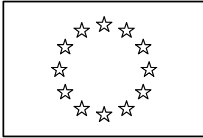

EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

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DECEMBER 2004 UPDATE OF THE STABILITY PROGRAMME OF BELGIUM (2004-2008)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS[1]

The Belgian 2004 stability programme update was approved by the Belgian government on 3 December 2004 and submitted on 6 December 2004. The programme covers the period 2004-2008. It broadly complies with the data requirements of the "code of conduct on the content and format of stability and convergence programmes" [2]. The programme does not include compulsory data on short- and long-term interest rates and a number of optional variables.

The programme is based on the assumption of economic growth of 2.5% in 2005 and 2006, slowing down to 2.0% in 2008. The macroeconomic scenario for 2005 and 2006 is very close to the Commission services' autumn 2004 forecast. The real GDP growth rates projected for 2007 and 2008 are marginally lower than the Commission services estimate for potential economic growth obtained from an application of the commonly agreed methodology to the figures of the programme. Accordingly, the macroeconomic scenario can be considered plausible.

The budgetary strategy outlined in the update aims to keep a balanced budget or a small surplus and maintain the debt ratio on a downward trend to prepare for the budgetary impact of the ageing population. The update targets a balanced budget in 2005 and 2006 and a surplus of 0.3% of GDP in 2007. This is the same as in the previous programme despite lower growth assumptions for 2005 in the current update. In 2008 a surplus of 0.6% of GDP is planned. Primary surpluses are projected to remain at around 4.5% of GDP, slightly lower than the projected 2004 outturn of 4.9% of GDP. This is due to the ongoing implementation of the 2001 direct tax reform and higher public investment ahead of the 2006 local elections. Primary surpluses should start rising again toward the end of the programme period. The programme foresees a declining interest burden, mainly as a result of the ongoing debt reduction. Revenue is expected to decrease towards 2006 and remain stable afterwards, while primary expenditure decreases slightly towards 2008. The cyclically-adjusted balance is projected to remain positive throughout the programme period, decreasing from a surplus of 0.5% of GDP in 2004 to 0.1% in 2006 and then picking up again to 0.9% in 2008.

The budgetary strategy of the update appears to be broadly balanced. So far the Belgian government has not yet announced what measures it will take in order to keep the 2006 budget in balance, despite the decrease by 0.3% of GDP as a result of the continued implementation of the 2001 direct tax reform and the fact that the 2005 budget benefits from a series of smaller one-off operations (in total about 0.2% of GDP). Also, while the macroeconomic scenario is plausible, the Belgian government balance remains relatively sensitive to changes in economic growth (sensitivity of 0.6). Finally, there is also some risk as regards the control of primary expenditure, mainly at the level of the social security system. The overrun recorded in the health care system in 2004 (despite the already high annual real growth target of 4.5%) suggests continued strong growth of

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[1] This technical analysis, which is based on information available up to 26 January 2005, accompanies the recommendation by the Commission for a Council opinion on the update of the stability programme, which the College adopted on 2 February 2005. It has been carried out by the staff of and under the responsibility of the Directorate-General for Economic and Financial Affairs of the European Commission. Comments should be sent to Gerrit Bethuyne (gerrit.bethuyne@cec.eu.int).

[2] Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, document EFC/ECFIN/404/01 - REV 1 of 27.06.2001 endorsed by the ECOFIN Council of 10.07.2001.

these expenditures. While new measures were announced near the end of 2004 to reduce costs in health care (in total 0.2% of GDP), their effectiveness is still difficult to evaluate. On the other hand, for the greater part of 2005 the minister of social affairs has been given a mandate to take necessary measures without prior parliamentary (or other) consultation, to enable a quick response to a possible further overrun. More generally, the Belgian government has also gained credibility for keeping its commitment to take measures to maintain a balanced budget. In view of this risk assessment, the risks to the budgetary targets appear to be broadly balanced and the budgetary stance in the programme is sufficient to adhere to the Stability and Growth Pact's medium-term objective of a budgetary position of close-to-balance or in surplus. In addition, there is a sufficient margin against the risk of breaching the 3% of GDP reference value for the deficit in the event of normal cyclical fluctuations.

The debt ratio has been falling steadily since 1993 but remains well above the 60% of GDP reference value. In 2004 it fell to 96.6%, less than foreseen in the previous update of the stability programme. Continued high primary surpluses and reduced interest payments are the main drivers for a further reduction of the debt ratio. Stock-flow adjustments are generally small, but in 2005 the government is planning to assume a EUR 7.4 billion debt from the national railway company SNCB (2.5% of GDP). The integration of the SNCB debt slows down the debt reduction in 2005, but otherwise the planned debt reduction is faster than scheduled in the previous update. The projected path for the debt is affected by the same uncertainties as the deficit, but all in all it can be considered plausible.

As mentioned above, the update outlines a number of planned measures to contain the cost of health-care expenditure (such as measures to control the cost of medicines or a case-related payment system for the most frequent types of medical treatment in hospitals) within its real growth objective of 4.5% annually. As regards initiatives to address low employment rates, the programme announces negotiations between social partners and the government which should result in new measures to limit access to the system of early retirement and to increase further the effective number of working years on the basis of social agreements. However, the outcome of these negotiations is still uncertain. All in all, the process of removing incentives to early retirement remains slow and few new concrete initiatives have been announced.

With regard to the long-term sustainability of the public finances, Belgium appears to be at some risk on grounds of the current level of gross debt. While declining, the debt ratio is still high and a steady reduction hinges upon sustaining high primary surpluses for a prolonged period. The strategy for coping with the budgetary cost of an ageing population outlined in the programme is mainly based on gross debt reduction through maintaining a balanced budgetary position or a small surplus (itself relying primarily on primary expenditure restraint) and an ageing fund. Containing primary expenditures might prove difficult, especially in the health care sector, but is important in view of the government's strategy of reducing the tax burden in order to create employment. Given the projected increase in the old-age dependency ratio (measured as the number of persons over the age of 60 per 100 persons aged 20 to 59), pursuing this broad strategy with determination is crucial to the achievement of long-term sustainability.

Regarding the Broad Economic Policy Guidelines, the economic policies outlined in the update are broadly consistent with the country-specific guidelines in the area of public finances. In particular, the update ensures that the debt ratio is kept on a sustained declining trend. In view of recent overruns in health-care spending (for which the target growth rate in real terms is set at a relatively high annual 4.5%), some risk exists in breaching the guideline to limit the real expenditure growth in entity I (federal

government and social security) to 1.5%. Therefore, maintaining high primary surpluses and limiting real expenditure growth is important, especially in view of the financial needs implied by ageing.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007	2008
Real GDP (% change)	**SP Dec 2004**	**2.4**	**2.5**	**2.5**	**2.1**	**2.0**
	COM Oct 2004	2.5	2.5	2.6	n.a.	n.a.
	SP Nov 2003	*1.8*	*2.8*	*2.5*	*2.1*	*n.a.*
HICP inflation (%)	**SP Dec 2004**	**1.9**	**2.0**	**1.8**	**1.8**	**1.8**
	COM Oct 2004	2.0	1.9	1.8	n.a.	n.a.
	SP Nov 2003	*1.4*	*1.4*	*1.4*	*1.4*	*n.a.*
General government balance (% of GDP)	**SP Dec 2004**	**0.0**	**0.0**	**0.0**	**0.3**	**0.6**
	COM Oct 2004	-0.1	-0.3	-0.5	n.a.	n.a.
	SP Nov 2003	*0.0*	*0.0*	*0.0*	*0.3*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2004**	**4.9**	**4.5**	**4.4**	**4.5**	**4.7**
	COM Oct 2004	4.8	4.2	3.6	n.a.	n.a.
	SP Nov 2003	*5.1*	*4.8*	*4.7*	*4.8*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP Dec 2004**[1]	**0.5**	**0.3**	**0.1**	**0.5**	**0.9**
	COM Oct 2004	0.4	0.0	-0.4	n.a.	n.a.
	SP Nov 2003[1]	*0.6*	*0.2*	*0.0*	*0.3*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2004**	**96.6**	**95.5**	**91.7**	**88.0**	**84.2**
	COM Oct 2004	95.8	94.4	90.9	n.a.	n.a.
	SP Nov 2003	*97.6*	*93.6*	*90.1*	*87.0*	*n.a.*

Note:
[1]Commission services calculations on the basis of the information in the programme.
Sources:
Stability programme (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations.

