Update of the Luxembourg stability programme for 1999 to 2003

(Statutory deadline for presentation: 1 March 2000)

Introduction

In accordance with Council Regulation (EC) 1466/97, Luxembourg presented its first stability programme to the Council and the Commission at the beginning of 1999. The programme was discussed by the Ecofin Council on 15 March 1999.

The general elections on 13 June 1999 produced a change of majority in the Luxembourg Parliament. The new Government, comprising members of the Christian-Social Party and the Democratic Party (Liberals), took office on 7 August 1999.

The coalition programme reaffirmed the principle of prudence governing the management of Luxembourg's public finances, which became one of the cornerstones of the government programme of 12 August 1999, in which the parties forming the coalition confirmed that "the first Luxembourg stability programme (…) is part of this new environment for monitoring and coordinating economic policy, setting out the following principles:

- public sector net lending must remain in surplus;
- the central government budget must remain in balance;
- the growth of ordinary central government expenditure must be lower than growth of the overall budget.

The two delegations undertake to observe these rules of conduct and to pursue a strict budgetary policy in order to preserve the current advantages of our financial situation."

This update of the stability programme, drawn up in the wake of the adoption of the Budget Law for 2000 and in the light of the recommendations set out in the broad economic policy guidelines, follows on from the first stability programme adopted in 1999. It was approved by the Government in cabinet and communicated to the Chamber of Deputies.

The updated programme for 1999 to 2003 can be consulted on the Finance Ministry's website at http://www/etat.lu/FI/

I. Trends in the Luxembourg economy in 1999*

Overview (table 1)

	% change (or as otherwise indicated)		
	1998	1999 /**	2000 /**
Final consumption of households (volume)	2.3	3.0	2.7
Final public consumption (vol.)	2.8	3.3	3.3
Gross fixed capital formation (vol.)	1.5	9.0	5.1
Exports of goods and services (vol.)	9.9	5.2	6.9
Imports of goods and services (vol.)	8.3	4.9	5.8
GDP (vol.)	5.0	4.9	4.9
GDP (LUF billion)	665.7	706.8	755.5
Payroll employment	4.6	5.3	4.0
Inflation (consumer prices)	1.0	1.0	1.6
Average nominal wage costs	1.8	2.4	2.5
Unemployment rate (% of working population)	3.1	2.9	2.8

Source: Statec, Adem, IGSS
/* estimates for national accounts aggregates; observed figures for other aggregates.
/** forecasts

I.1. GDP growth

There was a slowdown in the EU's economic growth in 1999, with GDP rising by only 2.1% compared with 2.7% in 1998. In Luxembourg, the main impact of the slowdown was felt in manufacturing and exports of goods. According to initial estimates, volume GDP grew by 5.0%, a performance which can be described as *stabilisation at a very high level of activity*.

Of the 5.0% real GDP growth in 1999, around 4.5% was generated by services, with banks alone accounting for 1.6%. However, manufacturing and construction, which provide around 20% of gross value added, have also enjoyed favourable conditions for at least three years.

Exports of goods and imports contributed around 6.0% to GDP growth as a result of the vigorous activity in (export-oriented) services and manufacturing. If we set this contribution against the "negative impact" of imports, the openness of the Luxembourg economy becomes apparent. Although domestic demand grew by 4.4% in volume, this was mainly due to investment in plant and machinery.

After two years of more modest growth (an average of 3% in 1995 and 1996), Luxembourg's GDP grew by an annual average of 5.7% between 1997 and 1999. Luxembourg continues to enjoy faster growth than its neighbours.

* See note on page 23.

I.2. Inflation

After ten years of progressive disinflation, the rise in consumer prices in the EU 15 was around 1.5% in 1998 and 1999. Inflation was even lower in Luxembourg (1.0% in 1998 and 1999), although slightly higher than in neighbouring countries (particularly France and Germany). The inflation rate is expected to be around 1.6% in 2000 and 1.8% in 2001, given the tension generated by the import prices of petroleum products.

Although the average annual rate for 1999 is still modest, inflation did pick up in the course of the year, rising above 2% in the final quarter, mainly because of the increase in price of petroleum products (up by an average of 4.4% in 1999). As petroleum product prices have been rising since March 1999, the basic trend of inflation, measured by underlying inflation, has also increased. While the average monthly increase in underlying inflation was only 0.09% in 1998, it rose to 0.13% in 1999.

