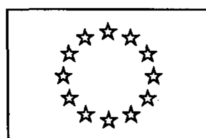

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 30.1.2003
SEC (2003) 125 final

EU RESTRICTED

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Article 5 of Council Regulation (EC) n°1466/97 of 7 July 1997 on the updated stability programme of Belgium, 2003-2005

(presented by the Commission)

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EXPLANATORY MEMORANDUM

Council Regulation (EC) No 1466/97, on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[1], stipulated that countries participating in the single currency were to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of the Regulation, the Council had to examine each stability programme based on the assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). The Commission adopted a recommendation on each programme. On the basis of this recommendation and after having consulted the Committee set up be Article 114, the Council delivered an Opinion, following its examination of the programme.

The first stability programme of Belgium covering the period 1999-2002 was submitted on 18 December 1998 and assessed by the Council on 15 March 1999[2].

According to the Regulation, the updated stability programmes, to be presented annually, may be examined by the Council in accordance with these same procedures. The first update of the stability programme was submitted to the Commission on 24 December 1999, the second update on 22 December 2000 and the third on 30 November 2001.

Belgium submitted its present 2002 updated stability programme, covering the period 2001-2005, on 2 December 2002. The Commission services have carried out a technical evaluation of this updated programme, namely taking into account the Communication from the Commission to the Council of 27 November 2002, on strengthening the co-ordination of budgetary policies. This evaluation warrants the following assessment.

> The new update of the Belgian stability programme presents macro-economic and general government budgetary projections covering the period 2002-2005. It is broadly in line with the revised "Code of Conduct on the content and format of stability and convergence programmes"[3]. However, it does not provide separated accounts for the Federal Government and Social Security although giving key components of the Social Security accounts.
>
> The open economy of Belgium has been adversely affected by the sharp slowdown in the world economy and international trade. Economic activity remained weak in 2002, real GDP growth reaching 0.7%, roughly the same pace as in 2001. Public finances have been adversely affected by the economic slowdown, although the impact on general government balance was relatively contained in 2002. The general government accounts are estimated to be in balance in 2002, after recording a small surplus of 0.2% of GDP in 2001 (a surplus of 0.4% of GDP if UMTS receipts are included). The budgetary target for 2002 set in the 2001 update was met despite lower than expected real GDP growth. The reduction in the debt ratio during 2001-2002 was, however, relatively limited, reaching a total 3.5 percentage points of GDP; this development was partly due to the economic slowdown but also to downward revisions of data concerning GDP and ad hoc financial operations, such as

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1 OJ L 209, 2.8.1997

2 OJ C 124, 5.5.1999

3 *Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes*, document EFC/ECFIN/404/01 – REV 1 of 27.6.2001 endorsed by the Ecofin Council on 10.7.2001

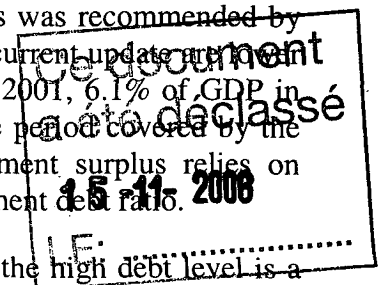
the assumption of debt of a number of public entities by the State. In 2002, the government debt ratio was still at a very high level, 106.1% of GDP, almost 3 percentage points of GDP higher than expected in the previous update.

According to the updated programme, real GDP growth should reach 2.1% in 2003, rising to 2.5% in 2004 and remaining at that level in 2005; these macroeconomic projections are plausible and close to those of the Commission. On this basis, the 2002 update is projecting maintenance of a balanced general government position in 2003 and a surplus of 0.3% of GDP in 2004 rising to 0.5% in 2005. The ground lost in the budgetary adjustment as targeted in the previous update, which was projecting a 0.5% of GDP surplus already in 2003, would be partly recovered by a somewhat faster adjustment during 2004 and 2005.

