BELGIUM'S STABILITY PROGRAMME

(2004-2007)

NOVEMBER 2003

Content

In this document

1. Introduction and summary

Targets of Stability Pact achieved again

In 2003, the Belgian economy should grow by 0.9%. This means that, for the third consecutive year, growth will be below 1%. However, the government is expecting its budget to be in balance or show a small surplus. For the fourth successive year, Belgian public finances will meet the targets of the Stability and Growth Pact, partly as a result of exceptional revenues.

Expected revival of European economy

After several years of weak economic activity, there are once again strong signs of a revival in economic growth in Europe. In 2004, growth is forecast at almost 1.8% in Belgium, and should strengthen in subsequent years. For the period 2004-2007, the government is continuing to link its fiscal policy mainly to the Stability and Growth Pact target of a cyclically adjusted balance or small surplus. The more favourable economic climate expected should make the budget outcome less dependent on non-recurring measures. At the end of the period, in 2007, a small surplus of 0.3% of GDP is forecast[1].

Acceleration of reduction in debt ratio

To reduce the debt ratio at a sufficiently rapid pace it is necessary to preserve the balance and, in the medium term, increase the surpluses. This reduction in the debt ratio is vital for the future absorption of the costs of the ageing population. Reducing the debt ratio in a period of disappointing economic growth is not straightforward. It is more difficult to achieve the budget targets, and a smaller GDP restricts the reduction in the debt ratio. That is why the government made a special effort in 2003 to accelerate the reduction in the debt ratio. That effort will bring the debt ratio below the 100% threshold during 2004, at the latest. A debt ratio of 87% is forecast for 2007[1].

Additional objectives budget policy

A responsible fiscal policy cannot confine itself to simply achieving a particular balance or net reduction in the debt. The budget remains a key instrument for implementing various political priorities. When it took office in July, the government made the creation of new jobs its primary objective. To that end, under a long-range budget, substantial resources have been earmarked for an additional reduction in charges and other employment promotion measures. The reduction in charges is additional to the planned cut in the burden of taxes and parafiscal levies resulting from the personal income tax reform adopted earlier.

If, during the 2004-2007 period, growth proves to be stronger than currently assumed, the government is committed, as in previous years, to using the additional margin first of all to improve the financing balance.

[1] Following the detailed macroeconomic assumptions set out in table 1 (page 3).

2. The economic context

2.1. The international context

Economic stagnation first half 2003

In the wake of the cyclical downturn which occurred in mid 2000, growth in the euro area has been weak since the middle of 2001. The recovery seen at the beginning of 2002 was short-lived, and economic activity stagnated worldwide in the first half of 2003.

Gradual recovery second half 2003

In mid November, the first figures for activity in the third quarter seemed to indicate a recovery which was only modest in Germany and the Netherlands but slightly stronger in France. In addition, a group of advance indicators and favourable circumstances are fuelling predictions that the recovery is progressively gaining momentum.

The surveys and leading indicators show an improvement in the economic climate, and in particular in consumer confidence, since April 2003. The geopolitical tensions have eased somewhat. Interest rates are at historically low levels and the financial markets are recovering. The weakness of price increases is underpinning the growth of incomes in real terms. The postponement of consumption and investment spending cannot continue indefinitely. Domestic demand is therefore expected to revive in the second half of 2003, while external demand should strengthen, in view of the accelerating growth in the United States, the recovery of the Japanese economy and the sustained dynamism of activity in the EU enlargement countries and Asia.

2. The economic context, Continuation

2.2. Short-term outlook for the Belgian economy

Evolution short-term outlook 2001-2003

The short-term outlook for the Belgian economy is in line with the average for Europe, and more particularly the euro area.

Following the contraction of domestic product in real terms, recorded quarter on quarter throughout 2001, a slow and modest recovery began early in 2002. This led the government to forecast GDP growth at 2.1% in real terms in 2003 when drawing up the budget, in accordance with the consensus at the time. However, growth was much weaker from the third quarter of 2002, and a very slight contraction in GDP was actually recorded in the second quarter of 2003 (-0.1% compared to the preceding quarter). The level of activity in the second quarter of 2003 was 0.8% above the level achieved in the corresponding quarter of the previous year[2].

Rise of NBB's synthetic curve

The NBB's synthetic curve, a leading indicator of activity, reached a low point in June 2003. Since then[3], it has risen strongly, except for a pause in September. After a year of decline, the smoothed synthetic curve which indicates the fundamental trend in the economy began to rise.

TABLE 1
Growth and related factors

Percentage change except where otherwise stated contraires	2002 (1)	2003(1)	2004(1)	2005(2)	2006(2)	2007(2)
Growth of GDP at constant prices	0,7	0,9	1,8	2,8	2,5	2,1
Level of GDP at current prices (in billions of euro)	260,0	268,9	278,0	290,6	302,4	312,9
GDP deflator	1,7	2,5	1,6	1,6	1,5	1,4
Change in the HICP	1,6	1,6	1,4	1,4	1,4	1,4
Change in employment	-0,8	-0,1	0,7	0,9	0,9	0,6
Unemployment, Eurostat definition (as a % of active population)	7,3	8,0	8,2	8,0	7,9	7,9
Change in labour productivity	1,5	1,0	1,1	1,9	1,6	1,4
	Growth sources : change at constant prices					
1. Final consumption expenditure of individuals	0,4	1,3	1,5	2,3	2,7	1,9
2. Final consumption expenditure of general government	1,9	1,9	1,6	1,6	1,4	1,6
3. Gross fixed capital formation	-2,5	2,1	2,9	4,6	3,4	1,4
4. Exports of goods and services	1,0	-1,1	4,8	5,5	5,1	5,0
5. Imports of goods and services	1,2	-0,1	5,0	5,4	5,4	4,8
	Contribution to growth of GDP					
6. Total final demand (1+2+3)	0,1	1,6	1,8	2,5	2,5	1,6
7. Change in stocks	0,7	0,2	0,0	0,0	0,0	0,0
8. Balance of goods and services	-0,1	-0,9	0,0	0,3	0,0	0,4

(1) Source : Federal Planning Bureau/NAI Economic Budget, September 2003.
(2) Source : Federal Planning Bureau, Projection 2003-2008 dated October 2003.

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2 Data adjusted for seasonal variations and calendar effects.
3 The latest known data concern October.

2. The economic context, Continuation

2.2. Short-term outlook for the Belgian economy

Expected increase of GDP	An initially slow but progressive recovery is predicted for GDP from the third quarter, causing GDP to grow in real terms by 0.9% in 2003 and 1.8% in 2004.
Moderate increase in private consumption	The apparent weakness of household consumption, on average, in 2002 (+0.4% as an annual average) was partly the reflection of simple accounting changes[4], and the stagnation at the beginning of the year. In reality, leaving aside a temporary dip in the fourth quarter, private consumption grew at a moderate, steady pace (averaging 0.6% per quarter) from the second quarter of 2002, after a year of deceleration. Household demand is underpinned by the improvement in purchasing power due, in particular, to reductions in personal income tax. This favourable effect on the disposable income of individuals will continue to be felt in 2004.
Increase of household savings	The adverse economic climate encouraged households to increase their savings; the weakness of the stock markets until the spring of 2003 may have reinforced that tendency. The improvement in the outlook for employment will take time to become apparent during 2004, and the pattern of household savings is unlikely to show any marked change beforehand. Wage increases should remain moderate, in accordance with the intersectoral agreement for 2003-2004. Overall, consumption by households is therefore expected to rise by slightly less than their disposable income, namely 1.3% in 2003 and 1.5% in 2004.
Slow growth of employment	By the end of 2003 at the earliest there should be a revival in the growth of employment, lagging somewhat behind the recovery of economic activity. The employment rate could therefore pick up slightly in 2004 to reach 61.6%.
Increase of business investments	Flagging demand certainly had an impact on investment by businesses, especially as their gross operating surplus stagnated in 2001-2002. Gross capital formation by businesses suffered a 2.6% decline in volume in 2002. As the outlook for demand improves, investment plans are multiplying. Profitability is also expected to improve during 2003, thanks to wage moderation accompanied by productivity gains, but also as a result of the euro appreciation which cuts the cost of imported inputs. Investment is therefore expected to expand by 2.6% in 2003, which is consistent with the results of business surveys, and to produce slightly stronger growth (+2.8%) in 2004.

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[4] From 2002, the public radio & television broadcasting companies were transferred from the non-financial corporations sector to the general government sector in the national accounts. It follows that the radio & television licence fee is now regarded as a tax, rather than as consumption expenditure.

2. The economic context, Continuation

2.2. Short-term outlook for the Belgian economy

Recovery of housing investments

After two years (2001 and 2002) of marked decline, investment in housing recovered somewhat in the first half of 2003. This should be confirmed in view of the low level of mortgage interest rates and the rise in households' disposable income. Investment in housing is expected to grow by 0.9% in 2003 and 2.1% in 2004.

