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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plans of Belgium

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of Belgium

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1. INTRODUCTION

Belgium submitted its Draft Budgetary Plan for 2017 on 17 October 2016 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. 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).

As the debt ratio was 105.4% of GDP in 2013 (the year in which Belgium corrected its excessive deficit), exceeding the 60% of GDP reference value, Belgium is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit (2014-2016). In that period it should ensure sufficient progress towards compliance. Following the end of the transition period, Belgium is subject to the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2016 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2016-2017 (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 (CSRs) adopted by the Council on 12 July 2016, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying Belgium's 2017 Draft Budgetary Plan (DBP hereafter) projects growth to reach 1.4% in 2016 and to slow down somewhat to 1.2% in 2017. This broadly concurs with the Commission 2016 autumn forecast (the Commission forecast hereafter), according to which the Belgian economy is set to grow by 1.2% and 1.3% in 2016 and 2017 respectively. The DBP expects the output gap to remain at -0.3% in 2016 and to widen again to -0.5% in 2017 as growth falls short of its estimated potential. This trend is broadly in line with the Commission forecast.

Table 1. Comparison of macroeconomic developments and forecasts

	2015	2016			2017		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.5	1.2	1.4	1.2	1.5	1.2	1.3
Private consumption (% change)	1.1	0.9	0.9	0.7	1.3	1.4	1.3
Gross fixed capital formation (% change)	2.4	-0.4	3.2	3.3	2.5	2.4	2.9
Exports of goods and services (% change)	4.3	4.1	3.4	3.7	4.0	3.6	3.9
Imports of goods and services (% change)	4.3	3.3	3.2	2.9	3.8	4.0	3.9
Contributions to real GDP growth:							
- Final domestic demand	1.2	0.4	1.2	1.2	1.2	1.4	1.2
- Change in inventories	0.3	0.0	0.0	-0.6	0.0	0.0	0.0
- Net exports	0.0	0.7	0.2	0.6	0.3	-0.2	0.1
Output gap[1]	-0.3	-0.6	-0.3	-0.4	-0.4	-0.5	-0.5
Employment (% change)	0.9	0.7	1.0	1.2	0.8	0.7	0.9
Unemployment rate (%)	8.5	7.9	8.3	8.0	7.9	8.2	7.8
Labour productivity (% change)	0.6	0.5	0.4	0.1	0.8	0.5	0.4
HICP inflation (%)	0.6	1.3	2.0	1.7	1.5	1.6	1.7
GDP deflator (% change)	0.9	1.6	1.3	1.3	1.5	1.6	1.6
Comp. of employees (per head, % change)	0.0	0.2	0.5	0.8	1.4	1.6	1.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.2	2.0	n.a	0.5	3.1	n.a	0.7

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

Whereas some small differences exist between both scenarios concerning 2016[1], the 2017 outlook is closer aligned. External assumptions regarding growth of export markets, interest rates and international oil prices are comparable, with both assuming overall supportive conditions to growth in 2017 in spite of an uptick in oil prices.

The DBP scenario expects domestic demand to be the main growth driver in 2017. This reflects a combination of rather strong investment growth and a pick-up in household consumption. Investment growth is projected to slow down somewhat in 2017 (from 3.2% to 2.4%) but would still represent about half of total GDP growth. The DBP scenario builds on a broad-based continuation of investment growth, with business investment, housing construction and government investment all projected to achieve rather robust growth rates

[1] It should be noted that the DBP scenario was finalised in September 2016, whereas the cut-off date for the Commission projections was 28 October 2016, so that revised figures for 1H-2016 and the flash outcome for 3Q-2016 are reflected in these projections. This timing factor explains most of the relatively small differences in GDP components for 2016.

next year. All three components are supported by specific factors, namely improving cost competitiveness in the case of business investment, historically low mortgage interest rates for housing construction, and the investment cycle of local governments as well as the start of large infrastructure works for public investment. This favourable investment outlook concurs with the Commission forecast, which projects investment growth to stay close to 3% next year.

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

The macroeconomic forecast underlying the DBP was provided by the National Accounts Institute in September 2016, providing the federal government as well as regions and communities with a common forecast that serves as a starting point for their budgetary projections. The preparation of this macroeconomic forecast is delegated by law to the Federal Planning Bureau (FPB).

