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The new European fiscal framework: Implications for fiscal policy in Belgium

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Introduction

Since the COVID-19 and energy crises, risks to the sustainability of public finances have increased significantly in several European countries, such as Belgium, France and Italy. These three countries are characterised by high public debt ratios (above 100 % of GDP) and high budget deficits (around 5 % of GDP).

A fiscal framework, which includes rules setting a threshold limit for the budget deficit or debt ratio, appears necessary to impose sufficient discipline on governments and gradually ensure the sustainability of public finances. Without such discipline, countries risk leaving the assessment of fiscal sustainability to the financial markets, which are susceptible to shocks.

In 2024, the European Union reached an agreement on a new European fiscal framework. This was essential following the temporary suspension of the previous fiscal framework from 2020 to 2023 due to the aforementioned crises and given that, prior thereto, the European Commission had already deemed the existing framework to be flawed and insufficiently supported and implemented.

In this article, we demystify the new European fiscal framework (section 1), which consists of a morass of legal texts, procedures and rules that are not always accessible. We highlight its key aspects and how it differs from the previous framework.

We then apply the new fiscal framework to the situation in Belgium and set out the budgetary targets it implies for the country as a whole (section 2). Thus, we determine the minimum fiscal targets Belgium should adopt in the coming years and the corresponding maximum expenditure growth rate to be pursued. Through this exercise, we open up the “black box” of European rules which, among other things, rely on debt sustainability analyses, to find out which economic parameters will determine the budgetary targets for Belgium.

Next, we look at what these fiscal rules will mean for the various governments within the country (section 3). Indeed, the fiscal targets have to be allocated across the federal level, the communities and regions, and local

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government. We base this allocation on the allocation key and methodology set out in the advice issued in July by the "Public sector borrowing requirements" section of the High Council of Finance. By comparing the fiscal target per entity with budget estimates assuming no change in policies, we also provide an indication of the fiscal effort required at the different levels of government to meet the target.

We conclude with a brief assessment of the new European fiscal framework against the objectives its designers had in mind (section 4). Finally, we highlight the efforts needed to align the Belgian fiscal framework with the European framework and thus ensure sustainable finances at all levels of government in Belgium.

1. The new European fiscal framework

A new, thoroughly reformed European fiscal framework is gradually being introduced in 2024, as part of a broader reform of the European economic governance framework. The latter consists of a system of institutions and procedures that has been created to coordinate EU Member States' economic policies and to achieve its economic objectives. It relies on the principles of monitoring, prevention, and correction of economic trends that could weaken individual Member States' economies or cause spillovers to other economies.[1]

The European fiscal framework is aimed at ensuring the soundness and sustainability of public finances over the medium and long term, for all Member States. This section begins by briefly explaining the importance of fiscal frameworks and then provides a short account of how the European fiscal framework was developed. Next, it describes the new framework's main features.

1.1 The importance of fiscal frameworks

Sound public finances are key to creating the conditions for price stability and for strong and sustainable growth that fosters employment.[2] Experience shows how harmful a lack of fiscal discipline can be for an economy over time. It is widely recognised that a fiscal framework, consisting of a set of procedures, independent institutions, and fiscal rules, can greatly contribute to sound fiscal policy.[3]

Fiscal frameworks impose constraints on fiscal policy and allow a so-called "deficit bias" to be avoided. Financial markets can, in principle, discourage inappropriate fiscal policy. However, this disciplinary mechanism does not always work perfectly, as was evident in retrospect from the period preceding the outbreak of the financial crisis in 2008. In a monetary union with a fragmented fiscal policy, the case for a strict fiscal framework is even stronger. The implementation of irresponsible fiscal policy by one or more governments in the monetary union may produce undesirable spillovers and distort the functioning of monetary policy. To minimise such contagion, the institutional architecture of a monetary union in which fiscal policy is fragmented therefore ought not only to provide the necessary guarantees to ensure central bank independence and that governments are not responsible for the debts of other governments (a "no-bail-out" clause) but should also lay down strict rules ensuring adequate fiscal discipline.

The fiscal policies of euro area countries, unlike monetary policy, have remained a national competence. The Maastricht Treaty and the Stability and Growth Pact established a European fiscal framework with binding

1 European Council, Council of the European Union (2024).
2 See also Melyn *et al.* (2015).
3 See also Melyn (2024).

fiscal rules. That framework is one of the cornerstones of monetary union, and for it to function well, it is crucial that Member States comply with the rules.[4]

1.2 The development of the European fiscal framework and the need for reform

1.2.1 A brief history of the European fiscal framework

Fiscal frameworks are set up to guide fiscal policy for several years. To achieve their purpose, they need to be stable enough to facilitate planning over time, but also flexible enough to adapt when the environment in which they operate changes. The need for stability is a major reason why a framework usually remains unchanged even despite minor weaknesses being identified.

Since its inception, the European fiscal framework has evolved in waves, in response to weaknesses that generally became apparent in times of economic crisis, and to new economic challenges. Initially, it was simple. As a result of successive reforms, the framework became broader and smarter, but its complexity significantly increased. The fact that there were frequent changes made to the framework and to the rules therein illustrates that it is hard to design good fiscal rules.

The foundations of the current European fiscal framework were laid in the Treaty on European Union (better known as the Maastricht Treaty), signed in February 1992, and in the Stability and Growth Pact (SGP), signed in June 1997. The Pact was reformed in 2005 and during the period 2011‑2013, including via the introduction of the legislative measures known as the six-pack and two-pack. From 2015 onwards, the EC took several initiatives aimed at clarifying the functioning of the framework and rendering its application more transparent within the existing legal context. Some of these initiatives gave the EC more discretionary powers to verify and enforce compliance with the SGP. It also made the monitoring of compliance more technical and susceptible to politically motivated considerations and assessments. This undermined the predictability and transparency of the decision-making process.[5]

The EU fiscal framework was *de facto* temporarily deactivated from the end of March 2020 to the end of 2023, via the application of the general escape clause due to the COVID-19 pandemic and the energy crisis.[6] During this period, reforms were made to the framework, prior to its re-activation in 2024.

1.2.2 The road to a new fiscal framework

In contrast to the past, the trigger for the most recent reform of the EU fiscal framework was not a crisis but, rather, a planned February 2020 review by the European Commission (EC) of the six-pack and two-pack regulations. The resulting report identified several weaknesses: debt was still too high in several countries; fiscal policy remained largely pro-cyclical; the rules remained complex; Member States were given too little responsibility; and there was too little focus on public investment. On top of this, its incremental evolution had resulted in the framework becoming complex, with medium-term planning not binding in practice, and with limited compliance and enforcement of the rules. All this clearly pointed to the need for comprehensive reform.

Based on the findings of the EC review, a public consultation on the future of the economic governance framework was launched in October 2021, following a delay due to the COVID-19 pandemic. This consultation

4 See also ECB (2024).

5 See Melyn (2024) and Melyn *et al.* (2015) for a more extensive description of the development of the EU fiscal framework.

6 The clause allows Member States to deviate temporarily from the medium-term budgetary objective or the path towards it, provided that this does not endanger fiscal sustainability in the medium term.

involved various stakeholders, including citizens, national governments, parliaments, the social partners, and several European institutions.[7,8]

In early November 2022, the EC published a proposal for the reform of the European economic governance framework. This was shaped by insights on the existing policy framework, as well as lessons learned from the COVID-19 crisis, and the shifts that had taken place in the macro-fiscal environment since the adoption of the Maastricht Treaty. Major changes in this regard included the considerable decline in potential growth, the widening divergence of the fiscal positions of Member States, and the materialisation of different tail risks. Since then, growing spending and investment needs have been identified, relating to geopolitical conflicts, climate change, digitalisation, and industrial policy, in addition to those associated with ageing populations.[9]

Based on these orientations and subsequent discussions in European fora, the EC formulated legislative proposals for the new European governance framework in April 2023. These proposals were discussed and fine-tuned over the following months and a political understanding was reached in the Ecofin Council at the end of 2023. After minor amendments by the European Parliament, an agreement was reached between the Ecofin Council and the European Parliament on 10 February 2024. The new framework was finally approved at the end of April 2024 and is being phased in gradually, over the course of the year.

According to the EC, the main objectives of the new framework are to strengthen Member States' debt sustainability, a precondition both for effective fiscal stability at the national level and for monetary policy to be able to focus effectively on price stability, and to promote sustainable and inclusive growth in all Member States through growth-enhancing reforms and priority investments. The framework should help to make the EU more competitive and better prepared for future challenges by supporting progress towards a green, digital, inclusive and resilient economy. The guiding principles are stronger national ownership via medium-term plans, simpler rules taking account of differing fiscal challenges, the promotion of reforms and investment, and the enhancement of enforcement.[10]

1.3 The new European fiscal framework

The 2020-2024 reform of the European fiscal framework introduced substantial changes. It is the most comprehensive reform since the introduction of the Stability and Growth Pact. This section presents an overview of the most important changes.[11] Firstly, we highlight which parts of the legal framework were changed and which were left unchanged. Secondly, we discuss the modified European fiscal calendar and the procedural obligations for Member States. Finally, we focus on the most important aspect of the reform: the new fiscal rules. The spotlight is on the institutional and EU-wide aspects, with the more technical aspects covered in section 2, where the rules are applied to Belgian public finances.

1.3.1 The legal context

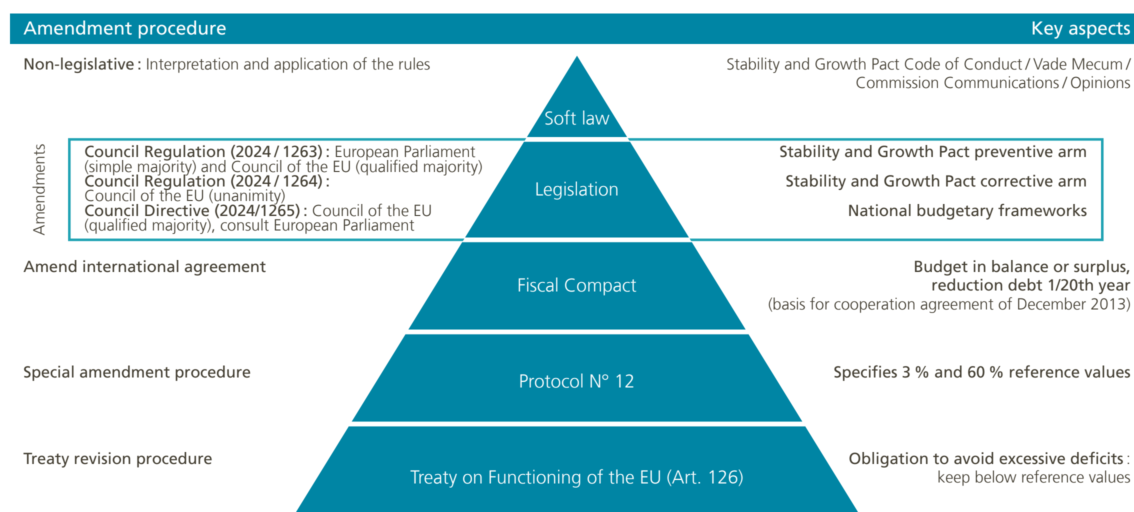
The European Union is based on the rule of law. Every action it takes is based on treaties that have been voluntarily and democratically approved by its members. Specific pieces of EU legislation help to achieve the objectives of the EU treaties and put EU policies into practice.[12]

7 See EC (2021).
8 See EC (2022).
9 See independent Authority for Fiscal Responsibility of Spain (2024).
10 See EC (2024c).
11 Based on the legal provisions approved in February 2024. See Council of the EU (2024).
12 EC (2024d).

