

Public finances – May 2016

With the prospect of increasing employment and low unemployment a gradual normalization of the fiscal policy from a lenient starting point is planned. The tightening is aligned with the economy being in a modest but robust recovery.

For the forecast period 2016-2017 the actual budget deficits comply with the 3 per cent of GDP limit given by the EU's Stability and Growth Pact. The estimated actual deficits amount to 2.0 per cent of GDP in 2016 and 1.8 per cent of GDP in 2017.

The budget bill for 2016 implies a strengthening of public finances, resulting in a margin to the deficit limit in the Budget Law. The estimated structural deficit amounts to 0.4 per cent of GDP in 2016. In 2017 the public finances is affected by an underlying weakening as a result of decreasing structural North Sea revenues. In order to maintain a certain distance to the budget law deficit limit in 2017, a technical reduction in public consumption expenditures of DKK 2 bn. was included in the Economic Survey, December 2015. This technical reduction is maintained in the current assessment. Fiscal policy for 2017 will be planned in more detail during the course of 2016 including agreements with local governments and the central government budget bill for 2017.

The Budget Law introduces binding separate expenditure ceilings for central government, municipalities and regions. Based on information on expenditure developments so far in 2016 compliance with the expenditure ceilings is expected.

Real public consumption is expected to increase by 1.0 per cent in 2016 and is assumed to remain unchanged in 2017. This primarily reflects a technical reduction of public consumption expenditures which was introduced in Economic Survey, December 2015, due to a weakening of the structural balance in 2017. Furthermore, the high level of public investment during the recession is to be gradually normalized.

The one-year fiscal effect – which is a calculated measure of the activity effects of fiscal policy compared to the previous year – is gauged to be -0.1 per cent of GDP in 2016 and -0.2 per cent of GDP in 2017, corresponding to a moderate tightening from a lenient starting point.

Net public debt is estimated at approx. 10 per cent of GDP in 2017, while gross debt (EMU) holds a broad margin against the 60 per cent of GDP limit given by the Stability and Growth Pact. Sound public finances and moderate public debt supports that Denmark is one of relatively few countries in the world with the highest credit rating (AAA) in the three major rating agencies Moody's, Standard & Poor's and Fitch.

1.1 Actual budget balance

According to Statistics Denmark's preliminary account figures the actual budget deficit was 2.1 per cent of GDP in 2015, *cf. table 1.1*. The budget deficit in 2015 is thus in line with the expected deficit of 2.0 per cent of GDP in Economic Survey, December 2015.

The budget balance in 2015 is affected by temporary revenues of approx. DKK 24½ bn. following the *Pension Package* from October 2014. On the other hand, the extraordinary depreciation of arrears from tax and duties in 2015 affects the actual budget balance negatively by approx. DKK 6 bn. in 2015. Altogether temporary effects are estimated to improve the budget balance by DKK 17 bn. (approx. 0.9 per cent of GDP) in 2015. Excluding these temporary measures the budget deficit in 2015 is close to 3 per cent of GDP.

Table 1.1
Actual budget balance (general government), 2012-2017

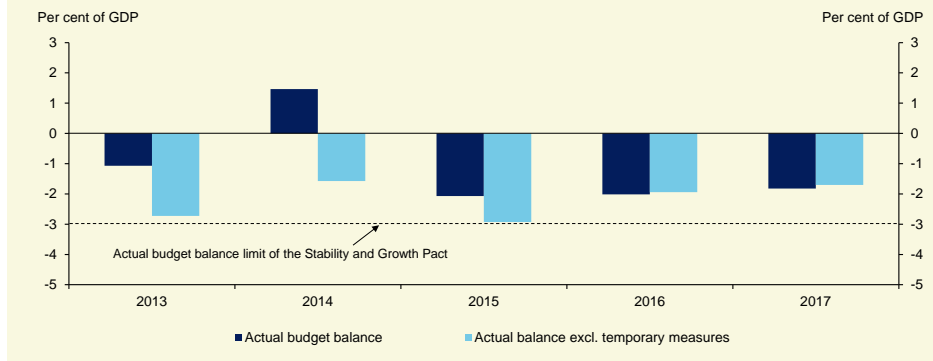
	2012	2013	2014	2015	2016	2017
Actual balance, per cent of GDP	-3.5	-1.1	1.5	-2.1	-2.0	-1.8
Actual balance, DKK bn.	-66.1	-20.4	28.5	-41.1	-40.8	-38.2

Source: Statistics Denmark and own calculations.

