

# Budget Outlook, December 2003

## 1. Introduction

In light of the short-term forecast for the Danish economy, *cf. Economic Survey*, December 2003, the central government budget bill and the local government budgets for 2004, both the central government current, investment and lending account, i.e. the CIL-account and the general government finances show a continued surplus in 2004.

The central government budget bill for 2004 is fully financed in 2004 and is in line with the central government draft budget bill from August in respect to fiscal policy 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 primarily from income tax cuts and to a lesser extent easing of revenues including reduced excise duties on tobacco and alcohol, the tax freeze and growth in public expenditure.

The central government budget bill for 2004 reflects the political budget agreements on police and the Prison Service, research, public transportation investments and theatres among other things.

## 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*, December 2003. Furthermore, estimates for 2003 are based on the central and local government budgets and national accounts for the first half of 2003. In 2004 the estimates reflect the central and local government budget bills for 2004. The estimates for 2005 are largely based on technical assumptions – including an expected 0.5 per cent real growth in public consumption.

The general government surplus is estimated at DKK 18.5bn in 2003 and DKK 20.7bn in 2004, *cf. table 1*. The surpluses correspond to 1.3 per cent of GDP in 2003 and 1.4 per cent of GDP in 2004.

**Table 1. General government budget balance, 1999-2005**

DKK bn, current prices	1999	2000	2001	2002	2003	2004	2005
August 2003	38.8	31.7	36.6	26.6	16.6	18.7	-
December 2003	38.8	32.5	37.5	21.2	18.5	20.7	21.5
December 2003 (per cent of GDP)	3.2	2.5	2.8	1.6	1.3	1.4	1.4

The expected decrease in the general government budget surplus from 2002 to 2003 primarily stems from the economic slowdown including lower employment and higher unemployment.

The expected economic recovery in 2004 implies an increase in the general government budget surplus in 2004 and 2005. The relative modest increase in the surplus from 2003 to 2005 is among other things due to the agreement on tax cuts from 2004.

Since August, fiscal policy changes have had a modest impact on the general government finances in 2003 and 2004, *cf. section 3*.

Compared to the August projection the general government budget surpluses have been adjusted upwards with approx. DKK 2bn in both 2003 and 2004, *cf. table 2*.

**Table 2. Revisions of budget balance from August to December, 2003 and 2004**

DKK bn, current prices	2003	2004
Total revision of budget balance	1.9	2.1
- Pension yield taxation	3.0	0.9
- Corporate taxes	2.3	2.0
- Revenues from the North Sea	0.0	4.0
- EU-contributions	0.0	0.9
- Personal income taxes and labour market contributions	-3.7	-3.9
- Income transfers	-0.1	-2.2
- Public subsidies	0.6	-0.1
- Public consumption and investment	-0.5	-0.6
- Other expenditures and revenues	0.3	1.1

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

The upward adjustments of the surpluses in 2003 and 2004 are primarily due to expected higher revenues from the pension yield taxation and corporate taxes.

In 2004 revenues from the North Sea activities are revised upwards with DKK 4bn compared to the August projection in light of a new agreement

on shared profits, which replaces the current agreement on royalties payments.

However, a downward adjustment of the revenues from personal income taxes and labour market contributions in both 2003 and 2004 in light of lower employment due to the economic slowdown contributes to a reduction of the surpluses. An upward adjustment of the unemployment in particular in 2004 explains the expected increase in expenditures for income transfers.

In 2003 the estimate for nominal public consumption is revised upwards with DKK ½bn. The estimate is primarily based on national account figures for the first half of 2003, which shows a higher nominal public consumption than estimated in August.

The nominal public consumption is adjusted upwards with approx. DKK ¼bn in 2004 due to a higher expenditure growth in the 2004 budget for the City of Copenhagen compared to the August projection.

Real growth in public consumption is estimated at 0.1 per cent in 2003 and 0.7 per cent in 2004 based on the nominal upward adjustments of the public consumption. Furthermore, in line with the August projection growth in public employment is estimated at zero in 2003 and 3,000 persons in 2004.

Detailed figures for the general government finances, including adjustments since the August estimate, can be found in *annex 1* below.

From 2001 to 2005 the expenditure burden, i.e. the ratio of general government expenditures to GDP, is expected to decrease by approx. 1¼ 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.

