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REPORT FROM THE COMMISSION

Belgium

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

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1. BACKGROUND

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 stipulates 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. The Commission may also prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit, the latter understood as the situation defined in Article 126(2) TFEU. 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 the question of Belgium's compliance with the deficit and debt criterion of the Treaty, with regard to the economic background and other relevant factors, before drawing a final conclusion on compliance.

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 stipulates 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. 3 years after the correction of the excessive deficit[3]). The "*Specifications on the implementation of the Stability and Growth Pact and guidelines on the*

[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] OJ L 140, 27.5.2013, p. 11: 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".

[3] Council Decision Article 126(12) TFEU of 20 June 2014. 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

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

On 13 January 2015 the Commission presented a Communication on Flexibility, providing new guidance on how to apply the existing rules of the SGP, 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 to 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, when examining whether an EDP needs to be opened (in the context of a report according 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 these relevant factors[4].

Data notified by the authorities on 7 October 2014[5] and subsequently validated by Eurostat[6] show that the general government deficit in Belgium reached 2.9% of GDP in 2013, while the debt was at 104.5% of GDP, above the 60% of GDP reference value. For 2014, the Draft Budgetary Plan (DBP) and the autumn 2014 notification planned a deficit of 2.9% of GDP and a debt of 105.6% of GDP. Furthermore, the DBP planned a deficit of 2.1% of GDP and a debt-to-GDP ratio of 105.1% in 2015.

The Commission 2015 winter forecast suggests that Belgium is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2014 and 2015 (see Table 1) as the change in the structural balance is estimated to have been -0.1% of GDP in 2014 compared to a required minimal linear structural adjustment (MLSA) of 0.7% of GDP[7] and is projected to amount to 0.6% of GDP in 2015 compared to the required 1.1% of GDP[8]. Moreover, according to the Commission 2015 winter forecast, Belgium's general

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4 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 […]"*.

5 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.

6 Eurostat news release No 158/2014 of 21 October 2014.

7 I.e. an annual structural adjustment over 2014-2016 of 0.7% of GDP is projected to ensure 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 2014 winter forecast materialise.

8 Given the expected shortfall in 2014, the required annual structural adjustment over the remaining years of the transition period (2015-2016) amounts to 1.1% in order to comply with the debt reduction benchmark at the end of this period, assuming that growth projections of the Commission 2014 winter forecast materialise.

government deficit is expected to have reached 3.2% of GDP in 2014 (compared to 2.9% of GDP announced in Belgium's 2015 DBP), exceeding the 3% of GDP reference value.

Table 1. General government deficit or/and debt (% of GDP)

		2011	2012	2013	2014		2015	
					COM	DBP	COM	DBP
Deficit criterion	General government balance	-3.9	-4.1	-2.9	-3.2	-2.9	-2.6	-2.1
Debt criterion	General government gross debt	102.1	104.0	104.5	106.4	105.6	106.8	105.1
	Change in structural balance	0.1	0.5	0.4	-0.1	0.4	0.6	0.7
	Required MLSA	n.r.	n.r.	n.r.	0.7	n.a.	1.1	n.a.

Source: Commission services, Belgium's 2015 Draft Budgetary Plan and Commission 2015 winter forecast

The estimated 2014 deficit outcome and the projected insufficient progress towards compliance with the debt reduction benchmark in 2014 and 2015 provide evidence that there appears to be *prima facie* a risk of the 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 the following report to comprehensively assess the excess over the reference value for the deficit and 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 Medium Term Objective (MTO). The report takes into account the Commission 2015 winter forecast, released on 5 February 2015, and the Commission's evaluation of subsequent developments.

2. DEFICIT CRITERION

In 2014, according to the Commission 2015 winter forecast, the general government deficit is estimated to have reached 3.2% of GDP, against 2.9% of GDP in 2013. Although in excess of 3% of GDP, the estimated deficit outcome is close to the Treaty reference value.

The estimated excess over the 3% of GDP reference value is exceptional. In particular:

- It does result from an unusual event in the sense of the Stability and Growth Pact, notably due to methodological changes related to the introduction of ESA2010 and statistical clarifications. Overall, statistical changes in government accounts in October 2014 entailed an upward revision of around 0.3% of GDP of the 2013 outcome[9]. These statistical revisions mainly relate to the inclusion of investment grants of around 0.4% of GDP into government expenditure at the time of the investment, in this case in 2013, while previously these grants were recorded over the lifetime of the asset (e.g. hospitals and elderly homes). These methodological changes are expected to have had a similar impact on the 2014 outcome, while they were not known when the initial budget for 2014 had

[9] 0.4 pp of GDP due to the revision of the deficit, partly offset by an upward revision of the denominator (GDP) following the change to ESA2010.

been adopted. These revisions should not be considered as a deterioration of the financial position of the government, but rather as a change in the timing of recording of certain government expenditure. Moreover, the recording of such investment grants was only clarified in October 2014. Hence the revisions were unexpected and not known well in advance, and therefore should not lead to procedural consequences under the Excessive Deficit Procedure.