The government debt ratio has been falling continuously since its peak level of 139.7% of GDP in 1993 and this trend is projected to accelerate in the coming years, after a relatively slow decline during 2001-2002. During the period 2003-2005, the 2002 update projects the debt ratio to decline by an annual average rate of about 4% to 93.6% of GDP in 2005; main contributors to such decline should be high primary surpluses and robust enough GDP growth in 2003 and more so as from 2004; this decline is expected to proceed from endogenous factors, as no ad hoc operations affecting the pace of debt reduction are included in the programme. However, the programme refers to the possibility, non-quantified, of assumption, by the State, of part of public entities debt.

In 2002, the cyclically-adjusted balance improved from a deficit of 0.2% of GDP to a surplus of 0.3% of GDP. During the years 2003-2005, the underlying budgetary position, which in the case of Belgium broadly corresponds to the cyclically adjusted balance, is estimated to remain practically constant, at the level reached in 2002, on the basis of Commission calculations using the production function method. The results of the calculations provided by the updated programme, indicate also a cyclically-adjusted surplus which, however, is increasing towards the end of period. In view of the above, Belgium can be considered as continuing to respect the requirements of the Stability and Growth Pact, reaching an underlying budgetary position of close to balance or in surplus in the medium-term. However, taking into account the very high level of the government debt a more robust budgetary effort would be required in the medium term.

The budgetary adjustment and the debt reduction strategy of the updated programme continues to be based on high primary surpluses, at 5.6% of GDP on average per year, combined with declining interest payments; a decline in the total tax and non-tax burden to be financed by a parallel control of expenditure growth is, also, a basic objective of the programme. The policy of maintaining high primary surpluses, based on effective control of primary expenditure, has been successful so far in eliminating budgetary deficits and reducing the government debt ratio as was recommended by the Council. However, the primary surpluses foreseen in the current update are lower compared to those obtained in recent years (7% of GDP in 2001, 6.1% of GDP in 2002) and are projected to remain broadly constant over the period covered by the programme. The projected increase in the general government surplus relies on declining interest payments, made possible by falling government debt ratio.



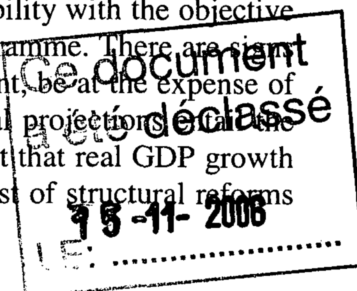
Expected lower primary surpluses, taking into consideration the high debt level is a disappointing aspect of the current programme; the Council, in its Opinion on the

2001 update, recommended to the Belgian government, to maintain primary surpluses around 6% of GDP in the coming years. In particular, a lower primary surplus in 2003, at 5.6% of GDP – to be compared with 6.1% of GDP reached in 2002 -, implies less budgetary adjustment this year, despite 2.1% projected real GDP growth; this is not in line with the second recommendation of the 2002 Broad Economic Policy Guidelines. Also, the expected reduction in the government debt ratio in 2003 at 3.8 percentage points of GDP, is lower than that targeted in the previous update, 5.5 percentage points of GDP. Moreover, the prospect of debt-increasing financial operations, related to the assumption of debt of public enterprises, notably of the Belgian railways company, the SNCB, makes uncertain the achievement of the projected rates of reduction in the debt ratio; in addition, it is not excluded that such an operation might also have an impact on the government deficit.

It must also be noted that no reference is made in the current update to the limit of 1.5% per year for real primary expenditure increase for Entity I, (Federal Government and Social Security) which has been a useful means to contain expenditure in recent years and was a requirement of both the Council Opinion on the 2001 update and the 2002 Broad Economic Policy Guidelines. The above elements may convey a signal of adjustment fatigue, which contrasts with the firm fiscal stance adopted so far. The projected medium-term budgetary effort should, therefore, be considered as the minimum effort necessary to pursue the necessary budgetary consolidation and debt reduction by Belgium over the period covered by the programme. The 2002 update states that the proceeds stemming from growth higher than projected will be allocated as a matter of priority to debt reduction.