1. INTRODUCTION

The Belgian 2004 stability programme update was approved by the Belgian government on 3 December 2004 and submitted on 6 December 2004. The programme covers the period 2004-2008.

The programme broadly complies with the data requirements of the "code of conduct on the content and format of stability and convergence programmes". In terms of data requirements, it does not provide detailed information on short-term and long-term interest rates, which are compulsory. Some information on interest assumptions can however be found in the text. The programme also does not provide some optional data, such as 'interest income' or 'privatisation receipts'[3]. The model structure from Annex 2 of the code of conduct has been largely followed, except for section 7 (horizontal issues affecting public finances), which has not been included as a separate section. However, the required information was reported in other sections.

2. MACROECONOMIC DEVELOPMENTS

The macroeconomic scenario in the update is based on the autumn forecast of the Federal Planning Bureau. Compared to the previous update, the present one assumes markedly higher GDP growth in 2004 and more modest growth for 2005. This assumption is in line with recent developments and is also consistent with the Commission services autumn 2004 forecast. The growth assumptions for 2006 remain unchanged as compared to the previous update and differ only marginally from the Commission services forecast. In terms of contributions to growth, the Commission services forecast puts somewhat more emphasis on the contribution of final domestic demand. The programme also assumes a somewhat higher unemployment rate. Regarding external assumptions the update is marginally more favourable in terms of the assumed growth rate for the EU and the development of oil prices than the Commission services forecast, whereas the assumptions on economic growth outside the EU are slightly more pessimistic. Both forecasts project similar inflation rates.

[3] Other (optional) missing variables are: US interest rates (long-term and short-term), nominal effective exchange rates (euro-area and EU), US and Japan growth rates, world import prices and non-oil commodity prices.

Table 1: Comparison of macroeconomic developments and forecasts

	2004		2005		2006		2007	2008
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	2.5	2.4	2.5	2.5	2.6	2.5	2.1	2.0
Contributions:								
- Final domestic demand	2.0	1.7	2.6	2.4	2.7	2.5	1.8	1.8
- Change in inventories	0.1	0.3	-0.1	0.0	0.1	0.0	0.0	0.0
- External balance on g&s	0.4	0.4	-0.1	0.1	-0.2	0.0	0.3	0.2
Employment (% change)	0.4	0.4	0.7	0.8	0.8	0.9	0.7	0.7
Unemployment rate (%)	8.2	8.5	8.1	8.5	7.9	8.3	8.2	8.1
HICP inflation (%)	2.0	1.9	1.9	2.0	1.8	1.8	1.8	1.8
GDP deflator (% change)	2.0	1.7	2.1	1.9	2.0	1.9	1.9	2.0
Current account (% of GDP)	4.5	n.a.	4.3	n.a.	4.1	n.a.	n.a.	n.a.

Sources:
Commission services autumn 2004 economic forecasts (COM); stability programme update (SP)

The programme's growth projections for 2007 and 2008 are consistent with the Commission services' calculations (according to the commonly agreed methodology) of potential growth and the output gap for Belgium based on the programme, shown in table 2. Potential growth increases slightly from 2.0% in 2004 to about 2.2% in the following years, and for 2007 and 2008 GDP growth is only marginally lower than potential growth. The decomposition of the potential growth rate (i.e. the contributions of labour, capital accumulation and total factor productivity) until 2006 is nearly identical to the Commission services forecast. The output gap almost closes in 2006 but widens again afterwards and thus remains negative throughout the programme period. Overall the macro-economic scenario can be considered plausible.

Table 2: Sources of potential output growth

	2004		2005		2006		2007	2008
	COM	SP[3]	COM	SP[3]	COM	SP[3]	SP[3]	SP[3]
Potential GDP growth[1]	2.0	2.0	2.2	2.2	2.3	2.2	2.2	2.1
Contributions:								
- Labour	0.6	0.5	0.6	0.6	0.6	0.6	0.6	0.4
- Capital accumulation	0.4	0.4	0.5	0.5	0.6	0.6	0.6	0.6
- TFP	1.0	1.0	1.1	1.0	1.1	1.1	1.1	1.1
Output gap[2,3]	-0.8	-0.8	-0.5	-0.5	-0.2	-0.2	-0.4	-0.5

Notes:
1 based on the production function method for calculating potential output growth
2 in percent of potential GDP
3 Commission services calculations on the basis of the information in the stability programme update

Sources: *Commission services autumn 2004 economic forecasts (COM); Commission services calculations*

3. BUDGETARY IMPLEMENTATION IN 2004

As in the previous update of the programme, the current update foresees a balanced budget for 2004, close to the Commission services autumn forecast which predicted a small deficit of 0.1% of GDP. However, there are some differences in how this was achieved compared to what was expected in the previous update.

At the time the previous update was submitted, there was still some uncertainty about the statistical treatment of a transfer of EUR 5 billion (1.9% of GDP) from the Belgacom pension fund. Since it involved payments in 2003 (1.3% of GDP) and 2004 (0.5% of GDP), it was originally planned to split the transfer between the 2003 and 2004 budget outcomes. However, in line with a Eurostat decision stipulating that "the operation has to

be recorded when the government becomes legally responsible for the payment of the future pension benefits to the employees previously covered by their employer scheme", the transfer had to be accounted entirely in 2003. The shift in revenue from the 2004 to the 2003 budget was offset by a decision by the Belgian authorities to advance to 2003 two expenditure items which were originally planned to burden the 2004 budget outcome, namely subsidies to the state railway company SNCB (0.4% of GDP) and a planned capital injection to postal company La Poste (0.1% of GDP).

For 2004 the government also planned a tax amnesty law ('déclaration libératoire unique'), which made it possible to legalise funds which had not been declared previously for tax purposes, against a single levy. However, the projected revenue of EUR 850 million (0.3% of GDP) was not met: by 15 December 2004, revenues of about EUR 100 million were recorded and the final outcome was estimated by the government on 6 January 2005 at EUR 200 million (0.1% of GDP). Additionally an overrun occurred in the health care system (0.2% of GDP). On the other hand, revenue from VAT and direct taxes are expected to have exceeded the projected value by about 0.4% of GDP in 2004, reflecting better-than-expected cyclical developments (real GDP growth in 2004 is estimated at 2.4% in the current update, against 1.8% in the previous one). In a nutshell, in 2004 better-than-expected cyclical developments offset revenue shortfalls on one-off income and a health care expenditure overrun.

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

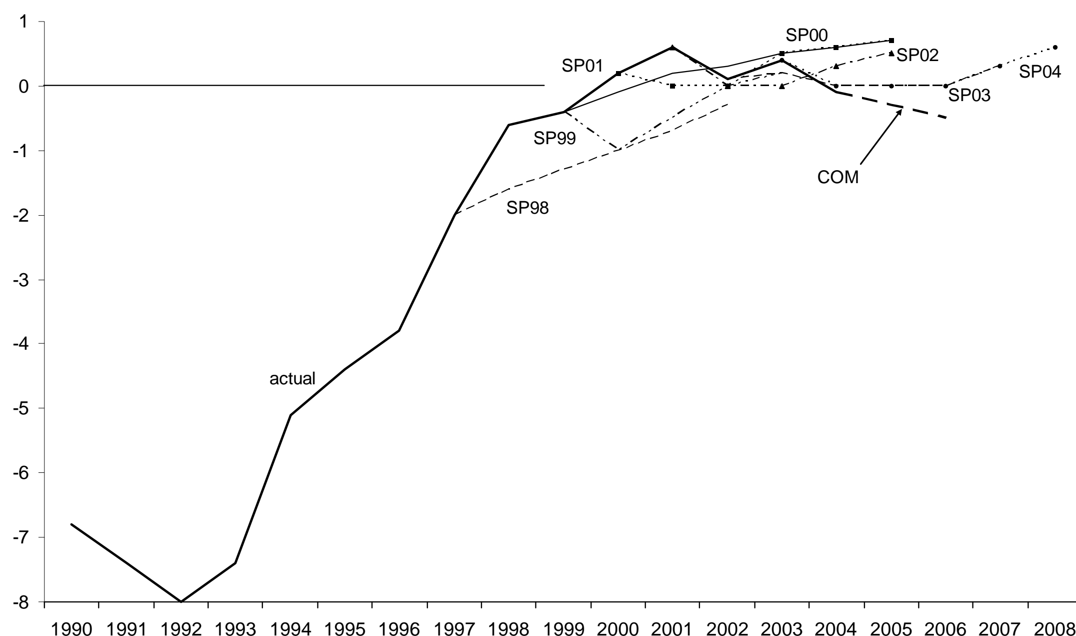
4.1. Evolution of budgetary targets in successive programmes

