5. Public finances

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5.1 The challenges facing Belgian public finances remain considerable

The nominal budget deficit widened again in 2019

The Belgian government ended the year 2019 with a nominal budget deficit of 1.7 % of GDP, up by 1 percentage point of GDP against 2018. The structural balance, which plays a crucial role in fiscal policy, deteriorated by 0.5 percentage point of GDP. The public debt continued to fall, dropping to 99.1 % of GDP, but is still high compared to that of most other euro area countries.

The nominal balance deteriorated in 2019, mainly owing to the sharp decline in revenue. In 2017 and 2018, corporation tax revenues had temporarily increased as a result of the steep rise in advance payments, but that reduced the corporation tax collected via the assessments in 2019. The measures relating to the tax shift also led to a further reduction in levies on labour. Social benefits increased – notably as a result of population ageing – so that primary expenditure also edged upwards. The low interest rate environment led to a further reduction in interest charges, but that only partly offset the negative impact of the aforesaid factors on the overall balance.

The position of Belgian public finances deteriorated in 2019

All this has taken place against the political backdrop of a federal government which, after resigning at the end of 2018, acted as a caretaker administration throughout the year. Parliament did not approve the federal budget for 2019, and expenditure was managed partly by granting credits for periods of two to four months, known as provisional twelfths. In principle, this expenditure may not exceed the amounts of the last approved expenditure budget relating to the period covered by the credit.

Table 12

General government overall balance and debt

(in % of GDP)

	2015	2016	2017	2018	2019 e
Revenue	51.3	50.7	51.2	51.4	50.3
Primary expenditure	50.8	50.4	49.6	50.0	50.1
Primary balance	0.5	0.3	1.6	1.4	0.2
Interest charges	2.9	2.7	2.3	2.1	1.9
Nominal overall balance	–2.4	–2.4	–0.7	–0.7	–1.7
p.m. Structural overall balance	*–2.6*	*–2.4*	*–1.7*	*–1.8*	*–2.4*
Public debt	105.2	104.9	101.8	100.0	99.1

Sources: NAI, NBB.

There was therefore no fundamental adjustment to public finances, and the increase in social benefits, which outpaces GDP growth (with no change of policy), remained unchecked. Owing to population ageing, that expenditure is set to rise by an annual average of 0.2 percentage point of GDP over the next two decades.

The general government budget deficit essentially reflects the deficit of the federal government, including social security. The Communities and Regions subsector posted a small deficit, while the local authorities' accounts were in balance.

The budget balance of the Communities and Regions improved in 2019 with the disappearance of the one-off correction, made in 2018, for the excess paid to the Regions since 2015 in respect of regional additional percentages on personal income tax. The Walloon Region and the Brussels-Capital Region recorded a deficit, as did the French Community. The accounts of the Flemish Community, like those of the other smaller entities, were more or less in balance.

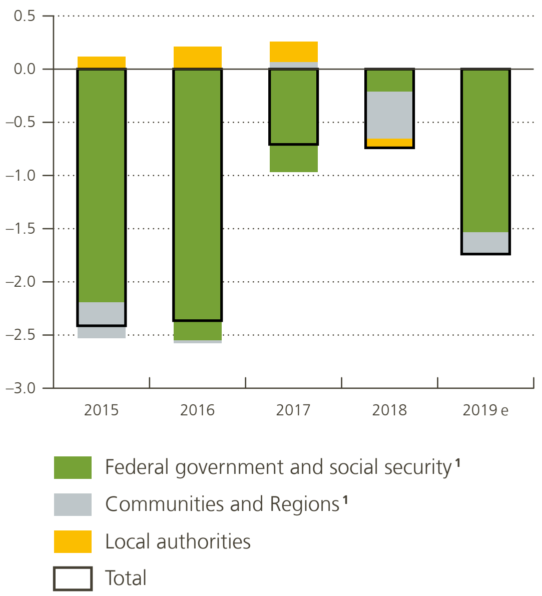
The structural budget deficit has widened, moving still further away from balance

In 2019, the nominal budget balance was adversely affected, primarily by the disappearance of one-off factors which had had a positive impact on it in the previous two years, and to a lesser degree by the economic situation. The structural budget balance, obtained by excluding the budgetary impact of these cyclical and temporary factors, deteriorated by 0.5 percentage point of GDP in 2019, resulting in a deficit of 2.4 % of GDP. The structural primary balance, which gives a better indication of discretionary fiscal policy

Chart 64

Overall balance of the government subsectors

(nominal overall balance, in % of GDP)



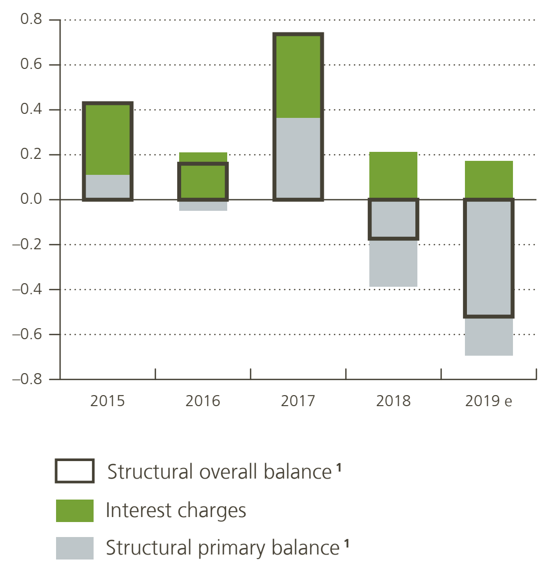
Sources: NAI, NBB.

1 With effect from 2015, these figures include advance payments on the additional regional percentages on personal income tax although, according to the ESA 2010 methodology, these advance payments are regarded as purely financial transactions and are only taken into account at the time of collection. This approach is in line with the guidelines for developing fiscal targets in the recommendations of the Public Sector Borrowing Requirement section of the High Council of Finance and in the Stability Programmes.

Chart 65

Fiscal policy was expansionary for the second consecutive year

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



Sources: EC, NAI, NBB.

1 The cyclical component of the structural primary balance and the structural overall balance is calculated according to the EC methodology.

since it is not influenced by changes in interest charges, deteriorated by 0.7 percentage point of GDP.

Fiscal policy was therefore expansionary for the second consecutive year. Yet a more restrictive policy would have been desirable to bolster the sustainability of public finances.

Without a change of policy, there is no prospect of any improvement in the structural budget balance in the medium term. Fiscal measures will therefore be necessary to reduce the deficit and make progress towards the objective of a balanced budget.

The necessary consolidation of Belgian public finances has made no further progress in the past two years

The financial crisis and the ensuing economic recession had serious repercussions on Belgian public finances. The nominal overall position changed from a balanced budget in 2007 to a deficit of 5.4 % of GDP in 2009, while the structural overall deficit deteriorated to 3.8 % of GDP in 2010.

In the years which followed, the nominal overall balance improved systematically, with the deficit dropping to 0.7 % of GDP in 2017. The structural budget deficit was reduced mainly in 2013, 2015 and 2017, when it came to 1.7 % of GDP. After that, however, the consolidation came to a halt and the deficits actually widened again.

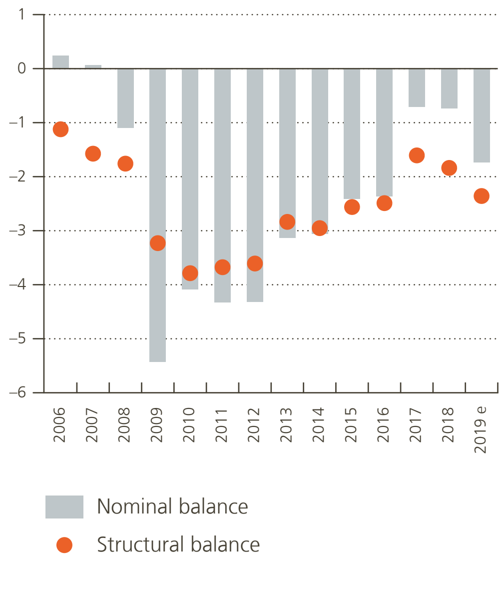
The nominal overall balance was therefore more negative in 2019 than before the outbreak of the economic and financial crisis, even though Belgian public finances benefited from the almost continuous decline in interest charges and rising revenue. Yet primary expenditure increased considerably during the crisis. Although expenditure did come down after reaching a peak in 2012, that decline was halted in 2017. Since then, it has risen slowly, so it still remains considerably higher than before the economic and financial crisis.

Chart 66

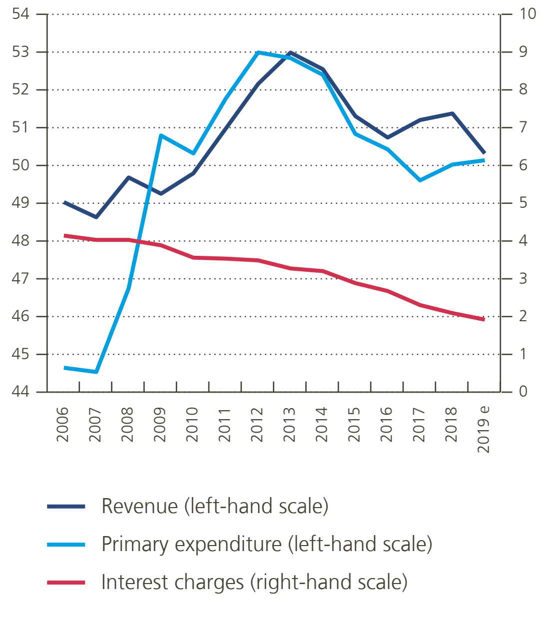
The necessary consolidation of public finances following the economic and financial crisis has come to a halt

(in % of GDP)

Budget balances



Revenue, primary expenditure and interest charges



Sources: EC, NAI, NBB.

