THE BELGIAN STABILITY PROGRAMME

(2005-2008)

UPDATE 2004

Contents

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1. INTRODUCTION AND SUMMARY

Update of the Belgian stability programme

In this stability programme the Belgian government explains its fiscal policy for the period 2005-2008. The stability programme 2005-2008 is an update of the stability programme 2004-2007. Like the previous programme, it is based on the budget decisions taken under the federal government agreement of May 2003. This includes the maintenance of a balanced budget as the minimum objective for the coming years, with the gradual creation of budget surpluses.

Balanced budgets expected in 2005-2006, surpluses in 2007-2008

In 2004, economic activity recovered more quickly and strongly than expected. When the budget for 2005 was drawn up, economic growth was estimated at 2.4%, but as the business cycle reached a peak earlier, growth in 2005 will be more modest than estimated in the stability programme for 2004-2007. Nonetheless, the government is determined to aim at a balanced budget in 2005 and 2006, followed by a surplus of 0.3% of GDP in 2007, in line with the coalition agreement. The target for 2008 is a surplus of 0.6% of GDP. This enables Belgium to adhere to the medium-term course recommended by the High Council of Finance. In view of the more favourable economic climate, the government can make the budget outcome gradually less dependent on one-off measures.

Creating a structural budget surplus in the medium term

It is necessary to create a structural budget surplus in the medium term in order to bring down the debt ratio sufficiently quickly. That is a key condition for absorbing the cost of population ageing in the future. In 2003, the debt ratio was cut to just below 100% of GDP, an important psychological milestone in the debt reduction process. Although the incorporation of the SNCB's debts in the public debt in 2005 will slow the reduction in the debt ratio, by the end of 2008 that ratio should be down to 84.2% of GDP, bringing the Belgian figure much closer to the average for the euro area.

Key initiatives affecting the budget

A responsible fiscal policy is not satisfied with merely achieving a particular balance or rate of debt reduction. The maintenance of a balanced budget is accompanied by initiatives which have an impact on the budget and relate to the government's objectives, such as:

- initiating and stimulating the economic revival and job creation, e.g. by an additional reduction in taxes on labour;
- enhancing social security and economic security for everyone;
- providing additional budget resources for the justice system and security services in order to make the security policy more effective;
- stepping up investments in mobility and the infrastructure.

If growth during the 2005-2008 period proves to have been stronger than is currently assumed, then – as in previous years – the government is committed to using the additional scope primarily to improve the financing balance.

2. THE ECONOMIC CONTEXT

2.1. The international context

The European environment

European Union sees upturn in economic activity

In general, the recovery which followed the turning point in the cycle reached - in the second half of 2003 - is continuing in the euro area. It gathered momentum in the first half of 2004, when the annual growth rate for the euro area approached its potential rate of around 2.5% in real terms. This cyclical upturn was apparent in varying degrees in the majority of the Member States of the European Union, although it did slacken pace in some countries during the third quarter.

Exports the main source of European GDP growth

Expanding exports were the key to the European rebound. Despite the substantial rise in imports, net exports contributed roughly half of the GDP growth in the euro area during the first six months of 2004.

It is noteworthy that, at least until mid 2004, the euro's appreciation did not impede the strong growth of exports by euro area countries, although some of those countries did lose market shares.

The world environment

Strong growth of the world economy

This export growth is underpinned by the strong expansion of world trade, which reached around 10% per annum in the first half of 2004. From the second half of the year, world growth and the expansion of export markets are expected to slow down somewhat, although the growth should still be fairly robust. According to the latest IMF forecasts, world growth should reach 5% this year before dropping to around 4.3% in 2005-2006.

The vigour of world growth stems from the fact that all the major economic regions are experiencing an expansion phase simultaneously, though it is the United States and China that are the main engines of growth.

Growth of around 3% expected in United States

In the United States the economy became slightly less dynamic in the second quarter of 2004, reverting to its growth potential (around 3 to 3.5%). Although interest rates are still at a very low level, despite the slight tightening of monetary policy on the part of the Federal Reserve, there no longer seems to be much room for manœuvre in fiscal policy. The American policy mix should therefore be more neutral than in the past. Nonetheless, the leading indicators for the American economy suggest that growth will be maintained at close to its current level in the months ahead.

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2.1. The international context, Continued

Growth of around 9% expected in China

China's GDP grew by 9.1% in real terms in 2003, and the growth rates recorded in the first and third quarters of this year were nearly as high. The Chinese authorities have taken monetary and fiscal measures to avoid overheating, and it is hoped that they will bring the growth rate down to a more sustainable level.

Growth of around 4% expected in Japan

With the benefit of the global economic upturn in general and Chinese expansion in particular, the Japanese economy has made a gradual recovery. At first, Japan's revival was supported by foreign demand but has gradually become more broadly based, bolstered by private consumption and investment. Growth of over 4% in real terms is expected for 2004, followed by some deceleration.

Growth remains robust in the euro area environment

Economic growth also remains robust in the euro area's immediate neighbours, be it the United Kingdom or the new EU Member States.

Consolidation of the recovery in the euro area

Domestic demand largely disappointing in the euro area

While the euro area's exports have been extremely buoyant for several months, domestic demand within the euro area has been somewhat disappointing. Private consumption picked up in the first half of 2004, but investment is still stagnating. Public consumption is helping to support activity.

Wide variations in domestic demand

These overall results conceal significant variations between countries. On the one hand, in countries such as France – at least until mid 2004 – or Spain, the growth of domestic demand has been relatively sustained, even though the increased energy prices have taken their toll on purchasing power; conversely, in Germany in particular, but also in Italy and the Netherlands, private consumption and business investment remain sluggish. Investment in housing is expanding practically everywhere, except in Germany.

Cyclical indicator more or less steady

The European Commission's cyclical indicator (business climate indicator) remained more or less steady from July to October. The Commission's household and business surveys point to consolidation or a slight improvement in the confidence of the economic agents for this period.

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2.1. The international context, Continued

Little improvement in employment

There has been hardly any expansion in employment since the start of the recovery. The business surveys indicate only a small increase in employment during the second half of 2004 and in 2005. The relative stability of employment during the previous cyclical downturn tends to increase the time lag between the start of the recovery and the improvement in the job situation.

Macroeconomic policy remains expansionary

Macroeconomic policy remains expansionary overall. In particular, interest rates are low and inflation remains under control, despite the rise in energy prices.

The trends thus outlined are consistent with a continuing, moderate-paced recovery, as growth could gradually become self-supporting and be based increasingly on internal components.

GDP growth expected for euro area

Under these circumstances, the Commission's autumn forecasts predict that the euro area's GDP will grow by 2.1% in real terms in 2004, 2% in 2005 and 2.2% in 2006. The corresponding growth rates for the Union as a whole are 2.5, 2.3 and 2.4% respectively.

Risk factors for growth in the euro area

However, there are some risk factors present.

The rise in energy prices may depress households' disposable income and hence their consumption, but could also inhibit business investment. However, the impact of a rise in energy prices on economic activity has lessened since the previous episodes of high oil prices. Moreover, the increase in these prices is no longer reflected in wages as systematically as in the past, and the reduction of these "second-round effects" should avoid the need for any monetary tightening. Furthermore, owing to the strength of the euro, the increase in the price of energy or other commodities is having less impact on domestic prices. However, if that strength persists, it could harm the competitiveness of industry in the euro area.

The imbalances in the American economy (household debt levels, budget deficit and current account deficit on the balance of payments) are causing growing concern for international financial stability and growth.

2.2. The short-term outlook for the Belgian economy

Belgium's economic performance above average

Within the euro area, Belgium is among the countries producing an above-average economic performance, and that has been the case since the end of 2002. In 2003, Belgium's GDP grew by 1.3% in real terms against an average of just 0.6% for the euro area. Economic growth measured by GDP growth compared to the corresponding quarter of the previous year increased steadily from 1% in the third quarter of 2003 to 3% in the third quarter of 2004, according to the NBB's "flash" estimate.

Overall, in October the Federal Planning Bureau predicted growth of 2.4% in 2004, which seems very cautious in the light of what was achieved by the end of the third quarter; the latest data suggest that growth of 2.7% is a possibility.

Belgium's growth expected to average 2.5%

Up to October 2004, at least, the consumer and business confidence indicators looked better overall in Belgium than the euro area average. However, in November, the NBB's synthetic indicator produced a marked fall. Nonetheless, the Bank's smoothed overall indicator which reflects the underlying trend in the economy continued to rise; but this curve had already begun to flatten out and its slope was no longer very steep. Capacity utilisation rates also declined slightly in October. These various factors appear consistent with the expectation that growth will moderate somewhat in the last part of the year, owing to the oil price hike. Once this impact has been absorbed, growth should strengthen in 2005; the Federal Planning Bureau expects it to rise to an annual average of 2.5%.

Inflation edges upwards

Inflation measured on the basis of the national consumer price index has been running at over 2% year-on-year since May 2004, owing to the influence of oil prices. But the underlying inflation rate (excluding changes in indirect taxes and the prices of energy, water, meat and fruit and vegetables), which was falling during the first three quarters of 2004, came to only around 1.5% in September. As an annual average, the increase in prices (HICP) will probably not exceed 1.9% in 2004. There should be little change in 2005 (2%), assuming that the price of a barrel of Brent drops to $ 37.5 in December 2005.