The 2002 updated stability programme contains a section on the sustainability of public finances. It includes national projections for public expenditures on pensions, health care, long term care and other social transfers which show an overall increase in age-related spending of 3.4% of GDP. On the basis of current policies, and in particular the policy of sustaining high primary surpluses, Belgium should be able to meet the budgetary costs of ageing populations. However, it should be borne in mind that long-run budgetary developments in a high debt country like Belgium are very sensitive to medium-term budget targets being achieved and sustained over the long-run. A failure to continue the policy of running large primary surpluses would mean that the risk of unsustainable public finances could not be excluded.

The programme reports on structural reforms, in particular the progressive implementation of the reform of the personal income tax, the corporate tax reform to be introduced from 2003 and administrative simplifications for setting-up and operating business activity. Also, draft legislation has been tabled to Parliament aimed at setting-up the regulatory framework for the second pillar of supplementary pensions. However, the budgetary implications of these reforms, in particular those involving tax and not-tax burden reduction and their compatibility with the objective of fiscal consolidation, are not quantified in the updated programme. There are signs that the implementation of such reforms would, to some extent, be at the expense of further budgetary consolidation, notably in 2003. These fiscal projections entail the risk that budgetary developments would be worse in the event that real GDP growth is lower. Consequently, it is imperative that the budgetary cost of structural reforms should be covered by containment of the expenditure increase.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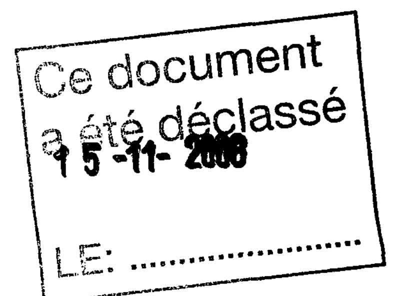
In the Federal institutional structure of Belgium, the achievement of national budgetary objectives depends on the respect of fiscal targets by the constituent parts of government. Belgium has indeed applied successfully a kind of "internal stability programme" whereby medium-term budgetary objectives are agreed for all parts of government (federal government, communities, regions and local authorities). An important element for such internal stability programme has been the inter-institutional agreement concluded initially in 2000 and renewed in 2002, covering the period of the current update.

Based on this assessment, the Commission has adopted the attached recommendation for a Council opinion on the updated Stability programme of Belgium and is forwarding it to the Council.



Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Article 5 of Council Regulation (EC) n°1466/97 of 7 July 1997 on the updated stability programme of Belgium, 2003-2005

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[4], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

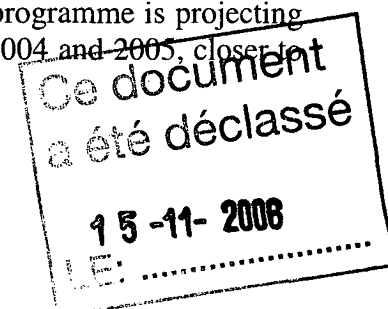
After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION :

On [18 February 2003] the Council examined the 2002 update of the stability programme of Belgium, which covers the period 2003-2005. The programme broadly complies with the requirements of the Code of conduct on the content and format of the stability and convergence programmes; the Council considers that the economic policies as reflected in the programme update comply in part with the recommendations of the Broad Economic Policy Guidelines.

The Council notes that economic activity remained weak in 2002 as real GDP growth is estimated at 0.7% as against 1.3% projected in the 2001 update. The impact of economic slowdown on public finances was contained in 2002 and the general government accounts reached balance after recording a surplus of 0.2% of GDP in 2001 (or a surplus of 0.4% of GDP if UMTS receipts are included). In 2001 and 2002, the decline in the government debt ratio continued, but reached only 3.5 percentage points of GDP, decelerating as a result of low GDP growth but also to debt-increasing financial operations. In 2002, the debt ratio was still at a high level, 106.1% of GDP.

According to the updated programme, economic recovery is expected to be progressive, gaining momentum during 2003 and remaining robust in subsequent years, supported by recovery in international trade and sustained domestic demand. The programme is projecting 2.1% real GDP growth in 2003 and more robust growth, at 2.5% in 2004 and 2005, closer to potential.



