Brussels, 18.5.2016
COM(2016) 291 final

REPORT FROM THE COMMISSION

Belgium

Report prepared in accordance with Article 126(3) of the Treaty

1. INTRODUCTION

Article 126 of the Treaty on the Functioning of the European Union (TFEU) lays down the excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1], which is part of the Stability and Growth Pact (SGP). Specific provisions for euro area Member States under EDP are laid down in Regulation (EU) No 473/2013[2].

According to Article 126(2) TFEU, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 126(3) TFEU provides that, if a Member State does not fulfil the requirements under one or both of the above criteria, the Commission has to prepare a report. This report also has to "*take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State*".

This report, which represents the first step in the EDP, analyses Belgium's compliance with the deficit and debt criterion of the Treaty, with due regard to the economic background and other relevant factors.

Following the amendments to the SGP in 2011, the debt requirement has been put on an equal footing with the deficit requirement in order to ensure that, for countries with a debt-to-GDP ratio above the 60% reference value, the ratio is brought below (or sufficiently declining towards) that value. Article 2(1a) of Council Regulation (EC) No 1467/97 provides that Member States that were subject to an excessive deficit procedure on 8 November 2011 benefit from a three-year transition period, starting in the year following the correction of the excessive deficit, during which they are expected to make sufficient progress towards compliance with the debt reduction benchmark. In the case of Belgium, the transition period covers the years 2014-2016 (i.e. three years after the correction of the excessive deficit[3]). The "*Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes*" of 3 September 2012 spell out how the requirement for the structural balance is defined and assessed. In particular, they

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[1] OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 3 September 2012, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/legal_texts/index_en.htm .

[2] Regulation (EU) No 473/2013 of the European Parliament and of the Council on "common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area" (OJ L 140, 27.5.2013, p. 11).

[3] Council Decision of 20 June 2014 abrogating the decision on the existence of an excessive deficit. All EDP-related documents for Belgium can be found at the following website: http://ec.europa.eu/economy_finance/economic_governance/sgp/corrective_arm/index_en.htm

define a minimum linear structural adjustment of the structural balance (MLSA) ensuring that the debt reduction benchmark is met by the end of the transition period.

On 13 January 2015 the Commission adopted a Communication on Flexibility[4], providing new guidance on how to apply the existing rules of the Stability and Growth Pact, in order to strengthen the link between effective implementation of structural reforms, investment, and fiscal responsibility in support of jobs and growth. The Communication does not amend any provision of the Pact but aims to further reinforce the effectiveness and understanding of its rules and develop a more growth-friendly fiscal stance in the euro area by ensuring the best use of the flexibility enshrined within the Pact, while preserving its credibility and effectiveness in upholding fiscal responsibility. In particular, the Communication clarified that – in line with the provisions of Article 2(3) of Council Regulation (EC) No 1467/97 - the Commission – in the context of a report pursuant to Article 126(3) TFEU - will analyse carefully all relevant medium-term developments regarding the economic, budgetary and debt positions. It has also clarified that the implementation of structural reforms in the context of the European Semester is to be considered among those relevant factors[5].

On 27 February 2015, the Commission issued a Report under Article 126(3) TFEU, as Belgium was not expected to make sufficient progress towards compliance with the debt rule in 2014, including the assessment of all relevant factors that might justify the *prima facie* lack of compliance, notably: (i) the unfavourable economic conditions, and in particular low inflation, which made the respect of the debt rule particularly demanding; (ii) the expectation that compliance with the required adjustment towards the medium-term budgetary objective (MTO) was broadly ensured; and (iii) the expected implementation of ambitious growth-enhancing structural reforms in line with the authorities' commitment, which was expected to contribute to debt reduction in the medium/long term.

Data notified by the Belgian authorities on 31 March 2016[6] and subsequently validated by Eurostat[7] show that the general government deficit in Belgium reached 2.6% of GDP in 2015, while debt was at 106.0% of GDP, above the 60% of GDP reference value. For 2016, the spring 2016 notification planned a deficit of 2.4% of GDP and a debt ratio of 106.2% of GDP, while the Stability Programme (SP) plans a deficit of 2.5% of GDP and a similar debt ratio. This upward revision of the deficit target results from the federal government's decision to exclude the budgetary impact of anti-terrorist measures from its structural targets.

Based on the notified data and the Commission 2016 spring forecast Belgium is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2015 and 2016 (see Table 1) as the change in the structural balance is estimated to have been 0.2%

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[4] Commission Communication on making the best use of the flexibility within the existing rules of the Stability and Growth Pact - COM(2015) 12 final.

[5] Article 2 of Regulation (EC) No 1467/97 provides that *" [...] The report shall reflect, as appropriate [...] the implementation of policies in the context of the prevention and correction of excessive macroeconomic imbalances, the implementation of policies in the context of the common growth strategy of the Union [...]".*

[6] According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Belgium can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/excessive_deficit/edp_notification_tables.

[7] Eurostat news release No 76/2016 http://ec.europa.eu/eurostat/documents/2995521/7235991/2-21042016-AP-EN.pdf

of GDP in 2015 compared to a required minimal linear structural adjustment (MLSA) of 1.1% of GDP[8] and is projected to amount to 0.3% of GDP in 2016 compared to the required 2.0% of GDP[9].

