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COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL OPINION

On the updated stability programme of Belgium, 2007-2011

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact 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 policies¹, which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme 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. As regards updated stability and convergence programmes, the regulation foresees that these are assessed by the Commission and examined by the Committee and if necessary and following the same procedure as set out above, the updated programmes may be examined by the Council.

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 21 April 2008, and is recommending 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 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);
- (2) the orientations for budgetary policies adopted by the April 2007 Eurogroup;
- (3) the May 2008 update of the country-specific broad economic policy guidelines in the area of budgetary policies;
- (4) the Commission's assessment of the October 2007 implementation report of the national reform programme.

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). The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

2.1. The assessment in the Council opinion on the previous update

In its opinion of 27 March 2007, the Council summarised its assessment of the previous update of the stability programme, covering the period 2006-2010, as follows. "The Council considers 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."

In view of its assessment, the Council invited Belgium to "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" and "in the light of the high level of debt and the projected increase in age-related expenditure, to better address the long-term sustainability of public finances by at least achieving the MTO as well as by implementing reforms."

2.2. Orientations for budgetary policies adopted by the Eurogroup in April 2007

On 20 April 2007, with a view to improving the coordination of fiscal policies in the euro area, Eurogroup ministers discussed national budgetary developments in 2007 and the preliminary policy outlook for 2008 and their implications for the euro area.

Reaffirming their adherence to the sound fiscal policy principles of the revised Stability and Growth Pact and to national fiscal rules, Ministers committed to (i) build on the better-than-expected budgetary outcomes in 2006 to pursue more ambitious budgetary targets than those set in the end-2006 updates of the stability programmes; (ii) implement their 2007 budgets as planned, avoiding expenditure overruns, and using unexpected extra revenues to reduce government deficit and debt; and (iii) carefully design fiscal policy plans for 2008 so as to accelerate the adjustment towards the MTO for Member States which have not reached it and for those which have reached it to avoid feeding macroeconomic imbalances overall².

2.3. May 2008 update of the country-specific broad economic policy guidelines in the area of budgetary policies

On 14 May 2008, the Council adopted a recommendation on the 2008 update of the broad guidelines for the economic policies of the Member States and the Community and on the implementation of Member States' employment policies³. In the area of budgetary policies, Belgium was recommended to "strengthen fiscal consolidation" and was encouraged to focus on "fully implementing the strategy aiming to ensure the long term sustainability of public finances, including expenditure restraints, fiscal surpluses, and a persistent reduction of government debt". In addition, all euro area Member States were recommended to "continue pursuing budgetary consolidation towards their medium-term objectives in line with the Stability and Growth Pact, hence striving to achieve an annual structural adjustment of at least 0.5 % of GDP as a benchmark" and "to improve the quality of public finances by reviewing

² The entire statement can be found at:
www.gouvernement.lu/salle_presse/actualite/2007/04/20pm_krecke_berlin/MTBR_EG_conclusions-finalCLEAN.rtf

³ OJ L 139, 29.5.2008, p. 59.

public expenditures and taxation, and by modernising public administration, with the intention to enhance productivity and innovation, thereby contributing to economic growth, employment and fiscal sustainability”.

2.4. The Commission assessment of the October 2007 implementation report of the national reform programme

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Belgium’s national reform programme⁴ and is summarised as follows.

Belgium’s national reform programme identifies as key 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 strengthening the synergies between environmental protection and growth. The Commission's assessment is that Belgium has made good progress in implementing its national reform programme over the 2005-2007 period, despite some slowdown in the pace of reforms in 2007.

Against the background of the strengths and weaknesses identified and the evidence on progress made, the Commission recommended that Belgium was recommended to give highest priority to the challenges in the areas of the high tax-burden on labour, whilst strengthening fiscal consolidation and improving labour market performance.

In addition, Belgium should also focus on the areas of: long term sustainability of public finances; the competition in gas and electricity markets; R&D and innovation performance; and the employment rate for older workers and vulnerable groups.

Based on the Commission Strategic Report, the Council adopted on 14 May 2008 recommendations on the 2008 update of the broad guidelines for the economic policies of the Member States, including Belgium.

⁴ Communication from the Commission to the European Council, “Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)” - COM(2007) 803, 11.12.2007.

