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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

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1. INTRODUCTION

Belgium has submitted its Draft Budgetary Plan for 2015 on 15 October 2014 in compliance with Regulation (EU) No 473/2013 of the Two-Pack and updated its Draft Budgetary Plan on 22 October 2014 with recently taken budgetary measures for 2015. Belgium is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO.

As the debt ratio was 104.5% of GDP in 2013 (the year in which Belgium corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit, Belgium is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark. In this period it should ensure sufficient progress towards compliance.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 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 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 2014-2015 (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 adopted by the Council on 8 July 2014, 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 macroeconomic scenario underlying Belgium's 2015 Draft Budgetary Plan (DBP) assumes a less dynamic recovery than the latest Stability Programme. Yet, as compared to the Commission 2014 autumn forecast, the DBP scenario for 2015 appears still optimistic.

Following the modest expansion (by 0.3%) in 2013, economic activity would grow by 1.1% in 2014 and accelerate further in 2015 with growth reaching 1.5%, according to the DBP scenario. This compares with a more muted Commission forecast for both years, with GDP projected to expand by 0.9%.

Table 1. Comparison of macroeconomic developments and forecasts

	2013	2014			2015		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0.3	1.4	1.1	0.9	1.8	1.5	0.9
Private consumption (% change)	0.3	1.3	1.2	1.2	1.6	1.2	1.0
Gross fixed capital formation (% change)	-2.2	1.3	3.3	3.6	3.1	1.7	0.9
Exports of goods and services (% change)	2.9	3.0	2.3	3.0	4.1	3.2	2.9
Imports of goods and services (% change)	1.8	2.7	2.0	2.9	3.9	2.9	2.8
Contributions to real GDP growth:							
- Final domestic demand	-0.1	1.2	1.6	1.7	1.7	1.2	0.7
- Change in inventories	-0.5	0.0	-0.8	-0.8	0.0	0.0	0.0
- Net exports	0.8	0.3	0.3	0.1	0.2	0.3	0.2
Output gap[1]	-1.3	-1.2	-1.3	-1.1	-0.5	-0.8	-1.1
Employment (% change)	-0.3	0.3	0.2	0.2	0.7	0.9	0.4
Unemployment rate (%)	8.4	8.4	8.5	8.5	8.3	8.3	8.4
Labour productivity (% change)	0.6	1.2	1.0	0.7	1.1	0.8	0.5
HICP inflation (%)	1.2	0.9	0.6	0.6	1.3	1.3	0.9
GDP deflator (% change)	1.5	1.4	0.9	0.8	1.6	1.4	0.6
Comp. of employees (per head, % change)	2.6	0.7	1.0	0.6	2.0	1.6	0.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.5	0.8	n.a.	-0.1	1.4	n.a.	-0.5

Note:
[1]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 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

The sizeable difference between both forecasts for 2015 can be attributed to several factors. First, the Commission autumn forecast assumes government consumption to contract by 0.3% as compared to an expansion by 0.7% in the macroeconomic scenario. While the latter precedes the actual DBP exercise and departs from a no-policy-change assumption for 2015, the Commission forecast includes the government measures spelled out in the DBP. This results in a GDP growth differential of about 0.2 pp. Slower investment growth (1.7% in the DBP vs. 0.9% in the Commission forecast) causes a comparable difference in overall growth. Concerning household consumption, the difference is less marked (1.2% in the DBP vs. 1.0% in the Commission forecast) and can be largely explained by fiscal measures contained in the draft budget and recently announced wage policies, which were evidently unknown at the time the macroeconomic scenario was drafted. Finally, there is a small difference in the contribution by net exports to overall growth (0.3 pp. in the DBP vs. 0.2 pp. in the Commission forecast).

The differing growth profile is reflected in the different expected labour market outcomes. As the DBP scenario did not yet include the decisions by the different government levels with regard to hiring and replacement policies in the public sector, overall employment is projected to rise by 0.9% in 2015, as compared to 0.4% in the Commission forecast. The consequence is a somewhat slower decrease in the unemployment rate, which, at 8.4%, would remain close to the 2014 level of 8.5%. Also the difference between the DBP scenario and the Commission projections regarding price pressures are in line with the differing assessment of the real economy.

