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ECONOMIC ASSESSMENT OF THE STABILITY PROGRAMME OF BELGIUM (UPDATE OF DECEMBER 2006)

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not. The most recent update of Belgium's stability programme was submitted on 5 December 2005.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs of the European Commission, was finalised on 21 March 2007. Comments should be sent to Gerrit Bethuyne (gerrit.bethuyne@ec.europa.eu). The main aim of the technical analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 7 March. The ECOFIN Council is expected to adopt its opinion on the programme on 27 March 2007.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:
http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

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SUMMARY AND CONCLUSIONS[1]

As part of the preventive arm of the Stability and Growth Pact, each Member State that uses the single currency, such as Belgium, has to submit a stability programme and annual updates thereof. The most recent programme, covering the period 2006-2010, was submitted on 13 December 2006.

Based on the analysis of the last ten years, it can be concluded that the Belgian business cycle has been moving very much in line with that of the euro area and shows similar levels in growth, although at the same time there was a fiscal consolidation in Belgium, which went much beyond that undertaken in the euro area as a whole, ending a long period of high budgetary deficits. Domestic demand and consumer confidence benefited from a steep reduction of the government debt ratio. Net exports also made a positive contribution to economic growth, but the country is confronted with a significant loss in market shares which is partially linked to its export structure, but also to the high cost of labour.

Against this background, the following challenges in the area of public finances can be identified. First, Belgium should create structural surpluses to ensure sustainability, in view of the ageing shock ahead. Although it was successful in achieving a balanced budget since 2000 (with the exception of 2005), surpluses have been envisaged several times in the past, which until now the authorities did not achieve, postponing them in successive stability programmes. Increasing labour market participation (which is among the lowest in the euro area) could also contribute to easing the impact of an ageing population. Moreover, the authorities continue to use one-off measures, which often mainly serve the short-term budgetary target without an adequate long-term strategy.

Second, as regards efficiency, the country benefits from high labour productivity, but in spite of recent reforms the labour market still suffers from a high tax burden on labour, and a benefit system that is quite unfavourable to employment for older workers. This explains the current low employment rate, in particular for older workers (currently less than 32%). Starting from 2004 the authorities stepped up the job search requirements for unemployed and in 2005 they launched the so-called 'Generation Pact', to improve job opportunities for older workers and to tighten the eligibility criteria for early retirement. However, further measures will be required to achieve the EU target of a 50% employment rate for older workers by 2010.

The macroeconomic scenario underlying the stability programme envisages that real GDP growth will decrease from 2.7% in 2006 to 2.2% on average over the rest of the programme period. For 2006, this may turn out to be a somewhat cautious forecast, as recent information indicates that economic growth is expected to reach over 3%. In line with the recent acceleration in economic activity, the programme projects employment growth to be relatively strong in 2006 and 2007 and to decrease again thereafter. Most of the macroeconomic assumptions used in the programme are very close to the Commission services' estimates, except for compensation of employees, for which the programme foresees significantly higher growth rates. Based on currently available information, the scenario for the future years appears to be based on plausible growth assumptions. The projections for inflation also appear realistic. The output gap remains

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[1]The analysis takes into account (i) the Commission services' autumn 2006 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

negative and there appears to be no particular inflationary pressure, but employment growth is sound. Therefore the economy can be regarded as being neither in good nor bad times.

The new stability programme assumes the achievement of a balanced budget in 2006 as foreseen in the previous update of the programme. This assumption seems to be broadly supported by most recent data, whereas the Commission services' autumn 2006 forecast projected a deficit of 0.2% of GDP. While cyclical conditions in 2006 turned out to be significantly better than foreseen in the previous update and expenditure developed broadly as expected, fiscal revenues were lower than anticipated (notably because of an underestimation of the impact of the final stage of the 2001 direct tax reform). This was partly compensated by the fact that one-off measures yielded more than expected, and by some additional one-offs. Therefore the structural balance significantly deteriorated in 2006.

The main goal of the medium-term budgetary strategy in the programme is to ensure a continuous reduction of the still high debt ratio (around 90% in 2006) to below 75% of GDP in 2010, through a gradual build-up of nominal budgetary surpluses (from 0.3% of GDP in 2007 to 0.9% in 2010), to prepare for the ageing shock ahead. The primary surplus, which has been decreasing since 2001 (when it was 7% of GDP), is expected to stabilise at around 4.1% of GDP. The adjustment is due to falling interest expenditure (¾ percentage point) resulting from the continuous debt reduction, as well as reduced primary expenditure (½ a percentage point). This is partly offset by a decrease in government revenue (½ a percentage point). Beyond 2007 the programme's projections broadly correspond to no-policy change projections, although the programme also (implicitly) seems to rely on further one-offs to achieve the budgetary targets. This strategy is largely similar to the one presented in the previous update.

As for the debt development, the Commission services' estimate[2] of the government gross debt is 89.4% of GDP in 2006. This is still far above the 60% of GDP Treaty reference value, although substantially lower than the peak of 133% of GDP in 1993. The programme projects the debt ratio to rapidly decline by around 15 percentage points over the programme period.

Assuming that the impact of one-off measures remains unchanged after 2007, the structural balance is planned to improve from a deficit of around 0.4% of GDP in 2006 to a surplus of 0.7% in 2010. As in the previous update, the medium-term objective (MTO) for the budgetary position is a structural surplus of 0.5% of GDP, which is in line with the Pact and is more demanding than what would be implied by the debt ratio and average potential output growth in the long term. According to the programme it would be achieved by 2008, which is one year later than in the previous update.

The budgetary outcomes could be slightly worse than projected in the programme, especially in 2007, for which the Commission services projected a 0.5% deficit in their 2006 autumn forecast (against a 0.3% of GDP surplus foreseen in the programme). The difference is owed to the fact that the 2006 autumn forecast did not include the impact of two (insufficiently specified) one-off measures foreseen in the budget and that it embodied somewhat less optimistic assumptions both regarding revenue and expenditure

[2] The programme reports a debt of 87.7% of GDP for 2006, but this does not include the debt assumption from the railway corporation SNCB in 2005, which according to Eurostat increases the debt level by 1.7% of GDP in the same year. Therefore the Commission services' estimate of the government gross debt is 89.4% of GDP in 2006

developments. Therefore additional measures seem necessary to achieve the target for 2007. Overall, although Belgium has a good track record of achieving the nominal budgetary targets and significant intra-year budget corrections are common practice, these measures could be delayed against the background of national elections planned for June 2007. A worse-than-targeted outcome in 2007 would also carry over to the following years. From 2008 onwards it is not clear how the expired one-offs will be replaced. Accordingly, the evolution of the debt ratio is also expected to be slightly less favourable than projected in the programme, although still rapidly declining.

In view of this risk assessment, the budgetary stance in the programme may not be sufficient to ensure that the rather ambitious MTO is achieved by 2008, as envisaged in the programme. The pace of the adjustment towards the MTO implied by the programme should be strengthened to be in line with the Stability and Growth Pact, which foresees an annual improvement in the structural balance of 0.5% of GDP as a benchmark. In particular, taking into account risks, the adjustment may fall short of the benchmark already in 2007 and will slow down thereafter, although the economy does not appear to be in bad times. Nevertheless, the debt ratio still seems to be sufficiently diminishing towards the reference value over the programme period.

As mentioned above, Belgium faces a challenge in the area of long-term sustainability of public finances. The initial budgetary position with a high primary surplus, albeit weaker compared to 2005, contributes to easing the projected long-term budgetary impact of an ageing population, but it is not sufficient to fully cover the substantial increase in expenditure related to ageing, notably for pension. The needed steady reduction of the debt ratio requires sustaining high primary surpluses for a long period of time. Overall, the sustainability of public finances appears to be at medium risk.

The October 2006 implementation report of the national reform programme (NRP) , provided in the context of the renewed Lisbon strategy for growth and jobs, identifies as key challenges/priorities: the sustainability of public finances; the reduction of labour costs; the creation of a more dynamic labour market; the stimulation of the economy through investment and reforms; strengthening the social security system; and the strengthening of synergies between environmental protection and growth. The Commission's assessment (adopted as part of its December 2006 Annual Progress Report[3]) of this report showed that Belgium is making good progress in the implementation and reinforcement of its NRP, although it pointed out a certain risk for the sustainability of public finances and the need for further steps to achieve the EU-wide employment rate goals, in particular for older people. Against this background, the country was recommended to undertake further actions to reduce the tax burden on labour and to reduce regional disparities in unemployment. Overall, the stability programme and the implementation report of the NRP do not seem well integrated, although both programmes envisage broadly similar policies.

The overall conclusion is that the strategy of a continued reduction of the still high debt stock provides an example of fiscal policies conducted in compliance with the Pact. However, while the programme foresees a gradual build-up of surpluses (notably through reduced interest expenditure) starting from a balanced position in nominal terms, there are some risks to the achievement of the budgetary targets. Nevertheless, the medium-term objective is expected to be reached within the programme period.

Comparison of key macroeconomic and budgetary projections

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[3] Communication from the Commission to the Spring European Council, "Implementing the renewed Lisbon strategy for growth and jobs - A year of delivery" - COM(2006) 816, 12.12.2006.

		2005	2006	2007	2008	2009	2010
Real GDP (% change)	**SP Dec 2006**	**1.2**	**2.7**	**2.2**	**2.1**	**2.2**	**2.2**
	COM Nov 2006	1.1	2.7	2.3	2.2	n.a.	n.a.
	SP Dec 2005	*1.4*	*2.2*	*2.1*	*2.3*	*2.2*	*n.a.*
HICP inflation (%)	**SP Dec 2006**	**2.5**	**2.4**	**1.9**	**1.8**	**1.8**	**1.9**
	COM Nov 2006	2.5	2.4	1.8	1.7	n.a.	n.a.
	SP Dec 2005	*2.9*	*2.8*	*2.0*	*1.9*	*1.7*	*n.a.*
Output gap (% of potential GDP)	**SP Dec 2006**[1]	**-0.8**	**-0.3**	**-0.4**	**-0.4**	**-0.4**	**-0.3**
	COM Nov 2006[5]	-1.0	-0.6	-0.6	-0.7	n.a.	n.a.
	SP Dec 2005[1]	*-0.8*	*-0.6*	*-0.6*	*-0.5*	*-0.4*	*n.a.*
General government balance (% of GDP)	**SP Dec 2006**	**0.1** **-2.3***	**0.0**	**0.3**	**0.5**	**0.7**	**0.9**
	COM Nov 2006	-2.3	-0.2	-0.5	-0.5	n.a.	n.a.
	SP Dec 2005	*0.0*	*0.0*	*0.3*	*0.5*	*0.7*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2006**	**4.3** **1.9***	**4.1**	**4.2**	**4.1**	**4.1**	**4.2**
	COM Nov 2006	1.9	3.9	3.4	3.2	n.a.	n.a.
	SP Dec 2005	*4.3*	*4.1*	*4.2*	*4.1*	*4.1*	*n.a.*
Cyclically-adjusted balance (% of GDP)	**SP Dec 2006**[1]	**0.8** **-1.6***	**0.2**	**0.5**	**0.7**	**0.9**	**1.1**
	COM Nov 2006	-1.7	0.1	-0.1	-0.1	n.a.	n.a.
	SP Dec 2005[1]	*0.4*	*0.3*	*0.6*	*0.8*	*0.9*	*n.a.*
Structural balance[2] (% of GDP)	**SP Dec 2006**[3]	**n.a.**	**-0.4**	**0.1**	**n.a.**	**n.a.**	**n.a.**
	COM Nov 2006[4]	0.2	-0.7	-0.2	-0.1	n.a.	n.a.
	SP Dec 2005	*0.0*	*-0.3*	*0.4*	*0.7*	*0.9*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2006**	**91.5** **93.2***	**87.7** **89.4***	**83.9** **85.6***	**80.4** **82.1***	**76.6** **78.3***	**72.6** **74.3***
	COM Nov 2006	93.2	89.4	86.3	83.2	n.a.	n.a.
	SP Dec 2005	*94.3*	*90.7*	*87.0*	*83.0*	*79.1*	*n.a.*

Notes:
[1]Commission services calculations on the basis of the information in the programme.
[2]Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.
[3]One-off and other temporary measures taken from the programme (0.6% of GDP in 2006 and 0.4% in 2007; all deficit reducing). The programme does not provide information on the use of one-off measures in other years.
[4]One-off and other temporary measures taken from the Commission services' autumn 2006 forecast (2.0% of GDP in 2005, deficit increasing; 0.8% in 2006 and 0.1 in 2007, both deficit reducing).
[5]Based on estimated potential growth of 2.2%, 2.3%, 2.3% and 2.2% respectively in the period 2005-2008.
* The deficit and debt figures in the programme for 2005 are those notified by the Belgian National Accounts Institute. On 23 October 2006 Eurostat amended the deficit and debt data notified by Belgium as they were found not to be in accordance with ESA95 rules, specifically, in relation to the assumption by government (FIF/FSI - Fonds de l'infrastructure ferroviaire / Fonds voor spoorweginfrastructuur) of EUR 7400 million (2.5% of GDP) of the debt of the railway company SNCB/NMBS in 2005 (see Eurostat News Release N° 139/2006). According to ESA95 rules, the impact on the 2005 government deficit is of the same amount; the impact on the government debt at the end of 2005 amounts to EUR 5200 million (1.7% of GDP, taking into account a partial reimbursement occurred in that year). Data for 2005 marked with an asterisk are as amended by Eurostat. Debt data marked with an asterisk for years 2006 to 2010 have been 'mechanically' adjusted by the Commission services to comply with ESA95. This adjustment of debt figures is based on the technical assumption that the stock of FIF/FSI's debts remains unchanged. In December 2006 the Belgian Government challenged Eurostat's amendment of the Belgian data before the European Court of First Instance.
Source:
Stability programme (SP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations

1. INTRODUCTION

The Belgian 2006 stability programme update was submitted on 13 December 2006[4] to the Commission, which is after the deadline of 1 December specified in the code of conduct. The Belgian authorities did not give a reason for the submission delay. The programme covers the period 2006-2010. It was approved by the Belgian government on 8 December 2006. It has not been formally adopted by Parliament, but it incorporates the results of the 2007 budget proposal, as approved by Parliament on 21 December.

The programme adheres to the model structure for stability and convergence programmes specified in the new code of conduct. It also broadly follows the data provision requirements prescribed by the new code of conduct. There are some gaps in the compulsory[5] and optional data[6]. Annex 2 provides a detailed overview of all aspects of compliance with the new code of conduct. As regards adherence to ESA95 standards, the 2006 update of the programme does not take into account the Eurostat amendments[7] of 23 October 2006 to the deficit and debt figures for 2005 (although the Eurostat comments are clearly mentioned in a separate box). Annex 3 provides a detailed overview of all aspects of compliance with the code of conduct.

2. ECONOMIC TRENDS AND POLICY CHALLENGES

This section is in five parts. The first provides a brief overview of the macroeconomic performance in terms of growth and other major macro-variables. The second part presents the results of a growth accounting exercise and tries to identify the main reasons for low or high average annual economic growth vis-à-vis the reference aggregate (euro area). The third looks at the volatility of growth and other key macroeconomic variables and the stabilising or destabilising role of macro-policies. The fourth part focuses on trends in public finances. The fifth part then identifies major economic challenges with implications for public finances.

2.1. Economic performance

Economic growth in Belgium matched the euro area average very closely from 1996 to 2005 (see Table 1 for an overview of key economic indicators). During the first half of

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4 The English translation was available on the Belgian website on 20 December 2006.

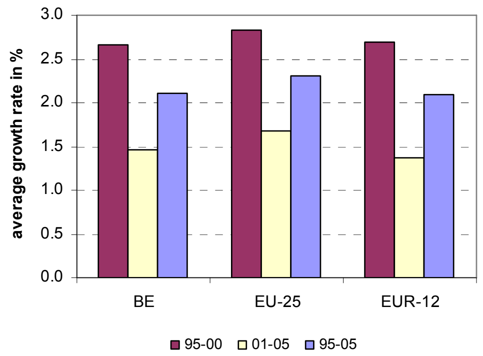
5 In Table 2 (general government budgetary prospects) the programme reports compensation of employees and intermediate consumption (including taxes) instead of consumption. The programme also does not provide information on social transfers in kind, but only on social benefits in kind provided by market producers. The rest category 'other' has been adjusted accordingly.

6 Table 3 (general government expenditure by function) is missing. Table 4 (general government debt developments) is incomplete. Missing variables are the breakdown of the stock-flow adjustment, liquid financial assets and net financial debt. Table 7 (long-term sustainability) is incomplete. The programme only provides information about total social security expenditure (with health care, unemployment benefits and a breakdown of pensions as separate categories) and education expenditure. The table also does not contain figures for 2040.

7 On 23 October 2006 Eurostat amended the deficit and debt data notified by Belgium for 2005 in relation to the assumption by government (FIF - Fonds de l'infrastructure ferroviaire) of EUR 7400 million (2.5% of GDP) of the debt of the railway company SNCB in 2005. According to ESA95 rules, the impact on the government deficit is of the same amount. Since part of the debt taken over from the SNCB has been reimbursed in the meantime, the impact on the government debt at the end of 2005 is slightly smaller, amounting to EUR 5200 million (1.7% of GDP).

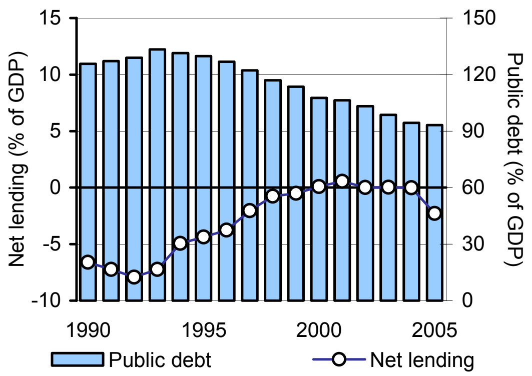
this period, real GDP growth reached 2.7% on average (identical to the euro area average). After 2000, the economic slowdown was slightly less pronounced in Belgium than in the rest of the euro area: annual growth decelerated to 1.5% on average for 2001-2005 against 1.4% for the euro area as a whole. On average, net exports contributed by about ¼ percentage point to real GDP growth annually during the last ten years, in spite of falling export market shares. Meanwhile household consumption expenditure has remained strong since 1995, underpinned by a continuous fall in the household savings rate (from 20.1% in 1995 to 13.2% in 2005). The unemployment rate (8.4% in 2005) is around the euro area average, but this does not take into account a significant number of discouraged workers who receive unemployment benefits, but are no longer actively searching for a job. Consumer prices inflation (HICP) also remained close to the euro area average throughout the last ten years.

Figure 1: Average GDP growth: Belgium vs. EU25 and euro area



Source:
Commission services

Figure 2: General government debt and net lending as % of GDP



Source:
Commission services

As regards public finances, after a long period of significant deficits (averaging almost 10% of GDP between 1980 and 1992), Belgium began to substantially consolidate its public finances around 1993 (when its debt peaked at 133% of GDP), backed by a strong political will to meet the Maastricht criteria and subsequently to respect the Stability and Growth Pact[8]. From 2000 until 2004 the authorities have maintained a position close to balance, but in 2005 it posted a government deficit of 2.3% of GDP, which can be attributed entirely to the assumption of debt from the national railway company SNCB. In spite of this transaction, government debt continued its downward trend and fell to 93.2% of GDP in 2005.

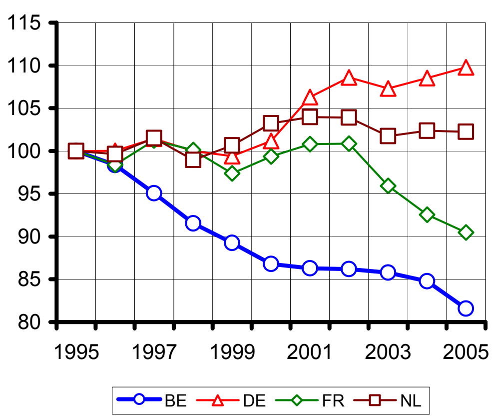
The Belgian economy can be considered as the prototype of a small open economy, with imports and exports totalling over 80% of GDP (and rising). The balance of trade in goods and services turned positive in the early eighties following the devaluation of the Belgian franc and has remained so since then. The market share of exports has been relatively stable until 1995, but since then exports have been growing considerably

[8] G. Bethuyne (2005), "Federalisation and fiscal consolidation: the Belgian experience", *Country Focus*, Vol. II/16, Brussels, European Commission – Directorate General for Economic and Financial Affairs.
(also available from: http://ec.europa.eu/economy_finance/publications/countryfocus_en.htm)

slower than the export-weighted average of external markets. The resulting loss in market share is among the highest in the EU (only Italy, Portugal, Cyprus and Malta perform worse), although the authorities claim that the problem may be somewhat overstated due to a statistical problem in disentangling price and volume effects. Figure 3 shows the loss in market share for Belgium and compares it to its main trading partners. The weaknesses in Belgium's export performance are an unfavourable product specialisation[9], combined with a handicap in wage competitiveness.

Overall, compared to the rest of the euro area, Belgian exports are predominantly products for which demand has been relatively weak in recent years (i.e. growing at a lower pace than the average growth of total import markets), such as basic chemicals, metal products and textiles. Important exceptions are exports of pharmaceuticals and passenger cars; but recently the car industry has been under considerable strain due to a possible relocation of production as a result of a loss in relative wage competitiveness and overall excess capacity in the industry. Belgium's exports are insufficiently oriented towards machinery and data processing equipment, electronics and telecommunications, products in which the expansion of international trade was more pronounced during the period under consideration, and which have a high technology content on average. According to National Bank estimates, about 44% of exports is situated in faster-than-average growing markets. Among the main trading partners, a similar result was found for the Netherlands, but in Germany well over 60% of total exports were situated in these fast-growing markets.

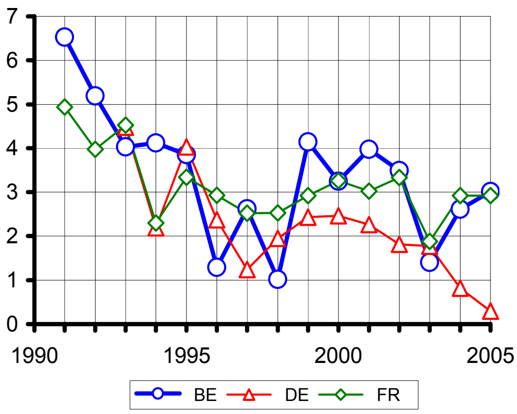
Figure 3: Export performance (goods and services) (1995 = 100)*



* Index for exports divided by an index for growth of export markets (weighted average of import growth of Belgium's trading partners according to their share in Belgium's exports).

