Analysis of policies for restoring sound Belgian public finances

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Introduction

As in almost all advanced countries, the financial crisis and subsequent economic recession have combined to hit public finances in Belgium hard, with the fiscal deficit widening smartly and debt levels surging. The Belgian government had to step in and devise a strategy to help the country return to sustainable public finances, by eliminating the fiscal deficit and getting the government debt ratio back on a downward path. The government has now put in place a proportion of the measures needed to achieve these objectives, but more still needs to be done.

This latest period of fiscal consolidation in Belgium was preceded by two earlier ones, the first in the 1980s and the second in the 1990s. This article discusses the key characteristics of all three periods, identifying consolidation episodes first, then moving on to economic, political and institutional contexts in the second section and briefly breaking down the main measures in the third. Section four delves deeper into the range of instruments used to implement consolidation policies and identifies their effects, while section 5 highlights how consolidation policies have affected the development of government debt and interest rates, and the article ends with a number of conclusions.

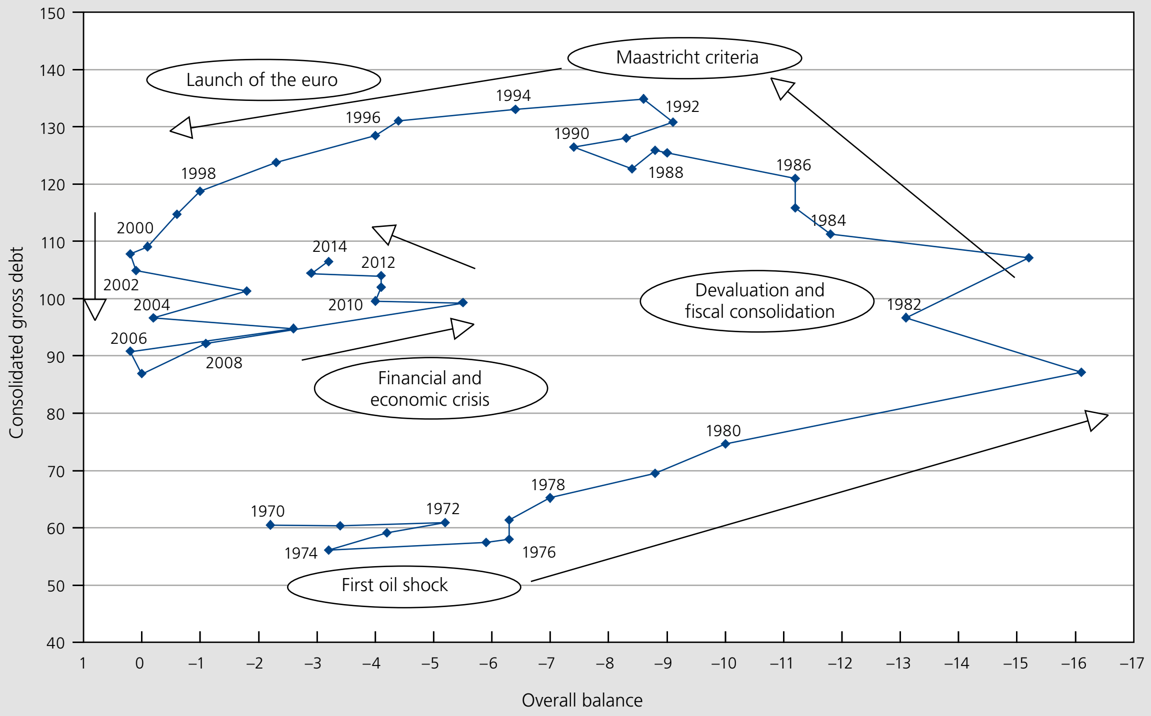
1. Developments in Belgian public finances and defining consolidation periods

Belgium's public finances have been on a rollercoaster ride over the past decades. The aftermath of the first oil shock in the early 1970s and the economic slowdown that followed caused the country's budget deficit to surge, partly on the back of sharply higher government spending. By 1981, the deficit had reached an excessively high level at 16.1 % of GDP.

In the early 1980s, Belgium faced significant macroeconomic imbalances, and 1982 saw the start of macroeconomic policies aimed at restoring the global competitiveness of the Belgian economy and returning to healthier public finances. In the event, these policies succeeded in slashing the fiscal deficit but were unable to keep government debt from steadily rising.

On 7 February 1992, the Maastricht Treaty was signed, looking ahead to the creation of a monetary union in Europe by the end of that decade. Countries aspiring to join the currency union had to fulfil a set of macroeconomic criteria, including for public finances. The fiscal deficit could not exceed 3 % of GDP, and government debt had

CHART 1 AN OVERVIEW OF BELGIAN PUBLIC FINANCES
(% of GDP)



Sources: NAI, NBB.

to be below 60 % of GDP, or be moving in that direction sufficiently quickly. Wanting to be among the first group of countries to join the currency union from the very start, Belgium took measures to reduce its fiscal deficit below the threshold value and to get its debt on a downward trajectory. It succeeded: around the turn of the century, the Belgian government rode a favourable business cycle towards a balanced budget, and it sustained this balanced budget in subsequent years, steadily reducing its government debt as a percentage of GDP.

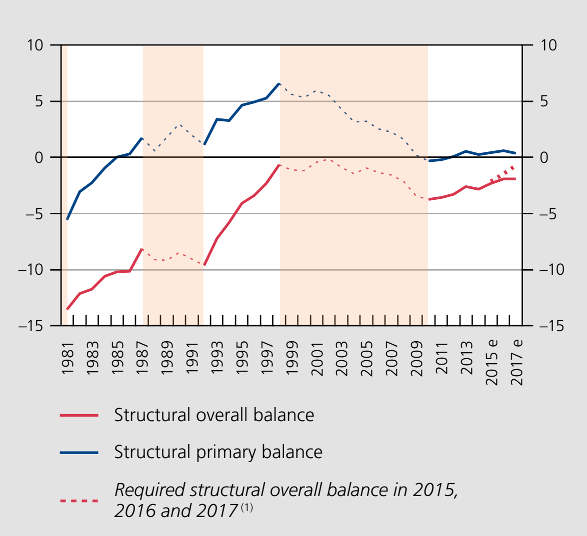
In 2008 and 2009, however, the financial crisis erupted and the economic recession that followed caused a further slippage in Belgian public finances: the fiscal deficit shot up and government debt rose as a result. By the end of 2009, Belgium was subject to a European excessive deficit procedure (EDP), and it has been taking measures to reduce its deficit ever since. To date, these measures have failed to restore a budget balance or to curb the inexorable rise in government debt.

This article defines the periods of restructuring of Belgian public finances by the development of the government's overall structural balance, i.e. the nominal balance adjusted for cyclical influences and non-recurring factors. From these figures, a picture of three consolidation periods emerges [1], much as expected. Starting in 1982 and ending in 1987, the first of these periods is marked by a structural improvement in the budget balance of 5.4 percentage points of GDP. The second period of consolidation came just before Belgium's entry into the currency union and ran from 1993 to 1998. It saw the structural fiscal deficit go down by 9 percentage points of GDP. The latest and our third period of consolidation followed the financial and economic crisis, and started in 2011. Between 2011 and 2014, the budget balance structurally improved by 0.9 percentage point of GDP. According to the Bank's latest projections, which factor in measures already decided, this improvement is set to continue. It is expected to reach 1.8 percentage points of GDP over the whole 2011-2017 period. However, additional consolidation measures will have to be adopted in order to meet the federal government's target of a structural

(1) For the period up to 1994, for which the National Accounts Institute does not provide statistics in keeping with the ESA 2010 methodology, a retropolation was carried out on the basis of the growth rates included in the national accounts according to ESA 95. In addition, key non-recurring factors were identified based on an in-depth analysis of detailed information about implementation of the budgets.

CHART 2 CONSOLIDATION PERIODS BY DEVELOPMENT OF THE STRUCTURAL BALANCE

(% of GDP)



Sources: EC, NAI, NBB.

(1) An improvement in the structural overall balance of 0.7% of GDP per annum, as recommended in March 2015 by the Public Sector Borrowing Requirement section of Belgium's High Council of Finance.

budget balance by 2018, as recommended by the Public Sector Borrowing Requirement section of Belgium's High Council of Finance.

2. Fiscal consolidation efforts: setting the context

In terms of the context in which these fiscal restructuring periods started, a number of significant similarities and differences emerge. What follows is a review of the elements that made up the economic background and the political and institutional circumstances.

2.1 Economic context

The three periods of fiscal consolidation started when Europe was in recession. For Belgium, these consolidation periods began at economically less-than-favourable points in time, as the output gap started all three periods in negative territory. And it stayed that way throughout each period, implying that these efforts combined with under-utilisation of production factors, making for pro-cyclical fiscal policies.

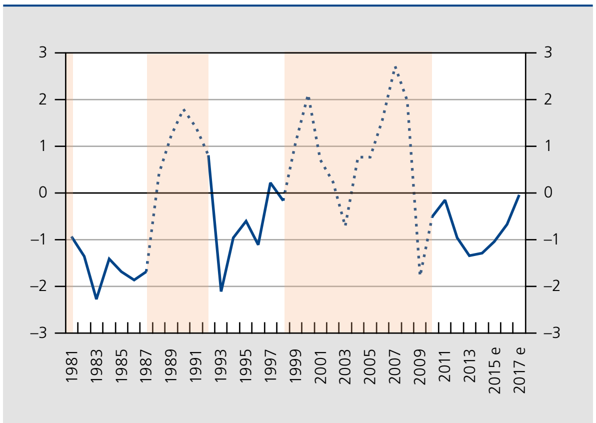
In all three periods, Belgium's macroeconomic conditions showed imbalances, albeit that these differed slightly from one period to the next. In 1981-82, for instance, all macroeconomic variables were unfavourable: flat economic growth, job losses, high inflation and a current account deficit. In 1992-1993, the euro area's weak growth was exacerbated in Belgium by a fresh deterioration in competitiveness, but inflation was under control and the country was building current account surpluses. In 2009, Belgium slid into a severe recession caused by the international financial crisis, which had wreaked havoc with its key credit institutions in 2008. However, inflation remained fully under control and the balance of payments had reached a state of virtual equilibrium.

