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Monetary and Exchange Rate Policies of the Euro Area—The Euro Area Stability Programs

This report on Monetary and Exchange Rate Policies of the Euro Area—The Euro Area Stability Programs was prepared by a staff team of the International Monetary Fund as background documentation for Article IV discussions with euro-area countries. As such, the views expressed in this document are those of the staff team and do not necessarily reflect the views of the euro-area authorities or the Executive Board of the IMF.

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Monetary and Exchange Rate Policies of the Euro Area—The Euro Area
Stability Programs

Prepared by Marco Annunziata and Alessandro Zanello

Approved by European I Department

April 27, 2000

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I. INTRODUCTION

1. The Stability and Growth Pact requires euro-area member states to present annual stability programs (SPs) outlining their medium-term fiscal objectives and providing information on how they intend to meet them. In the framework of intra-EU multilateral surveillance of national fiscal policies, these programs are assessed by the Commission, and—upon its recommendation—evaluated in a formal opinion by the Council of Finance Ministers. By the cut-off date for information included in this study (end March, 2000), updated versions for 2000-03 had been submitted by all euro-area countries.

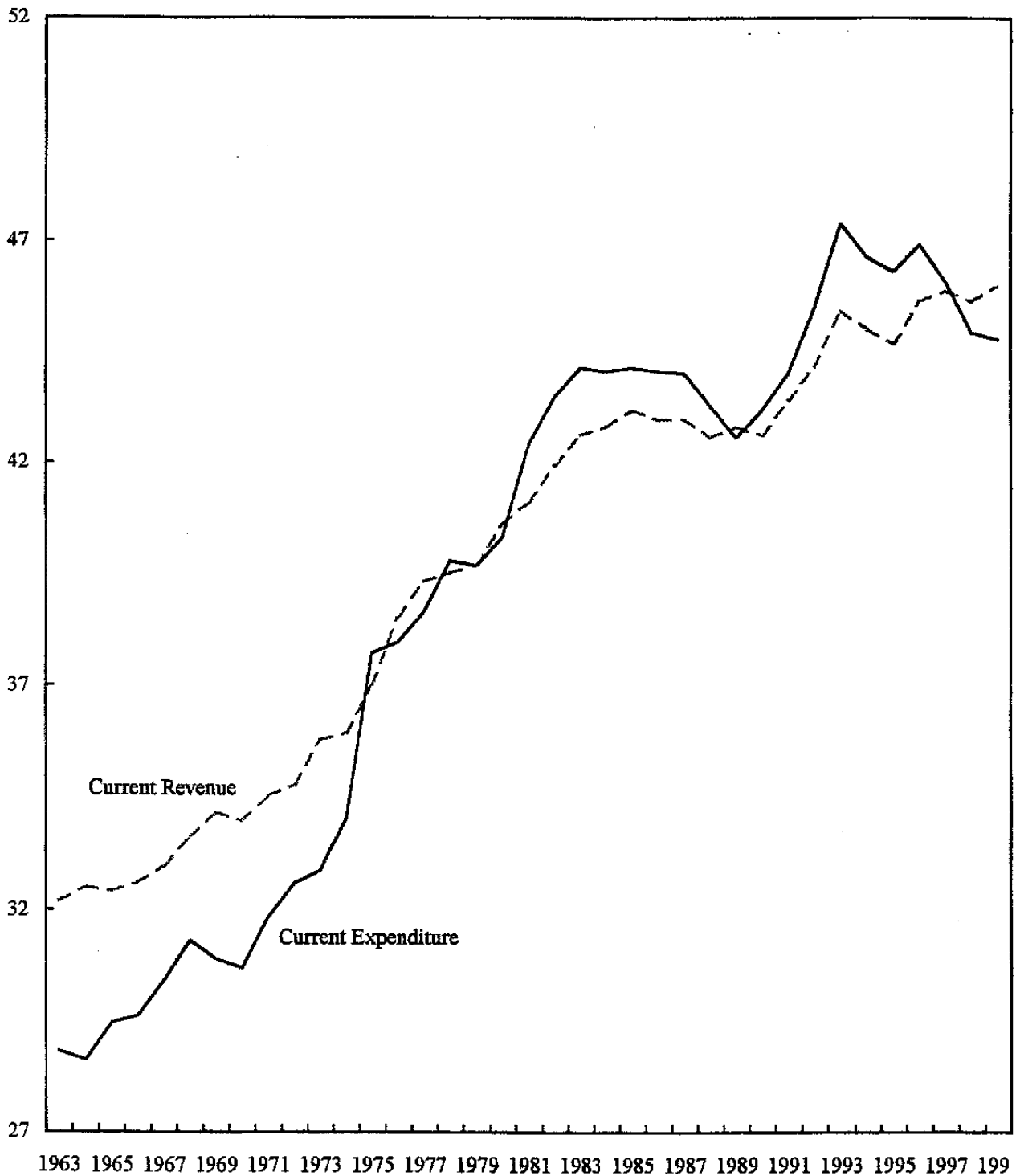
2. The objective of this note is to offer a preliminary review of the 2000-03 SPs. Section II of the paper gives historical context to the discussion. Sections III and IV analyze the medium-term prospects implied by the new SPs and compare them with more recent developments in the run-up to Stage 3 of EMU. Section V concludes. The Appendix presents in greater detail the available updated programs for the euro-area countries.

II. AN HISTORICAL PERSPECTIVE

3. Looking at fiscal developments in the euro area over the last few decades reveals some stylized facts that help putting into context the revised SPs fiscal strategies:

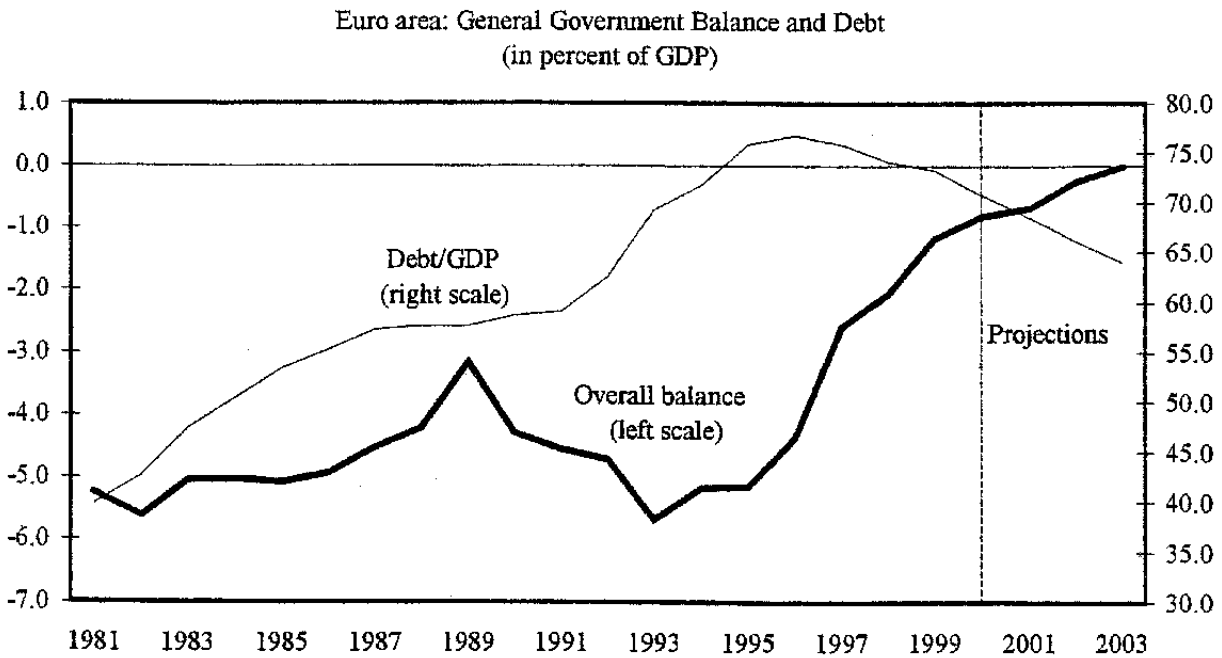
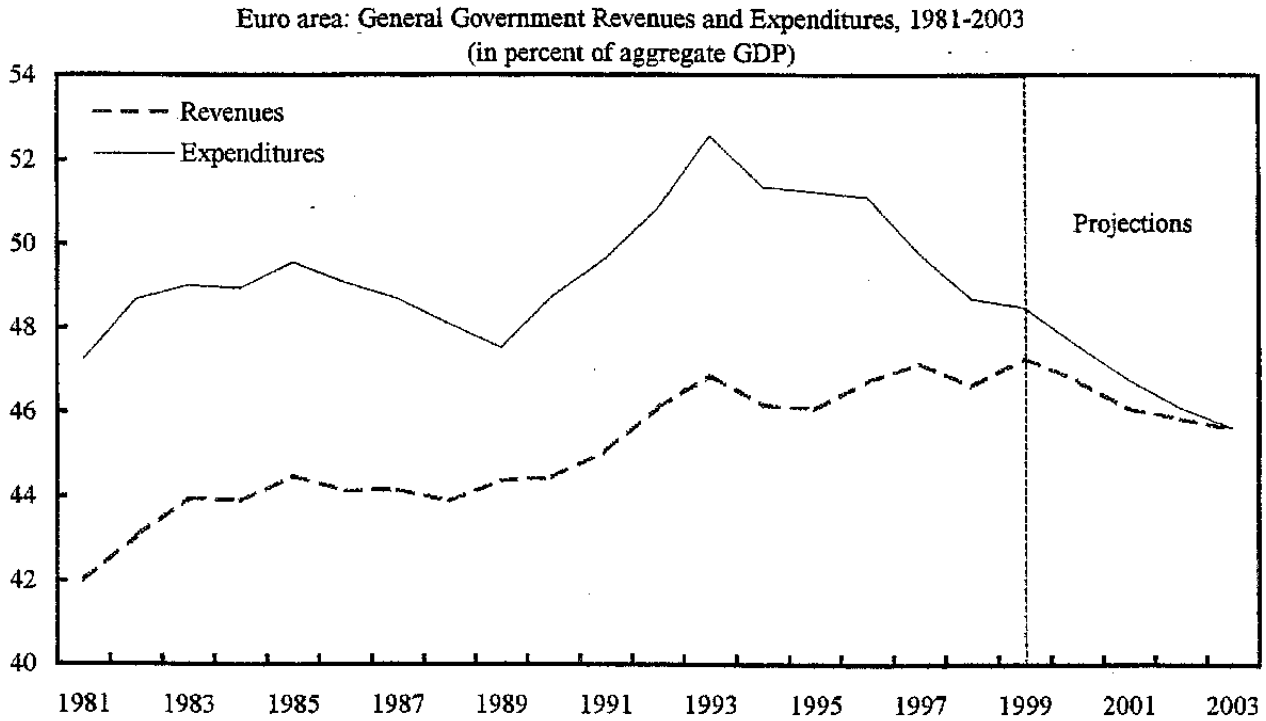
- *Over the last forty years, the weight of the public sector on economic activity has ballooned* (Figure 1). To wit: the size of government as measured by income shares of current expenditures and revenues has increased by 50 percent, from about 30 percent of aggregate GDP to about 45 percent.
- *Most of the increase in the size of the public sector took place during the 1960s and 1970s, although some increase has still occurred over the last two decades.* At end-1999, the revenue ratio and the expenditure ratio were higher than in 1981 by some 5 and 1¼ percentage points, respectively (Figure 2, top panel).
- *There was a clear structural break in the time series of general government balances around 1993.* Abstracting from cyclical fluctuations, the area-wide general government deficit had hovered around 5 percent of GDP through the 1980s and early 1990s. From 1993 to 1997, an unprecedented fiscal consolidation has taken place, particularly in 1997—the year when compliance with Maastricht criteria for founding membership in the euro area was established (Figure 2, bottom panel).
- *Since at least the late 1970s, fiscal policies in the euro area have tended to be pro-cyclical* (Figure 3).
- *All countries experienced sizable accumulation of debt—averaging about 40 percent of GDP—through end-1993* (Figure 4, top panel). Belgium, Italy, Finland, Ireland, and Spain have had the largest increases. Moreover, debt accumulation occurred while revenue ratios were still edging up in virtually all countries (the Netherlands

