COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23.1.2007
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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 9 (for CP) of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated convergence programme of Denmark, 2006-2010

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact, which entered into force on 1 July 1998, is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact acknowledged its usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Stability and Growth Pact, stipulates that Member States have to submit, to the Council and the Commission, stability or convergence programmes and annual updates thereof (Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes). The first convergence programme of Denmark was submitted in October 1998. In accordance with the Regulation, the Council delivered an opinion on it on 1 December 1998 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. In accordance with the same procedure, updated stability and convergence programmes are assessed by the Commission and examined by the Committee mentioned above, while the Council may examine them.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the convergence programme of Denmark, submitted on 30 November 2006, and has adopted a recommendation for a Council opinion on it (see box for the main points covered by the assessment).

In order to set the scene against which the budgetary strategy in the new convergence programme is assessed, the following paragraphs summarise:

(1) the economic and budgetary performance over the last ten years

(2) the most recent assessment of the country's position under the preventive arm of the Stability and Growth Pact (summary of the Council opinion on the previous update of the convergence programme); and

(3) the Commission's assessment of the October 2006 national reform programme.

2.1. Recent economic and budgetary performance

Over the last decade, the Danish economy has performed relatively well overall. Real GDP growth and inflation have developed broadly in line with the euro area. At the same time, the

[1] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

functioning of the labour market has improved and become very flexible, which has contributed to a gradual reduction of unemployment and to an increase in employment. Unemployment is at an historically low level and the employment rate is the highest in the EU. Moreover, Denmark has benefited from well-managed reforms and sound fiscal policies, which has led to successive general government surpluses and a rapid reduction of government debt. The strong public finances can be attributed to successful economic reforms and a medium-term fiscal strategy aimed at fiscal sustainability and expenditure discipline. An important element of this strategy is the tax-freeze which promotes expenditure discipline and is expected to reduce the tax burden over time. Denmark appears to be at low risk as regards long-term sustainability of public finances. The medium-term fiscal strategy, which focuses on creating budget surpluses and reducing government debt, has been successful in preparing the public finances for the effects of an ageing population. The Welfare Agreement reached in June 2006, which is foreseen to increase labour supply in the long-term, has further contributed to improving the ability of Denmark to face these effects.

2.2. The assessment in the Council opinion on the previous programme

On 24 January 2006, the Council adopted its opinion on the previous update of the convergence programme, covering the period 2005-2010. The Council was of the opinion that "overall, the budgetary position is sound and the budgetary strategy provides a good example of fiscal policies in compliance with the Stability and Growth Pact".

2.3. The Commission assessment of the October 2006 national reform programme

The Implementation Report of the National Reform Programme of Denmark, provided in the context of the renewed Lisbon strategy for growth and jobs, was submitted on 16 October 2006. Denmark's National Reform Programme identifies as key challenges/priorities: ensuring fiscal sustainability, improving competition in certain sectors; enhancing public sector efficiency; developing the knowledge society; securing environmental sustainability and energy; encouraging entrepreneurship; and increasing the labour supply.

The Commission's assessment of this programme (adopted as part of its December 2006 Annual Progress Report[2]) showed that Denmark is making very good progress in the implementation of its National Reform Programme. Denmark has with the June 2006 Welfare Agreement further strengthened its reform strategy in terms both of macro-economic and employment policy and has made very good progress in reaching a national consensus on reforms. Denmark has also made progress on micro-economic policies, including in the area of competition.

Against the background of progress made, Denmark was encouraged to also focus on the areas of labour supply over the medium term; competition; energy interconnection supply; emission reduction policies; and education.

[2] Communication from the Commission to the Spring European Council, "Implementing the renewed Lisbon strategy for growth and jobs - A year of delivery", 12.12.2006, COM(2006)816.

Box: Main points covered by the assessment

As required by Article 5(1) (for stability programmes) and Article 9(1) (for convergence programmes) of Council Regulation (EC) No 1466/97, the assessment covers the following points:

- whether the economic assumptions on which the programme is based are plausible;
- the medium-term budgetary objective (MTO) presented by the Member State and whether the adjustment path towards it is appropriate;
- whether measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle;
- when assessing the adjustment path towards the MTO, whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times, and, for euro-area and ERM II Member States, whether the Member State pursues an annual improvement of the cyclically-adjusted balance, net of one-off and other temporary measures, of 0.5% of GDP as a benchmark to meet its MTO;
- when defining the adjustment path to the MTO (for Member States that have not yet reached it) or allowing a temporary deviation from the MTO (for Member States that have), the implementation of major structural reforms which have direct long-term cost-saving effects (including by raising potential growth) and therefore a verifiable impact on the long-term sustainability of public finances (subject to the condition that an appropriate safety margin with respect to the 3% of GDP reference value is preserved and that the budgetary position is expected to return to the MTO within the programme period), with special attention for pension reforms introducing a multi-pillar system that includes a mandatory, fully-funded pillar;
- whether the economic policies of the Member State are consistent with the broad economic policy guidelines.

