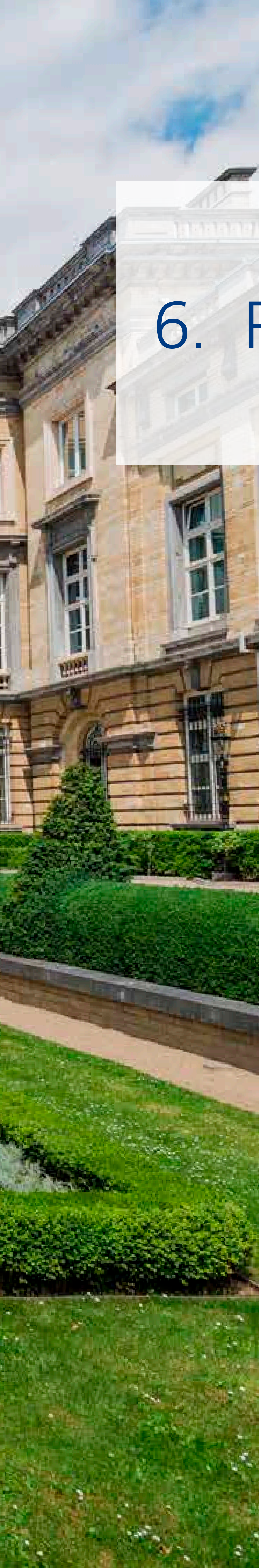

6. Public finances

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6.1 Overview of Belgium's fiscal position and the European fiscal framework

The budget balance improved considerably after the pandemic died down, but as the energy crisis intensified public finances once again came under pressure

In 2022, the budget deficit continued to fall, to 3.9 % of GDP. However, it remained under pressure due to the new measures adopted in response to the energy crisis and Russia's invasion of Ukraine. The budget balance recovered thanks to discontinuation of the temporary measures introduced to support the economy during the pandemic, which led to an improvement of around two percentage points of GDP, and the strengthening of the economy. Both of these factors led to a further reduction in the primary expenditure ratio. For its part, the revenue ratio fell back slightly under the effect of the measures introduced to moderate energy prices.

The recovery of the economy, which almost reached potential output, gave rise to a reduction in primary expenditure of 0.8 percentage point of GDP. The denominator effect of primary expenditure illustrates the impact of the business cycle on the expenditure ratio. It expresses the difference between primary expenditure as a percentage of GDP and as a percentage of potential GDP. If GDP is below potential, the primary expenditure ratio goes up and the balance deteriorates. Consequently, a rebound in activity lowers the expenditure ratio.

On the other hand, Russia's invasion of Ukraine and the aggravation of the energy crisis

Table 6.1

General government budget balance and debt

(in % of GDP)

	2017	2018	2019	2020	2021	2022 e
Revenue	51.3	51.4	49.9	49.9	49.9	49.8
of which: Taxes and social security contributions	44.2	44.2	42.9	42.9	43.1	42.9
Primary expenditure	49.7	50.1	49.9	57.0	53.8	52.2
Primary balance	1.7	1.3	0.0	−7.0	−3.9	−2.4
Interest expenses	2.4	2.1	2.0	1.9	1.7	1.5
Overall balance	−0.7	−0.9	−1.9	−9.0	−5.6	−3.9
Public debt	102.0	99.9	97.6	112.0	109.2	105.0

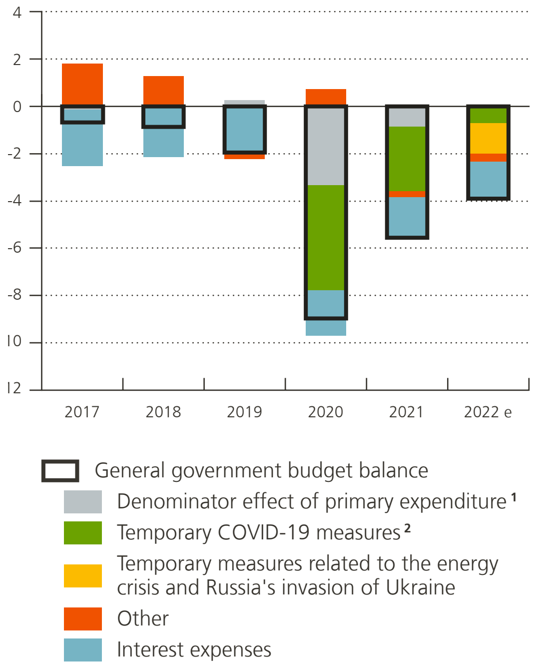
Sources: NAI and NBB.

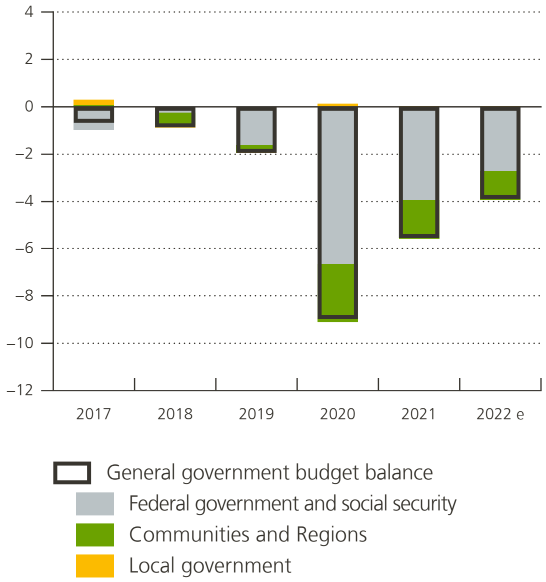
Note: It was more complex to estimate the budget balance in 2022 due to the limited amount of data available on taxes withheld from earned income and on corporate and personal income tax assessments. This can be explained by, amongst other factors, the possibility to obtain a tax deferral owing to the energy crisis. Payments deferred until 2023, but for which the deferral was granted in 2022, were in fact charged to fiscal year 2022 for accounting purposes.

Chart 6.1

Crisis measures hampered improvement of the budget balance

(general government budget balance, % of GDP)





Sources: NAI and 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 included spending on furlough schemes and the bridging allowance.

negatively impacted the budget balance. The significant increase in energy prices and the conflict between Russia and Ukraine obliged the government to take measures. Thus, on the heels of the pandemic, the government had to tackle new challenges, which slowed the recovery of public finances. The measures adopted mitigated the consequences of this new crisis on the economy.

Temporary measures taken in response to the energy crisis and Russia's invasion of Ukraine, which changed the balance by around 1.3 percentage points of GDP, mainly focused on lowering energy prices. These included a reduction in the VAT rate on electricity and natural gas and lower excise duties on petrol and diesel along with an expansion of the "social tariff" to a wider target group. These schemes provided direct support for household purchasing power. Furthermore, Russia's invasion of Ukraine pushed governments to commit to additional spending to provide humanitarian assistance to Ukraine and refugees arriving in Belgium.

The public deficit is mainly concentrated at federal level. The deficit of the federal government and social security fell by 1.3 percentage points of GDP, but remains very high. This level of government benefited more from the economic recovery as it encompasses most of the automatic stabilisers. It was also the federal government that mainly benefited from the continued withdrawal of COVID-19 support measures. Conversely, most of the measures introduced to face the energy crisis negatively affected the budget balance of the federal government and social security. At the regional level, deficits also shrunk modestly, by 0.4 percentage point of GDP, after the ending of most temporary COVID-19 support measures. As in the previous year, local governments came close to balancing their budgets thanks to *inter alia* transfers received from the federal government for the reception of refugees from Ukraine.

Interest expenses were again slightly down in 2022, despite the sharp increase in short- and long-term interest rates. High inflation and the subsequent tightening of monetary policy pushed up both short- and long-term interest rates. Consequently, deficits can no longer be serviced free of charge. Given the long maturity of public debt, however, the rise in interest rates will only gradually impact interest expenses. These fell somewhat further in 2022, as maturing debt can still be refinanced at a more favourable rate.

The sharp increase in prices temporarily reduced the debt ratio, but exacerbated medium-term structural challenges. In 2022, Belgium's debt ratio fell by 4.2 percentage points to 105 % of GDP. This decrease can be explained by a clear increase in the denominator, nominal GDP, as a result of high domestic inflation, combined with a historically low average interest rate on outstanding debt (the implicit interest rate). However, the fall in the debt ratio is unlikely to last due to the expected persistence of heavy primary deficits over the next few years, the normalisation of nominal GDP growth and the gradual increase in the implicit interest rate.

In general, fiscal policy remained accommodative in 2022. The main objective of this expansionist policy, characterised by a wide deficit, was to provide immediate support for household purchasing power. However, in order not to further strain public finances, such measures should target the most vulnerable groups, insofar as possible, and be financed by economic agents that benefit from soaring energy prices. In addition, for purposes of efficiency, price signals should be maintained to the extent possible, so as to also take into account the environmental impact of energy consumption. Moreover, given the level of the public deficit and debt, structural consolidation of Belgian public finances is required.

The suspension of the European fiscal rules was extended

The general escape clause of the European fiscal framework remained applicable in 2022. The Economic and Financial Affairs (Ecofin) Council activated this clause in March 2020, at the start of the COVID-19 crisis. In the spring, it was extended for a second time until the end of 2023. This extension was justified by heightened uncertainty and strong downward risks to the economic outlook in the wake of Russia's invasion of Ukraine, the unprecedented rise in energy prices and continued supply chain disruptions. The activation of this clause allows application of the European fiscal rules to be eased, thereby offering the possibility of a temporary derogation, provided doing so does not jeopardise the medium-term sustainability of public finances. That being said, the Stability and Growth Pact procedures remain in place, and the annual budgetary surveillance cycle continues.