Table 3 gives an overview of the evolution of budgetary targets in successive updates of the programme. In terms of the general government balance projections until 2007, there is no difference between the current and previous update despite considerably higher growth in 2004 and lower growth assumptions in 2005. The difference between the 2002 and 2003 update was the result of a significant downward revision in the GDP growth forecast for 2003 and 2004. While the path for the general government balance is unchanged, the current update projects higher revenue and expenditure (as a percentage of GDP) than the previous programme; in 2007 the difference amounts to 0.9 percentage points.

Table 3: Evolution of budgetary targets in successive programmes

		2003	2004	2005	2006	2007	2008
General government balance (% of GDP)	**SP December 2004**	**0.4**	**0.0**	**0.0**	**0.0**	**0.3**	**0.6**
	SP November 2003	0.2	0.0	0.0	0.0	0.3	n.a.
	SP November 2002	*0.0*	*0.3*	*0.5*	*n.a*	*n.a*	*n.a*
General government expenditure (% of GDP)	**SP December 2004**	**50.9**	**49.6**	**49.4**	**49.0**	**48.8**	**48.5**
	SP November 2003	50.2	49.6	49.0	48.4	47.9	n.a.
	SP November 2002	*48.9*	*48.4*	*48.0*	*n.a*	*n.a*	*n.a*
General government revenues (% of GDP)	**SP December 2004**	**51.3**	**49.6**	**49.4**	**49.0**	**49.1**	**49.1**
	SP November 2003	50.5	49.7	49.0	48.4	48.2	n.a.
	SP November 2002	*48.9*	*48.7*	*48.4*	*n.a*	*n.a*	*n.a*
Real GDP (% change)	**SP December 2004**	**1.3**	**2.4**	**2.5**	**2.5**	**2.1**	**2.0**
	SP November 2003	0.9	1.8	2.8	2.5	2.1	n.a.
	SP November 2002	*2.1*	*2.5*	*2.5*	*n.a.*	*n.a.*	*n.a.*
Sources: Stability programmes (SP)							

Chart 1: Evolution of budgetary targets (in % of GDP) in successive programmes



Sources: Commission services autumn 2004 economic forecasts (COM); stability programmes (SP)

4.2. Budgetary targets in the updated programme

The budgetary strategy outlined in the update aims at keeping the budget close to balance or in small surplus and maintaining the debt ratio on a downward trend to prepare for the ageing shock ahead. It entails a budgetary position in balance in 2005 and 2006 and a surplus of 0.3% of GDP in 2007. This is the same as in the previous programme despite current lower growth assumptions for 2005. In 2008 a surplus of 0.6% of GDP is foreseen.

Revenue as a percentage of GDP is expected to decrease towards 2006, mainly as a result of the continued implementation of the 2001 tax reform which will have reached its full impact by 2006 (see box 3 on page 18), and of reductions in social security contributions decided in 2004. After a small increase projected for 2005, primary expenditure as a percentage of GDP is expected to decrease, mainly as a result of reductions in collective consumption and in transfers and subsidies. In 2005 and 2006 some increase in public investment expenditure by local governments is expected in the run-up to the 2006 local elections, but by 2008 the share of public investment is projected to return to its original level of 2004.

The 2004 update also projects a continued decrease in interest charges, as a result of the ongoing debt reduction and refinancing of existing debt at lower interest rates (the 2004 implicit interest rate for Belgian government debt was 5.1%, whereas the long-term interest rate assumed in the programme was 3.4%). In the update, the debt refinancing effect is expected to fade away towards the end of the programme horizon, with the expected long-term interest rate increasing to 5%.

In the context of the federal structure of Belgium, keeping a balanced budget requires strict budgetary coordination between the federal and regional governments[4]. The

[4] A convention between federal and regional governments has been in force since 15 December 2000 (updated in 2002 and 2003), setting the budgetary targets for each layer of general government until

programme (based on the recommendations of the national High Council for Public Finance) includes a continued surplus by regional and local governments and a reduction of the federal deficit into a small surplus by 2008. According to the update the deficit for entity I (federal government and social security) of 0.4% of GDP in 2004 will be turned into a surplus of 0.3% of GDP by 2008. The surplus of 0.4% of GDP in 2004 in Entity II (regional and local authorities) is expected to decrease to 0.1% by 2006 as a result of increased public investment in the run-up to the 2006 local elections. After that, the surplus should be restored at 0.3% of GDP.

Table 4: Composition of the budgetary adjustment

(% of GDP)	2003	2004	2005	2006	2007	2008	Change: 2008-2004
Revenues	**51.3**	**49.6**	**49.4**	**49.0**	**49.1**	**49.1**	**-0.5**
of which:							
- Taxes & social security contributions	46.9	47.2	47.0	46.6	46.8	46.7	**-0.5**
- Other (residual)	4.4	2.4	2.4	2.4	2.4	2.3	**-0.1**
Expenditure	**50.9**	**49.6**	**49.4**	**49.0**	**48.8**	**48.5**	**-1.1**
of which:							
- Primary expenditure	45.5	44.8	44.9	44.7	44.6	44.4	**-0.4**
of which:							
Gross fixed capital formation	1.6	1.6	1.8	1.9	1.7	1.6	**0.0**
Collective consumption	15.5	15.4	15.2	15.0	15.0	15.0	**-0.4**
Transfers & subsidies	24.9	24.8	24.6	24.5	24.6	24.5	**-0.3**
Other (residual)	3.5	3.0	3.3	3.3	3.3	3.3	**+0.3**
- Interest payments	5.4	4.9	4.5	4.4	4.2	4.1	**-0.8**
Budget balance	**0.4**	**0.0**	**0.0**	**0.0**	**0.3**	**0.6**	+0.6
Primary balance	**5.7**	**4.9**	**4.5**	**4.4**	**4.5**	**4.7**	**-0.2**

Sources:
Stability programme update; Commission services calculations

There are a number of risks attached to the budgetary targets in the update. First, although considerably less than in previous years, the 2005 budget still contains a series of small one-off operations amounting in total to about 0.2% of GDP which will require new measures to compensate in 2006. Additionally, as a result of the direct tax reform of 2001 government revenue will decrease in 2006 by about 0.3% of GDP. The Belgian government has not yet announced which measures it will take to offset both effects in order to keep the 2006 budget in balance.

Second, there is also some risk as regards the control of primary expenditure, mainly at the level of the social security system. The overruns recorded in the health care system in 2004 (EUR 634 million, more than 0.2% of GDP) suggest continued strong dynamics of these expenditures. The overrun happened despite the already high annual real growth target of 4.5% for health care expenditure for 2003-2007. The 2005 budget contains some measures to reduce costs in this area and more recently (at the end of 2004) a set of additional measures has been announced (in total 0.2% of GDP, see box 1), but their effectiveness is still difficult to evaluate. Overall, the Belgian government should strictly adhere to the recommendation in the Broad Economic Policy Guidelines for the period

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2005. So far the convention has proven to be an effective instrument to meet the budgetary targets set for the general government sector. Negotiations for a new convention for 2005-2011 started in October 2004, based on the recommendations of the national High Council for Public Finance.

2003-2005 to limit real expenditure growth in entity I (federal government and social security) to 1.5%.

Finally, the Belgian government balance remains relatively sensitive to changes in economic growth. The programme assumes a sensitivity of 0.6 (in line with Commission services estimates), which is relatively high compared to other countries. An unanticipated slowdown of the economy may therefore have a substantial impact on the Belgian budget[5]. This could be especially important for 2005 and 2006, should the current boom in economic growth end sooner than anticipated. In recent years economic growth has been strongly based on domestic demand (mainly consumption). Should consumer confidence fall, corrective measures to keep the budget balance in line with the update's projections would be required.

