6. Fiscal policy and public finances

6.1 Public finances in the euro area remained under the coronavirus spell in 2021

Fiscal policy continued to play a key role in supporting the economy and health care

Just as in 2020, governments across the euro area drew heavily on fiscal policies to curb the economic and social impact of the pandemic. This was both a necessary and appropriate response, given that the health crisis was still raging and economic recovery far from complete. For one thing, the automatic stabilisers – i.e. lower tax receipts and higher employment benefits in the event of an economic downturn – had a further stabilising effect on the economy. In addition, and particularly in the first six months of 2021, discretionary measures remained in place, or new ones were introduced, to provide temporary and targeted support to health care and households and companies. These were increasingly combined with recovery measures, which bolstered total demand and should enhance the full potential of the economy.

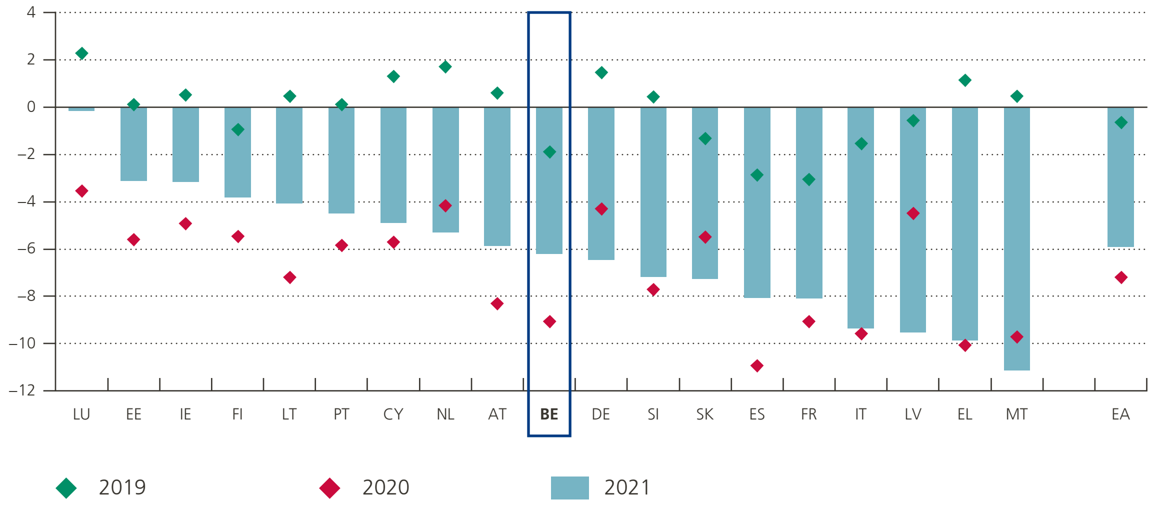
Fiscal policy in euro area remained strongly accommodative in 2021

Fiscal policies across the euro area remained highly accommodative, if slightly less so than in 2020. The euro area's nominal overall balance showed a deficit of 5.9 % of GDP in 2021. Although better than for 2020, this remains much worse than levels recorded in 2019. The budget deficit was still particularly high in countries whose balances had been less favourable even before the COVID-19 crisis. In 2021, developments varied between Member States, with balances deteriorating further in some. The Netherlands and Germany are cases in point, although both have more fiscal scope than most. By contrast, most Member States, including Belgium, saw their balances improve on the back of economic recovery and the partial wind-down of support and recovery measures. In fact, Belgium was among the countries that recorded a major improvement, as did Spain and Austria. In most euro area countries, support and recovery measures were as significant in 2021 as they had been in 2020. France and Italy, for instance, implemented sizeable recovery measures.

Chart 6.1

Public deficit stayed high in the euro area

(budget balances, in % of GDP)



Sources: EC, ESCB, NBB.

Application of general escape clause extended in Europe

Early in March, the European Commission released an important Communication with general guidance for EU Member States on fiscal policy. Its focus was mostly on the further application of the general escape clause and the impact of the EU Recovery Plan.

The general escape clause, activated in March 2020, remained in force throughout 2021 and was a key influence on the fiscal policies of the Member States, as the clause enabled them to temporarily deviate from their medium-term budgetary objectives or from the paths towards that goal, with the proviso that this should not jeopardise the sustainability of public finances in the medium term. With the activation of the clause, EU Member States were able to initiate broad-based fiscal stimulus. Early in June, the Commission indicated that the clause would remain in force in 2022 and would be deactivated from 2023. This conclusion resulted from a general assessment of the economic situation based on quantitative criteria. More specifically, the Commission proposed to deactivate the general escape clause the year after economic activity is back to pre-crisis levels in the EU or euro area. Spring projections in 2021 suggested this will happen in 2023. This conclusion was confirmed in November with the release of the European Semester's autumn package.

The general escape clause remained in place and is not set to be deactivated until 2023

The activation of the general escape clause has eased the application of European fiscal rules, but Stability and Growth Pact procedures remained in place, and the annual cycle of budgetary surveillance proceeded as normal. When reviewing stability programmes in June, the Commission felt unable to make any decisions about initiating excessive deficit procedures in view of continued uncertainty over the COVID-19 crisis. Additionally, country-specific recommendations remained relatively qualitative. In contrast to its 2020 recommendations, the Commission called for more differentiated fiscal policies. It drew a distinction between countries with high debt ratios (Belgium, France, Italy, Greece, Portugal and Spain) and the others. The first group of countries was advised to channel resources from the Recovery and Resilience Facility (RRF) featuring in the European Recovery Plan towards additional investment to bolster the recovery, while at the same time pursuing a cautious fiscal policy. This same group of countries was also advised to restrict any nationally financed growth in current spending. In keeping with these recommendations, the Commission's autumn assessment of the draft budgets noted that it is important for highly indebted countries to continue to pursue cautious fiscal policies when devising accommodative fiscal measures, given major sustainability issues in the longer term even before the outbreak of the COVID-19 pandemic.

The European Recovery Plan got underway

In 2021, the Next Generation EU Recovery Plan (NGEU), for which € 750 billion had been earmarked (at 2018 prices), became operational. Accounting for some 90 % of this amount, the main element of the plan, the Recovery and Resilience Facility (RRF), will support investment and reforms. Countries must at least spend 37 % of their allocated RRF funds towards the green transition and 20 % towards the digital transition. The facility is a mix of loans and grants, with the latter providing key support to the EU's least developed countries and so contributing to economic convergence in the European Union. In addition, the RFF grants will provide support to a few more developed countries that have been particularly hard hit by the coronavirus crisis, such as Spain and Italy. On initial calculations, Belgium's share of this support works out at € 5.9 billion [1], i.e. 1.2 % of GDP spread over the 2021-2026 period.

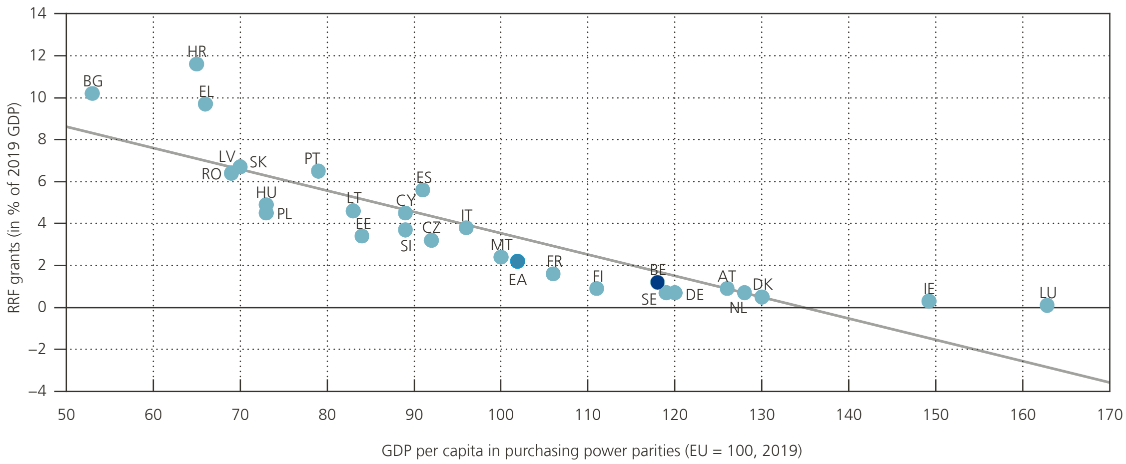
To tap into the facility, countries have to draw up and submit a Recovery and Resilience Plan (RRP), specifying the investments and reforms they are seeking to carry out. By the end of the year, all EU countries except the Netherlands had submitted their plans and 22 of them had seen these plans approved. Box 6 describes Belgium's plan. RRF resources are released when the plans' milestones and objectives have been achieved.

