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**BELGIUM'S STABILITY PROGRAMME**

**(2012-2015)**

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## **Preface**

Belgium's stability programme sets out the fiscal policy stance and targets for the period 2012-2015. It should be read in conjunction with the national reform programme.

In October 2011, during the negotiations for the purpose of forming a federal government, an agreement was concluded on a forthcoming reform of the State. The main points of that agreement are included later in the text. However, the stability programme does not give figures for all the budgetary implications since a number of details have yet to be determined.

This programme was drawn up with due regard for the principles contained in the document entitled "Opinion on the content and format of Stability and Convergence Programmes" dated 24 January 2012.

The programme develops the commitments set out in the 2011-2014 programme. It takes account of the coalition agreement and of the multi-annual plan for 2011-2014 drawn up during the government negotiations at federal level. It is also based on the opinion of the Borrowing Requirements section of the High Council of Finance dated March 2012.

This programme was approved by the Federal Council of Ministers on 28 April 2012 and Communities and Regions were consulted during the Interministerial Conference on Finance and Budget of 30 April.

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# 1 Introduction

## *General policy lines*

A new government took office on 6 December 2011. The coalition agreement is based on three main aspects:

- a State reform implying a substantial transfer of powers to the Communities and Regions, greater fiscal autonomy for the Regions and a reform of the Special Finance Act;
- consolidation of public finances to create a sound financial basis and to meet the European Union requirements;
- social and economic reforms to address future challenges, including population ageing.

The new State reform is to strengthen the country's structures in order to face the major socio-economic challenges.

Some significant structural reforms have already taken place. They concern in particular the regulations on unemployment, raising of the minimum age for early retirement, and the control of health care expenditure.

As part of the EU2020 strategy, the government intends to embark on a policy which aims to make the economy more dynamic and thus preserve social well-being.

## *Strategy on public finances*

Just as in other countries, public finances in Belgium were affected by the 2009 economic crisis. In that year, the deficit came to 5.6% of GDP. On 2 December 2009, for the first time since the creation of Economic and Monetary Union, the European Commission initiated an excessive deficit procedure against Belgium. In that context, on 2 December 2009 the Council of the European Union recommended that the Belgian government should fulfil the conditions for terminating the excessive deficit procedure by no later than 2012.

Since then, a major step towards normalising public finances has been taken. In 2011, the deficit was brought down to 3.7% of GDP (2.8% in structural terms). This is in line with the target in the stability programme for 2011-2014 (3.6% of GDP).

The government is committed to cutting the deficit below 3% in 2012. In order to retain some leeway, the budget was based on a target of 2.8%. Consequently, Belgium intends to fulfil the conditions for terminating the excessive deficit procedure in 2012, in line with the recommendations of the European Union Council.

In the period 2012-2015, the general government deficit is to decline gradually, to achieve a nominal balance in 2015. According to this path (and on the basis of the underlying macroeconomic assumptions), Belgium should achieve the "MTO" (Medium Term Objective) in 2015, while respecting the minimum condition concerning an improvement in the structural deficit. In the period 2012-2015, the debt reduction requirement will also be met.

The path outlined above is very close to the one in the stability programme 2011-2014. However, the growth prospects have been revised downwards, and it will take substantial additional efforts to keep to the original path. In case of significant deterioration in the growth outlook up to 2015, it belongs to the government, on the basis of a report of the Section "Borrowing Requirement" of the High Council of Finance (HCF), to reassess the budgetary prospects and to check in such a case that maintaining a strict nominal balance target in 2015 does not imply a overly restrictive fiscal stance. On the contrary, if the growth should appear to be higher than currently estimated for the coming years, lower improvements of the structural balances would be necessary for reaching the global normative path.

The consolidated general government target needs to be broken down between the various entities. The path selected is based on the idea that the budgets of all the entities will be balanced by 2015. For the period 2014-2015, and taking account of the local authority investment cycle, a small surplus of 0.1% of GDP is planned for Entity II. The details of the contribution of the Communities and Regions to the consolidation effort will be determined when the new Special Finance Act is finalised.

**Table 1: Key data of the stability programme 2012-2015**

<i>% GDP</i>	2011	2012	2013	2014	2015
Real GDP growth	1.9	0.1	1.3	1.7	1.8
Net lending general government	-3.7	-2.8	-2.15	-1.1	0.0
Structural balance	-2.8	-2.1	-1.2	-0.3	0.6
Debt ratio	98.0	99.4	97.8	95.5	92.3

The government will take the necessary measures to achieve these targets. When the 2013 budget is drawn up, the multiannual plan for 2012-2014 will be updated. The existing mechanisms for regular budget reviews and fiscal prudence will be maintained and reinforced if necessary. Together with the structural measures adopted, they in fact represent key tools to guarantee that the predefined target will be achieved.

### *Boosting competitiveness*

For the federal government to boost competitiveness is a priority objective. An inter-federal action plan will be drawn up in dialogue with the social partners, listing a range of specific measures in six areas corresponding to the targets under the national reform programme. This concerns (i) promoting sustainable, quality jobs, (ii) supporting businesses and their development, (iii) guaranteeing an ambitious competition policy, (iv) strengthening research and development and the transfer to innovation, (v) supporting a switch to a more sustainable economy, and (vi) promoting a favourable climate for entrepreneurship.

Preparations will take place until early June 2012 in a working group with representatives from the various federated entities. From June 2012 there will be a political debate in parallel with the social dialogue, in order to arrive at a concrete action plan by the end of July 2012. Thereafter measures will be phased in and monitored on a quarterly basis.



## 2 Economic situation and macroeconomic assumptions

### 2.1 *The international context*

In the April 2012 edition of the World Economic Outlook, the IMF amended its forecast for global economic growth in 2012, upgrading it slightly to 3.5% (1.4% in the industrialised countries and 5.7% in developing countries), compared to an estimate of 3.3% in January. In September, the IMF was still predicting growth of 4.0%.

A key reason for this muted outlook is that the euro area is entering a period of mild recession. Starting from a high level, the activity of the emerging economies and developing countries is slowing down slightly, particularly as a result of the repercussions of economic developments in Europe. Conversely, the US economy is tending to do slightly better than expected. In Japan, there appears to be confirmation of the moderate growth prospects for 2012.

Regarding the euro area, the European Commission based its February 2012 Interim Forecast on negative GDP growth of -0.3% in 2012 (compared to an estimate of +0.5% in the 2011 autumn forecasts). A slight recession is expected in the first half of the year. The economy is not expected to pick up until the second half of 2012.

This more negative outlook for the euro area in 2012 is due in particular to the growth slowdown which had already begun in the final quarter of 2011, the set of new fiscal measures introduced since the latest forecasts, and the delay in implementing some of the measures taken to combat the crisis in the euro area, which has hampered the restoration of confidence. However, the household and business confidence indicator in the euro area began rising again in January and February, and remained stable in March.

Although growth has slowed in practically all the EU Member States, there is still a marked growth gap between the Member States. While Greece (-4.4%) and Portugal (-3.3%) are in deep recession, growth still exceeds 2% in some of the new Member States. In 2012, economic activity in Germany and France, the two largest economies in the euro area, is set to expand by 0.6% and 0.4% respectively.

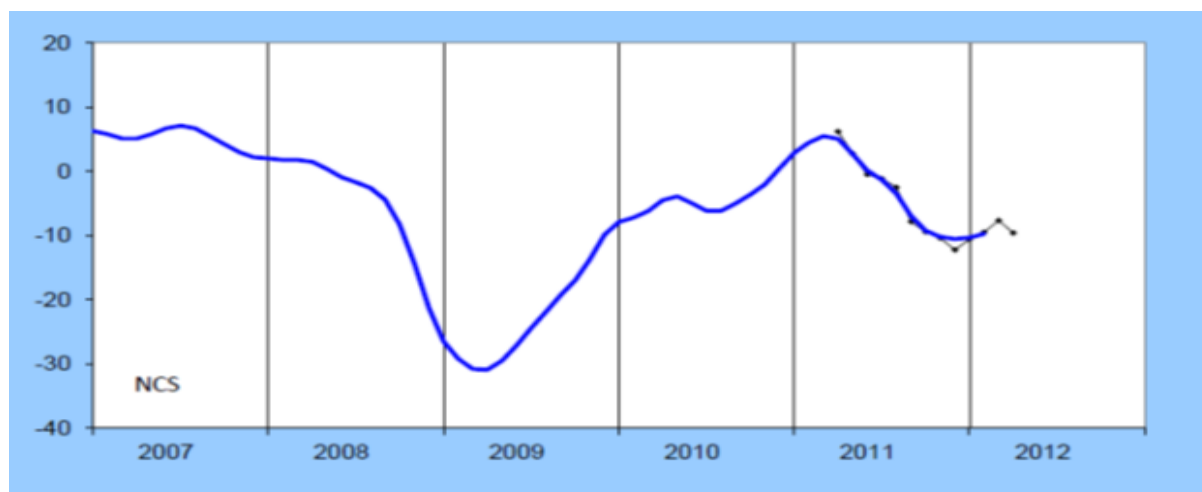
There is great uncertainty over the short-term economic outlook, mainly owing to the sovereign debt problem and the interaction between the financial sphere and the real economy. Moreover, geostrategic tensions could affect energy prices.

## ***2.2 Economic developments in Belgium***

In the first quarter of 2011 the Belgian economy was still growing strongly (0.9% against the previous quarter), but it subsequently slackened pace in line with the international economy. In the second quarter, it still achieved modest growth (0.3%), but in the third and fourth quarters the economy contracted slightly (-0.1%). On an annual basis, growth nevertheless came to 1.9% in 2011 .

Every month, the National Bank of Belgium assesses the confidence of both consumers and businesses in the Belgian economy. In 2011, the general trend in the synthetic curve of the monthly business survey was decidedly negative up to November. From December 2011 to February 2012, the curve resumed an upward trend. In March, the economic barometer was down slightly (gross data).

**Chart 1: Overall synthetic curve of the monthly business survey**



Source: National Bank of Belgium

### **2.3 Outlook for 2012-2015**

The path set out in this Stability Programme is based on draft economic projections by the Federal Planning Bureau dating from mid-March 2012. For the short term (2011 and 2012), these Federal Planning Bureau projections are based on the February 2012 “budget économique”, adjusted to take account of recent macroeconomic developments and the impact of the measures taken at the time of the March 2012 budget review.

**Table 2: External environment: basic assumptions**

	2011	2012	2013	2014	2015
Short-term interest rate (annual average)	1.4	0.9	1.7	2.3	2.9
Long-term interest rate (annual average)	3.9	3.6	3.5	3.8	3.9
USD/EUR exchange rate (annual average)	139.2	134.3	134.7	134.7	134.7
Nominal effective exchange rate (2000=100)	102.4	101.5	101.9	101.9	101.9
GDP-growth - world (excluding EU)	4.4	4.3	4.7	5.4	5.6
GDP-growth - EU	1.6	-0.1	1.2	2.1	2.1
Growth of relevant external markets	5.3	1.6	3.7	4.9	5.2
Global imports, by volume (excluding EU)	8.8	5.9	6.7	8.2	8.6
Oil price (USD per barrel of Brent)	111.4	120.6	114.1	118.5	123.1

Source: Federal Planning Bureau

For 2012, the Federal Planning Bureau predicts GDP growth of +0.1% in Belgium, following 1.9 % growth in 2011. The latest consensus forecast issued by Belgian Prime News in March 2012, which indicates the average forecasts produced by the leading financial institutions in Belgium, predicts zero growth for Belgium in 2012, compared to a contraction of -0.4% for the euro area as a whole.

From 2013, annual real GDP growth should recover under the impetus of the expansion on global markets. Nonetheless, growth is likely to remain below 2% in the medium term. For the years 2013, 2014 and 2015, Belgian growth is estimated at 1.3%, 1.7% and 1.8% respectively, while the corresponding figures for EU growth are estimated at 1.2%, 2.1% and 2.1% on the basis of the IMF's medium-term projection dated September 2011.

In the Plan's projection, the international environment for the years 2012-2013 is based on the economic predictions in the February 2012 edition of Consensus Economics. For subsequent years, the projection assumes an international environment based largely on the September 2011 medium-term projection by the International Monetary Fund.

Consequently, the global growth assumptions adopted are slightly higher – especially in 2013 – than those in the common external assumptions. In regard to the external demand confronting the EU, the assumptions used in the Plan were cautious compared to the provisional common external assumptions dating from March; they are slightly more favourable than the final assumptions dated 10 April.

The assumptions concerning exchange rates and oil prices are totally in line with those adopted by the Commission.

**Table 3: Detailed medium-term macroeconomic projections**

<i>% change unless otherwise stated</i>	ESA code	2011	2011	2012	2013	2014	2015
		billion EUR					
1. Real GDP	B1*g	327.7	1.9	0.1	1.3	1.7	1.8
2. Nominal GDP	B1*g	369.4	4.2	2.2	3.5	3.6	3.6
Components of real GDP							
3. Private consumption expenditure	P.3	171.3	0.8	-0.2	0.2	1.0	1.3
4. Government consumption expenditure	P.3	73.8	0.8	0.4	2.0	1.7	1.7
5. Gross fixed capital formation	P.51	66.8	5.0	0.4	1.2	1.5	2.1
6. Changes in inventories and net acquisition of valuables	P.52 + P.53	1.9	1.9	2.0	2.0	2.0	1.9
7. Exports of goods and services	P.6	275.9	5.0	0.4	2.4	3.5	4.0
8. Imports of goods and services	P.7	263.9	5.0	0.5	2.0	3.0	3.7
Contributions to real GDP growth							
9. Final domestic demand		-	1.6	0.1	0.9	1.2	1.5
10. Change in inventories and net acquisition of valuables	P.52 + P.53	-	0.3	0.0	0.1	0.0	-0.1
11. External balance of goods and services	B.11	-	0.1	0.0	0.4	0.5	0.4

Source: Federal Planning Bureau

Household consumption expenditure is set to decline in 2012 (-0.2%) following a 0.8% increase in 2011. The growth of the other main components of final domestic expenditure is projected to remain positive in 2012. However, within gross fixed capital formation, investment in housing is expected to decline further.

Growth of both imports and exports is expected to slow sharply in 2012. Import growth (+0.5%) is likely to be slightly higher than export growth (+0.4%). From 2013, net exports should again make a positive contribution to real GDP growth.

**Table 4: Prices in the medium term**

<i>% change</i>	2011	2011	2012	2013	2014	2015
	(2005=100)					
1. GDP deflator	112.7	2.3	2.2	2.2	1.9	1.8
2. Private consumption deflator	114.1	3.4	2.9	1.9	1.8	1.8
3. HICP	115.2	3.5	3.0	1.9	1.8	1.8
4. Public consumption deflator	120.6	2.9	2.6	2.3	1.9	1.7
5. Investment deflator	115.1	2.2	2.0	1.7	1.8	1.9
6. Export price deflator (goods and services)	113.3	5.1	4.0	1.7	2.1	2.1
7. Import price deflator (goods and services)	116.4	6.7	4.6	1.2	2.2	2.4

Source : Federal Planning Bureau

The rise in the harmonised index of consumer prices (HICP) accelerated in 2011 to reach 3.5%. The main factor was the surge in energy prices. In 2012, the harmonised index is expected to rise more slowly owing to a weaker increase in energy prices. However, when interpreting the movement in the index in 2012 it is necessary to take account of the impact of the government decision to impose a 9-month freeze on the upward indexation of variable energy prices.

In the future, the oil price will continue to be a key determinant of price levels. However, there are several factors of uncertainty here at international level. If there is no new international price shock, inflation should stabilise from 2013 at an annual average of around 1.8%.