Figure 1. Euro Area: General Government Current Revenues and Expenditures, 1963-1999
(in percent of GDP)



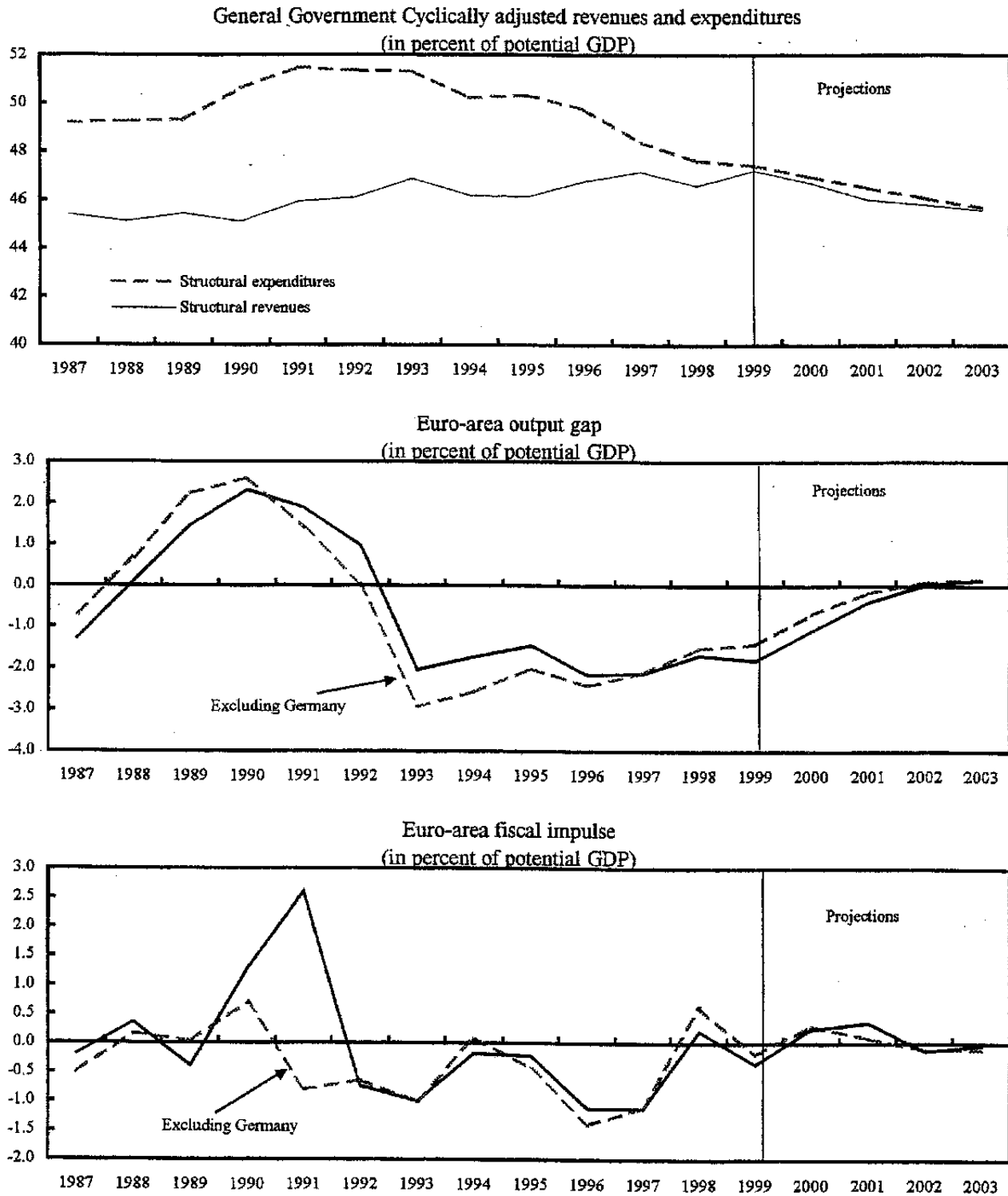
Source: OECD Economic Outlook database.

Figure 2. Euro Area: Fiscal Indicators, 1981-2003



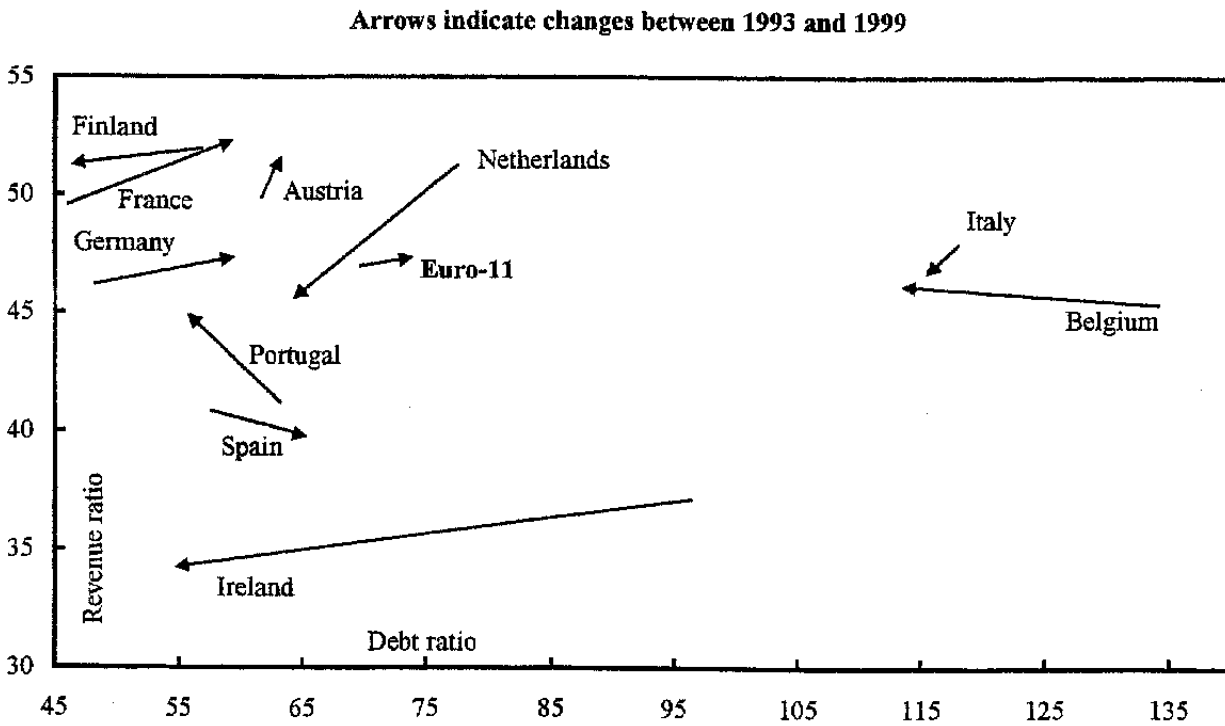
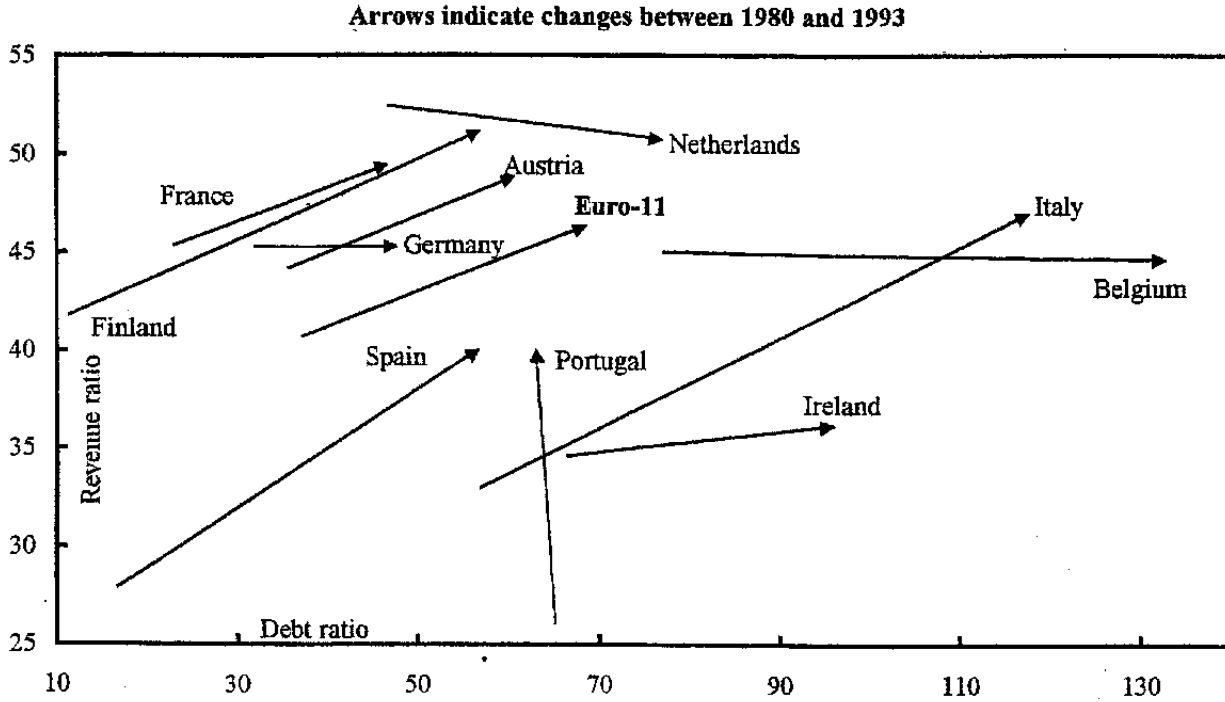
Source: WEO