Government measures funded by RRF grants are booked as fiscally neutral at the level of the individual Member State. In keeping with the ESA methodology used in the national accounts, RRF grants are booked at the same time as the expenditure – or tax cuts – they finance, irrespective of when the country receives the actual cash. If such a cash receipt and the relevant expense or tax cut do not coincide or match, a temporary impact on the debt

1 This preliminary amount will be reviewed in June 2022 as soon as the first official GDP numbers for 2021 have been published. The most recent estimates suggest that the amount for Belgium will be revised downwards.

Chart 6.2

RRF grants should foster economic convergence in the EU [1,2]



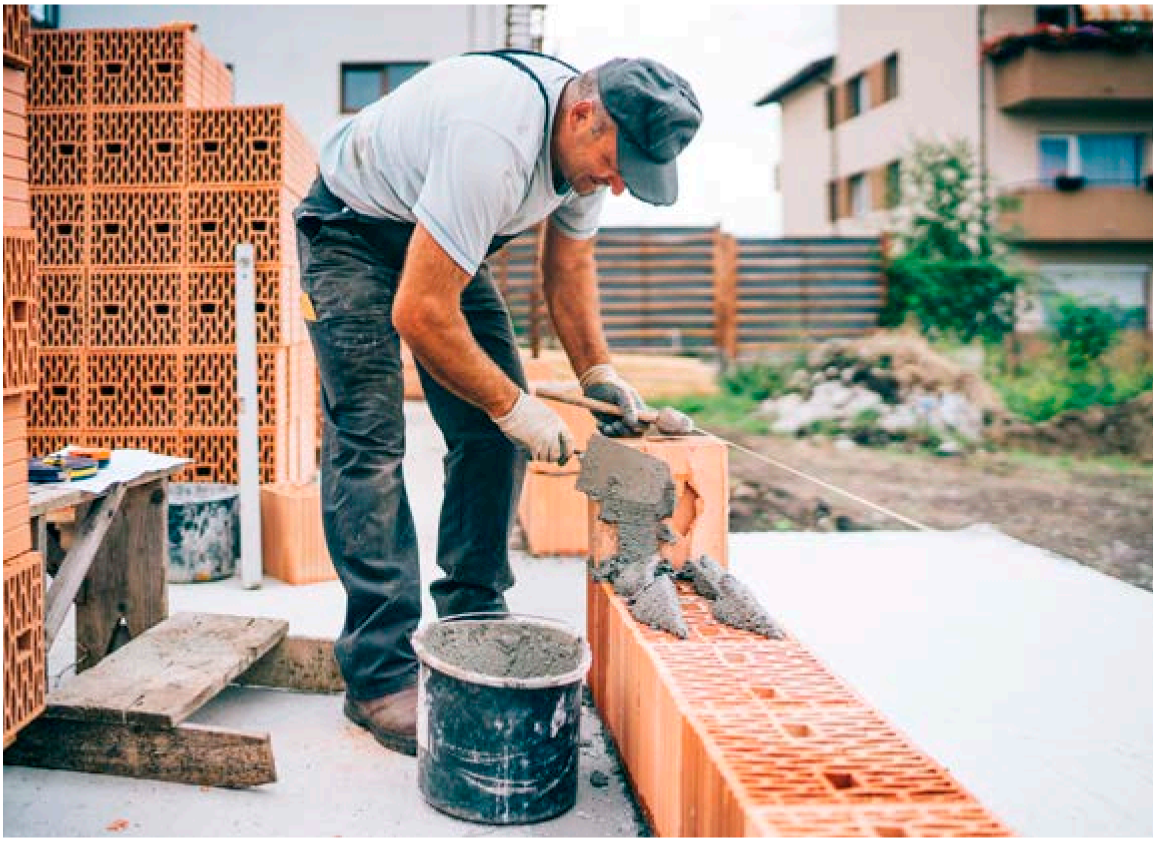
Sources: EC, NBB.
1 RRF grants only, no loans. The amounts will be spread over the 2021-2026 period.
2 For IE and LU: gross national income (GNI) per capita in purchasing power parities.

position will apply. As a matter of fact, in the year under review, pre-financing to the tune of 13 % of maximum grants was paid to those countries whose RRPs had been given the go-ahead. For Belgium, this involved a sum of € 770 million, which exceeded the spending it had made until that date and so temporarily reduced public debt for the difference. While RRF-financed policies are budget-neutral for Member States, these grants are making the fiscal stance of the EU as a whole more expansive. Lastly, any loans granted to Member States under the RRF are considered as national debt.

To fund the NGEU plan, the Commission launched a programme in June 2021 to borrow money in the financial markets on behalf of the EU, the first time it had tapped the markets for such a large amount (around € 800 billion at current prices). The money borrowed in this way will be paid back between 2028 and 2058. The proportion of the RRF paid in grants will be repaid from fresh new EU resources and, where necessary, from contributions by Member States calculated on the basis of their gross national income. RRF loans will be paid back to the EU by the Member States.

Lastly and for the sake of completeness, it should be noted that most other measures taken in 2020 at the European level in terms of fiscal policy to combat the crisis remained in place or were extended. Examples include flexibility with state aid rules and safety nets in the shape of loans against favourable interest rates[1].

1 For a more detailed discussion, see box 3, "European institutions' budgetary and financial response to the COVID-19 crisis", in the 2020 NBB Annual Report.



6.2 Belgium's public finances propped up health care and the economy

Belgian budget deficit shrank but remained historically high

Belgium saw its budget deficit fall in 2021, although it stayed historically high at 6.2 % of GDP. Fiscal policy remained highly supportive in a society still very much held captive by the coronavirus crisis. The deficit improvement by 2.9 percentage points compared with 2020 was attributable to the robust economic recovery and some winding down of support measures. Both factors contributed to the sizeable fall in primary expenditure – i.e. expenditure excluding interest charges – relative to GDP, by around 3.2 percentage points. Interest charges themselves also helped to reduce the deficit by 0.3 percentage points of GDP. Meanwhile, revenue as a percentage of GDP recorded a temporary decline. Despite a still hefty budget deficit, the debt ratio slid to 108.6 % of GDP, on the back of a strong rise in nominal GDP.

The budget balance breaks down into various components. There is the denominator effect of primary expenditure, of course, which captures the difference between primary expenditure as a percentage of GDP and as a percentage of potential GDP. For one thing, the denominator effect highlights the impact of the business cycle on the spending ratio. If GDP languishes below its potential, the primary spending ratio goes up and the balance deteriorates. And then there is the impact on the budget balance of temporary discretionary coronavirus measures. For the sake of simplicity, these also include the exceptional expense of furlough schemes and the bridging allowance, even though these are cyclical in nature. And lastly, there are the other factors that influence the balance.