The FPB is a well-established institution formally attached to the government that positions itself as an independent institution. As stipulated in the Law of 21 December 1994 that constituted the FPB in its current form, supervision of the institution lies with the Prime Minister and the Minister of Economic Affairs, while guidance on its proceedings originates from the federal government with also the Belgian Parliament and the Central Economic Council or the National Labour Council able to seek an evaluation by the FPB of the federal government's economic, social and environmental policies[2].

Household consumption is expected to grow modestly in 2016 which can be explained by low wage growth in recent years in combination with higher inflation. However, moving forward private spending is expected to benefit from the fact that wage indexation has been reactivated since spring, the scope for real wage increases in coming years and the income tax cuts enacted by the federal government. As a result, household consumption is expected to pick up in 2017. These DBP projections are close to the Commission forecast, which has slightly weaker consumption growth in both 2016 and 2017.

The largest discrepancy with the Commission forecast stems from government consumption, which the DBP projects to be higher than the Commission. This difference is partly due to the fact that the latter includes the impact of government measures spelled out in the DBP, contrary to the DBP scenario. In this respect, the robustness of the macroeconomic scenario underlying the Belgian budget could be enhanced by fully accounting for second-round effects emanating from budgetary measures.

Concerning the labour market, the DBP scenario expects a less dynamic performance than the Commission forecast, which concurs with the weaker overall economic performance included in the DBP scenario. It projects employment to increase by 1% and 0.7% in 2016 and 2017, compared with 1.2% and 0.9% in the Commission projections. As a result, the unemployment rate would arrive at 8.2% next year, as compared to 7.8% according to the Commission forecast.

The Commission forecast projects slightly higher inflation in 2017 than the DBP, which leads to a faster increase in public sector wages and social benefits than is assumed in the DBP.

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

All in all, the macroeconomic scenario underpinning the DBP is assessed as plausible, with relatively small differences as compared to the Commission forecast, both with respect to overall growth as to growth composition.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

2016

The DBP projects a general government deficit of 3.0% of GDP in 2016, compared to a deficit target of 2.5% of GDP in the latest Stability Programme. This revision reflects higher primary expenditures and is in line with the Commission forecast, which also expects a deficit of 3.0% of GDP in 2016. The Commission forecast has a better starting point than the one in the DBP of around 0.1% of GDP[3]. However, the DBP includes exceptional revenues stemming from the collection of corporate income taxation under the 'Excess profit ruling' scheme deemed illegal state aid by the Commission in January 2016 (0.1% of GDP). The Commission forecast does not include these revenues considering that accounting of this tax collection will take place once the final amount is irrevocably established and accepted by both parties, i.e. corporates which benefited from the scheme as well as the Belgian authorities, which have lodged an appeal against the Commission decision of January 2016[4].

While the higher deficit compared to the Stability Programme is due to higher expenditure, the deterioration compared to 2015 is situated at the revenue side with the revenue-to-GDP ratio declining from 51.3% in 2015 to 50.8% in 2016 according to the Commission forecast. This reflects the roll-out of a multiannual package of measures to reduce the tax pressure on labour, both through lower personal income taxation and social security contributions. This package was planned to be budgetary neutral and financed through a range of alternative revenue sources, mainly consumption and non-labour income. The reduction of the VAT rate on electricity was for example rolled back and excise duties on diesel, tobacco and alcohol have been gradually increased. The same holds for withholding taxes on interest and dividend income. Also a number of new taxes were introduced (e.g. health tax, tax on capital gains on short-term stock holdings), while others were revised (e.g. taxation of real estate funds) or their expected yield was, sometimes substantially, increased (e.g. transparency tax on offshore financial constructions). The Belgian authorities also planned to generate new revenues through a more efficient tax collection, by tackling fiscal fraud more effectively, and through the introduction of a permanent regularisation scheme for past tax fraud. By means of a 'redesign' of the federal administration, important administrative savings were envisaged as well.

In its analysis of the 2016 DBP the Commission indicated that the budget neutrality did not appear fully ensured. Subsequent calculations by the National Bank of Belgium and the Federal Planning Bureau put the financing gap of the overall package at 0.4-0.5% of GDP in 2016. Over the course of 2016, several of the measures disappointed. The new tax on capital gains on short-term stock holdings caused for example a decline in the tax on stock market transactions, and will be abolished as of next year. The same holds for the 'redesign' of the federal administration. Moreover, measures such as the transparency tax and the

[3] The 2015 deficit has been revised from 2.6% of GDP to 2.5%, though only after the submission of the DBP.

