COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.3.2007
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Recommendation for a

COUNCIL OPINION

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

on the updated stability programme of Belgium, 2006-2010

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact, which entered into force on 1 July 1998, is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact acknowledged its usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Stability and Growth Pact, stipulates that Member States have to submit, to the Council and the Commission, stability or convergence programmes and annual updates thereof (Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes). The first stability programme of Belgium was submitted in December 1998. In accordance with the Regulation, the Council delivered an opinion on it on 15 March 1999 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. In accordance with the same procedure, updated stability and convergence programmes are assessed by the Commission and examined by the Committee mentioned above, while the Council may examine them.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of Belgium, submitted on 13 December 2006, and has adopted a recommendation for a Council opinion on it (see box for the main points covered by the assessment).

In order to set the scene against which the budgetary strategy in the updated stability programme is assessed, the following paragraphs summarise:

(1) the economic and budgetary performance over the last ten years

(2) the most recent assessment of the country's position under the preventive arm of the Stability and Growth Pact (summary of the Council opinion on the previous update of the stability programme) and

(3) the Commission's assessment of the December 2006 national reform programme.

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[1] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

2.1. Recent economic and budgetary performance

Based on the analysis of the last ten years, 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).

2.2. The assessment in the Council opinion on the previous programme

On 14 February 2006, the Council adopted its opinion on the previous update of the stability programme, covering the period 2005-2009. The Council was of the opinion that, "overall, the budgetary position is sound and the continued debt reduction from its still high level envisaged in the programme provides an example of fiscal policies conducted in compliance with the Pact. The reliance on one-off measures at the beginning of the period underlines the need for front-loaded structural consolidation". The Council invited Belgium "to consider measures to avoid a deterioration of the structural balance in 2006 and to implement the required measures to reach the ambitious budgetary targets in subsequent years".

2.3. The Commission assessment 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. Belgium's national reform programme 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 of this programme (adopted as part of its December 2006 Annual Progress Report[2]) showed that Belgium is making good progress in the implementation and reinforcement of its 2005-2008 National Reform Programme. 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

[2] 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.

more mixed and steps are needed to achieve the EU-wide employment rate goals, in particular for older people.

Against the background of strengths and weaknesses identified, Belgium was recommended to undertake further actions to reduce the tax burden on labour; and to reduce regional disparities in unemployment.

Box: Main points covered by the assessment

As required by Article 5(1) (for stability programmes) and Article 9(1) (for convergence programmes) of Council Regulation (EC) No 1466/97, the assessment covers the following points:

- whether the economic assumptions on which the programme is based are plausible;
- the medium-term budgetary objective (MTO) presented by the Member State and whether the adjustment path towards it is appropriate;
- whether measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle;
- when assessing the adjustment path towards the MTO, whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times, and, for euro-area and ERM II Member States, whether the Member State pursues an annual improvement of the cyclically-adjusted balance, net of one-off and other temporary measures, of 0.5% of GDP as a benchmark to meet its MTO;
- when defining the adjustment path to the MTO (for Member States that have not yet reached it) or allowing a temporary deviation from the MTO (for Member States that have), the implementation of major structural reforms which have direct long-term cost-saving effects (including by raising potential growth) and therefore a verifiable impact on the long-term sustainability of public finances (subject to the condition that an appropriate safety margin with respect to the 3% of GDP reference value is preserved and that the budgetary position is expected to return to the MTO within the programme period), with special attention for pension reforms introducing a multi-pillar system that includes a mandatory, fully-funded pillar;
- whether the economic policies of the Member State are consistent with the broad economic policy guidelines.

The plausibility of the programme's macroeconomic assumptions is assessed by reference to the Commission services' autumn 2006 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. The assessment of consistency with the broad economic policy guidelines is made against the broad economic policy guidelines in the area of public finances as included in the integrated guidelines for the period 2005-2008.

The assessment also examines:

- the evolution of the debt ratio and the outlook for the long-term sustainability of the public finances, which should be given "sufficient attention in the surveillance of budgetary positions" according to the Council report of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact". A Commission Communication of 12 October 2006 sets out the approach to the assessment of long-term sustainability[3];
- the degree of integration with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs. In its cover note of 7 June 2005 to the European Council on the broad economic policy guidelines for the period 2005-2008, the ECOFIN Council stated that the national reform programmes should be consistent with the stability and convergence programmes;
- compliance with the code of conduct[4], which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

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3 Communication from the Commission to the Council and the European Parliament, "The long-term sustainability of public finances in the EU" - COM(2006) 574, 12.10.2006 - and European Commission, Directorate-General for Economic and Financial Affairs (2006), "The long-term sustainability of public finances in the European Union", European Economy No 4/2006.

4 "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.

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on the updated stability programme of Belgium, 2006-2010

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [27 March 2007] the Council examined the updated stability programme of Belgium, which covers the period 2006 to 2010[6].

(2) The macroeconomic scenario underlying the 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. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions. The programme's projections for inflation also appear realistic.