On the other hand, there are also positive factors reducing the risk. First the macro-economic scenario is plausible. Second the Belgian government has gained credibility for keeping its commitment to take measures to maintain the budget in balance. Third, recently new measures have been taken to reduce the cost of health care, and for the larger part of 2005 the minister of social affairs has been given a mandate to take necessary measures without prior parliamentary (or other) consultation, to enable a quick response to a possible further overrun. Therefore, the risks to the budgetary strategy appear to be broadly balanced.

Box 1: The budget for 2005

The key targets in the 2005 budget are to keep the budget in balance and to reduce debt further from 96.6% of GDP in 2004 to 95.5% of GDP in 2005. The 2005 budget includes the continued implementation of the 2001 tax reform and the impact of measures decided in the course of 2004 to reduce social security contributions. The former will lead to a further reduction of government revenue by 0.2% of GDP in 2005, the latter costs about 0.1% of GDP. Since the government aims to maintain the social security system in balance, it has taken measures to broaden the tax base such as expanding social security contributions to certain benefits in kind (use of corporate cars), while avoiding new taxes on labour.

On the expenditure side the budget plans a number of cuts in various primary expenditures to limit the growth of federal public services to 1%, with justice and security as the main exceptions (4.1% growth allowed). In the social security system, real growth in health care spending is again limited to 4.5% (see main text).

To avoid an overrun in the health care system as in 2004, the 2005 budget contains some measures to reduce costs, and more recently (at the end of 2004) a set of additional measures was announced (expected to reduce expenditure by 0.2% of GDP in total). They include measures to control the cost of medicines, a case-related payment system for the most frequent types of medical treatment in hospitals and a temporary freezing of medical fees.

In the margin of the 2005 budget, the government also decided to take measures to reduce the backlog in tax collection. In 2004 the Belgian government recorded a cumulative backlog of EUR 22.5 billion (8% of GDP) in outstanding tax claims (VAT and direct taxes), difficult or temporarily impossible to collect. Measures proposed to increase the efficiency of tax collection should reduce the backlog by some 0.1% of GDP. Additionally, the government is planning to sell a portfolio of 'bad tax claims' to financial institutions, worth 0.1% of GDP. The agreement would also include technical assistance from the financial sector to the finance ministry.

Table 5 shows that the Commission services autumn 2004 forecast, based on a no-policy-change assumption, projected an increasing deficit from 0.1% of GDP in 2004 to 0.5% by 2006, whereas the update assumes a balanced budget in each year. For 2004, the difference between the forecast and the programme can be explained by more recent

[5] The impact of a 0.5 percentage point slowdown of economic growth would create a deficit of 0.3% in 2005 and 2006 (or reduce the surplus by the same amount in 2007 and 2008).

information pointing to higher-than-expected proceeds from VAT and direct taxes. As regards 2005, various measures in the health care system taken at end-2004 would somewhat reduce the deficit projected by Commission services. In addition, some measures with an unknown financial outcome (such as increased efforts to reduce tax fraud) were not included in the Commission services forecast. As for 2006, the deficit predicted in the Commission services forecast is based on a no-policy change assumption since there is no information on how the government plans to compensate for lower proceeds from one-off measures and lower direct tax revenue as a result of the 2001 direct tax reform.

Table 5: Output gaps and cyclically-adjusted (primary) balances CA(P)B)

	2003		2004		2005		2006		2007	2008	Change: 2008-2004
	COM	SP	COM	SP	COM	SP	COM	SP	SP	SP	SP
Budget balance[2]	0.4	0.4	-0.1	0.0	-0.3	0.0	-0.5	0.0	0.3	0.6	0.6
Output gap[1,3]	-1.2	-1.2	-0.8	-0.8	-0.5	-0.5	-0.2	-0.2	-0.4	-0.5	0.3
CAB[1,2]	1.1	1.1	0.4	0.5	0.0	0.3	-0.4	0.1	0.5	0.9	0.4
CAPB[1,2]	6.5	6.5	5.3	5.4	4.5	4.8	3.7	4.5	4.7	5.0	-0.4

Notes:
[1] SP (stability programme): Commission services calculations on the basis of the information in the update
[2] in percent of GDP
[3] in percent of potential GDP
Sources:
Commission services autumn 2004 economic forecasts (COM); Commission services calculations

The cyclically adjusted (primary) balance derived by Commission services on the basis of the information in the update (using the commonly agreed methodology) and that of the Commission services autumn 2004 forecast both show a deterioration until 2006 as a result of an increase in public investment by local authorities and the ongoing implementation of the 2001 tax reform. But whereas the Commission services forecast predicts a swing from a 0.4% of GDP surplus in cyclically-adjusted terms in 2004 to a deficit of 0.4% of GDP in 2006 (on a no-policy-change basis), calculations derived from the programme show a less pronounced deterioration until 2006 followed by a marked improvement thereafter, resulting in a positive cyclically-adjusted balance throughout the period.

However, the Belgian government has gained credibility for keeping its commitment to take measures that maintain the budget in balance. Taking into account that the risks to the budgetary targets appear to be broadly balanced, the budgetary stance in the programme seems sufficient to adhere to the Stability and Growth Pact’s medium-term objective of a budgetary position of close-to-balance or in surplus. In addition, it can be concluded that there is a sufficient margin against the risk of breaching the 3% of GDP reference value for the deficit in the event of normal cyclical fluctuations[6].

4.3. Sensitivity analysis

In view of the high debt ratio and the relatively large share of interest payments (projected to decline from 4.9% of GDP in 2004 to 4.1% in 2008), the update presents a sensitivity analysis to evaluate the budgetary impact of a one percentage point increase in

[6] The Commission services’ most recent estimate of the minimum benchmark for Belgium is -0.7% of GDP (Public Finances in EMU, European economy 3/2002, p.48).

the interest rate over the entire programme horizon (on top of the assumed increase of interest rates from 3.4% in 2004 to 5% in 2008). The impact increases gradually towards the end of the programme as more and more debt is to be refinanced at higher interest rates, and reaches a maximum impact of 0.4% of GDP in 2008. This assessment seems broadly plausible. The Belgian government has been systematically reducing the share of its short-term debt (to a current 15% of total debt) so that the total implicit interest rate of Belgian government debt reacts rather slowly to interest rate shocks.

Commission services simulations of the cyclically-adjusted balances under the assumptions of (i) a sustained 0.5 percentage point deviation from the growth targets in the programme over the 2004-2008 period; (ii) trend output based on the HP-filter[7] and (iii) no policy response (notably, the expenditure level is as in the central scenario[8]) reveal that by 2008 the cyclically-adjusted balance is 0.8% below the central scenario. Hence, in case of persistently lower growth, additional measures of around 0.8% of GDP would be necessary to keep the public finances on the path targeted in the central scenario.

5. EVOLUTION OF THE DEBT RATIO

The Belgian debt ratio remains very high, but is on a steady downward path since 1993 (see chart 2). This mainly stems from high primary surpluses and a number of one-off operations. In 2003-2005 several one-off operations have been used by the Belgian government to reduce the deficit or just government debt (see box 2). Instead of directly reducing the debt, the proceeds from ‘below the line’ operations were often used to finance the ageing fund, which reduced the debt indirectly[9]. As for the years ahead, the debt ratio should stay on a downward path, reaching 84.2% of GDP by the end of the programme horizon. For 2004 the objective set in the previous update (97.6% of GDP) was largely met (96.6% of GDP), partly as a result of higher-than-anticipated economic growth (2.4% instead of 1.8% projected in the last update). The exchange rate risk related to the debt is extremely limited, as only 3% of Belgian debt is denominated in foreign currency.