Recovery of import and export

Since the bulk of our exports go to the euro area, and as the single currency has appreciated, a recovery in global trade will have only a very gradual impact on Belgian exports. In the first half of 2003, our exports declined in volume. For 2003 as a whole, they are expected to fall by 1.1%, with foreign trade making a negative contribution to growth (-0.9%). In 2004, the expansion of exports should strengthen (+4.8%), but with the rate of imports also accelerating, trade with other countries will make a zero net contribution.

Decrease of inflation

In 2002, underlying inflation was falling slightly. In 2003 it stabilised at around 2%. With the appreciation of the euro and the moderate evolution in labour costs, it should continue to fall. Consumer price fluctuations around this trend essentially reflected the movement in the prices of oil and fruit and vegetables. In 2003, the rise in the harmonised index of consumer prices should be around 1.6% as an annual average. It is estimated at 1.4% for 2004[5].

[5] In 2003 the rise in the price of a barrel of oil was offset by the appreciation of the euro. The forecast for 2004 assumes that the barrel price will drop from $28.1 in 2003 to $25.2 in 2004, on average, with the euro remaining approximately stable.

2. The economic context, Continuation

2.3. Medium-term forecasts

Updating of forecasts

In October 2003 the Federal Planning Bureau updated its medium-term forecasts. This projection takes account of the budgetary impact of the set of fiscal measures known as the « Kyoto package », adopted during the summer[6] but does not allow for the measures introduced during preparation of the 2004 budget. In relation to that projection, the implementation of the conclusions of the Employment Conference, as scheduled in the 2004 budget, should strengthen the growth of employment and produce a further fall in unemployment.

Evolution of Brent price and euro

The international environment for the period 2005-2007 is based on the OECD's medium-term projections dated March 2003. The average price of a barrel of Brent is presumed to rise by $0.6 per annum to reach around $27.1 in 2007; the euro is weakening very slowly but steadily against the dollar, starting from the average figure taken for 2003 of 1.115 dollars to the euro.

Marked recovery

This medium-term projection for Belgium is consistent with the assumptions underlying the medium-term projections produced by the Commission in spring 2003. In particular, the figures obtained are due to the assumption of reabsorption of the output gap at the end of the period. The resulting recovery profile is enhanced in Belgium, in 2005-2006, by the consequences of the tax reform and the local authority investment cycle.

Increase of GDP and growth

Thus, growth of GDP at constant prices is estimated at 2.8% in 2005 and 2.5% in 2006. The potential growth of 2.1% in 2007 is calculated by the method developed by the Commission.

[6] The main measures are the adjustment to the energy levy rates, the introduction of a "ratchet" system for duty on fuel and the dismantling of the excise compensatory duty, the general aim being to reduce the fixed costs and increase the variable costs of vehicle use.

3. The financing balance and the public debt

3.1. The fiscal strategy under the coalition agreement

Context budget in accordance with context stability programme

The present update of the stability programme is the first to be submitted by the government which came to power after the May 2003 elections. During negotiation of the coalition agreement, a long-range budget programme was drawn up in a macroeconomic context practically identical with that of the stability programme.

Adjustment of objectives

Assuming that economic activity picks up in 2003 and that the growth of GDP surpasses the trend rate from 2004, the stability programme for 2003-2005 had planned for the creation of a 0.5% budget surplus in 2005. The scenario used at the time forecast growth of GDP rising from 2.1% in 2003 to 2.5% in 2004 and 2005. On the basis of current forecasts, growth of GDP for the period 2003-2005 will be 1.6 percentage points lower than predicted in that scenario. In 2004, growth should just equal the potential growth rate, even though that rate was sharply downgraded. The change in the macroeconomic climate forced the government to adjust its targets for public finances.

Three important starting points

The government faces a triple challenge. Belgium must continue to meet the requirements of the Stability & Growth Pact by maintaining a budget position close to balance or with a slight surplus. Despite the less favourable economic climate, it is necessary to continue to cut the debt ratio. Moreover, within the framework of the budget, a special effort must be made to find the necessary resources for a number of priority policy aims, and firstly for the promotion of employment.

Three budgetary standards

The coalition agreement specifies three rules for the new budget framework:

- *"the progressive creation of budget surpluses in accordance with the ESA methodology, starting with a balance in 2004 and 2005, to reach 0.3% of GDP in 2007 with growth at the trend rate, which will bring the debt ratio below 90% of GDP by the end of 2007;*
- *maintenance of the financial balance in social security;*
- *steady reduction in fiscal and parafiscal revenues as a percentage of GDP."*

Absorbing budget impact of ageing

The commitment to a continued reduction in the debt ratio is directly linked to the aim of increasing the Ageing Fund reserves to 10 billion euro in 2007. These targets are basic elements of fiscal policy designed to absorb the budget impact of ageing (see section 6).

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3. The financing balance and the public debt, Continuation

3.1. The fiscal strategy under the coalition agreement

Balance as minimum objective

When the coalition agreement was drawn up, a small budget deficit was predicted for in 2003. That deficit was later converted to a balance or small surplus, partly by the allocation of exceptional revenues. For the 2004-2007 period, the aim is to achieve at least a balance. In 2007, a small surplus of 0.3% of GDP is expected. The more favourable economic climate expected should make the budget results steadily less dependent on non-recurring measures.

Promotion of employment

In this context, a few key policy options have been highlighted. The government's priority is to promote employment. For that purpose, an allocation of around 1 billion euro once the measures are fully implemented (from 2005), has been set aside for further reductions in charges and other measures to stimulate employment. The federal government held a national employment conference, attended by all the parties concerned (federated entities, employers and unions) in order to define the practical arrangements for these reductions in charges and other measures.

Growth target in real terms

Leaving aside reinvestment in public enterprises, the primary expenditure of the federal government will be subject to a target of 1.2% growth in real terms. Apart from the additional resources planned for public enterprises (SNCB and the Post Office), priorities will include spending on the judicial system and the police, within the limits of this growth target.

Increase of health care spending

In order to satisfy the new needs generated by such factors as the ageing population and the application of new medical techniques, the government will allow spending on health care to increase by 4.5% per annum in real terms over the next four years. A series of structural measures concerning, for example, the funding of pathology in hospitals or the assessment of the prescriptions issued by health care providers, will be taken in order to control the growth of expenditure and keep it within the limits planned.

Tax measures

As regards revenues, the long-range plan provides for a number of measures relating to indirect taxes. Taxation is an environmental policy instrument under the « Kyoto package » (see footnote n° 6). For 2004, the long-range plan also contains a measure enabling taxpayers to discharge their past tax liabilities by means of a unique liberatory declaration.

The government will also implement measures to combat tax evasion and benefits fraud, hereby generating additional revenues and cutting certain expenditures.

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3. The financing balance and the public debt, Continuation

3.1. The fiscal strategy under the coalition agreement

Cooperation with communities and regions	With the communities and regions, the federal government will negotiate a new cooperation agreement to determine the contribution of those entities to the further improvement of public finances.

3. The financing balance and the public debt, Continuation

3.2. Execution of the 2003 budget

Low GDP growth in 2003

When the initial 2003 budget was drawn up in September 2002, the basic assumption was still that economic growth would recover by the end of 2002. The government had therefore predicted GDP growth of 2.1%, which at that time tallied perfectly with the growth forecasts being made elsewhere. Such growth would have made it possible to achieve a balanced budget. However, the predicted economic recovery did not materialise. The GDP growth forecast for 2003 is currently just 0.9%. Thus, 2003 will be the third consecutive year with growth below 1%, something which has not been seen since the early 1980s.

Decrease of social and tax revenues in 2003

Macroeconomic factors do not all react at the same speed to a slowdown in growth. Thus, the employment market and the associated trend in wages always take some time to respond. That is why the 2001 budget, and to some extent the 2002 budget, have remained relatively unaffected by the economic climate. However, the 2003 budget is a totally different matter. Tax revenues and social security contributions have both been greatly influenced by the less favourable economic climate.

Influence of elections on budgetary control

The year 2003 was special for another reason: federal elections were held on 18 May. For the government, the dissolution of Parliament made it very difficult to approve the results of a traditional budget. That does not mean that the execution of the budget was not monitored, and adjusted where necessary, during 2003. Three intermediate budget audits were in fact conducted.

Surplus of 0,2% of GDP in 2003

The government currently predicts a surplus of 0.2% of GDP in 2003, partly thanks to the proceeds from the liquidation of the Belgacom pension fund (3,600 million euro). Without the proceeds from the Belgacom pension fund and the effect of several other unfavourable capital transactions, the deficit would have been 0.9% of GDP.

