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BELGIUM: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE APRIL 2009 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term budgetary programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not.

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 (DG ECFIN) of the European Commission, was finalised on 24 June 2009. Comments should be sent to Pim Lescrauwaet who worked on the assessment in Dir. G (Pim.Lescrauwaet@ec.europa.eu). The main aim of the 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.

The analysis takes into account (i) the Commission services' Spring 2009 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. Technical issues are explained in an accompanying methodological paper prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 24 June 2009. The ECOFIN Council adopted its opinion on the programme on 7 July 2009.

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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

1. INTRODUCTION

This document assesses the April 2009 update of Belgium's stability programme. The programme was submitted with a substantial delay with respect to the 1 December 2008 deadline stated in the Code of Conduct, which was for this round of programmes extended to end of December to allow the Member States to incorporate i.a. the impact of their recovery measures. The federal government, which has been reshuffled around year-end 2008, chose to submit a programme including an updated budget for 2009 in view of the rapid deterioration of the economic environment since the adoption of the initial budget at the end of 2008, also including the recovery measures that the federal government announced on 11 December.

The programme, which was submitted on 6 April 2009, covers the period 2008-2013 and builds on the amended budget law for 2009. It was approved by the government on 3 April. The programme includes a description of the measures adopted by the Belgian government in response to the economic downturn and the budgetary projections reflect the impact of the fiscal stimulus measures. As regards the data requirements specified in the code of conduct for stability and convergence programmes, the updated programme has substantial gaps in the required and optional data[1], which severely hampered the assessment of the programme, in particular as concerns the medium-term budgetary strategy.

2. MAIN CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

The Belgian economy had started losing momentum in the course of 2007 as export growth slowed down in line with weakening external demand. From the beginning of 2008, domestic demand also gradually softened as a result of the sharp increase in inflation and the loosening of labour market. In the fourth quarter, Belgium was hit hard by the economic and financial crisis and GDP contracted by 1.7% quarter-on-quarter. As a heavily export-oriented economy, with exports and imports summing up to over 180% of GDP, Belgium has been strongly affected by the fall in world demand. In addition, the impact of the crisis on the Belgian banking sector, with three large banks having received government support, also affected economic activity through confidence and wealth effects and tightened lending conditions. Overall, GDP growth in 2008 came out at 1.1%.

In the first quarter of 2009, exports further declined and the impact on domestic demand intensified, leading to a contraction of GDP of around the same size as in the previous quarter. In the subsequent quarters, taking into account the positive impact on economic activity of both the Belgian and foreign recovery packages, the fall in output is projected to slow down as the external environment should improve and the destocking process is expected to come to an end, with growth turning slightly positive only in the course of 2010. On the basis of this quarterly profile, the Commission services' spring 2009 forecast projects annual GDP to contract by 3.5% in 2009 and by 0.2% in 2010, the latter chiefly reflecting a negative carry-over from 2009.

The labour market usually reacts with a lag of about 2 quarters on changes in economic growth. As a result, the good economic performance of 2007 still contributed to the strong rise in employment (1.6%) and a fall in unemployment in 2008. However, in the last months

[1] In particular, the data on the sectoral balances and the breakdown of the budgetary targets between revenue and expenditure and among the different government tiers as from 2010 are not provided.

of 2008 the recession began to take its toll, with employment no longer increasing in the last quarter of 2008 compared to the previous one. The rise in the unemployment rate has been relatively limited as corporations have massively resorted to the system of temporary and economic unemployment (workers concerned retain their contract and thus are not included in unemployment statistics) and the reduction of overtime. Nevertheless, as the crisis becomes more protracted, a sharp increase in unemployment has to be expected, with the unemployment rate projected to rise above 10% in 2010, up from 7% in 2008.

The output gap, which amounted to a still positive 1.9% in 2008 according to the Commission services, is projected to turn negative in 2009 (-2.6%) and to further widen in 2010 (-3.8%). This profile reflects the sharp economic downturn and is based on a potential growth, which has also been revised downwards, of 1½% as estimated in the Commission services' spring 2009 forecast (on average for the period 2007-2010). Against this background, the economy seems to be in bad economic times in 2009 and 2010, as can be seen in Figure 1 in Annex 2.

Considerable risk factors still weigh on the medium-term economic outlook. In particular, domestic demand is likely to remain weak throughout 2009 and 2010. In view of the high openness of the Belgian economy, the economic recovery could however benefit from a positive impulse from external demand. However, the extent to which Belgium will be able to benefit from a rebound of the world economy may be reduced as a result of its loss of competiveness in recent years, which was due to a more rapid increase of unit labour costs, both related to a more rapid growth of wages and a more subdued increase in productivity.

In this context, key challenges to successfully exit from the current crisis include the stabilisation of financial markets, strengthening domestic demand, addressing rising unemployment, improving the competitive position, returning to a path of fiscal consolidation and re-invigorating efforts to raise potential growth through structural reforms.

According to the Commission services' calculations, Belgium has had a broadly neutral fiscal stance in 2004-2007, but the decline in interest expenditure has been used to increase primary expenditure and to cut taxes which lowered revenue. In that period, the headline balance has hovered around zero[2]. In 2008, fiscal policy was expansionary and the headline deficit increased to 1.2% of GDP, although growth remained relatively resilient up to the third quarter. According to the Commission services' spring 2009 forecast, the general government headline deficit is projected to widen to 4.5% of GDP in 2009. In addition to the impact of the automatic stabilisers, this is due to a number of discretionary measures, including the recovery package. After the finalisation of the spring forecast, it became clear that the government has to pay back corporate and personal income taxes totalling 0.5% of GDP, following two rulings by the European Court of Justice. On the other hand, the forecast also does not include the premiums the government will receive in exchange for additional guarantees provided to KBC Bank (around 0.3% of GDP). In 2010, under the usual no-policy-change scenario, the deficit is projected to reach around 6% of GDP, mainly due to the still negative economic environment, including a further decline in tax-rich items such as private consumption and employment. While the policy of achieving balanced budgets in recent years helped reduce government debt, the debt-to-GDP ratio remains very high and will again increase in the coming years as a result of rising interest costs, low nominal GDP growth and a strong deterioration of the primary balance.

[2] With the exception of 2005, when the assumption of the national railway company's debt led to a headline deficit of 2.7% of GDP.

This, in combination with the above-average budgetary impact of an ageing population (see section 5.2) and important contingent liabilities following the operations to stabilise the financial system, makes that Belgium's fiscal room for manoeuvre to cushion the impact of the economic downturn appears to be limited.

Belgium has adopted a set of measures in response to the crisis. In particular, a relatively contained fiscal stimulus has been introduced in view of the limited fiscal room for manoeuvre. It is worth mentioning that as a result of the openness of the economy, foreign packages should also contribute considerably to the recovery of the Belgian economy. The recovery package of the federal government, presented on 11 December, aims at providing (liquidity) support to corporations, ensuring the purchasing power of households, support employment and stimulate housing investment. The regional packages focus on ensuring the access to financing of corporations, in particular SMEs and start-ups, and on public investment. The packages include a number of structural measures, such as the improvement of active labour market policies, a further reduction of the tax wedge on labour and support to R&D. These measures are related to the Lisbon structural reform agenda and the country specific recommendation proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs and adopted by the Council on 28 April. In addition, the measures comprise limited incentives for green investment. About half of the fiscal measures in the recovery packages are permanent and not accompanied by future corrective measures.

Box: Measures to help stabilise the financial system

To stabilise the financial system, the Belgian government took measures, which can be divided into four categories. First, it provided capital injections to four major financial institutions, amounting to around 6% of GDP.[3] The government moreover has promised to provide, in case of need and on demand, additional capital injections into two banks, for EUR 2 billion each (1.2% of GDP in total). Second, it provided guarantees for future losses which banks may potentially incur on their portfolios of risky assets (almost 10% of GDP). Third, the government set up a scheme to guarantee, upon demand and under certain conditions, wholesale and interbank debt issued by banks. To date, one bank has applied and received a guarantee for a maximum amount of EUR 90.75 billion (26% of GDP), of which about 60% is currently used. Those guarantees will not have a negative impact on public finances unless they are called. For 2009, they will yield revenue for the government of around 0.4% of GDP as they are provided in exchange for a fee. Finally, the Belgian government offered a guarantee for all private bank deposits up to EUR 100 000 and extended it to certain insurance products, also in exchange for a fee. All these operations were successful in stabilising the financial system and may have prevented a stronger tightening of credit conditions.

3. MACROECONOMIC SCENARIO

According to the April 2009 update of the Stability Programme, GDP will contract by 1.9% in 2009 and grow by 0.6% in 2010. Once the recovery is under way, the programme expects the Belgian economy to exceed its potential growth rate. The programme does not explicitly mention whether the fiscal stimulus in response to the downturn has been included in the macroeconomic projections of the programme.

[3] In one case, existing shareholders belonging to the private sector contributed to the rescue operation for 0.3% of GDP. This amount may also be classified as state aid but does not impact upon public finances.

In comparison, the Commission services' spring 2009 forecast, published about one month after the submission of the programme update, presents a more pessimistic picture and expects GDP to decline by 3.5% in 2009 and to remain slightly negative in 2010 in spite of the gradual recovery. This takes into account the latest available information regarding the contraction in the first quarter of 2009 (1.6% q-o-q according to the flash estimate of the National Accounts Institute), the stabilisation of soft indicators at record low levels (suggesting that GDP will continue to contract in the coming months, albeit at a lower pace than in the previous quarters), as well as the fact that the international environment has further deteriorated.

Over the programme period, the output gap as recalculated by Commission services based on the information in the programme and using the commonly agreed methodology, is expected to become negative in 2009 (-1.9%) and widen further in 2010 (-2.7%), before narrowing gradually thereafter (to -0.6% in 2013). The Commission services' spring 2009 forecast shows a markedly faster and deeper decrease in the output gap, leading to a negative output gap of 3.8% in 2010.

Summing up, the programme's growth projections appear markedly favourable for the years 2009 and 2010. The macroeconomic projections in the programme can be considered favourable also for 2011 and 2012, when comparing the growth rates in the programme with the potential growth estimates (both according to the programme as recalculated by the Commission services (around 1½%) and according to the Commission services' spring 2009 forecast (around 1%)). Hence, there exist considerable downside risks to the programme scenario, related in particular to the more negative impact of confidence on consumption and investment, tighter credit conditions, wealth effects, and a sharper contraction of world trade.

Regarding the composition of growth, the programme expects final domestic demand to fall in 2009, before recovering slowly in 2010. Private consumption is expected to decline by 0.4% in 2009 and turn slightly positive (0.7%) in 2010. Business investment slowed down markedly in the second half of 2008 as a result of the deterioration in the demand outlook and tighter credit conditions. In 2009, a significant decline in investment is expected (-4.5%) and in spite of a gradual recovery, the annual growth rate would remain slightly negative in 2010 (-0.2%). Based on the assumptions made in the programme regarding the international environment, exports are set to fall by 4.5% in 2009, before increasing by 1.2% in 2010. The drop in imports (-3%) is expected to be smaller than that of exports in 2009 and should lead to a sizeable negative contribution of net exports to GDP growth. In 2010, the negative contribution of net exports would be much smaller.

The Commission services' spring 2009 forecast expects a much more negative behaviour of domestic demand in both years, with all main components (excluding government consumption) showing a stronger decline. Consumption is projected to contract by 0.7% in 2009 as confidence and wealth effects should lead to a quicker increase in the savings rate while disposable income is projected to increase much less. This is related to the more pronounced fall in employment in the Commission services' forecast as well as a more moderate increase in wages in view of the contraction of hours worked and expected lower inflation (which will limit indexation). In 2010, consumption is projected to remain negative as the further deterioration of the labour market will continue to weigh on confidence, resulting in a further increase of the savings rate. Investment is projected to fall by 6¼% in 2009 and by 2¼% in 2010, which mainly reflects a stronger fall in (world) demand, a more pronounced tightening of credit conditions as well as the deterioration of order books. Finally, the Commission services expect a more negative contribution of the change in stocks. The more pronounced contraction of domestic demand would lead to a stronger fall of imports but, given that the Commission services' forecast also projects a sharper decline in export markets,

the net contribution of net exports is of a similar magnitude as in the programme, both in 2009 and 2010.

The programme expects inflation to decline markedly to 0.7% in 2009, before picking up again to around 1¾% as from 2010. In the light of the latest developments in oil prices and the intensity of the global downturn, the programme's projections for inflation appear to be somewhat on the high side for 2009 and 2010, but can be considered realistic thereafter.

Employment trends initially showed considerable resilience in the face of the economic slowdown, but in the fourth quarter of 2008, employment creation halted and the unemployment rate started to rise. The programme expects a decline in employment of 0.5%, both in 2009 and 2010, but given the more negative growth outlook, the Commission services expect a larger drop in employment, also contributing to a lower projected increase in wages.

Table I: Comparison of macroeconomic developments and forecasts

	2008		2009		2010		2011	2012	2013
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	1.2	1.1	-3.5	-1.9	-0.2	0.6	2.3	2.3	2.1
Private consumption (% change)	1.0	0.9	-0.7	-0.4	-0.4	0.7	1.4	1.8	1.9
Gross fixed capital formation (% change)	4.8	4.3	-6.2	-2.8	-2.2	-0.2	2.8	2.8	1.7
Exports of goods and services (% change)	2.4	2.2	-12.8	-4.5	-1.0	1.2	4.5	4.8	4.7
Imports of goods and services (% change)	3.7	3.7	-11.0	-3.0	-0.9	1.4	4.3	4.5	4.4
Contributions to real GDP growth:									
- Final domestic demand	2.0	2.4	-1.4	-0.6	-0.2	0.8	2.1	2.1	1.8
- Change in inventories	0.4	0.3	-0.5	-0.2	0.0	0.1	0.2	0.0	0.0
- Net exports	-1.1	-1.2	-1.5	-1.3	0.0	-0.2	0.2	0.2	0.3
Output gap[1]	1.9	1.5	-2.6	-1.9	-3.8	-2.7	-1.9	-1.2	-0.6
Employment (% change)	1.6	1.6	-1.2	-0.5	-1.5	-0.5	0.4	1.0	0.9
Unemployment rate (%)	7.0	7.1	8.5	8.2	10.3	9.1	9.3	9.1	8.9
Labour productivity (% change)	-0.4	-0.5	-2.3	-1.4	1.2	1.1	1.9	1.3	1.1
HICP inflation (%)	4.5	4.5	0.3	0.7	1.2	1.8	1.8	1.7	1.8
GDP deflator (% change)	1.7	2.3	2.2	3.2	1.3	1.7	1.8	1.8	1.8
Comp. of employees (per head, % change)	3.3	3.3	2.1	3.2	1.8	2.2	3.0	2.8	3.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.1	n.a.	-2.5	n.a.	-2.6	n.a.	n.a.	n.a.	n.a.

