BELGIUM S STABILITY PROGRAMME 2002-2005

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(English version)

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Content

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1. The main orientations of the 2002-2005 stability programme

Actual trend: weakening economic activity

The terrorist attacks of 11 September 2001 hit the world economy at a time when it was particularly vulnerable. Even before those events, the European Union, the United States and Japan were simultaneously facing a downturn in economic activity. Belgium s economy and employment are also feeling the effects. All the indicators point to a rapid and substantial decline in economic activity during the initial months of 2001. On top of this weakness, the events mentioned above are bound to cause adverse shocks for the world economy and generate great uncertainty. In these circumstances, we need to gain a clear view without delay and see confidence restored, so that the outlook can once again be favourable.

Actual stability programme confirms the previous

The new 2002-2005 stability programme updates the December 2000 stability programme, which had centred on two political priorities : the steady creation of budget surpluses to allow the consolidation of public finances to continue unabated, and the creation of a budgetary margin to permit an innovative policy.

Assuming that the economy follows the existing trend, it was stated that the budget surplus would increase systematically from 0.2% of GDP in 2001 to 0.7% of GDP in 2005. This commitment to the creation of a surplus still applies even if growth is disappointing, unless there are significant negative deviations from the trend growth rate or exceptional changes in interest rates.

Significant negative deviation from the trend growth rate

The government considers that the present circumstances can be regarded as a significant negative deviation from the trend growth rate. The cumulative growth of GDP over the period 2001-2002 will be 2 to 3 percentage points below the trend growth rate taken as the basis for planning the budget under the stability programme (2.5 % in real terms).

It is expected that general government will probably more or less balance the books in 2001, despite the downturn in the economy. The actual result will depend in particular on the movement in tax revenues during the final months of this year.

Balanced budget as an objective

For 2002, the government is once again aiming at a balanced budget.

- By keeping fiscal policy on course, and thus ensuring its credibility, the government is not compromising the gains secured in the past. Despite the adverse economic conditions, a balanced budget could be achieved three years in a row and the reduction in the debt ratio is continuing.

- The government is also bolstering confidence by implementing in full the measures announced previously concerning the reduction in the burden of taxation and parafiscal charges, and the increase in benefits.

Crucial factors to the outcome of the 2002 budget

The macroeconomic and fiscal outlook is highly uncertain, even more so than in the past. Three factors will be particularly crucial to the eventual outcome of the budget for 2002:

- the evolution of in tax revenues during the final months of 2001, which will influence the basis for calculating 2002 revenues;
- the degree to which Entity II adheres to the budgetary targets adopted under the cooperation agreement concluded last year, having regard to the less favourable movement in the resources allocated to the communities and regions;
- the point at which the economic recovery begins, which is probably the most crucial factor.

Medium term objectives

If the economy strengthens, the government will continue to apply, in 2002, the rule concerning economic windfalls adopted by previous stability programmes. If growth in 2002 exceeds the current expectations, the additional margin will be allocated in priority to improving the budget balance.

In the medium term, the government is maintaining its objective of progressively creating a substantial budget surplus. If the economy turns around during 2002 and we see a strong recovery, we can expect growth figures in the region of 3% for 2003 (thanks to over 1% spill-over -growth accruing at the end of 2002). If these figures are achieved, the 2001-2005 stability programme will be back on course. The government is thereby confirming its policy of speeding up the reduction of the public debt.

In this way, the government emphasises the great importance which it attaches to the European Stability and Growth Pact and to the macroeconomic vision on which it is based ; guaranteeing sound public finances is essential to the creation of better conditions for price stability and the promotion of strong, sustainable growth and hence employment.

A sound budget brings stability and is important as the basis for confidence in the future. In today s difficult macroeconomic climate, a sound budget situation undeniably places the Belgian economy in a favourable starting position for the time when economic recovery sets in.

2. Economic environment

2.1. Short-term economic developments

Strong growth in 2000

Benefiting from a favourable international climate and strong domestic demand, the year 2000, with its 4% growth of GDP, represented an excellent year for the Belgian economy. On a quarterly basis, in the first quarter of 2000 growth reached the highest level seen since 1995 (6.1%). The subsequent quarters saw growth slowing down.

This fine performance in terms of growth was reflected in the labour market and public finances. Employment expanded by 1.6%, or over 60,000 units. The strong economic growth and prudent fiscal policy based on the golden hamster principle [1] meant that the 2000 budget ended in balance, whereas the original budget had still allowed for a deficit of 1% of GDP.

Slowdown of growth in 2001

At the start of 2001 the global economy looked set to slow down slightly, but before long it was clear that the slowdown in US growth was much more significant than predicted and would inevitably have an impact on the European economies. The quarterly accounts for the second quarter of 2001 clearly indicated that the Belgian economy could not escape this rapid deceleration in growth. The movement in GDP from one quarter to the next showed a drop of 0.5%, against an increase of 0.4% in the first quarter. The downturn in economic activity was evident primarily in the movement of production in the industrial sector. In contrast to the preceding quarters, domestic demand and more particularly, business investment and household consumption showed signs of weakness. For the first time in three years, the final consumption expenditure of households was down against the previous quarter.

(1) The golden hamster principle implies cautious estimation of the parameters when preparing the budget. This approach, which includes a budget safety margin, makes it possible to absorb unexpected adverse events without jeopardising the attainment of the budget targets in the immediate future.

Updated estimates for 2001 and 2002

It very soon became apparent that the July Economic Budget estimates, traditionally used as the basis for preparing the following year s budget, had been overtaken by events. The National Accounts Institute (NAI) was therefore asked to update those estimates. The figures produced by that exercise completed at the end of October are the ones shown in table 1 for the period 2001-2002.