Figure 3. Euro Area: Indicators of Fiscal Stance



Source: WEO

Figure 4. Euro Area: General Government Revenues and Debt
(in percent of GDP)



Source: WEO

being the exception). Debt growth started to slow down in 1994. Nevertheless, the aggregate debt-to-GDP ratio was still 4 percentage points higher by end-1999 than at end-1993. Four countries (France, Germany, Spain, and Austria) recorded a significant increases in public indebtedness in that period, while Ireland experienced a remarkable debt contraction (Figure 4, bottom panel).

4. Overall, the fiscal consolidation of the mid-1990s made significant progress toward repositioning the area-wide public finances on a sustainable path. However, it followed such a long period of fiscal profligacy that most euro-area countries still find themselves with high debt stocks and heavy tax burdens just on the eve of a demographic shock for which they are as yet ill-prepared.

III. THE REVISED STABILITY PROGRAMS

5. Table 1 below presents key characteristics of the 1999 and 2000 versions of the stability programs. A comparison of the two vintages is complicated by the fact that, whereas the 1999 SPs were based on ESA79 statistical methodology, the new versions are based on the revised national income accounting framework, ESA95.¹ For this reason, Table 1 focuses on the targeted cumulated changes in the variables, rather than their absolute levels.

Table 1. Euro area: Changes in Fiscal Indicators Between 1998 and 2002.

	Overall balance		Revenue ratio	
	1999 SP	2000 SP	1999 SP	2000 SP
Euro-area	1.7	1.5	-1.3	-1.1
Austria	0.8	1.0	-0.5	-2.2
Belgium	1.3	1.0	-1.1	-1.0
Finland	1.3	3.2	-3.4	-1.2
France	2.1	1.9	-1.6	-0.7
Germany	1.5	0.7	-2.0	-1.6
Ireland	-0.5	0.8	-2.4	-2.3
Italy	2.3	2.2	-0.3	-1.2
Netherlands	0.2	-0.3	-2.5	-2.3
Portugal	1.5	1.4	1.1	4.8
Spain	1.9	2.4	-0.4	0.0

¹ See WEO 2000 for a discussion of the two approaches.

6. For most countries the new stability programs maintain the previous targets for the overall fiscal balance through 2002 or improve upon them, and envisage further consolidation in 2003.² The earlier vintage SPs targeted for the euro area as a whole a reduction in the overall deficit of 1¼ percent of aggregate GDP over 1999-2002, and a reduction in the revenue ratio of 1¼ percentage points over the same period. At the disaggregated level, the most ambitious deficit-reduction targets were posted by Italy, France, and Spain, whereas Finland, the Netherlands, Ireland, and Germany were planning the most meaningful reductions in the revenue ratio.

7. Under the revised SPs, the revenue ratio for the euro area as a whole is still projected to decline by about 1 percent of aggregate GDP over the same period, and the overall deficit is projected to fall by 1½ percent of GDP.³ On balance, therefore, the updated stability programs do not represent a substantive improvement over their earlier versions, and the countries that originally had more ambitious deficit or tax reduction objectives still do—with Finland now joining the group of those targeting bolder improvements in overall balance, and Austria posting one of the most ambitious revenue reduction targets.

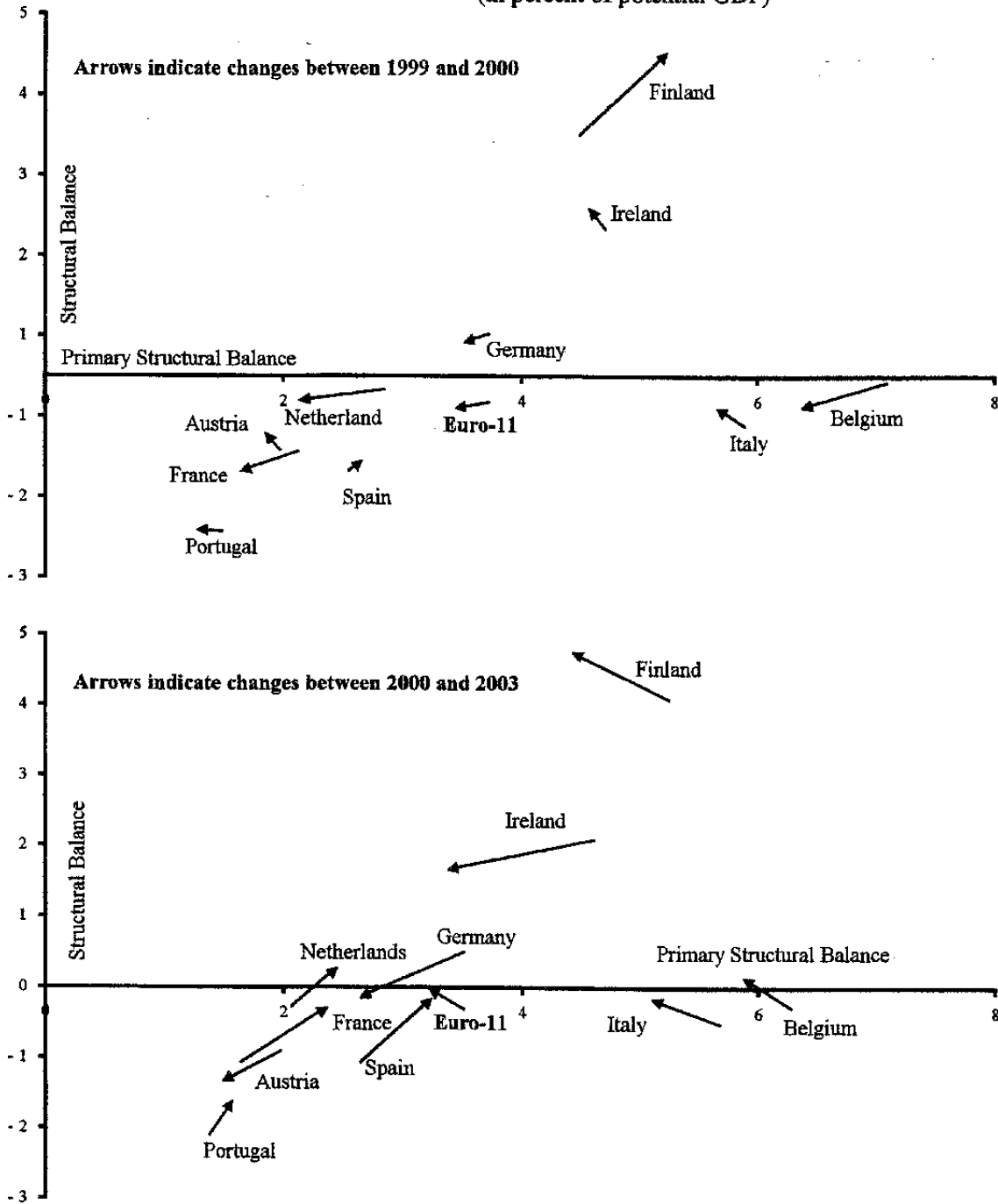
8. The projected improvement in fiscal balance is entirely explained by the cyclical upturn and the decline in average interest payments on the public debt (most notably for Italy, Spain, and Portugal). In the staff's estimates, the updated programs imply a reduction in the area-wide structural deficit of only 0.9 percent of GDP between 1998 and 2003. With a projected decline in interest payments by 1.1 percent of GDP, this implies a concomitant slight *deterioration* in the structural primary surplus. In particular, over 2000-03 the staff projects a deterioration in the structural primary balance of the order of ½ of 1 percent of GDP in Austria, Belgium, and Italy, and about twice as large in Finland, Germany, and Ireland (Figure 5).

