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Assessment of the 2016 Convergence Programme for Denmark

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

This document assesses Denmark's April 2016 Convergence Programme (hereafter called Convergence Programme), which was submitted to the Commission on 26 April 2016 and covers the period 2016-2020. It was approved by the government and presented to the European Affairs Committee and the Finance Committee of the national parliament.

Denmark is subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO).

On 16 November 2015, the Commission published a report prepared in accordance with Article 126(3) of the Treaty, analysing Denmark's compliance with the deficit criterion of the Treaty. The trigger for the report was the budgetary data notified by the Danish statistical authorities on 13 October 2015, and subsequently validated by Eurostat, showing that the general government budget balance in Denmark was planned to reach a deficit of 3.3% of GDP in 2015, thus exceeding the 3% of GDP reference value in the Treaty. This was confirmed by the Commission 2015 autumn forecast, which projected a general government deficit of 3.3% of GDP in 2015. The report concluded that the planned deficit was above but close to the 3% of GDP reference value in the Treaty. The estimated excess over the Treaty reference value could be qualified as exceptional in the sense of the SGP. Furthermore, it was considered temporary. The report also examined relevant factors and suggested that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/97 should be considered as complied with. In the most recent notification from Statistics Denmark, from April 2016, the general government deficit in 2015 has been revised significantly downwards to 2.1% of GDP. This estimate has been validated by Eurostat.

This document complements the Country Report published on 26 February 2016 and updates it with the information included in the Convergence Programme.

Section 2 presents the macroeconomic outlook underlying the Convergence Programme and provides an assessment based on the Commission 2016 spring forecast. The following section presents the recent and planned budgetary developments, according to the Convergence Programme. In particular, it includes an overview on the medium-term budgetary plans, an assessment of the measures underpinning the Convergence Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework and the quality of public finances. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

According to the Convergence Programme, the recovery of the Danish economy is expected to continue in the coming years, with estimated GDP growth rates of 1.1% in 2016 and 1.7% in 2017. GDP growth would be mainly driven by domestic demand in 2016, but exports are expected to take over as the main growth driver in 2017. GDP growth is expected to accelerate in 2018-2019, with annual GDP growth rates of 2.2% in both years, before slowing down somewhat to 1.9% in 2020.

Comparing the projections in the Convergence Programme with last year's projections in the Convergence Programme, GDP growth has been adjusted downwards significantly in 2015-2016, while minor downward revisions have been made for the years 2017-2019.

The programme's macroeconomic assumptions are in general plausible and broadly in line with the Commission 2016 spring forecast. Both projections forecast a strengthening and broadening of the economic recovery over the coming years. The Commission 2016 spring forecast projects a GDP growth of 1.2% in 2016, increasing to 1.9% in 2017.

The output gap, as recalculated by the Commission, following the commonly agreed methodology, projects a gradual closure of the output gap up to 2019[1]. The (recalculated) output gap is estimated at -2.5% of GDP in 2016 and is expected to be reduced by between 0.7 and 1.0 pps. per year in 2017-2019. In 2019, the gap is projected to be fully closed.

Table 1: Comparison of macroeconomic developments and forecasts

	2015		2016		2017		2018	2019	2020
	COM	CP	COM	CP	COM	CP	CP	CP	CP
Real GDP (% change)	1.2	1.2	1.2	1.1	1.9	1.7	2.2	2.2	1.9
Private consumption (% change)	2.1	2.1	2.0	1.8	2.1	1.8	2.2	2.3	1.9
Gross fixed capital formation (% change)	1.2	1.2	2.4	1.8	4.1	4.1	5.5	6.4	5.7
Exports of goods and services (% change)	-1.0	-1.0	1.5	1.9	4.2	4.3	4.2	4.5	3.9
Imports of goods and services (% change)	-1.4	-1.4	3.2	3.1	4.4	4.6	5.7	5.9	4.8
Contributions to real GDP growth:									
- Final domestic demand	1.4	1.4	1.7	1.5	1.8	1.7	2.5	2.6	2.2
- Change in inventories	-0.3	-0.3	0.2	0.1	0.0	0.0	0.2	0.0	0.0
- Net exports	0.1	0.1	-0.7	-0.4	0.1	0.1	-0.5	-0.5	-0.3
Output gap[1]	-2.8	-2.7	-2.5	-2.5	-1.6	-1.8	-0.8	0.0	0.5
Employment (% change)	1.1	1.1	0.9	1.0	0.9	0.9	1.3	1.2	0.8
Unemployment rate (%)	6.2	6.3	6.0	6.0	5.7	5.7	5.4	5.1	5.2
Labour productivity (% change)	0.1	0.1	0.3	0.1	1.0	0.8	0.9	1.0	1.1
HICP inflation (%)	0.2	0.2	0.3	0.6	1.5	1.6	1.6	1.6	1.7
GDP deflator (% change)	1.0	1.0	1.0	1.1	1.8	1.7	2.0	2.0	2.2
Comp. of employees (per head, % change)	1.9	2.0	2.0	2.0	2.3	2.4	2.9	2.9	3.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.0	7.0	5.7	7.7	5.8	7.5	7.1	6.7	6.3

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2016 spring forecast (COM); Convergence Programme (CP).

