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Analysis by the Commission services of the budgetary situation in Belgium following the adoption of the COUNCIL RECOMMENDATION to Belgium of 2 December 2009 with a view to bringing an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a

COUNCIL DECISION

giving notice to Belgium to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit

and the

Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Belgium in response to the Council Recommendation of 2 December 2009

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1. INTRODUCTION

On 2 December 2009, the Council decided, in accordance with Article 126(6) of the TFEU, that an excessive deficit existed in Belgium[1] and issued a recommendation to correct it by 2012 at the latest, in accordance with Article 126(7) of the TFEU and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[2]. In order to bring the general government deficit below 3% of GDP in a credible and sustainable manner, the Belgian authorities were recommended to (a) implement the deficit-reducing measures in 2010 as planned in the draft budget for 2010 and strengthen the planned fiscal effort in 2011 and 2012; (b) ensure an average annual fiscal effort of ¾% of GDP over the period 2010-2012, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus; (c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2012, cyclical conditions permitting, and to accelerate the reduction of the deficit if economic or budgetary conditions turned out better than expected at the time the EDP recommendations were issued; and (d) strengthen the monitoring mechanisms to ensure that fiscal targets are respected.

On 15 June 2010, the Commission concluded that based on the Commission services' 2010 Spring Forecast, Belgium had taken effective action in compliance with the Council recommendation of 2 December 2009 to bring its government deficit below the 3% of GDP reference value and considered that no additional step in the excessive deficit procedure was therefore necessary at that point in time.

This document provides an assessment of whether Belgium has undertaken effective action towards the correction of its excessive general government deficit. In particular, the document examines the budgetary developments since the Commission communication to the Council on action taken as of 15 June 2010.

2. RECENT MACRO-ECONOMIC AND BUDGETARY DEVELOPMENTS AND OUTLOOK FOR 2013-2014

Belgium experienced the full impact of the global economic recession in 2009 with real GDP contracting by 2.8%. The fiscal stimulus and extra liquidity by the Euro system combined with state guarantees to the financial sector helped to restore confidence and supported domestic demand. Thanks to the pick-up in world trade, the recovery in 2010 was stronger than expected, with GDP growing at 2.4%. Economic activity benefited from a strong increase in net exports, driven by the strong economic recovery of Germany, Belgium's main trading partner. The impact of the recession on employment was relatively contained. A temporary decline in hours worked and a decline in labour productivity per hour acted as a buffer. After a decrease of 0.2% in 2009, employment increased by 0.7% in 2010.

After the strong export-led recovery in 2010 and the first half of 2011, the Belgian economy came to a stand-still in the second part of 2011. The main factors contributing to this

[1] All documents related to the excessive deficit procedure of Belgium can be found at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/belgium_en.htm

[2] OJ L 209, 2.8.1997, p. 6.

slowdown were the general weakening of global activity and the persistence of the sovereign debt crisis, which depressed household spending as well as corporate investment. On the back of a strong first six months, 2011 still saw GDP growing by 1.8% for the full year. After benefiting from a momentary revival in the first quarter of 2012, activity declined abruptly again in the second quarter and remained anaemic in subsequent quarters. A robust contribution by net exports could not prevent GDP from contracting by 0.2% as household spending and investment both fell by 0.6%. 2012 marked the first time in many years of shrinking private consumption. It also contrasted with the 2009 recession, when private spending proved resilient.

Table 1: Comparison of macroeconomic developments and forecasts

	2009	2010			2011			2012		
	outturn	outturn	SP Jan 2010	COM 2009 AF	outturn	SP Jan 2010	COM 2009 AF	outturn	SP Jan 2010	COM AF 2009
Real GDP (% change)	-2.8	2.4	1.1	0.6	1.8	1.7	1.5	-0.2	2.2	n.a.
Contributions to real GDP growth:										
Domestic demand	-1.1	1.3	1.1	0.1	1.1	1.5	1.6	-0.4	2.0	n.a.
Changes in inventories	-1.1	0.3	0.4	0.1	0.6	0.0	0.0	-0.2	0.0	n.a.
Net exports	-0.5	0.7	-0.4	0.4	0.0	0.2	-0.1	0.4	0.2	n.a.
Employment (% change)	-0.2	0.7	-1.0	-1.4	1.3	0.5	0.1	0.2	0.9	n.a.
GDP deflator (% change)	1.2	2.0	1.3	1.3	2.0	1.9	1.6	2.1	1.9	n.a.
Output gap (% of potential G	-2.0	-0.8	-2.5	-2.8	0.0	-2.2	-2.4	-1.1	-1.4	n.a.
Potential output growth	1.1	1.2	1.3	1.0	1.0	1.4	1.2	0.9	1.5	n.a.

Source: SP Jan 2010 - Stability Programme January 2010; COM 2009 AF - Commission services' 2009 Autumn Forecast; COM 2013 SF - Commission services' 2013 Spring Forecast.

