Public finances

4. Public finances

4.1 Overview of fiscal policy [1]

Deficit dips just below the threshold of 3 % of GDP

Belgium ended 2015 on a general government deficit of 2.8 % of GDP. Only slightly better than the figure for 2014, this is the third consecutive year of a deficit very close to the threshold of 3 % of GDP that the European fiscal framework uses as its reference value for determining excessive deficits. General government debt edged down slightly to 106.5 % of GDP, thanks to specific factors.

Belgium's lower deficit matches the drop in interest charges on its public debt, while both primary expenditure and revenue, expressed as percentages of GDP, plunged in 2015, confirming the trend reversal first observed in 2014. The similar trend in 2015 partly reflected the index jump slowing down a number of expenditures and revenues, while spending was curbed by austerity measures and tax revenue fell below expectations.

Declines were almost of the same magnitude on the revenue and expenditure side, leaving the primary balance – i.e. the overall balance excluding interest charges – virtually unchanged and back in equilibrium. The latter contrasts with the state of play in the period before the onset of the financial and economic crisis : in 2007, Belgium's general government still recorded a primary surplus of 4 % of GDP, even if this was already undershooting levels notched up around the turn of the century.

Belgium's structural overall balance – which adjusts the budget for the effects of cyclical and temporary factors – improved by 0.3 percentage point of GDP in 2015 compared with the previous year, matching the improvement in the nominal balance. The business cycle may have

(1) As for all the macroeconomic estimates for Belgium, the 2015 estimates for public finances have been established on the basis of information available on 29 January 2016.

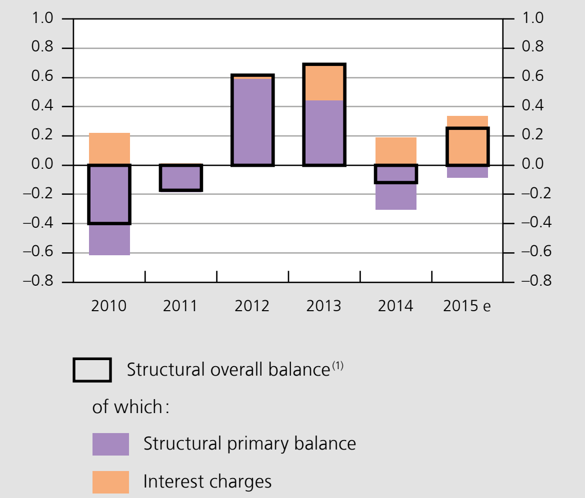
TABLE 15 GENERAL GOVERNMENT OVERALL BALANCE AND DEBT
(in % of GDP)

	2000	2007	2012	2013	2014	2015 e
Revenue	49.0	48.3	51.6	52.7	52.0	51.2
Primary expenditure	42.4	44.3	52.2	52.3	52.0	51.2
Interest charges	6.7	4.0	3.6	3.3	3.1	2.8
Primary balance	6.6	4.0	–0.6	0.4	0.0	0.0
Overall balance	–0.1	0.1	–4.1	–2.9	–3.1	–2.8
General government debt	108.8	86.9	104.1	105.1	106.7	106.5

Sources : NAI, NBB.

CHART 74 SLIGHTLY BETTER STRUCTURAL OVERALL BALANCE IN 2015 ON LOWER INTEREST CHARGES

(changes compared with the previous year, in percentage points of GDP)



Sources: EC, NAI, NBB.
(1) The cyclical component of the structural overall balance is determined based on EC methodology.

exerted a bit of an upward push on public finances, but the effect was cancelled out by the downward pull of non-recurrent factors that were less favourable than in 2014. The structural balance stalled on the same kind of figures as in 2013, while the general government had still enjoyed a structural improvement in 2012 and 2013 of 1.3 percentage points of GDP. Obviously, then, the much-needed further consolidation of public finances has virtually ground to a halt: capturing the fundamental trend in fiscal policies, the structural primary balance even deteriorated in 2014 and 2015 by a total of 0.4 percentage point of GDP.

Fiscal targets missed again

These outcomes imply that, once again, Belgium failed to meet its agreed fiscal targets after pushing them back several times in previous years.

In its April 2015 stability programme, which presents its budgetary plans for the current and subsequent three years to the EC, the Belgian government envisaged a reduction in its 2015 structural budget deficit by 0.7 percentage point of GDP. Subsequent years were to see a further improvement of the structural balance and equilibrium reached by 2018. These targets are in line with the European budgetary framework, which requires an annual improvement in the structural balance of 0.6 percentage point of GDP.

Belgium improved the structural balance by 0.3 percentage point of GDP in 2015, way below the target. The same had happened in 2014, when the aim was a rise of 0.5 percentage point of GDP but the reality brought an increase in the structural deficit of 0.1 percentage point

TABLE 16 TARGETS FOR THE OVERALL BALANCE OF BELGIAN GENERAL GOVERNMENT

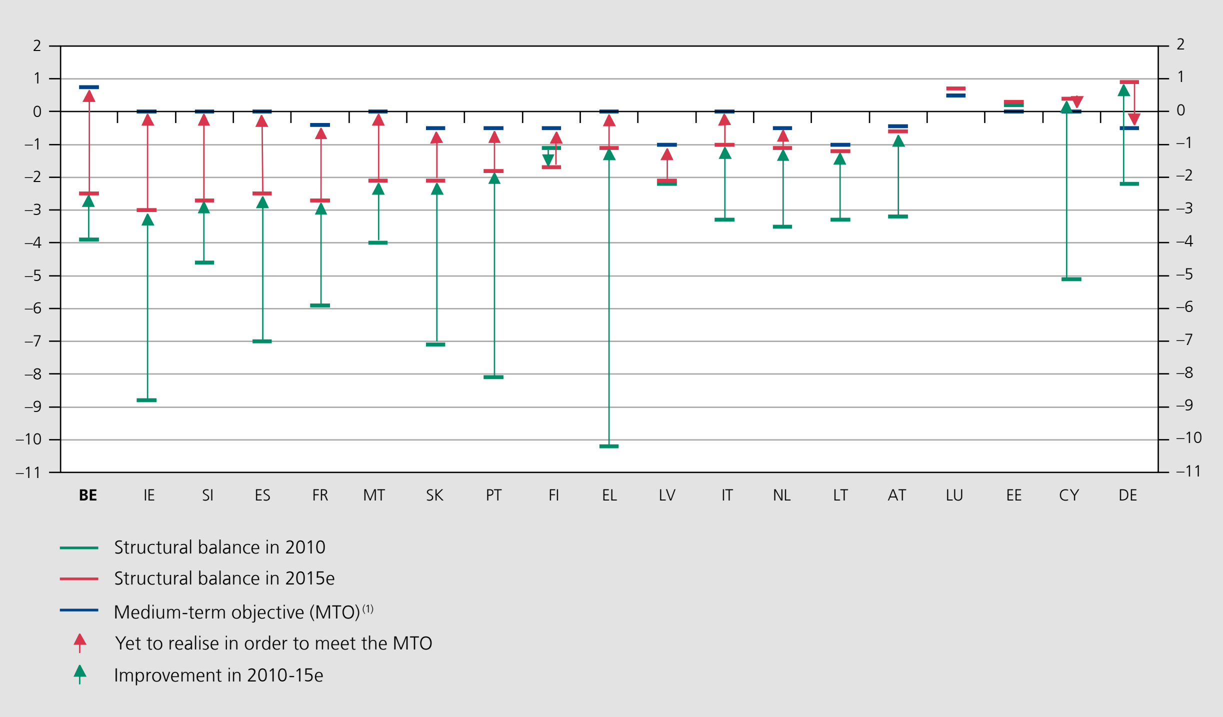
(stability programme targets; unless otherwise stated; in % of GDP)

	2012	2013	2014	2015	2016	2017	2018
Nominal balance							
April 2012	**–2.8**	–2.15	–1.1	0.0			
April 2013		**–2.5**	–2.0	–0.5	0.4		
April 2014			**–2.1**	–1.4	–0.4	0.6	
April 2015				**–2.5**	–2.0	–1.0	–0.2
October 2015 (draft budget)				–2.6	**–2.1**	–1.0	–0.3
p.m. actual	*–4.1*	*–2.9*	*–3.1*	*–2.8 e*			
Structural balance							
April 2013		**–1.8**	–1.2	0.0	0.75		
April 2014			**–1.4**	–0.7	0.0	0.75	
April 2015				**–2.0**	–1.3	–0.6	0.0
October 2015 (draft budget)				–2.0	**–1.2**	–0.5	0.0
p.m. actual	*–3.4*	*–2.7*	*–2.8*	*–2.5 e*			

Sources: EC, NAI, FPS Budget and Management Control, FPS Finance, NBB.

CHART 75 BELGIUM TO MAKE BIGGEST STRUCTURAL BALANCE IMPROVEMENT TO ACHIEVE MEDIUM-TERM OBJECTIVE

(in % of GDP)



Sources: EC, NBB.
(1) Minimum medium-term objective as defined by the EC in 2012. These targets will be reviewed at the beginning of 2016.

of GDP. Taking both years together, the deviation adds up to 1 percentage point of GDP.

The EC classified the breach of the reference value of 3 % of GDP for the budget deficit in 2014 as modest, temporary and exceptional, and ascribed it in particular to statistical adjustment as part of the transition to ESA 2010. It also said that the required improvement in the structural balance in order to comply with the debt rule in 2016 – prescribing an incremental decline of one-twentieth a year in the gap between the debt ratio and 60 % of GDP – was not achievable and not desirable in view of the exceptional economic conditions of low inflation coupled with slow economic growth; in fact it effectively ignored the debt rule laid down in 2011. Although defensible in the current climate, the EC turning a blind eye to its own debt criterion should remain a temporary matter and compliance with the debt criterion should once again be a central plank of fiscal policies as soon as inflation picks back up and economic activity rebounds. In addition, the EC took a similarly flexible line on the rules of the preventive arm, noting some, but no significant deviation from the desired path towards medium-term targets. It its autumn projections, which put the 2015 budget deficit at 2.7 % of GDP, the EC considered that similar risks prevailed in 2015.