Increased job creation

The protracted period of weak growth had a less negative effect than expected on employment. By the second half of 2003, employment was already picking up a little. Job creation should increase progressively as the recovery proceeds, rising from an annual average of +0.1% in 2003, to +0.4% in 2004 and +0.8% in 2005. As the labour force is expanding faster (+0.9%) than employment, the unemployment rate has continued to rise in 2004, reaching an annual average of 8.5% (Eurostat definition). This rate will probably remain unchanged in 2005.

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2.2. The short-term outlook for the Belgian economy, Continued

Composition of growth

In Belgium, the recovery has been apparent in both industry and services, especially in trade and the construction sector.

It is notable that in Belgium the recovery was initially driven by domestic demand. The Belgian export revival was slower than the average for the euro area and, taking account of the rise in imports, the net contribution which exports made to growth was negative up to the middle of 2004. During the second half of 2004, a balance should gradually be restored between the internal and external components of the economic expansion.

Table 1
Growth and associated factors

Percentage change unless otherwise stated	2003	2004	2005	2006	2007	2008
GDP growth at constant prices	1,3	2,4	2,5	2,5	2,1	2,0
GDP at current prices (in billions of euro)	269,5	280,8	293,3	306,6	318,9	331,8
GDP deflator	1,9	1,7	1,9	1,9	1,9	2,0
Change in the HICP	1,5	1,9	2,0	1,8	1,8	1,8
Change in employment	0,1	0,4	0,8	0,9	0,7	0,7
Unemployment, Eurostat definition (as a % of the labour force)	8,1	8,5	8,5	8,3	8,2	8,1
Change in labour productivity	1,3	2,0	1,7	1,6	1,3	1,3
	Growth sources: change at constant prices					
1. Final consumption expenditure of individuals	2,2	2,0	1,7	2,3	1,7	1,9
2. Final consumption expenditure of general government	2,6	1,3	1,9	2,1	2,4	1,7
3. Gross fixed capital formation	-0,8	1,7	5,7	3,9	1,7	2,4
4. Exports of goods and services	1,7	4,1	5,4	5,9	5,7	5,4
5. Imports of goods and services	2,9	3,8	5,7	6,2	5,7	5,5
	Contribution to GDP growth					
6. Total final demand (1+2+3)	1,6	1,7	2,4	2,5	1,8	1,8
7. Change in stocks	0,5	0,3	0,0	0,0	0,0	0,0
8. Balance of goods and services	-0,8	0,4	0,1	0,0	0,3	0,2

Source: Federal Planning Bureau, October 2004

Household consumption

Household purchasing power should rise faster in 2004 and 2005 than in 2003, even though the tax reforms will make a smaller contribution to the increase in disposable income. This expected increase, which is only modest, is due to the expansion of employment in the context of a cyclical upturn, and to a favourable movement in household assets. Conversely, the rise in energy prices will depress purchasing power at least for a time, since wages are linked to the health index which does not allow for fuel price movements.

Household consumption surged in the first quarter of 2004, then remained steady in the second. Both the consumer confidence indicator and the indicator of activity in the trade sector fell sharply from October.

According to the Federal Planning Bureau, private consumption at constant prices should increase by 2% in 2004 and 1.7% in 2005 in annual average terms. The savings ratio is expected to fall slightly in 2004 before stabilising in 2005.

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2.2. The short-term outlook for the Belgian economy, Continued

Investment is picking up

Business investment remained depressed in Belgium until mid 2004. Nonetheless, after two years of decline, taking account of the consolidation of the recovery and the favourable trend in profits, investment is expected to pick up from the second half of 2004. This is consistent with the result of the NBB surveys, and - despite the slight dip recorded in October 2004 –with a relatively high level of capacity utilisation. Overall, the Federal Planning Bureau predicts an acceleration in investment in 2005 (+ 4.7%) compared to the modest growth in 2004 (+ 1%).

Housing construction has been forging ahead since 2003, driven by the low level of mortgage interest rates. This trend should continue at a slightly more moderate pace (+ 2.5% in volume in 2004 and + 2% in 2005).

Finally, *public sector investment* should expand substantially in 2005, in accordance with the local authority investment cycle which is linked to the municipal election cycle.

Foreign trade is expanding

Most of Belgium's exports are destined for the euro area. It follows that, where export market growth is concerned, Belgium is less sensitive than other countries to a slowing of the rate of expansion outside the euro area. The assessment of export orders in the surveys seems to be more favourable than in many other European Union countries. Assuming that the effective exchange rate remains steady in 2005, the Federal Planning Bureau predicts that exports of goods and services will increase, at constant prices, by 4.1% in 2004 and 5.4% in 2005. The contribution of net exports to growth looks set to be slightly positive in 2004 and roughly neutral in 2005.

2.3. Medium-term forecasts (2006-2008)

Update of medium-term forecasts

In October 2004 the Federal Planning Bureau updated its medium-term forecasts. This projection takes no account of the measures adopted in drawing up the budget for 2005.

Euro-dollar projections

As every year, the international environment is based on the OECD's medium-term projections (April 2004). In these projections, the average price of a barrel of Brent, set at $39 in 2005, is presumed to fall to $38.2 in 2006, then to rise steadily to reach $40.1 in 2008. The euro is expected to weaken very slowly but steadily against the dollar, starting from the average figure taken for 2005 of 1.215 dollars to the euro.

Growth expected to average 2.1% until 2009

The projection includes the assumption of a virtually zero output gap in 2009. Potential growth is calculated using the methodology developed by the European Commission. It averages 2.1% over the period considered.

GDP growth at constant prices is thus estimated at 2.5% in 2006, as in 2005, 2.1% in 2007 and 2% in 2008. Economic growth is therefore expected to remain robust in 2006 before running out of steam somewhat and reverting to its potential rate.

Savings ratio practically stable

Private consumption is expected to remain buoyant in 2006, thanks to the impact on disposable income of the personal income tax reform, though that impact will subsequently fade. Household demand should move more or less in phase with household purchasing power, while the savings ratio will be practically stable.

Strong rise in investment

Despite the rise in interest rates, growth of business investment is forecast to continue at a sustained rate (over 3% as an annual average), thanks to increased profitability and satisfactory demand prospects. Investment in housing is expected to rise by an annual average of 2%, while government investment should reach a peak in 2005-2006, in line with the cycle of local authority infrastructure projects.

Exports down

During the 2006-2008 period, the growth of Belgium's potential export markets is likely to weaken slightly, and Belgian exports will probably continue to lose market share. Imports and exports are expected to move roughly in parallel, with foreign trade continuing to make a meagre net contribution to growth.

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2.3. Medium-term forecasts (2006-2008), Continued

Inflation under control

Inflation should remain under control. Wage rises are likely to be modest, in line with the movement in labour costs in Belgium’s three main trading partners.

Employment rate rising slowly

Employment should expand at a steady but moderate pace. The employment rate is expected to increase slowly from 62% of the population of working age in 2005 to 62.5% in 2008.

3. THE GENERAL GOVERNMENT FINANCING BALANCE AND THE PUBLIC DEBT

3.1. Fiscal policy stance

Situation

The stability programme for 2005-2008 is an update of the previous stability programme for 2004-2007 and forms part of the long-range budget programme drawn up during the federal coalition negotiations following the May 2003 elections. The budgetary stance of the present stability programme is therefore the same as for the previous programme. A balanced budget and a steady reduction in the debt ratio are still the central objectives. Moreover, the Belgian government aims to combine the current fiscal policy with adjustments to financial resources, reflecting the new emphasis that it wishes to place on certain political priorities.

A balanced budget

In 2005, the Belgian government aims to maintain a balanced budget as required by the stability and growth pact. Since 2000 that objective has been achieved. A balanced budget is also forecast for 2006. After that, budget surpluses will gradually be created, starting with a surplus of 0.3% of GDP in 2007. For 2008, the target is a surplus of 0.6% of GDP. This will enable Belgium to keep to the medium-term course recommended by the High Council of Finance.[1].

Further reduction in the debt ratio

At the end of 2004, the public debt will be cut to 96.6% of GDP. That means that, in the space of ten years, the debt ratio will have fallen by over 40 percentage points. In 2005, the debt ratio will be down to 95.5%. The reduction appears small compared to that of previous years, but it must be remembered that the federal government agreed to include in the public debt, in 2005, the debts of the SNCB [Belgian railways] totalling 7.4 billion euro, or 2.5% of GDP. The effort made by the government to reduce the debt ratio will therefore amount to around 3.6 percentage points in 2005, so that the reduction can readily withstand comparison with that of previous years.

Scope for new political priorities

When it took office in 2003, the new federal government drew up a detailed budget plan, reconciling the budget targets up to 2007 with the political initiatives negotiated at that time. The coalition agreement of June 2003 sets out four key political priorities:

- initiating and stimulating the economic revival and job creation, e.g. by an additional reduction in taxes on labour;
- enhancing social security and economic security for everyone;

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1 The "Public Sector Borrowing Requirement" section of the High Council of Finance is an advisory body which makes recommendations on the government's fiscal policy.

3.1. Fiscal policy stance, Continued

Scope for new political priorities (continued)

- providing additional budget resources for the justice system and security services in order to make the security policy more effective;
- stepping up investments in mobility and the infrastructure.

Obviously, the specification of these priorities will have an impact on the budget.

Controlling primary expenditure

Granting additional resources for political priorities implies a commitment to controlling primary expenditure in other areas. Thus, the coalition agreement sets a target for the growth of the federal government's primary expenditure at 1.2% in real terms, excluding reinvestment in public enterprises.