All in all, differences for the 2015 growth aggregates between both forecasts can to a large extent be explained by their different timing relative to the 2015 DBP. Nevertheless, the fact remains that the difference is substantial, which affects the robustness of the targets set in the DBP. This highlights the potential value added of fully incorporating second-round effects whilst drafting the budget.

Box 1: The macro economic forecast underpinning the budget in Belgium

The macroeconomic forecast underlying the Draft Budgetary Plan was provided by the National Accounts Institute in September 2014, providing the federal government as well as regions and communities with a common forecast that serves as a starting point for their budgetary projections. The preparation of this macroeconomic forecast is delegated by law to the Federal Planning Bureau (FPB).

The FBP is a well-established institution formally attached to the Government which positions itself as an independent institution. As stipulated in the Law of 21/12/1994 that constituted the FPB in its current form, supervision of the institution lies with the Prime Minister and the Minister of Economic Affairs, while guidance on its proceedings originates from the Federal Government with also the Belgian Parliament and the Central Economic Council or the National Labour Council able to seek an evaluation by the FPB of the federal government's economic, social and environmental policies[1].

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan projects a deficit of 2.9% of GDP in 2014, substantially higher than the target of 2.1% of GDP of the Stability Programme[2]. First of all, statistical revisions since the submission of the programme (including the changeover to ESA 2010 accounting standards) entailed an upward revision of the 2013 deficit outcome by 0.3 pp. of GDP, which also affects the budgetary projections for subsequent years. Secondly, the growth outlook for 2014 has been revised downwards. Lastly, the improvement of the structural balance[3] is revised downwards by 0.2 pp., to 0.3% of GDP. In this respect, besides the low GDP growth, also the downward revision of inflation weighs on tax revenues. According to the Commission autumn forecast, the deficit is expected to come out even slightly higher, at 3.0% of GDP, mainly explained by the worse macroeconomic projections compared to the DBP.

[1] *Wet houdende sociale en diverse bepalingen*, 21 december 1994, TITEL VIII - hervorming van het apparaat voor de statistiek en de economische vooruitzichten van de federale regering, HOOFDSTUK IV. - Het Federaal Planbureau, Art. 124-131.

[2] Revenue-to-GDP and expenditure-to-GDP ratios of the DBP and the Commission forecast cannot be directly compared to the figures of the Stability Programme, because the transition towards ESA 2010 since the latest Stability Programme and other statistical reclassifications affected both the general government accounts as well as the GDP level.

[3] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

While the (indicative) trajectory[4] of the 2014 Stability Programme targeted a headline deficit of 1.4% of GDP in 2015, the DBP targets a deficit of 2.1%. This upward revision is explained by the worse-than-previously expected economic outlook and by recent statistical revisions. The (recalculated) structural improvement of the DBP for 2015 is similar to the effort planned in the latest Stability Programme. The fiscal adjustment planned in the DBP is primarily on the expenditure side, especially in social payments, subsidies and interest expenditure.

The Commission 2014 autumn forecast projects a much higher headline deficit in 2015 than the DBP. To some extent, this is due to the more subdued GDP growth underlying the Commission forecast, which explains almost 0.4 pp. of GDP of the projected gap. Secondly, there is a slightly negative base effect of 0.1 pp. of GDP stemming from the more negative assessment of the budgetary outcome in 2014 according to the Commission forecast. Lastly, there is also a different assessment of the impact of new measures (impact of 0.2 pp. of GDP), as only the measures that were public and sufficiently specified at the time of the cut-off were taken into account in the Commission forecast. In particular, it is unclear at this stage how the budgeted impact of some of the measures specified in the Draft Budgetary Plan will be attained.

In terms of change in the structural balance, the Commission forecast is also more pessimistic than the DBP. This is notably due to the different assessment of the impact of new measures (see above) as well as a different assessment of the amount of one-off measures (see section 3.3).

