

Public finances - August 2016

Although the growth rate in the Danish economy is relatively modest, steady progress in the labour market is expected to continue. Hence, a gradual adjustment of the fiscal policy from a lenient starting point is planned. Along with increased labour supply, a gradual tightening of fiscal policy helps to reduce the risk of widespread labour shortages.

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 0.9 per cent of GDP in 2016 and 1.9 per cent of GDP in 2017.

For 2016 a structural deficit of 0.3 per cent of GDP is estimated, while the structural deficit is estimated to 0.4 per cent in 2017. With the budget proposal for 2017 and the annual agreements between the central government and municipalities and regions on their economy for the coming year, the structural deficit maintains a margin to the deficit limit in the Budget Law.

The Budget Law introduces binding separate expenditure ceilings for central government, municipalities and regions. Based on the budget proposal for 2017 and the annual agreements between the central government and municipalities and regions on their economy for 2017 the expenditure ceilings are complied. Along with the budget proposal for 2017 follows a bill on expenditure ceilings for the new fourth year, 2020.

Real public consumption is expected to increase by 1.2 per cent in 2016, caused by a lower level in 2015 than forecast in Economic Survey, May 2016. In 2017 the real public consumption is estimated to increase by 0.5 per cent. This reflects the budget proposal for 2017 and the agreed levels of expenditures in municipalities and regions in 2017. Furthermore, the high level of public investment during the recession continues to be gradually normalized in 2017.

Fiscal policy reduces economic activity in the period 2015-2017 compared to a lenient starting point. The one-year fiscal effect – which is a calculated measure of the activity effects of fiscal policy compared to the previous year – is estimated to -0.1 per cent of GDP in 2017.

Gross debt (EMU) holds a broad margin against the 60 per cent of GDP limit given by the Stability and Growth Pact in the forecast period, while net public debt is estimated at approx. 8 per cent of GDP in 2017. 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 DKK 34 bn. or 1.7 per cent of GDP in 2015. The budget balance in 2015 is affected by temporary measures of approx. DKK 18 bn. (approx. 0.9 per cent of GDP). Excluding these temporary measures the budget deficit in 2015 is approx. 2.5 per cent of GDP.

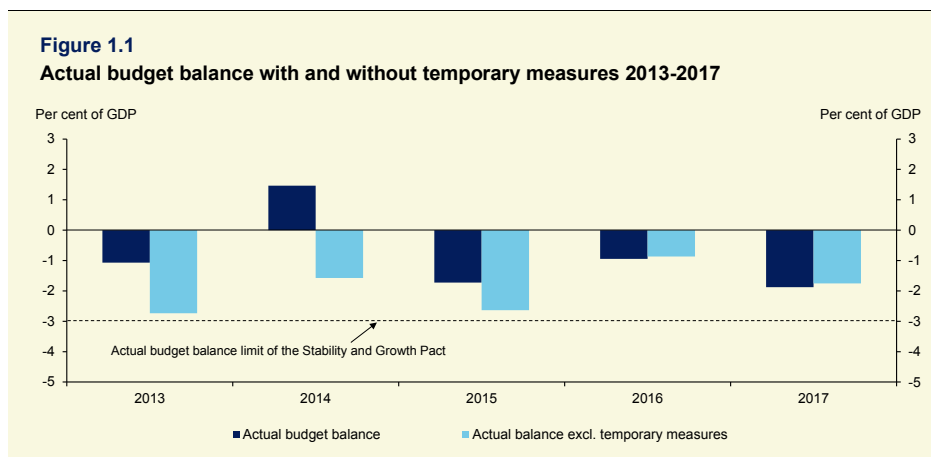
Table 1.1
Actual budget balance (general government), 2012-2017

	2012	2013	2014	2015	2016	2017
Actual balance, per cent of GDP	-3.5	-1.1	1.5	-1.7	-0.9	-1.9
Actual balance, DKK bn.	-66.1	-20.4	28.5	-34.3	-19.1	-39.1

Source: Statistics Denmark and own calculations.

Based on the current assessment of the economic outlook and the assumptions about economic policy, the actual budget deficits are estimated at 0.9 per cent of GDP in 2016 and 1.9 per cent of GDP in 2017, *cf. table 1.1*. Thus, the budget balance is expected to comply with the deficit limit of 3 per cent of GDP given by the EU Stability and Growth Pact.

