The Minister of Finance

STABILITY PROGRAMME

OF BELGIUM

(1999 - 2002)

18 December 1998

INTRODUCTION

This stability programme succeeds to the convergence programme adopted in December 1996, which focused mainly on reducing the public deficit to a level substantially below the 3% reference value laid down in the Maastricht Treaty.

By achieving this objective and attaining a high level of convergence, Belgium is in a position to belong to the group of 11 countries which will take part in the initial phase of Economic and Monetary Union (EMU) as from 1 January 1999, a phase which will represent both the completion of a process and the start of a new phase in the integration of European economies.

The Member States recognised that the transition to the single currency would require increased monitoring and coordination of economic policies in the euro zone. With this in mind, the European Council meeting in Amsterdam in June 1997 adopted a resolution on growth and employment aimed at giving a new impetus to the coordination process by putting employment back at the top of the list of political concerns in the European Union.

This situation was confirmed by the organisation in November 1997 of an extraordinary European Council in Luxembourg which decided to adopt '*guidelines for employment*' at Union level once a year, based on an analysis of the specific situation in each Member State. Each Member State also undertook in Luxembourg to draw up a national action plan for employment, based on the European guidelines. Hence in April 1998 the Belgian Government submitted the Belgian Action Plan for employment to the European Commission, and approved a preliminary draft bill on 10 December last aimed at enabling the implementation of the parts of this plan which require legislation. In application of the conclusions reached at the European Council in Cardiff, the Government has also just adopted a report on recent progress made in terms of structural policies.

In order to ensure that EMU functions properly, the European Council in Amsterdam also adopted the Stability and Growth Pact to stress the importance of maintaining sound public finances as a means of strengthening conditions for price stability and for strong sustainable growth conducive to employment creation.

In this context, the Member States committed themselves to respect a medium-term objective of budgetary positions close to balance or in surplus, with a view to being able to allow the automatic stabilisers to take effect in periods of economic slowdown and to guarantee the long-term sustainability of their public finances.

Moreover, the Member States undertook to submit a stability programme before the end of 1998 with the view to presenting their medium-term budgetary objectives, thereby facilitating the coordination of budgetary policies at European level.

According to this commitment, the Belgian Government has adopted its first stability programme for the period 1999-2002. It follows the commitments made by the Government, particularly in the 1996 convergence programme and during the preparatory discussions for the European Summit on 1 May 1998. It confirms the Belgian authorities' commitment to pursue in the future a budgetary policy which is in line with the medium-term objectives of the Stability and Growth Pact.

This document first of all describes the high level of convergence achieved by Belgium so far, particularly as regards the reduction of public deficits. The second part of the document looks at Belgian public finances for 1999. The main axes of the budgetary strategy for 2000-2002 are then examined in detail.

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1. THE HIGH LEVEL OF CONVERGENCE ACHIEVED BETWEEN 1995 AND 1998

1.1 Economic convergence

Since the decisions taken by the European Council in May last year, which confirmed that Belgium fulfilled the convergence criteria laid down in the Maastricht Treaty, the country's performance has been strengthened still further.

The stability of the exchange rate of the Belgian franc within the European monetary system and against the Deutsche mark has been remarkable.

As regards inflation, recent developments have confirmed the excellent performance recorded over the past few years, making it possible to tend to an annual average of 1%.

The credibility of the authorities' commitments in the monetary field, constantly underpinned by the progress made on the budget side, also explains why, compared with the three countries in the euro zone with the lowest inflation, the differential of the long-term interest rate remained at 10 basis points during the first ten months of 1998. This spread should be compared with that fixed by the Maastricht Treaty (200 basis points). As for the differential between Belgium and Germany in terms of short-term rates, this has been virtually non-existent for several years.

The consolidation of monetary and financial stability – in a difficult international context – was enhanced and supported by the general positive economic results recorded by Belgium. Unemployment fell to 8.8% in June, a level which is considerably lower than the European average of 10.1%. This result demonstrates that the Government's employment policy is bearing fruit. It also reflects the sustained growth rate in real terms – about 3% -- of the Belgian economy in 1997-98.

The fact that Belgium has thus been able to revive such a high level of activity at the same time as its budgetary deficit fell substantially below the 2% mark provides a clear illustration of the lasting advantages which our country and its people are entitled to hope for from the consolidation efforts made over the past decade.

1.2 The reduction in the budgetary deficit

The reduction in the deficit expected this year compared with 1995 (a minimum of 2.3 points of GDP) is substantial. It means that Belgian budgetary convergence is one year ahead of the probable scenario put forward in the Belgian convergence programme in December 1996.

Table 1.1 - Evolution of the public finances situation
(in % of GDP)

	1995	1996	1997	1998	Variation 98/95
Revenue	46.8	47.2	47.2	47.0	+0.2
• Tax revenue	30.7	31.1	31.6	31.7	+1.0
• Social security contributions	14.7	14.4	14.3	14.1	-0.6
• Other	1.5	1.7	1.4	1.2	-0.3
Primary expenditure	41.9	41.8	41.2	41.0	-0.9
Primary surplus	5.0	5.4	6.0	6.0	+1.0
Interest payments	8.9	8.5	7.8	7.5	-1.4
Deficit[1]					
• Outcome	3.9	3.1	1.9	1.6	-2.3
• 1996 convergence programme	4.1	3.4	2.9	2.0	-2.1
Debt ratio					
• Outcome	131.3	126.9	122.1	117.5	-13.8
1996 convergence programme	133.7	130.4	127.0	124.1	-9.6

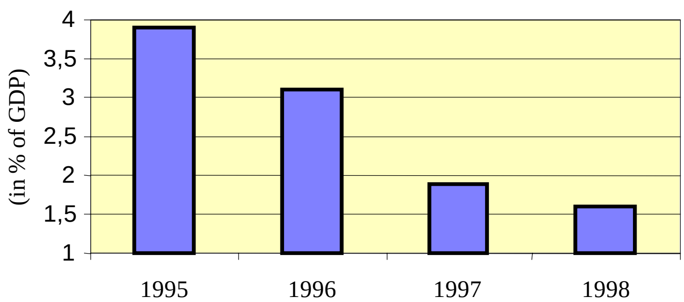
[1] *Net borrowing requirement.*

This trend, which is considerably more positive than anticipated, is a direct result of the better performance recorded in 1997, which allowed for a deficit 1 point lower than the target which the Federal Government initially set itself. This performance reflects:

- on the one hand, the cautious macroeconomic and financial assumptions adopted when the 1997 budget was drafted;

- on the other hand, the willingness of the various levels of authority to re-establish sound public finances. All the components of the general government sector in fact contributed towards bringing down the budgetary deficit more rapidly than planned.