The DBP also contains an updated fiscal trajectory up to 2018, with the target year for a balanced budget in structural terms postponed from 2016 to 2018. This revised trajectory will be assessed in spring in the context of the 2015 Stability Programme.

[4] Due to the end of the government's term and the national and regional elections held at the end of May 2014, the fiscal trajectory contained in the 2014 Stability Programme, which was based on the recommendations of the High Council of Finance, was labelled as indicative.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2013	2014			2015			Change: 2013-2015
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**51.5**	**51.1**	***51.3***	**50.9**	**51.3**	***50.9***	**50.7**	**-0.6**
of which:								
- Taxes on production and imports	12.9	12.9	*13.0*	13.0	12.8	*12.9*	13.0	0.0
- Current taxes on income, wealth, etc.	16.7	17.2	*16.9*	16.3	17.7	*17.0*	16.4	0.3
- Capital taxes	1.0	1.1	*1.0*	1.1	0.9	*0.9*	0.9	-0.1
- Social contributions	16.6	16.8	*16.5*	16.5	16.8	*16.2*	16.5	-0.4
- Other (residual)	4.3	3.1	*3.9*	3.9	3.1	*3.9*	3.8	-0.4
Expenditure	**54.4**	**53.3**	**54.1**	**53.8**	**52.8**	**53.0**	**53.4**	**-1.4**
of which:								
- Primary expenditure	51.2	50.2	51.1	50.7	49.8	50.2	50.5	-1.1
of which:								
Compensation of employees	12.5	n.a.	12.3	12.3	n.a.	12.2	12.1	-0.3
Intermediate consumption	4.0	n.a.	3.9	3.9	n.a.	3.7	3.7	-0.2
Social payments	25.2	26.3	25.3	25.5	26.1	25.0	25.8	-0.1
Subsidies	2.9	2.3	3.0	2.9	2.4	2.8	2.9	-0.2
Gross fixed capital formation	2.2	1.5	2.1	2.1	1.6	2.1	2.2	0.0
Other (residual)	4.6	n.a.	4.5	4.0	n.a.	4.4	3.8	-0.2
- Interest expenditure	3.2	3.1	3.1	3.1	3.0	2.8	2.9	-0.3
General government balance (GGB)	**-2.9**	**-2.1**	**-2.9**	**-3.0**	**-1.4**	**-2.1**	**-2.8**	**0.8**
Primary balance	**0.3**	**1.0**	**0.2**	**0.1**	**1.6**	**0.7**	**0.1**	**0.5**
One-off and other temporary	0.6	0.3	0.2	0.4	0.0	0.0	0.2	-0.5
GGB excl. one-offs	**-3.5**	**-2.4**	**-3.1**	**-3.3**	**-1.4**	**-2.2**	**-2.9**	**1.3**
Output gap[1]	-1.3	-1.2	-1.3	-1.1	-0.5	-0.8	-1.1	0.7
Cyclically-adjusted balance[1]	-2.1	-1.4	-2.1	-2.3	-1.1	-1.6	-2.1	0.4
Structural balance (SB)[2]	**-2.7**	**-1.7**	**-2.3**	**-2.6**	**-1.1**	**-1.7**	**-2.2**	**0.9**
Structural primary balance[2]	0.5	1.4	0.7	0.4	1.9	1.2	0.6	0.6

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 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.2. Debt developments

Due to statistical reclassifications, Belgium's government debt has been revised upwards by almost 7 pps. of GDP since the submission of the 2014 Stability Programme. This was partly offset by a rise in GDP following the transition to ESA 2010, which limited the overall increase in the 2013 debt-to-GDP ratio to 3 pps. of GDP. The Stability Programme counted on a stabilization of the debt ratio in 2014 and a sizable decrease in 2015. Due to the lower than expected primary surplus and lower nominal GDP growth, the DBP expects a further rise in the debt ratio in 2014 and a rather modest decrease in 2015. The Commission forecast projects a further increase in 2015, to over 107% of GDP. Although interest expenditure is historically low, very low nominal GDP growth creates a strong "snowball" effect. Stock-flow adjustments have a limited net impact on gross debt levels over the projection horizon.

