GRAND DUCHY OF LUXEMBOURG

MINISTRY OF FINANCE

3rd UPDATE OF THE LUXEMBOURG STABILITY AND GROWTH PROGRAMME

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3rd UPDATE OF THE LUXEMBOURG STABILITY AND GROWTH PROGRAMME

prepared for the period 2000-2004
and approved by the Cabinet on 30 November 2001

INTRODUCTION

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

An initial update, prepared following the change of Government and just after the adoption of the Budget Law for 2000, accorded with the recommendations made in the broad economic policy guidelines and followed on from the first programme. It was sent to the Council and the Commission in February 2000 and was discussed by the Ecofin Council on 13 March 2000. The second update was sent to the Council and the Commission on 11 January 2001 and was analysed by the Ecofin Council on 12 March 2001.

This third update of the stability programme has been conceived within the same framework as its predecessor, i.e. at the same time as the draft budget is being prepared, on which a final vote is due during December 2001, and includes the comments contained in the 2001 Report on the Broad Economic Policy Guidelines. It also takes into account the recommendations made by the Commission and by Ecofin on 12 March 2001.

This update of the Luxembourg stability programme, which coincides with discussions on the draft public sector budget for 2002, is affected by the tax reforms agreed and planned by the Government for 2001 and 2002.

The update has been approved by the Cabinet and has been laid before Parliament.

The updated programme is available on the website of the Ministry of Finance: http://www/etat.lu/FI/.

I. GENERAL ECONOMIC CONDITIONS

Trends in the Luxembourg economy in 2001

As a consequence of a slowdown in the global economy, the economic activity in most sectors of the Luxembourg economy has slowed down during 2001. As a result, STATEC has revised GDP growth downwards, and is henceforth working on the basis of an assumed growth rate of 3.9 per cent in 2001. This assumption is corroborated by the latest forecasts from the Commission, which indicate a growth rate of 4.0% for the current year.

Sectoral activity

In most sectors, the economic slowdown has already been evident during the first 9 months of 2001. Industrial activity overall is down in comparison with 2000, although increased growth has been reported in the production of certain goods during 2001. Construction activity has remained high, although it is now showing initial signs of slowing. The wholesale sector has also been affected by the negative economic climate, whilst the retail sector and the automobile retail sector are still reporting higher growth than in 2000. The banking sector has been affected by the financial turmoil, and although the net result before provisions, compared with the previous year, has remained high, it has nevertheless failed to progress during the first nine months of 2001, in contrast with the high growth in 2000. Finally, other commercial services have only reported a slight economic decline, with the exception of those provided mainly to companies, whose speed of growth is actually increasing.

Inflation and wages

Since January 2001, (ICPN, i.e., national version) consumer price inflation has been falling (+2.4% in September 2001, as against +3.5% in December 2000). The fall in inflation is mainly attributable to the drop in oil prices. Underlying inflation continued to rise at the beginning of 2001, before stabilising at around 3% since July. Relative inflation in Luxembourg in comparison with that within the euro zone as a whole has slightly improved throughout 2001. Whilst Luxembourg had the fifth highest inflation rate in the euro zone in December 2000, it regained fourth place in September 2001.

The STATEC forecasts are based on lower inflation in 2001 (consumer price index equal to 2.6%, compared with 3.2% in 2000) and in 2002 (2.2%). On the other hand, underlying inflation is higher in 2001 (2.8%, compared with 1.9% in 2000), and should only fall slightly in 2002 (2.6%).

Wage inflation accelerated slightly during the first half of 2001, compared with 2000 This meant that average real wage costs per person per month rose from 4.9% in 2000 to 5.5% over the year to the first half of 2001. The main reason for this rise lies in the fact that a wage indexation tranche fell due in April 2001. During the first half of 2001, labour costs continued to rise in Luxembourg at a higher rate than in neighbouring countries and compared with the average in the euro zone. The difference between the growth in the index in Luxembourg and that of the euro zone as a whole has risen continuously since 1997 (from -1.5 percentage points in 1997 to +3.8 points during the first half of 2001).

International trade

Due to a less buoyant international environment, exports of goods from Luxembourg have seen a damping down of growth during the first 7 months of 2001 (+4.7% at current prices, compared with +15.1% in 2000). In contrast, the rate of growth of imported goods only weakened slightly over the same period (+10.3%, compared with +12.6% for the year 2000), due in particular to aircraft and satellite purchases.

Over the first half year as a whole, Luxembourg's current account balance only showed a surplus of 1 billion euros, compared with 1.35 billion in the previous year, the main reasons being the rise in the wage balance, the net deterioration in the commercial deficit and the reduced growth in service exports. The surplus of investment revenue slightly improved during the first half of 2001 against that of the previous year, due to the continued positive development of the balance sheet activities of banks and the downward trend in short-term interest rates, which enabled credit institutions to refinance themselves subject to more favourable conditions.

Employment and unemployment

Since the second half of 2000, domestic payroll employment has been growing at an annual rate above 6%, an exceptional development, associated with the high economic growth over the past few years. The highest level of growth was reached in January 2001 (6.8%), since when the rate has slowed (5.7% in September).

Even if growth in jobs is slowing, it nevertheless remains high, although the rate of unemployment is no longer falling. In fact, whilst the latter has regularly fallen in an annual comparison since January 1998, it fell hardly at all during the third quarter of 2001 (2.44%, compared with 2.50% during the same quarter of 2000, a fall of 6 basis points, compared with a fall of around 30 points during the three preceding quarters). This phenomenon may be explained in part by the economic slowdown, but the high number of bankruptcies in 2001 has also contributed (an increase of 40.8% in the number of companies affected over the first 7 months of the year).

Another pointer towards the cooling of the employment market is the evolution of temporary employment. Both the growth in the number of temporary staff and that in the number of temporary hours worked have slowed during the first half of 2001, by +7.8% and +6.9% respectively over the year, compared with 13.8% and 15.7% in 2000.

Economic forecasts 2001-2004

Methodology

The macroeconomic situation underlying the Luxembourg 2001 to 2004 stability programme was prepared by STATEC during the summer of 2001. It does not therefore take account of recent economic developments, in particular the potential repercussions on the global economy of the terrorist attacks on September 11th 2001.

The forecasts published recently by the European Commission and by the OECD are based on the assumption of a sizeable recovery in economic activity during the second half of 2002, whilst prior to September 11th, STATEC had expected the recovery to kick in at the beginning of 2002. This delay in the recovery does not however unduly affect the medium term course of economic growth. This is why the growth forecasts appearing in table 1 have not been modified since publication of the autumn forecasts by the Commission, in order to maintain coherence.