9. The revised SPs still suffer in many cases from the same shortcomings as their previous versions: (i) lack of specificity as to the adjustment measures underlying the projections, in particular the quality of the envisaged expenditure cuts; and (ii) unduly back-loaded adjustment, especially in some peripheral countries facing overheating pressures. Moreover, in many cases the SPs include sizable budgetary cushions and rely on overly conservative growth assumptions. While such caution in charting the fiscal course opens up the possibility of stronger adjustment in terms of lower deficits or taxes, it also provides a setting for an undesirable tolerance of chronic expenditure slippages.

² The updated programs submitted by Ireland and the Netherlands cover the period through 2002, whereas those for most of the other countries extend to 2003. Portugal's program covers the period through 2004.

³ The projected reduction in revenue ratio is influenced by the substantial revenue increase in Portugal's SP.

Figure 5. Euro Area: General Government Structural Fiscal Balances
(in percent of potential GDP)



Source: WEO

IV. FISCAL ADJUSTMENT UNDER THE REVISED STABILITY PROGRAMS

10. This section discusses the past and prospective adjustment in the euro area as a whole and at the disaggregated level. Figure 6 offers a synoptic view of the fiscal effort—measured by the cumulative reduction in primary structural (i.e., cyclically adjusted) expenditures of the general government—envisaged under the SPs through 2003 in Stage 3 of EMU, compared with the earlier phase of adjustment. The basic message is that, after the vigorous fiscal consolidation of 1994-97, adjustment fatigue has set in. For the euro area as a whole, the cumulated reduction in primary structural spending projected over 1999-2003 is only one-third of that achieved over the previous five years, with the slackening of effort being most pronounced for Italy, Spain, and the Netherlands. France stands out as the only euro area member planning a larger reduction in structural spending, and Portugal alone appears as the country that has recorded—and is projecting—an *increase* in primary structural spending.

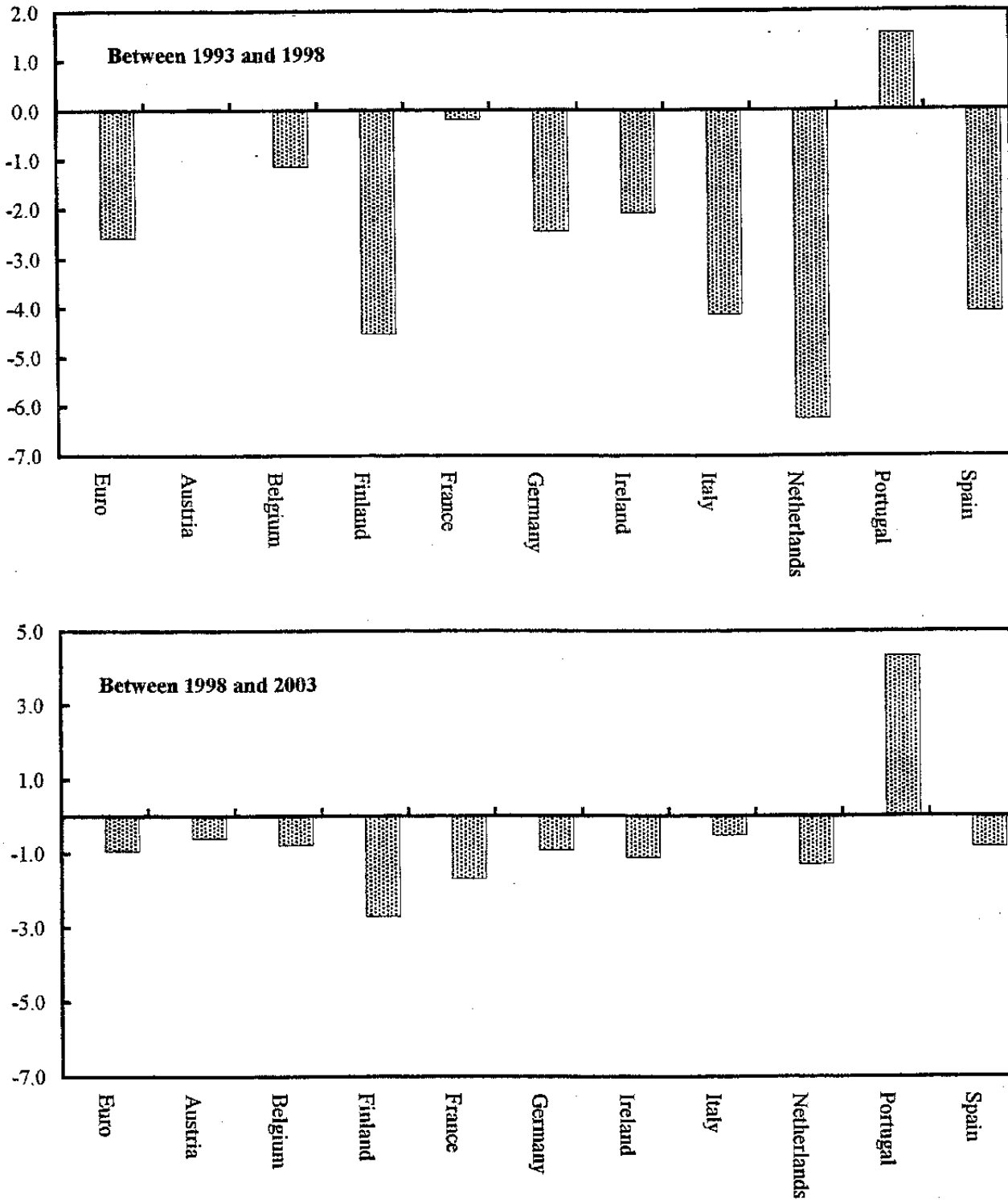
11. A legitimate question is whether the countries with less ambitious targets for the near future are the ones that made the most significant advances before. In fact, the top panel of Figure 6 shows that Italy, Spain, and the Netherlands—together with Finland—consolidated their public finances the most in the run-up to EMU. However, a cross-country comparison should also allow for different adjustment needs to start with. Heuristically, this can be done by weighting a country's change in primary spending by the ratio of its debt-to-GDP share to the average debt share for the area.^{4 5} Figure 7 is based on this adjusted measure of fiscal effort. In broad terms, the country ranking and the extent of adjustment fatigue is much the same as implied by the unweighted expenditure cuts. However, Figure 7 underscores that, in view of its high initial debt stock, the past adjustment in Italy looks much less impressive—while the prospective consolidation under the updated SPs by Finland and France gains importance.

12. An alternative way of presenting the relation between a country's fiscal effort and its initial fiscal conditions is shown in Figure 8, where cumulated changes in primary structural expenditures are plotted against initial debt-to-GDP ratios for the two periods 1993-98 and 1998-2003. The shaded quadrant to the north-east of the "Euro-11" data point represents constellations of above-average adjustment need and below-average adjustment effort;

⁴ The weighting scheme intends to "adjust" a given change in primary structural spending for both its direction and the initial fiscal condition. In fact, a given increase in primary spending in a high-debt country clearly implies a greater departure from fiscal prudence than in a low-debt country. Similarly, a given reduction in primary spending denotes a smaller step toward fiscal sustainability in a high-debt country than in a low-debt one. To capture these differences, the cumulated change in primary structural expenditures over a period is divided (if negative) or multiplied (if positive) by the ratio of a country's debt-to-GDP ratio to the euro-area average at the beginning of that period.

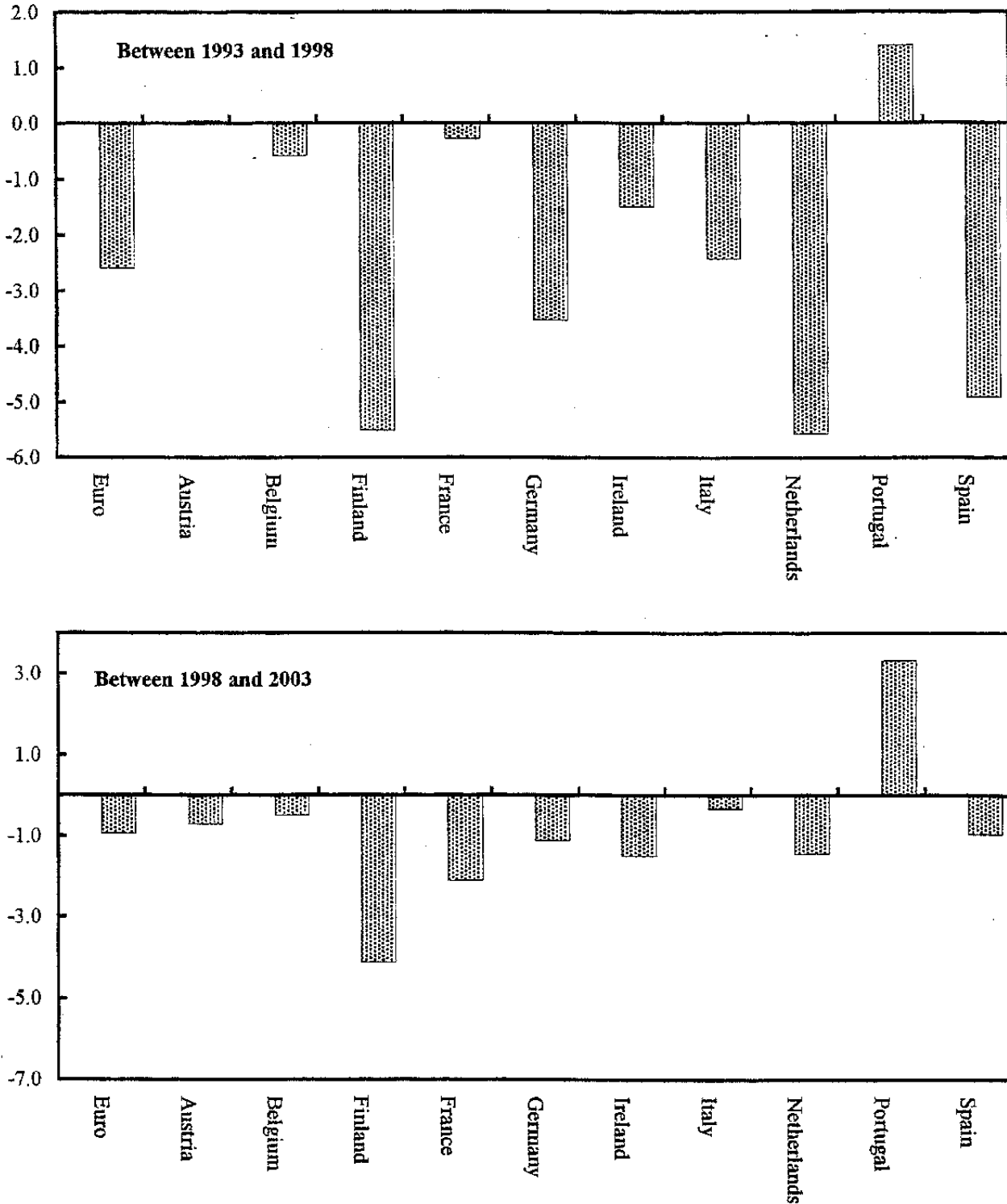
⁵ This implicitly regards a country's debt share as a sufficient statistic for the sustainability of its public finances, regardless of the long-term differential between interest and growth rates.

