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COMMISSION STAFF WORKING DOCUMENT

Analysis by the Commission services of the budgetary situation in Belgium in response to the Council Recommendation of 2 December 2009 with a view to bringing an end to the situation of excessive deficit

Accompanying the document

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of budgetary implementation in the context of the ongoing Excessive Deficit Procedures after the Commission services' 2011 Autumn Forecast

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1. INTRODUCTION

In 2009, public finances in Belgium deteriorated substantially as a result of the global economic and financial crisis that started at the end of 2008. To cushion the significant impact of the crisis on the economy, the Belgian authorities adopted fiscal stimulus measures in line with the European Economic Recovery Plan (EERP) with an estimated annual budgetary impact of 0.5% of GDP in 2009 and 2010. As a result of these measures and the impact of automatic stabilisers, the Commission services’ 2009 Autumn Forecast projected the government budget deficit to deteriorate to 5.9% of GDP in 2009, from 1.2% of GDP in 2008. In 2010 and 2011, the deficit was expected to stabilise at 5.8% of GDP. In addition, the authorities supported the financial sector through capital injections as well as guarantees amounting to about 19% of GDP. The debt ratio, which had been steadily reduced from 134.2% of GDP in 1993 to 84.2% of GDP in 2007, was projected to rise again from 89.8% of GDP in 2008 to 97.2% of GDP in 2009.

Against this background, on 2 December 2009, the Council decided under article 126(6) of the Treaty that an excessive deficit existed and addressed recommendations to Belgium in accordance with Article 126(7) of the Treaty with a view to bringing an end to the situation of an excessive government deficit by 2012[1]. The Belgian authorities were recommended to implement deficit-reducing measures in 2010 as planned in the 2010 draft budget and to ensure an average annual fiscal effort of at least ¾% of GDP in 2010-2012, which was also expected to contribute to bringing the government gross debt ratio back on a declining path. In addition, the Council asked the authorities to specify the measures that were necessary to achieve the correction of the excessive deficit by 2012 and to accelerate the reduction of the deficit and the debt beyond the fiscal effort if economic or budgetary conditions turned out better than expected at the time the EDP recommendations were issued. Furthermore, the authorities were recommended to strengthen the monitoring mechanisms to ensure that fiscal targets are respected. In its recommendations, the Council established a deadline of 2 June 2010 for effective action to be taken in line with the provisions of Article 3(4) of Regulation (EC) No 1467/97.

[1] OJ L 125, 21.5.2010, p. 34. All EDP-related documents for Belgium can be found at the following website: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm.

In its Communication of 15 June 2010, the Commission concluded that Belgium had taken effective action towards the correction of the excessive deficit by 2012. In particular, Belgium had broadly implemented the deficit-reducing measures in 2010 as planned, totalling 1% of GDP and leading to an improvement in the structural balance of ¼% of GDP. Furthermore, the 2010 headline deficit was expected by the Commission services to come out lower than the deficit for 2010 projected in the draft budget (5% of GDP instead of 5.6% of GDP). The authorities had also outlined in some detail the consolidation strategy by setting targets and indicating a number of measures supporting them. However, the measures underpinning the envisaged consolidation path from 2011 onwards still had to be specified further in order to reach the recommended average annual fiscal effort to correct the excessive deficit by 2012 and to ensure that the debt ratio embarked on a downward path by the end of the correction period. Moreover, Belgium still had to further strengthen monitoring mechanisms to ensure that fiscal targets are respected. All in all, the Commission considered that no further steps in the excessive deficit procedure of Belgium were needed at that time. In its conclusions of 13 July 2010, the Council shared this view.

This paper examines the progress made by Belgium towards a timely and sustainable correction of the excessive deficit. In particular, it examines the budgetary developments since the Commission communication to the Council on action taken of 15 June 2010. The assessment takes into account all decisions publically announced by the Belgian government and supplementary information provided by the authorities by 9 January 2012.