Every time it started restructuring, Belgium was under great fundamental pressure from the financial markets. In 1981-82 and 1992-93, this pressure on the Belgian franc affected the exchange rate with the German mark, while the most recent period has seen the pressures affect government bonds and equities issued by financial services providers, given the introduction of the euro as the single currency. There has been some let-up since 25 November 2011, when the newly formed federal government announced agreement on economic and fiscal aspects. In the years before the adjustments, long-term interest rates were significantly lower for the latest consolidation period than in the 1993-1998 period and even further below levels recorded between 1982 and 1987.

There were also marked differences in the starting fiscal position. In 1992, for instance, government debt stood at well over 130% of GDP, while it was limited to 87% of GDP in 1981 and was flirting with 100% of GDP by 2010. The trend was upwards in all three periods, primarily because of the size of the deficits. The 1981 deficit was significantly larger than those in 1992 and 2010.

CHART 3 OUTPUT GAP IN BELGIUM

(% of potential GDP)



Sources: EC, NAI NBB.

TABLE 1 ECONOMIC CONTEXT

Criteria	1982-1987	1993-1998	2011-2017
Initial economic situation			
Global economic cycle	Recession	Recession	Aftermath of economic crisis / severe recession
Situation in Belgium	Macroeconomic imbalances	Loss of competitiveness	Same for global economic cycle
Inflation	7.6 % (1981)	2.4 % (1992)	2.2 % (2010)
Long-term interest rates	13.4 % (1981)	8.7 % (1992)	3.3 % (2010)
Financial pressure	Speculation against the BEF	EMS crisis	Government debt crisis
Initial fiscal position (in % of GDP)	In 1981	In 1992	in 2010
Debt	87.1	130.8	99.5
Overall balance	–16.1	–9.1	–4.0
Fiscal and parafiscal pressure	39.1	39.3	42.3
Primary expenditure	52.6 Steep increase in 1970s	42.8 Subdued rise since the end of the 1980s	48.9 Steep increase since 2000
Social security benefits	22.3	21.4	23.9
Government investment	5.2	2.2	2.3
Developments during fiscal consolidation periods			
Potential growth (1)	1.7	2.1	1.0
Ageing population effect	Minor	Stronger	Stronger still

Sources: EC, OECD, NAI, NBB.
(1) Average of percentage changes on previous year.

Although the current consolidation drive would appear to require less of an effort than the previous two, some aspects are proving just as much of an obstacle as the problems experienced in those days.

The first key obstacle is potential growth: at 1 %, this is about half of what was attainable in the previous two consolidation periods.

The second hurdle is the effective tax rate. At the beginning of the current consolidation period, this was around 3 percentage points of GDP higher than at the start of the 1980s and 1990s consolidation periods, and recent increases pushed it up to an unprecedented high of nearly 45 % of GDP in 2014, which is very steep compared with other European countries. The margin for any tax increases would appear to have become exceedingly tight, although this does not preclude a tax shift to relieve the fiscal and parafiscal pressure on labour.

At the start of the current consolidation period, primary expenditure was somewhere between the historically high levels of the 1980s and the lower levels of the 1990s. And so the consolidation in the 1980s was all about cutting primary expenditure, while it focused on revenues in the 1990s. The current set of adjustments suggests some margin of manoeuvre at the expenditure end, but there is significant pressure at the level of social security benefits, while easy savings on investment spending are ruled out – as there is hardly any.

Between 1982 and 1987, the government was able to make deep cuts in public sector investment spending, which was still extremely high in 1981. The record levels of the early 1980s never returned and fresh cost-cutting in this type of spending will never generate the same result. What is more, the government had best leave investment spending untouched or even step it up as much as feasible, as such spending enhances growth potential.

Social security benefits were only slightly higher in 2010 than in the early 1980s and 1990s, although the ageing population is increasingly making its impact felt.

Ageing-related social spending, in particular on pensions and health care, is expected to go up further in 2017.

By contrast, the wage share of GDP has remained stable in the current consolidation period while the sharp declines of the two previous periods weighed down revenues, as wages are subject to higher taxes than other sources of income.

2.2 Political and institutional context

Significant similarities and differences can also be noted in the political and institutional arena.

2.2.1 European governance and fiscal targets

In the last two consolidation periods, budget adjustments in Belgium were encouraged by the European governance framework. By contrast, there was no such thing in 1981 – just pressure from peers, international institutions such as the IMF and the financial markets. In 1992, it was the Maastricht criteria that cast the die for Belgium's government: it needed to cut its overall balance to below 3 % of GDP by 1997 if it was to join the monetary union, 1997 being the year in which eligibility for the euro area was reviewed. As for the ongoing period, Belgium was subject to an excessive deficit procedure between December 2009 and June 2014, at a time of tighter rules under the Stability and Growth Pact in the shape of the Six Pack, the Two Pack and the Fiscal Compact (the budgetary section of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union).

This tighter European governance framework comes with ever more binding targets prescribed for governments. In the 1980s, when no European governance was in place, the Belgian government of the day aimed at a reduction to a net borrowing requirement of 7 % of GDP, only to push the date back to 1989. This budgetary principle on a cash basis was the main objective of Belgium's fiscal policies in the 1980s. In the 1990s, it was the overall general government balance in the national accounts that became key, as this featured in the Maastricht Treaty's convergence criteria. Unlike the net borrowing requirement, the general government's overall balance is not influenced by purely financial operations, such as privatisation proceeds. Criteria for the current period have become even tighter: future targets are defined by ESA 2010, while those for the 1990s were governed by ESA 1979. More particularly, the European governance framework now prescribes an improvement in the structural balance to help achieve equilibrium in the medium term, effectively preventing governments from achieving the fiscal targets through temporary measures. In addition, the Maastricht criteria put greater focus on reducing debt at a satisfactory pace when countries were looking to qualify for the euro. Debt criteria are also in place in this latest consolidation period, with those countries with the highest debt ratios required to make bigger structural fiscal efforts than others.

2.2.2 Federal elections and terms of office

The three consolidation periods started fairly early in the terms of office of the federal governments of the day, and were marked by a degree of stability. For the 1982-1987 period, the first consolidation programme was approved in March 1982, shortly after the November 1981 elections. And in the 1993-1998 period, the government did not draw up its first real consolidation plan until its April 1993 budget review, even if it had been taking fiscal measures since 1992. Parliamentary elections had in fact been held in November 1991, but policy-makers had been caught up in the fourth State reform negotiations, finally agreed in September 1992. In the current consolidation period, early fiscal measures were introduced straight after the new government took office in November 2011, but it had only reached agreement on these long after the parliamentary elections of 13 June 2010, because of the time it had taken to form a new government. This overall trend – of structural reforms and key fiscal measures being introduced as soon as a government agreement is in place – was confirmed in the 2015 budget of the coalition formed following the May 2014 parliamentary elections.

The three periods differed in terms of the parliamentary methods that federal governments adopted to have their fiscal measures and economic reforms approved. Whereas the 1982-1987 government opted to draw on special powers and also used Framework Laws in the 1993-1998 period, the current consolidation is based on traditional parliamentary procedures (Programme Laws).

2.2.3 State reforms and the role of Entity II

At the institutional level, these consolidation exercises took place against a backdrop of increased federalism, as the Communities and Regions gradually gained in political, economic and fiscal stature. The fiscal consolidation programmes also came after State reforms. The special Law on institutional reform of 8 August 1980 confirmed an institutional agreement, and with the decks thus cleared, a new government was quickly formed after the November 1981 elections to take on its budgetary duties. In 1993, the Saint Michael Accord was followed by fiscal consolidation, and in 2011 negotiations about the economic and fiscal aspects started straight after the agreement on the sixth State reform in October 2011.

Entity II, which includes the Communities, Regions and local government, has contributed to the consolidation of public finances in all three of these periods, albeit to a limited degree. The local authorities, whose finances had gone off the rails, implemented adjustments in the 1980s, with municipalities and provinces ordered to make sure their own normal budgets were in balance by 1988. This was all the harder as the federal government had meanwhile reduced the budget available for municipalities (*Gemeentefonds/Fonds des communes*). That said, the federal government had stepped in to take on the debts of Belgium's larger cities (by way of the Assistance Fund for the Financial Recovery of Municipalities) while the Regions, which became responsible for municipality finances after the 1988 State reform, had taken on the debts of other towns and smaller cities.

By contrast, in the 1990s and in 2010, it was the Communities and Regions that contributed to fiscal consolidation. As from 1994, formal collaboration agreements were signed between the federal government and the regional governments, on the recommendation of the Public Sector Borrowing Requirement section of Belgium's High Council of Finance, created as part of the special law of 16 January 1989 on the funding of the Communities and Regions. Each of the Regions received tailored recommendations on deficit ceilings to stabilise the ratio of debts to revenues by the end of the Special Finance Act's transition period, namely the year 2000. The new legislation also provided for the Communities and Regions to take on part of the federal government debt.

More recently, the special law of 6 January 2014 reforming funding of the Communities and the Regions, enhancing their fiscal autonomy and funding new powers and authorities specified various explicit contributions by the Communities and Regions to the consolidation of public finances. The December 2013 collaboration agreement set out the core aspects of the Fiscal Compact, and so set a formal stamp on practices in place, namely that federal government and the governments of the Communities and Regions reach collaborative agreements on fiscal targets. The agreement specifies that these annual fiscal targets be distributed across the various echelons in both nominal and structural terms, based on a recommendation by the High Council of Finance's Public Sector Borrowing Requirement section. This distribution will have to be approved by the Consultative Committee and its decision incorporated when the stability programme is updated.

