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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(2018) 8011 final}

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1. INTRODUCTION

Belgium submitted its Draft Budgetary Plan for 2019 (DBP) on 15 October 2018 in compliance with Regulation (EU) No 473/2013. Belgium is subject to the preventive arm of the Stability and Growth Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO) of a balanced budget in structural terms. As the debt ratio was 103.4% of GDP in 2017 Belgium also needs to comply with the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2018 autumn forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2018 autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2018-2019 (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 2018, 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 DBP scenario projects the Belgian economy to grow by 1.5% in both 2018 and 2019, after 1.7% in 2017. This pattern is somewhat less buoyant than what was envisaged in the Stability Programme but concurs with the Commission 2018 autumn forecast. According to the DBP and the Commission projections, the (recalculated[1]) output gap is expected to reach 0.1% of potential GDP in 2018 and 0.3% in 2019.

According to the DBP projections and the Commission forecast economic growth is expected to be driven by domestic demand in 2019. The DBP expects net exports to weigh on GDP growth in 2019, whereas a neutral contribution is projected in the Commission autumn forecast. After an expected deceleration in 2018 to 0.9%, household consumption growth would pick up again in 2019, to 1.6% and 1.5% in the DBP 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

[1] 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.

remain robust in 2019, albeit at a slower pace in both projections, while the unemployment rate is forecast to decrease towards 5.7% next year according to the DBP and 5.9% according to the Commission.

Public investment growth is expected to have accelerated in 2018 as a result of the local investment cycle, and is projected to decelerate in 2019. Nevertheless, Belgium would still remain at the low end of public investment in the EU, compared to other EU Member States. The DBP scenario projects total investment to increase by 3.4% in 2018 and 2.8% in 2019, a somewhat higher pace than in the Commission 2018 autumn forecast. This reflects a continued investment effort by companies given high capacity utilisation, favourable financing conditions and strong profit margins.

The DBP expects headline inflation to decrease slightly from 2.2% in 2017 to 2.0% in 2018 and 1.9% in 2019, whereas the Commission autumn forecast expects inflation to slightly accelerate to 2.3% in 2018 before slowing down to 2.1% in 2019. The difference is expected to stem mostly from differing assumptions regarding the evolution of energy prices. This notably contributes to a higher GDP deflator in the Commission forecast in 2018 and 2019 compared to what is projected in the DBP.

All in all, differences between the DBP scenario and the Commission 2018 autumn forecast are small, both with respect to the overall growth rate and to its composition. The DBP scenario is therefore assessed plausible.

Table 1. Comparison of macroeconomic developments and forecasts

	2017	2018			2019		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1,7	1,8	1,5	1,5	1,7	1,5	1,5
Private consumption (% change)	1,1	1,7	0,9	0,9	1,7	1,6	1,5
Gross fixed capital formation (% change)	1,8	3,9	3,4	2,6	2,9	2,8	2,3
Exports of goods and services (% change)	5,0	4,2	3,1	3,4	3,6	3,5	3,2
Imports of goods and services (% change)	4,3	4,3	2,7	3,1	3,8	3,8	3,3
Contributions to real GDP growth:							
- Final domestic demand	1,1	1,8	1,1	1,2	1,8	1,7	1,5
- Change in inventories	0,0	-0,2	0,0	0,0	0,0	0,0	0,0
- Net exports	0,6	0,0	0,4	0,3	-0,1	-0,2	0,0
Output gap[1]	0,0	0,1	0,1	0,1	0,4	0,3	0,3
Employment (% change)	1,4	1,2	1,2	1,0	1,0	0,9	0,7
Unemployment rate (%)	7,1	6,7	5,9	6,4	6,5	5,7	6,1
Labour productivity (% change)	0,3	0,6	0,3	0,5	0,7	0,6	0,8
HICP inflation (%)	2,2	1,7	2,0	2,3	1,3	1,9	2,1
GDP deflator (% change)	1,7	1,6	1,6	2,2	1,6	1,7	1,9
Comp. of employees (per head, % change)	1,9	1,9	2,2	2,2	2,1	2,3	2,0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1,0	-0,1	-1,0	1,2	-0,1	-0,5	1,2

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 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

Box 1: The macroeconomic forecast underpinning the Belgian DBP

The macroeconomic forecast underlying the DBP 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 FPB is a well-established institution that is formally attached to the government but positions itself as an independent body.

The DBP mentions that two different macroeconomic scenarios, both prepared by the FPB, were used by the Belgian authorities for drafting their 2019 budgets. The first scenario, published in June 2018, was used by the federal government when preparing its 2019 budget in July. A new scenario was published by the FPB in September 2018, and provided the sub-federal entities with the macroeconomic framework for drafting their 2019 budgets. The

September projections are those officially reported in the DBP (see Table 1) and are referred to as 'DBP scenario' in Section 2.