Peer review with communities and regions

A supplementary agreement was concluded with the communities and regions on the subject of several outstanding budget issues, and also fixing their contribution to the budget. As in previous years, the execution of the budget will be monitored very strictly during the closing months of the year. Once again, the execution of the budget will be monitored jointly with the communities and regions. Data on that execution will be exchanged monthly. This form of « peer review » makes it easier to hold the entities concerned to account.

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3. The financing balance and the public debt, Continuation

3.3. The 2004 budget

Expected increase GDP growth in 2004	After three years of growth below 1%, the economy is forecast to return to growth close to the potential growth rate in 2004. When the budget was drawn up, the government assumed that growth of GDP would equal 1.8%. For employment too, the negative trend of recent years looks set to end, and renewed expansion is forecast.
Measures with regard to employment	The main feature of the 2004 budget is its complete adoption of the results of the Employment Conference. The various parties concerned arrived at a broad consensus on a whole series of measures, which will be discussed in section 5. In 2004, employment promotion measures will represent additional investment totalling over 500 million euro. This corresponds to a set of measures worth in the order of 1 billion euro once the measures are in full operation.
Unique liberatory declaration	The practical arrangements relating to the unique liberatory declaration were devised when the 2004 budget was drawn up. The government assessed the proceeds of this measure at 850 million euro.

3. The financing balance and the public debt, Continuation

3.4. A general view of public finances, 2002-2007

Interpretation of table 2

Attention must be drawn to the status of the figures in table 2. The financing balances indicated represent targets, and therefore imply a firm commitment by the government. In contrast, the more detailed figures on revenue and expenditure are merely a guide. For one thing, these figures will obviously have to be updated each year when the budget is drawn up, and adjusted where necessary. Moreover, in order to arrive at aggregate revenue and expenditure figures, it is necessary to consolidate the revenue and expenditure of the various sub-sectors of general government. In the Federal Belgian State, the various entities guarantee to achieve a particular result in terms of the financing balance. They have considerable autonomy over their revenue and expenditure policy.

TABLE 2
The general government budget (1)

% of GDP	2002	2003	2004	2005	2006	2007
	Financing balance of the sub-sectors					
General government	**0,1**	**0,2**	**0,0**	**0,0**	**0,0**	**0,3**
Federal government	**-0,2**	**0,3**	**-0,5**	**-0,3**	**-0,2**	**-0,1**
Communities and regions	**-0,1**	**0,2**	**0,3**	**0,1**	**0,1**	**0,1**
Local authorities	**0,2**	**0,1**	**0,1**	**0,1**	**0,0**	**0,2**
Social security institutions	**0,3**	**-0,4**	**0,1**	**0,1**	**0,1**	**0,1**
	General government					
Total revenue	*50,5*	*50,5*	*49,7*	*49,0*	*48,4*	*48,2*
Total expenditure	*50,4*	*50,2*	*49,6*	*49,0*	*48,4*	*47,9*
Financing balance	*0,1*	*0,2*	*0,0*	*0,0*	*0,0*	*0,3*
Interest charges	*6,0*	*5,4*	*5,0*	*4,8*	*4,7*	*4,5*
Primary balance	*6,1*	*5,6*	*5,1*	*4,8*	*4,7*	*4,8*
	Main components of revenue					
Taxes	*31,1*	*30,2*	*30,5*	*30,1*	*29,7*	*29,7*
Social security contributions	*16,7*	*16,5*	*16,3*	*16,2*	*16,2*	*16,2*
Other	*2,7*	*3,7*	*2,8*	*2,6*	*2,5*	*2,4*
Total revenue	*50,5*	*50,5*	*49,7*	*49,0*	*48,4*	*48,2*
	Main components of expenditure					
Consumption expenditure (compensation & intermediate consumpt.)	*15,4*	*15,4*	*15,2*	*15,0*	*14,8*	*14,8*
Social benefits in kind	*6,6*	*6,9*	*7,0*	*7,1*	*7,2*	*7,4*
Other social benefits	*16,1*	*16,3*	*16,1*	*15,6*	*15,2*	*15,0*
Interest charges	*6,0*	*5,4*	*5,0*	*4,8*	*4,7*	*4,5*
Subsidies	*1,6*	*1,5*	*1,6*	*1,6*	*1,6*	*1,6*
Gross fixed capital formation	*1,6*	*1,6*	*1,6*	*1,8*	*1,9*	*1,7*
Other	*3,1*	*3,1*	*3,1*	*3,1*	*3,1*	*3,0*
Total expenditure	*50,4*	*50,2*	*49,6*	*49,0*	*48,4*	*47,9*

(1) Owing to rounding off, the totals may differ slightly from the sum of the items.

Balance 2002-2007

Despite a declining revenue ratio, the budget is at least in balance throughout the period under review. After several years in balance, the budget should once again generate a surplus in 2007.

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3. The financing balance and the public debt, Continuation

3.4. A general view of public finances, 2002-2007

Evolution total revenues

In 2003 and 2004 the movement in the ratio of total revenues was influenced by the recording of the proceeds of the liquidation of the Belgacom pension fund. This transaction represented about 1.3% of GDP in 2003 and 0.5% in 2004. Where tax revenues are concerned, a number of adjustments to indirect taxes in 2004 must be taken into account. The reduction in the fiscal and parafiscal pressure was suspended in 2004, mainly because of a series of other fiscal measures principally connected with fraud prevention and including the estimated revenue from the unique liberatory declaration. From 2005 onwards, the downward trend will be resumed; factors at work here include the impact of the personal income tax reform, which will become fully operational, and the reduction in social security contributions.

Evolution total expenditure

The movement in total expenditure depends very much on interest charges. The decline in interest charges will slow down towards the end of the period. In fact, the reduction in the implicit interest rate which, in recent years, has been a major factor in the decline in interest charges, will end in 2004.

Decrease primary expenditure

After rising in 2003, the share of GDP represented by primary expenditure will decline. Application of a real growth target of 4.5% to spending on health care will cause a slight rise in the share of social benefits in kind. However, this tendency is more than offset by the predicted trend in social benefits other than benefits in kind. A more favourable economic climate and the government measures promoting stronger labour intensity of growth will reduce the proportion of unemployment-related expenditure throughout the period.

Increase gross capital formation

Gross capital formation will tend to increase up to 2006, the year of the next municipal elections. This trend essentially reflects the pattern of local authority investment. In the past, this investment has followed an explicitly electoral cycle, always producing a surge a few years before the municipal elections.

3. The financing balance and the public debt, Continuation

3.5. The contribution of the various sub-sectors [7]

Tuning the budgetary policy of sub-sectors

In a federal State, the budgetary policy of the various entities has to be coordinated so that each entity contributes to the attainment of the target defined for general government as a whole. Belgium's experience proves that a system of agreements clearly specifying the results required, coupled with the accountability of the various sub-sectors, guarantees adherence to the target.

Agreements between federal government, communities and regions

Collaboration between the various levels of government for the purpose of achieving the targets took the form of agreements between the federal government, the communities and the regions. In the agreement dated 15 December 2000[8], the communities and regions undertook to respect, for the 2001-2005 period, the targets proposed by the General Government Financing Requirements Section of the High Council of Finance[9]. In ESA terms, the target is a financing capacity of 0.1% of GDP[10].

Supplements to the agreement

This agreement was supplemented on several occasions. Thus, the agreement of 21 March 2002 included a provision whereby the targets set on the basis of budget concepts would be progressively converted into a target in terms of the ESA. An agreement concluded by the Comité de Concertation on 22 September 2003 finalised the specific arrangements for this conversion to targets in ESA terms. At the same meeting, the Comité de Concertation also tried to find solutions to a number of outstanding budget issues, such as determination of the share of the communities and regions in the proceeds generated by the unique liberatory declaration.

Expected surplus of GDP communities and regions

Under this agreement, the communities and regions should achieve a financing capacity of 0.2% of GDP in 2003. Taking account of the provisions of this agreement and the updating of the parameters for calculating the taxes to be transferred to the federated entities, carried out during preparation of the 2004 budget, the federal government assumed a surplus of 0.3% of GDP for the communities and regions in 2004.

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7 In the analysis of Belgian public finances, a distinction is made between Entity I and Entity II. Entity I comprises the federal government and social security. Entity II is made up of the communities and regions plus the local authorities.

8 Agreement of 15 December 2000 between the Federal State, the Flemish Community, the French Community, the German-speaking Community, the Wallonia Region and the Brussels-Capital region setting out the budget targets for the period 2001-2005.

9 The Financing Requirements Section of the High Council of Finance is an advisory body which makes recommendations on the government' fiscal policy, and more particularly on that of the communities and regions.

10 The Section assumes that the various communities and regions will achieve a balanced budget in 2010. For the period as a whole, that would correspond to a surplus of around 0.1% of GDP in ESA terms.

