

## STRONG DETERIORATION OF FISCAL POSITIONS IN THE OECD

Fiscal positions have sharply deteriorated during the recent downturn, both in headline and in cyclically adjusted terms (Figures 1 and 2). The momentum of fiscal consolidation weakened in the late 1990s as rising tax receipts and overoptimistic growth projections led to tax cutting and new spending initiatives. In the United States, Canada and in many EU member states (including Austria, France, Finland, Germany, Ireland, Sweden, and the United Kingdom) revenue declines were particularly abrupt in 2002. The room for new tax reductions is now limited and will require effective restraint on the spending side. Once the recovery is underway, it will be of utmost importance to consolidate swiftly for structural balance and tax objectives to be met.

In the United States, the swing from a surplus of 1.4% of GDP in 2000 to a projected deficit of 4.2% in 2004 is due to the huge tax cuts of 2001 and 2002 and the costs of the Iraq war and reconstruction. The fiscal deterioration in the euro area appears to be predominantly cyclical. In Sweden (the surplus

Figure 2

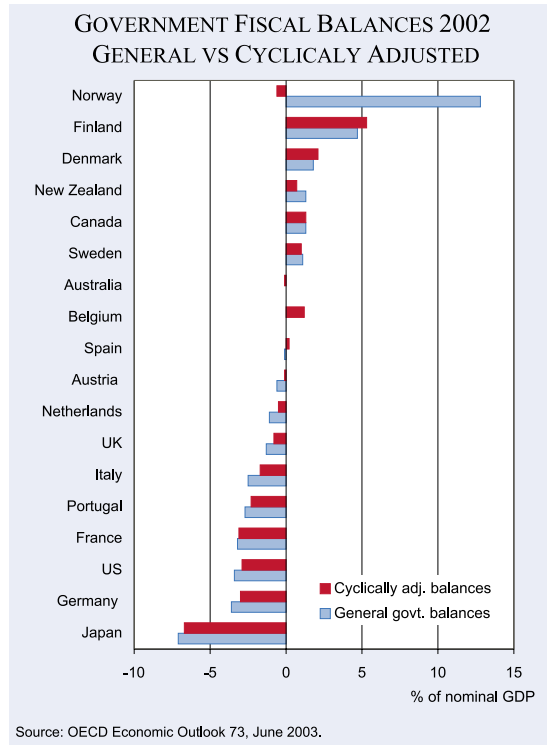
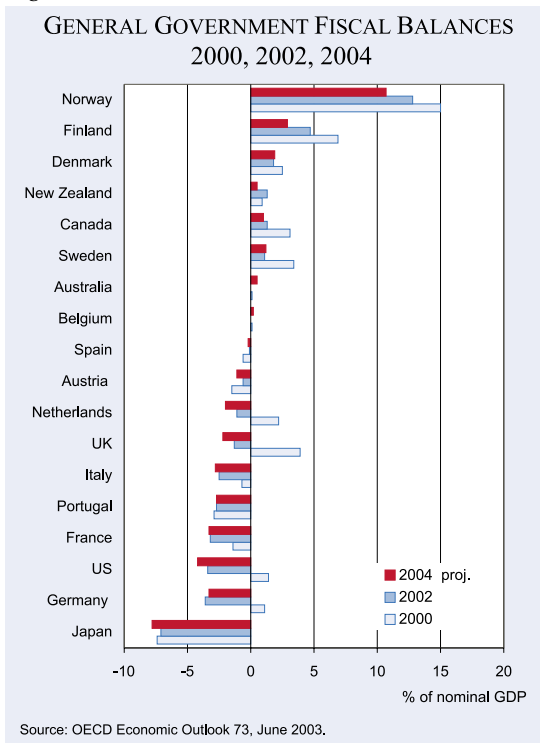


Figure 1



is declining from 4.8% of GDP in 2001 to a projected 1.2% in 2004) and the United Kingdom (going from a surplus of 3.9% of GDP in 2000 to a projected deficit of 2.2% in 2004), however, it also reflects a sizeable loosening of the fiscal stance. As foreseen in the EU Treaty, the excessive deficit procedure has been activated for Portugal (projected deficit of 3.2% of GDP in 2003), Germany (projected deficit of 3.7% in 2003), and France (projected deficit of 3.6% in 2003).