2. ECONOMIC DEVELOPMENTS AND OUTLOOK

Belgium felt the full impact of the global economic recession in 2009 with real GDP contracting by 2.8%. The fiscal stimulus and extra liquidity by the Eurosystem combined with state guarantees to the financial sector helped to restore confidence and supported domestic demand. Thanks to the pick-up in world trade, the recovery in 2010 was stronger than expected, with GDP growing at 2.3% (compared to the 1.3% still expected in the Commission services' 2010 Spring Forecast). Economic activity benefited from a strong increase in net exports, driven by the strong economic recovery of Germany, Belgium's main trading partner. The impact of the recession on employment was relatively contained. A temporary decline in hours worked and a decline in labour productivity per hour acted as a buffer. After a decrease of 0.2% in 2009, employment increased again in 2010 (by 0.8%).

After the strong recovery in 2010 and the first half of 2011, the Belgian economy slowed down considerably in the second part of the year. Main factors contributing to this slowdown are the general weakening of global activity and the sovereign debt crisis in the euro area, which have depressed consumer and business confidence. In addition, there are renewed concerns about the health of the banking sector and the impact on credit growth. GDP growth is expected to have weakened further towards the end of 2011 and to remain weak in 2012 as the positive contribution of net exports is expected to fade away so that only domestic demand remains supportive. Both the Commission services' 2011 Autumn Forecast and the latest GDP projections of the Belgian authorities expect a deceleration of GDP growth in 2012 to below 1% (0.9% and 0.8% respectively) after having estimated 2.2% and 2.4% in 2011, respectively. For 2013 a slight pick-up in GDP growth is foreseen by the 2011 Autumn Forecast which expects GDP growth to reach its potential by 2013 (1.5%), while the latest available figures of the Belgian authorities (those which are underlying the 2012 budget) are more optimistic, projecting growth of above 2% by 2013[2]. Although employment creation picked up relatively quickly after the crisis, the outlook on the labour market has recently become less positive and, according to the Commission services' 2011 Autumn Forecast, the unemployment rate will gradually rise again to about 8% in 2013, after the drop from 8.3% in 2010 to 7.6% in 2011. In view of the latest available information both domestically and internationally, the probability that negative risks will materialise has increased.

Table 1: Comparison of macroeconomic developments and forecasts

	2009	**2010**	**2011**		**2012**		**2013**	
	Outturn	**Outturn**	**COM AF 2011**	**National projections**	**COM AF 2011**	**National projections**	**COM AF 2011**	**National projections**
Real GDP (% change)	-2.8	2.3	2.2	2.4	0.9	0.8	1.5	2.1
Contributions to real GDP growth								
Final domestic demand	-1.2	1.2	2.0	1.8	1.0	1.5	1.2	NA
Changes in inventories	-1.1	-0.1	0.1	0.6	-0.1	0.0	0.0	NA
Net exports	-0.5	1.1	0.1	0.0	0.0	0.1	0.3	NA
Employment (% change)	-0.2	0.8	1.2	1.2	0.4	0.7	0.5	1.0
GDP deflator (% change)	1.2	1.8	2.3	2.3	2.1	2.2	2.2	NA

Notes:
- COM AF 2011 – Commission services' 2011 Autumn Forecast. National projections – Hoge Raad van Financiën – Bijwerking van het advies van maart 2011 ten gevolge van de gewijzigde economische context, October 2011.
- The growth forecast of the Federaal Planbureau, Economische Vooruitzichten 2011-2014, of September 2011 was 2.4% for 2011 and 1.6% for 2012.

Sources: Commission services, national authorities

Nonetheless, it should be noted that in 2009 and 2010 real GDP growth turned out better than expected in the Commission services' 2009 Autumn Forecast, the latest available at the time of adoption of the Council recommendation addressed to Belgium under Article 126(7) of the Treaty (see Table 2 below). This forecast foresaw a contraction of 2.9% in 2009, followed by a hesitant recovery to 0.6% growth in 2010. This compares with an actual contraction of 2.8% in 2009, which was very close to the forecast, but was followed by a much more vigorous recovery to 2.3% in 2010. For 2011 the picture is similar: at the time of the Council recommendation, real GDP growth was expected to come out at 1.5%, while the expected outturn according to the 2011 Autumn Forecast is 2.2%, albeit with downside risks. Thus, macroeconomic conditions in the period 2009-2011 have been better than expected and would have been supportive to implement and accelerate the fiscal consolidation recommended by the Council against a less favourable macroeconomic scenario at the time.

