COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 12.8.2009
SEC(2009) 1120 final

COMMISSION STAFF WORKING DOCUMENT

Public Finances in EMU – 2009

Part 2 of 3 (page 197 to 260)

CONTENTS

Part V

Member State developments

1. BELGIUM

Recent developments and medium-term prospects

In 2008, the general government deficit amounted to 1.2% of GDP. The difference between the outturn and the balanced budget target in the April 2008 update of the stability programme can be explained by the weakening of Belgium's economic performance and its impact through the automatic stabilisers, by the overly optimistic revenue projections in the initial budget and by higher than planned expenditure. The structural deficit increased by 0.7% of GDP as a result of measures to reduce the tax wedge on labour, a further rise of social benefits and a more rapid payment of invoices at the end of the year. After having declined for many years, general government debt increased from 84% of GDP in 2007 to 89.6% of GDP in 2008, mainly as a result of the operations to stabilise the financial system.

For 2009, the deficit target of the general government balance is 3.4% of GDP according to the April 2009 update of the stability programme ([1]). The initial budget planned a 1.2% of GDP deficit, but had to be adapted in view of the deteriorated economic environment and the introduction of a recovery package. The Commission services expect the deficit to amount to 4.5% of GDP. The main reason for this divergence is the different macroeconomic scenario, with the Commission services projecting a GDP contraction of 3.5%, compared to 1.9% in the budget. To cushion the impact of the economic downturn, the different government tiers have implemented fiscal stimulus packages. Whereas the budgetary impact of the regional packages is negligible, the federal one amounts to 0.5% of GDP. It is aimed at reducing the tax burden on labour and the VAT rate for residential construction, supporting the purchasing power of households, i.a. through higher unemployment benefits and a heating subsidy, and accelerating public investment. The packages come on top of measures foreseen in the initial budget (0.4% of GDP), including personal income tax reductions and higher social benefits to support households' purchasing power. The stimulus measures in most parts are broadly in line with the EERP. In particular, the reduction of the labour tax burden, of which a considerable part is granted to all workers, and the heating subsidy, which is provided to all households, do not appear sufficiently targeted. In addition, a substantial part of the stimulus, including the reduction of the tax burden on labour, is permanent and not accompanied by consolidating measures. Overall, fiscal policy is expansionary in 2009.

According to the Commission services' spring 2009 forecast, which is based on a no-policy change assumption, general government deficit would amount to 6.1% of GDP in 2010. The fiscal stimulus package implemented by the Belgian government continues to have a budgetary impact in 2010 (0.4% of GDP). The April 2009 update of the stability programme targets a 4% of GDP deficit, considerably better than the Commission services projection. This large difference can be broadly explained by differing macroeconomic projections. In addition, the stability programme takes into account unspecified measures amounting to 0.5% of GDP. Finally, a more negative outturn in 2010 also contributes to the larger deficit in 2009. The Commission services' spring 2009 forecast expects the debt-to-GDP ratio to rise rapidly and come out above 100% of GDP in 2010, as a result of low nominal GDP growth and large budget deficits. Measures taken up to now to stabilise the financial system led to an increase of public debt of about 6% of GDP, the bulk of which has been recorded as a stock-flow adjustment in 2008. The April 2009 update of the stability programme includes lower public debt projections, mainly as a result of its more favourable macroeconomic scenario, with higher nominal GDP growth and smaller deficits, and the fact that the programme implicitly takes into account unspecified corrective measures. To the extent that the guarantees provided to banks (which amount to over one third of GDP) would be called, public debt may further increase.

([1]) The programme can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.1.1: **Budgetary developments 2007-2013, Belgium (% of GDP)**

Outturn and forecast(1)	**2007**	**2008**	**2009**	**2010**			
General government balance (2)	-0.2	-1.2	-4.5	-6.1			
- Total revenues	48.1	48.6	48.4	48.2			
Of which : - taxes on production and imports	12.8	12.5	12.3	12.3			
- current taxes on income, wealth, etc.	16.3	16.5	15.9	15.9			
- social contributions	15.7	16.2	16.6	16.5			
- Total expenditure	48.3	49.8	52.9	54.3			
Of which: - compensation of employees	11.7	12.0	12.6	12.7			
- intermediate consumption	3.5	3.7	3.9	3.9			
- social payments	15.4	15.9	17.0	17.8			
- gross fixed capital formation	1.6	1.6	1.8	1.8			
- interest expenditure	3.8	3.7	3.9	4.0			
Primary balance	3.6	2.5	-0.6	-2.1			
Tax burden	44.0	44.5	44.1	44.0			
One-off and other temporary measures	-0.1	0.0	0.1	0.0			
Structural balance(3)	-1.5	-2.2	-3.2	-4.0			
Structural primary balance	2.3	1.5	0.7	0.0			
Government gross debt	84.0	89.6	95.7	100.9			
Real GDP growth (%)	2.8	1.2	-3.5	-0.2			
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
General government balance	-0.2	-1.2	-3.4	-4.0	-3.4	-2.6	-1.5
Primary balance	3.6	2.5	0.4	-0.1	0.6	1.5	2.5
One-off and other temporary measures	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Structural balance(3)(5)	-1.3	-2.0	-2.4	-2.6	-2.4	-1.9	-1.2
Government gross debt	84.0	89.6	93.0	95.0	94.9	93.9	92.0
Real GDP growth (%)	2.8	1.1	-1.9	0.6	2.3	2.3	2.1

(1) Commission services' spring 2009 economic forecasts.
(2) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in April 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Belgium.

Table V.1.2: **Main budgetary measures for 2009, Belgium**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
• VAT reduction for residential construction (-0.1% of GDP)	• Reduction in the tax wedge on labour through subsidies (0.1% of GDP)
	• Acceleration of payment of invoices (0.1% of GDP)
Other measures	
• Flemish reduction of personal income taxes (-0.2% of GDP)	• Increases in social benefits (0.1% of GDP)
• Federal measures to reduce personal income taxes (-0.1% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and April 2009 update of the stability programme of Belgium.

2. BULGARIA

Recent developments and medium-term prospects

In 2008, the general government surplus in Bulgaria was 1.5% of GDP, against an official target of 3% of GDP set out in the December 2007 update of the convergence programme ([2]). The budgetary under-performance was due to lower than expected revenues and lack of strict expenditure control. The deterioration in revenues reflects the negative impact of the global economic downturn taking hold since the last quarter of 2008 when the GDP growth rate decelerated sharply and the growth composition became less tax intensive. However, discretionary measures, such as the introduction of a 10% flat-rate personal income tax since the beginning of 2008 as well as a significant underperformance in planned EU funds absorption have also led to lower revenue growth. On the expenditure side, discipline has not been fully maintained. Additional social and infrastructure maintenance spending of around 1.8% of GDP was adopted through a supplementary budget in mid-2008. In addition, pensions were increased by more than the statutory rate and budgetary sector wage increases were higher than initially planned. In line with the budgetary surplus, the general government gross debt decreased to 14.1% of GDP from 18.2% of GDP in 2007.

The official target for the general government budget balance in 2009 is a surplus of 1.5% of GDP, as reported in the April 2009 fiscal notification. The target was revised downwards from a surplus of 3% of GDP in the December 2008 update of the convergence programme reflecting the negative impact of the economic crisis on the budget revenue. Still, the revised target is above the Commission services' spring 2009 forecast which expects the general government balance to deteriorate to a deficit of 0.5% of GDP based on a much less favourable macroeconomic scenario. Due to the lack of fiscal room for manoeuvre, as a result of large external and domestic macroeconomic imbalances, the 2009 budget does not foresee any fiscal stimulus measures in response to the economic downturn. Instead, the fiscal policy stance is broadly neutral and geared towards preserving investor confidence and contributing to macroeconomic stability through targeting positive budgetary balances. Hence, to ensure meeting the budgetary target, the so-called '90%' budget execution rule, which was abandoned in 2008, has been re-introduced in the 2009 budget. Under this rule, only 90% of the non-interest budget allocations (excluding social transfers) can be disbursed to the spending units in the course of the year. Given higher risks to the public finances in the current economic juncture, maintaining a budget surplus would require further expenditure cuts beyond the 90% rule, which might prove difficult in a rapidly deteriorating economic environment.

Under a no-policy-change assumption, the Commission services' spring 2009 forecast foresees a general government deficit of 0.3% of GDP in 2010, which is below the latest official projection of a 1.5% of GDP surplus. The difference reflects a less favourable growth scenario, implying a less tax-intensive composition of growth.

In line with the economic slowdown and deteriorating budgetary outcomes, the Commission services' spring 2009 forecast projects the general government gross debt to increase to 16% and just above 17% of GDP in 2009 and 2010, respectively. According to the latest official forecast by the authorities, the debt ratio would increase to almost 17% of GDP this year and then fall to around 15% of GDP next year, based on less favourable nominal GDP projections, while assuming sustained fiscal surpluses. At the same time, debt-increasing stock-flow adjustments due to a further accumulation of net financial assets are envisaged.

([2]) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.2.1: **Budgetary developments 2007-2012, Bulgaria (% of GDP) (1)**

Outturn and forecast(2)	**2007**	**2008**	**2009**	**2010**	
General government balance	0.1	1.5	-0.5	-0.3	
- Total revenues	41.5	39.0	39.0	39.0	
Of which : - taxes on production and imports	18.5	18.0	17.9	17.9	
- current taxes on income, wealth, etc.	6.6	6.5	6.5	6.5	
- social contributions	8.7	8.1	7.9	7.9	
- Total expenditure	41.5	37.4	39.5	39.3	
Of which: - compensation of employees	9.0	9.0	8.9	8.8	
- intermediate consumption	8.0	7.5	7.6	7.4	
- social payments	10.9	10.5	11.1	11.0	
- gross fixed capital formation	4.8	5.6	6.7	7.0	
- interest expenditure	1.0	0.8	0.8	0.8	
Primary balance	1.1	2.4	0.3	0.4	
Tax burden	34.1	33.6	33.3	33.4	
One-off and other temporary measures	-3.3	0.0	0.0	0.0	
Structural balance(3)	2.2	0.4	0.2	1.5	
Structural primary balance	3.2	1.3	1.0	2.2	
Government gross debt	18.2	14.1	16.0	17.3	
Real GDP growth (%)	6.2	6.0	-1.6	-0.1	
Convergence programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	0.1	3.0	3.0	3.0	3.0
Primary balance	1.1	3.9	3.9	3.9	3.9
One-off and other temporary measures	-3.3	0.0	0.0	0.0	0.0
Structural balance(3)(5)	2.9	2.6	3.2	3.6	3.6
Government gross debt	18.2	15.4	15.4	15.3	15.2
Real GDP growth (%)	6.2	6.5	4.7	5.2	5.8

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and convergence programme of Bulgaria.

Table V.2.2: **Main budgetary measures for 2009, Bulgaria**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
	• Limiting the disbursement of non-interest expenditure (excluding social security transfers) to 90% of budgeted allocations in case of a worse-than-budgeted revenue outcome (-2.3% of GDP)
	• Higher capital spending (0.1% of GDP)
Other measures	
• Reduction in the pension social contribution rate by 4% (-0.9% of GDP)	• Increasing pensions from 1 April and further pension indexations from 1 July 2009 (1% of GDP)
• Increase in the mandatory minimum insured income thresholds (0.7% of GDP)	• Increase in allocations for salaries in the budgetary sector by 10% (0.3% of GDP)
• Increase of the healthcare contribution rate by 2% (0.5% of GDP)	
• Increase in excise rates on kerosene, coal, electricity for economic and administrative needs and cigarettes (0.3% of GDP)	
• Increase in property valuations for local property taxes (0.3% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Source: Commission services, December 2008 Convergence Programme, December 2008 Addendum to the Convergence Programme.

3. THE CZECH REPUBLIC

The estimated outturn for the general government balance in 2008 is 1.5% of GDP compared to a target of 1.2% of GDP in the most recent November 2008 update of the convergence programme. The main reason for the slight deviation was a shift in revenues from tobacco excise duty from 2008 to 2007. The debt ratio in 2008 was 29% of GDP.

The target for the general government balance is 2009 is -4.5% of GDP based on the Ministry of Finance's latest April 2009 forecast, compared to a target of -1.6% in the latest November 2008 convergence programme(3). The main reason for the change is a significantly more pessimistic growth outlook. While the convergence programme foresaw modest growth in 2009, the most recent April 2009 forecast predicts that output will contract by 2.3% of GDP. The target of -4.5% of GDP for the general government balance in 2009 compares to a forecast of -4.3% of GDP in 2009 in the Commission services' spring 2009 forecast. The difference partly reflects higher growth in government consumption in the Ministry of Finance's April 2009 forecast. The Czech Republic has adopted two packages of stimulus measures in response to the downturn. The first stimulus package, adopted at the time of the 2009 budget, was mainly focused on cutting social security contributions paid by employees as well as additional spending on infrastructure investment. The second stimulus package, adopted in February 2009, comprises a range of revenue and expenditure measures aimed to support mainly small and medium size enterprises during the downturn. Principally, these include a provision for accelerated write-downs on capital goods, tax reductions on the purchase of small motor vehicles, as well as grants and subsidies. Both stimulus packages also include modest sized capital injections in order to ease credit conditions for SMEs. Both stimulus packages will have an expansionary impact on public finances in 2009. Nearly all the stimulus measures are of a temporary nature and should not interfere with the achievement of medium-term fiscal targets. The exception is the reduction in social security contributions, with a fiscal impact of about -½% of GDP, which in the event of a prolonged downturn may have to be counterbalanced by other measures. The stimulus measures are timely in that the Czech economy already registered negative growth in the fourth quarter of 2008 and is forecast to contract sharply in 2009 due to the impact of the economic crisis, triggered by a steep fall in external demand. In this respect, the reduction in social security contributions will take immediate effect from January 2009 while the impact of expenditure measures will be felt more gradually through the year. The measures taken are appropriately targeted in that they will stimulate domestic demand, partially compensating for the decline in external demand, and provide bridging support for small businesses including easing credit conditions. As a result of the stimulus measures, the fiscal stance in 2009 will be expansionary.

The Commission services spring 2009 forecast projects the general government deficit for 2010 at 4.9% of GDP, derived under the no-policy change assumption. This is significantly above the deficit target of 1.5% of GDP set in the most recent update of the convergence programme and reflects the expectation of only weak growth in 2010 as well as further rises in unemployment, which will put pressure on social and welfare expenditure. In structural terms, the budget is set to be contractionary due to the phase-out of fiscal stimulus measures implemented in 2009.

Government debt is set to rise to about 34% of GDP in 2009 and 38% of GDP in 2010 mainly due to the impact of worsening cyclical factors. The capital injections included in both stimulus packages will have a minor impact on the debt of about 0.1% of GDP.

(3) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.3.1: **Budgetary developments2007-2012, Czech Republic (% of GDP) (1)**

Outturn and forecast(2)	**2007**	**2008**	**2009**	**2010**	
General government balance	-0.6	-1.5	-4.3	-4.9	
- Total revenues	42.0	40.9	41.6	42.7	
Of which : - taxes on production and imports	11.2	11.1	11.4	11.6	
- current taxes on income, wealth, etc.	9.4	8.7	8.7	9.0	
- social contributions	16.3	16.2	16.5	16.7	
- Total expenditure	42.6	42.4	45.9	47.6	
Of which: - compensation of employees	7.6	7.6	8.0	8.0	
- intermediate consumption	6.2	6.1	6.0	6.0	
- social payments	12.9	12.7	14.2	15.1	
- gross fixed capital formation	4.7	4.8	5.4	5.8	
- interest expenditure	1.2	1.1	1.2	1.1	
Primary balance	0.5	-0.3	-3.2	-3.7	
Tax burden	37.0	36.7	37.3	38.0	
One-off and other temporary measures	-0.2	0.0	0.0	0.0	
Structural balance(3)	-2.5	-3.4	-4.0	-3.7	
Structural primary balance	-1.4	-2.3	-2.9	-2.5	
Government gross debt	28.9	29.8	33.7	37.9	
Real GDP growth (%)	6.0	3.2	-2.7	0.3	
Convergence programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	-1.0	-1.2	-1.6	-1.5	-1.2
Primary balance	0.2	0.0	-0.3	-0.4	-0.1
One-off and other temporary measures	-0.3	-0.1	0.0	0.0	0.0
Structural balance(3)(5)	-1.7	-1.9	-1.7	-1.3	-1.1
Government gross debt	28.9	28.8	27.9	26.8	25.5
Real GDP growth (%)	6.6	4.4	3.7	4.4	5.2

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in November 2008.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission Services and convergence programme of Czech Republic

Table V.3.2: **Main budgetary measures for 2009, Czech Republic**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
• Reduced SS contribution (-0.5% of GDP)	• Infrastructure investment (+0.4% of GDP)
• Write-down of capital goods (-0.2% of GDP)	
Other measures	
	• Government Consumption and Wages (-0.6% of GDP)
	• Indexation of pensions (+0.2% of GDP)

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and Czech Ministry of Finance

4. DENMARK

Recent developments and medium-term prospects

The general government recorded a budgetary surplus of 3.6% of GDP in 2008, higher than the target of 3% of GDP indicated in the December 2007 update of the convergence programme. This overachievement is all the more remarkable, as the economic situation in 2008 turned out to be significantly worse than anticipated. While the convergence programme had expected the economy to grow by 1.1%, it actually shrank by as much. Part of the benign budgetary outcome is owed to a more favourable starting position than was thought at the time, and the 2007 surplus has consequently been revised upwards by ¾% of GDP to 4.5% of GDP. Also, certain volatile revenues, e.g. from oil and gas extraction, came out higher than predicted. Unemployment, and hence related expenditure, remained remarkably low and even fell by ½ pp although economic activity slowed down.

The sizable surplus could not, however, prevent a large increase in the general government debt-to-GDP ratio from to 26.8% in 2007 to 33.3% in 2008. The issuing of new 30-year government bonds from November 2008, primarily addressing the needs of the pension sector, implied an equivalent increase in financial assets and liabilities. As only the latter are taken into account in the gross debt ratio, this largely explains the large stock-flow adjustment of around 8% of GDP.

The budgetary situation in 2009 will deteriorate substantially from the surplus registered in 2008. While the December 2008 update of the Danish convergence programme([4]) and the April 2009 fiscal notification foresee a balanced budget, the Commission spring forecast expects a deficit of 1.6% of GDP. The difference between the two is mainly explained by the now outdated growth projections of the Danish government, which foresaw only a mild GDP contraction by 0.2%, while the spring forecast expects a more substantive fall by 3.3% in 2009.

Three factors contribute to the expected budget decline. Most importantly, the economic downturn will activate the very strong automatic stabilisers in Denmark, accounting for roughly half of the change in the budgetary position. This is amplified by the diminishing revenue from volatile sources, such as the fall in oil and gas revenues and falling tax receipts on financial assets. In addition, discretionary policy measures have a sizeable expansionary impact in 2009. The tax adjustments decided in August 2007, will reduce revenues by some 0.5% of GDP. Also, agreements on green transport and municipal investment will add some 0.4% of GDP to expenditures.

While the original motivation of the 2009 tax adjustments precedes the crisis, the measures taken are in line with the European Economic Recovery Plan, as they are timely and, combined with the financial packages, targeted at the segments of the economy most at risk through the crisis. Many of the measures taken are of temporary nature. A number of them, however, such as the tax reductions are not, and could permanently lead to a weaker performance of public finances in so far as employment effects fail to materialise or financing falls short of estimates.

For 2010, the Commission services project a significant widening of the deficit to nearly 4% of GDP under a no-policy change scenario. This is significantly higher than the deficit of 1.2% of GDP foreseen by the Danish convergence programme, which employs a now outdated and too optimistic growth scenario. The most important fiscal development for 2010 is the so-called Spring Package, which is estimated to reduce tax revenues by a further 0.6% of GDP. The deficit figure for 2010 is topped off by a sizeable one-off for the pension yield compensation amounting to about ¾ % of GDP.

Rising deficits combined with stability measures for the domestic financial banks and vulnerable partner countries (Iceland, Latvia) are leading to a rapid increase in gross debt levels from 27 % of

([4]) The programme as well as its assessment by the Commission and by the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.4.1: **Budgetary developments 2007-2015, Denmark (% of GDP) (1)**

Outturn and forecast(2)	2007	2008	2009	2010			
General government balance	4.5	3.6	-1.5	-3.9			
- Total revenues	55.4	55.4	53.4	53.1			
Of which : - taxes on production and imports	17.8	17.4	17.8	18.2			
- current taxes on income, wealth, etc.	29.6	29.6	27.4	26.8			
- social contributions	1.9	1.8	1.9	1.9			
- Total expenditure	50.9	51.8	55.0	57.0			
Of which: - compensation of employees	16.9	17.1	18.3	18.4			
- intermediate consumption	8.9	9.1	9.4	9.4			
- social payments	15.0	14.9	16.5	17.2			
- gross fixed capital formation	1.7	1.8	2.0	2.1			
- interest expenditure	1.5	1.4	1.7	1.6			
Primary balance	6.1	5.0	0.1	-2.3			
Tax burden	48.7	48.4	46.7	46.4			
One-off and other temporary measures	0.0	-0.5	-0.1	-0.6			
Structural balance(3)	3.0	4.2	1.2	-0.4			
Structural primary balance	4.5	5.6	2.9	1.2			
Government gross debt	26.8	33.3	32.5	33.7			
Real GDP growth (%)	1.6	-1.1	-3.3	0.3			
Convergence programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2015**
General government balance	4.5	3.0	0.0	-1.2	0.3	0.1	-0.1
Primary balance	6.1	4.2	1.5	0.2	1.6	1.3	0.7
One-off and other temporary measures	-0.1	-1.0	-1.7	-1.7	-0.2	0.0	0.0
Structural balance(3)(5)	3.7	4.0	2.6	1.7	1.3	0.6	0.2
Government gross debt	26.3	30.3	27.9	26.3	25.4	24.6	22.6
Real GDP growth (%)	1.6	0.2	-0.2	0.7	1.9	1.7	1.6

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure
(2) Commission services' spring 2009 economic forecasts
(3) Cyclically-adjusted balance excluding one-off and other temporary measures
(4) Submitted in December 2008
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme
Source: Commission services and convergence programme of Denmark.

Table V.4.2: **Main budgetary measures for 2009, Denmark**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Tax credit for companies (-0.1% of GDP)	• Building repair and maintenance (0.1% of GDP)
	• Municipal investments (0.1% of GDP)
Other measures	
• Income tax cuts (-0.3% of GDP)	• Green transport infrastructure (0.1% of GDP)

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services, Danish Ministry of Finance.

GDP in 2007 to 34 % in 2010. A major risk to debt developments exists insofar as some of the rather sizeable banking guarantees of the Danish government might be called upon.

5. GERMANY

Recent developments and medium-term prospects

In 2008, Germany registered a close-to-balance position (-0.1% of GDP), which was an improvement on the planned deficit of ½% of GDP foreseen in the end-2007 update of the stability programme. The better-than-expected outcome was driven by substantially higher-than-anticipated revenue growth, in particular from income-related taxes due to higher wage and employment growth. Expenditure was around ¾% of GDP higher than previously expected mainly due to one-off measures related to the bank rescue operations and higher outlays for retirement benefits as a result of *ad hoc* changes in the pension adjustment formula. The debt-to-GDP ratio increased to almost 66% on the back of state guarantees granted to troubled *Landesbanken* (around 2% of GDP) ([5]).

The *Bundesrat* adopted the 2009 federal budget on 19 December 2008 and a supplementary budget on 20 March 2009. A target of a 2.9% of GDP deficit was presented in the December 2008 update of the stability programme ([6]) and confirmed by the German authorities in the April 2009 fiscal notification. The Commission services' spring 2009 forecast projects a deficit of almost 4% of GDP. This mainly reflects a more pessimistic macroeconomic scenario and the extension of the environmental premium adopted in April 2009. The deficit will be mainly fuelled by increased expenditure to automatic stabilisers and fiscal stimulus measures to address the economic crisis. The deterioration of the labour market is expected to lead to lower tax revenues, higher unemployment benefits and higher expenditure on short-time work.