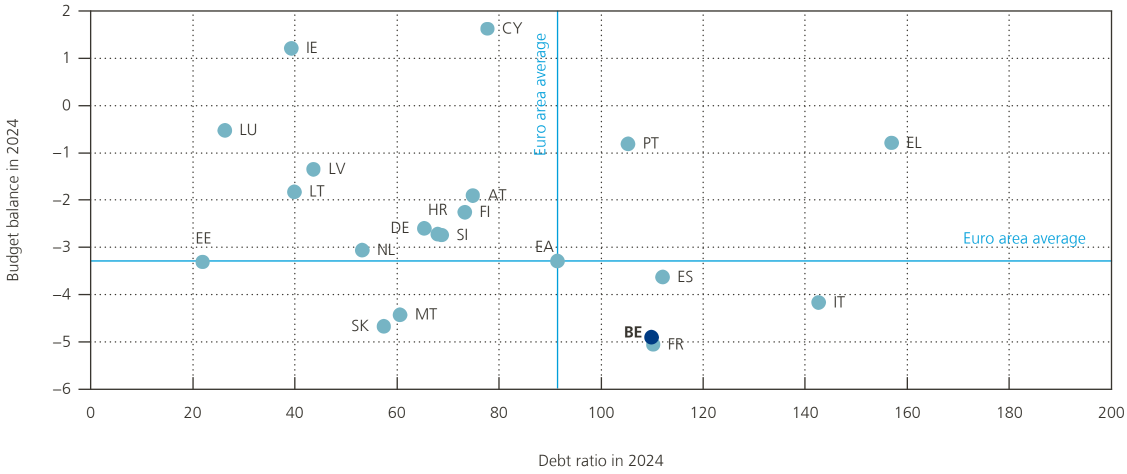
The 2022 country-specific recommendations remained largely qualitative, while calling for more differentiated fiscal policies. In June 2021, the Ecofin Council recommended that Belgium use the funds from the Recovery and Resilience Facility (RRF) of the European Recovery Plan to finance additional investment in 2022 to boost economic recovery while, at the same time, pursuing a prudent fiscal policy. It also recommended preserving nationally financed investment.

The 2023 country-specific recommendations, approved in June 2022, were more detailed than those for the previous year. In particular, the Ecofin Council recommended that, in 2023, Belgium keep growth in public expenditure financed at national level – corrected for temporary, targeted support for Ukrainian refugees and for households and companies most vulnerable to rising energy prices – below medium-term potential output growth. Furthermore,

Chart 6.2

Both the public debt ratio and the budget deficit are structurally high in Belgium

(% of GDP)



Sources: EC and NBB.

it was asked to stand ready to adjust current spending to the evolving situation. Finally, it was advised to expand public investment in the green and digital transitions and in energy security.

Suspension of the European fiscal rules runs counter to the pressing need to consolidate public finances in Belgium. Belgium is one of the worst performing countries in the euro area in terms of its budget balance and public debt. In 2022, Belgium's debt ratio was one of the highest in the area. Moreover, it is on course to worsen further in the coming years, unlike most other countries with a high debt ratio, due to a still hefty budget deficit. This is extremely concerning for the sustainability of Belgian public finances.

6.2 High inflation considerably impacted public finances

Inflation automatically led to a sharp increase in most forms of revenue and primary expenditure, although the effects on the primary balance remained limited in 2022

Inflationary pressures did not as such lead to a deterioration of the primary balance in 2022, but are expected to do so in the coming years. The budget balance even benefited temporarily from the delayed indexation of some expenditures and of the tax brackets applicable to certain revenue. These factors are however expected to change direction in the coming years, causing indexation to, this time, exceed the rise in domestic prices, if the latter develop as expected. In addition to these intrinsic effects, the nature of the inflationary shock, which was mainly due to supply-side disruptions, led to an impoverishment of the national economy, penalising public finances. The government responded to inflation by adopting a range of discretionary measures which had a clearly negative impact on the budget balance, as explained below.

Taxes on earned income increase in tandem with wages, which are adjusted based on the smoothed health index. Wage indexation takes place with a certain time lag, reflecting the various mechanisms used in different sectors of the economy. In addition, social security contributions, the rates for which are relatively uniform, are directly linked to the adjustment of wages. The latter also determines the evolution of personal income taxation, although the characteristics of the progressive nature of this tax require that additional factors be taken into account. Thus, inflationary pressures lead to a mismatch between adjustment of the tax brackets for taxes withheld from earned income, which are indexed based on the lower inflation figure for the previous year, and of wages, which are indexed more quickly. In 2022, the tax brackets were adjusted for indexation by approximately 2.3 %, while wages were indexed at 6.2 %. Consequently, the additional income received by taxpayers is taxed at a marginal rate above the previously applicable average rate. This leads to a temporary increase in the average tax rate, which is greater for the minority of taxpayers whose additional income falls into a higher tax bracket. The resulting temporary increase in tax revenue is neutralised when the tax brackets are adjusted in subsequent years.

The downward pressure on companies' margins, which may be expected when costs rise, did not curb growth in corporate tax revenue in 2022. Exogenous inflation causes rising costs for companies. The inability to pass these higher costs through in full to sales prices could affect their profit margins and therefore government tax revenue. In 2022, corporate profit margins remained high from a macroeconomic perspective, driven by the beneficial impact of the post-COVID-19 economic recovery. An increase in advance tax payments by companies remained noticeable throughout the year. Overall, given a fall in tax assessments which continues to reflect, with some delay, firms' poorer earnings during the COVID-19 crisis, corporate tax revenue, adjusted for the temporary measures introduced to combat the COVID-19 and energy crises, grew slightly more slowly than GDP.

Most tax revenue on goods and services, with the notable exception of excise duties, is directly and immediately correlated with a rise in consumer prices. VAT is applied directly to consumer prices and therefore closely reflects the sharp rise in inflation. On the other hand, excise duties are fixed amounts levied per unit sold and are only adjusted for inflation if their nominal amount is revised to this end, with such revisions being rare. That being said, the government has a certain flexibility to adjust excise duties for other reasons and effectively increased the duties on tobacco during the year. VAT and excise revenue also benefited from the persistent increased demand for goods and services which followed the COVID-19 crisis. Excluding the measures taken to deal with the energy crisis, VAT revenue rose by 10.1 % and excise revenue by 9.6 %.

Inflation influences taxes and levies on investment income and other income with a certain time lag. Withholding tax revenue, which is linked, with a delay, to corporate earnings, is expected to be adversely affected by inflation. In 2022, it was exceptionally high given the large profits recorded in 2021. Other types of tax revenue, on the other hand, tend to rise along with prices. In the case of property tax, cadastral income is explicitly indexed based on the consumer price index for the previous year. For other levies, the relationship with the rise in consumer prices is less automatic. Revenue from registration duties when purchasing a property for example, depends on property prices, which may have different dynamics than consumer prices. In 2022, tax revenue from investments and other income contracted slightly relative to GDP.

A large share of public expenditure is very sensitive to price changes, particularly through automatic indexation. This mechanism applies to

Chart 6.3

Change in tax revenue and primary expenditure, adjusted for the temporary measures related to COVID-19, the energy crisis and Russia's invasion of Ukraine [1]

(nominal percentage growth; in parentheses: weight of categories as a percentage of GDP in 2021)

Sources: NAI and NBB.

1 Including the decisions related to funding the measures.

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

3 Mainly taxes withheld from earned income, advance tax payments, tax assessments and the proceeds from surcharges on personal income tax.

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

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

6 Mainly withholding tax paid by individuals, property tax (including the proceeds from surcharges), inheritance taxes and registration duties.

7 Income from assets, imputed social contributions, current transfers and capital transfers from other sectors, plus sales of goods and services produced, including income on state guarantees for interbank loans.

8 Adjusted for the impact of the measures taken following the July 2021 floods.

social benefits and the remuneration of government employees, which are raised by 2 % one and two months, respectively, after the smoothed health index crosses the trigger threshold, which occurred five times in 2022. Given this staggering of indexation, the average annual pay rise was 7 % to 8 %, thus less than the increase in the health Index. This discrepancy will only be made up in 2023, when the rate of indexation is likely to exceed that of inflation. Overall, automatic indexation has a significant impact on public finances, insofar as the categories concerned represent approximately half of primary expenditure. With regard to social benefits, however, there is a notable exception, namely family allowances in Flanders, for which it was decided to raise the rate of annual increase for a significant portion of the base amounts, from 1 % to 2 %, as from 2022.

By default, inflation affects healthcare expenditure with a time lag. The annual federal healthcare budget includes a real growth target, currently set at 2.5 %, to which an indexation figure is added to account for changes. This figure is based partly on expected automatic wage indexation and partly on the change in the health index over the previous year. While this model works well when inflation is steady, it can be slow to react in the event of sudden price rises. Consequently, during the spring budget review, an envelope was allocated to permit the National Institute for Sickness and Invalidity Insurance (INAMI) to grant an additional allowance to healthcare providers in the context of surging inflation. Despite this allocation, which has since been deducted from the 2023 budget, total healthcare indexation barely exceeded 2 % in the past year. It should be noted that within the budgetary target, a series of subsidies, such as the advance to hospitals further to the health crisis, fell significantly. On the other hand, healthcare categorised as social benefits rose more sharply.

Typically, operating and investment credits are not automatically linked to inflation. In other words, the possibility and extent of their revaluation form the object of a political decision. In general, budgets for these items were not raised in line with the level of inflation observed in 2022. At the federal level, the government limited operating and investment credits to 2.9 %, with the exception of energy expenses which were indexed by 32.5 %. In Flanders, apart from a few exceptions, operating credits were frozen. In both cases, public spending was necessarily restricted in order to stay within the

allocated budget given the marked increase in the prices of everyday goods and services and investment projects. Substantial savings were therefore made in real terms.

With regard to residual expenditure, it can be indexed in full, in part or not at all, as the case may be. At the federal level, the SNCB's annual operating grant is indexed based on the change in prices measured at the end of the previous year. Exceptionally, the railway operator was granted additional assistance during the year, intended to help absorb the increase in both workers' wages and the energy bill, so as to avoid an increase in ticket prices. The budget allocated to the social (energy) tariff, classified as a miscellaneous social benefit, is closely linked to energy inflation as it cushions the increase in gas and electricity prices for eligible households. Some reductions in social security contributions, considered subsidies, are adjusted in tandem with the wages to which they relate. Exemptions from taxes withheld from earned income were moreover temporarily inflated by the time lag in adjustment of the tax brackets. At the regional level, the subsidies granted to approved service voucher companies are adjusted automatically when the trigger index is crossed.

High inflation and Russia's invasion of Ukraine led to a large-scale discretionary policy response

Fiscal policy was once again accommodative in 2022, not only in order to mitigate the impact of higher energy prices but also in response to Russia's invasion of Ukraine. The temporary discretionary measures implemented in 2022 represented a total estimated cost of € 7 billion (1.3 % of GDP). Energy measures accounted for most of this amount, coming in at € 5.8 billion (1 % of GDP), while the measures taken following Russia's invasion of Ukraine cost € 1.3 billion (0.2 % of GDP). Measures were adopted gradually over the year and were regularly extended and/or expanded in line with energy prices, which remained high.