The actual budget deficits are estimated at 2.0 per cent of GDP in 2016 and 1.8 per cent of GDP in 2017, respectively. Thus, the budget balance is expected to comply with the maximum deficit limit of 3 per cent of GDP given by the EU Stability and Growth Pact.

Despite expected growth in GDP and unemployment the actual budget deficit is thus expected to stay at the same level in 2016-2017 as in 2015. However, this reflects that the temporary revenues in 2015 do not continue into 2016-2017. Corrected for temporary measures the budget balance improves by 1 per cent of GDP from 2015 until 2017, *cf. figure 1.1*.

Figure 1.1
Actual budget balance with and without temporary measures 2013-2017



Source: Statistics Denmark and own calculations.

Revised estimates for the actual budget balance in 2016-2017

Compared to December estimates the actual budget balance has improved by approx. DKK 20 bn. in 2016 and DKK 3½ bn. in 2017, *cf. table 1.2*. The improvement of the budget balance in 2016 mainly reflects higher expected revenues from the so-called pension yield tax.

Compared to the December forecast expected higher revenues from pension yield tax improves the budget balance by approx. DKK 15¼ bn. in 2016 and DKK ¼ bn. in 2017. This reflects updated forecast for interest rate developments that imply a decrease in interest rates through 2016 and a lower increase in interest rates through 2017.

The expected revenue from the North Sea has been lowered by DKK 2¼ bn. in both 2016 and 2017. The adjustment is based on lower expected oil prices. The expected revenues from corporation taxes has been increased by DKK 1½ bn. in 2016 and DKK ½ bn. in 2017. The higher expected revenue from corporation taxes reflects that accounting information for 2015 shows higher revenues in 2015 than estimated in December. The higher revenue level in 2015 is to some extent expected to pass through into 2016 and 2017.

Expected revenues from personal taxes (incl. labour market contributions) has been increased by approx. DKK 4¼ bn. in 2016 and DKK 3 bn. in 2017 compared to the forecast in December. This reflects higher expected revenues from equity tax following high returns in recent years and lower expected interest deductibility, while lower expected compensation of employees pulls in opposite direction. Estimated revenues from VAT has been decreased by DKK 2¼-2¾ bn. in 2016-2017 due to – among other things – lower VAT revenue from investments than expected in December.

Table 1.2
Revised actual budget balance estimates for 2016-2017 compared to December

DKK bn.	2016	2017
Change in estimates concerning the public balance, DKK bn.	15.8	3.5
Hereof:		
- Pension yield tax	15.3	0.8
- North sea revenues (incl. North Sea fund)	-2.3	-2.2
- Corporation tax (excl. tax liability on hydrocarbon)	1.5	0.4
- Personal tax etc. (incl. labour market contributions)	4.2	3.1
- VAT	-2.8	-2.3
- Public consumption	0.5	1.0
- Public income transfers	2.5	1.4
- Other expenditure and revenue (residual)	-3.2	1.4

Note: Positive numbers indicate an improvement of budget balance due to higher revenue or lower expenditure. Negative numbers indicate a worsening of budget balance due to lower revenue or higher expenditure.

Source: Own calculations.

Regarding government expenditures the estimated nominal expenditure on public consumption is lowered by DKK ½ bn. in 2016 and DKK 1 bn. in 2017 compared to estimates in December due to lower expected public price- and wage development than estimated in December.

