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CONVERGENCE PROGRAMME FOR DENMARK

Updated programme for the period 2002-2010

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Updated convergence programme for Denmark

1. Introduction

Denmark hereby presents an update of *Convergence Programme 2001, January 2002*[1] *(CP2001)*. The projection presented in this year's Convergence Programme (CP2002) covers the period until 2010. The projection has been presented and analysed in more detail in *The Danish Economy 2002 - Medium Term Economic Survey (in Danish).*

Compared with the previous convergence programme a new population projection has been implemented, and a new short term forecast[2] has also been made, incorporating the 2003 fiscal bill proposal. Moreover, long-term fiscal policy requirements have been recalculated, and the initiatives in the action plan *More People in Work, Danish Government 2002* have been incorporated (see box 1.1).

Box 1.1. Revised assumptions compared with CP2001.

- Inclusion of the 2003 fiscal bill proposal.
- Revised population projection.
- New short term forecast, *see Economic Survey, August 2002.*
- Recalculation of long-term fiscal policy requirements.
- Incorporation of the action plan *More People in Work.*

[1] The convergence programme is prepared in accordance with the Council Regulation (EU) on the Stability and Growth Pact (No. 1466/97). According to this regulation, Euro Member States prepare stability programmes, whereas the other countries are required to prepare convergence programmes. This updated convergence programme follows the guidelines adopted at the ECOFIN Council meeting on July 10, 2001. The update of Denmark's Convergence Programme will be put before the Danish parliament.

[2] The international organizations, including the Commission, has revised the international outlook downward, compared to the assumptions behind national forecast from august on which the present programme is based. A new assessment for the period 2002-04 will be completed in December, also taking into account the rise in unemployment of 5-10,000 people from May to September. The overall picture is expected to remain broadly unchanged.

The fiscal priorities concerning tax levels and public expenditure are broadly unchanged compared with the projection in CP2001. This roughly reflects that not before spring 2003 a final decision will be made concerning the amount and composition of a possible reduction in the tax on earned income as from 2004.

The cornerstone in the medium-term strategy is sustainable fiscal policy. This implies that the general government surplus must be large enough to finance the expected future increase in net public expenditures due to ageing, without triggering a need for fiscal tightening at some later point. The projected development in unemployment and participation rates secures, that the path for tax levels and public expenditures is compatible with such a sustainable fiscal framework.

The new population projection anticipates slightly stronger population growth than the previous projection. This will add to the labour force, but also implies higher growth in the number of transfer recipients and, inter alia, public consumption. In total, the required surplus on general government finances is virtually unaffected by the new population base.

The tax freeze means that no direct or indirect tax may increase, irrespective of whether it is expressed and legislated in percentage- or krone value terms. Furthermore, a ceiling is put on nominal property value tax. The nominal principle of excise taxes and property value tax – technically projected until 2010 – implies a fall in paid tax of ¾ per cent of GDP (at the 2002 level) until 2010 compared with a scenario where excise taxes etc. expressed in krone value terms are set to increase in line with prices. As a technical assumption, the projection also includes an amount for lower tax on earned income.

Apart from preventing tax hikes, the tax freeze also plays a central role as a mechanism, which contributes to achieve the objective of modest growth in public consumption. The tax freeze advocates a stricter prioritisation of expenditure, which helps break the tendency towards rising actual expenditures compared with budgets. With debt reduction as a precondition, any adjustments needed in the event of negative deviations in the economic assumptions has also to an increasing extent been transferred to general government expenditures rather than to taxation.

The projection reports on a number of economic objectives that are essential for ensuring a stable and healthy economic development while preparing for ageing, which is expected to take off after the year 2010 (see box 1.2).

Box 1.2. Economic assumptions until 2010

- Surplus on general government finances of 1½-2½ per cent of GDP on average. This will ensure a sustainable fiscal policy and largely halve general government debt as a per cent of GDP from 2000 to 2010.
- Increase in participation rates and a reduction in structural unemployment to boost employment by 85,000 from 2000 and 2010.
- Tax freeze.
- Growth in real public consumption of 1 per cent a year between 2002 and 2005 and ½ or ¾ per cent a year between 2006 and 2010.
- Lower tax on earned income from 2004 onwards.
- Contracting-out and efficiency enhancement of the public sector.
- Low and stable inflation of just below 2 per cent a year.
- Favourable framework conditions for private savings, which, in conjunction with the surplus on general government finances, implies a significant reduction in foreign debt.

The strategy outlined in CP2002 and the economic targets meet the requirements of the Stability and Growth Pact and follow the economic policy guidelines recommended by the European Commission. Denmark more than meets all four convergence criteria.

The Danish parliament firmly supports the fixed exchange rate policy, and the government regards it as paramount that credibility in this policy is maintained. Following the Danish referendum on the euro in September 2000, the commitment to the fixed exchange rate policy within a narrow fluctuation band of ±2¼ per cent as stipulated in the ERM2 agreement has been undiminished. In fact, the deviations in the exchange rate from central parity have been much smaller than the bandwidth. The interest rate spread vis-à-vis German interest rates is not wider than before the referendum was called, but it is a little wider than would be expected in case of a Yes to the single currency.

The fixed exchange rate policy is an important tool for ensuring low inflation. The strategy implies that the low level of inflation in the euro area works as an anchor for Danish inflationary expectations and that the level of interest rates is predominantly determined by the ECB.

Structural policy measures

The Danish tax regime and labour market policy have been reformed on several occasions during the past 15 years. One result has been a significant reduction in structural unemployment, implying that general government finances now rest on a more solid foundation.

Changes to the tax regime have led to a cut in the tax on earned income, a lower taxable value of negative capital income, lower corporation tax, greater tax bases and higher and more green taxes.

Regarding active labour market policy, the right to and obligation of job activation has been extended and moved forward, benefit periods have been reduced and various schemes of retirement have been reformed or abolished since the mid-1990s.

Structural reforms are still needed in various areas. With respect to the labour markets, the initiatives outlined in the action plan *More People in Work, Danish Government 2002*, require that active labour market policy must be made simpler and more efficient with greater focus on activation directly qualifying a person for a job and that working must be worthwhile. At the same time, initiatives aimed at young people will now include people aged 25-29, and the government's agreement with the labour market and local authorities includes initiatives to improve integration of refugees and immigrants will be implemented. With respect to taxation, the government intends to reduce the tax on earned income if fiscal leeway can be found.

Future prosperity relies strongly on productivity growth. Due to the initiatives outlined in the growth strategy, *Growth on Purpose, Danish Government 2002*, the government has launched structural policy measures to improve productivity performance. The growth strategy consists of specific measures and strategy and objectives in a number of areas of considerable importance to productivity growth. The intention is to follow up and adjust the strategy on an ongoing basis to make sure that it contributes to increase productivity.

In order to improve efficiency and secure healthy competition in a number of service areas that have traditionally been public-sector tasks,

the opportunity for individuals to choose between private and public suppliers will be improved.

In addition, the government regards continued structural reform in the product and capital markets as important to stimulate growth in the private business sector (see the Danish Cardiff report).

The year 2002 has already seen the implementation of several initiatives aimed at alleviating administrative burdens, promoting the entrepreneurial culture, lowering statutory costs and encouraging the use of new schemes of payment. A slightly longer-term aim of the government is to liberalise the power and gas supplies market to reduce corporate sector and household costs.

2. Key assumptions

Labour market and production capacity

The labour force is projected to increase by 65,000 people between 2000 and 2010, while unemployment is set to fall gradually from about 5¼ per cent of the labour force in 2000 to 4½ per cent in 2010, or by 20,000 people. This implies an increase in employment of 85,000 people from 2000 to 2010.

The rise in employment should be seen in the light that the demographic development, viewed separately, generate a fall in employment of 53,000 people until 2010. Lower unemployment rate and rising participation rates must therefore contribute a total of 138,000 people if the goal is to be met. Rising participation rates gives the largest contribution of some 118,000 people (see table 2.1).

Table 2.1. Increase in employment between 2000 and 2010

	CP2001	CP2002
	1,000 people	
Demographic contribution	-66	-53
Higher participation rates	132	118
Lower unemployment rate	20	20
Increase in employment	87	85

Source: Own calculations.

The assumed increase in participation rates is lower than in CP2001. The difference corresponds to 15.000 people. The downward revision reflects a slightly improved assessment of general government finances. Hence, a slightly smaller increase in employment will be sufficient, within a sustainable fiscal framework, to secure the same improvements in terms of real public consumption per user and lower tax as in the previous projection. A rise in participation rates of the same magnitude as the one outlined in CP2001 would have increased employment by just below 100,000 people between 2000 and 2010.

Employment is estimated to increase by some 30,000 people between 2000 and 2010 in the absence of additional structural measures. This implies that a rise in participation rates for each cohort, gender etc., and falling unemployment is likely to contribute 80-85,000 people by virtue of already adopted measures (see table 2.2).

Table 2.2. Implemented and non-implemented employment requirements, from 2000 to 2010

	CP2001	CP2002
	---------- 1,000 people --------	
Demographic contribution	-66	-53
Implemented increase in participation rates	79	77
- Of which due to More People in Work	-	*5*
Lower unemployment due to *More People in Work*	-	5
Implemented increase in employment	14	29
Non-implemented increase in participation rates	53	41
Non-implemented reduction in unemployment	20	15
Non-implemented increase in employment	73	56
Total increase in employment	87	85

Source: Own calculations.

The estimated rise in employment of 30,000 people should be seen in the light of lower inflow to early retirement schemes in recent years and reforms of the pre early retirement scheme, the early retirement scheme and the disability pension scheme. Moreover, the calculations include the effects of the expanded maternity leave, grants for child care in own home and a slightly sharper underlying increase in the number of people opting for early retirement and disability pensions than previously assumed. Finally, the initiatives outlined in *More People in Work* are assumed to raise employment by some 10,000 people, of which one half should come from a larger labour force and the other half from lower unemployment.

If the medium-term objectives are to be fulfilled, an additional contribution of some 55,000 people will be needed, the majority due to higher participation rates. This includes possible contributions from, for instance, better integration of immigrants in the labour market, a faster flow through the education system and efforts to improve labour market attachment for senior workers.

The employment requirement needing additional reform is about 17,000 people fewer than estimated in the spring 2002. This reflects contributions due to initiatives from *More People in Work* and a number of opposing effects, including a slightly higher underlying increase in early retirement. Moreover, the requirement related to participation rates has, as mentioned, been relieved somewhat due to the improved assessment of general government finances, which – among other things – reflects the rise in average working hours of 0.6 per cent in 2001, against an expected fall of 0.5 per cent. Including the upward revision of population growth, the rise in the number of hours worked is larger than the one outlined in CP2000 and CP2001 (see table 2.3).