3.2. An overview of public finances 2004-2008

Overview of public finances 2004-2008

Table 2 sets out the targets and forecasts for public finances for the period 2004-2008. The general government financing balances represent a clear commitment.

The detailed figures for revenue and expenditure are estimates, and are intended more as a guide. When the budget is drawn up and at the time of the budget audit, the governments will update their figures and adapt them, if necessary, to circumstances at the time.

Table 2
The general government budget (1)

% of GDP	2003	2004	2005	2006	2007	2008
	Financing balance of the sub-sectors					
General government	**0,4**	**0,0**	**0,0**	**0,0**	**0,3**	**0,6**
Federal government	0,4	-0,5	-0,4	-0,2	0,0	0,2
Communities and regions	0,2	0,2	0,2	0,1	0,1	0,1
Local authorities	0,3	0,2	0,1	0,0	0,1	0,2
Social security institutions	-0,5	0,0	0,1	0,1	0,1	0,1
	General government					
Total revenue	*51,3*	*49,6*	*49,4*	*49,0*	*49,1*	*49,1*
Total expenditure	*50,9*	*49,6*	*49,4*	*49,0*	*48,8*	*48,5*
Financing balance	*0,4*	*0,0*	*0,0*	*0,0*	*0,3*	*0,6*
Interest charges	*5,4*	*4,9*	*4,5*	*4,4*	*4,2*	*4,1*
Primary balance	*5,7*	*4,9*	*4,5*	*4,4*	*4,5*	*4,7*
	Main components of revenue					
Taxes	*30,4*	*30,9*	*30,8*	*30,3*	*30,4*	*30,4*
Social security contributions	*16,5*	*16,3*	*16,2*	*16,3*	*16,4*	*16,3*
Other	*4,4*	*2,4*	*2,4*	*2,4*	*2,4*	*2,3*
Total revenue	*51,3*	*49,6*	*49,4*	*49,0*	*49,1*	*49,1*
	Main components of expenditure					
Consumption expenditure (compensation+ intermediate consumption)	*15,5*	*15,4*	*15,2*	*15,0*	*15,0*	*15,0*
Social benefits in kind	*7,0*	*7,1*	*7,1*	*7,3*	*7,5*	*7,5*
Other social benefits	*16,3*	*16,2*	*15,9*	*15,6*	*15,5*	*15,4*
Interest charges	*5,4*	*4,9*	*4,5*	*4,4*	*4,2*	*4,1*
Subsidies	*1,6*	*1,5*	*1,6*	*1,6*	*1,6*	*1,6*
Gross fixed capital formation	*1,6*	*1,6*	*1,8*	*1,9*	*1,7*	*1,6*
Other	*3,5*	*3,0*	*3,3*	*3,3*	*3,3*	*3,3*
Total expenditure	*50,9*	*49,6*	*49,4*	*49,0*	*48,8*	*48,5*

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

3.2. An overview of public finances 2004-2008

3.2.1. Execution of the 2004 budget

Growth prospects progressively revised

When the 2004 budget was drawn up, the estimate of the economic outlook was cautious even though growth was expected to accelerate compared to 2003.

However, when the 2005 budget was drawn up and the 2004 budget was simultaneously updated, it was clear that economic growth had been relatively sustained during the first half of the year. Moreover, the outlook for growth at the end of the year also appeared favourable, although the jittery oil markets did cause some uncertainty.

The growth forecasts were therefore progressively upgraded, from 1.8% at the time of the stability programme for 2004-2007 to 2% at the time of the budget audit and 2.4% when the 2005 budget was drawn up.

Tax revenue estimate upgraded

The better than expected growth prospects also have a positive impact on tax revenues. As shown by table 2, at first it is tax revenues that seem to best reflect the improvement in the economic situation. They increase from 30.4% to 30.9% of GDP.

Among tax revenues, it is mainly indirect taxes (VAT, registration fees, etc.) and corporation tax that significantly exceed the forecasts, while taxes linked to labour remain close to the initial predictions.

Social security revenues are slightly below the initial forecast. Like personal income tax, they depend on employment which traditionally lags behind the movement in business activity.

The revenue expected from the one-off declaration of assets, initially estimated at 0.3% of GDP, was revised during 2004 to 0.1% of GDP. However, this shortfall is offset by higher than expected tax revenues.

Impact of the Belgacom operation on revenues

Despite the strong growth of indirect tax revenues, total revenues appear to decline considerably in 2004, from 51.3% to 49.6 % of GDP. In reality, the revenues are influenced by the takeover of the Belgacom pension fund, worth around 1.9% of GDP, which had an impact on the budget balance for 2003. For the same reason, the primary balance is down from 5.7% to 4.9%. The effect of the Belgacom operation is clearly visible in the movement in ‘other’ revenues, down by 2% of GDP between 2003 and 2004. Without the Belgacom operation, revenues increased slightly as a percentage of GDP in 2004.

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3.2. An overview of public finances 2004-2008

3.2.1. Execution of the 2004 budget, Continued

Downward trend in total expenditure

The weight of total expenditure showed a marked fall in 2004, from 50.9% to 49.6% of GDP. A major contributory factor was the sharp decline in interest charges. On the one hand, this fall is due to the substantial debt reduction, from 100% to 96.6% of GDP to be achieved in 2004. Moreover, the implicit interest rate has continued to fall. As a result of these two mutually reinforcing trends, interest payments will come to 4.9% of GDP at the end of 2004, whereas the 2003 figure was still 5.4% of GDP. The weight of social security benefits in kind was slightly higher in 2004 than in 2003.

This rise is in line with an upward trend reflecting the increased expenditure on health care. Conversely, the proportion spent on ‘social security benefits other than benefits in kind’ is declining, following the temporary deceleration in the growth of pension expenditure; this is due to the fact that the less numerous generation born during the war is reaching retirement age. Nevertheless, this downward trend was curbed in 2004 by rising inflation, which caused the threshold index to be exceeded sooner than expected.

Strict budget monitoring

As in previous years, the government keeps a strict and systematic watch on revenue and expenditure, in order to achieve a balanced budget. This monitoring entails not only tight control of the federal budget, but also the coordinated monitoring of the fiscal policies of the Communities and Regions. If necessary, supplementary measures will be taken.

3.2. An overview of public finances 2004-2008

3.2.2. A balanced budget once again in 2005

Target for 2005: a balanced budget

For 2005, the Belgian authorities have set themselves the target of restoring a balanced budget, creating confidence among the population. They are also continuing to guarantee a financial balance in social security, as explicitly specified in the coalition agreement. The small surplus of 0.1% of GDP planned for social security, combined with the regional and local authority surpluses, offsets the federal government deficit.

A favourable economic climate

In line with the European Commission's Autumn Forecast, the Belgian authorities predict growth of 2.5% in 2005, which should be sufficient to maintain the level of tax revenues. In addition, the accelerating growth should stimulate employment sufficiently to convert the trend towards rising unemployment into a slight fall. The economic climate will therefore have a favourable impact on public finances.

Reductions in charges continue to ease the tax burden

The weight of tax revenues will fall in 2005 from 30.9% to 30.8% of GDP. To ensure that the economic upturn leads to maximum job creation, Belgium is maintaining its policy of reducing the taxes on labour; these will be cut by 0.3% of GDP in 2005. By way of partial compensation, the federal government is not only expecting higher indirect tax revenues, but also intends to step up the battle against tax fraud. Moreover, a securitisation operation is to be organised, whereby tax arrears which are difficult to recover will be placed with an institutional investor. Apart from the personal income tax reform, the second phase of the reduction in social security contributions will take effect, representing a sum of 480 million euro. This measure's impact on the budget will be partially offset by enlargement of the basis of contributions (for example, company cars will be taken into account).

Expenditure priorities

The priorities set out in the federal coalition agreement are also reflected in the expenditure planned in the initial budget for 2005. Under this budget, expenditure on Justice and Security will increase by 4.1% in real terms, as stipulated in the coalition agreement. The government also confirms its commitment to public enterprises and public services. The SNCB's investment grant is increased and additional resources are made available for the continuation of the computerisation plan for the FPS Finance. This is a carefully planned and controlled budget operation to make up lost ground, accompanied by measures to control costs and promote efficiency.

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Additional resources for health care

To meet the new needs arising partly as a result of population ageing and the application of new medical techniques, the coalition agreement of June 2003 stipulated that expenditure on health care should grow by 4.5% in real terms during the 2004-2007 period. The 2004 expenditure profile shows that the measures taken in the past are not sufficient to keep the growth of spending within the planned limits. In addition to the measures totalling 308 million euro, already taken when the 2005 budget was drawn up, the government decided at the end of November on a series of new measures totalling 238 million euro (or 0.2% of GDP altogether).

These measures constitute structural reforms which should lead to a change of behaviour on the part of the main players and institutions. The financial accountability of certain sectors, already introduced in the past, has been reinforced. In practice, a whole raft of supplementary measures was approved. They are intended to ensure that the expenditure of each sub-sector remains within the predetermined targets in 2005.

Where doctors' fees are concerned, the measures total around 84 billion euro (they include: a conditional freeze on the planned indexed bill, an additional limit on the budgets for radiology and clinical biology, etc.).

Expenditure on medicinal products is cut by 115 million euro (measures include a further extension of the reference reimbursement system and encouragement for sensible, price-conscious prescribing). When fully operational, these measures are expected to bring in 164 million euro. The necessary legal provisions will take the form of a pre-draft law at the end of the year.