Table 1: General government deficit and debt (% of GDP)

		2013	2014	2015	2016		2017	
					COM	SP	COM	SP
Deficit criterion	General government balance	-3.0	-3.1	-2.6	-2.8	-2.5	-2.3	-1.4
Debt criterion	General government gross debt	105.2	106.5	106.0	106.4	106.2	105.6	104.7
	Gap to the debt reduction benchmark	n.r.	n.r.	n.r.	n.r.	n.r.	2.3	n.a.
	Change in structural balance	0.6	0.1	0.2	0.3	0.6	0.2	0.8
	Required MLSA	n.r.	0.8	1.1	2.0	2.1	n.r.	n.r.

Source: Belgium's 2016 Stability Programme (SP) and Commission 2016 spring forecast (COM)

Overall, Belgium's insufficient progress towards compliance with the debt reduction benchmark in 2015 provides evidence of a *prima facie* existence of an excessive deficit in the sense of the Stability and Growth Pact before, however, considering all factors as set out below.

The Commission has therefore prepared this report to comprehensively assess the departure from the transitional debt rule in order to examine whether the launch of an Excessive Deficit Procedure is warranted after all relevant factors have been considered. Section 2 of the report examines the deficit criterion. Section 3 examines the debt criterion. Section 4 deals with public investment and other relevant factors, including the assessment of compliance with the required adjustment path towards the MTO. The report takes into account the Commission 2016 spring forecast, released on 3 May 2016, and the Commission's evaluation of subsequent developments.

2. DEFICIT CRITERION

In 2014, Belgium's deficit reached 3.1% of GDP. In its report under Article 126(3) TFEU of 27 February 2015, the Commission concluded that the deficit was close to the 3% of GDP reference value and the excess over the reference value was exceptional and temporary in the sense of the Stability and Growth Pact. In 2015, Belgium’s general government deficit decreased to 2.6% of GDP. According to both the 2016 Stability Programme and the Commission 2016 spring forecast, the deficit is also foreseen to respect the 3% of GDP Treaty reference value during the period 2016-2017. According to the Commission 2016 spring forecast, it is expected to amount to respectively 2.8% of GDP in 2016 and 2.3% in

[8] I.e. an annual structural adjustment over 2014-2016 of 0.8% of GDP would have ensured that - if followed – Belgium would comply with the debt reduction benchmark at the end of the transition period, assuming that growth projections of the Commission 2016 spring forecast materialise.

[9] Given the shortfalls in 2014 and 2015, the required annual structural adjustment over the remaining year of the transition period (2016) amounts to 2.0% in order to comply with the debt reduction benchmark at the end of this period, assuming that growth projections of the Commission 2016 spring forecast materialise.

2017. The 2016 Stability Programme plans the general government deficit-to-GDP ratio to decline to 2.5% in 2016 and to 1.4% in 2017. Belgium thus complies with the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/97.

3. DEBT CRITERION

General government gross debt increased steadily over the last years, growing from 87% of GDP in 2007 to 106.0% of GDP at the end of 2015 (+19 pps. of GDP).

The main drivers for the increase were the accumulation of primary budget deficits following the economic and financial crisis, as well as interventions in the financial system and subdued GDP growth. Despite the increase in debt levels, interest expenditure declined steadily over the same period as a result of the decline in interest rates (apart from a temporary rise in risk premia in 2012). A slightly positive primary balance had a positive impact on the debt ratio in 2014 and 2015. On the other hand, there was an upward snowball effect on the debt ratio. Indeed, as a result of relatively low inflation and real growth, nominal GDP growth for 2014 and 2015 was rather low, at respectively 2.0% and 2.3% while interest expenditure amounted to 3.2% and 2.9% of GDP, respectively. However, thanks to the reimbursement of a loan of 0.7% of GDP from KBC to the Flemish Region, which had been granted in 2009 in the context of bank rescue operations, the debt level decreased in 2015 for the first time since 2007.

According to the Commission 2016 spring forecast, the primary balance is expected to slip into deficit in 2016, for the first time since 2012. Therefore it will no longer have a downward impact on the debt development. On the other hand, the projected decrease in interest expenditure and the slight acceleration of nominal GDP growth should result in a reversed snowball effect as of 2016. At the same time stock-flow adjustments have a substantial upward impact on the debt evolution over the forecast horizon. All in all, the debt ratio is estimated to rise to 106.4% of GDP at the end of 2016. At unchanged policy, it is expected to fall to 105.6% at the end of 2017.

According to Belgium's 2016 Stability Programme, communicated to the Commission on 29 April 2016, the debt ratio is projected to reach 106.2% at the end of 2016 and decline to 104.7% in 2017. The difference from the Commission's projection is explained by a lower planned headline deficit. Assumptions for nominal GDP growth are broadly similar while stock-flow adjustments are expected to have a bigger debt-increasing impact in the stability programme.