As was the case last year, the federal government did not update its draft budget on the basis of the new September macroeconomic forecast, mostly due to procedural reasons related to the time of the budget preparation. Nonetheless, the DBP and the *'exposé général'* accompanying the budget state that the revisions between September and June are more or less favourable depending on which macroeconomic variable is considered: the September projections revised overall growth slightly down for 2018 and 2019. However, investment in fixed assets and unemployment were, for instance, revised upwards and downwards, respectively, for both years.

Therefore, it appears that the macroeconomic scenario underlying the 2019 DBP did not fully use the most recently available independently produced macroeconomic forecasts. Belgium therefore does not fully comply with the requirement of Regulation (EU) No 473/2013 that the draft budget has to be based on independently produced macroeconomic forecasts..

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP targets a general government headline deficit of 1.1% of GDP in 2018, from 0.9% in 2017, whereas in its latest Stability Programme Belgium anticipated a deficit of 1.0% of GDP. The small deterioration stems from higher overall expenditure projections, with an unchanged revenue-to-GDP ratio. The deficit increase compared to 2017 is mostly expenditure-based as the DBP expects primary expenditure to increase by 0.4 % of GDP in 2018. The headline balance target in the DBP broadly concurs with projections in the Commission 2018 autumn forecast, which expects a deficit of 1.0% of GDP in 2018. The revenue and expenditure-to-GDP ratios are both projected 0.3 percentage points lower than in the DBP. The difference between both projections stems notably from the difference in GDP deflators in 2018, which leads to a lower nominal GDP in the DBP. The Commission forecast also expects slower growth of direct taxation and a marginally different composition in terms of expenditure categories.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2017	2018			2019			Change: 2017-2019
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**51,3**	**50,7**	***51,3***	**51,0**	**50,4**	***51,0***	**50,7**	**-0,3**
of which:								
- Taxes on production and imports	13,0	13,1	*13,3*	13,2	13,1	*13,3*	13,2	0,3
- Current taxes on income, wealth, etc.	16,8	16,3	*16,7*	16,5	16,0	*16,5*	16,3	-0,3
- Capital taxes	0,8	0,9	*0,8*	0,8	0,9	*0,8*	0,9	0,0
- Social contributions	15,8	15,6	*15,7*	15,7	15,6	*15,8*	15,6	0,0
- Other (residual)	4,8	4,8	*4,8*	4,8	4,8	*4,6*	4,8	-0,2
Expenditure	**52,2**	**51,7**	**52,3**	**52,0**	**51,1**	**52,0**	**51,8**	**-0,2**
of which:								
- Primary expenditure	49,7	49,4	50,1	49,6	48,9	49,9	49,6	0,2
of which:								
Compensation of employees	12,3	12,1	12,2	12,2	11,9	12,0	12,1	-0,3
Intermediate consumption	4,0	4,0	4,0	4,0	4,0	4,1	4,0	0,1
Social payments	25,0	24,9	25,1	24,9	24,7	25,1	24,9	0,1
Subsidies	3,3	3,2	3,4	3,3	3,1	3,4	3,3	0,1
Gross fixed capital formation	2,2	2,4	2,4	2,4	2,4	2,3	2,5	0,1
Other (residual)	2,8	2,8	3,0	2,8	2,8	3,0	2,8	0,2
- Interest expenditure	2,5	2,3	2,2	2,4	2,2	2,1	2,2	-0,4
General government balance (GGB)	**-0,9**	**-1,0**	**-1,1**	**-1,0**	**-0,7**	**-1,0**	**-1,1**	**-0,1**
Primary balance	**1,6**	**1,3**	**1,1**	**1,4**	**1,5**	**1,1**	**1,2**	**-0,5**
One-off and other temporary measures	0,5	0,0	0,1	0,3	-0,1	-0,1	0,1	-0,6
GGB excl. one-offs	**-1,3**	**-1,0**	**-1,2**	**-1,3**	**-0,6**	**-0,9**	**-1,2**	**0,4**
Output gap[1]	0,0	0,1	0,1	0,1	0,4	0,3	0,3	0,1
Cyclically-adjusted balance[1]	-0,9	-1,1	-1,2	-1,1	-1,0	-1,2	-1,2	-0,2
Structural balance (SB)[2]	**-1,4**	**-1,1**	**-1,3**	**-1,3**	**-0,9**	**-1,1**	**-1,3**	**0,4**
Structural primary balance[2]	1,1	1,3	0,9	1,0	1,3	1,0	0,9	0,0

Notes:

[1] 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.

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

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

For 2019, the DBP plans a headline deficit of 1.0% of GDP, whereas the latest Stability Programme projected a deficit of 0.7% of GDP. This deterioration could be explained by the weaker macroeconomic scenario as well as by the base effect of the higher projected headline deficit in 2018. More specifically, the higher deficit compared to the Stability Programme is rather a result of a larger upward revision on the expenditure side than on the revenue side. In particular, expenditure as a share of GDP is projected to decrease by 0.3 percentage points by the DBP, compared to a decrease of 0.6 percentage points expected in the Stability Programme. This is notably driven by more dynamic social payments and subsidies. On the

other hand, revenues are expected to evolve in line with what was projected in the Stability Programme and reach 51% of GDP.