Table 1
Growth and related factors

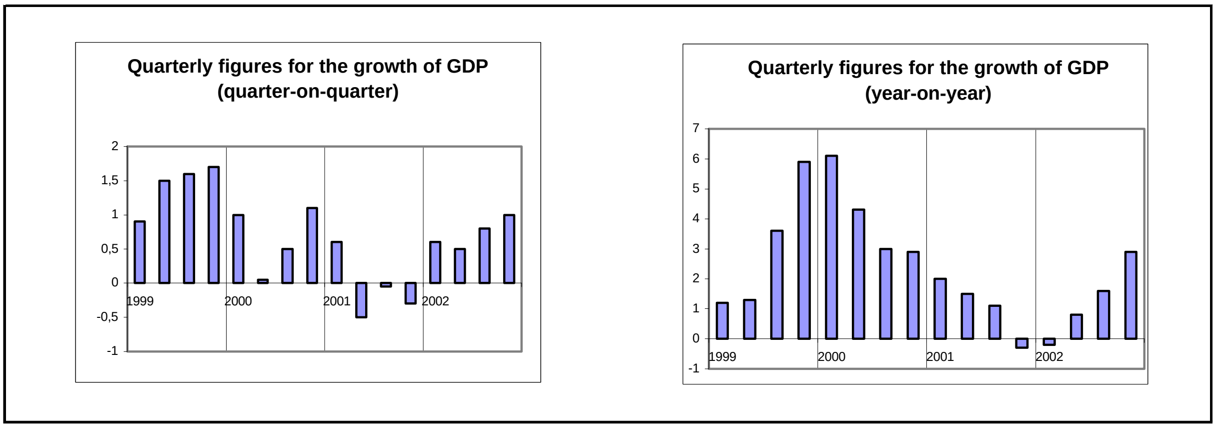
	2000	**2001** (1)	**2002** (1)	**2003** (2)	**2004** (2)	**2005** (2)
Growth of GDP at constant prices (7+8+9)	4,0	1,1	1,3	3,0	2,5	2,4
Level of GDP at constant prices	248,3	257,8	267,2	281,0	293,2	305,3
GDP deflator	1,4	2,7	2,3	2,1	1,8	1,7
Change in the HICP	2,7	2,5	1,3	1,8	1,7	1,7
Employment	1,6	1,0	0,3	1,0	0,7	0,7
Movement in labour productivity	2,4	0,1	1,0	2,0	1,8	1,7
	Sources of growth: change at constant prices					
1. Final consumption (private sector)	3,8	1,7	1,3	2,9	2,4	2,5
2. Final consumption (public sector)	2,5	1,7	1,2	2,0	1,4	1,8
3. Gross fixed capital formation	2,6	0,1	0,3	3,8	3,1	3,5
4. Change in stocks (contribution to GDP growth)	0,5	-0,2	0,0	0,0	0,0	0,0
5. Exports of goods and services	9,7	0,8	2,8	5,2	5,3	4,8
6. Import of goods and services	9,7	0,8	2,5	5,3	5,2	5,1
	Contribution to GDP growth					
7. Total final demand (1+2+3)	3,1	1,3	1,0	2,8	2,3	2,5
8. Change in stocks (=4)	0,5	-0,2	0,0	0,0	0,0	0,0
9. Balance of goods and services	0,5	0,0	0,3	0,2	0,2	-0,1

(1) Source: Federal Planning Bureau/NAI Economic Budget, October 2001
(2) Source: Federal Planning Bureau/NAI Medium-term outlook, November 2001.

Evolution of GDP

Owing to the pessimistic outlook for the international environment, the forecasts for the Belgian economy have been revised downwards. Belgium s external markets had expanded by 11.5% in 2000, but it is now assumed that they will grow by 2.5% and 3.5% respectively in 2001 and 2002. Both external and domestic demand are disappointing, and are depressing the growth of GDP. The real growth of GDP is estimated at 1.1% for 2001 and 1.3% for 2002. However, there are very different quarterly profiles concealed behind these almost identical figures. As illustrated by chart 1 (year-on-year figures) the year 2001 saw a constant decline in growth, so that the GDP for the closing quarter of 2001 actually ends up lower, at constant prices, than the figure for the last quarter of 2000. These figures are the mirror image of the profile expected for 2002.

Chart1



Evolution of the savings ratio and consumption expenditure in 2002

Household consumption expenditure increased by a further 3.8% in 2000. This growth will probably slow down in 2001 and 2002 to a figure of 1.7% and 1.3% respectively. Household purchasing power is bolstered by the continued phasing out of the additional crisis contribution and the first step in the reduction of personal income tax. But the growing uncertainty is reflected in the movement in the savings ratio, which is projected to rise from 14.7% to 15.4% in 2002. This means that private consumption is not expanding as quickly as real disposable incomes.

Evolution of investment in 2002

The slackening of demand and the adverse climate are inevitably affecting investment, which would rise by only 0.1% in 2001 and 0.3% in 2002. The trend in investment is greatly influenced by the movement in public investment, which traditionally sees a substantial fall in the year following the year of municipal elections (these were held in October 2000). The growth rates for business investment were forecasted as 0.7% and 1.3% respectively. In 2002 business investment is likely to be buoyed up once again by the recovery of demand and the low level of interest rates.

Evolution of employment in 2002

It takes time for employment to react to changes in the economic situation. That explains why employment will have increased by another 40,000 units approximately (1.0%) in 2001, despite the disappointing growth figures. In 2002 we shall see the reverse happening. Employment will be late to respond to the economic recovery. The number of new jobs created is unlikely to exceed 13,000. This delayed response by the labour market also accounts for the large divergence in the movement in labour productivity per head (0.1% in 2001 and 1.0% in 2002 respectively).

Evolution of inflation in 2002

Inflation peaked in June 2001. The rise in the harmonised index of consumer prices is estimated at 2.5% for 2001 ; it should then drop back to 1.3% in 2002. The estimates of the slowing of inflation are based on the assumption that oil prices continue to fall and the euro appreciates further.

2.2. Medium-term forecasts

Medium-term potential growth rate

At the government s request, the Federal Planning Bureau also produced a medium-term projection. It is based on the assumption that the growth of the world economy will accelerate in 2003, triggering stronger expansion of world trade and external markets of relevance to Belgium. The real growth of GDP is estimated at 3.0% for 2003, after which it is expected to drop to 2.4% - 2.5%, which is the medium-term potential growth rate.

In the period covered by the projection, growth is driven mainly by domestic demand. The contribution made by net exports remains small. Private consumption is sustained by the favourable movement in household disposable incomes. Apart from the expansion of employment, the impact of the cut in personal income tax is an important factor : that impact will be felt mainly at the end of the projection period. The better market outlook and the corporation tax reform should revitalise business investment as well.

3. Financing balance and public debt

3.1. Key elements of fiscal policy

Medium-term fiscal policy objectives

As far as medium-term fiscal policy is concerned, the government remains loyal to the objectives of the 2001-2005 Stability Programme. The latter has two aims:

- *« The progressive creation of budget surpluses steadfastly continues the consolidation of the public finances. This will permit a faster reduction of the public debt, which is a necessary condition for making the Belgian public finances less dependent on interest rate shocks, and which is a vital precondition for absorbing the impact of ageing during the coming decade.*

- *Maintenance of this budgetary target will make it possible, during the coming years, to free additional resources for an ambitious policy. This will be reflected in a new dynamism with regard to employment, especially through an appreciable reduction in the tax on labour, in a modernised social security system adapted to the new requirements of the population, in improved functioning of general government, justice and security, and in measures to promote sustainable development and mobility.* »

Objectives for the financing balance: elaboration of a surplus

The objectives for the financing balance, as set out in the 2001-2005 stability programme, are shown in table 2 below.

Table 2
Objectives for the financing balance as set out in the 2001-2005 stability programme

As % of GDP	2001	2002	2003	2004	2005
Financing balance	0,2	0,3	0,5	0,6	0,7

According to the 2002-2005 stability programme, *If the development of the economy follows its current trend growth, the financing surplus will be systematically increased, rising from 0.2% of GDP in 2001 to 0.7% in 2005. This commitment also applies in the event of a disappointing trend in economic activity, barring appreciable departures from trend growth or exceptional changes in interest rates.*

In view of the exceptional economic conditions, there shall be a deviation from this course in the short term. However, the commitments remain valid in the medium term.