Wage costs in the Luxembourg economy (nominal and average costs) rose at an increasing rate - by 2.4% compared with 1.8% in 1998 - largely because of index-linked payments in August. The first eight months of 1999 also saw a relatively large increase in wage costs in the financial sector (+3.4%), while the exceptional economic performance achieved by companies in 1998 and 1999 led to higher bonuses than usual.

However, the Luxembourg economy is not overheating, as high levels of public and private investment help to avoid potential bottlenecks and frontier workers provide an abundant supply of labour.

I.3. Employment and unemployment

Domestic payroll employment rose in 1999 to the highest level recorded since 1985 (5.3%), with a net total of around 11 500 new jobs being created within one year. The following points are worth noting:

- the great majority of jobs created were in services (around 9 500), with the biggest share in financial and insurance services, followed by services to companies and then distribution, hotels and catering;

- there was an increase of around 1 000 in the number of employees in each of the “secondary” sectors (manufacturing and construction);

- a more detailed breakdown shows that, in general, new jobs are spread fairly evenly across different branches of economic activity.

Frontier workers continue to take up the slack of jobs left unfilled by domestic supply. In 1999, frontier workers increased in number by 11.1% (7 800 individuals) and occupied two-thirds of the new jobs created. In 1999, as in 1998, national residents also benefited from the expansion of the labour market. The number of employed residents grew by 2.3% (around 4 000 individuals): most of these jobs were taken up by immigrants, but it seems that the domestic supply also increased.

In analysing unemployment, account must be taken not only of the unemployed proper but also of persons placed on training or work schemes.

The two groups experienced very different trends in 1999 compared with 1998. The number of people on schemes hardly changed in 1999, while the number of unemployed proper continued to fall. Those who gained most from falling unemployment were unemployed persons not receiving benefit (- 5.2%) rather than others (-0.6%). Overall, the number of job-seekers fell by an annual average of 2.5% in 1999. The unemployment rate should dip further to reach 2.8% in 2000.

I.4. Foreign trade

In the first nine months of 1999, Luxembourg's balance of payments surplus fell by LUF 9 billion, from LUF 66.8 billion to LUF 57.7 billion, as the deterioration of the balance on items structurally in deficit (trade in goods, income from work) outstripped the improvement of the balance on items structurally in surplus (provision of services, income from capital).

Goods exports rose by only 1.4% in value, while goods imports grew by 4.8%, the reason being that industrial activity slowed down in the first half of the year, while private consumption and the investment trend remain buoyant.

The situation is more balanced in the provision of services, where exports grew by 12.4% and imports by 13.7%. The large surplus was thus maintained: of the LUF 91.5 billion, more than two-thirds (LUF 66.5 billion) was generated by the financial sector.

The deficit on “compensation of employees” deepened further, as an increase in frontier workers (and average wages) pushed the “debit” side up by around 15%, while the “credit” side remained virtually unchanged. The balance on investment income grew by around LUF 6 billion, but this figure is still low compared with the flows involved (LUF 1 155 billion in income compared with LUF 1 059 in outflows during the first nine months) and therefore difficult to interpret.

II. The economic outlook for Luxembourg from 2000 to 2003

II.1. Baseline scenario

Luxembourg is now in a period of very strong economic expansion, which began in 1997 and then gathered pace, culminating in real GDP growth rates of some 5% in 1998/1999. For 1999 in particular, previous growth forecasts required appreciable upgrading as the international economic environment proved more favourable than expected. Luxembourg's central service for statistics and economic studies (STATEC) expects the rate of real GDP growth to be maintained at around 5% during the years ahead, provided that the GDP of the European Union (EU-15) increases in line with Community forecasts, i.e. by an annual average of 3%.

Economic growth is being fuelled on the one hand by sound domestic demand and on the other by very strong external demand. Private consumption is expected to rise by an annual average of around 2.6%, driven by a substantial increase in real personal disposable income. Investment grew very strongly in 1999, partly because ground was being made up after a very slight increase in 1998. The investment growth rate should be in line with a rate sustainable in the medium term of around 6% in volume. Exports of goods and services should reach their cruising speed of some 7.5% in volume by 2003, thereby contributing significantly to economic growth.