However STATEC has recently revised the figures relating to 2000, although this does not affect the global consideration of the current year.

GDP and main aggregates

The GDP growth in 2001 has been estimated by the macroeconomic model at 3.9%. This forecast is based on the assumption of healthy economic activity during the first half of the year (although slowing in comparison with 2000) and a definite slowing during the second half of the year. The latest statistical information confirms likely GDP growth of around 4% in 2001, whilst the slowing in the domestic economy following the attacks on September 11th should not be felt until 2002 and beyond.

During the period 2002 to 2004, GDP should gradually return to the average growth rate of 5.5% per year which we have seen over the past few years. However, as a result of the downturn in the global economy following September 11th, this return to the trend growth rate is not likely to be reached until 2003.

Growth in private consumption, supported by fiscal measures and globally positive economic forecasts, remained strong in 2001. Additional tax reductions and, to a lesser extent, one-off increases in retirement pensions during 2002, should take growth in private consumption to around 4% (compared with 3.5% in 2000 and 2001).

Public consumption, which was still affected in 2000 by the introduction of dependence insurance, should gradually converge towards an underlying growth rate of 3%, as is evident from the public expenditure figures which appear below.

Exports of goods and services rose by 14.3% in 2000, encouraged by world trade which developed at the same rate. In 2001, a rise of only 5% in exports of goods and services is forecast, since world trade is only expected to grow by around 2%. The overall relatively favourable evolution is due to the excellent resistance of some buoyant niches in the non-financial services sector. Gradual recovery in exports of goods and services is forecast for 2002 to 2004, moving towards an underlying growth rate of around 8%. Nevertheless, bearing in mind what has been said above, this trajectory needs to be toned down a little, given that the recovery in global activity will lag behind the initial STATEC forecasts.

Table 1. Economic growth and main aggregates

	ESA Code	2000	2001	2002	2003	2004
GDP at market prices (growth rate at constant prices)	Blg	8.5*	3.9*	5.3*	5.7*	5.6
GDP at market prices (at current prices - in billion €)	Blg	20.51	21.95	23.86	25.92	28.05
GDP deflator		4.1	3.0	3.2	2.8	2.5
Growth in employment						
payroll employment		6.0	5.5	4.0	4.5	4.5
national employment		2.8	2.5	1.4	2.2	2.3
Origins of growth: variations in percent at constant prices						
Final household consumption expenses	P3	3.5	3.5	4.0	4.0	3.8
Final public administration consumption expenses	P3	4.9	3.4	3.0	3.1	3.0
Gross fixed capital formation	P52+P53	0.5	1.5	5.8	10.5	9.0
Exports of goods and services	P6	14.3	4.9	7.1	8.0	7.8
Imports of goods and services	P7	10.5	4.2	6.6	8.4	7.9
Contribution to GDP growth						
Final consumption expenses		2.5	2.4	3.5	4.5	4.1
Balance of goods and services	B11	5.9	1.6	1.9	1.2	1.4

* Autumn forecasts from the Commission: +9.5% in 2000, +4.0% in 2001, +3.0% in 2002, +5.4% in 2003.

Over the entire forecast period, growth in gross fixed capital formation remains high, insofar as businesses believe that the current economic slowdown is of a transient nature rather than structural, which results in a time-lag in investment without however affecting its overall volume. It is therefore forecast that in the medium term, the gross fixed capital formation will reach a growth rate of 10%. Moreover, the corporate tax reform will increase the return on fixed capital, and will give added impetus to the growth in investment when the global economy begins to recover in 2003.

Prices and wages

Inflation will slow considerably in 2002 and 2003. STATEC is therefore currently forecasting an inflation rate (national version, which takes account of the consumption habits of resident households rather than using an "area-based" weighting system as is the case for the harmonised European index) of 2.6% in 2001 and of 2.2% in 2002, compared with a rate of 3.2% in 2000. The recent fall in oil prices has made a major contribution to inflation reduction. However the underlying rate of inflation remains high, and is only likely to fall slightly in 2002 (to 2.6%, as against 2.8% in 2001 and 1.9% in 2000) due to the time-lag in incorporating the rises in oil prices and wages into all other prices.

A new wage indexation tranche is likely to fall due during the second half of 2002 and will further boost underlying inflation. However its effect on the increase in nominal wages will be offset, at least in part, by the slowing in the economy and the reduced pressure on the labour market. In fact an increase in nominal average wages of 4.5% is forecast in 2002, as against 5% in 2000 and close on 6% in 2001.

Labour market

In 1999 and 2000, domestic jobs increased by "record" rates (an average of 5.3% over the two years). Growth peaked during the first quarter of 2001 (+6.1% for domestic jobs), and the market has since slowed. However there has been a significant knock-on effect, so that the number of domestic jobs will have risen by 5.5% in 2001. For the period 2002 to 2004, a growth in domestic jobs of more or less 4% is forecast, this being in line with the general slowing in activity.

The Eurostat version of the unemployment rate is only slightly rising, with cross-border commuters reducing some of the fluctuations in the labour market. Nevertheless an unemployment rate of 2.8% must be predicted at the end of the period, compared with 2.6% in 2000.

Sensitivity analysis

STATEC bulletin no. 2-00 (pages 90-96) includes an analysis of the sensitivity to exogenous shocks of the results of an earlier budgeting exercise. The basic scenario envisages GDP growth of 2.6% for the first year. Domestic payroll employment increases by 3.1% and the consumer price index by 1.1%. GDP will increase on average by 4.5% per year in the medium and long term.

In comparison with the reference scenario, the sensitivity analysis examines the repercussions on the endogenous variables, specifically GDP growth and inflation, of four types of shocks: a slowing in the economy in Europe, an increase in inflation in Europe, a serious recession in the Luxembourg banking sector and growth in public consumption.

A reduction in GDP of the 15 EU member states of 1% causes an immediate reduction in Luxembourg's GDP of 0.8% against the basic scenario (i.e. a fall from 2.6% to 1.8%). The total long-term effect of this exogenous shock is a fall in growth of 1.1%. Most of the impact takes place immediately and the effects quickly fade. An exogenous rise in inflation of 1% within the 15 EU member states has little effect on economic growth and jobs, but the consumer price index immediately increases by 0.4% (from 1.1% to 1.5%) against the basic scenario. The total long-term effect of this inflationary shock on the consumer price index is a rise of 0.9%.

A serious recession in the banking sector causes a total slowdown in GDP of 4%. The immediate effect of this recession will be a reduction in GDP growth of 2.6% down to 2.2%. Growth in jobs reduces and unemployment rises, but the effects in the medium and long term are relatively minor, with the unemployment rate increasing by 0.2% during the first three years.

