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8.1 General situation and challenges

The budget balance deteriorated sharply in 2023, despite the continued phase-out of temporary support measures

In 2023, Belgium's budget deficit widened by 0.7 percentage points of GDP to 4.2 % of GDP. After a clear improvement in the budget balance over the previous two years, mainly as a result of the economic recovery and the systematic lifting of the support measures adopted in response to the pandemic, this trend came to a halt in 2023. Nevertheless, temporary factors had a positive impact on the development of the budget balance. The almost complete withdrawal of the temporary pandemic-related measures in 2023 led to an improvement in the balance of 0.5 percentage points of GDP.

The budgetary impact of the temporary factors linked to the energy crisis and Russia's invasion of Ukraine fell by 0.4 percentage points of GDP. That being said, the measures adopted to shore up household purchasing power (such as the basic energy package), to preserve business profitability (such as the temporary reduction in employer social security contributions) and to cope with Russia's invasion of Ukraine (such as expenditure on refugee support) remained at the same level as in 2022. At the same time, the temporary additional revenue used to finance these measures rose sharply in 2023. Both revenue from the temporary tax on the windfall profits of electricity producers and the contribution from the nuclear sector increased significantly. In 2023, the federal government also received additional corporate tax revenue from the returns on frozen Russian assets held in Belgium.

Growth in primary expenditure weighed heavily on the primary deficit in 2023, taking it to a level well above that recorded before the pandemic.

Table 8.1

General government budget balance

(in % of GDP)

	2019	2020	2021	2022	2023 e
Revenue	49.9	49.9	49.5	49.6	49.9
of which: taxes and social security contributions	42.9	42.8	42.6	42.6	42.9
Primary expenditure	49.9	56.8	53.2	51.6	52.4
Current expenditure	46.6	53.2	49.4	48.0	48.6
Capital expenditure	3.4	3.6	3.8	3.6	3.7
Primary balance	0.0	−6.9	−3.7	−2.0	−2.5
Interest expense	2.0	1.9	1.7	1.5	1.8
Budget balance	−2.0	−8.9	−5.4	−3.5	−4.2

Sources: NAI, NBB.

This marked increase, which mainly concerned current expenditure, can be explained by several factors. Firstly, political measures such as a further increase in minimum benefits at the federal level and the strengthening of social security policy in Flanders had an impact. In addition, the costs of population ageing continue to rise structurally. Secondly, the automatic indexation of social benefits and public sector salaries pushed up the expenditure ratio in 2023. Finally, public investment also soared, driven by regional infrastructure projects.

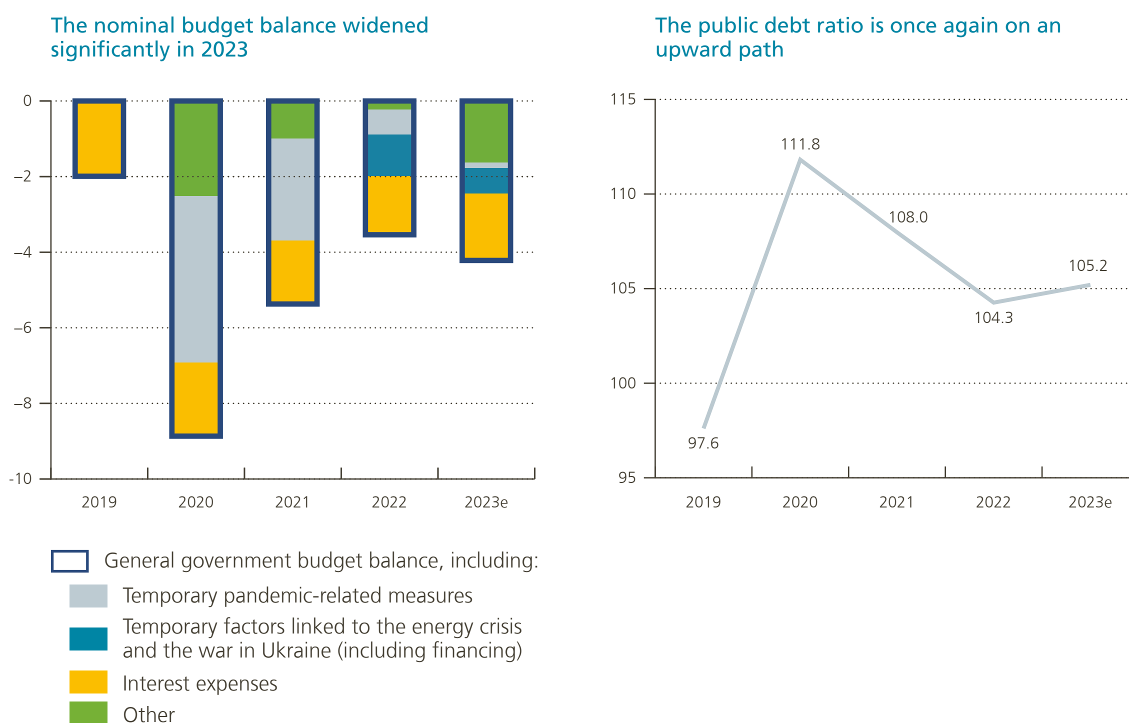
Excluding temporary factors related to the pandemic, the energy crisis and the war in Ukraine, tax revenue dropped in 2023. This decline was mainly due to the downward trend in indirect taxes, which were affected by the permanent reduction in the VAT rate on electricity and natural gas, which was not entirely recouped by the corresponding increase in excise duties, and the decline in revenue from registration duties due to the slowdown on the property market. Meanwhile, revenue from taxes on labour increased thanks to strong wage growth resulting from the delayed impact of automatic wage indexation. This effect was most apparent in the take from social security contributions. However, personal income tax revenue was in fact also contained by the sharp indexation of tax brackets, based on the previous year's inflation rate which far exceeded automatic wage indexation in 2023.

Against the backdrop of a primary deficit of 2.5 % of GDP, fiscal policy remained expansionary in 2023. While the economy almost reached potential output in 2023, the general government sector did not manage to reduce the primary deficit further. Since the end of the Covid-19 crisis, the primary balance has systematically recovered, albeit insufficiently in view of the rebound in economic activity. By comparison, in 2019, the economy was close to potential output and the primary balance was in equilibrium. Fiscal policy therefore remained very favourable in 2023. In fact, since 2019, there has been a structural increase in primary expenditure,

Figure 8.1

Belgium's budgetary situation is structurally deteriorating

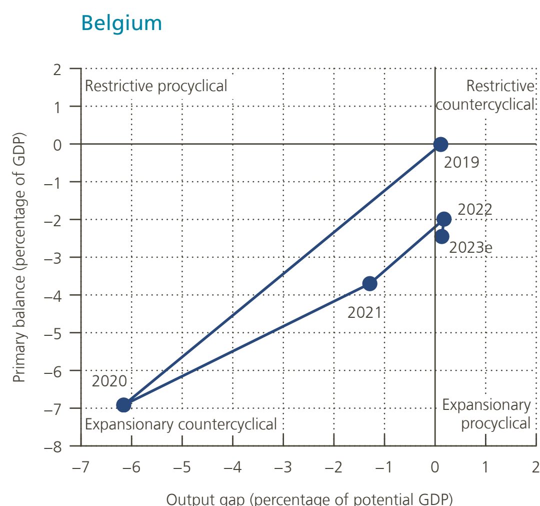
(percentage of GDP)

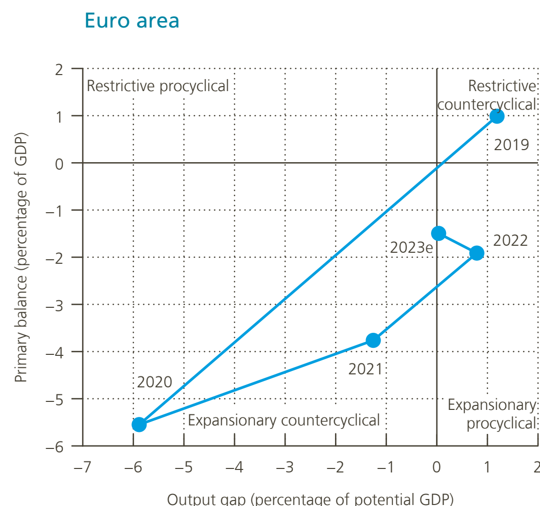


Sources: NAI, NBB.

Figure 8.2

Belgium's fiscal policy remains expansionary





Sources: EC, NBB.

while accommodative measures adopted in response to the energy crisis have not been quickly withdrawn.

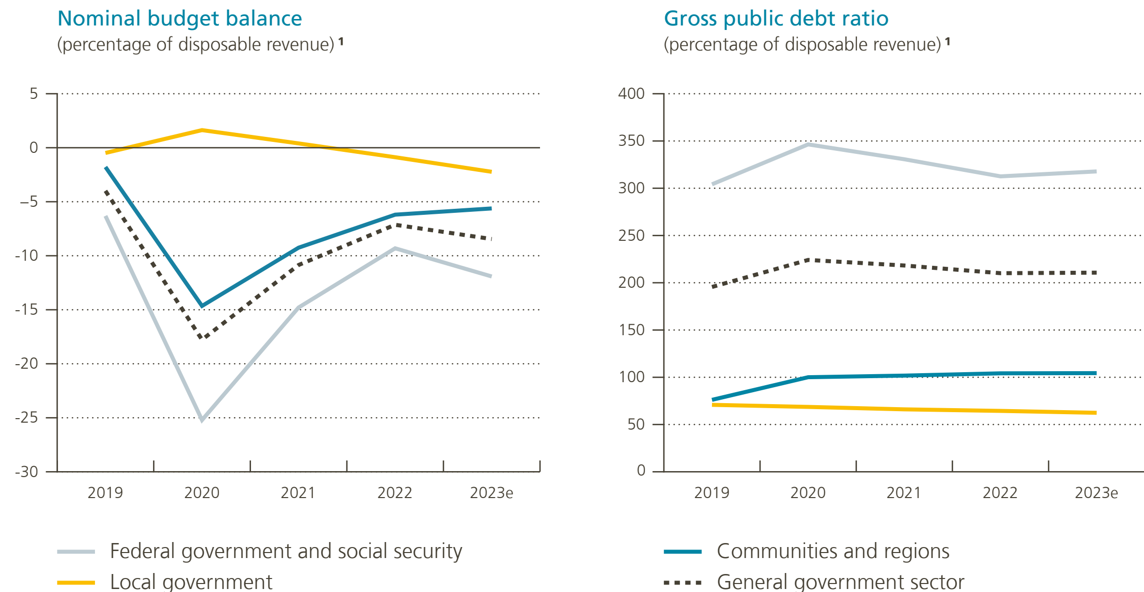
Interest expenses rose for the first time in many years, driven by further rises in short- and long-term interest rates. The rise in interest rates that began in early 2022 also led to a gradual acceleration in interest expenses as from last year. Although interest expenses fell slightly in 2022, as maturing debt could still be refinanced at a more advantageous rate, the average interest rate on outstanding debt (the implicit rate) rose again in 2023. Interest expenses are expected to rise by 0.2 % of GDP per annum on average over the next few years.

