

Public finances – December 2016

The cyclical upswing in the Danish economy strengthens the actual budget balance, but also emphasizes the need for a gradual adjustment of fiscal policy. Fiscal policy is planned in order to reduce the structural deficits towards structural budget balance.

For the forecast period 2016-2018 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 1.4 per cent of GDP in 2016 and 1.6 per cent of GDP in 2017. As a result of the stronger business cycle, the actual budget deficit is reduced to 0.9 per cent of GDP in 2018. Adjusted for fluctuations in the volatile revenue from the pension yield tax the actual budget balance is estimated to 0.2 per cent of GDP.

The structural deficit is estimated to 0.3 per cent of GDP in 2016 and to 0.5 per cent in 2017. The structural deficit for 2018 is based on technical assumptions concerning fiscal policy. Among others, the public consumption expenditures has technically been reduced by DKK 2 bn. (0.1 per cent of GDP) to ensure a structural deficit of 0.2 per cent of GDP in 2018.

The Budget Law introduces binding separate expenditure ceilings for central government, municipalities and regions. Based on information on expenditure developments so far in 2017 and budget figures for 2017 the expenditure ceilings are expected to be complied with.

Real public consumption is expected to increase by 0.4 per cent in 2016, caused by lower consumption expenditures than budgeted. In 2017 the real public consumption is estimated to increase by 0.7 per cent. Public consumption for 2018 is based on technical assumptions. The concrete priorities will be determined throughout 2017.

Furthermore, the high level of public investment during the recession continues to be gradually normalized over the forecast period.

The presumed fiscal policy reduces demand and capacity pressures in the period 2015-2018. Fiscal policy since 2014 is estimated to reduce GDP level by 0.4 per cent and thus helps to ensure that the output gap is approximately equal to zero in 2018.

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. 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 account figures the actual budget deficit was 1.3 per cent of GDP in 2015. The budget balance in 2015 is affected by temporary measures that improve the budget balance by approx. 0.8 per cent of GDP.

Table 1.1
Actual budget balance (general government), 2013-2018

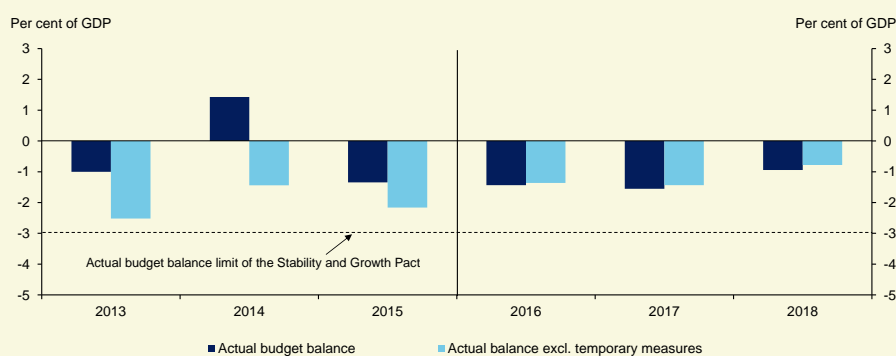
	2013	2014	2015	2016	2017	2018
Actual balance, per cent of GDP	-1.0	1.4	-1.3	-1.4	-1.6	-0.9
Actual balance, DKK bn.	-19.3	28.2	-27.2	-29.3	-32.6	-20.5

Source: Statistics Denmark and own calculations.

Based on the current assessment of the economic outlook and the assumptions about fiscal policy, the actual budget deficits are estimated at 1.4 per cent of GDP in 2016 and 1.6 per cent of GDP in 2017, improving to approx. 0.9 per cent of GDP in 2018, *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's 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 approx. $\frac{3}{4}$ per cent of GDP from 2015 to 2017, *cf. figure 1.1*. In line with cyclical upswing in the Danish economy, the actual budget deficit is expected to decrease by approx. 1 per cent of GDP in 2018. 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 2018.

