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Assessment of the 2018 Stability Programme for

Belgium

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION

On 27 April 2018, Belgium submitted its 2018 Stability Programme (hereafter called Stability Programme), covering the period 2018-2021. The overall trajectory included in the Programme was approved by the Consultative Committee, in which the federal government as well as community and regional governments are represented (see Section 6).

Belgium is currently subject to the preventive arm of the the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its medium-term budgetary objective (MTO). As the debt ratio was 103.1% of GDP in 2017, exceeding the 60% of GDP reference value, Belgium is also subject to the debt reduction benchmark.

On 23 May 2018, the Commission issued a report under Article 126(3) of the TFEU, as Belgium did not comply with the debt reduction benchmark in 2017. The report concluded, following an assessment of all the relevant factors, that as there is currently not sufficiently robust evidence to conclude on the existence of a significant deviation in Belgium in 2017 and over 2016 and 2017 together, the current analysis is not fully conclusive as to whether the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is or is not complied with. However, the adjustment in 2018 appears inadequate to ensure compliance with the adjustment path towards the MTO in 2018 based on the Commission 2018 spring forecast. The Commission will reassess compliance on the basis of the ex-post data for 2018 to be notified in Spring 2019.

This document complements the Country Report published on 7 March 2018 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2018 Spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview of the medium-term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission 2018 Spring forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

The Belgian economy grew by 1.7% in 2017, as stronger growth of external demand offset a slow-down in domestic demand. Employment continued to increase steadily, spurred notably by the decrease in labour taxation, while unemployment fell from 7.6% in 2016 to 6.9% in 2017.

The macroeconomic scenario underlying the Stability Programme expects economic growth to reach 1.8% this year and 1.7% in 2019, in line with the Commission 2018 Spring forecast (Table 1). In 2020, the programme projects GDP to grow by 1.5%. As in the Commission projections, growth is exclusively driven by domestic demand, as the contribution of external demand to growth is expected to be neutral in 2018 and 2019. More specifically, according to the Stability Programme, consumption growth is expected to increase from 1.1% in 2017 to 1.7% in 2018 and 2019 (COM 1.7% and 1.8% respectively), and is driven by rising purchasing power, engendered by a strong employment growth (1.4% in 2017, 1.2% in 2018 (COM 1.2%) and 1.0% in 2019 (COM 1.0%)) new reductions in the personal income tax (PIT), and an increase of capital income. Moreover, compared to previous years of strong wage restraint, nominal wages are expected to grow more rapidly in 2018, notably through indexation mechanisms and the implementation of new collective agreements. The unemployment rate is expected to fall to 6.7% in 2018 (COM 6.2%) and to 6.5% in 2019 (COM 6.0%).

Potential growth estimates for Belgium are rather moderate, at 1.4% on average over 2015-2019. The slowdown compared to the pre-2009 situation is broad-based as it reflects the continuation of a long-term trend of declining gains in total factor productivity (which is estimated to have stabilised at a low level in recent years), a decline in the contribution of labour to potential growth (due to a slower growth of the working age population) and somewhat lower capital accumulation. The negative output gap narrowed to -0.3% in 2017 compared to a trough of -1.6% in 2013. It is expected to close in 2018 and rise to 0.4% in 2019.

After a protracted period of low domestic price growth until 2015, inflation accelerated in Belgium to 1.8% in 2016 and 2.2% in 2017. The relatively low GDP deflator until 2015 has had an important impact on the evolution of the debt-to-GDP ratio in past years and increased the structural adjustment required to assure that the debt ratio stays on a firm downward path as required by the forward-looking debt benchmark (0.9% of GDP in 2017). Growth in consumer prices is expected to decelerate in 2018 to 1.7% and 1.3% in 2019 (COM 1.6% in both years[1]). Similarly, the GDP deflator is also expected to decelerate from 1.9% in 2017 to 1.6% in 2018 and 2019 (COM 1.6% in 2018 and 1.7% in 2019).

To conclude, the stability programme's macroeconomic scenario is broadly in line with the Commission forecast, although inflation is expected to decelerate further in 2019 according to the Stability Programme. Overall, the macroeconomic assumptions underlying the Belgian Stability Programme are assessed as plausible, both with regard to overall GDP growth and to its composition.

[1] The Commission forecasts the harmonized index of consumer prices (HICP), whilst the Stability Programme refers to the Belgian consumer price index, with limited differences arising between the two.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**
Real GDP (% change)	1.7	1.7	1.8	1.8	1.7	1.7	1.5	1.4
Private consumption (% change)	1.1	1.1	1.7	1.7	1.8	1.7	1.6	1.5
Gross fixed capital formation (% change)	1.0	1.0	4.0	3.9	2.7	2.9	2.9	2.1
Exports of goods and services (% change)	4.5	4.5	5.0	4.2	4.4	3.6	3.3	3.5
Imports of goods and services (% change)	4.1	4.1	5.0	4.3	4.5	3.8	3.6	3.6
Contributions to real GDP growth:								
- Final domestic demand	1.1	1.3	1.8	1.8	1.8	1.8	1.8	1.5
- Change in inventories	0.2	0.2	0.0	-0.2	0.0	0.0	0.0	0.0
- Net exports	0.4	0.4	0.0	0.0	0.0	-0.1	-0.2	-0.1
Output gap[1]	-0.2	-0.3	0.1	0.1	0.4	0.4	0.4	0.3
Employment (% change)	1.4	1.4	1.2	1.2	1.0	1.0	1.0	0.7
Unemployment rate (%)	7.1	7.2	6.4	6.7	6.0	6.5	6.2	6.0
Labour productivity (% change)	0.3	0.3	0.6	0.6	0.7	0.7	0.6	0.7
HICP inflation (%)	2.2	2.2	1.6	1.7	1.6	1.3	1.5	1.6
GDP deflator (% change)	1.9	1.9	1.6	1.6	1.7	1.6	1.4	1.5
Comp. of employees (per head, % change)	1.7	1.7	2.0	1.9	2.2	2.1	2.0	2.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.8	-0.1	0.7	-0.1	0.9	-0.1	0.0	0.0

Note:

[1] In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

Belgium's general government deficit narrowed from 2.5% of GDP in 2016 to 1.0% in 2017. The revenue-to-GDP ratio increased by 0.5 percentage points while the expenditure-to-GDP ratio fell by 1.1 percentage points. This outcome compares to a deficit of 1.5% of GDP expected in the 2018 Draft Budgetary Plan (DBP). The better-than-expected reduction is partly due to good economic conditions and strong job growth, as well as a low interest rate environment. At the federal level, the better revenue ratio was positively influenced by higher income from corporate income taxes (CIT), mainly caused by higher-than-anticipated advance payments; the sub-federal level (regions, communities and local authorities) achieved a small surplus, instead of a deficit as foreseen in the DBP, as a result of lower-than-expected expenditure growth. The temporary spending due to the refugee and security situation amounted to 0.3% of GDP in 2017.

The structural balance improved by 0.8 percentage points in 2017. Despite this improvement, the structural budget deficit still stood at 1.3% of GDP (see Table 2). The structural primary balance, which excludes interest rate movements and therefore better reflects discretionary fiscal policy, improved by 0.5 percentage points of GDP.

In 2018, the Stability Programme plans the headline deficit to remain constant at 1.0% of GDP. The general government deficit would be broadly equally spread over the federal and the sub-federal levels of government; 0.50% of GDP and 0.48% of GDP respectively out of a deficit of 1.0% of GDP. At the federal level, this would imply an improvement of the headline balance by 0.6 percentage points of GDP compared to 2017, whereas the expected deficit at the sub-federal level would represent a deterioration of 0.5 percentage points of GDP in 2018 compared to a balanced position in 2017. This deterioration is partly explained by a one-off settlement of transferred tax revenues between the federal government and the regions (of around 0.2% of GDP) over 2018 and 2019, which is neutral for general government[2], as well as by the investment cycle at local government level.