It should be noted that in 2009 and 2010 real GDP growth turned out better than expected in the Commission services' 2009 Autumn Forecast, underlying the Council recommendation addressed to Belgium under Article 126(7) of the Treaty. This forecast foresaw a contraction of 2.9% in 2009, followed by a hesitant recovery to 0.6% growth in 2010. This compares with an actual contraction of 2.8% in 2009, which was very close to the forecast, but was followed by a much more vigorous recovery to 2.4% in 2010. For 2011 the picture is similar: at the time of the Council recommendation, real GDP growth was expected to come out at 1.5%, while the actual number arrived at 1.8%. Thus, macroeconomic conditions in the period 2009-2011 have been better than expected and would have been supportive to implement and accelerate the fiscal consolidation recommended by the Council against a less favourable macroeconomic scenario at the time. On the other hand, the 2012 GDP contraction has been a substantially worse outcome than expected in the 2010 Stability Programme and in the technical assumption underpinning the EDP recommendation which assumed a gradual closure of the output gap between 2012 and 2015.

According to the Commission services' 2013 Spring Forecast published early May 2013 the Belgian economy is expected to record a flat GDP growth rate in 2013, followed by a pick-up in 2014 when GDP is projected to expand by 1.2%. Under this forecast, domestic demand is projected to continue the contraction initiated in 2012. While consumption by Belgian households is likely to stagnate in 2013, investment is expected to fall by another 1.6%, driven by an economy-wide lack of confidence, a depressed construction sector, tightening credit conditions and an industry featuring ample spare capacity. Both private consumption and investment are expected to gain pace only as of 2014 when domestic demand would become the main driver behind GDP growth. The latter role is reserved for net exports in

2013 with the open Belgian economy expected to take advantage of a global upturn. While export growth would further accelerate in 2014, import growth can be expected to catch up in the slipstream of a more robust domestic demand, thereby limiting further gains from net exports.

In terms of unemployment, the weak economic performance of 2012 led to a gradual rise in the unemployment rate and this trend is expected to continue during 2013 with unemployment touching 8.0% on average. This level is forecast as well for 2014 as job creation would fail to outpace labour force growth.

The general government deficit, which had increased to 5.6% of GDP in 2009 (which included 0.6 pp. of negative one-off factors), declined to 3.8% of GDP in 2010. Thanks to the better-than-expected macroeconomic outturns this outcome was substantially lower than the objective of 4.8% of GDP planned by the Belgian authorities in the January 2010 update of the Stability Programme. However, the structural improvement in 2010 is estimated at only ½ % of GDP, of which ¼ thanks to a strong decline in interest expenditure. In 2011, the headline deficit declined further to 3.7% of GDP, compared to the official target of 3.6% specified in the 2011 update of the Stability Programme. The nominal improvement was entirely due to the favourable macro-economic conditions, whereas the structural balance deteriorated by 0.1%.

In 2012, the deficit outcome was heavily impacted by the recapitalization of the Dexia banking group by the Belgian State for an amount of 0.8% of GDP, resulting in a deficit of 3.9% of GDP. Current government expenditure – which does not include this one-off operation – increased by 3.9% between 2011 and 2012 and reached the historically high level of 51.2% of GDP. Social transfers (+4.8%) and interest expenditure (+4.2%) recorded the highest growth rates. New measures included in the 2012 budget drove revenues up from 49.5% of GDP in 2011 to 50.8% in 2012.

The Commission services' 2013 Spring Forecast projects the general government deficit at 2.9% of GDP in 2013. The 2013 improvement is partly based on one-offs (amounting to 0.4% of GDP) and temporary factors such as lower interest rates and higher revenues from dividends. Against this background, under a no-policy-change assumption the Commission services' 2013 Spring Forecast projects the 2014 deficit to rise again, to 3.1% of GDP.

Public debt had declined from 134.2% of GDP in 1993 to 84.0% of GDP in 2007 due to primary surpluses and uninterrupted positive economic growth. From 2008 onwards, the debt ratio started to increase again, to almost 100% of GDP in 2012, although the rise was more limited than in many other EU member states where government debt rose by +28% on average between 2007 and 2012. The dynamics of the deficit and of GDP account for around 6.5 pps. of the increase, while exogenous factors amount to around 9 pps., mainly due to rescue operations in the financial sector under the form of equity injections (Dexia, Fortis, Ethias, KBC and Belfius, the latter being nationalized). The Commission services' 2013 Spring Forecast projects a further increase to more than 101% of GDP in 2013 and, based on a no-policy-change scenario, to over 102% of GDP in 2014. The Belgian government intends to sell financial assets in order to keep the debt below 100% of GDP. In this context, the Belgian government announced recently the sale of Royal Park Investment (the special purpose vehicle created in the context of the Fortis rescue operation) which would reduce the debt level by 0.2% of GDP.