3.2. Execution of the 2001 budget

Original objective for the 2001 budget: surplus

At the time of preparation of the 2001 budget, the general government was expected to see a surplus totalling 0.2% of GDP. This figure did not take into account the proceeds from the sale of UMTS licences.

Buffer against economic downturn

Although growth of GDP in 2001 was estimated at 3.1% when the initial 2001 budget was prepared, the federal government - applying the golden hamster principle - reckoned on growth of just 2.5%. This left a buffer of 0.3% of GDP. At the time of the budget review, the growth estimates were revised to 2.8%. The buffer was thus halved where fiscal and parafiscal revenues were concerned. In order to guarantee an additional buffer in case the economy did badly, the golden hamster principle was applied to interest charges, so that the favourable effect of the fall in interest rates was disregarded. Moreover, the improvement in the economy in 2000 produced an additional, exceptional increase in the resources for the communities and regions in 2001. Nevertheless, the calculation of the budget figures for general government as a whole was based on the target set by the cooperation agreement in the case of the communities and regions.

Measures to cope with economic downturn

While the 2001 budget review still assumed growth of 2.8%, it has since become clear that there was a marked downturn in economic activity in the first half of this year. The government therefore conducted an additional review of the budget figures for 2001 and took various measures. This made it possible to adhere to the budget target of 0.2% of GDP even if the growth of GDP dipped to around 2.0%.

Revised objective: balanced budget

Meanwhile, it has become apparent that even growth of GDP in the order of 2.0% for 2001 must be considered over-optimistic. As we have said, we are now expecting growth to slacken to 1.1%. In this adverse economic climate, the recommended target (namely a surplus of 0.2% of GDP) seems difficult to attain. On the other hand, according to the latest estimates it still seems feasible to achieve a balanced budget. Despite the adverse economic trend, the budget result for 2001 will be much closer to the budget targets than in a number of other European countries. The final outcome will depend essentially on the movement in tax revenues during the final months of 2001.

3.3. The 2002 budget

As stated earlier, the 2001-2005 stability programme, based on a trend growth rate of 2.5%, projected a budget surplus of 0.3% of GDP for 2002. This objective was to be maintained in the event of disappointing growth unless there were significant negative deviations from the trend growth rate or an exceptional change in interest rates.

Prudent macroeconomic assumptions

When preparing the 2002 budget, the government adopted prudent macroeconomic assumptions. It reckoned on 1.3% growth of GDP in 2002. Interest charges were calculated on the basis of the forward rates fixed on 3 October. Thus, interest charges for 2002 were estimated on the basis of average short-term interest rates of 3.4% (3-month treasury certificates) and a long-term rate of 5.3% (10-year government bonds). Since then, the rates have continued to move in a favourable direction. The macroeconomic parameters adopted by the federal government were confirmed in broad outline by the Economic Budget at the end of October.

In view of the development of the economy, the government faced a difficult choice. On the one hand, it wanted to maintain its budget targets unchanged, but it also needed to ensure that fiscal policy did not have an excessively depressing effect on domestic demand. Be that as it may, it would have been a mistake simply to sacrifice the results achieved by the policy of consolidation in order to bolster demand, as sound public finances, with a continued reduction in the debt ratio, are also an important factor affecting confidence.

Objective of a balanced budget

That is why the government chose to stick to the objective of a balanced budget. The government also took care not to inflict too much damage on disposable incomes or confidence by retrieving previously announced decisions.

Resources available used to stimulate the economy

The combination of a prudent assumption for growth and the maintenance of a balanced budget is bound to impose considerable restrictions on the budgetary margin. The resources available were used as far as possible to stimulate the economy, in a downward phase, by:

- supporting the purchasing power and disposable income of households:
  - by implementing in full the tax reduction announced previously and continuing to phase out the additional crisis contribution;
  - and by implementing the increase in certain social security benefits;
- continuing to reduce labour charges, e.g. by simplifying the existing systems and targeting additional resources mainly on young people and the elderly;

- pursuing a pro-active policy on employment.

Corporation tax reform

The government also agreed on the principles for corporation tax reform centred on the following key points:

- reduction in the rate of corporation tax from 40.17% to 33.99%; the impact which this measure has on the budget is offset by the simplification or abolition of certain deductions;

- encouragement for SMEs, e.g. by a similar reduction in the rate of tax, immunity from tax on retained profits.

In line with the Stability and Growth Pact

Owing to the constraints imposed by the economic environment, the initial target for 2002 was therefore lowered to a balanced budget. The government considers that this result is in line with the commitments endorsed in the 2001-2005 stability programme. It feels that a deviation of some 2.6 percentage points over two years in relation to the trend growth rate must be taken as a significant deviation. There is therefore every justification for departing from the planned course for the financing balance, without abandoning the objective of creating a structural surplus.

The government will also apply to the 2002 budget the rule adopted in previous stability programmes regarding economic windfalls. If growth exceeds the forecasts, the additional margin will be used primarily to improve the budget balance.

With a budget close to equilibrium in 2001 and 2002, Belgium would satisfy the requirements of the European Stability and Growth Pact, namely the pursuit of a sound budget position close to balance or in surplus.

3.4. The medium-term objectives

Ultimate objective: budget surplus

The government s ultimate objective is still the progressive accumulation of a substantial budget surplus over the medium term. Owing to the disappointing economic climate in 2001 and 2002, it is bound to depart from the planned course, but without compromising what has already been achieved in terms of the consolidation of public finances.

The government s stated objective is to return to the course outlined in the 2001-2005 stability programme as soon as the economic environment permits. At the time of the debate on the 2002 budget, attention was drawn to the commitment to use economic windfalls, if any, to improve the financing balance.

Accelerated reduction of the public debt

If the economy picks up in 2002 and the recovery is strong, we can expect to see growth figures for 2003 in the region of 3%, thanks to growth of over 1% accruing at the end of 2002. If these forecasts prove correct, we shall be back on the track of the 2001-2005 stability programme. The government thereby confirms its policy of accelerated reduction of the public debt.

Table 3
The budget for the general government

As % of GDP	2000	2001	2002	2003	2004	2005
	Growth assumptions (1)					
Real growth of GDP	4,0	1,1	1,3	3,0	2,5	2,4
Deflator	1,4	2,7	2,3	2,1	1,8	1,7
	Financing balance for the subsectors					
General government	0,1	0,0	0,0	0,5	0,6	0,7
Entity I	0,1	-0,6	-0,3	0,2	0,4	0,5
Entity II	0,0	0,6	0,3	0,3	0,2	0,2
Communities and Regions	0,2	0,6	0,1	0,1	0,1	0,1
Local authorities	-0,2	0,0	0,2	0,2	0,1	0,1
	General government					
Total revenue	49,5	49,0	48,7	48,4	48,3	48,1
Total expenditure	49,4	49,1	48,7	47,9	47,7	47,4
Financing balance	0,1	0,0	0,0	0,5	0,6	0,7
Interest charges	6,8	6,5	6,0	5,6	5,3	5,0
Primary balance	6,8	6,5	6,0	6,1	5,9	5,7

(1) Use was made of the Federal Planning Bureau projections as shown in Table 1. They differ slightly from the assumptions adopted by the government for the purpose of preparing its 2002 budget.