Continuing limits on spending

Since the reduction in taxes will reduce public revenues, spending will be kept under tighter control. One way of achieving that will be to rationalise the costs of running the semi-public welfare institutions and the operating costs of the benefit payment agencies. The federal public services are also encouraged to increase the efficiency of their operation. In 2005, the growth of the federal government's primary expenditure will be kept down to 1% in real terms compared to 2004. Apart from the pensions budget, real growth is limited to 0.3%.[2] Since this is less than the 2.5% economic growth forecast, it will have the effect of lowering the spending ratio. Moreover, in 2005 a further substantial fall in interest charges is predicted, following the reduction in the public debt and the continuing decline in the implicit interest rate.

[2] Spending defined according to the budget rules and after adjustment for spending in 2004, to take account of the fact that part of the SNCB grant was transferred from 2004 to 2003.

3.2. An overview of public finances 2004-2008

3.2.3. From a balanced budget to the progressive creation of surpluses during the period 2006-2008

Towards balance at all levels

The course mapped out for the budget in the coming years is clearly heading for a budget surplus of 1.5% in 2011, in line with the long-term strategy recommended by the High Council of Finance.

In 2006, the aim is still to achieve a balanced budget; in 2007 there will be a surplus of 0.3% of GDP. For 2008, the target is a surplus of 0.6% of GDP. This will enable Belgium to keep to the medium-term course recommended by the High Council of Finance.

In the period covered by the present stability programme, the federal government's budget deficit will be progressively reduced from 0.5% of GDP in 2004 to a balanced budget in 2007. Initially, this deficit is offset at the level of the regional and local authorities, which achieve small surpluses as specified in the agreements between the various authorities.

From 2007 onwards, the plan is to achieve a balanced federal budget, so that the surpluses of the regional and local entities become apparent at general government level.

Effects of the local elections in 2006

The local authority budget balance in 2006 is an exception to this strategy. Owing to the local elections scheduled for that year, there will be no surplus here in 2006. Local authorities actually have a specific cycle of expenditure: spending is always higher in election years. The local authority finances will therefore be in balance in 2006. The impact of the local elections on the budget is also reflected in gross fixed capital formation. It is local authority investment that is the primary reason for a rising trend in expenditure in the run-up to the elections. After 2006, gross investment will stabilise once again at around 1.6% of GDP.

Revenue ratio reduced as the tax reform becomes fully operational

The personal income tax reform will become fully operational in 2006. This will reduce the share of tax revenues in GDP from 30.8% in 2005 to 30.3%. The erosion of total revenues will continue, as they decline from 49.4% of GDP in 2005 to 49% of GDP in 2006. Social security contributions will stop falling in 2006, and instead will start rising slowly as a result of higher contributions from the self-employed. These higher contributions will help to pay for the extension of self-employed persons' health insurance to cover small risks from 2006.

This subject continues on the next page

3.2. An overview of public finances 2004-2008

3.2.3. From a balanced budget to the progressive creation of surpluses during the period 2006-2008, Continued

Growing surpluses created by a fall in the spending ratio

Although revenues decline significantly in 2006, the budget balance will be safeguarded by a corresponding decline in the spending ratio. After 2006, spending will continue to fall while the revenue ratio will remain steady. Although the rising cost of health care is causing a progressive increase in “social benefits in kind”, this trend will be neutralised by a reduction in “social benefits other than in kind”, due to the reduction in unemployment benefits and a temporary deceleration in the growth of pensions.

The lower interest charges will further reduce the spending ratio. The result will be expanding budget surpluses, thus providing structural finance for the Ageing Fund. The reduction in interest payments will gradually become less marked. That is not because of any curtailment of the government’s efforts to reduce the debt: the reason is that the current downward trend in the implicit interest rate will not continue in the future.

3.3. The contribution of the various sub-sectors

Need to coordinate fiscal policy

Belgium has a complex administrative structure in which power of decision rests at various levels, depending on the area of responsibility. An effective fiscal policy therefore has to be coordinated at these various levels so that each federated entity contributes to the attainment of the objectives set for the government as a whole. The Belgian experience has shown that a system of clear agreements on the results to be achieved at each level, coupled with the delegation of responsibility to the various sub-sectors, ensures the success of fiscal policy.

Cooperation by agreements

The individual targets for each federated entity are laid down by agreements concluded between the communities or regions and the federal government and containing a clear commitment.

The latest agreement dated 15 December 2000 was updated in 2002 and in 2003. It sets budget targets at all levels of authority up to the end of 2005. The agreement dated 15 December 2000 was based on the annual report of the High Council of Finance dated June 1999, recommending that the federated entities should progress towards a balanced budget in 2010. In ESA terms, that implied a surplus of around 0.1% of GDP for the communities and regions as a whole in the period 2000-2010.

At the end of October, the federal government and the communities and regions began a new round of negotiations with a view to a new budget framework covering the period 2005-2011. The federal government proposed using the annual report of the High Council of Finance dated June 2004 as the starting point for those negotiations. For the communities and regions, adherence to the High Council of Finance recommendations would imply achieving an overall surplus of around 0.2% of GDP in 2005, and maintaining a cumulative financing balance of roughly 0.1% of GDP from 2006.

The local authority spending cycle

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. The target set for the local authorities took account of the clearly evident electoral cycle, with spending and the budget balance fluctuating according to the timing of the local elections. That is one of the reasons why the surplus of 0.2% of GDP achieved in 2004 will be eroded in 2005, falling to 0.1%. For 2006, which is an election year, the balance is once again expected to deteriorate. That explains why 2006 is the only year for which no surplus is planned in the medium term.

This subject continues on the next page

3.3. The contribution of the various sub-sectors, Continued

The local authority spending cycle (continued)

After 2006, surpluses will once again be created at local level, namely 0.1% in 2007 and 0.2% in 2008. Entity II will thus see a steadily growing surplus, rising from 0.1% in 2006 to 0.3% in 2008. The surplus of the social security institutions, held at 0.1% of GDP, and the gradually declining federal government deficit will generate a progressive improvement in the financing balance of Entity I from a deficit of 0.1% of GDP in 2006 to a surplus of 0.3% in 2008. The contribution made by each of the two entities to the creation of a budget surplus will therefore be the same in 2008.

Table 3
Breakdown of the medium-term targets between the various sub-sectors (1)

% of GPD	2003	2004	2005	2006	2007	2008
Primary balance	5,7	4,9	4,5	4,4	4,5	4,7
Entity I	4,9	4,0	3,8	3,9	3,9	4,0
Entity II	0,9	0,9	0,7	0,5	0,6	0,7
Interest charges	5,4	4,9	4,5	4,4	4,2	4,1
Entity I	4,9	4,4	4,1	4,0	3,8	3,7
Entity II	0,5	0,4	0,4	0,4	0,4	0,4
Financing balance	0,4	0,0	0,0	0,0	0,3	0,6
Entity I	-0,1	-0,4	-0,3	-0,1	0,1	0,3
Entity II	0,4	0,4	0,3	0,1	0,2	0,3

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

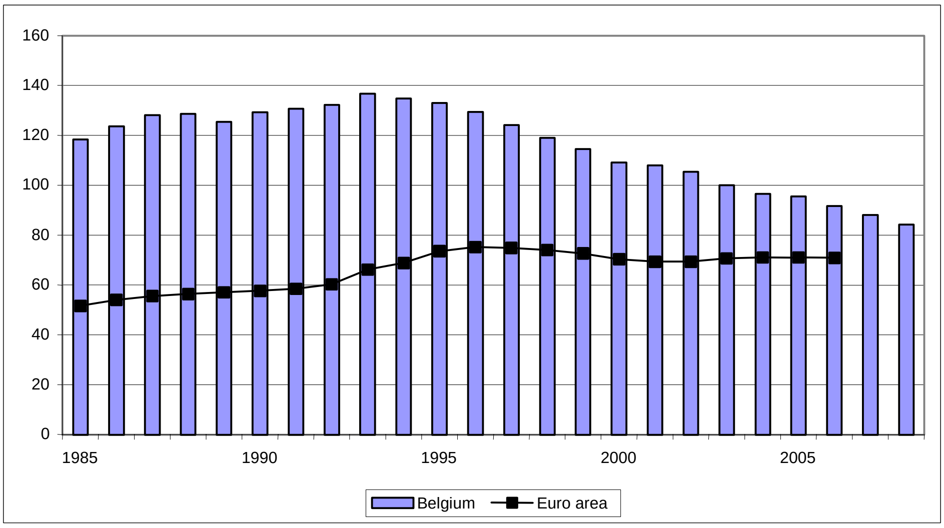
3.4. Debt developments

Debt reduction as the key aim

Since 2000, the Belgian budget has been in balance year after year. However, the country's high level of public debt remains a major concern for the government. Reducing the debt ratio at a sufficiently rapid pace is a crucial element of the government's strategy in the face of the budget effects of the ageing population. Debt reduction therefore remains the key aim of Belgian fiscal policy.

Chart 1

Movement in the debt ratio



A sustained effort to reduce the debt

Chart 1 shows how the Belgian debt ratio has been steadily reduced over the past ten years, from a record high of 137.9% of GDP in 1993 to below the 100% mark in 2003, even though growth has been weak in recent years. Table 4 presents the factors which determine the medium-term movement in the gross debt ratio.

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Table 4
Gross debt ratio

% of GDP	2003	2004	2005	2006	2007	2008
Debt ratio	100,0	96,6	95,5	91,7	88,0	84,2
Movement in the debt ratio	-5,4	-3,4	-1,0	-3,9	-3,7	-3,8
	Factors determining the movement in the gross debt ratio					
Primary balance	5,7	4,9	4,5	4,4	4,5	4,7
Interest charges	5,4	4,9	4,5	4,4	4,2	4,1
Nominal GDP growth	3,2	4,1	4,4	4,4	4,0	4,0
Endogenous change in the debt	-3,7	-4,0	-4,1	-4,1	-3,9	-4,0
Other factors influencing the debt ratio	-1,7	0,6	3,1	0,2	0,2	0,2
p.m.: implicit level of interest rates	5,3	5,1	4,9	4,8	4,8	4,8

2003: under the threshold of 100% of GDP

Clearly, a major effort was made in 2003 to bring the debt ratio down below 100% of GDP. The government achieved that target despite weak economic growth and the widening negative output gap.[3] However, in order to do so it had to use one-off measures, such as taking over the Belgacom pension fund. In accordance with the ESA rules, this operation representing 5 billion euro was included in the financing balance and therefore does not come under the item ‘other factors influencing the debt ratio’. The additional debt reduction resulting from ‘other factors’ is due essentially to two other one-off operations, namely the FADELS/ALESH transaction and the sale of the Credibe assets, representing 3.5 billion and 2.6 billion euro respectively.

2004: reduction of exceptional measures

At the end of 2004 the debt ratio will have been cut to 96.6% of GDP. In 2004, the one-off measures taken to reduce the debt but having no impact on the financing balance of general government were confined to the sale of 5% of the Belgacom shares for a total of 539 million euro and the sale of the stake owned by the public authorities in the airport operator, BIAC, which raised 352 million euro. The effect of the ‘other factors’ on the debt ratio is negative and represents 0.6% of GDP. This negative impact is due partly to the accounting treatment of the transfer of part of the SNCB’s grant from 2004 to 2003. This was in fact already recorded in 2003 and was included as such in the financing balance for 2003, but the actual cash was not paid out until 2004, so that the impact on the debt ratio was not felt until 2004.

This subject continues on the next page

[3] In 2003, the debt ratio was cut to 99.98% of GDP.

3.4. Debt developments, Suite

2005: inclusion of the SNCB's debt in the public debt

In 2005, debt reduction seems to slow down, as the apparent reduction in the debt ratio is only small, from 96.6% to 95.5%. This is due to the federal government's undertaking to incorporate the SNCB's debts in the public debt in 2005; these total 7.4 billion euro, or 2.5% of GDP. The balance of the item 'other factors influencing the debt ratio' therefore increases significantly, to 3.1% of GDP. Disregarding these debts, the total Belgian public debt reduction comes to roughly 3.6 % of GDP in 2005.

2006-2008: unremitting efforts

After 2005 the debt ratio will continue to be cut by an average of 3.8% of GDP per annum, bringing it down to 84.2% in 2008. For the period 2006 – 2008 the figures take no account of any privatisations. Nonetheless, a flat-rate adjustment of 0.2% of GDP is applied to the debt ratio each year, to take account of loans, shares and other equity, which do not influence the financing balance of general government according to the ESA95, but do affect the debt ratio from the cash angle. This adjustment is included under 'other factors influencing the debt ratio'.

3.5. The cyclically adjusted balance

Cyclically adjusted balances as a political instrument

Despite the problems inherent in estimating the output gap and the sensitivity of public finances to GDP growth, the cyclically adjusted balance is an additional indicator for assessing the budget outcome. Cyclically adjusted balances are increasingly used as a policy instrument. They are an essential component of the stability programme. Potential GDP growth was calculated in accordance with the methods[4] used by the European Commission, on the basis of the macroeconomic framework adopted for the preparation of the stability programme. Table 5 summarises the actual balances and the cyclically adjusted balances for the period 2003-2008.

Table 5
Actual balances and cyclically adjusted balances

% of GDP	2003	2004	2005	2006	2007	2008
1. GDP growth at constant prices	1,3	2,4	2,5	2,5	2,1	2,0
2. Actual financing balance	0,4	0,0	0,0	0,0	0,3	0,6
3. Interest charges	5,4	4,9	4,5	4,4	4,2	4,1
4. Potential GDP growth	1,9	1,8	2,0	2,2	2,2	2,1
5. Output gap	-1,1	-0,6	-0,1	0,3	0,1	0,1
6. Cyclical component of the budget	-0,7	-0,4	-0,1	0,2	0,1	0,1
7. Cyclically adjusted financing balance (2-6)	1,0	0,4	0,0	-0,2	0,2	0,5
8. Cyclically adjusted primary balance (7+3)	6,4	5,3	4,6	4,2	4,5	4,6

Output gap shrinking

In 2003, the output gap came to –1.1% GDP, following successive years of weak real growth. The business cycle therefore had a very negative effect of –0.7 percentage point on the financing balance. In 2003, the Belgian government made an adjustment for this negative cyclical effect by means of various non-recurring measures which had a cumulative impact on the financing balance estimated at +1.4% of GDP. Disregarding the impact of these one-off measures as well as the impact of the cycle, there would have been a net deficit of 0.4% of GDP in 2003, which is close to a structural balance.

In 2004, real growth exceeded potential growth by 0.6 percentage point, so that the output gap is rapidly shrinking. The negative cyclical impact on the budget is therefore down to –0.4% of GDP. Since the target for 2004 is a budget which is balanced in real terms, that will create a cyclically adjusted surplus of 0.4% of GDP. Owing to the virtual disappearance of the output gap in 2005, the impact of the cycle on the financing balance will be minimal. The basic assumption underlying the macroeconomic framework is also that the output gap will be eliminated by the end of the period under consideration. From 2006, as the output gap becomes slightly positive, the cyclically adjusted balances will be slightly smaller than the actual balances.

This subject continues on the next page

[4] Attached is a summary of the movement in the key factors determining potential growth.

3.5. The cyclically adjusted balance, Continued

(continued)

After a balanced budget in 2005, a slight deterioration in the cyclically adjusted balance appears in 2006. One reason for this is a substantial additional impact created by the personal income tax reform and, as previously mentioned, the fact that the local authorities are expected to achieve a balanced budget, not a surplus, in 2006.

4. COMPARISON WITH THE STABILITY PROGRAMME FOR 2004-2007 AND SENSITIVITY ANALYSIS

4.1. Comparison with the stability programme for 2004-2007

Table 6 compares the targets of the stability programme for 2004-2007 with the new targets set by the update for 2005-2008.

Table 6
Deviations from the previous programme

% of GDP	2003	2004	2005	2006	2007	2008
GDP growth						
previous update	0,9	1,8	2,8	2,5	2,1	
current update	1,3	2,4	2,5	2,5	2,1	2,0
deviation	0,4	0,6	-0,3	0,0	0,0	
Financing balance						
previous update	0,2	0,0	0,0	0,0	0,3	
current update	0,4	0,0	0,0	0,0	0,3	0,6
deviation	0,2	0,0	0,0	0,0	0,0	
Gross debt ratio						
previous update	100,8	97,6	93,6	90,1	87,0	
current update	100,0	96,6	95,5	91,7	88,0	84,2
deviation	-0,8	-1,0	1,9	1,6	1,0	

Stronger growth in the short term

The economic rebound came sooner than expected, so that growth in 2003 and 2004 ultimately exceeded the figure assumed in the previous stability programme. The peak of the cycle will not be reached in 2005 as originally expected, but will already have occurred in 2004. Moreover the growth forecast of 2.8% for 2005 no longer seems realistic at present, and was revised to 2.5%. The forecasts for 2006 and 2007 have been left unchanged. The resulting growth for the period 2005-2007 is slightly lower.

The government is adhering to its previous budget timetable

In 2003 the speedier growth revival led to a more favourable financing balance than predicted, with a debt ratio lower than forecast. For 2004 and subsequent years, the new forecasts do not call for any adjustment to the budget strategy previously proposed. The Belgian government is maintaining its balanced budget strategy leading to the creation of a structural surplus in 2007 and 2008.

This subject continues on the next page

4.1. Comparison with the stability programme for 2004-2007, Continued

Debt reduction confirmed

Up to 2004, the debt ratio was reduced more quickly than expected in the stability programme for 2004-2007. At the end of 2004, the debt ratio will be one percentage point lower than forecast. From 2005 onwards, the new reduction timetable seems to lag behind the one presented in the previous stability programme. That apparent delay is due to the inclusion of the SNCB's debts in 2005, totalling 2.5% of GDP. Without the SNCB's debts and with the government making the same effort, the debt ratio would have dropped to 93% in 2005. The apparent discrepancy between the previous debt reduction timetable and the current one will gradually diminish from 1.9 percentage point in 2005 to 1 percentage point in 2007. It can therefore be said that, in implicit terms, the debt reduction under the present stability programme is greater than under the previous one.

