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# 2002 UPDATE

# OF THE CONVERGENCE PROGRAMME OF BELGIUM

# (2003-2005)

## AN ASSESSMENT

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## SUMMARY AND CONCLUSIONS

The new update of the Belgian stability programme presents macro-economic and general government budgetary projections covering the period 2003-2005. It is broadly in line with the revised "Code of Conduct on the content and format of stability and convergence programmes"[1]. 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 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 pubic 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

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1 *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

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; it is not excluded that such an operation might imply 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.

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.

## 1. INTRODUCTION

The 2002 update of the stability programme was approved by the Belgian government on 29 November 2002 and submitted to the Commission on 2 December 2002[2]. It covers the period from 2003 to 2005.

Despite the unfavourable macroeconomic context, the Belgian government is adhering to the targets of the SGP, notably endeavouring to achieve a budget situation close to balance or in surplus. In this context, the government succeeded in balancing the general government accounts in 2002; the programme aims at maintaining a balanced budgetary position in 2003 which will turn into an expected surplus of 0.3% of GDP in 2004, rising to 0.5% of GDP in 2005. The budgetary and debt reduction strategy will continue to be based on high primary surpluses - lower than in recent past - and declining interest payments. Although declining, the government debt ratio will still reach 93.6% of GDP in 2005 at the end of the period covered by the update. Such a level, 5 percentage points of GDP higher than forecast in the previous update, is still to be considered a matter of concern taking into account the forthcoming budgetary costs of ageing population.

The budget for 2003, which is the first year of the current update has set the following three priorities: to consolidate public finances by guaranteeing a balanced budget, to sustain confidence by implementing in full the measures previously decided on and to create the scope, within a strict budget framework for new initiatives. However, no further budgetary adjustment is planned in 2003, conceding ground to the other initiatives, notably the tax reform.

The programme broadly complies with the Code of Conduct on the content and the form of the stability programmes. In particular, it provides projections for revenues and expenditures, including investment expenditures. It does not fully abide by the Code of Conduct requirement on the split of Federal Government and Social Security accounts, although it provides key components of the Social Security accounts.

## 2. IMPLEMENTATION OF THE 2001 STABILITY PROGRAMME

The economic activity remained weak in 2002, real GDP growth reaching 0.7%, similar to the rate achieved in 2001 and considerably lower than the 1.3% increase projected in the previous update. The recovery in economic activity in the first quarter of 2002 - real GDP growing by 0.6% on the previous quarter - did not continue in subsequent quarters. According to the 2002 update and to most available forecasts, recovery is expected to be progressive in 2003, gaining momentum during the year.

Despite the prolonged economic slowdown, which characterised the European and the Belgian economy in the last two years, the general government accounts are estimated to be in balance in 2002, as targeted in the 2001 update, after recording a small 0.2% of GDP surplus in 2001 (a surplus of 0.4% of GDP if UMTS receipts are included). The estimated small deterioration in the general government balance in 2002 is to be attributed to the weak economic activity; in fact, the cyclically-adjusted general government balance improved by 0.5 percentage points of GDP; strengthened

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[2] The first stability programme covering the period 1999-2002 was submitted on 18 December 1998 and assessed by the Council on 15 March 1999 (OJ C 124, 5.5.1999). The first update was submitted on 24 December 1999 and assessed by the Council on 28 February 2000 (OJ C 98, 6.4.2000).

expenditure controls, introduced during the budgetary control exercises in March and June 2002, contributed to the containment of primary expenditures. Moreover, two factors had a favourable influence on public finances in 2002: the proceeds from the sale of real estate and the reduction in the contribution to the EU budget. On the other hand, primary expenditure increased in 2002, as a result of the integration of the public radio and television broadcasting companies in the general government sector.

The level of the debt ratio in 2002 at 106.1% of GDP is higher by 2.8 points compared to the projection in the previous update. In 2002, the government debt ratio is estimated to have declined by 2.5 points of GDP compared to a reduction of 3.7 points targeted in the previous update. Most of the difference is due to lower GDP growth - in real and nominal terms - than projected in the previous update and the rest due to higher nominal debt level.

**Table 1- Comparison with 2001 update of the stability programme**

| % of GDP | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| **Actual budget balance** | | | | | |
| **2001 programme** | 0.0 (*) | 0.0 | 0.5 | 0.6 | 0.7 |
| **2002 programme** | 0.3 | 0.0 | 0.0 | 0.3 | 0.5 |
| **Gross debt levels** | | | | | |
| **2001 programme** | 107.0 | 103.3 | 97.7 | 93.0 | 88.6 |
| **2002 programme** | 108.6 | 106.1 | 102.3 | 97.9 | 93.6 |

(*) receipts from UMTS licences included (0.2% of GDP)

## 3. MACROECONOMIC ASSESSMENT

### Macroeconomic developments and prospects

The external economic assumptions included in the 2001 update are similar to those adopted in the Autumn 2002 Commission forecasts.

For 2003, the projected 2.1% real GDP growth is very close to the forecast by the Commission, 2%. For 2004, the Commission is projecting real GDP growth at around 2.8%, higher than forecast in the 2002 updated programme, 2.5%; a growth rate temporarily above potential is considered possible after an extended period of slow real GDP growth. The underlying assumptions for this macroeconomic scenario is that economic recovery would progressively gain momentum during 2003, supported by the recovery in the world economy and in international trade.

**Table 2 – GDP forecast (real annual percentage change)**

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| **2002 update of the stability programme** | 0.8 | 0.7 | 2.1 | 2.5 | 2.5 |
| **Commission 2002 Autumn forecast** | 0.8 | 0.7 | 2.0 | 2.8 | - |

According to the programme, real GDP growth at constant prices is estimated at 2.5% in both 2004 and 2005, i.e. slightly above potential, driven mainly by domestic demand;

household disposable income will be favourably influenced by the improvement in employment and the impact of the reduction in personal income tax; business investment will become increasingly sustained, encouraged by the improvement in demand prospects and the reform of corporate tax.

The macroeconomic projections in the updated programme are plausible. For 2003, the projected real GDP growth will, of course, depend on the timing and strength of economic recovery. Recent survey indicators, released just before the end of 2002, were indicating that both consumers and businesses confidence were still subdued. The global "synthetic" indicator of the National Bank deteriorated in December.

In subsequent years, it is expected that real GDP growth will be robust enough, exceeding potential in 2004, after three years of below potential progress. The fundamentals of the Belgian economy, notably low inflation - the inflation rate declined to 1.7% in 2002 down from 2.5% in 2001 – as well as the conclusion of a new framework wage agreement, for 2003-2004, characterised by rather moderate terms, suggest that Belgium should, in principle, be well placed to benefit from a recovery in domestic and external demand.