Source:
Commission services

Figure 4: Annual growth rate of nominal wages and salaries per employee



Source:
Commission services

In view of these developments, and given the increasing imports from low-income countries competing with Belgian industries for the Belgian domestic demand, maintaining competitiveness is an important challenge for the economy. Overall, labour

9 W. Melyn (2004), "Characteristics and development of Belgium's foreign trade", *Economic Review*, Brussels, National Bank of Belgium, N°3, pp. 7-27.

productivity is among the highest in the EU, but so is the tax burden on labour: according to OECD calculations[10], the average tax burden on labour for a single worker with average income is 55.4% (against 51.8% for Germany, 50.1% for France and 38.6% for the Netherlands). For a married worker with two children the burden is 40.3% (35.7% in Germany, 41.7% in France and 29.1% in the Netherlands). In recent years, government policies have focused on reducing the tax burden on labour (especially in the 2001 tax reform, but also some more recent selective reductions in social contributions). The authorities have expressed their intention to further reduce the tax burden on labour to the average level of the neighbouring countries, but it is not entirely clear how to compensate for the anticipated loss in tax revenue, especially in view of the tight budgetary targets and increasing costs from an ageing population.

The competitiveness of the Belgian economy is obviously also linked to relative wage developments. Currently, the 1996 competitiveness law determines the framework for Belgian wage formation. Wage negotiations are centred around a bi-annual national indicative wage norm (agreed by the social partners) which acts as guideline for further negotiations at the sectoral level. The wage norm is determined following an advice by the Belgian Central Council for the Economy[11], based on a comparison between wage developments in Belgium and its three main trading partners (Germany, France and the Netherlands). Within this framework, the strong wage moderation in Germany from 2001 onwards exercised a significant downward pressure on Belgian wages (see Figure 4). Although the system created more awareness of the competitiveness issue, it does not offer a watertight protection. In particular, the indicative wage norm is not strictly binding for the sectoral agreements and on top, additional wage increases can be granted at individual or firm level. Moreover, nearly all sectoral wage agreements in Belgium include some form of automatic wage indexation, excluding real wage cuts (although some wage agreements foresee the possibility to reduce real wage increases in case of unanticipated inflation). Recently the uniform wage norm for all sectors and regions has also been criticized in view of the large regional differences in unemployment.

Finally, the economy is characterized by significant regional disparities. From 1996 to 2004 average growth in the Flemish Region (representing some 53% of total GDP in 2004) was 2.1%, against 1.6% for the Walloon Region (producing about 23% of total GDP). Average growth in the Brussels Capital Region (19% of GDP) was 2.3%, but due to the specific nature of Brussels as a capital city, with large commuter flows from the two other regions, a significant part of its regional product constitutes income for the residents from the two other regions. The growth arrears in Wallonia can be largely attributed to its economic structure, with an important share of steel related industry and a low contribution of the private sector to total value added (around 58%, against 71% in Flanders). Growth differences are also reflected in the unemployment rate: 5.4% in the Flemish Region and 12% in the Walloon Region. Despite relatively high economic growth, the unemployment rate in the Brussels Capital Region was 15.7%, which is of course related to the high number of commuters working in the capital, combined with large numbers of low-skilled workers living in Brussels. In 2005, the Walloon Region launched a comprehensive plan to stimulate economic growth and employment (the so-called Marshall plan for Wallonia), but it is still too soon to evaluate its impact.

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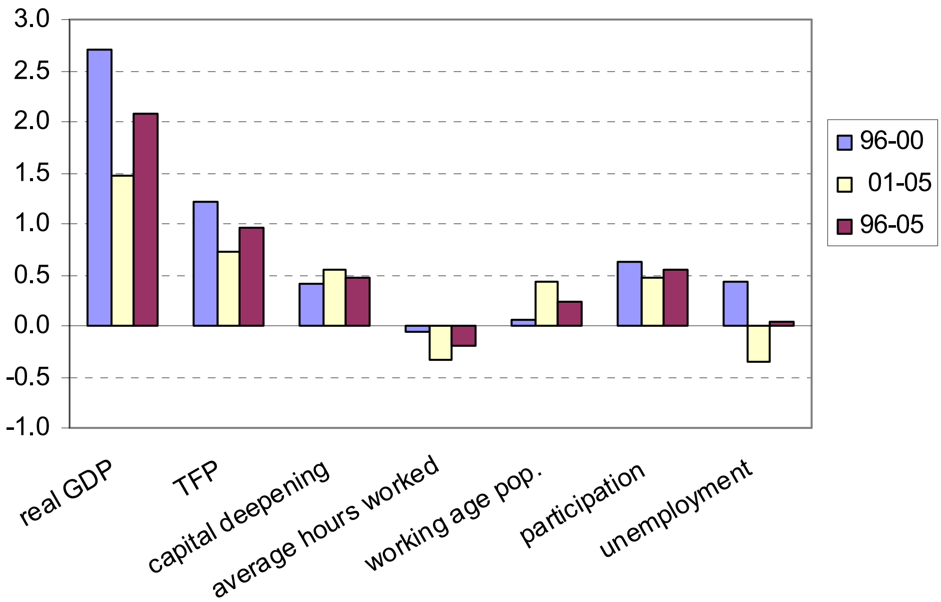
[10] OECD (2005), *Taxing wages 2004/2005*, Paris, OECD.
(also available from:
http://www.oecd.org/document/40/0,2340,en_2649_34533_36330280_1_1_1_1,00.html)

[11] Conseil Central de l'Economie (2006), *Rapport technique du sécrétariat sur les marges maximales disponibles pour l'évolution des coûts salariaux*, CCE.
(also available from: http://www.ccecrb.fgov.be/txt/fr/doc06-1250.pdf)

2.2. Anatomy of medium-term growth

This part dissects the sources of high or low average growth as well as possible differences in average economic growth vis-à-vis the euro area, using the framework of a traditional growth accounting exercise on the basis of a Cobb-Douglas production function. Figure 5 presents the result for real GDP over the 1996-2005 period.

Figure 5: Real GDP growth and its components



Note:

Assuming a Cobb-Douglas-production function $Y = A(L \cdot H)^{\alpha} K^{1-\alpha}$ where Y denotes the level of *GDP, L* employment, H the average hours worked per person employed, K the capital stock and α the labour share in income, real GDP can be written as:

$$Y = \frac{Y}{H \cdot L} H \cdot L = A \cdot \left(\frac{K}{H \cdot L} \right)^{1-\alpha} H \cdot WP \cdot PART \cdot (1 - ur)$$

where *WP* stands for working age population, *PART* denotes the participation ratio as a share of *WP* and ur the rate of unemployment. In terms of growth rates *g* this is:

$$g_Y = g_A + (1-\alpha)(g_K - g_L - g_H) + g_H + g_{WP} + g_{PART} - g_{ur} \cdot \frac{ur}{1-ur}$$

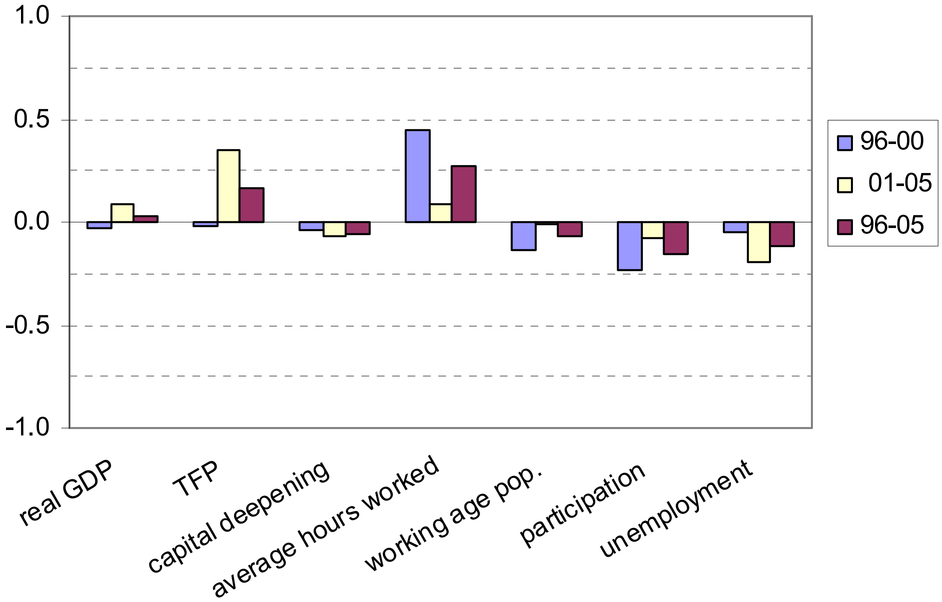
The expression $(g_K - g_L - g_H)$ is referred to as capital deepening, i.e. the increase in the capital labour ratio.

Source: Commission services

Economic growth in Belgium since 1996 (2.1% annually on average) can be attributed to changes in total factor productivity (0.9 percentage points), changes in labour input (0.6 percentage points) and capital deepening (0.4 percentage points). The contribution of labour input is mainly the result of increased labour market participation; the participation ratio increased from 64.0% in 1995 to 67.3% in 2005, largely due to the increased female labour market participation. In the first half of the reference period this contribution was reinforced by a decreasing unemployment rate, but this tendency was offset by the growth slowdown after 2001, pushing unemployment up again.

Until 2000, the contribution to growth of the three main components was nearly identical to the euro area average, but there were some differences in the composition of labour input. Whereas a decrease in average hours worked made a negative contribution of almost 0.5 percentage points to total growth in the euro area, average working time slightly increased in Belgium contributing some 0.1 percentage points to total growth. However, the higher contribution of working time in Belgium until 2000 was offset by a slower increase in the population at working age and (especially) a slower increase in the participation rate. From 2001 onwards, growth differences mainly stem from (slightly) higher productivity growth in Belgium compared to the euro area as a whole, although this is largely offset by a lower contributions of labour input (mainly due to higher unemployment) and capital deepening.

Figure 6: Real GDP growth and its components: Difference vis-à-vis euro area average



Note: See note of Figure 5.

Source:
Commission services

Although since 2000 labour market participation seems to move almost in lockstep with the euro area, the employment rate is still very low (61.1% in Belgium, the lowest in the euro area except for Greece and Italy) and increases more slowly than in the rest of the euro area (between 2000 and 2005 the employment rate increased by 0.7 percentage points in Belgium, as opposed to 2.1 percentage points in the euro area as a whole). The problem is particularly significant for older workers (55-64), with an employment rate as low as 31.8% (the lowest figure in the euro area except for Italy and Luxembourg, although since 1999 there is an increasing trend). This situation finds its origin in several attractive early retirement schemes often used to lay off older workers in restructuring corporations. Because the Belgian wage structure generally foresees significant wage increases based on seniority, older workers can no longer compete on the labour market and once unemployed, they often stay so until they reach the normal retirement age. Therefore, early retirement is considered a socially more acceptable alternative. In 2005, the Belgian authorities launched a 'generation pact' which includes several measures (most of them already implemented, others planned for 2007) to increase the employment rate. Among others, the aim of the generation pact is to tighten the eligibility criteria for early retirement schemes, combined with measures to reduce the wage cost of older workers through selective cuts in social contributions, but the impact of these measures will depend on the extent to which exceptions and alternative routes remain.

A persistently high level of unemployment is another shortcoming of the Belgian labour market. Although according to the Eurostat definition of unemployment, the unemployment rate in Belgium was 8.4% in 2005 (close to the euro area average), there is a significant number of people administratively recorded in the Belgian statistics as unemployed (and often receiving unemployment benefits) who are effectively no longer looking for employment. Therefore, the national administrative unemployment rate is significantly higher (12.8% in 2005). A poor matching of labour supply and demand is partly at the basis of this problem. Moreover, unemployment benefits are unlimited in time and until recently job-search requirements were very weak. In 2004, the Belgian authorities launched a plan to increase job-search requirements for long-term unemployed, and where necessary to provide additional training. Although still fragile, the first result of this exercise appears to be positive, but no plans exist so far to extend the job-search requirements to unemployed over 50 years.

2.3. Macro-policies against the backdrop of the economic cycle

After a severe slump in 1993, when GDP fell by 1%, economic cycles have remained fairly moderate with annual growth rates varying from 1.2% (in 1996) to 3.7% (in 2000). The output gap, which became negative as a result of the 1993 recession, gradually closed towards 1999 and peaked in 2000. After the economic slowdown in 2001 it turned negative again in 2003 and remained so since then (See Figures 7 and 8). Meanwhile the harmonised unemployment rate fell gradually from 9.8% in 1994 to 6.6% in 2001. Overall, the cyclical pattern of economic growth in Belgium matched the euro area average very closely. The economic slowdown that hit most of the euro area in 2001 was even somewhat less pronounced in Belgium.

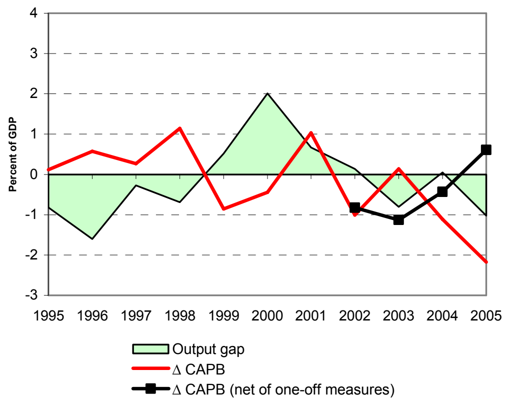
Several factors contributed to these relatively moderate cyclical swings experienced in the last ten years[12]:

- Wealth effects on domestic demand (most notably on private consumption) that could amplify the economic cycle have been insignificant in Belgium: the real estate market remained fairly stable (except perhaps for the last two years), there is no mortgage equity withdrawal and household indebtedness has remained fairly constant in spite of falling interest rates.
- Although the economic boom towards 2000 reduced unemployment, the cycle did not reach a point where market pressures might trigger severe wage inflation, which could imply additional loss in competitiveness (especially important for a small open economy like Belgium, where competitiveness is already under pressure).

[12] Gerrit Bethuyne and Bouke Buitenkamp (2006), "Smooth versus bumpy: differences in growth dynamics in Belgium and the Netherlands", *Country Focus*, Vol. III/9, Brussels, European Commission – Directorate General for Economic and Financial Affairs
(also available from: http://ec.europa.eu/economy_finance/publications/countryfocus_en.htm)

- Finally, fiscal policy may also have moderated the size of the cyclical upswing up to the 2000 cyclical peak due to continuous efforts to bring government deficits under control. The cyclically-adjusted primary balance continued to increase during most of the nineties and only started decreasing in 1999. The stance of fiscal policy since 2000 is somewhat more ambiguous. From that moment onwards Belgium has aimed to maintain a strict (nominal) balanced budget, and (partly) compensated the impact of the main cyclical downturn by one-off measures (most notably in 2003, with the assumption of the Belgacom pension fund). Overall, the resulting structural balance appears to have had a (limited) expansionary effect on the economy around 2002-2004. Moreover, the real short-term interest rate also had a dampening effect in both the upward and downward phase of the cycle.

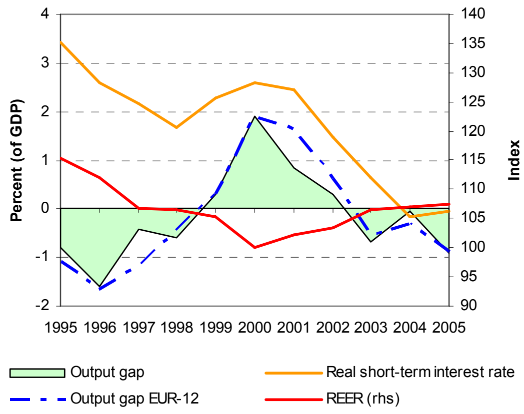
Figure 7: Output gap and fiscal stance



Note: ΔCAPB denotes the change in the cyclically-adjusted primary budget balance

Source:
Commission services

Figure 8: Output gap and monetary conditions



Source:
Commission services

2.4. Public finances

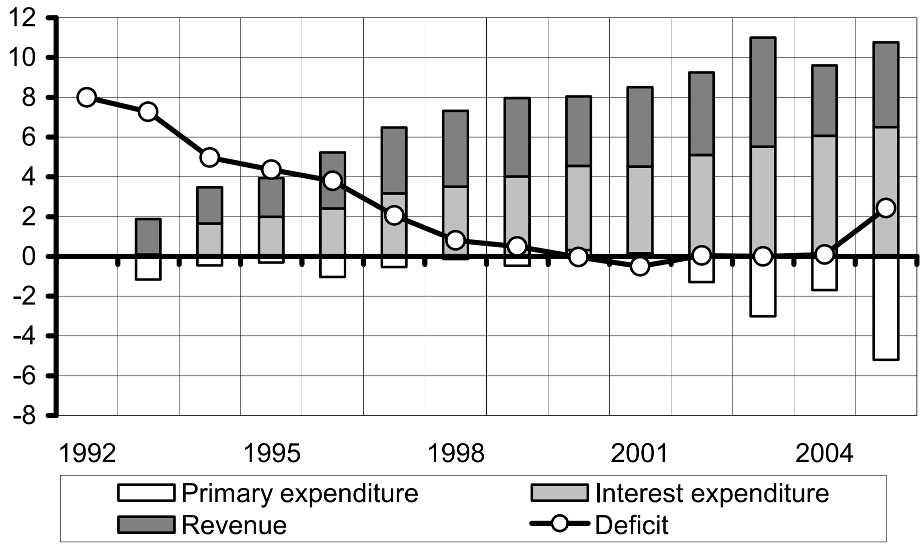
As regards public finances, a distinction should be made between the period up to 2000, characterized by a fiscal consolidation resulting in a balanced budget position and afterwards when this balance was maintained. After a long period of significant deficits (averaging close to 10% of GDP between 1980 and 1992), the signing of the Maastricht Treaty triggered renewed efforts to bring down the deficit (which was 7.9% of GDP in 1992) and rapidly reduce the debt (from its peak of 133% of GDP in 1993 to 93% in 2005) in order to meet the criteria required to join the euro. From 2000 onwards, Belgium often envisaged building up budgetary surpluses, but the creation of these surpluses was frequently postponed (see below) and the fiscal strategy de facto consisted of maintaining a balanced budget[13].

[13] In the October 2006 EDP notification Belgium reported a small surplus for 2005, but Eurostat has amended the deficit and debt data in relation to the assumption by government of 7400 million euro (2.5% of GDP) of debt of the railway company SNCB, resulting in a government deficit of 2.3% of GDP for 2005.

In view of the significant fiscal autonomy of Regions and Communities in Belgium, achieving this result required clear budgetary targets for all levels of government and an efficient mechanism to enforce them. To this end a series of political agreements (or 'budgetary conventions') between governments at federal and regional level have been created, setting the medium-term budgetary targets and acting as internal stability programmes. An independent council (the 'Public Sector Borrowing Requirements' section of the Belgian High Finance Council) acts as a supervisory body. Overall, regions and communities have demonstrated a strong commitment to stick to the medium-term targets set in the conventions.

Figure 9 illustrates the decomposition of the fiscal consolidation compared to 1992 (in % of GDP), showing that the entire consolidation was built on reduced interest expenditure and increased revenue. Overall, in the period leading up to 2000, about half of the consolidation stemmed from reduced interest payments and half from increased revenue. The net contribution of primary expenditure was close to zero. In fact, in most years primary expenditure (in percent of GDP) turned out to be higher than in 1992 (reflected as a negative contribution to the fiscal consolidation).

Figure 9: Government deficit and composition of the fiscal consolidation since 1992 (in % of GDP, cumulative changes compared to 1992)



Note: Negative contributions are deficit increasing, whereas positive contributions are deficit reducing.

Source: Commission services

The fiscal consolidation started with a significant increase in government revenue (by close to 2% of GDP) in 1993, building up further to nearly 4% of GDP in 1999. The main sources of additional revenue were corporate taxes (+1.7% of GDP from 1992 to 2000) and indirect taxes (+1.4% of GDP). On the other hand, social contributions were reduced from 14.7% to 13.9% of GDP. To accelerate the reduction of public debt (and therefore also the interest-burden) the government pressed ahead with significant privatisations (0.4% of GDP annually on average from 1992 until 2000), a reduction of the outstanding amount of the financial assets of general government with credit institutions, and the use of the capital gains made by the Central Bank on arbitrage transactions of gold against foreign currencies, resulting in a significant reduction in net financial assets. Moreover, the government benefited from falling interest rates, resulting from a de facto monetary union with Germany (Belgium implemented a hard peg to the Deutsche Mark from June 1990 until the creation of the euro zone) and following the general trend on financial markets. A significant reform of the financial instruments used to place the government debt, increasing competition between financial institutions, and an enhancement of the secondary market for government-issued securities further contributed to lower interest charges. As a result, the implicit interest rate on public debt dropped from 8.1% in 1992 to 6.2% in 2000.

In 2000, the consolidation effort resulted in a general government balanced budget and in 2001 the government even posted a surplus of 0.6% of GDP. However, while savings from reduced interest payments continued to grow, primary expenditure also started to increase, partly triggered by the economic downturn in 2001, and since 2002 it shows as a negative contribution to the deficit consolidation in Figure 9. Overall, from 2000 onwards Belgium has maintained its balanced budget position using the continuous fall in interest payments to finance new government policies, except in 2005, when it posted a 2.3% of GDP deficit related to a debt assumption from the railway corporation SNCB.

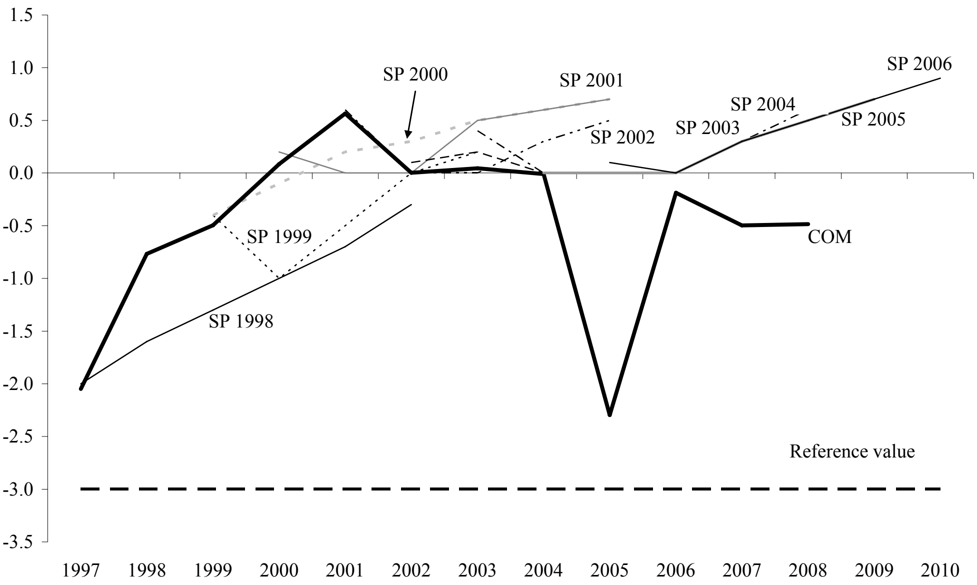
However, there are some issues of sustainability linked to this strategy. The fall in interest rates since 1990 has clearly favoured the consolidation effort and created some margin since 2000. But as interest rates start increasing, future gains from reduced interest payments will be limited in spite of a continued debt reduction. Moreover, in order to achieve a balanced budget, the authorities have often taken recourse to one-off measures (amounting to 0.65% of GDP on average since 2001[14]). Many of these one-off measures appear to be mainly created to meet the budgetary targets in the short run, creating significant future liabilities (e.g. in the case of the assumption of pension funds or sale-lease-back operations of real estate) or affecting future revenue (e.g. in the case of securitisations of tax-arrears). In some cases these operations are also not accompanied by an adequate long-term strategy or an analysis of costs and benefits (as illustrated in a recent report of the Belgian Court of Audit on real estate operations[15]), demonstrating the adverse effects of the pressure to meet nominal budgetary targets.