The target date for a balanced budget has been systematically postponed in the past few years, but to ensure the sustainability of Belgium's public finances, rapid strides will need to be taken towards that goal, and subsequently also towards achieving the medium-term objective set in the European fiscal framework. At this point, the target is pegged at a structural surplus of 0.75 % of GDP, but the calculations that underlie it date back to 2012 and are still based on the debt ratio as well as on the projected budgetary costs of an ageing population at the time. However, the debt ratio has deteriorated and therefore worsened the starting point, although the Belgian government has taken a range of measures to help curb the cost of ageing in the longer term. All things considered, the new minimum medium-term objective – which the EC will propose in the spring of 2016 and which should factor in the impact of structural measures – may be assumed to be less steep.

To achieve current medium-term objective, Belgium will require a bigger improvement in its structural balance than other euro area countries. One reason for this is that Belgium achieved a relatively minor improvement in its balance in the 2010-15 period when compared with the other countries. In fact, only a very few countries – Germany, for one – took restructuring further than strictly required, which is why the Germans now enjoy some budgetary wiggle room.

Contributions from the different entities to consolidation influenced by sixth State reform

Sound management of public finances is the essential duty of every government and every government subsector. Under the sixth State reform, the Communities and Regions gained in importance following the major transfer of authorities and resources from Entity I, which comprises the federal government and social security. The budget section, which came into force on 1 January 2015, features in the Special Finance Act of 6 January 2014 to reform funding of the Communities and Regions, enhance the fiscal autonomy of the Regions and fund new powers and authorities; the same was done for the German-speaking Community in the Law of 19 April 2014.

The Communities now enjoy full authority over all family allowances and various aspects of health care and social support, while the Regions acquired additional powers, most notably relating to employment – such as reductions in social security contributions – and tax expenditure – in particular mortgage interest relief (housing bonus). The French Community transferred most of its new responsibilities and associated resources to the Walloon Region and the French Community Commission, thus implementing the Sainte-Émilie agreements.

Most of the expenditure affected by the sixth State reform falls within the social security remit, and by transferring relevant resources to the Communities and Regions through earmarking tax revenues, grants or fiscal autonomy, the federal government gave up financial resources that it had previously used to keep social security in balance, regardless of whether it did so via alternative financial resources or by way of an equilibrium grant.

As it was, the year in which the budget section of the sixth State reform was put into place saw a reduction in transfers by Entity I to the Communities and the Regions. The Special Finance Act of 6 January 2014 had envisaged a larger contribution by the federated entities to the consolidation of Belgian public finances; this was to take the shape of a structural levy of € 1.25 billion on the personal income tax resources that are transferred to the Communities and Regions by the federal government, whereas they ended up contributing € 250 million in 2014. In fact, this levy will be raised to € 2.5 billion in 2016. Also, the so-called "responsibilisation contribution" (shortfall contribution) by the federated entities for the payment of their civil servants' pensions significantly increased for the first time in 2015. State reform also included a refinancing of various Brussels-based institutions, e.g. the Brussels-Capital Region, the French Community Commission, the Flemish Community Commission and the municipalities in that Region.

Against this institutional backdrop and given economic developments as described in this Report's other chapters, the slight reduction in the overall nominal deficit of the Belgian government was down to an improvement in the accounts of Entity I and to a lesser degree of Entity II, which is made up of the Communities and Regions as well as local government. Entity II's borrowing requirement still remains well below that for Entity I.

TABLE 17 OVERALL BALANCE OF GENERAL GOVERNMENT AND BY SUB-SECTOR
(in % of GDP)

	2012	2013	2014	2015 e (1)
Entity I	–3.6	–2.5	–2.6	–2.4
Federal government	–3.5	–2.4	–2.5	–2.4
Social security	–0.1	0.0	0.0	0.0
Entity II	–0.6	–0.4	–0.5	–0.4
Communities and Regions	–0.1	–0.2	–0.4	–0.3
Local government	–0.5	–0.2	–0.2	–0.1
Total	–4.1	–2.9	–3.1	–2.8

Sources: NAI, NBB.
(1) These figures include the advances on the regional additional percentages on personal income tax although, according to the methodology of ESA 2010, those advances are regarded as purely financial transactions and the regional additional percentages are only taken into account at the time of collection. This approach deviates from NAI practices but is in line with those observed in developing fiscal targets in the recommendations of the Public Sector Borrowing Requirement section of Belgium's High Council of Finance, as well as in stability programmes.

In 2015, the federal government deficit shrank by 0.1 % to 2.4 % of GDP. Besides the bigger consolidation contribution by the federated entities, federal finances also benefited from a further easing of interest charges, from the austerity measures taken by the government in its initial 2015 budget and the two adjustments of March and October, as well as from the full effect of earlier measures. That said, all these favourable factors were partly offset by various unfavourable ones on the revenue side.

In 2015, too, social security accounts were balanced. Measures taken on health care and unemployment meant that social benefit payments were under control, whereas the index jump proved a downward force for both benefits and social security contribution receipts.

Despite their contributions to the consolidation of public finances, the Communities and Regions still managed to cut their deficits from 0.4 % to 0.3 % of GDP, taking advantage of the downward effect of the index jump on public employees' wages and transferred social benefits, particularly child allowances, as well as the measures taken by the newly elected governments after the May 2014 general election. The Walloon Region, the Flemish Community and the French Community ended 2015 on a deficit, whereas the Brussels-Capital Region still ran a surplus.

Local government, a sub-sector not immediately affected by the State reforms, reported a virtually unchanged deficit of 0.1 % of GDP. Like the other sub-sectors, it was also able to reduce the wage bill on the back of the index jump.

Solid fiscal coordination essential

In the fiscal arena, there are countless interactions between a state's various federated entities; these require efficient and operational coordination, and even more so if this state has a strongly federal dimension.

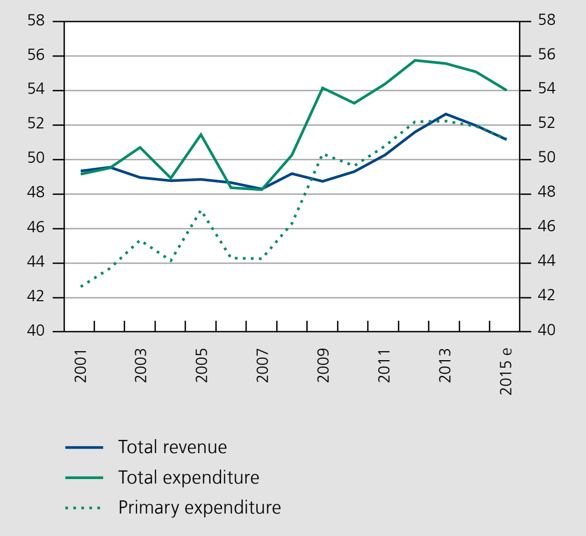
The 13 December 2013 cooperation agreement between the federal government, the Communities, the Regions and the Community Commissions implements the key aspects of the Fiscal Compact of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The agreement stipulates that when the stability programme is updated, annual budget targets will be allocated in nominal and structural terms between the various levels of government on the basis of a recommendation by the Public Sector Borrowing Requirement section of the High Council of Finance. This allocation will have to be approved by a decision of the Consultative Committee, a body comprising the Prime Minister and the Minister-Presidents of the Communities and Regions. The Public Sector Borrowing Requirement section is also designated as the independent body which, among other things, monitors compliance with these decisions and, more generally, checks that the governments fulfil their commitments.

In 2015, the Consultative Committee confined itself to taking note of the division of the fiscal targets across government sub-sectors as proposed by the federal government. The April 2015 stability programme determined that both the individual federated entities and the sub-sectors should put in place budgetary trajectories that lead to a structurally balanced budget by 2018 at the latest. Regarding individual entities, the programme did not specify any step-by-step process or targets for 2015.

4.2 Government revenues and expenditure both down

The fall in total general government expenditures by 1.1 percentage points of GDP can be traced back to a drop in interest charges of 0.3 percentage point and primary expenditure ending up 0.7 percentage point lower – the latter a continuation of a downtrend that started in 2014 and a clear reversal of the recent past, which had seen primary expenditure surge since the turn of the

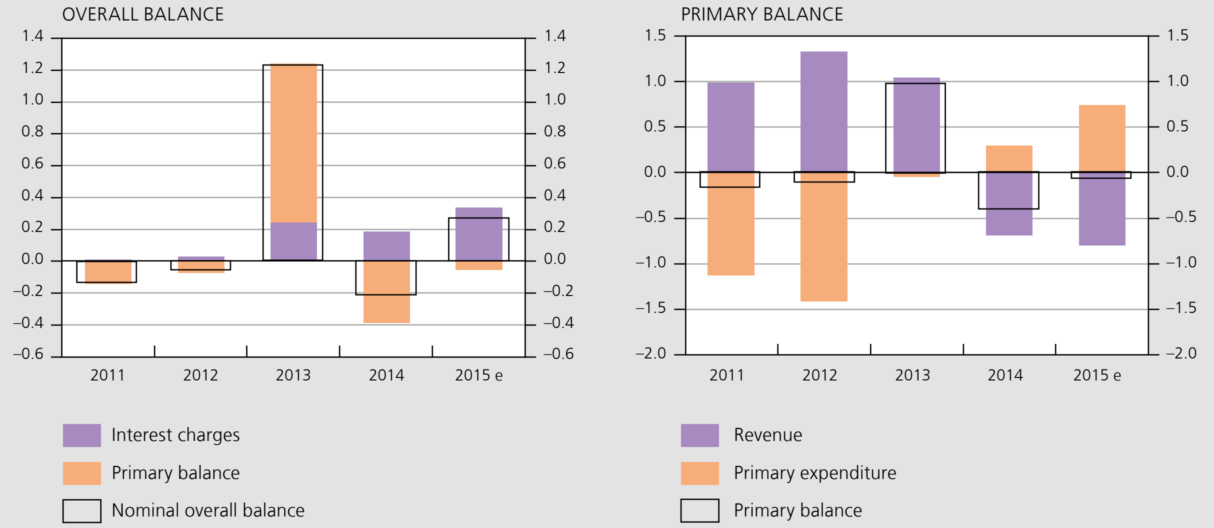
CHART 76 **GOVERNMENT INFLUENCE HAS WEAKENED IN RECENT YEARS**
(in % of GDP)



Sources: NAI, NBB.