Obviously, attainment of the targets shown in table 3 depends on certain factors, especially the points mentioned in the introduction.

3.5. The contribution of the various sub-sectors

Distinction between Entity I and Entity II

For the purpose of analysing Belgian public finances, we generally distinguish between Entity I and Entity II. Entity I comprises the federal government and social security. Entity II consists of the communities, regions and local authorities.

Agreements with the communities and regions

Agreements are concluded between the federal government and the communities and regions ensuring that the various levels of authority collaborate with a view to achieving the targets. In the Agreement of 15 December 2000 ([1]), the communities and regions undertook to adhere, during the 2001-2005 period, to the targets for financing requirements laid down by the "Government Financing Requirements" Section of the Superior Finance Council. ([2]) For the period 2002-2005, that corresponds to a balanced budget for the communities and regions as a whole. Taking into account certain differences between the accounting definitions used by the Requirements and Financing Section and those used by the National Accounts Institute, that corresponds to a surplus of 0.1% of GDP in ESA terms.

Financial situation of the local authorities

In their capacity as the supervising authority, the regions undertook to encourage the local authorities to achieve the objectives laid down in the 2001-2005 stability programme. In 2000 the local authorities had a budget deficit of 0.2% of GDP. The pattern of their revenue and expenditure (especially investment spending) is greatly influenced by the electoral cycle. We invariably see a deterioration in the balance during the year preceding the municipal elections and in the actual election year. Normally, the financial situation of the local authorities recovers during the period between two elections. That is why we assume that the local authorities will achieve a surplus of 0.2% of GDP in 2001-2003. For the period 2004-2005, a surplus of 0.1% of GDP is expected.

Opinion of the High Finance Council

As already provided for in the initial stability programme, the Financing Requirements section of the High Finance Council will publish every year, during the spring, an opinion concerning compliance with the aims of the updated stability programme.

(1) Agreement of 15 December 2000 between the Federal State, the French Community, the Flemish Community, the German-speaking Community, the Walloon Region and the Brussels Capital Region, setting out the fiscal targets for 2001-2005.

(2) The General government financing requirements section of the Superior Finance Council is a consultative body which formulates opinions each year on the budgetary policy of general government, and more especially on that of the communities and regions.

Internal stability programmes communities and regions

To ensure that the budgetary policy of the communities and regions fits in with the national stability programmes, the communities and regions draw up every year an evolving internal multiannual stability programme, the duration of which must be at least equal to that of Belgium s stability programme. In these internal stability programmes, the communities and regions show how they will attain the above-mentioned targets for each of the budget years concerned. As it already does for stability programmes at the level of general government as a whole, the High Finance Council will carry out an evaluation of the execution of these stability programmes every year.

Table 4
Allocation of the target among the various entities (1)

As % of GDP	2002	2003	2004	2005
Primary balance	6,0	6,1	5,9	5,7
Entity I	5,1	5,1	5,1	5,0
Entity II	0,9	0,8	0,6	0,6
Interest charges	6,0	5,6	5,3	5,0
Entity I	5,5	5,1	5,0	4,7
Entity II	0,5	0,5	0,4	0,4
Financing balance	0,0	0,5	0,6	0,7
Entity I	-0,3	0,2	0,4	0,5
Entity II	0,3	0,3	0,2	0,2

(1) The objectives set out in table 4 are those endorsed in the Agreement of 15 December 2000, but take no account of the implementing arrangements.

3.6. Development of the debt

Policy aimed at reduction of the debt ratio

The restoration of balanced public finances in 2000 was the culmination of a lengthy period of consolidation. However, the high level of government debt remains a weakness for Belgian public finances. The disadvantages of such a high debt burden are well known. That is why the government s budgetary policy is geared to steady reduction of the debt ratio.

Chart 2

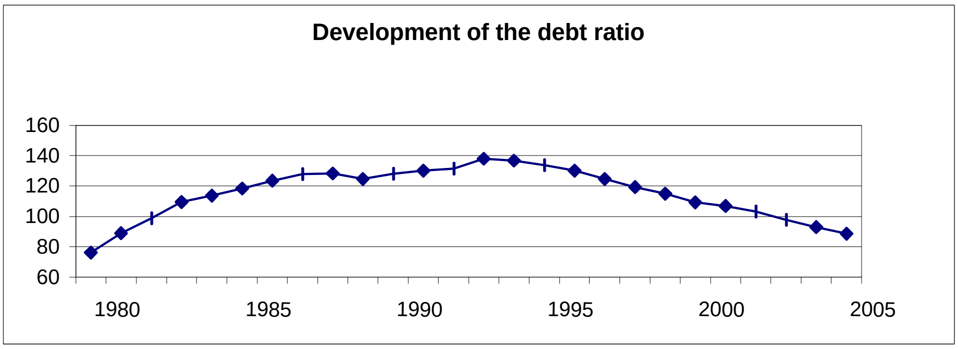


Chart 2 clearly illustrates the reduction of the debt ratio, beginning in 1993. In that year the public debt reached the record level of 138.1% of GDP. By the end of 2000 the debt ratio had been cut to 109.3% and is still falling : 107.0% in 2001 and 103.3% in 2002.

Table 5
Development of the public debt

As % of GDP	2000	2001	2002	2003	2004	2005
Gross debt ratio (1)	109,3	107,0	103,3	97,7	93,0	88,6
Development of the gross debt ratio	-5,7	-2,2	-3,5	-5,6	-4,7	-4,4
	Factors explaining the development of the gross debt ratio					
Primary balance	6,8	6,5	6,0	6,1	5,9	5,7
Interest payments	6,8	6,5	6,0	5,6	5,3	5,0
Nominal growth of GDP	5,4	3,8	3,6	5,2	4,3	4,1
Endogenous variations in the debt	-6,0	-4,1	-3,7	-5,6	-4,7	-4,4
Other factors influencing the debt ratio (2)	0,3	1,9	0,0	0,0	0,0	0,0
Of wich: privatisations	0,0	0,0	0,0	0,0	0,0	0,0
p.m.: implicit interest rate level	6,2	6,0	5,8	5,7	5,7	5,6

(1) Based on the Federal Planning Bureau s GDP figures, which differ slightly from the figures used by the government when preparing the 2002 budget.

(2) There is a technical reason for the substantial impact of other factors in 2001 (1.9% of GDP). In September 2001 the ex OCCH/CBHK debt guaranteed by the State was included in the Maastricht debt (1.4% of GDP).