3. EFFECTIVE ACTION

3.1. Background information

The current assessment of the effective action is based on the data notified by the Belgian authorities in April 2013 and validated by Eurostat. It takes into account the economic and budgetary developments since the last Council recommendation under Article 126(7) of the TFEU was issued in December 2009. The assessment starts by comparing the recommended fiscal effort in the Council recommendation, the apparent fiscal effort, measured by the change in the structural budget balance, and the adjusted structural effort. The adjustment of the structural balance takes into account (i) the impact of revisions in potential output growth compared to that underlying the growth scenario in the Council recommendation, and (ii) the impact on revenue of revisions of the tax content of economic activity (composition of economic growth or of other windfalls/shortfalls) relative to what is implied by standard long-term elasticities. This top-down approach in the assessment is complemented by a careful analysis, including a bottom-up assessment of consolidation measures undertaken by the Belgian government.

3.2. Assessment of effective action 2010-2013 - overview

The structural balance improved from -3.9% of GDP in 2009 to -3.0% of GDP in 2012. Hence, the average annual apparent fiscal effort over the period 2010-2012 is estimated at 0.3% of GDP, less than half of the recommended ¾ % of GDP. A decline in interest rate expenditure contributed to 0.15 pp. of the overall improvement in the structural balance.

Table 2: Change in the structural balance

	2010	*2011*	*2012*	*avg 2010-2012*	*total 2010-2012*
Change in structural revenue ratio (pp. of GDP)	0.4	1.0	0.8	0.7	2.1
Change in structural expenditure ratio (pp. of GDP)	-0.1	1.1	0.3	0.4	1.3
Change in structural balance (pp. of GDP)	0.5	-0.1	0.5	0.3	0.8

Source: European Commission Services' 2013 Spring Forecast

The adjusted average annual structural effort (+0.7, -0.6 and +0.9 in 2010, 2011 and 2012, respectively) also falls short of the level recommended by the Council (see Table 3), mainly due to lack of improvement in 2011 and, more generally, because the adjustment for the significant downward revision in potential output growth[3] since the time when the recommendation was issued (+0.15 pp.) is broadly offset by the correction for average windfall revenues (-0.1 pp.).

[3] The average potential growth at the time of recommendation over the reference period (2009-2014) was estimated at 1.3%. In the 2013 Spring Forecast, average potential growth over the new reference period (2009-2017) is estimated at 1.0% of GDP, with the economic crisis estimated to have a much more long-lasting impact on potential growth.

Table 3: Change in the structural balance corrected for revisions in potential output gap and revenue windfalls/ shortfalls

Un-corrected average effort (dS) up until			Corrected average effort up until			Required fiscal effort in the 2009 Council recomendation	Deadline for correction
2010	2011	2012	2010	2011	2012	2010 - 2012	2012
0.5	0.2	0.3	0.7	0.1	0.3	3/4	

Source: own calculations based on European Commission Services' 2013 Spring Forecast

In 2010, revenue developments, net of discretionary measures, evolved in line with standard elasticities, while in 2011 they increased at a higher rate than would have been implied by GDP growth based on standard elasticities. This is partly due to shifts in corporate income tax collection, with companies making less advance payments since 2009 due to the crisis and therefore higher payments compensating for resulting arrears at the moment of assessment in subsequent years. In addition, also revenues from dividends from commercial banks increased sharply following the state's interventions in the financial sector. In 2012 revenues fell somewhat short of what would be implied by standard elasticities.

3.3. Assessment of effective action 2010-2012 – detailed analysis of measures

The cumulative net impact of discretionary measures (excluding one-off measures) over 2010-2012, either taken during the period 2010-2012 or before but with an additional impact on this period, is estimated at some 2.0% of GDP (see Table 4). This calculation includes both deficit-reducing measures as well as expenditure increases to some extent due to policy decisions of the past (such as welfare adaptations of social benefits, rapidly increasing wage subsidies to companies and clean car subsidies) which partly offset the consolidation efforts.

A consolidation package announced before the opening of the EDP is estimated to have had a positive impact of over ¾% of GDP, but is broadly offset by the additional impact of stimulus measures and the above-mentioned impact of earlier policy decisions. After anticipative elections in June 2010, a political deadlock at federal level lasted until the end of 2011. However, the phasing-out of anti-crisis measures, rising financial sector contributions to the deposit guarantee scheme, as well as a number of corrective measures taken by the caretaker government, had an additional net effect of around 0.4% of GDP. The permanent measures taken in the 2012 budget and the subsequent budget controls by the newly appointed federal government are estimated to have had an impact of around 1.5% of GDP.

Table 4: Additional impact of discretionary measures (excluding one-off measures)

	2010	*2011*	*2012*	*avg 2010-2012*	*total 2010-2012*
Structural revenue measures (% of GDP)	0.4	0.5	1.0	0.6	1.9
Structural expenditure measures (% of GDP)	0.3	0.1	-0.5	0.0	0.0
Total impact of measures (% of GDP)	0.1	0.4	1.5	0.7	2.0

