Stability programme 2009-2013 complement

Introduction

This complement to Belgium's stability programme follows the stability programme submitted in April 2009. It was produced in response to the request from the Council of the European Union which, in its Council opinion on the updated stability programme of Belgium, 2008-2013, explicitly asked for a stability programme complement by 20 September 2009:

"Belgium is invited to submit, by 20 September at the latest, a complement of the programme including a well founded medium-term budgetary strategy and improve compliance with the data requirements of the code of conduct especially regarding compulsory data".

This complement adjusts the path of Belgian public finances in line with the recent macro-economic parameters, providing more data to support the budget targets specified. The government defined this path on the basis of the latest macro-economic forecasts, and was guided by the opinion requested in preparation for this complement from the High Council of Finance's Public Sector Borrowing Requirement section. According to the Public Sector Borrowing Requirement section, the general government deficit in 2009 will increase to 5.9% of GDP. Owing to the internal dynamics of interest charges and rising expenditure due to population ageing, a growth revival is not sufficient to reduce the deficit. In the medium term the deficit is predicted to increase further to over 7% of GDP.

As recommended by the Ecofin Council, Belgium aims to seize the modest growth recovery in 2010 to start consolidating its public finances, and the effort will be stepped up in subsequent years. In the short term, namely for 2010 and 2011, the government aims to improve the primary balance by 0.5 and 1% of GDP respectively. The target improvement for the ensuing years is set at 1.3% of GDP a year. On the basis of the assumptions made, this strategy should reduce the deficit from 2013 onwards to less than 3% of GDP, restoring a balanced budget in 2015.

The broad outline described here will be elaborated further during preparation of the multi-annual budget for 2010-2011. More details could therefore be available in the next stability programme which, according to the Commission's instructions, is to be submitted by the end of January 2010.

Macro-economic assumptions

The real GDP growth estimates were repeatedly revised during 2009. Up to the third quarter, the estimates were downgraded, but the trend has now been reversed and the prospects are being revised upwards. At present the outlook seems to be stabilising, but it should be noted that the prospects remain uncertain and that there is some divergence between the forecasts made by different institutions.

For the purpose of the stability programme complement, the outlook taken from the September economic forecast (2009-2011) issued by the National Accounts Institute was combined with the Federal Planning Bureau's May projections (2012-2014) and the estimate of the Study Committee on Ageing (2015).

International economic activity has stabilised sooner than expected. However, great uncertainty persists over the strength of the recovery, partly owing to the vulnerability of the financial system. The outlook presented in the economic forecast is based on a modest economic growth recovery in the euro area from the second half of 2009. In 2010, that should produce growth of 0.8%, with growth continuing to strengthen to 1.8% in 2011.

Table 1:

Belgian GDP growth forecasts

in %	2009	2010	2011	2012	2013	2014	2015
Stability programme (2009-2013)	-1,9	0,6	2,3	2,3	2,1		
European Commission forecast (May 2009)	-3,5	-0,2					
Stability programme complement	-3,1	0,4	1,9	2,4	2,2	2,2	2,1

The Belgian economy keeps closely in step with the economy of the euro area. The final quarter of 2008 and the first quarter of 2009 brought a sharp fall in economic activity (down by 1.7% per quarter). In the second quarter of 2009 the decline was limited to 0.3%. In the second half of 2009, growth is set to become slightly positive, driven mainly by exports. In 2010, economic growth should strengthen further as a result of a revival in private consumption and investment. The current assumption for Belgium is that the economy will contract by 3.1% in 2009, with GDP growing by 0.4% in 2010 (compared to respective figures of -1.9% and 0.6% in the April stability programme). The current forecasts are slightly better than those of the European Commission's Spring Forecast in May, which predicted a contraction of 3.5% in 2009 and 0.2% in 2010.