According to the Stability Programme, the revenue-to-GDP ratio as well as the expenditure-to-GDP ratio are both projected to decrease by 0.5 percentage points of GDP in 2018. On the revenue side, developments are broadly similar to those presented in the Draft Budgetary Plan (DBP) for 2018 with revenue decreasing to 50.7% of GDP, albeit from a higher base than what was expected in the DBP as revenue in 2017 surpassed expectations. Public expenditure would decline by 0.5 percentage points according to the Stability Programme, as compared to 0.8 percentage points in the DBP. This differential can be attributed to primary expenditure, which is expected to decline by 0.3 percentage points of GDP compared to a decrease of 0.5 percentage points of GDP in the DBP. The difference lies mostly (0.3%) in lower primary expenditure in 2017 than was planned in the DBP. However, some changes can be noted in the various components of expenditure. Social payments are expected to decrease by 0.1 percentage points of GDP more than planned in the DBP, which is notably explained by better

[2] The Stability Programme makes abstraction of the rectification in 2018 for regional personal income taxation under the new financing law. Since 2015 advances have been made from the federal to the regional level on the basis of preliminary estimates. In 2018 a rectification is made on the basis of final parameters. This has a one-off negative impact on the balance of the communities and regions versus a positive one-off impact on the federal government balance so that the general government balance is not affected.

macroeconomic expectations and additional measures approved in March 2018. Compensation of employees is expected to decrease slightly more slowly than in the DBP, which is explained by higher inflation assumptions leading to a faster indexation of public sector wages. Other expenditures are expected to remain stable compared to 2017, whereas the DBP tabled on a decrease by 0.3 percentage points of GDP. Public investment is expected to increase by 0.2 percentage points of GDP in 2018, compared to 0.1 percentage points of GDP in the DBP.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The Stability Programme is built around the ambition of reaching the MTO of a balanced budget in structural terms in 2020, a year later than planned in last year's Stability Programme. However, the recalculated[3] structural balance points to a small remaining deficit of 0.2% of GDP in 2020 as a result of a larger positive output gap than in the Programme at face value. The intermediary targets in the Programme are formulated in terms of annual structural improvements.

In 2018, the (recalculated) structural balance is planned to improve by 0.2% of GDP. The Commission forecast expects the structural balance to deteriorate by 0.1% of GDP in 2018. The difference with the Stability Programme target stems from a number of measures that have not been (fully) included in the Commission forecast because they are insufficiently specified (see Section 3.3) or the Commission considers the impact as temporary, most of which relates to the temporary increase of advance payments in the corporate income tax (see Section 3.5).

In 2019 and 2020 the (recalculated) structural balance is planned to improve by 0.2% and 0.7% of GDP respectively. So far, these targets are not supported by specified additional measures and the distribution of the planned adjustment between revenue and expenditure items is purely indicative. The Commission forecast currently projects a deterioration of the structural balance by 0.3% of GDP in 2019 at unchanged policy, as already specified tax cuts are not fully offset by revenue-increasing or expenditure-decreasing measures.

The headline balance is planned to improve somewhat faster over the programme horizon than the structural balance as a result of gradually improving cyclical conditions. According to the Programme, this is expected to result in a balanced budget in nominal terms in 2020.

[3] The structural balance as recalculated by the Commission according to the commonly agreed methodology on the basis of the information in the programme.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**51.2**	**50.7**	**50.7**	**50.4**	**50.4**	**50.7**	**50.7**	**-0.5**
of which:								
- Taxes on production and imports	13.1	13.0	13.1	13.0	13.1	13.2	13.1	0.1
- Current taxes on income, wealth, etc.	16.8	16.4	16.3	16.2	16.0	16.3	16.4	-0.4
- Social contributions	15.8	15.7	15.6	15.7	15.6	15.6	15.7	-0.1
- Other (residual)	5.5	5.5	5.6	5.5	5.6	5.6	5.4	0.0
Expenditure	**52.2**	**51.8**	**51.7**	**51.8**	**51.1**	**50.6**	**50.6**	**-1.6**
of which:								
- Primary expenditure	49.8	49.5	49.4	49.6	48.9	48.6	48.6	-1.1
of which:								
Compensation of employees	12.3	12.1	12.1	11.9	11.9	11.7	11.7	-0.6
Intermediate consumption	4.0	4.0	4.0	4.1	4.0	3.9	3.9	-0.1
Social payments	25.1	25.1	24.9	25.2	24.7	24.6	24.8	-0.3
Subsidies	3.4	3.1	3.2	3.1	3.1	3.1	3.0	-0.3
Gross fixed capital formation	2.2	2.4	2.4	2.5	2.4	2.5	2.4	0.1
Other (residual)	2.8	2.8	2.8	2.8	2.9	2.8	2.8	0.0
- Interest expenditure	2.5	2.3	2.3	2.2	2.2	2.1	2.0	-0.5
General government balance (GGB)	**-1.0**	**-1.1**	**-1.0**	**-1.3**	**-0.7**	**0.0**	**0.1**	**1.1**
Primary balance	**1.4**	**1.2**	**1.3**	**0.8**	**1.5**	**2.1**	**2.1**	**0.6**
One-off and other temporary	0.4	0.2	0.0	0.1	-0.1	0.0	0.0	-0.2
GGB excl. one-offs	**-1.4**	**-1.3**	**-1.0**	**-1.4**	**-0.6**	**0.1**	**0.1**	**1.3**
Output gap[1]	-0.2	0.1	0.1	0.4	0.4	0.4	0.3	0.6
Cyclically-adjusted balance[1]	-0.9	-1.2	-1.1	-1.6	-1.0	-0.2	-0.1	0.7
Structural balance[2]	**-1.3**	**-1.4**	**-1.1**	**-1.7**	**-0.9**	**-0.2**	**-0.1**	**1.1**
Structural primary balance[2]	1.2	0.9	1.3	0.5	1.3	1.9	1.9	0.7

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

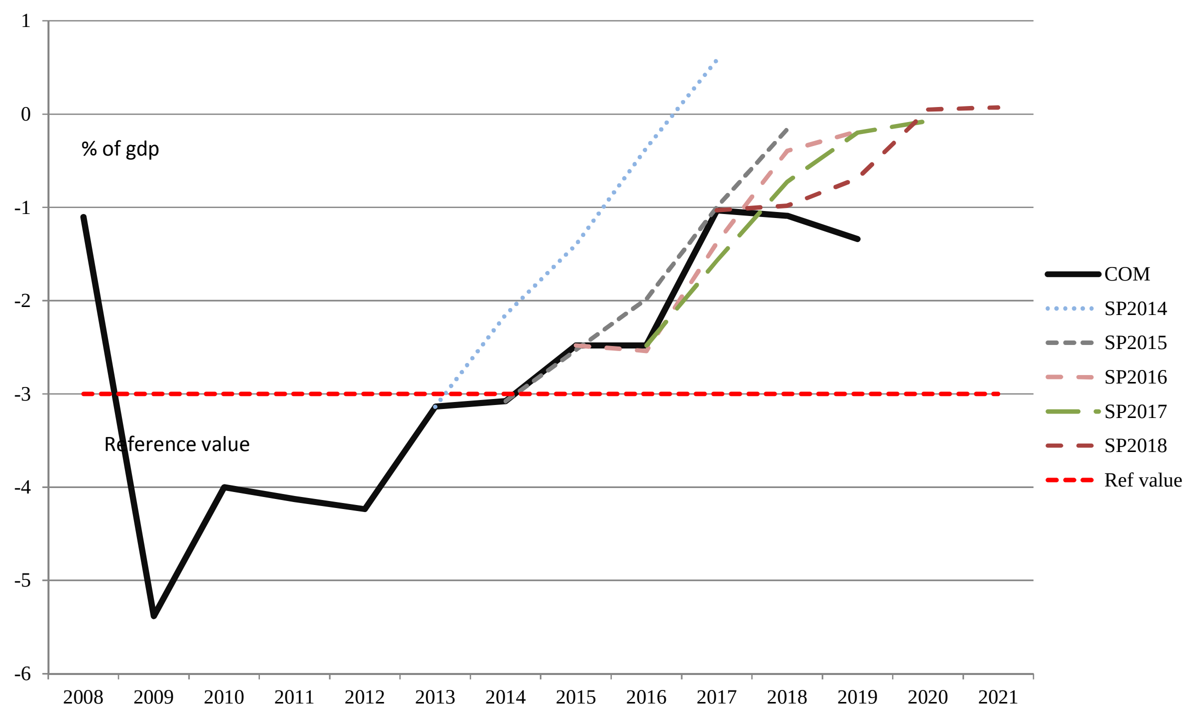
[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.