Table 2: Debt dynamics

	2013	2014	2015	2016		2017	
	COM	COM	COM	COM	SP	COM	SP
Government gross debt ratio	105.2	106.5	106.0	106.4	106.2	105.6	104.7
Change in debt ratio [b] (1 = 2+3+4)	1.1	1.3	-0.5	0.4	0.2	-0.8	-1.5
Contributions:							
• Primary balance (2)	-0.3	-0.1	-0.3	0.1	-0.1	-0.3	-1.1
• "Snowball" effect (3)	2.0	1.1	0.5	-0.1	-0.3	-0.5	-0.6
of which:							
Interest expenditure	*3.4*	*3.2*	*2.9*	*2.7*	*2.6*	*2.6*	*2.5*
Real GDP growth	*0.0*	*-1.3*	*-1.4*	*-1.2*	*-1.2*	*-1.6*	*-1.5*
Inflation (GDP deflator)	*-1.3*	*-0.7*	*-0.9*	*-1.5*	*-1.6*	*-1.4*	*-1.5*
• Stock-flow adjustment (4)	*-0.6*	*0.3*	*-0.8*	*0.4*	*0.6*	*0.0*	0.2

Notes:

[a] In percent of GDP.

[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.

Source: Belgium's 2016 Stability Programme (SP) and Commission 2016 spring forecast (COM)

Following the abrogation of the Excessive Deficit Procedure in June 2014, Belgium is subject toa three-year transition period to comply with the debt reduction benchmark, which started in 2014. In order to ensure continuous and effective progress towards compliance during the transition period, Member States should respect simultaneously the two conditions below:

a. First, the annual structural adjustment should not deviate by more than ¼ % of GDP from the minimum linear structural adjustment (MLSA) ensuring that the debt rule is met by the end of the transition period;

b. Second, at any time during the transition period, the remaining annual structural adjustment should not exceed ¾ % of GDP. However, this condition does not apply to the case of Belgium because the first condition implies an annual effort above ¾ % of GDP.

The structural adjustment by Belgium in 2014 and 2015 was not sufficient to meet the requirements of the transition period for the debt reduction benchmark (see Table 1). In 2014, the required MLSA calculated on the basis of the Commission 2016 spring forecast would have been equal to 0.8% of GDP, while the structural balance improved by 0.1% of GDP. Therefore, the deviation is above the maximum deviation allowed by the first condition. However, in its report of 27 February 2015, the Commission concluded that the debt criterion should be considered as complied with at that point in time.

In view of the shortfall in 2014, the minimum required adjustment rose to 1.1% of GDP in 2015, significantly above the adjustment towards the MTO of at least 0.6% of GDP recommended by the Council to Belgium in June 2015. Based on the outturn data notified

and validated in April 2016, the structural balance is estimated to have improved by 0.2% of GDP in 2015, and therefore also in 2015 the first condition is not respected.

In view of the shortfall in 2014 and 2015, the remaining required adjustment in the last year of the transition period, 2016, reaches 2.0% of GDP. According to the Commission 2016 spring forecast, the structural balance is projected to improve by 0.3% of GDP in 2016. Thus, Belgium is not expected to comply with the debt reduction benchmark by the end of the transition period. On the basis of the macroeconomic scenario of the Stability Programme, the required MLSA in 2016 reaches 2.1% of GDP, while the planned adjustment amounts to 0.6% of GDP. Hence, Belgium is not projected to and does not plan to comply with the debt reduction benchmark by the end of the transition period. This assessment would not change when taking into account the impact of financial solidarity operations.

The overall analysis above thus suggests that *prima facie* the debt criterion under the Treaty and Regulation (EC) No 1467/1997 appears not to be fulfilled based on 2016 Stability Programme as well as the Commission 2016 spring forecast before, however, consideration is given to all relevant factors set out in Section 4.

4. RELEVANT FACTORS

Article 126(3) TFEU provides that the Commission report "*shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State*. These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "*any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with the deficit and debt criteria and which the Member State has put forward to the Council and to the Commission*" need to be given due consideration.

In case of apparent breach of the debt criterion, the analysis of the relevant factors is particularly warranted given that debt dynamics are influenced by factors outside the control of the government to a larger extent than in case of the deficit. This is recognised in Article 2(4) of Council Regulation (EC) No 1467/97, which provides that the relevant factors shall be taken into account when assessing compliance on the basis of the debt criterion irrespective of the size of the breach.

In this respect, at least the following three main aspects need to be considered when assessing compliance with the debt criterion given their impact on the debt dynamics and sustainability.

1. **Adherence to the MTO or the adjustment path towards it**: the achievement of the MTO or the progress towards it is supposed, under normal macroeconomic circumstances, to ensure sustainability or rapid progress to sustainability. By construction, the country-specific MTO takes into account the debt level and implicit liabilities. Compliance with the MTO or the adjustment path towards it should ensure – in the medium term – convergence of the debt ratios towards prudent levels. In particular, Belgium would, in normal economic conditions, comply with the debt reduction benchmark when at its MTO.

2. **Structural reforms,** already implemented or detailed in a structural reform plan: the rationale for taking into account these reforms is that through their impact on growth they are expected to enhance sustainability in the medium

term, contributing to bring the debt-to-GDP ratio on a satisfactory downward path.

