BELGIUM’S STABILITY PROGRAMME

(2007-2010)

UPDATE 2006

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1 Introduction: general political framework and objectives

The present stability programme 2007-2010 explains the Belgian government's fiscal policy for the period concerned. This is an update of the stability programme 2006-2009. Like the previous programme, it is based on budgetary decisions taken under the May 2003 federal coalition agreement, whereby it was decided to maintain a balanced budget as the minimum objective with the gradual creation of budget surpluses.

For 2006, the government expects a balanced budget, despite some setbacks. The budget path was mapped out by the amended law on the Ageing Fund. Budget surpluses are to be achieved from 2007 onwards: initially, the surplus will equal 0.3 % of GDP and is to be increased each year thereafter by 0.2 percentage point. For 2007, the government has therefore defined a surplus of 0.3 % of GDP. For 2010, the surplus is to be increased to 0.9 % of GDP.

Up to 2006, the primary balance moved in line with interest charges. The budgetary scope which will result from the decline in interest charges will be used in the future to create the budget surpluses planned. If, during the period 2007-2010, growth proves to be higher than currently predicted, the government is committed to using the available additional scope primarily to improve the overall balance.

Reducing the public debt ratio at a sufficiently rapid rate remains a central objective of the Belgian fiscal strategy. Cutting the interest charges on the debt is in fact the key to creating scope in the budget to finance the costs of population ageing. According to the figures notified to Eurostat by the National Accounts Institute at the end of September, the debt ratio declined to 91.5 % in 2005. It is expected to continue falling to 87.7 % of GDP in 2006, 83.9 % in 2007 and 72.6 % in 2010.

A responsible fiscal policy creates a climate of confidence and is an important factor stimulating economic growth and job creation. The government combines this policy with an ambitious programme of social and economic reforms, placing the emphasis on the following points:

- Strengthening Belgium’s competitive position, particularly by providing additional incentives for research and development.

- Stimulating employment by reducing the burden of taxes and parafiscal levies on employment.

- Encouraging businesses to mobilise their tax-exempt reserves.

- A “greener” tax system, shifting the taxes on labour to other factors.

- Building and renovating social housing and encouraging the upgrading of certain urban districts.

- Better protection for patients’ rights by introducing the 'omnio' status and the maximum invoices payable by the chronically sick, and a new procedure for reimbursing the cost of implants and medical devices.

- Better social protection for persons receiving a replacement income, by an increase in certain social benefits or earlier introduction, or possibly extension, of certain increases previously decided on.

A diversified strategy for strengthening public finances and stimulating the economy and employment reflects the desire of the Belgian government to create a sound basis to cushion the costs of population ageing in the years ahead, and to guarantee a satisfactory level of purchasing power and prosperity for current and future generations.

Although some important steps have already been taken to allow for the effects of ageing, this aspect clearly has to remain the subject of special attention in the future.

2 The economic context

2.1 The international context

In the autumn of 2006, the global expansion appears to be widespread and relatively strong, and the outlook for growth is usually considered favourable. The US economy is slowing down slightly, but at the same time the recovery is gaining strength in the euro area, and the emerging economies, particularly in Asia, are still growing very vigorously. Overall, in September the IMF predicted a very slight slackening of world economic growth, from 5.1% in 2006 to 4.9% in 2007.

There are signs of some convergence in the performance of the developed economies.

The recent easing of oil prices is a factor bolstering economic activity, but the volatility of energy prices is also giving rise to uncertainty and creating a downside risk for the forecasts. The external payment imbalances remain a potential risk for economic performance. The same applies to the behaviour of fixed asset prices, considered to be overvalued in a number of economies, and especially in the United States. However, this risk factor was toned down by a recent OECD analysis.

2.1.1 The economic situation outside the euro area remains favourable

Outside the euro area, the economic climate should remain favourable in the short term, though some slowing down is predicted overall, mainly as a result of the US performance.

The slackening pace of US economic activity became evident in the first half of 2006, following the interest rate hike and soaring oil prices. This slowdown was evident primarily in the residential property sector, while the repercussions on household consumption appear to be relatively minor. Conversely, non-residential construction is expanding strongly, and foreign demand should remain sustained in a favourable economic environment. The scenario preferred by the forecasters is therefore a “soft landing”, accompanied by a gradual easing of monetary policy. Under these conditions, annual GDP growth at constant prices, reaching around 3.3% in 2006, is projected at 2.3% in 2007.

In Japan, growth is fairly vigorous, sustained by domestic demand. In that context, the Bank of Japan decided in July to end its zero interest rate policy. However, despite the economic recovery, excluding energy prices, inflation is hovering around zero. Monetary policy should therefore remain prudent, tending towards neutrality, while fiscal policy should be slightly restrictive. In that context, there should be only a marginal slowing of growth, with GDP at constant prices growing at an annual average of 2.7% in 2006 and around 2.2% in 2007.

In general, growth is likely to remain extremely vigorous in the developing countries and emerging economies, averaging over 7% per annum in both 2006 and 2007. China’s performance is set to be particularly remarkable with roughly 10% GDP growth at constant prices, despite a slight slowdown in response to the measures taken by the Chinese authorities to curb the expansion of liquidity and investment. By comparison, economic expansion is expected to be relatively disappointing in Latin America and particularly in Brazil (around 4%).

2.1.2 Stronger economic growth in the euro area

In the first half of 2006, economic activity in the euro area strengthened considerably. Domestic demand is now the main factor underpinning that expansion. In particular, business investment has speeded up significantly. The external net contribution to economic activity is modest but positive.

The consumer and business confidence indicators are rising or becoming stable at a high level, pointing to growth consolidation.

Nonetheless, the average growth rate in the euro area is expected to dip slightly at the beginning of 2007 for two reasons: the expected weakening of domestic demand in Germany following the increase in VAT, and the decline in US growth, reflecting the country's export performance. But except in Germany, domestic demand in the euro area should remain buoyant. Although investment in housing could slacken pace a little in some countries, following a period of tension on the property market and the raising of interest rates, business investment is likely to remain dynamic in view of the high level of profits and the good demand prospects. Household consumption should be bolstered by the expansion of employment and the fall in unemployment, while wage increases remain moderate. The unemployment rate is expected to drop below 8% in 2007, for the first time since 2001.

The upward trend in prices is still closely linked to the volatility of energy prices, but underlying inflation has remained at around 1.5%. Growth is exceeding its potential, and the European Central Bank has responded by a slight tightening of its monetary policy. Since the movement in wages is under control, inflation measured by the harmonised index of consumer prices is predicted to remain around 2%. On the whole, fiscal policy in the euro area has become slightly restrictive.

For the euro area as a whole, the Commission predicts GDP growth in real terms of 2.6% in 2006, 2.1% in 2007 and 2.2% in 2008. Growth rate differentials between EU member countries should tend to diminish.

These predictions are subject to the usual caution on account of various risk factors. Some of those mean a risk of less favourable performance, such as the possibility of renewed tension on the energy market or the chance that the slowing of the US economy might be more marked than predicted, e.g. because of an unexpectedly sharp adjustment on the property market. The international payment imbalances also remain a potential threat. But some factors could operate in favour of stronger economic expansion. For instance, productivity growth strengthened recently in Europe; if that trend is confirmed, it could encourage investors and hence growth.

2.2 Short-term outlook for the Belgian economy

Since the second quarter of 2005, the Belgian economy has seen a recovery on a scale comparable to the average for the euro area, except for a decidedly faster acceleration in activity in Belgium in the fourth quarter of 2005. During 2006, growth was confirmed although the pace slackened slightly quarter on quarter. In the third quarter, GDP growth at constant prices was 0.6% in relation to the previous quarter.(1) Assuming that the growth rate is maintained at approximately that level in the fourth quarter, the annual average growth of GDP will be 2.7% in 2006.

During the recovery, the confidence indicators(2) picked up less steadily but more strongly in Belgium than in the euro area, on average, the rise being particularly substantial in October. The NBB’s synthetic indicator surged strongly until the summer of 2006. The October and November figures, which were down slightly, seem to indicate that this trend is levelling out.

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(1) data adjusted for seasonal and calendar effects.
(2) Economic sentiment indicator (European Commission).

Overall, Belgium's economic performance thus appears to have slightly surpassed the euro area average in 2006. The same should apply in 2007, for which year the Federal Planning Bureau predicts 2.2% growth. [3]

The 2006 inflation picture presented by the national consumer price index (NCPI) is partly distorted by the adjustment of the basket of products used as the basis for calculating the index. Inflation measured by the new index is about 0.5% lower than the figure indicated by the old index, following the incorporation of products such as mobile phones or computers in the reference sample. Inflation as measured by the new index is similar to the figures produced by the European harmonised index (HICP).

The movement in the NCPI is strongly influenced by energy prices. The health index, which excludes fuel prices, is more stable: it increased by an average of 2.2% in 2005 and stood at 1.9% year-on-year at the end of October 2006, taking account of the technical factors mentioned.

Leaving aside those technical factors, e.g. by referring to the deflator of private consumption, inflation appears to have eased slightly in 2006. In 2007, assuming that international oil prices remain more or less stable, inflation should continue to fall slowly as a result of wage moderation and the strength of the euro.

The rise in prices (HICP and NCPI) should come to around 1.9% in 2007; the rise in the health index is expected to be similar to that for the NCPI.

(3) Economic budget, September 2006.

Table 1
Price movements

% change

1. GDP deflator

2. Deflator of final consumption expenditure of individuals

3. Change in HICP (1996=100)

4. Deflator of final consumption expenditure of general government

5. Deflator of investment

6. Deflator of exports of goods and services

7. Deflator of imports of goods and services

Variation en %	2005 (2000=100)	2005	2006	2007	2008	2009	2010
1. Déflateur du PIB	110,2	2,2	2,2	2,0	1,9	2,1	2,1
2. Déflateur des dépenses de consommation finale des particuliers	110,9	2,8	2,4	1,9	1,8	1,9	1,9
3. Variation de l'IHPC (96=100)	110,3	2,5	2,4	1,9	1,8	1,8	1,9
4. Déflateur des dépenses de consommation finale des pouvoirs publics	115,2	3,4	2,6	2,4	2,2	2,4	2,2
5. Déflateur des investissements	102,9	0,9	3,0	2,2	1,6	1,8	2,0
6. Déflateur de l'exportation de biens et services	107,4	5,7	4,6	1,3	0,9	1,1	1,2
7. Déflateur de l'importation de biens et services	108,1	6,4	5,2	1,3	0,8	0,9	0,9

Since there is a time lag before job creation reflects the rate of growth, a low point was reached at the end of 2005 and the revival is expected to accelerate until the beginning of 2007, encouraged by the moderate rise in labour costs. On average, employment is likely to expand by around 1 p.c. in both 2006 and 2007, though a little more strongly in 2007. The employment rate is expected to rise from 61.9% in 2005 to 62.5% in 2007, thus exceeding the level reached at the end of the last boom period (62.3% in 2001).

Composition of growth

In 2006, the growth of domestic demand is likely to be a little slower than in previous years. That is due to the stabilisation of business investment at a high level, following the extremely strong growth recorded in 2005. Conversely, household consumption is showing a marked increase. The favourable economic environment is boosting exports, so that foreign trade is making a very positive net contribution to growth.