Table 2:

Detailed medium-term macro-economic projections

% change unless otherwise stated	2007 billions	2007	2008	2009	2010	2011	2012
1. Real GDP	288,7	2,8	1,1	-3,1	0,4	1,9	2,4
2. Nominal GDP	334,9	5,2	2,8	-2,2	1,8	3,7	4,1
	Components of real GDP						
3. Private consumption expenditure	149,1	2,1	0,9	-0,9	0,6	1,9	1,8
4. Government consumption expenditure	60,5	2,3	2,3	1,9	1,4	1,7	2,1
5. Gross fixed capital formation	65	6,2	5,5	-3,9	-1,5	3,1	3
6. Changes in inventories and net acquisition of valuables	-						
7. Exports of goods and services	263,5	4	2,2	-15,1	1,5	4,1	4,9
8. Imports of goods and services	253,8	4,6	3,3	-13,7	1,4	4,4	4,6
	Contribution to real GDP growth						
9. Final domestic demand	-						
10. Changes in inventories and net acquisition of valuables	-	0,3	-0,2	-0,9	0,0	0,0	
11. External balance of goods and services	-	-0,4	-0,9	-1,2	0,1	-0,3	

Since wage indexation in 2009 still to some extent reflects last year's high inflation, the real disposable income of households increases in 2009 from a macro-economic perspective, despite the fall in employment. Nevertheless, households are restraining their expenditure, primarily because of the negative economic climate and the banking crisis. Private consumption is therefore expected to fall by 0.9% in 2009, with a rise in the savings ratio. In 2010 private consumption is projected to pick up slightly (0.6%) with normal growth restored in 2011 (1.9% growth in 2011 and 1.8% in 2012) thanks to rising employment, wage increases and higher capital incomes.

In contrast, investment is forecast to fall sharply in 2009 (-3.9%). Weak demand has led to excess capacity, and credit terms have become more stringent. The investment climate is only expected to revive gradually from mid 2010, as a result of better sales prospects. For 2010 as a whole, investment is projected to fall by 1.5%. A year-on-year increase in investment is not expected until 2011 (with a rise of 3.1% in 2011 and 3.0% in 2012).

In the fourth quarter of 2008 and the first quarter of 2009, exports contracted sharply in line with foreign markets. In the second half of the year, the export volume is expected to show a slight recovery. Year-on-year, exports are likely to be 15% down. Imports also declined sharply in 2009 as a result of lower domestic demand and falling exports. Imports should similarly see a gradual recovery in 2010 and 2011 as economic activity picks up. However, imports declined less sharply than exports in 2009, and will expand more strongly than exports from 2010, so that the trade balance will continue to deteriorate.

Table 3:

Medium-term projection for prices

% change	2007 (2000=100)	2007	2008	2009	2010	2011	2012
1. GDP deflator	116,0	2,4	1,7	0,9	1,4	1,8	1,7
2. Private consumption deflator	117,4	2,8	4,3	-0,1	1,5	1,6	1,6
3. HICP	114,9	1,8	4,5	0,0	1,5	1,6	1,6
4. Public consumption deflator	122,9	1,8	4,7	3,3	1,2	2,2	1,9
5. Investment deflator	111,6	2,2	2,3	-1,2	2,7	2,1	1,2
6. Export price deflator (goods and services)	112,9	3,0	4,3	-2,8	0,8	1,8	1,5
7. Import price deflator (goods and services)	113,1	2,6	7,3	-4,1	1,3	1,8	1,5

In regard to prices, zero inflation is expected for 2009. These exceptionally low inflation figures are due to the movement in oil prices, leading to negative year-on-year inflation from May to October 2009 (the health index disregards petrol and diesel prices and will therefore be less influenced by this development). For other goods and services, inflation remains positive but low owing to the economic slowdown and the transmission of lower energy prices in the prices of other goods and services. From 2010, rising oil prices are likely to restore a more normal inflation level of 1.5% in 2010 and 1.6% in 2011 in 2012 on an annual basis.

According to the projections, the GDP deflator will be 0.9% in 2009 and 1.4% in 2010, subsequently reverting to a normal level. All components of the price level are down in 2009, with a gradual return to normal predicted from 2010.