Despite expected growth in GDP and employment the actual budget deficit is thus expected to increase slightly from 2015 to 2017. However, this reflects that the temporary measures in 2015 do not continue into 2016-2017. Corrected for temporary measures the budget balance improves by almost 1 per cent of GDP from 2015 to 2017, *cf. figure 1.1*. The development in the actual balance from year to year also reflects that the expected revenue from the pension yield tax is cut by half from 2015 to 2017.



Source: Statistics Denmark and own calculations.

Revised estimates for the actual budget balance in 2016-2017

Compared to the estimates in *Economic Survey* May 2016 the actual budget balance has improved by approx. DKK 21¼ bn. in 2016 and weakened by approx. DKK 1 bn. in 2017, cf. *table 1.2*. The changed estimates of the budget balance mainly reflects that the expected revenue from the so-called pension yield tax has been increased by DKK 12½ bn. in 2016 and lowered by DKK 5 bn. in 2017. In addition to this the expected revenue from personal taxes has been increase in both years, including a considerable adjustment of the expected revenue from equity taxes by approx. DKK 4¼ bn.

The adjustments in the revenues from pension yield tax reflects updated forecast for interest rate developments that imply a larger decrease in interest rates through 2016 and a slightly higher increase in interest rates through 2017 compared to May estimates. In both years lower assets in pension funds at the beginning of 2016 contribute to a decrease in the estimated revenue from pension yield tax.

The expected revenue from the North Sea in 2016 is roughly unchanged and increased by approx. DKK 1½ bn. in 2017. The adjustment is based on higher expected oil prices, lower expected costs and increasing gas production, compared to May estimates.

The estimated revenue from personal taxes has been increased by approx. DKK 4¼-4¾ bn. in 2016-2017 compared to the forecast in May. This reflects new information about the revenues in 2015. Furthermore, the estimated revenue is affected by an upward adjustment of employment in 2016 and 2017, lower expected net interest expenses in households and an increase in the expected pension payments compared to May estimates.

The expected revenue from equity income taxes has been upward adjusted by approx. DKK 4¼ bn. in 2016. The adjustments reflects new information from The Ministry of Taxation that shows higher revenue in 2015 as well as total tax payments for dividend income in the 1st half of 2016 on the same level as the tax payments in the same period last year.

Estimated revenues from VAT and excise duties has been decreased by approx. DKK ½ bn. in 2016-2017, while the expected revenue from registration tax has been increased by DKK ¾-1 bn. in 2016-2017, reflecting higher car sales compared to the expectations in May.

Table 1.2
Revised actual budget balance estimates for 2016-2017 compared to *Economic Survey*, May 2016

DKK bn.	2016	2017
Change in estimates concerning the public balance, DKK bn.	21.7	-0.9
Hereof:		
- Pension yield tax	12.5	-4.9
- North sea revenues (incl. North Sea fund)	-0.1	1.5
- Personal tax etc. (incl. labour market contributions, ex. Tax on equity)	4.5	4.7
- Tax on equity	4.2	0.0
- VAT and excise duties	-0.4	-0.5
- Registration tax	0.8	1.0
- Public consumption	0.0	-2.5
- Other expenditure and revenue (residual)	0.2	-0.2

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 unchanged in 2016 and increased by DKK 2.5 bn. in 2017 compared to estimates in May. The upward adjustment of public consumption in 2017 reflects, among others, that there has been added approx. DKK ½ bn. to specific actions on the social, health- and labor market area (satspulje). Furthermore public consumption expenditure is affected by rearrangements within the sub-ceiling for central government operating expenditures on the budget proposal for 2017, including lower budgeted expenditure on EU that is reallocated to public consumption expenditure.

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.

For 2015 and 2016 the structural public deficits are estimated to be respectively 0.5 and 0.3 per cent of GDP. Thus, the structural deficit has improved by 0.1 per cent of GDP in both years compared with the estimates in *Economic Survey*, May 2016. In particular, the improvement is due to new information on public revenues, where projected revenues from personal income taxes have been revised up – especially for taxes on income from equities – leading to an improvement of the structural deficit in both years.