Table 2
Growth and associated factors

Percentage change unless otherwise stated

billion

1. GDP growth at constant prices

2. GDP at current prices (in billions of euro)

Growth sources: change at constant prices

3. Final consumption expenditure of individuals

4. Final consumption expenditure of general government

5. Gross fixed capital formation

6. Change in stocks and net acquisition of assets

7. Exports of goods and services

8. Imports of goods and services

Contribution to GDP growth

9. Total final demand (3+4+5)

10. Change in stocks and net acquisition of assets

11. Balance of goods and services

variation en % sauf indications contraires	2005 milliard	2005	2006	2007	2008	2009	2010
1. Croissance du PIB à prix constants	270,6	1,2	2,7	2,2	2,1	2,2	2,2
2. PIB à prix courants (en milliards d'euro)	298,2	3,5	5,0	4,3	4,0	4,3	4,4
	Sources de la croissance: variation à prix constants						
3. Dépenses de consommation finale des particuliers	143,2	1,1	2,3	2,1	1,5	1,9	1,9
4. Dépenses de consommation finale des pouvoirs publics	59,4	0,2	1,8	2,4	2,5	2,0	2,0
5. Formation brute du capital fixe	57,7	8,5	2,2	2,4	2,6	2,9	2,8
6. Variation de stocks et acquisition nette d'actifs	0,0	0,9	0,9	0,9	0,8	0,8	0,8
7. Exportations de biens et services	241,9	1,8	5,4	4,9	5,6	5,6	5,7
8. Importations de biens et services	234,0	3,4	4,8	5,0	5,6	5,7	5,7
	Contribution à la croissance du PIB						
9. Demande finale totale (3+4+5)	-	2,3	2,1	2,1	1,9	2,0	2,0
10. Variations de stocks et acquisition nette d'actifs	-	0,2	0,0	-0,0	-0,0	-0,0	-0,0
11. Balance des biens et services	-	-1,2	0,6	0,1	0,2	0,2	0,2

Household consumption

The expansion of household consumption expenditure is gradually strengthening, quarter-on-quarter; in the second quarter of 2006 it was 2.3% up against the corresponding period of the previous year. The NBB’s consumer confidence indicator showed a further marked rise in October and November, indicating that households are becoming more optimistic about their financial situation, probably because of the decline in oil prices. However, according to the November survey, business confidence was flagging in the trade sector.

Household disposable income is being supported by the expansion of employment, the effect of the personal income tax reform, the easing of inflation and the increase in property incomes. The same factors will apply in 2007, but the savings ratio should edge upwards, in view of the generally larger percentage of property incomes set aside as savings.

During both 2006 and 2007, household demand will make a notable contribution to growth; according to the Federal Planning Bureau, annual average growth of private consumption at constant prices should total 2.3 and 2.0% respectively.

Investment

Business investment grew extremely strongly in 2005, one factor being the implementation of projects which had previously been postponed. Now that this backlog has been eliminated, the growth rate of this investment is slowing down somewhat. However, the healthy profits, favourable demand prospects, continuing moderate level of interest rates and high rate of capacity utilisation (over 83 %, despite a slight fall according to the October survey) are all factors stimulating productive investment. Business investment will therefore continue to underpin growth in both 2006 and 2007. The Federal Planning Bureau predicts annual average expansion of 2.1 % in 2006 and 2.2 % in 2007.

The growth of investment in housing is continuing at a fairly sustained and steady pace. However, it must be expected to slow down under the influence of less favourable conditions for mortgage loans. In the construction sector, business confidence regarding the outlook for demand was noticeably weaker in the NBB's November business survey. The Federal Planning Bureau is therefore predicting that annual average growth of housing construction will decline from 4 % in 2006 to 2.3 % in 2007.

Public investment is strongly influenced by the cycle of local authority infrastructure projects, which were stepped up in view of the local elections in October 2006 and should be scaled down in 2007.

Foreign trade

The strengthening of economic activity in the euro area is particularly favourable to Belgian exports, more than 60% of which are destined for that region. Otherwise, the euro's appreciation against the dollar has a slightly adverse impact on Belgium's export performance. Overall, exports of goods and services are expected to increase by 5.4 % at constant prices in 2006. The slight loss of momentum forecast for economic expansion in 2007 in the euro area, and especially in Germany, is likely to cause the growth of Belgian exports to subside somewhat, to 4.9 %. That movement should be reflected in the net contribution to growth made by foreign trade, which having been decidedly positive in 2006 (0.6 %), is likely to be more neutral in 2007 (0.1 %).

2.3 Medium-term forecasts (2008-2010)

In October 2006 the Federal Planning Bureau updated its medium-term forecasts. This projection takes no account of the measures introduced when the 2007 budget was drawn up.

As every year, the international environment is based on the OECD's latest medium-term projections (May 2006). In these projections, the average price of a barrel of Brent is set at $66.1 for the year 2006. It is then expected to rise to $67.5 in 2007, then fall steadily to $65 in 2009. The euro is assumed to remain steady at 1.29 dollars from 2008, slightly higher than the 2006 average (1.25).

This projection includes the assumption of a virtually zero output gap at the end of the period. Potential growth is calculated using the methodology developed by the European Commission, and approved by the ECOFIN Council. That growth is estimated at 2.1% in 2008, and 2% in 2009 and 2010. The erosion of potential growth is due to the slower pace of expansion in the labour force, due to demographic reasons.

GDP growth at constant prices is estimated at 2.1% in 2008, 2.2% in 2009 and 2.2% in 2010. Economic growth will therefore be in the region of the potential rate in 2008 before slightly exceeding that figure.

The growth of household disposable income is being favourably influenced by the trend in employment and the steady erosion of unemployment, the rise in net property incomes due to the increase in interest rates and, gradually, by the effects of the Generation Pact. Wage increases remain moderate, in line with the movement in labour costs in Belgium's three main trading partners. Households are adjusting the growth of their consumption more or less in line with their increased income, as their savings ratio remains stable.

Over the period 2008-2010, business investment is expected to grow by around 3 %. It should be bolstered by satisfactory profitability and demand prospects, but will weaken slightly over time as a result of interest rate rises. The growth of investment in housing is likely to be less sustained, mainly because of the gradual increase in mortgage rates. The expansion of public investment is strongly influenced by local authority investment, which is tending to diminish after reaching a peak before the 2006 local elections.

Belgium's potential export markets look set to maintain steady growth, but Belgian exports will continue to see slow erosion of their market share. Imports and exports are expected to move roughly in parallel, with foreign trade making a meagre net contribution to growth.

Inflation should remain under control, owing to the moderate rise in domestic costs and the weak increase in imported inflation. Measured by the deflator of private consumption, inflation is predicted to remain below 2 %.

The employment rate should continue to rise slowly, reaching 63.7 % in 2010.

Table 3
Labour market movements

Variation en %	2004 Volume		2004	2005	2006	2007	2008	2009
1. Emploi intérieur	4.162,0	(a)	0,6	0,7	0,7	0,7	0,9	0,8
2. Nombre d'heures travaillées	6.510,3	(b)	0,6	0,6	0,6	0,6	0,8	0,7
3. Taux de chômage (% définition Eurostat)	7,8		7,8	7,8	7,8	7,8	7,6	7,5
4. PIB réel par personne active	59,2	(c)	2,0	0,7	1,5	1,3	1,4	1,4
5. PIB réel par heure travaillée	37,8	(d)	2,0	0,9	1,6	1,5	1,5	1,5
6. Coût salarial des employés	148,2		4,1	3,9	4,1	4,0	4,6	4,6

a. mille
b. millions d'heures
c. milliers euros
d. euros

% change

1. Domestic employment

2. Number of hours worked

3. Unemployment rate (%, Eurostat definition)*

p.m. unemployment rate (%, FPB definition)

4. Employment rate

5. Real GDP per person in work

6. Real GDP per hour worked

7. Labour cost of employees

a. thousands

b. millions of hours

c. euro

d. thousands of euro

e. billions of euros

(*) In 2005-2006, there was a divergence between the movement in the administrative unemployment rate (Federal Planning Bureau definition) and the Eurostat harmonised unemployment rate, the former declining and the latter increasing, on

average, in 2006. This seems to be due to the measures taken to encourage unemployed persons receiving benefits to make an active effort to find work. The Eurostat surveys only count unemployed persons who are actively seeking jobs.

3 The overall budget balance and the public debt

3.1 Fiscal policy stance

Situation

The stability programme for 2007-2010 is an update of the previous stability programme for 2006-2009 and forms part of the long-range budget programme drawn up during the federal coalition negotiations following the May 2003 elections. A balanced budget and, from 2007, the steady creation of surpluses and reduction in the debt ratio are still the central objectives. This fiscal policy is linked to an ambitious social and economic policy.

From a balanced budget to the creation of surpluses

At the end of 2006, the budget will once again be in balance. From 2007, budget surpluses will gradually be created, initially amounting to 0.3 % of GDP; after that, the surplus is to be increased by 0.2 percentage point each year. These surpluses will be used to provide structural finance for the Ageing Fund. By passing the law amending the law of 5 September 2001 guaranteeing a continuous reduction in the public debt and creating an Ageing Fund, parliament has adopted legislation which embodies this government budget strategy and the associated financing of the Ageing Fund.

Further reduction in the debt ratio

By the end of 2006 the debt ratio will be down to 87.7 %, falling to 83.9 % by the end of 2007 and 72.9 % by the end of 2010. That is a huge improvement on the ratio of 137.1 % at the end of 1993, and even 107.8 % in 2000. In the space of six years, between 2000 and 2006, the ratio was cut by 20 percentage points; between 1993 and 2010, that reduction will total 64 percentage points.

Stimulating economic growth and employment: guaranteeing a strong social security system based on solidarity

The fiscal policy is supplemented by an economic and social policy which stimulates employment by a continuing programme of cuts in charges while aiming to enhance social security and purchasing power.

Controlling primary expenditure

In accordance with the federal coalition agreement, additional resources have been earmarked for justice and security, while the funding provided for mobility, development cooperation and e-government is guaranteed. Granting additional resources for political priorities implies severe restrictions on primary expenditure in other areas. In that context, it is vital to continue to control expenditure on health care, which has a major impact on the social security balance.

3.2 An overview of public finances, 2006-2010

The 2005 figures shown for public finances in this stability programme are the ones notified to Eurostat by the National Accounts Institute at the end of September. Assuming that the Rail Infrastructure Fund is deconsolidated, a surplus of 0.1 % of GDP and a debt ratio of 91.5 % will be recorded in 2005. At the time of the publication of the 2005 figures for the public debt and the budget balances, Eurostat stated that it disagreed with the treatment of the Rail Infrastructure Fund in the Belgian figures. According to the Eurostat figures, the financing requirement will be 2.3 % of GDP and the debt ratio 93.2 % of GDP.

The government still has reservations about Eurostat’s interpretation. That is why the figures for 2005 and subsequent years are still based on the assumption of the deconsolidation of the Rail Infrastructure Fund.

Table 4 sets out the objectives and forecasts for public finances for the period 2006-2010. The general government's overall budget balances represent a clear commitment. The detailed figures for revenue and expenditure are merely estimates, and are intended only 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 4

General government budget forecasts

% of GDP

(in millions of euro)

Overall balance of the sub-sectors

1. General government

2. Federal government

3. Communities and regions

4. Local authorities

5. Social security institutions

General government

6. Total revenue

7. Total expenditure

8. Overall balance

9. Interest charges (incl. FISIM)

10. Primary balance

Main components of revenue

11. Total taxes

11a. Taxes on production and imports

11b. Taxes on income, tax on assets, etc.