- In addition, according to the Commission 2015 winter forecast, the 2014 budget outcome is also impacted by revenue shortfalls, contributing to a temporary increase in the general government deficit. However, some of these shortfalls could have been foreseeable, as they notably relate to reduced dividends and guarantee fees from the financial sector.

The estimated excess over the 3% of GDP reference value is temporary in the sense of the Stability and Growth Pact. In particular, the budgetary forecasts as provided by the Commission indicate that the deficit will fall below the reference value as of 2015. At unchanged policy, the deficit will remain below this value in 2016. While there is still an impact to be expected from the above-mentionned methodological changes, this impact has been offset by additional consolidation measures taken at different levels of government.

In sum, the estimated deficit outcome is close to the 3% of GDP reference value and the estimated excess over the reference value is exceptional and temporary in the sense of the Stability and Growth Pact. This analysis suggests that after consideration of the above factors the deficit criterion as defined in the Treaty and in regulation 1467/1997 should be considered as currently complied with. It should be noted that this assessment is based on the estimated outcome for the year 2014 according to the Commission 2015 winter forecast. The forthcoming publication by Eurostat in April 2015 of notified and validated data on the 2014 outcome may entail a new assessment of the fulfillment of the deficit criterion.

3. DEBT CRITERION

The general government gross debt has increased steadily over the last years, growing from 87% of GDP in 2007 to 104.5% of GDP at the end of 2013 (+18 pps. of GDP). 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 thanks to the decline in interest rates (apart from a temporary rise in risk premia in 2012). In 2013, the debt level broadly stabilized, also thanks to the sale of government assets.

According to Belgium's 2015 DBP, communicated to the Commission on 15 October 2014 and updated on 22 October 2014, the debt ratio was expected to reach 105.6% at the end of 2014 and would decline to 105.1% in 2015. According to the Commission 2015 winter forecast, the debt ratio is estimated to have reached 106.4% at the end of 2014. It is expected to rise further to 106.8% at the end of 2015, before stabilizing in 2016 at unchanged policy. Besides the higher expected headline deficit, it is in particular the lower nominal GDP growth which explains the difference with the DBP.

According to the Commission forecast, given the high debt the projected nominal growth is insufficient to offset the impact of interest expenditure on the debt ratio in 2014 and 2015, resulting in a debt-increasing snowball effect whereas the slightly positive primary balance has a minor downward impact on the debt ratio. Stock-flow adjustments are not expected to have a substantial impact on the debt evolution over the forecast horizon.

Table 2: Debt dynamics

	2011	2012	2013	2014		2015	
	COM	COM	COM	COM	DBP	COM	DBP
Government gross debt ratio	102.1	104.0	104.5	106.4	105.6	106.8	105.1
Change in debt ratio [b] (1 = 2+3+4)	2.6	1.8	0.6	1.9	1.1	0.4	-0.5
Contributions:							
• Primary balance (2)	0.5	0.7	-0.3	0.1	-0.2	-0.2	-0.7
• "Snowball" effect (3)	-0.3	1.2	1.3	1.3	1.0	0.7	-0.1
of which:							
Interest expenditure	*3.4*	*3.4*	*3.2*	*3.0*	*3.1*	*2.8*	*2.8*
Real GDP growth	*-1.6*	*-0.1*	*-0.3*	*-1.0*	*-1.1*	*-1.2*	*-1.5*
Inflation (GDP deflator)	*-2.1*	*-2.1*	*-1.6*	*-0.7*	*-0.9*	*-0.9*	*-1.4*
• Stock-flow adjustment (4)	2.4	-0.1	-0.5	0.4	0.2	-0.2	0.3
of which:							
Cash/accruals difference	*0.0*	*-0.8*	*0.1*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Net accumulation of financial as.	*2.1*	*0.6*	*-0.8*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Valuation effect & residual	*0.2*	*0.0*	*0.3*	*n.a.*	*n.a.*	*n.a.*	*n.a.*

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.