The projection in the Convergence Programme includes estimated macroeconomic impacts of structural reforms, such as the 2011 pension reform. The five largest reforms implemented since 2008 are estimated to increase labour supply by 121.000 persons (full-time employment) in 2020.

[1] At -2.5% in 2016, the (recalculated) output gap is larger than the estimated -1.2% in the Convergence Programme. The closure of the output gap is, however, expected to take place in the same year, in 2019.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2015

The general government deficit was 2.1% of GDP in 2015, compared to an estimated deficit of 1.6% of GDP in last year's programme. In the forecast underpinning the budget for 2016, the Economic Survey December 2015, the budget balance in 2015 was estimated at -2.0% of GDP.

The general government balance in 2015 has been revised downwards by 0.4 pp. compared to last year's programme. Total public expenditure has been revised down from 55.4% of GDP last year, to 54.5% of GDP, mainly reflecting lower public consumption and lower social transfers. However, the downward revision of public revenues has been even larger from 53.7% of GDP to 52.4% of GDP, partly due to lower than expected revenues from the pension yield tax, which have been revised down from 1.9% of GDP to 1.1% of GDP.

3.2. Medium-term strategy and targets

The Convergence Programme aims at achieving a balanced budget in structural terms in 2020. Furthermore, the fiscal policy is planned within the framework of the Budget Law, the 2020-plan (the current medium-term plan, which is expected to be updated with a 2025-plan this summer) and the SGP. Denmark has chosen a MTO of -0.5% of GDP, which reflects the objectives of the Pact. The chosen MTO is more ambitious than the updated minimum MTO for 2017-2019 of -1.0% of GDP, as revised earlier this year. The MTO and the objective of a balanced budget in 2020 are unchanged compared to last year's programme.

The Commission's recalculated structural balance[2], according to the commonly agreed methodology, shows the structural balance at 0.0% of GDP in both 2016 and 2017. In the last years of the projection, the (recalculated) structural balance is gradually deteriorating, reaching a level of -0.3% of GDP in 2020, which is still within the MTO of -0.5% of GDP.

The headline balance is projected to improve from a level of -2.3% of GDP in 2016 to balanced budget in 2020. The projected deficit for 2016 has improved compared to last year's Convergence Programme, which targeted a general government deficit of 2.6% of GDP in 2016 as depicted in Figure 1. This is mainly due to higher-than-previously-expected tax revenues, partly owing to stronger-than-expected labour market performance, as well as to lower-than-previously-expected expenditure on social transfers. The improvement of the headline balance is stronger in the last two years of the projection, which reflects that a drop in expected revenues from the pension yield tax drags down public revenues in 2017-2018. Overall, public revenues are expected to decline from 51.2% of GDP in 2016 to 50.4% of GDP in 2020.

The reduction of public expenditure, from 53.5% of GDP in 2016 to 50.4% of GDP in 2020, is expected to be gradual. There are, however, somewhat larger reductions in the two first years of the projection, reflecting a reduction of expenditure related to both transfers and public consumption. The reduction in public expenditure reflects both a normalisation of the economic cycle, which owing to the operation of the automatic stabilisers leads to lower spending on unemployment benefits and other transfers, and the effects from past structural reforms, as for example the 2011 pension reform, which is expected to increase labour supply and GDP.

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[2] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

