Ministry of Economic Affairs
Ministry of Finance

Updated Convergence Programme for Denmark

1. Introduction

Denmark hereby presents an update of the convergence program of December, 1999[1].

The convergence program is based on the targets for the government for economic developments up to 2005:

- Securing sustainability of public finances by maintaining surpluses on the balance of the public sector averaging 2-3 per cent of GDP.
- Growth in public consumption is dampened to 1 per cent annually.
- The tax burden is expected to fall.
- Low and stable inflation.
- Reduction of the foreign debt.
- An increase in the labour force of appr. 80,000 persons.

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1) The convergence program is prepared in accordance with the Council Regulation on the Stability and Growth Pact (no. 1466/97). According to this regulation, the Euro countries will prepare stability programs whereas the other countries will prepare convergence programs. The update of the Danish convergence program will be put before Folketinget (Danish parliament).

- Unemployment is to be reduced to around 5 per cent.

The economic-policy strategy and the economic objectives and targets are considered to continue to meet the requirements of the Stability and Growth Pact and the broad economic policy guidelines recommended by the Commission.

After the Euro referendum in September, 2000, the fixed-exchange-rate policy has been maintained within the framework of the narrow ERM2 band of ± 2 1/4 per cent. The interest differential vis-a-vis the Euro has not increased in relation to the level before calling the referendum but is slightly higher than expected in a situation where the result of the referendum had resulted in a "yes".

The economic policy is designed to sustain the stability of Danish economy and to provide a sustainable economic development. Structural improvements are being made not least in the tax, educational/training, and labour market areas in order that the economic objectives and targets can be achieved.

The Danish economy is very much dependent on developments in the surrounding world, including not least developments in the EU, covering around 70% of Danish foreign trade. The government thus attaches great importance to provide - particularly through the broad guidelines of economic policies and the employment guidelines - the basis for a stable economic development in Europe.

2. Economic Policy

Along with structural reforms, seven years of solid economic progress has brought about a marked improvement of public finances and cut unemployment to appr. 4 1/4 per cent in 2000 (Eurostat definition). This economic growth did, however, also lead to a deterioration of the balance of payments as well as pressure on the labour market, resulting in higher pay increases.

To dampen domestic demand and ease the pressure on the labour market, heavy austerity measures were adopted in 1998 by way of the so-called Whitsun economic retrenchment package. The latter is gradually being phased in during the period of 1999 to 2002. These measures of resulted in a clear slow-down in domestic demand already in 1999. At the same time, exports showed substantial growth, thus achieving an improved composition of demand with greater emphasis on exports.

In the last couple of years inflation in Denmark has been somewhat above that of the Euro area. The current upturn in the Euro area - and the more subdued growth in Denmark - is expected to contribute to approximate Danish inflation to the inflation in the Euro countries in the coming years.

The government attaches great importance to having wage and price developments subdued in order to comply with the convergence criterion for inflation, and so as not to damage the credibility of the fixed exchange rate policy and the potential of a continued high rate of employment. Further, government endeavours to intensify competition on the goods and services markets may contribute to reduce the rate of price increases.

The fixed exchange-rate policy is a central element of the economic policy. So it is the task of monetary policy to ensure a stable exchange rate. The exchange rate has been stable at DKK 7.43 - 7.45 per Euro since the introduction of the Euro on January 1, 1999, with larger fluctuations around the Euro referendum on September 28, 2000. Danmarks Nationalbank's increase of the lending rate and the interest on deposit certificates by half a percentage point the day after the vote has, combined with a stable Danish economy, contributed to maintaining the Danish Krone rate in relation to the Euro close to the central rate. Recently, Danmarks Nationalbank has been able to normalise monetary policy, making it similar to the situation prior to the referendum.

The short-term interest rate differential has narrowed to 0.35 percentage points medio December, equivalent to the level before the Euro vote was called. The expected strengthening of the Euro is foreseen to trigger an increase of the interest differential to 0.55 percentage points in 2002, as historically the interest differential has increaeed in periods of a rising DM vis-a-vis the dollar.

The economic upturn and structural improvements have resulted in a surplus on the general government budget since 1997. In 2000, a surplus is predicted equivalent to 2.7 per cent of GDP and the surplus is expected to increase in 2001 to 2.8 per cent of GDP. In 2002, the surplus is expected to amount to 2.6 per cent of GDP. After this, the annual surpluses are expected to be just over 2 1/2 per cent of GDP in the years up to 2005.

The fiscal policy is neutral in 2000. The adjustments of the income taxes contained in the Whitsun package reduce the tax value of interest deductions, a fact increasing the savings incentive and dampening economic activity. The overall economic policy thus leads to a moderate dampening of economic growth in 2000. In 2001 economic policy will be largely neutral owing to the long-term structural effects from the Whitsun package whereas the actual fiscal policy is slightly expansionary, equivalent to a fiscal effect of appr. 1/2 per cent of the GDP. For 2002, a more or less neutral fiscal policy has been assumed.

Public expenditure is expected to increase by nearly 1 per cent in 2000. Due to local government budgets and the Finance Act agreements, public expenditure is, however, expected to rise by just over 2 per cent in 2001. Public investments are given a higher priority in 2000 and 2001, and will show a real increase of 6 per cent in both years. Also, local government income taxes will rise by nearly 1/2 percentage point in 2001 and will thus reduce the activity effect of the increase in public expenditure.The public gross debt is clearly below the convergence criterion and is expected to be further reduced to 48 per cent of the GNP in 2000, 45 per cent in 2001, and appr. 34 per cent in 2005.