For the first time since 1982, the debt is likely to be less than GDP in 2003. In the scenario outlined, the debt ratio will fall to 88.6% by 2005. In the 2002-2005 period, the development is determined solely by the financing balance. As a working hypothesis, the proceeds from any future privatisations are disregarded.

3.7. Cyclically adjusted balance

Cyclically adjusted balance as an indicator of fiscal policy

The development of the primary balance and the financing balance adjusted for cyclical variations is used increasingly frequently as an indicator of fiscal policy. Despite numerous problems connected with, amongst other things, the estimation of the output gap and the assessment of the sensitivity of public finances to the growth of GDP, it still gives some indication of the fundamental trend in public finances.

The trend growth rate was calculated by the Hodrick-Prescot method on the basis of the Federal Planning Bureau s forecasts explained earlier. Owing to the impact of the growth slowdown in 2001 and 2002, the trend growth rate was downgraded against earlier estimates. For the 2001-2005 period, it hovers around 2.4%, which is a fraction lower than the 2.5% figure used by the government in the 2001-2005 stability programme. The output gap was entirely closed in 1999. The strong growth achieved in 2000 caused the output gap to become positive. In 2001 and 2002, growth will remain well below the trend rate. The positive output gap therefore disappears almost entirely in 2001, becoming negative in 2002. In the light of the growth forecast used, the output gap will be closed in 2003. In subsequent years it will stabilise.

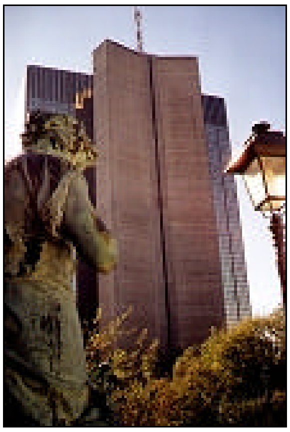
Table 6
Cyclical pattern of public finances

As % of GDP	2000	2001	2002	2003	2004	2005
1. Growth of GDP at constant prices	4,0	1,1	1,3	3,0	2,5	2,4
2. Actual financing balance	0,1	0,0	0,0	0,5	0,6	0,7
3. Interest payments	6,8	6,5	6,0	5,6	5,3	5,0
4. Potential growth of GDP	2,4	2,4	2,4	2,4	2,4	2,4
5. Output gap	1,8	0,5	-0,5	0,1	0,2	0,2
6. Cyclical component of the budget	0,6	0,2	-0,1	0,1	0,1	0,1
Of wich:						
Deviation from trend growth rate	1,1	0,3	-0,3	0,1	0,1	0,1
Composition of growth	-0,5	-0,1	0,2	0,0	0,0	0,0
7. Cyclically adjusted financing balance (2-6)	-0,5	-0,2	0,1	0,4	0,5	0,6
(adjusted for UMTS revenues)		-0,4				
8. Cyclically adjusted primary balance (7+3)	6,3	6,3	6,1	6,1	5,8	5,6
(adjusted for UMTS revenues)		6,1				

Methods used to adjust the balance

The method of adjusting the balance for cyclical influences on the basis of the trend growth is relatively simple, using a long-term estimate of elasticity in relation to GDP, and therefore disregarding the composition of the growth. That is why table 6 also takes account of the impact made by the composition of the growth (line 6). By taking both effects into account we obtain a more complete picture of the movement in the cyclically adjusted balance.

According to this method, the balance achieved in 2000 is therefore reduced to a cyclically adjusted 0.5% deficit. After adjustment for the UMTS revenues, it is expected to stabilise at a similar level in 2001. In the medium term a structural surplus will be built up.



4. Comparison with the 2001-2005 stability programme and sensitivity analysis

4.1. Comparison with the 2001-2005 stability programme

Differences in 2001 and 2002 in relation to the previous stability programme

When the 2001-2005 stability programme was drawn up, it was assumed that there would be a small deficit of 0.1% of GDP in 2000. Since growth was stronger than predicted, the eventual result, namely a balanced budget, was actually slightly better. As we have said, the government is adhering to the scenario of the 2001-2005 stability programme, departing from it only in 2001 and 2002 on account of the economic climate. Assuming that economic growth reaches at least 3%, the original scenario will be picked up again in 2003.

Table 7
Differences in relation to the previous programme

As % of GDP	2000	2001	2002	2003	2004	2005
Growth of GDP						
previous update	3,8	2,5	2,5	2,5	2,5	2,5
current update	4,0	1,1	1,3	3,0	2,5	2,4
difference	0,2	-1,4	-1,2	0,5	0,0	-0,1
Financing balance						
previous update	-0,1	0,2	0,3	0,5	0,6	0,7
current update	0,1	0,0	0,0	0,5	0,6	0,7
difference	0,2	-0,2	-0,3	0,0	0,0	0,0
Gross debt ratio						
previous update	110,6	105,8	101,4	97,2	92,9	88,7
current update (1)	109,3	107,0	103,3	97,7	93,0	88,6
difference	-1,3	1,2	1,9	0,5	0,1	-0,1

(1) In 2001 the debt ratio was influenced by the inclusion of the ex OCCH/CBHK state-guaranteed debt in the Maastricht debt (1.4% of GDP).

Putting the deviation in its context

The differences in 2001 and 2002 must be viewed in their economic context. Taken over two years, the cumulative growth is 2.6 percentage points short of the original forecasts. Despite this setback, the deviation from the fiscal target is only 0.3% of GDP. We must also stress that the targets for the financing balance have been tightened up under successive stability programmes. The set of fiscal targets used in the 1999-2002 stability programme, for example, specified a deficit of 0.7% of GDP for 2001 and 0.3% for 2002. In the first stability programme submitted by the current government for 2000-2003, the deficit for 2001 was taken as 0.5% of GDP and the budget was expected to balance in 2002. The disappointing economic climate should therefore not prevent the objectives of the 2000-2003 stability programme from being achieved in 2002.

The debt ratio has also been increased slightly in the latest scenario. In 2002 the deviation is expected to rise to 1.9 percentage points of GDP, but should diminish thereafter.

4.2. Sensitivity analysis

Ambition to be back on course with the 2001-2005 stability programme by 2003

By 2003, the government aims to be back on course in meeting the targets for the financing balance set in the 2001-2005 stability programme. However, whether it achieves that, will depend on economic growth. Apart from the uncertainty over growth in 2002, it is growth in 2003 which is particularly crucial for this scenario. The government tables on growth of around 3.0% in 2003. This assumption was backed up by the recent medium-term projections issued by the Federal Planning Bureau and explained in section 2.2.

Elements influencing the primary balance

According to the OECD s calculations, the primary balance reacts to a 1 percentage point deviation in the growth of GDP by a factor of 0.6. (1) This calculation, based on the GDP-elasticity of various revenue categories and on expenditure relating to the labour market must be regarded as a sort of average. Calculations originating from the European Commission clearly illustrate that the impact may vary greatly, depending on whether the changes in GDP are driven by consumption, exports or investment. (2)

The high level of the public debt and interest charges is an additional burden on Belgian public finances. However, they may also have a stabilising effect on the balance. In a normal economic situation, the interest rate will fall when the economy is contracting. Despite the fairly high degree of consolidation of the Belgian public debt (only about 12% is short-term debt), part of the impact of the disappointing growth on the primary balance will be offset in that way. In a period of buoyant activity, the opposite mechanism operates.