2 Note that this estimation was based on a more optimistic growth figure for 2012 (1.6%), so the growth expectations for 2013 are likely to be revised downward by the Belgian authorities as well.

Table 2: Comparison of real GDP growth forecast at the time of the Council recommendation (COM AF 2009) and the actual outturn (COM AF 2011)

	2009	2010	2011
COM AF 2009	**-2.9%**	**0.6%**	**1.5%**
Outturn (COM AF 2011)	**-2.8%**	**2.3%**	**2.2%***

Notes: COM AF 2009 – Commission services' 2009 Autumn Forecast; COM AF 2011 – Commission services' 2011 Autumn Forecast.

** This figure represents the best approximation to the actual outturn of real GDP growth in 2011, although a slight downward revision is plausible given the worse than expected economic situation in the last quarters of the year.*

Source: Commission services

3. BUDGETARY SITUATION AND PROJECTIONS FOR THE PERIOD 2011-2013

The general government deficit, which had increased to 5.8% of GDP in 2009, declined to 4.1% in 2010. Thanks to the better-than-expected macroeconomic outturns this outcome was substantially lower than the objective of 4.8% of GDP planned by the Belgian authorities in the January 2010 update of the Stability Programme (SP), two months after the Council had decided that an excessive deficit existed in Belgium and recommended to end the excessive deficit situation. However, the structural effort in 2010 was only ½ a percentage point which represents two-thirds of the annual average reduction recommended by the Council (¾% of GDP).

3.1. Estimated outturn for 2011

In the Commission services' 2011 Autumn Forecast, the general government deficit was estimated at 3.6% of GDP in 2011, 0.5 percentage points lower than in the previous year. This outcome is in line with the official target specified in the 2011 update of the SP. However, at 0.4% of GDP, the estimated annual average change in the structural budget balance in 2010-2011 is only about half of the annual average fiscal effort recommended by the Council (see Table 3) despite the fact that macroeconomic conditions both in 2010 and 2011 were better than expected at the time of the Council recommendation.

Table 3: Comparison of fiscal efforts, change in the structural balance (% of GDP) based on the Commission services' 2011 Autumn Forecast

Average annual change of structural balance 2010 - 2011		Average annual change ofstructural balance 2010-2012		Additional average annual effort needed to correct the excessive deficit	Average annual fiscal effort recommended by the Council	Deadline for correction
Uncorrected	Corrected	Uncorrected	Corrected			
0.4	0.4	-0.1	-0.1	1.6	3/4% in 2010-2012	2012

Notes:
- The additional average annual effort (i.e. on top of measures already included in the 2011 Autumn Forecast) is calculated for the period from 2011 until the deadline for correction (2012).
- The uncorrected average annual change in the structural balance is the estimated change in the structural balance from the Commission services' 2011 Autumn Forecast. The corrected average annual change in the structural balance is the uncorrected average annual change in the structural balance plus a correction factor capturing the effect of revisions to potential output growth between the projections at the time of the EDP recommendations and the Commission services' 2011 Autumn Forecast (see European Commission (2004) Public Finances in EMU – 2004, European Economy, Brussels; and European Commission (2006) Public Finances in EMU – 2006, European Economy, Brussels).

Source: Commission services

3.2. Deficit projections for 2012-13

The Belgian authorities announced in the course of 2011 a deficit target of 2.8% of GDP for 2012 without indicating at the time the measures that would allow reaching this objective. Since there was no budget for 2012 at the cut-off date of the Commission services' 2011 Autumn Forecast, this forecast was made under the no-policy-change assumption. On this basis, the deficit was projected to rise by 1 percentage point of GDP in 2012, reaching 4.6% of GDP, which is substantially above the 3% of GDP reference value of the Treaty. In 2013, again assuming that no further measures would be taken, the deficit was projected to decline marginally to 4.5% of GDP, while the structural deficit would remain broadly constant at 4.0%.