3. Key measures

3.1 Key measures: 1980s

3.1.1 Background

Restoring macroeconomic equilibrium was the top priority of the government installed after the November 1981 elections, and its stability programme as approved in early 1982 chiefly comprised measures to bolster the competitiveness of the Belgian economy. Its drive started off with an 8.5 % devaluation of the Belgian franc in February 1982 [1]. Meanwhile, price controls were imposed and the wage moderation seen in 1981-1982 included a real-terms wage freeze. The government introduced tax incentives such as a stimulus to subscribe to share issues, special coordination centres and a capital spending deduction. Parafiscal incentives included various reductions and exemptions for employers' contributions to social security – e.g. the Maribel scheme, which started in July 1981. The scheme involved a reduction in employers' contributions on blue-collar wages in specific sectors, and was offset by higher indirect taxes. The government also made its first budgetary adjustments to help reduce the fiscal deficit.

From March 1984, the government gradually shifted its focus to public finances, and its early 1982 target of scaling back the budget deficit to around 7 % of GNP was pushed back a year, from 1985 to 1986, albeit that the delay was linked to a multi-annual restructuring plan. In 1985, the next government decided to push back the return to a net borrowing requirement of 7 % of GNP to 1989, and approved the Sainte-Anne Plan agreed in May 1986 to boost the credibility of its commitment. Additional measures were taken in 1987.

Undoubtedly, the period's symbolically most important budgetary measure was the threefold suspension of automatic indexation ('index jumps') envisaged in the March 1984 multi-annual plan; these took place in April 1984, January 1985 and June 1987. The plan extended wage restraint on the part of employees, but not to the benefit of the corporate world, as companies were to transfer all gains from the measure in the shape of a wage restraint levy. Meanwhile, waiving automatic indexation helped the authorities to reduce the salaries of their own employees as well as the greater proportion of social security benefits, and a new social security levy was now also imposed on the earned incomes of the self-employed.

(1) Other parity changes within the EMS also reflected back on the exchange rate of the Belgian franc in the period, in particular the revaluations of the German mark and the Dutch guilder.

3.1.2 Primary expenditure-focused measures

Throughout the 1982-1987 period, Belgium imposed cutbacks on most federal government primary expenditure. No formal percentage had been agreed, but budget circulars were designed to keep any increases in this expenditure at or below the rate of inflation.

In addition to the indexation waiver, the federal government cut its wage bill by curbing employment at ministries, schools and in the armed forces. It achieved its aims through various measures, for instance by selectively not filling job openings through natural wastage, by encouraging part-time work and through early retirement arrangements in education. Other measures also served to reduce expenditure on employment in education, such as the downward revision of staff education norms. By 1986, available resources for research were cut, and thus also those for researchers.

Government investment, operating expenses, grants to public enterprises and subsidies to private ones were all slashed. To a degree, this was offset by plans to support the public sector with significant amounts of one-off spending, specifically in 1981 and 1983.

Austerity measures also hit the whole range of social security benefits. Between 1982 and 1990, the 'welfare adjustment' was suspended, the link between benefits and the national consumer price index levelled off from October 1983 and most social security benefits were subject to the suspension of automatic indexation from 1984. In addition, some benefits were capped, reflecting a more rigorous approach.

Retirement and survivors' pensions did not escape a specific set of measures, albeit that their effects were tempered by raising the minimum levels and guaranteed income for older people.

Various initiatives aimed to keep health care spending under control: in addition to the index jumps, there was only partial indexation of doctors' fees, the daily cost of hospital care only moved in line with inflation, with certain exceptions, the number of beds at hospitals and care and retirement homes fell, patient fees for long-term hospital stays increased, so-called 'comfort medicines' were no longer reimbursed and recognition criteria for widows, disabled people, pensioners and orphans were tightened up. Sick pay and disability benefits were equally subject to limits.

Specific austerity measures related to child benefit were a fixed deduction from April 1982 and the discontinuation in 1983 of the 13th and 14th month for employees receiving normal, grade-one child benefit. In 1984, limits were imposed on grants of increased child benefit.

For unemployment benefits, the government introduced a distinction between single people and those living together among unemployed people who are not heads of households, and cut to subsistence levels any unemployment benefits to those in cohabiting households if they had been unemployed for more than two years. At the same time, it tightened up procedures governing exclusions to the right to receive unemployment benefits, for instance by cutting such benefits in cases of repeat or unusually lengthy periods of unemployment.

The federal government also reduced its transfers to local authorities, and particularly those channelled through the budget available for municipalities (*Gemeentefonds / Fonds des communes*). In their turn, the local authorities also scaled back spending: salaries declined thanks to the index jumps, but also because municipalities pruned their workforces, in both administration and education. Investment expenditure also came down.

3.1.3 Revenue-focused measures

The federal government had planned to collect more fiscal revenues. Some VAT rates – e.g. a special tax on luxury products – and excise duties were increased, in particular to fund the Maribel scheme. Withholding tax was raised from 20 % to 25 % in 1984 and was designated as the final levy. The government also reduced fiscal spending benefiting companies, in 1986 scrapping corporation tax deductibility for some social benefits and tightening up controls on a number of inappropriate coordination centre advantages. In terms of non-fiscal revenues, universities increased fees after facing cutbacks in their transfers from the federal government.

In terms of social security, the government also licked its finances into shape by raising social security contributions. Quite aside from the wage restraint levy, which helped it profit from the index jumps, the government launched multiple initiatives to raise social security contributions, far outstripping the agreed contribution cuts (of which Maribel was the most important). The most significant changes were a broadening of the definition of what constitutes a salary, on which contributions are then levied, (double holiday allowances, end-of-year bonuses, profit-sharing etc.), the increase and subsequent scrapping from 1981 of the pay ceiling, higher employers' contributions and individual social security contributions (health contributions, special contribution imposed on those with high incomes, single households and those without children, etc.), while the self-employed also faced increased social security contributions.

Lastly, the local authorities bolstered their own revenues by adding higher local surcharges to personal income tax rates.

3.2 Key measures : the 1990s

3.2.1 Background

The federal government formed in March 1992 put forward a convergence programme in June of the same year that aimed to curb the fiscal deficit to 3 % of GDP by 1996, to qualify Belgium for the third phase of Economic and Monetary Union. The 1993 initial budget already included a few measures, but things really kicked into gear in April 1993, when the budget review resulted in the approval of a significant consolidation programme. The efforts came thick and fast, with the approval of a general plan for employment, competitiveness and social security in November 1993 and supplementary measures resulting from the various stages of drafting and reviewing the federal budget. When presenting its statement about its general policies in September 1994, the government set a target of a primary surplus of over 6 % of GDP after 1996. Parliamentary elections were moved forward to the spring of 1995, to facilitate the approval of any supplementary measures and so achieve these fiscal targets. In their June 1995 government agreement, the coalition formed after the elections endorsed these fiscal targets and the working methods to be applied to a number of standards. These targets, including the intention to sustain this large primary surplus, were adopted in the December 1996 convergence programme. The government also put in place a number of Framework Laws in 1996 to facilitate reforms in areas such as employment, competitiveness, budget and social security.

With the consolidation of public finances starting just as the business cycle deteriorated and competitiveness weakened, these fiscal policies were put in a longer-term perspective. At the end of July 1993, the Ecofin Council agreed to widen the EMS fluctuation bands from 2.25 % to 15 % for members aspiring to the currency union. Over time, this softened the speculation against some currencies, including the Belgian franc, and ensured their link to the German mark as a monetary policy objective.

In the absence of an agreement between the social partners, the government sought to restore competitiveness by imposing a number of wage restraint measures. Its Global Plan for Employment, Competitiveness and Social Security, dating from November 1993, froze real wages for the 1995-1996 period and proposed the introduction of a health index as a benchmark for indexation of wages, benefits, income in the professions, bonuses and rents – rather like the national consumer price index but without tobacco, alcohol, petrol and diesel. The 1996 version of the plan also introduced a so-called 'wage norm' that limits the risk of nominal labour costs rising faster in Belgium than in the country's three main trading partners – Germany, France and the Netherlands. Corporations saw their competitiveness enhanced by the Maribel *bis* scheme in July 1993 and by a series of selected reductions in employers' social security contributions. Priority groups were singled out, such as young job-seekers, companies better at redistributing work and the low-skilled, specifically by introducing a reduction in employers' contributions on low-paid jobs. The scheme was extended in the second half of the decade and the Maribel scheme expanded in 1997 to meet EU legislation. One Maribel scheme focused on job creation in the non-market sector.

Between 1993 and 1998, fiscal policies were designed to satisfy the dual objective of improving the overall balance and reducing debt. To address the latter, the government partly or wholly privatised various state-owned companies such as the public credit institutions and Belgacom, while also realising gains on the sale of the Bank's gold reserves.

To help improve the overall balance, the federal government identified three targets as early as 1992, targets that had to be complied with in all areas within its sphere of influence. First, fiscal revenues had to keep pace with GNP ; second, any increases in the federal government's primary expenditure needed to be limited to the level of inflation. Lastly, an annualised financial equilibrium was defined for social security spending, subject to the limitation that federal government subsidies had to remain the same in nominal terms.

3.2.2 Primary expenditure-focused measures

To actually achieve its own target of frozen primary expenditure in real terms, the federal government stepped up the number of initiatives. Subsidies to state-owned companies were kept at the same nominal levels for several years, as were resources for the armed forces. Primary expenditure of ministries and public service institutions was frozen in real terms, and cuts in operating expenses would have brought it down in real terms. Lastly, the introduction of the health index helped to curb public employees' pay.

In addition to the health index's general effect in as much as it applied to social security benefits, numerous measures were put in place to help curb this type of expenditure.