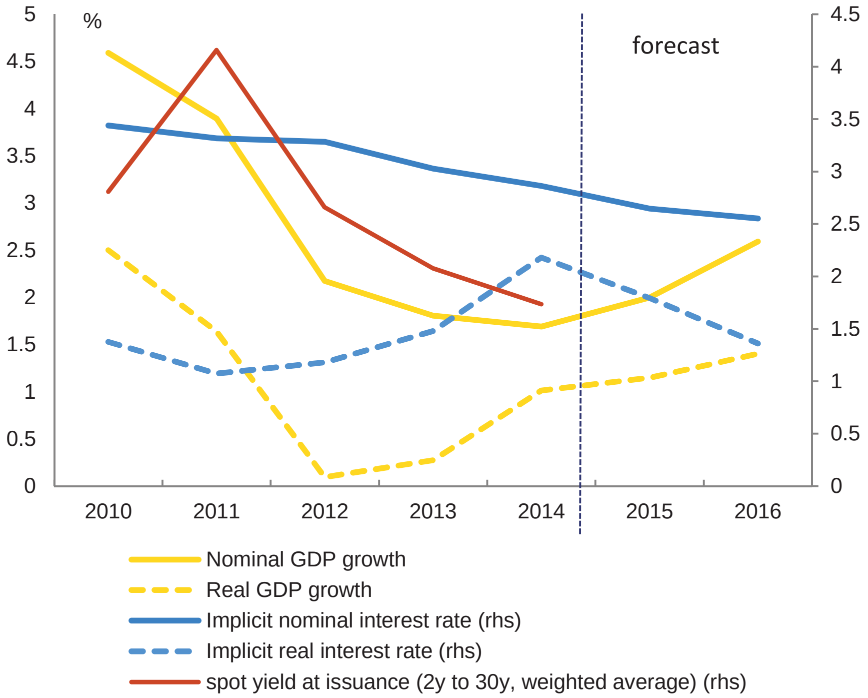
Source: Eurostat and Commission 2015 winter forecast

More specifically, as a result of low inflation and real growth, projections of nominal GDP growth for 2014 and 2015 are subdued, at respectively 1.7% and 2.0% in the 2015 winter forecast (compared to 2.9% in both 2014 and 2015 according to the 2014 spring forecast) which would reduce the debt ratio by 1.7% and 2.1 in 2015, whereas interest expenditure raises the debt by 3.0 and 2.8% of GDP, respectively. This leads to a "snowball" effect of 1.3% of GDP in 2014 and a somewhat lower 0.7% of GDP in 2015.

Looking specifically at the impact of inflation and interest rate developments on the snow-ball effect, it appears that the decrease in inflation leads in the short term to a higher real implicit interest rate on the debt[10] despite decreasing nominal interest rates. This is because, while the impact of lower inflation is immediate, the lower nominal yields only gradually pass-through on the cost of the outstanding debt stock given that debt instruments maturing in less than one year currently only amount to 16% of the outstanding (central) government debt. Concretely, the real implicit interest rate, which amounted to 1.5% in 2013, rose to 2.2% in 2014. In 2015 it is expected to decline again to 1.8%. The debt-increasing impact of the implicit real financing cost of debt thus temporarily rises.

[10] The real implicit interest rate at time t can be defined as the average nominal yield paid by the government to service the outstanding debt at the end of time $t-1$, net of the impact of inflation at time t (using the GDP deflator).

Graph 1: Drivers of the'snowball effect' on government debt



Source: Eurostat and Commission 2015 winter forecast.

Following the abrogation of the EDP in June 2014, Belgium benefits from a three-year transition period to comply with the debt reduction benchmark, starting in 2014. In order to ensure continuous and realistic 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 projected structural effort by Belgium in 2014 and 2015 is 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 2015 winter forecast is equal to 0.7% of GDP, while the structural balance in Belgium is projected to deteriorate by 0.1% of GDP. Hence, the deviation is above the maximum deviation allowed by the first condition. In view of this shortfall in 2014, the minimum required adjustment is projected to rise to 1.1% of GDP in 2015, while the structural balance in Belgium is forecast to improve by 0.6% of GDP in that year. Hence, also in 2015 the first condition is not respected.

The overall analysis above thus suggests that *prima facie* the debt criterion in the sense of the Treaty and regulation 1467/1997 appears not to be fulfilled based on the Commission 2015 winter forecast before however consideration is given to all relevant factors as set out below.

4. RELEVANT FACTORS

Article 126(3) of the 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 stipulates 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. Besides 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 current environment of low inflation – on top of the protracted low growth – requires the concerned Member States to achieve very demanding structural adjustments to comply with the MLSA under the transitional debt rule. Moreover, negative inflation surprises have contributed to the upward revisions of the required MLSA. Under such conditions, adherence to the MTO or the adjustment path towards (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.

Based on the Commission 2014 spring forecast, on which the Council based its fiscal recommendation to Belgium, the required MLSA was estimated at only 0.3% of GDP in 2014 and 0.5% of GDP in 2015[11]. The required MLSA is substantially higher when calculated based on the projections of the 2015 winter forecast, which forms the basis of the assessment, at 0.7% of GDP in 2014 and 1.1% of GDP in 2015 (taking into account the 2014 outcome). This revision is partly driven by the downward revision in real growth and inflation since the 2014 spring forecast, explaining more than half of the increase in the requirement. The rest of the increase in the MLSA since spring 2014 is mainly explained by the upward revision of the 2013 deficit deficit due to methodological changes. On the other hand, the changes in GDP following the changeover to ESA2010 and the changes in the semi-elasticity used to calculate the structural balance had a minor downward impact on the requirement. These factors will be discussed in more detail in the relevant sections below.