CHART 77 DETERMINANTS OF THE CHANGE IN THE GENERAL GOVERNMENT'S NOMINAL OVERALL BALANCE AND PRIMARY BALANCE [1]

(changes, in percentage points of GDP)



Sources: NAI, NBB.

(1) The government-paid capital increase for Dexia in 2012 is recognised as a capital transfer and had a negative effect of 0.8 % of GDP on that year's overall balance and primary balance.

century. Also persisting in its 2014 showings, government revenue fell by 0.8 percentage point of GDP in 2015. All that said, Belgium's expenditure and revenue ratios remained stubbornly high, both from historical perspective and in comparison with other European countries.

As for the contribution of primary expenditure and total revenue to the consolidation of public finances after the financial crisis and the subsequent recession, two clear periods emerge : first, a recovery largely driven by income-boosting measures in the 2011-13 period, and second, a shift in focus towards scaling back primary expenditure from 2014. However, consolidation was rather limited in size as government revenues also fell hard in this period.

Steep falls in revenue from payroll taxes and government revenues from financial institutions

The downturn in total government revenue reflects across-the-board falls in fiscal, parafiscal and other revenues.

In regard to fiscal and parafiscal revenue, it was levies on earned income that went down hardest, by 0.3 percentage point of GDP, virtually entirely because of reduced revenue from personal income tax. The share of wages in GDP contracted in the wake of the index jump and the freezing of real negotiated wages, the impact of which was compounded by the increase in tax-deductible professional expense allowances taken into account in payroll tax calculations. Meanwhile, a lower pay ratio adversely affected social security contributions, although this was offset by a shift from allocated to real social contributions for child benefit granted to public employees, the authority for which has been transferred to the Communities under the sixth State reform.

Revenue from taxes on company profits nudged 3.3 % of GDP, up 0.1 percentage point of GDP on 2014, chiefly because of 2015 assessments making up for delays in 2014.

In financial 2015, a range of fiscal measures conspired to push up the tax base for corporation tax, such as the subjection to corporation tax of some intermunicipal utility companies and restrictions on the use of the notional interest system by banks. A similar effect derived from new legislation on the liquidation levy imposed on small and medium-sized enterprises. If SMEs keep their profits as a reserve in their companies and pay 10 %, no additional withholding tax will be due upon liquidation on condition that these retained earnings stay in the company until its liquidation. Lastly, lower reference rates for notional interest deductions – linked to yields on ten-year Belgian government bonds – had an upward effect on corporation tax due.

TABLE 18 GENERAL GOVERNMENT REVENUE [1]

(in % of GDP)

	2011	2012	2013	2014	2015 e
Fiscal and parafiscal revenue	43.2	44.3	45.2	44.8	44.4
Levies weighing chiefly on earned income	25.7	26.0	26.4	26.2	25.9
Personal income tax [2]	11.4	11.5	11.8	11.6	11.3
Social contributions [3]	14.3	14.5	14.7	14.5	14.5
Taxes on company profits [4]	2.8	3.0	3.1	3.2	3.3
Levies on other incomes and on assets [5]	3.7	4.0	4.4	4.4	4.3
Taxes on goods and services	10.9	11.3	11.2	11.1	10.9
of which:					
VAT	6.9	6.9	6.9	6.9	6.7
Excise duties	2.1	2.1	2.0	2.1	2.1
Non-fiscal and non-parafiscal revenue [6]	7.1	7.3	7.5	7.2	6.8
Total revenue	50.3	51.6	52.7	52.0	51.2

Sources: NAI, NBB.
(1) In line with ESA 2010, total revenue of general government does not include the proceeds of customs duties transferred to the EU nor the revenues levied directly by the EU.
(2) Mainly payroll tax, advance payments, assessments and additional percentages on personal income tax.
(3) Including the special social security contribution and the contributions of people not in work.
(4) Mainly advance payments, assessments and withholding tax.
(5) Mainly withholding tax on income of individuals, withholding tax on income from immovable property (including the proceeds of additional percentages), inheritance taxes and registration fees.
(6) Income from assets, imputed social contributions, current transfers and capital transfers from other sectors, plus sales of goods and services produced, including revenues on guarantees granted by the State on interbank loans.

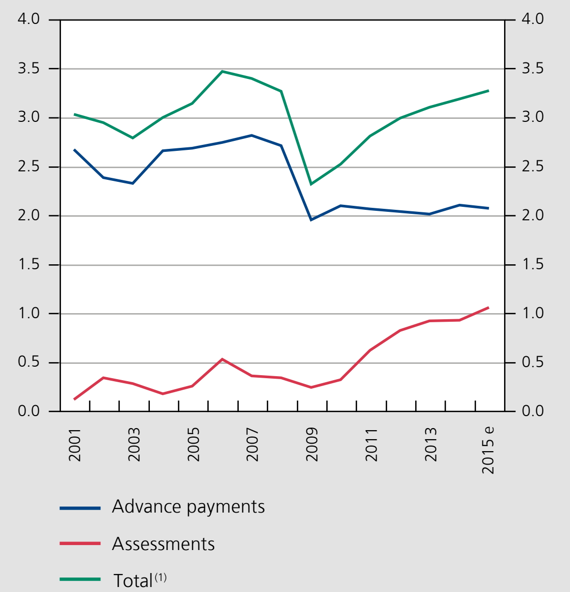
Contrary to expectations at the time of the initial budget, the effect of these factors only partially showed through in advance tax payments by companies, which remained virtually unchanged. Consequently, revenue from tax assessments may be expected to rise further in future, continuing the post-crisis shift to tax assessments from tax collection via advance payments. Supporting this trend is the low tax surcharge due in the event of insufficient advance payments, i.e. 1.125 % in the 2016 tax year.

Levies on other income and on assets decreased by 0.1 percentage point of GDP to 4.3 % of GDP – a clear break with the recent past and a result of lower revenue from withholding tax. This revenue had seen a temporary uptick in 2014 due to a change in the law on liquidation gains, for which withholding tax was raised from 10 % to 25 % in October 2014. Income from the third tax regularisation operation, announced as the final window for tax forgiveness, also slumped.

Taxes on goods and services, expressed as a percentage of GDP, declined slightly in the wake of lower VAT revenues, which itself was down to a hefty increase in refunds in the first half of 2015, while gross VAT revenue was in line with tax base expectations. The first half's unexpected surge in refunds may be partly due to the strong rise in capital

CHART 78 CORPORATION TAX SHIFTS TO COLLECTION VIA TAX ASSESSMENTS

(in % of GDP)



Sources: NAI, NBB.
(1) Including other taxes, the most important of which is the withholding tax.

spending in the first quarter, while significant growth in inventories in the first two quarters of the financial year may also be part of the explanation. The second half of 2015, by contrast, saw average refunds slide and somewhat offset the steep rise of the first six months. VAT revenue returned to its upward trajectory when VAT rates on households' electricity consumption were raised to 21 % from the beginning of September. In a separate development, income from excise duties was stable at 2.1 % of GDP, as it will not be until 2016 that the full extent of higher excise duties on diesel and alcohol will feed through to revenue, these having come into effect on 1 November of the year under review.

The slowdown in non-fiscal and non-parafiscal revenue by 0.3 percentage point of GDP was caused, among other factors, by the State receiving less income from various financial institutions. The Bank's payments to the State, for one, declined, as did fees paid by Dexia for government guarantees. Banks' payments into Belgium's resolution fund ceased as this was replaced by a European version from 2015, and as the Belgian State merely serves as a conduit to funnel the banks' payments to this European fund. Lastly, the shift from imputed to actual social contributions pushed down other revenue.

TABLE 19 MAIN FISCAL AND PARAFISCAL MEASURES (1)

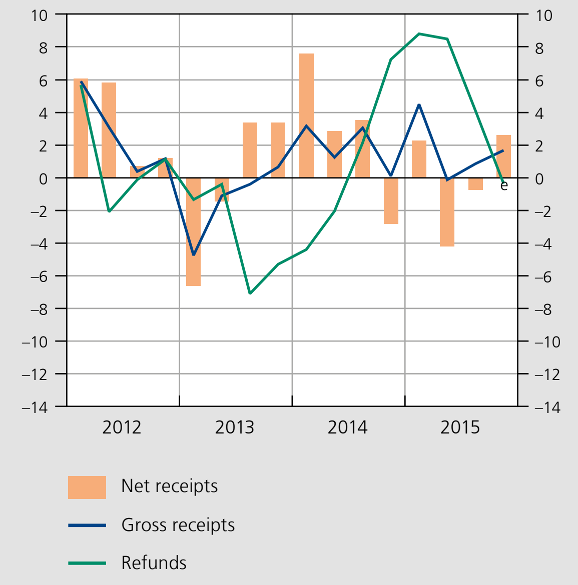
(in € million, differences compared with the previous year)

	2013	2014	2015
Total fiscal measures	2 795	221	684
Structural fiscal measures	1 747	545	1 244
Federal government and social security	1 720	525	1 161
Personal income tax	461	–56	–492
Corporation tax	552	327	1 022
Levies on other incomes and on assets	71	131	358
Taxes on goods and services	636	123	273
Communities and Regions and local authorities	27	20	82
Non-recurrent measures	1 048	–324	–560
of which:			
Liquidation gains	600	65	–665
Tax regularisation	625	293	–642
Tax agreements and court decisions	–52	–248	323
Delayed collection of inheritance taxes	0	–150	225
Delayed personal income tax assessments	250	–150	100
Structural parafiscal measures	–60	–285	–174
Total	**2 735**	**–64**	**510**
p.m. In % of GDP	*0.7*	*0.0*	*0.1*

Sources: Budget documents, NBB.
(1) This generally concerns the presumed influence of the measures according to the budget documents. The final impact may be different.