[4] http://ec.europa.eu/competition/state_aid/cases/256735/256735_1748545_185_2.pdf

regularisation scheme are not expected to yield the initial targets according to the Commission forecast.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2015	2016			2017			Change: 2015-2017
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**51.3**	**50.8**	*50.9*	**50.8**	**50.8**	*51.0*	**50.9**	**-0.3**
of which:								
- Taxes on production and imports	12.8	13.1	*13.2*	13.2	13.1	*13.2*	13.2	0.4
- Current taxes on income, wealth, etc.	16.6	16.1	*16.3*	16.2	16.2	*16.4*	16.3	-0.2
- Capital taxes	0.9	1.0	*0.9*	0.9	1.0	*0.9*	0.9	0.0
- Social contributions	16.5	16.1	*16.0*	16.1	15.9	*15.9*	16.0	-0.6
- Other (residual)	4.5	4.5	*4.5*	4.5	4.6	*4.6*	4.4	0.1
Expenditure	**53.9**	**53.4**	**53.9**	**53.8**	**52.2**	**52.7**	**53.2**	**-1.1**
of which:								
- Primary expenditure	50.9	50.7	51.2	51.2	49.7	50.4	50.8	-0.5
of which:								
Compensation of employees	12.5	12.3	12.4	12.4	12.1	12.2	12.4	-0.3
Intermediate consumption	4.1	4.2	4.3	4.2	4.1	4.2	4.2	0.1
Social payments	25.3	25.1	25.4	25.5	24.7	25.1	25.6	-0.2
Subsidies	3.4	3.3	3.5	3.4	3.3	3.4	3.4	0.0
Gross fixed capital formation	2.4	2.4	2.3	2.4	2.5	2.3	2.4	0.0
Other (residual)	3.3	3.4	3.3	3.3	3.0	3.2	2.9	-0.1
- Interest expenditure	3.0	2.7	2.6	2.6	2.4	2.3	2.4	-0.7
General government balance (GGB)	**-2.5**	**-2.5**	**-3.0**	**-3.0**	**-1.4**	**-1.7**	**-2.3**	**0.8**
Primary balance	**0.5**	**0.1**	**-0.3**	**-0.5**	**1.1**	**0.7**	**0.1**	**0.2**
One-off and other temporary measures	0.3	-0.1	0.0	-0.1	0.1	0.0	0.0	-0.3
GGB excl. one-offs	**-2.8**	**-2.4**	**-3.0**	**-3.0**	**-1.5**	**-1.7**	**-2.4**	**1.1**
Output gap[1]	-0.3	-0.6	-0.3	-0.4	-0.4	-0.5	-0.5	0.0
Cyclically-adjusted balance[1]	-2.3	-2.2	-2.8	-2.8	-1.1	-1.4	-2.0	0.9
Structural balance (SB)[2]	**-2.6**	**-2.0**	**-2.8**	**-2.7**	**-1.2**	**-1.4**	**-2.0**	**1.1**
Structural primary balance[2]	0.4	0.7	-0.1	-0.2	1.2	0.9	0.4	0.5

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP as recalculated by Commission on the basis of the DBP scenario using the commonly agreed methodology.

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

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

The fiscal effort in structural terms in 2016 has changed from a targeted improvement of 0.6% of GDP in the Stability Programme to a deterioration of 0.2% according to the (recalculated)

structural balance[5] in the DBP. At -0.1% of GDP, the Commission forecast projects a broadly comparable deterioration in 2016.

2017

In 2017, the DBP targets a headline deficit of 1.7% of GDP, 0.3 pp. above the target in the latest Stability Programme. The 0.5 pp. deviation in 2016 from the nominal trajectory put forward in the Stability Programme would thus be partly made up for in 2017. The federal government targets a deficit 0.2 pp. above the one in the Stability Programme, regional and local authorities plan to diverge by 0.1 pp. The deterioration of the macroeconomic assumptions and a less positive net contribution of temporary factors are compensated by a higher planned structural effort compared to the previous target (1.4% vs. 0.8%). The expenditure-to-GDP ratio would decline from 53.9% in 2016 to 52.7% in 2017 according to plans. Social benefits (-0.3 pp.), interest payments (-0.3 pp.) and compensation of employees (-0.2 pp.) would see the largest declines. The revenue-to-GDP ratio would rise slightly, from 50.9% of GDP in 2016 to 51% in 2017, inter alia because of faster wage growth, employment growth and higher taxes on financial income.