By way of primary expenditure's denominator effect, the economic revival of 2021 improved the budget balance by around 2.5 percentage points

Table 6.1

General government overall balance and debt

(in % of GDP)

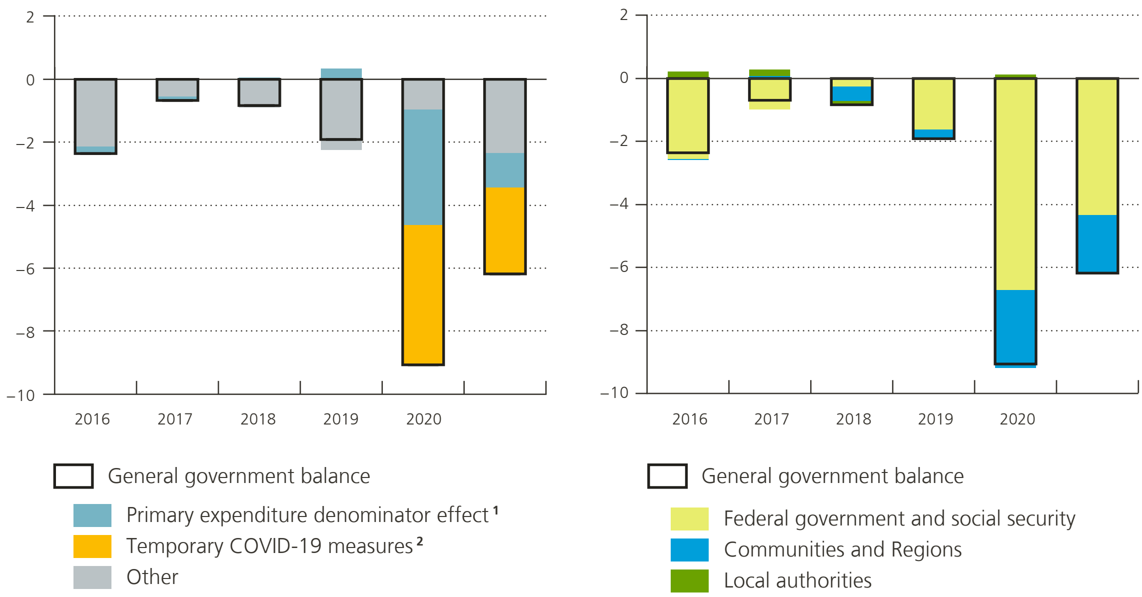
	2016	2017	2018	2019	2020	2021 e
Revenue	50.8	51.3	51.4	49.9	50.1	49.4
of which : Fiscal and parafiscal revenue	43.6	44.2	44.2	42.9	43.1	42.6
Primary expenditure	50.4	49.7	50.1	49.9	57.2	54.0
Primary balance	0.3	1.7	1.3	0.1	−7.1	−4.6
Interest charges	2.7	2.4	2.1	2.0	1.9	1.6
Overall balance	−2.4	−0.7	−0.8	−1.9	−9.1	−6.2
Public debt	105.0	102.0	99.9	97.7	112.8	108.6

Sources : NAI, NBB.

Chart 6.3

Budget deficit remained high despite economic revival – and highest at the federal level

(general government budget balance, in % of GDP)



Sources: NAI, NBB.

1 The denominator effect of primary expenditure is calculated as the difference between primary expenditure as a percentage of GDP and primary expenditure as a percentage of potential GDP.

2 Temporary COVID-19 measures also include spending on temporary lay-offs and the bridging allowance.

of GDP – as economic activity bounced back in 2021, having slumped well below its potential in 2020.

The reduced deficit also came on the back of the phasing out of temporary COVID-19 support measures, with the budgetary cost of these measures down by 1.7 percentage points of GDP in 2021, even if they remained substantial at 2.7 % of GDP. For one thing, employees and self-employed workers were still able to sign up to the furlough scheme and bridging allowance, while companies were still being propped up by a range of support measures, including regional allowances, and spending to address the health crisis remained high.

Improved balance mainly fuelled by economic revival

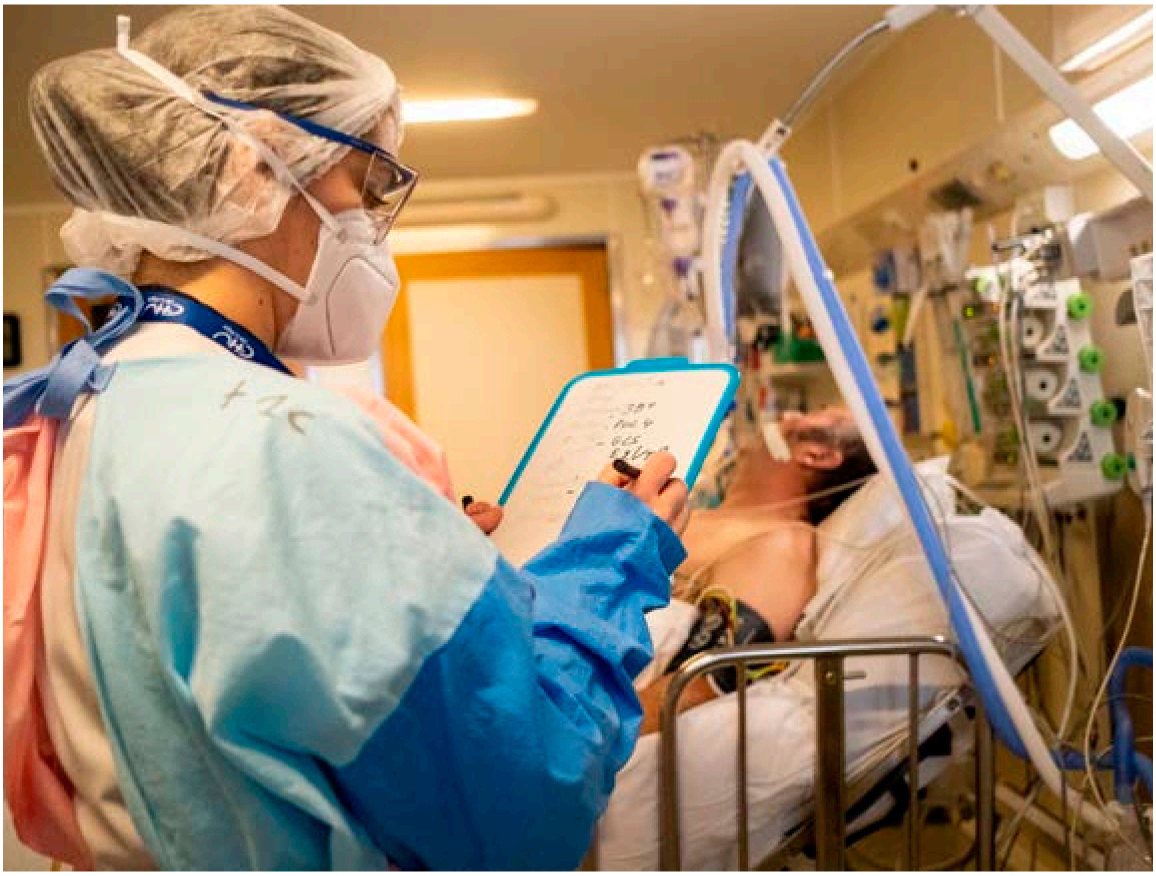
Broadly speaking, the other elements constituted more of a drag on the general government balance in 2021 than in 2020. The flooding in the summer of 2021 prompted the various authorities – and particularly in Wallonia – to engage in exceptional temporary spending. What is more, the regional authorities devised wide-ranging recovery plans to kick-start the economic recovery after COVID-19. Meanwhile, a number of structural measures came into effect, which will steadily push up expenditure in the future, such as higher wage subsidies in health care and minimum social benefits as decided by the federal government.

Lastly, interest charges were under no pressure from the financial markets. Additional and rollover debt was still funded free of charge and thus a lot cheaper than in the past. Continued asset purchasing by the Eurosystem helped to keep interest rates down.

The continuation of expansive fiscal policies in 2021 was imperative to absorb the ongoing repercussions of the pandemic. As economic activity reverts to its potential level, however, support measures will have to be wound down at an appropriate pace and Belgian public finances will need to be structurally consolidated (see section 7.4).

Improved balance mostly at federal level

The federal government's, social security's and Communities' and Regions' deficits declined but remained high. At 4.3 % of GDP, the federal deficit was significantly higher than in the Communities and Regions, which were 1.9 % of GDP in the red. That said, the federal government and social security did notch up a major improvement of 2.4 percentage points, as it is at this policy level that the bulk of the automatic stabilisers kick in, and so it was the federal government that benefited more from the economic revival. At the regional, level the deficit improvement was stymied by expenditure on the economic recovery and arising from the floods. And lastly, local government balanced its budget, as additional spending related to the coronavirus crisis and the floods was to a large degree offset by transfers from the Regions and the federal government.



6.3 Crisis-related support measures gradually wound down

In 2021, government authorities again implemented or extended temporary support measures to mitigate the impact of the health crisis. Though still significant, the overall amount was less sizeable than it had been in 2020: estimated at € 13.9 billion in 2021, compared with around € 20.4 billion in 2020.

A large number of measures was either extended or implemented in the first half of 2021, while subsequent months saw these gradually wound down as the public health situation improved and the green shoots of recovery spread across all sectors of the economy. Some sectors of activity that had faced more exacting restrictions than others received more support and for longer. As the public health situation took a turn for the worse towards the end of the year, a number of support measures were reactivated.