Table 3. Expenditure, tax and revenue burden, 1999-2005								
Per cent of GDP	1999	2000	2001	2002	2003	2004	2005	Change 2001-2005
Expenditure burden	55.4	53.8	54.3	54.4	54.6	54.0	53.1	-1.2
Tax burden <sup>1)</sup>	51.5	49.5	49.9	48.7	49.1	48.6	48.0	-1.9
Revenue burden	58.6	56.4	57.1	55.9	56.0	55.5	54.5	-2.6

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. 2 percentage points from 2001 to 2005 can among other things be referred to a decrease in the personal income tax burden due to the income tax cuts from 2004, the adjustment of the spe-

cial pension-scheme savings<sup>1</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 2005. 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*.

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	-0.2	0.1
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

The contribution of 0.1 from public expenditures in 2004 is slightly higher than estimated in August. The adjustment is primarily due to an upward adjustment of real growth in public investment from 2.0 per cent in August to 3.2 per cent based on the local government budgets for 2004.

Compared to the August projection the fiscal effect has been adjusted slightly upward in 2003 primarily due to a higher estimate for the growth in public consumption. However, estimated decreases in public investments and subsidies contribute to the negative contribution from the expenditure policy in 2003.

Fiscal policy in 2004 is viewed to be in line with the expected business cycle, *cf. Economic Survey*, December 2003. The fiscal policy stance for 2005 will be determined in 2004.

<sup>1</sup> The special pension-scheme savings has been changed into a private/individual scheme, i.e. the previous re-distributive element is cancelled.

#### 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 at 2.1 per cent of GDP in 2003 and 1.8 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	-0.1	0.0	-0.1
1997	-0.5	1.4	1.3	0.5	0.1	0.1	-0.6
1998	-0.2	0.3	0.4	0.6	0.2	0.2	-1.1
1999	1.6	1.8	0.5	0.5	0.2	0.8	-0.2
2000	2.1	0.5	0.1	0.3	0.0	0.3	-0.2
2001	2.4	0.4	-0.3	0.2	-0.1	0.3	0.3
2002	1.5	-0.9	-0.5	0.0	0.0	-0.3	-0.2
2003	2.1	0.6	0.1	0.0	0.0	0.3	0.3
2004	1.8	-0.3	-0.7	0.0	0.0	0.2	0.2
2005	1.6	-0.2	-	-	-	-	-
Total	-	3.6	0.5	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 from 2003 to 2005. This is due to the negative impact on the actual budget balance from the slowdown in economic activity and the fairly low revenues from the pension yield taxation.

The estimated reduction of the structural budget balance from 2003 to 2005 is primarily due to the tax cuts from 2004.

The estimated structural budget surpluses from 2003 to 2005 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*, December 2003.

## 5. Central government finances

The central government budget bill for 2004 implies a surplus on the so-called CIL-account of DKK 10bn or 0.7 per cent of GDP, *cf. table 6*. The estimated CIL-surplus is approx. DKK 4¾bn larger than expected on the general government draft budget bill for 2004 from August, which is primarily due to the new agreement on shared profits regarding the North Sea oil and gas activities.

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

DKK bn., current prices	2003			2004		
	Aug.	Dec.	Diff.	Aug.	Dec.	Diff.
Total revenues	434.2	438.6	4.3	450.1	454.8	4.7
Total expenditures	428.8	425.8	-3.0	444.8	444.8	0.0
CIL-account	5.4	12.8	7.3	5.3	10.0	4.7
CIL-account (per cent of GDP)	0.4	0.9	0.5	0.4	0.7	0.3