11c. Taxes on capital

12. Social security contributions

13. Property incomes

14. Other

15(=6): Total revenue

p.m. tax burden

Main components of expenditure

16. Consumption expenditure

17. Total social benefits

17a. Social benefits in kind

17b. Other social benefits

18. Interest charges (incl. FISIM)

19. Subsidies

20. Gross fixed capital formation

21. Other (21=22-16+17+18+19+20)

22(=7): Total expenditure

p.m. Compensation of employees

En % du PIB	2005 (en million d'euros)	2005	2006	2007	2008	2009	2010
	Solde de financement des sous-secteurs						
1. Ensemble des pouvoirs publics	308,1	0,1	0,0	0,3	0,5	0,7	0,9
2. Pouvoir fédéral	-197,1	-0,1	-0,1	0,0	0,3	0,4	0,6
3. Communautés et régions	809,4	0,3	0,2	0,1	0,0	0,0	0,0
4. Pouvoirs locaux	-463,1	-0,2	-0,2	0,0	0,1	0,2	0,2
5. Administrations de sécurité sociale	158,9	0,1	0,1	0,2	0,1	0,1	0,1
	Ensemble des pouvoirs publics						
6. Recettes totales	148.986,3	50,0	49,1	48,9	48,9	48,8	48,7
7. Dépenses totales	148.678,2	49,9	49,1	48,6	48,4	48,1	47,8
8. Solde de financement	308,1	0,1	0,0	0,3	0,5	0,7	0,9
9. Charges d'intérêt (incl. SIFIM)	12.657,4	4,2	4,1	3,9	3,6	3,4	3,3
10. Solde primaire	12.965,5	4,3	4,1	4,2	4,1	4,1	4,2
	Principales composantes des recettes						
11. Impôts totaux *(11=11a+11b+11c)*	92.433,4	31,0	30,7	30,5	30,7	30,6	30,6
11a. Impôts sur la production et les importations	39.429,4	13,2	13,5	13,4	13,5	13,4	13,4
11b. Impôts sur le revenu, impôt sur le patrimoine, etc.	51.123,4	17,1	16,5	16,5	16,6	16,6	16,6
11c. Impôts sur le capital	1.880,6	0,6	0,7	0,6	0,6	0,6	0,7
12. Cotisations sociales	47.963,4	16,1	15,8	15,7	15,7	15,7	15,7
13. Revenus de la proprieté	1.979,1	0,7	0,6	0,6	0,6	0,5	0,5
14. Autres *(14=15-(11+12+13))*	6.610,4	2,2	2,0	2,0	1,9	1,9	1,8
15. (=6): Revenu total	148.986,3	50,0	49,1	48,9	48,9	48,8	48,7
p.m.: pression fiscale	142.358,8	47,7	47,1	46,9	47,1	47,0	47,0
	Principales composantes des dépenses						
16. Dépenses de consommation	46.962,5	15,75	15,55	15,43	15,29	15,20	15,12
17. Prestations sociales totales	68.873,2	23,1	22,8	22,8	22,9	22,9	22,9
17a. Prestations sociales en nature	21.248,7	7,1	7,1	7,2	7,4	7,5	7,5
17b. Prestations sociales autres	47.624,5	16,0	15,8	15,6	15,5	15,5	15,4
18.(=9): Charges d'intérêt (incl.SIFIM)	12.657,4	4,2	4,1	3,9	3,6	3,4	3,3
19. Subsides	4.981,9	1,7	1,7	1,7	1,6	1,6	1,6
20. Formation brute de capital fixe	5.303,9	1,8	1,6	1,5	1,7	1,7	1,7
21. Autres (21=22-16+17+18+19+20)	9.899,3	3,3	3,3	3,3	3,3	3,2	3,2
22. (=7): Dépenses totales	148.678,2	49,9	49,1	48,6	48,4	48,1	47,8
pm: Rémunérations des salariés	36.198,4	12,1	12,0	11,9	11,8	11,7	11,7

3.2.1 Execution of the 2006 budget

Economic growth stronger than expected

In both the European Union as a whole and the euro area, economic growth exceeded the forecasts in the first half of 2006. In the second half, growth slackened pace somewhat. In the case of the Belgian economy, growth actually outstripped the rate for the euro area, with the figure for the year reaching 2.7 %. When the 2006 budget was drawn up, growth had been estimated at 2.2 %.

Revenues have failed to match the trend in economic growth

In 2006, the movement in tax revenues was not entirely in line with economic growth. Owing to the effects of the less favourable composition of GDP, the rise in total tax revenues has not been as good as might have been expected on the basis of the current growth estimates.

Lower expenditure ratio

In 2006, the general government expenditure ratio was 0.9 percentage point lower than in 2005. In relation to GDP, both primary expenditure (-0.6 percentage point) and interest charges (-0.2 percentage point) declined. In 2005, certain categories of expenditure increased sharply: investment in public works (this expenditure traditionally increases in the run-up to the local elections), the BNRC subsidies (which are back to their normal level) and business subsidies (increased by the service voucher system). In 2006, this expenditure followed a more normal pattern. Also, continuous monitoring brought health care expenditure under control in 2006, actually reducing it below the target figure.

Stringent budget monitoring

As in previous years, the government is keeping a stringent and systematic watch on revenue and expenditure in order to balance the budget. Apart from the traditional budget audit at the end of March, an additional audit was conducted in July. When the initial 2007 budget was drawn up, some setbacks in the execution of the budget necessitated a third, more extensive audit. As usual, both revenue and expenditure will be stringently monitored in the closing months of the year.

3.2.2 The 2007 budget

From balance to surplus

In 2000, a lengthy period of deficits came to an end. In the period which followed, owing partly to weak economic growth, the central aim was to safeguard the balance. It is necessary to reduce the debt at a sufficiently rapid pace to allow for the expenditure relating to population ageing. That is why the government is opting for the progressive creation of surpluses. A first step in that direction was taken by the 2007 budget, which provides for a surplus of 0.3 % of GDP.

More than achieving a surplus

Apart from the measures required to create a budget surplus, the 2007 budget also contains measures in favour of employment, the economic climate, the environment and social protection. Thus, additional measures are planned to stimulate research and development. Other measures are also scheduled to provide tax incentives for the mobilisation of tax-exempt reserves, and to impose a levy on waste packaging, plus tax incentives for investments designed to save energy and for the purchase of cars which cause less pollution. The government is firmly committed to a social housing policy, taking measures to promote the construction of social housing and urban renewal. Social protection for patients is being enhanced, and certain measures to adjust social benefits in line with prosperity will be implemented more quickly or be extended in scope.

Coordination of the fiscal policies of the various public authorities

2006 was a local election year. Traditionally, owing to the influence of the electoral budget cycle, there is a marked deterioration in the budget balance of local authorities in the year before these elections, and in the election year, and an improvement thereafter. Local authority finances should therefore be back in balance in 2007.

In 2007, the financial resources of the communities and regions will expand strongly, by more than those entities predicted in their estimates at the time of the preparation of their respective budgets. This has enabled the communities and regions to make an extra effort in 2007, together creating a surplus of 0.1 % of GDP.

Entity I (federal government and social security) is expected to achieve a surplus of 0.2 % of GDP, via a surplus in the social security budget combined with a balanced federal government budget. The general government balance will therefore come to 0.3 % of GDP, in accordance with the amended law on the Ageing Fund.

Taxation, an instrument for steering the economy

The government conducts an active fiscal policy in order to encourage job creation and investment. Thus, the tax rules in favour of the employment of scientific researchers in corporate research centres have been extended, the flat-rate professional expenses allowance has been increased and there are special tax rules to make the mobilisation of tax-exempt reserves more attractive. Once again, the government has chosen to shift the general burden of taxation from earned incomes to other factors. In addition, a new tax on waste packaging should encourage consumers and producers to favour packaging which is less harmful to the environment.

Control of expenditure by stringent monitoring

The 2007 budget is once again a thrifty budget. As before, public service spending is subject to stringent monitoring. Thus, the total primary expenditure of the federal government cannot increase by more than 2.3 % in real terms. If pension expenditure is left out of account, that figure falls to around 1 %. In nominal terms, the growth rates are 4.2 % and 2.9 % respectively. The government’s political priorities are nevertheless safeguarded. The 2007 target for health care expenditure was set in accordance with the coalition agreement. However, within that target, some credits will probably remain unused. Thus, a sum of € 309 million is being transferred to a fund to finance health care in the future. The ratio of general government primary expenditure to GDP will decline by 0.2 percentage point, as will the ratio of interest charges to GDP.

3.2.3 The period 2008-2010

Gradual creation of budget surpluses

The budget strategy outlined from 2007 was designed to cushion the additional cost of the ageing of the Belgian population. In line with the long-term strategy, in 2007 the government will start gradually building up budget surpluses which it will pay into the Ageing Fund to finance the increase in pension costs. The surplus to be achieved by general government in 2007 comes to 0.3 % of GDP. The amended law on the Ageing Fund provides for an annual increase in this surplus of 0.2 % of GDP, bringing it to 1.3 % in 2012. In 2008, general government will have to achieve a surplus of 0.5% of GDP. It is at federal level that the greatest effort will go into achieving these surpluses. However, these targets can only be achieved with the full cooperation of the other public authorities.

A substantial budget surplus as the medium-term objective(MTO)

Article 2 of the new Stability and Growth Pact obliges the Member States of the European Monetary Union to formulate individual medium-term budget targets in terms of nominal growth and the debt ratio. The MTO has a triple purpose:

- To provide a safety margin in relation to the 3 % deficit criterion.
- To ensure sufficiently rapid progress towards tenability.
- To provide scope for other items, such as public investment.

The Belgian government maintains a medium-term objective of 0.5 % of GDP. Taking account of the cyclically adjusted balance, estimated at a minimum of 0.9% of GDP, from 2008 onwards, and assuming that the impact of the one-off measures does not exceed 0.4 % of GDP, the medium-term objective will be achieved by 2008.

3.3 The contribution of the various sub-sectors

Belgium is a federal State in which power of decision is exercised at various levels, depending on the area of responsibility. In principle, the communities and regions are free to conduct their own fiscal policy. However, the Financing Requirements Section of the High Council of Finance may advise the federal authority to limit their borrowing capacity. The targets set for public authorities as a whole can therefore be attained only if the fiscal policy of the various levels of power is coordinated. 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.

A new agreement on the budget targets of the communities and regions

In its budget plans for the period 2007-2010, the Belgian federal government continues to create budget surpluses, providing finance for a reserve fund to cushion the future increase in the cost of pensions. Right from the start of this new phase in fiscal policy, it is vital to define clearly the responsibilities of each level of government. The first step in that direction was taken at the end of 2005, when the federal government concluded a new agreement with the communities and regions on the budget targets for the period 2005-2009. Under this agreement, the communities and regions will make an additional effort in 2005 and 2006. However, they may set that additional effort against the previous targets for the period 2006-2009. That explains why the normalised target for the communities and regions is cut from 0.2 % of GDP in 2005 to virtually zero from 2007 onwards. When the federal budget for 2007 was drawn up and it emerged that the communities and regions would receive more funds than expected in previous estimates, they were prepared to make an extra effort in 2007 as well, equivalent to the amount of the estimated additional revenues.

