



EUROPEAN COMMISSION  
Directorate-General  
Economic and Financial Affairs

Brussels, 27 May 2015

**Assessment of the 2015 Convergence Programme for  
DENMARK**

*(Note prepared by DG ECFIN staff)*

## CONTENTS

1. INTRODUCTION.....	3
2. MACROECONOMIC OUTLOOK.....	3
3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS.....	5
3.1. Deficit developments in 2014.....	5
3.2. Target for 2015 and medium-term strategy.....	5
3.3. Debt developments.....	8
3.4. Risk assessment.....	10
4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT.....	11
5. LONG-TERM SUSTAINABILITY .....	13
6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES.....	15
6.1. Fiscal framework.....	15
6.2. Quality of public finances .....	15
7. CONCLUSIONS.....	16
ANNEX.....	17

## **1. INTRODUCTION**

This document assesses Denmark's April 2015 Convergence Programme (hereafter called Convergence Programme), which was submitted to the Commission on 27 March 2015<sup>1</sup> and covers the period 2014-2020. It was approved by the government and presented to the European Affairs Committee and the Finance Committee of the national parliament.

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

This document complements the Country Report published on 26 February 2015 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 2015 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the Stability and Growth Pact, 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 summarises the main conclusions.

## **2. MACROECONOMIC OUTLOOK**

The Convergence Programme foresees a strengthening recovery of the Danish economy, with GDP growth increasing from 1.0% in 2014 to 1.6% and 2.0% in 2015 and 2016, respectively. According to the programme, the recovery is projected to be broad-based, with both domestic and external demand picking-up.<sup>2</sup>

Compared to the projections in last year's Convergence Programme, the fiscal balance has improved significantly in 2014 and 2015, while the projected deficits in the years 2016-2019 have been revised upwards, primarily due to lower oil prices in the whole period, which reduces revenues from the oil and gas activities in the North Sea. As last year, the programme still aims to reach a balanced budget in 2020. Public gross debt has been revised down significantly compared to last year, primarily reflecting the decision taken in January 2015 to temporarily stop the issuance of government bonds in order to dampen the appreciation pressure on the Danish krone.

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<sup>1</sup> An English translation was submitted on 31 March.

<sup>2</sup> The external assumptions in the Convergence Programme are broadly in line with the Commission 2015 winter forecast, even though the projected oil price is somewhat higher. While the estimated oil price in 2015 is in line with the oil price in the Commission 2015 spring forecast, the estimate for 2016 is slightly higher (72.2 USD per barrel compared to 66 USD per barrel in the Commission spring forecast).

The output gap, as recalculated by the Commission based on the information in the programme, following the commonly agreed methodology, is estimated at -3.7% of GDP in 2014 and is expected to narrow gradually by around 1 pps. per year, closing in 2018.<sup>3</sup>

**Table 1: Comparison of macroeconomic developments and forecasts**

	2014		2015		2016		2017	2018	2019	2020
	COM	CP	COM	CP	COM	CP	CP	CP	CP	CP
Real GDP (% change)	1.1	1.0	1.8	1.6	2.1	2.0	1.9	2.4	2.4	1.8
Private consumption (% change)	0.5	0.3	1.8	1.8	2.1	1.7	2.3	2.4	2.4	2.1
Gross fixed capital formation (% change)	3.7	2.9	2.7	2.9	3.7	5.0	4.1	6.0	5.7	5.1
Exports of goods and services (% change)	2.6	2.9	3.2	4.0	4.6	4.7	5.4	4.5	4.0	3.6
Imports of goods and services (% change)	3.8	4.0	3.1	4.9	4.4	5.3	6.1	5.4	4.6	4.8
<i>Contributions to real GDP growth:</i>										
- Final domestic demand	1.3	1.1	1.6	1.7	1.8	1.8	2.2	2.5	2.6	2.3
- Change in inventories	0.3	0.3	0.0	0.0	0.0	0.3	-0.2	0.1	0.0	0.0
- Net exports	-0.5	-0.4	0.2	-0.2	0.3	0.0	-0.1	-0.3	-0.1	-0.5
Output gap <sup>1</sup>	-3.8	-3.7	-2.8	-2.8	-1.9	-1.8	-1.2	-0.3	0.4	0.4
Employment (% change)	0.7	0.7	0.8	0.9	0.9	0.9	1.1	1.3	1.3	0.6
Unemployment rate (%)	6.6	6.8	6.2	6.4	5.9	6.0	5.5	5.0	4.6	4.6
Labour productivity (% change)	0.4	0.3	1.0	0.7	1.2	1.1	0.8	1.1	1.1	1.2
HICP inflation (%)	0.3	0.4	0.6	0.4	1.7	1.6	1.9	2.4	2.1	2.2
GDP deflator (% change)	0.6	0.5	1.0	0.9	1.6	1.6	1.9	2.2	2.1	2.3
Comp. of employees (per head, % change)	1.8	1.4	2.0	1.7	2.2	2.1	2.3	2.7	3.1	3.2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.2	6.6	7.0	6.6	5.3	6.4	5.5	4.8	4.5	3.8
<p><u>Note:</u></p> <p><sup>1</sup>In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.</p> <p><i>Source :</i></p> <p><i>Commission 2015 spring forecast (COM); Convergence Programme (CP).</i></p>										

The programme's macroeconomic assumptions are plausible and broadly in line with the Commission 2015 spring forecast. Both projections imply a strengthening and broadening of the economic recovery, with both domestic and external demand driving the recovery.