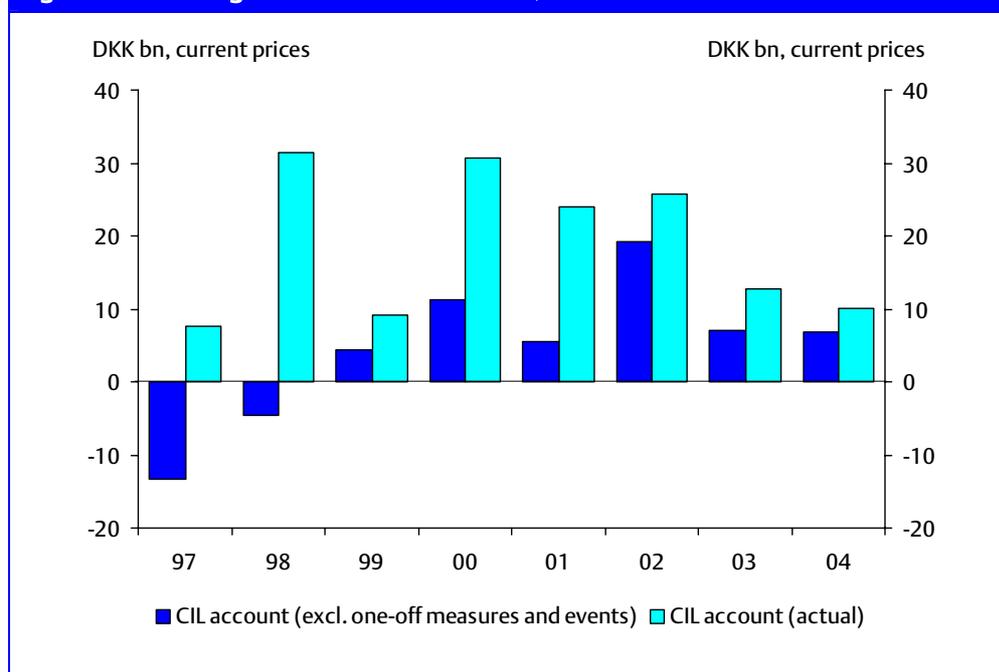
In 2003 the CIL-account is estimated at approx. DKK 12¾bn or 0.9 per cent of GDP. Compared to the August projection the estimate for the CIL-account is adjusted upwards with approx. DKK 7¼bn in 2003.

The decline in the CIL-account from 2003 to 2004 stems among other things from the reduction of the personal income taxes from January 1<sup>st</sup> 2004 and increasing expenditures for unemployment benefit and a higher Danish EU-contribution.

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 1*.

Corrected for one-off measures and extraordinary events the CIL-surpluses are approx. DKK 7bn in both 2003 and 2004.

**Figure 1. Central government CIL-account, 1997-2004**



## 6. Central government financing requirement and debt

In 2004 central government debt as a 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	37.3	35.9
Central government debt, adj. for re-lending, per cent of GDP	38.4	37.2	36.2	34.5
Central government debt, DKK bn	514.1	520.6	521.5	522.4
Re-lending to infrastructure entities <sup>1)</sup>	5.8	12.5	16.2	20.3
Central government debt, adjusted for re-lending	508.3	508.1	505.3	502.1

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 1bn in spite of a surplus on the CIL-account amounting to DKK 10bn. This is primarily due to factors such as re-lending – approximately DKK 5bn – to government owned infrastructure entities and technical factors relating to periodizing of tax incomes etc., *cf. table 8*. Central government debt adjusted for re-lending is expected to decrease from DKK 505.3bn in 2003 to DKK 502.1bn in 2004.

At the end of 2003 central government debt is expected to amount to 37.3 per cent of GDP. In nominal terms, central government debt is foreseen to increase by approximately DKK 1bn despite the expected surplus

on the CIL-account amounting to almost DKK 13bn. Also in 2003 the minor increase in debt can be attributed mainly 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	12.8	10.0
Total re-lending <sup>1)</sup>	-4.7	-5.1
Periodizing etc.	-7.4	-2.7
Net balance	0.6	2.2
Net financing requirement (-net balance)	-0.6	-2.2
Redemption of central government debt	116.5	108.6
Gross financing requirement	115.8	106.4
Gross financing <sup>2)</sup>		
- Domestic borrowing	86.1	86.5
- Foreign borrowing	17.0	16.0
- Drawing on the central government's account in Danmarks Nationalbank	12.8	3.9

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 106.4bn, *cf. table 8*. This is a consequence of a net financing requirement equal to DKK -2.2bn and DKK 108.6bn in redemption on domestic debt and foreign debt. The gross financing requirement is covered by domestic borrowing equal to DKK 86.5, foreign borrowing of DKK 16.0bn and drawing on the central government's account in the central bank of DKK 3.9bn.