Planned improvements in the (recalculated) structural balance of 0.1%, 0.2% and 0.6% of GDP in 2018, 2019 and 2020 compare to improvements of 0.6%, 0.4% and 0% of GDP in the 2017 Stability Programme for the same years, when the aim was to reach the MTO in 2019. This target has now been delayed until 2020. Targets for the headline balance have been repeatedly delayed over the course of successive programmes (see Figure 1).

Figure 1: Government balance projections in successive programmes (% of GDP)



Source: Commission 2018 Spring Forecast. Stability and convergence programmes

3.3. MEASURES UNDERPINNING THE PROGRAMME

In its budget review of March 2018 the federal government confirmed its target of a structural improvement of 1% of GDP in 2017 and 2018 together. This budget review largely consisted of updated assessments of earlier announced revenue measures and of underlying assumptions, with some additional spending measures announced as well.

The main measures in 2018 concern, at the federal level, the decrease of personal income tax (PIT) for low and middle incomes (2nd phase of the tax shift), the reduction of the corporate tax base rate, which is assumed to be budgetary neutral and is, amongst others, financed by means of a revision of the notional interest deduction scheme, restrictions on tax deductions for companies, and new taxes on capital revenues, e.g. the new tax on securities accounts and the increase of the tax on stock exchanges. Other major measures include taxes on consumption (higher excise duties) and financial income (broader scope of withholding tax, increased tax on stock exchange transactions and transparency tax), as well as part of the expected collection of cross-border road fines and anti-fraud measures. New measures have been taken to activate savings in order to stimulate investment. At the regional level, there is, amongst others, the new energy levy in Flanders, the abolition of the PIT deduction for mortgage payments in Brussels and the lower gift duties and exemption of the "family residence" from inheritance duties in Wallonia. Insufficiently specified tax collection associated with the fight against fraud was not fully included in the Commission 2018 Spring forecast. Other announced measures that have not been included in full in the 2018 forecast relate to the new system of tax regularisation, the end-of-career jobs, the extension of flexi-jobs and e-commerce. The budgetary targets beyond 2018 are not underpinned by measures.

3.4. DEBT DEVELOPMENTS

General government gross debt increased by almost 20 pps. of GDP between 2007 and 2014, when it peaked at 107% of GDP. In 2015 it fell back to 106.1% thanks to a downward stock-flow adjustment linked to the repayment of support granted to a financial institution. Debt broadly stabilised in 2016 as a small primary surplus compensated for an upward stock-flow adjustment with the snowball effect (the interest-growth rate differential) about neutral[4].

Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**105.7**	**103.1**	**101.5**	**101.2**	**100.2**	**99.4**	**97.1**	**94.6**
Change in the ratio	0.7	-2.8	-1.6	-1.9	-1.4	-1.9	-2.3	-2.4
Contributions[2] :								
1. Primary balance	**-0.1**	**-1.4**	**-1.2**	**-1.3**	**-0.8**	**-1.5**	**-2.1**	**-2.1**
2. "Snow-ball" effect	**0.9**	**-1.2**	**-1.1**	**-1.1**	**-1.2**	**-1.1**	**-0.8**	**-0.8**
Of which:								
Interest expenditure	3.2	2.5	2.3	2.3	2.2	2.2	2.1	2.0
Growth effect	-1.0	-1.7	-1.8	-1.8	-1.7	-1.7	-1.4	-1.3
Inflation effect	-1.3	-2.0	-1.6	-1.6	-1.7	-1.5	-1.4	-1.5
3. Stock-flow adjustment	**-0.1**	**-0.1**	**0.7**	**0.5**	**0.7**	**0.7**	**0.6**	**0.5**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

[1] End of period.

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

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP), Comission calculations.

In 2017, debt fell to 103.1% of GDP thanks to a growing primary surplus, a downward snowball effect (lower interest expenditures than nominal GDP growth) and overall, slightly downward stock-flow adjustments, as the sale of part of the Belgian State's participation in BNP Paribas on 3 May 2017, a divestment that represents around 0.5% of GDP, outweighed the upward impact on debt of, amongst others, the increased lending related to the social

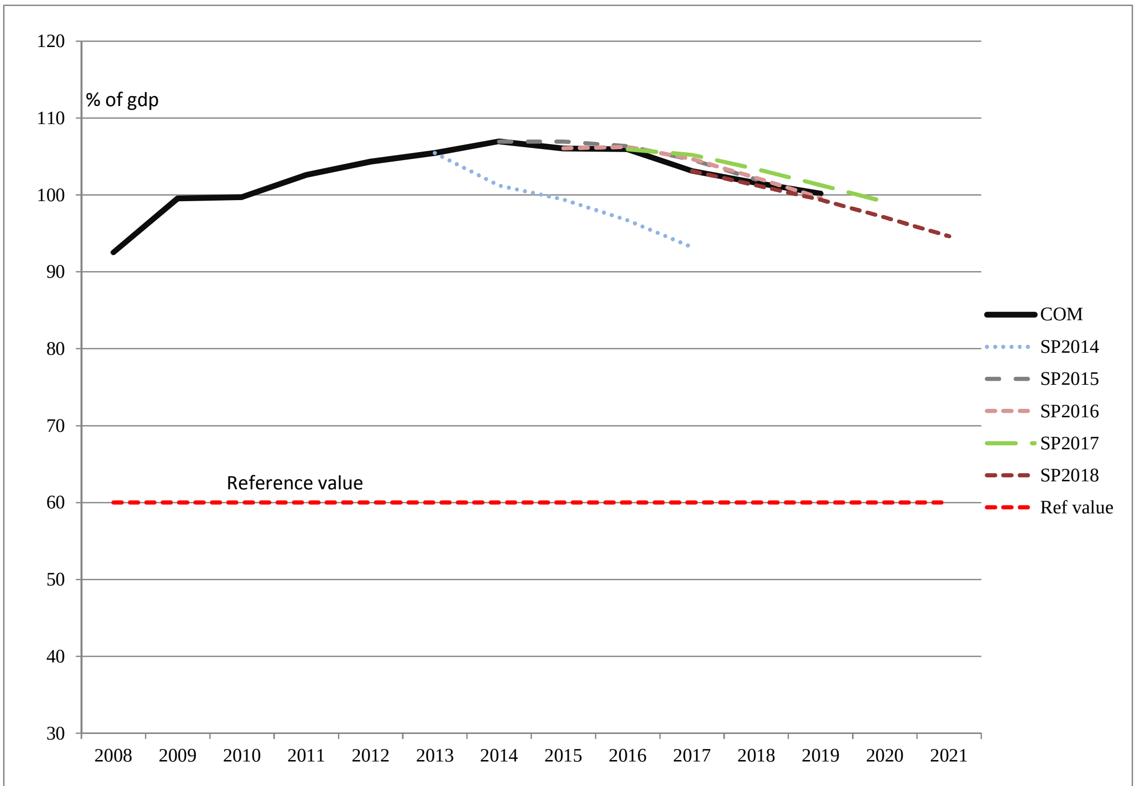
[4] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets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

housing policy. The Programme implies a further debt reduction as of 2018, with a debt ratio of 101.2% at the end of 2018 and 99.4% at the end of 2019. Debt would further fall back to 94.6% of GDP in 2021. This development reflects the planned increase in primary surpluses, the downward impact of which would be enhanced by the snowball effect, driven by a further decrease in interest expenditures while nominal GDP growth remains robust. Stock-flow adjustments are projected to have a debt-increasing impact over the programme horizon.