**Table 5: Labour market**

% change	2011 Level	2011	2012	2013	2014	2015
1. Employment, persons	4547.4 (a)	1.2	0.2	0.3	0.7	1.0
2. Employment, hours worked	6636.2 (b)	1.7	-0.2	0.6	0.8	0.9
3. Unemployment rate (% , Eurostat definition)	7.2	7.2	7.5	7.8	7.8	7.5
4. Labour productivity, persons	72.1 (c)	0.6	-0.1	1.0	1.0	0.8
5. Labour productivity, hours worked	49.4 (c)	0.2	0.2	0.6	0.9	0.9
6. Compensation of employees	190.9 (d)	4.7	3.4	3.6	3.7	3.5
7. Compensation per employee	50.1 (c)	3.4	3.3	3.4	2.8	2.3

(a) thousands; (b) millions of hours; (c) €; (d) € billions

Source : Federal Planning Bureau

Up to now, employment in Belgium has proved relatively resilient despite the economic crisis. In 2011, as annual average employment growth outpaced the expansion of the labour force, the harmonised unemployment rate (Eurostat definition) declined to 7.2%. However, in mid-2011 job creation came to a halt following the contraction of economic activity. During 2012, employment expressed in thousands of persons is expected to recovery, but only slightly, while the volume of labour expressed as the number of hours worked is projected to fall. In all cases, employment growth in 2012 will be outstripped by the expansion of the labour force, resulting in an increase in the number of unemployed persons. Consequently, the harmonised unemployment rate is expected to rise to 7.5% in 2012.

Job creation is set to pick up under the impetus of the cyclical upturn from 2013. This should be reflected in domestic employment growth amounting to 0.3% in 2013, 0.7% in 2014 and 1.0% in 2015. As a result of the improvement on the labour market, the harmonised unemployment rate is likely to stabilise in 2014, after peaking at 7.8% in 2013, and should subside to 7.5 % in 2015.

## 2.4 Sectoral balances

Table 6 summarizes balances for the different sectors. These data apply with a no change policy.

**Table 6: Sectoral balances**

<i>% of GDP</i>	ESA code	2011	2012	2013	2014	2015
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	2.0	1.5	2.2	2.6	2.6
<i>of which:</i>						
- Balance on goods and services		1.5	1.0	1.7	2.1	2.2
- Balance of primary incomes and transfers		0.6	0.6	0.5	0.5	0.5
- Capital account		-0.1	-0.1	-0.1	-0.1	-0.1
2. Net lending/borrowing of the private sector	B.9	5.9	4.2	5.4	5.6	5.7
3. Net lending/borrowing of general government	EDP B.9	-3.7	-2.7	-3.1	-3.0	-3.0
4. Statistical discrepancy		-0.2	-0.1	-0.1	-0.1	-0.1

Source : Federal Planning Bureau

## 3 Balance and debt of the general government

### 3.1 Path 2012-2015

#### 3.1.1 Medium-term path

In line with the recommendations of the European Union Council with a view to ending the excessive deficit procedure in 2012, the Belgian government undertakes to bring down the deficit below 3% in 2012. A target of 2.8% was adopted both for the preparation of the original budget and for the budgetary review, in order to retain some fiscal scope. The use of cautious growth estimates and the maintenance of a reserve underline that aim.

#### **The excessive deficit procedure against Belgium**

Since 2 December 2009, Belgium has been the subject of an excessive deficit procedure. To bring that situation to an end, in its recommendation dated 2 December 2009 the Council asked Belgium, among other things, to cut its deficit below 3% of GDP by 2012 in a credible and sustainable manner, and to make an annual structural budget effort averaging 0.75% of GDP over the period 2010-2012.

In July 2011, on the basis of a communication from the European Commission assessing the measures taken to cut the deficit, the Council considered that Belgium had thus far complied with the recommendations.

The Belgian authorities subsequently continued to ensure that these recommendations were respected.



*Deficit reduction below 3% of GDP in 2012 and continuing consolidation of public finances*

In December 2011, the new federal government presented the budget for the year 2012. It makes provision for cutting the Belgian general government deficit to 2.8% of GDP in 2012, thus respecting the Council's recommendation.

In March 2012 a budget review was conducted in order to update the macroeconomic and fiscal parameters, particularly in view of the deterioration in the economic outlook. The aim of a deficit amounting to 2.8% of GDP in 2012 was confirmed and an additional budgetary effort of €1.8 billion, shared equally between revenue and expenditure, was achieved in order to fulfil that aim.

Pending this budget review, the Belgian authorities also responded favourably to the request from the European Commission in early January 2012 by freezing expenditure at the equivalent of €1.3 billion in order to ensure compliance with the recommendation. The European Commission had in fact estimated the deficit at 3.2% of GDP in 2012 and requested additional measures.

In its communication dated 11 January 2012, the European Commission therefore considered that Belgium had again taken effective action to correct the excessive deficit in a sustainable manner and within the deadline.

Moreover, despite the sharp downward revision of the growth forecasts,, the budgetary target for 2012 has been maintained. That implied a significant additional budgetary effort.

*Annual structural budgetary effort*

According to the macroeconomic and fiscal assumptions underlying this programme, the improvement in the structural balance should represent 0.7% of GDP in 2012.

According to the March 2012 projections by the Federal Planning Bureau, the improvement in the structural balance should come to 1.6% of GDP over the period 2010-2012, or just over 0.5% of GDP per annum, on average. However, the nominal balance does not improve by an amount equivalent to the impact of the measures implemented to the extent that it is deteriorated by some non discretionary factors such as the effects of population ageing. The structural effort comes to about 2% of GDP according to a bottom-up approach based on the implemented measures<sup>1</sup>. The budget path is thereby close to the recommendation of the Council, namely a structural budget effort of around 0.75% of GDP

In the ensuing years, and in compliance with Belgium's undertakings to the European Union, the deficit will continue to fall gradually by at least 0.5% per annum to achieve gradually the "MTO"<sup>2</sup>. Thus, the general government deficit will be cut to 2.15% of GDP in 2013, and then to 1.1% in 2014, before a balance is finally achieved in 2015. This path thus respects the European commitments concerning deficit reduction.

The path adopted for the general government largely conforms to that proposed in the previous stability programme, namely a gradual reduction in the borrowing requirement until a nominal balance is achieved in 2015. The growth forecasts for 2012 and for subsequent years were significantly revised downwards. In view of this growth slowdown (the growth lost over the period 2012 – 2015 comes to 4.1 percentage points), adherence to the path will entail substantial additional efforts. In case of significant deterioration in the growth outlook up to 2015, it belongs to the government, on the basis of a report of the Section "Borrowing Requirement" of the HCF, to reassess the budgetary prospects and to check in such a case that maintaining a strict nominal balance target in 2015 does not imply a overly restrictive fiscal stance.

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<sup>1</sup> See also the European Commission: « Update of the budgetary situation in Belgium after the March 2012 budgetary control exercise » (March 2012).

<sup>2</sup> See Article 1.5 of Regulation (EU) n° 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, amending Article 2bis of Regulation (EU) No 1466/97.

On the contrary, if the growth should appear to be higher than currently estimated for the coming years, lower improvements of the structural balances would be necessary for reaching the global normative path. Moreover, any early repayments of its capital stakes in the financial sector and any capital gains which the government can expect prior to 2015 will be devoted in full to speedier debt reduction.

### **3.1.2 Sharing of the effort between the entities**

*Advice of the Section "Borrowing requirement" <sup>3</sup>*

In an institutional structure such as Belgium, where many powers and financial resources are decentralised, the required fiscal consolidation must be allocated in the best possible way. In its recommendation, the High Council of Finance proposed a path which should achieve a balanced budget in 2015, both at the level of the two Entities and for the Entity II sub-sectors, i.e. for each Community and each Region.

In its recommendation the High Council stresses that this balance can only be achieved by the two Entities if the fiscal consolidation effort is shared fairly. That balance can therefore only be attained if a number of charges are transferred from Entity I to Entity II, since the federal government currently bears most of the debt burden (historical debt), and has to ensure social benefits, in particular by bearing most of the costs of population ageing.

The High Council states that, in order to ensure that the allocation of fiscal consolidation is fair, the financial burdens transferred between the entities up to 2015 could represent up to 1% of GDP.

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- <sup>3</sup> Conseil supérieur des Finances – Section Besoins de Financement des Pouvoirs publics – Avis : Trajectoire budgétaire pour le programme de stabilité 2012-2015. – Hoge Raad van Financiën – Afdeling Financieringsbehoeften van de Overheid – Advies : Begrotingstraject voor het Stabiliteitsprogramma 2012-2015.

*Sharing decided in this program*

In this stability program, this implies that Entity II achieves a balanced budget by 2013, and then a small surplus (0.1% of GDP) in 2014 and 2015 taking into account the investment cycle of the local governments.

**Table 7: Fiscal balance per entity**

% GDP	2011	2012	2013	2014	2015
General government	-3.7	-2.8	-2.15	-1.1	0.0
- Entity I	-3.4	-2.4	-2.15	-1.2	-0.1
- Entity II	-0.3	-0.4	0.0	0.1	0.1

The respective targets of Entity I and Entity II are conditioned, from 2014, on a transfer of charges from Entity I to Entity II. Such a transfer may be materialized, in particular, through the implementation of the Special Finance Act Reform. The different entities will make the relevant efforts to safeguard the path to the budget balance by 2015. For this purpose, the Government will base on the April 2012 Report of the HCF.

### 3.2 Outcomes in 2011

The 2011 budget of Entity I was drawn up in the spring of 2011. Its targets were based on the March 2011 recommendation of the Borrowing Requirements section of the High Council of Finance. That section recommended limiting the deficit to 3.7% of GDP. The target for 2011 was set at the more ambitious figure of 3.6% of GDP.

In the estimates published by the NAI on 30 March, the resulting budget balance for 2011 (-3.7% of GDP), corresponds closely with the target proposed in the stability programme for 2011-2014 (3.6% of GDP).

**Table 8: Fiscal balance and debt ratio 2011**

% GDP	2009	2010	2011	
			Stability programme	Actual figures
General government	-5.6	-3.8	-3.6	-3.7
Entity I	-4.9	-3.1	-3.1	-3.4
Federal government	-4.2	-3.0	-3.1	-3.4
Social security	-0.7	-0.1	0.0	-0.1
Entity II	-0.7	-0.7	-0.5	-0.3

In 2011, the federal government deficit came to 3.4% of GDP, a deterioration compared to the 2010 figure. Social security ended the year with a deficit of just 0.1% of GDP. In regard to social security, account should be taken of the impact of the special subsidy pursuant to Article 173 of the Programme Law of 23 December 2009.

In 2011, the Communities and Regions managed to lead back their deficit to 0.2% of GDP. This improvement compared to 2010 (0.5% of GDP) was achieved despite the inclusion in their capital expenditure of the debts of the dismantled Holding Communal which were taken over or cancelled (0.2% of GDP). The amounts of personal income tax and VAT transferred to the Communities and Regions under the Finance Act also increased by 0.5% of GDP.

As in 2010, the local authority accounts ended the year with a small deficit. When the March 2012 EDP tables were published, the local authority accounts for the period 2004-2010 underwent fundamental revision.

*Explanation of the revised method of compiling local authority statistics<sup>4</sup>*

When producing the estimate for the excessive deficit procedure, forwarded to Eurostat on 30 March 2012, the National Accounts Institute (NAI) – as announced in its previous publication – made fundamental changes to the methodology used for compiling the local authority statistics and made considerable improvements to the quality of those statistics.

The NAI, the High Council of Finance and Eurostat had already been concerned for some years about the inadequate quality of the ESA 1995 accounts of local authorities. The method used was in fact based on detailed data obtained from surveys for a reference year, supplemented by data from counterparties, administrative data and external research. The latest data relating to the accounts or budgets went back to the year 2000 for the provinces, 2003 for the municipalities and 1997 for the public welfare centres [CPAS]. Since the reference years, which were partly extrapolated, dated back a long way, doubt over the reliability of the statistics had increased.

The NAI, the High Council of Finance and Eurostat all considered that this situation was not ideal and that a structural solution had to be found in order to ensure the quality of the local authority statistics. Since 2004, the NAI had asked to improve the situation, both in its annual publications and by means of letters sent to the competent ministers.

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- <sup>4</sup> Source: High Council of Finance (2012)

In order to revise the compilation of local statistics, it was essential to have good quality source data in good time. If it is to compile statistics on the local authorities, the NAI must have timely access to the accounts of the provinces, municipalities, public welfare centres, local police districts and all other local entities in the public sector. Those accounts must be made available in individual, harmonised, digital form by the competent authorities. During 2011, increasing numbers of supervisory authorities began forwarding detailed data on the accounts of local entities, thus enabling the NAI to modify its working method<sup>5</sup>.

The revision of the method of compiling the local authority accounts implies a structural improvement in the fiscal balance of both local authorities and general government averaging around 0.2% of GDP over the period 2004-2010. The upward revision is the outcome of the upward revision of local authority revenues, particularly as a result of revision of the revenues from local taxes and dividend income, and a downward revision of expenditure due mainly to a downward revision of social benefits and intermediate consumption. The downward revision of social benefits is attributable in particular to the increased amount of the minimum subsistence income paid as wages since 1997. Since the wage bill data were based on information from ONSSAPL [national social security office for provincial and local authorities] which also included these subsistence incomes, and since there was no indication of the extent of this method of paying those incomes, that type of expenditure was counted twice.

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- <sup>5</sup> A detailed methodological note on the new method and on the basic information available appears in the annual publication of the public authorities' accounts on the National Bank of Belgium's website.

**Table 9: Public finances 2009-2011**

	2009	2010	2011	2009	2010	2011
	<i>In % of GDP</i>			<i>Actual change</i>		
Revenues	48.1	48.9	49.4	-3.6	4.0	2.2
Fiscal and para-fiscal revenues	45.2	45.7	46.0	-3.5	3.6	1.6
Direct taxes	15.2	15.6	15.9	-9.8	5.1	3.1
Households	12.5	12.7	12.7	-5.6	4.0	1.4
Enterprises	2.6	2.9	3.1	-26.0	10.6	10.7
Other sectors	0.0	0.0	0.0	20.7	-3.5	-17.7
Indirect taxes	12.5	12.8	12.6	-2.1	5.2	-0.6
Taxes on capital	0.7	0.7	0.7	-6.3	9.6	3.9
Social security contributions	16.8	16.6	16.7	2.0	0.7	1.8
Other	2.9	3.2	3.5	-4.3	10.6	10.0
Current expenditure excluding interest charges	46.7	46.6	46.8	5.5	2.0	1.4
Wages	12.8	12.6	12.6	3.3	1.2	0.7
Operating costs	3.9	3.8	3.7	4.3	0.6	-0.9
Social benefits	25.3	25.0	25.2	6.6	1.2	1.3
Other	4.8	5.1	5.2	6.8	4.3	3.1
Capital expenditure	3.4	2.8	3.1	23.0	-15.7	13.0
Primary balance	-2.0	-0.4	-0.4			
Interest charges	3.6	3.4	3.3			
Net lending	-5.6	-3.8	-3.7			
Debt ratio	95.8	96.0	98.0			

Revenues were up from 48.9% of GDP to 49.4%. That increased proportion is due partly to the movement in tax revenues. Company tax assessments are much more positive than in 2010, confirming the shift between assessments and advance payments. Other fiscal and para-fiscal revenues remained more or less constant in terms of GDP. 'Other' revenues were up as a result of the compensation paid out by the financial sector in connection with the financial crisis, and as a result of dividends.

Both staff and operating costs and expenditure on social benefits grew less than GDP in real terms. The increased proportion of capital expenditure and its strong growth in real terms are due largely to the debts taken over or cancelled by the Regions in connection with the dissolution of Holding Communal. In addition, there was a surge in local authority investment spending.



At the end of 2011, the debt ratio stood at 98.0%, 2.0% higher than in 2010. On the basis of the actual deficit and the other parameters adopted to determine the endogenous movement in the debt, the debt ratio was more or less stable, or even down slightly, in 2011. Its increase is therefore due entirely to exogenous factors, namely the loans to Greece in 2011 (0.3% of GDP), Belgium's participation in the mutual aid mechanism via the EFSF in favour of Portugal and Ireland (0.2% of GDP), and the acquisition of the shares in Dexia Bank (1.1% of GDP).