In 2003 the gross financing requirement is forecasted at DKK 115.8bn. The financing is split between DKK 86.1bn in domestic borrowing, DKK 17.0bn in foreign borrowing and a reduction of the central government capital balance at the central bank equal to DKK 12.8bn. The significant reduction of the capital balance at the central bank 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 -----		
	Aug.	Dec.	Diff.	Aug.	Dec.	Diff.	Aug.	Dec.	Diff.
Consumption	358.7	358.5	-0.2	369.0	369.5	0.5	382.2	382.5	0.3
Income transfers	239.0	238.6	-0.4	251.4	251.5	0.1	258.1	260.3	2.2
Investment	24.2	24.2	0.0	23.8	23.8	0.0	24.7	25.0	0.3
Interest expenditures	49.8	50.0	0.2	47.2	47.5	0.3	46.2	46.0	-0.2
Other expenditures <sup>1)</sup>	70.5	71.1	0.7	71.5	70.7	-0.8	72.3	72.3	0.1
Total expenditure	742.2	742.5	0.3	762.9	763.0	0.1	783.4	786.1	2.7
Personal income taxes <sup>2)</sup>	306.7	301.4	-5.3	313.7	310.4	-3.2	319.6	316.3	-3.3
Labour market contrib.	62.0	61.1	-0.9	63.3	62.8	-0.5	65.9	65.3	-0.6
Corporate taxes	38.6	38.9	0.3	37.6	39.9	2.3	38.1	40.1	2.0
Pension yield taxation	0.8	1.1	0.3	3.1	6.1	3.0	8.7	9.6	0.9
Value added tax	132.6	132.5	-0.1	136.5	135.8	-0.7	142.3	141.2	-1.1
Vehicle registration fee	15.1	15.1	0.0	14.1	13.1	-1.0	15.1	15.2	0.0
Excise duties	90.4	90.4	0.0	91.2	92.7	1.5	91.9	93.0	1.1
Other taxes <sup>3)</sup>	22.7	22.7	0.0	23.1	23.1	0.0	23.9	24.0	0.0
Interest revenues	31.4	31.5	0.1	31.4	32.0	0.7	31.4	31.6	0.2
Gross operating surplus	26.7	26.7	0.0	27.1	27.1	0.0	27.5	27.4	-0.1
Other revenues <sup>4)</sup>	41.9	42.4	0.5	38.4	38.5	0.0	37.6	43.2	5.6
Total revenue	768.8	763.6	-5.2	779.5	781.5	2.0	802.1	806.8	4.7
General government budget balance	26.6	21.2	-5.5	16.6	18.5	1.9	18.7	20.7	2.1
Net interest expenditure	18.4	18.6	0.1	15.8	15.5	-0.4	14.8	14.4	-0.4
General government primary balace <sup>5)</sup>	45.1	37.7	-5.3	32.5	34.0	1.5	33.4	35.1	1.7

- 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. 1999-2004								
Per cent of GDP	1999	2000	2001	2002	2003	2004	2005	Diff. 2001- 2005
Consumption	25.8	25.2	25.9	26.3	26.5	26.3	26.0	0.1
Income transfers	17.8	17.3	17.3	17.5	18.0	17.9	17.5	0.2
Investments	1.7	1.7	1.9	1.8	1.7	1.7	1.7	-0.2
Interest expenditures	4.8	4.3	4.0	3.7	3.4	3.2	2.9	-1.1
Other expenditures	5.3	5.3	5.1	5.2	5.1	5.0	4.9	-0.2
Expenditure burden	55.4	53.8	54.3	54.4	54.6	54.0	53.1	-1.2
Personal income taxes	22.3	22.3	22.5	22.1	22.2	21.7	21.5	-1.0
Labour market contributions	4.5	4.4	4.5	4.5	4.5	4.5	4.5	0.0
Pension yield taxation	1.2	0.8	0.1	0.1	0.4	0.7	0.7	0.6
Corporate tax	3.0	2.4	3.1	2.8	2.9	2.8	2.6	-0.5
Value added tax	9.9	9.7	9.7	9.7	9.7	9.7	9.6	-0.1
Other duties	8.5	7.7	7.8	7.9	7.7	7.6	7.5	-0.3
Other taxes	2.1	2.3	2.2	1.7	1.7	1.6	1.6	-0.6
Tax burden	51.5	49.4	49.9	48.7	49.1	48.6	48.0	-1.9
Interest revenue	2.5	2.5	2.6	2.3	2.3	2.2	2.2	-0.4
Other non-tax revenue	4.9	4.5	4.7	5.1	4.7	4.9	4.5	-0.2
Tariffs etc. to EU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0
Revenue burden	58.6	56.4	57.1	55.9	56.0	55.5	54.5	-2.6