The rise in average wages was moderated in 1999 and should remain so in 2000, remaining below 2%. It should then accelerate, boosted by a slight upturn in inflation and a return of productivity growth to its long-term trend. This should have a positive impact on personal disposable income, which will help to boost private consumption.

As inflation in Europe picks up, with consumer price increases of close to 1.5% in two years' time, Luxembourg will of course experience similar increases. Because of other, more buoyant price components, in particular exports of goods and services, the GDP deflator should rise by an average of around 2% up to the end of the forecast period.

Payroll employment rose sharply in 1998 and 1999. The rate of increase is likely to fall off slightly, but will remain very high - above 3.5%. This will help absorb unemployment, albeit marginally: the unemployment rate will fall by 0.1% per year, from 3.1% in 1998 to 2.6% in 2003.

TABLE 2: STABILITY PACT FORECASTS 1999-2003: BASELINE SCENARIO						
	1998	1999	2000	2001	2002	2003
	Volume growth rate (%)					
GDP	5.0	4.9	4.9	5.1	5.2	5.4
Final consumption of households	2.3	3.0	2.7	3.5	1.8	2.2
Public consumption	2.8	3.3	3.3	3.3	3.3	3.3
Gross fixed capital formation	1.5	9.0	5.1	5.3	5.8	6.4
Exports of goods and services	9.9	5.2	6.9	7.2	7.3	7.4
Imports of goods and services	8.3	4.8	5.8	6.4	5.9	6.1
	growth rate (%)					
GDP implicit price deflator	1.5	1.2	1.9	2.2	2.1	2.0
Consumer price index	1.0	1.0	1.6	1.5	1.6	1.8
Wage indexation (sliding scale)	0.2	1.0	1.4	2.1	1.5	1.4
Average nominal wage cost	1.8	2.4	2.5	2.7	2.4	2.5
Payroll employment	4.6	5.0	4.0	3.6	3.7	3.8
Wage bill	6.5	7.5	6.6	6.4	6.2	6.4
Operating surplus of businesses	5.6	3.8	7.2	6.8	6.9	6.9

II.2. Sensitivity analysis

One of the main exogenous assumptions underlying the baseline scenario is GDP trend growth of 3% for the EU-15. While this assumption forms part of the Commission and OECD autumn forecasts for 2000 and 2001, it is less clear whether it can be prolonged until 2003. The EU-15 experienced average growth of 2.4% over the period 1985-98, 3.3% between 1985 and 1990 and 1.8% from 1991 to 1998. The Commission staff assumes a real growth rate of some 3% as a potential growth rate, in accordance with their own medium- and long-term forecasting exercises.

The high-growth scenario is therefore based on GDP growth of 3.5% in the EU in the years 2000 to 2003, while the low-growth scenario is based on growth of 2.5%. No other exogenous variable was changed vis-à-vis the baseline scenario.

These simulations generated a growth differential (high-growth scenario minus low-growth scenario) for real GDP in Luxembourg which averages 1.4%. The high-growth scenario assumes that Luxembourg's GDP can increase in the medium term by around 6% in volume. Under the low-growth scenario, this rate falls to around 4.5%, given a state of equilibrium. The same 1.4% range of growth would apply to the operating surplus of businesses and the wage bill, the two major components of the direct tax base.

TABLE 3: STABILITY PACT FORECASTS 1999-2003: SENSITIVITY ANALYSIS						
	1998	1999	2000	2001	2002	2003
"High-growth" scenario						
	growth rate (%)					
GDP (volume)	5.0	4.9	5.5	5.8	6.0	6.2
GDP implicit price deflator	1.5	1.2	1.9	2.0	1.9	1.9
Wage bill	6.5	7.5	6.8	6.9	6.8	7.1
Operating surplus of businesses	5.6	3.8	8.1	7.5	7.6	7.6
"Low-growth" scenario						
	growth rate (%)					
GDP (volume)	5.0	4.9	4.3	4.4	4.5	4.6
GDP implicit price deflator	1.5	1.2	1.9	2.3	2.3	2.2
Wage bill	6.5	7.5	6.4	5.9	5.6	5.7
Operating surplus of businesses	5.6	3.8	6.2	6.1	6.3	6.1

II.3. The main structural measures

The Law of 8 June 1999 on the state budget, accounts and treasury is designed to modernise Luxembourg's budgetary and accounting system. It provides *inter alia* for improvements to budget accounting rules, the introduction of commitment-based accounts, the creation of the post of Financial Controller, the possibility of granting certain government departments greater financial autonomy and measures to speed up payment procedures.