The Commission forecast at unchanged policy expects a mild debt reduction in coming years, to 101.5% of GDP in 2018 and 100.2% in 2019. The annual downward impact of 2.1% of GDP on average rendered by primary surpluses and the snowball effect is projected to be partially offset by upward stock-flow adjustments in 2018-2019. These projections do not account for the impact of potential financial sector asset sales.

Several times over the past, the debt trajectory has been revised upwards or delayed in successive programmes (see Figure 2). This was due to a higher starting point given the inclusion of more units in the general government sector and because of higher-than-planned deficits and lower-than-projected nominal GDP growth. In contrast, the 2016 and 2017 debt targets have been overachieved compared to the 2016 and 2017 Programme, given lower or negative stock-flow adjustments, higher than planned primary surplusses as well as somewhat higher than expected nominal GDP growth. The debt trajectory in the 2018 Stability Programme is slightly more ambitious than that of last year's Programme.

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



Source: Commission 2018 Spring Forecast. Stability and Covergence programmes

3.5. RISK ASSESSMENT

With respect to 2017, a downside risk relates to the classification principles used in fiscal surveillance, and more specifically the one-off nature of some tax collection. In particular the corporate income tax (CIT) reform has changed the regime on advance payments by introducing a surcharge for non-payment of advance tax payments, and by granting a credit that will be deducted from the overall surcharge if timely advance payments are made. In the wake of that measure, sizeable CIT advance payments have been collected in 2017 (2.2 billion EUR -around 0.5% of GDP- more than in 2016). This measure thus introduces -at least in part- a permanent change in the timing of recurrent revenue[5], by shifting tax collection from ex-post tax settlement to advance tax payments, and therefore it creates an exceptional and temporary peak in tax revenue in 2017. The extent to which this will turn out to be the case is uncertain and, therefor, creates a downside risk should the assumption comprized in the Stability Programme about the structural nature –as opposed to the one-off nature- of part of CIT payments in 2017 turn out to be too optimistic. Conversely, the Commission's baseline scenario is more conservative than that of the Stability Programme and therefore contains a significant upside risk (see also section 4.2).

The potential budgetary consequences of the pending resolutions of the Arco Group pose a risk to the 2018 target. A general risk to the targets stems from inflation with public wages and social benefits automatically adjusted for inflation in Belgium. Higher than anticipated inflation could thus, again, entail negative consequences for underlying budgetary trends.

The budgetary targets beyond 2018 are mostly not underpinned by measures. According to the Commission 2018 Spring forecast, reaching the MTO in 2020 as planned would require a structural improvement of 1.4% of GDP in 2019-2020. At the same time, the Commission forecast expects the structural balance to deteriorate by 0.3 pp. of GDP at unchanged policy in 2019, the last year of the Commission projections. In 2020-2021 the structural balance would remain broadly stable at unchanged policy according to the High Council of Finance. The projected deteriorations up to 2019 would mainly result from the ongoing tax reform with planned reductions in PIT and social security contributions not offset by increases for other revenue sources or expenditure cuts. Reaching the MTO in 2020 implies thus substantial additional measures and a strict execution of the budget, also in view of implementation risks towards the end of the current legislative period in 2019.

Between 2007 and 2016 interest expenditure fell by approximately 1.1 percentage points of GDP. This had a positive bearing of the same size on the structural balance. The programme projects a further decline in interest expenditure by 0.5 percentage points of GDP between 2017 and 2021. The sensitivity analysis in the 2018 Stability Programme highlights how a linear increase of the yield curve by 100 basis points would imply 0.1% of GDP higher costs in 2018, rising to 0.2% of GDP in 2021[6], though relative to the baseline of falling interest payments. This underscores a risk inherent to a consolidation strategy that partly leans on windfall gains stemming from lower interest expenditures.

In contrast with the practice of the last couple of Programmes, in which the Concertation Committee merely "took note" of the trajectory, all levels of government have now approved the overall fiscal trajectory presented in the Stability Programme and on the achievement of the fiscal target by 2020 by all government levels (see Section 6). This ads credibility to the

[5] Report on Public Finances in EMU 2015, p. 58.
[6] Stability Programme Belgium 2018-2021, p. 19.

overall trajectory compared to the engagements in the past. The 2018 programme includes trajectories for the individual entities. However, the Concertation Committee took only note of the distribution of the annual effort between the different levels of government, in other words, there was no formal agreement on the annual fiscal targets at all levels of government. This could undermine the viability of the country's overall trajectory towards its medium-term objective as laid down in the Stability Programme. Systematic coordination between the federated entities, before the adoption of draft budgetary plans and not only for drafting the Stability Programme, could prevent a misalignment between the two documents, as currently observed.

In Annex 4 of the Programme, the federal government (National Pact for Strategic Investments), the Flemisch Community (Antwerp ring road), the Walloon Region (Walloon Investment Plan), the Brussels-Capital Region (metro 3 North-South, tunnels/bridges/viaducts) and the French-speaking Community (educational reform) list a number of projects which bear a (rising) budgetary impact over the programme horizon. In the 2018 DBP the impact of some of these projects was announced to 'fall outside of the fiscal target'. It is not clear to what extent the targets of the Stability Programme include these planned investment projections.

Finally, in their Stability Programme, the Belgian authorities announce their intention to continue, in the coming months, their work on the flexibility clauses for structural reforms and investment, in consultation with the European Commission. It is announced that the results in terms of flexibility will be taken into account during future budget exercises of each of the Belgian entities.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

4.1. Compliance with the debt criterion

Following the abrogation of the excessive deficit procedure in June 2014, Belgium was subject to a three-year transition period to make sufficient progress towards compliance with the debt reduction benchmark as its debt-to-GDP ratio is above the 60% reference value. This transition period started in 2014 and ended in 2016. Since 2017, after the end of the transition period, the debt reduction benchmark is applicable.

According to the notified data, the government debt to GDP ratio breached the reference value of 60% in 2017 and Belgium did not comply with the debt reduction benchmark, as the gap to the benchmark is 0.9% of GDP (see Table 1). The analysis thus suggests that, *prima facie,* the debt criterion for the purpose of the Treaty and Regulation (EC) No 1467/1997 is not fulfilled. The Commission has therefore prepared a report under Article 126(3) TFEU to analyse whether Belgium is compliant with the debt criterion of the Treaty.

Box 1. Council Recommendations addressed to Belgium

On 22 May 2017, the Commission adopted a report for Belgium under Article 126 (3) of the Treaty on the Functioning of the European Union (TFEU), in which it reviews its progress towards compliance with the debt criterion of the Treaty. The 2016 outturn data and the Commission 2017 Spring forecast as well as the 2017 Stability Programme suggested that, prima facie, the debt criterion for the purpose of the Treaty and Regulation (EC) No 1467/1997 was not fulfilled. However, consideration was given to all relevant factors, notably: (i) the previously unfavourable but improving macroeconomic conditions, which makes them less of a factor to explain Belgium's large gaps as regards compliance with the debt reduction benchmark; (ii) the fact that, based on the Commission forecast, the deviations from the required adjustment towards the MTO pointed to a risk of some deviation in 2016 and 2017 individually, but to a significant deviation in 2016 and 2017 together, which could still be corrected in 2017; and (iii) the implementation of growth-enhancing structural reforms in recent years, several of which are considered substantial and projected to help improve debt sustainability. The conclusion was that the debt criterion should be considered as currently complied with.

