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signed by Mr Jordi AYET PUIGARNAU, Director

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Brussels, 16.11.2015
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COMMISSION STAFF WORKING DOCUMENT

Analysis of the 2016 Draft Budgetary Plan of Belgium

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of BELGIUM

{C(2015) 8100 final}

Analysis of the 2016 Draft Budgetary Plan of Belgium

1. INTRODUCTION

Belgium submitted its Draft Budgetary Plan (DBP) for 2016 on 15 October 2015 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Belgium is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO).

As the general government gross debt ratio was 105.1% of GDP in 2013 (the year in which Belgium corrected its excessive deficit), during the three years following the correction of the excessive deficit Belgium is also subject to the transitional debt rule. In this period it should ensure sufficient progress towards compliance.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2015 autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2015-2016 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact (SGP). Section 5 provides an analysis of implementation of reforms in the area of fiscal governance in response to the latest Country-specific Recommendations (CSRs) adopted by the Council on 14 July 2015, including those to reduce the tax wedge. Section 6 concludes.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying Belgium's 2016 DBP assumes a continued moderate recovery. This is in line with the Commission 2015 autumn forecast and somewhat below the projections included in the latest Stability Programme.

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

The macroeconomic forecast underlying the DBP was provided by the National Accounts Institute in September 2015 – an update of the June 2015 projections –, providing the federal government as well as regions and communities with a common forecast that serves as a starting point for their budgetary projections. The preparation of this macroeconomic forecast is delegated by law to the Federal Planning Bureau (FPB).

The FPB is a well-established institution formally attached to the government which positions itself as an independent institution. As stipulated in the Law of 21/12/1994 that constituted the FPB in its current form, supervision of the institution lies with the Prime Minister and the Minister of Economic Affairs, while guidance on its proceedings originates from the federal government with also the Belgian Parliament and the Central Economic Council or the

National Labour Council able to seek an evaluation by the FPB of the federal government's economic, social and environmental policies¹.

Following GDP growth of 1.3% in 2014, economic activity would expand by 1.2% in 2015 and by 1.3% in 2016, according to the DBP scenario (see Table 1). This is almost fully in line with the Commission forecast of economic growth of 1.3% in both years, insufficient to close an output gap of about -1%. This being said, the government counts on an additional positive economic impact as of 2016 of the measures taken to shift taxes away from labour (see section 3.3), while this impact has already been taken into account in the Commission forecast.

Table 1. Comparison of macroeconomic developments and forecasts

	2014	2015			2016		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.3	1.2	1.2	1.3	1.5	1.3	1.3
Private consumption (% change)	0.4	1.3	1.9	2.0	1.1	0.6	0.7
Gross fixed capital formation (% change)	7.0	0.2	2.7	2.1	2.2	-0.3	0.5
Exports of goods and services (% change)	5.4	3.7	3.4	3.6	4.1	4.2	4.5
Imports of goods and services (% change)	5.9	3.4	4.2	4.1	3.9	3.3	3.8
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	1.9	0.8	1.7	1.6	1.2	0.4	0.6
- Change in inventories	-0.2	0.0	0.1	0.1	0.0	0.0	0.0
- Net exports	-0.4	0.3	-0.6	-0.4	0.3	0.9	0.7
Output gap ¹	-1.0	-1.1	-0.9	-0.9	-0.6	-0.9	-0.9
Employment (% change)	0.3	0.5	0.6	0.6	0.8	0.7	0.7
Unemployment rate (%)	8.5	8.4	8.5	8.6	8.2	8.3	8.4
Labour productivity (% change)	1.0	0.6	0.7	0.7	0.7	0.5	0.6
HICP inflation (%)	0.5	0.2	0.4	0.6	1.2	1.2	1.7
GDP deflator (% change)	0.7	1.0	0.7	1.1	0.9	1.1	1.0
Comp. of employees (per head, % change)	0.9	0.4	0.4	0.5	0.2	0.5	0.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.6	0.5	n.a.	1.7	0.6	n.a.	1.9
Note:							
¹ In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.							
Source:							
<i>Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations</i>							

¹ *Wet houdende sociale en diverse bepalingen*, 21 december 1994, TITEL VIII - hervorming van het apparaat voor de statistiek en de economische vooruitzichten van de federale regering, HOOFDSTUK IV. - Het Federaal Planbureau, Art. 124-131.

For 2016, the DBP scenario and the Commission forecast both foresee a slowdown in domestic demand as compared to 2015. This slowdown is mainly caused by household consumption and business investment. With respect to government consumption the DBP scenario projects an increase by 0.7% in 2016. This is close to the 0.4% growth rate in the Commission forecast, especially considering the fact that the latter includes the impact of government measures spelled out in the DBP. In this respects the robustness of the macroeconomic scenario underlying the Belgian budget could be enhanced by fully accounting for second-round effects generated by budgetary measures. The laudable initiative by the federal government to initiate the budgetary process before the summer recess creates the scope to do so.

