Belgium's stability programme 2003-2005

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(English version)

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Content

1. The key points of the stability programme for 2003-2005

Second update of the 2001-2005 stability programme

The stability programme for 2003-2005 constitutes the second update of the 2001-2005 stability programme, presented at the end of 2000. That programme had two aims :

- first, the consolidation of public finances and reduction of the public debt are being relentlessly pursued by progressively building up budget surpluses. Assuming a trend growth rate of 2.5%, the stability programme expected to see a surplus of 0.7% of GDP built up by 2005;

- second, within this budget framework, under the medium-term plan for 2001-2005, the necessary funding was made available for structural measures. This created the margin essential to reduce the fiscal and parafiscal pressure, and more funds were provided for various priority policy areas (public administration, development cooperation, mobility, sustainable development, security, social policy and employment policy, etc.).

Disappointing growth

Since the marked weakening of the economy which became apparent early in 2001, and more than a year after the events of 11 September 2001, the situation of the world economy remains highly uncertain. The initial optimism about a rapid recovery has faded. Growth forecasts for 2002 and 2003 have been repeatedly downgraded. The macroeconomic context is very different from the one prevailing at the time of previous stability programme updates.

With GDP up by 0.7% at constant prices, growth in 2002 will reach about half the level of 1.3% originally predicted. Despite this disappointing growth, public finances will probably be more or less in balance at the end of 2002.

The target remains a balanced budget

Despite the unfavourable macroeconomic context, the Belgian government is therefore adhering to the targets of the Stability and Growth Pact, notably endeavouring to achieve a budget situation close to balance or in surplus. Guaranteeing sound public finances is important to create the best conditions for price stability and strong, sustainable growth, thus promoting employment. Furthermore, in the Belgian context, these principles must be maintained in order to ensure a sufficiently rapid reduction in the public debt. This should make it possible to absorb the growing demographic pressure on social spending.

Adjustment of the targets

In the stability programme for 2002-2005 approved last year, the aim of progressively creating a substantial budget surplus was maintained. Assuming that the economy turned around during 2002 and a strong recovery ensued, we could then expect the 2003 growth figures to be in the region of 3%. If this expectation had come true, the stability plan for 2001-2005, which provided for a budget surplus totalling 0.5% of GDP, would have been back on course.

Meanwhile, it has become apparent that this expectation is unrealistic. According to the growth forecasts used to draw up the 2003 budget (0.7% in 2002 and 2.1% in 2003), the cumulative growth for these two years will be 1.5 percentage points lower than was projected last year. This sharp and unexpected deterioration in economic growth has thwarted the planned creation of financing capacity from 2003 onwards, and forced the government to adjust its targets.

Priorities for the 2003 budget

The government has set three priorities for the 2003 budget:

- to consolidate public finances by guaranteeing a balanced budget;
- to sustain confidence by implementing in full the measures previously decided on;
- to create, within a strict budget framework, the scope for a series of new social and economic policy initiatives.

If growth in 2003 exceeds current expectations, then - as in previous years - the declared priority will be to allocate the additional margin to improving the financing balance.

Consolidation of restoring sound public finances

Preservation of a balance consolidates the progress made in restoring sound public finances. At the same time, it establishes the basis for creating a surplus as soon as the macroeconomic situation permits. The economy is expected to pick up in 2003, and in the ensuing years GDP growth is expected to outpace the trend growth rate. In view of these predictions and the assumptions adopted regarding interest rates, the government considers it desirable to create financing capacity of 0.5% of GDP by 2005. This would mean that, even though the economic environment is decidedly less favourable than forecast, the target set by the stability programme for 2001-2005 would be almost met, and fully respected in structural terms.

Work for the next government

Since federal parliament elections will be held in 2003, this stability programme update is the last one to be submitted by the present government. It will be for the next government to define, in its first stability programme, a new scenario covering the forthcoming legislative period (2003-2007).

2. The economic environment

2.1. The international context

2001: economic slowdown and hesitating recovery

During most of 2001 there was a marked slowdown in economic activity, temporarily accentuated following the events of 11 September. However, by the end of the autumn 2001 a vigorous recovery had begun in the United States. It became widespread in the industrial world, and especially in Europe, in the first quarter of 2002. However, in the second quarter the initial momentum seemed to ebb away.

In the United States the effects of the policy of stimulating demand are probably beginning to fade. More generally, consumer and business confidence may have been hit by the situation on the financial markets and the threat of international conflict. Finally, the necessary adjustments for the development of the upward phase in the cycle - reducing stocks or cutting back excess capacity in some sectors- have probably taken longer than was hoped.

However, in the absence of new shocks, factors which have hitherto inhibited growth could fade away, and economic expansion in Europe could gradually gather momentum.

2.2. Short-term outlook for the Belgian economy

Short-term outlook in line with European average

Generally speaking, the short-term outlook for the Belgian economy is in line with the average for Europe, and more particularly for the euro area.

Following the contraction of domestic product, in real terms, observed from the beginning of 2001, economic activity revived in the first half of 2002. The national accounts data relating to the second quarter of 2002 show that the recovery recorded in the first quarter continued into the second, though at a less sustained rate. GDP grew by 0.3% in the second quarter compared to the first ; the corresponding growth for the first three months of the year had been 0.6%. In the second quarter, the level of activity was 0.5% higher than the figure for the corresponding quarter in the previous year. (1)

The National Bank's synthetic curve, a slightly advanced indicator of activity, rose sharply until May before undergoing a marked decline during the summer. The November figures tend to show a slight improvement in the economic climate.

[1] All data adjusted for seasonal variations and/or calendar effects.

TABLE 1 Growth and related factors					
Percentage change except where otherwise stated	**2001**	**2002(1)(3)**	**2003(2)**	**2004(2)**	**2005(2)**
Growth of GDP at constant prices (7+8+9)	0,8	0,7	2,1	2,5	2,5
Level of GDP at current prices (in billions of euro)	254,3	261,3	271,0	282,3	293,7
GDP deflator	2,0	2,1	1,6	1,6	1,5
Change in the HICP	2,4	1,5	1,4	1,6	1,6
Change in employment	1,2	-0,6	0,8	0,8	0,8
Unemployment (Eurostat definition)	6,6	6,9	6,8	6,9	6,9
Change in labour productivity	-0,3	1,4	1,4	1,7	1,7
	Growth sources: change at constant prices				
1. Final consumption expenditures of individuals	1,0	0,5	2,1	2,3	2,3
2. Final consumption expenditures of general government	2,2	1,6	2,0	1,5	1,8
3. Gross fixed capital formation	0,5	-2,2	2,2	2,6	3,2
4. Change in stocks	-0,7	-0,1	-0,1	-0,1	-0,1
5. Exports of goods and services	1,1	-0,4	4,6	4,9	4,9
6. Imports of goods and services	0,8	-0,4	4,7	4,7	4,9
	Contribution to growth of GDP				
7. Total final demand (1+2+3)	1,1	0,1	2,0	2,1	2,3
8. Change in stocks	-0,7	0,6	0,0	0,0	0,0
9. Balance of goods and services	0,3	0,0	0,2	0,4	0,2

(1) Source : Federal Planning Bureau/NAI Economic Budget, September 2002.

(2) Source : Federal government on the basis of the September 2002 medium-term projection for 2002-2006 by the Federal Planning Bureau.

(3) The movement in certain aggregates was influenced in 2002 by the effect on the national accounts of the transfer of public radio and television broadcasting companies from the non-financial corporations sector to the general government sector..

Evolution savings ratio and consumption

In 2001, the real growth of household consumption was extremely weak from the second quarter onwards. The financial market turbulence and the deterioration in the labour market encouraged households to step up their savings. The factors which boosted household propensity to save in the second half of last year persisted for most of 2002, increasing the savings ratio from 14.4% in 2001 to 15.8% in 2002. But from here on, the savings ratio should stabilise and private consumption should keep more or less in line with the movement in household disposable incomes, sustained by the impact of the personal income tax reform and the gradual recovery of job creation. This would cause private consumption to increase by 2.1% in 2003 against 0.5% in 2002.

Evolution employment

Employment should start to expand again, though lagging slightly behind the upturn in the economy, as job creation strengthens steadily during 2003 to reach 0.8% (around 30,000 units) over the year as a whole.

Evolution business investment

Similarly, business investment is likely to take time to revive. The existence of excess capacity, some uncertainty over the strength of demand, and the past erosion of profitability will impede that recovery, which will probably not occur until the beginning of 2003. Overall, investment should increase by 2.2% in 2003 after a corresponding fall in 2002.

Evolution GDP

When drawing up the 2003 budget, the Government predicted economic growth of 0.7% for the full year in 2002. In real terms, GDP is forecast to grow by 2.1% in 2003.

Evolution consumption prices

The downward trend in inflation which had begun in mid 2001 suffered only a temporary interruption from January to March. Since July, the year-on-year rise in private consumption prices has been steady in the region of 1.3%. As an annual average, the rise in the harmonised index of consumer prices should be in the order of 1.5% in 2002. It is estimated at 1.4% for 2003. (2).

[2] This forecast takes account of an increase in the average price of a barrel of oil (Brent) to $25.5 in 2003 against $ 24.5 in 2002, an increase which will be only partly offset by the appreciation of the euro.

2.3. Medium-term forecasts

Update medium-term forecasts

In September 2002 the Federal Planning Bureau updated its medium-term forecasts. For 2004 and 2005, the growth of Belgium's potential export markets (+5.5% and +5.2% respectively) is calculated on the basis of a cautious assumption, based on the potential growth of the 15 EU countries. The average price of a barrel of Brent is estimated to increase by $1 each year ($27.4 in 2005).

The growth of GDP at constant prices is estimated at 2.5% in both 2004 and 2005, i.e. slightly above the potential growth rate.

The growth will continue to be driven mainly by domestic demand, the contribution made by net exports being very small. Household disposable income will be favourably influenced by the improvement in employment and the impact of the reduction in personal income tax, as the wages share stabilises. Business investment will become increasingly sustained, encouraged by the improvement in demand prospects, but also by the reform of corporation tax.

3. The financing balance and the public debt

3.1. Key points of fiscal policy

Objectives for medium-term fiscal policy

In its stability programme for 2001-2005 presented at the end of 2000, the government had adopted two aims for its medium-term fiscal policy.

- *Pursued consolidation of public finances*

  First, the consolidation of public finances was to be pursued by the progressive creation of budget surpluses. This is not only necessary to render the budget less sensitive to changes in interest rates, but is also vital for absorbing the budgetary impact of the ageing population over the next decade. The 2001-2005 stability programme provided for the creation of financing capacity rising from 0.2% of GDP in 2001 to 0.7% in 2005, on the assumption of a trend growth rate of 2.5%.

- *Making available funding for structural measures*

  Second, within this budget framework, the funding necessary for structural measures was made available, one aim being to enhance the growth potential of the Belgian economy. Thus, the government aimed to create a new dynamism in employment - e.g. by a sharp cut in taxes on earned incomes - to modernise social security in order to adapt it to the new needs of the population, to boost the efficiency of public administration, judicial authorities and security bodies and to promote sustainable development and mobility. Important initiatives were developed in all these areas.

Adjusting budget targets

Meanwhile, it is now clear that the macroeconomic framework forming the basis of the stability programme for 2001-2005 has been overtaken by events. During the 2001-2003 period, the cumulative growth of GDP will be about 4.0 percentage points lower than the figure assumed in the stability programme for 2001-2005. In this modified context, circumstances made it necessary to adjust the budget targets.

Adhering to achieve an equilibrium or

Despite the unfavourable macroeconomic context, the government is therefore adhering to the targets of the Stability and Growth Pact, notably endeavouring to achieve a budget situation close to balance or in surplus. Guaranteeing sound public finances is important to create the best conditions

surplus

Guaranteeing sound public finances is important to create the best conditions for price stability and strong, sustainable growth, and hence for promoting employment. Thus, in 2003 a balanced budget was presented for the fourth consecutive year.

A sound fiscal policy undeniably helps to create a general climate of confidence. It is at least equally important that the government has made a point of ensuring full implementation of the measures announced, in both 2002 and 2003, within the tight budget framework. Moreover, an additional effort has been made on each occasion to create the supplementary margin necessary for essential new initiatives.

The maintenance of a balanced budget in 2003 also makes it possible to consolidate past efforts. Furthermore, it permits the creation of a sound basis for the progressive development of a surplus, as soon as the macroeconomic climate takes a turn for the better.

3.2. Execution of the 2002 budget

Budget 2002 drawn on economic recovery

The initial 2002 budget was drawn up after the events of 11 September 2001. Although the slowdown in growth was apparent before that date, it was very difficult to foresee how the economy would react to these events. The government adopted a macroeconomic scenario based on a gradual economic recovery which would strengthen during 2002. The estimated rate of GDP growth assumed for 2002 was 1.5%. To be on the safe side, in estimating fiscal and parafiscal revenues, the federal government assumed that GDP would grow by 1.3% and, for that purpose, made provision for an anticyclical buffer in the budget. In response to the slackening of growth, the original target of a surplus of 0.3% of GDP had to be reduced to a balance.

Budget review: budget 2002 revised

At the time of the budget review, early in 2002, the various assumptions underlying the original budget were revised in line with more recent data. Meanwhile, it had become obvious that the growth revival would emerge later than predicted. The growth forecast was downgraded to 0.9%. The estimate of tax revenues had to be revised, not only in consequence of the unfavourable growth but also following the disappointing 2001 revenue figures. Despite these setbacks, the target for the financing balance, namely a balanced budget, remained unchanged.

Additional mechanisms to meet the targets

On the occasion of the same budget review, some additional mechanisms were developed so that the target could actually be met. In order to keep in line with the movement in primary expenditure of federal government, that expenditure was made subject to the " anchor principle ". In practice, this means that the pattern of primary expenditure was strictly monitored in 2002. The agreements concerning the targets to be met were confirmed between the various communities and regions and the federal government, and a system for monitoring the progress of primary expenditure was also set up. Data on developments in this primary expenditure are exchanged every month. This form of "peer review" increases the accountability of the entities concerned.

Additional budget review

As in 2001, the federal government conducted an additional budget review at the beginning of July 2002. This revealed that, in general, the execution of the budget was proceeding as planned.

The 2003 budget

The preparation of the 2003 budget (which was finalised at the beginning of October) presented a new opportunity to evaluate the execution of the 2002 budget. This update is in fact used as the basis for drawing up the 2003 budget. The federal government's tax revenues appear to be in line with the estimates. Revenue from social security contributions will probably exceed the budget figures, one reason being the cautious assessment at the time of the budget review. This " gain " should make it possible, in particular, to absorb the unemployment expenditure which will be higher than forecast. According to the available data, and in contrast to previous years, expenditure on health care should keep within the limits of the budget allocated. The government is keeping a close eye on revenue and expenditure. The 2002 budget can therefore be expected to end up more or less in balance once again.

3.3. The 2003 budget

GDP growth lower than forecasted

The stability programme for 2002-2005 had aimed at financing capacity totalling 0.5% of GDP in 2003. Meeting that target meant reckoning on a strong recovery in economic growth. If the turning point in the cycle occurred in 2002 and brought a vigorous revival in economic growth, then - with the growth of more than 1% achieved by the end of 2002 - growth in the region of 3% could be forecast for 2003. If this forecast proved correct, the stability programme for 2001-2005 would be back on course, heading for the target of a budget surplus totalling 0.5% of GDP.

When the 2003 budget was drawn up, the government assumed that growth would be in line with the latest forecasts, namely GDP growth of 2.1%. The macroeconomic scenario therefore did not correspond to the one described in the stability programme for 2002-2005. With economic growth expected to total 0.7% in 2002 and 2.1% in 2003, the cumulative growth for these two years is about 1.5 percentage points lower than the 4.3% suggested in the 2002-2005 stability programme.

Maintaining balance in stead of surplus

In view of this altered context, the government considers that it will be meeting its commitments by maintaining a balance. However, if growth in 2003 should prove to be higher than currently predicted, the additional margin would be used as a matter of priority for improving the financing balance.

It was not only the weakness of the economy that made it difficult to achieve a balanced budget in 2003; as well as that, it was necessary to compensate for the disappearance of two factors which had a favourable influence on the 2002 budget, namely the proceeds from the sale of real estate and the reduction in the contribution to the European Union, due to the carrying forward of the EU budget surpluses in 2001. ([3])This meant that, for 2003, not only was there a lack of funding for new initiatives, but it was also necessary to take economy measures.

The achievement of a balanced budget does not mean that the government has suddenly abandoned the policy pursued in previous years. On the contrary, it will implement in full the measures already decided on. Some of those measures are discussed in section 5 below.

[3] At the time of the 2002 budget review, allowance was made for a reduction of 380 million euro in the total contribution to the European Union budget. The central government budget made provision for 471 million euro for the proceeds from the sale of real estate. The impact of these two factors is around 0.3% of GDP.

3.4. The medium-term objectives

Necessity to bring down public debt

In Belgium there is a broad consensus about the key points of medium-term fiscal policy. The attainment and consolidation of a balanced budget must not mean the end of the overhaul of public finances. In fact, it is necessary to bring down the high level of public debt sufficiently quickly so that, among other things, it will be possible to cushion the pressure on spending exerted by population trends. This must be done by steadily building up financing capacity as soon as the economic context permits.

Gradual creation of a budget surplus

The original aim has been modified in the light of the economic developments over the past three years. In 2003, for the fourth consecutive year, a balanced budget is presented. This not only consolidates the past efforts to restructure public finances, but also establishes the basis for creating a budget surplus as soon as the economic situation permits. Thus, in 2003 the economy is expected to pick up and in the ensuing years GDP growth is predicted to outpace the trend rate of growth. In view of these expectations and the assumptions adopted as regards interest rates, the government considers it desirable to create financing capacity of 0.5% of GDP by 2005.

Since elections for the federal parliament will be held some time in 2003, it will be for the next government to define a course for the 2004-2007 period in the next stability programme, on the basis of the points described above.

3.5. A general view of public finances 2001-2005

Interpretation figures table 2

Attention should be drawn to the status of the figures in table 2. The figures for the financing balance for 2003 represent a clear commitment by the current government. That is not so in the case of the target financing balances for 2004 and 2005, or for the more detailed figures for revenue and expenditure. For various reasons, these figures are more by way of a guide:

- *Federal elections in 2003*

  First, in view of the parliamentary elections scheduled for 2003, the present government cannot give any commitment for the period after 2003. However, we can assume that the fiscal policy geared to a reduction in the public debt will be maintained. If additional effort should be required to achieve that, it will be for the next government to make the necessary decisions.

- *Autonomy of the various entities*

  Second, in order to obtain data on revenue and expenditure at an aggregate level, it is necessary to amalgamate the movements in revenue and expenditure of the various entities in the general government sector. Under the Belgian federal system, the various federated entities guarantee to achieve a certain result in terms of the financing balance. They have extensive autonomy over their revenue and expenditure policy.

TABLE 2 The general government budget					
% of GDP	2001(1) (2)	2002	2003	2004	2005
Financing balance of the sub-sectors					
General government	0,4	0,0	0,0	0,3	0,5
Federal government	-0,9	-0,4	-0,4	-0,1	0,1
Communities and regions	0,8	0,1	0,1	0,1	0,1
Local authorities	-0,1	0,1	0,2	0,1	0,1
Social Security institutions	0,7	0,2	0,1	0,2	0,2
General government					
Total revenue	49,8	49,5	48,9	48,7	48,4
Total expenditure	49,4	49,5	48,9	48,4	48,0
Financing balance	0,4	0,0	0,0	0,3	0,5
Interest charges	6,5	6,1	5,6	5,3	5,1
Primary balance	7,0	6,1	5,5	5,6	5,6
Main components of revenue					
Taxes	30,7	30,4	30,1	30,0	29,8
Social security contributions	16,4	16,4	16,2	16,2	16,1
Other	2,7	2,7	2,6	2,6	2,6
TOTAL REVENUE	49,8	49,5	48,9	48,7	48,4
Main components of expenditure					
Consumption expenditure (compensation and intermediate consumption)	14,8	14,7	14,6	14,5	14,3
Social benefits in kind	6,6	6,6	6,8	6,8	6,9
Other social benefits	15,5	15,8	15,6	15,4	15,1
Interest charges	6,5	6,1	5,6	5,3	5,1
Subsidies	1,6	1,6	1,5	1,5	1,5
Gross fixed capital formation	1,5	1,5	1,5	1,5	1,7
Other	2,8	3,3	3,3	3,4	3,4
TOTAL EXPENDITURE	49,4	49,5	48,9	48,4	48,0

(1) Figures for 2001 include revenue from the sale of UMTS licences. Excluding the UMTS revenue, the central government's financing capacity comes to 0.3% of GDP.

(2) In 2001, the federal government took over the debts of the social security systems covering employees and self-employed persons. According to the ESA methodology, this operation is recorded as a capital transfer, causing a deterioration in the financing capacity of central government, while that of the social security authorities has improved.

Reduction in revenues due to personal income tax reform

In future years, a feature of public finances will be the continuing reduction in revenues in relation to GDP. The impact on the budget of the personal income tax reform (see section 5) will in fact increase year by year, reaching its full level in 2006. In conjunction with the progressive abolition of the complementary crisis contribution, which will come to an end in 2003, this reform will reduce the burden of taxation by around 1.3% of GDP between 2001 and 2005.

The large structural increase in the reduction in social security contributions made itself felt particularly in 2000 and 2001. Section 5 presents comments on the latest measures in this field.

Weight of primary expenditure

The weight of primary expenditure increased in 2002 as a result of the weak growth in 2001 and 2002 (denominator effect), the rise in unemployment expenditure and the integration of the public radio and television broadcasting companies in the general government sector. Given normal economic growth, the share of primary expenditure in GDP will tend to decline in future years.

Reduction in interest charges

This update of the stability programme is based on the assumption that, in a more favourable economic climate, long-term interest rates will rise from 5.1% in 2003 to 5.4% in 2004. By the end of that period, short-term interest rates will be 4.4%. These assumptions about interest rates, combined with the composition of the debt, would lead to a reduction in interest charges from 6.5% of GDP in 2001 to 5.1% in 2005.

Necessary primary surplus

Taking account of these interest rate assumptions, in order to achieve financing capacity of 0.5% of GDP in 2005 the primary surplus can remain practically stable at the 2003 level.

3.6. The contribution of the various sub-sectors to general government ([4])

Coordination of budgetary policy with federated entities is required

In a federal state, the fiscal policy of the various federated entities has to be coordinated so that each of them contributes towards the attainment of the target set at general government level. The Belgian experience shows that a system of clear agreements about the result to be achieved, coupled with the accountability of the various sub-sectors, ensures fulfilment of the obligations.

Agreements with regions and communities

The collaboration of the various levels of public authority in the attainment of the targets is ensured by the conclusion of agreements between the federal government and the communities and regions. Under the agreement of 15 December 2000 [(5)] the communities and regions undertook to adhere, during 2001-2005, to the targets proposed by the 'Financing Requirements' section of the Superior Finance Council. [(6)] In ESA terms, that amounts to achieving financing capacity of 0.1% of GDP.

In their role of supervising the local authorities, the regions undertook to encourage the latter to attain the budget targets set in the stability programme for 2001-2005. For local authorities, the agreement suggested financing capacity of 0.2% of GDP for the 2001-2003 period. This anticipated the improvement in the budget position of local authorities which, traditionally, occurs in the years immediately following the municipal elections [(7)].The suggested target financing capacity for subsequent years (2004-2005) is 0.1% of GDP. For 2002, the government is currently assuming that local authorities will have financing capacity of 0.1%. For 2003 and subsequent years, it is assumed that local authorities will meet the target set in the agreement.

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[4] For the purpose of analysing Belgian public finances, a distinction is often made between Entity I and Entity II. Entity I comprises the federal government and social security, whereas Entity II comprises the communities, regions and local authorities.

[5] Agreement of 15 December 2000 between the Federal State, the Flemish Community, the French Community, the German-speaking Community, the Wallonia Region and the Brussels-Capital Region concerning the budget targets for the period 2001-2005.

[6] The " Financing Requirements " section of the Superior Finance Council is an advisory body which puts forward recommendations each year on the government's fiscal policy, and more particularly that of the communities and regions.

[7] The local elections are held every 6 years. They last took place in October 2000.

TABLE 3 Breakdown of the targets between the various entities					
% of GDP	Actual figure 2001	Estimate 2002	Agreement		
			2003	2004	2005
Primary balance	7,0	6,1	5,5	5,6	5,6
Entity I	5,8	5,4	4,8	5,0	5,0
Entity II	1,2	0,7	0,7	0,6	0,6
Interest charges	6,5	6,1	5,6	5,3	5,1
Entity I	6,0	5,6	5,1	4,9	4,7
Entity II	0,5	0,5	0,5	0,4	0,4
Financing balance	0,4	0,0	0,0	0,3	0,5
Entity I	-0,2	-0,2	-0,3	0,1	0,3
Entity II	0,7	0,2	0,3	0,2	0,2

Internal stability programmes federal entities

In order to integrate their fiscal policy into the national stability programmes, the communities and regions draw up an internal open-ended medium-term stability programme each year, at least equal in duration to the Belgian stability programme. In their internal stability programmes, the communities and regions show how they will meet the targets mentioned above for each of the budget years concerned. The 'Financing Requirements' section of the Superior Finance Council evaluates these medium-term programmes each year.

At the time of the 2002 budget review, an additional agreement was concluded between the federal state and the communities and regions. That agreement confirmed once again that the various entities concerned would endeavour to meet the agreed targets.

3.7. Development of the debt

Further reduction debt ratio

In 2000, an important milestone was reached in the overhaul of public finances by the restoration of a balanced position. However, this is not an end in itself. The central aim of fiscal policy is in fact to continue to reduce the high debt ratio.

Evolution debt ratio

Chart 1

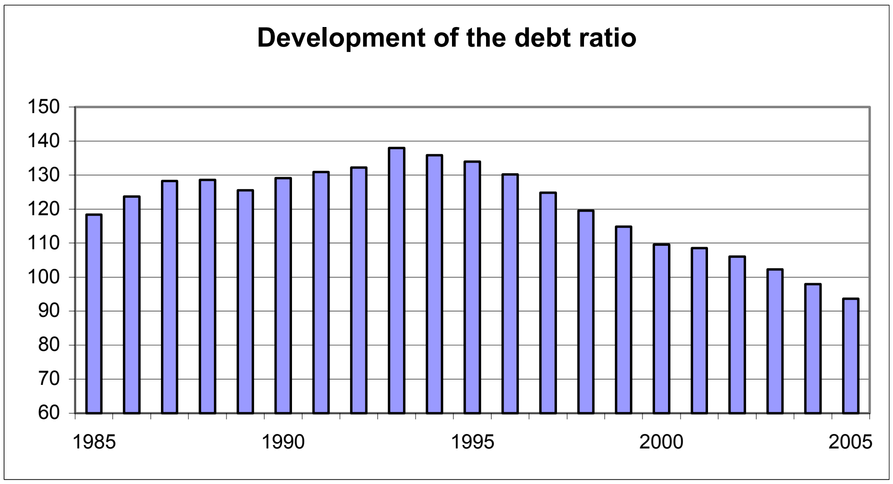


Chart 1 clearly shows the effort which has been made to reduce the debt ratio. In 1993, the public debt reached a record level of 137.9% of GDP. Since then, the debt ratio has fallen systematically. At the end of 2001, the debt ratio was cut to 108.6% of GDP. The estimated ratio for the end of 2002 is 106.1%.

TABLE 4 Development of the public debt					
% of GDP	**2001**	**2002[3]**	**2003**	**2004**	**2005**
Gross debt ratio [1] [2]	108,6	106,1	102,3	97,9	93,6
Change in the gross debt ratio	-1,0	-2,5	-3,8	-4,3	-4,3
Factors determining the movement in the gross debt ratio [2]					
Primary balance	6,9	6,1	5,5	5,6	5,6
Interest charges	6,5	6,1	5,6	5,3	5,1
Nominal growth of GDP	2,8	2,8	3,7	4,1	4,0
Endogenous change in the debt	-3,3	-3,0	-3,9	-4,3	-4,3
Other factors influencing the debt ratio [1]	2,3	0,5	0,1	0,0	0,0
Of which: privatisations (in billions of euro)	0,1	0,0	0,0	0,0	0,0
p.m. implicit level of interest rates	6,1	5,8	5,4	5,4	5,4

(1) These figures disregard, for 2004 and 2005, the actual fulfilment of the commitment made by the current government concerning partial assumption of the debt of the SNCB/NMBS.

(2) In past years, various statistical adjustments have been made to the Maastricht debt. The development of that debt has also been influenced by a number of debts taken over. The debts of the following entities have been included in the Maastricht debt : FADELS/ALESH, CREDIBE, Berlaymont, Belfin. Without these factors, the debt ratio would be approximately as follows : 2001 : 105.4 - 2002 : 103.0 - 2003 : 99.3 - 2004 : 94.9 - 2005 : 90.6.

(3) The 2002 debt ratio (106.1) is higher than the figure stated in the second notification of public deficits (104.8). This difference is due exclusively to the revision of GDP. The nominal amount of the debt estimated at the end of 2002 remains unchanged.

Further reduction debt ratio
(continued)

During the period covered by this stability programme update, the debt ratio will continue to decline. According to the scenario outlined, that ratio will again fall below 100% in 2004, dropping to 93.6% in 2005. The movement during the 2003-2005 period is attributable solely to the effect of what are called endogenous factors. No account has been taken of autonomous factors influencing the debt, such as proceeds from privatisation operations.

Moreover, table 4 clearly shows that, from 2004 onwards, the movement in the implicit interest rate will no longer contribute as much towards the reduction in interest charges. In fact, the stock of high interest debt reaching maturity will soon have disappeared altogether. Refinancing of the debt at maturity (or in the case of early repayment) therefore no longer has any substantial effect on interest charges.

3.8. The cyclically adjusted balance

Evolution cyclically adjusted balance

The movement in the cyclically adjusted primary and financing balance is increasingly used as an indicator for fiscal policy. Despite the problems associated with factors such as the estimation of the output gap and the sensitivity of public finances to the growth of GDP, this still provides an additional reference point for assessing the movement in the most important parameters of public finances.

TABLE 5
Cyclical development of public finances

% in GDP	2001	2002	2003	2004	2005
1. GDP growth at constant prices	0,8	0,7	2,1	2,5	2,5
2. Actual financing balance	0,4	0,0	0,0	0,3	0,5
3. Interest charges	6,5	6,1	5,6	5,3	5,1
4. Potential growth of GDP (1)	2,2	2,2	2,2	2,3	2,3
5. Output gap	0,6	-0,9	-1,0	-0,8	-0,6
6. Cyclical component of the budget	0,4	-0,5	-0,6	-0,5	-0,4
7. Cyclically adjusted financing balance	0,1	0,5	0,6	0,8	0,8
8. Excluding UMTS	-0,1				
9. Cyclically adjusted primary balance (7+3)	6,6	6,6	6,1	6,1	6,0
10. Excluding UMTS	6,4				

(1) The estimates of trend growth used here are lower than those used in previous updates.

Evolution output gap

The Hodrick-Prescott filter method has once again been used for the time being to calculate the potential growth of GDP and the resulting output gap.[8]

The strong growth in 2000 led to a large, positive output gap. Despite the marked downturn in growth in 2001, the positive gap persisted. It was only in 2002, the second consecutive year with growth of less than 1%, that real GDP fell below its trend level. For 2003, the estimated growth of GDP is more or less equal to the trend growth, so that the output gap will remain almost constant. In 2004 and 2005 the estimated growth will once again exceed the trend growth and the output gap will gradually decline. Nevertheless, in 2005 the negative output gap will still not have been eliminated. Throughout the 2002-2005 period, the economic cycle will have a negative impact on the budget balance.

[8] The estimated output gap used here differs from that published in the autumn of 2002 by the European Commission. The main reason for this discrepancy is the different estimate of GDP growth in 2004 (the European Commission estimates growth at 2.8%, the present stability programme uses an estimate of 2.5%). Also, the output gap was calculated on the basis of the Hodrick-Prescott filter, whereas the European Commission is now calculating the structural balance on the basis of a production function. It is evident from the European Commission simulations that the results of the two methods are largely similar in Belgium's case. For more information on the impact of the various methods of calculating the output gap and the cyclically adjusted balance, see :
- Economic Policy Committee : Report on Potential Output and the Output Gap. ECFIN/EPC/670/01, October 2001;
- European Commission, Directorate-General for Economic and Financial Affairs : Public finances in EMU 2002 in European Economy nr. 3/2002 pg. 42-48.

Evolution cyclically adjusted balance

In 2001, Belgium achieved a financing capacity of 0.4% of GDP. After adjustments for the impact of the cycle and for revenue from the sale of UMTS licences, that amounts to a structural deficit of just 0.1% of GDP. Although the surplus achieved in 2001 was reduced to a balance in 2002, the cyclically adjusted balance is up by 0.4 percentage points (0.6 if the 2001 balance is adjusted for revenue from the UMTS licences). In the years ahead, the cyclically adjusted balance continues to grow to around 0.8%.

4. Comparison with the stability programme for 2002-2005 and sensitivity analysis

4.1. Comparison with the stability programme for 2002-2005

GDP-growth lower than forecasted

At the time of the preparation of the stability programme for 2002-2005, submitted at the end of 2001, it was announced that the 2002 budget would be in balance. In the medium term, the government was sticking to its target of progressively building up a substantial budget surplus. As stated earlier, the government was reckoning on a strong recovery in growth to bring it back into line, in 2003, with the original stability programme for 2001-2005, by achieving a financing capacity of 0.5% of GDP.

The first lines in table 6 clearly show that the growth context for 2001-2003, as foreseen in the present update, is different from that in the stability programme submitted at the end of 2001. The cumulative growth of GDP during that period is 1.8 percentage points lower. It is therefore logical that the plans for public finances have been adjusted in line with this very different situation.

Budget balance in 2002 despite everything

For 2002, the target for the financing balance remains unchanged. Despite the lower than expected growth in 2001 and 2002, the budget will be more or less in balance, as explained earlier. This is thanks to the cautious assumptions used in drawing up the budget, and particularly to the tighter control over the execution of the budget.

Again budget balance in 2003

For 2003, the growth forecasts have been downgraded by almost one percentage point. The original goal of getting back on course by achieving a surplus of 0.5% of GDP has had to be modified. For 2003, the aim is now a balanced budget. In 2004 and 2005 the growth of GDP is expected to outpace the trend growth. In view of these expectations and the assumptions made about interest rates, the government considers it desirable to achieve a financing capacity of 0.5% of GDP by the end of 2005.

Deviations from the previous programme

Although there was a cumulative growth gap of 1.8 percentage points for the 2001-2003 period, the ultimate target underwent only minor adjustment. As illustrated by table 5 above, the aim of developing a structural surplus has been maintained in full.

TABLE 6
Deviations from the previous programme

% of GDP	2001	2002	2003	2004	2005
Growth of GDP					
previous update	1,1	1,3	3,0	2,5	2,4
current update	0,8	0,7	2,1	2,5	2,5
deviation	-0,3	-0,6	-0,9	0,0	0,1
Financing balance					
previous update	0,0	0,0	0,5	0,6	0,7
current update (1)	0,3	0,0	0,0	0,3	0,5
deviation	0,3	0,0	-0,5	-0,3	-0,2
Gross debt ratio (2)					
previous update	107,0	103,3	97,7	93,0	88,6
current update	108,6	106,1	102,3	97,9	93,6
deviation	1,6	2,8	4,6	4,9	5,0
Attributable to:					
nominal debt level	0,1	0,4	0,9	1,3	1,5
GDP gap (denominator effect)	1,5	2,3	3,6	3,6	3,6

(1) Excluding revenue from the sale of UMTS licences.
(2) The movement in the debt ratio was influenced (1.4%) by the fact that, in September 2001, the state-guaranteed debt of the former Central Mortgage Credit Office (OCCH/CBHK) was included in the Maastricht debt. In 2000, the debt of the Social Housing Loans Amortisation Fund (FADELS/ALESH) was also included. This has an impact of around 1.5% of GDP on the debt ratio in 2003.

According to the present update, the debt ratio in 2005 will be about five percentage points higher than originally planned. To clarify the reasons for it, this discrepancy has been broken down into two explanatory elements in table 6 : the nominal debt level and the GDP gap or denominator effect. The deviation from the previous update is due essentially to this latter effect.

4.2. Sensitivity analysis

Introduction

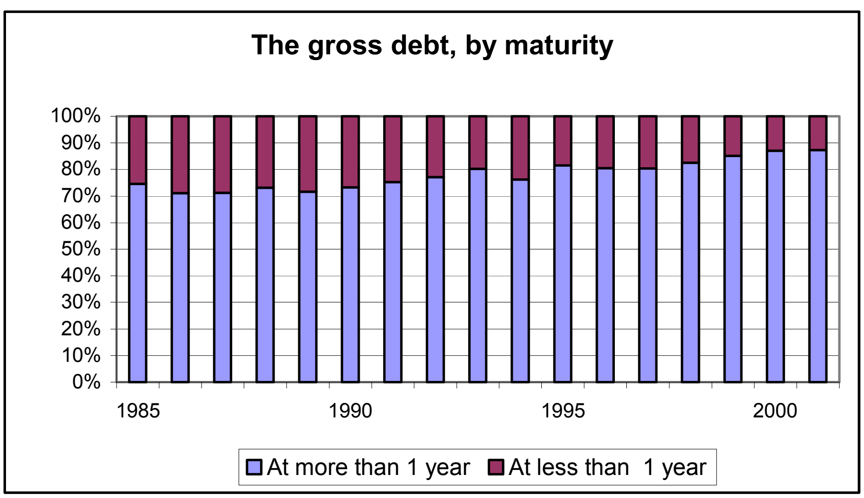
The events of preceding years have shown that fiscal policy can be adapted in time to attain the objective of balance, despite a deteriorating context. It is therefore necessary to make a clear distinction between a technical analysis of sensitivity and the question of how the policy will respond if the macroeconomic context changes. The impact of a change in the assumptions regarding interest and growth is explained here in technical terms.

4.2.1. A change in the interest assumptions

Reducing short-term debt

The introduction of the euro is among the reasons why the proportion of the debt in foreign currency has now fallen below 3%. The currency risk has therefore become practically negligible. However, in view of the high level of the debt, public finances are still sensitive to interest rate variations. That sensitivity has been considerably reduced. In recent years, the management of the debt - e.g. by the federal government, which holds the major part of the debt - has been geared towards reducing the proportion of the short-term debt. At the end of 2001, the proportion of the total gross debt represented by debt with a term of less than one year had been cut to around 13%. Owing to the structure of the public debt, a change in interest rate levels is slow to be reflected in a change in the interest charges.

Chart 2



Effect of an upward shift in the interest rates

A technical analysis was conducted on the effect of a radical change in the interest rate assumption, namely the impact of a marked upward shift in the interest rate curve. Table 7 shows the effect of an increase of 100 basis points in the interest rate assumptions for each year in the period 2003-2005. After 3 years, in 2005, the effect would come to about 0.4% of GDP.

TABLE 7
Impact of a change in the interest rate assumptions

% of GDP	2003	2004	2005
Degree to which interest charges deviate from the scenario described	0,1	0,3	0,4

4.2.2. An adjustment to the growth hypotheses

Sensitivity to growth assumptions

When the economic climate is uncertain, the obvious question concerns the impact of a different growth assumption. For the 2002-2005 period, allowance was made for GDP growth averaging just under 2 %. This assumption can be considered realistic, although the successive adjustments to the growth forecasts do give grounds for caution.

Table 8 examines the extent to which the balance of public finances would react to an adjustment in the growth assumptions. The average elasticity of public finances in relation to GDP growth is used here. The final outcome will depend partly on the nature of the growth slowdown.

TABLE 8
Sensitivity of the balance to growth assumptions

	2001	2002	2003	Cumulative impact
Stability programme				
Real growth of GDP	2,1	2,5	2,5	
Financing balance	0,0	0,3	0,5	
Weaker growth				
Real growth of GDP	1,6	2,0	2,0	
Impact	-0,3	-0,3	-0,3	-0,9
Stronger growth				
Real growth of GDP	2,6	3,0	3,0	
Impact	0,3	0,3	0,3	0,9

In regard to this sensitivity analysis, it should be pointed out that, in practice, in recent years a balanced budget represented a lower limit for the financing balance. In the event of slackening growth, the necessary effort was made to attain this minimum target. Conversely, if growth exceeds the forecasts, the government has declared that it will give priority to allocating the additional margin to improving the balance.

5. The quality of public finances

5.1. Main initiatives on the revenue side

Reducing fiscal pressure

The policy of reducing the fiscal and parafiscal pressure continued with the aim of establishing a more favourable environment for employment. This stimulated both the labour supply and the demand for labour, thus doing much to reduce the employment traps.

Personal income tax reform

The progressive implementation of the personal income tax reform is continuing. This reform is based on four key elements : a reduction in the tax burden on labour, neutrality as regards lifestyle choices, better allowance for dependent children and a more ecological tax system. The year 2003 will see the total elimination of the complementary crisis contribution and the abolition of marginal rates in excess of 50%. A new band for the granting of a tax credit for those on the lowest incomes and an increase in the flat-rate allowance for professional expenses are also scheduled for 2003, both of which will benefit earned incomes. Adjustment of the intermediate tax scales will begin. The first stage in the reduction of tax discrimination between married couples and those who are cohabiting will start. Finally, there will be a tax cut on certain energy-saving investments.

Impact personal income tax reform

The overall impact of the reform will be 1.3 p.c. of GDP once the measures become fully operational in 2006.

Additional cuts in social security contributions

Apart from the reduction in the tax burden, it has been decided to make additional cuts in social security contributions. Additional reductions in employers' social security contributions were introduced with effect from 1 April 2002, with a major part targeting workers aged over 58 years, in order to encourage an increase in their employment rate. In the 2003 budget it was also decided to step up the reductions in personal social security contributions (by just under 100 million euro) in order to boost the earned incomes of the lowest paid workers. The total budget for the social security contribution reductions is in excess of 3.8 billion euro.

Reform corporation tax

The year 2003 will also see the entry into force of the corporation tax reform, leading to a reduction in the nominal rate of tax from 40.17% to 33.99% (including the complementary crisis contribution). SMEs will qualify for a reduced rate of 24.98% (instead of 28.84%). This reform is neutral in its impact on the budget, as the lowering of the rate of tax is offset by the reduction in various tax allowances.

5.2. Main administrative simplifications in favour of businesses and employment

Crossroads Bank for businesses

Making procedures simpler and more transparent helps to reduce the burden on businesses.

As regards administrative simplification, an important step was taken by the creation of the Crossroads Bank for businesses, a data bank which assigns to each business a unique identification number, eliminating the need to repeat similar formalities with different authorities.

Simplification of the measures for reducing social security contributions

In addition, an agreement was concluded recently with a view to the radical simplification of the measures for reducing employers' social security contributions. The complexity and multiplicity of these measures may have caused under-utilisation of these instruments underpinning the employment policy.
From 2004 onwards, there will be only two types of reduction:

- an automatic, structural, flat-rate reduction valid for all workers in all firms, higher for low-paid workers;
- flat-rate reductions targeting specific groups, such as the young, older workers, the long-term unemployed, etc.

These two types of reduction may be cumulative.

5.3. Main initiatives on expenditure

Containing primary expenditure

Although the slackening of economic growth is putting pressure on primary spending, the real growth of this item was kept down to 1.3% at federal level when the 2003 budget was drawn up.
Control over spending is accompanied by particular attention to the quality of social services.

Sickness insurance

Sickness insurance expenditure appears to be within the planned budget guidelines in 2002. Some additional measures were taken to contribute towards future control over health spending, which is rising considerably in Belgium as in many other countries. These measures mainly concern the medicinal products sector ; in particular, numerous "comfort medicaments" will be reclassified for the purpose of the reimbursement procedures.

Pensions

Allowance for the impact of the ageing population (see below) implies, among other things, ensuring socially adequate pension levels. To that end, the pensions of the oldest pensioners and the guaranteed minimum pensions for employed workers and the self-employed will be raised in 2003.

6. The sustainability of public finances

6.1. Introduction

Preparation Strategic Document on Ageing

The approval of the law of 5 September 2001 guaranteeing a continuous reduction in the public debt and the creation of an Ageing Fund introduced a procedure which should ensure that, when the fiscal policy is defined, sufficient attention is paid to long-term sustainability. The government is in fact required to prepare a Strategy Document on Ageing each year, in which it has to explain its policy on the ageing population. The above law provides for three stages in the preparation of the Strategy Document on Ageing:

- the first stage is represented by the annual report of the Working Group on Ageing, which examines the budgetary and social effects of the ageing population;
- in the second phase, the 'Financing Requirements' section of the Superior Finance Council takes account of this report when formulating its fiscal policy recommendations;
- finally, in the third stage the government presents its Strategy Document on Ageing, setting out its policy on the effects of the ageing population. This strategy document also contains an account of the payments made to the Ageing Fund (and later on, will state what the Fund has paid out).

The various steps specified by the law were followed for the first time when the 2003 budget was drawn up. The main points of the Strategy Document on Ageing are set out below.

6.2. The ageing population: budgetary effects

Basic assumptions of the Working Group on Ageing

As stated above, when defining its policy the government may make use of the estimate of the budgetary cost of the ageing population, produced by the Working Group on Ageing, which was set up for that purpose. The basic assumptions adopted by the Working Group differ in a number of respects from those used by the Economic Policy Committee (EPC). The main differences between the two simulations are as follows: [9]

- the demographic scenario is based on a bigger increase in life expectancy and a greater concentration of migratory flows on the young age groups than the Eurostat forecasts used by the EPC in its simulations;
- the Working Group has based its predictions for the first period on the latest medium-term forecasts, which therefore also take account of the latest policy measures;
- the Working Group based its views on a more cautious scenario where productivity gains are concerned. From 2007 onwards, these are estimated at 1.75%. In the EPC scenario, it is assumed that productivity gains will tend towards 1.75% by about 2020;
- the method used to estimate health care costs is not the same. The Working Group scenario takes account not only of the straightforward age structure, as one of the factors influencing health care costs;
- the Working Group also uses a different scenario for the adjustment of pensions and other benefits in line with prosperity. The Working Group thus anticipates the possible future pressure to link pensions more closely to the increase in wages;
- finally, it should be pointed out that the Working Group predictions cover total social security expenditure.

[9] Economic Policy Committee, Working Group on Ageing, "Budgetary challenges posed by ageing populations: the impact on public spending on pensions, health and long-term sustainability of public finances", Brussels, October 24th, 2001. Superior Finance Council, Working Group on Ageing, annual report, April 2002.

TABLE 9 The main assumptions used for the long-term projection				
	2000	2010	2020	2030
Socioeconomic and macroeconomic				
Changes in productivity	2,2	1,8	1,8	1,8
Real growth of GDP	3,9	2,2	1,7	1,6
Male participation rate (20-64)	78,2	75,6	74,6	75,5
Female participation rate (20-64)	63,8	68,3	70,0	71,8
Total participation rate (20-64)	71,0	71,9	72,3	73,6
Unemployment rate	10,0	7,3	6,1	5,0
Demographic				
Birth rate	1,61	1,66	1,70	1,70
Life expectancy at birth (male)	75,06	77,23	80,96	80,96
Life expectancy at birth (female)	81,53	83,35	86,43	86,43
Migratory balance	18.445	16.893	17.358	17.358
Social				
Wage ceiling	1,25% per annum			
Minimum entitlement per working year	1,25% per annum			
Equalisation of public sector pensions	1,25% per annum			
Index-linking	0,5% per annum			
Index-linking of flat-rate allowances	1,0% per annum			
Source: Working Group on Ageing, Annual Report, April 2002				

Changes in the age structure of population

Table 10 summarises the essential changes in the age structure of the population. The most striking feature is the expansion of the population aged over 60 years. From 2010 onwards, the post-war bulge of " baby boomers " will cross the age 60 threshold. Between 2000 and 2030 this age group will expand by around 50%. Its share of the total population will increase by about 22% to the region of 31%. This trend is even more marked in the very elderly age group. The number of people over 80 years of age will more or less double during 2000-2030.

TABLE 10 Age structure of the population						
	Total population (*1000)	Distribution in the age pyramid				
		(*1000)			(%)	
		0-19	20-59	60-	20-59	60-
1970	9.650,9	3.000,5	4.819,3	1.831,1	49,9	19,0
2000	10.252,5	2.415,8	5.591,7	2.245,0	54,5	21,9
2010	10.519,8	2.351,7	5.682,2	2.485,9	54,0	23,6
2030	10.887,6	2.272,6	5.287,9	3.327,1	48,6	30,6
2050	10.953, 8	2.228,2	5.172,7	3.552,9	47,2	32,4

Source : National Statistical Institute, Federal Planning Bureau, Population forecasts for 2000-2050 per district, 2001.

Impact demographic changes

The demographic trends thus outlined are bound to have an impact on the operation of the welfare state, and more particularly on the pattern of social security spending. More elderly people means more expenditure on pensions, health care and assistance for the elderly. According to the scenario adopted (table 11), during 2000-2030 the weight of expenditure on pensions, after an initial fall, will increase by 2.7 percentage points of GDP. Health care costs will rise more steadily : their weight in GDP will increase by around 2 percentage points. According to this simulation, spending on pensions and health care will rise by roughly 4.7 percentage points of GDP.

On the other hand, a number of spending categories, such as family allowances, unemployment benefits, early retirement pensions, etc., can be expected to decline in relation to GDP. Allowing for this partial offsetting, total social spending will increase by roughly 3.1 percentage points of GDP. These figures take no account of changes in education spending.

TABLE 11 Public spending and the ageing population					
% of GDP	**2000**	**2010**	**2020**	**2030**	**2030-2000**
	Movement in certain categories of expenditure				
Pensions	8,7	8,3	9,7	11,4	2,7
Health care	6,2	6,9	7,5	8,2	2,0
Pensions and health care	14,9	15,2	17,2	19,6	4,7
Other social security expenditure (1)	7,3	6,2	6,1	5,7	-1,6
TOTAL	22,2	21,4	23,3	25,3	3,1

Source: Working Group on Ageing, Annual Report, April 2002.
(1) This includes expenditure on family allowances, unemployment, early retirement pensions, industrial accidents, occupational diseases and a number of residual schemes.

6.3. A modified fiscal policy

Long-term budget scenario

The expected demographic pressure on social protection expenditure raises the question of the long-term sustainability of public finances. The obligation to produce a Strategy Document on Ageing each year has incorporated this point in fiscal policy.

The government considers that the growing demographic pressure on expenditure is a structural challenge. Fiscal policy can make a major contribution towards coping with this problem. By steadily building up a budget surplus, we create a dual margin : on the one hand, interest charges are reduced, and on the other, it will ultimately be possible to consume this surplus.

In its 2002 annual report, the 'Financing Requirements' section of the Superior Finance Council recommended constituting a surplus of 1.5% of GDP in the medium term (by 2010), which will be progressively reduced from 2015 onwards. As is evident from table 12, that will make it possible not only to absorb the cost of the ageing population, but also to make provision for the necessary structural financing of the Ageing Fund, by means of the surpluses built up (at the level of Entity I). The money paid into the said fund, and the interest earned by investing that money, should make it possible to finance the increased expenditure on statutory pensions during 2010-2030. However, the resources of the Ageing Fund will not be available for use until the debt ratio of general government falls below 60%.

TABLE 12
A long-term budget scenario

% of GDP	2005	2010	2020	2030
1. Level of the financing balance (1)	0,7	1,5	1,0	0,0
2. Level of the debt ratio	89,1	68,1	37,4	23,8
3. Level of interest charges	5,0	3,8	2,1	1,3
4. Necessary level of the primary balance (=3+1)	5,7	5,3	3,1	1,3
	2005-2010	**2010-2020**	**2020-2030**	**2005-2030**
5. Movement in interest charges	-1,2	-1,7	-0,8	-3,7
6. Gross margin at the level of the primary balance (=movement in 4)	0,4	2,2	1,8	4,4
7. Impact of demography	0,2	1,9	2,0	4,1

Source: Superior Finance Council, 'Government Financing Requirements' section, Annual Report 2002.
(1) When preparing its recommendation, the 'Government Financing Requirements' section had assumed that the targets of the stability programme for 2002-2005 would be met.

Sufficiently rapid reduction in public debt required

The government endorses the key recommendations of the 'Financing Requirements' section as regards medium-term fiscal policy. A sufficiently rapid reduction in the public debt is therefore central to the medium-term strategy on public finances. Concrete measures to reduce the public debt (and hence to develop a surplus) will obviously have to be phased in accordance with the macroeconomic environment. That means that when economic activity is depressed, the reduction may be slowed down somewhat, but conversely, when the economic situation is favourable, it will be necessary to take maximum advantage of that.

6.4. The financing of the Ageing Fund

Financing the Ageing Fund

The Ageing Fund was set up in order to finance the increase in expenditure on pensions in the period 2010-2030. In addition to the income from investing its money, the Ageing Fund has three possible sources of finance:

- budget surpluses;
- social security surpluses;
- non-fiscal revenues.

In 2001, an initial capital of 614.9 million euro was allocated to the Ageing Fund. When the 2002 budget was drawn up, the plan was to pay in an equivalent sum in 2002. For 2003, it was also decided to allocate 625 million euro from non-fiscal revenues to the fund. Taking account of the planned payments, the capital (excluding the accrued interest) will total about 0.7% of GDP by the end of 2003.

In the years ahead, the effort to finance the Ageing Fund will continue.

6.5. Fiscal policy as an element of a global strategy

Stringent fiscal policy over the long period

In the context of the stability programme, attention focused mainly on fiscal policy's contribution towards absorbing the effects of ageing population. Although the disadvantage of a high debt ratio can be turned into an advantage - the reduction in the public debt almost automatically creates a budget margin - we must not lose sight of the scale of the challenge. If we want to succeed, it will be necessary to maintain a stringent fiscal policy over a long period in order to achieve a sufficiently large primary surplus.

Suitable employment policy

That is why the entire strategy must not focus on this one area alone. Other aspects of policy can also make a substantial contribution and must therefore be used to full advantage. Apart from fiscal policy, a suitable employment policy geared towards increasing the employment rate can play an important role. Belgium fully endorses the objectives of the Lisbon European Council, in particular the employment rate of 70% to be achieved by 2010. Though it has improved in recent years, the level achieved by our country so far is still below the European average. This is largely due to the low rate of activity for workers over the age of 55 years, and also - though to a lesser extent - the low rate of activity among young people. In the case of the latter category of workers, the fact that they are in full-time education is the reason for their absence from the labour market.

To attain the Lisbon objectives will mean continuing the effort already made to increase the employment rate of the entire reserve labour supply, and more specifically women.

The measures taken by this government to meet the Lisbon objectives have essentially involved increasing the financial incentives and improving the quality of work.

Construction of a second pillar for pensions

The construction of the second pillar also deserves close attention. Although statutory pensions will remain the foundation of social protection for the elderly, the second pillar is also destined to play an important role. In fact, statutory pensions usually provide a benefit which is well below the level of final salary on retirement. The second pillar can make a major contribution towards limiting the drop in income. The government has presented parliament with a bill introducing fundamental changes to both the regulatory framework and the tax rules applicable to supplementary pensions. The government intends that the proposed adjustments will lead to widespread use of the system. The ultimate aim should be for all workers to be capable of participating.

Annexes

Main assumptions used by the Federal Planning Bureau for the medium-term forecasts relating to the international environment					
	2001	2002	2003	2004	2005
Short-term interest rate (annual average)	4,1	3,3	3,6	4,2	4,2
Long-term interest rate (annual average)	5,1	5,2	5,4	5,4	5,5
USD/euro exchange rate (annual average)	89,5	93,8	96,5	97,0	97,4
GDP growth - world (excl. EU)	2,4	3,2	4,1	3,9	3,9
GDP growth - EU	1,7	1,4	2,8	2,5	2,4
Growth of relevant external markets	0,7	1,7	5,8	5,5	5,2
Global imports, by volume (excl. EU)	-0,2	4,0	7,2	5,8	5,8
Oil price (USD)	24,4	24,5	25,5	26,4	27,4

The targets for public finances under consecutive stability programmes								
Programme	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
	Financing balance							
1999-2002	-1,6	-1,3	-1,0	-0,7	-0,3			
2000-2003		-1,1	-1,0	-0,5	0,0	0,2		
2001-2005			-0,1	0,2	0,3	0,5	0,6	0,7
2002-2005				0,0	0,0	0,5	0,6	0,7
2003-2005					0,0	0,0	0,3	0,5
	Debt ratio							
1999-2002	117,5	114,5	112,2	109,6	106,8			
2000-2003		114,9	112,4	108,8	105,0	101,3		
2001-2005			110,6	105,8	101,4	97,2	92,9	88,7
2002-2005				107,0	103,3	97,7	93,0	88,6
2003-2005					106,1	102,3	97,9	93,6

Movement in GDP and some key aggregates in public finances										
% of GDP unless otherwise stated	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
GDP (in billions of euro)	179,7	185,1	195,0	202,2	207,0	217,2	225,2	235,6	247,5	254,3
Real growth (annual growth rate)	1,5	-1,0	3,2	2,4	1,2	3,6	2,0	3,2	3,7	0,8
Primary balance	3,2	3,8	4,6	4,9	5,0	6,0	6,8	6,5	6,9	7,0
Of which:										
Federal government	3,7	4,5	4,1	4,6	4,6	4,8	5,3	4,9	5,8	5,2
Social security	-0,4	-0,5	0,5	0,0	-0,2	0,4	0,4	0,6	0,5	0,6
Communities and regions	-0,8	-0,6	-0,5	-0,4	0,0	0,2	0,6	0,6	0,5	1,0
Local authorities	0,7	0,4	0,5	0,8	0,7	0,6	0,5	0,4	0,0	0,2
Financing balance (Maastricht definition)	-8,1	-7,3	-5,0	-4,3	-3,8	-2,0	-0,7	-0,5	0,1	0,4
Of which:										
Federal government	-6,7	-5,8	-4,6	-3,8	-3,4	-2,5	-1,7	-1,6	-0,5	-0,9
Social security	-0,4	-0,5	0,5	-0,1	-0,2	0,4	0,4	0,6	0,6	0,7
Communities and regions	-1,0	-0,8	-0,9	-0,8	-0,4	-0,1	0,3	0,4	0,2	0,8
Local authorities	0,1	-0,2	-0,1	0,3	0,2	0,2	0,2	0,1	-0,3	-0,1
Debt ratio	132,2	137,9	135,9	134,0	130,2	124,8	119,6	114,9	109,6	108,6