<sup>3</sup> Compared to the (recalculated) output gaps, the Convergence Programme projects a smaller output gap in 2014 of -2.2% of GDP, narrowing gradually by 0.5 pp. per year in the period 2016-2019, before closing in 2019. The difference between the (recalculated) output gap and the gaps presented in the Convergence Programme comes from methodological differences, as the output gap as estimated by Danish authorities is a weighed sum of a total factor productivity gap and an employment gap.

### **3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS**

#### **3.1. Deficit developments in 2014**

The general government balance posted a surplus of 1.3% of GDP in 2014, compared to a projected deficit of 1.4% of GDP in last year's programme. In the forecast underpinning the budget for 2015, the *Economic Survey December 2015*, the budget balance in 2014 was estimated at a surplus of 1.8% of GDP.

The strong upward revision of the budget balance compared to last year's programme is mainly due to higher than expected one-off revenues from the restructuring of capital pension taxation and windfall revenues from the pension yield tax. The increase is reflected in an increase in total public revenues in 2014 as a share of GDP, from 54.3% of GDP in last year's Convergence Programme, to 57.3% in this year's programme. Total public expenditures also increased somewhat, from 55.7% of GDP to 56.1%, partly reflecting higher expenditures on income transfers than expected in last year's programme.

#### **3.2. Target for 2015 and medium-term strategy**

##### **The target for 2015**

The Convergence Programme projects a public finance deficit of 1.6% of GDP in 2015, a clear improvement compared to the deficit of 3.0% of GDP that was projected in last year's programme and in line with the deficit of 1.5% of GDP foreseen in the Commission 2015 spring forecast. In the *Economic Survey December 2015*, the fiscal deficit in 2015 was estimated at 2.5% of GDP.

The improvement of the fiscal deficit compared to last year comes from an upward adjustment of expected revenues from the pension yield tax, due to lower interest rates than expected last year. Revenues are also revised upwards compared to last year due to an extension by one year of the one-off measure concerning the restructuring of capital pension funds, which originally was set to expire by the end of 2014, and an introduction of a similar measure on the so-called LD pension funds.

The Commission's recalculated structural balance on the basis of the information in the programme and according to the commonly agreed methodology shows a deterioration of the structural balance from a surplus of 0.5% of GDP in 2014 to a deficit of 0.5% of GDP in 2015. The deterioration is mainly due to an expected decrease in revenues from the pension yield tax and from North Sea oil and gas drilling revenues. In the programme, the authorities correct the structural balance for these volatile revenue items.

The budgets for municipalities and regions are technically assumed to be in balance in the whole programme period. Local government finances are legally required to be in balance in cash terms; however based on national accounts principals, there might be small surpluses or deficits in some years.

##### **The medium-term strategy**

The Convergence Programme aims at achieving at least a balanced budget in structural terms by 2020, as well as keeping public finances within the rules coming from EU regulation and the Budget Law, including adherence to the medium-term objective (MTO). Denmark has chosen a MTO of -0.5% of GDP, reflecting the objectives of the Pact. The MTO and the Convergence Programme's objective in 2020 are unchanged compared to last year.

According to the recalculated structural balance, Denmark will be at the MTO of -0.5% of GDP in 2015. In the following years, the structural balance is expected to remain stable, but slightly below the MTO, at -0.6 of GDP in 2016 and 2017, before gradually improving to -0.4% in 2019 and -0.3% in 2020.

The headline budget balance is foreseen to deteriorate up to 2017, reaching a deficit of 2.7% of GDP, before improving in the years 2018-2020, reaching balance in 2020.

Both public revenues and expenditures as a share of GDP are projected to decline up to 2020. The profile of public revenues is affected by the restructuring of capital pension taxation, which leads to one-off revenues in 2013-2015, with a peak in 2014. In 2016, no extra revenues are expected from this measure. In the following years, public revenues are set to decline further, but more gradually, as personal income taxes as a share of GDP are expected to decrease from 2016 to 2020.

Public expenditure as a share of GDP is set to decrease over the programme period, from 56.1% of GDP in 2014 to 50.9% in 2020, reflecting both a normalisation of the economic cycle, which leads to lower spending on unemployment benefits and other transfers, but also the effects from past reforms, as for example the pension reform, which is expected to contribute to reducing the number of people on early retirement, and increasing labour supply and GDP.