For 2019, the Commission 2018 autumn forecast projects a headline deficit of 1.1% of GDP, 0.1 percentage point higher than the DBP. The difference with the DBP arises mostly from a slower decrease in the expenditure-to-GDP ratio in the Commission autumn forecast (-0.2 percentage points of GDP) compared to the reduction planned in the DBP (-0.3 percentage points).

Finally, the difference in headline balance developments between the Commission 2018 autumn forecast and the DBP also translates into a different structural effort. The DBP plans a (recalculated) structural improvement of 0.2% of GDP, confirming the target of the Stability Programme, whereas the Commission 2018 autumn forecast does not expect a structural improvement. The assessment of compliance with the required structural adjustment is covered in Section 4.2.

Risk factors

With respect to 2018, there are both upside and downside risks to the DBP projection regarding the headline deficit. The main uncertainty stems from corporate income tax (CIT) payments. Estimates of CIT revenues in 2018 are subject to higher-than-usual uncertainty because of a 2017 reform intended to shift CIT collection from *ex-post* (i.e. tax settlements) to *ex-ante* (i.e. advances) payments. The reform gradually introduced stronger incentives to make advanced payments by establishing penalties for undue large tax settlements. This has resulted in a strong increase in advance payments in 2017 and the first half of 2018, but it remains to be seen to what extent this behavioural change affects CIT settlements in the last quarter of 2018. .

In structural terms, the main risk stems from the one-off nature of the rise in CIT advance payments. By bringing tax collections forward in time, the reform introduced a change in the timing of recurrent revenues[2]. As a result, this measure creates a temporary peak in tax revenue. CIT advance payments grew by close to EUR 3 billion (or 0.7% of GDP) in 2017 and are projected to increase by EUR 2 billion (0.4% of GDP) in 2018, which will at least partly impact CIT settlements in 2018 and the coming years. In its 2018 spring and autumn forecasts the Commission estimated the structural trend of total CIT revenue by extrapolating its medium-term trend. The latest estimate points to a slightly higher share of structural revenue compared to the 2018 spring forecast. This would be supported by lower tax settlements in 2018 compared to 2017, pointing to a normalisation of the tax collection structure. On the other hand, the authorities calculate a higher share of temporary payments now. As a result, both estimates are now closer than in spring. However, the share of structural CIT revenue in 2017 and 2018 remains subject to uncertainty.

The 2019 budgetary targets in the DBP are associated with some other risk factors. First, the DBP excludes some capital expenditure items from the calculation of the structural balance, as it expects that the flexibility clause regarding public investment in the Stability and Growth Pact will be granted although Belgium did not request the use of this clause and is currently not eligible to benefit from it. Second, the DBP does not include information regarding the – direct or indirect – budgetary impact from a potential orderly resolution process of the cooperative Arco holding. Finally, higher than anticipated inflation could entail negative

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

budgetary consequences, as public wages and social benefits in Belgium are indexed to inflation.

Low interest rate environment

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Belgium currently at 0.82%[3]. 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 DBP, interest expenditure would fall from 2.5% of GDP in 2017 to 2.2% in 2018 and is projected to decrease further next year, at 2.1% of GDP in 2019, well below the 3.6% of GDP at the peak of the euro area sovereign debt crisis in 2011-2012. The picture stemming from the DBP differs slightly from the Commission 2018 autumn forecast, which projects higher interest expenditure, albeit converging towards the DBP projection in 2019. Considering the decline in interest expenditure, the planned improvement in the (recalculated) structural balance (0.2% of GDP in both 2018 and 2019) is accompanied by a small deterioration in the structural primary balance in 2018 (-0.1% of GDP), followed by a small improvement in 2019 (0.1% of GDP).

Flexibility clause

The 2019 DBP is accompanied by a formal request to avail of the flexibility available under the preventive arm pursuant to the "Commonly agreed position on Flexibility within the Stability and Growth Pact" endorsed by the Council in February 2016. Belgium requested a temporary deviation from the adjustment path towards the MTO as of 2018 in view of the planned implementation of major structural reforms with a positive impact on the long-term sustainability of public finances. As the request for the temporary deviation should be submitted in the year ahead of the application of the clause, the Commission assessed the fulfilment of the eligibility criteria for the structural reform clause as of 2019[4].

Based on the Commission 2018 autumn forecast, Belgium will continue to respect the minimum benchmark in 2019 which provides a safety margin towards the 3% of GDP deficit threshold.. In particular, the initial distance of Belgium to its MTO is below the maximum allowed distance of 1.5% of GDP. In addition, the headline deficit is expected to remain below the 3% of GDP reference value and Belgium’s structural deficit, after the temporary deviation is applied, is currently projected to remain below the minimum benchmark of 1.4% of GDP in 2019, ensuring an appropriate safety margin towards the 3% of GDP reference value.