Table 2.3. Growth in the number of hours worked from 2000 to 2010

	Average working hours	Employment	Number of hours worked
	Total growth (%)		
CP2000	-3.0	3.7	0.7
CP2001	-2.7	3.2	0.4
CP2002	-1.6	3.2	1.5

Source: ADAM data bank and own calculations.

The assumption regarding the unemployment rate is to reach 4½ per cent of the labour force by 2010 (national definition). Hence, unemployment must predominantly be short term and related to job turnover and institutional features such as daily cash benefits during holidays, supplementary benefits, etc. This will place heavy demands on the well functioning labour markets. If such a low level of unemployment is to be achieved, it will also require that a pronounced economic downturn be avoided during the period until 2010.

A fall in average working hours towards 2010 is projected to reduce growth in the effective labour supply. Hence, recent collective agreements imply an increase in the number of paid annual holidays. The growing

number of older and quite young people in the labour force will also reduce average working hours as they, on average, work fewer hours than others. In total, average working hours are set to fall by just over 1½ per cent between 2000 and 2010 (see table 2.4). This requires that the social partners agree not to reduce average working hours more than already planned.

Table 2.4. Contribution to the increase in total hours worked

	2000	2003	2005	2010	2000-10
	Per cent of labour force				
Unemployment	5.3	4.9	4.9	4.5	-0.8
	1,000				
Unemployment	150	142	142	130	-20
Labour force	2,856	2,880	2,897	2,921	65
Employment	2,705	2,738	2,755	2,791	85
	Hours per person				
Avg. annual working hours	1,539	1,539	1,531	1,515	-1.6
	Million hours				
Labour supply	4,395	4,433	4,434	4,424	0.7
Employment	4,163	4,215	4,216	4,227	1.5

Source: ADAM data bank and own calculations.

Hourly productivity in the private business sector is assumed to increase by 2 per cent a year on average from 2004 to 2010. This corresponds to the average historical growth rate since 1980. For the entire private sector productivity is set to increase by 2¼ per cent a year. As the national accounts do account for productivity increases in the public sector, representing approximately 30 per cent of total employment, the increase in hourly productivity for the economy as a whole is about 1¾ per cent a year (see table 2.5).

Table 2.5. Hourly productivity growth

	1980-93	1995-00	1980-00	1980-00[1)]	2001-03	2004-10
	Annual growth (%)					
Private business sector	1.7	1.5	2.0	1.6	1.6	2.0
Private sector	2.1	1.9	2.4	2.0	1.6	2.2
Entire economy	1.7	1.5	2.0	1.6	1.2	1.8

1) Excluding the extraordinarily sharp rise in productivity in 1994, which may have been partially overrated due to a statistical break in the series for average working hours.

Source: ADAM data bank and own calculations.

The likelihood of achieving the projected level of productivity growth can of course be strengthened by structural policy measures. The initiatives outlined in *Growth on Purpose* will contribute to increase productivity. These contributions will help achieve the stipulated growth rates, which are a bit on the high side compared to recent events.

Productivity growth is the engine of sustained improvements in production and prosperity. However, stronger productivity growth will not strengthen general government finances although tax revenues will go up when productivity, and thus income, increases. This reflects that expenditure rises more or less in tandem because most general government expenditures are adjusted to wage increases, and hence productivity growth, in the private sector by virtue of the rate adjustment act and public collective agreements.

Stronger GDP growth driven by productivity improvements therefore cannot be expected to improve general government finances and will not create additional fiscal leeway for lower tax or higher public consumption expenditure in percent of GDP. On the other hand, the projection is also robust to a smaller-than-anticipated increase in productivity.

Fiscal policy

The tax freeze means that no direct or indirect tax may increase, irrespective of whether it is legislated and expressed in percentage or Danish krone value terms. Moreover, a ceiling is put on nominal property value tax, while the average local (percentage) tax rate is assumed to be constant from 2002 onwards.

The nominal principle for excise taxes and property value tax implies that revenue from these sources rise at a lower rate than nominal GDP and general government expenditure, which, given the existing rules and practises, automatically increase when prices and wages increases. Freezing property value tax and excise duties in krone value terms will reduce tax receipts by about ¾ per cent of GDP (at the 2002 level) until 2010. This is equivalent to a tax cut since the amount paid falls compared with income.

Revenue-neutral changes to the tax regime can be made within the framework of the tax freeze insofar as they result from EU decisions and

provided they do not result in higher tax revenue. The projection technically assumes that revenue loss in connection with countering the abolishment of the 24-hour rule is financed.

Given the same increase in real public consumption per user from 2000 to 2010 as in CP2001, real public consumption would have to increase by 1 per cent a year on average from 2002 to 2005 and by just under ¾ per cent a year from 2006 to 2010. This largely equals the assumptions made in the previous two projections. However, there is a small upward adjustment of just below ¼ percentage point for the period 2006-2010.

The revision of real public consumption growth reflects a rise in demand for public services due to demographic changes triggered by higher population growth. This implies that annual real growth in public consumption on average is about 0.6 percentage points higher than the rise in the number of users of public services (i.e. the demographic determined demand for public services) from 2000 to 2010. Consequently, so-called real standard improvements amount to 0.6 per cent a year on average, the same as in CP2001. This leaves room for a reduction in earned income tax in the amount of ¼ per cent of GDP.

In convergence programme 2001 real growth in public consumption was ½ per cent a year from 2006 to 2010. If this assumption is maintained instead, an amount may be included for lower tax on earned income of ½ per cent of GDP (see table 2.6). Both scenarios require that the increase in employment can be achieved in order to ensure fiscal sustainability.

Table 2.6. Real growth in public consumption and lower tax on earned income

	Real standards as in CP2001[1)]	Real growth as in CP2001[1)]
Real growth in public consumption, 2002-2005....	1	1
Real growth in public consumption, 2006-2010....	¾	½
Lower tax on earned income (per cent of GDP).....	¼	½

1) Implies that real growth in public consumption per user from 2000 to 2010 is maintained.
Source: Own calculations.

The rise in employment assumed to take place in the absence of new labour market initiatives – the implemented requirements – in itself gives

fiscal leeway in the amount of 0.7 per cent of GDP (see table 2.7). Thus, the effects of the nominal principle of the tax freeze are fully covered. However, the assumed improvements in real service standards cannot be fully covered in the absence of additional structural reforms.

Real growth in public consumption per user and lower tax on earned income from 2004 onwards must therefore be covered by the non-implemented rise in employment. If this rise in employment is achieved, the level of fiscal sustainability can be calculated at 0.1 per cent of GDP in the projection. Fiscal policy and labour market improvement thus make sure that fiscal burdens are not passed on to future generations.

Fiscal sustainability has been calculated by adjusting the general government budget balance for the present value of the expected future increase in net public expenditures due to ageing (see section 5). *Appendix 3* lists the consequences for fiscal sustainability if the non-implemented increase in employment fails to take place.

Table 2.7. Contribution to fiscal sustainability in 2003

	Real standards as in CP2001	Real growth as in CP2001
	--------- Per cent of GDP ---------	
Sustainability indicator, demographic scenario[1)]	-0.1	-0.1
Fiscal leeway due to implemented employment requirements	0.7	0.7
Tax freeze[2)]	-0.6	-0.6
Real growth in public service standards.....	-0.7	-0.5
Sustainability indicator, implemented scenario	-0.7	-0.5
Fiscal leeway due to non-implemented employment requirements	1.0	1.0
Lower tax on earned income.....	-0.2	-0.4
Sustainability indicator, CP2002	0.1	0.1

1) Assuming unchanged participation rates, unemployment rate, and real public service standards from 2003 to 2010 (see section 5).

2) The tax freeze in itself lowers tax receipts by ¾ per cent of GDP at the 2002 level towards 2010. Converted to a fixed annual amount (net present value) in 2003, the tax freeze implies a permanent net revenue loss of 0.6 per cent of GDP compared with a scenario where excise taxes, etc., are price-indexed.

Source: Own calculations (see section 5).

For calculation purposes, the differences concerning priority of public consumption and lower tax is implemented assuming different growth rates in public real net purchases of goods and services. If the target for

real growth in public consumption is maintained, real net purchases of goods and services will increase by 2 per cent a year from 2006 to 2010. If real growth in public consumption per user is maintained, the increase will be 1.4 per cent a year (see table 2.8).

Table 2.8. Public net purchases of goods and services

	1995-00	2001-03	2004-05	2006-10	2001-10
	---------- Annual real growth (%) ----------				
Real standards as in CP2001	4.2	3.3	2.8	2.0	2.5
Real growth as in CP2001.....	4.2	3.3	2.8	1.4	2.2
	---------- Per cent of GDP, end-year level ----------				
Real standards as in CP2001	6.2	6.3	6.4	6.4	6.4
Real growth as in CP2001.....	6.2	6.3	6.4	6.1	6.1
	-- Per cent of public consumption[1)], end-year level -				
Real standards as in CP2001	26.9	27.1	27.3	27.2	27.2
Real growth as in CP001.....	26.9	27.1	27.3	26.6	26.6

1) Public payroll costs and net purchases of goods and services.
Source: ADAM data bank and own calculations.

Hence, public employment growth is the same in the two cases, amounting to 35,000 people from 2000 to 2010 (see table 2.9). This equals an average annual rise in employment of 3-4,000 people.

Table 2.9. Public consumption and investment

	1995-00	2001-03	2004-05	2006-10	2001-10
	---------- Annual change, 1,000 people ----------				
Public-sector employment.....	10.6	4.5	4.3	2.6	3.5
	---------- Annual real growth (%) ----------				
Public investment	3.3	2.5	2.0	2.0	2.2
Public-sector employment.....	1.1	0.5	0.5	0.3	0.4
Number of hours worked.....	1.2	0.6	0.2	0.1	0.3
	---------- Annual growth (%) ----------				
Consumption deflator.....	2.5	3.1	3.2	3.1	3.1
Hourly wage deflator.....	2.9	4.0	3.9	3.8	3.9
Private-sector wages	4.0	4.1	4.0	3.8	3.9

Source: ADAM databank and own calculations.

The number of average annual working hours falls by 0.2 per cent a year on average from 2000 to 2010. This implies that the total number of working hours in the public sector increases by some 0.3 per cent a year on average, largely corresponding to growth in demand for public services triggered solely by demographic changes.

Public investment goes up by 2 per cent a year, implying that public investment amount to a more or less constant share of GDP.

The stipulated increase in public net purchases of goods and services also allows for purchases of slightly more staff-intensive services in the private sector. Any efficiency gains achieved in public branches can contribute to increase the quality of public services compared to the increase in resources allocated to public consumption.

