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**COMMISSION STAFF WORKING DOCUMENT**

**Analysis of the Draft Budgetary Plan of Belgium**

*Accompanying the document*

**COMMISSION OPINION**

**on the Draft Budgetary Plan of Belgium**

{C(2019) 9101 final}

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### *Accompanying the document*

#### COMMISSION OPINION

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### 1. INTRODUCTION

Belgium submitted its Draft Budgetary Plan for 2020 on 15 October 2019 in compliance with Regulation (EU) No 473/2013. The Draft Budgetary Plan provides a no-policy-change scenario as, following the election of 26 May 2019 resulting in the ongoing government formation process, a caretaker government has adopted budgets prepared under a no-policy-change assumption. Belgium is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO) of 0% of DP. As the debt ratio was 100% of GDP in 2018, exceeding the 60% of GDP reference value of the Treaty, Belgium also needs to comply with the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2019 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2019 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2019-2020 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations in the context of the European Semester adopted by the Council in July 2019<sup>1</sup>, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

### 2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The Draft Budgetary Plan scenario<sup>2</sup> projects the Belgian economy to grow by 1.1% in both 2019 and 2020, after 1.5% in 2018. This pattern is less buoyant than what was envisaged in the Stability Programme but broadly concurs with the Commission 2019 autumn forecast.

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<sup>1</sup> Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Belgium and delivering a Council opinion on the 2019 Stability Programme of Belgium, OJ C 301, 5.9.2019, p.1

<sup>2</sup> Note that the DBP uses a macroeconomic forecast that is based on the national accounts dating before the benchmark revision published on 18/10/2019.

According to the Draft Budgetary Plan and the Commission projections, the (recalculated<sup>3</sup>) output gap is expected to reach 0.4% of potential GDP in 2019 and -0.1% in 2020.

**Table 1. Comparison of macroeconomic developments and forecasts**

	2018	2019			2020		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.5	1.3	1.1	1.1	1.4	1.1	1.0
Private consumption (% change)	1.5	1.6	0.8	1.0	1.5	1.2	1.2
Gross fixed capital formation (% change)	4.0	2.3	3.2	3.4	2.4	1.8	1.7
Exports of goods and services (% change)	1.2	2.7	2.8	0.6	2.9	1.6	1.2
Imports of goods and services (% change)	2.1	2.9	2.6	0.6	3.2	1.8	1.6
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	1.9	1.5	1.4	1.6	1.6	1.3	1.3
- Change in inventories	0.3	-0.1	-0.5	-0.5	0.0	0.0	0.0
- Net exports	-0.7	-0.2	0.2	0.0	-0.2	-0.2	-0.3
Output gap <sup>1</sup>	0.8	0.2	0.4	0.4	0.2	-0.1	-0.1
Employment (% change)	1.4	0.9	1.3	1.3	1.0	0.8	0.9
Unemployment rate (%)	6.0	5.5	5.5	5.5	5.3	5.5	5.4
Labour productivity (% change)	0.1	0.4	-0.2	-0.1	0.4	0.3	0.1
HICP inflation (%)	2.3	1.6	1.5	1.3	1.4	1.4	1.4
GDP deflator (% change)	1.5	1.7	1.5	1.6	1.6	1.6	1.9
Comp. of employees (per head, % change)	1.9	2.2	2.2	1.7	2.0	2.1	1.8
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.0	-0.1	0.1	-0.8	0.0	-0.1	-0.9

Note:

<sup>1</sup>In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

*Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations*

According to the projections and the Commission forecast, economic growth is expected to be driven by domestic demand in 2020. The Draft Budgetary Plan and the Commission forecast expect net exports to weigh on GDP growth in 2020. After an expected deceleration in 2019 to 0.8% (1.1% according to the Commission forecast), household consumption growth would pick up again in 2020, to 1.2% and 1.3% in the Draft Budgetary Plan and the Commission autumn forecast respectively, enabled by rising purchasing power as a result of higher employment, sustained wage growth and personal income tax cuts. Employment growth is projected to remain robust in 2020, albeit at a slower pace in both projections, while the unemployment rate is forecast to stabilise at 5.5% next year according to the Draft Budgetary Plan and to decrease to 5.4% according to the Commission.

<sup>3</sup> Output gap (in % of potential GDP) according to the DBP as recalculated by Commission on the basis of the DBP scenario using the commonly agreed methodology.