## 4. BUDGETARY TARGETS AND MEDIUM-TERM PATH OF PUBLIC FINANCES

### 4.1 Programme overview

Despite the unfavourable macroeconomic context, the programme confirms the adherence to the targets of the stability and growth pact, in achieving a budget situation close to balance or in surplus. The targeted surplus in 2005 at 0.5% of GDP is lower than that in the 2001 update, 0.7% of GDP; the difference is primarily due to lower budgetary adjustment in 2003. However, taking into account the high level of the government debt, the budgetary adjustment included in the 2002 update of the stability programme lacks ambition and conveys an impression of budgetary fatigue.

In 2003, no budgetary adjustment is foreseen, although the projected real GDP growth at 2.1%, is not much below the estimated potential growth for Belgium. Similarly, the projected reduction in the government debt ratio in 2003, at 3.8 percentage points of GDP, is considerably 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 the debt of the Belgian railways company, the SNCB, mentioned in the updated programme, makes uncertain the implementation of the projected rates of reduction in the debt ratio; moreover, remains to be seen if such an operation implies any impact on the government deficit.

From 2003 to 2005, the budgetary adjustment and debt reduction in the medium term continues to be based on the achievement of high primary surpluses, combined with declining interest payments made possible by falling government debt ratio. However, the general government primary surplus is projected to decline by 0.5 percentage points of GDP between 2002 and 2003 to 5.5% of GDP and remain stable thereafter at practically the level achieved in 2003. The projected decline in interest payments is expected to ensure the achievement of the budgetary surpluses foreseen in the programme. A lower level of primary surpluses – as high as they might still be – compared to levels achieved in recent years, reduces the speed of decline in the government debt ratio, while it becomes pressing to prepare for the budgetary implications of the demographic trend.

In parallel to fiscal consolidation, the government intends to ensure full implementation of the measures announced in both 2002 and 2003 and create the supplementary margin necessary for essential new initiatives. However, the budgetary implications of such initiatives and reforms, in particular those involving reduction of tax and not-tax burden and their compatibility with the objective of fiscal consolidation, are not quantified in the current update. The implementation of such reforms would, to some extent, be at the expense of further budgetary consolidation, notably in 2003.

According to the updated programme, since elections for the Federal Parliament will be held in May 2003, it will be for the next government to define the course for the period 2004-2007, in the next stability programme update.

**Table 3 – General government budgetary developments**

| % of GDP | ESA code | **2001** | **2002** | **2003** | **2004** | **2005** | **2002-2005** |
|---|---|---|---|---|---|---|---|
| **Net lending (B9) by sub-sectors** | | | | | | | |
| **1. General government** | S13 | 0.4 | 0.0 | 0.0 | 0.3 | 0.5 | 0.5 |
| **2. Federal government** | S1311 | -0.9 | -0.4 | -0.4 | -0.1 | 0.1 | 0.5 |
| **3. Social security** | S1314 | 0.7 | 0.2 | 0.1 | 0.2 | 0.2 | 0.0 |
| **4. Communities and Regions** | S1312 | 0.6 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 |
| **6. Local authorities** | S1313 | 0.0 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 |
| **General government (S13)** | | | | | | | |
| **7. Total receipts** | ESA | 49.8 | 49.5 | 48.9 | 48.7 | 48.4 | -1.1 |
| **8. Total expenditures** | ESA | 49.4 | 49.5 | 48.9 | 48.4 | 48.0 | -1.5 |
| **9. Budget balance** | B9 | 0.4 | 0.0 | 0.0 | 0.3 | 0.5 | 0.5 |
| **10. Net interest payments** | | 6.5 | 6.1 | 5.6 | 5.3 | 5.1 | -1.0 |
| **11. Primary balance** | | 7.0 | 6.1 | 5.5 | 5.6 | 5.6 | -0.5 |

In a Federal State, fiscal policy of the various federal entities has to be co-ordinated so that each of them contributes towards the attainment of the target set at general government level. Experience so far indicates that clear agreements about the result to be achieved by each part of government and commitment by all to respect the targets worked well. In order to integrate their fiscal policy into the national stability programmes, the Communities and Regions drew up internal open-ended medium-term stability programme each year, at least equal in duration to the Belgian stability programme. In their internal stability programmes, the Communities and Regions show how they will meet the targets mentioned above for each of the budget years concerned. The “Financing Requirements” section of the High Finance Council evaluates these medium-term programmes each year.

At the time of the 2002 budget review, an additional agreement was concluded between the Federal State and the Communities and Regions confirming their commitment to meet the targets set compatible with the targets in the Belgian stability programme.

## 4.2 Public finances in 2003

The present update is targeting balanced general government accounts in 2003, an objective also set in the budget for that year. This compares with a surplus of 0.5% of

GDP targeted in the previous update and recommended in the 2002 Broad Economic Policy Guidelines. To the lack of budgetary improvement in nominal terms corresponds an unchanged cyclically-adjusted balance, a situation implying that no budgetary adjustment is foreseen for 2003. It must be noted that the absence of budgetary adjustment in 2003 is adversely affecting the overall budgetary adjustment throughout the period covered by the programme, the projected acceleration in subsequent years being subject to important uncertainties.

Public finances in 2003 will be affected by the on-going tax reform. Total revenue is expected to decline by 0.6 percentage points of GDP in 2003, reflecting mainly the impact of the on-going reform of the personal income tax - aimed principally, at a reduction in the tax burden on labour income - and the elimination of the special crisis levy after its progressive diminution over a number of years; the combined effect of these reforms in terms of lower tax revenue is estimated at about 0.4% of GDP. In 2003 the reform of the corporate tax will enter into force, involving, notably, the reduction in the marginal tax rate from 40.17 to 33.99%; the reform is designed to be tax-neutral as the diminution of the tax rate would be compensated by reduction in tax exemptions.

The decline in the expenditure to GDP ratio in 2003 is largely proceeding from the projected fall in interest payments as percent of GDP. The Federal Government real primary expenditure increase is projected at 1.3% in 2003, an ambitious target suggesting continuation of effective expenditure control in this sector. However, expenditure increase in the social security sector will be considerably higher, about 2.8% in real terms. This implies that real expenditure in Entity I (Federal Government and Social Security) will increase by 2.2%, higher than the 1.5% limit included in both the Council Opinion on the 2001 update and recommendations of the 2002 Broad Economic Policy Guidelines. Contrary to these recommendations, no mention is included in the 2002 update to any binding norm for primary expenditure to be respected in Entity I.

In 2003, the government debt ratio is expected to decline by about 4 percentage points, to an estimated 102.3% of GDP. No ad hoc financial operations are foreseen for 2003; as a consequence, the reduction in the debt ratio would result exclusively from endogenous factors, notably a primary surplus of 5.5% of GDP.