Graph 1.1 General government deficit



The better achievements of 1997 resulted in more favourable prospects for 1998, as the anticipated overall public deficit was brought down to a maximum of 1.6% of GDP (see Graph 1.1.).

Taking the period from 1995 to 1998 as a whole, Table 1.1. also shows that the reduction in the deficit can be attributed to a considerable improvement in the overall primary surplus, coupled with a further reduction in the share of the interest burden. 80% of this improvement results from a reduction in the ratio of primary expenditure and the remaining 20% from a rise in the ratio of total public revenue.

It will also be noted that the ratio of total revenue stabilised as from 1996, reflecting:

- on the one hand, the increase in tax revenue as a % of GDP in 1997, which can be largely attributed to the overall increase in the level of corporate tax (+ 0.35% of GDP), following the improvement in the profit situation of the corporate sector and improved tax collection;

- on the other hand, the significant and structural reduction in the social security charges weighing on labour which, combined with the effects of wage moderation, brought about a reduction in the ratio of actual social security contributions of 0.6% of GDP.

Table 1.2 - Evolution of primary balances per major entities[1]
(in % of GDP)

	1995	1996	1997	1998	Variation 98/95
Entity I [2]					
Revenue	33.7	34.0	33.9	33.9	+0.2
Primary expenditure	29.4	29.4	28.7	28.6	-0.8
Primary balance	4.3	4.6	5.2	5.3	+1.0
Entity II [2]					
Revenue	14.7	14.9	15.1	14.8	+0.1
Primary expenditure	14.0	14.0	14.3	14.2	+0.2
Primary balance	0.7	0.8	0.8	0.6	+0.1

[1] *The revenue and primary expenditure totals do not correspond to the data given in Table 1.1 which are corrected to take account of the fact that certain transactions are counted twice since they appear in both the primary expenditure for one entity and in the revenue for another. This correction has remained stable on overage over the period at about 1.6% of GDP.*

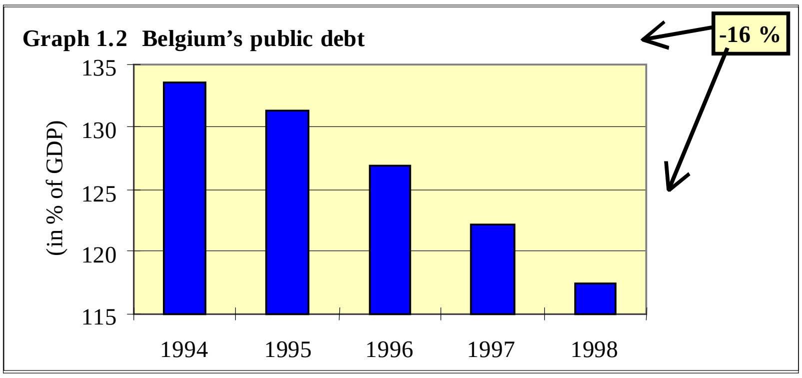
[2] *Entity I comprises the Federal Authorities and Social Security and Entity II includes the Communities, Regions and local authorities.*

Table 1.2 shows that the reduction in primary expenditure can be attributed almost entirely to the efforts made at the level of Entity I, that is the Federal Authorities and the Social Security.
This can also be seen from Table 1.3 which shows the real growth rates of final primary expenditure at each level of authority.

Table 1.3 - Evolution of final primary expenditure per level of authority [1] (Annual of variation rates in real terms)					
	1994	1995	1996	1997	1998[2]
General government	0.9	1.9	0.6	1.5	2.1
Federal authorities	-0.2	0.8	-2.0	-0.6	0.7
Regions and Communities	2.9	4.0	1.0	4.8	3.2
Social security	-0.1	2.7	1.5	0.4	2.1
Local authorities	4.2	-2.0	1.1	4.1	2.6

[1] *Primary expenditure budgetary transfers and allocated revenue.*
[2] *The growth rate indicated does not include the effect of an extraordinary and non-recurrent outlay of BEF 23 billion in capital transfers, neither for the general government nor for the federal authorities.*

1.3 The debt reduction process



Over a four-year period (1995-98) the level of indebtedness of the Belgian general government will have been reduced by no less than 16% of GDP (see Graph 1.2). Hence with an expected level of 117.5% of GDP at the end of this year, the reduction in the level of indebtedness is over two years ahead of the targets laid down in the 1996 convergence programme.

Table 1.4 highlights the structural and lasting nature of this process, which has been made possible thanks to the achievement of a high and stable level of primary surplus. In fact, it may be noted that for the period 1995-98, 9/16 of the reduction in the level of indebtedness can be attributed to the inverted 'snowball effect' and that this effect gained considerable momentum in 1997-98.

The substantial reduction in the level of public indebtedness was accompanied by a very significant decline in the burden of the interest charges paid by the Belgian general government. This decline was enhanced by the considerable reduction in the average cost of financing the debt, since the underlying interest rate on the public debt fell from 7.8% in 1994 to 6.4% in 1998.