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 the estimates in *Economic Survey* August 2016 the actual budget balance has weakened by approx. DKK 10¼ bn. in 2016 and improved by approx. DKK 6¼ bn. in 2017, cf. *table 1.2*. The changed estimates of the budget balance mainly reflect that the expected revenue from the so-called pension yield tax has been decreased by DKK 15¾ bn. in 2016 and DKK 1¼ bn. in 2017. In addition to this the higher expected revenue from corporate taxes and VAT, and the lower expected expenditure for public consumption and income transfers contribute to an improved budget balance in both 2016 and 2017.

The adjustments in the revenues from the pension yield tax reflects updated forecast for interest rate developments that imply a smaller expected decrease in interest rates through 2016.

The estimated revenue from personal taxes has been decreased by approx. DKK 1¼ bn. in 2016, while the revenue is expected to be unchanged in 2017 compared to the forecast in August. The decrease in 2016 reflects a higher level of pension savings and lower expected expenditure for income transfers than in the August survey.

The expected revenue from corporate taxes has been increased by approx. DKK 4 bn. in 2016 and DKK 3 bn. in 2017 compared to the August survey. The adjustments reflect new information from The Ministry of Taxation regarding the second part-payment in 2016.

Estimated revenues from VAT and excise duties have been increased by approx. DKK 1¾-2 bn. in 2016-2017. The increase from VAT revenues reflect information regarding the first three quarters of 2016, while the revenue from excise duties has been decreased owing to the gradual out-phasing of the PSO-duty.

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

DKK bn.	2016	2017
Change in estimates concerning the public balance, DKK bn.	-10.3	6.5
Hereof:		
- Pension yield tax	-15.8	-1.3
- Personal tax etc. (incl. labour market contributions, ex. Tax on equity)	-1.8	-0.2
- Corporate taxes	4.0	3.1
- VAT and excise duties	2.0	1.9
- Public consumption	2.5	1.9
- Public investment	-0.6	-1.2
- Public income transfers	1.7	2.2
- Other expenditure and revenue (residual)	-2.2	0.1

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 has been decreased by DKK 2½ bn. in 2016 and approx. DKK 2 bn. in 2017 compared to estimates in August. The lower expected public consumption expenditures in 2016 reflects lower expected expenditures in central government and municipalities based on preliminary accounting figures. In 2017 lower expected public consumption expenditures reflects the political priorities in the agreements on the central government budget bill for 2017.

The expected expenditures on public investments have been increased by approx. DKK ½ bn. in 2016 and approx. DKK 1¼ bn. in 2017. For 2016 the adjustment reflects higher expected investment expenditures in the municipalities, while higher expected expenditures on public investment in 2017 reflect new priorities in the central government budget bill.

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 also implies that discretionary measures cannot be introduced afterwards if they weaken the structural balance beyond the deficit limit given by the Budget Law.

For 2016 and 2017 the structural public deficits are estimated to be respectively 0.3 and 0.5 per cent of GDP. Thus, the structural deficit is unchanged in 2016 and is weakened by 0.1 per cent of GDP in 2017 compared with the estimates in *Economic Survey*, August 2016.

With the fiscal budget agreement for 2017 and the budget agreements with the municipalities and regions, fiscal policy for 2017 has been planned so that the structural deficit will amount to 0.4 per cent of GDP and hence maintain some distance to the deficit limit in Budget Law. However, new information since the survey in August weakens the structural balance to a deficit of 0.5 per cent of GDP in 2017. The new information only reflects changes in the estimates underlying the forecast and not changes in fiscal policy. Among other things, it includes new information on contributions to pension schemes and pension benefits, which suggest that net pension payments will assume a slightly lower level than what was previously assumed. Revenues from personal income taxes are therefore smaller than the stronger business cycle stance would imply and it weakens the structural budget balance. Also larger than expected write-downs and write-offs of tax arrears contribute to a weak structural balance.

The new information, including the net pension payments and the write-down of the value of tax arrears, has also weakened the structural balance in 2018 compared to the latest medium-term projection in August (*DK2025 – A stronger Denmark*). In order to ensure a reduction in the structural deficit towards balance, public consumption expenditures have technically been reduced by DKK 2 bn. (0.1 per cent of GDP), which implies a structural deficit of 0.2 per cent of GDP in 2018 in line with the latest medium-term projection in August.