Table 3. Debt developments

(% of GDP)	2013	2014			2015		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**104.5**	**101.2**	**105.6**	**105.8**	**99.4**	**105.1**	**107.3**
Change in the ratio	0.6	-0.3	1.1	1.3	-1.8	-0.5	1.5
Contributions[2] *:*							
1. Primary balance	**-0.3**	**-1.0**	**-0.2**	**-0.1**	**-1.6**	**-0.7**	**-0.1**
2. "Snow-ball" effect	**1.3**	**0.3**	**1.0**	**1.3**	**-0.4**	**-0.1**	**1.4**
Of which:							
Interest expenditure	3.2	3.1	3.1	3.1	3.0	2.8	2.9
Growth effect	-0.3	-1.4	-1.1	-0.9	-1.8	-1.5	-0.9
Inflation effect	-1.6	-1.5	-0.9	-0.8	-1.6	-1.4	-0.6
3. Stock-flow adjustment	**-0.5**	**0.4**	**0.2**	**0.1**	**0.2**	**0.3**	**0.2**
Of which:							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial		n.a.	n.a.		n.a.	n.a.	
of which privatisation proceeds		n.a.	n.a.		n.a	n.a.	
Valuation effect & residual		n.a.	n.a.		n.a.	n.a.	

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

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.3. Measures underpinning the draft budgetary plan

Consolidation measures envisaged in the Draft Budgetary Plan focus on expenditure restraint, with an overall impact of 1.4% of GDP at face value. They include linear cuts in staff, operating costs and investment of the central state (0.1% of GDP), cuts in development cooperation and defence expenditure (0.1% of GDP taken together) and a reduction of subsidies to the national railway company (0.05%). In the social security sector, the real growth ceiling of health expenditure has been revised downwards (0.2% of GDP) and access conditions for some social benefits have been tightened (0.1% of GDP). Regions and communities also announce a series of expenditure cuts with an impact of 0.3% of GDP.

Finally, there are two other planned measures which lower overall expenditure but for which the impact on the budget balance is said to be offset on the revenue side. Firstly, the temporary suspension of the automatic indexation of public sector wages and social benefits (the so-called 'index jump') is expected to decrease federal government expenditure by 0.25% of GDP. The positive budgetary impact is expected to be fully offset by a decrease in federal tax revenues, notably because also wages in the private sector will not be indexed. The impact on expenditure and revenues of other government entities (regions, communities and local authorities) is not specified in the DBP. Secondly, the federal government plans to transform the semi-automatic welfare adjustments of social benefits (0.1% of GDP) into a tax credit in a budgetary neutral way. It will depend on the precise design of the measure – which is not clear at this stage – if it will indeed result in a decrease of expenditure and revenue ratios.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government – revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Taxes on production and	n.a.	0.1	n.a.
Current taxes on income, wealth,	n.a.	-0.2	n.a.
Capital taxes	n.a.	0.1	n.a.
Social contributions	n.a.	-0.1	n.a.
Property Income	n.a.	0.0	n.a.
Other	n.a.	0.1	n.a.
Total	n.a.	0.0	n.a.

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan 2015

B. Discretionary measures taken by General Government – expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Compensation of employees	n.a.	-0.2	n.a.
Intermediate consumption	n.a.	-0.2	n.a.
Social payments	n.a.	-0.7	n.a.
Interest Expenditure	n.a.	-0.1	n.a.
Subsidies	n.a.	0.0	n.a.
Gross fixed capital formation	n.a.	-0.3	n.a.
Capital transfers	n.a.	0.0	n.a.
Other	n.a.	0.0	n.a.
Total	n.a.	-1.4	n.a.