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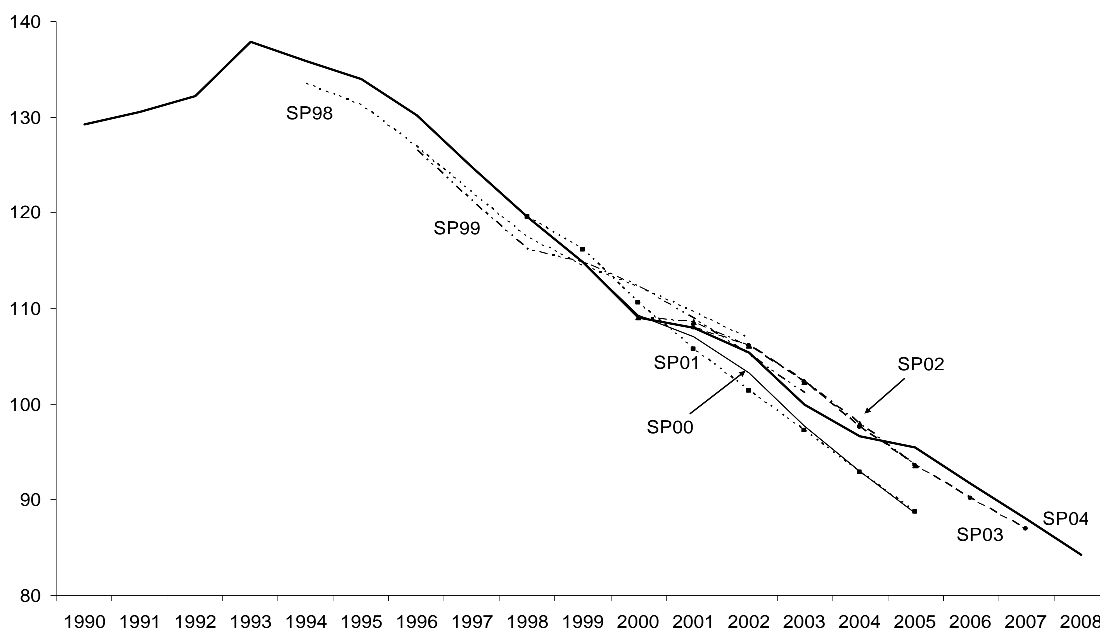
7 In the absence of a fully-specified macroeconomic scenario that would underlie such deviations, it is obviously impossible to derive new estimates of potential growth from the agreed production function method.

8 The effect of lower/higher growth on revenues is captured by using the conventional sensitivity parameters adopted in cyclical adjustment procedures.

9 Financial assets owned by the Belgian ageing fund consist solely of Belgian government debt. Therefore, according to the Maastricht definition, the Belgian debt ratio is net of all assets owned by the ageing fund. Hence, the effect of an increase in the assets of the ageing fund on the debt ratio is equivalent to a direct debt reduction of the same magnitude.

Chart 2: Evolution of the debt targets (in % of GDP) in successive programmes



Sources: Commission services autumn 2004 economic forecasts (COM); stability programmes (SP)

Box 2: One-off measures

In recent years, the Belgian debt ratio has benefited from the proceeds of a number of one-off operations. Some of these are 'above the line' in the sense that they have a direct impact on the budget deficit. Others ('below the line') include financial transactions which have an impact on the debt, but not on the budget.

In 2003 the government accounts benefited from one-off measures amounting to about 1.5% of GDP. Revenue increased by 1.9% of GDP from the transfer of the Belgacom pension fund (against future pension liabilities) and by 0.1% of GDP as a result of the sale of government buildings. The government also advanced to 2003 two expenditure items which were originally planned to burden the 2004 budget outcome, namely subsidies to the state railway company SNCB (0.4% of GDP) and a planned capital injection to postal company La Poste (0.1% of GDP). 'Below the line' operations in 2003 amounted to 2.4% of GDP. They included the sale of financial assets of the central mortgage credit office Credibe (1.0% of GDP), a financial operation relating to the debt of the social housing loan amortisation fund Fadels (1.3% of GDP) and a reduction of the debt ratio stemming from unreturned Belgian banknotes after the introduction of the euro (0.1% of GDP).

In 2004 the impact of one-off operations on the budget was about 0.7% of GDP. First there was the above-mentioned anticipation of subsidies to SNCB and the capital injection in La Poste from 2004 to 2003 (together 0.5% of GDP). The take-over of the pension fund of Brussels International Airport Company BIAC improved the budget by another 0.1% of GDP. The proceeds of the tax amnesty law ('déclaration libératoire unique'), originally estimated at 0.3% of GDP, were probably limited to about 0.1% of GDP. Important financial operations (with no impact on the deficit) were the reduction of the government's participation in the Belgacom phone company (0.2% of GDP) and in the Brussels airport company BIAC (0.1% of GDP).

As for 2005, the impact of one-off operations on the budget is much lower. A series of smaller one-off operations reduce the deficit by about 0.2% of GDP. An important 'below the line' operation in 2005 concerns the targeted debt take-over from the national railway company SNCB (-2.5% of GDP). The take-over was already announced in the previous update and is included in the government's projections for the debt ratio in 2005. The total impact of major one-off operations is summarized in the following table:

Impact of one-off operations as a percentage of GDP		
	on the deficit	on debt
2003	-1.5%	-3.9%
2004	-0.7%	-1.0%
2005	-0.2%	+2.3%

Negative figures reduce the deficit / debt and vice versa

Table 6 describes the evolution of the debt ratio and its driving forces in more detail. The main driving force behind the debt reduction is the high primary surpluses that Belgium has posted for a number of years. Lower interest rates have also contributed to a large extent to the positive debt dynamics. On the contrary some stock-flow adjustments have an increasing effect on the debt ratio, but this is only sizeable in 2005 (3% of GDP), which is largely the result of the inclusion of debt from the state railway company SNCB (2.5% of GDP) into the government debt.

The Belgian debt ratio has been exceeding the 60% of GDP reference value since the presentation of the initial stability programme in 1998. A tentative assessment of the pace of debt reduction over a medium-term horizon is presented in chart 3. It compares the projections for the debt ratio in each year of the programme (starting from the projection for 2004) with the values obtained for the same year by applying an illustrative "rolling debt reduction rule". This rule describes a minimum reduction in the debt ratio over the previous five/four/three-year period. For example, the projection for 2004 is compared with the values obtained for the same year by applying the formula over the periods 1999-2004, 2000-2004 and 2001-2004[10]. If the debt levels projected in the programme exceed those obtained by applying the rule, this is taken as an indicator of a slow reduction in the debt ratio. This is consistent with the idea that the minimum debt reduction should be ensured not year after year but over a medium-term horizon. The graph shows that the debt ratio in the update is planned to diminish over the entire programme period by more than what the rolling debt reduction rule would have implied.

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[10] The "rolling debt reduction rule" in the graph is shown for successive five-year periods through a recursive application of the formula:

$$\left(\frac{D_t}{Y_t}\right)_{rule} = 0.05 * \left[60 - \left(\frac{D_{t-1}}{Y_{t-1}}\right)_{rule}\right] + \left(\frac{D_{t-1}}{Y_{t-1}}\right)_{rule}$$

where t is a time subscript and D and Y are the stock of government debt and nominal GDP, respectively (note that, in the first year of the five-year period, the debt ratio in the previous year is the actual debt ratio). The change in the debt ratio can be decomposed as follows (assuming that the stock-flow adjustment is equal to zero):

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{DEF_t}{Y_t} - \left(\frac{y_t}{1+y_t}\right) * \left(\frac{D_{t-1}}{Y_{t-1}}\right) \cong \frac{DEF_t}{Y_t} - y_t * \left(\frac{D_{t-1}}{Y_{t-1}}\right)$$

where *DEF* is the government deficit and *y* represents nominal GDP growth. Noting that 0.05*60 = 3, the formula for the "rolling debt reduction rule" describes the path for convergence of the debt ratio towards the 60% of GDP debt reference value consistent with a deficit equal to the 3% of GDP reference value. Consistency is achieved for a nominal GDP growth rate of 5% of GDP. For nominal GDP growth rates higher than 5%, the minimum debt reduction rule can be respected with deficits in excess of 3% of GDP; for nominal GDP growth rates lower than 5%, respect of the minimum debt reduction rule necessitates deficits lower than 3% of GDP.