3. Economic outlook until 2010

In 2001, Denmark met all four convergence criteria by a wide margin (see table 3.1). This is also expected to be the case over the coming years. The surplus on general government finances of 2.8 per cent of GDP in 2001 exceeded the convergence criteria of minus 3.0 per cent of GDP, and the debt ratio of 44.7 per cent of GDP at the end of the year also met the convergence criteria.

Table 3.1. Convergence situation in 2001

	Consumer prices[1]	Long-term interest rates[2]	General government budg. balance	General government debt
	Growth (%)	--- Per cent --	-------- Per cent of GDP -----	
Denmark	2.1	5.1	2.8	44.7
EU	2.3	5.0	-0.8	63.0
Euroland	2.5	5.0	-1.5	69.3
Convergence criteria	3.1	7.0	-3.0	60.0

1) EU Harmonised Index of Consumer Prices (HICP).
2) 10-year government bonds.
Source: The European Commission's 2002 autumn forecast and Statistics Denmark.

The rate of inflation – as measured by the EU Harmonised Index of Consumer Prices – was also well below the convergence criteria. In the projection period, the nominal principle of the tax freeze will in itself curb the rise in consumer prices by 0.1 percentage points compared with the rise in net prices.

Low Danish long-term interest rates compared with the criterion should, in particular, be seen in the light of the stable krone rate against the euro and the surplus on general government finances.

International assumptions

The august short term economic forecast suggest that international growth will increase from 1½ per cent in 2002 to just below 3 per cent in 2003. In 2004 and 2005 international growth amount to 2½ and 2¼ per cent, respectively. In the following years it is assumed that international growth equals potential, which is set to be 2.2 per cent (see table 3.2).

Partly due to the recent monetary easing, the yield on German 10-year government bonds is estimated at 5 per cent in 2002, but it is likely to rise to just under 5¼ per cent in 2003 due to expectations of stronger growth. Towards 2006 the interest rate is assumed to stabilise just above 5½ per cent.

The yield spread between Danish and German 10-year government bonds has averaged some 0.30 percentage points since the autumn of 2000. This is about 0.15 percentage points higher than anticipated if Denmark had participated in the single currency. The yield spread to Germany is estimated to widen to about 0.5 percentage points until 2006, corresponding to an additional yield of about 0.35 percentage points compared with the estimated level, had Denmark participated in the single currency.

Table 3.2 International key assumptions

	2001	2002	2003	2004	2005	2006-10
	Annual real growth (%)					
Real GDP[1)]	1.5	1.5	2.9	2.6	2.2	2.2
Real market growth (manuf.)	-0.3	1.4	7.8	5.2	4.4	4.4
Hourly wages	3.2	3.1	3.1	3.8	3.8	3.8
	%, end-year level					
Germany, 10-year euro yield	4.8	5.0	5.2	5.4	5.5	5.6

1) Trade-weighted.
Source: The European Commission's 2002 autumn forecast, OECD and own calculations.

The yield spread may at times be wider or narrower than 0.5 percentage points, depending on the economic situation in Denmark and the euro area as well as financial market developments. The yield spread will, during times of balanced economic developments, be narrower than the average yield spread, but, in single years of economic recession and financial turbulence, the yield spread may be somewhat wider.

Presently, the level of international interest rates and the good indicators for the Danish economy point to a narrower yield spread. However, several of these factors can be expected to fluctuate over a longer period of time. The medium-term yield spread has been determined on the basis of historical relations between yield spreads, inflation differences and other aspects of importance (see *The Danish Economy 2000, Medium Term Economic survey).*

Economic outlook until 2010

The projection shows increasing growth during 2003, implying that capacity utilisation in the Danish economy – as measured by the so-called output gap – is likely to remain fairly high throughout 2003. This being the case and recognising the expected pick up in activity, the output gap in 2004 is assumed to be more or less the same as in 2003, and it should then narrow gradually and be closed in 2006. Subsequently, real GDP is assumed to grow in line with potential.

High capacity utilisation implies that the rate of wage increases in 2004 and 2005 should be slightly above that in other countries, which is set to 3.8 per cent (see table 3.3).

Table 3.3. Output gap and wage increase

	2001	2002	2003	2004	2005	2006-10
	Per cent of GDP					
Output gap	0.7	0.6	0.7	0.6	0.3	0.0
	Annual growth (%)					
Hourly wages	4.2	4.1	4.0	4.0	3.9	3.8

Note: The calculation of the output gap deviates from the Commission's calculations. The output gap primarily depends on the difference between actual and structural unemployment and is estimated in a system, which also determine the structural level of unemployment, using the Kalman filter. No ad hoc adjustments have been made regarding the smoothness of the estimated level of structural unemployment. The underlying wage relation implies, that structural employment should be interpreted as a short term NAIRU-concept. This means that the output gap can be regarded as a macro-indicator for cyclical inflationary pressures in the economy.

Source: ADAM data bank and own calculations.

Real GDP is estimated to grow by 1¾ per cent a year on average during the entire period from 2000 to 2010 (see table 3.4). The slowdown

compared with the 1995-2000 period mainly reflects that the plunge in unemployment during that period cannot be repeated.

The assumptions for the labour market and fiscal policy imply that the (structural) general government budget balance, on average, will show a surplus of 2.2 per cent of GDP during the period from 2002 to 2010. The projected surpluses will nearly halve general government debt as per cent GDP between 2000 and 2010.

Table 3.4. Key eonomic indicators

	2001	2002	2003	2004	2005	2006-10
	Annual growth (%)					
Real GDP	1.0	1.5	2.2	1.8	1.7	1.8
Hourly wages	4.2	4.1	4.0	4.0	3.9	3.8
	1,000 people, end-year level					
Employment	2,720	2,725	2,738	2,748	2,755	2,791
- Private sector	1,892	1,892	1,902	1,907	1,910	1,933
- Public sector	828	834	837	841	845	858
Labour force	2,865	2,869	2,880	2,889	2,897	2,921
Unemployment	145	144	142	142	142	130
	Per cent of GDP, end-year level					
Gen. gov. budget balance	2.8	2.1	2.2	2.5	2.4	2.2
Current account	2.5	2.3	2.4	2.6	2.6	3.0
Gen. gov. debt	44.7	43.9	42.1	39.2	36.7	26.0
Foreign debt	16.7	13.9	10.9	7.9	5.0	-8.9

Source: ADAM data bank and own calculations.

A growing surplus on the balance of goods and services and falling net interest payments will improve the current account during the projection period. A sustained surplus contributes to a significant reduction in foreign debt, which, disregarding typically significant value adjustments, can be turned into a net asset position during the period from 2005 to 2010.

For the projection period as a whole, net exports do not contribute to GDP growth. Net exports contribute negatively in the latter half of the period as the predicted improvement in the terms of trade and falling net interest payments to foreign creditors generate an additional rise in income, thus leading to stronger growth in private consumption than in GDP. This paves the way for an increase in private domestic demand during the period 2006-2010, which is greater than growth in GDP and the production potential (see table 3.5).

Table 3.5. Contribution to production potential and GDP

	1995-00	2001-05	2006-10	2001-10
	---------- Annual real growth (%) ----------			
Growth in production potential	*2.5*	*1.8*	*1.9*	*1.8*
Of which contribution from:				
- hourly productivity	1.5	1.4	1.8	1.6
- structural unemployment	0.9	0.1	0.1	0.1
- labour force	0.0	0.3	0.2	0.2
- working hours	0.1	-0.1	-0.2	-0.2
	---------- Annual real growth (%) ----------			
GDP growth	*2.7*	*1.6*	*1.8*	*1.7*
Of which contribution from:				
- domestic demand	2.8	1.6	1.9	1.7
- net exports	-0.1	0.1	-0.1	0.0

Source: ADAM data bank and own calculations.

The projection implies a sustainable wage increase of 3.8 per cent and net price increases of about 1.8 per cent. The nominal principle of the tax freeze contributes to reduce the rate of increase in consumer prices to some 1.7 per cent a year (see table 3.6).

Table 3.6. Deflators and price index

	2001	2002	2003	2004	2005	2006-10
	---------- Annual growth (%) ----------					
GDP deflator	2.8	1.7	2.3	2.1	2.2	2.1
Net price deflator[1)]	1.6	2.4	2.0	1.9	1.9	1.8
Consumer price deflator	2.1	2.4	1.7	1.7	1.7	1.7
Consumer price index	2.4	2.3	1.8	1.6	1.6	1.7
Do, EU HICP	2.3	2.2	1.7	1.5	1.5	1.6
Euroland (HICP)	2.5	2.3	1.9	1.8	-	-

1) Corresponds to the consumer price deflator net of taxes and duties.
Source: Statistics Denmark, The European Commission's 2002 autumn forecast and own calculations.

4. Fiscal policy activity impact and general government finances

Fiscal policy activity impacts

The fiscal bill proposal for 2003 is estimated to give a first-year growth effect of about 0.0 per cent of GDP (fiscal effect) (see table 4.1). This should be seen in the light of a tight labour market, and Danish wage increases which are somewhat higher than abroad.

Table 4.1. Contribution to GDP growth, 1993-2003

	1993-94	1995-96	1997-98	1999-00	2001	2002	2003
GDP growth	2.7	2.6	2.7	2.7	1.0	1.5	2.2
One-year fiscal effects	0.7	0.4	-0.2	0.1	0.1	0.2	0.0
Economic policy	0.7	0.3	-0.9	-1.1	-0.7	-0.2	-0.1
- Multi-year fiscal effects	0.7	0.3	-0.7	-0.5	-0.3	-0.1	-0.1
- Saving effects, etc.[1)]	-	-	-0.2	-0.6	-0.4	-0.1	0.0
Interest-rate changes[2)]	0.2	0.4	1.0	1.0	-0.1	0.2	0.3
Other factors	1.8	1.9	2.6	2.8	1.8	1.5	2.0

Note: The multi-year effects of fiscal policy have been calculated including the multi-annual activity impacts from fiscal policy since 1993.
1) Whitsun Package structural effects to boost savings, etc.
2) Calculated as the isolated impact on real GDP from interest rate changes since 1993 and until mid-april 2002.
Source: ADAM data bank and own calculations.

The fall in interest rates which have occurred in recent years, will – viewed separately – provide an appreciable growth contribution in 2003, offset neither by the activity contributions from fiscal policy of previous years nor by the estimated effects of reducing the tax value of interest payments introduced by the Whitsun Package from 1998, the purpose of which was to boost savings.

The Danish economy is fundamentally healthy and robust and seems well prepared to face the risks ahead. The surplus on the balance of payments is large, thus providing room for adjustments. Moreover, general government finances show suitable surpluses, allowing automatic stabilisers to take effect.