On the labour market, employment is expected to contract by 0.8% in 2009. This fall is much less marked than the decline in economic activity, since temporary lay-offs and working time reduction schemes cope with part of the fall in demand. It is only subsequently that firms adjust the size of their workforce. Domestic employment therefore did not start to decline until the first quarter of 2009. However, these dynamics mean that employment will continue to decline by 1.3% in 2010. A modest recovery in employment (+0.4%) is not expected until 2011. The harmonised Eurostat unemployment rate is projected to rise from 7% in 2008 to 9.6% in 2011.

The overall balance and the public debt

A deficit of 5.9% in 2009

Pending the publication of the final public accounts for 2008, the March NAI estimate is used, namely a deficit of 1.2% of GDP. For 2009, a deficit of 5.9% of GDP is now projected. Of course, this marked deterioration in the budget balance must be viewed in the macro-economic context. As already stated in section 1, the Belgian economy is forecast to contract by 3.1% in 2009. In line with the European Economic Recovery Plan, the Belgian government decided to launch an economic recovery plan providing targeted support for economic activity but limited in scale owing to the meagre scope offered by public finances. The impact of these plans on public finances can be estimated at a good 1% of GDP in 2009. In addition, the government has allowed the automatic stabilisers to operate to the full in order to further stabilise the economy. The impact of the crisis is therefore reflected via the automatic stabilisers in the government's overall balance. The economic crisis is most strongly felt in a steep rise in unemployment expenditure and a marked contraction in tax revenues (especially withholding tax on dividends and corporation tax).

A further deterioration in public finances under an unchanged policy

In preparing this complement to the stability programme for 2009-2012, the government based its work on the advice of the Public Sector Borrowing Requirement section of the High Council of Finance[1]. Owing to the expanding deficits in 2009-2010, a recurrence of the interest payment snowball effect is expected from 2010. If there is no change of policy, this will drive up the debt ratio and exert pressure on the structural deficits. Under an unchanged policy, the combined effect of rising interest charges and increasing social expenditure resulting from population ageing imply that a growth revival will not be enough to reverse the negative trend in public finances. If growth returns to normal from 2011, the

[1] Short and medium term budget paths for the amended stability programme 2009-2012, September 2009

budget deficit will continue to rise to over 7% of GDP (7.4% in 2015). This finding of the Borrowing Requirement section formed the starting point for the government in outlining an adjusted scenario for public revenues.

Balance restored in 2015

The government endorses the path described by the Borrowing Requirement section for the restoration of a balanced general government budget by 2015. The scenario depicted assumes that the fragile recovery in 2010 is not snuffed out. That is in line with the recommendations of most international institutions for Belgium and the euro area. The path is based on a progressive increase in the impact of the measures, as it takes a while for many of them to become fully operational, while others produce a cumulative effect. This scenario assumes that the efforts of the various levels of government will contribute 0.5% of GDP in 2010 and 1% in 2011, making a cumulative structural effort of 1.5% for 2010-2011, and 1.3% in each of the ensuing years.

The government considers that the path outlined fully complies with the request made in the assessment of the stability programme 2009-2013, calling for resumption of the consolidation of public finances and more vigorous structural efforts from 2011. Public finances will be brought back into line with the requirements of the stability and growth pact within a reasonable period of time. In 2013 the deficit will subside below the 3% limit. The restoration of balance is a key condition for the sustainability of public finances in the longer term. The decline in interest charges resulting from the restoration of a balanced budget could ultimately be used to meet part of the cost of population ageing.

Table 4

Targets for the overall balance

in % of GDP	2009	2010	2011	2012	2013	2014	2015
Overall balance	-5,9	-6,0	-5,5	-4,4	-2,8	-1,3	0,0
Entity I	-4,9	-4,5	-4,4	-3,7			
Entity II	-1,0	-1,5	-1,1	-0,7			
	Effort at primary balance level						
Effort	0,0	0,5	1,0	1,3	1,3	1,3	1,3
Cumulative effort	0,0	0,5	1,5	2,8	4,1	5,4	6,7

This path is valid on the basis of the growth assumptions made. Table 4 shows the targets and predictions for the general government balance on the basis of the growth estimate used.