The main measures in the 2009 budget are the elements of a sizeable fiscal stimulus package for 2009 (around 1½% of GDP) and 2010 (around 2% of GDP) adopted in line with the European Economic Recovery Plan (EERP). The package consists of a mix of revenue and expenditure instruments which aim at bolstering private consumption, boosting public and private investment, ensuring access to finance, avoiding lay-offs, improving access to training and which include measures that support the automobile industry. By and large, the allocation of funds corresponds to the areas most affected by the crisis. While some of the instruments are of temporary nature, a substantial part of them will be permanent. Thus, the full reversibility of the short term stimulus measures is not ensured.

However, the German authorities envisage a debt repayment schedule to facilitate the redemption of debt caused by temporary measures from 2010 onwards. They also intend to introduce a new constitutional budgetary rule to limit the structural deficit ([7]), which will be an important anchor to bring about the necessary fiscal consolidation process once the crisis recedes. This is in line with the EERP which also underscores the need for strengthening national budgetary rules and frameworks. Overall, fiscal policy is expansionary in 2009.

For 2010, the December 2008 update of the stability programme targets a deficit of 4% of GDP driven by further discretionary fiscal expansion (around 2% of GDP). Under a no-policy-change scenario, the Commission projects a deficit of almost 6% of GDP. The difference is due to more pessimistic macroeconomic assumptions underlying the Commission forecast.

In the light of higher deficits, lower nominal GDP and financial market stabilisation measures, the Commission services' spring 2009 forecast projects the debt ratio to increase from almost 66% of GDP in 2008 to around 79% of GDP in 2010.

([5]) In 2008, the German authorities have recorded the guarantees given to the troubled *Landesbanken* as debt-increasing, but without any impact on the deficit. These guarantees will only affect the deficit if and when called.

([6]) The programme as well as its assessment by the Commission and the Council, can be found at:http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

([7]) The new rule foresees a structural deficit limit of 0.35% of GDP for the federal government as of 2016 and structurally balanced budgets for the *Länder* governments as of 2020.

Table V.5.1: **Budgetary developments 2007-2012, Germany (% of GDP)**

Outturn and forecast(2)	2007	2008	2009	2010		
General government balance	-0.2	-0.1	-3.9	-5.9		
- Total revenues	44.0	43.8	44.3	43.0		
Of which : - taxes on production and imports	12.6	12.5	13.0	12.8		
- current taxes on income, wealth, etc.	11.2	11.3	10.5	9.6		
- social contributions	16.5	16.4	17.1	16.9		
- Total expenditure	44.2	43.9	48.2	49.0		
Of which: - compensation of employees	6.9	6.9	7.4	7.5		
- intermediate consumption	4.2	4.3	4.6	4.6		
- social payments	17.3	16.9	18.8	19.1		
- gross fixed capital formation	1.5	1.5	1.9	2.0		
- interest expenditure	2.8	2.8	2.9	3.0		
Primary balance	2.6	2.6	-1.0	-2.9		
Tax burden	39.8	39.7	39.7	38.8		
One-off and other temporary measures	-0.3	-0.5	0.1	-0.1		
Structural balance(3)	-1.2	-1.2	-2.4	-3.9		
Structural primary balance	1.6	1.6	0.6	-0.9		
Government gross debt	65.1	65.9	73.4	78.7		
Real GDP growth (%)	2.5	1.3	-5.4	0.3		
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
General government balance	-0.2	-0	-3	-4	-3	-2½
Primary balance	2.6	2½	0	-1	0	½
One-off and other temporary measures	-0.3	-½	0	-0	-0	0
Structural balance(3)(5)	-0.9	-0.8	-2.5	-3.4	-2.4	*-2.1*
Government gross debt	65.1	65½	68½	70½	71½	72½
Real GDP growth (%)	2.5	1.3	-2¼	1¼	1¼	1¼

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in January 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Germany.

Table V.5.2: **Main measures in the budget for 2009, Germany**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Reduction in social contributions rates (-0.3% of GDP)	• Investment, incl. infrastructure (+0.3% of GDP)
• Income support, incl. lower income tax (-0.2% of GDP)	• Environmental premium (+0.2% of GDP)
• Support to private investment, incl. more favourable depreciation rules (-0.1% of GDP)	• Industry support (+0.1% of GDP)
• Re-introduction of commuter allowance (-0.1% of GDP)	• Labour market support (+0.1% of GDP)
Other measures	
	• Higher expenditure on the health-care sector (+0.2% of GDP)

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and the Federal Ministry of Finance.

Debt developments are subject to the risks attached to the deficit and additional risks related to possible further capital injections and potential bank takeovers (with an impact on the debt, though some effect on the deficit cannot be excluded).

Fiscal costs of the crisis and adjustment to economic imbalances

Since 1995, Germany has significantly improved its cost and price competitiveness, mainly through sustained wage moderation coupled with labour shedding. Relying on a technologically strong manufacturing industry and benefiting from a booming world economy and greater exchange rate stability after the creation of the euro area, exports have provided a strong growth impulse. Consequently, the external balance moved into a surplus, mainly owing to growing corporate net saving and significant improvements of the general government fiscal position since 2005.

Due to its high export dependence and specialisation on particularly volatile investment goods, Germany is being hit hard by the current downturn. In the light of the sharp contraction in world trade and the inevitable correction of global economic imbalances, the German economy faces sharp adjustment processes. Given the sustained fall in orders, exports of goods and services are projected to drop by over 16% in 2009. The current account surplus would thus shrink from 6½% of GDP in 2008 to 3½% of GDP in 2009, mainly driven by a narrowing in the trade balance from 7½% of GDP in 2008 to 5% in 2009.

Facing a much worse business outlook, tighter financing conditions, and a plunge in capacity utilisation, companies will further curtail investment, deplete savings and reduce costs. The household saving rate is expected to increase on the back of precautionary motives given the growing risks of unemployment, negative wealth effects and possible Ricardian effects linked with rising budget deficits. Consequently, private consumption is likely to decline. In the light of weak domestic demand, the economic recovery will largely rely on a positive impulse from abroad. While Germany should be well positioned to benefit from a rebound in external demand, its specialisation on investment goods and the sharp drop in global capacity utilisation during the current crisis imply a risk of a fairly protracted recovery.

The deterioration of labour markets and erosion of tax bases across all categories will be reflected in higher fiscal deficits. The expansionary policies to address the crisis will burden the budget further. Even though the fiscal stimulus measures will not be sufficient to prevent a significant contraction of GDP in 2009, they will help soften the downturn. In particular, tax relief measures and higher transfer payments should limit the negative impact of the crisis on households. Higher government consumption and substantial increases in public investment should also act as stabilising factors. Rising fiscal deficits will support domestic demand and thus – via higher demand for imports – contribute to reducing the current account surplus further.

Given the rising deficits and mounting debt, fiscal consolidation will become all the more necessary once the crisis recedes. Importantly, as the additional revenue from higher economic growth might be limited ([8]), the consolidation efforts will likely need to rely on tax increases and/or expenditure cuts. In the latter case, the new budgetary rule would be instrumental.

However, the fiscal consolidation and the expiry of the stimulus could weigh on the economic recovery. Therefore, concrete measures need to be devised to aid budgetary consolidation and at the same time strengthen potential growth and support the economic recovery. Moreover, structural reforms to enhance competition in product markets and to improve the quality of and access to education and training raised within the framework of the Lisbon Strategy, could help limit the impact of the crisis on long-term economic growth and to lay the basis for a sustainable recovery.

([8]) Only some of the stimulus measures have been designed with a view to strengthen long-term growth (e.g. infrastructure, R&D, lower wage costs), which could translate into future return to the public sector in the form of higher revenues from increased economic growth.

6. ESTONIA

Recent developments and medium-term prospects

The general government posted a deficit of 3.0% of GDP in 2008, following six years of budgetary surpluses. The outcome was considerably worse than the surplus target of 1.3% set in the November 2007 convergence programme, due to a sharp revenue contraction mirroring the worse-than-expected decline in economic activity. Despite the adoption of a restrictive supplementary budget in mid-2008, total expenditure increased by close to 20% compared to 2007, worsening the structural balance and implying a significantly counter-cyclical fiscal stance. The debt-to-GDP ratio increased only modestly, however, from 3.5% of GDP as of end-2007 to 4.8%, mainly on account of new borrowing by local governments, since the deficit of the central government was largely financed by running down accumulated surpluses of previous years.

The 2009 budget law was adopted on 10 December 2008 and, according to the December 2008 update of the convergence programme, implied a general government deficit of 1.7% of GDP[9]. However, a steep deterioration in the economic outlook, in particular around the turn of the year, indicated that risks to the budgetary outlook were rapidly building up. With a view to limiting the depletion of reserves, as well as the objective of accession to the euro area, the government and Parliament adopted a series of consolidation measures. A restrictive supplementary budget of above 3% of GDP, mainly lowering planned expenditure, was adopted in February. This was followed in end-April by additional consolidation measures of around 1% of GDP (including a temporary suspension of the state contribution to the mandatory funded pension scheme) affecting both revenue and expenditure. The April 2009 fiscal notification, which took into account the February supplementary budget, revised the 2009 general government deficit target to 2.9% of GDP. The Commission services' spring 2009 forecast, taking into account both the February and April consolidation measures, expects the headline deficit to be maintained at 3.0% of GDP in 2009, against a considerable further deterioration of cyclical conditions. The implied restrictive fiscal stance is in line with the European Economic Recovery Plan agreed in December 2008, facilitating the correction of previously high external and internal imbalances. The authorities have adopted some measures to underpin the economic recovery, without these measures having a significant short-term budgetary impact (most notably the advancement of the adoption of the new Labour Law, frontloading the use of EU structural funds in certain sectors and broader use of state-backed guarantees). The intensified use of EU structural funds will increase both revenue and expenditure levels, without greatly affecting the overall balance.

For 2010, the Commission services' spring 2009 forecast projects a deficit of 3.9% of GDP, assuming unchanged policy. While tax revenue is expected to continue declining, some of the consolidation measures adopted in 2009 will have a positive budgetary impact also in 2010, in particular the temporary suspension of state contributions into the mandatory funded pension scheme. The most recent update of the convergence programme, based on the assumption of a significantly less severe and protracted recession as compared to the Commission services' spring forecast, projected a general government deficit of 1.0% of GDP in 2010.

The Commission services' spring 2009 forecast projects the general government debt-to-GDP ratio to increase from 4.8% in 2008 to 6.8% in 2009 and to 7.8% in 2010. These projections are based on the assumption that the deficit is financed by a combination of gradual running down of accumulated surpluses of previous years (around 8% of GDP as of end-2008) and new borrowing. In the most recent update of the convergence programme the deficit was assumed to be financed solely on account of the accumulated reserves, implying a stabilisation of the debt-to-GDP ratio around 3½% of GDP.

(9) The programme as well as its assessment by the Commission and by the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.6.1: **Budgetary developments 2007-2012, Estonia (% of GDP)**

Outturn and forecast (1)		2007	2008	2009	2010		
General government balance (2)		2.7	-3.0	-3.0	-3.9		
- Total revenues		38.2	37.9	42.0	43.4		
Of which :	- taxes on production and imports	13.8	12.3	12.8	12.9		
	- current taxes on income, wealth, etc.	7.8	8.1	7.6	7.6		
	- social contributions	11.1	12.1	14.0	14.8		
- Total expenditure		35.5	40.9	45.0	47.3		
Of which:	- compensation of employees	10.0	11.5	12.5	13.0		
	- intermediate consumption	6.5	7.2	7.1	6.9		
	- social payments	9.0	10.8	13.1	14.0		
	- gross fixed capital formation	5.4	5.6	6.2	6.8		
	- interest expenditure	0.2	0.2	0.4	0.5		
Primary balance		2.9	-2.7	-2.7	-3.4		
Tax burden		33.0	32.7	34.7	35.6		
One-off and other temporary measures		0.4	0.2	0.6	1.2		
Structural balance (3)		-0.8	-4.1	-1.0	-1.9		
Structural primary balance		-0.7	-3.9	-0.6	-1.4		
Government gross debt		3.5	4.8	6.8	7.8		
Real GDP growth (%)		6.3	-3.6	-10.3	-0.8		
Convergence programme (4)		**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
General government balance		2.7	-1.9	-1.7	-1.0	0.1	0.2
Primary balance		2.9	-1.8	-1.5	-0.8	0.3	0.4
One-off and other temporary measures		0.4	0.2	0.1	0.4	0.1	0.0
Structural balance (3)(5)		-0.1	-2.4	-0.1	0.4	1.2	0.7
Government gross debt		3.5	3.7	3.7	3.5	3.0	2.8
Real GDP growth (%)		6.3	-2.2	-3.5	2.6	4.8	5.0

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and convergence programme of Estonia

Table V.6.2: **Main measures in the budget for 2009, Estonia**

Revenue measures(1)(2)	Expenditure measures(1)(3)
Measures in response to the downturn	
	• Advancement of enforcement of the new Labour Law (+0.2% of GDP)
Other measures	
• Increase in social tax minimum contribution basis (+0.5% of GDP)	• Increase in pensions (+0.6% of GDP)
• Suspension of state contributions to the mandatory funded pension scheme from 01.06.09 (+0.6% of GDP)	
• Increase in unemployment insurance contribution rate (+0.3% of GDP)	

(1) Including supplementary budget of February 2009 and consolidation measures of April 2009.
(2) Estimated impact on general government revenues.
(3) Estimated impact on general government expenditure.
Source: Commission services, convergence programme, Budget Law and other legal acts of Estonia

Macroeconomic imbalances, adjustment and the role of public finances

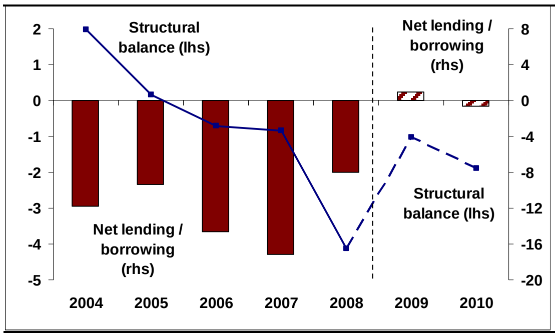
During the period between 2004 and 2007, the Estonian economy experienced the combined positive shock from EU accession and financial deepening. As country risk premia fell and the Estonian banking sector was integrated into major Nordic financial groups, capital inflows amounted to 10-20% of GDP per year. Coupled with optimistic expectations of households, this triggered a credit and real estate boom which resulted in unsustainable domestic-demand-led growth significantly above potential. In the absence of an independent monetary policy, fiscal policy remained one of the few available options to address the overheating of the economy, be it directly through a surplus of government saving over investment, or by anchoring expectations. While neutralising the combined impact of capital inflows and elevated expectations solely through fiscal policy would not have been feasible, a tighter fiscal stance could have mitigated the overheating tendencies of the economy.

The prolonged period of above-potential growth led to an accumulation of sizeable macroeconomic imbalances. Wage growth of around 10% on average between 2000 and 2005 increased further to over 20% in 2007. Wage growth in the public sector was particularly high during the boom years when the labour market situation remained tight, although this followed a period of public sector wages lagging behind those in the private sector. The unemployment rate reached a trough of below 5% in late 2007 and early 2008. The external deficit peaked at just over 17% of GDP in 2007, while core inflation hit its highest point of above 9% in early 2008. High public sector expenditure growth over this period, routine recourse to mid-year supplementary budgets that revised expenditure targets further upwards and structural tax cuts reinforced the overall optimistic expectations of domestic agents. However, part of the windfall revenues was also saved, leading to the accumulation of a central government fiscal buffer of around 11½% of GDP at end-2007.

Though still supported by a favourable external environment, the economy started decelerating in 2007. However, 2008 marked an abrupt reversal of the cycle that was increasingly aggravated by the deepening global financial crisis, with the economy contracting by 3.6% in that year. The turnaround resulted in a rapid decline of the macroeconomic imbalances. The external deficit halved in 2008 compared to the previous year and continued to rapidly decline in the first months of 2009. While headline inflation remained high in 2008 due to world commodity prices and substantial administrative price increases, the ongoing adjustment in prices and domestic costs (wages) is projected to keep inflation below 1% in 2009 and 2010. After an initially slow reaction, the adjustment on the labour market gathered pace in late 2008 and early 2009. Whole-economy wage growth is expected to turn negative in the course of 2009, reversing some of the losses in cost competitiveness accumulated during the boom period. The reversal of excessive wage growth in the public sector proved to be more difficult than in the private sector, but was eventually achieved in consecutive consolidation measures. To facilitate the adjustment on the labour market, the authorities advanced the enforcement of the new Labour Law that makes lay-offs less costly for enterprises, while strengthening the social safety net. However, a rapid increase in unemployment since end-2008 renewed the discussion regarding the financial sustainability of the unemployment insurance, despite an increase in the insurance rate from 0.9% to 3% as from June 2009.

Overall, throughout the years of above-potential growth, fiscal policy fell short of decisevely counteracting the overheating tendencies. Surpluses were nevertheless recorded, preserving some room for policy manoeuvre that has been helpful during the financial crisis. Looking ahead, the planned sharply restrictive fiscal stance in 2009 will avoid the emergence of persistent fiscal imbalances, in particular by bringing the public expenditure and revenue in line with more moderate rates of output growth expected over the medium term. The ability of the state to meet its domestic and external obligations also in the following years will in turn foster the confidence of domestic agents and markets and thus support the recovery of the economy.

Graph V.6.1: **Estonia: Net lending / borrowing (% of GDP) and structural balance (% of GDP)**



Source: Commission services

7. IRELAND

Recent developments and medium-term prospects

The general government deficit reached 7.1% of GDP in 2008, compared to a planned deficit of 0.9% of GDP in the budget for 2008. After a slight surplus of 0.2% in 2007, this significantly worse-than-expected outturn was mainly due to the different macroeconomic scenario (real GDP fell by 2.3% compared to positive growth of 3.0% underlying the budget) and the working of the automatic stabilisers on taxes and unemployment benefits as well as the massive impact of the permanent loss of housing boom related tax revenue. Primary spending was also somewhat higher than targeted although some savings were made in mid-year. General government gross debt reached 43.2% of GDP in 2008, up from 25.0% in 2007. This increase was mainly driven by a very sizeable stock-flow adjustment (9.1 percentage points of GDP, mainly related to the precautionary accumulation of liquid assets) as well as by the large primary deficit.

According to the Commission services' spring 2009 forecast, the deficit is projected to widen further to 12% of GDP in 2009, the highest in the euro area. The deficit target for this year was revised up to 10¾% in the supplementary budget adopted in April 2009, from 9.5% in the January 2009 addendum to the stability programme update([10]) and 6.5% in the October 2008 budget. The projected deterioration of the deficit would take place despite successive consolidation efforts since mid-2008, including the supplementary budget, with an estimated overall net deficit-reducing effect of around 4% of GDP in 2009. The main measures include the introduction of an income levy (estimated yield 0.7% of GDP), the reprioritisation of public investment (1.2% of GDP) and a "pension levy" on public sector wages (0.4% of GDP). In spite of tax-raising measures, current revenue is expected to decrease by over 12%, reflecting the further adjustment in the housing market and the continued fall in economic activity. The projected growth in current expenditure of almost 6% is largely driven by a steep increase in social spending in response to the rapid rise in unemployment and by sharply rising debt service costs. The Commission services' higher deficit forecast compared to the target is mainly due to a more pessimistic economic outlook, including a higher forecast unemployment rate.

As part of a broader consolidation effort, Ireland adopted some measures to support economic activity and to promote structural reforms, in line with the European Economic Recovery Plan. The size of the recovery package is adequate in view of the absence of room for manoeuvre implied by the fiscal deterioration. Direct support to the economy is targeted at the most vulnerable groups and sectors expected to be most affected by the crisis. The measures in response to the crisis were taken in a timely manner. Given that the overall thrust of fiscal policy is consolidation oriented, the measures are of a permanent rather than temporary nature.

Risks to the budgetary targets are related to the short-term economic outlook as well as to contingent liabilities arising from the government's support for the financial sector.

For 2010, the Commission services' spring 2009 forecast projects the deficit to widen to 15½% of GDP on a no-policy-change basis. The difference to the authorities' target of 10¾% of GDP is mainly due to different projections for the 2009 budgetary outcome and the implementation of the no-policy change assumptions, which inter alia implies the non-inclusion of the indications for the budgetary measures for 2010 presented in the April supplementary budget.

The debt ratio should reach 61.2% of GDP in 2009 and almost 80% in 2010, more than three times the value recorded in 2007. This is due to the large primary deficits as well as increasing interest expenditure and falling nominal GDP, while no impact of the government's support measures for

([10]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.7.1: **Budgetary developments 2007-2012, Ireland (% of GDP) (1)**

Outturn and forecast(2)	2007	2008	2009	2010			
General government balance	0.2	-7.1	-12.0	-15.6			
- Total revenues	35.9	33.8	33.7	33.5			
Of which : - taxes on production and imports	13.3	11.9	10.8	10.5			
- current taxes on income, wealth, etc.	12.6	11.1	10.7	10.6			
- social contributions	6.3	6.7	6.9	7.2			
- Total expenditure	35.7	41.0	45.8	49.1			
Of which: - compensation of employees	9.4	10.3	11.1	11.3			
- intermediate consumption	5.3	5.8	5.8	6.2			
- social payments	9.8	11.5	14.8	16.1			
- gross fixed capital formation	4.4	5.4	4.4	4.5			
- interest expenditure	1.0	1.1	2.3	3.2			
Primary balance	1.1	-6.1	-9.8	-12.5			
Tax burden	31.2	28.5	27.8	27.7			
One-off and other temporary measures	0.0	0.0	0.7	0.0			
Structural balance(3)	-1.8	-7.5	-9.8	-12.2			
Structural primary balance	-0.9	-6.4	-7.6	-9.0			
Government gross debt	25.0	43.2	61.2	79.7			
Real GDP growth (%)	6.0	-2.3	-9.0	-2.6			
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
General government balance	0.2	-6.3	-9.5	-9.0	-6.4	-4.8	-3.8
Primary balance	1.2	-5.2	-7.3	-6.4	-3.5	-1.7	-0.7
One-off and other temporary measures	0.2	-0.3	0.0	0.0	0.0	0.0	1.0
Structural balance(3)(5)	-1.7	-6.2	-8.1	-7.4	-5.0	-4.1	-3.1
Government gross debt	24.8	40.6	52.7	62.3	65.7	66.2	67.2
Real GDP growth (%)	6.0	-1.4	-4.0	-0.9	2.3	3.4	4.4

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in January 2009 (addendum to the October 2008 stability programme update).
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Ireland.

Table V.7.2: **Main budgetary measures for 2009, Ireland**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Reduction of stamp duty top rate (-0.1% of GDP)	• Social welfare package (0.3% of GDP)
• Widening of standard rate tax band (-0.1% of GDP)	
Other measures	
• Introduction of income levy (0.7% of GDP)	• Reprioritisation of public investment (-1.2% of GDP)
• Introduction of health levy, change in pay related social insurance (0.5% of GDP)	• Savings in social transfers (-0.3% of GDP)
• Stricter rules for interest related tax relief (0.1% of GDP)	• "Pension levy" on public sector wages (-0.4% of GDP, taking into account tax deductibility)
• Increase in standard VAT rate (0.1% of GDP)	• Reduction in public service payroll (-0.2% of GDP)
• Increase in excise duties (0.3% of GDP)	• Postponement of agreed pay increase (-0.1% of GDP)
• Advancing corporation and capital gains tax payment dates (0.3% of GDP)	• Reduction in overseas development aid (-0.1% of GDP)
• Increase in capital gains tax rate (0.1% of GDP)	
• Transfer of pension fund assets (0.3% of GDP, one-off)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and the budget for 2009 (including July 2008 package, the January 2009 addendum to the stability programme update and the April 2009 supplementary budget).

the financial sector is included in the Commission services' projections.