Local authorities

In the electoral budget cycle of the local authorities, the local elections have a negative impact on the budget balance. As gross investment in immovable assets declines after the elections, local authorities will once again achieve a balanced budget in 2007. After 2007, the local authorities will have to create small surpluses.

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Table 5

The medium-term targets for the various sub-sectors

En % du PIB	2005	2006	2007	2008	2009	2010
Solde primaire	4,3	4,1	4,2	4,1	4,1	4,2
Entité I	3,9	3,8	3,7	3,7	3,6	3,7
Entité II	0,5	0,3	0,5	0,4	0,5	0,5
Charges d'intérêt	4,2	4,1	3,9	3,6	3,4	3,3
Entité I	3,9	3,7	3,5	3,3	3,1	3,0
Entité II	0,4	0,3	0,3	0,3	0,3	0,3
Solde de financement	0,1	0,0	0,3	0,5	0,7	0,9
Entité I	0,0	0,1	0,2	0,4	0,5	0,7
Entité II	0,1	-0,1	0,1	0,1	0,2	0,2

% of GDP

Primary balance

Entity I

Entity II

Interest charges

Entity I

Entity II

Overall balance

Entity I

Entity II

The objective for the communities and regions combined with the estimates for local authorities results in a surplus of 0.1 % for Entity II in 2007. In subsequent years, the decline in the surplus of the communities and regions will be offset by the improvement in the local authority balance. In 2010, Entity II is expected to achieve a surplus of 0.2 % of GDP.

Entity I is to continue gradually building up surpluses. In 2007, that surplus is created at the level of social security. From 2008 onwards, the federal government must itself create ever larger surpluses. The Entity I surplus will thus increase to 0.7 % of GDP in 2010.

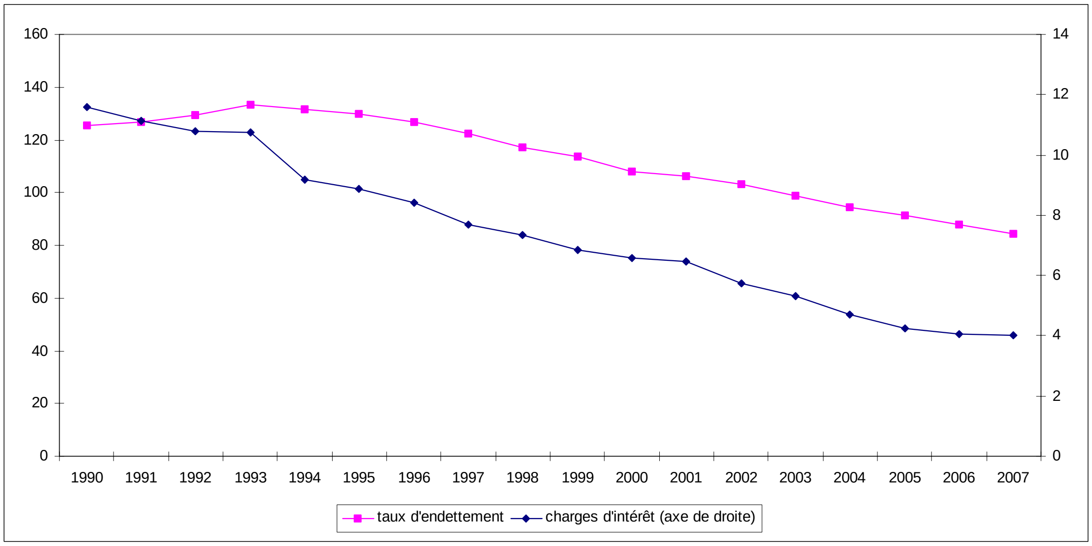
3.4 Debt developments

Debt reduction as the key aim

The achievement of a balanced budget represents a break in the trend for Belgian public finances. However, the large Belgian public debt remains a significant adverse factor despite the efforts to reduce it. Reducing the debt ratio at a sufficiently rapid pace is a crucial element of the government's strategy for coping with the budgetary effects of the ageing population.

Chart 1

Movement in the debt and interest charges (% of GDP)



Debt ratio

Interest charges (right-hand scale)

Chart 1 illustrates the efforts made to reduce the debt. In the early 1990s the debt ratio was still 130 %, but was reduced below 100 % in 2003. This debt reduction policy has continued in the past few years, bringing the ratio down to 91.5 % in 2005.

Table 6
Movement in the general government debt ratio

% of GDP

1. Gross debt

2. Change in the debt ratio

Factors influencing the movement in the gross debt ratio

3. Primary balance

4. Interest charges (incl. FISIM)

5. Exogenous change in the debt

p.m.: implicit level of interest rates

En % du PIB	2005	2006	2007	2008	2009	2010
1. Dette brute	91,5	87,7	83,9	80,4	76,6	72,6
2. Changement dans le taux d'endettement	-2,8	-3,8	-3,8	-3,5	-3,8	-3,9
	Éléments contribuants à l'évolution du taux d'endettement brut					
3. Solde primaire	4,6	4,1	4,2	4,1	4,1	4,2
4. Charges d'intérêt (incl. FISIM)	4,2	4,1	3,9	3,6	3,4	3,3
5. Variation exogène de la dette	0,3	0,5	0,2	0,2	0,2	0,2
p.m. niveau implicite du taux d'intérêt	4,6	4,7	4,6	4,5	4,4	4,5

Continuing reduction

For 2007 and subsequent years, the proceeds from any privatisation operations are no longer taken into account. The movement in the debt ratio is therefore defined largely by exogenous changes. According to the growth and interest rate assumptions adopted for the period 2007-2010, a primary balance of no more than 0.4 % of GDP is sufficient to stabilise the debt ratio; that emphasises the soundness of the debt reduction scenario. Owing to the proposed budget targets combined with the expected movement in interest rates, a primary surplus of around 4.1 % of GDP will be needed, engendering a corresponding endogenous change in the debt. This is attenuated somewhat by the assumptions adopted in relation to the impact of loans and participating interests and other factors (difference between cash and scheduling). By the end of 2010, the debt ratio should be down to 72.6 %.

3.5 The cyclically adjusted balance

According to the Federal Planning Bureau's estimates, the potential growth of the Belgian economy in the medium term varies between 2.2 and 2 %. The largest contribution to this potential growth comes from total factor productivity. Initially, capital and labour have the same impact on potential growth, but towards the end of the period concerned, the contribution of the factor labour will fall sharply as the population ages.

In 2005, since GDP was relatively weak, the output gap was decidedly negative. In 2006, with growth estimated at 2.7 %, the negative output gap is cut to 0.7 %. In the macroeconomic scenario adopted, growth over the period 2008-2010 is only slightly above the potential growth rate. This means that, over the period as a whole, the cycle has a negative impact on the primary balance and the overall balance. After cyclical adjustment, a surplus of 0.4 % of GDP will be created in 2006, rising to 1.1 % in 2010. The said adjustment for the impact of the cycle takes account only of the output gap and not the composition of GDP.

Table 7

Output gap and cyclically adjusted balance

En % du PIB	2005	2006	2007	2008	2009	2010
1. Croissance réelle du PIB	1,2	2,7	2,2	2,1	2,2	2,2
2. Solde de financement effectif de l'ensemble des administrations publiques	0,1	0,0	0,3	0,5	0,7	0,9
3. Charges d'intérêt (incl.FISIM)	4,2	4,1	3,9	3,6	3,4	3,3
4. Croissance potentielle du PIB	2,2	2,2	2,2	2,1	2,0	2,0
Contribution:						
- emploi	0,6	0,6	0,6	0,4	0,3	0,3
- capital	0,7	0,7	0,6	0,6	0,7	0,7
- productivité totale des facteurs	0,9	1,0	1,0	1,0	1,0	1,0
5. Output gap	-1,2	-0,7	-0,7	-0,7	-0,5	-0,3
6. Composante cyclique du budget	-0,6	-0,4	-0,4	-0,4	-0,3	-0,2
7. Solde de financement corrigé des variations du cycle (2-6)	0,8	0,4	0,6	0,9	1,0	1,1
8. Solde primaire corrigé des variations du cycle (7-3)	5,0	4,5	4,5	4,5	4,4	4,3

% of GDP

1. Real GDP growth

2. Actual overall balance of general government

3. Interest charges (including FISIM)

4. Potential GDP growth

Contribution:

- employment

- capital

- total factor productivity

5. Output gap

6. Cyclical component of the budget

7. Cyclically adjusted overall balance (2-6)

8. Cyclically adjusted primary balance (7-3)

The adjustment for the impact of the cycle is only a first step in the interpretation of the more fundamental trend in the key figures for public finances. After that, adjustment has to be made for the impact of one-off measures. The estimated total for one-off measures in 2006 came to 0.6 % of GDP. In 2007, they amount to 0.4 % of GDP.[(4)] Following adjustment for the impact of these one-off measures, a structural surplus of 0.2 % of GDP will be achieved in 2007.

(4) In 2007, the most important one-off measures are the property transactions and the assumption of the pension liabilities, each measure representing 0.2 % of GDP.

4 Comparison with the stability programme for 2006-2009 and sensitivity analysis

4.1 Comparison with the stability programme for 2006-2009

Table 8 compares the targets of the stability programme for 2006-2009 with the new targets.

Table 8
Deviations from the previous programme

En % du PIB	2005	2006	2007	2008	2009	2010
Croissance du PIB						
mise à jour précédente	1,4	2,2	2,1	2,3	2,2	
mise à jour actuelle	1,2	2,7	2,2	2,1	2,2	2,2
écart	-0,2	0,5	0,1	-0,2	0,0	0,0
Solde de financement						
mise à jour précédente	0,0	0,0	0,3	0,5	0,7	
mise à jour actuelle	0,1	0,0	0,3	0,5	0,7	0,9
écart	0,1	0,0	0,0	0,0	0,0	
Taux d'endettement brut						
mise à jour précédente	94,3	90,7	87,0	83,0	79,1	
mise à jour actuelle	91,5	87,7	83,9	80,4	76,6	72,6
écart	-2,8	-3,0	-3,1	-2,6	-2,5	

% of GDP

GDP growth

previous update

current update

deviation

Overall balance

previous update

current update

deviation

Gross debt ratio

previous update

current update

deviation

Practically no changes to the medium-term macroeconomic framework

At the time of the drafting of the stability programme for 2006-2009, economic growth was already forecast to slow down in 2005. That year's growth was actually 0.2 percentage point below the forecast figure, at 1.2 % of GDP. Conversely, in 2006 growth was higher than forecast. Like the European Union as a whole and the euro area, the Belgian economy experienced a strong surge in the first three quarters of 2006. Current estimates point to GDP growth outstripping the figure predicted in the stability programme for 2006-2009. For subsequent years, the deviations from the previous stability programme are less explicit. For 2005-2009, the cumulative growth deviation is 0.2 percentage point.

Targets maintained

As already mentioned, the law of 20 December 2005 amending the law of 5 September 2001 guaranteeing a continuous reduction in the public debt and creating an Ageing Fund indirectly fixed the targets for the overall balance, by specifying that from 2007 onwards surpluses will be gradually created; this means that the budget plan remains unchanged in relation to the previous stability programme.