On that basis, Belgium may qualify for the requested temporary deviation of 0.5% of GDP in 2019 for structural reforms. In order to benefit from the structural reform clause, reforms should be major and have long-term positive budgetary effects, including by raising potential

[3] 10-year bond yields as of 26 October 2018. Source: Bloomberg.

[4] The ‘Commonly agreed position on Flexibility within the Stability and Growth Pact’ stipulates that Member States that want to benefit from the structural reform clause should apply for it in their Stability and Convergence Programme. The flexibility is granted in the context of the assessment of the SCPs, specifically in the relevant Country Specific Recommendation. This Country Specific Recommendation could make the granting of flexibility conditional on the subsequent fulfilment of certain eligibility criteria (e.g. the respect of the safety margin). Euro area Member States may request to benefit from the Structural Reform Clause at the time of the Draft Budgetary Plans to be submitted by 15 October

growth. The Commission has carried out a preliminary assessment of the structural reforms plan put forward by the authorities as detailed below.

Regarding process and credibility of the presented reforms, the Belgian authorities have provided a summary of the contents, state of implementation and latest impact assessment of the structural reforms. The credibility of the measures is backed by having been specified either in the draft laws, publicly available, or in the annex to the DBP. Moreover, they are either in force or the timeline for their adoption and implementation is specified in the annex to the DBP.

The presented reforms concern the pension system, the tax system, labour market and public administration. Addressing these is important to address the macroeconomic imbalances and structural weaknesses of the Belgian economy to restore the economy's competitiveness, improve fiscal sustainability and create growth and jobs. They have been the subject of country-specific recommendations since 2012 and of further analysis in the respective Country Reports on Belgium. The Commission has conducted a preliminary assessment of the impact of the reforms, based on the information provided by the Belgian authorities in the annex to their DBP.

In particular, with regards to the pension reform, legislation was adopted in 2015 (Law of 10 August 2015), whose main effect is to raise the statutory retirement age from 65 up to 66 by 2025 and to 67 by 2030; second, to further raise the minimum age for qualifying for early retirement to 63 by 2018 and the number of required career years to 42 by 2019; and third, to increase the minimum age for survivor’s pension. The civil servant pension scheme underwent an additional reform as of 2016: the years of studies taken into account in the above mentioned career condition for early retirement will be progressively phased out as from 2015 (by steps of 4 to 6 months/year). As a result, in line with the conclusions of the Commission's 2018 Ageing Report, the cost of ageing in the long run is expected to increase at a slower pace: the annual growth in cost of ageing is expected to halve from the current 4–5% per year; pension expenditures are projected to rise by 1.3% of GDP between 2013 and 2060 (from 11.8% of GDP to 13% of GDP), compared to 3.3% before the 2015 reforms[5]. The reforms are also expected to contribute to an increase in the effective exit age from the labour market.

The tax reform measures from 2015 aim to raise employment, strengthen purchasing power and boost competitiveness. The reform reduces taxes on labour, including personal income taxation and employers' social security contributions, in several steps between 2016 and 2020. In parallel, indirect taxes have been increased to partially compensate for the labour tax cuts. Overall, estimates by the Federal Planning Bureau and the National Bank of Belgium suggest the net creation of at least 52,000 jobs by 2021.[6] Additional positive effects are expected from tax reductions targeting SMEs and self-employed. Overall, this tax shift is expected to increase GDP by 1 percentage point by 2020. However, it is not expected to be budgetary neutral. In particular, the negative impact on the primary balance is expected to accumulate to almost 0.9 percentage points by the end of 2020.

[5] Federal Planning Bureau, 2015, Les conséquences budgétaires du vieillissement à l'horizon 2060 pour la Belgique.

[6] https://www.nbb.be/doc/ts/publications/other/ds1707320nl.pdf
https://www.plan.be/publications/publication-1504-fr-effets+macro+economiques+et+budgetaires+des+mesures+de+tax+shift+du+gouvernement+federal

Belgium has also adopted, on 25 December 2017, a reform of its corporate income tax. The previous setup was characterised by a high statutory rate of 34%, with numerous exemptions and deductions. The reform establishes lower statutory rates and fewer exemptions. The statutory tax rate should be reduced to 29.6% in 2018 and 25% in 2020 (for SMEs: 20% on the first 100.000€ as from 2018). According to the authorities, the reform involves a budgetary cost of 0.3% of GDP in 2018, rising to 0.9% of GDP in 2020 and to 1.2% of GDP at cruising speed. To counter this deterioration, the government has broadened in parallel the tax base. Additional measures are expected to have an impact by 2020, including the Anti-Tax Avoidance Directive.

In 2017, Belgium launched a series of labour market reforms, including wage moderation policies. These included setting lower margins for real wage growth between 2011 and 2016; second by adopting a temporary suspension of wage indexation clauses in both the private and government sectors and a revision of the 1996 Law on employment and competitiveness, introducing amendments to the private sector wage negotiation framework, including strengthening the government's ability to take measures in the event of excessive wage growth. Overall, this reform is expected to help address the wage gap that has arisen in relation to Belgium's main trading partners, improving the competitiveness of the Belgian economy. The government also adopted a law to improve flexibility in the workplace, in particular in terms of working time arrangements. Taken together, these measures are expected to support job creation and reduce unemployment.