4.2. Sensitivity analysis

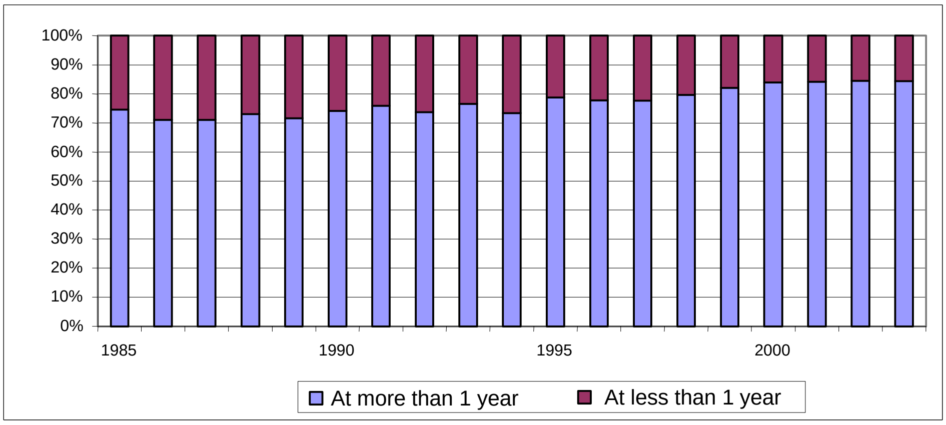
4.2.1. Interest rate sensitivity of the financing balances

Financing balances less sensitive to interest rates

Following the introduction of the euro, the debt denominated in foreign currency was reduced to less than 3% of the total Belgian debt, so that the exchange risk has become more or less negligible. However, in view of the size of the public debt, public finances are still sensitive to changes in interest rates. Although this sensitivity has been significantly reduced, in recent years entities such as the federal government (which holds roughly 90% of the total debt) have concentrated their debt management strategy on reducing the percentage of short-term debt. The proportion of the debt in euro at less than one year has been cut to around 15 % (cf. chart 2).

Chart 2

The gross debt in euro, by maturity



Impact of a change in the interest rate assumptions

Extension of the duration of the existing debt will further delay the impact of a change in the level of interest rates on interest charges. To illustrate this, we examine the impact of a substantial increase in interest rates.

This subject continues on the next page

4.2. Sensitivity analysis

4.2.1. Interest rate sensitivity of the financing balances, Continued

Impact of a change in the interest rate assumptions (continued)

Table 7 shows the effect of an increase in the interest rate assumptions of 100 basis points for the entire period 2005-2008. At the end of the period, the effect would come to around 0.4% of GDP. The increase in the level of interest rates taken as a working assumption is added to the increase already included in the basic assumption. When the budget framework was drawn up, long-term interest rates were assumed to increase from 3.4% in 2004 to 5% in 2008.

Table 7
Impact of a change in the interest rate assumptions

% of GDP	2005	2006	2007	2008
Degree to which interest charges deviate from the scenario	0,1	0,3	0,3	0,4

4.2. Sensitivity analysis

4.2.2. Growth sensitivity of the financing balances

Estimated growth figures and impact of divergent assumptions on growth

The movement in both revenues and public expenditure is determined by the level and composition of economic growth. For the 2004-2008 period, the trend growth rate is expected to average just over 2.1%. The estimate for real average growth is a little higher at 2.3%. This seems to be a realistic assumption, since it is necessary to eliminate an output gap of -1.1% and to take account of the economic situation in 2004 which generated growth of 2.4%. However, the successive adjustments to the growth forecasts in recent years encourage caution. That is why we outline the impact of divergent growth assumptions on the financing balance. In Belgium, the growth elasticity of the financing balance is around 0.6. If we assume that growth is 0.5 percentage point higher or lower than in the base case scenario, we obtain the following results:

Table 8
Sensitivity of the financing balance to changes in growth

	2005	2006	2007	2008	Cumulative impact
Stability programme					
Real GDP growth	2,5	2,5	2,1	2,0	
Financing balance	0,0	0,0	0,3	0,6	
Potential growth					
Real GDP growth	2,0	2,2	2,2	2,1	
Impact on the financing balance	-0,3	-0,2	0,1	0,1	-0,4
Weaker growth					
Real GDP growth	2,0	2,0	1,6	1,5	
Impact on the financing balance	-0,3	-0,3	-0,3	-0,3	-1,2
Stronger growth					
Real GDP growth	3,0	3,0	2,6	2,5	
Impact on the financing balance	0,3	0,3	0,3	0,3	1,2

A balanced budget as a realistic aim

In the absence of additional measures, a growth scenario close to real potential growth would create a small deficit in 2005 and 2006. If the real annual growth were, on average, 0.5 percentage point lower than in the base case scenario, that would lead to a modest deficit of 0.3% over the whole of the period. However, the government regards that as a purely theoretical scenario. In practice, a balanced budget is considered to be a realistic aim. Moreover, if growth is higher than forecast, the government has promised that it will give priority to allocating the additional budgetary scope to reducing the debt ratio.

5. THE QUALITY OF PUBLIC FINANCES

Considerable challenges

For a number of years now, in line with the Lisbon objectives and taking account of the specific challenges facing Belgium, the Belgian authorities have been pursuing numerous reforms to augment growth potential by stimulating employment, improving the fiscal and regulatory environment for enterprises, creating the conditions of competition or strengthening existing competition, and assisting progress towards a knowledge-based society. New initiatives are planned to stimulate innovation and entrepreneurial spirit, to relieve and simplify the administrative burden and to develop infrastructures. But whatever the progress already achieved, the first challenge concerns employment. Improving the efficiency of the labour market, increasing the participation rate and controlling labour costs are therefore key priorities. As regards the budget, some shifts have taken place in favour of priority issues, as part of the overall control of primary expenditure.

5.1. Employment policy

Employment rate improving

The indirect labour cost reduction policy and the assistance and activation policy, in place for many years now and progressively stepped up, have yielded undeniable results in view of the employment figures: the employment rate increased from 58.1% in 1996 to 62.3% in 2001, before the economic slowdown caused a slight dip (61.6% in 2003).

Labour cost reduction and other fiscal measures

Reduction in the tax burden on labour

The tax reform initiated in 2002 and the reduction in social security contributions are helping to bring down the burden of taxes and parafiscal levies on labour. In 2004, additional reductions in social security contributions were granted. The concessions focused in particular on low wage earners, on the one hand, and highly skilled jobs on the other. There was an increase in the pay threshold for the additional reduction aimed at the low skilled, and at the other end of the pay scale, the reduction in employers' social security contributions was augmented in the case of high wage earners. This last measure will be reinforced in 2005.

This subject continues on the next page

Combating the unemployment traps

In addition, the instruments for mitigating the unemployment traps were reviewed in order to make them more effective. The incentive offered by the tax credit, introduced in favour of the lowest incomes via the tax reform, was evidently impaired by the fact that the recipients do not feel the benefit until later, at the time of settling their tax bill. It was therefore decided to replace the tax credit for wage earners with an employment bonus from 1 January 2005, in the form of a reduction in employees' social security contributions, which will be apparent immediately. In addition, the income guarantee allowance for part-time workers will be adapted so that, by working longer hours, they can increase their income.

Reducing labour costs

Overall, the reductions in social security contributions will total almost 5 billion euro in 2005 (1.8% of GDP). Moreover, the progressive implementation of the tax reform is nearing completion; its impact when fully operational in 2006 should be in the order of 1.3% of GDP.

Other measures

Various other targeted fiscal measures, designed to stimulate demand for labour or increase the labour supply, have been introduced or announced. Examples include the extension of exemption from payment of the withholding tax on earned income in the case of researchers, from October 2005, and the increased scope for claiming child-care costs as a tax deductible expense from 1 January 2005.

In addition, the service voucher system, subsidising demand for domestic and local services within a legal framework, introduced in January 2004, is exceeding expectations (7,500 jobs at the end of 2004).

The priorities of a new employment policy

Attention to quality and labour market efficiency

The Belgian employment policy pays special attention to every aspect of labour quality and enhanced labour market efficiency. Thus, the new system of monitoring the unemployed, in force since 1 July 2004, is not confined to checking availability but is also intended to provide more assistance and guidance for job seekers. Initially aimed at young people, this new system will apply to all job seekers under the age of 40 from 1 July 2005.

This subject continues on the next page

Major investment in training

Guidance and training for workers are central to a new vision of employment, reconciling mobility with job security. In these areas, in particular, the role of the federated entities and the social partners is fundamental. The regions and communities are investing huge amounts in their training facilities. They have also initiated moves to develop a system of certificates for skills acquired. As for the social partners, they will have to define a practical and legal framework to implement the agreement already concluded which provides that, by 2010, 50% of workers are to take part in an education and training project every year.

Reconciling work and family life

The new time credit scheme is an initial response to the problem of reconciling work and family life. After obtaining the opinion of the social partners, the government intends to improve the parental leave system. It has also asked the social partners, when conducting intersectoral negotiations, to consider modernising the system of working hours, introducing more flexibility in order to reconcile the needs of businesses with the requirements of the workers.

Other ideas for consideration

Various other ideas were put to the social partners in such areas as the social security provisions and regulations applicable to temporary agency workers, the redeployment of workers by firms in the event of restructuring, and free commuter travel.

The question of those reaching the end of their career

Initiatives concerning the oldest workers

In the past three years there have already been numerous measures introduced to prevent the oldest workers – whose employment rate is particularly low in Belgium - from retiring early from the labour market. These measures concerned labour costs, access to training or support for employees of companies being restructured, ways of cutting working hours, or the availability for the labour market of older unemployed persons and the financial incentives for a return to work.

Wishing to step up these efforts and make them systematic, the government launched a consultation process between the government and the social partners in order to arrive at concrete proposals for improving the participation rate of persons aged over 50.