### **3.3 The 2012 budget**

#### **3.3.1 Entity I**

##### *3.3.1.1 Initial 2012 budget and multi-annual budget 2012-2014 (December 2011)*

Belgium is committed to limiting the general government deficit to 2.8% of GDP in 2012; that commitment was included in the federal government agreement, and implies that the federal government undertakes to limit the Entity I deficit to 2.4% of GDP. It also means that the Entity II levels of power must keep their deficit down to maximum 0.4% of GDP.

In December 2011 the federal government drew up the initial budget for 2012 in a multi-annual perspective covering the period 2012-2014. The guiding principle behind this initial budget is the April 2011 stability programme for 2011-2014. The federal government was careful to adhere to the path which that programme proposes. The basic figures for the initial budget were supplied by the federal government Monitoring Committee, which had produced an estimate of the fiscal balance - assuming there were no changes in the regulations - on the basis of economic growth amounting to 0.8% in 2012 and 2.1% in 2013 and 2014.

Those figures showed that efforts amounting to €11.3 billion in 2012, €13.2 billion in 2013 and €15.9 billion in 2014 were necessary to achieve the target deficit proposed by the High Council of Finance in its March 2011 recommendation.

The measures taken under the initial budget can be broken down into those relating to expenditure, revenue and other factors (see table below). Altogether, these measures enable Entity I to achieve the wished deficit, such as proposed by the High Council of Finance.

In the context of the government agreement, a multi-annual budgetary framework has been determined until 2014. In this framework, the share of expenditure reductions increases, from 42% in 2012 to 48% in 2013 and 52% in 2014. The revenue share decreases, from 34% in 2012, 31% in 2013 and 28% in 2014. The share of other factors goes from 24% in 2012, to 21% in 2013 and 20% in 2014.

**Table 10: Initial budget measures**

<i>(In € million)</i>	2012		2013		2014	
Expenditure	4,369	42%	6,033	48%	8,091	52%
Revenu	3,524	34%	3,932	31%	4,313	28%
Other	2,557	24%	2,630	21%	3,083	20%
<b>Total new measures</b>	10,450		12,595		15,487	
Technical adjustments	999		866		946	
Institutional agreement	-159		-248		-343	
<b>Total including technical adjustments</b>	11,290		13,213		16,090	
			0		0	
Gain on interest charges	0		259		441	
New measures	0		-285		-615	
<b>Total including interest charges</b>	11,290		13,187		15,916	

The multi-annual perspective reveals the structural character of the measures taken. Their impact excluding technical adjustments is estimated at €10.5 billion in 2012 and €15.5 billion in 2014.

## Expenditure

Expenditure is restricted at various levels, namely at the level of primary expenditure, fiscal expenditure and social security expenditure. The impact of the "usurped" powers has also to be taken into account. The various measures are listed in detail in the annex.

First, the MEVA/MMA fund (supporting the purchase of cars causing less pollution) was abolished on 31/12/2011 (yield: €328 million in 2012 rising to €397 million in 2014). Second, there were various reductions in the grant to the SNCB group [Belgian national railways], such as the cut in the investment grant in 2012 (- €203 million) and the reduction in the operating and investment grants (down by €50 million in 2012 and €100 million in 2014). Third, in the case of the DGCD/DGOS (Development Cooperation Department) the grants were frozen at the 2011 figure, saving €145 million in 2012 and 2013, rising to €310 million in 2014. Fourth, substantial additional savings were decided for the federal public services, notably a reduction in staff appropriations (estimated yield €120 million in 2012 rising to €215 million in 2014) and operating and investment grants (estimated yield €51 million in 2012 rising to €153 million in 2014). In addition, account was taken of the fact that the Communities and Regions are to bear more of the cost of their statutory civil servants pensions via the 'accountability contribution' (estimated yield €89 million in 2012 rising to €116 million in 2014). Significant structural measures were also adopted in regard to public pensions (estimated yield €212 million in 2013 rising to €424 million in 2014).

The tax allowances for energy-saving expenditure in the home will be cut as from 2013. The net yield is estimated at €260 million in 2013 rising to €520 million in 2014. Furthermore, the system of personal income tax allowances will be simplified (yield estimated at €56 million in 2013 rising to €116 million in 2014).

Most of the expenditure constraints will be seen in social security. First, in the case of sickness insurance the standard increase has been revised (yielding €1 562 million in 2012, rising to €2 016 million in 2013 and €2 520 million in 2014). Additional savings will also be made in health care and social security, amounting to €823 million in 2012, €745 million in 2013 and €828 million in 2014.

Furthermore, in health care there is under-utilisation amounting to €320 million. Use of the welfare budgets in schemes covering employees and self-employed persons is restricted to 60% in 2013 and 2014 (yielding €123 million and €245 million respectively). The service voucher system has also been modified (yielding €106 million in 2013 and €120 million in 2014). In addition, spending by public social security institutions and external bodies will be tightly controlled (yielding €141 million in 2012, rising to €234 million in 2014).

Structural measures have also been implemented, with a substantial impact on expenditure. The system of time-credit and career breaks has been reformed (yielding an estimated €52 million in 2012, rising to €125 million in 2014). The employment market has also been reformed in various ways, notably by revision of the system of interim allowances for the unemployed (yielding €131 million in 2012, rising to €136 million in 2014), by increasing the degressivity of the benefits, and by incentive measures (yielding €116 million in 2012, rising to €332 million in 2014).

The "usurped" powers are powers devolved to the Regions and Communities, but the federal government still pays for corresponding expenditures. The federal multi-annual budget provides for savings in this regard amounting to €250 million in 2012 and €300 million in 2013 and 2014. Consultations with the Communities and Regions took initially place on 27 March 2012 at an interministerial conference of finance and budget and will continue in working groups.

## Revenues

A detailed overview of the measures relating to the revenue in the multi-annual budget for 2012-2014 is given in the annex. The revenue measure with the biggest impact on the budget concerns the reform of the system of notional interest allowance (yield estimated at €1 620 million in 2012 rising to €2 318 million in 2014). Another measure concerns harmonisation of the withholding tax on income from movable property at 21%, and 25% for such income in excess of €20 000 (yielding €917 million in 2012 rising to €943 million in 2014). Other key measures concern the adjustment to tax on corporate capital gains (yielding €150 million in 2012, rising to €180 million), and the exclusion of notaries and bailiffs from certain VAT exemptions (yielding €100 million in 2012, rising to €109 million in 2014). The method of calculating the value of free provision of private accommodation by companies will be revised (yielding €170 million in 2012 rising to €177 million in 2014). In addition, the excise duty on tobacco will be increased (annual yield estimated at €158 million) and the rate of VAT on pay TV is raised to 21% (yielding €84 million in 2012 rising to €92 million in 2014). Finally, the calculation of the benefit in kind derived from the provision of company vehicles has been adjusted (yielding €200 million in 2012, rising to €210 million in 2014).

## Miscellaneous

The various measures include some significant items which raise money for the budget (the annex contains a list of these measures). The battle against tax evasion and benefit fraud has been stepped up (yielding €720 million in 2012, rising to €1 billion in 2013 and €1.5 billion in 2014). A supplementary, recurrent bank tax is imposed (yielding €100 million in 2012, 2013 and 2014). In addition, there is provision for taking revenue from the deposit protection fund amounting to €476 million in 2012 and €159 million in 2013. The inheritance declaration procedure is being modified (yielding €150 million in 2012 and €156 million in 2014).

Account has also been taken of a number of feedback effects resulting from increased job creation following the implementation of the structural measures (€263 million in 2012 rising to €630 million in 2014).

Finally, we would mention some non-fiscal revenues such as the nuclear revenues (annual yield €300 million), the extraordinary dividend from Belgacom (annual yield €96 million), recurrent revenues from the National Bank of Belgium (annual yield €100 million) and the public sale of 4G licences (estimated yield €80 million in 2012).

### *3.3.1.2 2012 budget review (March 2012)*

In February 2012, the Monitoring Committee produced a new report with the latest information on Entity I revenue and expenditure. The deterioration in the economic situation made it necessary to take supplementary measures in order to achieve the 2012 budget target. Thus, at the time of the March 2012 budget review, an additional effort amounting to €1.8 billion was made for the 2012 fiscal year.

In relation to the figures available before the conclave, it was decided to make some technical adjustments to the initial estimates (€0.3 billion). Primary expenditure (excluding the contribution to the European stability mechanism and the social security balancing grant) was cut by €0.2 billion. Additional tax revenues totalling €0.4 billion were decided on, as were new non-fiscal revenues for the same amount. Lower interest rates made it possible to revise the interest burden downwards by €0.1 billion. In social security, new economy measures have been taken which amount to €0.1 billion. And finally, the €250 million coming from the "usurped" powers in the initial 2012 budget are confirmed.

Two buffers were created to safeguard the aim in view. The February economic budget provided for real growth limited to 0.1% for 2012. The government decided to create a cyclical reserve of €350 million. This therefore implied the assumption that the economy would contract slightly by 0.1%. That is also in line with the estimates produced by the National Bank and the European Commission, available at the time of the budget review.

Apart from this €350 million buffer, the government decided to create a budget reserve of €650 million in ESA terms, formed partly by an administrative block on primary expenditure (€70 million in the interdepartmental provision, €80 million in investment grants and €124 million in operating grants) and €166 million in health care expenditure, and partly by the possibility of mobilising tax revenues from the third pension pillar (€210 million).

In addition, a new fiscal prudence mechanism is applied for the rest of the fiscal year, and will be assessed at the time of the July 2012 budget review. This implies that all expenditure items will be assessed in advance by a working group comprising representatives of the Prime Minister, the Deputy Prime Ministers and the Minister for the Budget.

**Table 11: Fiscal control measures**

<i>(In € billion)</i>	2012
Expenditure	0.3
<i>Primary expenditure</i>	0.2
<i>Social security</i>	0.1
Revenu	0.8
<i>Tax revenues</i>	0.4
<i>Non-fiscal revenues</i>	0.4
<b>Total new measures</b>	<b>1.1</b>
Technical adjustments	0.3
"Usurped" powers (reconfirmation)	0.3
<b>Total including technical adjustments</b>	<b>1.7</b>
Gains on interest charges	0.1
<b>Total including interest charges</b>	<b>1.8</b>
Spending freeze and revenu available for mobilisation	0.7

Part of the additional effort comes from one-off factors. A range of measures will have an increasing effect in the years ahead. Broadly speaking, it can be said that around 2/3 of the additional measures are structural while the remaining 1/3 or €0.6 billion concerns one-off measures. Those measures are additional to the ones adopted when the initial budget was drawn up, amounting to €11.3 billion. When adding the supplementary measures taken under the budget review, the total for 2012 efforts would come to €12.8 billion or around 3.4% of GDP.

### **3.3.2 Measures concerning Entity II**

The federated entities have also taken significant measures, essentially with a view to improving the efficiency of public services. The following sections set out the contributions of the respective federated entities.



### 3.3.2.1 The Walloon Region and the French Community

As soon as they took office in the summer of 2009, the Governments of Wallonia and the French Community accorded priority to the consolidation and sustainability of the public finances of the two entities. It should be remembered that, following the 2009 economic recession, Wallonia and the French Community had to contend with an automatic reduction in their revenues (particularly their institutional revenues) amounting to some €1.25 billion.

The two Governments then committed themselves to ensure that, overall, the budget of the two Entities would be restored to balance by no later than the 2015 fiscal year. Thus, in the autumn of 2009 they adopted a set of – mainly structural – measures aimed at controlling the growth of primary expenditure and optimising the collection of Wallonia's own revenues. The scale of these measures was calibrated so as to set Wallonia and the French Community on the road to restoration of a balanced budget by 2015, and to safeguard the funding, over the whole period considered, of the Marshall Plan 2.Green, the government's programme of socio-economic measures aimed at pursuing the economic revival of Wallonia and the French Community.

When the initial budget for 2012 was drawn up, the Government decided to restrict the overall borrowing requirement of the French Community and Wallonia to a maximum deficit corresponding to 2.8% of the two entities' total revenues. The new path towards restoring the balance according to this decision for the two entities is shown in the following table:

**Table 12: Targeted path – Initial budget 2012**

<i>(In € million)</i>	2012	2013	2014	2015
French Community	-257.9	-202.9	-101.4	0
Wallonia	-201.7	-135.3	-67.6	0
Total	-459.6	-338.2	-169.1	0

Note: for the years 2013 to 2014 the breakdown of the target between Wallonia and the French Community is given as a guide.

In addition, the Government was careful to protect the power sectors which contribute the most to economic growth: education, employment and training policy, research, aid for businesses, housing and mobility policy, and projects cofinanced by the European Union. That approach is producing results, as is evident in particular from the narrowing of the gap between the per capita yield of personal income tax in Wallonia and the average for Belgium, down from -14.92% in 2007 to -11.63% in 2012. The government is also taking care to preserve the financial sustainability of local authorities. The system of financing via municipal funds has been maintained (indexation increased by 1%), as has the policy of support for local investment. As noted by analysts from the Belfius bank, debt expenditure per capita declined faster in Wallonia than in the other two Regions between 2007 and 2011. The Government also safeguarded solidarity between the French-speaking entities, notably by making exceptional grants to the French Community Commission in 2010, 2011 and 2012. The main structural measures adopted in 2009 and maintained by the government since then are as follows:

- reduction in the number of ministers;
- 15% cut in spending on ministerial offices, in addition to the 10% cut already made in 2005;
- annual 3% cut in spending on the civil service, accompanied by making senior officials more responsible for recruitment policy;
- 30% cut in spending on communication in Wallonia;
- freezing (zero growth) of the operating grant paid to the Walloon Parliament and the Parliament of the French Community;

- freezing of operating subsidies paid to public interest bodies and the like, and monitoring of the use of their reserves, having regard to any implications for the consolidated budget balance;
- freezing of certain 'optional' primary expenditure (i.e. spending which evolution is not regulated) and which represents a budget of €1.9 billion in Wallonia and €0.5 billion in the French Community;
- monitoring of investment expenditure.

Apart from these structural measures, the adjustment of the 2009 budget also concerned the cancellation of a number of new policies which had not yet been implemented.

At the level of the French Community, the phasing of certain multi-annual expenditure plans (revision of operating grants and subsidies of compulsory education institutions, refinancing of universities, etc.) was revised in order to spread the impact over the period in question. The Government also decided to raise the minimum age for persons in the education sector to be granted special leave on personal grounds prior to retirement from 55 to 58 years; taking account of the transitional measures, that should reduce spending on teaching staff by €13.5 million in 2013, €22.2 million in 2014 and €39.7 million in 2015.

Regarding 'optional' primary expenditure (€1.9 billion in Wallonia and € 0.28 billion in the French Community), apart from the fact that it has not been increased since 2009, a number of cuts have been made which imply structural path improvement:

- In Wallonia:
  - ✓ -2.5% (around €50 million) when the initial 2010 budget was drawn up;
  - ✓ -2.5% (around €50 million) when the initial 2012 budget was drawn up;
  - ✓ -1.3% (around €25 million) at the time of the March 2012 review of the 2012 budget.
  
- In the French Community:
  - ✓ -3.8% (around €10 million) at the time of the March 2012 review of the 2012 budget.

In the context of the March 2012 budget review, the Walloon Government also decided to impose administrative blocks amounting to €23 million (1.3%) on optional primary expenditure in order to compensate if necessary, for any further deterioration in the macroeconomic environment and its negative repercussions on regional revenues, identified at the time of a second 2012 budget adjustment scheduled for the third quarter.