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)	2014	2015		2016		2017	2018	2019	2020	Change: 2014-2020
	COM	COM	CP	COM	CP	CP	CP	CP	CP	CP
<b>Revenue</b>	<b>58.5</b>	<b>54.8</b>	<b>53.7</b>	<b>52.3</b>	<b>51.5</b>	<b>50.5</b>	<b>50.4</b>	<b>50.3</b>	<b>50.9</b>	<b>-7.6</b>
<i>of which:</i>										
- Taxes on production and imports	16.6	16.5	16.7	16.4	16.6	16.5	16.5	16.5	16.5	-0.1
- Current taxes on income, wealth, etc.	33.7	30.4	30.5	28.5	28.7	27.8	27.8	27.7	28.3	-5.4
- Social contributions	1.1	1.0	0.1	1.0	0.1	0.1	0.1	0.1	0.1	-1.0
- Other (residual)	7.1	6.8	6.4	6.3	6.1	6.1	6.0	6.0	6.0	-1.1
<b>Expenditure</b>	<b>57.2</b>	<b>56.3</b>	<b>55.4</b>	<b>54.9</b>	<b>54.1</b>	<b>53.2</b>	<b>52.2</b>	<b>51.4</b>	<b>50.9</b>	<b>-6.3</b>
<i>of which:</i>										
- Primary expenditure	55.7	54.9	53.9	53.6	52.9	52.0	50.9	50.0	49.6	-6.1
<i>of which:</i>										
Compensation of employees	16.9	16.5	16.5	16.2	16.2	16.0	15.8	15.6	15.5	-1.4
Intermediate consumption	9.5	9.3	9.7	8.8	9.5	9.5	9.3	9.2	9.2	-0.3
Social payments	19.3	19.4	19.7	19.3	19.4	19.1	18.5	18.1	17.8	-1.5
Subsidies	2.2	2.1	2.1	2.0	2.0	1.9	1.8	1.8	1.8	-0.4
Gross fixed capital formation	3.9	3.8	3.6	3.7	3.5	3.3	3.2	3.1	3.1	-0.8
Other (residual)	3.9	3.8	3.3	3.6	3.3	3.3	3.2	3.1	3.2	-1.1
- Interest expenditure	1.6	1.5	1.5	1.3	1.2	1.2	1.3	1.4	1.3	-0.3
<b>General government balance (GGB)</b>	<b>1.2</b>	<b>-1.5</b>	<b>-1.6</b>	<b>-2.6</b>	<b>-2.6</b>	<b>-2.7</b>	<b>-1.8</b>	<b>-1.1</b>	<b>0.0</b>	<b>-1.2</b>
<b>Primary balance</b>	<b>2.8</b>	<b>-0.1</b>	<b>-0.2</b>	<b>-1.3</b>	<b>-1.4</b>	<b>-1.5</b>	<b>-0.6</b>	<b>0.3</b>	<b>1.3</b>	<b>-1.5</b>
One-off and other temporary	3.2	0.8	0.6	0.0	-0.9	-1.4	-1.2	-1.0	0.0	-3.2
<b>GGB excl. one-offs</b>	<b>-1.9</b>	<b>-2.3</b>	<b>-2.2</b>	<b>-2.6</b>	<b>-1.7</b>	<b>-1.3</b>	<b>-0.6</b>	<b>-0.1</b>	<b>0.0</b>	<b>1.9</b>
Output gap <sup>1</sup>	-3.8	-2.8	-2.8	-1.9	-1.8	-1.2	-0.3	0.4	0.4	4.2
Cyclically-adjusted balance <sup>1</sup>	3.6	0.2	0.1	-1.4	-1.5	-2.0	-1.6	-1.3	-0.3	-3.9
<b>Structural balance (SB)<sup>2</sup></b>	<b>0.4</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-1.4</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.4</b>	<b>-0.3</b>	<b>-0.3</b>	<b>-0.7</b>
Structural primary balance <sup>2</sup>	2.0	0.9	1.0	-0.2	0.6	0.6	0.9	1.1	1.0	-0.9
<b>Notes:</b> <sup>1</sup> 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. <sup>2</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures. <b>Source:</b> Convergence Programme (CP); Commission 2015 spring forecasts (COM); Commission calculations.										

### **Measures underpinning the programme**

A central objective for the Danish government is to increase growth in GDP up to 2020 by DKK 40 bn (EUR 5.4 bn) compared to baseline, corresponding to 2% of GDP, by following three reform tracks.

The first reform track consists of reforms that aim at strengthening the framework for businesses, thereby being expected to increase GDP by DKK 20 bn in 2020. By now, measures corresponding to an estimated impact on GDP of DKK 11.5 bn out of the 20 bn have been implemented, while measures corresponding to DKK 8.5 bn still remain to be put in place. The already implemented measures include the initiatives made in the 2013 Growth Plan DK and the 2014 Growth Package.

The second reform track aims at increasing the education level and lifting structural employment. This track is also set to increase GDP by DKK 20 bn. Currently, measures corresponding to an estimated impact on GDP of DKK 19.3 bn out of the 20 bn have already been implemented. Main reforms have been the tax reform, the disability pension reform and the flexi-job scheme reform in 2012, the reform of students' grants and social assistance, as well as the reform of the sickness benefit system in 2013, and the reform of active labour market policies and the agreement on international recruitment in 2014.

A third reform track consists of a modernisation of the public sector. It aims to secure a more efficient use of resources and secure continued high quality in public welfare service. The aim is to free up DKK 12 bn that will be used to develop public services.

Danish authorities have not provided a quantification of detailed discretionary measures in the Convergence Programme.

### **3.3. Debt developments**

The Convergence Programme foresees a decline in the public gross debt ratio from 45.3% of GDP in 2014 to 38.3% of GDP in 2018. The debt is expected to remain significantly below the 60% of GDP reference value of the Treaty, which is broadly in line with the Commission 2015 spring forecast for 2015-2016. A large reduction in the debt level is expected to take place already in 2015, reflecting the temporary halt of issuance of Danish government bonds as from January 2015, in order to dampen the appreciation pressure on the Danish krone. The halt in issuance of government bonds was possible due to the high fiscal surplus in 2014, which implied that the sales of government bonds in 2014 were higher than the financing need. At the end of 2014, the deposit of the central government in the National Bank amounted to DKK 213 bn (EUR 28.6 bn), which corresponds to 11% of GDP. The reduction in the gross debt level in 2016-2018 is mainly due to the denominator effect from the increase in nominal GDP.

As the debt-to-GDP ratio of Denmark is expected to stay well below the 60% reference value of the Treaty, the debt reduction benchmark is not applicable.