Finally, measures to reform of the public administration are planned to be adopted by February 2019. Based on the DBP, these measures are expected to have a positive impact of ca. 0.1% of GDP.

To conclude, a preliminary assessment suggests that on the basis that the minimum benchmark in 2019 is respected and that Belgium has largely implemented most of the agreed reforms, it appears Belgium would be eligible for the requested temporary deviation of 0.5% of GDP in 2019 for structural reforms. A final assessment of the request for flexibility will take place within the normal European Semester cycle in the context of the assessment of the 2019 Stability Programme.

3.2. Debt developments

Public debt peaked at 107.6% of GDP in 2014 and fell gradually to 103.4% of GDP in 2017. The DBP projects a continuation of the downward trend in public debt, to 101.9% and 100.2% of GDP in 2018 and 2019 respectively. This development reflects projected primary surpluses, the downward impact of which would be enhanced by a favourable snowball effect, driven by decreasing interest expenditures and robust nominal GDP growth. Stock-flow adjustments are projected to have a debt-increasing impact in 2018 and 2019. Overall, this allows for a continued reduction of the debt ratio in 2018-2019.

Despite higher stock-flow adjustments than those projected in the DBP, the Commission 2018 autumn forecast projects a slightly stronger reduction in the debt to GDP ratio in 2018 than in the DBP due to a larger primary surplus and downward snowball effect. The latter can be explained by a higher inflation effect compared to the DBP's projections. The debt reduction projected by the DBP in 2019 is broadly in line with the Commission 2018 autumn forecast.

Table 3. Debt developments

(% of GDP)	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**103,4**	**101,2**	**101,9**	**101,4**	**99,4**	**100,2**	**99,8**
Change in the ratio	-2,7	-2,2	-1,5	-2,0	-1,9	-1,7	-1,6
Contributions [2] :							
1. Primary balance	**-1,6**	**-1,3**	**-1,1**	**-1,4**	**-1,5**	**-1,1**	**-1,2**
2. "Snow-ball" effect	**-1,0**	**-1,1**	**-0,9**	**-1,3**	**-1,1**	**-1,1**	**-1,1**
Of which:							
Interest expenditure	2,5	2,3	2,2	2,4	2,2	2,1	2,2
Growth effect	-1,7	-1,8	-1,5	-1,5	-1,7	-1,5	-1,5
Inflation effect	-1,7	-1,6	-1,6	-2,2	-1,5	-1,7	-1,8
3. Stock-flow adjustment	**-0,1**	**0,3**	**0,5**	**0,7**	**0,7**	**0,6**	**0,7**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

Notes:

[1] End of period.

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

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

The consolidation effort in structural terms is of around 0.2% of GDP in the 2019 DBP. Achieving this effort entails a rise of 0.4% of GDP in additional revenue, with a stable expenditure-to-GDP ratio.[7]

On the revenue side, the 2019 DBP presents new measures with a net deficit-reducing impact of about 0.4 % of GDP, mainly in terms of income and wealth taxation, as well as social contributions. The main reform (the "jobs deal") comprises 28 labour market measures expected to deliver an overall budgetary gain of 0.1 % of GDP stemming from additional income taxation and higher social contributions. The reform has been presented with a sufficient level of detail so as to be included in the Commission's forecast, compared to other smaller labour market measures also stated in the DBP which are only partially considered in

[7] These figures were deduced from the change in the revenue and expenditure ratios between 2018 and 2019 at unchanged policy versus those after measures, as reported in the DBP.

the Commission's forecast due to their small size and poor track record in previous years. The projected increase in income taxation stems from higher-than-expected advance corporate tax payments following the adoption of higher surcharges for ex-post tax payments in 2017 and 2018, further shifting tax collection from ex-post tax settlement to advance tax payments. The additional impact included in the DBP accounts for around EUR 0.3 billion in 2019. The DBP also presents additional initiatives tackling tax and social fraud, for an estimated budgetary impact of EUR 0.25 billion. The Commission forecast includes a lower amount from these measures as they failed to meet expected targets in the past and are in general hard to monitor. The Commission's evaluation of these measures, together with the exclusion of technical corrections and volume effects reported as measures by the authorities, which are partly included in the underlying trend of the Commission's forecast, explain some of the difference in headline deficit between both projections.

On the spending side, the DBP does not envisage new measures with a significant budgetary impact in 2019. In particular, only intermediate consumption is affected with a slight deficit-increasing impact of 0.1% of GDP. On the deficit-decreasing side of expenditure, the government presented measures accounting for less than 0.1% of GDP, which have been included in the Commission's forecast with the exception of volume effect. However, these are mostly neutralised by technical corrections, as well as other small deficit-increasing initiatives. Overall, the expenditure-to-GDP ratio between the scenario with and without measures remains thus unchanged.