Apart from expenditures, a number of voluntary measures concerning revenue were adopted in the 2009, 2010, 2011 and 2012 fiscal years:

- Environmental taxes:
  - revision of the conditions for granting 'eco-bonuses' (incentives rewarding vehicles with low CO<sub>2</sub> emission rates) to take account of the steady improvement in the performance of vehicles in Wallonia and the tougher set of 'eco-penalties' intended to further promote this improvement by targeting vehicles with CO<sub>2</sub> emissions in excess of the regional average;
  - revision of the rates charged for waste disposal;
  - implementation of a new charge for drinking water extraction.

- Registration fees on the transfer of real estate: application of the reduced rates granted for sales of property giving rise to land registry fees of €745 or less to the part of the property's market value which does not exceed the thresholds for the grant of subsidised mortgage loans.
- Registration fees on gifts of immovable property: 10% increase in the rates from 3 to 3.3%, 5 to 5.5% and 7 to 7.7% respectively.
- Radio and television licence fees: active policy aimed at improving the collection rate, which thus has increased from 80 to 94.7%.
- Taxes on motor vehicles: the three Belgian Regions reached agreement on the introduction of a vehicle tax disc, scheduled for implementation in 2013.

In the initial 2012 budget, the government had anticipated the slowdown in economic activity which seemed to have begun at the start of the third quarter of 2011. It had thus decided to create cyclical provisions amounting to €40 million in Wallonia and €88 million in the French Community. The purpose of those provisions was to absorb a large part of the loss of revenue resulting from the steep fall in real GDP growth expected in 2012 (down from an original forecast of 1.6% to a revised forecast of 0.1%). At the time of the 2012 budget review, the government maintained a cyclical provision of €9.4 million in Wallonia and €13.4 million in the French Community. Those provisions can be used, if necessary, to compensate for a further decline in real GDP growth expected for 2012.

In addition to the quantitative measures, the government also took qualitative measures to improve fiscal governance. The government set up a number of budget monitoring processes regarding civil service expenditure, spending on the salaries of teaching staff, student grants and loans, energy premiums and expenditure relating to investment in waste processing. Since 2010, the government has engaged in a constructive dialogue with representatives of the National Accounts Institute (NAI), in order to incorporate in the budget processes the latest developments in Eurostat case-law concerning the application of the ESA95 standards. In particular, operations concerning loans and equity investments are subject to constant assessment in regard to the definition of financial transactions under the ESA. On the basis of the NAI's recommendations, some operations concerning loans and equity investments are no longer regarded as financial transactions as defined in the ESA. Others, whose status is still being analysed, give rise to provisions intended to neutralise any reclassification as non-financial transactions. This dialogue also led to confirmation that various regional intervention measures were classed as financial transactions under the ESA. Finally, the Region will in the future first consult the NAI in order to ensure that transactions are correctly imputed under the ESA standards. There have also been various improvements in debt management and the fulfilment of borrowing requirements, designed to improve control over the interest rate risk, spread the repayments more evenly, diversify the counterparties, increase competition, diversify funding methods, boost reactivity, reduce timescales and thus optimise the financing conditions in a challenging financial context.

Since 2009, the government of Wallonia and the French Community has always made sure that it respected the budget targets which it was given under the consultation with the Federal State and the other Federated Entities. Note that for the years 2009 and 2010, an agreement broke down the Stability Programme objectives among the various levels of power. In 2010, the government had also decided to allocate a part of the new revenues generated by the upturn in economic activity, amounting to €100 million, towards the reduction of the borrowing requirement. For the years 2011 and 2012, the breakdown of the objectives was discussed at the interministerial conference on the budget and finances. While no formal agreement was signed, the Federated Entities nevertheless undertook to keep their deficits within limits compatible with the Stability Programme. For the year 2011, the government of Wallonia and the French Community also restricted the overall borrowing requirement of Wallonia and the French Community to €563.6 million, representing an improvement of €252.1 million on the target of €815.7 million which had been discussed with the Federal Government. On the basis of the figures available so far, this margin of €252 million should cover the 2011 interventions in favour of Dexia Holding and some of its shareholders while still remaining within the limits defined by the Stability Programme.

In conclusion, the government of Wallonia and the French Community is committed to continuous monitoring of the two entities' public finances.

### 3.3.2.2 *The Flemish Community*

#### **Drawing up the 2012 budget (September 2011)**

The initial 2012 budget was based on the September 2011 economic growth forecasts of the Federal Planning Bureau which predicted growth of 2.4% and 1.6% respectively in 2011 and 2012. Compared to 2011, the gross budget margin is increased by €1.14 billion as a result of expanding revenues and a revision of the estimate of under-used appropriations. For the year 2012, the ESA-adjusted revenues are estimated at €26.9 billion. That represents €1.0 billion or 4.0% more than expected at the time of the 2011 budget review, which assumed a figure of €25.9 billion.

The gross budget margin is used primarily for the purpose of a 'constant' policy in the sum of €763 million.

In order to take account of the indexation effect, provision was made for an additional €418 million in relation to the 2011 budget review. On the one hand, these additional appropriations are necessary to cover the exceeding of the trigger index in April 2011 and in February 2012, and to create a buffer in case the trigger index is exceeded in October 2012. The staff appropriations and operating grants outside the indexation system are also adjusted by 2%.

Regarding other constant policy expenditures, such as the expansion of the municipal funds stipulated by decree, the movement in expenditure on teaching staff, and the Aquafin bill, it is appropriate to make provision for a sum of €284 million.

Finally, €55 million of the gross budget margin is absorbed by the disappearance of the one-off application in 2011 of the Vlaams Woningfonds reserves (€25 million) and those of the Vlaamse Maatschappij voor Sociaal Wonen (€30 million).



The remaining €378 million of the budget margin is being used for:

- the measures announced for the purpose of stimulating the labour market participation of low-income earners following the abolition of the working tax credit amounting to €38.4 million;
- creation of a cyclical buffer totalling €40 million;
- creation of a €60 million provision for policy credits and €70 million for payment credits to remedy any budgetary effects of both the introduction of the Rekendecreet and urgent investment expenditure;
- €230 million relating to new initiatives in accordance with the implementation of the coalition agreement.

The Flemish government's budget ends with an overall surplus of €0.7 million.

#### **1<sup>st</sup> adjustment to the 2012 budget (February 2012)**

The first adjustment to the budget took place in February 2012. In September 2011, when the 2012 budget was drawn up, the Federal Planning Bureau predicted economic growth of 1.6%. The latest Planning Bureau estimates indicate economic growth falling to 0.1% for 2012, whereas the inflation forecasts are still rising. Growth for 2011 has also been revised downwards.

These adjusted forecasts have implications for both the resources budget and the expenditure budget of the Flemish Region.

On the basis of the Federal Planning Bureau's adjusted growth figures of 1.9% for 2011 and 0.1% for 2012, the resources generated under the Special Finance Act are currently estimated at €19.73 billion, which is €308 million less than in the initial 2012 budget.

Regional tax revenues are estimated at €4.97 billion, down by a substantial €82.7 million. If there is no change of policy, regional taxes will fall by €172.7 million. Additional revenues totalling €60 million are projected in respect of inheritance taxes, following the one-month reduction in the declaration period, and €30 million as a result of a 1 percentage point increase in registration fees in the case of shared inheritances.

Finally, in 2012 a €57.9 million income was recorded because part of the planned sale of land and installations by the Vlaamse Milieumaatschappij to Aquafin in 2011 could not be completed in that year. In short, the ESA-adjusted revenues of the Flemish public authorities are estimated at €332.7 million less than forecast in the initial 2012 budget.

In addition, the budget margin is down by a further €56.7 million owing to the effects of higher inflation estimates on appropriation expenditure. In fact, expenditure is linked, at least in part, to the movement in the health index. The latest health index estimates come to 2.7% in 2012, or 0.7 percentage points above the figure estimated at the time of the initial 2012 budget.

The increase in indexation from 2% to 2.7% implies an additional cost of €15 million for appropriations relating to wages and €16.5 million for those not connected with wages. The upward revision of the estimated health index figure in 2012 also implies that the index will first be exceeded in January 2012 (and not in February as projected in the initial budget), and that the index will be exceeded for the second time in October 2012. The extra cost comes to €45.2 million, of which €20 million can be absorbed by the buffer for the indexation provision. There is therefore a further net €25.2 million to be recorded.

Apart from these unfavorable revisions at the level of revenue and expenditure, the budget margin is increased, on the one hand, by a higher estimate of the under-utilisation of appropriations amounting to €27.2 million, while on the other hand it is reduced by the €7.4 million increase in the surplus.

Consequently, the total budget margin is down by €369.6 million. That is why, in order to maintain a balanced budget, the government wants to make savings, in addition to the discretionary measures concerning regional taxes, by cutting the same amount on the expenditure appropriations:

- First, at the end of 2011 the Flemish government took a number of measures to reduce the effort for 2012. Thus, at the end of the year it paid invoices which were not due until 2012, amounting to a total of €89.4 million.
- A second effort consists in conducting a prudent fiscal policy in line with that applied in previous years by introducing a range of buffers. These buffers are provided partly to reduce the deficit, as the uncertainty underlying the buffers diminishes. The cyclical buffer is cut by €24 million, leaving it at €16 million. The buffer created for payment incidents is cut from €50 million to €30 million. €41.8 million has been found in the Vlaams Fonds voor Lastendelging. The buffers for the application of the Rekendecreet and for urgent investment yielded €10 million on the liquidation appropriations. Finally, the interest buffer can be cut by €17.5 million, thanks to lower market interest rates.
- A final effort concerns economy measures in various areas totalling €167 million. The Flemish government focuses most of the effort on cutting expenditure on public bodies by €104.2 million. In practice, that is achieved by freezing appropriations unconnected with 2012 wages at their 2011 level (namely €76.8 million), by saving €10.5 million on the same appropriations and - on the proposal of the College of General Civil Servants - a saving of €16.85 million on appropriations relating to staff. The strategic subsidies supporting training and investment were rearranged in a single strategic transformation subsidy. Better targeting of these aid instruments can produce recurring savings (€20 million) on the Fonds voor Flankerend Economisch Beleid. Savings amounting to €30 million can also be achieved by delaying the entry into force of measures concerning a new social policy.

Finally, it is important to stress that the Flemish government, entirely in line with its prudent fiscal policy, also provides a further buffer of €106 million to cope with any setbacks in 2012.

In all, the Flemish government concluded its first budget adjustment with a surplus of €10.9 million, enabling it to pursue much of its new policy in 2012 (€200 million) aimed at consolidating the economic fundamentals. The only item to be postponed is the launch of its new social policy. Moreover, decisions have been taken which will have a positive impact on the budgets of future years (see below).

A second budget adjustment is likewise scheduled; it will be concluded at the end of April.

As usual, a monitoring committee keeps track of the evolution of the expenditures and revenues in the current fiscal year.

### **Medium-term measures**

At the time of the first 2012 budget adjustment, the Flemish government took a number of decisions which will improve the budget balance in the years ahead, and will therefore enable it to maintain a balanced budget:

- The pre-pension scheme for teaching staff will be scaled down (TBS [special leave] scheme).

For teachers of the nursery schools born on or after 1 January 1957 (below the age of 55 years on 31 December 2011), the present TBS scheme will be restricted to 2 years preceding the date on which the employee concerned is entitled to a State pension.

For other staff members born on or after 1 January 1955 (below the age of 57 years on 31 December 2011), the TBS scheme will be abolished.

The interim salary of staff members taking up the TBS scheme will also be reduced.

- When the 2013 budget is drawn up, restrictions will apply to the Flemish Community, including the education sector – just as to the French Community – limiting the number of days' sick leave which can be taken cumulatively (prior to retirement) to 180 working days or 250 calendar days with effect from 1 January 2013.
- The target for reducing the number of employees in the Flemish public sector is increased from 5% to 6% in 2014.
- Regarding De Lijn, cost coverage must increase by 0.5 percentage point per annum in accordance with the provisions of the management agreement. In 2013 and subsequent years, that will be achieved in part by measures concerning revenues.

### *3.3.2.3 Brussels-Capital Region*

The 2011 budget and the 2012 adjustment took account of a budget deficit of €313 million. When the 2012 budget was drawn up, the budget deficit was cut to €254 million, which was about 20% down against the 2011 target. Since agreement was reached at federal level on the proper funding of the Brussels-Capital Region, the Region will pursue a multi-annual path to arrive at a balanced budget.

The 2012 budget comprises a reduction in the deficit, but that is coupled with a reduction in the outstanding amount in the government departments. There is provision for more liquidation appropriations than for commitment appropriations. The excess amounts to around €70 million.

Regarding the priority challenges for the Brussels-Capital Region, namely the population growth which we face, measures concerning employment, training and mobility are included in the 2012 budget:

- more than €50 million extra for a mobility policy;
- more than €20 million extra for the New Deal and the employment policy;
- the resources needed to guarantee the funding of 3 500 new teaching posts.

Although it is not yet possible to give the exact ESA deficit figure for the execution of the 2011 budget, it can be assumed that the target of - €313 million will certainly be achieved. That figure takes account of the budget implications following the voluntary liquidation of Holding Communal. For the Brussels-Capital Region, that implies an additional deficit of €97.5 million which was to be offset at the time of execution of the 2011 budget.

#### *3.3.2.4 German-speaking Community*

Following the repercussions of the financial crisis on public budgets and the medium-term economic outlook, the government of the German-speaking Community is considering various measures to ensure a balanced budget in 2015.

While avoiding any job cuts, the government will take the following measures:

a) reduction in wage costs:

- Staff of the German-speaking Community departments, including teaching staff:
  - temporary wage scale reduction of 1% in 2013 and a further 1% in 2014 ; this measure will be abolished in 2018 and 2019; the specific measures are at the negotiation stage with the unions (results expected in mid-April);
  - reform of the system of cumulative days' sick leave in the civil service.
- Government and Parliament:
  - permanent 2% reduction in the salaries of Ministers and the Parliamentary President.

b) reduction in operating expenses and subsidies

- Government departments:

reduction of up to 10% in the department operating costs which are not linked to current contracts;
- local authority grants:

grant increases in 2013 and 2014 will be limited to the increase in the index;
- public interest bodies:

grants for 2013 and 2014 will be limited to the figure for 2012;
- bodies subsidised under a management contract in force up to 2014:

2015 subsidy will be limited to the amount of the subsidy granted in 2014.

### 3.3.2.5 The French Community Commission (COCOF)

The COCOF suffers from structural under-funding which has hampered its budget position for a number of years. The entity does not in fact have any tax-raising powers and is therefore dependent on institutional funding.

In view of this situation, a strategy for restoring a balanced budget was introduced in 2009 by a dual mechanism: expenditure control and reliance on the solidarity of the main institutional funding providers (the French Community and the Brussels-Capital Region). For many years the COCOF has also sought structural refinancing by the federal government. Under the Sixth Institutional Reform, refinancing becomes a reality, and will be spread over the years 2012 to 2015 in tranches of €8 million per annum, eligible for indexation and linked to growth. In 2016, the refinancing amounting to €32 million will take full effect in an annual budget of approximately €380 million.

The efforts made and the refinancing obtained will enable the COCOF to view the future with more equanimity. The target path set by the High Council of Finance for the COCOF provides for a deficit of €11.5 million in 2012. In the initial 2012 budget, the COCOF had made provision for a budget deficit of €1.5 million. In accordance with its own path for the restoration of a balanced budget since 2009, the COCOF has in fact systematically recorded a deficit equal to or less than the figure "authorised" by the HCF, as is evident from the table below:

**Table 13: The COCOF path**

<i>(In € million)</i>	Deficit authorised by the HCF	Deficit entered in the initial budget
2009	4.0	4.0
2010	2.0	2.0
2011	8.1	2.0
2012	11.5	1.5



However, for 2012 there is a significant one-off factor to be taken into account: by a decision on 26 January 2012, the College of the French Community Commission authorised the IBFFP [Brussels French Institute of Vocational Training] (Bruxelles-Formation – OIP [Brussels-Training - Office of International Programmes] included in the consolidation scope of the COCOF) to acquire a building for the purpose of organising its training programmes and to cut its rental costs in the future while improving the vocational training available in the Brussels-Capital Region. That purchase will have a direct impact on the budget balance in 2012 without exceeding the target set by the HCF. This one-off transaction will secure structural savings in the COCOF OIP budget from 2013 onwards, and the COCOF will revert to its original path for restoring a balanced budget.