Table 6: Debt dynamics

	average 2000-2003	2004		2005		2006		2007	2008
	COM	COM	SP	COM	SP	COM	SP	SP	SP
Government gross debt ratio	**105.6**	**95.8**	**96.6**	**94.4**	**95.5**	**90.9**	**91.7**	**88.0**	**84.2**
Change in debt ratio (1 = 2+3+4)	-3.6	-4.2	-3.4	-1.4	-1.1	-3.6	-3.8	-3.7	-3.8
Contributions:									
- **Primary balance** (2)	**-6.5**	**-4.8**	**-4.9**	**-4.2**	**-4.5**	**-3.6**	**-4.4**	**-4.5**	**-4.7**
- **"Snow-ball" effect** (3)	**2.6**	**0.6**	**0.9**	**0.3**	**0.4**	**0.0**	**0.3**	**0.7**	**0.7**
- Interest expenditure	6.2	4.9	4.9	4.5	4.5	4.1	4.4	4.2	4.1
- Real GDP growth	-1.8	-2.4	-2.3	-2.3	-2.3	-2.3	-2.3	-1.9	-1.7
- Inflation (GDP deflator)	-1.8	-2.0	-1.7	-1.9	-1.8	-1.8	-1.9	-1.7	-1.7
- **Stock-flow adjustment** (4)	**0.3**	**0.0**	**0.6**	**2.5**	**3.0**	**0.0**	**0.3**	**0.1**	**0.2**
- Cash/accruals	0.5								
- Accumulation of financial assets	-0.6								
of which: Privatisation proceeds	-0.3								
- Valuation effects & residual adj.	0.4								

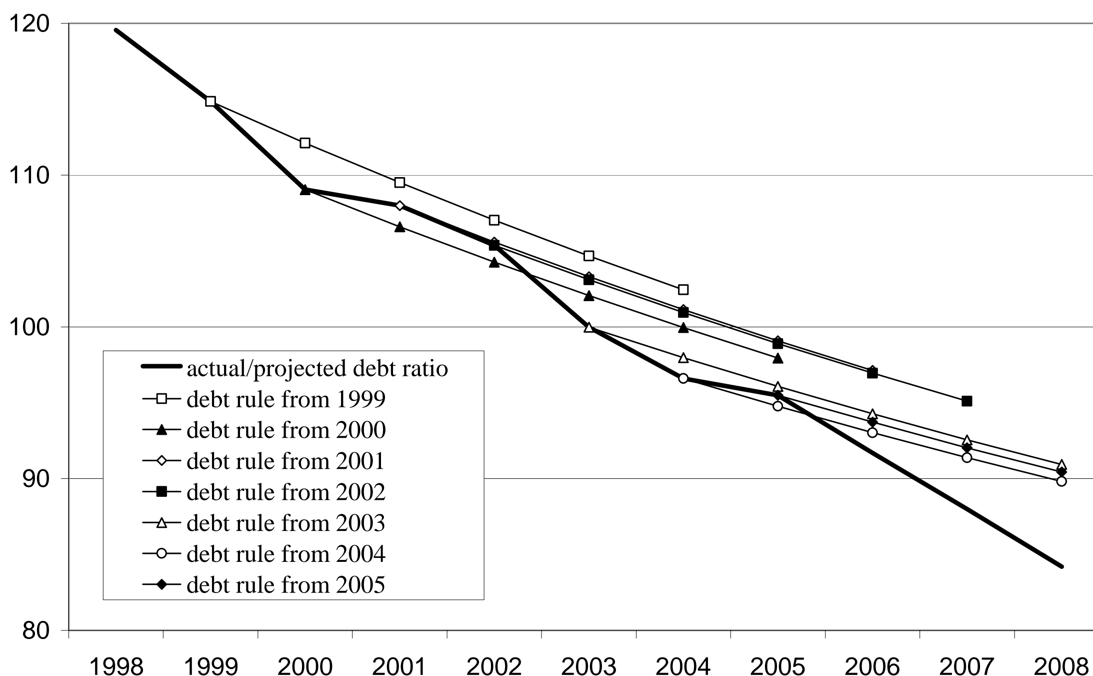
Note:
The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect.

Sources: *Stability programme update (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations*

Chart 3: Rolling five year debt rule



Source: *Commission services calculations*

6. STRUCTURAL REFORM AND THE QUALITY OF PUBLIC FINANCES

To achieve the budgetary strategy in the programme (to maintain a budget in balance or in surplus and to keep the debt ratio on a downward trend) the programme highlights structural reform in health care expenditure and employment. Additionally, the budget will be affected by the ongoing implementation of the 2001 direct tax reform.

Health care expenditure has a tendency to grow beyond its already high target real growth rate of 4.5% annually foreseen in the government agreement. Overruns amounted to EUR 634 million in 2004, or over 0.2% of GDP. Recently a set of measures has been announced to reduce the cost of health care by 0.2% of GDP (see also box 1). Additionally, for the larger part of 2005 the minister of social affairs has been given a mandate to take necessary measures without prior parliamentary (or other) consultation, to enable a quick response to a possible further overrun. This should enable the Belgian government to comply with the policy recommendation in the Broad Economic Policy Guidelines for the period 2003-2005 to limit the real expenditure increase in Entity I (federal government and social security) to 1.5 %.

A low employment rate especially among older workers (below 27% compared to an EU-average of 40% for the age group 55-64) is a second structural problem with budgetary implications. Some limited measures were approved in 2002 and 2003 to stimulate employment in the age category above 50, but in 2004 no new measures were adopted. The programme announces negotiations between social partners and the government which should result in new measures to limit access to the system of early retirement and to increase further the effective working years on the basis of social agreements. However, the outcome of these negotiations is still very uncertain. All in all, progress in removing incentives to early retirement is slow and activity and employment rates remained broadly unchanged in 2004.

Finally, the ongoing implementation of the 2001 tax reform (see box 3) will reduce revenue from direct taxes by 0.2% of GDP in 2005 and by an additional 0.3% in 2006. Whereas for 2005 some compensating measures have been included in the budget, it is not clear so far what measures will be taken to offset the effect in 2006.

Box 3: The Direct Income Tax Reform

In 2001, the Belgian government approved a direct income tax reform to be implemented progressively in the years 2002-2005, on the revenues of years 2001-2004. A new steady state will prevail as from 2006, the first year in which taxpayers will receive the full tax benefits of the reform (the tax statements in 2005 apply to the revenues of 2004 but some tax corrections only take place in 2006, hence there is also an impact on the 2006 tax take – see main text). In addition, the surcharge income tax ('crisis levy') which had been introduced in the fiscal year 1994 in the context of severe budgetary difficulties, was phased out gradually over the period 2000-2003.

The 2001 personal income tax reform includes in particular the following measures: 1) a tax credit for low labour income earners; 2) the streamlining of marginal tax rates on medium income tax brackets; 3) new work-related tax-deductible expenses; 4) a reduction of the top marginal tax rate from 55% to 50%; 5) higher tax exemptions on the income of married double-income earning couples alongside the tax exemptions for unmarried double-income earning couples; 6) separate taxation of non-work related income; and 7) increases in the tax allowances for dependent children.

No offsetting budgetary measures were planned since the government considered that it had a sufficient budgetary margin to accommodate these tax cuts, derived from primary surpluses and the falling debt service.

It has been estimated by the Belgian Federal Planning Bureau that from 2006 onwards the ex-ante yearly cost of the tax measures adopted would amount to 1.6% of GDP. This comprises 1.3% of GDP from the income tax reform and 0.3% of GDP from the fading out of the crisis levy. The impact on GDP would be around 0.8% after 2006, whereas second-round effects would mitigate the effect on the general government balance (from 2006 onwards) from 1.6% of GDP to 1.3%.

7. THE SUSTAINABILITY OF THE PUBLIC FINANCES

The assessment of the sustainability of the Belgian public finances is based on an overall judgement of the results of quantitative indicators and qualitative features. The quantitative indicators project debt developments according to two different scenarios, to take into account different budgetary developments over the medium term. The "programme" scenario (baseline) assumes that the medium-term objective set in the programme is actually achieved, while the "2004" scenario assumes that the underlying primary balance remains throughout the programme period at the 2004 level.

The graph below presents gross debt developments according to the two different scenarios. On the basis of the programme and additional information provided by the Economic Policy Committee and the Belgian Federal Planning Bureau, age-related expenditure is foreseen to increase by some 5% of GDP between 2009 and 2050 (see Annex 2 for a breakdown of different age-related expenditures). Gross debt is projected to steadily decline during most of the period in the baseline scenario and reach very low levels in the long run. A broadly similar picture emerges in the "2004" scenario. The pronounced projected reduction of the debt ratio, from its currently high level, hinges upon the achievement of continued high primary surpluses, to the tune of 4% of GDP, for another 15 years[11].

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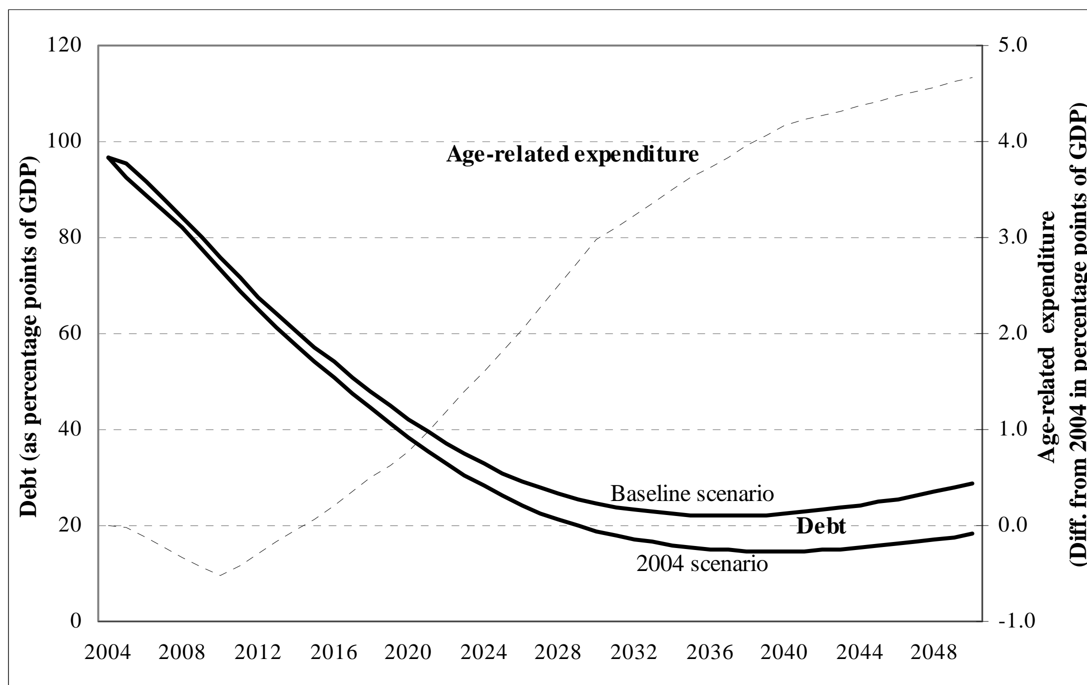
[11] It should be recalled that, being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of likely outcomes and should not be taken at face value.

Long-term sustainability: summary results



Sustainability indicators

	S1*	S2**	RPB***
Baseline scenario	-0.5	0.5	5.2
2004 scenario	-0.7	0.4	5.1

Notes:

* It indicates the required change in tax revenues as a share of GDP over the projection period that guarantees to reach debt to GDP ratio of 60% of GDP in 2050.

** It indicates the change in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon to the debt as existing at the outset of the projection period; p.m. debt to GDP ratio in 2050: -3.8%

*** Based on S2, the Required Primary Balance (RPB) indicates the average minimum required cyclically adjusted primary balance as a share of GDP *over the first five years* of the projection period that guarantees the respect of the intertemporal budget constraint of the government for this period.

On the basis of the debt projections, it is possible to calculate a set of sustainability indicators to measure the gap between the current policies and a sustainable one. The S1 indicator shows the permanent change in the primary balance in order to have a debt to GDP ratio in line with the 60% of GDP reference value in the very long run (year 2050)[12]. S2 shows the gap between the current tax policies and those that would ensure respect of the intertemporal budget constraint given the future impact of ageing on public expenditure, namely the change in the tax ratio that would equate the present discounted value of future primary balances to the current stock of gross debt. According to the latter, in order to tackle the cost of ageing entirely through a budgetary strategy, Belgium should increase its tax ratio permanently by 0.5 percentage points compared with the projected one at the end of the programme period. This would lead to a sustainable debt ratio of around zero by the middle of the century[13]. The budgetary effort over the first 5

[12] The respect of the underlying debt path does not ensure sustainability over an infinite horizon, but only that debt remains below 60% up to 2050. In most cases, this would imply an increasing trend and possible imbalances after the end of the projection period.

[13] The debt ratio of around zero in 2050 according to the S2 indicator illustrates that the sustainability gap is higher in order to ensure a sustainable evolution of gross debt beyond 2050, compared with the S1 indicator, which illustrates that a lower budgetary consolidation effort is compatible with the 60% reference value in 2050.

years of projections (i.e. after the end of the programme period) to respect the intertemporal budget constraint requires a primary surplus of 5.2% of GDP on average, compared with 4.6% of GDP targeted for the last year of the programme period (measured in underlying terms).

In interpreting these results, several factors must be taken into account.

First, the Belgian labour market is characterised by low participation rates (especially among women and older workers) and relatively high unemployment. In recent years the Belgian government has made efforts to reduce the tax burden on labour through the direct tax reform of 2001 (progressively implemented until 2006; see box 3) and by reducing social security contributions. In addition, measures were taken to make work more attractive by flexibilizing working time. Some limited progress has been made in the last few years to increase the actual retirement age. Discussions have started recently between government and social partners to deal with the problem of early retirement and the employability of older people, but no significant measures to reform the system have been taken so far. In its projections, the Belgian High Council for Public Finance estimates the impact of lower unemployment benefits on the budgetary cost of ageing at -1.2% of GDP by 2030. However, based on the High Council for Public Finance's sensitivity analysis for the budgetary cost of ageing, the OECD recently concluded that a smaller increase in the employment rate (4.7 percentage points instead of 7.0 used by the High Council for Public Finance) and a lower growth rate of productivity (1.4% instead of 1.7%) would increase the budgetary cost of ageing by around a further 1% of GDP by 2030. Overall some risk exists that the official long-term forecasts are on the optimistic side.

Second, population ageing will impact on the budget mainly through outlays for pensions and health care (see Annex 2 for a breakdown of different age-related expenditures). The impact on pension outlays estimated by the Belgian High Council for Public Finance assumes that real pensions will increase at an average annual rate of 0.5%, which implies a smaller decline relative to average wage rates than in the past. This assumption seems prudent in view of an ageing population with a growing electoral weight.

It should also be emphasised that the projected results rely on the rather optimistic assumption that the real average growth rate in health-care expenditure will fall back to 2.8% after 2007, from a current 4.5%. The rise in health care expenditure is a matter of concern since it has progressively increased in recent years. If health care expenditure cannot be contained within this growth path, the cost of ageing is likely to be underestimated.

However, the Belgian authorities are currently building an ageing fund ('fonds de veillissement'). The ageing fund is a state fund that will be used after 2010 to finance the increased pension liabilities. At present the ageing fund amounts to EUR 11.4 billion (4.1% of GDP) and is aimed to reach EUR 13 billion by 2007 (4.1% of GDP). In the past the ageing fund was mainly financed with the proceeds from one-off operations, which are being phased out in the future.

