Part V

Member State developments

1. Belgium

In the 2002 update of the stability programme, the target for the general government accounts was a balanced budget. This target was based on much stronger economic growth than actually took place. Still, the budget recorded a small surplus. The budget benefited from a decrease in interest payments and a strict control of expenditures but also from sizeable one-off measures. Without these measures the budget deficit would have stood at about 1 % of GDP. The debt target for 2003 in the 2002 update of the stability programme was 102.3 % of GDP. The actual debt was even lower at 100.5 % of GDP due to the abovementioned one-off measures, as well as due to some financial operations [1].

[1] These include the sale of financial assets of Credibe (formerly the Central Mortgage Credit Office) and the reimbursement of loans granted by Fadels (Fund for the Repayment of Social Housing Debt).

Table V.1

Budgetary developments 2002–07, Belgium

(% of GDP)

Outturn and forecast [1]	**2002**	**2003**	**2004**	**2005**		
General government balance	0.1	0.2	– 0.5	– 0.7		
— Total revenue	50.5	51.7	49.4	48.6		
Of which: — current taxes	30.6	30.2	29.9	29.3		
— social contributions	16.7	16.4	16.2	16.0		
— Total expenditure	50.5	51.5	49.9	49.4		
Of which: — collective consumption	8.2	8.3	8.3	8.2		
— social transfers [4]	30.1	30.9	30.8	30.3		
— interest expenditure	6.1	5.6	5.1	4.8		
— gross fixed capital formation	1.6	1.6	1.6	1.7		
Primary balance	6.1	5.8	4.7	4.1		
Pm Tax burden	46.6	45.9	45.4	44.5		
Government debt	105.8	100.5	97.4	94.3		
Pm Cyclically adjusted balance	0.1	0.7	0.0	– 0.5		
Pm Cyclically adjusted primary balance	6.2	6.3	5.1	4.3		
Pm Real GDP [3]	0.7	1.1	2.0	2.5		
Stability programme [2]	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	0.1	0.2	0.0	0.0	0.0	0.3
Primary balance	6.1	5.6	5.1	4.8	4.7	4.8
Government debt	106.1	102.3	97.6	93.6	90.1	87.0
Pm Real GDP [3]	0.7	0.9	1.8	2.8	2.5	2.1

[1] Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
[2] Submitted in November 2003.
[3] Annual % change.
[4] In kind and other than in kind.

Source: Commission services and stability programme of Belgium.

Fiscal policy as reflected in the 2004 budget and in the most recent updated stability programme is focused on employment promoting measures, notably through the reduction in social contributions. However, the budgetary outcome is also influenced to a large extent by the temporary tax regulation (*déclaration libératoire unique*), the income tax reform and the anticipation of subsidies and transfers to SNCB (railway company). Another important measure is the decision to increase health expenditure by 4.5 % annually in real terms. Further details are given in the accompanying table.

Following weak economic development in 2003, the target for the 2004 budget was revised in the most recent update of the stability programme, which targets a balanced budget, compared to a surplus of 0.3 % of GDP in the previous update. The Commission's spring 2004 forecast projects a deficit of 0.5 % of GDP. The difference between the target in the updated programme and the spring 2004 forecast is not only due to the fact that the Commission only takes into account measures already announced and approved but also a more cautious approach by the Commission. The spring 2004 forecast assumes that no additional revenue is expected from the temporary tax regulation. In addition, it assumes that employment growth is less favourable than expected in the updated programme. According to the forecast, the cyclically adjusted budget moves from a surplus of 0.7 % of GDP to balance in 2004. However, the deterioration disappears if one-off measures are excluded.

The updated stability programme targets a balanced budget in 2005. The spring 2004 forecast on the other hand projects a further deterioration of the budget deficit by 0.2 percentage points, to 0.7 % of GDP, based on the usual no-policy change assumption. This means that the improvement in the business cycle is not enough to offset the loss of revenue from one-off measures.

The debt level is particularly high in Belgium but it is also declining rapidly. A fall by more than 6 percentage points to about 94 % of GDP is projected in the spring 2004 forecast over the period 2003–05.

Table V.2

Main measures in the budget for 2004, Belgium

Revenue measures	Expenditure measures
• Déclaration libératoire unique (0.3 % of GDP) • Income tax reform (– 0.2 % of GDP) • Reductions in social contributions (– 0.2 % of GDP) • Increase in 2004 in income taxes withheld in 2004 at the expense of 2005 (0.1 % of GDP)	• Bringing forward subsidies and transfers to SNCB from 2004 to 2003 (0.4 % of GDP) [1]

[1] This measure was taken after the budget but it has been included in the forecast.

Source: Commission services and Ministry of Finance and Ministry of Budget.

2. Czech Republic

The general government balance recorded a deficit of 12.9 % of GDP in 2003. This compares with a targeted deficit of 7.3 % set in the 2003 pre-accession economic programme (PEP). The very large deviation from target was mainly due to a one-off imputation of State guarantees to the general government deficit (about 6–7 % of GDP). Without this one-off operation the deficit would be actually lower than planned in the PEP owing to a higher than projected growth and a revised base level for GDP. Government debt was 37.6 % of GDP in 2003.

The State budget for 2004 was approved on 3 December 2004. It reflected the fiscal measures as presented in the 2003 PEP. The three major expenditure-side measures are a cut in the wage bill of the central government administration, reductions in discretionary spending of individual ministries, and reductions in sickness benefits. These three measures together constitute more than three quarters of all expenditure cuts. On the revenue side, a shift is foreseen in the structure of budget revenues — a reduction in corporate income tax should be more than offset by an increase in VAT and in excise duties. Further details are given in the accompanying table.

The target for the general government deficit in 2004 in the 2003 PEP is 5.9 % of GDP. In the Commission's spring 2004 forecast, the projected outcome in nominal values is slightly worse than the one targeted by the government, but because of the upward revision of GDP, the

Table V.3

Budgetary developments 2002–05, Czech Republic

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**
General government balance (3)	– 6.4	– 12.9	– 5.9	– 5.1
— Total revenue	45.6	45.0	45.0	44.1
Of which: — current taxes	20.7	21.1	21.0	20.7
— social contributions	15.1	15.0	14.8	14.6
— Total expenditure (3)	52.0	57.9	50.9	49.2
Of which: — collective consumption	10.9	10.0	9.8	9.6
— social transfers (4)	23.9	23.1	22.9	22.7
— interest expenditure	1.5	1.3	1.3	1.3
— gross fixed capital formation	4.4	4.2	4.2	4.2
Primary balance (3)	– 5.0	– 11.7	– 4.6	– 3.8
Pm Tax burden	35.8	36.2	35.9	35.3
Government debt	28.9	37.6	40.6	42.4
Pm Real GDP (2)	2.0	2.9	2.9	3.4

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Annual % change.
(3) Including UMTS receipts of 0.09 % of GDP in 2001, 0.02 % of GDP in 2002 and 2003, and 0.16 % of GDP in 2004.
(4) In kind and other than in kind.

Source: Commission services.

deficit/GDP ratio is the same (5.9 % of GDP). The deviation reflects a less optimistic view on the final outcome of cuts in government consumption. It also takes into account the risk of imputation of a part of remaining State guarantees.

The debt ratio is rather low, at around one third of GDP, but its dynamics is worrying. It jumped from 28.9 % in 2002 to 37.6 % of GDP in 2003. In 2004 and 2005, government debt is expected to further increase from 40.6 % of GDP in 2004 to 42.4 % of GDP in 2005.

Table V.4

Main measures in the budget for 2004, Czech Republic

Revenue measures	Expenditure measures
• Broadening the VAT base • Transferring of some goods and services from the reduced VAT rate (5 %) towards the standard one (22 %) • Increase of the excise duty on spirits and tobacco • Reduction of the corporate income tax rate (from 31 % in 2003 to 24 % in 2006) • Increase of social security contribution base of self-employed persons (to 50 % of the difference between revenues and costs, instead of the previous 35 %)	• Cuts in the wage bill of the public sector (2 % of public sector jobs are to be lost annually over the period 2004–06) • Reduction in sickness benefits • Cuts in discretionary spending of individual ministries (mainly cuts in military expenditures, in the State subsidy for housing savings programmes, in subsidies to businesses, and in the operating costs of ministries) • Parametric changes in the PAYG pension pillar • Cuts in social assistance and social care benefits

Source: Commission services.

3. Denmark

The general government balance in 2003 is estimated to be a surplus of 1.5 % of GDP. This is below the 2.2 % of GDP target in the 2002 update of the convergence programme. The main reason for the lower outturn is GDP growth, which is estimated to have been 0.4 % in 2003 ([1]), compared to the 2.2 % assumed in the convergence programme update. This comparatively robust surplus is due to the fact that tax revenues remained strong. In particular corporate tax revenues were high. Moreover, as private consumption grew by more than 1 %, revenues from indirect taxes held up relatively well.

The debt/GDP ratio in 2003 was 45 %, compared to the target of 42 % in the update of the convergence programme. The deviation is due to lower than foreseen sur-

([1]) GDP growth in 2003 was revised from 0.0 to 0.4 % subsequent to the publication of the Commission's spring 2004 forecast. Table V.5 is based on the Commission's spring forecast, and therefore does not take account of this revision.

Table V.5

Budgetary developments 2002–07, Denmark

(% of GDP)

Outturn and forecast ([1])	**2002**	**2003**	**2004**	**2005**		
General government balance	1.7	1.5	1.1	1.5		
— Total revenue	57.3	57.5	56.9	56.2		
Of which: — current taxes	46.9	47.3	46.8	46.5		
— social contributions	2.7	2.7	2.7	2.6		
— Total expenditure	54.9	55.4	55.8	54.7		
Of which: — collective consumption	7.6	7.6	7.6	7.5		
— social transfers ([4])	36.3	37.1	37.1	36.4		
— interest expenditure ([4])	2.8	2.6	2.5	2.3		
— gross fixed capital formation	1.8	1.6	1.7	1.7		
Primary balance	4.5	4.0	3.6	3.8		
Pm Tax burden	48.9	49.4	49.0	48.5		
Government debt	47.2	45.0	42.3	40.0		
Pm Cyclically adjusted balance	1.0	2.1	1.4	1.5		
Pm Cyclically adjusted primary balance	3.8	4.7	3.9	3.7		
Pm Real GDP ([3])	1.0	0.0	2.1	2.2		
Convergence programme ([2])	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	1.6	1.2	1.3	1.8	1.9	2.1
Primary balance	2.9	2.3	2.3	2.7	2.6	2.3
Government debt	45.5	42.7	41.2	38.7	36.4	27.5
Pm Real GDP ([3])	2.1	1.4	2.3	2.2	1.9	1.7

([1]) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
([2]) Submitted in November 2003.
([3]) Annual % change.
([4]) In kind and other than in kind.

Source: Commission services and convergence programme of Denmark.

pluses, but also to an upward revision of historical data for consolidated government debt.

The agreement on the budget for 2004 was concluded on 8 November 2003. On the expenditure side, it includes measures to improve transport infrastructure. In line with the agreement with local governments earlier in 2003, the growth in real public consumption is to be limited to 0.7 % in 2004. On the revenue side, the budget incorporated the largest part of the income tax cuts of the tax reform (see Table V.6).

On 23 March 2004, an agreement in the parliament was reached based on the fiscal package presented by the government earlier in the month. The new measures include the full implementation of the tax reform in 2004 (originally planned for 2004–07); the suspension of contributions to a mandatory savings scheme (1 % of gross income) in 2004 and 2005; public investment and social and health spending earmarked for 2005 is brought forward to 2004; increased labour market expenditure on training of unemployed. The direct impact on public finances of the larger tax cuts is, however, to a large extent offset by the fact that the contributions to the mandatory savings are tax deductible, implying that tax revenues will rise when the contributions to the savings scheme are not paid.

The target for general government balance in the year 2004 in the 2003 update of the convergence programme is a surplus of 1.3 % of GDP.

This target has been revised down from 2.2 % in the previous programme update, *inter alia*, due to expected lower revenues as a consequence of tax reductions. The Commission's spring 2004 forecast foresees a general government surplus of 1.1 % of GDP.

The difference from the target of the 2003 update of the convergence programme is due to the fact that the Commission foresees higher unemployment and incorporates the effects of the March 2004 fiscal package. The fiscal stance in 2004 as measured by the change in the cyclically adjusted balance is a considerable easing relative to 2003. However, it should be kept in mind that the increase in the cyclically adjusted balance in 2003 was not due to tight fiscal policy ([1]).

The Commission's spring forecast foresees a rise in the surplus to 1.5 % of GDP in 2005. The forecast is based on a no-policy change assumption, but incorporates the changes brought about by the March 2004 fiscal package, where expenditure and revenue changes are brought forward to 2004. The target for 2005 in the 2003 update of the convergence programme is a general government surplus of 1.8 % of GDP. The difference *vis-à-vis* the Commission forecast is due to effects of the recent fiscal measures and higher labour market expenditure.

Due to the successive general government surpluses, the government debt ratio continues to decline. In the Commission's spring forecast it is projected to fall to 42 % of GDP in 2004 and to 40 % in 2005. This is slightly above the path for the debt ratio foreseen in the last updated Danish convergence programme.

([1]) Revenues from corporate taxes and the pension fund yield tax, in particular, tend to be volatile in Denmark and at times weakly correlated to the business cycle, and can thus distort the cyclically adjusted budget balances. The Danish authorities therefore exclude these and certain other revenue items in their calculations of cyclically adjusted balances.

Table V.6

Main budgetary measures for 2004, Denmark

Revenue measures	Expenditure measures
• Full implementation in 2004 of the tax cuts of the tax reform: the level for middle-bracket income tax is raised; an earned-income tax credit is introduced (2/3 % of GDP) • Temporary suspension of (tax deductible) contributions to mandatory saving raises revenues (1/4 % of GDP) • Lower excise duties on alcohol, tobacco, soft drinks	• Bringing forward public investments and health spending • Increased expenditure on training of unemployed • Growth of real public consumption limited to 0.7 %

Source: Commission services, Danish Ministry of Finance.

4. Germany

The general government budget deficit rose from 3.5 % of GDP in 2002 to an estimated 3.9 % of GDP in 2003, thus breaching the 3 % reference value for the second consecutive year. In its update of the stability programme of December 2002, the German authorities had foreseen a deficit of 2 % of GDP for 2003. This was based on expected real GDP growth at 1 % of GDP. In fact, Germany recorded – 0.1 % real growth in 2003, which led to considerable tax revenue shortfalls and higher social spending. Government debt amounted to 64.2 % of GDP, also breaching the 60 % reference value for the second consecutive year.