The vast majority of energy measures were adopted at federal level. These were mainly designed to provide immediate support for household purchasing power. At the regional level, measures were taken to remove certain charges from the electricity bill, intended to finance suppliers' public service obligations, and to support a reduction in energy consumption and provide direct assistance to firms.

In terms of the budgetary cost, two thirds of the measures pertained to interventions that reduced the cost of an additional unit of energy. Consequently, these measures partially cancelled out the "price" incentive to limit energy consumption. In this context, the lowering of the VAT rate on gas and electricity introduced in April represented a budgetary cost of € 1.5 billion. The extension of the social tariff cost € 0.9 billion. Finally, the lowering of excise duties on petrol and diesel – a tax based not on the price paid but on the volume consumed – represented a cost of € 0.9 billion.

The remaining third of the budgetary cost of these measures was attributable to various decisions to shore up household income without impacting the marginal cost of energy. In this case, households received a sum of money that was not dependent on their energy consumption and therefore did not distort the price signal, which is preferable to maintain the incentive to reduce energy demand. Such assistance mainly took the form of various vouchers to help reduce the energy bill as well as a credit of € 135 towards the gas bill and of € 61 towards the electricity bill in November and December. These vouchers and credits represented a budgetary cost of € 1.7 billion in 2022.

All of these measures also influenced the health index, with the exception of the reduction in excise duties on petrol and diesel. Since they lead to lower prices, they curb inflation and the associated wage indexation. For households, this offsets the measure's positive effect on purchasing power, while for companies, it mitigates the increase in the wage bill.

The federal government also offered the possibility of a tax deferral to support the liquidity of households and companies. This decision applied to all payments for tax year 2022, for both personal income tax and corporate tax. Moreover, the standard payment deadline for all assessment notices was extended from two to four months. In addition, companies were able to defer for two months the payment of taxes withheld from earned income for November and December. These measures did not affect the budget balance, however, since deferred payments are imputed to the year in which the tax is assessed in accordance with ESA methodology.

The measures were not sufficiently targeted. Although the government responded strongly to the exceptional situation, in order to be fair, effective and not jeopardise the sustainability of public finances, assistance should target the economic agents that need it most. The social tariff, intended for all benefits recipients and social housing tenants, and its extension to all low-income households qualifying for greater assistance are an example of a measure designed to target more vulnerable groups. On the other hand, the lump-sum credits for gas and electricity are not considered targeted, even though these amounts are subject to tax in the hands of the highest earners. Indeed, the targeted nature of this type of measure is very limited since the threshold above which the special social security contribution is levied is high, and reimbursement remains partial.[1] This general lack of targeting obviously had a regrettable significant effect on the budgetary cost of the support measures.

The support measures were only partially offset by discretionary financing measures. Reference is made here only to new discretionary measures introduced to finance the support measures. The endogenous effects of inflation on government revenue, such as the increase in VAT revenue, were not included in this calculation. Direct financing measures included a contribution from the oil industry of € 0.3 billion. Furthermore, a decision was made to tax the excess profits of energy producers (see box) which was expected to bring in € 0.2 billion for 2022. Non-gas-based electricity producers could indeed make substantially higher profits during the energy crisis. In addition to an income ceiling of € 130 per megawatt hour from August 2022 to June 2023, they had to report these transactions to the energy sector regulator (CREG). The amount in excess of the ceiling must be paid to the government.

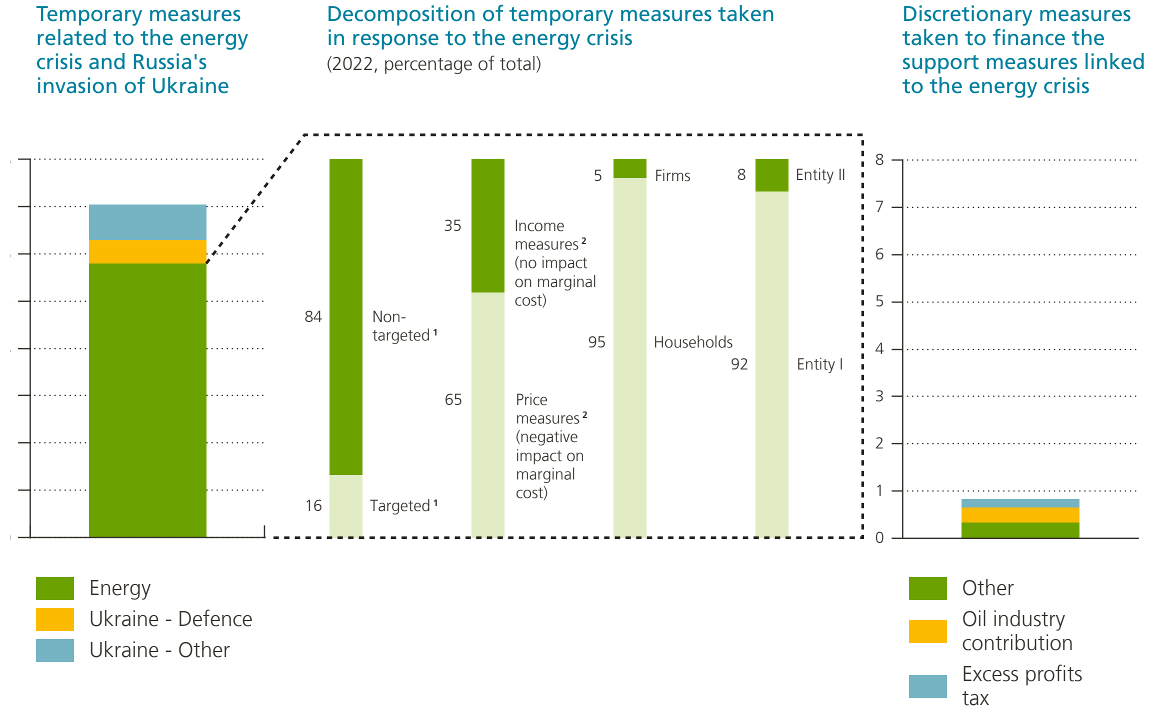
At the same time, the government took measures in response to Russia's invasion of Ukraine. At the federal level, a provision of € 0.8 billion was earmarked for this purpose. In 2022, around half this amount was spent on the reception of Ukrainian refugees, who also received integration income. The federal government used some of this amount to provide public social welfare centres with funding to cover this additional cost. Moreover, humanitarian assistance was sent to Ukraine. Specific appropriations were also made in each of the three Regions, totalling € 0.3 billion. Finally, in terms of defence, a budget of € 0.5 billion was released in order to fund the acquisition of military equipment and infrastructure investments so as to improve in the short-term the preparedness of the armed forces.

1 For individuals with an annual net taxable income in excess of € 62,000 and couples with an annual net taxable income above € 125,000 (increased by € 3,700 per dependant), a social security contribution, of 1.5 times the average tax rate, will be applied based on 2022 income.

Chart 6.4

Substantial temporary measures were taken in response to the energy crisis and the war in Ukraine

(2022, in billions of euros)



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

1 A targeted measure should be interpreted as referring to one “targeting households or firms that are vulnerable to rising energy prices”. For households, a measure is considered targeted if it is subject to some type of means testing and is not intended to apply to most of the population. Means testing can take any form. A fundamental requirement is that the measure be applied selectively based on real income, specific social needs, access to other social benefits generally reserved for the poorest households, etc.

2 The distinction between price measures and income measures is based on their impact on the marginal cost of energy consumption. Price measures directly lower the cost of consumption of an additional unit of energy. Consequently, they reduce incentives to consume less or to increase energy efficiency. Income measures, on the other hand, do not directly depend on the quantity of energy consumed by an entity (for example, a low-income household or vulnerable SME) and therefore maintain the incentive to reduce demand or save energy. Measures that reduce energy consumption are also categorised as income measures.

BOX 5

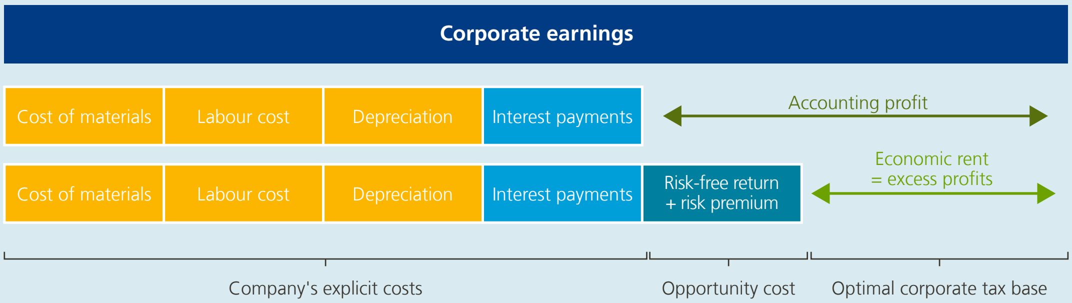
Should there be a tax on the excess profits of energy companies ?

In early 2022, the Bank was asked to investigate whether it would be possible and appropriate to tax the excess profits of energy companies resulting from high gas and electricity prices. This box summarises the conceptual economic opinion provided to the federal energy minister.[1]

1 The Bank did not comment on the practical arrangements for or legal feasibility of a tax on excess profits.

According to tax policy, it is optimal to apply a high tax rate to excess profits, defined as a company's revenue after the deduction of its costs, including opportunity cost. This requires that excess profits be identifiable and internationally immobile. In practice, excess profits are not always easy to identify, justifying a more pragmatic approach. Current corporate tax systems do not tax excess profits but rather the more broadly defined accounting profit, and only at a relatively low rate. The corporate tax rate in Belgium is 25 %.

What are excess profits?