It is the objective of the government that the growth in public expenditure be moderated with a view to easing the pressure on the labour market and the tax burden. According to the agreements on local government economy, local councils will contribute to ensure that the growth rate in public expenditure may be cut to 1 per cent in the years ahead. On account of the underlying expenditure pressure, this will make strong demands on the effectiveness and changed priorities in the public sector.

It is an important element of the government medium-term strategy that the period up to 2005 be used to considerably reduce public debt. The debt reduction aims to ensure that the economic challenges from the ageing of the population may be handled without necessitating at a later stage heavy tax increases or service reductions. Furthermore, the continued consolidation of public finance will provide a buffer in the event of unfavourable cyclical developments.

Some of the fall in the tax burden is part of the further phasing-in of the Whitsun package. Furthermore, a minor tax reduction is assumed as part of tax restructuring. The aim is to stimulate labour surpply and alleviate pressure on the tax bases stemming from increased mobility of goods and capital - including adjustment of taxes on goods particularly exposed to cross-border trading. The assumed fall in tax burden will, however, depend on whether the assumed public expenditure control is realized.

In recent years, a number of imporant structural reforms have been adopted:

- The introduction of the Whitsun package entails an *adjustment of the tax system* in the years of 1999-2002. The tax changes entail, among other things, relatively large cuts reductions in the marginal tax rate for lower incomes, a lower value of tax deductions particularly for interest payments, and higher green taxes. Thus, the incentives to work and to save up are increased while at the same time supporting an environmentally sustainable development.

- *The reform of corporate taxation* contained in the Finance Act for 2001 reduces the corporate tax rate from 32 per cent to 30 per cent in 2001; at the same time, depreciation provisions are tightened. The objective is to achieve an improved structure in business taxation. Favourable tax depreciation provisions will benefit particularly capital intensive lines of business. The tax restructuring aims to reduce these tax concessions to make room for a reduction of the corporate and business tax benefiting the entire industry and trade, and not merely selected lines of business.

- In 1999, a number of changes were introduced, inducing senior citizens to postpone the time of their *retirement from the labour market.* Also, the possibilities of having paid work while receiving early retirement benefit have been improved. Furthermore, an early retirement contribution was introduced so as to make the contribution made by the individual to the funding of the early retirement scheme more visible. It is estimated that these measures may increase the average retirement age by slighly more than half a year, cf. Ministry of Economic Affairs report: *A Sustainable Pension System,* of 2000.

- The implementation of the third stage of the *labour market reform* has continued in 2000. The shortening of the total benefit period from 5 to 4 years and the advancing of the right and duty of activation have continued and are expected to be completed early 2001, cf. box 1. The Finance Act for 2001 contains minor adjustments of the labour market reform, including a new instrument in the active labour market policy, aiming to support the job search by unemployed.

- In connection with the Finance Act for 2000, a reform of the *adult training and retraining* (ATR) has been agreed, adding to the responsibility of the labour market parties for education and training and entailing more focused target direction of the ATR efforts.

- Further, early December, 2000, agreement was achieved on an *early retirement pension reform* and the inclusive labour market. This reform, coming into effect on January 1, 2003, will simplify the early retirement pension system and support the active line, with as few people as possible on passive maintenance. Due to this reform, only persons who cannot be brought to manage in supported or unsupported jobs may be granted early retirement pension. This reform assumes that an intensified effort be made to create more flex jobs (i.e. jobs with salary supplement) so that more people with reduced fitness for work may be employed.

The labour force need to be increased considerably if the government medium-term objectives for employment, public finance, etc. are to be achieved. Since the demographic development entails a fall in the labour force in the years to come, the active participation of the particular age groups will have to be increased. The labour market reforms and the change in the retirement system are significant elements in these endeavours. To this should be added development of the inclusive labour market and better integration of immigrants. There will be a need of continued structural improvement in the years ahead if the 2005 targets for Danish economy are to be realized.

Box 1. Denmark's National Action Plan for Employment 2000

The national action plan for employment is part of the EU coordinated employment strategy. The Council will provide each year common employment guidelines, to be allowed for by the countries in their own employment policies, and the Council may also make recommendations for the employment policies of the particular countries. The action plan, published in May, 2000, accounts for how Denmark has followed up on guidelines and recommendations.

The guidelines are distributed on four pillars:
- *Improving employability.* In this pillar, particularly the active labour market policy is accounted for. Denmark already meets the guideline that all young unemployed are to get an active offer within six months, and the advancing of the activation offers for adult unemployed has continued so that the target of an active offer before twelve months of unemployment is expected to be met early 2001. The results of an evaluation of the activation efforts particularly show that right and duty of activation has a motivating effect for the job search of those unemployed, and that activation generally leads to upgrading of skills and enhances the unemployed persons' possibilities of becoming employed. In this pillar, also the retirement reform, a number of initiatives in the educational/training area, as well as the endeavours to make the labour market more inclusive, are mentioned.
- *Developing entrepreneurship.* The government industrial development strategy dk.21 contains a number of initiatives for entrepreneurs. The continued phasing in of the Whitsun package contributes to render the tax and excise provisions more employment friendly.
- *Encouraging adaptability of businesses and their employees.* Particularly accounting for the fact that the renewal of the collective agreements in parts of the private labour market in the spring of 2000 generated a higher degree of flexibility with regard to local agreement based variation of the working hours and an increased potential of creating part-time jobs.
- *Strengthening equal opportunities policies for men and women.* The principle of equal opportunities for men and women is sought integrated in the implementation of all guidelines. The framework conditions of families with dependent children have been improved through continued extended care potential for children.