### 4.3 Targets and adjustment in 2004-2005

The budgetary projections in the programme imply that the ground lost towards budgetary adjustment, due to the slowdown in economic activity, would be partly recovered by faster consolidation during 2004 and 2005.

The projected budgetary surpluses in 2004 and 2005 would result from a larger reduction in government expenditures, by 1.5 percentage points of GDP, than in government revenue, projected to decline by 1.1 percentage points. Lower interest payments would account for two thirds of the total reduction in the expenditure ratio to be realised exclusively due to a reduction in the government debt ratio, as interest rates are not projected to decline over the period of the programme.

In the coming years, a feature of public finances will be the continuing reduction in revenues in relation to GDP. The impact on the budget of the personal income tax reform will in fact increase year by year, reaching its full level in 2006. This underlines the importance of disposing of expenditure norms and mechanisms for an effective primary expenditure control and, in this respect, the already mentioned absence of any reference in

the updated programme to the 1.5% limit on primary expenditure for Entity I is disappointing.

The government debt ratio is expected to be reduced further, by 8.7 percentage points, during 2004-2005 to 93.6% of GDP. However, the prospect of debt-increasing financial operations related to the assumption of debt of public enterprise, notably of the Belgian railways company, the SNCB, mentioned in the updated programme, makes uncertain the implementation of the projected rates of reduction of the debt ratio.

*Cyclically-Adjusted Budget Balances*

The 2002 update provides cyclically-adjusted calculations for the general government balance based on the Hodrick-Prescott filter method; according to these estimates, the cyclically adjusted general government balance would remain in surplus throughout the period of the programme building on a clear improvement in 2002, to 0.5% of GDP from 0.1% in 2001, rising to 0.6% in 2003 and 0.8% of GDP in the final two years. These cyclically-adjusted budgetary balances result from the pattern of the output gap which after reaching a negative trough, -1%, in 2003, diminishes thereafter.

Applying the production function method, using Commission parameters, to the projections provided by the 2002 update, the cyclically-adjusted general government balance remains positive over the period covered by the programme. The production function method indicates, also, a considerable improvement in the budgetary position in 2002, reflecting the maintenance of a balanced position despite the sharp economic slowdown; however the underlying budgetary position in subsequent years remains practically unchanged at around 0.2% to 0.3% of GDP while the output gap turns positive in 2004, increasing further in 2005.

**Table 4. Cyclically-Adjusted Budget Balance**

| % GDP | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| 1. GDP growth at constant prices | 0.8% | 0.7% | 2.1% | 2.5% | 2.5% |
| 2. Net borrowing | 0.4% | 0.0% | 0.0% | 0.3% | 0.5% |
| 3. Potential GDP growth | 2.0% | 2.1% | 2.0% | 2.0% | 2.2% |
| 4. Output gap | 0.9% | -0.5% | -0.4% | 0.1% | 0.4% |
| 5. Cyclical budgetary component | 0.6% | -0.3% | -0.3% | 0.1% | 0.3% |
| 6. Cyclically-adjusted balance | -0.2% | 0.3% | 0.3% | 0.2% | 0.2% |

*Source: Commission services calculations on the basis of the PF and using macroeconomic and budgetary projections of the 2002 update of SP of Belgium.*

These results show that Belgium is in compliance with the requirement of the Stability and Growth Pact of medium term close to balance of in surplus budgetary balance, in both nominal and underlying terms.

### 4.4 Sensitivity analysis

The current update provides a technical sensitivity analysis of the impact of different interest rate and real GDP growth assumptions. The analysis is purely technical, in the sense that it does not address the question of how economic policy would respond to the situation described by the different scenarios.

Regarding interest rates changes, the impact of an increase by 100 basis points in the interest rates assumptions for each year in the period 2003-2005 is examined. After 3 year, in 2005, the effect would reach about 0.4% of GDP. Also, it is examined how public finances would be affected by lower or higher real GDP growth than the reference scenario, assuming an average elasticity of public finances in relation to GDP growth. Real GDP growth at just under 2% on average results in a cumulative budgetary deficit of 0.9% of GDP during 2003-2005.

However, this technical analysis should be qualified: it is noted in the updated programme that a balanced budget represented in practice, in recent years, a lower limit for the general government balance; on the other hand, if growth exceeds the forecasts, the margin would be allocated as a matter of priority to improving the budgetary balance.

### 4.5 Debt ratio

The government debt ratio is projected to decline by a yearly average of slightly above 4 percentage points of GDP during the period 2003-2005, to 93.6% of GDP in 2005. The main contributors to this debt ratio are expected to be high primary surpluses, projected at 5.6 percentage points on average per year during that period. However, taking into account that the primary surpluses are stable over the period, any improvement in the debt ratio critically depends on the reduction in interest payments as percentage of GDP (see table 5).

In 2001, and to a lesser extent in 2002, the reduction in the government debt ratio was decelerated by ad hoc factors, notably the take over by the State of the debt of a number of public entities. These operations, included in the entry “stock-flow adjustment” in table 5, are estimated at 2.4% of GDP in 2001 and 0.4% in 2002. No ad hoc operations are foreseen in the updated programme for the coming years - either increasing the debt ratio or decreasing it, such as receipts from eventual privatisations -, a situation implying that the projected reduction in the government debt ratio would result exclusively from endogenous factors. However, reference is made in the programme to the prospect of debt-increasing financial operations related to the assumption of debt of public enterprise, notably of the Belgian railways company, the SNCB; this makes uncertain the implementation of the projected rates of reduction of the debt ratio included in the updated programme. Moreover, remains to be seen if these operations might also impact the government deficit.

**Table 5 – Decomposition of changes in the government debt ratio**

| (as % of GDP) | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Change in government debt ratio: | -1.0 | -2.5 | -3.8 | -4.3 | -4.3 |
| - Contribution of primary balance | -6.9 | -6.1 | -5.5 | -5.6 | -5.6 |
| - Interest and GDP dynamics | 3.5 | 3.2 | 1.7 | 1.3 | 1.3 |
| Stock-flow adjustment | 2.4 | 0.4 | 0.0 | 0.0 | 0.0 |
| Government debt ratio | 108.6 | 106.1 | 102.3 | 97.9 | 93.6 |