The projected deceleration for household consumption in the DBP from around 2% in 2015 to 0.6% in 2016 (0.7% in the Commission forecast) is in line with lower real disposable income growth as a result of continued low wage growth and a pick-up in inflation.

The projected sluggish capital formation in 2016 reflects strong growth in 2014 and 2015, when a series of vessels was purchased and a large patent acquired. The correction for these exceptional investments only occurs in full in 2016. That being said, the DBP scenario is more negative on investment growth than the Commission forecast (-0.3% vs. 0.5%), a difference that could be explained at least partially by a less robust projection for external demand, as comes to the fore in export growth in 2016 (4.2% vs. 4.5%).

Considering that the aforementioned exceptional investments concern imported vessels and patents, a similar correction applies to imports – albeit less visible given the larger volume of imports.

When it comes to the labour market, projected dynamics in the DBP scenario and the latest Commission forecast are quite similar with the unemployment rate expected to decline by 0.2pp. in 2016 under both projections.

With regard to inflation the difference between the projections in the DBP scenario and the Commission forecast for 2016 (1.2% vs. 1.7%) can be largely traced back to measures announced in the DBP, which are included in the Commission projections for inflation but were not in the DBP. The most important ones relate to a reversal of the reduction in the VAT rate on electricity consumption by households², an increase of excise duties, and a new fixed charge on electricity use in the Flemish Region.

All in all, the macroeconomic scenario depicted in the DBP can be assessed as plausible, with relatively small differences in growth composition as compared to the Commission forecast.

Box 2: Impact of the current low interest rate environment on compliance with the SGP

Identifying an interest rate windfall/shortfall for 2016

Sovereign bond yields have fallen sharply since end-2013 and reached historical lows in the first half of 2015, before increasing somewhat during the summer months. However, yields in

² The DBP underscores how the incorporation of this VAT measure results in an inflation projection of 1.5% in 2016. Note that the inflation numbers in the DBP are for the National Index of Consumer Prices (NICP), which differs slightly from the Harmonized Index of Consumer Prices (HICP) used in the Commission forecast.

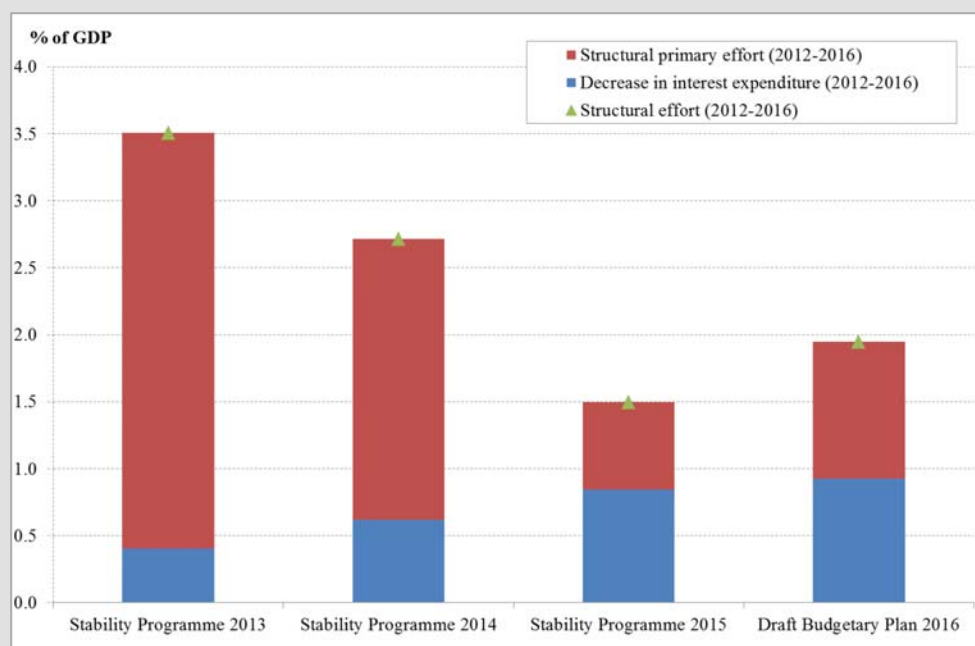
Belgium still remain well below their long-term average of 4.3%, with 10-year rates standing at 0.9% in October 2015. As a result of lower interest rates, total interest payments by the general government have also decreased over the last few years. Interest expenditure in Belgium is expected to fall from 3.6% of GDP in 2012 to 2.8% in 2015, and is projected to decrease further next year, to 2.7% of GDP, based on the information provided in the DBP. Lower interest expenditure is thus expected to contribute 0.1% of GDP of the planned structural improvement in 2016, against 0.25% in the most recent Stability Programme. In the Commission forecast, interest expenditure declines slightly less in 2015, to 2.9% of GDP, and is expected to show a similar declining trend in 2016 as in the DBP. This difference could be explained by different assumptions regarding the debt that will be refinanced at the current low rates before coming to maturity. Lower interest expenditure is projected to contribute 0.25% of GDP to the structural improvement in 2015 and 0.1% of GDP in 2016.