CHART 79 VAT REFUNDS SMARTLY UP IN FIRST HALF OF 2015

(VAT revenue, percentage changes compared with the previous year)



Sources: NAI, NBB.

Restrictive primary expenditure management

Primary expenditure as a percentage of GDP was down considerably in 2015. This ratio, which measures government spending excluding interest charges, dropped back from 52 % of GDP in 2014 to 51.2 %. This downward trend reflected a stabilisation of primary expenditure in volume terms, coupled with economic activity growth in real terms.

To obtain a true picture of the fundamental trend in fiscal policy, the growth of expenditure should be adjusted for temporary factors as well as for cyclical factors and indexation effects. For one thing, non-recurrent factors slowed spending growth by 0.1 percentage point in 2015, e.g. the extension of UMTS licences, whose allocation is recognised as a negative expense in the national accounts. Second, unemployment benefits showed the effects of the business cycle on primary expenditure and recorded

TABLE 20 GENERAL GOVERNMENT PRIMARY EXPENDITURE

(deflated by the GDP deflator, percentage changes compared with the previous year, unless otherwise stated)

	2011	2012	2013	2014	2015 e	Average 2000-2014
Level recorded (1)	50.8	52.2	52.3	52.0	51.2	47.2
1. Real recorded growth	4.1	2.9	0.1	0.8	–0.1	2.8
2. Influence of non-recurrent or fiscally neutral factors (2)	0.4	1.1	–1.4	0.2	–0.1	0.0
3. Influence of cyclical factors (2)	–0.3	0.1	0.1	–0.1	–0.2	0.0
4. Indexation effect (2), (3)	0.4	0.3	0.5	–0.4	0.0	0.0
5. Adjusted real growth (1 – 2 – 3 – 4)	3.6	1.3	0.9	1.0	0.3	2.7

Sources: DGS, NAI, NBB.
(1) In % of GDP.
(2) Contribution to real recorded growth of primary expenditure.
(3) Effect caused by the difference between the actual indexation (or the theoretical indexation for 2015 in view of the agreed index jump) of public sector wages and social security benefits and the rise in the GDP deflator. The other effects due to differences between inflation measured by the GDP deflator and the movement in price factors influencing other expenditure categories – whether these are attributable to the indexation mechanisms or to divergent patterns in the prices of certain expenditure categories – are not adjusted, owing to the absence of sufficient information.

a growth rate below their typical average in 2015, which means that, all in all, the cyclical component shaved 0.2 percentage point off the change in primary expenditure. And lastly, indexation-related factors – excluding the index jump – had a negligible impact on expenditures.

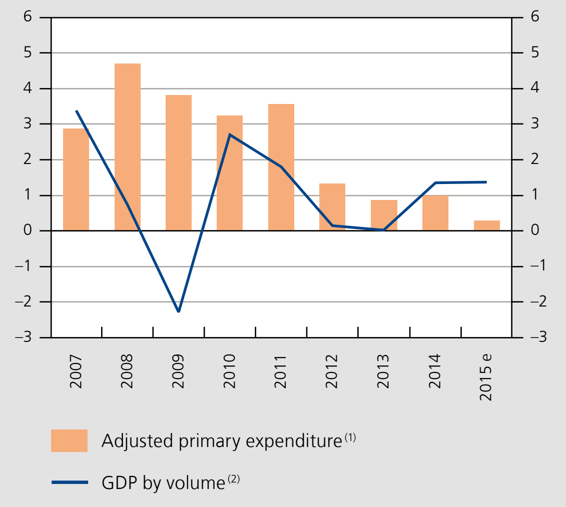
At the end of the day, primary expenditure recorded adjusted growth of 0.3 % in 2015, and so has managed to stay below real GDP growth for the second year running. The gap with economic activity growth nevertheless widened to 1 percentage point in 2015. This slowdown suggests that the current fiscal policy stance, geared towards consolidation of public finances by way of spending cuts, remained on course.

Numerous austerity measures at various levels of government have combined to slow down primary expenditure, and the index jump was a key driver: for one thing, it helped all government sub-sectors to keep their wage bills in check, including in the Communities and Regions, as well as in local government, which accounted for 45 % and 37 % of government employment respectively. And for another, the implementation of an index jump put the brakes on higher social benefits – which were set for a 2 % increase in July if automatic indexation had been in force. This single measure therefore has significant effects on total primary expenditure even if it has failed to improve the overall balance, as government revenue has also fallen in the wake of constrained employee compensation.

On balance, civil servants' remuneration inched down on lower employee numbers in addition to the index jump, as not all vacancies left by employee departures were filled. Lower government employment has a significant impact as compensation accounts for one-quarter of public sector expenditures – 12.5 % of GDP in 2015. Compensation

CHART 80 PRIMARY EXPENDITURE LAGS BEHIND ECONOMIC GROWTH

(percentage volume changes compared with the previous year)



Sources: NAI, NBB.
(1) Primary expenditure deflated by the GDP deflator and adjusted for cyclical and non-recurrent or budget-neutral factors, and for the indexation effect. The latter is caused by the difference between the actual indexation (or the theoretical indexation for 2015 in view of the agreed index jump) of public sector wages and social security benefits and the rise in the GDP deflator.
(2) Calendar adjusted data.

TABLE 21 PRIMARY EXPENDITURE IN 2015

(year-on-year percentage changes by volume. unless otherwise stated)

	Year-on-year change	*p.m. Average change 2000-2014*	In % of GDP	*p.m. In % of GDP in 2000*
Wages	–0.3	*2.3*	12.5	*11.1*
Intermediate consumption	0.5	*2.7*	4.3	*3.7*
Pensions	1.3	*3.0*	10.2	*8.1*
Health care	1.5	*3.3*	6.9	*5.3*
Unemployment	–6.6	*1.3*	1.5	*1.7*
Sickness and disability benefits	4.7	*4.8*	1.8	*1.1*
Other social benefits	0.1	*2.4*	4.7	*4.1*
Business subsidies	–1.5	*6.7*	3.3	*1.7*
Current transfers	1.2	*2.2*	2.1	*1.8*
Gross investment	5.1	*1.3*	2.5	*2.4*
Other capital expenditure	–18.5	*3.5*	1.4	*1.3*
Total	–0.1	*2.9*	51.2	*42.4*

Sources: NAI. NBB.

controls were in place at federal government level, which had committed to cutting payrolls by 4 % in 2015, both for the public administration and social security bodies. Local authorities, Communities and Regions also attempted to restrain this expenditure.

Savings were made on purchases of goods and services across all government sub-sectors. On balance, intermediate consumption still grew in real terms, but at a clearly slower rate than the average since 2000. This is particularly true for the federal government and social security bodies, which had agreed to slash their operating budgets.

Subsidies were likewise revised downwards. This category includes reductions in payroll tax, targeted cuts in social security contributions and service vouchers, as well as federal government subsidies to Belgium's national rail company SNCB, which were scaled back in 2015.

Current transfers, including external transfers, were slightly up in real terms. This was the outcome of two factors pulling in opposite directions: cost-cutting measures related to the development aid budget partly offset Belgium's higher fourth-resource contribution to the EU's budget.

Public investment was significantly up in the year under review; gross fixed capital formation was the only expenditure rising faster than its average trend in the past 15 years. Major school construction projects, particularly in the Flemish Community, were a key driving force, as was the pick-up in investment by local government in keeping with its typical electoral cycle. The federal government, by contrast, cut down on its capital spending in the past year.

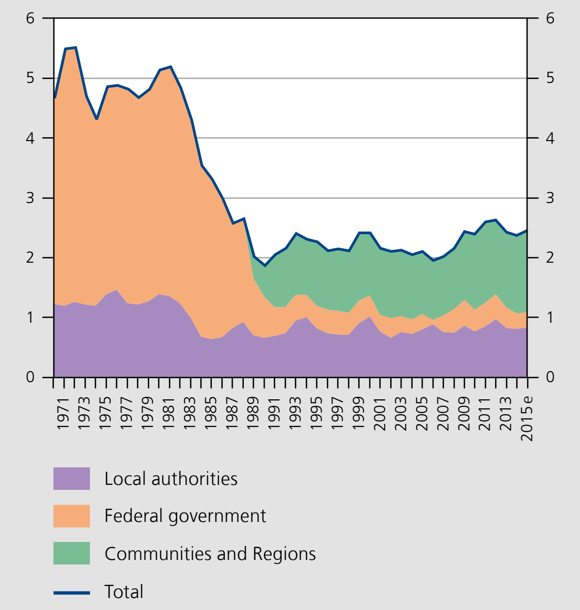
Box 8 – Public investment trends

Public investment can take many different forms, from buildings and other construction projects, to transport, to intangible assets including R&D, etc. In Belgium, this expenditure amounted to close to € 10 billion in 2015.

Belgium's Communities and Regions accounted for over half of public investment, which quite logically extended to their remits in education, road infrastructure, public transport, etc. Local authorities take up over one-third of public investment, although this typically varies in line with municipalities' six-year electoral cycle. This type of capital spending tends to focus on provincial and municipal roads and schools, as well as waste management. The federal government, which includes social security that calls for little or no capital spending, today only represents one-tenth of total public investment in Belgium, for instance on defence.

COMMUNITIES AND REGIONS ACCOUNT FOR THE BULK OF PUBLIC INVESTMENT

(public investment by sub-sector(1), in % of GDP)



Sources: NAI, NBB.