The projections in the programme are based on the so-called cautionary principle, which implies that only reforms and agreements where a majority in Parliament has already been found are included in the programme.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2015	2016		2017		2018	2019	2020	Change: 2015-2020
	COM	COM	CP	COM	CP	CP	CP	CP	CP
Revenue	**53.6**	**52.3**	**51.2**	**51.6**	**50.5**	**49.9**	**49.8**	**50.4**	**-3.2**
of which:									
- Taxes on production and imports	16.5	16.7	16.5	16.6	16.4	16.3	16.3	16.3	-0.2
- Current taxes on income, wealth, etc.	29.9	28.6	29.1	28.4	28.5	27.8	27.8	28.4	-1.5
- Social contributions	1.0	1.0	0.1	0.9	0.1	0.1	0.1	0.1	-0.9
- Other (residual)	6.1	6.0	5.5	5.7	5.5	5.7	5.6	5.6	-0.5
Expenditure	**55.7**	**54.8**	**53.5**	**53.5**	**52.5**	**51.7**	**51.1**	**50.4**	**-5.3**
of which:									
- Primary expenditure	54.1	53.5	52.3	52.3	51.3	50.6	49.9	49.2	-4.9
of which:									
Compensation of employees	16.5	16.3	16.4	16.0	16.1	16.0	15.8	15.6	-0.9
Intermediate consumption	9.2	9.3	9.2	8.9	9.1	9.1	9.0	8.9	-0.3
Social payments	19.0	19.0	19.2	18.8	18.9	18.5	18.2	18.0	-1.0
Subsidies	2.0	1.9	2.0	1.7	1.9	1.7	1.7	1.7	-0.3
Gross fixed capital formation	3.8	3.6	3.5	3.6	3.4	3.2	3.2	3.2	-0.6
Other (residual)	3.6	3.4	3.0	3.2	2.9	3.0	2.8	2.9	-1.0
- Interest expenditure	1.6	1.2	1.2	1.2	1.2	1.1	1.2	1.2	-0.4
General government balance (GGB)	**-2.1**	**-2.5**	**-2.3**	**-1.9**	**-1.9**	**-1.8**	**-1.3**	**0.0**	**2.1**
Primary balance	**-0.5**	**-1.2**	**-1.1**	**-0.7**	**-0.8**	**-0.7**	**-0.1**	**1.2**	**1.7**
One-off and other temporary measures	1.4	0.1	-0.8	0.0	-0.8	-1.2	-1.1	0.0	-1.4
GGB excl. one-offs	**-3.5**	**-2.5**	**-1.5**	**-1.9**	**-1.1**	**-0.6**	**-0.2**	**0.0**	**3.5**
Output gap[1]	-2.8	-2.5	-2.5	-1.6	-1.8	-0.8	0.0	0.5	3.2
Cyclically-adjusted balance[1]	-0.4	-0.9	-0.8	-0.9	-0.8	-1.3	-1.3	-0.3	0.1
Structural balance[2]	**-1.8**	**-1.0**	**0.0**	**-0.9**	**0.0**	**-0.1**	**-0.2**	**-0.3**	**1.5**
Structural primary balance[2]	-0.2	0.3	1.2	0.3	1.2	1.0	1.0	0.9	**1.1**

Notes:

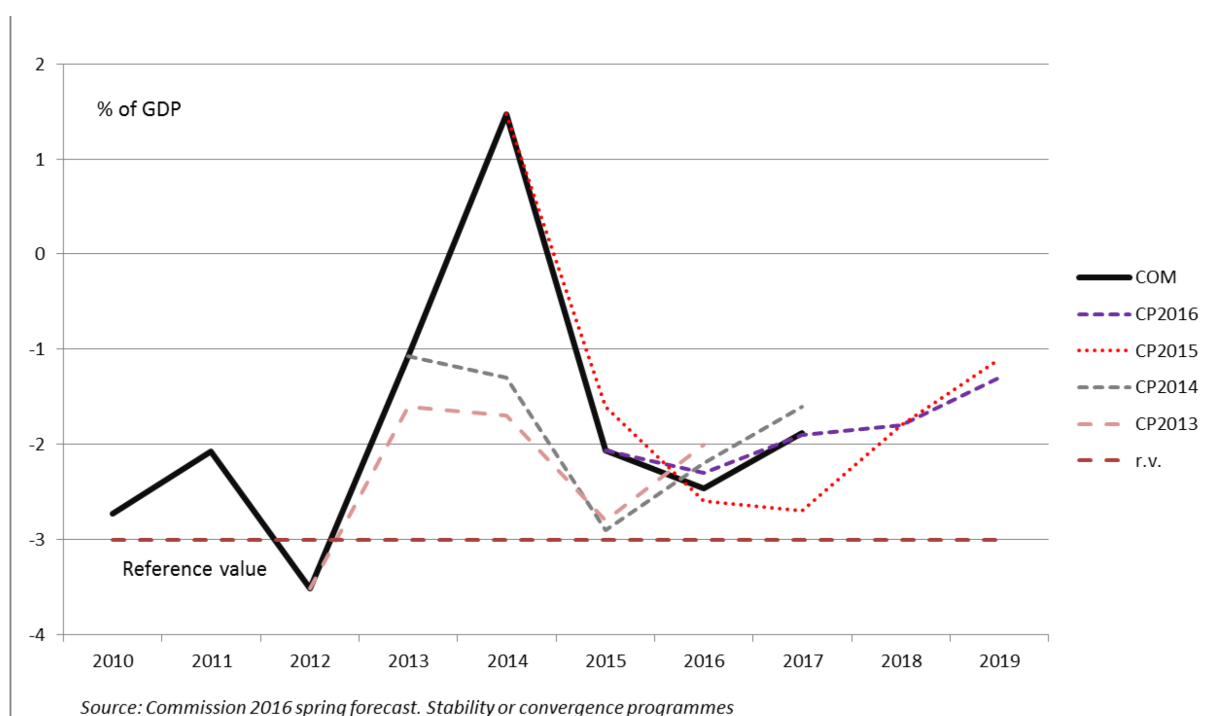
[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence Programme (CP); Commission 2016 spring forecasts (COM); Commission calculations.

