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(Resolutions, recommendations and opinions)

OPINIONS

COUNCIL

COUNCIL OPINION

of 7 July 2009

on the updated stability programme of Belgium, 2008-2013

(2009/C 166/01)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 7 July 2009 the Council examined the updated stability programme of Belgium, which covers the period 2008 to 2013.

(2) In 2008, the ongoing deceleration of the Belgian economy intensified as a result of the global economic and financial crisis. In particular, the collapse of world trade together with decreasing confidence, wealth effects and tighter credit conditions led to a sharp contraction of the economy in the last quarter of 2008 and the first of 2009. Also for 2009 as a whole, GDP is expected to contract sharply. This is projected to lead to a sharp increase in the unemployment rate, to above 10 % in 2010 according to the Commission services' spring 2009 forecast. The main policy challenges in the downturn are to restore the normal functioning of the financial sector, restore confidence to support domestic demand and improve competitiveness. The downturn will have a significant adverse impact on public finances, with the general government deficit set to deteriorate from 1,2 % of GDP in 2008 to above 6 % of GDP in 2010 according to the Commission services' spring 2009 forecast. This is due both to the normal functioning of automatic stabilisers and the impact of the recovery plans adopted by the federal and regional governments at the end of 2008 (0,5 % of GDP in 2009 and 0,4 % of GDP in 2010). These plans come on top of other measures of about 0,4 % of GDP already included in the budget for 2009. The main measures of the recovery plans are a reduction of the tax wedge on labour, a reduction of the VAT rate for residential construction, a frontloading of public investment and the provision of liquidity support to corporations. The government has implemented a limited number of structural reforms, i.a. to improve the functioning of the labour market.

[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

(3) The macroeconomic scenario underlying the programme envisages that, after expanding by 1,1 % in 2008, real GDP will fall by 1,9 % in 2009, before recovering to a 0,6 % growth rate in 2010 and to an average rate of around 2 1/4 % over the rest of the programme period. Assessed against currently available information ([1]), this scenario appears to be markedly favourable. Projected growth for 2009 and also 2010 appears to be on the high side in view of the rapidly deteriorating international environment, the year-on-year GDP growth estimate of – 3,1 % for the first quarter of 2009 and continued low confidence indicators.

(4) The Commission services' spring 2009 forecast expects GDP to contract by 3,5 % in 2009 and by 0,2 % in 2010. The projected evolution of growth in the medium term could also be considered optimistic compared to the significantly lower average potential growth figures, both as recalculated on the basis of the programme and in the Commission services' spring 2009 forecast. The programme's projections for inflation of 0,7 % and 1,8 % for 2009 and 2010 appear to be relatively high but can be considered realistic afterwards.

(5) In 2008, the general government deficit amounted to 1,2 % of GDP, against a balanced budget target set in the previous update of the stability programme. Revenue turned out to be 0,4 % of GDP lower than expected while expenditure was 0,8 % of GDP higher than expected. The worse outturn results from lower-than-expected nominal GDP growth (2,9 % instead of the projected 4,6 % in the April 2008 update of the programme), and an accelerated payment of public invoices at the end of the year as part of the recovery plans.

(6) The update contains a deficit target for 2009 of 3,4 % of GDP, against a projection of 4,5 % in the Commission services' spring 2009 forecast. The deterioration in the 2009 deficit reflects the impact of the automatic stabilisers (around 2 1/2 % of GDP), the expansionary measures included in the 2009 budget (0,4 % of GDP) and the fiscal stimulus packages set up by the regional and federal governments (0,5 % of GDP). The structural deficit (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) on the basis of the information provided in the updated stability programme, and recalculated by the Commission services according to the commonly agreed methodology, is projected to rise to 2 1/2 % of GDP in 2009 from 2 % in 2008. The Commission services' spring 2009 forecast expects a more pronounced worsening of the structural balance (by 1 percentage point) in 2009. The fiscal stance in 2009 can thus be considered as expansionary, in line with the European Economic Recovery Plan (EERP). In addition to the fiscal impulse associated with the EERP (0,5 % of GDP), the fiscal expansion is explained by previously decided measures to increase households' purchasing power (0,4 % of GDP). Therefore, the net impact amounts to around 0,9 % of GDP.