Public investment growth is expected to have decelerated in 2019 as a result of the local investment cycle, and is projected to decelerate further in 2020. The Draft Budgetary Plan scenario projects total investment to increase by 3.2% in 2019 and 1.8% in 2020, broadly in line with the Commission 2019 autumn forecast (3.4% in 2019 and 1.7% in 2020). Business investment is set to lose momentum in 2020 amid markedly weaker confidence indicators and lower pressure to increase capacity.

The Draft Budgetary Plan expects headline inflation to decrease from 2.3% in 2018 to 1.5% in 2019 and 1.4% in 2020, whereas the Commission autumn forecast expects inflation to decrease to 1.3% in 2019 and accelerate to 1.4% in 2020. The GDP deflator in the Commission forecast is slightly higher compared to what is projected in the Draft Budgetary Plan for 2019 and 2020.

All in all, differences between the Draft Budgetary Plan scenario and the Commission 2019 autumn forecast are small, both with respect to the overall growth rate and to its composition. The Draft Budgetary Plan scenario is therefore assessed as plausible.

**Box 1: The macroeconomic forecast underpinning the Belgian Draft Budgetary Plan**

The macroeconomic forecast underlying the Draft Budgetary Plan should either be prepared or endorsed by an independent body as stipulated in the Two-Pack Regulation (EU) No 473/2013. In Belgium, the National Accounts Institute is responsible for providing the 'economic budget' containing the macroeconomic projections required to prepare the budgets of the federal government and the regions and communities. The National Accounts Institute delegates this task by law to the Federal Planning Bureau (FPB). The Federal Planning Bureau is a well-established institution that is formally attached to the government but positions itself as an independent body.

The Draft Budgetary Plan uses the macroeconomic scenario prepared by the Federal Planning Bureau and published in September 2019. The September projections are referred to as 'Draft Budgetary Plan scenario' in Section 2.

Therefore, the macroeconomic scenario underlying the 2019 Draft Budgetary Plan used the most recently available independently-produced macroeconomic forecasts and appears to be fully in line with Council Directive (EU) No 85/2011 on requirements for budgetary frameworks of the Member States.

### 3. RECENT AND PLANNED FISCAL DEVELOPMENTS

#### 3.1. Deficit developments

The no-policy change Draft Budgetary Plan projects a rise in the general government headline deficit from 0.7% in 2018 to 1.7% of GDP in 2019, whereas Belgium's latest Stability Programme targetted a deficit of 0.8% in 2019 (see Table 2). The large deterioration stems mostly from the fact that budgetary targets of the Programme<sup>4</sup> were not backed by adopted or sufficiently detailed measures, as well as a too optimistic estimation of the lasting effect of the

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<sup>4</sup> The 2019 Stability Programme for Belgium was submitted in the context of a caretaker government who did not enjoy full budgetary powers according to the national constitutional rules and/or conventions at the time of submitting the Stability Programme.

CIT tax collection peak in 2017 and 2018. The Draft Budgetary Plan presents a much higher expenditure growth projection in 2019, in particular due to social payments, compensation of employees and intermediate consumption.

For 2019, the headline deficit projection in the Draft Budgetary Plan at face value is in line with that of the Commission 2019 autumn forecast. However, the two projections differ as regards the revision of national accounts data used. The Commission's forecast is also based on a no-policy change assumption but uses the latest version of national accounts data incorporating the benchmark revision, unlike the Draft Budgetary Plan and the Stability Programme<sup>5</sup>. As a result of the data revision, the composition of the revenue and expenditure categories is slightly different in the two projections and a higher nominal GDP realised in 2018 is used in the Commission forecast. However, considering that the revision had only a marginal impact on the headline balance in 2018<sup>6</sup>, the two projections broadly align. A slightly lower nominal GDP growth expected in the Draft Budgetary Plan does not change the conclusion. The two projections differ only marginally in terms of composition across expenditure and revenue categories. On the revenue side, the Commission forecast expects a less robust direct tax collection growth, a larger decrease in current taxes on income and wealth and a less dynamic growth of social contributions. On the expenditure side, the Commission forecast foresees slightly lower growth of social spending, compensation of employees and intermediate consumption.

For 2020, the Draft Budgetary Plan plans a headline deficit of 2.3% of GDP, whereas the latest Stability Programme projected a deficit of 0.2% of GDP. The deterioration is once again explained by the fact that the targets for 2019 and 2020 in the Programme were not underpinned by adopted or sufficiently detailed measures. Thus, the base effect of a higher deficit in 2019 accounts for 0.9 % of GDP of the deterioration in the headline balance in 2020. Moreover, the Draft Budgetary Plan also expects an increase in the expenditure-to-GDP ratio from 53,4% of GDP in 2019 to 54%, while the Stability Programme expected a decrease of a similar magnitude. This is mostly driven by a more dynamic social payments and compensation of employees expected in the Draft Budgetary Plan. On the other hand, according to the Draft Budgetary Plan, revenues as a share of GDP are projected to remain stable, compared to an increase of 0.2 percentage points expected in the Stability Programme. This is a result of a lower direct tax collection and less dynamic social contributions.