The DBP for 2015 did not contain sufficient information beyond 2015 to calculate the MLSA based on government assumptions and plans. This being said, the DBP for 2015 targeted a (recalculated) structural improvement[12] of 0.7% of GDP in 2015, which exceeded the effort recommended by the Council in the country specific recommendations to Belgium which was supposed to also ensure compliance with the MLSA[13].

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 was followed by a period of sluggish growth, with only slightly positive GDP growth in 2012 and 2013. According to the Commission 2015 winter forecast, GDP growth reached 1% in 2014 and is expected to remain around the same level in 2015, with slightly higher growth expected in 2016. Subdued domestic demand, in particular private and public consumption, weighs on the growth outlook.

[11] I.e. an annual structural adjustment over 2014-2016 of 0.3% of GDP (0.5% of GDP over 2015-2016 if no further progress in 2014 would be made) was projected to ensure that - if followed – Belgium would comply with the debt reduction benchmark at the end of the transition period, assuming that growth and budgetary projections of the Commission 2014 spring forecast would have materialised.

[12] Change in the cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the DBP, using the commonly agreed methodology.

[13] "[…]In 2015, significantly strengthen the budgetary strategy to ensure the required adjustment of 0,6 % of GDP towards the medium-term objective, *which would also ensure compliance with the debt rule*.[…]".

Potential growth estimates for Belgium are rather low, at 0.9% on average over 2012-2016. The contribution of labour to potential growth fell drastically since the crisis, due to a slower growth of working age population and a decline in the trend participation rate. Also the contribution of capital accumulation slowed down, while the contribution of total factor productivity continued its long term erosion. The negative output gap was almost closed in 2011, but widened again in recent years, and is projected to remain negative over the forecast horizon.

As other Member States of the euro area, Belgium currently experiences a protracted period of low inflation. Headline inflation reached 0.6% on average in 2014 and fell back to zero at the end of the year on the back of retreating energy prices. According to the Commission 2015 winter forecast, the downward trend in inflation is expected to continue over the first half of 2015. Overall, the general price level would rise by just 0.1% in 2015. In 2016, inflation is expected to rise to around 1%, still far below its long term average[14]. The GDP deflator is estimated to have risen by 0.7% in 2014, the lowest increase since 1999. The rise projected for 2015 and 2016 remains modest, by 0.8% and 1.2% in 2015, respectively 2016.

This small increase in the GDP deflator has an important impact on the evolution of the debt-to-GDP ratio. For instance, under a more usual scenario of a price change of 2% a year between 2014 and 2016, the debt ratio would have peaked at 105.1% in 2014 and would be projected to decline to 104.3% in 2015 and 103.3% in 2016 (compared to 106.6% according to the Commission 2015 winter forecast), all other factors unchanged. The low inflation also weighted on the evolution of tax revenues, resulting in a lower than expected structural adjustment in 2014. On the other hand, also interest expenditure fell more than initially expected, thanks to the low interest rate environment, but this only partially compensated for the the other effects.

Also the required MLSA is heavily dependent on real growth and inflation developments. The impact of the downward revision of real growth and, in paticular, inflation since Spring 2014 is only partly offset by the higher GDP level following the changeover to ESA2010 accounting standards. All in all, the changes in the macro-economic scenario, including the low inflation, the higher cyclical deficit and the lower potential growth, have substantially increased the MLSA for 2014 and 2015 (respectively +0.2 pp of GDP and +0.3 pp of GDP), bringing it above the adjustment towards the MTO recommended in July 2014 (see also Section 4). While real GDP growth was subdued but not exceptionally low, the current period of low inflation could be considered as a new and exceptional factor. The combination of these adverse cyclical conditions make it particularly demanding to comply with the MLSA at the current juncture.

[14] Average HICP inflation between 1999 and 2013 reached 2.1%.