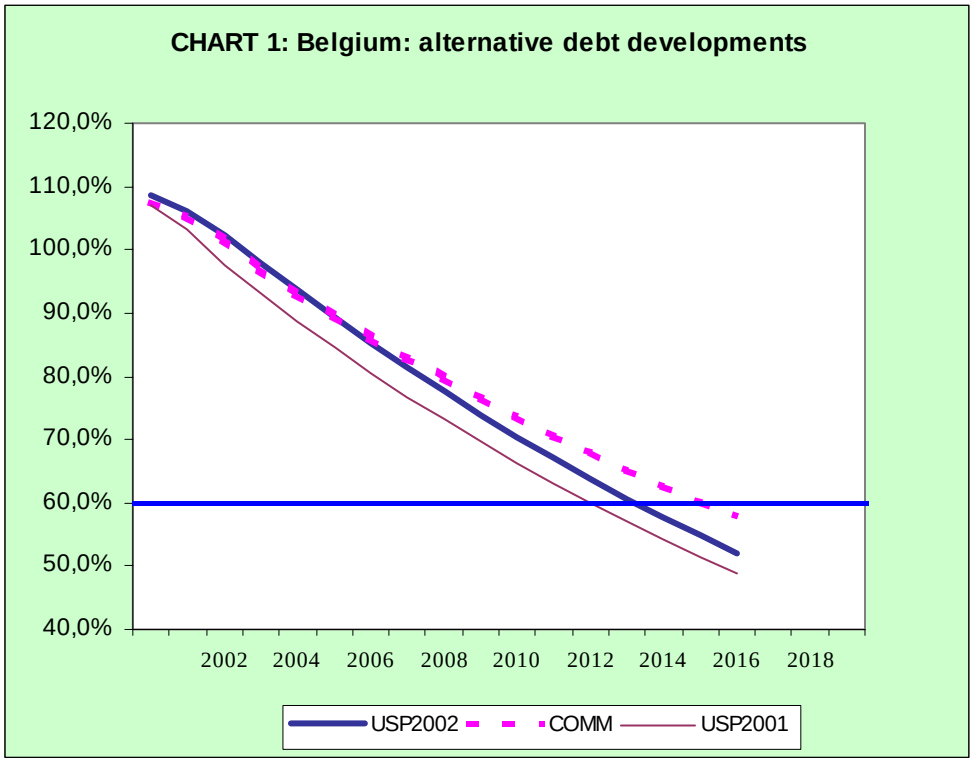
*Note:* The decomposition of changes in the gross debt ratio is based on the following equation for the budget constraint.

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \frac{i_t - y_t}{1 + y_t} \bullet \frac{D_{t-1}}{Y_{t-1}} + \frac{SF_t}{Y_t}$$

D = government debt, PD = primary deficit, Y = GDP at current market prices, i = implicit interest rate on government debt, y = nominal GDP growth rate, and SF = stock-flow adjustment.

*Source:* Commission estimates based on budgetary projections given in the stability programme.

Evident from the above table is the crucial importance of high primary surpluses for the reduction in the government debt ratio: in recent years, primary surpluses above 6% of GDP allowed a continuing though slow decline in the debt ratio, despite debt increasing ad hoc financial operations and low real, and nominal, GDP growth. The projected lower primary surpluses than in recent past increase the risk of slower reduction in the government debt ratio, particularly in the event of lower than expected GDP growth rates or/and debt increasing ad hoc operations.




According to Commission services calculations, extrapolating real GDP growth, inflation and budgetary balance projected in the last year of the updated programme, the 60% reference value for the debt ratio would be reached by Belgium in 2014. It is to be noted that in the long-term sustainability section of the updated programme the reference value would be reached about two years earlier, the main difference proceeding from the assumed increase in the general government surplus to 1.5% of GDP in 2010 from 0.7% in 2005

## 5. THE SUSTAINABILITY OF PUBLIC FINANCES

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.

It is first necessary to consider whether current budget polices can ensure that the SGP will continue to be respected in the future in light of the budgetary implications of ageing populations. Analysis presented below shows that based on 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 target 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 (see Annex 2).

A second issue is whether the budgetary strategy outlined in the programme is compatible with improving the sustainability of public finances. The Commission welcomes the measures adopted in 2001 to strengthen the assessment of the sustainability of public finances as part of the annual budgetary planning process, which

includes regular assessments of the budgetary impact of ageing populations. The planned move to a small surplus in 2005 and the sustained running of large primary surpluses should lead to a fast pace of debt reduction, which, if sustained, would lead to large savings on interest payment over time.

Finally, it is necessary to consider the type and scale of the budgetary challenges that will emerge in coming years to ensure sustainable public finances. The strategy to ensure sustainable public finances hinges upon achieving a large and sustained reduction in the debt ratio in coming decades: this may prove challenging during economic downturns and in the face of competing pressures to pursue other budgetary objectives. The existing strategy needs to be strengthened in order to prepare for the budgetary impact of ageing populations. Debt reduction needs to be complemented with measures to raise employment rates amongst older workers which are amongst the lowest of all EU countries.

## 6. STRUCTURAL MEASURES AND OTHER REFORMS WITH LIKELY BUDGETARY IMPACT

The review of structural reforms, in progress as well as planned ones, is placed by the programme under the heading quality of public finances, notably by reforms concerning directly government revenues and expenditures.

Reforms include the progressive implementation of the reform of personal income tax which started in 2001 and is expected to be completed in 2006 and the corporate tax reform to be introduced from 2003, as well as administrative simplifications for setting-up and operating business activity. Also, draft legislation has been tabled with the Parliament, setting-up the regulatory framework for the “second pillar” of supplementary pensions. Key objectives of introduced and planned reforms are to promote employment creation, in particular concerning the less qualified labour and improving the performance of the economy.

*Tax reform*

The reduction of fiscal and parafiscal pressure continued with the aim of establishing a more favourable environment for employment. The tax reform includes the progressive implementation of the personal income tax, the elimination, in 2003, of the complementary crisis contribution and additional cuts in social security contributions paid by low wage employees. In 2003, entered into force the corporation tax reform leading to a reduction in the marginal tax rate; the reform is designed to be budget neutral, as the lowering of the tax rate is offset by the reduction of various tax allowances. The overall impact of the tax reform is estimated at 1.3% of GDP once the measures become fully operational in 2006.

*Administrative simplification*

Notable measures taken in this area are the creation of the “crossroads bank for businesses” a data bank which assigns to each business a unique identification number, eliminating the need to repeat similar formalities with different authorities. Also, an agreement was concluded for the radical simplification of the measures for reducing the social security contributions of employers, as the complexity of these measures is estimated to have caused under-utilisation of these instruments of employment policy. From 2004 onwards there will be only two types of reduction a) an automatic, structural, flat-rate reduction valid for all workers in all firms, higher for low-paid workers, and

b) flat-rate reductions targeting specific groups, such as the young, older workers, the long-term unemployed etc.

*Main initiatives on expenditure*

Real growth of primary expenditure at federal level was set at 1.3% in 2003. Control over spending has been accompanied by particular attention to the quality of social services. Additional measures were taken to achieve better control over health expenditures.