The feasibility and procedural requirements for amending the various elements of the SGP were important considerations in the debate surrounding the reform of the European fiscal framework.[13] A pyramid of legal provisions underpins the framework, ranging from treaties, protocols, international agreements, regulations, and directives, to non-binding soft law instruments such as communications and opinions. The legal feasibility and procedural requirements of any reforms depend on where the relevant provisions are located in this pyramid: the closer to the base, the heavier the requirements. The most demanding procedure concerns a revision to the treaties.[14] Under the (ordinary) procedure for treaty revision, unanimity is required between the Member States to make any changes. At the top of the pyramid lie soft-law instruments that are the easiest to change: the endorsement of the Economic and Financial Committee or of the Ecofin Council may be sufficient to make amendments thereto.

Figure 1

Only certain aspects of the EU fiscal framework were amended



Sources: ECB, Nguyen.

The 2020-2024 reform ultimately required amendments to secondary Union law, through two Council regulations and a Council directive. Council Regulation (EU) 2024/1263 on the preventive arm of the SGP replaced Regulation (EC) No 1466/97 and was approved by a simple majority in the European Parliament and a qualified majority of the Ecofin Council. Council Regulation (EU) 2024/1264 on the corrective arm of the SGP amended Regulation (EC) No 1467/97 and was approved by unanimity in the Ecofin Council. Lastly, the Council Directive on the requirements of the budgetary frameworks of the Member States (EU) 2024/1265 amended Directive 2011/85/EU and was approved by a qualified majority in the Ecofin Council after the consultation of the European Parliament. Other aspects of the EU fiscal framework remained unchanged. Consequently, the new framework is still built around Article 126 of the Treaty on the Functioning of the European Union (TFEU) and its Protocol No 12. These lay out a standard for good fiscal behavior by EU governments based on the standard 3% and 60% of GDP reference values, as well as the excessive deficit procedure (EDP) for dealing with countries that exceed these thresholds.

It should be noted that the Fiscal Compact was not changed. It forms part of the intergovernmental Treaty on Stability, Coordination and Governance (TSCG) which entered into force in 2012 after the European sovereign

13 ECB (2024).
14 Nguyen (2022).

debt crisis. This treaty was approved unanimously by the participating Member States. The Fiscal Compact contains provisions stating that general government budgets must be balanced or in surplus and that debt must be reduced annually by 1/20th of any amount in excess of the 60 % of GDP benchmark. This seems contradictory to the new fiscal framework. However, pursuant to the principle of supremacy in EU law, international agreements such as the TSCG are subordinated to EU legislation. This means that any provisions in the Fiscal Compact that are stricter than EU law need not be transposed into national legislation, such as in Belgium's Cooperation Agreement of 13 December 2013. [15] In section 2.3 we discuss the implications of the reformed European fiscal framework on Belgium's national fiscal framework.

1.3.2 The new European fiscal calendar

The implementation of the European fiscal framework by Member States and the monitoring undertaken by the European institutions is integrated into the European semester. This is an annual cycle for the coordination of economic policies that ensures that Member States' fiscal and economic policies remain in line with their European obligations. The reformed European fiscal framework features a number of formal requirements and a timetable that Member States have to respect with regard to the public finance aspects of the European semester. This section focuses on those aspects.

Medium-term fiscal-structural plans (MTFSP) and progress reports are at the centre of the reformed European fiscal calendar. They replace the former stability or convergence programmes and national reform programmes and have been introduced to strengthen national ownership via plans established by Member States themselves and to set out a binding, country-specific medium-term fiscal path.

MTFSPs will be prepared by each Member State and span four or five years, depending on the regular length of the legislative term of the state concerned. In the case of Belgium, this will consequently be five years. The plans set out a fiscal path to be followed based on a reference trajectory [16] or technical information provided by the EC, as well as priority public investments and structural reforms to be made, over a four-to-seven-year adjustment period. [17] Together, these measures are aimed at ensuring sustained and gradual debt reduction and sustainable and inclusive growth. Divergence between the fiscal path and the reference trajectory will be allowed, provided the Member State concerned is deemed to have put forth sound and data-driven economic arguments for this. MTFSPs will be integrated into national budgets for the entire adjustment period. Unlike the stability or convergence programmes, they will remain unchanged throughout their time horizons and only be modified in exceptional circumstances – including a change of government.

The Member States had to submit their first MTFSP by 20 September 2024 [18] (unless the Member State and the Commission had agreed on a reasonable extension), prior to which several steps took place. The first of these was a technical exchange between the EC and each Member State based on the most recent statistical information available and the country's economic and fiscal outlook. Secondly, Member States with general government debt exceeding 60 % of GDP or a budget deficit exceeding 3 % of GDP received a reference fiscal trajectory for the adjustment period from the EC, by 21 June. Finally, a technical dialogue between the country and the EC took place to ensure that the MTFSP complies with the applicable requirements of the preventive arm.

Within six weeks of submission, each national medium-term fiscal-structural plan will be assessed by the Commission. Upon a recommendation from the Commission – and within six weeks from the issuance of this

15 ECB (2024).

16 For Member States with government debt exceeding 60 % of GDP or government deficit exceeding 3 % of GDP. Member States with government debt not exceeding 60 % of GDP and government deficit not exceeding 3 % of GDP will receive, upon request, guidance in the form of technical information. For more information see section 1.3.3.

17 This extension may be granted if Member States carry out certain reforms and investments that improve the growth potential and foster fiscal sustainability (see section 2.1 for more details).

18 The dates refer to the transitional provisions applicable to the first plan to be submitted in 2024. The most important dates under the normal provisions are prior guidance by the EC by 15 January and submission of the plan by the Member State by 30 April of the last year of the plan in force.

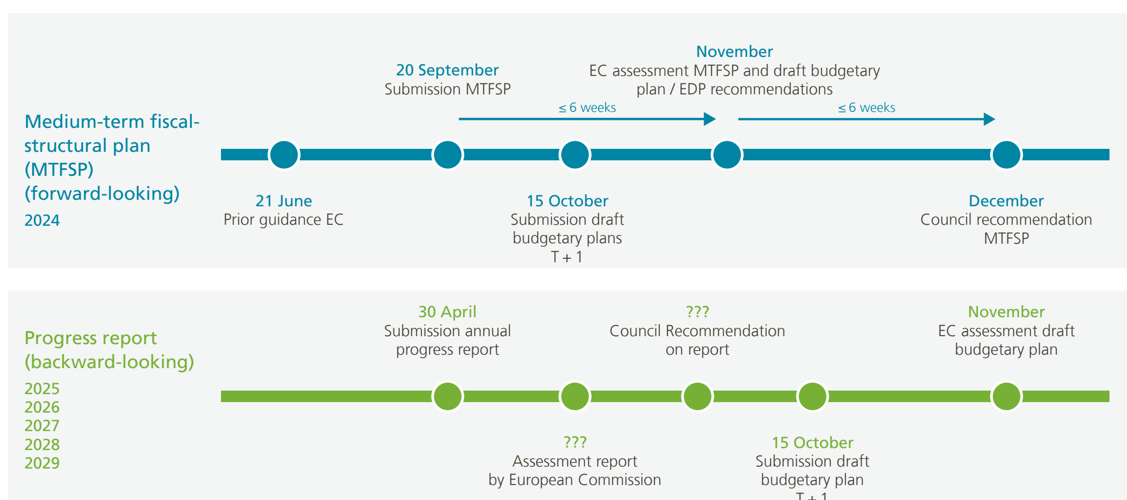
recommendation – the Ecofin Council will formally adopt the fiscal path of the Member State concerned and, where applicable, endorse the set of reform and investment commitments underpinning any extension of the adjustment period.

The submission of annual draft budgetary plans remains an important part of the European fiscal calendar. Under the new European fiscal framework, the deadline for submission is unchanged at 15 October. When assessing these plans, the EC will evaluate whether they are consistent with the fiscal paths of the MTFSP approved by the Ecofin Council.

The second important element in the new European fiscal calendar is the annual progress report that each Member State will have to submit on the implementation of its medium-term fiscal-structural plan. This will need to be produced by 30 April of each year of the plan's time horizon and contain information on the progress in implementing the fiscal path, the broader reforms and investments in the context of the European Semester and, where applicable, the set of reforms and investments underpinning an extension of the adjustment period. The EC will subsequently make public its assessment of the report, based on which the Ecofin Council will issue a recommendation.

Figure 2

Medium-term fiscal-structural plans and progress reports at the centre of the new EU fiscal framework



Source: EC.

1.3.3 The main elements of the new European fiscal rules

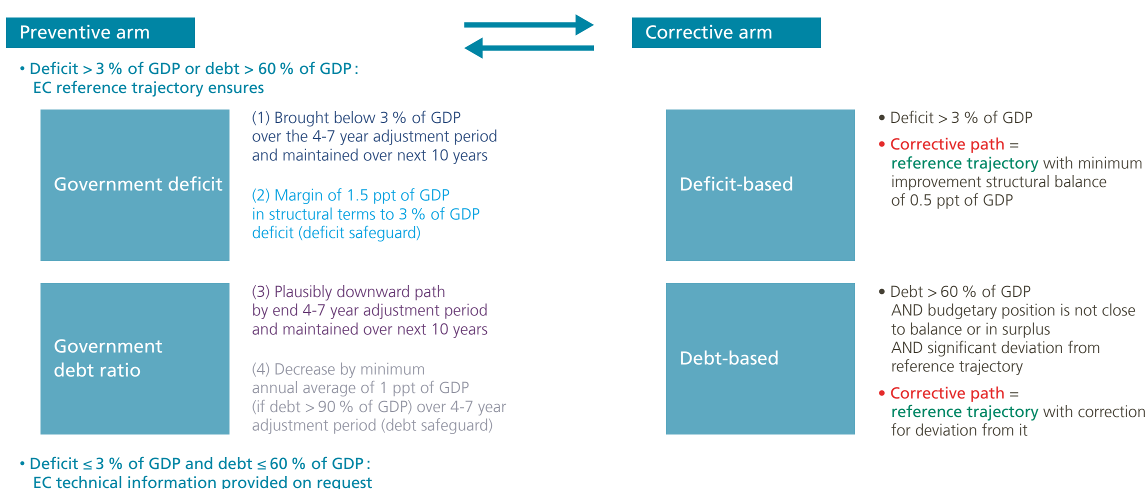
Since the introduction of the Stability and Growth Pact in 1997, the European fiscal rules comprise a preventive arm that is meant to avert the development of unsustainable budget positions, and a corrective arm that concerns the recovery measures for Member States facing an excessive public deficit or an excessive public debt. They remain the core components in the reformed fiscal rules. The main changes concern the preventive arm. The new framework guarantees consistency between both arms of the SGP.