The public net debt-to-GDP ratio – which includes public gross debt and financial assets – stood at 4% by the end of 2014. Due to the estimated fiscal deficits, the net debt ratio is expected to increase, reaching 8% in 2020.



**Table 3: Debt developments**

(% of GDP)	Average 2009-2013	2014	2015		2016		2017	2018	2019	2020
			COM	CP	COM	CP	CP	CP	CP	CP
<b>Gross debt ratio<sup>1</sup></b>	<b>44.1</b>	<b>45.2</b>	<b>39.5</b>	<b>39.8</b>	<b>39.2</b>	<b>39.4</b>	<b>39.0</b>	<b>38.3</b>	<b>37.0</b>	<b>36.7</b>
Change in the ratio	2.3	0.2	-5.7	-5.4	-0.3	-0.4	-0.4	-0.7	-1.3	-0.3
<i>Contributions<sup>2</sup>:</i>										
<b>1. Primary balance</b>	<b>0.6</b>	<b>-2.8</b>	<b>0.1</b>	<b>0.2</b>	<b>1.3</b>	<b>1.4</b>	<b>1.5</b>	<b>0.6</b>	<b>-0.3</b>	<b>-1.3</b>
<b>2. “Snow-ball” effect</b>	<b>1.4</b>	<b>0.8</b>	<b>0.2</b>	<b>0.3</b>	<b>-0.1</b>	<b>-0.2</b>	<b>-0.2</b>	<b>-0.5</b>	<b>-0.3</b>	<b>-0.1</b>
<i>Of which:</i>										
Interest expenditure	1.9	1.6	1.5	1.4	1.3	1.2	1.2	1.2	1.4	1.3
Growth effect	0.2	-0.5	-0.8	-0.7	-0.8	-0.8	-0.7	-0.9	-0.9	-0.6
Inflation effect	-0.7	-0.3	-0.4	-0.4	-0.6	-0.6	-0.7	-0.8	-0.8	-0.8
<b>3. Stock-flow adjustment</b>	<b>0.3</b>	<b>2.2</b>	<b>-6.0</b>	<b>-5.9</b>	<b>-1.5</b>	<b>-1.6</b>	<b>-1.7</b>	<b>-0.8</b>	<b>-0.7</b>	<b>1.2</b>
<b>Of which:</b>										
Cash/accruals diff.										
Acc. financial assets										
Privatisation										
Val. effect & residual										

Notes:

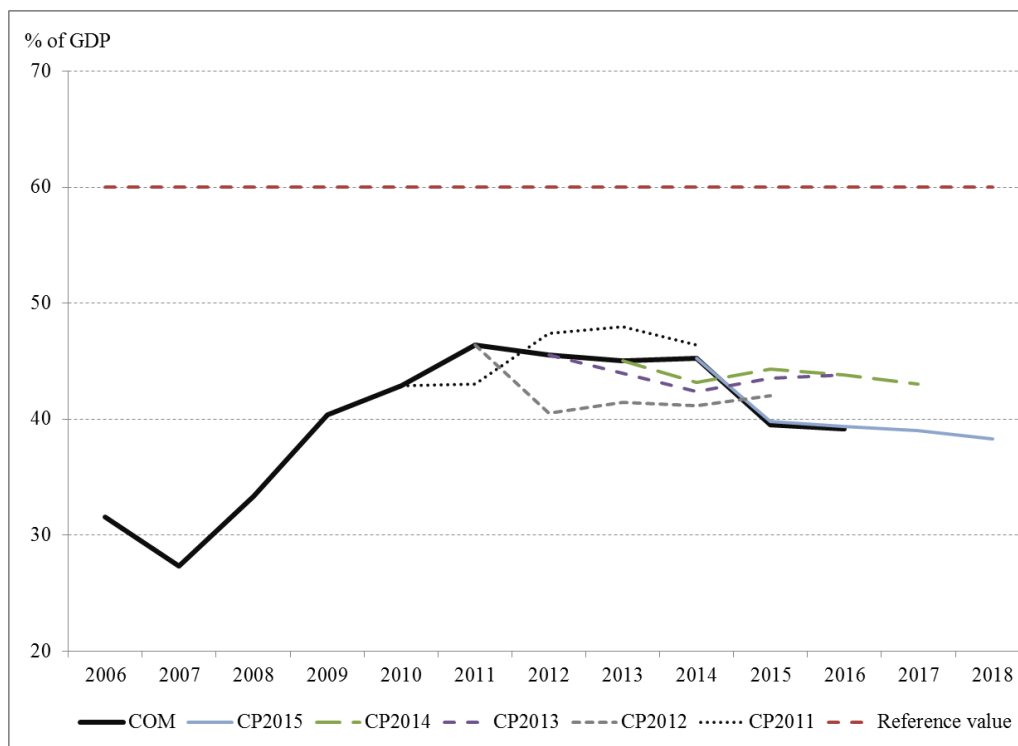
<sup>1</sup> End of period.

<sup>2</sup> 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 2015 spring forecast (COM); Convergence Programme (CP), Commission calculations.