The budget for 2004 is shaped by four major developments. Firstly, a large reduction in income tax rates as a consequence of tax relief laws passed in 2000 will be implemented. Secondly, structural measures in the public pension and health systems with budgetary

Table V.7

Budgetary developments 2002–07, Germany

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	– 3.5	– 3.9	– 3.6	– 2.8		
— Total revenue	45.0	45.0	44.5	44.3		
Of which: — current taxes	22.6	22.7	22.4	22.3		
— social contributions	18.4	18.6	18.5	18.2		
— Total expenditure	48.5	48.9	48.0	47.1		
Of which: — collective consumption	7.9	7.9	7.8	7.6		
— social transfers (4)	30.6	31.1	30.5	29.9		
— interest expenditure	3.1	3.1	3.1	3.1		
— gross fixed capital formation	1.6	1.5	1.4	1.3		
Primary balance	– 0.4	– 0.7	– 0.4	0.3		
Pm Tax burden	40.6	40.7	40.4	40.1		
Government debt	60.8	64.2	65.6	66.1		
Pm Cyclically adjusted balance	– 3.5	– 3.2	– 3.0	– 2.5		
Pm Cyclically adjusted primary balance	– 0.4	0.0	0.1	0.7		
Pm Real GDP (3)	0.2	– 0.1	1.5	1.8		
Stability programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	– 3.5	– 4.0	– 3¼	– 2½	– 2	-1½
Primary balance	– 0.4	– 0.9	– ¼	½	1	1½
Government debt	60.8	64	65	65½	65½	65
Pm Real GDP (3)	0.2	– 0.1	1.7	2¼	2¼	2¼

(1) Commission services’ spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted in December 2003 (with addendum in January 2004), projections are rounded.
(3) Annual % change.
(4) In kind and other than in kind.

Source: Commission services and addendum to the 2003 update of the stability programme of Germany.

consolidation effects have been enacted. Thirdly, the government expects large revenues from a tax amnesty on undeclared interest earned abroad. Fourthly, a number of small consolidation measures (reductions in tax allowances and subsidies) have been passed into law.

The budget for 2004 was finalised in late December 2003. As a result, the German authorities provided an addendum to the update of the stability programme in January 2004, which projects a general government deficit of 3 % of GDP as the target for 2004. In the Commission services' spring 2004 forecast, the outcome is projected at 3.6 % of GDP. The difference is mainly due to budgetary developments not foreseen in the update, in particular a low Bundesbank profit in 2003 (which is relevant for the 2004 budget) and the postponement of the road toll to 2005. In addition, the Commission made a cautious assumption on the expected revenue from the tax amnesty. The spring forecast projects the cyclically adjusted deficit at 3.0 % of GDP in 2004, showing an improvement by 0.2 percentage points compared to 2003. This falls short of the reduction projected in the update of the stability programme. The difference can be mainly explained by the subsequent downward revision of 0.2 percentage points of the 2003 deficit and the one-time budgetary effects for 2004 described above.

For 2005, the Commission services project a general government deficit of 2.8 % of GDP, with growth of real GDP at 1.8 %. This is above the German Government projection of a 2 % deficit contained in the updated stability programme, which was based on a growth projection higher by about a percentage point. Under its no-policy-change assumption, the Commission projection incorporates those structural measures for 2005 that were passed into law in 2003. In line with recent developments, it also assumes continuing restraint in the remuneration of public sector employees. This explains the projection of a falling government expenditure share in 2004 and 2005. If growth in 2005 turns out lower than projected or if the structural measures do not show the expected consolidation effect, Germany clearly risks breaching the 3 % reference value in 2005 for the fourth consecutive time.

The Commission's spring 2004 forecast projects the debt ratio at 65.6 and 66.1 % of GDP in 2004 and 2005, respectively. This increase reflects the high deficits and results in the debt ratio remaining above the 60 % reference value both in 2004 and 2005.

Table V.8

Main measures in the budget for 2004, Germany

Revenue measures	Expenditure measures
• Second and part of third stage of income tax rate reduction (– 0.7 % of GDP) • Tax amnesty (+ 0.2 % of GDP) • Basket of reductions in tax allowances • Increase in tobacco tax	• Reduced coverage of public health insurance (– 0.2 % of GDP) • Adjustments in public pension system (– 0.2 % of GDP) • Numerous small cuts in other transfers and subsidies

Source: Commission services, Ministry of Finance of Germany.

5. Estonia

The general government posted a surprise surplus of 2.6 % of GDP in 2003. This compares with a targeted surplus of 0.4 % of GDP in the August 2003 update of the pre-accession economic programme. This positive result was achieved mainly through strong growth of 4.7 %, but also through improved tax collection, despite additional election-induced spending in 2003, and considerable deficits of some local governments (notably Tallinn). This outcome of the general government confirms once again a healthy tendency towards conservative budget forecasts. Government debt represented a mere 5.8 % of GDP in 2003, according to the reporting of government deficit and debt levels submitted in March 2004, and as confirmed by the first Estonian convergence programme of 13 May 2004.

For 2004, the government originally had targeted a balanced general government budget, on the assumption that a strong adjustment phase of domestic demand would set in. The convergence programme, however, suggests that the unexpectedly high level of revenues in 2003 will have a strong carry-over effect on the 2004 budget. Indeed, budget execution figures for the first few months of 2004 suggest once again strong revenue performance. As a result, the general government budget target was revised upwards to a 0.7 % of GDP surplus in the convergence programme.

Tax cuts that are being implemented starting in 2004, along with increased social benefits, and the EU accession-related expenditure requirements are expected to

Table V.9

Budgetary developments 2002–05, Estonia

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**
General government balance (3)	1.8	2.6	0.7	0.0
— Total revenue	39.6	41.2	43.4	42.2
Of which: — current taxes	22.1	23.3	23.7	23.4
— social contributions	12.3	12.3	11.8	11.4
— Total expenditure (3)	37.9	38.6	42.8	42.2
Of which: — collective consumption	8.6	9	9.5	8.4
— social transfers (3) (4)	13.0	13.8	14.6	14.3
— interest expenditure	0.3	0.3	0.3	0.3
— gross fixed capital formation	4.9	4.7	4.5	4.3
Primary balance (3)	2.1	2.9	1.0	0.3
Pm Tax burden	34.4	36.1	36.5	35.8
Government debt	5.7	5.8	5.4	5.3
Pm Real GDP (2) (4)	6.0	4.7	5.4	5.9

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Annual % change.
(3) In kind and other than in kind.
(4) GDP was revised upwards on 18 May 2004, to 7.2 % (from 6 %) in 2002, and to 5.1 % (from 4.7 %) for 2003, following the introduction of new national accounts rules, definitions and classifications fully compatible with ESA 95.

Source: Commission services, Estonian Ministry of Finance.

put some pressure on public finances in both 2004 and 2005. On the other hand, projected higher tax revenues, the introduction or increase of VAT rates and excise duties upon EU accession (implementing requirements of the EU *acquis*), and strict expenditure control are expected to offset part of the budgetary deterioration (see table for details). On the whole, for 2004 a reduced surplus of around 0.7 % of GDP is projected, whereas for 2005 a balanced budget is forecast. Overall, a period of quite significant fiscal easing is envisaged for the early years of EU membership. Estonia is earmarking 11 % of central government expenditure in the 2004 budget for EU-related funding purposes. Following the positive outturn in 2002/03 together with a cautious forecasting strategy, Estonia should for the foreseeable future be in a position to run budgets close to balance or in surplus.

The medium-term fiscal strategy has been presented within the framework of the country's first convergence programme 2004 in May 2004, very much along the lines of the 2003 PEP. Estonia's plans to proceed with the ongoing tax reform are quite ambitious, but cautiously implemented in a sequenced way. They are based on the principles of a simple taxation with a broad tax basis, low tax rates and a low and declining overall tax burden. A proportional personal income tax equals the corporate flat tax rate, whereby for the latter, generous tax exemptions for reinvested earnings are granted, in order to stimulate investment.

Government debt in Estonia is expected to further decrease, from 5.8 % of GDP in 2003 to 5.4 % of GDP in 2004 and 5.3 % of GDP in 2005. Government debt is backed up by a 'national stabilisation' reserve fund of the central government, which amounts to around 3.8 % of GDP. This fund has been built up since 1997 through privatisation receipts and budget surpluses.

Table V.10

Main measures in the budget for 2004, Estonia

Revenue measures	Expenditure measures
• Personal income tax: increase in tax-free thresholds for low income tax bracket (– 1.2 % of GDP) • Increases in excise duties on tobacco, alcohol and fuel (+ 0.6 % of GDP) ([1]) • Introduction of heavy vehicle tax (+ 0.05 % of GDP) • VAT: abolition of tax-free trading in shipping and aviation within EU (+ 0.25 % of GDP) ([1]) • VAT: introduction of VAT for pre-ordered periodical papers and magazines subscription (+ 0.01 % of GDP) ([1]) • VAT: electricity generated by wind and hydro-power lose their VAT-free status, introduction of a 18 % VAT rate (+ 0.002 % of GDP) ([1]) • VAT: abolition of VAT incentives for foreign aid and foreign aid loans (+ 0.3 % of GDP) ([1]) • VAT: refund to travellers from third countries (– 0.01 % of GDP) ([1]) • VAT: change of VAT regime for finance lease (+ 0.3 % of GDP) ([1]) • Deferment of moment of VAT taxation, by introduction of VAT clearing system among EU Member States (– 0.55 % of GDP, with one-off accruals effect in 2004) ([1])	• Introduction of parent-benefit scheme (+ 0.4 % of GDP) • Increase in teachers' salaries (+ 0.001 % of GDP) • One-off increase in pensions, in addition to normal indexation (– 0.05 % of GDP) • Introduction of new spending category: Estonian payment to EU budget (+ 0.8 % of GDP) ([1]) • EU co-financing, under assumption of full absorption of funds, estimated at 11 % of total government expenditure (+ 3.4 % of GDP) ([1])

([1]) Introduced upon EU accession, these measures become effective only from 1 May 2004.

Source: Commission services, Estonian Ministry of Finance, Estonian pre-accession economic programme 2003.

6. Greece

According to the second revised EDP notification communicated by the Greek authorities on 4 May 2004 and validated by Eurostat, the general government balance recorded a deficit in 2003, of 3.2 % of GDP, despite strong economic growth of 4.2 % achieved during the year. The debt ratio reached 103 %. In the light of this evidence the Commission has decided to initiate the excessive deficit procedure (EDP) for Greece.

During a mission by Eurostat and the Economic and Financial Affairs DG to Athens late in April 2004, it became clear that there will be significant further, and as regards deficits almost certainly upward revisions for 2003 and earlier years, when the customary EDP notification is made in September 2004. The recently notified deficit compares with a deficit of 1.7 % of GDP according to a first notification sent early March 2004, which was modified at the end of the same month, providing a figure of

Table V.11

Budgetary developments 2002–07, Greece

(% of GDP)

Outturn and forecast ([1])	**2002**	**2003**	**2004**	**2005**		
General government balance	– 1.4	– 3.2	– 3.2	– 2.8		
— Total revenue	45.3	44.2	44.0	44.1		
Of which: — current taxes	24.1	23.4	22.9	22.8		
— social contributions	14.1	14.6	14.8	15.0		
— Total expenditure	46.7	47.1	47.2	46.9		
Of which: — collective consumption	9.4	9.4	9.5	9.2		
— social transfers ([4])	22.7	23.4	23.7	23.8		
— interest expenditure	6.2	5.7	5.6	5.5		
— gross fixed capital formation	3.8	4.2	4.2	4.2		
Primary balance	4.7	2.7	2.4	2.7		
Pm Tax burden	36.3	36.7	36.4	36.3		
Government debt	104.7	103.0	102.8	101.7		
Pm Cyclically adjusted balance	– 1.7	– 3.6	– 4.1	– 3.8		
Pm Cyclically adjusted primary balance	4.4	2.1	1.5	1.7		
Pm Real GDP	3.9	4.2	4.0	3.3		
Stability programme ([2])	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	– 1.2	– 1.4	– 1.2	– 0.5	0.0	n.a.
Primary balance	n.a.	4.7	4.7	5.1	5.3	n.a.
Government debt	104.7	101.7	98.5	94.6	90.5	n.a.
Pm Real GDP ([3])	3.8	4.0	4.2	4.0	3.8	n.a.

([1]) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure. For 2003, a revision of the data on general government balance was done in April 2004.
([2]) Submitted in December 2003.
([3]) Annual % change.
([4]) In kind and other than in kind.

Source: Commission services and stability programme of Greece.

2.95 % of GDP. It also compares with a targeted deficit of 0.9 % of GDP set in the December 2002 update of the stability programme. This significant slippage is attributable first to extraordinary factors (expenditure overruns related to the preparation of the Olympic Games and compensation for weather damages), secondly, to a lack of control over primary spending (social transfers and public sector wages) and finally to revenue shortfalls (VAT, income taxes and property income). With a positive output gap of 1.5 % in 2003, up from 0.8 % in 2002, the sharp deterioration of the government balance cannot be attributed to cyclical factors. The estimated cyclically adjusted deficit rose from 1.7 % of GDP in 2002 to 3.9 % of GDP in 2003, and the primary surplus fell from 4.7 to 2.5 % respectively. At the end of 2003, the debt ratio was reported at 103.0 % of GDP as compared with 100.2 % of GDP set in the December 2002 update of the stability programme. The difference of the 2.8 percentage points is due partly to the higher general government deficit and partly to the stock-flow adjustments.

Table V.12

Main measures in the budget for 2004, Greece

Revenue measures	Expenditure measures
• Tax incentives for investment	• Support to farmers and to low incomes
• Introduction of an objective tax payment control	• Public wages and pensions
• Tax reductions for cars and bicycles	• Grants to social security funds and medical care

Source: Commission services.

The target for the general government deficit in 2004 set in the December 2003 updated stability programme is 1.2 %. In the Commission's spring 2004 forecast, the projected outcome for 2004 is significantly worse than this target, with the general government deficit forecast at 3.2 % of GDP. This is due firstly, to the significant base-year effect from the higher deficit in 2003 (notice that Commission 2004 spring forecasts were based on the then available first revised notification of 30 March which indicated a lower 2003 deficit than that of the second revised 4 May notification); secondly, to the impact of the 2003 social package, which seems to have been understated in the expenditure projections; and finally, to the lower than officially projected growth in tax revenues, given the recent tax reform.

The overall budgetary cost of the package of new measures approved by the parliament in December 2003, is estimated at EUR 2.36 billion (or 1.4 % of GDP), mostly in 2004. On the revenue side, a new tax policy will be introduced, the main characteristics of which are: tax incentives for investment and employment, the introduction of an objective tax payment control system and tax reductions on car registrations. On the expenditure side, the social package provides for: an increase in public sector wages and pensions and in grants to social security funds and medical care agencies; and measures to support farmers and low incomes. Based on the adjusted wage law that implements the outcome of the collective bargaining process between the government and the unions of the public sector employees, the budget will implement an increase in wages and pensions of 7.7 %.

The projected worsening of the general government balance as compared to 2003 in combination with an expected positive output gap, reflects the pro-cyclical, expansionary nature of fiscal policies in Greece. According to the forecast, the cyclically adjusted budget position and the cyclically adjusted primary balance in 2004 will both deteriorate by 0.2 percentage points, and 0.5 percentage points respectively, indicating a move further away from a budgetary position of close to balance or in surplus.

Under the usual assumption of unchanged policy, a marginal improvement is expected to take place in 2005, assuming that some primary expenditure related to the preparation of the Olympic Games will not be recurring in 2005. The general government deficit is forecast at 2.8 % of GDP as against the target of 0.5 % of GDP set in the December 2003 update of the stability programme.

