Public finances in economic and monetary Union EMU in 2003

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PURPOSE : to present a Commission communication on Public Finances in EMU 2003. CONTENT : 2002 and the early part of 2003 has been a difficult period in terms of actual budgetary developments. The nominal deficit for the euro area increased from 1.6% of GDP in 2001 to 2.2% in 2002 and is forecast to rise to 2.5% of GDP in 2003. By the end of 2002, only six EU countries, including four euro area countries (accounting for under 18% of euro area output), had achieved budget positions in both nominal and cyclically-adjusted terms that respected the 'close to balance or in surplus' requirement of the Stability and growth Pact (SGP): in contrast, two euro area countries accounting for half of the euro area output had nominal deficits above 3% of GDP. The paper cites the deficits in Portugal, France, Germany and Italy. Deficits have also re-emerged in countries that already had reached balanced budget positions, notably Austria (0.6% of GDP in 2002), the Netherlands (1.1%) and also in the UK (1.3%). These three countries are forecast to record an important deterioration of the deficit in 2003. The Commission expresses concern that underlying budgetary trends indicate a discretionary loosening of the fiscal stance by some Member States, brought about by a combination of unfunded tax cuts, discretionary expenditure increases and slippages as regards budgetary execution. The deterioration has been particularly pronounced in Germany (where the CAB increased to 3.2% of GDP in 2002) and France (to 3.3%). In Italy it has improved but remained high (at 2.1%). The latest updates of the stability and convergence programmes contain a commitment to reach the target of 'close to balance or in surplus', but the medium-term targets of Member States are based on growth assumptions, which in light of developments in recent months now appear to be optimistic. For countries where large underlying deficits remain, the date for reaching the 'close to balance or in surplus' objective has been pushed back to 2006 or 2007, and even this deadline will only be met if additional consolidation measures are undertaken. It is vital therefore that all efforts are made to achieve these goals and maintain sound positions over the medium-term. EU budgetary surveillance, for the second time, includes a systematic assessment of the sustainability of public finances on the basis of the updated stability and convergence programmes submitted in late 2002. The analysis shows that there is a risk of unsustainable public finances in some half of EU countries, notably Belgium, Germany, Greece, Spain, France, Italy, Austria, and Portugal. With a fast closing window of opportunity prior to the budgetary impact of ageing populations taking hold, the risk of unsustainable public will finances will increase substantially higher if Member States with large deficits do not achieve and sustain the budgetary consolidation plans outlined in their stability and convergence programmes. In Spain and Greece, a substantial share of the risk of emerging budgetary imbalances is due to a very large projected increase in pension expenditure. In several Member States (notably Germany, France, Austria and Portugal) the risk of emerging budgetary imbalances is a combination of factors including projected increase in public spending on pensions and health care, a slow the pace of debt reduction and relatively low labour force participation rates ofolder workers. High debt countries (Belgium, Greece and Italy) face a particular set of challenges, because they must be able to sustain large primary surpluses over several decades. Several Member States appear to have sustainable public finances including Denmark, Luxembourg, the Netherlands, Finland, Sweden and the UK. They do, however, face budgetary challenges as a result of ageing populations. The framework for budgetary surveillance at EU level is being prepared for the accession of ten countries to the EU in May 2004. The aggregate general government deficit of these ten countries widened but is projected to improve in 2003 and 2004. Despite a significant acceleration in growth, however, the projected reduction in the aggregate deficit of the ten acceding countries is not sufficient to reverse the deterioration recorded in 2002. This suggests that structural, rather than cyclical, factors underlie current budgetary imbalances. Concerning the thirteen candidate countries as a whole, the aggregate budget position is influenced to a large extent by the exceptional advance recorded in 2002 and forecast for the coming years in Turkey. Nine countries plan to reduce their budget deficits by 2005, leading to a fall in the average deficit.