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 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 1.6 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. -0.2 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 getting 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 0.8 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

	2015	2016	2017	2018
Per cent of GDP				
1. Actual balance	-1.3	-1.4	-1.6	-0.9
<i>Hereof temporary impact on the actual balance from:</i>				
2. Cyclical component (gap-related)	-1.0	-0.5	-0.2	-0.1
3. Corporate taxes ¹⁾	0.1	0.3	0.2	0.1
4. Vehicle registration	0.0	0.1	0.1	0.2
5. Pension yield tax	0.0	0.1	-0.7	-0.7
6. North Sea revenues ²⁾	-0.7	-0.8	-0.4	-0.2
7. Net interest payments ¹⁾	-0.3	-0.2	0.1	0.2
8. Special budget items ³⁾	0.0	-0.1	-0.1	-0.1
9. Other factors ⁴⁾	1.0	0.0	-0.1	-0.1
10. Structural balance (1-2-3-4-5-6-7-8-9)⁴⁾	-0.5	-0.3	-0.5	-0.2
<i>Memo item: Weighted cyclical gap</i>	<i>-1.3</i>	<i>-0.7</i>	<i>-0.3</i>	<i>-0.1</i>

- 1) Excluding revenues regarding North Sea activities.
- 2) The structural level in 2015-2018 has been adjusted by the change of the permanent effect compared to the medium term projection in September 2015. The permanent effects are adjusted by 0.06-0.07 per cent of GDP in 2015-2018.
- 3) Includes a correction for extraordinary depreciations of tax arrears in 2015 amounting to approx. DKK 22¼ bn. in 2015 distributed equally between 2013, 2014 and 2015. In 2018 the special budget items are adjusted by the investment in fighterjets. The investment is planned in the period 2021-2026 but affects the structural budget balance throughout a seven-year centered average.
- 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 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's figures.

Source: Statistics Denmark and own calculations.

Figure 1.2
Corporate taxes (excl. hydrocarbon)