Estimated expenditure on income transfers has been decreased by approx. DKK 2½ bn. in 2016 and by DKK 1½ bn. in 2017 compared to the assessment in December. This adjustment mainly reflects lower expected expenditures on unemployment benefits due to lower estimated unemployment in both 2016 and 2017.

1.2 Structural budget balance

Fiscal policy is primarily planned on the basis of the structural balance, which is an estimated measure of the underlying position of public finances. With the Danish Budget Law a requirement for structural budget balance was implemented. Thus, the annual structural balance may not exceed a deficit of ½ per cent of GDP at the time of the budget proposal unless extraordinary conditions are present. While the structural deficit limit essentially applies when presenting the budget proposal this does not imply that discretionary measures can be introduced afterwards if they weaken the structural balance beyond the deficit limit given by the Budget Law.

The budget bill for 2016 included a strengthening of public finances by DKK 5 bn. ($\frac{1}{4}$ per cent of GDP) reducing the structural deficit to 0.4 per cent of GDP in 2016 and hence securing a margin to the structural deficit limit in Budget Law. In this survey the estimated structural deficit is unchanged at 0.4 per cent of GDP in 2016.

The structural deficit is estimated to remain unchanged at 0.4 per cent of GDP from 2016 to 2017. In order to ensure a margin to the structural deficit limit the technical reduction of public consumption expenditures by DKK 2 bn. (0.1 per cent of GDP) from Economic Survey, December 2015 is also included in Economic survey, May 2016. The underlying weakening reflects among other things lower expected revenues from oil activities in the North Sea.

From actual to structural budget balance

The Danish Ministry of Finance calculates the structural budget balance by correcting the actual balance for cyclical effects and the impact of other temporary factors, including the often large fluctuations in the pension yield tax and North Sea revenues.

As an example, the calculation of the structural balance in 2017 starts with the estimated actual deficit of 1.8 per cent of GDP, *cf. table 1.3* (row 1). The cyclical position of the economy is estimated to be weaker than a normal situation (based on a weighted output and employment gap). Thus, the cyclical impact on the actual balance is estimated at approx. -0.7 per cent of GDP (row 2). Moreover the actual budget balance is corrected for a number of fluctuations in the revenues from North Sea activities, the pension yield tax, corporate taxes, vehicle registration tax etc. In total these items are estimated to be 0.7 per cent of GDP below the structural revenue levels in 2017 (row 3-8), *cf. figure 1.2-1.7*. The actual balance is also corrected for other factors (row 9) which primarily reflects that there in some years are large one-off measures with no impact on the structural balance.

Table 1.3
From actual to structural budget balance

	2014	2015	2016	2017
Per cent of GDP				
1. Actual balance	1.5	-2.1	-2.0	-1.8
<i>Herof temporary impact on the actual balance from:</i>				
2. Cyclical component (gap-related)	-1.5	-1.3	-1.0	-0.7
3. Corporate taxes ¹⁾	-0.1	0.0	0.1	0.1
4. Vehicle registration	-0.1	0.0	0.1	0.1
5. Pension yield tax	1.7	0.0	0.3	-0.4
6. North Sea revenues	-0.4	-0.7	-0.7	-0.5
7. Net interest payments ¹⁾	0.1	-0.3	0.0	0.1
8. Special budget items ²⁾	-0.5	-0.2	-0.3	-0.1
9. Other factors ³⁾	3.2	0.9	-0.1	-0.1
10. Structural balance (1-2-3-4-5-6-7-8-9)⁴⁾	-1.0	-0.6	-0.4	-0.4
<i>Memo item: Weighted cyclical gap</i>	<i>-2.0</i>	<i>-1.7</i>	<i>-1.3</i>	<i>-0.9</i>

1) Excluding revenues regarding North Sea activities.

2) Includes a correction for extraordinary depreciations of tax arrears in 2015 amounting to approx. DKK 18 bn. in 2015 distributed equally between 2013, 2014 and 2015.