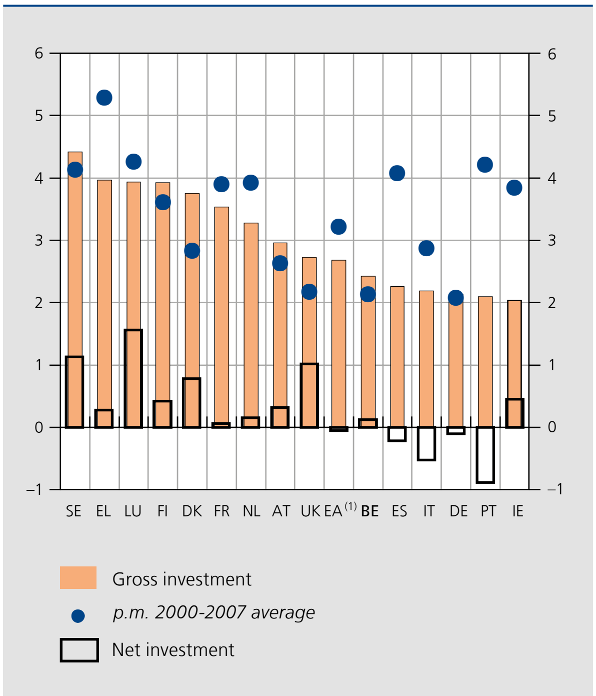
(1) The national accounts did not include the Communities and Regions as fully-fledged sub-sectors until 1989. For the period before 1995, for which the NAI does not provide statistics in keeping with the ESA 2010 methodology, a retropolation was carried out on the basis of the growth rates included in the national accounts according to ESA1995.

Between 1970 and 2015, public investment as a percentage of GDP halved and it now accounts for a mere 2.5 % of GDP, as against 5.5 % in its heyday in the early 1970s. Compared with total expenditure, public investment fell even harder and now only takes up one-third. Forty-five years ago, Belgium spent 13 % of its budget on investment, but it saw this percentage nosedive over the subsequent two decades to 5 % in 1990. The ratio has since fluctuated around 5 % of primary expenditure.

The biggest cuts were recorded in the fiscal consolidation drive of the 1980s – after all, capital spending is easy to scrap or postpone at times of austerity. However, by the end of the 1980s, investment stabilised and it currently varies between 2 % and 2.5 % of GDP – very different from other spending categories, most of which have risen sharply since 2000.

PUBLIC INVESTMENT DOWN IN EUROPE AND REMAINS LOW IN BELGIUM

(fixed capital formation, estimates for 2015, in % of GDP)



Source: EC.
(1) The average value given for the euro area is in fact the figure for 2007.

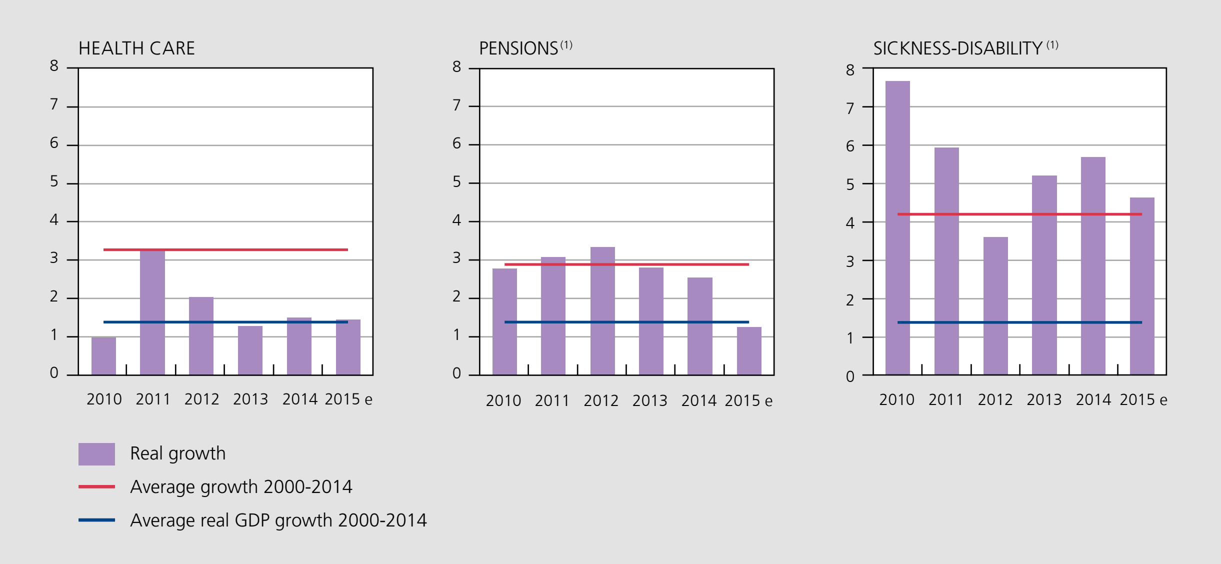
For many embattled countries, Europe's economic and financial crisis brought deep cuts in public investment, e.g. in Ireland, Portugal and the Mediterranean countries. Like Belgium, these countries – Greece excepted – are now among the group of countries with the lowest levels of public investment. Germany is one of them: just like in Belgium, public investment in Germany was low even before the crisis and has since hardly budged. The Scandinavian countries, by contrast, have investment ratios that are twice as high, at close to 4 % of GDP. In 2015, public investment as a percentage of GDP averaged 2.7 % in the euro area.

In terms of net fixed capital formation, Belgium is in the middle of the rankings at a ratio of nearly nil in 2015. Net fixed capital formation is defined as the difference between gross fixed capital formation and the use of investment, i.e. investment less depreciation of fixed assets due to normal wear and tear. Post-crisis, net fixed capital formation has also fallen sharply across Europe, by an average 0.8 percentage points of GDP between 2007 and 2015 in the euro area.

Like some other government expenditure – e.g. on education and R&D – capital spending clearly benefits a country's long-term growth potential. In a situation like the current one, with public investment low in Belgium and in other European countries, the government had best leave investment spending untouched or even step it up as much as feasible, as this facilitates higher capital stock and benefits an economy's production capacity. Enhancing a country's capital stock also has less obviously immediate benefits: public investment may encourage private spending and raise productivity. But how public investment influences potential growth depends on the type of investment, and government should single out spending considered sufficiently productive, such as on infrastructure – both maintenance and new construction –, investment in training and education, and 'green' investment. Lastly, the decision-making process should be as efficient as possible and allow for the government to achieve the best possible projects at the lowest possible cost.

CHART 81 RELATIVELY LIMITED INCREASE IN PUBLIC EXPENDITURE ON HEALTH CARE AND PENSIONS IN CONTRAST TO SICKNESS AND DISABILITY BENEFITS

(deflated by GDP deflator; percentage changes compared with the previous year, unless otherwise stated)



Sources: Budget documents, NAI, NBB.

(1) Expenditure adjusted for the indexation effect, caused by the difference between the actual indexation (or the theoretical indexation for 2015 in view of the agreed index jump) of public sector wages and social security benefits and the rise in the GDP deflator.

Other capital expenditure has fallen sharply as limits on tax credits for energy-efficiency investment, as approved by the previous federal government, took hold. From now on, these tax reductions are recognised in the national accounts as investment grants and no longer as lower revenue.

The budget for social benefits has grown once more, despite the index jump. Full-2015 expenditure was up by 2.3 % on volume factors and a benefits review allocating a 'welfare' budget that links benefits to general living standards. However, the actual growth percentage is still below the average of the past 15 years.

Health care spending added 1.5 % in real terms, similar to the previous year's increase but still a lot below past trends. The year 2015 saw the implementation of a range of health care measures such as an increase in patient fees for selected consultants, price cuts for subsidised medicines and the promotion of generic drugs, as well as shorter hospital stays after giving birth.

Pension expenditure increased by 1.3 % in real terms, taking down growth even further, to half of the average increase since 2000. Key drivers were the index jump and a slowdown in the growth of the number of pensioners. In 2015, the age threshold for early retirement was raised to 61.5 and the career length condition to 40 years from 39. However, it will be some time before the reforms approved by the current federal government have any visible effects.

Meanwhile, benefits paid under the sickness and disability scheme continued to rise to well above the long-term average in real terms. This is being driven by a steep upturn in the number of disability benefit claimants, as the baby boom generation grows older and with it the number of women in the older age brackets who are increasingly active in the labour market. Other factors include stricter eligibility conditions for other social benefits, such as unemployment benefits and more recently also early retirement.

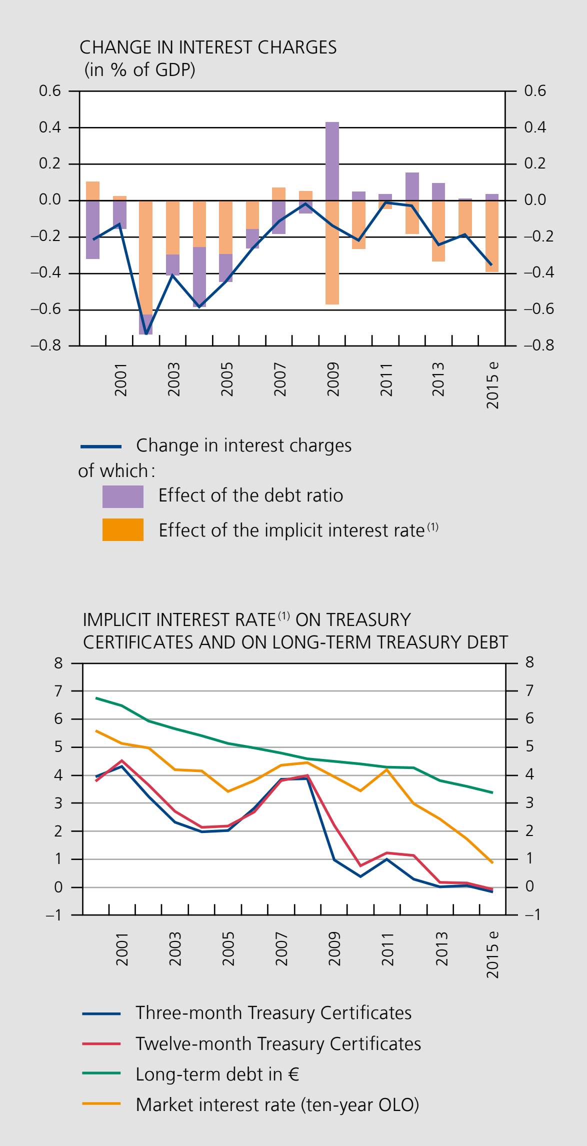
Lastly, cyclically adjusted unemployment benefits fell in real terms on the back of the labour market reforms agreed by the federal government as described in chapter 2.