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source:

Commission services' Spring 2009 forecasts (COM); Stability programme (SP)

4. BUDGETARY STRATEGY

4.1. Budgetary implementation in 2008

The general government balance recorded a deficit of 1.2% in 2008 (see Table 1 in Annex 2). This is considerably below the balanced budget which was set in the April 2008 update of the stability programme. The difference is due to both revenue and expenditure surprises in the course of 2008. In particular, revenue turned out to be 0.4% of GDP lower than expected while expenditure was 0.8% of GDP higher than expected.

The growth rate of total revenue amounted to 4.2%, 1 p.p. lower than expected in the previous stability programme. This lower growth rate results from too optimistic revenue assumptions in the initial budget for 2008 in relation to the economic scenario at that time as well as from

lower-than-expected real economic growth (1.1% instead of 1.9%). The impact of these elements has been partly compensated however by the positive impact of higher-than-expected inflation on personal income taxes and social contributions. Specifically, while corporate taxes and taxes on production and imports suffered from the negative growth surprise (by 0.3% of GDP each), higher-than-projected inflation led to a substantial increase in the share of wages in GDP and thus to a pronounced expansion of personal income tax and social contributions (0.6% and 0.5% of GDP respectively). Expressed as a percentage of GDP, revenue stood at 48.6% compared to a planned 49.0% in the previous programme, the difference being explained by the base effect associated to a worse-than-expected starting position (0.6% of GDP).

Total expenditure increased by 6.2% in 2008, compared to a projected 4.8% in the previous update of the stability programme. This higher-than-expected increase was mainly due to more rapid payments of invoices at the end of the year (0.3% of GDP), and to higher salaries, social benefits and subsidies, notably related to higher-than-expected inflation. Expressed as a percentage of GDP, expenditure stood at 49.8% compared to a planned 49.0% in the previous programme. This difference occurred in spite of a better-than-expected starting position (in contrast with and fully compensated by the worse starting position on the revenue side).

Several bank rescue operations by the Belgian government led to a significant increase in gross public debt (see section 2). The effects of the operations on the government balance were negligible in 2008 (see sections 2 and 5.1 for further details).[4]

4.2. Near-term budgetary strategy

The programme sets a deficit target of 3.4% for 2009. This target takes into account the implementation of the regional recovery packages as well as the federal recovery package announced on 11 December. It is consistent with the budgetary targets adopted by the government at the occasion of the budget control exercise that took place in February and the amended budget Law. The initial budget was agreed in October and voted by the Federal Parliament in January. It included a balanced budget, but was based on much more optimistic macroeconomic parameters (GDP growth of 1.2%) and did not include the impact of the recovery package.

In the update of the stability programme, the revenue-to-GDP ratio is expected to decrease from 48.6% in 2008 to 48.2% in 2009, on the back of falling taxes on production and imports and on income and wealth. The expenditure ratio would increase from 49.8% to 51.6% due to higher social payments and to lesser extent also compensation of employees and intermediate consumption. The programme sets budgetary targets for the different government tiers. All levels of government will present a deficit position in 2009, whereas in 2008 only the federal level recorded a deficit. This reflects the impact of the economic downturn on each of these entities as well as the adopted deficit-increasing measures.

The budgetary projections in the update of the programme take into account the measures included in the stimulus package as well as the measures that were already included in the initial budget for 2009. The latter amount to 0.4% of GDP and in particular include increases in social benefits (0.1% of GDP), mainly for pensioners, further measures to reduce the tax

[4] The treatment of these interventions according to the ESA95 rules is subject to further investigation by Eurostat.

wedge on labour (0.2% of GDP)[5] and limited additional subsidies to households for heating costs.

The stimulus packages were relatively contained in view of the limited fiscal room for manoeuvre. Overall, their budgetary impact is estimated at around ½% of GDP both in 2009 and 2010[6]. The regional packages focus on ensuring the access to financing of corporations, in particular SMEs and start-ups, and on public investment. Their budgetary impact will be limited as most investment was already planned or will take place through public-private partnerships. The package of the federal government, presented on 11 December, aims at:

- providing support to corporations by improving their liquidity position (through a more rapid payment of invoices and more flexibility in transmitting certain taxes to the government), reducing the tax wedge on labour and stimulating the residential construction market through a targeted and temporary VAT reduction;
- supporting employment through the permanent reduction of the tax wedge on labour as well as a number of measures to enhance the functioning of the labour market, such as a better follow-up of dismissed workers due to restructuring, more forceful outplacement obligations, improved access to training and qualifications as well as better advice to job seekers ;
- ensuring the purchasing power of households by temporarily increasing unemployment benefits for temporary unemployed and additional subsidies for heating oil;
- temporarily stepping up public investment, mainly in infrastructure.

The different recovery packages also include a number of measures that will not have a budgetary impact. These mainly consist of guarantees provided to enterprises, the facilitation of access to risk capital and investment projects through public-private partnerships.

Most of the measures are more or less in line with the EERP and the package is well balanced between revenue and expenditure. While the measures are expected to be effective in cushioning the impact of the downturn, not all of them seem to be sufficiently targeted. In particular, this applies to the reduction of the tax wedge on labour, of which a considerable part is granted to all workers, and the heating subsidy, which is provided to all households. In addition, part of the stimulus, including the investment packages and the labour cost reductions, may come rather late to cushion the immediate impact of the crisis. Finally, in spite of the permanent nature of a substantial part of the stimulus, the package did not include consolidating measures. Thus, the full reversibility of the measures adopted in response to the crisis is not ensured, which also is contrary to the guidelines of the EERP, agreed by the European Council on 11 December 2008. This in particular concerns the reduction of the tax wedge on labour, which is a welcome structural measure but the budgetary impact of which (0.3% of GDP in 2010) should have been offset by savings measures.

The improvement of active labour market policies, the reduction of labour taxes and the investment in infrastructure should to some extent support potential growth. Other measures, such as investment in public transport and incentives for green investment, are in line with the

[5] This amount includes in particular the Flemish "job reduction" (i.e. a lump sum reduction of personal income taxation for inhabitants of the Flemish region), but does not include the indexation of tax brackets. As this indexation taxes place each year it is not considered as a measure.

[6] Our assessment of the budgetary impact differs slightly from that of the national authorities as we do not take into account some payment facilities (0.1% of GDP) granted to corporations in 2009, as these would have no impact on the budget balance according to the European System of Accounts.

policy objectives regarding climate change. However, the recovery packages do not include a comprehensive set of measures to effectively tackle the longer term challenges, for instance regarding the sustainability of public finances, the efficiency of the labour market and the low participation rate.

Overall, the relatively limited fiscal stimulus package appears to be an appropriate response to the sharp downturn, given that when the downturn arose, Belgium's fiscal room for manoeuvre was limited (see sections 2 and 5.1).

The structural deficit (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) on the basis of the information provided in the updated stability programme and recalculated by the Commission services according to the commonly agreed methodology is projected to attain 2.4% of GDP in 2009, compared to 2% in 2008. The Commission services spring 2009 forecast expects a more pronounced worsening of the structural balance (1 percentage point) in 2009. The fiscal stance can thus be considered as expansionary and can be explained by the fiscal impulse associated with the stimulus packages (0.5% of GDP) on the one hand and by measures to increase households' purchasing power included in the initial budget for 2009 (0.4% of GDP) on the other hand.

Table II. Main budgetary measures for 2009

Revenue measures ([1])	Expenditure measures ([2])
Measures in response to the downturn	
• VAT reduction for residential construction (-0.1% of GDP)	• Reduction in the tax wedge on labour through subsidies (0.1% of GDP) • Acceleration of payment of invoices (0.1% of GDP)
Other measures	
• Flemish reduction of personal income taxes (-0.2% of GDP) • Federal measures to reduce personal income taxes (-0.1% of GDP)	• Increases in social benefits (0.1% of GDP)

Notes:

([1]) Estimated impact on general government revenue: -0.3% of GDP.

([2]) Estimated impact on general government expenditure: 0.6% of GDP.

Source: Commission services and April 2009 update of the Belgian stability programme

Table III: Composition of the budgetary adjustment

(% of GDP)	2007	2008		2009		2010		2011	2012	2013	Change: 2008-2013
	COM	COM	SP	COM	SP	COM[1]	SP	SP	SP	SP	SP
Revenue	**48.1**	**48.6**	**48.6**	**48.4**	**48.2**	**48.2**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
of which:											
- Taxes on production and imports	12.8	12.5	12.5	12.3	12.2	12.3	n.a.	n.a.	n.a.	n.a.	n.a.
- Current taxes on income, wealth, etc.	16.3	16.5	16.5	15.9	16.1	15.9	n.a.	n.a.	n.a.	n.a.	n.a.
- Social contributions	15.7	16.2	16.2	16.6	16.3	16.5	n.a.	n.a.	n.a.	n.a.	n.a.
- Other (residual)	3.3	3.5	3.4	3.6	3.6	3.6	n.a.	n.a.	n.a.	n.a.	n.a.
Expenditure	**48.3**	**49.8**	**49.8**	**52.9**	**51.6**	**54.3**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
of which:											
- Primary expenditure	44.5	46.1	46.1	49.0	47.8	50.3	n.a.	n.a.	n.a.	n.a.	n.a.
of which:											
Compensation of employees and intermediate consumption	15.2	15.8	15.8	16.5	16.1	16.6	n.a.	n.a.	n.a.	n.a.	n.a.
Social payments	22.3	23.2	23.2	24.9	24.6	25.9	n.a.	n.a.	n.a.	n.a.	n.a.
Subsidies	2.0	2.1	2.1	2.4	2.1	2.5	n.a.	n.a.	n.a.	n.a.	n.a.
Gross fixed capital formation	1.6	1.6	1.6	1.8	1.7	1.8	n.a.	n.a.	n.a.	n.a.	n.a.
Other (residual)	3.3	3.4	3.4	3.5	3.3	3.4	n.a.	n.a.	n.a.	n.a.	n.a.
- Interest expenditure	3.8	3.7	3.7	3.9	3.8	4.0	3.9	4.0	4.1	4.1	0.4
General government balance (GGB)	**-0.2**	**-1.2**	**-1.2**	**-4.5**	**-3.4**	**-6.1**	**-4.0**	**-3.4**	**-2.6**	**-1.5**	**-0.3**
Primary balance	**3.6**	**2.5**	**2.5**	**-0.6**	**0.4**	**-2.1**	**-0.1**	**0.6**	**1.5**	**2.5**	**0.0**
One-off and other temporary measures	-0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-0.2**	**-1.2**	**-1.2**	**-4.6**	**-3.4**	**-6.1**	**-4.0**	**-3.4**	**-2.6**	**-1.5**	**-0.3**
Output gap[2]	2.5	1.9	1.5	-2.6	-1.9	-3.8	-2.7	-1.9	-1.2	-0.6	-2.1
Cyclically-adjusted balance[2]	-1.6	-2.2	-2.0	-3.1	-2.4	-4.0	-2.6	-2.4	-1.9	-1.2	0.8
Structural balance[3]	**-1.5**	**-2.2**	**-2.0**	**-3.2**	**-2.4**	**-4.0**	**-2.6**	**-2.4**	**-1.9**	**-1.2**	**0.8**
Change in structural balance		*-0.7*	*-0.5*	*-1.0*	*-0.4*	*-0.8*	*-0.2*	*0.2*	*0.4*	*0.8*	
Structural primary balance[3]	2.3	1.5	1.7	0.7	1.4	0.0	1.3	1.6	2.2	2.9	1.2
Change in structural primary balance		*-0.8*	*-0.6*	*-0.8*	*-0.3*	*-0.7*	*-0.1*	*0.3*	*0.5*	*0.8*	

Notes*:*

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability programme (SP); Commission services' Spring 2009 forecasts (COM); Commission services' calculations

4.3. Medium-term budgetary strategy

The programme does not present a well-founded medium term-budgetary strategy in the sense of the Stability and Growth Pact. In particular, Council Regulation 1466/97, Art. 3(2c), asks for "*a detailed and quantitative assessment of the budgetary and other economic policy measures taken*". Moreover, the code of conduct explicitly refers to the need to include information "*on the expenditure and revenue ratios and on their components separately identified*", as well as a "[breakdown] *by subsector of general government*". This information was not provided as a result of which the programme breaches several points of the Regulation and the code of conduct.

The programme contains a budgetary path with decreasing headline deficits as of 2011, but it does not include information on the measures foreseen to achieve the targets, nor on the planned development of the broad revenue and expenditure components and the targets for the different government tiers.

As a reference, the programme update provides alternative projections of the headline balances under an unchanged policy scenario. Using this scenario, the overall budget balance

is set to reach 3.4% of GDP in 2009 and rise to 4.5% of GDP in 2010, before stabilising around 5% of GDP in the medium term. This means that a return to vigorous growth alone, as expected in the programme, will not be sufficient to eliminate the high deficits.

According to the programme, reducing headline and structural deficits will thus require corrective action, especially as measures decided in previous years as well as the fiscal stimulus package continue to have an expansionary effect throughout most of the programme period. Indeed, in spite of the permanent nature of a substantial part of the stimulus, in particular the reduction of the tax wedge on labour (0.3% of GDP in 2010), the recovery package did not include consolidating measures.

In particular, the programme plans consolidating measures for 0.5% of GDP if growth is positive, with an additional effort of 0.25% of GDP if annual growth is between 1% and 2% and of another 0.8% if growth exceeds 2% (for each p.p. of growth above 2%). Taking account of the growth predictions in the programme, this would mean that the headline deficit would, after reaching a peak of 4% of GDP in 2010, be gradually reduced by 0.6% in 2011 and by around 1% of GDP thereafter, thus reaching 1.5% by the end of the programme period in 2013. According to the programme, this would lead to a balanced budget in 2015, both in structural and nominal terms. From 2009 onwards, the primary balance shows a slightly better improvement than the headline balance as interest expenditure is expected to increase as a percentage of GDP by on average 0.1 p.p. per year until 2012.