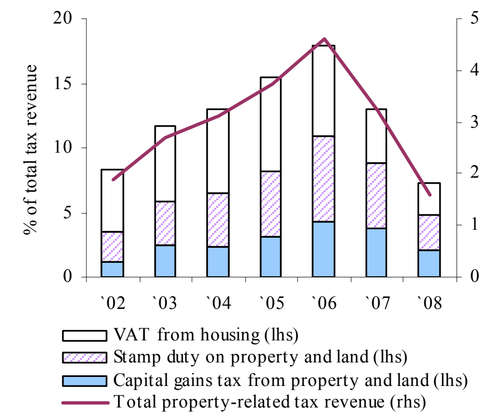
Tax revenue exposure to the property market

While the deterioration in the public finances since 2006 reflects to a large extent the loss of housing-related revenue, the same revenue item also drove the improvement in the fiscal balance witnessed in the preceding years. In particular, following the predominantly export-led growth of the 1990s, domestic demand took over as the main driver of the strong growth rates in the first half of the current decade. The buoyant domestically-driven expansion, led by the construction sector, produced revenue windfalls and a growing general government surplus until 2006, when the housing market peaked. Between 2002 and 2006, general government revenue rose by 3¾ percentage points of GDP and it is estimated that 2¾ percentage points of this increase were directly related to property-related taxes, in particular from the booming housing market. Moreover, buoyancy of other tax categories during that period reflected the overall tax-rich composition of growth as an indirect effect of the property market cycle. Revenue outcomes also reflected some limited discretionary measures ([11]).

Three tax categories are directly related to property transactions: stamp duty on land and property, capital gains tax and value-added tax on new houses. Revenue from these tax categories recorded exceptionally high growth rates during the housing boom period and their share in total tax revenue increased from 8.4% in 2002 to 18% in 2006 ([12]). However, from 2007 the situation quickly turned as the housing cycle receded and the share in total tax receipts in 2008 was below that recorded in 2002. Expressed as a share of GDP, property-related tax revenue is estimated to have decreased from a peak of 4.6% in 2006 to 1.6% of GDP in 2008.

Over the period 2003 to 2006 budgetary outturns were better than planned largely due to revenue windfalls owing to the favourable economic conditions. The overall tax-to-GDP elasticity exceeded its long-term average value. First, individual elasticities relative to the respective tax bases were generally above unity for all major tax categories. Second, individual tax bases (the wage bill, private consumption and investment ([13])) grew very strongly relative to GDP and thus contributed to high tax revenue growth.

Graph V.7.1: **Ireland - property-related tax revenue**



Source: Irish Revenue Commissioners, Department of Finance, Commission services' calculations

However, neither GDP nor revenue levels were sustainable in view of the housing boom. From 2007, with the housing market starting to correct, revenue growth moderated significantly, while expenditure growth rose further, well above the growth rate of nominal GDP. The general government balance deteriorated by some 3 percentage points of GDP in 2007, to a broadly balanced position, and further worsened by some 7 percentage points in 2008 to a deficit not seen in Ireland for 20 years.

([11]) Tax-increasing measures with an estimated effect of 0.6% of GDP on average were taken in 2002 and 2003, while tax-decreasing measures followed and amounted to on average 0.5% of GDP annually from 2005 to 2007 . The estimated effects are taken from the successive budgets and are expressed in cash terms. They do not account for an impact of the budget measures on the economy with changes in consumption and investment patterns leading to additional tax buoyancy.

([12]) The analysis in the paragraph draws mainly on data on a cash basis for central government, for which more detailed information is available.

([13]) The sum of private consumption and gross fixed capital formation is used as a proxy for the tax base for indirect taxation, given the significant share of indirect taxation related to investment.

8. GREECE

Recent developments and medium-term prospects

The general government deficit reached 5% of GDP in 2008 (including 0.4% of GDP deficit-decreasing one-off measures), against an official target of 1.6% of GDP included in the December 2007 update of the stability programme ([14]). The deviation of almost 3½ percentage points of GDP reflects both revenue shortfalls and expenditure overruns. Total revenue was almost 1 percentage point of GDP less than budgeted, due to the lower-than-expected yield of the revenue-enhancing measures implemented in 2008. Expenditure overruns in turn, amounted at around 2¼% of GDP, reflecting primary current expenditure slippages and higher-than-estimated debt-servicing payments. As the impact on the Greek economy of the global economic downturn has been limited the government did not implement any fiscal stimulus and financial sector rescue operations in 2008. The debt-to-GDP ratio increased to 97¾% in 2008, due both to the rise in general government deficit and the slowdown in GDP growth. Stock-flow adjustment remained sizeable, reaching the highest level of the recent years.

Despite the worse-than-expected budgetary outturn in 2008, the deficit target for 2009 remains unchanged at 3.7% of GDP (including a deficit-reducing one-off measures of 0.5% of GDP), as set in the January 2009 update of the stability programme. On account of a less favourable growth scenario and a prudent assessment of the revenue enhancing measures, consistent with past outcomes, the Commission services project a deficit of just above 5% of GDP in 2009. Overall, the fiscal stance is foreseen to be mildly restrictive in 2009. Given the lack of room for fiscal manoeuvre and in view of the large economic imbalances, the Greek government has not adopted a short-term stimulus package in response to the economic slowdown, in line with the EERP. However, a number of fiscal consolidation measures have been undertaken by the Greek authorities. More specifically, the revenue-to-GDP ratio is projected to grow by 1 percentage point of GDP in 2009, on the back of a revenue-enhancing package presented in the stability programme. This package includes higher excise duties on tobacco and alcohol products, an increase in the advance payment rate for enterprises and the introduction of a tax on dividends, capital gains and stock options. On the revenue side, the authorities have also proceeded with the settlement of past years' tax obligations, including the collection of delinquent obligations to the state. Moreover, in March, an additional one-off supplementary tax contribution was decided to be imposed on tax-payers with an annual income above 60.000 euro. Total expenditure in turn, is estimated to decrease by about ¼ of a percentage point of GDP in 2009, stemming from a wide spending-constraining set of measures, including limitations for public sector employment growth, cuts in the public sector's high-level officials' remuneration and a 10% cut in current expenditure. In addition, the Greek government announced a public wages freeze for 2009 and the intensification of efforts to contain primary expenditure.

Under no-policy-change assumption, the Commission services' project the 2010 deficit at 5¾% of GDP. This compares with the revised official target of 2.9% of GDP, from 3.2% of GDP set in the stability programme. The 2010 target is not underpinned with concrete measures.

The Commission services' spring 2009 forecast projects the debt-to-GDP ratio to exceed 103½% in 2009 and rise further to 108% in 2010. These projections are higher than the official targets for both years, due to a less favourable growth projection and more realistic deficit estimations. Apart from the rising deficit and declining GDP, a sizeable stock-flow adjustment contributes to the strong rise in the debt ratio. Additional financial transactions within the framework of the financial sector support package may also put further upward pressure to the debt-to-GDP ratio.

([14]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.8.1: **Budgetary developments 2007-2012, Greece (% of GDP) (1)**

Outturn and forecast(2)		2007	2008	2009	2010	
General government balance		-3.6	-5.0	-5.1	-5.7	
- Total revenues		40.1	39.9	40.2	39.5	
Of which :	- taxes on production and imports	12.2	12.3	12.7	12.6	
	- current taxes on income, wealth, etc.	7.9	7.7	8.1	7.6	
	- social contributions	13.9	14.0	14.2	14.1	
- Total expenditure		43.7	44.9	45.3	45.2	
Of which:	- compensation of employees	11.0	11.2	11.8	11.7	
	- intermediate consumption	5.1	4.6	4.8	4.9	
	- social payments	17.3	18.4	19.1	18.9	
	- gross fixed capital formation	3.0	2.9	3.0	2.8	
	- interest expenditure	4.1	4.4	4.6	4.8	
Primary balance		0.5	-0.7	-0.5	-0.9	
Tax burden		32.0	31.4	32.3	31.6	
One-off and other temporary measures		-0.2	0.4	0.7	0.0	
Structural balance(3)		-4.6	-6.6	-5.8	-4.8	
Structural primary balance		-0.6	-2.3	-1.2	0.0	
Government gross debt		94.8	97.6	103.4	108.0	
Real GDP growth (%)		4.0	2.9	-0.9	0.1	
Stability programme(4)		**2007**	**2008**	**2009**	**2010**	**2011**
General government balance		-3.5	-3.7	-3.7	-3.2	-2.6
Primary balance		0.6	0.3	0.8	1.2	1.7
One-off and other temporary measures		-0.5	0.4	0.5	0.0	0.0
Structural balance(3)(5)		-4.4	-4.5	-4.3	-2.8	-2.2
Government gross debt		94.8	94.6	96.3	96.1	94.7
Real GDP growth (%)		4.0	3.0	1.1	1.6	2.3

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in January 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Greece.

Table V.8.2: **Main budgetary measures for 2009, Greece**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
	• Ad hoc Social Cohesion benefits to low income pensioners and registered unemployed.
	• Ad hoc housing benefit to registered unemployed on mortgage (housing loan taken before 2009)
	• Twofold increase in the Easter bonus for registered unemployed
	All above mentioned measures are financed through the National Fund for Social Cohesion (0.2% of GDP)
Other measures	
• Increase in the excise duties of tobacco and alcohol (0.15% of GDP)	• Restraining public sector employment growth (0.3% of GDP)
• Increase in the advance payment rate for enterprises to 80% from 65% (0.15% of GDP)	• Cuts in the public sector's high-level officials' remuneration (<0.1% of GDP)
• The introduction of a tax rate of 10% on dividends; the same rate holds for capital gains from selling stocks (<0.1% of GDP)	• 10% cut in elastic public expenditure items
• The introduction of a new tax on stock options, in line with rules pertaining to wage income (<0.1% GDP)	• Public wages freezing for 2009 (0.2 of GDP)
• Tax settlement (0.5% of GDP)	
• One-off supplementary tax contribution on tax-payers with annual income above 60.000 euro (>0.1% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services, stability programme of Greece and 2009 Budget Law

9. SPAIN

Recent developments and medium-term prospects

For 2008, the general government deficit reached 3.8% of GDP. This is a much worse budgetary outcome than in 2007 (a surplus of 2.2% of GDP), and well below the target in the 2008 budget law (a surplus of 1¼% of GDP). The deviation from the target is due to both discretionary measures, such as the tax allowance of €400 per taxpayer, and the functioning of automatic stabilisers.

The latest update of the stability programme submitted on 30 January 2009, covering the period 2008-2011, targets a government deficit of 5.8% of GDP in 2009. These figure rest on the programme's assumptions that GDP will decline by 1.6% in 2009. According to the Commission services' spring 2009 economic forecasts, the government deficit is projected to reach 8½% of GDP in 2009. The more marked deterioration in public finances in the Commission service's forecasts results, notably from a significantly sharper contraction of growth in the forecast and a concomitant gloomier labour market outlook. In 2009, all major tax categories are expected to recede, while total expenditure is projected to sharply increase in terms of GDP. The sizeable government deficit is also due to the discretionary measures adopted in response to the economic downturn. Spain has implemented a large fiscal stimulus ([15]), including a package in November 2008 of around 1% of GDP adopted in line with the European Economic Recovery Plan (EERP) and aiming mostly at fostering public investment. Such fiscal expansionary measures are at the base of a clearly expansionary fiscal policy in 2009.

In 2010, the Commission services' spring 2009 forecast estimates the general government deficit at 9¾% of GDP in 2010, based on the customary no-policy-change scenario. These are well below the deficit target of 4.8% in 2010 set out in the January 2009 update of the stability programme. This budgetary target does not appear to be achievable given the deteriorating economic situation and the impact of automatic stabilisers. According to the Commission services' forecasts revenues in 2010 are projected to grow by around 3%, above nominal GDP growth, reflecting mainly the reversal of one-off revenue-decreasing measures of the precedent year. Total expenditure is assumed to grow above nominal GDP, by 5¼%, mainly due to the functioning of automatic stabilisers, especially higher unemployment benefits and, to a less extent, the increased burden of interest payments associated with debt repayments.

The government debt-to-GDP ratio grew (by 2¾ percentage points) to 40.3% in 2008, after a number of years of continued decline. Given the high budgetary deficits and the stagnating nominal GDP growth, debt is projected to continue to rise rapidly by more than 20 percentage points to exceed 62% in 2010.

The economic impact of the Spanish fiscal stimulus measures to withstand the crises

This section aims at assessing the economic impact of the Spanish fiscal stimulus, considering the multipliers of the Commission services' spring 2009 economic forecasts, considering also simultaneous monetary accommodation (Commission services' spring 2009 forecast[16]). Theory suggests that fiscal policies have a relevant role to play in the face of a global recession. In particular, a sizeable fiscal stimulus has the potential to mitigate the downward trend in demand and thus to limit its negative knock-on effects on both investment and employment. In this sense, the Spanish stimulus measures provide a temporary support to economic activity in 2009. Its impact will be also reinforced by the functioning of automatic stabilisers, which will work fully in Spain.

([15]) This fiscal stimulus is explained in more detail in the next section.

([16])Box 1.6.1, Table 1.

Table V.9.1: **Budgetary developments 2007-2011, Spain (% of GDP) (1)**

Outturn and forecast(2)	2007	2008	2009	2010	
General government balance	2.2	-3.8	-8.6	-9.8	
- Total revenues	41.0	36.6	36.6	37.3	
Of which :	11.7	9.8	9.4	10.0	
- current taxes on income, wealth, etc.	12.9	10.7	10.4	10.7	
- social contributions	13.0	13.0	13.0	12.9	
- Total	38.8	40.5	45.2	47.1	
Of which:	10.2	10.7	11.7	12.6	
- intermediate consumption	5.1	5.4	6.0	6.4	
- social payments	11.6	12.3	14.1	15.4	
- gross fixed capital formation	3.8	3.8	4.7	3.7	
- interest expenditure	1.6	1.6	1.6	1.9	
Primary balance	3.8	-2.3	-6.9	-7.8	
Tax burden	37.1	32.8	32.0	32.7	
One-off and other temporary measures	0.0	-0.3	-0.7	0.0	
Structural balance(3)	1.6	-3.9	-6.8	-8.2	
Structural primary balance	3.2	-2.4	-5.2	-6.3	
Government gross debt	36.2	39.5	50.8	62.3	
Real GDP growth (%)	3.7	1.2	-3.2	-1.0	
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	2.2	-3.4	-5.8	-4.8	-3.9
Primary balance	3.8	-1.9	-4.1	-2.9	-1.9
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0
Structural balance(3)(5)	1.6	-3.5	-4.7	-3.4	-2.8
Government gross debt	36.2	39.5	47.3	51.6	53.7
Real GDP growth (%)	3.7	1.2	-1.6	1.2	2.6

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in Jan 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Spain.

Table V.9.2: **Main budgetary measures for 2009, Spain**

Revenue measures(1)	Expenditure measures(2)
• Specific reduction of tax withholdings to taxpayers with mortgages (-0.15% of GDP)	• Central Government Fund for Local Public Investment (+0.72% of GDP)
• Change of the system of VAT returns (-0.56% of GDP)	• Fund to improve certain strategic sectors (Fondo para la dinamización de la economía y el empleo) (+0.27% of GDP)
• Reduction in Personal Income Tax (-0.47% of GDP)	
• Abolition of the wealth tax (-0.21% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and Ministry of Finance.

The Spanish fiscal stimulus has been articulated in four packages: April 2008, August 2008, November 2008, and early 2009 (February/March/April) and amounts to around 3% of GDP in 2009. Overall, the Spanish fiscal stimulus is expected to have a temporary impact on GDP of around 2¼% in 2009, taking into consideration the presence of simultaneous monetary accommodation. However, different types of measures have dissimilar effects on economic activity. Here we analyse the November 2008 package as an example of government investment support and the combined April-August 2008 packages, as an illustration of disposable income supporting measures. These are the main fiscal stimulus packages adopted in by the Spanish authorities.

Table V.9.3: **GDP effects of fiscal measures**

Fiscal measure	M Permanent stimulus	Permanent stimulus	M Temporary stimulus (one year)	Temporary stimulus (one year)	M Temporary with monetary accommodation*	Temporary with monetary accommodation*
Investment subsidy	0.46	0.02	1.37	0.07	2.19	0.11
Government investment	0.84	0.77	1.07	0.98	1.40	1.29
Government consumption	0.36	0.01	0.99	0.04	1.40	0.06
Consumption tax	0.37	0.28	0.67	0.52	0.99	0.76
Government transfers	0.22	0.02	0.55	0.04	0.78	0.05
Labour tax	0.48	0.00	0.53	0.01	0.68	0.01
Corporate profit tax	0.32	0.35	0.03	0.03	0.05	0.06

Notes: M stands for multiplier
GDP percentage difference from baseline for global shocks of 1% of (baseline) GDP, assuming long run financing through labour tax increases.
* Unchanged nominal interest rates for 1 year.
Source: Commission services

First, the November 2008 package, the largest stimulus package in Spain, awards particular priority to measures aimed at expanding infrastructure and other productive investment, which are likely to have a significant impact on the Spanish economy. The DGSE models ([17]) and other empirical research have found that public investment has relatively strong short-run as well as long-run effects on the economy ([18]). These models find a short-run fiscal multiplier of public investment slightly larger than 1 in the first year. In the current economic crisis, the effect of public infrastructure on productive public inputs with immediate demand-side effects is particularly needed in the short run, while it can also increase the productivity of the economy in the medium to long run. Moreover, the composition of this stimulus and its focus on local government investment projects seems to be very favourable to domestic production and employment as its imported content is likely to be very limited. The November package is expected to have a temporary impact on GDP of below 1½%.

Nevertheless, not all measures appear to be equally effective or well targeted. The April and August 2008 stimulus packages focused on income support measures and included tax cuts of over 1 pp of GDP in total. These two packages are expected to have a more limited impact and simulations point to a temporary impact on GDP of slightly below ¾%.

These effects on GDP growth are calculated using multipliers simulated for the EU. However, in the case of Spain these effects on GDP could be more moderate due to potentially smaller multipliers, particularly in the case of income support measures (packages of April and August 2008). The high indebtedness of the Spanish economy could be triggering a more acute process of deleveraging than in other countries in the euro area. The result is that the measures may be less effective because instead of fully boosting consumption or private investment, they would increase the saving rate in a context of credit restrictions, high unemployment and high current account and budget deficits.

([17]) Ratto M., W. Roeger and J. in 't Veld (2008): "QUEST III: an estimated DSGE model of the euro area with fiscal and monetary policy", European Economy, Economic Papers. July N° 353. European Commission. Brussels.

([18]) See for instance: Aschauer, D. (1989), 'Is public expenditure productive?', *Journal of Monetary Economics*, 23, pp 177–200; or Giordano, R, S. Momigliano, S. Neri, and R. Perotti (2007), 'The effects of fiscal policy in Italy: Evidence from a VAR model', *European Journal of Political Economy*, 23(3), pp 707-733.

10. FRANCE

Recent developments and medium-term prospects

The French authorities set out a deficit target of 3.4% in the April 2009 fiscal notification, which compares with the initial target of 2.3% in the 2007 update of the stability programme. This gap of around 1% of GDP can be largely explained by a worse-than-anticipated outcome in 2007 mainly due to lower than expected revenue (0.3 pp) and a markedly weaker growth in 2008 than anticipated (0.7% according to the notification and 2-2.5% in the 2007 update of the stability programme), lowering tax revenue compared to plan (0.5 pp). Public debt increased in 2008 to 68% of GDP, from 63.8% in 2007. In the context of the financial crisis, the government established two funds that increased debt by almost 1½% of GDP: one was established to subordinate bank debt issues without acquiring voting rights and the other to guarantee bank debt.

The latest update of the stability programme of December 2008 ([19]) projected public deficit at 3.9% of GDP in 2009 based on a growth assumption of +0.5%. On account of a new growth projection (-1.5%), the deficit would reach 5.6% of GDP in 2009, as announced by the Government in March, including the almost 1% of GDP budgetary impact of the measures in response to the economic crisis. Adopted measures encompass public investment, labour market, support to firms and support to household purchasing power. They are in line with the European Economic Recovery Plan, as they are targeted, timely, and temporary, therefore reversible, with no costs for public finances beyond 2010. Apart from the measures in response to the economic crisis, those included in the 2009 Budget Law are broadly neutral, as they refer, for example, to a new tax on capital gains, which would offset the cost of the new minimum income aimed at making work pay (*Revenu de Solidarité Active*). Risks to the official target stem mainly from a likely worse growth outcome in 2009 than expected by the Government, which still projects growth at -1.5%. The official target of a 5.6% of GDP deficit substantially differs from the 6.6% of GDP deficit projection in the Commission services' spring forecast. The forecast includes all the previously mentioned measures, and is based on a -3.0% growth for 2009. In this context, expenditure would rise sharply (from 52.7% of GDP in 2008 to 55.6% of GDP in 2009), in line with deteriorating labour market conditions, and tax revenue would decrease significantly (from 49.3% of GDP in 2008 to 49% in 2009). Specifically, on top of normal functioning of automatic stabilisers, revenues could suffer from the decline in asset prices weighing on corporate and real estate transaction taxes (see next section).

The French authorities set a deficit target for 2010 of 2.7% of GDP in the latest update of the stability programme. This target was revised twice to eventually reach 5.2% of GDP, on account of a new growth projection for 2010 (+1.0%, instead of +2.0% in the latest update of the stability programme) and of a base effect stemming from a revision of the deficit forecast for 2008 and 2009. Under the customary no-policy-change assumption, the Commission forecasts a further deterioration in the general government deficit to 7% of GDP in 2010. The phasing-out of the recovery plan in 2010 would have a positive impact on the expenditure-to-GDP ratio, but it would be more than offset by the impact of the normal functioning of automatic stabilisers.

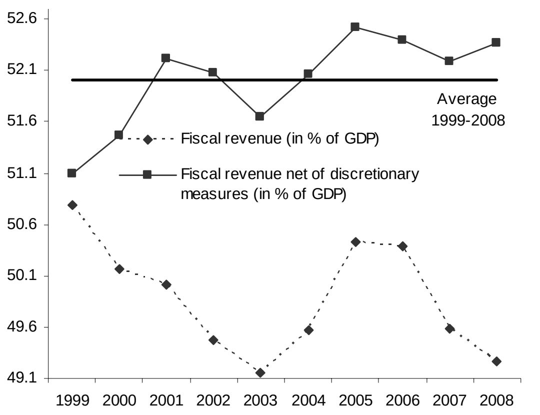
The debt ratio in the Commission services ' spring forecast is expected to increase sharply in 2009, when it would almost reach 80% of GDP; it would further increase in 2010 to reach 86% of GDP. These figures compare with official targets set out at 74% of GDP for 2009 and 77½% of GDP for 2010, which do not include the impact of the liabilities stemming from the SFEF (*Société de Financement de l'Economie Française*), a scheme to improve the liquidity of the banks. Risks to debt developments are mainly linked to snow-ball effects from higher than anticipated deficits, as well as to potential additional capital injections.

([19]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Asset prices and the evolution of fiscal revenue

Between 2004 and 2008 and coinciding with a substantial increase of equity and real estate prices, revenues, net of discretionary measures, have recorded an average GDP-share of around ¼ pp. above their 10-year average. This contrasts with the declining path of the revenue ratio since 2006, and shows the strong dynamism of tax revenues over the past 5 years.

Graph V.10.1: **Fiscal revenue and fiscal revenue net of discretionary measures (in % of GDP)**



Source: Commission services.

Specifically, corporate tax and other current taxes on income and wealth have been particularly robust: together, they increased from 5.9% of total fiscal revenue in 2003 to 7.8% in 2007.

The sharp increase in corporate taxes over the past five years is linked to the unusually high profits, notably of the financial sector, which accounts for around ¼ of total corporate tax. Other current taxes on income and wealth rely on financial and housing assets; the value of those investments has increased markedly from 2004 to the end of 2008. If we consider the CAC40 index as a proxy for equity prices, this index has increased by around 47% from 2004 to 2007; over the same period, housing prices have increased by around 33%.

A quantitative estimate of the impact on public revenue of the recent and rapid deterioration of equity markets as well as the decline in housing prices can be found in a recent paper from Morris and Schucknecht (2007)[20]. Asset price elasticities to fiscal revenue are obtained by regressing tax revenues for four tax categories. Table V.10.1 presents the sensitivities for France. Specifically, asset prices are expected to notably impact corporate tax, especially through the housing market.