The aim of the College of the French Community Commission is in fact to achieve a balance in the initial 2013 budget, or at the latest in the initial 2014 budget, taking account of the movement in the inflation and growth parameters. For that purpose, on 17 November 2011 the COCOF adopted a multi-annual projection based on strict parameters for the movement in expenditure and cautious revenue assumptions.

In parallel with the structural measures for monitoring expenditure, processes for the monitoring of the execution of the budget were set up some years ago. In fact, an annual budget review is always conducted in the initial months of the year and may give rise to adjustment measures if necessary. Moreover, adjustments are made systematically at the end of the year, at the same time as the initial budget is drawn up for the following year. This monitoring process has already proved effective and has kept the deficit under control in recent years.

### **3.4 The medium-term budget**

In preparation for the present stability programme, the Federal Planning Bureau carried out a macro-economic projection for the period 2012 – 2017.<sup>6</sup> The Borrowing Requirements section of the High Council of Finance used this as the basis for its recommendation. The scenario assumes that there is no change of policy, and decisions of the federal budget review and, if the data are already available, those of the Communities and Regions are taken into account. The actual figures, used as basis, for 2011 differ in several respects from the figures which the NAI stated in its notification in connection with the excessive deficit procedure. The basic figures also take no account of the change of method in the local authority accounts.

Table 14 shows the budget evolution with no change of policy, as estimated by the Federal Planning Bureau, following adjustment of the local authority accounts. The Borrowing Requirements section based its opinion on these same adjusted figures.

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- <sup>6</sup> Economic outlook 2012 – 2017, March 2012 version.

**Table 14 : Path with no change of policy and target path**

<i>In % of GDP</i>	2011	2012	2013	2014	2015
	With no change policy				
Net lending	-3.7	-2.7	-3.1	-3.0	-3.0
Primary balance	-0.4	0.7	0.4	0.4	0.5
Interest charges	3.3	3.5	3.5	3.5	3.5
	Target path				
Net lending	-3.7	-2.8	-2.15	-1.1	0.0
Primary balance	-0.4	0.7	1.3	2.3	3.4
Interest charges	3.3	3.5	3.5	3.4	3.4
	Annual difference in comparison to no change policy				
Net lending	0.0	-0.1	1.0	0.9	1.1
Primary balance	0.0	0.0	1.0	0.9	1.0
Interest charges	0.0	0.0	0.0	-0.1	-0.1
	Cumulated difference in comparison to no change policy				
Net lending	0.0	-0.1	1.0	1.9	3.0
Primary balance	0.0	0.0	1.0	1.9	2.9
Interest charges	0.0	0.0	0.0	-0.1	-0.2

Source: Federal Planning Bureau, High Council of Finance (March 2012)

Annual difference in comparison to no policy change Cumulated difference in comparison to no policy change. The Federal Planning Bureau predicts in its interim forecasts that the 3% limit will be exceeded slightly in 2013. The final version of this multiannual projections of the Federal Planning Bureau will be published in mid-May. Attention should be drawn to the following points:

- The basic figures for 2011 differ slightly from those which the NAI used in its notification in connection with the excessive deficit procedure; thus, the social contributions are €80 million lower than the NAI figures.
- For 2012, the Federal Planning Bureau took the figures proposed regarding measures to combat fraud, but without taking account of the growth profile predicted by the government for the coming years. Taking this evolution into account, the yield should increase by €280 million in 2013.

- When the multi-annual plan was drawn up, a clear growth path had been specified for health care. In 2013, the budget target may increase by 2% in real terms, but the Federal Planning Bureau takes no account of that decision and uses its own method to estimate health care expenditure. The expenditure estimated by the Planning Bureau consequently exceeds the statutory target by €190 million.
- At the time of the budget review, the federal government decided to make provision for revenue amounting to €203 million in 2012 in consequence of the acceleration of the levy on life insurance reserves. A similar measure could be considered in regard to pension savings, and would bring in revenue amounting to €211 million. That revenue could already be used in 2012 or, if not, in 2013. The estimates by the Federal Planning Bureau and the High Council with no change of policy do not yet allow for the potential effect of this revenue amounting to €211 million.

Taking account of the foregoing, the estimate with no change of policy can therefore be considered cautious. The federal government takes the view that, on the basis of the observations mentioned, the balance will remain below the 3% limit in the years ahead with no change of policy. In any case, as already stated, the Belgian authorities will take the necessary measures to bring the deficit down to 2.15% of GDP in 2013 and achieve a balanced budget in 2015.

Table 15 sets out the targets for the general government.

The federal authorities will almost have to eliminate the deficit by 2015, knowing that – according to the path adopted here – a small 0.1% deficit is still assumed. In regard to social security, a balanced budget is projected for the period 2012-2015. For the years 2012-2014, that is the combined result of the economy measures and the balancing appropriation provided for by the Programme Law. In the future, further efforts will also be needed to restore the financial balance of the system. In the meantime, the federal authorities will continue to ensure a balanced budget in ESA terms by means of a balancing appropriation (including after 2014).

Regarding the Communities and Regions, a balanced budget is projected for 2014, with a small surplus for the local authorities of around 0.1% of GDP, owing to the impact of the electoral cycle<sup>7</sup>. It can therefore be assumed that Entity II will record a small surplus over the period 2014-2015.

As already described, the respective targets of Entities I en II are conditioned, as from 2014, on transfer of charges from Entity I to Entity II. Such a transfer may be notably materialized through the implementation of the Special Finance Act reform. The different entities will make the relevant efforts to safeguard the path to the budget balance in 2015. For this purpose, the government will base on the April 2012 report of the HCF.

Table 15 sets out the commitments relating to the balance. This path is valid on the basis of the said growth assumptions. If the growth forecasts by 2015 were to be revised downwards, it belongs to the government, on the basis of a report of the Section "Borrowing Requirement" of the HCF, to reassess the budgetary prospects and to check in such a case that maintaining a strict nominal balance target in 2015 does not imply an overly restrictive fiscal stance. On the contrary, if the growth should appear to be higher than currently estimated for the coming years, lower improvements of the structural balances would be necessary for reaching the global normative path.

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- <sup>7</sup> The cooperation agreement dated 19/12/2009 contained a comparable wording: " .... Moreover, the ESA-95 rules must be applied on a multi-annual basis (a municipal legislature) to take account of the local authority investment cycle."

**Table 15: General government budget outlook**

	2011 <i>Level</i>	2011 <i>% of GDP</i>	2012	2013	2014	2015
1. General government	-13,709	-3.7	-2.8	-2.15	-1.1	0.0
2. Central government	-12,438	-3.4	-2.4	-2.15	-1.2	-0.1
3. Communities and regions and local authorities	-888	-0.2	-0.2	-0.1	0.0	0.0
4. Local authorities	-158	0.0	-0.2	0.1	0.1	0.1
5. Social security	-225	-0.1	0.0	0.0	0.0	0.0
<b>General government</b>						
6. Total revenue	182,412	49.4	51.3	51.3	51.6	52.0
7. Total expenditure	196,121	53.1	54.0	53.5	52.7	52.0
8. Net lending/borrowing	-13,709	-3.7	-2.8	-2.1	-1.1	0.0
9. Interest expenditure (EDP)	12,196	3.3	3.5	3.5	3.4	3.4
10. Primary balance	-1,513	-0.4	0.7	1.3	2.3	3.4
11. One-off and other temporary measures	-1,844	-0.5	0.3	0.0	0.0	0.0
<b>Selected components of revenue</b>						
12. Total taxes	108,023	29.2	30.5	30.6	30.8	31.1
12a. Taxes on production and imports	46,627	12.6	13.1	13.0	13.1	13.2
12b. Current taxes on income, wealth, etc	58,729	15.9	16.7	16.9	17.0	17.1
12c. Capital taxes	2,667	0.7	0.7	0.7	0.7	0.8
13. Social contributions	61,593	16.7	17.0	17.1	17.1	17.1
14. Property income	3,709	1.0	1.0	1.0	1.0	1.0
15. Other	9,088	2.5	2.7	2.7	2.7	2.7
16. Total revenue	182,412	49.4	51.3	51.3	51.6	52.0
p.m. Tax burden	171,370	46.4	47.9	48.2	48.4	48.7
<b>Selected components of expenditure</b>						
17. Final consumption expenditure	60,170	16.3	16.5	16.1	15.8	15.4
18. Social payments	92,983	25.2	25.8	25.9	25.8	25.7
<i>of which</i> Unemployment	6,669	1.8	1.8	1.8	1.8	1.7
19. Interest expenditure	12,196	3.3	3.5	3.5	3.4	3.4
20. Subsidies	9,544	2.6	2.7	2.6	2.5	2.5
21. Gross fixed capital formation	6,256	1.7	1.8	1.6	1.5	1.5
22. Other	14,972	4.1	3.8	3.7	3.6	3.5
23. Total expenditure	196,121	53.1	54.0	53.5	52.7	52.0

The distribution of efforts between revenue and expenditure, as mentioned in Table 15, is purely indicative.

### **3.5 Structural improvement in the balance in accordance with the European Union requirements**

In the course of the excessive deficit procedure, the European Council had recommended that the Belgian authorities reduce the structural deficit by an average of 0.75% of GDP per annum during the period 2010-2012. That target was met for 2012. According to the present path, the structural improvement will be at least 0.75% per annum in the coming years (see table 16).

**Table 16: Composition of the structural balance**

<i>% of GDP</i>	2011	2012	2013	2014	2015
1. Real GDP growth	1.9	0.1	1.3	1.7	1.8
2. Net lending of general government	-3.7	-2.8	-2.15	-1.1	0.0
3. Interest expenditure	3.3	3.5	3.5	3.4	3.4
4. One-off and other temporary measures	-0.5	0.3	0.0	0.0	0.0
5. Potential GDP growth	1.3	1.2	1.3	1.4	1.5
Contributions:					
Labour	0.5	0.4	0.4	0.5	0.5
Capital	0.5	0.4	0.4	0.4	0.4
Total factor productivity	0.3	0.4	0.4	0.5	0.6
6. Output gap	-0.7	-1.9	-1.9	-1.5	-1.2
7. Cyclical budgetary component	-0.4	-1.0	-1.0	-0.8	-0.6
8. Cyclically-adjusted balance (2 - 7)	-3.3	-1.8	-1.1	-0.3	0.6
9. Cyclically-adjusted primary balance (8 + 3)	0.0	1.8	2.4	3.1	4.0
10. Structural balance (8 - 4)	-2.8	-2.1	-1.2	-0.3	0.6

The structural component of the fiscal balance is calculated on the assumption that potential growth increases slightly by around 1.2% in 2012 rising to 1.5% in 2015. Potential growth is in fact still well below the figure prevailing before the financial crisis, when it was between 1.8 and 1.9%. The financial crisis caused lasting erosion of potential growth, particularly via a decline in the capital stock and an increase in structural unemployment, which is reflected in a loss of human capital.

In 2014, the structural deficit will already be reduced to 0.3% of GDP, while a structural surplus of 0.6% of GDP is projected for 2015. This means that in 2015 Belgium will have met its MTO in structural terms, defined for Belgium as 0.5% of GDP. Attainment of the MTO will permit prefinancing of part of the costs of population ageing.

True, these estimates are uncertain, notably because of the possible impact of the economic and financial crisis on the potential growth of the economy. Also, the extent to which the decline in potential growth due to the financial crisis and population ageing will be structural and permanent depends on the economic policy decisions taken now and in the future by the various levels of power. In that context, the Belgian authorities aim to continue to increase the employment rate and step up the measures to encourage research and development under the EU2020 strategy. Such measures should provide sustainable support for the potential growth of the Belgian economy.

### ***3.6 Reduction in the public debt in accordance with the European commitments***

In 2007, the debt ratio was cut to 84.1% of GDP. The financial and economic crisis halted that reduction. In 2011, the debt ratio climbed to 98%. Apart from the endogenous increase in the debt ratio due to the contraction or weak growth of GDP and the significant deterioration of public finances in the wake of the economic crisis, the increase in the debt ratio is also attributable to the importance of exogenous factors. For one thing, it was necessary to intervene repeatedly to stabilise the financial sector; as well as that, the contribution to the various European support mechanisms and operations also has an impact on the debt.

Since the high debt ratio makes the Belgian economy particularly sensitive to sudden interest rate movements, the Belgian government aims to stabilise the debt ratio as quickly as possible. Taking account of the impact of certain operations in connection with the European support mechanisms, it is first necessary to continue with the structural consolidation of public finances in order to allow the endogenous factors to reduce the debt ratio.



**Table 17: Debt ratio determinants**

% of GDP	2011	2012	2013	2014	2015
1. Gross debt	98.0	99.4	97.8	95.5	92.3
2. Change in gross debt ratio	2.0	1.3	-1.6	-2.3	-3.2
	Contributions to changes in gross debt				
3. Primary balance	-0.4	0.7	1.3	2.3	3.4
4. Interest expenditure	3.3	3.5	3.5	3.4	3.4
5. Stock-flow adjustment	2.1	0.9	-0.5	0.0	0.1
<i>p.m. Implicit interest rate on debt</i>	3.6	3.7	3.6	3.6	3.7
<i>p.m. Endogenous factors</i>	-0.1	0.4	-1.1	-2.3	-3.3

Since economic growth will remain weak in 2012, the target primary balance will no longer be enough to achieve an endogenous reduction in the debt ratio. As well as an endogenous increase of 0.4%, the debt ratio will also see an exogenous rise of 0.9%. Moreover, the figures take account of a substantial repayment of loans granted to financial institutions at the time of the financial crisis (€2.6 billion). However, the positive impact on the debt ratio is negated by the impact of factors such as Belgium's contribution under the European Stability Mechanism (€1.1 billion) and the EFSF operations (€4.8 billion)<sup>8</sup>. Exogenous factors are therefore the main reason why the debt ratio will rise to 99.4%.

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- <sup>8</sup> The inclusion of EFSF operations in the debt takes account of the Eurostat guidelines (publication dated 12/04/2012).

In 2013, the repayment of certain loans by financial institutions both to the federal government and to certain Regions will continue to be taken into account. In 2013, account will also be taken of the payment of two tranches to the ESM totalling €1.1 billion. That being so, exogenous factors will reduce the debt ratio. The combination of stronger economic growth and the effects of the target scenario means that this process will be reinforced by endogenous factors, bringing the debt ratio down by 1.6%. In subsequent years, it is mainly endogenous factors that will reduce the debt ratio by 2.3% in 2014 and 3.2% in 2015. In the coming three years, the debt ratio will therefore be cut by over 2%, on average, in conformity with the European regulations on the subject.<sup>9</sup>

Apart from a substantial loan repayment by one financial institution, this path takes no account of other possible operations (such as privatisations).

In the period 2012-2015, the debt ratio will decline by 7.5%, making an annual average reduction of 2.5%. Tables 18 and 19 show that this reduction is based largely on the effects of the structural consolidation of public finances. The difference between the target primary balance and the primary balance needed to stabilise the debt bears witness to the robustness of the scenario.

**Table 18: The primary balance**

<i>In % of GDP</i>	2011	2012	2013	2014	2015
Primary balance required to stabilise the debt	-0.5	1.2	0.2	0.0	0.1
Target primary balance	-0.4	0.7	1.3	2.3	3.4

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<sup>9</sup> The new European regulations stipulate that the debt must be cut each year by 1/20<sup>th</sup> of the difference between the debt ratio and the ceiling of 60% of GDP. That annual reduction is calculated as an average over three years. See: Regulation (EU) n° 1177/2011 of the Council of 8 November 2011 amending Regulation (EC) n° 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, amending Article 2 of Regulation (EU) n° 1467/97 by inserting an Article 2(a).

