COUNCIL OPINION

of 4 March 2008

on the updated convergence programme of Denmark, 2007-2010

(2008/C 74/04)

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 ([1]), 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 4 March 2008, the Council examined the updated convergence programme of Denmark, which covers the period 2007 to 2010 ([2]) and gives further indications of developments towards 2015.

(2) In recent years, the Danish economy has been characterised by strong real GDP growth, sizeable employment gains, high capacity utilisation, low inflation and a stable exchange rate within the ERM II.

Over the past year, however, capacity constraints have started to inhibit economic activity, and signs of increasing price and wage inflation have appeared. While the external balance still shows a surplus, the implication of mounting cost pressures and labour shortages for competitiveness is of rising concern. Public finances remain strong with sustained general government surpluses and a continued reduction of debt. The key challenge for fiscal policy at the current juncture is to maintain a prudent fiscal stance so as to avoid contributing to further labour market pressure. Ensuring that spending limits are adhered to represents an additional challenge, particularly in times of buoyant revenue, but is nevertheless important given the government's ambitions for ensuring fiscal sustainability.

(3) The programme envisages that the Danish economy is at the peak of its business cycle and is now facing a period of more moderate growth. Therefore, real GDP growth is expected to slow down from 2 % in 2007 to 1 % on average over the rest of the programme period. Assessed against currently available information ([3]), this scenario appears to be based on plausible growth assumptions in 2008 and cautious assumptions thereafter due to the underlying assumption in the update of a large positive output gap (calculated using a national methodology) ([4]) closing towards 2011. The programme's projections for wage and price inflation appear to be on the low side, particularly for 2009, in view of domestic wage pressures as well as global trends. However, price stability should be preserved throughout the programme period.

([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). The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

([2]) The update was submitted more than 3 weeks beyond the 1 December deadline set in the code of conduct in view of the formation of a new government following the November general elections.

([3]) The assessment takes into account notably the Commission services' autumn 2007 forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

([4]) Using the national methodology, different from the commonly agreed methodology, leads to higher output gaps (due to a lower estimate of potential growth).

(4) For 2007, the general government surplus is estimated at 4,0 % of GDP in the Commission services' autumn 2007 forecast, against a target of 2,8 % of GDP set in the previous update of the convergence programme. This over-performance reflects a significant positive base effect from 2006 due to stronger-than-expected employment growth and higher revenue from oil- and gas- related activities in the North Sea than anticipated.

The current programme anticipates a surplus at 3,8 % of GDP, but in light of more recent information ([1]), revenue is likely to be higher than expected by 0,5 percentage point of GDP, and thus the surplus is likely to be revised upwards accordingly (to about 4,5 % of GDP).

(5) Guided by the general objective of ensuring fiscal sustainability, the main goal of the budgetary strategy is to maintain high, although rapidly declining surpluses (from 3,8 % of GDP in 2007 to 3,0 % in 2008 and further to 1,2 % in 2010 ([2])) against the background of weakening cyclical conditions. The medium-term objective (MTO) for the budgetary position is revised upwards ([3]) by 0,25 percentage point of GDP to a structural surplus (i.e. cyclically adjusted surpluses net of one-off and other temporary measures) of between 0,75 % and 1,75 % of GDP. The MTO will be fully respected throughout the programme period. The path for the headline surplus is broadly similar to the previous update, although starting from a higher surplus, against a broadly comparable macroeconomic background. The strategy relies on the continued application of the tax freeze ([4]) and expenditure restraint and envisages some tax cuts. The expenditure restraint is targeted through annual limits for real public consumption expenditure growth (becoming increasingly tight from 1,75 % in 2008 to 1 % in 2009-2010), and a cap on nominal public consumption expenditure at 26,5 % of cyclically-adjusted GDP towards 2015. The structural balance calculated according to the commonly agreed methodology is foreseen to remain broadly unchanged at 3,5 % in 2007-2008 and to drop to 2,5 % in 2009-2010 ([5]). The programme indicates lower surpluses towards 2015, as the effects of ageing are expected to set in and revenue sources in the North Sea are foreseen to subside.

(6) The budgetary outcomes could be better than projected in the programme, particularly in view of the better-than-expected outcome for 2007 as indicated at the presentation of the 2008 draft budget bill on 5 February 2008. The good track record of sizable surpluses, often being revised upwards due to positive revenue surprises, and the cautious macro-economic outlook from 2009 outweigh the risk relating to the somewhat weaker performance in adhering to government consumption expenditure growth limits.

(7) In view of this risk assessment, the budgetary stance in the programme allows meeting the MTO by a wide margin throughout the programme period, as envisaged in the programme. The fiscal policy stance implied by the programme is broadly in line with the Stability and Growth Pact throughout the period.

(8) Denmark appears to be at low risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is lower than on average in the EU, notably thanks to the pension reform included in the Welfare Agreement ([6]). Moreover, the budgetary position in 2007 as estimated in the programme, with a large structural surplus, contributes to the reduction of gross debt. Maintaining high primary surpluses over the medium term will further limit any risks to the sustainability of public finances

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([1]) The *Budget Outlook* accompanying the draft budget bill presented on 5 February 2008.

([2]) In the forecast accompanying the new draft budget bill for 2008, published by the Danish Ministry of Finance on 5 February 2008, surpluses are revised upwards to 4,4 % of GDP in 2007, 3,7 % in 2008 and 2,7 % in 2009.

([3]) This is due to the assumed continued suspension beyond 2008 of the 'special pension contribution', which previously generated an income tax deduction for private pension savings in the order of 0,25 % of GDP. It is therefore planned to increase the MTO by the resulting increase in tax revenue.

