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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 11.11.2009
SEC(2009) 1554 final

Recommendation for a

COUNCIL OPINION

**in accordance with the third paragraph of Article 5 of
Council Regulation (EC) No 1466/97 of 7 July 1997**

On the complement to the updated stability programme of Belgium, 2008-2012

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact acknowledged its usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. In particular, it introduced greater flexibility in the application of the rules governing the excessive deficit procedure, notably with regard to the definition of "exceptional circumstances" and the setting of deadlines for the correction of an excessive deficit.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme and annual updates thereof. Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

In its opinion of 7 July 2009 on the April 2009 update of the stability programme, the Council summarised its assessment as follows: "The overall conclusion is that public finances in Belgium, starting from a relatively unfavourable position in view of the high government debt ratio, will be affected by the economic downturn. The fiscal stance in 2009 is appropriately expansionary, in line with the EERP. It notably reflects the fiscal stimulus whose size had to be limited given the high debt level. The government balance will exceed the 3% of GDP deficit reference value in 2009. At the same time, the government gross debt-to-GDP ratio, which started to rise again in 2008 as a result of the measures to stabilise the financial system, is expected to continue its upward movement. This comes after an impressive decline, from 134% in 1993 to 84% in 2007. The consolidation path in the updated programme aims at gradually reducing the headline deficits and thereby ensuring the long-term sustainability of public finances. The absence of crucial information in the programme, such as the expenditure and revenue ratios, has severely hampered the possibility to assess the credibility of the deficit and debt targets in the programme. The absence of underpinning of these targets suggests that they are not backed by a well-founded medium-term budgetary strategy in the meaning of the Stability and Growth Pact. The path is clearly subject to considerable downside risk over the entire programme period, stemming from the favourable macroeconomic assumptions and the lack of underlying measures. Moreover, also in the light of the debt dynamics and the long-term sustainability of public finances, it lacks ambition regarding the decisive correction of the deficit as the economic situation improves." In view of this assessment, the Council invited Belgium to (i) "submit a complement of the programme including a well founded medium-term budgetary strategy and improve compliance with the data requirements of the code of conduct especially regarding compulsory data", (ii) to "implement the stimulus

¹ OJ L 209, 2.8.1997, p. 1. The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

measures in line with the EERP as planned while avoiding a further deterioration of the structural balance in 2009 and resume fiscal consolidation as from 2010 when the economy is expected to improve and speed up the structural consolidation effort in 2011"; (iii) to "improve the quality of public finances by adopting a more stringent budgetary framework, encompassing binding, multi-annual expenditure ceilings and budgetary agreements among the different government tiers, including the establishment of enforcement mechanisms to ensure the respect of the fiscal targets" and (iv) "in addition to the budgetary consolidation efforts, to undertake structural reforms of the social security system, the labour market and product markets to enhance potential growth, increase the employment rate and reduce the budgetary impact of ageing, in order to improve the long-term sustainability of public finances".

In response to the first policy invitation to submit a complement to the programme including a well founded medium-term budgetary strategy, Belgium submitted a complement to its April 2009 stability programme update on 21 September 2009 to the Commission and the Council. The Commission has examined this complement and has adopted a recommendation for a Council opinion on it. This recommendation for a Council opinion updates the one provided on the April 2009 update of the stability programme, taking into account the information contained in the complement to the April 2009 programme.

Recommendation for a

COUNCIL OPINION

**in accordance with the third paragraph of Article 5 of
Council Regulation (EC) No 1466/97 of 7 July 1997**

On the complement to the updated stability programme of Belgium, 2008-2012

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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 policies², 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 [2 December 2009] the Council examined the complement to the April 2009 update of the stability programme of Belgium (hereafter called "the complement"), which covers the period 2008 to 2012³, submitted by the Belgian authorities in response to an invitation by the Council included in its opinion of 7 July 2009 on the April 2009 programme. The current opinion updates that of July, taking into account the information contained in the complement to the April 2009 programme.
- (2) The collapse of world trade together with decreasing confidence, wealth effects and tighter credit conditions led to a sharp contraction of the economy in the last quarter of 2008 and the first of 2009. In the second quarter, the contraction was more limited and quarterly growth is expected to turn slightly positive in the second half of the year in view of the improved international environment. According to the Commission services' autumn 2009 forecast, annual GDP is expected to contract by around 3% in 2009 and turn positive in 2010 (0.6%). In 2011, growth is projected to increase to 1½%, thus somewhat outpacing potential growth which has been reduced by the drop in investment and the rise in unemployment rate in the context of the crisis. The downturn will also have a significant adverse impact on public finances; according to

² 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/about/activities/sgp/main_en.htm.