## 4 Comparison with the stability programme 2011–2014, sensitivity analysis

### 4.1 *Comparison with the stability programme 2011-2014*

The consolidation path for public finances proposed by the Belgian authorities under this stability programme ensures the speedy reduction of the deficit and the public debt. That reduction is in phase with the previous stability programme and meets the requirements set by the European Union Council.

Table 20 compares the growth assumptions and budget targets of the two successive stability programmes.

The projected for economic growth is lower than last year's forecast. The economic downturn worsens significantly forecasts for 2012, and it will be hard to achieve 2% growth in the coming years as was still being projected last year. For the period 2012-2015 and compared to the previous programme, the growth lost will represent 4.1 percentage points, i.e. an average of 1 percentage point less per annum.

Despite this deterioration in the economic outlook, the path still leads to balance in 2015.

The debt ratio is higher than was forecast last year. The reason lies notably in the aid to the financial sector (Dexia) and the aid for EU Member States in difficulty. In 2013 the debt ratio will fall by 1.6% of GDP to 97.8%. After that, the debt will diminish each year by over 2% of GDP, in accordance with the European regulations<sup>10</sup>.

It is vital to reduce the debt and create budget surpluses after 2015 in order to guarantee the sustainability of public finances in the long term in the context of population ageing.

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- <sup>10</sup> See note 9.

**Table 19: Comparison with the previous stability programme**

<i>In % of GDP</i>	2011	2012	2013	2014	2015
<b>Real GDP growth</b>					
Previous update	2	2.3	2.1	2.3	2.3
Current update	1.9	0.1	1.3	1.7	1.8
Difference	-0.1	-2.2	-0.8	-0.6	-0.5
<b>General government net lending</b>					
Previous update	-3.6	-2.8	-1.8	-0.8	0.2
Current update	-3.7	-2.8	-2.15	-1.1	0.0
Difference	-0.1	0.0	-0.3	-0.3	-0.2
<b>General government gross debt</b>					
Previous update	97.5	96.5	95.1	92.2	88.4
Current update	98.0	99.4	97.8	95.5	92.3
Difference	0.5	2.9	2.7	3.3	3.9

#### **4.2 Sensitivity analysis**

The economic outlook remains uncertain in the context of the debt crisis within the euro area, uncertainty on the financial markets, and a substantial rise in the prices of oil and commodities.

In accordance with the code of conduct, it is therefore important to conduct sensitivity analyses on the macroeconomic parameters for the path described in this stability programme.

Two sensitivity analyses are conducted, one concerning GDP growth and the other concerning interest rates.

#### **a. Sensitivity analysis concerning GDP growth**

In regard to GDP growth, we examine two alternative scenarios. In the first scenario, economic growth slows down over the period 2012-2015, by 0.5 percentage point per annum, or a cumulative 2% during the period in question. In the second scenario, GDP growth over the period 2011-2015 is 0.5 percentage point higher than in the scenario used for the present stability programme.

In this analysis, we assume that the elasticity of public finances to GDP is constant at 0.54, of which 0.47 relates to revenue and 0.07 to expenditure.

If growth is higher, the fiscal balance will automatically become positive more quickly. If growth were 0.5% higher than in the baseline scenario, the fiscal balance for 2012 would improve by 0.27% of GDP. In 2015, the impact on the fiscal balance of growth which is 0.5% higher than the baseline scenario in each year would be 1.1% of GDP. According to this hypothesis, the deficit will already be reduced to 0.3% in 2014 and there will be a surplus in 2015

If growth is lower than forecast, the annual impact would be 0.27% of GDP, which means that the fiscal balance would deteriorate by 0.27% of GDP. In 2015 this deterioration would be 1.1% of GDP. This increase in the deficit is due partly to factors relating to revenue, such as a reduction in tax revenues, and partly to factors concerning expenditure, such as higher spending on unemployment benefits.

**Table 20: Impact of growth deviations on the fiscal balance**

<i>In % of GDP</i>	2011	2012	2013	2014	2015
Stability programme					
Real GDP growth	1.9	0.1	1.3	1.7	1.8
Net lending	-3.7	-2.8	-2.15	-1.1	0.0
Positive deviation of 0.5 percentage point					
Real GDP growth		0.6	1.8	2.2	2.3
Net lending		-2.5	-1.6	-0.3	1.1
Negative deviation of 0.5 percentage point					
Real GDP growth		-0.4	0.8	1.2	1.3
Net lending		-3.0	-2.7	-1.9	-1.1

In case of significant deterioration in the growth outlook up to 2015, it belongs to the government, on the basis of a report of the Section “Borrowing Requirement” of the HCF, to reassess the budgetary prospects and to check in such a case that maintaining a strict nominal balance target in 2015 does not imply an overly restrictive fiscal stance. On the contrary, if the growth should appear to be higher than currently estimated for the coming years, lower improvements of the structural balances would be necessary for reaching the global normative path. In any case, the federal government is committed to a structural improvement in the fiscal balance of at least 0.5% of GDP per annum until the MTO is achieved<sup>11</sup>.

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<sup>11</sup> In accordance with Article 1.5 of Regulation (EU) n° 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Regulation (EC) no 1466/97 of the Council on the strengthening and the surveillance of budgetary positions and the surveillance and coordination of economic policies, amending Article 2(a) of Regulation (EU) n° 1466/97.

## b. Sensitivity analysis concerning interest rates

In the current economic environment, this interest rate sensitivity analysis is essential in view of the sensitivity of public finances to interest rate fluctuations.

A rise in financial market interest rates would affect public finances via various channels. First, in view of the continuous need for refinancing, a direct impact on interest charges which would have an adverse effect on the balance. Next, interest rate increases have an adverse influence on economic activity, mainly via the direct effect of interest rates on consumption and investment. In addition, depending on the nature of the interest rate rise (short- or long-term), financial institutions would become less profitable.

If both short- and long-term interest rates were to rise by 100 basis points from 1 May 2012 over the entire period 2012-2015, the impact on the federal public debt interest charges (over 90%), taking account of the estimated average maturity of the debt, comes to +€0.2 billion in 2012 (0.05% of GDP) and +€1.7 billion in 2015 (0.40% of GDP).

**Table 21: Impact of an interest rate increase**

<i>Impact of a 100 basis point increase from 1 May 2012</i>	2012	2013	2014	2015
Difference in interest charges compared to the baseline scenario (in € million)	199	959	1,322	1,682
Difference in interest charges compared to the baseline scenario described (in % of GDP)	0.1	0.2	0.3	0.4

The impact on the fiscal balance solely concerns the direct effect of an interest rate increase, as the indirect impact is not included in this sensitivity analysis.

## 5 Sustainability of public finances

### 5.1 *Political strategy*

The medium- and long-term sustainability of public finances constitutes a major challenge for the future. Like many other countries, Belgium faces a substantial twofold budgetary challenge: on the one hand, demographic developments and on the other, the consequences of the economic and financial crisis.

For the Belgian public authorities, population ageing is one of the major challenges of the decades ahead. The "fiscal cost of ageing" is a fundamental indicator in the assessment of the long-term sustainability of public finances. That is why the challenge of population ageing must be at the heart of the definition of the priorities of the various levels of government. That is expressed by the procedure included in the Law of 5 September 2001 guaranteeing a constant reduction in the public debt and creating an Ageing Fund. That law in fact stipulates that the Study Committee on Ageing will publish an annual estimate of the cost of ageing, and that the public authorities must spell out their policy on the subject.

To address the challenge of population ageing, the Belgian public authorities have developed a strategy geared to three fundamental priorities. The first concerns the budget, and aims at reducing the public debt. The second priority is economic, and concerns raising the employment rate and stimulating economic activity. The third priority relates to the consolidation of a social security system which is strong and affordable and based on solidarity.

Fiscal policy has always been a key element of the Belgian strategy for coping with the budgetary impact of ageing. However, that was thwarted by the economic and financial crisis, which had an adverse influence on both the revenue and the expenditure side of the government accounts.



The Belgian public authorities chose to make gradual progress towards balanced public finances by means of economy measures while safeguarding economic growth. At the end of 2009, the various Belgian levels of government endorsed the objective of restoring a balanced budget for the government as a whole by 2015 in order to ensure sustainable public finances in the medium and long term. Fiscal sustainability forms the foundation of economic growth which is not only sustainable but is also based on solidarity, by ensuring collective funding of age-related expenditure in a context of population ageing. Cutting the debt ratio reduces future interest charges, so that the resulting margin can be used, in particular, to cover the rising expenditure on social welfare<sup>12</sup>.

The second pillar of the Belgian strategy for addressing the ageing problem concerns boosting the employment rate (see section 6.1 below). A higher number of persons in work means that the burden of funding social expenditure is more evenly spread. The Belgian public authorities are currently implementing structural reforms <sup>13</sup> relating to pensions (more particularly early retirement) and the labour market ("prévisions" system which is to be known from now on as "unemployment with a company supplement", career breaks and time credit, and unemployment benefits). These measures are intended to boost the employment rate.

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- <sup>12</sup> In the latest version of the survey on Belgium, the OECD calculated that Belgium's debt ratio will decline between now and 2030 if Belgium adheres to the path of the stability programme 2011-2014, notably a surplus of 0.2% of GDP in 2015 (see Annex 1.A2 to the 2011 survey on Belgium). After that date, the costs of ageing will increase the debt ratio.

- <sup>13</sup> Cf. December 2011 coalition agreement. A summary of these structural measures is also presented in the section on "Quality of public finances".

Apart from the key aspects relating to public debt reduction and boosting the employment rate, the third pillar of the Belgian strategy for coping with the problem of population ageing consists in strengthening the sustainability of social security. Structural reforms, particularly those mentioned above, are also planned to guarantee social security in the long term. The ceiling for the maximum growth of health care expenditure is reduced without that having an adverse impact on the quality and accessibility of patient care (see section 6.4 below). In regard to pensions, the federated entities are being given responsibility since they will have to contribute towards funding pensions for their staff.

## **5.2 Long-term budgetary outlook and implications of population ageing**

The most recent report by the Study Committee on Ageing is dated June 2011<sup>14</sup>. That document calculates the fiscal cost of ageing, a concept defined as the variation in total social expenditure over a given period. Owing to the recent structural reforms<sup>15</sup>, notably those concerning pensions and the labour market, implemented by the Belgian public authorities since June 2011, the Federal Planning Bureau – which provides the secretariat for the Study Committee on Ageing – carried out an update, in March 2012, of the estimate of the fiscal cost of ageing which takes account of the impact of these reforms in so far as the necessary data are already available.

Some of the reforms or measures are not included in the simulation because, at this stage, there is insufficient information available on their implementing arrangements (e.g. in the case of the public sector pension reforms). The final arrangements and some methodological fine-tuning will be taken into account in the annual report by the Study Committee on Ageing, to be published in June 2012.

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- <sup>14</sup> High Council of Finance, Study Committee on Ageing, *Annual Report*, June 2011.

- <sup>15</sup> Cf. December 2011 coalition agreement and "Quality of public finances" section.

The projection by the Planning Bureau takes its demographic assumptions from the "Population forecast 2010-2060". Regarding the long-term macroeconomic assumptions, per capita labour productivity increases by 1.5% and the structural unemployment rate is 8%<sup>16</sup>, as in the previous reports by the Study Committee on Ageing (including older unemployed persons not seeking work). According to the resulting macroeconomic projection, the employment rate rises from 64.2% in 2011 to 68.8% in 2060. Between 2011 and 2060, annual economic growth averages 1.7%. The scenario adopted assumes the gradual return to a growth rate comparable to the average recorded before the crisis.

According to the baseline scenario used by the Federal Planning Bureau for the March 2012 update, total social expenditure would increase by 6.0% of GDP between 2011 and 2060. More specifically, total social expenditure would come to 31.3% of GDP in 2060, compared to 25.3% of GDP in 2011. The two main components of this increase are pension expenditure and health care costs. Between 2011 and 2060, pension expenditure would rise by 4.6% of GDP (from 9.9% of GDP to 14.5% of GDP), while health care costs would increase by 2.9%. According to the assumptions made, unemployment expenditure would fall by 0.9% of GDP between now and 2060. A decline is also seen in the costs relating to family allowances (-0.3% of GDP), incapacity for work (-0.1% of GDP), expenditure on unemployment with a company supplement<sup>17</sup> (-0.2% of GDP) and the costs relating to other social spending (-0.1% of GDP).

In the long term, between 2012 and 2060 the reforms introduced by the new government should generate a considerable increase in the employment rate of older workers (55-64 years). Compared to the baseline scenario, that rate would increase by 5.6%. The reforms yield total savings amounting to 0.4% of GDP on the fiscal cost of ageing. Both the costs relating to unemployment and those concerning unemployment with a company supplement (formerly "pre-pension") would decline by 0.1% of GDP. The cost of employees' pensions would fall by 0.2% of GDP. As already stated, this is an initial estimate of the impact of the reform, as knowledge of the implementing arrangements is still incomplete.

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- <sup>16</sup> Definition by the Federal Planning Bureau.

- <sup>17</sup> Formerly "pre-pension".

Moreover, there are some additional decisions which have yet to be taken (e.g. concerning "pension bonus").

The reforms are an important step in the right direction. Some accompanying decisions, such as concerning the retirement bonus, may further enhance the reforms' impact on the budget. The government wish to increase the average retirement age gradually but systematically, in order to strengthen fiscal sustainability thereafter. However, to ensure that the policy is effective both socially and in economic terms, it is essential for the reforms to be accompanied by a change of attitude among workers and employers concerning the employment of staff over the age of 50 years.

In the medium term, from 2011 to 2015, the fiscal cost of ageing would rise by 1.2% of GDP. Still in the medium term, the biggest increase will occur in expenditure on pensions (+0.6% of GDP) and health care costs (+0.4% of GDP). Conversely, unemployment expenditure would decline by 0.1% of GDP between 2011 and 2015.

**Table 22: Budgetary implications of ageing**

<i>(In % of GDP)</i>	2011	2012	2015	2030	2060	2011- 2015	2015- 2060	2011- 2060
Pensions	9.9	10.2	10.5	13.7	14.5	0.6	4.0	4.6
Employees	5.4	5.6	5.8	7.6	7.9	0.4	2.1	2.5
Self-employed	0.8	0.8	0.8	1.1	1.1	0.0	0.3	0.3
Public sector	3.7	3.9	3.9	5.0	5.5	0.2	1.6	1.8
Health care	8.1	8.2	8.5	9.4	11.0	0.4	2.5	2.9
Invalidity	1.6	1.7	1.7	1.6	1.5	0.1	-0.2	-0.1
Unemployment	2.0	2.0	1.9	1.3	1.1	-0.1	-0.8	-0.9
Unemployment with company supplement	0.4	0.4	0.4	0.3	0.3	0.0	-0.1	-0.2
Family allowances	1.6	1.7	1.6	0.6	1.4	0.0	-0.2	-0.3
Other social security expenditure	1.7	1.7	1.8	1.7	1.6	0.1	-0.2	-0.1
<b>Total</b>	<b>25.3</b>	<b>26.0</b>	<b>26.5</b>	<b>29.6</b>	<b>31.3</b>	<b>1.2</b>	<b>4.8</b>	<b>6.0</b>
p.m. Salaries of teaching staff	4.1	4.2	4.2	4.3	4.2	0.1	0.0	0.1

Source: Federal Planning Bureau

### **5.3 Contingent liabilities**

The sustainability of public finances is determined not only by the government's actual liabilities, but also by the contingent liabilities. These contingent liabilities are not part of the public debt but only represent a potential debt. When guarantees are called, they trigger capital transfers which then have an adverse impact on the fiscal balance and therefore on the public debt.