However, the government surplus is not larger than the average needed over the economic cycle to ensure long-term sustainability of fiscal policy

(see section 5). Fiscal measures aimed solely at strengthening activity should therefore be reserved for periods of economic recession when unemployment is higher and clearly rising and inflation is low. Furthermore, allowance should be made for whether Denmark is in sync with the surrounding world, i.e. whether monetary easing and interest-rate cuts are introduced to counter weak economic conditions, as is currently the case.

General government finances

Average surpluses on general government finances are 2.2 per cent of GDP from 2002 to 2010 (see table 4.2). This is almost in the middle of the target range between 1½ to 2½ per cent of GDP, and is hence considered to be consistent with a sustainable path for fiscal policy.

Table 4.2. General government finances

	ESA	2001	2002	2003	2004	2005	2010
Net borrowing/lending							
General government	S13	2.8	2.1	2.2	2.5	2.4	2.2
Of which:							
- Central government	S1311	1.3	1.1	1.2	1.7	1.6	1.4
- Local government	S1313	-0.1					
- Social security funds	S1314	1.6	1.0	1.0	0.8	0.8	0.8
General gov. revenue	ESA	56.1	55.1	54.3	54.5	54.2	53.2
- of which tax		49.0	48.2	47.7	48.0	47.6	46.8
General gov. expenditure	ESA	53.2	52.9	52.1	52.0	51.8	51.0
General gov. budget balance	B9	2.8	2.1	2.2	2.5	2.4	2.2
Net interest income		-1.5	-1.3	-1.3	-1.0	-0.9	-0.2
Primary budget balance		4.4	3.5	3.3	3.6	3.3	2.4

Source: Statistics Denmark and own calculations.

Local authorities are under the obligation to balance their revenue and expenditure, while central government and Social security funds are likely to generate surpluses in the entire period.

The surplus on general government finances implies that general government debt will decrease from almost 45 per cent of GDP in 2001 to 26 per cent of GDP in 2010 (see table 4.3). This explains the sharp drop in the ratio of net interest payments to GDP from 1.5 per cent in 2001 to 0.2 per cent in 2010. Excluding Social security funds (Labour Market Supplementary Pension Fund (ATP) and others) net interest

payments will decrease from 2.5 to 1.2 per cent of GDP from 2001 to 2010.

Table 4.3. Breakdown of change in general government debt

ESA	2001	2002	2003	2004	2005	2006-10
	---------- Per cent of GDP ----------					
General gov. debt	44.7	43.9	42.1	39.2	36.7	26.0
Change in general gov. debt	-2.0	-0.8	-1.8	-2.9	-2.5	-10.6
Contribution to change in debt:						
- Central and local gov. budget balance	-1.2	-1.1	-1.2	-1.7	-1.6	-6.9
- GDP growth contribution	-1.7	-1.4	-1.9	-1.6	-1.5	-6.2
- Change in funds share of gov. bonds[1)]	0.4	-0.5	-0.5	-0.2	-0.2	-0.7
- Financial items, etc.[2)]	0.4	2.2	1.7	0.7	0.7	3.1

1) This item reflects the fact that the portfolios of government bonds held by funds (ATP etc.) and of the Social Pensions Fond are deducted from debt measured.

2) This item includes receipts from the sale of government assets (privatisation, etc.), payment shifts in the taxation area, capital losses on securities issues, relending, etc.

Source: ADAM data bank and own calculations.

The general government budget balance is relatively sensitive to economic fluctuations. A cyclical increase in GDP – or a widening of the output gap – of 1 percentage point is estimated to improve general government finances by 0.6-0.7 per cent of GDP.

The structural balance provides an estimate of general government finances adjusted for cyclical effects and special items such as fluctuations in share prices. The structural budget balance is likely to fall, only as a technical correction, by ½ per cent of GDP from 2001 to 2002 due to the change in the Special Pension Savings Scheme. The general government budget balance in 2004 and 2005 is expected to be slightly higher than the structural budget balance, while it is projected to return to its structural level in 2006 (see table 4.4).

Table 4.4. Structural budget balance, 2000-2005

	2001	2002	2003	2004	2005	2006-10
	---------- Per cent of GDP, end-year level ----------					
Real GDP growth	1.0	1.5	2.2	1.8	1.7	1.8
General gov. budget bal. (1)	2.8	2.1	2.2	2.5	2.4	2.2
Interest payments	-1.5	-1.3	-1.1	-1.0	-0.9	-0.2
Potential real GDP growth	1.2	1.6	2.1	2.0	2.0	1.9
Output gap	0.7	0.6	0.7	0.6	0.3	0.0
Cyclical contributions (2)	0.4	0.3	0.4	0.3	0.2	0.0
Contributions from special items (3)	-0.3	-0.3	-0.4	0.0	0.0	0.0
Structural budget balance (1)-(2)-(3)	2.7	2.1	2.2	2.2	2.2	2.2

Note: The special items primarily account for the deviation of tax on accrued pension returns, corporation tax (excluding the tax revenue from oil and gas extraction in the North Sea) and net interest payments to trend.
Source: Statistics Denmark and own calculations.

General government expenditure, excluding net interest payments, will fall by 0.5 per cent of GDP from 2001 to 2010. A decrease in transfer payments accounts for the main part. Primary revenue as a share of GDP will drop from 56,1 per cent of GDP in 2001 to 53,2 per cent of GDP in 2010, mainly due to a reduction in the tax burden of 2.2 per cent of GDP. The tax freeze and lower tax on earned income will contribute 0.7 per cent of GDP (see table 4.5). If, on the other hand, tax on earned income is reduced by ½ per cent of GDP, then the tax burden fall by 2¼ per cent of GDP.

The tax freeze reduces the calculated tax burden by 0.45 per cent of GDP. Two opposing effects are involved. First, the isolated effect of the tax freeze is a drop in tax payments of 0.75 per cent of GDP (in 2002 terms). Second, the lower excise tax revenue (which is included in GDP) will dampen GDP growth, thus (in technical terms) increasing the measured tax burden by about 0.3 per cent of GDP. The remaining effect on general government finances is measured as an increase in general government expenditure as a share of GDP.

The projected normalising of the currently high corporation tax revenue will contribute to a decrease of 0.7 per cent of GDP from 2001 to 2010.

The plunge in share prices in 2001 and 2002 implies that revenue from tax on accrued pension returns is estimated to amount to virtually 0 per cent of GDP from 2001 to 2003. From 2004 onwards, share price increases are set to return to "normal" levels, which – combined with the accumulation of pension fund assets – allows tax on accrued pension returns to account for 1 per cent of GDP in 2010. From 2001 to 2010 this will contribute 0.9 per cent of GDP to the tax burden.

Large contribution to the change in the tax burden – and thus also general government finances – from tax on accrued pension returns should be seen against the fact that the rate of tax on accrued pension returns on shares was raised from 5 to 15 per cent in 2000, while the rate of tax on returns on bonds, which are far more stable, was reduced from 25 to 15 per cent.

Table 4.5. Composition of general government finances

	ESA	2001	2002	2003	2004	2005	2006-10
		---------- Per cent of GDP ----------					
General gov. budget balance.....	B9	2.8	2.1	2.2	2.5	2.4	2.2
Total expenditure.....	ESA	53.2	52.9	52.1	52.0	51.8	51.0
- Primary expenditure		49.1	49.3	48.8	48.8	48.7	48.6
- Public consumption.....	P32	25.5	25.6	25.4	25.5	25.6	25.4
- Investment.....	P51	1.7	1.8	1.8	1.8	1.8	1.8
- Transfer payments		17.0	17.0	16.9	16.7	16.5	16.6
- Gross interest payments		4.1	3.6	3.3	3.3	3.1	3.4
Total revenue.....	ESA	56.1	55.1	54.3	54.5	54.2	53.2
- Tax.....		49.0	48.2	47.7	48.0	47.6	46.8
- Personal tax and labour market contribution		25.2	25.0	25.0	24.7	24.4	24.1
- of which property value tax.		0.7	0.7	0.7	0.7	0.7	0.7
- Land tax		1.1	1.1	1.2	1.2	1.2	1.1
- Tax on accr. pens. returns..		0.1	0.0	0.0	0.8	0.9	1.0
- Corporation tax.....		3.1	3.0	2.7	2.7	2.6	2.4
- Compulsory contributions.		1.2	1.2	1.1	1.1	1.1	1.3
- Indirect tax.....		13.5	13.6	13.5	13.4	13.3	12.9
- Interest income.....	D41	2.5	2.3	2.2	2.2	2.2	2.2
- Other revenue		4.5	4.6	4.4	4.3	4.4	4.2

Note: This assumes the same real standards in public consumption as in CP2001 and lower tax on earned income ¼ per cent of GDP which is also unchanged. If the same real growth target as in CP2001 is assumed, tax and public consumption will decreas by an additional ¼ per cent of GDP.

Source: Statistics Denmark and own calculations.

A rough estimate based on historical experience shows that revenue from tax on accrued pension returns will fluctuate by slightly more than 1 per cent of GDP on average under the new rules. This reflects the relative stability of bond returns, while changes in share prices cause tax revenue to fluctuate substantially.

By way of comparison, the annual fluctuations in general government finances have been 1½ per cent of GDP on average during the past 25 years and lower than 1 per cent of GDP since 1990. The change in tax on accrued pension returns may thus double fluctuations in general government finances, and changes are very difficult to predict.

The large fluctuations from year to year in revenue from tax on accrued pension returns do not affect long-term sustainability of general government finances, and compensation should not be made through changes in fiscal policy, which would then become very unstable. Yet the fluctuations may increase the importance of average surpluses on general government finances so that random fluctuations do not give rise to speculation about the sustainability of fiscal policy.

The annual fluctuations in revenue from different types of tax, such as tax on accrued pension returns, also imply that tax receipts as a per cent of GDP may fall or increase appreciably in individual years in spite of the tax freeze.

5. Fiscal sustainability

The sustainability of fiscal policy has been assessed on the basis of the medium-term projection until 2010, whereas stylised assumptions are used for the years following 2010. After 2010, adjustments of transfer payments and public consumption per user will follow private-sector wage increases. This implies that, in general, shifts in the composition of the population, will be the main force driving the development in public consumption expenditure and transfer payments as a share of GDP (see appendix 2, which describes the overall assumptions for projecting general government finances).

After 2010, taxes expressed in percentage terms are kept constant, while indirect tax rates expressed as fixed amounts in Danish kroner are adjusted in line with price increases. Hence, revenue from taxation will

generally follow nominal GDP after 2010 in addition to the effect of changes in tax bases(relative to GDP).