(7) The programme does not present a well-founded medium term-budgetary strategy and does not meet important requirements of the Stability and Growth Pact. In particular, Council Regulation (EC) No 1466/97, Article 3(2c), asks for '*a detailed and quantitative assessment of the budgetary and other economic policy measures taken*'. Moreover, the code of conduct explicitly refers to the need to include information '*on the expenditure and revenue ratios and on their components separately identified*', as well as a '(breakdown) *by subsector of general government*'. This information was not provided. The programme contains a budgetary path with decreasing headline deficits from 2011 onwards, but it does not provide information on the measures foreseen to achieve the targets, nor on the planned development of the broad revenue and expenditure components and the targets for the different government tiers. The headline deficit is set to increase further to 4 % in 2010 before declining to 1,5 % by the end of the programme period. The primary balance broadly follows the same path. The recalculated structural deficit is set to deteriorate by a further 0,2 percentage points in 2010 before gradually improving thereafter, in particular in 2012 and 2013. The programme does not foresee the Medium Term Objective (a surplus of 0,5 % of GDP in cyclically-adjusted terms and net of one-off and other temporary measures) to be reached within the programme period. According to the programme, the achievement of these deficit targets will require corrective action, especially as measures decided in previous years as well as the fiscal stimulus package continue to have an expansionary effect throughout most of the programme period. The updated programme estimates government debt at 89,6 % of GDP in 2008, compared to 84 % in 2007. Apart from the rise in the deficit and the decline

([1]) The assessment notably takes into account the Commission services' spring 2009 forecast, but also other information that has become available since then.

in GDP growth, a significant stock-flow adjustment mainly reflecting bank rescue operations (6 % of GDP) contributes to the rise in the debt ratio. The programme expects the debt-to-GDP ratio to rise further to 95 % in 2010, to stabilise in 2011 and to slightly decline thereafter. According to the Commission services' spring 2009 forecast, the debt ratio would reach around 96 % of GDP in 2009 and just exceed 100 % of GDP in 2010, the difference with the updated programme being explained by the divergent growth and general government deficit figures.

(8) While the lack of key information in the programme as well as the breach of several points of the code of conduct, as mentioned above, makes it very difficult to assess the programme, it is clear that the budgetary targets are subject to significant downside risks throughout the programme period. First, the macroeconomic environment is likely to be worse than envisaged in the programme over the entire programme period. Second, the (structural) targets can only be achieved by taking sizeable additional measures. However, the programme does not provide any information on those measures nor on the planned development of the broad revenue and expenditure components underpinning the targets and thus the latter are clearly not backed by a medium-term budgetary strategy. The fact that measures in the recovery package of a permanent nature are not offset by future savings further adds to this risk and is contrary to the guidelines in the European Economic Recovery Plan, agreed by the European Council on 11 December 2008. Moreover, the Belgian authorities have a mixed track record in achieving budgetary targets (see paragraph 9). Finally, the government offered sizeable guarantees to the banking sector which might drive up future deficits and debt to the extent that they are called. In view of considerable downward risks to the budgetary targets, the evolution of the debt ratio is also likely to be less favourable than projected in the programme.

(9) The long-term budgetary impact of ageing is above the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades. This i.a. reflects that Belgium did not yet introduce sufficient reforms of the pension system in order to increase the effective retirement age and to reduce its cost. The budgetary position in 2008 as estimated in the programme worsened from the estimated starting position of the previous programme, slightly reducing the mitigating impact of the initial budgetary position on the sustainability gap. If the 2009 budgetary position as projected by the Commission services' spring 2009 forecast was taken as the starting point, the sustainability gap would worsen substantially. Moreover, the current level of gross debt in terms of GDP is well above the Treaty reference value. Reforms of the labour market and the social security system, would increase potential growth and, together with high primary surpluses, contribute to reducing the risks to the sustainability of public finances, which are currently at a medium level. The policy response to the financial crisis could lead to a steeper rise of the debt ratio than projected in the programme if costs are not recouped in the future.