Since 2008, against the backdrop of the financial crisis, the federal government has granted – and is still granting – guarantees covering both interbank borrowings by Dexia and risky structured assets of miscellaneous financial institutions. The outstanding amount of the guarantees actually granted by the Federal State to certain financial institutions in connection with the financial crisis decreased from €62.05 to €46.96 billion between the end of 2009 and the end of 2011. In December 2011, the Belgian State granted Dexia Holding SA and Dexia CL (DCL) a provisional State guarantee (up to 31 May 2012) on issues with a maximum maturity of three years, with a ceiling of €27.225 billion (participation rate 60.5% out of a total of €45 billion), of which €24.8 billion was actually granted at the end of March 2012. Apart from this new guarantee granted on 16 December 2011, the outstanding amount of the guarantees to financial institutions is falling steadily. At the end of March 2012 the total amount of the guarantees to financial institutions thus stood at €53.89 billion.

Apart from the guarantees granted in the context of the financial crisis from 2008 onwards, the debts of institutions or firms whose debt service is guaranteed by the Federal State have been declining. At the end of 2011, this State debt guarantee came to €5.35 billion. At the end of December 2011, the total amount of the Federal State debt guarantee thus came to €52.31 billion.

As payment for the grant of the guarantees (service fee) during the financial crisis, the financial institutions paid the federal government €687.3 million in 2010 and €727.9 million in 2011, on the basis of recorded rights . For this year, these non-fiscal revenues are estimated, following the March 2012 budget review, at €840 million.

To complete the picture, it should also be noted that Belgium, as a member state of the euro area, also guarantees the EFSF loans in proportion to its share in the ECB's capital (3.72% at present). These guarantees are not included in the "contingent liabilities" because the EFSF loans are recorded by Eurostat in the consolidated gross public debt.

Finally, it should be mentioned that the Regions have also granted guarantees. In 2011, owing to the liquidation of Holding Communal, the Regions activated guarantees amounting to €450 million. Following the liquidation of Holding Communal, the federated entities no longer provided guarantees for the financial sector on account of the financial crisis.

**Table 23: Contingent liabilities**

<i>In % of GDP</i>	2011	31/03/2012
Guarantees	14.2	15.7
Of which: concerning the financial sector	12.7	14.3

## 6 Quality of public finances

The Belgian authorities consider it essential to pursue the sustainable consolidation of public finances in order to ensure sustainable, balanced economic growth. A credible fiscal consolidation strategy was defined for that purpose, with the effort balanced between revenue and expenditure.

In addition to strictly fiscal measures, this consolidation is based on a series of structural reforms of the labour market. They aim to boost the employment rate, particularly among older workers, and thus to strengthen the economy's growth potential. These reforms will also make it possible to preserve our economic and social model, particularly in the face of the challenge of population ageing.

As part of the fiscal effort relating to revenue, the government also took care not to increase the levies on labour incomes in order to avoid discouraging employment and margins have even been preserved for encouraging job creation. The tax system was made fairer by improving the contribution of the various income categories.

The savings achieved on public spending must not impair the availability of good quality public services. On the contrary, the Belgian authorities ensured that spending became more efficient. In addition, expenditure will be subject to even stricter monitoring.

## **6.1 Boosting labour market participation**

Labour market participation is boosted by reforming the unemployment system and by encouraging the employment of older workers, including by modifying the pension systems.

### ***Reforms of the unemployment system***

The low youth employment rate is a weakness of the Belgian labour market. To ensure that young people enter the job market more quickly, the system of interim allowances for young people leaving education is adjusted from 2012. The benefit is being renamed the integration allowance. The access conditions are tightened up and there is also a time limit on the allowances, taking account of the young person's family circumstances.

Active job-seeking is the priority: the efforts made will be regularly assessed and must be approved for the young person to qualify for benefits. In addition, the period between leaving education and receiving the 1<sup>st</sup> allowance has been extended.

Ordinary unemployment benefits will become more degressive from mid-2012, to encourage job seekers to return to the labour market.

The amount of the benefits will be increased in the first 3 months, but will decline thereafter. The replacement rate will rise to 65% during those first 3 months, and then fall to 60%. The wage ceiling will be reduced after 6 months. A system of additional degressivity will be introduced after a maximum period of 2 years, with systematic reduction of the allowances every 3 months. The current level of the minimum unemployment benefit which depends on the family circumstances will thus be attained gradually after a maximum period of 4 years, depending the work history of the unemployed person.



The concept of a suitable job has been revised in order to increase the occupational and geographical mobility of job seekers. The period in which a job is considered unsuitable has been shortened and adjusted according to age and length of career.

### *Employment of older workers*

Although the employment rate of older people has risen significantly, it is still too low in Belgium. A whole range of measures have therefore been adopted to encourage workers to continue working longer. The measures concern the unemployment, early retirement (prévisions) and retirement systems.

Regarding the rules on unemployment, the age at which a job seeker is subject to the normal procedure for monitoring the search for work (principle of active availability) will be raised from 55 years in 2013 to 58 years in 2016. The checks will be extended to include alternatives to early retirement (pseudo-prévisions) and early retirement (prévisions) . From July 2012, the age criterion according entitlement to the unemployment benefit seniority supplement will be increased from 50 to 55 years.

Access to early retirement (prévisions) is also tightened up, with an increase in the age and seniority conditions from 2012. The age for access to an "ordinary" early retirement (prévisions) increases from 58 to 60 years, and the required seniority is raised from 38 to 40 years. The reform is being phased in and will be completed in 2015. The expression "prévision" is also replaced by 'unemployment with a company supplement'. The specific circumstances of struggling businesses or those undergoing restructuring are taken into account<sup>18</sup> and there is a transitional period for incorporating the differences in the length of working life between men and women. In addition, it will no longer be possible to use the system of half-time early retirement.

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- <sup>18</sup>In the case of struggling businesses, the age for access to early retirement (prévisions) is raised from 50 to 52 years in 2012 and will subsequently be increased in stages to 55 years in 2018. For businesses undergoing restructuring, the minimum stipulated age will rise from 50 to 55 years in 2013.

Employers are also discouraged from resorting to pseudo-pensions and prépensions by an increase in employers' contributions on the supplements that they pay to former workers from April 2012. The amount will be adjusted according to the recipient's age: the earlier the age at retirement, the higher the contributions. Furthermore, firms will have to adopt a specific plan for keeping the oldest workers in employment.

In addition, in the event of restructuring, firms will have to respect their internal age pyramid. They will not be allowed to dismiss all the older workers: instead, they will have to maintain a balance between the various age groups. If they do not, an additional contribution will be levied on early retirement (prépensions), or reductions in social contributions will have to be repaid.

In the face of the challenge of population ageing, it is essential to modernise our pension system to ensure that it is appropriate and sustainable.

In order to increase the actual age at retirement, the conditions concerning minimum age and seniority for early retirement will be gradually increased from 2013. Whereas at present it is possible to take early retirement from age 60 after a 35-year career, those criteria will be 62 and 40 years respectively in 2016. Exceptions are available for long careers.

The pension bonus will also be assessed before December 2012 to reinforce its character as an incentive for working longer.

The requirements will be stepped up for the time credit and career break schemes specific to the end of working life.

From 2012, some periods of inactivity will count less than periods of work when the pension is calculated (it concerns some unemployment periods with a lump-sum allowance, some early retirement (pré-pensions) periods before age 60 and some periods of career breaks). In the private and public sectors, some careers will be extended by aligning the special schemes with the general scheme. In the public sector, pensions will be calculated on the basis of salary in the last 10 years of activity, instead of the last 5 years as previously.

Conditions for working beyond retirement age will be made more favourable from 2013. In particular, the ceiling on permitted earned incomes will be abolished for persons fulfilling the criterion of a 42-year career.

The system of survivor's pension, which is a significant employment trap and mainly concerns women, will be replaced by a system of transitional allowances according entitlement to unemployment benefits with a transitional regime for all people over the age of 30 years on 1<sup>st</sup> January 2012. The rules on cumulating the survivor's pension and an earned income will be made more flexible.

## **6.2 A tax system which favours employment**

In 2013 the government will generate margins for new initiatives, such as:

- A €200 increase in the basic exempted income on low and medium incomes, to reduce the tax burden on working people. This implies a net gain of around €50 EUR per annum for workers (employees, self-employed persons or public officials).
- Additional reductions in social contributions for the first 3 persons recruited in SMEs.
- Creation of new jobs in the non-market sector to take account of the growing needs relating to personal services.

### **6.3 A fairer, greener tax system**

Regarding capital incomes, a new system of taxes on income from movable property is being introduced, including a solidarity contribution on high incomes, the tax on stock market transactions is increased, some capital gains on shares are taxed, and taxation on stock options is raised.

Progress towards a tax system geared more to behaviour favouring the environment is continuing via a new system of taxing company cars. The benefit in kind is now determined on the basis of two factors: the vehicle's CO<sub>2</sub> emissions and its list price. In addition, the excise duty on tobacco is being increased.

A 21% VAT rate now applies to the services of notaries and bailiffs.

The banking sector and the energy sector are also being required to contribute, with a €300 million increase in the proceeds from the nuclear revenue. The fight against tax evasion and social security fraud is being further intensified.

### **6.4 Greater efficiency and rigorous monitoring of expenditure**

An effort has been made to increase the efficiency of public administration, notably by improving interdepartmental management while guaranteeing high quality public services.

The control of health care expenditure aims to ensure the financial balance of social security in a sustainable manner, and is also associated with the aim of reinforcing the high quality system of social welfare.

The ceiling for the growth of health care expenditure has been cut to 2% in 2013 and 3% in 2014<sup>19</sup>. Structural savings are being made, notably in the medicinal products sector, but without increasing the costs to patients.

Expenditures on service vouchers are also controlled by limiting the number per user from 2012 and by increasing the price in 2013.

The structural labour market reforms described previously will also keep down public expenditure while stimulating employment.

Fiscal prudence is also reinforced by the establishment of a "selection committee" responsible for assessing the appropriateness of all expenditure. This committee comprises members of the offices of the Prime Minister, the Deputy Prime Ministers and the Minister for the Budget.

Budget developments will continue to be closely monitored. Following an initial budget review in March 2012, another review will take place in July 2012.

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- <sup>19</sup> From 2015, the ceiling will set by law. In the absence of any legal amendment, the 2014 ceiling will continue to apply.

## 7 Institutional aspects of public finances

### 7.1 Stronger budget procedures

Budget procedures have been reinforced at various points, for two purposes: to boost the efficiency of public spending and to ensure the structural attainment of the objective.

A multi-annual budgeting approach guarantees a structural approach to public finances and discourages one-off measures, instead encouraging efforts to find measures which have an increasing impact as time goes by. The preparation of a multi-annual budget plan for 2012-2014 was a key element in the government negotiations. It will be updated when the initial 2013 budget is drawn up.

The consolidation of public finances requires a multi-annual perspective plus constant monitoring during the fiscal year. At the level of Entity I, the first budget review was already conducted at the beginning of March, while a second is scheduled for July. In addition, some expenditure has been frozen and there is provision for revenues which can be mobilised, which should ensure that the deficit is brought down to 2.8% in 2012. During the preparations for the budget review, the government decided to instruct the monitoring committee<sup>20</sup> - which was set up to monitor the budget position at the time of the caretaker government – to produce a report when preparing each budget review.

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<sup>20</sup>As in 2007, in view of the caretaker government situation, the Council of Ministers of 7 May 2010 created a monitoring committee with the task of monitoring public revenue and expenditure, producing forecasts and preparing regular reports containing specific information on the current and future budget position. The monitoring committee comprises the following members:

- the head of FPS B&CG [Budget and Management Control] or his representative (chairman);
- the head of FPS Finance or his representative;
- the head of FPS Social Security or his representative;
- the general administrator of the NSSO or his representative;
- the general administrator of the INAMI [National Institute for Health and Disability Insurance] or his representative;
- the chief of the Finance Inspectorate;
- the general administrator of the INASTI [National Institute for the Social Security of the Self-Employed] or his representative;

The federal government wants to step up the control of waste and to pursue efficiency gains, so that it can offer a good public service at lower cost. Additional savings can be achieved by improvements to interdepartmental management and better coordination of purchasing procedures. It will also be necessary to reinvest part of the efficiency gains in operational improvements. To that end, the government and the officials in charge will have the support of a small, temporary unit called “Optifed”, comprising internal experts from the public services, notably FPS P&O [Personnel and Organisation] and B&CG, under the authority of the Prime Minister, the Minister for the Civil Service and the Minister for the Budget.

At the time of the budget review, the federal government decided to reinforce the fiscal prudence mechanism for the rest of the year; it will be assessed at the time of the July 2012 budget review. All expenditure items will be assessed in advance by working groups comprising representatives of the Prime Minister, the Deputy Prime Ministers and the Minister for the Budget.

## **7.2 The sixth State reform**

The political agreement concluded on 11 October 2011 by the various parties composing the Government plus the Green Party members outlines a sixth reform of the Belgian State. On the one hand, it was decided to transfer a substantial set of responsibilities from the federal level to the federated entities. There is also provision for a radical change to the Special Finance Act (SFA). That change to the SFA is necessary to regulate the transfer of budget resources to the Communities and Regions following the transfer of powers, but also to clarify the financial responsibility of the Communities and Regions and give them greater fiscal autonomy.

### Transfer of powers

In order to make the power packages more homogeneous and more coherent, thus avoiding conflicts of power between the various authorities levels and increasing managerial efficiency, substantial powers were transferred to the Communities and Regions amounting to a total of €16 898 million<sup>21</sup>. The most substantial power transfers concerned the following spheres:

- Employment market (total: €4 326.1 million) :
  - checks on the availability of unemployed persons;
  - policy geared to target groups;
  - placement.
  - service voucher

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- <sup>21</sup> These are the figures which were set at the time of the 2011 negotiations.



- Health care and personal assistance (total: €4 211.4 million) :
  - standardisation of aid for the disabled, policy on hospitals, policy for the elderly, mental health care, preventive care;
  - organisation of front line health care.
- Family allowances (total: €5 900.1 million):
  - transfer of family allowances, birth and adoption allowances.
- Justice (total: €94.7 million):
  - policy on prosecution and the imposition of penalties;
  - law on juvenile penalties.
- Mobility and road safety (total: €87 million):
  - speed limits, regulations on road signs, vehicle loads, transport of hazardous and abnormal loads.
- Tax expenditure (total: €1 911.4 million)<sup>22</sup> :
  - tax expenditure on accommodation;
  - expenditure on energy-saving investment;
  - service voucher tax credit.

On the occasion of each transfer of powers, the corresponding staff and operating resources (operating costs, buildings) to be transferred will be determined.

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- <sup>22</sup> At the moment of the transfer, the savings measures already taken by the federal government will be taken into account.

## Special Finance Act

To enable the Communities and Regions to exercise their new powers in the optimum way, it is necessary to adapt their resources in line with the new circumstances. Since 1989, transfers of federal power to the Communities and Regions have been governed by the Special Finance Act, which has been amended several times over the years.

The proposed adaptation of the law is based on the principle that, for the Regions, the emphasis must be on fiscal autonomy and financial responsibility. For the Communities, the focus must be on mechanisms linked to the needs of the population.

In regard to the **Regions**, the most significant change in the law on funding concerns the extension of their fiscal autonomy, which was previously very limited. Under the present law, the Regions would derive around 43% of their revenue from their fiscal autonomy with the new law this percentage would rise to 73%. The fiscal autonomy of the three Regions implies that they have the right to levy additional percentages or grant percentage deductions on federal taxes.

This principle implies that a regional government can decide to levy an additional amount or grant a deduction on the federal personal income tax within the limits specific to the Region. While the current special law limits that autonomy to a maximum of +/- 6.75% of the federal tax, the new Special Finance Act will abolish those limits, implying greater autonomy for the Regions to carry out policies in their power fields.. The extent of the fiscal autonomy equals the current transfers of part of the personal income tax less a negative term, increased by an amount corresponding to 40% of the estimated transferred tax expenditure in October 2011.