In 2019, the structural budget deficit likewise exceeded its pre-crisis level.

Why is it important for Belgium to continue aiming for a structurally balanced budget ?

It is important for Belgium to achieve a structurally balanced budget in the medium term. First, the level of the public debt – which is still considerable – needs to be reduced, because it makes Belgium vulnerable to a rise in interest rates, whether in the form of a widespread increase in interest rates in the euro area or higher risk premiums on Belgian government securities. A structurally balanced budget and the resulting steady decline in the debt ratio could avoid any upward pressure on the spreads on Belgian government bonds compared to the government borrowings of euro area countries considered to be risk-free. More generally, sound public finances are essential to the confidence of economic agents since they promote sustainable growth, conducive to employment. In addition, if a structurally balanced budget is achieved when economic conditions are favourable, that makes it possible to create margins which may be useful in an economic downturn (see box 8).

A structurally balanced budget would lead to a steady decline in the debt ratio, which is still high

A structurally balanced budget also creates scope for funding policies to address future challenges – population ageing undeniably being one of the main ones. Although the pension reform, which aims to raise the actual age of retirement, makes a crucial contribution to the sustainability of Belgian public finances and to the financing of social protection, population ageing will in fact lead to a further rise in social expenditure in the coming decades.

The government has three levers for achieving a structurally balanced budget, namely increasing revenue, restricting primary expenditure, and pursuing a growth-friendly policy centred on raising the employment rate and boosting productivity. In the coming years, it will therefore be necessary to keep control over primary expenditure, despite the strong upward pressure that ageing will exert on the spending of the various branches of government. At the same time, a shift in expenditure will be needed to give priority to expenditure categories likely to strengthen economic growth in the long term, such as investment in infrastructures. Managing the environmental problems and achieving the energy transition will also entail public expenditure in the decades ahead, particularly spending on investment. The government will likewise need to make efficiency gains in providing services for society. There is hardly any further scope available on the revenue side, owing to the already high tax burden. The composition of revenue, like that of expenditure, will need to be as growth-friendly as possible.

A structurally balanced budget is also the central aim of the European budgetary rules

Achieving a structurally balanced budget is Belgium's medium-term objective (MTO) under the preventive arm of the Stability and Growth Pact, which is intended to prevent the emergence of unsustainable budgetary situations. In recent years, Belgium's stability programmes have systematically referred to this objective of a balanced budget. It is currently the minimum "MTO" target for Belgium, as set by the EC at the beginning of 2019 on the basis of the debt ratio, the budgetary cost of population ageing and the expected nominal economic growth.

Belgium's stability programme for 2019-2022, presented to the EC in April 2019, only mapped out a purely indicative path for both the overall budget target and its apportionment across the various levels of power, in view of the federal and regional elections scheduled in May. On the basis of the indicative path, each government entity was to achieve a structural balance in 2021; that represented a further delay of one year in attaining that objective. The governments formed after the elections should decide on the path in accordance with the procedure laid down in the cooperation agreement of 13 December 2013, which is the formal framework for budgetary coordination in Belgium. In any event, effective coordination by the conclusion of cooperation agreements on binding budget targets is crucial.

For 2019, the stability programme aimed at an improvement in the structural budget deficit of 0.15 percentage point of GDP. In that regard, the federal government anticipated the EC's final approval of the flexibility requested in the draft budget for 2019, owing to the implementation of a number of structural reforms, such as the tax shift and the pension reform. That approval authorised a temporary deviation of half a percentage point of GDP from the adjustment path for attaining the MTO. The improvement in the structural budget balance required for 2019 was therefore reduced from 0.6 to 0.1 percentage point of GDP.

The draft budget for 2020 presented to the EC in October 2019 was also purely indicative, with a path involving no change of policy for the federal government and social security, as the federal government was still a caretaker administration at that time. On the basis of this draft budget and its own autumn forecasts, the EC concluded that there is a risk of non-compliance with the Stability and Growth Pact. More specifically, Belgium risks deviating significantly in 2019 and 2020 from the adjustment path towards the MTO required by the Ecofin Council. For 2019, the assessment took account of the aforesaid concession based on the flexibility clause regarding structural reforms. According to the EC's autumn forecasts, Belgium will also fail to meet the debt criterion in 2019 and 2020. The EC therefore invited Belgium to submit an adjusted draft budget as soon as a new federal government takes office, and as a rule at least one month before the draft budget law is planned to be adopted by Parliament, as laid down in the EU budgetary procedures. The EC is also inviting the government to incorporate in this modified version the measures necessary to make the budget conform to the European budgetary rules.

The current European budgetary framework is aimed primarily at the long-term sustainability of public finances in each Member State. Taken overall, the recommendations addressed to the Member States therefore do not necessarily correspond to the optimum fiscal policy for the euro area as a whole, aimed at stabilising the business cycle as well as achieving sustainability. In October 2019, in connection with the further deepening of Economic and Monetary Union, the Eurogroup concluded an agreement on the budgetary instrument for convergence and competitiveness, which focuses on the funding of structural reforms and public investment in order to strengthen the potential growth of the euro area economies and enhancing the euro's resilience to economic shocks. The arrangements for applying this instrument are

Table 13

Targets for the general government overall balance

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

	2015	2016	2017	2018	2019	2020	2021	2022
Nominal balance								
April 2015	**−2.5**	−2.0	−1.0	−0.2				
April 2016		**−2.5**	−1.4	−0.4	−0.2			
April 2017			**−1.6**	−0.7	−0.2	−0.1		
April 2018				**−1.0**	−0.7	0.0	0.1	
April 2019					**−0.8**	−0.2	0.1	0.0
October 2019 (draft budget)					**−1.7**	−2.3		
p.m. Actual/Estimate	*−2.4*	*−2.4*	*−0.7*	*−0.7*	*−1.7 e*			
Structural balance [1]								
April 2015	**−2.0**	−1.3	−0.6	0.0				
April 2016		**−1.7**	−0.8	0.0	0.0			
April 2017			**−1.0**	−0.4	0.0	0.0		
April 2018				**−0.8**	−0.6	0.0	0.0	
April 2019					**−0.8**	−0.2	0.0	0.0
October 2019 (draft budget)					**−1.9**	−2.1		
p.m. Actual/Estimate	*−2.6*	*−2.4*	*−1.7*	*−1.8*	*−2.4 e*			

Sources: EC, FPS Finance, FPS Policy and Support, NAI, NBB.
1 For the Actual/Estimate figures, the cyclical component of the structural balance was calculated according to the EC methodology, whereas FPB estimates were used for the stability programmes and other budget documents.

yet to be devised in the course of the negotiations concerning the EU multiannual financial framework for 2021-2027, but the amounts to be allocated to it will be small. This instrument is not able to stabilise the business cycle in the euro area, whereas that function does exist in other monetary unions.

In the spring of 2020, the EC will publish its assessment of the European fiscal framework and after that may put forward amendment proposals if need be.

In any case, adjustments are warranted if they lead to simplification, as transparency is essential to ensure that the regulatory framework functions efficiently. It is also important for the fiscal framework to support a policy conducive to growth, not least when it comes to investment. In any case, good European budgetary rules are very useful to countries in the Monetary Union and should therefore be correctly applied. That is primarily the responsibility of the Member States, but the EC must also ensure that the rules are respected.

BOX 8

What is the best fiscal policy to adopt in the event of a cyclical downturn ?

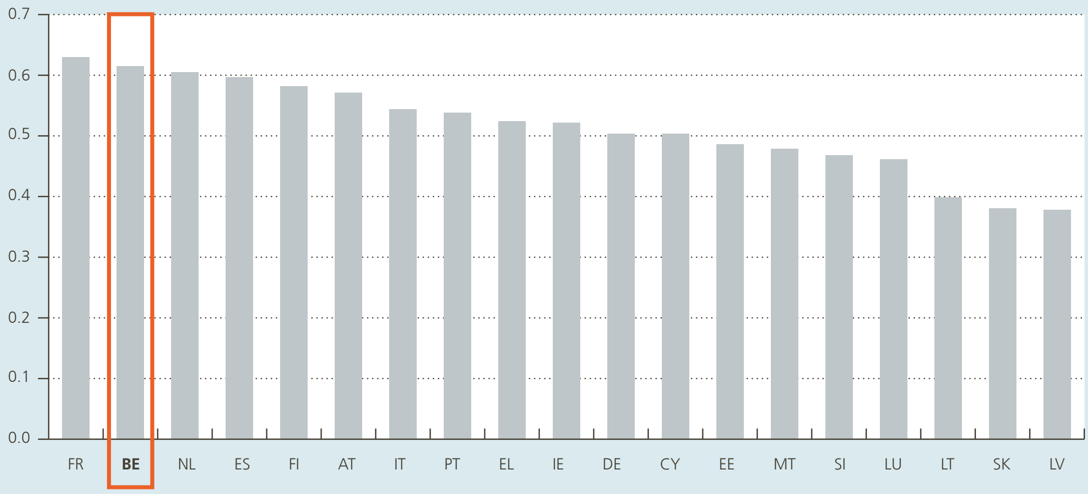
From a macroeconomic angle, one of the aims of fiscal policy is to foster the stabilisation of the business cycle, but on condition that public finances remain sustainable in the long term.