Finally, the expansionary fiscal policy produces positive real effects in the short term, without however reviving inflation. In fact, an additional increase in public spending of 3% causes GDP and domestic employment to increase by 0.3% against the basic scenario, but has no effect on the private consumer price index.

II. GENERAL OBJECTIVES OF FISCAL POLICY

Overall trend of the budget for 2002

The draft budget for 2002 presents as follows:

	2002 draft budget	Variation	
		in euros	in %
Current budget			
Revenues	5,941,446.9	+528,628.7	+9.77
Expenditures	5,122,865.1	+485,906.1	+10.48
Surplus	+818,581.8	+42,722.6	…
Capital budget			
Revenues	35,949.4	+2,058.5	+6.07
Expenditures	845,316.5	+36,866.2	+4.56
Surplus	-809,367.1	-34,807.7	…
Total budget			
Revenues	5,977,396.3	+530,687.2	+9.74
Expenditures	5.968,181.6	+522,772.3	+9.60
Surplus	+9,214.7	+7,914.9	…

<u>Notes:</u> - *The amounts are stated in billion euros.*
- *The percentages represent the variation rates of draft budget for 2002 against the approved budget for 2001.*
- *The 2002 Draft Budget presented to Parliament on 19 September 2001 is likely to undergo amendments prior to the final vote, which will take place in December 2001. These amendments will not affect the overall balance of the budget.*

The 2002 draft budget was prepared prior to the events of September 11th, which will have the predictable effect of delaying the economic recovery which was initially expected during the first half of 2002. The Government has nevertheless decided to maintain the cap on its fiscal policy and not to modify the trends and the overall balance of the budget for 2002. In fact fiscal policy must be viewed in the medium term and, as has been explained above, the medium term trend towards economic growth has not been fundamentally called into question due to the delay in the recovery envisaged during 2002. On the contrary, a substantial reduction in the budgetary expenditure planned for 2002, which would of necessity mainly affect investment expenditure, would have thwarted the impact of the automatic stabilisers and had a negative effect on growth.

The basic fiscal policy stance underlying the government programme

The Government has based its approach on the following two sets of fundamental considerations when preparing the draft budget for 2002:

a) The multiannual budgeting principles underlying the government programme;
b) The economic and fiscal policy guidelines of the Council of the European Union.

<u>a) The multiannual budgeting principles underlying the government programme</u>

In its Statement of 12 August 1999 to Parliament, the Government stresses in particular that Luxembourg's prosperity can be maintained in the long and medium term only if the public sector succeeds in preserving the current equilibrium of the public finances, which provides a solid basis for the action which the new Government will take.

The Government stresses in this respect that the Luxembourg stability programme, which was approved unreservedly at European level, is consistent with the new European environment for monitoring and co-ordinating economic policies, since it is based on the following principles:

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

It is essential, therefore, for the Government to maintain strict budgetary discipline and to see in particular that the increase in public sector expenditure does not, in the medium term, exceed the limits of economic growth.

It should be emphasised in this respect that the Government is committed to keeping the national debt at its very low level, and budget reserves and investment fund assets at their high level.

The willingness to implement a fiscal policy which seeks to match the increase in Government spending to GDP growth in the medium term, demands in principle that the increase in Government spending should exceed the medium term scope for economic growth, leaving aside any discrepancies due to economic circumstances. Given the quite rigid nature of current public expenditure, a fiscal policy seeking to keep budgeted growth in Government spending and of GDP absolutely in parallel would prove impossible in practice. Consequently, the respect of the budgetary principles adhered to by the Government must be viewed in a multiannual context, rather than on a purely annual basis.

b) The economic and fiscal policy guidelines of the Council of the European Union

In its April 2001 report on the Broad Economic Policy Guidelines of the Member States of the European Union, the Commission considers that, with a view to the improvement of the quality and viability of public finances, Member States should:

- continue their efforts to make the tax and benefit systems more favourable to employment, reducing global fiscal pressure, in particular on the low paid, whilst continuing to strive towards budgetary stabilisation, and improving the efficiency of the tax systems;
- improve the efficiency of public expenditure through institutional and structural reforms; in particular the introduction or improvement of the expenditure control mechanisms;
- improve the long-term viability of the public finances. Apart from measures aimed at increasing job numbers, this will require a speedy reduction in public authority debt and greater reforms to retirement schemes. Amongst the measures aimed at providing a more sound financial basis to retirement schemes, those countries who have not yet made such an effort need to place greater emphasis on capitalisation, in order to achieve a better balance between the various pillars which make up these retirement schemes;
- pursue fiscal co-ordination in order to avoid damaging fiscal competition and with a view to efficient implementation of the Council Agreement of November 2000 relating to the fiscal package.

The Commission noted that economic activity in Luxembourg was especially buoyant in 1999 and 2000, but that a slowing in GDP growth must be expected in 2001 and 2002. The Commission insists that "Recent economic results have been extremely positive and public finances are very sound. However the increased speed of wage and price rises represents a major challenge to economic policy".

As to fiscal policy, the Commission observes that in view of the large budget surpluses and the increase in budgetary expenditure which is focused primarily on investments and on measures intended to support specific aims, such as the development of the information society and of research, fiscal policy should seek to:

- implement a more restrictive fiscal policy during execution of the 2001 budget and preparation of the 2002 budget, with a view to neutralising inflationary pressures, if these persist, and
- closely monitor growth in public spending in order to be in a position to preserve the balance of public finances in the event of a slowing in the volume of GDP, and their sustainability in the long term, bearing in mind the ageing population.

Trend of government revenues and expenditures in 2002

The draft expenditure budget for 2002 is up 9.6% compared with the approved expenditure budget for 2001, while the draft revenue budget shows an increase of 9.7%.

As regards the revenue side of the budget, the fiscal effect of the significant tax reform which the Government introduced in 2001, the second stage of which is planned for the year 2002, must be taken into account.

The planned reduction in personal tax rates which commenced in 2001 will continue in 2002, and will achieve, with effect from the 2002 tax year, a reduction in the overall tax burden of some 421 million euros in comparison with the 2001 tax year.

With effect from 2002, the Government proposes to reduce the tax rate on corporate income from 30% to 22%. This measure, combined with some other proposals aimed at reducing corporate taxation, should result in reduction of the tax burden on companies by around 322 million euros in the 2002 tax year.

As regards the capital expenses budget, which includes primarily financing of public facilities, the funding proposed for 2002 has increased by 4.56% in comparison with the approved budget for 2001.