In regard to Belgium's public finances, it is important to lay down clear arrangements on the allocation of the effort among the various divisions of government. In its recommendation, the Borrowing Requirement section outlined various ways in which the effort could be spread across the various entities. The figures do not pre-judge the future allocation of the efforts to be incorporated in the multi-annual budget 2010-2011 and the ensuing fiscal cooperation agreement with the various entities composing the federal state. However, the paths set out in the various government agreements do facilitate that objective.

A scenario up to 2012

Table 5 reiterates the general government budget balance to which the Belgian government is clearly committed. The detailed figures for both the balances of the various subsectors and the underlying movement in revenue and expenditure have the status of estimates and are intended mainly as a guide.

Table 5

General government budget outlook

	In % of GDP (unless otherwise stated)	2008 level	2008	2009	2010	2011	2012
		Net lending by sub-sector					
1.	General government	-4.123	-1,2	-5,9	-6,0	-5,5	-4,4
2.	Central government	-5.752	-1,7	-3,9	-4,0	-4,1	-3,7
3.	State government	-88	0,0	-0,5	-1,1	-0,9	-0,5
4.	Local government	-119	0,0	-0,5	-0,4	-0,2	-0,2
5.	Social security funds	1.837	0,5	-1,0	-0,5	-0,3	0,0
		General government					
6.	Total revenue	*167.690*	*48,7*	*47,9*	*48,1*	*48,5*	*49,2*
7.	Total expenditure	*171.813*	*49,9*	*53,8*	*54,1*	*53,9*	*53,6*
8.	Net lending/borrowing	*-4.123*	*-1,2*	*-5,9*	*-6,0*	*-5,4*	*-4,4*
9.	Interest expenditure	*12.837*	*3,7*	*3,9*	*4,1*	*4,2*	*4,3*
10.	Primary balance	*8.715*	*2,5*	*-2,0*	*-1,9*	*-1,2*	*-0,1*
11.	One-off and other temporary measures	*0*	*0,0*	*0,0*	*0,0*	*0,0*	*0,0*
		Selected components of revenu					
12.	Total taxes	*102.430*	*29,8*	*28,5*	*28,7*	*29,1*	*29,4*
12a.	Taxes on production and imports	*43.170*	*12,5*	*12,3*	*12,5*	*12,4*	*12,4*
12b.	Current taxes on income, wealth, etc	*56.882*	*16,5*	*15,5*	*15,6*	*16,0*	*16,3*
12c.	Capital taxes	*2.378*	*0,7*	*0,7*	*0,7*	*0,7*	*0,7*
13.	Social contributions	*55.702*	*16,2*	*16,4*	*16,2*	*16,2*	*16,3*
14.	Property income	*2.485*	*0,7*	*0,8*	*0,8*	*0,8*	*0,9*
15.	Other	*7.072*	*2,1*	*2,2*	*2,3*	*2,4*	*2,5*
16.	Total revenue	*167.690*	*48,7*	*47,9*	*48,1*	*48,5*	*49,2*
p.m.	Tax burden	*160.413*	*46,6*	*44,9*	*45,0*	*45,3*	*45,7*
		Selected components of expenditure					
17.	Compensation of employees + intermediate consumption	*54.354*	*15,8*	*16,6*	*16,5*	*16,3*	*15,9*
18.	Social payments	*80.045*	*23,3*	*25,2*	*25,6*	*25,6*	*25,6*
19.	Interest expenditure	*12.837*	*3,7*	*3,9*	*4,1*	*4,2*	*4,3*
20.	Subsidies	*7.285*	*2,1*	*2,3*	*2,6*	*2,5*	*2,4*
21.	Gross fixed capital formation	*5.623*	*1,6*	*1,8*	*1,7*	*1,9*	*1,9*
22.	Other	*11.668*	*3,4*	*4,0*	*3,6*	*3,5*	*3,4*
23.	Total expenditure	*171.813*	*49,9*	*53,8*	*54,1*	*53,9*	*53,6*
p.m.	Primary expenditure	*158.975*	*46,2*	*49,9*	*50,0*	*49,7*	*49,2*

At various levels of government, work on the preparation of the budgets for next year and subsequent years is well under way. The federal government has ended the traditional one-year approach to this exercise, and will produce a multi-annual budget for 2010-2011. This means that the exact distribution of the effort across revenue and expenditure and within each specific category cannot be stated until this exercise has been completed. More details will therefore be available in the next stability programme which – according to the Commission’s guidelines – is to be submitted at the end of January 2010.