Figure 1: Government balance projections in successive programmes (% of GDP)



3.3. Measures underpinning the programme

Over the last eight years, Denmark has undertaken a number of important reforms that are expected to have a positive effect on labour supply, employment and public finances in the coming years. Among these are the 2011 Pension Reform, the 2012 reform of disability pension, flex jobs, student grants and social transfers, as well as the 2009 Spring Package. According to the Convergence Programme, the five largest reforms introduced since 2008 are expected to increase labour supply by 121.000 persons in 2020 (full-time equivalents), and to increase employment by 93.000 persons (full time equivalents), corresponding to an increase in employment of approximately 3% in 2020 (compared to a scenario without these reforms).

The Convergence Programme projects an average annual growth in public consumption of 0.5% in the years 2017-2020, which is relatively muted, compared to the annual average growth rate in the years 2000-2015 of 1¼%. This appears ambitious, also in the light of the authorities' updated estimate of expenditure growth in public services related to demographics, including higher expenditures related to the recent inflow of asylum seekers, of 0.8% per year, revised upwards from an average of 0.5% per year estimated last September.

In addition, a central assumption behind the projection up to 2020 is a gradual reduction of public investments from the current historical high level to a level in 2020 that is closer to, but still higher, than the historical average.

The Danish authorities have not provided a quantification of detailed discretionary measures in the Convergence Programme, which is not in line with the guidelines laid down in the Code of Conduct.[3]

3.4. Debt developments

According to the projections in the Convergence Programme, the general government gross debt ratio is expected to decline from 40.2% of GDP in 2015 to 35.1% of GDP in 2020. The debt ratio is thus expected to decline gradually and to remain significantly below the 60% of GDP reference value of the Treaty. The projection is broadly in line with the Commission 2016 spring forecast for 2016-2017 (figure 2). The reduction is expected to be gradual over the projection horizon and to a large extent driven by the denominator effect from the increase in nominal GDP. The primary balance, on the other hand, is expected to be negative up to 2019.

The general government net debt-to-GDP ratio, which includes public gross debt and financial assets, stood at 5% by the end of 2015. The net debt ratio is expected to increase gradually to 10.1% in 2020.

Table 3: Debt dynamics

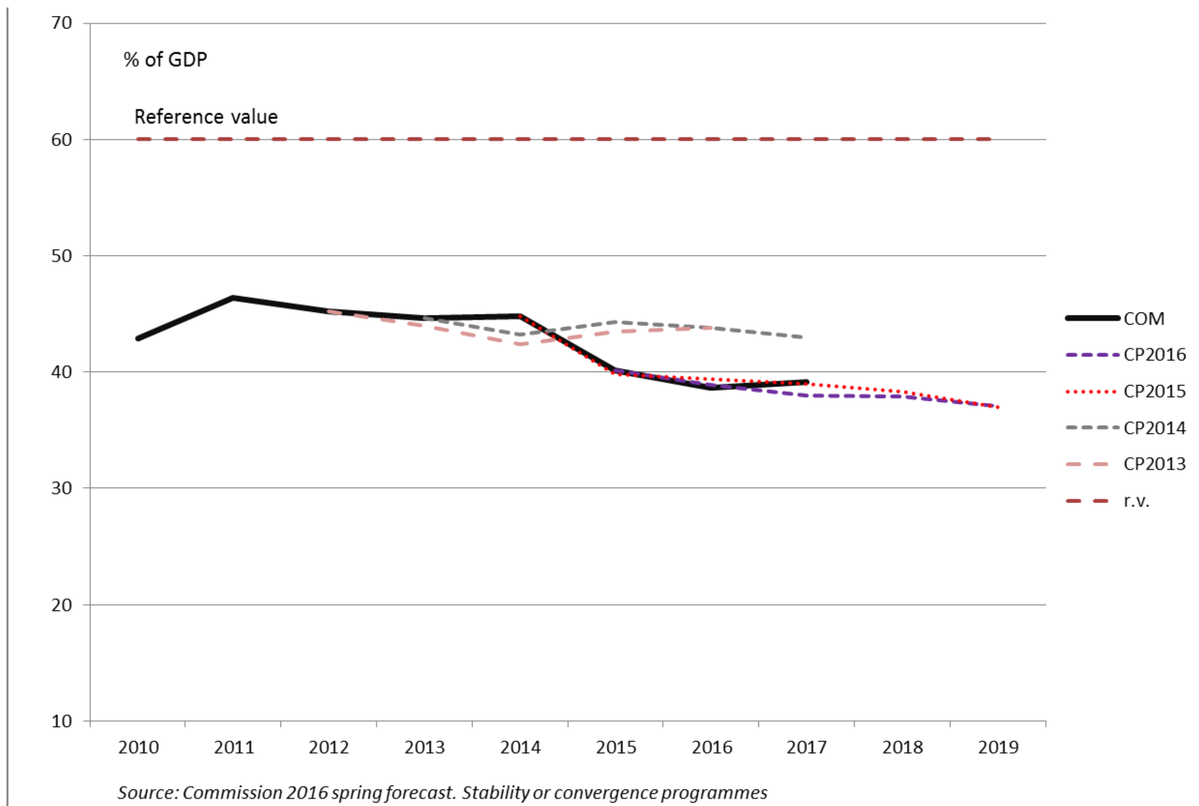
(% of GDP)	Average 2010-2014	2015	2016		2017		2018	2019	2020
			COM	CP	COM	CP	CP	CP	CP
Gross debt ratio[1]	**44.8**	**40.2**	**38.7**	**38.9**	**39.1**	**38.0**	**37.9**	**37.1**	**35.1**
Change in the ratio	0.9	-4.6	-1.5	-1.3	0.5	-0.9	-0.1	-0.8	-2.0
Contributions[2] :									
1. Primary balance	**-0.2**	**0.5**	**1.2**	**1.1**	**0.7**	**0.8**	**0.7**	**0.1**	**-1.2**
2. "Snow-ball" effect	**0.7**	**0.6**	**0.4**	**0.3**	**-0.2**	**-0.2**	**-0.4**	**-0.3**	**-0.2**
Of which:									
Interest expenditure	1.8	1.6	1.2	1.2	1.2	1.1	1.1	1.2	1.2
Growth effect	-0.3	-0.5	-0.5	-0.4	-0.7	-0.6	-0.8	-0.8	-0.7
Inflation effect	-0.8	-0.5	-0.4	-0.5	-0.7	-0.7	-0.7	-0.7	-0.8
3. Stock-flow adjustment	**0.4**	**-5.7**	**-3.1**	**-2.7**	**0.0**	**-1.5**	**-0.4**	**-0.6**	**-0.5**