The preventive arm

The reformed preventive arm is based on a tailored budgetary target for each Member State, taking account of their different fiscal positions, public debt levels and dynamics, and economic challenges. The new system is anchored in debt sustainability, meaning debt should be put on a sustainable downward path, and aims to promote sustainable and inclusive growth.

Figure 3

The main elements of the new European fiscal rules



Sources : EC, NBB.

The starting point for setting this target is a fiscal reference trajectory that the EC sends to those Member States with general government debt exceeding 60 % of GDP or a government deficit exceeding 3 % of GDP. The trajectory is based on four different rules in order to make debt sustainable in the medium-term.[19] The first two rules concern the government deficit and the third and fourth relate to the debt ratio.

Firstly, the trajectory ensures that the general government deficit is reduced to below 3 % of GDP over the adjustment period and remains below that threshold for the next ten years, assuming no further budgetary measures are taken. This means that by the end of the adjustment period, a buffer compared with the 3 % threshold is needed, equal to the worsening of the budget balance should fiscal policy remain unchanged during the ten years thereafter. In practice, this worsening of the budget balance is assumed to originate from two main factors : rising ageing-related costs and increasing interest payments. As a result, this rule requires that the expected increase in expenditure be pre-financed by the end of the adjustment period. Secondly, a deficit resilience safeguard provides a structural safety margin of 1.5 % of GDP below the deficit reference value of 3 % of GDP. This means that fiscal consolidation must continue after the deficit is reduced below the 3 % benchmark until a structural deficit of 1.5 % of GDP is reached. The annual improvement in the structural primary balance necessary to achieve the required margin will be 0.4 percentage points of GDP, which will be reduced to 0.25 percentage points of GDP in the case of an extension of the adjustment period.

19 Member States with government debt not exceeding 60 % of GDP and a government deficit not exceeding 3 % of GDP can request guidance in the form of technical information from the European Commission.

Thirdly, the reference trajectory ensures that, by the end of the adjustment period, the projected general government debt ratio is put or remains on a plausibly downward path (or stays at prudent levels below 60 % of GDP) over the medium term, also assuming no further budgetary measures are implemented. This trajectory is based on a debt sustainability analysis and is explained in detail in section 2.1.4. Fourthly, a sustainability safeguard also applies with respect to the debt level. It ensures that the debt-to-GDP ratio will be reduced by a minimum annual average amount of 1 percentage point of GDP if it is above 90 %. If the debt ratio is between 60 and 90 % of GDP, it must be reduced by 0.5 percentage points of GDP.[20] The average decrease shall be calculated from the year before the start of the reference trajectory or the year in which the excessive deficit procedure is projected to be abrogated, whichever occurs later, until the end of the adjustment period.

Based on their reference trajectory, Member States will incorporate their fiscal adjustment path into their national medium-term fiscal-structural plan. The fiscal path may differ from the proposed reference trajectory but only subject to a thorough explanation on the basis of sound and data-driven economic arguments. The EC will evaluate whether this requirement is fulfilled when assessing the national medium-term fiscal-structural plans.

The corrective arm

Member States must avoid excessive government deficits and debts, in line with the Treaty on the Functioning of the EU. In practice, this means that Member States should not exceed the reference values of 3 % of GDP for their deficit ratios and 60 % of GDP for the debt ratios. The excessive deficit procedure (EDP) tries to deter excess public deficits or debt and to prompt their correction should they occur.

As was already the case under the previous framework, the EC will consider initiating a deficit-based EDP if the government deficit ratio exceeds the reference value of 3 % of GDP. The corrective path should ensure that the deficit falls or is maintained below 3 % within a deadline established by the Ecofin Council. This path should, in principle, be the one originally set by the Council, taking into account the need to ensure a minimum annual improvement of the structural balance of at least 0.5 percentage points of GDP. As a transitional arrangement, it was agreed that over the period 2025-2027, this minimum requirement applies to the structural *primary* balance, to accommodate temporarily for increases in interest payments.

Under the new fiscal framework, the debt-based EDP, for countries with a debt ratio above 60 % of GDP, focuses on deviations from the fiscal path approved by the Ecofin Council. The Commission must set up a control account to keep track of each Member State's cumulative upward and downward deviations from their fiscal path. It will consider initiating a debt-based EDP if the deviations recorded in this control account exceed either 0.3 % of GDP annually or 0.6 % of GDP cumulatively, the government debt-to-GDP ratio exceeds the reference value, and the budgetary position is not close to balance or in surplus. The control account balance is reset to 0 after the approval of a new plan. The corrective path under the debt-based procedure shall be at least as demanding as the fiscal path set by the Ecofin Council under the preventive arm and correct the cumulative deviations from this path, as recorded in the control account.

For both types of EDP, the EC will prepare a report under Article 126(3) of the TFEU. When preparing this report, the Commission shall take into account all the relevant factors as indicated in that Article, in so far as they significantly affect the assessment of the Member State's compliance with the deficit and debt criteria. These factors encompass changes in the medium-term economic position including potential growth, inflation developments, and cyclical developments, as compared to the assumptions underlying the expenditure path as set by the Ecofin Council.[21]

20 Other requirements apply: the fiscal adjustment effort over the period of the national medium-term fiscal-structural plan is linear as a rule and at least proportional to the total effort over the entire adjustment period; and there is consistency with the corrective path referred to in Article 3(4) of Regulation (EC) No 1467/97, where applicable.

21 European Parliament (2024).

Based on an opinion of the Economic and Financial Committee on this report, the Commission, if it considers that an excessive deficit exists, shall address an opinion and a proposal to the Ecofin Council, and shall inform the European Parliament. At the end of July 2024, the Ecofin Council concluded that an excessive deficit exists for Belgium (and six other EU countries). The EDP recommendations are expected to be issued by the Ecofin Council during the month of November and will be published together with the Commission's assessments on Member States' draft budgetary plans. This approach ensures consistency between the budgetary requirements under the excessive deficit procedure and the adjustment path set out in the national medium-term fiscal-structural plans. The 2024 timeline is exceptional as it is linked to the transition to the new framework. Member States will have a deadline of up to six months by which to take effective action but this may be reduced to three months under specific circumstances. The recommendations will also include a corrective net expenditure path that brings the general government deficit below the reference value within the specified deadline.

After the start of an excessive deficit procedure, the public finances of the Member State concerned are under increased supervision by the European institutions, and they are subject to additional requirements. Countries have to report on actions taken in response to the Council recommendations within a set deadline. The Commission and Ecofin Council will monitor compliance with the recommendations, and if necessary, the Council may issue revised recommendations. If the excessive deficit continues to persist, the Council may impose sanctions, including fines. It may impose a fine amounting to up to 0.05 % of the latest estimate of the previous year's GDP, for a six-month period, and this fine shall be paid every six months until the Council assesses that the Member State concerned has taken effective action. In each six-month period the Council shall assess whether the participating Member State concerned has taken effective action. In this semi-annual assessment, the Council may decide to intensify the sanctions, unless the participating Member State has complied with the Council's notice.

The Council abrogates the excessive deficit decision, and possible sanctions, when the deficit is brought below the reference value and projected to remain so, or when the Member State has respected the corrective net expenditure path.

Escape clause

Under the new framework, a national escape clause may be activated by the Ecofin Council if this is requested by a Member State and recommended by the Commission. This would suspend the rules only for the Member State concerned, in the event that exceptional circumstances outside the control of that Member State are having a major impact on its public finances. The clause will be activated only if doing so does not put fiscal sustainability at risk in the medium term, and the Ecofin Council will specify a time limit for its activation. The general escape clause is maintained to address severe crisis situations affecting the euro area or the EU as a whole. The main difference with respect to the provisions previously in place concerns the explicit *ex ante* authorisation of the Council that is required to activate the clause and to extend it beyond its otherwise strict time limit.

The expenditure growth benchmark

The new fiscal framework is built around a single operational indicator which will serve as a basis for carrying out annual fiscal surveillance for each Member State: the expenditure growth benchmark. This benchmark is derived from and consistent with the budgetary rules explained above. To obtain it, the fiscal adjustment path, as expressed in terms of the change in the structural primary balance, is translated into primary expenditure growth, assuming revenue grows in proportion to potential GDP (see section 2.1.8 for more information).

The expenditure benchmark applies to net primary expenditure, which is government expenditure corrected for several factors. Firstly, interest expenditure is deducted to be consistent with the concept of the primary balance. Secondly, national expenditure on EU programmes fully matched by EU revenue is deducted in order not to counterbalance expenditure of European funds. Thirdly, co-financing of EU-funded programmes is subtracted.

This additional correction was decided by the European Parliament and aims to protect government investment. Fourthly, cyclical unemployment expenditure and one-off and other temporary revenue and expenditure are excluded, in order to determine a structural measure of expenditure. The existing methodology to calculate these measures is retained. Finally, discretionary revenue measures are excluded to allow governments also to take measures on the revenue side. The formula for the calculation of aggregate net expenditure is very similar to that for the expenditure benchmark under the previous framework, with the exception that national co-financing of EU-funded programmes is excluded, and the fact that public investment expenditure will no longer be averaged out over a four-year period.

The idea behind using net primary expenditure growth as an indicator is to have a measure of spending that is under the direct control of the government. The definition of net primary expenditure is not affected by the operation of automatic stabilisers and compliance with the rule therefore allows for counter-cyclical macroeconomic stabilisation.

The growth rate for net expenditure is frozen over the adjustment period and will be the only indicator used in the new fiscal framework. It is the central indicator in the medium-term fiscal-structural plans submitted by the Member States, and in the monitoring of these plans, through the control account.