The structural balance, as recalculated by the Commission services on the basis of the information in the programme, is projected to continue deteriorating in 2009 and 2010, from a structural deficit of 2.0% of GDP in 2008 to 2.4% of GDP in 2009 and 2.6% of GDP in 2010. Afterwards, it is set to improve to -1.2% by 2013. The adjustment would amount to only 0.2% of GDP in 2011, to 0.5% of GDP in 2012 and to 0.7% of GDP in 2013. The Commission services' spring 2009 forecast projects the structural balance to decrease by 1% of GDP in 2009 and another 0.8% of GDP in 2010, thus reaching -4% of GDP.

According to the recalculated information in the programme, the planned fiscal policy stance is broadly neutral in 2010 and 2011, turns mildly restrictive in 2012 and becomes restrictive in 2013. In order to achieve these recalculated structural adjustments, considerably larger consolidation efforts are needed, as previously-decided measures and population ageing put an upward pressure on the structural deficit. The programme does not foresee the MTO (which is a structural surplus of 0.5% of GDP) to be reached within the programme period.[7]

4.4. Risks to the budgetary targets

While the lack of key information in the programme as well as the breach of several points of the code of conduct, as mentioned above, has severely hampered the possibility to assess the credibility of the deficit and debt targets in the programme, it is clear that the budgetary targets are not backed by a medium-term strategy in the sense of the Stability and Growth Pact and are therefore subject to significant downside risks throughout the programme period. For 2009 and 2010, the general government deficit targets presented in the programme are significantly lower than the Commission services' deficit projections in their spring 2009

[7] Contrary to a somewhat misleading reference in the programme (page 3), the authorities have reaffirmed to the Commission that their MTO is unchanged at the previous level of 0.5% of GDP.

forecast[8], in spite of the fact that the programme does reflect all the measures decided up to now, including the recovery packages of the federal and regional governments.

The macroeconomic environment will most probably be considerably worse than envisaged in the programme, which appears markedly favourable over the entire programme period, as concluded in section 3. In 2009 and 2010, the Commission services project the crisis to be deeper and more protracted. Also for the outer years, downside risks are large, as the economic projections in the programme are substantially higher than the Commission services' most recent potential growth estimates for 2009 and 2010. In this context, budgetary outcomes are likely to come out below those in the programme. For 2009, the larger impact of the automatic stabilisers in view of the more negative macroeconomic scenario seems to be the main explanation of the difference between the Commission services' projection and the target in the programme. For the subsequent years, significant additional risks, on top of the worse starting position at the end of 2009, can be identified.

As explained in the programme, the adoption of additional measures is necessary in order to achieve the budgetary targets, which will be all the more true if one takes into account a more negative macroeconomic scenario. As the budgetary stance under an unchanged policy assumption, which is also provided in the programme, remains expansionary throughout most of the programme period in view of previously decided measures and permanent measures in the recovery package for which a correction at later stage were not identified, sizeable consolidation efforts are needed to achieve the (structural) budgetary targets. The programme mentions that measures of over 3% of GDP are needed over the programme period. However, the fact that it does provide information on (i) any measure backing the consolidation path, (ii) the development of revenue and expenditure, (iii) the breakdown of the targets between government tiers seems to imply that the budgetary path is not based on a well-founded medium-term strategy.

Another risk relates to the fact that the Belgian authorities have a mixed track record in achieving budgetary targets. In particular, the Belgian authorities have in subsequent programme updates postponed the realisation of headline surpluses (see Figure 2 in Annex 2). In particular, the target has not been reached in 2007 in spite of the good macroeconomic environment and also in 2008 part of the slippage could have been avoided.

Overall, there is a strong risk that the budgetary outcomes will be considerably worse than targeted in the programme. This is especially the case as of 2010, given that the programme does not present a medium-term budgetary strategy in the sense of the Stability and Growth Pact and relies on unspecified measures to achieve a significant structural adjustment, possibly in a still difficult economic environment.

5. DEBT DEVELOPMENTS AND LONG-TERM SUSTAINABILITY

5.1. Debt developments

The Belgian debt ratio has been on a steady downward path between 1993 (134% of GDP) and 2007 (84.9% of GDP).[9] This substantial decline was mainly possible thanks to high –

[8] It recently appeared that as a result of a ruling of the European Court of Justice, the Belgian government will have to pay back corporate taxes for maximum 0.4% of GDP. This element was not yet included in the Commission services' spring 2009 forecast and further adds to the downward risks in 2009.

[9] The assumption of the national railway company's debt in 2005 caused a temporary slowdown of the trend.

though decreasing – primary surpluses. Debt developments also benefited from declining interest expenditure. In 2008, the debt ratio increased as a result of the operations to stabilise the financial system, which amounted to around 6% of GDP and led to a significant stock-flow adjustment. The headline deficit was also higher than in the previous years, but still lower than nominal GDP, which partly compensated for the important stock-flow adjustment.

The updated stability programme expects a further rise in the debt ratio to 93% of GDP in 2009 and 95% in 2010. Afterwards, the foreseen consolidation path is projected to lead to a reduction of the debt-to-GDP ratio to 92% in 2013.

Table IV: Debt dynamics

(% of GDP)	average 2002-06	2007	2008		2009		2010		2011	2012	2013
			COM	SP	COM	SP	COM	SP	SP	SP	SP
Gross debt ratio[1]	**95.3**	**84.0**	**89.6**	**89.6**	**95.7**	**93.0**	**100.9**	**95.0**	**94.9**	**93.9**	**92.0**
Change in the ratio	-3.7	-3.9	5.6	5.6	6.2	3.4	5.2	2.0	-0.1	-1.0	-1.9
Contributions[2]*:*											
1. Primary balance	**-4.2**	**-3.6**	**-2.5**	**-2.5**	**0.6**	**-0.4**	**2.1**	**0.1**	**-0.6**	**-1.5**	**-2.5**
2. "Snow-ball" effect	**0.8**	**-0.5**	**1.4**	**1.0**	**5.0**	**2.7**	**3.1**	**1.7**	**0.3**	**0.4**	**0.4**
Of which:											
Interest expenditure	4.8	3.8	3.7	3.7	3.9	3.8	4.0	3.9	4.0	4.1	4.0
Growth effect	-1.9	-2.3	-1.0	-0.9	3.1	1.7	0.2	-0.5	-2.1	-2.1	-1.9
Inflation effect	-2.0	-2.0	-1.4	-1.8	-2.0	-2.8	-1.2	-1.6	-1.6	-1.6	-1.7
3. Stock-flow adjustment	**-0.3**	**0.2**	**6.8**	**7.2**	**0.5**	**1.1**	**0.0**	**0.2**	**0.2**	**0.1**	**0.2**
Of which:											
Cash/accruals diff.	0.4	-0.4		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.
Acc. financial assets	-0.6	0.5		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.
Privatisation	-0.1	0.0		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.
Val. effect & residual	-0.1	0.0		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability programme (SP); Commission services' Spring 2009 forecasts (COM); Commission services' calculations

For 2009 and 2010, differing macroeconomic and deficit projections in the Commission services' spring 2009 forecast cause a substantially divergent forecast for public debt, with projected debt-to-GDP ratios of around 96% in 2009 and 101% in 2010. Headline balances may also come out worse than in the programme as the consolidation path is not backed by a medium-term budgetary strategy in the sense of the Stability and Growth Pact.

Finally, the Belgian government cumulates considerable contingent liabilities related to the guarantees provided to banks, amounting to over one third of GDP. To the extent that the government will introduce new asset relief programmes, through which the government would take over potential losses on certain bank assets, or other mechanisms to support the stability of the financial sector, public debt may further increase.

Taking into account the risks mentioned above, in particular to the budgetary targets but also to the macroeconomic scenario, the debt ratio will further increase throughout most of the programme period and thus clearly not sufficiently diminish towards the reference value over the programme period (see Figure 3 in Annex 2).

5.2. Long-term sustainability

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology.[10]

Table 2 in Annex 2 shows that the projected increase in age-related spending is rising by 6.6% of GDP between 2010 and 2060, above the average of around 5% for the euro area. Sustainability indicators for two scenarios are presented in Table 4 in Annex 2. Including the increase of age-related expenditure and assuming that the structural primary balance remained at its 2008 level, the sustainability gap (S2)[11] would amount to 4.8% of GDP; about 1.8 percentage points more than in last year's assessment, which is due to a lower estimated structural primary balance in the starting year. The starting budgetary position is just sufficient to stabilize the debt ratio over the long-term before considering the long-term budgetary impact of ageing. If the 2009 budgetary position of the Commission services' spring 2009 forecast was taken as the starting point, the projected sustainability gap would increase to 6.7% of GDP.

In contrast to the "2008 scenario", the "programme scenario", which is based on the end-of-programme structural primary balance, shows a smaller gap. If the budgetary consolidation planned in the programme was achieved, risks to long-term sustainability of public finances would be mitigated.

Based on the assumptions used for the calculation of the sustainability indicators, Figure 4 in Annex 2 displays the projected debt-to-GDP ratio over the long-term.

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account, as shown in Table 5 in Annex 2. Notably, the programme makes a reference to national projections, which differ from the common EPC projections. These projections would have only a small impact on the sustainability indicators.[12]

The long-term budgetary impact of ageing is above the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades. This i.a. reflects that Belgium did not yet introduce sufficient reforms of the pension system in order to increase the (effective) retirement age and to reduce its cost. The budgetary position in 2008 as estimated in the programme worsened from the estimated starting position of the previous programme, slightly reducing the mitigating impact of the initial budgetary position on the sustainability gap. If the 2009 budgetary position as projected by the Commission services' spring 2009 forecast was taken as the starting point, the sustainability gap would worsen substantially. Moreover, the current level of gross debt in terms of GDP is well above the Treaty reference value. Reforms of the labour market and the social security system

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[10] Economic Policy Committee and the European Commission (2009), 'The impact of aging on public expenditure: projections for the EU-27 Member States on pensions, health care, long-term care, education and unemployment transfers (2008-60)', *European Economy* No. 2/2009. European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006. European Commission (2008), *Public finances in EMU – 2008*, *European Economy* No. 4/2008.

[11] The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

[12] The national projections of 2007 were assessed to have a small positive effect on the sustainability gaps. The 2008 update of these projections referred to in the programme show a slightly higher increase in age-related expenditure than the 2007 projection.

(unemployment benefit scheme, pension system, health care[13]), would increase potential growth and, together with high primary surpluses, contribute to reducing the risks to the sustainability of public finances, which are currently at a medium level. The policy response to the financial crisis could lead to a steeper rise of the debt ratio than projected in the programme if costs are not recouped in the future.

6. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

In view of Belgium's decentralised government structure, which includes substantial autonomy of communities and the regions over their budgets, coordination of fiscal policy between the different levels is crucial. A key element of the coordination mechanism is the annual advice to the government of the "Public Sector Borrowing Requirements" section of the HFC on the budgetary policy to be adopted. This advice includes recommendations on the budget balances of the various levels of government and form the basis of a series of budgetary conventions, which take the form of political agreements between governments at federal and regional level, setting the medium-term budgetary targets for the different levels of government and acting as internal stability programmes.

So far, as confirmed in the programme update, no such agreement has been concluded for the years covered in the programme, although these are an important tool to ensure budgetary discipline and have contributed to Belgium's budgetary performance in the past. A renewed agreement should be concluded after the regional elections of 7 June. In order to give the regional entities more incentives to contribute to the consolidation effort, it could be envisaged to develop effective mechanisms to ensure that the different government tiers comply with the predefined targets. In addition, it could be useful to analyse the possibilities to revise the income sources of the regions and communities in order to increase the impact of their budgetary and economic choices on their budgetary position.

The revised Silver Law of 2005 already includes binding multi-annual budget targets, but these have not been achieved in spite of reasonably benign macroeconomic circumstances. Therefore, and in order to avoid further expenditure slippages, the introduction of more specific and binding expenditure rules, together with a more transparent reporting system for all levels of government, as announced in the programme, would be welcome.

Up to now, the government took several measures to reform the tax system, including tax reductions for labour and to a lesser extent enterprises. In spite of those measures, the labour tax system continues to include, also as a result of its interactions with the system of unemployment benefits, significant inactivity, unemployment and low wage traps. Moreover, future reforms will have to take place in an environment of strict budgetary consolidation. Structural reforms of the pension system, including in particular early retirement schemes, have been initiated with the 2005 Generation Pact, but it appears that the activity rate of older workers remains low and that further efforts are needed to increase labour market participation and employment and at the same time to reduce the budgetary cost of the pension system.

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[13] For instance, while unemployment benefits are currently fixed for the entire duration of unemployment, they could follow a decreasing path and be made more conditional on retraining or mobility efforts. Regarding the pension system, access to the still existing possibilities to retire before the legal retirement age could be further reduced. Regarding the health care system, savings might be possible in long term care, hospital care and pharmaceutical expenditure.

7. ASSESSMENT

This section assesses the budgetary strategy, taking into account risks, in the light of (i) the adequacy of the fiscal stimulus package and the overall fiscal stance; (ii) the criteria for short-term action laid down in the Commission Communication of 26 November 2008 on the European Economic Recovery Plan (EERP) as endorsed by the European Council conclusions on the European Economic Recovery Plan (EERP) on 16 December 2008; and (iii) the objectives of the Stability and Growth Pact.

The adequacy of the stimulus package has to be assessed taking into account Belgium's specific circumstances, notably as regards the fiscal room for manoeuvre. Considering all relevant indicators, in particular the very high and rising debt-to-GDP ratio, the above-average cost of ageing and considerable contingent liabilities following the operations to stabilise the financial system, the fiscal room for manoeuvre of Belgium can be characterised as limited. This relative fragility of public finances is accompanied by a weak competitiveness, notably due to the deterioration of cost-competitiveness compared to Belgium's main trading partners, which resulted in considerable market-share losses and contributed to the quick reversal of the large current account surplus into a deficit since 2008. In this context, the Belgian stimulus packages appear to be a broadly appropriate response to the downturn, although some of the measures do not appear easily reversible and are not accompanied by compensatory measures. The stimulus package, the impact of which is estimated at around ½% of GDP in both 2009 and 2010, comes on top of expansionary measures already included in the initial budget for 2009 of about 0.4% of GDP and the sizeable automatic stabilisers (estimated at around 2½% of GDP in 2009 and ¾% in 2010).

The fiscal stance, as measured by the change in the structural balance and taking into account the risks to the budgetary projects, is expansionary in 2009 in line with the EERP. The expansion also partly reflects the response of the Belgian government to the EERP. Thereafter, the programme foresees a broadly neutral fiscal stance in 2010 and 2011 and a restrictive stance as from 2012.