This plan reflects the Government’s desire to ensure a financial balance in social security, without prejudging the way in which that aim is to be achieved partly by the reinforcement of social security funding and partly by the effort to be made by the social security institutions themselves.

Obviously, in view of the scale of the effort, it will have to be spread across revenue and expenditure. During the detailed planning, the measures to be taken will be tested for their impact on sustainable economic growth. Apart from anticipating the measures to be taken in relation to the budget figures, the increase in tax revenue shown in the table reflects on the one hand the restoration of normality for revenue categories hard hit by the economic crisis (withholding tax on dividends, corporation tax), and on the other hand the spontaneous revenue growth under an unchanged policy, and the broadening of the tax base via the activation policy.

On the expenditure side, the attainment of the target presumes a thrifty policy. In addition, expenditure will decline as a % of GDP as a result of a cyclical upturn and the employment promotion policy. Attainment of the path described for public finances will go hand in hand with a structural policy which, in line with the Lisbon strategy, aims to create stronger, sustainable economic growth and a higher rate of activity.

Change in the debt ratio

The continuous decline in the debt ratio from 1994 onwards was halted in 2008 owing to the impact of the measures to support the financial sector.[2] The debt ratio increased from 84% in 2007 to 89.7% in 2008.

[2] Their impact on the debt ratio amounted to 6.4% of GDP.

Table 6

Change in the general government debt

	% of GDP	2008	2009	2010	2011	2012	2013	2014	2015
1.	Gross debt	89,7	97,5	101,9	103,9	104,3	103,4	101,0	97,4
2.	Change in gross debt ratio	5,7	7,8	4,5	1,9	0,5	-1,0	-2,4	-3,5
		Contributions to changes in gross debt							
3.	Primary balance	2,5	-2,0	-1,9	-1,2	-0,1	1,7	3,2	4,5
4.	Interest expenditure	3,7	3,9	4,1	4,2	4,3	4,5	4,5	4,5
5.	Exogenous factors influencing debt ratio	6,8	-0,1	0,2	0,2	0,2	0,2	0,2	0,2
6.	Endogenous factors influencing debt ratio	-1,1	7,9	4,3	1,7	0,3	-1,2	-2,6	-3,7
	p.m. Implicit interest rate on debt	4,6	4,2	4,2	4,3	4,3	4,5	4,5	4,6

The steep rise in the debt ratio in 2009 shows the combined effect of the estimated deficit (5.9% of GDP) and the fall in nominal GDP (-2.2%). Account was taken of the Flemish government's move to strengthen the core capital of the KBC group by 3.5 billion euro and the loan of 0.2 billion euro granted by the federal government for the restructuring of Kaupthing Bank Luxemburg. The adverse impact on the debt is more than offset by the repayment of State aid granted last year in the sum of 4.6 billion euro to the Federal government. For 2009, the debt ratio is estimated at 97.5% with a marked endogenous deterioration.

In the path mapped out, under the assumptions adopted the debt ratio will rise further to 104.2% in 2012. It is not until 2013 that endogenous factors will again contribute to a decline in the debt ratio. Their impact rises from 1.1% to 3.7%. As is usual for the stability programmes, an average exogenous deterioration in the debt ratio of 0.2% is taken into account for 2010. Any proceeds from the sale of assets acquired for the purpose of combating the financial crisis are therefore disregarded.

From 2015 the debt ratio will drop back below 100% of GDP.