Due in particular to a pronounced primary deficit, the debt ratio increased in 2023 and remained well above its pre-pandemic level. In 2023, Belgium's gross debt ratio increased by 0.9 percentage points to 105.2 % of GDP. The denominator, nominal GDP, also rose sharply in 2023, driven by still substantial domestic inflation (growth in the GDP deflator). However, the favourable denominator effect was partially offset by the impact of the high deficit. Moreover, the issuance of a one-year State note in September 2023 proved exceedingly popular and led to a temporary 1.5 percentage point increase in gross debt (and a corresponding increase in cash reserves). In the coming years, the persistence of large primary deficits threatens to further increase debt, especially as implicit interest rates continue to rise. Belgium's debt ratio is therefore on a structurally upward path, an observation that applies to both the federal government and the communities and regions.

The increase in the public deficit in 2023 was almost entirely at the federal level. The deficit of the federal government and social security rose by 0.6 percentage points of GDP in 2023, corresponding more or less to the increase in the general government borrowing requirement. Primary expenditure swelled at the federal level partly as a result of a structural increase in the costs associated with population ageing. At the regional level, deficits remained virtually stable. If the budget balance of the various governments is expressed as a percentage of their disposable revenue, which allows a more accurate comparison, it appears that the deficits of both the federal government and those of the communities and regions are still much higher than they were before the Covid-19 pandemic. Finally, as was the case in 2022, the local government sector ran a small deficit, reflecting the local investment cycle in the run-up to elections in 2024.

Figure 8.3

Federal and regional budget balances remain structurally less favourable than before the pandemic



Sources: NAI, NBB.

1 Disposable revenue includes only revenue effectively available to government to implement a policy. More specifically, government revenue has been adjusted to take into account transfers to other levels of government.

Over the next few years, the budget deficit must be brought below 3 % of GDP, so as to put the debt ratio on a downward trajectory

A significant improvement in the budget balance is required to ensure the sustainability of public finances. Firstly, the deficit must be brought below 3 % of GDP in order to reduce the debt ratio. Secondly, as part of a forward-looking policy, it is important to build up reserves in calmer economic times so as to be able to cope with future shocks. Furthermore, a more restrictive fiscal policy helps contain inflation and thus aids monetary policy.

An effective European fiscal framework plays a key role in achieving sound public finances. At the end of the year, the Ecofin Council reached a political agreement on a new European economic governance framework, the fiscal dimension of which is a significant part. The primary objective of this new framework is to strengthen the sustainability of public finances, while supporting employment and promoting sustainable and inclusive growth. Member States will have to present medium-term fiscal-structural plans covering four or five years. These plans should adhere to country-specific fiscal trajectories, depending on the risk to the sustainability of their public finances. The trajectory will then be converted into an expenditure measure that allows subsequent monitoring to be ensured. Box 8 provides an overview of the main features of this new framework.

In March, the European Commission (EC) asked Belgium to bring its budget deficit below the reference value of 3 % of GDP by 2026 at the latest and to set its debt ratio on a downward path over the medium term. Although the recommendations for Belgium are based on the old fiscal framework, they include several elements that fall under the new framework. The EC further announced that it will propose to the Ecofin Council, in the spring of 2024, that the excessive deficit procedure be initiated for countries in non-compliance with the requirements, on the basis of figures recorded for 2023. In its April opinion, the Government Financing Requirements Section of the High Council for Finance adopted the deficit and debt targets proposed by the EC. It insisted that the requisite fiscal

consolidation should begin without delay, in the 2024 budget at the latest, in order to achieve the necessary turnaround in fiscal policy in the very near future.

In its country-specific recommendations published in July, the Ecofin Council asked Belgium to make a structural effort of at least 0.7 percentage points of GDP in 2024, by keeping the nominal increase in net primary expenditure financed at national level [1] to a maximum of 2 %. This was the first time since the general escape clause entered into force that a quantitative recommendation was made. The Council also ordered Belgium to phase out the current energy support measures as soon as possible and to allocate the resulting savings to reducing the public deficit. For the period after 2024, the EC recommended that Belgium pursue a fiscal strategy based on gradual and sustainable consolidation, combined with investment and reforms conducive to higher sustainable growth, so as to achieve a prudent fiscal position in the medium term.

1 This is nationally financed expenditure less discretionary revenue measures, interest expenses and cyclical unemployment expenditure.

BOX 8

The new European fiscal framework

At the end of December, the Ecofin Council reached a political agreement on a new European economic governance framework, the fiscal dimension of which is a significant part.[1] The European economic governance framework consists of a set of institutions, rules and procedures to coordinate and monitor economic and fiscal policies in the EU. The agreement on a new framework was the culmination of a process that began in early February 2020, with the publication of an assessment of the existing framework by the European Commission. It must still be presented to the European Parliament and could be adapted. [2] The new framework should be progressively introduced as from 2024.

1 See Council of the European Union, "Economic governance review: Council agrees on reform of fiscal rules", Press release, 21 December 2023.
2 An agreement was reached between the Ecofin Council and the European Parliament on 10 February 2024. This agreement does not contain any substantial changes.

The old framework has been adapted to remedy a number of shortcomings and to take account of several new challenges. According to an EC assessment, the old framework had several shortcomings, such as overly complex rules, a lack of national ownership, the often pro-cyclical nature of fiscal policy, a lack of attention to reforms and investment, and limited compliance with and enforcement of the rules. Stakeholders also called for greater account to be taken of the increased heterogeneity amongst Member States and the challenges facing the EU. These include the digital and climate transitions, energy security, population ageing, high budget deficits and public debt following the crises of previous years, and strategic security.

The new fiscal framework maintains several important features of the former framework and introduces several changes and new elements relating to Member State fiscal policies. Several major aspects of the former fiscal framework have been retained, such as the reference values of 3 % and 60 % of GDP for the budget deficit and public debt, respectively; the breakdown into preventive and corrective arms; the European Semester as an instrument for policy coordination; and the existence of escape clauses.[1] The main new aspects are outlined below.

National medium-term fiscal-structural plans covering four or five years (depending on the length of the legislative term) are the cornerstone of the new framework. These replace the current national stability, reform and convergence programmes. In these plans, the Member States commit to budgetary objectives as well as reform and investment targets. The aim is to facilitate a coherent and streamlined process and to strengthen national ownership. The fiscal trajectory set out in the plan will remain unchanged for its entire duration. Member States must submit an annual progress report on the implementation of their plan to the European Commission by 30 April at the latest.

1 The main aspects that have been abolished concern achievement of a medium-term budgetary objective (MTO), convergence towards this objective, the annual reduction in the debt ratio by 1/20th of the deviation from the 60 % of GDP reference value, and the national stability, reform and convergence programmes.

For countries whose deficit exceeds 3 % of GDP and/or whose debt ratio exceeds 60 % of GDP, the EC will establish a technical trajectory to be used as a basis for preparing a national plan. [1] This path forms the essence of the preventive arm of the fiscal framework. It is expressed in terms of maximum nominal growth in net primary expenditure financed at national level [2] and covers a four-year adjustment period, which can be extended by up to three years. An extension may be granted if Member States carry out certain reforms and investments that improve growth potential and foster fiscal sustainability.

The technical trajectory is based on an analysis of the sustainability of public finances per country and guarantees that, on the one hand, by the end of the adjustment period at the latest, the projected public debt ratio will be on a downward path or will remain below 60 % of GDP over the medium term [3] assuming no further budgetary measures. Secondly, during the adjustment period, the projected government deficit will be brought below the reference value of 3 % of GDP and will remain below this level in the medium term, assuming no further budgetary measures.

The technical trajectory must also meet two additional conditions. Firstly, it must enable the projected debt ratio to be reduced by a minimum annual average amount of at least one percentage point of GDP over the adjustment period, if the debt ratio exceeds 90 % of GDP, or by half a percentage point of GDP, if it is between 60 % and 90 % of GDP. Secondly, it must ensure that fiscal adjustment continues until a deficit level is reached that ensures a structural safety margin of 1.5 % of GDP in relation to the reference value of 3 % of GDP. The annual improvement in the structural primary balance to achieve the required margin is 0.4 % of GDP, which will be reduced to 0.25 % of GDP if the adjustment period is extended.

According to simulations by the think tank Bruegel, the technical trajectory for Belgium would require an annual fiscal adjustment of 0.7 percentage points of GDP for seven years or 1.2 percentage points of GDP for four years. [4] The structural primary balance would then trend towards a surplus of around 2.5 % of GDP. These simulations are based on the EC's autumn projections, which forecast a deficit of 4.9 % of GDP in 2024, and were prepared in accordance with the Commission's current methodology for analysing debt sustainability.

Member States determine the adjustment trajectory they intend to follow; this may deviate from the technical trajectory proposed by the EC. It must, however, be supported by objective factors and approved by the EC and the Ecofin Council.

For Member States whose debt exceeds 60 % of GDP and that stray too far from the agreed trajectory, as well as those whose deficit is persistently above 3 % of GDP, the excessive deficit procedure (EDP) will be initiated. This remains the corrective arm of the budgetary framework.

1 No fiscal adjustment is required from countries whose deficit does not exceed the reference value of 3 % of GDP and whose debt ratio does not exceed the reference value of 60 % of GDP. However, the EC can provide technical guidance upon request.

2 This is public expenditure net of discretionary revenue measures, interest expenses, expenditure on cyclical unemployment and expenditure on EU programmes fully covered by receipts from EU funds. One-off and temporary measures are also excluded from net expenditure.