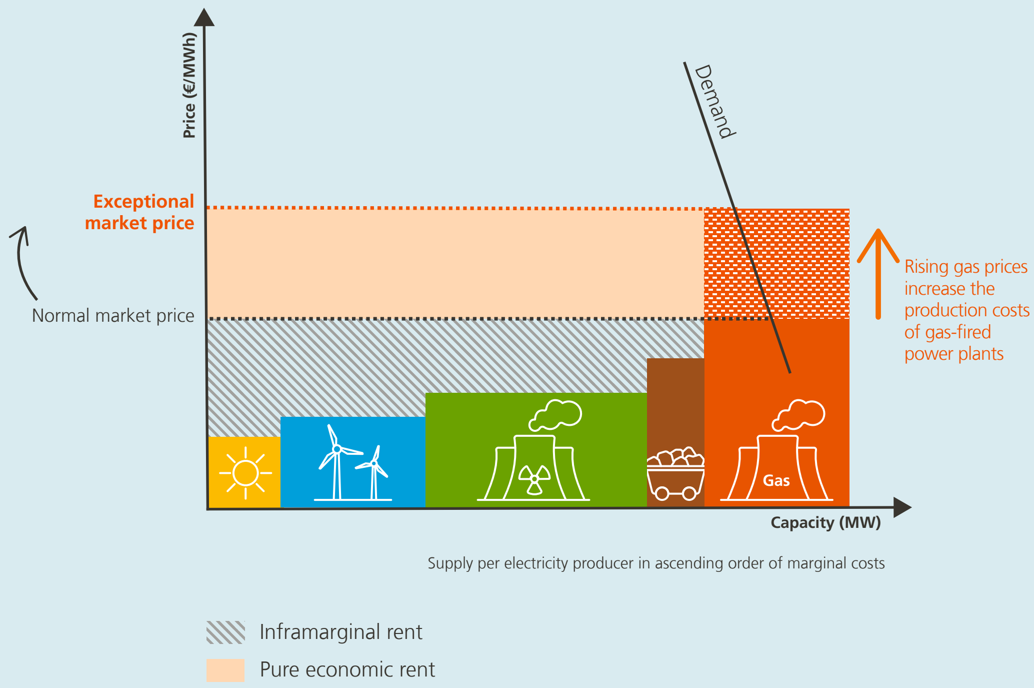


Source: NBB.

Nevertheless, if there are substantial excess profits which can more or less be defined and identified, it may be appropriate to specifically tax them. A permanent excess profits tax is preferable to a temporary scheme. An occasional increase in tax risks undermining business confidence in government and discouraging private investment. Furthermore, a permanent tax allows for time-consistent taxation, meaning negative excess profits from other years can be offset against positive excess profits.

In Belgium, as in other European countries, the electricity market has been liberalised, but remains far from the theoretical model of perfect competition in many respects. In a completely free market, an inframarginal rent can temporarily appear if an economic agent manages to produce at a lower cost than its competitors. This rent can be considered compensation for the fixed costs and initiative-taking – along with the associated risks – that led to the efficiency gain. There is no reason to tax this profit at a higher rate. Over the long term, as other firms with similar efficiencies arrive on the free market, the rent will fade away. Such inframarginal rent also exists on the European electricity market. This market operates in accordance with a merit order, whereby electricity producers are called on based on ascending order of their respective marginal costs, in order to satisfy electricity demand at the lowest cost. The price of electricity is determined by the marginal cost of the final supplier, i.e. the most expensive one (generally gas-fired power plants). Under normal circumstances, this market price enables the most efficient electricity producers to benefit from an inframarginal rent.

The European electricity market operates in accordance with a merit order system [1]



Source: NBB.
1 Simplified illustration.

In addition to the inframarginal rent realised under normal circumstances, certain particularities may give rise to excess profits, for which specific taxation is justified. Thus, nuclear power plants that were put into operation before market liberalisation continue to benefit from past market power. Excess profits can also be caused by a sharp increase in electricity prices resulting from a marked rise in the marginal production cost of the final producer in the merit order. This form of profit can be seen as scarcity rent. In this way, extremely high gas prices determine the price of electricity when gas-fired power plants are the marginal supplier. Electricity producers with lower marginal costs then make excess profits. As long as marginal suppliers continue to use fossil fuels, the risk of expensive and volatile electricity prices will remain, as will excess profits. Having regard to the ecological transition, the geopolitical context and other market circumstances and uncertainties, we should not lose sight of the fact that fossil fuel prices will remain subject to significant fluctuations.

Several European countries, including Belgium, have already opted to introduce a temporary tax on excess profits. This decision is understandable from a practical standpoint, insofar as the implementation of a more permanent system takes time and is fraught with technical difficulties. That being said, temporary measures should where possible be as intelligent as permanent ones and pay particular attention to the need to ensure legal and economic certainty and consistency over time.

As excess profits can be subject to substantial uncertainty, it is important to set the threshold for taxation sufficiently high and/or limit the applicable tax rate.

In addition to an excess profits tax, it would be useful to conduct an investigation into the causes of high and volatile electricity prices. The moderation of these prices would limit excess profits. We can think here of the functioning of the electricity market and its merit order system, in which the marginal cost of the final supplier determines the price of electricity. This means of organisation ensures that electricity prices are only loosely connected to the average production cost, towards which the market price should move in the long-term, both in theory and from an efficiency perspective. However, various considerations should be taken into account in any discussion of the organisation of the electricity market. First, discussions should ideally be held at European level, having regard to European rules and regulations and the interconnected nature of the markets. Second, it is important to keep in mind the importance of short- and long-term price signals. This is the most effective mechanism to ensure that supply matches demand, including in the short term. Furthermore, it is essential for the market price to take into account the negative externalities of electricity production.

In addition to inflation, a handful of other factors influenced the primary balance

The past year was marked by the gradual discontinuation of numerous COVID-19 measures and an associated reduction in the budgetary cost. The main savings were in the area of social security, primarily replacement income paid to furloughed employees and the bridging allowance for the self-employed. These items, significantly lower than the previous year, nonetheless represented a cost of € 1 billion in 2022. The federal government also decided not to extend certain measures, such as the monthly allowance paid to several categories of benefits recipients, still in effect in the first quarter of the year. For companies that had experienced difficulties due to the economic repercussions of the pandemic, compensatory allowances granted by the three Regions also declined noticeably. On the public health front, screening, contact tracing and vaccination campaigns continued to affect public finances. In general, the budgetary cost of the temporary COVID-19 measures, although down by over € 9 billion compared to 2021, was still estimated at approximately € 4 billion for 2022, or 0.7 % of GDP.

Provisional figures indicate that public spending under Belgium's Recovery and Resilience Plan (RRP), launched in 2021, remained substantially below initial expectations.[1] According to NAI statistics, over the first nine months of 2022, some € 270 million was spent, while the initially projected expenditure was around € 1.7 billion euros for the year. Likewise, expenditure on recovery plans not financed by the RRF was lower than expected. In Flanders, in the first half of the year, such spending was well below the annual forecast. In Wallonia, the adjusted budget to stimulate lending was € 1.6 billion, only a fraction of which was used.

The amount of subsidies that Belgium can claim under the Recovery and Resilience Facility (RRF) for the period 2021-2026 was reduced from € 5.9 billion to € 4.5 billion. This adjustment followed the announced recalculation, carried out in June 2022, of the share per Member State of the total available amount, which takes into account the relative economic loss sustained by each due to

1 For more information on the Belgian RRP, see box 6 of the NBB's 2021 Report.

the COVID-19 crisis.[1] According to the GDP figures validated by Eurostat, the upward revision of these figures for the period 2020-2021, compared to those on which the provisional amount was based, was more significant for Belgium than the EU average. Consequently, the amount Belgium can claim was reduced.

Since the European subsidies Belgium will receive are lower than the spending projected in the RRP, the annual accounting of the related income and expenditure is no longer neutral for the budget balance but rather will have a negative effect on it. The NAI follows Eurostat's recommendations for accounting purposes. These stipulate that, each year, expenditure can be neutralised by European subsidies but only to the extent of the ratio between the revised and initial subsidies, which for the period 2021-2026 amounts to just over 76 % for Belgium.

In Wallonia, spending to rebuild infrastructure destroyed by the July 2021 floods also boosted investment. However, compensation to policyholders that filed claims no longer had any effect on the Region's budget balance in 2022, insofar as this expenditure was charged to the previous year, in accordance with national accounting rules.

Structurally, gradual implementation of the government agreement continued to contribute to growth in federal spending. Here, too, this mainly concerned social security. In terms of healthcare, the real growth target rose to 2.5 % last year, thus more in line with the sector's needs, which exceed the growth outlook for economic activity. This revision is on top of a pay rise for healthcare personnel provided for in the social agreement for the non-market sector, booked as a subsidy. Furthermore, the gradual raising of many minimum social benefits, including old age pension, disability, unemployment and social assistance, planned until 2024, continued. A number of structural budgetary efforts were however agreed, including new linear savings in the federal government.

In terms of revenue, the impact of structural measures remained limited. At the federal level, the mini tax shift that entered into effect on 1 April aims to reduce taxes on labour through a shift to other revenue sources in order to neutralise the net impact, hence the introduction of a new tax on air travel and increased duties on tobacco. In addition, savings were realised through the imposition of stricter eligibility conditions for the partial exemption from the obligation to withhold taxes from wages for night and shift work. On the other hand, labour costs were mainly reduced through reform of the system for the reduction of employee social security contributions for low-paid workers and partial abolition of the special social security contribution. At the regional level, the gradual abolishment of tax benefits formerly granted to owner-occupiers had a favourable effect on revenue.

Rising inflation led to an increase in interest rates but not yet interest expenses

The past year was marked by a significant increase in short- and long-term interest rates. The reference rate on ten-year bonds, which averaged 0.3 % in January 2022, rose by 2.7 % on average in December 2022. In terms of short-term yields, those on six-month Treasury certificates stood at −0.7 % in January 2022 and 1.9 % in December 2022. The public deficit can no longer be serviced free of charge on the financial markets and maturing securities will be refinanced at less favourable rates than in the past. This widening of the Belgian spread, i.e. the gap between the ten-year yield on Belgian government bonds and that on German government bonds which are considered the most solvent and liquid in the euro area, rose from 30 basis points at the end of 2021 to approximately 60 basis points at the end of 2022.