Table 1.4 - Breakdown of the variation in the debt ratio[1]
(in % of GDP)

	1995	1996	1997	1998
Variation in the debt ratio	-2.2	-4.4	-4.8	-4.6
Contribution :				
• of the inverted "snowball effect" [2] calculated on the basis of :	-1.0	-0.7	-3.6	-3.7
- the actual primary surplus	-5.0	-5.4	-6.0	-6.0
- the breakeven primary surplus	+4.0	+4.7	+2.4	+2.3
• stock/flow adjustments [3]	-1.2	-3.7	-1.2	-0.9
The debt ratio	131.3	126.9	122.1	117.5

[1] *See also Table A.1 in annex.*
[2] *The inverted "snowball effect" is defined as the difference between the level of the actual primary surplus for the year t and the primary surplus required to maintain the debt ratio at a constant level (see annex for method of calculation).*
[3] *This item includes the positive effects of the sale of part of the gold stock of the National Bank of Belgium, internal consolidation measures of debts and surpluses inside the general government and the sale of certain financial assets.*

1.4 Modern management of the public debt

Since early 1997, the management of the public debt undertaken by the Belgian Treasury has been based directly on a reference portfolio called "the Benchmark Debt Portfolio". This portfolio provides an efficient and robust debt structure in terms of risk and costs, that is a portfolio structure that minimises the cost of the debt in the medium term at an appropriate risk level in a context of highly volatile macroeconomic scenarios.

Thanks to this new instrument it has been possible to situate the optimal average 'duration' of the Belgian debt at between 3.5 years and 4.5 years, which implies maintaining a short-term debt (less than one year) of around 20% of the total portfolio.

At the end of 1996, when the 10-year OLO or linear bond rates stood at 6.20% and the differential with the 6-month rates was approximately 3%, the average 'duration' of the domestic debt was 3.65 years. It was therefore near the bottom of the range, bearing in mind the relatively high level of long-term rates. In 1998, the Treasury took advantage of the reduction in long-term rates and the differential with the short-term rate to bring the average duration of the debt closer to its average target of 4 years.[1] In addition to the auctions and exchange bids which have favoured long-term maturities since the start of the year, the Treasury opened a 30-year OLO line in February 1998 and has actively pursued the OLO programme in FRF and DEM which also granted access to new investors.

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[1] The 'duration' is the period of time an asset still has to run, taking into account intermediate payments (e.g. coupons) generated by this asset. This measurement can be used to determine the sensitivity of the value of the asset to fluctuations in yields.

Similarly, the exchange rate risk on the debt has been reduced substantially over the past two years. The debt in foreign currencies amounted to 7.6% of the total debt at the end of 1996. At the start of 1999, after the conversion into euro of the debt denominated in DEM, FRF and NLG, this proportion will be reduced to around 3.5%.

The authorities responsible for managing the Belgian public debt have also recently adopted a series of measures aimed at reducing the cost of financing the debt to the largest extent possible after the introduction of the euro. The creation of a 'Debt Agency' with a view to strengthening the efficiency of the management of the public debt is worth stressing in particular.

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2. BELGIUM'S BUDGETARY POSITION FOR THE YEAR 1999

The 1999 budget is characterised by the following two factors:

- on the one hand, the overall deficit of the Belgian public authorities will be reduced again, being brought down to a maximum of 1.3% of GDP;

- on the other hand, the overall public debt ratio will again fall by 3% of GDP, thus decreasing from 117.5% of GDP in 1998 to 114.5% of GDP in 1999.

These two objectives will be achieved by maintaining, for the third consecutive year, an overall primary surplus of 6% of GDP and by making a further reduction in the share of the interest burden of 0.2% of GDP.

This approach is fully in line with the commitments made by the Government in the spring of 1998 to maintain the primary surplus at the level of some 6% of GDP and thereby continue to reduce the public debt ratio. Achieving these objectives will also enable the Government to fulfil the recommendations made to it last July by the Council of the European Union when the broad guidelines for economic policy were adopted.

2.1 Macroeconomic assumptions

In order to establish the credibility of the budget submitted for 1999, the Government has taken care to adopt cautious macroeconomic assumptions.

For example, as regards the forecast for economic growth, the Government has moved away from the usual procedure of starting from the estimate made in July by the Federal Planning Bureau[2] when drawing up the economic budget, namely 2.6%. The Government has taken a more recent and lower estimate of 2.4% with a view to integrating the potential consequences of developments in the financial crisis in emerging economies, as well as a lower exchange rate for the dollar. As regards the 3 months interest rates, the assumption made is an average of 4.1% in 1999.

The cautious nature of these assumptions can be assessed in particular in relation to the economic forecasts made in the autumn of 1998 by the European Commission, which anticipated that GDP in Belgium would grow by 2.5% and short-term interest rates would stand at 3.5% in 1999.

Table A.2 in the annex gives the main assumptions on which the 1999 budget is based.

[2] On behalf of the Institute of National Accounts.

2.2 Budgetary objectives per entity

The table below gives the objectives for 1999 in terms of deficit and primary balances for the general government as well as for Entity I (that is the Federal Government and the social security) and Entity II (that is the Communities, Regions and local authorities).

Table 2.1 - Objectives in terms of primary surplus and fiscal deficit
(in % of GDP)

	1997	1998	1999
Entity I [1]			
Primary surplus	5.2	5.3	5.3
Interest payments	7.1	6.8	6.7
Deficit	2.0	1.5	1.3
• Federal authorities	2.3	1.6	1.6
• Social security	-0.3	-0.2	-0.3
Entity II [1]			
Primary surplus	0.8	0.6	0.7
Interest payments	0.7	0.7	0.7
Deficit	-0.1	0.1	0.0
Entities I and II			
Total revenue [2]	47.2	47.0	46.7
Total expenditure [2]	41.2	41.0	40.7
Primary surplus	6.0	6.0	6.0
Interest payments	7.8	7.5	7.3
Deficit	1.9	1.6	1.3

1 *Entity I comprises the Federal Authorities and Social Security and Entity II comprises the Communities, Regions and local authorities.*
2 *Estimates/forecasts for 1998-99.*

The following comments should be made regarding the table above:

- As regards Entity I, the primary surplus target of 5.3% of GDP is in line with the objective of an overall primary surplus of 6% of GDP, while at the same time complying with the recommendation of a minimum primary surplus of 5.3% of GDP for Entity I as formulated by the 'General government deficit' section of the *Conseil supérieur des Finances* (CSF)[3].