Source: Commission Services

Table 5: Composition of the budgetary adjustment

% of GDP	2009	2010			2011			2012		
	outturn	outturn	SP Jan 2010	COM 2009 AF	outturn	SP Jan 2010	COM 2009 AF	outturn	SP Jan 2010	COM AF 2009
Revenue	48.1	48.7	49.1	48.0	49.5	49.5	48.2	50.8	49.8	n.a.
of which:										
- Taxes on production and imports	12.5	12.8	12.4	12.3	12.6	12.4	12.4	12.9	12.4	n.a.
- Current taxes on imcome, wealth, etc.	15.2	15.6	16.3	15.5	16.0	16.4	15.7	16.4	16.6	n.a.
- Social contributions	16.8	16.5	16.6	16.2	16.6	16.5	16.1	17.0	16.6	n.a.
- Other (residual)	3.6	3.9	3.8	4.0	4.3	4.2	4.0	4.5	4.2	n.a.
Expenditure	53.7	52.6	53.9	53.8	53.4	53.6	54.0	54.8	52.8	n.a.
of which:										
- Primary expenditure	50.0	49.0	50.2	49.8	49.9	49.9	49.9	51.3	49.0	n.a.
of which:										
- Compensation of employees	12.8	12.5	16.5a	16.4a	12.6	16.1a	16.2a	12.8	15.7a	n.a.
- Intermediate consumption	3.8	3.7			3.7			3.7		n.a.
- Social payments	25.3	24.8	25.8	25.8	25.1	25.9	26.0	25.8	25.7	n.a.
- Subsidies	2.2	2.6	2.3	2.4	2.7	2.4	2.4	2.7	2.2	n.a.
- Gross fixed capital formation	1.7	1.7	1.7	1.9	1.8	1.8	2.0	1.7	1.9	n.a.
- Other (residual)	4.2	3.7	3.8	3.3	4.0	3.7	3.3	4.6	3.6	n.a.
- Interest expenditure	3.7	3.5	3.7	4.0	3.5	3.7	4.1	3.5	3.8	n.a.
General government balance (GGB)	-5.6	-3.8	-4.8	-5.8	-3.7	-4.1	-5.8	-3.9	-3.0	n.a.
Primary balance	-1.9	-0.4	-1.1	-1.8	-0.4	-0.4	-1.7	-0.5	0.8	n.a.
One-off and other temporary measures	-0.6	0.0	0.0	0.1	-0.2	0.0	0.0	-0.3	0.0	n.a.
Structural balance	-3.9	-3.4	-3.4	-4.4	-3.5	-2.9	-4.5	-3.0	-2.2	n.a.
Change in structural balance	1.7	0.5	0.3	-0.2	-0.1	0.5	-0.1	0.5	0.7	n.a.
Real GDP growth	-2.8	2.4	1.1	0.6	1.8	1.7	1.5	-0.2	2.2	n.a.
GDP deflator	1.2	2.0	1.3	1.3	2.0	1.9	1.6	2.1	1.9	n.a.
Nominal GDP growth	-1.6	4.5	2.4	1.9	3.9	3.6	3.1	1.9	4.1	n.a.

a) Compensation of employees and intermediate consumption

Source: SP Jan 2010 - Stability Programme January 2010; COM 2009 AF - Commission services' 2009 Autumn Forecast; COM 2013 SF - Commission services' 2013 Spring Forecast.

The largest revenue-increasing impact comes from the lowering – in several stages − of the reference rate for the notional interest deduction in corporate taxation (allowance for corporate equity), accounting for 0.4% of GDP (see Table 6). Other measures with a sizeable impact include the increase in the financial income tax in 2012 (0.2% of GDP) and several increases of taxes on products (0.3% of GDP). Contributions by financial institutions account for another 0.2% of GDP. The impact of discretionary revenue measures ('bottom-up approach') is broadly in line with the observed change in the structural revenue ratio ('top-down approach'), with only a significant gap in 2011, due to the above-mentioned windfall revenues.

On the expenditure side, the net impact of measures is close to zero. The main deficit-reducing measures consist of reducing the wage bill and functioning costs of public administration (0.4% of GDP), curbing the rising trend in health expenditure (0.2% of GDP) and reforms in the social security (0.1% of GDP). These measures have been broadly offset by expenditure-increasing measures such as welfare adaptations of social benefits (0.3% of GDP), the expansion of wage subsidy schemes (0.4% of GDP), and an increasing recourse to clean car subsidies (up to 2011).

Table 6: Main budgetary measures over 2010-2012	
Revenue	**Expenditure**
2010	
• Increase in excise duties on Diesel: 0.1% of GDP • Levy on the nuclear rent: 0.1% of GDP • Increase in CIT (Modification of the reference rate for notional interest deduction and other changes in deductions): 0.1% of GDP • Abolishment of the PIT reduction in the Flemish Region (0.1% of GDP) • Reduced VAT rate on restaurant bills: -0.1% of GDP	• Savings on staff expenditure and functioning costs: -0.1% of GDP • Welfare adaptations of social benefits: +0.1% of GDP • Expansion of wage subsidy schemes: +0.2% of GDP
2011	
• Lifting of bank secrecy, regularization and court settlements: 0.1% of GDP • Increase in the fee for the deposit protection fund: 0.1% of GDP	• Reduction in primary expenditure (other than social benefits): -0.15% of GDP • Reduction in health care expenditure: -0.1% of GDP • Welfare adaptations of social benefits: +0.1% of GDP • Expansion of wage subsidy schemes: +0.1% of GDP
2012	
• Reform of the system of notional interest deductibility: 0.3% of GDP • Increase in the taxation of dividends and interests: 0.2% of GDP • Increase in the levy on nuclear rent: 0.1% of GDP • Measures against tax fraud: 0.1% of GDP	• Expenditure savings in health care: -0.1% of GDP • Suppression of the subsidy for clean cars: -0.1% of GDP • Reduction in administrative expenditure: -0.1% of GDP • Expenditure saving measures in social security (e.g. reform of the unemployment benefit system): -0.1% of GDP • Welfare adaptations of social benefits: +0.1% of GDP
Note: A positive sign implies that revenue / expenditure increases as a consequence of this measure. Annual budgetary impacts are estimated by the Commission services and expressed as a % of GDP. Measures with a budget impact of at least 0.1% of GDP are listed.	