For 2017 a structural deficit of 0.4 per cent of GDP is projected, thus maintaining a margin to the deficit limit in the Budget Law. The budget proposal for 2017 and the annual agreements between the central government and municipalities and regions on their economy for the coming year are in line with the overall framework of fiscal policy and maintain the sound course for public finances.

In the budget proposal for 2017, the expenditures within the central government sub-ceiling for operating expenditures are projected to be DKK 0.7 bn. below the ceiling, while projections in *Economic Survey*, May 2016 were based on a technical assumption of expenditures DKK 2 bn. below the ceiling in order to maintain a structural deficit of 0.4 per cent of GDP.

The expenditures within the central government sub-ceiling for operating expenditures should be seen in light of the updated assessment of public finances – *inter alia* the improvement due to the lowering of the projected expenditures on asylum seekers – which has made it possible to use a larger share of the ceiling in 2017 than earlier assumed technically.

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. The structural balance is thus an estimate of how large the public surplus or deficit would have been in a normal situation, in other words, a situation where economic activity is neither particularly high nor low and where the public finances are not affected by other temporary factors.

As an example, the calculation of the structural balance in 2017 starts with the estimated actual deficit of 1.9 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. -0.5 per cent of GDP (row 2). The negative cyclical effect is smaller in 2017 compared to 2016 which reflects that employment as well as production are closer to their structural levels. 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 0.9 per cent of GDP below the structural revenue levels in 2017 (row 3-8), *cf. figure 1.2-1.7*. This is mainly driven by low actual profit levels for the pension yield tax and North Sea revenues. 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	-1.7	-0.9	-1.9
<i>Hereof temporary impact on the actual balance from:</i>				
2. Cyclical component (gap-related)	-1.5	-1.2	-0.8	-0.5
3. Corporate taxes ¹⁾	-0.1	0.2	0.1	0.1
4. Vehicle registration	-0.1	0.0	0.1	0.1
5. Pension yield tax	1.7	0.0	0.9	-0.6
6. North Sea revenues ²⁾	-0.4	-0.7	-0.7	-0.4
7. Net interest payments ¹⁾	0.2	-0.3	-0.1	0.1
8. Special budget items ³⁾	-0.6	0.0	-0.1	-0.1
9. Other factors ⁴⁾	3.1	0.7	0.0	-0.1
10. Structural balance (1-2-3-4-5-6-7-8-9)⁴⁾	-0.9	-0.5	-0.3	-0.4
<i>Memo item: Weighted cyclical gap</i>				
	-2.0	-1.5	-1.1	-0.7

- 1) Excluding revenues regarding North Sea activities.
 - 2) The structural level has been adjusted by the permanent effect compared to the budget expenditure ceiling baseline. In 2014 the permanent effect is adjusted by -0.16 per cent of GDP. The permanent effects are adjusted by -0.06 per cent of GDP in 2015 and -0.07 per cent of GDP in 2016-2017. The adjustments should be seen in light of the falling oil prices.
 - 3) 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.
 - 4) 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 25½ 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. In addition, adjustments are made for changes in the phasing in of the EU discount between 2015 and 2016 corresponding to the correction of the expenditure ceilings. Also includes a correction for new information on public revenues in 2014 and 2015 which is not yet reflected in Statistics Denmark figures. Further corrections are made for the deviation of the revenue of equity income taxation from its structural level and for the budget reduction in 2016.
 - 5) Structural balance in per cent of structural GDP.
- Source: Statistics Denmark and own calculations.

Figure 1.2
Corporate taxes (excl. hydrocarbon)