Denmark is to follow up on two recommendations:
- The reforms of the tax and transfer systems are to continue with a view to increasing the labour supply. The Danish initiatives in this area particularly cover the implementation of the Whitsun economic retrenchment package, the advancing of the activation offers, and the retirement reform.
- Promoting education/training and job potential for unemployed women and reducing the gender segregation on the labour market. In the PES system a number of initiatives have been taken aiming to promote equal opportunities on the labour market. Female overrepresentation in unemployment in relation to men has been falling in the period of 1997-99.

3. Prospects and Targets for the Economic Developments through 2005

Denmark fulfilled the convergence criteria in 1999, and with a wide margin, too, for three of the criteria, cf. table 1.

The real growth in GDP in 2000 is expected to be 2 1/2 per cent. The comparatively strong growth is primarily due to a relativly big increase in exports, as well as a strong growth in investment, particularly due to the repair work after the damage caused by the hurricane in December, 1999. This period further saw a clear slow-down of private consumption which is estimated to increase by 0.2 per cent in 2000.

The GDP growth in 2001 and 2002 will be more subdued, at around 1 3/4 per cent. This is required to ensure a more balanced development including dampening of the inflation pressure.

The medium-term projection has been resumed in table 2, and table B.1 shows a comparison with the previous convergence program. In 2003-2005, GDP growth is thought to be at the medium-term growth potential of 1.7 per cent per year.

Table 1. The Convergence Situation in 1999

	Consumer prices[1]	Long-term interest rate[2]	General government budget	Government gross debt (ult.)
	- Increase rate in relation to 1998 -	- Per cent per year -	- Per cent of GNP -	- Per cent of GNP -
Denmark	2,1	4,9	2,8[3]	52,6
EU countries	1,2	4,7	-0,7	67,5
Euro countries	1,1	4,6	-1,3	72,1
The Convergence Criterion	2,1	6,8	-3,0	60,0

1) EU Harmonized Index of Consumer Price (HICP)
2) 10-year government bonds.
3) According to revised figures from Statistics Denmark the general government surplus in 1999 is 0,3 percentage points higher than stated here.

Table 2. Convergence Programme Key Figures

	1999	2000	2001	2002	2003	2004	2005
Percentage change:							
Real GNP	1,7	2,4	1,8	1,7	1,7	1,6	1,7
Consumer price index (HICP)	2,1	2,8	2,5	1,8	2,0	2,0	2,0
Per cent of GDP:							
General government budget[1)]	2,8	2,7	2,8	2,6	2,6	2,7	2,9
Structural budget balance	2,2	1,9	2,4	2,6	2,6	2,7	2,9
Government gross debt (year-end.)	52,6	48,3	44,7	41,8	39,2	36,8	33,7
Balance of current account	2,2	2,3	2,5	2,6	2,6	2,6	2,6
Foreign debt (year-end)	14,3	13,6	10,5	7,5	4,6	1,8	-0,9
Per cent:							
Long-term interest rate (10-year government bond)	4,9	5,7	5,9	5,9	6,1	6,3	6,3
Per cent of the work force:							
Unemployment	5,6	5,3	5,3	5,2	5,2	5,1	5,0
Do., EU-definition	5,2	4,7	4,7	4,6	4,6	4,5	4,4

Kilde: For 1999-2002 the figures are according to Economic Survey, December 2000.

1) Statistics Denmarks latest revision of the public finance for 1999 has not been included. According to the revised figures the General government surplus in 1999 is 0,3 points higher than stated here.

In 2000 and 2001, a surplus on the total general government finances of 2 1/4 per cent of GDP is estimated. From 2002 to 2005, a surplus of just over 2 1/2 per cent of the GDP is expected. The government medium-term budget target is thus expected to be met up to 2005. The debt quota is expected to fall from 48 per cent of GDP in 2000 to nearly 34 per cent in 2005.

Employment will grow by an average 14,000 persons (1/2 per cent) per year up to 2005, and unemployment is anticipated to fall to 4 1/2 per cent in 2005.

A fairly substantial surplus on the external current account of 2.3 per cent of GDP is expected in 2000 . The surplus is assumed to be 2 1/2 per cent of GDP up to 2005 so that the foreign debt will have been settled by 2005.

Table 3. GDP and consumption deflator, consumption and net price index as well as harmonized index of consumer prize.

	1999	2000	2001	2002	2003	2004	2005
GDP deflator	2,7	3,0	2,5	1,9	2,1	2,1	2,1
Consumption deflator	2,6	3,4	2,6	1,9	1,9	1,9	1,9
Consumer price index	2,5	2,9	2,5	1,8	2,0	2,0	2,0
EU harmonized index of consumer price (HICP)	2,1	2,8	2,5	1,8	2,0	2,0	2,0
Net price index[1)]	2,1	3,2	2,4	1,9	1,7	1,6	1,6
Euro-11 inflation (HICP)[2)]	1,1	2,4	2,2	1,9			

1) The caluculation method for consumer and net price index has been changed from January, 2000.
2) Source: EU-Commission Autumn Forecast

Based on the agreements made, and due to the subdued growth and improvement in the labour market structure, the wage growth is expected to fall from 4 per cent in 2000 to 3 3/4 per cent in 2001 and 3 1/2 per cent in 2002. In the remaining part of the projection period, an annual increase of 3 3/4 per cent is expected, largely equivalent to the increase assumed abroad.