Debt reduction takes place in parallel

The difference in the debt ratio compared to the previous stability programme is due largely to the fact that, in the figures used in that programme, the Rail Infrastructure Fund managing a large part of the former BNRC's debt is no longer consolidated with the federal government. As a result of the adjustments to Aquafin's structure and funding arrangements, (5) that company no longer falls within the public sector from

(5) Aquafin is the company which carries out sewage treatment for the Flemish Region.

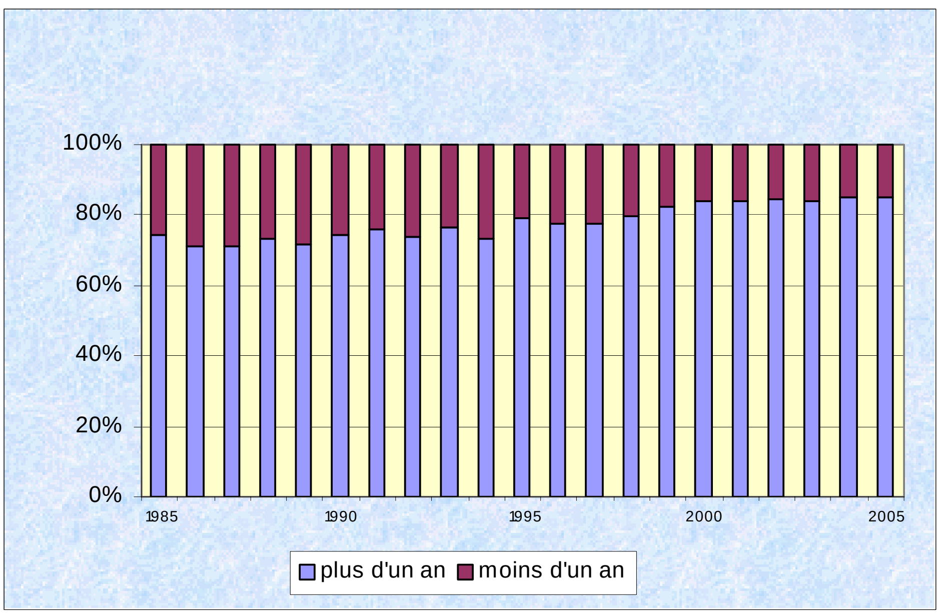
2005. The two adjustments have a total impact of roughly 2.3 % of GDP. The rest of the deviation in relation to the previous programme is due to the more favourable than expected movement in other items linking the overall balance and the movement in the debt, and the deviations in economic growth.

4.2 Sensitivity analysis

4.2.1 Interest rate sensitivity of the overall balance

Since the introduction of the euro, the debt denominated in foreign currency has been cut to less than 1% of the total Belgian public debt, so that the exchange risk has become more or less negligible. However, in view of the size of the Belgian public debt, public finances are still sensitive to interest rates fluctuations. The federal government (which holds roughly 90% of the total debt) manages its debt in such a way as to control the various risks (exchange rate, interest rate and refinancing risks), adhering to the general guidelines on the debt which are imposed each year.

Chart 2



The gross debt in euro, by maturity

at up to one year

at over one year

The extension of the duration of the existing debt prolongs the impact on the interest charges of a change in the level of interest rates. Table 9 shows the effect on the interest charges of an increase in the interest rate assumptions of 100 basis points for the entire period 2007-2010.

Table 9
Impact of a change in the interest rate assumptions

% of GDP

Degree to which interest charges deviate from the scenario described

En % du PIB	2007	2008	2009	2010
Écart des charges d'intérêt par rapport au scénario décrit	0,2	0,3	0,3	0,4

A draconian increase in interest rates of 100 basis points would increase the interest charges by 0.2 % of GDP in the first year and 0.4 % of GDP after 4 years.

4.2.2 Growth sensitivity of the overall balance

On both the revenue and the expenditure side, the general government's final budget balance depends on the volume and the composition of economic growth. The sensitivity of Belgian public finances is estimated at 0.54.

Table 10
Sensitivity of Belgian public finances to changes in GDP

Sensitivity of revenue

Sensitivity of expenditure

Overall sensitivity

Sensibilité des recettes	0,47
Sensibilité des dépenses	-0,07
Sensibilité globale	0,54

A change in GDP mainly affects Belgian public revenue. Expenditure is far less sensitive. On the basis of this overall sensitivity, we outline the impact of possible divergences from the base scenario as regards medium-term economic growth. We compare the base scenario with the growth path corresponding to potential growth, on the assumption of lower growth with a negative annual deviation of 0.5 percentage point and higher growth with a positive annual deviation of 0.5 percentage point.

Table 11
Sensitivity of the overall balances to changes in growth

Stability programme 2007-2010

Real GDP growth

Overall balance

Potential growth

Real GDP growth

Overall balance

Weaker growth

Real GDP growth

Overall balance

Stronger growth

Real GDP growth

Overall balance

	2007	2008	2009	2010
Programme de stabilité 2007-2010				
Croissance réelle du PIB	2,2	2,1	2,2	2,2
Solde de financement	0,3	0,5	0,7	0,9
Croissance potentielle				
Croissance réelle du PIB	2,2	2,1	2,0	2,0
Solde de financement	0,3	0,5	0,6	0,7
Une croissance moins forte				
Croissance réelle du PIB	1,7	1,6	1,7	1,7
Solde de financement	0,0	0,0	-0,1	-0,2
Une croissance plus forte				
Croissance réelle du PIB	2,7	2,6	2,7	2,7
Solde de financement	0,5	1,0	1,5	2,0

The growth figure assumed in the present stability programme for 2007-2010 is close to potential growth. The deviation from the central scenario is therefore very small. In 2010, the surplus would be 0.7 instead of 0.9 % of GDP. If growth surpasses the estimates, and provided that the additional growth is all used to improve the overall balance, this surplus would amount to 2 % of GDP in 2010. If growth were lower in every year of the period considered, 2007-2010, and in the absence of any compensatory efforts, there would be a small deficit of 0.2 % of GDP at the end of the period. However, the government considers that to be a purely theoretical scenario. Owing to the link to the financing of the Ageing Fund, the timetable for creating medium-term fiscal surpluses has been indirectly laid down by law. Furthermore, if growth exceeds the forecasts, 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

The Belgian authorities have been pursuing their policy of reforms to augment the economy's growth potential. A whole range of measures have been implemented and new ones have been introduced.

The Generation Pact concluded at the end of December 2005 is the source of numerous initiatives aimed at promoting the recruitment of young people, encouraging older people to remain active, and strengthening the social security system. Since then, many of these initiatives have been put into practice, notably in the execution of the 2006 budget and the drafting of the 2007 budget.

More generally, numerous measures have been taken to stimulate supply and demand on the labour market, to continue improving the environment for businesses in terms of taxation and regulations, and ensuring a high standard of social protection. Funds have also been made available for certain priority areas.

5.1 Stimulating demand and supply on the labour market

The policy of encouraging both demand for labour and the labour supply was confirmed by the introduction of new reductions in charges and the extension of existing measures. The cuts in fiscal and parafiscal charges on labour are aimed at certain target groups (the highly skilled and low skilled, young people and the older age groups) or at all workers in general.

Despite the progress made, the employment rate for older workers is still too low. They are retiring from the labour market prematurely. Young people, especially the low skilled, are not adequately integrated into the world of work. As well as cutting labour costs, the government has therefore taken specific measures to boost participation in the labour market by these two segments of the population.

5.1.1 Increasing demand for labour

In order to support the creation of highly skilled jobs in sectors with good future prospects, the exemption from the withholding tax on earned incomes has been increased in the case of research and development (see 5.4).

There is a tax concession to encourage work placements designed to prepare young people better for the labour market. The employer can deduct 120 % of the remuneration paid to young people as business expenses. This provision in favour of young people is in addition to the reduction in social security contributions for low wage earners aged from 19 to 29 years.

Apart from the existing reduction in employers' social security contributions for workers aged over 57 years, the employment of workers aged over 50 will be encouraged by the introduction, on 1 April 2007, of a reduction in social security contributions, increasing with age, for the recruiting firms.

The system of partial exemption from the withholding tax on earned incomes in the case of night work and shift work has been extended. The rate of exemption, already increased for the first time in 2006, will be doubled in 2007, rising to 10.7 %. New measures to reduce charges are also planned for overtime work.

5.1.2 Making work more attractive

Apart from the personal income tax reform which became fully operational in 2006, several measures aim to make work more financially worthwhile, in particular by making it more attractive to take on a paid job instead of not working. These provisions increase the worker's net income without generating any additional costs for the employer.

A general reduction in the tax burden on earned incomes is being effected by a 1.1% increase in the first tranche of the flat-rate professional expenses allowances from 2006. This reduction will be incorporated in the withholding tax on earned incomes from December 2006 and will be doubled in 2007.

The "work bonus" system, which comprises a degressive reduction in personal social security contributions, was further extended in 2006. The amount of the reduction has been increased and the pay threshold below which the bonus is granted has been raised in order to combat the unemployment traps. Still with the aim of preventing unemployment traps, persons receiving unemployment or invalidity benefits who find a job will be able to continue receiving increased family allowances for a period of two years.

A fund is being set up to encourage employers to invest in the training of workers providing services under the service voucher system; these workers generally have low skills.

5.1.3 Increasing the participation of the young and older persons in the labour market

Both the public and the private sector are expanding the opportunities for young people to gain work experience and find employment.

The obligation on the federal authorities to provide a "first job" for young people is being augmented. In future, the federal public services will have to allocate 3% of jobs to young people under the age of 26 years, in the same way as private sector enterprises employing over 50 workers. Those jobs should preferably go to young low-skilled workers.

To encourage traineeships in enterprises, financial incentives are being offered to young people who participate. Successful completion of a traineeship entitles them to a starting bonus. Apart from that tax concession, the enterprises taking on the trainees also receive a trainer's bonus.

There are to be new allowances for certain young people receiving training, pursuing traineeships or preparing to set up in business as self-employed persons.

Apart from the reduction in social security contributions already mentioned, numerous measures are being introduced to promote activity among older people and to encourage them to continue working. They are intended to bring about a change of attitude and behaviour among both employers and workers.

First, conditions for taking early retirement are being tightened up. An activation policy is being set up to limit the numbers taking early retirement when their firm undergoes restructuring. Redundant workers will be given guidance by an employment unit and will receive an integration benefit from their employer. They will have to demonstrate that they have made every effort to find work before becoming eligible for early retirement. The standard early retirement age will also be raised from 58 to 60 years between now and 2008, with seniority conditions progressively revised upwards. There will be some exceptions, yet to be specified, in the case of heavy work, long service, etc.

Next, there are provisions discouraging the use of alternatives to early retirement which combine unemployment benefits with additional allowances paid by the employer. Higher social security contributions will be charged on these allowances, and the rate of tax on them will also increase. However, there will be favourable fiscal and parafiscal treatment to encourage workers benefiting from such a system to resume work while continuing to receive this additional allowance in conjunction with earned income.

Older unemployed workers are also encouraged to find a job, even if the rate of pay is less than before, by the grant of an income supplement if they go back to work. The eligibility conditions are being eased for this category of workers, with no requirement concerning the length of the unemployment period.