The "automatic stabilisers" are the primary means of smoothing out cyclical fluctuations via public finances. A cyclical downturn leads to lower revenues and higher unemployment benefits, and hence a deterioration in the budget balance. Conversely, favourable macroeconomic conditions result in an improvement in the balance. These variations in the budget balance moderate the cyclical fluctuations to some extent without the government needing to intervene : hence the term "automatic" stabilisers.

The impact of cyclical fluctuations on the general government budget balance – and consequently also the scale of the automatic stabilisers – increases the higher the ratio of public revenue and expenditure and the greater their cyclical sensitivity. Budgetary semi-elasticity is a common way of measuring this

In Belgium, cyclical fluctuations have a big impact on the general government budget balance

(budgetary semi-elasticity[1] for 2018)



Source : EC.
1 Change in the budget balance resulting from a change in the output gap.

impact; it is used by the EC, for instance, to calculate the structural budget balance. Belgium has a budgetary semi-elasticity of around 0.6, which is a relatively high figure, owing to the government sector's major role in the economy.

If, in a cyclical downturn, the output gap – in other words, the extent to which actual GDP deviates from potential output – declines by 1 percentage point, the general government budget balance will consequently deteriorate by around 0.6 percentage point of GDP. This fiscal stimulus – which supports the incomes of individuals and firms – will boost GDP, though the effect will be smaller because the increase in income does not only promote consumption and investment, it also leads to higher savings and a rise in imports. The immediate impact of a fiscal stimulus equal to 0.6 % of GDP comes to 0.2 % of GDP, and that effect increases after a few quarters to 0.3 % of GDP. This means that the automatic stabilisers offset about a third of the initial cyclical fluctuation.

However, there is a risk that the automatic stabilisers may not operate to the full. In the absence of an adequate safety margin in the budget, a marked growth slowdown may increase the public deficit so that it exceeds the Maastricht Treaty limit of 3 % of GDP, thus necessitating consolidation measures. That could happen in Belgium since, according to the Bank's December 2019 projections, if there is no change in policy the nominal deficit will rise to 2.8 % of GDP in 2022. Furthermore, these stabilisers will not achieve their optimum effect in stabilising business activity unless they are accompanied by sustainable public finances. Otherwise, the confidence of the economic agents could be undermined, prompting them to cut their investment or consumption, and there is a danger that an increase in the risk premiums incorporated in interest rates could counteract the benefits of the automatic stabilisers.

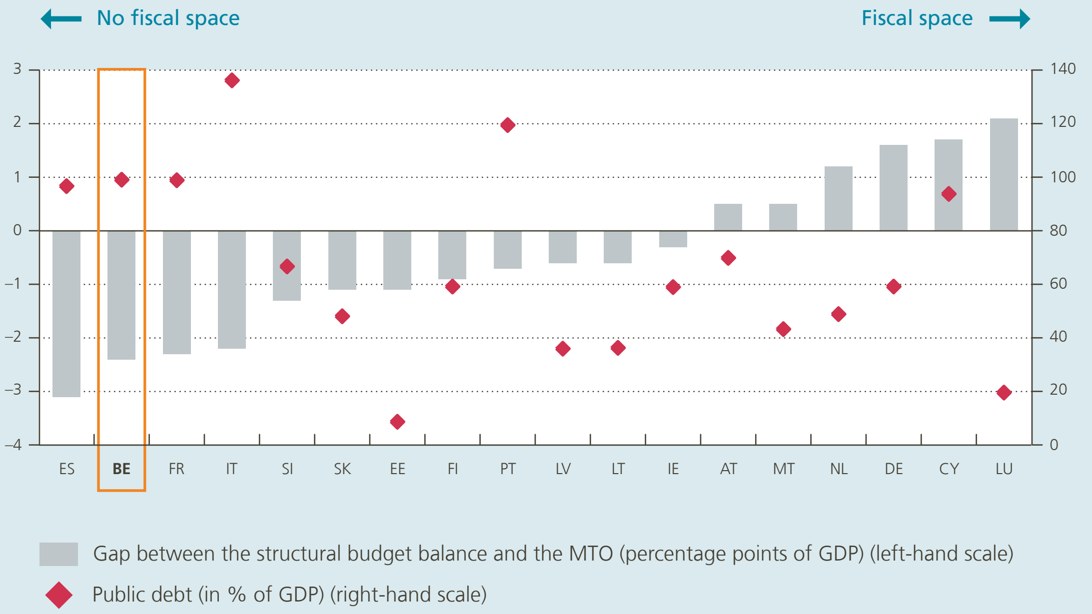
The automatic stabilisers can be supplemented by a discretionary countercyclical policy. For that purpose, in the face of a decline in economic demand, the government must actually decide, for example, to increase public consumption or investment, or other expenditure, or to cut taxes. The impact of such a fiscal stimulus on GDP – known as the "budgetary multiplier" – and therefore also the degree to which these measures moderate cyclical fluctuations, depends on the nature of the stimulus and the circumstances, which may vary considerably over time and from one country to another.

During the past year, in view of the deteriorating economic outlook, several international institutions have called for discretionary fiscal policy to be allowed to play a more active role in the euro area. At its meeting on 12 September 2019, the ECB Governing Council established that, in order to reap the full benefits of the monetary policy measures, other areas of economic policy must make a more decisive contribution. As regards fiscal policy, in view of the weakening economic outlook and the continued prominence of downside risks, governments with fiscal space should act in an effective and timely manner. In countries where public debt is high, governments need to pursue prudent policies that will create the conditions for automatic stabilisers to operate freely. This call was reiterated after subsequent meetings and supplemented by the recommendation that, in countries where public debt is high, the government should meet structural balance targets.

The stronger support for the economy via discretionary fiscal policy therefore has to come from countries where the government has some fiscal space. That means Germany, the Netherlands and Luxembourg in particular. Belgium, along with France, Italy and Spain, belongs to the group of euro area countries with no room for pursuing an expansionary discretionary fiscal policy. Those countries are in fact still a long way from achieving their set medium-term objective and are still saddled with a high public debt.

Belgium has no space to pursue an expansionary discretionary fiscal policy

(estimates for 2019)



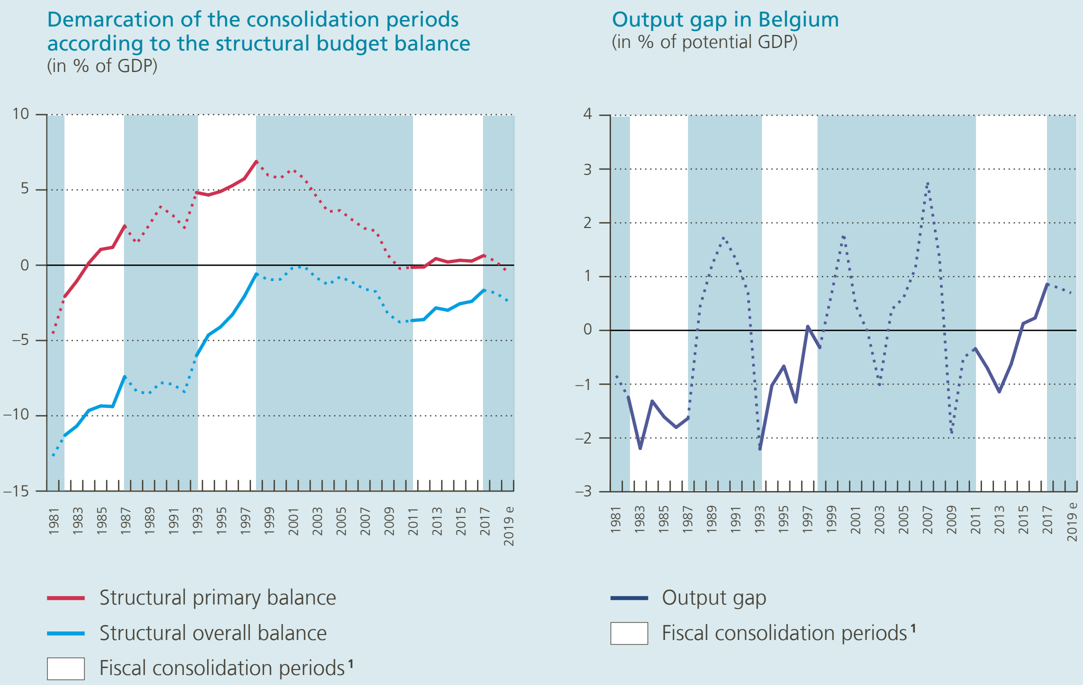
Sources: EC, NBB.

Finally, it should be noted that the fiscal policy stance in Belgium has often been contrary to the recommendations of the macroeconomic literature. For instance, the three adjustment periods identifiable since the early 1980s all started during a period of weak economic activity. In fact, the output gap was negative at the start of each of these periods, and remained so virtually throughout, which indicates that the efforts were accompanied by under-utilisation of the production factors. When embarking on fiscal consolidation, Belgium was systematically subject to heavy pressure from the financial markets. Since more favourable economic periods were not exploited to build up reserves, or not to a sufficient extent, fiscal policy was therefore frequently procyclical [1].

In its assessment of Belgium's draft budgetary plan in November 2019, the EC stressed that the favourable economic circumstances of recent years had not been used sufficiently to consolidate public finances, a situation which – combined with a high debt level – impairs the ability to withstand economic shocks and market pressure.

1 See Bisciari P *et al.* (2015), "Analysis of policies for restoring sound Belgian public finances", NBB, *Economic Review*, June, 73-94.

