I

*(Resolutions, recommendations and opinions)*

# OPINIONS

# COUNCIL

## COUNCIL OPINION

## on the updated stability programme of Belgium, 2009-2012

(2010/C 143/01)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 26 April 2010 the Council examined the updated stability programme of Belgium, which covers the period 2009 to 2012.

(2) The collapse of world trade together with decreasing confidence, wealth effects and tighter credit conditions led to a sharp contraction of the Belgian economy around the turn of 2008. While the downturn was very sharp, it was followed by a relatively strong rebound in the second half of 2009, which was partly the result of temporary factors, including the (domestic and foreign) stimulus packages and a positive contribution from inventories.

Continued headwinds stemming from the restructuring of financial institutions and a further rise in unemployment together with low capacity utilisation are expected to slow down growth again in the first half of 2010. While due to the high degree of openness of the Belgian economy the recovery could benefit considerably from the rebound of world trade, the extent of this impulse may be limited as a result of Belgium's loss of cost competiveness in recent years. The downturn has had a significant adverse impact on public finances. The general government deficit deteriorated from 1,2 % of GDP in 2008 to 5,9 % of GDP in 2009. Moreover, while the government debt-to-GDP ratio declined between 2000 and 2007 on the back of overall cautious fiscal policies, the ratio started to increase again in 2008 as a result of the interventions in the financial sector (to 97,9 % in 2009). The Council decided on 2 December 2009 that an excessive deficit existed in Belgium and issued a recommendation to correct the deficit by 2012 through an average annual fiscal effort of 0,75 % of GDP. The strong deterioration of public finances in combination with the above-average budgetary impact of population ageing and significant contingent liabilities following the operations to stabilise the financial system translate into a need for continued budgetary consolidation and structural reforms to ensure the long-term sustainability of public finances.

(3) Although much of the observed decline in actual GDP in the context of the crisis is cyclical, the level of potential output has also been negatively affected. In addition, the crisis may also affect potential growth in the medium term through lower investment, constraints in credit availability and increasing structural unemployment. Moreover, the impact of the economic crisis compounds the negative effects of demographic ageing on potential output and the sustainability of public finances. Against this background it will be essential to accelerate the pace of structural reforms with the aim of supporting potential growth. In particular, for Belgium it is important to undertake reforms that improve competition, in particular in network industries, and that increase labour supply, including reforms of the labour market (i.a. the wage formation system and the incentives to take up work) and the pension system.

[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/sgp/index_en.htm

(4) The macroeconomic scenario underlying the programme envisages that, after a contraction of 3,1 % in 2009, real GDP will grow by 1,1 % in 2010 and accelerate to 1,7 % in 2011 and further to 2,2 % in 2012. According to the Commission services' autumn 2009 forecast, annual GDP growth is expected to turn slightly positive in 2010 (0,6 %) and to increase to 1,5 % in 2011. However, these projections appear on the low side in view of more recent information, including the better-than-expected outcome for the second half of 2009. The projected composition of growth seems to slightly overstate the contribution of domestic demand to growth in 2010, but appears realistic thereafter. Therefore, assessed against currently available information [1], the growth assumptions of the programme are broadly plausible, while the composition of growth is favourable in 2010. The programme's projections for inflation appear realistic. On the other hand, wage growth assumptions appear to be on the high side as lower labour cost growth in other euro area countries should exercise some downward pressure on Belgian wages in a context of high unemployment. In addition, the projected increase in labour cost per employee exceeds considerably the projected productivity growth.

(5) The programme estimates the general government deficit in 2009 at 5,9 % of GDP. The significant deterioration from a deficit of 1,2 % of GDP in 2008 reflects to a large extent the impact of the crisis on government finances, but was also brought about by stimulus measures amounting to 0,5 % of GDP which the government adopted in line with the European Economic Recovery Plan (EERP). The deterioration mainly reflects a rise in the expenditure-to-GDP ratio. According to the programme, fiscal policy is planned to become restrictive in 2010 and 2011 and more significantly so in 2012, with a view to correcting the excessive deficit by 2012 and returning to a sustainable public finance position. This is broadly in line with the exit strategy advocated by the Council, taking also into account the high public debt-to-GDP ratio and the above-average budgetary impact of ageing.