3. The financing balance and the public debt, Continuation

3.5. The contribution of the various sub-sectors

Increase of resources to be transferred to communities and regions

Pending the conclusion of a new agreement for the 2005-2007 period, the target defined by the General Government Financing Requirements Section of the High Council of Finance, based on the December 2000 agreement, has been adopted. When drawing up its budget for 2004, the federal government adjusted this target to take account of the increased resources to be transferred to the communities and regions (around 0.05% of GDP) following the application of the latest parameters.

Evolution GDP local authorities

As the bodies which supervise the local authorities, the regions undertook to encourage those authorities to achieve the objectives of the stability programme for 2001-2005. For those authorities, the agreement foresees a financing capacity of 0.2% of GDP for the 2001-2003 period. This therefore anticipates the improvement in the budget situation of local authorities traditionally seen in the years following the municipal elections. For the subsequent period (2004-2005), the target is a surplus of 0.1% of GDP. For 2003, on the basis of recent estimates, the government foresees a surplus of 0.1% of GDP. Owing to the electoral cycle which influences the budget situation of the local authorities, this surplus is expected to fall in 2006, leaving the budget in balance. From 2007 onwards, a surplus of 0.2% of GDP should once again be achieved.

TABLE 3
Breakdown of the targets between the various sub-sectors (1)

% of GDP	2002	2003	2004	2005	2006	2007
Primary balance	6,1	5,6	5,1	4,8	4,7	4,8
Entity I	5,6	4,9	4,2	4,1	4,1	4,1
Entity II	0,6	0,7	0,8	0,7	0,6	0,7
Interest charges	6,0	5,4	5,0	4,8	4,7	4,5
Entity I	5,5	4,9	4,5	4,4	4,3	4,1
Entity II	0,5	0,5	0,5	0,4	0,4	0,4
Financing balance	0,1	0,2	0,0	0,0	0,0	0,3
Entity I	0,1	-0,1	-0,3	-0,2	-0,1	0,0
Entity II	0,0	0,2	0,4	0,2	0,1	0,3

(1) Owing to rounding off, the totals may differ slightly from the sum of the items.

Internal stability programmes communities and regions

In order to integrate their fiscal policy into the national stability programmes, the communities and regions each year draw up an internal moving medium-term stability programme, at least equal in duration to the Belgian stability programme. In their internal stability programmes, the communities and regions show how they will meet the targets mentioned above for each of the budget years concerned. The Financing Requirements Section of the High Council of Finance evaluates these medium-term programmes each year.

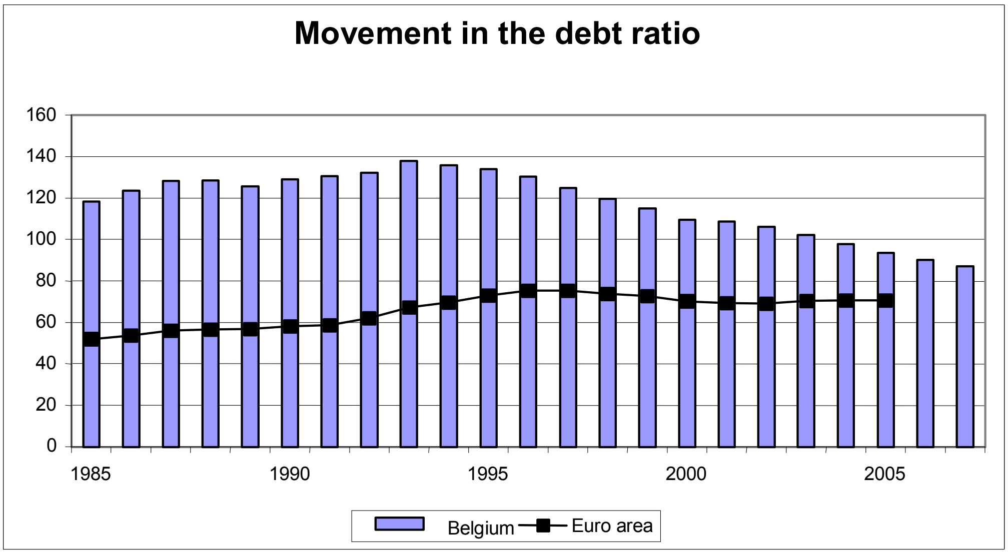
3. The financing balance and the public debt, Continuation

3.6. The public debt

Further reduction debt ratio

The restoration of a balanced position in 2000 marked the end of a key phase in the recovery of public finances. However, this was not the end of the process. A continuing reduction in the debt ratio is in fact a central aim of fiscal policy. According to earlier stability programmes, the reduction in the public debt was to be achieved primarily by the creation of a surplus. However, the disappointing growth of GDP not only had a denominator effect on the reduction in the debt ratio, it also halted the creation of surpluses. Nonetheless, the government is adhering steadfastly to the priority accorded to the reduction in the debt ratio.

Chart 1



Interpretation of chart 1

Chart 1 clearly shows the effort which has been made to reduce the debt ratio. In 1993, the public debt reached a record level of 137.9% of GDP. In the ensuing decade, the debt ratio declined systematically. At the end of 2002, the debt ratio was cut to 106.1% of GDP, as planned in the 2003-2005 stability programme. Thanks to the maintenance of a sound budget situation and additional efforts to reduce the level of debt, the debt ratio will drop below the 100% mark in 2004 at the latest, falling to 97.6% by the end of the year.

Continued on next page

3. The financing balance and the public debt, Continuation

3.6. The public debt

Special operations to speed up reduction debt ratio

In order to speed up the reduction in the debt ratio, a number of special operations have been scheduled and some have already been carried out. Thus, during 2003 the assets of Credibe[11] were sold. Credibe's debts had been included in the 'Maastricht' debt in 2001. In terms of the ESA, this financial transaction has no impact on the financing balance, but it does influence the gross consolidated debt. An operation relating to the debt of FADELS[12] (social housing debt) is being prepared jointly with the regions. As a precaution, this operation was included in table 4 under the figures for 2004.

Although this operation is included in the financing balance, and therefore cannot be regarded as a debt operation in the strict sense, mention should be made here of the proceeds from the liquidation of the Belgacom pension fund, of which 3,600 million euro will be paid in 2003 and 1,400 in 2004.

TABLE 4
Movement in the public debt

% of GDP	2002	2003	2004	2005	2006	2007
Gross debt ratio	106,1	102,3	97,6	93,6	90,1	87,0
Change in the gross debt ratio	-2,7	-3,8	-4,7	-4,0	-3,5	-3,1
	Factors determining the movement in the gross debt ratio					
Primary balance	6,1	5,6	5,1	4,8	4,7	4,8
Interest charges	6,0	5,4	5,0	4,8	4,7	4,5
Nominal growth of GDP	2,4	3,4	3,4	4,5	4,1	3,5
Endogenous change in the debt	-2,7	-3,7	-3,3	-4,2	-3,7	-3,3
Other factors influencing the debt ratio	0,0	-0,1	-1,4	0,2	0,2	0,2
p.m. : implicit level of interest rates	5,7	5,3	5,1	5,1	5,2	5,2

Planned take-over of SNCB debt

The debt ratio figures here presented take no account of the government's commitment to take over part of the debt of the SNCB (Belgian railway company). The regulatory framework for taking over the debt was outlined in Section 492 of the Programme Law of 24 December 2002[13] which stipulates that the take over of the debt :

- must not influence the financing balance of general government according to the ESA system;
- must not cause the estimated general government debt ratio to exceed 100% in relation to gross domestic product (Maastricht definition);

Continued on next page

[11] Credibe : formerly the Central Mortgage Credit Office
[12] FADELS : social housing loan amortisation fund
[13] Published in the Moniteur belge, 31 December 2002.

3. The financing balance and the public debt, Continuation

3.6. The public debt

Planned take-over of SNCB debt (continuation**)**	• must be preceded by the government's approval of an SNCB business plan offering the necessary guarantees as regards the debts incurred by the SNCB in the future**.** The debt will be taken over in 2005, subject to compliance with the above conditions.

3. The financing balance and the public debt, Continuation

3.7. The cyclically adjusted balance

Cyclically adjusted balance

Despite the difficulty of estimating the output gap and assessing the sensitivity of public finances to GDP growth, the cyclically adjusted balance is an additional benchmark for evaluating the budget results. Under the procedure for monitoring the Stability & Growth Pact, increasing importance is attached to this concept[14].