Notes:
[1] End of period.
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :
Commission 2016 spring forecast (COM); Convergence Programme (CP), Comission calculations.

[3] "*Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes*", 3 September 2012: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/code_of_conduct_en.pdf

Figure 2: Government debt projections in successive programmes (% of GDP)



3.5. Risk assessment

The projection in the Convergence Programme is generally prudent, and risks are assessed to be limited.

In general, the Danish public finances rely on large and volatile revenue items. Examples of these are revenues from the pension yield tax and revenues from oil and gas drilling in the North Sea. The programme projections of developments in these items are prudent, but due to their inherent volatility, surprises – either positive or negative – can have a significant impact on the headline budget balance in a single year.

The introduction in 2014 of multiannual expenditure ceilings for all three levels of government appears to have had a significant effect in budget discipline. The framework, which is supported by economic sanctions in case of non-adherence, has put an end to overspending by municipalities, which was the main driver behind the higher-than-planned public consumption in the 1990s and 2000s.

Risks concerning debt developments are assessed to be limited, as Denmark has a favourable initial position, with a relatively low gross debt level, and a stable fiscal outlook.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council recommendations addressed to Denmark

On 14 July 2015, the Council addressed recommendations to Denmark in the context of the European Semester. In particular, in the area of public finances the Council recommended to Denmark to avoid deviating from the medium-term objective in 2016.

Since 2014, Denmark has been subject to the preventive arm of the SGP. The 3% of GDP general government deficit reference value in the Treaty has been respected, and the general government deficit is expected to remain below that threshold over the projection period. With a general government gross debt level of 40.2% of GDP at the end of 2015, Denmark is not subject to any requirements concerning debt reduction.

The structural balance is estimated to have deteriorated from a structural surplus of 0.2% of GDP in 2014 to a structural deficit of 1.8% of GDP in 2015, pointing to a risk of some deviation from the MTO (deviation of -0.3% of GDP). At the same time, the growth rate of government expenditure, net of discretionary revenue measures, was lower than the applicable reference rate, meaning that the expenditure benchmark pillar was fulfilled with a margin of 0.2% of GDP. This calls for an overall assessment. The steep deterioration of the structural balance is linked to a sharp drop in revenues from the pension yield tax and oil and gas production in the North Sea. Revenues from the pension yield tax amounted to 2.8% of GDP in 2014, while in 2015 they corresponded to 1.1% of GDP. North Sea revenues dropped from 0.8% of GDP in 2014 to 0.2% of GDP. This revenue volatility is fully reflected in the developments in the structural balance. The expenditure benchmark is negatively impacted by lower one-off revenues compared to 2014 (stemming from a revenue-raising measure related to capital pension taxation). Therefore, the overall assessment suggests that Denmark was in line with the requirements in 2015.

For 2016, the (recalculated) structural balance in the Convergence Programme is estimated at 0.0% of GDP, well above the MTO, while the expenditure benchmark is in line with the requirement both in 2016 and over 2015-2016 taken together (leading to deviations of 0.6% and 2.0% of GDP, respectively).