[3] The *Conseil supérieur des finances* is an independent advisory body made up of experts which periodically issues recommendations regarding the various levels of the Belgian public authorities with a view to setting the objectives for budgetary policy in the short, medium and long term. As part of Belgium's convergence programme of December 1996, it was also entrusted with the task of continuing to submit to the Government a report on the implementation of the convergence programme during the previous year. Consequently every year this group prepares and publishes an opinion on the implementation of the convergence programme. The various levels of authority concerned pay great attention to this report.

- As regards Entity II, the budgetary balance targeted corresponds to the objective reiterated by the *Conseil supérieur des finances* in its report published in June 1998 as well as to the commitment made by the Communities and Regions for 1999 in the context of the Cooperation Agreement concluded with the Federal Government on 17 July 1996 for the period 1996-99.

2.3 A budget with priorities

The 1999 budget has been drawn up on the basis of the anticipated budgetary results of 1998, which in turn benefited from a positive context characterised by high revenue levels sustained by growth, as well as by the low level of interest rates.

The return to a favourable budgetary situation has once again given the Government limited but real margins for the cautious development of new actions in areas considered to be priorities.

Consequently, the main focus was on employment – in accordance with the Belgian Action Plan for Employment – and major efforts were made to help businesses in the form of further reductions in employers' contributions (worth BEF 18 billion at cruising speed) as of 1 July, as well as in favour of the social-profit sector (for a total of about BEF 10 billion). It should also be noted that the Government has decided to postpone the reduction in employers' contributions by six months in order to ensure that the primary surplus is maintained at 6% of GDP.

In addition to the continued modernisation of the judicial system and the implementation of a reform of the police services, the 1999 budget also plans for a series of measures aimed at the social sector, in order to meet the needs of the weakest members of society more effectively, as well as the full re-establishment of the indexation of all tax scales and the reduction in tax discrimination between married and unmarried couples. These decisions result in a scheduled substantial reduction in the overall fiscal and parafiscal pressure in a context in which primary expenditure is kept under control.
Finally, as regards the debt ratio, the target of reducing the consolidated gross level to 114.5% of GDP is expected to be attained by the end of 1999, mainly thanks to the inverted 'snowball effect'.

2.4 Follow-up of the implementation of the 1999 Budget

The Government undertakes to ensure that the stabilisation norm of a primary surplus of 6% will be respected, if necessary by taking corrective measures when the budget is reviewed at the beginning of the year.

This commitment reflects – once again in practical terms – the Government's commitment to remain in line with the perspective of the Monetary Union as outlined in the Maastricht Treaty.

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3. BUDGETARY STRATEGY FOR 2000-2002

3.1 The objective of stabilizing the primary surplus at 6% of GDP

The budgetary strategy which will be followed in Belgium over the next few years is based on the commitment to maintain the primary surplus of the general government at a level of some 6% of GDP over the medium term.

This political commitment was made in the context of the preparatory discussions for the European Summit on 1 May and enabled the European Commission to recommend that Belgium be allowed to accede to the single currency as from 1 January 1999.

The objective of a primary surplus of 6% has therefore become the new focal point of future budgetary policy in Belgium.

3.2 Implications of the 6% norm in a reference macroeconomic scenario

3.2.1 Budgetary norms adopted for Entities I and II

Following the 1998 Annual Report from the *Conseil supérieur des finances*, the overall norm for the primary surplus will imply for the period 2000-2002 :

- an objective of stabilising the primary surplus of Entity I at the level planned for 1999 (5.3% of GDP) ;

- an objective of balancing the budget of Entity II, in line with the consolidation within each federated entity, of the norm-based scenarios for the stabilization of their levels of indebtedness, as recommended by the *Conseil supérieur des finances* on the basis of existing financing laws, as well as with the rule on balanced budgets of the local authorities.

3.2.2 Macroeconomic reference projection

With a view to examining the implications of the 6% norm for the budgetary deficit and the rate of public indebtedness, a macroeconomic projection has been prepared by the Federal Planning Bureau on the basis of the international environment taken into consideration by the European Commission for the medium term.

However, bearing in mind the uncertainties weighing on economic forecasts, the potential market growth rate for Belgian exports has been brought down to 4.9% for the period 2000-2002, i.e. the growth rate for the country's export markets for the period from 1970 to 1998, instead of the 6.2% figure included in the Commission's scenario.

In addition, this projection presupposes :

- for 1999, a GDP growth rate of 2.4%, i.e. the assumption adopted in the 1999 budget ;
- for 2000-2002, an evolution in the various categories of revenue and primary expenditure, assuming unchanged legislation and policy and incorporating the indexation of tax scales and the reduction in social security contributions announced by the Government for the period under review;
- the assumptions adopted by the European Commission as regards interest rates. These assumptions may be considered cautious, given that the international environment taken into consideration is less buoyant than that of the European Commission. It should also be noted that the 10-year rate (5.2%) is considerably higher than the current rate for this maturity and that the 3-month rate used (3.7%) is in line with the forward rates currently estimated.

The macroeconomic results of this projection are given in detail in table A.3 in the annex and summarised in Table 3.1 below. It should be stressed that growth is maintained at 2.3% per year for the period 2000-2002, which is the potential growth rate of the Belgian economy estimated by the European Commission.