*The budgetary impact of reforms*

The budgetary implications of these reforms, in particular those involving reduction of tax and not-tax burden and their compatibility with the objective of fiscal consolidation, are not adequately treated in the updated programme. There are signs that the implementation of such reforms will be, to some extent, 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. It is imperative that the budgetary cost of structural reforms, notably those involving reduction of the tax and non-tax burden, be covered by containment of expenditure growth so that the targeted budgetary adjustment and the reduction of the government debt ratio be ensured.

## 7. OVERALL ASSESSMENT OF COMPLIANCE WITH THE STABILITY AND GROWTH PACT

The 2002 updated stability programme, on the basis of plausible macroeconomic assumptions, is projecting maintenance of a balanced general government position in 2003 and surpluses in the subsequent two years. The underlying budgetary position, after a significant improvement in 2002, is estimated to remain practically stable during the years 2003-2005 at a surplus of 0.3% of GDP. Belgium would, therefore, continue to comply with the requirement of the stability and growth pact of an underlying budgetary position close to balance or in surplus in the medium-term.

However, the budgetary adjustment path presents a number of weak aspects: practically no budgetary adjustment in 2003 is foreseen, largely postponed to the years 2004-2005; moreover, the projected primary surpluses are lower and the pace in the reduction of the government debt ratio slower than targeted in the previous update. In view of the still very high government debt ratio and the need to prepare for the budgetary cost of the ageing population, budgetary projections of the programme should be seen as the minimum effort required to ensuring the necessary budgetary adjustment and reduction in the government debt ratio over the years covered by the programme.

# ANNEX I

## Main assumptions used by the Federal Planning Bureau for the medium-term forecasts relating to the international environment

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Short-term interest rate (annual average) | 4,1 | 3,3 | 3,6 | 4,2 | 4,2 |
| Long-term interest rate (annual average) | 5,1 | 5,2 | 5,4 | 5,4 | 5,5 |
| USD/euro exchange rate (annual average) | 89,5 | 93,8 | 96,5 | 97,0 | 97,4 |
| GDP growth - world (excl. EU) | 2,4 | 3,2 | 4,1 | 3,9 | 3,9 |
| GDP growth - EU | 1,7 | 1,4 | 2,8 | 2,5 | 2,4 |
| Growth of relevant external markets | 0,7 | 1,7 | 5,8 | 5,5 | 5,2 |
| Global imports, by volume (excl. EU) | -0,2 | 4,0 | 7,2 | 5,8 | 5,8 |
| Oil price (USD) | 24,4 | 24,5 | 25,5 | 26,4 | 27,4 |

## The targets for public finances under consecutive stability programmes

| Programme | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|
| | Financing balance | | | | | | | |
| 1999-2002 | -1,6 | -1,3 | -1,0 | -0,7 | -0,3 | | | |
| 2000-2003 | | -1,1 | -1,0 | -0,5 | 0,0 | 0,2 | | |
| 2001-2005 | | | -0,1 | 0,2 | 0,3 | 0,5 | 0,6 | 0,7 |
| 2002-2005 | | | | 0,0 | 0,0 | 0,5 | 0,6 | 0,7 |
| 2003-2005 | | | | | 0,0 | 0,0 | 0,3 | 0,5 |
| | Debt ratio | | | | | | | |
| 1999-2002 | 117,5 | 114,5 | 112,2 | 109,6 | 106,8 | | | |
| 2000-2003 | | 114,9 | 112,4 | 108,8 | 105,0 | 101,3 | | |
| 2001-2005 | | | 110,6 | 105,8 | 101,4 | 97,2 | 92,9 | 88,7 |
| 2002-2005 | | | | 107,0 | 103,3 | 97,7 | 93,0 | 88,6 |
| 2003-2005 | | | | | 106,1 | 102,3 | 97,9 | 93,6 |

## Movements in GDP and some key aggregates in public finances

| % of GDP unless otherwise stated | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|---|---|---|
| GDP (in billions of euro) | 179,7 | 185,1 | 195,0 | 202,2 | 207,0 | 217,2 | 225,2 | 235,6 | 247,5 | 254,3 |
| Real growth (annual growth rate) | 1,5 | -1,0 | 3,2 | 2,4 | 1,2 | 3,6 | 2,0 | 3,2 | 3,7 | 0,8 |
| Primary balance | 3,2 | 3,8 | 4,6 | 4,9 | 5,0 | 6,0 | 6,8 | 6,5 | 6,9 | 7,0 |
| Of which : | | | | | | | | | | |
| Federal government | 3,7 | 4,5 | 4,1 | 4,6 | 4,6 | 4,8 | 5,3 | 4,9 | 5,8 | 5,2 |
| Social security | -0,4 | -0,5 | 0,5 | 0,0 | -0,2 | 0,4 | 0,4 | 0,6 | 0,5 | 0,6 |
| Communities and regions | -0,8 | -0,6 | -0,5 | -0,4 | 0,0 | 0,2 | 0,6 | 0,6 | 0,5 | 1,0 |
| Local authorities | 0,7 | 0,4 | 0,5 | 0,8 | 0,7 | 0,6 | 0,5 | 0,4 | 0,0 | 0,2 |
| Financing balance (Maastricht definition) | -8,1 | -7,3 | -5,0 | -4,3 | -3,8 | -2,0 | -0,7 | -0,5 | 0,1 | 0,4 |
| Of which : | | | | | | | | | | |
| Federal government | -6,7 | -5,8 | -4,6 | -3,8 | -3,4 | -2,5 | -1,7 | -1,6 | -0,5 | -0,9 |
| Social security | -0,4 | -0,5 | 0,5 | -0,1 | -0,2 | 0,4 | 0,4 | 0,6 | 0,6 | 0,7 |
| Communities and regions | -1,0 | -0,8 | -0,9 | -0,8 | -0,4 | -0,1 | 0,3 | 0,4 | 0,2 | 0,8 |
| Local authorities | 0,1 | -0,2 | -0,1 | 0,3 | 0,2 | 0,2 | 0,2 | 0,1 | -0,3 | -0,1 |
| Debt ratio | 132,2 | 137,9 | 135,9 | 134,0 | 130,2 | 124,8 | 119,6 | 114,9 | 109,6 | 108,6 |