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan 2015

The overall impact of new measures on the revenue side is planned to be neutral (when taking into account both budgetary neutral measures mentioned above which have a planned impact of -0.25% of GDP on revenues). Tax increases (+0.3% of GDP) include an advanced taxation of pension savings, an inclusion of intermunicipal corporations ('intercommunales') in corporate income taxation, an increase in excise duties, and an increase in the stock exchange tax and annual contribution by banks. In addition, a reduction in social security contributions announced by the previous government for 2015 has been postponed to 2016 (+0.1% of GDP). On the other hand, the DBP includes some personal income tax reductions (-0.15% of GDP) in order to compensate workers' purchasing power for the negative impact of the suspension of wage indexation.

Most measures had been sufficiently specified to be taken into account in the Commission forecast. However, a number of announced measures are actually updated estimates (e.g. increase in dividend revenue, second-round effects of competitiveness measures), while for some other measures it is unclear at this stage how the estimated impact will be attained (e.g. the impact of stricter conditions for some social benefits, some anti-fraud measures, the reform of the tax on liquidation surpluses, abolishment of a special anti-fraud fine). It should be noted that some measures with a positive impact on the federal budget, might have an adverse impact on other entities (e.g. the smaller federal PIT base on which regions and local authorities levy surcharges, the taxation of intermunicipal corporations might affect dividend revenue of local government). Lastly, the advanced taxation of the existing stock of pension savings during the next five years (planned annual revenue of 0.07% of GDP) constitutes only a temporary change in the timing of revenues and should thus be considered as a one-off measure which does not improve the structural budget balance.

Some new measures aim to lower the very high tax burden on labour, while focussing tax increases on capital and consumption. However, the overall tax shift away from labour remains very limited, while the potential to shift taxes more to consumption and pollution remains largely unexploited (see also box 3).

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

Box 2. Council recommendations addressed to Belgium

On 8 July 2014, 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 reinforce the budgetary measures for 2014 in the light of the emerging gap of 0.5% of GDP based on the Commission services 2014 spring forecast, pointing to a risk of significant deviation relative to the preventive arm of the Stability and Growth Pact requirements. In 2015, significantly strengthen the budgetary strategy to ensure the required adjustment of 0.6% of GDP towards the medium-term objective, which would also ensure compliance with the debt rule. Thereafter, until the medium-term objective is achieved, pursue the planned annual structural adjustment towards the medium-term objective, in line with the requirement of an annual structural adjustment of at least 0.5% of GDP, and more in good economic conditions or if needed to ensure that the debt rule is met in order to put the high general government debt ratio on a sustained downward path. Ensure a balanced contribution by all levels of government to the fulfilment of fiscal rules including the structural budget balance rule, through a binding instrument with an explicit breakdown of targets within a medium-term planning perspective.

The Council also recommended Belgium to improve the balance and fairness of the overall tax system and prepare a comprehensive tax reform that will allow shifting taxes away from labour towards more growth friendly bases, simplifying the tax system, closing loopholes, increasing VAT efficiency, broadening tax bases, reducing tax expenditures and phasing out environmentally harmful subsidies.

Belgium was also recommended to contain future public expenditure growth relating to ageing, in particular from pensions and long-term care, by stepping up efforts to reduce the gap between the effective and statutory retirement age, bringing forward the reduction of early-exit possibilities, promoting active ageing, aligning the retirement age to changes in life expectancy, and improving the cost-effectiveness of public spending on long-term care.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2013, Belgium is in a transition period to comply with the debt reduction benchmark. The DBP does not include sufficient information to assess compliance with the transitional arrangements of the debt benchmark.

Based on the Commission 2014 autumn forecast, the deviation from the minimum linear structural adjustment (MLSA) exceeds the allowed deviation in both 2014 and 2015. It should be noted that the required MLSA has been revised substantially upwards since the 2014 spring forecast and the assessment of the Stability Programme, from 0.3% of GDP to 0.8% of GDP in 2014 and from 0.5% of GDP to 1.1% of GDP in 2015. The increase in MLSA is mainly due to the downward revision in nominal GDP growth prospects since the spring forecast and upward revision of the 2013 deficit outcome. Both factors make the structural effort needed to put the debt ratio on a sufficiently decreasing path at the end of the transition period more demanding.