Table V.10.1: **Increase in revenue (in % of GDP) given a 10% increase in equity and real estate prices**

		Coefficient
Direct taxes on corporations	Equity prices	0.07
	Housing prices	0.16
Direct taxes on households	Equity prices	0.04
	Housing prices	0
Indirect taxes	Equity prices	0
	Housing prices	0
Taxes on financial transactions	Equity prices	0.01
	Housing prices	0.05
Total	Equity prices	0.12
	Housing prices	0.21
Grand total		0.33

Source: Commission services.

These elasticities can be used to calculate the impact on fiscal revenue of equity and real estate price increases between 2004 and 2007, *i.e.* during the asset price boom. A preliminary estimate would point to an overall increase of around 1¼% of GDP, from which almost 1% of GDP would correspond to corporate tax and the rest equally shared by taxes on financial transactions and direct taxes on households. In this vein, it cannot be discarded that part of tax revenues, considered initially as permanent, turn out to be of a temporary nature in the end.

Therefore, the fiscal revenue ratio might decrease in line with the correction of asset prices, implying that, in a context in which public finances will have to be brought back to a sustainable path, expenditure restraint would represent the adequate consolidation strategy.

([20]) Morris, R., and L. Schuknecht, 'Structural balances and revenue windfalls: the role of asset prices revisited', Working Paper Series, ECB, March 2007

Table V.10.2: **Budgetary developments 2007-2013, France (% of GDP)**

Outturn and forecast(1)	2007	2008	2009	2010		
General government balance(2)	-2.7	-3.4	-6.6	-7.0		
- Total revenues	49.6	49.3	49.0	49.3		
Of which : - taxes on production and imports	15.1	14.8	14.7	14.9		
- current taxes on income, wealth, etc.	11.4	11.4	11.0	11.1		
- social contributions	18.0	17.9	18.1	18.0		
- Total expenditure	52.3	52.7	55.6	56.4		
Of which: - compensation of employees	12.8	12.7	13.2	13.3		
- intermediate consumption	5.0	5.0	5.2	5.3		
- social payments	17.4	17.6	18.9	19.1		
- gross fixed capital formation	3.3	3.2	3.5	3.5		
- interest expenditure	2.7	2.8	2.8	3.1		
Primary balance	0.0	-0.6	-3.8	-4.0		
Tax burden	43.2	42.7	42.4	42.6		
One-off and other temporary measures	0.1	0.1	0.0	0.0		
Structural balance(3)	-3.9	-4.3	-5.5	-5.5		
Structural primary balance	-1.2	-1.5	-2.7	-2.5		
Government gross debt	63.8	68.0	79.7	86.0		
Real GDP growth (%)	2.2	0.7	-3.0	-0.2		
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
General government balance	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
Primary balance	0.1	0.0	-1.1	0.1	0.9	1.7
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0
Structural balance(3)(5)	-2.9	-2.6	-3.0	-1.9	-1.4	-0.9
Government gross debt	63.9	66.7	69.1	69.4	68.5	66.8
Real GDP growth (%)	2.2	1.0	0.2-0.5	2.0	2.5	2.5

(1) Commission services' spring 2009 economic forecasts.
(2) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of France.

Table V.10.3: **Main budgetary measures for 2009, France**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Acceleration of government payments to corporations (-0.3% of GDP)	• Sectoral aid for housing and automobile industry (0.1% of GDP)
	• Social measure in favour of the low income households (0.1% of GDP)
	• Additional public investment (-0.3% of GDP)
Other measures	
• Increase of the tax on the turnover of complementary insurance and on pharmaceutical companies (0.1% of GDP)	• Making work pay measure (Revenu de Solidarité Active) (0.1% of GDP)
• New tax on capital gains (0.1% of GDP)	
• Fiscal package (-0.1% of GDP)	
• Change in the dividend taxation (-0.1% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditures.
Source: Commission services and Budget Law.

11. ITALY

Recent developments and medium-term prospects

The general government deficit increased to 2.7% of GDP in 2008, from 1.5% in 2007. In spite of a positive base effect, the deficit target set in the November 2007 update of the stability programme, at 2.2% of GDP, was not met. This was due to both the adverse economic developments and the execution of various discretionary measures. The revenue ratio fell by nearly ½ of a percentage point of GDP. A still healthy growth of direct taxes and social contributions, supported by the rise in employment and wages, was offset by a substantial fall of indirect taxes, partly due to the abolition of the tax on primary residential property and the cut of the labour tax wedge. Primary expenditure growth largely outpaced the slower nominal GDP growth. In particular, a sizeable increase in compensation of employees and intermediate consumption pushed current spending up, whereas capital expenditure dropped. Higher interest rates entailed increased debt servicing costs. The structural balance decreased by ½ percentage point of GDP relative to 2007. The gross debt ratio increased by 2.3 percentage points of GDP in 2008, to just below 106%, also reflecting the precautionary accumulation of liquid assets held with the Bank of Italy at the end of the year.

In the summer 2008 the government adopted a three-year fiscal package – later confirmed by the 2009 Budget Law – planning an expenditure-based budgetary consolidation over the period 2009-2011. The February 2009 update of the stability programme([21]) restated the pledge to fiscal consolidation by broadly confirming the medium-term projections for individual spending categories and the measures for their achievement, with some deviations from the original yearly targets stemming from the actions put in place to respond to the economic crisis, in the context of the European Economic Recovery Plan.

On the back of a deeper contraction of real GDP than assumed in the stability programme (-4.4% instead of -2%), the Commission services' spring 2009 forecast anticipates the headline deficit to increase to 4½% of GDP in 2009. Revenues are set to decline in response to the downturn. The Commission services expect direct taxes paid by corporations to be driven down by falling profits, while social contributions would decrease in line with the reduction in the total wage bill. Indirect taxes are expected to decline by more than nominal consumption, in particular due to a further shift away from more tax-intensive durable goods consumption. Conversely, personal income taxes would increase marginally relative to 2008, also on the back of the growth of pensions indexed to the high inflation recorded in 2008. Because the downturn is driven by relatively less tax-rich components, such as exports and investment, and given the impact of the discretionary measures, the decline in nominal GDP will outpace that of revenues, resulting in an increasing revenue-to-GDP ratio. The primary expenditure ratio is forecast to increase by around 3 percentage points of GDP relative to 2008, as significant spending increases combine with a declining nominal GDP. The income-support recovery measures, together with the budgeted spending, would entail a 3½% annual rise in current primary expenditure. In addition, the announced acceleration in public investment, the repurchase of some previously securitised real estate and the incentives for energy-efficient durable goods are expected to generate a significant increase in capital spending. The government balance in structural terms is expected to improve by around ¾ of a percentage point of GDP in 2009 compared with 2008. As this improvement is mainly due to lower interest expenditure, the fiscal stance planned for 2009 appears broadly neutral.

In a context of economic stagnation and under the usual no-policy-change assumption, the spring 2009 forecast projects a further increase in the overall deficit in 2010, to around 4¾% of GDP. This is the result of the additional fall in taxes paid by companies and higher servicing cost of debt.

([21]) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.11.1: **Budgetary developments 2007-2011, Italy (% of GDP) (1)**

Outturn and forecast(2)	2007	2008	2009	2010	
General government balance	-1.5	-2.7	-4.5	-4.8	
- Total revenues	46.4	46.0	46.7	46.3	
Of which : - taxes on production and imports	14.7	13.7	13.8	13.7	
- current taxes on income, wealth, etc.	15.1	15.4	15.5	15.1	
- social contributions	13.3	13.7	13.9	13.8	
- Total expenditure	47.9	48.8	51.2	51.1	
Of which: - compensation of employees	10.6	10.9	11.4	11.3	
- intermediate consumption	5.2	5.4	5.6	5.6	
- social payments	17.1	17.7	19.1	19.1	
- gross fixed capital formation	2.3	2.2	2.5	2.4	
- interest expenditure	5.0	5.1	4.7	4.8	
Primary balance	3.5	2.4	0.2	0.1	
Tax burden	43.1	42.8	43.3	42.8	
One-off and other temporary measures	0.1	0.2	0.0	0.1	
Structural balance(3)	-2.9	-3.4	-2.6	-2.8	
Structural primary balance	2.1	1.8	2.0	2.0	
Government gross debt	103.5	105.8	113.0	116.1	
Real GDP growth (%)	*1.6*	*-1.0*	*-4.4*	*0.1*	
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	-1.6	-2.6	-3.7	-3.3	-2.9
Primary balance	3.4	2.5	1.3	1.9	2.6
One-off and other temporary measures	0.1	0.2	0.1	0.1	0.1
Structural balance(3)(5)	-2.5	-2.9	-2.7	-2.0	-1.7
Government gross debt	104.1	105.9	110.5	112.0	111.6
Real GDP growth (%)	*1.5*	*-0.6*	*-2.0*	*0.3*	*1.0*

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in February 2009
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Italy.

Table V.11.2: **Main budgetary measures for 2009, Italy**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Corporate income tax relief (-0.1% of GDP)	• One-off income support to households (+0.2% of GDP)
• One-off tax on revaluation of company assets (+0.2% of GDP)	
• Intensified fighting of tax evasion/avoidance (+0.1% of GDP)	
Other measures	
• Taxes on energy/banking/insurance sectors (+0.3% of GDP)	• Rationalisation of government resources (-0.3% of GDP)

(1) Estimated impact on general government revenue.
(2) Estimated impact on general government expenditure.
Source: Commission services and Ministry of the Economy and Finance

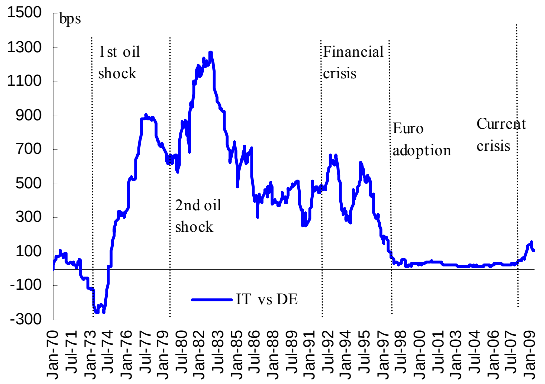
The lower nominal GDP level and the eroded primary surplus will weigh on the government debt ratio, which is forecast to increase to around 116% of GDP by 2010.

The Commission services' spring forecast is broadly in line with the new economic and budgetary projections released by the government on 2 May 2009. Slightly higher interest expenditure in the latter explains a marginally higher deficit ratio in 2009. For 2010, the government projects less dynamic primary expenditure growth and a faster recovery in revenue growth, resulting in an unchanged deficit ratio compared to 2009.

Italy's public debt amid increased risk aversion

The global financial crisis has led to increased risk aversion in financial markets, highlighting the vulnerability of the Italian economy stemming from the very high public debt. The spread between yields paid on Italian and German bonds has widened by more than in most other euro area countries. For 10-year bonds, this differential reached a peak of around 170 bps in January 2009, from an average of 25 bps over 1999-2007, to then fall partially back to around 90-100 bps in May 2009. Although substantial, this is well short of the spreads recorded before the monetary union, when they incorporated exchange risk premia (Graph V.11.1). The government's prudent fiscal response to the downturn, together with the relative soundness of the banking system, may also have contributed to containing the perception of Italy's fiscal risk by financial markets.

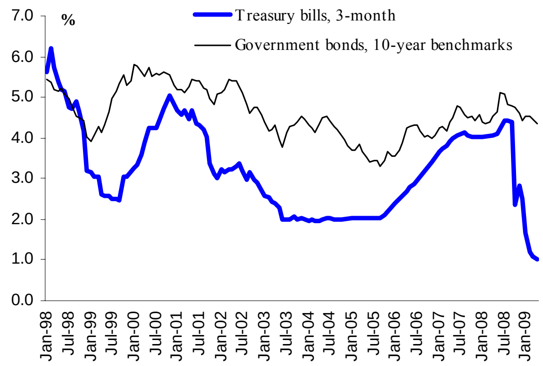
Graph V.11.1: **Spread 10-year government bond yield**



Source: EcoWin

While persistently large spreads will raise the cost of the debt service in the long term, so far their impact on government interest expenditure has been limited. This is because the wider spreads are the result of a significant drop in long-term yields on German bonds, while yields on Italian bonds have remained broadly stable since mid-2008. Short-term yields are even substantially lower than last year, implying a lower service cost of the debt in 2009 compared with 2008 (Graph V.11.2). In addition, careful debt management by the Treasury, explicitly aimed at raising the overall average maturity of the public debt and increasing the liquidity of Italian government bonds in the securities' market after the financial crisis in 1992/1993, has allowed successful public debt auctions even in the recent months. This is reassuring, in particular given the large volume of sovereign issuances anticipated at the global level and the fact that foreign investors represent more than half of the total investors in Italian government securities.

Graph V.11.2: **Interest rates on Italian securities**



Source: EcoWin

A lesson learned from the current crisis is that looking at financial stock variables - that is, assets and liabilities - in a country's sectoral and aggregate balance sheets provides a more complete picture of its systemic vulnerability than looking at public debt alone (Table V.11.3). Despite the high government debt, which reflects the accumulation of government deficits in the past, the balance sheet of the Italian economy shows a broadly balanced position *vis-à-vis* the rest of the world, which in turn reflects overall positive trade balances of goods and services over the past decades.

Table V.11.3: **Net financial assets (stocks - % of GDP)**

	1997	2002	2007	Q3 2008
General government	-104.5	-100.3	-91.7	-92.1
Households and NPISH	183.4	201.2	197.1	175.5
Financial corporations	3.4	-2.9	-4.2	-0.3
Non-financial corporations	-82.0	-102.2	-100.5	-88.6
Total economy	0.3	-4.1	0.7	-5.5

Source: Bank of Italy - Financial accounts

The absence of major external imbalances is the mirror image of the relatively sound financial position of the private sector. In particular, households have relatively low indebtedness and continue to accumulate sizeable savings. This might in part reflect precautionary savings due to the persistently fragile situation of the Italian public finances. Still, the internal imbalances created by the very high public debt do affect Italy's financial vulnerability and may lead to a relatively high cost of capital for the entire economy, thus weighing on its growth potential.

12. CYPRUS

Recent developments and medium-term prospects

The general government surplus is estimated to have fallen to 1% in 2008 from 3.4% of GDP in 2007, which compares with a target of 0.5% of GDP set in the December 2007 stability programme of Cyprus ([22]). The better-than-expected outcome reflects higher than expected revenue, lower interest payments and a positive base effect from 2007, when the final budget surplus rose to 3.4% of GDP compared to an anticipated outcome of 1.5%. No one-off or other temporary measures were implemented. The general government debt ratio in 2008 declined by about 10¼ percentage points of GDP to around 49¼% of GDP, benefiting largely from the planned reduction of deposits with the central bank (sinking funds), a primary surplus and a positive growth effect.

According to the most recent update of the Stability Programme, submitted on 13 February 2009, the budgetary target for 2009 is a deficit of 0.8% of GDP. (23) Compared with the surplus of 1% of GDP targeted in the 2009 budget law (approved by the Parliament on 18 December 2008), it represents a downward revision by 1¾ percentage points of GDP. This is explained by a downward revision of total revenue projections, consistent with slower growth prospects. Specifically, the revenue-to-GDP ratio is set to decline in 2009 compared with the outturn of 2008, mainly due to subdued activity in the real estate sector and reduced corporate profitability. No one-off measures are planned. Public expenditure is expected to increase only slightly, as higher social transfers are offset by savings in interest payments. Overall, the stance of fiscal policy will be expansionary in 2009, in line with the EERP. The budgetary outcomes are subject to downside risks. In particular, the macroeconomic scenario projected in the update appears to be based on favourable growth assumptions throughout the programme period. On the revenue side, risks are higher than in previous years and are associated with a possible sharper contraction and rebalancing of economic growth towards a less-tax rich composition of growth. In view of the expected economic slowdown and the pressure to stimulate domestic demand through increased public expenditure, the risks of potential overruns are non negligible. The evolution of the debt ratio may be less favourable than projected in the update, given the risks to the macroeconomic scenario and the budgetary targets. Also, the rapidly decreasing primary surplus, coupled with measures to support the financial sector, may put upward pressure on the debt ratio.

The Commission services spring 2009 forecast projects a higher fiscal deficit, of almost 2% of GDP, in line with a slower GDP growth scenario. This projection takes into account additional revenues from the recently adopted pension reform and an extra-budgetary package of social expenditure measures. In structural terms, the worsening in 2009 is expected to be about 2¼ percentage points of GDP. The structural balance points to a significant deviation from the MTO, defined as a balanced budget in structural terms. The projected increase of the fiscal deficit is mainly explained by an increase in current primary expenditure, in particular social payments and wages.

For 2010, based on the customary no-policy-change assumption, the Commission services spring 2008 forecast projects the deficit to edge up, due to an increase in current primary expenditure. Also the debt-to-GDP ratio is forecast to increase slightly, contrary to the downward path foreseen in the Stability Programme update.

([22]) http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2

([23]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.12.1: **Budgetary developments 2007-2012, Cyprus (% of GDP) (1)**

Outturn and forecast(2)		**2007**	**2008**	**2009**	**2010**		
General government balance		3.4	0.9	-1.9	-2.6		
- Total revenues		46.4	44.9	42.5	42.4		
Of which :	- taxes on production and imports	19.7	18.7	17.6	17.6		
	- current taxes on income, wealth, etc.	14.0	13.1	11.4	11.4		
	- social contributions	7.7	8.3	8.7	8.7		
- Total expenditure		42.9	44.0	44.4	45.0		
Of which:	- compensation of employees	14.5	14.3	14.6	14.6		
	- intermediate consumption	5.1	5.3	5.5	5.6		
	- social payments	11.6	12.5	13.0	13.5		
	- gross fixed capital formation	3.0	3.0	3.0	3.0		
	- interest expenditure	3.1	2.9	2.3	2.2		
Primary balance		6.5	3.8	0.4	-0.4		
Tax burden		40.6	39.4	37.1	37.1		
One-off and other temporary measures		0.0	0.0	0.0	0.0		
Structural balance(3)		2.8	0.3	-1.9	-2.1		
Structural primary balance		5.9	3.2	0.4	0.1		
Government gross debt		59.4	49.1	47.5	47.9		
Real GDP growth (%)		4.4	3.7	0.3	0.7		
Stability programme(4)		**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
General government balance		3.4	1	-0.8	-1.4	-1.9	-2.2
Primary balance		6.5	3.9	1.5	0.8	0.2	-0.2
One-off and other temporary measures		0	0	0	0	0	0
Structural balance(3)(5)		3.4	0.7	-0.8	-1.2	-1.7	*-2.1*
Government gross debt		59.4	49.3	46.8	45.4	44.2	44.2
Real GDP growth (%)		4.4	3.8	2.1	2.4	3	3.2

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in January 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Cyprus.

Table V.12.2: **Main budgetary measures for 2009, Cyprus**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
• Reduction of landing fees at airports levied on airline companies and cancelation of overnight stay fees levied by local authorities on hoteliers for the period 1.4.2009 - 31.12.2009 (-0.12% of GDP)	• Boosting tourism promotion and encouraging domestic tourism (0.13% of GDP)
• Application of the reduced VAT rate on hotel accommodation of 5% instead of 8% for the period 1.5.2009 - 30.04.2010 (<0.1% of GDP, the impact in 2009)	• Increase of public infrastructure investments (1.2% of GDP)
Other measures	
• Increase of the excise duty on petrol, due to the expiration of the transitional period granted upon EU accession (0.15% of GDP)	• Compensating measures offsetting the impact of the increase on the excise duty on petrol. (0.15% of GDP)
• No dividend income from semi-governmental organisations (-0.5% of GDP)	• Application of the minimum VAT rate on building land (<0.1% GDP)
• Reduction of the corporate tax rate for the semi-governmental organisations from 25% to 10% to harmonise it with the one applied to private enterprises (-0.2% of GDP)	
• Withholding tax on interest earned by the Social Security Funds will be reduced from 10% to 3%, bringing it in line with the tax levied on other pension funds. Due to consolidation reasons, this measure has no fiscal impact.	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and 2009 Budget Law.

13. LATVIA

Recent developments and medium-term prospects

According to the April 2009 EDP notification, the general government deficit was 4.0% of GDP in 2008. This is a far weaker outturn than the target surplus of 0.7% of GDP set in the initial budget and weaker than the 3.5% of GDP deficit projected in the convergence programme update submitted in January 2009. This reflects a significantly worsened economic environment, a sharp contraction of tax revenues and substantially higher-than-budgeted expenditures, including an increase in social transfers. The debt-to-GDP ratio increased to 19.5% in 2008 from 9.0% in 2007, mainly as a result of bail-out financing to the largest domestic bank (Parex Banka).

An initial, very expansionary budget for 2009 was adopted in November 2008 but prior to implementation was replaced by the outline budget law adopted on 12 December 2008 as an integral part of the government's economic stabilisation programme, following Latvia's request for international financial assistance. This revised the target general government deficit to 5.3% of GDP[24]. Major consolidation measures comprised tax reforms, public sector wage cuts and procurement reductions, while maintaining core social protection and EU-supported project spending. However, VAT increases implemented in early 2009 failed to bring the expected results and public spending in the first months of 2009 was well above corresponding 2008 levels. In particular, social transfers increased significantly due to generous pension increases in 2008. Public finances are thus set to deteriorate significantly more in 2009 than assumed in the budget forecast, mainly due to the weaker macroeconomic context, but also due to higher discretionary expenditure. According to the Commission services' spring forecast, without further measures, the general government deficit could exceed 11% of GDP.

In response to these trends, the government is expected to propose additional fiscal consolidation measures, with an objective, endorsed by Latvia's international lenders, being to achieve well-grounded structural consolidation measures. Based on these, a supplementary budget is expected to be adopted by the parliament in June.

The European Economic Recovery Plan called for a differentiated approach to fiscal support measures. As a country facing significant external and internal imbalances, Latvia is focusing its budgetary policy at correcting such imbalances through fiscal consolidation. The main goal of the medium-term budgetary strategy is to fulfil Maastricht budgetary criteria in 2011, with planned general government deficits remaining around 5% of GDP in 2010 but falling below 3% in 2011.

The authorities have proposed some measures to support economic activity without a significant short-term budgetary impact, most notably frontloading use of EU structural funds in certain sectors and broader use of state-backed guarantees. The intensified use of EU structural funds will increase revenue and expenditure levels without greatly affecting the overall budget balance.

For 2010, the Commission services' spring forecast projects a deficit of 13% of GDP, assuming unchanged policy. While the tax revenues will continue declining, some of the consolidation measures already or expected to be adopted in 2009 will have a positive impact also in 2010, in particular the proposed reforms in healthcare, education and public administration.

According to the Commission services' spring forecast, general government debt is projected to reach some 34% of GDP in 2009 and around 50% in 2010, mostly reflecting the take-up of international assistance provided by the EU, IMF and other contributors. The January 2009 update of the convergence programme put the general government debt estimate at 32.4% of GDP in 2009 and 45.4% of GDP in 2010.