**ANNEX II**

# Tables from the 2002 updated stability programme

## Table 1
## Growth and related factors

| | Percentage change except where otherwise stated | 2001 | 2002 (1) (3) | 2003 (2) | 2004 (2) | 2005 (2) |
|---|---|---|---|---|---|---|
| | Growth of GDP at constant prices (7+8+9) | 0,8 | 0,7 | 2,1 | 2,5 | 2,5 |
| | Level of GDP at current prices (in billions of euro) | 254,3 | 261,3 | 271,0 | 282,3 | 293,7 |
| | GDP deflator | 2,0 | 2,1 | 1,6 | 1,6 | 1,5 |
| | Change in the HICP | 2,4 | 1,5 | 1,4 | 1,6 | 1,6 |
| | Change in employment | 1,2 | -0,6 | 0,8 | 0,8 | 0,8 |
| | Unemployment (Eurostat definition) | 6,6 | 6,9 | 6,8 | 6,9 | 6,9 |
| | Change in labour productivity | -0,3 | 1,4 | 1,4 | 1,7 | 1,7 |
| | | Growth sources : change at constant prices | | | | |
| 1. | Final consumption expenditures of individuals | 1,0 | 0,5 | 2,1 | 2,3 | 2,3 |
| 2. | Final consumption expenditures of general government | 2,2 | 1,6 | 2,0 | 1,5 | 1,8 |
| 3. | Gross fixed capital formation | 0,5 | -2,2 | 2,2 | 2,6 | 3,2 |
| 4. | Change in stocks | -0,7 | -0,1 | -0,1 | -0,1 | -0,1 |
| 5. | Exports of goods and services | 1,1 | -0,4 | 4,6 | 4,9 | 4,9 |
| 6. | Imports of goods and services | 0,8 | -0,4 | 4,7 | 4,7 | 4,9 |
| | | Contribution to growth of GDP | | | | |
| 7. | Total final demand (1+2+3) | 1,1 | 0,1 | 2,0 | 2,1 | 2,3 |
| 8. | Change in stocks | -0,7 | 0,6 | 0,0 | 0,0 | 0,0 |
| 9. | Balance of goods and services | 0,3 | 0,0 | 0,2 | 0,4 | 0,2 |

(1) Source : Federal Planning Bureau/NAI Economic Budget, September 2002.
(2) Source : Federal government on the basis of the September 2002 medium-term projection for 2002-2006 by the Federal Planning Bureau.
(3) The movement in certain aggregates was influenced in 2002 by the effect on the national accounts of the transfer of public radio and television broadcasting companies from the non-financial corporations sector to the general government sector.

## Table 2
## The general government budget

| % of GDP | 2001(1) (2) | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| | **Financing balance of the sub-sectors** | | | | |
| **General government** | **0,4** | **0,0** | **0,0** | **0,3** | **0,5** |
| **Federal government** | **-0,9** | **-0,4** | **-0,4** | **-0,1** | **0,1** |
| **Communities and regions** | **0,8** | **0,1** | **0,1** | **0,1** | **0,1** |
| **Local authorities** | **-0,1** | **0,1** | **0,2** | **0,1** | **0,1** |
| **Social Security institutions** | **0,7** | **0,2** | **0,1** | **0,2** | **0,2** |
| | *General government* | | | | |
| *Total revenue* | *49,8* | *49,5* | *48,9* | *48,7* | *48,4* |
| *Total expenditure* | *49,4* | *49,5* | *48,9* | *48,4* | *48,0* |
| *Financing balance* | *0,4* | *0,0* | *0,0* | *0,3* | *0,5* |
| *Interest charges* | *6,5* | *6,1* | *5,6* | *5,3* | *5,1* |
| *Primary balance* | *7,0* | *6,1* | *5,5* | *5,6* | *5,6* |
| | *Main components of revenue* | | | | |
| *Taxes* | *30,7* | *30,4* | *30,1* | *30,0* | *29,8* |
| *Social security contributions* | *16,4* | *16,4* | *16,2* | *16,2* | *16,1* |
| *Other* | *2,7* | *2,7* | *2,6* | *2,6* | *2,6* |
| *Total revenue* | *49,8* | *49,5* | *48,9* | *48,7* | *48,4* |
| | *Main components of expenditure* | | | | |
| *Consumption expenditure (compensation and intermediate cons.)* | *14,8* | *14,7* | *14,6* | *14,5* | *14,3* |
| *Social benefits in kind* | *6,6* | *6,6* | *6,8* | *6,8* | *6,9* |
| *Other social benefits* | *15,5* | *15,8* | *15,6* | *15,4* | *15,1* |
| *Interest charges* | *6,5* | *6,1* | *5,6* | *5,3* | *5,1* |
| *Subsidies* | *1,6* | *1,6* | *1,5* | *1,5* | *1,5* |
| *Gross fixed capital formation* | *1,5* | *1,5* | *1,5* | *1,5* | *1,7* |
| *Other* | *2,8* | *3,3* | *3,3* | *3,4* | *3,4* |
| *Total revenu* | *49,4* | *49,5* | *48,9* | *48,4* | *48,0* |

1) Figures for 2001 include revenue from the sale of UMTS licences. Excluding the UMTS revenue, the central government's financing capacity comes to 0.3% of GDP.
2) In 2001, the federal government took over the debts of the social security systems covering employees and self-employed persons. According to the ESA methodology, this operation is recorded as a capital transfer, causing a deterioration in the financing capacity of central government, while that of the social security authorities has improved.

## Table 3
## Breakdown of the targets between the various entities

| % of GDP | Actual figure | Estimate | Agreement | | |
|---|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 2004 | 2005 |
| Primary balance | 7,0 | 6,1 | 5,5 | 5,6 | 5,6 |
| Entity I | 5,8 | 5,4 | 4,8 | 5,0 | 5,0 |
| Entity II | 1,2 | 0,7 | 0,7 | 0,6 | 0,6 |
| Interest charges | 6,5 | 6,1 | 5,6 | 5,3 | 5,1 |
| Entity I | 6,0 | 5,6 | 5,1 | 4,9 | 4,7 |
| Entity II | 0,5 | 0,5 | 0,5 | 0,4 | 0,4 |
| Financing balance | 0,4 | 0,0 | 0,0 | 0,3 | 0,5 |
| Entity I | -0,2 | -0,2 | -0,3 | 0,1 | 0,3 |
| Entity II | 0,7 | 0,2 | 0,3 | 0,2 | 0,2 |

## Table 4
## Development of the public debt

| % of GDP | 2001 | 2002 (3) | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Gross debt ratio (1) (2) | 108,6 | 106,1 | 102,3 | 97,9 | 93,6 |
| Change in the gross debt ratio | -1,0 | -2,5 | -3,8 | -4,3 | -4,3 |
| | Factors determining the movement in the gross debt ratio (2) | | | | |
| Primary balance | 6,9 | 6,1 | 5,5 | 5,6 | 5,6 |
| Interest charges | 6,5 | 6,1 | 5,6 | 5,3 | 5,1 |
| Nominal growth of GDP | 2,8 | 2,8 | 3,7 | 4,1 | 4,0 |
| Endogenous change in the debt | -3,3 | -3,0 | -3,9 | -4,3 | -4,3 |
| Other factors influencing the debt ratio | 2,3 | 0,5 | 0,1 | 0,0 | 0,0 |
| of which : privatisations (in billions of euro) | 0,1 | 0,0 | 0,0 | 0,0 | 0,0 |
| p.m. : implicit level of interest rates | 6,1 | 5,8 | 5,4 | 5,4 | 5,4 |

1) These figures disregard, for 2004 and 2005, the actual fulfilment of the commitment made by the current government concerning partial assumption of the debt of the SNCB/NMBS.
2) In past years, various statistical adjustments have been made to the Maastricht debt. The development of that debt has also been influenced by a number of debts taken over. The debts of the following entities have been included in the Maastricht debt : FADELS/ALESH, CREDIBE, Berlaymont, Belfin. Without these factors, the debt ratio would be approximately as follows : 2001 : 105.4 – 2002 : 103.0 – 2003 : 99.3 – 2004 : 94.9 – 2005 : 90.6.
3) The 2002 debt ratio (106.1) is higher than the figure stated in the second notification of public deficits (104.8). This difference is due exclusively to the revision of GDP. The nominal amount of the debt estimated at the end of 2002 remains unchanged.