3 Based on the European Commission's legislative proposals of April 2023, this is assumed to be a 10-year period.

4 See J. Zettelmeyer, *Assessing the Ecofin compromise on fiscal rules*, 21 December 2023, Bruegel.org.

The EDP rules on exceeding the 60 % debt-to-GDP threshold have been strengthened. For Member States whose debt exceeds 60 % of GDP and whose headline deficit is neither close to balance nor in surplus, the EC will launch an EDP (excessive deficit procedure) if the country's net expenditure strays significantly from the agreed trajectory. A deviation is considered significant if the actual change in net expenditure deviates by more than 0.3 percentage points of GDP in a given year or by more than 0.6 percentage points of GDP cumulatively from the path defined in the national plan. This ceiling on the cumulative deviation authorised over more than two years is a new feature. The corrective trajectory for net expenditure is at least as demanding as the agreed trajectory and, moreover, redresses cumulative deviations built up in previous years.[1]

The EDP rules based on the deficit criterion have been retained. Should the deficit remain above 3 % of GDP, the corrective trajectory for net expenditure is in principle the same as the agreed trajectory, with a minimum annual structural adjustment of 0.5 % of GDP. The Member States have agreed that the EC may, during the 2025-2027 transitory period, take into account higher interest expenses when calculating the adjustment required.

The fine to be imposed in the event of non-compliance with the Ecofin Council's recommendations under the EDP has been reduced. Whereas it was previously set at a maximum of 0.5 % of the preceding year's GDP per annum, it is now capped at 0.05 % of the preceding year's GDP per six-month period. The fine must continue to be paid until the Ecofin Council finds that its recommendations have been met ; it may also decide to increase the penalties.

A standing and more independent European Fiscal Board (EFB) should play a greater role. The role of the EFB has been strengthened by extending its consultative powers in the governance process. To this end, its independence and access to information should be improved. The role of the national independent fiscal institutions has been confirmed but not strengthened. The national authorities may, however, turn to these institutions to assess compliance with the net expenditure trajectory. That being said, the resulting analyses are not binding on the EC.

A provisional assessment of the new European economic governance framework paints a mixed picture. The new framework includes clear improvements. This is particularly the case for the use of expenditure growth as the sole operational variable, the emphasis on the medium term for national plans which remain unchanged for the years to which they apply, the encouragement of greater ownership on the part of Member States through individualised trajectories, and reinforced rules for the debt-based EDP. Nonetheless, certain reservations remain. For example, the use of debt sustainability analysis as the touchstone to determine the fiscal trajectory will not lead to simplification. In addition, this method requires an upfront financing effort for the increasing costs of population ageing, which makes the requirements for Belgium particularly strict. The additional conditions concerning the technical trajectory and the 2025-2027 transitory period further complicate matters. In addition, the possible extension of the fiscal adjustment period to a maximum of seven years could raise questions about the application of the criteria used to this end. Only time will tell whether these adjustments will improve compliance with and application of the rules. The precise implications for Belgian fiscal policy are not yet entirely clear, as they will depend on the parameters used to calculate the technical trajectory and the use of discretionary powers by the European institutions when implementing the rules.

1 Annual deviations from the agreed net expenditure path are aggregated by the EC for each Member State in a control account.

In the stability programme put forward by Belgium in April 2023, the various governments set out a fiscal trajectory that could bring the deficit below 3 % of GDP in 2026, but which allows for a further increase in the debt ratio in subsequent years. The aim is to reduce the nominal general government deficit to 2.9 % of GDP by 2026. To achieve this, the deficit of the federal government and social security would fall to 2.2 % of GDP, while the combined deficit of the communities and regions and of local authorities would fall to 0.7 % of GDP. A structural improvement of 0.8 percentage points of GDP is targeted for 2024, to be achieved almost entirely by the communities and regions. This assumes a nominal deficit of 5.1 % of GDP in 2023, which is more pessimistic than more recent estimates.

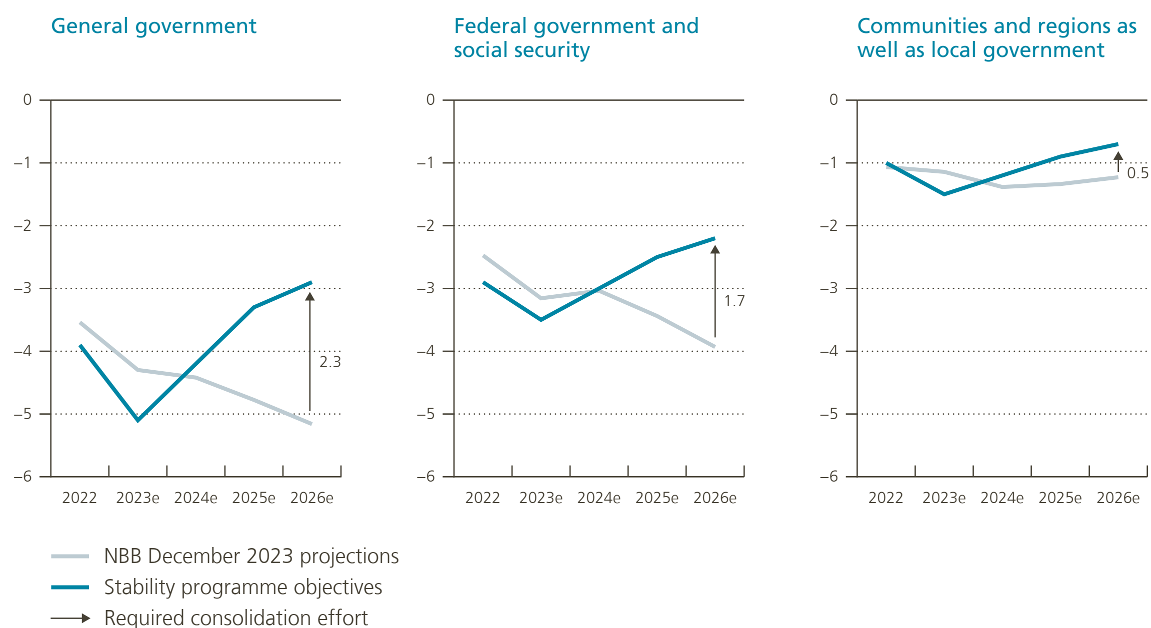
Once again this year, fiscal policy coordination between the various levels of government in Belgium proved unsatisfactory. Indeed, the various authorities were unable to agree on fiscal targets for the period 2023-2026 within the Concertation Committee. Since the entry into force of the cooperation agreement of 13 December 2013, the governments have never managed to agree on a common fiscal target – except in 2018 – and on how to allocate it between the entities within the stability programme. Achieving the necessary fiscal consolidation will, however, require the involvement of all levels of government in Belgium, as well as appropriate cooperation between them. It is therefore high time to conclude clear and binding arrangements on the division of these efforts among the various levels of government.

The Bank's December projections indicate that a substantial effort is required to achieve the objectives of the stability programme. At unchanged policy, a further widening of the deficit is forecast in the coming years, which would run counter to these objectives. The general government budget deficit is set to increase slightly in 2024. The envisaged structural improvement, of 0.8 percentage points of GDP, is thus unlikely to be achieved. The budget balance is expected to deteriorate by a further 0.4 percentage points of GDP per year in both 2025 and 2026, reaching 5.2 % of GDP in 2026. The deficit of the federal government and social security would thus increase, as would those of the communities and regions and of local government.

Figure 8.4

Substantial efforts are needed to achieve the stability programme objectives

(nominal government budget balance, percentage of GDP)



Sources: FPS BOSA, NBB.

All levels of government will therefore have to make a considerable effort, amounting to 2.3 percentage points of GDP, to meet the targets by 2026, of which 1.7 percentage points of GDP will have to come from the federal government and social security.

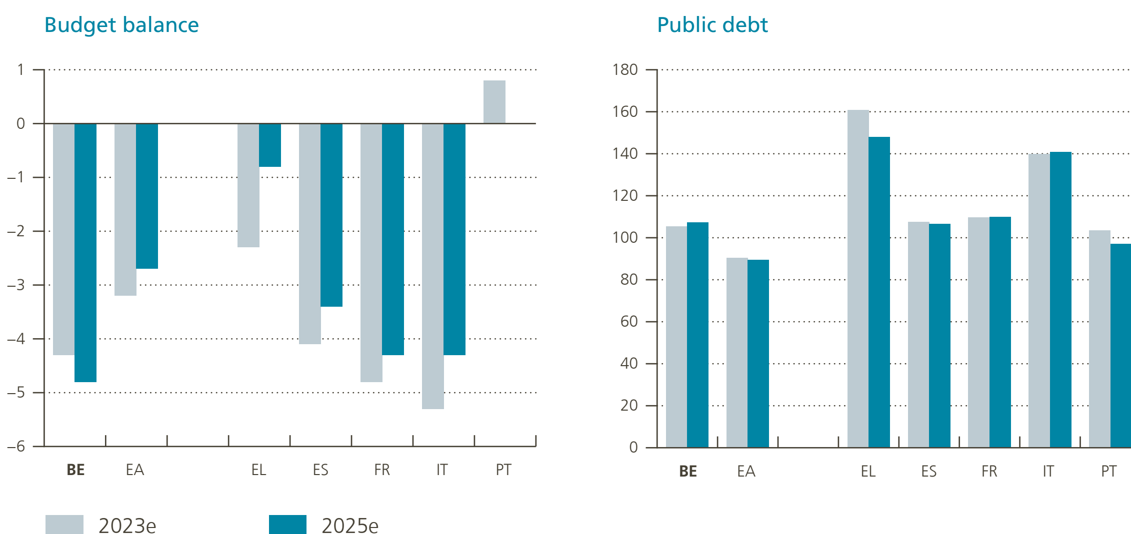
Based on its autumn forecasts, the European Commission estimated that the fiscal trajectory for 2024 may not be in line with the recommendations issued by the Ecofin Council in July. This conclusion was reached in its assessment of the Member States' draft 2024 budgetary plans. According to EC forecasts, nominal growth in net primary expenditure financed at national level will amount to 3.8 %, thus in excess of the maximum recommended increase of 2 %. The Commission has therefore asked Belgium to take the necessary measures under the national budgetary procedure to ensure that its fiscal policy in 2024 complies with these recommendations.