In order to fully appreciate Government efforts in relation to the creation and modernisation of the country's infrastructure and equipment, account must also be taken of the major investment expenses which are financed through special investment funds.

Government investment expenditure is in fact made up of expenditure recorded in the budget proper, plus the special fund expenditure. Investment expenditure which is financed via these special funds represents some 70% of total Government investment during 2002.

The draft current expenditure budget for 2002, which includes current and long-term national authority expenditure, has increased by 10.48% against the approved budget for 2001.

This increase is explained by the fact that a feature of the current expenditure budget is its rigid structure and that a high proportion of current public expenditure (staffing costs, transfers to social security, other income and capital transfers, etc.) is determined by or by virtue of legislative provisions.

This increase can also be explained by the fact that the draft budget for 2002 includes a number of supplementary expenditure lines which have been included by the Government with a view to the implementation of some priority measures within its policy programme.

Without going into detail, the following new schemes, which affect the budget in total by 91 million euros for the budgetary year 2002, must be noted:

Increase in the rates of immunity in relation to the guaranteed minimum wage	5.0 million euros
Extension of the benefit of the baby year to mothers of children born prior to 1988	9.0 million euros
Allocation of a flat rate education allowance to certain parents	22.5 million euros
Increase in family allowances	54.5 million euros
Total	91.0 million euros

Not taking into account these new expenditure categories which are included in the draft budget figures for the year 2002, the increase in the total of current expenditure will reduce from 10.48% to 8.51% between 2001 and 2002.

In the analysis of the global rates of increase of Government budgetary expenditure between 2001 and 2002 (+9.6%), we must also take account of the financial repercussions of these new measures, which represent in total an increase of 1.6 points in the budgetary total between 2001 and 2002. If these new expenditure projects are deducted, the total increase in Government budgetary expenditure between 2001 and 2002 is 7.9% instead of 9.6%.

Within this context, it must also be noted that what appears at first sight to be a sizeable increase in the expenditure budget between 2001 and 2002 is largely the result of the Government's desire to place its expenditure on the financing of the special funds, and more particular of investment funds, on an even more sound basis. To this end, a very large proportion of the growth in budgetary expenditure has been assigned to the increase in the allocations to the following main special funds:

(in million euros)

Development Co-operation Fund	+ 9.3
National Research Fund	+ 2.5
Employment Fund	+ 2.8
Rail Fund: Repairs and Maintenance	+ 12.6
National Fund for Support to Audiovisual Production	+ 2.0
Water Management Fund	+ 0.7
Special Fund for Hospital Investments	+ 2.0
Environmental Protection Fund	+ 1.7
Road Fund	+ 1.0
Public Administrative Investments Fund	+ 2.8
Public School Investments Fund	+ 6.3
Guarantee Law Fund	+ 1.0
Rail Fund: Investments	+ 15.0
International Rail Links Fund	+ 5.0
Total	+ 64.7

Overall equilibrium of the budget

As can be seen from the summary table at the beginning of this section, the draft budget for 2002 shows a surplus of revenues of 9.2 million euros, assuming that no additional debt is incurred.

Given the trend of tax revenues and the control of current expenditure, the 2002 draft budget does not provide for any new borrowing, either for the budget proper or for financing investment fund expenditure.

Within this context it should also be noted that the 2002 draft budget includes a global provision for amendments totalling 12 million euros, the distribution of which is to be specified when the budgetary amendments are presented to Parliament.

Main aims of fiscal policy

<u>Reducing the overall tax burden</u>

In accordance with the general direction of its budgetary and financial policy, the Government has given priority to the pursuit of its plan of reduction of the tax burden both for individuals and companies. Thanks to major fiscal measures which the Government has implemented with effect from the year 2001, the second stage of which is planned for 2002, households will not only see a direct increase in their purchasing power, but will also be able to derive benefit from the acceleration of economic growth and from the resulting job creation.

The fiscal measures which are proposed by the Government for the year 2002 are described in detail in the annex.

Promoting the information society

Within the context of the increasing globalisation of economic relations, the countries which will prosper are likely to be those which excel in terms of innovation and the development of new ideas. Success will still depend even more on the desire and capacity to create and develop a strong and innovative economy, to the benefit of the public.

In line with the conclusions of the Lisbon summit, and in an awareness of this reality, which represents a challenge not only in economic terms, but also in social and cultural terms, the Government has made research into and optimisation of the conditions of access to, use and development of computer and telecommunication technologies one of its main priorities.

In line with the commitments given by the Government in this respect, the 2002 draft budget is making a very large increase in the resources allocated to accelerating Luxembourg's progress in the information society. The most visible expression of this is in an increase of 3.7 million euros in the appropriation for the Ministry of State, with a view to implementing the national action plan for the information society. The funding in the 2002 budget totals 8 million euros.

As well as this large funding commitment, it should be noted that the overall effect of the choices made by the Government in finalising the 2002 budget is to exceptionally increase by 8.9 million euros the funding earmarked for the wider use of information technology in government departments and public services (purchase of hardware and software, study and consultancy costs. etc.).

Promoting research and innovation

Investment in research and innovation thanks to increased budgetary funding constitutes one of the key priorities of Government policy. The capacity to innovate and to develop new scientific and technological initiatives necessitates mobilisation of all public and private sector bodies.

In an awareness of this need, the Government proposes to make a substantial increase to the budgetary funding of both scientific and applied public research, which total (both current and capital expenditure) 27.4 million euros in the 2002 draft budget.

The total funding is thus increasing by 9.5 million euros, or 53.33% in comparison with that of the 2001 budget, amounting to some 0.19% of GDP in 2002. In the space of four years, the total budgetary funding for scientific research and technological development activities will thus have increased by +279%.

In this respect it should be recalled that in 2000, the Government signed four agreements with the National Research Fund, relating to the following priority multiannual research programmes, and involving a total of 25.2 million euros:

- Security and effectiveness of new electronic commerce practices
- New materials and nanotechnology
- Sustainable management of water resources
- Biotechnology and health

It should also be noted that the total Government allocations to public research centres to allow their operation has increased from 3.3 million euros in 2001 to 3.9 million euros in 2002. This extremely large rise of 20.7% is in response to the Government's concern to strengthen the financial base of existing research structures.

Lastly, the Government is giving major emphasis to its financial support of the "Technoport Schlassgoart" project, which is being implemented in collaboration with the town of Esch-sur-Alzette and the ARBED and ProfilARBED companies.

Increasing public sector investments

Being confronted on the one hand with global economic development which looks set to be less favourable, and on the other hand with high demographic growth, the Government aims to meet public infrastructural requirements by continuing to pursue and even intensifying its ambitious investment policy in relation to the creation of public infrastructure.