[14] This does not take into account the one-off impact of the debt assumption from the SNCB in 2005, which represents a negative one-off of 2.5% of GDP. However, the latter was clearly not intentional, as it was stated explicitly by law that the government would only go ahead with the operation if it had no effect on the deficit.

[15] Recently the Belgian Court of Audit concluded that (in the case of real estate sales): "*Government's policy has been to replace buildings it has on its own by leased buildings but while doing so, Government favoured a short term objective, that is budgetary equilibrium. Buildings for disposal were not selected on the basis of criteria relevant for the objectives announced. Estimates of the buildings value were not always sufficiently supported by relevant documents. If sold buildings were immediately leased, the profitability of the transaction was hardly ever calculated. And if sold buildings were leased on a short time basis for practical reasons, the transaction did not prove profitable for the federal Government.*"

(Cour des Comptes (2006), *La vente de patrimoine immobilier par la Régie des bâtiments*, Brussels, Cour des Comptes. The quote is taken from the original English abstract).
(also available on: http://www.ccrek.be/docs/Reports/2006/2006_22_RegieDesBatiments.pdf)

Figure 10: General government balance projections in successive stability programmes (% of GDP)



Source:
Commission services and successive national stability programmes

As shown in Figure 10, since 2000 the Belgian authorities frequently envisaged the objective of creating nominal surpluses as part of a general strategy to prepare for the impact of the ageing shock ahead. The Belgian strategy in this respect largely consists in a plan to build up surpluses in the coming years and to maintain them at this level so as to bring down the debt rapidly. From 2018 onwards, surpluses could be reduced as a result of the increasing cost of ageing. However, except for 2001, the government did not meet these objectives and postponed them in subsequent stability programmes.

2.5. Medium and long-term policy challenges for public finances

Based on the discussion and analysis on the last ten years presented in the previous parts, it can be concluded that overall, the Belgian business cycle is moving very much in line with that of the euro area and shows similar levels in growth. This is all the more important since at the same time there was a fiscal consolidation in Belgium, which went much beyond that undertaken in the euro area as a whole, ending a long period of high budgetary deficits. Since 2000, Belgium has aimed to maintain a balanced budget (or – so far unsuccessfully - to accumulate surpluses), but it also continues to rely on one-off measures to achieve this target. Domestic demand and consumer confidence benefited from a steep reduction of the government debt ratio. Over the last decade, the household savings rate fell from around 20% in 1995 to some 13% in 2005. Net exports also made a positive contribution to economic growth, but Belgium is confronted with a significant loss in market shares which could threaten employment and growth in the long run. Belgium's poor export performance is partially linked to its export structure, but also to the high cost of labour. Unemployment benefits that are unlimited in time, low job search requirements for older unemployed, and the existence of generous early retirement schemes explain why labour market participation is among the lowest in the euro area (especially for older workers). Overall, there appear to be no major imbalances in terms of stabilisation.

The challenges faced by the Belgian economy are related to sustainability and efficiency. In particular:

- On sustainability:

Despite a significant fiscal consolidation since 1992, Belgium still faces the challenge to create structural surpluses necessary to prepare for the ageing shock ahead. Surpluses have been envisaged several times in the past, but until now the Belgian authorities did not meet these objectives and postponed them in subsequent stability programmes. Increasing labour market participation (which is among the lowest in the euro area) could also contribute to easing the impact of an ageing population by enlarging the tax basis and reducing the amount of social benefits.

Moreover, the Belgian authorities continue to use one-off measures, thereby creating future liabilities or reducing future revenues. Often these operations mainly serve the short-term objective of reaching the (nominal) budgetary target, without an adequate long-term strategy or an analysis of costs and benefits. As a result, some of these operations are clearly not beneficial for public finances in the long run.

- On efficiency:

Belgium benefits from high labour productivity, but in spite of recent reforms the labour market still suffers from a high tax burden on labour (aggravated by moderate wage developments in the neighbouring countries – especially Germany) and a benefit system that is quite unfavourable to employment for older workers.

Because of past policies to free up jobs held by older workers in favour of the youth, and to ease the problem of older (long-term) unemployed who find it difficult to compete on the labour market, a large number of people currently benefit from attractive early retirement schemes. In addition, for older workers who don not have access to early retirement, the system of unemployment benefits is unlimited in time and de facto imposes little or no job search requirements. As a result, the employment rate for older workers in Belgium is currently less than 32%.

Recently the Belgian authorities stepped up the job search requirements for those who receive unemployment benefits, combined with additional assistance and training aimed at long-term unemployed, but these measures do not yet apply to older workers. At the end of 2005, a plan (the so-called 'Generation Pact') was also launched to improve job opportunities for older workers and to tighten the eligibility criteria for early retirement schemes. Although this can be considered a first important step towards a change in attitude on early retirement, further steps will be required to achieve the EU target of a 50% employment rate for older workers by 2010.

Table 1: Key economic indicators

	Belgium						Euro area					
	Averages			2003	2004	2005	Averages			2003	2004	2005
	'96 - '05	'96 - '00	'01 - '05				'96 - '05	'96 - '00	'01 - '05			
Economic activity												
Real GDP (% change)	2.1	2.7	1.5	1.0	3.0	1.1	2.1	2.7	1.4	0.8	2.0	1.4
Contributions to real GDP growth:												
Domestic demand	1.8	2.4	1.3	0.9	3.0	1.5	2.0	2.7	1.3	1.4	1.8	1.6
Net exports	0.2	0.3	0.2	0.1	0.0	-0.5	0.1	0.1	0.1	-0.7	0.2	-0.2
Prices, costs and labour market												
HICP inflation (% change)	1.8	1.6	2.0	1.5	1.9	2.5	1.9	1.7	2.2	2.1	2.1	2.2
Labour productivity (% change)	1.2	1.6	0.9	1.1	2.4	0.1	1.2	1.5	0.8	0.8	1.6	0.9
Real unit labour costs (% change)	-0.3	-0.4	-0.2	-1.0	-2.7	0.2	-0.5	-0.6	-0.5	-0.1	-1.0	-0.8
Employment (% change)	0.9	1.3	0.6	0.1	0.7	0.9	1.2	1.5	0.9	0.7	0.7	0.8
Unemployment rate (% of labour force)	8.3	8.7	7.8	8.2	8.4	8.4	9.1	9.8	8.5	8.7	8.9	8.6
Competitiveness and external position												
Real effective exchange rate (% change) (1)	-0.6	-2.7	1.5	2.9	-0.1	1.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Export performance (% change) (2)	-1.9	-2.8	-1.1	-0.4	-1.4	-3.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
External balance (% of GDP)	4.4	5.0	3.9	4.4	3.6	2.5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public finances												
General government balance (% of GDP)	-0.9	-1.4	-0.3	0.0	0.0	-2.3	-2.3	-2.1	-2.5	-3.1	-2.8	-2.4
General government debt (% of GDP)	108.3	117.5	99.1	98.6	94.3	93.2	70.9	72.5	69.3	69.3	69.8	70.8
Structural budget balance (% of GDP) (3)	n.a.	n.a.	n.a.	-1.0	-0.9	0.2	n.a.	n.a.	n.a.	-3.2	-2.9	-2.0
Financial indicators (4)												
Long term real interest rate (%) (5)	3.3	4.2	2.4	2.5	1.7	1.4	3.1	4.1	2.1	2.0	2.2	1.5
Household debt (% of GDP) (6)	39.6	39.4	39.8	39.4	40.2	42.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Corporate sector debt (% of GDP) (7)	70.3	65.3	75.3	74.1	77.1	75.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:
More detailed tables summarising the economic performance of the country are included in Annex 4.
(1) Unit labour costs relative to rest of a group of industrialised countries (USD): EU24 (=EU25 excl. LU), BG, RO, TR, CH, NR, US, CA, JP, AU, MX and NZ.
(2) Market performance of exports of goods and services on export weighted imports of goods and services of 35 industrial markets.
(3) Cyclically-adjusted budget balance net of one-off and other temporary measures.
(4) Data available up to 2004.
(5) Using GDP deflator.
(6) Households' and non-profit institutions serving households' debt, defined as loans and securities other than shares.
(7) Non-financial corporate sector debt, defined as loans and securities other than shares.
Source:
Commission services

3. MACROECONOMIC OUTLOOK

This section is in seven parts, six of which refer to various dimensions of the macroeconomic scenario, notably: the external assumptions, overall economic growth, the labour market, costs and prices, sectoral balances and potential output growth. The final part summarises the assessment and includes (i) an overall judgement on the plausibility of the macroeconomic scenario and (ii) an indication of whether economic conditions over the programme period can be characterised as economic ‘good’ or ‘bad’ times.

3.1. External assumptions

The most recent update of the Belgian stability programme expects world GDP (excluding the EU) to grow at 5.7% in 2006 and at 5.2% in 2007 and 2008 (in line with the Commission services' autumn 2006 forecast). From 2009 onwards, growth would slow down to 4.5% per annum. The projections of world import volumes in the programme are also much in line with the autumn forecast: 9.2% in 2006 and around 8.0% thereafter. The update foresees some further depreciation of the dollar compared to the euro until 2008, from USD 1.25 per euro in 2006 to USD 1.29 per euro in 2008, when the exchange rate stabilises. Oil prices are expected to increase from USD 66.1 per barrel in 2006 to USD 68.4 in 2008 (slightly higher than in the external assumptions of the Commission services autumn forecast), and to decrease afterwards to USD 65.0 by 2010. Overall, the programme's external assumptions appear broadly plausible and the differences with those of the autumn forecast are minor.

3.2. Economic activity

The programme foresees real GDP growth of 2.7% in 2006, slowing down to around 2.2% thereafter. The output gap (recalculated by the Commission services on the basis of the information in the programme) is expected to remain at around -0.4% of potential output throughout the programme period. The growth level anticipated in the programme is also very close to the average growth performance in the last ten years (2.1%), with growth contributions of the individual demand components in line with historical averages.

Real GDP growth assumptions in the programme are nearly identical to the projections in the Commission services' autumn forecast. For 2006, this may turn out to be a somewhat cautious forecast, as economic growth may come close to 3%. Growth projections in the outer years of the programme are also in line with the average potential growth of the period 2006-2008 in the Commission services' autumn forecast of around 2.3%.

Assumptions on private consumption growth in the programme are in line with the autumn forecast, except for 2008 when the programme foresees a temporary slowdown. The programme does not provide an explanation for this deceleration. On the other hand, gross fixed capital formation and external demand are expected to grow somewhat faster than in the Commission services' forecast. Overall, most of the macroeconomic assumptions used in the programme are very close to the Commission services' estimates, except for compensation of employees, for which the programme foresees significantly higher growth rates (see also Section 3.5).

Table 2: Comparison of macroeconomic developments and forecasts

	2006		2007		2008		2009	2010
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	2.7	2.7	2.3	2.2	2.2	2.1	2.2	2.2
Private consumption (% change)	2.3	2.3	2.1	2.1	1.9	1.5	1.9	1.9
Gross fixed capital formation (% change)	2.8	2.2	2.4	2.4	2.3	2.6	2.9	2.8
Exports of goods and services (% change)	5.3	5.4	4.9	4.9	4.6	5.6	5.6	5.7
Imports of goods and services (% change)	5.0	4.8	4.9	5.0	4.4	5.6	5.7	5.7
Contributions:								
- Final domestic demand	2.2	2.1	2.1	2.1	1.9	1.9	2.0	2.0
- Change in inventories	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- External balance on g&s	0.5	0.6	0.2	0.1	0.3	0.2	0.2	0.2
Output gap[1]	-0.6	-0.3	-0.6	-0.4	-0.7	-0.4	-0.4	-0.3
Employment (% change)	0.9	1.0	1.0	1.1	0.9	0.8	0.8	0.8
Unemployment rate (%)	8.6	8.6	8.5	8.4	8.4	8.3	8.2	8.0
Labour productivity growth (%)	1.8	1.7	1.3	1.1	1.3	1.2	1.3	1.4
HICP inflation (%)	2.4	2.4	1.8	1.9	1.7	1.8	1.8	1.9
GDP deflator (% change)	2.1	2.2	2.0	2.0	2.1	1.9	2.1	2.1
Comp. of employees (% change)	3.6	3.9	3.3	3.6	3.3	4.0	4.7	4.6
Real unit labour costs (% change)	-1.4	-1.1	-1.2	-0.7	-1.2	0.0	0.4	0.2
External balance (% of GDP)	2.8	2.0	2.9	2.0	3.3	2.2	2.4	2.7

Note:

[1]In percent of potential GDP, with potential GDP growth as reported in Table 4 below.

Source:

Commission services' forecasts, national Stability programme and Commission services.

The output gap as recalculated by the Commission services based on the information in the programme according to the commonly agreed methodology is slightly smaller (in absolute value) than the values resulting from the autumn forecast. However, in both cases the output gap is expected to remain fairly constant over the entire forecast horizon. As shown in Table 3, output gaps for Belgium calculated in successive Commission services' forecasts and in stability programmes appear to be relatively stable. The improvement in the output gap in more recent estimates can be linked to higher-than-expected growth in 2006, and a statistical effect related to the introduction of chain linking for the estimation of real GDP growth.

Table 3: Output gap estimates in successive Commission services' forecasts and stability programmes

	2006		2007		2008	
	COM	SP[1]	COM	SP[1]	COM	SP[1]
Dec 2006	-	-0.3	-	-0.4	-	-0.4
Autumn 2006	-0.6	-	-0.6	-	-0.7	-
Spring 2006	-0.9	-	-1.0	-	-	-
Dec 2005	-	-0.6	-	-0.6	-	-0.5
Autumn 2005	-0.8	-	-1.0	-	-	-
Spring 2005	-0.6	-	-	-	-	-
Dec. 2004	-	-0.2	-	-0.4	-	-0.5

Note:

[1] Commission services' calculations according to the commonly agreed method based on the information in the programme.

Source:

Commission services' forecasts, national Stability programme and Commission services.

3.3. Potential growth and its determinants

As illustrated in Table 4, Commission services' calculations of potential growth according to the commonly agreed methodology, based on the information provided in the programme, are almost identical to the values presented in the Commission services' forecast. They also match average economic growth in the past ten years (2.1%) closely.

Table 4: Sources of potential output growth

	2006		2007		2008		2009	2010
	COM	SP[2]	COM	SP[2]	COM	SP[2]	SP[2]	SP[2]
Potential GDP growth[1]	2.3	2.2	2.3	2.2	2.2	2.2	2.2	2.1
Contributions:								
- Labour	0.4	0.5	0.4	0.5	0.3	0.4	0.3	0.2
- Capital accumulation	0.7	0.6	0.7	0.7	0.7	0.7	0.7	0.7
- TFP	1.1	1.1	1.2	1.1	1.2	1.1	1.1	1.2

Notes:
[1]Based on the production function method for calculating potential output growth
[2]Commission services' calculations on the basis of the information in the programme
Source:
Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations

3.4. Labour market developments

In line with the recent acceleration in economic activity in 2006, the programme projects employment growth to be relatively strong in 2006 and 2007 and to decrease again thereafter. These employment projections differ only marginally from the Commission services' autumn 2006 forecast. They are also broadly consistent with the average labour content of GDP growth in the past. As regards unemployment, in line with the Commission autumn forecast, the programme foresees a slow decrease in the unemployment rate (from 8.6% in 2006 to 8.0% in 2010). These projections also seem consistent with the cyclical conditions of the economy as measured by the output gap (recalculated by Commission services on the basis of the programme).

3.5. Costs and price developments

As regards price developments, the programme foresees moderate inflation (around 1.9% per annum), in line with the Commission services' autumn forecast. However, for the compensation of employees, it foresees slightly higher increases than the Commission services (3.6% in the programme against 3.3% in the autumn forecast, partly reflecting the somewhat better employment prospects in the programme). In 2008, the difference between the programme and the autumn forecast further increases (4.0% compared to 3.3% in the forecast). For 2009 and 2010, the programme even assumes a further acceleration (4.6% and 4.7%), which seems somewhat on the high side against the background of slightly decreasing employment growth, low HICP inflation and the anticipated growth of labour productivity. Labour productivity is expected to slow down somewhat in 2007, as a result of increased employment growth following the economic upturn in 2006. From 2008 onwards, it is expected to grow at a stable annual rate of around 1.3%.

3.6. Sectoral balances

The Belgian stability programme provides projections for the sectoral balances in annex, but without further comments. Although these projections seem internally consistent and in line with recent trends, it appears as if they do not include the measures announced in the 2007 budget. In any case, they are not consistent with the macroeconomic scenario and the budgetary projections outlined in the rest of the programme. Whereas the programme foresees a budget balance for 2006 and a gradual build-up of surpluses afterwards (to 0.9% of GDP by 2010), the programme's projections for sectoral balances foresee a deficit of 0.3% of GDP in 2006, which deteriorates towards a deficit of 1% in 2007 and 0.9% in 2008. Towards 2010 the anticipated deficit decreases again to 0.3%.

3.7. Assessment

The assessment of the macroeconomic outlook covers two questions: first, whether the macroeconomic scenario is plausible, and, second, whether the economy should be considered to be in economic 'good' or 'bad' times.

3.7.1. Plausibility of the macroeconomic scenario

The macroeconomic scenario underlying the programme envisages that after strong economic growth in 2006 real GDP growth decreases towards its potential level (around 2.2%). HICP inflation is expected to return to a relatively moderate level of around 1.9% annually. Following the acceleration of economic activity in 2006, employment growth should still be strong in 2007 and decrease slightly afterwards. Until 2008 this macroeconomic scenario nearly coincides with the Commission services' autumn forecast, with the main exception being the projected compensation of employees, which seems to be somewhat on the high side (especially in the outer years of the programme). Hence, the overall conclusion is that assessed against currently available information, this scenario appears to be based on plausible macroeconomic assumptions.

3.7.2. Economic good vs. bad times

According to the Commission services' autumn forecast, although still negative the output gap narrowed from 1% of potential GDP in 2005 to 0.6% in 2006. From then onwards, real GDP growth remains close to potential growth, resulting in a small but stable negative output gap throughout the programme period. There appears to be no particular inflationary pressure. Employment growth is sound in 2007 (some 1.0%) and also throughout the rest of the programme period (around 0.8% per annum). Moreover, output gaps for Belgium calculated in successive Commission services' forecasts and in stability programmes appear to be diminishing slightly. Therefore the overall assessment is that Belgium's economy is currently neither in good nor bad times.

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first part discusses budgetary implementation in the year 2006 and the second presents the budgetary strategy in the new update, including the programme's medium-term objective (MTO) for the budgetary position. The third analyses the risks attached to the budgetary targets in the programme. The final part contains the assessment of the fiscal stance and of the country's position in relation to the budgetary objectives of the Stability and Growth Pact.

4.1. Budgetary implementation in 2006

In their autumn 2006 forecast, the Commission services' forecasted a small deficit of 0.2% of GDP. The programme expects that the 2006 budget has been in balance in nominal terms, in line with the plans in successive updates of the Belgian stability programme (Table 5). However, this small difference with the autumn forecast hides a somewhat more fundamental deviation. Whereas the 2005 update of the Belgian stability programme foresaw 2.2% economic growth in 2006 after a weak 2005, the economic upturn was considerably more pronounced with economic growth probably exceeding the 2.7% growth estimated in the Commission services' autumn forecast. Nevertheless, government revenue (excluding the impact from one-off measures) turned out to be lower than anticipated (in particular direct taxes, mainly because the budgetary impact of the final stage of the 2001 tax reform seems to have been underestimated by the authorities, a fact that was only discovered in the second half of 2006[16]). Government expenditure remained reasonably on track and in July (before the overestimation of direct tax revenues was discovered) the Belgian authorities even considered that there was a small budgetary margin for some additional initiatives.

The unfavourable developments in fiscal revenue were partially compensated by the better-than-anticipated proceeds from some real estate operations and by some additional (one-off) measures to advance the collection of corporate taxes. As a result, the total impact of one-off measures turned out to be ¾% of GDP. The December 2006 stability programme reports only 0.6% of GDP in one-off measures (as foreseen in the 2005 update), but this turned out to be an underestimation of the actual outcome[17]. The 2005 update of the stability programme anticipated a deterioration of the structural government balance in 2006 (recalculated by the Commission services, based on the information from the programme) of 0.3% of GDP, which was already a deviation from the benchmark adjustment of 0.5% of GDP per annum towards the medium term objective, as foreseen in the Pact. As a result of the more favourable GDP growth and the higher impact of one-off measures the structural balance in 2006 is expected to deteriorate by almost 1%, in spite of last year's policy invitation by the Council "*to consider measures to avoid a deterioration of the structural balance in 2006* (…)".

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[16] In September 2006 the Belgian authorities discovered that household direct income tax revenue had been overestimated by almost 0.3% of GDP.

[17] The 2006 update reports 0.6% of GDP of one-off measures for 2006, but it does not explain what measures are included. However, on 5 January 2007 issued a press release on the execution of the 2006 budget, reporting 0.7% of GDP in one-off measures: real-estate sale lease back operations, the sale of the Tokyo embassy, securitisation of tax-arrears and a one-off effect of a permanent advancement of the collection of taxes. The press release did not refer to some additional (minor) one-off revenue stemming from a fiscal regularisation procedure for income taxes and a tax amnesty for the Belgian diamond sector.