While the bottom-up sum of measures at the expenditure side shows a broadly neutral deficit impact of measures over the consolidation period, the structural expenditure ratio not only did not decrease, but even increased by 1.3 pps. of GDP over the correction period. This is among others due to the negative autonomously rising trend in health care costs[4] and pensions[5], as a result of population ageing. Also the strong increase in investment at local government level in the run-up to the 2012 local elections contributed to a temporary rise in expenditure of around 0.1% of GDP between 2010 and 2012.

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4 Since 2003, the maximum expenditure growth of the health care system is set at 4.5% on top of inflation. In practice, real expenditure has grown at a lower rate, at 4.3% on average between 2003 and 2009, which exceeds medium-term GDP growth. Over the correction period, measures have been taken to curb this growth and the low inflation in 2009 limited the effect of the automatic indexation system in 2010. This resulted in a real growth rate of 0.8% of GDP in 2010 and 2.2% in 2011. In the 2012 budget, real growth has been limited to 2%.

5 Between 2009 and 2012, the population aged over 65 increased by 4.8%, while the population at working age (15-64) rose by only 2.6%. At the end of 2011, the Belgian government adopted a pension reform aiming to curb the rise in age-related expenditure, but this will only yield significant effects in the medium term.

3.4. Budgetary implementation in 2010

The general government deficit, which had increased to 5.6% of GDP[6] in 2009 (compared to 5.9% of GDP expected in November 2009 when the EDP was initiated), declined to 3.8% in 2010. Thanks to the better-than-expected macroeconomic outturns (2.4% of GDP growth) this outcome was substantially lower than the objective of 4.8% of GDP planned by the Belgian authorities in the January 2010 update of the Stability Programme (SP), two months after the Council had decided that an excessive deficit existed in Belgium and recommended to end the excessive deficit situation. Overall, the net effect of discretionary measures is estimated to be around 0.1% of GDP. In addition, interest expenditure declined by 0.2 pp. of GDP. The low inflation in 2009 curbed temporarily the autonomous growth of the public sector wage bill and social transfers (which are indexed on past inflation). The primary balance improved from a deficit of 1.9% of GDP in 2009 to 0.4% of GDP in 2010.

Overall, the structural improvement in 2010 stood at ½ percentage point, falling short of the annual average reduction recommended by the Council (¾ % of GDP). This is broadly in line with the structural adjustment[7] planned in the 2010 Stability Programme. However, when combined with the narrowing output gap and revenue developments, the structural balance improved by some 0.7% of GDP. Accounting for the downward revision of potential output growth since the time of the Council recommendation would increase the annual apparent fiscal effort in 2010 by about 0.15 pp, while revenue developments over 2010 were broadly in line with those implied by standard elasticities.

3.5. Budgetary implementation in 2011

Despite GDP growth above potential, the headline deficit fell only marginally in 2011, to 3.7% of GDP, compared to a target in the 2011 Stability Programme of 3.6% of GDP. Moreover, the 2011 Stability Programme still assumed a deficit of 4.1% of GDP in 2010 whereas the final outcome was 3.8%. The nominal improvement at sub-federal level (regions, communities and local authorities) was almost entirely offset by a deterioration at federal level. The liquidation of the Holding Communal following the collapse of the Dexia banking group had a negative one-off impact of 0.2% of GDP, mainly at the expense of the regions. The primary balance remained broadly stable in 2011, with a primary deficit of around 0.4% of GDP.

The structural balance deteriorated slightly in 2011 (by 0.1 pp. of GDP). When taking into account the revisions of potential growth and windfall revenues, the deterioration in the structural balance is even larger, at -0.6 pp. of GDP. The lack of structural improvement is partly related to the absence of a government with full powers at federal level between mid-2010 and end-2011. The investment cycle at local level in the run-up to the 2012 local elections had a negative impact of 0.1 pp. of GDP on the structural balance. On the other hand, the modest decrease in interest expenditure - despite rising interest rates towards the end of 2011 - had a positive impact of almost 0.1 pp. of GDP on the balance.

[6] Of which 0.6 pp. is due to temporary and one-off factors, such as tax refunds as a consequence of a court decision and an acceleration in personal income tax settlement with a negative impact on 2009.

[7] recalculated by the Commission services based on the information in the programme.

