

Budget Outlook, December 2004

1. Introduction

Based on the budgets of the central and local governments fiscal policy is expected to have a neutral impact on economic activity in 2005.

Fiscal policy in 2005 is viewed to be in line with the expected business cycle given the degree of uncertainty about projections of growth and unemployment, *cf. Economic Survey, December 2004*.

The current account, the central government account and the general government finances are expected to show large surpluses.

The political agreements on the central government budget bill for 2005 give special priority to research and education, the health sector, families and children, the elderly and cultural initiatives.

2. General government finances

The estimates of the general government finances in 2004 and 2005 are based on the short-term forecast for the Danish economy, *cf. economic Survey, December 2004*. Furthermore, the estimates are based on the central and local government budgets for 2005.

Local government budgets for 2005 reflect public consumption expenditures that are DKK 1½bn higher than stipulated in the agreements from June 2004. The central government and the local government associations are currently considering solutions that can support a local government consumption development in 2005 in line with the June agreements.

The general government surplus is estimated at DKK 21.9bn in 2004 and DKK 25.5bn in 2005, *cf. table 1*. The surpluses correspond to 1.5 per cent of GDP in 2004 and 1.7 per cent in 2005.

Table 1. General government budget balance, 2000-2006							
DKK bn, current prices	2000	2001	2002	2003	2004	2005	2006
August 2004	32.5	37.5	21.2	16.9	17.4	29.7	-
December 2004	32.5	37.5	21.2	14.6	21.9	25.5	26.8
<i>Hereof: Central and local governments</i>	<i>13.2</i>	<i>15.5</i>	<i>7.7</i>	<i>-0.9</i>	<i>10.5</i>	<i>12.7</i>	<i>14.2</i>
<i>Social funds</i>	<i>19.3</i>	<i>22.1</i>	<i>13.4</i>	<i>15.5</i>	<i>11.4</i>	<i>12.7</i>	<i>12.6</i>
December 2004 (per cent of GDP)	2.5	2.8	1.6	1.0	1.5	1.7	1.7

The estimated increase in the general government surplus from 2003 to 2004 is primarily due to expected higher revenues from the pension yield taxation scheme.

From 2004 to 2006 higher surpluses are expected in light of the economic upturn including lower unemployment and higher employment and due to lower net interest payments.

Compared to the August projection the general government budget surpluses have been adjusted upwards with approx. DKK 4½bn in 2004 and adjusted downwards with approx. DKK 4¼bn in 2005, *cf. table 2*.

Table 2. Revisions of budget balance from August to December, 2004 and 2005		
DKK bn, current prices	2004	2005
Total revision of budget balance	4.5	-4.2
Pension yield taxation	4.0	-3.0
- Corporate taxes	-0.3	0.9
- Profit-sharing etc. from the North Sea oil exploration activities	0.2	0.6
- VAT and other excise duties	2.5	2.3
- Income taxation and labour market contributions	-3.0	-2.4
- Income transfers	2.0	0.0
- Public consumption	-1.5	-1.9
- Public subsidies	-0.2	-0.7
- Public investment	0.0	-0.7
- Net interest payments	0.8	0.9
- Other expenditures and revenues	0.0	-0.2

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 revision in 2004 is mainly due to higher revenues, while the downward revision in 2005 is primarily due to increased expenditures.

Changes in the expected revenues from the pension yield taxation scheme explain a significant part of the overall change in the balance. The upward adjustment of the revenues from the pension yield taxation scheme in 2004 is due to higher returns on bonds, while the downward adjustment in 2005 is due to lower expected returns on shares.

The upward adjustments of profit-sharing from the North Sea activities in 2004 and 2005 can be referred to expected higher oil prices.

Revenues from VAT and other excise duties have also been adjusted upwards in 2004 and 2005, which is primarily due to expected higher revenues from the excise duties on vehicle registration.