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' spring 2008 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

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 sustainability⁵;
- the degree of consistency with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs, and its October 2007 implementation report. 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 conduct⁶, which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

⁵ 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.

⁶ "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.

Recommendation for a

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On the updated stability programme of Belgium, 2007-2011

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 policies⁷, 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 [8 July 2008] the Council examined the updated stability programme of Belgium, which covers the period 2007 to 2011⁸.
- (2) Over the last 10 years, real GDP has grown by some 2¼% on average, slightly above the average growth rate in the euro area. This relatively high GDP growth led to a decline in the unemployment rate, while the employment rate (especially of the younger and older workers) and the hours worked remain low, reflecting high labour taxation and labour market rigidities, low job search requirements and a low effective retirement age. The budget has been hovering around a balanced position since 2000 (except in 2005), and the debt ratio, which had fallen from 134% of GDP in 1993 to 108% of GDP in 2000, continued its impressive decline and is now below 85% of GDP. Increasing the employment rate, together with ambitious budgetary positions, would contribute to the long-term sustainability of public finances.
- (3) The macroeconomic scenario underlying the programme projects real GDP growth to fall from 2.8% in 2007 to 1.9% in 2008 and stabilise around 2% in the following

⁷ 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://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

⁸ The update was submitted once a government with full powers had been installed, thus well beyond the 1 December deadline set in the code of conduct.

years. Assessed against currently available information⁹, the scenario for 2008 and 2009 appears to be based on favourable growth assumptions given the deteriorated external environment and higher inflation since the projections included in the programme were finalised. Growth assumptions for 2010-2011 are broadly plausible. The programme update expects inflation to rise to 3.0% in 2008, and to slow down to 1¾% over the period 2009-2011. The programme's inflation projections for 2008-2009 appear to be on the low side in view of the marked rise in commodity and processed food prices in recent months. Furthermore, the employment growth projections of around 1% *per annum* in the programme update appear to be relatively high in view of below-potential GDP growth throughout the programme period. While the programme's wage growth projections are on the low side for 2008, they appear high for the following years (3¼ - 3½ %), especially compared to the projected low inflation rate.

- (4) For 2007, the general government deficit was 0.2% of GDP, against a surplus target of 0.3% of GDP set in the previous update of the stability programme. The worse outturn in 2007 was due to higher expenditure growth than planned which was only partly offset by a small positive base effect from a better-than-expected outcome in 2006 and a positive revenue growth surprise. Higher-than-planned expenditure reflected, in particular, a strong increase in subsidies paid to companies under the service voucher scheme and a lower-than-expected impact of one-off measures. The revenue surprise resulted chiefly from higher-than-expected social contributions and occurred in spite of the non-implementation of a number of planned revenue-increasing one-offs. The budgetary implementation in 2007 was thus not fully in line with the invitation in the Council opinion of 27 March 2007 on the previous update of the stability programme¹⁰ and with the April 2007 Eurogroup orientations for budgetary policies, since unexpected extra revenue was used for higher-than-budgeted expenditure.
- (5) The main goal of the medium-term budgetary strategy in the programme is to ensure a continuous reduction of the still high debt ratio of close to 85% of GDP in 2007 to around 71% of GDP in 2011 through a gradual build-up of headline budgetary surpluses to 1% of GDP in 2011, starting from a balanced budget in 2008. The primary surplus, which has been decreasing since 2001 (from 7.0% to 3.7% of GDP in 2007) in parallel to the progress in debt reduction, is projected to increase to 4.4% of GDP by 2011. As a result of the worse-than-expected outturn in 2007, the budgetary targets (both in nominal and structural terms) are below the ones in the previous update throughout the programme period. The structural balance, calculated according to the commonly agreed methodology, is expected to improve from a deficit of ¼% of GDP in 2007 to a surplus of almost 1½% of GDP in 2011. Compared to what was envisaged in the previous update of the stability programme, the achievement of the medium-term objective (MTO) - a surplus of 0.5% of GDP in structural terms (i.e. in cyclically-adjusted terms net of one-off and other temporary measures) - is delayed by one year to 2009. The adjustment takes place on both the expenditure and revenue side. The planned expenditure reduction of 0.7 percentage point of GDP in nominal terms is attributable chiefly to a fall in interest expenditure which results from the projected decline in the debt ratio. The revenue increase amounts to 0.5% of GDP and

⁹ The assessment takes notably into account the Commission services' spring 2008 forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

¹⁰ OJ C 89, 24.4.2007, p. 2.

follows from the expected growth of tax bases. In contrast to the previous update, the programme explicitly foresees no further recourse to one-off measures after 2008.