The federal government (and that includes social security) still assumed the bulk of the spending to

Table 6.2

Temporary measures[1] to mitigate the impact of the crisis have eased compared with 2020, but remained significant

(impact on general government budget balance; in € billion, unless otherwise stated)

	Federal government and social security		Communities and Regions		Total[1]		*p.m. In % of GDP*	
	2021	**2020**	**2021**	**2020**	**2021**	**2020**	**2021**	**2020**
Health crisis management	3.1	3.9	0.8	1.1	3.9	4.9	*0.8*	*1.1*
Income support to households	5.2	8.4	0.0	0.4	5.2	8.7	*1.0*	*1.9*
Furlough scheme benefits	1.9	3.9	0.0	0.0	1.9	3.9	*0.4*	*0.8*
Bridging allowance for self-employed	2.1	3.3	0.0	0.0	2.1	3.3	*0.4*	*0.7*
Other social benefits and premiums	1.3	1.1	0.0	0.4	1.3	1.5	*0.3*	*0.3*
Support to companies	2.4	2.6	2.4	4.2	4.8	6.8	*0.9*	*1.5*
Premiums for forced closures or massive revenue falls	0.3	0.7	1.9	2.7	2.3	3.4	*0.5*	*0.7*
Solvency-boosting tax measures	0.4	0.7	0.0	0.0	0.4	0.7	*0.1*	*0.1*
Support to specific sectors and other	1.7	1.3	0.4	1.5	2.1	2.8	*0.4*	*0.6*
Total	10.7	14.8	3.2	5.7	13.9	20.4	*2.7*	*4.5*
p.m. In % of GDP	*2.1*	*3.2*	*0.6*	*1.2*	*2.7*	*4.5*		

Sources: FPS Policy and Support, FPS Finance, FPS ELSD, FPB, Communities and Regions, NBB.

1 Excluding structural measures to provide additional funding for health care and the plan for the overall recovery.

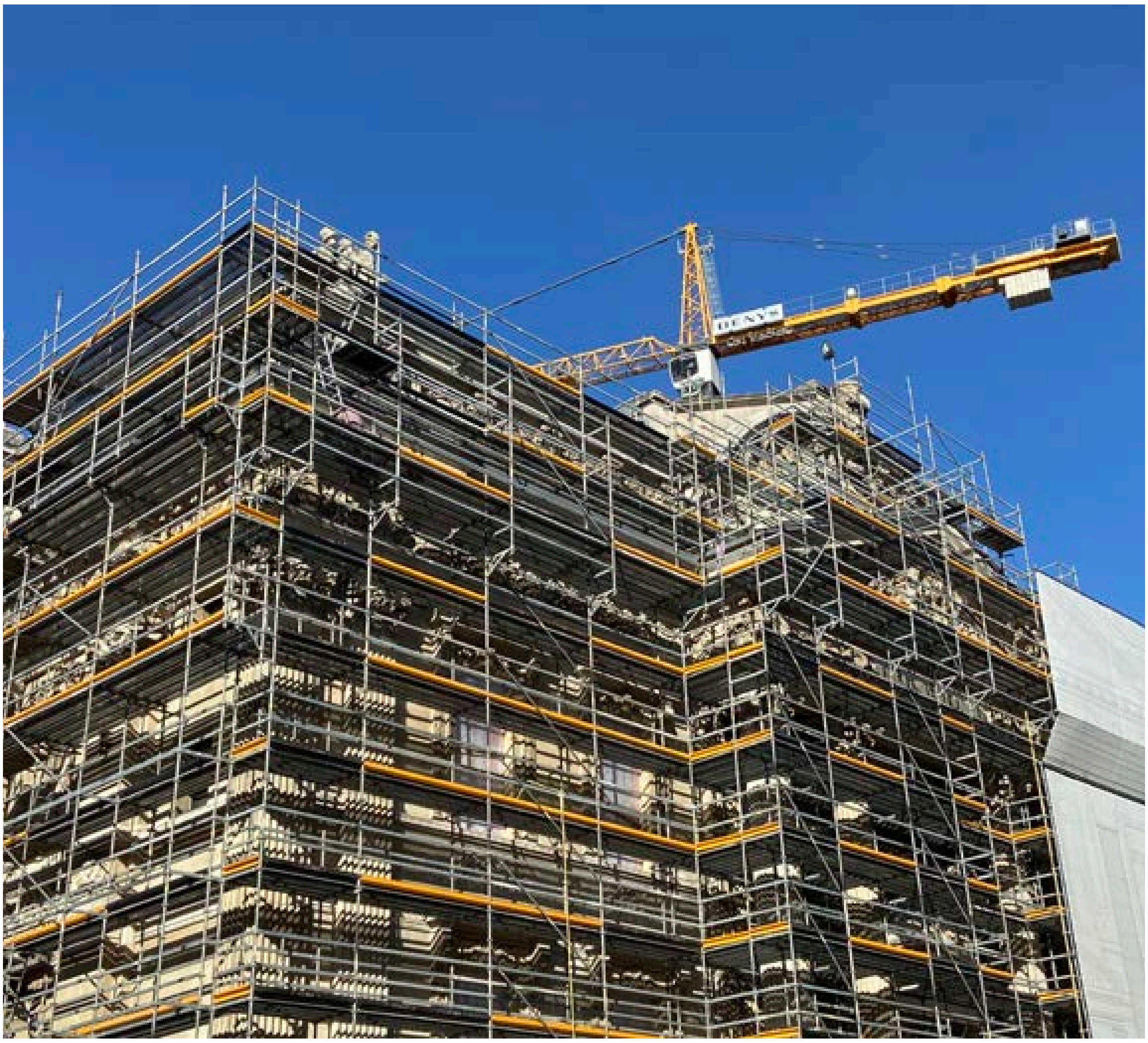
2 Excluding measures taken by local government. Some municipalities decided to abolish, reduce or suspend local taxes on businesses (on outdoor seating, tourist overnight stays, etc.) and/or handed out vouchers and other bonus payments.

mitigate the health crisis, not ignoring the key role the Communities and Regions were playing in contact tracing, testing, and establishing and running vaccination centres.

The federal government (and that includes social security) also propped up household purchasing power: throughout 2021, employees were still able to access furlough schemes, and self-employed workers could still benefit from the bridging allowance. The budgetary costs of both sharply declined in 2021, albeit less so for the bridging allowance, as at the end of 2020 self-employed workers had been offered a double bridging allowance if forced to stop trading. More specific assistance was also provided to vulnerable households in 2021, to the same degree as it had been in 2020. This served to freeze the tapering of unemployment benefits, while some social benefits – monthly payments to beneficiaries of integration incomes, old people's guaranteed income and disability benefits – were, in fact, adjusted upwards. At the end of 2020, the government also decided to extend its social energy rate, which came into force in 2021.

Temporary and focused support still necessary to get hard-hit companies and households through the crisis

In 2021, companies received help from both the federal government and the Regions. Support by the Communities and Regions to companies and self-employed workers nearly halved compared with 2020, whereas that extended by the federal government stayed closed to the levels estimated for 2020. Together, these discretionary support measures totalled € 4.8 billion in 2021.



Compared with the measures taken in 2020, the three Regions again granted allowances to companies that were still turning over significantly less than they had done before the health crisis and to those forced to close during part of the year. Most of these regional allowances were discontinued in the summer or in early autumn. Some payments had been lump sums and not systematically linked to actual losses incurred because of COVID-19 or consistent with companies' fixed costs. Meanwhile, any such regional allowances and assistance provided in the wake of the pandemic remained exempt from tax by the federal government, while a range of tax measures agreed in 2020 did not show up in the budget until after some time lag. Examples include tax carry-backs for company losses incurred in 2020, the reconstruction reserve and the investment allowance.

Lastly, certain sectors received targeted assistance if they were particularly hard hit by the public health measures, e.g. tourism, culture and events, as well as the hospitality businesses. As in 2020, when a similar measure was introduced, VAT rates were temporarily cut on restaurant services and the sale of alcoholic beverages. In a broader sense, the federal government waived employers' contributions towards annual holiday for employers who had put in place the furlough scheme. It also agreed reductions in social security contributions to encourage employers to stop using furlough and to put their staff back to work as soon as possible. To encourage entrepreneurs in construction, VAT rates on demolishing buildings and rebuilding residential property were lowered to 6 % until the end of 2022. And the country's national rail company SNCB received support to offset losses due to reduced train use.