In CP2001, the development in general government finances after 2010 were based on a stylised demographic scenario. But, as mentioned, CP2002 include the targets for the development in employment, public-sector services and taxes until 2010, which improves fiscal sustainability by 0.2 per cent of GDP compared to the demographic scenario (see table 5.4).

Any long-term projection of general government finances will always be subject to uncertainty, implying that long-term pressures on general government finances may be larger or smaller than suggested by the projection (see appendix 3, which contains sensitivity analyses). Yet the isolated impact of ageing and changes in private net pension savings is fairly robust. Other relevant factors for long-term trends are subject to uncertainty that may pull in either directions.

Long-term trends of general government finances

Due to a rise in the number of older people and a fall in the effective labour force, general government net expenditures will increase compared to GDP towards 2040 (see figure 5.1a). This reflects the fact that the increase in general government expenditure exceeds the predictable changes in tax revenue especially from private pension savings (see figure 5.1b to figure 5.1d).

Figure 5.1. Overall contributions to central and local government primary budget balance, change on 2003

Figure 5.1a. Contributions to primary budget balance

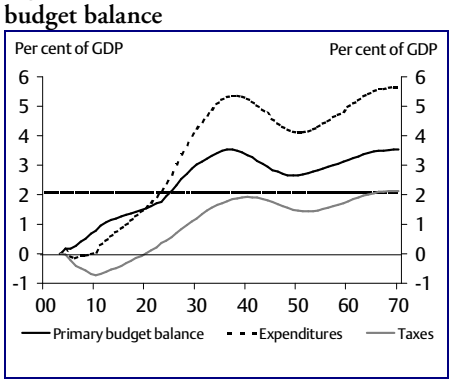


Figure 5.1b. Public consumption

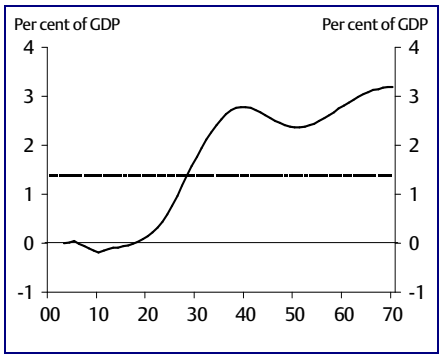


Figure 5.1c. Transfer payments after direct taxes, indirect taxes and means testing, including old-age pensions

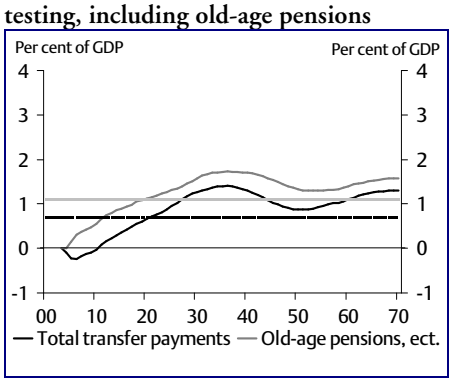
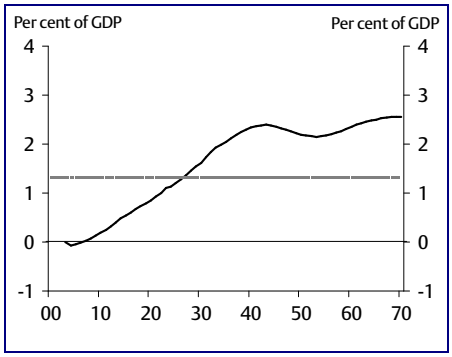


Figure 5.1d. Tax revenue from net pension payments



Note: Horizontal (red) lines specify the change as a per cent of GDP, converted into a fixed, annual change on 2003 (net present value).
Source: Own calculations.

On the basis of the expenditure rules applied, public consumption will rise over the coming decades as the population grows older. Public consumption will peak in 2070 when it is expected to have increased by 3.2 per cent of GDP (see table 5.1). Expenditure on transfer payments after tax will go up by 1.7 per cent of GDP until 2070.

Table 5.1. Projection of central and local government primary budget balance, change from 2003, % of GDP

	2010	2040	2070	Constant annual contribu-tion from 2003[1)]
	---------- Per cent of GDP ----------			
1. Central government expenditure	*-0.2*	*4.1*	*4.5*	*2.1*
1.1 Consumption[2)]	-0.2	2.8	3.2	1.4
1.2 Transfer payments after tax	0.0	1.7	1.7	0.9
1.3 Means testing	0.0	-0.4	-0.5	-0.2
2. Central government revenue	-1.0	0.7	0.9	0.0
2.1 Tax on pension savings, net	0.2	2.3	2.6	1.3
2.2 Revenue from North Sea oil extraction	-0.3	-0.7	-0.7	-0.6
2.3 Lower tax	-0.9	-0.9	-0.9	-0.8
- of which tax freeze until 2010	-0.7	-0.7	-0.7	-0.6
- of which lower tax on earned income[2)]	-0.3	-0.3	-0.3	-0.2
3. Impact on primary budget bal., total (1-2)	*0.8*	*3.3*	*3.5*	*2.1*
3.1 Increase in expenditures	0.1	5.3	5.7	-
3.2 Increase in taxes	-0.7	1.9	2.1	-

Note: The effects on the central and local government budget balance have been calculated on a structural basis and are exclusive of net interest expenditure. Expenditures also excludes payments under the Labour Market Supplementary Pension Scheme because this scheme – from a fiscal policy perspective – is eqvivalent to a private pension scheme. Note that the government revenue in the table does not include income taxes and excise taxes on transfer payments.

1) Specifies the net present value of future changes as a share of GDP, converted into a constant annual contribution as a per cent of GDP with effect as from 2003.

2) Contribution from public consumption/lower tax on earned income is about 0.2 per cent of GDP lower/higher at a rate of real growth in public consumption of 0.5 per cent a year from 2006 to 2010.

Source: Own calculations.

On the basis of the current rules governing the means testing of old-age-pension supplements and rent allowances, the increase in pension payments subject to income tax to old-age pensioners will curb the rise in transfer payments after tax by as much as 0.5 per cent of GDP until 2070.

Private-sector pension assets are set to increase from about 112 per cent of GDP in 2003 to about 200 per cent of GDP in 2040. Over this period,

taxable pension payments will gradually grow, implying a shift from net pension contributions of nearly 2 per cent of GDP in 2003 to net pension payments of about 3½ per cent of GDP in 2040. Tax revenue from net pension payments is expected to rise by about 2½ per cent of GDP until 2070.

The increase in net tax revenue from private-sector pension savings is partly offset by an expected decrease in revenue from oil and gas extraction in the North Sea. The revenue of about 0.7 per cent of GDP in 2003 from the North Sea are technically set to be phased out until 2020.

The projection of general government finances implies that general government expenditure will rise by about 5.7 per cent of GDP from 2003 to 2070, while general government revenue is set to increase by about 2.1 per cent of GDP over the same period. The implication is that the impact on the primary budget balance – the surplus before net interest payments – will be an increase of 3.5 per cent of GDP until 2070.

Generally, this increase in future obligations can be converted into a fixed annual amount of 2.1 per cent of GDP with effect as from 2003.

General government finance surplus requirements

To determine whether fiscal policy is robust to the expected future deterioration of the central and local government primary budget balance and the interest burden of general government net debt, future net obligations are compared with general government finances in 2003.

The central and local government structural primary budget balance accounts for 3.4 per cent of GDP in 2003 (see table 5.2), while the effect of the ageing of the population etc., requires a structural primary surplus of 3.3 per cent of GDP in 2003. This requirement can be broken down into two components. The first component is the interest burden of central and local government net debt of about 26 per cent of GDP in 2002, implying an expenditure of about 1.1 per cent of GDP in 2003. The interest burden consists of the share of net interest payments that is not eroded by GDP growth and therefore requires funding to prevent debt from rising as a share of GDP. The second component is the future

net obligations triggered by the ageing of the population, etc., converted into a fixed annual amount of 2.1 per cent of GDP in 2003 (see above).

Table 5.2. Long-term requirements for general government finances

	2003	2010
Present general government finances:	Per cent of GDP	
General government budget balance	2.2	2.2
- of which Social security funds	1.0	0.8
- of which central and local government budget balance	1.2	1.4
Central and local government net interest payments	1.9	1.2
Central and local government primary budget balance	3.2	2.5
Cyclical contributions to central and local government primary budget balance	-0.2	0.0
1. Central and local government structural primary budget balance	*3.4*	*2.5*
Contributions to future net obligations:		
Central government expenditure[1)]	2.1	2.7
Tax on private pension savings	-1.3	-1.4
Revenue from extraction in the North Sea	0.6	0.4
Tax freeze and lower tax on earned income as from 2004[1)]	0.8	0.0
Interest burden of general government net debt[2)]	1.1	0.7
2. Requirements for central and local government structural primary budget balance	*3.3*	*2.4*
3. Sustainability indicator (adjusted structural budget balance)	*0.1*	*0.1*

1) See note 1 for table 5.1.
2) The interest burden of general government net debt has been calculated on the basis of general government net interest payments, adjusted for growth and inflation.
Source: Own calculations.

The structural budget balance adjusted for future net obligations – the sustainability indicator – thus shows a surplus of about 0.1 per cent of GDP in 2003. This indicator specifies the hypothetical fiscal expansion with effect as from 2003, which is possible while still allowing fiscal policy to be continued without any subsequent changes in tax rates or expenditure standards.

Towards 2010, the surplus on the central and local government primary budget balance will decrease to 2.5 per cent of GDP, while the requirement for the primary surplus will drop to 2.4 per cent of GDP. The sustainability indicator still shows a balance of 0.1 per cent of GDP in 2010, but the composition of contributions to future net obligations will change towards 2010. Surpluses on general government finances and

a reduction of general government debt will cause the interest burden of debt to fall towards 2010. However, the contribution from general government expenditure to future net obligations will increase, since ageing will be less distant (and discounting less severe).

Given the uncertainties involved, a sustainability indicator ranging from -½ to ½ per cent of GDP implies that fiscal policy is considered sustainable. This means that the target for surplus on total general government finances of 1½-2½ per cent of GDP until 2010 is in line with the calculated requirement for maintaining sustainability of fiscal policy (see table 5.3).

Table 5.3. Requirements for general government structural budget balance

		2003	2010
		Per cent of GDP	
	Requirements for central and local gov. structural primary budget balance	3.3	2.4
	Central and local gov. structural net interest payments	2.0	1.2
-	Structural balance (social funds)	0.8	0.8
+	*Requirements for general government structural budget balance*	2.1	2.1
=			
	General government structural budget balance	*2.2*	*2.2*
	Sustainability indicator (adjusted structural general gov. budget balance)	*0.1*	*0.1*

Source: Own calculations.