Consumer prices are expected to rise by nearly 3 per cent in 2000, cf. table 3. In 2001, the increase is estimated to be 2.5 per cent, and in the rest of this period the growth rate is expected to be appr. 2 per cent annually. The difference between the development in the consumer price index and the net price index in the period of 2003 to 2005 is due to the fact that continued shifting from income taxes to green taxes has been assumed.

The EU harmonized price index (HICP) has risen a little slower than the national consumer price index in 2000, and for the year as a whole the HICP is estimated to increase by 2.8 per cent. In the years ahead, there will be only marginal differences between the increases in the two indices.[2)]

The Danish increase in consumer prices in 2000 has been moving around the convergence limit, particularly to be viewed as an effect from the fact that wage increases in Denmark are relatively higher due to Denmark being at a rather advanced stage of the cyclical trend. Also, it is due to moderate price increases in Sweden and Great Britain.

The relatively high rate of inflation in Denmark is thought to be a temporary matter, and the difference between the inflation in Denmark and the euro area is expected to disappear in 2002 when the decreasing wage growth will gradually make its impact.

Assumptions on Development Abroad

The assumptions of the projection on the development abroad appear from table 4.

Table 4. Assumptions regarding international developments

	1999	2000	2001	2002	2003	2004	2005
Annual growth (per cent):							
Real GDP abroad (weighted by export)	2,5	3,6	3,2	2,7	2,4	2,3	2,3
Danish manufactured export markets (real)	4,2	9,2	8,1	6,9	4,8	4,6	4,6
Hourly wage abroad (weighted by export)	3,0	3,2	3,3	3,5	3,8	3,8	3,8
Germany, 10-year euro interest per cent	4,5	5,3	5,4	5,4	5,5	5,6	5,6

Note: The 2000-2002 figures are in accordance with the assumptions in *Economic Survey, December, 2000.*

2) As from January, 2000, there was a change in the calculation method for the national consumer price index taking the increase in this close to the increase in the EU harmonized consumer price index (HICP) by which the convergence is determined. The remaining slight difference derives from the housing item.

The market growth for Danish industrial exports is expected to drop from 9 per cent in 2000 to 7 per cent in 2002 along with the dampening of the European trade outlook. After this, the market growth is expected to be gradually subdued, to 5 in 2003 and slightly over 4 1/2 per cent in 2005.

The average wage growth rate abroad is expected to increase from 3.2 per cent in 2000 to 3.5 per cent in 2002. In the remaining part of the projection period, the wage growth rate abroad is expected to remain at 3 1/4 per cent annually. Compared to the expected domestic pay increase, this will ease Denmark's situation with regard to competitiveness and convergence for the inflation.

On this background, the real growth in Danish industrial exports is expected to gradually decline from 7 per cent in 2000 to 6 1/2 per cent in 2002. After this, the growth in industrial exports is expected to decrease to just over 4 per cent in 2005, cf. table B.1.

The 10 years government bond rate in the euro area is expected to rise from 5.3 per cent per year in 2000 to 5.4 per cent in 2002. After that, a slight increase is expected to slightly over 5 1/2 per cent in 2003-2005. In view of this, the government bond rate in Denmark is thought to rise from 5.7 per cent in 2000 to slightly over 6 per cent in 2005, as the long-term interest differential in relation to the euro is expected to be increased from 0.4 points in 2000 to 0.7 points in 2005.

In the past part of 2000, the Danish krone has been stable in relation to the Euro, and the value of Euro measured in Danish kroner is close to the central rate. The long-term interest differential to the Euro area is currently just over 0.3 points.

4. General Government Budget

It is the aim of the government to maintain a general government finances surplus over the business cycle. Thus aiming to reduce the public gross debt. The consolidation has been one of the chief objectives of the Danish government. This aim is maintained so that the public debt may be reduced to nearly 45 per cent in 2001 and to appr. 34 per cent in 2005, cf. table 5.

The surplus on the general government finances is predicted to be in 2000 2.7 per cent of GDP. In 2001, a surplus of 2.8 per cent of GDP is expected. For 2002 and 2003, a surplus of 2.6 per cent of GDP is expected. The decrease in the surplus in 2002 may particularly be referred to the Whitsun package income tax reductions of nearly 0.3 per cent of GDP, the lower-bracket tax rate being reduced by 3/4 percentage points and the middle-bracket tax rate limit being increased by DKK 8,000. The tax value of tax deductions will be reduced.

Up to 2005, it is assumed that the surplus on general government finances will rise to 2.9 per cent of GDP.

Table 5. General Government budget

Per cent of GDP	1999	2000	2001	2002	2003	2004	2005
Primary expenditure	50,3	49,3	49,6	49,5	49,1	48,9	48,6
Primary revenue	55,2	53,9	54,0	53,5	52,9	52,6	52,2
Primary balance	4,9	4,6	4,4	4,0	3,8	3,7	3,6
Net interest payments	2,1	1,9	1,6	1,5	1,2	1,0	0,8
Budget balance	2,8	2,7	2,8	2,6	2,6	2,7	2,9
Here of:							
Central government	1,4	1,4	1,6	1,4	1,5	1,6	1,8
Municipalities	0,1						
Funds	1,3	1,3	1,2	1,1	1,1	1,1	1,1
Public debt	52,6	48,3	44,7	41,8	39,2	36,7	33,7

The expenditure for transfer payments and interest will make a falling share of GDP up to 2005. The consolidation of the public finance has caused a reduction in public interest expenditure. The public net interest expenses are thus estimated to be 1.6 per cent of the GDP in 2001, as against 1.9 per cent in 2000. In 2005, the net interest expenses are expected to be 0.8 per cent of GDP, cf. table 5.