Such support measures will gradually have to be replaced by structural policy measures to encourage transition to viable economic activity. Support measures are at their most effective when temporary, time-limited and targeted on households and companies that actually need them – and must be discontinued as soon as the economy is showing signs of sufficient recovery.

6.4 Other factors also determined how primary expenditure and revenue developed

Revenue and primary expenditure were driven by a number of factors other than temporary coronavirus measures. Disregarding the latter, primary expenditure recorded growth that – if taken together for the past two years – may be considered in line with potential nominal GDP. Revenue (in which coronavirus measures had a minor part to play) staged a robust recovery when compared with 2020, as did economic activity, although it is still lagging far behind the potential nominal GDP trend.

Consequently, factors other than temporary coronavirus measures and the economic recovery contributed to a deteriorating budget balance.

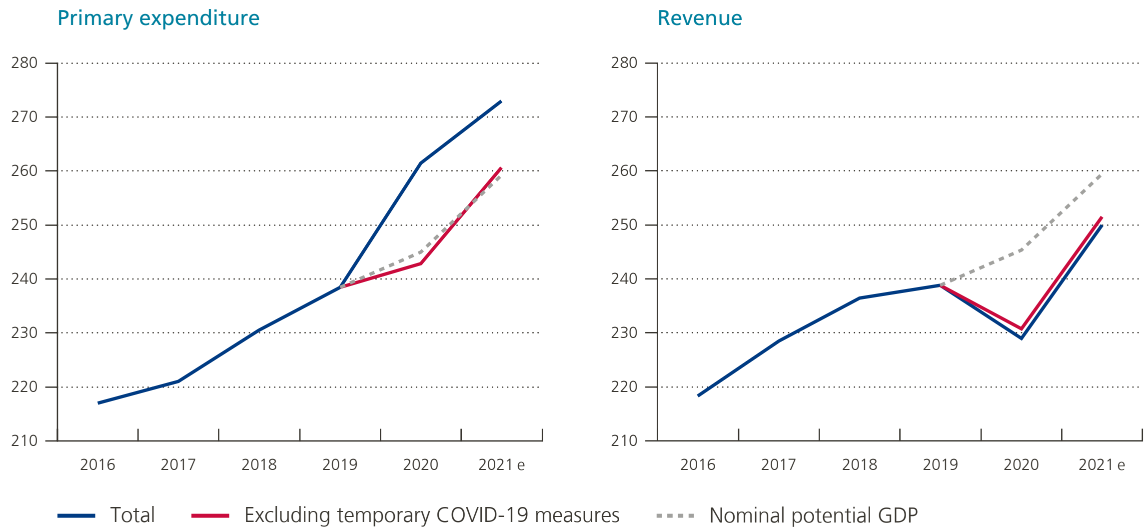
Primary expenditure driven by recovery plans and floods among other factors

To obtain a true picture of the impact of other factors on primary expenditure developments

Chart 6.4

Disregarding temporary coronavirus measures, primary expenditure grew about as rapidly as nominal potential GDP, while revenue recovery was strong but not complete

(in € billion)



1 Sources: NAI, NBB.

Table 6.3

Key primary expenditure categories [1]

(in % of potential GDP)

	2016	2017	2018	2019	2020	2021 e
Compensation of employees	12.4	12.4	12.4	12.3	12.4	12.4
Purchases of goods and services	4.1	4.0	4.1	4.1	4.1	4.1
Social benefits	24.6	24.5	24.6	24.6	26.3	26.4
Pensions	10.1	10.2	10.3	10.4	10.5	10.7
Health care	6.6	6.6	6.7	6.7	6.6	7.0
Sickness and disability	1.8	1.8	1.9	2.0	2.1	2.2
Unemployment [2]	1.3	1.2	1.1	1.0	2.6	1.9
Other	4.7	4.6	4.6	4.6	4.6	4.6
Subsidies to companies	3.7	3.6	3.7	3.8	4.6	4.3
Current transfers	2.2	1.8	2.0	2.0	2.8	2.7
Gross fixed capital formation	2.4	2.4	2.6	2.6	2.6	2.8
Other capital expenditure	0.9	0.8	0.8	0.8	0.8	1.2
Total	50.2	49.5	50.2	50.2	53.6	53.9
p.m. Total excluding temporary COVID-19 measures	*50.2*	*49.5*	*50.2*	*50.2*	*49.7*	*51.5*

Sources: NAI, NBB.

1 In 2021 primary expenditure is adjusted for the exceptional difference between GDP deflator developments and those of the automatic indexation of public sector pay and social benefits.

2 Including furlough schemes and bridging allowance.

in 2021, it is useful to strip out the temporary coronavirus measures and express the outcome as a percentage of potential GDP. It is also useful to adjust nominal primary expenditure that is automatically index-linked (such as the wages of public sector employees and social benefits) to take account of the difference between the GDP deflator and indexation based on the health index. In 2021, after all, indexation was way behind inflation as measured by the GDP deflator, temporarily keeping down the spending ratio. Following these adjustments, primary expenditure rose from 49.7 % of potential GDP in 2020 to 51.5 % of potential GDP in 2021, on the back of a range of temporary and structural factors.

The pandemic sparked various structural social agreements in the health care sector at federal, Community and regional level. These came into force in the course of the year under review and aim to raise wages and improve labour standards for people working in hospitals, nursing homes and other care facilities. In the government accounts, these pay rises are included under subsidies from the federal government and the various federated entities to the organisations under their respective authority. Adding in refinancing of mental health care, fully effective since this year, all these measures will total € 1.5 billion when fully operational.

Wage costs in the public sector likewise reflect the impact of the health crisis. In 2021, education saw an unprecedented rise in employment, partly to replace people on sick leave or in self-isolation, but also because of recruitment to offer educational and psychosocial support to students.

2021 was the first implementation year for a series of structural measures from the federal government agreement, one example being the gradual increase until 2024 of many social minimums, including old age pension, disability, unemployment and social assistance. This structural measure has no bearing on temporary monthly allowances for groups of people on benefits under COVID-19 support schemes.

The floods that hit Belgium in July had a varying impact on the public finances of the public administration sub-sectors. The federal government provided emergency assistance through civil protection and defence, while freeing up resources to help the public social welfare centres and the Red Cross. The bulk of the budgetary hit will be shouldered by the Walloon Region, as it is the Regions that are responsible for natural disasters and Wallonia faced the brunt of the disaster. In view of the caps on insurance pay-outs, the Walloon authorities soon announced they would pay for what remained of the estimated damage and so fully reimburse insured flood victims. There is also a significant, if partial, government compensation scheme in place for uninsured victims. Both schemes, totalling around € 1.5 billion for 2021 alone, are in the shape of capital transfers to households and companies. The proportion pre-funded by insurers but ultimately payable by the Region – estimated at € 1.1 billion – will be recognised as public spending in keeping with European accounting rules. Apart from these compensation payments, spending will mostly be on public infrastructure and may well be spread across multiple years.

Rebuilding infrastructure destroyed by the floods will take years

In 2021, Belgium also drew up its National Recovery and Resilience Plan, pulling together a great many recovery projects that are to be implemented in the short and medium term and that require government investment and other capital spending on the part of the federal government and the federated entities (see box 6). With this spending funded by European grants, there should be no direct implications for national budgets. That said, this spending will contribute to the government investment ratio, which the federal government is looking to raise to 3.5 % of GDP in 2024 and to 4 % of GDP by 2030.

In 2021, investment by all of Belgium's government authorities accounted for 2.8 % of potential GDP. Investment is driven by the implementation of a range of recovery plans, at the federal level as much as at the level of the Communities and Regions, and its overall scale exceeds the national plan submitted to the European authorities. The total budget for all these plans, known variously as the Federal Recovery and Investment Plan, *Vlaamse veerkracht* and *Plan de relance de la Wallonie*, adds up to around € 16 billion, of which € 5.9 billion is funded

by Europe and the rest by the entities concerned. The net effect of these plans on public finances has yet to be established, as they may include projects that were already on the drawing board and might have been implemented in normal times.