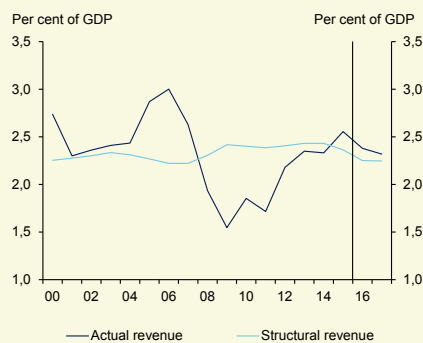


Figure 1.3
Vehicle registration tax

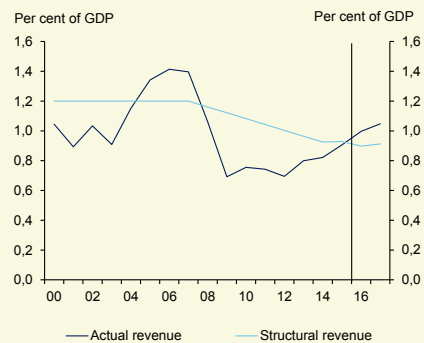


Figure 1.4
Pension yield tax

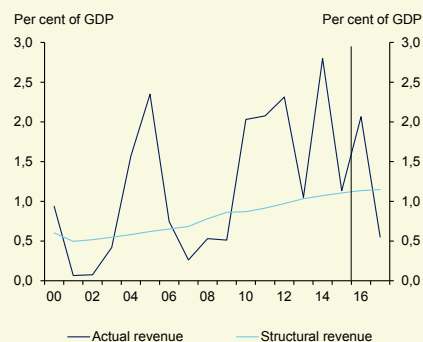


Figure 1.5
North Sea revenues

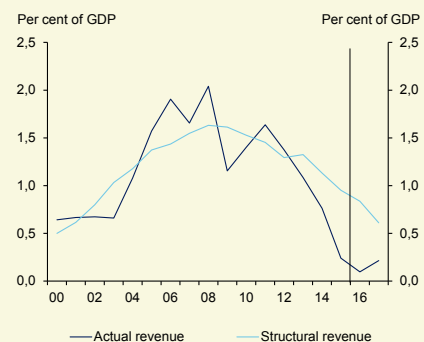


Figure 1.6
Net interest payments

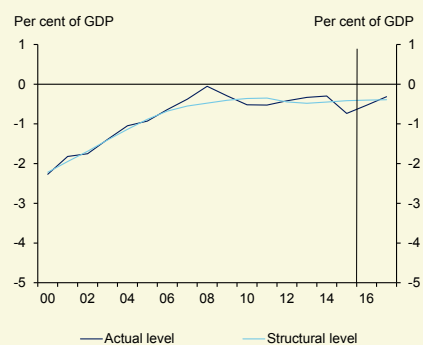
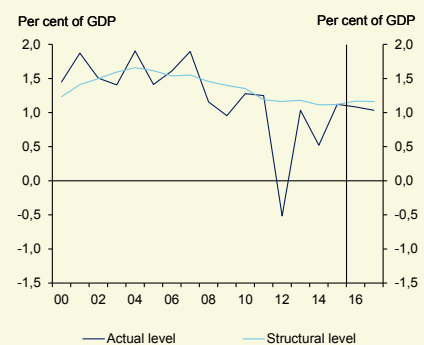


Figure 1.7
Special budget items¹⁾



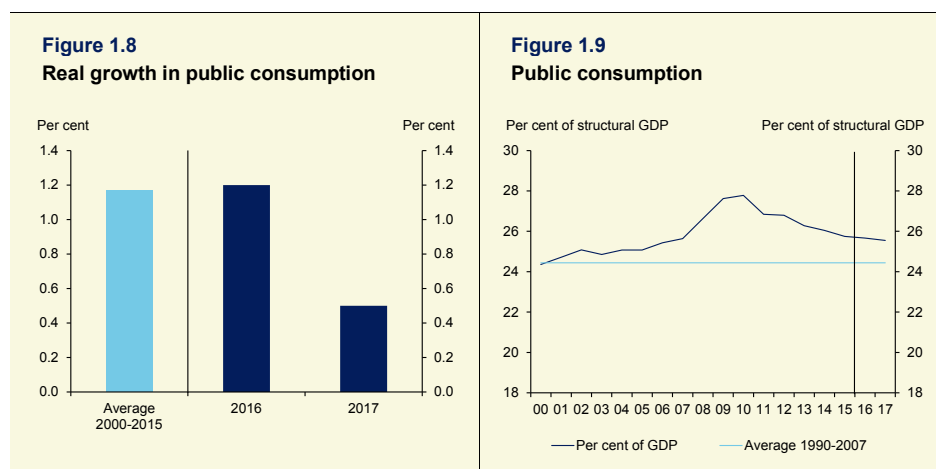
1) The actual level is affected by one-off effects such as the repayment of contributions to the early retirement scheme of DKK 28½ bn. in 2012 (1½ per cent of GDP) which is corrected for in the calculation of the structural level.