Adherence to the MTO (or the adjustment path towards it) along with implementation of structural reforms (in the context of the European Semester) is expected to bring debt dynamics on a sustainable path, through the combined impact on the debt level itself (through the achievement of a sound budgetary position at the MTO) and on economic growth (through the reforms).

3. Apart from these two main factors, **the occurrence of extraordinary economic conditions**, which may hamper the reduction of the debt-to-GDP ratios and make compliance with the SGP provisions particularly demanding, needs to be taken into account. Specifically, the protracted period of relatively low nominal GDP growth – requires the concerned Member States to achieve very demanding structural adjustments to comply with the MLSA under the transitional debt rule. By construction, the transitional debt rule assumes that the growth of the GDP deflator will only return to the long term average value of 2% by 2020, which makes compliance with the forward-looking debt rule particularly demanding. Under such conditions, adherence to the MTO or the adjustment path towards it (as spelled out under 1) is a key relevant factor in assessing compliance with the debt rule.

In view of the above provisions, the following subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position, including an assessment of compliance with the required adjustment towards the MTO and the development of public investment; (3) the developments in the medium-term government debt position, its dynamics and sustainability; (4) other factors considered relevant by the Commission; and (5) other factors put forward by the Member State.

4.1. Medium-term economic position

Cyclical conditions, potential growth and inflation

The Belgian economy proved to be rather resilient following the global economic recession in 2009. GDP quickly regained pre-crisis levels, thanks to strong economic growth in 2010 and 2011. This period of growth was followed by a period of stagnation, with only slightly positive GDP growth in 2012 and flat GDP in 2013. In 2014 and 2015, GDP growth reached around 1.3 to 1.4%. According to the Commission 2016 spring forecast, economic growth is expected to slow down to 1.2% in 2016 due to the weaker external environment and the short-term impact of the March 2016 terrorist attacks. More robust domestic demand is projected lift growth to 1.6% in 2017.

Potential growth estimates for Belgium are rather low, at 1.1% on average over 2014-2017. The contribution of labour to potential growth slowed down since the crisis, mostly due to a slower growth of working age population. In addition, the contribution of capital accumulation dropped, while the contribution of total factor productivity continued its long term erosion. While the negative output gap narrowed since its trough in 2013, it is projected to remain negative over the forecast horizon.

As with other Member States of the euro area, Belgium experienced a protracted period of low domestic inflation. The GDP deflator has risen by 0.7% in 2014 and 0.9% in 2015. The increase projected for 2016 and 2017 remains below the historical average, by respectively

1.5% and 1.4%. By construction, the debt reduction benchmark assumes that the increase in the GDP deflator will only gradually convergence to a more normal rate of 2%, notably by 2020. This relatively slow increase in the GDP deflator has an important impact on the evolution of the debt-to-GDP ratio and has a substantial impact on the adjustment required to put the debt on a firm downward path as required by the forward-looking debt benchmark. Indeed, the MLSA for Belgium calculated on the basis of the Commission 2016 spring forecast is substantially higher than what had been recommended by the Council in June 2015. In view of the above-mentionned adverse cyclical circumstances, such high effort may be neither feasible nor desirable.

Table 3: Macroeconomic and budgetary developments [a]

	2013	2014	2015	2016		2017	
	COM	COM	COM	COM	SP	COM	SP
Real GDP (% change)	0.0	1.3	1.4	1.2	1.2	1.6	1.5
GDP deflator (% change)	1.3	0.7	0.9	1.5	1.6	1.4	1.5
Potential GDP (% change)	0.8	1.0	1.1	1.2	1.3	1.4	1.4
Output gap (% of potential GDP)	-1.4	-1.0	-0.7	-0.7	-0.6	-0.5	-0.4
General government gross debt	105.2	106.5	106.0	106.4	106.2	105.6	104.7
General government balance	-3.0	-3.1	-2.6	-2.8	-2.5	-2.3	-1.4
Primary balance	0.3	0.1	0.3	-0.1	0.1	0.3	1.1
One-off and other temporary measures	0.6	0.3	0.4	-0.1	-0.1	0.0	0.1
Government gross fixed capital formation	2.4	2.4	2.3	2.3	2.4	2.4	2.5
Cyclically-adjusted balance	-2.2	-2.5	-2.2	-2.4	-2.1	-2.0	-1.1
Cyclically-adjusted primary balance	1.2	0.7	0.7	0.3	0.9	0.6	1.7
Structural balance [b]	-2.8	-2.8	-2.6	-2.3	-2.0	-2.1	-1.2
Structural primary balance	0.5	0.4	0.3	0.4	0.7	0.5	1.2

Notes:

[a] In percent of GDP unless specified otherwise.

[b] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission 2016 spring forecast (COM), Belgium's 2016 Stability Programme (SP)

Structural reforms

The 2016 Country Report for Belgium found that macroeconomic risks related to competitiveness have narrowed in recent years given corrective action[10]. This trend is expected to continue in the near term. However, the report also highlighted that only structural reforms of the wage-setting framework itself could prevent new competitiveness gaps from emerging. Risks stemming from the high public indebtedness are mitigated by an increasing average maturitiy of this debt stock and the overall healthy financial state of the private sector. Nevertheless, the high public debt level complicates consolidation efforts for the Belgian government moving forward.