The requirements for the central and local government structural primary budget balance in 2003 equal a surplus on total general government finances of 2.1 per cent of GDP, which is within the target range for the surplus on general government finances until 2010.

Appendix 1. Projection changes

Growth in GDP remains largely unchanged compared to CP2001. In the years until 2005, average GDP growth is only slightly lower, while it remains unchanged in the period from 2006 to 2010. In the years from 2001 to 2010, both projections imply that GDP grow by 1¾ per cent a year on average, corresponding to the increase in production potential.

In the new projection, consumer prices largely grow at the same pace as in CP2001. Yet, growth in consumer prices in 2002 has been revised upward by 0.7 percentage points, primarily reflecting higher growth in food and fuel prices.

Table 1. Changes in key economic indicators

	2001	2002	2003	2004	2005	2006-10
GDP growth	---------- Annual real growth ----------					
- CP2001	1.1	1.4	2.4	1.9	1.9	1.8
- CP2002	1.0	1.5	2.2	1.8	1.7	1.8
- Change	-0.1	0.1	-0.2	-0.1	-0.2	0.0
Consumer price index	---------- Annual real growth ----------					
- CP2001	2.3	1.6	1.9	1.6	1.6	1.7
- CP2002	2.4	2.3	1.8	1.6	1.6	1.7
- Change	0.0	0.7	-0.1	0.0	0.0	0.0
General gov. budget balance	---------- Per cent of GDP, end-year level ----------					
- CP2001	1.9	1.9	2.1	2.1	2.1	2.1
- CP2002	1.8	2.1	2.2	2.5	2.4	2.2
- Change	0.9	0.3	0.1	0.5	0.2	0.1
General government debt	---------- Per cent of GDP, end-year level ----------					
- CP2001	43.5	42.9	40.1	37.6	35.1	24.4
- CP2002	44.7	43.9	42.1	39.2	36.7	24.6
- Change	1.2	1.1	2.0	1.6	1.6	1.6
Tax burden	---------- Per cent of GDP, end-year level ----------					
- CP2001	48.0	47.9	47.6	47.4	47.1	46.3
- CP2002	49.0	48.2	47.7	48.0	47.6	46.8
- Change	1.0	0.4	0.1	0.6	0.5	0.5

Source: Own calculations.

The tax burden will decrease by 1.4 per cent of GDP in the period from 2001 to 2005 and by 2.2 per cent of GDP from 2001 to 2010. This is about 0.5 per cent of GDP more than set out in the previous projection. The main explanation is that the Special Pension Savings Scheme is considered a private scheme for 2002 and onwards in the national

accounts, and not as expected from 2001. From 2002 to 2010, the decrease in the tax burden is largely identical.

Appendix 2. Demographic assumptions

The projection of general government finances follows the medium-term projection until 2010. In general, the projection after 2010 is based on demographic contributions to employment and general government finances on the basis of *DREAM's* projection[3] from September 2002.

The new population projection implies that fertility will edge up (see figure 1a), while average life expectancy until 2100 is set to rise by slightly more than 5 years for men and a little more than 2 years for women (see figure 1b). Average life expectancy is set to rise by about 3½ years for men until 2050. This is somewhat less than the estimated increase in average life expectancy in EU member states[4]. Net immigration is set to amount to about 10,000 – mostly young – people on an annual basis (see figure 1c).

The projection shows substantial ageing of the population over the next few decades, implying that the number of older people will increase considerably, while the number of people of employable age largely remains unchanged (see figure 1d). The gradual ageing of the population implies a steep increase in the old age dependency ratio and an almost identical rise in the dependency ratio (see figure 1e).

[3] Population projection used in the *DREAM* CGE model.
[4] EU figures from EPC, *Budgetary challenges posed by ageing populations*, October 2001.

Figure 1. Key assumptions in the DREAM population projection

Figure 1a. Fertility

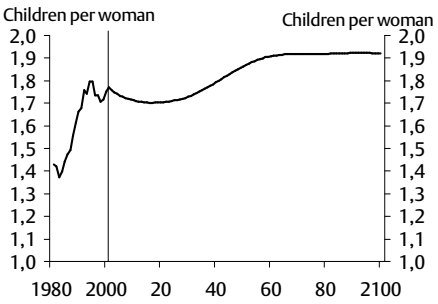


Figure 1b. Average life expectancy

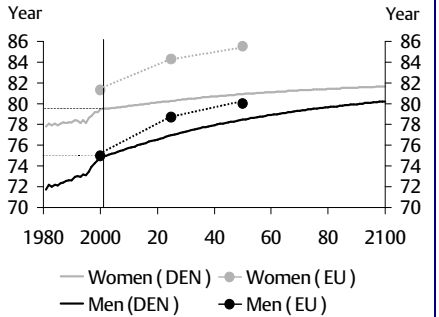


Figure 1c. Net immigration

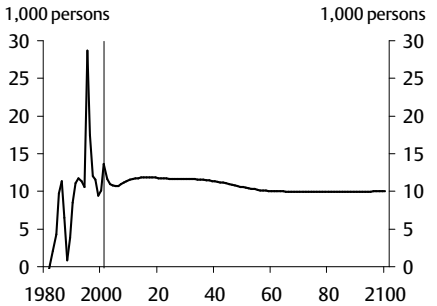


Figure 1d. Trends in age groups

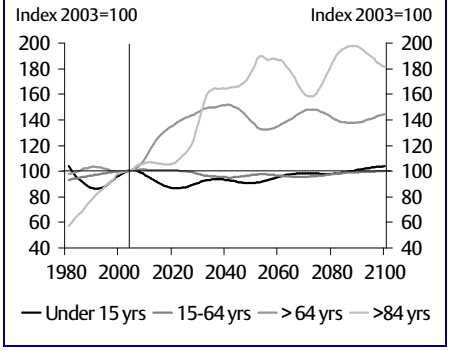


Figure 1e. Dependency ratios

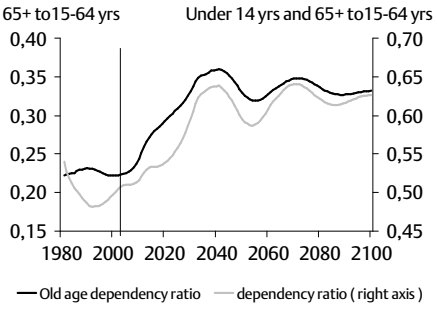
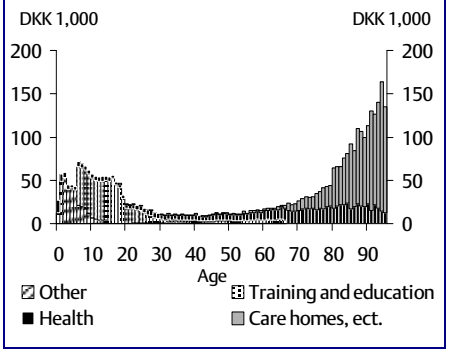


Figure 1f. Individual public consumption by age distribution in 1998



Source: DREAM population projection and own calculations.

Individual public consumption includes expenditure that is directly or indirectly attributable to users, such as hospitals, childcare, training and

education etc., and thus depends on the age composition of the population. Expenditure on administration, defence, legal systems, traffic and other areas is attributable to non-age-dependant collective public consumption. Individual public consumption accounts for the majority share (about two thirds) of total public consumption.

Average individual public expenditure on older people is markedly higher than expenditure on children and young people, whereas people of employable age on average have the lowest use of public-sector services (see figure 1f).

Table 1. Long-term general government finances and some basic assumptions.

	2003	2005	2010	2020	2030	2040	2070
	% of GDP	---------- Compared with 2003 ----------					
General gov. expenditure, excl. net interest payments	48.8	0.0	0.1	1.5	4.2	5.3	5.7
- Public consumption	25.4	0.0	-0.2	0.1	1.8	2.8	3.2
- Health and old-age care	7.5	-0.1	-0.2	0.3	1.3	1.8	1.7
- Public transfer payments [1]	16.9	0.0	0.3	1.4	2.5	2.5	2.4
- Old-age pension	4.3	0.4	0.9	1.8	2.7	2.9	2.8
Total general government revenue	54.3	-0.2	-0.7	0.0	1.2	1.9	2.1
- Tax on pension payouts, net	-	-0.1	0.2	0.9	1.6	2.3	2.6
Pension assets [2]	113	119	137	170	196	206	213
Assumptions	---------- Per cent ----------						
Nominal GDP per employed.	4.2	3.9	3.9	3.9	3.9	3.9	3.9
Nominal GDP	3.9	4.0	4.0	3.6	3.4	3.8	3.8
Participation rate, men (20-64 yrs)	85.8	86.0	86.0	85.5	84.6	84.8	84.0
Participation rate, women (20-64 yrs)	75.6	75.7	76.0	75.1	73.6	74.1	73.2
Participation rate, all (20-64 yrs)	80.7	80.9	81.0	80.3	79.1	79.5	78.6
Unemployment (% of labour force)	4.9	4.9	4.5	4.5	4.5	4.5	4.5
Structural unemployment	5.4	5.1	4.5	4.5	4.5	4.5	4.5

Note: The projection imply that unemployment and participation rates broken down by gender, age and origin are kept at a constant level after 2010 while tax revenue - with important exemptions related to pension savings, etc. - follows nominal GDP growth. Note that contrary to table 5.1 expenditures on transfer payments is calculated before income and excise tax.

1) Transfer payments from Social security funds (Labour Market Supplementary Pension Fund and others) have not been included.

The projection of the number of transfer recipients after 2010 is based on the demographic development in the number of transfer recipients in

each transfer category broken down by gender, age and origin. Since transfer payment rates are set to be adjusted in line with the increase in private-sector annual wages and as the wage share (wages relative to GDP) is assumed to remain constant after 2010, changes in transfer payments' (in per cent of GDP) will depend only on the number of transfer recipients compared to total employment after 2010.

Demographic shifts in the composition of the population will be the only factor to affect participation rates after 2010. The unemployment rate, set to drop to 4.5 per cent in 2010 (see table 1), will remain unchanged after 2010. Employment rates will also remain constant for age groups, gender and origin after 2010.

Appendix 3. Sensitivity analysis of fiscal policy sustainability

Any long-term projection of general government finances will always be subject to considerable uncertainty, implying that the long-term pressures on general government finances may be larger or smaller than suggested by the projection. The isolated impact of ageing and private pension savings may, however, be predicted with rather high certainty, although even minor changes in average life expectancy may have a noticeable impact on fiscal policy requirements (see table 1).