The Commission 2016 spring forecast, on the other hand, projects a structural deficit of 1.0% of GDP in 2016. The difference between the (recalculated) structural deficit and the spring forecast stems from a somewhat larger projected headline deficit in the Commission's forecast and, more importantly, the different treatment of temporary fluctuations in the before-mentioned volatile revenue items in the Convergence Programme and in the Commission's forecast. While in the Danish authorities' calculations, the structural balance is corrected for the deviation of volatile revenue items from their estimated structural levels, the commonly agreed methodology applied by the Commission does not make such a correction. As a result, the Convergence Programme includes an effect on the structural balance from extraordinary items and one-offs of 0.8% of GDP, primarily related to low revenues from the North Sea oil and gas extraction. The Commission 2016 spring forecast, on the other hand, only includes for 2016 a minor one-off of 0.1% of GDP related to the impacts stemming from the retroactive implementation of the 2014 Own Resources Decision (2014 ORD). On this basis, the Commission 2016 spring forecast projects an improvement of 0.8% of GDP in the structural balance this year, resulting in a positive deviation of 0.8% pf GDP vis-à-vis the requirement.

At the same time, the Commission 2016 spring forecast points to a significant deviation from the expenditure benchmark in 2016 (deviation of -1.1%). This calls for an overall assessment. The revenue-raising measure related to capital pension taxation has an impact on the profile of expenditure growth net of discretionary revenue measures (net expenditure growth) in the

years 2013-2016. The measure, which has raised revenues in 2013-2015, is fully phased out in 2016. The pick-up of net expenditure growth in 2015 and 2016 can, therefore, be seen as reflecting the significant drop in net expenditures in 2013 and 2014. If this one-off measure were filtered out of the calculations, the net expenditure growth in 2016 would not deviate significantly from the benchmark. On the other hand, volatile revenue items positively impact on the change in the structural balance. Considering these different elements, the overall assessment suggests that Denmark is projected to be in line with the requirements in 2016.

In 2017, the Convergence Programme points to some deviation from the recommended adjustment on the basis of the structural balance pillar (deviation -0.3% of GDP), while it is above the requirement over 2016-2017 taken together (deviation of 0.8% of GDP). On the basis of the expenditure benchmark pillar, the programme is in line with the requirement in both 2017 and over 2016-2017 taken together (deviations of 0.3% and 0.5% of GDP, respectively).

The Commission 2016 spring forecast also shows some deviation in 2017 on the basis of structural balance pillar (deviation of -0.1% of GDP), while it is above the requirement over 2016-2017 taken together (deviation of 0.3% of GDP). The expenditure benchmark, on the other hand, is in line with the requirement in 2017 (deviation of 0.2% of GDP). However, the pick-up in net expenditure growth in 2016, due to the phasing out of the capital pension taxation measure affects negatively the expenditure benchmark measured over the years of 2016 and 2017 taken together. The expenditure benchmark thus points to a risk of significant deviation (deviation of -0.5% of GDP) over two years. This calls for an overall assessment. If the one-off revenue measure were filtered out of the calculations, the two-year average net expenditure growth in 2017 would not deviate from the benchmark. Taking this into account, the overall assessment suggests that Denmark is projected to be in line with the requirements in 2017.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2015	2016		2017	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-1.8	-1.0		-0.9	
Structural balance based on freezing (COM)	-0.5	-1.0		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		Not at MTO	
(% of GDP)	**2015**	**2016**		**2017**	
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.0		0.3	
Required adjustment corrected[5]	-1.7	0.0		0.3	
Change in structural balance[6]	-2.0	1.8	0.8	0.0	0.1
One-year deviation from the required adjustment [7]	-0.3	1.8	0.8	-0.3	-0.1
Two-year average deviation from the required adjustment [7]	0.8	0.8	0.3	0.8	0.3
Expenditure benchmark pillar					
Applicable reference rate[8]	4.2	1.1		0.3	
One-year deviation [9]	0.2	0.6	-1.1	0.3	0.2
Two-year average deviation [9]	1.2	2.0	-0.5	0.5	-0.5
Conclusion					
Conclusion over one year	Overall assessment	Compliance	Overall assessment	Overall assessment	Overall assessment
Conclusion over two years	Compliance	Compliance	Overall assessment	Compliance	Overall assessment

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Convergence Programme (CP); Commission 2016 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

Denmark does not appear to face fiscal sustainability risks in the short run.[4]

Based on Commission forecasts and a no-policy-change scenario beyond forecasts, general government gross debt, at 40.2% of GDP in 2015, is expected to steadily decrease (to 30.6% in 2026), thus remaining below the 60% of GDP Treaty reference value. Over this horizon, government debt is projected to have peaked in 2015. This highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the Convergence Programme would put debt on a more steeply decreasing path by 2026, with debt remaining below the 60% of GDP reference value in 2026.