[10] See Commission Communication COM(2016) 95 final.

In its Communication of 13 January 2015[11], the Commission strengthened the link between effective implementation of structural reforms, investment, and fiscal responsibility in support of jobs and growth, within the existing rules of the SGP. Since taking office at the end of 2014, the Belgian federal government has outlined and started to implement a structural reform agenda. Reforms relate primarily to pensions, taxation and the labour market and cover several of the challenges identified in the country-specific recommendations for Belgium[12].

In recent years, Belgium has made important progress in reforming its public pension system. In order to raise the effective retirement age, early exit possibilities have been reduced by further tightening the standard eligibility requirements for both early and pre-retirement. The legal retirement age will rise from 65 to 66 in 2025 and 67 to 2030. The long-term impact of this set of measures is discernible in the latest projections of the Ageing Working Group: pension expenditures are projected to rise by 1.3 pp. of GDP between 2013 and 2060, compared to 3.3 pp. before the 2015 reforms. The difference is mostly due to the pension reform itself (-1.6 pp. of GDP), while other measures, such as the temporary suspension of indexation and lower public employment (-0.4 pp. of GDP), will also curb expenditure growth. These more positive ageing projections have allowed for a lower minimum medium-term objective under the SGP.

Although already enacted reforms have thus substantially reduced the projected rise in public pension spending, curbing the expected increase in age-related spending further through additional reforms would improve fiscal sustainability in the long term. Indeed, the intended adoption of a credit-based public pension system by 2019 would, once fully implemented, allow for automatic adjustment mechanisms in response to demographic or economic developments. At the same time, a mechanical shift to early exit through the sickness and disability schemes needs to be prevented.

In recent months new measures have already been announced which focus on the civil servant pension scheme and their convergence with the private sector pension scheme. Years of study will, for example, no longer affect pension benefits (in line with the 2015 reform which did the same with regard to career requirements) unless these years are regularised by means of additional contributions. Favourable accrual rates for certain profiles with regard to career requirements and pension rights will also be reviewed once a list of arduous professions is determined.

Within the framework of the multi-annual tax shift outlined in 2015 and introduced as of this year, the tax pressure on labour is being reduced. Both employers and employees benefit from measures to narrow the tax wedge. On the one hand, the statutory rate of employers' social security contributions will be reduced to 25% by 2018, with lower effective rates for low to medium wages. In addition, wage subsidies for shifted and night labour have been increased. SMEs and independents are exempted from social security contributions for the first newly hired employee, while contributions are reduced for the next five employees. On the other hand, the take home pay of employees is being increased through a combination of increases in the lump sum allowance for professional expenses, the work bonus, the tax exempted amount, and a reshuffling of tax brackets. The announced labour tax cuts represent EUR 11.5 billion by 2020, or 2.2% of GDP. The budgetary neutrality of the tax shift is

[11] See footnote 4.
[12] For an exhaustive overview of reform measures, see Belgian National Reform Programme 2016.

currently not assured, which weighs on the budget outlook for 2016 and 2017. In the medium-term the initial negative budgetary impact of the tax shift will be partly offset by its positive impact on growth and employment. Despite recent reforms, the Belgian tax system remains hampered by widespread distortions which narrow tax bases and contribute to the system's complexity.

A third wharf concerns the modernisation of labour legislation with the double goal of enhancing flexibility for employers and work tenability for employees. Proposals were outlined by the federal government in a letter sent on 15 April 2016 to the Commission, with forthcoming legislative proposals scheduled for adoption by the end of the year. Newly envisaged rules comprise the calculation of the average working period on an annual basis, with a standard maximum daily/weekly working time of 9/45 hours (11/50 in case of a sectoral agreement to exceed the standard limits). In addition, all employees can dispose over an annual credit of 100 hours of overtime which they do not have to compensate but can have either paid out or added to a 'career account' on which also leave rights can be accumulated if agreed at sector level. Other reforms entail the introduction of an individual annual training right, a legal framework for occasional telework, and more flexible rules regarding working hours and overtime.

In its 2016 National Reform Programme the Belgian government subscribes to the need of a structural reform of the wage-setting framework. With this goal in mind it was announced that the legal framework defining wage negotiations (the 'Law of 1996') will be revised with legislation to be introduced in Parliament in coming months. Planned revisions include the introduction of automatic correction mechanisms and a stricter monitoring of compliance with the wage norm, as was already announced in the government agreement of October 2014.

4.2. Medium-term budgetary position

Headline, structural balance and adjustment towards the MTO

Belgium's headline deficit reached 2.6% of GDP in 2015, down from 3.1% in 2014. In 2016, the headline deficit is expected to increase to 2.8% of GDP according to the Commission 2016 spring forecast. This deterioration is explained by one-off factors, which contributed positively in 2015 (0.4% of GDP) but are projected to turn negative in 2016 (-0.1% of GDP). Moreover, the 2016 headline deficit is impacted by additional expenditure related to asylum-seekers and security measures, of respectively 0.2% and 0.1% of GDP. At unchanged policy, the 2017 headline deficit is expected to drop to 2.3% of GDP.