According to the spring forecast, the debt ratio is projected to decline in the period 2004–05, albeit at a slow pace, given still high stock-flow adjustments and debt-increasing financial transactions. Debt is projected at 102.8 % of GDP at the end of 2004 and at 101.7 % of GDP at the end of 2005, as compared with 98.5 % of GDP and 94.6 % of GDP, respectively, in the December 2003 update of the stability programme.

7. Spain

Despite the effects of a reform of personal income tax and slower than expected growth (3 against 2.4 % finally registered), the initial fiscal targets for 2003 were overachieved. Compared with the balanced budget objective of the 2003 budget law and the 2002 updated stability programme, the outturns were a surplus of 0.3 % of GDP. This result can be explained by several factors, including the strong domestic demand and the resilience of job creation. In particular, the social security subsector recorded a surplus of 1.0 % of GDP, while the State and territorial governments registered deficits of 0.4 and 0.3 % of GDP, respectively. The debt ratio continued to decrease to 50.8 % of GDP, lower than the previously envisaged 53.1 % in the 2002 updated stability programme.

The 2004 budget law approved in December 2003 included a balanced budget target for the general govern-

Table V.13

Budgetary developments 2002–07, Spain

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	– 0.0	0.3	0.4	0.6		
— Total revenue	39.9	39.9	40.0	40.1		
Of which: — current taxes	22.6	22.5	22.6	22.7		
— social contributions	13.6	13.6	13.7	13.7		
— Total expenditure	39.9	39.5	39.6	39.5		
Of which: — collective consumption	7.6	7.7	7.7	7.8		
— social transfers (4)	22.5	22.5	22.5	22.4		
— interest expenditure	2.8	2.5	2.4	2.3		
— gross fixed capital formation	3.4	3.5	3.5	3.6		
Primary balance	2.8	2.9	2.8	2.9		
Pm Tax burden	36.2	36.2	36.3	36.4		
Government debt	54.6	50.8	48.0	45.1		
Pm Cyclically adjusted balance	– 0.2	0.4	0.6	0.7		
Pm Cyclically adjusted primary balance	2.6	2.9	2.9	3.0		
Pm Real GDP (3)	2.0	2.4	2.8	3.3		
Stability programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	0.1	0.5	0.0	0.1	0.2	0.3
Primary balance	2.8	3.0	2.6	2.5	2.6	2.6
Government debt	54.5	51.8	49.6	47.7	45.7	43.8
Pm Real GDP (3)	2.0	2.3	3.0	3.0	3.0	3.0

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted on 12 January 2004.
(3) Annual % change.
(4) In kind and other than in kind.

Source: Commission services and stability programme of Spain.

ment sector in 2004. However, given the fiscal decentralisation in Spain, this budget only refers to the central government and its autonomous bodies and the social security subsector. The main expenditure priorities in the budget were active labour market policies, the justice system and civilian security and pensions. On the revenue side, further social security contribution rebates are planned so as to promote employment on a permanent basis. On the expenditure side, the lowest and widowhood pensions were set to increase while the pension reserve fund was planned to reach 1.6 % of GDP. Further details are given in the accompanying table.

The 2003 updated stability programme retains the balanced budget target for 2004 previously set in the budget law. The Commission's spring 2004 forecast, in contrast, envisages a surplus of 0.4 % of GDP, partially based on the better than expected outturn registered in 2003. In addition, within a context of economic recovery, indirect taxes and social security contributions are expected to remain buoyant, supported by strong job creation, whereas direct tax receipts should regain some strength as the effects of the 2003 personal income tax reform fade away. According to the Commission forecast, the cyclically adjusted budget position in 2004 is set to improve slightly, while the cyclically adjusted primary balance is expected to remain unchanged.

In 2005, based on a no-policy change assumption, the government budget balance is foreseen to show a surplus of 0.6 % of GDP, compared with a small surplus of 0.1 % of GDP envisaged in the 2003 updated stability programme. However, this forecast is clearly subject to policy changes that could be announced by the new government that gained office in April 2004.

According to the Commission's spring 2004 forecast, the debt/GDP ratio is expected to continue to decline during the forecasting period, falling to around 45 % of GDP by end-2005. This compares with the more conservative forecast in the 2003 updated stability programme, which projects a debt/GDP ratio of 47.7 % in 2005.

Table V.14

Main measures in the budget for 2004, Spain

Revenue measures	Expenditure measures
• Social security rebates to promote employment on a permanent basis (– 0.3 % of GDP) • Freeze of income tax brackets (0.1 % of GDP)	• Lowest and widowhood pension increases (0.1 % of GDP) • Justice system and civilian security (less than 0.1 % of GDP) • Increase in the reserve fund for pensions (0.4 % of GDP, financial operation that does not affect the general government balance)

Source: Commission services.

8. France

The general government deficit is estimated to have increased from 3.2 % of GDP in 2002 to 4.1 % of GDP in 2004. This compares with a targeted deficit of 2.6 % of GDP in the 2002 update of the stability programme. The deviation from target can be mainly attributed to a deterioration in cyclical conditions: real GDP growth was only 0.2 % in 2003, as against 2.5 % expected in the 2002 updated stability programme. However, about one third of the slippage is directly linked to a significant overspending. General government expenditures in real terms increased by about 2.0 % in 2003, compared to the 1.2 % rise planned in the 2002 update of the stability programme. The largest part of the expenditures overrun can be attributed to slippages in categories of expenditures which are not directly influenced by cyclical developments, namely health expenditures and local authorities' expenditures.

Table V.15

Budgetary developments 2002–07, France

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	– 3.2	– 4.1	– 3.7	– 3.6		
— Total revenue	50.2	50.6	50.7	50.5		
Of which: — current taxes	26.6	26.3	26.3	26.4		
— social contributions	18.2	18.5	18.5	18.2		
— Total expenditure	53.5	54.7	54.4	54.1		
Of which: — collective consumption	9.3	9.6	9.4	9.4		
— social transfers (4)	32.5	33.3	33.1	33.0		
— interest expenditure	3.0	3.0	3.0	3.0		
— gross fixed capital formation	3.0	3.2	3.2	3.2		
Primary balance	– 0.2	– 1.0	– 0.6	– 0.5		
Pm Tax burden	43.7	43.7	43.7	43.5		
Government debt	58.6	63.7*	64.6	65.6		
Pm Cyclically adjusted balance	– 3.8	– 3.9	– 3.4	– 3.3		
Pm Cyclically adjusted primary balance	– 0.7	– 0.8	– 0.3	– 0.3		
Pm Real GDP (3)	1.2	0.2	1.7	2.4		
Stability programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	– 3.1	– 4.0	– 3.6	– 2.9	– 2.2	– 1.5
Primary balance	0.1	– 0.9	– 0.6	0.1	0.9	1.6
Government debt	59.0	61.4	62.8	63.2	62.8	61.8
Pm Real GDP (3)	1.2	0.5	1.7	2.5	2.5	2.5

(1) Commission services' spring 2004 economic forecasts for the years 2004 and 2005. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted on 11 December 2003.
(3) Annual % change.
(4) In kind and other than in kind.
* Notified by France after the official EDP notification of 1 March 2004.

Source: Commission services and stability programme of France.

Due to the increase in the deficit, but also to low nominal GDP growth and debt-increasing stock-flow adjustments amounting to 1.3 percentage points of GDP [1], the debt/GDP ratio rose by 4.4 percentage points in 2003 to 63.7 % of GDP.

The budget for 2004 plans a marked slowdown in public spending. After increasing by 3.8 % in 2002 and about 2 % in 2003, real general government expenditures are projected to increase by 1.1 % in 2004. This target is planned to be achieved through (i) a stabilisation of State expenditures in real terms; (ii) a sharp deceleration in health expenditures; (iii) a tightening of eligibility conditions to unemployment benefits; (iv) a slowdown in local authorities expenditures. On the revenue side, discretionary measures are planned to trigger an increase in the tax burden by 0.1 percentage points of GDP: increases in excise duties and in local taxes will more than offset targeted cuts in social contributions and in the income tax (see table for details). Finally, non-fiscal revenues are planned to increase by 0.1 percentage points of GDP, due to sales of real estate properties and payments from State-owned companies.

The French authorities confirmed in March 2004 the target set in the finance law of a 2004 government deficit at 3.6 % of GDP. The Commission services, in their spring 2004 forecast, projected the 2004 deficit at 3.7 % of GDP. In this forecast, it is assumed that expenditures plans included in the budget will be respected, except for a slippage in the health sector. Based on the method agreed by the Council, the macroeconomic and budgetary projections of the spring 2004 Commission forecast are consistent with a reduction in the cyclically adjusted deficit by % of GDP. This is 0.15 percentage points less than the adjustment included in the 2003 update of the stability programme. The difference stems notably from (i) the slippage in expenditures incorporated in the Commission forecast and (ii) the fact that the potential growth estimate resulting from the Commission forecast is slightly lower than that implicit in the 2003 update of the stability programme.

According to the latest forecasts of the French authorities, the general government deficit will be reduced from 3.6 % of GDP in 2004 to 2.9 % of GDP in 2005. Most of the adjustment would be achieved through a further decline in the expenditure-to-GDP ratio, warranted by a freeze in State expenditures in real terms and the savings generated by the implementation of the reform of the health insurance system that is currently being designed. The Commission projects the general government deficit to decline only marginally to 3.6 % of GDP in 2005. Based on the assumption of unchanged policy, real general government expenditures are projected to increase by 2.2 % in real terms in 2005, in line with the trend observed in the last five years. The Commission forecast incorporates tax cuts for a total amount of 0.15 % of GDP (mostly cuts in social contributions).

The Commission projects the debt/GDP ratio to increase further in 2004–05. This ratio would reach 65.6 % in 2005, more than three times the level of 1980 (20.7 % of GDP). Developments in the debt are projected to reflect those of the deficit and nominal GDP, since no significant stock-flow operations are incorporated in the forecast.

[1] The stock-flow operations consist mainly of the recapitalisation of the public company France Telecom in spring 2003 (0.6 % of GDP) and a large decrease in deposits (0.7 % of GDP) resulting from a financial transaction with the Pension Reserve Fund.

Table V.16

Main measures in the budget for 2004, France

Revenue measures	Expenditure measures
• Cut in the income tax (0.1 % of GDP) • Increase in the income tax credit (0.05 % of GDP) • Increases in excise duties (tobacco, energy) (0.15 % of GDP) • Increase in local taxes	• Stabilisation of State expenditure in real terms • Tightening of eligibility conditions to unemployment benefits • Specific measures aimed at curbing the rapid growth of healthcare spending (reimbursement of medicine, increase in the *forfait hospitalier*)

Source: Commission services, Ministry of Finance of France.

9. Ireland

The general government balance is estimated to have recorded a small surplus in 2003, of 0.2 % of GDP. This compares with a targeted deficit of 0.7 % of GDP set in the December 2002 update of the stability programme. The deviation from the target in 2003 owes to a tax overshooting driven by capital taxes and savings on expenditure, especially on interest payments and discretionary capital spending. Government debt represented one third of GDP in 2003.

The budget for 2004 was unveiled on 3 December 2003 together with the updated stability programme for the period 2004–06. On the expenditure side, it implements a further reduction in the growth rate of current discre-

Table V.17

Budgetary developments 2002–06, Ireland

(% of GDP)

Outturn and forecast (1)		**2002**	**2003**	**2004**	**2005**	
General government balance (4)		– 0.2	0.2	– 0.8	– 1.0	
— Total revenue		33.1	34.6	34.3	33.7	
Of which:	— taxes	23.7	24.9	24.9	24.6	
	— social contributions	5.7	5.8	5.9	5.8	
— Total expenditure (4)		33.3	34.3	35.1	34.7	
Of which:	— collective consumption	5.5	5.7	5.9	5.8	
	— social transfers (5)	18.0	19.1	19.6	19.4	
	— interest expenditure	1.4	1.4	1.4	1.4	
	— gross fixed capital formation	4.3	3.8	3.8	3.8	
Primary balance (4)		1.2	1.6	0.6	0.3	
Pm Tax burden		28.6	30.0	29.9	29.6	
Government debt		32.3	32.0	32.4	32.6	
Pm Cyclically adjusted balance		– 1.9	0.1	– 0.3	– 0.2	
Pm Cyclically adjusted primary balance		– 0.5	1.5	1.1	1.2	
Pm Real GDP (3)		6.9	1.2	3.7	4.6	
Stability programme (2)		**2002**	**2003**	**2004**	**2005**	**2006**
General government balance (4)		– 0.2	– 0.4	– 1.1	– 1.4	– 1.1
Primary balance (4)		1.2	1.0	0.3	0.1	0.3
Government debt		32.4	33.1	33.3	33.5	33.3
Pm Real GDP (3)		6.9	2.2	3.3	4.7	5.2

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted in December 2003.
(3) Annual % change.
(4) Including UMTS receipts of 0.2 % of GDP in 2002.
(5) In kind and other than in kind.

Source: Commission services and stability programme of Ireland.

tionary spending (1) (to 7.5 from 9.5 % in 2003) and a return to positive growth in discretionary capital spending after the cut in 2003. On the revenue side, there was a more modest hike in indirect taxes than in recent budgets, while the personal income tax system was only partially adjusted for inflation. Further details are given in the accompanying table.

The target for the general government deficit in 2004 in the updated stability programme is 1.1 % of GDP (2). In the Commission's spring 2004 forecast, the projected outcome in 2004 is slightly better than targeted (deficit of 0.8 % of GDP) mainly reflecting base effects. The spring forecast projects the cyclically adjusted deficit to widen by % of GDP. Given that the 2003 outcome incorporates a one-off yield of some 0.4 % of GDP from advancing the date of payment of capital gains tax, this points to a broadly neutral fiscal stance in 2004. However, it is subject to the caveat that calculations of the cyclically adjusted balances are surrounded by a high degree of uncertainty that is linked especially to the difficulty of estimating the output gap in Ireland.

(1) The term 'discretionary' refers, in this context, to the concept of 'voted' current spending, for which annual approval by Parliament is required. It excludes, *inter alia*, the service of the national debt and the contribution to the EU budget.

(2) This was confirmed in the March 2004 reporting of government deficits and debt levels in spite of a much better outturn for 2003, namely a deficit of 0.4 % of GDP in the stability programme compared to a surplus of 0.2 % of GDP in the March 2004 reporting.

Given the non-indexed nature of Irish tax and social benefit systems, the no-policy change assumption for 2005 in the spring 2004 forecast is made operational, in the absence of previously announced measures, by freezing average tax rates and adjusting social transfer payments by the forecast CPI inflation rate (with a small top-up). On these assumptions, the spring forecast projects the deficit to widen to 1.0 % of GDP, again somewhat better than the target in the updated stability programme (deficit of 1.4 % of GDP). This target includes a technical provision for unspecified future budget measures (at a full-year cost of % of GDP, which is subject to review in light of emerging economic conditions) as well as a contingency provision (against unforeseen developments) of 0.4 % of GDP.

The debt ratio is projected to remain broadly stable in 2004–05, at around one third of GDP and non-general government assets are continuing to be built up in the National Pensions Reserve Fund (NPRF) (3).