In section 5, calculations have been made of the expense pressure from the rising number of senior citizens after 2005. These calculations show that the change in the composition of the population in Denmark will entail an increased load on public finance in year 2035 by an amount equivalent to 4 per cent of GDP. Keeping the surplus on public finances of an average 2-3 per cent of the GDP up to 2005 would set an appropriate rate of speed in reducing the debt, for lower public debt interest expenditure outbalancing the increasing expenditure on pensions, health services, and care of senior citizens. If, however, the debt rate reducing ambition is lowered, this would sooner or later require austerity measures which would, by virtue of compound interest, be heavier than the immediate relief.

The general government finances are quite sensitive to market fluctuations. Most estimates would seem to indicate that an increase in GDP of 1 per cent above the trend development in GDP would improve the balance by appr. 0.8 per cent of GDP. Thus entailing that if the growth up to 2005 would be l percentage point lower each year than assumed (i.e. an annual GDP growth of around 1 per cent), the general government balance 2005 will be appr. 4 percentage points lower than otherwise. In other words, any such lower growth would entail a deficit on general government finances of appr. 1 per cent of GDP in 2005. So Denmark would, even if in any such depressive development, meet the convergence criterion by a large margin.

Table 6. Fiscal policy 1999-2005

	1999	2000	2001	2002	2003	2004	2005
Budget balance (1)	2,8	2,7	2,8	2,6	2,6	2,7	2,9
Cyclical influence (2)	0,6	0,8	0,4	0,0	0,0	0,0	0,0
Structural balance (1)-(2)[1)]	2,2	1,9	2,4	2,6	2,6	2,7	2,9

1) The structural balance is based on the EU-Commission guidelines.

The structural budget surplus is expected to be improved from nearly 2 per cent of GDP in 2000 to 2.4 per cent in 2001, cf. table 6. The cyclical contribution to the balance is expected to decrease as the economic growth is being subdued. For 2005, a surplus on the structural budget of 2.9 per cent of GDP is expected.

Table 7. The composition of the General Government Budget

Per cent of GDP	1999	2000	2001	2002	2003	2004	2005
Budget balance:	2,8	2,7	2,8	2,6	2,6	2,7	2,9
Public expenditure/Cost pressure	55,0	53,5	53,5	53,2	52,5	52,0	51,4
-Primary expenditure	50,3	49,3	49,6	49,5	49,1	48,9	48,6
Government consumption	25,7	25,3	25,6	25,6	25,6	25,5	25,5
Government investments	1,7	1,7	1,8	1,8	1,8	1,8	1,8
Transfer payments	17,7	17,2	17,2	17,1	16,8	16,5	16,2
-Interest payments	4,7	4,3	3,9	3,7	3,4	3,0	2,8
Public revenue	57,8	56,2	56,4	55,8	55,1	54,7	54,3
-Tax burden	50,6	49,3	49,5	49,2	48,6	48,3	48,0
Personal tax and labour market contribution	26,3	26,2	26,3	25,9	25,0	24,7	24,5
Here of property value tax	0,0	0,7	0,7	0,7	0,7	0,7	0,6
Property Tax	1,1	1,1	1,1	1,1	1,1	1,1	1,1
Tax on real rate of return and Company Tax	4,1	3,4	3,7	3,8	3,4	3,4	3,3
Compulsory premiums	2,1	2,2	2,2	2,1	2,1	2,1	2,1
Duties	17,0	16,5	16,3	16,2	16,3	16,3	16,4
-Interest revenue	2,5	2,4	2,4	2,2	2,2	2,1	2,0
-Other revenue	4,7	4,5	4,5	4,4	4,3	4,3	4,3

The assessment of the increase in the structural surplus is subject to much uncertainty but should be viewed in the light of the fact that the effects of the pension and labour market reforms will gradually make their impact on employment and unemployment, cf. section 2. To this should be added that further structural improvements are assumed to occur up to 2005.

Local councils are obliged to maintain more or less equilibrium between revenues and expenses whereas the other part sectors - the central government as well as social funds - are expected to show a surplus in 2001, cf. table 5. This is expected to be maintained on an average up to 2005.

In the convergence program, the tax burden will fall from 49 per cent in 2000 to 48 per cent in 2005, cf. table 7. This fall is due to the further phasing in of the Whitsun package as well as a reserve for tax concessions to counteract the pressure on the tax bases by way of problems with the labour supply and mobile tax bases, as mentioned above. Along with the aim of continued debt consolidation, this development entails that in the years ahead the framework will be tight for the development in public expenses. In 2000 and 2001, a real growth in public consumption of nearly 1 and just over 2 per cent is expected. As from 2002, it is assumed that the real growth in public consumption will not exceed 1.0 per cent on an average.

Table 8. Composition of the change in public debt.