On the tax front, the aim of the coalition agreement in the years ahead is to consolidate and increase business competitiveness and to promote social justice for citizens. For businesses, it provides for a reduction in the effective rate of taxation from the present 37.5% to less than 35%.

As regards direct taxes on households and sole traders, the Government will take steps to reduce the tax burden which will go well beyond a full adjustment for inflation. The reduction will include a component for structural adjustments in the tax scales.

To tackle unemployment, the Government will pursue an active labour market policy and the national plan for employment will be implemented to the letter.

III. The public finances

In its Statement of 12 August 1999 the Government first of all stresses that it will not be possible to maintain Luxembourg's long- and medium-term prosperity unless the State manages to preserve the present situation of balanced public finances, which form a solid foundation for the new Government's action.

In the Government's view, it is important to respect the rules of conduct laid down in the first stability programme and to pursue a rigorous budgetary policy in order to preserve the present advantages of the financial situation.

It is therefore important to adhere to strict budget discipline and to ensure in particular that in the medium term the growth of central government expenditure does not exceed the limits of economic growth.

The Government has also undertaken to maintain, first, the amount of public debt at its very low level, and second, the budgetary reserves and the investment fund assets at their high level.
It has also undertaken to present each year to the Chamber of Deputies a multiannual programme of State capital expenditure which will cover a moving 5-year period.

III.1 The need for a prudent budgetary policy focused on the medium term

As indicated above, in its Statement the Government announced that it would pursue a budgetary policy which aims at adjusting the variation in total central government expenditure to the variation in gross domestic product over the medium term.

The first important point is that the expenditure budget is characterised by extreme rigidity.

A high proportion of public expenditure (expenditure on salaries, social security transfers, other transfers of income and capital, etc.) is laid down or governed by law, so that the budget lacks elasticity for major cyclical changes - upwards or downwards -, especially during years in which economic activity slows down, or even remains flat or goes into recession.

What is more, the rigidity caused by this obligatory and irreducible nature of most items of expenditure is further exacerbated by the buoyancy inherent in these different categories of charges. A very large volume of the various items of expenditure is driven by an upward trend which derives directly or indirectly from the factors governing their behaviour, such as the growth of incomes, the increase in the school population, the improvement in health care, the increase in the number of pensioners, etc. Most of this expenditure is also laid down by or under laws, regulations or contractual provisions.

The growth of public expenditure is also boosted by the rising trend of the general level of prices. Some two-thirds of current expenditure in the central government budget is linked, via wage indexation, to changes in the consumer price index. Variations in current expenditure are therefore very heavily dependent on the movements of this indicator and are equally unaffected by any direct measure to curb expenditure.

The small size of its economy, which is very open and highly integrated into the European economy with which it trades most of its goods and services (exports to the EU account for over

90% of GDP), means that Luxembourg cannot follow an independent policy of stabilising the economic cycle. In order to guard against a possible asymmetrical shock, the Government is following a very prudent budgetary policy aimed at building up surpluses to cushion the effects of a marked slowdown in growth or even a recession. The low level of the (net) public debt forms part of the same provident strategy.

Compliance with the budgetary policy principles contained in the Government Statement should therefore be assessed in a multiannual context, i.e. throughout the life of the new parliament and not in a purely annual framework. The question of compliance with the budgetary target should also be assessed from a medium-term viewpoint.

This being so, prudence requires budgetary policy to consider the low-growth scenario to be realistic rather than the high-growth scenario.

III.2 The budget which has been voted for 2000

The central government budget for financial year 2000 is based on revenue of LUF 194.2 billion and expenditure of LUF 194.0 billion. It must be said right away that this is not merely a transitional budget bridging the action of the former government and that of the new one. On the contrary, the financial year 2000 budget already comprises a package of appropriations designed to implement certain priority measures of the government programme.