Private sector pensions, for instance, were reformed in 1997, with the effect of the reforms becoming more noticeable over time. The key change was the gradual lengthening of careers from 40 to 45 years and the gradual increase in the retirement age taken into account in pension calculations for women in compliance with the EU Directive on the progressive implementation of the principle of equal treatment for men and women in matters of social security.

In health care, a real growth target of 1.5 % was introduced – but rarely observed – in the 1995-1999 period. Moreover, the target was repeatedly eased, as a number of priority areas were kept out of its scope altogether, such as programmes for the chronically ill and the expansion of palliative care. The purpose of yet other measures was to improve patient access to health care, but many others served to reduce demand – e.g. raising patient contributions to medical fees and scrapping restitution payments on some medicines – or tried to curb it by addressing volumes – e.g. by imposing university intake restrictions on medical students, encouraging mergers between hospitals etc. – and funding methods for health care providers, hospitals and nursing homes.

Stricter controls on unemployment were introduced, abuses were sanctioned more harshly and programmes were launched to get more people back into the workforce. Meanwhile, the government raised the age for early retirement but failed to stop the rise in the number of non-job-seeking older unemployed.

3.2.3 Revenue-focused measures

The 1993-1998 recovery period's symbolically most important budgetary measure revolved around fiscal revenues.

In the area of personal income tax, this entire period saw the government stick to its decision to suspend the indexation of most tax bands, following on from its initial budget for 1993. Following the April 1993 budget review, it introduced a supplementary crisis contribution, levied on both personal income tax and corporation tax, including withholding tax, in the form of a levy of 3 additional centimes. Fiscal expenditure on long-term savings was also curbed.

On the corporation tax front, various measures were introduced to curb or scrap fiscal expenditure, with a range of tax breaks made more rigorous or deactivated altogether – e.g. notional withholding tax for the coordination centres, capital spending deduction, etc. The government also took the opportunity to correct improper use of tax laws, for instance by changing the system of fixed foreign tax credit (FFTC), finally taxed income and losses carried forward, as well as introducing a clause on abuse of law. Electricity producers also saw taxes increase.

A range of indirect tax measures generated additional revenues, either benefiting the federal government directly or acting as alternative sources of social security funding, cushioning the fall in revenues from lower employers' contributions. In 1994, the VAT rate was raised from 19.5 % to 20.5 %, and in 1996 to 21 %. Excise duties went up, in particular on products not in the health index, i.e. fuels, alcohol and tobacco. In addition, the energy sector was hit by a charge on heating oil, a levy on energy consumption and excise-offsetting levies on diesel cars.

In terms of alternative funding, extra levies were imposed on income from securities and property to help refinance social security. Withholding tax on fixed-income securities grew steadily from 10 % to 15 %, while taxes on stock market transactions were raised from 0.35 % to 1 % and property taxes on second homes and rental properties went up by 25 %.

Social security revenues were boosted by the introduction of new contributions and increases in existing ones, the most notable of these measures being the special social security charge of April 1994. The self-employed saw charges on professional income raised. In addition, taxes were levied on social security benefits, such as the so-called 'solidarity contribution' on pensions. Also in the 1990s, the federal government introduced new targeted taxes on group insurance premiums, company cars and student contracts, while employees' social contributions were raised by one percentage point as early as July 1992.

3.3 Key measures : the 2010s

3.3.1 Background

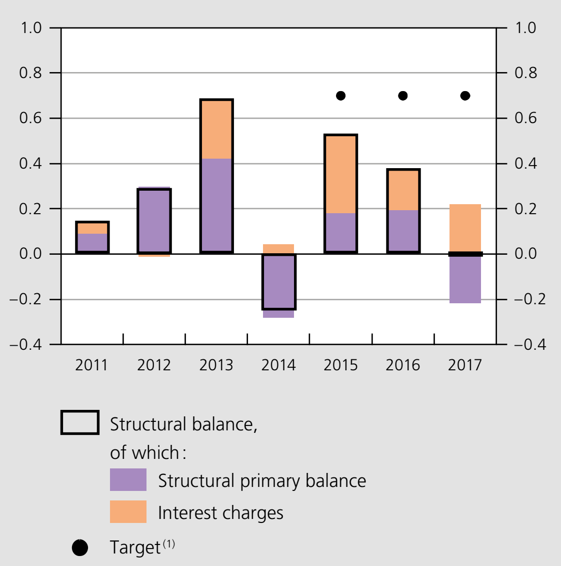
The financial crisis and its economic repercussions had hit Belgian public finances so hard that the Ecofin Council opened an excessive deficit procedure for Belgium by the end of 2009. The Council recommended getting the budget deficit down to below 3 % of GDP by 2012 by implementing structural improvements amounting to 0.75 percentage point of GDP per annum in the 2010-2012 period. Not long after, the Public Sector Borrowing Requirement section of Belgium's High Council of Finance put forward the same target figure and recommended that the budget balance be restored by 2015. Subsequent governments committed to consolidating their budgets but repeatedly pushed back the return to a balanced budget.

The consolidation period that started in 2011 breaks down into two quite distinct sub-periods, in which the country was governed by two different federal majorities. The 2011-2013 period saw an improvement in the structural balance by 1 percentage point of GDP, mainly on the back of higher revenues. The year 2014 saw budget efforts stall on the traditional loss of rigour in the run-up to parliamentary elections, which this time coincided with regional and European elections. The second sub-period starts in 2015 and is marked by falling primary expenditure. Quite a number of measures proposed for the second sub-period have yet to be fleshed out.

Once again, fiscal policies in this era should be considered against the larger backdrop of macroeconomic targets set for the European Union as a whole. These targets include a higher employment rate, an increase in R&D investment, a reduction in environmental pressures, better education indicators, and lower levels of poverty and social exclusion. These EU targets have been translated into national ones and closely aligned with further fiscal consolidation, which in Belgium has brought major challenges such as addressing the problem of an ageing population and bolstering competitiveness. Successive federal governments have established fundamental pension reforms aimed at reducing the ageing bill in the longer term, and introduced measures to cut labour costs.

CHART 4 DETERMINANTS OF THE DEVELOPMENT OF THE OVERALL STRUCTURAL BALANCE OF BELGIUM

(changes relative to previous year, in percentage points of GDP)



Sources: EC, NAI, NBB.

3.3.2 Primary expenditure-focused measures

The measures put forward by the federal government in December 2011 comprised a rigorous control of operating expenses, a slowdown in the growth of the health care budget, cuts in subsidies to state-owned companies and curbs on tax incentives for energy-saving investment. During the term of this government, eligibility conditions for unemployment benefits became stricter and were made more degressive.

A new austerity wave initiated by the new government installed in October 2014 started to make significant inroads into the federal government's primary expenditure levels and social security from 2015. Austerity savings include across-the-board cuts in public sector pay, purchases of goods and services, and investment. A new 'index jump' should keep in check social security benefits and the overall public sector wage bill. Other significant savings are targeting the health care budget, which saw its real growth target limited to 1.5 %, and sick pay and disability benefits, while a range of restrictions were put into place for unemployment benefit entitlements and time-credit schemes.

The Communities and Regions, as well as local authorities, also approved various austerity measures, most of these related to all possible types of primary expenditure.

3.3.3 Revenue-focused measures

Key measures to boost revenues were taken in terms of personal income tax and taxes on company profits, indirect taxation and taxes on other types of income and assets.

Personal income tax benefited from the termination of the flat-rate reduction in the Flemish Region, and other regional measures are expected to boost this category of revenues going forward, by means of less generous tax rebates on mortgage interest for instance. At federal level, the range of personal income tax measures targeted non-cash benefits such as company cars and homes made available to employees free of charge. Tougher measures to combat fraud also boosted fiscal and parafiscal revenues. By contrast, taxes on earned income were depressed by other factors during the same period, e.g. the general reduction in employers' contributions to social security and a higher flat-rate reduction for professional costs.

Taxes on company profits were most affected by the changes made to the system of notional interest deduction. In 2012, this rate was limited to 3 %, and to 3.5 %

for SMEs, after which the reference rate was calculated on the basis of the third quarter of the year preceding the relevant tax year, allowing a lock-in of the interest cuts that had taken place in the course of 2012. In addition, limits were imposed on deduction transfer and on the deduction's tax base, in particular for banks. Various other measures benefited revenues, such as those combating fraud, higher taxes on company cars, taxes on gains realised on the sales of shares, the fairness tax and taxes levied on utility companies. A number of measures were to prove rewarding at the end of the consolidation period, such as the transparency tax and a new liquidation bonus system, i.e. early collection of after-tax profit at smaller companies, with this being put into a special liquidation reserve.

Measures targeting taxes on goods and services focused on excise duties, particularly on tobacco but also on alcohol and diesel, as well as the excess charge utility companies pay for keeping nuclear energy on stream. Other taxes were also either ratcheted up, such as those on stock market transactions and life insurance, or implemented, such as tax on credit institutions. Moves on VAT, by contrast, cancelled each other out, with rate cuts on electricity and on some tour operator products offset by VAT newly imposed on specific activities by notaries, bailiffs and lawyers, while VAT rates for pay TV were raised and VAT levies on electronic services and plastic surgery imposed. VAT revenues were also boosted by higher excise duties.

A range of other measures helped push up revenues: withholding tax on numerous financial products was gradually raised from 15 % to 25 % and taxes on savings deposits charged at financial institutions were also increased. Early collection of taxes on pension savings should also provide a boost, while other significant factors included temporary measures such as those governing the liquidation bonus and tax regularisation.

In 2017, non-fiscal and non-parafiscal revenues should be almost back at their 2010 levels. Meanwhile, they should benefit from higher contributions from banks in the shape of dividends, guarantee payments for interbank lending and contributions to the Belgian resolution fund. Only the contributions to the deposit guarantee scheme are likely to be much higher in 2017 than they were in 2010.