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



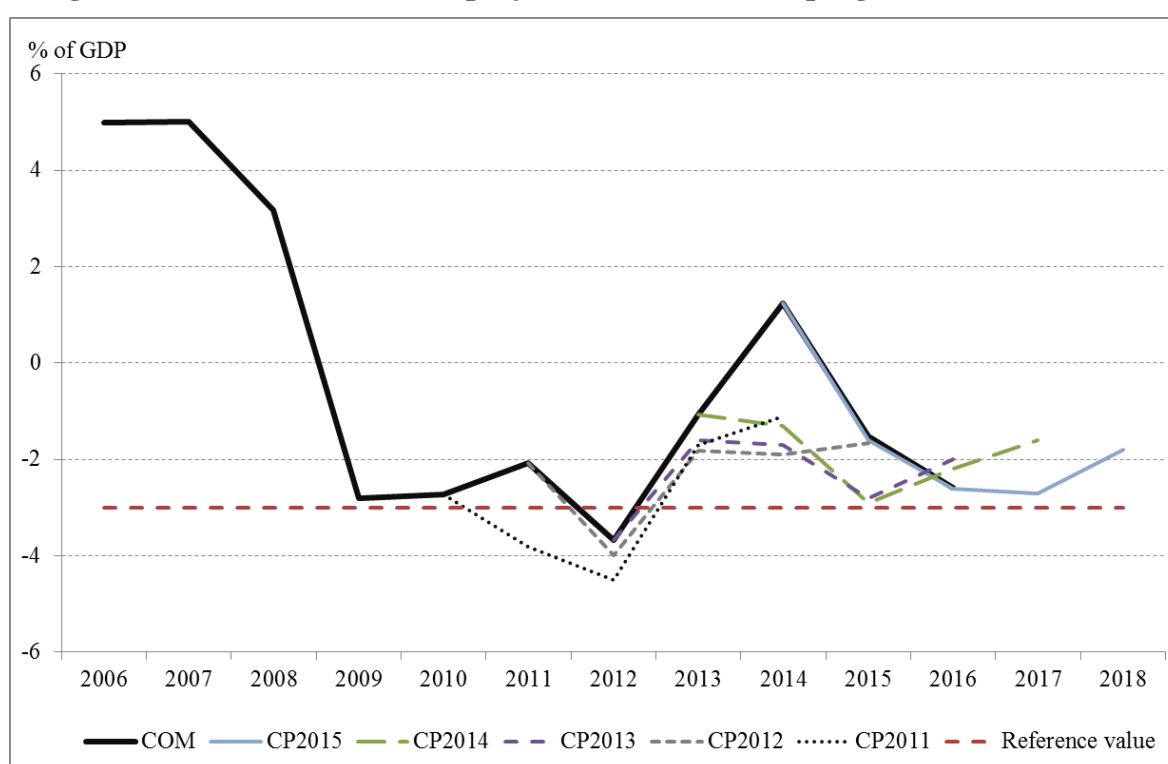
Source: Commission 2015 spring forecast; Convergence Programmes

### 3.4. Risk assessment

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

On the expenditure side, the implementation of the binding multiannual expenditure ceilings on all three levels of government, which took effect in 2014, appears to have significantly improved budgetary control. The expenditure ceilings are supplemented with sanction mechanisms that are activated if a ceiling is breached. Spending by municipalities was the main driver of higher-than-planned public consumption in the 1990s and 2000s, and the strengthening of the budgetary framework appears to have put an end to this trend.

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



Source: Commission 2015 spring forecast; stability and Convergence Programmes

The (recalculated) structural balance in the Convergence Programme and the estimates in the Commission 2015 spring forecast are in line for 2015, while there is a significant difference for 2016. According to the (recalculated) structural balance, a deficit of 0.6% of GDP is expected in 2016, while the Commission 2015 spring forecast projects a deficit of 1.4% of GDP. The difference stems from the fact that, contrary to the methodological approach followed by the Commission, temporary fluctuations in the before-mentioned volatile revenue items vis-à-vis an estimated structural level have been treated as one-off in the Convergence Programme, in line with the national methodology for calculating the structural balance<sup>4</sup>. As a

<sup>4</sup> On 5 May 2015, the Danish Ministry of Finance submitted a note explaining the main differences on the estimation of the structural balance, between the Danish Ministry of Finance's methodology and the commonly agreed methodology used by the Commission.

number of volatile revenue items are expected to generate revenues below their structural levels in 2016, this has a direct negative impact on the Commission's estimate of the structural balance.

Due to the favourable initial position, with a relatively low gross debt level, and a stable fiscal outlook, risks concerning debt developments are assessed to be limited.

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

##### **Box 1. Council recommendations addressed to Denmark**

On 8 July 2014, the Council addressed recommendations to Denmark in the context of the European Semester. In the area of public finances the Council recommended that Denmark, following the correction of the excessive deficit, continues to pursue a growth-friendly fiscal policy and preserve a sound fiscal position, ensuring that the medium-term budgetary objective continues to be adhered to throughout the period covered by the Convergence Programme.

Denmark met its MTO in 2014, reaching an estimated structural surplus of 0.5% of GDP, mainly reflecting windfall revenues from the pension yield tax.

Denmark is projected to remain at the MTO in 2015 and is therefore assessed to be compliant with the requirements. The risks vis-à-vis this outcome are assessed to be broadly balanced.

For 2016, the Commission 2015 spring forecast projects a structural deficit of 1.4% of GDP, while the (recalculated) structural deficit is estimated at 0.6% of GDP. The difference between the (recalculated) structural deficit and the spring forecast stems from a different treatment of temporary fluctuations in the before-mentioned volatile revenue items in the Convergence Programme and in the Commission's forecast. The pension yield tax is for example estimated to generate revenues corresponding to 1.9% of GDP in 2015, while the structural level of revenues is estimated to be in the order of 1.1%. Windfall revenues from this tax in 2015, i.e. revenues in excess of the structural level, would therefore correspond to 0.8% of GDP. In 2016, on the other hand, pension yield tax revenues are expected to fall below its structural level due to a gradual normalisation of interest rates, generating revenues that are 0.2% below the structural level.