On 12 November 2014, the federal government tabled its draft 2015 budget law in Parliament. The medium-term economic scenario included in this draft law would require a lower MLSA, notably thanks to the higher projected nominal growth. A preliminary analysis of the budgetary targets (taken at face value) included in the budget law points to its consistency with the transitional arrangements of the debt rule in 2015.

Table 6. Compliance with the debt criterion*

	2014		2015		
	DBP	COM	SP	DBP	COM
Gap to the debt benchmark [1,2]	n.r.	n.r.	n.r.	n.r.	n.r.
Structural adjustment [3]	0.3	0.1	0.6	0.7	0.4
To be compared to:					
Required adjustment [4]	n.a.	0.8	n.a.	n.a.	1.1

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 (DBP) budgetary projections for the previous years are achieved and that GDP growth follows COM (DBP) forecast.

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

* An ex-ante assessment of planned compliance with the debt criterion can be assessed based on the DBP only for the concerned countries providing extended data series in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September.

4.2. Adjustment towards the MTO

For 2014, the change of the (recalculated) structural balance in the DBP is insufficient to meet the required adjustment of 0.5% of GDP, but the deviation is not significant. The deviation projected in the Commission 2014 autumn forecast is larger; but still not significant. According to the information provided in the Draft Budgetary Plan, the growth rate of government expenditure, net of discretionary revenue measures, in 2014 is expected to contribute to the required annual structural adjustment of 0.5% of GDP towards the MTO. This is because the growth rate of net expenditure is below 0.17%, the applicable expenditure benchmark for 2014. This assessment is confirmed by the Commission 2014 autumn forecast for 2014. The divergent messages of both indicators, according to the DBP as well as the Commission forecast, is partly due to the occurrence of sizeable revenue shortfalls compared to standard elasticities, which has a negative impact of 0.7% of GDP on the structural balance (0.8% of GDP according to the DBP) while it does not impact on the expenditure benchmark. On the other hand, the reference growth rate underlying the expenditure benchmark may allow for too dynamic expenditure developments in view of the current lower estimates of the potential growth rate.

In 2015, the planned change of the (recalculated) structural balance in the DBP is appropriate. According to the Commission forecast, the structural improvement in 2015 falls currently short of the required 0.6% of GDP effort, but the deviation is below the threshold of significance. The divergence between the DBP and the Commission forecast is explained by a different assessment of the impact of measures as well as a different assessment of the size of one-offs.

According to the information provided in the Draft Budgetary Plan, the growth rate of government expenditure, net of discretionary revenue measures, in 2015 is not expected to ensure the required 0.6% of GDP annual structural adjustment towards the MTO. This is because the growth rate of expenditure (net of discretionary revenue measures) is slightly above -0.03%, the applicable expenditure benchmark for 2015. The divergence with the evolution of the structural balance can be explained by the decrease in one-off revenues in 2015 according to the plans, which affects negatively the expenditure benchmark[5] while it is neutral for the structural balance.

The Commission forecast also shows an expenditure growth, net of discretionary revenue measures, above the reference rate. In this projection, the deviation has a negative impact of 0.2% of GDP on the 2015 structural balance. This is in line with the assessment of the structural balance, which also shows a shortfall of 0.2pp. of GDP compared to the required effort of 0.6% of GDP.

Even if the deviations on the basis of the structural balance are not judged to be significant in 2014 and 2015 individually, on the basis of the Commission 2014 autumn forecast, there is a risk that the projected change over 2014 and 2015 together leads to a significant deviation over 2014-2015. The average deviation from the required adjustment is projected at -0.3 pp. of GDP, just above the threshold for significance for the two year assessment which is at 0.25 pp. on average. At the same time, the expenditure benchmark is fully met over 2014-2015. The explanation for the different messages emerging from the insufficient improvement in the structural balance and the overachievement of the expenditure benchmark is the same as for 2014 individually, where the largest slippage is expected. Firstly, the potential GDP growth rate in 2014 and 2015 used as a benchmark for the computation of the structural balance is substantially lower than the benchmark rate used in the computation of the expenditure benchmark. Secondly, the occurrence of sizeable revenue shortfalls in 2014, which is observed in both the DBP as well as the Commission projection, affects the structural balance in 2014 and is not projected to be offset by windfall revenues in 2015.