The measures relating to pension schemes are intended both to delay the age of retirement and to encourage people to work while drawing a pension. As an incentive to continue working longer, a ‘‘pension bonus” will be granted from 2007 to employees who continue working after the age of 62 years or after a working life of 44 years. This bonus will have the effect of increasing their pension. Also, supplementary pensions converted to a capital sum will be taxed less heavily if the recipient was working up to the statutory retirement age. As regards continued employment after retirement, the scope for combining a pension and an income from employment is being extended.

Finally, there are measures to promote the training of workers over the age of 45 years. They can qualify for a training allowance in respect of personal vocational training.

5.2 Improving the fiscal and regulatory environment for businesses

A fiscal and regulatory environment conducive to business investment and activity contributes towards job creation and economic growth.

Business investment is being encouraged by the application of an advantageous rate of tax on the use of tax-exempt reserves. Those reserves correspond to undistributed profits placed in reserve on the liabilities side of the balance sheet. Businesses remain free to choose how to allocate the sums released. However, the rate of tax is more attractive if those funds are reinvested rather than being distributed.

This measure is in addition to the notional interest allowance which came into effect in 2006 and also encourages companies to finance themselves. This allowance comprises an exemption from the basis of assessment for corporation tax equivalent to the notional return on equity.

The efforts to reduce the administrative burden on businesses have been stepped up, with simplification of the legislation and the development of e-government, particularly in regard to tax liabilities, personnel policy, publication requirements, the amount of time involved in setting up a business, etc.

5.3 Improved social security with a balanced budget

Improving what is a generally high quality social security system and, in particular, maintaining a decent standard of living for households by adjusting social benefits in line with prosperity is a priority for the Belgian authorities. In particular, that requires structural funding for social security and control over health care expenditure.

5.3.1 Restructured funding sources

Since social security funding is too dependent on earned incomes, the diversification of funding sources has been developed to transfer the levies to other bases of taxation.

In the 2007 budget, the government augmented this alternative funding of social security by raising the excise duty on tobacco and extending the packaging levy. The efforts to combat social security fraud will also be reinforced.

In addition, the Generation Pact stipulates that, from 1 January 2007, part of the personal income tax and corporation tax revenues will be allocated to social security, in return for the new reductions in employers' social security contributions. The decline in these charges encourages job creation, leading to an increase in taxed incomes.

5.3.2 Health care expenditure under control

Health care expenditure in 2005 adhered to the budget target. That was achieved by structural measures to rationalise expenditure, adopted previously to keep costs under control. According to the latest estimates, expenditure in 2006 will once again meet the growth target.

In accordance with the coalition agreement, the health care budget for 2007 adheres to the real annual growth norm of 4.5 %. The policy of rigorous control over spending is being maintained. In the new measures adopted, the accent is on controlling hospital supplements.

Strict control over spending and additional revenues will make funds available within that norm to finance new initiatives. A forward-looking strategy is being developed by establishing a Fund to guarantee the future of the health care system With an allocation of € 309 million in 2007, this Fund will cover future health care investments necessary to cope with the challenge of population ageing.

Patient protection is also being enhanced. A new "Omnio" status will be introduced on 1 April 2007. It will extend entitlement to preferential health care rates and will be granted to households whose income is below a certain threshold. The intervention system will be improved for the chronically sick, and access to various forms of care will be facilitated by extending reimbursement.

The measures also concern the health care providers, and include upgrading of the role of general practitioners.

5.3.3 Upgrading of social benefits

The maintenance of a high standard of social protection is a factor contributing to social cohesion and the fight against poverty. By ensuring that household disposable income is maintained, this system also contributes towards supporting economic activity, thus strengthening growth. In order to achieve these economic and social objectives, a whole series of social benefits will be upgraded..

The 2% increase in the social integration wage and the lowest welfare benefits, scheduled for October 2007, has been brought forward to April 2007. The cost of this earlier implementation comes to € 16 million. In addition, a further 2 % is planned for 1 January 2008, totalling € 32 million. This benefit will be linked to prosperity in the same way as other social benefits from 2009.

In 2007, new adjustments to pensions and allowances for invalidity, industrial accidents or occupational diseases are planned, amounting to € 182 million. They will be targeted particularly on the oldest and lowest pensions and annuities. From 2008, there will also be an annual budget for a structural adjustment in line with prosperity. In 2008 that budget will total € 209 million for employees and € 25 million for self-employed workers.

In addition, at the time of the July 2006 budget audit, the government decided to increase from December 2006 the amount of the minimum income for elderly persons (Income Guarantee for the Elderly: IGE) by € 60 and € 90 respectively for households or persons living alone, to bring them up to the European poverty threshold.

Family allowances for the first child of self-employed persons are being increased from 1 April 2007. Minor risks will be included in the compulsory health insurance for all self-employed persons from 2008. New self-employed persons and those receiving the IGE or a very low pension have already been insured for minor risks since 1 July 2006.

Household purchasing power was also increased by the granting of a family allowance supplement in September 2006, at the start of the school year. This measure will be repeated from 2007.

5.4 Efforts aimed at political priorities

Control over primary expenditure has released funds for allocation to priority areas. The previous commitments relating to justice, security and mobility are being fulfilled. The funds available for development cooperation and e-government are guaranteed. New priorities have also been defined in the 2007 budget, particularly regarding research and development, housing and the environment.

In order to support research and development work, an exemption from the withholding tax on earned incomes is being granted to new categories of staff in the private sector. From 1 January 2006, a 25% waiver of the payment of withholding tax was offered to enterprises employing civil engineers and persons holding a doctorate in science. The 2007 budget goes a step further by extending the tax concession to all persons holding a masters degree in a scientific subject (physics, biology, chemistry, pharmacy, etc.).

Institutions active in the field of basic research will be totally exempt from social security contributions, in order to encourage the creation of new jobs. In addition, a concessionary rate of tax will apply to incomes which scientific personnel receive as a result of their research. Finally, a series of projects by scientific institutions will receive financial support from the Ideas Fund, and new federal research projects will be launched.

The housing policy is being reinforced, notably by tax measures. A 6% reduced rate of VAT will apply to the construction of social housing and to the construction, following demolition, of housing in specific areas of large towns. A tax incentive will be granted for residential renovation work, if the owner offers the property for rent through a social housing agency. The fees for registering tenancy agreements are being abolished.

The tax system is being used as an instrument to encourage more environmentally responsible behaviour. Energy saving in the home is being promoted by doubling the tax reductions on energy-saving investments. A tax reduction of € 150 will also be granted for the purchase of a vehicle producing low emissions.

A waste packaging levy which takes account of the CO2 emissions in the production process will be introduced as a dissuasive measure, following consultation with the economic sector concerned and with due respect for the European consultation procedures. It is intended to encourage both producers and consumers to change their behaviour in regard to packaging. This provision also helps to reduce the charges imposed on earned incomes by transferring them to other factors.

6 The long-term sustainability of public finances

6.1 Introduction

In common with most western countries, Belgium has to contend with major changes in the age structure of its population. The cumulative effect of the falling birth rate and lengthening life expectancy is already altering the age structure. In the period after 2010, this trend will be even more marked. There will be a declining number of persons of working age who will have to finance social benefits for a growing number of inactive persons.

The government is responding to this trend by establishing a coherent strategy which comprises a specifically targeted fiscal, economic and social policy. This strategy should safeguard the maintenance of a sufficiently high level of prosperity for the community as a whole in the medium term.

6.2 The impact of ageing

As stipulated by the law on the Ageing Fund, the Study Committee on Ageing updates its estimate of the budgetary cost of ageing once a year. The Belgian government uses that estimate as the basis for drawing up its policy on ageing. According to the latest report of the Study Committee on Ageing, social expenditure will increase by 3.8% of GDP between 2005 and 2030, and by 5.8% between 2005 and 2050. (6)

This estimate takes account of the Generation Pact measures which have an impact on the cost of ageing. This Pact comprises financial incentives aimed at encouraging workers to delay their retirement (pension bonus, etc.) while tightening the conditions for access to early retirement. These measures should reduce the numbers eligible (persons receiving early retirement pensions and to a lesser extent pensioners) while also increasing the amount of the pensions. Other social policy measures (adjustment

(6) See also Annex 3.

in line with prosperity, increase in pay thresholds, adjustment of flat-rate amounts in line with prosperity) are reflected in increased social benefit expenditure. However, in the long term that additional cost will be more than offset by the increased revenue from employment and higher GDP, which will have a favourable overall impact on public finances, actually improving the Belgian budget balance by 0.3 % of GDP in 2030 and 0.2 % in 2050.

Table 12 contains the estimates of the Study Committee on Ageing and those of the AWG. The figures published by the European Commission at the beginning of 2006[(7)] disregarded the impact of the Generation Pact. Since then, the Federal Planning Bureau, working with the Commission, has updated the AWG's projections to take account of the Generation Pact measures and a revision of the historical series concerning the number of workers.[(8)] In the updated version, the costs of ageing for the period 2005-2050 come to 6.2 % of GDP, which is 0.2 % less than the figures published by the AWG.

The two projections differ in terms of both their assumptions and their methodology. In its May 2006 annual report, the Study Committee comments in detail on the differences between the two projections. The AWG projection aims to ensure international comparability, while the Study Committee on Ageing tries to take maximum account of federal policy measures and the special characteristics of the Belgian social security system.

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(7) European Commission: The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050) – Report prepared by the Economic Policy Committee and the European Commission, European Economy, Special Report nr 1/2006.

(8) Federal Planning Bureau: incorporation of the Generation Pact in the AWG's social expenditure projection.

Table 12
Budgetary impact of population ageing

En % du PIB	2005	2010	2020	2030	2050	2005-2030	2005-2050
	Comité d'étude sur le vieillissement						
Pensions	9,1	8,9	10,0	12,0	13,0	2,9	3,9
Soins de santé	7,1	7,9	8,6	9,5	10,8	2,4	3,7
Autres dépenses de la sécurité sociale	6,9	6,6	5,8	5,3	5,0	-1,6	-1,9
Dont:	0	0	0	0	0	0	0
Invalidité	1,2	1,2	1,2	1,2	1,1	0,0	-0,1
Chômage	2,2	2,1	1,5	1,3	1,2	-1,0	1,1
Prépensions	0,4	0,4	0,3	0,3	0,3	-0,1	-0,1
Autres secteurs	1,4	1,4	1,4	1,4	1,4	0,0	0,0
Dépenses de la sécurité sociale	23,1	23,4	24,4	26,8	28,8	3,8	5,8
P.m. rémunérations du personnel enseignants	4,1	3,9	3,6	3,7	3,7	-0,5	-0,4
	Ageing working group						
Pensions	10,4	10,5	12,0	14,5	15,4	4,1	5,0
Pensions de retraite et de survie	9,2	9,2	10,8	13,4	14,5	4,2	5,3
Invalidité	0,8	0,8	0,8	0,7	0,7	-0,1	-0,1
Prépensions	0,4	0,5	0,4	0,4	0,3	-0,1	-0,1
Soins de santé	7,1	7,4	7,8	8,4	9,4	1,3	2,3
Chômage	2,2	2,1	1,9	1,8	1,8	-0,5	-0,5
Dépenses de la sécurité sociale	19,8	19,9	21,7	24,6	26,6	4,9	6,8
Enseignement	5,6	5,2	4,9	5,0	4,9	-0,6	-0,6
Total	25,3	25,2	26,6	29,6	31,5	4,3	6,2

% of GDP

Study Committee on Ageing

Pensions

Health care

Other social security expenditure

Of which:

Incapacity

Unemployment

Early retirement

Other sectors

Social security expenditure

P.m. remuneration of teaching staff

Ageing Working Group

Pensions

Retirement and survivors' pensions

Incapacity

Pre-retirement pensions

Health care

Unemployment

Social security expenditure

Education

Total

6.3 A single strategy, a three-pronged policy

The Belgian political authorities consider population ageing to be one of the greatest challenges for the decades ahead. In order to meet that challenge, the government has developed a coherent strategy focusing on three fundamental aspects of policy:

1. Budgetary policy: continue to reduce the public debt and build up reserves in the Ageing Fund;

2. Economic policy: by targeted reductions in charges, boost the employment rate and the quality of labour, particularly in the case of the young and workers aged over 50 years;

3. Social policy: continue developing a strong social security system based on solidarity.

6.3.1 Budgetary policy and the Ageing Fund

Table 12 reveals that population ageing will be accompanied by a substantial increase in social spending. The government’s budgetary policy anticipates these long-term developments. As in the past decade, the debt ratio will have to continue to be reduced at a significant rate. The resulting fall in interest charges will create additional scope for absorbing the cost of population ageing.