3) Includes minor corrections including a conversion of the structural balance in per cent of actual GDP to per cent of structural GDP. Also includes a correction for the following one-off measures: One-off revenues of DKK 59¼ bn. (approx. 3.1 per cent of GDP) in 2014 following from the restructuring of capital pensions. One-off revenues of DKK 24½ bn. (1¼ per cent of GDP) in 2015 following from the pension package from October 2014. Advanced revenues from pension taxation of approx. DKK 5 bn. in 2013 (¼ per cent of GDP) and DKK 2 bn. (0.1 per cent of GDP) in 2014 assumed to take place uniformly from 2015-2019. Also includes a correction for new information on public revenues in 2014 and 2015 which is not yet reflected in Statistics Denmark figures.

4) Structural balance in per cent of structural GDP.

Source: Statistics Denmark and own calculations.

Figure 1.2
Corporate taxes (excl. hydrocarbon)

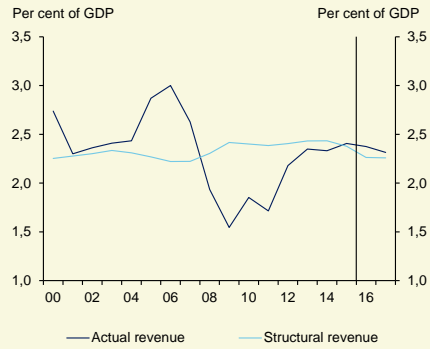


Figure 1.3
Vehicle registration tax

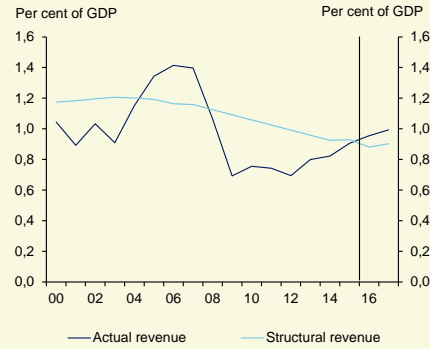


Figure 1.4
Pension yield tax

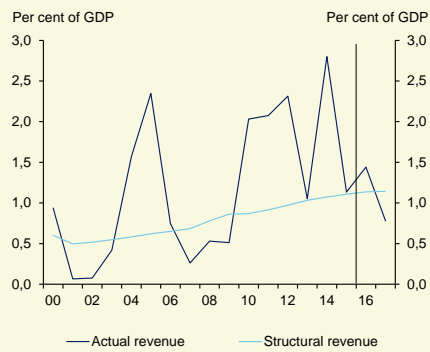


Figure 1.5
North Sea revenues

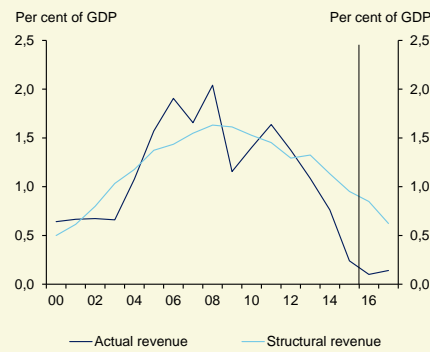


Figure 1.6
Net interest payments

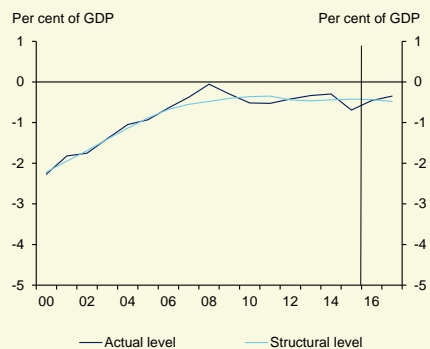
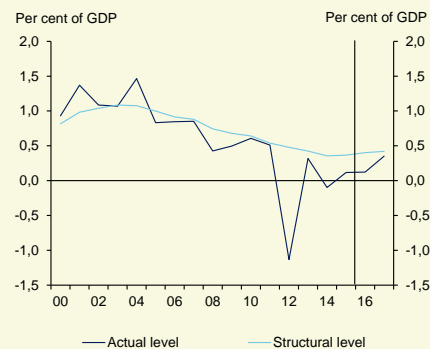