On 27 November 2011, after the cut-off date of the 2011 Autumn Forecast, the incoming Prime Minister Di Rupo announced an agreement on the 2012 budget. The draft budget was submitted to Parliament on 21 December 2011. It aims to bring the deficit to 2.8% of GDP (of which 2.4% for Entity I, i.e. the federal government and social security, and 0.4% of GDP for Entity II, i.e. regions, communities and local authorities).

The draft budget contains measures representing, according to the authorities, a consolidation effort amounting to 2.7% of GDP, relative to the baseline deficit assumed by the government of 5.6% of GDP in ESA terms (of which 5.2% of GDP is for Entity I). This baseline notably takes into account the view presented in the latest report of the "Monitoring Committee" that healthcare spending would grow in 2012 at the maximum legally possible rate, i.e. by 4.5% a year in real terms (with inflation measured by the rise in the so-called "health index", which excludes car fuel as well as alcohol and tobacco products).

According to the authorities, the allocation of the consolidation is as follows: 42% of estimated savings would fall on expenditure reduction, 34% on extra revenues and 24% on so-called "diverse" other measures, which essentially consist in additional revenues not generated by increases in taxation, such as levies from the nuclear electricity producers and from banks but also non-tax revenues and revenues from fight against tax evasion (see Table 4). The budgetary package also includes structural measures in labour market policy, with an increase in the degree of degressivity of unemployment benefits and extra measures to increase "activation" of older workers. Further structural reforms are envisaged in the pension system: (i) the early retirement age is planned to be brought to 62 years (instead of 60) and (ii) early retirement is foreseen to be possible after a career of 40 years (instead of 35 years).

Table 4: Main budgetary measures for 2012 (as presented in the budget)

Revenue	Expenditure
• Reform of the system of "notional interests": 0.4% of GDP • Increase in the taxation of dividends and interests: 0.2% of GDP • Fighting tax evasion: 0.2% of GDP • Abolition of bank secrecy: 0.1% of GDP • Increase in VAT on pay-TV and introduction of VAT on services of notaries and bailiffs: 0.05% of GDP • Taxation on houses freely put at the disposal of company bosses: 0.05% of GDP • Increase in excise duties on tobacco products: 0.05% of GDP • Reform of the taxation on capital gains inside companies: 0.05% of GDP	• Suppression of the subsidy for clean cars: -0.1% of GDP • Reduction in transfers to railways: -0.1% of GDP • Reduction in development aid expenditure: -0.05% of GDP • Slower increase and additional savings in healthcare spending: -0.6% of GDP

Note: Budgetary impact as reported in the 2012 budget and additional information provided by the national authorities. A positive sign implies that revenue / expenditure increase.

The Commission services forecast for 2012 had shown a deficit of 4.6% of GDP based on a no-policy change basis.

In broad terms, the gap with the Commission services forecast can be in particular explained by differing projections of health care expenditure under unchanged policies. Based on past trends the Commission forecast had assumed a development in healthcare spending that was substantially less dynamic than the maximum rate permitted, which in turn was taken as the baseline by the Belgian authorities. In recent years, the actual increase in healthcare spending had been substantially lower than the maximum growth permitted (4.5% plus inflation); this suggests that a part of the healthcare savings compared to the maximum permitted growth are already captured in the Commission Autumn Forecast by the no-policy-change assumption.

As a result of the above, for the sake of simplicity and comparability, the starting point of this updated Commission services assessment is the updated no policy-change baseline of the authorities in ESA terms of 5.2% of GDP for Entity I. Disregarding the difference in baseline, the main divergences between the Belgian authorities' estimates of the measures and those of the Commission services are listed in Table 5. They include:

- A difference of slightly less than 0.1% of GDP in the estimate of additional tax revenues, of which about half on the reform of notional interests and the other half on the increase in the tax on dividends and interests. In both cases, a small reduction in the tax base can be expected as a result of behavioural changes of companies and households in response to the increase in taxation, which is foreseen by the Commission services to slightly reduce the expected return of the measures compared to what is assumed in the budget.