Belgium's Draft Budgetary Plan for 2016 indicated that the budgetary impact of the exceptional inflow of refugees is significant in 2015 and 2016 and that it should be considered as an unusual event outside the control of the government, as defined in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97. In relation to this situation, Belgium requested a temporary deviation from the adjustment path towards the MTO. In a letter sent to the Commission on 17 March 2016, the Belgian authorities also invoked these provisions with respect to exceptional expenditure in 2016 linked to security measures and the fight against terrorism.

Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees as well as the severity of the terrorist threat are exceptional events, their impact on Belgium`s public finances is significant and sustainability

would not be compromised by allowing for a deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2015 should be reduced to take into account additional refugee-related costs estimated at 0.03% of GDP in that year[13].

The structural balance is projected to have improved by 0.2% of GDP in 2015, 0.4% of GDP below the required effort of 0.6% of GDP under the preventive arm of the Pact. On the other hand, Belgium is compliant with the expenditure benchmark. Over 2014 and 2015 together, the structural balance hardly improved, pointing to a risk of significant deviation based on the structural balance pillar (average gap of -0.5% of GDP). On the other hand, the expenditure benchmark pillar points to compliance over 2014 and 2015 taken together. It calls for an overall assessment. In 2014, the structural balance was negatively impacted by a sizable revenue shortfall (0.3% of GDP), among others due to a loss in revenue from the financial sector (e.g. dividends and guarantee fees). Also in 2015, the structural balance was impacted by revenue shortfalls (0.6% of GDP) compared to standard elasticities, due to particularly low wage growth and low inflation (relative to the change in GDP deflator). The revenue shortfall was only partially counterbalanced by savings in interest expenditure which improved the structural balance but which is not taken into account in the expenditure benchmark pillar. After correcting for the above-mentioned revenue shortfalls, the structural balance pillar would point to some deviation. Therefore, the overall assessment points to some deviation from the adjustment path towards the MTO over 2014 and 2015 taken together.

In 2016, the structural balance is projected to improve by of 0.3% of GDP, just half of the required adjustment of 0.6% of GDP, pointing to a risk of some deviation. The expenditure benchmark points to a risk of significant deviation (gap of -1.2% of GDP). The expenditure benchmark is negatively impacted by the development of one-off factors (impact of 0.5% of GDP), without which the gap would be 0.7% of GDP. The additional budgetary impact of the exceptional inflow of refugees and exceptional security measures following recent terrorist threats in Belgium taken into account in the Commission forecast is estimated at 0.17% and 0.12% of GDP respectively. In case the impact of one-offs would be netted out and the additional budgetary impact of the exceptional inflow of refugees as well as of exceptional security measures was excluded from the assessment, both indicators would point to some deviation.

Over 2015 and 2016 together, both indicators point to a risk of signification deviation (average gap of -0.3% of GDP and -0.6% of GDP on the structural balance and on the expenditure benchmark pillar respectively). Therefore, there is a risk of significant deviation from the adjustment path towards the MTO in 2016. In case the additional budgetary impact of the exceptional inflow of refugees (0.10% of GDP on average over 2015 and 2016) as well as of exceptional security expenditure (0.06% of GDP on average) was excluded from the assessment, the average deviation on the structural balance pillar would fall below the threshold of significance. The expenditure benchmark is negatively impacted by the development of one-off factors (annual average impact of -0.2% of GDP over 2015 and 2016). Netted out for this element and excluding the additional impact of refugee-related

[13] See also the Commission Recommendation for a Council Recommendation of 18 May 2016 on the 2016 national reform programme of Belgium and delivering a Council opinion on the 2016 stability programme of Belgium.

expenditure and anti-terrorism measures, the expenditure benchmark would also point to some deviation in 2016. Therefore, taking into account the exceptional nature of the costs related to the sizeable inflow of refugees and the recent terrorist threats, Belgium can be considered broadly compliant with the required adjustment towards the MTO in 2016.

Overall, based on the Commission 2016 spring forecast and taken into account the flexibility foreseen in the Stability and Growth Pact for unusual events outside the control of the government, Belgium can be considered broadly compliant with the required adjustment towards its MTO in 2015 and 2016. Full compliance with the required adjustment towards the MTO in 2017 and subsequent years would ensure that the forward-looking debt rule is met as of 2018.

In their 2016 stability programme, the Belgian authorities revised their MTO to a balanced budget in structural terms, down from a structural surplus of 0.75% of GDP. The new MTO is more ambitious than the new minimum MTO for Belgium of -0.5% of GDP. Belgium plans to reach this MTO by 2018, which would require an effort of 1.7% of GDP over 2017-2018 according to the plans. According to the spring forecast, a higher effort (2.3% of GDP) would be needed due to a different estimate of the 2015 structural balance position and a different projection for the 2016 deficit. In normal conditions, the planned adjustment towards the MTO and the achievement of the new MTO by 2018 would lead to compliance with the forward-looking debt rule as of 2017.