The Commission 2019 autumn forecast projects a headline deficit of 2.3% of GDP in 2020 broadly in line with the Draft Budgetary Plan at face value. A slightly lower nominal GDP growth expected in the Draft Budgetary Plan does not change the conclusion. However, the composition across revenue and expenditure categories marginally differs. Having factored in the different data revisions used in the two projections (see *supra*), the Commission forecasts expects a lower growth of revenue, notably from both direct and indirect taxation, as well as from social contributions. On the expenditure side, the Draft Budgetary Plan forecast plans a higher growth of expenditure. In particular, the Draft Budgetary Plan plans a higher increase in social spending and a higher growth of compensation of employees.

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<sup>5</sup> The national accounts data, implementing a benchmark revision, was published on 18 October 2019, after the DBP publication.

<sup>6</sup> The effect of an upward revision of the headline deficit was neutralised by a higher nominal GDP used in the denominator. For more information, see « Comptes nationaux; Révision méthodologique 2019; Aperçu des principaux changements », 2019, Banque Nationale de Belgique.

In 2020, the Draft Budgetary Plan projects an expansionary fiscal stance, with deterioration in the structural balance<sup>7</sup> of 0.3% of GDP. This is in line with the Commission forecast. On the other hand, the Stability Programme planned an improvement of 0.6% of GDP. The reduced adjustment compared to Stability Programme mostly stems from the deterioration of the headline deficit (1% of GDP).

**Table 2. Composition of the budgetary adjustment**

(% of GDP)	2018	2019			2020			Change: 2018-2020
	COM	SP	DBP	COM	SP	DBP	COM	DBP
<b>Revenue</b>	<b>51.4</b>	<b>51.1</b>	<b>51.7</b>	<b>50.5</b>	<b>51.3</b>	<b>51.7</b>	<b>50.3</b>	<b>0.3</b>
<i>of which:</i>								
- Taxes on production and imports	13.5	13.2	13.6	13.3	13.2	13.6	13.3	0.1
- Current taxes on income, wealth,	16.8	16.4	16.4	16.0	16.5	16.4	15.9	-0.4
- Capital taxes	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.0
- Social contributions	15.5	15.9	15.8	15.6	16.0	15.8	15.5	0.3
- Other (residual)	4.8	4.8	5.1	4.8	4.8	5.1	4.8	0.3
<b>Expenditure</b>	<b>52.1</b>	<b>51.9</b>	<b>53.4</b>	<b>52.3</b>	<b>51.4</b>	<b>54.0</b>	<b>52.6</b>	<b>1.9</b>
<i>of which:</i>								
- Primary expenditure	50.0	49.8	51.4	50.3	49.5	52.1	50.7	2.1
<i>of which:</i>								
Compensation of employees	12.3	12.0	12.5	12.2	11.8	12.6	12.2	0.3
Intermediate consumption	4.1	4.1	4.3	4.1	4.0	4.4	4.2	0.3
Social payments	24.6	25.2	25.6	25.0	25.2	26.0	25.3	1.4
Subsidies	3.6	3.3	3.7	3.7	3.3	3.7	3.8	0.1
Gross fixed capital formation	2.6	2.4	2.6	2.6	2.4	2.7	2.7	0.1
Other (residual)	2.8	2.8	2.7	2.7	2.8	2.7	2.7	-0.1
- Interest expenditure	2.1	2.1	2.0	2.0	1.9	1.9	1.8	-0.2
<b>General government balance (GGB)</b>	<b>-0.7</b>	<b>-0.8</b>	<b>-1.7</b>	<b>-1.7</b>	<b>-0.2</b>	<b>-2.3</b>	<b>-2.3</b>	<b>-1.6</b>
<b>Primary balance</b>	<b>1.4</b>	<b>1.3</b>	<b>0.3</b>	<b>0.2</b>	<b>1.8</b>	<b>-0.4</b>	<b>-0.4</b>	<b>-1.8</b>
One-off and other temporary measures	0.5	0.0	0.1	0.1	0.0	0.0	0.2	-0.5
<b>GGB excl. one-offs</b>	<b>-1.3</b>	<b>-0.8</b>	<b>-1.8</b>	<b>-1.8</b>	<b>-0.2</b>	<b>-2.3</b>	<b>-2.4</b>	<b>-1.0</b>
Output gap <sup>1</sup>	0.8	0.2	0.4	0.4	0.2	-0.1	-0.1	-0.8
Cyclically-adjusted balance <sup>1</sup>	-1.2	-0.9	-1.9	-2.0	-0.3	-2.3	-2.2	-1.1
<b>Structural balance (SB)<sup>2</sup></b>	<b>-1.8</b>	<b>-0.9</b>	<b>-2.0</b>	<b>-2.1</b>	<b>-0.3</b>	<b>-2.3</b>	<b>-2.4</b>	<b>-0.5</b>
<b>Structural primary balance<sup>2</sup></b>	<b>0.3</b>	<b>1.2</b>	<b>0.0</b>	<b>-0.1</b>	<b>1.6</b>	<b>-0.4</b>	<b>-0.5</b>	<b>-0.7</b>