On 11 July 2017, the Council addressed recommendations to Belgium in the context of the European Semester. In particular, in the area of public finances the Council recommended to Belgium to pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Belgium's public finances. Belgium was also recommended to use windfall gains -such as proceeds from asset sales- to accelerate the reduction of the general government debt ratio, to agree on an enforceable distribution of fiscal targets among government levels and ensure independent fiscal monitoring, to remove distortive tax expenditures, and to improve the composition of public spending in order to create room for infrastructure investment, including on transport infrastructure.

The Council noted that "In 2018, in light of its fiscal situation and in particular of its debt level, Belgium is expected to further adjust towards its medium-term budgetary objective of a balanced budgetary position in structural terms. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure6 which does not exceed 1,6 % in 2018. It would correspond to an annual structural adjustment of at least 0,6 % of GDP. As recalled in the Commission Communication on the 2017 European Semester accompanying these country-specific recommendations, the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Belgium's public finances."

Table 5. Compliance with the debt criterion

	2017	2018		2019	
		SP	COM	SP	COM
Gross debt ratio	**103**	**101.2**	**101.5**	**99.4**	**100.2**
Gap to the debt benchmark [1,2]	0.9	-0.1	0.9	-0.8	0.9
Structural adjustment [3]	nr	nr	nr	nr	nr
To be compared to:					
Required adjustment [4]	nr	nr	nr	nr	nr

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

This report was adopted on 23 May 2018 and includes an assessment of all the relevant factors, notably (i) the previously unfavourable but improving macroeconomic conditions, which makes them less of a factor to explain Belgium's large gaps as regards compliance with the debt reduction benchmark; (ii) the fact that there there is currently not sufficiently robust evidence to conclude on the existence of a significant deviation in Belgium in 2017 and over 2016 and 2017 together, whereas based on the Commission forecast, the deviations from the required adjustment towards the MTO point to a risk of significant deviation in 2018 and in 2017 and 2018 together, which can still be corrected in 2018 by additional fiscal measures; and (iii) the implementation of growth-enhancing structural reforms in recent years, several of which are considered substantial and projected to help improve debt sustainability. On the basis of this assessment, the report concluded, following an assessment of all the relevant factors, that, as there is currently not sufficiently robust evidence to conclude on the existence of a significant deviation in Belgium in 2017 and over 2016 and 2017 together, the current analysis is not fully conclusive as to whether the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is or is not complied with. However, the adjustment in 2018 appears inadequate to ensure compliance with the adjustment path towards the MTO in 2018 based on the Commission 2018 spring forecast. The Commission will reassess compliance on the basis of the ex-post data for 2018 to be notified in Spring 2019.

Belgium is forecast not to comply with the debt reduction benchmark in 2018 and 2019 as its debt-to-GDP ratio is expected to remain 0.9% of GDP above the forward-looking debt reduction benchmark according to the Commission 2018 Spring forecast. On the basis of the scenario included in the 2018 Stability Programme, compliance with the debt criterion would be ensured as of 2018 with an overachievement of the forward-looking debt reduction benchmark by 0.1% and 0.7% of GDP in 2018 and 2019 respectively.

The 2017 Stability Programme planned compliance with the debt criterion as of 2019. Part of the difference with the Commission forecast is due to a deficit reduction that is 0.1% higher in 2018 and 0.6% higher in 2019 given that the Commission forecast is based on a no-policy change assumption whereas the Stability Programme reflects the planned effort. Moreover, the calculation of the forward-looking debt benchmark on the basis of the Commission forecast is based on some technical assumptions beyond the forecast horizon, such as a stable structural balance, while the calculation on the basis of the Programme is based on a fully-fledged scenario up to 2021, beyond the Commission Spring forecast. Broadly speaking, the technical assumptions followed by the Commission beyond its forecast horizon are more conservative than those of the SP, resulting in a slower debt reduction.

4.2. Compliance with the required adjustment path towards the MTO

Eligibility to the 'unusual events' provision

The 2018 Stability Programme does not provide information on the budgetary impact of the exceptional security-related measures in 2017. However, in a letter dated 9 May 2018, the Belgian authorities have provided adequate evidence of the scope and nature of eligible *additional* expenditure linked to the exceptional security measures in 2017, which amounted to 0.02% of GDP. The provisions defined in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 allow that additional expenditure to be catered for, in that the severity of the terrorist threat is an exceptional event, their impact on Belgium's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the MTO. As the amounts reported by Belgian authorities appear plausible, the required structural improvement in 2017 has consequently been reduced from 0.6% of GDP to 0.58% of GDP.

Adjustment towards the MTO

Belgium is subject to the preventive arm of the SGP as of 2017 and has to ensure compliance with the required adjustment towards the MTO.

In 2017, to this end, Belgium was required to pursue an annual structural adjustment towards the MTO of at least 0.6% of GDP. Based on the 2017 outturn data and the Commission 2018 Spring forecast, the growth of primary government expenditure, net of discretionary revenue measures and one-offs, exceeded the expenditure benchmark[7] of 1.58% – corrected for the impact of unusual events – by 0.4% of GDP in 2017, pointing to some deviation. By contrast, the structural balance is estimated to have improved by 0.8% of GDP in 2017, 0.2 pp. of GDP above the recommended effort of at least 0.58% of GDP towards the MTO, suggesting compliance. This calls for an overall assessment. The difference between the deviations from the structural balance and the expenditure benchmark requirements (0.7% of GDP) is mostly explained by the effect of lower interest payments (0.4% of GDP), which positively impact the reading of the fiscal effort based on the structural balance but are not taken into account for the expenditure benchmark. Second, the difference stems from the different GDP deflators

[7] Net government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

used in the calculation of the respective indicators (0.2% of GDP). As was the case in 2016[8], the reading of the fiscal effort based on the expenditure benchmark pillar is also negatively impacted by higher than expected inflation in 2017. Whereas the reference growth rate for the expenditure benchmark was based on a GDP deflator forecast of 1.5% for 2017, the actual GDP deflator amounted to 1.9% of GDP in 2017, closer to the long-term average. The impact on expenditure growth from higher than anticipated inflation transpires from the fact that the automatic indexation of social benefits and public sector wages occurred earlier than was expected in the Commission 2016 Spring forecasts which was the basis to set the expenditure benchmark for 2017. The budgetary impact is estimated at around 0.1% of GDP in 2017. In other words, when taking into account the impact of this higher-than-anticipated inflation on public expenditure, the deviation from the expenditure benchmark requirement in 2017 would be 0.3% of GDP, pointing to some deviation from the recommended adjustment path in 2017.

Over 2016 and 2017 together, the average deviations were larger in view of the deviation that was also observed in 2016, when Belgium was recommended to pursue an annual structural adjustment towards the MTO of at least 0.47% of GDP correcting for unusual events. Indeed, over those two years, the deviation based on the expenditure benchmark amounted to 0.5% of GDP, pointing to significant deviation. In turn, the structural balance points to a deviation of 0.1% of GDP, pointing to some deviation.

This calls for an overall assessment, in which the following three main factors are to be considered:

First, the change in the structural balance was inter alia positively impacted by lower interest expenditure, contributing to 0.4 pp. of GDP of the change. That windfall improves the reading of the fiscal effort based on the structural balance but does not affect compliance with the expenditure benchmark, which is therefore considered to reflect more appropriately the underlying fiscal effort.