Some of the main points of government policy are summarised below, without being exhaustive.

– The expansion of economic activities

In its Statement of 12 August 1999 the Government undertook to concentrate on the qualitative aspects of growth and on the enduring nature of economic, social and ecological development.

To this end, the 2000 budget contains a coherent package of measures to support and stimulate businesses in the financial, industrial, commercial and craft sectors.

– Employment policy

The central government budget for 2000 is very heavily marked by the implementation of the national employment plan, which was voted into law on 12 February 1999.

The many new measures, which are intended to galvanise the Luxembourg employment market, are chiefly reflected in the expenditure of the Employment Fund, which will be required to act in eight new areas. The forecast cost of implementing the national employment plan may be put at some LUF 1.6 billion for 2000.

– Increasing the safety of citizens

In accordance with the Government Statement of 12 August 1999, the maintenance of order and internal security represents a key Government priority. The budget for 2000 therefore strongly reflects the determination to put into practice, in terms of both physical resources and staffing levels, the new law creating a single police force for Grand Duchy.

– **The development of social, medical and family infrastructure**

The extraordinary budget of the Ministry of Family Affairs plans to allocate LUF 2.2 billion to the fund for social and family investment. This amount will make it possible to assist in particular large-scale projects initiated by municipalities or congregations with a view to building or renovating integrated centres for the elderly.

The Ministry of Health budget is influenced by the continued efforts to develop quality programmes (definition of hospital standards), preventive medicine (improvement of vaccination programmes, epidemiological information systems and health education) and by the development of services, in particular psychiatric services, in a non-hospital setting.

– **Expansion of the policy of solidarity and humanitarian action**

In its Statement of 12 August 1999 the new Government set itself the objective of devoting 0.7% of GNI (Gross National Income) to official development assistance in 2000 and of increasing such assistance to close on 1% by the end of the current parliament.

In accordance with the timetable laid down, the target of 0.7% of GNI will be reached in the budget for financial year 2000.

– **The expansion of central government investment**

As part of its budgetary work, the Government has made the development and modernisation of public infrastructure a high priority.

The Government's objective is to maintain a high level of public investment, in particular for the development of infrastructure. Public investment as a proportion of GDP is close to 5%, one of the highest figures in the EU.

– **The central government contribution to the financing of sickness, pension and long-term care insurance**

The increase in appropriations for sickness and maternity insurance is chiefly due to the substantial growth of maternity benefits.

The increase in the central government's contribution to the contributory pension insurance scheme can be explained, as in preceding years, mainly by the steady growth in the number of contributors, and also, but to a lesser extent, by the growth of real earnings.

– **The central government's contribution to the financing of family benefits**

The Ministry of Family Affairs budget for 2000 provides for a central government contribution of over LUF 18 billion to various benefits under the national family allowance scheme (CNPF) (including the Employment Fund's contribution to the financing of parental leave).

III.3 The public debt

After all possibilities of early repayment were used in 1999, the stock of debt of the Luxembourg State fell, at the end of 1999, to the irreducible level of LUF 28.139 billion.

This amount is equivalent to 4.28% of GDP. At 31 December 1999 the average life of this debt was 5 years and 29 days; no repayment is possible until the end of 2002 and the last due date is in 2007.

The weighted average rate of debt interest to be serviced is 6.55%, which is equivalent to an annual interest charge of some 0.28% of GDP; this diminishes as the debt matures.

Over half the stock of debt is covered by the assets of the public debt servicing fund. There are no plans to resort to borrowing during the next few years if the cost of a new outstanding amount of debt were to remain higher than the yield on placements of central government funds.

III.4 General government net lending (1998-2003)

- The 1998 financial year

Table 4

	as % of GDP	bill. LUF
Central government expenditure	28.0%	186.4
Central government revenue	28.9%	192.5
Balance	0.9%	6.2
Social security expenditure	17.8%	118.2
Social security revenue	19.4%	129.0
Balance	1.6%	10.9
Local government expenditure	6.9%	45.6
Local government revenue	6.9%	45.8
Balance	0.0%	0.2
General government expenditure	42.3%	281.4
General government revenue	44.9%	298.7
Balance	2.6%	17.3

As already noted in the first stability programme, the background to the public finances is one of sustained economic growth. As a result, public sector net lending stands at 2.6% of GDP, i.e. it has reached a level higher than originally forecast in the first stability programme (median scenario 2.1%). GDP has been revised upwards for 1998, from LUF 631.3 billion to LUF 665.7 billion. Because of this, net lending has risen from the LUF 13.4 billion originally forecast in the first stability programme to LUF 17.3 billion. The increase in net lending is reflected in the central government and social security figures, since local government net lending has been revised downwards.