TABLE 5
Actual balance and cyclically adjusted balance

% of GDP	2002	2003	2004	2005	2006	2007
1. GDP growth at constant prices	0,7	0,9	1,8	2,8	2,5	2,1
2. Actual financing balance	0,1	0,2	0,0	0,0	0,0	0,3
3. Interest charges	6,0	5,4	5,0	4,8	4,7	4,5
4. Potential growth of GDP	1,9	1,8	1,8	2,0	2,2	2,2
5. Output gap	0,0	-0,9	-0,9	-0,1	0,2	0,1
6. Cyclical component of the budget	0,0	-0,6	-0,6	-0,1	0,1	0,1
7. Cyclically adjusted financing balance (2-6)	0,1	0,8	0,6	0,1	-0,1	0,2
8. Cyclically adjusted primary balance (7+3)	6,1	6,2	5,6	4,9	4,5	4,8

Calculation of potential GDP growth

The potential growth of GDP was calculated in accordance with the method used by the European Commission, on the basis of the macroeconomic framework used to draw up the stability programme. During the 2003-2007 period, potential growth fluctuates around 2%[15].

Unchanged output gap

The strong growth recorded at the end of the last decade generated a large, positive output gap. It was not until 2003, the third consecutive year of disappointing growth, that real GDP dropped below potential GDP. As actual growth will coincide with potential growth in 2004, the output gap will remain unchanged. Taking account of the underlying assumption of the macroeconomic framework, the output gap will be zero at the end of the period.

Cyclically adjusted surplus in 2004

A financing capacity of 0.2% of GDP is forecast for 2003. According to the method used, after cyclical adjustment this figure corresponds to a surplus of 0.8% of GDP. In 2004, a cyclically adjusted surplus is also predicted. Subsequently, that surplus will be reduced, so that the budget is more or less in balance. At the end of the period, there should once again be a small surplus.

Continued on next page

[14] The report approved by the Ecofin Council on 3 March 2003 on "the improvement in the coordination of fiscal policy" explicitly refers to the cyclically adjusted balance as an indicator of compliance with the Stability & Growth Pact requirement of a budget position close to balance or in surplus.

[15] The annex contains a summary of the movement in the key factors determining potential growth.

3. The financing balance and the public debt, Continuation

3.7. The cyclically adjusted balance

Positive factors on the 2003 and 2004 balance

In order to ascertain the more structural trend in the primary balance and the financing balance, it is necessary to make adjustments to eliminate not only cyclical effects but also various non-recurring factors. The main factors having a positive impact on the balance in 2003 and 2004 are the estimated proceeds from the liquidation of the Belgacom pension fund and the unique liberatory declaration.

Adjusted primary balance +/- constant 2003-2007

Even after adjustment for these factors, the 2003 surplus declines to a structural deficit of around 0.5% of GDP, close to a structural balance. In subsequent years this deficit is steadily eliminated and converted to a small surplus. Apart from a slight fall in 2006, the adjusted primary balance will remain constant at around 4.8% throughout the 2003-2007 period. The promised reductions in charges (personal income tax reform and reduction in social security contributions) will therefore not cause any structural deterioration in the primary balance.

4. Comparison with the stability programme for 2003-2005 and sensitivity analysis

4.1. Comparison with the stability programme for 2003-2005

The stability programme for 2003-2005, submitted at the end of 2002, provided for a balanced budget in 2003. Growth was expected to pick up in 2003, and it was predicted that in 2004 and 2005 it would exceed the potential growth estimated at the time at 2.3%. On the basis of these assumptions, the government expected to achieve a surplus of 0.5% of GDP in 2005.

TABLE 6
Deviations from the previous programme

% of GDP	2002	2003	2004	2005	2006	2007
Growth of GDP						
previous update	0,7	2,1	2,5	2,5		
current update	0,7	0,9	1,8	2,8	2,5	2,1
deviation	0,0	-1,2	-0,7	0,3		
Financing balance						
previous update	0,0	0,0	0,3	0,5		
current update	0,1	0,2	0,0	0,0	0,0	0,3
deviation	0,1	0,2	-0,3	-0,5		
Gross debt ratio						
previous update	106,1	102,3	97,9	93,6		
current update	106,1	102,3	97,6	93,6	90,1	87,0
deviation	0,0	0,0	-0,3	0,0		

Changed economic climate

However, the growth revival expected in 2003 did not take place, and for 2004, the forecast growth is still less than the figure given in the previous programme. The cumulative deviation in growth over the 2003-2005 period comes to 1.6 percentage points. In a less favourable economic climate, the government had two aims. First, it had to consolidate the efforts made in the past to achieve a sound position, and therefore to maintain at least a balanced budget. And in this constrained fiscal context, it also had to provide the resources to stimulate economic growth and employment.

Exceptional measures

In 2003 the adjustment of the budget targets is masked by the impact of several exceptional factors. The better result in 2003 is thus due entirely to the proceeds of the liquidation of the Belgacom pension fund.

Evolution towards surplus in 2007

The government is now expecting to achieve a balance in 2004 and 2005, and a surplus in 2007.

Continued on next page

4. Comparison with the stability programme for 2003-2005 and sensitivity analysis

4.1. Comparison with the stability programme for 2003-2005

Debt ratio same level as last programme

The differences in the debt ratio between the two programmes are only small. As already mentioned, a special effort was made to reduce the debt ratio in 2003 by exogenous means. Despite the poorer performance as regards the balance, the debt ratio for 2005 should match the level planned in the 2003-2005 stability programme.

4. Comparison with the stability programme for 2003-2005 and sensitivity analysis, Continuation

4.2. Sensitivity analysis

Continuous policy adjustment

A clear distinction has to be made between the technical sensitivity analysis and the question of how the policymaker will respond to a change in the macroeconomic climate. In recent years, fiscal policy has required constant adjustments to the budget on account of continually changing forecasts of the economic climate. Despite the effects of the automatic stabilisers, the government is maintaining a balanced budget.

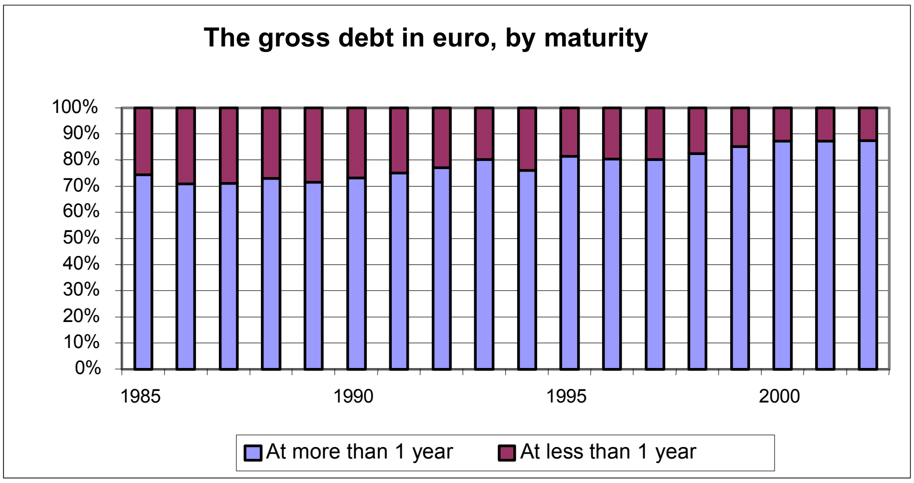
The impact of a change in the assumptions regarding interest rates and growth is examined below.

4.2.1. A change in the interest rate assumptions

Reduction of sensitivity to interest rate fluctuations

Following the introduction of the euro, the proportion of the foreign currency debt was reduced to less than 3%, so that the exchange rate risk became more or less negligible. However, in view of the size of the public debt, public finances are still sensitive to interest rate fluctuations, although that sensitivity has been reduced considerably. In recent years, management of the debt, particularly the debt of the federal authority which issues about 90% of the total, has been mainly targeted to reducing the percentage of short-term debt. The proportion of the euro debt with a maturity of less than one year has been cut to around 13%.

Chart 2



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4. Comparison with the stability programme for 2003-2005 and sensitivity analysis, Continuation

4.2. Sensitivity analysis

Interpretation of table 7

The extension of the duration of the existing debt further delays the effects on interest charges of a change in interest rates. To illustrate this point, the impact of a substantial rise in interest rates is examined below. Table 7 shows the effect of a 100 basis point rise in the interest rate assumed for the whole of the 2004-2007 period. At the end of the period, the effect would total around 0.4% of GDP. The rise in interest rates taken as a working hypothesis is added to the increase already included in the basic assumption. When the budget framework was drawn up, the assumption was that the long-term interest rate would increase from 4.1% in 2003 to 5.4% in 2007.