Belgium is among the countries facing the greatest risks to the medium-term sustainability of their public finances. The outlook for public finances is less favourable in Belgium than in most other euro area countries. In contrast to expected developments in Belgium, the EC forecasts suggest that the budget balance will improve in the euro area and in other high-debt countries, with the exception of Portugal, which is expected to achieve a balanced budget in 2025. Belgium is set to have the highest deficit of these countries. Its debt ratio is expected to rise, while that of the euro area is projected to fall. Among the other high-debt countries, only France and Italy are expected to see a slight increase in their debt ratio.

Figure 8.5

Public finances are projected to develop less favourably in Belgium than in other euro area countries

(percentage of GDP)



Sources: EC (November 2023 projections), NBB (December 2023 projections).

8.2 The deterioration in the primary balance is attributable to higher expenditure

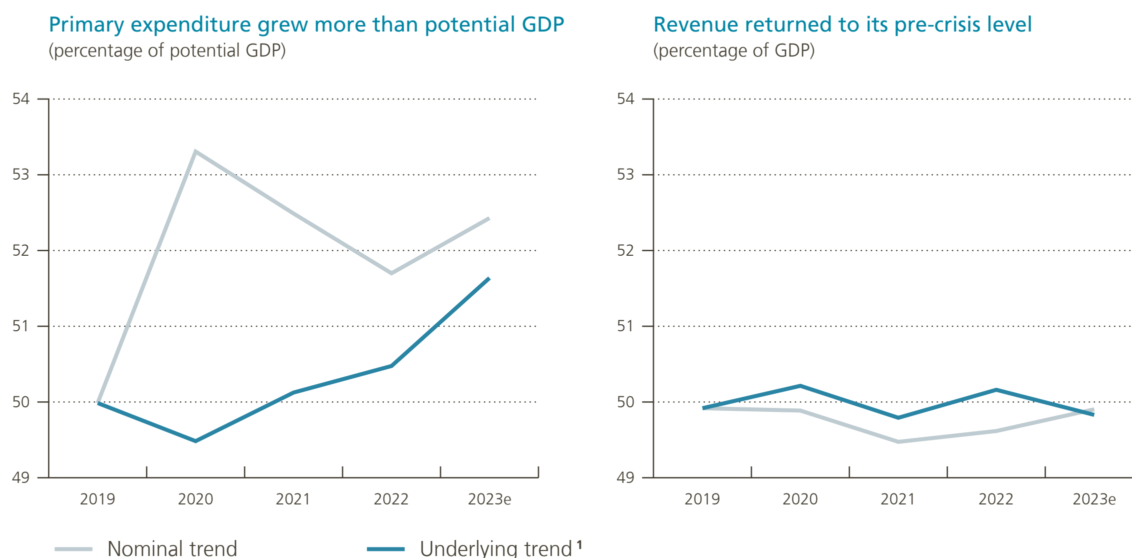
The significant deterioration in the primary balance since 2019 is entirely due to the increase in primary expenditure. By 2023, revenue had returned to its level in 2019, the year before the series of crises. This section looks successively at the changes in primary expenditure and revenue both over the past year and in relation to 2019. A distinction is systematically drawn between, on the one hand, the temporary factors attributable to the Covid-19 pandemic, the energy crisis and the war in Ukraine and, on the other hand, the underlying trend excluding these temporary factors.

Primary expenditure continues to rise structurally, regardless of temporary factors

The 2023 general government budget still provided for expenditure to help households and firms cope with the rise in energy prices. The scale of this support (€ 3.2 billion in expenditure, or 0.5 % of GDP) remained stable compared with 2022, despite the fall in prices on international markets. Households continued to benefit from the basic voucher for gas and electricity throughout

Figure 8.6

The recent deterioration in the primary balance is attributable to public spending



Sources: NAI, NBB.

1 Change in expenditure and revenue excluding temporary factors caused by the Covid-19 pandemic, Russia's invasion of Ukraine and the energy crisis, including temporary funding factors.

the first quarter. The extension of the "social tariff" to persons eligible for a higher healthcare reimbursement rate (BIM/RVT) ended on 30 June. In this respect, the fiscal cost of the standard social tariff, which is not considered temporary, fell sharply in the wake of the drop in energy prices. At regional level, depending on the fiscal space available in Flanders, Brussels and Wallonia, various subsidies were made available to help firms and nonprofits pay their energy bills.

Russia's invasion of Ukraine once again generated significant public expenditure in Belgium. A substantial share of Ukrainian refugees received the equivalent of the minimum income allowance. Funds were also allocated to provide temporary or permanent accommodation for migrants. In addition, humanitarian aid and military support were provided on the ground in Ukraine. If certain measures aimed at raising the level of preparedness of the Belgian army are classified as exceptional expenditure, it appears that the crisis mobilised a budget of around € 1.2 billion (or 0.2 % of GDP) over the course of 2023.

In contrast, the Covid-19 crisis had almost no budgetary implications. It generated residual expenditure estimated at around € 200 million, a far cry from the € 2.7 billion still disbursed in 2022 (representing a fall equivalent to 0.5 % of GDP).

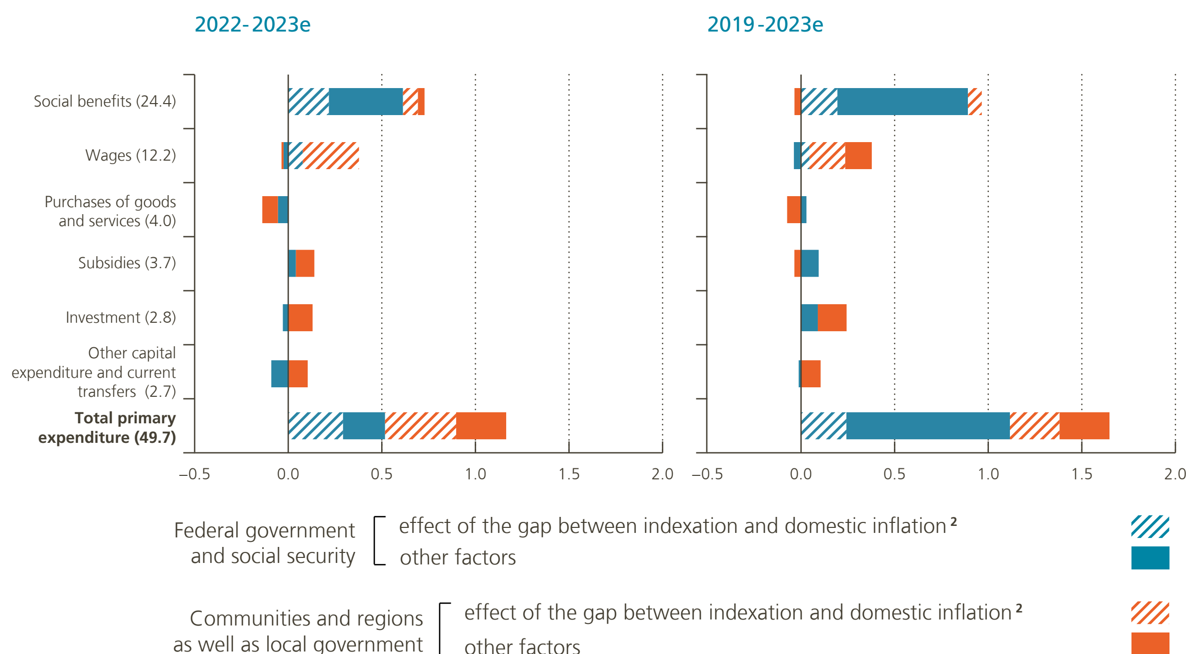
Leaving aside these various temporary factors, the underlying trend in expenditure is clearly upwards. In order to get a more accurate idea of the dynamics at work in public expenditure, it is important to exclude the exceptional expenditure caused by various recent crises (Covid-19, Ukraine, energy). In addition, it is important to associate them with the most appropriate denominator, namely potential GDP. This approach is adopted below.

In the space of four years, primary expenditure rose by the equivalent of 1.7 percentage points of potential GDP. In other words, the underlying trend in public spending since 2019 has outpaced potential economic growth in Belgium. This gap widened significantly in 2023, mainly due to the federal government and social security.

Figure 8.7

Social benefits are contributing substantially to expenditure growth

(underlying change[1] in percentage points of potential GDP; in brackets: weight of the category as a percentage of potential GDP in 2022)



Sources: NAI, NBB.
1 Change in expenditure excluding temporary measures due to the Covid-19 pandemic, Russia's invasion of Ukraine and the energy crisis.
2 Effect of the difference observed between the level of automatic indexation and that of domestic inflation measured by the GDP deflator.

Social benefits accounted for more than half the increase in expenditure between 2019 and 2023. These came mainly out of social security. This expenditure item is rising largely as a result of population ageing, which is putting pension and healthcare spending under pressure. In addition to this volume effect, minimum social benefits at federal level continue to rise gradually, and the gap between actual indexation and domestic inflation, as measured by the GDP deflator, continues to widen.

Pensions are the main driver of the rise in social benefits. Notably as well, over the last four years, benefits paid to people on sick leave increased more than the healthcare reimbursement budget. While the provision of healthcare services did fall temporarily during the Covid-19 crisis, as a result of the suspension of non-urgent consultations and hospitalisations, healthcare has benefited from a real growth target of 2.5 % since 2022. On the other hand, the fiscal cost of unemployment benefits trended downwards over the period under review. As the labour market proved resilient during the crisis and growth was job intensive during the economic recovery, the number of people receiving unemployment benefits has been falling for several years. This effect is compounded by the influence of structural factors which have driven up the employment of certain categories of workers, such as those aged 55-64 and women.

The automatic indexation of social benefits and public sector salaries undeniably weighed on expenditure. In 2023, growth in the health index slowed compared with the previous year. The pivot threshold, which triggers indexation, was crossed only once. In fiscal terms, however, the year under review saw the delayed impact of the five overruns that had occurred in 2022. As a result, inflation in expenditure items subject to automatic indexation was between 6 % and 7 %. This increase sustained the expenditure ratio, given that growth in the GDP

deflator was limited to 4 %. Overall, this delay between indexation and inflation, as measured by the GDP deflator, has contributed to underlying growth in expenditure of 0.5 % of GDP since 2019.

In practice, the increase in the government wage bill can only be seen in the communities and regions and at the local level. In 2023, the indexation gap mentioned above played a major role. Since 2019, the rise in the wage bill has also been fueled by growth in public sector employment, concentrated at regional and local levels. By contrast, personnel costs appear to be under control at federal level, where employment levels are fairly stable.