The net expenditure path is expressed in nominal terms, based on inflation expectations during the adjustment period. If inflation turns out higher than estimated *ex ante*, and therefore leads to higher expenditure growth, the Commission will take this into consideration. More precisely, in case of a breach of the control account thresholds, the EC will consider this as a relevant factor in its assessment of compliance with the relevant path. However, if inflation is lower than expected, respecting the path may not lead to the targeted structural balance at the end of the adjustment period. In that case, the Commission will, in principle, avoid tightening the normalised path. This results from the asymmetric application of the deviations from the assumptions: favourable cyclical economic, budgetary and financial developments shall not be considered as mitigating factors, while unfavourable developments may be considered as mitigating factors.

If revenue grows more slowly than expected nominal potential GDP, this will not increase the required fiscal effort to meet the expenditure benchmark, except to the extent this is caused by discretionary revenue measures.

The choice of a frozen net expenditure path also implies that potential economic feedback effects from fiscal consolidation measures don’t have any impact on compliance with the fiscal rules. Firstly, the definition of net primary expenditure is meant to exclude cyclical elements. Secondly, the path itself is frozen, meaning that any *ex post* revision of (potential) GDP does not affect it.

2. Implications for fiscal policy in Belgium

In this section we apply the fiscal rules, as outlined in the previous section, to Belgium. We use technical simulations to obtain the resulting normative trajectories.[22] Next, we compare these trajectories with past consolidation efforts undertaken by the Belgian government. Given that, Belgium’s government deficit is above 3 % of GDP and public debt above 60 % of GDP, the country is one of a large group of Member States that has received a reference trajectory from the European Commission. In addition, in July 2024, a deficit-based excessive deficit procedure was opened against Belgium, meaning that the corrective arm of the fiscal framework has also been activated.

22 Note that the fiscal benchmarks shown here serve purely as illustrations of the rules, they are not binding as Belgium has not yet agreed with the EC on a fiscal path.

2.1 Applying and illustrating the rules

The EC's new fiscal framework puts forward country-specific adjustment paths that are differentiated according to each country's fiscal situation and debt sustainability challenges. Central to these challenges is the expected future path of the budget balance and the debt ratio assuming no changes in fiscal policy, which the EC projects for each country using a common methodology. Therefore, before applying and illustrating the four rules for Belgium, we construct a scenario in which fiscal policy remains unchanged, using the EC's methodology. With this scenario in hand, we can apply the rules to Belgium.

2.1.1 A scenario based on unchanged fiscal policy

Projecting the future path of the public deficit and debt, assuming unchanged fiscal policy, relies on numerous forward-looking inputs (including potential GDP growth, inflation, the impact of ageing on public spending, etc). We broadly follow the methodology applied by the EC in the new fiscal framework, as described in detail in the EC's 2023 Debt Sustainability Monitor; a short overview of the main assumptions of this methodology can be found in the Annex. We apply the methodology using data from the Federal Planning Bureau's (FPB) June 2024 Economic Outlook up to 2026. From 2027 onwards, we use projections as described in the Annex.[23]

Concretely, the fiscal path based on unchanged policy is constructed as follows. We start from the budget deficit for 2024 as projected in the FPB's June outlook. From 2025, the structural primary balance (that is, the headline budget balance excluding interest charges and adjusted for the impact of the business cycle and one-off factors) is assumed to deteriorate with the increase in ageing-related costs, as projected in the EC's 2024 Ageing Report. The EC projects ageing-related costs (net of taxes on pensions) to rise by 1.2 percentage points of GDP over the period 2024-2038. Gross expenditure related to ageing would amount to 1.4 % of GDP over the same period. We would like to point out that the Study Committee on Ageing (SCA) in its July 2024 report projects a bigger increase of 2.5 percentage points of GDP.[24] Next, interest expenditure is calculated according to the EC methodology, using market expectations for short- and long-term interest rates on government debt. Finally, the cyclical component of the budget balance (which approximates the influence of the business cycle on the budget balance), is calculated based on the expected path of the output gap.[25]

Overall, under a no-fiscal-policy-change scenario, Belgium's budget balance deteriorates from –4.5 % of GDP to –7.2 % of GDP in 2038 due to rising ageing-related costs and interest payments. Consequently, the public debt ratio is set to increase from 105.7 % of GDP in 2024 to 130 % by 2038 (see Figure 4). It is important to note that the interest-growth differential[26] stays negative (which is favourable) over the entire period, meaning that the debt-decreasing effect stemming from positive nominal GDP growth is higher than the debt-increasing effect stemming from rising interest expenditure. A high and deteriorating primary deficit is thus the main culprit behind the upward debt trajectory.

23 The Regulation foresees that the assumptions in the medium-term fiscal-structural plans designed by the Member States may – under certain conditions – differ from those in the EC's reference trajectories. For instance, the EC could accept that Member States deviate from its 2024 Spring forecast (covering the period 2024-2025) to include more recent information on the fiscal starting position, economic growth, inflation, and market interest rates. The FPB June projections are indeed more recent than the EC Spring projections. An additional advantage of the FPB projections is that these also cover fiscal variables at the sub-national level (which the EC projections do not), and these are used in part three of this article.

24 In its July 2024 Report, the SCA dedicates an entire chapter to explaining the differences between its ageing-related costs projections and those from the EC. In a nutshell, the SCA projects higher budgetary costs due to both higher expenditure on healthcare and education

25 More specifically, the cyclical component is calculated as the product of the output gap and a country-specific semi-elasticity of the budget balance. The latter is 0.615 for Belgium (see Mourre and Poissonnier (2019)).

26 This is the difference between the implicit interest rate on public debt and nominal GDP growth, multiplied by the debt ratio at the end of the previous year.

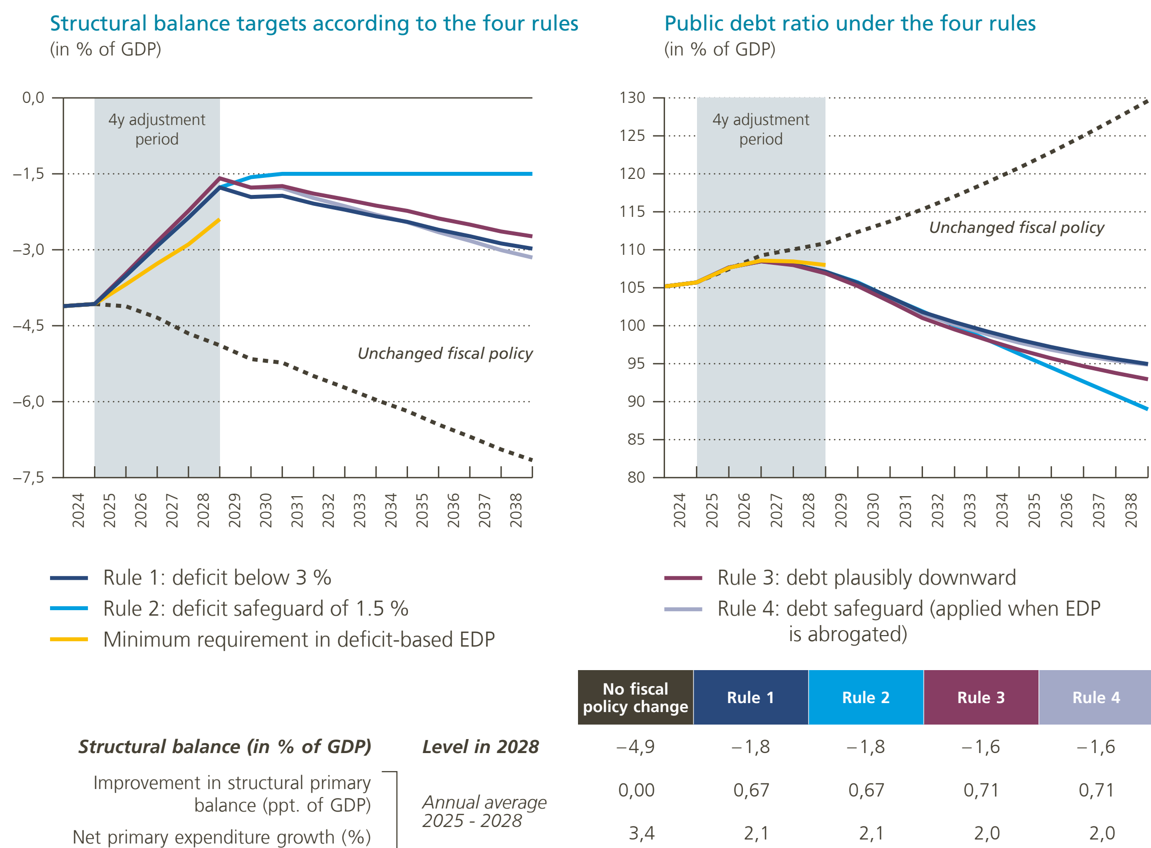
What do the new rules imply for Belgian fiscal targets ? The following sections address this, focusing foremost on an adjustment period of four years. In line with the new framework's methodology, the fiscal adjustment is first calculated in terms of the structural primary balance. Next, we explain how this translates into a normative expenditure growth path.

2.1.2 Deficit below 3 % (rule 1)

This rule requires that the headline deficit is brought below 3 % of GDP by the end of the four-year adjustment period (2028) and is maintained below 3 % of GDP during the ten years thereafter, assuming that no further budgetary measures are taken. For the deficit to remain below 3 % of GDP up to 2038, the structural deficit must reach 1.8 % of GDP in 2028, compared to 4.1 % of GDP in 2024 (see dark blue line in Figure 4). Indeed, ageing-related costs and interest expenditure continue to increase over the period 2029-2038 (by 0.9 and 0.3 percentage points of GDP, respectively). Hence, to comply with the 3 % deficit rule up to 2038, future ageing-related and interest burdens must be pre-financed during the four-year adjustment period. Reaching the structural balance target requires an improvement in the structural primary balance of an average 0.67 percentage points of GDP per year over the period 2025-2028. In this scenario, the debt ratio in the longer term falls to 95 % of GDP by 2038. During the adjustment period itself, however, debt reduction is limited and by the end of the adjustment period the debt ratio would still be higher than before the start of the consolidation : 107.1 % of GDP in 2028 versus 105.7 % in 2024.

Figure 4

Application of the new fiscal rules to Belgian public finances



		No fiscal policy change	Rule 1	Rule 2	Rule 3	Rule 4
Structural balance (in % of GDP)	***Level in 2028***	–4,9	–1,8	–1,8	–1,6	–1,6
Improvement in structural primary balance (ppt. of GDP)	*Annual average 2025 - 2028*	0,00	0,67	0,67	0,71	0,71
Net primary expenditure growth (%)		3,4	2,1	2,1	2,0	2,0

Sources : EC, FPB, NBB.