Success of recovery plans will be measured by the quality of the investment and reforms

The biggest chunk of recovery spending is supposed to be made by 2024, i.e. before the current governments' terms in office end. This schedule looks highly ambitious in view of the usual delays in construction – a problem made worse by the shortages of people and materials currently besetting the industry. The amounts actually spent in 2021, incidentally, were lower than those originally planned. Whatever the case may be, the success of these programmes will not be measured by the number of projects selected, nor by the resources committed. Whether or not these recovery plans succeed will in fact depend on the relevance of the projects that make the grade (selectivity and coherence between plans, coordination between federated entities, etc.), the efficacy of their implementation, their ability to promote corporate investment, etc.

BOX 6

The National Recovery and Resilience Plan [1]

On 30 April 2021, Belgium submitted its National Recovery and Resilience Plan, drawing on the assumption that the country stands to receive € 5.9 billion (1.2 % of GDP) in grants between 2021 and 2026. Belgium has not applied for any RRF loans.

Belgium's Recovery and Resilience Plan provides a list of planned investments and reforms towards which it wishes to put the grants it will receive. The breakdown between the various authorities is the outcome of a political agreement by the Consultative Committee, which settled on the largest portion going to the Flemish Community (38 %), followed by the Walloon Region (25 %) and then the Federal State (21 %).

The plan aims to accelerate Belgium's transition to a more sustainable, structurally stronger and more inclusive economy while at the same time to keep strengthening its social, economic and climate-related ambitions. It also supports boosting public investment and is structured around six axes of key challenges facing Belgium today. Together, the three biggest axes – Climate, sustainability and innovation, Mobility, and Economy of the future and productivity – account for over 80 % of total planned spending.

Most of the planned investment will go to renovating government buildings, improving cycling infrastructure, digital transformation of government bodies and education, and on enhancing research and development. To be eligible for the EU funds, EU Member States are required to pursue a number of ambitious reforms, including reforming pensions and end-of-career set-ups, promoting

1 For more details, see Bisciari P., W. Gelade and W. Melyn (2021), "Investment and reform in Germany, France, Italy, Spain and Belgium's National Recovery and Resilience Plans", NBB, Economic Review, December.

emissions-free transport, and spending reviews. To date, not much flesh has been put on the bones of these reforms. The plan clearly focuses on the first four years in which over 80 % of the total available grants are to be spent.

On 23 June 2021, the European Commission approved Belgium's Recovery and Resilience Plan, as formalised in a Decision adopted by the Ecofin Council on 13 July.

Belgian Recovery and Resilience Plan structured around six strategic axes
(in € billion)

Strategic axes	Planned spending		
	Total	Federal	Communities and Regions
1. Climate, sustainability and innovation	2.0	0.3	1.8
2. Digital transformation	0.8	0.4	0.4
3. Mobility	1.3	0.4	0.9
4. Social and living together	0.8	0.0	0.8
5. Economy of the future and productivity	1.0	0.1	0.9
6. Public finances	0.0	0.0	0.0
Total	5.9	1.2	4.7

Sources: Recovery and Resilience Plan, NBB.

Government revenues gradually returning to pre-crisis levels

After steep falls in 2020 – and the key role they had played as the economy's automatic shock absorber – government revenues bounced back in keeping with economic activity in 2021. The recovery was not quite complete, though, and neither was the recovery of economic activity, which still remained below its potential.

Also, revenue shrank by 0.7 of a percentage point relative to economic activity in 2021, a temporary disconnect fully attributable to relatively subdued growth of taxes on earned income and replacement incomes. First of all, the rise in income from employment smoothed in 2020 and 2021, as the drop in income from employment had been less pronounced than that in GDP in 2020 – which also happened to be the year when the tax base swelled through the massive uptake of the furlough schemes for employees and the bridging allowance for the self-employed. The flipside was that the total wage bill and replacement incomes lagged behind GDP growth in 2021. And the disconnect intensified even further in 2021, as wage indexation fell behind the growth in the price component of GDP – a temporary gap that is expected to close in the years ahead. Personal income tax being progressive, the overall tax take was still slightly ahead of the 2019 reference year. Social security contributions, by contrast, shrank by 0.2 percentage point of GDP compared with pre-pandemic levels.

Table 6.4

General government revenue [1]

(in % of GDP)

	2016	2017	2018	2019	2020	2021 e
Fiscal and parafiscal revenue	43.6	44.2	44.2	42.9	43.1	42.6
Levies applicable mainly to earned incomes	24.7	24.7	24.5	23.9	24.9	23.9
Personal income tax [2]	10.9	11.0	10.9	10.4	11.0	10.6
Social security contributions [3]	13.8	13.7	13.6	13.5	13.9	13.2
Corporate income taxs [4]	3.4	4.1	4.3	3.7	3.3	3.5
Levies on other incomes and on assets [5]	4.1	4.0	4.0	3.9	3.8	4.0
Taxes on goods and services	11.5	11.4	11.5	11.4	11.1	11.3
of which:						
VAT	6.7	6.7	6.8	6.6	6.4	6.6
Excise duties	2.7	2.7	2.7	2.6	2.5	2.5
Non-fiscal and non-parafiscal revenue [6]	7.1	7.2	7.1	7.0	7.1	6.8
Total revenue	50.8	51.3	51.4	49.9	50.1	49.4

Sources: NAI, NBB.

1 In accordance with the ESA 2010, general government revenues do not include the tax revenues transferred to the EU, nor revenues collected directly by the EU.

2 Mainly withholding tax on earned income, advance payments, assessments and proceeds of additional percentages on income tax.

3 Including the special social security contribution and the contributions of people not in work.

4 Mainly advance payments, assessments and the withholding tax on income from movable property payable by companies.

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

6 Property incomes, imputed social security contributions, current and capital transfers from other sectors, and sales of produced goods and services, including revenues on guarantees granted by the State on interbank loans.

While wages displayed relative stability, corporate earnings have been more volatile than GDP in the past two years. 2021's robust demand for products and services triggered a comparatively sharp revival of corporate earnings, prompting corporation tax revenues to advance by 0.2 of a percentage point of GDP and thus normalising these as a percentage of GDP. The same applied to VAT takings, which also benefited from higher demand. Excise duties were virtually unchanged as a percentage of GDP, pushed up by higher tobacco duties but at the same time recording clearly lower tax-based growth relative to nominal GDP growth. Excise duties happen to be correlated with consumer volume movements, whereas nominal GDP in 2021 was pushed up higher by the price component as well.

Levies on other income and taxes on property grew by 0.1 of a percentage point on the introduction of a "solidarity contribution" on securities accounts to replace the previous Securities Account Tax that had been rendered void by the Constitutional Court. More specifically, the contribution amounts to a levy of 0.15 % on securities accounts with average values of over € 1 million during a reference period.

Lastly, non-fiscal and parafiscal revenue was down by 0.2 of a percentage point of GDP, mainly caused by the denominator effect. As noted, the GDP deflator increased by a lot more in 2021 than did consumer prices, which tend to co-determine the way sales develop. In addition, any resources left in the pension funds acquired since the early 2000s – of which Belgacom was by far the biggest – had been steadily depleted. These had been funding the retirement pensions of the relevant employees, paid out by the government and making for a neutral budget balance. Budget neutrality will end, though, as these pensions will continue to be paid. Grants received towards NGEU spending in 2021 exerted a positive effect on non-fiscal revenue to the tune of around 0.1 % of GDP.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6.5 Public debt and interest charges

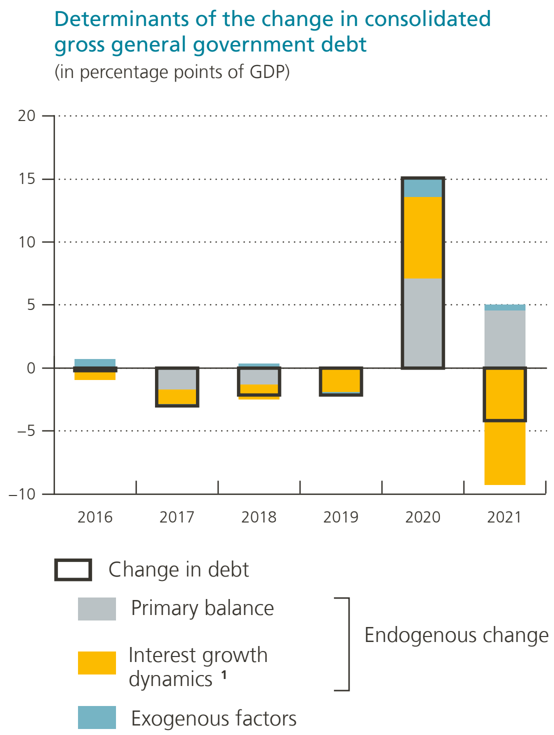
The fall in the debt ratio is only a temporary phenomenon on the back of reviving economic growth