According to the national methodology for calculating the structural balance, the deviation of volatile revenue items from their estimated structural levels is corrected for. According to the commonly agreed methodology that is applied in the Commission's forecast, such a correction is not made. The expected decline in pension yield tax revenue from 2015 to 2016 mentioned above, therefore, leads to a deterioration of the structural balance of 1 pps. of GDP according to the Commission's forecast, while it does not have an impact on the structural balance based on the national methodology (unless the structural level changes).

The Commission 2015 spring forecast also points to some deviation in 2016 from the expenditure benchmark (real net expenditure growing by 1.7%, compared to a benchmark of 1.1%, corresponding to a one-year deviation of -0.3% of GDP), while the Convergence Programme projects no deviation (real net expenditure growth of -1.2%, compared to a benchmark of 1.1%, corresponding to a one-year growth differential of 1.2% of GDP). The difference between the Commission's forecast and the Convergence Programme is related to the treatment of the phasing out of the capital pension taxation restructuring in 2015-2016.

**Table 4: Compliance with the requirements under the preventive arm**

(% of GDP)	2014	2015		2016	
Initial position <sup>1</sup>					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance <sup>2</sup> (COM)	0.4	-0.5		-1.4	
Structural balance based on freezing (COM)	1.2	-0.5		-	
Position vis-a -vis the MTO <sup>3</sup>	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	2014	2015		2016	
	COM	CP	COM	CP	COM
Structural balance pillar					
Required adjustment <sup>4</sup>	0.0	0.0		0.0	
Required adjustment corrected <sup>5</sup>	-1.6	-1.7		0.0	
Change in structural balance <sup>6</sup>	0.3	-0.8	-0.9	-0.1	-0.9
One-year deviation from the required adjustment <sup>7</sup>	2.0	0.9	0.8	-0.1	-0.9
Two-year average deviation from the required adjustment <sup>7</sup>	In EDP	1.4	1.4	0.4	-0.1
Expenditure benchmark pillar					
Applicable reference rate <sup>8</sup>	n.a. (structural balance above the MTO)			1.1	
One-year deviation <sup>9</sup>				0.5	-0.3
Two-year average deviation <sup>9</sup>				1.4	-0.3
Conclusion					
Conclusion over one year	Compliance			Overall assessment	Overall assessment
Conclusion over two years				Compliance	Overall assessment
Notes					
<sup>1</sup> 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 is allowed in order to be evaluated as having reached the MTO.					
<sup>2</sup> Structural balance = cyclically-adjusted government balance excluding one-off measures.					
<sup>3</sup> Based on the relevant structural balance at year t-1.					
<sup>4</sup> 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 28.).					
<sup>5</sup> Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.					
<sup>6</sup> Change in the structural balance compared to year t-1.					
<sup>7</sup> The difference of the change in the structural balance and the required adjustment corrected.					
<sup>8</sup> 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 not at its MTO.					
<sup>9</sup> 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 2015 spring forecasts (COM); Commission calculations.					

Discretionary revenue measures (including one-off measures) are taken on board in the calculation of the net expenditure growth in the Commission 2015 spring forecast, while one-off measures are not included in the measure of 'incremental impact of discretionary revenue measure' in the Convergence Programme. In the absence of the phasing out of this measure,

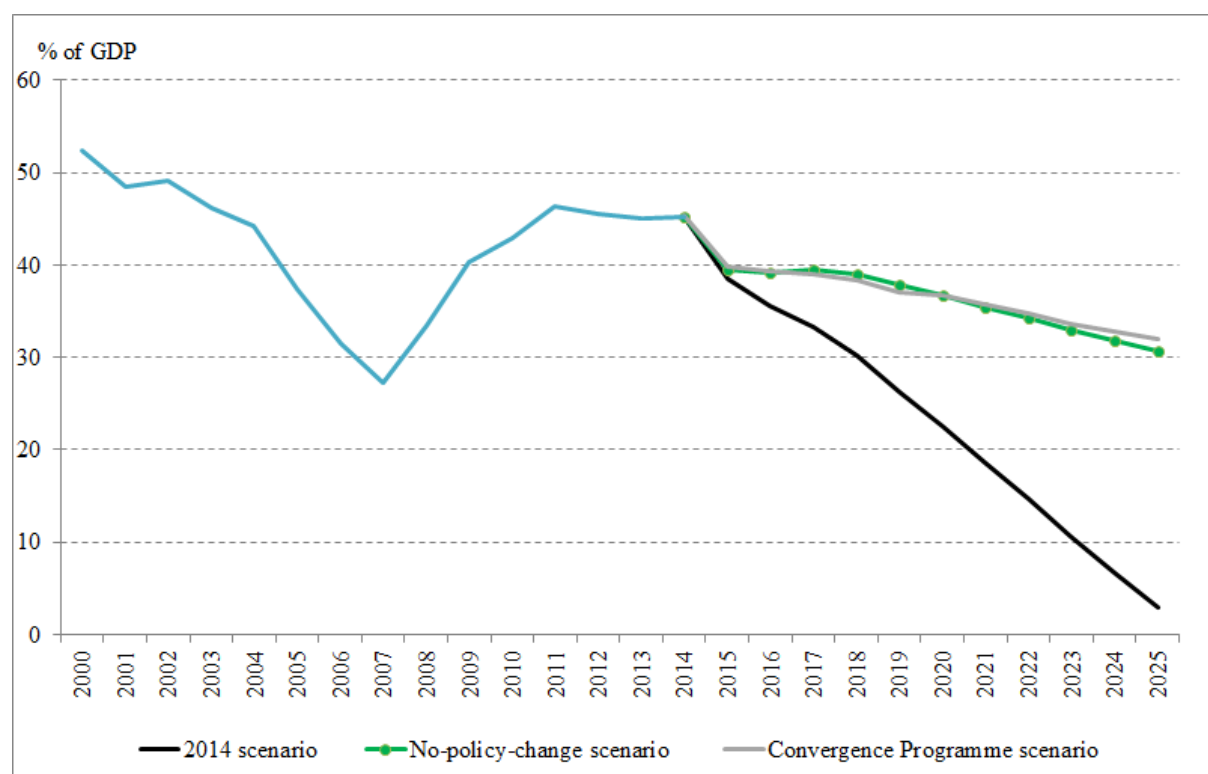
the Commission's assessment would be in line with the Convergence Programme, i.e. no deviation in the expenditure benchmark, neither on the single year assessment nor on the two-year average. According to current plans, the one-off capital pension taxation restructuring measure is fully phased-out in 2016, and its impact on the expenditure benchmark calculations will therefore vanish in the years beyond 2016.