1 The headline budget balance equals the structural balance once the output gap closes, which occurs in 2028 under the no-fiscal-policy-change scenario.

For the calculation of the debt paths, the EC methodology incorporates a negative feedback effect from the fiscal consolidation on GDP growth via a uniform fiscal multiplier of 0.75 (based on Carnot and Castro, 2015). More precisely, an improvement in the structural primary balance of 1 percentage point of GDP, reduces GDP growth by 0.75 percentage points in the same year compared with a scenario in which fiscal policy remains unchanged. In turn, the negative economic effects of consolidation impact the fiscal variables in two ways. Firstly, a deterioration in the output gap results in a more negative cyclical component for the nominal budget balance; secondly, a lower level of real GDP implies a smaller denominator for the debt ratio. These feedback effects thus affect the fiscal paths.

2.1.3 Deficit safeguard of 1.5 % (rule 2)

Once the headline deficit reaches the reference value of 3 % of GDP, the new fiscal framework requires that fiscal adjustment be continued. More precisely, the structural primary balance must improve each year by 0.4 percentage points of GDP until the structural deficit reaches 1.5 % of GDP.[27] In line with this, we apply the deficit safeguard from the year after the headline deficit reaches 3 % of GDP under rule 1; in our calculations, this is as of 2029. In that year, the structural primary balance improves by 0.4 percentage points of GDP, consequently the structural deficit nears 1.5 % of GDP and is kept at 1.5 % thereafter (see the light blue line in Figure 4). So, over the adjustment period, the fiscal consolidation under rule 2 equals that under rule 1 but thereafter, rule 2 requires further fiscal efforts.[28] The debt ratio drops below 90 % of GDP by the end of the horizon considered.

This simulation clearly illustrates that the new fiscal framework expects improvements in the budget balance in Belgium to continue beyond the first four-year adjustment period.

2.1.4 Debt on a plausible downward path (rule 3)

The legislation states that for countries with public debt above 60 % of GDP the fiscal effort over the adjustment period (2025-2028) should ensure that by the end of the adjustment period, the debt ratio is "*on a plausibly downward path […] over the medium term*", without additional budgetary measures being taken. The latter means: taking into account future budgetary burdens stemming from ageing-related expenditure and interest payments. Applying the EC methodology, this translates to a necessary decrease in the structural deficit to 1.6 % of GDP by 2028 (see dark purple line in Figure 4). This corresponds to an improvement of 0.71 percentage points of GDP in the structural primary balance in each year of the four-year adjustment period. The debt ratio then continuously declines as of 2028 to reach 93 % of GDP by 2038.

It is important to note that the consolidation needed over the adjustment period to ensure debt is on a downward path takes into account adverse circumstances. Indeed, for the debt ratio to be considered *plausibly* declining, the new fiscal framework requires two conditions to be met: the debt ratio should fall (i) including under adverse scenarios; and (ii) with a sufficiently high probability. To assess this, the new framework makes use of parts of the EC's well-established Debt Sustainability Analysis (DSA) framework.[29] The EC developed its DSA framework for fiscal surveillance purposes: it enables the assessment of short-, medium- and long-term risks to the sustainability of public finances in EU Member States. The DSA framework encompasses numerous indicators, including a debt simulation tool, on which the new fiscal framework heavily relies.

27 Remember that, in the case of a seven-year adjustment period, the structural primary balance must improve by 0.25 percentage points of GDP per year.

28 Of course, after the first four-year adjustment period, a new adjustment plan will have to be submitted in which the adjustment required by the rules will be recalculated and will thus differ from what is shown here in the graph. Beyond the adjustment period, the fiscal paths can thus not simply be compared to one another, but they serve to illustrate the longer-term fiscal developments implied by the new fiscal framework when applied to a single adjustment period.

29 For more information see EC (2024b).

With respect to the first condition, the DSA defines the deterministic scenarios under which the debt ratio has to fall, after the adjustment period, being:

- A baseline scenario: which builds on plausible macro-economic and financial developments and unchanged fiscal policy as of 2024 (see the scenario in which fiscal policy remains unchanged described above and in the Annex);
- A financial shock scenario: compared to the baseline, interest rates rise by 100 basis points plus a risk premium for high-debt countries (amounting to close to 100 basis points in the case of Belgium[30]), for one year after the adjustment period;
- A fiscal shock scenario: compared to the baseline, the structural primary balance deteriorates by 50 basis points over the whole post-adjustment period;
- An interest-growth shock scenario: compared to the baseline, interest rates rise by 50 basis points and economic growth declines by 0.50 percentage points over the entire post-adjustment period.

So, according to the first condition, the debt ratio has to fall by the end of the adjustment period and the ten years thereafter under the baseline scenario as well as under the three scenarios that cover more pessimistic assumptions on the drivers of public debt dynamics.

In addition, with regard to the second condition, the DSA contains a stochastic simulation tool that allows us to ascertain that five years after the end of the adjustment period (2033), there is a 70 % probability that the debt ratio under the most binding scenario sits below its 2028 level. Whereas the four deterministic scenarios described above each yield a single debt path, the outcome of the stochastic analysis is a distribution of debt paths resulting from a broad range of shocks to the drivers of debt dynamics, namely: the budgetary position (more precisely, the primary balance), nominal economic growth and interest rates. The shocks are calibrated based on the historic volatility in the debt drivers and the correlation between them. The stochastic analysis thus takes into account wide-ranging uncertainty surrounding the debt dynamics, based on past experience.

Figure 5 illustrates all the debt conditions under rule 3. The grey line in the left-hand graph shows that under the baseline scenario assumptions, Belgium's structural deficit should evolve towards 2.4 % of GDP by 2028, putting the public debt ratio on a continuously declining path as of then. This corresponds to an annual improvement in the structural primary balance of 0.51 percentage points of GDP over the adjustment period. The other lines show how debt declines under the same macro-economic conditions as in the baseline scenario, but with a structural deficit that is low enough to ensure that debt would also be declining under the three adverse shock scenarios. The green line shows a debt path that declines at a slightly faster rate, given that a slightly lower structural deficit (2.3 % of GDP) is needed to ensure that debt is still declining in the case of a temporary financial shock. An even lower structural deficit (of 1.9 % of GDP) is necessary by 2028, to ensure a declining debt path in the case of a fiscal shock scenario entailing a permanent deterioration in the structural primary balance (orange line). The lowest structural deficit (1.6 % of GDP) is required to guarantee a declining debt path under the interest-growth-shock scenario (purple line). More demanding structural balances obviously translate into higher annual improvements in the structural primary balance being required, as indicated in the legend for Figure 5. The right-hand graph in Figure 5 shows that the interest-growth-shock scenario also fulfils the stochastic analysis condition. The structural deficit in 2028 that ensures that debt declines under the adverse purple scenario, also ensures that there is a greater than 70 % probability of debt falling, taking into account the historical volatility of macroeconomic and fiscal variables. As the interest-growth-shock scenario fulfils all the conditions of rule 3, it constitutes the binding fiscal path of rule 3 which was also illustrated in Figure 4.

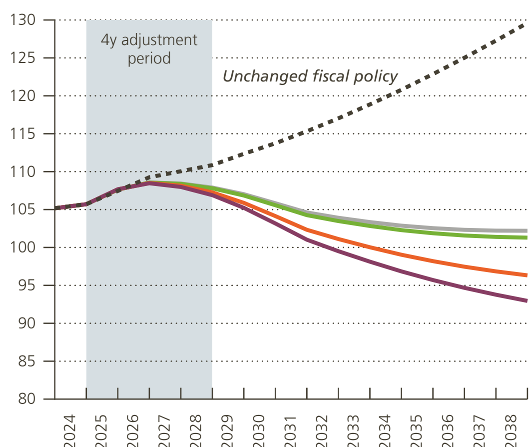
30 The risk premium is equal to 0.06 times the excess of debt over 90 % of GDP (based on Pamies *et al.* (2021)).

Figure 5

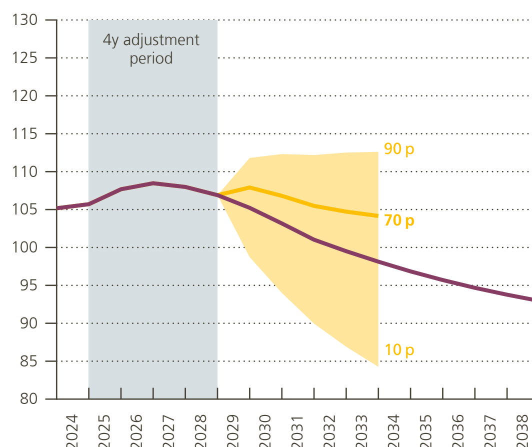
Rule 3 'debt on a plausible downward path' is defined by the debt sustainability analysis (DSA)

(debt, in % of GDP)

The debt ratio declines over ten years under four deterministic scenario's ...



... and stabilizes with 70% probability over five years according to a stochastic analysis



		Annual average improvement in structural primary balance over adjustment period (in ppt. of GDP)
Debt declines ...	0.51	
... when interest rates + 100 bp + additional risk premium in 2029	0.53	
... when structural primary balance deteriorates by 0.5 ppt of GDP over 2029 - 2038	0.64	
... when interest-growth differential + 100 bp over 2029 - 2038	0.71	

Sources: EC, FPB, NBB.

The EC's DSA methodology clearly plays a big role in the application of the new fiscal framework. As with any DSA methodology, the assumptions, methodological choices and shock scenarios are open to discussion. A working group will be set up to explore possible changes, but in the first application of the framework, the existing DSA methodology is used to construct the reference trajectory. We have a more fundamental remark, however, on the role of the deterministic debt projections in the new fiscal framework. Whereas these are indeed useful to analyse sustainability risks under different circumstances, it is a rather audacious undertaking to let a specific shock scenario determine the binding, multiannual fiscal adjustment path, as will appear to be the case for Belgium. Put differently, another definition of a shock scenario may alter Belgium's budgetary benchmark.

2.1.5 Debt safeguard (rule 4)

The debt safeguard requires the projected debt-to-GDP ratio to decrease by a minimum annual average amount of 1 percentage point of GDP if the debt ratio is above 90 % of GDP. The average decrease should be calculated from the year before the start of the adjustment period or – in the case that a country is subject to an EDP – the year in which the EDP is projected to be abrogated, up to the end of the adjustment period.

Since Belgium is subject to an EDP, this rule does not apply until the EDP is abrogated. According to our calculations, when applying the strictest of the first three rules (in this case, rule 3), Belgium's deficit would fall below 3 % of GDP in 2028, and consequently the EDP would be abrogated in 2029. Therefore, for illustrative purposes, we apply rule 4 only from 2029 onwards, meaning that we impose that the debt ratio falls on average by 1 percentage point a year over the period 2029-2038 (see light purple line in Figure 4).