4. Impact of the various policy instruments

4.1 General picture

During the three major consolidation periods – in the 1980s, 1990s and from 2010 – other instruments were consistently preferred as a means of achieving fiscal consolidation.

In the 1980s, the government made deep cuts in its primary expenditure, which fell by more than 7 percentage points of GDP between 1981 and 1987. During the same period, government revenues made a slight contribution to the recovery, while interest charges rose further due to the growing debt ratio.

Virtually the reverse situation occurred in the 1990s. The restrictive fiscal policies were this time based chiefly on an increase in revenues, which went up by 5 percentage points of GDP between 1992 and 1998, while primary expenditure remained virtually flat. At the same time, interest charges fell by 3.5 percentage points thanks to a fall in both interest rates and the debt ratio, which together made a major contribution to the improvement in the overall balance in this period.

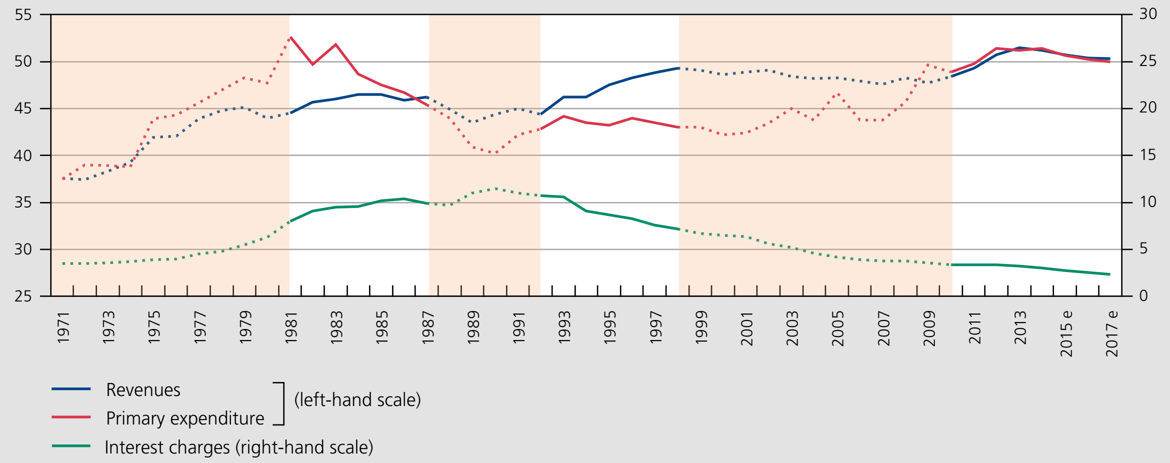
The observed and anticipated developments in the present period of consolidation are less clear-cut. At the start of the period, government revenues were the favoured instrument for restructuring public finances, and rose by 3 percentage points of GDP between 2010 and 2014. At the same time, primary expenditure grew further, putting even more pressure on the overall balance. However, the austerity measures implemented by the present federal government are expected to reverse this dual trend, with the emphasis henceforth on lower spending in combination with virtually flat revenues. Interest charges fell further thanks to the low interest rate environment, though at a slower pace due to the rising debt level.

4.2 Revenues

The three consolidation periods share a number of characteristics as regards government revenues. Levies on income from employment increased each time, for example, especially at the start of the period, albeit to differing degrees. Even clearer was the fact that taxes on capital and the income they generated, including corporation tax, were used as the main lever to improve the national accounts in all three consolidation periods. Revenues from indirect taxation, by contrast, show a different and more

CHART 5 REVENUES, PRIMARY EXPENDITURE AND INTEREST CHARGES

(% of GDP)



Sources : NAI, NBB.

subdued development : falling in the early 1980s and rising more or less steadily in the two following periods. Finally, non-fiscal and non-parafiscal revenues, even in the best case, made no significant contribution to the consolidation efforts.

4.2.1 Levies on employment

Levies on employment consist principally of income tax – mainly payroll tax, pre-payments, tax assessments and local tax surcharges – and employees' and employers' social security contributions.

At the start of the 1980s, the increase in levies was accompanied by a fall in the wage share of GDP. The consolidation was therefore based at least in part on measures that helped to boost those revenues. These measures did not lead to higher income tax revenues, which actually fell slightly over the period despite the raising of local government taxes. By contrast, they did lead to an increase in social security contributions of 2.5 percentage points of GDP between 1981 and 1987, the waiving of automatic indexation – also known as 'index jumps' – on three occasions being the most symbolically important measure. That in turn led to an increase in employers' contributions, as the proceeds were paid out in the form of a wage restraint levy. As already stated, several contributions were also raised or introduced.

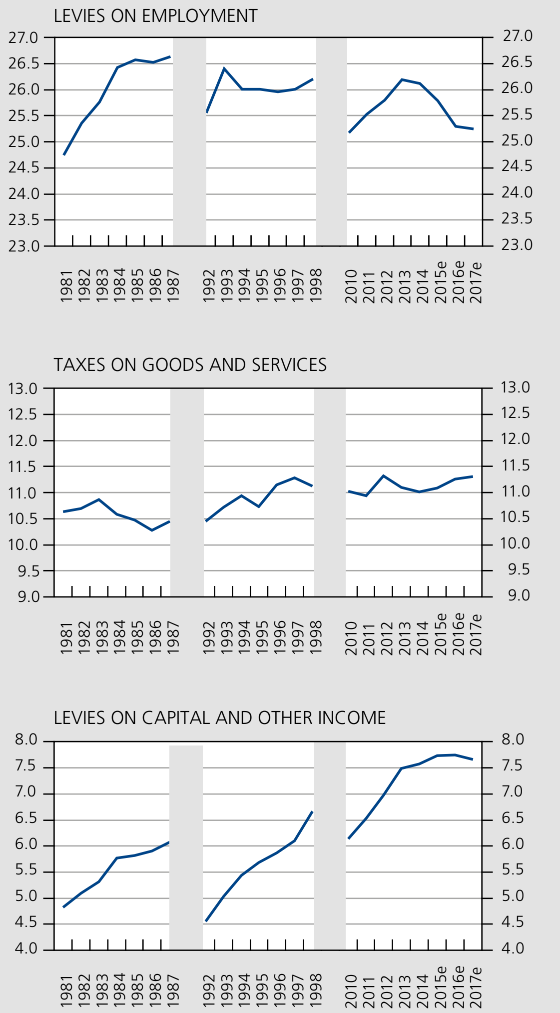
There was another notable increase in levies on income from employment in 1993, amounting to 0.8 percentage point of GDP over one year. A large number of measures contributed to this sharp increase, including the suspension of indexation of most tax bands, the introduction of the supplementary crisis contribution and, to a lesser extent, the curtailing of tax relief on long-term savings. This enabled income tax revenues to be maintained in the ensuing years, despite a sharp deterioration in the wage share of GDP. By contrast, social security contributions were trending downwards as the impact of cuts in employers' contributions intended to safeguard competitiveness and boost employment proved greater than the effect of introducing the special social security contribution.

Moving to the current period, levies on income from employment increased again between 2011 and 2013 before stabilising, and are expected to fall by 2017. These movements, which have a largely parallel effect on income tax and social security contributions, stem both from the trend in the wage share of GDP and from measures already discussed extensively earlier.

4.2.2 Taxes on goods and services

The changes in tax rates on goods and services – with VAT and excise duties as the main components – were less pronounced. They also made no contribution to the consolidation in the 1982-1987 period, but played a bigger role in the 1990s. Their contribution in the current period is just in positive territory.

CHART 6 FISCAL AND PARAFISCAL REVENUES
(% of GDP)



Sources: NAI, NBB.

Between 1982 and 1987, indirect taxes were boosted by measures to raise VAT and excise duties under the Maribel scheme, which began in July 1981. The effect of these increases was however cancelled out by falling consumption and housing investment. The rates were raised yet again thereafter and the tax base was widened, albeit to a limited extent, so that the reduction in the share taken by domestic demand in GDP led to a fall in taxes on goods and services expressed as a percentage of GDP.

The 1993-1998 period saw a clear increase in indirect tax revenues, totalling 0.7 percentage point of GDP. This was despite a reduction in the share of private consumption and housing investment and reflected a series of measures taken on VAT, excise duties and other indirect taxes.

The present consolidation has thus far been characterised by fluctuating revenues from indirect taxation, though the general trend is still upwards. These developments are largely related to the irregular development of the share of the tax base in GDP, though taken over the period as a whole this has been stable. The measures taken on excise duty and other indirect taxes explain the slight upward trend.

4.2.3 Levies on capital and other income

The levies on capital and other income made the biggest and most regular contribution in the three consolidation periods considered here. These levies comprise tax on company profits plus a wide array of contributions, particularly withholding tax and property tax as well as registration fees, inheritance tax and gift tax.

During the 1982-1997 period, these levies rose by 1.3 percentage points of GDP, driven by an increase in their two main components. Taxes on company profits rose by 0.6 percentage point of GDP thanks to the recovery in corporate profitability and the impact of numerous measures to limit fiscal expenditure at the end of the period. By contrast, other measures served to curtail these revenues, including the reduction in corporation tax from 48 % to 45 % in 1982 and then to 43 % in 1987, as well as a number of tax incentives developed at the start of the period, such as the legislation on coordination centres. Levies on other income and on capital rose overall by 0.7 percentage points of GDP, partly due to the increase in withholding tax in 1984.

This category of revenues made an even bigger contribution in the 1993-1998 period, which saw their share in GDP rise from 4.5 % in 1992 to 6.7 % in 1998. This sharp increase was due almost entirely to corporation tax, which rose by 1.8 percentage points of GDP. Corporation tax revenues were boosted by the greater share of corporate earnings in GDP, partly as a result of the lowering of employers' social security contributions plus a host of other measures, such as the increase in the nominal tax rate from 39 % to 40.17 % in 1993, due to a rise in the supplementary crisis contributions and various measures to broaden the tax base. Taxes on other income and on capital also increased slightly during this period, by 0.3 percentage points of GDP, mainly due to higher revenues from withholding tax on income from immovable assets, inheritance tax and gift tax as well as a number of other duties.