Prospects and vulnerability

Over the next three years, one third of the central government debt (which has a share of 83% in total government debt) will have to be renewed. This is an opportunity to further benefit from the low interest rate environment and can even bring further down the implicit interest rate on the outstanding debt, which stands currently at 2.7%. On the other hand, a significant increase in the interest rate would hamper fiscal consolidation given that current plans partly built on an expected further decline in interest expenditure (to 2.1% of GDP by 2018 according to the 2015 Stability Programme).

Consequences for public finances

Structural effort and decrease in interest expenditures between 2012 and 2016 based on government plans



Source: Stability programmes, Draft Budgetary Plan 2016 and AMECO

Comparing the interest expenditure projections across different vintages of Belgium's Stability Programme and the DBP sheds more light on the (unexpected) interest windfall since the fall in interest rates (see Chart)³. In the 2013 Stability Programme, decreasing interest expenditure was expected to contribute 0.4% of GDP to the planned 2012-2016 fiscal consolidation. It was submitted in April 2013, when a return to historical levels was generally expected. In subsequent programmes, the contribution of declining interest expenditure over 2012-2016 grew gradually, to 0.9% of GDP taking into account the outturn data and projections of the 2016 DBP. The difference with the 2013 Programme could be seen as a

³ Note that, while it is likely that revisions in the interest expenditure projections across different vintages primarily reflect changes in interest rates, other factors such as debt dynamics, the maturity profile of debt and statistical reclassifications (e.g. the switchover to the ESA 2010 standard of national accounts) may also have played a role.

benchmark to approximate the size of the interest windfall. The actual unexpected interest rate windfall is even larger, but partly offset by a higher than planned increase in debt levels.

The gradual decrease in the structural effort over 2012-2016 between the different programmes is mostly due to slippages compared to the targets as well as statistical revisions to past outcomes, rather than to a lower planned structural effort for the remaining years of the period under review. This being said, the decline in interest expenditure was generally offset by a decline in structural primary effort, or in other words the interest windfalls have been used to reduce the primary fiscal effort, rather than to accelerate the fiscal adjustment. All in all, declining interest expenditure contributed around 0.7% of GDP to the fiscal consolidation between 2012 and 2015 while the overall improvement in the structural balance reached around 1% of GDP over the same period.

The fall in interest rates is partly the result of an unexpected low inflation environment over the last few years, which also affects the government's balance through other channels than interest expenditure. The low inflation impacted directly VAT revenues, as well as taxes and social contributions on wages which are automatically indexed to a price index in Belgium (in general with some delay). As of 2014, the unexpected lower inflation curbed expenditure on government wages and social benefits which are automatically adapted to (past) inflation.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP projects a deficit of 2.6% of GDP in 2015, just above the deficit target of the latest Stability Programme. The revision mainly reflects a lower net positive contribution of one-offs to the budget balance, while the targeted structural improvement did not change since the Stability Programme. The Commission forecast for 2015 is slightly more pessimistic, despite a higher nominal GDP growth. The authorities count on reinforced procedures for spending and an expected anticipation effect of announced 2016 tax increases to avoid budgetary slippages, while these have not been taken into account in the Commission forecast. Also a slight upward revision of the 2014 deficit outcome at regional level, which occurred in the course of October 2015, does not seem to have been factored in in the DBP.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2014	2015			2016			Change: 2014-2016
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	52.0	50.6	51.6	51.6	50.4	51.3	51.3	-0.7
<i>of which:</i>								
- Taxes on production and imports	12.9	12.8	12.9	12.9	12.8	13.3	13.3	0.4
- Current taxes on income, wealth, etc.	16.7	16.7	16.5	16.6	16.8	16.7	16.5	0.0
- Capital taxes	1.0	1.0	1.0	0.9	0.9	0.9	0.9	-0.1
- Social contributions	16.7	16.4	16.6	16.6	16.1	15.9	16.1	-0.8
- Other (residual)	4.7	3.8	4.6	4.6	3.7	4.5	4.5	-0.2
Expenditure	55.1	53.1	54.2	54.3	52.3	53.4	53.9	-1.7
<i>of which:</i>								
- Primary expenditure	52.0	50.3	51.4	51.4	49.8	50.7	51.1	-1.2
<i>of which:</i>								
Compensation of employees	12.7	12.2	12.6	12.5	11.9	12.3	12.3	-0.4
Intermediate consumption	4.4	3.8	4.3	4.3	3.8	4.2	4.4	-0.2
Social payments	25.3	25.4	25.3	25.3	25.1	25.3	25.2	0.0
Subsidies	3.4	2.9	3.3	3.4	2.9	3.4	3.3	-0.1
Gross fixed capital formation	2.4	2.3	2.5	2.4	2.3	2.5	2.4	0.1
Other (residual)	3.8	3.8	3.4	3.5	3.8	3.0	3.6	-0.6
- Interest expenditure	3.1	2.8	2.8	2.9	2.5	2.7	2.8	-0.5
General government balance (GGB)	-3.1	-2.5	-2.6	-2.7	-2.0	-2.1	-2.6	1.0
Primary balance	0.0	0.2	0.1	0.2	0.5	0.6	0.2	0.5
One-off and other temporary measures	0.3	0.3	0.2	0.3	0.0	-0.1	0.0	-0.4
GGB excl. one-offs	-3.4	-2.8	-2.8	-3.0	-2.0	-2.0	-2.6	1.4
Output gap ¹	-1.0	-1.1	-0.9	-0.9	-0.6	-0.9	-0.9	0.1
Cyclically-adjusted balance ¹	-2.5	-1.9	-2.1	-2.2	-1.6	-1.6	-2.1	1.0
Structural balance (SB)²	-2.8	-2.2	-2.3	-2.5	-1.6	-1.5	-2.1	1.4
Structural primary balance ²	0.3	0.6	0.5	0.4	0.9	1.2	0.7	0.9
Notes:								
¹ Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.								
² Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
Source:								
Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations								