Regarding non-recurring measures classified as one-offs, the overall impact in the Draft Budgetary Plan accounts for 0.1% of GDP. These concern revenue measures only, notably related to the increased collection of CIT advance payments in 2019 due to higher fines on late tax payments, advanced provision of pensions savings and the tax-shift correction. However, the Commission 2018 autumn forecast does not account for the tax shift correction, as it is considered a transfer between different levels of government, neutral once consolidated, and includes a larger one-off share of CIT revenue.

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)
	2019
Taxes on production and imports	0,0
Current taxes on income, wealth, etc.	0,2
Capital taxes	
Social contributions	0,1
Property Income	0,0
Other	0,1
Total	0,4

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 for 2019

B. Discretionary measures taken by general government - expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)
	2019
Compensation of employees	0,0
Intermediate consumption	0,1
Social payments	0,0
Interest Expenditure	0,0
Subsidies	0,0
Gross fixed capital formation	0,0
Capital transfers	0,0
Other	
Total	0,1

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 for 2019

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 MTO. Box 2 reports the latest country-specific recommendations in the area of public finances. As the debt ratio was 103.4% of GDP in 2017, above the 60% Treaty threshold, Belgium is also subject to the debt reduction benchmark.

Box 2. Council recommendations addressed to Belgium

On 13 July 2018, the Council addressed recommendations to Belgium in the context of the European Semester. In particular, in the area of public finances the Council recommended Belgium to ensure that the nominal growth rate of net primary government expenditure does not exceed 1.8% in 2019, corresponding to an annual structural adjustment of 0.6% of GDP, and to use windfall gains to accelerate the reduction of the general government debt ratio.

The Council recalled that in 2019, in light of its fiscal situation and in particular of its debt level, Belgium is expected to further adjust towards its medium-term budgetary objective of a balanced budgetary position in structural terms. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure which does not exceed 1.8% in 2019. This corresponds to an annual structural adjustment of at least 0.6% of GDP.

4.1. Compliance with the debt criterion

As Belgium did not comply with the debt reduction benchmark in 2017, 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[8] was adopted on 23 May 2018 and included an assessment of all the relevant factors, notably (i) the previously unfavourable but improving macroeconomic conditions, which makes them less of a factor to explain Belgium's large gaps as regards compliance with the debt reduction benchmark; (ii) the fact that there is currently not sufficiently robust evidence to conclude on the existence of a significant deviation in Belgium in 2017 and over 2016 and 2017 taken together; and (iii) the implementation of growth-enhancing structural reforms in recent years, several of which are considered substantial and projected to help improve debt sustainability.

Table 6. Compliance with the debt criterion

	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	103.4	101.2	101.9	101.4	99.4	100.2	99.8
Gap to the debt benchmark [1,2]	0.5	-0.1		0.5	-0.7		0.5
Structural adjustment [3]	0.9	0.2	0.2	0.0	0.2	0.2	0.0
To be compared to:							
Required adjustment [4]							

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 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 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

Based on an overall assessment of compliance with the preventive arm, and given large uncertainties related to key factors of fiscal performance in 2017, the report stated that there was insufficient robust evidence to conclude that Belgium was non-compliant with the required adjustment path towards the MTO in 2017 and over 2016 and 2017 together. Therefore, the analysis was not fully conclusive as to whether the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 was complied with. However, Belgium was assessed to be at risk of significant deviation in 2018 and over 2017 and 2018 taken together. Hence, the report called on Belgium to take the necessary measures as of 2018 to comply with the provisions of the Stability and Growth Pact.

The DBP does not include sufficient information to assess compliance with the debt reduction benchmark in 2018 and 2019. Based on the Commission 2018 autumn forecast, which projects comparable debt developments overall in 2018-2019 to those in the DBP, Belgium would not comply with the debt reduction benchmark in 2018 or in 2019 (gap of 0.5% of

[8] https://ec.europa.eu/info/sites/info/files/economy-finance/com_2018_429_en.pdf

GDP both years). These projections do not account for the impact of potential financial sector asset sales beyond 2018.

4.2. Adjustment towards the MTO

Belgium is subject to the preventive arm of the SGP and has to ensure compliance with the required adjustment towards the MTO. In 2018, to this end, Belgium was required to pursue an annual structural adjustment towards the MTO of at least 0.6% of GDP.

The Commission Communication on the 2017 European Semester of May 2017[9] stated that the Commission stands ready to use its margin of appreciation in cases where the impact of a large fiscal adjustment on growth and employment is particularly significant. The Council Recommendation of 11 July 2017[10] mentioned that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances.

Following the Commission's assessment of the strength of the recovery in Belgium while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Belgium's 2018 Draft Budgetary Plan, no additional elements in that regard need to be taken into account.