In the current period, taxes on capital and other income are expected to reach 1.6 percentage points of GDP. This increase is once again attributable chiefly to corporation tax revenues, which are likely to rise from 2.5 % of GDP in 2010 to 3.6 % of GDP in 2017 due to the restrictions imposed on the notional tax relief on interest payments and the influence of other measures already mentioned. Additionally, since the financial crisis, companies have switched from tax prepayments to payment based on tax assessments. This had a temporary negative effect on tax revenues in 2009 and 2010, as assessment-based tax payments take place later. The taxes on other income and on capital have also increased thanks to the various measures already mentioned, which it is estimated will lift returns by 0.4 percentage point of GDP between 2010 and 2017.

4.3 Primary expenditure

The fiscal consolidation in the 1980s related largely to primary expenditure. This period saw reductions in public sector pay, investment and other capital expenditure, bringing down primary expenditure by a total of more than 7 percentage points of GDP between 1981 and 1987. In the subsequent consolidation periods, by contrast, less use appears to have been made of the expenditure lever. Savings on certain items were at least offset by higher spending in other categories, because overall primary expenditure remained stable between 1992 and 1998, and is projected to rise slightly during the current consolidation period.

A number of key categories are highlighted in the following sections, namely social security expenditure, public sector pay and investment.

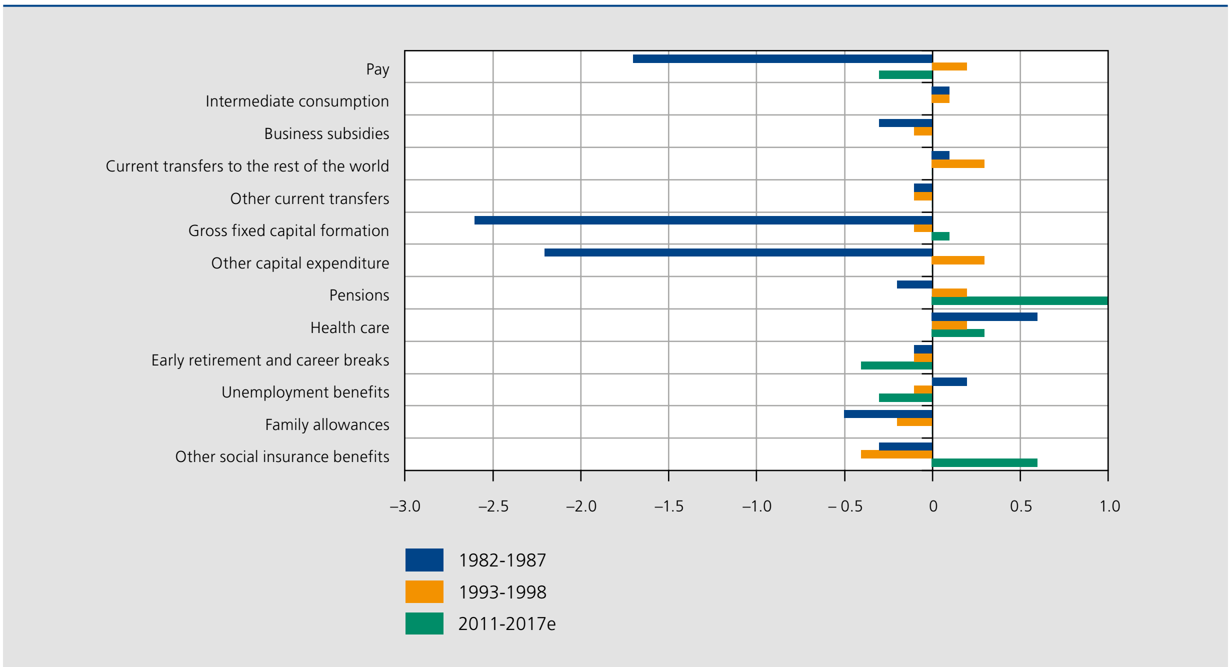
4.3.1 Social security expenditure

Social security spending represented half of all primary government expenditure in Belgium in 2014, or 25 % of GDP. That is 4 percentage points of GDP more than in 1980. This difference alone is enough to explain the increase in total primary expenditure over the period.

The main drivers of the rise in social security spending are higher pension benefits, in turn caused by the growing number of pensioners due to ongoing population ageing. The share of over-65s in the Belgian population has increased from 14 % in 1980 to a projected 18 % in 2016. In the 1980s, however, the growth in pension payments did not keep pace with the increase in the older population, mainly because of the waiving of automatic indexation on three occasions during the first consolidation period. The discrepancy has been reduced during the most recent consolidation period, however, thanks to the addition of top-up payments to pensions from the so-called 'welfare adjustment'.

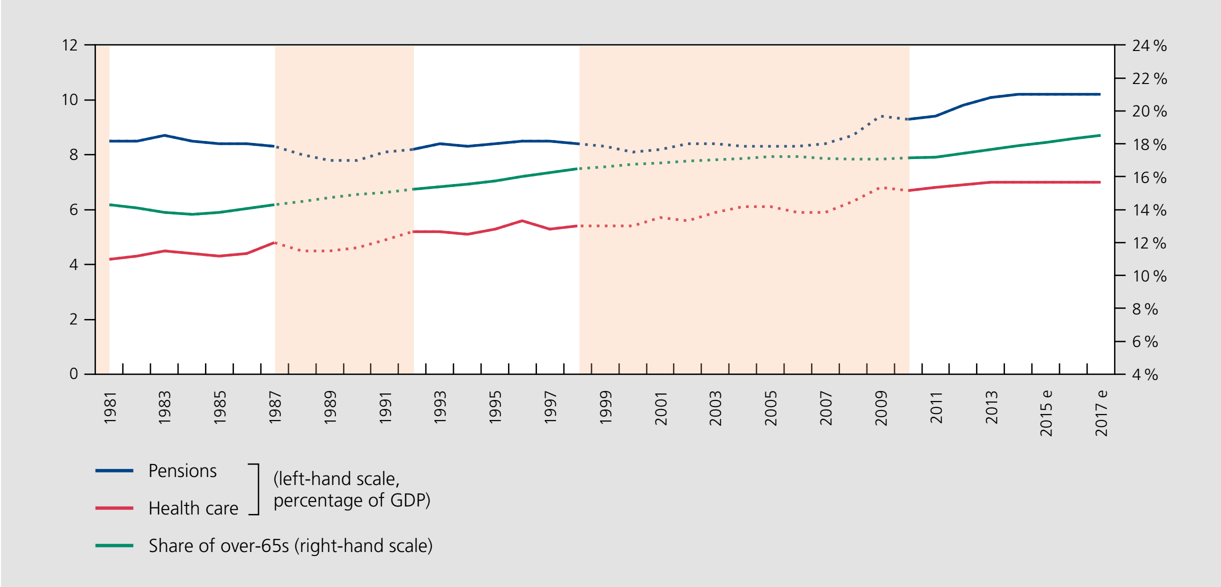
Population ageing also influenced spending on health care, taking it from 4.1 % of GDP in 1980 to a projected

CHART 7 TREND IN PRIMARY EXPENDITURE DURING THE PERIODS OF FISCAL CONSOLIDATION
(% of GDP)



Sources: NAI, NBB.

CHART 8 SOCIAL BENEFITS AND POPULATION AGEING



Sources: FPB, NAI, NBB.

7 % in 2017. However, we would again point out the mitigating effect of the waiving of indexation on three occasions and the resultant temporary wage freeze, which became evident from 1984. Health care spending evidently did increase outside the consolidation periods.

Other social security spending shows a downward trend over the whole period since 1980, and especially during the consolidation periods. The three 'index jumps' meant that this downturn was most pronounced during the first restructuring period. Generally speaking, other social security expenditure has shown a declining trend, occasionally interrupted by more or less pronounced cyclical changes. These movements are most likely driven by demographic or cyclical factors, over and above the impact of policy measures to mitigate spending.

Demographic developments have led to an overall reduction in child benefit. The low birth rate means the number of children in the Belgian population is falling: at present, 23 % of the population are aged below 20, compared with 28 % in 1980. Child benefit budgets fell more sharply in the 1980s than the number of beneficiaries and allocated budgets. The cause was the repeated decision to waive automatic indexation as well as specific containment measures implemented in the 1980s. Another explanation is shrinking family size in a system where the amount of child benefit increases with the child's rank. The extension of compulsory education to age 18 in 1983 had the opposite effect, causing child benefit to rise. During the present period, child benefit is projected to remain fairly stable relative to GDP.