Second, both in 2016 and 2017, the expenditure aggregate was negatively impacted by higher than expected inflation. Whereas the reference growth rate for the expenditure benchmark is based on a GDP deflator forecast of 1.0% for 2016 and 1.5% for 2017, the actual GDP deflator used for the structural balance amounted to 1.6% in 2016 and 1.9% of GDP in 2017. The impact on expenditure growth from higher than anticipated inflation transpired in the fact that the automatic indexation of social benefits and public sector wages occurred earlier than expected in the Commission forecast. While the inflation surprise resulted in higher-than-expected public expenditure, it had a positive impact on tax revenues (as private wages are generally indexed to inflation). However, the expenditure benchmark only captures the expenditure side and thus the negative impact of the inflation surprise, and therefore under-estimates the underlying fiscal effort. The impact of higher inflation was estimated at around 0.2% of GDP for 2016 and 0.1% in 2017, correcting the GDP deflator for the share of public expenditure directly indexed on inflation. The deviation from the expenditure benchmark would thus be reduced from 0.43% to 0.37% of GDP in 2017 and from 0.5% to 0.4% of GDP over 2016 and 2017 together.

Third, there are substantial uncertainties regarding the treatment of the substantial increase in advanced corporate income tax payments collected in 2017 (around ½ % of GDP in 2017). This revenue increase stems notably from the introduction, in 2017, of significantly higher

[8] European Commission, Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, 22/05/2017, p.11.

surcharges for non-payment of advance tax payments as well as of grants to be deducted from the overall surcharge if timely advance payments are made. This measure thus introduces a permanent change in the timing of recurrent revenue[9], by shifting -at least in part- tax collection from ex-post tax settlement to advance tax payments, and therefore it creates an exceptional and temporary peak in tax revenue in 2017. In the baseline scenario of the 2018 Spring forecast, the Commission considered that any tax collection in excess of the trend was to be considered as a one-off, temporary revenue, which would eventually be offset by lower tax settlement revenue in the following years. Other analysts, such as the National Bank of Belgium or the government, consider a higher share of the CIT-revenue increase in 2017 as structural. While the Commission acknowledges that this is indeed a possibility which should not be discarded, it considered it in its Spring forecast as an upside risk rather than a factor to be integrated in the baseline scenario. The uncertainty surrounding this measure is highlighted by the fact that, while the outturn CIT data for 2018 will already give a preliminary indication, its permanent impact will only be measurable ex post after a longer time span of some years. This issue will remain relevant over the coming years, given that, for financial years starting from 1 January 2018 (assessment year 2019), the surcharge rate will further increase, from the current 2.25% to 6.75%, while the currently applicable credit rate rewarding sufficient tax advanced payment will also be adjusted. Advance payments are thus expected to become considerably more important for companies that are interested in avoiding extra tax liabilities.

Amid such uncertainty as to the future evolution of corporate income tax revenue, it is worth noting that an ex post upward revision of the permanent effect of the measure could considerably improve the assessment of the underlying budgertary position and potentially reduce the deviation from the expenditure benchmark in 2017, bringing it below the significance threshold.

Therefore, in the context of this report, the relatively more conservative stance from the Commission clearly represents a relevant factor to be considered in the overall assessment, given both the magnitude of the extra revenues (around ½ % of GDP in 2017), as well as the high level of uncertainty as regards the extent of their temporary nature.

On the basis of this, while the deviation from the adjustment path towards the MTO in 2016 and 2017 together remains significant when taking into account the impact of the higher-than-anticipated inflation on the share of public expenditure directly indexed on inflation, the Commission is of the view that, given the high uncertainty regarding the treatment of the additional CIT revenues, there is currently not sufficiently robust evidence to conclude on the existence of a significant deviation in Belgium over 2016 and 2017 together.

In 2018, Belgium is required to pursue an annual structural adjustment towards the MTO translating into a nominal growth rate of net primary government expenditure which does not exceed 1.6% which would correspond to a structural adjustment of at least 0.6% of GDP. According to the information provided in the Stability Programme, the planned growth of nominal[10] primary government expenditure, net of discretionary revenue measures and one-offs, is expected to equal the applicable expenditure benchmark, pointing to compliance. However, the in the Programme reported amount of discretionary revenue measures (+0.2%

[9] Report on Public Finances in EMU 2015, p. 58.

[10] As part of the agreement on the EFC Opinion on "Improving the predictability and transparency the SGP: a stronger focus on the expenditure benchmark in the preventive arm", which was adopted by the EFC on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

of GDP in 2018) does not seem to be consistent with the planned drop in the revenue ratio (-0.5% of GDP) and does not seem to include all revenue-decreasing measures announced so far. This could distort the reading of the expenditure benchmark and result in an underestimation of the planned primary expenditure growth net of the discretionary revenue measures on the basis of the Programme. The (recalculated) structural balance is planned to improve by 0.2% of GDP, falling 0.4% of GDP short of the recommended minimum structural adjustment towards the MTO of 0.6% of GDP.

Over 2017 and 2018 together, the average deviation from the expenditure benchmark calculated on the basis of the Programme amounts to -0.2% of GDP, signalling a risk of some deviation. The change in the structural balance over two years slightly falls short of the requirements according to the authorities' plans, by 0.1% of GDP. This calls for an overall assessment. Taking into consideration the above-mentioned higher than anticipated inflation in 2017 -which had a budgetary impact of 0.1% of GDP-, the average deviation from the applicable expenditure benchmark over 2017 and 2018 goes down to 0.2% of GDP, pointing to some deviation. As the expenditure benchmark does not show the windfall gain stemming from declining interest expenditure, it is seen as correctly signalling the fiscal effort undertaken. Therefore, the Stability Programme plans some deviation from the recommended structural adjustment towards the MTO over 2017 and 2018 taken together.

In turn, based on the Commission 2018 Spring forecast, the growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable expenditure benchmark of 1.6% in 2018, leading to a deviation of 0.8% of GDP in the underlying fiscal position, pointing to a risk of a significant deviation in 2018. The deterioration in the structural balance by 0.1% of GDP in 2018 points to a risk of significant deviation from the recommended structural adjustment of 0.6% of GDP towards the MTO as well, with a gap of -0.7% of GDP. On the one hand, the difference of 0.1% of GDP between both pillars reflects revenue shortfalls underlying the forecast (-0.1% of GDP), as well as an increase in investment (-0.2% of GDP) the latter of which is smoothed for in the assessment of the expenditure benchmark, while they negatively impact the structural balance pillar. These elements are only partly offset by a decline in interest expenditure (0.2% of GDP) which impacts the structural balance positively compared to the expenditure benchmark. Taking all these factors into consideration, both indicators would point to a risk of some deviation from the requirements.

Over 2017 and 2018 together, the expenditure benchmark points to a risk of significant deviation with an average deviation of -0.6% of GDP. The average deviation for the structural balance over the same period amounts to -0.2% of GDP according to the Commission 2018 Spring forecast, indicating a risk of some deviation. When taking into account the impact of unforeseen inflation in 2017 -discussed above- the deviation for the expenditure benchmark in 2017-2018 narrows to -0.6% of GDP, still above the threshold for significant deviation. The remaining difference with the average deviation from the structural balance requirement reflects the impact of the decline in interest expenditure in both years (0.3% of GDP). That windfall improves the reading of the fiscal effort based on the structural balance but does not affect compliance with the expenditure benchmark, which is therefore considered to reflect more appropriately the underlying fiscal effort. As a result, based on the overall assessment, the Commission forecast points to a risk of a significant deviation from the recommended structural adjustment path towards the MTO in 2018, and over 2017 and 2018 taken together.

In 2019, Belgium is required to pursue an annual structural adjustment towards the MTO translating into a nominal growth rate of net primary government expenditure which does not exceed 1.8% which would correspond to a structural adjustment of 0.6% of GDP. According to the information provided in the Stability Programme, the planned growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, is expected to equal the applicable expenditure benchmark of 1.8%, pointing to compliance. However, the calculation of compliance with the expenditure benchmark on the basis of the Programme might be distorted by the apparent inconsistencies between the amount of reported discretionary revenue measures and the planned decrease in the government revenue ratio. The (recalculated) structural balance is expected to improve by 0.2 pp. of GDP in the Stability Programme, planning some deviation (-0.4% of GDP) from the recommended structural adjustment towards the MTO of 0.6% of GDP.