The medium-term fiscal sustainability risk indicator S1 is at -2.8 pps. of GDP, thanks to contributions from all its components, i.e. a debt ratio far below the 60% Treaty reference value, decreasing age-related public spending, and a favourable initial budgetary position, thereby indicating a sound fiscal stance and low risks in the medium term. The full implementation of the Convergence Programme would put the sustainability risk indicator S1 at -4.2 pps. of GDP, leading to similar medium-term risk. Overall, risks to fiscal sustainability over the medium-term are, therefore, low. Fully implementing the fiscal plans in the Convergence Programme would further decrease those risks.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 0.7 pps of GDP. Denmark therefore appears to face low fiscal sustainability risks also in the long-term. The required adjustment is primarily related to the initial budgetary position, while in the category of age-related public spending the projected impact of healthcare and long term care is essentially cancelled out by the mitigating outlook on pensions and other ageing-related costs. Full implementation of the Convergence Programme would put the S2 indicator at 0.9 pps. of GDP, leading to a broadly similar long-term risk.

[4] This conclusion is based on the short-term fiscal sustainability risk indicator S0, which incorporates 14 fiscal and 14 financial-competitiveness variables. The fiscal and financial-competitiveness sub-indexes (reported in table 5) are based on the two sub-groups of variables respectively. For sustainability risks arising from the individual variables, by country, see the Commission's Fiscal Sustainability Report 2015 (page 67).

Table 5: Sustainability indicators

Time horizon				No-policy Change Scenario		Stability / Convergence Programme Scenario	
Short Term				**LOW risk**			
	S0 indicator [1]			0.3			
		Fiscal subindex (2015)		0.2	LOW risk		
		Financial & competitiveness subindex (2015)		0.3	LOW risk		
Medium Term				**LOW risk**			
	DSA [2]			LOW risk			
	S1 indicator [3]			-2.8	LOW risk	-4.2	LOW risk
	of which						
		IBP		-0.5		-1.7	
		Debt Requirement		-1.5		-2.4	
		CoA		-0.8		-0.1	
Long Term				**LOW risk**		**LOW risk**	
	S2 indicator [4]			0.7		0.9	
	of which						
		IBP		0.8		0.3	
		CoA		-0.1		0.7	
		of which					
			Pensions	-1.5		-1.0	
			HC	0.6		0.5	
			LTC	1.6		1.5	
			Other	-0.7		-0.4	

Source: Commission services; 2016 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2016 forecast until 2017. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2015 Ageing Report.

[1] The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.35 and 0.45.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections. See Fiscal Sustainability Report 2015.

[3] The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the forecast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2017) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

[4] The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

6. FISCAL FRAMEWORK

As Denmark has ratified the Treaty on Stability, Cooperation and Governance (TSCG) and opted to apply its Article 14.5 of the TSCG, it is bound by the substance of the TSCG, including its Fiscal Compact. The national fiscal framework in Denmark essentially consists of the Budget Law, a medium-term budgetary strategy (currently up to 2020[5]). The basic budgetary principle of the framework targets fiscal sustainability and achieving a structural general government balance in 2020.

The 2012 Budget Law transposed the provisions of the TSCG, including the introduction of a structurally balanced budget rule with a correction mechanism and independent monitoring. Thus, at the time the budget bill proposal is presented in August every year, the structural deficit in the following year may not surpass the MTO of -0.5% of GDP. In the period after the presentation of the budget bill proposal, political decisions may not be made that lead to a breach of the MTO. If the projections point to a significant deviation from the MTO – i.e. a structural deficit of 1.0% of GDP or higher – a correction mechanism will be triggered.

Based on the structural balance in the programme, the current projection suggest adherence to the requirement of the Budget Law in the projection period up to 2020.

The fiscal objectives are supported by binding, multiannual expenditure ceilings, which apply for all three levels of governance and cover around three quarters of all public expenditures. Current expenditure ceilings are fixed by law for the period 2016-2019. The expenditure ceilings are supported by sanctions mechanisms, which take effect if the ceilings are not adhered to. The expenditure ceilings came into effect in 2014 and have arguably been successful in improving budgetary discipline.

Based on the information provided in the Convergence Programme, the past, planned and forecast fiscal performance in Denmark appears to comply with the requirements of the applicable national numerical fiscal rules.

In its interim report from February 2016, the Danish Economic Councils (the national fiscal council, DØRS), estimated that the structural balance, as calculated following the Budget Law's methodology, is compliant with the MTO in 2014-2017, as well as in 2020.[6] The Economic Council's estimates indicate that the structural balance is in surplus in the whole period. The main difference compared to the Ministry of Finance's estimate is to be found in the assessment of the structural employment level and thus the level of potential GDP.

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[5] An updated medium-term budgetary strategy, up to 2025, is expected to be published this summer.

[6] The report does not specify the estimates in 2018-2019.

7. CONCLUSIONS

The structural balance is estimated to have deteriorated from a surplus of 0.2% of GDP in 2014 to a deficit of 1.8% of GDP in 2015, corresponding to a deviation from the recommended adjustment towards the MTO of -0.3%. On the other hand, the growth rate of government expenditure, net of discretionary revenue measures, indicates overachievement of the applicable expenditure benchmark rate by 0.2% of GDP in 2015. Following an overall assessment, this points to adherence to the MTO in 2015.