3.6. Budgetary implementation in 2012

Based on the Commission Services' 2011 Autumn forecast, there was clear evidence of compliance risks with the 2009 EDP recommendation, given the still significant excess over the 3% of GDP deficit threshold close to the deadline in the absence of a 2012 budget and the fact that the fiscal effort achieved until then fell short of the recommended one. Therefore, the Commission expressed its concerns and urged Belgium to take the necessary measures in time to avoid a stepping-up of their EDP. In response to the Commission concerns and in order to meet the deadline set by the Council, the newly constituted Belgian government reacted swiftly and agreed on the draft budget for 2012 on 27 November. The final budget adopted included a series of consolidation measures aiming to reduce the deficit to 2.8% of GDP. In addition, the Belgian government adopted a spending freeze of about 0.35% of GDP. The Commission services concluded in January 2012 that, based on the prevailing growth projection of 0.9% according to the Commission services' 2011 Autumn Forecast (while 2012 growth turned out at -0.2%), on the consolidation measures in the budget and on the additional freeze, the deficit would reach 2.9% of GDP in 2012. Hence the Commission considered that no further steps in the excessive deficit procedure of Belgium were needed at that point in time.

However, in the first months of 2012, growth projections were substantially revised downwards. In March 2012, the Belgian authorities carried out a budgetary monitoring exercise, which resulted in the adoption of new measures amounting to about 0.3% of GDP. Also sub-federal government layers (regions, communities and local authorities) took additional measures in order to stick to their respective nominal deficit targets. In their 2012 Spring Forecast, the Commission services projected the deficit at 3% of GDP in 2012, based on a zero growth assumption and taking into account the disappointing tax revenues recorded in the first months of the year. Part of the consolidation measures consisted of measures with a one-off impact (in total estimated at 0.4% of GDP). In July 2012, the government undertook an additional budget control as part of a strengthened budgetary monitoring, which confirmed that Belgium was broadly on track to reach its own 2.8% of GDP deficit target, partly because of an expected improvement of the macro-economic situation based on the outcome of the first quarter. However, GDP growth in the second quarter proved to be particularly negative (-0.5%), and also growth in the second half of 2012 remained sluggish. The government undertook a budget control in October 2012, resulting in additional spending reductions and a number of one-off measures in order to ensure the reduction of the deficit to 2.8% of GDP.

At the end of 2012, the Belgian and French governments needed to increase the capital of Dexia, in order to remedy a negative net asset position and allow the orderly resolution of the group to go ahead. For Belgium, this had a one-off negative impact[8] on the deficit of 0.8% of GDP. Moreover, the economic downturn impacted government revenue more than expected, resulting in a deficit at federal level (central government + social security) of 2.7% of GDP excluding the impact of the Dexia recapitalization compared to their own target of 2.4%. In addition, in the April 2013 EDP notification, it turned out that the local government level had missed its deficit target (- 0.3% of GDP instead of -0.2%), which was only partly offset by a better than expected result by regions and communities (-0.1% of GDP instead of -0.2%). As a result, the notified and validated deficit came out at 3.9% of GDP. Even without the impact

[8] See Eurostat's view of 19 March 2013 on the recapitalization of Dexia: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/BE-Dexia-recapitalisation_advice-2013-03-19.pdf.

of the Dexia operation, the deficit would have remained above the reference value, at 3.2% of GDP. The primary balance deteriorated from a deficit of 0.4% of GDP in 2011 to 0.5% in 2012, due to the impact of the Dexia recapitalization, without which the primary balance would have shown a surplus of 0.3% of GDP.

Despite sizeable government measures, the structural budget balance is estimated to have improved by ½ pp. of GDP in 2012. The adjusted change in the structural balance is estimated at around 0.9 pp. of GDP. Rising interest expenditure had a negative impact of 0.1 pp. of GDP on the structural balance. In addition, the automatic indexation mechanism resulted in a strong autonomous increase in public sector wages and social benefits (accounting for more than half of public expenditure) due to the high inflation in 2011 and at the beginning of 2012. This has an estimated negative impact of around 0.2 pp. of GDP on the structural balance. The rise in the number of pensioners and accumulated pension rights is estimated to have had a negative impact of 0.1 pp. on the structural balance.

3.7. Budgetary developments in 2013 and 2014

According to the Commission services' 2013 Spring Forecast, the general government deficit is projected to decrease to 2.9% of GDP in 2013. The initial 2013 budget targeted a nominal deficit of 2.15% of GDP. Main expenditure measures included cuts in the central administration (0.1% of GDP), in the health care (0.1% of GDP) and in the social security (0.1% of GDP). The package also contained around 0.3% of GDP of new taxes, partly offset by a decrease in social security contributions (0.1% of GDP). The biggest impact comes from an increase in capital income taxation (0.1% of GDP) and a limitation of the notional interest deductibility in corporate income taxation (0.05% of GDP). Lastly, another 0.3% of GDP comes from non-tax revenues such as a temporary fiscal regularisation, anti-fraud measures, the sale of telecommunication licences and financial sector contributions.