Notes:

<sup>1</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/Programme as recalculated by Commission on the basis of the DBP/Programme scenario using the commonly agreed methodology.

<sup>2</sup> Structural (primary) balance corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

## Risk factors

<sup>7</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology

With respect to 2019, there are mostly downside risks to the Draft Budgetary Plan projection. The main uncertainty stems from the macroeconomic scenario. In the context of increasing trade tensions and decelerating intra-EU trade, Belgium as a small and open economy could suffer from a negative demand shock, affecting tax collection. A slowdown in value-added tax (VAT) and corporate income tax collection has already been observed during the latest government budgetary control. Risks to the baseline expenditure projections in the context of a no-policy change budget also exist. As revealed in the latest budgetary control, public spending related to pensions and health expenditure has been largely underestimated for 2019. This was partly due to the base effect of the prolongation of the 2018 budget, allowing for higher spending credits in 2019 and to a lower yield of measures expected in 2019. Therefore expenditure realisation could potentially further change to the downside. Finally, corporate income tax collection in 2019 appears strongly affected by a past measure incentivising advanced tax payments. As a consequence of this measure, the corporate income tax collection had increased temporarily in 2017 and 2018 by around 1% of GDP. Following this peak, corporate income tax revenue is expected to decrease in 2019 as it reverts to its trend. The Draft Budgetary Plan expects a softer decrease in the tax collection than foreseen by the Commission.

In addition to the above-mentioned macroeconomic risks, other risk factors are associated with 2020. The main upside risk stems from the no-policy-change nature of the Draft Budgetary Plan. The formation of a new federal government and adoption of new budgetary measures could improve the budgetary figures for 2020. On the downside, several regional entities have announced their intention to exclude some expenditure items from their deficit targets (e.g. Oosterweel Link in Flanders, investments linked to the Transition Plan in Wallonia, transport and security investment in Brussels region or education reform in the French community). Although the Draft Budgetary Plan included in their projections these large deficit-increasing items, regional deficits could be much larger than planned. Finally, several important tax measures could weigh on the tax collection. This notably concerns the corporate taxation reform, which decreases corporate income tax rates further in 2020, and the last phase of the so-called 'tax shift', further lowering employers' social contributions in 2020. While both reforms were initially assumed to be budgetary neutral by the federal government, several evaluations pointed to their negative budgetary impact<sup>8</sup>. The latter could be further aggravated considering that some compensatory measures are negatively impacted by the low interest rate environment (e.g. notional interest rates reduction).

#### *Interest expenditure*

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Belgium currently standing at -0.1%<sup>9</sup>. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in Belgium is expected to fall from 2% of GDP in 2019 to 1.9% in 2020, well below the 3,6% recorded in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from the Draft Budgetary Plan is broadly confirmed by the Commission forecast.

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<sup>8</sup> See National Bank of Belgium (2017) : « Incidence macroéconomique et budgétaire du scénario de tax shift révisé par le cabinet du ministre des Finances et comparaison avec l'exercice de novembre 2015 » for the tax shift and « Aspects budgétaires et macroéconomiques de la réforme de l'impôt des sociétés en Belgique » for the corporate income tax reform.

<sup>9</sup> 10-year bond yields as of 28 October 2019. Source: Bloomberg.