Most of the measures Belgium has taken in response to the economic crisis are more or less in line with the EERP and the package is well balanced between revenue and expenditure. However, the reduction of the tax wedge on labour, of which a considerable part is granted to all workers, and the heating subsidy, which is provided to all households, do not appear sufficiently targeted. In addition, part of the stimulus, including the investment packages and the labour cost reductions, may come rather late to cushion the immediate impact of the crisis. Finally, a substantial part of the stimulus is of a permanent nature and no compensatory measures are foreseen even for future years. Thus, the full reversibility of the measures adopted in response to the crisis is not ensured. This concerns in particular the reduction of the tax wedge on labour, which is a welcome structural measure but the budgetary impact of which should have been offset by savings measures.

In addition to the reversibility of deficit-increasing measures, the EERP stressed the need for improving budgetary policy-making in the medium term, by strengthening the national budgetary rules and frameworks. In the case of Belgium, as mentioned in section 6, there is a lot of room for improvement.

In conclusion, while the lack of an adequate medium-term budgetary strategy in the programme as well as the breach of several points of the code of conduct, as mentioned above, have severely hampered the possibility to assess the credibility of the deficit and debt targets in the programme, it is clear that the budgetary targets are subject to significant downside risks throughout the programme period. First, the macroeconomic environment will

probably be considerably worse than envisaged in the programme over the entire programme period. Second, the (structural) targets can only be achieved by taking sizeable additional measures. However, the programme does not provide any information on those measures nor on the planned development of the broad revenue and expenditure components underpinning the targets and thus the latter are clearly not backed by a medium-term budgetary strategy in the sense of the Stability and Growth Pact. The fact that measures in the recovery package of a permanent nature are not offset by future savings further adds to this risk. Moreover, the Belgian authorities have a mixed track record in achieving budgetary targets. Finally, sizeable guarantees have been provided to the banking sector, which might drive up future deficits and debt to the extent that they are called. In view of considerable downward risks to the budgetary targets, the evolution of the debt ratio is also likely to be less favourable than projected in the programme.

Taking into account the above-mentioned risks to the budgetary targets, the fiscal stance is likely to remain expansionary up to 2011 (included) and turn at best neutral thereafter. The programme foresees a return of the headline deficit below the reference value only in 2012, and it does not offer a safety margin against a breach until the end of the programme period. The programme does not foresee the MTO to be reached within the programme period. The proposed path lacks ambition regarding the decisive correction of the deficit as the economic situation improves. This does not seem appropriate in view of the risks related to the long-term sustainability of public finances, including the very high level of government debt which is moreover not sufficiently diminishing towards the reference value over the programme period, and considerable contingent liabilities following the measures to stabilise the financial system. In this context, Belgium should avoid a further deterioration of the structural balance in 2009 and resume fiscal consolidation as from 2010, when the economy is expected to improve, so as to return to a consolidation path compatible with the long-term sustainability of public finances.

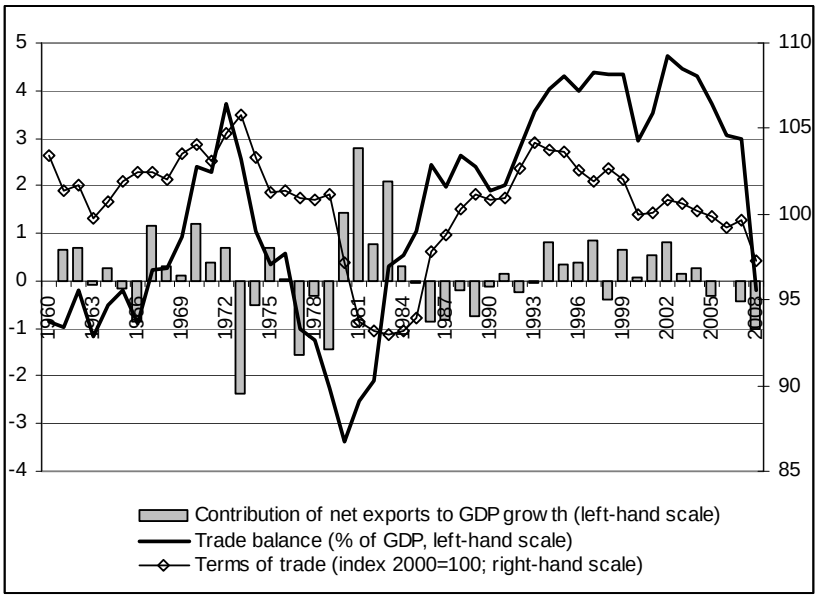
ANNEX 1. SPECIAL TOPIC: EXTERNAL COMPETITIVENESS AND IMPLICATIONS FOR FISCAL POLICY

Economic growth in Belgium amounted to 2.1% on average in the period from 2003 up to 2008, in line with the performance in the previous decade. In 2008, growth fell to 1.1%, compared to 2.8% in 2007, mainly as a result of the strongly deteriorated international environment, the domestic consequences of the financial crisis and high inflation.

Belgium has a very open economy (trade as a share of GDP stood at over 180% of GDP at the end of 2008) and GDP growth is thus highly influenced by net exports. Whereas net exports contributed positively (0.4 percentage points on average) to GDP growth in 1993-2002, GDP growth since 2003 was largely driven by domestic demand. Indeed, low export volume growth (average annual growth of 3.7%) together with strong imports (4.1%) resulted in an average negative contribution of net exports to GDP growth of -0.1 percentage points.

Together with the gradual deterioration of Belgium's terms of trade since 2003, negative net export volumes led to a continuous deterioration of the trade balance from a record surplus of 4.7% of GDP in 2002 to an expected deficit of 0.5% of GDP in 2008. The deficit is expected to widen in the coming years. While this development does not point to major macro-economic imbalances, the deterioration of the trade balance took place rapidly and the losses in market shares have been considerable in recent years, suggesting that Belgium should take action to curb the deterioration of its competitive position in order to increase growth potential.

Figure 1: Determinants of the development of the trade balance



Source: Ameco.

While the trade balance surplus started to shrink only in 2003, mainly as a result of the deterioration of the terms of trade and vigorous domestic demand, Belgian exporters have in fact been unable to fully take advantage of strong world trade growth for a much longer period of time. Since 1990, Belgium's exports rose by 4.0% on average per year (in volume), compared to an annual growth rate of world trade of 6.6% (in volume, based on IMF data).

This raises the question what are the reasons behind this relatively structural poor performance of Belgium’s exports. Moreover, there may be a case for public policy to pay

further attention to the competitive position of Belgian corporations. In this context, the broader concept of quality of public finance, which assesses to what extent public finances are conducive to economic growth, should, in the case of Belgium, also put the accent on the external side and competitiveness.

The chapter is organised as follows. Section 1 analyses Belgium's export performance since 2002 on the basis of the geographical and product composition of exports, cost and price competitiveness and non-price competitiveness. Section 2 gives an overview of how public finances currently support competitiveness and what further policy actions may be needed to improve the policy in this field. Section 3 concludes.

1. AN ANALYSIS OF BELGIUM'S EXPORT PERFORMANCE

Belgium's export performance is determined by several factors. A first driver is the geographical and product specialisation of exports. Given that not all markets and products are equally dynamic, the country's specialisation can determine its competitiveness. Although these elements are assumed to be exogenous in the short term, they can change in the long run as a result of dedicated policy action, both by exporters and the government. A second determinant of export performance is the extent to which the country succeeds in maintaining its market share. The latter is determined by the country's price and cost competitiveness as well as a wide range of other factors determining its competitiveness, such as the technological content of exports and the business environment for exporters.

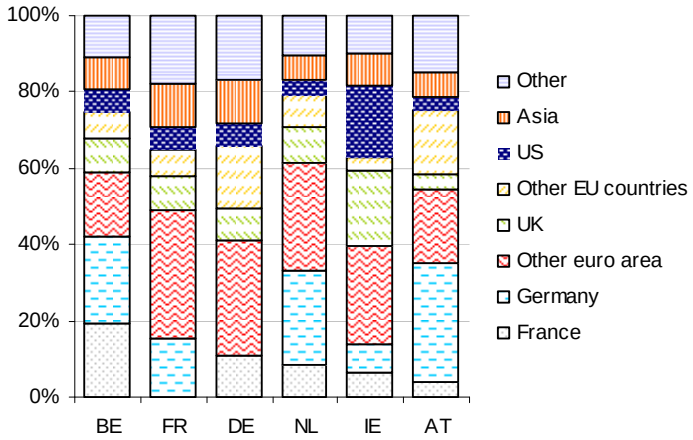
1.1. Geographical specialisation

Geographical and cultural proximity is an important determinant of trade[14]. This also holds in the case of Belgium, as its exports are mainly directed towards its neighbours Germany, France and the Netherlands, which account for 45% of total exports (in value terms). Taking account of the euro area as a whole, the figure increases to over 60% (see figure 2). Belgium's exports to faster growing countries are relatively small, with 6.2% of total exports to non-euro area EU countries excluding the UK (mainly new member states) and 7.4% to Asia. Euro area countries' imports tend to increase more slowly than those of upcoming economies, such as the recently acceded member states, as well as China, India and the economies of South America.

The growth of world demand addressed to Belgium (which is defined as the weighted sum of import volumes of all its trading partners) amounted to 5.6% per year since 2002. This equals growth for the Netherlands, is slightly below the figure for Germany (5.7%), Austria (6.5%), Finland (6.1%) and Sweden (5.9%), but more than for France (5.5%) and Ireland (4.8%). All in all, the demand to these countries has developed similarly and can only provide a partial explanation of the more important export growth differences.

[14] Redding, S. and A.J. Venables (2004), "Economic Geography and International Inequality", *Journal of International Economics*, n. 62(1), pp. 53-82.

Figure 2: Geographical composition of exports
(% of total in 2007)



Source: Eurostat.

1.2. Product specialisation

If a country's exports are oriented towards mainly to products for which demand is less dynamic than the average, market share losses become inevitable[15]. Over the period 2003-2006, Belgium's export performance has been only slightly negatively influenced by an adverse product specialisation. Figures from Bureau van Dijk's Chelem database show that Belgium's exports increased by on average 13.9% in 2003-2006. In case Belgium's exports would have been composed as world trade, annual growth would have amounted to 14.4%. Belgium has on average benefited from its overspecialisation in basic metals and under-specialisation in agricultural products. On the other hand, the overspecialisation in low-growing products such as construction materials and food products and the under-specialisation in rapidly growing mining and energy products held back Belgian exports. However, the main reason for Belgium's weak export performance was the fact that exports for most products grew slower than world demand. The difference was particularly marked for metal products, including cars and technological equipment.

Turning to the future, as Belgium seems to be specialised more than its main competitors in raw-material intensive goods and low- and medium-tech products which are relatively easy to imitate, including mainly food and beverages, basic metallurgy and chemical products (see figure 3). Other European countries, including Germany and France, have specialised more in high-tech products that are difficult to imitate, such as machinery and equipment[16].

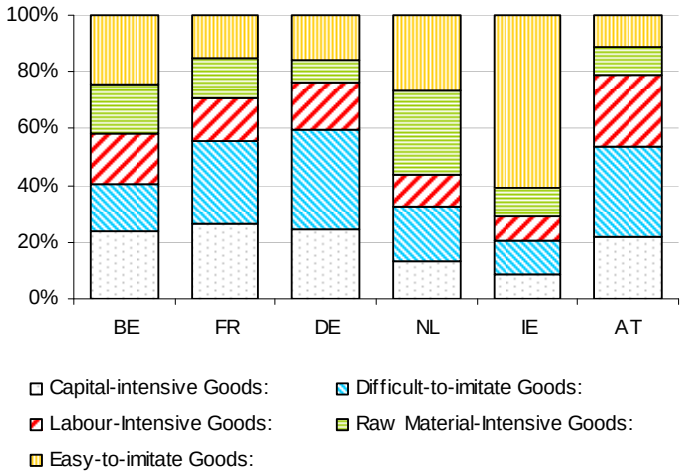
While Belgium has up to now not suffered from its specialisation in raw-material intensive goods and products that are easy to imitate, demand for such products might at some point start to grow more slowly while that for high-tech products might increase more strongly. In addition, price competition from less-advanced exporters may further increase, putting pressure on future export growth and margins. In particular the low technology content of

[15] See e.g. Michel, B. (2005), "Trends in export market shares between 1991 and 2001", Working Paper, n. 7/05, Federal Planning Bureau.

[16] See also European Central Bank (2005), "Competitiveness and the export performance of the euro area", Occasional Paper, n. 30, June 2005.

Belgian exports, as witnessed by the fact that Belgian exports currently consist for 6.6% of high-tech products, compared to 16.6% in the EU, may limit future export potential and illustrates the importance of investment in R&D.

Figure 3: product specialisation of Belgian exports
(% of total in 2007)



Source: Eurostat.

1.3. Price and cost competitiveness

Belgium's exports markets have grown by 5.6% per year on average since 1990, compared to export growth in Belgium of 4.0%. This points out that Belgian exporters lost market share[17] amounting to on average 1.6% per year since 1990. This led to a cumulative loss of 23.7% since 1990 and 9.1% since 2002, which is more than the losses incurred by the neighbouring countries. The losses have been particularly relevant in 2005 and 2006 and are especially high for high-tech products, such as office and communication equipment and, to a lesser extent, transport equipment. These market share losses can be explained by a loss of price and cost competiveness as well as problems in the field of non-price competiveness (see section 1.4).