This subject continues on the next page

5.1. Employment policy, Continued

Initiatives concerning the oldest workers (continued)

A raft of measures is to be presented in the spring of 2005. The government has already proposed around thirty avenues for discussion as a basis for the consultation. They centre on five major topics:

- the statutory retirement age is not an issue: the problem concerns people leaving the labour market early;
- the measures to be taken will not apply to those who have already left the labour market early;
- the new measures will accord special treatment to the small group of employees who have pursued their occupation under difficult working conditions or who have been affected by restructuring;
- the new measures should cut down early retirement by encouraging employees to carry on working longer or to find new work more easily if they lose their job, and by encouraging employers to retain older persons for longer or actually to recruit older persons;
- finally, the new measures should restrict early retirement schemes by making them less attractive to both employers and employees.

5.2. Improving the fiscal and regulatory environment for firms and fostering the entrepreneurial spirit

Reducing the administrative burden

The administrative burden borne by firms and the self-employed in Belgium was assessed by a Federal Planning Bureau survey at the equivalent of 3.4% of GDP in 2002.

In recent years, numerous measures to reduce that burden have already been initiated both at federal level and by the regional authorities. Thus, ways of completing various procedures electronically have been developed (VAT returns, social security declarations and reporting of new employees, etc.). The Belgian authorities intend to continue expanding these facilities and build on the progress already made in regard to a single data collection system.

Now that the Central Enterprise Data Bank (CEDB) has become operational during 2004, the time taken to complete all the administrative procedures for starting a new business has already been greatly reduced. When the CEDB is linked to the civil-law notaries at the beginning of 2005, that should cut the time required to an average of 11 days.

Furthermore, under the "Kafka Plan", by the end of 2004, new regulations will be tested to assess their administrative impact before they are approved.

Improving the tax environment for businesses

The corporation tax reform which took effect on 1 January 2003 reduced the basic rate of the tax from 40.17 to 33.99% (including the complementary crisis contribution). This reform will undergo assessment in July 2005 and be adjusted if necessary.

In addition, a system of rulings (or prior agreements) had been introduced at the same time as the corporation tax reform. Under this system, a decision can be given in advance on the tax implications of a transaction or plan. It was decided to augment the staff responsible, who will be required to give opinions within a shorter timescale from the first quarter of 2005.

New financial instruments for businesses

The authorities want to help expand the funding sources available to businesses in general, and particularly those for innovative SMEs in the start-up phase. The year 2004 saw the entry into operation of various financial instruments launched the previous year (Private Closed-End Equity Funds and Starter Funds).

Finally, risk-taking is bound to be encouraged by the existence of a fair, minimum level of social insurance for entrepreneurs. A progressive increase in pensions for the self-employed has begun. In three years the difference between their pensions and those of employees should be halved. An improvement in their health care cover is also scheduled.

5.3. Competition on the energy markets

Concentrated energy market

Belgium’s gas and electricity markets are now 90% open to competition. The production, distribution and marketing activities has now been separated, or soon will be. The transport and distribution operators have been appointed or will shortly be decided (distribution in Wallonia and Brussels). Nonetheless, the market is still very concentrated.

While gas prices on the Belgian market appear highly competitive, Belgian manufacturers still have to pay a high price for electricity compared to the corresponding costs borne by their European competitors, even though the rate of tax included in the electricity prices is lower in Belgium than in neighbouring countries.

Measures promoting competition

The authorities are therefore planning a series of new measures aimed at facilitating real competition on the energy market. The government is very keen to avoid any excessive concentration of production or distribution capacity. In particular, it will ensure that auctions are organised more efficiently, by finalising the legal framework for the Belgian electricity exchange, Belpex, as soon as possible (establishment of the exchange having been approved in principle in September 2004). Moreover, it will ensure that additional money is invested in the network capacity. Moves will be initiated shortly to develop new ecological production units.

5.4. A qualitative shift within primary expenditure

Policy priorities

With due regard for an overall policy of controlling primary expenditure, the government has made a particular effort in certain areas which it considers merit priority, such as:

- justice;
- the SNCB's investment grant;
- modernisation of the FPS Finance.

To permit a substantial increase in this expenditure within the budget framework set, it was necessary to keep other primary expenditure under very tight control. The efforts made affected almost all the federal and planning public services; one example is a 4.8% cut in operating resources.

6. LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

6.1. Introduction

The problem of population ageing in Belgium

In common with the majority of western countries, Belgium has to contend with major changes in the age structure of its population. These changes will have a considerable impact on social protection and how it is financed. In view of the ageing population, the government has taken a number of steps to ensure the long-term maintenance of a sufficiently high standard of welfare for the community.

Annual policy document on ageing

In order to highlight the importance accorded to guaranteeing effective social protection in general and pensions in particular in the long term, the government set up an Ageing Fund. Establishment of the fund was accompanied by the obligation to produce an annual policy document on ageing. The law of 5 September 2001 guaranteeing a continuing reduction in the public debt and creation of an Ageing Fund provides for three stages in the procedure for preparation of the policy document:

- the Study Committee on Ageing produces an annual report which includes an analysis of the fiscal and social effects of the ageing population;
- the “Public Sector Borrowing Requirement” section of the High Council of Finance formulates its fiscal policy recommendations, taking account of the report by the Study Committee on Ageing;
- finally, the actual policy document on ageing is produced. The government draws up its policy document on the basis of the report by the Study Committee on Ageing and the annual recommendation of the “Public Sector Borrowing Requirement” section of the High Council of Finance. In this policy document the government sets out its policy on the issue of population ageing.

When the 2005 budget was drawn up, this procedure was followed for the third time. The main points of the policy document on ageing are outlined below.

6.2. Population ageing: impact on the budget

Population ageing after 2010

In the coming decades there will be a fundamental shift in the age structure of the Belgian population. The cumulative effects of the declining birth rate and the big increase in life expectancy are causing the population to age. Moreover, a large number of people - the “ baby boom” generation - will be reaching retirement age around 2010. As a result of these trends, by 2030 the number of people aged over 60 will have increased sharply. Table 9 presents figures which summarise what is happening.

Table 9
Changes in the composition of the population (x1000)

	2003	2010	2020	2030	2030-2003	2030-2003 (%)
0-19	2.406,7	2.351,7	2.275,1	2.272,6	-134,1	-5,6
20-59	5.700,5	5.682,2	5.534,4	5.287,9	-412,6	-7,2
60 +	2.260,8	2.485,9	2.904,4	3.327,1	1.066,3	47,2
Total	10.368,0	10.519,8	10.713,9	10.887,6	519,7	5,0
	Percentage of the total population					
0-19	23,2	22,4	21,2	20,9	-2,3	-10,1
20-59	55,0	54,0	51,7	48,6	-6,4	-11,7
60 +	21,8	23,6	27,1	30,6	8,8	40,1
	Dependency ratio					
0-19	42,2	41,4	41,1	43,0	0,8	1,8
60 +	39,7	43,7	52,5	62,9	23,3	58,6
Total	81,9	85,1	93,6	105,9	24,0	29,3

Source: Study Committee on Ageing, Annual Report, April 2004.

Fundamental impact of demographic changes

According to the forecasts, the proportion of persons aged 60 or over in the Belgian population will increase from 21.8 % in 2003 to 30.6 % in 2030. In addition, the numbers of young people (0-19 years) and the population of working age (20-59 years) are expected to decline in absolute terms, even if the total population still increases. By 2030, that will result in a dependency ratio – i.e. the non-working population in relation to the population of working age – of 105.9%.

These demographic changes will obviously have a major impact on the operation of social protection in general and on public revenue and expenditure in particular. In its third report in April 2004, the Study Committee on Ageing updated the estimate of the social and fiscal implications of ageing between 2004 and 2030.

This subject continues on the next page

6.2. Population ageing: impact on the budget, Continued

Table 10
The ageing population: impact on the budget

	2003	2005	2010	2020	2030
Total expenditure (1)	50,9	49,4	47,9	47,8	49,1
Social expenditure	23,4	23,2	23,1	24,6	26,7
Pensions	9,2	9,0	8,8	10,1	12,0
Health care	6,9	7,2	7,8	8,6	9,3
Other social expenditure	7,3	7,0	6,5	5,8	5,4
Interest charges	5,4	4,6	3,8	2,3	1,4
Total revenues (1)	51,3	49,4	49,1	49,1	49,1
	Assumptions				
Movement in labour productivity	1,1	1,8	1,8	1,8	1,8
GDP growth in real terms	0,9	2,9	2,5	1,7	1,5
Male participation rate (20-64)	81,9	82,1	81,6	81,4	81,8
Female participation rate (20-64)	65,9	67,1	68,6	70,0	72,0
Overall participation rate (20-64)	73,9	74,6	75,1	75,7	77,0
Unemployment rate (2)	11,5	11,4	9,9	7,4	6,1

(1) The estimate of total expenditure assumes that the primary expenditure (other than social spending) will remain more or less constant at the 2008 level in terms of GDP. A similar assumption is made for revenues, where the ratio is kept constant at its estimated level for 2008.

(2) This refers to unemployment according to the administrative definition used in Belgium. This differs in certain respects from the European definition used in table 1.

Estimated cost of ageing

It is clear from table 10 and chart 3 that pensions and health care will be the main items accounting for the increased expenditure, although the negative impact of pensions only appears after 2010. The latest Study Committee report estimates the cost of ageing over the period 2003-2030 at 3.4 % of GDP, an upward revision of 0.7% compared to the previous forecast. The increase occurs mainly in the period 2003-2007. The principal cause is the adjustment of the norm for health expenditure growth in real terms, set at 4.5% for that period. The increase in expenditure on pensions and health care is partly offset by a reduction in the weight of other social expenditure, especially that on unemployment and family allowances.