(1) OECD: Structural budget balances : a methodological note. Economic outlook, sources and methods
(2) European Commission Directorate-general for economic and financial affairs: Public finances in EMU 2001 pp.157-164.

5. Quality of public finances

5.1. Principal initiatives concerning revenues

Tax reforms

In accordance with the Broad Economic Policy Guidelines, the tax system is becoming more favourable to labour. Reforms are in progress or in preparation in the field of personal income tax, corporation tax and social security contributions.

Key points of the personal income tax reform

The reduction in personal income tax proposed by the government was approved by parliament. The approved reform centres on four key points:

- *reduction in the burden of taxation on labour* whereby, apart from the abolition of the top rates of 52.5% and 55%, adjustment of the tax scales, granting of a tax credit and an increase in flat-rate professional expenses will reduce the levies payable on low or moderate incomes. Similarly, worker mobility is being encouraged by measures to promote the use of public transportation;

- *guaranteed neutrality in relation to life-style choices*, permitting equal treatment for married and cohabiting couples by aligning minimum tax exempt allowances and by measures concerning replacement incomes. This therefore represents a first step towards individual tax treatment, but without impairing the special status of single persons;

- *making greater allowance for the expense of children and for one-parent families* by tax rebates for dependent children, and by extending the tax rebates for dependent children from single persons to all one-parent families;

- *a greener tax system*: as part of the reform and the simplification of personal tax allowances, measures will be taken to promote energy saving in the residential sector.

Impact personal income tax reform

The impact of the planned tax reform will increase steadily from 0.25 billion euros in 2002 to 2 billion euros in 2005. In 2006 the reform will be fully operational. These figures take no account of the abolition of the additional crisis contribution, which reduces the tax burden each year by some 0.25 billion euros or 0.1% of GDP during 2001-2003. The total effort will rise to about 1.0% of GDP by 2005.

Key points of the corporation tax reform

Apart from reforming personal income tax, the federal government is also preparing a corporation tax reform. The current high nominal rate of tax (40.17%) gives a false impression of the tax burden on companies. The government has therefore decided on two measures.

- the 40.17% tax rate is being cut to 33.99%;
- introduction of a generalised ruling system.

At the same time as the reduction in the rate of corporation tax, the rate of tax on SMEs will be cut from 28.84% to 24.98%. From now on, SME s will be granted exemption from corporation tax on profits allocated to the investment reserve. The cost of these planned measures will be partly offset by simplification of the tax system and partly by the abolition of certain allowances, permitting the expansion of the tax base and better control of certain improper practices.

Reduction of social security contributions

Apart from the reduction of the tax burden, a major effort was made to reduce social security contributions in 2000. A substantial cut in payroll taxes was introduced from the second quarter of 2000. This increased the total amount of the reduction in social security contributions from 1.9 billion euros in 1999 to 4.0 billion euros in 2002. This effort will reduce the implicit employer s contribution (expressed as a percentage of the wage bill) from 25.3% in 1999 to 23.7% in 2002. When preparing the 2002 budget, the government decided to increase the total reduction planned. It also decided that the various existing job schemes qualifying for a reduction in charges should be converted to a single structural reduction of charges. Moreover, businesses will no longer need to apply for this reduction: it will be granted automatically. With a view to the further expansion of the active welfare state, the additional reduction in charges will be used first to tackle problem areas in the employment policy: young people under the age of 25 and particularly people over 50.

5.2. Principal initiatives concerning expenditure

Limited real growth of primary expenditure

Both cyclical factors (higher unemployment expenditure) and non-recurring factors will affect primary expenditure in 2002. Over the medium term, the federal government is aiming at a real growth of 1.5% of primary expenditure for which it is responsible.

Mobility policy

In order to achieve a carefully considered mobility policy, a multiannual plan has been established for the railways. Apart from the modification of the NMBS/SNCB (the Belgian railways) management structures, this plan also provides for additional funding for investment in the railways. The money made available for NMBS/SNCB investment is being steadily increased by 25 million euros per annum. In addition, the necessary money will be provided for a fund intended specifically to finance an urban network around Brussels (regional express network).

Reform of the administration

As soon as it took office, the government made the reform of public administration and the improvement of the public services one of its key priorities. The first stages of the Copernicus project were completed in 2001. In 2002 these reforms are to be extended to all public authorities.

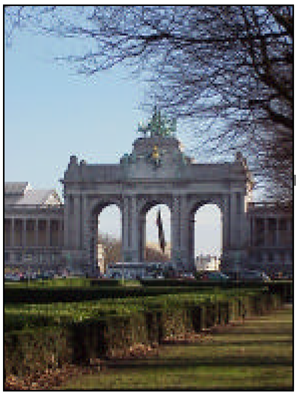
Reform of health service spending

Health service spending has risen steeply in recent years. This development is not unique to Belgium; one reason for it is the dramatic progress in medical techniques. The spontaneous momentum of the system needs to be kept under control, otherwise the survival of the system itself will ultimately be jeopardised. A radical reform is therefore being prepared. It will be based on three clear objectives:

- the elimination of individual medical practices identifiable as excessively expensive in the light of objective scientific criteria;
- the introduction of measures to restrain the inefficient use of the health service; this will benefit both hospital managers and doctors;
- the development of new techniques whereby those prescribing treatment and those providing the health care individually assume responsibility for the costs which they generate.

Social reform

The planned conversion of the subsistence level into a living wage is a perfect illustration of what the government means by its active welfare state strategy, because the reform is intended not to make people dependent on benefits but instead to help integrate or reintegrate them into the labour market.



6. The sustainability of public finances

6.1. Cost of the ageing population and fiscal policy

Anticipation on ageing population

Demographic changes have long-term implications which become apparent as the generations progress through the age pyramid. Since demographic variations are to some extent predictable, they can be anticipated in time. The fiscal policy therefore naturally anticipates the ageing which will have an impact from 2010 onwards.

The ageing of the population which will emerge from 2010 must be accepted as a fact. Table 8 sets out the main changes in the age structure of the population. The change in the proportion of people over 60 years old is particularly striking. Between 1970 and 2000, this proportion increased only slightly, from about 19% to 22%. This figure contrasts with the pattern expected between 2010 and 2030. The baby-boom generation will begin to reach the age of 60 in 2010. While about one Belgian in five was over 60 in 2000, the figure will be almost one in three by 2030.