(24) ESA basis: see January 2009 update of the convergence programme. The programme as well as its assessment by the Commission and by the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.13.1: **Budgetary developments 2007-2011, Latvia (% of GDP) (1)**

Outturn and forecast(2)	**2007**	**2008**	**2009**	**2010**	
General government balance	-0.4	-4.0	-11.1	-13.6	
- Total revenues	35.5	35.5	35.7	36.2	
Of which : - taxes on production and imports	12.2	10.8	9.9	9.9	
- current taxes on income, wealth, etc.	9.2	9.7	8.8	8.0	
- social contributions	8.9	8.8	9.8	10.2	
- Total expenditure	35.9	39.5	46.8	49.8	
Of which: - compensation of employees	10.6	12.0	12.0	12.5	
- intermediate consumption	6.1	7.2	7.4	7.2	
- social payments	7.1	8.3	12.5	13.4	
- gross fixed capital formation	5.7	4.9	5.6	6.1	
- interest expenditure	0.5	0.9	1.4	2.3	
Primary balance	0.1	-3.1	-9.7	-11.3	
Tax burden	30.5	29.4	28.5	28.1	
One-off and other temporary measures	0.0	0.0	0.5	0.8	
Structural balance(3)	-4.5	-5.8	-9.5	-11.5	
Structural primary balance	-4.1	-4.9	-8.1	-9.2	
Government gross debt	9.0	19.5	34.1	50.1	
Real GDP growth (%)	10.0	-4.6	-13.1	-3.2	
Convergence programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	0.1	-3.5	-5.3	-4.9	-2.9
Primary balance	0.5	-2.9	-3.7	-3.5	-1.4
One-off and other temporary measures	0.0	n.a.	n.a.	n.a.	n.a.
Structural balance(3)(5)	-3.3	-5.1	-4.9	-3.3	-1.5
Government gross debt	9.5	19.4	32.4	45.4	47.3
Real GDP growth (%)	10.3	-2.0	-5.0	-3.0	1.5

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and convergence programme of Latvia

Table V.13.2: **Main budgetary measures for 2009, Latvia**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
Other measures	
· Increase of standard VAT rate from 18% to 21%; increase of reduced VAT rates from 5% to 21% (+1.92% of GDP).	· Increase in social payments (+2.1% of GDP).
· Increases of excise taxes on alcohol, tobacco, petrol, and certain non-alcoholic beverages (+0.74% of GDP).	
· Maintaining the rate of social contribution accruing into the state funded pension scheme at 8% and increasing the minimal wage (+0.34% of GDP).	
· Reducing of PIT from 25% to 23%; increasing of minimal wage from 160 LVL to 180 LVL; increasing of threshold of PIT tax-exemtion from 80-90 LVL (0.63% of GDP).	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services, convergence programme, Budget Law and other legal acts of Latvia

14. LITHUANIA

Recent developments and medium-term prospects

In 2008, the general government deficit amounted to 3.2% of GDP mainly due to expansionary fiscal policy. This outturn compares with a target deficit of 0.5% of GDP set in the 2007 update of Lithuania's convergence programme and in the Law on Fiscal Discipline adopted in November 2007. Revenue growth was somewhat weaker than expected due to slowing GDP growth. Particularly VAT collection was significantly lower than planned. However, the sharp rise in the government deficit mostly reflects a considerable upward revision of expenditure, without adoption of a supplementary budget. Following policy decisions during the year, social transfers and public sector wages increased substantially. On the other hand, public investment was lower than planned. The debt-to-GDP ratio continued to decrease from 17.0% in 2007 to 15.6%, mainly due to strong nominal growth and run-down of financial assets.

The budget for 2009 was approved by parliament on 22 December 2008. The general government target, confirmed in the January 2009 update of the convergence programme[25], is a deficit of 2.1% of GDP. Main measures on the revenue side comprise a cut in the personal income tax rate from 24% to 21% (from it levying a 6% tax to the health insurance fund), an increase in the corporate profit tax from 15% to 20%, an increase in VAT rate from 18% to 19%, substantial increases in excise duties on tobacco, fuel and alcohol and the abolition of most existing tax exemptions. On the expenditure side, the budget includes significant cuts in current expenditure but also reflects higher social transfers and wage increases for certain categories of public sector employees. Furthermore, the contribution rate to the second pillar pension funds was temporarily reduced from 5.5% to 3%. In view of a sharper than expected deterioration in the macroeconomic outlook at the beginning of 2009 and weaker than planned revenue collection, despite revenue increasing measures, a supplementary budget was approved by parliament on 7 May 2009 targeting a general government deficit of 2.9% of GDP. It includes further substantial fiscal consolidation measures, mainly in the form of current expenditure cuts (including public sector wage and staffing levels) and investment. Contributions to the second pillar pension funds have been reduced further from 3% to 2%. A restrictive fiscal stance is in line with the European Recovery plan as Lithuania aims at correcting internal and external imbalances, taking into account the difficulty to secure new financing due to market risk aversion. Furthermore, the Lithuanian authorities adopted a comprehensive package of measures aiming at business support by reducing administrative burden, improving access to finance and facilitating exports and investment. As energy dependency is high on the agenda, the government passed measures to improve energy efficiency. The use of EU structural funds is also planned to be simplified and enhanced.

Despite these consolidation measures, the Commission services' spring 2009 forecast projects the general government deficit in 2009 to widen further to 5.4% of GDP. This reflects a markedly more cautious assessment of revenue prospects compared to the budget but also higher social benefits due to deteriorating labour market situation. Despite the government's intentions to cut some national investment programmes, overall investment should remain at a similar level to 2008, due to accelerating absorption of EU funds.

In 2010, based on the no-policy change assumption, the Commission services' spring 2009 forecast projects the general government deficit to widen further to 8.0% of GDP, due to continuing negative domestic growth. This contrasts with the most recent update of the convergence programme, which on the basis of more favourable growth assumptions foresees the general government to record a deficit of 1.0% in 2010. The spring 2009 forecast projects the general government debt to increase rapidly to about 32% over the forecast period mainly due to high forecast primary deficits.

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(25) The programme as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.14.1: **Budgetary developments 2007-2011, Lithuania (% of GDP) (1)**

Outturn and forecast(2)		**2007**	**2008**	**2009**	**2010**	
General government balance		-1.0	-3.2	-5.4	-8.0	
- Total revenues		33.9	34.0	34.1	34.8	
Of which :	- taxes on production and imports	11.6	11.5	10.7	10.4	
	- current taxes on income, wealth, etc.	9.3	9.3	8.8	8.6	
	- social contributions	8.9	9.3	9.5	9.5	
- Total expenditure		34.9	37.2	39.5	42.7	
Of which:	- compensation of employees	10.0	10.8	11.1	11.2	
	- intermediate consumption	5.4	5.7	4.9	5.2	
	- social payments	9.2	11.0	13.1	14.5	
	- gross fixed capital formation	5.2	4.9	5.0	5.8	
	- interest expenditure	0.7	0.6	1.1	1.5	
Primary balance		-0.3	-2.6	-4.3	-6.5	
Tax burden		29.9	30.3	29.2	28.7	
One-off and other temporary measures		-0.6	-0.1	0.5	0.6	
Structural balance(3)		-2.8	-5.2	-4.3	-5.5	
Structural primary balance		-2.1	-4.5	-3.1	-3.9	
Government gross debt		17.0	15.6	22.6	31.9	
Real GDP growth (%)		8.9	3.0	-11.0	-4.7	
Convergence programme(4)		**2007**	**2008**	**2009**	**2010**	**2011**
General government balance		-1.2	-2.9	-2.1	-1.0	0.0
Primary balance		-0.5	-2.3	-1.2	0.0	1.1
One-off and other temporary measures		0.6	0.5	0.5	0.5	0.0
Structural balance(3)(5)		-2.6	-4.9	-1.8	0.1	1.1
Government gross debt		17.0	15.3	16.9	18.1	17.1
Real GDP growth (%)		8.9	3.5	-4.8	-0.2	4.5

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in January 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services, convergence programme of Lithuania and the Ministry of Finance.

Table V.14.2: **Main budgetary measures for 2009, Lithuania**

Revenue measures(1)(3)	**Expenditure measures(2)(3)**
• Reduction of personal income tax from 24% to 21% (-0.45% of GDP)	• Higher social transfers other than in kind (0.9% of GDP)
• Increase of corporate income tax and tax on dividends from 15% to 20% (0.4% of GDP)	• Reduction of contributions to pension funds (2nd pillar) (0.48% of GDP)
• Increase of VAT from 18% to 19% (0.9% of GDP)	• Reduction in transfers to local governments (-0.5% of GDP)
• Inclusion of some professions to social security system (0.17% of GDP)	• Cuts in public sector wages (-0.7% of GDP)
• Increase in excise duties on fuel, tobacco and alcohol (0.65% of GDP)	• Cuts in current government expenditure (-0.9% of GDP)
• Ongoing pension reform (2nd pillar) (-0.3% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
(3) Including May 2009 supplementary budget.
Source: Commission services, convergence programme of Lithuania and the Ministry of Finance.

15. LUXEMBOURG

Recent developments and medium-term prospects

According to recently released data, the general government surplus amounted to 2.6% of GDP in 2008, 1 percentage point of GDP below the 3.6% of GDP surplus recorded in 2007. The initial target set by the 2007 stability programme was a surplus of 0.8% of GDP, slightly down from an estimated 1.0% in 2007. Thus, the 2008 surplus turned out to be 1.8 percentage point of GDP higher than planned but its decrease with respect to 2007 was 0.8 percentage point of GDP stronger. The much larger than expected surplus in 2008 was thus exclusively due to the base effect associated to a similar upward revision of the 2007 outcome since expenditure rose much stronger than revenues in 2008: the 2007 programme projected government revenues to increase by 5.6%, while expenditure was planned to rise by 5.9% but, actually, revenues increased slightly more than expected, by 6.7%, while spending rose substantially faster than forecast, by 10.1%. Current expenditure increased by 9.7% and government investment surged by 18%. The revenue and expenditure ratios both strongly increased in 2008, but, besides the stronger than expected increase in revenues and spending, this was for a large part due to the very weak GDP growth in 2008 (+0.7% in value and -0.9% in volume). The public debt rose from 6.9% of GDP in 2007 to 14.7% in 2008 as a result of the financing of the loans granted by the authorities to two large banks.

The 2008 update of the stability programme [26] planned the general government surplus to decrease from 2.3% of GDP in 2008 to 1.1% in 2009 but, in view of the sharp deterioration in economic conditions and the stimulus measures already taken at the moment, the January 2009 addendum, apart from revising downwards the 2008 surplus to 2.0% of GDP, significantly lowered the 2009 target to a deficit of 0.6% of GDP. The Commission services' spring 2009 forecast projects the general government balance to deteriorate from a surplus of 2.6% of GDP in 2008 (instead of 2% in the January addendum) to a deficit of 1.5% in 2009. The main reasons for this difference with the addendum's projection are the further deterioration in economic perspectives (the addendum used the macroeconomic scenario of the Commission services' January interim forecast, which projected real GDP to contract by 0.9% in 2009, to be compared with a decline of 3% in the spring forecast) and the sizeable stimulus measures decided since January. The 2009 budget already foresaw an important increase in income tax brackets and, since then, the Luxembourgish authorities have decided a whole series of additional measures, especially another sizeable increase in government investment. These measures comply in general terms with the principles of the European Economic Recovery Plan as they are timely and in most cases targeted, especially the increase in public investment. The cuts in income tax are not temporary as they were primarily designed to compensate for the non-indexation of tax brackets since 2001. However, taking into account the very favourable condition of Luxembourg's public finances, this does not really constitute a risk to their long-term sustainability. In total, with stimulus measures amounting to about 3.3% of GDP (including the tax cuts decided in the budget), Luxembourg's fiscal policy in 2009 appears clearly expansionary. Some risks to the budgetary targets could stem from possible additional measures of support to the financial sector (Luxembourg has guaranteed the commitments of one big bank towards other financial institutions for a maximum amount equal to about 12% of GDP) but there is not indication to date that these risks could materialise.

The Commission services project the deficit to increase (under the no-policy change assumption but including the stimulus measures already decided) from 1.5% in 2009 to 2.8% in 2010, while the January addendum to the 2008 programme plans it to widen from 0.6% of GDP to 1.5%. This difference is partly due to the lower deficit projection for 2009 in the addendum and partly to a more pessimistic macroeconomic

(26) Submitted in October 2008 with an addendum submitted in January 2009. The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.15.1: **Budgetary developments 2007-2010, Luxembourg (% of GDP) (1)**

Outturn and forecast(2)		2007	2008	2009	2010
General government balance		3.6	2.6	-1.5	-2.8
- Total revenues		40.8	43.3	42.7	42.9
Of which :	- taxes on production and imports	12.6	12.8	13.1	13.4
	- current taxes on income, wealth, etc.	13.4	14.4	12.8	12.7
	- social contributions	11.0	11.7	12.1	12.0
- Total expenditure		37.2	40.7	44.2	45.7
Of which:	- compensation of employees	7.3	7.9	8.3	8.5
	- intermediate consumption	3.1	3.4	3.7	3.7
	- social payments	22.5	24.5	26.3	27.3
	- gross fixed capital formation	3.4	3.9	4.6	5.1
	- interest expenditure	0.2	0.3	0.6	0.6
Primary balance		3.9	2.9	-0.9	-2.2
Tax burden		37.4	38.6	37.8	37.9
One-off and other temporary measures		0.0	0.0	0.0	0.0
Structural balance(3)		0.9	2.0	0.6	0.1
Structural primary balance		1.1	2.3	0.6	0.7
Government gross debt		6.9	14.7	16.0	16.4
Real GDP growth (%)		5.2	-0.9	-3.0	0.1
Stability programme(4)		**2007**	**2008**	**2009**	**2010**
General government balance		3.2	2	-0.6	-1.5
Primary balance		3.5	2.3	-0.3	-1.2
One-off and other temporary measures		0	0	0	0
Structural balance(3)(5)		3.5	2.3	-0.3	-1.2
Government gross debt		7	14.4	14.9	17
Real GDP growth (%)		5.2	1	-0.9	1.4

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in October 2008. For the period 2008-2010, data from the January 2009 addendum.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Luxembourg.

Table V.15.2: **Main budgetary measures for 2009, Luxembourg**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Indexation by 9% of personal income tax brackets: 0.9% of GDP	• Increase in government investment: 0.7% of GDP
• Replacement of the tax reduction for children by a tax bonus: 0.3% of GDP	• Increase by 2% in old-age (and assimilated) pensions: 0.2% of GDP
• Abolition of the "droit d'apport" (tax paid on the capital of a new company or an increase in the capital of an existing one): 0.3% of GDP	• Encouragement of the recourse to partial unemployment (especially via the reim-bursement by the government of the employers' part of the allowance): 0.4% of GDP

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services, addendum to Luxembourg's 2008 stability programme and "Plan de soutien à la conjoncture" of the Luxembourgish government.

scenario for 2010 in the Commission services' spring forecast (GDP growth of +0.1% instead of +1.4% in the addendum).

According to the Commission services' spring 2009 forecast, the public debt should rise from 14¾% of GDP in 2008 to 16% in 2009 and 16½% in 2010 as a result of the deficits and the financing of several investment projects financed by public-private partnership. These projections are close to those of the January addendum to the stability programme (14.9% in 2009 and 17.0% in 2010).

16. HUNGARY

Recent developments and medium-term prospects

In 2008, the budget deficit was 3.4% of GDP, sharply down from 9.2% of GDP in 2006 and 4.9% of GDP in 2007. It was also significantly lower than the original deficit target of 4% of GDP set in the November 2007 update of the convergence programme. This overachievement by 0.6% of GDP is fully explained by better-than-expected revenues. In particular, this concerns personal income taxes which were higher by around 0.2% of GDP (partly linked to further efforts to address tax evasion) as well as inflows from other revenues of over 0.5% of GDP (mainly due to the own revenues of budgetary institutions). Divergences in the expenditure side happened to offset each other. Most notably, savings in public investments by ¾ of GDP were almost counterbalanced by increased railway-related costs (around 0.6% of GDP, chiefly linked to a one-off capital transfer to the railway company). The debt-to-GDP ratio was increased by 7 percentage points of GDP in 2008 as international loans were drawn on, mainly to increase reserves.

The 2009 budget adopted by Parliament on 15 December 2008 sets a general government deficit target of 2.6% of GDP, in line with the adjustment path of the December 2008 convergence programme([27]). This represented a tightening from the previous 3.2% of GDP in the context of the Government's new economic programme, which was endorsed by an IMF-EU-WB loan of EUR 20 bn in October 2008. While there was no major change on the revenue side, the budget contained further restraints for the operational costs of budgetary institutions and savings in the chapter-administered government programmes. Additional measures targeted a nominal cut in the public wage bill as well as a substantial slowdown in the increase of social transfers in cash. Given the sizeable macroeconomic imbalances, the Government did not adopt fiscal stimulus measures, which is fully in line with the EERP. Thereby the government's response to the financial crisis comprised budget-neutral measures, such as a strengthening of active labour market policies and a support package to improve SME's access to financing. These schemes are chiefly financed from EU funds as well as by reshuffling among existing expenditure lines. The Government also adopted a new fiscal policy framework, containing multiannual numerical rules and the establishment of the Fiscal Council. In view of the significant deterioration in the 2009 growth outlook (from -1% to -3.3%), the Government revised slightly its deficit target to 2.9% of GDP in February while adopting additional corrective measures of around 0.7% of GDP. Following a further deterioration in anticipated GDP growth to around -6%, the authorities announced new corrective measures amounting to 1% of GDP in April so as to respect the revised target. The Commission services' spring 2009 forecast projects a deficit of 3.4% of GDP for 2009. It could not take into account the recent decision of the European Court of Justice, which found the Hungarian regulation on VAT deduction in 2004-2005 to be against the EU law (around 0.25% of GDP). The distance vis-à-vis the 2.9% target of GDP is chiefly explained by the fact that not all the measures announced by the new government in April were detailed enough to be incorporated in the forecast. The fiscal stance remains considerably restrictive in 2009.

For 2010, the Commission services' forecast, on the basis of a no-policy-change assumption, projects a deficit of 3.9% of GDP against the official target of 2.8% of GDP. The forecast does not take into account any expenditure cuts linked to the announced additional structural reform steps in the pension, social support and public administration systems in view of the lack of detail as well as the pending Parliamentary approvals.

The Commission services' spring 2009 forecast projects the debt-to-GDP ratio to sharply increase to around 81% in 2009 and to over 82% in 2010. These dynamics are mainly explained by the combination of the revaluation of FX-denominated debt due to the depreciating exchange rate and the lacklustre nominal GDP outlook.

([27]) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.16.1: **Budgetary developments 2007-2011, Hungary (% of GDP)**

Outturn and forecast(1)	**2007**	**2008**	**2009**	**2010**	
General government balance (2)	-4.9	-3.4	-3.4	-3.9	
- Total revenues	44.8	46.5	47.4	48.1	
Of which : - taxes on production and imports	15.6	15.7	16.3	16.9	
- current taxes on income, wealth, etc.	10.2	10.6	10.1	10.1	
- social contributions	13.6	13.9	14.0	13.8	
- Total expenditure	49.7	49.8	50.8	52.0	
Of which: - compensation of employees	11.5	11.6	11.2	11.6	
- intermediate consumption	6.7	7.0	7.2	7.2	
- social payments	15.2	15.9	16.5	16.8	
- gross fixed capital formation	3.6	2.8	3.1	3.6	
- interest expenditure	4.0	4.2	4.8	4.9	
Primary balance	-0.9	0.8	1.4	1.0	
Tax burden	39.4	40.2	40.4	40.8	
One-off and other temporary measures	-0.9	-0.3	0.0	0.0	
Structural balance(3)	-5.5	-4.5	-1.7	-2.0	
Structural primary balance	-1.5	-0.3	3.1	2.9	
Government gross debt	65.8	73.0	80.3	82.3	
Real GDP growth (%)	1.1	0.5	-6.3	-0.3	
Convergence programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	-5.0	-3.4	-2.6	-2.5	-2.2
Primary balance	-0.9	0.6	1.9	2.0	2.2
One-off and other temporary measures	-0.9	-0.4	0.0	0.0	0.0
Structural balance(3)(5)	-4.5	-3.0	-1.8	-1.5	-1.3
Government gross debt	65.8	71.1	72.5	72.2	69.0
Real GDP growth (%)	1.1	1.3	-0.9	1.6	2.5

(1) Commission services' spring 2009 economic forecasts.
(2) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Source: Commission services and convergence programme of Hungary.

Table V.16.2: **Main budgetary measures for 2009, Hungary**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
• Temporary 8% tax (surcharge) on the profits of energy companies (the so-called 'Robin Hood tax') for 2009 and 2010 (+0.1% of GDP)	• Modernisation and subsidy programme for district heating schemes (+0.1% of GDP, financed from the earmarked 'Robin Hood' tax)
	• Capping the 13th monthly pension payment for pensioners at the level of the average pension and abolishing it for some groups of early pensioners (-0.2% of GDP)
	• Partly compensated suspension of the 13th monthly salary in the public sector and a nominal freeze of public wages (net impact: -0.25% of GDP)
	• Across-the-board cuts in the operational costs of budgetary institutions (-0.2% of GDP)
	• Cuts in chapter-administered and other government programmes (e.g. transport development and environmental protection, -0.25% of GDP)
	• Savings in social transfers due to the postponement of the forthcoming steps of the 5-year pension correction programme and the regular indexation of family allowances from 1 January to 1 September 2009 (-0.15% of GDP combined)
Other measures	
• Introducing a duty-free limit for succession at HUF 20 million (~EUR 70 000) (-0.04% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Source: Commission services and 2009 budget bill; "Annual report on the budget proposal" by the State Audit Office.

17. MALTA

Recent developments and medium-term prospects

In 2008, the general government deficit is estimated to have reached 4.7% of GDP, against a target of 1.2% of GDP in the November 2007 stability programme. Revenue is estimated to have been around 0.4 percentage points of GDP lower than planned in the 2007 update as a result of lower tax revenue and lower-than-anticipated absorption of EU structural funds. The expenditure-to-GDP ratio in 2008 is estimated to have been 3 percentage points higher than targeted, reflecting an unplanned deficit-increasing one-off related to early retirement schemes given to Malta Shipyards employees (0.8 percentage points), the reclassification of the shipyards into the general government sector (1.3 percentage points) ([28]) as well as higher compensation of employees and energy subsidies given to households. General government debt is estimated at slightly above 64% of GDP, substantially higher than the target of 60% of GDP, primarily reflecting the deterioration in the primary balance and weaker economic growth.

The 2009 budget targets a general government deficit of 1.5% of GDP for 2009, confirmed by the 2008 update of the stability programme([29]). The Commission services' spring 2009 forecast projects the deficit at 3.6% of GDP. A comparison between the deficit projections is complicated by the fact that the stability programme target is predicated on a deficit outturn of 3.3% of GDP for 2008 and on an outdated macroeconomic scenario. That said, the main reasons for the higher headline deficit in the spring forecast are: (i) much weaker revenue, specifically from direct taxes (less by 1.7 percentage points); (ii) an assumed lower absorption of EU structural funds; and (iii) a less pronounced decline in the expenditure ratio, especially in government consumption. Malta has adopted several measures to support the economy in 2009, but embedded in a broader consolidation effort in view of the high general government deficit and debt ratios and the deteriorating competitive position. The measures are aimed at increasing public investment in infrastructure and the environment, as well as supporting manufacturing, tourism and SMEs and households' purchasing power. Most of the measures are timely and targeted. Concerning temporariness, while the public investment measures are of a temporary nature, no concrete end-date is foreseen for the ad-hoc support to companies and the remaining measures are of a permanent nature. With an overall budgetary impact of 1.5% of GDP, the measures will be more than financed by an increase in excise duty on a number of products and a reduction in various subsidies, notably energy subsidies to households, suggesting that the fiscal stance can be characterised as restrictive in 2009.

Under the no-policy-change scenario, the Commission services' spring 2009 forecast projects a further decline in the general government deficit in 2010, to 3.2% of GDP. The 2008 update of the stability programme targets a deficit-to-GDP ratio of 0.3%. The deviation is mostly accounted for by the significantly favourable macroeconomic scenario underpinning the programme's budgetary projections.

According to the Commission services' spring 2009 forecast, the debt ratio is forecast to rise to 67% of GDP in 2009 and, under the no-policy-change scenario, almost 69% of GDP in 2010. In contrast the 2008 update of the stability programme projects a downward trend in gross debt, to 56¼% in 2010. The deviation from the targets is driven by the higher deficits in 2009 and 2010 and weakening economic growth. The contribution of the stock-flow adjustment to the change in the debt ratio is negligible over the forecast horizon.

([28]) Netting out the sales of Malta Shipyards Ltd., which are booked under revenue, the impact of the re-classification on general government deficit amounts to 0.4% of GDP.