Consumption of goods and services is the only category with essentially no underlying growth. This expenditure item even fell slightly in 2023. Operating costs were only partially adjusted for the high inflation seen in recent years, which explains this relative stability.

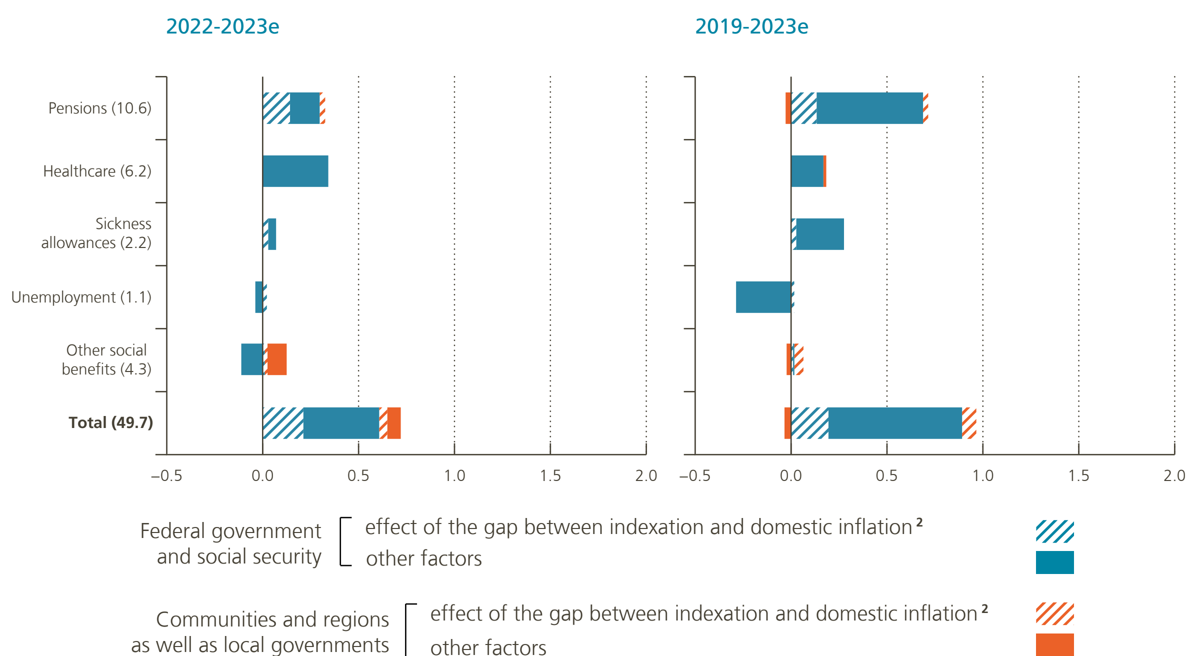
Subsidies have grown comparatively modestly since 2019. In this category, exemptions from the obligation to remit taxes withheld on earned income grew faster than potential GDP, while targeted reductions in social security contributions and subsidies for service voucher companies developed at a rate comparable to that of economic activity. The non-profit sector benefited from additional federal funding through the *Fonds blouses blanches* (White Coat Fund) and the social agreement to improve working conditions in hospitals. The regions adopted similar measures for nursing homes.

In terms of capital expenditure, 2023 was characterised by sustained growth, mainly at regional and local levels. Investment by local authorities was robust, as is often the case in the year preceding municipal elections. In Flanders, the huge Oosterweel project to complete the Antwerp ring road picked up steam. Stimulus projects also gained momentum, mainly generating direct public investment and state

Figure 8.8

Social spending is rising as the population ages

(underlying change[1] in percentage points of potential GDP; in brackets: weight of the category as a percentage of potential GDP in 2022)



Sources: NAI, NBB.

1 Change in expenditure excluding temporary measures due to the Covid-19 pandemic, Russia’s invasion of Ukraine and the energy crisis.

2 Effect of the difference between the level of automatic indexation and that of domestic inflation, measured by the GDP deflator.

support for investment. These favourable dynamics, which emerged in the wake of the Covid-19 crisis, were nevertheless slow to materialise, but were to the advantage of many projects, whether matched by European funding or not (see below).

In the absence of far-reaching reforms, expenditure will continue to swell

Without major fiscal reforms, current expenditure will inevitably continue to rise. Population ageing plays a large part in this development. The fiscal burden of pensions and healthcare will continue to rise as a result. Added to this demographic factor is the worrying rise in the number of long-term sick, which is placing an increasing strain on Belgium's public finances. Assuming unchanged policy, the Study Committee on Ageing (SCA) expects the cost of social benefits to rise by 3.7 percentage points of GDP by 2050. Half of this increase will occur over the next nine years.

On the whole, the pension reforms adopted since 2011 have undeniably helped mitigate the expected rise in the costs of ageing. For example, the proportion of senior citizens who are pensioners will be reduced by the upcoming raising of the statutory retirement age and by the postponement of the qualifying age for early retirement, which is already applicable. On the other hand, the De Croo administration has gradually increased minimum pensions, while raising the pensions of the self-employed and certain categories of employees. These benefit increases were partially offset by a number of measures adopted in July 2023, the most important of which was the introduction of a cap on the increase in public sector pensions.

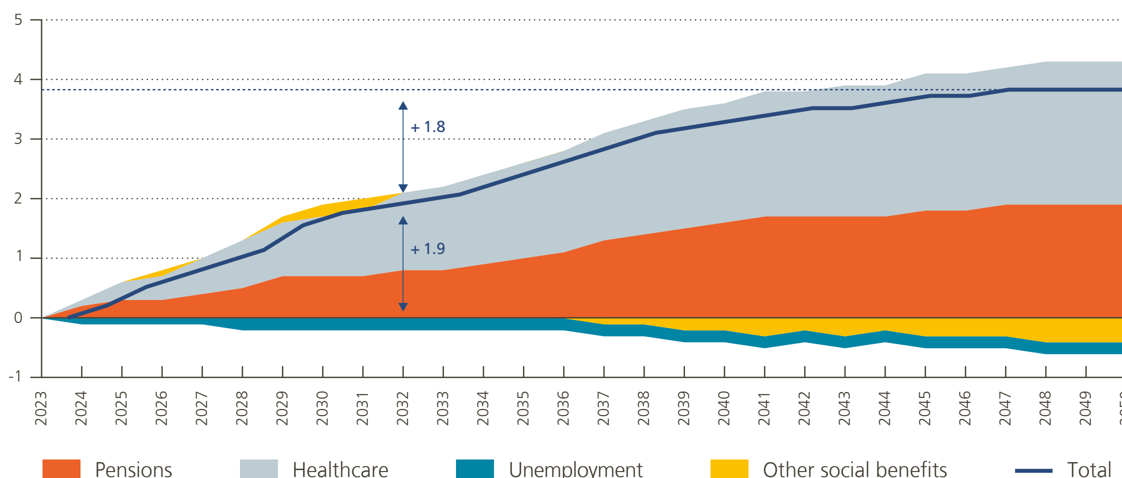
In a recent article,[1] the Bank described simulations setting out different ways to keep the pensions bill under control. This exercise showed that it is possible to reduce pension expenditure significantly as a percentage of GDP (or at least slow its growth) by bringing the determinants of the ratio into line with the euro area average. This will admittedly require tough, new measures. The most favourable policy entails raising the employment rate of older people, which would limit pension spending and increase GDP while reducing the risk of poverty among the elderly. More generally, policies aimed at increasing GDP by boosting employment or productivity

1 See M. Deroose, W. Melyn, P. Stinglhamber and S. Van Parys (2023), "Is public spending on pensions in Belgium sustainable? A comparison with other euro area countries", *NBB Economic Review*.

Figure 8.9

At unchanged policy, the cost of pensions and healthcare will rise

(change relative to 2023 in percentage points of GDP)



Source: SCA.

also have the advantage of reducing the overall government expenditure ratio. However, a rebound in productivity will only lead to a fall in the pension expenditure ratio if the pensions of current retirees are not increased accordingly. Finally, any reduction (or slower rise) in the average state pension should preferably be at the expense of the highest pensions, so as not to increase the risk of poverty.

The NIHDI budget is also set to grow in the coming years. Healthcare costs are primarily being affected by population ageing, although new medical treatments made possible by technological advances are also driving up expenditure. In this sector, savings should be made without affecting the quality of care. To this end, greater efforts should be made in the area of prevention, in order to spare many patients treatments that prove costly for social security. As the effects of such preventive measures are only felt in the long term, they should ideally be implemented without delay. The other task entrusted to the NIHDI is the payment of sickness allowances. The budget for these has exploded in recent years, driven by long-term illnesses such as burnout and depression. Thus far, measures designed to tackle this problem have failed to reverse the trend. During the current legislative term, the "Back to Work Plan" was introduced, setting out a reintegration pathway for people on sick leave who are still able to work. In this area, too, better prevention, particularly in terms of mental health, would benefit all parties involved (workers, employers and society). Combined with getting the long-term sick back to work, such measures would be particularly beneficial for public finances.

Unlike current spending, capital expenditure should be boosted, provided it is well targeted. Over the last few years, governments have realised the importance of public investment and have begun to redress its trajectory. In this respect, the National Recovery and Resilience Plan (NRRP), which benefits from European funding, has acted as a catalyst for other programmes financed by the federal, community and regional governments. During the year under review, Belgium submitted a revised version of its plan to the European authorities, which was approved. The plan now covers projects totaling € 5.3 billion. Most of this funding comes from grants (€ 5 billion, including € 4.5 billion from the Recovery and Resilience Facility, with the remainder from the REPowerEU programme and the Brexit Adjustment Reserve). These subsidies, which generate a debt for the EU, are supplemented by a loan of just over € 250 million.

In this context, it is important to continue to carry out ongoing projects and to implement the expected reforms, to make full use of the resources allocated to Belgium. It appears that selected projects often require more time than foreseen in their budget planning. Delays typical of the construction sector have recently been exacerbated by labour and materials shortagages. Rising prices and wage indexation have also hindered the deployment of planned investments in some areas. Finally, Belgium has been slow in going further with pension reforms, which are considered necessary to qualify for a new tranche of European funds.