According to the (recalculated) structural balance, Denmark plans to achieve a structural balance both in 2016 and in 2017 (0.0% of GDP). According to the Convergence Programme, in both years, the growth rate of government expenditure, net of discretionary revenue measures, is expected to remain below the applicable reference rate of the expenditure benchmark measured both on the single year and the two-year average calculation.

According to the Commission 2016 spring forecast, the structural balance is projected to improve by 0.8% of GDP in 2016, and by additional 0.1% of GDP in 2017. However, a risk of a significant deviation based on the expenditure benchmark pillar emerges in both 2016 and 2017 on the basis of the two-year average calculation, reflecting the phasing out of the one-off restructuring of capital pension taxation. On the basis of the Commission forecast, and following an overall assessment, Denmark appears to be in line with the requirements of the preventive arm in both 2016 and 2017.

8. ANNEX

Table I. Macroeconomic indicators

	1998-2002	2003-2007	2008-2012	2013	2014	2015	2016	2017
Core indicators								
GDP growth rate	2.0	2.0	-0.6	-0.2	1.3	1.2	1.2	1.9
Output gap [1]	1.9	2.3	-2.3	-3.7	-3.1	-2.8	-2.5	-1.6
HICP (annual % change)	2.2	1.6	2.4	0.5	0.4	0.2	0.3	1.5
Domestic demand (annual % change) [2]	1.6	3.0	-0.9	-0.2	1.3	1.1	2.0	1.9
Unemployment rate (% of labour force) [3]	4.7	4.7	6.4	7.0	6.6	6.2	6.0	5.7
Gross fixed capital formation (% of GDP)	21.3	21.9	19.7	18.9	19.1	19.1	19.2	19.7
Gross national saving (% of GDP)	24.4	26.2	24.7	26.6	27.6	26.5	26.2	26.5
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**0.7**	**3.4**	**-1.6**	**-1.1**	**1.5**	**-2.1**	**-2.5**	**-1.9**
Gross debt	**50.0**	**37.3**	**41.6**	**44.7**	**44.8**	**40.2**	**38.7**	**39.1**
Net financial assets	**-27.4**	**-7.7**	**1.6**	**-4.0**	**-4.9**	**n.a**	**n.a**	**n.a**
Total revenue	54.4	54.8	54.3	55.5	57.4	53.6	52.3	51.6
Total expenditure	53.7	51.5	55.9	56.5	56.0	55.7	54.8	53.5
of which: Interest	3.8	2.1	1.8	1.7	1.5	1.6	1.2	1.2
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**5.2**	**4.1**	**7.1**	**8.4**	**8.4**	**4.1**	**3.9**	**3.9**
Net financial assets; non-financial corporations	**-46.3**	**-74.3**	**-73.1**	**-92.9**	**-95.8**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-29.2**	**-26.3**	**-19.9**	**-4.4**	**-3.1**	**n.a**	**n.a**	**n.a**
Gross capital formation	13.3	13.1	11.5	11.4	11.7	12.4	12.8	13.3
Gross operating surplus	22.0	22.6	21.9	22.7	22.4	22.1	21.5	21.8
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.2**	**-4.2**	**-0.8**	**-0.2**	**-2.1**	**5.0**	**4.3**	**3.8**
Net financial assets	**85.8**	**104.4**	**105.8**	**137.3**	**149.4**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	47.4	46.6	48.4	47.3	47.7	48.3	48.6	48.4
Net property income	0.9	2.0	1.4	2.2	2.7	4.3	4.3	4.5
Current transfers received	22.4	22.9	23.9	25.5	26.0	26.7	26.0	25.5
Gross saving	2.5	2.9	3.8	4.1	2.2	7.6	7.8	7.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**2.7**	**3.3**	**4.7**	**7.1**	**7.7**	**7.0**	**5.7**	**5.8**
Net financial assets	**17.4**	**4.3**	**-13.5**	**-35.3**	**-44.9**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	5.9	4.9	4.9	6.0	6.1	6.4	5.8	5.8
Net primary income from the rest of the world	-1.3	0.5	1.6	3.2	3.5	2.5	2.8	2.8
Net capital transactions	0.1	0.0	0.1	0.0	0.0	0.0	-0.5	-0.4
Tradable sector	41.3	39.9	37.8	38.1	37.9	37.4	n.a	n.a
Non tradable sector	44.4	45.4	48.3	48.2	48.6	49.1	n.a	n.a
of which: Building and construction sector	4.5	4.7	4.3	4.0	3.9	3.9	n.a	n.a
Real effective exchange rate (index, 2000=100)	85.5	93.3	99.9	97.6	99.1	97.0	98.5	98.2
Terms of trade goods and services (index, 2000=100)	92.6	95.6	98.3	100.1	100.6	100.8	101.2	101.3
Market performance of exports (index, 2000=100)	109.7	106.4	103.7	100.9	99.9	94.2	92.0	91.6

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2016 spring forecast