

## Abstract

Fiscal sustainability is a widely discussed topic in the economic debate in Denmark. After several years with surpluses on the government budgets, it is expected that Denmark in 2010 will obtain a budget deficit reaching 5.1 % of GDP. Due to this fact Denmark has received a recommendation from the European Commission with a view to bringing an end to the excessive government deficit. The fiscal sustainability in Denmark can thus be seen to be under pressure. This development is also indicated by calculations based on the DREAM model which predicts that fiscal sustainability in the long-term requires a permanent improvement of the government budget by 2,2 % of GDP each year.

The main intention of this project is to examine whether the fiscal policy in Denmark the last two decades can be characterized as being sustainable. Furthermore the tax policy conducted since 2001 will be analyzed in order to reveal how it has affected the fiscal sustainability. Since the conducted tax policy can be explained and discussed from a methodological point of view, different economic methodologies will be incorporated into the project.

The empirical analysis of fiscal sustainability from a historical perspective indicates that the public debt in Denmark from 1992 to 2009 has been stationary. This is equivalent to the absence of Ponzi games which implies that the interest payments associated with the existing public debt have not been financed with the issue of new public debt. Furthermore it means that the public debt in the analyzed period has not shown any signs of explosive behaviour. The empirical analysis also includes a test for cointegration between the public expenses containing interest payments on the public debt and public revenues. The result of this analysis indicates that public expenses and revenues are cointegrated and thereby share a common long-term equilibrium which means they have not moved arbitrarily in proportion to one another. Furthermore a test for causality between the public revenues and the public expenditures has been performed which shows causality going from the public revenues to the public expenditures. This result can be seen to be in accordance with the Danish government's implemented tax freeze. The test for stationarity of the public debt as well as the test for cointegration between public expenses and revenues indicates that the fiscal policy has displayed simple sustainability in the analyzed period.

The conducted tax policy since 2001 can be characterized as being expansive which consequently has led to a reduced tax yield for the government. In 2010 the reduced tax yield amounts to 40.2 billion DKK and for the whole period from 2002 to 2010 the conducted tax policy has induced a reduction in the tax yields amounting to 164.7 billion DKK. As stated earlier the budget deficit in Denmark in 2010 will reach 5.1 % of GDP. Own calculations indicate that the budget deficit would have amounted to a mere 2.85 % of GDP in case of the conducted tax policy being disregarded. This implies that the conducted tax policy causes Denmark in 2010 not to fulfil the restrictions concerning fiscal sustainability outlined in the Stability and Growth pact.

From a methodological perspective the conducted tax policy can be characterized as being focused on the supply side of the economy. As a result of this it is expected that a reduction in income taxes is able to affect the supply of labour with approximately 70.000 fulltime persons. In a postkeynesian perspective the assumptions behind the conducted tax policy can be problematized. At best the completed model calculations of supply elasticities need to be perceived with a large degree of uncertainty and such relations should be tested and supported by empirical conditions. As the economic context is changeable the postkeynesian perspective argues that all types of model calculations should be taken with caution. In a postkeynesian framework Say's law does not exist which implies that the government's implemented tax cuts not necessarily leads to an increase in the employment level. Whether or not the tax cuts leads to an increase in the employment level is from a postkeynesian perspective determined by context-dependent parameters in the economy including the aggregated demand that plays a significant role. The connection between the aggregated demand and the employment level has been tested empirically. This test shows cointegration and thereby a long-term relationship between these two variables. Because of this the state from a postkeynesian perspective should intervene in the economy in case of the market not being self-regulating in order to make sure that a possible saving surplus in the private sector is canalized into the economy through a saving deficit in the public sector.

That the conducted tax policy is focused on the supply side of the economy can be seen from the analysis performed by the Danish Ministry of Taxation that shows that a decrease in the highest marginal tax rate will be more than self-financed. The methodology can thus be seen to play a crucial role for the fact that the conducted tax policy has been used as an instrument to obtain an increase in the employment level.