Table 8
Population age structure

	Total population (*1000)	Distribution among the age categories					
		(*1000)			Proportion		
		0-19	***20-59***	***60-***	***0-19***	***20-59***	***60-***
1970	9.650,9	3.000,5	4.819,3	1.831,1	31,1	49,9	19,0
2000	10.252,5	2.415,8	5.591,7	2.245,0	23,6	54,5	21,9
2010	10.519,8	2.351,7	5.682,2	2.485,9	22,4	54,0	23,6
2030	10.887,6	2.272,6	5.287,9	3.327,1	20,9	48,6	30,6
2050	10.953,8	2.228,2	5.172,7	3.552,9	20,3	47,2	32,4

Sources: Demographic forecasts of the Federal Planning Bueau and the NSI

Long-term projection concerning demographic changes

Obviously, the demographic changes must have implications for the operation of the welfare state, and especially for expenditure on social security. A larger number of elderly persons means more spending on pensions, health care and assistance for the elderly. In contrast, some categories of expenditure will see an improvement, such as family allowances, unemployment benefits and expenditure on education. Table 9 sets out the main results of a long-term projection produced by the Federal Planning Bureau.

Table 9 Public spending and the ageing population (1)				
As % of GDP	**2000**	**2010**	**2030**	**2050**
	Movement in certain categories of expenditure			
Pensions	8,7	8,2	11,1	11,8
Health care	6,2	6,9	8,2	9,3
Other social security spending (1)	7,3	6,2	5,6	5,0
Total	22,1	21,3	24,8	26,1
Education (remuneration)	4,3	3,8	3,7	3,7
Total	26,4	25,1	28,5	29,8
	Assumptions			
Movement in labour productivity	2,2	1,8	1,8	1,8
Real GDP growth	3,9	2,2	1,6	1,6
Male participation rate (20-64)	78,2	75,6	75,5	76,4
Female participation rate (20-64)	63,8	68,3	71,8	72,6
Total participation rate (20-64)	71,0	71,9	73,6	74,5
Unemployment	10,0	7,3	5,0	5,0
Source : Federal Planning Bureau				
(1) This concerns certain social security sectors in the strict sense (unemployment, pre-pensions, family allowances, invalidity, industrial accidents) and certain sectors which are not included (secured livelihood).				

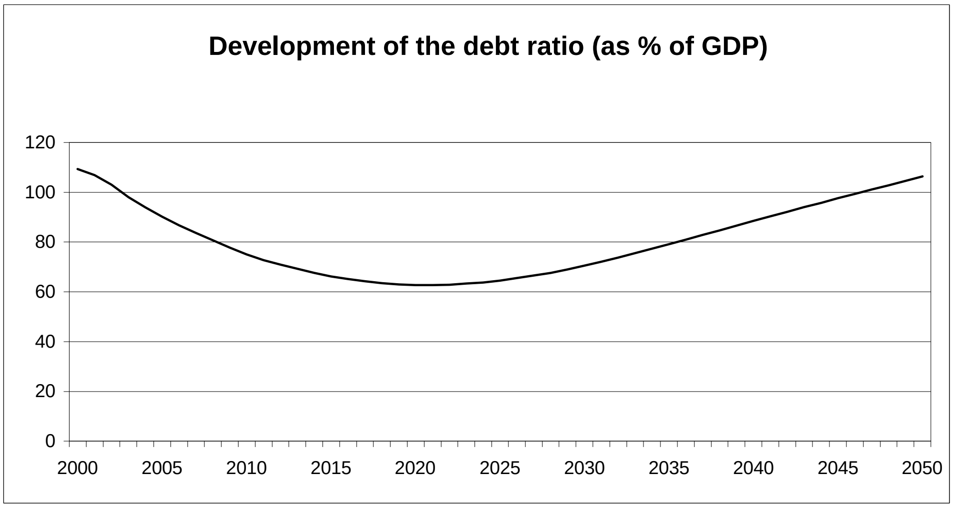
According to this projection, spending on pensions and health care will rise from 14.9% of GDP in 2000 to 19.3% of GDP in 2030, and 21.1% in 2050, an increase of 6.2 percentage points of GDP over 50 years. As stated earlier, certain spending categories will actually see a reduction in demographic pressure and will therefore be able to cushion the impact, to some extent, at the level of pensions and health spending. The total amount of the expenditure shown in table 9 came to 26.4% of GDP in 2000. After initially declining, until about 2010, the proportion of this spending will rise to 29.8% of GDP in 2050.

Naturally, forecasts covering a period of 30 to 50 years are bound to be subject to many uncertainties. However, a number of alternative scenarios would appear to indicate that the above projection provides a valid indication of the foreseeable impact of ageing, and can therefore be used as the central scenario.

Hypothesis:
NO ANTICIPATION on the costs of ageing

It is right to ask to what extent fiscal policy should anticipate the expected pattern of expenditure. A stylised example based on the assumption that of maintaining a balanced budget until 2010 (which implies that the margin available during this period is used up) and that afterwards a deficit is allowed as the costs of ageing increase, shows that this is not a valid policy option. Chart 3 illustrates how the debt ratio would move in this scenario.

Chart 3

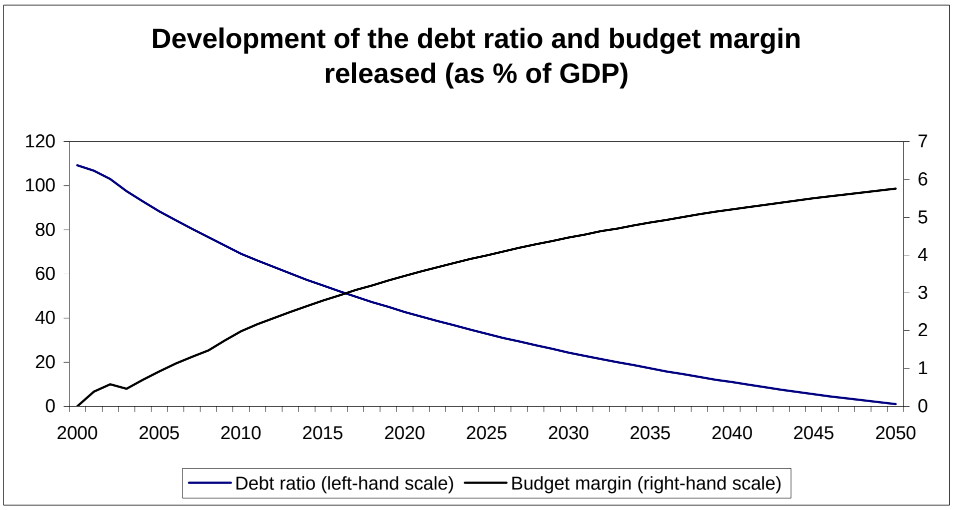


According to this assumption, the debt ratio would initially fall, until roughly 2020, but without breaking through the 60% barrier. Under the pressure of the growing deficit, the debt ratio would then begin to climb back to over 70% in 2030 and even beyond 100% in the longer term. Such a development is not only at odds with the commitments entered into in the European Stability and Growth Pact, but would also cause permanent derailment of public finances. As the debt ratio rises, interest charges impose an increasingly heavy burden on expenditure, public finances become more and more sensitive to interest rate shocks and once again the risk of the interest snowball effect becomes reality.