The 2017 DBP does not include any information regarding the pending resolution of the Arco Group and the potential compensation of its private shareholders by the Belgian state or by the state-owned Belfius bank. It is thus unclear to which extent such compensation, either by the state or by Belfius bank (the DBP contains EUR 250 mn or 0.06% of GDP Belfius dividends in 2017), might entail a negative budgetary impact in 2017.

At 2.3% of GDP, the Commission forecast has a considerably higher headline deficit than the DBP in 2017. First, a less favourable appreciation of the expected impact of certain measures underpinning the 2017 budget explains about 0.3 pp. of the headline difference. Some of the measures where insufficiently specified to be taken into account in the Commission forecast by the cut-off date, while for other measures the estimated impact has been assessed to be lower than in the DBP (see section 3.3). Moreover, measures that are not expected to yield the envisaged revenues in 2016 (e.g. the system of permanent fiscal regularisation and the transparency tax) are not projected to catch up in 2017. Second, the DBP includes an improvement by 0.1% of GDP of the regional and local authorities' budget, while according to the Commission forecast the deficit will deteriorate slightly from the 2016 level, given a limited improvement at the regional level and a widening deficit at local level. Whereas the DBP assumes that local authorities will respect the target put forward in the Stability Programme, the Commission forecast expects, in the run up to elections in 2018, similar spending dynamics as in past cycles even though revenue growth would not accelerate on the basis of the macroeconomic scenario.

Third, inflation assumptions result in 0.1 pp. of GDP higher expenditures than the DBP. Social benefits and public sector wages are adjusted for inflation every time the health index has risen by 2% since the previous adjustment. Considering the slightly higher inflation in the Commission forecast, the latter assumes an adjustment two months earlier than the DBP. The positive impact from higher tax receipts due to private sector wage increases only materialises with a lag. Fourth, declining interest rates are expected to contribute 0.2 pp of GDP to deficit reduction, compared to 0.3 pp. of GDP in the DBP.

[5] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

The differing view on the evolution of the headline balance reflects the projected structural improvement in 2017. The DBP targets a (recalculated) structural improvement of 1.4% of GDP whereas the Commission forecast estimates it at 0.7% of GDP. Also a larger net positive impact of one-off measures contributes to the smaller structural improvement in the Commission forecast.

Flexibility

The Belgian authorities indicated in the 2016 DBP that the budgetary impact of the increased inflow of refugees is significant in 2015 and 2016 and should be considered as an unusual event outside the control of the government, for the purposes of Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97. More specifically, this expenditure is estimated at 0.03% of GDP in 2015 and 0.14% in 2016 according to the 2017 DBP (compared to 0.19% in the 2016 Stability Programme). In the 2016 Stability Programme the Belgian authorities also invoked the clauses with respect to exceptional expenditure linked to security measures and the fight against terrorism in 2016, which it estimated at 0.12% of GDP in 2016. This estimate was updated to 0.06% in the 2017 DBP, which requests the clause to be also applied in 2017 as well, when expenditures would remain at 0.06% of GDP. As a result, Belgium requests a temporary deviation from the adjustment path towards the MTO of 0.20% of GDP in 2016 and 0.06% in 2017. These amounts appear plausible.

A final assessment, including on the eligible amounts, will be made in spring 2017 and spring 2018 on the basis of observed data as provided by the Belgian authorities for 2016 and 2017 respectively.

Interest rates

The implicit nominal interest rate on Belgian public debt has fallen continuously over the past two decades and this trend has only accelerated in recent years. At 0.42% [6], Belgian sovereign 10-year bond yields are currently at historically low levels. 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 in Belgium is expected to fall from 3.0% of GDP in 2015 to 2.6% in 2016 and would decrease further next year, to 2.3% of GDP. The Commission forecast, expects a smaller decline in interest expenditure, from 2.6% of GDP in 2016 to 2.4% in 2017. Against this background of falling interest expenditure, the projected change in the structural balance in 2016-2017 according to the Commission forecast (-0.1% and 0.7% respectively) is accompanied by a more pronounced deterioration in 2016 in the structural *primary* balance (-0.5%) and a lower improvement in 2017 (0.5%).

3.2. Debt developments

Public debt has been on an upward trajectory since 2008. Debt decreased only in 2015, due to stock-flow adjustments linked to the repayment of a loan provided to a large bank during the financial crisis. Both the 2017 DBP and the Commission forecast expect gross public debt to rise to 107% of GDP in 2016, 0.8 pp. higher than envisaged in the 2016 Stability Programme. In 2017, the fulfilment of government plans would allow the debt-to-GDP-ratio to decline to

[6] 10-year bond yields as of 2 November 2016. Source: Bloomberg.