4 OJ L 209, 2.8.1997

The Council notes that, on the basis of plausible macroeconomic assumptions, the 2002 update of the stability programme is projecting a balanced general government position in 2003 and surpluses of 0.3% and 0.5% of GDP, respectively, for 2004 and 2005. The ground lost compared to the targeted budgetary adjustment in the previous update would be partly recovered by a somewhat faster adjustment during 2004 and 2005.

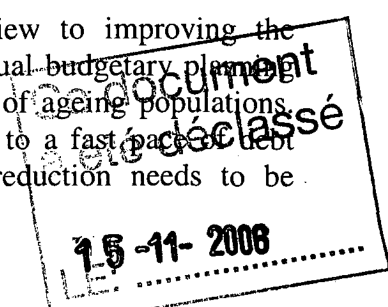
The Council notes that the cyclically-adjusted balance, calculated by the Commission on the basis of the production function method, after improving considerably, by 0.5% of GDP, in 2002 is projected to remain practically unchanged during the period 2003-2005, reaching an estimated surplus between 0.2% and 0.3% of GDP. Consequently, the Council considers that Belgium continues to be in conformity with the requirement of the stability and growth pact to reach a budgetary position of close to balance or in surplus in the medium term. However, taking of into account the high level of the government debt, the Council notes that a more robust medium term budgetary adjustment would be needed.

The Council notes that the government debt ratio is projected to decline by about 4 percentage points of GDP per year over the period considered by the 2002 update, to 93.6% of GDP in 2005. However, the planned assumption of debt of public enterprises by the State in 2004-2005, mentioned in the programme, may reduce the pace of debt reduction and, possibly, also impact on the deficit. The Council recommends that compensatory measures will be taken in order to maintain the government debt ratio on a sustained declining trend.

The Council notes that the budgetary strategy implied by the 2002 update continues to be based on the achievement of high primary surpluses combined with declining interest payments over the period of the programme; the Council commended, in past opinions, such a strategy which, based on effective control of expenditure growth, has proved successful in eliminating budgetary deficits and allowing a significant reduction in the government debt ratio. The Council notes, however, that the primary surpluses projected in the current programme, at around 5.5% of GDP per year are lower than those, above 6% of GDP, realised in recent years; moreover, the Council regrets that no mention is made in the current update to the 1.5% limit on real expenditure growth for Entity I, (including the Federal Government and Social Security), which was recommended in its Opinion on the 2001 update[5] and in the 2002 Broad Economic Policy Guidelines.

The Council considers that the fiscal consolidation projections in the 2002 updated programme represent the minimum effort required in order to meet the challenge of a rapid reduction in the still very high debt ratio and to prepare for the budgetary implications of population ageing. The Council considers that, given projected real GDP growth accelerating to 2.1%, further budgetary adjustment would be warranted in 2003. The Council recommends to the Belgian authorities to seek every opportunity to realise further budgetary adjustment in 2003 and in subsequent years. The Council urges the Belgian authorities to achieve primary surpluses not lower than 6% of GDP per year and to respect the limit of 1.5% per year on real primary expenditure growth for Entity I, over the period covered by the programme.

The Council welcomes the measures adopted in 2001 with a view to improving the monitoring of the sustainability of public finances as part of the annual budgetary planning process, which include regular assessments of the budgetary impact of ageing populations. The Council notes that running large primary surpluses should lead to a fast pace of debt reduction. To ensure the sustainability of public finances, debt reduction needs to be



5 OJ C 33, 6.2.2002

complemented with measures to raise employment rates, especially amongst older workers as the effective retirement age is one amongst the lowest of all EU countries.

The Council notes the progress made in implementing structural reforms including draft legislation for setting up the framework for supplementary pensions, the simplification of administrative procedures for business activity and continued implementation of tax reform aimed at improving the performance of the economy and encouraging employment creation. The Council recommends that the budgetary cost of structural reforms, notably those involving tax and non-tax burden reduction, be covered by containment of expenditure growth so that the targeted budgetary adjustment and the reduction of the government debt ratio be ensured.

The Council welcomes the renewed agreement between the various parts of government to set budgetary objectives and the commitment to ensure their achievement; the Council considers such "internal stability programmes" particularly appropriate in the federal institutional framework of Belgium.

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