(10) Up to 2007, Belgium has succeeded in maintaining broadly balanced budgets ([1]). However, budgetary targets have been repeatedly relaxed in consecutive updates of the stability programme, even under relatively benign macroeconomic conditions. Moreover, the results have been partly achieved through deficit-decreasing one-off measures which negatively affect future budgets and in a context of declining interest expenditure. Now that more substantial consolidation efforts will be required to correct the stimulus measures and bring the debt back to a downward path, a more stringent budgetary framework may be needed, in particular encompassing multi-annual and binding expenditure ceilings and budgetary agreements among the different government tiers, including the establishment of enforcement mechanisms to ensure the respect of the fiscal targets.

(11) In response to the financial crisis, the Belgian government undertook a number of measures to ensure the stability of the financial sector. First, it provided capital injections to four major financial institutions, amounting to around 6 % of GDP. Second, it provided guarantees on specified portfolios of risky assets of certain systemic banks. Third, the government also guaranteed, upon demand and under certain conditions, wholesale and interbank debt issued by banks. These guarantees, amounting to over one third of GDP maximum, are granted in return for a fee and do not have an impact on the deficit unless they are called. Finally, the Belgian government offered a guarantee for all private bank deposits up to EUR 100 000 and extended it to certain insurance products, also in exchange for a fee.

([1]) With the exception of 2005, when the deficit amounted to 2,7 % of GDP as a result of the assumption by the government of the national railway company's debt.

(12) In response to the economic crisis, Belgium has adopted a set of recovery measures. The federal government's package, with a budgetary impact of 0,5 % of GDP in 2009 and 0,4 % of GDP in 2010 aims at (i) providing (liquidity) support to corporations through a more rapid payment of government invoices and payment facilities, (ii) ensuring the purchasing power of households through higher unemployment benefits, (iii) supporting employment through a reduction of the tax wedge on labour and (iv) stimulating investment through a targeted reduction of the VAT rate for residential construction and additional public investment, mainly in infrastructure. The regional governments' packages focus on ensuring the access to financing of corporations, in particular SMEs and start-ups, and on the acceleration of public investment. In view of limited fiscal room for manoeuvre, the fiscal stimulus package appears to be an adequate response to the downturn. Most of the measures are broadly in line with the EERP and the package is well balanced between revenue and expenditure. However, the reduction of the tax wedge on labour, of which a considerable part is granted to all workers, and the heating subsidy, which is provided to all households, do not appear sufficiently targeted. In addition, part of the stimulus, including the investment packages and the labour cost reductions, may come rather late to cushion the immediate impact of the crisis. Finally, no compensatory measures are foreseen, even for future years, for the part of the stimulus which is of a permanent nature (0,1 % of GDP in 2009 and 0,3 % of GDP in 2010), in particular regarding the reduction of the tax wedge on labour. The packages include limited structural measures, such as the improvement of active labour market policies, a further reduction of the tax wedge on labour and support to R&D, which should somewhat mitigate the reduction of potential growth and thus, together with product market reforms, address long-term challenges of the economy. These measures are related to the Lisbon structural reform agenda and the country specific recommendation proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs and adopted by the Council on 28 April. The structural measures in the recovery packages are welcome but do not appear to be sufficiently comprehensive in order to effectively tackle the longer term challenges, for instance regarding the sustainability of public finances and the efficiency of the labour market.