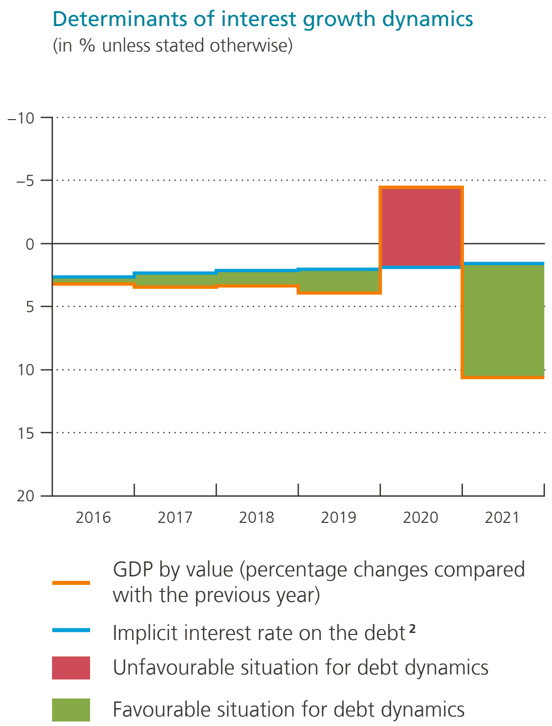
By the end of 2021, the Belgian government's debt ratio stood at 108.6 % of GDP. As a result, public debt shrank by 4.2 percentage points compared with the previous year, when the pandemic had fuelled an exceptional surge. Actual levels remain high, though: 10.9 percentage points up on the end of 2019 and nearly 12 percentage points higher than the euro area average (see chapter 7).

The 2021 drop is largely down to steep growth in nominal GDP on the back of a return to normal economic activity. This temporary effect strongly benefited the debt ratio denominator and was a major factor in growth exceeding the implicit

Chart 6.5

Debt ratio benefited from revived economic growth





Sources: NAI, 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 Ratio between interest charges in the current year and debt at the end of the previous year.

interest rate on public debt. The difference, which is further enhanced by historically low interest rates, currently constitutes the endogenous determinant causing a downward effect on debt ratio dynamics. Conversely, the primary balance – which is recording a significant deficit – is responsible for an upward effect on public debt.

Exogenous factors, which influence debt but do not affect the overall balance, pushed up debt by 0.5 of a percentage point. Some economic support measures taken because of the COVID-19 crisis, for instance, exerted an upward effect on the debt ratio, more specifically government loans and stakes in private companies and the discontinuation of the so-called December advance on payroll withholding tax. Under the ESA methodology used in the national accounts, such payment deferral does not affect the year's budget balance, as revenue postponed in this way will be recognised in the economic activity year in which it arises. However, this does mean that the government has to borrow more at the end of the year and that its debt is therefore temporarily higher.

Loans granted by the Flemish Region under its social housing policies also pushed up debt.

Other exogenous factors partly offset the upward effects described above : pre-funding of European grants for Belgium under the NGEU and the Brexit Adjustment Reserve (BAR) pushed down debt, for instance. The proportion of pre-funding received but not spent on projects in 2021 is not recognised in the balance, but does reduce the debt to be financed. This impact is only temporary, however, and will be neutralised in the years ahead as financed projects progress.

Another exogenous factor that helped push down government debt temporarily relates to the damages disbursed to flood victims, which are being paid by the Walloon Region. Although only a proportion of these payments had actually been made to these beneficiaries, the total estimated amount was already recognised in the 2021 budget balance. The difference between these two sums temporarily reduced government debt, as the government did not have to borrow this amount.

The exogenous factor that contributed most to the debt reduction was the accounting adjustment for debt instruments' issue premiums. The Belgian Debt Agency has issued multiple securities at issue values in excess of their nominal values. At maturity, investors will therefore be repaid a lower amount than they laid out in the first place. In the first year of issue, such premiums have a favourable effect on government debt, but this is offset by an upward effect on the debt ratio in subsequent years, until the debt instruments mature.

Interest charges continue their downward trend

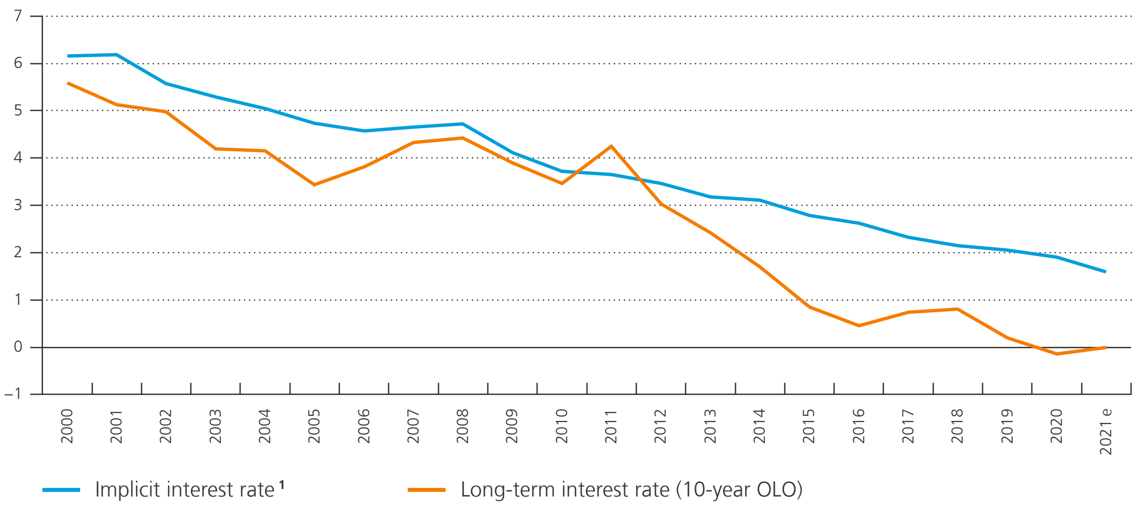
Interest charges kept moving down in 2021, narrowing by 0.3 percentage point of GDP compared with their 2020 levels. Financing conditions remained very favourable, with the reference rate on ten-year bonds at nil across the year, even if it edged up compared with 2020 (–0.1 %). By the end of December, long-term yields were found to be rising. In terms of short-term debt, 2021 yields on Treasury Certificates came down slightly from 2020, meaning that the federal government was again rewarded for short-dated issues as well as for various longer-dated issues in 2021. Three-month Treasury Certificates to the tune of around € 1 billion, for instance, were being financed at record negative rates of –0.93 % by December 2021.

The fall in interest rates in the past few years and their stabilisation at low levels has made it possible for the government to refinance its debt using issues at lower interest rates than those on maturing instruments, steadily reducing the public debt's implicit interest rate.

At a given level of debt, interest charges fall when market rates on new issues are below yields on instruments that are maturing. At the federal level, the OLOs that matured in 2021 and that will need to be rolled over in 2022 had still been issued at average interest rates of between 3.5 % and 4 %. Unless 2022 sees interest rates really take off, interest charges will continue to contract in 2022. However, if debt is not wound down, refinancing gains will start to fall, as instruments due for refinancing will be commanding lower rates from 2023.