(3) Around 1 % of GNP annually is set to be aside for the pre-funding of the pension liabilities. At the end of 2003, it was worth 7 % of GDP.

Table V.18

Main measures in the budget for 2004, Ireland

Revenue measures	Expenditure measures
• Increases in excise duties (tobacco, auto diesel and petrol; 0.2 % of GDP) • Increase in the 'employee credit' (– 0.2 % of GDP) • No other changes in the parameters of the personal income tax system	• Increase in social welfare benefit rates by between 6 and 8 % (0.4 % of GDP) • Further implementation of benchmarking (1) • Further implementation of the national development plan 2000–06

(1) The benchmarking process was initiated in mid-2000 to adjust pay rates in the public sector by reference to rates in the private sector for comparable jobs. The benchmarking body's report of mid-2002 recommended pay increases differentiated by grade, leading to an 8.9 % rise in public sector pay costs. The national agreement foresees a gradual implementation of the benchmarking awards, with a first tranche (25 %) paid retrospectively to December 2001 in the course of 2003, a second tranche (50 %) in early 2004 and the final tranche (25 %) by mid-2005; payment of the final two tranches is conditional on further progress on flexibility and modernisation and on maintenance of the industrial peace.

Source: Commission services and Department of Finance (2004 budget).

10. Italy

In 2003, the general government deficit was 2.4 % of GDP, compared with a targeted deficit of 1.5 % of GDP set in the 2002 updated stability programme. At first sight, the divergence of the budgetary outturn in 2003 from the original target would appear to result exclusively from an overestimation of economic growth. Upon closer examination, however, the figures show that much higher than initially planned temporary receipts from one-off measures on the revenue side (a generalised amnesty for under-declaration of past tax liabilities and a compulsory levy on tax collectors) compensated a shortfall in revenues for the given growth assumptions. On the expenditure side, lower than officially expected interest expenditure partly compensated higher current and capital expenditure (also a result of much lower than planned sales of real assets). Overall, the improvement brought about by temporary measures in 2003 is estimated to have been in excess of 2 percentage points of GDP. Despite this, the erosion of the primary surplus continued, with the balance declining by more than half

Table V.19

Budgetary developments 2002–07, Italy

(% of GDP)

Outturn and forecast ([1])	**2002**	**2003**	**2004**	**2005**		
General government balance	– 2.3	– 2.4	– 3.2	– 4.0		
— Total revenue	45.6	46.5	45.4	44.7		
Of which: — current taxes	29.0	28.2	28.2	28.0		
— social contributions	12.8	13.1	13.2	13.2		
— Total expenditure	47.9	48.9	48.7	48.7		
Of which: — collective consumption	7.2	7.5	7.5	7.4		
— social transfers ([4])	28.8	29.2	29.5	29.2		
— interest expenditure	5.8	5.3	5.0	5.2		
— gross fixed capital formation	1.9	2.6	2.5	2.8		
Primary balance	3.5	2.9	1.8	1.2		
Pm Tax burden	42.1	42.9	41.6	41.3		
Government debt	108.0	106.2	106.0	106.0		
Pm Cyclically adjusted balance	– 2.2	– 1.9	– 2.6	– 3.6		
Pm Cyclically adjusted primary balance	3.5	3.4	2.4	1.6		
Pm Real GDP ([3])	0.4	0.3	1.2	2.1		
Stability programme ([2])	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	– 2.3	– 2.5	– 2.2	– 1.5	– 0.7	0.0
Primary balance	3.4	2.8	2.9	3.5	4.4	5.1
Government debt	106.7	106.0	105.0	103.0	100.9	98.6
Pm Real GDP ([3])	0.4	0.5	1.9	2.2	2.5	2.6

([1]) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
([2]) Submitted on 1 December 2003.
([3]) Annual % change.
([4]) In kind and other than in kind.

Source: Commission services and updated stability programme of Italy.

a percentage point to 2.9 % of GDP. Following a large revision of government debt data, the debt ratio fell to 106.2 % of GDP from 108.0 % in 2002, thanks to privatisation operations carried out at the end of the year in conjunction with the transformation of 'Cassa Depositi e Prestiti', the formerly public deposits and loans bank, into a joint-stock company.

The 2004 budget and related legislation were adopted by parliament at the end of December 2003. The legislation includes tax breaks for R & D investment and additional funding for renewals of contracts for public sector employees. Corrective measures comprise further securitisation and sales of publicly-owned real assets, a tax amnesty for urban zoning regulation violations and an extension of the terms of the tax amnesty introduced in 2003. In addition, small savings in expenditure are to be achieved as a result of the privatisation of the 'Cassa Depositi e Prestiti'.

In the 2003 updated stability programme (USP2003) the general government deficit in 2004 was targeted at 2.2 % of GDP (incorporating the measures set out in the budget), built on an economic growth forecast of 1.9 %. In the Commission 2004 spring (COM2004) forecast the projected budgetary outturn is a deficit of 3.2 % of GDP in spite of sizeable one-off measures amounting to around 1 percentage point of GDP (slightly less than in the official forecast). Real GDP growth in 2004 is forecast at 1.2 %. On 7 May 2004 the government released new objectives for this year which largely mirror the COM2004 forecast. With real GDP growth projected at 1.2 %, the nominal deficit is targeted at 2.9 % of GDP. The difference compared to the COM2004 forecast of 3.2 % of GDP is largely due to a classification issue. As in the USP2003, the new official target incorporates the saving from classifying ANAS, the agency charged with investment in and maintenance of the State road network, outside the general government sector. The budgetary impact in 2004 is around 0.2 % of GDP. According to the COM2004 forecast the cyclically adjusted deficit in 2004 would widen by over a percentage point of GDP and the cyclically adjusted primary surplus would deteriorate even more. In the USP2003 the cyclically adjusted deficit showed a marginal improvement; the cyclically adjusted primary surplus was projected to remain unchanged.

The COM2004 forecast for 2005 is based on legislation currently in force, an approach which underestimates some expenditure items, namely compensation of public sector employees and government investment. In the absence of budgetary correction, the deficit would reach 4 % of GDP, reflecting the expiry of one-off measures (no tax amnesties and considerably lower sales of real assets compared to the previous year). Interest expenditure is expected to increase as a percentage of GDP, reversing a trend established over the previous eight years and signalling that the margins for gains from refinancing older higher-rate bonds with new issues at lower rates are almost exhausted. A sizeable budgetary correction would be needed to achieve the official target of a deficit of 1.5 % of GDP set in the USP2003.

In the COM2004 forecast the debt ratio is projected to remain broadly stable at 106.0 % of GDP in 2004 and 2005. In the new official forecast the debt/GDP ratio in 2004 is projected at 105.9 %, up from 105.0 % in the USP2003. The upward revision also reflects the impact of debt-increasing transactions, confirming the persisting and even increasing divergence between the *fabbisogno* — a deficit measure based on cash flows and including transactions with financial assets but excluding proceeds from privatisation — and the EDP deficit. In 2004, the *fabbisogno* is now officially estimated at 5.3 % of GDP, 2.3 percentage points above the EDP deficit.

The planned marginal decline in debt/GDP ratio in 2004 would be achieved only thanks to privatisations and disposals of other financial assets, the proceeds of which are estimated at EUR 21 billion, around 1.6 % of GDP.

Table V.20

Main measures in the budget for 2004, Italy

Revenue measures	Expenditure measures
• Tax amnesty for zoning regulation violations (0.2 % of GDP) • Extension of the terms of the tax amnesty introduced in 2003 (0.1 % of GDP) • Tax settlement scheme (0.3 % of GDP)	• Renewals of contracts for public sector employees (0.1 % of GDP) • Securitisation and sales of publicly-owned real assets (0.4 % of GDP on top of 0.3 % of GDP already established) • Savings in expenditure because of privatisation of the Cassa Depositi e Prestiti and SACE (0.1 % of GDP)

Source: Ministry for Economy and Finances.

11. Cyprus

For 2003 the general government budget deficit rose to 6.3 % of GDP, compared to a targeted deficit of 1.9 % as provided in the 2002 pre-accession economic programme (PEP) and 5.4 % in the 2003 PEP. Similarly to the slippage in 2002, the above-target deficit can partly be ascribed to continued modest growth of the European economy, reverberating repercussions of 11 September 2001 and other terrorist attacks, the Iraq War and SARS, all of which contributed to diminishing external tourism demand feeding into lower than expected GDP growth (2.0 % compared with 2.8 % in the 2002 PEP). Furthermore, another factor adversely affecting public finances was higher than originally planned defence outlays, and a discretionary increase in expenditures partly to offset the economic downturn. At the same time, the tax reform that started in July 2002 (with a shift from direct taxes to VAT and excise duties) aimed at a neutral impact on public finances. However, this reform was not applied as originally planned since compensatory measures were introduced to secure broad political support. With these developments, the government debt ratio increased from 67.1 % of GDP in 2002 to 72.2 % of GDP in 2003.

The fiscal consolidation programme introduced in the 2003 PEP of September last year — after the previous one was effectively abandoned in the course of the year — no longer targets a budget balance over the medium term, while in the meantime the PEP deficit targets for 2004 and 2005 have again been revised upwards. The budget for 2004 focuses on further implementation of tax reform and on current expenditure restraint through, *inter alia*, a ceiling on defence expenses (investment is not targeted for cutback). Further details are given in the accompanying table.

Table V.21

Budgetary developments 2002–05, Cyprus

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**
General government balance	– 4.6	– 6.3	– 4.6	– 4.1
— Total revenue	37.2	40.2	37.5	37.6
Of which: — current taxes	25.4	27.3	n.a.	n.a.
— social contributions	7.0	6.9	n.a.	n.a.
— Total expenditure	41.7	46.4	42.1	41.7
Of which: — collective consumption	10.4	11.1	n.a.	n.a.
— social transfers	19.1	19.3	n.a.	n.a.
— interest expenditure	3.2	3.3	n.a.	n.a.
— gross fixed capital formation	3.1	3.8	n.a.	n.a.
Primary balance	– 1.3	– 3.0	n.a.	n.a.
Pm Tax burden	32.4	34.3	n.a.	n.a.
Government debt	67.1	72.2	74.6	76.9
Pm Real GDP (2)	2.0	2.0	3.4	4.1

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definition used in the excessive deficit procedure.
(2) Annual % change.

Source: Commission services.

The general government budget deficit target as set out in the March 2004 reporting of deficit and debt levels is 4.3 % of GDP, up from 3.7 % of GDP still targeted in the 2003 PEP. The Commission's spring 2004 forecast is largely in line with this target but, given the mixed historical record of fiscal consolidation and upward deficit revisions by the government, it assumes that objectives will not be completely met. Hence, the deficit is projected at 4.6 % of GDP.

For 2005, the spring 2004 forecast projects a modest deficit decline to 4.1 % of GDP, above the 2003 PEP government target of 2.8 %. Here again the forecast assumes that revenue and expenditure targets will not be fully met, for similar reasons as in 2004.

Given these deficit developments, the debt ratio in 2004–05 is projected to rise to nearly 77 % of GDP at the end of the period.

Table V.22

Main measures in the budget for 2004, Cyprus

Revenue measures	Expenditure measures
• Increase of public service fees • Measures to improve tax administration and compliance	• Containment of defence outlays • Reduction of agricultural subsidies • Slower pace of civil service employment growth • Other expenditure containing measures

Source: Commission services.

12. Latvia

In 2003, the general government deficit is estimated to be 1.8 % of GDP ([1]). This is about 1 percentage point lower than the targeted deficit of 2.9 % set in the 2003 pre-accession economic programme. The deviation was mainly due to better-than-expected tax revenues, itself representing improvements in tax collection as well as higher-than-expected growth (7.4 % compared to 6.5 % respectively), and close monitoring of expenditure by the government. In fact, total government expenditure did not reach the initially allocated amount. The reduction of the general government budget deficit was also due to an improvement in the balance of both the local government and the social security sectors. The 2004 budget was adopted by the parliament on 13 November 2003. On the revenue side, a shift is foreseen in the structure — decreases in corporate income tax and social security contributions should be offset by an increase in VAT and excise duties. On the expenditure side, the budget includes provisions for ongoing public administration and pension reforms. Further details are given in the accompanying table.

The target for the general government deficit in 2004 is 2.1 % of GDP.

This is in line with the commitment of the Latvian authorities to pursue a gradual reduction of the general government deficit and to keep the deficit below 3 % of GDP as stipulated in the document 'Statement

([1]) The general government debt and deficit figures should be treated with caution, since the data submitted for the excessive deficit procedure were not yet validated by Eurostat. The current methodology used by the Latvian authorities is not fully consistent with ESA 95 accounting standards and suffers from low source data reliability.

Table V.23

Budgetary developments 2002–05, Latvia

(% of GDP)

Outturn and forecast ([1])	**2002**	**2003**	**2004**	**2005**
General government balance	−2.7	−1.8	−2.2	−2.0
— Total revenue	41.9	41.5	39.6	38.4
Of which: — current taxes	21.6	21.2	21.5	22.3
— social contributions	10.1	9.7	9.3	8.9
— Total expenditure	44.6	43.3	41.8	40.4
Of which: — collective consumption	9.6	9.2	9.1	9.0
— social transfers ([3])	21.7	21.1	20.3	19.5
— interest expenditure	0.9	0.9	0.8	0.7
— gross fixed capital formation	3.3	2.4	2.3	2.1
Primary balance	−1.8	−1.0	−1.4	− 1.2
Pm Tax burden	31.9	31.6	30.7	30.4
Government debt	15.5	15.6	16.0	16.1
Pm Real GDP ([2])	6.1	7.5	6.2	6.2

([1]) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
([2]) Annual % change.
([3]) In kind and other than in kind.

Source: Commission services.

on macroeconomic development and fiscal policy in 2004–08'.

In the Commission services' spring 2004 forecast, the projected outcome is slightly higher than targeted (a deficit of 2.2 % of GDP) mainly reflecting more cautious growth expectations (a 6.2 % annual growth rate rather than 6.7 %). Also contributing are different estimates on by how much revenues are set to decrease following the lowering of the corporate income tax rate and the change in the VAT legislation.

Based on a no-policy change assumption, the Commission services' spring 2004 forecast projects the general government deficit to decrease slightly to 2.0 % of GDP in 2005. The projected outcome is slightly more optimistic than the one targeted by the government (2.2 % of GDP) [1]. The difference is mainly due to the Commission's slightly higher estimate of tax revenues.

The government debt/GDP ratio is expected to increase modestly from 15.6 % at end-2003 to 16.0 % of GDP by the end of 2004 and 16.1 % in 2005.

(1) The convergence programme of the Republic of Latvia 2004–07 projects a general government budget deficit of 2.2 % of GDP.

Table V.24

Main measures in the budget for 2004, Latvia

Revenue measures	Expenditure measures
• Alignment of the VAT legislation leading to an increase of the rate on various products to 18 % (base rate) or 9 % (reduced rate) • Broadening the VAT base • Increase of the excise duty on spirits and tobacco and fuel • Reduction of the corporate income tax rate (from 22 % in 2003 to 15 % in 2004) • Reduction of social insurance payments base rate from 35.09 to 33.09 %	• Some parametric changes in the PAYG pension pillar • Wage increases in public sector • Increased expenditure for training of unemployed

Source: Commission services.