([4]) The tax freeze implies that from 2002 onwards, neither direct nor indirect tax rates can be raised, whether defined in nominal or percentage terms.

([5]) Differences in the definition of one-offs and temporary measures imply that estimates for the structural balance are not readily comparable with the Commission services' projections.

([6]) The 'Agreement on Future Prosperity, Welfare and Investments in the Future', concluded by the government in June 2006, raises the standard retirement age from 65 to 67 years and the early retirement age from 60 to 62 years over the next 20 years. From 2025 age limits will be indexed to changes in life expectancy.

(9) The convergence programme seems to be consistent with the October 2007 implementation report of the national reform programme. Both the programme and the implementation report are based on the economic strategy 'Towards new goals — Denmark 2015', presented by the government in August 2007. Public finance effects of major reform measures such as the envisaged energy strategy and the so-called 'Quality Fund' for investments in public services (mainly healthcare, child care and care for the elderly) are explicitly taken into account.

(10) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most of the optional data ([1]).

The overall conclusion is that the programme aims at maintaining a sound budgetary position fully respecting the MTO throughout the period, consistent with the objective of long-term fiscal sustainability. Foreseeing high, albeit rapidly declining, surpluses over the programme period, the budgetary targets appear to be on the cautious side, in view of the better-than-expected 2007 outcome and the most recent projections. The risk to long-term sustainability is assessed to be low. For the present, the most important policy challenge is to address labour shortages and looming cost pressures through a mix of structural and macroeconomic policies. Further measures need to be identified and implemented to stimulate labour supply. Meanwhile, the fiscal stance should be considered carefully so as to avoid pro-cyclicality. Therefore, containing public consumption expenditure growth, as foreseen in the programme, remains of high priority.

Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	**CP Dec 2007**	**3,5**	**2,0**	**1,3**	**1,1**	**0,5**
	COM Nov 2007	3,5	1,9	1,3	1,4	n.a.
	CP Dec 2006	*2,7*	*2,0*	*0,7*	*0,7*	*0,6*
HICP inflation (%)	**CP Dec 2007**	**1,9**	**1,7**	**2,4**	**1,6**	**1,9**
	COM Nov 2007	1,9	1,7	2,4	2,4	n.a.
	CP Dec 2006	*2,0*	*1,8*	*1,7*	*1,8*	*1,7*
Output gap ([1]) (% of potential GDP)	**CP Dec 2007**	**1,2**	**1,0**	**0,3**	**– 0,4**	**– 1,5**
	COM Nov 2007 ([2])	1,1	0,7	– 0,2	– 0,9	n.a.
	CP Dec 2006	*0,9*	*0,9*	*– 0,3*	*– 1,3*	*– 2,3*
Net lending/borrowing *vis-à-vis* the rest of the world (% of GDP)	**CP Dec 2007**	**2,4**	**1,7**	**1,3**	**1,9**	**2,2**
	COM Nov 2007	2,4	1,2	0,7	0,6	n.a.
	CP Dec 2006	*1,6*	*1,7*	*1,3*	*1,2*	*1,3*
General government balance (% of GDP)	**CP Dec 2007**	**4,6**	**3,8**	**3,0**	**2,0**	**1,2**
	COM Nov 2007	4,6	4,0	3,0	2,5	n.a.
	CP Dec 2006	*3,1*	*2,8*	*2,5*	*1,8*	*1,2*

([1]) However, total revenue and total expenditure figures and some subcomponents do not correspond to the harmonised definitions. The specifications of the stock-flow adjustments are missing among the optional data.

		2006	2007	2008	2009	2010
Primary balance (% of GDP)	**CP Dec 2007**	**6,2**	**5,2**	**4,2**	**3,0**	**2,1**
	COM Nov 2007	6,2	5,3	4,3	3,6	n.a.
	CP Dec 2006	*4,7*	*4,3*	*3,3*	*2,5*	*1,8*
Cyclically-adjusted balance [1] (% of GDP)	**CP Dec 2007**	**3,8**	**3,1**	**2,8**	**2,3**	**2,2**
	COM Nov 2007	3,9	3,6	3,2	3,0	n.a.
	CP Dec 2006	*2,5*	*2,2*	*2,7*	*2,6*	*2,7*
Structural balance [3] (% of GDP)	**CP Dec 2007**	**2,7**	**3,5**	**3,4**	**2,5**	**2,5**
	COM Nov 2007	3,6	3,2	3,4	3,0	n.a.
	CP Dec 2006	*2,2*	*1,9*	*2,7*	*2,6*	*2,7*
Government gross debt (% of GDP)	**CP Dec 2007**	**30,1**	**25,6**	**21,6**	**19,2**	**18,6**
	COM Nov 2007	30,3	25,0	20,9	17,5	n.a.
	CP Dec 2006	*29,8*	*25,8*	*22,7*	*20,5*	*19,0*

Notes:

(1) Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

(2) Based on estimated potential growth of 2,2 %, 2,3 %, 2,2 % and 2,0 % respectively in the period 2006-2009.

(3) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 1,1 % of GDP in 2006 (surplus-increasing) and 0,4 %, 0,6 %, 0,2 % and 0,3 % of GDP respectively in the period 2007-2010 (all surplus-reducing) according to the most recent programme and 0,3 % of GDP in both 2006 and 2007 (surplus-increasing) and 0,2 % in 2008 (surplus-reducing) in the Commission services' autumn forecast. However, the programme uses a different definition of a one-off measure, as the temporary variations in revenue identified in the programme are not considered as one-offs by the Commission services.

Sources:

Convergence programme (CP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations.