COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 2.2.2005
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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Belgium, 2004-2008

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1] stipulates that participating Member States, that is, those which have adopted the single currency, had to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of this Regulation, the Council had to examine each stability programme based on assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). On the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme. According to the Regulation, Member States need to submit annual updates of their stability programmes, which may also be examined by the Council in accordance with these same procedures.

The first stability programme of Belgium, covering the period 1999-2002, was submitted on 18 December 1998 and assessed by the Council on 15 March 1999. Updates were presented every following year. Belgium submitted the most recent update of its stability programme on 6 December 2004. The Commission services have carried out a technical evaluation of this update, taking into account the results of their own Autumn 2004 economic forecasts, and having regard to the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances, the recommendations in the broad economic policy guidelines for the period 2003-2005 and the principles laid down in the Communication from the Commission to the Council and the European Parliament of 27 November 2002 on strengthening the coordination of budgetary policies[3]. This evaluation is as follows:

– 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". 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

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1 OJ L 209, 2.8.1997. All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

2 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

3 COM(2002) 668 final, 27.11.2002.

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 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.

On the basis of this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the updated stability programme of Belgium and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of Belgium, 2004-2008

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[4], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [17 February 2005] the Council examined the updated stability programme of Belgium, which covers the period 2004 to 2008. The programme broadly complies with the data requirements of the "code of conduct on the content and format of stability and convergence programmes". The programme does not include some compulsory and a number of optional variables. Accordingly, Belgium is invited to achieve compliance with the data requirements.

(2) The macroeconomic scenario underlying the programme envisages a real GDP growth of 2.5% in 2005 and 2006, slowing down to 2.0% towards the end of the programme period. On the basis of currently available information, this scenario reflects plausible growth assumptions. The programme's projections for inflation also appear realistic.

(3) The budgetary strategy outlined in the update aims to maintain a balanced budget or a small surplus and the debt ratio on a downward trend to prepare for the budgetary impact of the ageing population. The update projects a balanced budget in 2005 and 2006 and a surplus of 0.3% of GDP in 2007 and 0.6% in 2008. Overall, compared with the previous update (which ended in 2007), the current update broadly confirms the planned adjustment against a broadly unchanged macroeconomic scenario. Because of the impact of the ongoing implementation of the 2001 direct tax reform and higher

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4 OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

public investment in the run-up to the 2006 local elections, the primary surplus is projected to fall slightly towards 2006 but to rise again afterwards. The programme foresees a declining interest burden, mainly as a result of ongoing debt reduction. Revenue is expected to decrease until 2006 and remain stable afterwards, while primary expenditure decreases slightly towards 2008. The cyclically-adjusted balance (based on the information in the programme, using the commonly agreed methodology) 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.

(4) The risks to the budgetary projections in the programme appear broadly balanced. In particular, 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 these expenditures. New measures were announced near the end of 2004 to reduce costs in health care (in total 0.2% of GDP), but their effectiveness is still difficult to evaluate. On the other hand, 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. More generally, the Belgian government has gained credibility for keeping its commitment to take measures to maintain a balanced budget.

(5) In view of this risk assessment, the risks to the budgetary targets appear to be broadly balanced and 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, 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 in each year.

(6) The debt ratio is estimated to have reached 96.6% of GDP in 2004, well above the 60% of GDP Treaty reference value. The programme projects the debt ratio to decline by 12.4 percentage points over the programme period to 84.2% of GDP in 2008. This figure includes the assumption of a EUR 7.4 billion debt (2.5% of GDP) from the national railway company SNCB in 2005. 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.

(7) 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, pursuing this broad strategy with determination is crucial to the achievement of long-term sustainability.

(8) The economic policies outlined in the update are broadly consistent with the country-specific broad economic policy 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 4.5% annual rate), 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 limit 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.