Per cent of GDP.	1999	2000	2001	2002	2003	2004	2005
Debt ratio	52,6	48,3	44,7	41,8	39,2	36,8	33,7
Change in debt ratio	-3,2	-4,3	-3,6	-2,9	-2,6	-2,4	-3,1
– Budget balance	-3,2	-2,8	-2,9	-2,7	-2,7	-2,8	-3,0
– Growth contribution	-2,4	-2,7	-1,9	-1,5	-1,5	-1,4	-1,3
– Financial items etc.[1)]	2,4	1,2	1,3	1,3	1,6	1,8	1,2

1) Revenues following the sale of public assets(privatizations etc.) entails a reduction of debt. In years without any large privatizations, there is a trend that this item will be positive (i.e.pull towards an increase in the debt ratio) particularly due to the surplus of the Labour Market Supplementary Pension Fund being mostly placed in shares and non-government bonds which cannot be offset against the EMU gross debt, as well as payment shifts in the tax area.

Public investments are given a higher priority in the school, hospital, and traffic areas in 2000 and 2001, where investments are estimated to show a real increase of appr. 6 per cent in both years. In the following years up to 2005, it is assumed that the growth in public investments be kept at an average of 2 per cent.

5. Sustainability of Public Finances

An increase in the number of senior citizens is expected in the decades to come. This will put pressure on public expenditure.

To handle the fiscal challenges, the government aims to increase the labour force by 80,000 and maintain surpluses on public finances of more than 2 per cent of GDP. If these objectives are realized, fiscal policy will be very close to being sustainable, even taking into account the growth of public consumption towards 2005, cf. *A Sustainable Pension System*[3)].

Long-term sustainability of public finances requires that the surplus of public finances is kept at 2-3 per cent of the GDP right up to 2010. This will imply that the reduction of expenditure on interest payments will outweigh the increase in expenditure on pensions and long term care. This will ensure that the fiscal policy in Denmark is sustainable.

The structural improvements in terms of higher labour supply and lower unemployment will make the expansion of public consumption possible.

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3) In the report: "A Sustainable Pension System", of June, 2000, the need for tightening of fiscal policy was estimated to be appr. 0.4 per cent. But the introduction of a sixth week of holidays means - as shown in the report - that the need for tightening of fiscal policy will increase to 1 per cent of GDP.

If the government objectives on labour force and public surpluses up to 2005 are not met, the need for tightening of fiscal policy will increase to 2.6 per cent of GDP.

Development in Demography and Public Expenditure

Owing to a longer life expectancy, the total number of senior adults will grow by appr. 47 per cent up to 2035. Further, the number of 15-64-year olds will remain more or less unchanged. Thus, the future will see the same number of active workers having to fund more senior citizens. This change is expected to be most pronounced in 2030-40. After that, the number of senior citizens will decrease.

The Ageing and Public Expenditure

Total public expenditure is expected to grow by 4.4 per cent of GDP up to 2035, of which the major part may be explained by increased expenses for senior citizens, cf. table 9.

The total public pensions for senior citizens will totally rise by around 3.5 per cent of GDP from 1998 to 2035, cf. table 10. This is primarily due to an extension of the Labour Market Supplementary Pension Schemes which are, however, to be regarded as an independent funded pension not affecting public finance. Correcting, for the

Table 9. The development in selected public expenditure and the share by senior citizens of these

Share of GDP	Changes relative to 1998					
	Level 1998	2005	2010	2015	2035	2040
Public consumption	25,5	0,5	0,8	1,0	2,9	2,8
- Related to the elderly	3,3	0,0	0,3	0,6	1,9	2,0
Public transfer payments	17,0	0,1	0,5	0,9	1,5	0,8
- Pensions[1)]	9,6	0,8	1,3	1,6	1,9	1,3
Total	**42,6**	**0,6**	**1,3**	**1,9**	**4,4**	**3,6**

1) Excl. The Supplementary Labour Market Pension Fund, ATP, which is a funded pension and may thus be viewed as neutral with respect to fiscal sustainability. These figures are based on a population forecast from Statistics of Denmark. It differs from the EUROSTAT population forecast that was used for the report from the EPC on the macroeconomic consequences of the aging populations in having shorter life-expectancy and a higher rate of immigration.

Source: Own calculations.

Table 10. The development in public transfers to senior citizens. Shares in per cent of GDP.

	1998	2005	2015	2035	2050	Change from 1998-2035
Social pensions	7,1	7,4	8,2	9,2	8,2	2,1
Early retirement allowance	1,4	1,5	1,3	1,4	1,3	0,0
Labour market supplementary Pension fund	0,3	0,5	1,1	1,9	1,9	1,6
Civil service retirement payments	1,1	1,5	1,7	0,9	0,7	-0,2
Total	**9,9**	**10,8**	**12,3**	**13,4**	**12,2**	**3,5**
Total excl. labour market Supplementary fund	**9,6**	**10,3**	**11,2**	**11,5**	**10,3**	**1,9**

Source: ADAM, as well as own calculations on DREAM.

Labour Market Supplementary Pension Schemes, we get a growth of 1.9 percentage ponts of the GDP in the total transfers to senior citizens.

The senior age groups are characterized by a relatively heavy consumption of public service as a result of their weaker health and general need of care. An increasing number of senior citizens will thus mean increased public expenditure for rest homes, hospitals, etc., cf. figure 1.