6.3.1.1 Budgetary policy

The budget submitted for 2007 provides for a surplus of 0.3 % of GDP. That surplus should subsequently increase by 0.2 % each year to reach 1.3 % in 2012. That path is laid down by the law of 5 September 2005 amending the law of 5 September 2001 guaranteeing a continuous reduction in the public debt and creating an Ageing Fund. Chart 3 illustrates the impact of this scenario on some key parameters of public finances.

On the basis of the government’s current schedule for reducing the public debt, the debt ratio will be cut to less than 60 % of GDP by 2014. This reduction in the debt ratio will reduce the interest charges from 4.2 % of GDP in 2005 to 1.1 % in 2030. The estimated cost of population ageing does not move in parallel with expanding scope created by the reduction in interest charges. That scope can be used primarily to create surpluses.

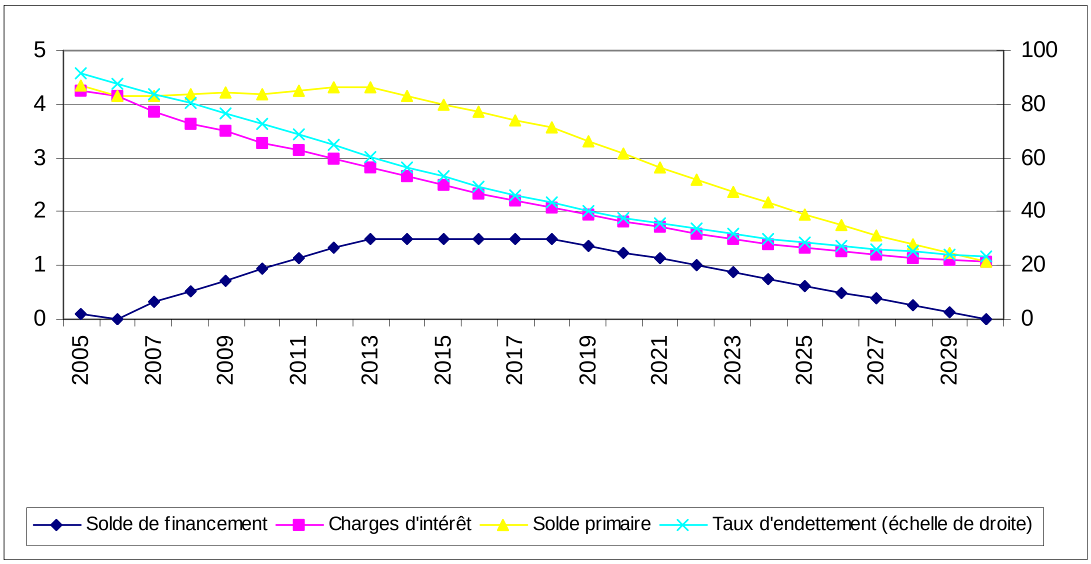
Chart 3
Illustration of the main parameters of public finances
(in % of GDP)

Overall budget balance

Interest charges

Primary balance

Debt ratio (right-hand scale)



Up to now, the Belgian government's policy on ageing and the Ageing Fund had both set the year 2030 as the time horizon. If the forecasts are extended to 2050, assuming that the primary balance excluding ageing remains constant in terms of GDP, it is apparent that the budget would show a deficit of 2.7 % of GDP and the debt ratio would come to 41 % of GDP. The budgetary policy on ageing will therefore require regular appraisal and, where necessary, adjustment.

6.3.1.2 The Ageing Fund

The Ageing Fund was set up in 2001 to build up reserves in order to guarantee the funding for the additional expenditure under the various statutory pension schemes during the period 2010-2030. The law of 5 September 2001 guaranteeing continuous reduction in the public debt and creating an Ageing Fund provides for the Fund to be financed out of budget surpluses, social security surpluses, non-fiscal revenues and investment income. Up to 2006, the Fund has been financed mainly by non-recurring revenues. The amended law on the Ageing Fund first provides that the growing budget surpluses[9] planned until 2012 are to be paid into the Fund. After 2013, payments into the Ageing Fund will be determined by the King by Royal Decree discussed by the Council of Ministers, in accordance with the overall budget balance achieved. The second major component of the amendment to the law concerns the restriction on the possibility of financing the Ageing Fund by operations which have an impact on the debt without affecting the overall balance (non-recurring measures). For the period 2007-2010, this amount is limited to € 250 million per annum, and € 500 million for subsequent years. The Ageing Fund resources can be used to absorb the increase in expenditure on the various statutory pension schemes during the period 2010-2030 on condition that the general government debt ratio is less than 60 % of GDP.

6.3.1.3 Capital invested in the Ageing Fund

Table 13 summarises the capital invested in the Ageing Fund. At the end of 2005, the Ageing Fund reserves totalled € 12,391.8 million. At maturity, that corresponds to € 20,559 million.

[9] See 3.1. Fiscal policy stance

Table 13

Capital invested in the Ageing Fund

		Montants placés	Cumulés
2001	UMTS	437.805.323,80	
	plus-value or	177.114.565,60	
	intérêts CT	9.156.142,90	
		624.076.032,30	**624.076.032,30**
2002	bénéfices BNB	429.000.000,00	
	intérêts CT	2.740.237,50	
		431.740.237,50	**1.055.816.269,80**
2003	dividendes 2002 Belgacom	237.252.326,50	
	billets de banque	213.965.560,00	
	Credibe	2.645.687.591,80	
	intérêts CT	293.449,69	
		3.097.198.927,99	**4.153.015.197,79**
2004	dividendes 2003 Belgacom	290.000.021,30	
	intérêts CT	6.159.344,10	
	fonds de pension Belgacom	5.000.000.000,00	
	Fadels	2.500.000.000,00	
		7.796.159.365,40	
2005	DLU	422.897.175,76	**11.949.174.563,19**
	solde Credibe	19.754.399,06	
	intérêts CT	2.058,25	
		442.653.633,07	
			12.391.828.196,26

Amounts invested

Cumulative

UMTS

capital gain on gold

short-term interest

NBB profits

short-term interest

Belgacom 2002 dividends

banknotes

Credibe

short-term interest

Belgacom 2003 dividends

short-term interest

Belgacom pension fund

SHLAF

One-off declaration of financial assets

Credibe balance

short-term interest

In 2006, it is planned to transfer 0.2 % of GDP to the Ageing Fund. In addition, at the budget audit in July it was decided that the 2006 balance to be determined by the National Bank of Belgium in February 2007 will be paid into the Fund as a new contribution.

As planned, in 2007 the surplus of 0.3 % of GDP – or € 900 million – will be allocated to the Fund, boosting its resources to 14 billion. The target of € 13 billion by the end of 2007, defined at the time of the Ostend Council of Ministers on 20 and 21 March 2004, will therefore be exceeded.

6.3.1.4 Long-term operation of the Ageing Fund

Chart 4 illustrates the long-term operation of the Ageing Fund. As indicated earlier, from 2007 the non-recurring funding will be replaced by structural funding, in particular by the allocation of the general government surpluses created. The interest on the investments will also play an increasingly important role in the funding. The capital of the Fund will exceed 16% of GDP. According to the assumption on which public finances are based, the general government debt ratio will decline below 60%

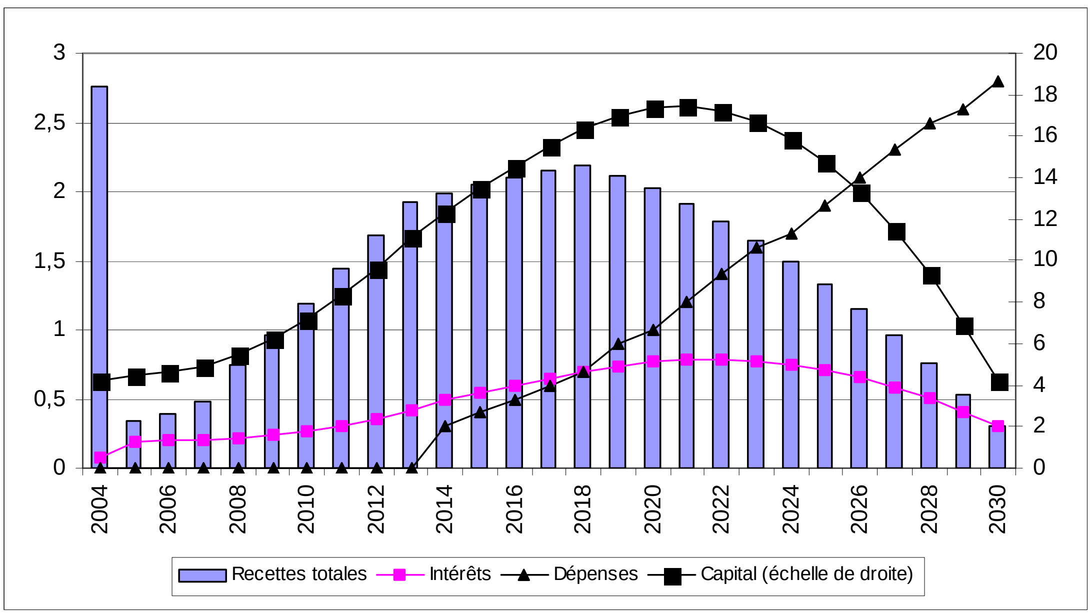
in 2014. In accordance with the law, from then on the Ageing Fund resources can be used to finance the increased expenditure on pensions. The combination of rising expenditure and the drying up of the structural revenues (since the surpluses will disappear) will lead to a gradual reduction in the Fund's capital. The favourable influence of debt reduction and declining interest charges will continue to play a role.