Table 5: Evolution of budgetary targets in successive programmes

		2005	2006	2007	2008	2009	2010
General government balance (% of GDP)	**SP Dec 2006**	**-2.3***	**0.0**	**0.3**	**0.5**	**0.7**	**0.9**
	SP Dec 2005	0.0	0.0	0.3	0.5	0.7	n.a.
	SP Dec 2004	*0.0*	*0.0*	*0.3*	*0.6*	*n.a.*	*n.a.*
	COM Nov 2006	-2.3	-0.2	-0.5	-0.5	n.a.	n.a.
General government expenditure (% of GDP)	**SP Dec 2006**	**52.3***	**49.1**	**48.6**	**48.4**	**48.1**	**47.8**
	SP Dec 2005	49.7	49.4	48.9	48.3	48.0	n.a.
	SP Dec 2004	*49.4*	*49.0*	*48.8*	*48.5*	*n.a.*	*n.a.*
	COM Nov 2006	52.2	49.2	49.0	48.5	n.a.	n.a.
General government revenues (% of GDP)	**SP Dec 2006**	**50.0**	**49.1**	**48.9**	**48.9**	**48.8**	**48.7**
	SP Dec 2005	49.7	49.4	49.2	48.8	48.7	n.a.
	SP Dec 2004	*49.4*	*49.0*	*49.1*	*49.1*	*n.a.*	*n.a.*
	COM Nov 2006	49.9	49.0	48.5	48.0	n.a.	n.a.
Real GDP (% change)	**SP Dec 2006**	**1.2**	**2.7**	**2.2**	**2.1**	**2.2**	**2.2**
	SP Dec 2005	1.4	2.2	2.1	2.3	2.2	n.a.
	SP Dec 2004	*2.5*	*2.5*	*2.1*	*2.0*	*n.a.*	*n.a.*
	COM Nov 2006	1.1	2.7	2.3	2.2	n.a.	n.a.

Note:
* The programme reported a general government surplus for 2005 of 0.1% of GDP and a government debt of 91.5% of GDP. However, on 23 October 2006 Eurostat amended the deficit and debt data notified by Belgium for 2005 in relation to the assumption by government (FIF - Fonds de l'infrastructure ferroviaire) of EUR 7400 million (2.5% of GDP) of the debt of the railway company SNCB in 2005. According to ESA95 rules, the impact on the government deficit is of the same amount; the impact on the government debt at the end of 2005 amounts to EUR 5200 million (1.7% of GDP). Therefore, in this assessment all figures related to the general government's deficit (for 2005) and debt (from 2005 onwards) taken from the programme have been 'mechanically' adjusted, in order to comply with the Eurostat decision. The adjustment to the debt figure for 2006-2010 is an approximation, assuming that the debt of the FIF remains unchanged.

Source:
Stability programme (SP); Commission services' autumn 2006 economic forecasts (COM)

4.2. The programme's medium-term budgetary strategy

This section covers in turn the following aspects of the medium-term budgetary strategy outlined in the programme: (i) the main goal of the budgetary strategy; (ii) the composition of the budgetary adjustment, including the broad measures envisaged; and (iii) the programme's medium-term objective and the adjustment path towards it in structural terms.

4.2.1. The main goal of the programme's budgetary strategy

In line with previous updates, the December 2006 update of the Belgian stability programme aims at ensuring a continuous reduction of the still high debt ratio to below 75% of GDP in 2010, through a gradual build-up of nominal budgetary surpluses (from 0.3% of GDP in 2007 to 0.9% in 2010), to prepare for the ageing shock ahead. The corresponding primary surplus is expected to stabilise at around 4.1% of GDP (see also Tables 5 and 6). Compared with the previous programme, the new update confirms the planned adjustment against a broadly unchanged macroeconomic scenario.

Table 6: Composition of the budgetary adjustment

(% GDP)	2005	2006	2007	2008	2009	2010	Change: 2010-2006
Revenues	**50.0**	**49.1**	**48.9**	**48.9**	**48.8**	**48.7**	**-0.4**
of which:							
- Taxes & social contributions	47.1	46.5	46.2	46.4	46.3	46.3	-0.2
- Other (residual)	2.9	2.6	2.7	2.5	2.5	2.4	-0.2
Expenditure	**52.2***	**49.1**	**48.6**	**48.4**	**48.1**	**47.8**	**-1.3**
of which:							
- Primary expenditure	48.1*	45.0	44.7	44.8	44.7	44.5	-0.5
of which:							
Compensation of employees, intermediate consumption and social benefits other than in kind provided by market producers[1]	22.8	22.6	22.6	22.7	22.7	22.6	0.0
Transfers other than in kind & subsidies	17.7	17.5	17.3	17.1	17.1	17.0	-0.5
Gross fixed capital formation	1.8	1.6	1.5	1.7	1.7	1.7	+0.1
Other (residual)	5.7*	3.3	3.3	3.3	3.2	3.2	-0.1
- Interest expenditure	4.2	4.1	3.9	3.6	3.4	3.3	-0.8
General government balance (GGB)	**-2.3***	**0.0**	**0.3**	**0.5**	**0.7**	**0.9**	**+0.9**
Primary balance	**1.9***	**4.1**	**4.2**	**4.1**	**4.1**	**4.2**	**+0.1**
One-offs[2]	n.a.	0.6	0.4	n.a.	n.a.	n.a.	n.a.
GGB excl. one-offs	**-0.3**	**-0.6**	**-0.1**	**0.5**	**0.7**	**0.9**	**+1.5**

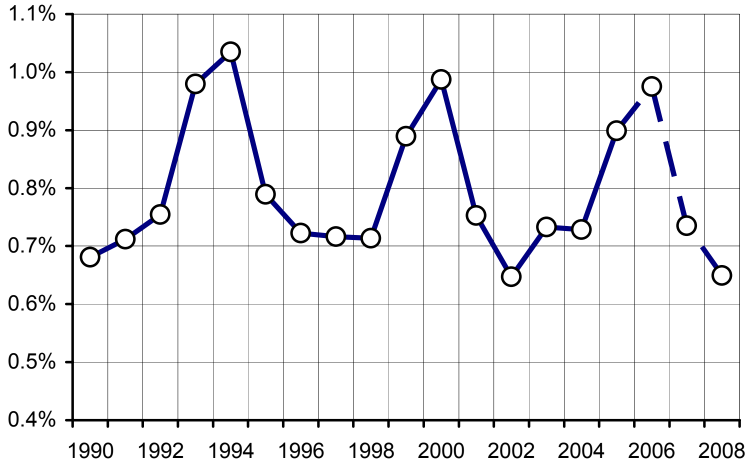
Note:
* Figures for 2005 taken from the programme have been 'mechanically' adjusted, in order to include the Eurostat decision of 26 October 2006. See also the note in Table 5.
[1] The programme reports compensation of employees and intermediate consumption instead of collective consumption. It also does not provide information on social transfers in kind, but only on the subcategory social benefits in kind.
[2] One-off and other temporary measures.
Source:
Stability programme update; Commission services' calculations

4.2.2. The composition of the budgetary adjustment

The build-up of a 0.9% of GDP surplus by 2010 is nearly entirely due to reduced expenditure (-1.3% of GDP between 2006 and 2010), mainly in the form of falling interest expenditure (-0.8% of GDP) resulting from the continuous debt reduction. However, part of the expenditure reduction is offset by a decrease in government revenue by 0.4% of GDP. Primary expenditure falls by 0.5% of GDP over the programme period, which is largely the result of the anticipated expenditure cuts by local authorities after the 2006 elections (see below). Otherwise primary expenditure seems to grow only marginally slower than the nominal GDP. Beyond 2007 the programme's projections broadly correspond to no-policy change projections, although the programme also *seems to* rely on further one-offs to achieve the budgetary targets.

Public investment figures for 2006 and 2007 in the programme (see also Table 6) have been substantially affected by a number of large real estate operations (0.3% of GDP in 2006 and 0.2% of GDP planned for 2007, recorded as negative investments). Without these exceptional one-off operations, public investment would have reached 1.9% of GDP in 2006 and returned to a stable 1.7% of GDP afterwards. The unusual increase in public investment around 2006 is almost entirely the result of investments by municipalities in the run-up to local elections in October 2006, a cycle which has also been observed around previous election years (See also Figure 11 - 1994, 2000 and 2006 were election years).

Figure 11: Gross capital formation by local authorities as % of GDP



Source: Belgostat and Commission services' forecast

For 2007, the programme refers to the main measures that have been included in the budget law that was recently approved by the Belgian Parliament (see Box 1). The 2007 budget includes some new revenue increasing measures (e.g. a tax on packing material and increased excise duties on tobacco – see Box 1 for details), partly offset by some initiatives to reduce the tax burden on labour[18] as well as the announcement of some new one-offs. According to the programme the latter amount to 0.4% of GDP, mainly some further real estate sales and the take-over of pension funds from public corporations, but these have not yet been specified in further detail.

The programme does not provide information about specific measures beyond 2007. Normally this should not pose a major problem, as the programme does not foresee a significant deviation from the normal trend in revenue and expenditure that would require a substantial government intervention.

However, for 2008 the programme does not include measures to account for the loss in income due to the expiration of the one-off measures included in the 2007 budget. It also does not provide information on the use of one-offs for 2008-2010 or include a commitment to reduce the future use of one-offs. In the past the Belgian authorities have often relied on one-off measures to achieve the nominal budgetary targets (on average around 0.65% of GDP per annum in the past five years). Moreover, the programme also indicates that new one-off measures are likely. More in particular, it says that "(…) *assuming that the impact of the one-off measures does not exceed 0.4% of GDP [in 2008], the medium term objective will be reached by 2008*".

[18] The apparent drop in revenue-to-GDP ratio in 2007 is also linked to the expiration of one-off measures in the 2006 budget, in particular the advanced collection of corporate taxes (0.2% of GDP) and the securitisation of tax arrears (0.2%).

Box 1: The budget for 2007

The 2007 budget was presented in October 2006 and approved by Parliament on 21 December. The budget targets a nominal surplus of 0.3% of GDP (against a balanced budget in 2006), in spite of the expiration of a significant package of one-off measures in the previous budget (which turned out to be around ¾% of GDP) and some initiatives to further reduce the tax burden on labour (around 0.2% of GDP, some of which had already been decided earlier in 2006).

Some new taxes (a new fiscal framework for corporate tax-exempt reserves – a tax shelter for corporate profits – and a tax on packing material), higher excise duties on alcohol and tobacco, and new initiatives to fight tax fraud should increase fiscal revenue by close to ½% of GDP. Moreover, although less than in 2006, a series of new one-off and other temporary measures (for over 0.4% of GDP) were also announced. These include a planned take-over of pension funds and the sale of real estate, but so far the Belgian authorities have not yet provided further details about these operations. Some changes in the timing of social contributions on holiday allowances also have a temporary positive effect on government revenue.

In line with a multi-annual plan for the financing of Regions and Communities, an increasing share of total government revenue is transferred to the regional governments, but for 2007 the regional governments have agreed to refrain from spending part of their additional revenue (about 0.1% of GDP). As for the local governments, after a marked investment boom in the run-up to the 2006 local elections, local government expenditure is expected to return to its normal trend level.

Table: Main measures in the budget for 2007

Revenue measures*	Expenditure measures**
o Take-over of pension funds (0.2% of GDP)	o Agreement with regions and communities not to spend the additional transfers they receive from the federal level in 2007 (-0.1% of GDP)
o Measures to reduce taxes and social contributions on labour (-0.2% of GDP)	o Real estate sales (-0.2% of GDP)***
o New tax regime for corporate tax exempt reserves (0.1% of GDP)	
o New tax on packing material (0.1% of GDP)	
o Increased excise duties on tobacco (0.1% of GDP)	
o New measures to fight fiscal fraud (0.1% of GDP)	
o Advancing social contributions on holiday allowances (0.1% of GDP)	

* Estimated impact on general government revenues.
** Estimated impact on general government expenditure.
*** Real estate sales are recorded as negative investments and therefore should be considered as expenditure decreasing
Sources: Commission services and Chambre de Répresentants de Belgique, *Budget des recettes et dépenses pour l'année 2007: Exposé Général*.

The budgetary adjustment foreseen in the programme would be mainly the result of fiscal consolidation by the federal government, which is planned to move from a 0.1% of GDP deficit in 2006 to a 0.6% surplus in 2010. This seems to be in line with the fact that the over 90% of Belgian government debt belongs to the federal government, and therefore the federal government should benefit most from reduced interest payments in case of a debt reduction. A further contribution to the fiscal adjustment would come from the local authorities, which should move from a 0.2% of GDP deficit in 2006 to a 0.2% surplus in 2010, mainly as a result of the electoral cycle[19]. On the other hand, regions and

[19] 2006 was an election year, which usually triggers increased public investment by local authorities. The next elections are only foreseen for 2012.

communities which have so far posted a surplus (0.3% of GDP in 2006), are expected to return to a balanced budget.

4.2.3. The medium-term objective (MTO) and the structural adjustment

The December 2006 update maintains its medium-term objective (MTO) for the budgetary position of a 0.5% of GDP surplus in structural terms as put forward in the previous update of the stability programme (see Box 2). According to the programme, "*assuming that the impact of the one-off measures does not exceed 0.4% of GDP [in 2008], the medium term objective will be achieved by 2008"*. This is one year later than foreseen in the previous update of the programme. The reason why the MTO is expected to be reached later than foreseen in the previous update is the significant deterioration of the structural balance in 2006 mentioned earlier, which is not compensated in 2007 by a stronger adjustment.

Box 2: The medium-term objective (MTO) for the budgetary position

According to the Stability and Growth Pact, stability and convergence programmes must present a medium-term objective (MTO) for the budgetary position. The MTO is country-specific to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risk to the sustainability of public finances.

The MTO should fulfil a triple aim. First, it should provide a safety margin with respect to the 3% of GDP deficit limit. Second, it should ensure rapid progress towards sustainability. Third, taking into account the first two goals, it should allow room for budgetary manoeuvre, considering in particular the needs for public investment. The code of conduct further specifies that, as long as the methodology for incorporating implicit liabilities is not fully developed and agreed by the Council, the country-specific MTOs are set taking into account the current government debt ratio and potential growth (in a long-term perspective), while preserving a sufficient margin against breaching the 3% of GDP deficit reference value. Member States are free to set an MTO that is more demanding than strictly required by these provisions.

The MTO is defined in structural terms, i.e. it is adjusted for the cycle and one-off and other temporary measures are excluded. For countries belonging to the euro area or participating in the exchange-rate mechanism (ERM II), the MTO should be in a range between a deficit of 1% of GDP and balance or surplus (in structural terms).

As already indicated in the assessment of the previous programme, the MTO chosen by the Belgian authorities is more demanding than the minimum benchmark (a deficit of 1¼% of GDP in the case of Belgium), which is the estimated budgetary position that provides a sufficient safety margin for automatic stabilisers to operate freely during normal economic downturns without breaching the 3% of GDP deficit reference value. Hence, the achievement of the MTO should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and it is more demanding than what would be implied by the debt ratio and average potential output growth in the long term. This choice of MTO is part of Belgium's forward-looking strategy to prepare for the ageing shock ahead by building up surpluses and reducing the debt ratio.

Table 7: Output gaps and cyclically-adjusted and structural balances

(% of GDP)	2005		2006		2007		2008		2009	2010	Change: 2010-2006
	COM	SP[1]	COM	SP[1]	COM	SP[1]	COM	SP[1]	SP[1]	SP[1]	SP[1]

Gen. gov't balance	-2.3	-2.3*	-0.2	0.0	-0.5	0.3	-0.5	0.5	0.7	0.9	0.9
One-offs[2]	-2.0	-2.0*	0.8	0.6	0.1	0.4	0.0	n.a.	n.a.	n.a.	n.a.
Output gap[3]	-1.0	-0.8	-0.6	-0.3	-0.6	-0.4	-0.7	-0.4	-0.4	-0.3	-
CAB[4]	-1.7	-1.9*	0.1	0.2	-0.1	0.5	-0.1	0.7	0.9	1.1	0.9
change in CAB	*-1.7*	*-1.7**	*1.9*	*2.0*	*-0.3*	*0.3*	*0.0*	*0.2*	*0.2*	*0.2*	-
CAPB[4]	2.5	2.3*	4.2	4.3	3.8	4.4	3.6	4.3	4.3	4.4	0.1
Structural balance[5]	0.2	0.1	-0.7	-0.4	-0.2	0.1	-0.1	n.a.	n.a.	n.a.	n.a.
change in struct. bal.	*1.1*	*1.1*	*-0.9*	*-0.6*	*0.4*	*0.5*	*0.1*	*n.a.*	*n.a.*	*n.a.*	-
Struct. prim. bal.[5]	4.5	4.3	3.4	3.7	3.7	4.0	3.6	n.a.	n.a.	n.a.	n.a.

Notes:

*Figures for 2005 taken from the programme have been 'mechanically' adjusted, in order to include the Eurostat decision of 26 October 2006. See also the note in Table 5.
[1]Output gaps and cyclical adjustment according to the stability programme (SP) as recalculated by Commission services on the basis of the information in the programme.
[2]One-off and other temporary measures.
[3]In percent of potential GDP. See Table 2 above.
[4]CA(P)B = cyclically-adjusted (primary) balance.
[5]Structural (primary) balance = CA(P)B excluding one-offs and other temporary measures.

Source:
Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations

The structural balance according to the Commission services' calculations on the basis of the information in the programme is expected to improve by ½% of GDP in 2007 (see Table 7). Since the programme does not provide information on the use of one-offs beyond 2007, the further development of the structural balance cannot be derived explicitly from the programme. However, "*assuming that the impact of the one-off measures does not exceed 0.4% of GDP*" in 2008 and that the use of one-off measures does not change fundamentally thereafter, the development of the structural balance should follow roughly the same pattern as the cyclically adjusted balance. Assuming one-offs of 0.4% of GDP from 2007 onwards, the structural balance (recalculated by the Commission services, based on the information in the programme) would improve by 0.2% of GDP each year, from a surplus of 0.1% of GDP in 2007 to a surplus of 0.7% of GDP in 2010, essentially because of reduced interest payments as the cyclically-adjusted primary balance does not change between 2007 and 2010. Under the same assumptions regarding the impact of one-off measures after 2007, the planned stance of fiscal policy could be considered broadly neutral.

4.3. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2008, Table 8 compares the detailed revenue and expenditure projections in the Commission services' autumn 2006 forecast, which are derived under a no-policy change scenario, with those in the updated programme.

Table 8: Comparison of budgetary developments and projections

(% of GDP)	2005	2006		2007		2008		2009	2010
		COM	SP	COM	SP	COM[1]	SP	SP	SP
Revenues	49.9	49.0	49.1	48.5	48.9	48.0	48.9	48.8	48.7
of which:									
- Taxes & social contributions	47.1	46.3	46.5	46.0	46.2	45.6	46.4	46.3	46.3
- Other (residual)	2.8	2.7	2.6	2.5	2.7	2.4	2.5	2.5	2.4
Expenditure	52.2	49.2	49.1	49.0	48.6	48.5	48.4	48.1	47.8
of which:									
- Primary expenditure	48.0	45.1	45.0	45.1	44.7	44.8	44.8	44.7	44.5
of which:									
Consumption	22.9	22.9	*22.6*[*]	22.9	*22.6*[*]	22.9	*22.7*[*]	*22.7*	*22.6*[*]
Transfers other than in kind & subsidies	17.6	17.5	17.5	17.5	17.3	17.4	17.1	17.1	17.0
Gross fixed capital formation	1.8	1.6	1.6	1.8	1.5	1.8	1.7	1.7	1.7
Other (residual)	5.6	3.1	*3.3*[*]	2.8	*3.3*[*]	2.6	*3.3*[*]	*3.2*[*]	*3.2*[*]
- Interest expenditure	4.2	4.1	4.1	3.9	3.9	3.7	3.6	3.4	3.3
GGB	-2.3	-0.2	0.0	-0.5	0.3	-0.5	0.5	0.7	0.9
Primary balance	1.9	3.9	4.1	3.4	4.2	3.2	4.1	4.1	4.2
One-offs[2]	-2.0	0.8	0.6	0.1	0.4	0.0	-	-	-
GGB excl. one-offs	-0.3	-1.0	-0.6	-0.6	-0.1	-0.5	0.5	0.7	0.9

Notes:
[*]The programme reports compensation of employees, intermediate consumption (including taxes) and social benefits in kind provided by market producers. Although there is a large overlap, the sum of these categories is not equal to government consumption. Therefore, a direct comparison between the Commission services' forecast and the information in the programme is not meaningful for this expenditure category. For the same reason a similar comment applies to the rest category 'other'.
[1]On a no-policy change basis.
[2]One-offs and other temporary measures.

Source:
Commission services' autumn 2006 economic forecast (COM); Stability programme update (SP); Commission services' calculations

- Macro economic scenario and composition of growth: The macro economic scenario in the programme is broadly similar to the Commission services' autumn forecast and from 2008 the programme assumes economic growth to be close to potential output growth. Therefore GDP growth projections can be considered plausible (as concluded in Section 3.7.1), with no particular upward or downward risk. However, the programme foresees a substantial increase in the compensation of employees from 2008 onwards, in spite of a slowdown in employment and only a mild reduction in unemployment. If compensation of employees should rise at a slower pace, this is likely to have some implications for household income taxes and social contributions.

  The programme provides a sensitivity analysis for the nominal budgetary targets with respect to changes in interest rates and economic growth. As regards the sensitivity to interest rate variations, the programme reports simulations of the effect of an increase by 1 percentage point above the central scenario. The anticipated effect is estimated to be an increase of 0.2% of GDP in interest payments in 2007, gradually rising to 0.4% of GDP towards the programme horizon. The relatively slow impact of interest rate increases is explained by the term structure of Belgian government debt, which contains some 85% long-term debt. As regards the sensitivity to alternative growth scenarios, the programme reports the general government balance corresponding to the potential growth rate as well as to a growth rate which is 0.5 percentage point above/below the central scenario in the update. In the worst case of a sustained 0.5 percentage point growth deceleration, the budgetary outcome would be a balanced budget in 2007, changing into a 0.2% of GDP deficit towards 2010 (compared to the programmed surplus of 0.9% of GDP).

These results are broadly in line with the outcome of Commission services' simulations of the cyclically-adjusted balance which, under the assumptions of (i) a sustained 0.5 percentage point deviation from the real GDP growth projections in the programme over the 2006-2010 period; (ii) trend output based on the HP-filter and (iii) no policy response (notably, the expenditure level is as in the central scenario), reveal that, by 2010, the cyclically-adjusted balance is 1 percentage point of GDP below the central scenario. Hence, in the case of persistently lower real growth, additional measures of around 1 percentage point of GDP would be necessary to keep the public finances on the path targeted in the central scenario.

- <u>Information about the measures</u>: The programme briefly refers to the measures that are included in the 2007 budget. Although in the programme these measures are not always quantified or spelled out in detail, more information can be found in the "exposé général des recettes et des dépenses" of the 2007 budget. Nevertheless the assessment of the impact of new measures sometimes appears optimistic or difficult to evaluate because the modalities for implementation still have to be determined. There is also not enough information on the precise nature of new one off measures (see also the next paragraph). Beyond 2007 the programme's targets broadly correspond to no-policy-change projections, and therefore do not require further measures. However, the programme does not explain what measures will be taken to replace the one-off measures foreseen in the 2007 budget after they have expired.