Figure 1.7
Special budget items¹⁾



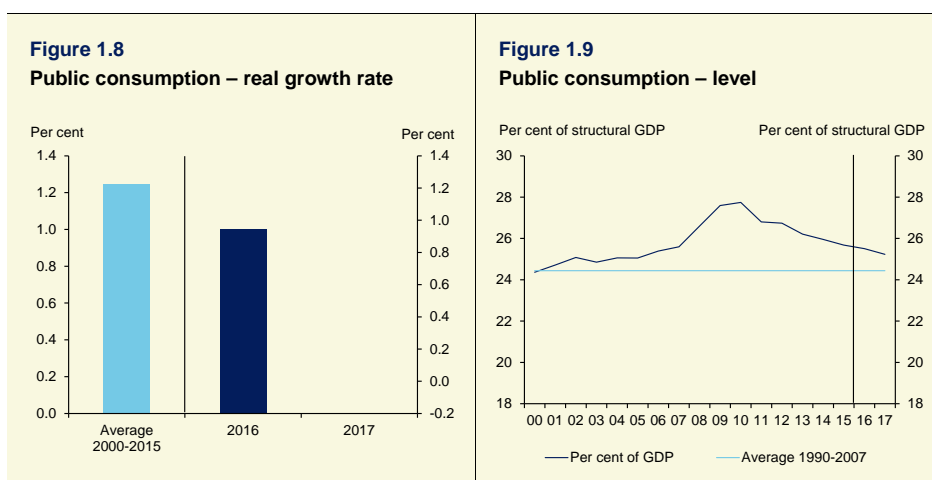
1) The actual level is affected by one-off effects such as the repayment of contributions to the early retirement scheme of DKK 28½ bn. in 2012 (1½ per cent of GDP) which is corrected for in the calculation of the structural level.

Source: Own calculations.

1.3 Public consumption and investment

Moderate real growth in public consumption

Real growth in public consumption is expected at 1.0 per cent in 2016 while in 2017 public consumption is expected to remain unchanged, *cf. figure 1.8*. The estimated real growth rates for public consumption for the forecast period 2016-2017 is relatively moderate compared to the period 2000-2015, where the average annual growth rate amounted to 1¼ per cent. Nonetheless, the level of public consumption (as a share of structural GDP) is still relatively high by historical standards, *cf. figure 1.9*.



Source: Statistics Denmark and own calculations.

Nominal public consumption expenditure is estimated at DKK 530½ bn. in 2016, which is DKK ½ bn. lower than the estimate in Economic Survey, December 2015, *cf. table 1.4*. This reflects changes in price and wage conditions in 2016, which indicate lower consumption expenditures than previously assumed.

Table 1.4
Public consumption estimates

	2015	2016	2017
Real growth rate (per cent)			
December Survey	0.8	0.8	0.0
May Survey	0.6	1.0	0.0
<i>Change since December (percentage points)</i>	-0.2	0.2	0.0
DKK bn.			
December Survey	520.2	530.9	541.1
May Survey	519.7	530.5	540.1
<i>Change since December</i>	-0.5	-0.4	-1.0

Source: Own calculations.

The projected real growth rate of public consumption is increased from 0.8 per cent to 1.0 per cent in 2016. This mainly reflects a lower level of public consumption in 2015 than previously expected.

For 2017, nominal public consumption expenditure is estimated at approx. DKK 540 bn., which is a reduction of DKK 1 bn. compared to the December survey. This reflects changes in price and wage conditions which indicate lower consumption expenditures than previously assumed.

