.7	36.0	32.8	29.7

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

The larger reduction of central government debt in 2004 reflects a higher net balance primarily due to a larger surplus on the CIL-account and a bigger difference between posted revenues/expenditures and cash flow than expected in December.

Central government debt is expected to decrease by approx. DKK 25bn from 2004 to 2005. Measured as per cent of GDP central government debt is expected to amount to 31.0 per cent in 2005.

The reduction of central government debt from 2004 to 2005 follows from a net balance of approximately DKK 26½bn, *cf. table 8*. While the

CIL-account is expected to show a surplus of DKK 30¾bn, the net balance is somewhat lower primarily due to on lending to government garanteed infrastructure entities etc. amounting to approximately DKK 3¾bn and differences between posted revenues/expenditures on the CIL-account and actual cash flow, including net due interest and distributed capital losses on issue, which amount to approx. DKK ½bn. Central government debt adjusted for on lending is expected to decrease by close to DKK 26bn to DKK 449.2bn in 2005.

Table 8. Central government borrowing, 2004-2005

DKK bn	2004	2005
CIL-account	27.7	30.7
Total on lending[1]	-5.4	-3.7
Differences between posted revenues/expenditures and cash flow	1.4	-0.5
Net financing requirement (-net balance)	-23.6	-26.5
Redemption of central government debt	116.0	113.0
Gross financing requirement	92.4	86.5
Gross financing[2]		
- Domestic borrowing	92.6	43.1
- Foreign borrowing	16.1	15.4
- Drawing on the central government's account in Danmarks Nationalbank	-16.3	28.0

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.

In 2005 the gross financing requirement is estimated at DKK 86½bn, stemming from a net balance of DKK 26½bn and DKK 113bn in redemptions on central government debt. The financing is split between DKK 43.1bn in domestic borrowing, DKK 15.4bn in foreign borrowing and a DKK 28.0bn reduction of the central government account in Danmarks Nationalbank.

Annex 1.

Table 1. General government finances 2004-2006

DKK bn., current prices	2004 Dec.	2004 May	2004 Diff.	2005 Dec.	2005 May	2005 Diff.	2006 Dec.	2006 May	2006 Diff.
Consumption	385.7	385.6	-0.1	396.8	396.9	0.1	408.8	409.6	0.8
Income transfers	261.0	260.6	-0.4	266.3	266.5	0.2	272.0	271.8	-0.2
Investment	25.2	25.1	-0.1	26.9	26.9	0.0	27.6	27.7	0.0
Interest expenditure	46.0	46.0	-0.0	42.9	40.2	-2.7	41.9	39.6	-2.4
Subsidies	31.6	31.8	0.1	32.0	32.8	0.8	32.8	34.0	1.3
Other expenditure[1)]	42.9	45.1	2.3	44.2	42.5	-1.7	45.8	45.0	-0.8
Total expenditure	792.4	794.3	1.9	809.2	805.9	-3.3	828.9	827.7	-1.2
Personal income taxes[2)]	314.0	316.4	2.4	326.3	324.2	-2.1	333.8	332.7	-1.1
Labour market contribution	64.9	64.9	0.0	67.5	67.1	-0.4	70.3	69.7	-0.6
Corporate taxes	43.8	42.1	-1.7	45.7	49.9	4.2	50.0	53.0	3.0
Pension yield taxation	13.0	15.1	2.1	7.0	8.4	1.4	7.2	5.5	-1.7
VAT	141.0	142.8	1.8	147.4	149.8	2.4	152.1	155.2	3.2
Vehicle registration fee	17.1	17.3	0.3	18.3	19.9	1.6	18.9	20.8	1.9
Other duties	93.7	93.9	0.2	95.4	95.6	0.2	96.9	97.3	0.5
Other taxes[3)]	23.8	23.9	0.0	24.1	24.1	0.1	24.4	25.2	0.8
Interest revenues	33.8	39.1	5.3	34.0	35.8	1.8	32.5	33.6	1.1
Gross operating surplus	27.4	27.4	-0.0	28.1	28.1	-0.0	28.7	28.7	0.0
Other revenue	41.7	45.0	3.3	41.0	41.9	0.9	41.0	42.3	1.3
Total revenue	814.2	827.9	13.7	834.7	844.7	10.1	855.7	864.1	8.4
General government budget balance	21.9	33.7	11.8	25.5	38.8	13.3	26.8	36.4	9.6
Net interest expenditure	12.3	6.9	-5.4	9.0	4.4	-4.5	9.4	6.0	-3.5
General government primary balance[5)]	34.1	40.6	6.4	34.4	43.2	8.8	36.2	42.3	6.2

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 2000-2006

Pct. of GDP	2000	2001	2002	2003	2004	2005	2006	Diff. 2001-2006
Consumption	25.3	25.9	26.5	26.7	26.7	26.2	26.1	0.1
Income transfers	17.3	17.4	17.7	18.2	18.0	17.6	17.3	-0.1
Investments	1.7	1.9	1.8	1.7	1.7	1.8	1.8	-0.1
Interest expenditures	4.3	4.0	3.7	3.4	3.2	2.7	2.5	-1.5
Other expenditures	5.3	5.1	5.3	5.1	5.3	5.0	5.0	-0.1
Expenditure burden	53.9	54.4	55.0	55.2	54.9	53.3	52.7	-1.7
Personal income taxes	22.3	22.6	22.3	22.2	21.9	21.4	21.2	-1.4
Labour market contributions	4.4	4.5	4.5	4.5	4.5	4.4	4.4	0.0
Pension yield taxation	0.8	0.1	0.1	0.4	1.0	0.6	0.4	0.3
Corporate tax	2.4	3.1	2.9	2.8	2.9	3.3	3.4	0.2
Value added tax	9.7	9.7	9.8	9.7	9.9	9.9	9.9	0.2
Other duties	7.7	7.8	8.0	7.8	7.9	7.8	7.7	-0.1
Other taxes	**2.3**	**2.2**	**1.7**	**1.7**	**1.7**	**1.6**	**1.6**	**-0.6**
Tax burden	49.6	50.0	49.3	49.0	49.7	49.1	48.5	-1.5
Interest revenue	2.5	2.6	2.3	2.5	2.7	2.4	2.1	-0.5
Other non-tax revenue	4.5	4.8	5.1	4.8	5.0	4.6	4.5	-0.2
Tariffs etc. to the EU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0
Revenue burden	56.5	57.2	56.5	56.2	57.2	55.9	55.0	-2.2