- A difference of slightly more than 0.1% of GDP in the estimate of savings in expenditure of which about 0.03% of GDP concerns the Federal State and 0.07% the social security. As far as the expected savings in Federal State spending are concerned, the divergence is due in particular to the introduction of a contribution from sub-federal government levels for the pensions of their civil servants (the so-called "responsibilisation"): this measure will reduce the transfers of the Federal State to the Pension fund of the civil service and hence its deficit but will increase the expenditure of the sub-federal government levels by the same amount, thus without any direct effect on the deficit of the general government. This accounts for 0.02% out of the 0.03% of GDP divergence on savings in Federal State expenditure.

- As far as the social security is concerned, on top of the change in the growth norm (explained above during the discussion of the different baselines), the budget foresees savings in healthcare amounting to EUR 418 million (slightly more than 0.1% of GDP) and supported by specific and binding measures, so that this estimate can be accepted. By contrast, the measures that would allow saving an additional EUR 320 million in healthcare (the "underutilisation" estimated for 2011 and extrapolated for 2012) have been only specified for about EUR 70 million at the moment. Thus the Commission services could not take into consideration so far the savings not yet supported by specific measures, which leads to another divergence amounting to EUR 250 million. This divergence largely explains the 0.07% of GDP difference between the Belgian authorities' and the Commission services' estimates of savings in healthcare.

- A difference of 0.06 pp of GDP in the assessment of the return of the "other" measures. In particular, the return on the fight against tax evasion, how desirable it can be, often falls short of expected returns. The divergence between the Belgian authorities' and the Commission services' estimates on this issue amount to about 0.04% of GDP. As far as the second-round effects of additional job creation are concerned, the Commission services' estimate is slightly lower (by 0.02% of GDP) than that of the Belgian authorities (0.1% of GDP).

In sum, the Commission services estimate the ex-ante reduction in the deficit resulting directly from the measures in the budget to be about ¼% of GDP lower than the Belgian authorities[3]. This implies that the Commission assessment is in large part in line with the budget. It notably includes its projection of interest payments, despite the relatively high increase of interest rates which this projection implies (+10.7%). However, such an assumption may be regarded as prudent, which is warranted in the context of financial market uncertainties and a relatively large refinancing of debt in 2012 (about EUR 33.7 billion or 8.8% of GDP) of long term debt and 28.3 billion or 7.4% of GDP of short-term debt).

[3] This does not take into account the differences in the starting point of the forecast where the Commission had already foreseen a more prudent expansion of health expenditure than the baseline scenario of the Monitoring Committee.

To these divergences on the expected return of the consolidation measures, it should be added the ex-post increase in the deficit that will result from the impact of the adjustment package on growth, which does not seem to have been taken into account in the draft budget. The impact of the consolidation on growth can be estimated at about 0.3% of GDP. This assumes relatively low multipliers taking into account the nature of the measures and the large openness of the economy as well as high savings and tax rates and there is therefore some risk that this second round effect might eventually turn out to be somewhat higher. Consequently, the effect on the deficit is estimated at around 0.15% of GDP, using the 0.54 sensitivity coefficient (of the government balance to changes in GDP growth) computed by the Commission services[4]. Actually, once the differences in baseline have been accounted for, this second round effect constitutes the most sizeable divergence between the deficit estimates of the Belgian authorities and of the Commission services: starting from the budget estimate of 2.8% of GDP, this factor alone would be sufficient to bring the deficit in the immediate neighbourhood of the 3% of GDP reference value, so that any - even marginal - additional increase in the deficit would push it above that threshold.

Finally, since the Commission Services 2011 Autumn Forecast assumed a growth of 0.9% of GDP while the budget assumes 0.8%, a 0.05% of GDP positive correction is applied to the current calculations so that the assessment uses the same underlying growth forecast as the Autumn Forecast.