106.5% of GDP. However, given the higher deficit projection in the Commission forecast, the latter expects debt to stay about unchanged next year.

Interest expenditures in terms of GDP falling below nominal GDP growth result in a negative snow-ball effect next year, which together with the projected primary surplus would allow for an automatic reduction of the debt ratio if not for positive stock-flow adjustments. These are related to regional loans and corrections for cash versus accrual accounting. The possible future incorporation of government controlled hospitals within the public sector accounts would result in a limited increase in government debt of around 0.3 pp of GDP.

Table 3. Debt developments

(% of GDP)	2015	2016			2017		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**105.8**	**106.2**	**107.0**	**107.0**	**104.7**	**106.5**	**107.1**
Change in the ratio	-0.7	0.5	1.2	1.2	-1.6	-0.5	0.1
Contributions[2] *:*							
1. Primary balance	**-0.5**	**-0.1**	**0.3**	**0.5**	**-1.1**	**-0.7**	**-0.1**
2. "Snow-ball" effect	**0.5**	**-0.2**	**0.4**	**0.0**	**-0.6**	**-0.5**	**-0.6**
Of which:							
Interest expenditure	3.0	2.7	2.6	2.6	2.4	2.3	2.4
Growth effect	-1.6	-1.2	-1.5	-1.3	-1.5	-1.3	-1.4
Inflation effect	-0.9	-1.6	-0.8	-1.3	-1.5	-1.5	-1.7
3. Stock-flow adjustment	**-0.7**	**0.8**	**0.5**	**0.8**	**0.2**	**0.7**	**0.8**

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The planned overall consolidation in 2017 is about evenly divided between the revenue and the expenditure side. On the revenue side the main contribution (0.1% of GDP) stems from a further increase of the standard financial withholding tax from 27% to 30%, following an increase in 2016 from 25% to 27%. The assumed yield appears to be plausible, also when accounting for the fact that financial income taxation has generally fallen short of expectations in 2016. The second largest measure on the revenue side concerns the introduction of a fixed levy imposed on employers for company fuel cards, a benefit in kind granted to employees. Both measures have been included in the Commission forecast.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General government - revenue side

Components	Budgetary impact (% GDP)
	2017
Taxes on production and imports	0.06
Current taxes on income, wealth, etc.	0.14
Capital taxes	0.00
Social contributions	0.04
Property Income	0.03
Other	0.01
Total	0.27

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 2017

B. Discretionary measures taken by general government- expenditure side

Components	Budgetary impact (% GDP)
	2017
Compensation of employees	0.00
Intermediate consumption	-0.10
Social payments	-0.29
Interest expenditure	-0.01
Subsidies	+0.08
Gross fixed capital formation	+0.03
Capital transfers	0.00
Other	-0.01
Total	-0.31

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 2017

Improved tax collection, a widening of the scope of the stock exchange transaction tax and anti-fraud measures are the main other tax measures in the DBP. Whereas the first two items have been partly taken into account, assuming non-compliance as well as behavioural changes due to repeated alterations of the fiscal treatment of stock market operations, the anti-fraud

measures are not included in the Commission forecast as these are still mostly unspecified. The authorities also count on higher dividends from government participations; mainly from state-owned Belfius bank and the National Bank of Belgium. Total dividends received from Belfius in 2017 would rise to EUR 200 mn according to the DBP. The Commission forecast currently assumes only EUR 75 mn of Belfius dividends next year, considering that a recurrence of the 2016 interim dividend of EUR 75 mn and the additional dividend of EUR 50 mn included in the DBP do not appear assured yet, also when considering that Belfius only started paying dividend in 2016.

Social contributions would increase as a result of a temporary possibility for employees to regularise years of study and as an (indirect) consequence of government measures that allow for night work in sectors subject to e-commerce and reduce minimum wages for people below the age of 21. The latter entails a return to the system that existed until 2014. These indirect measures are incorporated in the macroeconomic scenario of the Commission forecast.