- <u>Reliance on one-off measures</u>: The programme identifies 0.4% of GDP of one-off measures for 2007, mainly in the form of new real estate sales and the take-over of pension obligations from public corporations (each around 0.2% of GDP), but it does not give further details about the precise nature of these transactions[20]. Moreover, the programme fails to identify the one-off increase in social contributions, due to some changes in the timing of social contributions on holiday allowances (about 0.1% of GDP, see also Box 1), as a one-off measure.

  In the past new (unscheduled) one-off measures have been frequently used to compensate for unanticipated budgetary developments[21], thereby helping the authorities to achieve the nominal budgetary targets. On the other hand, they are also an important source of uncertainty. In the past several one-off measures have largely missed the specified targets as a result of the intrinsic difficulty to estimate their budgetary impact (e.g. in the case of real-estate sales or the securitisation of tax arrears, it is often difficult to anticipate the offers that potential buyers will make). Moreover, the programme gives no information on the use of one-off measures

[20] For this reason these measures were not taken into account in the Commission services' autumn forecast.

[21] For instance, in December 2005 the Belgian authorities decided to take over pension obligations from the Antwerp Port Authority and the railway company SNCB (about 0.2% of GDP, which were not foreseen in the budget), in order to achieve their budgetary targets.

beyond 2007, although it seems to assume that new one-offs will be used in future years (also in view of the lack of structural measures to replace the current one-offs mentioned above and the discussion on the budgetary adjustment path in Section 4.2.2).

- Assumptions about the tax intensity of economic activity: The tax revenue projections in the programme seem to be slightly more optimistic than the Commission services' autumn forecast, especially for 2008 (see also Table 9 and the detailed breakdown in Annex 5). One source of this difference between the Commission services' forecast and the programme appears to be the somewhat higher growth assumptions in the programme regarding compensation of employees, which explains most of the differences in social contributions and personal income tax revenue (see the composition component of differences in the tax-to-GDP ratio in the Table in Annex 5). Another deviation is linked to a rather high elasticity of indirect taxes to consumption projected in the programme for 2008.
- The degree of expenditure restraint: Although there are no formal expenditure ceilings in Belgium, the programme also relies on a primary expenditure restraint, especially in 2007 (-0.3% of GDP). This can partly (about 0.2% of GDP in 2007) be attributed to the normal electoral cycle ending after the 2006 local elections, although the overall result still seems slightly optimistic compared to the Commission services' autumn forecast. The anticipated decline in interest expenditure appears realistic.
- The overall track record: Overall the Belgian authorities have a high credibility with respect to meeting the nominal (balanced) budgetary targets (except in 2005, see e.g. Figures 9 and 10), but one-off measures continue to play an important role, especially to compensate for the effects of a negative downturn, thereby often increasing future expenditure.

Table 9: Assessment of tax projections

	2007			2008			2009	2010
	SP	COM	OECD[3]	SP	COM[1]	OECD[3]	SP	SP
Change in tax-to-GDP ratio	-0.2	-0.3	0.0	0.2	-0.4	0.0	-0.1	0.0
Difference (SP– COM)	0.0		/	0.6		/	/	/
of which[2]:								
- discretionary and elasticity component	-0.1		/	0.3		/	/	/
- composition component	0.1		/	0.3		/	/	/
Difference (COM - OECD)	/	-0.2		/	-0.4		/	/
of which[2]:								
- discretionary and elasticity component	/	-0.2		/	-0.3		/	/
- composition component	/	0.0		/	-0.1		/	/
p.m.: Elasticity to GDP	0.9	0.9	1.0	1.1	0.8	1.0	0.9	1.0

Notes:
[1]On a no-policy change basis
[2]The decomposition is explained in Annex 5
[3] Based on OECD ex-ante elasticity relative to GDP
Source:
Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations and OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434)

The overall assessment is that there is a risk that the budgetary outcomes could be (slightly) worse than targeted in the programme. This is especially the case for 2007, mainly because the 2007 budget seems to be on the optimistic side and sometimes provides insufficient details about the envisaged measures. Additional measures seem necessary to achieve the target, and although it is not uncommon in Belgian budgetary practice that there are significant budget revisions ("contrôle budgétaire") in the course of the year, these could be delayed by national elections mid-2007. A worse-than-expected outcome in 2007 would also carry over to the following years. Moreover, from 2008 onwards there is also a risk that expired one-offs will not be replaced by structural measures.

4.4. Assessment of the fiscal stance and budgetary strategy

The table below offers a summary assessment of the country's position relative to the budgetary requirements laid down in the Stability and Growth Pact. In order to highlight the role of the preceding analysis of the risks that are attached to the budgetary targets presented in the programme, this assessment is done in two stages: first, a preliminary assessment on the basis of the targets taken at face value is made (middle column) and, second, the final assessment that also takes into account risks (final column).

Table 10: Overview of compliance with the Stability and Growth Pact

	Based on programme[3] (with targets taken at face value)	**Assessment** (taking into account risks to targets)
a. Safety margin against breaching 3% of GDP deficit limit[1]	throughout programme period	throughout programme period
b. Achievement of the MTO	From 2009 onwards[4]	Probably in 2010[4]
c. Adjustment towards MTO in line with the Pact[2]?	Should be strengthened (after 2007)[4]	Should be strengthened throughout the programme period[4]

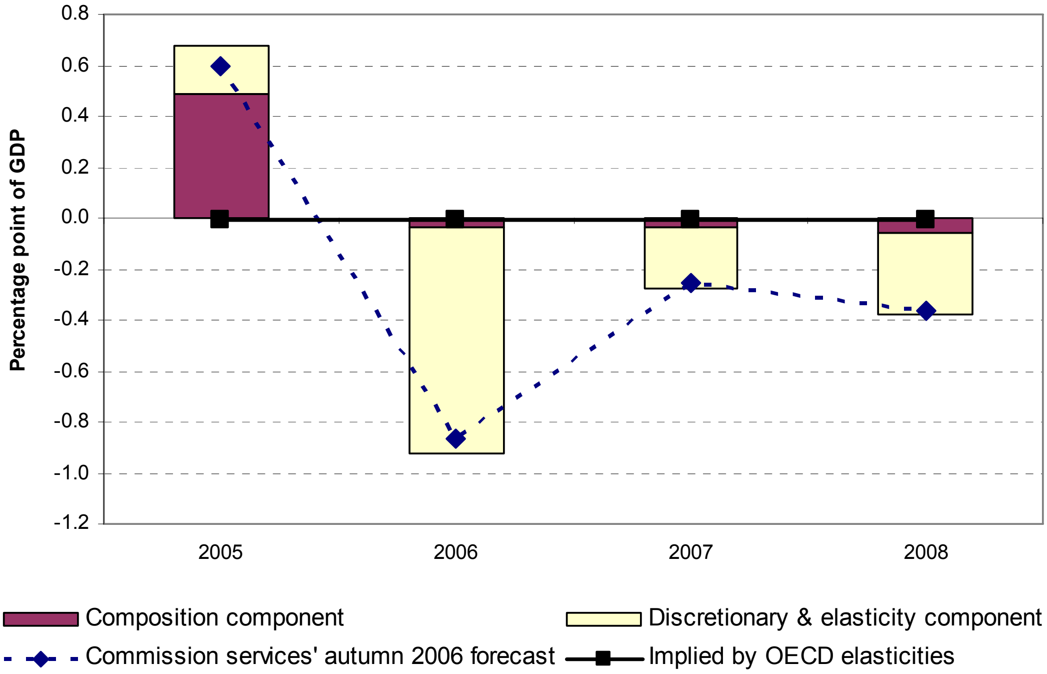
Notes:
[1]The risk of breaching the 3% of GDP deficit threshold with normal cyclical fluctuations, i.e. the existence of a safety margin, is assessed by comparing the cyclically-adjusted balance with the above mentioned minimum benchmark (estimated as a deficit of around 1¼% of GDP for Belgium). These benchmarks represent estimates and as such need to be interpreted with caution.
[2]The Stability and Growth Pact requires Member States to make progress towards their MTO (for countries in the euro area or in ERM II, this has been quantified as an annual improvement in the structural balance of at least 0.5% of GDP as a benchmark). In addition, the structural adjustment should be higher in good times, whereas it may be more limited in bad times.
[3]Targets in structural terms as recalculated by Commission services on the basis of the information in the programme.
[4]Assuming that the impact of one-off measures is 0.4% of GDP per annum from 2008 onwards.

Source:
Commission services

The budgetary stance in the programme provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations over the programme horizon, as the cyclically adjusted balance (based on the information in the programme and taking into account the risks mentioned before) is better than the minimum benchmark (estimated for Belgium at a deficit of around 1¼% of GDP) throughout the programme period. The outlined budgetary strategy should also enable Belgium to reach its MTO within the programme period, although this may happen somewhat later than foreseen in the programme (i.e. in 2009) in view of the risks identified above. However, it should also be recalled that the MTO is more demanding than required by the Stability and Growth Pact and that, taking into account risks to the budgetary projections, a budgetary position in structural terms that can be considered as appropriate under the Pact (i.e. a position close to balance in structural terms) could already be reached in 2008.

Figure 12: Changes in the tax-to-GDP ratio:

actual/projected changes vs. changes implied by OECD elasticity



Note:
The dashed line displays the change in the tax ratio in the Commission services' 2006 autumn forecast, for 2008, on a no-policy-change basis. The solid line shows the change in the tax ratio implied by the ex-ante OECD elasticity with respect to GDP. The difference between the two is explained by the bars. The composition component captures the effect of differences in the composition of aggregate demand (more tax rich or more tax poor components). The discretionary and elasticity component captures the effect of discretionary fiscal policy measures as well as variations of the yield of the tax system that may result from factors such as time lags, variations of taxable income that do not necessarily move in line with GDP e.g. capital gains. Both components may not add up to the total difference because of a residual component, which is generally small. The decomposition is explained in detail in Annex 5.

Source:
Commission services

As regards the adjustment path, after a significant deterioration in 2006, the structural balance is expected to improve by around ½% of GDP in 2007 (according to the programme) and approach the MTO at a slower pace afterwards. Taking into account the risks related to the budgetary outcome, the adjustment towards the MTO is likely to turn out to be slower than the 0.5% benchmark for euro area and ERM II countries in 2007 and subsequent years and should therefore be strengthened throughout the programme period. The slow adjustment towards the MTO cannot be attributed to cyclical conditions, as Belgium appears to be neither in economic good nor bad times, and as illustrated in Table 9 and Figure 12, changes in tax to GDP ratios are generally small and can be explained largely by recent discretionary measures (mainly the impact of the final stage of the implementation of the 2001 tax reform in 2006, selective cuts in social contributions for 2006 and 2007, but also some adverse effects of securitisations of tax-arrears in earlier years). Moreover, primary expenditure continues to grow at a rate close to nominal GDP growth.

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

Government debt is the result of the financing needs of government over the years. It corresponds primarily to an accumulation of deficits, although the build-up of financial assets and other adjustments may also play a role.[22] The reform of the Stability and Growth Pact has raised attention to the crucial importance of government debt and of sustainability in fiscal surveillance.

This section is in two parts: a first part describes recent developments and the medium-term prospects for government gross debt; it describes the stability programme's targets, compares them with the Commission services' forecasts and assesses the associated risks. A second part looks into the government debt from a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

As mentioned before, the debt projections in the programme do not include the impact of the debt assumption from the SNCB/NMBS. This is in spite of the fact that Eurostat previously amended deficit and debt data notified by Belgium.[23] For this reason all debt figures in this assessment from 2005 onwards have been 'mechanically' adjusted upwards, to include the base effect of the debt assumption in 2005. This correction was made to allow a meaningful comparison between Commission services' estimates and the programme. In the absence of more detailed information, the adjustment was based on the technical assumption that there is no reimbursement of debts taken over from SNCB/NMBS during the period 2006 to 2010. This technical assumption likely is likely to lead to an overestimation of the government debt.

The Belgian debt ratio has been on a steady downward path since 1993 (when it stood at 133% of GDP) but is still high (89.4% of GDP in 2006, see also Figure 2). This impressive decline mainly stems from high – though decreasing – primary surpluses. Moreover, the debt development also benefited from declining interest expenditure, which are, in part, the result of decreasing interest rates. The assumption of SNCB/NMBS debts in 2005 caused a temporary slowdown of the trend, but without reversing it. For 2006, the outcome foreseen in the programme (after the above-mentioned correction) is identical to the Commission services autumn forecast and in line with the debt targets foreseen in previous programmes. Maintaining the primary balance at around 4.1% of GDP as foreseen in the programme should ensure the continuation of this debt-reduction path. For the future, the update does not foresee major operations (such as privatisations) affecting the debt through the stock-flow adjustment.

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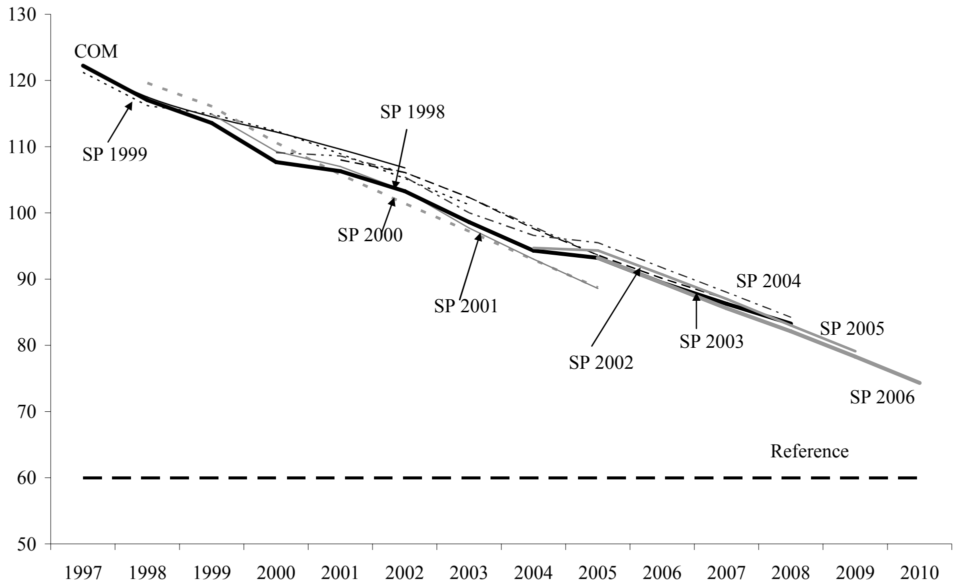
[22] On the factors other than the deficit which explain the evolution of the government debt, see "The dynamics of government debt: decomposing the stock-flow adjustment", chapter II.2.2 of *Public Finances in EMU 2005*, European Economy, N°3/2005.

[23] See Eurostat News Release 139/2006 of 23 October 2006.

Figure 13: Debt projections in successive stability programmes (% of GDP)



Note: Figures taken from the December 2006 stability programme have been 'mechanically' adjusted, in order to be consistent with data published by Eurostat. See also the note in Table 5.

Source:
Stability programme update (SP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations.

Table 11: Debt dynamics

(% of GDP)	average 2000-04	2005	2006		2007		2008		2009	2010
			COM	SP	COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	94.3	93.2	89.4	89.4*	86.3	85.6*	83.2	82.1*	78.3*	74.3*
Change in the ratio	-3.9	-1.1	-3.8	-3.8	-3.2	-3.8	-3.0	-3.5	-3.8	-4.0
Of which[2]*:*										
Primary balance	-5.9	-1.9	-3.9	-4.1	-3.4	-4.2	-3.2	-4.1	-4.1	-4.2
"Snow-ball" effect	1.7	1.4	-0.2	-0.3	0.2	0.2	0.2	0.3	0.0	0.0
Of which:										
Interest expenditure	5.8	4.2	4.1	4.1	3.9	3.9	3.7	3.6	3.4	3.3
Growth effect	-2.0	-1.0	-2.4	-2.4	-1.9	-1.9	-1.8	-1.7	-1.7	-1.7
Inflation effect	-2.0	-1.9	-1.9	-2.0	-1.8	-1.8	-1.7	-1.6	-1.7	-1.7
Stock-flow adjustment	0.4	-0.5	0.4	0.6	0.0	0.2	0.1	0.3	0.3	0.2
Of which:										
Cash/accruals diff.	0.5	0.1								
Acc. financial assets	-0.5	-0.2								
Privatisation	-0.1	-0.1								
Val. effect & resid.	0.3	-0.5								

Notes:
[1]End of period.
[2]The change in the gross debt ratio can be decomposed as follows:

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

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth (in the table, the latter is decomposed into the growth effect, capturing real GDP growth, and the inflation effect, measured by the GDP deflator). The term in parentheses represents the "snow-ball" effect. The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.
Source:
Stability programme update (SP); Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations

5.1.2. *Assessment*

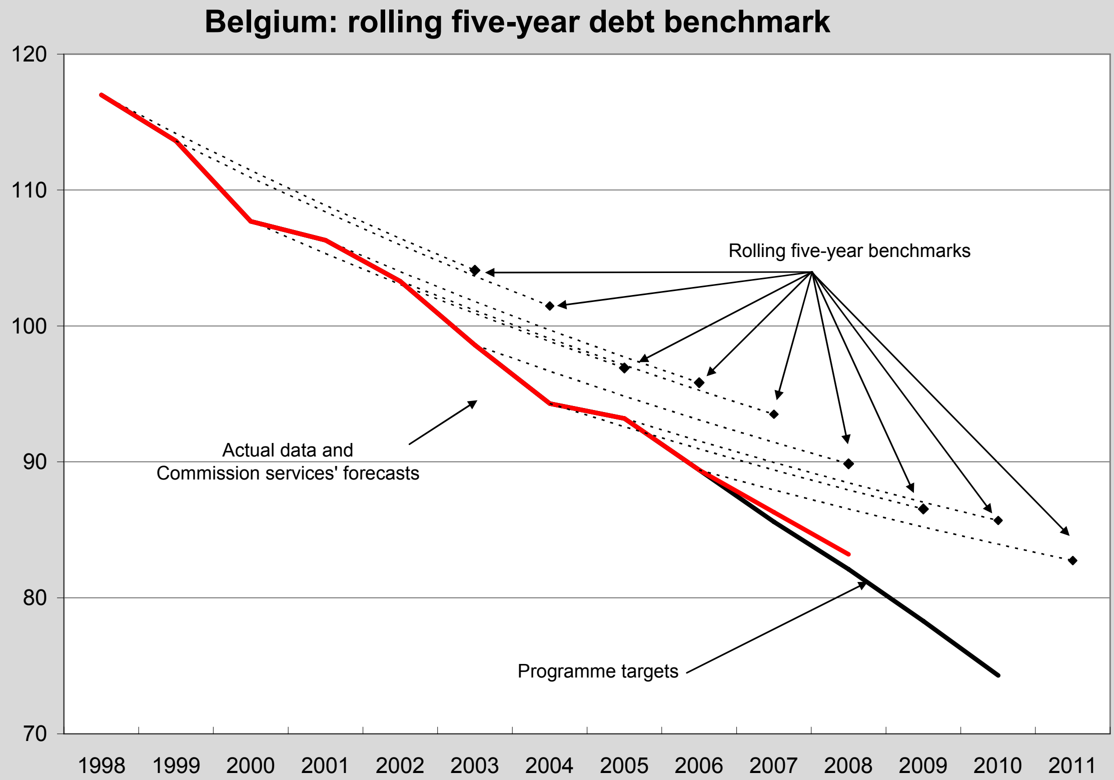
Overall the differences between the Commission service's forecast for the debt ratio and the (corrected) targets in the 2006 update of the programme are relatively small and related to the less optimistic budgetary outcome in the Commission services' forecast (see also Section 4.3 above). Other than the risks attached to the budgetary outcomes mentioned before, the specific risks related to debt developments seem broadly balanced.

Over the past decade, the structure of Belgian public debt has been gradually improved to reduce the risks related to a high debt ratio. Profiting from low interest rates, the term structure of the debt has been geared gradually towards long-term debt; debts with residual maturity of less than 1 year amount to around 16% of GDP, while debts with residual maturity above five years amount to around 40% of GDP. Since the introduction of the euro, the debt denominated in foreign currency represents less than 1% of GDP, thereby almost eliminating exchange rate risks.

In view of the strong sustained downward trend and also taking into account the above-mentioned risks, the debt ratio can be considered sufficiently diminishing over the programme period (see also the information in Box 3).

Box 3: The rolling debt reduction benchmark

The debt ratio has been exceeding the 60% of GDP reference value since the presentation of the initial stability programme in 1998. A tentative assessment of the pace of debt reduction over a medium-term horizon is presented in the accompanying graph. It shows historical data, the Commission services' autumn 2006 forecasts until 2008 (which are on a no-policy change scenario) and the multi-annual debt projections in the update and compares them with the paths obtained by applying an illustrative "rolling debt reduction benchmark" ([*]). The benchmark reflects the idea that a minimum debt reduction should be ensured not year after year but over a medium-term horizon (five years in the graph). For instance, the debt projection for 2007 is compared with the value obtained for the same year by applying the formula starting in 2002. Debt level projections in the programme exceeding those obtained by applying the benchmark are taken as an indicator of a slow reduction in the debt ratio. The graph clearly shows that the planned reduction of the debt ratio in the update is more than implied by the five-year rolling debt reduction benchmark.



Source : Stability programme and Commission services

(*) The rolling debt reduction benchmark for successive five-year periods is defined as a reduction in the difference between the debt ratio and the 60% of GDP reference value of 5 percent per year:

$\left(\frac{D_t}{Y_t}\right)_{benchmark} = \left(\frac{D_t}{Y_t}\right)_{benchmark} - 5\% \times \left[\left(\frac{D_t}{Y_t}\right)_{benchmark} - 60\right]$, where t is a time subscript and D and Y are the stock of government debt and nominal GDP, respectively. In the first year of the five-year period, the debt ratio in the previous year is the actual debt ratio. Given the usual approximation of the change in the debt ratio $\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{DEF_t}{Y_t} - \frac{y_t}{1+y_t} \times \frac{D_{t-1}}{Y_{t-1}} \cong \frac{DEF_t}{Y_t} - y_t \times \frac{D_{t-1}}{Y_{t-1}}$ and assuming that the stock-flow adjustment is zero, it is easy to show that the rolling debt reduction benchmark describes the path for convergence of the debt ratio towards 60% of GDP which would take place with the deficit at 3% of GDP and nominal GDP growth at 5%. In other words, the 5 percent per year benchmark is the value that makes consistent a continuous respect of the 3% of GDP deficit threshold and an asymptotic respect of the 60% of GDP debt reference value.