Table 5: Main divergences in 2012 between Belgian authorities' and Commission services' estimates (COM Jan 2012)

	Budget estimates		COM Jan 2012		Difference	
	EUR millions	**% GDP**	**EUR millions**	**% GDP**	**EUR millions**	**% GDP**
Divergences on tax revenues	3,550	0.93	3,242	0.85	-308.2	-0.08
Divergences on expenditure	2,782	0.73	2,306	0.60	-475.6	-0.12
Of which Federal state	1278	0.33	1,145	0.30	-133.1	-0.03
Of which Social security	878	0.23	611	0.16	-267.3	-0.07
Divergences on diverse measures	2,557	0.67	2,274	0.60	-282.9	-0.07
Total divergences on measures	8,889	2.33	7,822	2.05	-1,066.7	-0.28
Effect on the deficit of slower growth due to the consolidation	-	-	577	-0.15	-577.1	-0.15
Effect on the difference in growth assumptions (0.8% versus 0.9%)	-	-	-206	-0.05	+206.2	-0.05
Total difference	-	-	-	-	-1,437.6	-0.38
General government deficit before freeze	-10,690	-2.8	-12,128	-3.2	-1,437.6	-0.38

Whereas the draft budget and the implied second round effects would, according to the Commission assessment, have led to a deficit of around 3¼% of GDP (without taking into account the base effect from 2011 and the impact of the recent deterioration of the macroeconomic environment in the EU and Belgium specifically), further measures were decided on 6 January 2012 and implemented by a circular on 9 January and published in the Moniteur Belge. In particular, ahead of the budget control exercise planned for February,

[4] European Commission, New and updated budgetary sensitivities for the EU budgetary surveillance, September 2005 (http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/budg_sensitivities_092005_v02_en.pdf)

which can be expected to decide on savings measures based on a new assessment of the budgetary situation based on the outcome in 2011 and the deteriorated macroeconomic environment, the government has decided to freeze an additional EUR 1.3 billion of expenditure (about 0.35% of GDP). It concerns notably a freeze of EUR 280 million of the "interdepartmental provision", EUR 125 million of healthcare spending, EUR 400 million of transfers to the SNCB group, EUR 120 million of government investment and the postponement of the purchase of helicopters for the Defence Department (EUR 102 million).

Taking this additional measure into account including some second round effects, the Commission services estimate that the general government deficit will come out at about 2.9% of GDP, thus below the 3% of GDP threshold.

In 2013, according to the Commission services' 2011 Autumn forecast, the public deficit would have been 4.5% of GDP under the same "unchanged policy" assumption used for 2012. Taking into account the 2012 draft budget and the additional measures subsequently decided, it is now likely that the deficit would decline to about 2¾% of GDP, as a result of the lasting impact of the measures entered into force in 2011, of the effect of additional measures scheduled to enter into force in 2012 and of the recovery in growth after the slowdown in 2012 as foreseen in the Commission Services' 2011Autumn Forecast.

Table 6: Comparison of budgetary projections, including impact of measures announced/taken post Commission services' 2011 Autumn Forecast, general government balance (% of GDP)

	2010	**2011**	**2012**	**2013**
COM AF 2011	-4.1	-3.6	-4.6	-4.5
2012 Budget	-4.1	-3.6	-2.8	-1.8*
COM Jan 2012	-4.1	-3.6	-2.9	-2 ¾

** April 2011 update of the Stability Programme*
Sources: Commission services and Belgian authorities

On the basis of the Commission services' 2011 Autumn Forecast the annual average change in the structural budget balance over the adjustment period 2010-2012 was estimated at -0.1% of GDP (see Table 3). Taking into account the Commission services' updated assessment of the 2012 budget, i.e. should the expected deficit decline below 3% of GDP in 2012 as a result of the consolidation measures announced in the draft budget and in the decision of 6 January, the structural effort in 2012 would amount to about ½% of GDP. The cumulative effort over the period 2010-2012 would thus come out at about 1½% of GDP, around ¾% of GDP lower than the recommendation of the Council (2¼% over three years). This implies that the annual average effort of 0.5% of GDP is well below the ¾% of GDP recommended by the Council.