However, since the drafting of the budget, the official growth projections underpinning the budget (+0.7%, in line with the Commission services' 2012 Autumn Forecast) have been substantially revised downwards, to 0.2% in the 2013 Stability Programme and 0.0% in the Spring Forecast. Therefore, the government abandoned the nominal deficit target and replaced it by a commitment to improve the structural balance by 1.0% of GDP. In March 2013, the government took additional measures amounting to 0.2% of GDP, which have been taken into account in the Commission services' 2013 Spring Forecast. This forecast projects a structural improvement of ¾ pp. in 2013, with lower interest expenditure contributing around ¼ pp. to the improvement. Hence, the gap with the official structural target amounts to ¼% of GDP, according to the Commission services' 2013 Spring Forecast.

At unchanged policy, the Commission Services' 2013 Spring Forecast projects the deficit to rise again in 2014, to 3.1% of GDP, despite the projected growth above potential. This new rise is due to the autonomous rising trend in social transfers and the fact that the 2013 budget also included around 0.4% of GDP of one-off and temporary revenues, such as a fiscal amnesty, the sale of telecom licenses and an exceptionally high dividend from the National Bank of Belgium.

4. PROPOSED NEW ADJUSTMENT PATH

Belgium did not correct its excessive deficit by the deadline recommended by the Council. The average annual fiscal effort since 2010 is estimated at 0.3% of GDP, significantly below the ¾% of GDP recommended by the Council. Also after correction for the effects of revised potential output growth and revenue developments, the adjusted average fiscal effort is less than half of the recommended effort. It therefore appears necessary to issue a Council Decision giving notice to Belgium to take measures for the deficit reduction judged necessary in order to remedy the situation of the excessive deficit.

Measures taken in the initial 2013 budget and the March 2013 budget control, are currently expected to bring the deficit below 3% of GDP in 2013. However, according to the Commission services' 2013 Spring Forecast, the safety margin against breaching the Treaty reference value is very narrow. Moreover, the correction is currently not yet sustainable. Therefore, a further reduction of the 2013 defict to 2.7% of GDP would be warranted in order to secure a lasting improvement in the general government balance, which is consistent with a structural improvement of 1.0% of GDP in 2013. To this end, additional measures with an estimated impact of ¼ % of GDP are considered necessary, also in view of possible negative second round effects.

In its 2013 Stability Programme, Belgium committed to reach a balanced budget in structural terms by 2015, before reaching its medium-term objective of a surplus of 0.75% of GDP in structural terms in 2016. Achieving a balanced budget in structural terms by 2015 would require an average structural effort of 1% over 2013-2015 according to the Commission services' calculations.

Furthermore, it is important to underpin the consolidation of public finances by adjusting the fiscal framework to ensure that the budgetary targets are binding at federal and sub-federal levels, and increase transparency of burden-sharing and accountability across layers of government. There is also a need to adopt a rule on the general government budget balance/surplus that complies with the requirements of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

The European Commission Fiscal Sustainability Report 2012 shows that the long-term budgetary impact of ageing in Belgium is well above the EU average. This is mainly the result of a rapid increase in pension expenditure as a share of GDP over the coming decades. Although the December 2011 pension reform was an important positive step, additional measures appear necessary to fully restore the long-term sustainability of public finances. In this respect, additional efforts are needed to close the gap between the effective and the statutory retirement age, while measures to link the statutory retirement age to developments in life expectancy would allow safeguarding the sustainability of the pension system in the long term.

Table 7 – Forecast of key macroeconomic and budgetary variables under the baseline scenario

% of GDP	2012	2013
Revenues	50.8	51.1
Current revenues	49.8	50.1
Discretionary measures with impact on current revenue[1]	1.4	0.2
Expenditure	54.8	54.2
Real GDP growth (%)	-0.2	0.0
Nominal GDP growth (%)	1.9	1.7
Potential GDP growth (%)	0.9	0.9
Structural balance	-3.0	-2.3
General government balance	-3.9	-2.9
p.m CAB methodology revenue elasticity		
p.m Apparent revenue elasticity		
p.m Output gap (% of potential output)	-1.1	-1.9

Note:

[1] Measures clearly specified and committed to by governments ahead of the recommendation

Table 8 - Forecast of key macroeconomic and budgetary variables under the EDP scenario

% of GDP	2012	2013
Real GDP growth (%)	-0.2	0.0
Potential GDP growth (%)	0.9	0.9
Structural balance	-3.0	-2.0
General government balance	-3.9	-2.7
p.m Output gap (% of pot. output)	*-1.1*	-2.0

5. CONCLUSIONS

Following the EDP notification of the 2012 general government deficit and its validation by the Commission (Eurostat), the 2012 deficit came out at 3.9% of GDP. Hence, Belgium did not correct its excessive deficit by the deadline recommended by the Council. This was partly due to the urgent need to recapitalize the banking group Dexia at the end of 2012, which had a negative impact of 0.8% of GDP on the government deficit. However, also without this operation the deadline would have been missed, with a deficit of 3.2% of GDP excluding the one-off negative impact of that operation. Moreover, the 2012 budget contained substantial deficit reducing one-off measures, estimated at around 0.4% of GDP.