The planned improvement of the (recalculated) structural balance⁴ amounts to 0.6% of GDP in 2015, compared to a projected improvement of 0.4% of GDP in the Commission forecast. Besides the divergence on the headline balance, this is also explained by a difference in what

⁴ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

is considered one-offs between the Commission forecast and the DBP. This results in a higher net positive contribution from one-offs in the Commission forecast, and hence a lower structural improvement compared to the DBP.

The DBP targets a headline deficit of 2.1% of GDP in 2016, slightly above the target of the Stability Programme. The deterioration of the macro-economic assumptions and a more negative net contribution of one-offs are compensated by a higher planned structural effort compared to the Stability Programme. The planned adjustment will mainly be achieved through expenditure restraint. It is planned to rise by only 0.8%, resulting in a strong decline in the expenditure-to-GDP ratio. The revenue-to-GDP ratio is also planned to decrease further in 2016, especially because wage growth is rather limited (relative to GDP growth). Neither the revenue- nor the expenditure-to-GDP ratio can be fully compared between the Stability Programme and the DBP due to methodological changes in the recording of certain tax reductions, previously on the revenue side and now considered as expenditure.

The Commission 2015 autumn forecast projects a much higher headline deficit in 2016 than the DBP (2.6% of GDP vs. 2.1%). First of all, there is a base effect of 0.1% of GDP because of the different projected outcome in 2015. Secondly, there is a difference of around 0.3% of GDP on the expected impact of measures underpinning the 2016 budget, because either some of them have not been sufficiently specified to be taken into account in the Commission forecast (which has a cut-off date on 22 October 2015), or because their estimated impact is expected to be lower than in the DBP (see section 3.3). The government also counts on an improvement of the headline balance by 0.1% of GDP thanks to positive second round effects of the announced tax shift away from labour which was not yet included in the macro-economic assumptions of the plan, while in the Commission forecast this impact is already factored in in the macro-economic scenario. Hence the targets of the plans are implicitly based on slightly more optimistic macro-economic assumptions. The DBP also counts on a further improvement of the local government's budget balance in 2016 (0.1% of GDP), while this is not yet ensured according to the Commission forecast. Lastly, the higher inflation assumptions in the Commission forecast give rise to an indexation of public wages and social benefits in the second half of 2016, contrary to the assumptions of the DBP, which is initially only partly offset by higher tax revenues.

This different view on the evolution of the headline balance is also reflected in the projected structural improvement. The DBP targets a (recalculated) structural improvement of 0.8% of GDP while the autumn forecast estimates it at 0.4% of GDP.

3.2. Debt developments

Table 3. Debt developments

(% of GDP)	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio¹	106.7	106.9	107.2	106.7	106.3	107.0	107.1
Change in the ratio	1.6	0.3	0.5	0.1	-0.6	-0.2	0.4
<i>Contributions² :</i>							
1. Primary balance	0.0	-0.2	-0.1	-0.2	-0.5	-0.6	-0.2
2. “Snow-ball” effect	1.1	0.6	0.8	0.5	0.0	0.2	0.4
<i>Of which:</i>							
Interest expenditure	3.1	2.8	2.8	2.9	2.5	2.6	2.8
Growth effect	-1.4	-1.2	-1.3	-1.3	-1.5	-1.4	-1.4
Inflation effect	-0.7	-1.0	-0.7	-1.1	-1.0	-1.1	-1.1
3. Stock-flow adjustment	0.6	0.0	-0.1	-0.2	-0.1	0.2	0.2

Notes:
¹ End of period.
² The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and

Source:
Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

Gross debt is planned to rise to over 107% of GDP by the end of 2015, slightly higher than foreseen in the Stability Programme due to an upward revision of the 2014 starting point. The Commission forecast expects a higher nominal GDP growth in 2015 as well as somewhat more downward stock-flow adjustments, resulting in a stabilization of the debt ratio. In 2016, plans would result in a small decline of the debt-to-GDP-ratio. The higher deficit projection in the Commission forecast on the other hand would result in a further debt increase in 2016.