Public investment

Public investment peaked in 2012 at 2.5% of GDP, due to the investment cycle at local level. For the same reason, it decreased afterwards, to 2.4% of GDP in 2013 and 2014. In 2015, public investment dropped further, to 2.3% of GDP. Investment grants to non-financial corporations (among others for railway infrastructure, hospitals, elderly homes and schools), amounting to 1.1% of GDP in 2014, are not included in these figures. Over the forecast horizon, investment is projected to increase due to large investment projects at regional level and the investment cycle of local authorities.

4.3. Medium-term government debt position

Between 1998 and 2007, Belgium's government debt-to-GDP ratio decreased by 32 pps, thanks to sizeable primary surpluses (although gradually declining), sustained economic growth as well as a decreasing interest burden. At the end of 2007, Belgium's general government debt stood at 87% of GDP. Since the start of the financial and economic crisis in 2007, the Belgian government debt has been rising again. However, despite massive interventions in the financial sector and a deficit above or around 3% of GDP since 2009, the recent debt increase is less pronounced in Belgium (+ 19 pps. of GDP between 2007 and 2015) than in many other Member States and the euro area as a whole (28 pps. of GDP in the euro area on aggregate). Despite the increase in debt levels, interest expenditure declined steadily over the same period thanks to a further decline in interest rates, apart from a temporary rise in risk premia in 2012.

The reduction of Belgium's public debt is hampered by a protracted period of relatively low nominal growth. Up to 2015, it was insufficient to offset interest expenditure, resulting in an upward snowball effect. The decline in interest rates trickles only gradually through to a lower implicit interest rate on the outstanding debt stock. Moreover, the primary government balance is also impacted by adverse cyclical conditions. Stock-flow adjustments reduced the

debt by 0.8pp. of GDP in 2015. They are expected to have a debt-increasing impact of around 0.4% of GDP in 2016, while assumed to be neutral in 2017. All in all, the debt is projected to peak at 106.4% of GDP in 2016 and to decline to 105.6% of GDP in 2017 thanks to the expected improvement of the primary balance and a downward snowball effect.

Currently, Belgium does not seem to face a risk of financial stress in the short term. The average life to maturity of the federal debt portfolio[14] is relatively long, at 7.98 years in February 2016[15]. The Belgian government used the current low interest environment to refinance the outstanding debt at low rates and pre-financed part of the 2016 financing needs, a strategy which will be pursued further in 2016. The 12-month and 60-month refixing risk[16] of the federal debt decreased from 20.3% and 56.8% at the end of 2012 to 15.0% and 44.4% at the end of 2015[17]. In line with the euro area wide evolution, interest rates on Belgian debt instruments are historically low. The spread between Belgian and German bonds averaged 34 basis points in 2015, compared to 55 basis points in 2014, and a maximum of 366 basis points on 25 November 2011. The implicit interest rate declined steadily in recent years, from 4.6% in 2007 to 2. 7% in 2015. It is projected to decline further to 2.4% in 2017.

Recent pension reforms curbed the expected increase in age-related expenditure in the medium to long term. At unchanged policy, the debt level is projected to decline to 99% of GDP by 2026[18]. A 1 pp. increase in the interest rate assumptions or 0.5 pp. lower GDP growth would bring the debt level to around 103% of GDP in 2026. This being said, according to the Commission 2015 Fiscal sustainability report, Belgium still appears to face high fiscal sustainability risks in the medium term and medium fiscal risks in the long term. Adequate progress towards Belgium's MTO[19], as required by the Stability and Growth Pact, would put the debt on a sustained downward path, arriving at around 81% of GDP by 2026. In such a scenario, Belgium would be compliant with the forward-looking debt rule as of 2018.

Lastly, the sustainability of public debt is also determined by the economy's growth potential. As described above, a gradual erosion of the contribution of total factor productivity since the beginning of the nineties substantially lowered the potential growth outlook, illustrating the importance of implementing structural reforms boosting potential growth.

Despite the high public indebtedness, the net financial asset position of the Belgian economy as a whole is highly positive (+ 50% of GDP in 2015), compared to a net debtor position of 10% of GDP for the euro area. This overall healthy position is notably thanks to the very high

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[14] The federal debt represents 84% of the general government debt.

[15] Source: Belgian Debt Agency, *Review 2015, 2016 Outlook.*

[16] The share of outstanding debt which matures in a given time period or which is subject to changes in interest rates (because of a floating interest rate).

[17] Source: Belgian Debt Agency, *Review 2015, 2016 Outlook.*

[18] These projections start from the European Commission 2016 winter forecast, with the no-policy change assumption translated into a structural primary balance kept constant (excluding ageing costs) at the level of the last year of the forecast (2017). The baseline scenario is based on the following macro-economic assumptions for the long term: potential GDP growth remains around 1%; inflation and the change in the GDP deflator stabilise at 2% in the medium term; long-term interest rates on new and rolled-over debt converge to 3% in real terms by 2026 and short-term rates to a value consistent with the long-term interest rate and historical (pre-crisis) euro area yield curve (see also European Commission, 2012). Projected ageing costs are based on the 2015 Ageing Report.

[19] In its 2016 stability programme, Belgium revised its MTO from a surplus of 0.75% of GDP to a balanced budget in structural terms.

net financial wealth of Belgian households, which more than offset the net liabilities of the public sector and the non-financial corporations.