13. Lithuania

The general government deficit is estimated to have increased slightly from 1.4 % of GDP in 2002 to 1.7 % in 2003. This compares with a targeted deficit of 2.4 % set in the budget for 2003. The deviation from the target was due to a tax overshoot induced by significantly higher than anticipated output growth. Against the background of higher revenue collection than expected in the first half of 2003, the government decided to allocate additional expenditure by means of a supplementary budget in July 2003, which prevented a reduction of the deficit in 2003 compared to 2002. The government debt accounted for 21.9 % of GDP in 2003.

The budget for 2004 was approved by the parliament in December 2003. On the expenditure side, the budget implements a marked acceleration in capital expenditure growth, largely related to new investment projects co-financed by the EU. The growth rate of current expenditure is also planned to accelerate, although more moderately, mainly driven by salary increases for public sector workers, higher subsidies to farmers and higher social welfare benefits (e.g. pensions and child benefits). The revenue side is expected to be positively influenced by increases in excise duties for tobacco and petrol and higher VAT rates for heating of residential buildings implemented upon EU accession. The transition costs of the pension reform (i.e. introduction of a second pillar pension scheme) are expected to be significant in 2004, although the voluntary option of participation in the second pillar for all age groups makes it difficult to quantify its impact on the budget.

The general government deficit target published in the budget for 2004 was 2.95 % of GDP, but the government recently revised the target down to 2.7 % of GDP. In the

Table V.25

Budgetary developments 2002–05, Lithuania

(% of GDP)

Outturn and forecast (1)		**2002**	**2003**	**2004**	**2005**
General government balance		– 1.4	– 1.7	– 2.8	– 2.6
— Total revenue		33.8	33.9	34.7	34.7
Of which:	— current taxes	20.4	22.1	22.2	22.2
	— social contributions	8.9	8.8	8.6	8.2
— Total expenditure		35.2	35.6	37.4	37.3
Of which:	— collective consumption	7.8	7.6	7.7	7.8
	— social transfers (3)	21.8	22.2	22.6	22.5
	— interest expenditure	1.6	1.3	1.4	1.3
	— gross fixed capital formation	2.9	2.9	3.2	3.2
Primary balance		0.1	– 0.4	– 1.4	– 1.3
Pm Tax burden		29.3	30.9	30.8	30.4
Government debt		22.8	21.9	22.8	23.2
Pm Real GDP (2)		6.8	9.0	6.9	6.6

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Annual % change.
(3) In kind and other than in kind.

Source: Commission services.

Commission services' spring 2004 forecast, the projected outcome is slightly worse than the present target (deficit of 2.8 % of GDP), mainly explained by higher estimated current expenditure.

The Commission's spring 2004 forecast foresees a deficit of 2.6 % of GDP in 2005. The forecast is based on the no-policy change assumption but present deliberations about tax changes could materialise into policy actions that would likely lead to revised projections.

The debt ratio is projected to increase slightly from 21.9 % of GDP in 2003 to about 23.2 % by 2005, to a large extent reflecting higher general government deficits.

Table V.26

Main measures in the budget for 2004, Lithuania

Revenue measures	Expenditure measures
• Increases in excise duties (tobacco and petrol) • Alignment of VAT rates with EU leading to higher rates for heating of residential buildings	• Salary increases for public sector workers (mainly within health and education sectors) • Significant increase in subsidies to farmers • Increases in social welfare benefits (e.g. pensions, child benefits) • Further implementation of the restitution for losses of rouble savings • Pension reform (introduction of a second-pillar scheme) ([1])

([1]) The immediate impact of the creation of the second pillar is accounted for as higher expenditure because the pension contributions assigned to the second pillar are still collected by the government and transferred to the new pillar.

Source: Commission services.

14. Luxembourg

The general government balance in 2003 is estimated to have reached a small deficit of 0.1 % of GDP, which is a slightly better outturn than the target deficit of 0.3 % of GDP projected in the 2002 update of the stability programme. Some special factors account for this outcome, such as a speed-up in the collection of back taxes, higher-than-expected social security contributions, and additional indirect tax revenues due to the start of operations of a few large multinational companies in the Grand Duchy in the course of last year. Some expenditure overruns were compensated by lower interest payments. Luxembourg has the lowest debt ratio among EU Member States and this ratio declined somewhat in 2003, by 0.8 % of GDP, to 4.9 % of GDP, partly reflecting changes in net financial assets.

The amended budget for 2004 was unveiled on 3 December 2003 and voted in the Chamber of Deputies on

Table V.27

Budgetary developments 2002–07, Luxembourg

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	2.7	– 0.1	– 2.0	– 2.3		
— Total revenue	47.0	47.1	46.8	46.8		
Of which: — current taxes	30.3	30.0	29.0	28.3		
— social contributions	12.4	13.0	13.0	12.8		
— Total expenditure	44.3	47.3	48.8	49.1		
Of which: — collective consumption	7.4	8.0	8.2	8.1		
— social transfers (4)	26.2	28.0	28.2	28.0		
— interest expenditure	0.2	0.2	0.2	0.1		
— gross fixed capital formation	4.8	4.9	4.9	4.8		
Primary balance	3.0	0.1	– 1.9	– 2.2		
Pm Tax burden	41.5	41.8	40.7	39.7		
Government debt	5.7	4.9	4.5	3.8		
Pm Cyclically adjusted balance	2.7	1.3	0.6	1.2		
Pm Cyclically adjusted primary balance	2.9	1.5	0.8	1.3		
Pm Real GDP (3)	1.3	1.8	2.4	3.1		
Stability programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	2.4	– 0.6	– 1.8	– 2.3	– 1.5	n.a.
Primary balance	2.7	– 0.4	– 1.6	– 2.1	– 1.5	n.a.
Government debt	5.7	4.9	5.2	5.0	4.4	n.a.
Pm Real GDP (3)	1.3	1.2	2.0	3.0	3.8	n.a.

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted in November 2003.
(3) Annual % change.
(4) In kind and other than in kind.

Source: Commission services and stability programme of Luxembourg.

16 December. Tax revenue is estimated to be rather weak, as the lagged effect of the economic downturn still would take its toll on business taxes in particular. On the expenditure side, total current expenditure is expected to grow at a high rate of around 9 %, similar to 2003. Spending on healthcare and social transfers would continue to increase rapidly. The government has announced a freeze in hiring in most of the public sector to curb expenditure growth. Public investment is planned to remain buoyant at around 3 % of GDP. However, a large part of this investment expenditure is planned to be financed out of the reserves of so-called special funds, which were built up during past years with high surpluses. Further details are given in the accompanying table.

The target for the general government balance in 2004 is a deficit of 1.8 % of GDP according to the 2003 update of the stability programme. For 2004, the Commission services' spring 2004 forecast projects a slightly larger widening of the deficit, to 2.0 % of GDP, mainly reflecting base effects. The continued strong growth of expenditure despite sluggish revenue is the main reason for the projected substantial widening of the deficit. Weak revenue is driven both by the tax reforms implemented in 2001 and 2002, and by cyclical factors. The spring forecast projects the cyclically adjusted deficit to remain broadly stable at a surplus of around 1 % of GDP. However, this figure should be treated with caution in view of the large margins of uncertainty surrounding estimates of potential growth in Luxembourg.

Under a no-policy change assumption the Commission's spring forecast projects the deficit to increase somewhat further in 2005, to 2.3 % of GDP, in line with the target in the 2003 stability programme update. The deterioration in the balance would take place in spite of an expected pick up in tax receipts. This is due to the fact that the positive impact of the economic upturn on tax revenue would feed through only with a substantial delay. Thus, the planned deceleration in current expenditure growth to slightly below 4 % would not be sufficient to prevent the deficit from rising.

According to the Commission's spring forecast, the debt ratio would decrease somewhat further, from 4.9 % of GDP in 2003 to 3.8 % of GDP in 2005. While the debt of central government is being largely repaid, this would be partly offset by a rise in the debt of local government.

Table V.28

Main measures in the budget for 2004, Luxembourg

Revenue measures	Expenditure measures
• Deceleration in the collection of back business taxes (continuing impact of operation started in 2003) • Increase in excise duties on petrol (0.25 % of GDP) and tobacco (0.1 % of GDP) • Sale of real estate (0.3 % of GDP)	• Larger part of public investment in multi-annual capital spending plan financed out of assets accumulated in special funds • Increase of international development aid from 0.82 % of GDP to 0.84 % of GDP • No recruitment of additional civil servants in central government, except in education and police (0.1 % of GDP) • Increase in doctors' and dentists' fees and indexation of fees on prices

Source: Commission services.

15. Hungary

In 2003 the general government deficit turned out to be 5.9 % of GDP. The initial target of a deficit of 4.5 % of GDP for 2003, as set in the budget for 2003, as well as the later revised higher target, was significantly overshot. Higher than expected spending occurred in a number of areas, such as on subsidies, on housing loans and on prescribed drugs (0.35 % of GDP), interest expenditure (0.2 % of GDP) and unforeseen pay-outs due to a legal ruling regarding eligibility for a supplement to childcare fees (0.15 % of GDP). Weaker tax revenues were mostly due to lower than envisaged personal income and corporate taxes. The debt ratio in 2003 almost reached the 60 % of GDP reference value, with 59.0 % of GDP, up from 57.1 % in 2002.

The budget for 2004 was adopted by parliament in December 2003. On the revenue side major changes in the tax system are being implemented. A rise in indirect tax rates (VAT and excise taxes) is expected to lead to higher revenue. Direct tax rates (both personal income tax and corporate taxes) were lowered, while numerous tax allowances and credits were eliminated. This should contribute to a decline in corporate tax revenues, while personal income tax revenues are expected to remain broadly stable.

On the expenditure side a reduction in the growth rate of discretionary spending is foreseen. A real wage freeze in the public sector, and the ongoing reduction of the number of public employees should contribute to the reduction of the high growth rate in the nominal wage bill observed over the last three years. The substantial tightening of housing subsidies and the recent freezing of subsidised pharmaceutical products' prices should help prevent the

Table V.29

Budgetary developments 2002–05, Hungary

(% of GDP)

Outturn and forecast (1)		**2002**	**2003**	**2004**	**2005**
General government balance		– 9.3	– 5.9	– 4.9	– 4.3
— Total revenue		44.5	44.5	n.a.	n.a.
Of which:	— current taxes	n.a.	26.6	n.a.	n.a
	— social contributions	n.a.	12.6.	n.a.	n.a
— Total expenditure		53.7	50.4	n.a.	n.a.
Of which:	— collective consumption	n.a.	7.9	n.a.	n.a.
	— social transfers	n.a.	24.7.	n.a.	n.a.
	— interest expenditure	4.1	4.4	4.0	3.9
	— gross fixed capital formation	4.9	4.0	4.5	4.6
Primary balance		– 5.1	– 2.0	– 0.9	– 0.5
Pm Tax burden		n.a.	n.a.	n.a.	n.a.
Government debt		57.1	59.0	58.7	58.0
Pm Real GDP (2)		3.5	2.9	3.2	3.4

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Annual % change.

Source: Commission services.

overspending on subsidies, as seen in 2003. Further details are given in the accompanying table.

In January, the initial budget deficit target for 2004 of 3.8 % was revised to 4.6 % of GDP. In addition, a series of expenditure cuts equivalent to around 1 % of GDP were announced, in order to meet the revised target. Additional correction measures have been announced in case the revised target might be in danger of being missed. However, while the measures adopted so far should provide a basis for a significant narrowing of the budget deficit, the revenue shortfall and the overspending of 2003 indicate that the achievement of the revised target for 2004 is subject to risks. The spring 2004 forecast projects a deficit of 4.9 % of GDP in 2004, somewhat above the revised target.

In 2005, expenditure linked to the co-financing of EU-related investment projects, and the realisation of other postponed investment projects might limit the scope for a deficit reduction. On the basis of a no-policy change assumption, the spring 2004 forecast projects a narrowing of the deficit to 4.3 % of GDP.

The government debt ratio is expected to decrease moderately to 58.7 % in 2004 and further to 58.0 % of GDP in 2005.

Table V.30

Main measures in the budget for 2004, Hungary

Revenue measures	Expenditure measures
• Increase of VAT rates due to EU harmonisation, while maintaining the high top rate of 25 %. Increase of excise tax rates • Increase in social security contribution rates • Cuts in rates and extension of brackets in personal income tax, while elimination of numerous tax allowances and credits (on balance, income should remain as in 2003 in real terms) • Decrease of corporate tax rate from 18 to 16 %	• Reduction of public employment (approximately 10 % for central government and 6 % in other public areas) • Reduction of transfers to the wage bill of local government, which are supposed to induce reduction of local-government employees • Adoption of two correction packages (to the tune of about 1 % of GDP) • Reduction of housing loan subsidies • Freezing of subsidised drug prices

Source: Commission services.

16. Malta

The general government deficit recorded a substantial increase to 9.7 % of GDP in 2003 from 5.7 % in 2002. This figure compares negatively to the target of 4.5 % of GDP set in the 2002 pre-accession economic programme. The principal reasons for this deviation are lower tax collection due to weak GDP growth and in the restructuring of Maltese shipyards and the accounting of the associated debt assumed by the general government sector. The latter brought about an increase in public liabilities of 3.2 % of GDP. Principally, as a result of the high deficit, the debt/GDP ratio attained 72.0 % of GDP, from 61.7 % of GDP in 2002.

The 2004 budget was presented in November 2003. On the revenue side, receipts are expected to increase by MTL 102 million or 5.3 percentage points of GDP, 50 % of this amount being due to inflows under the Italian financial protocol (a cooperation treaty between Malta and Italy) and from EU funds. Other revenue increases stem from stronger enforcement in tax collection, mainly in the real estate sector, and VAT rate and excise increases. On the expenditure side, recurrent payments are forecast to increase by 3.6 % of GDP, linked to increases in social benefits and debt interest. Capital expenditures will rise to 6.6 % of GDP, with the increase largely attributable to a major hospital construction project.

Both the 2003 PEP and the latest reporting of deficit and debt level point to a general government deficit in the range of 5.3–5.4 % of GDP. The Commission's 2004 spring forecast raises this figure to 5.9 % of GDP based on economic growth developments in 2004 somewhat lower than projected in the PEP (1.4 % compared with 2.5 % respectively).

Table V.31

Budgetary developments 2002–05, Malta

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**
General government balance	– 5.7	– 9.7	– 5.9	– 4.5
— Total revenue	n.a.	n.a.	40.2	40.4
Of which: — current taxes	n.a.	n.a.	n.a.	n.a.
— social contributions	n.a.	n.a.	n.a.	n.a.
— Total expenditure	n.a.	n.a.	45.3	44.0
Of which: — collective consumption	n.a.	n.a.	n.a.	n.a.
— social transfers	n.a.	n.a.	n.a.	n.a.
— interest expenditure	3.7	3.6	2.6	2.5
— gross fixed capital formation	n.a.	n.a.	n.a.	n.a.
Primary balance	– 2.0	– 6.1	– 3.3	– 2.0
Pm Tax burden	n.a.	n.a.	n.a.	n.a.
Government debt	61.7	72.0	73.9	75.9
Pm Real GDP (2)	1.7	0.4	1.4	2.0

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Annual % change.