Chart 4
An illustrative scenario for the Ageing Fund

Total revenue

Interest

Expenditure



Capital (right-hand scale)

6.3.1.5 Budgetary policy as an element of a global strategy

As stated earlier, the budgetary policy mentioned above is only one element of a more global strategy. In principle, it would be sufficient to reduce the public debt fast enough to absorb the increasing cost of ageing. However, that would imply that all future scope in the budget is allocated to that single political objective, with no resources for other political initiatives or other challenges. The Belgian economy would then lose its dynamism, and that would have an impact on public revenues. It would therefore be a mistake to base the ageing population strategy on a single budgetary pillar. Other policy areas must also contribute. Promoting employment, and economic growth in general, will strengthen the financial basis for absorbing the costs of ageing. Increased dependency on social security accentuates the importance of a strong social security system based on solidarity. Under the Generation Pact, the government has taken a series of measures in the areas mentioned and discussed in section 5.

7 Institutional aspects of Belgian budgetary policy

Two bodies play a key role in the Belgian budgetary process, namely the High Council of Finance and the National Accounts Institute. The High Council of Finance plays a normative role, assessing the stability programmes and analysing the financing requirements of the various public authorities. The National Accounts Institute draws up the macroeconomic projections which form the basis of the federal budget and the main macroeconomic statistics.

The Ageing Fund and its various associated procedures and structures also have a major impact on Belgian budgetary policy.

7.1 The High Council of Finance and coordination of budgetary policy in a federal state

In 1989, the High Council of Finance underwent a radical reform. One of its new tasks was to supervise the budgetary policy of the communities and regions and to coordinate the budgetary policy of the various public authorities. To that end, a Financing Requirements Section was formed within that Council, comprising experts nominated by the National Bank of Belgium, the Federal Ministers of Finance and the Budget, and the governments of the communities and regions.

In its annual recommendation, the Financing Requirements Section sets out the budget targets for the various public authorities: the federal government, social security, each community and region, and the local authorities as a whole. As already stated, the communities and regions have substantial autonomy over their budgets, so that the recommendations of the High Council are not binding. They form the starting point for agreements to be concluded between the federal government and the communities and regions at the Interministerial Conference on Finance and the Budget, and to be confirmed by the Consultative Committee.

In 2001, the High Council of Finance set up a Study Committee on Ageing to analyse the budgetary and social effects of ageing. That analysis forms the basis of the recommendations made by the Financing Requirements Section. Since the law creating the Ageing Fund, the government in turn has to publish in its strategy document on ageing the recommendations of the Financing Requirements Section and the Study Committee on Ageing.

7.2 The NAI as an autonomous body compiling statistics and preparing macroeconomic projections

Both the International Monetary Fund and the European Commission emphasise the importance of autonomous bodies compiling the key statistics and the estimates of the macroeconomic parameters to be used in drawing up the budget. The law of 21 December 1994 established the National Accounts Institute (NAI), which coordinates the preparation of the key statistics and the macroeconomic projections. The statistics are compiled by:

- The National Bank of Belgium (national and regional accounts, foreign trade statistics, financial accounts).

- The Federal Planning Bureau (short-term forecasts, the economic budget, the input/output tables).

- The two institutions draw up the national accounts.

The NAI’s Board of Directors comprises representatives of the National Bank of Belgium, the Federal Planning Bureau and the FPS Economic Affairs. In addition, a guidance committee has been set up for the national accounts, and two scientific committees, one for the national accounts and the other for the economic budget.

The economic budget measures all the macroeconomic parameters which the government uses as the basis for drawing up its budget. It is prepared by the Federal Planning Bureau, submitted to the scientific committee on the economic budget, and approved by the Board of Directors of the NAI. This method, which involves various autonomous bodies in the preparation of the economic budget via their representation on the Board of Directors or the scientific committee, guarantees good quality forecasts unaffected by political influence. The government takes the budget estimates as the starting point when drawing up the budget. Sometimes, the government makes provision for cyclical buffers to take account of abnormally high uncertainty regarding future growth or interest rates.

7.3 The Ageing Fund and budgetary policy

The Ageing Fund was set up in 2001 to build up reserves in order to guarantee the funding for the additional expenditure under the various statutory pension schemes during the period 2010-2030. The law of 5 September 2001 guaranteeing continuous reduction in the public debt and creating an Ageing Fund provides for the Fund to be financed out of budget surpluses, social security surpluses, non-recurring non-fiscal revenues and investment income. The Ageing Fund resources can be used to absorb the increase in expenditure on the various statutory pension schemes during the period 2010-2030 on condition that the general government debt ratio is less than 60 % of GDP.

The establishment of the Ageing Fund created a direct link between the debt reduction policy and the future financing of pensions. That link was reinforced by the law of 20 December 2005, amending the law of 5 September 2001 guaranteeing a continuous reduction in the public debt and creating an Ageing Fund.

The amended law on the Ageing Fund first makes provision for a system of financing the Fund up to 2012. In principle, in 2007, 0.3 % of GDP should be paid into the Fund, increasing by 0.2 percentage points each year to reach 1.3 % in 2012. From 2013, payments into the Ageing Fund will be determined by Royal Decree, discussed by the Council of Ministers. However, the actual payments into the Fund will depend on the general government surpluses achieved.

The second key component of the amendment to the law concerns the restriction on the scope for financing the Ageing Fund via transactions which affect the debt but do not affect the overall balance (non-recurring measures). For the period 2007-2010, that amount must not exceed € 250 million per annum, and € 500 million in subsequent years.

The amendments to the law place the Fund's financing on a more structural basis while indirectly laying down by law a plan for budget surpluses.

As well as specifying the budget surpluses to be achieved, the law creating the Ageing Fund also stipulated a procedure to be completed annually. As stated in point 7.1, the Study Committee on Ageing established by the High Council of Finance produces an annual report analysing the budgetary and social effects of ageing. The Financing Requirements Section of the High Council of Finance takes account of the Committee's report in its recommendations on the budgetary policy to be adopted. Finally, the government has to spell out its policy on ageing in its strategy document on ageing. These arrangements ensure that the issue of ageing remains on the political agenda.

Annexes

Annex 1 : Sectoral balance

en % du PIB	2005	2006	2007	2008	2009	2010
1. Solde de financement par rapport au reste du monde	1,9	2,0	2,0	2,2	2,4	2,7
dont:						
- Solde des transactions courantes (biens et services)	2,3	2,5	2,5	2,7	2,9	3,3
- Solde des revenus primaires et des transferts	-0,4	-0,4	-0,4	-0,4	-0,4	-0,4
- Solde des opérations en capital	-0,1	-0,1	-0,1	-0,1	-0,1	-0,1
2. Solde de financement du secteur privé	1,7	2,4	3,0	3,0	3,0	3,0
3. Solde de financement de l'ensemble des pouvoirs publics	-0,0	-0,3	-1,0	-0,9	-0,5	-0,3
4.Écart statistique	-	-	-	-	-	-

% of GDP

1. Overall financial balance in relation to the rest of the world

of which:

Balance of current transactions (goods and services)

Balance of primary incomes and transfers

Balance of capital transactions

2. Financial balance of the private sector

3. Financial balance of general government

4. Statistical deviation

	2004	2005	2006	2007	2008	2009
Taux d'intérêt à court terme (moyenne annuelle)	2,1	2,9	3,6	3,6	3,7	3,7
Taux d'intérêt à long terme (moyenne annuelle)	3,3	3,9	4,1	4,2	4,4	4,5
Taux de change USD/€ (moyenne annuelle)	124,4	125,0	128,0	129,0	129,0	129,0
Taux de change effectif nominal (2000=100)	106,5	106,9	107,2	107,4	107,4	107,4
Croissance PIB - monde (hors UE)	5,4	5,7	5,2	5,2	4,5	4,5
Croissance PIB - UE	1,6	2,8	2,3	2,4	2,3	2,3
Croissance marchés extérieurs pertinents	6,2	8,3	6,2	6,7	6,5	6,4
Importations mondiales en volume (hors UE)	7,9	9,2	8,2	7,9	7,9	7,9
Prix du pétrole (USD)	54,4	66,1	67,6	68,4	67,4	65,0
Prix à la consommation hors produits pétroliers (en USD),	8,3	23,3	2,7	-1,6	1,3	1,5

Annex 2 : Main assumptions used for the medium-term forecasts relating to the international environment

Short-term interest rate (annual average)

Long-term interest rate (annual average)

USD/€ exchange rate (annual average)

Nominal effective exchange rate (2000 = 100)

GDP growth – world (excluding EU)

GDP growth – EU

Growth of relevant external markets

Global imports by volume (excluding EU)

Oil price (USD)

Consumer prices excluding petroleum products (in USD)

Annex 3 : The basic assumptions of the Study Committee on Ageing

The government based its long-term budget strategy partly on the estimates of the budgetary cost drawn up by the Study Committee on Ageing. Each year it updates its estimates of the long-term movement in social expenditure. The basic assumptions are as follows:

Summary of the basic assumptions in the scenario adopted by the Study Committee on population ageing (SCA)

Demographic scenario

Birth rate

Life expectancy at birth: male

Life expectancy at birth: female

Net migration

Socio-economic scenario (by sex and age group, impact of ageing on successive generations)

Standard of education: maintained at the latest recorded level

Potential activity rate, male:

Potential activity rate, female

Numbers leaving the labour force: disabled, older unemployed workers, persons taking early retirement or normal retirement

modelled taking account of the cohorts and the probable switching between socio-demographic categories by sex and age group.

Macro-economic scenario (long-term)

Increase in productivity and annual wages per capita: 1.75% per annum

Structural unemployment rate (*including older unemployed persons not seeking work)*: 8%

Employment rate (% of the population of working age (15-64 years)):69.5%

Social policy scenarios (long-term)

Pay threshold: 1.25% per annum

Minimum entitlement per year worked: 1.25% per annum

Equalisation of public sector pensions: 1.25% per annum

Adjustment in line with prosperity (general scheme): SCA scenario: 0.5% per annum

Linking of flat-rate benefits to prosperity: SCA scenario: 1.0% per annum

Aperçu des hypothèses de base du scénario du Comité d'étude sur le vieillissement de la population

Scénario démographique	**2000**	**2030**	**2050**
Taux de fécondité	1,61	1,70	1,75
Espérance de vie à la naissance: hommes	75,1	81,0	83,9
Espérance de vie à la naissance: femmes	81,6	86,4	88,9
Solde migratoire	18 445	17 358	17 300

Scénario socio-économique (par sexe et classe d'âge, impact du vieillissement sur les générations successives)

Taux de scolarité	maintenu au niveau de l'observation la plus récente
Taux d'activité potentielle: hommes	modélisation tenant compte des cohortes et des
Taux d'activité potentielle: femmes	probabilités de transition entre catégories socio-
Sorties de la population active vers: invalidité, chômeurs âgés, prépension, pension	démographiques par sexe et classe d'âge

Scénario macro-économique (à long terme)

Croissance de la productivité et des salaires annuels par tête	1,75% par an
Taux de chômage structurel (*y compris les chômeurs âgés non-demandeurs d'emploi)*	8%
Taux d'emploi (% de la population d'âge actif (15-64 ans)	69,5%

Scénarios de politique sociale (à long terme)

Plafond salarial	1,25% par an
Droit minimum par année de carrière	1,25% par an
Péréquation des pensions du secteur public	1,25% par an
Adaptation au bien-être (régime général)	scénario CEV: 0,5% par an
Liaison au bien-être des allocations forfaitaires	scénario CEV: 1,0% par an