The 2019 DBP indicates that the growth of primary government expenditure, net of discretionary revenue measures and one-offs, will exceed the expenditure benchmark[11] of 1.6% in 2018. The resulting gap (-0.6% of GDP) points to a significant deviation from the adjustment path towards the MTO. The change in the (recalculated) structural balance in 2018 points to some deviation, 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 declining interest spending, positively impacting the reading of the fiscal effort as measured by the change in the structural balance. As a result, the overall assessment confirms the risk of a significant deviation as read by both pillars.

Based on the Commission 2018 autumn forecast, the growth of primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the expenditure benchmark of 1.6%, resulting in a gap of 0.8% of GDP in 2018, pointing to a significant deviation. The structural balance is expected to remain broadly stable in 2018, below the recommended effort of at least 0.6% of GDP towards the MTO, pointing to a significant deviation as well. Hence, in 2018, Belgium is at risk of significant deviation from the required adjustment path.

As discussed above, uncertainties remain regarding the treatment of the strong increase in corporate income tax payments in 2017 and 2018, resulting from a shift in timing in CIT

[9] https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-specific-recommendations-commission-recommendations-communication.pdf

[10] Council Recommendation of 11 July 2017 on the 2017 National Reform Programme of Belgium and delivering a Council opinion on the 2017 Stability Programme of Belgium (OJ 2017/C 261/01)

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

collection. In line wih the methodology used in its 2018 spring forecast, the Commission estimated a baseline trend of corporate income tax revenue and considered any tax collection in excess of the trend as a one-off, temporary revenue, which would eventually be offset by lower tax settlement revenue in the following years. Given the differing estimates of the trend by the Commission, Belgian authorities and independent stakeholders, the Commission still acknowledges the possibility that the structural component of CIT collection in 2017 and 2018 might be higher than estimated, which would improve the underlying budgetary position.

For 2019, according to the information provided in the DBP, the growth of primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the expenditure benchmark of 1.8%, resulting in a gap of 0.6% of GDP, pointing to a risk of significant deviation. Given the planned improvement in the structural balance of 0.2% of GDP compared to a required adjustment of 0.6% of GDP, the (recalculated) structural balance points to a risk of some deviation from the requirements in 2019. For 2018 and 2019 together, the DBP signals a risk of significant deviation based on the expenditure benchmark (average gap of -0.6% of GDP) as well as on the structural balance (average gap of -0.4% of GDP).

According to the Commission 2018 autumn forecast, the growth of primary government expenditure, net of discretionary revenue measures and one-offs, deviates from the expenditure benchmark by -0.9% of GDP in 2019, pointing to a risk of significant deviation. The structural balance also confirms this risk, with a deviation of -0.6% of GDP. For 2018 and 2019 together both indicators point to a risk of significant deviation with gaps of -0.9% 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, as well as by declining interest spending, both positively impacting the reading of the fiscal effort as measured by the change in the structural balance. Taking this into account, the overall assessment confirms the risk of a significant deviation. The same conclusion stems from the assessment for 2018 and 2019 taken together.

Finally, in the Draft Budgetary Plan Belgium requested flexibility under the structural reform clause, allowing for a maximum temporary deviation from the adjustment path towards the MTO of 0.5% of GDP. Were the maximum allowed deviation to be granted, according to the Commission's 2018 autumn forecast, the deviation from the expenditure benchmark in 2019 alone would drop to 0.4% of GDP, thus pointing to a risk of some deviation. However, the deviation from the expenditure benchmark pillar over 2018-2019 together would still point to a risk of significant deviation of 0.6% of GDP. The structural balance pillar would point to some deviation for 2019 but would still point to a risk of significant deviation for 2018-2019 taken together, considering the large deviation expected in 2018. An overall assessment would still point to a risk of significant deviation. The final assessment of eligibility for flexibility under the structural reform clause will take place within the normal European Semester cycle in the context of the assessment of the 2019 Stability Programme in spring 2019.

Table 7: Compliance with the requirements of the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	0,0	0,0		0,0	
Structural balance[2] (COM)	-1,4	-1,3		-1,3	
Structural balance based on freezing (COM)	-1,5	-1,3		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0,6	0,6		0,6	
Required adjustment corrected[5]	0,6	0,6		0,6	
Change in structural balance[6]	0,8	0,2	0,0	0,2	0,0
One-year deviation from the required adjustment [7]	0,3	-0,4	-0,6	-0,4	-0,6
Two-year average deviation from the required adjustment [7]	-0,1	-0,1	-0,2	-0,4	-0,6
Expenditure benchmark pillar					
Applicable reference rate[8]	0,0	1,6		1,8	
One-year deviation adjusted for one-offs [9]	-0,5	-0,6	-0,8	-0,6	-0,9
Two-year average deviation adjusted for one-offs [9]	-0,5	-0,5	-0,6	-0,6	-0,9

Notes

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

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

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

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

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

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

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

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

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

Source :

Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations.