The impact of the increase in interest rates on interest expenses remained limited in 2022. Nearly all public debt is financed at fixed nominal rates. Rising interest rates thus only affect debt that needs to be financed or refinanced. At the federal level, debt issued by the Belgian Debt Agency in 2022 was subject to an average annual rate of 1.7 % (compared to 0.1 % in 2021). By comparison, the OLO to be refinanced in 2022 were still issued at an average rate of close to 3.5 %. Long-term refinancings were thus still favourable in terms of interest expenses. These positive dynamics largely offset the negative effect of higher interest expenses to service the public deficit and short-term debt. Interest expenses on short-term debt, which represents around 10 %

1 A detailed description of the subsidy calculations is presented in box 1 of the article by Bisciari, P., P. Butzen, W. Gelade, W. Melyn and S. Van Parys, "The EU budget and the Next Generation Recovery Plan: A game changer?", NBB, *Economic Review*.

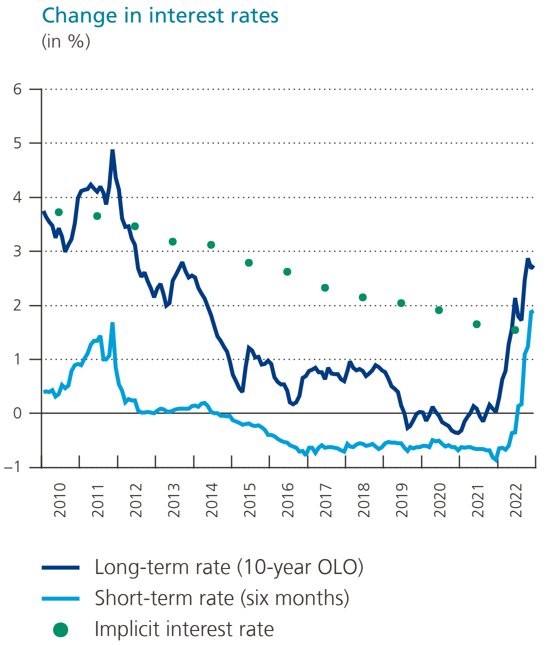
of outstanding government debt, increased in 2022, since this type of debt is refinanced at least once a year. Overall, the implicit interest rate on public debt fell slightly in 2022, albeit to a lesser extent than in previous years. Refinancing gains are expected to disappear as from 2023, due to the lower yields associated with the instruments to be refinanced and substantially higher market expectations of the trend in long-term rates.

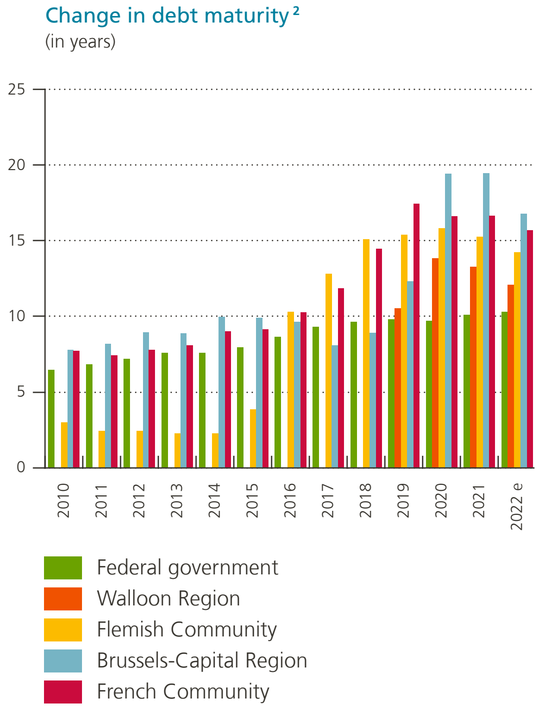
The increase in the ECB's key interest rates will negatively impact the general government budget balance as from 2023 following the downward trend in the Bank's earnings. Over the last few years, the Bank acquired significant holdings of Belgian sovereign bonds under the Eurosystem's asset purchase programmes. The share of Belgian public debt held by the Bank thus now exceeds 20 %. The Bank receives interest on these long-term bonds. At the same time, these purchases were financed by bank deposits, on which the Bank pays a deposit rate. The yield on long-term bonds is low and fixed until they mature, whereas the ECB has significantly increased the deposit rate and plans to do so again. This situation explains the negative earnings expected by the Bank in 2022 and, in all likelihood, in subsequent years.

Debt maturity is still very high at the federal level as well as in the Communities and Regions. At the federal level, the initial maturity of long-term bonds issued in 2022 was 16.5 years. Very long-dated loans were again issued regularly, as in previous years. As a result, the average remaining term-to-maturity of outstanding debt increased further in 2022. By the end of 2022, the average remaining term-to-maturity of federal debt, which stood at around six years at the end of 2010, had risen to ten years and four months, the highest level ever recorded. Rising rates thus did not upset the strategy of government debt managers to maintain debt maturity at a relatively high level. Such staggering of the maturity dates of long-dated debt allows refinancing volumes to be limited every year. As this strategy was gradually

Chart 6.5

Change in interest rates, the implicit interest rate [1] and debt maturity



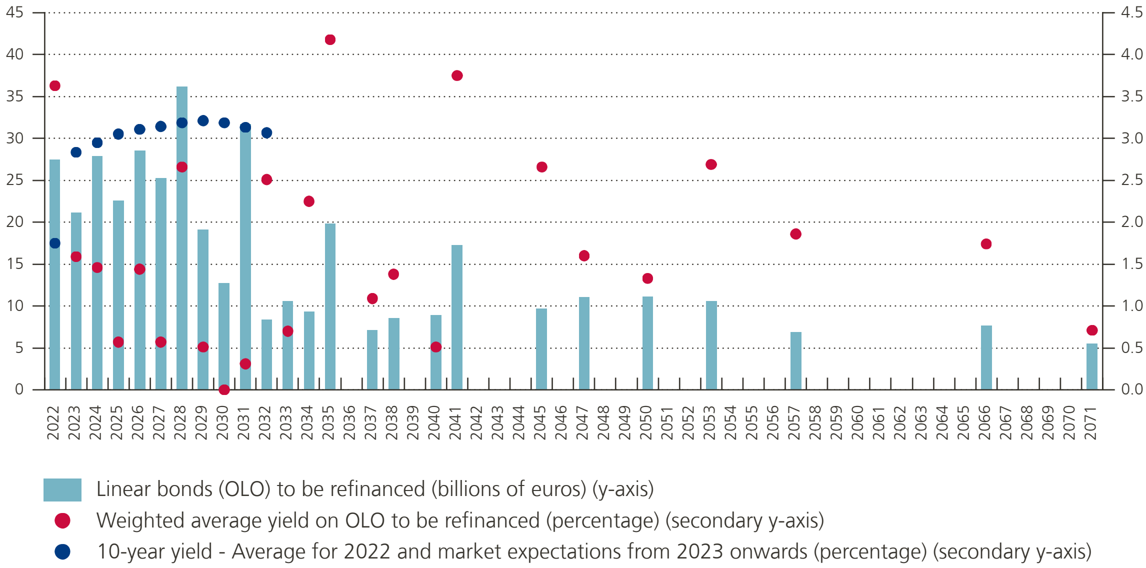


Sources: Belgian Debt Agency, Communities and Regions and NBB.
1 Ratio between interest expenses in the current year and indebtedness at the end of the previous year.
2 Direct debt only. Data for the Walloon Region are not available prior to 2019.

Chart 6.6

As from 2023, the refinancing of linear bonds (OLO) should exert upward pressure on the federal government's interest expenses

(maturity of long-term debt (OLO) to be refinanced by the federal government at the end of 2022, associated interest rates and change in yield over 10 years)[1]



Sources: Belgian Debt Agency, NAI and NBB.
1 2022 average for 10-year OLO, forward rate as from 2023, based on the average interest rate level observed in December 2022.

deepened in recent years, a large portion of the debt is immune to the current hike in interest rates. In the Communities and Regions, an extension of the maturity of direct debt has also been observed in recent years. At the end of 2022, the maturity was 12 years in the Walloon Region, 14 years in Flanders and 17 years in the Brussels-Capital Region and the French Community. Refinancing volumes are also limited.

High inflation temporarily reduced the debt ratio

In 2022, Belgium's debt ratio again shrank, by 4.2 percentage points, to 105 % of GDP. The level remains high, however, at 7.4 percentage points more than before the COVID-19 crisis and 11.3 percentage points higher than the euro area average. From 2023, the Belgian debt ratio should start to rise again, while that of the euro area is expected to follow a downward trajectory.

The fall in the debt ratio was due, once again, to exceptionally strong nominal economic growth, specifically the price component. The surge in domestic inflation, as measured by the GDP deflator, translated into a higher denominator for the debt ratio which, consequently, reduced the debt by 7.1 percentage points of GDP in 2022. Strong nominal GDP growth, coupled with a historically low implicit interest rate on debt, resulted in an extremely favourable contribution by the interest rate-growth differential to debt dynamics. The interest rate-growth differential reached its second highest level since 1971 and, consequently, contributed significantly to reducing the debt ratio. However, the primary deficit of 2.4 % of GDP weighed on the debt ratio.