Interest charges down significantly

In 2015, interest charges fell by 0.3 percentage point to 2.8 % of GDP, in line with the ongoing downward movement in the interest-charges-to-GDP ratio since the early 1990s. The contraction was due mainly to the steady reduction in the implicit interest rate on the public debt, down from 10.1 % of GDP in 1990 to 2.7 % in 2014.

CHART 82 LOWER INTEREST CHARGES ON FURTHER IMPLICIT INTEREST RATE FALLS

(in %, unless otherwise stated)



Sources: FPS Finance, NAI, NBB.
(1) Ratio between interest charges in the current year and debt at the end of the previous year.

Up to 2007, the fall in interest charges was also caused by the significant decline in the debt ratio, but the rise in the debt ratio has slowed this reduction since the end of 2008.

2015 was no different and the further decline in interest charges mirrored the exceedingly low interest rates on new securities and government loans, both short-dated and longer-dated bonds. Owing to negative interest rates throughout the year, the government generated some funds through the issuance of Treasury bills with maturities of less than one year. In April 2015, yields on ten-year reference bonds plumbed intra-year lows of around 0.3 % to rise again to 1.3 % in June and to 1 % by the end of the year. The spread on ten-year linear Belgian bonds relative to Bunds stabilised at around 30 basis points by the end of 2015.

4.3 Public debt still high, but pension reforms boost long-term sustainability of public finances

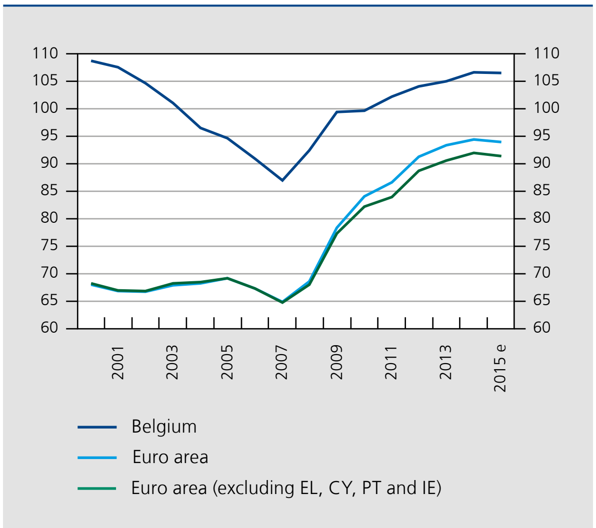
Debt ratio slightly down

Public debt, which had been steadily rising after the onset of the financial and economic crisis in 2008, came down only slightly in 2015, to 106.5 % of GDP. Belgium's debt ratio nevertheless remains high compared with the euro area (down to 94 % of GDP). The gap between the two again increased somewhat. Between 2010 and 2013, Belgian public debt did not rise as fast as that of the euro area, which shot up because of rapidly rising debts in a number of peripheral countries.

The slight fall in the debt ratio is exclusively attributable to exogenous factors, so named because they have an impact on the public debt but not on the overall balance. Endogenous factors as in interest-rate-to-growth dynamics, which capture the impact of implicit interest rates and

CHART 83 DEBT RATIO DOWN IN BELGIUM AND IN EURO AREA

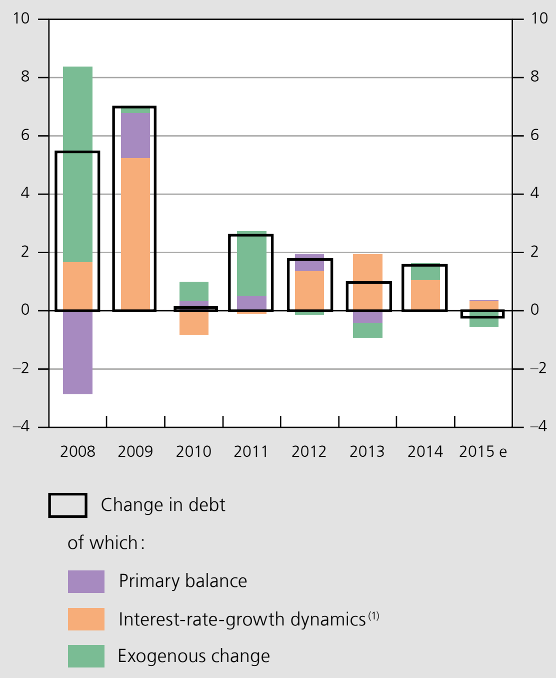
(consolidated gross government debt, in % of GDP)



Sources: EC, NAI, NBB.

CHART 84 DETERMINANTS OF THE CHANGE IN THE CONSOLIDATED GROSS DEBT OF GENERAL GOVERNMENT

(in percentage points of GDP)



Sources: NAI, NBB.

(1) The difference between the debt's implicit interest rate and nominal GDP growth, multiplied by the debt at the end of the previous year and GDP in the period under review.

nominal GDP growth on debt ratios, pushed it slightly upward. Indeed, debt ratios automatically increase when implicit interest rates exceed nominal growth, unless the primary balance is positive enough to cushion this. These dynamics have added 10.7 percentage points of GDP to debt growth since 2008, mainly triggered by the recession in 2009 and because of relatively low nominal growth in GDP in the past four years. In 2015, implicit interest rates on the public debt, although steadily moving down, still exceeded nominal GDP growth; to prevent an endogenous increase in the debt ratio in 2015, a small primary surplus was required. As it happened, the primary balance remained at 0 %.

In 2015, exogenous factors proved a downward influence on the debt ratio: KBC repaid the last remaining debt it had received from the Flemish Community in 2010 in the aftermath of the financial crisis, while Greece paid off part of the loans it had received since 2012 under the European Financial Stability Facility (EFSR). Sound debt management helped to reduce the debt ratio, more specifically because of the favourable effects of issue premiums – with nominal coupons exceeding market rates, their issue values were higher than their nominal values. Issue premiums have also been a feature of previous years as yields on government bonds have fallen. However, the downward effects on debt are only temporary and typically evaporate as and when higher coupons are paid. Once again, in 2015, interest payments on a cash basis for securities issued above face value in the past few years exceeded those on a transaction basis, which serve as the reference value for interest charges in the general government accounts. A similar upward effect derived from the costs of interest-rate swaps and other derivative contracts entered into in the autumn of 2014 in order to issue government bonds at then applicable rates in 2015. In a separate development, debt was swollen by state pension liabilities related to pension funds that were taken over from corporations in the past. With the implementation of ESA 2010, government acquisitions of pension funds – such as Belgacom's in 2003 – are recognised as purely financial transactions and have no impact on the overall balance. Funds thus taken over initially depress debt, but future pension liabilities will push it up year after year. Lastly, higher loans granted under social housing policy caused upward pressure on the debt ratio.

General government debt management benefits from lower interest rates

Federal government debt is by far the most important component of total general government debt in Belgium.

In 2015, the federal government's gross balance to be financed amounted to € 41 billion, i.e. € 2.8 billion more than in the previous year, as medium-term and long-term debt expiring in 2015 was significantly higher than in 2014. Conversely, fewer outstanding loans were bought back and the budget deficit shrank in cash terms.

Belgium's higher financing requirements were mostly met through the issuance of OLOs, while funding by means of non-standardised debt securities was also up, by € 1.2 billion. Unlike highly liquid standardised OLOs, these latter securities are tailored to the needs of investors: in 2015, for instance, the government issued securities – for the first time and on a limited scale – with a maturity of 100 years, as well as inflation-linked securities for which investors will receive an annual interest coupon on a nominal amount linked to an inflation index and the index-linked nominal amount at maturity. Unlike in 2014, in 2015, the government actually reduced the volume of Treasury bills, by € 1.1 billion.

TABLE 22 FINANCING REQUIREMENTS AND RESOURCES OF THE FEDERAL GOVERNMENT
(in € billion)

	2013	2014	2015
Gross balance to be financed . . .	40.4	38.2	41.0
Gross financing requirements	33.0	32.9	37.0
Budget deficit (+) or surplus (–)(1)	5.7	10.5	9.0
Medium- and long-term debt maturing during the year	27.3	22.4	28.0
In euro	27.3	22.4	28.0
In foreign currencies	0.0	0.0	0.0
Buybacks (securities maturing the next year or beyond)	7.4	5.3	4.0
Funding resources	46.7	35.7	40.7
Linear bonds (OLOs)	42.3	31.8	35.6
State notes and others	4.4	3.8	5.1
Net change in the short-term debt in foreign currencies	0.6	0.0	0.0
Change in the outstanding amount of Treasury Certificates	–7.1	1.8	–1.1
Net change in other short-term debts in € and in financial assets	0.1	1.4	1.4

Source : FPS Finance.
(1) The overall balance is calculated on a cash basis and takes account of financial transactions which are not included in the overall balance of general government which, in accordance with ESA 2010, is calculated on a transaction basis.