³ The April 2009 update of the stability programme covered the period 2008 to 2013.

the Commission services' autumn 2009 forecast, the general government deficit set to deteriorate from 1.2% of GDP in 2008 to around 6% of GDP in 2009. The deficit is projected to stabilise in 2010 and 2011 taking into account (i) that the budgetary impact of the stimulus measures adopted at the end of 2008 in response to the EERP remains at ½% of GDP in 2010, reflecting that the package includes permanent measures, and (ii) the consolidation measures adopted by the different government tiers in the context of their budgets for 2010 (¾% of GDP) and 2011 (¼% of GDP). However, the adverse composition of economic growth in 2010 with a further strong increase in unemployment, higher interest expenditure, as well as expenditure growth linked to population ageing (also reflecting measures taken in recent years to increase social benefits, including pensions), are expected to compensate completely the impact of consolidation measures on the headline balance.

- (3) The macroeconomic scenario underlying the complement envisages that, after expanding by 1.1% in 2008, real GDP will fall by 3.1% in 2009, before recovering to a 0.4% growth rate in 2010. Thereafter, GDP growth is projected at 1.9% in 2011 and 2.4% in 2012. Compared to the April 2009 update of the programme, growth has been revised downward, especially in 2009. Assessed against currently available information⁴, this new scenario appears to be broadly plausible; it might be slightly cautious for the period 2009-2010, but somewhat favourable for the outer years against most recent potential output estimates. While the Commission services' autumn 2009 forecast also expects a gradual closing of the output gap after the downturn, the projected speed of the closing of the gap in the complement seems rather optimistic. The composition of growth is broadly plausible over the entire period covered by the complement. The forecast for inflation in the complement can be considered realistic. On the other hand, projected wage growth appears to be on the high side over the entire period as lower labour cost growth abroad might exercise more downward pressure on Belgian wages in a context of high unemployment. Finally, the employment growth projection for 2011 in the complement may also be slightly optimistic.
- (4) The complement contains a deficit target for 2009 of 5.9% of GDP (in line with the Commission services' autumn 2009 forecast). The increase in the deficit in 2009 compared to 1.2% of GDP in 2008 mainly reflects the impact of the automatic stabilisers. This impact has been much more important than what an application of standard elasticities would suggest, and in particular includes a strong fall in corporate tax revenue. The expansionary measures in the budget for 2009 (½% of GDP) and the fiscal stimulus packages set up by the regional and federal governments (½% of GDP) were relatively contained in line with the limited room for manoeuvre stemming from the high debt level. Finally, the budgetary deterioration reflects also negative one-off measures of about ½% of GDP, mainly following two Court decisions⁵. As a result of these one-off measures and a larger-than-expected impact of automatic stabilisers, the current deficit target for 2009 is 2½% of GDP higher than the one included in the April 2009 update of the stability programme, while no additional expansionary

⁴ The assessment notably takes into account the Commission services' autumn 2009 forecast.

⁵ First, the European Court of Justice ruled that corporate taxes had to be repaid as the Belgian dividends received deduction regime was not compatible with Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. Second, the Belgian Constitutional Court ruled that unduly paid personal income taxes should be repaid to cohabiting and married unemployed to ensure equal treatment.

measures have been taken. The structural deficit (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) on the basis of the information provided in the complement and recalculated by the Commission services according to the commonly agreed methodology, is projected to rise to 4.7% of GDP in 2009 from 2.3% in 2008. The Commission services' autumn 2009 forecast expects a somewhat smaller increase in the structural deficit in 2009 (by 2 instead of 2.4 percentage points), mainly because the complement did not consider the ½% of GDP impact of the Court decisions in 2009 to be one-offs.