Figure 6. Euro Area: Cumulated Changes in Primary Structural Expenditures
(in percent of potential GDP)



Source: WEO

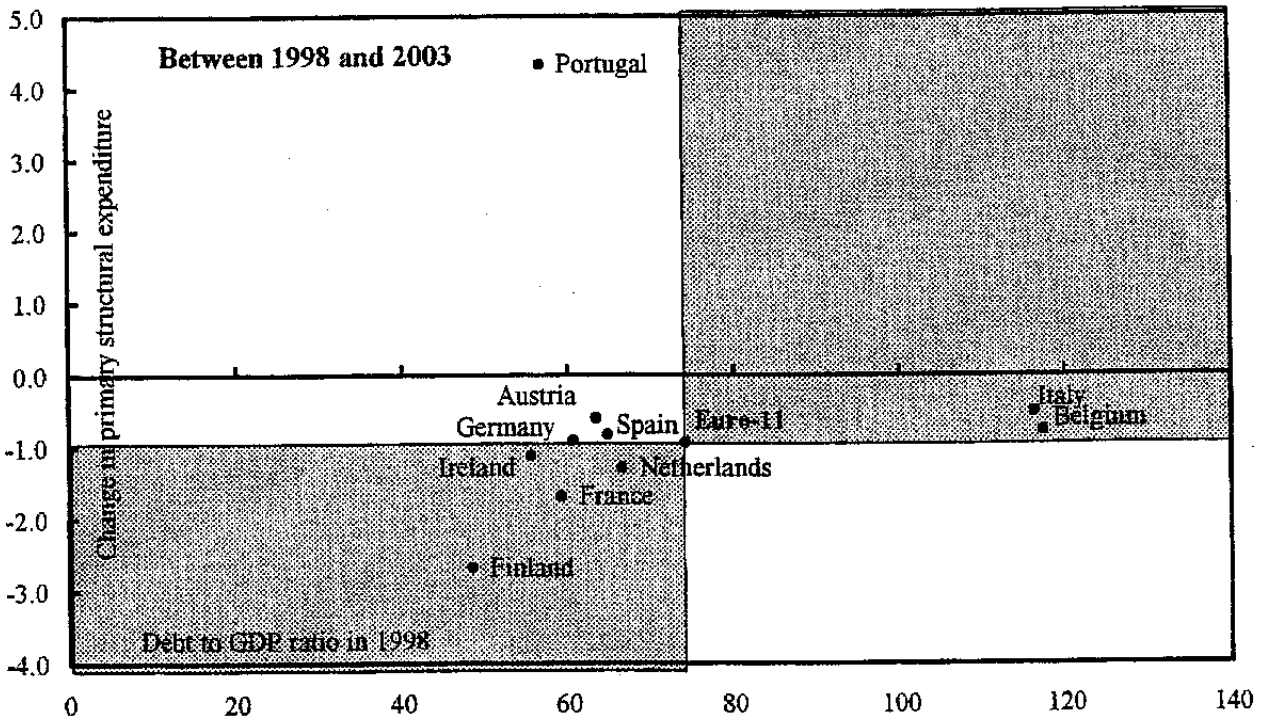
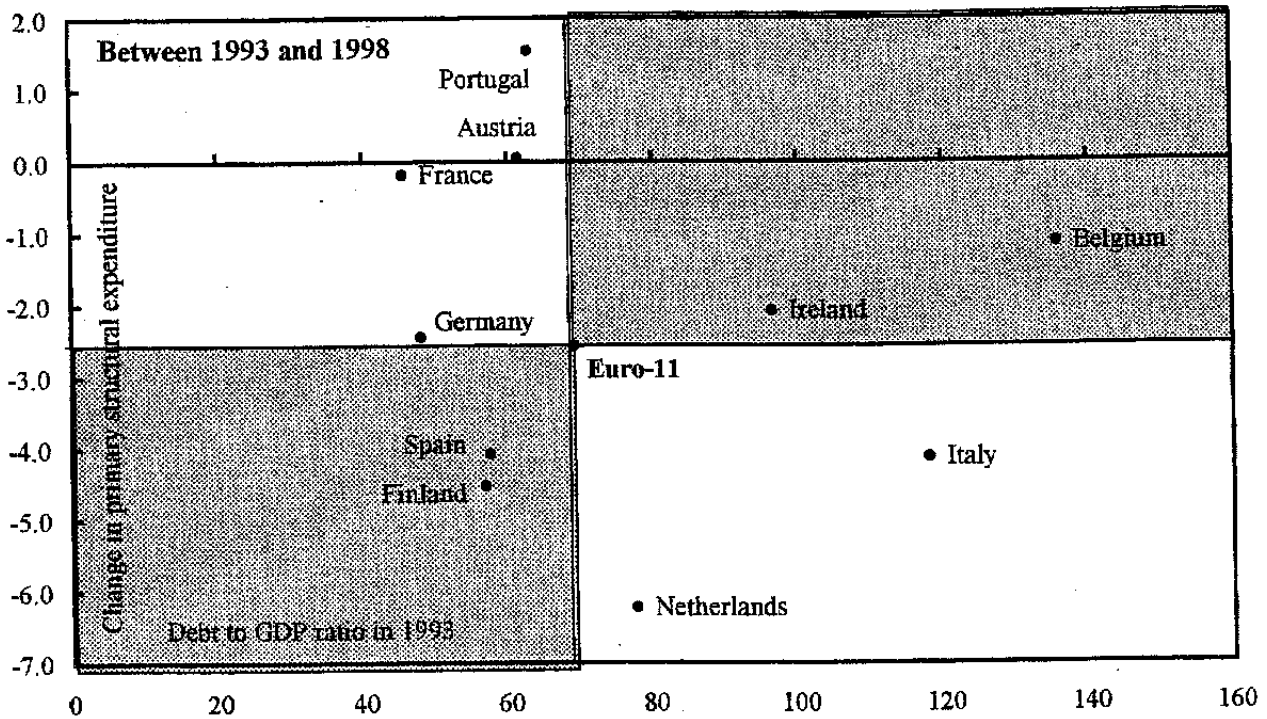
Figure 7. Euro Area: Cumulated Changes in Adjusted Fiscal Effort



Source: WEO

Note: the adjusted fiscal effort index equals the cumulated change in primary structural expenditures over the period, weighted (divided if negative, multiplied if positive) by the ratio of a country's debt-to-GDP ratio to the euro area average at the beginning of the period.

Figure 8. Euro Area: Debt Ratios and Cumulated Changes in Primary Structural Expenditure (in percent of GDP)