(13) The fiscal stance, as measured by the change in the structural balance and taking into account the risks to the budgetary projects, is expansionary in 2009, in line with the EERP. This partly reflects the response of the Belgian government to the EERP. Thereafter, the programme foresees a broadly neutral fiscal stance in 2010 and 2011 and a restrictive stance as from 2012. While the assessment of the stance as from 2010 was considerably hampered by the lack of information in the programme, it appears that considerable downward risks to the budgetary targets exist, implied among other things by the fact that the targets are not backed by a medium-term budgetary strategy in the sense of the Stability and Growth Pact. As a result, the fiscal stance is likely to remain expansionary until 2011 and turn at best neutral thereafter. The programme foresees a return of the headline deficit below the reference value only in 2012. Moreover, such a path does not seem appropriate in view of the risks related to the long-term sustainability of public finances, including the very high level of government debt which is moreover not sufficiently diminishing towards the reference value over the programme period, and considerable contingent liabilities following the measures to stabilise the financial system.

(14) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the updated programme has substantial gaps in the required and optional data ([1]), despite a delayed submission by four months compared to the official deadline. These gaps severely hampered the Council in assessing the programme, in particular the medium-term budgetary strategy.

(15) The overall conclusion is that public finances in Belgium, starting from a relatively unfavourable position in view of the high government debt ratio, will be affected by the economic downturn. The fiscal stance in 2009 is appropriately expansionary, in line with the EERP. It notably reflects the fiscal stimulus whose size had to be limited given the high debt level. The government balance will exceed the 3 % of GDP deficit reference value in 2009. At the same time, the government gross debt-to-GDP ratio, which started to rise again in 2008 as a result of the measures to stabilise the financial system, is expected to continue its upward movement. This comes after an impressive decline, from 134 % in 1993 to 84 % in 2007. The consolidation path in the updated programme aims at gradually reducing the headline deficits and thereby ensuring the long-term sustainability of public finances. The absence of crucial information in the programme, such as the expenditure and revenue ratios, has severely hampered the possibility to assess the credibility of the deficit and debt targets in the programme. The absence of underpinning of these targets suggests that they are not backed by

([1]) In particular, the data on the sectoral balances and the breakdown of the budgetary targets between revenue and expenditure and among the different government tiers as from 2010 are not provided.

a well-founded medium-term budgetary strategy in the meaning of the Stability and Growth Pact. The path is clearly subject to considerable downside risk over the entire programme period, stemming from the favourable macroeconomic assumptions and the lack of underlying measures. Moreover, also in the light of the debt dynamics and the long-term sustainability of public finances, it lacks ambition regarding the decisive correction of the deficit as the economic situation improves.

In view of the above assessment, Belgium is invited to:

(i) submit, by 20 September at the latest, a complement of the programme including a well founded medium-term budgetary strategy and improve compliance with the data requirements of the code of conduct especially regarding compulsory data;

(ii) implement the stimulus measures in line with the EERP as planned while avoiding a further deterioration of the structural balance in 2009 and resume fiscal consolidation as from 2010 when the economy is expected to improve and speed up the structural consolidation effort in 2011;

(iii) improve the quality of public finances by adopting a more stringent budgetary framework, encompassing binding, multi-annual expenditure ceilings and budgetary agreements among the different government tiers, including the establishment of enforcement mechanisms to ensure the respect of the fiscal targets;

(iv) in addition to the budgetary consolidation efforts, undertake structural reforms of the social security system, the labour market and product markets to enhance potential growth, increase the employment rate and reduce the budgetary impact of ageing, in order to improve the long-term sustainability of public finances.

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	**SP Apr 2009**	**2,8**	**1,1**	**- 1,9**	**0,6**	**2,3**	**2,3**	**2,1**
	COM Spring 2009	2,8	1,2	- 3,5	- 0,2	n.a.	n.a.	n.a.
	SP Apr 2008	*2,8*	*1,9*	*2,0*	*2,0*	*2,0*	*n.a.*	*n.a.*
HICP inflation (%)	**SP Apr 2009**	**1,8**	**4,5**	**0,7**	**1,8**	**1,8**	**1,7**	**1,8**
	COM Spring 2009	1,8	4,5	0,3	1,2	n.a.	n.a.	n.a.
	SP Apr 2008	*1,8*	*3,0*	*1,7*	*1,8*	*1,8*	*n.a.*	*n.a.*
Output gap [1] (% of potential GDP)	**SP Apr 2009**	**2,3**	**1,5**	**- 1,9**	**- 2,7**	**- 1,9**	**- 1,2**	**- 0,6**
	COM Spring 2009 [2]	2,5	1,9	- 2,6	- 3,8	n.a.	n.a.	n.a.
	SP Apr 2008	*0,3*	*- 0,1*	*- 0,4*	*- 0,5*	*- 0,8*	*n.a.*	*n.a.*