Table 3.1 - Reference macroeconomic scenario [1]
(in %)

GDP (volume)			GDP (deflator)			S.T. interest rates			L.T. interest rates		
2000	2001	2002	2000	2001	2002	2000	2001	2002	2000	2001	2002
2.3	2.3	2.3	1.1	1.1	1.1	3.7	3.7	3.7	5.2	5.2	5.2

[1] *See also Table A.3 in annex.*

3.2.3 Norm-based budgetary path

The implications of the norm of a primary surplus of 6% are given in Table 3.2, taking into account the results of the reference projection and adopting the same assumptions as regards interest rates as those adopted by the European Commission.

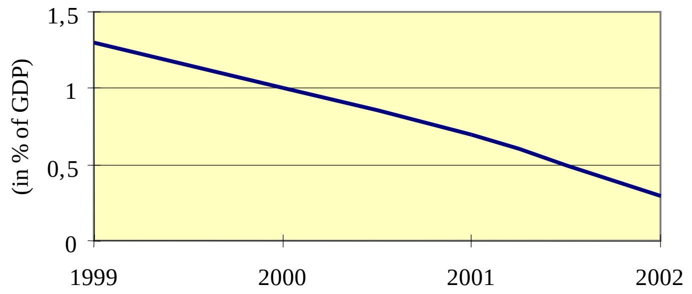
Table 3.2 - Norm-based budgetary path
(in % of GDP)
Reference macroeconomic scenario

	1999	2000	2001	2002
Entity I				
Primary surplus	5.3	5.3	5.3	5.3
Interest payments	6.6	6.3	6.0	5.6
Deficit	1.3	1.0	0.7	0.3
Entity II				
Primary surplus	0.7	0.7	0.7	0.7
Interest payments	0.7	0.7	0.7	0.7
Deficit	0.0	0.0	0.0	0.0
Entities I and II				
Primary surplus	6.0	6.0	6.0	6.0
Interest payments	7.3	7.0	6.7	6.3
Deficit	1.3	1.0	0.7	0.3
Debt ratio	114.5	112.2	109.6	106.8

Table 3.2. shows that stabilising the primary surplus of the general government at 6% of GDP entails a reduction in the deficit for the general government from 1.3% of GDP in 1999 to 0.3% in 2002, the continuation of the debt reduction process at an average annual rate tending towards 3 points of GDP, and a reduction in the overall interest burden between 1999 and 2002 from 7.3% of GDP to 6.3%. This reduction can be attributed not only to the fall in the debt ratio but also to the decline in the underlying interest rate on the debt, which is linked to the importance of the amounts outstanding to be refinanced during the years 2000 to 2002 and the interest rate differential between loans reaching maturity and new loans.

Graph 3.1 General government deficit

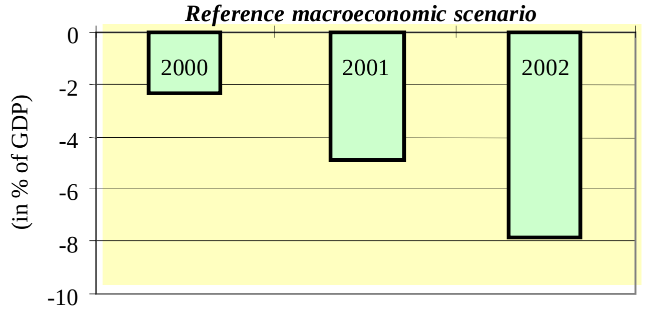
Reference macroeconomic scenario



The outlook resulting from this projection confirms that a primary surplus of 6% is suitable for the budgetary situation of Belgium. Compared with the situation in the1980s, the expected evolution represents a fundamental reversal, which has been made possible thanks to the consolidation efforts accomplished during the past few years.

Graph 3.2 Cumulative reduction in the debt ratio compared with 1999

Reference macroeconomic scenario



In structural terms, the budgetary situation has also improved substantially. In fact, on the basis of the methodology used by the European Commission, Belgium's structural deficit, that is the deficit excluding its cyclical components, may be estimated at around 1.3% of GDP in 1999[4]. Consequently, by maintaining the primary surplus at 6% in 2000-2002, it would be possible, all other things being equal, to virtually eliminate Belgium's overall structural budgetary deficit by the year 2002 (see Table 3.3).

Table 3.3- Structural balances of the general government

Reference macroeconomic scenario

	1997	1998	1999	2000	2001	2002
GDP (volume)[1]	3.0	2.9	2.4	2.3	2.3	2.3
Potential GDP[1]	2.1	2.2	2.2	2.3	2.3	2.3
Output gap[2]	-0.7	-0.2	0.0	0.0	0.0	0.0
General government deficit[2]	1.9	1.6	1.3	1.0	0.7	0.3
Structural primary surplus[2]	6.3	6.1	6.0	6.0	6.0	6.0
General government structural deficit[2]	1.6	1.4	1.3	1.0	0.7	0.3

[1] *Annual growth rate.*
[2] *In % of GDP.*

[4] This estimate is based on the assumption that the output gap will disappear in 1999 given a real growth in GDP of 2.4%.

3.2.4 The sensitivity of the budgetary path to interest rates

The sensitivity of the Belgian public finances to variations in market interest rates is indicated in Table 3.4.

It should also be recalled that the development of the ‘Benchmark Debt Portfolio’ makes it possible to maintain a public debt structure in line with the situation of the Belgian public finances. It may therefore be shown that for the ‘snowball effect’ to reoccur within the next two years, short-term and long-term rates would have to rise to 10% and 13%, respectively, at the start of 1999 – a scenario that is totally improbable.

Table 3.4 - Effect on interest burden of a rise in rates of 50 percentage points as of 1 January 2000
(in billions francs)

	Effect of the rise in S.T. interest rates	Effect of the rise in L.T. interest rates	Overall effect	In % of GDP
2000	8.1	0.0	8.1	0.08
2001	8.2	5.6	13.8	0.14
2002	8.3	10.7	19.0	0.18

3.2.5 The sustainability of the primary surplus norm

In principle, by maintaining the primary surplus at 6% of GDP, the public authorities are able to allow primary expenditure and public revenue to grow at the same rate as GDP. A priori, therefore, the constraint which will weigh on the budgetary policy in the period 2000-2002 will be considerably less than that experienced over the past few years.