Public consumption is adjusted upwards by DKK 1.5bn in 2004 and DKK 1.9bn in 2005, which reduces the surplus in both years. Based on reported spending through the 3rd quarter local government budget overruns are expected in 2004. Furthermore, growth in public sector employment has been higher in 2004 than projected in August. Hence, real growth in public consumption has been revised upwards from 0.3 to 0.7 per cent in 2004, and public sector employment growth is expected to reach 4.000 persons in 2004 compared to the August projection of 2.000 persons. The national accounts, that show almost no real growth in public consumption through the 3rd quarter in 2004, is presumed to underestimate public consumption expenditures in 2004 including in particular public sector wage costs.

The upward revision of public consumption expenditure in 2005 is primarily due to local government budgets for 2005, that reflects higher growth in consumption than agreed in June 2004. Based on the upward revisions in 2004 and 2005 real growth in public consumption is expected to reach 0.6 per cent in 2005, which is 0.1 percentage point higher than the August projection of 0.5 per cent.

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

From 2001 to 2006 the expenditure burden, i.e. the ratio of general government expenditures to GDP, is expected to decrease by almost 2 percentage points, *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	54.2	54.6	54.9	54.3	53.0	52.4	-1.9
Tax burden	49.6	49.9	48.9	48.7	48.9	48.1	47.8	-2.1
Revenue burden	56.5	57.1	56.1	55.9	55.8	54.7	54.1	-3.0

The estimated drop in the tax burden, i.e. the ratio of aggregate tax revenues to GDP, of 2 percentage points from 2001 to 2006 can among other things be referred to a decrease in the personal income tax burden due to the tax cuts in 2004.

A decrease of approximately 3 percentage points in the revenue burden 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 burden 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 is expected to have a neutral impact on economic activity in 2005, *cf. table 4*.

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

Note: The method of calculating the fiscal effect has been revised, *cf. Fiscal Survey 2004*, June 2004 and *Economic Survey*, December 2004. The revision mainly reflects a recalculation of the model based effects of discretionary changes in expenditures and revenues on economic activity according to the latest official version of the macroeconomic model, ADAM, from Statistics Denmark.

1) Special pension scheme.

Fiscal policy in 2005 is viewed to be in line with the expected business cycle given the degree of uncertainty about projections of growth and unemployment, *cf. Economic Survey*, December 2004.

In 2004 fiscal policy is expected to stimulate economic activity corresponding to 0.5 per cent of GDP mainly due to the DKK 10bn tax cut. The contribution from the expenditure side primarily stems from the growth in public consumption of 0.7 per cent.

Additionally, a stimulus to activity in 2004 is expected from the temporary suspension of payments to the special pension scheme, SP.

The fiscal policy stance for 2006 will be determined in 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 structural budget balance surplus is estimated at 1.4 per cent of GDP in 2004 and 1.6 per cent of GDP in 2005, *cf. table 5*. Based on fiscal policy assumptions, reintroduction of payments to the special pensions schemes etc. the structural budget balance surplus is estimated at 1.3 per cent of GDP in 2006.

Table 5. Structural budget balance, 1995-2006

Per cent of GDP	Structural balance		Change due to						
	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	-0.9								
1996	-1.6	-0.7	0.0	0.3	-0.4	0.2	-0.4	-0.1	-0.3
1997	-0.8	0.8	0.7	0.3	0.0	0.1	-0.2	-0.1	0.0
1998	-0.7	0.1	0.1	0.4	-0.2	0.3	-0.5	-0.1	0.1
1999	0.5	1.2	0.5	0.3	-0.2	0.3	0.9	-0.4	-0.2
2000	1.6	1.1	-0.1	0.4	0.3	0.3	0.4	-0.8	0.6
2001	1.6	0.0	-0.3	0.1	0.4	0.3	-0.1	-0.4	0.0
2002	1.1	-0.5	-0.4	0.1	-0.3	0.3	-0.4	0.0	0.2
2003	1.5	0.4	-0.1	0.0	0.1	0.2	0.1	0.1	0.0
2004	1.4	-0.1	-0.5	0.0	0.0	0.2	0.0	0.2	0.0
2005	1.6	0.2	0.1	0.0	0.0	0.2	-0.1	0.1	-0.1
2006	1.3	-0.3	-	-	-	-	-	-	-
Total	-	2.2	-0.1	2.0	-0.4	2.5	-0.5	-1.5	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 increase in the structural budget balance surplus of 2.2 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. Since 1995 a 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 budget bill for 2005 implies a surplus on the CIL-account of approximately DKK 23½bn or 1.5 per cent of GDP, *cf. table 6.*