On the expenditure side, savings on healthcare and social benefits represent the bulk of the consolidation efforts in 2017. Healthcare savings consists of measures to curb the underlying trend of rising expenditure. The government lowered the real annual growth norm for healthcare spending to 1.5% as of 2015. Measures representing 0.16% of GDP have been outlined in the DBP to respect this reduced growth norm in 2017. In addition to this, the DBP contains a number of measures representing an extra 0.05% of GDP in healthcare savings, effectively lowering the real growth norm to approximately 0.6% next year. Considering that Belgium has a good track record of respecting the growth norm, these additional measures are also included in the Commission forecast. Still, it should be noted that past norms were set at considerably higher rates than is currently the case, which facilitated compliance. The limitation of the budget for welfare adjustments of social benefits improves the budgetary balance by 0.04% of GDP in 2017 and has been included in the Commission forecast as well. Lower intermediate consumption (-0.1% of GDP) is about offset by higher subsidies at the regional level.

4. Compliance with the provisions of the Stability and Growth Pact

Belgium is subject to the preventive arm of the Stability and Growth Pact and should ensure sufficient progress towards its medium-term objective (MTO) of a structural balance of 0% of GDP. Box 2 reports the latest country specific recommendations in the area of public finances. Belgium is also subject to the transitional debt rule in 2014-2016.

Box 2: Council recommendations addressed to Belgium

On 12 July 2016, the Council addressed recommendations to Belgium in the context of the European Semester. In particular, in the area of public finances the Council recommended to Belgium to achieve an annual fiscal adjustment of at least 0.6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017, to use windfall gains to accelerate the reduction of the general government debt ratio, to agree on an enforceable distribution of fiscal targets among all government levels, and to simplify the tax system and remove distortive tax expenditures.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2013, Belgium entered a transition period as regards the debt criterion for the following three years, i.e. 2014-2016. This implies that, during this period, the country is required to make sufficient progress towards compliance with the debt

criterion (as defined by the minimum linear structural adjustment (MLSA)) and to fully comply with the debt benchmark at the end of the transition period in 2016. As of 2017 Belgium needs to comply with the debt reduction benchmark proper.

The DBP does not include sufficient information to assess compliance with the debt rule in 2016 and 2017. Based on the Commission 2016 autumn forecast, Belgium will not make sufficient progress towards compliance with the debt rule in 2016. Given shortfalls from the requirements in the first two years of the transition period, the MLSA in 2016 reaches 2.6% of GDP on the basis of the Commission forecast, while the expected adjustment amounts to -0.1% of GDP this year. The relatively low nominal GDP growth in recent years makes the structural adjustment required to put the debt-to-GDP ratio on a downward path more demanding, though at the same time interest rate developments have been favourable and a prime driver of the structural effort achieved in recent years (see section 3.1). After the end of the transition period, Belgium is forecast not to comply with the debt rule as its debt-to-GDP ratio is expected to remain 2.9% of GDP above the debt benchmark in 2017.

Table 5. Compliance with the debt criterion*

	2015	**2016**			**2017**		
		SP	**DBP**	**COM**	**SP**	**DBP**	**COM**
Gross debt ratio	105.8	106.2	107.0	107.0	104.7	106.5	107.1
Gap to the debt benchmark [1,2]					n.a	n.a	2.9
Structural adjustment [3]	0.2	0.5	-0.2	-0.1	0.8	1.4	0.7
To be compared to:							
Required adjustment [4]	1.4	n.a	n.a	2.6			

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

* *An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the concerned countries providing extended data series (i.e. covering years up to t+4) in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack..*

Following non-compliance with the debt rule in 2015, the Commission prepared a report under Article 126(3) of the Treaty in May 2016, based on the 2015 outcome and the Commission 2016 spring forecast for 2016. This report concluded, after the assessment of all the relevant factors, that the debt criterion as defined in the Treaty and in Regulation (EC) No

1467/1997 should be considered as complied with at that time. These relevant factors included notably (i) the unfavourable economic conditions which make the respect of the debt rule more demanding; (ii) the expectation that compliance with the required adjustment towards the MTO was broadly ensured; and (iii) the expected implementation of growth-enhancing structural reforms in line with the authorities' commitment, which should contribute to debt reduction in the medium to long term[7].

4.2. Adjustment towards the MTO

2016

According to the information provided in the DBP, the expected change in the (recalculated) structural balance of -0.2% of GDP falls 0.8% of GDP short of the required improvement in 2016, thus pointing to a risk of a significant deviation. The growth rate of government expenditure net of discretionary revenue measures exceeds the applicable real expenditure benchmark rate of 0% in 2016 (gap of 0.4% of GDP), pointing to some deviation. This calls for an overall assessment. According to the information provided in the DBP, the structural balance is impacted by revenue shortfalls compared to standard elasticities in 2016, as has been repeatedly the case in the past. As a consequence, the expenditure benchmark appears to be a better indicator of the underlying fiscal effort. Therefore, the overall assessment on the basis of the DBP points to a risk of some deviation from the adjustment path towards the MTO in 2016. That conclusion would not change if the budgetary impact of the exceptional inflow of refugees and security measures were deducted from the assessment.