Within general government, the largest balance - LUF 10.9 billion or 1.6% of GDP in value - is generated by the social security funds. This figure is over LUF 2 billion up on the 1998 estimates.

For central government, net lending stands at LUF 6.2 billion, or 0.9% of GDP. The LUF 2 billion increase in net lending compared with the forecasts for 1998 is attributable to lower expenditure growth: LUF 188.2 billion (1998 forecasts) compared with LUF 186.3 billion (provisional figures). In fact, some items of investment expenditure originally forecast for 1998 have been carried over to the following financial years.

Revenue shows little change and will reach LUF 192.5 billion. Examination of the structure of central government expenditure reveals that almost 30% of all budgetary expenditure consists of transfers to social security. Central government's direct transfers to households represent 9.8% whereas transfers to firms represent under 9%. Central government gross fixed capital formation (i.e. investment expenditure) represents 8.4% and it should be borne in mind that most of the transfers to the municipalities (9% in 1998) are in fact used by them for investment. Finally, it should also be noted that debt interest accounts for only one per cent of all central government expenditure. On the revenue side, direct taxes account for 50% of all central government revenue whereas indirect taxes account for 41%. For the whole of the forecast period, the structure of central government revenue and expenditure will not vary significantly.

The deterioration in local government net lending (which is still LUF 0.2 billion) as compared with the 1998 estimates is attributable to a smaller inflow of revenue.

- The 1999 financial year

Table 5

	as % of GDP	**bill. LUF**
Central government expenditure	29.6%	209.0
Central government revenue	30.3%	213.8
Balance	0.7%	4.7
Social security expenditure	18.9%	133.4
Social security revenue	20.5%	145.1
Balance	1.6%	11.6
Local government expenditure	6.7%	47.5
Local government revenue	6.7%	47.5
Balance	0.0%	0.0
General government expenditure	44.1%	311.4
General government revenue	46.4%	327.8
Balance	2.3%	16.4

Preliminary estimates for 1999 put public sector net lending at 2.3%. Compared with the estimates in the first stability programme, this is in excess of the most optimistic scenario, which forecast net lending of 1.2%. The difference of over one percentage point can be explained by stronger GDP growth. When drawing up the stability programme, STATEC forecast GDP in value of LUF 666.4 billion (high-growth scenario), whereas the latest estimates forecast GDP in value of LUF 706.8 billion. This major revaluation of GDP will therefore have a significant effect on social security and central government revenue.

For the subsectors of general government it is again social security which generates substantial net lending - LUF 11.6 billion or 1.6% of GDP. This increase is due to the growth of employment and of the wage bill in general. The LUF 0.8 billion increase over 1998 is therefore a consequence of growth of reserves (up LUF 11 billion) for the general pension scheme: in 1999 these reserves stood at more than LUF 148 billion whereas the reserves of the sickness and maternity insurance scheme fell by LUF 0.6 billion, to LUF 3.3 billion in 1999. An additional reserve (up LUF 1.2 billion) was constituted on the introduction of long-term care insurance. Overall, the reserves of all the schemes taken together stand at LUF 163.9 billion in 1999.

Central government is expected to generate net lending of LUF 4.7 billion, which is equivalent to 0.7% of GDP (0.04% of GDP or LUF 0.3 billion in the first programme). As already stressed above, the different estimates for GDP in 1998 and 1999 explains this large discrepancy. Revenue for 1999 was estimated at LUF 202.0 billion, whereas the most recent estimates put it at LUF 213.8 billion. On the expenditure side, the original estimates of LUF 201.7 billion have risen to LUF 209.0 billion; this increase can mostly be explained by higher investment expenditure and by higher spending on measures to combat unemployment. The broad structure of central government expenditure is much the same as in 1998. Nevertheless expenditure on consumption falls to 28% and central government spending on direct investment rises to 9.7%. The investment expenditure of the whole of general government will thus represent over 3.9% of GDP, and this high figure puts Luxembourg well above the average for the Union (EU-11 and EU-15). Part of the reason for such a high level of investment is that Luxembourg has a very low level of indebtedness, which means that it does not have to allocate large sums to debt repayment. Debt interest falls below one per cent. Indirect taxes as a proportion of total central government revenue increases by 2 percentage points in 1999 to reach LUF 91.5 billion, whereas the proportion of direct taxes falls to 48% or LUF 102.1 billion.