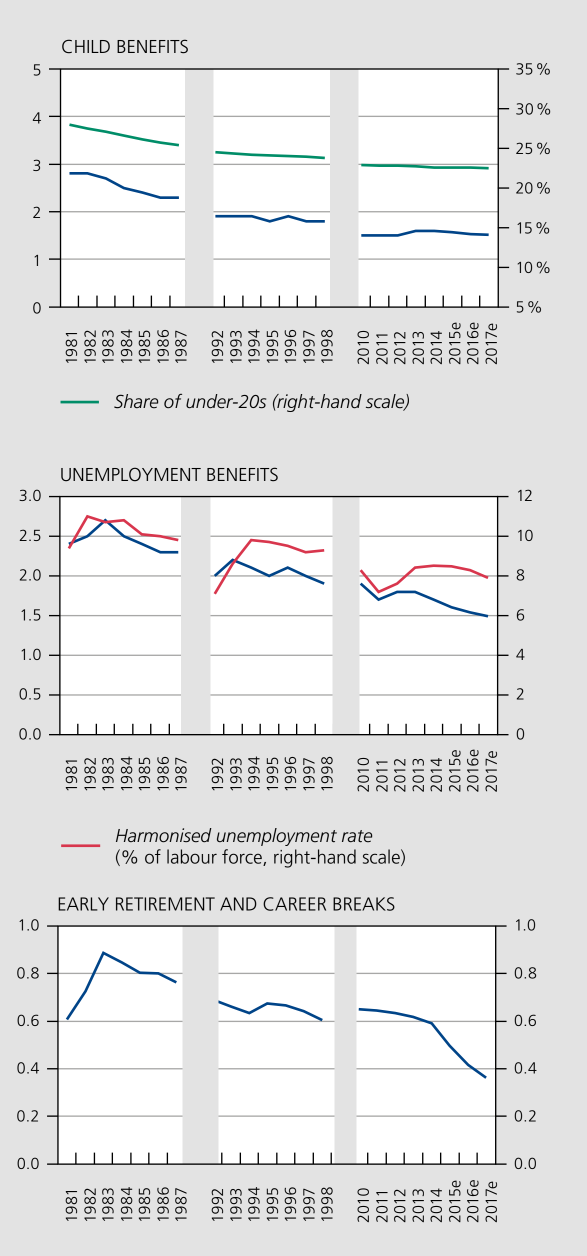
Unemployment benefits today represent only a limited share of social security spending. That share fluctuates considerably from year to year, depending on the state of the economy, but over the period as a whole, we observe a downward trend in the wake of the falling unemployment rate and restrictive measures that also have an impact on benefits.

The trend in sick pay and disability benefits is more irregular. After falling substantially due to both structural effects (increased proportion of working women and relative increase in white-collar workers compared with blue-collar workers) and restrictive measures, benefits are projected to rise once again to reach the levels seen in the early 1980s, namely 1.7 % of GDP, by 2017.

The budget for early retirement and career breaks has also fallen over the last 30 years, from a peak of 0.9 % of GDP in 1983 to a projected 0.6 % of GDP in 2017. This trend demonstrates the will to keep employees in work for as long as possible. The measures to restrict early retirement benefits have also had an impact, especially since the 1990s, and more recently also the action to curtail time-credit schemes. In the 1982-1987 period, the relative weight of both categories of social security benefits increased, following the launch of the career break system in 1985 and because early retirement was encouraged

CHART 9 CHILD BENEFIT, UNEMPLOYMENT BENEFIT, EARLY RETIREMENT AND CAREER BREAK BENEFITS

(% of GDP, unless otherwise stated)



Sources: NAI, NBB.

at the start of the period with the aim of redistributing employment in favour of young people.

4.3.2 Public sector pay

The pay of public sector workers fell significantly between 1982 and 1987, and increased slightly in the 1993-1998 period. During the current period, it first rose slightly, then began to fall, a trend which is projected to continue until 2017. Public sector pay fell during the first consolidation period, despite an increase in public sector employment. This illustrates the mitigating effect of the freeze on real wages, followed by the threefold disapplication of wage indexation ('index jumps'). Encouraging part-time work may also have contributed to the increase in employment measured in number of persons. Public sector pay increased during the second period due to the general overhaul of pay scales in the early 1990s, which was spread over several years. On the other hand, restrictive fiscal policies put downward pressure on public sector employment. People who retired during this period were less often replaced through recruitment. In fact, the volume of work also fell due to the encouragement of part-time working. The abolition of compulsory military service in 1994 also played a role, as thousands of military personnel disappeared from the public sector employment statistics within a short space of time. Public sector employment, especially at federal level, has fallen slightly in the most recent period, helping to temper the trend in pay. This mitigating effect is likely to be reinforced in 2015 and beyond by the austerity measures announced by the new federal, regional and local governments.

4.3.3 Public investment

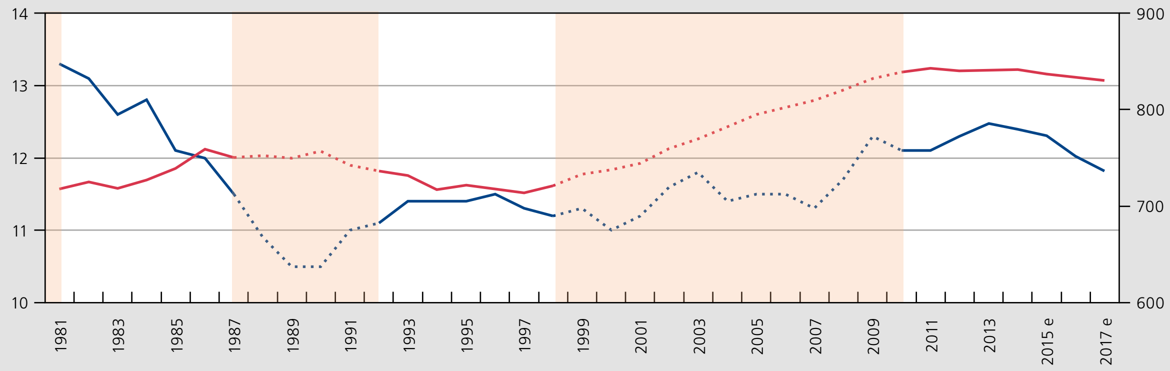
Public sector investment has fallen substantially as a share of GDP over the entire observation period. After peaking at 5 % of GDP in 1980, it stood at just 2 % in 2014. The biggest fall occurred during the fiscal consolidation in the 1980s. Investment is a form of expenditure that is relatively easy to scrap in times of restructuring. Since the end of the 1980s, the level of investment has fluctuated between 2 % and 2.5 % of GDP, a very low level which leaves little scope for further cutbacks.

4.4 Government debt

Measures were also taken during the different consolidation periods which had a direct impact on government debt without influencing the overall government balance. Factors that influence the level of debt but not the overall balance are also referred to as exogenous factors.

During the reconstruction period in the 1990s, the government took a number of measures to reduce the debt ratio with a view to joining the currency union. As an example, the government embarked on a series of privatisations of state-owned companies, which together raised 2.6 % of GDP. At federal level, these actions included the whole or partial privatisation of some formerly public credit institutions (ASLK/CGER in 1993 and 1997,

CHART 10 PAY AND EMPLOYMENT IN THE PUBLIC SECTOR

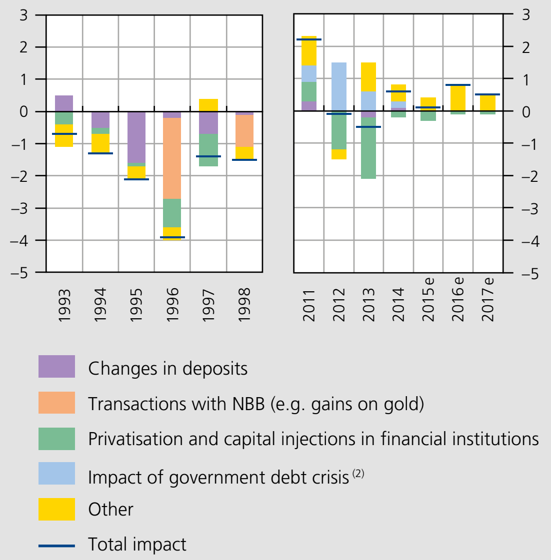


Sources: NAI, NBB.

the *Nationaal Instituut voor Landbouwkrediet / Institut national du crédit agricole* (agricultural loans) in 1995 and 1996, and the Nationale *Maatschappij voor Krediet aan de Nijverheid / Société nationale de crédit à l'industrie* (lending to industry) in 1995), the partial privatisation of the national telecommunications operator Belgacom in 1996 and the privatisation of part of the portfolio of the National Investment Company in 1994. At regional level, the Flemish government sold shares in investment company GIMV in 1997. And at local level, part of the stake in Gemeentekrediet, a bank specifically set up to finance local authority investment, was sold off in that same year. The federal government also decided to reduce its deposit holdings, thus cutting the amount of Treasury borrowing needed. During the 1993-1998 period, deposit exposure fell by 2.6 % of GDP. The National Bank of Belgium also made significant gains in 1996 and 1998 from selling gold for foreign currency. These gains were largely used by the State to pay down the foreign currency debt. These transactions led to a reduction in government debt of 2.5 % and 1.5 % of GDP, respectively, in 1996 and 1998.

CHART 11 IMPACT OF EXOGENOUS FACTORS ON GOVERNMENT DEBT [1]

(% of GDP)



Sources: NAI, NBB.

(1) The consolidation period in the 1980s is left out of consideration here due to a lack of detailed data.

(2) Direct impact of loans to other members of the euro area (bilateral loans to Greece and loans via the EFSF) and of capital injections into the ESM.

During the restructuring period that began in 2010, the exogenous factors mainly stemmed from the aftermath of the financial crisis and the government debt crisis in Europe. Most of the capital injections in financial institutions took place in 2008 and 2009, though as late as 2011 the government bought Dexia Bank Belgium (subsequently re-named Belfius) from Dexia for 1.1 % of GDP [1]. From 2012, the government was able to start recouping a portion of the capital used to support financial institutions at the height of the crisis. KBC Bank, for

(1) In the 2014 national accounts, which were published by the National Accounts Institute (NAI) on 17 April 2015, 0.2 % of GDP was recorded as a capital transfer, with a direct negative impact on the overall government balance. Furthermore, the capital injection into Dexia in 2012, amounting to 0.8 % of GDP, was not treated as an exogenous factor, but as a capital transfer.

example, repaid an amount equivalent to 1 % of GDP to the federal government in 2012, followed by 0.4 % of GDP to the Flemish regional government in 2013 and 0.1 % of GDP in 2014 and subsequent years. The federal government also sold its stake in BNP Paribas Fortis (0.8 % of GDP) in 2013, as well as the bulk of its interest in Royal Park Investments (0.2 % of GDP). The European sovereign debt crisis drove up debt in the 2011-2014 period. The support provided to Greece via bilateral loans, and to Greece, Ireland and Portugal through the European Financial Stability Facility (EFSF) between 2011 and 2014, combined with the injection of capital into the ESM since 2012, pushed up government debt by a total of 2.8 % of GDP over the period.