- (6) The budgetary outcomes could be worse than projected in the programme. First, the macroeconomic environment could be worse than projected in the programme update, especially in 2008 and 2009. In particular, the favourable assumptions regarding employment, wage and consumption growth may have led to an overestimation of tax revenue. In addition, the expected overall tax elasticity seems on the high side in 2008. Regarding primary expenditure, the programme does not include measures that seem necessary to achieve the planned adjustment in a context of rising ageing-related costs and relatively strong projected wage increases. Moreover, excluding the reduction in interest expenditure, the composition of the adjustment is geared strongly to the revenue side, possibly reducing the sustainability of the adjustment. Finally, whilst the budget remained broadly in balance over the last years, the achievement of the aimed-for budget surpluses was postponed. In spite of the good macroeconomic conditions in 2007, the budgetary target was not reached in the absence of a government with full powers following the federal elections in June. In 2008, further measures seem necessary to achieve the target. In view of the risks to the macro-economic outlook and the budgetary targets mentioned above, the development of the debt ratio is likely to be somewhat less favourable than projected in the programme, although the debt remains on a firm downward path.
- (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 2009, as envisaged in the programme. However, a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal cyclical fluctuations will be provided throughout the programme period. The pace of adjustment towards the MTO implied by the programme should be strengthened in 2008 by implementing additional structural budgetary measures in the context of the planned budget control exercise in order to ensure that the objective of a balanced budget is met. In 2009, it should be backed up by measures, in particular on the expenditure side, to be in line with the 0.5 % of GDP benchmark improvement specified in the Stability and Growth Pact and to reach the MTO as planned. The Council also notes that the budgetary plans for 2008 are not fully consistent with the April 2007 Eurogroup orientations for budgetary policies. Although the debt ratio may decrease less than projected in the programme, it seems to be sufficiently diminishing towards the reference value over the programme period.
- (8) Belgium appears to be at medium risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is above the EU-27 average, influenced notably by a relatively high increase in pension expenditure as a share of GDP over the coming decades. The effective retirement age in Belgium is one of the lowest in the EU, and raising it is the aim of the Generation Pact which brought a number of changes to the pension system. Although this represents a step in the right direction, national projections show that this reform would not reduce the sustainability gaps. The budgetary position in 2007 as estimated in the programme, though slightly worse than the starting position of the previous programme, contributes to offsetting the projected long-term budgetary impact of population ageing but is not sufficient to fully offset future spending pressures. Maintaining high primary surpluses over the medium term, bringing the debt ratio below the Treaty reference value and implementing further measures aimed at addressing the substantial

increase in age-related expenditure would contribute to reducing risks to the sustainability of public finances.

- (9) The stability programme seems to be consistent to some extent with the October 2007 implementation report of the national reform programme. In particular, both reports consider the sustainability of public finances in light of population ageing as a key challenge for the Belgium economy. The stability programme however does not contain a qualitative assessment of the overall impact of the October 2007 implementation report of the national reform programme within the medium-term fiscal strategy nor systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme. On the other hand, the budgetary projections of the programme seem to take into account the public finance implications of the actions already implemented on the basis of the national reform programme.
- (10) The budgetary strategy in the programme is broadly consistent with the country-specific broad economic policy guidelines included in the integrated guidelines and the guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy.
- (11) 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 data¹¹.

The overall conclusion is that, after an impressive reduction in the debt ratio since 1993 to 85% in 2007, the programme envisages a continued and rapid reduction through a gradual build-up of headline surpluses following the budgetary deterioration in 2007. The budgetary consolidation mainly builds upon a reduction in interest expenditure and an increase in tax revenue, while efforts on primary expenditure remain small. There are risks to the achievement of the budgetary targets particularly in view of the relatively favourable underlying macroeconomic assumptions and the fact that the programme does not specify measures which seem required to meet the targets. The adjustment to the MTO in 2008 does not appear to be sufficient and it seems unlikely that the MTO will be met in 2009, as planned, in the absence of additional measures.