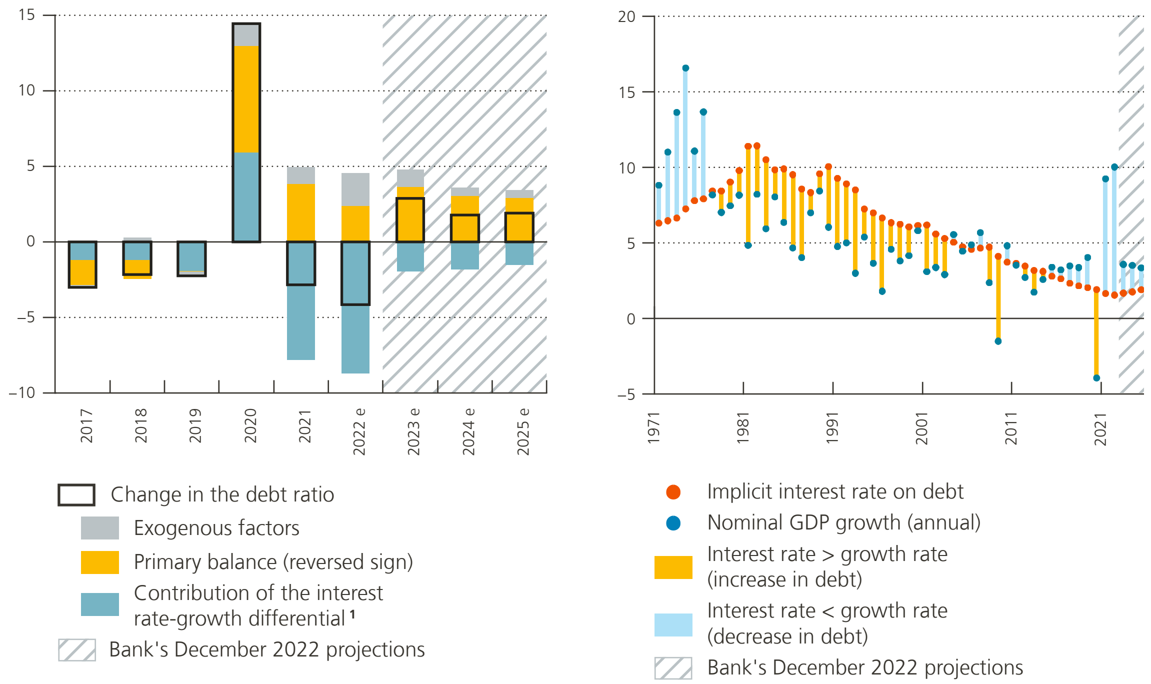
Exogenous factors increased the debt by 2.2 percentage points of GDP. Exogenous factors include variations in the debt that are not explained by the change in the general government budget balance. For example, in 2022, investments in the portfolios of Ageas and Euroclear by the Federal Holding and Investment Company (SFPI-FPIM) exacerbated the debt. Consequently, these companies, which the government deems strategically important for the economy, became more firmly anchored in

Chart 6.7

The debt ratio continued to fall due to exceptionally strong nominal GDP growth

Decomposition of the change in consolidated gross public debt
(in percentage points of GDP)

Interest rate-growth differential
(in %)



Sources: NAI and NBB.

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

Belgium. Another exogenous debt-increasing factor concerns loans granted by the Flemish Community in the framework of its social housing policy. Moreover, a series of accounting adjustments, including the payment of compensation to flood victims in the Walloon Region, further increased the debt. The total estimated flood-related compensation was included in the budget balance in 2021 (the year in which the damage occurred) in accordance with European accounting rules (ESA). However, at the end of that year, only a portion of the compensation had actually been paid. The difference did not need to be borrowed that year. In 2022, a larger portion of the compensation was paid out, which led to an increase in the Walloon Region's debt. More specifically, this is debt owed by the Walloon Region to the insurers that pre-financed the compensation paid to insured parties that sustained flood damage. A similar accounting principle applies to defence investments, for which delivery does not coincide with payment. Thus, the prepayment made by the Ministry of Defence in 2022 increased the debt, whereas the investment expenditure will only be included in the budget balance when the investment is actually delivered. Likewise, the possibility to defer the payment of taxes withheld from earned income and assessed taxes in response to the energy crisis is likely to temporarily have driven up the debt in 2022. Nonetheless, this did not influence the budget balance since, from an accounting perspective, deferred payments of taxes withheld from earned income and assessed taxes are included in government revenue in the year in which the payment is assessed. The non-receipt of subsidies under the European Commission's RRF also led to a temporary upward correction of the debt, although, in accordance with ESA rules, the revenue was included in the general government balance for expenses incurred in 2022. Another accounting correction concerned the recording of issue premiums for debt securities. The Belgian Debt Agency issued multiple securities at values below par. In 2022, the year of issuance, the premiums were negative and temporarily increased the debt.

The fall in the debt ratio observed in 2021 and 2022 is not expected to last: from 2023, the ratio is expected to start to rise again, according to the Bank's December 2022 projections, under the influence of stubbornly high primary deficits. While the interest rate-growth differential is expected to remain favourable, it will most likely nevertheless decrease. Nominal GDP growth should begin to return to normal and, on the other hand, the implicit interest rate on public debt should rise slightly as a result of the rise in market rates caused by the normalisation of monetary policy.

6.3 Belgian public finances are still subject to substantial structural challenges

The risks to the sustainability of public finances are high in the medium to long term.

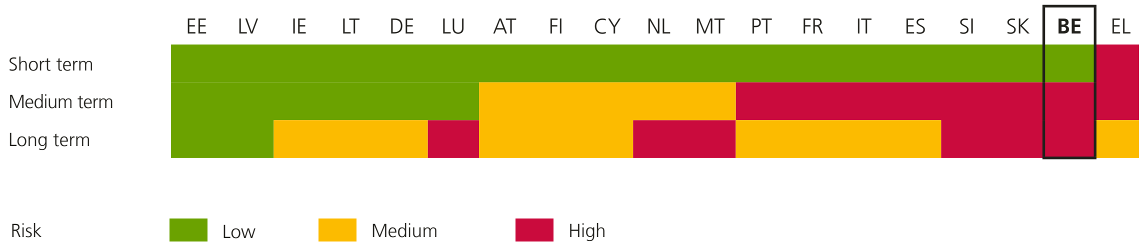
Belgium's high debt ratio and, more importantly, its upward trajectory in the coming years, assuming unchanged policy, are concerning. Heavy debt reduces the margin available to the government to cushion shocks and deal with future challenges (such as population ageing and the energy transition) and increases the risk of losing control of the debt dynamics. The interest rate-growth differential can deteriorate quickly and considerably when there is a sudden fall in GDP growth (as was the case during the pandemic) or an unexpected rise in interest rates fuelled by a tightening of monetary policy or an increase in risk premiums (as at the time of the financial crisis). If the implicit interest rate exceeds nominal growth, the debt ratio may start down an explosive trajectory. The higher the debt, the greater the adverse effect of the interest rate-growth differential and the greater the efforts (in the form of primary surpluses) the government must make to stabilise the debt ratio. While the interest rate-growth differential is currently expected to remain favourable, there is no basis for treating this as free reign to run high deficits. Given the current inflationary climate, in which disruptions have led to a mismatch between supply and demand, an expansionist fiscal policy is inappropriate and impedes monetary policy efforts to get inflation under control.

The risks to the sustainability of Belgian public finances are deemed substantial. A high and climbing debt ratio indicates risks to the sustainability of public debt. The European Commission also stressed this in its detailed sustainability analysis. The analysis takes into account a large number of relevant and forward-looking indicators, synthesised into three measures reflecting the risks associated with the sustainability of public debt in the short, medium and long term, respectively.

Chart 6.8

The future sustainability of Belgian debt is under pressure

Risks to the sustainability of Belgian public debt according to the European Commission



Source: EC (based on spring 2022 projections).

The findings indicate that Belgium's public finances do not pose significant short-term risks, although the substantial deficits raise the government's annual financing needs. However, they point to significant medium- and long-term risks. According to the simulations, based on assumptions regarding the future development of certain key macroeconomic and budgetary variables, the debt ratio will continue to climb over the next ten years. In particular, rising costs due to population ageing are expected to contribute to this, although the interest rate-growth differential should remain favourable. The fiscal effort required to stabilise the debt is substantial from a historical perspective and amongst the greatest in the euro area.

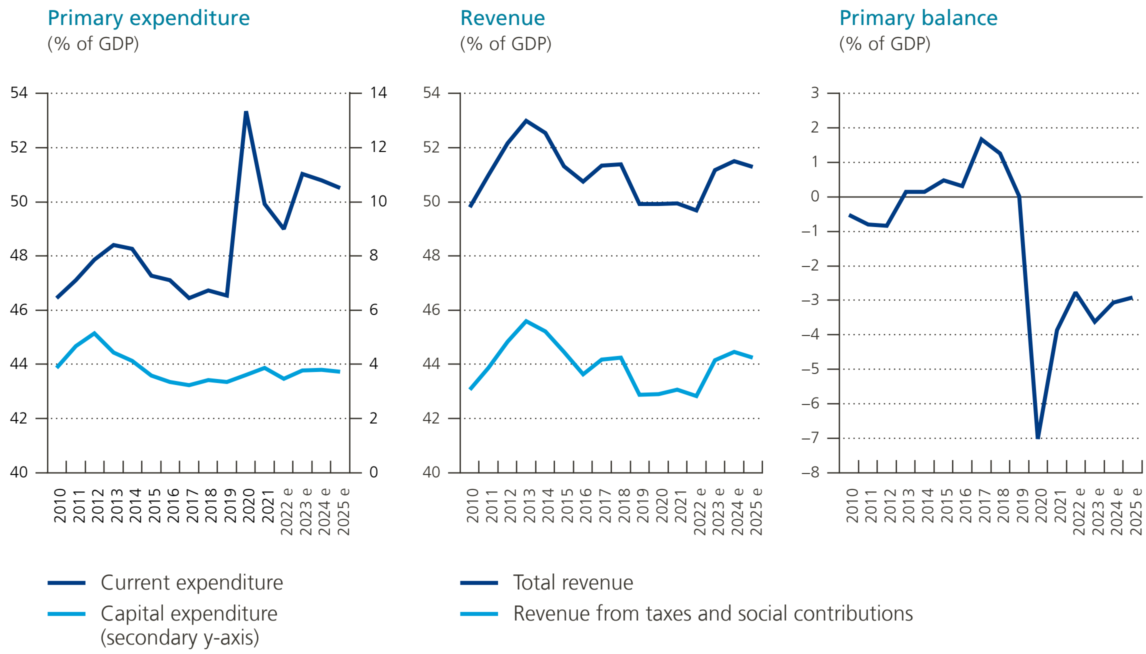
In November, the European Commission proposed using its analysis of the sustainability of public finances to anchor the new European fiscal framework. In accordance with these proposals, Belgium, like other countries exhibiting a high level of sustainability risk, would have to meet more stringent conditions than countries outside this group. More precisely, after a transition period, at unchanged policy the debt ratio in countries that present high sustainability risk should demonstrate uninterrupted decline over a ten-year period, while the budget deficit should remain below 3 % of GDP for the same period. The fact that the focus is on the medium term is certainly a positive development, but, unlike the current framework, the new proposal does not set a specific goal for the budget balance, aside from the 3 % of GDP deficit limit. Although one of the main aims of the proposed reforms is to simplify the framework, the use of the EC's complex sustainability analysis does not appear to align with this objective. The Commission's proposals still contain many ambiguities that require clarification. Once these points have been cleared up, the new fiscal framework will have to be submitted to the Member States for approval.