Fiscal consolidation in Belgium took place in periods of weak economic activity



Sources: EC, NAI, NBB.

1 Fiscal consolidation periods in Belgium are indicated in white. They are defined on the basis of the government's structural budget balance.

5.2 Revenue fell back sharply and primary expenditure rose slightly in 2019

Public revenues declined following the disappearance of a temporary boost from corporation tax revenue in previous years

In 2019, public revenues declined by 1.1 percentage point of GDP, ending the upward trend of previous years which had resulted from a temporary rise in corporation tax revenue.

Advance payments by companies rose sharply in 2017 and 2018 as a result of the significant increase in the base rate for the tax surcharge in the event of insufficient advance payments, setting it at 6.75 % with

Table 14

Public revenue [1]

(in % of GDP)

	2015	2016	2017	2018	2019 e
Fiscal and parafiscal revenue	44.4	43.6	44.1	44.2	43.1
Levies applicable mainly to earned incomes	25.7	24.7	24.6	24.4	24.1
Personal income tax [2]	11.3	10.9	10.8	10.9	10.5
Social security contributions [3]	14.4	13.8	13.7	13.5	13.6
Corporate income tax [4]	3.3	3.4	4.1	4.3	3.8
Levies on other incomes and on assets [5]	4.2	4.1	4.0	4.0	3.9
Taxes on goods and services	11.3	11.5	11.4	11.5	11.4
of which:					
VAT	6.6	6.7	6.7	6.8	6.7
Excise duties	2.5	2.7	2.7	2.7	2.6
Non-fiscal and non-parafiscal revenue [6]	6.9	7.1	7.1	7.2	7.2
Total revenue	51.3	50.7	51.2	51.4	50.3

Sources: NAI, NBB.

1 In line with the ESA 2010, general government revenue does not include the proceeds of customs duties transferred to the EU or 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.

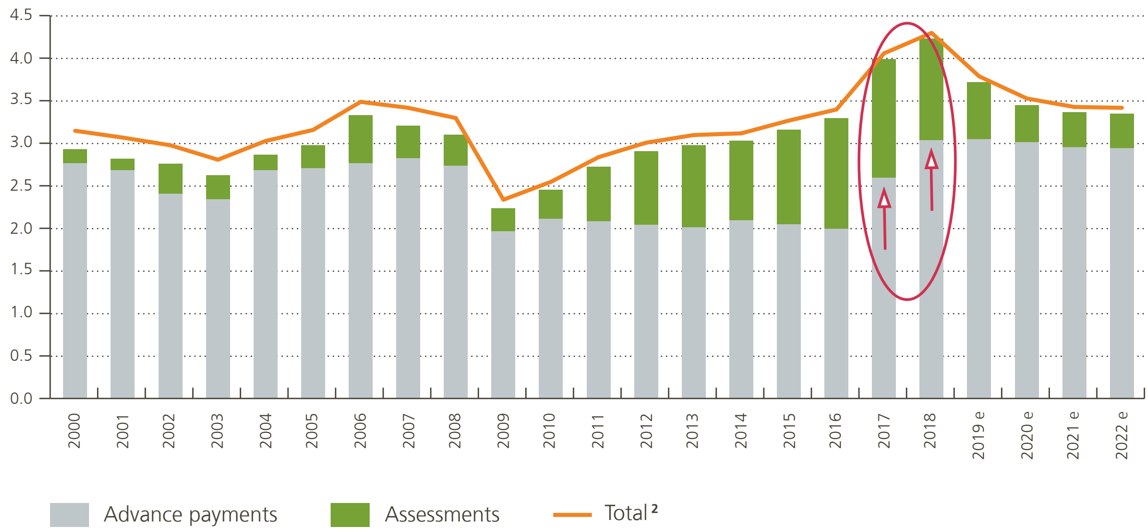
5 Mainly withholding tax on income of individuals, withholding tax on income from movable property (including the proceeds of additional percentages), inheritance taxes and registration fees.

6 Income from assets, imputed social contributions, current transfers and capital transfers from other sectors, plus sales of goods and services produced.

Chart 67

The sharp rise in corporation tax revenue in 2017 and 2018 was temporary [1]

(in % of GDP)



Sources: NAI, NBB.
1 The data for 2020-2022 are taken from the Bank's December 2019 projections.
2 Including other taxes, of which withholding tax is the most important.

effect from 2018 incomes. In that situation, it was logical for firms to make larger advance payments, especially as the low interest rate environment enabled those with insufficient liquidity to take advantage of highly favourable borrowing conditions to cover the payments. This surplus revenue in 2017 and 2018 was only temporary, since the residual balance of the corporation tax subsequently collected via the assessments – when the tax recoverable for a particular tax year is determined – was reduced. The 0.5 percentage point decline in corporation tax revenue in 2019 is almost entirely attributable to the reduction in the assessments.

Revenue derived from levies on earned incomes also declined in relation to GDP. That resulted from the measures adopted under the tax shift approved in 2015, which aimed to improve firms' competitiveness, stimulate employment and boost household purchasing power. In that connection, it was mainly personal income tax that declined in 2019. The increase in the tax-free allowance, adjustment of the tax bands, and raising of the percentage for calculating the working tax credit reduced the tax burden by 0.3 percentage point of GDP.

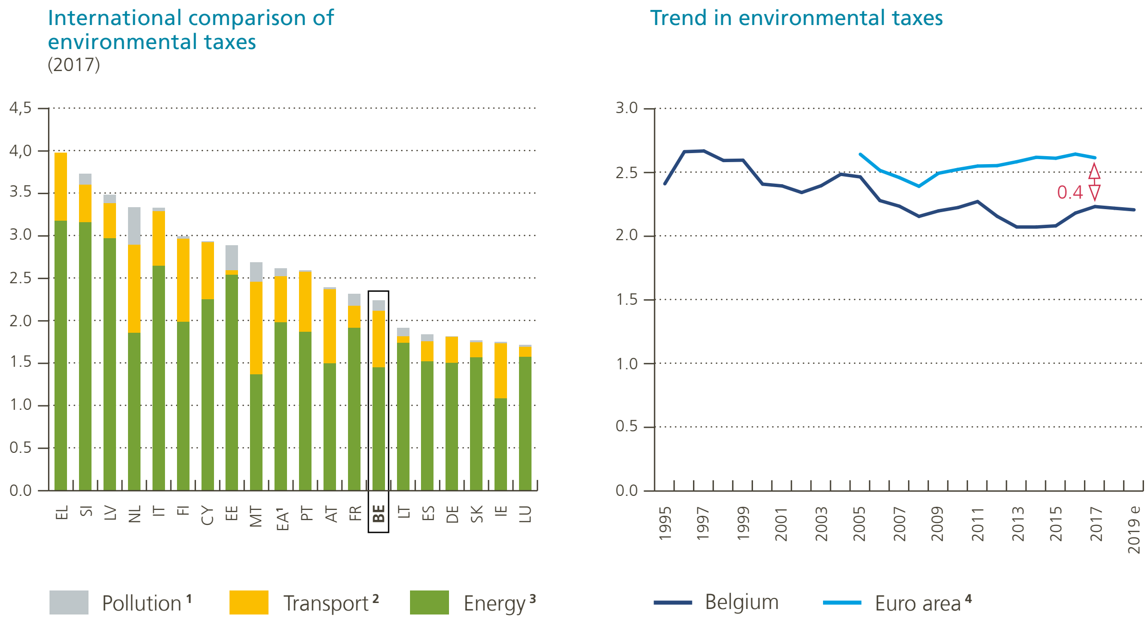
Taxes on other incomes and on assets were down by 0.1 percentage point of GDP, as the low interest rate environment reduced withholding tax revenue. The inheritance tax reform introduced in the Flemish Region in September 2018 likewise led to a slight fall in revenue from inheritance taxes. Revenue from the tax on securities accounts remained more or less steady, at 0.1 % of GDP. On 17 October 2019, the Constitutional Court decided to annul this tax owing to non-compliance with the constitutional principles of equality and non-discrimination, so that the State will lose this source of taxes in 2020.

Revenue from VAT and excise duties both declined by 0.1 percentage point of GDP. VAT income was curbed by the modest growth of household consumption expenditure. In the case of excise duties, the federal government's decision not to carry out

Chart 68

Revenue from environmental taxes is low in Belgium

(in % of GDP)



Sources: EC, NAI, NBB.

1 In Belgium, these taxes mainly comprise the packaging levy and regional water taxes.

2 These taxes include the road tax paid by households and businesses.

3 These taxes mainly comprise excise duties on fuel, plus taxes on electricity consumption (excluding VAT and levies directly related to the funding of green certificates) and revenue from the sale of emission rights.

4 Unweighted averages.

the planned index-linking of the rates in 2019 also depressed revenue.

The revenue from environmental taxes remained stable in Belgium in 2019. Compared to other countries, their level is among the lowest in the euro area. More particularly, taxes on energy – the principal component of environmental taxes – are relatively low, the rate of the implicit levy on energy as calculated by the EC being one of the lowest in the euro area.

Finally, non-fiscal and non-parafiscal revenue increased slightly as a result of the payment of almost € 300 million by a foreign financial institution under an amicable settlement with the Brussels Public Prosecution Department.

The slight rise in primary expenditure in 2019 confirmed that the downward trend had ceased

The government's primary expenditure, i.e. its expenditure excluding interest charges, increased slightly faster than economic activity in 2019, reaching 50.1 % of GDP. This was due entirely to the marked rise in social benefits, which account for roughly half of primary expenditure. Spending on pensions, health care and sickness and disability benefits went up particularly sharply. The decline in unemployment benefits moderated that growth, as the number of claimants declined further. There was actually a 25 % fall in the number of people in the unemployment with employer top-up scheme – the former pre-pension system.