Annex 1: Summary tables from the stability programme update

Table 0. Basic assumptions

	2003	2004	2005	2006	2007	2008
Short-term interest rate (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term interest rate (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
United States: short-term (three-month money market)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
United States: long term (10-year government bonds)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
USD/€exchange rate (annual average)	113.0	122.2	121.5	121.2	121.0	120.8
Nominal effective exchange rate (euro area)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Nominal effective exchange rate (EU)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World GDP growth, excluding EU	4.4	5.1	4.7	3.8	3.8	3.8
United States, GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Japan, GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EU GDP growth	0.8	2.0	2.4	2.6	2.5	2.4
Growth of relevant foreign markets	3.3	6.8	6.7	6.6	6.2	5.8
World import volumes, excluding EU	7.3	9.7	8.5	6.9	6.9	6.9
World import prices (goods, in USD)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Oil prices (Brent, USD/barrel)	28.8	37.4	39.0	38.2	39.1	40.1
Non-oil commodity prices (in USD)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Table 1. Growth and associated factors

	2003	2004	2005	2006	2007	2008
GDP *growth* at *constant* market prices (7+8+9)	1.3	2.4	2.5	2.5	2.1	2.0
GDP *level* at *current* market prices	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
HICP change	1.5	1.9	2.0	1.8	1.8	1.8
Employment growth	0.1	0.4	0.8	0.9	0.7	0.7
Labour productivity growth	1.3	2.0	1.7	1.6	1.3	1.3
Sources of growth: percentage changes at constant prices						
1. Private consumption expenditure	2.2	2.0	1.7	2.3	1.7	1.9
2. Government consumption expenditure	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. Changes in inventories and net acquisition of valuables as a % of GDP	0.5	0.3	0.0	0.0	0.0	0.0
5. Exports of goods and services	1.7	4.1	5.4	5.9	5.7	5.4
6. Imports of goods and services	2.9	3.8	5.7	6.2	5.7	5.5
Contribution to GDP growth						
7. Final domestic demand (1+2+3)	1.6	1.7	2.4	2.5	1.8	1.8
8. Change in inventories and net acquisition of valuables (=4)	0.5	0.3	0.0	0.0	0.0	0.0
9. External balance of goods and services (5-6)	-0.8	0.4	0.1	0.0	0.3	0.2

Table 2. General government budgetary developments

% of GDP	2003	2004	2005	2006	2007	2008
Net lending by sub-sectors						
1. General government	0.4	0.0	0.0	0.0	0.3	0.6
2. Central government	0.4	-0.5	-0.4	-0.2	0.0	0.2
3. State government	0.2	0.2	0.2	0.1	0.1	0.1
4. Local government	0.3	0.2	0.1	0.0	0.1	0.2
5. Social security funds	-0.5	0.0	0.1	0.1	0.1	0.1
General government						
6. Total receipts	51.3	49.6	49.4	49.0	49.1	49.1
7. Total expenditures	50.9	49.6	49.4	49.0	48.8	48.5
8. Budget balance	0.4	0.0	0.0	0.0	0.3	0.6
9. Net interest payments	5.4	4.9	4.5	4.4	4.2	4.1
10. Primary balance	5.7	4.9	4.5	4.4	4.5	4.7
Components of revenues						
11. Taxes	30.4	30.9	30.8	30.3	30.4	30.4
12. Social contributions	16.5	16.3	16.2	16.3	16.4	16.3
13. Interest income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
14. Other	4.4	2.4	2.4	2.4	2.4	2.3
15. Total receipts	51.3	49.6	49.4	49.0	49.1	49.1
Components of expenditures						
16. Public consumption	15.5	15.4	15.2	15.0	15.0	15.0
17. Social transfers in kind	7.0	7.1	7.1	7.3	7.5	7.5
18. Social transfers other than in kind	16.3	16.2	15.9	15.6	15.5	15.4
19. Interest payments	5.4	4.9	4.5	4.4	4.2	4.1
20. Subsidies	1.6	1.5	1.6	1.6	1.6	1.6
21. Gross fixed capital formation	1.6	1.6	1.8	1.9	1.7	1.6
22. Other	3.5	3.0	3.3	3.3	3.3	3.3
23. Total expenditures	50.9	49.6	49.4	49.0	48.8	48.5

Table 3. General government debt developments

% of GDP	2003	2004	2005	2006	2007	2008
Gross debt level	100.0	96.6	95.5	91.7	88.0	84.2
Change in gross debt	-5.4	-3.4	-1.0	-3.9	-3.7	-3.8
Contributions to change in gross debt						
Primary balance	5.7	4.9	4.5	4.4	4.5	4.7
Interest payments	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
Other factors influencing the debt ratio [1]	*-1.7*	*0.6*	*3.1*	*0.2*	*0.2*	*0.2*
Of which: Privatisation receipts	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
p.m. implicit interest rate on debt	5.3	5.1	4.9	4.8	4.8	4.8

[1] Stock-flow adjustment

Table 4. Cyclical developments

% 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 balance	0.4	0.0	0.0	0.0	0.3	0.6
3. Interest payments	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 budgetary component	-0.7	-0.4	-0.1	0.2	0.1	0.1
7. Cyclically-adjusted 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

Table 5. Divergence from previous update

% of GDP	2003	2004	2005	2006	2007	2008
GDP growth						
SP November 2003	0.9	1.8	2.8	2.5	2.1	n.a.
SP November 2004	1.3	2.4	2.5	2.5	2.1	2.0
Difference	0.4	0.6	-0.3	0.0	0.0	n.a.
Actual budget balance						
SP November 2003	0.2	0.0	0.0	0.0	0.3	n.a.
SP November 2004	0.4	0.0	0.0	0.0	0.3	0.6
Difference	0.2	0.0	0.0	0.0	0.0	n.a.
Gross debt levels						
SP November 2003	100.8	97.6	93.6	90.1	87.0	n.a.
SP November 2004	100.0	96.6	95.5	91.7	88.0	84.2
Difference	-0.8	-1.0	1.9	1.6	1.0	n.a.

Table 6. Long-term sustainability of public finances

% of GDP	2003	2005	2010	2020	2030	2040	2050	2060	2070
Total expenditure	50.9	49.4	47.9	47.8	49.1	n.a.	n.a.	n.a.	n.a.
Old age pensions	9.2	9.0	8.8	10.1	12.0	n.a.	n.a.	n.a.	n.a.
Health care (including care for the elderly)	6.9	7.2	7.8	8.6	9.3	n.a.	n.a.	n.a.	n.a.
Interest payments	5.4	4.6	3.8	2.3	1.4	n.a.	n.a.	n.a.	n.a.
Total revenues	51.3	49.4	49.1	49.1	49.1	n.a.	n.a.	n.a.	n.a.
Of which: from pensions contributions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
National pension fund assets (if any)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions [1]									
Labour productivity growth	1.1	1.8	1.8	1.8	1.8	n.a.	n.a.	n.a.	n.a.
Real GDP growth	0.9	2.9	2.5	1.7	1.5	n.a.	n.a.	n.a.	n.a.
Participation rate males (aged 20-64)	81.9	82.1	81.6	81.4	81.8	n.a.	n.a.	n.a.	n.a.
Participation rates females (aged 20-64)	65.9	67.1	68.6	70.0	72.0	n.a.	n.a.	n.a.	n.a.
Total participation rates (aged 20-64)	73.9	74.6	75.1	75.7	77.0	n.a.	n.a.	n.a.	n.a.
Unemployment rate	11.5	11.4	9.9	7.4	6.1	n.a.	n.a.	n.a.	n.a.

[1] Percentage change

Annex 2: Indicators of long-term sustainability for Belgium

Main assumptions - baseline scenario (as % GDP)	**2009**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Total age-related spending	27.1	27.0	28.3	30.5	31.7	32.2	5.1
Pensions	8.8	8.8	10.1	12.0	12.9	13.0	4.2
Health care	7.7	7.8	8.6	9.3	10.1	10.6	2.9
Education*	4.1	4.0	3.7	3.8	3.7	3.7	-0.4
Unemployment benefits	1.9	1.8	1.4	1.1	1.0	1.0	-0.9
Others	4.6	4.6	4.5	4.3	4.0	3.9	-0.7
*Total primary non age-related spending***	17.2						
*Total revenues***	49.0						

*EPC projections

** constant

Results (as % GDP)	**2009**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Baseline scenario							
Gross debt	80.0	75.7	42.3	24.7	22.6	28.8	-51.3
i + 0.5*	80.5	76.5	46.4	31.5	32.4	42.4	-38.1
2004 scenario							
Gross debt	77.7	73.2	38.4	19.0	14.7	18.3	-59.4
i + 0.5*	78.1	74.0	42.3	25.3	23.5	30.2	-47.9

* i + 0.5 represents the evolution of debt under the assumption of the nominal interest rate being 50 basis points higher throughout the projection period.