To sum up, based on the outturn data and the Commission 2015 spring forecast, the ex-post assessment suggests compliance with the requirements in 2014. In 2015, Denmark is projected to be at the MTO of -0.5% of GDP and thereby remains to be compliant with the requirements. In 2016, the structural balance is projected to deteriorate to a deficit of 1.4% of GDP according to the Commission's forecast, while the (recalculated) structural balance in the Convergence Programme points to a structural deficit of 0.6% of GDP, marginally below the MTO. Following an overall assessment, the Commission is of the opinion that there is a risk of some deviation from the MTO in 2016.

## 5. LONG-TERM SUSTAINABILITY

The analysis in this section includes the new long-term budgetary projections of age-related expenditure (pension, health care, long-term care, education and unemployment benefits) from the 2015 Ageing Report<sup>5</sup> published on 12 May. It therefore updates the assessment made in the Country Reports<sup>6</sup> published on 26 February.

**Figure 3: Gross debt as % of GDP – Medium-term debt projections**



Source: Commission calculations

<sup>5</sup> See [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/2015/ee3\\_en.htm](http://ec.europa.eu/economy_finance/publications/european_economy/2015/ee3_en.htm)

<sup>6</sup> See [http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index\\_en.htm](http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm)

Denmark appears to face low fiscal sustainability risks. The medium-term sustainability gap, is at -2.6% of GDP, indicating low risks in the medium-term. Also in the long-term, Denmark appears to face low risks, both reflecting the structural primary balance in 2016 and the projected decrease of ageing costs over the very long run. The long-term sustainability gap shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, and is estimated at 1.4% of GDP.

**Table 5: Sustainability indicators**[illegible]

## **6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES<sup>7</sup>**

### **6.1. 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 fiscal framework in Denmark consists of the Budget Law, a medium-term budgetary strategy (currently up to 2020), as well as the Stability and Growth Pact. The basic budgetary principle of the framework targets fiscal sustainability and achieving a structural general government balance or surplus 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 – a correction mechanism will be triggered.

The fiscal objectives are supported by binding, multiannual expenditure ceilings, which apply for all three levels of governance and cover around ¾ of all public expenditures. Current expenditure ceilings are fixed by law for the period 2015-2018, while expenditure ceilings for the following year, 2019, will be proposed together with the Budget Bill proposal in August. 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.

### **6.2. Quality of public finances**

The expenditure ratio was generally on a declining path from the early 1990s until the outbreak of the crisis, declining from close to 60% of GDP in 1993 to just below 50% in 2007. Danish public finances are generally characterised by strong automatic stabilisers, and the financial crisis led to a sharp increase of 6.3 pps of GDP in public expenditures from 2008 to 2009, both due an increase in expenditures and due to nominator effects from the fall in GDP. The expenditure rate has remained broadly stable at an elevated level in the years 2009-2014. Expenditure on social protection accounts for 43% of general government expenditure.

At 3.8% of GDP, the public investment rate reached the highest level in 35 years in 2014. The Convergence Programme projects a normalisation of the public investment ratio, it is however expected to remain at a level above the historical average.

Public revenues has remained broadly stable at close to 55% of GDP since the mid-1980s, but have been boosted in 2013-2014 by one-off revenues from the restructuring of capital pensions. Looking forward, the public revenues ratio is projected to decrease gradually, reaching a level of 51% of GDP in 2020, in particular reflecting a reduction in the share of revenues from personal income taxes.

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<sup>7</sup> This section complements the Country Report published on 26 February 2015 and updates it with the information included in the Convergence Programme.

## **7. CONCLUSIONS**

In 2014, Denmark achieved a structural balance surplus of 0.4% of GDP, an improvement of 0.3% of GDP compared to 2013. The growth rate of government expenditure, net of discretionary revenue measures, also remains below the applicable expenditure benchmark rate.

The (recalculated) structural balance is expected to deteriorate from a surplus of 0.4% in 2014 to a deficit of 0.5% of GDP in 2015, which corresponds to the MTO. In 2016-2018, the structural balance deficit is expected to hover around 0.6-0.7% of GDP, broadly in line with the MTO. According to the Convergence Programme, growth in government expenditure, net of discretionary revenue measures, is expected to remain below the reference rate of the expenditure benchmark measured both on the single year and the two-year average calculation.