The projected real growth rate of public consumption remains unchanged in 2017. This primarily reflects a discretionary reduction of public consumption in order to counter a weakening of the structural balance in 2017.

Stable development in public employment

In 2010 the public employment reached a historically high at a level of 850,000 persons. Since then, the level of public employment has declined, and in 2015 the public employment level was approximately at the level of 2009, *cf. figure 1.10*.

The level of public employment is currently estimated to increase in 2016 by 1,000 persons, *cf. table 1.5*, while in 2017 a reduction of 1,000 persons is expected.

Figure 1.10
Public employment (national accounts)



Table 1.5
Public employment estimates

	2015	2016	2017
Change compared to the previous year (1,000 persons)			
December	0.0	2.0	-1.0
May 2016	-1.9	1.0	-1.0
Change	-1.9	1.0	-
Level in May	815	816	815

Source: Statistics Denmark and own calculations.

Public investment

Public investment expenditure as a share of GDP has been historically high over the past years in order to stimulate economic activity during the recession. However, a normalization of the investment expenditure level is planned over the coming years as the recovery gains further momentum. Thus, the public investment (as share of GDP) is expected to decline from 3.7 per cent in 2015 to 3.5 per cent in 2017, *cf. table 1.6*. However, the projected level of public investments in 2017 is still historically high at DKK 73.2 bn.

Furthermore, the estimated public investment expenditure level in 2017 is based on the estimated progress of infrastructure projects etc. which is uncertain due to time lags in construction activity between individual years etc.

Table 1.6
Public investment estimates

	2015	2016	2017
Public investment expenditure (DKK bn, current prices)	73.6	71.8	73.2
Real growth rate (per cent)	-1.0	-3.7	0.2
Share of GDP (per cent)	3.7	3.6	3.5

Source: Statistics Denmark and own calculations.

1.4 Expenditure ceilings for central and local governments

Starting in 2014 the Budget Law introduced separate binding expenditure ceilings for central government, municipalities and regions, respectively. The expenditure ceilings continuously cover a 4 year period and are determined in accordance with the medium-term projections.

The final expenditure control for central government based on central government account figures for 2015 and an assessment of local government accounts for 2015 shows compliance with the relevant expenditure ceilings in 2015, *cf. table 1.7*.

Based on central government accounts for 2015 central government operating expenditures was approx. DKK 9 bn. lower than the relevant sub-ceiling in 2015. The lower expenditures in 2015 mainly reflects the adjustment of foreign aid expenditure to 0.73 per cent of GNI in 2015, lower expenses regarding immigration and lower contributions to the EU.

Central government spending on income transfers in 2015 was approx. DKK 6¼ bn. below the relevant subceiling, primarily due to lower expenditures regarding old age pensions and disability pensions.

Table 1.7
Expenditure ceilings, 2015

Bn. DKK (2015-prices)	Central government sub-ceilings		Municipalities	Regional sub-ceilings	
	Operating expenditures	Income transfers	Operating expenditures	Health expenditures	Development expenditures
Expenditure ceiling	188.4	257.7	233.2	104.7	3.0
Accounts	179.3	250.9	231.5	104.6	3.0

Source: Final accounts 2015, Statistics Denmark and The Ministry of Finance.

With the fiscal bill for 2016 and local government budgets for 2016 fiscal policy in 2016 was planned in accordance with the relevant sub-ceilings for all levels of government.

The first preliminary expenditure control for 2016 for central government – based on a departmental expenditure review – shows that central government expenditures in 2016 are below the relevant subceilings in 2016, *cf. table 1.8*.

Table 1.8
Expenditure ceilings, 2016

Bn. DKK (2016-prices)	Central government sub-ceilings		Municipalities	Regional sub-ceilings	
	Operating expenditures	Income transfers	Operating expenditures	Healthcare expenditures	Development expenditures
Expenditure ceiling	182.2	257.4	237.4	107.4	3.0
Budget bill and local gov. budgets for 2016	182.2	254.3	237.2	107.4	3.0
Estimate, May 2016	181.3	253.4	-	-	-

Source: Budget Bill for 2016 and local government budgets for 2016.