### 3.2. Debt developments

According to the latest data revision, public debt peaked at 107.8% of GDP in 2014 and fell gradually to 100% of GDP in 2018. The Draft Budgetary Plan (at face value, using nominal GDP series published before the most recent national account revision) projects a decrease in public debt from 102% of GDP in 2018 to 101.5% in 2019 (see Table 3). The decrease in the debt ratio projected in 2019 is less pronounced than initially planned in the Stability Programme, due to lower projected primary surpluses, lower inflation and less robust real GDP growth. For 2020, the Draft Budgetary Plan plans an increase in debt to 101.8% of GDP, driven by a primary deficit and debt-increasing stock-flow adjustments. In contrast, the Stability Programme planned a further decrease in the debt ratio. The difference is driven mostly by a lower primary balance targeted in the Draft Budgetary Plan and weaker economic growth.

**Table 3. Debt developments**

(% of GDP)	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
<b>Gross debt ratio<sup>1</sup></b>	<b>100.0</b>	<b>100.6</b>	<b>101.5</b>	<b>99.5</b>	<b>98.5</b>	<b>101.8</b>	<b>99.6</b>
Change in the ratio	-1.7	0.6	1.5	-0.5	-2.1	0.3	0.1
Contributions <sup>2</sup> :							
<b>1. Primary balance</b>	<b>-1.4</b>	<b>-1.3</b>	<b>-0.3</b>	<b>-0.2</b>	<b>-1.8</b>	<b>0.4</b>	<b>0.4</b>
<b>2. “Snow-ball” effect</b>	<b>-0.9</b>	<b>-0.9</b>	<b>-0.5</b>	<b>-0.7</b>	<b>-0.9</b>	<b>-0.7</b>	<b>-1.0</b>
<i>Of which:</i>							
Interest expenditure	2.1	2.1	2.0	2.0	1.9	1.9	1.8
Real growth effect	-1.4	-1.3	-1.1	-1.1	-1.4	-1.1	-0.9
Inflation effect	-1.5	-1.7	-1.4	-1.5	-1.5	-1.6	-1.9
<b>3. Stock-flow adjustment</b>	<b>0.5</b>	<b>0.9</b>	<b>0.4</b>	<b>0.4</b>	<b>0.6</b>	<b>0.7</b>	<b>0.6</b>
<i>Of which:</i>							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

Notes:

<sup>1</sup> End of period.

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

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

The debt projections in the Draft Budgetary Plan, once corrected for the denominator effect<sup>10</sup> (due to data revision, see *supra*), broadly align with those of the Commission 2019 autumn forecast. According to the Commission forecast the debt ratio is expected to decrease from 100% in 2018 to 99.5% of GDP in 2019, which is marginally higher than the projection of the Draft

<sup>10</sup> The data revision of the 2018 debt as % of GDP from 102% to 100% stems mostly from different nominal GDP used as denominators. The nominal GDP used in the DBP amounts to EUR 450.5 billion in 2018 against EUR 459.8 billion in the Commission’s calculations.



Budgetary Plan. The difference is due to a slightly lower primary surplus forecast by the Commission. For 2020, the Commission forecasts a slightly lower increase in debt driven by a marginally higher primary deficit compared to what is planned by the Draft Budgetary Plan.

For 2020, both the Draft Budgetary Plan and the Commission forecast present upside risks related to stock-flow adjustments. The latest budgetary control for 2019 revealed lower stock-flow adjustment than initially planned, due to large issuance premia driven by lower than expected interest rates. If the situation reproduces, the debt might be lower than projected by both the Draft Budgetary Plan and Commission forecast.

### **3.3. Measures underpinning the Draft Budgetary Plan**

Following the elections of 26 May 2019 resulting in the ongoing federal government formation process, the caretaker federal government, which does not enjoy full budgetary powers, submitted a no-policy change Draft Budgetary Plan. Thus, it does not contain new major measures as regards the federal government. Several small measures (e.g. adaptation of the tax exception on pensions and replacement income) adopted by the federal parliament have been taken into account. They account however for less than 0.1% of GDP.

The regional governments of Wallonia, Flanders and the German community have announced new measures during the preparation of their budgetary plans. However, both revenue and expenditure measures are relatively small and account for less than 0.1% of GDP. Considering the lack of precise explanations in the case of most measures and their small budgetary impact, the Commission has not included them in its forecast.

Overall, the net deficit-decreasing impact of the presented measures is less than 0.1% of GDP.

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

Belgium is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective . Box 2 reports the latest country specific recommendations in the area of public finances. Belgium is also subject to the debt reduction benchmark.