3.3. Measures underpinning the Draft Budgetary Plan

At federal level, a multi-annual budget framework for 2015-2018 was agreed in October 2014, with measures that were expected to have an additional impact beyond 2015. This included among others structural reforms in the social security, a lower growth norm for health care expenditure, savings in the administration, reduced subsidies to the railway company as well as an increase in some excise duties and VAT rates.

Additional measures were announced in July and October 2015. Consolidation measures mainly focus on expenditure restraint (-0.6% of GDP), with the biggest contribution coming from curbing rising expenditure on health care and social benefits (-0.2% of GDP). However, not all of the measures are currently fully specified. Also some announced savings in administrative expenditure are not known in detail yet. In addition to the impact of

consolidation measures, there is also a planned budgetary neutral shift from wage subsidies to a direct reduction in social security contributions, which also reduces expenditure.

The federal government coupled the preparation of the 2016 budget with a multi-annual plan to shift taxes away from labour (amounting to 0.5% of GDP in 2016). Employers' social security contributions will be gradually reduced, as well as personal income tax. Specific tax decreases are foreseen for self-employed and high-tech industries. Around half of these tax reductions will be financed by an increase in excise duties and a return to the 21% rate for VAT on electricity. In addition, some financial taxes will be increased such as the withholding tax on dividends and interest income, the taxation of real estate funds and a newly introduced tax on capital gains on shares. The 'transparency' tax on offshore financial constructions introduced in 2015 is expected to raise additional revenues as well while the Belgian authorities also project to generate additional revenues through a more efficient tax collection, by tackling fiscal fraud more effectively, and through the introduction of a permanent tax regularisation scheme.

While this tax shift away from labour seems to go in the direction recommended in the country-specific recommendations to Belgium, it also entails some budgetary risks. The impact of some revenue-increasing measures to finance this tax shift, such as the above-mentioned 'transparency' tax (planned to yield over 0.1% of GDP), is currently uncertain. In addition, the announced tax reductions by the federal government will also have a negative impact on the budget balance of regional and local authorities, which levy surcharges on the federal personal income tax. On the other hand, some of the announced reductions in social security contributions seem to have been delayed compared to the Draft Budgetary Plan, of which the positive budgetary impact has been taken into account in the Commission forecast.

As mentioned above, the programme also qualifies some unforeseen expenditure as well as negative revenue surprises as one-offs, while these do not meet the criteria used by the Commission to be considered as one-off, despite their temporary character. This relates for instance to the additional reserve for asylum and migration expenditure at federal and regional level, as well as a sizeable VAT reimbursement related to the 2014 decrease of the VAT rate on electricity (which has been scaled back in September 2015).

The DBP estimates that additional expenditure linked to increased migration flow amounts to 0.03% of GDP in 2015 and an additional 0.10% of GDP in 2016⁵. While the Belgian authorities consider these costs as one-off expenditure in their DBP, they also refer to article 5.1 of Regulation 1466/97 invoking an unusual event outside the control of the Member State with a major impact on the financial position of the government. A slightly higher budgetary impact was taken into account in the Commission's autumn forecast. Without this additional expenditure, the structural effort would have been projected at 0.5% of GDP in 2016.

⁵ This figure includes the impact reported in the DBP for the federal government (2015 and 2016) as well as the Flemish Community (only 2016). The DBP does not contain information on the impact on the budgets of the other communities and regions.

Table 4. Main discretionary measures reported in the DBP**A. Discretionary measures taken by General Government - revenue side**

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2015	2016	2017
Taxes on production and imports	n.a.	0.42	n.a.
Current taxes on income, wealth, etc.	n.a.	-0.01	n.a.
Capital taxes	n.a.	0.00	n.a.
Social contributions	n.a.	-0.35	n.a.
Property Income	n.a.	0.05	n.a.
Other	n.a.	0.03	n.a.
Total	n.a.	0.13	n.a.

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2016

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2015	2016	2017
Compensation of employees	n.a.	-0.04	n.a.
Intermediate consumption	n.a.	-0.03	n.a.
Social payments	n.a.	-0.20	n.a.
Interest Expenditure	n.a.	-0.01	n.a.
Subsidies	n.a.	-0.21	n.a.
Gross fixed capital formation	n.a.	-0.03	n.a.
Capital transfers	n.a.	-0.02	n.a.
Other	n.a.	-0.02	n.a.
Total	n.a.	-0.56	n.a.