2.1.6 Minimum requirement in case of a deficit-based EDP

The new European framework indicates that under the excessive deficit procedure, the corrective path would, in principle, be consistent with the reference trajectory set in the preventive arm but should also be consistent with a minimum structural adjustment of 0.5 percentage points of GDP in case of a breach of the deficit criterion. This minimum structural adjustment is requested in terms of the structural primary balance over the period 2025-2027, and in terms of the structural balance thereafter. As a result, we apply this minimum structural adjustment to Belgium (which is subject to an EDP) as a fifth rule (see yellow line in Figure 4), on top of the four rules that make up the preventive arm.[31] The EDP rule is shown only until 2028, as in 2029 the EDP would be abrogated according to our calculations.

2.1.7 The binding rule

The reference trajectory has to satisfy all the rules, including the minimum structural adjustment requirement in the case of a deficit-based EDP (which is the case for Belgium). For each year of the adjustment period, the rule that requires the strongest improvement in the structural primary balance is the binding rule for that year. The reference trajectory can thus have a non-linear profile. In our simulations, rule 3, namely that debt is on a plausible downward path, requires the largest fiscal effort in each year of the four-year adjustment period and thus delivers the binding fiscal adjustment path.[32]

A couple of observations are worth mentioning here. Firstly, the deterministic debt simulations indeed play a decisive role in the application of the new framework to Belgium. Although it should be noted that the fiscal effort required by rule 3 over the adjustment period is very similar to that required by rule 1. Secondly, our calculation of the required adjustment (namely an annual average improvement of 0.71 percentage points of GDP over a four-year adjustment period) differs slightly from that put forth by the EC (namely 0.72 percentage points of GDP, see Table 3 in High Council of Finance (2024)) because of the FPB’s slightly more optimistic projection for the structural primary balance for 2024 compared to the EC Spring 2024 Forecast[33]. Finally, it is interesting to note that the reference trajectory is more demanding than the minimum requirement of the corrective arm in the case that a country is subject to a deficit-based EDP.

2.1.8 From a change in the structural primary balance to net expenditure growth

Up to this point, the required fiscal effort has been calculated in terms of both the structural balance to be achieved by 2028 and the corresponding change in the structural primary balance. However, the single operational indicator in the new fiscal framework is net primary expenditure growth.

To obtain the net primary expenditure growth benchmark, the fiscal adjustment path in terms of the change in the structural primary balance is translated in terms of net primary expenditure growth, using the following formula:

$$\textbf{Nominal net primary expenditure growth norm} = \text{Yearly potential GDP growth} + \text{Inflation (as measured by the GDP deflator)} - \frac{\text{Required change in the structural primary balance}}{\text{Net primary expenditure to GDP ratio}}$$

Note that the formula assumes that public revenue grows structurally at the same pace as nominal potential GDP (which is a plausible assumption). Indeed, to translate a budget balance benchmark into an expenditure benchmark, it is necessary to make an assumption about how revenue will develop.[34] Applying the formula

31 The interplay between the new preventive rules and the EDP is still, however, under discussion (see also Pench (2024)).

32 By design, rules 1 and 3 deliver a linear adjustment path, meaning that the required improvement in the structural primary balance is the same in each year of the adjustment period.

33 Also note that our binding structural primary balance benchmarks and corresponding expenditure growth benchmark are consistent with those of the HCF (see table 5 and 6 in their 2024 advice). Our structural balance benchmarks differ slightly, however, due to small differences in interest expenditure stemming inter alia from a higher debt ratio projection in 2024.

34 For more information and the derivation of the formula see section 5.6 in HCF (2024).

using averages over the period 2025-2028, the combination of real potential GDP growth of 1.3 % with GDP deflator growth of 2.1 %, a required fiscal improvement of 0.71 percentage points of GDP and a primary expenditure ratio of 53 % of GDP, results in a net primary expenditure growth benchmark of 2.0 %.

It is important to stress that the four deficit and debt rules described above are defined *ex ante*, at the time of the calibration of the adjustment path, but *ex post* assessment of compliance with the framework will only be considered in terms of the expenditure path whereby net primary expenditure growth may not exceed the benchmark (2.0 % for Belgium).

Another point worth mentioning here concerns the impact of the GDP-deflator assumption on the expenditure benchmark. The higher the assumed inflation rate, the higher the expenditure benchmark as the latter is determined by nominal potential GDP growth. According to the framework's methodology, GDP-deflator growth converges over a ten-year horizon to euro area inflation as expected by financial markets (see the Annex). At the time of conducting our analysis, financial markets expected inflation to be above 2 % in the medium term (namely reaching 2.6 % ten years from now).[35] In case inflation turns out lower than assumed, compliance with the expenditure benchmark will result in a smaller improvement in the structural primary balance than the intended 0.71 percentage points of GDP. The assumption that inflation converges to the 2 % inflation target over the ten-year horizon, results in a more restrictive expenditure benchmark. Moreover, it implies the need for an improvement in the structural primary balance greater than 0.71 % of GDP in order to comply with the preventive rules. After all, lower GDP deflator growth implies a lower denominator of the debt ratio, thus requiring more consolidation.

In the same respect, it should be noted that if revenue turns out to grow structurally at a slower pace than expected nominal potential GDP (contrary to the assumptions used to derive the expenditure benchmark), the expenditure benchmark will not be adjusted. In that case, meeting the expenditure benchmark will not be sufficient to meet the structural balance benchmark. From a procedural perspective, this is not problematic, because a Member State is only held accountable for meeting the expenditure benchmark. But from a sustainability perspective, a sharp deviation of revenue from *ex ante* expectations may be a cause of concern. Note that this only pertains to the development of revenue excluding discretionary revenue measures. The latter are accounted for in the evaluation of the expenditure benchmark via the correction in the 'net primary expenditure' definition.

Finally, it is interesting to note that *ex post* monitoring of compliance with the expenditure benchmark is not affected by possible negative economic feedback effects stemming from fiscal consolidation (as explained in section 1.3.3). However, the derived expenditure benchmark anticipates stylized negative feedback effects. Indeed, the change required in the structural primary balance *ex ante* does take into account negative effects on GDP (via the debt-based rules, as explained above) and thus the resulting *ex ante* expenditure benchmark is more restrictive than it would be were this feedback effect not factored in.

2.1.9 Extending the adjustment period from four to seven years

The previous calculations all considered an adjustment period of four years. However, the period can be extended to seven years. This is conditional on a country committing to a list of verifiable and time-bound reforms and investments. These reforms should, in general, be growth-enhancing and support fiscal sustainability. Taken together, they should address the country-specific recommendations under the European Semester, the common priorities of the Union (such as a fair, green and digital transition, social and economic resilience, and energy security), and be consistent with commitments included in the approved national recovery and resilience plans. Finally, in the case of an extension being granted, the overall level of government-financed

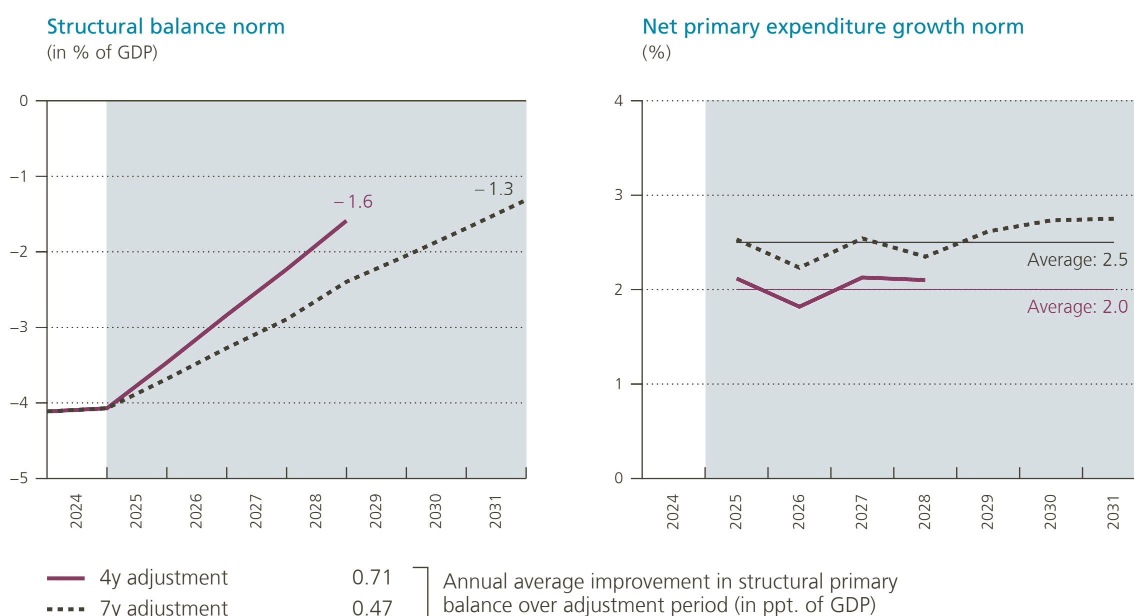
35 It is important to keep in mind that market-based inflation expectations include an inflation risk premium and are thus not necessarily aligned with genuine inflation expectations. These pure, longer-term inflation expectations appear to have remained well-anchored around the ECB's 2 % inflation target, despite the higher inflation environment that followed the COVID-19 pandemic (see for instance De Backer *et al.* (2023)).

public investment planned over the five-year period of the medium-term fiscal-structural plan may not be lower than the medium-term level prior to that period.[36]

According to our calculations, compliance with the four rules and the minimum structural adjustment in the case that a country is subject to a deficit-based EDP, over a seven-year adjustment period, requires the structural deficit to improve to 1.3 % of GDP by 2031 (see Figure 6). This corresponds to an average annual improvement of 0.47 percentage points of GDP in the structural primary balance during the seven-year adjustment period compared to 0.71 percentage points of GDP under a four-year period. The annual fiscal effort under the seven-year period is thus lower – which makes it appealing for national governments to pursue it – and its profile is non-linear. The latter reflects the fact that until 2028, the corrective-arm rule of a minimum structural improvement of 0.5 % of GDP is binding and thereafter, when the EDP is abrogated, rule 3 (requiring that debt is on a plausible downward path) becomes the binding rule. The required annual average improvement in the structural (primary) balance thereby drops from 0.50 percentage points of GDP over the period 2025-2028 to 0.42 percentage points of GDP over the period 2029-2031.

Figure 6

Extending the adjustment period from four to seven years



Sources: EC, FPB, NBB.