Source: Commission services.

On a no-policy change assumption, the spring forecast projects a general government deficit of 4.5 % of GDP in 2005, whilst the 2003 PEP target is a deficit of 4.1 % of GDP and the current budget target is 4.3 % of GDP.

The debt/GDP ratio is expected to further increase to 73.9 % of GDP and to 75.9 % of GDP in 2004 and 2005, respectively.

Table V.32

Main measures in the budget for 2004, Malta

Revenue measures	Expenditure measures
• VAT rate increase (from 15 to 18 %). Additional receipts (MTL 21 million or 1.1 % of GDP) will be credited to the health account. Increase in excises on tobacco • Actions against tax evasion, namely on property sales • Italian financial protocol and EU funds (MTL 48 million or 2.5 of GDP)	• Strengthen transparency and control over expenditure • Creation of sub-accounts in strategic sectors to enhance expenditure scrutiny

Source: Commission services.

17. Netherlands

According to provisional data for 2003, the general government deficit increased to 3.2 % of GDP, from 1.9 % of GDP in 2002. This compares with a targeted deficit of 1.6 % of GDP deficit in the 2002 stability programme update. The deficit increased despite substantial consolidation efforts equivalent to around 1.2 % of GDP, largely in the form of structural reductions in expenditure. The weakening of central government revenues in response to the economic slowdown was the main reason for the deterioration in the government balance but a larger-than-foreseen deficit of local authorities also played a role. The debt ratio increased from 52.6 % of GDP in 2002 to 54.8 % of GDP in 2003 mainly due to the combination of an increasing deficit and weak nominal GDP growth.

The budget for 2004 was presented to parliament on 16 September 2003. The 2004 budget included a further

Table V.33

Budgetary developments 2002–07, Netherlands

(% of GDP)

Outturn and forecast ([1])	**2002**	**2003**	**2004**	**2005**		
General government balance	– 1.9	– 3.2	– 3.5	– 3.3		
— Total revenue	45.9	45.6	45.1	44.8		
Of which: — current taxes	24.6	24.0	23.7	24.0		
— social contributions	14.9	15.5	15.6	14.9		
— Total expenditure	47.8	48.8	48.6	48.1		
Of which: — collective consumption	11.4	11.6	11.6	11.3		
— social transfers	24.9	26.1	26.4	26.0		
— interest expenditure	3.1	2.9	2.9	3.0		
— gross fixed capital formation	3.3	3.5	3.4	3.3		
Primary balance	1.2	– 0.3	– 0.7	– 0.3		
Pm Tax burden	39.5	39.4	39.2	38.9		
Government debt	52.6	54.8	56.3	58.6		
Pm Cyclically adjusted balance	– 2.6	– 2.0	– 1.7	– 1.3		
Pm Cyclically adjusted primary balance	0.4	0.9	1.1	1.7		
Pm Real GDP ([3])	0.2	– 0.8	1.0	1.6		
Stability programme ([2])	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	– 1.6	– 2.3	– 2.3	– 1.6	– 0.9	– 0.6
Primary balance	1.7	0.6	0.6	1.2	1.8	2.1
Government debt	52.4	54.0	54.5	53.7	53.0	52.2
Pm Real GDP ([3])	0.2	0.0	1.0	2.5	2.5	2.5

([1]) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
([2]) Submitted in October 2003.
([3]) Annual % change.

Source: Commission services and stability programme of October 2003.

package of substantial savings, equivalent to around 1.2 % of GDP. The measures in the budget consist to a large extent of expenditure cuts on social security, healthcare public wages and subsidies, but also incorporate some tax-revenue-raising measures. In response to a projected further worsening of public finances since the submission of the 2004 budget, the government decided on 16 April 2004 on additional savings measures equivalent to 0.6 % of GDP. This additional package of measures intends to achieve a deficit of below 3 % of GDP from 2004 onwards, and consists mainly of further cost reductions in healthcare, and of a series of smaller measures (some of them of a one-off nature) to increase revenue in 2004. Further details are given in the accompanying table.

The medium-term projections in the budget are the same as in the 2003 stability programme update. Despite the consolidation efforts, the deficit was projected to reach 2.3 % of GDP in 2004 according to the budget, the same estimated figure as for 2003. However, the most recent data show that the deficit reached 3.2 % of GDP in 2003. Under the assumption of no changes in fiscal policy, the Commission's spring 2004 forecast projected the deficit to rise further to 3.5 % of GDP in 2004. The deviation from the target in the budget mainly stems from the upward revision of the 2003 deficit and from the impact of weaker-than-expected economic activity on tax revenue. In addition, higher tax deduction of mortgage interest and pension premiums in the wake of rises in house prices and falls in global asset prices also play a role. The spring forecast, published on 7 April 2004, did not yet incorporate the additional package of measures decided on by the government on 16 April. It projects the cyclically adjusted balance to improve from – 2.0 % of GDP in 2003 to – 1.7 % in 2004 in response to fiscal tightening. This is an improvement of the same order of magnitude as foreseen in the 2002 updated stability programme.

As public finances respond with a lag to the cycle and fiscal tightening, the deficit is projected to decrease only somewhat in 2005, to 3.3 % of GDP, according to the Commission's spring forecast. This is a less favourable projection than the 0.9 % of GDP deficit expected in the 2003 updated stability programme and reflects the substantial downward revisions to economic growth and upward adjustments to the deficit data and projections that occurred in the mean time. In view of the severity of the economic downturn, the cyclically adjusted balance is expected to develop more favourably, reaching a deficit of 1.3 % of GDP in 2005 according to the Commission's spring forecast. Also for 2004 the spring forecast neither took into account the impact of the measures for 2004 decided by the Dutch authorities on 16 April 2004 nor the package of roughly equal size announced for 2005 but not yet specified.

In the spring forecast, the debt ratio is expected to rise further in 2005, to around 58 % of GDP in response to the projected rise in the deficit and still weak GDP growth.

Table V.34

Main measures in the budget for 2004 and additional package, Netherlands

Revenue measures	Expenditure measures
• Higher contributions for healthcare • Broadening of the tax base by limiting tax-deductibility of mortgage interest payments • Termination of subsidies to employ low-skilled workers	• Freeze in public sector wage increases • Reductions in social security expenditure by tightening eligibility for unemployment and invalidity benefits • Reduction in healthcare expenditure • Reduction in subsidies • Delay of planned expenditures on public consumption and investment

Source: Commission services.

18. Austria

In 2003, the budgetary position weakened markedly. The deficit widened by more than a full percentage point from 0.2 % of GDP in 2002 to 1.3 %, in line with the target set out in the November 2003 update of the stability programme. Expenditure exceeded the budget, reflecting a sharper-than-expected rise in unemployment and additional discretionary spending such as an increase in social transfers, an extra pay-rise for public sector employees, additional labour market expenditure foreseen in the fiscal stimulus package, topped by deferred flood-related spending. Tax revenues, by contrast, developed more favourably than budgeted. Helped by a considerably lower interest burden, the debt/GDP ratio developed more favourably than expected. Interest expenditure amounted to 3.3 % of GDP, some 0.3 percentage points below the projection of the updated stability programme. Government debt stood at 65 % of GDP at the end of 2003 compared with a target of 66.4 %, helped by higher growth of nominal GDP.

Table V.35

Budgetary developments 2002–07, Austria

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	– 0.2	– 1.1	– 1.1	– 1.9		
— Total revenue	51.0	49.9	49.5	47.7		
Of which: — current taxes	28.9	28.7	28.6	27.4		
— social contributions	16.6	16.5	16.3	16.2		
— Total expenditure	51.2	51.0	50.7	49.7		
Of which: — collective consumption	7.0	7.0	6.8	6.6		
— social transfers (4)	30.2	30.8	30.6	30.4		
— interest expenditure	3.4	3.1	3.1	3.1		
— gross fixed capital formation	1.3	1.2	1.2	1.1		
Primary balance	3.1	2.0	2.0	1.2		
Pm Tax burden	44.2	43.9	43.6	42.4		
Government debt	66.6	65.0	65.5	65.3		
Pm Cyclically adjusted balance	– 0.3	– 0.9	– 0.9	– 1.8		
Pm Cyclically adjusted primary balance	3.1	2.2	2.3	1.2		
Pm Real GDP (3)	1.4	0.7	1.8	2.5		
Stability programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	– 0.1	– 1.3	– 0.7	– 1.5	– 1.1	– 0.4
Primary balance	3.5	2.4	2.8	1.9	2.2	2.8
Government debt	66.7	66.4	65.8	64.1	62.3	59.9
Pm Real GDP (3)	1.4	0.9	1.9	2.5	2.5	2.4

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted in November 2003.
(3) Annual % change.
(4) In kind and other than in kind.

Source: Commission services and stability programme of Austria.

In January 2004, the first step of an income tax break took effect, including certain family-related tax relief measures, which were originally planned for 2005. In total, the budgetary impact amounts to some EUR 0.75 billion or almost 0.4 % of GDP. Taxes for low and middle incomes were lowered through higher tax allowances and preferential taxation for retained profits will be introduced. Moreover, non-wage labour costs, in particular for older workers, were reduced, a measure that had been repeatedly postponed. Already in 2003, the 13th monthly VAT prepayment was abolished. By contrast, social contributions increased and energy and mineral oil taxes were raised as of 2004, with a view to aligning energy taxation to the EU average. Last but not least, the two economic stimulus packages and a ‘growth’ package, passed since December 2002, continue to burden budgetary spending (see Table V.36).

On balance, the tax measures and the rise in social contributions largely offset each other and therefore the impact on the general government budget should be neutral. As regards deficit-decreasing effects, expected savings from the pension reform for private and federal employees are considerable, largely outpacing the increase in discretionary spending. However, several factors prevent a narrowing of the deficit. Firstly, certain tax relief measures, originally planned for 2005 and worth some 0.1 percentage points of GDP, were brought forward. Secondly, the finance ministry revised downwards the expected surpluses of the sub-federal government levels by 0.2 percentage points to 0.5 % of GDP. Last but not least, central bank profits (in 2003 but affecting the 2004 budget) turned out considerably lower due to low interest rates and the depreciation of the US dollar. As a result, and despite the expected acceleration in domestic demand, the general government deficit is estimated to remain in the same order of magnitude as in 2003, which is percentage point above the target set in the updated stability programme. With real GDP growth expected to resume its trend rate, the deficit in cyclically adjusted terms is expected to remain unchanged. In 2005, the second step of the tax reform consisting of a sizeable income tax relief for both households and enterprises will take effect. The Austrian parliament passed the respective bill in the beginning of May. The wage and income tax relief and tax cuts for enterprises will amount to some 0.5 % of GDP each. In addition, excise duties with negligible revenue impact (‘*Bagatellsteuern*’) will be abolished. In total, the tax cuts planned for 2005 are worth some 1.0 % of GDP. To some, albeit small, extent these revenue shortfalls will be offset by continued structural savings from the pension and administrative reforms. Despite the projected strengthening of domestic demand and the closing of the output gap, the general government deficit is projected to widen some 2 % of GDP, which is percentage point above the target set in the November 2003 stability programme update.

Reflecting the expected deficit developments but helped by rather favourable interest rate developments, government debt will decline only slowly. According to the Commission’s spring 2004 forecast, and taking into account more recent data, the debt/GDP ratio is expected to fall to some 65 % by 2005.

Table V.36

Main measures in the budget for 2004, Austria

Revenue measures	Expenditure measures
• First phase of income tax relief (some 0.3 % of GDP)	• Reform of public administration (staff reduction, current cost cuts)
• Family-related tax measures (new tax deductions for single income earner families with children, 0.1 % of GDP)	• Pension reform — private (*ASVG*) and federal employees
• Increase in energy taxes	• Wage increases 2004 for civil servants
• Rise in social contributions	• Increase in discretionary expenditure (R & D, universities, agriculture, sport and culture, ODA)
• Reduction in non-wage labour costs	• Continued impact of increase in family allowances

Source: Commission services, Ministry of Finance of Austria.

19. Poland

In 2003, the general government deficit estimated at 4.1 % of GDP was slightly lower than expected. This is mainly due to a higher than initially foreseen growth rate. As the Eurostat decision on the classification of funded pension schemes ([1]) is of a generic nature with the individual cases to be assessed in time for the reporting due by 1 September 2004, this figure still considers the open pension funds as part of the government sector ([2]). The debt ratio in 2003 stands at 45.4 % of GDP as compared to 41.2 % of GDP in 2002, a level 0.6 percentage points higher than expected at the beginning of the year. This difference is mainly due to lower privatisation receipts.

The budget for 2004, voted by the Parliament on 19 December 2003, unveiled an important increase of the financing needs of the government and a significant widening of the deficit despite the acceleration of growth. It is based on (over)optimistic macroeconomic assumptions. The stock of government debt, measured according to the Polish methodology, would approach the second prudence threshold of 55 % of GDP ([3]). The 2004 budget is

([1]) Eurostat news release 30/2004, 'Classification of funded pension schemes in case of government responsibility or guarantee', 2 March 2004.
([2]) This figure might increase to 5.7 % if the open pension funds are classified outside the general government sector.

([3]) The Polish Constitution and the Public Finance Act require guarantees to be included in the calculations of the public debt. The Public Finance Act provides for a series of prudence procedures when the public debt ratio breaks the levels of 50, 55 and 60 % of GDP. If the public debt exceeds 55 % of GDP in year *t*, in year *t+2* the State Treasury debt/GDP ratio assumed in the budget made in year *t+1* cannot exceed the ratio observed in year *t*.

Table V.37

Budgetary developments 2002–05, Poland

(% of GDP)

Outturn and forecast ([1])	**2002**	**2003**	**2004**	**2005**
General government balance	– 3.6	– 4.1	– 6.0	– 4.5
— Total revenue	41.3	41.0	40.8	41.2
Of which: — current taxes	21.6	22.0	21.5	21.1
— social contributions	15.0	14.7	14.3	14.4
— Total expenditure	44.9	45.1	46.8	45.7
Of which: — collective consumption	9.1	9.2	9.0	8.8
— social transfers ([3])	26.3	25.8	25.4	25.4
— interest expenditure	2.9	3.1	3.2	3.3
— gross fixed capital formation	3.5	3.5	3.5	3.7
Primary balance	– 0.7	– 1.0	– 2.8	– 1.2
Pm Tax burden	n.a.	n.a.	n.a.	n.a.
Government debt	41.2	45.4	49.1	50.3
Pm Real GDP ([2])	1.4	3.7	4.6	4.8

([1]) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
([2]) Annual % change.
([3]) In kind and other than in kind.