The average annual fiscal effort since 2010 is estimated at 0.3% of GDP, significantly below the ¾% of GDP recommended by the Council. Also after correction for the effects of revised potential output growth and revenue developments, the adjusted average fiscal effort is less than half of the recommended effort. In particular, the fiscal effort was entirely absent in 2011 due to the political deadlock at federal level. At the end of 2011, the newly appointed government swiftly adopted sizeable consolidation measures, also in response to the Commission's call for action in order to ensure the timely correction of the excessive deficit. As a result, the adjusted fiscal effort in 2012 was above the recommended annual structural effort. A bottom-up calculation estimates the cumulative impact of discretionary measures of a permanent nature at around 2% of GDP over 2010-2012. Deficit-reducing measures have been partly offset by expenditure increases following policy decisions of the past (e.g. welfare adaptations of social benefits, rapidly rising wage subsidies to companies). Moreover, the impact of discretionary measures has been insufficient to curb the rising trend in public expenditure due to population ageing, which explains the limited improvement of the structural balance over the consolidation period.

Measures taken in the initial 2013 budget and the March 2013 budget control, are currently expected to bring the deficit below 3% of GDP in 2013. However, according to the Commission services' 2013 Spring Forecast, the safety margin against breaching the Treaty reference value is very narrow. Moreover, the correction is currently not yet sustainable. Therefore, a further reduction of the 2013 deficit to 2.7% of GDP is warranted in order to secure a lasting improvement in the general government balance, which is consistent with a structural improvement of 1.0% of GDP in 2013. To this end, additional measures with an estimated impact of ¼ % of GDP are considered necessary, also in view of possible negative second round effects.

Table 9: Comparison of key macroeconomic and budgetary projections

		2009	2010	2011	2012	2013
Real GDP (% change)	COM SF 13	-2.8	2.4	1.8	-0.2	0.0
	COM AF 09	-2.9	0.6	1.5	n.a.	n.a.
	SP 13	n.a.	n.a.	n.a.	-0.2	0.2
Output gap[1] (% of potential GDP)	COM SF 13	-2.0	-0.8	0.0	-1.1	-1.9
	COM AF 09	-2.3	-2.8	-2.4	n.a.	n.a.
	SP 13	n.a.	n.a.	n.a.	-1.1	-1.9
General government balance (% of GDP)	COM SF 13	-5.6	-3.8	-3.7	-3.9	-2.9
	COM AF 09	-5.9	-5.8	-5.8	n.a.	n.a.
	SP 13	n.a.	n.a.	n.a.	-3.9	-2.5
Primary balance (% of GDP)	COM SF 13	-1.9	-0.4	-0.4	-0.5	0.3
	COM AF 09	-2.0	-1.8	-1.7	n.a.	n.a.
	SP 13	n.a.	n.a.	n.a.	-0.5	0.8
Cyclically-adjusted balance[1] (% of GDP)	COM SF 13	-4.5	-3.3	-3.7	-3.4	-1.9
	COM AF 09	-4.6	-4.3	-4.5	n.a.	n.a.
	SP 13	n.a.	n.a.	n.a.	-3.4	-1.4
Structural balance[2] (% of GDP)	COM SF 13	-3.9	-3.4	-3.5	-3.0	-2.3
	COM AF 09	-4.2	-4.4	-4.5	n.a.	n.a.
	SP 13	n.a.	n.a.	n.a.	-3.0	-1.7
Government gross debt (% of GDP)	COM SF 13	95.7	95.5	97.8	99.6	101.4
	COM AF 09	97.2	101.2	104.0	n.a.	n.a.
	SP 13	n.a.	n.a.	n.a.	99.6	100.0

Note:

[1] Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the bass of the information in the programmes.

[2] Cyclically-adjusted balance excluding one-off and other temporary meaures

Source: *Commission services' 2013 Spring Forecast (COM SF 13), Commission services' 2009 Autumn Forecast (COM AF 09), and 2013 Stability Programme (SP 13)*

Annex

Table A1: Adjustment of apparent structural effort for the revision in potential growth – details of calculation

Average potential GDP growth underlying the Council Recommendation (%)	Average potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient (% of nominal potential GDP)
(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
1.30	0.99	0.30	51.11	0.15

Table A2: Adjustment of apparent structural effort for the revenue shortfalls/windfalls as compared to standard elasticities – details of calculation

	Change in current revenues (yoy) (billions of national currency)	Discretionary current revenue measures (billions of national currency)	Nominal GDP growth assumptions (%)	Current revenues in year t-1 (billion of national currency)	Revenue gap (billion of national currency)*	Correction coefficient (% of nominal potential GDP)
	2013SF	2013SF	2013SF	2013SF		
	(1)	(2)	(3)	(4)	(5)=(1')-(2')-ε*(3')*(4')	
2010	9.2	2.4	4.5	161.4	-0.09	-0.02
2011	9.5	1.2	3.9	170.6	2.15	0.58
2012	7.6	5.4	1.9	180.1	-0.97	-0.26
average						0.10