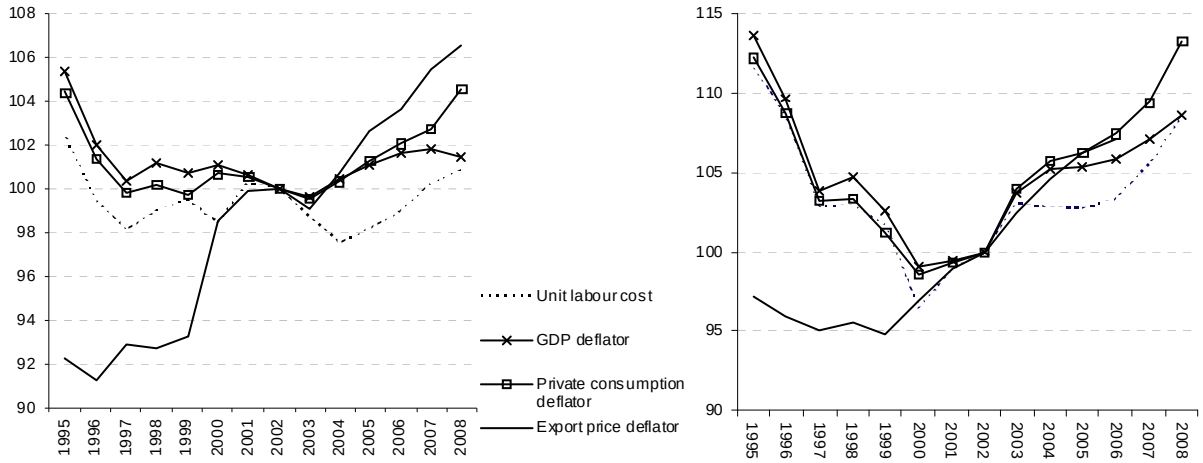
Price competitiveness can be measured through the real effective exchange rate deflated by export prices. In Belgium, this real exchange rate has appreciated considerably, both against a sample of 35 industrialised countries and against the euro area as a whole (see figure 4a). The appreciation amounted to 10.9% and 6.6% respectively between 2002 and 2008. One contributing factor to this appreciation was the deterioration of cost competitiveness. The real effective exchange rate deflated by unit labour costs appreciated by 8.5% vis-à-vis IC35 and 0.9% vis-à-vis the euro area since 2002 (see figure 4b). The REER deflated by unit labour costs rose much less than the REER deflated by export prices. The rise in labour costs thus only explains part of the deteriorated competitiveness.

In this connection, it is important to note that labour productivity remains very high in Belgium, although the advantage compared to other euro area countries is gradually closing. More rapid wage increases further diminish this advantage.

[17] As calculated by the growth differential between Belgian export markets and Belgian exports.

Figure 4: Real effective exchange rate using different deflators (Index 2002 = 100)

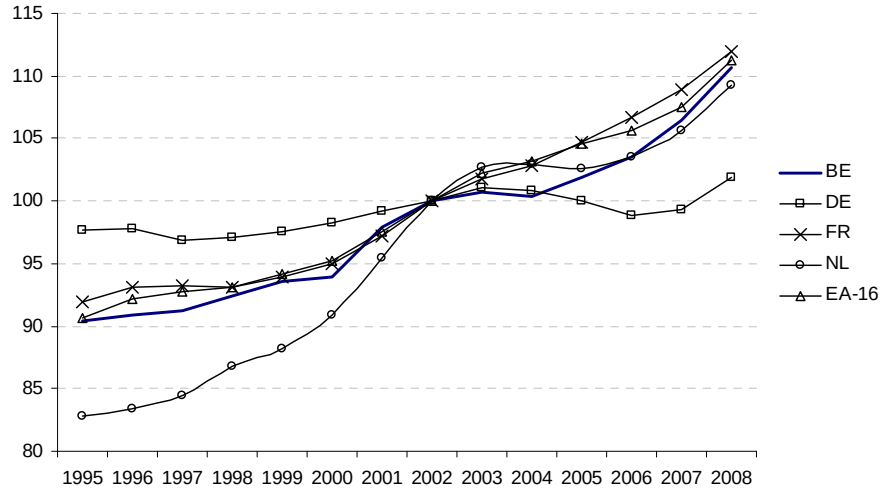
(a) Vis-à-vis the euro area (b) Vis-à-vis IC-35



Source: Ameco.

Whereas ULC growth remained below the euro area average up to 2004, it started to increase more strongly than in the euro area as of 2005 (see figure 5). The more rapid increase in wage costs as of 2005 occurred in spite of measures taken by the government to reduce the tax wedge on labour and the existence of a law, since 26 July 1996, for the stimulation of employment and the safeguarding of competitiveness.

Figure 5: Nominal unit labour costs (Index 2002 = 100)



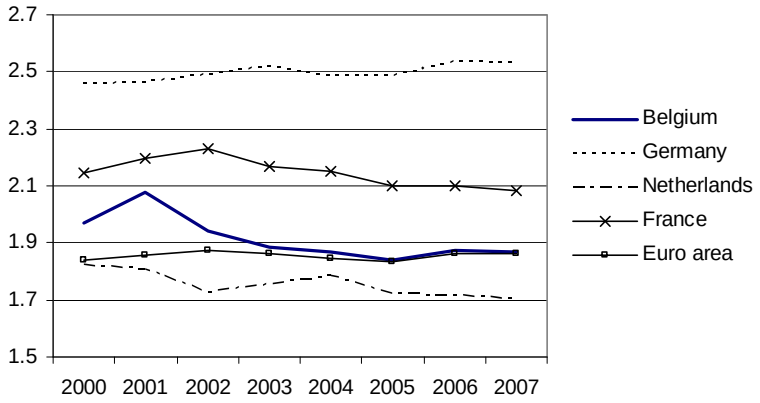
Source: Ameco.

1.4. Non-price competitiveness

A countries' competitiveness is also determined by its capacity to innovate, by the behaviour of individual firms and the quality of the business environment. Regarding innovation, R&D spending as a percentage of GDP provides an indication of country's capacity to innovate, to increase efficiency and to reduce production costs. In Belgium, R&D expenditure amounted to 1.9% in 2007; this is equal to the euro area average, but below Belgium's main competitors, such as France and Germany (see figure 6). The share of public R&D spending stood amounts to around 23% in Belgium, compared to 36% in the euro area. R&D expenditure is moreover concentrated in a limited number of (often foreign-owned) companies, pointing to a lack of diversification of R&D. Finally, Belgium’s R&D expenditure is more geared towards low and

medium-low-tech industries and less to medium-high-tech, which seems to be related to the sectoral composition of the Belgian economy[18]. The relatively low level, high concentration and adverse composition of Belgian R&D have a negative impact on the country's competitiveness.

Figure 6: level of R&D expenditure in Belgium and its main competitors
(% of GDP, both private and public)



Source: Eurostat.

Another element that may negatively influence export performance is the fact that only 17% of Belgian industrial firms are exporting (figure for 2006).[19] In recent years, the number of exporters has moreover declined. Mainly large firms tend to export.[20] This concentration of exports seems to stem from a structure of small and medium sized companies (SMEs) which are not export oriented. This may be explained by (i) high fixed costs for exporting and (ii) few SMEs having a technological competitive advantage[21]. The lack of competitive advantage of SMEs is corroborated by the low share of SMEs involved in R&D[22]. Exporting SMEs are moreover less productive than large exporters.[23] In order to increase the number of exporters, productivity gains should be spread wider throughout the economy, by setting up an effective innovation system and the stimulation of entrepreneurship.

2. IMPLICATIONS FOR FISCAL POLICY

In order to support competitiveness and thus economic growth, the government has at its disposal a number of tools. The extent to which public finances are supportive for growth is

[18] Conseil central de l'économie (2006), "Diagnose van het Belgisch innovatiesysteem".

[19] National bank of Belgium (2009), "Annual Report 2008".

[20] Muuls, M. and M. Pisu (2007), "Imports and exports at the level of the firm: evidence from Belgium", *Working Paper*, n. 114, National Bank of Belgium.

[21] Moen, O. (1999), "The relationship between firm size, competitive advantages and export performance", *International Small Business Journal*, 18/53.

[22] The Gallup Organisation (2007), "Observatory of European SMEs", study conducted upon the request of Directorate-General for Enterprise and Industry and coordinated by the Eurobarometer team of the European Commission.

[23] The International Study group on Exports and Productivity (2008), "Export en productiviteit – vergelijkbare indicaties voor 14 landen", *Working Paper*, n. 128, National Bank of Belgium.

measured by the "quality of public finances" (QPF). QPF[24] is a concept encompassing all arrangements and operations of fiscal policy that support the macroeconomic goals of fiscal policy, in particular long-term economic growth. QPF comprises policies that not only ensure sound budgetary positions and long-term sustainability, but also facilitate stabilising the economy and adjusting to demand and supply shocks. To achieve these outcomes, public resources need to be used in an efficient and effective way. At the same time, governments should operate expenditure and revenue policies in a way that creates incentives for an efficient functioning of labour, goods and services markets.

QPF is a multidimensional concept, which is needed to reflect the complex relationships to growth. In particular, the impact on growth can run through (i) the size of the government, (ii) the level and sustainability of fiscal positions, (iii) the composition and efficiency of expenditure, and (iv) the structure and efficiency of revenue systems. At the same time, the set-up of fiscal rules, institutions and procedures ((v) fiscal governance) can affect all of the above dimensions. Moreover, there are many ways in which public finances can impact the functioning of markets and the overall business environment, which can therefore be seen as a sixth, though indirect, dimension of quality of public finances.

For the purpose of this section, we will focus on the dimensions of QPF which are deemed to be most relevant in supporting external growth and competitiveness. In particular, the government is able to influence cost competitiveness through the level and structure of taxes, including for instance the distribution between direct and indirect taxation. On the expenditure side, the share and the efficiency of spending on education and investment in infrastructure and R&D, have an impact on non-price competitiveness. In addition, the government's influence on the business environment, which is part of the sixth dimension of QPF, may have an impact on competitiveness. This includes a wide range of micro and macroeconomic areas, including for instance the functioning of the labour market, macroeconomic stability, sustainability of public finances, the regulatory burden and the functioning of financial markets. These factors will only be included to the extent they have a direct impact on government revenue or expenditure. Fiscal governance has, as mentioned above, a more indirect effect, and will therefore not be discussed in detail.

2.1. Level and composition of revenue

The level of taxation is important because (i) taxes are generally distortive and, (ii) taxes transfer resources from the private sector to the public sector which is often presumed to be less efficient. Hence, a high taxation level might, ceteris paribus, reduce the growth potential of a country because of the negative impact it might have on labour supply and demand, investment decisions, risk taking and on the allocation of resources in general. However, not all taxes have the same impact on the economy. While the relationship is complex and a wide range of parameters may have an influence, one can broadly say that direct taxes and taxes that are imposed with high marginal rates tend to be more damaging[25]. In particular, regarding competitiveness, high direct taxes tend to drive up production costs of exporters.

Taxes as a percentage of GDP amounted to 48.6% in 2007 in Belgium, compared to 44.6% in the euro area as a whole. Belgium's tax structure is geared towards direct taxes, in particular

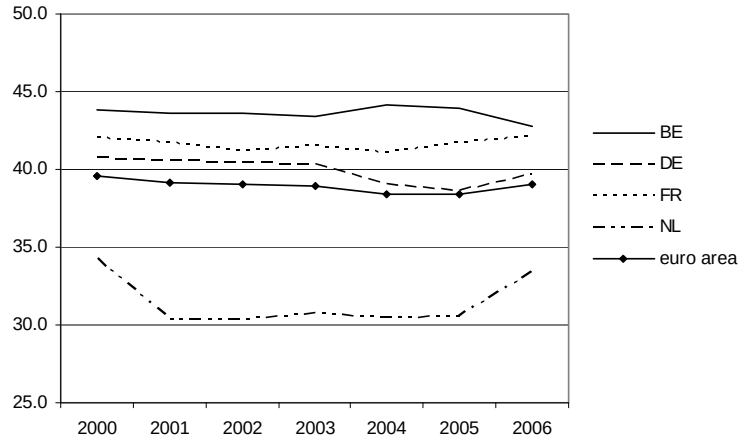
[24] European Commission (2008), "Public Finances in the EMU – 2008", *European Economy*, X, 2008, DG Economic and Financial Affairs.

[25] Alfonso, A., W. Ebert, L. Schuknecht and M. Thöne (2005), "Quality of public finances and growth", *Working Paper Series*, n. 438, February 2005, European Central Bank.

labour taxes, and thus seems to be particularly harmful for economic growth. Compared to the euro area, direct taxes as a percentage of GDP in 2007 were 3.7 p.p. higher, whereas indirect taxes were 1.1 p.p. lower. Social contributions were 3.0 p.p. higher than in the euro area, the difference being largely situated with the employers' contributions.

The implicit tax rate on labour in Belgium amounted to 42.8% of GDP in 2006, compared to a euro area average of 39.0% (see figure 7). Also the marginal tax rate is amongst the highest in the euro area[26] and the progressivity of the tax system is strong. As mentioned in section 2 of the assessment of the previous update of the stability programme[27], high labour taxation puts a drag competitiveness and on labour supply and demand, and, hence, economic growth. Whereas wage moderation in order to safeguard competitiveness and to increase employment is primarily the responsibility of the social partners and depends on the availability of an efficient wage bargaining mechanism, also a reduction of the tax rate on labour could contribute to a reduction of wage costs.

Figure 7: Implicit tax rate on labour in Belgium (%)



Source: Eursotat.

Recent policy decisions in Belgium have led to a reduction of the gap in the tax wedge between Belgium and the euro area. More specifically, the implicit tax rate on labour in Belgium was reduced by 1.1 p.p. since 2000, compared to only 0.5 p.p. in the euro area. Closing the remaining gap requires additional measures. Further reductions should be focused on low-paid workers, where competitive pressures may be the strongest in the short run. On the other hand, in order to promote R&D and technological progress, with a positive impact on competitiveness also in the long run, further tax reductions for highly skilled workers are important. In order to ensure that the reduction in taxes effectively leads to lower wage costs for employers and does not entirely result in an increase in net wages for employees, labour demand and supply should be well matched. This is not always the case as a result of the existing mismatch between offered and required skills on the one hand and the combination of

[26] For instance, the marginal total tax rate for a single person with an average revenue and without children amounted to 66.4% in 2007.

[27] Commission Services (2008), "Macro fiscal assessment of the April 2008 update of the Belgian Stability Programme", June 2008.

high unemployment in Wallonia and strong labour demand in Flanders in a context of low (geographical) mobility of the workforce on the other hand[28].

Also corporate tax rates are higher in Belgium than in the euro area: the base rate stands at 34%, compared to 27% on average in the euro area. The implicit tax rate for Belgian corporations is much lower however (21.7% and no data available for the euro area) and has declined by 5.7 p.p. since 1998. This reduction partly resulted from a tax reform carried out in 2003, which was a first step towards improving corporate competiveness. This reform cut the base rate from 40.17% to 33.99% and lowered the reduced base rates applicable for SMEs. The tax status of SMEs was also improved.[29] A number of compensatory measures, reducing some tax deductions, were adopted in order to strive for budgetary neutrality.