By offering countries the option to extend their adjustment periods to seven years – thereby lowering the average annual fiscal adjustment required – the new fiscal framework incentivises investment and structural reforms. However, if a country commits to stepping up investment, it must still adhere to the fiscal rules (from which investment is not excluded). An increase in public investment may thus require additional consolidation in the non-investment budget (see also Darvas *et al.* (2024)). This raises the question of how well-designed the framework is in terms of protecting and, preferably, promoting investment.

36 For Belgium, this implies that public investment should not fall below 2.8 % of GDP (see Study Committee on Public Investment (2024)).

2.2 A historical perspective

It is insightful to put the fiscal adjustment required by the new fiscal framework into a historical perspective. Figure 7 shows that an annual improvement in the structural primary balance of 0.71 percentage points for four years, or of 0.47 percentage points for seven years, is indeed considerable but not without precedent in Belgium. The consolidations of the 1980s and of the 1990s required a similar or stronger improvement in the structural primary balance. That said, many of the fiscal measures taken in the past cannot be repeated today[37] and circumstances differ.

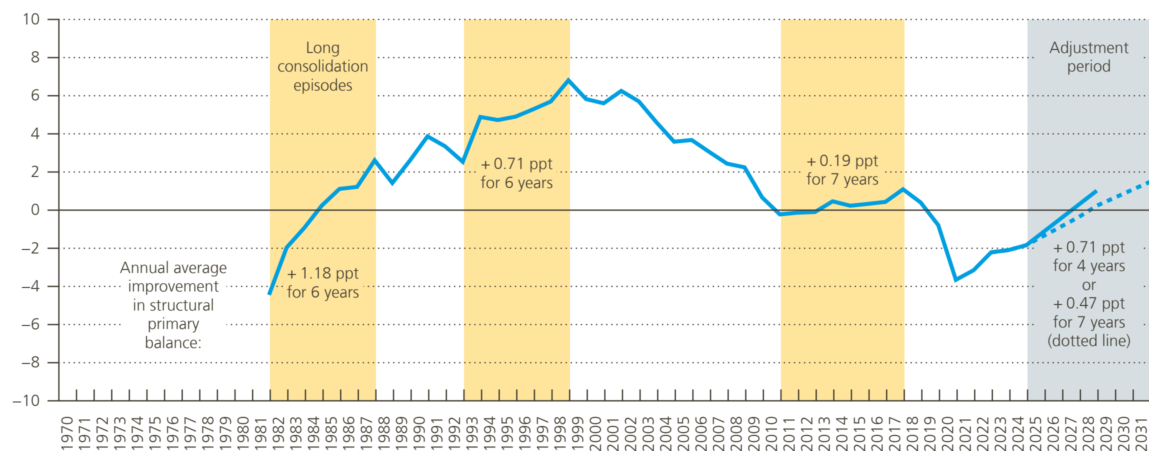
The consolidation of the 1980s chiefly comprised measures to bolster the competitiveness of the Belgian economy. It focused mainly on cutting primary expenditure: public investment was slashed (from very high levels), the public wage bill was cut by curbing employment at ministries, schools and in the armed forces, and social security benefits were reduced. The consolidation in the 1990s was inspired by the desire to qualify for euro area membership. It focused on raising revenue and cutting back interest expenditure. Indexation of personal income tax bands was suspended, crisis contributions were levied on personal income tax and corporate tax, the VAT rate was raised, and social security revenues were boosted. In the consolidation period following the global financial crisis, the improvement in the structural primary balance was limited given that gains made on the revenue side over the period 2011-2013 were countered by deteriorations on the expenditure side – and for the period 2015-2017, the reverse occurred. Consolidation efforts stalled temporarily in 2014, in the run-up to parliamentary, regional and European elections. It is interesting to note that over the period 2009-2014, Belgium was subject to an excessive deficit procedure. However, the corrective measures implemented did not suffice, unfortunately, to guide Belgian public finances on to a structurally healthy pathway.

37 For a more detailed description of the consolidation measures taken in the past by the Belgian government, see Bisciari *et al.* (2015).

Figure 7

The required structural improvement is considerable

(structural primary balance, in % of GDP)



	1982 - 1987	1993 - 1998	2011 - 2017	2025 - 2028/2031
Revenue	46.1	46.1 ↑	49.8 ↑	50.8
Primary expenditure (in % of GDP, one year before start of period)	53.2 ↓	43.2 ↓	50.3	53.1
Ageing costs (in ppt of GDP, change over period)			0.6	1.1 / 1.5

Sources: EC, FPB, SCA, NBB.

In terms of the scope for future adjustment, Belgium's high overall tax burden leaves less room to raise government revenue than under previous episodes of consolidation. The level of spending reaches that of the early 1980s and offers opportunities for savings. Addressing high and rapidly rising spending on population ageing is a key challenge. Over the upcoming four- or seven-year adjustment period, ageing-related costs are projected to increase by 1.1 and 1.5 percentage points of GDP respectively, starting from a level of 26.4 % of GDP in 2024 (according to the SCA's 2024 report). This is much higher than during the 2011-2017 consolidation period, when these costs rose by 0.6 percentage points of GDP, from a base of 24 % of GDP in 2010. The increased burden of ageing calls for structural reforms or higher savings in other areas. Implementing cuts to investment and defence expenditure seems less likely, however, than during the consolidation of the 1980s. The new fiscal framework aims to protect the former, while the latter may be stepped up given the more unstable geopolitical landscape today. Finally, potential GDP growth may also turn out to be less of a tailwind for consolidation compared to the past.

2.3 Implications for the national fiscal framework

European fiscal rules need to be supported by strong, efficient national fiscal frameworks which set out a range of requirements for budgeting at the national level.[38] These frameworks are seen partly as a way of creating the necessary environment for compliance with the European fiscal rules, and partly as a way of reinforcing national ownership of those rules.[39] The 2020-2024 reform of the European fiscal framework consequently has implications for the Belgian fiscal framework.

Belgium's fiscal framework will be impacted directly by the amendments to Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States. The most important amendments are as follows. The first concerns a change to budgetary statistics: Member States will need to publish quarterly debt and deficit data for the different levels of domestic government. Currently, only debt data by subsector are published on a quarterly basis. The amendments made to Directive 2011/85/EU also concern independent fiscal institutions (IFIs), with their role and functioning now clearly defined in a separate chapter but left broadly unchanged. The reform of the Directive explicitly introduces a new task to assess the consistency, coherence, and effectiveness of national fiscal frameworks. Member States should bring into force the necessary changes in order to comply with this Directive, by the end of 2025.

National fiscal frameworks will also be impacted indirectly by the changes to the European fiscal rules. Firstly, there is also an impact on budgetary statistics in this regard. Member States will have to publish additional information on government investment in defence, which is a relevant factor under the EDP. Additionally, data on national government co-financing of EU-programs will have to be provided. Secondly, there is an impact on the Belgian Cooperation Agreement of December 2013. This provides a formal framework for budgetary coordination in Belgium and is largely based on the Fiscal Compact. As already mentioned in section 1.3.1., some of the provisions of the Fiscal Compact are stricter than the reformed EU fiscal rules. The former no longer have to be applied by the Member States. This implies that the Cooperation Agreement could be adapted to bring it into line with the single operational indicator in the new budgetary framework. Finally, the changes to the European fiscal rules also have important implications for the High Council of Finance. For each MTFSP, the HCF will be asked to provide an opinion on how the fiscal effort has to be allocated across the different government entities, based on the single operational indicator in the reference trajectory provided by the Commission (as it did in July 2024: see HCF (2024)). The High Council of Finance will also have to reflect on whether and how it will monitor the implementation of this allocation.

38 A national fiscal framework is generally defined as the set of provisions, procedures, rules and institutions underlying the conduct of fiscal policy.
39 Bisciari *et al.* (2020).

3. Breakdown of fiscal targets between entities

It turns out that the EC expects Member States to follow a certain budgetary trajectory without, however, taking a position on how the fiscal effort implied by that trajectory should be shared across the various levels of public administration in each country. In view of the new European budgetary framework, however, it is important to allocate each level of government its own budgetary target in order to respect the obligations incumbent on the country as a whole.

Generally speaking, a country's public finances reflect the consolidation of the revenues and expenditure of its various levels of government (known as government sub-sectors). As a result, each sub-sector bears its share of responsibility for changes in the financing balance and the debt ratio. The same should apply to compliance with a common budgetary path.

In Belgium, the allocation of the budgetary target across government entities cannot be imposed by the federal level, given the autonomy assigned to the federated entities. It is the task of the High Council of Finance (HCF), via its "Public sector borrowing requirements" section, to advise the governments on the effort that they each need to make. The cooperation agreement of 13 December 2013 officially gave the HCF this function. Pending an update of this agreement, the HCF was invited by the federal government to produce advice on the distribution of efforts among the different levels of government based on the expenditure benchmark included in the reference trajectory proposed by the EC under the new budgetary framework.

This "Advice on the allocation of the reference trajectory transmitted by the European Commission to Belgium for the period 2025-2028/2031" was delivered and published in July 2024. The National Bank of Belgium made an active contribution to the work of the HCF in preparing the advice, and endorses the methodology used and the results obtained. This section will frequently refer the reader to the advice for more details, particularly on the methodology used. It will focus primarily on illustrating the proposed breakdown of a (fictive) debt path, and the resulting breakdown of the financing balance and of expenditure growth targets.

3.1 Debt

Allocating effort to adhere to Belgium's fiscal path across the different levels of government must be done in a way that safeguards the sustainability of the public debt of each individual entity. This is in line with the European Commission's philosophy for the country as a whole. It is therefore sensible initially to envisage an allocation key for a (hypothetical) debt benchmark, as the HCF did.

How should public debt be distributed between the various entities in order to ensure their respective sustainability and respect the actual institutional framework? [40] The HCF proposed an allocation key on the basis of several criteria, namely: (i) the availability of fiscal levers on the expenditure or revenue side to control the debt; (ii) the degree of an entity's fiscal autonomy; and (iii) the amount of debt inherited from the past combined with the limited accumulation of debt expected for the communities and regions. The proposed key allocates a debt benchmark according to an entity's share in the sum of total final primary expenditure and total own revenues of all public administrations. This means that entities with a greater share of primary expenditure and of own revenues are allowed to hold more debt. A comprehensive explanation of this key can be found in sections 2.3, 2.4 and 5.3 of HCF (2024).

40 This institutional framework consists of the division of powers on the expenditure and revenue side, the corresponding statutory transfers and the inheritance of debt and the accumulation of debt expected/desired by communities and regions (see also HCF (2024), section 2.2).