(6) The programme targets a general government deficit of 4,8 % of GDP in 2010 which is in line with the Council recommendation under Article 126(7) of 2 December 2009. The federal budget for 2010 projected a deficit of 5,6 % of GDP. The downward revision of the budgetary target for 2010 reflects the more favourable macro-economic prospects in the update (lowering the deficit by about 0,3 % of GDP) as well as the fact that the federal budget does not take into account the planned consolidation measures worth 0,5 % of GDP of other government tiers. According to the update, the revenue ratio increases from 47,7 % of GDP in 2009 to 49,1 % in 2010, whereas the expenditure ratio rises from 53,7 % to 53,9 % of GDP. The structural deficit in the programme (i.e. the cyclically adjusted balance net of one-off and other temporary measures, recalculated by Commission services on the basis of the information in the programme according to the commonly agreed methodology) shows an improvement from 3,8 % of GDP in 2009 to 3,4 % of GDP in 2010. Taking into account that the programme classified some of the temporary stimulus measures in 2009 (0,2 % of GDP) as one-offs, the overall adjustment would amount to 0,5 % of GDP. The improvement of the structural balance in 2010 reflects consolidation measures amounting to around 1 % of GDP. These measures include an increase in personal income taxes in Flanders, an increase in excise duties, higher corporate taxes, non-fiscal revenues stemming from the banking sector and the producers of nuclear energy, and savings on inter-mediate consumption and the wage bill. This is partly offset by an expansionary expenditure growth trend as a result of previously taken measures and the budgetary impact of population ageing (around 0,5 % of GDP). The role of one-off measures is very limited (below 0,1 % of GDP).

(7) The main goal of the medium-term budgetary strategy is to correct the excessive deficit by 2012, in line with the Council recommendation under Article 126(7) of 2 December 2009 and to achieve a balanced budget by 2015, both in nominal and structural terms. To this end, the programme targets an improvement of the headline deficit from 5,9 % of GDP in 2009 to 4,8 % in 2010, 4,1 % in 2011 and 3 % in 2012. The primary balance shows a slightly stronger improvement as interest expen-diture is planned to rise by 0,2 % of GDP over the programme period. The structural deficit (recalculated on the basis of information in the programme), improves from 3,8 % of GDP in 2009 to 3,4 % of GDP in 2010, 2,9 % of GDP in 2011 and 2,2 % of GDP in 2012. After the adjustment amounting to 0,5 % of GDP in 2010, the programme plans an adjustment of 0,5 % and 0,75 % of GDP in 2011 and 2012 respectively, thus amounting on average to over 0,5 % of GDP per year over the programme period. This is somewhat below the 0,75 % of GDP average fiscal effort recommended under Article 126(7), because the path is based on better macro-economic assumptions. The adjustment appears to be somewhat back-loaded and is based to a larger extent on revenue increases than on expenditure restraint. The adjustment is built on a strong reduction of the deficit of the federal government and smaller reductions of the deficits of the social security system and the Regions and Communities. The government does not plan one-off measures. The measures backing the target for 2011 are partly unspecified and no measures have been specified for 2012. The programme confirms the commitment to the medium-term objective (MTO), which is a 0,5 % of GDP budgetary surplus in structural terms. Given the most

[1] The assessment notably takes into account the Commission services' autumn 2009 forecast, but also other information that has become available since then.

recent projections and debt level, the MTO reflects the objectives of the Pact; however, the programme does not envisage achieving it within the programme period.