TABLE 7
Impact of a change in the interest rate assumptions

% of GDP	2004	2005	2006	2007
Degree to which interest charges deviate from the scenario described	0,1	0,3	0,3	0,4

4. Comparison with the stability programme for 2003-2005 and sensitivity analysis, Continuation

4.2. Sensitivity analysis

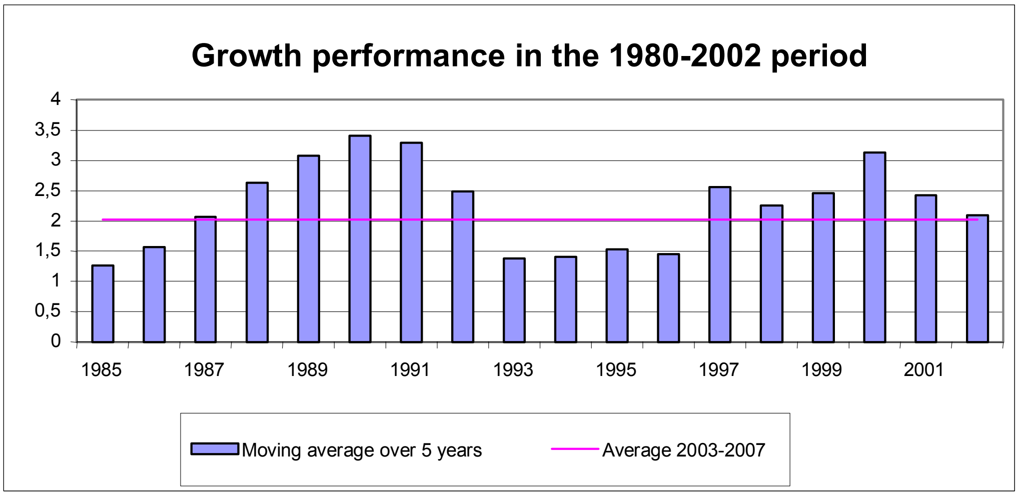
4.2.2. An adjustment to the growth assumptions

Expected average growth of GDP

The movement in both revenues and public expenditure is determined by the level and composition of growth. For the 2003-2007 period, GDP is expected to grow at an average rate of 2.0%. This seems realistic, in view of the current negative output gap, disregarding the actual year-by-year phasing. The successive adjustments to growth forecasts in past years encourage caution.

Chart 3 compares the average growth under the stability programme with the historical figures for the 1980-2002 period.

Chart 3



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4. Comparison with the stability programme for 2003-2005 and sensitivity analysis, Continuation

Table 8 illustrates the cumulative impact of three different growth scenarios for the 2004-2007 period. In the first scenario, the assumption is that actual growth in the next few years will equal potential growth. It follows that the output gap remains negative. The other two scenarios show the impact of negative and positive deviations of 0.5 percentage points in relation to the basic scenario.

TABLE 8
Sensitivity of the balance to the growth assumptions

	2004	2005	2006	2007	Cumulative impact
Stability programme					
Real growth of GDP	1,8	2,8	2,5	2,1	
Financing balance	0,0	0,0	0,0	0,3	
Potential growth					
Real growth of GDP	1,8	2,0	2,2	2,2	
Impact on the financing balance	0,0	-0,4	-0,2	0,1	-0,5
Weaker growth					
Real growth of GDP	1,3	2,3	2,0	1,6	
Impact on the financing balance	-0,3	-0,3	-0,3	-0,3	-1,2
Stronger growth					
Real growth of GDP	2,3	3,3	3,0	2,6	
Impact on the financing balance	0,3	0,3	0,3	0,3	1,2

5. The quality of public finances

Introduction

The Belgian authorities have introduced and are planning numerous reforms to strengthen the production potential by stimulating employment, facilitating entrepreneurial activity, assisting in the transition to a knowledge-based society and increasing the efficiency of the markets – especially in the public services sector and the network industries. These policies are accompanied by particular attention to social integration, and to maintenance of a high standard of social protection.

5.1. The reduction in taxes on labour

Reduction of tax pressure on labour

The policy of reducing the fiscal and parafiscal pressure on labour continued. This stimulated both the labour supply and the demand for labour. Special attention focused on the mitigation of the employment traps.

Implementation personal income tax reform in 2004

The personal income tax reform will be implemented in full in 2004. Following the elimination of the complementary crisis contribution and abolition of the marginal rates in excess of 50%, achieved in 2003, this final stage in the reform will essentially concern adjustment of the intermediate tax scales, the reduction of tax discrimination between married and cohabiting couples, and a final stage in the establishment of a tax credit system for the lowest incomes.

5. The quality of public finances, Continuation

5.2. Other employment promotion measures

General reduction of employers' social contributions	In the autumn of 2003 the government convened a National Employment Conference attended by all the players concerned : employers and unions, the federal government and the federated entities. The conclusions of this conference were reflected in the decision to boost the reduction in employers' social security contributions. The additional reduction in contributions which was decided on will be worth 840 million euro when fully implemented in 2005.
Impact of measures on budget	For the 2004 budget, the decisions taken have an impact of 508 million euro, namely 400 million euro for the reduction in contributions, 66 million euro for additional investment in the « service vouchers » system and 42 million euro for the reduction in fiscal pressure in favour of shift workers and night workers.
Additional reduction of social contributions target groups	Apart from an addition to the general, structural reduction in social security levies, the further easing of the social contributions burden is spread among five target groups : unskilled or inexperienced workers, part-timers, workers whose high standard of qualifications is reflected in their salary, businesses undergoing restructuring and the non-market sector.
Lowly-qualified workers	The reduction for low wages will now apply to workers on a monthly wage of less than 1,956 euro. In addition, a further reduction in employers' contributions will be granted in future for « knowledge-based occupations».
Lowly-educated young	Moreover, a target group reduction will be granted to all young people with few educational qualifications, up to the end of the quarter in which they reach the age of 26. Simplification of the existing system will enable more young people to use it.
Firms undergoing restructuring	The policy of activation in firms undergoing restructuring, centred on long-term redeployment, will be encouraged : reimbursement of the actual outplacement costs incurred by the employer, granting of a reduction in personal social security contributions for the worker and a large cut in contributions payable by the new employer.

Continued on next page

5. The quality of public finances, Continuation

5.2. Other employment promotion measures

Non-market sector	Employment in the non-market sector will receive supplementary support, as the reduction in contributions under the « social Maribel » scheme will be boosted by 37.5 million euro in 2004 and 77.5 million euro in 2005.
Stronger stimulus to service vouchers	The federal government will provide a stronger stimulus for local jobs by allocating additional resources to the « service vouchers » system and by simplifying it. An extra 66 million euro will be added to the existing budget of 25 million euro in 2004.
Initiatives for oldest workers	Over the past two years (2002 and 2003) there have been numerous initiatives designed to prevent early retirement from the labour market by the oldest workers, whose rate of activity is particularly low in Belgium[16]. Those initiatives related not only to the cost of labour and access to training or assistance in cases where the business was undergoing restructuring, but also to providing options for reductions in working hours, making older unemployed persons available to the labour market and providing financial incentives for a return to employment. At the National Employment Conference, employers and unions undertook to ensure that 60,000 workers a year would receive training between 2004 and 2010. The groups at risk (older workers, the unskilled, etc.) will be the focus of special attention.
Combatting fraud and illicit working	Finally, measures to combat benefits fraud and illicit working will be better coordinated and stepped up.

[16] The employment rate for the 55-64 age group was 25.8 % in 2002.

5. The quality of public finances, Continuation

5.3. Encouraging entrepreneurs

Simplification of administrative procedures

Simplification of administrative procedures is considered particularly important for enterprises. There have been numerous initiatives in this area, both at federal level and by the regional authorities. In particular, facilities have been developed for completing various procedures electronically (such as the VAT return, social security return and the notice of recruitment). The government's aim is that by mid 2005 the entire procedure entailed in setting up a business can be completed in 3 days (Central Business Data Bank).

Corporate tax reform

The Belgian authorities carried out a corporate tax reform which should help to make Belgium more competitive and boost its attractiveness as a production location. There are special provisions applicable to SMEs which should encourage their development.

Other measures favouring the SMEs

The corporate tax reform, which is neutral for the budget, came into effect on 1 January 2003. It involves a reduction in the basic rate of corporate tax to 33.99 p.c.[17]. The reduced rate for SMEs is cut to 24.98%[18]. In addition, SMEs are now eligible for partial exemption in respect of reinvested profits, and an increase in that exemption is planned. This measure is intended to enhance tax neutrality among the various sources of finance and should enable small firms to reinvest more of their retained profits. It also caters for the specific difficulty which some SMEs have in raising finance by borrowing or increasing their capital, in view of the problems of assessing the risks of their activity, for example.

Introduction of ruling system

Another key aspect of the corporate tax reform is the establishment of a generalised ruling system (or prior agreement system) facilitating an advance ruling on the tax implications of a transaction or project. This therefore provides investors with a degree of legal certainty which should encourage investment.