Hypothesis: ANTICIPATION on the costs of ageing

However, another scenario is possible, in which public finances anticipate the effects of ageing. This involves using at least part of the scope created in the 2000-2010 period by the decline in interest charges and the easing of demographic pressure on expenditure to accelerate the debt reduction. This second scenario illustrates the political strategy adopted by the government. In the medium term, a substantial budget surplus will be built up (in this scenario, we are assuming a surplus of 1% of GDP in 2008). The financing balance will then be maintained at that level. As chart 4 illustrates, such a strategy permits accelerated debt reduction. This leads to a rapid decline in interest charges. During the first phase, part of the amount not spent on interest will be used to increase the budget surplus. Once the costs of ageing actually make themselves felt, this scope can be used to absorb them. Chart 4 thus shows that, according to the assumptions adopted, the margin created will total around 4.5% of GDP in 2030.

Chart 4



If a prudent fiscal policy aimed at reducing the debt ratio is pursued, the decline in interest charges will generate a budget margin sufficient to cope with the cost of ageing. Our country therefore needs to turn the disadvantage of the high public debt into an advantage; if, in the coming years, we set aside the budget margin created by the decline in interest charges, the ageing of the population should not cause any insurmountable difficulties for public finances.

6.2. The Ageing Fund and the Memorandum on Ageing

Establishing an Ageing Fund

The budgetary strategy adopted by the government, which aims to build up a small surplus, prepares public finances for the impact of ageing. The Ageing Fund and the Memorandum on Ageing play an important role in this strategy. The law of 5 September 2001 guaranteeing a continuous reduction in the public debt and establishing an Ageing Fund provides the legislative framework for the creation of the Ageing Fund and obliges the government to produce a Memorandum on Ageing each year.

The Memorandum on Ageing as a policy document

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Financing the Ageing Fund

The Ageing Fund was established in order to build up reserves which can be used to finance the additional expenditure which the various statutory pension schemes will incur as a result of ageing in the 2010-2030 period. There are four potential sources of financing for the Ageing Fund:

- budget surpluses;
- social security surpluses;
- non-fiscal revenues;
- income from investments effected by the Ageing Fund.

The Ageing Fund s reserves cannot be used until 2010 onwards, and then only if the public debt ratio is less than 60% of GDP.

Real capital of the Ageing Fund

For 2001, the government has decided to allocate to the Ageing Fund the proceeds from the sale of the UMTS licences (438 million euros) and the appreciation in value gained by the National Bank of Belgium following the contribution of part of its gold reserves to the European Central Bank (177 million euros). Thus, in 2001 the Ageing Fund will have an initial capital of 615 million euros. An amount at least equal to that will be paid in 2002.

Apart from the allocation of non-fiscal revenues, the appropriation of budget surpluses and social security system surpluses will provide future funding for the Ageing Fund.

The Ageing Fund as an instrument of budget discipline

Owing to the link between budget surpluses and the financing of the Ageing Fund, the latter becomes an instrument of budget discipline. It reinforces the social and political support for thrifty management geared to accelerated debt reduction, because the Ageing Fund provides a real objective for the strict fiscal policy and debt reduction.

6.3. A global strategy is required to cushion the impact of ageing

Global strategy to cope with the consequences of ageing

An appropriate fiscal policy is obviously a key element in the strategy for coping with the impact of ageing. But as stressed by the Broad Economic Policy Guidelines it is only one element of a comprehensive strategy which may also consist in: *« reforming the pension and health care systems, raising the statutory retirement age, encouraging greater participation in the labour force, establishing and building up capital funding for public pensions and encouraging the development of privately financed supplementary pension schemes (second and third pillars).»*

These various points have been incorporated in Belgian fiscal policy in recent years.

Pensions reforms

One of the key elements of the pensions reform of 1 July 1997 was the brake on the increase in pension spending applied by the gradual introduction of the same retirement age for men and women, making the entitlement to an early pension dependent on a career condition, and the abolition of the revaluation ratio for wages earned in the years between 1955 and 1974.

Section 5 has already mentioned the policy aimed at increasing the rate of activity and controlling health care spending.

On 28 June 2001, a draft law on supplementary pensions was put before Parliament. Statutory pensions remain the keystone of social protection for the elderly in our society. However, an important role is also reserved for the second pillar, as statutory pensions generally offer benefits well below the final salary received before retirement. The second pillar can do much to help limit this drop in income. The government intends that the proposed modification should make the system more democratic, the ultimate aim being that all workers should be able to make use of it.

7. Institutional reforms

Transferring competences

The special law of 13 July 2001 transferring various competences to the regions and communities, and the special law of 13 July 2001 refinancing the communities and regions represent a new stage in the federal structure of the Belgian state. These two laws put into effect an agreement concluded between the federal government and the governments of the communities and regions.[1]

Certain competences were transferred from federal to regional level ; these include competences relating to agriculture and fisheries, scientific research concerning agriculture, foreign trade and provincial and municipal legislation.

Modification of the funding system of the communities

The funding system was also modified. In the Belgian federal structure, the communities have the authority over education. In the old funding system, the resources transferred by the federal government to the communities to finance education were linked only to inflation (and a factor for the falling birth rate). The European Summit in Lisbon rightly emphasised the need to create a knowledge society in order to ensure sustained growth. Education and lifelong learning are key elements of future economic development. That is why part of the available margin at federal level was used for systematically increasing the budget resources of the communities. Under the new scheme, by 2005 these resources will be about 0.3% of GDP higher than under the previous scheme. Moreover, in the longer term this funding will be (91%) linked to real growth, as well as being indexed annually.

(1) A separate draft law provides for adjustments to the system of funding for the German-speaking Community.

Extension of the fiscal autonomy of the entities

The political competences and the financial responsibility of the entities were simultaneously reinforced by the extension of their fiscal autonomy. For example, within the limits of a margin set to prevent harmful fiscal competition, the regions will have the competence to make general flat-rate or percentage adjustments (reductions or increases), or to grant general allowances linked to the exercise of their authority. This gives the regions total power over certain taxes in respect of which they had already been accorded partial power.

Annex

Main assumptions regarding the international environment adopted by the Federal Planning Bureau for the medium-term projection

	2001	2002	2003	2004	2005
Short-term interest rate (annual average)	4,1	2,7	3,4	4,0	4,4
Long-term interest rate (annual average)	5,2	4,9	5,1	5,4	5,3
USD/euro exchange rate (annual average)	1,1	1,1	1,1	1,1	1,1
Growth of GDP - world (excluding EU)	2,3	2,7	4,0	4,0	4,0
Growth of GDP - EU	1,8	1,8	2,8	2,6	2,3
Growth of relevant external markets	2,5	3,5	6,1	5,8	5,3
Volume of world imports (excluding EU)	0,8	2,3	5,8	5,8	5,8
Oil price (USD)	24,9	21,8	22,3	22,8	23,4