Source: WEO

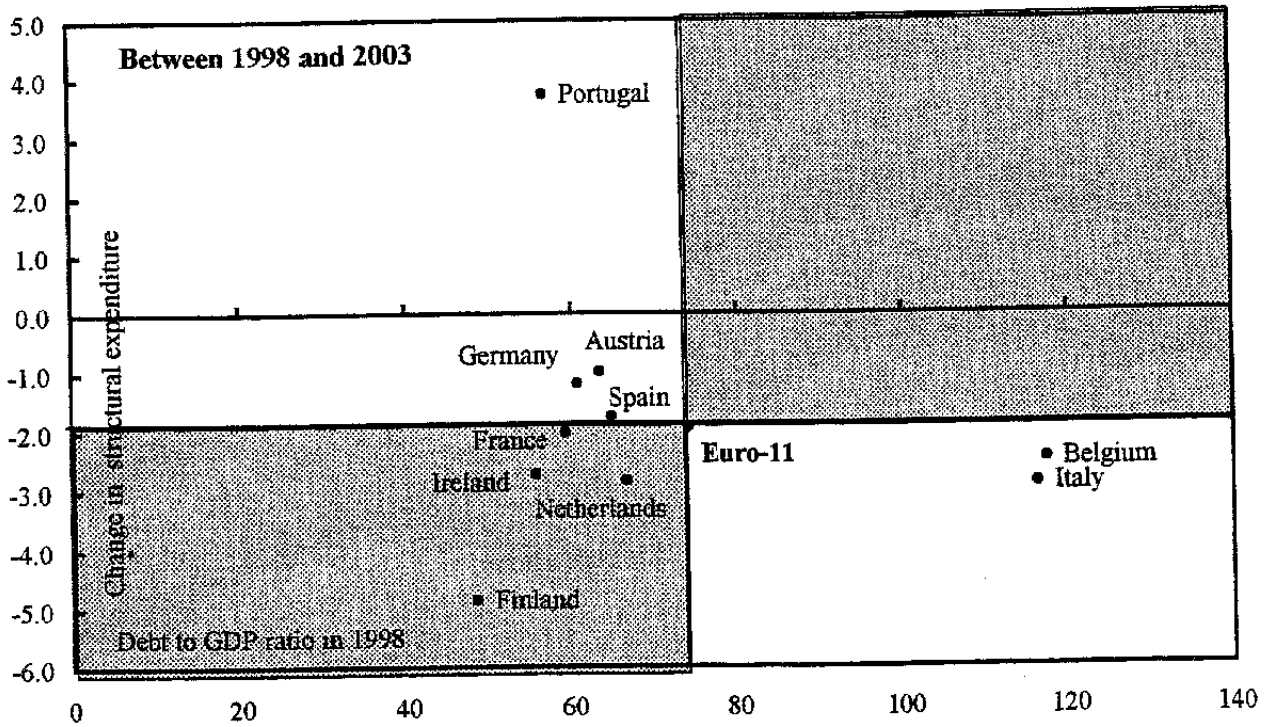
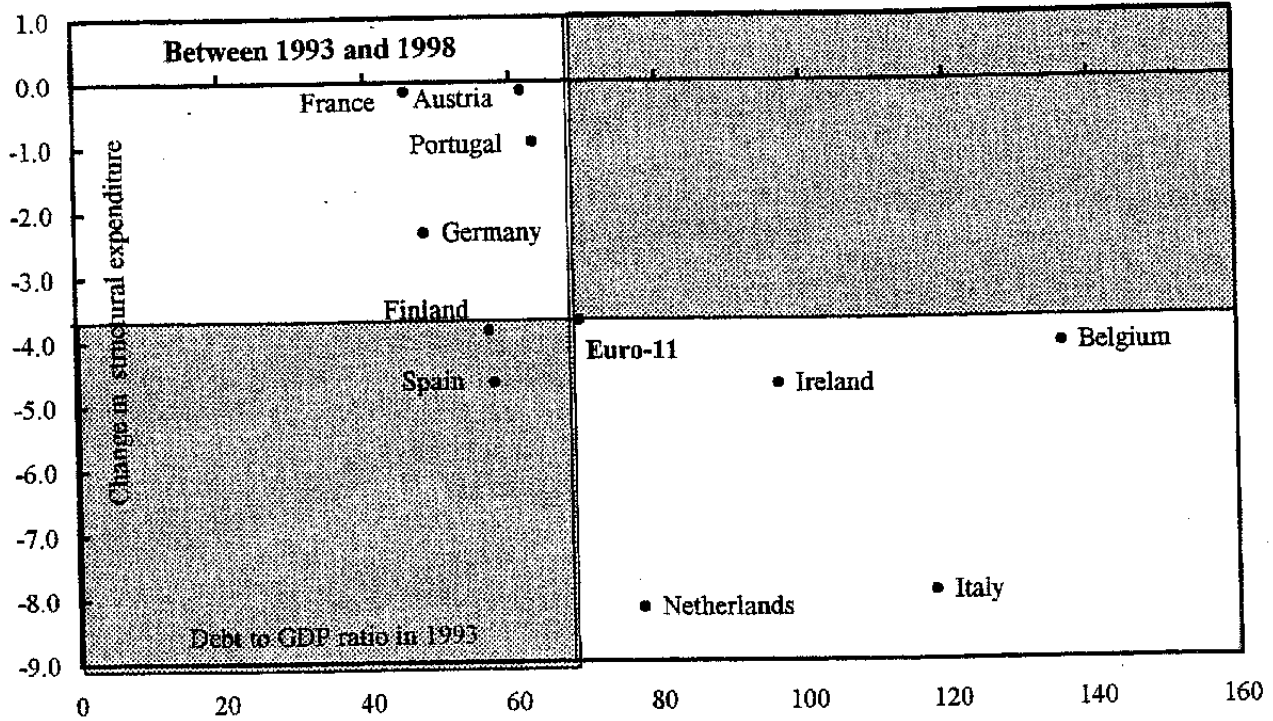
conversely, the shaded quadrant to the south-west of the "Euro-11" data point represents constellations of below-average adjustment need and above-average adjustment effort. By this taxonomy, over the ten-year timeframe spanned by the run-up to EMU and the end of the SPs' horizon: (i) Belgium is consistently in the relatively high adjustment need-relatively low adjustment effort quadrant, where Italy is also expected to be by the end of the second phase (1998-2003); (ii) Ireland, which had lagged in its fiscal consolidation effort in 1993-98, joins the ranks of the countries in the relatively low adjustment need-relatively high adjustment effort quadrant in 1998-2003, as do France and the Netherlands; and (iii) of the two countries with the most ambitious expenditure reductions in 1993-98, only Finland is projected to remain in the lead, although its pace of fiscal consolidation also slows down considerably. Changes in primary spending could be considered the most appropriate measure of the fiscal effort, because they entail discretionary policy changes. However, to the extent that the reduction in interest rates that has benefited several euro-area countries in recent years can be ascribed to the higher credibility from the fiscal consolidation undertaken, focussing on primary spending may underestimate the extent of the structural fiscal adjustment achieved. Figure 9 plots initial debt-to-GDP ratios against changes in total structural expenditures, and shows that by this metric high-debt countries such as Belgium, Ireland, and Italy perform much better.

13. The focus on changes in primary structural expenditures is motivated by the fact that—as noted above—by 1993 most euro area countries had accumulated large debt stocks and ratcheted up the revenue ratios to record levels. In this setting, reductions in both fiscal deficits and taxes appeared desirable, making cuts in public spending a policy necessity which has now become the hallmark of the medium-term fiscal strategies of virtually all countries. Figure 10 provides evidence that the emphasis in policymaking has shifted from improving the fiscal balances toward lessening the fiscal pressure. The top panel of the figure illustrates that over 1993-98 the objective of deficit and debt reduction was paramount, and was achieved in some cases—including France and Germany—through revenue increases as well as expenditure reductions. By contrast, the bottom panel shows that, under the revised SPs, all countries but Portugal and (marginally) Spain are contemplating a revenue reduction—which for the area as a whole will average about 1 percent of aggregate GDP. Moreover, the fact that the bulk of the data points cluster closer to the 45-degree line suggests that, in allocating freed budgetary resources to the competing ends of deficit and tax cuts, the revealed preferences of policymakers have become increasingly tilted toward tax reductions.