The widening of the primary budget deficit is due to the rise in primary expenditure

According to the Bank's December projections, the general government budget deficit should reach 4.9 % of GDP in 2025. This deficit can be considered structural since, during this period, economic activity is expected to reach potential output and the budget balance to no longer be burdened by the temporary crisis measures.

Chart 6.9

The primary budget deficit remains high due to a sharp increase in current expenditure [1]



Sources: NAI and NBB.

1 The figures relating to the period 2022-2025 are taken from the Bank's December 2022 macroeconomic projections, which cover the period until 2025.

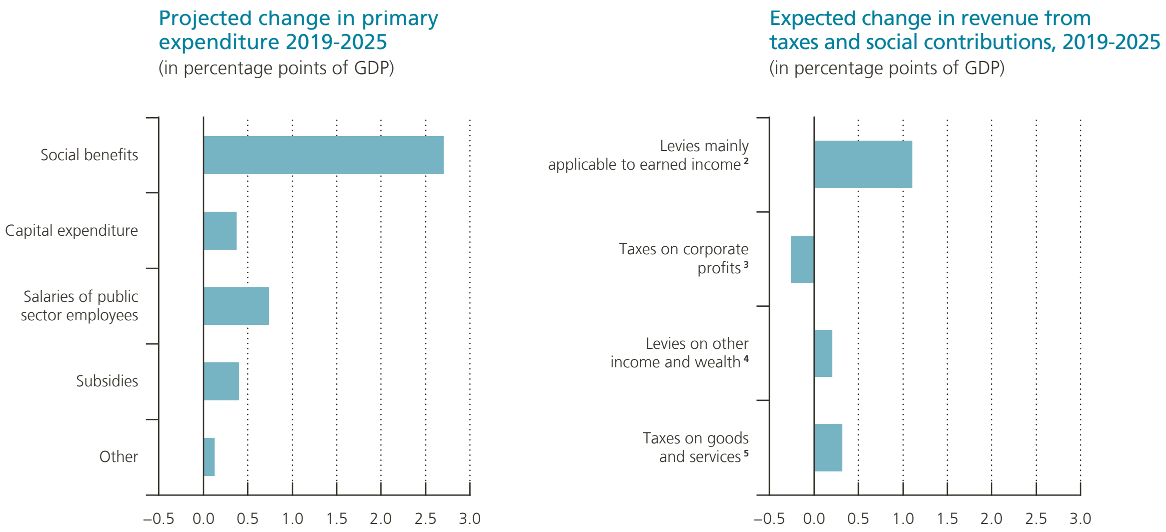
The clear structural upturn in primary expenditure since 2019 is the source of the high public deficit expected in 2025. Between 2019, the year before the coronavirus pandemic, and 2025, the primary spending ratio is expected to increase by 4.3 percentage points of GDP. This sharp rise can be fully explained by the growth in current expenditure. In fact, capital expenditure, which contributes to boosting potential output, has grown only marginally, while it is precisely this type of expenditure that should be increased.

Growth in current expenditure is being driven in large part by growth in social benefits. In practice, social benefits are projected to rise by 2.7 percentage points of GDP by 2025, compared to their 2019 level, primarily due to the growing costs associated with population ageing. However, the upward trend in pension spending should temporarily slow in 2025 when the statutory retirement age is raised from 65 to 66. Furthermore, social benefits are being driven structurally upwards by the gradual increase in minimum social benefits (approved in 2020). In addition to social benefits, both business subsidies and the wages of government employees will rise again by 2025. Higher salaries for government employees can be explained by automatic wage indexation, based on the change in the health index, which exceeds that of the GDP deflator. The rise in business subsidies is largely due to higher wage subsidies in the healthcare sector from 2019 to 2022.

Government income is projected to grow slightly until 2025 due to higher revenue from taxes on labour. By 2025, revenue from taxes and social contributions is expected to rise by 1.4 percentage points of GDP compared to 2019. This rebound can largely be explained by increased revenue from taxes on labour, i.e. personal income tax and social security contributions. Such taxes benefit from automatic wage indexation in accordance with the sharply rising health index. By contrast, the change in the GDP deflator is expected to be more subdued. Consequently, the share of labour in GDP should increase, which will translate into greater revenue from taxes on labour.

Chart 6.10

The strong increase in social benefits is a key factor explaining primary expenditure growth [1]



Sources: NAI and NBB.
1 The figures relating to the period 2022-2025 are taken from the Bank's December 2022 macroeconomic projections, which cover the period until 2025.
2 These include personal income tax and social security contributions. Personal income tax mainly consists of taxes withheld from earned income (payroll tax), advance tax payments, tax assessments and surcharges on personal income tax. Social security contributions include the special social security contribution and contributions of those not in work.
3 Mainly advance tax payments, tax assessments and withholding tax.
4 Mainly withholding tax payable by individuals, property tax (including proceeds from surcharges), inheritance tax and registration duties.
5 The main revenue categories are VAT and excise duties.

On the other hand, the share represented by corporate profits, which are subject to a lower tax rate, should decrease.

Rising pension expenditure puts public finances at serious risk in the coming years and decades

Population ageing is the greatest structural challenge to the medium- and long-term sustainability of public finances. According to the Study Committee on Ageing's (SCA) latest report, the increase in social benefits compared to 2022 will peak at 4.1 percentage points of GDP in 2049, before falling slightly until 2070. The most substantial increase will be over the next 15 years, with annual average growth of 0.2 percentage point of GDP. Pensions are the main category of social benefits. This expenditure has already increased sharply in recent years and will continue to rise considerably in the decades ahead as the population ages. The SCA projects that spending on pensions will continue to increase by 2.8 percentage points of GDP between 2022 and 2059 before dropping slightly until 2070.

In the medium and long term, pension spending is set to grow more substantially in Belgium than in most other euro area countries. The European Commission's latest Ageing Report, published in May 2021, indicated that the increase in public pension spending over the period 2019-2070 would be significantly higher in Belgium than in most other euro area countries. The increase is expected to amount to 3 percentage points of GDP in Belgium.[1] This rate is far higher than the euro area average of just 0.1 percentage point of GDP. These costs are even expected to decline in all other

1 The pension spending figures in the Ageing Report are not directly comparable to those of the SCA, but the methodology applied in this report can nevertheless be used to compare EU countries. The 2021 Ageing Report covers government measures taken until September 2020. For Belgium, this means that the impact of a range of measures, including the increase in minimum pensions, adopted after this date, which will increase pension spending, has not been taken into account.

euro area countries with high debt. Furthermore, the temporary profile of pension costs reveals significant disparities. Unlike in these other countries, costs in Belgium should continue to rise during most of the projection period, after which they are expected to stabilise. Consequently, Belgium's pension costs will probably be the highest in this group of countries at the end of the period, while they were amongst the lowest in 2019.

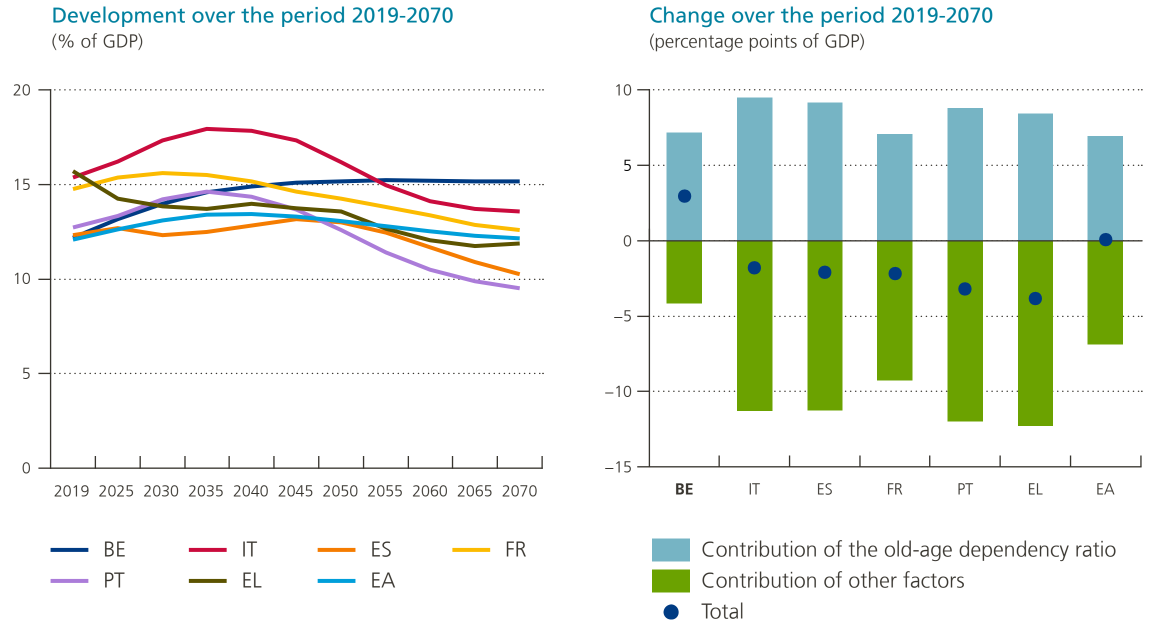
The steeper rise in pension costs expected in Belgium is due not so much to demographic factors as to other factors that can generally be influenced by policy. Based solely on the increase in the old-age dependency ratio, i.e. the ratio between the number of people aged 65 and over and the number of people aged 20 to 64, pension costs in Belgium should climb by 7.2 percentage points of GDP over the period 2019-2070. With the exception of France, the contribution of this demographic factor is greater in other countries with high debt. In the euro area, the expected average increase is 7 percentage points of GDP. It should be noted that growth in pension spending arising from demographic factors can be mitigated and even reversed by changes in other factors, which can generally be influenced by policy. In particular, these include raising the statutory or effective retirement age, increasing the employment rate and reducing the generosity of the pension system. In Belgium, over the period 2019-2070, these other factors are expected to lead to a much less significant reduction in pension costs than in other countries with high debt and in the euro area on average.

In July, the federal government reached an agreement on the continuation of pension and (end of) career reform. This is one of the reforms incorporated into the national recovery plan. Three measures were announced. The first pertains to the introduction of a pension bonus for employees, self-employed workers and civil servants who continue to work after they have reached retirement age (early or not). The second measure reforms access to the minimum pension under all three pillars, with a minimum number of days worked taken into account. Finally, a measure was approved on the revaluation of part-time work for the purpose of calculating employee pensions.