Revenue returned to its 2019 level

Temporary support measures linked to the energy and Covid-19 crises continued to weigh on revenue, amounting to 0.4 % of GDP in 2023. In 2022, these measures still amounted to 0.6 % of GDP. The temporary reduction of the VAT rate on electricity and gas only affected the first quarter, and cost around three times less than the previous year. The same was true of the reductions in excise duties on petroleum products. Social security contributions were marked by a temporary exemption of 7 % in the first two quarters of the year, at an estimated cost of around € 1 billion. Business support measures adopted during the Covid-19 crisis continued to depress revenue, by 0.1 % of GDP.

Temporary financing components linked to the energy crisis and the situation in Ukraine boosted revenue by up to 0.5 % of GDP in 2023, compared with 0.1 % of GDP in 2022. These included, in particular, the taxation of excess profits of electricity producers, which peaked during the year, and a specific contribution from the gas transport sector. A further boost came from the increase in revenue from the taxation of nuclear power generation, which was favourably impacted by the high prices recorded in 2022. In addition, in 2023, corporate tax revenue rose due to income from frozen assets held by Euroclear following the imposition of international sanctions on Russia. The institution holds cash corresponding to the income from these assets and maturing securities. The investment of this cash generates singular profits which are subject to corporate tax.

Figure 8.10

Overall, general government revenue[1] returned to a level close to that seen in 2019

(underlying change[2] in percentage points of GDP; in brackets: weight of the category as a percentage of GDP in 2022)

Sources: NAI, NBB.

1 In accordance with ESA 2010, general government revenue does not include customs duties transferred by government to the EU or revenue collected directly by the EU.

2 Change in revenue excluding temporary factors caused by the Covid-19 pandemic, Russia's invasion of Ukraine and the energy crisis.

3 Mainly taxes withheld from earned income, advance payments of tax, tax assessments and revenue from personal income tax surcharges.

4 Including the special social security contribution and contributions paid by people not in work.

5 Mainly advance payments of tax, tax assessments and corporate withholding tax.

6 Mainly withholding tax on income from personal property, property tax (including revenue from surcharges), inheritance tax and registration duties.

7 Income from property, imputed social security contributions, current and capital transfers from other sectors and sales of goods and services produced, including remuneration for government guarantees on interbank loans.

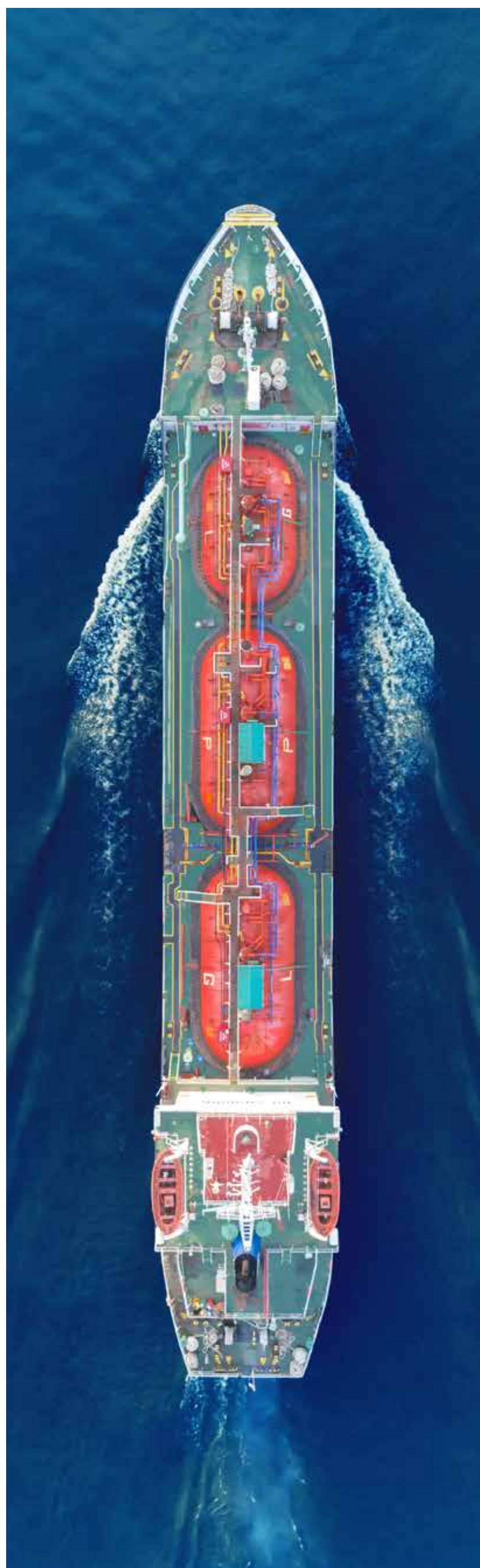
Excluding the impact of the temporary factors mentioned above, revenue fell by 0.3 % of GDP in 2023 and is back to pre-crisis levels. Given the significant impact of temporary factors on the development and level of the various revenue categories, they are excluded from the the above figure and the following analysis. Total underlying revenue essentially held steady compared with 2019, as a result of opposing movements in the various components. Levies imposed mainly on earned income (social security contributions and personal income tax) rose sharply relative to GDP, primarily because the wage bill increased more than GDP. Taxes on consumption (VAT and excise duties) were lower in 2023 than before the crisis. Finally, within the category of taxes on income from capital and wealth, the rise in corporate tax was almost entirely offset by a fall in levies on other income and wealth.

Compared with 2019, taxes on earned income expressed as a percentage of GDP increased, driven by automatic wage indexation, which outstripped the rise in the GDP deflator. The main factor was the sharp rise in personal income tax (0.4 % of GDP). Over this period, the measures taken in relation to personal income tax (PIT) contributed little to this trend. Bullish

measures, such as gradual reforms of the former regional housing tax-relief systems, were largely offset by bearish moves, such as the partial abolishment of the special social security contribution. In 2023, PIT revenue was broadly stable. The favourable effect on PIT revenue of automatic wage indexation, by 7.5 %, was tempered by growth in the tax brackets, by 9.5 % based on the previous year's high inflation. In addition, in 2023, the calculation of taxes withheld from earned income was adjusted in order to narrow the gap with the final tax due, which had a temporary downward impact. In addition, the correction applied after the final calculation of tax due, which usually results in a rebate, was artificially eased in 2022, and as such put revenue under strain in 2023. Social security contributions, for their part, have grown little in relation to GDP since 2019, although they have also benefited from the wage bill dynamics. This is due to greater reductions in employer contributions following the "tax shift" and, for employees, extension of the "employment bonus" aimed at low earners.

Taxes imposed mainly on consumption fell over the period 2019-2023. The decline in VAT receipts as a share of GDP largely reflects the permanent reduction in VAT rates on gas and electricity introduced in 2023 in the wake of the energy crisis. These reductions, from 21 % to 6 %, which were still temporary in the first quarter of 2023, were made permanent in the second quarter. They were partially offset by a permanent increase in excise duties on these products. Despite this increase in 2023 and the successive rate hikes for tobacco products, excise duties declined in relation to GDP over the period as a whole. Indeed, as these indirect taxes are defined as lump sums per quantity sold, their revenue does not automatically keep pace with inflation. Other taxes on goods and services fell slightly.

The increase in corporate tax over the period 2019-2023 should be viewed in conjunction with that of the macroeconomic parameters reflecting the tax base. Over the period as a whole, growth in gross operating surplus was more pronounced than that of nominal GDP. Another factor was the less marked change in depreciation, which is tax deductible. Depreciation for tax purposes is assessed based on the capital stock at historical prices, meaning it follows price increases with a certain delay. As the increase in depreciation was less than the increase in gross operating surplus, taxable income was even higher.



Leaving aside temporary favourable factors, corporate tax revenue grew more slowly than GDP in 2023, while remaining at a historically high level. The stagnation of gross operating surplus at the macroeconomic level weighed on the growth of this item. In addition, following strong growth in advance tax payments in 2022, the amounts received after calculating the tax due on the previous year's profits fell sharply. The downward impact of these factors was only partially offset by revenue-enhancing measures, mainly a reduction in tax deductions for the banking sector and measures temporarily reducing the deductions available to large firms.

The development of levies on other income and wealth was largely determined by the sharp fall in revenue from real estate transactions. The significant reduction in registration duties for the purchase of an "own and only" home in Flanders in 2022 compounded the considerable impact of the slowdown on the property market in 2023. This slowdown was reflected in both a fall in the number of transactions giving rise to the payment of registration duties and sluggish growth in sales prices. Overall, the other components of this revenue item, including in particular taxes withheld from income from movable property and real estate, grew at a rate close to that of GDP over the period, despite the raising of the tax on securities accounts.

8.3 Rising interest rates are leading to a gradual increase in the interest expense on the public debt

For the first time in several decades, the interest expense on the public debt rose

In line with the rise seen in 2022, interest rates climbed again, on average, in 2023. The ten-year interest rate on Belgian government bonds, which averaged 1.8 % in 2022, stood at 3.1 % on average in 2023. In the last two months of the year, however, the benchmark rate fell back slightly, to below the level seen at the end of the previous year. As far as short-term rates are concerned, the rate on three-month Treasury certificates averaged 0.1 % in 2022 and 3.3 % in 2023. Overall, servicing the public deficit on the financial markets is thus more expensive than in the past, and maturing securities are being refinanced at less favourable rates.

Spreads suggests that the financial markets still have confidence in Belgian government securities. The risk premium relative to other countries rose only slightly in 2023 compared with 2022.

The spread between the ten-year yield on Belgian government bonds and on German government bonds – which are considered the most creditworthy and liquid in the euro area – held stable in 2023, at around 63 basis points. This was also the case for French sovereign bonds, at around 10 basis points over the year as a whole. By way of comparison, in 2022, the Belgium-Germany spread was around 55 basis points, compared with four basis points for the spread with France.

The higher interest rates apply to (re)financing needs. At federal level, in 2023, in addition to financing on a cash basis of € 27.4 billion, OLOs amounting to around € 21 billion matured. These were issued at an average rate of close to 1.5 %. In 2023, the Federal Debt Agency issued long-term debt at an average annual rate of 3.2 % (compared with 1.7 % in 2022 and 0.1 % in 2021). Short-term refinancing was also significantly more expensive than in the past. The stock of Treasury certificates to be refinanced several times a year stood at around € 20 billion at the end of 2023. This was revised downwards by € 10 billion during the year (see below).