V. CONCLUSIONS

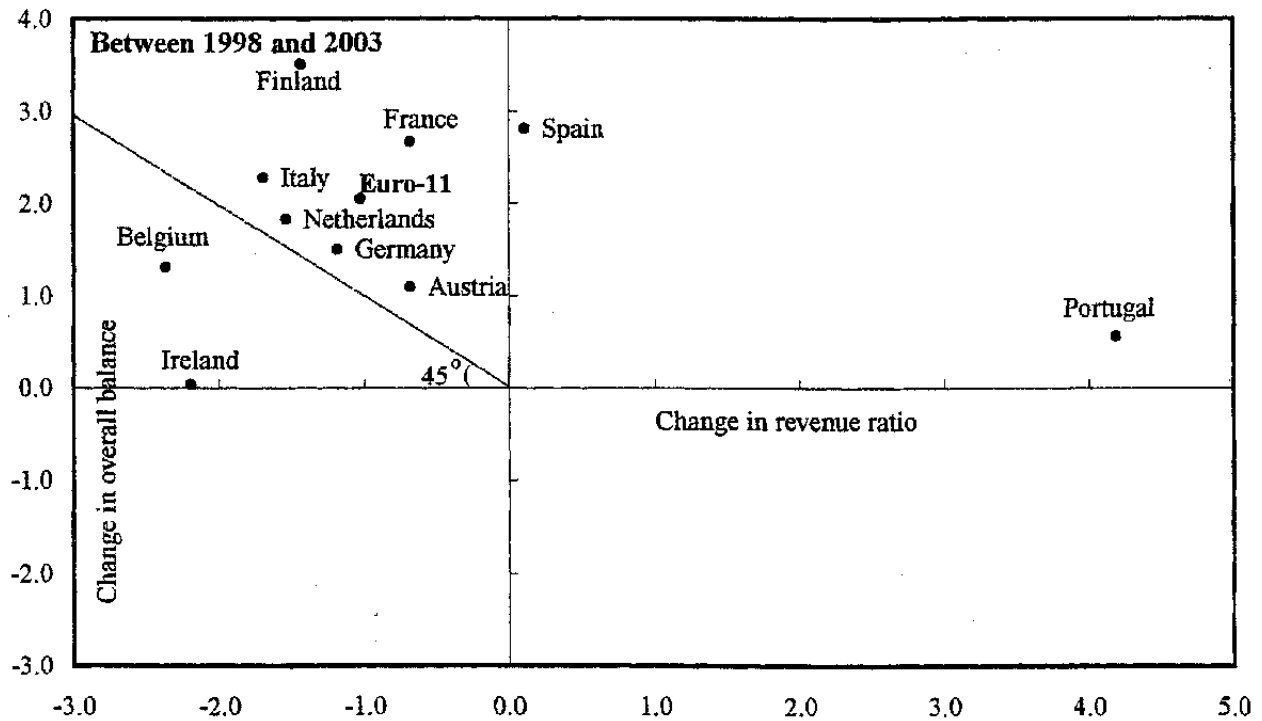
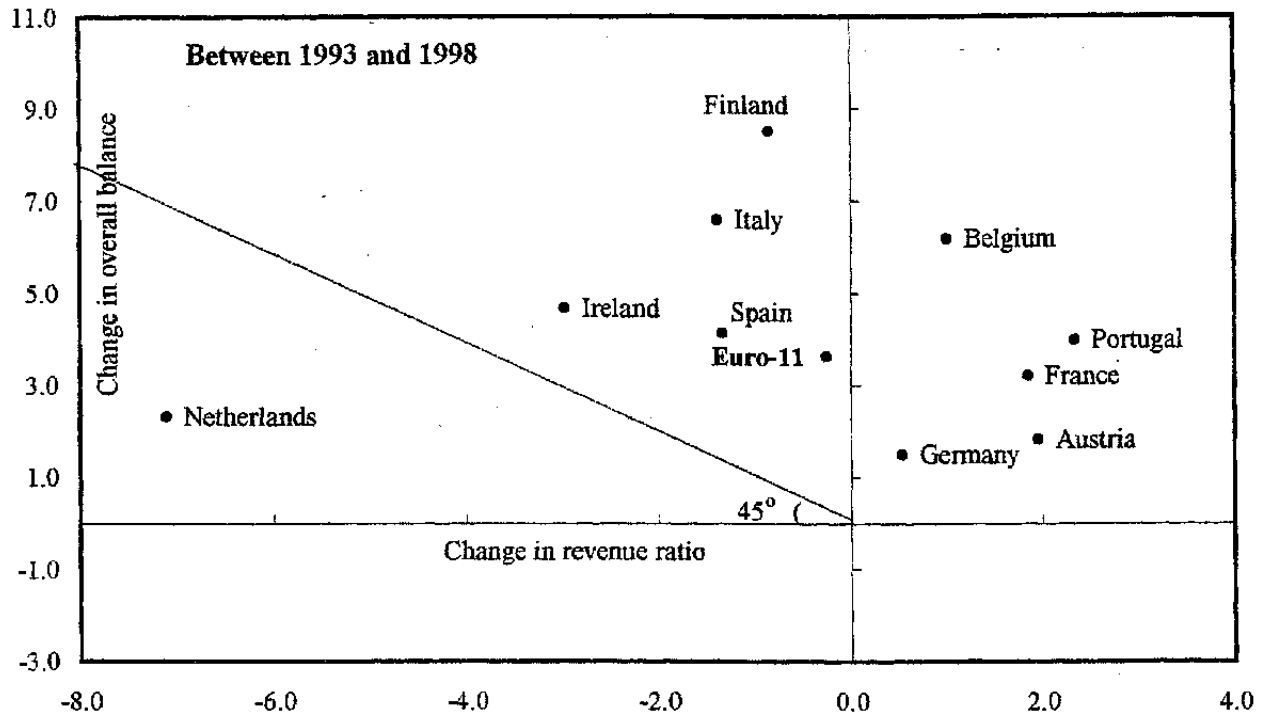
14. The run-up to Stage 3 of EMU has been characterized by a noteworthy fiscal effort that has put the euro-area debt ratio on a downward path, and the area as a whole appears poised to be close to overall balance by the end of the revised SP's horizon. This achievement should not, however, be cause for complacency, for two main reasons. First, the debt ratio and tax burden will remain high in most countries. Second, the prospective improvement in fiscal positions owes much to the ongoing cyclical upturn—which may well be over by 2003—and to the continued (but dwindling) effect of past declines in interest rates. Thus, looking beyond 2003, the remaining need for fiscal and structural adjustment ahead of the looming demographic shock will still be considerable, and may have to take place under conditions less favorable than in the near future.

Figure 9. Euro Area: Debt Ratios and Cumulated Changes in Total Structural Expenditures (in percent of GDP)



Source: WEO

Figure 10. Euro Area: Cumulated Changes in Revenue Ratio and Overall Balance
(in percent of GDP)



Source: WEO

FISCAL STRATEGIES ACROSS THE EURO AREA

15. This appendix describes in some detail the available revised stability program (as submitted by the national authority to the European Commission), summarizing key features of the medium-term strategy of each country.⁶ In particular, the trajectory of the main fiscal variables under the SP is outlined in a table. The appendix offers a critical presentation of the programs but not staff appraisals, which naturally belong in the context of bilateral consultations.

⁶ In particular, it should be noted that figures for 1999 represent the authorities' estimates at the time of submission, and may therefore differ from the outturns.

Germany

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	-1.2	-1.0	-1.5	-1.0	-0.5
Revenues	47.3	46.5	45.0	45.0	44.5
Expenditures	48.5	47.5	46.5	46.0	45.0
Government debt ratio	61.0	61.0	60.5	59.5	58.5
Real GDP growth	1.4	2.5	2.5	2.5	2.5

- The assumed growth rate over the medium term may well be conservative, if deeper structural reforms and wage moderation continue to bolster the growth potential.
- The SP builds on better-than-expected outturns in 1998 and 1999, largely owing to over-performance at the regional and local levels. Achievement of the SP's targets therefore is contingent on continued fiscal prudence at the periphery and a strengthened internal stability pact.
- The program embodies ambitious reductions in personal income taxes and social charges, as well as in corporate taxation starting in 2001 (albeit partially offset by an increase in green taxes). While the planned tax cuts are significant, the projected decline in the revenue-to-GDP ratio overstates the extent of the prospective tax reductions, as part of the decline in revenues reflects a projected further fall in the labor share of national income.⁶
- On the expenditure side, targeted reductions are envisaged in subsidies, public consumption, and social spending.
- In the staff's estimates, the path of expenditures in the SP implies an average growth of real primary structural spending about ½ of 1 percent below potential output growth over 1999-2003.
- The revised SP stands out as one of the most ambitious, and sets an example with its strategy of meaningful tax cuts financed by sustainable and well-targeted public expenditure reductions.

⁶ Since the tax burden on labor exceeds the one on capital, a shift in the distribution of income away from labor involves a revenue reduction at unchanged tax rates.

France

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	-2.1	-1.7	...	...	-0.3
Revenues	51.8	51.3	...	...	50.1
Expenditures	53.9	53.0	...	...	50.4
Government debt ratio	60.3	59.4	...	...	57.2
Real GDP growth	3.1	3.0	3.0	3.0	3.0

- The revised SP—like the previous version—involves two alternative growth assumptions, the highest of which is taken to be the baseline scenario.
- The 1999 outturn was characterized by a strong revenue over-performance, which does not appear to be fully reflected in the new medium-term objectives.
- The overall cut in the deficit over the four-year period 1999-2003 is somewhat smaller than that envisaged under the previous program over 1998-2002.
- The targeted reduction in taxes and social security contributions to 43.7 percent of GDP in 2003 is not more ambitious than the one along the path envisaged under the previous program, and implies a reduction of 1.2 percent of GDP over 1998.
- The revised program envisages a decrease in public spending of 2.6 percent of GDP over the three-year period to 2003, compared with a 3 percent of GDP reduction in the previous program in the three-year period to 2002. This is partly explained by the downward revision in inflation assumptions, given that budgetary expenditure targets are set in nominal terms.
- The SP hinges on ceilings to real expenditure growth by level of government and for key budgetary items such as health expenditures. In the staff's estimates, the path of expenditures in the SP implies an average growth of real primary structural spending 1 percentage point below potential output growth over 1999-2003.

Italy

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	-2.0	-1.5	-1.0	-0.6	-0.1
Revenues	46.7	46.2	45.8	45.3	44.9
Expenditures	48.7	47.7	46.8	45.8	45.0
Government debt ratio	114.7	111.7	108.5	104.3	100.0
Real GDP growth	1.3	2.2	2.6	2.8	2.9

- As the cyclical upturn in 2000-01 could well be stronger than projected in the SP, the assumed real GDP growth may be conservative particularly if further inroads are made into narrowing regional imbalances, and efforts in labor market reform are stepped-up.
- The revised SP confirms the deficit targets of the earlier program. Despite the lower-than-anticipated growth, preliminary estimates indicate that the original 1999 budget deficit target of 2 percent of GDP has been slightly exceeded, largely as a result of strong revenue performance. To the extent that this reflects structural factors such as greater efficiency in tax administration, deficit targets for the outer years should be within reach.
- The new SP embodies a downward revision in interest payments and, accordingly, a lower primary surplus than was implied by the previous program (from 5.5 percent of GDP to 5 percent).
- In the staff's estimates, the path of expenditures in the SP implies an average growth of real primary structural spending marginally below potential output growth over 1999-2003.
- The medium-term strategy continues to reflect the ongoing effort to reduce expenditures and ease the heavy tax burden—with planned reductions in personal income taxes and a reform of corporate taxation. The envisaged reduction in capital spending, however, raises concern about the impact of the consolidation on the long-term growth potential.
- Italy faces the most adverse demographic trend in the euro area, including a shrinking population, and still has the highest debt-to-GDP ratio in the euro area.

Spain

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	-1.3	-0.8	-0.4	0.1	0.2
Revenues	40.1	40.1	40.0	39.9	39.8
Expenditures	41.3	40.8	40.4	39.8	39.5
Government debt ratio	63.5	62.8	60.6	58.1	55.8
Real GDP growth	3.7	3.7	3.3	3.3	3.3

- The macroeconomic scenario underlining the program appears realistic and the growth objectives attainable in the context of a process of real convergence to the euro-area average.
- The Ministry of Finance has announced that the overall deficit in 1999 was 1.1 percent of GDP, lower than expected in the revised SP, which already forecasted an improvement over the target in the original SP. The revised program also improves—albeit marginally—on the objective for 2000. Nonetheless, given the advanced cyclical conditions in Spain, a more front-loaded adjustment may be desirable.
- The SP maintains the emphasis on control of current primary expenditures to make room for tax reductions and increased public investment. This control hinges on strengthening the ongoing coordination between the center and the territorial governments—which are taking an increasing role in expenditure policies.
- In the staff's estimates, the path of expenditures in the SP implies an average growth of real primary structural spending broadly in line with potential output growth over 1999-2003.
- In light of the expected fiscal impact of population aging, the commitment to bolster the social security reserve fund created in 2000 is helpful.
- Past structural reforms have paid off in terms of faster growth and job creation in recent times. Sustained implementation of reforms in the labor and product markets remains essential to guarantee the attainment of the SP's objectives.