In view of the above assessment and also in the light of the April 2007 Eurogroup orientations for fiscal policies Belgium is invited to:

- (i) ensure that the objective of a balanced budget is met in 2008 and the MTO is obtained in 2009 by carrying out the benchmark adjustment in structural terms of 0.5% of GDP, including through the implementation of additional structural measures, in particular on the expenditure side;
- (ii) in the light of the still high level of debt and the projected increase in age-related expenditure, continue addressing the long-term sustainability of public finances by achieving high structural primary surpluses as well as by implementing reforms to increase the employment rate and potential growth and to reduce the budgetary cost of ageing.

¹¹ In particular, the data on the sectoral balances are not provided.

Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010	2011
Real GDP (% change)	SP Apr 2008	2.8	2.7	1.9	2.0	2.0	2.0
	COM Apr 2008	2.8	2.7	1.7	1.5	n.a.	n.a.
	SP Dec 2006	2.7	2.2	2.1	2.2	2.2	n.a.
HICP inflation (%)	SP Apr 2008	2.3	1.8	3.0	1.7	1.8	1.8
	COM Apr 2008	2.3	1.8	3.6	2.3	n.a.	n.a.
	SP Dec 2006	2.4	1.9	1.8	1.8	1.9	n.a.
Output gap ¹ (% of potential GDP)	SP Apr 2008	0.1	0.3	-0.1	-0.4	-0.5	-0.8
	COM Apr 2008 ²	0.1	0.3	-0.3	-1.0	n.a.	n.a.
	SP Dec 2006	-0.3	-0.4	-0.4	-0.4	-0.3	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	SP Apr 2008	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	COM Apr 2008	3.4	3.2	2.6	2.4	n.a.	n.a.
	SP Dec 2006	2.0	2.0	2.2	2.4	2.7	n.a.
General government balance (% of GDP)	SP Apr 2008	0.3	-0.2	0.0	0.3	0.7	1.0
	COM Apr 2008	0.3	-0.2	-0.4	-0.6	n.a.	n.a.
	SP Dec 2006	0.0	0.3	0.5	0.7	0.9	n.a.
Primary balance (% of GDP)	SP Apr 2008	4.3	3.7	3.7	3.8	4.1	4.3
	COM Apr 2008	4.3	3.7	3.3	2.9	n.a.	n.a.
	SP Dec 2006	4.1	4.2	4.1	4.1	4.2	n.a.
Cyclically-adjusted balance ¹ (% of GDP)	SP Apr 2008	0.3	-0.4	0.0	0.5	1.0	1.4
	COM Apr 2008	0.3	-0.3	-0.2	-0.1	n.a.	n.a.
	SP Dec 2006	0.2	0.5	0.7	0.9	1.1	n.a.
Structural balance ³ (% of GDP)	SP Apr 2008	-0.4	-0.3	0.0	0.5	1.0	1.4
	COM Apr 2008	-0.6	-0.3	-0.2	-0.1	n.a.	n.a.
	SP Dec 2006 ⁴	-0.4	0.1	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	SP Apr 2008	88.2	84.9	81.5	78.1	74.7	71.1
	COM Apr 2008	88.2	84.9	81.9	79.9	n.a.	n.a.
	SP Dec 2006	87.7	83.9	80.4	76.6	72.6	n.a.

Notes:

¹ Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

² Based on estimated potential growth of 2.5%, 2.5%, 2.2% and 2.2% respectively in the period 2006-2009.

³ Cyclically-adjusted balance excluding one-off and other temporary measures. According to the most recent programme, one-off and other temporary measures are deficit-reducing for 0.7% of GDP in 2006 and deficit-increasing for 0.1% of GDP in 2007. According to the Commission services' spring forecast, one-off and other temporary measures are deficit-reducing for 0.9% of GDP in 2006 and deficit-increasing for 0.1% in 2007.

⁴ The December 2006 update of the stability programme did not provide information on the use of one-off measures in the years 2008 to 2010.

Source:

Stability programme (SP); Commission services' spring 2008 economic forecasts (COM); Commission services' calculations