However, the real margin of manoeuvre that will be open to the Government each time a budget is drawn up, will depend on the spontaneous evolution of the primary surplus, which could be achieved on the basis of unchanged legislation and policy. Hence any ‘spontaneous’ reduction in the ratio of total public revenue to GDP will reduce the real growth margin for primary expenditure below the real growth rate of GDP.

Given this reality, and in order to comply with the code of conduct on the content of the stability programmes adopted at European level, the Government wanted to have an assessment of the ‘spontaneous’ evolution of total revenue, associated with the reference macroeconomic projection. This assessment was carried out by the Federal Planning Agency, which left unchanged all the parameters of tax legislation and, in particular tax rates, with the exception of :

- the personal income tax scales, which have been indexed to price rises as of the tax year 2000;
- social security contribution rates, which have been reduced in order to bring down social security charges by BEF 18 billion a year (as of 1 July 1999) as laid down in the Belgian Action Plan for employment.

These two assumptions are in line with the guidelines adopted by the Government for its medium-term economic policy. The first assumption reflects the Government's willingness to restore the neutrality of the evolution of personal income tax in relation to inflation and thereby contribute towards easing the tax pressure in Belgium. The second confirms the Government's decision to reduce labour costs by gradually bringing employers' contributions into line with the average of neighbouring countries over a six-year period.

These assumptions, in the context of the reference macroeconomic projection, lead to a reduction of 0.8% of GDP in the ratio of total public revenue, of which 0.6% of GDP will come from the reduction in social security charges.

Table 3.5 shows the evolution of public primary expenditure compatible with this spontaneous evolution in total public revenue and the stabilisation of the primary surplus at 6%. In the context of the reference projection, and providing that the policy on the alternative financing of the Social Security remains unchanged, this evolution implies that the rate of growth of real primary expenditure will need to be limited to about 1.6% a year at the most[5], which – bearing in mind the past observations and the available forecasts based on unchanged policies – appears sustainable. This result provides an important reference point for the conduct of Belgium's budgetary policy over the medium term.

Table 3.5 - Spontaneous evolution of total public revenue [1]
(in % of GDP)

	1999	2000	2001	2002	Variation 2002/1999
Tax revenue	31.5	31.5	31.4	31.4	-0.1
Social security contributions	13.9	13.7	13.5	13.3	-0.6
Other revenue	1.2	1.2	1.2	1.2	-0.1
–> Total revenue	46.7	46.4	46.1	45.9	-0.8
Primary expenditure [2]	40.7	40.4	40.1	39.9	-0.8

1 *Evolution calculated in the context of the reference macroeconomic projection.*
2 *Evolution of the primary expenditure ratio compatible with the spontaneous evolution of total public revenue and the stabilisation of the primary surplus of the general government at 6% of GDP.*

3.3 <u>What will happen if growth is in line with the European Commission forecasts</u> ?

In its medium-term scenario, the European Commission forecasts for Belgium a growth rate of around 2.8% per year, in the period 2000 and 2002 (see Table 3.6).

The Government wanted to highlight what it would do if this growth scenario were to be confirmed. By clarifying in this way its position on the role it intends to reserve for automatic stabilisers, the Government wishes to contribute towards facilitating the adoption of an appropriate policy mix within the euro zone. This is in line with the procedures for the coordination of economic policies adopted at the European Council in Luxembourg.

5 Estimate based on the GDP deflator.

Table 3.6 - Macroeconomic scenario of the European Commission (in %)											
GDP (volume)			GDP (deflator)			S.T. interest rates [1]			L.T. interest rates [1]		
2000	2001	2002	2000	2001	2002	2000	2001	2002	2000	2001	2002
2.7	2.9	2.8	1.5	1.5	1.7	4.1	4.3	4.3	5.5	5.5	5.5

[1] *For caution and coherence purposes with regard to the reference macroeconomic projection, the assumptions as regards market interest rates have been revised upwards compared with the Commission's medium-term scenario.*

If economic conditions develop better than expected, the Government considers it reasonable to set the following rule of cyclical bonuses : in the event of anticipated growth of 2.3% à 2.7% per year, the spontaneous growth in the primary surplus which could be achieved on the basis of unchanged policy should be used partly (at least 1/3) to accelerate the reduction in the budgetary deficit, and partly, to finance initiatives considered to be priorities. The Government will take care when defining its priorities to avoid burdening the budgets of future years with measures the sustainability of which could not be assured in a context of normal growth; in the case of anticipated growth exceeding of 2.7% per year, the Government should use the benefit of the higher growth entirely to reduce the deficit.

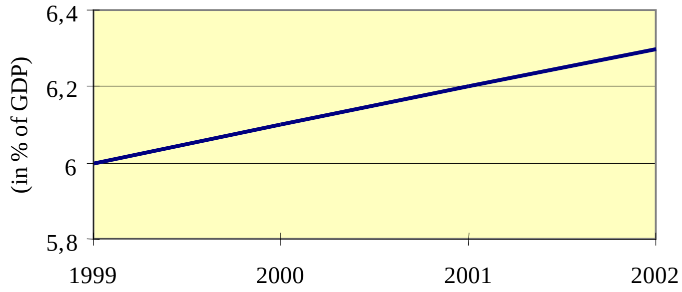
By adopting this approach, the Government considers that for a growth level between 2.3% and 2.7%, the need to constitute a cyclical margin of security is less pressing, particularly since the probability of a major economic reversal is low when the real growth rate fluctuates around its potential level. However, when expected growth exceeds a certain threshold – which has been set at 2.7% – growth is of an exceptional nature and the risk of an abrupt cyclical slowdown is higher. This justifies establishing a margin of security in order to be able to absorb more easily the negative impact of an economic slowdown.