The Commission forecast projects the structural balance to deteriorate by 0.1% of GDP in 2016. This gap of -0.7% of GDP relative to the required effort points to a risk of a significant deviation. With a gap of -1.4% of GDP, also the expenditure benchmark signals such a risk[8]. Considering that both pillars point in the same direction, there is strong presumption of significant deviation in 2016 before the overall assessment. As was indicated above, the structural balance is negatively impacted by revenue shortfalls compared to standard elasticities. Taking this into account would bring the gap to -0.3% of GDP, signalling some deviation. Considering that the expenditure benchmark is not influenced either by revenue windfalls or shortfalls the gap for the expenditure benchmark does not change. Conversely, one-off factors, which do not show in the structural balance, negatively impact the expenditure benchmark in 2016 by 0.4% of GDP. When this is taken into account, the deviation from the requirement narrows to -1% of GDP, still considerably above the threshold for significant deviation. By construction, the expenditure benchmark assesses the change in primary spending, whereas the structural balance indicator fully integrates interest expenditures. As a consequence, the substantial decline in interest expenditures in 2016 improves the structural balance by 0.4% of GDP but not the expenditure benchmark, which highlights that interest windfalls are being spent. Therefore, the expenditure benchmark is considered to correctly reflect the underlying fiscal effort. As a result, the overall assessment

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[7] See: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/belgium_en.htm

[8] The substantial difference between the deviation in the expenditure benchmark according to the DBP and according to the Commission forecast reflects the expectation of stronger expenditure growth in the Commission forecast and, more importantly, the different appreciation of discretionary government revenue measures, namely new and higher taxes which were supposed to finance a multiannual tax shift away from labour, but which are not expected to generate the revenues put forward by the Belgian authorities (see section 3.1). As the expenditure benchmark nets out discretionary revenue measures, this revenue-decreasing tax reform has a negative impact on the expenditure benchmark in 2016.

on the basis of the Commission forecast points to a risk of significant deviation from the adjustment path towards the MTO in 2016. That conclusion would not change if the budgetary impact of the exceptional inflow of refugees and security measures were deducted from the assessment.

2017

In 2017, the (recalculated) structural balance shows a planned improvement by 1.4% of GDP, compared to a required effort of 0.6% of GDP. Also the expenditure benchmark points to compliance, with a positive gap of 0.5% of GDP compared to the requirements. Thanks to this planned overachievement in 2017, also 2016 and 2017 together point to compliance in spite of the deviation in 2016.

According to the Commission forecast, the structural balance would comply with the requirements in 2017 given a projected improvement of 0.7% of GDP. The expenditure benchmark shows a deviation by -0.1% of GDP, signalling a risk of some deviation in 2017. In contrast, 2016 and 2017 together indicate a risk of significant deviation for both pillars given average deviations of -0.3% of GDP and -0.8% respectively. This calls for an overall assessment with a strong ex ante presumption of significant deviation considering that both pillars point in the same direction. As mentioned above, the structural balance and the expenditure benchmark are negatively impacted by, respectively, revenue shortfalls and one-factors in 2016. When taking these elements into account, the average gap for the structural balance amounts to -0.2% of GDP, pointing to a risk of some deviation. The average gap for the expenditure benchmark narrows to -0.6% after accounting for the one-off factors and thus continues to point to a risk of significant deviation in 2016-2017. The difference between both indicators is mainly explained by the different incorporation of interest expenditures discussed above, which led to the conclusion that the expenditure benchmark is considered to correctly reflect the underlying fiscal effort. As a consequence, the overall assessment on the basis of the Commission forecast concludes that there is a risk of significant deviation from the adjustment path towards the MTO over 2016 and 2017 taken together. That conclusion would not change if the budgetary impact of the exceptional inflow of refugees and security measures were deducted from the assessment.