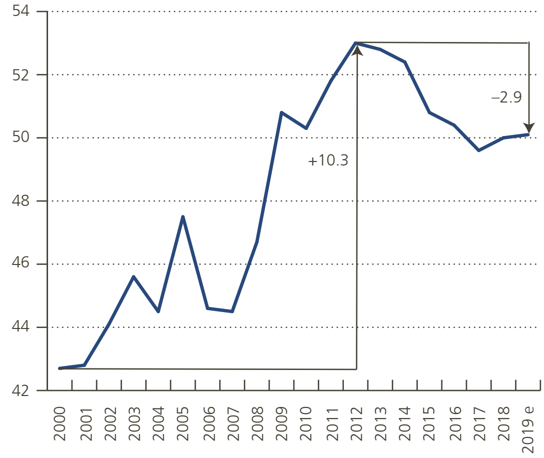
Public investment expenditure was down against the previous year, owing to the influence of the electoral cycle at local authority level. Local authority investment, which amounts to around a third of the total government investment, generally rises very steeply in the run-up to the local elections, as was the case in 2018, before subsiding in the following year. Wages of government personnel were slightly lower in relation to GDP, while purchases of goods and services stagnated. At federal level, the fact that expenditure in 2019 was managed via provisional credits and was constrained by the limits imposed on a caretaker government favoured this development.

The modest rise in primary expenditure in 2019 confirmed the 2018 increase in spending which had halted the downward trend of the preceding four years. While the strong moderation of expenditure growth between 2013 and 2017 had brought down the spending ratio, it had only partly offset the significant increase in public expenditure recorded since 2000.

Chart 69

In 2019, primary expenditure accounted for about half of GDP

(in % of GDP)



Sources: NAI, NBB.

Primary expenditure has escalated since the turn of the century

To obtain a true picture of the fundamental trend in expenditure compared to economic activity, spending has to be adjusted for the influence of temporary or fiscally neutral factors, as well as for cyclical developments, and expressed as a percentage of potential GDP.

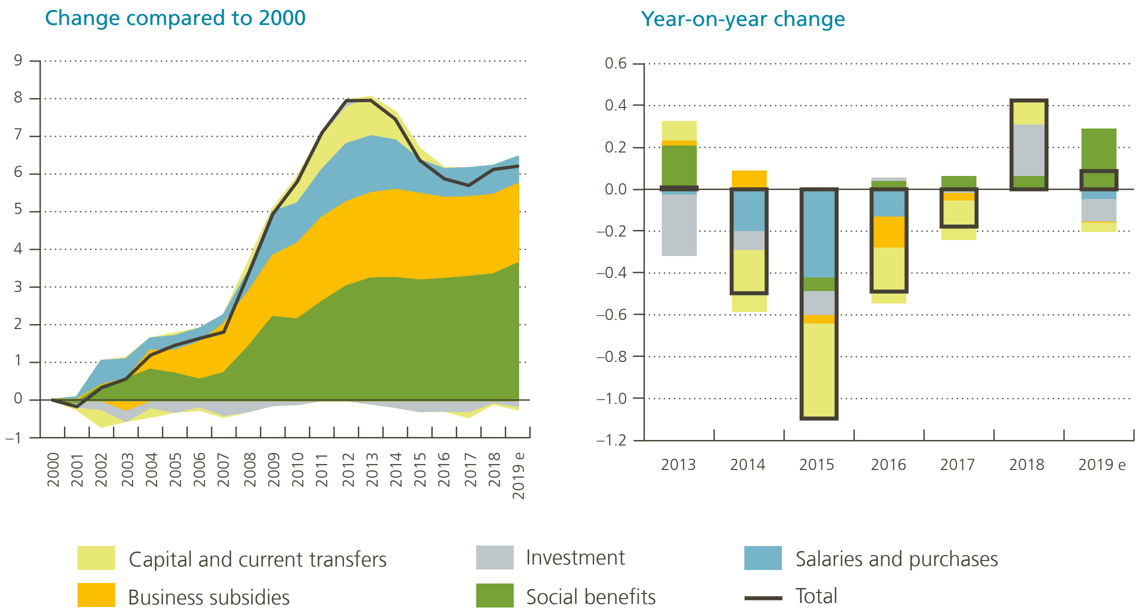
The expenditure growth between 2000 and 2012 concerned most categories and the various sub-sectors of government. The rise in social security benefits accounted for more than a third of that increase. The salaries of government personnel, as well as purchases of goods and services – three-quarters of the total spent by the Communities and Regions and the local authorities – also rose steadily. The amount of business subsidies doubled as a result of targeted reductions in labour costs for the private sector and expansion of the service voucher system. Capital transfers expanded temporarily in the form of an increase in investment appropriations and tax credits granted for households' energy-saving investment. Conversely, public investment formed an exception to this upward trend, and virtually stagnated in relation to GDP.

Since 2013, at the level of Entity I comprising the federal government and social security, primary expenditure has been cut back. The federal government slashed the capital transfers, in particular by abolishing the tax credit for energy-saving investment and reducing the investment appropriations to the SNCB. Substantial savings were also made on public sector employees' wages and on purchases of goods and services. Entity II, comprising the Communities and Regions and local authorities,

Chart 70

The decline in primary expenditure which had begun in 2013 was reversed in 2018

(primary expenditure [1, 2], percentage points of potential GDP)



Sources: NAI, NBB.

1 In order to obtain a true picture of the government's structural policy on primary expenditure, spending was adjusted for the influence of temporary or budget-neutral factors, and for the business cycle. For the purpose of this analysis, the impact of the sixth State reform in 2015, which transferred some of the Entity I expenditure to the Communities and Regions, was neutralised.

2 The rise in the primary expenditure ratio since 2000 is less marked than on the basis of the national accounts data used in chart 69. Compared to 2000, the reference year, the output gap was decidedly positive. Nominal GDP then exceeded potential GDP, whereas the reverse happened in 2012 and 2013. In addition, temporary or budget-neutral stimulated public expenditure in 2012 and 2013.

moderated its expenditure on salaries and purchases, and on business subsidies and investment grants. Public investment was down slightly in both entities. Finally, social benefits were up, despite their moderation during 2014‑2018. The 2015 index jump – the one‑off arrangement for not increasing public sector employees' wages and the majority of social benefits by 2 % after the key index was exceeded – was a major contributory factor in the savings made during that period.

Altogether, over the period 2000‑2019, there was a structural rise in primary expenditure amounting to 6.2 percentage points of potential GDP. Social benefits accounted for more than half of that increase, namely 3.6 percentage points. Other expenditure was up by 0.8 percentage point for Entity I and 1.8 percentage points for Entity II. Annual average nominal growth of the other expenditure of Entity II came to 4.0 %, slightly above that of Entity I, for which the figure was 3.8 %.

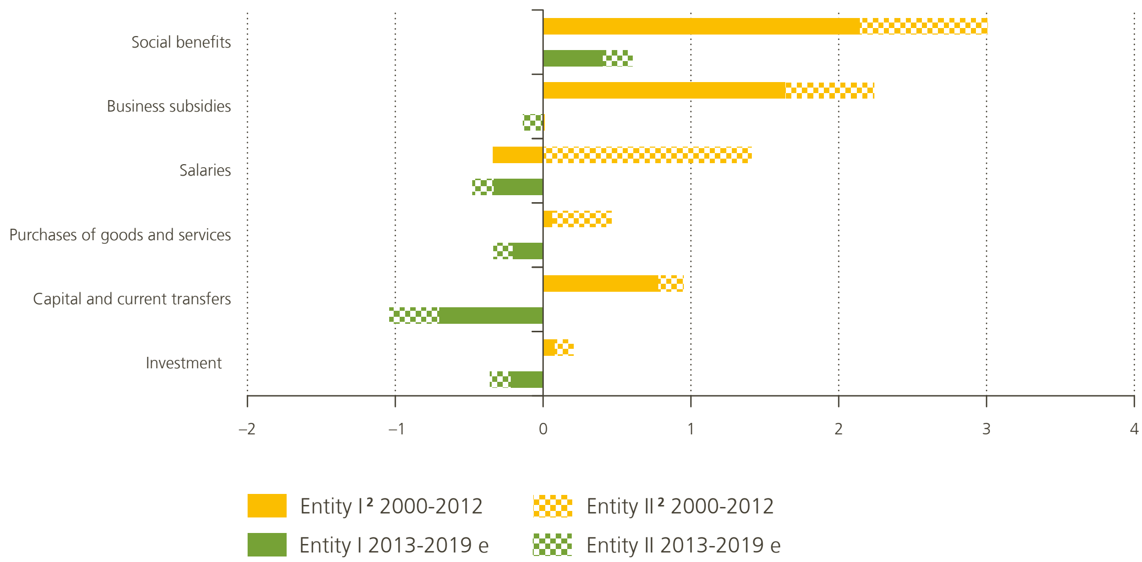
A shift in favour of public investment is desirable

Capital transfers and public investment formed the exception to the growth of the various expenditure categories since 2000. After adjustment for the upward effect on investment resulting from reclassification of the rail infrastructure operator, Infrabel, from the non‑financial corporations sector to the government sector from 2014 onwards, public investment has fallen slightly. Belgium is among the euro area countries with the highest primary expenditure, whereas its public investment has long been among the lowest. New investment therefore barely makes up for the depreciation of past investment, so that net investment – which determines the change in the capital stock – has been virtually zero in recent years. Owing to this persistently weak investment, the government sector's capital stock is below levels recorded in the neighbouring countries. Productivity growth has also fallen sharply in Belgium over the past ten years.