Table 3: Macroeconomic and budgetary developments [a]

	2011	2012	2013	2014		2015	
	COM	COM	COM	COM	DBP	COM	DBP
Real GDP (% change)	1.6	0.1	0.3	1.0	1.1	1.1	1.5
GDP deflator (% change)	2.2	2.1	1.5	0.7	0.9	0.8	1.4
Potential GDP (% change)	1.3	0.9	0.7	0.8	NA	0.9	NA
Output gap (% of potential GDP)	-0.2	-1.0	-1.5	-1.3	-1.3	-1.0	-0.8
General government gross debt	102.1	104.0	104.5	106.4	105.6	106.8	105.1
General government balance	-3.9	-4.1	-2.9	-3.2	-2.9	-2.6	-2.1
Primary balance	-0.5	-0.7	0.3	-0.1	0.2	0.2	0.7
One-off and other temporary measures	-0.2	-0.4	0.6	0.3	0.2	0.1	0.0
Government gross fixed capital formation	2.3	2.3	2.2	2.1	2.1	2.2	2.1
Cyclically-adjusted balance	-3.8	-3.5	-2.0	-2.4	-2.1	-2.0	-1.6
Cyclically-adjusted primary balance	-0.4	-0.1	1.2	0.6	1.0	0.8	1.2
Structural balance [b]	-3.6	-3.0	-2.6	-2.8	-2.3	-2.1	-1.7
Structural primary balance	-0.2	0.4	0.5	0.3	0.7	0.7	1.2

Notes:

[a] In percent of GDP unless specified otherwise.

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

Source: Commission 2015 winter forecast (COM), Draft Budgetary Plan of Belgium for 2015 (DBP)

It is notable in this respect that the medium-term economic scenario included in the 2015 budget law would require a lower MLSA, in particular thanks to the higher projected nominal growth. Under these more optimistic macro-economic assumptions, the planned fiscal trajectory of Belgium would actually be compliant with the transitional arrangements. However, these assumptions seem to have become too optimistic in the meantime[15].

Structural reforms

Belgium experiences macroeconomic imbalances, which require monitoring and policy action[16]. The 2015 Country Report for Belgium found that macro-economic risks related to competitiveness have narrowed given corrective action undertaken in recent years. Risks stemming from the high public indebtedness are mitigated by the healthy financial state of the private sector, but nevertheless complicate consolidation efforts for the Belgian government moving forward.

In its Communication of 13 January 2015, 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. In this context, in a letter sent to the Commission in November 2014, the Belgian authorities committed to a number of structural reforms implementing the 2014 country-specific recommendations issued by the Council in July 2014. These structural reforms were further specified in a report sent on 30

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15 In the February update of the macro-economic projections by the Federal Planning Bureau, which provides the official forecast underlying the budget and subsequent budget reviews, nominal GDP growth has been substantially revised downwards and is now broadly in line with the Commission's 2015 winter forecast.

16 See Commission Communication COM(2015)85.

January 2015. This report gives an overview of all envisaged measures and included a timeline for their implementation. Most measures will be gradually implemented over the government term (2015-2019), with first steps often already taken.

The most important action concern pension reforms by means of measures reducing early exit possibilities. These should help to reduce the gap between the effective and statutory retirement age. First, a further increase of the minimum age and the minimum career length for early retirement is foreseen after 2016. These were increased from respectively 60 and 35 to 62 and 40 by the previous government. By 2019 the minimum age would rise to 63 and the career requirement to 42 years. Exceptions to this general rule would apply for arduous professions or long careers. Second, age and career length requirements for pre-retirement through the elderly unemployment benefit system are being tightened progressively with the minimum age being increased to 62 since January 2015. Transition rules and exceptions apply for arduous professions, long careers and collective dismissals. Third, the civil servant pension scheme would undergo a reform as of 2016, including an alteration of the accrual rules to extend the average working career. Finally, on a longer time horizon, the government agreement of October 2014 announced the intention to increase the legal retirement age from 65 now to 66 in 2025 and 67 to 2030, and the transition towards a credit-based pension system to allow for a strengthening of the link between the retirement age and life expectancy.

In a report sent on 5 February (updated on 13 February 2015), the Belgian authorities have provided first estimates on the long term impact (2060) of these envisaged pension-related reforms. The quantification only includes the impact of new measures, in the sense that the impact of the 2012 pension reform over the projection horizon has not been counted. Relative to the baseline scenario excluding the planned reforms, the number of retired persons would decrease by 312,000 in 2060 while the active population would increase by 246,000 persons; the difference mainly corresponding to a rising number of disabled persons. As a result, the employment rate is expected to rise to over 72% by 2060 against 68% without the reform. Nominal GDP is projected to be 6.2% higher by 2060 compared to the baseline scenario. The planned pension reforms would result in a reduction of 1.9% of GDP of pension expenditure by 2060 compared to a projection at unchanged policy, while unemployment expenditure would be 0.1% of GDP higher.