(3) For 2006, the general government deficit is estimated at 0.2% of GDP in the Commission services' autumn 2006 forecast, against a target of a balanced budget set in the previous update of the stability programme. While cyclical conditions in 2006 turned out to be significantly better than foreseen in the previous update and expenditure developed broadly as expected, revenues were lower than anticipated (notably because of an underestimation of the impact of the final stage of the 2001 direct tax reform, detected in the second half of 2006). In order to (partly) compensate for the revenue shortfall and secure a balanced budget outcome, the use

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5 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

6 The update was submitted almost 2 weeks beyond the 1 December deadline set in the code of conduct.

of one-off measures was increased. Therefore the structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) significantly deteriorated in 2006.

(4) 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 nearly entirely due to reduced expenditure (by 1¼ percentage point of GDP between 2006 and 2010). The expenditure reduction is mainly in the form of falling interest expenditure (¾ percentage point) which results from the continuous debt reduction and is partly offset by a decrease in government revenue (0.5 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 of the stability programme against a broadly unchanged macroeconomic scenario.

(5) As the programme does not provide information on the use of one-off and other temporary measures after 2007, the structural balance from 2008 onwards cannot be calculated based on the information in the programme. Assuming that the relative impact of one-off measures remains unchanged after 2007, the structural balance calculated according to the commonly agreed methodology is planned to improve from around -0.4% of GDP in 2006 to 0.7% at the end of the programme period. As in the previous update of the stability programme, the medium-term objective (MTO) for the budgetary position presented in the programme is a structural surplus of 0.5% of GDP, which according to the programme "will be achieved by 2008, assuming that the impact of the one-off measures does not exceed 0.4 % of GDP". This is one year later than in the previous update. As the MTO is more demanding than the minimum benchmark (estimated at a deficit of around 1¼% of GDP), achieving it 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 is more demanding than implied by the debt ratio and average potential output growth in the long term.

(6) The budgetary outcomes could be slightly worse than projected in the programme. This is especially the case for 2007, mainly because the budget appears to be somewhat on the optimistic side and sometimes provides insufficient details about the envisaged measures (including the one-off measures in the area of real estate sales or the take-over of pension obligations from public corporations, which are not further specified). Belgium overall has a good track record of achieving the nominal budgetary targets, but additional measures seem necessary to achieve the target for 2007. Although significant intra-year budget amendments are common practice in Belgium, these 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 there is also a risk that expired one-offs will not be replaced by structural measures.

(7) In view of this risk assessment, the budgetary stance in the programme may not be sufficient to ensure that the MTO is achieved by 2008, as envisaged in the programme. However, as stated above, the MTO is more demanding than implied by the debt ratio and average potential output growth in the long term. The budgetary strategy seems sufficient to achieve a budgetary position in structural terms that can be considered appropriate under the Pact from 2008 onwards. In addition, the budgetary stance in the programme seems to provide a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period. 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 specifies that, for euro-area and ERM II Member States, the annual improvement in the structural balance should be 0.5% of GDP as a benchmark and that the adjustment should be higher in good economic times and could be lower in bad economic times. In particular, taking into account risks, the adjustment towards the MTO may fall short of the benchmark already in 2007 and will slow down significantly thereafter although Belgium does not appear to be in bad times.

(8) 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, which is still far above the 60% of GDP Treaty reference value, although substantially decreasing over the last several years. The programme projects the debt ratio to rapidly decline by around 15 percentage points over the programme period. In view of the risk assessment and in particular the risks to the budgetary targets mentioned above, the evolution of the debt ratio is likely to be slightly less favourable than projected in the programme. However, the debt ratio still seems to be sufficiently diminishing towards the reference value over the programme period.

(9) 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 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.

(10) The stability programme does not contain a qualitative assessment of the overall impact of the October 2006 implementation report of the national reform programme within the medium-term fiscal strategy. In addition, it provides no systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme but its budgetary projections seem to take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the stability programme seem consistent with those foreseen in the national reform programme. In particular, both programmes envisage the gradual implementation of the

'generation pact' (a comprehensive plan to increase employment and strengthen the social security), a further gradual reduction of the tax burden on labour and measures to stimulate research and entrepreneurship.

(11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

(12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data[7].

The overall conclusion is that the 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 risks to the achievement of the budgetary targets. Nevertheless, the medium-term objective is expected to be reached within the programme period.

In view of the above assessment, Belgium is invited to:

(i) ensure that the budgetary target for 2007 is met and strengthen the pace of adjustment towards the MTO thereafter, including through a reduction of the recourse to one-off measures.

(ii) in the light of the high level of debt and the projected increase in age-related expenditure, to improve the long-term sustainability of public finances by at least achieving the MTO as well as by taking measures to further reduce the cost of ageing.

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7 The general government deficit and debt projections in the programme do not include the impact of a debt assumption from the railway company SNCB in 2005 as decided by Eurostat on 23 October 2006. Moreover, the programme also does not provide information on the use of one-off and other temporary measures in 2008-2010.

Comparison of key macroeconomic and budgetary projections

		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 not in line with ESA95. On 23 October 2006 Eurostat amended the deficit and debt data notified by Belgium 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 No 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.

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