Chart 71

All levels of power were involved in the reduction in expenditure since 2013

(primary expenditure [1], change in percentage points of potential GDP)



Sources: NAI, NBB.
1 Structural trend as defined in note 1 to chart 70.
2 Entity I comprises the federal government and social security. Entity II comprises the Communities and Regions and the local authorities.

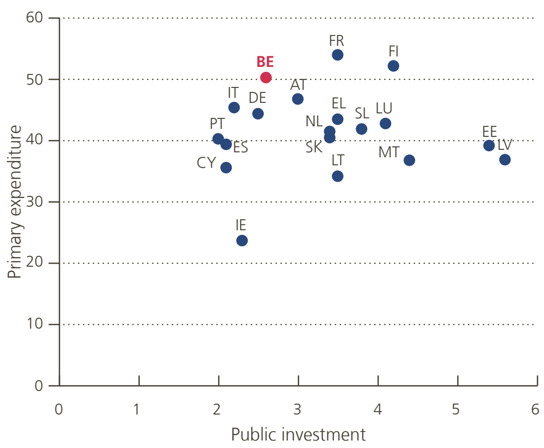
All these factors indicate the need to stimulate public investment in Belgium, and particularly investment that supports the economy's growth potential. More generally, public expenditure which, if executed efficiently, could boost productivity should be a priority. That applies particularly to investment in R&D conducive to innovation, and investment in education and training, and in infrastructure. Both government and businesses must give the necessary impetus to investment in transport networks to relieve congestion, investment in the energy supply to eliminate the uncertainties in that regard, and investment in communication networks to generate efficiency gains and create new innovation opportunities. Investment must also drastically reduce the dependence on fossil fuels and minimise the harmful impact on the environment.

In view of the scale of primary expenditure in Belgium, accompanied by a high tax burden, any further increase in relation to GDP is inadvisable. The desired revival of public investment and other expenditure beneficial to long-term growth potential can therefore only be achieved by cutting less productive expenditure.

Chart 72

Public investment is relatively low in Belgium, but total expenditure is high

(in % of GDP, 2019)



Source: EC.

Social benefits have escalated in recent decades

Since the turn of the century, social benefits have risen by 3.6 percentage points of potential GDP. This increase was most marked up to 2013, after which the government managed to curb the growth of social benefits.

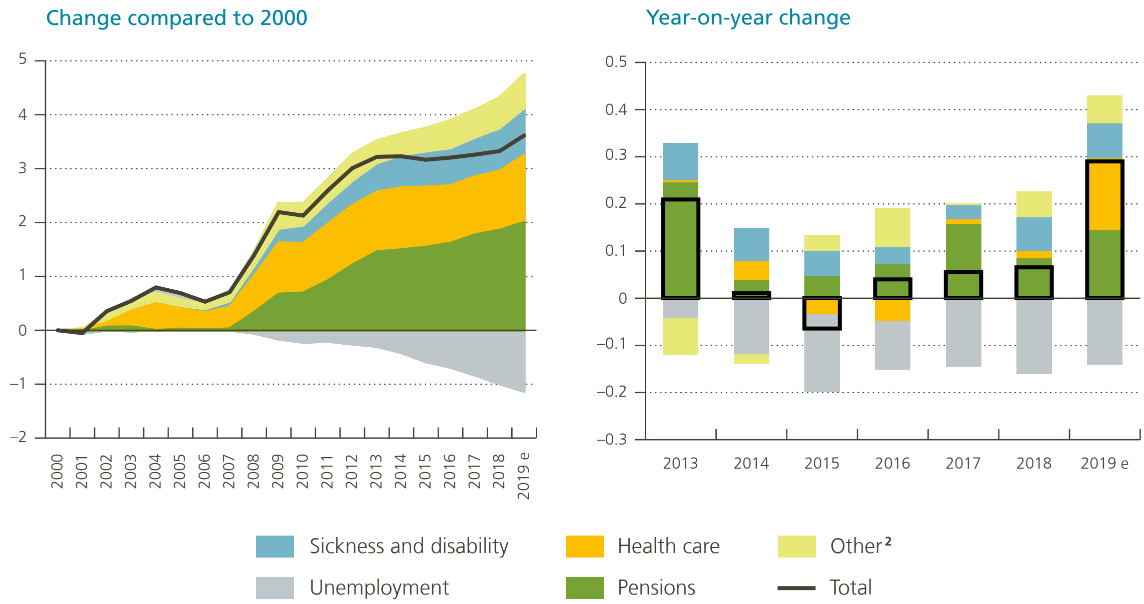
The increase up to 2013 concerned most benefits other than those relating to unemployment in the broad sense. That means not only actual unemployment, but also early retirement, career breaks and time credit. Pension expenditure, which had stabilised in the initial years of this century, outstripped the rise in nominal potential GDP from 2008. There were various contributory factors: the pensioner population expanded faster, potential economic growth declined, the gap between the automatic indexation of social benefits on the basis of the health index and the GDP deflator widened – to three or four percentage points, partly as a result of the deteriorating terms of trade – and the welfare-linked adjustment introduced in 2005 under the Law on the "Generation Pact" raised the average pension amount. Health care expenditure soared and was not curbed by the generous real growth target which the authorities set at 4.5 % between 2005 and 2011. Finally, sickness and disability benefits increased markedly owing to the substantial rise in the number of claimants.

Although population ageing has clearly accelerated since the start of the last decade, with a substantial rise in the proportion of elderly and retired people, the government succeeded in keeping social benefits almost stable as a ratio of potential GDP between 2013 and 2017. That is attributable mainly to the buoyant labour market, which brought a structural decline in unemployment expenditure in the broad sense. The government itself played a role by taking numerous structural measures in relation to employment and reducing the tax burden on labour. In addition, up to 2018, vigorous action kept the real rise in health care expenditure below the 1.5 % target for real growth, applicable since 2014. The surge in that expenditure in 2019 therefore contrasts with that picture. Finally, the rise in pension expenditure was curbed by a range of measures which pushed up the actual retirement age, and by the only partial implementation of welfare-linked adjustments in some years. Moreover, most social

Chart 73

Social benefits have risen considerably since the turn of the century

(social benefits[1], percentage points of potential GDP)



Sources: NAI, NBB.

1 Structural trend as defined in note 1 to chart 70.

2 This item mainly covers family allowances, integration incomes, benefits for industrial accidents and occupational diseases, handicapped persons' benefits and transfers to care institutions.

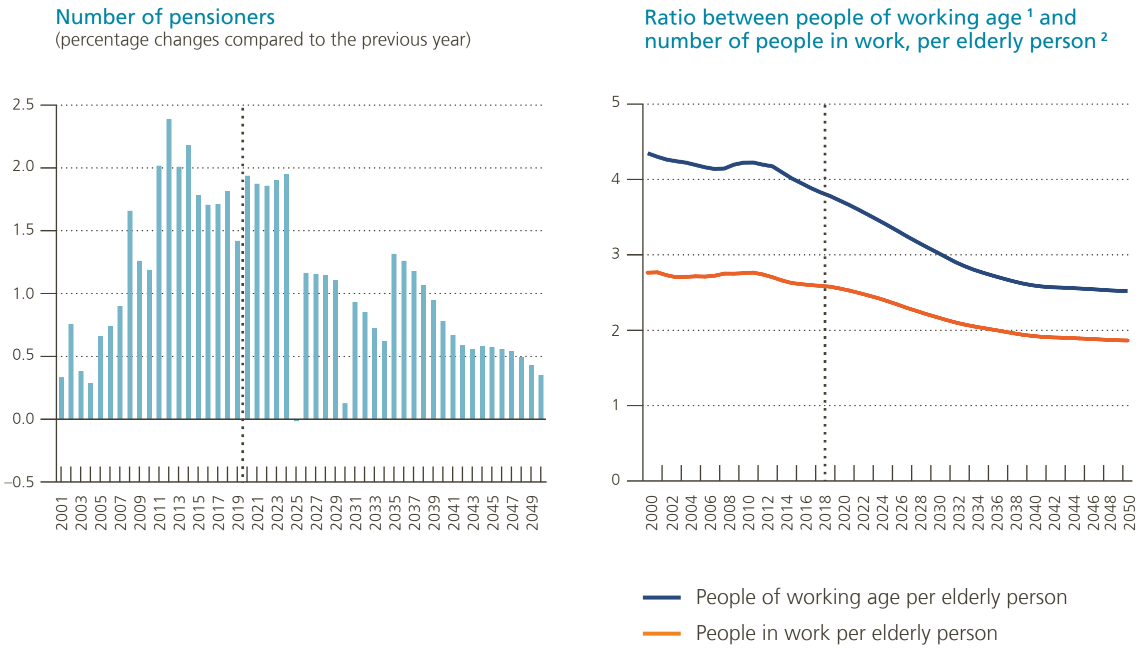
benefits were held down by the index jump in 2015. Nevertheless, sickness and disability benefits still rose by a nominal average of just over 6 % per annum after 2012.