Projections were made by the Belgian Federal Planning Bureau, which is an independent forecast institution and has a long-standing reputation for long term macro-economic projections, for example in the framework of the Belgian Study Committee on Ageing. The assumptions used are detailed in the report and partly based on the methodology of the Ageing Working Group. The report only presents the results on the very long term (2060), while the expected medium-term impact of the reforms has not been communicated. Results are in the same order of magnitude as similar reform scenarios simulated in the context of the forthcoming 2015 Ageing Report. The reforms would offset around 60% of the expected rise in pension expenditure by 2060. This being said, not all reform measures have been effectively adopted yet there is a risk of dilution of the reforms during the legislative process, might lead to a lower impact. Overall, the quantification of the planned reforms is consistent and well-founded and the estimated impact appears to be plausible. Moreover, an additional positive impact could be expected from non-pension related plans, which are not included in these projections, such as employment measures, measures in the unemployment and health care systems and tax measures (see below).

Reform plans with a shorter term horizon entail, inter alia, measures to boost competitiveness. In particular, additional corrective measures were outlined to narrow the relative labour cost gap. These include the suspension of wage indexation schemes and the prospective reduction of employer social security contributions in 2016 and 2019. Yet, the announced shift from labour towards less growth distortive tax bases included in the multi-annual budgetary plan remains limited in scope so far. In spite of preparatory work in the past year and public commitments to pursue further action, no concrete plans for a comprehensive tax reform have been tabled.

As to enhance labour market participation and lift potential growth, the Belgian authorities have introduced measures to strengthen incentives to take up work. On the one hand, the take home pay is increased for all employees through an increase of the lump sum allowance for professional expenses since January 2015 and, for low wage earners, through an increase in the fiscal 'workbonus' as of January 2016. On the other hand, certain unemployment benefits were cut (e.g. the income top-up for part-time unemployed and the seniority top-up for elderly unemployed), and eligibility criteria were tightened for the insertion allowance for young unemployed.

Overall, Belgium has made some progress in addressing the 2014 country-specific recommendations. Substantial progress was made in the area of pension reforms, with measures taken to narrow the gap between the effective and the statutory retirement age, as well as the intention to increase the latter in the longer term. Some progress was made to restore competitiveness with corrective measures adopted to narrow the relative labour-cost gap and first steps taken to reform the wage-setting system. Some progress was also made with regard to the employment challenges. Headway was most tangible on reducing financial disincentives to work and addressing skills mismatches and early-school leaving. Other policy responses have been less developed, including labour market access for disadvantaged groups. At the same time, limited progress has been made towards a comprehensive tax reform entailing in particular a clear shift from labour towards less growth-distorting tax bases. There has also been limited progress on the functioning of retail markets and deregulation of professional services. On the recommendation to ensure that greenhouse gas reduction targets are met, progress is considered limited in the absence of an intergovernmental agreement on the distribution of efforts and auctioning revenues. Also progress to align the contribution of transport with the objective of reducing road congestion was limited.

4.2. Medium-term budgetary position

Headline, structural balance and adjustment towards the MTO

Subdued cyclical conditions had a negative impact on the 2014 budget outcome. Statistical revisions in government accounts, partly due to the changeover to ESA2010 (see above), entailed an upward revision of around 0.3% of GDP of both the headline as well as the structural deficit compared to the Commission 2014 spring forecast. While these statistical changes are not expected to have had a significant impact on the change of the structural balance in 2014 and 2015, they contributed to the upward revision of the MLSA in these years since the time of the July 2014 Council recommendation (respectively +0.2 pp of GDP in 2014 and +0.3pp of GDP in 2015).

The structural balance is estimated to have deteriorated by 0.1% of GDP in 2014 (compared to an improvement of 0.3% according to Belgium's 2015 DBP). This points to a significant deviation from the required 0.5% of GDP adjustment towards the MTO in 2014. Also the expenditure benchmark points to some deviation (-0.2% of GDP gap). This warrants an overall assessment. The structural effort is reduced by a sizable revenue shortfall in 2014 (0.25% of GDP) compared to standard elasticities, among others due to a loss in dividend revenue from financial sector shares. The lower than expected inflation in 2014 also weighted on government revenues. On the other hand, the assessment based on the expenditure benchmark is negatively affected by lower one-off revenues. Therefore, based on an overall assessment, there is some deviation from the adjustment path towards the MTO (a structural surplus of 0.75% of GDP) in 2014.

In 2015, the projected structural effort over one year is in line with the requirement (0.6% of GDP), while there is some deviation from the expenditure benchmark (-0.2% of GDP of gap). However, the distinction between the two indicators is explained by the fact that part of the structural improvement stems from lower interest expenditure and a a replacement of one-off[17] by structural measures in 2015, which improve the structural balance but not the expenditure benchmark. Therefore, the overall assessment points to compliance with the requirements in 2015.

The average deviation from the structural balance pillar over 2014 and 2015 taken together (-0.3%) is around the threshold of significance (0.25%), while there is also some deviation on average on the expenditure benchmark pillar (gap of 0.2% of GDP). Based on an overall assessment taking into account the above-mentioned factors, there is a risk of some deviation from the adjustment path towards the MTO over 2014-2015, especially due to the deviation in 2014.