Source: Own calculations

1.3 Public consumption and investment

Public consumption

Real growth in public consumption is expected at 1.2 per cent in 2016 and 0.5 per cent in 2017. When viewed over both years, the estimated real growth rate of public consumption is slightly lower than the average of the period 2000-2015, cf. figure 1.8. Nonetheless, the level of public consumption (as a share of structural GDP) is still relatively high by historical standards, cf. figure 1.9.



Note.: In figure 1.8 the real growth rate in 2000-2008 is determined by the input method. In the period 2008-2015 the real growth rate is determined by the output method.

Source: Statistics Denmark and own calculations.

The public consumption expenditure is estimated at DKK 530½ bn. in 2016, which is unchanged compared to *Economic Survey*, May 2016, cf. table 1.4.

The projected real growth rate of public consumption is increased by 0.2 percentage points in 2016 compared to the *Economic Survey*, May 2016. This mainly reflects a lower level of public consumption in 2015 than previously estimated.

Table 1.4
Public consumption estimates

	2015	2016	2017
Real growth rate (per cent)			
<i>Economic Survey, May 2016</i>	0.6	1.0	0.0
<i>Economic Survey, August 2016</i>	-0.7 ¹⁾	1.2	0.5
<i>Change since May (percentage points)</i>	-1.3	0.2	0.5
DKK bn.			
<i>Economic Survey, May 2016</i>	519.7	530.5	540.1
<i>Economic Survey, August 2016</i>	518.8	530.5	542.6
<i>Change since May (percentage points)</i>	-0.9	0.0	2.5

Source: Statistics Denmark and own calculations.

For 2017, public consumption expenditure is estimated at approx. DKK 542½ bn., which is an increase of DKK 2½ bn. compared to the May survey. This reflects the general government budget proposal, including a lower budgeted contribution to the EU that converts other expenditure to public consumption, and an increase in the [social reserve fund].

In addition, the expected number of asylum seekers in 2017 has been lowered since the survey in May. This lowers expenditures regarding public income transfers making it possible to increase public consumption expenditure without weakening the budget balance.

Moderate decrease in public employment in 2016-2017

Following the considerable growth in public employment in the late 2000's, the number of publicly employed decreased correspondingly from 2010 to 2012, cf. *figure 1.10*. Since 2012, public employment has decreased further but in a more moderate manner than in the years before.

Figure 1.10
Public employment (national accounts)

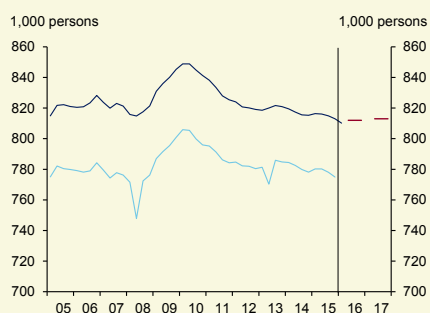


Table 1.5
Public employment estimates

	2015	2016	2017
Change compared to the previous year (1,000 persons)			
May 2016	-1.9	1.0	-1.0
August 2016	-1.8	-3.0	1.0
Change	0.1	-4.0	2.0
Level in August	815	812	813

Source: Statistics Denmark and own calculations.

In 2016 public employment is expected to decrease by 3,000 persons. This is a downward adjustment of approx. 4,000 persons compared to estimations in May, which reflects a relatively weak development in public employment in the first part of 2016.

With the expected real growth in public consumption of 0.5 per cent in 2017 it is technically assumed that public employment will increase by 1,000 persons from 2016 to 2017, *cf. table 1.5*.

Adjustment of public investments

Public investment expenditure 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 in 2017. 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*.

Table 1.6
Public investment estimates

	2015	2016	2017
Public investment expenditure (DKK bn, current prices)	73.6	71.8	72.9
Real growth rate (per cent)	-1.1	-3.3	-0.2
Share of GDP (per cent)	3.7	3.6	3.5

Source: Statistics Denmark and own calculations.

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

1.4 Expenditure ceilings for central and local governments

Starting in 2014 the Budget Law introduced 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 budget proposal for 2017 shows compliance with expenditure ceilings for central government, municipalities and regions, respectively, *cf. table 1.7*. Based on the budget proposal for 2017 central government operating expenditures was approx. DKK 0,7 bn. lower than the relevant sub-ceiling, while the projections in *Economic Survey May 2016* was based on a technical assumption of expenditures DKK 2 bn. below the ceiling in order to maintain a structural deficit of 0.4 per cent of GDP.