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2016

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Belgium is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. Box 3 reports the latest CSRs in the area of public finances. Belgium is also subject to the transitional debt rule.

Box 3: Council recommendations addressed to Belgium

On 14 July 2015, the Council addressed recommendations to Belgium in the context of the European Semester. In particular, in the area of public finances the Council recommended to Belgium to achieve a fiscal adjustment of at least 0.6% of GDP towards the medium-term budgetary objective in 2015 and in 2016; to use windfall gains to put the general government debt ratio on an appropriate downward path; to complement the pension reform by linking the statutory retirement age to life expectancy; and to agree on an enforceable distribution of fiscal targets among all government levels. Moreover, the Council recommended to Belgium to adopt and implement a comprehensive tax reform broadening the tax base, shifting the tax burden away from labour and removing inefficient tax expenditures.

4.1. Compliance with the debt criterion

After correcting its excessive deficit in 2013, Belgium entered the transition period as regards the debt criterion for the following three years. This implies that, during this period, it is required to make sufficient progress towards compliance with the debt criterion (as defined by the minimum linear structural adjustment (MLSA) and comply with the debt rule at the end of the transition period (2016).

The DBP does not include sufficient information to assess compliance with the transitional debt rule. Based on the 2015 autumn forecast, Belgium will not make sufficient progress towards compliance with the debt rule in 2015 and 2016. The required MLSA over 2015-2016 reaches 1.1% of GDP on the basis of the Commission forecast, while the planned adjustment amounts to 0.4% of GDP in both years. Assuming no further structural adjustment in 2015, the required structural effort would reach 1.9% of GDP in 2016. The relatively low nominal GDP growth makes the structural adjustment required to put the debt-to-GDP ratio on a downward path particularly demanding.

Table 5. Compliance with the debt criterion*

	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	106.7	106.9	107.2	106.7	106.3	107.0	107.1
Gap to the debt benchmark ^{1,2}							
Structural adjustment ³	-0.1	0.6	0.6	0.4	0.6	0.8	0.4
<i>To be compared to:</i>							
Required adjustment ⁴	0.7	1.2	n.a.	1.1	1.8	n.a.	1.9

Notes:

¹ Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

² Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

³ Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

⁴ Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

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

The Commission prepared a report under Article 126(3) of the Treaty in February 2015, based on the estimated 2014 outcome and the Commission 2015 winter forecast for 2015. This report concluded, after the assessment of all the relevant factors, that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 should be considered as complied with at that time. These relevant factors included notably (i) the unfavourable economic conditions which make the respect of the debt rule 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 term⁶. This analysis is still broadly valid.

4.2. Adjustment towards the MTO

In 2015, Belgium plans a (recalculated) structural adjustment of 0.6% of GDP, in line with the requirement. However, due to the fact that the structural adjustment in 2014 falls short of the

⁶ See: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/belgium_en.htm

required 0.5% of GDP effort (gap of 0.6% of GDP) for that year, this would result in an average deviation of 0.3% of GDP over 2014-2015 taken together, pointing to a significant deviation. On the other hand, according to the information provided in the DBP the growth rate of government expenditure, net of discretionary revenue measures, in the years of 2014 and 2015 taken together will not exceed the applicable expenditure benchmark rate (0.2% in 2014 and 0.0% in 2015 in real terms). This calls for an overall assessment. In 2014, the structural balance is negatively impacted by a sizeable revenue shortfall (0.5% 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 is 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). Considering these factors, the expenditure benchmark appears to be a better indicator of the fiscal effort. Therefore the overall assessment points to compliance of the plans with the adjustment path towards the MTO in 2015.

On the basis of the Commission 2015 autumn forecast, the structural balance is projected to improve by 0.4% of GDP in 2015, resulting in an average improvement of 0.2% of GDP over 2014 and 2015 together. This points to a risk of significant deviation based on the structural balance pillar (average gap of -0.4% of GDP), especially due to the large gap in 2014. The expenditure benchmark points to a risk of some deviation (average gap of -0.2% of GDP) over 2014 and 2015 taken together. This calls for an overall assessment. As explained above, the expenditure benchmark is the better indicator of the fiscal effort over 2014-2015, due to the large revenue shortfalls in both 2014 and 2015 compared to standard elasticities. Hence, on the basis of the forecast, the overall assessment points to a risk of some deviation from the adjustment path towards the MTO in 2015. This conclusion would not change in case the budgetary impact of the exceptional inflow of refugees was excluded from the assessment.

In 2016, Belgium targets a (recalculated) structural adjustment of 0.8% of GDP above the required minimum structural adjustment of 0.6% of GDP. According to the information provided in the DBP, the growth rate of government expenditure, net of discretionary revenue measures, in 2016 will not exceed the applicable expenditure benchmark rate (0.0% in real terms). Therefore plans are compliant with the required adjustment path towards the MTO in 2016⁷.