4.4. Other factors considered relevant by the Commission

Among the other factors considered relevant by the Commission, particular consideration is given to financial contributions to fostering international solidarity and achieving the policy goals of the Union, the debt incurred in the form of bilateral and multilateral support between Member States in the context of safeguarding financial stability, and the debt related to financial stabilisation operations during major financial disturbances (Article 2(3) of Regulation (EC) No 1467/97).

Rescue operations in the financial sector explain part of the debt increase since 2008. In recent years, the direct cumulative impact of these operations reached almost 7% of GDP in 2011 but declined to around 3.6% of GDP in 2015 due to the sale of some of the acquired assets as well as the reimbursement of loans granted. Contingent liabilities related to guarantees granted to the financial sector are gradually being reduced and reached 7.7% of GDP at the end of 2015, with Dexia the only remaining beneficiary.

Article 12(1) of Regulation (EU) No 473/2013 requires that this report considers also "the extent to which the Member State concerned has taken into account the Commission's Opinion on the country's DBP, as referred in Article 7(1)" of the same Regulation. The Commission Opinion on the 2016 DBP presented by Belgium in October 2015 has been partially taken into account in the budget for 2016 and its subsequent implementation. The Commission Opinion on the budgetary plans for 2016 pointed to broad compliance with the provisions of the SGP. It invited the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP. In comparison to the 2016 DBP, an additional provision for security expenditure of 0.1% of GDP had been included in the adopted budget. In April 2016, the federal government agreed on additional measures in order to close the projected deviation of the 2016 structural target. However, not all of these measures were sufficiently specified at the cut-off date of the Commission 2016 spring forecast and therefore have not all been included in the Commission projection. This is notably the case for some of the announced savings in the social security, the redesign of the government's administration and a number of anti-fraud measures.

4.5. Other factors put forward by the Member State

On 9 April 2016, the Belgian authorities transmitted a letter with relevant factors in accordance with Article 2(3) of Council Regulation (EC) No 1467/97. The analysis presented in the previous sections already broadly covers the key factors put forward by the authorities.

The authorities notably argue that the MLSA for Belgium is excessively demanding, referring to the Commission report under Article 126(3) TFEU of 27 February 2015 which stated that such an effort was neither feasible nor desirable. Secondly, the authorities refer to the continuation of the structural reform agenda by the Belgian government, in line with what is mentioned in Section 4.1. On top of last year's reforms in the areas of competitiveness and social security (particularly with regard to pensions), the federal government has carried out a tax shift away from labour and a labour market reform is due to take place by the autumn. The structural reforms undertaken in the area of pensions allowed a downward revision of Belgium's minimum MTO from a surplus of 0.75% of GDP to a deficit of 0.5% of GDP. The

Belgian authorities opted for a more ambitious MTO of a balanced budget, planned to be reached by 2018, in order to ensure compliance with the debt criterion.

In their letter, the Belgian authorities also point to the fact that the debt ratio has fallen in 2015, for the first time since the economic and financial crisis of 2008, and is planned to decrease further as of 2017. According to the authorities' calculations, the budgetary path presented in the stability programme should enable compliance with the debt criterion as of 2017. The authorities also invoke exceptional refugee-related costs and security measures. While neutralized under the preventive arm, they have an impact on the headline balance and thus on public debt developments. Lastly, the authorities recall that the sustained period of low economic growth is detrimental to debt dynamics and deficit reduction.

5. CONCLUSIONS

General government gross debt reached 106.0 % of GDP at the end of 2015, well above the 60% of GDP reference value, and according to the Commission 2016 spring forecast, Belgium is not projected to make sufficient progress towards compliance with the debt reduction benchmark. This suggests that *prima facie* the debt criterion as defined in the Treaty appeared to be not fulfilled before however consideration is given to all relevant factors. In line with the Treaty, this report also examined the relevant factors.

Taking into account the flexibility foreseen for the impact of exceptional events outside the control of the government, Belgium is not expected to deviate significantly from its adjustment path towards the MTO in 2015 and 2016 and can therefore be considered to be broadly compliant with the preventive arm of the SGP. The MLSA for Belgium calculated on the basis of the Commission 2016 spring forecast is substantially higher than what had been recommended by the Council in June 2015. The effort required by the MLSA is very demanding in view of the relatively low nominal GDP growth. In view of these adverse cyclical circumstances, such a high effort may be neither feasible nor desirable.

Belgium made good progress in implementing the structural reforms announced at the beginning of 2015, notably in the area of pensions, taxation and the labour market. They are substantial and are expected to contribute to enhancing the economy's growth potential and reduce the risks of macro-economic imbalances, thereby having a positive impact on debt sustainability. In a letter sent on 15 April 2016, Belgium announced further reforms, in particular in the labour market, which are further detailed in the 2016 National Reform Programme.

The analysis presented in this report includes the assessment of all the relevant factors, and notably (i) the unfavourable economic conditions which make the respect of the debt rule particularly demanding; (ii) the expectation that compliance with the required adjustment towards the MTO is broadly ensured; and (iii) the implementation of ambitious growth-enhancing structural reforms in line with the authorities' commitment, which is expected to contribute to debt reduction in the medium/long term. It suggests that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as currently complied with.