5. Impact of the restructuring policies

5.1 Impact on government debt

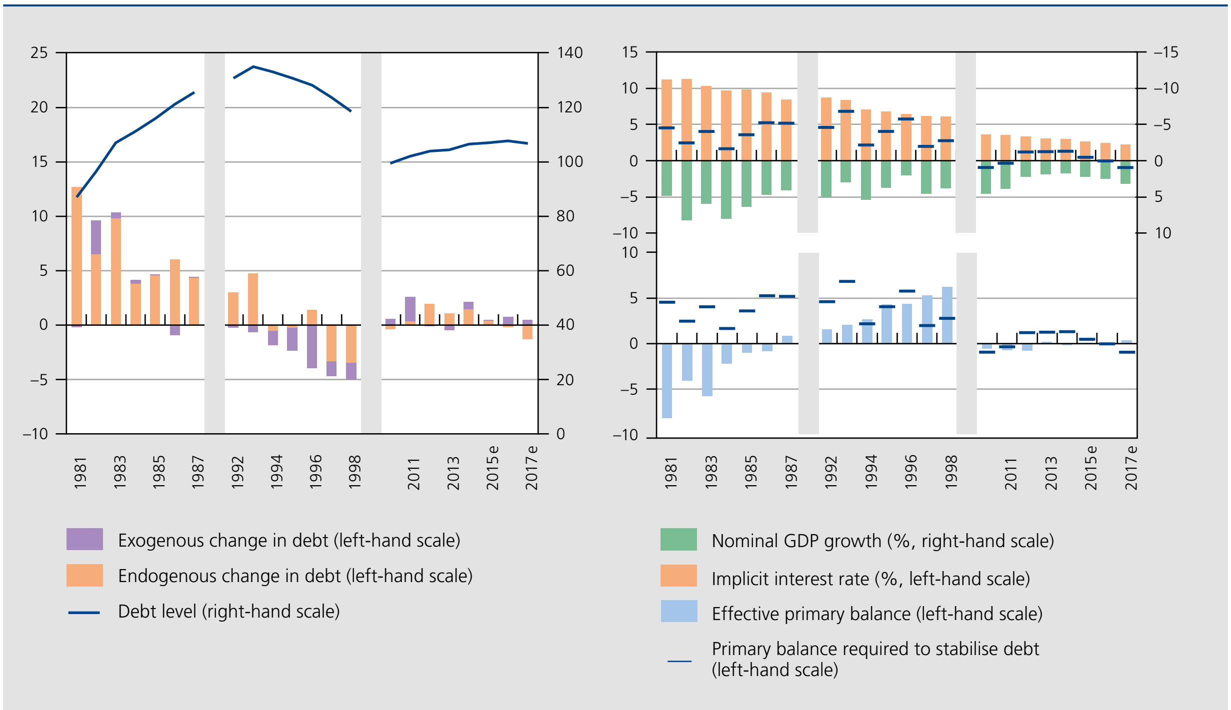
At first sight, the restructuring policies appear to have been successful in reducing Belgian government debt only during the consolidation period in the 1990s. Between 1992 and 1998, government debt fell from 130.8 % to 118.6 % of GDP, whereas in the 1981-1987 period, notwithstanding major restructuring efforts, it continued to rise substantially, from 87.1 % to 125.5 % of GDP, and in the 2010-2017 period it is projected to go up from 99.5 % to 106.8 % of GDP.

Breaking down the factors into exogenous and endogenous factors and further analysing the latter category presents a more complete picture of the development of government debt.

In the 1980s, government debt was driven up mainly by endogenous factors, determined on the one hand by the difference between the implicit interest on the debt and the growth in nominal GDP, and on the other by the level of the primary balance. During the period under consideration, the implicit interest rate on the debt averaged 10 %, substantially higher than the average nominal growth in GDP of 6 %, while the government's primary balance was in deficit. The high interest rates meant that government debt – via the budget balance – rose more quickly than nominal GDP, in turn pushing up the debt ratio.

Halting an interest snowball such as this – leaving aside the exogenous factors – requires a positive primary balance. It was not until the mid-1990s that the government managed to achieve sufficiently high primary surpluses to

CHART 12 DETERMINANTS OF THE DEVELOPMENT OF GOVERNMENT DEBT
(% of GDP, unless otherwise stated)



Sources: NAI, NBB.

neutralise the interest snowball and reverse the endogenous trend in government debt to set it on a downward path. The government was helped by the falling implicit interest rate on government debt which, thanks to the growth in economic activity, meant that the primary surplus required to stabilise the debt was lower. Exogenous factors also contributed to the reduction in the debt ratio in this period.

The present consolidation period, with the exception of the initial phase, has been characterised by only limited growth in nominal GDP. As a result, even with historically low implicit interest rates on government debt, a slight primary surplus is needed in order to stabilise the debt ratio. Partly because of the weak economy, the consolidation policies put in place have proven insufficient to improve the primary balance to the level needed to stabilise the debt ratio. Exogenous changes caused by the financial and government debt crises have driven up the debt ratio further, and stabilisation is not expected to be achieved until 2016, supported by an upturn in economic activity.

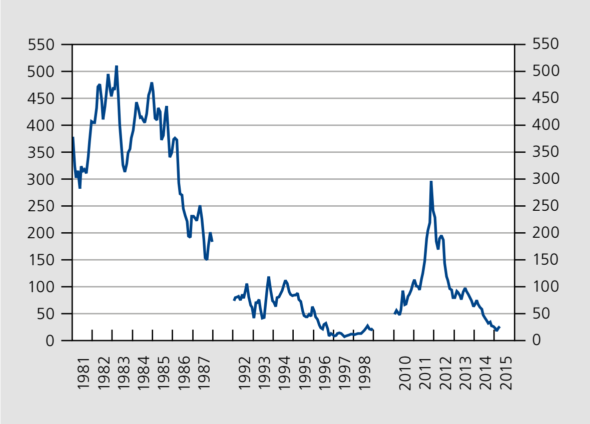
5.2 Impact on yield spreads on government loans

Long-term yields on government bonds have fallen significantly worldwide since the early 1980s. In Belgium, they have dropped from around 12 % in 1980 to 0.4 % in April 2015. This can be attributed in part to the consolidation of Belgium's public finances, though other factors are also important. First, there was the Great Moderation, a period of greater macroeconomic stability which lasted from the end of the 1980s until 2006 and was characterised by falling inflation, positive and relatively stable economic growth and the belief that the economic cycles were more under control. Second, there was the global savings surplus which arose at the end of the 1990s. Finally, yields came under pressure in the wake of the financial and economic crisis due to the introduction of unconventional monetary policy measures, the fall in potential growth and the flight to safe assets. However, it is worth noting that during the government debt crisis, which intensified during 2011, yields on Belgian government debt went up temporarily.

The trend in yield spreads on long-term government loans issued by euro area countries relative to German Bunds means that the influence of global factors can be largely eliminated. National budgetary indicators have always played a role in the analysis of these spreads, together with other factors such as the liquidity of the various markets and external indicators such as the trade balance and current account balance.

CHART 13 DEVELOPMENT OF YIELD SPREADS BETWEEN BELGIAN LONG-TERM GOVERNMENT BONDS AND GERMAN BUNDS DURING CONSOLIDATION PERIODS

(in basis points)



Sources: IMF, Thomson Reuters Datastream.

During the consolidation periods studied in this article, there was a clear narrowing of the yield spread between long-term Belgian government loans and German Bunds. The timing of this narrowing differed from period to period, however. For example, the spread only began to narrow substantially towards the end of the 1982-1987 consolidation period, while between 1993 and 1998 it narrowed substantially around the middle of the period due to the convergence of government bond yields in the run-up to the launch of the third phase of Economic and Monetary Union. Finally, in the current consolidation period, the spread at first widened in the wake of the government debt crisis, from around 50 basis points in early 2010 to a peak of almost 300 basis points at the end of 2011. This spread then began to narrow rapidly from early 2012, to stand at around 20 basis points in the current year. These observations suggest that it is highly likely that the fiscal consolidation policies have contributed to reducing the spreads.

Conclusions

In this article, we have analysed Belgian policies for restoring sound public finances since the early 1980s. For this purpose, three consolidation periods were identified based on the development of the structural overall balance.

The first period began in 1982 and lasted until 1987, and began at a time of recession and major imbalances in the Belgian economy, including a substantial government deficit. The major fiscal consolidation efforts that ensued were based on a sharp reduction in public expenditure and a limited increase in government revenues. The onset of the second period, which ran from 1993 to 1998, was also characterised by recession. The consolidation that took place during this period was achieved mainly through an increase in revenues combined with a reduction in interest charges. The third consolidation period followed the financial and economic crisis and began in 2011. This period was initially characterised by an increase in government revenues, but since 2015 the emphasis has shifted onto cutting expenditure. There has also been a further reduction in interest charges over this period.

The analysis of the restructuring policies since the early 1980s shows that fiscal consolidation programmes consistently begin in periods of low economic activity. They are also always accompanied by structural reforms. This led in each case to a recovery in competitiveness and higher employment. Attention was also devoted to the affordability of the social security system, not least through pension reforms.

Major restructuring efforts are being made in the present consolidation period, but these are still relatively limited compared with the previous two restructuring periods. It should be noted here, however, that today's fiscal consolidation is taking place in more difficult circumstances, with weaker potential growth, heavy fiscal and parafiscal pressure, low public sector investment and the rising costs of population ageing. Finally, additional measures need to be taken as part of the ongoing fiscal consolidation in order to restore a structural budget balance.

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