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

According to the DBP, the consolidation effort in 2019 increases the revenue-to-GDP ratio from 50.6% at unchanged policy to 51.0% after measures. This would be in line with the reduction of the revenue-to-GDP ratio observed since the peak of 52.7% of GDP reached in 2013 (0.36 percentage points average annual reduction until 2017). The expenditure-to-GDP ratio would decrease to52% of GDP in 2019 according to the DBP, continuing the effort to reduce the expenditure-to-GDP ratio (0.65 percentage points average annual reduction until 2017) since the peak attained in 2012 at 55.9% of GDP. The fiscal effort would be evenly distributed between revenues and expenditure in 2019.

This distribution between revenues and expenditure differs from the composition of the cumulative fiscal effort between 2011 and 2018. As in previous years, declining interest expenditure is expected to contribute to the improvement in the structural balance, accounting for 0.1% of GDP in 2019. Government investment would decrease from 2.4% of GDP in 2018 to 2.3% in 2019 according to the DBP, in line with the average public investment rate from 2007 to 2017.

The 2018 Country Report for Belgium underlined the fact that, despite recent reforms, the Belgian tax system remains complex. The reform of the corporate income tax will lower statutory rates and simplify the system. Nevertheless, many exemptions and distortionary incentives remain, as evidenced by the rising trend in total amount of tax breaks. The 2018 Country Report also concluded that, aside from the reform to lower the tax pressure on labour (see Box 3), opportunities to shift taxes to more growth-friendly bases could be further used, given that revenues from environment related taxes are still among the lowest in the EU. Despite the recent introduction of alternative mobility incentive schemes, the favourable tax treatment of company cars continues to contribute to the complexity of the tax system and to aggravate traffic congestion. Additionally, further scope to give spending restraint a larger role in fiscal consolidation was pointed out, as total public expenditure as a percentage of GDP is above the euro area average. In this regard, the importance of improving the efficiency and composition of public spending at all levels of government, including to create room for public investment, cannot be underestimated. For instance, so far no level of government in Belgium is currently bound by domestic expenditure rules, with the exception of a ceiling for healthcare spending. More generally, progress has been made in relation to establishing sufficient safeguards regarding the independence of the High Council of Finance. However, there is still no formal agreement on annual fiscal targets at all levels of government. Effective budget coordination is essential in a federal Member State like Belgium, where a large part of the spending power has been devolved to sub-national governments. Finally, carrying out spending reviews was also explicitly signalled in the 2018 Country Report for Belgium. Spending reviews can contribute to a smarter allocation of expenditure and support growth-friendly consolidation.

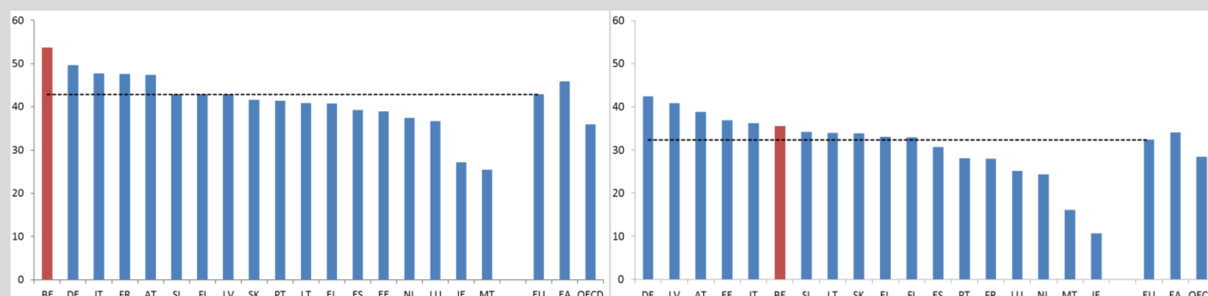
Box 3 – Addressing the tax burden on labour in the euro area

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 (2017)



Notes: No recent data is available for Cyprus. 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.

With respect to the Recommendation of 13 July 2018 addressed by the Council to Belgium to remove disincentives to work, Belgium is rolling out a multiannual tax reform with the aim of reducing the tax burden on labour by lowering personal income taxes and employers' social security contributions. However, the Draft Budgetary Plan does not include any new measure affecting the tax wedge on labour and, in particular, for average wage earners. So far, this remains the highest in the EU.

The DBP mentions the intention to take new measures aimed inter alia at limiting the growth of health expenditure, strengthening the long-term sustainability of the pension system, notably by facilitating part-time work for pensioners and reforming the system of complementary pensions. The DBP also mentions the intention to setup a mechanism linking public asset sales to the financing of strategic investment projects. 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 2019.

6. OVERALL CONCLUSION

Based on the Commission 2018 autumn forecast Belgium would not comply with the debt reduction benchmark in 2018 and 2019. Following an overall assessment of the DBP, the planned adjustment involves a risk of significant deviation from the adjustment path towards the MTO in 2018 and in 2019 recommended by the Council. The overall assessment based on the Commission 2018 autumn forecast confirms those risks. The assessment would not change if flexibility under the structural reform clause requested by Belgium would be taken into account.