5.2. Long-term debt projections and the sustainability of public finances

The issue of long-term sustainability is a multi-faceted one. It involves avoiding imposing an excessive burden on future generations and ensuring the country's capacity to appropriately adjust budgetary policy in the medium and long run.[24]

Debt sustainability is derived from the government's *inter-temporal budget constraint*. It imposes that current total liabilities of the government, i.e. the current public debt and the discounted value of future expenditure including the budgetary impact of ageing populations, should be covered by the discounted value of future government revenue. If current policies ensure that the inter-temporal budget constraint is fulfilled, current policies are sustainable.

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[24] For a detailed analysis of long-term sustainability issues, see "The Long Term Sustainability of Public Finances – A report by the Commission services", European Economy n°4/2006, published in October 2006 (hereafter Sustainability Report).

The approach adopted by the Commission services and the Ageing Working Group of the Economic Policy Committee (EPC) is to project the debt, and to calculate the associated sustainability indicators (see Box 4), on the basis of two different scenarios. The first scenario assumes that the structural primary balance will remain unchanged from 2006 through 2010, the final year of the stability programme; it is called the "2006 scenario". Debt projections in this scenario start in 2007. The second scenario assumes that the macroeconomic and budgetary plans until 2010 provided in the stability programme will be fully respected. This is the "programme scenario". Debt and primary balance projections in this scenario start in 2011. Both projections assume zero stock-flow adjustments. In addition to this quantitative analysis, other relevant factors are taken into account which allows to better qualify the assessment with regard to where the main risks are likely to stem from and to reach an overall assessment.

5.2.1. Sustainability indicators and long-term debt projections

Table 12 shows the evolution of government spending on pensions, healthcare, long-term care for the elderly, education and unemployment benefits according to the EPC's projections.[25] Non age-related primary expenditure and revenue is assumed to remain constant as a share of GDP.

Table 12: Long-term age-related expenditure: main projections

(% of GDP)	**2004**	**2010**	**2020**	**2030**	**2040**	**2050**	**changes**
Total age-related spending	25.4	25.1	26.6	29.9	31.6	31.7	6.3
Pensions	10.4	10.4	12.1	14.7	15.7	15.5	5.1
Healthcare	6.2	6.4	6.8	7.1	7.5	7.6	1.4
Long-term care	0.9	0.9	1.1	1.3	1.6	1.8	1.0
Education	5.6	5.2	4.9	5.0	5.0	5.0	-0.7
Unemployment benefits	2.3	2.0	1.8	1.8	1.7	1.8	-0.5

Note: the stability programme includes long-term projections that point to a lower increase in age-related expenditure, see section 5.2.2.
Source: Economic Policy Committee and Commission services.

The projected increase in age-related spending in Belgium is significantly above the EU average, rising by 6.3% points of GDP between 2004 and 2050. This is particularly due to pension expenditure being projected to rise more than on average in the EU, by 5.1% points of GDP. The increase in health-care expenditure is projected to be 1.4% points of GDP, lower than on average in the EU. For long-term care, the projected increase of 1.0% points up to 2050, is above the average in the EU.

Based on the long-term budgetary projections, sustainability indicators can be calculated:

25 These assumptions cover labour productivity growth, real GDP growth, participation rates, unemployment rate, demographic developments, government spending in pensions, healthcare, long-term care for the elderly, education and unemployment benefits. See Economic Policy Committee and European Commission (DG ECFIN) (2006), "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)", European Economy, Special Report No 1 (hereafter Ageing Report).

Table 13: Sustainability indicators and the required primary balance

	2006 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
Value	1.3	2.7	6.2	1.0	2.4	6.2
of which:						
Initial budgetary position	-2.7	-2.6	-	-3.0	-3.0	-
Debt requirement in 2050	0.3	-	-	0.3	-	-
Future changes in budgetary position	3.7	5.3	-	3.7	5.3	-
Source: Commission services.						

Table 13 shows the sustainability indicators for the two scenarios. In the "2006 scenario", the sustainability gap (S1) that assures reaching the debt ratio of 60% of GDP by 2050 would be 1.3% of GDP. The sustainability gap (S2) which satisfies the intertemporal budget constraint would be 2.7% of GDP. Compared with the results of the Commission's Sustainability Report, the sustainability gaps are higher by 0.8 % of GDP. This is mainly due to a lower structural primary balance in 2006 (3.7% of GDP) compared to the structural primary balance in 2005 estimated in spring 2006 (4.5% of GDP) that was used in the Sustainability Report.

Box 4: Sustainability indicators*

- The **sustainability gap S1** shows the permanent budgetary adjustment (often presented as an increase in the tax burden**) required to reach a debt ratio in 2050 of 60% of GDP.
- The **sustainability gap S2**, shows the permanent budgetary adjustment that guarantees the respect of the intertemporal budget constraint of the government. In order to estimate S2, the revenue and expenditure ratios (age-related and non age-related) after 2050 are assumed to remain constant at the 2050 level.
- The sustainability indicators can be decomposed into the: (i) **initial budgetary position (IBP)**; (ii) **long-term change in the budgetary position (LTC)**.
- In addition, the **required primary balance (RPB)** can be derived from the S2 indicator. It measures the average primary balance over the first five years after the programme horizon (i.e. 2011-2015) that results from a permanent budgetary adjustment carried out to comply fully with the S2 indicator.

Summarizing the sustainability indicators

	Impact of		
	Initial budgetary position		**Long-term changes in the primary balance**
S1*=**	Gap to the debt-stabilizing primary balance	+	Additional adjustment required to finance the increase in public expenditure *up to 2050*
S2=	Gap to the debt-stabilizing primary balance	+	Additional adjustment required to finance the increase in public expenditure *over an infinite horizon*

* For a complete description of the sustainability indicators, see Annex I of the "The Long Term Sustainability of Public Finances – A report by the Commission services", European Economy n°4/2006, published in October 2006.

** Although the sustainability gap indicators (S1, S2) are usually defined as differences between revenue ratios, this does not mean that countries are asked to increase taxes to reach sustainability. There are several ways to ensure sustainability and governments typically choose a combination of budget consolidation over the medium term (either through expenditure reduction and/or tax hikes) and the implementation of structural reforms aiming at curbing long-term public spending (e.g. pension reforms).

*** Moreover, in the case of S1, the decomposition also separates the impact of the debt position (60% of GDP in 2050); the debt requirement in 2050 (DR). In particular, if the current debt/GDP ratio is below 60% of GDP debt is allowed to rise and this component reduces the sustainability gap as measured by the S1 indicator, and vice versa.

The initial budgetary position is not sufficiently high to offset the impact of the large increase in age-related expenditure up to 2050. The budgetary plans in the programme foresee a strengthening of the structural balance between 2006 and 2010 by 1.1% of GDP, implying an improvement of the structural primary balance of 0.3% of GDP (as interest expenditure as a share of GDP falls as a consequence of the reduction in the debt ratio[26].

If achieved, such a consolidation would reduce risks to long-term sustainability of public finances. The difference between the initial budgetary position in the 2006 scenario and the programme scenario illustrates how the full respect of the stability programme targets will contribute to tackling the budgetary challenges raised by the demographic developments. However, a significant sustainability gap would remain. Indeed, according to both sustainability gaps, the long-term budgetary impact of ageing is relatively high in Belgium.

The required primary balance (RPB) is about 6.2% of GDP, higher than the structural primary balance of about 4.0% of GDP at the end of the programme period. Moreover, the sustainability gap indicators would increase by around 0.2% of GDP if the planned adjustment were to be postponed by 5 years, highlighting that savings can be made over time if action is taken sooner rather than later.

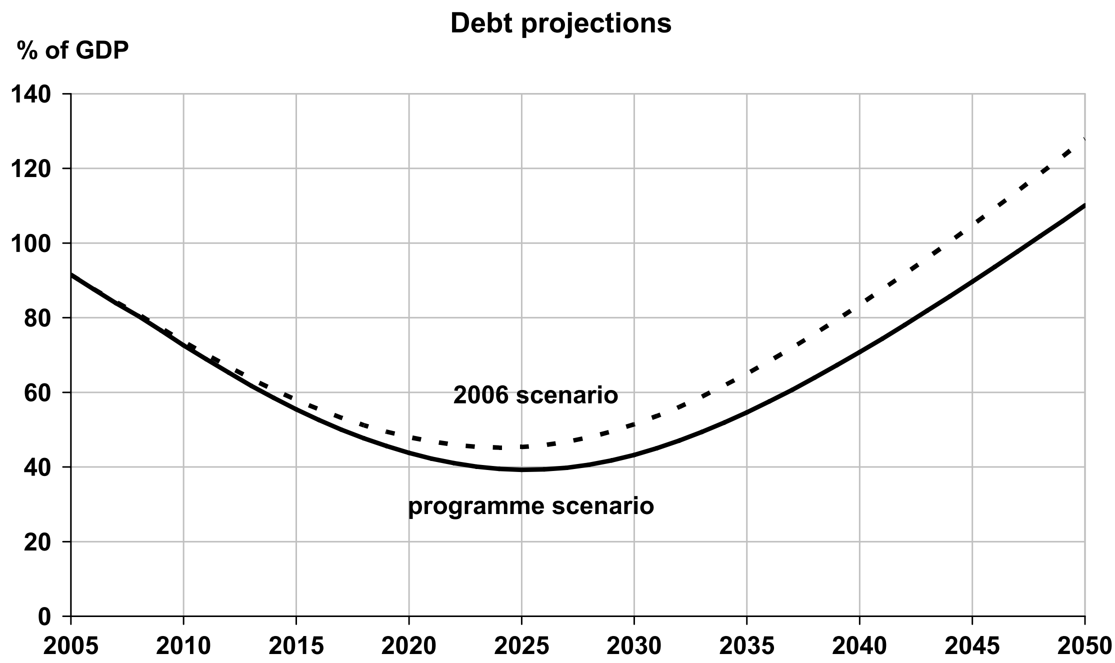
Another way to look at the prospects for long-term public finance sustainability is to project the debt/GDP ratio over the long-term using the same assumptions as for the calculations of S1 and S2. The long-term projections for government debt under the two scenarios are shown in Figure 14.

The gross debt ratio is currently very high at 87.7% of GDP in 2006. According to the “2006 scenario”, the debt ratio would decrease rapidly over the next two decades and would reach the 60% threshold around the mid-2010s. However, it would start increasing significantly as of 2025, as the budgetary impact of ageing takes hold. In the “programme scenario”, the debt dynamics would be somewhat more favourable than in the 2006 scenario thanks to the consolidation of public finances over the programme period.[27]

[26] Interest expenditure is projected to decline by 0.8% points of GDP between 2006 and 2010.

[27] It should be recalled, however, that being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services’ short-term forecasts, but as an indication of the risks faced by Member States.

Figure 14: Long-term projections for the government debt ratio



Source: Commission services

5.2.2. Additional factors

To reach an overall assessment of the sustainability of public finances, other relevant issues are taken into account, which in addition allows to better qualify the assessment with regard to where the main risks are likely to stem from.

First, the projections of the programme are not those of the Ageing report. They include the impact of the Generation Pact, which among other things aims at increasing the employment rate of older workers. According to the update of the programme, this Pact would reduce the increase in age-related expenditure by around 0.2% of GDP in 2050 compared to the projections of the Ageing report[28]. Therefore, the sustainability gaps would be only slightly reduced and the long-term sustainability of public finances in Belgium would marginally improve.

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[28] The programme update refers to projections of the *"Comité d'études sur le vieillissement".* which, points to an overall increase in public expenditure of around 5.8% points of GDP, which is slightly lower to the Ageing report. The difference between the two sets of projections is explained in the annual report of the "*Comité du vieillissement*", May 2006.

According to these national projections, pension expenditure are projected to increase less than in the common projections (of around 1¼% points of GDP) due to more favourable demographic and economic assumptions. Unemployment benefits are also assumed to decrease more (by -0.2% of GDP) due to a larger reduction in the unemployment rate. Finally, the Belgian authorities now project a decrease in child-care benefits (of around ½ points of GDP). On the other hand, health-care and long-term care spending are more dynamic in the projections of the *"Comité d'études sur le vieillissement"*, by around 1½% points of GDP. This is chiefly due to an assumption of a higher income elasticity of healthcare and a more pessimistic assumption regarding the health status of elderly citizens; the Belgian national scenario is closer to the 'pure ageing scenario' of the Ageing report where all the gains in life expectancy are assumed to be spent in bad health. The overall impact of these additional national projections would have a small impact on sustainability, as the difference between the projected increases is less than ½ percentage points of GDP.

(See: http://www.plan.be/fr/pub/other/OPVERG200601/OPVERG200601fr.pdf).

Second, the current level of debt is very high, although it has been resolutely reduced for a number of years. Indeed, debt reduction is the backbone of the Belgian strategy to face ageing[29]. Ensuring a reduction of debt to below the 60% of GDP reference value at a satisfactory pace is necessary to strengthen the resilience of the public finances to adverse shocks and to reduce public finance sustainability risks.

Third, the tax burden on labour in Belgium is among the highest in the EU and the government's current strategy is to reduce it. These measures, aiming at increasing employment rates and fostering growth, could therefore ease pressure on public finances in the long term, though it may reduce revenues in the short term.

5.2.3. Assessment

The long-term budgetary impact of ageing in Belgium is above the EU average, influenced notably by a large increase in pension expenditure as a share of GDP over the coming decades.

The initial budgetary position with a high primary surplus, albeit weaker compared to 2005, contributes to easing the projected long-term budgetary impact of an ageing population, but it is not sufficient to fully cover the substantial increase in expenditure. Moreover, the current level of gross debt, while declining, remains well above the Treaty reference value. The steady reduction of the debt/GDP ratio requires sustaining high primary surpluses for a long period of time, which would contribute to reducing risks to the sustainability of public finances.

Overall, Belgium appears to be at medium risk with regard to the sustainability of public finances.

[29] The reduction of the government debt as a strategy to prepare for the ageing of population is often described in connection with the existence of an ageing fund. In fact, the ageing fund is just a tool of reducing debt that does no accumulate assets.

6. STRUCTURAL REFORM, THE QUALITY OF PUBLIC FINANCES AND INSTITUTIONAL FEATURES

In 2006, the Belgian authorities have gradually implemented the Generation Pact, a comprehensive strategy to strengthen employment and to reduce early retirement. It also includes measures to improve the funding of the social security system by attributing part of the revenue from taxes on financial income and excise duties to the social security system, but this has no effect on the budgetary position of the government sector as a whole, as it only entails a transfer from the federal government to the social security system. In the context of this plan, a number of selective cuts in social contributions have been made (such as for older workers or low-skilled workers), measures to improve the employability of young workers have been taken, and eligibility criteria for early retirement have been tightened. It is too early, however, to evaluate the impact of these measures on the employment rate. However, the anticipated budgetary impact of these measures can be considered small (See also Section 5.2.2).

On an institutional level, after two years of inactivity, the Belgian authorities have appointed the new members of the 'Public sector borrowing requirement' section of the Belgian High Finance Council. By law, the Belgian authorities are required to seek the advice of the High Finance Council, to be included in the budget law. This usually entails an analysis of the borrowing requirements of the regional entities and the budgetary policy to be adopted, including recommendations on the budget balances of the various levels of government. However, in 2005 and 2006 the High Finance Council did not produce such an advice because the Belgian authorities did not replace some of its members after their mandate expired. With the new members appointed in September 2006, the High Finance Council is expected to resume its work in the course of 2007. The work of the High Finance Council can be considered as an important institutional tool to ensure budgetary discipline and definitely contributed to Belgium's budgetary performance in the past[30].

The use of one-off measures mentioned above continue to represent a substantial part of government revenue for Belgium, contrary to previous announcements. Whereas from 2003 until 2005, a downward trend could be discerned (1.2% of GDP in 2003, 0.8% in 2004 and 0.5% in 2005 – not taking into account the negative one-off effect on general government of the SNCB debt assumption), this no longer holds for 2006. For that year, the government initially projected some 0.6% of GDP in one-offs, including some real estate operations (0.2% of GDP), securitisation of tax-arrears (0.2%) and a fiscal regularisation procedure (0.1%). Whereas the sale of real estate turned out to be considerably more successful than anticipated, the proceeds of the fiscal regularisation procedure stayed well below expectations. However, the government also added some unforeseen one-offs in the course of the year, mainly in the form of an advanced collection of corporate taxes (some 0.2% of GDP), resulting in a total impact of one-off measures of around 0.8% of GDP. The 2007 budget now includes some 0.5% of GDP in one-offs, but as mentioned before it is not uncommon for the Belgian authorities to step

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[30] Gerrit Bethuyne, "Federalisation and fiscal consolidation: the Belgian experience", *Country Focus*, European Commission – Directorate General for Economic and Financial Affairs, Vol. II, Issue 16, September 2005, 6 pp.
(also available at: http://ec.europa.eu/economy_finance/publications/countryfocus_en.htm)

European Commission, Economic and financial affairs, *Public finances in the EMU*, European Economy, N°3, 2006, p. 204-205. (also available at:
http://ec.europa.eu/economy_finance/publications/european_economy/public_finances2006_en.htm)

up the use of one-offs in the course of the year and their use often seems to be largely inspired by the need to achieve the short-term nominal budgetary targets (see also Section 2.5).

7. CONSISTENCY WITH THE NATIONAL REFORM PROGRAMME AND WITH THE BROAD ECONOMIC POLICY GUIDELINES

The measures in the stability programme appear fully in line with the National Reform Programme and the progress recorded in the Implementation Report thereof submitted in October 2006 in the context of the renewed Lisbon strategy for growth and jobs, despite the lack of detail in the description of the measures in the programme. Both reports consider the sustainability of public finances in light of population ageing as a challenge for the Belgium economy, which is at medium risk with regard to the sustainability of public finances (as indicated in Section 5.2). The stability programme does not contain a qualitative assessment of the overall impact of the National Reform Programme (NRP) within the medium term fiscal strategy, nor does it contain detailed or systematic information on the direct budgetary costs (or savings) associated with the main reforms envisaged in the NRP. The budgetary projections of the programme seem to take into account the public finance implications of the actions outlined in the national reform programme, and the degree of integration is considered high as both documents reflect the same policies.

Box 5: The Commission assessment of the implementation report of the National Reform Programme

The implementation report of the National Reform Programme of Belgium, provided in the context of the renewed Lisbon strategy for growth and jobs, was submitted on 16 October 2006. The Commission's assessment of this report, which was adopted on 12 December 2006 as part of its Annual Progress Report, can be summarised as follows.

Overall, Belgium is making good progress in the implementation and reinforcement of its 2005-2008 National Reform Programme (NRP). The NRP) identifies six main priorities in order to create growth and jobs: the sustainability of public finances; the reduction of labour costs; the creation of a more dynamic labour market; the stimulation of the economy through investment and reforms; strengthening the social security system; and the strengthening of synergies between environmental protection and growth. While there is a certain risk for the sustainability of public finances in the context of an ageing population, overall the policy framework is appropriate. Despite moderate progress on R&D, Belgium is implementing the measures announced in the micro-economic field and reinforcing existing reforms to increase investment. The picture in the employment field is more mixed and steps are needed to achieve the EU-wide employment rate goals, in particular for older people. Belgium has launched a series of measures to respond to the commitments made by the 2006 Spring European Council.

Among the strengths of the Belgian National Reform Programme and its implementation are: the continued downward trend of the debt ratio; the stabilisation in R&D intensity after a decline in 2003; the development of clusters and competitiveness poles; the improved record on the transposition of internal market directives; further measures in the field of better regulation and administrative simplification; the policy to promote business start-ups; the measures to improve the alternate learning system; and the formal recognition of acquired skills and the quality of the technical education system are welcome.

The policy areas in the Belgian National Reform Programme where weaknesses need to be tackled with the highest priority are: reducing the tax burden on labour and reducing regional disparities in unemployment. Against this background Belgium is recommended to undertake further efforts to reduce the tax-burden on labour (especially for low-skilled workers) towards the average of its neighbouring countries, while continuing fiscal improvement, and to take further measures aimed at reducing regional disparities in unemployment through a comprehensive economic strategy, including active labour market policies, reintegration and education policies.

In addition, it will be important for Belgium over the period of the National Reform Programme to focus on: ensuring the long term sustainability of public finances; identifying further emission reduction policies and measures; improving competition in gas and electricity markets, including through independent and effective regulators and through additional measures concerning transmission and distribution operators; and increasing the employment rate for older workers and vulnerable groups, in particular by further tightening the eligibility criteria for early retirement schemes and by enhancing preventive (education, training) and active labour market policies.

The table below provides an overview of whether the strategy and policy measures in the programme are consistent with the broad economic policy guidelines in the area of public finances, which are included in the integrated guidelines for the period 2005-2008. The assessment of guideline 1 corresponds to the evaluation in Section 4.4 above, whereas that of the pace of debt reduction in guideline 2 (relevant for high-debt countries only) is covered in Section 5.1.2 above. Information on the different elements covered by the remaining guidelines in the table can be found in Sections 5.2 and 6.

Overall, the budgetary strategy in the stability programme is broadly consistent with the broad economic policy guidelines.

Table 11: Consistency with the broad economic policy guidelines

Broad economic policy guidelines	Yes	Steps in right direction	No	Not applicable
1. To secure economic stability				
– Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it[1].		X		
– Member States should avoid pro-cyclical fiscal policies[2].				X
– Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits[3].				X
– Member States posting current account deficits that risk being unsustainable should work towards (…), where appropriate, contributing to their correction via fiscal policies.				X
2. To safeguard economic and fiscal sustainability In view of the projected costs of ageing populations,				
– Member States should undertake a satisfactory pace of government debt reduction to strengthen public finances.	X			
– Member States should reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible (…)		X		
3. To promote a growth- and employment-orientated and efficient allocation of resources				
Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives and ensure the overall coherence of reform packages.		X		

Notes:
[1]As further specified in the Stability and Growth Pact and the code of conduct, i.e. with an annual 0.5% of GDP minimum adjustment in structural terms for euro area and ERM II Member States.
[2]As further specified in the Stability and Growth Pact and the code of conduct, i.e. Member States that have already achieved the medium-term objective should avoid pro-cyclical fiscal policies in "good times".
[3]As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.

Source:
Commission services

* * *

Annex 1: Glossary

Automatic stabilisers Various features of the tax and spending regime which tend to have a dampening effect on economic fluctuations without requiring a discretionary intervention of the fiscal authorities. As a result, the budget balance in percent of GDP tends to improve in years of high growth and deteriorate during economic slowdowns. See also *cyclically-adjusted balance*, *structural balance* and *minimum benchmark*.

Broad economic policy guidelines (BEPGs) Guidelines for the economic and budgetary policies of the Member States. Together with the Employment Guidelines, they form the Integrated Guidelines, prepared by the Commission and adopted by the Council of Ministers responsible for Economic and Financial Affairs (ECOFIN). See also *Lisbon strategy*.