- (5) The main goal of the medium-term budgetary strategy in the complement is to ensure a gradual return to a balanced budget by 2015. The complement does not explicitly mention the MTO and it also does not foresee Belgium's original Medium Term Objective (a surplus of 0.5% of GDP in cyclically-adjusted terms and net of one-off and other temporary measures) to be reached within the period covered by the complement. The headline deficit is set to stabilise at around 6% of GDP in 2010 thanks to 0.5% of GDP corrective measures, before gradually improving to 4.4% of GDP by 2012 (on the back of consolidation measures amounting to 1% in 2011 and 1¼% in 2012). The complement mentions a target of 2013 for the deficit to be brought below the 3% of GDP reference value, but it does not present a fully developed scenario for that year⁶. The structural deficit in the complement, recalculated according to the commonly agreed methodology, is set to improve by around ¼ percentage point both in 2010 and 2011 and by ½ percentage point in 2012. As the complement did not consider the ½% of GDP impact of the Court decisions in 2009 to be one-offs, the structural balance would actually deteriorate by ¼% of GDP in 2010 (from -4.2% of GDP in 2009 to -4.4% of GDP in 2010). The structural adjustments foreseen in the complement are considerably smaller than the amounts of planned measures that are mentioned above. This reflects that the structural balance under unchanged policies would automatically deteriorate by on average ½% of GDP per year as a result of the adverse composition of economic growth in 2010, higher interest expenditure, and higher spending linked to population ageing (also reflecting measures taken in recent years to increase social benefits, including pensions). According to the complement, the planned consolidation effort is equally based on increases in tax revenue (in particular of taxes on income and wealth) and reductions in expenditure (in particular of intermediate consumption, compensation of employees and social transfers in kind). The complement estimates government debt at 89.6% of GDP in 2008, compared to 84% of GDP in 2007, where the rise is largely the result of a significant stock-flow adjustment stemming from the bank rescue operations (6% of GDP). The complement expects the debt-to-GDP ratio to rise further to about 104% in 2011 where it broadly stabilises; this is substantially higher than in the April update (essentially due to the higher deficits). The Commission services' autumn 2009 forecast projects a comparable increase in the debt ratio.
- (6) The budgetary targets are overall subject to downside risks, mainly as of 2011. First, the macroeconomic environment is uncertain and worse results than envisaged in the complement in 2011 and 2012 cannot be excluded; this would result, in particular, in lower VAT and income tax revenue as well as higher social expenditure. Second, the

⁶ The programme provides the headline deficits for 2013-2015 (2.8% of GDP in 2013, 1.3% of GDP in 2014 and 0% of GDP in 2015), but does not give a further breakdown or a macroeconomic scenario to underpin these targets.

consolidation measures mentioned in the complement to back the targets are not sufficiently specified. While for 2010, it appears on the basis of the draft 2010 budgets of the different government tiers, agreed after the submission of the complement, that the amount of corrective measures exceeds the 0.5% of GDP foreseen in the complement, as the sufficiently specified measures currently amount to around ¾% of GDP, for the later years, there is only little information available on the nature of the planned measures. Finally, 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. On the other hand, mirroring the stronger-than-projected revenue fall in 2009, it cannot be excluded that tax revenue might be more dynamic than what would be implied by standard elasticities. In view of the overall downward risks to the budgetary targets, the evolution of the debt ratio may also be less favourable than projected in the complement.

- (7) The fiscal stance, as measured by the recalculated change in the structural balance of the complement and taking into account the above-mentioned risks, is expansionary in 2009, in line with the EERP, and broadly neutral for the rest of the programme period. In view of the risks related to the long-term sustainability of public finances, including the high level of government debt, which is moreover not sufficiently diminishing towards the reference value over the programme period, and important contingent liabilities following the measures to stabilise the financial system, the consolidation path should be considerably strengthened from 2011 onwards.
- (8) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the complement has improved compliance with the requirements of the code of conduct although some gaps in the required and optional data remain⁷.

The overall conclusion is that the expansionary fiscal stance in 2009 is in line with the EERP. Combined with the functioning of the automatic stabilisers, supportive discretionary measures will drive the headline deficit to almost 6% of GDP. 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 to 104% in 2012. This comes after an impressive decline, from 134% in 1993 to 84% in 2007, based on the achievement of balanced budgets. The consolidation path in the complement aims at gradually reducing the headline deficit to 4.4% in 2012 after which it would further decline to 2.8% of GDP in 2013 and a balanced budget in 2015. The path is overall subject to downside risk as of 2011, stemming from the fact that the underlying measures are not sufficiently specified and the somewhat favourable macroeconomic assumptions. In the light of the debt dynamics and the long-term sustainability of public finances, the planned consolidation should be considerably strengthened from 2011 onwards in order to decisively bring the deficit below the 3% of GDP reference value.