The Netherlands

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	-0.6	-0.6	-1.3	-1.1	...
Revenues	...	...	...	...	...
Expenditures	...	...	...	...	...
Government debt ratio	64.3	62.3	61.8	61.0	...
Real GDP growth	2.8	2.5	2.0	2.0	...

- The updated SP broadly maintains the three macroeconomic scenarios of the first program, and the corresponding real GDP average growth assumption, with preference again given to the most cautious one. In light of the growth outturn in 1999 and the latest projection for 2000, the cautious scenario appears too pessimistic.
- The program does not take fully into account the recent better economic and fiscal results (the latest estimate of the 1999 budgetary outturn is substantially better than originally envisaged—a surplus of at least $\frac{1}{3}$ of 1 percent of GDP versus a deficit of 0.6 percent).
- Underlying the SP is a system of fiscal rules outlined in the 1998 Coalition Agreement, which allocate revenue windfalls between deficit and tax cuts, with the share devoted to the latter equal to one-half (one-quarter) as long as the overall balance is better (worse) than a deficit of $\frac{3}{4}$ of 1 percent of GDP. The pro-cyclical bias of this fiscal strategy may exacerbate overheating pressures in the near term.
- The Coalition Agreement also calls for expenditure ceilings across budgetary items. In the staff's estimates, the path of expenditures in the SP implies an average growth of real primary structural spending some 1 percentage point below potential output growth over 1999-2002.
- The program embodies an extensive tax reform in 2001, comprising a shift from direct to indirect taxes and lower household income taxation, including cuts in social security contributions. This reform will ensure the continuation of the trend toward lowering fiscal pressure: the revenue ratio is projected to be some 10 percentage points below its mid-1980s level by 2002.

Belgium

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	-1.1	-1.0	-0.5	0.0	0.2
Revenues	46.4	45.8	45.5	45.4	45.2
Expenditures	47.5	46.8	46.0	45.4	45.0
Government debt ratio	114.9	112.4	108.8	105.4	101.3
Real GDP growth	1.7	2.5	2.5	2.3	2.3

- The updated SP sets more ambitious targets for the overall fiscal balance than the previous version, with balance envisaged for 2002 (compared with 0.3 percent of GDP deficit) and a small surplus for 2003, when the debt ratio is projected to fall to 100 percent. Moreover, the government views the 2000 deficit objective as a minimum, and has indicated that—depending on real GDP growth—overall balance may be achieved by 2001.
- The underlying fiscal strategy, which so far has been centered on stabilizing the primary surplus at no less than 6 percent of GDP, appears to be shifting toward targeting the overall structural balance: the SP argues that a limited structural surplus would be desirable to accelerate debt re-absorption and prepare for population aging.
- Large tax cuts are envisaged in the 2000 budget, and a tax reform is planned for 2002. Reductions in the tax pressure should be helpful in improving labor market performance.
- Under the new SP, average annual growth in primary expenditure is limited to 1½ percent in real terms after 2000. Accordingly, in the staff's estimates, the path of expenditures in the SP implies an average growth of real primary structural spending some ⅓ of 1 percentage point below potential output growth over 1999-2003.

Ireland

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	3.2	3.3	2.8	2.9	...
Revenues	35.5	35.0	34.1	33.6	...
Expenditures	32.3	31.7	31.3	30.7	...
Government debt ratio	52.0	46.0	40.0	36.0	...
Real GDP growth	8.4	7.4	6.5	5.7	...

- The revised SP sets the economic and budgetary objectives for the period 2000-02, but does not extend to 2003. The assumed real GDP growth—which is expected to remain well above the euro-area average—is lower than projected by the staff.
- The program reflects the impact of the ongoing tax reform, which includes changes designed to improve work incentives and eliminate unemployment and poverty traps. However, the strategy of trading tax cuts for wage moderation appears risky, given the diminishing effectiveness of wage agreements in an increasingly tight labor market.
- The reduction in the stock of debt is projected to bring about a further drop in debt servicing costs, that will be accompanied by cuts in primary current expenditures, notably on goods and services and transfers—the latter stemming from the continuing fall in the unemployment rate.
- In the staff's estimates, the path of expenditures in the SP implies an average growth of real primary structural spending almost 1 percentage point below potential output growth over 1999-2003.
- The SP embodies a commitment to meet the investment needs of a fast-growing economy, as reflected in the new National Development Plan for 2000-06.

Finland

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	3.1	4.7	4.2	4.6	4.7
Revenues	51.2	51.4	50.4	49.9	49.3
Expenditures	48.1	46.7	46.2	45.3	44.6
Government debt ratio	46.6	42.9	40.7	38.0	35.2
Real GDP growth	3.8	3.9	3.0	2.6	2.6

- The updated SP differs from the previous one by setting a much more ambitious fiscal objective (doubling the 2002 surplus target from 2.3 percent of GDP to 4.6 percent) and by outlining a medium-term strategy for structural policies.
- The projected surplus for the general government builds on growing surpluses in all sub-sectors (in particular in pension funds) in preparation for the anticipated demographic shock.
- The program hinges on a virtual freeze of central government expenditures in real terms. In the staff's estimates, the path of total public expenditures in the SP implies an average growth rate of real primary structural spending more than 1 percentage point below potential output growth over 1999-2003.
- On the tax front, the program envisages reductions in labor income taxes, partly financed by higher taxation on corporate and capital income. The government also plans an increase in taxes on energy consumption and pollution, although the corresponding budgetary impact has not been incorporated in the SP.
- Prospective reductions in the debt-to-GDP ratio could be larger than projected in the SP, depending on the privatization strategy and the use of privatization receipts.

Portugal

	1999	2000	2001	2002	2003	2004
General government balance (percent of GDP)	-2.0	-1.5	-1.1	-0.7	-0.3	0.0
Revenues	45.9	48.0	48.2	48.1	47.9	47.7
Expenditures	47.9	49.6	49.3	48.8	48.2	47.7
Government debt ratio	57.2	57.1	55.2	53.3	51.0	48.4
Real GDP growth	3.1	3.3	3.6	3.6	3.5	3.5

- The revised SP maintains the deficit objectives of the previous version, and envisages a continuation of the adjustment through 2004, when the budget is projected to reach balance.⁷
- Current revenues are projected to rise by 1¼ percent of GDP in 2000, owing to improvements in tax administration and in spite of a 2 percentage points decline in the corporate income tax rate.
- Primary current expenditures are scheduled to increase by 1½ percentage points of GDP in 2000, owing to, inter alia, earlier job reclassifications that boosted average salaries in the public sector. This increase is projected to be gradually reversed over 2001-04.
- Attainment of the SP's targets is subject to several risks, notably related to: (i) the projected yield from improved tax administration, taxes on small firms, and petroleum and automobile taxes; and (ii) the absence of concrete measures to strengthen expenditure control.

⁷ Preliminary information on the Portuguese SP was made available to the staff in late February 2000, with the complete program expected to be released in early March.

Luxembourg

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	2.3	2.5	2.6	2.9	3.1
Revenues	46.4	45.2	44.3	43.4	42.4
Expenditures	44.1	42.7	41.7	40.5	39.3
Government debt ratio	4.3	...	...	...	...
Real GDP growth	4.9	4.9	5.1	5.2	5.4

- The revised SP has been made public only in late February 2000.
- The macroeconomic scenario underlying the program assumes the current strong economic expansion will continue into the medium term, with real GDP growing at about 5 percent per year. This projection is not without risks, as Luxembourg's competitive niche could be eroded in the process of greater European integration.
- The program reflects the government's continued commitment to fiscal prudence, evidenced by a sustained surplus and an extremely low level of indebtedness.
- The SP contemplates a substantial tax reform: the government intends to lower the corporate income tax rate below 35 percent (from the current 37.5 percent), eliminate the local trading tax, and undertake an overhaul of the personal income tax system by 2002.
- The program does not explicitly address the implication of a possible EU-wide withholding tax on interest income.

Austria

	1999	2000	2001	2002	2003
General government balance (percent of GDP)	-2.0	-1.7	-1.5	-1.4	-1.3
Revenues	51.7	51.1	50.2	49.5	49.1
Expenditures	53.7	52.7	51.6	50.9	50.4
Government debt ratio	64.9	64.1	62.7	61.9	61.2
Real GDP growth	2.2	2.8	2.8	2.5	1.9

- The revised SP has been made public only in March 2000.
- The revised SP envisages an extremely gradual reduction in both the fiscal deficit and the debt-to-GDP ratio over the period. By 2003, the general government deficit would be marginally below the EC-recommended level that should allow normal cyclical fluctuations to be absorbed without breaching the 3 percent of GDP ceiling. The SP envisages that the debt stock would fall below 60 percent only by 2005.
- The program incorporates the 2000 tax reform, which aims at reducing the tax burden on wages, strengthen income support for families and children, bolster business competitiveness by reducing non-wage labor costs and business taxes, and improve tax administration.
- On the expenditure side, the SP envisages a 2 percent per year reduction in the number of Federal civil servants, improved efficiency in government procurement practices, and additional savings through further reform measures in the pension system.
- In order to foster employment creation, the new SP augments the 1999 National Employment Action Plan by envisioning improvements in job-placement services, the creation of a new voluntary unemployment-insurance scheme, and a review of social welfare benefits; budgetary allocations for active labor market measures—markedly increased in 1999—will be safeguarded.