Over 2018-2019 together, based on the information in the Stability Programme, the expenditure benchmark points towards compliance while the planned change in the structural balance points to a risk of significant deviation.

In turn, based on the Commission 2018 Spring forecast, the growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable expenditure benchmark of 1.8% in 2019, leading to a deviation of 1.4% of GDP in the underlying fiscal position pointing to a risk of a significant deviation. The structural balance is expected to deteriorate by 0.3 percentage points of GDP in 2019, thus also pointing to a risk of a significant deviation by -0.9%. of GDP from the recommended minimum structural adjustment of 0.6% of GDP towards the MTO.

Following an overall assessment, a significant deviation from the adjustment path towards the MTO is to be expected in 2018 and 2019 putting at risk compliance with the requirements of the preventive arm of the Pact.

The Country-Specific Recommendation adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances.

Following the Commission's assessment of the strength of the recovery in Belgium while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Country's Draft Budgetary Plan, no additional elements in that regard need to be taken into account.

Table 6: Compliance with the requirements under the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	0.0	0.0		0.0	
Structural balance[2] (COM)	-1.3	-1.4		-1.7	
Structural balance based on freezing (COM)	-1.5	-1.4		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6	0.6		0.6	
Required adjustment corrected[5]	0.6	0.6		0.6	
Change in structural balance[6]	0.8	0.2	-0.1	0.2	-0.3
One-year deviation from the required adjustment[7]	0.3	-0.4	-0.7	-0.4	-0.9
Two-year average deviation from the required adjustment[7]	-0.1	-0.1	-0.2	-0.4	-0.8
Expenditure benchmark pillar					
Applicable reference rate[8]	0.1	1.6		1.8	
One-year deviation adjusted for one-offs[9]	-0.4	0.0	-0.8	0.0	-1.4
Two-year deviation adjusted for one-offs[9]	-0.5	-0.2	-0.6	0.0	-1.1
PER MEMORIAM: One-year deviation[10]	0.0	-0.2	-1.0	0.0	-1.5
PER MEMORIAM: Two-year average deviation[10]	-0.4	-0.1	-0.5	-0.1	-1.2

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2017) is carried out on the basis of Commission 2018 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Stability Programme (SP); Commission 2018 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

Belgium does not appear to face fiscal sustainability risks in the short run.[11]

Based on the Commission 2018 Spring forecast and a no-policy-change scenario beyond the forecast horizon, government debt is expected to decrease from 103.1% of GDP in 2017 to 100.2% in 2028, thus remaining well above the 60% of GDP Treaty threshold. Over this horizon, government debt peaks in 2017. Sensitivity analysis shows similar risks.[12] The full implementation of the Stability Programme would put debt on a clearly decreasing path by 2028, although remaining above the 60% of GDP reference value in 2028.

The medium-term fiscal sustainability risk indicator S1[13] is at 4.3 percentage points of GDP, primarily related to the high level of government debt and the projected ageing costs, which contribute 3.1 and 1.2 percentage points of GDP repectively, thus indicating high sustainability risks in the medium term. The full implementation of the Stability Programme would put the S1 indicator at 3.0 percentage points of GDP, leading to similar medium-term risk. Overall, risks to fiscal sustainability over the medium-term are, therefore, high. Fully implementing the fiscal plans in the Stability Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 is at 4.3 percentage points of GDP. In the long term, Belgium therefore appears to face medium fiscal sustainability risks, due to the projected ageing costs, contributing 3.6 percentage points of GDP, primarily related to pensions and long-term care expenditure. Full implementation of the programme would put the S2 indicator at 2.6 percentage points of GDP, leading to a similar long-term risk.[14]

Belgium has been reforming its public pension system in recent years. Standard eligibility requirements for both early and pre-retirement have been tightened and the legal retirement age will rise from 65 to 67 in 2030. These reforms have reduced the projected rise in public pension spending, which are nevertheless expected to increase by around 2.9 percentage points of GDP between 2016 and 2070.[15] By the end of its term in 2019, the government intends to lay the groundwork for the introduction of a credit-based public pension system as of 2030. Once fully implemented such a system would allow for automatic adjustment mechanisms in response to demographic or economic developments.

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[11] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 6 for a definition of the indicator.

[12] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

[13] See the note to Table 5 for a definition of the indicator.

[14] The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

[15] 2018 Ageing Report (forthcoming).

Table 4: Sustainability indicators

Time horizon			Commission Scenario		Stability / Convergence Programme Scenario	
Short Term			**LOW risk**			
S0 indicator [1]			0.3			
Fiscal subindex			0.3	LOW risk		
Financial & competitiveness subindex			0.2	LOW risk		
Medium Term			**HIGH risk**			
DSA [2]			HIGH risk			
S1 indicator [3]			4.3	HIGH risk	3.0	HIGH risk
of which						
	Initial Budgetary Position		0.1		-1.1	
	Debt Requirement		3.1		3.1	
	Cost of Ageing		1.2		1.0	
	of which					
		Pensions	0.9		0.7	
		Health-care	0.1		0.1	
		Long-term care	0.1		0.1	
		Other	0.1		0.1	
Long Term			**MEDIUM risk**		**MEDIUM risk**	
S2 indicator [4]			4.3		2.6	
of which						
	Initial Budgetary Position		0.6		-0.7	
	Cost of Ageing		3.6		3.4	
	of which					
		Pensions	1.9		1.7	
		Health-care	0.3		0.3	
		Long-term care	1.3		1.3	
		Other	0.1		0.1	

Source: Commission services; 2018 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.

6. FISCAL FRAMEWORK

The Cooperation Agreement of 13 December 2013 between federal, regional and community governments includes a structural budget balance rule for the general government. Pursuant to the Agreement, this rule is considered fulfilled if the structural balance is at its MTO or if the adjustment path towards the MTO as defined in the Stability Programme is respected. The 2017 Stability Programme planned a structural improvement of 1.0% of GDP at face value in 2017, while the realised improvement reached 0.8% of GDP. Therefore, based on the information provided in the programme, the past fiscal performance appears to comply only partially with the requirements of national numerical fiscal rules.

The 2013 Cooperation Agreement also entails a consultation of the federal and the different regional and community governments on the individual budgetary targets in the so-called Consultative Committee[16]. On 31 March 2018 the Public Borrowing Section of the High Council of Finance published its advice on the budgetary trajectory for the period 2018-2021 and the distribution of the fiscal effort across federated entities[17].

For the first time since 2013, an agreement was reached among all levels of governments regarding the achievement of the MTO by 2020. In its foreword, the 2018 Stability Programme mentions that the Consultative Committee agrees on the overall trajectory of the Stability Programme. However, despite the agreement of the two entities to converge towards a structural equilibrium in 2020, there was no formal commitment on the annual fiscal targets among the different sub-entities within each entity. This may hinder the Public Borrowing Section of the High Council of Finance, which is tasked with monitoring compliance with the agreed distribution of targets, and, hence, hamper an activation of the correction mechanism laid down in the Cooperation Agreement in the event of significant deviation from the agreed targets. All in all, this may affect the credibility of the programme and may put its implementation at risk. Belgium considers its Stability Programme, together with its National Reform Programme, as its national medium-term fiscal plan in the sense of the Two-Pack Regulation 473/2013. Annex 4 of the Stability Programme includes indications of the expected economic returns of non-defence public investment projects as required by Article 4.1 of the above-mentioned regulation.