Table 1. Selected sensitivity analysis. Change in the sustainability indicator

	Effect on fiscal sustainability
Demography:	Per cent of GDP
Fertility increases by 4,000 children a year from 2004	-0.02
Average life expectancy increases by 1 year	-0.22
Increase in average life expectancy until 2050 equals EU average	-0.58
Average life expectancy increases to average EU level in 2050	-0.70
Active employment:	
Average retirement age increases by half a year	0.25
Immigration (annual change compared to demographicc scenario):	
Immigration from average country rises by 5,000	0.00
Immigration from average country falls by 5,000	0.00
Immigration from less developed countries rises by 5,000	-0.12
Immigration from less developed countries falls by 5,000	0.12
Immigration from more developed countries rises by 5,000	0.12
Immigration from more developed countries falls by 5,000	-0.12
More old-age pensioners (50,000) residing abroad:	
Small loss of tax revenue	-0.08
Average loss of tax revenue	-0.13
Large loss of tax revenue	-0.18

Source: DREAM and own calculations.

The importance of increasing employment

If no additional structural measures are introduced, employment is forecast to increase by some 30,000 people between 2000 and 2010, implying that additional measures are needed to reach the target of 85,000 people. Moreover, this requires that no reduction of working hours is introduced other than the one following from recent collective agreements and changes in the age composition of the labour force.

If the non-implemented requirements for employment are not realised – implying that the increase in structural employment from 2003 to 2010 will be about 61,000 people[5] less than anticipated – the fiscal leeway will be reduced by 1 per cent of GDP. However, if the non-implemented

[5] The non-implemented requirements for employment imply an increase of 48,000 people from 2003 to 2010. The calculation of the sustainability of fiscal policy is based on structural employment, where the non-implemented employment requirement is 61,000 people from 2003 to 2010 (see section 5). The difference is attributable to the fact that structural employment in 2003 will exceed actual employment by 13,000 people.

employment requirements are realised, but average working hours fall by about 2¼ per cent more than projected – largely corresponding to the performance of 61,000 full-time workers – the fiscal leeway will be reduced by 0.7 per cent of GDP (see table 2).

Table 2. Effect on fiscal sustainability if assumptions concerning employment and working hours fail

	Per cent of GDP	DKK bn 2002
Non-implemented requirements are not realised.....	-1.0	-14
Fall in average working hours of 2¼ per cent.....	-0.7	-10
Fall in agreed and avr. working hours of 2¼ per cent..	-0.5	-7

Note: The wages of the affected persons are assumed to be in line with average levels. The number of hours worked in the public sector is assumed unchanged, implying that more people will be employed in the case of shorter working hours.
Source: ADAM data bank and own calculations.

If such a fall in average working hours follows from a reduction in agreed working hours based on a collective agreement – and not merely from a change in, for instance, the composition of the population or part-time frequency – a similar reduction will be made in the adjustment of transfer payments as the rate adjustment is related to annual wages. This will reduce general government expenditure on transfer payments, thus reducing the fiscal leeway by only 0.5 per cent of GDP, should working hours be lowered by another 2¼ per cent. The calculations assume higher public-sector employment to ensure the same number of working hours in the public sector.

The reduction in the fiscal leeway reflects the fact that lower employment and shorter average working hours in the private sector lowers production and tax payments. However, the fall in working hours has less impact on fiscal opportunities than a comparable fall in employment, since a lower number of people employed is offset by a rise in the number of recipients of transfer payments, and thus in expenditure on transfer payments. However, if the fall in average working hours is not a result of a collective agreement, the rate adjustment – and thus expenditure on transfer payments – is not changed.

Annex

Table B1 and B2 show the key figures in the two scenarios. One scenario assumes the same real standards in public consumption as in CP2001, while the other scenario assumes the same real growth rate in public consumption as in CP2001. The medium term projection does not give priority to one of the two scenarios, and they both require that the employment target is achieved.

The subsequent tables in annex display the scenario with the same real standards as in CP2001 and a reduction in earned income tax in the amount of ¼ per cent of GDP.

Table A1. Key figures for the Danish economy with real standards in public consumption as in CP2001.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	Annual real growth, (%)										
Private consumption	-0.3	0.8	2.3	2.3	2.2	2.3	2.4	2.5	2.4	2.6	2.4
Public consumption	0.6	1.2	1.3	0.7	1.0	1.0	0.7	0.7	0.7	0.7	0.7
Residential investments	11.0	-13.5	-2.0	1.5	2.3	2.2	2.1	2.0	2.1	2.2	2.0
Business investments	11.1	3.0	0.2	3.4	2.4	2.2	2.2	2.4	2.4	2.4	2.4
Public investments	6.7	3.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Stock investments[1)]	0.2	0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic demand	2.6	1.1	1.2	2.1	1.9	2.0	1.9	2.0	2.0	2.0	2.0
Exports	11.5	3.7	4.3	5.1	4.0	3.5	3.5	3.5	3.5	3.5	3.5
of which industry	12.8	2.6	4.3	6.0	4.8	4.0	4.1	4.1	4.1	4.1	4.1
Imports	11.2	4.3	3.9	5.1	4.5	4.2	4.2	3.9	4.0	4.0	4.0
GDP	3.0	1.0	1.5	2.2	1.8	1.7	1.7	1.8	1.8	1.9	1.8
Gross factor income in business sector	5.4	2.6	1.2	2.8	2.2	2.1	2.1	2.3	2.2	2.3	2.2
	Annual growth, (%)										
Hourly wage costs	3.9	4.3	4.2	4.1	4.0	3.9	3.8	3.8	3.8	3.8	3.8
Hourly wages	3.6	4.2	4.1	4.0	4.0	3.9	3.8	3.8	3.8	3.8	3.8
Hourly productivity, business sec	3.7	1.1	1.4	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Private disposable incomes	3.9	1.0	1.9	2.7	1.9	2.6	2.6	2.6	2.5	2.6	2.5
Export prices	10.7	4.2	-1.5	0.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6
Import prices	9.9	2.7	-0.4	0.1	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Consumer prices	2.9	2.4	2.3	1.8	1.6	1.6	1.6	1.7	1.7	1.7	1.7
Nominal house prices	6.5	5.8	2.5	2.5	1.5	1.6	1.6	2.2	2.3	2.4	2.3
	Per cent										
Effective yield on gov. bonds	5.6	5.1	5.2	5.5	5.8	6.0	6.1	6.1	6.1	6.1	6.1
	Bn. DKK										
Current account	20.6	34.2	31.5	35.0	38.6	40.5	42.6	45.9	49.4	53.1	57.5
of which interest payments etc.	-29.0	-29.9	-29.6	-31.5	-29.5	-27.9	-26.1	-24.4	-22.4	-20.1	-17.5
Public finances	32.7	38.1	29.7	32.2	38.2	37.3	36.4	36.8	38.5	39.8	41.9
of which interest payments etc.	-22.7	-20.6	-18.6	-15.9	-15.4	-14.2	-12.7	-10.6	-8.1	-5.6	-3.0
	Per cent of GDP										
Current account	1.6	2.5	2.3	2.4	2.6	2.6	2.6	2.7	2.8	2.9	3.0
Public finances	2.5	2.8	2.1	2.2	2.5	2.4	2.2	2.2	2.2	2.2	2.2
Private financial savings	-0.9	-0.3	0.1	0.2	0.0	0.2	0.4	0.5	0.6	0.7	0.8
Tax burden	48.8	49.0	48.2	47.7	48.0	47.6	47.3	47.1	47.0	46.8	46.8
Expenditure burden	53.2	53.2	52.9	52.1	52.0	51.8	51.6	51.5	51.3	51.2	51.0
	1,000 persons										
Total employment	2,705	2,720	2,725	2,738	2,748	2,755	2,760	2,768	2,775	2,783	2,791
of which public	823	828	834	837	841	845	848	851	853	856	858
of which private	1,882	1,892	1,892	1,902	1,907	1,910	1,912	1,917	1,922	1,928	1,933
Labour force	2,856	2,865	2,869	2,880	2,889	2,897	2,902	2,907	2,912	2,916	2,921
Registered unemployment	150	145	144	142	142	142	142	139	136	133	130
Per cent of the labour force	5.3	5.1	5.0	4.9	4.9	4.9	4.9	4.8	4.7	4.6	4.5
Do. EU-definition	4,4	4,3	4,2	4,1	4,1	4,1	4,1	4,0	3,9	3,8	3,7

1) Shows stock changes' contribution to GDP-growth.

Table A2. Key figures for the Danish economy with real growth in public consumption as in CP2001