1.5 Fiscal stance

To measure the impact of fiscal policy changes on economic activity so-called *fiscal effects* (an indicator of the fiscal policy stance) are calculated. The multi-year fiscal effects are computed as the fiscal policy impact as of 2015 and onwards. Thus, the fiscal effects are calculated from a relative expansionary starting point in 2014 characterized by historically high levels of public consumption and investment. Overall, fiscal policy (from 2015 onwards) is estimated to reduce GDP growth by 0.2 per cent in 2016¹ and 2017, cf. table 1.9.

Table 1.9
Activity effects fiscal policy and other economic policy measures from 2015 onwards

	2015	2016	2017
Per cent of GDP			
<i>GDP level</i>			
Fiscal policy as of 2015 (multi-year effects)	-0.1	-0.3	-0.5
<i>Growth contribution</i>			
Fiscal policy (multi-year effects)	-0.1	-0.2	-0.2
- hereof one-year fiscal effect	-0.1	-0.1	-0.2

Note: Multi-year effects are computed as the activity effect of the fiscal policy from 2015 and onwards.
Source: Own calculations.

¹ Besides the contribution from the one-year fiscal effect in 2016 the multi-year effect of the fiscal policy in 2016 reflects that both revenue and expenditure elements also have multi-year effects. These elements have a negative growth effect in 2016.

The planned fiscal policy is assessed to be aligned with an economy where the labour market is now entering the fourth year of robust growth. GDP growth is expected to increase as is private-sector employment in the coming years. Furthermore, monetary policy is expected to remain highly accommodative in the coming years, increasing the need for fiscal tightening in order to support a sustainable recovery

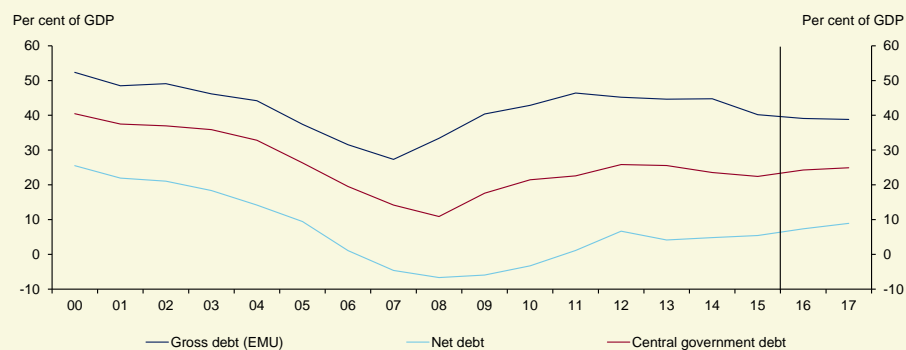
1.6 Public debt

Sound public finances and moderate public debt supports that Denmark is one of relatively few countries in the world with the highest credit rating (AAA) in the three major rating agencies Moody's, Standard & Poor's and Fitch. The high credit rating reflects a high confidence in the Danish economy. It is an important objective for fiscal policy to support a high credit rating, as it supports low interest rates for the Danish government, Danish homeowners and other Danish borrowers.

The gross public debt (EMU-definition) is estimated at approx. 38-40 per cent of GDP in the forecast period 2016-2017, thus maintaining a broad safety margin against the 60 per cent of GDP limit of the Stability and Growth Pact.

Central government debt (as share of GDP) is estimated to increase from 22¾ per cent in 2015 to 25 per cent in 2017, cf. figure 1.11. Furthermore, net public debt – the key debt concept concerning fiscal sustainability – is estimated at a rather moderate level of approx. 10 per cent of GDP in 2017.

Figur 1.11
Gross (EMU) and net public debt relatively moderate



Source: Statistics Denmark and own calculations.