([29]) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.17.1: **Budgetary developments 2007-2012, Malta (% of GDP) (1)**

Outturn and forecast(2)	2007	2008	2009	2010	
General government balance	-2.2	-4.7	-3.6	-3.2	
- Total revenues	40.4	40.6	40.8	41.6	
Of which : - taxes on production and imports	14.7	14.7	15.1	15.1	
- current taxes on income, wealth, etc.	13.3	13.1	12.5	12.9	
- social contributions	7.3	7.6	7.6	7.6	
- Total expenditure	42.6	45.3	44.4	44.8	
Of which: - compensation of employees	13.0	13.9	13.6	13.7	
- intermediate consumption	5.4	6.8	6.3	6.5	
- social payments	12.6	13.5	13.8	13.7	
- gross fixed capital formation	4.0	2.7	3.4	3.4	
- interest expenditure	3.3	3.3	3.5	3.5	
Primary balance	1.1	-1.4	-0.2	0.4	
Tax burden	34.7	34.4	34.0	34.5	
One-off and other temporary measures	0.6	-0.5	0.1	0.0	
Structural balance(3)	-3.3	-4.9	-3.6	-2.8	
Structural primary balance	0.0	-1.6	-0.2	0.7	
Government gross debt	62.1	64.1	67.0	68.9	
Real GDP growth (%)	3.6	1.6	-0.9	0.2	
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	-1.8	-3.3	-1.5	-0.3	1.2
Primary balance	1.6	0.0	1.9	3.0	4.3
One-off and other temporary measures	0.6	0.3	0.3	0.1	0.1
Structural balance(3)(5)	-2.8	-3.7	-1.7	-0.2	0.9
Government gross debt	62.2	62.8	61.9	59.8	56.3
Real GDP growth (%)	3.7	2.8	2.2	2.5	2.8

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Malta.

Table V.17.2: **Main budgetary measures for 2009, Malta**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Widening of personal income tax bands (-0.2% of GDP)	• Support for tourism (0.1% of GDP)
• Motor Vehicle Licences reform (-0.1% of GDP)	• Infrastructure - roads, maritime facilities (0.2% of GDP)
	• Education (0.1% of GDP)
	• Investment projects related to industry (0.1% of GDP)
	• Higher incentives for investment (0.2% of GDP)
	• Investment in educational institutions (0.3% of GDP)
	• Sustainable development at local level (0.1% of GDP)
Other measures	
• Increase in excise duty (0.3% of GDP)	• Environmental measures (0.1% of GDP)
• Environmental measures (0.1% of GDP)	• Reduction in energy subsidies (-1% of GDP)(3)
	• Reduction in other subsidies (-0.4% of GDP)

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
(3) Measure not specific to 2009 budget
Source: Commission services, 2009 budget and addendum to the updated stability programme 2008-2011.

18. THE NETHERLANDS

Recent developments and medium term prospects

In 2008, the general government balance came out at a surplus of 1% of GDP, a significant improvement with respect to the surplus of 0.3% of GDP recorded in 2007. The November 2007 update of the stability programme had targeted a general government surplus of 0.5% of GDP for 2008, which was revised up in September 2008 in the context of the budget preparation to a surplus of 1.2% of GDP. The better-than-expected outcome of the general government balance as compared to the November 2007 stability programme, can be mainly explained by the better-than-expected non-tax gas revenues, related to the unforeseen sharp increase in the oil price in 2008. This outweighed the somewhat lower tax revenues, related to a lower-than-expected GDP growth in 2008 (2% compared to 2½% in the November 2007 update of the stability programme), and the worse local government balance. The government debt ratio increased by 12.6% of GDP in 2008 to 58.2% of GDP, despite the budget surplus. This increase can be fully explained by government operations to stabilise financial markets (such as share acquisitions and capital injections).

For 2009, the budgetary target was revised down by the Dutch government from surplus of 1.2% of GDP as presented in both the draft budget and the November 2008 update of the Stability programme ([30]) to a deficit of 3.8% of GDP in the spring 2009 budget memorandum. This is more negative than the Commission services' 2009 spring forecast, which projects a general government deficit of 3.4% of GDP for 2009. The downward revision is due to several factors. First, the economic growth projection for 2009 has been lowered by 4¾ percentage points to -3½% since the November 2008 update of the stability programme, leading to a sharp fall in tax revenues and at the same time to an increase in cyclically sensitive expenditure like social security. Second, gas revenues are expected to decrease in 2009, as a result of a lower oil price. Finally, the government decided on additional recovery measures (¾% of GDP). In the 2009 budget it was already decided to decrease social contributions for employees (¼% of GDP) in order to support household incomes. The additional measures focus on increasing public and private investment, protecting employment, ensuring access to finance and on providing liquidity support for companies, mostly through tax measures. The recovery packages are timely and targeted, in line with the EERP, and partially temporary. The fiscal stance is expected to be expansionary. There are significant downside risks to the budgetary target due to guarantees to the financial sector.

The government balance in 2010 is expected to deteriorate further to -6.1% of GDP according to the Commission services' spring 2009 forecast, under a no-policy change assumption. The most recent budgetary figure for 2010 published by the Dutch government in the supplementary coalition agreement foresees a general government balance of -5.7%. The difference mainly comes from the fact that a planned consolidation effort, amounting to ¾% of GDP in 2010, was not taken into account in the spring forecast, as no specific measures had been identified by the Dutch authorities. The difference between the two forecasts was somewhat smaller than the consolidation effort, given that public gas revenues are approximately ¼% of GDP higher in the spring forecast, as a result of a somewhat higher oil price projection. The size and composition of the recovery package in 2010 does not deviate substantially from 2009.

Despite the projected budget deficit, the spring forecast expects the debt-to-GDP ratio to decrease slightly to 57% in 2009, because of the repayment of a €34 billion (around 6% of GDP) short term loan by Fortis Bank. In 2010, the debt ratio is foreseen to increase again to 63.2% of GDP in 2010, surpassing the 60% of GDP threshold. The high level of guarantees to the financial sector constitutes a risk for a further increase in the gross public debt ratio.

([30]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.18.1: **Budgetary developments 2007-2011, Netherlands (% of GDP)**

Outturn and forecast(1)	2007	2008	2009	2010	
General government balance (2)	0.3	1.0	-3.4	-6.1	
- Total revenues	45.6	46.4	44.9	44.1	
Of which : - taxes on production and imports	12.6	12.2	12.4	12.1	
- current taxes on income, wealth, etc.	12.0	11.6	11.7	11.2	
- social contributions	14.3	15.2	13.9	14.4	
- Total expenditure	45.3	45.4	48.3	50.2	
Of which: - compensation of employees	9.2	9.2	9.7	9.9	
- intermediate consumption	7.2	7.2	7.4	7.5	
- social payments	10.4	10.3	11.2	12.0	
- gross fixed capital formation	3.3	3.3	3.5	3.6	
- interest expenditure	2.2	2.2	2.6	2.7	
Primary balance	2.6	3.2	-0.8	-3.4	
Tax burden	38.9	39.0	38.0	37.7	
One-off and other temporary measures	0.0	0.0	0.3	0.0	
Structural balance(3)	-1.0	-0.5	-2.6	-4.3	
Structural primary balance	1.2	1.7	0.0	-1.6	
Government gross debt	45.6	58.2	57.0	63.1	
Real GDP growth (%)	3.5	2.1	-3.5	-0.4	
Stability(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	0.3	1.2	1.2	0.8	1.1
Primary balance	2.6	3.4	3.3	2.9	3.1
One-off and other temporary measures	0	0	0.3	0	0
Structural balance(3)(5)	-0.1	0.9	0.8	0.9	1.2
Government gross debt	45.7	42.1	39.6	38	36.2
Real GDP growth (%)	3.5	2¼	1¼	2	2

(1) Commission services' spring 2009 economic forecasts.
(2) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in November 2008.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of the Netherlands.

Table V.18.2: **Main budgetary measures for 2009, Netherlands**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Reduction in social contributions (-0.3% of GDP)	• Increase in infrastructure projects (-0.1% of GDP)
• Accelerated depreciation for investments (-0.2% of GDP)	• Labour market measures (e.g. part-time unemployment) (-0.1% of GDP)
Other measures	
• Lower health care premiums (-0.1% of GDP)	• Increase in education expenditure (-0.3% of GDP)
• Exceptional expenses deductible (0.1% of GDP)	
• Increase in excise duties (0.1% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services, 2009 budget and supplementary coalition agreement.

19. AUSTRIA

Recent developments and medium-term prospects

At 0.4% of GDP, the general government deficit for 2008 turned out lower than the initial 0.6% of GDP targeted in the November 2007 Stability Programme. The favourable outturn was mainly due to higher-than-expected revenues from wage and income taxes as well as capital yields taxes and lower interest payments. These positive developments more than offset new policy measures aimed at curbing the loss in household purchasing power as a consequence of high inflation such as reduced social contribution rates for low-income earners and increased social payments. After the debt-to-GDP ratio fell below the 60% threshold in 2007, it increased to 62.5% in 2008, mainly because of support measures for commercial banks in the wake of the global financial crisis. These "below-the-line" measures increased the debt-to-GDP ratio without affecting the deficit.

The federal budgets for 2009 and 2010 were presented to the parliament in April 2009 and will be adopted by end of May. In the Stability Programme ([31]) a general government budget deficit target of 3.5% of GDP was announced for 2009. The Commission services' spring 2009 forecast, which is based on a more pessimistic macroeconomic scenario ([32]), projects a higher deficit of 4¼% of GDP. Sizeable revenue losses and increased expenditure due to automatic stabilisers and discretionary fiscal measures to address the economic crisis as well as efforts to stabilise financial markets will contribute to a significant deterioration of Austria's public finances in 2009. Hence, the fiscal stance will be expansionary.

The discretionary stimulus measures adopted are in line with the European Economic Recovery Plan as far as targeting and timeliness is concerned. The measures focus mainly on household income support, the labour market to avoid lay-offs (short-time work), and improved training. Support to credit-constrained enterprises comes mainly in off-budget form as guarantees and subsidised loans. Some fiscal measures were already taken in 2008 to support private household purchasing power, but will remain largely effective in 2009. The discretionary impulses are timely as a major part of them took effect in the first quarter 2009. However, most of the measures are permanent, hence their reversibility is not ensured.

For 2010, the Austrian Stability Programme foresees a government deficit of 4.7% of GDP. Under the no-policy-change assumption the Commission services' spring 2009 forecast projects the deficit to widen to 5¼% of GDP. The difference results, apart from the base effect, from a less optimistic macroeconomic outlook in the Commission forecast.

In the light of the higher deficits, stock-flow adjustments as a consequence of financial stabilisation measures "below the line" and lower nominal GDP, the Commission services' forecast foresees the debt-to-GDP ratio to increase to 70½% in 2009 and 75¼ of GDP in 2010.

The macroeconomic scenario underlying the authorities' budgetary projections in the April 2009 Stability Programme is subject to considerable uncertainty with respect to the duration, extent and impact of the recession. In particular, the growth assumptions appear quite favourable. Consequently, the programme's fiscal targets are subject to substantial downside risks. The fiscal risks in the context of the support programmes for enterprises and commercial banks are currently estimated to be limited, as large parts of them are off-budget in the form of guarantees. These operations have a budgetary effect only in the event of public guarantees being called. However, if the number of non-performing domestic and foreign loans increases to a degree that the solvency of major Austrian banks is put at risk, public finances would deteriorate further as

([31]) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

([32]) In the stability programme Austrian authorities assume a fall of real GDP by 2.2%, whereas Commission services project a decline of 4%.

Table V.19.1: **Budgetary developments 2007-2012, Austria (% of GDP)**

Outturn and forecast(2)	**2007**	**2008**	**2009**	**2010**		
General government balance	-0.5	-0.4	-4.2	-5.3		
- Total revenues	48.0	48.2	47.4	46.7		
Of which : - taxes on production and imports	14.1	14.1	14.3	14.3		
- current taxes on income, wealth, etc.	13.5	14.0	12.6	12.2		
- social contributions	15.9	16.0	16.3	16.2		
- Total expenditure	48.5	48.6	51.6	52.1		
Of which: - compensation of employees	9.1	9.1	9.8	9.8		
- intermediate consumption	4.3	4.5	4.4	4.6		
- social payments	18.0	18.1	19.7	19.9		
- gross fixed capital formation	1.0	1.0	1.1	1.1		
- interest expenditure	2.7	2.5	3.0	3.2		
Primary balance	2.2	2.1	-1.1	-2.1		
Tax burden	42.3	42.9	42.2	41.7		
One-off and other temporary measures	0.0	0.0	0.0	0.0		
Structural balance(3)	-1.8	-1.8	-3.2	-3.8		
Structural primary balance	1.0	0.8	-0.1	-0.6		
Government gross debt	59.4	62.5	70.4	75.2		
Real GDP growth (%)	3.1	1.8	-4.0	-0.1		
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
General government balance	-0.5	-0.4	-3.5	-4.7	-4.7	-4.7
Primary balance	2.3	2.2	-0.6	-1.7	-1.4	-1.3
One-off and other temporary measures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Structural balance(3)(5)	-1.7	-1.6	-3.1	-3.9	-4.0	-4.1
Government gross debt	59.4	62.5	68.5	73.0	75.7	77.7
Real GDP growth (%)	3.1	1.8	-2.2	0.5	1.5	2.0

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in April 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and Austrian Stability Programme April 2009.

Table V.19.2: **Main budgetary measures for 2009, Austria**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
• Income tax reduction (-0.7% of GDP)	• Labor market package - short-time work (0.1% of GDP)
• Increased tax allowances for children (-0.1% of GDP)	
Other measures	
• Repeal of university fees (-0.1% of GDP)	
• Tax exemptions (-0.1% of GDP)	
• Reduction of VAT on pharmaceuticals (-0,1% of GDP)	
• Reduction in unemployment insurance contributions (-0.1% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and Austrian Stability Programme April 2009.

substantial additional capital injections by the government would be necessary.

20. POLAND

Recent developments and medium-term prospects

Due to the reduction of social contributions (estimated at nearly 1½% of GDP), an increase in personal income tax reliefs for families, a generous indexation of pensions and social benefits and a deterioration of the economic situation towards the end of the year, the general government deficit was expected to widen in 2008. It increased by about 2 percentage points to 3.9% of GDP in 2008, which is significantly more than planned in the March 2008 convergence programme ([33]) (2.5%). In particular, non-tax revenues were much lower (mainly capital transfers due to underexecution of projects cofinanced with EU funds) while intermediate consumption (including military expenditure) and compensation of employees much higher than presented in the programme. At 47.1% of GDP, debt turned out to be by almost 3 percentage points higher in 2008 than projected in the March 2008 convergence programme. It resulted mainly from a considerably higher deficit but also a deep depreciation of the Polish currency resulting in a sharp increase of the foreign-denominated fraction of the debt.

Despite an additional reduction of central government expenditure of ¾% of GDP, introduced after the adoption of the 2009 budget, the general government deficit is forecast to deteriorate to about 6½% of GDP in 2009. This is the expected outcome of the recession and discretionary measures. Automatic stabilisers will contribute to an increase in social transfers on top of high statutory growth under new indexation rules referring to high inflation and wages in 2008. Among the stimulus measures, a rise in public investment, a personal income tax reform and a reduction of the tax burden for businesses are set to be costly for the Polish public finances. An increase in excise duties, a reduction in subsidies and the replacement of early pensions with less costly "bridge pensions" will be insufficient to offset the effects of the rapid deterioration of the economic situation and the deficit-increasing measures. The Polish authorities revised their 2009 deficit target from 2.5% of GDP presented in the December 2008 convergence programme to 4.6% in the April 2009 fiscal notification. The difference between the Commission services' deficit forecast and the national target results mainly from different growth scenarios. Besides, the Polish authorities may anticipate some corrective measures, to be included in an amended budget, which are not yet publically known.

In 2010, the general government deficit is expected to further deteriorate to more than 7% of GDP on the back of still weak growth and a further weakening of the labour market as well as a one-off measure (debt cancellation). Also the assumption of no policy change has been applied. In particular, nominal expenditure growth targets presented in the latest convergence programme are included in the forecast, contributing to an increase of the general government expenditure ratio of about ⅔ percentage point. This spending growth comprises a further increase in social expenditure, due to rising unemployment, and ambitious investment plans which, however, may be revised. Higher risk aversion towards emerging markets and quickly mounting debt are expected to result in an increase in interest expenditure. Finally, possible changes on the revenue side, e.g. raising healthcare contributions, are not considered.

As a consequence of high deficits and still slow privatisation, gross debt is projected to increase sharply to 54% of GDP in 2009 and further to only slightly less than 60% in 2010. The debt projections are subject to significant uncertainty because of the high volatility of the exchange rate and the ensuing valuation effects of the foreign-denominated part of the debt.

([33]) The successive updates of the convergence programme and the assessments by the Commission and Council of them can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.20.1: **Budgetary developments 2007-2012, Poland (% of GDP) (1)**

Outturn and forecast(2)		**2007**	**2008**	**2009**	**2010**	
General government balance		-1.9	-3.9	-6.6	-7.3	
- Total revenues		40.2	39.2	39.5	39.5	
Of which :	- taxes on production and imports	14.2	14.2	14.5	14.4	
	- current taxes on income, wealth, etc.	8.6	8.6	8.1	8.2	
	- social contributions	12.0	11.4	11.4	11.2	
- Total expenditure		42.1	43.3	46.1	46.8	
Of which:	- compensation of employees	9.6	9.8	10.4	10.5	
	- intermediate consumption	6.0	6.2	6.1	5.9	
	- social payments	14.2	14.1	15.2	15.4	
	- gross fixed capital formation	4.1	4.6	5.5	6.0	
	- interest expenditure	2.3	2.2	2.9	3.0	
Primary balance		0.4	-1.7	-3.7	-4.4	
Tax burden		34.6	34.0	33.9	33.7	
One-off and other temporary measures		0.0	0.0	0.0	-0.2	
Structural balance(3)		-3.2	-5.3	-6.0	-5.6	
Structural primary balance		-0.9	-3.1	-3.1	-2.9	
Government gross debt		44.9	47.1	53.6	59.7	
Real GDP growth (%)		6.6	4.8	-1.4	0.8	
Convergence programme(4)		**2007**	**2008**	**2009**	**2010**	**2011**
General government balance		-2.0	-2.7	-2.5	-2.3	-1.9
Primary balance		0.5	-0.3	0.1	0.2	0.5
One-off and other temporary measures		0.0	0.0	0.0	-0.2	-0.2
Structural balance(3)(5)		-2.5	-3.1	-2.5	-2.3	-1.7
Government gross debt		44.9	45.9	45.8	45.5	44.8
Real GDP growth (%)		6.7	5.1	3.7	4.0	4.5

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and convergence programme of Poland

Table V.20.2: **Main budgetary measures for 2009, Poland**

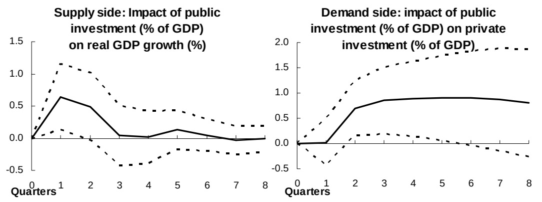
Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
	• Investment (+0.3% of GDP)
Other measures	
• Personal income tax (-0.6% of GDP)	• Investment (+0.6% of GDP)
• Taxes on business (-0.2% of GDP)	• Subsidies (-0.2% of GDP)
• Excise duties (+0.2% of GDP)	• Intermediate consump. (-0.7% of GDP)

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and budget for 2009.

Public investment: refocusing is desirable

There appears to be a positive relationship between public investment, private investment and GDP growth in Poland, as indicated by impulse response functions based on vector autoregression (Graph V.20.1). First, a demand stimulus can already be noticed after 1-2 quarters. Second, the supply-side effect appears to be visible in the positive impact on private investment. The impact materialises after 2-3 quarters and reaches its maximum after 6 quarters.

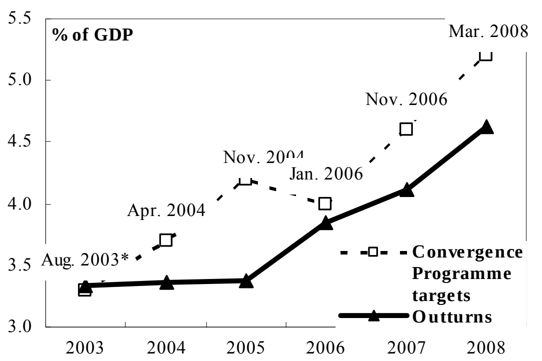
Graph V.20.1: **Orthogonalised impulse-response functions based on vector autoregression for Poland**



Note: Orthogonalised impulse-response. Sample period: 1999Q3-2007Q4. Dashed lines indicate 90% confidence band. VAR includes two lags of GDP growth, private investment and public investment (in the order of endogeneity) and quarterly dummies.
Source: Commission Services.

The execution of public investment, though improving, was always below plans in the recent years (Graph V.20.2) and the underperformance appears in central government.

Graph V.20.2: **Short-term plans and outturns**

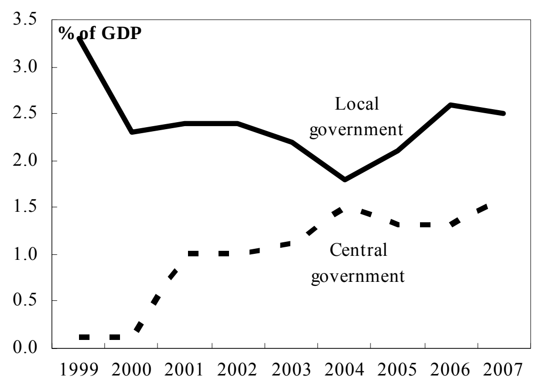


Note: * Pre-Accession Economic Programme 2003.
Source: Commission services.

The local government investment ratio declined since 1999 until EU accession, whereas central government investment followed the opposite pattern (Graph V.20.3). After accession, central government investment levelled off around 1½% of GDP while local government investment increased from less than 2% to about 2½%.

Local government investment in Poland appears to counteract regional income dispersion, since poorer regions invested more (relative to their GDP) than richer regions in 1999-2006.

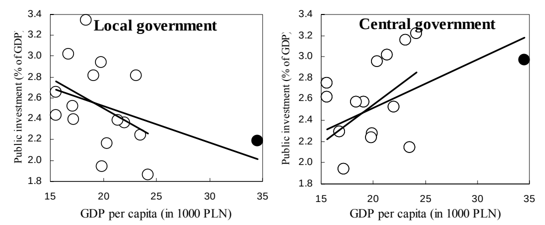
Graph V.20.3: **The evolution of public investment (ESA95) by local and central government in Poland**



Source: Commission services.

In contrast, central government investment was larger in higher-income regions (Graph V.20.4).

Graph V.20.4: **Regional GDP per capita and public investment (non ESA95) in different government subsectors, long-term averages for 1999-2006**



Note: The outlier (black dot) is the capital region.
Source: Polish central statistical office (GUS).

The positive link between public investment and growth in Poland should be exploited more, in particular now, when there is a need to counteract a deep growth slowdown and, at the same time, seek to fully use EU funds to finance a large part of public investment. Being in the EDP, Poland should not increase expenditure, but take the opportunity to change its composition.

Besides, the central government investment could be refocused towards less developed regions. In these regions the impact of the crisis is stronger and socially more painful due to a low diversification of their production structures and an underdevelopment of services. However, the return on scarcer infrastructure is likely to be higher.

21. PORTUGAL

Recent developments and medium-term prospects

In 2008, the general government deficit in Portugal was 2.6% of GDP, against an official target of 2.4% of GDP set out in the 2008 Budget Law and the December 2007 update of the stability programme([34]). This fiscal outturn benefited from deficit-reducing one-off operations worth over ¾% of GDP. The budgetary under-performance in 2008 stemmed mainly from lower-than-projected economic growth, as GDP stagnated in volume terms in 2008 compared with a forecast of 2.2% growth in the Budget Law, having nonetheless benefited from a better-than-expected 2007 budgetary execution by some ½% of GDP. In 2008, general government gross debt amounted to 66.4% of GDP, after 63.5% of GDP in 2007. Besides the deficit and GDP outturns, this reflects also a debt-increasing stock-flow adjustment of almost 1½% of GDP on account inter alia of acquisition of financial assets and repayments of commercial debt.