However, according to the Commission 2015 spring forecast, there is a risk of some deviation in 2016 driven by lower expected revenues from volatile revenue items such as pension yield taxes and revenues from oil and gas drilling in the North Sea, while on the deviation based on the expenditure benchmark pillar mainly reflects the phasing out of the restructuring of the capital pension taxation.



## ANNEX

Table I. Macroeconomic indicators

	1997-2001	2002-2006	2007-2011	2012	2013	2014	2015	2016
<b>Core indicators</b>								
GDP growth rate	2.6	1.9	-0.4	-0.7	-0.5	1.1	1.8	2.1
Output gap <sup>1</sup>	2.1	1.7	-1.0	-3.5	-4.3	-3.8	-2.8	-1.9
HICP (annual % change)	2.1	1.8	2.2	2.4	0.5	0.3	0.6	1.7
Domestic demand (annual % change) <sup>2</sup>	2.3	2.9	-0.6	-0.3	-0.2	1.7	1.7	1.9
Unemployment rate (% of labour force) <sup>3</sup>	4.8	4.8	5.7	7.5	7.0	6.6	6.2	5.9
Gross fixed capital formation (% of GDP)	21.2	21.4	20.6	18.3	18.3	18.7	19.0	19.4
Gross national saving (% of GDP)	24.1	25.9	25.0	24.6	26.0	25.6	25.8	26.2
<b>General Government (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>0.5</b>	<b>2.4</b>	<b>0.1</b>	<b>-3.7</b>	<b>-1.1</b>	<b>1.2</b>	<b>-1.5</b>	<b>-2.6</b>
<b>Gross debt</b>	<b>50.4</b>	<b>41.7</b>	<b>38.1</b>	<b>45.6</b>	<b>45.0</b>	<b>45.2</b>	<b>39.5</b>	<b>39.2</b>
<b>Net financial assets</b>	<b>-27.1</b>	<b>-12.5</b>	<b>2.6</b>	<b>-7.3</b>	<b>-5.5</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	54.7	54.6	54.3	55.1	56.0	58.5	54.8	52.3
Total expenditure	54.3	52.2	54.2	58.8	57.1	57.2	56.3	54.9
<i>of which: Interest</i>	4.2	2.4	1.8	1.8	1.7	1.6	1.5	1.3
<b>Corporations (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>5.7</b>	<b>4.6</b>	<b>5.8</b>	<b>8.7</b>	<b>9.1</b>	<b>8.4</b>	<b>7.5</b>	<b>7.4</b>
<b>Net financial assets; non-financial corporations</b>	<b>-61.8</b>	<b>-65.1</b>	<b>-83.8</b>	<b>-64.1</b>	<b>-68.8</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets; financial corporations</b>	<b>-4.7</b>	<b>-12.2</b>	<b>-1.4</b>	<b>-3.7</b>	<b>-5.4</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	13.3	12.9	12.1	10.6	10.7	11.2	11.5	12.0
Gross operating surplus	21.9	22.6	21.7	22.2	22.0	21.8	21.7	22.0
<b>Households and NPISH (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-3.8</b>	<b>-3.2</b>	<b>-2.1</b>	<b>0.7</b>	<b>-0.8</b>	<b>-3.4</b>	<b>1.0</b>	<b>0.4</b>
<b>Net financial assets</b>	<b>74.9</b>	<b>83.5</b>	<b>89.6</b>	<b>112.1</b>	<b>118.6</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	47.3	46.7	48.3	49.1	49.0	49.5	49.4	49.1
Net property income	0.8	1.9	1.4	2.0	2.2	2.4	2.4	2.4
Current transfers received	22.6	23.0	23.5	24.7	25.9	25.7	24.8	24.4
Gross saving	1.9	3.3	3.5	3.7	3.5	1.0	4.7	5.9
<b>Rest of the world (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>2.3</b>	<b>3.7</b>	<b>3.8</b>	<b>5.6</b>	<b>7.2</b>	<b>6.2</b>	<b>7.0</b>	<b>5.3</b>
<b>Net financial assets</b>	<b>19.2</b>	<b>6.8</b>	<b>-5.8</b>	<b>-35.2</b>	<b>-37.6</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	5.5	5.7	4.4	5.4	5.7	5.3	5.5	5.6
Net primary income from the rest of the world	-1.3	0.1	1.3	2.3	3.6	2.9	3.0	3.0
Net capital transactions	0.1	0.0	0.1	0.0	0.0	0.0	0.8	-0.9
Tradable sector	41.6	40.2	38.1	37.7	37.3	37.3	n.a	n.a
Non tradable sector	44.2	45.3	47.8	48.5	48.8	49.1	n.a	n.a
<i>of which: Building and construction sector</i>	4.4	4.6	4.5	3.9	3.8	3.8	n.a	n.a
Real effective exchange rate (index, 2000=100)	85.1	91.1	100.3	95.5	98.3	99.8	95.7	95.1
Terms of trade goods and services (index, 2000=100)	92.4	95.1	97.8	98.0	99.4	99.9	100.1	99.8
Market performance of exports (index, 2000=100)	108.0	108.3	104.1	101.4	100.6	99.3	98.3	97.7

**Notes:**

<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

<sup>2</sup> The indicator on domestic demand includes stocks.

<sup>3</sup> 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; Commission 2015 spring forecast (COM)