Budget balance The balance between total public revenue and expenditure (according to *ESA95*); with a positive balance indicating a surplus (also know as *government net lending*) and a negative balance indicating a deficit (also known as *government net borrowing*). For the monitoring of Member States' budgetary positions, the EU uses *general government* aggregates. See also *cyclically-adjusted balance*, *primary balance, structural balance* and *reference values*.

Budget constraint A basic condition applying to the public finances, according to which total public expenditure in any one year must be financed by taxation, borrowing or changes in the monetary base; the latter is prohibited in the EU. See also *stock-flow adjustment* and *long-term sustainability*.

Budgetary sensitivity The variation in the *budget balance* brought about by a change in the *output gap*. In the EU, it is estimated to be 0.5 on average, i.e. for any percentage point of GDP below or above potential, the budget-balance-to-GDP ratio deteriorates or improves by half a percentage point. The size of the budgetary sensitivity essentially reflects (i) the revenue and expenditure elasticities of the budget and (ii) the size of discretionary government expenditure. See also *cyclically-adjusted balance, structural balance* and *tax elasticity*.

Code of conduct Policy document adopted by the Economic and Financial Committee (an advisory committee gathering high-level officials from national governments, national central banks, the European Central Bank and the European Commission which prepares the meetings of the Council of Ministers responsible for Economic and Financial Affairs (ECOFIN)) and endorsed by the ECOFIN Council in October 2005, containing specifications on the implementation of the *Stability and Growth Pact* and guidelines on the format and content of *stability programmes* and *convergence programmes*.

Contingent liabilities A possible government obligation to pay, the existence of which will be confirmed by the occurrence of one or more uncertain events in the future not wholly under the control of the government. For instance, government guarantees on debt issued by private or public companies are contingent liabilities since the government obligation to pay depends on the non-ability of the original debtor to honour its obligations. See also *implicit liabilities*.

Convergence programme Medium-term budgetary strategy presented by each Member State that has not yet adopted the euro; updated annually, according to the provisions of the *Stability and Growth Pact*. See also *stability programme, code of conduct* and *medium-term objective*.

Cyclically-adjusted balance The *budget balance* adjusted for its cyclical component (which captures the part of public revenue and expenditure that is linked to the *output gap*), i.e. the budget balance that would prevail if GDP were at its potential level. See also *structural balance, budgetary sensitivity* and *output gap*.

Cyclically-adjusted primary balance The *cyclically-adjusted balance* net of interest expenditure on *general government* debt. See also *interest burden*.

Debt dynamics The evolution of *government debt* as a ratio to GDP; it depends on the primary deficit, the debt-increasing impact of interest payments, the dampening effect of GDP growth on the ratio and the *stock-flow adjustment*.

EDP notification See *notification of deficit and debt*.

ERM II Exchange rate mechanism linking some currencies of non-euro Member States to the euro, which is the centre of the mechanism. For the currency of each Member State participating in the mechanism, a central rate against the euro and a standard fluctuation band of ±15% are defined.

ESA95 European accounting standards for the compilation and reporting of macroeconomic (including budgetary) data by the EU Member States.

Excessive deficit procedure (EDP) A procedure, laid down in the EC Treaty, according to which the Commission and the Council monitor the development of national *budget balances* and *public debt* in relation to the *reference values*, in order to assess the existence (or risk) of an excessive deficit in each Member State and to ensure its correction. Its application has been further clarified in the *Stability and Growth Pact*.

Fiscal stance A measure of the thrust of discretionary fiscal policy such as, in this document, the change in the *structural balance* (or in the *structural primary balance*) relative to the preceding year. When the change is positive (negative) the fiscal stance is said to be restrictive (expansionary).

Funded pension scheme Pension system in which current pension expenditures are financed by running down assets accumulated over the years on the basis of contributions by the scheme beneficiaries. According to *ESA95*, defined-contribution funded pension schemes are not considered as part of the *general government* sector. See also *pay-as-you-go pension scheme*.

Government debt See *public debt*.

General government The focus of EU budgetary surveillance under the *Stability and Growth Pact* and the *excessive deficit procedure* is on general government aggregates, with the general government sector covering national, regional and local government, as well as social security. In principle, public enterprises are excluded.

Government net lending/borrowing See *budget balance*.

Implicit liabilities Future government expenditure which has not yet been funded, even when future expenditure is not backed by law or contractual obligations, but is simply grounded in strong expectations of the public. To be meaningful for economic analysis, implicit liabilities should be assessed net of future revenue assuming that the government will keep collecting taxes (and other non-tax revenue) at rates comparable to current levels. See also *contingent liabilities*.

Interest burden *General government* interest expenditure on *government debt* as a share of GDP.

Intertemporal budget constraint A basic condition imposing that current total liabilities of the government, i.e. the current public debt and the discounted value of future expenditure including the budgetary impact of ageing populations, be covered by the discounted value of future government revenue.

Lisbon strategy Partnership between the EU and Member States for growth and more and better jobs. Originally approved in 2000, the Lisbon Strategy was revamped in 2005. Based on the Integrated Guidelines (merger of the *broad economic policy guidelines* and the employment guidelines, dealing with macro-economic, micro-economic and employment issues) for the period 2005-2008, Member States drew up 3-year national reform programmes in autumn 2005. They reported on the implementation of the national reform programmes for the first time in autumn 2006. The Commission analyses and summarises these reports in an EU Annual Progress Report each year, in time for the Spring European Council.

Long-term sustainability A combination of *budget balance* and *public debt* that ensures that the latter does not grow without bound. While conceptually intuitive, an agreed operational definition of sustainability has proven difficult to achieve.

Maturity structure of public debt The profile of *public debt* in terms of when it is due to be paid back. Interest rate changes affect the *budget balance* directly to the extent that the *general government* sector has debt with a relatively short maturity structure. Long maturities reduce the sensitivity of the *budget balance* to changes in the prevailing interest rate. See also *interest burden*.

Medium-term objective (MTO) According to the *Stability and Growth Pact*, *stability programmes* and *convergence programmes* must present a medium-term objective for the budgetary position. It is country-specific to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risk to the sustainability of public finances, and is defined in structural terms (see *structural balance*).

Minimum benchmark Estimated budgetary position (in *cyclically-adjusted* terms) that provides a "safety margin" that is enough for the *automatic stabilisers* to operate freely during normal economic slowdowns without breaching the 3% of GDP deficit *reference value*. The minimum benchmarks are estimated by the European Commission. They do not cater for other risks such as unexpected budgetary developments and interest rate shocks.

National reform programme (NRP) See *Lisbon strategy*.

Notification of deficit and debt (EDP notification) Twice a year (by 1 April and 1 October), EU Member States have to notify their *general government* deficit and debt figures (and a number of associated data) to the Commission, the quality of which is then checked by Eurostat, the Commission department in charge of statistics. See also *budget balance* and *public debt*.

One-off and temporary measures Government transactions having a transitory budgetary effect that does not lead to a sustained change in the intertemporal budgetary position. See also *structural balance*.

Output gap The difference between actual GDP and potential GDP in any given year, usually expressed as a percent of potential GDP. Potential GDP is an unobserved variable and needs to be estimated from actual data. It is the level of real GDP in a given year that is consistent with a stable rate of inflation. If actual output rises above its potential level, then constraints on capacity begin to bind and inflationary pressures build; if output falls below potential, then resources are lying idle and inflationary pressures abate. See also *production function method*.

Pay-as-you-go pension scheme (PAYG) Pension system in which current pension expenditures are financed by the contributions of current employees. Also known as *unfunded pension scheme*. See also *funded pension scheme*.

Primary balance The *budget balance* net of interest expenditure on *general government* debt. See also *interest burden*.

Pro-cyclical fiscal policy A *fiscal stance* which amplifies the economic cycle by lowering the *structural balance* when the *output gap* is positive or improving, or by increasing the *structural balance* when the *output gap* is negative or widening, as opposed to a counter-cyclical fiscal policy stance. A neutral fiscal policy keeps the *structural balance* unchanged over the economic cycle by letting the *automatic stabilisers* work.

Production function method A method to estimate potential GDP typically based on a Cobb-Douglas production function. Potential GDP is estimated as the level of GDP consistent with a full utilisation of capital, an unemployment rate that does not accelerate inflation and factor productivity at its trend level. See also *output gap, cyclically-adjusted balance, budgetary sensitivity*.

Public debt (or government debt) Consolidated gross debt for the *general government* sector. It includes the total nominal value of all debt owed by government units, except that part of the debt which is owed to government units in the same Member State. It is a gross debt measure meaning that government financial assets on other sectors are not netted out. See also *debt dynamics* and *reference values*.

Public investment The component of total public expenditure which consists in the acquisition of durable assets and through which governments increase and improve the stock of capital employed in the production of the goods and services they provide. Also known as government gross fixed capital formation (GFCF).

Public-private partnerships (PPP) Agreements between government and corporations according to which the latter build and operate public-use infrastructure (roads, tunnels, bridges, but also hospitals, prisons, concert halls, etc.) which were traditionally directly controlled by government. In exploiting the infrastructure, the corporation receives prices paid by final users, rentals or fees from the government or both. Infrastructure built under PPPs is considered as either *public investment* or corporate investment depending on a number of specific criteria.

Quality of public finances A multi-dimensional concept which refers to the contribution that public finances make to the efficient allocation of resources in the economy and to achieving the government's strategic objectives (sustainable growth, macroeconomic stability, competitiveness, social cohesion etc.). It concerns notably the overall level of expenditure and taxation, their composition, the budgeting and control mechanisms and the institutional arrangements for deciding on public finance issues.

Reference values for public deficit and debt Respectively, a 3 percent *general government* deficit-to-GDP ratio and a 60 percent *general government* debt-to-GDP ratio. See also *excessive deficit procedure, government debt* and *budget balance*.

Sensitivity analysis An econometric or statistical simulation designed to test the robustness of an estimated economic relationship or projection to changes in the underlying assumptions.

'Snow-ball' effect The self-reinforcing effect of *public debt* accumulation or decumulation arising from a positive or negative differential between the implicit interest rate on public debt and the GDP growth rate. See also *debt dynamics*.

Stability and Growth Pact (SGP) Approved in 1997 and reformed in 2005, the SGP clarifies the provisions on budgetary surveillance in the EC Treaty. The "preventive" arm of the SGP obliges Member States to submit annual *stability programmes* or *convergence programmes*, while the "corrective" arm of the SGP clarifies and speeds up the *excessive deficit procedure*.

Stability programme Medium-term budgetary strategy presented by each Member State that has already adopted the euro; updated annually, according to the provisions of the *Stability and Growth Pact*. See also *convergence programme, code of conduct* and *medium-term objective*.

Stock-flow adjustment (SFA) The stock-flow adjustment (also known as the debt-deficit adjustment) ensures consistency between *government net borrowing*, which is a flow variable, and the variation in *government debt*, which is a stock variable. It includes differences between cash and accrual accounting, accumulation of financial assets, changes in the value of debt denominated in foreign currency and remaining statistical adjustments. See also *debt dynamics.*

Structural balance The *budget balance* in *cyclically-adjusted* terms and excluding *one-off and temporary measures*. See also *fiscal stance*.

Structural primary balance The *structural balance* net of interest expenditure on *general government* debt. See also *interest burden*.

Tax elasticity A parameter measuring the relative change in tax revenues with respect to a relative change in GDP. The tax elasticity is an input to the *budgetary sensitivity*.

Annex 2: Summary tables from the programme update

The tables below present the information provided in the programme in the format prescribed by the code of conduct (Annex 2 thereof).

Table 1a. Macroeconomic prospects

	ESA Code	2005	2005	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	270.6	1.2	2.7	2.2	2.1	2.2	2.2
2. Nominal GDP	B1*g	298.2	3.5	5.0	4.3	4.0	4.3	4.4
Components of real GDP								
3. Private consumption expenditure	P.3	143.2	1.1	2.3	2.1	1.5	1.9	1.9
4. Government consumption expenditure	P.3	59.4	0.2	1.8	2.4	2.5	2.0	2.0
5. Gross fixed capital formation	P.51	57.7	8.5	2.2	2.4	2.6	2.9	2.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	0.0	0.9	0.9	0.9	0.8	0.8	0.8
7. Exports of goods and services	P.6	241.9	1.8	5.4	4.9	5.6	5.6	5.7
8. Imports of goods and services	P.7	23.4.0	3.4	4.8	5.0	5.6	5.7	5.7
Contributions to real GDP growth								
9. Final domestic demand		-	2.3	2.1	2.1	1.9	2.0	2.0
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.2	0.0	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	-1.2	0.6	0.1	0.2	0.2	0.2

Table 1b. Price development

	ESA Code	2005	2005	2006	2007	2008	2009	2010
		level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		110.2	2.2	2.2	2.0	1.9	2.1	2.1
2. Private consumption deflator		110.9	2.8	2.4	1.9	1.8	1.9	1.9
3. HICP[1]		110.3	2.5	2.4	1.9	1.8	1.8	1.9
4. Public consumption deflator		115.2	3.4	2.6	2.4	2.2	2.4	2.2
5. Investment deflator		102.9	0.9	3.0	2.2	1.6	1.8	2.0
6. Export price deflator (goods and services)		107.4	5.7	4.6	1.3	0.9	1.1	1.2
7. Import price deflator (goods and services)		108.1	6.4	5.2	1.3	0.8	0.9	0.9

[1] Optional for Stability programmes.

Table 1c. Labour market developments

	ESA Code	2005 Level		2005 rate of change	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Employment, persons[1]		4203.1	(a)	0.9	1.0	1.1	0.8	0.8	0.8
2. Employment, hours worked[2]		6599.2	(b)	0.7	0.9	1.0	0.7	0.7	0.8
3. Unemployment rate (%)[3]		8.4		8.4	8.6	8.4	8.3	8.2	8.0
4. Labour productivity, persons [4]		64.4	(c)	0.3	1.7	1.1	1.2	1.3	1.4
5. Labour productivity, hours worked[5]		41.0	(d)	0.5	1.8	1.2	1.3	1.4	1.4
6. Compensation of employees	D.1	152.1	(e)	3.7	3.9	3.6	4.0	4.7	4.6

(a) thousands
(b) millions of hours
(c) thousands of euro
(d) euros
(e) billions of euros
[1] Occupied population, domestic concept national accounts definition.
[2] National accounts definition.
[3] Harmonised definition, Eurostat; levels.
[4] Real GDP per person employed.
[5] Real GDP per hour worked.

Table 1d. Sectoral balance

% of GDP	ESA Code	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	1.9	2.0	2.0	2.2	2.4	2.7
of which:							
- Balance on goods and services		2.3	2.5	2.5	2.7	2.9	3.3
- Balance of primary incomes and transfers		-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
- Capital account		-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
2. Net lending/borrowing of the private sector	B.9	1.7	2.4	3.0	3.0	3.0	3.0
3. Net lending/borrowing of general government	EDP B.9	0.0	-0.3	-1.0	-0.9	-0.5	-0.3
4. Statistical discrepancy		-	-	-	-	-	-

Table 2. General government budgetary prospects

	ESA code	2005 Level	2005 % of GDP	2006 % of GDP	2007 % of GDP	2008 % of GDP	2009 % of GDP	2010 % of GDP
Net lending (EDP B.9) by sub-sector								
1. General government	S.13	308.1	0.1	0.0	0.3	0.5	0.7	0.9
2. Central government	S.1311	-197.1	-0.1	-0.1	0.0	0.3	0.4	0.6
3. State government	S.1312	809.4	0.3	0.2	0.1	0.0	0.0	0.0
4. Local government	S.1313	-463.1	-0.2	-0.2	0.0	0.1	0.2	0.2
5. Social security funds	S.1314	158.9	0.1	0.1	0.2	0.1	0.1	0.1
General government (S13)								
6. Total revenue	TR	148986.3	50.0	49.1	48.9	48.9	48.8	48.7
7. Total expenditure	TE[1]	148678.2	49.9	49.1	48.6	48.4	48.1	47.8
8. Net lending/borrowing	EDP B.9	308.1	0.1	0.0	0.3	0.5	0.7	0.9
9. Interest expenditure (incl. FISIM)	EDP D.41 incl. FISIM	12657.4	4.2	4.1	3.9	3.6	3.4	3.3
pm: 9a. FISIM								
10. Primary balance	[2]	12965.5	4.3	4.1	4.2	4.1	4.1	4.2
Selected components of revenue								
11. Total taxes (11=11a+11b+11c)		92433.4	31.0	30.7	30.5	30.7	30.6	30.6
11a. Taxes on production and imports	D.2	39429.4	13.2	13.5	13.4	13.5	13.4	13.4
11b. Current taxes on income, wealth, etc	D.5	51123.4	17.1	16.5	16.5	16.6	16.6	16.6
11c. Capital taxes	D.91	1880.6	0.6	0.7	0.6	0.6	0.6	0.7
12. Social contributions	D.61	47963.4	16.1	15.8	15.7	15.7	15.7	15.7
13. Property income	D.4	1979.1	0.7	0.6	0.6	0.6	0.5	0.5
14. Other (14=15-(11+12+13))		6610.4	2.2	2.0	2.0	1.9	1.9	1.8
15=6. Total revenue	TR	148986.3	50.0	49.1	48.9	48.9	48.8	48.7
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[3]		142358.8	47.7	47.1	46.9	47.1	47.0	47.0
Selected components of expenditure								
16. Collective consumption[4]	P.32	46962.5	15.7	15.5	15.4	15.3	15.2	15.1
17. Total social transfers [5]	D.62 + D.63	68873.2	23.1	22.8	22.8	22.9	22.9	22.9
17a. Social transfers in kind [5]	P.31 = D.63	21248.7	7.1	7.1	7.2	7.4	7.5	7.5
17b. Social transfers other than in kind	D.62	47624.5	16.0	15.8	15.6	15.5	15.5	15.4
18.=9. Interest expenditure (incl. FISIM)	EDP D.41 incl. FISIM	12657.4	4.2	4.1	3.9	3.6	3.4	3.3
19. Subsidies	D.3	4981.9	1.7	1.7	1.7	1.6	1.6	1.6
20. Gross fixed capital formation	P.51	5303.9	1.8	1.6	1.5	1.7	1.7	1.7
21. Other (21=22-(16+17+18+19+20))		9899.3	3.3	3.3	3.3	3.3	3.2	3.2
22=7. Total expenditure	TE[1]	148678.2	49.9	49.1	48.6	48.4	48.1	47.8
Pm: compensation of employees	D.1	36198.4	12.1	12.0	11.9	11.8	11.7	11.7

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41 + FISIM recorded as intermediate consumption, item 9).

[3] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[4] Instead of collective consumption, Belgium reports the compensation of employees and intermediate consumption (including taxes) by the government sector.

[5] Instead of social transfers in kind, Belgium reports social benefits in kind provided by market producers.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2004	2010
1. General public services	1		
2. Defence	2		
3. Public order and safety	3		
4. Economic affairs	4		
5. Environmental protection	5		
6. Housing and community amenities	6		
7. Health	7		
8. Recreation, culture and religion	8		
9. Education	9		
10. Social protection	10		
11. Total expenditure (= item 7=26 in Table 2)	TE[1]		

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP		2005	2006	2007	2008	2009	2010
1. Gross debt[1]		91.5	87.7	83.9	80.4	76.6	72.6
2. Change in gross debt ratio		-2.8	-3.8	-3.8	-3.5	-3.8	-3.9
Contributions to changes in gross debt							
3. Primary balance[2]		4.6	4.1	4.2	4.1	4.1	4.2
4. Interest expenditure (incl. FISIM) [3]		4.2	4.1	3.9	3.6	3.4	3.3
5. Stock-flow adjustment		0.3	0.5	0.2	0.2	0.2	0.2
of which:							
- Differences between cash and accruals[4]							
- Net accumulation of financial assets[5]							
of which							
- privatisation proceeds							
- Valuation effects and other[6]							
p.m. implicit interest rate on debt[7]		4.6	4.7	4.6	4.5	4.4	4.5
Other relevant variables							
6. Liquid financial assets[8]							
7. Net financial debt (7=1-6)							

[1] As defined in Regulation 3605/93 (not an ESA concept).
[2] Cf. item 10 in Table 2.
[3] Cf. item 9 in Table 2.
[4] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.
[5] Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.
[6] Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.
[7] Proxied by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.
[8] AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2005	2006	2007	2008	2009	2010
1. Real GDP growth (%)		1.2	2.7	2.2	2.1	2.2	2.2
2. Net lending of general government	EDP B.9	0.1	0.0	0.3	0.5	0.7	0.9
3. Interest expenditure (incl. FISIM recorded as consumption)	EDP D.41 + FISIM	4.2	4.1	3.9	3.6	3.4	3.3
4. Potential GDP growth (%)		2.2	2.2	2.2	2.1	2.0	2.0
contributions:							
- labour		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
- total factor productivity		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. Cyclical budgetary component		-0.6	-0.4	-0.4	-0.4	-0.3	-0.2
7. Cyclically-adjusted balance (2-6)		0.8	0.4	0.6	0.9	1.0	1.1
8. Cyclically-adjusted primary balance (7-3)		5.0	4.5	4.5	4.5	4.4	4.3

Table 6. Divergence from previous update

	ESA Code	2005	2006	2007	2008	2009	2010
Real GDP growth (%)							
Previous update		1.4	2.2	2.1	2.3	2.2	
Current update		1.2	2.7	2.2	2.1	2.2	2.2
Difference		-0.2	0.5	0.1	-0.2	0	
General government net lending (% of GDP)	EDP B.9						
Previous update		0.0	0.0	0.3	0.5	0.7	
Current update		0.1	0.0	0.3	0.5	0.7	0.9
Difference		0.1	0.0	0.0	0.0	0.0	
General government gross debt (% of GDP)							
Previous update		94.3	90.7	87.0	83.0	79.1	
Current update		91.5	87.7	83.9	80.4	76.4	72.6
Difference		-2.8	-3.0	-3.1	-2.6	-2.5	

Table 7. Long-term sustainability of public finances

% of GDP	2000	2005	2010	2020	2030	2040	2050
Total expenditure		25.3	25.2	26.6	29.6		31.5
Of which: age-related expenditures							
Pension expenditure							
Social security pension		10.4	10.5	12.0	14.5		15.4
Old-age and early pensions		9.6	9.7	11.2	13.8		14.8
Other pensions (disability, survivors)		0.8	0.8	0.8	0.7		0.7
Occupational pensions (if in general government)							
Health care		7.1	7.4	7.8	8.4		9.4
Long-term care *(this was earlier included in the health care)*							
Education expenditure		5.6	5.2	4.9	5.0		4.9
Other age-related expenditures							
Interest expenditure							
Total revenue							
Of which: property income							
of which: from pensions contributions (or social contributions if appropriate)							
Pension reserve fund assets							
Of which: consolidated public pension fund assets							
(assets other than government liabilities)							
Assumptions							
Labour productivity growth							
Real GDP growth							
Participation rate males (aged 20-64)							
Participation rates females (aged 20-64)							
Total participation rates (aged 20-64)							
Unemployment rate							
Population aged 65+ over total population							

Table 8. Basic assumptions

	2005	2006	2007	2008	2009	2010
Short-term interest rate[1] (annual average)	2.1	2.9	3.6	3.6	3.7	3.7
Long-term interest rate (annual average)	3.3	3.9	4.1	4.2	4.4	4.5
USD/€ exchange rate (annual average) (euro area and ERM II countries)	124.40	125.00	128.00	129.00	129.00	129.00
Nominal effective exchange rate	106.5	106.9	107.2	107.4	107.4	107.4
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)						
World excluding EU, GDP growth	5.4	5.7	5.2	5.2	4.5	4.5
EU GDP growth	1.6	2.8	2.3	2.4	2.3	2.3
Growth of relevant foreign markets	6.2	8.3	6.2	6.7	6.5	6.4
World import volumes, excluding EU	7.9	9.2	8.2	7.9	7.9	7.9
Oil prices, (Brent, USD/barrel)	54.4	66.1	67.6	68.4	67.4	65.0

[1] If necessary, purely technical assumptions.