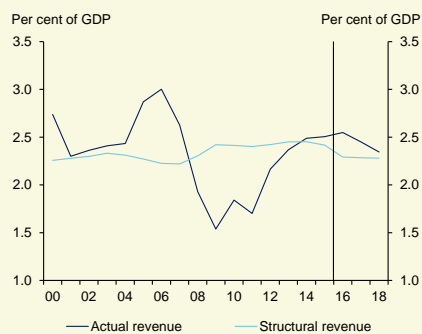


Figure 1.3
Vehicle registration tax

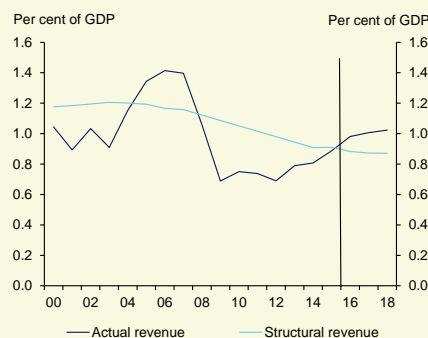


Figure 1.4
Pension yield tax

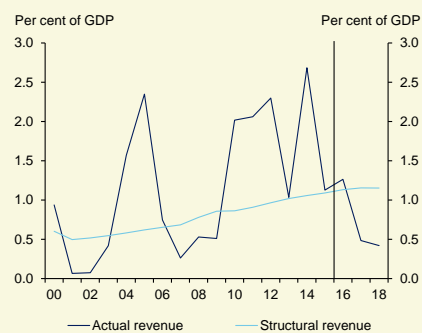


Figure 1.5
North Sea revenues

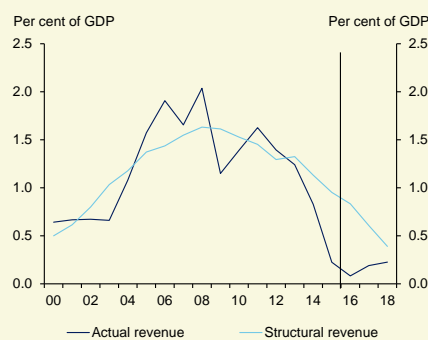


Figure 1.6
Net interest payments

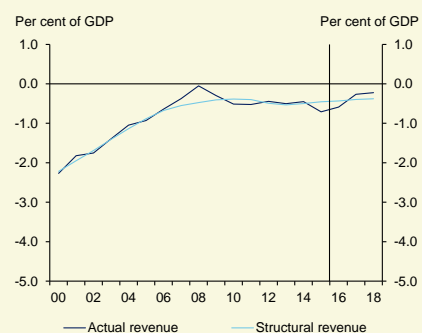
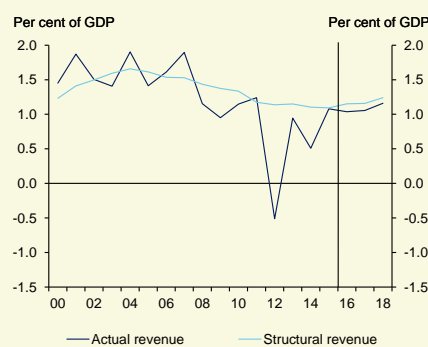


Figure 1.7
Special budget items¹⁾



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

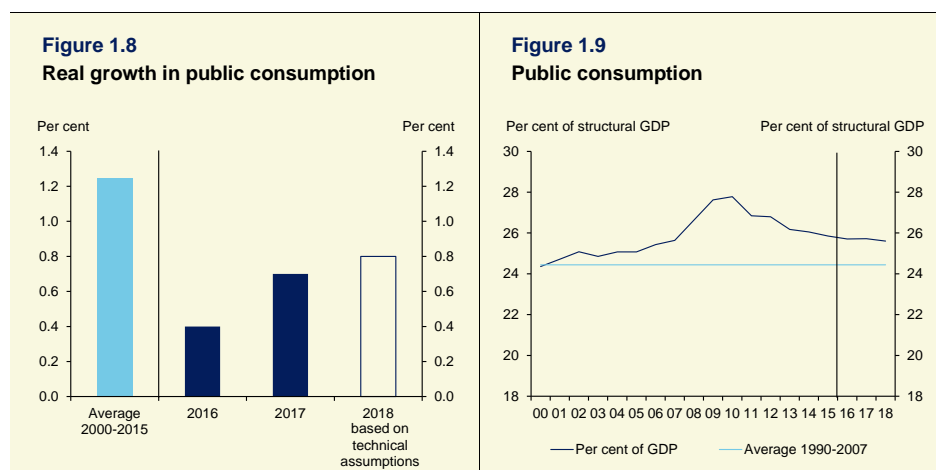
1.3 Public consumption and investment

Public consumption

Real growth in public consumption is expected at 0.4 per cent in 2016 and 0.7 per cent in 2017. In 2018 the real growth in public consumption is estimated to 0.8 per cent. The projection for 2018 relies on technical assumptions.

The government has in the Government Platform “to a freer, richer and safer Denmark” a target of annual basis real growth in public consumption of 0.3 per cent per year. In addition to this, the government has specified that public consumption may be effected by reforms, e.g. a reform of student grants, and by increased investment in national security. The government wants to obtain an annual real basis growth of 0.3 per cent and that the remaining 0.5 per cent in 2018 is earmarked to other priorities, including the lowering of taxes.

The estimate of real growth in 2018 can change as the result of new information coming through up to the budget proposal for 2018. The concrete priorities for 2018 will be determined throughout 2017 as the government puts forth new proposals for economic policy towards 2025, the budget proposal for 2018 as well as the budget agreements with municipalities and regions.



Note.: In figure 1.8 the real growth rate is determined by the input method.

Source: Statistics Denmark and own calculations.

When viewed over all three 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*.

The public consumption expenditure is estimated at DKK 528 bn. in 2016, which is approximately DKK 2½ bn. lower than the estimate from *Economic Survey*, August 2016, *cf. table*

1.4. This is due to preliminary account figures from the state and municipalities indicating a lower than expected public consumption.