Following an overall assessment of the Member State’s Draft Budgetary Plan, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, some deviation from the adjustment path towards the MTO is to be expected in 2014-2015.

[5] Notably because expenditure increases matched by discretionary revenue measures (including one-off revenue measures) are netted out.

Table 7. Adjustment towards the MTO

<table>
<tr><td>(% of GDP)</td><td>2013</td><td colspan="2">2014</td><td colspan="2">2015</td></tr>
<tr><td colspan="6">Initial position[1]</td></tr>
<tr><td>Medium-term objective (MTO)</td><td>0.8</td><td colspan="2">0.8</td><td colspan="2">0.8</td></tr>
<tr><td>Structural balance[2] (COM)</td><td>-2.7</td><td colspan="2">-2.6</td><td colspan="2">-2.2</td></tr>
<tr><td>Structural balance based on freezing (COM)</td><td>-2.3</td><td colspan="2">-2.3</td><td colspan="2">-</td></tr>
<tr><td>Position vis-a -vis the MTO[3]</td><td>Not at MTO</td><td colspan="2">Not at MTO</td><td colspan="2">Not at MTO</td></tr>
<tr><td rowspan="2">(% of GDP)</td><td>2013</td><td colspan="2">2014</td><td colspan="2">2015</td></tr>
<tr><td>COM</td><td>DBP</td><td>COM</td><td>DBP</td><td>COM</td></tr>
<tr><td colspan="6">Structural balance pillar</td></tr>
<tr><td>Required adjustment[4]</td><td rowspan="5">n.a.
in EDP in
2013</td><td colspan="2">0.5</td><td colspan="2">0.6</td></tr>
<tr><td>Change in structural balance[5]</td><td>0.3</td><td>0.1</td><td>0.7</td><td>0.4</td></tr>
<tr><td>One-year deviation from the required adjustment after considering the relevant factors [6]</td><td>-0.2</td><td>-0.4</td><td>0.1</td><td>-0.2</td></tr>
<tr><td>Two-year average change in structural balance[5]</td><td colspan="2" rowspan="2">n.a.
in EDP in 2013</td><td>0.5</td><td>0.2</td></tr>
<tr><td>Two-year average deviation from the required adjustment after considering the relevant factors [6]</td><td>-0.1</td><td>-0.3</td></tr>
<tr><td colspan="6">Expenditure benchmark pillar</td></tr>
<tr><td>Applicable reference rate[7]</td><td rowspan="3">n.a.
in EDP in
2013</td><td colspan="2">0.2</td><td colspan="2">0.0</td></tr>
<tr><td>One-year deviation [8]</td><td>0.6</td><td>0.5</td><td>-0.1</td><td>-0.2</td></tr>
<tr><td>Two-year average deviation [8]</td><td colspan="2">n.a. in EDP in 2013</td><td>0.3</td><td>0.1</td></tr>
<tr><td colspan="6">Conclusion</td></tr>
<tr><td>Conclusion over one year</td><td rowspan="2">n.a.
in EDP in
2013</td><td>Overall assessment</td><td>Overall assessment</td><td>Overall assessment</td><td>Overall assessment</td></tr>
<tr><td>Conclusion over two years</td><td colspan="2">n.a. in EDP in 2013</td><td>Overall assessment</td><td>Overall assessment</td></tr>
</table>

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 28.).

[5] Change in the structural balance compared to year t-1. Expost assessment (for 2013) is carried out on the basis of Commission 2014 spring forecast.