Against this background, the EU Commission proposed to postpone the target year for reaching close to balance or surplus positions from 2004 to 2006 (originally the target year was 2002) in order to avoid pro-cyclical fiscal decisions in the midst of subdued economic activity. At the same time the Commission put forward a requirement for member states that are still far from a "safe" position to reduce their structural deficits by half a percentage point per annum, starting in 2003. This approach was endorsed by euro area finance ministers.

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## ITALY AND BELGIUM REMAIN THE HIGH SAVERS

In the late 1990s household savings rates fell to their lowest levels in decades. High asset prices boosted the wealth of private households, inducing them to raise their spending. With spending outpacing income, the savings rate declined. This effect was most notable in the United States where household savings rates fell to just 2 percent of disposable income. This was topped only by New Zealand, whose savings rate even turned negative.

When the asset price bubble burst, equity prices plummeted. By September 2002, broad equity price indices had fallen by over 40 percent from their 2000 peaks in the United States and the United Kingdom, and by close to 50 percent in the euro area and Japan. Employees saw a large share of their retirement assets evaporate, as pension funds and insurance companies reevaluated their portfolios. This asset shock has contributed to a rebound of household savings rates.

With few exceptions, savings rates in the OECD increased again in 2002, although still falling short of their longer-term average. Besides the wealth effect, household spending has also been depressed (and

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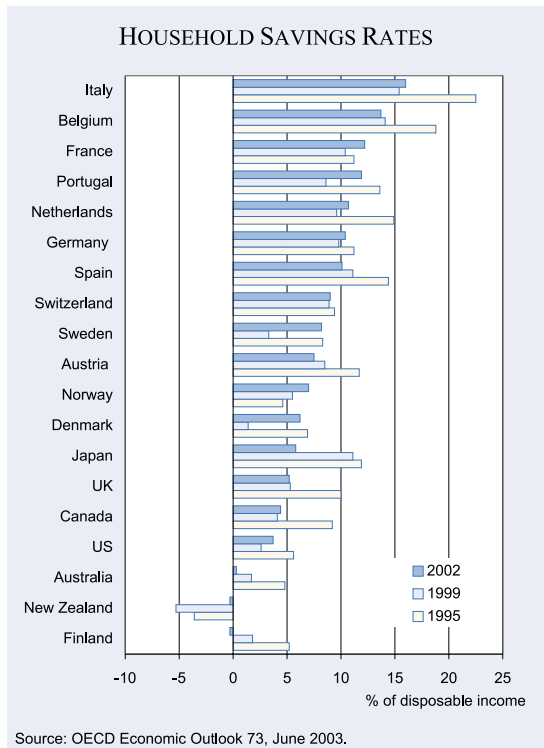
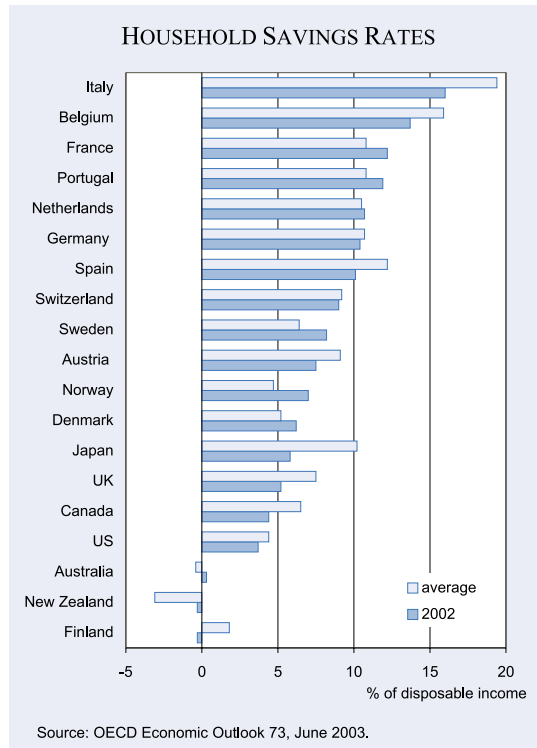


Figure 2



savings increased) by the job uncertainty created by the general economic slowdown.

Despite the fluctuations of household savings over time, the high savers are still the same: Italy at 16 percent and Belgium at close to 14 percent. Other countries with two-digit savings rates include France (12.2%), Portugal (11.9%), the Netherlands (10.7%), and Germany (10.4%). At the low end of the range we find the formerly high saver Japan (5.8%), Norway and the United Kingdom (5.5%), Canada (4.4%), the United States (3.7%), Australia (0.3%) as well as Finland and New Zealand (-0.3%). The OECD projects generally higher household savings rates for 2003 and 2004.

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