Figure 1 - Age distributed public expenditure in 1995. Total expense in DKK 1,000 per person per year

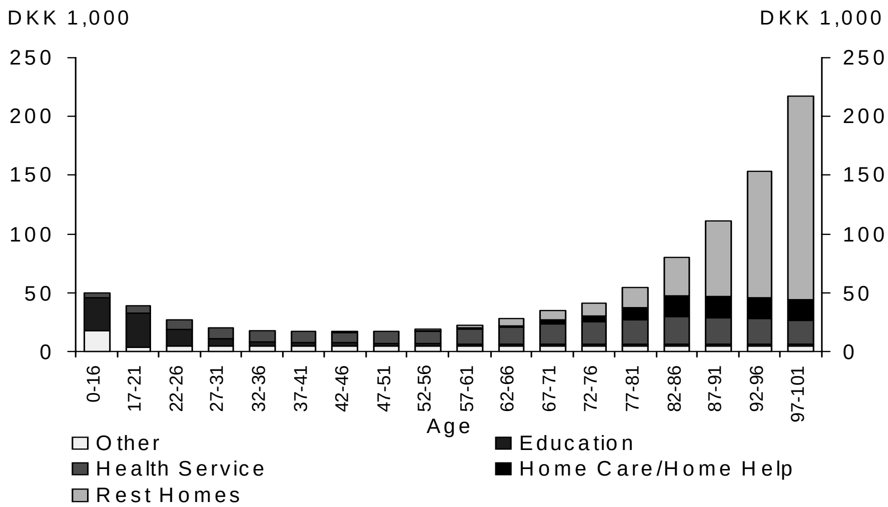

Table 11. The change in public consumption distributed on age groups by per cent of GDP.

	Entire Population			Senior Citizens	Active workers	Children
Services age distributed	Level 1998	2005	2035	2035	2035	2035
Rest homes, home help	2,0	0,1	1,1	1,1	0,0	0,0
Daycare	1,7	0,1	0,2	0,0	0,0	0,2
Education and training	4,5	0,2	0,5	0,0	0,2	0,3
Health service	4,5	0,2	0,8	0,6	0,2	0,0
Other age distributed	1,8	0,1	0,3	0,2	0,1	0,0
Not age distributed	11,0	0,0	0,0	-	-	-
Total	25,5	0,5	2,9	1,9	0,5	0,5

Source: Own calculations on DREAM, as well as Ministry of Economic Affairs generational account of 1998.

Source: Ministry of Economic Affairs 1998 generation accounts

The expected demographic development implies that, public expenditure will grow by 2.9 per cent of GDP up to 2035, cf.11. Appr. 1.9 percentage point of this is due to an increased number of senior citizens who will primarily demand rest home and health services. The other age groups contribute merely 1 percentage point to the increase owing to increased demand particularly for education and training.

The Ageing and The Tax Revenue

On the revenue side, there will also be changes in the future, even at unchanged tax rates. A major reason for this is the build-up of the labour market pensions which will entail increased realization of deferred tax in the pension funds. Also, the proceeds from the taxation of returns of pension funds will grow.

Table 12 shows that the increased labour market pensions will to some extent substitute free savings, entailing that the proceeds from taxation of household capital income are falling.

Table 12. The development in the tax proceeds, after 2005 when the Whitsun package will have been fully phased in.

Changes relative to 2005 in per cent of GDP	2010	2020	2035	2040
Tax on capital income	-0,2	-0,6	-0,8	-0,8
Tax on returns of pension funds	0,1	0,4	0,8	0,9
Tax on labour market pensions	0,3	1,0	2,1	2,3
Other taxes	0,1	0,5	0,5	0,2
Total	**0,3**	**1,3**	**2,6**	**2,7**

Source: Own calculations on DREAM

Total revenues are expected to increase by 2.6 percentage points of GDP from 2005 up to 2035 primarily because of taxation of the labour market pensions.

Fiscal Policy Sustainability

Fiscal policy sustainability entails that public expenditure matches revenues on a long-term view. The increase in public expenditure of appr. 3.8 per cent of the GDP up to 2035 will to some extent be balanced by an increase in tax proceeds of just over 2.5 per cent.

Long term sustainability is secured by maintaning a surplus on general governmental finances of 2-3 per cent of GDP until 2010. This is made possible through the recent structural reforms that will increase labour supply and lower unemployment.

The forecasts above are all based on the assumption that the government objectives regarding the labour force and public debt will be realized. The increase in the labour force of 80,000 persons will raise tax revenues and lower expenditures on transfers. This will in turn raise the surplus so as to leave room for reducing the debt and thus future interest expenses.

If the government objectives are not realized, the need for fiscal restraint will increase, as the public sector would then have to fund heavier interest expenditure and receive less in tax revenues. In this case, the need for tightening will rise to 2.6 per cent of the GDP. Thus stressing the need of reducing the public debt before the increase in public expenditure really makes itself felt.

Annex. Changes of Estimates

According to the latest evaluation of the trend, GDP growth in Denmark in 2000 promises to be somewhat stronger than the previous convergence program was based upon[4)], whereas the growth in 2001 and 2002 is thought to be a little slower.

The upward adjustment of the growth in 2000 is particularly due to a relatively stronger growth in exports combined with heavily increasing investments particularly on account of the repair work after the damage from the hurricane in December last year. The separate effect of the hurricane on the GDP growth is 1/2 - 1/4 percentage point. The fair increase in exports contributes to a considerable improvement of the balance of payments in 2000. A surplus on the current account in 2000 of 2.3 per cent of the GDP is estimated. The surplus in 2001-2002 is estimated to increase to 2 1/2 per cent of GDP in both years.