In contrast, on the basis of the Commission 2015 autumn forecast, the projected structural improvement of 0.4% of GDP falls 0.2% of GDP short 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 -0.7% of GDP). This calls for an overall assessment. Unlike the structural balance, the expenditure benchmark is negatively impacted by the development of one-off revenues and expenditure between 2015 and 2016: one-off revenues decline by 0.2% of GDP between 2015 and 2016 (impacting the expenditure benchmark through the netting out of discretionary revenue measures) while in 2016 there is also a one-off expenditure of 0.1% of GDP related to the retroactive implementation of the 2014 Own Resources Decision (impacting directly the evolution of expenditure). Considering these factors, the structural balance appears to be a better indicator of the fiscal effort at the current juncture. Therefore, the overall assessment points to a risk of some deviation from the adjustment path towards the

⁷ It is to be noted again, that the additional costs linked to increased migration flow (0.03% of GDP in 2015 and 0.1% of GDP in 2016) is considered one-off in the DBP which is not in line with the Commission approach (see section 3.3).

MTO in 2016. This conclusion would not change in case the budgetary impact of the exceptional inflow of refugees was excluded from the assessment.

Following an overall assessment of the Member State's DBP, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures some deviation from the adjustment path towards the MTO is to be expected in 2015 and 2016.

Table 6: Compliance with the requirements of the preventive arm

(% of GDP)	2014	2015		2016	
Initial position¹					
Medium-term objective (MTO)	0.75	0.75		0.75	
Structural balance ² (COM)	-2.8	-2.5		-2.1	
Structural balance based on freezing (COM)	-2.3	-2.3		-	
Position vis-a -vis the MTO³	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	2014	2015		2016	
	COM	DBP	COM	DBP	COM
Structural balance pillar					
Required adjustment ⁴	0.5	0.6		0.6	
Required adjustment corrected ⁵	0.5	0.6		0.6	
Change in structural balance ⁶	-0.1	0.6	0.4	0.8	0.4
<i>One-year deviation from the required adjustment⁷</i>	-0.6	0.0	-0.2	0.2	-0.2
<i>Two-year average deviation from the required adjustment⁷</i>	N.a. (in EDP)	-0.3	-0.4	0.1	-0.2
Expenditure benchmark pillar					
Applicable reference rate ⁸	0.2	0.0		0.0	
<i>One-year deviation⁹</i>	-0.2	0.2	-0.3	0.1	-0.7
<i>Two-year average deviation⁹</i>	0.8	0.0	-0.2	0.1	-0.5
Conclusion					
Conclusion over one year	Overall assessment	Compliance	Overall assessment	Compliance	Overall assessment
Conclusion over two years	N.a. (in EDP)	Overall assessment	Overall assessment	Compliance	Overall assessment
<i>Notes</i>					
¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.					
² Structural balance = cyclically-adjusted government balance excluding one-off measures.					
³ Based on the relevant structural balance at year t-1.					
⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).					
⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.					
⁶ Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.					
⁷ The difference of the change in the structural balance and the corrected required adjustment.					
⁸ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.					
⁹ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.					
<i>Source:</i>					
Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations.					

5. IMPLEMENTATION OF REFORMS IN THE AREA OF FISCAL GOVERNANCE

Belgium adopted several measures in the area of pensions in order to improve the sustainability of its public finances. The DBP mentions the increase in the statutory retirement age from 65 year now to 67 year by 2030. This increase complements other measures adopted since last year's DBP such as the abolishment of the so-called pension bonus (adopted in December 2014), the phasing-out of a pension bonus for diplomas for the access to the civil servants' pension system (adopted in April 2015) and an increase in the minimum age for early exit ('unemployment with company allowance, adopted in December 2014). In its DBP, the government announces some further pension measures in the framework of the 2016 budget: the reduction of non-active periods (such as career breaks) that are taken into account in the pension calculation, the increase in the minimum age to take up private pension benefits, as well as measures to activate beneficiaries of the unemployment with company allowance system. The government also announced that a reflexion on further reforms is ongoing, notably in the context of a 'National Pension Committee' which was founded in June 2015.

The DBP mentions that the 2016 budgets of the different sub-entities are part of a general government trajectory towards a balanced budget in structural terms by 2018 as presented in Belgium's Stability Programme. However, the Draft Budgetary Plan does not contain specific measures to improve the budgetary coordination of fiscal targets among the different levels of government. In the absence of an enforceable distribution of fiscal targets among all government levels, the credibility of the commitment to the overall trajectory is weakened.