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[17] Or 33% plus the complementary crisis contribution.
[18] Or 24.25% plus the complementary crisis contribution.

5. The quality of public finances, Continuation

5.3. Encouraging entrepreneurs

New financial instruments for businesses

The expansion of investment in general, and innovative investment in particular, requires enterprises – and more specifically young SMEs – to be able to access stable, diversified and appropriate sources of finance. In 2003, various new financial instruments were set up in order to help stimulate investment in venture capital. Thus, the private, unlisted PRICAF is a type of mutual investment fund with fixed capital, established for a maximum of 12 years, which guarantees that the investment will take place. It can raise capital from both businesses and individuals.

The general measures in favour of SMEs are particularly welcome for new businesses operating in innovative sectors.

Encouragement of the knowledge economy

At the National Employment Conference, all parties (federal government, governments of the federated entities, employers and unions) emphasised the importance of the aim of devoting 3% of GDP to scientific research[19].

Since the mid 1990s, the public resources earmarked for research & development have grown at an average rate of 5% per annum, thanks in particular to the substantial effort made by the Regions. As well as acting as a catalyst, the federal government took a number of initiatives of its own. Thus, to encourage the recruitment of researchers, from October 2003 the scientific bodies which employ them are required to pay only half the withholding tax on earned income in respect of the earnings of this category of staff. There is also provision for reducing the social security contributions for highly skilled personnel.

[19] R&D expenditure totalled 2.2% of GDP in Belgium in 2001.

5. The quality of public finances, Continuation

5.4. The modernisation of public enterprises

Stepping up of public service reform	Efforts to modernise public enterprises were stepped up. The emphasis was on diversifying the services, upgrading their quality and developing commercial and social policies which would ensure that the budget at least balanced, while also meeting the growing need for public services.
Railway investments	An ambitious programme of State-funded investment in the railways was defined for the years 2004-2007 with provision for the use of regional and external bridging finance for priority investments such as the « DIABOLO » project, which will improve rail access to the Brussels National airport from the main Belgian cities and integrate it into the RER project. The SNCB debt will be taken over on 1 January 2005, in accordance with the European rules, in parallel with the implementation of a new business plan.
Speeding up postal service modernisation	In order to develop a high quality service, the modernisation drive which has begun in the postal service will be speeded up. Automation will be a central theme. The computerisation of business transacted at post office counters and the organisation of efficient sorting facilities are practical examples.
New telephone and broad band services (Belgacom)	While guaranteeing a universally high standard in the existing basic services, Belgacom will pay special attention to reducing the digital divide and boosting the competitiveness of the Belgian economy. It will offer new services via the broad band network and will develop data services via the mobile network. An agreement has been concluded whereby the minority shareholder will sell its shares on the financial markets: this will take place once the conditions are right.
Conversion of BIAC into private limited liability company	BIAC will be converted into a private limited liability company and will provide the bridging finance for the DIABOLO project mentioned above.

5. The quality of public finances, Continuation

5.5. Opening up the energy markets to competition

Liberalisation of electricity market

More efficient and competitive markets can have a beneficial impact on productivity as well as being good for consumers. Liberalisation of the energy markets should lead to more transparent, competitive pricing.

80% of the electricity market is now open to competition. In particular since 1 July 2003 the electricity distribution sector has been fully liberalised in Flanders.

The separation of production, distribution and marketing activities has been completed. Rates for access to the transport and distribution networks have been fixed and published.

The Competition Council has taken decisions which, in the context of the liberalised markets, should clarify the role of the intermunicipal associations, which play a major part in the distribution of electricity.

It is true that, at this stage, only a small percentage of consumers have changed their electricity supplier[20], but this is only the first phase. The new government has also made provision for evaluating the liberalisation process. If necessary, it will take measures to improve market liquidity, e.g. by adjusting cross-border transport conditions.

Competition in gas market

90% of the gas market should be open to competition on 1 January 2004. The liberalised market structures are being established at a slightly slower pace than they were for the electricity market, but the changes are similar.

20 7% of total demand for electricity in Flanders and 2% in Wallonia at the beginning of 2003.

6. Long-term sustainability of public finances

6.1. Introduction

Yearly drawing up of Strategy Document on Ageing

The approval of the Law of 5 September 2001 guaranteeing a continuous reduction in the public debt and the creation of an Ageing Fund introduced a procedure which should ensure that, when the fiscal policy is defined, sufficient attention is paid to the long-term sustainability of public finances. The government is in fact required to prepare a Strategy Document on Ageing each year, in which it has to explain its policy on the ageing population.

The above law provides for three stages in the preparation of the Strategy Document on Ageing:

- the first stage is represented by the annual report of the Working Group on Ageing, which examines the budgetary and social effects of the ageing population;

- in the second phase, the 'Financing Requirements' section of the High Council of Finance takes account of this report when formulating its fiscal policy recommendations;

- finally, in the third stage the government presents its Strategy Document on Ageing, setting out its policy on the effects of the ageing population. This strategy document also contains an account of the payments made to the Ageing Fund (and later on, will state what the Fund has paid out).

The various steps specified by the law were followed for the second time when the 2004 budget was drawn up. The main points of the Strategy Document on Ageing are set out below.

6. Long-term sustainability of public finances

6.2. The ageing population: budgetary effects[21]

Radical increase of elderly persons

In the coming decades, the age structure of the population will change radically. From 2010, the large number of people in the « baby boomers » generation will pass the age 60 mark. Between 2000 and 2030 the number of people over age 60 will increase by around 50%. As a proportion of the total population, they will increase from around 22% to 31%. This trend is even more marked in the group of very elderly persons. The number of people over the age of 80 will more or less double during the 2000-2030 period.

Change of ratio old / young

The percentage of young people (0-19 years) will not change as radically. The proportion of the population of working age (20 to 59) will drop by roughly 55% to around 49%. The ratio between actives and non-actives can also be stated as a dependence ratio, which indicates the proportion of the extreme age groups in relation to the population of working age. In 2030, the total dependence ratio will exceed 100%.

TABLE 9
Population trends and age structure

	2000	2010	2020	2030	2030-2000	2030-2000 (%)
	Total population (*1000)					
0-19	2.416,1	2.351,7	2.275,1	2.272,6	-143,5	-5,9
20-59	5.590,9	5.682,2	5.534,6	5.287,9	-303,0	-5,4
60 +	2.244,4	2.486,0	2.904,3	3.327,2	1.082,8	48,2
Total	10.251,4	10.519,9	10.714,0	10.887,7	636,3	6,2
	Percentage of the total population					
0-19	23,6	22,4	21,2	20,9	-2,7	-11,4
20-59	54,5	54,0	51,7	48,6	-6,0	-10,9
60 +	21,9	23,6	27,1	30,6	8,7	39,6
	Dependence ratio					
0-19	43,2	41,4	41,1	43,0	-0,2	-0,5
60 +	40,1	43,8	52,5	62,9	22,8	56,7
Total	83,4	85,1	93,6	105,9	22,5	27,0

Source – Working Group on Ageing, Annual Report, May 2003

Continued on next page

[21] When defining its policy the government makes use of the estimate of the budgetary cost of the ageing population, produced by the Working Group on Ageing which was set up for that purpose. As explained in detail in last year's stability programme for 2003-2005 (see pages 23-27), the assumptions and methods adopted by the Working Group differ in a number of aspects from those used by the Economic Policy Committee (EPC).

6. Long-term sustainability of public finances, Continuation

6.2. The ageing population: budgetary effects

Ageing cost

The demographic trends thus outlined are bound to affect the operation of the welfare state, and more particularly the pattern of social security expenditure. Assuming a medium-term growth rate of 1.75% and an average annual increase in prosperity of 0.5%, the Working Group on Ageing concluded that the budgetary cost of ageing would equal 3.1% of GDP for the 2002-2030 period.

TABLE 10
Budgetary cost of ageing as % of GDP

% of GDP	2002	2010	2030	2002/2030
	Movement in certain categories of expenditure			
Pensions	9,2	8,8	11,8	2,6
Health care	6,6	7,2	8,7	2,1
Pensions and health care	15,8	16,0	20,5	4,7
Other social security expenditure (1)	7,1	6,4	5,5	-1,6
Total	22,9	22,4	26,0	3,1

Source: Working Group of Ageing, Annual Report, May 2003.

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

Expected increase of social expenditure

After an initial decline, expenditure on pensions will increase by 2.6% of GDP. Health care expenditure will stay more in line with a trend, and according to this simulation will increase by 2.1% of GDP. In 2030, the weight of these two spending categories will have increased by 4.7% bringing them to over 20% of GDP. Conversely, a number of spending categories, such as family allowances, unemployment benefits and early retirement pensions, can be expected to account for a smaller proportion of GDP. Overall, total welfare expenditure will increase by around 3.1% of GDP. This assessment of the budgetary cost of ageing takes no account of changes in education spending.