Ageing

In its June 2009 report, the Study Committee on Ageing assessed the budgetary cost of population ageing at 8.2 % of GDP over the period 2008-2060. That cost had been estimated at 6.3 % of GDP over the period 2007-2050 in the Study Committee's previous report.

Table 7

Budgetary cost of ageing

In % of GDP	2008	2014	2030	2050	2060	2008-2014	2008-2060
Pension expenditure	9,1	10,3	13,3	14,4	14,4	1,2	5,3
Health care	7,3	8,6	9,5	11,2	11,5	1,3	4,2
Other social security expenditure	6,8	7,6	6,2	5,6	5,4	0,8	-1,4
of which:							
Disability	1,3	1,5	1,4	1,3	1,3	0,1	0,0
Unemployment	1,9	2,3	1,5	1,2	1,2	0,4	-0,7
Early retirement	0,4	0,5	0,3	0,3	0,3	0,0	-0,1
Family allowance	1,6	1,6	1,4	1,3	1,2	0,0	-0,4
Other social expenditure	1,6	1,7	1,6	1,5	1,4	0,1	-0,2
Social security expenditure	23,2	26,4	29,0	31,1	31,3	3,2	8,2
P.m. personnel expenditure for education	3,9	4,0	3,9	3,8	3,8	0,1	-0,1

Three factors may explain this upward revision. First, the impact of the economic and financial crisis on GDP has added 1.2% of GDP to the cost of ageing. Next, the downgrading of the assumption regarding long-term annual productivity growth (from 1.75 % to 1.50 %) in the reference scenario puts up this cost by another 0.9% of GDP. That assumption takes account of the uncertainty over the economic outlook and corresponds to the average of the productivity gains recorded over the past 30 years. Finally, the extension of the projection period explains an additional rise of 0.2 % of GDP.

Over the period 2008-2014, the cost of ageing should come to 3.2 % of GDP, or 2.1% of GDP more than in the previous projections. The extra cost occurs in the period 2008-2010, mainly because of a denominator effect due to the weaker GDP growth in the context of the economic crisis.

This rise in the budgetary cost of ageing makes it more necessary than ever to pursue a multidimensional strategy to absorb that cost. In that connection, two sensitivity studies were conducted to measure the budgetary impact of changes in the reference scenario parameters and thus to outline possible ways of limiting the cost of ageing. Those parameters concern, on the one hand, the adjustment of benefits in line with prosperity, and on the other hand, the movement in the employment rate.

The cost of ageing is reduced by 0.9 % of GDP if the calculation of the parameters for adjustment in line with prosperity takes better account of the assumption concerning the actual movement in wages. That decline is particularly noticeable at the level of pension expenditure, since the smaller adjustment in line with prosperity concerns a large number of pensioners. However, the Study Committee on Ageing does emphasise the social impact of such a policy, caused by the decline in the benefit ratio (ratio between average pensions and corresponding average wages).

If the employment rate of the over 55s rises to the average recorded in the Scandinavian countries in 2008 (namely an increase of 14 percentage points), the cost of ageing falls by 1.2 % of GDP. In that scenario, the decline in the structural unemployment rate triggers more sustained economic growth and consequently a broader economic base.

In addition, alternative scenarios have been developed for the assumption of long-term annual productivity growth, put at 1.5 % in the reference scenario. If productivity growth is weaker at 1.25%, the cost of ageing increases by 1.2% of GDP, whereas that cost falls by 1.2% of GDP if productivity growth equals 1.75%.

Annex : Macroeconomic projections up to 2015

	2009	2010	2011	2012	2013	2014	2015
GDP							
Real growth (in %)	-3,1	0,4	1,9	2,4	2,2	2,2	2,1
GDP deflator (in%)	0,9	1,4	1,8	1,7	1,7	1,7	1,7
Nominal growth (in %)	-2,2	1,8	3,7	4,1	3,9	3,9	3,8
Nominal GDP (in EUR billions)	336,6	342,6	355,4	370,1	384,7	399,8	415,1
Inflation							
Consumer price index (in %)	0,0	1,5	1,6	1,6	1,7	1,7	1,7