Source: Commission services.

built upon a set of measures on the revenue side (see Table V.38 below). No major measures are foreseen on the expenditure side, except for the ones resulting from the reform of local governments. A 'medium-term fiscal strategy', which indicates the way forward without, however, showing the precise measures, has been unveiled shortly after the presentation of the budget draft by the government (October 2003). The 'programme of public spending rationalisation and reduction' ('Hausner plan') assumes in turn a reduction of social and administrative spending over the period 2004–07. The 2004 budget has not been amended to incorporate the savings foreseen for 2004 by the 'Hausner plan'. In the Commission's spring 2004 forecast, the general government balance is projected to increase substantially to 6 % of GDP notwithstanding the strengthening of economic growth. The projected outcome is more pessimistic than the one targeted by the government in its first convergence programme (5.7 % of GDP) ([1]). Eventual savings, announced in the 'Hausner plan', will be offset by additional expenditures resulting from higher indexation of old-age and disability pensions and the unforeseen magnitude of the zloty depreciation in 2003 inducing an increased contribution to the EU budget. The rise in indirect taxation is not expected to neutralise the decline in the revenues from the corporate tax. It is projected that the deficit will fall in 2005 to 4.5 % of GDP. The fiscal adjustment would be mainly cyclical with a positive role played by positive net inflows from the EU budget. The forecast takes into account eventual savings reflected in the bills voted in parliament (mainly changes in the indexation of pension schemes, in the allocation of the pre-retirement benefits and in the rural pension system) in March 2004.

The government debt ratio is expected to be slightly above 49 % of GDP by the end of 2004 and to exceed 50 % in 2005 ([2]) mainly because of delays in the privatisation process and the depreciation of the zloty against the euro in 2003, boosting the domestic currency value of the Polish government debt denominated in foreign exchange.

([1]) The 2003 PEP (August 2003) targeted a general government deficit of 5 % for 2004.

([2]) If the open pension funds are classified outside of the government sector, these figures might increase by approximately 4.5 percentage points.

Table V.38

Main measures in the budget for 2004, Poland

Revenue measures	Expenditure measures
• Reduction of the corporate income tax rate from 27 to 19 % • Introduction of the possibility to pay the corporate income tax rate of 19 % for small companies (self-employed), which paid so far taxes according to the personal income tax thresholds, if they renounce all tax exemptions and rebates • Alignment of the VAT legislation leading to an increase of the rate on various products to 22 % (e.g. construction materials) and an increase in excise taxes • Introduction of a flat tax of 19 % on capital income (e.g. dividends)	• Local governments' reform: gradual transfer of personal and corporate income tax revenues from the central budget to local authorities (self-governments) and a simultaneous reduction of subsidies • No other major measure is included in the 2004 budget law despite savings foreseen in the 'Hausner plan'

Source: Commission services.

20. Portugal

The general government deficit for 2003 is estimated at 2.8 % of GDP. This compares with a targeted deficit of 2.4 % of GDP set in the January 2003 update of the stability programme. The deviation from target is due to a massive tax shortfall (excluding the sale of tax and social security contributions arrears), resulting from the unanticipated decline of GDP in 2003 by an estimated 1.3 %. On the expenditure side, by contrast, the government has been broadly successful in securing the planned restraint. Together, these revenue and expenditure developments would have led to a government deficit clearly above 3 % of GDP in 2003. In order to prevent this, the Portuguese authorities relied on two one-off measures, worth in total 2.1 % of GDP. The government debt/GDP ratio continued to rise in 2003, approaching the 60 % benchmark.

The budget for 2004 was presented to parliament in October 2003, then approved and ratified by the end of

Table V.39

Budgetary developments 2002–07, Portugal

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	– 2.7	– 2.8	– 3.4	– 3.8		
— Total revenue	43.4	44.6	43.2	43.0		
Of which: — current taxes	24.7	24.7	23.5	23.4		
— social contributions	12.2	12.6	12.7	12.7		
— Total expenditure	46.1	47.5	46.6	46.9		
Of which: — collective consumption	8.5	8.5	8.3	8.1		
— social transfers (4)	25.6	26.5	26.5	26.3		
— interest expenditure	3.0	2.9	2.9	3.1		
— gross fixed capital formation	3.4	3.9	3.1	3.7		
Primary balance	0.3	0.1	– 0.5	– 0.8		
Pm Tax burden	36.9	37.2	36.0	35.9		
Government debt	58.1	59.4	60.7	62.0		
Pm Cyclically adjusted balance	– 2.7	– 1.8	– 2.1	– 2.6		
Pm Cyclically adjusted primary balance	0.3	1.1	0.8	0.5		
Pm Real GDP (3)	0.4	– 1.3	0.8	2.2		
Stability programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	– 2.7	– 2.9	– 2.8	– 2.2	– 1.6	– 1.1
Primary balance	0.3	– 0.1	0.1	0.9	1.5	2.0
Government debt	58.0	59.5	60.0	59.7	58.6	57.0
Pm Real GDP (3)	0.4	– 0.8	1.0	2.5	2.8	3.0

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted in December 2003.
(3) Annual % change.
(4) In kind and other than in kind.

Source: Commission services and stability programme of Portugal.

2003. On the revenue side, it implements the first of a two-stage reduction in the corporate tax rate, introduces significant rises in the prices of marketed government services and plans sales of real estate amounting to 0.7 % of GDP. On the expenditure side, it implements for a second year running a quasi-freeze of employment and wage scales in the central government. Further details are given in the accompanying table.

The Commission services' 2004 spring forecast projects a general government deficit of 3.4 % of GDP for 2004, thereby significantly above the official target of a deficit of 2.8 % of GDP ([1]). The difference can basically be accounted for by three elements: (i) projected growth of GDP is percentage point lower in the Commission forecast; (ii) base effects due to the significant amount of one-off measures adopted in 2003, mainly affecting the revenue side; and (iii) the partial substitution of the one-off measures taken in 2003, i.e. from 2.1 % of GDP to a so far planned value of 0.7 % of GDP. Excluding one-off measures, the spring forecast projects a marked narrowing of the cyclically adjusted deficit in 2004 by 1 percentage point of GDP.

([1]) This was confirmed in the March 2004 reporting of government deficits and debt levels (in accordance with Council Regulation (EC) No 3605/93, as amended by Council Regulation (EC) No 475/2000).

Table V.40

Main measures in the budget for 2004, Portugal

Revenue measures	Expenditure measures
• Reduction in the corporate tax rate from 30 to 25 % (0.1–0.2 % of GDP) • Reform of the real estate tax system • Rises in the prices of marketed government services • Planned sales of real estate worth a total of EUR 1 billion (0.7 % of GDP)	• A 10 % cut in working expenditure in the central government • A quasi-freeze of employment and wage scales in the central government

Source: Commission services.

21. Slovenia

In 2003, the general government deficit came to 1.8 % of GDP — slightly better than projected in the 2003 pre-accession economic programme (1.95 %), thanks to a determined fiscal policy, and against the background of faltering growth. On the revenue side, taxes on profits and capital gains increased markedly, while substantial savings on interest payments materialised due to lower than anticipated inflation. After unexpected shortfalls leading to failures in achieving the targets and frequent revisions of budgets in previous years, fiscal consolidation seemed to be on track in 2003. Government debt declined to 27.1 % of GDP in 2003.

In December 2003, the Parliament adopted a supplementary budget for 2004. The budget implementation bill stipulates a novel measure: in case of a revenue shortfall due to an economic downturn the government has the discretion to reduce expenditure proportionally — up to SIT 15 billion (0.25 % of GDP) in the course of the year, without having to propose the budget to be amended. If unfavourable macroeconomic conditions persist, an up to SIT 10 billion (0.17 % of GDP) budget deficit overrun will nevertheless be accepted at the end of the year. Moreover, the agreement on public sector wages for 2004–05, which introduced forward-looking indexation — with anticipated rather than actual domestic inflation and also taking into account EU inflation and the euro/tolar exchange rate — is expected to contain budget expenditure as wages constitute an important part of general government spending. Furthermore, indexation of some social benefits has also been weakened (see Table V.42 for details on the public finance measures in 2004).

According to the March 2004 fiscal notification, the target for the general government deficit in 2004 is 1.6 % of GDP. At 1.7 %, the Commission services project a

Table V.41

Budgetary developments 2002–05, Slovenia

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**
General government balance	– 1.9	– 1.8	– 1.7	– 1.8
— Total revenue	41.5.	41.6.	42.3	42.3
Of which: — current taxes	n.a.	n.a.	n.a.	n.a.
— social contributions	n.a.	n.a.	n.a.	n.a.
— Total expenditure	43.9	43.6.	44.0	44.0
Of which: — collective consumption	n.a.	n.a.	n.a.	n.a.
— social transfers	n.a.	n.a.	n.a.	n.a.
— interest expenditure	2.1	1.9	1.7	1.6
— gross fixed capital formation	n.a.	n.a.	n.a.	n.a.
Primary balance	– 0.3	– 0.1	– 0.1	– 0.1
Pm Tax burden	n.a.	n.a.	n.a.	n.a.
Government debt	27.8	27.1	28.3	28.2
Pm Real GDP (2)	2.9	2.3	3.2	3.6

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Annual % change.

Source: Commission services.

slightly worse outcome since a tendency towards accommodating government consumption in an election year was assumed ([1]).

Despite the planned measures in revenue policy — reforming the direct taxes as well as improving the tax administration — and expenditure limits, the general government budget deficit is projected to increase marginally to 1.8 % of GDP in 2005.

On the one hand, the introduction of the real estate tax, which will replace the current local tax, is expected to have a neutral fiscal effect.

([1]) The European Parliament elections took place in June while national parliamentary elections are due in November.

On the other hand, the corporate income tax will increase the general government revenues by broadening the tax base and eliminating loopholes in the legislation while the new personal income tax regime, designed to disburden the lowest income classes from 2005, will adversely affect the revenues. On the expenditure side, the measures enhancing cost-effectiveness and flexibility will result in savings, which will be partly offset by additional spending commitments related to EU accession (Schengen border).

The debt ratio is relatively low and will remain so in the future. In the Commission's spring 2004 forecast, the government debt is projected to increase from 27.1 % of GDP in 2003 to 28.3 % this year and then stabilise around that level.

Table V.42

Main measures in the budget for 2004, Slovenia

Revenue measures	Expenditure measures
• Further harmonisation of excise duties on spirits and tobacco with the *acquis*	• Containing the rise in public wages and social benefits through weakened indexation mechanisms • Increasing cost effectiveness of the public administration (cuts in discretionary spending of individual ministries mainly through rationalisation of material costs) • Further restructuring (reallocation of expenditure items favouring investment in education and research and promoting regional cohesion)

Source: Commission services.

22. Slovakia

After the 2002 election year, the newly formed Slovak government initiated a fiscal turn-around. The budget for 2003 targeted a general government deficit of 5.0 % of GDP (down from 5.7 % of GDP in 2002). During the budget execution, the government took additional measures against emerging risks, which occurred in particular in the form of underperforming VAT revenues, for instance by advancing excise tax increases from the beginning of 2004 to August 2003. In the end, the general government deficit turned out to be much lower than planned and amounted to 3.6 % of GDP — partly due to spending postponements. The budget for 2004 reflects the major part of the public finance reform agenda of the current government. At the beginning of 2004, far-reaching tax reforms took effect, consisting mainly of the introduction of a flat income tax and a unified value added tax, both at a rate of 19 %. The tax reform package leads to a shift from direct to indirect taxation and is likely to strengthen incentives and growth. On the expenditure side, the 2004 budget incorporates notably a multitude of incentive-enhancing measures in the area of social transfers. Table V.44 lists major measures. In addition, the budget for 2004 is, for the first time, affected by the contributions to and transfers from the EU associated with Slovakia's membership as of 1 May 2004.

The budget passed by parliament last December is in line with a general government deficit target of 4.0 % of GDP for 2004. The Commission's spring 2004 forecast projects that the government will basically meet this target. These estimates are subject to the caveat that budget forecasts are relatively uncertain in the present wide-ranging reform environment.

Table V.43

Budgetary developments 2002–05, Slovakia

(% of GDP)

Outturn and forecast [1]	**2002**	**2003**	**2004**	**2005**
General government balance	−5.7	−3.6	−4.1	−3.9
— Total revenue [4]	45.2	49.1	42.0	43.1
Of which: — current taxes	19.5	18.3	17.5	17.6
— social contributions	13.6	14.0	13.2	13.6
— Total expenditure [4]	50.9	52.7	46.1	47.0
Of which: — collective consumption	11.3	11.2	10.9	10.7
— social transfers [3]	20.6	20.3	19.7	19.2
— interest expenditure	3.6	2.4	2.7	2.9
— gross fixed capital formation	3.3	3.0	2.7	2.5
Primary balance	−2.1	−1.2	−1.4	−1.0
Pm Tax burden	33.0	32.3	30.7	31.2
Government debt	43.3	42.8	45.1	46.1
Pm Real GDP [2]	4.4	4.2	4.0	4.1

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Annual % change.
(3) In kind and other than in kind.
(4) Revenue and expenditure ratios are not consolidated.

Source: Commission services.

For 2005, the Commission's spring 2004 forecast predicts a general government deficit of 3.9 % of GDP. As in 2004, the forecast is based on already passed reform measures on the revenue and expenditure side — with the notable exception of some specified health reform measures. The forecast includes the effect of the introduction of a mandatory funded pension pillar in 2005. So far, the government has not indicated any additional measures to compensate for the associated increase of the general government deficit of some 0.7 % of GDP.

The debt/GDP ratio is likely to hover between 45 and 46 % of GDP in 2004/05.

Table V.44

Main measures in the budget for 2004, Slovakia

Revenue measures	Expenditure measures
The tax reform package leads to a considerable shift from direct to indirect taxation, increases the transparency of the tax system and is likely to strengthen incentives and growth. Elements of the package are: • introduction of a flat tax rate of 19 % for both individual and corporate income taxation, coupled with the removal of tax exemptions; • introduction of a unified VAT tax rate of 19 %; • abolition of some less significant taxes (inheritance tax, gift tax) and amendments to some others (real estate tax, vehicle tax). In addition, the health and social insurance contribution rates payable by employers and employees have been reduced, albeit to a less significant extent, i.e. to a still relatively high total level of roughly 48 % of gross wages.	The reforms on the expenditure side effect in particular the area of social transfers. *Inter alia*, the following incentive-enhancing measures have been implemented: • changes in key parameters of the pay-as-you-go pillar of the pension system (e.g. benefit formula, indexation, retirement age) — while a funded pension pillar will be instituted in 2005; • various changes in other components of the social insurance system (e.g. sickness benefits), of social assistance and of social benefits (e.g. child benefits); • changes in the healthcare system (e.g. full impact of introduction of co-payments).

Source: Commission services.

23. Finland

In 2003, the general government balance continued to be in surplus, at 2.3 % of GDP. This was in line with the target set in the November 2003 update of the stability programme. The overall budgetary outturn was in line with expectations, although central government finances posted a surplus 0.3 % of GDP compared with a projected deficit of 0.1 %. This derived from higher indirect tax revenues and also from savings in subsidies and transfer payments and lower interest expenditure. However, the social security surplus was slightly lower than anticipated, whereas the local government deficit was close to target. The debt ratio in 2003 was 45.3 % of GDP, while the target in the updated stability programme was 45.1 %. The 2.7 percentage points rise in the debt ratio from 42.6 % of GDP in 2002 follows mainly from a technical change in the classification of central government debt as the repo portfolio was removed from the State Treasury's balance sheet.