For 1999 local government should close the financial year in balance.

- Projections 2000-03

Table 6

	2000		2001		2002		2003	
	as % of GDP	bill. LUF	as % of GDP	bill. LUF	as % of GDP	bill. LUF	as % of GDP	bill. LUF
Central government expenditure	29.1%	219.4	28.5%	230.9	27.9%	242.7	27.1%	252.1
Central government revenue	29.4%	221.9	28.9%	234.5	28.4%	247.2	27.7%	259.3
Balance	0.3%	2.5	0.4%	3.6	0.5%	4.5	0.6%	7.2
Social security expenditure	18.6%	139.9	18.0%	146.2	17.4%	151.9	16.9%	158.7
Social security revenue	20.6%	155.3	20.1%	163.1	19.7%	171.6	19.2%	180.6
Balance	2.0%	15.5	2.1%	16.9	2.3%	19.7	2.3%	21.9
Local government expenditure	6.6%	49.6	6.4%	51.7	6.2%	53.9	6.1%	56.2
Local government revenue	6.7%	50.3	6.5%	52.5	6.3%	54.9	6.2%	57.9
Balance	0.1%	0.8	0.1%	0.8	0.1%	1.0	0.1%	1.7

General government expenditure	42.7%	322.2	41.7%	338.3	40.5%	353.2	39.3%	368.5
General government revenue	45.2%	341.0	44.3%	359.7	43.4%	378.4	42.4%	397.1
Balance	2.5%	18.8	2.6%	21.4	2.9%	25.2	3.1%	28.6

The forecast period from 2000 to 2003 is marked by an acceleration in public sector net lending. For 2000, net lending should reach LUF 18 billion, or 2.5% of GDP in value. This figure will probably rise to over 3% or LUF 28.6 billion in 2003. If we compare these figures with the estimates made at the time of the first stability programme, we see that even the optimistic scenario (net lending of 2.5% of GDP in 2002) will probably be overshot. As in the case of 1999, this difference in estimates is above all attributable to higher GDP growth. Whereas in 1998 GDP for 2002 was estimated at LUF 754.1 billion in the optimistic scenario, recent estimates consider that LUF 871.7 billion is likely for 2002.