The plausibility of the programme's macroeconomic assumptions is assessed by reference to the Commission services' autumn 2006 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. The assessment of consistency with the broad economic policy guidelines is made against the broad economic policy guidelines in the area of public finances as included in the integrated guidelines for the period 2005-2008.

The assessment also examines:

- the evolution of the debt ratio and the outlook for the long-term sustainability of the public finances, which should be given "sufficient attention in the surveillance of budgetary positions" according to the Council report of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact". A Commission Communication of 12 October 2006 sets out the approach to the assessment of long-term sustainability[3];
- the degree of integration with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs. In its cover note of 7 June 2005 to the European Council on the broad economic policy guidelines for the period 2005-2008, the ECOFIN Council stated that the national reform programmes should be consistent with the stability and convergence programmes;
- compliance with the code of conduct[4], which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

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3 Communication from the Commission to the Council and the European Parliament, "The long-term sustainability of public finances in the EU", 12.10.2006, COM (2006) 574 final and European Commission, Directorate-General for Economic and Financial Affairs (2006), "The long-term sustainability of public finances in the European Union", European Economy No 4/2006.

4 "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005.

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in accordance with the third paragraph of Art. 9 (for CP) of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated convergence programme of Denmark, 2006-2010

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[5], and in particular Article 9(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [27 February 2007] the Council examined the updated convergence programme of Denmark, which covers the period 2006 to 2010.

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth will slow from 2.7% in 2006 to 1.0% on average over the rest of the programme period. Assessed against currently available information, this scenario appears to be based on markedly cautious growth assumptions, in particular for the period 2008-2010 due to the technical assumption in the update of the closing of a (positive) output gap in 2010. The programme's projections for inflation appear realistic.

(3) For 2006, the general government surplus is estimated at 3.2% of GDP in the Commission services' autumn 2006 forecast, against a target of 2.1% of GDP set in the previous update of the convergence programme. This reflects higher-than-expected growth as well as continued high energy prices given the importance of revenues linked to Denmark's oil and gas production.

[5] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

(4) The budgetary strategy aims at maintaining structural surpluses (i.e. cyclically-adjusted surpluses net of one-off and other temporary measures) of between ½% and 1½% of GDP on average over the programme period, implying a marked reduction in the general government debt ratio in order to ensure fiscal sustainability in the long term. The strategy is based on expenditure restraint (annual growth of real public consumption spending limited to approximately 1% on average for the period 2007 to 2010, up from 0.5% in the previous update) and on the maintenance of the tax freeze introduced in 2001 and of the requirement that local government budgets be balanced. The update foresees the surplus to narrow slightly from 3.1% of GDP in 2006 to 2.8% in 2007, and to decline further to 1.2% in 2010 (from 4.7% in 2006 to 1.8% in 2010 in primary terms). The decline as from 2008 reflects the markedly cautious assumptions about GDP growth. Compared with the previous update, the general government balance is higher in 2006 to 08 but lower towards the end of the programme period.

(5) The structural balance calculated according to the commonly agreed methodology is projected to be around 2% of GDP or better throughout the programme period, with a slight deterioration in 2007 and a somewhat stronger improvement in 2008. The medium-term objective (MTO) for the budgetary position presented in the programme is a structural balance of between ½% and 1½% of GDP, which the programme plans to maintain by a large margin throughout the programme period. The MTO is unchanged from the previous update once account is taken of the exclusion in the new programme of the second pillar pension scheme (included in Denmark's previous programmes) in line with the Eurostat decision of 2 March 2004[6]. As the MTO is more demanding than the minimum benchmark (estimated at a deficit of around ½% of GDP), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO lies within the range indicated for euro-area and ERM II Member States in the Stability and Growth Pact and the code of conduct and is significantly more demanding than implied by the debt ratio and average potential output growth in the long term.

(6) The budgetary outcomes could be better than projected in the programme, in particular for the years 2008 to 2010. This is essentially because of the programme's markedly cautious macroeconomic scenario, which outweighs the risk that real public consumption expenditure growth could be higher than targeted.

(7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the MTO throughout the programme period, as envisaged in the programme. In addition, it provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations in each year. The fiscal policy stance implied by the programme is fully in line with the Stability and Growth Pact.

(8) Government gross debt is estimated to have declined below 30% of GDP in 2006, well below the 60% of GDP Treaty reference value. The programme projects the gross debt ratio to decline by around a further 11 percentage points over the programme period.

(9) The long-term budgetary impact of ageing in Denmark is higher than on average in the EU; influenced notably by a relatively high increase in pension expenditure as a share

[6] See Eurostat News Releases No 30/2004 of 2 March 2004 and No 117/2004 of 23 September 2004.

of GDP over the coming decades. However, the comprehensive reform package adopted in June 2006, the "Agreement on Future Prosperity, Welfare and Investments in the Future" or simply Welfare Agreement, aims at delaying retirement and should contribute to curb the long-term expenditure trends and thus improve public finance sustainability. Moreover, the initial budgetary position with a large structural surplus contributes significantly to ease the long-term budgetary impact of ageing. Maintaining high primary surpluses over the medium-term will contribute to reducing risks to the sustainability of public finances. Taking into account these developments, Denmark appears to be at low risk with regard to the sustainability of public finances.