Moreover, it is the importance of ensuring that the structural deficit continues to fall at a satisfactory pace for another few years, in accordance with the European recommendations, which explains why the Government considers that part of the cyclical bonuses should be used to reduce the deficit.

Graph 3.3 presents the increase in the primary surplus of the general government which may be expected – if policy remains unchanged – from the application of the rule of cyclical bonuses[6] in the macroeconomic scenario forecast by the European Commission. This increase reflects the high growth the Commission is expecting for the medium term and the positive impact of the automatic stabilisers in periods of high economic growth.

Graph 3.3 General government primary surplus

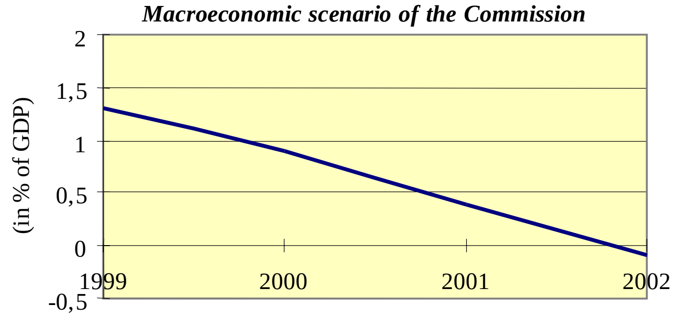
Macroeconomic scenario of the Commission



Graph 3.4 shows that in this scenario the expected deficit could be eliminated totally by the year 2002, despite the fact that the interest rates taken into consideration are less favourable than those used by the Commission. It should also be noted that the evolution of the deficit is more favourable than that expected for the reference macroeconomic scenario.

Graph 3.4 General government deficit

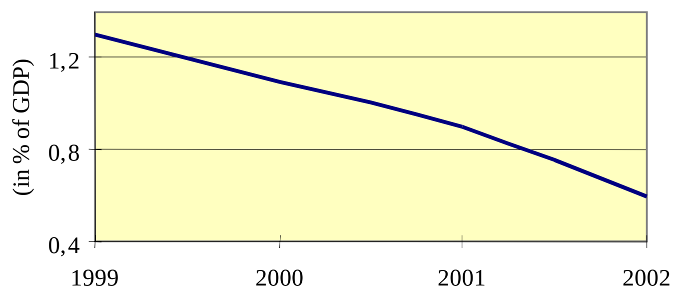
Macroeconomic scenario of the Commission



Despite this, the structural deficit expected by the year 2002 is slightly higher than that expected in the reference macroeconomic scenario (see Graph 3.5) given that in the growth zone of 2.3% to 2.7% only part of the cyclical bonuses is used to reduce the deficit. However, it should be noted that this approach is compatible with the continued reduction of the structural deficit of the general government, which approaches the threshold of 0.5% of GDP in this scenario.

Graph 3.5 Structural deficit of the general government

Macroeconomic scenario of the Commission



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[6] The assumption has been made that the primary surplus of the general government increases by an amount equal to one third of half the amount by which real growth in GDP exceeds 2.3% when growth is between 2.3% and 2.7% per year, and half the amount of the excess for higher growth rates. This hypothesis presupposes that, provided there is no change in policy, the primary surplus of the general government increases spontaneously on average by half the spread between the real growth in GDP and 2.3%. Given the results presented in section 3.1.5, this hypothesis may be considered reasonable.

4. THE FOLLOW-UP OF THE STABILITY PROGRAMME

The 1996 convergence programme gave the ‘General government deficit’ section of the *Conseil supérieur des finances* (CSF) the task of submitting, at the start of every year, a report on the implementation of the convergence programme during the previous year.

The Government considers that those reports have proved useful in helping to maintain the budgetary policy on the lines laid out in the convergence programme. This is why it is proposing that the CSF continue its task by preparing a report every year on the achievement of the objectives laid down in the stability programme.

*

* *

5. Conclusion

During the term of this parliament the Government has made every effort to achieve, in a final and irreversible way, the three basic objectives of its policy, namely:

· to ensure Belgium's accession to and participation in European Economic and Monetary Union under optimal conditions;

· to continue to bring down unemployment by maintaining a stable economic environment and pursuing an employment policy;

· to strengthen Belgium's structural base and the quality of its public service in order to maintain a framework favourable to economic dynamism and the prosperity of the population.

Belgium's qualification to participate in the launch of the single currency on 1 January 1999, the adoption and implementation of the Belgian Action Plan for employment, and the in-depth reform of the judicial system and the police services represent important steps on the way towards achieving the Government's objectives.

Progress has also been made as regards structural policies, as is witnessed by the report which the Government adopted on 10 December last, in application of the conclusions reached by the European Council in Cardiff. The actions undertaken have made it possible in particular to speed up the transposition of European directives into national law, reduce the State's participation in the financing of the merchant sector, and improve the functioning of the markets for goods and services and of the capital markets.

The importance of the inter-professional agreement signed by the social partners on 8 December 1998 for 1999 and 2000 should also be stressed. By adopting a rule setting at 5.9% the nominal wage increase throughout the private sector, the social partners have acknowledged the need to limit growth in average wage costs in Belgium to the expected average rise in wage costs in Belgium's three main trading partners. This agreement reflects the willingness of the Belgian social partners to preserve price and cost stability and, thus, the competitiveness of the Belgian enterprises.

This agreement is also fully in line with the Belgian Action Plan for employment to the extent that it also adopts a voluntarist approach to training and employment. It should be noted in particular that the employers have undertaken to devote a larger proportion of their wage bill to permanent staff training. Moreover, the social partners have accepted the principle that in the year 2000, the BEF 18 billion reduction in employers' contributions decided upon justifies greater efforts as regards training and employment. The Belgian Action Plan for employment and the inter-sectorial agreement are therefore complementary and mutually reinforcing. Complying with the commitments made by the Government and the social partners will consolidate the bases for sustained and non-inflationary growth and for the creation of jobs.