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	Annual real growth (%)										
Private consumption	-0.3	0.8	2.3	2.3	2.3	2.4	2.5	2.6	2.5	2.6	2.5
Public consumption	0.6	1.2	1.3	0.7	1.0	1.0	0.5	0.5	0.5	0.5	0.5
Residential investments	11.0	-13.5	-2.0	1.5	2.3	2.4	2.4	2.4	2.2	2.3	2.0
Business investments	11.1	3.0	0.2	3.4	2.5	2.3	2.3	2.3	2.2	2.3	2.4
Public investments	6.7	3.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Stock investments[1]	0.2	0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic demand	2.6	1.1	1.2	2.1	2.0	2.1	2.0	2.0	1.9	2.0	2.0
Exports	11.5	3.7	4.3	5.1	4.0	3.5	3.5	3.5	3.5	3.5	3.5
of which industry	12.8	2.6	4.3	6.0	4.8	4.0	4.1	4.1	4.1	4.1	4.1
Imports	11.2	4.3	3.9	5.1	4.6	4.3	4.2	4.0	3.9	3.9	3.9
GDP	3.0	1.0	1.5	2.2	1.9	1.8	1.7	1.8	1.8	1.8	1.8
Gross factor income in business sector	5.4	2.6	1.2	2.8	2.2	2.2	2.1	2.2	2.2	2.2	2.2
	Annual growth (%)										
Hourly wage costs	3.9	4.3	4.2	4.1	4.0	3.9	3.8	3.8	3.8	3.8	3.8
Hourly wages	3.6	4.2	4.1	4.0	4.0	3.9	3.8	3.8	3.8	3.8	3.8
Hourly productivity, business sector	3.7	1.1	1.4	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Private disposable incomes	3.9	1.0	1.9	2.7	2.1	2.7	2.7	2.6	2.5	2.6	2.5
Export prices	10.7	4.2	-1.5	0.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6
Import prices	9.9	2.7	-0.4	0.1	1.5	1.5	1.5	1.4	1.5	1.5	1.5
Consumer prices	2.9	2.4	2.3	1.8	1.6	1.6	1.7	1.7	1.7	1.7	1.7
Nominal house prices	6.5	5.8	2.5	2.5	1.6	1.8	1.9	2.4	2.3	2.5	2.3
	Per cent										
Effective yield on gov. bonds	5.6	5.1	5.2	5.5	5.8	6.0	6.1	6.1	6.1	6.1	6.1
	Bn. DKK										
Current account	20.6	34.2	31.5	35.0	38.4	39.8	41.5	44.4	48.1	52.2	56.9
of which interest payments etc.	-29.0	-29.9	-29.6	-31.5	-29.5	-27.9	-26.2	-24.6	-22.7	-20.4	-17.9
Public finances	32.7	38.1	29.7	32.2	37.2	35.4	34.1	35.0	37.1	38.9	41.6
of which interest payments etc.	-22.7	-20.6	-18.6	-15.9	-15.4	-14.2	-12.8	-10.7	-8.3	-5.8	-3.2
	Per cent of GDP										
Current account	1.6	2.5	2.3	2.4	2.5	2.5	2.5	2.6	2.7	2.8	3.0
Public finances	2.5	2.8	2.1	2.2	2.5	2.3	2.1	2.1	2.1	2.1	2.2
Private financial savings	-0.9	-0.3	0.1	0.2	0.1	0.3	0.5	0.6	0.6	0.7	0.8
Tax burden	48.8	49.0	48.2	47.7	47.9	47.4	47.0	46.8	46.7	46.6	46.5
Expenditure burden	53.2	53.2	52.9	52.1	52.0	51.7	51.5	51.3	51.2	51.0	50.8
	1,000 persons										
Total employment	2,705	2,720	2,725	2,738	2,748	2,757	2,762	2,769	2,776	2,784	2,791
of which public	823	828	834	837	841	845	848	851	853	856	858
of which private	1,882	1,892	1,892	1,902	1,907	1,912	1,914	1,919	1,923	1,928	1,933
Labour force	2,856	2,865	2,869	2,880	2,889	2,897	2,902	2,907	2,912	2,916	2,921
Registered unemployment	150	145	144	142	141	140	140	138	135	133	130
Per cent of the labour force	5.3	5.1	5.0	4.9	4.9	4.9	4.9	4.8	4.7	4.6	4.5
Do. EU-definition	4,4	4,3	4,2	4,1	4,1	4,1	4,1	4,0	3,9	3,8	3,7

1) Shows stock changes' contribution to GDP-growth.

Table A3. Growth and associated factors.

	ESA	2001	2002	2003	2004	2005	2006-10
		---------- Annual growth (%) ----------					
GDP growth at constant market prices	B1g	1.0	1.5	2.2	1.8	1.7	1.8
GDP level at current market prices	B1g	1,344	1,388	1,450	1,509	1,568	1,904
GDP deflator		2.8	1.7	2.3	2.1	2.2	2.1
HICP		2.3	2.2	1.7	1.5	1.5	1.6
Employment		0.5	0.2	0.5	0.3	0.3	0.3
Labour productivity		0.4	1.3	1.7	1.5	1.4	1.5
Sources of growth:		---------- Annual real growth rate (%) ---------					
Private consumption	P3	0.8	2.3	2.3	2.2	2.3	2.5
Government consumption	P3	1.2	1.3	0.7	1.0	1.0	0.7
Gross fixed capital formation	P51	-0,2	0.0	2.9	2.4	2.2	2.3
Changes in inventories and net acquisition of valuables[1)]	P52+ P53	0.4	-0.2	0.0	0.0	0.0	0.0
Exports of goods and services	P6	3.7	4.3	5.1	4.0	3.5	3.5
Imports of goods and services	P7	4.3	3.9	5.1	4.5	4.2	4.0
Contribution to GDP growth		---------- Annual real growth rate (%) ----------					
Final domestic demand		1.0	1.2	2.0	1.9	1.9	1.9
Changes in inventories and net acquisition of valuables[1)]	P52+ P53	0.4	-0.2	0.0	0.0	0.0	0.0
Net exports	B11	-0.1	0.3	0.2	0.0	-0.2	0.0

1) Contribution to GDP growth

Table A4. General government budgetary developments

	ESA	2001	2002	2003	2004	2005	2010
Net lending (B9) by sub-sector		---------- Per cent of GDP ----------					
General government	S13	2.8	2.1	2.2	2.5	2.4	2.2
Central government	S1311	1.3	1.1	1.2	1.7	1.6	1.4
Local government	S1313	-0.1	0.0	0.0	0.0	0.0	0.0
Social security funds	S1314	1.6	1.0	1.0	0.8	0.8	0.8
General government (S13)							
Total receipts	ESA	56.1	55.1	54.3	54.5	54.2	53.2
Total expenditures	ESA	53.2	52.9	52.1	52.0	51.8	51.0
Budget balance	B9	2.8	2.1	2.2	2.5	2.4	2.2
Net interest payments		1.5	1.3	1.1	1.0	0.9	0.2
Primary balance		4.4	3.5	3.3	3.6	3.3	2.4
Components of revenues							
Taxes	D2+D5	46.8	46.6	46.1	46.4	46.0	45.2
Social contribution	D61	2.2	1.6	1.6	1.6	1.6	1.6
Interest income	D41	2.5	2.3	2.2	2.2	2.2	2.2
Other		4.5	4.6	4.4	4.3	4.4	4.2
Total receipts	ESA	56.1	55.1	54.3	54.5	54.2	53.2
Components of expenditures							
Collective consumption	P32	25.5	25.6	25.4	25.5	25.6	25.4
Social transfers in kind	D63	17.7	17.7	17.5	17.6	17.6	17.5
Social transfers other than in kind	D62	17.0	17.0	16.9	16.7	16.5	16.6
Net interest payments	D41	4.1	3.6	3.3	3.3	3.1	2.4
Subsidies	D3	2.0	2.0	1.9	1.9	1.9	1.9
Gross fixed capital formation	P51	1.7	1.8	1.8	1.8	1.8	1.8
Other		2.9	2.9	2.8	2.8	2.9	2.9
Total expenditures	ESA	53.2	52.9	52.1	52.0	51.8	51.0

Table A5. General government debt developments

	ESA	2001	2002	2003	2004	2005	2010
		---------- Per cent of GDP ----------					
Gross debt level		44.7	43.9	42.1	39.2	36.7	26.0
Change in gross debt		-2.0	-0.8	-1.8	-2.9	-2.5	-10.6
Contribution to change in gross debt							
Central and local gov. primary budget balance		-3,6	-3,3	-3,2	-3,6	-3,4	-14,0
Interest payments	D41	2,5	2,2	1,9	1,9	1,8	7,1
GDP growth contribution	B1g	-1,7	-1,4	-1,9	-1,6	-1,5	-6,2
Other factors influencing the debt ratio		0,8	1,7	1,3	0,5	0,5	2,4
Of which: Privatisation receipts		0.0	0.0	0.0	0.0	0.0	0.0
p.m. implicit interest rate on debt		7.6	6.9	6.4	6.4	6.5	6.2

Table A6. Cyclical developments

	ESA	2001	2002	2003	2004	2005	2010
		---------- Per cent of GDP ----------					
GDP growth at constant prices	B1g	1.0	1.5	2.2	1.8	1.7	1.8
Actual budget balance	B9	2.8	2.1	2.2	2.5	2.4	2.2
Net interest payments	D41	4.1	3.6	3.3	3.3	3.1	2.4
Potential GDP growth		1.2	1.6	2.1	2.0	2.0	1.9
Output gap		0.7	0.6	0.7	0.6	0.3	0.0
Cyclically-adjusted balance		2.7	2.1	2.2	2.2	2.2	2.2
Cyclically-adjusted primary bal.		3.7	2.8	2.8	2.6	2.4	1.8

Table A7. Divergence from previous update

	ESA	2001	2002	2003	2004	2005	2010
GDP growth	Blg	---------- Per cent of GDP ----------					
Previous update		1.1	1.4	2.4	1.9	1.9	1.8
Latest update		1.0	1.5	2.2	1.8	1.7	1.8
Difference		-0.1	0.1	-0.2	-0.1	-0.2	0.0
Actual budget balance	B9						
Previous update		1.9	1.9	2.1	2.1	2.1	2.1
Latest update		2.8	2.1	2.2	2.5	2.4	2.2
Difference		0.9	0.3	0.1	0.5	0.2	0.1
Gross debt level							
Previous update		43.5	42.9	40.1	37.6	35.1	24.4
Latest update		44.7	43.9	42.1	39.2	36.7	26.0
Difference		1.2	1.1	2.0	1.6	1.6	1.7

Table A8. Long term sustainability of public finances

	ESA	2000	2005	2010
		--------- Per cent of GDP --------		
Total expenditure		53.2	51.1	51.0
Old age pensions		4.4	4.5	5.1
Health care (including care for the elderly)		7.5	7.4	7.3
Interest payments		4.2	3.1	2.4
Total revenues		55.7	54.2	53.2
Of which: from pensions contributions			-1.3	-1.1
National pension fund assets		115	119	137
Assumptions		---------- Per cent ----------		
Nominal GDP growth per employee		5.3	3.9	3.9
Real GDP growth		3.0	1.7	1.8
Participation rate males (aged 20-64)		85.3	86.0	86.0
Participation rate females (aged 20-64)		74.5	75.7	76.0
Total participation rates (aged 20-64)		80.5	80.9	81.0
Unemployment rate		5.8	5.1	4.5

Table 7. Basic assumptions

ESA	2001	2002	2003	2004	2005	2010
	---------- Per cent of GDP ----------					
Short-term interest rate (annual avg.)	4.6	3.7	3.9	4.5	4.8	4.9
Long-term interest rate annual average)	5.1	5.3	5.5	5.8	6.0	6.1
USA: long term (10-year government bonds)	5.1	5.0	5.5	5.8	5.9	6.0
USD/EURO exchange rate (annual average)	0.90	0.94	0.98	0.97	0.97	0.97
(for non-euro countries) exchange rate vis-à-vis the EURO (annual average)	7.46	7.43	7.46	7.46	7.46	7.46
World excluding EU. GDP growth	2.4	3.0	3.9	4.2	3.5	3.5
US	0.3	2.4	2.4	2.4	2.4	2.4
Japan	-0.1	-0.6	1.2	1.5	1.5	2.0
EU-15 GDP growth	1.6	1.0	2.1	2.1	2.1	2.1
Growth of relevant foreign markets	-0.3	1.4	7.8	5.2	4.4	4.4
World import volumes. Excluding EU	-1.7	3.2	6.8	7.4	6.6	5.0
Oil prices. (Brent. USD/barrel)	24.8	24.0	25.0	25.3	25.5	26.8
Non-oil commodity prices (in USD)	-8.1	1.1	-0.4	-1.3	-0.5	0.5