Overall, based on the Commission 2015 winter forecast, Belgium can be considered broadly compliant with the required adjustment towards its MTO.

In their DBP, the Belgian authorities committed to reach a balanced budget in structural terms by 2018, compared to 2016 in the (indicative) trajectory of the latest stability programme, which would require an effort of 2.3% of GDP over 2015-2018. According to the winter forecast, a higher effort (2.8% of GDP) would be needed due to the different estimation of the structural balance position.

Public investment

Public investment peaked in 2012 at 2.3% of GDP, due to the investment cycle at local level. For the same reason, it fell strongly in 2013, to 2.2% of GDP, a decline which is set to have continued in 2014 (to 2.1% of GDP). In 2015, public investment is expected to pick up again, reaching 2.2% of GDP. Investment grants to non-financial corporations (among others for railway infrastructure, hospitals, elderly homes and schools), which are not included in these figures, increased strongly in recent years, to 1.1% of GDP in 2013. They are expected to have further increased by 0.1pp of GDP in 2014, which contributed to the deterioration of the structural balance in 2014. In 2015, these investments are projected to remain broadly stable over the forecast horizon.

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

[17] Notably because expenditure increases matched by discretionary revenue measures (including one-off revenue measures) are netted out.

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 (+ 20 pps. of GDP between 2007 and 2014) than in many other Member States and the euro area as a whole (29 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.

At the current juncture, the reduction of Belgium's public debt is hampered by protracted low growth and, in particular, low inflation. Nominal GDP growth is insufficient to offset interest expenditure, leading to a negative 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 deteriorated as a consequence of the above-mentioned statistical revisions as well as the cyclical conditions. Over the forecast horizon, stock-flow adjustments are projected to reduce the debt by 0.2pp. of GDP in 2015 while having a debt-increasing impact of around 0.1% of GDP in 2016. All in all, the debt is projected to peak at 106.8% of GDP in 2015 and to stabilize thereafter thanks to the improvement of the primary balance and higher nominal GDP growth.

Currently, Belgium does not seem to face a risk of fiscal stress in the short term. The average life to maturity of the federal debt portfolio[18] is relatively long, at 7.8 years in October 2014[19]. The Belgian government used the current low interest environment to refinance the outstanding debt at low rates and pre-financed part of the 2015 financing needs. The 12-month and 60-month refixing risk[20] of the federal debt decreased from 20.3% and 56.8% at the end of 2012 to 16.1% and 46.4% at the end of 2014[21]. 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 55 basis points in 2014, compared to 84 basis points in 2013, and a maximum of 366 basis points on 25 November 2011. At the end of 2014, it stood at 28 basis points. The implicit interest rate declined steadily in recent years, from 4.4% in 2007 to a projected 2.6% in 2015.

In contrast, Belgium appears to face high fiscal sustainability risks in the medium and long term, due to the above average projected impact of ageing. At unchanged policy[22], ageing costs are projected to bring the debt level to 111% of GDP by 2025[23]. A 1 pp. increase in the

18 The federal debt represents 84% of the general government debt.

19 Source: Belgian Debt Agency, 2014.

20 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).

21 Source: Belgian Debt Agency, 2014.

22 Excluding the recently announced or adopted measures discussed in Section 4.1.

23 These projections start from the European Commission 2015 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 (2016). 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 2025 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 2012 Ageing Report. These projections

interest rate assumptions or 0.5 pp. lower GDP growth would bring the debt level to 117% of GDP in 2025. On the other hand, adequate progress towards Belgium's MTO[24], as required by the SGP, would put the debt on a sustained downward path, arriving at around 80% of GDP threshold by 2025. In this context, it should be noted that Belgium has already a relatively high tax burden. Hence, the fiscal space to service a higher debt or reduce the debt burden through revenue-increasing measures is limited. However, there is room to make the tax system less growth distortive, notably through a shift in taxes away from labour (see 2015 Country Report on Belgium).

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 (+42.5% of GDP in 2013), 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 net assets of Belgian households (224% of GDP, compared to 139% in the euro area), 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).

In assessing sufficient progress towards compliance with the debt reduction benchmark, financial assistance to euro area Member States with a debt or a deficit-increasing impact has been taken into account. According to the Commission 2015 winter forecast for Belgium, the cumulative impact of the Greek loan facility, EFSF disbursements, capital contributions to the ESM, and operations under Greek programme over the period 2010-2015 on debt is 2.9% of GDP. When taking into account the impact of these operations, the required MLSA is marginally lower, at 0.7% of GDP in 2014, 1.0% of GDP in 2015 and 1.5% in 2016.