### **Box 2. Council recommendations addressed to Belgium**

On 9 July 2019, the Council addressed recommendations to Belgium in the context of the European Semester. In particular, in the area of public finances the Council recommended that Belgium should ensure that the nominal growth rate of net primary government expenditure does not exceed 1.6% in 2020, corresponding to an annual structural adjustment of 0.6% of GDP and use windfall gains to accelerate the reduction of the general government debt ratio.

### **4.1. Compliance with the debt criterion**

According to the latest data revision, as the debt ratio was 100% of GDP in 2018, Belgium needs to comply with the debt reduction benchmark.

Considering that Belgium did not comply with the debt reduction benchmark in 2018, the Commission issued a report under Article 126(3) TFEU to examine up-close this prima facie risk of the existence of an excessive deficit, taking into account all relevant factors. This report was adopted on 5 June 2019 and included an assessment of all the relevant factors, notably (i) the

macroeconomic conditions, which are no longer considered a factor to explain Belgium's gap to the debt reduction benchmark; (ii) the implementation of growth-enhancing structural reforms in past years, several of which are considered substantial and projected to help improve debt sustainability, even if they have a temporary non-neutral budgetary impact; (iii) the fact that there is no sufficiently robust evidence to conclude on the existence of a significant deviation from Belgium's adjustment path towards the medium-term budgetary objective in 2018 and over 2017 and 2018 taken together. Overall, the report stated that the analysis was 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.

The Draft Budgetary Plan does not include sufficient information to assess compliance with the debt reduction benchmark in 2019 and 2020. Based on the Commission 2019 autumn forecast, which projects comparable debt developments overall in 2019-2020 to those in the Draft Budgetary Plan (once corrected by the denominator effect), Belgium would not comply with the debt reduction benchmark in 2019 or in 2020 (gap of 1.5% of GDP in 2019 and 2.7% in 2020).

Therefore, based on an overall assessment of the Draft Budgetary Plan, the debt reduction benchmark is expected not to be met in 2019 and in 2020.

**Table 4. Compliance with the debt criterion**

	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
<b>Gross debt ratio</b>	<b>100.0</b>	<b>100.6</b>	<b>101.5</b>	<b>99.5</b>	<b>98.5</b>	<b>101.8</b>	<b>99.6</b>
Gap to the debt benchmark <sup>1,2</sup>	0.4	-0.2		1.5	-0.6		2.7
Structural adjustment <sup>3</sup>	-0.1	0.5	-0.3	-0.3	0.6	-0.2	-0.3
<i>To be compared to:</i>							
<b>Required adjustment <sup>4</sup></b>							

Notes:

<sup>1</sup> Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

<sup>2</sup> 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.

<sup>3</sup> Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

<sup>4</sup> Defines the remaining minimum 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 (SP) budgetary projections for the previous years are achieved.

Source:

*Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations*

## **4.2. Adjustment towards the Medium Term Budgetary Objective**

Belgium is subject to the preventive arm of the SGP and has to ensure compliance with the required adjustment towards the medium-term budgetary objective. For 2019, Belgium benefitted from the application of flexibility for structural reforms allowing for a temporary deviation from the required adjustment towards the medium-term budgetary objective. In 2019, Belgium was therefore required to pursue an annual structural adjustment of at least 0.1% of GDP.

According to the information provided in the Draft Budgetary Plan, the growth rate of primary government expenditure, net of discretionary revenue measures and one-offs, in 2019 will exceed the applicable expenditure benchmark rate (2.8%) leading to a deviation of -0.8% of GDP. The resulting gap points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective. The change in the (recalculated) structural balance in 2019 points to some deviation from the required adjustment<sup>11</sup>, as the gap is -0.4% of GDP. This calls for an overall assessment. The difference in size of the deviation of both indicators is driven mainly by relatively important revenue windfalls, positively impacting the reading of the fiscal effort as measured by the change in the (recalculated) structural balance. Following an overall assessment, the Draft Budgetary Plan appears to point to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective in 2019.

Based on the Commission 2019 autumn forecast, the growth rate of net government expenditure in 2019 is expected to exceed the applicable expenditure benchmark rate (2.8%) leading to a deviation of -0.7% of GDP. The resulting gap points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective. The change in the (recalculated) structural balance in 2019 points to some deviation from the required adjustment<sup>12</sup>, as the gap is -0.4% of GDP. The overall assessment reveals that the difference in size of the deviation of both indicators is driven mainly by the difference in potential growth estimation and by decreasing interest expenditure, both positively impacting the reading of the fiscal effort as measured by the change in the (recalculated) structural balance. Following an overall assessment, the Commission 2019 autumn forecast points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective in 2019.