The adoption of the stability programme as presented in this document aims to strengthen this positive outlook. The strategy developed will enable Belgium to enter the 21st century with a budget position close to balance or in surplus. This outlook will enable the authorities to allow the automatic stabilisers to play fully through economic cycles, while at the same time avoiding falling back to a situation of excessive deficit.

The strategy of stabilising the primary surplus should also make it possible to bring down the rate of indebtedness to about 100% of GDP within the next five years, thereby contributing to the continuation of the process of debt reduction, the success of which will enable Belgium to cope, in stable financial condition, with the challenge of social and demographic changes of the second decade of the next century.

The gains which Belgium can therefore expect from the norm of a primary surplus of 6% are considerable in both the short and the long term. This is why the Government has adopted it, considering it perfectly suitable for the situation of the Belgian public finances. This principle has also been confirmed by the main guidelines for economic policy adopted at the European level in July 1998.

In the light of these considerations, the Government is confident of the support which this stability programme – its objectives and the outlook it offers – will receive from Parliament and the people of Belgium.

ANNEX 1

Table A.1 - Derivation of the inverted "snowball effect"
(in % or in % of GDP)

	1994	1995	1996	1997	1998
Debt ratio	133.5	131.3	126.9	122.1	117.5
Underlying interest rates (i)	7.8	6.9	6.6	6.4	6.4
Nominal growth in GDP (g)	4.9	3.9	2.9	4.5	4.5
Differential (i-g)	2.9	3.1	3.7	2.0	2.0
Breakeven primary balance (e) [1]	3.7	4.0	4.7	2.4	2.3
Actual primary balance (s)	5.2	5.0	5.4	6.0	6.0
Inverted "snowball effect" (e-s)	1.5	1.0	0.7	3.6	3.7

[1] *That is the level of the primary surplus which, given the differential between the average implicit interest rate on the debt and the nominal GDP growth rate, as well as the initial debt ratio, would make it possible to stabilise the debt ratio.*

ANNEX 2

Table A.2 -Macroeconomic scenario underlying the 1999 budget
(variations in % in volume - unless otherwise indicated)

	1997	1998	1999
Private consumption	2.1	2.8	2.1
Public consumption	1.1	1.1	1.6
Gross formation of fixed capital	5.4	4.8	3.5
Final national demand	2.2	3.0	2.3
Exports	5.9	5.1	4.3
Imports	5.1	5.5	4.4
Gross domestic product	2.9	2.8	2.4
Consumer prices (%)	1.6	1.1	1.3
Health index (%)	1.3	1.3	1.4
GDP deflator (%)	1.4	1.4	1.4
Real disposable income	0.8	2.4	1.5
Households savings rate (%)	15.2	14.8	14.4
Domestic employment (variation in thousands)	18.5	45.5	41.8
Unemployment rate (Eurostat standardised rate, yearly average)	9.3	8.6	8.1
Current account balances (in % du GDP)	5.4	5.7	5.8
Short-term interest rates (%)	3.4	3.7	4.1
Long-term interest rates 10 years (%)	5.8	5.0	4.6

ANNEX 3

Table A.3 – Main macroeconomic results of the reference projection[1]
(Changes in % in volume, unless otherwise indicated)

	2000	2001	2002	Average 2000-2002
Private consumption	2.1	2.0	2.0	2.0
Public consumption	1.2	1.2	1.0	1.1
Gross formation of fixed capital	3.4	2.9	3.2	3.1
Final national demand	2.1	2.1	2.1	2.1
Exports	4.5	4.8	4.7	4.7
Imports	4.4	4.7	4.6	4.6
Gross domestic product	2.3	2.3	2.3	2.3
Consumer prices (%)	1.2	1.2	1.3	1.3
Health index (%)	1.3	1.3	1.3	1.3
GDP deflator (%)	0.9	1.1	1.1	1.1
Real disposable income	2.1	2.1	2.0	2.1
Households savings rate (%)	15.6	15.6	15.6	15.6
Domestic employment (variation in thousands)	26.0	20.5	22.3	22.9
Current account balance (in % of GDP)	5.8	5.9	6.0	5.9
Potential export market (%)	4.9[2]	4.9[3]	4.9[3]	4.9
Import price of non-energy goods in BEF (%)	2.2	2.0	2.0	1.8
Import price of energy products in BEF (%)	7.0	2.0	2.0	3.7
S.T. interest rates (%)	3.7	3.7	3.7	3.7
L.T. interest rates (%)	5.2	5.2	5.2	5.2

1 This forecast follows on from the macroeconomic assumptions on which the 1999 budget is based, using the most recent figures calculated by the European Commission as regards the external environment, except for the growth rate of the potential export market.

The assumptions concerning public finances correspond to a scenario based on unchanged legislation and policy. The hypothesis regarding unchanged legislation mainly concerns social contributions and income taxes, replacement income and ‘scaled’ salaries. The hypothesis of unchanged policy basically concerns categories of expenditure which are subject to annual budgetary decisions (investment, purchases of goods and services, public sector employment).

As regard social contributions and income taxes, all the parameters of fiscal legislation and, in particular, tax rates, have therefore been maintained unchanged for the period, with the exception of the personal income tax scales, which are indexed as of the tax year, and the rates of social security contributions, which are reduced by BEF 18 billion per year (as of 1 July 1999), as provided for in the Belgian Action Plan for Employment. This reduction in the social security charges, together with the maintaining of wage restraint, partly explains the low inflation observed in this forecast.

As regards expenditure, the forecast is based on a scenario in which the strict budgetary policy of the past few years is maintained. This concerns in particular public-sector employment and primary expenditure on social security, the growth of which corresponds to the underlying growth rate.

2 Instead of 5.9 taken into consideration by the Commission in its medium-term scenario.

3 Instead of 6.3 taken into consideration by the Commission.