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 4.4% of GDP in 2014 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 9.4% of GDP at the end of 2014, 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

will be updated in the forthcoming 2015 edition of the Ageing Report, to be published in the first half of 2015.

[24] The MTO of Belgium is set at a surplus of the government balance in structural terms of 0.75% of GDP.

Commission Opinion on the 2015 DBP presented by Belgium in November 2014 has been partially taken into account in the budget for 2015. The Commission Opinion on the budgetary plans for 2015 pointed to the risk of non-compliance with the provisions of the SGP. It invited the authorities to ensure full compliance with the SGP within the national budgetary process to ensure that the 2015 budget will be compliant with the SGP. Since the adoption of the Commission Opinion, announced measures have been specified at federal and regional level. Together with the budgetary impact of lower interest rate, this resulted in an increase of the projected structural effort in 2015 from 0.4% to 0.6% of GDP.

4.5. Other factors put forward by the Member State

On 13 February 2015, 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 other sections of this report already broadly covers the key factors put forward by the authorities.

Regarding the non-compliance with the MLSA, Belgium argues that the required minimum adjustment was fulfilled until the publication of the 2014 autumn forecast, when the MLSA was substantially revised upwards due to (i) methodological statistical revisions which became known only very late in 2014, when it was almost impossible for budgetary policy to react, and (ii) the emergence of semi-deflationary tendencies combined with a deceleration of the business cycle. Therefore, the Belgian authorities claim that the fact that the required MLSA has become extremely volatile, which was not the intention when the rule was put into place, should be taken into consideration as a relevant factor.

Moreover, the Belgian authorities stress the ambitious fiscal effort of the country for 2015, which would be the highest in the euro area based on the Commission 2015 winter forecast. The Belgian authorities also highlight the recent structural reforms decided by the government, which should also considerably improve the long term sustainability of Belgian public debt, in line with what is mentioned in Section 4.1 of this report.

Regarding the breach of the 3% of the GDP reference value in 2014, the Belgian authorities note that there is a need to await the EDP notification to Eurostat in spring 2015, even if they considered the Commission projection rather plausible. According to the authorities, the excess of the reference value is largely the consequence of the untimely revision of the national accounts methodology by Eurostat in the autumn of last year, at a moment when it was too late to take corrective action during the on-going budget year. The Belgian authorities argue that the deficit would probably have been 2.9 % of GDP under ESA 95. The methodological changes occurred. This is in line with the conclusion of section 2 of this report. The authorities also point out that the disappointing result was partly due to an unexpected deceleration of the business cycle, but in fact the growth outcome was broadly in line with initial budget assumptions.

5. Conclusions

The general government deficit in Belgium is estimated to have reached 3.2% of GDP in 2014, above, but close to the 3% of GDP reference value. The estimated excess over the reference value can be qualified as exceptional within the meaning of the Stability and Growth Pact. Furthermore, it can be considered temporary. This suggests that the deficit criterion in the Treaty is fulfilled.

General government gross debt reached 104.5 % of GDP in 2013, well above the 60% of GDP reference value, and according to the Commission 2015 winter 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 was given to all relevant factors.

In line with the Treaty, this report also examined the relevant factors. As specified in the SGP, the relevant factors can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the general government deficit remains close to the reference value and its excess over the reference value is temporary[25], which is the case. These factors can also be considered when assessing compliance on the basis of the debt criterion.

Belgium is not expected to deviate significantly from its path towards the MTO in 2014 and 2015 and can therefore be considered to be broadly compliant with the preventive arm of the SGP. Both the headline and the structural improvement in 2014 were negatively impacted by revenue shortfalls compared to standard elasticities as well as by lower than expected inflation. Compliance with the required mimimum linear structural adjustment in both 2014 and 2015 is further jeopardized by substantial changes in the medium-term growth and inflation outlook as well as statistical revisions of historical deficit figures, both outside the control of the government. As a consequence of these changes, the MLSA for Belgium calculated on the basis of the Commission 2015 winter forecast is substantially higher than what had been recommended in July 2014. The effort currently required by the MLSA is demanding in view of the low expectations for growth and inflation. In view of these adverse cyclical circumstances, such high effort may be neither feasible nor desirable.

In its letters of 30 January 2015 and 5 February 2015 (updated on 13 February 2015), Belgium presented a dedicated structural reform plan. The announced reforms are substantial and are expected to contribute to enhancing the economy's growth potential and reducing the risks of macro-economic imbalances, thereby having a positive impact on debt sustainability. In this respect, the swift implementation of the ongoing structural reform agenda forms a necessary part of a credible debt reduction strategy.

Overall, the analysis presented in this report including the assessment of all the relevant factors and notably (i) the currently 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 expected 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 suggests that, the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as currently complied with.

[25] Article 2(4) of Council Regulation (EC) No 1467/97.