6.3. A suitable fiscal policy

Increased reduction debt ratio

Fiscal policy should not only offer a solution to short-term problems but must also deal with the inevitable challenges of the future, such as absorption of the budgetary cost of ageing. If this problem is not anticipated, a substantial cost will be passed on to future generations, placing a heavy burden on future fiscal policy. By setting up the Ageing Fund and by the annual procedure associated with it, fiscal policy is taking a long-term view.

In its most recent annual reports, the Financing Requirements Section of the High Council of Finance has drawn attention to the fact that the progressive creation of budget surpluses to speed up the debt reduction is the cornerstone of a policy which aims to safeguard the long-term sustainability of public finances.

Creating surpluses

The government is also of the opinion that a sound fiscal policy which aims to reduce the debt ratio is an essential condition for absorbing the costs of the ageing population. However, the short-term fiscal policy must be placed in the appropriate cyclical context. Weaker growth could make it more difficult to create budget surpluses in the short term. The implications of that situation can be overcome to some extent by maintaining at least a balanced budget, and allocating a number of exceptional revenue items to the reduction of the public debt. However, the government is adhering to the aim of creating surpluses in the medium term as an accelerated debt reduction strategy.

Continued on next page

6.3. A suitable fiscal policy

Interpretation of chart 4

The chart below illustrates the dynamics of such a strategy. It is assumed that a surplus of 0.3% of GDP will be created in 2007, and subsequently increased progressively to 1.5% in 2013 and maintained at that level for the ensuing five years, after which the budget is gradually restored to balance.

Chart 4

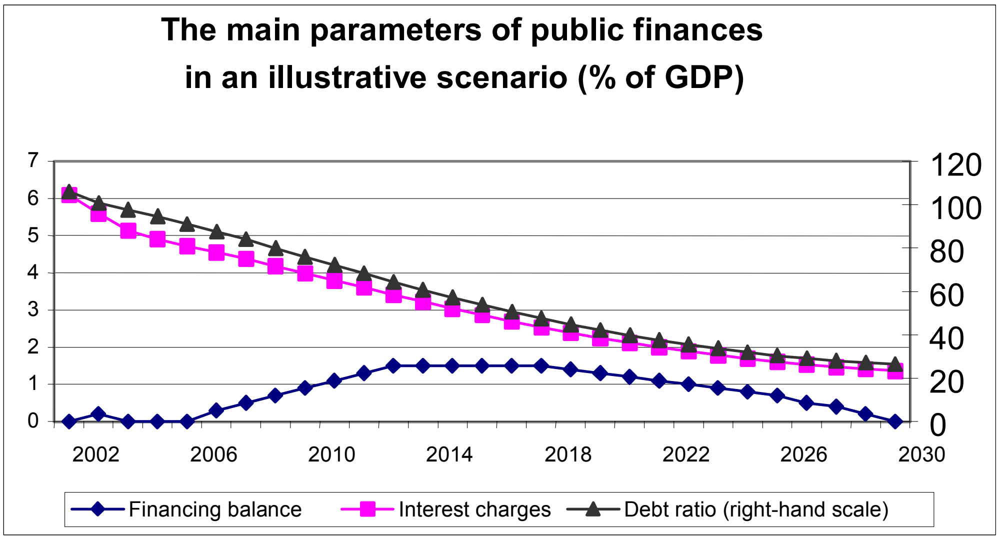

Chart 4 clearly shows what fiscal policy is required to achieve in the medium term. Reducing the debt ratio eases the burden of interest charges. The margin created in this way, together with the progressive reduction of the surplus formed, can then be used to absorb the costs of the ageing population without having to cut other spending or make drastic adjustments to fiscal policy.

6. Long-term sustainability of public finances, Continuation

6.4. The financing of the Ageing Fund

Sources of finance Ageing Fund

The Ageing Fund was set up in order to finance the increase in expenditure on pensions in the period 2010-2030[22].

The Ageing Fund has four possible sources of finance:

- budget surpluses;
- social security surpluses;
- non-fiscal revenues;
- the income from its investments.

Available capital Ageing Fund

When the Fund was set up in 2001, the government allocated it an initial capital of 614.9 million euro out of non-fiscal revenues. In 2002 a comparable amount of 666.3 million euro was allocated to the Fund out of non-fiscal revenues. When the 2003 budget was drawn up, provision was made for paying into the Fund a sum equivalent sum to that allocated in 2002 and 2003. This figure includes the proceeds from banknotes not exchanged for euro notes (214 million euro) and the Belgacom dividend. Finally, the outcome of the additional debt reduction measures, the net proceeds from the sale of Credibe (2,645.7 million euro) and part (3,600 million euro) of the proceeds from the liquidation of the Belgacom pension fund will be allocated to the Ageing Fund.

At the end of 2003, the Fund will have capital totalling around 8,100 million euro, taking account of the payments planned, or about 3% of GDP. At the end of 2004, allowing for payment of the second tranche of the proceeds from the liquidation of the Belgacom pension fund (1,400 million euro), the capital will total around 9,500 million euro or 3.4% of GDP.

22 The law stipulates that, as a supplementary condition, the resources of the Fund can be used only once the debt ratio has dropped below the 60% mark.

6. Long-term sustainability of public finances, Continuation

6.5. Fiscal policy as an element of a global strategy

Persistent budgetary challenge

In the context of the stability programme, attention focuses mainly on the contribution that fiscal policy can make towards absorbing the effects of an ageing population. Although the disadvantage of a high debt ratio can be turned into an advantage – the reduction in the public debt almost automatically creates a budget margin – we must not lose sight of the scale of the challenge. The fiscal policy outlined here implies the need to maintain a sufficiently high primary surplus over a long period.

Contribution of other policies

It would therefore be inappropriate to base the entire strategy on fiscal policy alone. Other policies can also make a substantial contribution. Employment promotion and, more generally, economic growth will strengthen the financial basis for absorbing the cost of ageing. The measures taken from this point of view have already been explained in section 5.

ANNEXES

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

	2003	2004	2005	2006	2007
Short-term interest rate (annual average)	2,2	2,3	3,5	4,3	4,5
Long-term interest rate (annual average)	4,1	4,3	4,8	5,2	5,4
USD/euro exchange rate (annual average)	111,5	111,3	111,0	110,8	110,6
GDP growth – world (excl. EU)	3,2	3,7	3,8	3,8	3,8
GDP growth – EU	1,0	1,9	2,5	2,3	2,3
Growth of relevant external markets	3,0	5,8	5,9	5,5	5,4
Global imports, by volume (excl. EU)	5,4	6,6	6,7	6,7	6,7
Oil price (USD)	28,1	25,2	25,8	26,5	27,1

Source : Federal Planning Bureau, Projection 2003-2008, October 2003

Key determinants of potential growth

	2002	2003	2004	2005	2006	2007
Potential growth	1,9	1,8	1,8	2,0	2,2	2,2
Output gap (% of potential output)	0,0	-0,9	-0,9	-0,1	0,2	0,1
	Contributions to potential growth					
Labour factor	0,5	0,4	0,4	0,5	0,6	0,6
Capital factor	0,6	0,5	0,5	0,6	0,6	0,5
Total productivity of the factors	0,8	0,8	0,9	1,0	1,0	1,0
	Determinants of potential growth					
Population of working age (growth rate as %)	0,5	0,4	0,2	0,4	0,5	0,5
Trend participation rate (% of population of working age)	71,0	71,3	71,6	71,8	72,0	72,1
Trend component of unemployment	13,9	14,1	14,0	14,0	13,9	13,7
Investment (as % of potential output)	20,3	20,4	20,6	21,1	21,3	21,2
Capital depreciation rate	5,8	5,9	6,1	6,2	6,3	6,3

Source : Federal Planning Bureau, Projection 2003-2008, October 2003.

The targets for public finances under consecutive stability programmes

Programme	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
	Financing balance									
1999-2002	-1,6	-1,3	-1,0	-0,7	-0,3					
2000-2003		-1,1	-1,0	-0,5	0,0	0,2				
2001-2005			-0,1	0,2	0,3	0,5	0,6	0,7		
2002-2005				0,0	0,0	0,5	0,6	0,7		
2003-2005					0,0	0,0	0,3	0,5		
2004-2007						0,2	0,0	0,0	0,0	0,3
	Debt ratio									
1999-2002	117,5	114,5	112,2	109,6	106,8					
2000-2003		114,9	112,4	108,8	105,0	101,3				
2001-2005			110,6	105,8	101,4	97,2	92,9	88,7		
2002-2005				107,0	103,3	97,7	93,0	88,6		
2003-2005					106,1	102,3	97,9	93,6		
2004-2007						102,3	97,6	93,6	90,1	87,0