New transfers will be arranged to cover the new powers transferred to the Regions. In the 'employment' allocation, this concerns 90% of the current federal budget. As stated earlier, 40% of transferred tax expenditure are included in the fiscal autonomy, the remaining 60% will be transferred to the Regions as a grant which will be adjusted annually in line with inflation and 70% of GDP growth.

Another important change is the reform of the horizontal solidarity mechanism between the Regions. The criterion for granting solidarity has been modified, as has the method of calculation in order to remedy the perverse effects of the present system. The solidarity mechanism under the old law is triggered when the proceeds of the per capita personal income tax are below the national average. The Regions concerned then receive a fixed sum which is indexed per head of population and multiplied by the gap in relation to national GDP. The current reform results in 80% compensation for the difference between a Region's share in the population and its share in the proceeds from personal income tax.

Under the current Special Finance Act, the **Communities** receive grants derived from personal income tax and VAT. The new Special Finance Act maintains these two pillars. An important change in the funding results from the elimination in 2012 of the turbo effect provided for by the 2001 Lambermont agreement.

The powers transferred to the Communities concern family allowances, health care, personal assistance and assistance for the elderly. Like the new regional powers, the new Community powers will be transferred simultaneously with the necessary funds, which will be shared among the Communities according to their percentage of the population. The criterion for family allowances is the number of children between the ages of 0 and 18 years. The transfers will be adjusted annually according to changes in that criterion and inflation. The criterion for assistance for the elderly is the number of persons over the age of 80 years. The amount will be adjusted annually according to changes in that criterion and inflation, and 82.5% of economic growth. Finally, in regard to personal assistance, a Community's overall percentage of the population will be taken into account. The annual adjustment will be calculated on the basis of inflation and 82.5% of economic growth.

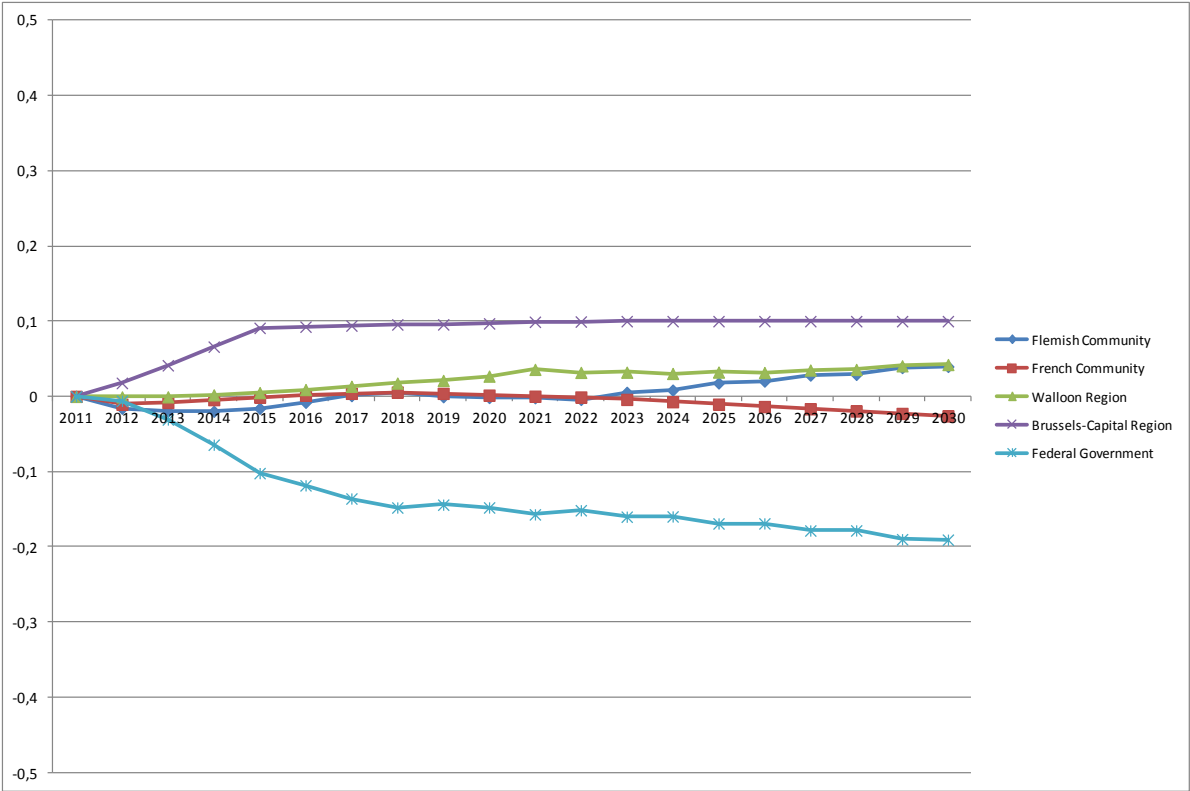
Like the other Regions, **the Brussels-Capital Region** will undergo changes in regional funding. In addition, there are special supplementary measures for the Brussels-Capital Region. Taking into account the specific and complex functions of the capital, from 2012 onwards, a budget which increases each year will be made available to help the Region in its specific functions and needs. In particular, it will contribute to compensate for commuters from other Regions and the lack of tax revenues resulting from the exemption granted to the staff of international institutions. In addition, funding will be available for the mobility and security policy. The policy agreement provides for a grant of €134 million in 2012, rising to €461 million in 2015, around 50% of which being allotted automatically, the other half being allocated by the Brussels government to its chosen policy areas. After 2015, this grant must not exceed 0.1% of GDP.

Mention should also be made of a transitional mechanism guaranteeing that no Region or Community gains or loses from the new Special Finance Act, in comparison with the old one. In practice, the transitional mechanism will run for a 20-year period. It will have a constant nominal value for the first 10 years, reduced gradually to 0 in the 10 years after that.

The following chart shows the change in revenues expressed as a percentage of GDP, for the various entities, both national and federated, following entry into force of the new Special Finance Act. The figures are based on the current agreement and are therefore still provisional. The chart shows that the Brussels-Capital Region will gain the most from the new law, essentially as a result of the supplementary grants.

As stipulated in the coalition agreement, the policy agreement on the SFA is to be finalised after the debate on the consolidation of public finances aimed at restoring a balanced budget in Belgium by 2015. Following that debate, without altering the said mechanisms and fiscal autonomy arrangements of the Regions and the proper funding of the Brussels institutions, it will be necessary to make the final adjustments to certain variables in the SFA, such as the reference amounts for the transfers and their adjustment parameters.

**Chart 2: Change in the resources of the entities compared to the SFA (in % of GDP)**



Finally, the new Special Finance Act sets out two principles relating to future challenges. First, there is the challenge of paying for future pensions. The costs of population ageing will increase, so that action must be taken. To that end, a contribution will be required from the Regions and Communities for the payment of the pensions of their civil servants. In 2030, that contribution should equal the contribution of private sector workers, namely 8.86%. The second challenge is climate change. To encourage the Regions to take the necessary measures, a financial bonus-malus system will be devised.

## Annex 1: Expenditure measures under the multi-annual budget for 2012-2014 <sup>(23)</sup>

(In € million)	2012	2013	2014
<b>PRIMARY EXPENDITURE</b>			
Personnel	120	210	215
Government arbitrage provision/Optifed (particularly for Justice, Police, Fire Service and Customs)	-30	-30	-30
Better inter-departmental management	15	30	45
Operations and investment	51	102	153
Offices/Ministers/State secretaries	3.0	3.1	6.2
Optional subsidies	20	20	21
Grants (including Parliament, Audit Office, royal family), excluding Communities	6	13	13
Public interest agencies and the like (personnel and operation costs)	13	22	23
Defence (target 30,000 military personnel)	0	0	20
Defence (other measures)	15	25	35
Development cooperation	145	145	310
SNCB group (excluding safety) (cf. in particular unused recorded in recent years)	50	70	100
SNCB group structural reform	0	20	50
SNCB group: Infrabel reserves and arrangements for financing rolling stock (excluding safety)	203	0	0
Belgian Post [bpost]	10	10	10
Abolition of MMA Fund [environmental measures relating to motor vehicles]	328	361	397
Contribution concerning responsibility for (statutory) pensions, Entity II	89	103	116
Items pending after the bilateral administrative meetings (columns C and C')	90	90	90
Under-use of appropriations	100	100	100
Public interest bodies and the like (under-use)	50	50	50
Public pensions – structural measures	0	212	424
<b>Total primary expenditure</b>	<b>1,278</b>	<b>1,556</b>	<b>2,148</b>
<b>TAX EXPENDITURE</b>			
Energy-saving expenditure ("usurped" power)	0	300	600
Conversion of deductible expense into tax reductions and setting of 2 single rates for the latter	0	56	116
<b>Total tax expenditure</b>	<b>0</b>	<b>356</b>	<b>716</b>
<b>SOCIAL SECURITY</b>			
<i>Non-structural measures</i>			
Statutory target for the growth of health care	1,562	2,016	2,520
Health care (supplementary saving)	418	745	828
Under-use in health care (including freezing of reserved amounts)	320	p.m.	p.m.
Indexation of the high wage threshold for reductions in employers' contributions	14	36	54
Service vouchers: price increase (€8.5 in 2013)	0	106	120
Service vouchers: amended conditions (500 per person, 1000 per household)	7	7	7
Public social security institutions (administrative expenses)	33	34	49
Public social security institutions (increase in under-use)	52	53	55
Mutuals/Insurers	43	83	104
Unions/service providers	4	6	6
Family allowance funds	3	5	5
Social secretariats (private firms)	5	10	15
Welfare allocation	0	123	245
<b>Total non-structural social security measures</b>	<b>2,461</b>	<b>3,225</b>	<b>4,008</b>
<i>Structural measures</i>			
Time credit and career breaks	52	83	125
Private sector pensions (employees and self-employed)	0	80	205
Voluntary work after age 65	0	-20	-20
Ceiling on remuneration taken into account for 2nd pillar deductibility	5	5	5
Interim allowances: limit on access, extension of training period, activation	131	134	136
Responsibility for redundancy	14	14	15
Early retirement scheme (pre-pensions)	25	50	75
Structural measures on unemployment (check on availability, suitable job, incentive effects, degressivity)	116	204	332
Raising the age for seniority supplement on unemployment benefit from 50 to 55 years	8	15	15
"Back to work" plan	30	31	31
<b>Total structural social security measures</b>	<b>380</b>	<b>596</b>	<b>919</b>
<b>Total social security</b>	<b>2,841</b>	<b>3,821</b>	<b>4,927</b>
<b>"USURPED" POWERS</b>	<b>250</b>	<b>300</b>	<b>300</b>
<b>Total expenditure measures</b>	<b>4,369</b>	<b>6,033</b>	<b>8,091</b>

- <sup>23</sup> Overview of measures taken in the initial budget 2012, November 2011.

## Annex 2: Revenue measures under the multi-annual budget for 2012-2014 <sup>(24)</sup>

<i>(In € million)</i>	2012	2013	2014
Reform of taxes on income from movable property (including harmonised 21% rate)	917	929	943
Tax on stock options	20	21	22
Tax on stock market transactions	50	50	50
ISOC capital gains	150	180	180
Notional interest: extension of 2011 rate (3.425%)	963	1,212	1,461
Notional interest: 3% rate and end of specific postponement option from 2012	557	557	557
Notional interest on past inventories: staggering of inventory deduction	100	200	300
Insurance (harmonisation of internal pensions for management)	55	55	55
All benefits in kind reduction in car CO2 emissions	200	205	210
Free provision of private accommodation by companies	170	173	177
VAT on pay TV	84	88	92
Excise duty on tobacco	158	158	158
VAT bailiffs and notaries	100	104	109
<b>Total revenue measures</b>	<b>3,524</b>	<b>3,932</b>	<b>4,313</b>

## Annex 3: Other measures under the multi-annual budget for 2012-2014 <sup>(25)</sup>

<i>(In € million)</i>	2012	2013	2014
Fraud and proper application of the law (tax and social security)	720	1,000	1,500
Inspection services	-12	-12	-12
Sigedis [pension database] cross-checking of data	30	30	30
Notaries	150	153	156
Conversion of bearer securities	30	60	
Bank contribution: recurrent supplementary contribution	100	100	100
Deposit Protection Fund	476	159	0
Nuclear revenue (supplement on 250)	300	300	300
CO2 quotas	0	69	69
Impact of structural reforms on economic activity	263	462	630
Lottery: monopoly revenue	40	40	40
Lottery: exceptional dividend	10		
Miscellaneous non-fiscal revenues (Belgacom: 96 + bpost: 32 + NBB: 100)	228	228	228
Non-fiscal revenues: registration plates	18	18	18
Non-recurrent non-fiscal revenues (4G licences: 80, NBB: 100)	180	0	0
Increase in additional fines from 45 to 50	24	24	24
<b>Total other measures</b>	<b>2,557</b>	<b>2,630</b>	<b>3,083</b>

- <sup>24</sup> cf. foot note 23

- <sup>25</sup> cf. foot note 23



## Annex 4: Long-term sustainability of public finances

<i>% of GDP</i>	2007	2010	2020	2030	2040	2050	2060
<b>Total expenditure</b>	na	na	na	na	na	na	na
Of which: <b>age-related expenditure</b>	na	na	na	na	na	na	na
Pension expenditure paid by mandatory private scheme	na	na	na	na	na	na	na
Social security pension	9.9	11.2	12.9	15.1	16.0	16.0	15.7
Old-age and early pensions (a)	9.1	10.2	11.8	14.0	15.0	15.0	14.8
Other pensions (disability, survivors) (b)	0.8	1.0	1.1	1.1	1.0	1.0	0.9
Occupational pensions (if in geneneral government) (c)	-	-	-	-	-	-	-
Health care	5.8	6.6	7.3	7.6	7.8	8.0	8.0
Long-term care	1.2	1.3	1.5	1.8	2.3	2.8	3.0
Education expenditure	3.8	4.2	4.1	4.3	4.2	4.2	4.2
Other age-related expenditures	5.5	6.0	5.6	5.2	4.9	4.8	4.7
Interest expenditure	na	na	na	na	na	na	na
<b>Total revenue</b>	na	na	na	na	na	na	na
Of which: property income	na	na	na	na	na	na	na
Of which : from pensions contributions (or social contributions if appropriate)	na	na	na	na	na	na	na
Pension reserve fund assets	na	na	na	na	na	na	na
Of which : consolidated public pension fund assets (assets other than government liabilities)	na	na	na	na	na	na	na
<b>Systemic pension reforms</b>							
Social contributions diverted to mandatory private scheme	na	na	na	na	na	na	na
Pension expenditure paid by mandatory private scheme	na	na	na	na	na	na	na
<b>Assumptions</b>							
Labour productivity growth	1.2	1.4	0.9	1.5	1.5	1.5	1.5
Real GDP growth	2.9	2.3	1.6	1.6	1.8	1.8	1.9
Participation rate (d) males (aged 20-64)	87.1	86.0	85.2	84.7	84.8	84.9	85.0
Participation rate females (aged 20-64)	73.0	74.3	77.7	78.5	78.9	79.0	79.1
Total participation rate (aged 20-64)	80.1	80.2	81.5	81.6	81.8	81.9	82.0
Unemployment rate	12.4	12.5	10.9	8.5	8.0	8.0	8.0
Population aged 65+ over total population	17.1	17.2	19.1	22.2	24.1	24.5	24.8

(a) survivors included, (b) only disability, (c) not in the general government,  
(d) potential participation rate = employment + unemployment + prepension + full time career breaks

Source : Federal Planning Bureau

## Annex 5: Evolution of revenue

	2011	2011	2012	2013	2014	2015
	<i>Level</i>	<i>% GDP</i>				
1. Total revenue under constant policy	182,412.1	49.4	51.3	50.9	50.8	50.8
2. Revenue measures		0.0	0.0	0.4	0.8	1.2