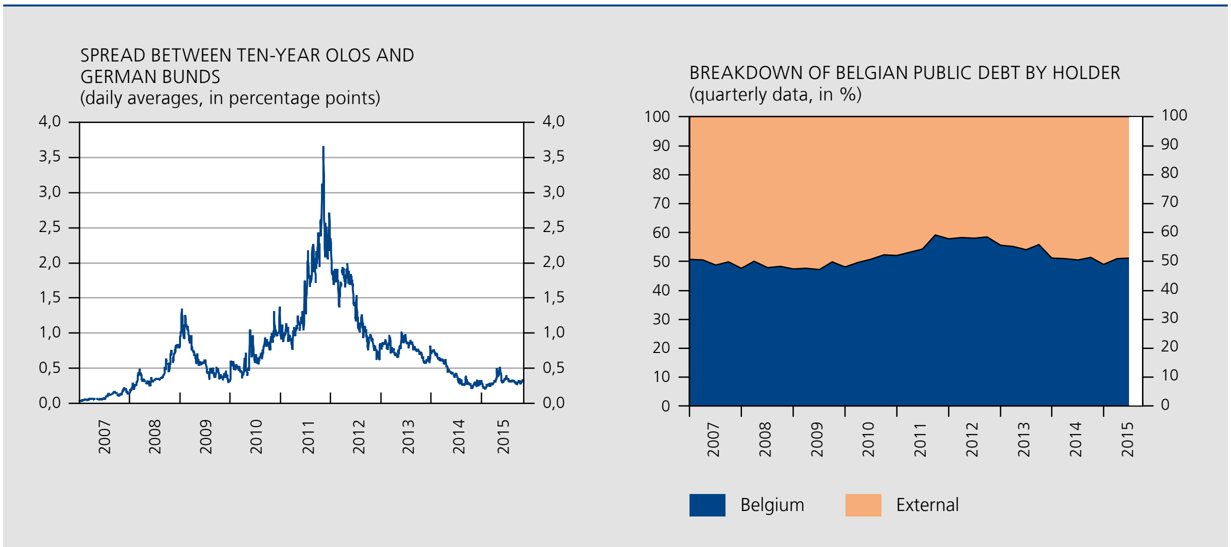
This selection of funding resources resulted in a minor upturn in the average maturity of the debt portfolio, to eight years – still quite a hefty change on 2010, when it was still at six years. A longer average maturity typically reduces refinancing risks.

Debt ownership also remained virtually stable on 2014, with domestic and foreign investors holding around half of general government debt. By the end of 2011, the proportion of foreign investors in the total had shrunk to 41 % in the wake of reduced confidence in Belgian government paper, but in 2014 this returned to more or less normal pre-sovereign debt crisis levels. This renewed confidence in Belgium is also clear from the low spread between ten-year OLOs and German Bunds, which fluctuated around 30 basis points throughout the year, its lowest average since 2007.

Guarantees granted to financial institutions decline further

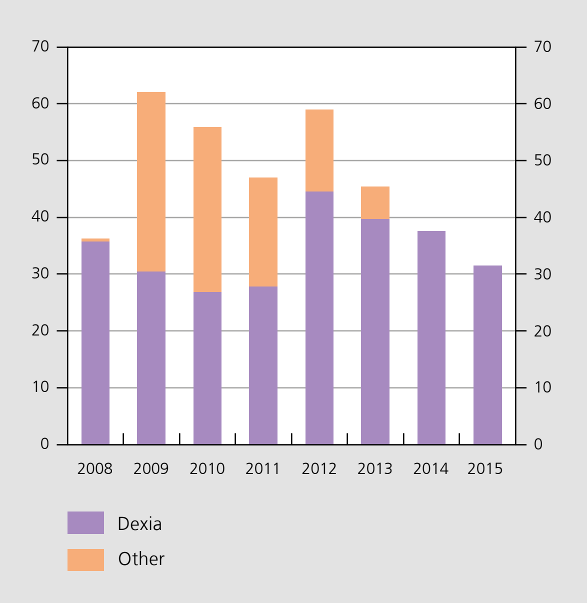
Against the backdrop of the financial crisis, the Belgian government, principally the federal State, granted guarantees to financial institutions, which do not affect the budget balance or the debt unless they are called on. Since the end of 2014, the only remaining guarantee relates to the Dexia interbank funding that had been agreed in December 2011. This was replaced by a final agreement in January 2013, with the ceiling for the Belgian State put at € 43.7 billion. The guarantee declined from € 37.6 billion in 2014 to € 31.5 billion in 2015.

CHART 85 DEBT SPREADS AND OWNERSHIP RETURN TO NORMAL AFTER FINANCIAL AND ECONOMIC CRISIS



Sources : Thomson Reuters Datastream, NAI, NBB.

CHART 86 FURTHER REDUCTION IN GUARANTEES GRANTED TO FINANCIAL INSTITUTIONS
(guarantees granted to financial institutions, in € billion)



Sources: FPS Finance, NAI, NBB.

Fresh steps in pension reforms

Keeping public finances sustainable in the longer term is an essential prerequisite for fiscal policy, with the spend on pensions, health care and care for the elderly key determinants that need to be kept in check. On taking office in October 2014, the federal government tabled a number of proposals for further reform of the pension systems, based on the underlying principle of keeping people in work longer. This would boost employment, support economic activity and slow down the increasing budgetary cost of an ageing population.

The new government's most notable proposals were to raise the statutory retirement age, to further tighten up early retirement conditions and to abolish the pension bonus – a financial stimulus to keep people approaching the end of their careers in work longer. The government also announced its intention to harmonise the various pension systems governing civil servants and private sector employees. In addition to these reforms, the government announced the creation of an advisory National Pension Committee to help pave the way for fundamental reform and to oversee the financial and social sustainability of Belgium's pension systems. The committee is supported by the pensions Knowledge Centre and an Academic Council. These bodies were created in the spring of 2015.

Today, a number of these pension reform measures have already been put into place: the statutory retirement age will be raised from 65 to 66 in 2025 and to 67 in 2030, when any and all career length requirements will cease. In addition, early retirement conditions were tightened up further. At the end of 2011, the previous federal government had agreed to raise the required minimum age from 60 to 62 years and to raise the minimum career length from 35 to 40 years. Going one step further, the incumbent federal government raised this minimum age to 62.5 in 2017 and to 63 in 2018, with the compulsory career length increasing to 41 years in 2017 and to 42 years from 2019 – with some exceptions still applying to people who have had very long careers. Meanwhile, the government will limit the number of people eligible for survivor pensions by gradually raising the minimum age from 45 to 50 in 2025, and to 55 in 2030. Lastly, the system of pension bonuses was abolished with effect from 1 January 2015, and no bonus entitlements will accrue after that date unless they were built up before the announcement that the system would be axed. All reforms pertain to the three most important pension systems: of the civil service, private sector employees and the self-employed.

Meanwhile, a number of adjustments were also agreed specifically for public sector pensions. One key change is the abolition of the so-called 'diploma bonus', with academic study years counting towards calculations of career length gradually phased out between 2016 and 2030. People will now also be allowed to combine, without limitation, a public sector retirement pension with income from the exercise of a professional activity, from 65 years of age or after a career of 45 years.

Taking a leaf from the previous coalition's book, the government also tightened up the conditions governing unemployment benefit with employer top-up, i.e. pre-pension arrangements. Two key changes were introduced: it raised the minimum eligibility age and it stipulated that this group of unemployed people should be registered as job-seekers and be available for work. Some exceptions apply for people in heavy and arduous jobs, people who have had unusually long careers and people with serious medical conditions. In future, it will also be impossible for people to collect their supplementary occupational pensions before they effectively retire, and any new schemes will not be allowed to end before members turn 65.

In the years ahead, further reforms may be expected in the various pension systems, as the National Pension Committee was set up precisely to prepare such reforms. It has been tasked with defining objective criteria for heavy and arduous work, investigating the possibility of part-time pensions, reviewing the harmonisation of the diploma bonus system in pension calculations in the three main pension systems and studying the implementation of a points-based pension scheme. The federal government hopes to have secured agreement on such a scheme by the end of its term in office and is looking to its implementation by 2030. Other reforms announced include harmonisation of some aspects of the public sector scheme with that in the private sector, an overhaul of pension institutions and enhancement of the link between labour input and pension amounts. Measures were also tabled that should strengthen the second pension pillar.

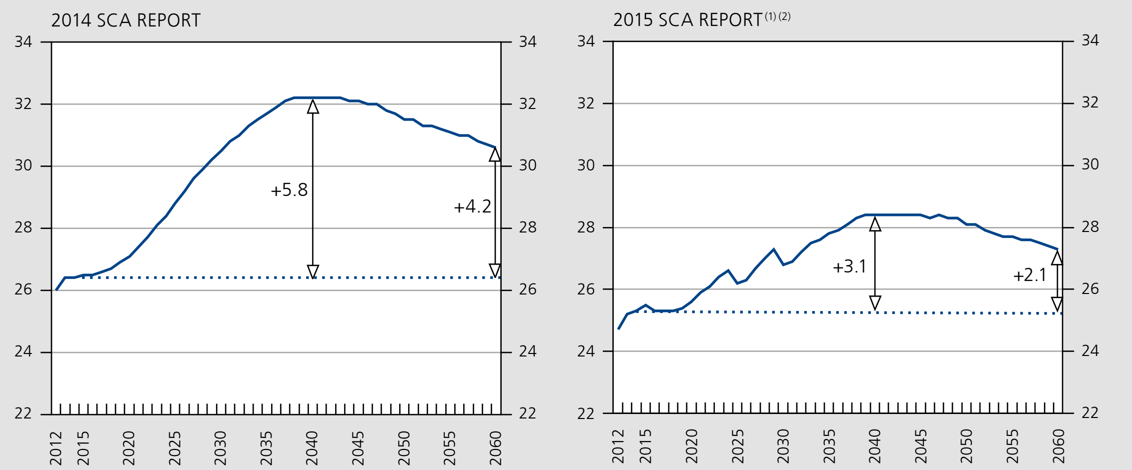
Pension reforms reduce the budgetary cost of an ageing population

The Study Committee on Ageing (SCA) analyses the social and budgetary consequences of an ageing population in the longer term and calculates the budgetary cost of ageing as the change in percentages of GDP in social benefits as a whole.