The projected real growth rate of public consumption is decreased by 0.8 percentage points in 2016 compared to the *Economic Survey*, August 2016. This reflects both a higher level of public consumption in 2015 than previously estimated and the lower estimate of public consumption in 2016.

Table 1.4
Public consumption estimates

	2015	2016	2017	2018
Real growth rate (per cent)				
<i>Economic Survey</i> , August 2016	-0.7	1.2	0.5	-
<i>Economic Survey</i> , December 2016	0.6 ¹⁾	0.4	0.7	0.8
<i>Change since August (percentage points)</i>	1.3	-0.8	0.2	-
DKK bn.				
<i>Economic Survey</i> , August 2016	518.8	530.5	542.6	-
<i>Economic Survey</i> , December 2016	520.8	528.0	540.7	556.1
<i>Change since August</i>	2.0	-2.5	-1.9	-

1) The significant change in the real growth rate in 2015 reflects a data revision at Statistics Denmark regarding the output method.

Source: Statistics Denmark and own calculations.

For 2017, public consumption expenditure is estimated at approx. DKK 540¼ bn., which is a decrease of approx. DKK 2 bn. compared to the survey in August. This primarily reflects the general government budget, which includes initiatives that are not regarded as public consumption being financed by reserves that were technically presumed as public consumption in the August survey.

The real growth in public consumption in 2018 is based on technical assumptions regarding fiscal policy based on the latest medium term projection of the Danish economy. Furthermore, public consumption is technically reduced by DKK 2 bn. in 2018 to avoid a weakening of the structural budget balance.

Stable development in public employment

Public employment has decreased slightly during the later years and the number of public employees in the third quarter of 2016 were approx. 4,000 people less than the level in 2012, cf. figure 1.10.

Since the August survey, Statistics Denmark has revised the measure of public employment in the National Accounts. The revision has led to an increase in the number of public employ-

ees of approx. 3,500-9,000 persons in 2013-2015. According to the revised numbers, public employment increased by approx. 2,000 persons in 2015, *cf. table 1.5*.

Figure 1.10
Public employment (national accounts)

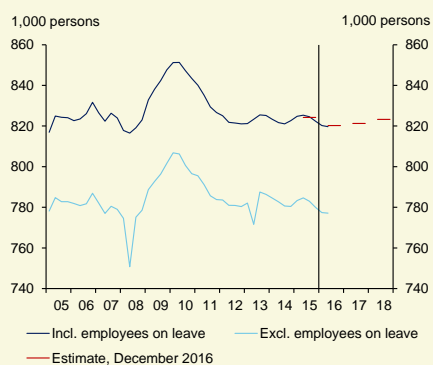


Table 1.5
Public employment estimates

1,000 persons	2015	2016	2017	2018
Change compared to the previous year				
August 2016	-1.8	-4.0	1.0	2.0
December 2016	2.1	-3.0	1.0	2.0
Change	3.9	-1.0	0.0	0.0
Level in December	824	820	821	823

Source: Statistics Denmark and own calculations.

From 2015 to 2018 public employment is expected to be approx. unchanged with moderate fluctuations. This is partly due to the presumed real growth in public consumption in the same period.

Adjustment of public investments

Public investment expenditures have been historically high over the past years in order to support economic activity during the recession. However, a normalization of the investment expenditure level is planned in 2017 and 2018. Thus, the public investment (as share of GDP) is expected to decline from 3.6 per cent in 2016 to 3.4 per cent in 2018, *cf. table 1.6*.

Table 1.6
Public investment estimates

	2016	2017	2018
Public investment expenditure (DKK bn., current prices)	72.5	74.2	73.9
Real growth rate (per cent)	0.7	0.6	-2.5
Share of GDP (per cent)	3.6	3.5	3.4

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.

Based on current information concerning public investment projects etc. the estimated expenditure for 2018 exceed the level stipulated in the latest medium-term projection by DKK 2 bn, *cf. latest medium-term projection (DK2025 – A stronger Denmark)*, August 2016 (only available in Danish at www.fm.dk). Thus it will be necessary to adjust public investment when fiscal policy for 2018 is planned more concretely.