(8) The budgetary outcomes could turn out somewhat worse than projected in the programme. In 2010, this could stem from the possible overestimation of corporate taxes. Furthermore, the measures underlying the budgetary path are partly unspecified for 2011 and that no measures have been specified for 2012. In addition, the slightly favourable macroeconomic scenario, with relatively high wage growth projections, may lead to worse than expected budgetary outcomes. Moreover, the government offered sizeable guarantees to the banking sector which might drive up future deficits and debt to the extent that they are called, although some of the cost of government support to the financial sector could also be recouped in the future. Finally, the achievement of the targets and the correction of the excessive deficit by 2012 may not be fully secured as the path is to some extent back-loaded and the target of 3 % of GDP in 2012 leaves no margin, given the track record in respecting the fiscal targets.

(9) Government gross debt is estimated at 97,9 % of GDP in 2009, up from 89,8 % in the year before. This increase is explained by the strong increase in the deficit and the negative GDP growth. The government gross debt ratio thus was well above the Treaty reference value in 2009, and according to the programme it is on an increasing trend until 2011 (reaching 101,4 % of GDP). It would fall slightly to 100,6 % of GDP in 2012. The further increase is mainly driven by continued high government deficits. In view of the negative risks to the budgetary targets, the evolution of the debt ratio could be less favourable than projected in the programme, especially as from 2011. Risks related to the possible need for further support to the financial sector appear limited at the current juncture.

(10) Medium-term debt projections that assume GDP growth rates to gradually recover to the values projected before the crisis, tax ratios to return to pre-crisis levels, and include the projected increase in age-related expenditure show that the budgetary strategy envisaged in the programme, taken at face value and with no further policy change, would not be enough to stabilise the debt-to-GDP ratio by 2020 and consolidation should thus continue after the programme period.

(11) The long-term budgetary impact of ageing is clearly higher than the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades. The budgetary position in 2009 as estimated in the programme compounds the budgetary impact of population ageing on the sustainability gap. Ensuring primary surpluses over the medium term and undertaking reforms of the labour market and the social security system, in particular a further pension reform aimed at curbing the projected substantial increase in pension expenditure, would contribute to reducing the risks to the sustainability of public finances which were assessed in the Commission 2009 Sustainability Report [1] as medium.

(12) The fiscal framework in Belgium benefits from the existence of independent fiscal institutions. However, numerical fiscal rules and medium-term budgetary frameworks appear to be weak, which has contributed to frequent slippages in the past. The programme announces a number of improvements, including the conclusion of multi-annual budgetary agreements among all governments, some steps towards multi-annual budgeting at the federal level, frequent and stringent budget control exercises and the plan to improve the reporting system of local governments. Nevertheless, more could be done to improve the fiscal framework. In particular, there do not exist multi-annual, enforceable expenditure ceilings.

(13) Belgium is confronted with a high overall tax burden in combination with a high level of government spending. The government has taken several measures to reform the tax system, including important tax reductions on labour and to a lesser extent for enterprises. In spite of those measures, the labour market continues to include, also as a result of its interactions with the system of unemployment benefits, significant inactivity, unemployment and low wage traps. In a context of strict budgetary consolidation, further labour tax cuts will have to be fully compensated. On the expenditure side, primary expenditure growth has outpaced nominal GDP growth in the period 2000-2009. The planned reform of the pension system is a welcome step that could lead to a significant positive impact on the budget and potential growth.

(14) Overall, in 2010 the budgetary strategy set out in the programme is consistent with the Council recommendations under Article 126(7). From 2011 on, taking into account the risks, the budgetary strategy may not be fully consistent with the Council recommendation under

(1) In the Council conclusions from 10 November 2009 on sustainability of public finances ‘the Council calls on Member States to focus attention to sustainability-oriented strategies in their upcoming stability and convergence programmes’ and further ‘invites the Commission, together with the Economic Policy Committee and the Economic and Financial Committee, to further develop methodologies for assessing the long-term sustainability of public finances in time for the next Sustainability report’, which is foreseen in 2012.