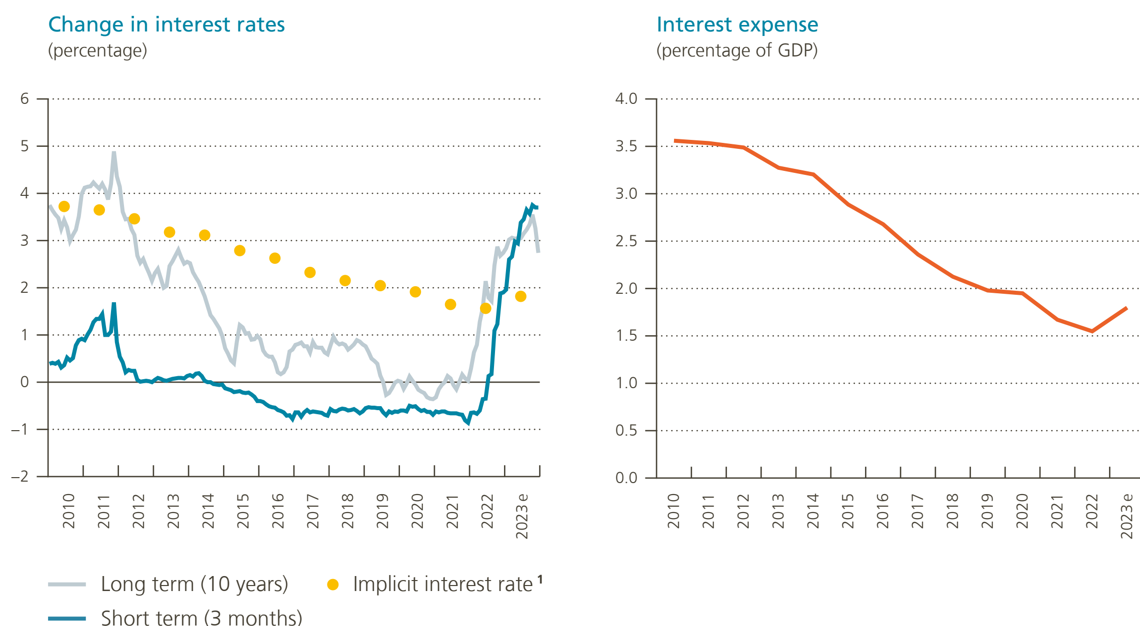
For the first time in several decades, the general government's interest expense on public debt increased. While it was around 1.5 % of GDP in 2022, it was approximately 1.8 % of GDP in 2023. The implicit interest rate on public debt, i.e. the ratio between interest expense for the current year and debt at the end of the previous year, also rose in 2023, from 1.6 % to 1.8 %.

The rise in the ECB's key interest rates impacts the Bank's earnings, which in turn affects the allocation of profits to the Belgian State. In recent years, the Bank purchased a large quantity of Belgian bonds with low yields to maturity. These purchases were financed by bank deposits, on which a deposit rate is payable, which has risen significantly in the meantime. This situation explains the negative earnings expected by the Bank in the coming years.

2023 was marked by the highly successful issuance of a State note at the beginning of September. Nearly € 22 billion was raised through this issuance, which has a historically short maturity of one year (see also Box 7 in chapter 7). The gross

Figure 8.11

In 2023, higher interest rates resulted in a historic increase in the interest expense on public debt



Sources: NAI, NBB.
1 Ratio of interest expense in year n to debt at the end of year n-1.

coupon of 3.30 %[1] offers a net yield of 2.81 % after the deduction of withholding tax at a reduced rate of 15 %. The success of the State note was due both to its short maturity and the low rates offered by commercial banks on other savings vehicles. This was the most successful issuance of a State note ever. Previously, the record had been held by the so-called "Leterme notes", which raised a total of € 5.7 billion in December 2011, with maturities of three, five or eight years.

The Federal Debt Agency's financing plan was revised following issuance of the State note. In particular, the amount of outstanding Treasury certificates was reduced by more than € 10 billion in 2023. Medium and long-term debt issuances were revised downwards by € 2.25 billion. The remaining cash surplus of around € 9 billion was reinvested in short-term securities with a yield at least equal to that of the State note. This investment led to a temporary increase in general government gross debt (see section 8.4).

1 After deduction of a bank commission of 30 basis points. At the time of this issuance, the yield on one-year Belgian government bonds on the secondary market was around 3.60 %.

The issuance of the State note did not have a significant impact on the federal debt management strategy. Once again, very long-term issuances were made. Over 2023 as a whole, the average maturity of new long-term borrowings was 17.3 years. At the end of 2023, the average residual maturity of all outstanding debt was ten years and five months, slightly higher than the previous year and well above the levels seen in the early 2010s.

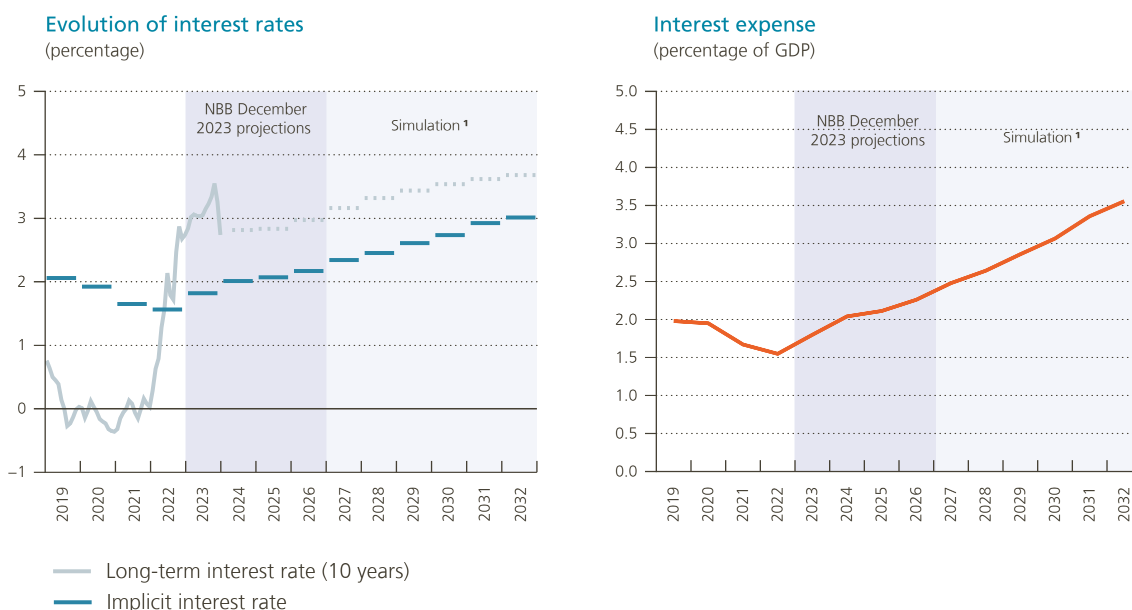
Over the next few years, interest expenses are set to rise steadily, putting pressure on the general government budget balance.

In January 2024, the markets expected the long-term interest rate to be around 3.5 % by 2030. Such higher interest rates, which are of course still very uncertain, would lead to a gradual and sustained increase in the interest expense on public debt.

Figure 8.12

Rising interest rates will have a gradual effect on interest expenses and the implicit interest rate on public debt over the next decade

(percentage, unless otherwise stated)[1]



Sources: Regional governments, Federal Debt Agency, SCA, NAI, NBB.

According to a simulation[1] based on these market expectations, interest expenses would thus rise from 1.8 % of GDP in 2023 to around 3.6 % of GDP in 2032. The average interest rate on the debt would rise from 1.8 % in 2023 to 3 % in 2032.

Over the next decade, interest expenses are expected to rise by, on average, 0.2 % of GDP per year, contributing to the deterioration of the budget balance. In the last decade, the opposite was true : interest expenses fell by around 0.2 % of GDP per year. In view of the increase in interest expenses, the fiscal adjustment required to keep the budget balance and debt dynamics under control will be increasingly large.

The simulation is based on the Bank's December 2023 projections, with the exception of the government's interest expense, which was calculated on the basis of market expectations in January 2024, according to which the 10-year interest rate on Belgian government securities will rise from 2.8 % in 2024 to 3.7 % in 2032. From 2027 onwards, (1) real GDP is derived from the December 2023 projections of potential GDP, (2) inflation is 2 %, which corresponds to the price stability objective, (3) the primary balance (as a percentage of GDP) corresponds to that of 2026 and is increased by the expected annual increase in ageing costs (as calculated in the Study Committee on Ageing's 2023 report), and (4) there are no exogenous factors.

1 For more information on this simulation, see the footnote to Figure 8.12.

8.4 High primary deficits are structurally increasing the public debt, while the favourable interest rate-growth differential is fading

Debt no longer melts like snow in the sun

Belgium's public debt rose by 0.9 percentage points to 105.2 % of GDP in 2023 and is significantly higher than before the pandemic. In 2021 and 2022, the debt ratio continued to contract – despite a high primary deficit – due to the very favourable contribution of the interest rate-growth differential. In fact, the combination of a historically low implicit interest rate on public debt and exceptionally strong nominal GDP growth turned the differential strongly negative. This means that the denominator of the debt ratio was increasing more than the numerator. In 2023, the interest rate-growth differential also had a debt-reducing effect (–3.7 percentage points of GDP), but this effect faded. On the one hand, nominal GDP growth slowed somewhat and, on the other hand, the implicit interest rate on debt increased as a result of higher policy and market rates. However, the high primary deficit (2.5 % of GDP) and exogenous factors[1] (2.1 % of GDP) outweighed the favourable interest rate-growth dynamics, leading to an increase in the debt ratio.

An important exogenous factor which temporarily increased the debt was cash reserves, which rose by € 9 billion due to the successful issuance of a one-year State note in September 2023. Loans extended by the Flemish Region under its social housing policy also added to the debt. In addition, debt management had an upward effect given that many government securities were issued at a discount in 2023: the issue value was lower than the face value, since the market rate was higher than the coupon rate. The debt therefore temporarily increased, as a corrective measure, up to the amount of the discount.[2] The accounting difference in the recording – under the budget balance and the debt, respectively – of tax revenue and defence expenditure also temporarily increased the debt.[3] On the other hand, the increase in exogenous factors was tempered by, among other things, the sale of a portion of the federal government's stake in BNP Paribas, which brought in approximately € 2 billion euros.