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 general government budget bill for 2017 shows compliance with expenditure ceilings for central government, municipalities and regions, respectively, *cf. table 1.7*. Based on the budget bill for 2017 central government operating expenditures are on level with the ceiling while the expenditures for income transfers are approx. DKK 4¼ bn. lower than the relevant sub-ceiling.

Preliminary budgets for the municipalities in 2017 show expected operating expenditures approx. DKK ½ bn. below the sub-ceiling. At the same time, however, the municipalities expect a corresponding increase in investment expenditures. The preliminary budgets thus indicate that total municipal expenditures are in accordance with the expenditure ceiling and the agreements on the economy for 2017.

Based on preliminary budgets for the regions in 2017, the regional expenditures are expected to be in compliance with the regional sub-ceilings for 2017.

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	186.3	262.2	242.4	110.0	3.0
Budget/agreements	186.2	257.9	241.9	110.0	3.0

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

The expenditure ceilings for 2017-20 on the budget bill for 2017 are shown in table 1.8.

Table 1.8
Expenditure ceilings on the central government budget for 2017

	2017	2018	2019	2020
Bn. DKK (2017-prices)				
Central government sub-ceiling operating expenditures	186.3	195.3	200.0	202.9
Central government sub-ceiling income transfers	262.2	258.9	257.0	254.1
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 bill for 2017.

1.5 Fiscal stance

A stronger-than-expected increase in employment relative to what was forecasted in the *Economic Survey*, August 2016 emphasizes the need of a gradual adjustment of fiscal policy combined with measures that increase labour supply. Also, monetary policy is expected to remain highly accommodative in the coming years a gradual tightening is key in ensuring that economic policy as a whole supports a sustainable upturn. The gradual adjustment of fiscal policy supports that the structural budget deficits are making progress towards a balanced budget.

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

	2016	2017	2018
Per cent of GDP			
GDP level			
Fiscal policy as of 2015 (multi-year effects)	-0.3	-0.3	-0.4
GDP growth			
Fiscal policy (multi-year effects)	-0.2	0.0	-0.1
- hereof one-year fiscal effect	-0.1	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.

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 calcu-

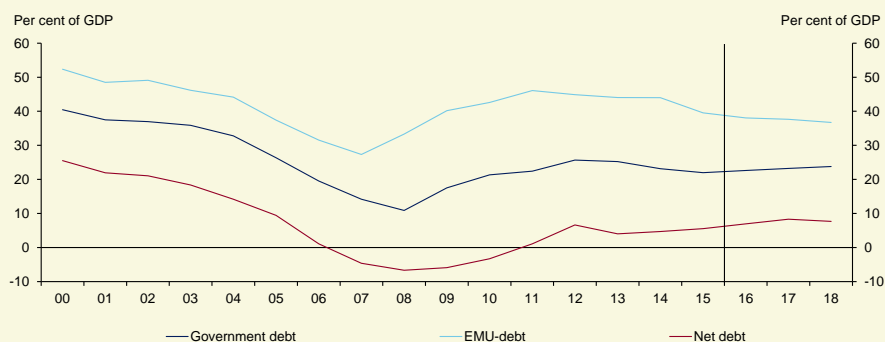
lated from a relative expansionary starting point in 2014 characterized by historically high levels of public consumption and investment. Overall, fiscal policy (from 2015 onwards) is estimated to reduce the GDP level by 0.4 per cent in 2018, *cf. table 1.9*.

1.6 Public debt

Sound public finances and moderate public debt support 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 supports low interest rates for the Danish government, Danish homeowners and other Danish borrowers.

The gross public debt (EMU-definition) is estimated at approx. 37-38 per cent of GDP in the forecast period 2016-2018, thus maintaining a broad safety margin against the 60 per cent of GDP limit of the Stability and Growth Pact, *cf. figure 1.11*.

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



Source: Statistics Denmark and own calculations.

Central government debt (as share of GDP) is estimated at approx. 22.5-23.8 per cent from 2016-2018, *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 2018.