Article 126(7). In particular, the measures underpinning the target for 2011 are only partly specified and there are no measures specified for 2012. The somewhat optimistic macroeconomic scenario combined with the somewhat smaller-than-recommended annual fiscal effort, constitutes an additional risk for the outer years. The strategy taking into account the risks may not be sufficient to bring the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace. Therefore, the strategy needs to be backed up by fully specified measures as from 2011 and additional measures need to be considered to ensure the achievement of the targets if risks materialise. This would also help in view of Belgium's high public debt-to-GDP ratio, above-average budgetary cost of ageing, and the government's considerable contingent liabilities in view of guarantees provided to the financial sector.

(15) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has limited gaps in the required data and some gaps in the optional data [1]. In its recommendations under Article 126(7) of 2 December 2009 with a view to bring the excessive deficit situation to an end, the Council also invited Belgium to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. Belgium complied with this recommendation through a complement to the programme.

The overall conclusion is that, following the expansion in 2009 in line with the EERP, the budgetary stance turns restrictive in 2010 and 2011 and more significantly so in 2012. At face value, this should lead to a correction of the excessive deficit by 2012, in line with the recommendation of 2 December 2009 under Article 126(7) of the TFEU. The government gross debt-to-GDP ratio, which rose in 2008 as a result of the measures to stabilise the financial system, will continue its upward movement up to 2011 and start declining again in 2012. This would bring the debt back on a downward path. However, the budgetary path is subject to some downside risks. In 2010, potentially optimistic tax estimates may lead to a somewhat higher deficit and may call for additional measures to be taken in the context of the foreseen budget control exercises. As from 2011, the main risk relates to the fact that the measures underpinning the target for 2011 are only partly specified and there are no measures specified for 2012. In addition, the slightly favourable macroeconomic assumptions combined with an average annual fiscal effort that is somewhat below the 0,75 % of GDP recommended by the Council, pose further downward risks to the targets. The Belgian government however committed in the programme to take the necessary exceptional measures if economic growth is insufficient to achieve the 3 % of GDP deficit target in 2012, which may indeed be needed. The adjustment could also benefit from a stronger focus on expenditure restraint. Finally, while the programme announces a number of improvements to the fiscal framework, more needs to be done to support the consolidation effort, in particular as regards the introduction of enforceable, multi-annual expenditure ceilings.

In view of the above assessment and also in the light of the recommendation under Article 126 TFEU of 2 December 2009, Belgium is invited to:

(i) ensure that the 2010 deficit target of the programme is met; specify the measures underlying the budgetary targets from 2011 onwards in order to achieve the recommended average annual fiscal effort of 0,75 % of GDP in line with the Article 126(7) Recommendation; and stand ready to strengthen the fiscal effort in case risks related to the fact that the programme scenario is more favourable than the scenario underpinning the Article 126(7) Recommendation materialise; seize as prescribed in the EDP recommendation any opportunity beyond the fiscal efforts, including from better economic conditions, to accelerate the reduction of the gross debt ratio towards the 60 % of GDP reference value;

(ii) ensure high primary surpluses over the medium term and undertake structural reforms in order to improve the long-term sustainability of public finances;

(iii) improve the quality of public finances by adopting a more stringent budgetary framework, encompassing the creation of enforceable, multi-annual expenditure ceilings.

**Comparison of key macroeconomic and budgetary projections**

| | | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| Real GDP (% change) | **SP Jan 2010** | **1,0** | **– 3,1** | **1,1** | **1,7** | **2,2** |
| | COM Nov 2009 | 1,0 | – 2,9 | 0,6 | 1,5 | n.a. |
| | *SP Sep 2009* | *1,1* | *– 3,1* | *0,4* | *1,9* | *2,4* |

[1] In particular, the data on the sectoral balances are not provided.

| | | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| HICP inflation (%) | **SP Jan 2010** | **4,5** | **0,0** | **1,5** | **1,7** | **1,8** |
| | COM Nov 2009 | 4,5 | 0,0 | 1,3 | 1,5 | n.a. |
| | *SP Sep 2009* | *4,5* | *0,0* | *1,5* | *1,6* | *1,6* |
| Output gap (1) (% of potential GDP) | **SP Jan 2010** | **1,8** | **– 2,4** | **– 2,5** | **– 2,2** | **– 1,4** |
| | COM Nov 2009 (2) | 1,7 | – 2,3 | – 2,8 | – 2,4 | n.a. |
| | *SP Sep 2009* | *2,0* | *– 2,3* | *– 2,9* | *– 2,3* | *– 1,5* |
| Net lending/borrowing vis-à-vis the rest of the world (% of GDP) | **SP Jan 2010** | **n.a.** | **n.a.** | **n.a.** | **n.a.** | **n.a.** |
| | COM Nov 2009 | – 0,2 | 0,1 | 0,4 | 0,3 | n.a. |
| | *SP Sep 2009* | *– 1,6* | *– 1,9* | *– 2,1* | *– 2,3* | *n.a.* |
| General government revenue (% of GDP) | **SP Jan 2010** | **48,8** | **47,7** | **49,1** | **49,5** | **49,8** |
| | COM Nov 2009 | 48,8 | 47,7 | 48,0 | 48,2 | n.a. |
| | *SP Sep 2009* | *48,7* | *47,9* | *48,1* | *48,5* | *49,2* |
| General government expenditure (% of GDP) | **SP Jan 2010** | **50,0** | **53,7** | **53,9** | **53,6** | **52,8** |
| | COM Nov 2009 | 50,0 | 53,6 | 53,8 | 54,0 | n.a. |
| | *SP Sep 2009* | *49,9* | *53,8* | *54,1* | *53,9* | *53,6* |
| General government balance (% of GDP) | **SP Jan 2010** | **– 1,2** | **– 5,9** | **– 4,8** | **– 4,1** | **– 3,0** |
| | COM Nov 2009 | – 1,2 | – 5,9 | – 5,8 | – 5,8 | n.a. |
| | *SP Sep 2009* | *– 1,2* | *– 5,9* | *– 6,0* | *– 5,5* | *– 4,4* |
| Primary balance (% of GDP) | **SP Jan 2010** | **2,6** | **– 2,3** | **– 1,10** | **– 0,4** | **0,8** |
| | COM Nov 2009 | 2,6 | – 2,0 | – 1,8 | – 1,7 | n.a. |
| | *SP Sep 2009* | *2,5* | *– 2,0* | *– 1,9* | *– 1,2* | *– 0,1* |
| Cyclically-adjusted balance (1) (% of GDP) | **SP Jan 2010** | **– 2,2** | **– 4,6** | **– 3,4** | **– 2,9** | **– 2,2** |
| | COM Nov 2009 | – 2,1 | – 4,6 | – 4,3 | – 4,5 | n.a. |
| | *SP Sep 2009* | *– 2,3* | *– 4,7* | *– 4,4* | *– 4,2* | *– 3,6* |
| Structural balance (3) (% of GDP) | **SP Jan 2010** | **– 2,2** | **– 3,8** | **– 3,4** | **– 2,9** | **– 2,2** |
| | COM Nov 2009 | – 2,2 | – 4,2 | – 4,4 | – 4,5 | n.a. |
| | *SP Sep 2009* | *– 2,3* | *– 4,7* | *– 4,4* | *– 4,2* | *– 3,6* |
| Government gross debt (% of GDP) | **SP Jan 2010** | **89,8** | **97,9** | **100,6** | **101,4** | **100,6** |
| | COM Nov 2009 | 89,8 | 97,2 | 101,2 | 104,0 | n.a. |
| | *SP Sep 2009* | *89,7* | *97,5* | *101,9* | *103,9* | *104,3* |

*Notes:*

(1) Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.
(2) Based on estimated potential growth of 1,7 %, 1,1 %, 1,0 % and 1,2 % respectively in the period 2008-2011.
(3) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0,8 % of GDP deficit increasing in 2009 according to the most recent programme; and 0,1 % of GDP deficit-reducing in 2008 and 2010 and 0,5 % of GDP deficit increasing in 2009 in the Commission services' November 2009 forecast.

*Source:*

*Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.*