Growth in expenditure in this area therefore amounts to 28% in 2002, bringing the total to 541 million euros.

As a result, the percentage of this expenditure within GDP will also continue to rise, and will total 3.0% in 2002, having reached the forecast levels of 2.5% in 2001 and 2.0% in 2000.

It should also be revealed in this context that the investment level reached by Luxembourg, expressed by the gross fixed capital formation of the whole of the public sector, remains the highest in the European Union. For 2002, this ratio will be 4.6% of GDP, whilst the EU average stands at 2.4%.

Without going into too much detail regarding the various investment projects, the main areas of emphasis decided in the multiannual capital expenditure programme which covers the forecast period 2001-2005 should be recalled.

As regards highway infrastructure, the main projects in progress are the *Grande voirie du Nord* and the motorway link to the Sarre in Germany. At a global cost of 632.3 million euros, investments still outstanding for the *Grande voirie du Nord* between 2002 and 2005 and beyond stand at 394.3 million euros. The link with the Sarre, whose global cost stands at 246.7 million euros, will have a global impact of 84.8 million euros on the budgets for 2002 and beyond. The costs of other infrastructural highway projects beyond 2002 will total 152.4 million euros.

A primary feature of the development of the rail infrastructure in 2002 and beyond are projects whose global cost amounts to 550 million euros. One of these projects involves a rail link from the European district at the Kirchberg to the central station and to Luxembourg airport.

As regards building investments, we need to look mainly at the public investment funds associated with the Ministry of Public Works. Thus the public administrative investment fund makes provision for expenditure of 592.6 million for the period 2002-2005.

In the sphere of public school investment funds, the global cost of investments over the period 2002-2005 stands at 496.4 million euros.

Total investments in health and social investment funds amount globally to 165.1 million euros for the period 2002-2005.

As regards hospital investments, the global cost of investments stands at 328.3 million euros for the period 2002-2005.

Socio-family infrastructure investment, which is financed via the socio-family infrastructure fund, totals 335 million euros for the period 2002-2005.
This expenditure is broken down as follows:

- infrastructure for elderly persons, 181 million euros;
- infrastructure for disabled persons, 34 million euros;
- infrastructure for infant day care and responsibility for children outside school hours, 8 million euros;
- other projects, 112 million euros.

This list of the political areas of emphasis decided by the Government when it drew up the 2002 draft budget is far from exhaustive. It does not reflect the range of instances of Government involvement, in particular in the award of interest and capital subsidies, aimed at stimulating investments by other public and private sector bodies, for example five year sports equipment programmes and tourism infrastructure programmes.

Financing priority foreign action

When it was drawing up the 2002 draft budget, the Government decided to put Luxembourg in a position to make an appropriate contribution towards the financing of efforts at maintaining peace and stability in Europe and in the world at large.

Development of the policy of solidarity and humanitarian action

The level of assistance in this sphere, which exceeded 0.7% of GDP in 2000, will increase to 0.75% from 2001, this level having been achieved in 2001 and being slightly lower than the rate aimed at when the budget was prepared (following the exceptional rise in GDP reported in 2000), and to 0.80% in 2002. As a result, bearing in mind the accompanying rise in GDP, there will be an increase in total development assistance of over 26 million euros, or 16.8%. The achievement of these levels means that Luxembourg remains in the top five countries in the world providing the highest level of development assistance.

The effect of measures to improve the general pension insurance system

Within the context of analysis of the final declaration on 16. July 2001 of the round table discussions on pensions, the Government has drawn up the following proposals which involve certain categories of insured and uninsured persons, who will affect the budget for the coming year:

Unit: thousand euros

	Cost	Entry into force
1) Increase from 20% to 30% of guaranteed global minimum wage, of the rate of immunity of professional or replacement incomes and of other supplements awarded under Luxembourg or foreign social security	5,000	1.1.2002
2) Extension of the baby year benefit to the mothers of children born before 1988	9,000	1.3.2002
3) Award of a flat rate education allowance in the order of 74.37 euros per month per child, to parents not having a personal pension	22,500	1.7.2002
Total repercussions on the budget for the year 2002	36,500	-

Given that the measures listed under 1) and 3) do not specifically relate to the beneficiaries of contributory pension insurance schemes, the related funding has been appropriated in the budget of the Ministry of the Family, Social Solidarity and Youth. A more detailed description of the round table discussions on pensions is included in the annex.

Development of social, medical and family infrastructure

The Government intends to continue to actively develop infrastructure in the socio-family context, focusing on the disabled, young persons and child daycare centres.

As regards the hospital sector, the increase from 35 to 37 million euros of the allocation to the hospital investment fund must be viewed in conjunction with the supplementary allocation provided for in the draft law relating to the appropriation of the 2000 surpluses of revenues (100 million euros). This supplementary allocation will allow the various renovation and construction projects which derive from the law of 21 June 1999 to be financed via ordinary annual allocations of the same magnitude as those proposed for 2002.

Government involvement in the financing of health, pension and accident insurance

As in previous years, the growth in health insurance and pension insurance funding, which amounts to 10.7%, is fundamentally characterised by the increase in the potential volume of contributions.

This is due primarily to the continued growth in the number of contributors, and secondly but less importantly, to the growth in real wages, added to which is the effect of the rise in inflation and hence of the wage indexation scale.

III. GENERAL GOVERNMENT NET LENDING

The 2000 financial year

Just as the 2000 budgetary year was characterised by exceptional GDP growth, this growth is also reflected in net public sector lending. Thus net lending reached a historical high of 6.2% of GDP, which exceeded the estimates made during the last update of the stability programme. On the one hand, general government expenditure has increased less quickly than forecast, and on the other hand, recvenues significantly exceeded initial estimates. In 2000, budgetary revenues thus totalled 9.2 billion euros, or 44.9% of GDP, and expenditure totalled 7.9 billion euros, compared with the 8.3 billion euros forecast in the last stability programme update. However investment expenditure remained very high, at 4% of GDP.

Within the sub-sectors, it may be recalled that the net lending of the central government sub-sector totalled 3% of GDP, the highest level in terms of GDP since 1990 (first year calculated on the basis of the European Accounting System 95). It goes without saying that such a rate will be difficult to achieve in future. The net lending of this sub-sector has improved by 2% against the estimates made during the last programme update. This improvement has been due to higher growth in revenues. Similarly, the net lending of the social security sub-sector peaked at 3% of GDP. It should finally be noted that the net lending of local authorities has improved over the last estimates in this respect.