Annex 3: Compliance with the code of conduct

standard text: The table below provides a detailed assessment of whether the programme respects the requirements of Section II of the code of conduct. It is in four parts, covering compliance with (i) the window for the date of submission of the programme; (ii) the model structure (table of contents) in Annex 1 of the code; (iii) the data requirements (model tables) in Annex 2 of the code; and (iv) other information requirements.

Guidelines in the code of conduct	Yes	No	Comments
1. Submission of the programme			
Programme was submitted not earlier than mid-October and not later than 1 December[1].		X	
2. Model structure			
The model structure for the programmes in Annex 1 of the code of conduct has been followed.	X		
3. Model tables (so-called data requirements)			
The quantitative information is presented following the standardised set of tables (Annex 2 of the code of conduct).	X		
The programme provides all compulsory information in these tables.		X	See annex 2
The programme provides all optional information in these tables.		X	See annex 2
The concepts used are in line with the European system of accounts (ESA).	X		Except for the deficit (for 2005) and debt figures (for 2005-2010), which do not include the Eurostat amendment of 23 October 2006 (see Section 1 of this assessment).
4. Other information requirements			
a. Involvement of parliament			
The programme mentions its status vis-à-vis the national parliament.		X	
The programme indicates whether the Council opinion on the previous programme has been presented to the national parliament.		X	
b. Economic outlook			
Euro area and ERM II Member States uses the "common external assumptions" on the main extra-EU variables.		X	
Significant divergences between the national and the Commission services' economic forecasts are explained[2].		X	But there very little significant divergences.
The possible upside and downside risks to the economic outlook are brought out.		X	
The outlook for sectoral balances and, especially for countries with a high external deficit, the external balance is analysed.		X	The sectoral balances are inconsistent with the rest of the programme.
c. Monetary/exchange rate policy			
The convergence programme presents the medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable
d. Budgetary strategy			
The programme presents budgetary targets for the general government balance in relation to the MTO, and the projected path for the debt ratio.	X		
In case a new government has taken office, the programme shows continuity with respect to the budgetary targets endorsed by the			Not applicable

Guidelines in the code of conduct	Yes	No	Comments
Council.			
When applicable, the programme explains the reasons for possible deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify the situation, and provide information on them.			Not applicable
The budgetary targets are backed by an indication of the broad measures necessary to achieve them and an assessment of their quantitative effects on the general government balance is analysed.	X		
Information is provided on one-off and other temporary measures.	X		Only for 2006 and 2007
The state of implementation of the measures (enacted versus planned) presented in the programme is specified.		X	
If for a country that uses the transition period for the classification of second-pillar funded pension schemes, the programme presents information on the impact on the public finances.			Not applicable
e. "Major structural reforms"			
If the MTO is not yet reached or a temporary deviation is planned from the achieved MTO, the programme includes comprehensive information on the economic and budgetary effects of possible 'major structural reforms' over time.			Not applicable
The programme includes a quantitative cost-benefit analysis of the short-term costs and long-term benefits of such reforms.			Not applicable
f. Sensitivity analysis			
The programme includes comprehensive sensitivity analyses and/or develops alternative scenarios showing the effect on the budgetary and debt position of: a) changes in the main economic assumptions b) different interest rate assumptions c) for non-participating Member States, different exchange rate assumptions d) if the common external assumptions are not used, changes in assumptions for the main extra-EU variables.	 X X	 X	 a) Only GDP growth c) Not applicable
In case of "major structural reforms", the programme provides an analysis of how changes in the assumptions would affect the effects on the budget and potential growth.			Not applicable
g. Broad economic policy guidelines			
The programme provides information on the consistency with the broad economic policy guidelines of the budgetary objectives and the measures to achieve them.		X	
h. Quality of public finances			
The programme describes measures aimed at improving the quality of public finances on both the revenue and expenditure side (e.g. tax reform, value-for-money initiatives, measures to improve tax collection efficiency and expenditure control).		X	There is a discussion on institutional features (the National Accounts Institute, the High Finance Council and the Ageing Fund), but not on new measures.
i. Long-term sustainability			
The programme outlines the country's strategies to ensure the sustainability of public finances, especially in light of the economic and budgetary impact of ageing populations.	X		
Common budgetary projections by the AWG are included in the programme. The programme includes all the necessary additional information. (…) To this end, information included in programmes should focus on new relevant information that is not fully reflected in the latest common EPC projections.	X		The figures in the programme include the impact of the 'Generation Pact', but it should be noted that this has not yet been submitted to peer review in the

Guidelines in the code of conduct	Yes	No	Comments
			AWG.
j. Other information (optional)			
The programme includes information on the implementation of existing national budgetary rules (expenditure rules, etc.), as well as on other institutional features of the public finances, in particular budgetary procedures and public finance statistical governance.	X		

Notes:
[1]The code of conduct allows for the following exceptions: (i) Ireland should be regarded as complying with the deadline in case of submission on "budget day", i.e. traditionally the first Wednesday of December, (ii) the UK should submit as close as possible to its autumn pre-budget report; and (iii) Austria and Portugal cannot comply with the deadline but will submit no later than 15 December.
[2]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.

Source:
Commission services

Annex 4: Key economic indicators of past economic performance

This Annex includes two tables. The first displays key economic indicators that summarise the economic performance of the country. To put the country's performance into perspective, the second table displays the same set of indicators for the euro area.

Belgium – Key economic indicators

	Averages 1996 - 2005	Averages 1996 - 2000	Averages 2001 - 2005	2003	2004	2005
Economic activity						
Real GDP (% change)	2.1	2.7	1.5	1.0	3.0	1.1
Private consumption (% change)	1.7	2.3	1.0	0.9	1.5	0.9
Government consumption (% change)	1.8	1.8	1.8	2.2	2.1	-0.6
Investment (% change)	3.0	4.2	1.8	-0.7	7.9	4.0
Exports (% change)	4.2	5.7	2.7	2.9	5.9	2.8
Imports (% change)	4.1	5.6	2.6	3.0	6.3	3.5
Contributions to real GDP growth:						
Domestic demand	1.8	2.4	1.3	0.9	3.0	1.5
Net exports	0.2	0.3	0.2	0.1	0.0	-0.5
Output gap (% of potential GDP)	-0.1	0.0	-0.2	-0.8	0.1	-1.0
Prices and costs						
HICP inflation (% change)	1.8	1.6	2.0	1.5	1.9	2.5
Unit labour costs (% change)	1.3	0.8	1.8	0.6	-0.3	2.3
Labour productivity (% change)	1.2	1.6	0.9	1.1	2.4	0.1
Real unit labour costs (% change)	-0.3	-0.4	-0.2	-1.0	-2.7	0.2
Comparative price levels (EUR25=100)	105.2	107.4	102.9	103.1	103.1	103.3
Labour market						
Employment (% change)	0.9	1.3	0.6	0.1	0.7	0.9
Employment (% of working age population)	60.8	59.7	61.8	61.6	61.7	61.9
Unemployment rate (% of labour force)	8.3	8.7	7.8	8.2	8.4	8.4
NAIRU (% of labour force)	8.0	8.0	7.9	7.9	7.9	7.9
Participation rate (% of working age population)	66.1	65.3	67.0	66.9	67.2	67.6
Working age population (% change)	0.2	0.1	0.4	0.4	0.4	0.5
Competitiveness and external position						
Real effective exchange rate (% change) (1)	-0.6	-2.7	1.5	2.9	-0.1	1.0
Export performance (% change) (2)	-1.9	-2.8	-1.1	-0.4	-1.4	-3.0
External balance of g & s (% of GDP)	4.0	4.0	3.9	4.4	4.1	3.0
External balance (% of GDP)	4.4	5.0	3.9	4.4	3.6	2.5
FDI inflow (% of GDP)	n.a.	n.a.	n.a.	10.8	11.8	7.5
Public finances						
Total expenditure (% of GDP)	50.4	50.5	50.3	51.1	49.3	52.3
Total revenue (% of GDP)	49.5	49.1	49.9	51.1	49.2	49.9
General government balance (% of GDP)	-0.9	-1.4	-0.3	0.0	0.0	-2.3
General government debt (% of GDP)	108.3	117.5	99.1	98.6	94.3	93.2
Structural budget balance (% of GDP) (3)	n.a.	n.a.	n.a.	-1.0	-0.9	0.2
Financial indicators (4)						
Short term real interest rate (%) (5)	1.6	2.3	0.8	0.7	-0.3	0.2
Long term real interest rate (%) (5)	3.3	4.2	2.4	2.5	1.7	1.4
Household debt (% change) (6)	5.4	5.7	5.1	5.2	6.9	10.5
Corporate sector debt (% change) (7)	6.9	9.2	4.6	1.7	9.1	1.6
Household debt (% of GDP) (6)	39.6	39.4	39.8	39.4	40.2	42.9
Corporate sector debt (% of GDP) (7)	70.3	65.3	75.3	74.1	77.1	75.6

Notes:
(1) Unit labour costs relative to rest of a group of industrialised countries (USD): EU24 (= EU25 excl. LU), BG, RO, TR, CH, NR, US, CA, JP, AU, MX and NZ.
(2) Market performance of exports of goods and services on export weighted imports of goods and services of 35 industrial markets.
(3) Cyclically-adjusted budget balance net of one-off and other temporary measures.
(4) Data available up to 2004.
(5) Using GDP deflator.
(6) Households' and non-profit institutions serving households' debt, defined as loans and securities other than shares.
(7) Non-financial corporate sector debt, defined as loans and securities other than shares.
Source:
Commission services

Euro area – Key economic indicators

	Averages			2003	2004	2005
	1996 - 2005	1996 - 2000	2001 - 2005			
Economic activity						
Real GDP (% change)	2.1	2.7	1.4	0.8	2.0	1.4
Private consumption (% change)	2.0	2.6	1.4	1.2	1.5	1.3
Government consumption (% change)	1.7	1.7	1.7	1.8	1.2	1.4
Investment (% change)	2.6	4.3	1.0	1.0	2.2	2.5
Exports (% change)	5.8	8.1	3.5	1.1	6.8	4.3
Imports (% change)	5.9	8.4	3.4	3.1	6.7	5.3
Contributions to real GDP growth:						
Domestic demand	2.0	2.7	1.3	1.4	1.8	1.6
Net exports	0.1	0.1	0.1	-0.7	0.2	-0.2
Output gap (% of potential GDP)	-0.1	-0.1	0.0	-0.6	-0.5	-1.1
Prices and costs						
HICP inflation (% change)	1.9	1.7	2.2	2.1	2.1	2.2
Unit labour costs (% change)	1.3	0.8	1.7	2.0	0.9	1.0
Labour productivity (% change)	1.2	1.5	0.8	0.8	1.6	0.9
Real unit labour costs (% change)	-0.5	-0.6	-0.5	-0.1	-1.0	-0.8
Comparative price levels (EUR25=100)	n.a.	n.a.	102.1	103.0	102.7	102.3
Labour market						
Employment (% change)	1.2	1.5	0.9	0.7	0.7	0.8
Employment (% of working age population)	63.7	62.0	65.4	65.4	65.6	65.8
Unemployment rate (% of labour force)	9.1	9.8	8.5	8.7	8.9	8.6
NAIRU (% of labour force)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Participation rate (% of working age population)	69.9	68.5	71.2	71.4	71.7	71.8
Working age population (% change)	0.3	0.2	0.4	0.5	0.5	0.5
Competitiveness and external position						
Real effective exchange rate (% change) (1)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Export performance (% change) (2)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
External balance of g & s (% of GDP)	1.9	1.7	2.0	2.1	2.1	1.5
External balance (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
FDI inflow (% of GDP)	2.4	2.5	2.2	1.9	1.1	n.a.
Public finances						
Total expenditure (% of GDP)	48.2	48.7	47.7	48.2	47.6	47.6
Total revenue (% of GDP)	45.8	46.5	45.1	45.1	44.8	45.1
General government balance (% of GDP)	-2.3	-2.1	-2.5	-3.1	-2.8	-2.4
General government debt (% of GDP)	70.9	72.5	69.3	69.3	69.8	70.8
Structural budget balance (% of GDP) (3)	n.a.	n.a.	n.a.	-3.2	-2.9	-2.0
Financial indicators (4)						
Short term real interest rate (%) (5)	1.7	2.7	0.7	0.2	0.2	0.3
Long term real interest rate (%) (5)	3.1	4.1	2.1	2.0	2.2	1.5
Household debt (% change) (6)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Corporate sector debt (% change) (7)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Household debt (% of GDP) (6)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Corporate sector debt (% of GDP) (7)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:
(1) Unit labour costs relative to rest of a group of industrialised countries (USD): EU24 (= EU25 excl. LU), BG, RO, TR, CH, NR, US, CA, JP, AU, MX and NZ.
(2) Market performance of exports of goods and services on export weighted imports of goods and services of 35 industrial markets.
(3) Cyclically-adjusted budget balance net of one-off and other temporary measures.
(4) Data available up to 2004.
(5) Using GDP deflator.
(6) Households' and non-profit institutions serving households' debt, defined as loans and securities other than shares.
(7) Non-financial corporate sector debt, defined as loans and securities other than shares.
Source:
Commission services

Annex 5: Assessment of tax projections

Table 9 in the main text compares the tax projections of the programme with those of the Commission services' autumn 2006 forecast and those obtained by using standard ex-ante elasticities, as estimated by the OECD. It summarises the results for the total tax-to-GDP ratio. The underlying analysis exploits information for the four major tax categories, i.e. indirect taxes, corporate and private income taxes and social contributions (see results in the table below)[31].

Conceptually, the analysis draws on the definition of a semi-elasticity, which measures the change in a ratio vis-à-vis the relative change in the denominator. The semi-elasticity of the tax-to-GDP ratio of the *i-th* tax $\frac{T_i}{Y}$ can be written as:

$$\eta_i = \frac{d\left(\frac{T_i}{Y}\right)}{dY}Y = \left(\frac{dT_i}{dY}\frac{Y}{T_i} - 1\right)\frac{T_i}{Y} = \left(\frac{dT_i}{dB_i}\frac{B_i}{T_i}\frac{dB_i}{dY}\frac{Y}{B_i} - 1\right)\frac{T_i}{Y} = (\varepsilon_{T_i,B_i}\varepsilon_{B_i,Y} - 1)\frac{T_i}{Y}$$

where ε_{T_i,B_i} and $\varepsilon_{B_i,Y}$ denote the elasticity of the *i-th* tax T_i relative to its tax base B_i and the elasticity of the tax base B_i relative to aggregate GDP Y respectively.

To the extent that ε_{T_i,B_i} is derived from observed or projected data, it will typically reflect (i) the effect of discretionary measures (including one-offs) and (ii) the tax elasticity[32]. By contrast, if ε_{T_i,B_i} is the standard *ex-ante* elasticity, as estimated by the OECD, it will be net of discretionary measures.

The second elasticity $\varepsilon_{B_i,Y}$ can be used as an indicator of the tax intensity of GDP growth; for instance, a higher elasticity of consumption relative to GDP means that for the same GDP growth indirect taxes will be higher.

The definition of a semi-elasticity has two practical implications. First, any change in the tax-to-GDP ratio of the *i-th* tax can be written as the product of the semi-elasticity and GDP growth:

$$d\left(\frac{T_i}{Y}\right) = \eta_i \cdot \frac{dY}{Y}$$

and the change in the total tax-to-GDP ratio is the sum:

$$\sum_i d\left(\frac{T_i}{Y}\right) = \sum_I \eta_i \frac{dY}{Y}.$$

Second, differences between two tax projections can be decomposed into an elasticity component and a composition component:

$$d\left(\frac{T_i}{Y}\right)' - d\left(\frac{T_i}{Y}\right) \approx \left[\left(\varepsilon'_{T_i,B_i}\varepsilon'_{B_i,Y} - 1\right)\frac{T_i}{Y} - \left(\varepsilon_{T_i,B_i}\varepsilon_{B_i,Y} - 1\right)\frac{T_i}{Y}\right]\frac{dY}{Y}$$

[31] Private and corporate income taxes are generally not provided, neither in the programme nor in the Commission services' autumn 2006 forecast. Only the aggregate, direct income taxes, is given. For the purpose of this exercise the breakdown is obtained using the average shares over the past ten years, i.e. the composition of direct taxes is assumed to stay constant.

[32] The observed or projected elasticity (ex-post elasticity) of the *i*-th tax also includes the effect of other factors (OF) such as discretionary measures: $\frac{\Delta T_i}{T_i} = \varepsilon_{T_i,B_i exante}\frac{dB_i}{B_i} + \frac{OF_i}{T_i} = \varepsilon_{T_i,B_i ex post}\frac{dB_i}{B_i}$.

If $(\varepsilon^{'}_{T_i,B_i} - \varepsilon_{T_i,B_i}) = \alpha_i$; $(\varepsilon^{'}_{B_i,Y} - \varepsilon_{B_i,Y}) = \beta_i$,

then $d\left(\frac{T_i}{Y}\right)^{'} - d\left(\frac{T_i}{Y}\right) \approx \left[\left(\alpha_i \varepsilon_{B_i,Y} + \beta_i \varepsilon_{T_i,B_i} + \alpha_i \beta_i\right)\frac{T_i}{Y}\right]\frac{dY}{Y}$

where $\alpha_i \varepsilon_{B_i,Y} \frac{T_i}{Y}\frac{dY}{Y}$ determines the elasticity component and $\beta_i \varepsilon_{T_i,B_i} \frac{T_i}{Y}\frac{dY}{Y}$ the composition component. The third component in the equation $\alpha_i \beta_i \frac{T_i}{Y}\frac{dY}{Y}$ measures the interaction of the elasticity and the composition components. It is generally small but can become important in some cases. The tax elasticity relative to GDP of total taxes is obtained as $\varepsilon = \sum_i w_i \varepsilon_{T_t B_i} \varepsilon_{B_i Y}$ with w_i the share of the *i-th* tax in the overall tax burden.

Assessment of tax projections by major tax category

	2007			2008			2009	2010
	SP	COM	OECD[1]	SP	COM[2]	OECD[1]	SP	SP
Taxes on production and imports:								
Change in tax-to-GDP ratio	-0.1	-0.1	0.0	0.1	-0.1	0.0	-0.1	0.0
Difference SP– COM	-0.1			0.2			/	/
of which[3]:								
- discretionary & elasticity component	-0.1			0.2			/	/
- composition component	0.0			0.0			/	/
Difference COM – OECD	/	-0.1		/	-0.1		/	/
of which[3]:								
- discretionary & elasticity component	/	0.0		/	0.0		/	/
- composition component	/	0.0		/	-0.1		/	/
p.m.: Elasticity								
- of taxes to tax base[4]	0.9	1.0	1.0	1.4	1.0	1.0	0.9	1.1
- of tax base[4] to GDP	0.9	0.9	1.0	0.8	0.8	1.0	0.9	0.9
Social contributions:								
Change in tax-to-GDP ratio	-0.1	-0.1	-0.1	0.0	-0.2	-0.1	0.0	0.0
Difference SP– COM	0.0		/	0.2		/	/	/
of which[3]:								
- discretionary & elasticity component	0.0		/	0.0		/	/	/
- composition component	0.1		/	0.1		/	/	/
Difference COM – OECD	/	0.0		/	-0.1		/	/
of which[3]:								
- discretionary & elasticity component	/	0.0		/	-0.1		/	/
- composition component	/	0.0		/	0.0		/	/
p.m.: Elasticity								
- of taxes to tax base[5]	1.0	1.1	1.1	1.0	0.9	1.1	0.9	1.0
- of tax base[5] to GDP	0.8	0.8	0.7	1.0	0.8	0.7	1.1	1.0
Personal income tax[6]:								
Change in tax-to-GDP ratio	0.0	-0.1	0.1	0.1	-0.1	0.0	0.0	0.0
Difference SP– COM	0.1		/	0.2		/	/	/
of which[3]:								
- discretionary & elasticity component	0.0		/	0.0		/	/	/
- composition component	0.1		/	0.2		/	/	/
Difference COM – OECD	/	-0.1		/	-0.1		/	/
of which[3]:								
- discretionary & elasticity component	/	-0.2		/	-0.2		/	/
- composition component	/	0.0		/	0.0		/	/
p.m.: Elasticity								
- of taxes to tax base[5]	1.2	1.2	1.6	1.2	1.1	1.6	0.9	1.0
- of tax base[5] to GDP	0.8	0.8	0.7	1.0	0.8	0.7	1.1	1.0
Corporate income tax[6]:								
Change in tax-to-GDP ratio	0.0	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0
Difference SP– COM	0.0		/	0.0		/	/	/
of which[3]:								
- discretionary & elasticity component	0.0		/	0.1		/	/	/
- composition component	0.0		/	0.0		/	/	/
Difference COM – OECD	/	0.0		/	-0.1		/	/
of which[3]:								
- discretionary & elasticity component	/	0.0		/	-0.1		/	/
- composition component	/	0.0		/	0.0		/	/
p.m.: Elasticity								
-of taxes to tax base[7]	0.9	0.7	1.1	1.2	0.7	1.1	1.1	1.0
-of tax base[7] to GDP	1.2	1.2	0.7	1.0	1.2	0.7	0.9	1.0

Notes:
[1]Based on OECD ex-ante elasticities
[2]On a no-policy change basis
[3]The decomposition is explained in the text above
[4]Tax base = private consumption expenditure
[5]Tax base = compensation of employees
[6]Taxes on income and wealth are split into private and corporate income tax using the average tax share over the past ten years, i.e. the share is assumed to be constant over the programme period
[7]Tax base = gross operating surplus

Source:
Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations and OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434)