Belgium carried out a second corporate tax reform in 2006, which introduced a tax relief for risk capital, also known as the "notional interest deduction". The notional interest deduction allows corporations to calculate a fictitious interest cost on their equity capital which can be deducted from the tax base, in the same way as interest payments on debt funding are traditionally deducted. The reform also included a number of compensatory measures to contain the budgetary impact (e.g. a change in the definition of tax-exempt realised value gains, the abolishing of the tax credit for SMEs and the freezing of the tax deduction for investments). Nevertheless, the second reform reduced corporations' implicit tax rate (as the implicit tax rate based on gross operating income is estimated to have decreased by around 1% between 2006 and 2008) and, thus, should have made Belgium more attractive to foreign investors from the tax angle and should have improved the competitiveness of Belgian exporters by reducing their costs. According to a study by the National Bank of Belgium, the reform entailed a gross reduction of corporate taxes by EUR 2.4 billion in 2006 (0.8% of GDP)[30]. This amount is higher than expected as companies adapted their funding structure to optimise the deduction. The net cost of the measure for public finances is much more limited and estimated by the National Bank at between 140 to EUR 430 million (0.04% to 0.14% of GDP). This large difference stems from the increase in the taxable basis following a number of compensating measures and the attraction of new foreign investments, as well as the broader positive macroeconomic effects.

Although both reforms have contributed to a reduction of the effective tax rate of Belgian corporations, it remains above the euro area average. One possibility to further reduce the tax rate on corporate profits would be the introduction of the fiscal unity of corporations, whereby taxes would be levied on a consolidated basis instead of on a company basis. As a result, profits and losses of companies within a same group could compensate for each other, leading in most cases to lower taxes to be paid for the group as a whole. Further tax reductions, closing the gap with the euro area average, could help to improve the competitive position of Belgium corporations, but the budgetary impact should be taken into account.

Lowering the high direct tax rate would be beneficial for growth, but in order to limit the budgetary impact, such cuts should be well-targeted and should give preference to reductions of labour taxes as these are expected to have a more positive impact on employment. In

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[28] J. Konings and D. Persyn (2008), "Het effect van een algemene lastenverlaging op vacatures en werkloosheid, *Leuvense Economische Standpunten*, n. 2008/123, Onderzoekseenheid Centrum voor Economische Studiën, Katholieke Universiteit Leuven.

[29] Note however that the beneficial tax treatment of SMEs may discourage these companies to grow.

[30] National Bank of Belgium (2008), "Macro-economische en budgettaire impact van de belastingaftrek voor risicokapitaal".

addition, in order to safeguard the long-term sustainability of public finances, they should be compensated by other tax increases and/or expenditure restraint.

A shift towards indirect taxation may be achieved by limiting the recourse to reduced rates. Further increasing the normal rate does not seem appropriate in the case of Belgium, given its already high level. Indeed, a further rise might have a negative impact on consumption, also taking into account that Belgium is a small open economy[31]. All in all, it appears that compensation will mainly have to stem from expenditure restraint.

Public expenditure as a percentage of GDP is markedly higher in Belgium than in the euro area. As it will also be discussed below, expenditure is more than in other countries oriented towards non-productive spending and is thus not particularly supportive to growth. It also reflects the impact of the high debt-to-GDP ratio. High deficit recorded in the past currently entail high interest expenditure. In the same vein, certain one-off operations executed in more recent years will also burden future budgets.

Restraining expenditure should be based on comprehensive reviews of expenditure, primarily aimed at identifying inefficient spending, possibilities to streamline spending and weaknesses in the effectiveness of the social security system. To contain spending, more effective arrangements for coordinating among government levels, multiyear budgeting with binding spending ceilings will be needed. Some of these issues have been analysed in the macro-fiscal assessment of the previous update of the Belgian stability programme.[32]

2.2. Composition of expenditure: share of productive expenditure

In deciding on expenditure restraint, it should however be borne in mind that some types of expenditure actually enhance growth while others have a neutral or even negative impact. For instance, well-targeted public investment in the field of transportation and communication, as well as expenditure on R&D and education appear to be more systematically matched with higher growth, having a direct positive impact on the country's competitiveness[33].

Total public investment amounted to 1.7% of GDP in Belgium in 2007, compared to a much higher 2.9% in the euro area.[34]. In addition, public R&D expenditure is lower in Belgium (0.45% of GDP) than in the euro area (0.52% of GDP). On the other hand, spending for education amounted to 5.9% of GDP in 2006, compared to 5.2% in the euro area.

A sufficient amount of spending should be accompanied by the ability to achieve the envisaged outcomes. Therefore, also high efficiency and effectiveness are required. Efficiency is measured by calculating ratios between inputs and outputs. Input measures are government expenditure as well as "technical inputs" such as student/teacher ratios and the number of researchers. Output measures are for instance educational attainment, quality of education, number of patents and the length of motorways. Finally, these outputs should be closely linked with the ultimate policy objectives, such as a higher labour productivity, lower labour costs or faster technological progress. It has to be noted that outputs and outcomes are also possibly highly affected by environmental factors which are not included in the measures used. The next paragraphs will analyse to what extent Belgium's education, R&D and

[31] High Finance Council (2007), “Taxation du travail, emploi et compétitivité”.

[32] Commission services (2008), "Macro fiscal assessment of the April 2008 update of the Belgian Stability Programme", June 2008.

[33] European Commission (2008).

[34] For investment in infrastructure, there are no figures available for Belgium

infrastructure expenditure are supporting the country's competitive position as a result of their good outcomes and efficiency.

High quality education leads to the availability of highly-skilled workers, with a positive impact on the labour supply, labour productivity and supporting a specialisation in higher value-added products. The outcome of education in Belgium, as measured i.a. by the OECD PISA scores compared to a euro area average, educational attainment and survey results, is above the euro area average (see table 1). The good score is however not surprising given the high level of expenditure. Also regarding efficiency, Belgium appears to perform better than the euro area average on the basis of a number of efficiency measures such as the ratio between the PISA score and public expenditure[35]. While Belgium performs better than the euro area average, further efficiency gains seem possible. For instance, Eugene (2008) found that both the Netherlands and Finland spend less money on education, while the outcome is equally good or even better.

Table 1: Education input and output measures

	PISA scores	Homegeneity of PISA scores (25th/75th)	Cumulative expenditure per student (2002 US$)	Number of teachers per 100 students
Belgium	542.9	0.7	54449	9.1
euro area	522.7	0.8	53165	8.3

Source: OECD.

In order to stimulate the production of innovative, high value-added goods and services, investment in R&D is also important. Private sector expenditure to R&D is relatively high in Belgium, although it is concentrated in a limited number of foreign companies, as indicated above. Public expenditure on R&D on the other hand is lower than the euro area average and is moreover stagnating in recent years. The government does not foresee major new initiatives except for a further limited decline in the tax burden for researchers.

Regarding outcome, patents show the country's capacity to exploit knowledge and translate it into potential economic gains. In this context, indicators based on patent statistics are widely used to assess the inventive performance of countries. The number of patent applications per inhabitant is higher in Belgium than in other euro area countries but the number of patents granted is lower. In the competitiveness index of the World Economic Forum, Belgium obtains a higher score than the euro area on innovation. Overall, the outcome of investment in R&D is also slightly better than in the euro area, but this is due to the higher level of private R&D spending. Efficiency measures are even lower than in the euro area. The impact of the low level of public expenditure is difficult to isolate, but the government can play a role in improving overall efficiency of R&D i.a. by coordinating better the policy mix between the various levels of government. This should help to further increase the currently very low share of high tech exports in total exports in Belgium and contain the particularly large loss of market share for more high-tech products.

There are no figures available on public investment in infrastructure, but total public investment in Belgium is lower than the euro area average. On the basis of the COFOG classification, it seems that all categories of investment are below the euro area average.[36]

[35] See also Eugene, B. (2008), "The efficiency frontier as a method for gauging the performance of public expenditure: a Belgian case study", *Working Paper Research*, n. 138, National Bank of Belgium.

[36] The sale of real estate to facilitate the achievement of the headline budget targets in recent years may have contributed to some extent to the low public investment rate.

Nevertheless, given high investment in the past, in particular in the 1970s, the output remains positive, with for instance a high availability of motor and rail ways and good energy infrastructure. However, Belgium as a logistics centre should actually invest more than other countries in infrastructure, amongst others to close certain missing road links. Therefore, after a prolonged period of particularly low investment, well-targeted infrastructure projects are needed to improve the competitive position. A number of new projects are currently being financed through public-private partnerships, which may lead to an underestimation of government investment in the years to come (government expenditure related to these projects will be classified as current expenditure, e.g. rents and fees). These partnerships include for instance the building of new school infrastructure and some important road works. Such projects should be encouraged alongside proper public investment as the further improvement of infrastructure and, more generally, the business environment could partly make up for the high wage costs in Belgium.

At the same time, further measures should be taken to reduce government consumption in order not to jeopardise fiscal consolidation in view of population ageing. In particular, a thorough review of wage expenditure at the different levels of government seems useful.

3. CONCLUSIONS

Belgium has a very open economy. As a result, export performance has an important impact on GDP growth. Since 2003, exports grew by 3.6% on average per year, compared to 5.5% in the euro area. This relatively weak performance resulted from a variety of factors, including the adverse geographical composition of exports, the more rapid rise in export prices which was i.a. due to a strong rise of unit labour costs, the weak export performance regarding goods with high technology content related to some weaknesses in the field of R&D, the low propensity to export of the large number of SMEs and some remaining problems in the business environment. The loss of competitiveness puts a drag on economic growth, also with an impact on public finances. On the other hand, public finances can provide support to improve competitiveness. In particular, this chapter assessed the appropriateness of the level and structure of taxes, including for instance the distribution between direct and indirect taxation. On the expenditure side, the share and efficiency of productive spending, such as education and investment in infrastructure and R&D, have been analysed.

Belgium has high taxes compared to the euro area and the tax structure is geared towards direct taxes, in particular labour taxes. A high level of taxes and the importance of direct taxes, with moreover high marginal rates, are in general found to be negative for economic growth. For exporters, it contributes to higher production costs. However, given the overall high level of taxation, the scope for a shift from direct to indirect taxation appears to be limited, also taking into account that Belgium is a small and open country. Therefore, further tax reductions, in particular for labour taxes, should be compensated by lower government expenditure, in particular public consumption.

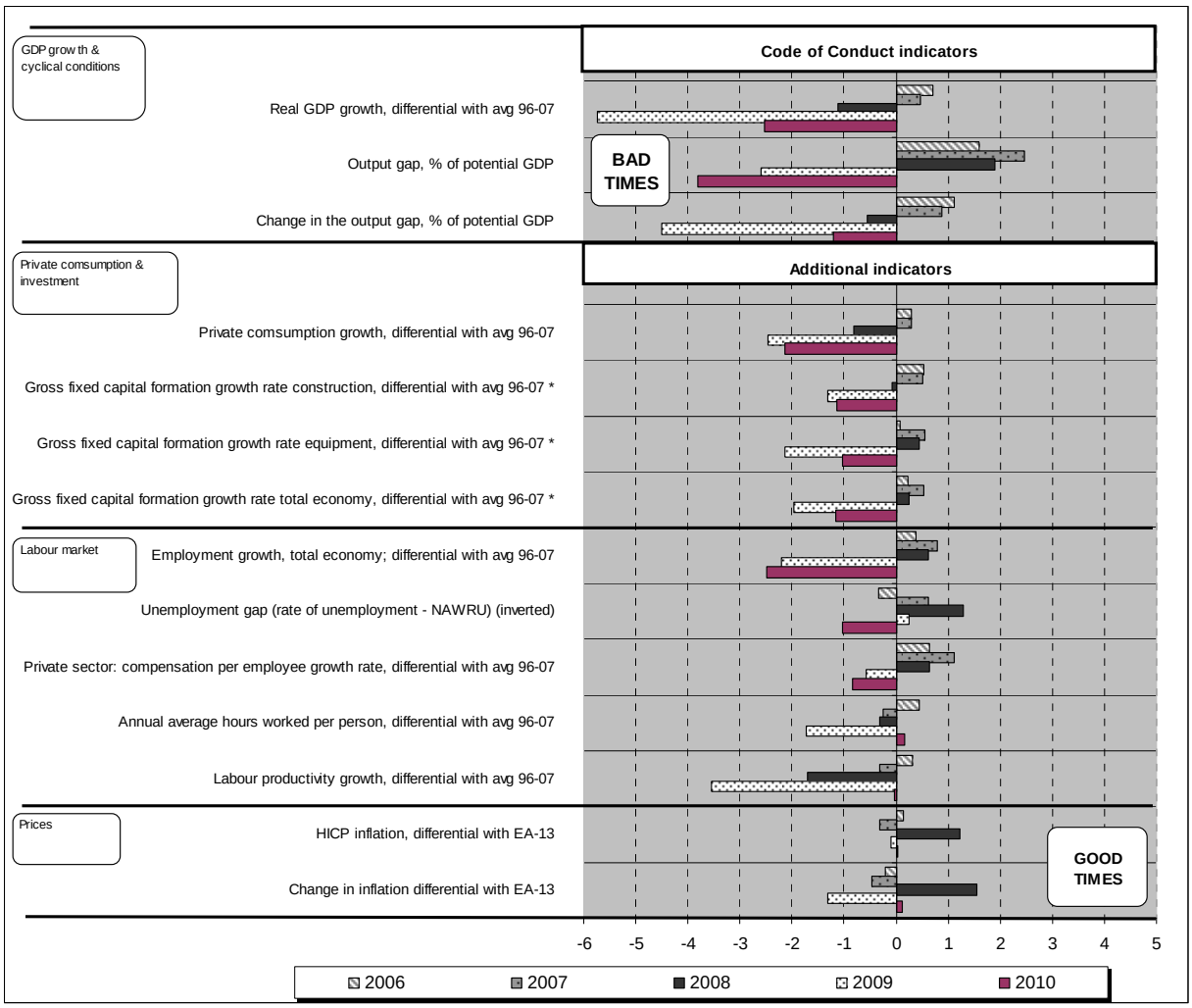
Public expenditure is also higher in Belgium than in the euro area as a whole. Expenditure can be broken down in productive and non-productive expenditure, with only the former having a positive impact on economic growth in a permanent way. In particular expenditure on education, R&D and infrastructure may have a positive impact on the competitive position by stimulating innovation, ensuring the availability of highly skilled workers and by improving the business environment. The share of productive expenditure as a share of GDP is higher in Belgium than in the euro area. This mainly reflects the high level of education spending. In contrast, public expenditure on R&D and infrastructure are lower.

A sufficient amount of spending should be accompanied by the ability to achieve the envisaged outcomes. Therefore, also high efficiency and effectiveness are required. Regarding education, the high level of public spending contributes to a well educated workforce, as witnessed i.a. by the high PISA scores. The efficiency of expenditure is also higher than the euro area average, but some countries, such as the Netherlands and Finland, do even better. In the field of R&D, the low level of public spending does not lead to a lower outcome, pointing to a high efficiency of expenditure. This good score may be due to the higher level of private funding of R&D. In any case, the share of high-tech exports remains weak and the research system could be made more efficient i.a. by coordinating better the policy mix between the various levels of government. There are no figures for public investment in infrastructure, but given the low level of total investment, it is likely that it will also be low for infrastructure. Nevertheless, the outcome is good as a result of past investments, distorting the efficiency measures. In order to safeguard the competitive position, well-targeted projects should be executed, for instance regarding the missing road links and the railway network.

Given the overall high level of public spending, increases in the above-mentioned types of expenditure should be compensated by a higher efficiency and/or a reduction of other types of expenditure. There appears to be some room for this in the field of public employment and in the social security system, for instance regarding health care, unemployment benefits and the pension system. Measures in the latter two fields may also contribute to higher employment, which in turn has a positive impact on public finances.

ANNEX 2. ADDITIONAL TABLES AND FIGURES

Figure 1: Good and bad economic times



Source: Commission services' Spring 2009 forecast (COM)

Table 1: Budgetary implementation in 2008

	2007		2008	
	Planned SP Apr 2008	**Outcome COM**	**Planned SP Apr 2008**	**Outcome COM**
Government balance (% of GDP)	-0.2	-0.2	0.0	-1.2
Difference compared to target	**0.0**		**-1.2**	
Of which : due to a different starting position end 2007			0.0	
due to different revenue / expenditure growth in 2008			-1.1	
p.m. Denominator effect and residual [2,3]			-0.1	
p.m. Nominal GDP growth (planned and outcome)			4.6	2.9
Revenue (% of GDP)	48.7	48.1	49.0	48.6
Revenue surprise compared to target [1]	**-0.6**		**-0.4**	
Of which : due to a different starting position end 2007			-0.6	
due to different revenue growth in 2008			-0.5	
p.m. Denominator effect [2]			0.7	
p.m. Residual [3]			0.0	
p.m. Revenue growth rate (planned and outcome)			5.2	4.2
Expenditure (% of GDP)	48.9	48.3	49.0	49.8
Expenditure surprise compared to target [1]	**0.6**		**-0.8**	
Of which : due to different starting position end 2007			0.6	
due to different expenditure growth rate in 2008			-0.6	
p.m. Denominator effect [2]			-0.8	
p.m. Residual [3]			-0.1	
p.m. Expenditure growth rate (planned and outcome)			4.8	6.2

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source : Commission services

Table 2: Evolution of budgetary targets in successive programmes

		2007	2008	2009	2010	2011	2012	2013
General government balance (% of GDP)	**SP Apr 2009**	**-0.2**	**-1.2**	**-3.4**	**-4.0**	**-3.4**	**-2.6**	**-1.5**
	SP Apr 2008	*-0.2*	*0.0*	*0.3*	*0.7*	*1.0*	*n.a.*	*n.a.*
	COM Spring 2009	-0.2	-1.2	-4.5	-6.1	n.a.	n.a.	n.a.
General government expenditure (% of GDP)	**SP Apr 2009**	**48.3**	**49.8**	**51.6**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	SP Apr 2008	*48.9*	*49.0*	*48.5*	*48.3*	*48.2*	*n.a.*	*n.a.*
	COM Spring 2009	48.3	49.8	52.9	54.3	n.a.	n.a.	n.a.
General government revenue (% of GDP)	**SP Apr 2009**	**48.1**	**48.6**	**48.2**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	SP Apr 2008	*48.7*	*49.0*	*48.8*	*48.9*	*49.2*	*n.a.*	*n.a.*
	COM Spring 2009	48.1	48.6	48.4	48.2	n.a.	n.a.	n.a.
Structural balance[1] (% of GDP)	**SP Apr 2009**	**-1.3**	**-2.0**	**-2.4**	**-2.6**	**-2.4**	**-1.9**	**-1.2**
	SP Apr 2008	*-0.3*	*0.0*	*0.5*	*1.0*	*1.4*	*n.a.*	*n.a.*
	COM Spring 2009	-1.5	-2.2	-3.2	-4.0	n.a.	n.a.	n.a.
Real GDP (% change)	**SP Apr 2009**	**2.8**	**1.1**	**-1.9**	**0.6**	**2.3**	**2.3**	**2.1**
	SP Apr 2008	*2.8*	*1.9*	*2.0*	*2.0*	*2.0*	*n.a.*	*n.a.*
	COM Spring 2009	2.8	1.2	-3.5	-0.2	n.a.	n.a.	n.a.

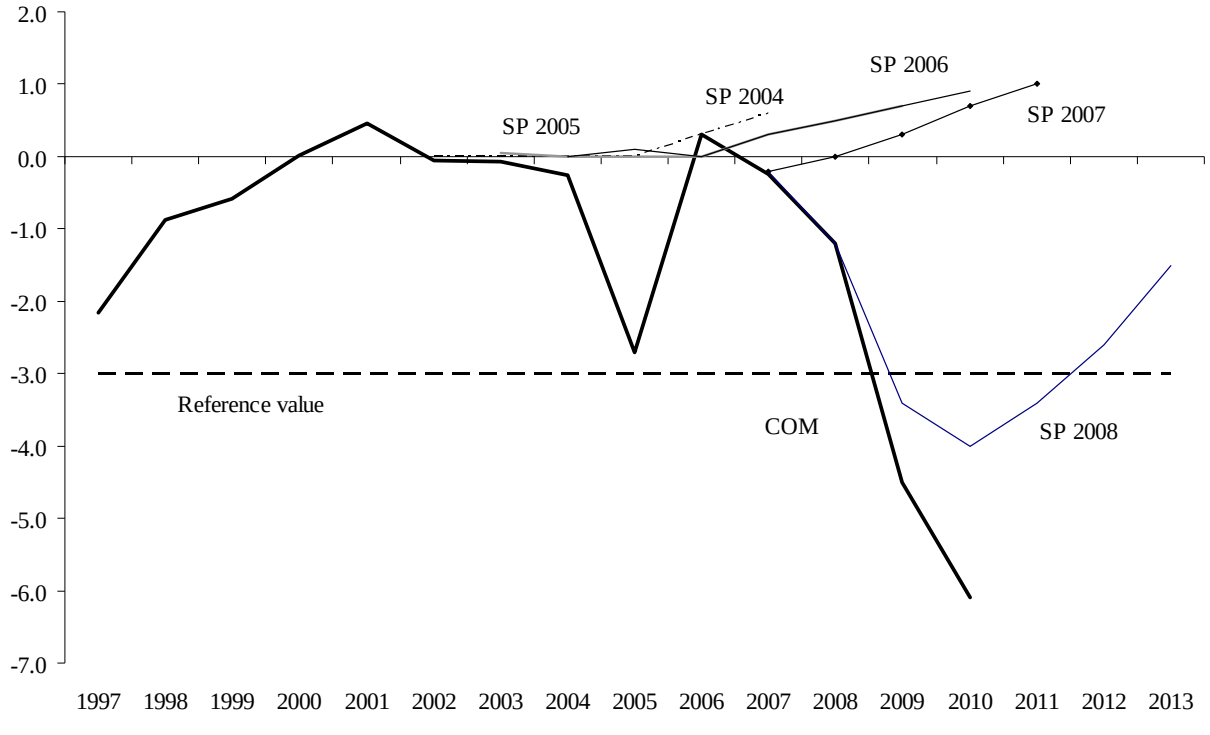
Note:

[1]Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. According to the most recent programme one-off and other temporary measures are deficit-increasing for 0.2% of GDP. According to the Commission services' Spring forecast, one-off and other temporary measures are deficit-increasing for 0.1% of GDP in 2007 and deficit-reducing for 0.1% of GDP in 2009.

Source:

Stability programmes (SP); Commission services' Spring 2009 forecasts (COM)

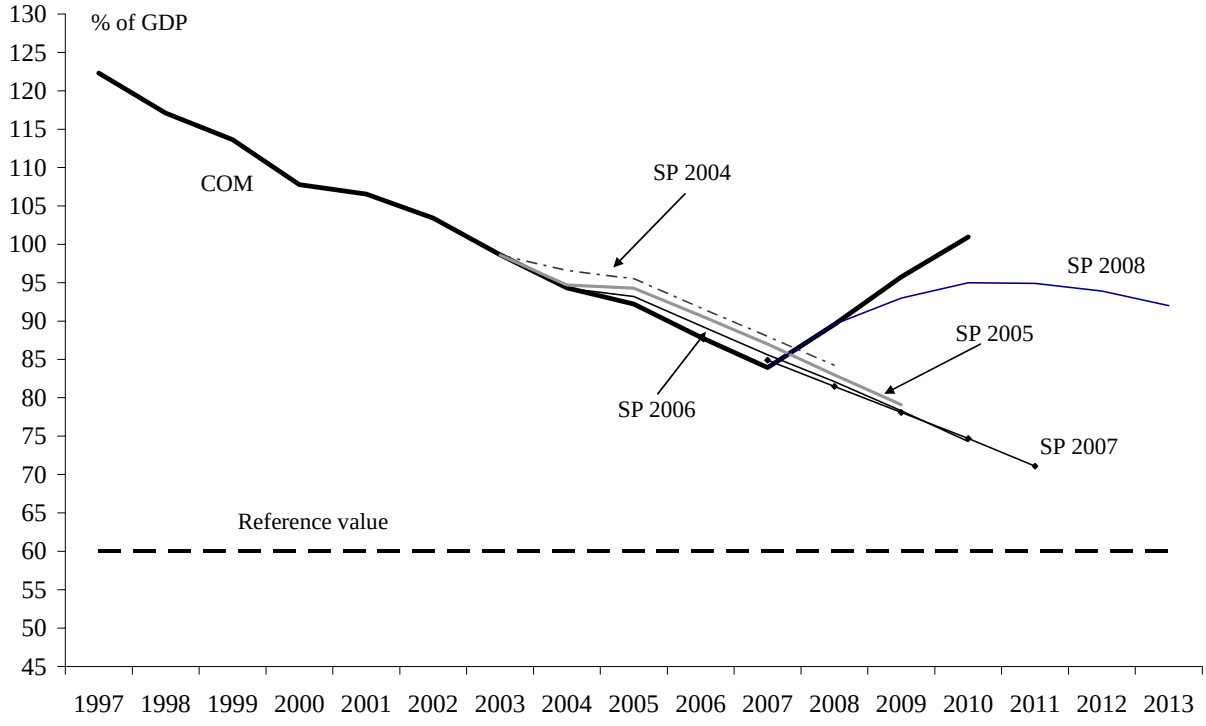
Figure 2: Government balance projections in successive programmes (% of GDP)



This

Source: Commission services' Spring 2009 forecast (COM) and successive stability programmes

Figure 3: Debt projections in successive programmes (% of GDP)



Source: Commission services' Spring 2009 forecast (COM) and successive stability programmes

Table 3: Long-term age-related expenditure: main projections

(% of GDP)	2007	2010	2020	2040	2060	Change 2010- 60
Total age-related spending	**26.5**	**26.8**	**28.2**	**32.7**	**33.4**	**6.6**
- Pensions	10.0	10.3	11.8	14.6	14.7	4.5
- Healthcare	7.6	7.7	8.1	8.7	8.8	1.1
- Long-term care	1.5	1.5	1.7	2.5	2.9	1.3
- Education	5.5	5.4	5.1	5.4	5.5	0.1
- Unemployment benefits	1.9	1.9	1.5	1.5	1.5	-0.4
Property income received	**0.6**	**0.6**	**0.5**	**0.5**	**0.4**	**-0.2**

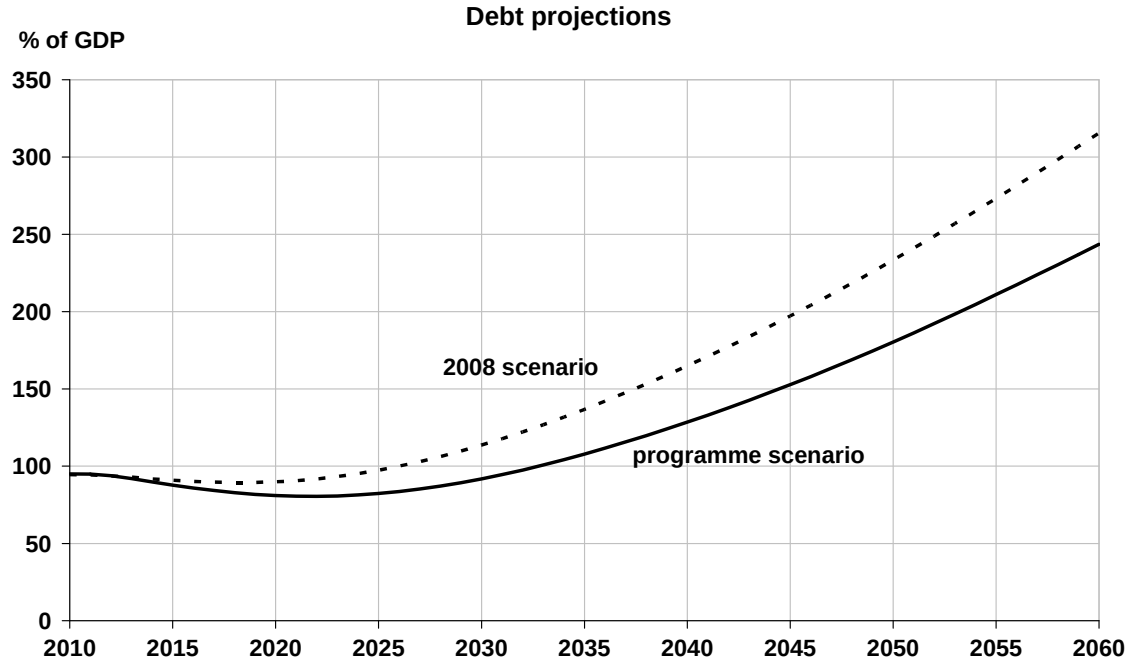
Source: Economic Policy Committee and Commission services.

Table 4: Sustainability indicators and the required primary balance

	2008 scenario			Programme scenario		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	4.0	4.8	6.2	2.9	3.7	6.2
of which:						
Initial budgetary position (IBP)	-0.6	-0.5	-	-1.7	-1.6	-
Debt requirement in 2050 (DR)	0.5	-	-	0.5	-	-
Long-term change in the primary balance (LTC)	4.1	5.3	-	4.1	5.3	-

Source: Commission services.

Figure 4: Long-term projections for the government debt ratio



Note: 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.
Source: Commission services.

Table 5: Additional factors

	Impact on risk
Debt and pension assets	-
Decline in structural balance until 2010 in COM spring 2009 forecast	na
Significant revenues from pension taxation	na
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	-
Non-age related budgetary measures with intertemporal effect	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability.
'na': not applicable.
Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".
An explanation on these factors can be found in chapter IV of: European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006.
Source: Commission services.

ANNEX 3. COMPLIANCE WITH THE CODE OF CONDUCT AND TABLES FROM THE PROGRAMME

The programme update does not provide all compulsory data specified in the standard tables in Annex 2 of the code of conduct. Table 1 d) on the sectoral balance does not provide the compulsory data. Table 2 on the general government budgetary prospects is largely incomplete as it reports all data only for the period 2007 to 2009, while for the outer period (from 2010 to 2013) all compulsory data are missing, except for the general government balance, interest expenditure and the primary balance. In addition, some optional data are missing. Table 1 d) is not filled. Table 2 reports only the sum of compensation of employees and intermediate consumption (line 17), while the breakdown between the two is missing. Similarly, for line 18 on Social payments, only the aggregate social payments are reported, while the breakdown between social transfers in kind and transfers other than in kind is not provided. Data on total government consumption are also missing. Table 3 on general government expenditure by function is empty. Table 4 on general government debt developments is incomplete. The missing variables are the breakdown of the stock-flow adjustment, the liquid financial assets and net financial debt. Table 7 on long-term sustainability is incomplete as the programme only provides information about pension and health care expenditure.

The tables on the following pages show the data presented in the April 2009 update of the stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

Table 1a. Macroeconomic prospects

	ESA Code	2007	2007	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	*288.7*	2.8	1.1	-1.9	0.6	2.3	2.3	2.1
2. Nominal GDP	B1*g	*334.9*	5.2	3.4	1.2	2.4	4.1	4.1	4.0
Components of real GDP									
3. Private consumption expenditure	P.3	*149.1*	2.1	0.9	-0.4	0.7	1.4	1.8	1.9
4. Government consumption expenditure	P.3	*60.5*	2.3	2.4	1.9	1.7	2.3	2.2	1.9
5. Gross fixed capital formation	P.51	*65*	6.2	4.3	-2.8	-0.2	2.8	2.8	1.7
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*n.a.*	1.3	1.7	1.5	1.6	1.7	1.7	1.7
7. Exports of goods and services	P.6	*263.5*	4.0	2.2	-4.5	1.2	4.5	4.8	4.7
8. Imports of goods and services	P.7	*253.8*	4.6	3.7	-3.0	1.4	4.3	4.5	4.4
Contributions to real GDP growth									
9. Final domestic demand		-	3.2	2.4	-0.6	0.8	2.1	2.1	1.8
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.3	0.3	-0.2	0.1	0.2	0.0	0.0
11. External balance of goods and services	B.11	-	-0.4	-1.2	-1.3	-0.2	0.2	0.2	0.3

Table 1b. Price developments

	ESA Code	2007	2007	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		*116.0*	2.4	2.3	3.2	1.7	1.8	1.8	1.8
2. Private consumption deflator		*117.4*	2.8	4.3	0.7	1.8	1.8	1.7	1.8
3. HICP[1]		*114.9*	1.8	4.5	0.7	1.8	1.8	1.7	1.8
4. Public consumption deflator		*122.9*	1.8	4.0	3.4	1.8	2.0	1.8	2.0
5. Investment deflator		*111.6*	2.2	4.1	1.4	2.3	1.5	1.5	1.4
6. Export price deflator (goods and services)		*112.9*	3.0	3.5	-2.5	1.0	1.8	1.7	1.8
7. Import price deflator (goods and services)		*113.1*	2.6	6.1	-4.7	1.5	1.7	1.7	1.8

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2007	2007	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*4364.8*	1.8	1.6	-0.5	-0.5	0.4	1.0	0.9
2. Employment, hours worked[2]		*6458.9*	2.0	1.1	-1.3	-0.2	0.8	0.8	0.9
3. Unemployment rate (%)[3]		*7.5*	7.5	7.1	8.2	9.1	9.3	9.1	8.9
4. Labour productivity, persons[4]		*66.1*	0.9	-0.5	-1.4	1.1	1.9	1.3	1.1
5. Labour productivity, hours worked[5]		*44.7*	0.8	0.1	0.6	0.8	1.5	1.5	1.2
6. Compensation of employees	D.1	*168*	5.8	5.2	2.6	1.8	3.5	4.0	4.2
7. Compensation per employee		*45.9*	3.7	3.3	3.2	2.2	3.0	2.8	3.1

[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 balances

% of GDP	ESA Code	2007	2008	2009	2010	2011	2012	2013
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
of which :								
- Balance on goods and services		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Balance of primary incomes and transfers		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Capital account		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2. Net lending/borrowing of the private sector	B.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Net lending/borrowing of general government	EDP B.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Statistical discrepancy		n.a.	optional	optional	optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	2007	2007	2008	2009	2010	2011	2012	2013
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector									
1. General government	S.13	*-784*	-0.2	-1.2	-3.4	-4.0	-3.4	-2.6	-1.5
2. Central government	S.1311	*-3592*	-1.1	-1.7	-2.4	n.a.	n.a.	n.a.	n.a.
3. State government	S.1312	*993*	0.4	0.0	-0.3	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-191*	-0.1	0.0	-0.2	n.a.	n.a.	n.a.	n.a.
5. Social security funds	S.1314	*1824*	0.5	0.5	-0.4	n.a.	n.a.	n.a.	n.a.
General government (S13)									
6. Total revenue	TR	*160947*	48.1	48.6	48.2	n.a.	n.a.	n.a.	n.a.
7. Total expenditure	TE[1]	*161882*	48.3	49.8	51.6	n.a.	n.a.	n.a.	n.a.
8. Net lending/borrowing	EDP B.9	*-784*	-0.2	-1.2	-3.4	-4.0	-3.4	-2.6	-1.5
9. Interest expenditure	EDP D.41	*12838*	3.8	3.7	3.8	3.9	4.0	4.1	4.1
10. Primary balance[2]		*12053*	3.6	2.5	0.4	-0.1	0.6	1.5	2.5
11. One-off and other temporary measures[3]		*n.a.*	-0.2	0.0	0.0	n.a.	n.a.	n.a.	n.a.
Selected components of revenue									
12. Total taxes (12=12a+12b+12c)		*99490*	29.7	29.7	29.0	n.a.	n.a.	n.a.	n.a.
12a. Taxes on production and imports	D.2	*42810*	12.8	12.5	12.2	optional	optional	optional	optional
12b. Current taxes on income, wealth, etc	D.5	*54455*	16.3	16.5	16.1	optional	optional	optional	optional
12c. Capital taxes	D.91	*2225*	0.7	0.7	0.7	optional	optional	optional	optional
13. Social contributions	D.61	*52663*	15.7	16.2	16.3	optional	optional	optional	optional
14. Property income	D.4	*2087*	0.6	0.7	0.8	optional	optional	optional	optional
15. Other[4]		*6707*	2.0	2.1	2.1	optional	optional	optional	optional
16=6. Total revenue	TR	*160947*	48.1	48.6	48.2	n.a.	n.a.	n.a.	n.a.
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			46.1	46.5	46.0	n.a.	n.a.	n.a.	n.a.
Selected components of expenditure									
17. Compensation of employees + intermediate consumption	D.1+P.2	*51105*	**15.3**	**15.8**	**16.1**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
17a. Compensation of employees	D.1	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
17b. Intermediate consumption	P.2	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18. Social payments (18=18a+18b)		*74651*	22.3	23.2	24.6	n.a.	n.a.	n.a.	n.a.
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18b. Social transfers other than in kind	D.62	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
19=9. Interest expenditure	EDP D.41	*12838*	3.8	3.7	3.8	n.a.	n.a.	n.a.	n.a.
20. Subsidies	D.3	*6543*	2.0	2.1	2.1	n.a.	n.a.	n.a.	n.a.
21. Gross fixed capital formation	P.51	*5439*	1.6	1.6	1.7	n.a.	n.a.	n.a.	n.a.
22. Other[6]		*11307*	3.3	3.4	3.3	n.a.	n.a.	n.a.	n.a.
23=7. Total expenditure	TE[1]	*161882*	48.3	49.8	51.6	n.a.	n.a.	n.a.	n.a.
p.m.: Government consumption (nominal)	P.3	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

[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, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

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

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2006	2011
1. General public services	1	n.a.	n.a.
2. Defence	2	n.a.	n.a.
3. Public order and safety	3	n.a.	n.a.
4. Economic affairs	4	n.a.	n.a.
5. Environmental protection	5	n.a.	n.a.
6. Housing and community amenities	6	n.a.	n.a.
7. Health	7	n.a.	n.a.
8. Recreation, culture and religion	8	n.a.	n.a.
9. Education	9	n.a.	n.a.
10. Social protection	10	n.a.	n.a.
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	n.a.	n.a.

[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	ESA Code	2007	2008	2009	2010	2011	2012	2013
1. Gross debt[1]		84.0	89.6	93.0	95.0	94.9	93.9	92.0
2. Change in gross debt ratio		-3.9	5.6	3.4	2.0	-0.1	-0.9	-1.9
Contributions to changes in gross debt								
3. Primary balance[2]		3.6	2.5	0.4	-0.1	0.6	1.5	2.5
4. Interest expenditure[3]	EDP D.41	3.8	3.7	3.8	3.9	4.0	4.1	4.1
5. Stock-flow adjustment		0.2	6.8	1.1	0.2	0.2	0.2	0.2
of which:								
- Differences between cash and accruals[4]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets[5]		-	-	-	-	-	-	-
of which:		-	-	-	-	-	-	-
- privatisation proceeds		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other[6]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
p.m.: Implicit interest rate on debt[7]		4.6	4.6	4.3	4.3	4.4	4.5	4.5
Other relevant variables								
6. Liquid financial assets[8]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

[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 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	2007	2008	2009	2010	2011	2012	2013
1. Real GDP growth (%)		2.8	1.1	-1.9	0.6	2.3	2.3	2.1
2. Net lending of general government	EDP B.9	-0.2	-1.2	-3.4	-4.0	-3.4	-2.6	-1.5
3. Interest expenditure	EDP D.41	3.8	3.7	3.8	3.9	4.0	4.1	4.1
4. One-off and other temporary measures[1]		-0.2	0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		2.1	1.9	1.5	1.4	1.4	1.5	1.5
contributions:								
- labour		0.8	0.6	0.4	0.4	0.3	0.3	0.3
- capital		0.9	1.0	0.8	0.7	0.7	0.8	0.7
- total factor productivity		0.4	0.3	0.3	0.3	0.4	0.4	0.4
6. Output gap		2.1	1.3	-2.2	-2.9	-2.1	-1.3	-0.7
7. Cyclical budgetary component		1.1	0.7	-1.2	-1.6	-1.1	-0.7	-0.4
8. Cyclically-adjusted balance (2 - 7)		-1.4	-1.9	-2.2	-2.4	-2.3	-1.9	-1.1
9. Cyclically-adjusted primary balance (8 + 3)		2.5	1.8	1.6	1.5	1.7	2.2	2.9
10. Structural balance (8 - 4)		-1.2	-1.9	-2.2	-2.4	-2.3	-1.9	-1.1

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2007	2008	2009	2010	2011	2012	2013
Real GDP growth (%)								
Previous update		2.7	1.9	2.0	2.0	2.0	n.a.	n.a.
Current update		2.8	1.1	-1.9	0.6	2.3	2.3	2.1
Difference		0.1	-0.8	-3.9	-1.4	0.3	n.a.	n.a.
General government net lending (% of GDP)	EDP B.9							
Previous update		-0.2	0.0	0.3	0.7	1.0	n.a.	n.a.
Current update		-0.2	-1.2	-3.4	-4.0	-3.4	-2.6	-1.5
Difference		0.0	-1.2	-3.7	-4.7	-4.4	n.a.	n.a.
General government gross debt (% of GDP)								
Previous update		84.9	81.5	78.1	74.7	71.1	n.a.	n.a.
Current update		84.0	89.6	93.0	95.0	94.9	93.9	92.0
Difference		-0.9	8.1	14.9	20.3	23.8	n.a.	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2000	2007	2010	2020	2030	2050
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension expenditure	n.a.	8.8	9.1	10.5	12.3	13.3
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other pensions (disability, survivors)	n.a.	1.2	1.3	1.3	1.2	1.1
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	n.a.	7.0	7.6	8.1	8.9	10.4
Long-term care *(this was earlier included in the*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Education expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : from pensions contributions (or social contributions if appropriate)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Real GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Participation rate males (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Participation rates females (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total participation rates (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Unemployment rate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Population aged 65+ over total population	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Table 8. Basic assumptions

	2007	2008	2009	2010	2011	2012	2013
Short-term interest rate[1] (annual average)	n.a.	3.7	1.2	1.8	2.5	2.9	3.0
Long-term interest rate (annual average)	n.a.	4.4	3.6	3.9	4.9	4.9	4.9
USD/€ exchange rate (annual average) (euro area and ERM II countries)	n.a.	147.10	134.50	133.70	133.70	133.70	133.70
Nominal effective exchange rate	n.a.	110.5	111.6	111.9	111.9	111.9	111.9
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	n.a.	4.0	1.2	3.2	5.0	5.0	5.0
EU GDP growth	n.a.	1.0	-1.8	0.5	2.4	2.4	2.4
Growth of relevant foreign markets	n.a.	3.5	-3.1	2.5	6.2	6.4	6.4
World import volumes, excluding EU	n.a.	5.6	1.8	4.5	7.0	7.0	7.0
Oil prices (Brent, USD/barrel)	n.a.	96.9	52.5	63.1	64.9	66.9	69.0

[1]If necessary, purely technical assumptions.

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