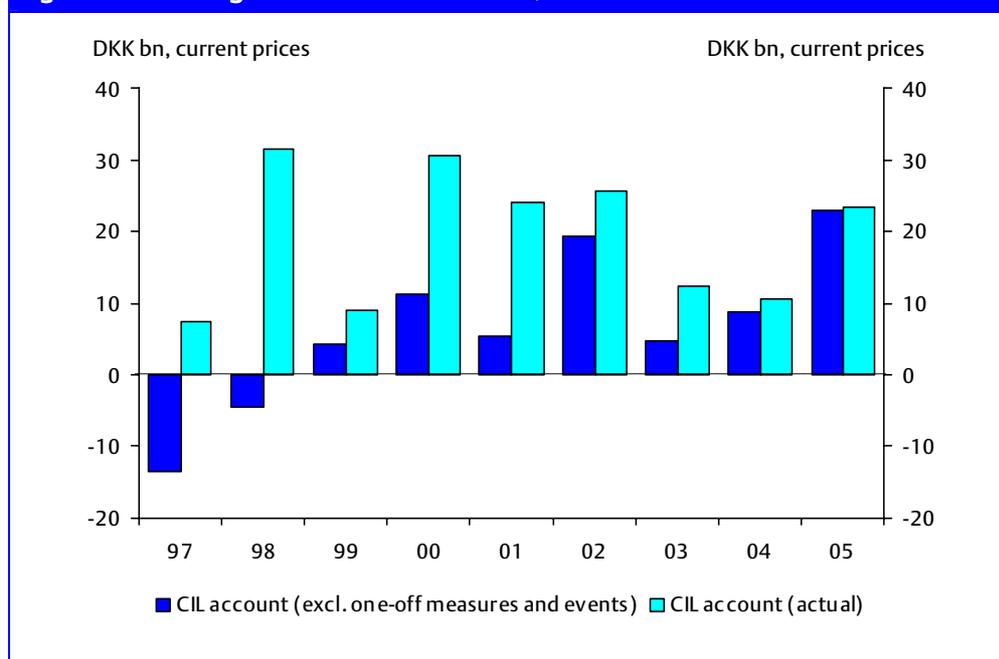
Table 6. CIL-account, 2004 and 2005						
DKK bn., current prices	2004			2005		
	Aug.	Dec.	Diff.	FFL	FL	Diff.
Total revenues	450.7	457.7	7.0	476.5	480.4	3.9
Total expenditures	447.9	447.1	-0.8	456.1	457.0	1.0
CIL-account	2.8	10.6	7.8	20.5	23.4	2.9
CIL-account (per cent of GDP)	0.2	0.7	0.5	1.3	1.5	0.2

In 2004 the CIL-account surplus is estimated at approximately DKK 10½bn or 0.7 per cent of GDP. The improvement of the CIL-account from 2004 to 2005 is among other things due to the expected economic upturn and higher oil prices.

Compared to the August projection the estimate for the CIL-account surplus in 2005 is almost DKK 3bn higher. This derives partly from higher expected revenues primarily from corporate taxes and excise duties from vehicle registration.