In view of the above assessment and in addition to earlier invitations issued in the Council opinion of 7 July 2009 to improve the quality and long-term sustainability of public finances, Belgium is also invited to achieve the amount of consolidation measures in 2010 as planned in the draft 2010 budget and considerably strengthen the adjustment effort as from 2011 through

⁷ In particular, the table on cyclical developments is not provided.

specified structural measures, in order to decisively bring the deficit below the 3% of GDP reference value.

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012
Real GDP (% change)	SP Sep 2009	2.8	1.1	-3.1	0.4	1.9	2.4
	COM aut 2009	2.9	1.0	-2.9	0.6	1.5	n.a.
	SP Apr 2009	2.8	1.1	-1.9	0.6	2.3	2.3
HICP inflation (%)	SP Sep 2009	1.8	4.5	0.0	1.5	1.6	1.6
	COM aut 2009	1.8	4.5	0.0	1.3	1.5	n.a.
	SP Apr 2009	1.8	4.5	0.7	1.8	1.8	1.7
Output gap ¹ (% of potential GDP)	SP Sep 2009	2.6	2.0	-2.3	-2.9	-2.3	-1.5
	COM aut 2009	2.4	1.7	-2.3	-2.8	-2.4	n.a.
	SP Apr 2009	2.3	1.5	-1.9	-2.7	-1.9	-1.2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	SP Sep 2009	2.1	-1.6	-1.9	-2.1	-2.3	n.a.
	COM aut 2009	3.5	-0.2	0.1	0.4	0.3	n.a.
	SP Apr 2009	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
General government revenue (% of GDP)	SP Sep 2009	n.a.	48.7	47.9	48.1	48.5	49.2
	COM aut 2009	48.2	48.8	47.7	48.0	48.2	n.a.
	SP Apr 2009	48.1	48.6	48.2	n.a.	n.a.	n.a.
General government expenditure (% of GDP)	SP Sep 2009	n.a.	49.9	53.8	54.1	53.9	53.6
	COM aut 2009	48.4	50.0	53.6	53.8	54.0	n.a.
	SP Apr 2009	48.3	49.8	51.6	n.a.	n.a.	n.a.
General government balance (% of GDP)	SP Sep 2009	n.a.	-1.2	-5.9	-6.0	-5.5	-4.4
	COM aut 2009	-0.2	-1.2	-5.9	-5.8	-5.8	n.a.
	SP Apr 2009	-0.2	-1.2	-3.4	-4.0	-3.4	-2.6
Primary balance (% of GDP)	SP Sep 2009	n.a.	2.5	-2	-1.9	-1.2	-0.1
	COM aut 2009	3.6	2.6	-2.0	-1.8	-1.7	n.a.
	SP Apr 2009	3.6	2.5	0.4	-0.1	0.6	1.5
Cyclically-adjusted balance ¹ (% of GDP)	SP Sep 2009	-1.6	-2.3	-4.7	-4.4	-4.2	-3.6
	COM aut 2009	-1.5	-2.1	-4.6	-4.3	-4.5	n.a.
	SP Apr 2009	-1.5	-2.0	-2.4	-2.6	-2.4	-1.9
Structural balance ³ (% of GDP)	SP Sep 2009	-1.5	-2.3	-4.7	-4.4	-4.2	-3.6
	COM aut 2009	-1.4	-2.2	-4.2	-4.4	-4.5	n.a.
	SP Apr 2009	-1.3	-2	-2.4	-2.6	-2.4	-1.9
Government gross debt (% of GDP)	SP Sep 2009	n.a.	89.7	97.5	101.9	103.9	104.3
	COM aut 2009	84.2	89.8	97.2	101.2	104.0	n.a.
	SP Apr 2009	84.0	89.6	93.0	95.0	94.9	93.9
Notes:							
¹ Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the complement.							
² Based on estimated potential growth of 1.9%, 1.7%, 1.1%, 1.0% and 1.2% respectively in the period 2007-2011.							
³ Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0 all over the period according to the complement. According to the Commission services' autumn 2009 forecast, one-offs are deficit-reducing both in 2008 and 2010 (0.1% of GDP) and deficit-increasing in 2009 (0.5% of GDP).							
Source:							
September 2009 complement to the April 2009 update of the stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.							