Chart 6.6

Low interest rates continue to push down implicit interest rate

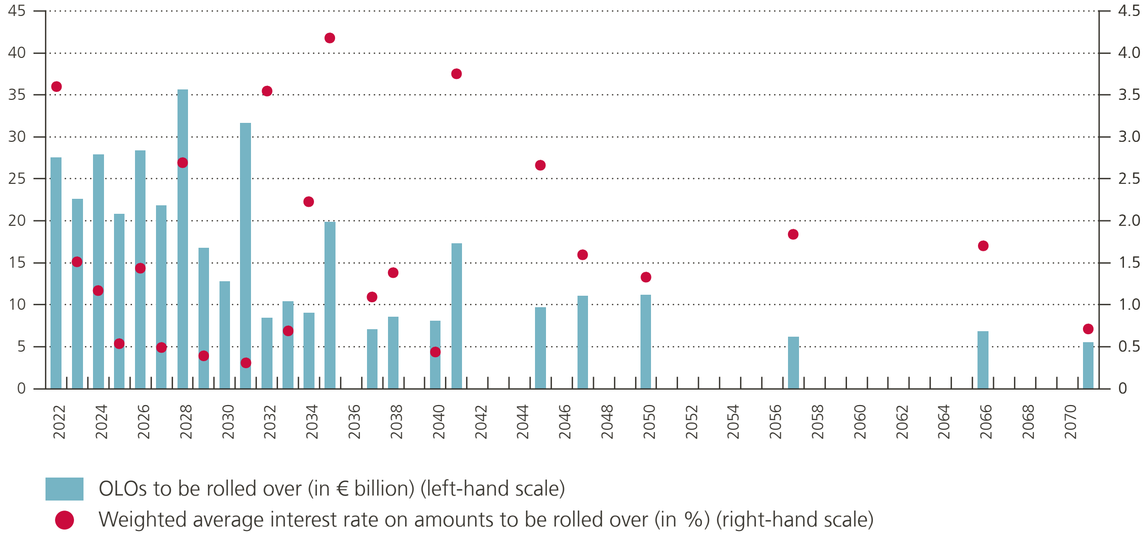


Sources: NAI, NBB.
1 Ratio between interest charges in the current year and general government debt at the end of the previous year.

Chart 6.7

Margins to reduce interest charges should narrow beyond 2022

(maturity of federal government's long-term debt (OLOs), end-2021)

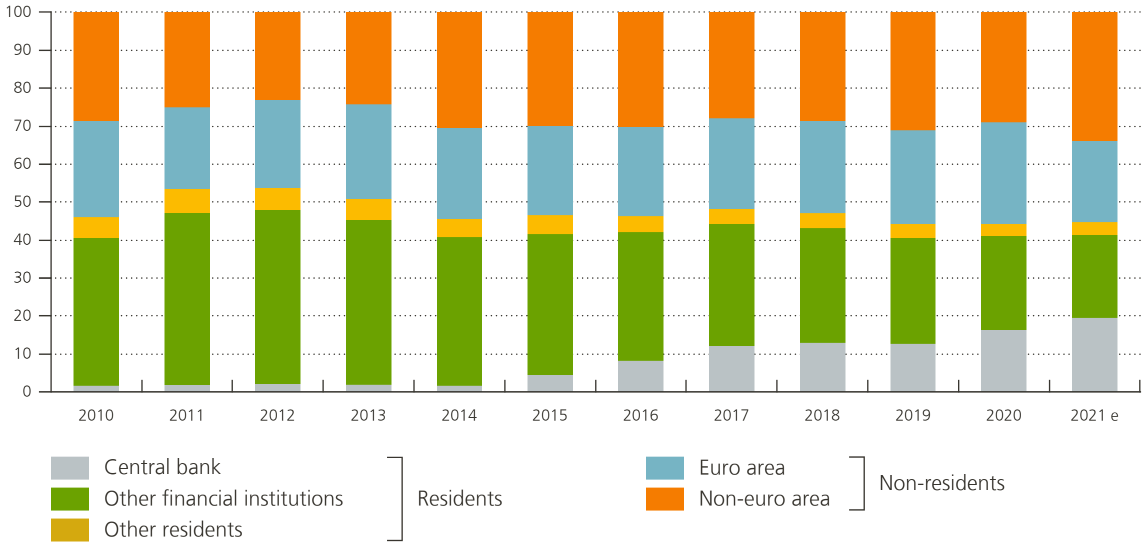


Sources: Belgian Debt Agency, NBB.

Chart 6.8

Proportion of NBB-held public debt on the rise

(breakdown of general government's consolidated gross debt by holder [1])



Source: NBB.
1 For 2021: estimate for situation as at 30 September.

Public debt maturity still rising

Debt issued by the Belgian Debt Agency in 2021 commanded an annual interest rate of 0.14 % and an initial maturity of 18 years, the longest ever. Once again, a range of very long-dated loans were issued, a number of which will mature in 2071. As a result, the remaining term to maturity of total federal debt increased further in 2021. The remaining term to maturity of government debt, which had stood at around six years by the end of 2010, had gone up to ten years and one month by the end of 2021, its highest level on record.

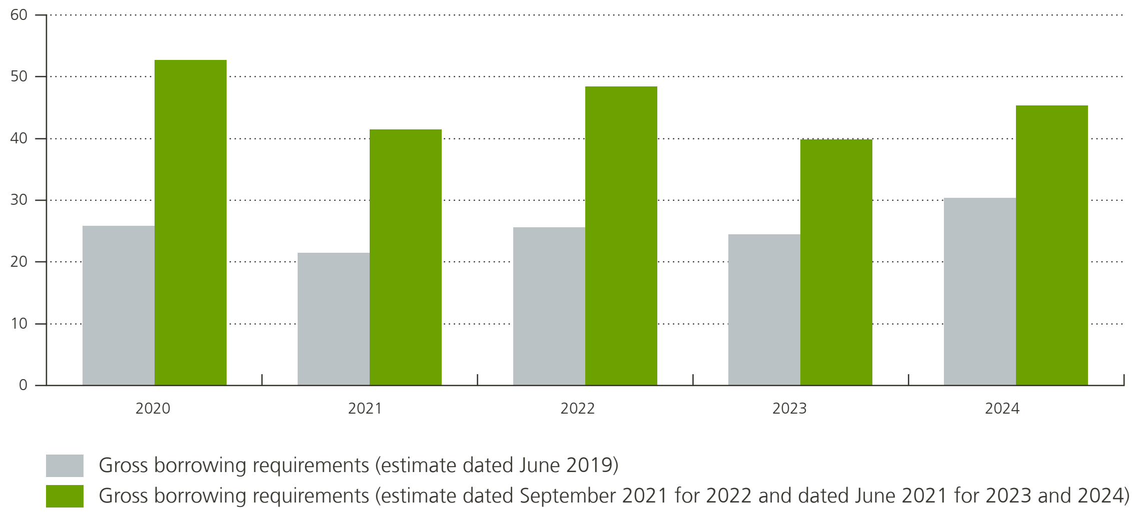
For a number of years now, those who manage government debt have viewed lower interest rates as an opportunity to reduce the refinancing risk at lower cost, a policy that was gradually deepened as market rates continued to fall. By staggering the maturity dates of long-dated debt, refinancing volumes falling due can be limited – and these volumes can be substantial in highly indebted countries such as Belgium.

In the secondary markets, the proportion of debt held by the Bank has been steadily growing since 2015 under the Eurosystem's asset purchasing programmes, taking up over 19 % in 2021 compared with less than 2 % of outstanding debt in 2014. The proportion of debt held by other Belgian residents – and particularly financial institutions – has fallen to the same degree. Over half of Belgian public debt is held by non-residents.

Chart 6.9

Gross borrowing requirement[1] on the rise since the start of the pandemic

(federal government, in € billion)



Source: Belgian Debt Agency.

1 The federal government's gross borrowing requirement covers, on the one hand, the current year's deficit and, on the other, early debt repayments and refinancing of debt reaching maturity.

Gross borrowing requirements raised since start of pandemic

Gross borrowing requirements include both funding of the current year's deficit and refinancing of maturing debt. These requirements are largely covered by OLO issues, which account for over 85 % of outstanding federal public debt.

Increased borrowing requirements are making Belgium more vulnerable to liquidity crisis

The COVID-19 crisis has had significant repercussions for the government budget since 2020, mostly because of the numerous support measures taken. In future, deficits are likely to stay higher than they were before the pandemic – and these deficits will also have to be financed in the markets.

Although extended debt maturity has enabled the Belgian government to better spread annual refinancing volumes, a large deficit does imply an upward revision of the gross borrowing requirements, making Belgium more vulnerable to a liquidity crisis event and potential interest rate rises. It is precisely for that reason that it started increasing the average maturity of government debt in 2010.

Asset purchases by the Eurosystem have had a downward effect on yields, but it would be unwise to base fiscal policy and debt management on the assumption that these favourable financing conditions will continue in the medium to longer term. Belgium's public finances should be consolidated and the country needs a sufficiently high primary balance to reduce future liquidity risks to public debt.