## Table 5
## Cyclical development of public finances

| % in GDP | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| 1. GDP growth at constant prices | 0,8 | 0,7 | 2,1 | 2,5 | 2,5 |
| 2. Acutal financing balance | 0,4 | 0,0 | 0,0 | 0,3 | 0,5 |
| 3. Interest charges | 6,5 | 6,1 | 5,6 | 5,3 | 5,1 |
| 4. Potential growth of GDP (1) | 2,2 | 2,2 | 2,2 | 2,3 | 2,3 |
| 5. Output gap | 0,6 | -0,9 | -1,0 | -0,8 | -0,6 |
| 6. Cyclical component of the budget | 0,4 | -0,5 | -0,6 | -0,5 | -0,4 |
| 7. Cyclically adjusted financing balance (2-6) | 0,1 | 0,5 | 0,6 | 0,8 | 0,8 |
| 8. Excluding UMTS | -0,1 | | | | |
| 9. Cyclically adjusted primary balance (7+3) | 6,6 | 6,6 | 6,1 | 6,1 | 6,0 |
| 10. Excluding UMTS | 6,4 | | | | |

1) The estimates of trend growth used here are lower than those used in previous updates

## Table 6
## Deviations from the previous programme

| % of GDP | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Growth of GDP | | | | | |
| previous update | 1,1 | 1,3 | 3,0 | 2,5 | 2,4 |
| current update | 0,8 | 0,7 | 2,1 | 2,5 | 2,5 |
| deviation | -0,3 | -0,6 | -0,9 | 0,0 | 0,1 |
| Financing balance | | | | | |
| previous update | 0,0 | 0,0 | 0,5 | 0,6 | 0,7 |
| current update (1) | 0,3 | 0,0 | 0,0 | 0,3 | 0,5 |
| deviation | 0,3 | 0,0 | -0,5 | -0,3 | -0,2 |
| Gross debt ratio (2) | | | | | |
| previous update | 107,0 | 103,3 | 97,7 | 93,0 | 88,6 |
| current update | 108,6 | 106,1 | 102,3 | 97,9 | 93,6 |
| deviation | 1,6 | 2,8 | 4,6 | 4,9 | 5,0 |
| Attributable to : | | | | | |
| nominal debt level | 0,1 | 0,4 | 0,9 | 1,3 | 1,5 |
| GDP gap (denominator effect) | 1,5 | 2,3 | 3,6 | 3,6 | 3,6 |

1) Excluding revenue from the sale of UMTS licences.

2) The movement in the debt ratio was influenced (1.4%) by the fact that, in September 2001, the state-guaranteed debt of the former Central Mortgage Credit Office (OCCH/CBHK) was included in the Maastricht debt. In 2000, the debt of the Social Housing Loans Amortisation Fund (FADELS/ALESH) was also included. This has an impact of around 1.5% of GDP on the debt ratio in 2003.

## Table 7

## Impact of a change in the interest rate assumptions

| % of GDP | 2003 | 2004 | 2005 |
|---|---|---|---|
| Degree to which interest charges deviate from the scenario described | 0,1 | 0,3 | 0,4 |

## Table 8

## Sensitivity of the balance to growth assumptions

| | 2003 | 2004 | 2005 | Cumulative impact |
|---|---|---|---|---|
| Stability programme | | | | |
| Real growth in GDP | 2,1 | 2,5 | 2,5 | |
| Financing balance | 0,0 | 0,3 | 0,5 | |
| Weaker growth | | | | |
| Real growth of GDP | 1,6 | 2,0 | 2,0 | |
| Impact | -0,3 | -0,3 | -0,3 | -0,9 |
| Stronger growth | | | | |
| Real growth of GDP | 2,6 | 3,0 | 3,0 | |
| Impact | 0,3 | 0,3 | 0,3 | 0,9 |

## Table 9

### The main assumptions used for the long-term projection

| | 2000 | 2010 | 2020 | 2030 |
|---|---|---|---|---|
| Socioeconomic and macroeconomic | | | | |
| Changes in productivity | 2,2 | 1,8 | 1,8 | 1,8 |
| Real growth of GDP | 3,9 | 2,2 | 1,7 | 1,6 |
| Male participation rate (20-64) | 78,2 | 75,6 | 74,6 | 75,5 |
| Female participation rate (20-64) | 63,8 | 68,3 | 70,0 | 71,8 |
| Total participation rate (20-64) | 71,0 | 71,9 | 72,3 | 73,6 |
| Unemployment rate | 10,0 | 7,3 | 6,1 | 5,0 |
| Demographic | | | | |
| Birth rate | 1,61 | 1,66 | 1,70 | 1,70 |
| Life expectancy at birth (male) | 75,06 | 77,23 | 80,96 | 80,96 |
| Life expectancy at birth (female) | 81,53 | 83,35 | 86,43 | 86,43 |
| Migratory balance | 18.445 | 16.893 | 17.358 | 17.358 |
| Social | | | | |
| Wage ceiling | 1,25% per annum | | | |
| Minimum entitlement per working year | 1,25% per annum | | | |
| Equalisation of public sector pensions | 1,25% per annum | | | |
| Index-linking | 0,5% per annum | | | |
| Index-linking of flat-rate allowances | 1,0% per annum | | | |

Source: Working Group on Ageing, Annual Report, April 2002

## Table 10

### Age structure of the population

| | Total population (*1000) | Distribution in the age pyramid (*1000) | | | Percentage share | |
|---|---|---|---|---|---|---|
| | | 0-19 | 20-59 | 60- | 20-59 | 60- |
| 1970 | 9.650,9 | 3.000,5 | 4.819,3 | 1.831,1 | 49,9 | 19,0 |
| 2000 | 10.252,5 | 2.415,8 | 5.591,7 | 2.245,0 | 54,5 | 21,9 |
| 2010 | 10.519,8 | 2.351,7 | 5.682,2 | 2.485,9 | 54,0 | 23,6 |
| 2030 | 10.887,6 | 2.272,6 | 5.287,9 | 3.327,1 | 48,6 | 30,6 |
| 2050 | 10.953,8 | 2.228,2 | 5.172,7 | 3.552,9 | 47,2 | 32,4 |

Source : National Statistical Institute, Federal Planning Bureau, Population forecasts for 2000-2050 per district, 2001.