[6] The difference of the change in the structural balance and the required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[7] 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 lower rate applies as long as the country is adjusting towards its MTO, including in year t. The reference rates applicable to 2014 onwards have been updated in 2013.

[8] 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 :

Draft Budgetary Plan 2015 (DBP), Commission 2014 autumn forecast (COM), Commission calculations

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

Several measures outlined in the 2015 Draft Budgetary Plan relate to the issues of low labour market participation and financial disincentives to work underlined in the Council's country-specific recommendations addressed to Belgium (see also Box 3). Thus, for instance, the DBP includes various changes in the unemployment benefit system such as the abolition of seniority top-ups for elderly long-term unemployed, the introduction of a less favourable benefit calculation method for regular unemployment benefits, the further tightening of the eligibility requirements for the insertion allowance for young unemployed and the reduction of the benefit top-up for part-time unemployed. Also, the initiated reforms of the pre-retirement and early retirement schemes are carried further to reduce the gap between the effective and statutory retirement age.

The 2015 DBP also foresees a temporary suspension of wage and social benefit indexation, with some compensation foreseen for the lowest incomes. Apart from its direct budgetary impact, this measure is intended to reduce the wage cost differential accumulated in the past versus other countries. While a positive effect on the country's competitiveness position could thus be expected, it should nevertheless be highlighted that the Council's recommendation called upon Belgium to reform the full wage-setting system in a structural way.

Box 3. Addressing the tax wedge

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 its commitment to effectively reduce the tax burden on labour. It will take stock of Member States' plans for reductions of the tax burden when discussing the DBPs. In the context of the European Semester, Belgium was issued the recommendations to "increase labour market participation, in particular by reducing financial disincentives to work" and to "prepare a comprehensive tax reform that will allow shifting taxes away from labour towards more growth friendly bases."

The tax wedge in Belgium is well above the EU average. The tax wedge for a single person without children earning 50% of the average wage was 41.9% compared to an EU average of 34% in 2013, for 67% of the average wage it was 50.1% (EU average: 37.7%) and for the average wage it was 55.8% (EU average: 41.1%). The Belgian employment rate in 2013 was 67.2% against a 68.4% EU average.

Belgium's Draft Budgetary Plan contains the plan to increase the fixed professional cost deduction in personal income taxation as of 2015. This measure affects all workers which do not make use of the possibility to specify their professional costs. As such, it should slightly narrow the tax wedge for all labour income categories and strengthen the take-home pay. The Draft Budgetary Plan also highlights how the planned increase of excise duties and the so-called harmonization of VAT need to be seen in the context of a tax shift towards non-labour sources. The same could possibly be said about the non-indexation of a series of tax expenditures and some taxes on financial income. However, considering the limited amounts involved, these measures appear to fall short of a comprehensive rethinking of the tax system.

With regard to efforts to push back high tax pressure on labour, the reduction of employers' social contributions by EUR 450 mn (0.1% of GDP) as announced in the 2013 'Competitiveness Pact' will be postponed by one year, i.e. from 2015 to 2016, while at the same time the reduction announced for 2017 will be brought forward by one year. In addition, when drafting its 2015 budget, Flanders came back on the commitment to budget EUR 125mn (0.03% of GDP) to reduce wage costs for employees under 30 or over 55 in Flanders.

6. OVERALL CONCLUSION

Based on the Commission 2014 autumn forecast, the deviation from the required minimum linear structural adjustment under the transitional debt rule exceeds the allowed deviation in both 2014 and 2015.

In 2014, Belgium plans to deviate from the adjustment path towards the medium term objective, but the deviation is not judged significant. In 2015, the planned progress towards the medium term objective is appropriate when taken at face value. However, according to the Commission autumn forecast, a deviation is currently expected both in 2014 and 2015, which does not breach the threshold of significance. The accumulation of both shortfalls, which mainly occurred in 2014, also leads to a risk of some deviation with respect to the two-year benchmark.

Following an overall assessment of the Member State's Draft Budgetary Plan, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, some deviation from the adjustment path towards the MTO is to be expected in 2014-2015.