Table V.45

Budgetary developments 2002–07, Finland

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	4.3	2.3	2.0	2.1		
— Total revenue	54.4	52.7	52.6	52.2		
Of which: — current taxes	33.1	32.1	31.6	31.3		
— social contributions	12.4	12.1	12.3	12.4		
— Total expenditure	50.1	50.5	50.7	50.1		
Of which: — collective consumption	7.6	7.7	7.8	7.8		
— social transfers (4)	30.9	31.3	31.5	31.4		
— interest expenditure	2.2	1.9	1.9	1.7		
— gross fixed capital formation	2.9	3.0	2.8	2.7		
Primary balance	6.5	4.1	3.8	3.8		
Pm Tax burden	46.1	44.8	44.5	44.4		
Government debt	42.6	45.3	44.5	44.3		
Pm Cyclically adjusted balance	3.7	2.3	2.1	2.2		
Pm Cyclically adjusted primary balance	5.9	4.2	3.9	3.9		
Pm Real GDP (3)	2.3	1.9	2.6	2.7		
Stability programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
General government balance	4.2	2.3	1.7	2.1	2.1	2.2
Primary balance	4.4	2.4	1.6	1.8	1.8	1.8
Government debt	42.7	45.1	44.7	44.9	45.0	44.6
Pm Real GDP (3)	2.2	1.4	2.7	2.5	2.4	2.4

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted in November 2003.
(3) Annual % change.
(4) In kind and other than in kind.

Source: Commission services and stability programme of Finland.

The State budget for 2004 was approved by parliament on 19 December. Expenditures will go up by 4 % in real terms from 2003. Half of the increase derives from appropriation increases forced by current legislation and decisions made by the previous government, and the other half from the spending increases included in the new government's programme and compensations payable to other government levels due to income tax cuts. Revenues are set to grow by over 1 %, even though the government has cut taxes on income and alcohol.

The target for the general government surplus in 2004 in the semi-annual economic survey of the Ministry of Finance is 1.9 % of GDP (1.7 % in the November 2003 update of the stability programme) ([1]). The Commission's spring 2004 forecast of the general government surplus is 2.0 % of GDP ([2]) for 2004. It implies that the cyclically adjusted surplus will remain virtually unchanged at some 2 % of GDP during 2004–05. In 2004, the cyclically adjusted surplus will decrease by some 0.3 percentage points from 2003, indicating a slightly expansionary stance in fiscal policy.

Given the no-policy change assumption in the forecast for 2005, the general government finances are foreseen to record a surplus of 2.1 % of GDP, which is in line with the surplus target presented in the November 2003 update of the stability programme.

According to the spring 2004 forecast, the debt ratio is seen to decrease slightly from 44.5 % of GDP to 44.3 % during 2004–05. The economic survey from the Ministry of Finance sees debt ratio ease to 44.7 % of GDP in 2004.

([1]) Starting from 2003, the national accounts definition and the EDP definition of the general government balance will differ due to swap-interest payments. The difference in 2003 was 0.2 percentage points, the EDP definition of general government surplus being at 2.3 % of GDP and the national accounts definition at 2.1 %.

([2]) EDP definition, Ministry of Finance will continue to use the national account definition.

Table V.46

Main measures in the budget for 2004, Finland

Revenue measures	Expenditure measures
• Decrease in earned income taxation (0.5 % of GDP) • Decrease in excise duty on alcohol by an average of 33 % (0.2 % of GDP)	• Increase in active labour market policy measures (0.1 % of GDP) • Increase in central government transfers to local government (0.3 % of GDP)

Source: Ministry of Finance (budget for 2004).

24. Sweden

The general government balance is estimated to have recorded a surplus in 2003, of 0.7 % of GDP. This compares with a targeted surplus of 1.5 % of GDP set in the November 2002 update of the convergence programme. The deviation from the projection is due to higher-than-projected primary expenditures, in particular transfer payments. This was however partially offset by lower-than-projected interest expenditure. Moreover, the tax hikes in the local government sector offset weaker-than-expected tax revenue for central government linked to weaker-than-forecast economic growth. The government debt/GDP ratio continued to fall and was 51.9 % of GDP in 2003.

Table V.47

Budgetary developments 2002–06, Sweden

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**	
General government balance	0.0	0.7	0.2	0.7	
— Total revenue	58.1	59.5	59.1	58.9	
Of which: — taxes	35.2	36.3	36.2	36.2	
— social contributions	15.0	14.7	14.5	14.4	
— Total expenditure (4)	58.1	58.8	58.9	58.3	
Of which: — collective consumption	8.5	8.6	8.6	8.6	
— social transfers (5)	37.9	38.8	38.8	38.4	
— interest expenditure	2.9	2.1	2.3	2.4	
— gross fixed capital formation	3.3	3.1	3.0	2.9	
Primary balance (4)	2.9	2.9	2.5	3.1	
Pm Tax burden	50.4	51.0	50.7	50.6	
Government debt	52.6	51.9	51.8	50.5	
Pm Cyclically adjusted balance	– 0.5	0.7	0.3	0.8	
Pm Cyclically adjusted primary balance	2.4	2.9	2.6	3.2	
Pm Real GDP (3)	2.1	1.6	2.3	2.6	
Convergence programme (2)	**2002**	**2003**	**2004**	**2005**	**2006**
General government balance (4)	0.2	0.4	0.6	1.4	1.9
Primary balance (4)	3.4	3.0	3.2	4.1	4.6
Government debt	52.7	51.7	51.5	50.0	48.3
Pm Real GDP (3)	1.9	1.4	2.0	2.6	2.5

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definition used in the excessive deficit procedure.
(2) Submitted in December 2003. In the 2004 spring Fiscal Policy Bill released on 15 April, the following projections were made: GDP growth: 2.5 % in 2004, 2.6 % in 2005 and 2.5 % in 2006. General government budget balance (% of GDP): 0.3 % in 2004; 0.6 % in 2005; 1.1 % in 2006. Government debt (% of GDP): 52.1 % in 2004, 51.5 % in 2005, and 50.6 % in 2006.
(3) Annual % change.
(4) This figure corresponds to the updated convergence programme's concept of 'net lending with accruals taxes', which best reflects Statistics Sweden's revised methodology to report tax receipts.
(5) In kind and other than in kind.

Source: Commission services and convergence programme of Sweden.

The budget for 2004 was unveiled on 22 September 2003. The updated convergence programme for the period 2003–06, drawing fully on the budget, was submitted to the Commission on 1 December 2003. Expenditure in relation to GDP is expected to fall in 2004. New expenditure-increasing measures adopted in the budget were very small in size and offset by cost-cutting measures, though some additional measures have been announced since the release of the budget, described in the accompanying table. This reflects to a large degree the virtually non-existing budgetary margin included under the expenditure ceiling at the central government level in 2004. Therefore, the previously announced expenditure ceiling for 2004 may be considered to have been binding for the government when preparing the budget. Revenues by contrast are expected to remain unchanged in 2004, influenced also by the announced tax hikes at the local government level.

The updated convergence programme projects a general government surplus in 2004 of 0.6 % of GDP ([1]). In the Commission services' spring 2004 forecast, the 2004 outcome is somewhat worse than projected by the Swedish authorities (surplus of 0.2 % of GDP) reflecting to a large part the Commission's worse outlook for the labour market and also some additional factors. Subject to the caveat that calculations of the output gap are surrounded by a large degree of uncertainty in Sweden, the spring forecast projects the cyclically adjusted surplus to narrow by % of GDP and the cyclically adjusted primary surplus to narrow less. This suggests a slightly expansionary fiscal stance in 2004. By contrast, the calculations in the Commission's assessment of the updated programme suggested a somewhat restrictive fiscal stance. This difference is due both to additional expenditure measures and a smaller effect of the cycle in the spring forecast.

On current policies the spring forecast projects an increase in the surplus to 0.7 % of GDP in 2005, which is below the projection in the updated convergence programme of a surplus of 1.4 % of GDP ([2]). Half of the difference is due to the new measures announced by the government in December 2003 (the 'three-party negotiations package' together with the Left and the Green parties). The other half is mainly due to higher transfer payments to households, in particular as a result of a weaker labour market performance foreseen in the Commission's spring forecast.

In the spring Fiscal Policy Bill released on 15 April, the expenditure ceilings set in the September 2003 budget were confirmed though the 2004–06 budgetary margins were narrowed further. Gradually higher surpluses in the government finances were projected though considerably lower than the projections in the September 2003 budget. In 2004, a surplus of 0.3 % of GDP is projected, followed by 0.6 and 1.1 % of GDP in 2005 and 2006, respectively. The bill's estimate of the structural budget balance in 2004 is almost unchanged compared with the September 2003 budget, reflecting an estimate of a more negative output gap in this bill (going forward to 2006). The fiscal stance in 2005–06 is assessed to be restrictive, but less so than in the September 2003 budget.

General government debt, which mainly lies in central government, is projected to rise as the central government is expected to remain in deficit until 2005. This rise is however slower than nominal GDP growth and the debt ratio is therefore projected to continue to decline in 2004–05, to slightly above 50 % of GDP.

([1]) This figure corresponds to the updated convergence programme's concept of 'net lending with accrual taxes', which best reflects Statistics Sweden's revised methodology to report tax receipts. According to the previous methodology, the surplus projection in the 2003 update was 0.4 % of GDP.

([2]) See previous footnote. For 2005, the surplus projection according to the previous methodology was 1.2 % of GDP.

Table V.48

Main measures in the budget for 2004, Sweden

Revenue measures	Expenditure measures
• Green tax swap (increase of energy taxes and a reduction of labour taxes) and a reduction of wealth and inheritance taxes (– 0.1 % of GDP) ([1])	• Additional resources to the Swedish National Labour Market Administration for labour market programmes and also for life-long learning activities (0.2 % of GDP) ([2])

([1]) At the same time, the 2003 updated convergence programme estimated tax rises at the local government level of 0.1 % of GDP.
([2]) These measures were introduced with the December 2003 'three-party negotiations package'

Source: Commission services, Swedish Ministry of Finance (budget for 2004).

25. United Kingdom

The outturn for the general government balance is estimated (in budget 2004) to be a deficit of 3.2 % of GDP in financial year 2003/04 — compared with a deficit of 2.4 % projected in budget 2003. This result, worse than expected, appears to be mostly due to differences in the composition of GDP, with lower-than-expected growth in wages implying lower receipts from income tax and social security contributions. Corporation tax receipts were lower than expected, while higher discretionary expenditure related to the Iraq War also contributed. General government debt is estimated to be 39.8 % of GDP at the end of 2003/04, higher than the 39 % that had been projected in the 2003 budget.

The latest budget was released on 17 March 2004, setting out a number of discretionary policy changes, which over-

Table V.49

Budgetary developments 2002–07, United Kingdom

(% of GDP)

Outturn and forecast (1)	**2002**	**2003**	**2004**	**2005**		
General government balance	– 1.6	– 3.2	– 2.8	– 2.6		
— Total revenue	39.5	39.6	39.5	39.6		
Of which: — taxes	29.1	28.7	28.6	28.7		
— social contributions	7.4	7.8	8.0	8.0		
— Total expenditure	41.1	42.8	42.3	42.2		
Of which: — collective consumption	7.7	7.7	7.7	7.7		
— social transfers (5)	25.9	27.0	26.6	26.4		
— interest expenditure	2.0	2.0	2.0	2.1		
— gross fixed capital formation	1.3	1.5	1.8	2.0		
Primary balance	0.4	– 1.2	– 0.7	– 0.5		
Pm Tax burden	36.5	36.7	36.7	36.8		
Government debt	38.5	39.9	40.1	40.6		
Pm Cyclically adjusted balance	– 1.5	– 2.9	– 2.6	– 2.3		
Pm Cyclically adjusted primary balance	0.6	– 0.9	– 0.5	– 0.2		
Pm Real GDP (3)	1.6	2.2	3.0	2.8		
Convergence programme (2)	**2002–03**	**2003–04**	**2004–05**	**2005–06**	**2006–07**	**2007–08**
General government balance (4)	– 2.1	– 3.3	– 2.6	– 2.4	– 2.1	– 2.0
Primary balance (4)	– 0.5	– 1.7	– 0.9	– 0.7	– 0.4	– 0.3
Government debt	37.9	39.3	40.2	40.8	41.1	41.4
Pm Real GDP (3)	1 1/4	2 1/4	3 1/4	2 3/4	2 1/2	2 1/4

(1) Commission services' spring 2004 economic forecasts. Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Submitted in December 2003.
(3) Annual % change.
(4) Figures include UMTS receipts of 0.1 % of GDP in each year.
(5) In kind and other than in kind.

Source: Commission services, convergence programme of the United Kingdom and 2003 pre-budget report.

all, have only a minor impact on the UK's fiscal position. Measures with the largest fiscal impact included a new package aimed at increasing compliance with direct taxes, a one-off transfer to the over-70s to assist with living expenses, and, in line with usual practice, a rebuilding of the precautionary margin against overspend in annually managed government spending. Further details are given below in the accompanying table.

The 2004 budget also set out new estimates and projections for the public finances, updating those set out in the December 2003 convergence programme update. The general government balance is expected to improve over the course of 2004, to show a deficit of 2.6 % for 2004/05. In the Commission's spring 2004 forecast, the projected outcome for calendar year 2004 is slightly less optimistic, at 2.8 % of GDP, largely reflecting a more conservative estimate of the recovery in revenues — despite forecasts for GDP growth broadly similar to the 'cautious' forecasts used by the government to forecast the public finances. While estimates of the output gap inherently involve a degree of uncertainty, the cyclically adjusted deficit is projected to narrow by 0.3 percentage points, reflecting to a large extent the falling-away of expenditures associated with the Iraq War.

In 2005, under a no-policy change assumption, the spring 2004 forecast projects a further improvement in the general government balance, to a deficit of 2.6 % of GDP. Again, the deficit is projected to remain slightly higher than official projections of 2.4 % in the 2005/06 financial year. As well as differences in view over revenue growth, the difference also reflects a more optimistic growth projection used by the UK authorities. In particular, the 'cautious' growth rate for GDP used by the government to project the public finances (3.0 % in 2005/06) is above the Commission forecast of 2.8 % for the 2005 calendar year.

According to the Commission forecast, the general government debt/GDP ratio, is expected to rise modestly over the forecast period, from 39.9 % of GDP in 2003 to reach 40.6 % in 2005. Nonetheless, government debt remains at a prudent level well below the 60 % reference value.

Table V.50

Main measures in the budget for 2004, United Kingdom

Revenue measures	Expenditure measures
• Direct taxes compliance package (+ 0.1 % of GDP by 2006/07) • Minimum rate of tax, distributed profits (+ 0.04 % of GDP by 2006/07)	• GBP 100 payment to the over-70s (– 0.04 % of GDP in 2004/05 only) • Resetting of the margin against overspend in annually managed expenditure (– 0.1 % of GDP in 2004/05, – 0.2 % of GDP in 2005/06) • Scheme to allow local government to retain a proportion of growth in local non-domestic rates revenue (– 0.02 % of GDP by 2006/07)

Source: Source: HM Treasury, budget 2004.