The expenditures within the central government sub-ceiling for operating expenditures should be seen in light of the updated assessment of public finances – *inter alia* the improvement due to the lowering of the projected expenditures on asylum seekers – which has made it possible to use a larger share of the ceiling in 2017 than has hitherto been technically assumed. Based on the current projection the structural budget deficit is thus estimated to 0.4 per cent of GDP in 2017, which is equal to the estimate in May.

Table 1.7
Expenditure ceilings, 2017

Bn. DKK (2017-prices)	Central government sub-ceilings		Municipalities	Regional sub-ceilings	
	Operating expenditures	Income transfers	Operating expenditures	Health expenditures	Development expenditures
Expenditure ceiling	189.8	262.0	242.4	110.0	3.0
Budget/agreements	189.1	258.0	242.4	110.0	3.0

Source: The budget proposal for 2017 and agreements on municipalities' and region's economy in 2017.

With the budget proposal for 2017 expenditure ceiling for the new fourth year has been legislative proposed. The expenditure ceilings for 2017-20 on the budget proposal for 2017 are shown in table 1.8.

Table 1.8
Expenditure ceilings on the budget proposal for 2017

	2017	2018	2019	2020
Bn. DKK (2017-prices)				
Central government sub-ceiling operating expenditures	189.8	197.5	201.5	203.9
Central government sub-ceiling income transfers	262.0	258.9	256.9	253.9
Municipalities ceiling of operating expenditures	242.4	241.9	241.4	240.9
Regional sub-ceiling of healthcare expenditures	110.0	109.9	109.9	109.8
Regional sub-ceiling development expenditures	3.0	3.0	3.0	2.9

Source: Budget proposal for 2017.

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 in both 2016 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)	-0.2	-0.3	-0.4
<i>GDP growth</i>			
Fiscal policy (multi-year effects)	-0.2	-0.1	-0.1
- hereof one-year fiscal effect	-0.2	-0.0	-0.1

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

Although the growth rate in the Danish economy is relatively modest, and the uncertainty about the international economic outlook has increased over the summer, steady progress in the labour market is expected to continue. Unemployment has fallen to a low level, and more

companies are reporting labour shortages. Hence, it is important to maintain a prudent fiscal policy stance to reduce the risk of widespread labour shortages.

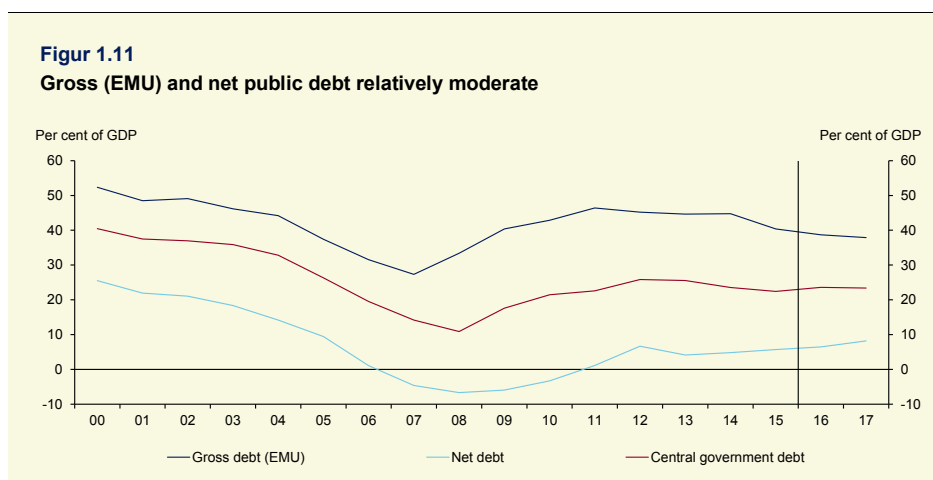
Furthermore, monetary policy is expected to remain highly accommodative in the coming years, increasing the need for fiscal adjustment in order to support a sustainable upturn.

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. 38-39 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 at approx. 23 per cent in both 2016 and 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. 8 per cent of GDP in 2017.



Source: Statistics Denmark and own calculations.