The target for the 2009 general government balance set in the January 2009 update of the stability programme was a deficit of 3.9% of GDP. However, in mid May, in the Medium-Term Steering Report on Fiscal Policy (*Relatório de Orientação da Política Orçamental),* this target was revised to 5.9% of GDP. This compares with a deficit projection of 6.5% of GDP in the Commission services' spring 2009 economic forecasts, with the latter reflecting a sharper recession than foreseen in the former (GDP is expected to decline by 3.7% in volume terms, against 3.4%). Besides the severe economic downturn, fiscal developments in 2009 reflect also the impact of a number of discretionary fiscal measures that Portugal has adopted to stimulate economic activity. Notably, in the context of the European Economic Recovery Plan (EERP), a package was adopted in December 2008 focused on public investment and on a mix of revenue and expenditure instruments to support employment, social protection, investment and exports. This package represents a fiscal impulse of 1¼% of GDP in 2009 (of which 0.8% of GDP is to be financed out of the national budget and the rest through EU funds). Overall, the package is in line with the EERP: its measures are timely and targeted at the areas most affected by the crisis. In addition, most of the measures are temporary and limited to 2009. This fiscal stimulus adds to a number of other separate measures that had already been announced earlier in 2008 to support households' income and firms' investment amounting to almost ½% of GDP, to the reduction in the standard VAT rate from 21% to 20% as from July 2008, as well as to some minor measures taken already in 2009 (see Table V.21.2). All in all, an overall expansionary fiscal policy is expected for 2009.

Under the no-policy-change assumption, the Commission services' spring 2009 economic forecasts foresee a general government deficit of 6.7% of GDP in 2010. This compares with an official target of a deficit of 2.9% of GDP set in the January 2009 update of the stability programme. Besides the base effect coming from the differences on the 2009 fiscal outlook, this divergence reflects a much less favourable GDP growth scenario in the Commission forecasts.

On the back of the continued economic downturn and the deteriorating budgetary outcomes, the Commission services' spring 2009 economic forecasts project the government debt to increase to 75½% and 81½% of GDP in 2009 and 2010, respectively. According to the January 2009 update of the stability programme, the debt ratio would increase to 69.7% of GDP this year and to 70.5% of GDP next year. Government efforts to support the financial markets, notably provisions for granting of guarantees to new borrowing by banks and the possibility of reinforcing banks' capital through government investment up to a combined total of some 12% of GDP until end 2009, have not had a detrimental fiscal impact, but possible rescue operations may put upward pressure on government finances.

([34]) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

Table V.21.1: **Budgetary developments 2007-2011, Portugal (% of GDP)**

Outturn and forecast (1)	**2007**	**2008**	**2009**	**2010**	
General government balance (2)	-2.6	-2.6	-6.5	-6.7	
- Total revenues	43.1	43.2	42.4	42.0	
Of which : - taxes on production and imports	15.0	14.6	14.4	14.4	
- current taxes on income, wealth, etc.	9.7	9.9	9.6	9.4	
- social contributions	12.7	13.0	11.8	12.0	
- Total expenditure	45.7	45.9	48.9	48.7	
Of which: - compensation of employees	12.9	12.9	11.6	11.6	
- intermediate consumption	4.1	4.4	4.8	5.0	
- social payments	15.1	15.6	17.1	17.5	
- gross fixed capital formation	2.3	2.1	2.5	2.0	
- interest expenditure	2.8	2.9	3.0	3.3	
Primary balance	0.2	0.3	-3.6	-3.4	
Tax burden	36.8	36.8	35.0	35.0	
One-off and other temporary measures	0.1	0.8	0.1	0.0	
Structural balance (3)	-3.3	-3.8	-5.5	-5.1	
Structural primary balance	-0.5	-0.9	-2.5	-1.8	
Government gross debt	63.5	66.4	75.4	81.5	
Real GDP growth (%)	1.9	0.0	-3.7	-0.8	
Stability programme (4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	-2.6	-2.2	-3.9	-2.9	-2.3
Primary balance	0.2	0.8	-0.6	0.4	1.1
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0
Structural balance (3)(5)	-2.7	-2.0	-3.0	-1.8	-1.2
Government gross debt	63.6	65.9	69.7	70.5	70.0
Real GDP growth (%)	1.9	0.3	-0.8	0.5	1.3

(1) Commission services' spring 2009 forecast.
(2) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in Jan 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Portugal.

Table V.21.2: **Main budgetary measures for 2009, Portugal**

Revenue measures(1)	**Expenditure measures**(2)
Measures in response to the downturn	
• Temporary reduction of social contributions for some selected groups (-0.2% of GDP)	• Renewal of schools premises (0.2% of GDP)
• Support to firms liquidity through changes in the procedures and timing of some tax payments (-0.1% of GDP)	• Investment (and support to investment) in energy and telecommunications infra-structure (0.2% of GDP)
	• Special support to activity, exports and SMEs (0.1% of GDP)
Other measures	
• Reduction of the VAT standard rate by one percentage point as from July 2008 (-0.15% of GDP)	• Support to household income (0.2% of GDP)
• Lower tax burden related to housing assets (-0.1% of GDP)	• Support to firms (0.1% of GDP)

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and January 2009 stability programme update.

22. ROMANIA

Recent developments and medium-term prospects

In 2008, the general government recorded a deficit of 5.4% of GDP, more than double compared to the official target of 2.4% of GDP set in the budget rectification from March 2008, down from the initial target of 2.9% of GDP foreseen in the December 2007 convergence programme ([35]). The significant deviation is mainly due to weak budgetary planning and execution, which resulted in substantially higher-than-planned current spending, notably in public wages and social transfers. In addition, overly optimistic revenue projections did not materialise and a sudden drop in revenue collection in the last two months of the year owing to the economic slowdown added to the worse-than-expected outcome. The debt to GDP ratio stood at 13.6% in 2009, up by almost 1pp compared to 2008.

In view of the large domestic and external imbalances and the adverse effect of the global financial turmoil on the economy, the Romanian authorities made a request for multilateral financial assistance in March 2009[36]. In this context, the government envisages a significant fiscal adjustment effort targeting a deficit of 5.1% of GDP in 2009 against a sharp deterioration of the macroeconomic outlook. The 2009 budget adopted in February 2009 contains several measures to lower the deficit, including a recruitment freeze and the reduction of various bonuses in the public sector, cuts in expenditure for goods and services and subsidies, limiting pension increases to inflation, a 3.3pps rise in the pension contribution rate and a bringing forward of the schedule to increase excise taxes. Under the economic programme to be undertaken in the framework of the multilateral financial assistance, the government has pledged to undertake additional expenditure-driven fiscal adjustment measures, These measures, reflected in a budget rectification approved by the government in April 2009 include further cuts in the public sector wage bill, expenditure on goods and services, some capital spending and subsidies. On the revenue side, measures aim at eliminating certain tax deductions and allowances (in particular for company cars and depreciation of revalued assets). On the other hand, the government plans a substantial increase in public investment in 2009 compared with 2008, also as a means to sustain the economic recovery. In addition, given the need for fiscal consolidation, only a limited set of fiscal stimulus measures has been adopted aiming at supporting businesses, labour market, a good functioning of the labour market and supporting household income. Taking into account the above-mentioned fiscal adjustment measures, the Commission services' spring 2009 forecast projects the general government deficit to reach 5.1% of GDP in 2009. Overall, the fiscal policy stance seems restrictive.

Based on the no-policy change assumption, the Commission services' spring 2009 forecast projects the general government deficit to increase to 5.6% of GDP in 2010. However, in the multilateral financial assistance programme, the authorities committed to continue the fiscal adjustment throughout 2010, aiming at a deficit of below 3% of GDP in 2011.

The high primary deficits and a significant increase in interest payments on government debt will result in the debt-to-GDP ratio rising to 18¼% in 2009 and 22¾% in 2010.

([35]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm

([36]) The total multilateral financial assistance amounts to up to EUR 20 billion over the period to the first quarter of 2011. The EU provides a medium-term loan of up to EUR 5bn in conjunction with EUR12.95 billion from the International Monetary Fund. Additional multilateral support of €2 billion will be provided by the World Bank (€1 billion), the European Investment Bank and the European Bank of Reconstruction and Development (€1 billion together) on top of their general lending activities.

Table V.22.1: **Budgetary developments 2007-2012, Romania (% of GDP) (1)**

Outturn and forecast(2)	2007	2008	2009	2010	
General government balance	-2.5	-5.4	-5.1	-5.6	
- Total revenues	34.0	33.1	33.4	33.3	
Of which : - taxes on production and imports	12.7	12.3	11.7	11.5	
- current taxes on income, wealth, etc.	6.8	6.9	6.5	6.5	
- social contributions	10.6	10.3	10.9	10.7	
- Total expenditure	36.6	38.5	38.5	38.9	
Of which: - compensation of employees	9.4	10.2	9.3	9.3	
- intermediate consumption	6.2	6.5	5.1	5.1	
- social payments	9.3	10.6	11.8	11.7	
- gross fixed capital formation	5.7	5.4	6.3	6.7	
- interest expenditure	0.8	0.8	1.5	1.6	
Primary balance	-1.8	-4.7	-3.6	-4.0	
Tax burden	29.4	28.9	28.4	28.2	
One-off and other temporary measures	-0.1	0.0	0.0	0.0	
Structural balance(3)	-4.4	-7.9	-5.2	-4.7	
Structural primary balance	-3.7	-7.2	-3.7	-3.1	
Government gross debt	12.7	13.6	18.2	22.7	
Real GDP growth (%)	6.2	7.1	-4.0	0.0	
Convergence programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	-2.5	-5.4	-5.1	-4.1	-2.9
Primary balance	-1.8	-4.7	-3.6	-2.4	-1.4
One-off and other temporary measures	-0.2	n.a.	n.a.	n.a.	n.a.
Structural balance(3)(5)	-3.7	-6.8	-3.3	-0.7	1.3
Government gross debt	12.7	13.6	18.0	20.8	22.0
Real GDP growth (%)	6.2	7.1	-4.0	0.1	2.4

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in June 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and convergence programme of Romania.

Table V.22.2: **Main budgetary measures for 2009, Romania**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
	• Public investment (+1% of GDP)
	• Instituting a minimum "social" pension (+0.1% of GDP)
Other measures	
• Increasing the social contribution rate (+0.8% of GDP)	• Lower expenditure on goods and services (-1.3% of GDP)
• Bringing forward the schedule to increase excise duties (+0.1% of GDP)	• Cuts in personnel expenditure (-0.9% of GDP)
• Updating the tax base for local property taxes, bringing to the market value (+0.1% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services and the Romanian Ministry of Finance

23. SLOVENIA

Recent developments and medium-term prospects

In 2008, the general government deficit amounted to 0.9% as planned in the November 2007 update of the stability programme. The impact of a significantly better starting position – arising from the fact that the 2007 outcome was a surplus instead of a deficit, a difference of just over 1 percentage point of GDP - and stronger revenue growth in 2008 than budgeted were offset by much higher expenditure growth than planned. Revenue surprised on the upside in capital taxes (part of personal income tax), social contributions and non-tax revenues. Expenditure overruns occurred in public investment, social transfers (especially pensions) as well as compensation of employees. General government gross debt declined to just below 23% of GDP.

According to the April 2009 update of the stability programme([37]), the general government deficit is targeted to widen to 5.1% of GDP in 2009, higher than the target of 3.7% set in the March 2009 supplementary budget and the original target of 0.6% of GDP set in the November 2007 budget covering 2008-2009 in line with the two-year rolling budgetary procedure. The new target embodies additional consolidation measures, amounting to 0.9% of GDP, expected to be presented in summer 2009 in a second supplementary budget for 2009. The Commission services' spring 2009 forecast does not include these as yet unspecified measures and projects a deficit of 5.5% of GDP. The government's response to the European Economic Recovery Plan, the Slovenian government has been timely, with the approval of two stimulus packages, the first one in December 2008 and the second one in February 2009. These measures are designed to mitigate the impact of the crisis on productive capacity and jobs. The main measure is the wage subsidy per employee to companies that reduce their working time from 40 hours per week to 32 - 36 hours, which can be granted for a maximum period of 6 months. Subsidies to increase investment and R&D and support to SMEs and start-ups would further stimulate the economy, together with tax allowances for investment. Most of these measures are temporary - valid for either one or two years - but their extension cannot be excluded, especially if a more protracted recession than currently foreseen were to unfold. Further support to the economy should come from decisions taken earlier (by the previous government and confirmed by the present one), all reducing the tax burden on companies, in particular the phasing-out of the payroll tax by the end of 2008 and a further lowering of the corporate income tax rate by 1 percentage point in January 2009. These measures are of a permanent nature. Other developments impacting public finances in 2009 are a rise in the public sector wage bill as a percent of GDP (in spite of some steps to limit the increase) and in social transfers. Overall, the 2009 fiscal stance can be characterised as expansionary.

On the basis of the no-policy-change assumption, the Commission services' spring 2009 forecast projects the general government deficit to widen to 6.5% of GDP in 2010. The April 2009 update of the stability programme targets a deficit of 3.9% of GDP in 2010. The large divergence is due to different macroeconomic scenarios but mainly to the application of the no-policy-change assumption, since the programme target is conditional on the adoption of further consolidation measures.

The Commission services' spring forecast foresees general government gross debt to rise steeply to around 29¼% of GDP in 2009 (slightly lower than in the updated stability programme) and to continue to increase in 2010, to some 35% of GDP. The stock-flow adjustment of 0.6% of GDP in 2009 reflects the recapitalisation of the Slovene Export and Development Bank and of the Fund for Entrepreneurship, as part of the measures to ease credit conditions for companies and support the financing of exports.

([37]) The programme can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm. As soon as they are completed, the assessment of the programme by the Commission and the Council will be made available there as well.

Table V.23.1: **Budgetary developments 2007-2011, Slovenia (% of GDP) (1)**

Outturn and forecast(2)	2007	2008	2009	2010	
General government balance	0.5	-0.9	-5.5	-6.5	
- Total revenues	42.9	42.7	42.2	42.1	
Of which : - taxes on production and imports	14.6	14.0	14.2	14.2	
- current taxes on income, wealth, etc.	9.5	9.3	8.9	8.9	
- social contributions	14.0	14.3	14.2	14.1	
- Total expenditure	42.4	43.6	47.7	48.6	
Of which: - compensation of employees	10.6	10.8	11.9	12.5	
- intermediate consumption	5.9	6.1	6.5	6.6	
- social payments	14.4	14.7	15.8	15.8	
- gross fixed capital formation	3.7	4.2	4.4	4.4	
- interest expenditure	1.3	1.2	1.6	1.8	
Primary balance	1.8	0.2	-3.9	-4.7	
Tax burden	38.2	37.7	37.4	37.3	
One-off and other temporary measures	0.0	0.0	0.0	0.0	
Structural balance(3)	-1.7	-2.5	-4.9	-5.2	
Structural primary balance	-0.4	-1.3	-3.3	-3.4	
Government gross debt	23.4	22.8	29.3	34.9	
Real GDP growth (%)	*6.8*	*3.5*	*-3.4*	*0.7*	
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	0.5	-0.9	-5.1	-3.9	-3.4
Primary balance	1.8	0.2	-3.6	-2.2	-1.6
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0
Structural balance(3)(5)	-1.6	-2.9	-4.1	-2.3	-2.0
Government gross debt	23.4	22.8	30.5	34.1	36.3
Real GDP growth (%)	*6.8*	*3.5*	*-4.0*	*1.0*	*2.7*

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in April 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Slovenia.

Table V.23.2: **Main budgetary measures for 2009, Slovenia**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• Elimination of payroll tax (-0.6% of GDP)	• Wage subsidy for shorter hours worked (0.6% of GDP)
• Reduction of corporate tax rate by 1 percentage point, from 22% to 21% (-0.1% of GDP)	• Support for SMEs and start-up companies (0.1% of GDP)
• Additional investment allowance for companies (-0.1% of GDP)	• Subsidies for investment in new technologies and R&D (0.2% of GDP)
• Additional investment allowance for sole proprietors (-0.2% of GDP)	
Other measures	
• Increase in excise duties (0.9% of GDP)	• Public sector wage bill (0.2% of GDP) (implementation of decision to eliminate "wage isparities" (0.4% of GDP)[3] partly offset by measures to restrain the wage bill)
	• Increases in specific transfers in kind (0.1% of GDP)[3]

(1) Estimated impact on general government revenue.
(2) Estimated impact on general government expenditure.
(3) Measure decided in 2008.
Source: Commission services and stability programme of Slovenia.

24. SLOVAKIA

Recent developments and medium-term prospects

In 2008, the general government deficit reached 2.2% of GDP, slightly better than the planned target of 2.3% of GDP foreseen in the November 2007 Convergence Programme. Factors contributing to the better-than-expected budget outcome included revenue increasing measures (e.g. broadening of the corporate and personal income tax base, increase in the maximum ceiling of social contributions), more transfers from the fully-funded to the PAYG pillar of the pension system, one-off revenues (e.g. sale of surplus emission quotas), and better results from regional administrative units and municipalities. These revenue measures more than compensated for the negative impact stemming from the write-off of claims with non-financial corporations and the takeover of a debt related to privatization. The debt-to-GDP ratio decreased further in 2008 to 27.6% due to growth in the nominal GDP and stock-flow adjustment.

In the April 2009 update of the Stability Program([38]), the authorities revised the estimate for the 2009 budged deficit upwards to 3% of GDP from originally envisaged 1.7% in the December budget. There remains, however, a stark contrast to the Commission services' 2009 spring forecast, which projects a general government deficit of 4.7% of GDP in 2009. The main reason for this large discrepancy is the much bleaker macroeconomic outlook in the forecast. While the Stability Program estimates economic activity to expand by 2.4% in 2009, the Commission services anticipate a GDP contraction of 2.6%. Overall, fiscal policies can be regarded as expansionary. The government foresees to spend some 0.5% of GDP on anti-crisis measures that are largely being counterbalanced by savings in other areas. On the revenue side, the main measures include a temporary increase in the tax-free income, in-work benefit for low-income employees and a decrease of social contributions for mandatorily insured self-employed. The expenditure side supports the labour market through the funding of social enterprises and subsidies to employers for social benefits payments. R&D spending is increased as well as support of financing for SMEs, while a car scrapping scheme is introduced. In addition, a large stimulating effect is expected from improved drawing of EU structural funds and progress with public private partnership (PPP) projects for motorway construction. The adopted measures are broadly in line with the European Economic Recovery Plan. Most of them are to take effect in the first half of 2009, are targeted on specific sectors or groups and with few exceptions are temporary. However, the launch of the PPP projects may be postponed due to difficulties related to securing the necessary financing. Moreover, these projects are expected to put pressure on the budget in later years when the government will start paying regular instalments for availability.

According to the Commission services' 2009 spring forecast, the general government deficit is projected to deteriorate further to 5.4% of GDP in 2010 on the basis of the no-policy-change assumption. Lower revenue, due to the expectations of subdued economic growth, coupled with higher unemployment related expenditure are the two main factors explaining the fiscal deterioration. On the basis of a more favourable macroeconomic scenario and a stronger economic recovery, the 2008 stability program plans a general government deficit of 2.9% of GDP.

In view of large deficits, government gross debt will increase substantially although remaining at relatively contained levels. In 2009 and 2010 the gross government debt is projected to increase to 32% and roughly 36% of GDP, respectively, from around 27½% of GDP in 2008.

([38]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

Table V.24.1: **Budgetary developments 2007-2012, Slovakia (% of GDP) (1)**

Outturn and forecast(2)	**2007**	**2008**	**2009**	**2010**	
General government balance	-1.9	-2.2	-4.7	-5.4	
- Total revenues	32.5	32.7	33.6	34.1	
Of which : - taxes on production and imports	11.2	10.7	10.6	10.2	
- current taxes on income, wealth, etc.	6.2	6.4	6.2	5.9	
- social contributions	11.8	12.1	12.5	12.6	
- Total expenditure	34.4	34.9	38.3	39.4	
Of which: - compensation of employees	6.8	6.6	6.8	6.9	
- intermediate consumption	4.5	3.8	4.6	4.3	
- social payments	11.6	11.3	12.3	12.8	
- gross fixed capital formation	1.9	1.8	2.0	2.1	
- interest expenditure	1.4	1.2	1.3	1.4	
Primary balance	-0.5	-0.9	-3.3	-4.0	
Tax burden	29.6	29.3	29.5	28.8	
One-off and other temporary measures	0.0	0.2	0.1	0.0	
Structural balance(3)	-3.8	-4.7	-5.0	-4.7	
Structural primary balance	-2.4	-3.5	-3.7	-3.3	
Government gross debt	29.4	27.6	32.2	36.3	
Real GDP growth (%)	10.4	6.4	-2.6	0.7	
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	-1.9	-2.2	-3	-2.9	-2.2
Primary balance	-0.6	-0.9	-1.7	-1.7	-1.0
One-off and other temporary measures	0.8	-0.3	0.4	0.1	0.1
Structural balance(3)(5)	-4.2	-3.8	-4.4	-3.5	-2.6
Government gross debt	29.4	27.6	31.4	32.7	32.7
Real GDP growth (%)	10.4	6.4	2.4	3.6	4.5

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in April 2009.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and Stability programme for Slovakia 2008-2012.

Table V.24.2: **Main budgetary measures for 2009, Slovakia**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
• Income tax (-0.2% of GDP)	• Subsidy of purchases of new cars (0.1% of GDP)
Other measures	
• Excise duties on tobacco (0.2% of GDP)	• Changes in welfare measures (0.5% of GDP)
• Changes in social contributions and capital transfers from the second pension pillar (0.4% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services, Stability programme of Slovakia for 2008-2012 and 2009 budget.

Effectiveness of fiscal stimuli in a small, open economy

Discretionary fiscal policy normally tends to yield positive fiscal multipliers although the exact size and timing of its effect remain uncertain. Simulations have shown that the impact of measures directly supporting aggregate demand is larger than an equivalent reduction of taxes and the size of the impact declines with the degree of openness. ([39]) In a closed economy the multiplier depends only on the marginal propensity to consume and tax rates, but in an open economy a third factor – the propensity to import - affects the

([39]) "Does discretionary fiscal stabilisation warrant a comeback in the EU", Box I.1.1 of *Public Finances in EMU 2008, European* Economy, 4/2008.

size of the fiscal multiplier. Hence, the effectiveness of expansionary fiscal policy is reduced as a part of the increase in consumption is spent on imports.

The Slovak government reacted to the global economic downturn by adopting three anti-crisis packages including measures aimed at alleviating the negative effects of the crisis. The first anti-crisis package, adopted in November 2008, was followed by two additional packages in February 2009. While some of the adopted measures target the labor market and business sector, most measures aim directly or indirectly at supporting domestic aggregate demand (an increase of tax-free income, decrease of social contributions for selected groups, support of R&D activities).

The high trade openness is one of the main traits of the Slovak economy. In 2008, the sum of exports and imports amounted to almost 170% of GDP compared with the EU average of slightly more than 80%. Moreover, Slovakia is a net import country that has recorded a trade balance in surplus only twice since 1993. The negative trade balance is caused by imports of raw materials, foodstuff, and consumer goods. In addition, it is explained by the import of capital goods which is directly related to FDI with the aim to establish export facilities (e.g. construction of plants for the car and electronic production). Considering Slovakia's strong trade linkages with other economies and its position of a net importer, two important implications may be drawn as regards the effectiveness of the fiscal policy response to the current economic downturn.

First, given the size of imports, the impact of extra spending by the government to smooth the output over a cycle can be expected to be only partial. This is best illustrated by the example of the 'car scrapping' scheme, which was adopted in Slovakia in the first quarter of 2009. The Slovak government allocated some EUR 55 million to support purchases of new cars that were conditioned by scrapping of old ones. The car brands produced in Slovakia account for only 20% of the domestic car market. The remaining 80% of cars sold in Slovakia are imported. The scheme can hence support domestic car producers only to a limited extent, as car producers located in other countries will benefit as well. Due to Slovakia's position as a net importer, other demand stimulating measures can be expected to have similar outcomes.