The estimated CIL-account surplus in 2004 is almost DKK 8bn higher than projected in August, which mainly stems from expected higher revenues from the pension yield taxation scheme.

One-off measures etc. are expected to have a limited impact on the CIL-account in 2005. Corrected for one-off measures etc. the CIL-account surplus is estimated at approximately DKK 23bn in 2005, *cf. figure 2.*

Figure 2. Central government CIL-account, 1997-2005

6. Central government financing requirement and debt

In 2005 central government debt as per cent of GDP is expected to continue to decrease to 32.9 per cent of GDP, *cf. table 7*.

Table 7. Central government debt, 2002-2005

End of year, nominal value	2002	2003	2004	2005
Central government debt, DKK bn	521.3	515.3	516.4	502.0
On lending to infrastructure entities etc. ¹⁾	12.5	14.7	18.0	18.9
Central government debt, adjusted for on lending	508.8	500.6	498.4	483.1
Central government debt, per cent of GDP	38.3	36.8	35.4	32.9
Central government debt, adjusted for on lending, per cent of GDP	37.4	35.8	34.2	31.7

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

In nominal terms central government debt in 2005 is expected to decrease by approximately DKK 14½bn due to a net balance of approximately DKK 18½bn, *cf. table 8*. While the CIL-account is expected to show a surplus of DKK 23½bn, the net balance is somewhat lower due to on lending to government owned infrastructure entities etc. amounting to approximately DKK 4bn and differences between accrued revenues/expenditures on the CIL-account and actual cash flow, including net due interest and distributed capital losses on issue. Central government debt adjusted for on lending is expected to decrease by close to DKK 15½bn to DKK 483.1bn in 2005.

Table 8. Central government borrowing, 2004-2005

DKK bn	2004	2005
CIL-account	10.6	23.4
Total on lending ¹⁾	-4.8	-4.0
Differences between accrued revenues/expenditures and cash flow	-2.8	-0.7
Net financing requirement (-net balance)	-2.9	-18.7
Redemption of central government debt	112.8	110.6
Gross financing requirement	109.9	91.9
Gross financing ²⁾		
- Domestic borrowing	82.9	74.7
- Foreign borrowing	16.1	17.2
- Drawing on the central government's account in Danmarks Nationalbank	10.9	-

Note: The 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.

Central government debt is expected to amount to 35.4 per cent of GDP in 2004. Based on a surplus on the CIL-account of 10.6bn, the net balance is estimated at DKK 2.9bn. Again, the difference can be attributed to on lending and differences between accrued revenues/expenditures and actual cash flow. Central government debt in nominal terms is expected to decrease by DKK 1bn to DKK 516.4bn.

In 2005 the gross financing requirement is estimated at DKK 91.9bn, stemming from a net balance of DKK 18.7bn, DKK 95.7bn in redemptions on domestic debt and DKK 15.0bn in redemptions on foreign debt. Financing is expected to derive from domestic borrowing equal to DKK 74.7 and foreign borrowing of DKK 17.2bn.

In 2004 the gross financing requirement is estimated at DKK 109.9bn. The financing is split between DKK 82.9bn in domestic borrowing, DKK 16.1bn in foreign borrowing and a DKK 10.9bn reduction of the central government account in Danmarks Nationalbank. The significant reduction of the account in Danmarks Nationalbank in 2004 following a DKK 5.5bn reduction in 2003 is the result of improved cash management within the central government.

Annex 1.