## Table 11

### Public spending and the ageing population

| % of GDP | 2000 | 2010 | 2020 | 2030 | 2030-2000 |
|---|---|---|---|---|---|
| | Movement in certain categories of expenditure | | | | |
| Pensions | 8,7 | 8,3 | 9,7 | 11,4 | 2,7 |
| Health care | 6,2 | 6,9 | 7,5 | 8,2 | 2,0 |
| Pensions and health care | 14,9 | 15,2 | 17,2 | 19,6 | 4,7 |
| Other social security expenditure (1) | 7,3 | 6,2 | 6,1 | 5,7 | -1,6 |
| Total | 22,2 | 21,4 | 23,3 | 25,3 | 3,1 |

Source: Working Group on Ageing, Annual Report, April 2002.

1) This includes expenditure on family allowances, unemployment, early retirement pensions, industrial accidents, occupational diseases and a number of residual schemes.

# Table 12

## A long-term budget scenario

| % of GDP | 2005 | 2010 | 2020 | 2030 |
|---|---|---|---|---|
| 1 Level of the financing balance (1) | 0,7 | 1,5 | 1,0 | 0,0 |
| 2 Level of the debt ratio | 89,1 | 68,1 | 37,4 | 23,8 |
| 3 Level of interest charges | 5,0 | 3,8 | 2,1 | 1,3 |
| 4 Necessary level of the primary balance (=3+1) | 5,7 | 5,3 | 3,1 | 1,3 |
| | 2005-2010 | 2010-2020 | 2020-2030 | 2005-2030 |
| 5 Movement in interest charges | 1,2 | 1,7 | 0,8 | 3,7 |
| 6 Gross margin at the level of the primary balance (=movement in 4) | 0,4 | 2,2 | 1,8 | 4,4 |
| 7 Impact of demography | 0,2 | 1,9 | 2,0 | 4,1 |

Source: Superior Finance Council, 'Government Financing Requirements' section, Annual Report 2002.

1) When preparing its recommendation, the 'Government Financing Requirements' section had assumed that the targets of the stability programme for 2002-2005 would be met.

**ANNEX III**

## A quantitative assessment of the sustainability of public finances

This is the second assessment of the sustainability of Belgian public finances as part of the Stability and Growth Pact. The quantitative indicators are similar to those used last year, but have been adjusted in line with the recommendations of the Ageing Working Group to the EPC.[3]

The stability programme contains a section assessing the sustainability of public finances and includes national budgetary projections for public expenditures on pensions, health care, long term care and other social transfers. These were made on the basis of a different demographic projection and macroeconomic assumptions to that used by the EPC. In assessing the sustainability of public finances under the SGP, the Commission has to draw a balance between using national projection which may be more comprehensive and up to date, and the need to ensure comparability across countries. Given the explanations provided in the stability programme, the Commission decided to use the projections provided by the Belgian authorities in the stability programme, which are of a similar order of magnitude to the projections of the EPC.

The table below presents the debt and budget balance development according to two different scenarios, a "programme scenario" and a "2002 situation scenario". The "programme scenario" is calculated on the following basis:

- the projections for age-related expenditures come from the stability programme;
- government revenues are held constant at the ratio projected for 2005;
- the starting point for gross debt and the primary surplus are the 2005 levels reported in the programme.

The "2002 situation scenario" is based on the budgetary data for 2002 in the programme. It is that no budgetary adjustment occurs during the time frame of the stability programme: in other words the primary balance remains unchanged at its 2002 level until 2006. This allow one to gauge the impact on the sustainability of public finances of the proposed change in the underlying budget position during the programme.

According to the quantitative indicators, public finances appear to be sustainable as large net assets are accumulated by the government sector by the end of the projection period. It is important to bear in mind that these results are based on the assumption that the national authorities will continue to run large primary (and indeed actual) surpluses in the years following the end point of the programme. This effect of doing so is particularly strong in high debt countries.

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3 'How the sustainability of public finances was assessed using the 2001 updates of stability and convergence programmes: recommendations for improvements in future years', Note from the AWG to the EPC, EPC/ECFIN/396-02 of 23 July 2002.

## Quantitative indicators on the sustainability of public finances

| Main assumptions - baseline scenario (as % GDP) | 2005 | 2010 | 2020 | 2030 | 2040 | 2050 | changes |
|---|---|---|---|---|---|---|---|
| *Total age-related spending* | 21,9 | 21,4 | 22,4 | 23,3 | 24,4 | 25,3 | 3,4 |
| Pensions | 8,5 | 8,3 | 9,0 | 9,7 | 10,6 | 11,4 | 2,9 |
| Health care | 6,6 | 6,9 | 7,2 | 7,5 | 7,9 | 8,2 | 1,6 |
| Other age related expenditures | 6,8 | 6,2 | 6,2 | 6,1 | 5,9 | 5,7 | -1,1 |
| *Total non age-related spending** | 21,0 | | | | | | |
| *Total revenues** | 48,4 | | | | | | |

* constant

| Results (as % GDP) | 2005 | 2010 | 2020 | 2030 | 2040 | 2050 | changes |
|---|---|---|---|---|---|---|---|
| *Programme scenario* | | | | | | | |
| Debt | 93,6 | 70,0 | 23,4 | -21,3 | -65,2 | -108,2 | -201,8 |
| Net borrowing | 0,5 | 1,8 | 3,5 | 5,0 | 6,4 | 7,8 | 7,3 |
| *2002 situation scenario* | | | | | | | |
| Debt | 92,9 | 66,1 | 12,4 | -41,3 | -96,7 | -153,6 | -246,5 |
| Net borrowing | 0,8 | 2,6 | 4,7 | 6,6 | 8,6 | 10,8 | 10,0 |

| Tax gaps | T1* | T2** | T3*** |
|---|---|---|---|
| Programme scenario | -1,7 | -2,0 | 0,1 |
| 2002 situation scenario | -2,4 | -2,7 | -0,5 |

* it expresses the constant difference between projected revenues and the revenues required to reach in 2050 the same debt to GDP ratio as the close to balance position holds for the whole projection period. P.m. debt to GDP at the end of the period: 18.3%

** it expresses the constant difference between projected revenues and the revenues required to reach in 2050 a debt to GDP ratio equals to 40%.

*** It indicates the change in tax revenues as a share of GDP that guarantees the respect of the interteporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

**Source:** 2002 Updated stability programme of Belgium. Commission calculations