Second, for smaller economies, an improvement in the economic situation of foreign partners can be expected to influence domestic growth through higher demand for exports. As roughly 85% of Slovak exports are directed to EU countries, proactive anti-crisis measures of other EU member states that aim at increasing private consumption should therefore have a positive impact on Slovakia through increased demand for Slovak products, in particular if stimulus measures are concerted.

Openness of an economy may thus indeed trim the effectiveness of fiscal policies especially if they are pursued in isolation to other countries. However, if the economy is integrated in a larger economic space (e.g. the EU), demand stimulating fiscal packages intended to ease the impact of a downturn have their role to play also in small open economies provided that they are carried out across countries, as intended with the European Economic Recovery Plan (EERP). The coordination among the EU members of the fiscal response to the crisis ensures that free riding behavior is reduced and that the cost related to tackling the crisis is shared among all member states.

25. FINLAND

Recent developments and medium-term prospects

The general government surplus reached 4.2% of GDP in 2008, which is considerably higher than the target of 3.7% of GDP set in the November 2007 update of the Stability Programme. The difference arises mainly from the base effect as the surplus recorded in 2007 was 0.8 percentage points higher than planned. This originates principally from two sources. Firstly, economic growth was higher than expected in 2007, boosting tax revenue while expenditure remained contained. Secondly, a change in the recording of property income from social security's assets resulted in an upward revision by almost 0.4% of GDP (for further details, see the Commission services' assessment of the 2007 Stability Programme update). The underlying revenue and expenditure trends in 2008 have remained close to what was planned in the previous programme update, with the discretionary stimulus measures taking effect in the main from 2009 onwards. The general government debt ratio continued to decline, as over the past years, and settled at 33.4% of GDP in 2008, down from 35.1% recorded in the previous year. The large size of the fiscal surplus would suggest an even faster decline in the debt ratio. However, about 3 percentage points of the surplus is accounted for by the accumulation of pension funds assets, which does not impact on the general government gross debt ratio (recorded as stock flow adjustment).

The most recent Ministry of Finance forecast from spring 2009 projects the general government balance to fall rapidly to a deficit of 1.9% of GDP in 2009, considerably worse than a surplus of 2.1% of GDP targeted in the most recent Stability Programme update from December 2008 ([40]). The rapid deterioration in this projection reflects primarily a markedly weaker economic outlook than expected in autumn 2008 and the additional stimulus measures adopted in the meantime. In comparison, the Commission services' most recent forecast from spring 2009 expects the fiscal deficit to reach 0.8% of GDP in the same year, which would be more benign than expected by the Finnish authorities on account of somewhat more positive expectations of short term economic prospects and related tax revenues. The Finnish stimulus measures were announced in several waves, totalling 1.6% of GDP in 2009 and concentrating mainly on permanent tax cuts supporting consumers' purchasing power (see Table 2). Overall, the stimulus packages comply with the general principles of the European Economic Recovery Plan, being targeted and timely. However, the bulk of the fiscal stimulus is provided through permanent tax cuts that are not planned to be reversed given the initially large fiscal surplus and the Government's longer term tax policy aims. Fiscal policy will therefore be expansionary over 2009-2010, which will help to mitigate the effects of the economic crisis but at the same time erode the strong budgetary position that was built up over the previous years. Some compensating tax rises (energy tax, real estate tax, pension contributions), are planned to take effect from 2011, but their size is considerably less than the cost of the current stimulus. Overall, the government has not yet announced a comprehensive fiscal consolidation strategy to restore the long term sustainability of public finances once the present economic crisis abates.

The general government deficit is projected to increase further in 2010 and reach 2.9% of GDP, under the no-policy change assumption. This differs largely from the projection for a surplus of 1.1% of GDP in the December 2008 Stability Programme, a target by now outdated.

On account of the budgetary surpluses turning into deficits and some financial transactions impacting on the stock flow adjustment, the general government debt ratio is forecast to increase sharply over 2009 and 2010 to almost 46% of GDP (assuming that the banking sector does not resort to state financing schemes). The debt ratio projections in the December 2008 Stability Programme (34% of GDP in 2010) are similarly outdated, as noted above.

([40]) The programme as well as its assessment by the Commission and the Council can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_polic /sg_programmes9147_en.htm.

Table V.25.1: **Budgetary developments 2006-2011, Finland (% of GDP) (1)**

Outturn and forecast(2)	**2007**	**2008**	**2009**	**2010**	
General government balance	5.2	4.2	-0.8	-2.9	
- Total revenues	52.5	52.5	52	51.5	
Of which : - taxes on production and imports	13	12.8	13	12.6	
- current taxes on income, wealth, etc.	17.5	17.4	16	15.9	
- social contributions	12	12.1	12.3	12.1	
- Total expenditure	47.3	48.3	52.8	54.3	
Of which: - compensation of employees	13	13.2	14.3	14.6	
- intermediate consumption	9	9.4	10.5	10.9	
- social payments	15.1	15.2	16.8	17.3	
- gross fixed capital formation	2.5	2.5	2.8	2.9	
- interest expenditure	1.5	1.4	1.3	1.4	
Primary balance	6.7	5.6	0.5	-1.5	
Tax burden	43.1	42.8	41.9	41.3	
One-off and other temporary measures	0	0	0	-0.2	
Structural balance(3)	3.2	2.8	0.8	-0.7	
Structural primary balance	4.6	4.2	2.1	0.7	
Government gross debt	35.1	33.4	39.7	45.7	
Real GDP growth (%)	4.2	0.9	-4.7	0.2	
Stability programme(4)	**2007**	**2008**	**2009**	**2010**	**2011**
General government balance	5.3	4.4	2.1	1.1	1.0
Primary balance	6.8	5.8	3.4	2.4	2.2
One-off and other temporary measures	n.a.	n.a.	n.a.	n.a.	n.a.
Structural balance(3)(5)	4.5	3.7	2.4	1.7	1.6
Government gross debt	35.1	32.4	33.0	33.7	34.1
Real GDP growth (%)	4.5	2.6	0.6	1.8	2.4

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecasts.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in November 2008
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and stability programme of Finland

Table V.25.2: **Main measures in the budget for 2009, Finland**

Revenue measures (1)	**Expenditure measures (2)**
Measures in response to the downturn	
• Income tax cuts (-0.7% of GDP)	• Supporting enterprises access to finance (0.2% of GDP)
• Lowering tax on pension income (-0.1% of GDP)	• Boosting infrastructure investment (0.1% of GDP)
• Increasing various tax deductibles (-0.1% of GDP)	• Boosting construction of rental housing (0.05% of GDP)
Other measures	
• Increases of alcohol and tobacco excises (0.05% of GDP)	• Funding municipal mergers (0.05% of GDP)

(1) Estimated impact on general government revenue.
(2) Estimated impact on general government expenditure.
Source: Commission services and 2008 Stability Programme and the Budget for 2009.

26. SWEDEN

Recent developments and medium-term prospects

In 2008, the general government recorded an estimated surplus of 2.5% of GDP. This was somewhat worse than the 2.8% initially foreseen in the convergence programme of December 2007.([41]) The worse-than-expected general government balance was mainly the result of unexpectedly low tax receipts from capital gains and corporate income, reflecting the impact of falling stock market indices and the economic slowdown, in particular towards the end of the year. Thanks to the surplus, government debt is estimated to have fallen to 38% of GDP in 2008.

According to the macroeconomic scenario underpinning the spring budget bill presented in April 2009, the government forecasts a general budget deficit of 2.7% of GDP in 2009. This is close to the view taken in the Commission spring forecast, which foresees a deficit of 2.6% of GDP in 2009 based on a slightly more optimistic macroeconomic scenario, but is significantly worse than the surplus of 1.1% of GDP envisaged in the 2008 update of the convergence programme (based on the 2009 budget bill scenario). The difference is mainly due to the sharp and sudden deterioration in the macroeconomic situation and outlook that has taken place since the publication of the 2009 budget bill in September 2008, but also to further discretionary fiscal stimulus measures. As the economic situation and outlook has worsened, the focus of these measures has shifted from structural objectives, such as improving the incentives to work through reduced income taxes (the main theme of the 2009 budget bill), to short-term stimulus objectives, such as improving matching on the labour market (bill to promote employment and transition of January 2009) and increased state transfers to the regional and local level of government to dampen employment cut-backs (supplementary budget bill of April 2009). Many of the measures are permanent in nature, notably the reductions in labour income taxes, and thus do not follow the general principle of the European Economic Recovery Plan that stimulus measure should be temporary. However, these measures do not only have a stimulus role to play, but are also intended to raise long-term potential growth, for example by stimulating people to take up work, work longer hours or acquire human capital. The measures do to a large extent follow the principles that they should be timely and well-targeted. Including the measures contained in the 2009 budget bill, fiscal policy could clearly be characterised as expansionary in 2009. Additional measures proposed as the downturn worsened have been rather limited in size. This reflects the government's concerns about maintaining public finances on a sustainable footing, in particular in view of the heightened uncertainty about the duration of the downturn and the large contingent liabilities implied by extensive guarantees to the financial sector. There is also the risk that the sharp rise in unemployment could lead to higher structural unemployment with adverse effects on the fiscal balance.

In the Commission spring forecast, the fiscal deficit is foreseen to widen to 3.9% in 2010. This forecast is based on a no-policy-change assumption and reflects the costs of rising unemployment. In the most recent update of the convergence programme, the general government surplus was seen to rise from 1.1% of GDP in 2009 to 1.6% of GDP in 2010. As was the case for 2009, this large discrepancy mainly reflects the much rosier macroeconomic scenario in the updated programme.

According to the Commission spring forecast, government debt is expected to reach 44% and 47% of GDP in 2009 and 2010, respectively. This compares with 32% and 28% of GDP, respectively, in the updated convergence programme. Apart from the differences stemming from different macroeconomic scenarios, the convergence programme still assumed privatisation receipts of SEK 50 billion a year, whereas the Commission assumes no further privatisations and possible public capital injections.

([41]) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm.

Table V.26.1: **Budgetary developments 2007-2011, Sweden (% of GDP) (1)**

Outturn and forecast(2)		**2007**	**2008**	**2009**	**2010**	
General government balance		3.8	2.5	-2.6	-3.9	
- Total revenues		56.3	55.7	54	53.4	
Of which :	- taxes on production and imports	16.8	18.2	18.3	18.3	
	- current taxes on income, wealth, etc.	19.1	17.5	15.6	15.4	
	- social contributions	12.8	11.9	12.1	11.9	
- Total expenditure		52.5	53.1	56.6	57.3	
Of which:	- compensation of employees	15.1	14.9	15.6	15.5	
	- intermediate consumption	9.4	9.7	9.8	9.8	
	- social payments	15.3	15.1	16.8	17.4	
	- gross fixed capital formation	3.1	3.3	3.6	3.7	
	- interest expenditure	1.8	1.7	1.5	1.4	
Primary balance		5.6	4.2	-1.2	-2.5	
Tax burden		48.3	47.2	45.6	45.1	
One-off and other temporary measures		0	0.3	0.1	0	
Structural balance(3)		1.9	1.7	-0.5	-1.9	
Structural primary balance		3.7	3.4	0.9	-0.5	
Government gross debt		40.5	38	44	47.2	
Real GDP growth (%)		2.6	-0.2	-4	0.8	
Convergence programme(4)		**2007**	**2008**	**2009**	**2010**	**2011**
General government balance		3.6	2.8	1.1	1.6	2.5
Primary balance		5.4	4.7	2.6	3	3.8
One-off and other temporary measures		0.8	0.3	0.1	0.1	0.1
Structural balance(3)(5)		2.2	2.8	1.9	2.1	2.5
Government gross debt		40.6	35.5	32.2	28.3	23.8
Real GDP growth (%)		2.7	1.5	1.3	3.1	3.5

(1) Commission services' spring 2009 forecast.
(2) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures.
(4) Submitted in December 2008.
(5) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and convergence programme of Sweden.

Table V.26.2: **Main measures in the budget for 2009, Sweden**

Revenue measures(1)	**Expenditure measures(2)**
Measures in response to the downturn	
• Lower taxes on earned income (-0.5% of GDP)	• Increased investment in and maintenance of infrastructure (+0.2% of GDP)
• Tax deductibility of home improvement services (-0,1% of GDP)	• Increased education and research expenditure (+0.1% of GDP)
• Lower corporate income tax (-0.2% of GDP)	• Increased coaching, activation and training of unemployed (+0.1% of GDP)
• Lower taxes on pensions (-0.1% of GDP)	
• Lower social contributions (-0.3% of GDP)	
Other measures	
• Changed under-pricing rules for certain companies (+0.2% of GDP)	
• Changed deductibility of interest costs for companies (+0.2% of GDP)	

(1) Estimated impact on general government revenue.
(2) Estimated impact on general government expenditure.
(3) On-going measure, not specific to 2009 Budget
Source: Commission services and 2008 stability programme and the Budget for 2009.

27. UNITED KINGDOM

Recent developments and medium-term prospects

The general government deficit in 2008/09([42]) is estimated at 7.2% of GDP, up from 2.8% in 2007/08. The estimate for 2008/09 is 4.3 percentage points (pp) higher than the projection in the United Kingdom's convergence programme of November 2007([43]). Underlying the very significant overshoot in the headline deficit in 2008/09 was the impact of the economic recession on taxation receipts and the cost of the fiscal stimulus measures announced by government in November 2008. In addition, on the expenditure side, government financial sector interventions contributed to an unanticipated one-off deficit-increasing rise in capital transfers of ¾% of GDP. In 2008/09, payments made by the Financial Services Compensation Scheme (FSCS) to depositors of defaulting banks led to a (deficit-neutral) increase in the revenue and expenditure ratios by almost 1½ pp. The debt-to-GDP ratio surged upward by 12 percentage points, to around 55%, with financing transactions related to bank nationalisations accounting for almost half of the increase in debt.

The 2009 Budget, which was presented on 22 April 2009, envisages a significantly weaker outlook for public finances compared to the most recent convergence programme. According to the Budget projections, the deficit in 2009/10 will reach 12.7% of GDP, up by 4½ percentage points compared to the programme and broadly in line with the Commission services' spring 2009 forecast of 13% of GDP. In addition to the carry-over of part of the deficit overshoot recorded in 2008/09, around two-thirds of the upward revision in the deficit forecast is due to the deeper contraction in overall economic activity, the impact of lower-than-expected inflation on tax bases, and higher reductions in revenue from two hitherto major sources: the financial sector and the housing market (see following section).

Fiscal policies in 2009/2010 can be regarded as expansionary, departing from a high structural government deficit already before the economic recession. In response to the economic downturn, a major stimulus package was adopted in November 2008 as part of the Pre-Budget Report, heavily weighted towards supporting household purchasing power. A smaller package was announced as part of the 2009 Budget, which put more emphasis on supporting industrial and business sectors and the labour market. Overall, the cost of fiscal stimulus measures amounts to around 1½% of GDP. The measures are consistent with the EERP: they are focused on supporting domestic demand when economic activity is expected to be at its weakest, targeted at those sectors worst affected by the crisis, and many of the measures should be temporary.

Under a no-policy-change assumption, the Commission services' forecast a deficit in 2010/11 of 12¾% of GDP. The latter is ¾ percentage points higher than in the latest government projections, almost entirely on account of the weaker macroeconomic outlook in the forecast. In addition, there remain significant negative risks, mainly stemming from: pressure to extend to 2010 at least some of the temporary stimulus initiatives if the path of economic recovery envisaged by the UK authorities does not materialise, the possible realisation of contingent liabilities incurred by the government as a result of its financial sector rescue operations, and potentially higher debt-servicing costs in the face of increased market concern about growing government debt. The debt-to-GDP ratio is forecast by the Commission services to increase by almost 30 percentage points to close to 85% by 2010/11, including as a result of additional debt-increasing financial transactions of around 2½% of GDP in 2009/10.

(42) The UK financial year runs from April to March.
(43) The programme, as well as its assessment by the Commission and the Council, can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/sg_programmes9147_en.htm
(3) The cut-off date for the Commission projections preceded the government's statement on the 23 April that it now envisages elements of compensation to those negatively affected by the removal of the 10% starting rate on income tax (one of the measures announced in the March 2007 budget).

Table V.27.1: **Budgetary developments 2007/08-2013/14, United Kingdom (% of GDP) (1)**

Outturn and forecast(2)	2007/08	2008/09	2009/10	2010/11			
General government balance (3)	-2.8	-7.2	-13.0	-12.8			
- Total revenues	41.6	41.1	38.4	39.0			
Of which : - taxes on production and imports	12.4	11.5	11.2	11.7			
- current taxes on income, wealth, etc.	17.0	15.8	14.6	14.9			
- social contributions	8.3	8.4	8.4	8.3			
- Total expenditure	44.4	48.3	51.2	51.8			
Of which: - compensation of employees	10.9	11.2	11.9	12.1			
- intermediate consumption	11.9	12.2	13.9	13.9			
- social payments	12.7	13.5	15.1	15.2			
- gross fixed capital formation	2.0	2.4	2.8	2.5			
- interest expenditure	2.2	2.2	2.1	3.1			
Primary balance	-0.6	-5.0	-10.7	-9.6			
Tax burden	38.4	37.9	34.9	35.5			
One-off and other temporary measures	0.0	-0.7	0.0	0.0			
Structural balance(4)	-3.7	-6.7	-11.6	-11.3			
Structural primary balance	-1.6	-4.5	-9.5	-8.2			
Government gross debt	43.3	55.4	72.4	83.4			
Real GDP growth (%)	3.0	-0.9	-3.0	0.7			
Convergence programme(5)	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**
General government balance	-2.8	-5.5	-8.2	-7.1	-5.6	-4.4	-3.4
Primary balance	-0.6	-3.4	-6.4	-4.5	-2.6	-1.4	-0.3
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Structural balance(4)(6)	-3.2	-5.3	-7.2	-6.2	-5.1	-4.2	-3.5
Government gross debt	43.2	52.9	60.5	65.1	67.5	68.6	68.5
Real GDP growth (%)	3	-¼	-½	2	3	3	3

(1) Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
(2) Commission services' spring 2009 economic forecast. The UK financial year runs from April to March. The excessive deficit procedure applies to the UK on a financial year basis. The figures for 2008/09 are Commission estimates based on provisional outturn data.
(3) Total revenues exclude UMTS receipts in line with the decision by Eurostat of 14 July 2000.
(4) Cyclically-adjusted balance excluding one-off and other temporary measures.
(5) Submitted in December 2008.
(6) Commission services' calculations on the basis of the information in the programme. One-off and other temporary measures taken from the programme.
Source: Commission services and convergence programme of the United Kingdom.

Table V.27.2: **Main budgetary measures for 2009/10, United Kingdom**

Revenue measures(1)	Expenditure measures(2)
Measures in response to the downturn	
• VAT rate reduction (-0.6% of GDP)	• Front-loading capital spending (0.2% of GDP)
• Lower income taxation (-0.3% of GDP)	• Support for business and industry (0.2% of GDP)
• Tobacco and alcohol duties (0.1% of GDP)	• Social and housing ependiture (0.2% of GDP)
• Deferral of business rate increase (-0.1% of GDP)	

(1) Estimated impact on general government revenues.
(2) Estimated impact on general government expenditure.
Source: Commission services, 2008 Convergence Programme and 2009 Budget.

Revenue losses from banking sector asset writedowns

This section evaluates the fiscal consequences of the losses incurred by the financial sector on investments in international structured financial instruments and on domestic mortgage lending.

The emergence of the financial sector crisis since August 2007 has translated into a sharp increase in banks' losses from asset writedowns, principally from marking asset values to market. These losses include those due to defaults on US residential mortgage-backed securities, as well as those triggered by exposures to the collapse of Lehman Brothers in September 2008 and investments related to Icelandic banks.

Banks' credit losses imply lower corporate tax revenue on financial sector profits and reduced income tax receipts on distributed profits. In the UK, financial sector writedowns of structured financial instruments, particularly those backed by the US sub-prime mortgages, could reduce tax revenues on financial sector profits by around 1½% of GDP, predominantly due to lower corporate tax income.

Table V.27.3: **Fiscal costs of banking sector credit losses**

	Credit losses		Potential fiscal costs (1)	
	Qtr.4 2007 and 2008		Loss in corporate tax revenue	Loss in income taxes on distributed profits (2)
	€ bln	% of GDP	% of GDP	
UK	77.0	4.2	1.19	0.22
Germany (3)	58.4	2.3	0.53	0.08
Switzerland	50.1	14.2	3.01	1.28
France	23.2	1.2	0.34	0.15
Netherlands	14.4	2.4	0.62	0.21
Belgium	15.7	4.5	1.48	0.31
USA/Canada	590.9	4.7	1.42	0.29
Europe (4)	267.2	2.1	0.46	0.14

(1) Estimates based on statutory tax rates on corporate profits and dividend income. Tax rates derived from Tax Database, Centre for Tax Policy and Administration, OECD: http://www.oecd.org/document/60/0,3343,en_2649_34533_1942460_1_1_1_1,00.htm
(2) Estimates assume dividends as a share of profits of 35%, reflecting computations based on the UK economic accounts.
(3) Estimates based on an effective corporate tax rate of 38½% in 2007 and 28½% in 2008.
(4) Europe includes banks from countries that are not members of the European Union, primarily those registered in Switzerland.
Source: Bloomberg (data reported as of 4 April 2009), Commission estimates.

The estimates above probably represent a ceiling to the tax losses that the governments of Member States could incur from reported asset writedowns. In fact, a part of the reported writedowns could include asset value reductions that only decrease equity and are excluded by the banks from their earnings figures. Some of the credit losses are expected to be recorded outside the Member State where the parent bank is registered, through subsidiaries based in other Member States or other jurisdictions. Tax legislation in some Member States, including in the UK, also allows companies to carry forward losses to offset against income in future accounting periods. This may prolong the impact of higher losses on tax revenues. However, prevailing liquidity constraints reduce the likelihood of corporations carrying forward lower tax liabilities from credit losses. In the UK, losses incurred in 2008, for example, could be used to claim refunds of corporate taxes paid in the preceding year, which would bring forward the significant negative effect of financial sector losses on UK public finances.

The particularly marked downward adjustment in house prices in the UK also carries the risk of an increase in mortgage defaults, which, combined with the effect of the broader macroeconomic weaknesses on the banking sector's loan book, would feed into higher credit losses. The stress-testing calibrations published by the Bank of England([44]) in October 2008 indicate that, in a risk scenario characterised by a contraction in output and a sharp fall in asset prices, bank write-offs on lending to households, principally due to increasing mortgage defaults, and non-financial companies([45]) would result in cumulative domestic credit losses for UK banks of up to £70 billion (4½% of annual average GDP) over the next five years. The potential losses envisaged by the Bank of England in the risk scenario would lead to cumulative reductions in corporate tax receipts on financial sector profits during the next five years of 1¼% of GDP. This compares with annual average corporate tax revenues during the past five years of around 4% of GDP.

The April 2009 UK budget assumes that weaker financial sector profitability and the downturn in the property market will lower receipts from the two sectors in 2009/10 by 1¾% of GDP compared to 2007/08([46]). The above estimates on potential tax revenue losses as a result of lower financial sector profits, coupled with previous Commission services' estimates on the prospective reduction in stamp duty intakes by ½% of GDP over the two-year period ending 2009/10 as a result of the downturn in the UK housing market([47]), indicate that there are significant risks that the fall in revenue losses from property and financial sector activity could be higher than envisaged in the latest budget.

([44]) Bank of England Financial Stability Report, October 2008, Issue No. 24, pp. 28.
([45]) In the stress scenario, mortgage arrears are estimated to rise to a peak of 4.4%, while UK corporate insolvencies rise to 1.7%.
([46]) "The impact of the financial and housing sector on the public finances", Box C3, Budget 2009.
([47]) "*The economic and fiscal significance of the UK housing market*", United Kingdom Macro Fiscal Assessment of December 2008 Update of the Convergence Programme, Annex 1; http://ec.europa.eu/economy_finance/publications/publication14266_en.pdf