For 2020, according to the information provided in the Draft Budgetary Plan, the growth of net government expenditure is expected to exceed the expenditure benchmark of 1.6%, resulting in a gap of -1.5% of GDP, pointing to a risk of significant deviation. The change in the (recalculated) structural balance in 2020 points to a risk of significant deviation from the required adjustment, as the gap is -0.8% of GDP. For 2019 and 2020 together, the Draft Budgetary Plan signals a risk of significant deviation based on the expenditure benchmark (average gap of -1.1% of GDP) as well as on the structural balance (average gap of -0.6% of GDP).

According to the Commission 2019 autumn forecast, the growth of net government expenditure deviates from the expenditure benchmark by -1.5% of GDP in 2020, pointing to a risk of significant deviation. The structural balance also confirms this risk, with a deviation of -0.9% of GDP. For 2019 and 2020 taken together, both indicators point to a risk of significant deviation with gaps of -1.1% and -0.6% of GDP for the expenditure benchmark and the structural balance pillar, respectively. The difference in size of the deviation of both indicators is driven mainly by a slightly higher GDP deflator used for the structural balance indicator compared to the one underlying the expenditure benchmark, different potential growth estimation and fall in interest rates. All the factors positively impact the reading of the fiscal effort as measured by the change in the structural balance. The same conclusion stems from the assessment for 2019 and 2020 taken together. Therefore, there is a risk of significant deviation from the adjustment path towards the medium-term budgetary objective in 2020 and over 2019 and 2020 taken together.

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<sup>11</sup> The requirement for 2019 is "frozen" based on the forecast available in spring of 2019 unless, based on the 2019 autumn forecast, the Member State is found to be in very bad or exceptionally bad times, or is approaching the medium-term budgetary objective.

**Table 5: Compliance with the requirements of the preventive arm**

(% of GDP)	2018	2019		2020	
<b>Initial position<sup>1</sup></b>					
Medium-term budgetary objective (MTO)	0.0	0.0		0.0	
Structural balance <sup>2</sup> (COM)	-1.8	-2.1		-2.4	
Structural balance based on freezing (COM)	-1.3	-1.4		-	
Position vis-a-vis the MTO <sup>3</sup>	Not at MTO	Not at MTO		Not at MTO	
	<b>2018</b>	<b>2019</b>		<b>2020</b>	
(% of GDP)	<b>COM</b>	<b>DBP</b>	<b>COM</b>	<b>DBP</b>	<b>COM</b>
<b>Structural balance pillar</b>					
Required adjustment <sup>4</sup>	0.6	0.6		0.6	
Required adjustment corrected <sup>5</sup>	0.6	0.1		0.6	
Change in structural balance <sup>6</sup>	0.0	-0.3	-0.3	-0.2	-0.3
One-year deviation from the required adjustment <sup>7</sup>	-0.6	-0.4	-0.4	-0.8	-0.9
Two-year average deviation from the required	-0.1	-0.5	-0.5	-0.6	-0.6
<b>Expenditure benchmark pillar</b>					
Applicable reference rate <sup>8</sup>	1.6	2.8		1.6	
One-year deviation adjusted for one-offs <sup>9</sup>	-0.7	-0.8	-0.7	-1.5	-1.5
Two-year average deviation adjusted for one-offs <sup>9</sup>	-0.6	-0.7	-0.7	-1.1	-1.1
<i>Notes</i>					
<sup>1</sup> 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 is allowed in order to be evaluated as having reached the MTO.					
<sup>2</sup> Structural balance corresponds to cyclically-adjusted government balance excluding one-off measures.					
<sup>3</sup> Based on the relevant structural balance at year t-1.					
<sup>4</sup> 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 ed. 2018, page 38.).					
<sup>5</sup> Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.					
<sup>6</sup> Change in the structural balance compared to year t-1. Ex post assessment (for 2018) was carried out on the basis of Commission 2019 spring forecast.					
<sup>7</sup> The difference of the change in the structural balance and the corrected required adjustment.					
<sup>8</sup> 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.					
<sup>9</sup> 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.					
<i>Source:</i> Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.					

## 5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

According to the no-policy-change Draft Budgetary Plan, the consolidation effort pursued in previous years would have halted in 2018. At face value, the revenue-to-GDP ratio as planned by the Draft Budgetary Plan would remain broadly stable in 2020 at 51.7% of GDP. The fiscal loosening would be mostly expenditure-driven. The expenditure-to-GDP ratio would increase from 53.4% to 54.0% of GDP. The increase in expenditure would mostly stem from rising social payments, notably pensions and health expenditure. The Draft Budgetary Plan also expects an increase in gross fixed capital formation from around 2.6% of GDP in 2019 to

2.7% in 2020, due to large regional investments starting in 2020. Despite this planned increase, public investment would remain relatively low.