The 2001 financial year

Before analysing the growth in net lending envisaged for 2001, it must be emphasised that the GDP growth estimated for this period is only 4%, compared with 8.5% in 2000. Despite this unquestioned deceleration in GDP growth, public sector net lending remains high, at 896 million euros, or 4.1% of GDP. Similarly the gross formation of fixed capital of the entire public sector continues to progress, and will be high in 2001, namely 4.3% of GDP.

The continued high level of net lending is primarily due to the net social security lending, which totalled 606 million euros, or 2.8% of GDP. At the same time, the total social security reserves rose by 12% against 2000.

As regards central government net lending, a certain slowing has been evident in comparison with 2000. It is clear that the exceptional result realised in 2000 is difficult to repeat, if only due to the GDP growth. This slowing, which moreover simply represents a return to the average levels since 1990, may be explained by a number of factors inherent in fiscal policy.

First of all, the first stage of the tax reform was brought in on 1 January 2001. The cost of this stage of the tax reform, which focused primarily on a reform of the marginal rates of personal income taxation, was valued by the direct contributions tax authority at 248 million euros for fiscal 2001. This cost is a static valuation and that the fall in revenues from individuals will not be of this scale in 2001.

On the other hand we must consider the sizeable increase in investment expenditure by central government. In fact central government investments will increase by close on 28%, which represents 2.5% of GDP. To this must be added the fact that a large number of measures are included in the budget with a view to promoting investments, on both a communal level and on that of other economic agents.

As regards the net lending of local government, the same phenomenon may be observed. The level of net lending has effectively reduced in 2001, to total 0.3% of GDP. As is the case for central government, local government investment expenditure remains very high, despite deterioration in revenues due to lower GDP growth.

Table 2. General government budget situation

as % of GDP	ESA Code	2000	2001	2002	2003	2004
Net lending (B9) by sub-sectors						
General government	S13	6.2	4.1	2.8	3.1	3.4
Central government	S1311	3.0	1.0	0.0	0.3	0.4
Local government	S1313	0.5	0.3	0.2	0.2	0.3
Social security	S1314	2.7	2.8	2.6	2.7	2.7
General government (S13)						
Total revenues	ESA	44.9	44.4	43.2	42.7	41.8
Total expenditure	ESA	38.6	40.3	40.4	39.6	38.4
Balance	B9	6.2	4.1	2.8	3.1	3.4
Interest payments		0.3	0.3	0.5	0.3	0.2
Primary balance		6.5	4.4	3.3	3.4	3.6

The forecasts for the period 2002-2004

Before going into detail regarding the forecasts for the period 2002-2004, it must be emphasised that forecasts in relation to central government revenues have been very prudent.

For the period 2002 to 2004, general government net lending is on average equal to 3.1% of GDP, which is the same as the average net lending for the period 1990-2001.

In an analysis of the general government sub-sectors, it is again social security net lending, with an average rate of 2.7% of GDP, which produces the largest positive balance. To this must be added the fact that the social security reserves should reach 7.2 billion euros, or 26% of GDP, in 2004.

Despite the major tax reform and maintenance of a high level of investment, central government net lending will remain positive in 2002, and will continue to progress during 2003 to 2004.

After the first stage of the major tax reform which started in 2001, the Luxembourg Government intends to continue its reforms in 2002. Thus the estimated static cost of the second stage of the reform of personal tax rates for 2002 has been estimated by the direct contributions tax authority at around 174 million euros. To this must be added the impact of the first stage in the rate reform for personal taxpayers, which will have repercussions in 2002 at a cost of 248 million. The reform of corporate tax will be reflected in lower revenues in the order of 325 million euros. Overall, the total cost of the tax reform in the budget year 2002 has been estimated by the direct contributions authority at 747 million euros. As mentioned earlier, this valuation of the fall in revenues does not take account of the normal growth in revenues due to economic growth, or of the wage bill, nor of the effects on the economy produced by the tax reform.

<u>In summary:</u>

1st stage of the tax reform for personal taxpayers in 2002	248 million euros
2nd stage of the tax reform for personal taxpayers in 2002	174 million euros
Tax reform for companies in 2002	325 million euros
Total cost to central government of the tax reform	747 million euros

As regards central government investments, it should be noted that the average growth rate over the period 2002-2004 will be 17% per annum, which amounts to an average of 3% of GDP.

Local authority net lending will be on average equal to 0.2% of GDP for the period 2002-2004. The fall in net lending is mainly due to the fall in revenues. The local government sub-sector is in fact involved in the attempt to reduce the global tax level on companies. The cost of reduction of the basic rate of local trade tax for 2002 is estimated at 79 million euros. Despite this fall in revenues, an average growth rate of investments of 7% per annum remains a possibility.

Conclusion

Based on the period under review (2000-2004), general government net lending is on average equal to 3.9% of GDP, whilst this same net lending was still on average equal to 2.7% of GDP between 1990-1999. At the same time, total expenditure will stabilise at around 38% of GDP in 2004, compared with 44% in 1990. Similarly total revenues, which still accounted for 49% of GDP in 1990, should reach a level of 42% in 2004.

Luxembourg has therefore succeeded in reducing the fiscal pressure on the economy, in coping with its expenses, whilst developing and modernising its infrastructure, without burdening future generations with a high level of debt.

IV. THE STRUCTURAL TRENDS OF PUBLIC DEBT

Public sector debt

Public sector debt, or more precisely the ratio of the consolidated public sector debt to GDP within the sphere of application of the EC Treaty, is especially important. Article 104 of the Treaty provides that public debt should not exceed 60% of GDP.

It should be noted in this context that "public debt" includes the entire debt of the public sector, i.e. of both central government and of local government and social security. Social security operates with a structural surplus and consequently its debt is marginal. Similarly, local government debt is not very high (>2% of GDP) and its evolution remains static.

In this context it is important to note that over the past few years, the government has set aside sizeable financial funds by way of provisions in the public debt fund, which are intended to pay interest and to reimburse capital on loans issued by the government.

Government debt

The government issued no new debt between 1998 and 2001.

The total public debt at 31 December 2000 stood at 697.4 million euros.

Table 3. Development of public debt

% OF GDP	ESA Code	2000	2001	2002	2003	2004
Gross public debt *of which: central government*		5.34 3.58	4.97 3.18	4.58 2.92	4.21 2.54	3.88 1.63
Variation in gross debt		-0.61	-0.37	-0.39	-0.37	-0.33
Contributions to the variation in gross debt						
Primary balance		6.5	4.4	3.3	3.4	3.6
Payment of interest *of which: central government*	D41	0.29 0.21	0.29 0.19	… 0.39	… 0.17	… 0.11
GDP growth (at current prices)	B1g	13.0	7.0	8.7	8.7	8.2

A breakdown of the total outstanding public debt by financial instruments produces the following situation at 31.12.2000:

- linear loans: 78.62% of the total;
- savings certificates with capitalised interest: 8.15% of the total;
- traditional bond loans: 7.11% of the total;
- bank loans: 6.12% of the total.