In parallel to the preparation of the 2016 budget, the federal government agreed on measures to shift the tax burden away from labour to other revenue sources (see Box 4). All in all, these measures go in the direction recommended by the Council in July 2015 to shift taxes away from labour to less growth distortive tax bases and to improve the functioning of the labour market by reducing financial disincentives to work. However, the tax system remains complex and tax bases are often eroded by specific exemptions, deductions, reduced rates, and tax expenditures, which create efficiency losses and introduce distortions and possible loopholes.

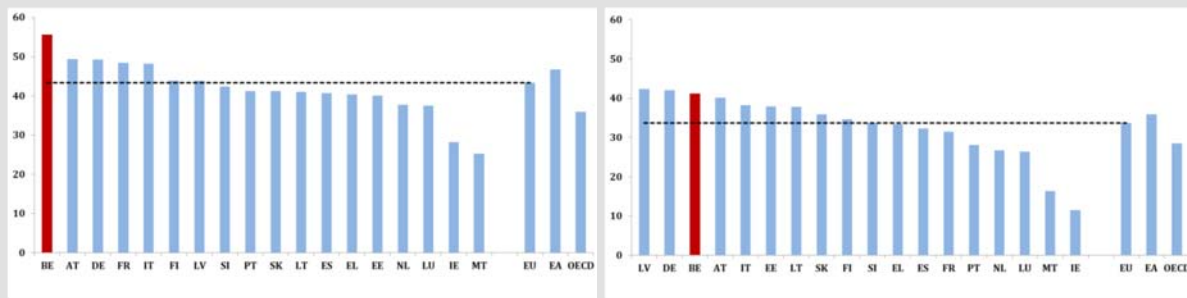
A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the CSRs adopted by the Commission in May

Box 4: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce this tax burden. On 12 September 2015, the Eurogroup agreed to screen euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability. Furthermore, the Eurogroup expressed its intention to take stock of the state of play in the reduction of the tax burden on labour when discussing the DBPs of euro area Member States.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire additional staff. The graphs below show the tax wedge in Belgium for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Belgium at the average wage and at low wage (2014)



Notes: Data for Latvia, Lithuania and Malta is for 2013. No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

This screening is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance would indicate that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

In the context of the 2015 European Semester, Belgium was issued the recommendations to "adopt and implement a comprehensive tax reform broadening the tax base, shifting the tax burden away from labour and removing inefficient tax expenditures" and to "improve the functioning of the labour market by reducing financial disincentives to work (...)."

Belgium's DBP contains a number of measures to gradually shift away taxation from labour in coming years. These come on top of other relevant measures that were already announced in last year's DBP and have meanwhile been enacted. They reduce the tax wedge on labour both through reductions in personal income taxation and employer social security contributions.

- Further increase of the standard deductible amount for professional expenses as of 2016 (already foreseen in 2015 DBP), increase of the tax-exempted income, abolition of the 30% tax bracket in two steps and increase of the lower boundary for the 45% tax bracket. Also, the so-called 'work bonus' in personal income taxation will rise further, lifting the take-home pay for low income earners.

- Phased reduction as of 2016 of employer social security contributions from the current maximum facial tariff of 32.4% to 25%, partly through the absorption of existing wage subsidies (i.e. budgetary neutral), partly through additional reductions for low and medium wages.
- Exemption of employer contributions for the first employees hired by SMEs. The existing reduction for the first five employees becomes applicable for 2nd to 6th new hire. Contributions by self-employed will be reduced from 22% currently to 20.5% in 2018%.

These measures are to be financed through a range of alternative revenue sources, mainly consumption and non-labour income. The reduction of the VAT rate on electricity has been rolled back since September 2015, while excise duties on diesel, tobacco and alcohol will gradually increase. Withholding taxes on interest and dividend income will rise from 25% to 27%, and also the taxation of real estate funds will be revised. In addition a number of new taxes are to be introduced, including a health tax and a tax on capital gains on short-term stock holdings. The transparency tax on offshore financial constructions introduced in 2015 is expected to raise additional revenues as well while the Belgian authorities also hope to generate new revenues through a more efficient tax collection, by tackling fiscal fraud more effectively, and through the introduction of a permanent regularisation scheme for past tax fraud. Finally, a 'redesign' of the federal government should lead to important administrative savings. Considering a lack of details and the inherent unpredictable nature of several of the measures on the financing side, the budgetary neutrality of the tax 'shift' outlined by the Belgian authorities does not appear to be fully ensured at the current juncture.

6. OVERALL CONCLUSION

Based on the Commission 2015 autumn forecast, the structural improvement in 2015 and 2016 falls short of the minimum linear structural adjustment to ensure sufficient progress towards compliance with the debt criterion.

Following an overall assessment of the DBP, the planned structural adjustment is in line with the required adjustment path towards the MTO both in 2015 and 2016. However, following an overall assessment based on Commission 2015 autumn forecast there is a risk of some deviation from the adjustment path towards the MTO both in 2015 and 2016. This conclusion would not change in case the budgetary impact of the exceptional inflow of refugees was excluded from the assessment.