The 2019 Country Report for Belgium underlined the fact that total public expenditure as a share of GDP in Belgium is among the highest in the euro area and is projected to increase over the Draft Budgetary Plan horizon, despite a marked decline in interest spending. Belgium spends comparatively more than the euro area average on public wages, private sector subsidies and social benefits. Finally, social benefits, mainly pensions, healthcare and long-term care services, account for around half of public expenditure in Belgium. Due to population ageing, the growth of social expenditure is expected to accelerate significantly in the coming years, questioning the long-term sustainability of public spending. Considering these risks, the Recommendation of 9 July 2019 addressed by the Council encouraged Belgium to continue reforms to ensure the fiscal sustainability of the long-term care and pension systems, including by limiting early exit possibilities from the labour market. Due to the caretaker character of the federal government, no new major reforms have been included in the Draft Budgetary Plan for 2020 to further complement past efforts in these areas. Past reforms for which Belgium was granted the structural reform clause last Spring, including pension reforms, the tax system and labour market reforms are being implemented and appear to be slightly more deficit-increasing in the short-term.

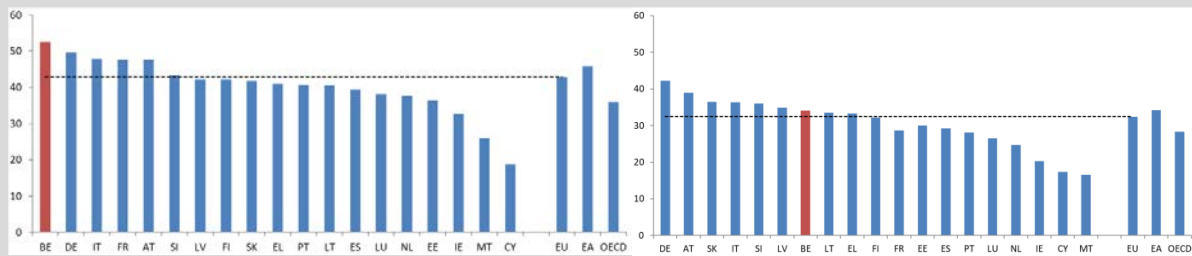
The high level of public expenditure suggests that there is scope for a more spending-based fiscal adjustment. A large portion of public spending is mandated by permanent legislation, which limits governments' ability to review and change spending priorities. Therefore, the Council recommended Belgium to improve the composition and efficiency of public spending, notably through spending reviews. Although Belgium has so far not undertaken a spending review at the federal level, the Draft Budgetary Plan highlights that to this aim a joint project of the authorities with the OECD and the Structural Reform Support Service (SRSS) has been initiated in 2019. Moreover, given the importance of fiscal coordination at all level of government in a federal state like Belgium, the Council recommended Belgium to ensure the coordination of fiscal policies by all levels of government, which is so far limited by the lack of formal agreement on annual fiscal targets at all levels of government. The points out however that a project initiated by the High Council of Finance with help from the SRSS seeks to improve the budgetary framework in Belgium. A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2019 Country Report and in the context of the country-specific recommendations to be proposed by the Commission in May 2020.

#### **Box 4 - Addressing the tax burden on labour in the euro area**

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Belgium for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

**The tax burden on labour in Belgium at the average wage and at low wage (2018)**



Notes: EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

The Council Recommendation of 9 July 2019 encouraged Belgium to remove disincentives to work. Over the Draft Budgetary Plan horizon, Belgium is pursuing a multiannual tax reform with the aim of reducing the tax burden on labour by lowering personal income taxes and employers' social security contributions. Due to its no-policy change nature, Belgium's Draft Budgetary Plan does not include any new major measures that affect the tax wedge on labour.

## 6. OVERALL CONCLUSION

Based on the Commission 2019 autumn forecast, Belgium is not expected to comply with the debt reduction benchmark in 2019 and 2020.

Following an overall assessment of the no-policy change Draft Budgetary Plan, the planned structural adjustment is not in line with the required adjustment path towards the medium-term objective in both 2019 and 2020. The Commission 2019 autumn forecast confirms that Belgium is at risk of significant deviation from the adjustment path towards the medium-term objective recommended by the Council in both 2019 and 2020.