The public debt contracted by the government is virtually entirely denominated in the national currency (LUF or EUR). Only a few loans come under the category of foreign debt, because they are denominated in CHF or based on the capacity of the creditor. Such foreign currency debt amounts to 4.35% of the total.

Other features of central government public debt at 31 December 2000 are as follows:

- average weighted rate: 6.53% (compared with 6.55% at the end of 1999);

- debt/GDP ratio: 3.40% (compared with 3.85% at the end of 1999);
- debt per capita: 1,601.37 euros (compared with 1,626.11 euros at the end of 1999);
- average term: 4 years and 29 days (compared with 5 years and 29 days at the end of 1999);

The outstanding amount of Treasury bonds at 31 December 2000 is in the order of 16.3 million euros, which corresponds to a reduction of 0.7 million euros in comparison with the previous year. These Treasury bonds do not constitute a short-term monetary financing instrument, but represent commitments towards international financial institutions which, as they fall due, are paid out of the budget for the year concerned.

Table 4. Economic development

% of GDP	ESA Code	2000	2001	2002	2003	2004
GDP growth rate at market prices (at constant prices)	B1g	8.5	3.9	5.3	5.7	5.6
Budget balance	B9	6.2	4.1	2.8	3.1	3.4
Interest charge	D41	0.21	0.19	0.39	0.17	0.11

N.B.: *STATEC does not currently calculate a potential GDP for Luxembourg. However research on this topic is underway and should result in the establishment of this concept for 2002. The figures produced by the Commission in this respect for Luxembourg need to be treated with caution, since they are based on filtering methods. This purely statistical procedure does not take account of the economic realities of Luxembourg, which are characterised by extremely flexible employment opportunities. Similarly, a potential GDP based on a 'production function' type method would have to be excluded inasmuch as it is based on a national unemployment rate that does not take into account cross-border employment opportunities*

Table 5. Divergences from the previous programme

% of GDP	ESA Code	2000	2001	2002	2003
GDP growth *previous programme*	B1g	8.3	5.2	5.3	5.8
current programme		8.5	3.9	5.3	5.7
difference					
Net lending *previous programme*	B9	3.0	2.6	2.5	2.5
current programme		6.2	4.1	2.8	3.1
difference					
Gross debt *previous programme*		…	…	…	…
current programme		5.34	4.97	4.58	4.21
difference		…	…	…	…

ANNEX 1: Demographic ageing and consequences for the sustainability of pension insurance

In his Declaration on the economic, social and financial situation of the Nation on 10 May 2000, the Prime Minister issued invitations to a round table on pensions ("Rentendësch"). Between March and July 2001, the "Rentendësch" met on nine occasions under the chairmanship of the Minister for Social Security. It was attended by representatives of the parliamentary factions, union representatives and representatives of the employers, the *Union des entreprises luxembourgeoises* (UEL).

Discussions focused in particular on the recommendations of the International Labour Office entitled "Actuarial and financial assessment of the general pension insurance scheme of the Grand Duchy of Luxembourg" which had been commissioned by the government.

This study confirmed the excellent financial situation of the private sector pension insurance scheme. On 31 December 1999, the social security financing reserve stood at 3,688.8 million euros or 20% of GDP. The reserve currently represents approximately three times the total of annual contributions. The International Labour Office predicts that the relative level of the reserve will continue to rise until 2020, when it will reach five times the total of annual contributions. After 2020, the financial situation of social security will deteriorate, as a consequence of the ageing of the population. Nevertheless, subject to economic growth of 4% per annum and a rise in employment of 2% per annum, The ILO simulation forecasts no financing problems of the private sector pension scheme between now and 2050. Over the entire forecasting period, the financing reserve remains positive, and its relative level will remain well above the total of annual contributions.

The report from the economic policy committee "*Budgetary challenges posed by ageing populations*" adopted by the ECOFIN council, confirms the long-term sustainability of the Luxembourg pension scheme. Sustainability is assessed on the basis of the ratio between pension expenditure and GDP over the next 50 years. This ratio stood at 7.4% in 2000. It peaks at 9.5% in 2040 and falls to 9.3% in 2050. Luxembourg's ratio of pension expenditure to GDP is well below the European average (10.4% in 2000 and 13.3% in 2050) and its growth is amongst the lowest in the EU.

After completing its work, the "Rentendësch" adopted a package of measures to the benefit of pensioners under the private sector pension scheme, regarding which consensus was reached by all those involved, with the exception of the employer representatives. These final measures total 128.9 million euros per year.

The following measures are to be applied from March 2002 to private sector pensions:

- Linear rise in pensions of 3.9%. The pro rata rate of increase will rise from 1.78% to 1.85%. Cost of this measure: 47.1 million euros.
- Moreover, in order to encourage the active population to work longer, the rate of increase rises from 0.01% to a maximum of 2.05% for every additional year of work after age 55, with a minimum number of contributory years of 38. The cost of this measure, which does not apply retroactively: 2.48 million euros.
- An end of year supplement of 12.39 euros will be paid for every contribution year. Cost of the measure: 32.23 million euros.
- Increase in the basic pension of 11.9%. Cost of the measure: 32.23 million euros.
- Increase in the amount of the minimum pension (which currently corresponds to a gross amount of 1,161.18 euros). Cost of the measure: 4.96 million euros.
- The survival pension will not be reduced if its amount falls below that of the minimum pension. Cost of the measure: 4.96 million euros.
- Moreover, the members of the round table decided to extend the baby years to births which took place before 1 January 1988 and to grant a flat rate education allowance of 74.37 euros per month and per child to women who were not able to benefit from the baby years.

In fact, the "Rentendësch" was of the opinion that the country's favourable economic situation and its repercussions on pension fund finances currently allow the adoption of a package of measures as proposed above, in the order of 123.95 million euros per year, without putting at risk the financial basis of pension insurance, and with the aim of achieving:

- greater convergence of pension schemes and
- more generous redistribution to the benefit of low pensions.

The participants at the "Rentendësch" agreed that they would reconsider the new measures introduced, without affecting low pensions, in the event that the actuarial balance prepared every seven years were to indicate that the level of the reserve risked falling below the legal minimum of 1.5 times annual expenditure, and that the long-standing financing of pensions was no longer guaranteed without imposing additional burdens on future generations.