Table 1. General government finances 2003-2005									
DKK bn., current prices	----- 2003 -----			----- 2004 -----			----- 2005 -----		
	Aug.	Dec.	Diff.	Aug.	Dec.	Diff.	Aug.	Dec.	Diff.
Consumption	371.8	371.8	0.0	384.2	385.7	1.5	394.9	396.8	1.9
Income transfers	252.6	252.6	0.0	262.9	261.0	-2.0	266.3	266.3	0.0
Investment	23.8	23.8	0.0	25.2	25.2	0.0	26.2	26.9	0.7
Interest expenditure	47.9	47.9	0.0	45.6	46.0	0.4	42.7	42.9	0.2
Subsidies	30.0	30.0	0.0	31.4	31.6	0.2	31.4	32.0	0.7
Other expenditure ¹⁾	41.1	41.1	0.0	42.4	42.9	0.5	43.6	44.2	0.6
Total expenditure	767.1	767.1	0.0	791.7	792.4	0.6	805.1	809.2	4.1
Personal income taxes ²⁾	309.5	308.1	-1.4	316.7	314.0	-2.7	328.3	326.3	-2.0
Labour market contrib.	63.0	62.2	-0.8	65.2	64.9	-0.3	67.9	67.5	-0.4
Corporate taxes	39.1	39.1	0.0	44.1	43.8	-0.3	44.8	45.7	0.9
Pension yield taxation	5.2	5.2	0.0	9.0	13.0	4.0	10.0	7.0	-3.0
VAT	135.4	135.4	0.0	140.6	141.0	0.4	146.3	147.4	1.1
Vehicle registration fee	13.5	13.5	0.0	15.3	17.1	1.8	16.4	18.3	1.9
Other duties	92.3	92.3	0.0	93.3	93.7	0.4	96.1	95.4	-0.7
Other taxes ³⁾	23.4	23.4	0.0	23.8	23.8	0.0	23.9	24.1	0.2
Interest revenues	35.3	35.3	0.0	32.6	33.8	1.2	32.8	34.0	1.1
Gross operating surplus	27.1	27.1	0.0	27.4	27.4	0.0	28.0	28.1	0.0
Other revenue	40.0	40.0	0.0	41.1	41.7	0.6	40.3	41.0	0.7
Total revenue	784.0	781.7	-2.3	809.1	814.2	5.1	834.8	834.7	-0.1
General government budget balance	16.9	14.6	-2.3	17.4	21.9	4.5	29.7	25.5	-4.2
Net interest expenditure	12.6	12.6	0.0	13.0	12.3	-0.8	9.9	9.0	-0.9
General government primary balance ⁵⁾	29.5	27.2	-2.3	30.4	34.1	3.7	39.6	34.4	-5.2

- 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	26.3	26.6	26.4	26.0	25.8	-0.1
Income transfers	17.3	17.3	17.5	18.1	17.9	17.5	17.2	-0.1
Investments	1.7	1.9	1.8	1.7	1.7	1.8	1.7	-0.2
Interest expenditures	4.3	4.0	3.7	3.4	3.2	2.8	2.6	-1.4
Other expenditures	5.3	5.1	5.2	5.1	5.1	5.0	5.0	-0.1
Expenditure burden	53.9	54.2	54.6	54.9	54.3	53.0	52.4	-1.9
Personal income taxes	22.3	22.5	22.1	22.0	21.5	21.4	21.1	-1.4
Labour market contributions	4.4	4.5	4.5	4.4	4.4	4.4	4.4	-0.0
Pension yield taxation	0.8	0.1	0.1	0.4	0.9	0.5	0.5	0.4
Corporate tax	2.4	3.1	2.9	2.8	3.0	3.0	3.2	0.0
Value added tax	9.7	9.7	9.7	9.7	9.7	9.7	9.6	-0.1
Other duties	7.7	7.8	7.9	7.7	7.8	7.6	7.5	-0.3
Other taxes	2.3	2.2	1.7	1.7	1.6	1.6	1.5	-0.7
Tax burden	49.6	49.9	48.9	48.7	48.9	48.1	47.8	-2.1
Interest revenue	2.5	2.6	2.3	2.5	2.3	2.2	2.1	-0.5
Other non-tax revenue	4.5	4.7	5.1	4.8	4.7	4.5	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	56.5	57.1	56.1	55.9	55.8	54.7	54.1	-3.0