Dangerous debt dynamics loom

In the absence of a change in policy, the persistence of high primary deficits will further increase the debt burden. According to the Bank's December projections, the primary deficit will deepen further to reach 2.7 % of GDP in 2026, pushing the debt ratio structurally upwards.

In addition, the favourable contribution of the interest rate-growth differential is uncertain. Interest expenses are likely to rise sharply.

1 Exogenous factors directly influence debt, i.e. they do not affect the budget balance and concern, for example, the purchase and sale of financial assets by the government.

2 Over the next few years, the debt will again be adjusted downwards by the difference between (1) interest expenses calculated based on the higher market rate (and included in the budget balance) and (2) interest expenses calculated based on the lower coupon rate actually paid by the government.

3 This is because, according to ESA, revenue and expenditure are included in the budget balance at the time when the economic transaction takes place, whereas public debt is determined on the basis of cash flows, which may take place at different times.

The numerator of the debt ratio will then rise considerably, while nominal GDP growth returns to a more normal pace, meaning the denominator of the debt ratio will act less as a counterweight. According to a simulation, updating the Bank's December projections with interest rate expectations from January 2024 onwards, the interest rate-growth differential remains favourable (i.e. negative) but is gradually narrowing. A positive differential would put the Belgian debt ratio on a steeper upward trajectory. The debt ratio would then rise spontaneously as a result of a self-sustaining process in which the numerator increases faster than the denominator. Given the high level of indebtedness, this snowball effect of interest expenses can quickly become significant.

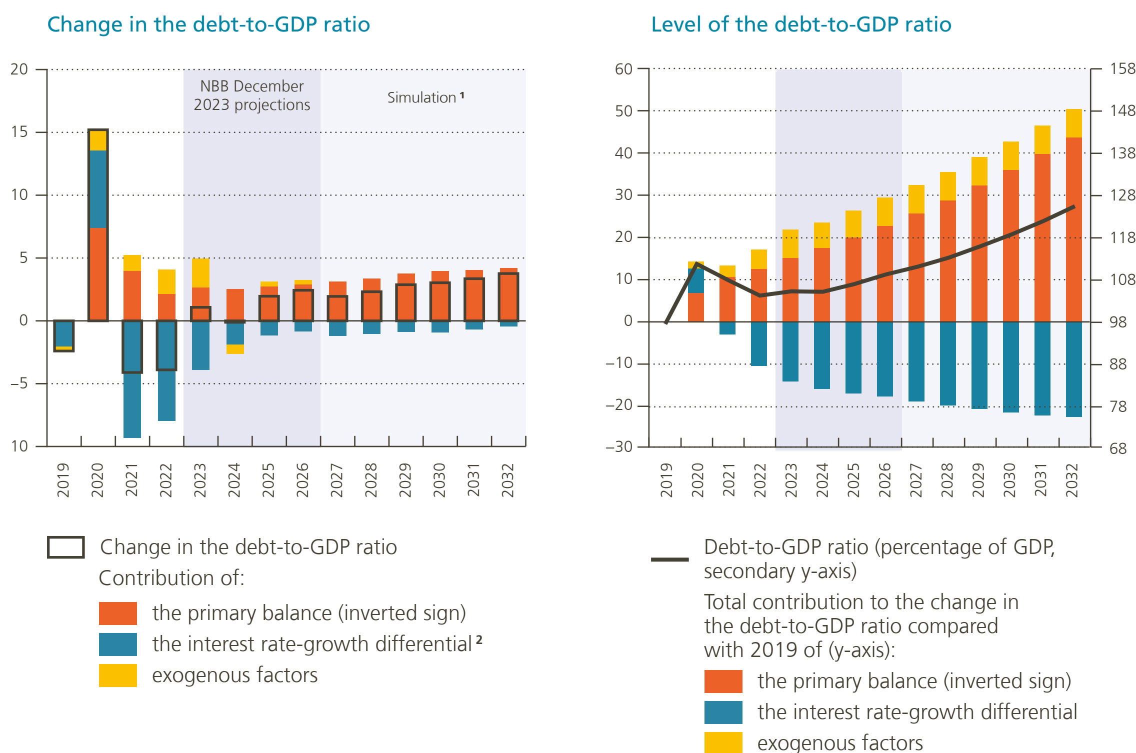
While the sustainability of public debt is not compromised in the short term, the upward debt dynamics are unsustainable in the long term. The European Commission considers the risks to the longer-term sustainability of Belgium's public finances to be "high".[1] According to simulations, assuming no policy change, Belgium's debt will amount to 126 % of GDP in 2033. Other high-debt countries, such as Greece, Portugal and Spain, seem to have their debt dynamics better under control in the medium term.

1 Based on a comprehensive analysis, the European Commission outlines the risks to the sustainability of public finances in the EU Member States in the short, medium and long term. More detailed information on the methodology is available in the Debt Sustainability Monitor 2022.

Figure 8.13

The favourable interest rate-growth differential is becoming narrower

(percentage points of GDP)



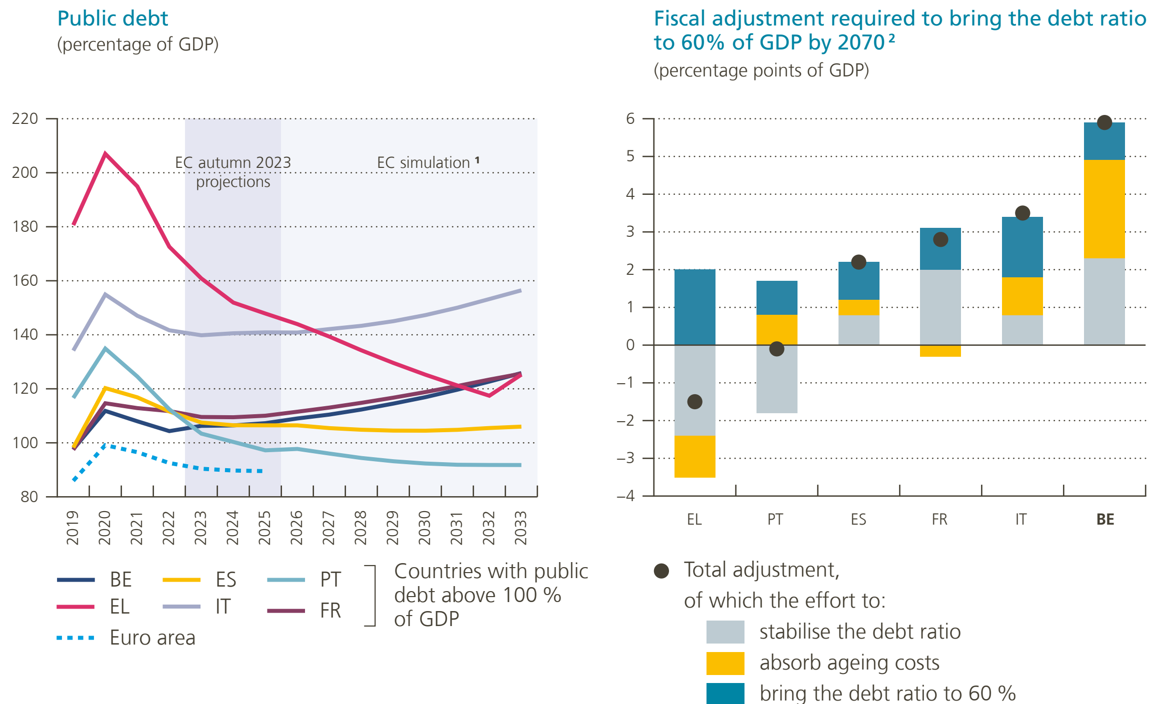
Sources: Regional governments, Federal Debt Agency, SCA, NAI, NBB.

1 The simulation is based on the Bank's December 2023 projections, with the exception of the government's interest expense, which was calculated on the basis of market expectations in January 2024, according to which the 10-year interest rate on Belgian government securities will rise from 2.8 % in 2024 to 3.7 % in 2032. From 2027 onwards, (1) real GDP is derived from the December 2023 projections of potential GDP, (2) inflation is 2 %, which corresponds to the price stability objective, (3) the primary balance (as a percentage of GDP) corresponds to that of 2026 and is increased by the expected annual increase in ageing costs (as calculated in the Study Committee on Ageing's 2023 report), and (4) there are no exogenous factors.

2 Difference between the implicit interest rate on public debt and nominal GDP growth, multiplied by the debt ratio at the end of the previous year.

Figure 8.14

The higher the initial level of debt and the greater its rise, the greater the risks to sustainability



Source: EC.

1 Debt simulation based on the EC's spring 2023 projections, which are included in the European Semester country reports.

2 This is the S1 indicator used by the EC in its debt sustainability analysis. It measures the permanent adjustment of the structural primary balance in 2024, relative to a baseline scenario, which ensures that the debt ratio is below 60 % of GDP by 2070.

In the very long term, too, Belgium will face an enormous budgetary challenge – both historically and from a European perspective. According to the European Commission, stabilising the debt between now and 2070 will require a structural adjustment of almost 5 % of GDP from 2024 onwards, also taking into account the increasing costs of population ageing. An additional structural adjustment of 1 % of GDP will be required to reach the European budgetary framework objective of a debt ratio of 60 % of GDP.

Debt sustainability analysis plays a key role in the new European fiscal rules and will largely determine the debt trajectory to be followed. High-debt-risk countries, including Belgium, will have to make greater efforts. At the end of the adjustment period, their debt ratio should be below the starting level and continue to fall thereafter for ten years (see Box 8).

To put the debt ratio on a downward trajectory, considerable fiscal consolidation will be required. More specifically, the deficit should be reduced to less than 3 % of GDP in the coming years. Secondly, a buffer will be needed to deal with unforeseen shocks. Given the expected developments that will put a strain on public spending – including population ageing, the climate transition and interest expenses – this will be a complex but essential task. The combination of limited resources and significant investment needs will oblige policymakers to set priorities. The consolidation of public finances is essential in order to maintain the confidence of the financial markets and prevent the risk premium on Belgian public bonds from rising and thus avoid or minimise the snowball effect of the debt ratio. The more swiftly consolidation is undertaken, the less will need to be spent on additional interest expenses.