However, while this assessment is not based on a full update of the 2011 Autumn Forecast, the economic situation seems to be changing significantly. In particular, in view of the latest available information, the macroeconomic scenario supporting the 2012 draft budget (with expected real GDP growth of 0.8% in 2012) could be too optimistic. The additional decline in consumer and business confidence recorded in recent months are reflecting more negative prospects for private consumption and investment, so that the growth expectations for the fourth quarter of 2011 and the first half of 2012 are lower than expected in September or

October 2011[5] when the macroeconomic projections underlying the budget as well as the Commission services autumn forecast were carried out. Specifically, the latest projections of the National Bank of Belgium (NBB) released on 14 December 2011 already present a picture of a Belgian economy growing by only 0.5% in 2012. Moreover, the quarterly growth figures of the second and third quarter of 2011 have been revised downwards, resulting in a lower carry-over into 2012 of about 0.2 pp. At present, a more realistic growth forecast for 2012 could be that of close to zero growth[6].

Furthermore, the latest forecast from the National Bank of Belgium indicates that the government deficit might have turned out at 4.2% of GDP in 2011, substantially higher than the 3.6% of GDP on which the 2012 budget was built. About half of this upward revision would be explained by recurrent factors, the rest being due to additional, presumably non-recurrent spending related to the support of Dexia. The 2012 deficit could thus increase by about 0.3 pp. due to the base effect stemming from the higher deficit in 2011.

Additionally, as the Treaty reference values for the deficit and debt apply to the general government as a whole, the effort cannot be limited to Entity I (federal government and social security) but should also include Entity II (regions, communities and municipalities). However, the federal level has limited means to control and rein in the spending of the regions and communities and therefore, a higher deficit from those government tiers than the currently planned 0.4% of GDP for 2012 cannot excluded at this point in time.

Moreover, implementation risks might be higher than expected given the nature of certain key measures (such as fight against fraud or the increase in efficiency of the administration). Finally, there is a risk that the second round effect of the measures in the budget and the subsequent expenditure freeze may be higher than expected.

3.3. Debt developments

According to the Commission services' 2011 Autumn Forecast, gross general government debt, which reached 96.2% of GDP in 2010, is projected to continue to rise over the forecast horizon on the back of the persisting deficits and exogenous factors like the take-over of the Belgian subsidiary of Dexia. Debt projections also include the impact of guarantees to the European Financial Stability Facility (EFSF), bilateral loans to Greece and the participation in the capital of the European Stability Mechanism (ESM) as planned on the cut-off date of 2011 Autumn Forecast. Under the no-policy-change scenario, on which the Commission services' autumn 2012 forecast has been based, gross public debt was expected to reach just above 100% of GDP by 2013. Based on this preliminary estimate of the 2012 deficit but taking also into account additional factors that are likely to have increased the debt in 2011 (like the Dexia take-over which according to the NBB might represent around 0.3% of GDP), the debt ratio will probably remain just below 100% in 2012 and possibly also in 2013.

Beyond 2013 and under the assumption of no further policy changes, the debt ratio would be on an increasing path and reach 114 % of GDP by 2020. However, an additional annual

5 Hoge Raad van Financiën – Bijwerking van het advies van maart 2011 ten gevolge van de gewijzigde economische context, October 2011. This report contained already a growth update compared to the latest report of the Monitoring Committee of 30 September 2011, in which the growth prediction for 2012 was still 1.6%.

6 The consensus growth projection for 2012 has been revised to 0.1%. See NBB, Belgian prime news, n° 54, 6 January 2012. (http://www.nbb.be/doc/ts/Publications/BPNews/bpn54.pdf).

structural fiscal consolidation of 0.5 p.p. of GDP from 2014 onwards in order to reach the MTO would almost stabilise the debt ratio, reaching 101 % of GDP in 2020. A more ambitious consolidation effort (of 1 p.p. per annum) would set the debt ratio on a declining path from 2015 onwards in Belgium.