Population ageing requires a growth-friendly policy and efficient government

In the coming decades, population ageing will bring a further rise in social benefits in relation to economic activity, as the number of pensioners will continue to rise significantly. The growth of this population will come to a halt in 2025 and 2030, when the statutory retirement age will go up to 66 and 67 years respectively. The rise in the number of people of working age will slow considerably and even become negative between 2024 and 2040. At present, there are still around four people of working age per elderly person, but that figure will drop to

Chart 74

Demographics will continue to exert pressure on public finances in the coming years



Sources: FPB, SCA, Statbel.
1 People aged between 18 and 66 years.
2 People aged 67 or more.

just 2.5 by 2040. The Study Committee on Ageing (SCA) considers that, with no change of policy, ageing will drive up social benefits by a further 3.5 % of GDP between 2019 and 2050. Over the next ten years, the cost of ageing will inflate primary expenditure by just over 0.2 percentage point per annum, on average, on account of pensions and health care expenditure. The latter will increase not only because of population ageing but also as a result of the rising cost of treatments, due partly to technological progress. In regard to pensions and other social benefits, the SCA assumes that the welfare-linked adjustments will continue to apply.

In the decades ahead, population ageing will continue to drive up social benefits

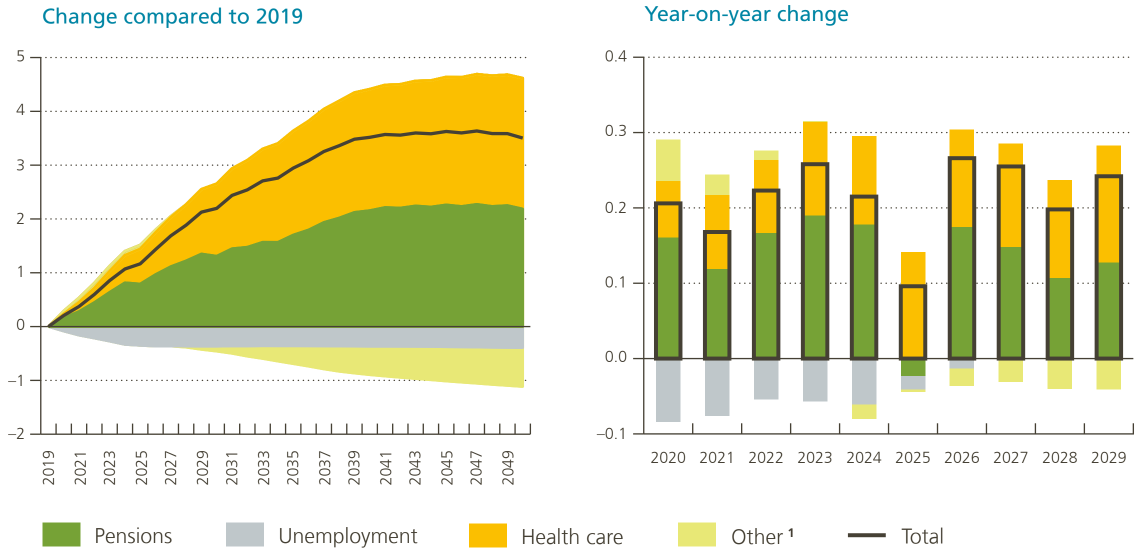
Population ageing is therefore a fundamental challenge for society. In order to address it effectively, it is necessary to adopt a strategy that stimulates potential growth by boosting labour market participation and increasing productivity gains, to continue moderating the budgetary cost of ageing, and to put public finances on a sound footing by wiping out the budget deficit and reducing the debt.

The government thus faces the difficult task of combining various aims within its fiscal policy over the coming years, namely to step up investment and absorb the budgetary costs of ageing while cutting expenditure in order to eliminate the budget deficit. To that end, maximum efficiency in government action should in any case be the key objective for all levels of power in Belgium during the years ahead.

Chart 75

Ageing will continue to drive up social benefits in the decades ahead

(social benefits, percentage points of GDP)



Source: SCA.

1 This item mainly includes sickness and disability benefits, family allowances, inclusion integration incomes, benefits for industrial accidents and occupational diseases and handicapped persons' benefits.

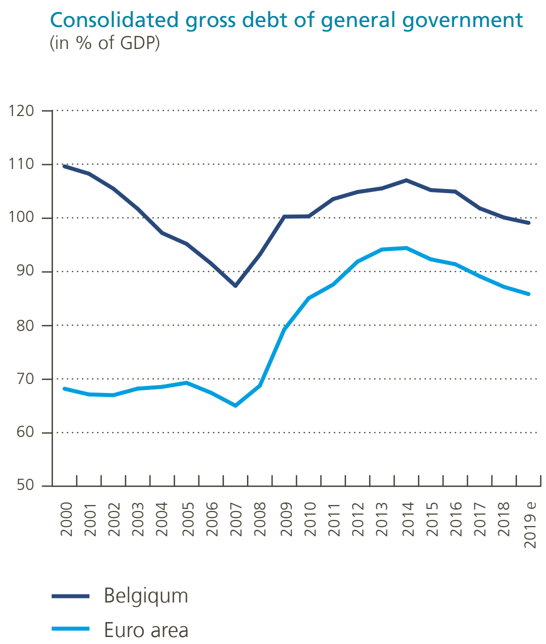
5.3 The public debt is still high, while interest charges have fallen as a result of low interest rates

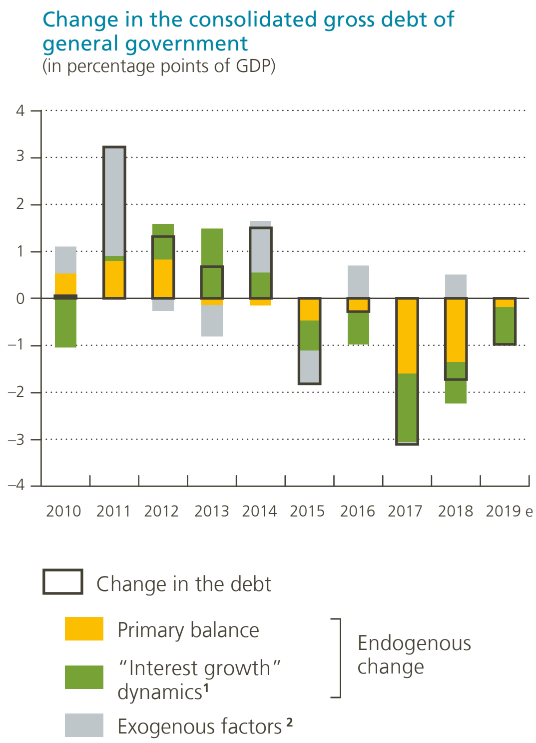
Debt has only come down slowly

After having fallen to the symbolic level of 100 % of GDP at the end of 2018, the government debt ratio declined by 1 percentage point in 2019, to 99.1 % of GDP at the end of the year. While the public debt remains high in international terms, the rate of debt reduction lost momentum, and was slower than the

Chart 76

The debt ratio was only down slightly in 2019





Sources: EC, NBB.

1 The difference between the implicit interest rate on the debt and nominal GDP growth, multiplied by the ratio between the debt at the end of the previous year and GDP in the period considered.

2 Exogenous factors also include the effect of statistical reclassifications. In October 2018, the NAI reclassified Infrabel, the rail infrastructure operator, under general government. That change, effective from 2014, increased the debt ratio by around 0.5 percentage point.

average for the euro area. It also failed to achieve the annual minimum stipulated by the Stability and Growth Pact – the benchmark being one-twentieth of the deviation from the ratio of 60 % of GDP.

The decline in the debt ratio was fuelled by endogenous factors. Thus, the primary surplus – still positive, but down sharply against the previous year – contributed again, but to a smaller degree than in 2017 and 2018. However, this factor was reinforced by the positive gap between nominal GDP growth and the implicit interest rate on the public debt, which automatically lowers the debt ratio.

In contrast, exogenous factors – i.e. those which influence the debt but not the budget balance – were neutral overall. For instance, the rise in loans granted under the social housing policy in the Flemish Region added to the public debt. Conversely, accounting factors relating to the management of the debt reduced it, on balance. In recent years, securities have often been issued at nominal interest rates exceeding market rates, so that the issue values were higher than the nominal bond values. In the year of issuance, these issue premiums had a downward impact on the debt expressed in nominal terms. However, that was wiped out in subsequent years, up to the maturity of the securities, by an upward effect on the debt ratio resulting from the difference between interest payments on a cash basis and those on a transaction basis, the latter serving as the reference for interest charges in the national accounts. In 2019, this difference was smaller than the amount of the issue premiums. Moreover, in that year, there were no extraordinary financial transactions affecting the State's assets.

Debt maturity has reached a new peak

At the end of 2019, the average maturity of the federal debt stood at 9 years and 10 months, the highest level ever. In 2010 it was six years and has risen constantly since then.

The debt managers viewed the drop in interest rates as an opportunity to reduce the refinancing risk at relatively low cost. That policy was expanded from year to year as market interest rates continued their downward trend. Lengthening the maturity of the debt in the long term limits the annual gross borrowing requirements covering both the current year's deficit and the refinancing of debt reaching maturity.

These borrowing requirements thus declined from around 24 % of GDP at the start of the decade to around 13 %. The risks associated with a possible rise in interest rates are therefore lower and the public debt is more resilient to an interest rate shock. For instance, as pointed out by a study [1] published recently, in the event of a modest but persistent rise, this longer maturity is ultimately more beneficial than keeping the maturity at its 2010 level. It may also give rise to a reduction in the risk premium incorporated in the interest rate spread.

The longer maturity limits the annual refinancing needs

Nevertheless, the longer maturity entails a cost in terms of interest charges, as the interest rate on issues of new loans maturing at a later date is higher.