The macroeconomic forecast underlying the Stability Programme has been prepared by the Federal Planning Bureau (FPB). The FPB is a well-established institution positioning itself as independent, however formally attached to the government. As stipulated in the Law of 21 December 1994, which constitutes the FPB in its current form, the Prime Minister and the Minister of Economic Affairs supervise the institution, while the federal government provides guidance on the FPB's proceedings. The Belgian Parliament and the Central Economic Council or the National Labour Council have the right to seek an evaluation by the FPB of the federal government's economic, social and environmental policies[18]. In line with the federal government commitment to reinforce the autonomy of the national Fiscal Council and the independence of its members, the imminent adoption of a Royal Decree is expected to strengthen the independence of the Public Borrowing Section of the High Council of Finance.

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[16] The Concertation Committee (Comité de concertation/Overlegcomité) brings together all Belgian governments to reach a common position in the case of shared competences or to solve conflicts between governments.

[17] www.hogeraadvanfinancien.be/sites/default/files/public/publications/hrf_fin_advies_2018_03_0.pdf (NL) or www.conseilsuperieurdesfinances.be/sites/default/files/public/publications/csf_fin_avis_2018_03_0.pdf (FR).

[18] Loi du 21 décembre 1994 portant des dispositions sociales et diverses, TITRE VIII – Réforme de l'appareil statistique et de prévision économique du gouvernement fédéral, CHAPITRE IV - Le Bureau fédéral du Plan, Art. 124-131.

7. SUMMARY

According to the outturn data, Belgium did not comply with the debt reduction benchmark in 2017. *Prima facie* there thus appears to be a risk of the existence of an excessive deficit in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU analysing whether Belgium is compliant with the debt criterion of the Treaty. The report concluded, following an assessment of all the relevant factors, that as there is currently not sufficiently robust evidence to conclude on the existence of a significant deviation in Belgium in 2017 and over 2016 and 2017 together, the current analysis is not fully conclusive as to whether the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is or is not complied with. However, the adjustment in 2018 appears inadequate to ensure compliance with the adjustment path towards the MTO in 2018 based on the Commission 2018 spring forecast. The Commission will reassess compliance on the basis of the ex-post data for 2018 to be notified in Spring 2019.

In 2017, net primary expenditure growth exceeded the applicable expenditure benchmark rate by 0.4% of GDP. The structural balance improved by 0.8% of GDP, which is above the required adjustment towards the MTO. Following an overall assessment, this points to some deviation from the recommended adjustment path towards the MTO in 2017. In 2016-2017 together the expenditure benchmark pillar suggests a significant deviation from the requirement (average gap of -0.5% of GDP). On the other hand, over 2016 and 2017 together, the structural balance pillar points to some deviation of -0.1% of GDP from the requirement. Based on an overall assessment of compliance with the preventive arm, and given large uncertainties related to key factors of fiscal performance in 2017, there is no sufficient evidence to conclude that Belgium is non-compliant with the required adjustment path towards the MTO in 2017 and over 2016 and 2017 together.

Belgium plans to contain primary expenditure growth equal to the expenditure benchmark in 2018 and 2019. It also plans an improvement of the structural balance of 0.2% of GDP in 2018 and in 2019. Belgium committed to reach the MTO in 2020, while the recalculated structural balance still points to a structural deficit of 0.2% of GDP in 2020. This path implies an average deviation of 0.2 pp. over 2017-2018, while being appropriate in 2019 when taken at face value.

However, following an overall assessment, a significant deviation from the adjustment path towards the MTO is to be expected in 2018 and 2019 putting at risk compliance with the requirements of the preventive arm of the Pact. Belgium is also assessed to be at risk of significant deviation in 2017 and 2018 together. Hence, the necessary measures should be taken as of 2018 to comply with the provisions of the Stability and Growth Pact. The use of any windfall gains to further reduce the general government debt ratio would be prudent.

8. ANNEX

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	2.1	1.3	1.3	1.4	1.5	1.7	1.8	1.7
Output gap [1]	0.3	1.0	-0.5	-0.6	-0.5	-0.2	0.1	0.4
HICP (annual % change)	2.0	2.2	2.0	0.6	1.8	2.2	1.6	1.6
Domestic demand (annual % change) [2]	1.6	1.7	1.2	1.4	2.1	1.2	1.8	1.8
Unemployment rate (% of labour force) [3]	7.5	7.8	8.0	8.5	7.8	7.1	6.4	6.0
Gross fixed capital formation (% of GDP)	21.5	22.9	22.4	23.2	23.4	23.2	23.6	23.7
Gross national saving (% of GDP)	26.9	26.5	24.4	23.1	24.0	25.2	25.4	25.6
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.4**	**-1.8**	**-3.7**	**-2.5**	**-2.5**	**-1.0**	**-1.1**	**-1.3**
Gross debt	**103.7**	**93.0**	**103.8**	**106.1**	**105.9**	**103.1**	**101.5**	**100.2**
Net financial assets	**-97.1**	**-80.6**	**-89.0**	**-95.1**	**-93.2**	**-88.0**	**n.a**	**n.a**
Total revenue	49.1	48.8	51.2	51.3	50.8	51.2	50.7	50.4
Total expenditure	49.5	50.6	54.9	53.8	53.2	52.2	51.8	51.8
of which: Interest	5.8	4.0	3.5	3.0	2.9	2.5	2.3	2.2
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**0.7**	**1.4**	**3.3**	**1.6**	**2.5**	**1.6**	**1.8**	**1.9**
Net financial assets; non-financial corporations	**-69.9**	**-84.5**	**-85.4**	**-115.9**	**-109.2**	**-103.1**	**n.a**	**n.a**
Net financial assets; financial corporations	**-7.8**	**-9.4**	**-2.0**	**5.4**	**-2.8**	**-4.7**	**n.a**	**n.a**
Gross capital formation	14.5	15.3	14.7	15.5	15.9	16.6	16.9	16.9
Gross operating surplus	22.3	24.6	24.9	25.7	26.4	26.8	27.1	27.4
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**4.4**	**2.9**	**1.7**	**0.5**	**0.2**	**0.1**	**0.0**	**0.3**
Net financial assets	**227.0**	**220.6**	**228.6**	**250.8**	**250.8**	**243.8**	**n.a**	**n.a**
Gross wages and salaries	38.3	37.7	38.1	37.6	37.4	37.3	37.3	37.2
Net property income	10.3	9.0	7.8	6.6	6.2	6.0	5.9	5.8
Current transfers received	21.1	21.2	22.6	22.8	22.7	22.6	22.5	22.7
Gross saving	10.0	9.7	7.9	6.9	6.4	6.3	6.1	6.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**4.7**	**2.5**	**1.3**	**-0.4**	**0.2**	**0.8**	**0.7**	**0.9**
Net financial assets	**-51.1**	**-44.8**	**-50.2**	**-43.5**	**-43.7**	**-46.1**	**n.a**	**n.a**
Net exports of goods and services	4.3	2.8	1.0	1.4	1.3	1.3	1.3	1.5
Net primary income from the rest of the world	1.8	1.3	1.8	-0.2	0.6	0.8	1.0	0.9
Net capital transactions	-0.1	-0.2	0.0	0.0	0.1	0.1	0.2	0.2
Tradable sector	41.8	40.3	37.6	37.2	36.8	36.7	n.a	n.a
Non tradable sector	47.8	49.1	51.9	52.4	52.5	52.4	n.a	n.a
of which: Building and construction sector	4.5	4.8	5.0	4.8	4.8	4.7	n.a	n.a
Real effective exchange rate (index, 2000=100)	95.6	100.4	102.4	99.5	99.1	100.8	102.5	102.6
Terms of trade goods and services (index, 2000=100)	103.1	100.8	99.1	100.1	100.8	100.3	100.3	100.6
Market performance of exports (index, 2000=100)	104.0	99.1	101.0	98.6	102.0	101.9	101.8	101.8

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2018 spring forecast