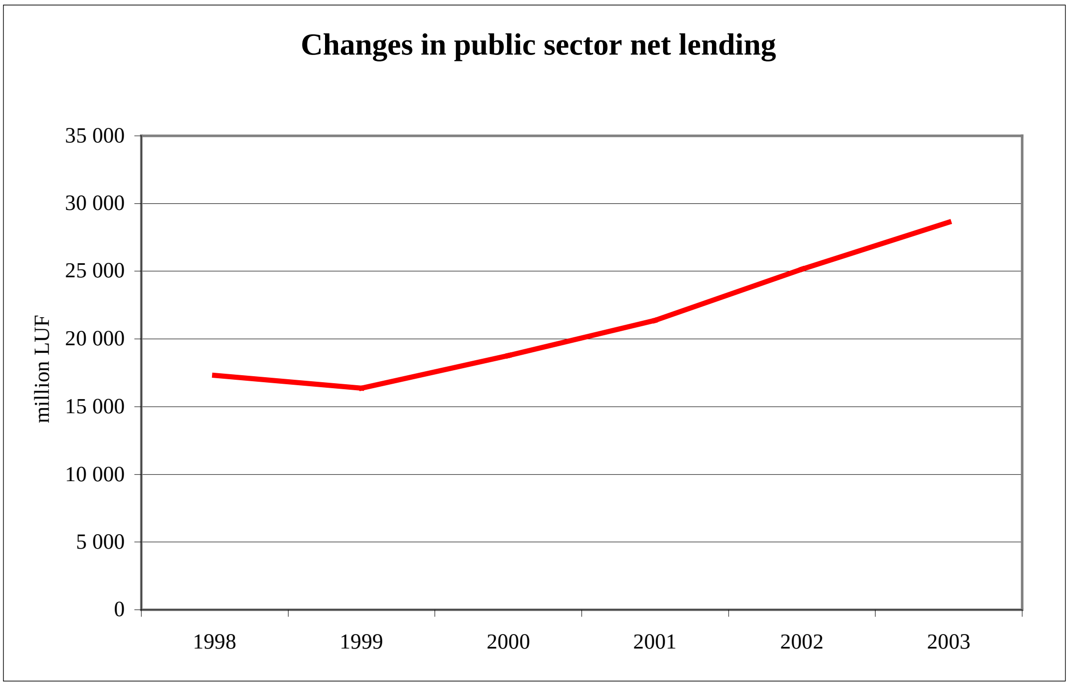
For the subsectors of general government, social security net lending should be close to LUF 15.5 billion (2.0% of GDP) in 2000, and will reach LUF 21.9 billion (2.3% of GDP) in 2003. The total reserves of all the social security schemes taken together will reach LUF 236.9 billion in 2003. In 2000 the balance on the general pension scheme will reach LUF 13.8 billion, taking its reserves to LUF 162 billion. During the period 2001-03 the increase in the general pension scheme reserves will grow steadily, to reach LUF 213.7 billion in 2003, equivalent to a balance of LUF 19.3 billion on this scheme alone. After the introductory period in 1999 of long-term care insurance, the benefits in question will increase. As a result, the balance on this scheme will stabilise at half a billion whereas the reserves will reach LUF 3.4 billion in 2003. In 2003 the accident insurance reserves will stand at LUF 9.7 billion and the sickness and maternity insurance reserves at LUF 6.7 billion.

With a view to ensuring the long-term financing of the pension scheme, the government has commissioned a study, the results of which will be available in 2000.

Central government net lending will grow throughout the forecast period, from LUF 2.5 billion (0.3% of GDP) in 2000, and reaching LUF 5.6 billion (0.6% of GDP) in 2003. As already indicated above, the rapid growth of GDP will have an accelerator effect on central government tax revenue, while as regards expenditure, the policy of curbing expenditure, in particular expenditure on consumption, will be continued. As a result, it will be possible to build up reserves to cope with any downturn in the cycle. Whereas revenue growth will average LUF 12.5 billion over the period 2000-03, expenditure growth will average only LUF 11.2 billion. Examination of the structure of expenditure indicates that for the period 2000-03 transfers to the social security funds and expenditure on consumption still represent some 60% of all central government expenditure. However, what is interesting is that we see an inversion of the relative weight of these two items. In 1998 social security transfers represented 27.9% and expenditure on consumption 30.1%, whereas in 2003 social security transfers will increase to 39.7% and expenditure on consumption will then fall to 27.8% of all central government expenditure. Central government expenditure on net investment will go on rising during the forecast period to reach 10.9% of all central government expenditure or 3% of GDP in 2003. Throughout the forecast period, the growth of gross fixed capital formation for the whole of general government will average 8% a year. As regards the redemption of central government debt, over LUF 2 billion will be repaid in 2002 and over LUF 8 billion in 2003.

For the period 2000-03, local government net lending will be close on 0.1%. The municipalities, like the rest of general government, will benefit from the steady growth of the economy. Expenditure growth will average 4% during the period 2000-03, whereas revenue growth will average 5%. In the case of revenue, central government transfers (representing a proportion of the tax revenue collected by the State) are the main reason for the average rate of 5%. Operating expenditure (averaging 76%) represents the major part of the municipalities' expenditure, followed by investment expenditure (averaging 22%).

Graph 1:



Conclusion

For the whole of the forecast period, Luxembourg will generate substantial net lending in the case of general government. This net lending is based, first, on a policy of prudent expenditure, and second, on substantial revenue growth. Since forecast net lending is high, on the basis of a realistic scenario for economic growth, the public sector has a safe margin for dealing with unpredictable cyclical shocks. Even if economic growth is lower, Luxembourg will still meet the stability pact criteria.