In its 2015 report, the Study Committee presents a baseline scenario capturing the main measures taken by the federal government in the past year in terms of social expenditure, and particularly pensions, unemployment benefit with employer top-up, unemployment, health care and disability. The scenario also allows for a possible shift in retirement behaviour patterns whereby the increase in the statutory pension age prompts people to postpone retirement by an average of two years. Social expenditure under the baseline scenario will climb from 25.3 % of GDP in 2014 to 27.3 % of GDP in 2060, having peaked at 28.4 % of GDP in 2040. Between 2014 and 2060, the budgetary cost of ageing thus works out at 2.1 percentage points of GDP, down by half of the figure in the SCA's 2014 report.

Invariably, such long-term projections are fraught with considerable uncertainty, as they rely completely on their underpinning assumptions – and the scenario outcomes are particularly influenced by the assumptions pertaining to productivity growth and the labour market, which underpin calculations of potential economic growth. The scenario sees productivity growth increasing gradually by an average 0.8 % per annum in the 2014-20 period, to 1.5 % a year from 2035. If actual productivity undershoots this assumption by 0.25 percentage points from 2035, the budgetary cost of ageing would be 1.2 percentage point of GDP higher by 2060. In the baseline scenario, the administrative unemployment ratio will drop steeply, from 12.3 % of the labour force in 2014 to 8 % by 2036. To make these projections come true, the country needs active policies to support productivity growth and boost labour market participation.

CHART 87 **PENSION REFORMS SLOW DOWN RISE IN SOCIAL BENEFITS**
(social benefits, in % of GDP)



Source : Study Committee on Ageing (SCA).
(1) In terms of pension reforms, the Study Committee factored in the increase in the legal retirement age, stricter eligibility conditions for early retirement, tightening of unemployment benefit with employer top-up, increase in the minimum age for survivor pensions, the abolition of the pension bonus in the three pension systems and the abolition of the diploma bonus for the career condition in the civil service scheme.
(2) Social expenditure, in percentages of GDP, was subject to a downward effect due to the upward revision of GDP after the transition to ESA 2010 in the national accounts.

TABLE 23 LONG-TERM IMPACT OF PENSION REFORMS IN THE LABOUR MARKET

(impact by 2060; changes in thousands, unless otherwise stated; difference between baseline scenario and no reforms scenario)

Number of retired	–315
Number of non-job-seeking unemployed with employer top-up	–80
Total	**–395**
Labour force	318
Employment	292
Job-seeking unemployed	25
Inactive	77
Employment (change, in %)	*5.6*

Source: Study Committee on Ageing (SCA).

To study the specific impacts of the main pension reform measures on the labour market, economic activity, the cost of an ageing population and the social sustainability of pensions, the SCA took its 2015 report's baseline scenario and compared it with a scenario that does not include these measures. Its findings show that the reforms combine to reduce by 395 000 the number of people eligible for retirement pensions and the number of non-job-seeking unemployed with employer top-up in the rather longer term (by 2060). This is offset by a comparable rise in the non-retired population, made up of the labour force and the economically inactive. The reforms should take the total employment ratio 3.9 percentage points higher, with the ratio of the 55-66 age bracket even climbing by 16.4 percentage points. An increase in the labour force would translate into a 5.6 % expansion in employment, while GDP is expected to rise by the same percentage on the assumption of unchanged productivity growth.

The reforms, then, would push down the cost of an ageing population by 2.1 percentage points of GDP, of which 1.5 percentage points is attributable to lower pension expenditure and 0.6 percentage point to other social expenditure. Lower spending on pensions reflects three factors: a fall in the number of retired people and non-job-seeking unemployed enjoying an employer top-up, the abolition of the pension bonus and the upward revision of economic growth.

Lengthier careers will also add up to higher average pension amounts than in a scenario of no reforms. This, coupled with higher labour market participation by women should help to reduce the risk of poverty for the retired, while also narrowing inequality within this group. Pension reform measures already in place should therefore help cut the budgetary cost of ageing while at the same time enhancing the social sustainability of pensions.

Absorbing structural budget deficit is essential to guarantee sustainable public finances

While structural measures have helped the government to significantly cut the expected future costs of an ageing population, these remain quite significant and the sustainability of Belgian public finances therefore remains a concern, especially against a backdrop of high and rising general government debt – way over the Maastricht Treaty criterion of 60 % of GDP – and a budget deficit that came within an inch of the target of 3 % of GDP in 2015.

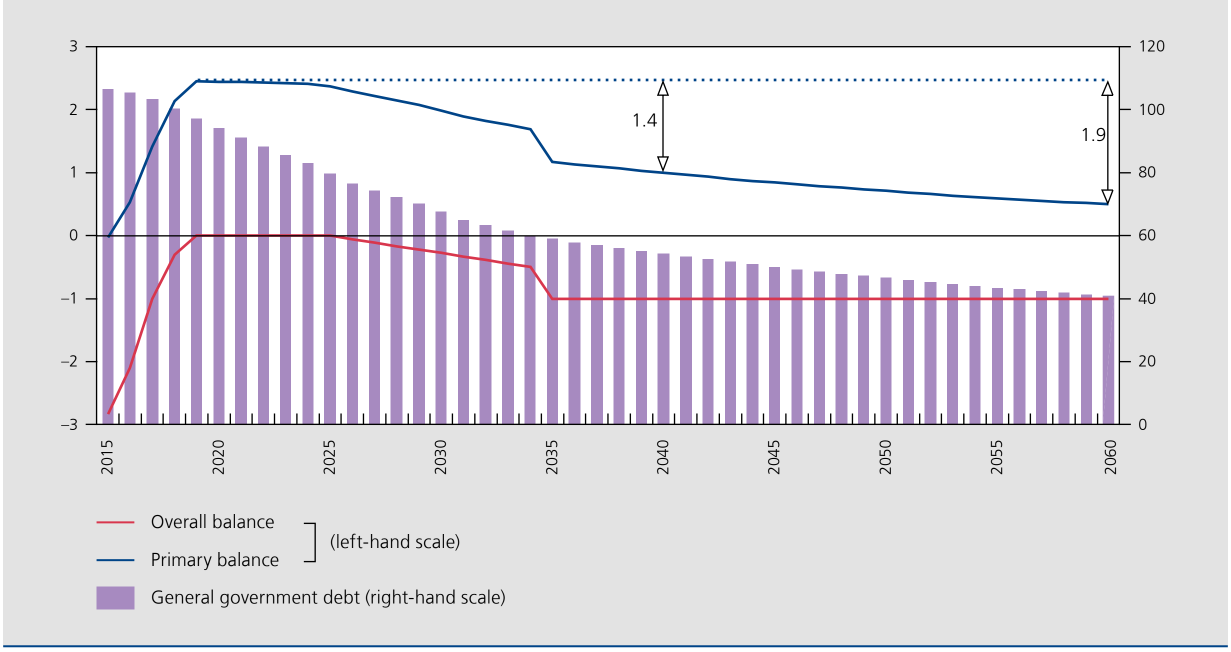
By complying with the European fiscal framework and by meeting the targets as set out in its stability programme, Belgium should be able to ensure the sustainability of its public finances. If Belgium does actually meet both these conditions, it will create a budgetary margin to help cushion the cost of an ageing population, because more rapid deleveraging should push down interest charges and as the budget balance may then be used for this purpose.

This is corroborated by a simulation exercise plotting the development of public finances in the longer term. The exercise assumes that Belgium will achieve a structurally balanced budget by 2018, in line with the stability programme target, while this balanced budget is assumed to stay in place until 2025. The government's overall balance would then incline towards a deficit of 0.5 % of GDP after 2025. The deficit is then assumed to revert back to 1 % of GDP once government debt has dipped below 60 % of GDP. This scenario is fully compliant with the European fiscal framework, which specifies that the budget deficit may rise to a maximum of 0.5 % of GDP in the medium term and to 1 % of GDP in countries with debt ratios below 60 % of GDP and with low risks to the sustainability of public finances in the long term. The exercise next factors in the growth assumptions underpinning the baseline scenario of the Study Committee on Ageing, which sees labour productivity increase by an average 1.3 % per annum in the 2016-60 period, while employment should add 0.4 %, taking economic activity growth to an average of 1.7 % per annum.

The simulation exercise throws up a primary balance at 2.4 % of GDP in 2019, gradually declining to 1 % in 2040 and to 0.5 % by 2060. The permitted deterioration of the primary surplus by 1.4 % of GDP between 2019 and 2040 is less than half of the expected impact on

CHART 88 EUROPEAN FISCAL FRAMEWORK TARGETS SHOULD BE MET TO ENSURE SUSTAINABILITY OF PUBLIC FINANCES

(public finances based on fiscal targets (1), in % of GDP)



Sources : EC, FPB, NAI, SCA, NBB.

(1) Simulation based on the macroeconomic assumptions underpinning the SCA baseline scenario as well as on the assumption that implicit interest rates on general government debt will rise to 3.75 % in 2035 and then stabilise at that level. Inflation is assumed to be at 1.9 % from 2018.

the balance of the cost of ageing in that period. By 2060, the decline in the primary surplus should produce a margin nearly equal to the expected ageing costs. Belgium's debt is expected to dip below 60 % of GDP around 2035.

To be able to fund future social benefits and other expenditure without having to raise taxes in a major way, Belgium would be well advised to achieve its stability programme targets and comply with the rules of the European fiscal framework, while also keeping government expenditure on pensions and health care strictly under control. Lastly, policies should be put in place that focus on increasing potential growth by promoting productivity and encouraging employment, all the more so because the estimates of the budgetary cost of ageing are hedged with uncertainties, particularly when it comes to assumptions about economic growth.