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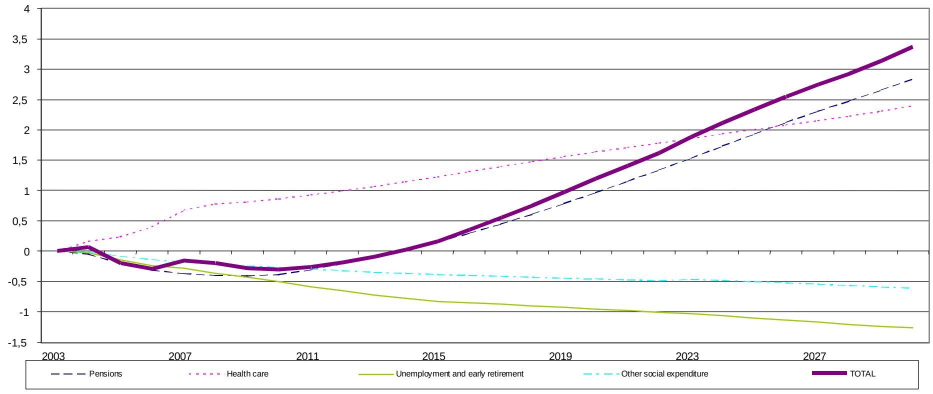
6.2. Population ageing: impact on the budget, Continued

Chart 3

The budgetary cost of ageing (social expenditure in % of GDP)



Expected reduction in GDP growth

The rise in the number of persons aged 60 and over, and the decline in the number of persons aged under 60, also have an influence on the productive capability of the economy. According to the Study Committee's projections, the growth of the Belgian economy should slow during the coming decades to 1.5% of GDP in 2030 (assuming constant productivity of 1.75 %), owing to the diminishing labour force.

6.3. A suitably tailored fiscal policy

Draft strategy on ageing

Aware that the changes in the age structure of the population will place a considerable strain on public budgets over a long period, the Belgian government has developed a multi-pronged strategy for absorbing the additional costs of ageing in the long term.

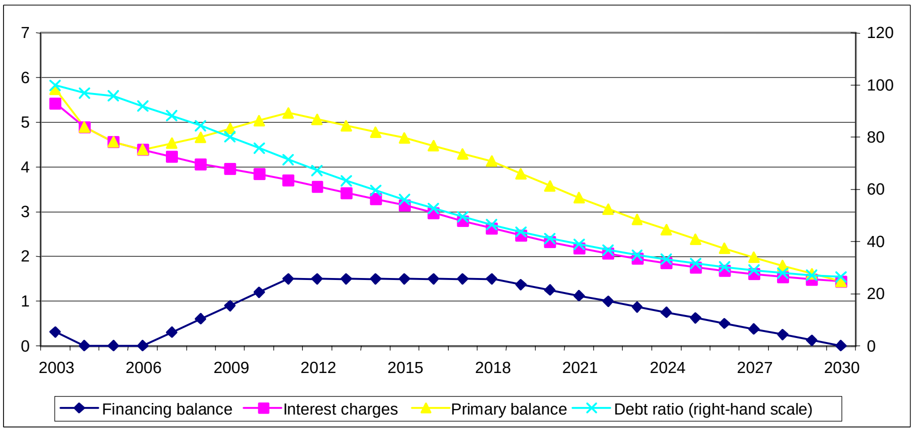
Debt reduction by the progressive creation of budget surpluses

Speeding up the debt reduction

In view of the increasing social expenditure caused by population ageing and considering that it is not desirable to increase the tax burden, the Belgian government is committed to keeping tight control over expenditure. The government wants to continue to maintain a balanced budget in the future by keeping control of the growth of primary expenditure and adjusting it in line with the political priorities. Moreover, in conformity with the recommendation of the High Council of Finance, the public authorities aim to create steadily growing budget surpluses. These surpluses should make it possible to speed up the debt reduction, thus creating greater financial scope for absorbing the expected increase in social expenditure. In addition, the reduction of the surpluses created will ultimately provide additional scope for absorbing the increased social expenditure without immediately causing a deficit or without the need for supplementary taxes or drastic economy measures to cover it. Chart 4 illustrates the dynamics of this strategy.

Chart 4

The main parameters of public finances in an illustrative scenario (% of GDP)



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The Ageing Fund: a financial reserve for the future

Forming a financial reserve: the Ageing Fund

The Ageing Fund was formed for the explicit purpose of financing the increase in pension expenditure over the period 2010-2030. This Fund is therefore a financial reserve formed specifically to absorb the impact of the ageing population on the budget. To that end, it has four possible sources of finance:

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

Ageing Fund capital

As table 11 shows, after 4 years the Ageing Fund has acquired capital of almost 12 billion euro (or a little over 4% of GDP) from these various sources. Under the coalition agreement of 10 July 2003, the Belgian authorities had set themselves the target of increasing the Ageing Fund's capital to 10 billion euro by 2007. At the time of the budget audit, this target was increased to 13 billion. The Ageing Fund currently has capital of 11,948.9 million euro. The target of 13 billion euro by the end of 2007, set at the time of the budget audit, therefore appears realistic. In 2005, moneys allocated to the Ageing Fund should include the proceeds from the sale of part of the government's stake in the airport operator, BIAC.

Restrictions on use of the Ageing Fund capital

The capital built up in the Ageing Fund is not available for unrestricted use. The law of 5 September creating the Ageing Fund stipulates the additional condition that the Fund resources may only be used if the debt ratio is below 60% of GDP. That condition is a further incentive for future governments to maintain the overall strategy for absorbing the costs of ageing. It also prevents the Ageing Fund from being used lightly.

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Table 11
Capital invested in the Ageing Fund

		Amounts invested	Cumulative total
2001	UMTS	437,8	
	capital gains on gold	177,1	
	short-term interest	9,2	
		624,1	**624,1**
2002	NBB profits	429,0	
	short-term interest	2,7	
		431,7	**1.055,8**
2003	Belgacom 2002 dividend	237,3	
	banknotes	214,0	
	Credibe	2.645,7	
		3.096,9	**4.152,7**
2004	Belgacom 2003 dividend	290,0	
	short-term interest	6,2	
	Belgacom pension fund	5.000,0	
	FADELS/ALESH	2.500,0	
		7.796,2	**11.948,9**

6.4. Fiscal policy as part of an overall strategy

More finance for ageing from other budget measures

Under the stability programme, special attention is paid to the contribution which fiscal policy will make towards absorbing the effects of ageing. Although in principle a substantial reduction in the public debt should be sufficient to create the necessary scope in the budget for absorbing the increase in social expenditure, that alone would not leave sufficient resources to cater for other policy initiatives or political challenges. The Belgian economy could lose its dynamism, which would in turn have an impact on public revenues. It would therefore be wrong to base the ageing strategy exclusively on the budget aspect. Several other areas can also make a significant contribution. Employment promotion and, in more general terms, economic growth can augment the financial basis available to absorb the cost of ageing. The measures taken in this regard were explained in section 5.

ANNEXES

Main assumptions used for the medium-term forecasts relating to the international environment

	2003	2004	2005	2006	2007	2008
USD/euro exchange rate (annual average)	113,0	122,2	121,5	121,2	121,0	120,8
GDP growth – world (excl. EU)	4,4	5,1	4,7	3,8	3,8	3,8
GDP growth EU	0,8	2,0	2,4	2,6	2,5	2,4
Growth of relevant external markets	3,3	6,8	6,7	6,6	6,2	5,8
Global imports, by volume (excl. EU)	7,3	9,7	8,5	6,9	6,9	6,9
Oil price (USD)	28,8	37,4	39,0	38,2	39,1	40,1

Source: Federal Planning Bureau, Projections 2004-2009, October 2004.

Key determinants of potential growth

	2003	2004	2005	2006	2007	2008
Potential growth	1,9	1,8	2,0	2,2	2,2	2,1
Output gap (% of potential)	-1,1	-0,6	-0,1	0,3	0,1	0,1
	Contributions to potential growth					
Labour factor	0,5	0,4	0,5	0,6	0,6	0,5
Capital factor	0,5	0,5	0,5	0,6	0,6	0,6
Total factor productivity	0,9	0,9	1,0	1,0	1,0	1,0
	Determinants of potential growth					
Population of working age (growth rate as %)	0,3	0,2	0,4	0,5	0,5	0,4
Trend participation rate (% of population of working age)	71,5	71,3	71,6	71,8	72,0	72,1
Trend component of unemployment	13,9	13,9	13,9	13,8	13,7	13,5
Investment (% of output potential)	19,7	19,7	20,4	20,8	20,7	20,7
Capital depreciation rate	5,9	6,0	6,1	6,1	6,2	6,2

Source: Federal Planning Bureau, Projections 2004-2009, October 2004.

Targets for public finances under successive stability programmes

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
	Financing balance										
Programmes											
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	
2005-2008							0,0	0,0	0,0	0,3	0,6
Actual figures	-0,6	-0,4	0,2	0,6	0,1	0,4					
	Debt ratio										
Programmes											
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	
2005-2008							96,6	95,5	91,7	88,0	84,2
Actual figures	119,0	114,5	109,1	108,0	105,4	100,0					