Table 6: Compliance with the requirements of the preventive arm

(% of GDP)	2015	2016		2017	
Initial position[1]					
Medium-term objective (MTO)	0.8	0.8		0.0	
Structural balance[2] (COM)	-2.6	-2.7		-2.0	
Structural balance based on freezing (COM)	-2.3	-2.3		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2015**	**2016**		**2017**	
	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]	0.2	-0.2	-0.1	1.4	0.7
One-year deviation from the required adjustment[7]	-0.4	-0.8	-0.7	0.8	0.1
Two-year average deviation from the required adjustment[7]	-0.5	-0.6	-0.5	0.0	-0.3
Expenditure benchmark pillar					
Applicable reference rate[8]	0.0	0.0		0.0	
One-year deviation[9]	0.1	-0.4	-1.4	0.5	-0.1
Two-year average deviation[9]	0.0	-0.2	-0.7	0.0	-0.8
Conclusion					
Conclusion over one year	Overall	Overall	Significant	Compliance	Overall
Conclusion over two years	Overall assessment	Overall assessment	Significant deviation	Compliance	Significant deviation

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 27.).

[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 2014) was carried out on the basis of Commission 2015 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 and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations.

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

The DBP contains no new information regarding the internal distribution of fiscal targets among government levels, as was called for in the 2016 country-specific recommendations. The absence of unequivocal commitments to multiannual budgetary targets undermines Belgium's overall consolidation strategy and prevents the High Council of Finance from executing in full the monitoring task it has been charged with.

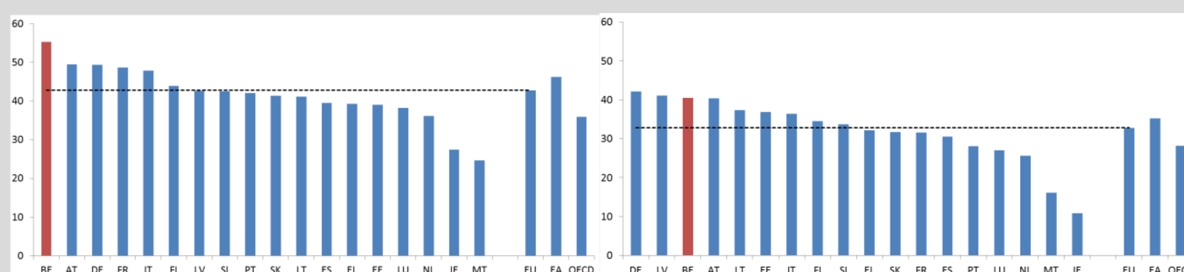
The DBP lists a number of structural reforms that were agreed on during the budget discussions at federal level and that respond to the (other than fiscal-structural) Country Specific Recommendations. They relate to measures to allow for a more flexible organisation of labour, provisions to nurture e-commerce activities, the reintroduction of reduced minimum wages for employees below the age of 21, and the reform of the Law of 1996 on competitiveness. A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2017 Country Reports and in the context of the country-specific recommendations to be adopted by the Commission in May 2017.

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 (data are for 2015, i.e. not yet reflecting the tax shifting measures enacted by Belgium in 2016).

The tax burden on labour in Belgium at the average wage and a low wage (2015)



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 in a particular country, 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.

In the context of the 2016 European Semester, Belgium was recommended to "simplify the tax system and remove distortive tax expenditures." The 2017 DBP does not include notable new measures that affect the tax wedge on labour. However, it should be pointed out that Belgium is implementing a multiannual tax reform, which aims at reducing the tax burden on labour, both for employers and employees. The next big phase of this reform is planned for 2018. The budget neutrality of this package is not acquired, though, as has been reflected in revenue shortfalls in 2016, which risk reoccurring in coming years.

The DBP announces that the government is examining the possibility to reform corporate income taxation. The abolition of a series of tax reductions would allow for a gradual reduction of the applicable tax rate. Considering the consolidation effort that lies ahead in order to reach the MTO and the financing gaps stemming from the tax reform mentioned higher, it will be crucial to perform this envisaged reform in a budgetary-neutral way. Also the possible introduction of a general tax on financial gains will be looked into according to the DBP.

6. OVERALL CONCLUSION

Based on the Commission 2016 autumn forecast, the structural improvement in 2016 falls short of the minimum linear structural adjustment to ensure sufficient progress towards compliance with the debt criterion. Also in 2017 the debt reduction benchmark would not be complied with.

Following an overall assessment of the DBP, the planned structural adjustment is considered to be in line with the required adjustment path towards the MTO in 2017, while 2016 shows a risk of some deviation. However, following an overall assessment based on the Commission 2016 autumn forecast there is a risk of significant deviation from the adjustment path towards the MTO both in 2016 and 2017 (based on 2016 and 2017 taken together). That conclusion would not change if the budgetary impact of the exceptional inflow of refugees and security measures were deducted from the assessment.