ANNEX 2: Salient features of the 2002 tax reform (Draft Statute 4855)

Within the context of the government declaration in 1999, the Prime Minister set out the broad outlines of tax policy. Regarding the direct taxation of households and businesses operated individually or jointly, the government announced that it wished to undertake a "reduction of the tax burden which will go well beyond an integral correction to take account of inflation. This reduction will comprise a structural adjustment element in relation to the tax scale. This will result *inter alia* from the conclusions of an in-depth examination of various existing tax deductions in order to determine their effectiveness in relation to the general and voluntarist trends of the government's general policy".

Personal taxation

In June 2000, the government decided to reform the marginal personal income tax rates scale with effect from the tax year 2001, this having initially been planned for 2002. The first stage of the scale reform, which may therefore be described as interim, was confirmed under the law of 22 December 2000 relating to the revenues and expenditure budget for the year 2001. It entered into force on 1 January 2001. The second stage of the scale reform is characterised primarily by a new reduction in the income tax scale for all taxable income levels. The scale alterations correspond to the social policy aims and are integrated into the national economic strategy, and are also intended to foster international competitiveness.

The second stage of the scale reform will further reduce the tax burden on households. The threshold for the lowest rate will increase from 9,668 euros to 9,750 euros for class 1 taxpayers (single persons) and from 19,336 euros to 19,500 euros for class 1a and 2 (single persons aged over 65 or widowed and married couples without children). The maximum rate will fall from 42% to 38%. This rate will apply from a taxable income of 34,500 euros for class 1 taxpayers and from 69,000 euros for class 1a and class 2 taxpayers.

The government also undertook a detailed examination and analysis of the effectiveness and justification for income tax deductions related to procurement costs, special expenditure and income allowances, within the context of the general and voluntarist nature of the government's policy. All the existing deduction methods retain a significant degree of fiscal incitement, bearing in mind their specific mechanism and the aim sought, and are all retained, with the exception of one, namely the movable asset investment deduction. No new income tax deductions will be introduced. It should be noted that a substantial improvement is made in relation to the promotion of savings for retirement.

Moreover the government proposes to provide extensive relaxation to the tax system on the profit shares collected by resident and non-resident directors, since the current system was deemed excessive and out of touch with economic realities. To achieve this, it is proposed that in future the principle of taxation at source of profit share income should be formally adopted, to be charged through the tax base. As regards non-resident taxpayers, the tax at source is levied subject to certain conditions and limits.

It is also proposed that the wealth tax burden should be lightened, in particular to the benefit of small and medium savers and investors, by increasing certain allowances appearing in the law relating to the valuation of goods and assets or by introducing new income tax deductions which can be claimed when determining taxable wealth.

Corporate taxation

The tax measures relating to companies involve a number of aspects.

On the one hand, the draft law places emphasis on the reduction in the tax burden on companies. Whilst one-person businesses and partnerships are to benefit from scale adjustments to personal income taxation, companies are to benefit from the proposed reduction in the tax scale on corporate earnings from 30% to 22% for taxable earnings above 10,000 euros. Moreover, all companies liable for local trade tax, regardless of their legal status, will also benefit from the reduction proposed in the local trade tax base.

As regards indirect taxes, the current rate of 0.06% of the unit trust annual subscription tax is reduced to 0.05%.

The problem of company restructuring operations was the subject of in-depth analysis. As a result, the draft law provides for solutions which suit the majority of the scenarios which may appear in relation to restructuring. The analysis takes account of the fiscal consequences, for both companies and partners, which arise from the various merger, split, absorption, share exchange alternatives etc.

In order to further stimulate private investment, the rebate on investment tax becomes accessible to certain intangible investments. The measure has been slightly amended in other ways, in particular as regards the clarification of the concept of initial establishment.

Moreover, the tax systems relating to audiovisual investment certificates and venture capital investment certificates have been adapted. The fiscal measure will henceforth take the form of a tax rebate, in place of the current system of a revenue allowance.

Cost of measures benefiting individuals and companies

In total, the measures proposed for 2002 to benefit individuals will bring about tax reductions in the order of some 185.92 million euros in comparison with the 2001 tax year. The greater part of these reductions is attributable to the reduction in the income tax scale (173.53 million euros in comparison with the 2001 tax year). The other measures only have low budgetary impact or broadly offset one another. It should be recalled that the first stage of the scale reform, realised in 2001, enabled tax reductions in the order of 247.89 million euros to be achieved in comparison with the 2000 tax year, i.e. 495.79 million euros over the two tax years of 2001 and 2002. In total, over these two tax years, the cumulative impact of the 2001/2002 scale reform is thus some 669.31 million euros in comparison with the 2000 tax year.

In total, the tax reductions granted for 2002 in relation to corporate revenue tax, local trade tax and wealth tax are estimated at 342.09 million euros in comparison with the 2001 tax year.

The greater proportion is attributable to the reduction in the tax scales on corporate earnings (247.89 million euros) and in local trade tax (86.76 million euros), i.e. a cumulative total of 334.66 million euros for the 2002 tax year, in comparison with the 2001 tax year.

Moreover, the measures aimed at bringing the tax bases of corporate tax and local trade tax closer should produce a slight positive fiscal impact, in terms of higher revenues, in the order of some 7.44 million euros.

For the 2002 tax year, the fall in revenues under local trade tax will therefore be 79.33 million euros.

As regards the purely static and mechanical impact of the fall in the rate of unit trust subscription tax, this may be estimated at some 61.97 million euros.

From a budgetary point of view, the fiscal loss envisaged for the 2002 tax reform respects the limits set by the government, in such a way as not to call into question current and future financing of budgetary requirements.

The total cost of the 2002 tax reform, taking all the measures together (individuals / companies operated as sole traders / companies) comes out at some 528 million euros for the 2002 tax year, in comparison with the 2001 tax year.

The tax revenue foregone does not directly affect the 2002 budgetary year, bearing in mind the time-lag in taxation and the quarterly adjustments in advance payments over several years, in particular as regards companies. Around 315 million euros, excluding the impact of the unit trust subscription tax, are chargeable to the 2002 budgetary account in relation to the year 2001.

ANNEX 3: Macroeconomic scenario - basic hypotheses

	2000	2001	2002	2003	2004
USD/€ exchange rate (annual average) *N.B.: increase = depreciation*	0.92	+4.5%	+3.5%	0	0
Economic growth in foreign markets	+8.5%	+5.2%	+5.8%	(+6.1%)	(+6.1%)
Oil price **(Brent, USD per barrel)**	28.6	-7.8%	-5.2%	(0)	(0)