The long-term debt issued during 2019 had an initial maturity of 16 years and 5 months, and an average interest rate of 0.67 %. Among these issues, some securities will not mature until 2038, 2050 or 2066.

Interest charges continued falling

The downward trend in interest charges continued in 2019. Compared to their 2018 level, they were down by 0.2 percentage point of GDP. As in recent years, that fall was due largely to the decline in interest rates, as the debt ratio made only a very minor contribution.

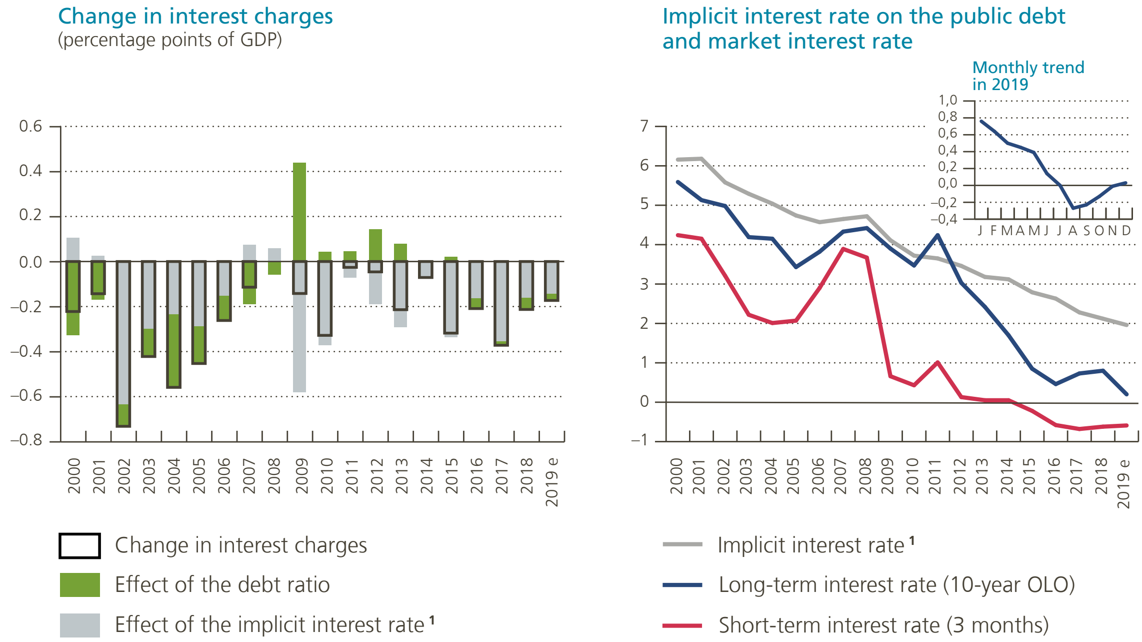
While the benchmark yield on 10-year bonds still averaged 0.76 % in January 2019, it declined throughout the first half year and was negative for the first time in July. It dropped to an average low point of –0.27 % in August. Thereafter, it edged upwards to just over 0 %

1 See Cornille D. *et al.* (2019), "How risky is the high public debt in a context of low interest rates ?", NBB, *Economic Review*, September, 71–95.

Chart 77

The fall in the implicit interest rate on the debt further reduced interest charges in 2019

(in %, unless otherwise stated)

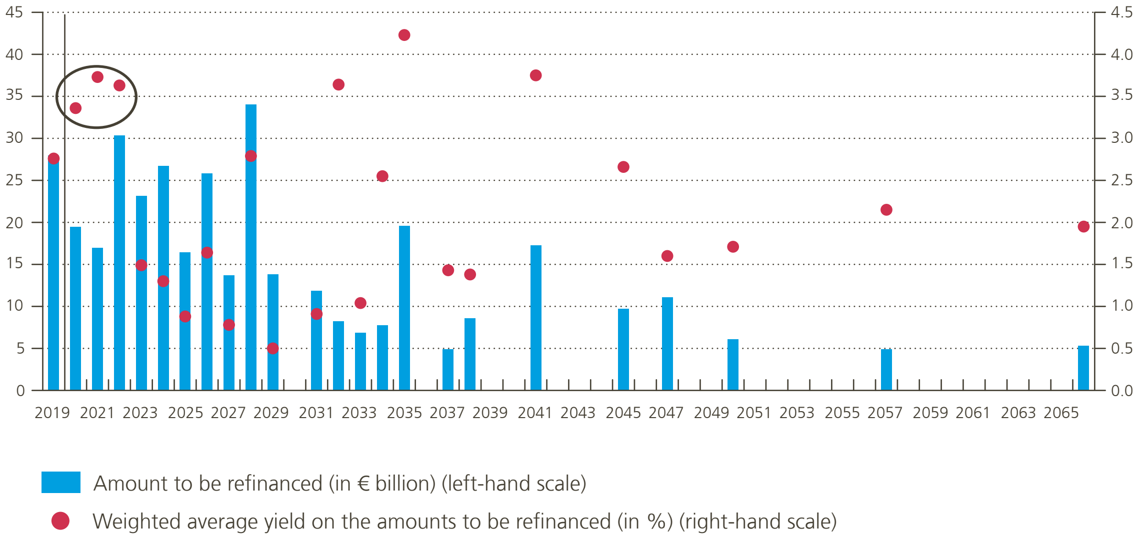


Sources: Belgian Debt Agency, NAI, NBB.
1 Ratio between interest charges in the current year and the debt at the end of the previous year.

Chart 78

The scope for reducing interest charges will be fairly large until 2022

(maturity of the long-term debt (OLO) of the federal government and associated annual average yield, end of 2019)



Sources: Belgian Debt Agency, NBB.

at the end of the year. The federal government therefore issued a number of 10-year OLOs at negative rates last year, and thus received remuneration on some long-term issues. That has also been the case in the past few years for the short-term debt, financed by Treasury certificates. In 2019, the interest rate on 3-month Treasury certificates averaged –0.59 % and the rate on 1-year certificates came to –0.57 %.

Interest rates on the public debt have been historically low

For a given debt ratio, interest charges fall if the market interest rate paid on new issues is less than the rate on securities reaching maturity. OLOs maturing and to be refinanced between 2020 and 2022 were issued at an average of between 3 and 4 %. Unless interest rates rise significantly, the decline in interest charges will continue, especially in the next three years. That will apply to a lesser degree thereafter, as the securities to be refinanced then carry lower interest rates. If there is no reduction in the debt, the gains in terms of interest charges will therefore steadily dwindle.

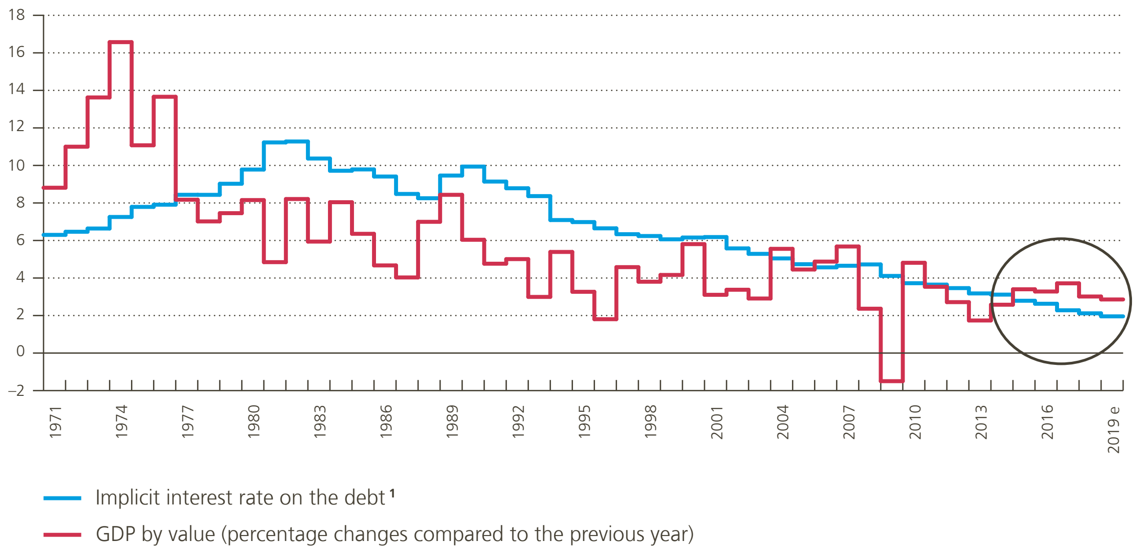
Low interest rates have created highly favourable financing conditions

The downward trend in interest rates on the public debt over several decades has accelerated in recent years. In 2019, interest rates declined to an all-time low. The Belgian government is therefore enjoying extremely favourable financing conditions.

Chart 79

The decline in the implicit interest rate has lowered the risks of a "snowball effect" on the debt ratio

(in %, unless otherwise stated)



Sources: NAI, NBB.

1 Ratio between interest charges in the current year and debt at the end of the preceding year.

The low interest rates reduced the risk of the "snowball effect" in which interest charges themselves constantly add to the debt. Since 2015, the implicit interest rate on the public debt has been lower than nominal GDP growth in Belgium. In that case, primary surpluses are not necessary to avoid an increase in the debt ratio.

However, the current situation of very low, or even negative, interest rates cannot be seen as normal in the medium and long term. It would be reckless to base fiscal policy and debt management on the assumption that these favourable financing conditions will persist. On the contrary, it is instead advisable to use the budgetary scope afforded by the low interest rates to consolidate public finances and achieve a primary balance large enough to cut the budget deficit and the public debt.