The surplus on the external current account in 1999 was considerably larger than previously expected, and this is particularly why the Surplus from 2000 and onwards has been upward adjusted in relation to the previous convergence program.

Due to the heavier GDP growth in 2000, unemployment has fallen more than expected. Wage increases have nevertheless been as expected in 2000. In 2001 and 2002 a somewhat smaller wage

4) Cf. the comparison with the previous convergence program in table B.1. As mentioned above, the update of the convergence program for 2000 - 2002 is equivalent to the short-term forecast in Økonomisk Oversigt, December, 2000.

increase than previously is expected, particularly viewed in the light of the collective agreements made and of the slightly lower GDP-growth.

The increase now estimated in consumer prices in 2000 of 2.9 per cent is a little higher than the one previously forming the basis, particularly resulting from heavier oil price increases.

The upward adjustment of the price increase in 2001 is particularly due to slightly higher import prices as the euro rate appreciates slower than previously expected.

The expected total surplus on general government finances in 2000 of 2.9 per cent of GDP is 0.6 percentage points higher than previously anticipated. The estimated surpluses in 2001 and 2002 have been slightly upward adjusted, too. The upward adjustment is generally caused by the more favourable unemployment development. To this should be added higher tax proceeds particularly from income, pension, and corporate taxes.

Medium-Term Projection Adjustments

There is a prospect of a more favourable development for the overall objectives in the evaluation of the development in 2003-2005 in the medium-term projection in relation to the previous convergence program, cf. table B.1.

The balance of payments may be expected to be better than expected throughout the period. Further, the share price development caused a heavy fall in the foreign debt in 1999 so that the foreign debt may be finally settled in 2005, sooner than previously anticipated.

The employment increase up to 2005 has been downward adjusted a little. But the target of seeing unemployment fall to 5 per cent in 2005 is still expected to be realized.

The surplus on general government finances in the final year of 2005 is expected to be more favourable than previously expected (2.9 per cent as compared to 2.6 per cent of GDP), particularly because of the lower unemployment and a higher tax revenue. The debt quota in 2005 will thus be somewhat lower (34 as against 36 per cent of the GDP).

Table B.1 Main features of developments and comparison with previous convergence programme

	1999		2000		2001		2002		2003-2005	
	Dec 99	Dec 00	Dec 99	Dec 00	Dec 99	Dec 00	Dec 99	Dec 00	Dec 99	Dec 00
Real growth per cent:										
Private Consumption	0,9	0,6	1,3	0,2	1,7	1,3	2,1	2,0	2,4	2,3
Government Consumption	1,4	1,4	1,2	0,8	1,0	2,2	1,0	1,0	1,0	1,0
Government investment	-2,0	0,5	6,5	6,0	1,0	6,0	1,0	1,0	1,0	2,0
Residential investment	-2,0	1,2	-4,0	16,0	0,0	-12,0	3,0	-4,0	3,6	1,2
Business investment	2,8	0,0	1,0	6,3	1,9	2,1	4,1	2,0	3,4	3,0
Total domestic demand[1)].	0,2	-0,4	1,3	2,4	1,7	1,2	2,2	1,5	2,2	2,0
Export of goods and services . . .	3,4	7,9	4,0	5,4	3,9	5,8	4,5	4,2	4,0	3,6
Here of industrial exports	3,5	7,3	5,7	7,0	6,5	9,0	5,2	6,5	4,6	4,2
Import of goods and services . . .	0,7	2,2	3,2	5,8	3,4	4,7	4,3	3,9	4,3	4,6
GDP	1,3	1,7	1,6	2,4	2,0	1,8	2,3	1,7	2,1	1,7
Increase, per cent:										
Consumer price index	2,5	2,5	2,3	2,9	1,9	2,5	1,6	1,8	2,1	2,0
Hourly wage rate	4,5	4,1	4,0	4,0	3,5	3,8	3,9	3,5	3,9	3,7
Interest, 10-year governm. bond (per cent)	4,9	4,9	5,6	5,7	5,6	5,9	5,2	5,9	5,1	6,2
Change in employm. (1000 pers.)	19	22	8	25	12	13	22	12	21	15
Level of employment (per cent)[2)]	74,2	73,5	74,3	74,1	74,6	74,3	74,6	74,5	75,7[3)]	75,2[3)]
Unemployment, per cent of work force.	5,6	5,6	5,7	5,3	5,9	5,3	5,6	5,2	5,0[3)]	5,0[3)]
Per cent of GNP:										
Current account	0,0	2,2	0,2	2,3	0,5	2,5	0,7	2,6	1,0[3)]	2,6[3)]
Foreign debt (year-end)	24,9	14,3	23,9	13,6	22,5	10,5	21,6	7,5	16,0[3)]	-0,9[3)]
Budget balance	2,9	2,8	2,1	2,7	2,2	2,8	2,3	2,6	2,8[3)]	2,9[3)]
Government debt (year-end). . . .	52,8	52,6	50,1	48,3	47,5	44,7	44,5	41,8	35,9[3)]	33,7[3)]

Note: Consumer prices equal the domestic consumer price index, and unemployment is national definition. The method of calculation for the consumer price index is changed from January, 2000.

1) Inclusive inventory changes. 2) Employed compared to ages 15-66 3) year-endlevel 2005.