According to simulations by the Knowledge Centre on Pensions, it appears that the

Chart 6.11

Public pension spending: development and factors explaining the variation



Source: EC.

pension reform will further increase long-term population ageing costs. This is mainly due to the introduction of the pension bonus, the estimated cost of which by 2070 is expected to be in the range of 0.1 to 0.3 percentage point of GDP. Estimates show that the budgetary impact of the other two measures will most likely be limited and that they should have only a slight impact on the budgetary costs of ageing. The reform does not help improve the financial sustainability of the pension system, which is a prerequisite for obtaining additional subsidies under the RRF.

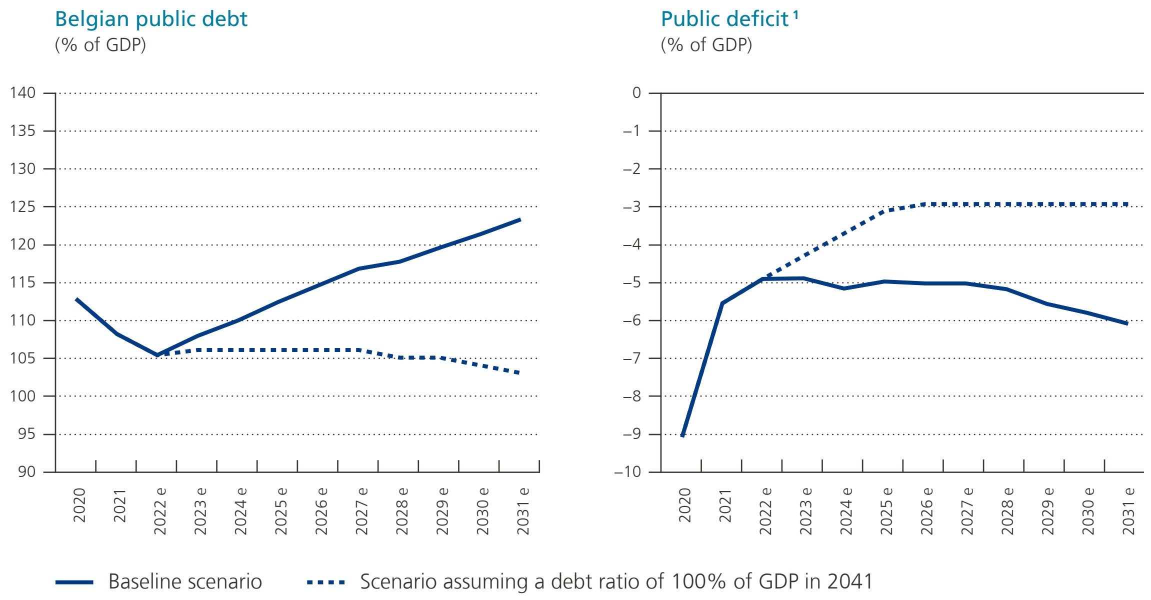
Substantial consolidation efforts at all levels of government are required to reduce the debt ratio

At unchanged policy, the Belgian debt ratio will gradually continue to rise. From a sustainability perspective, fiscal consolidation is required. Under a baseline scenario assuming no policy change and using the forecasts of the Federal Planning Bureau for 2022-2027, Belgian public debt is expected to exceed 120 % of GDP in the coming decade.[1] Fiscal consolidation is needed to reverse the debt dynamics. A simulation that sees the Belgian debt ratio reduced to 100 % of GDP over 20 years illustrates that even to achieve this minimum objective, substantial efforts will be needed. More specifically, the Belgian government deficit must be brought to just under 3 % of GDP as quickly as possible. The efforts required will be even greater if economic growth and the interest rate develop less favourably than predicted in the assumptions used in the simulation. In order to build margins which can be used to absorb such

1 For more information on the simulation, see Cornille, D., M. Deroose, H. Godefroid, W. Melyn, P. Stinglhamber and S. Van Parys (2022), "How sustainable are the finances of the federal government, the regions and the communities in Belgium ?" NBB, *Economic Review.*

Chart 6.12

At unchanged policy, Belgian public debt will continue to rise



Sources: FPB, NAI and NBB.

1 The baseline scenario is based on the June 2022 projections of the Federal Planning Bureau so as to be consistent with the regional projections used later in the analysis. According to the Bank's latest projections, the public deficit for 2022 should be narrower than the Planning Bureau's June estimate but, in subsequent years, should approach 5 % of GDP. This means that, in line with the alternative scenario, an additional annual fiscal effort of 0.6 percentage point of GDP will be required over the period 2023-2026 to push the public deficit to below 3 % of GDP, i.e. the level at which the debt will reach 100 % of GDP in 2041. An effort of 0.6 percentage point is consistent with the guidelines in the "preventive arm" of the Stability and Growth Pact.

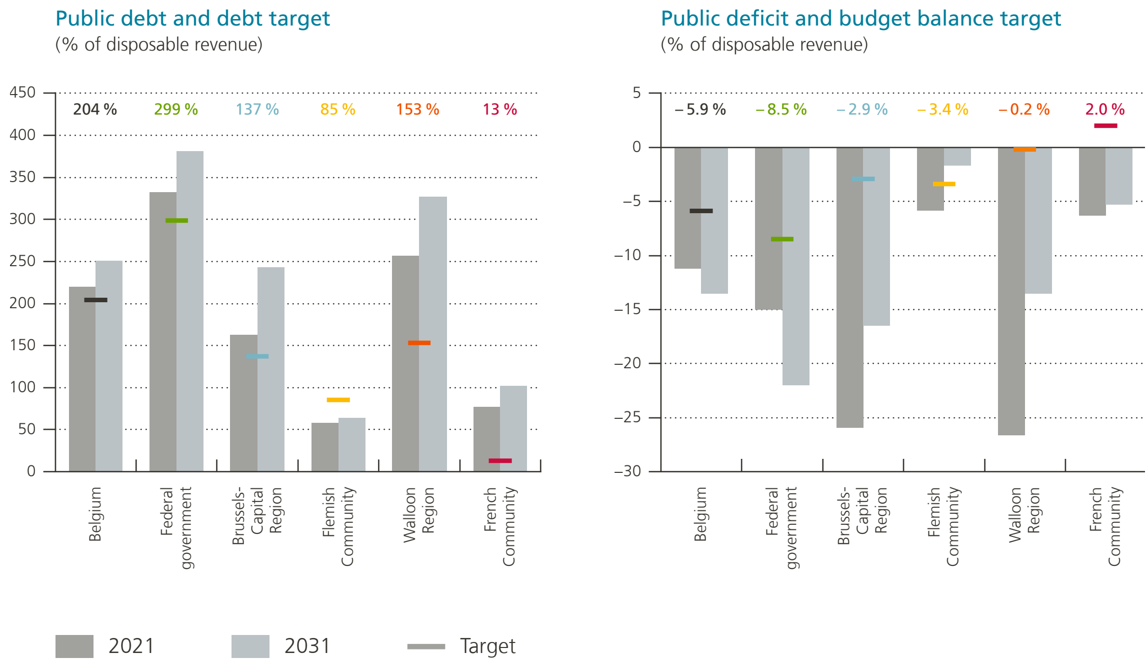
shocks or interest rate increases, the national deficit needs to be brought to well below the reference value of 3 % of GDP in the medium term. A return to the debt ceiling of 60 % of GDP as provided in the current European fiscal framework will require even more substantial fiscal efforts. Reducing the debt to 100 % of GDP should therefore be considered a minimum scenario to contain the sustainability risks.

Although the lion's share of public debt is concentrated at the level of the federal government, the increase in the debt ratio at regional level also entails risks. In order to be able to compare the debt ratios of different government entities, they are expressed as a percentage of disposable government revenue rather than GDP. Disposable revenue is defined as the total revenue of an entity less any transfers to other entities. Consequently, it is a good indicator of the resources available per entity. The baseline scenario of no policy change, which again relies mainly on the projections of the Federal Planning Bureau, shows that the debt ratios of nearly all government entities will continue to rise over the next decade. This increase will be particularly pronounced for entities with an already high debt burden (the federal government, the Walloon Region and the Brussels-Capital Region). Only the debt ratio of the Flemish Community is expected to shrink after 2027, as the budget should balance based on the medium-term projections of the Federal Planning Bureau.

Reversing the upward dynamics of public debt requires action at all levels of government. In order to lower Belgian public debt to 100 % of GDP, for example, efforts must be spread across all levels of government. This will require defining an allocation method for the national debt ceiling. In the simulation, the selected key was the share of own revenue in total national revenue. Own revenue is defined as total revenue less any transfers received from

Chart 6.13

Substantial efforts by almost all entities will be required to reduce Belgian public debt to 100 % of GDP by 2041



Sources: FPB and NBB.
The budget balance target indicates the budget balance required in 2031 to bring the debt ratio back to the debt target by 2041, as indicated in the left-hand panel.

other government entities.[1] This allocation key can be justified by the basic principal that governments should only be allowed to incur debt to the extent they have their own, directly manageable revenue. Consequently, entities that depend exclusively on income from transfers should not, over a long period, spend more than they receive in transfers. Based on this allocation key, a national debt target for Belgium of 100 % of GDP, or 204 % of disposable revenue, would translate into a debt ceiling of 299 % of disposable revenue for the federal government, 85 % for the Flemish Community, 153 % for the Walloon Region, 137 % for the Brussels-Capital Region and 13 % for the French Community. According to the baseline scenario of no policy change, the debt ratios of nearly all entities currently exceed these debt ceilings and will continue to do so in the future.

All levels of government will have to make considerable consolidation efforts. In order to meet their respective debt targets by 2041, the federal government, the Walloon Region and the Brussels-Capital Region will have to reduce their projected deficits for 2031 (expressed in relation to their disposable revenue) by approximately 13 percentage points and the French Community by 7 percentage points. According to the simulation, the Flemish Community should not need to make additional efforts to remain below its debt target, provided it executes its policy plans and balances its budget in the medium term. If every entity makes the efforts required to respect its own debt limit by 2041, the national deficit should fall to just below 6 % of disposable revenue or 3 % of GDP. To achieve this goal, clear and binding agreements on budgetary targets for the various government entities are essential.

1 More specifically, own revenue is defined as total government revenue less transfers received from other government entities, imputed social security contributions and production for own final use.