(10) The convergence programme contains a qualitative assessment of the overall impact of the October 2006 implementation report of the national reform programme within the medium-term fiscal strategy. In addition, it provides systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme and its budgetary projections explicitly take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the convergence programme seem consistent with those foreseen in the national reform programme. In particular, both programmes envisage the implementation of reforms aimed at increasing labour supply in the long term, in particular the agreement to raise statutory pension ages and thus promote longer effective working lives.

(11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

(12) As regards the data requirements specified in the code of conduct for stability for stability and convergence programmes, the programme provides all required data and most optional data.[7]

The overall conclusion is that the medium-term budgetary position is sound and the budgetary strategy provides a good example of fiscal policies conducted in compliance with the Stability and Growth Pact.

[7] In particular, specifications of the stock-flow adjustment are missing among the optional data.

Comparison of key macroeconomic and budgetary projections[1]

		2005	2006	2007	2008	2009	2010
Real GDP (% change)	**CP Nov 2006[2]**	**3.6**	**2.7**	**2.0**	**0.7**	**0.7**	**0.6**
	COM Nov 2006	3.0	3.0	2.3	2.2	n.a.	n.a.
	CP Nov 2005	*2.4*	*2.4*	*1.1*	*1.6*	*n.a.*	*2.1*
HICP inflation (%)	**CP Nov 2006**	**1.7**	**2**	**1.8**	**1.7**	**1.8**	**1.7**
	COM Nov 2006	1.7	2.0	2.0	1.9	n.a.	n.a.
	CP Nov 2005	*1.6*	*2*	*1.3*	*1.9*	*n.a.*	*1.8*
Output gap (% of potential GDP)	**CP Nov 2006[3]**	**0.3**	**0.9**	**0.9**	**-0.3**	**-1.3**	**-2.3**
	COM Nov 2006[4]	-0.6	-0.2	-0.4	-0.6	n.a.	n.a.
	CP Nov 2005[2]	*-0.3*	*0.1*	*-0.7*	*-0.9*	*n.a.*	*-0.6*
General government balance (% of GDP)	**CP Nov 2006**	**4.0**	**3.1**	**2.8**	**2.5**	**1.8**	**1.2**
	COM Nov 2006	4.0	3.2	3.3	3.2	n.a.	n.a.
	CP Nov 2005	*2.7*	*2.1*	*2.2*	*1.7*	*n.a.*	*1.9*
Primary balance (% of GDP)	**CP Nov 2006**	**5.8**	**4.7**	**4.3**	**3.4**	**2.5**	**1.8**
	COM Nov 2006	5.8	4.9	4.6	4.3	n.a.	n.a.
	CP Nov 2005	*4.7*	*3.7*	*3.1*	*2.5*	*n.a.*	*2.7*
Cyclically-adjusted balance (% of GDP)	CP Nov 2006[3]	**3.8**	**2.5**	**2.2**	**2.7**	**2.6**	**2.7**
	COM Nov 2006	4.4	3.3	3.5	3.6	n.a.	n.a.
	CP Nov 2005[3]	*2.9*	*2.0*	*2.6*	*2.3*	*n.a.*	*2.3*
Structural balance[5] (% of GDP)	CP Nov 2006[6]	**3.5**	**2.2**	**1.9**	**2.7**	**2.6**	**2.7**
	COM Nov 2006[7]	4.1	3.0	3.2	3.6	n.a.	n.a.
	CP Nov 2005	*2.7*	*1.7*	*2.3*	*2.3*	*n.a.*	*2.3*
Government gross debt (% of GDP)	**CP Nov 2006**	**36.2**	**29.8**	**25.8**	**22.7**	**20.5**	**19.0**
	COM Nov 2006	36.2	29.7	25.7	23.2	n.a.	n.a.
	CP Nov 2005	*35.9*	*32.9*	*30.1*	*27.7*	*n.a.*	*22.7*

Notes:
1 The budgetary projections include the impact of the Eurostat decision of 2 March 2004 on the classification of funded pension schemes. Excluding this impact, the general government balance would be 4.9% of GDP in 2005, 4.0% in 2006, 3.8% in 2007, 3.5% in 2008, 2.8% in 2009 and 2.2% in 2010, while government gross debt would be 35.9% of GDP in 2005, 28.6% in 2006, 24.6% in 2007, 21.5% in 2008, 19.3% in 2009 and 17.8% in 2010.
2 The GDP growth projections in the update pertaining to 2008, 2009 and 2010 are based on a technical assumption of a closing output gap in 2010.
3 Commission services calculations on the basis of the information in the programme.
4 Based on estimated potential growth of 2.2%, 2.6%, 2.5% and 2.5% respectively in the period 2005-2008.
5 Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.
6 One-off and other temporary measures taken from the programme (0.3% of GDP each year in 2005-2007, surplus increasing).
7 One-off and other temporary measures taken from the Commission services' autumn 2006 forecast are the effects of the suspension until 2007 of the contributions to the special pension (SP) scheme. As contributions are tax deductible, their suspension strengthens public finances by an estimated 0.3% of GDP in 2005-2007.

Source:
Convergence programme (CP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations