
THE BELGIAN STABILITY PROGRAMME

(2006-2009)

UPDATE 2005

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1. Introduction: general political framework and objectives

In the present stability programme 2006-2009, the Belgian government explains its fiscal policy for the period concerned. This is an update of the stability programme 2005-2008. Like the previous programme, it is based on budgetary decisions taken under the May 2003 federal government agreement, whereby it was decided to maintain a balanced budget as the minimum objective with the gradual creation of budget surpluses.

For the fifth consecutive year, the budget ended in balance in 2004 so that the government is adhering to its commitment under the coalition agreement and the previous stability programme. Despite the several downward revisions to the growth forecasts, the government expects the budget to balance in 2005. Similarly, a balance was envisaged when the 2006 budget was drawn up. For the period after 2006, the government has mapped out a programme for the creation of budget surpluses and pension reserves. Parliament has passed a law which embodies this fiscal programme and the financing of the Ageing Fund.

Until 2006, the primary balance mirrors the movement in interest charges. After that it will remain steady at around 4.1%. The budgetary scope resulting thereafter from the decline in interest charges will be used to create the planned budget surpluses.

If, during the period 2006-2009, growth proves to be higher than currently predicted, the government is committed - as in previous years - to using the available additional scope primarily to improve the overall balance.

Although Belgium's debt ratio has been falling steeply for a number of years, it remains high. That debt ratio and the projected potential economic growth make it essential for Belgium to achieve a balanced budget or a small surplus as the medium-term objective. In its budget programme, the government predicts a surplus of 0.7 % of GDP in 2009 for general government. With this medium-term surplus, Belgium fulfils the conditions of the updated Stability and Growth Pact.

Reducing the public debt ratio at a sufficiently rapid rate remains a central objective of the Belgian fiscal strategy. Cutting the interest charges is in fact the key to creating scope in the budget to finance the costs of population ageing. In 2005, debt reduction will slow temporarily owing to the assumption of part of the BNRC debt. However, in 2009 the debt ratio will be cut to 79.1 %, bringing the Belgian ratio steadily closer to the euro area average, whereas in 1993 it still stood at the record level of 137.1 % of GDP.

A responsible fiscal policy creates a climate of confidence and is an important factor stimulating economic growth and job creation. The government combines this policy with an ambitious programme of social and economic reforms, placing the emphasis on the following points:

- adapting the Belgian economy to an increasingly global, liberalised environment by reductions in charges, a research and development drive and administrative simplification;
- stimulating employment, particularly of the young and those over age 50, by continuing to make selective cuts in taxes on labour;
- enhancing social security and economic security for everyone by adjusting benefits in line with prosperity and expanding the basis of funding;
- putting additional investment into mobility and augmenting security funding.

This multi-pronged strategy for strengthening public finances and stimulating the economy and employment reflects the desire of the Belgian government to create a sound basis to cushion the costs of population ageing in the years ahead, and to guarantee a satisfactory level of well-being for current and future generations.

2. The economic context

2.1. The international context

For 2005 and 2006, the IMF expects to see the global economy expand fairly steadily (+4.3%), at a rate only slightly below the exceptionally good performance recorded in 2004. International trade looks set to grow faster than output at around 7%.

The substantial increase in oil prices will therefore not have had a major impact on global economic activity, probably because of the predominance of the service sector in the developed economies. However, the higher cost of energy and the volatility of oil prices do introduce an additional element of uncertainty, and downside risk, in the forecasts. The imbalances in external payments and the level of asset prices – particularly real estate, which has helped to sustain demand in some industrialised countries, mainly Britain and America – are also potential risks for economic performance.

2.1.1. The economic situation outside the euro area remains favourable

Outside the euro area, the economic climate should remain favourable in the short term, though economic growth is expected to fall slightly over time.

In the United States, though growth has slowed down slightly it should remain robust in the months ahead, continuing to underpin global demand.

In the first half of 2005, US economic growth remained strong. The dip which apparently occurred in September/October seems to be due purely to the effects of the hurricanes; on the other hand, the reconstruction work should stimulate activity at the beginning of 2006. The policy mix is perhaps less obviously expansionary, but if the monetary policy stance tends towards neutrality via the interest rate hikes implemented by the Federal Reserve, the public deficit – which seemed set to fall in 2005 – could grow larger once again owing to the reconstruction work. The higher energy costs are a burden on household incomes, and private consumption should

gradually feel the effects of that; the raised interest rates are expected to curb investment in real estate. Having reached 4.2% in 2004, the growth of US GDP will gradually fall to 3.5% in 2005 and 3.2% in 2006, thus reverting to a level close to production potential.

In Japan, moderate growth has been restored, the basis having been steadily extended from exports to business investment and private consumption. The policy mix remains expansionary: fiscal consolidation should be only very gradual and there seems to be no need for the Bank of Japan to abandon its zero rate policy in the near future. Only a slight slowing of economic growth is generally predicted, thus putting the figure in the region of 2% in 2006 and 2007.

In China, economic expansion is continuing to steam ahead. Growth in excess of 9% is forecast for 2005, and only a slight deceleration is expected in 2006-2007. The economic outlook is similar for much of Asia.

Relatively strong albeit slightly slower growth is also expected in Latin America and in Central and Eastern Europe.

2.1.2. A gradual recovery in the euro area

In the first half of 2005, economic activity in the euro area was very disappointing, owing to the lack of dynamism in domestic demand, growth being based mainly on net exports. But although there is as yet little tangible evidence of a revival in activity, the consumer confidence indicators, and more particularly the business confidence indicators, have been moving back up since July, with a still more marked increase in October.

This highly favourable trend in business expectations supports the prediction of a significant recovery in business investment in the months ahead. That recovery should be made possible by healthy profits and the particularly low level of long-term interest rates. The depreciation of the euro against the dollar is a factor in the improved outlook, as external demand could provide stronger support for growth. After a certain time-lag, job creation should strengthen as the recovery proceeds. Private demand is thus expected to expand gradually, despite the adverse impact of the rise in energy prices on the disposable income of households.

The European Commission expects to see a relatively neutral fiscal policy in 2006. For the moment, monetary policy remains decidedly expansionary. Any increase in the ECB's key rates is likely to be relatively small, as underlying inflation – excluding the impact of energy prices and certain foods – remained under control in September at 1.5% year-on-year, and wage moderation continues to apply, limiting the “second-round” effects.

For the euro area as a whole, the Commission predicts GDP growth in real terms of 1.3% in 2005, rising to 1.9% in 2006 and 2.1% in 2007. Growth rate differentials between countries should gradually diminish.

Certain risk factors which will tend to impair performance, already mentioned in connection with world growth, are particularly valid for the euro area, the most obvious being the possibility of further increases in energy prices. While it is true that

the impact of an energy price rise on economic activity appears to be modest, it could still be greater at higher price levels. Moreover, the imbalances in the US economy (household debt, budget deficit and balance of payments current account) continue to cause concern.

2.2. The short-term outlook for the Belgian economy

Within the euro area, Belgium's economic performance has been above average since 2002. That should continue to be the case overall, though perhaps to a lesser extent in 2005 and 2006. In 2007, Belgium's performance is likely to correspond to the average.

In 2004, the Belgian economy achieved sustained growth year-on-year (+2.6% of GDP at constant prices). But activity had decelerated sharply in the fourth quarter. It remained relatively stagnant in the first quarter of 2005, although a very modest recovery emerged in the second quarter (GDP growth up by 0.2% against the previous quarter) ⁽¹⁾. During the summer the recovery strengthened (+0.4%), and should be confirmed in the fourth quarter (+0.5%), so that GDP growth could reach 1.4% by the end of 2005. At the end of the third quarter, GDP had grown by 1.1% against the corresponding quarter of the previous year, according to an NBB estimate.

Since the low point in the spring, the business surveys suggest that the confidence indicators are recovering much faster in Belgium than is generally the case in the euro area. The NBB's synthetic indicator surged in September and October before stabilising in November. The capacity utilisation rate also began to move up. All these indications bear out the prediction of a consolidation of economic growth. The Federal Planning Bureau is forecasting growth of 2.2% in 2006.

Inflation measured by the national consumer price index has been running at over 2% year-on-year since May 2004; in the third quarter it crossed the 3% threshold before dropping back to 2.5% in October. The rise in oil prices, now combined with the depreciation of the euro against the dollar, is the main factor behind these rates.

¹ data adjusted for seasonal and calendar variations.

Underlying inflation (excluding changes in indirect taxes, and the prices of energy, water, meat, fruit and vegetables) has hovered between 1% and 1.5% since the beginning of 2005. It could edge upwards in the coming months, as the rise in oil prices affects the prices of other goods and services. The annual average increase in prices (HICP) is predicted at 2.9% in 2005, against 1.9% in 2004. Assuming that there is no further strong rise in energy prices, it should remain more or less unchanged in 2006 (+2.8%). Underlying inflation is expected to run at an annual average of 1.5% in 2005, perhaps reaching 1.8% in 2006.

Table 1
Price movements

% Change	2004 (95=100)	2004	2005	2006	2007	2008	2009
1. GDP deflator	115,6	2,3	2,4	2,3	2,0	2,1	1,9
2. Private consumption deflator	118,2	2,5	2,9	2,8	2,0	1,9	1,7
3. Change in HICP (96=100)	114,4	1,9	2,9	2,8	2,0	1,9	1,7
4. Public consumption deflator	122,0	2,7	3,1	3,0	2,4	2,3	2,3
5. Deflator of investment	110,9	1,9	2,1	2,6	1,8	1,6	1,6
6. Deflator of exports of goods and services	117,0	2,4	4,2	2,2	1,0	0,9	0,8
7. Deflator of imports of goods and services	120,6	2,9	4,8	2,7	0,8	0,5	0,5

The slowdown in activity noticeable from the fourth quarter of 2004 caused job creation to decline during 2005. Taking account of the time lag between the revival in activity and the improvement in job creation, the latter should accelerate in 2006.

Composition of growth

In 2005, both foreign and domestic demand were lower than in 2004. The weakness of the European economy led to slower export growth, so that foreign trade made a negative net contribution to economic growth. Domestic demand was influenced by the impact of higher energy prices on household purchasing power.

Table 2
Growth and associated factors

<i>percentage change unless otherwise stated</i>	2004 billion	2004	2005	2006	2007	2008	2009
1. GDP growth at constant prices	246,2	2,6	1,4	2,2	2,1	2,3	2,2
2. GDP at current prices (in billions of euro)	288,1	4,9	3,8	4,6	4,1	4,5	4,2
	<i>Growth sources: change at constant prices</i>						
3. Private consumption expenditure	129,1	1,5	1,3	1,6	1,5	2,0	2,0
4. Final consumption expenditure of general government	54,2	2,0	1,0	2,2	2,3	2,7	2,1
5. Gross fixed capital formation		1,6	1,8	1,8	1,7	1,7	1,6
6. Change in inventories and net acquisition of valuables	0,0	0,1	0,0	0,0	0,0	0,0	0,0
7. Exports of goods and services	48,8	6,2	2,2	5,1	5,6	5,7	5,8
8. Imports of goods and services	190,2	6,4	2,8	5,4	5,5	5,9	5,9
	<i>Contribution to real GDP growth</i>						
9. Total final demand (3+4+5)	-	2,1	1,8	2,2	1,7	2,1	2,0
10. Change in stocks and net acquisition of assets	-	0,4	0,0	0,0	0,0	0,0	0,0
11. External balance of goods and services	-	0,2	-0,3	0,0	0,4	0,2	0,2

Household consumption

There was only a modest rise in household consumption in the first half of 2005. Up to September, the consumer confidence indicators and those in the trade sector remained at very low levels. In October, these indicators showed a marked improvement, but the trade recovery was not confirmed by the November survey.

In 2006, household disposable income should increase more significantly than in 2005, as the implementation of the final phase of the personal income tax reform will make a substantial contribution to the increase in purchasing power and renewed growth of employment. Private consumption should therefore provide more support for economic growth, without affecting the savings ratio, which fell sharply between 2002 and 2005.

According to the Federal Planning Bureau, private consumption is set to grow by 1.3% in 2005 and 1.6% in 2006, in annual average terms and at constant prices.

Investments

After two years of decline, business investment picked up in the second half of 2004 and expanded at an extremely robust rate in the first half of 2005. This recovery has been temporarily accentuated by the implementation of projects which had been postponed, but the economic recovery, healthy profits and the low level of interest rates should facilitate a continuation of this trend, albeit at a slightly less vigorous rate in 2006. Owing to the accelerator effect, business investment is a major factor underpinning economic growth. The Federal Planning Bureau is predicting annual average growth of investments at 3.9% in 2005 and 2.9% in 2006.

After two years of strong expansion, investment in housing was much less dynamic in the first half of 2005. However, the NBB business surveys indicate an upward trend in the forecasts for demand in the building sector. Moreover, mortgage interest rates remain favourable, so that a modest recovery is predicted for 2006 (+2.7% against +1.4% in 2005).

Finally, government investment should be a significant factor bolstering growth in 2005 and 2006, particularly in view of the local authority investment cycle, which is geared to the local elections in 2006.

Foreign trade ²

Belgium's export performance was disappointing in the first half of 2005. But according to the surveys, order books showed a marked improvement in the autumn, with Belgium seeing a much better increase than the euro area as a whole. The euro area accounts for the bulk of Belgian exports, which should benefit from the improvement in the economic climate expected there. Moreover, no further significant appreciation of the effective exchange rate is predicted, and that should be good for competitiveness. Under these circumstances, the Federal Planning Bureau is expecting that exports of goods and services will expand by 51% at constant prices in 2006, after a rise of just 2.2% in 2005. The contribution made by net exports to growth, which was negative in 2005, should be roughly neutral in 2006.

2.3. Medium-term forecasts (2007-2009)³

In October 2005 the Federal Planning Bureau updated its medium-term forecasts. This projection takes no account of the measures introduced when the 2006 budget was drawn up.

As every year, the international environment is based on the OECD's latest medium-term projections (May 2005). In these projections, the average price of a barrel of Brent is set at \$57.4 for the year 2005. It is then expected to rise to \$67.5 in 2006, then fall steadily to \$62.6 in 2009. The euro is assumed to remain steady at 1.265 dollars from 2006, very slightly higher than the 2005 average (1.262).

² See annex 1, sectoral balance

³ For the main assumptions used for the medium-term forecasts, see annex 2

This projection includes the assumption of a virtually zero output gap at the end of the period. Potential growth is calculated using the methodology developed by the European Commission, and approved by the ECOFIN Council. That growth is estimated at 2.1% in 2007, as in 2006, 2% in 2008 and 1.9% in 2009.

GDP growth at constant prices is estimated at 2.1% in 2007, 2.3% in 2008 and 2.2% in 2009. Economic growth will therefore be in the region of the potential rate in 2006 and 2007, before slightly exceeding that figure.

From 2007, the positive impact of the tax reform on household purchasing power fades away. The growth of household disposable income benefits from the expansion in employment and a revival in property incomes, due to the rise in interest rates. Households adjust their consumption more or less in line with the movement in their income. Their savings ratio is being slightly eroded.

The growth of business investment looks set to continue at a sustained rate (3% or more as an annual average), despite the higher interest rates, thanks to satisfactory profitability and domestic and foreign demand prospects. The growth of investment in housing is likely to be less sustained, mainly because of the gradual rise in interest rates. Government investment will tend to subside after peaking in 2005-2006, reflecting the cycle of local authority infrastructure projects.

During the period 2007-2009, the growth of Belgium's potential export markets is likely to weaken slightly, and Belgian exports will probably continue to lose market share. Imports and exports are expected to move roughly in parallel, with foreign trade continuing to make a meagre net contribution to growth.

Inflation should remain under control. Wage increases will be modest, in line with the movement in labour costs in Belgium's three main trading partners.

Employment is predicted to expand at a modest but steady pace, with employment rising from 61.9% in 2005 to 63.2% of the population of working age in 2009.

Table 3
Labour market movements

% Change	2004	2004	2005	2006	2007	2008	2009
	Volume						
1. Domestic employment	4.162,0 (a)	0,6	0,7	0,7	0,7	0,9	0,8
2. Number of hours worked	6.510,3 (b)	0,6	0,6	0,6	0,6	0,8	0,7
3. Unemployment rate (% , Eurostat definition)	7,8	7,8	7,8	7,8	7,8	7,6	7,5
4. Real GDP per person in work	59,2 (c)	2,0	0,7	1,5	1,3	1,4	1,4
5. Real GDP per hour worked	37,8 (d)	2,0	0,9	1,6	1,5	1,5	1,5
6. Compensation of employees	148,2	4,1	3,9	4,1	4,0	4,6	4,6

a. thousand

b. millions of hours

c. thousands of euros

d. euros

3. The overall budget balance and the public debt

3.1. *The fiscal policy stance*

Introduction

The stability programme for 2006-2009 is an update of the previous stability programme for 2005-2008 and forms part of the long-range budget programme drawn up during the federal coalition negotiations following the May 2003 elections. The budgetary stance of the present stability programme is therefore the same as for the previous programme. A balanced budget and, from 2007, the steady creation of surpluses and reduction in the debt ratio are still the central objectives. This fiscal policy is linked to an ambitious social and economic policy.

From a balanced budget to the creation of surpluses

Although real economic growth in 2005 will be below its potential rate, the government is maintaining the objective of a balanced budget. That objective has been achieved every year since 2000,⁴ and is being maintained in 2006. After that, budget surpluses will be gradually created: 0.3 % of GDP in 2007, rising by 0.2 % of GDP each year. These surpluses will be used to provide structural finance for the Ageing Fund. By passing the law amending the law of 5 September 2001 guaranteeing a continuous reduction in the public debt and creating an Ageing Fund, parliament has adopted legislation which embodies this government budget strategy and the associated financing of the Ageing Fund.

⁴ In EDP terms, a small deficit of € 31.9 million was recorded in 2002, or just 0.01 % of GDP.

Further reduction in the debt ratio

At the end of 2005, the public debt will be cut to 94.3% of GDP, despite the assumption of a large part of the BNRC debt (representing 2.5% of GDP). Towards the end of the present stability programme, the debt ratio will be down to 79.1%, whereas in 1993 it was still 137.1%. A reduction of 58 percentage points will therefore have been achieved in the space of 16 years.

Stimulating economic growth and employment: guaranteeing a strong social security system based on solidarity

The fiscal policy is supplemented by an economic and social policy which stimulates employment by a programme of cuts in charges while aiming to enhance social security and purchasing power. When preparing the 2006 budget, and after consulting the social partners, the government drew up a pact on solidarity between generations.

It contains a series of measures aiming:

- to encourage jobs for the young
- to keep older people in work for longer
- to use social security as a factor of economic dynamism
- to ensure a structural financial balance in social security and to link social benefits to improvements in prosperity.

Controlling primary expenditure

In accordance with the coalition agreement, additional resources have been earmarked for justice and security, mobility and development cooperation. Granting additional resources for political priorities implies severe restrictions on primary expenditure in other areas. In that context, it is vital to continue to control expenditure on health care, which has a major impact on the social security balance.

3.2. An overview of public finances, 2005-2009

Table 4 sets out the objectives and forecasts for public finances for the period 2005-2009. The general government's overall budget balances represent a clear commitment. The detailed figures for revenue and expenditure are merely estimates, and are intended only as a guide. When the budget is drawn up and at the time of the budget audit, the governments will update their figures and adapt them, if necessary, to circumstances at the time.

Table 4
General government budget forecasts

% of GDP	2004	2004	2005	2006	2007	2008	2009
	<i>(in millions of euros)</i>						
	<i>Financing balance of the sub-sectors</i>						
1. General government	4,7	0,0	0,0	0,0	0,3	0,5	0,7
2. Federal government	-414,1	-0,1	-0,1	0,1	0,2	0,3	0,4
3. Communities and regions	684,2	0,2	0,2	0,1	0,0	0,0	0,0
4. Local authorities	-353,5	-0,1	-0,2	-0,2	0,0	0,1	0,2
5. Social security institutions	88,1	0,0	0,1	0,0	0,1	0,1	0,1
	<i>General government</i>						
6. Total revenue	142.329,6	49,4	49,7	49,4	49,2	48,8	48,7
7. Total expenditure	142.324,9	49,4	49,7	49,4	48,9	48,3	48,0
8. Financing balance	4,7	0,0	0,0	0,0	0,3	0,5	0,7
9. Interest charges (incl. FISIM)	13.745,8	4,8	4,3	4,1	3,9	3,6	3,4
10. Primary balance	13.750,5	4,8	4,3	4,1	4,2	4,1	4,1
	<i>Main components of revenue</i>						
11. Total taxes	87.972,5	30,5	30,9	30,8	30,7	30,4	30,2
<i>(11a+11b+11c)</i>							
11a. Taxes on production and imports	37.463,3	13,0	13,1	13,5	13,4	13,1	13,0
11b. Current taxes on income, wealth, etc..	48.324,1	16,8	17,2	16,8	16,6	16,6	16,6
11c. Taxes on capital	2.185,1	0,8	0,6	0,6	0,6	0,6	0,6
12. Social security contributions	46.870,3	16,3	16,1	16,0	16,0	15,9	15,9
13. Property income	1.666,1	0,6	0,6	0,6	0,6	0,5	0,5
14. Other <i>(14a+15+(11+12+13))</i>	5.820,7	2,0	2,0	2,0	2,0	2,0	2,0
15=6: Total revenue	142.329,6	49,4	49,7	49,4	49,2	48,8	48,7
p.m.: tax burden	136.616,3	47,4	47,7	47,5	47,3	46,9	46,7
	<i>Main components of expenditure</i>						
16. Consumption expenditure	45.224,5	15,70	15,77	15,72	15,59	15,45	15,33
17. Total social transfers	66.702,1	23,2	23,2	23,2	23,2	23,1	23,0
17a. Social benefits in kind	20.597,7	7,1	7,1	7,2	7,4	7,4	7,5
17b. Social transfers other than in kind	46.104,4	16,0	16,0	16,0	15,8	15,7	15,6
18. Interest charges (inc. FISIM)	13.745,8	4,8	4,3	4,1	3,9	3,6	3,4
19. Subsidies	3.515,5	1,2	1,4	1,4	1,4	1,5	1,5
20. Gross fixed capital formation	4.589,5	1,6	1,8	1,8	1,7	1,7	1,6
21. Other <i>(21=22-16+17+18+19+20)</i>	53.772,0	18,7	18,9	18,9	18,7	18,6	18,5
22=7: Total expenditure	142.324,9	49,4	49,7	49,4	48,9	48,3	48,0
pm: Compensation of employees	34.683,9	12,0	12,1	12,1	12,0	11,9	11,7

3.2.1. Execution of the 2005 budget

Downgrading of economic growth...

The revival in economic activity in Belgium in 2004 came to a halt in 2005 owing to the slowdown in the global economy caused by the rise in oil prices. Real growth underwent systematic revision: starting from 2.5 % at the time of the previous stability programme, it was cut to 2.2 % at the time of the March 2005 budget and 1.4 % at the time of the October budget. Despite this decidedly unfavourable economic climate, the government is adhering to its objective of a balanced budget.

...but favourable movement in tax revenues

In 2005, the movement in revenues was influenced by the phasing in of the personal income tax reform, a supplementary cut in social contributions and a series of other reductions targeting the tax burden. Despite the slackening of economic growth in the first half of 2005, general government revenues as a percentage of GDP will exceed the 2004 figure. It is surprising to find that taxes on earned income and property income have risen from 16.8 to 17.2 % of GDP. The main reason for this increase is the revenue expected to be raised by the securitisation of direct taxes (around 0.2 % of GDP). In 2005, revenue from the withholding tax on income from movable assets surged as a result of the direct and indirect effects of the repatriation of capital, associated with the one-off declaration of financial assets and entry into force of the European directive on savings. Corporation tax revenues reflect the favourable business climate and increased sharply in 2005. The small rise in indirect taxes is due partly to the impact of a series of measures introduced in order to shift the burden on labour towards indirect taxes and partly to stronger activity and rising prices on the property market, accounting for an increase in registration fees. The weight of social charges has fallen to 16.1 % of GDP.

Opposing movements within the expenditure ratio⁵

In 2005, the expenditure ratio was the outcome of opposing movements which partly cancelled one another out. While primary expenditure increased its share of GDP, interest charges declined. Leaving aside the effect of weak GDP growth, the increase in the weight of primary expenditure was due partly to heavier spending on infrastructure investments by local authorities in the run-up to the local elections. Business subsidies increased following entry into force of the service voucher system, aimed at promoting employment, and the return to their normal level of BNRC subsidies, following a shift between 2003 and 2004. Health care expenditure was kept under control in 2005 by continuous monitoring and certain spending cuts introduced at the end of 2004. In addition, interest charges fell from 4.8% to 4.3 % of GDP.

Stringent budget monitoring

As in previous years, the government is keeping a stringent and systematic watch on revenue and expenditure in order to balance the budget. Apart from the traditional budget audit at the end of March, an additional audit was conducted in June, partly to examine the impact of weaker growth on revenue and expenditure. In September, when the 2006 budget was drawn up, the 2005 figures were checked once again. This monitoring was further stepped up in the closing months of the year.

⁵ For expenditure classified by function, see the table in annex 3

3.2.2. The 2006 budget

A budget with a clear vision

Apart from the measures needed to achieve a balanced outcome, the 2006 budget includes some specific priorities. It can be regarded as a budget of programmes creating the conditions for an active policy. The key elements of that policy are the stimulation of the economy and employment via reductions in charges and other measures, optimisation of public services by additional investments in mobility, and an increase in the funding earmarked for security, the linking of social benefits to prosperity and the structural refinancing of social security.

Surpluses at all other levels to compensate for the local authority deficit

The local elections in 2006 cause the local government balance to deteriorate, in view of the electoral cycle of their expenditure. Their 2006 deficit is estimated at 0.2 % of GDP. Conversely, the accounts of the communities and regions, social security and – for the first time – federal government show a small surplus.⁶ These surpluses will be sufficient to offset the local authority deficit so that, overall, the general government budget will remain in balance.

⁶ The balanced federal budget has thus been achieved a year earlier than announced in the previous stability programme.

Shift in charges to stimulate job creation

The government pursues an active fiscal policy aimed at stimulating job creation in Belgium. Apart from the cut in personal income tax already mentioned, which will take full effect in 2006, this policy designed to boost activity will continue in 2006, along three main lines: first, in 2006 a new series of selective tax cuts and reductions in charges on labour costs⁷ will be implemented. This reduction in charges will be partly offset by an increase in the revenue generated by consumption and income from movable assets. The overall tax burden on earned incomes (including social contributions) will thus be shifted partly towards taxes on other factors. From 1 January 2006, income from capitalisation funds which hold 40% or more of their assets in fixed-income securities will attract a 15% withholding tax. An annual tax will also be imposed on individual life insurance premiums in branches 21 and 23. Finally, the intention is to broaden the social security funding base by allocating a fixed percentage of the revenue from the withholding tax on movable incomes and excise duties.

Controlling expenditure by stringent monitoring

The 2006 budget is a rigorous one. At federal level, real departmental expenditure excluding pensions cannot increase overall by more than 0.3 %. In addition, a whole set of measures has been introduced to control the growth of social security expenditure, keeping it at 1.73 % in real terms. Thus, primary expenditure will grow more slowly than GDP. Finally, the reduction in interest charges is also contributing to the decline in the expenditure ratio.

⁷ For a detailed description, see section 5

3.2.3. The period 2007-2009

Gradual creation of budget surpluses

The budget strategy outlined from 2007 was designed to cushion the additional cost of the ageing of the Belgian population. In line with the long-term strategy, in 2007 the government will start gradually building up budget surpluses which it will pay into the Ageing Fund to finance the increase in pension costs. The surplus to be achieved by general government in 2007 comes to 0.3 % of GDP. The amended law on the Ageing Fund provides for an annual increase in this surplus of 0.2 % of GDP, bringing it to 1.3 % in 2012. It is at federal level that the greatest effort will go into achieving these surpluses. However, in 2007, a decisive factor in the attainment of the objective is the elimination of the local government deficit at the end of the electoral cycle.

A substantial budget surplus as the medium-term objective

Article 2 of the new Stability and Growth Pact obliges the Member States of the European Monetary Union to formulate individual medium-term budget targets in terms of nominal growth and the debt ratio. The European Commission has issued a document setting out an exercise, by way of example, and estimating that Belgium's medium-term objective is a balanced budget or a small surplus.⁸ The Belgian government targets previously outlined provide for a surplus of 0.7 % of GDP at the end of the period covered by the present stability programme. That figure is thus well above the Commission's estimate. With a surplus of 0.7 % in 2009, as its MTO, Belgium therefore fulfils the medium-term condition of the Stability and Growth Pact.

⁸ *Identifying sustainable targets for the medium-term objective of close-to-balance or in surplus (CTBOIS)*, Brussels, 23 September 2004.

Gradual reduction in total revenue as a percentage of GDP

The pact on solidarity between generations provides for a series of selective reductions in charges which will come into force or become fully operational in 2007.⁹ They will lead to a reduction in public revenues as a percentage of GDP. The gradual decline in the total revenues of general government is also due to a less favourable composition of GDP.

Spending cuts permit new reductions in charges

The budgetary scope needed for new reductions in charges comes from an overall reduction in expenditure as a percentage of GDP, resulting from the reduction of the weight of primary expenditure (consumption expenditure, etc) and interest charges. Towards the end of the period concerned, the decline in interest charges will be less marked. Since interest rates are already low, the implicit rate will fall less steeply than in previous years. In order to achieve the scheduled surpluses expanding year by year, the primary balance will need to be held steady at 4.1% of GDP.

3.3. The contribution of the various sub-sectors

Belgium is a federal State in which power of decision is exercised at various levels, depending on the area of responsibility. In principle, the communities and regions are free to conduct their own fiscal policy. However, the Financing Requirements Section of the High Council of Finance may advise the federal authority to limit their borrowing capacity. The targets set for public authorities as a whole can therefore be attained only if the fiscal policy of the various levels of power is coordinated. The Belgian experience has shown that a system of clear agreements on the results to be achieved at each level, coupled with the delegation of responsibility to the various sub-sectors, ensures the success of fiscal policy.

⁹ See details in chapter 5.

A new agreement on the budget targets of the communities and regions

In its budget plans for the period 2006-2009, the Belgian federal government is beginning to create budget surpluses providing resources for a reserve fund to absorb the future increase in pension costs. It is important for the responsibilities of each level of public authority to be clearly defined right at the start of this new phase. That is why, on 26 October 2005, the federal government concluded a new agreement with the communities and regions on the budget targets for the period 2006-2009. Under this agreement, the communities and regions will make an additional effort in 2005 and 2006. They have undertaken to refrain from using the whole of the large increase in their revenues (both their own tax revenues and their share of personal income tax and VAT paid over by the federal government), in order to create larger surpluses. However, the communities and regions will be able to deduct from this additional effort the previous targets relating to the period 2006-2009. That explains why the standardised target of the communities and regions drops from 0.2 % of GDP to virtually zero from 2007.

Local authorities

In the electoral budget cycle of the local authorities, the local elections have a negative impact on the budget balance. Such an impact is expected in 2006. On the eve of the October 2006 elections, the local government deficit will probably amount to 0.2 % of GDP. As gross investment in immovable assets declines in 2007, local authorities will once again achieve a balanced budget. After 2007, the local authorities will have to create small surpluses.

Table 5
The medium-term targets for the various sub-sectors

<i>% of GDP</i>	2004	2005	2006	2007	2008	2009
Primary balance	4,8	4,3	4,1	4,2	4,1	4,1
Entity I	4,2	3,8	3,8	3,8	3,7	3,6
Entity II	0,5	0,5	0,3	0,4	0,4	0,5
Interest charges	4,8	4,3	4,1	3,9	3,6	3,4
Entity I	4,3	3,9	3,7	3,5	3,3	3,1
Entity II	0,4	0,4	0,4	0,3	0,3	0,3
Financing balance	0,0	0,0	0,0	0,3	0,5	0,7
Entity I	-0,1	-0,1	0,1	0,3	0,4	0,5
Entity II	0,1	0,1	-0,1	0,0	0,1	0,2

The objective for the communities and regions combined with the estimates for local authorities results in a small deficit for Entity II in 2006. In subsequent years, the decline in the surplus of the communities and regions will be offset by the improvement in the local authority balance. In 2009, Entity II is expected to achieve a surplus of 0.2 % of GDP.

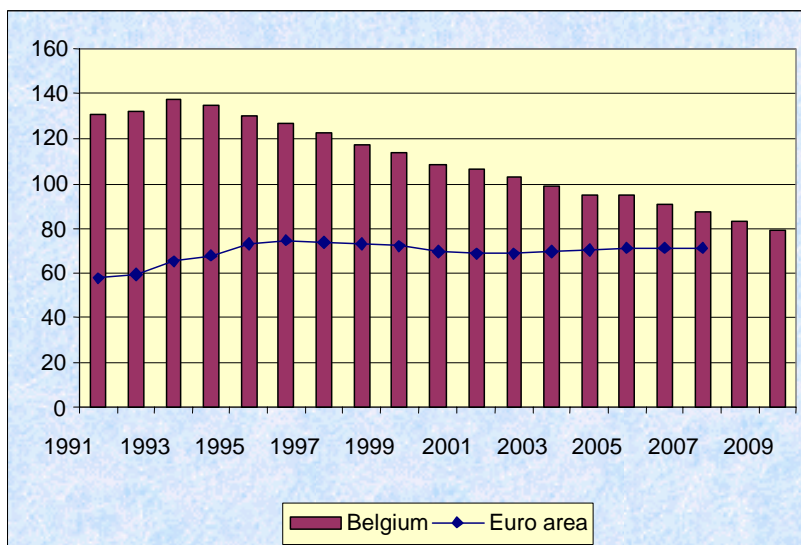
At the level of Entity I, the federal government will start gradually building up surpluses. For social security, a balance is planned corresponding to a small surplus in ESA terms. As a result of these two factors, the Entity I surplus will increase to 0.5 % of GDP in 2009.

3.4. Debt developments

Debt reduction as the key aim

Since 2000, the Belgian budget has been in balance year after year. However, the country's high level of public debt remains a serious adverse factor. Reducing the debt ratio at a sufficiently rapid pace is a crucial element of the government's strategy for coping with the budget effects of the ageing population.

Chart 1
Movement in the debt ratio in Belgium and in the euro area



The Belgian debt ratio has been steadily reduced over the past ten years, from 137.1 % of GDP in 1993 to below the 100% threshold in 2003. Table 6 sets out the factors which determine the medium-term movement in the gross debt ratio.

Table 6
Movement in the general government debt ratio

% of GDP	2004	2005	2006	2007	2008	2009
1. Gross debt	94,7	94,3	90,7	87,0	83,0	79,1
2. Change in the debt ratio	-3,8	-0,4	-3,6	-3,7	-4,0	-3,8
<i>Contributions to change in gross debt</i>						
3. Primary balance	4,8	4,3	4,1	4,2	4,1	4,1
4. Interest charges (incl. FISIM)	4,8	4,3	4,1	3,9	3,6	3,4
5. Stock-flow adjustment	0,8	3,0	0,5	0,2	0,2	0,2
of which						
- differences between cash and accruals	0,4	0,2	0,1	0,0	0,0	0,2
- net accumulation of financial assets	-0,1	0,2	0,2	0,2	0,2	0,2
of which:						
privatisation proceeds	0,4	0,0	0,0	0,0	0,0	0,0
- valuation effects and others	0,5	2,7	0,2	0,0	0,0	0,0
p.m. implicit interest rate on debt	5,1	4,7	4,5	4,4	4,3	4,3

Slower rate of debt reduction in 2005

Between 2004 and 2005, the debt ratio will only decline from 94.7 to 94.3 %. This slower pace of debt reduction is attributable to the assumption of a large part of the BNRC's debt totalling € 7.4 billion, or 2.5 % of GDP. This assumption of the debt accounts for much of the unusually high figure for the exogenous change in the debt in 2005. Privatisations are not expected to generate any substantial revenues in 2005. Moreover, the government wanted a strategic partner for the Post Office. This operation was effected by increasing the capital. The exogenous change in the debt is also determined by the adjustment of net expenditure relating to the granting of loans and the acquisition of participating interests, and other factors such as the difference between the cash position and the scheduling.

Unremitting efforts from 2006 to 2009

For 2006 and subsequent years, the figures no longer allow for revenue from any privatisation operations. The movement in the debt ratio is therefore due largely to the endogenous change. According to the growth assumptions adopted, during the period 2006-2009 a primary balance of around 0 % of GDP will be sufficient to stabilise the debt ratio. The proposed fiscal targets combined with the expected movement in interest charges will permit the creation of a primary surplus of at least 4.1 % of GDP, resulting in a similar endogenous change in the debt. The assumptions concerning lending and the acquisition of participating interests will have little effect on the debt reduction, and the same applies to other factors (difference between the cash position and scheduling). At the end of 2009 the debt ratio should be down to 79.1 %.

3.5. The cyclically adjusted balance

According to the Federal Planning Bureau's estimates, the potential growth of the Belgian economy in the medium term varies between 1.9 and 2.1 %. The largest contribution to this potential growth comes from total factor productivity. Initially, capital and labour have the same impact on potential growth, but towards the end of the period concerned, the contribution of the factor labour will fall sharply as the population ages.

Table 7
Output gap and cyclically adjusted balance

% of GDP	2004	2005	2006	2007	2008	2009
1. Real GDP growth	2,6	1,4	2,2	2,1	2,3	2,2
2. Financing balance of general government	0,0	0,0	0,0	0,3	0,5	0,7
3. Interest charges (incl.FISIM)	4,8	4,4	4,1	3,9	3,6	3,5
4. Potential GDP growth	1,9	2,0	2,1	2,1	2,0	1,9
Contribution:						
- labour	0,5	0,6	0,6	0,6	0,5	0,3
- capital	0,5	0,5	0,6	0,6	0,6	0,6
- total factor productivity	0,9	0,9	0,9	1,0	1,0	1,0
5. Output gap	-0,4	-1,0	-0,9	-0,9	-0,6	-0,3
6. Cyclical component of the budget	-0,2	-0,5	-0,5	-0,5	-0,3	-0,1
7. Cyclically adjusted financing balance (2-6)	0,2	0,5	0,5	0,8	0,8	0,8
8. Cyclically adjusted primary balance (7+3)	5,0	4,9	4,6	4,7	4,4	4,3

In 2004, real economic growth substantially outstripped potential growth. The output gap subsequently declined sharply to 0.4 %. However, the upturn in the economic cycle soon came to an end following the slowdown of the global economy combined with a strong euro. In 2005 the output gap therefore increased again to 1.0 %, so that the business cycle had a substantial negative impact on the overall balance of around 0.5 percentage point. The cyclically adjusted overall balance therefore shows a surplus of 0.5 %. In 2006 and 2007, the negative impact of the cycle on the overall balance will remain at 0.5 % of GDP and decline thereafter. Combined with the larger surpluses on the real overall balance, that will mean that the cyclically adjusted balance remains steady at 0.8 % of GDP from 2007 to 2009.

Structural balance again in 2005 and 2006

In 2005 and 2006, the economic cycle once again had a strong negative effect on the budget. The Belgian government took non-recurring measures¹⁰ which partially corrected that impact. The cumulative impact of those measures on the overall balance comes to 0.4% of GDP in 2005 and 0.6% in 2006. As the impact of the non-recurring measures on the overall balance is comparable to the impact of the business cycle, the budget will be structurally in balance in both 2005 and 2006.

¹⁰In 2005 and 2006, the main non-recurring measures are:

<i>% of GDP</i>	2005	2006
Securisation of taxes	0,2	0,2
Sale of land and buildings	0,1	0,0
Funds investing in buildings (SICAV)	0,1	0,2
Regularisation measures		0,1
Shift in BNRC appropriation		0,0
Total	0,4	0,6

4. Comparison with the stability programme for 2005–2008 and sensitivity analysis

4.1. Comparison with the stability programme for 2005-2008

Table 8 compares the targets of the stability programme for 2005-2008 with the new targets.

Table 8
Deviations from the previous programme

<i>% of GDP</i>	2004	2005	2006	2007	2008	2009
Growth of GDP						
previous update	2,4	2,5	2,5	2,1	2,0	
current update	2,6	1,4	2,2	2,1	2,3	2,2
deviation	0,2	-1,1	-0,3	0,0	0,3	
Financing balance						
previous update	0,0	0,0	0,0	0,3	0,6	
current update	0,0	0,0	0,0	0,3	0,5	0,7
deviation	0,0	0,0	0,0	0,0	-0,1	
Gross debt ratio						
previous update	96,6	95,5	91,7	88,0	84,2	
current update	94,7	94,3	90,7	87,0	83,0	79,1
deviation	-1,9	-1,2	-1,0	-1,0	-1,2	

Weaker growth predicted

The upturn in economic activity began earlier than expected but also ran out of steam sooner, being hit by the impact of the sudden sharp rise in oil prices on the global economy. The outcome for the Belgian economy was twofold: in 2004, economic growth was 0.2 percentage point higher than the growth forecasts of the previous stability programme, but in 2005 growth dropped to 1.4%, far below the estimate of 2.5%. In 2006, economic growth looks set to be weaker than previously forecast. Over the period 2004-2006, cumulative economic growth will be 1.2 percentage points below the forecasts used for the previous update.

Practically no changes to the budget plans

Although growth falls well short of the forecasts, the new general government budget plan is practically the same as that in the previous stability programme. A balanced budget was achieved in 2004, the 2005 budget is heading for balance, and the practical conditions for balancing the budget in 2006 have been specified. 2007 still marks a turning point as the year in which the objective will be to create an initial surplus of 0.3 % of GDP.

Debt reduction is on schedule

The difference in the debt ratio recorded in 2004 is due largely to the statistical adjustments made to both the public debt and GDP by the National Accounts Institute. Overall, the debt ratio is declining. The less favourable movement in nominal GDP will wipe out part of this advantage in 2006, bringing the difference to 1.2 percentage points. In the ensuing years, the difference in relation to the debt ratio planned under the stability programme for 2005-2008 will be almost constant at around 1 percentage point.

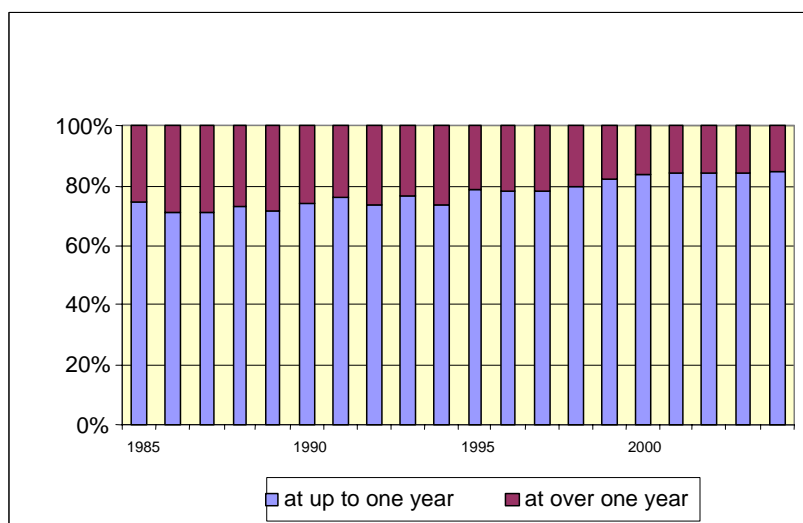
4.2. Sensitivity analysis

4.2.1. Interest rate sensitivity of the overall balance

Since the introduction of the euro, the debt denominated in foreign currency has been cut to less than 1% of the total Belgian public debt, so that the exchange risk has become more or less negligible. However, in view of the size of the Belgian public debt, public finances are still sensitive to changes in interest rates. In recent years, a voluntary policy has been applied in a systematic attempt to reduce this sensitivity. The federal government (which holds roughly 90% of the total debt) has taken advantage of the historically low interest rates to make systematic reductions in the

percentage of short-term debt. In 2004 the proportion of the debt in euro at less than one year was cut to around 15 %.

Chart 2
The gross debt in euro, by maturity



The constant extension of the duration of the existing debt delays still further the impact on the interest charges of a change in the level of interest rates. Table 9 shows the effect on the interest charges of an increase in the interest rate assumptions of 100 basis points for the entire period 2006-2009.

Table 9
Impact of a change in the interest rate assumptions

% of GDP	2006	2007	2008	2009
Degree to which interest charges deviate from the scenario described	0,1	0,3	0,3	0,4

If the interest rate were increased by 100 basis points – which is unlikely in the current economic circumstances – that would cause a small rise in the interest charges from 0.1 % of GDP in 2006 to 0.4 % in 2009.

4.2.2. Growth sensitivity of the overall balance

On both the revenue and the expenditure side, the general government's final budget balance depends on the volume and the composition of economic growth. A recent OECD estimate, referred to by the European Commission, indicates that the overall sensitivity of Belgian public finances to the economic situation is as follows:

Table 10
Sensitivity of Belgian public finances

Sensitivity of revenue	0,47
Sensitivity of expenditure	-0,07
Overall sensitivity	0,54

It emerges that a change in GDP mainly affects Belgian public revenue. On the basis of this OECD estimate of overall sensitivity, we outline the impact of possible divergences from the base scenario as regards medium-term economic growth. We compare the base scenario with a growth path corresponding to potential growth, on the assumption of lower growth with a negative annual deviation of 0.5 percentage point and higher growth with a positive annual deviation of 0.5 percentage point:

Table 11
Sensitivity of the financing balances to changes in growth

	2006	2007	2008	2009	Cumulative impact
Stability programme 2006-2009					
Real GDP growth	2,2	2,1	2,3	2,2	
Financing balance	0,0	0,3	0,5	0,7	
Potential growth					
Real GDP growth	2,1	2,1	2,0	1,9	
Financing balance	-0,05	0,30	0,34	0,54	-0,38
Weaker growth					
Real GDP growth	1,7	1,6	1,8	1,7	
Financing balance	-0,27	0,03	0,23	0,43	-1,08
Stronger growth					
Real GDP growth	2,7	2,6	2,8	2,7	
Financing balance	0,27	0,57	0,77	0,97	1,08

Leaving aside the negative output gap and assuming that the policy remains constant, a growth scenario close to potential growth would give rise to a small deficit in 2006. In any case, steadily increasing surpluses would build up from 2007 onwards, although to a lesser extent than in the base scenario. If real annual growth were, on average, half a percentage point lower than in the base scenario, that would only create a deficit in 2006 if the policy remained unchanged, and surpluses would build up from 2007. However, the government considers this scenario to be purely theoretical. Owing to the link to the financing of the Ageing Fund, the timetable for creating medium-term fiscal surpluses has been indirectly laid down by law. Furthermore, if growth exceeds the forecasts, the government has promised that it will give priority to allocating the additional budgetary scope to reducing the debt ratio.

5. The quality of public finances

For a number of years now, the Belgian authorities have been pursuing a policy of reforms to augment growth potential by stimulating employment, improving the fiscal and regulatory environment for enterprises, creating and strengthening the conditions of competition, and assisting progress towards a knowledge society. This reform policy was given further impetus by the government's October 2005 statement. That is echoed in the National Reform Programme for 2005-2008 which defines the priorities of the Belgian authorities in terms of the attainment of the Lisbon objectives. The first priority is employment. The pact on solidarity between generations, which has formed the subject of consultation with the social partners, defines the conditions for boosting the employment rate of the youngest and oldest workers. The policy of reducing labour costs is being maintained and intensified. Moreover, promoting economic growth and employment requires a climate conducive to investment, entrepreneurial spirit and innovation; new moves have also been initiated to achieve that. Economic growth and prudent fiscal management will enable us to maintain a good quality social security system: measures have been taken to ensure cost control (especially in the health sector) and the structural financing of social security. Finally, within the overall system of controlling primary expenditure, it has been possible to focus on certain priority areas.

5.1. Employment policy

The indirect labour cost reduction policy and the assistance and activation policies, in place for many years now and progressively stepped up, have undeniably yielded results but that is still not enough: the employment rate increased from 58.1% in 1996 to 62.3% in 2001, before the economic slowdown caused a slight dip (61.6% in 2003). With no change in policy, the recovery which began in 2004 seemed destined to be only modest and very gradual. New initiatives were therefore implemented to boost the activity rate, which is still too low.

5.1.1. Reducing indirect labour costs

New measures to reduce indirect labour costs are planned under the 2006 budget, or were announced in the pact on solidarity between generations.

From 2006, a further cut in employers' contributions will target young workers aged 19 to 29 earning low wages. This cut can be converted into a bonus on the total social contributions payable by the employer if it exceeds the amount of the contributions which the employer has to pay on the young worker's wages. It follows that in such cases the employment of young workers will cut the cost of other employees working for the same business.

Altogether, the cuts in social contributions will total € 5.5 billion in 2006, or 1.8% of GDP.

After that, it is planned that the cuts in employers' social contributions for workers aged over 50 will be increased according to the age of the workers.

Various fiscal measures are also intended to cut the indirect cost of labour. Implementation of the personal income tax reform has been completed. Since 1 October 2005, the withholding tax on the salaries of researchers working in enterprises which have concluded a cooperation agreement with an approved research centre has been halved. Since then, it has been decided to introduce a more general reduction of 25% in the withholding tax for all researchers and doctors in scientific disciplines. The type and therefore the number of enterprises concerned will increase further in 2006. The reduction in the withholding tax on earned incomes of shift workers will be stepped up. Altogether, these tax cuts total over € 7.5 billion in 2006.

In order to encourage the labour supply, particularly in the case of low wage earners, the employment bonus – a system of reducing personal social contributions, already reinforced in April 2005 – will be further extended: the amount of the reduction has been increased and the pay threshold up to which it applies will be raised.

The development of the service voucher system, which subsidises demand for local services, will continue.

5.1.2. Boosting the rate of participation in the labour market

The Belgian authorities' desire to increase the activity rate is clearly demonstrated by the set of measures included in the pact on solidarity between generations. This agreement, drawn up after consultation with the social partners, aims essentially to increase the participation in the labour market of young people and older workers, the two population segments in which Belgium performs less well than the European average in terms of the employment rate.

Many measures have been planned, constituting a coherent package. The main thrust of the measures is as follows:

- In the case of **young people**, apart from the cuts in social contributions already mentioned, the measures defined mainly concern:
 - encouraging part-time working combined with training;
 - increasing the supply of first jobs in the public services;
 - activation and assistance for the young, especially in the launch of a self-employed activity.

- In the case of **older workers**, a range of possibilities will be explored in order to encourage them to participate in the labour market:
 - special attention will be paid to changing the perception of the workplace and of the contribution of the oldest workers in the business;
 - there must be no discrimination against older workers in the enhanced in-service training drive to which businesses are committed (1.9% of the wage bill in 2006) ;
 - instruments will be set up in the event of restructuring in order to minimise the use of early pensions (severance pay, employment unit, etc.). In the event of redundancy, workers aged over 45 will be entitled to an outplacement formula;

- to encourage them to return to the labour market, the unemployed who accept a job which pays less than they previously earned could qualify for a “back-to-work supplement” paid by their former employer or by the unemployment benefits agency;
- to encourage them to continue working, older workers can be accorded more flexible conditions of employment: thus, the right of persons aged over 55 to work 4/5ths of standard working time will be very greatly extended. A bonus system will be introduced, granting a pension supplement to those who continue working after age 60. The scope for drawing a pension at the same time as receiving earned income will be further extended;
- the age and seniority conditions for entitlement to the early pension will be increased, except in a few specific cases.

5.2. Improving the fiscal and regulatory environment for businesses

To ensure the growth of productivity and employment, it is necessary to reinforce the conditions for developing entrepreneurship and innovation.

For businesses, finance is crucial to their development. Internal capital funding favours stability. In order to eliminate any tax discrimination at the level of financing by internal resources and in order to encourage self-financing, the Belgian authorities decided to introduce a 'notional interest' system from 1 January 2006. This system consists in granting a deduction from the basis of assessment for corporation tax equal to a percentage of the capital corresponding to a notional return on the equity capital. This means an implicit reduction in the rate of corporation tax, and thus increases the fiscal attractiveness of Belgium for foreign investors.

For a number of years, the Belgian government has been working to reduce the administrative burden on businesses by developing e-government, establishing the Central Enterprise Data Bank and the business service desks (guichets d'entreprises), the Kafka plan, etc. Results have already been achieved: according to a survey, this burden declined from 3.43% of GDP in 2002 to 2.57% in 2004. These efforts are continuing. In particular, in accordance with the guidelines defined at European Union level, ex-ante evaluation of new draft legislation is now carried out (Kafka test).

5.3. Improved social security with a balanced budget

The Belgian authorities have implemented a series of measures aimed at ensuring the long-term financial balance of social security, partly by restructuring its funding base and partly by ensuring that costs are kept under control, especially in health care, while adjusting social benefits in line with national wealth.

5.3.1. Restructured funding sources

The revenues of public authorities, and especially of social security, are too heavily based on the factor labour. As the government wishes both to step up its policy of reducing the fiscal and parafiscal burden on labour and to guarantee a high standard of social security, it has become essential to develop alternative sources of funding.

From 2005, the amount of the packaging levy is being allocated to the financing of health care. More fundamentally, from 2006 15% of the annual revenue generated by the withholding tax on income from movable assets will be allocated to the financing of social security, and part of the tobacco excise revenue will be structurally allocated to health care funding. At the same time, the basis for levying taxes is being expanded. Thus, a tax is being introduced on capitalisation investment funds and on certain individual life insurance premiums.

From 2008, funding for the health care budget target should be provided by expanding the funding sources if this target exceeds the growth rate of social contributions.

5.3.2. Health care expenditure under control

Controlling health care expenditure is a key priority for the government. During 2005, a series of structural measures were introduced which had the effect of curbing the upward trend in this expenditure. In 2006, that effect should be confirmed and consolidated..

The coalition agreement provides for health expenditure growth of 4.5% in real terms. This very substantial growth was justified temporarily to make up lost ground in a number of areas, e.g. from the point of view of hospital facilities and the wages of nursing staff. But despite its high level, this norm tended to be exceeded spontaneously. To curb this trend the government presented a draft law in February 2005 on the structural control of health care expenditure. This led to a decline in the growth of this expenditure, and the decisions included in the 2006 budget should consolidate that improvement. Without going into excessively technical details, it is possible to outline a few key points structuring the measures taken:

- controlling abuses and promoting good practice

The idea here is to refer to standard profiles for responsible medical prescribing, the use of specialists or expenditure on certain hospital stays. More rational use and distribution of heavy medical equipment (medical imaging, scanners, etc.) is also envisaged, and cooperation between hospitals is being encouraged.

- promotion of the general practitioner's role

In particular, patients will be encouraged to visit their general practitioner before going to see the specialist.

- control of expenditure on drugs

This includes, for example, extending the system of benchmark reimbursement for all forms of the same active ingredient, or for all substances indicated for similar purposes; also the introduction of a degree of competition at the level of reimbursement, by arranging tenders or taking account of the situation in other countries.

- improving access to health care

This particularly concerns the most vulnerable population groups.

5.3.3. Linking social benefits to prosperity

Adjusting pensions and other social benefits in line with national prosperity safeguards the standard of living of the recipients. In this connection, under the pact on solidarity between generations, additional resources have been earmarked in 2006 for measures to improve the pensions of persons whose working life does not follow the standard pattern - this applies particularly to women - and for measures in other areas such as adjustments to family allowances, with increases for disabled children, and adjustments intended to harmonise third party assistance. Special attention will also focus on the lowest pensions. Up to and including 2007, the government has scheduled annual increases in the IGE (Income Guarantee for the Elderly) and an adjustment in line with prosperity for all pensions commencing between 1997 and 2001. For these measures, an additional budget of € 85 million has been set aside. From 2008, there will be structural funding for such adjustments. It will be at least equivalent to the implementation of the scenario adopted here by the Study Committee on Ageing (an annual average of +0.5% in real terms for non flat-rate benefits and +1% for flat-rate benefits; the pay threshold will increase by 1.25% per annum) in its estimate of the movement in social security expenditure, an estimate which is used as the basis for defining the long-term government targets for public finances.

5.4. Efforts aimed at political priorities

Within the framework of the strict control of primary expenditure growth (+0.8% in real terms in 2006, +0.3% excluding pensions) the federal government has nevertheless devoted particular efforts to certain political priorities:

- justice and security;
- mobility and, in particular, investments in the BNRC;
- development cooperation.

6. The long-term sustainability of public finances

6.1. Introduction

In common with most western countries, Belgium has to contend with major changes in the age structure of its population. Life expectancy is increasing and the birth rate is stagnating, the proportion of elderly persons in the Belgian population is growing: the population is ageing. The government is responding to this trend by establishing a coherent strategy which comprises a specifically targeted fiscal, economic and social policy. This strategy should safeguard the maintenance of a sufficiently high level of prosperity for the community as a whole in the medium term.

6.2. Demographics and the fiscal cost of population ageing

6.2.1. Demographic aspects

Changes in the age structure of the population have a direct impact on public expenditure and revenue, particularly in the social security sphere. The Belgian federal government has drawn up the necessary procedures to ensure that the policy takes account of its decisions in this inevitable development. Table 12 shows the results of the latest population forecasts produced by the Federal Planning Bureau and the National Statistical Institute for the period 2000-2030, and the dependency ratio for the same period.

Table 12
Changes in the composition of the population (x1000)

	2000	2004	2010	2020	2030	2030-2004	2030-2004 (%)
0-19	2.416,1	2.402,5	2.351,7	2.275,1	2.272,6	-129,9	-5,4
20-59	5.590,9	5.708,6	5.682,2	5.534,4	5.287,9	-420,7	-7,4
60 +	2.244,4	2.280,5	2.485,9	2.904,4	3.327,1	1.046,7	45,9
Total	10.251,4	10.391,6	10.519,8	10.713,9	10.887,6	496,1	4,8
<i>Percentage of the total population</i>							
0-19	23,6	23,1	22,4	21,2	20,9	-2,2	-9,7
20-59	54,5	54,9	54	51,7	48,6	-6,4	-11,6
60 +	21,9	21,9	23,6	27,1	30,6	8,6	39,3
<i>Dependency ratio</i>							
0-19	43,2	42,1	41,4	41,1	43	-0,2	2,1
60 +	40,1	39,9	43,7	52,5	62,9	22,8	57,5
Total	83,4	82	85,1	93,6	105,9	23,9	29,1

The cumulative effect of the decline in the birth rate and the large increase in life expectancy is already causing changes in the age structure of the population in the period 2000-2010. These trends will be reinforced in subsequent years. According to the forecasts, which also form the basis of the work of the Study Committee on Ageing, the number of young people (0-19 years) will tend to decline even if the total population expands. Their share of the total population will fall from 23.1 % in 2004 to 20.9 % in 2030. The decline in the population of working age (20 – 59 years) is even greater, in both absolute and relative terms. The ageing of the “baby boom” generation will significantly increase the number of persons in the over 60 age group. Their share in the total population will rise from 21.9 % in 2004 to 30.6 % in 2030. In 2030, around one-third of the population will be over the age of 60.

The dependency ratio reflects the percentage of the extreme age groups in relation to the population of working age (between 20 and 59 years). For the young, the ratio is relatively constant, in contrast to the ratio for persons aged 60 and over, which will rise from 39.9 % in 2004 to 62.9 % in 2030, an increase of 22.8 percentage points. The overall dependency ratio will increase in the space of thirty years to around 106%, which means that in 2030 there will be one person receiving benefits for every person in work. A smaller number of workers will have to fund social benefits for a

larger number of non-active persons. That will obviously have an impact on public finances.

6.2.2. The impact of population ageing on the budget

The fourth report of the Study Committee on Ageing, in May 2005, updates the estimated social and budgetary effects of population ageing up to 2030. That is the period during which the largest demographic changes will occur. Table 13 summarises the estimated costs of population ageing.¹¹

Table 13
Impact of population ageing on the budget

<i>% of GDP</i>	2004	2005	2010	2020	2030
Total expenditure (1)	49,4	49,7	47,8	47,4	48,7
Social expenditure	23,7	23,5	23,5	24,9	27,3
Pensions	9,3	9,2	9,0	10,4	12,3
Health care	7,3	7,2	7,9	8,6	9,5
Other social expenditure	7,2	7,1	6,6	5,9	5,5
Interest charges	4,8	4,3	3,3	2,0	1,3
Total revenues (1)	49,4	49,7	48,7	48,7	48,7
Movement in labour productivity	1,8	0,9	1,3	1,8	1,8
GDP growth in real terms	2,6	1,4	2,2	1,6	1,5
Male participation rate (20-64 years)	86,2	86,2	85,6	84,3	83,3
Female participation rate (20-64 years)	72,0	72,7	75,3	76,9	77,4
Overall participation rate (20-64 years)	79,2	79,5	80,5	80,6	80,4
Unemployment rate (2)	14,4	14,5	12,7	9,4	7,5
Percentage of the total population aged over 65 years	17,2	17,2	17,5	20,3	24,1

(1) The estimate of total expenditure assumes that primary expenditure (other than social spending) will fall slightly in terms of GDP. In the case of revenues, the ratio is assumed to be constant after 2009.

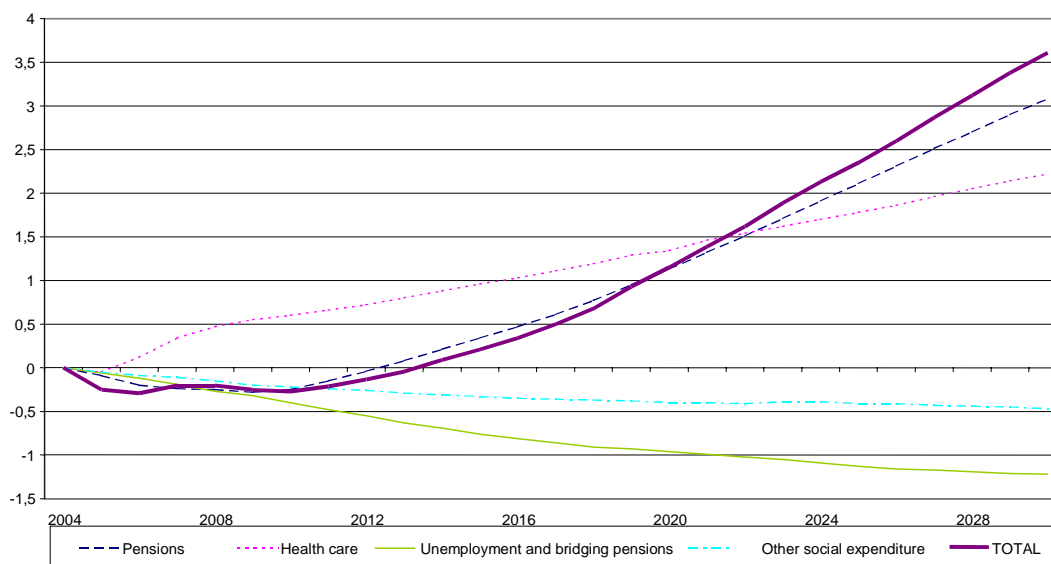
(2) This refers to unemployment according to the Federal Planning Bureau's definition, which differs in certain respects from the European definition.

Up to the end of the current parliament, in 2007, the movement in health care expenditure is based on the growth norm of 4.5% laid down in the coalition

¹¹ See also annex 4.

agreement.¹² The total cost of ageing is estimated at 3.6 % of GDP over the period 2004-2030. This increase is due mainly to the rise in expenditure on pensions (particularly those of employees) and health care (particularly long-term care). The small decline in the total cost between 2004 and 2010 is due to certain demographic effects (fewer people retiring, fewer family allowances) and a small reduction in the unemployment rate. Chart 3 shows the movement in the various parameters.

Chart 3
The budgetary cost of the ageing population (% of GDP)



Compared to last year, the estimate of the cost of population ageing has been increased by 0.2 % of GDP, mainly because of refinements to the method. Slightly weaker economic growth and a smaller reduction in expenditure on unemployment and pensions had only a minor impact on this result.

¹² After 2008 the growth rate is lower according to the estimation method used by the Study Committee on Ageing: that method implies that the movement in health care expenditure depends on the composition and size of the population, and changes in the level of prosperity.

6.3. A single strategy, a three-pronged policy

The Belgian political authorities consider the ageing of the population to be one of the greatest challenges for the decades ahead. In order to meet that challenge, the government has developed a coherent strategy focusing on three fundamental aspects of policy:

1. Budgetary policy: continue to reduce the public debt and build up reserves in the Ageing Fund;
2. Economic policy: by targeted reductions in charges, boost the employment rate and the quality of labour, particularly in the case of the young and workers aged over 50 years;
3. Social policy: continue developing a strong social security system based on solidarity.

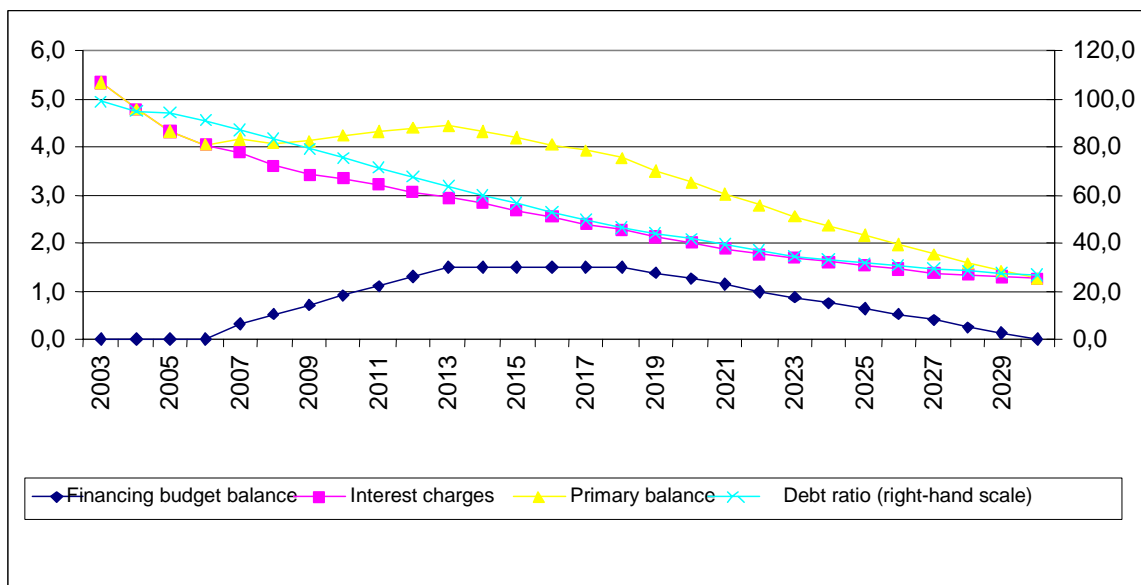
6.3.1. Budgetary policy and the Ageing Fund

Table 13 reveals that population ageing will be accompanied by a substantial increase in social spending. In its budgetary policy, the government anticipates these long-term developments. As in the past decade, the debt ratio will have to continue to be reduced at a sufficiently rapid pace. The resulting fall in interest charges will create additional scope for absorbing the cost of population ageing.

6.3.1.1 Budgetary policy

On the basis of the government's current schedule for reducing the public debt, the debt ratio will be cut to less than 60 % of GDP by no later than 2015. This reduction in the debt ratio will cut the interest charges from 4.8 % of GDP in 2004 to 1.3 % in 2030. The estimated rise in the cost of population ageing does not parallel the development of the scope created by the reduction in interest charges. That is why it will first be necessary to use that scope to create surpluses. The government is planning an initial surplus of 0.3 % in 2007 and wants to increase that by 0.2 % each year to 1.3 % in 2012. This process is laid down by law, following the parliament's approval of the draft law amending the law of 5 September 2001 guaranteeing the continuous reduction in the public debt and the creation of an Ageing Fund. Chart 4 illustrates the impact of this process on the basis of a number of key parameters of public finances.

Chart 4
Illustration of the main parameters of public finances
(% of GDP)



6.3.1.2 The Ageing Fund

The Ageing Fund was set up in 2001 to build up reserves in order to guarantee the funding for the additional expenditure under the various statutory pension schemes during the period 2010-2030. The law of 5 September 2001 guaranteeing continuous reduction in the public debt and creating an Ageing Fund provides for the Fund to be financed out of budget surpluses, social security surpluses, non-recurring non-fiscal revenues and investment income. So far, the Fund has been financed mainly by non-recurring revenues. The amended law on the Ageing Fund first provides that the growing budget surpluses¹³ planned until 2012 are to be paid into the Fund. After 2013, payments into the Ageing Fund will be determined by the King by Royal Decree discussed by the Council of Ministers, in accordance with the overall budget balance achieved. The second major component of the amendment to the law concerns the restriction on the possibility of financing the Ageing Fund by operations which have an impact on the debt without affecting the overall balance (non-recurring measures). For the period 2007-2010, this amount is limited to € 250 million per annum, and € 500 million for subsequent years. The Ageing Fund resources can be used to absorb the increase in expenditure on the various statutory pension schemes during the period 2010-2030 on condition that the general government debt ratio is less than 60 % of GDP, which will be the case by 2015 at the latest.

6.3.1.3 Capital invested in the Ageing Fund

Table 14 summarises the capital invested in the Ageing Fund. At the end of September 2005, the Ageing Fund reserves totalled € 12,391.5 million.

¹³ See 3.1. Fiscal policy stance

Table 14
Capital invested in the Ageing Fund

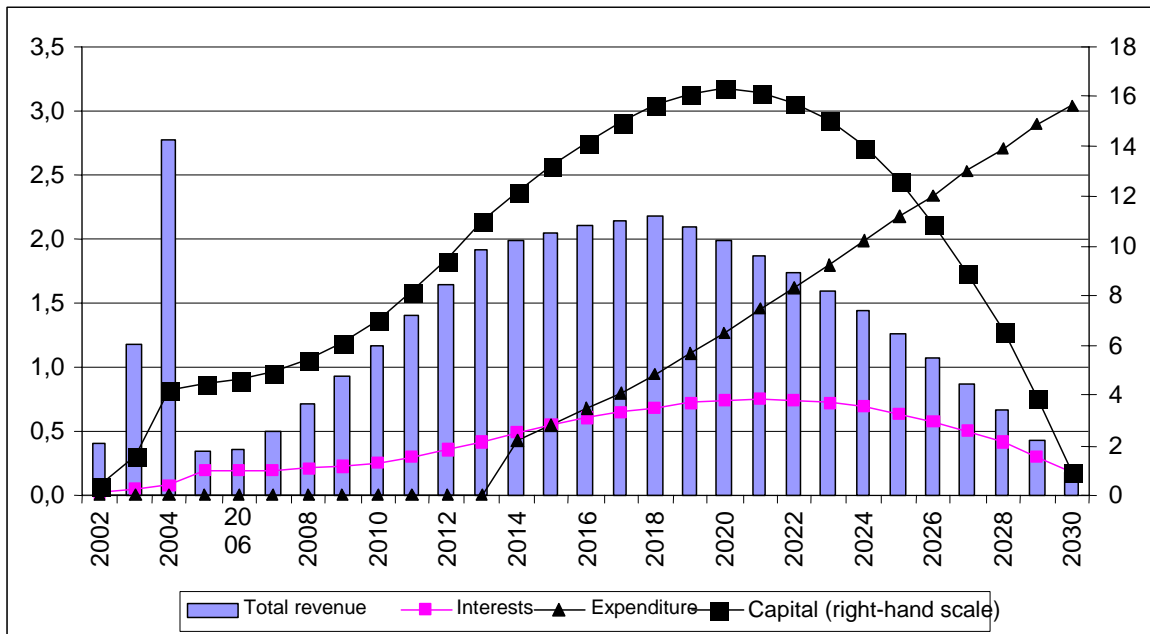
		Amounts invested	Cumulative
2001	UMTS	437.805.323,8	
	surplus value gold	177.114.565,6	
	short-term interest	9.156.142,9	
		624.076.032,3	624.076.032,3
2002	NBB profits	429.000.000,0	
	short-term interest	2.740.237,5	
		431.740.237,5	1.055.816.269,8
2003	Belgacom 2002 dividends	237.252.326,5	
	banknotes	213.965.560,0	
	Credibe	2.645.687.591,8	
		3.096.905.478,3	4.152.721.748,1
2004	Belgacom 2003 dividends	290.000.021,3	
	short-term interest	6.159.344,1	
	Belgacom pension fund	5.000.000.000,0	
	SHLAF	2.500.000.000,0	
		7.796.159.365,4	11.948.881.113,5
2005	One-off declaration of financial assets	422.897.175,8	
	Credibe balance	19.754.399,1	
	short-term interest	2.058,3	
		442.653.633,1	
	Total		12.391.534.746,5

In 2006, a transfer to the Ageing Fund totalling 0.2 % of GDP (€ 616 million) is planned. The target of € 13 billion by the end of 2007, defined at the time of the Ostend Council of Ministers on 20 and 21 March 2004, will therefore be achieved in 2006.

6.3.1.4 Long-term operation of the Ageing Fund

Chart 5 illustrates the long-term operation of the Ageing Fund. As indicated earlier, from 2007 the non-recurring funding will be replaced by structural funding, in particular by the allocation of the general government surpluses created. The interest on the investments will also play an increasingly important role in the funding. The capital of the Fund will exceed 16% of GDP. According to the assumption on which public finances are based, the general government debt ratio will decline below 60% by no later than 2015. In accordance with the law, from then on the Ageing Fund resources can be used to finance the increased expenditure on pensions. The combination of rising expenditure and the drying up of the structural revenues (since the surpluses will disappear) will lead to a gradual reduction in the Fund's capital. In 2030 it will be more or less used up, but that should not cause any problems, as the reduction in the debt will guarantee sufficient scope, thanks to the decline in the interest charges.

Chart 5
An illustrative scenario for the Ageing Fund



6.3.1.5 Budgetary policy as an element of a global strategy

As stated earlier, the budgetary policy mentioned above is only one element of a more global strategy. In principle, it would be sufficient to reduce the public debt fast enough to absorb the increasing cost of ageing. However, that would imply that all future scope in the budget is allocated to that single political objective, with no resources for other political initiatives or other challenges. The Belgian economy would then lose its dynamism, and that would have an impact on public revenues. It would therefore be a mistake to base the ageing population strategy on a single budgetary pillar. Other policy areas must also contribute. Promoting employment, and economic growth in general, will strengthen the financial basis for absorbing the costs of ageing. Increased dependency on social security accentuates the importance of a strong social security system based on solidarity. As mentioned in section 5, under the pact on solidarity between generations, the government has just taken measures in the areas specified above.

Annexes

Annex 1 : Sectoral balance

% of GDP	2004	2005	2006	2007	2008	2009
1. Net lending/borrowing vis-à-vis the rest of the world	3,1	2,6	3,1	3,4	3,8	4,1
of which:						
- Balance on goods and services	3,3	2,4	1,8	2,2	2,5	2,7
- Balance of primary incomes and transfers	0,3	0,3	0,1	0,1	0,1	0,2
- Capital account	-0,6	-0,7	-0,7	-0,7	-0,6	-0,6
2. Financial balance of the private sector	3,1	2,6	3,1	3,1	3,3	3,4
3. Financial balance of general government	0,0	0,0	0,0	0,3	0,5	0,7
4. Statistical discrepancy	-	-	-	-	-	-

Annex 2 : Main assumptions used for the medium-term forecasts relating to the international environment

	2004	2005	2006	2007	2008	2009
Short-term interest rate (annual average)	2,1	2,1	2,1 (1)	2,8	3,6	4,0
Long-term interest rate (annual average)	4,0	3,4	3,3	4,1	5,0	5,3
USD/€ exchange rate (annual average)	124,4	126,2	126,5	126,5	126,5	126,5
GDP growth – world (excluding EU)	5,7	4,8	4,5	4,0	4,0	4,0
Growth GDP - EU	2,2	1,3	2,0	2,5	2,4	2,2
Growth of relevant external markets	8,1	6,3	6,1	6,7	6,6	6,6
Global imports by volume (excluding EU)	12,2	9,0	7,6	7,6	7,6	7,6
Oil price (USD)	38,2	57,4	67,5	64,8	63,7	62,6

(1) For the 2006 budget, the government took the short-term interest rate as 2,26%

Annex 3 : General government expenditure broken down by functional classification (1)

% of GDP	Code COFOG	2003
1. General public services	01	9,4
2. Defence	02	1,2
3. Public order and security	03	1,7
4. Economic affairs	04	4,8
5. Environmental protection	05	0,7
6. Housing and public amenities	06	0,3
7. Health	07	6,9
8. Leisure, culture and religion	08	1,2
9. Education	09	6,2
10. Social protection	10	17,8
11. Total expenditure	TE	50,1

(1) the latest published expenditure figures broken down by functions date from the detailed public accounts for 2003. Since then, the definition of GDP has undergone several revisions, so that there could be deviations from the latest estimates.

Annex 4 : Long-term public finances

4.1 The budgetary cost of population ageing (% of GDP)

	2004	2010	2020	2030	2004-2030
Pensions	9,3	9,0	10,4	12,3	3,0
Employees	5,2	5,2	6,3	7,6	2,4
Self-employed	0,7	0,7	0,7	0,7	0,0
Public sector	3,3	3,1	3,4	4,0	0,7
Health care	7,3	7,9	8,6	9,5	2,2
Acute care	6,3	6,8	7,3	8,0	1,7
Long-term care	0,9	1,1	1,3	1,5	0,6
Disability	1,3	1,3	1,3	1,3	0,0
Unemployment	2,3	1,9	1,4	1,2	-1,2
Early pensions	0,4	0,4	0,4	0,4	-0,1
Family allowances	1,7	1,5	1,3	1,3	-0,5
Other social expenditure	1,5	1,5	1,5	1,5	0,0
TOTAL	23,7	23,5	24,9	27,3	3,6

4.2 The basic assumptions of the Study Committee on Ageing

The government based its long-term budget strategy partly on the estimates of the budgetary cost drawn up by the Study Committee on Ageing. Each year it updates its estimates of the long-term movement in social expenditure. The basic assumptions are as follows:

Summary of the basic assumptions in the scenario adopted by the Study Committee on population ageing (SCA)		
Demographic scenario	2000	2030
Birth rate	1,61	1,7
Life expectancy at birth: male	75,06	80,96
Life expectancy at birth: female	81,53	86,43
Net migration	18445	17358
Socio-economic scenario (by sex and group, impact of ageing on successive generations)		
Standard of education	maintained at the latest recorded level	
Potential activity rate: male	modelled taking account of the cohorts and the	
Potential activity rate: female	probable switching between socio-demographic	
Numbers leaving the labour force:	categories by sex and age group	
disability, older unemployed workers, bridging pension, pension		
Macro-economic-scenario (long-term)		
Increase in productivity and annual wages per capita	1,75 per annum	
Structural unemployment rate (including older unemployed persons not seeking work)	7,50%	
Employment rate (15-64 years)	67,60%	
Social policy scenarios (long-term)		
Pay threshold	1,25% per annum	
Minimum entitlement per year worked	1,25% per annum	
Equalisation of public sector pensions	1,25% per annum	
Adjustment in line with prosperity (general scheme)	scenario SCA: 0,5% per annum	
Linking of flat-rate benefits to prosperity	scenario SCA: 1,0% per annum	

Summary of the basic assumptions in the scenario adopted by the Study Committee on population ageing (SCA)

Since these assumptions sometimes differ from those of the Working Group on Ageing, the estimates may also differ in certain respects. Thus the results for the movement in expenditure on pensions are different from those of the Working Group on Ageing. The differences are due mainly to variations in the demographic assumptions:

4.3 Variations in the assumptions on pensions

% of GDP	2004	2030
Pension expenditure		
Study Committee scenario	9,2	12,5
WGA scenario	9,2	13,2
Dependency ratio (65+/15-64)		
Study Committee scenario	26,2	39,9
WHA scenario	26,2	41,6

Annex 5 : The objectives for public finances in the successive stability programmes

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Programme	<i>Overall ratio</i>											
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				
2004-2007						0,2	0,0	0,0	0,0	0,3		
2005-2008							0,0	0,0	0,0	0,3	0,6	
2006-2009								0,0	0,0	0,3	0,5	0,7
Actualizations	-0,8	-0,5	0,1	0,6	0,0	0,1	0,0					
Programme	<i>Debt ratio</i>											
1999-2002	117,5	114,5	112,2	109,6	106,8							
2000-2003		114,9	112,4	108,8	105	101,3						
2001-2005			110,6	105,8	101,4	97,2	92,9	88,7				
2002-2005				107	103,3	97,7	93	88,6				
2003-2005					106,1	102,3	97,9	93,6				
2004-2007						102,3	97,6	93,6	90,1	87		
2005-2008							96,6	95,5	91,7	88	84,2	
2006-2009								94,3	90,7			
Actualizations	117,0	113,6	107,7	106,3	103,2	98,5	94,7	94,3	90,7	87,0	83,0	79,1