		2007	2008	2009	2010	2011	2012	2013
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Apr 2009**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	COM Spring 2009	2,1	- 2,1	- 2,5	- 2,6	n.a.	n.a.	n.a.
	SP Apr 2008	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
General government revenue (% of GDP)	**SP Apr 2009**	**48,1**	**48,6**	**48,2**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	COM Spring 2009	48,1	48,6	48,4	48,2	n.a.	n.a.	n.a.
	SP Apr 2008	*48,7*	*49,0*	*48,8*	*48,9*	*49,2*	*n.a.*	*n.a.*
General government expenditure (% of GDP)	**SP Apr 2009**	**48,3**	**49,8**	**51,6**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	COM Spring 2009	48,3	49,8	52,9	54,3	n.a.	n.a.	n.a.
	SP Apr 2008	*48,9*	*49,0*	*48,5*	*48,3*	*48,2*	*n.a.*	*n.a.*
General government balance (% of GDP)	**SP Apr 2009**	**- 0,2**	**- 1,2**	**- 3,4**	**- 4,0**	**- 3,4**	**- 2,6**	**- 1,5**
	COM Spring 2009	- 0,2	- 1,2	- 4,5	- 6,1	n.a.	n.a.	n.a.
	SP Apr 2008	*- 0,2*	*0,0*	*0,3*	*0,7*	*1,0*	*n.a.*	*n.a.*
Primary balance (% of GDP)	**SP Apr 2009**	**3,6**	**2,5**	**0,4**	**- 0,1**	**0,6**	**1,5**	**2,5**
	COM Spring 2009	3,6	2,5	- 0,6	- 2,1	n.a.	n.a.	n.a.
	SP Apr 2008	*3,7*	*3,7*	*3,8*	*4,1*	*4,3*	*n.a.*	*n.a.*
Cyclically-adjusted balance ([1]) (% of GDP)	**SP Apr 2009**	**- 1,5**	**- 2,0**	**- 2,4**	**- 2,6**	**- 2,4**	**- 1,9**	**- 1,2**
	COM Spring 2009	- 1,6	- 2,2	- 3,1	- 4,0	n.a.	n.a.	n.a.
	SP Apr 2008	*- 0,4*	*0,0*	*0,5*	*1,0*	*1,4*	*n.a.*	*n.a.*
Structural balance ([3]) (% of GDP)	**SP Apr 2009**	**- 1,3**	**- 2,0**	**- 2,4**	**- 2,6**	**- 2,4**	**- 1,9**	**- 1,2**
	COM Spring 2009	- 1,5	- 2,2	- 3,2	- 4,0	n.a.	n.a.	n.a.
	SP Apr 2008	*– 0,3*	*0*	*0,5*	*1,0*	*1,4*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**SP Apr 2009**	**84,0**	**89,6**	**93**	**95**	**94,9**	**93,9**	**92**
	COM Spring 2009	84,0	89,6	95,7	100,9	n.a.	n.a.	n.a.
	SP Apr 2008	*84,9*	*81,5*	*778,1*	*74,7*	*71,1*	*n.a.*	*n.a.*

Notes:

([1]) Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

([2]) Based on estimated potential growth of 1,9 %, 1,7 %, 1,0 % and 1,0 % respectively in the period 2007-2010.

([3]) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0,2 % of GDP in 2007, deficit increasing, according to the most recent programme and 0,1 % of GDP, deficit increasing, in 2007 and 0,1 % of GDP, deficit reducing, in 2009 according to the Commission services' Spring 2009 forecast.

Source:

Stability programme (SP); Commission services' Spring 2009 forecast (COM); Commission services' calculations.