The Bank endorses this key. At the same time, it should be noted that other approaches were conceivable, such as an allocation solely reflecting the share of an entity's own revenue in total general government revenue.[41] Such a key is stricter for entities with less fiscal autonomy and would imply that entities without fiscal autonomy – considered over a longer period – may not spend more than the revenue they receive from other entities.[42]

As Figure 8 shows, the current breakdown of public debt (blue bars) deviates significantly from the key proposed by the HCF in its advice (orange bars).[43] At first glance, some entities appear to be over-indebted, while others appear to have a margin with respect to a debt target derived from the current level of debt for Belgium as a whole. Does this mean that some entities could afford to increase their debt? No, because Belgium's current public debt ratio as a whole remains too high. In fact, the HCF key applies to the very long-term debt ratio target, not the current ratio.

For this reason, the graph also illustrates, for the record, the proposed allocation of Belgian public debt were it to return to the EU reference value of 60 % of GDP (grey shaded bars). Compared to the current level, all entities would have to reduce their debt ratios, with the exception of the Flemish Community and the local authorities.

To make a more accurate comparison between entities, debt in Figure 8 is measured relative to disposable revenue[44] instead of GDP. For Belgium as a whole, a debt ratio of 105 % of GDP (the current level) corresponds to a ratio of 211 % of disposable revenue; with disposable revenue representing 50 % of GDP.

41 Note that the key is fixed based on expenditure and revenues in 2016 (see HCF (2024), section 2.4, for further explanation).
42 Such a key was used in Cornille *et al.* (2022).
43 More specifically, key 3 in table 7 of HCF (2024).
44 Disposable revenue is obtained by subtracting transfers paid to other general government sub-sectors from total revenue (see Cornille *et al.* (2022) for a detailed discussion)

Figure 8

Actual breakdown of public debt, compared to breakdown according to the proposed 'sustainability' allocation key

(% of disposable revenue[1])

Actual breakdown (total = 2023 level = 105 % of GDP)
Breakdown according to advised 'sustainability' key, in case of: 105 % of GDP debt target
Breakdown according to advised 'sustainability' key, in case of: 60 % of GDP debt target

Sources: HCF, NBB.
1 Disposable revenue is obtained by subtracting transfers paid to other general government sub-sectors from total revenue.

3.2 Budget balance

Having obtained an optimal key for the distribution of public debt, we ultimately need to break down the budget balance imposed by the European authorities at the end of the adjustment period (in this case, 2028 or 2031). This operation is facilitated by the mathematical relationship between the budget balance achieved repeatedly and the level of debt targeted in the very long term. The link between the debt-to-GDP ratio at infinity and the budget-balance-to-GDP ratio that follows from the debt dynamics equation is explained and illustrated in sections 2.5 and 2.6 of the HCF advice. It shows that the level of the budget balance is reflected in the level of public debt over the very long term.

As a result, the allocation key adopted for the debt ratio in the long run is used to allocate between the entities the structural balance target for general government in the short run, to be obtained at the end of the adjustment period. This gives a normalised structural balance per individual entity for 2028/2031.

In the case of local authorities, the HCF (2024) advises them to achieve a balanced budget, following the strict budgetary framework imposed by their respective competent supervisory regions. Consequently, the structural deficit theoretically "allocated" to the local authorities is added to that allocated to their respective supervisory authorities.[45] See HCF (2024), section 2.7, for a more detailed explanation.

The target structural (primary) balances obtained are shown in the table. They can be compared with the structural primary balances estimated by the FPB should fiscal policy remain unchanged. The budgetary gaps between the target and the projection by 2028 or 2031 are substantial. For example, if the adjustment were to take place over seven years, there would be a gap of €25 billion between the 2029 target (at the end of the legislative term) and the structural primary balance expected at the same time (under a scenario in which fiscal policy remains unchanged). It should be noted that this exercise is illustrative. The final effort to be made may differ from the budgetary gap shown here because of (i) assumptions used when converting from the structural primary balance to expenditure growth (notably on how revenue will develop, as explained above) and (ii) possibly different estimates under a scenario in which fiscal policy remains unchanged.

Obviously, these amounts must be measured against the budgets of the various entities, which vary in size. The same budgetary effort to be achieved in nominal terms is more difficult for an entity with comparatively low revenue and/or expenditure (and vice versa). To take this parameter into account, we have plotted the expected change in the financing balance, expressed as a percentage of disposable revenue, assuming no changes in policy in Figure 9. The following results emerge.

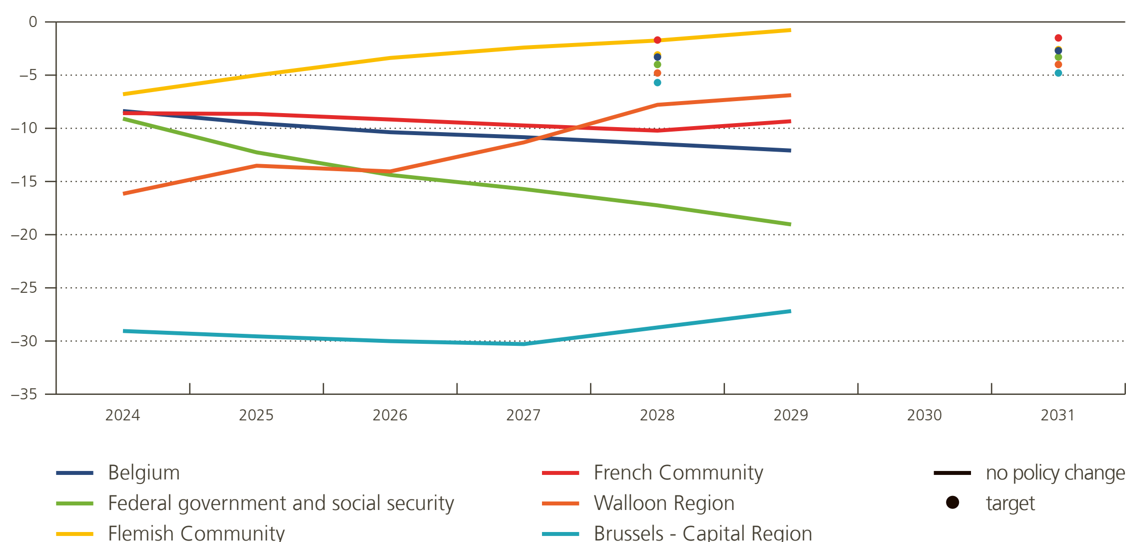
The Brussels-Capital Region faces a considerable fiscal challenge given that its deficit amounts to nearly 30 % of its disposable revenue. For the Walloon Region, the effort required would be limited due to the improvement in the balance expected under a scenario in which fiscal policy remains unchanged. For the Flemish Community, the required improvement in the structural balance would be fully covered by the expected reduction in the deficit over the next few years. Finally, the federal level faces an important budgetary challenge, also when expressed in terms of its disposable revenue, given the continuing deterioration in its deficit assuming no changes in policy.

45 This derived allocation key for efforts to meet the balance target would result in regions moving towards a higher debt share in the long run than shown in Figure 8 (in section 3.1) and local government then moving towards a debt ratio of zero in the long run.

Figure 9

Breakdown of the deficit target at the end of the adjustment period

(structural balance in % of disposable revenue[1])



Sources: EC, FPB, HCF, NBB.

1 Disposable revenue is obtained by subtracting transfers paid to other general government sub-sectors from total revenue.

Table 1

Structural (primary) balance targets vs. projections

(in € billion)

	Starting point	Target (4-year)	No policy change	Target (7-year)	No policy change	Target (7-year)
	2024	**2028**	**2028**	**2029**	**2029**	**2031**
Structural balance						
Belgium	−24.8	−11.1		–		−10.2
Federal government and social security	−14.9	−7.6		–		−6.9
Flemish Community	−3.8	−1.9		–		−1.8
French Community	−1.2	−0.3		–		−0.2
Walloon Region	−2.3	−0.8		–		−0.7
Brussels-Capital Region	−1.2	−0.3		–		−0.2
Structural primary balance						
Belgium	−11.2	7.1	−18.7	4.7	−20.7	11.4
Federal government and social security	−4.7	6.1	−17.5	5.0	−20.4	9.2
Flemish Community	−2.6	−0.4	0.5	−0.8	1.3	0.0
French Community	−0.9	0.1	−1.1	−0.1	−0.9	0.2
Walloon Region	−1.3	0.6	0.1	0.2	0.3	0.9
Brussels-Capital Region	−0.9	0.2	−0.8	0.0	−0.7	0.3

Sources: EC, FPB, HCF, NBB.

3.3 Expenditure growth

In a final stage, the structural balance targeted by the end of the adjustment period is converted into a required annual improvement in the structural primary balance, which in turn is converted into a net primary expenditure growth benchmark. This is modelled on the EC methodology which applies to the general government. For each entity, the required annual improvement in the structural primary balance must be translated into a nominal growth benchmark for net primary expenditure. It is the concept of final expenditure (i.e. expenditure excluding transfers paid to other entities) that is taken into account here, so that the sum for all entities coincides with total primary expenditure.

The transition formula used for Belgium as a whole also principally applies to the individual entities: assuming that revenues grow structurally at the same pace as nominal potential GDP, net final primary expenditure can grow at the same rate as nominal potential GDP, after deducting the required improvement in the structural primary balance. However, for the individual entities there are two additional corrections, justified by the fact that certain transfers *received* from other entities and transfers *paid* to other entities are programmed in advance and deviate from nominal potential GDP growth (notably, the transfers provided for under the Special Financing Law). On the one hand, the expenditure growth benchmark obtained is reduced/increased by a correction if these predefined *received* transfers structurally increase at a slower/faster pace than nominal potential GDP. On the other hand, the growth benchmark is increased/decreased by a correction if the predefined *paid* transfers structurally increase at a slower/faster pace than nominal potential GDP.

The detailed technical assumptions made by the HCF to determine the growth benchmark for each entity are set out in section 2.6 of its advice and are endorsed by the Bank.

The results of the application of the HCF methodology are illustrated in Figure 10. Each graph represents the final primary expenditure of a general government entity. It compares the change equivalent to that of potential GDP, the expected change assuming no changes in policy, and the normalised changes for the two adjustment periods (four years and seven years). It should be noted that the primary expenditure growth expected under a scenario in which policies remain unchanged (based on the FPB projections), is not corrected here for the items for which net primary expenditure is normally corrected (see section 1.3.3), except with respect to interest payments. As a result, only an indicative measure of the required consolidation effort can be derived from it.

From the outset, it should be noted that it is the federal level that will have to make a great effort in terms of expenditure. Whether the adjustment takes place over four or seven years, the growth in net primary expenditure will have to be well below that expected under a scenario in which policies remain unchanged. In fact, spending growth is expected to exceed the seven-year benchmark for the federal government and social security by 8 percentage points in 2029.

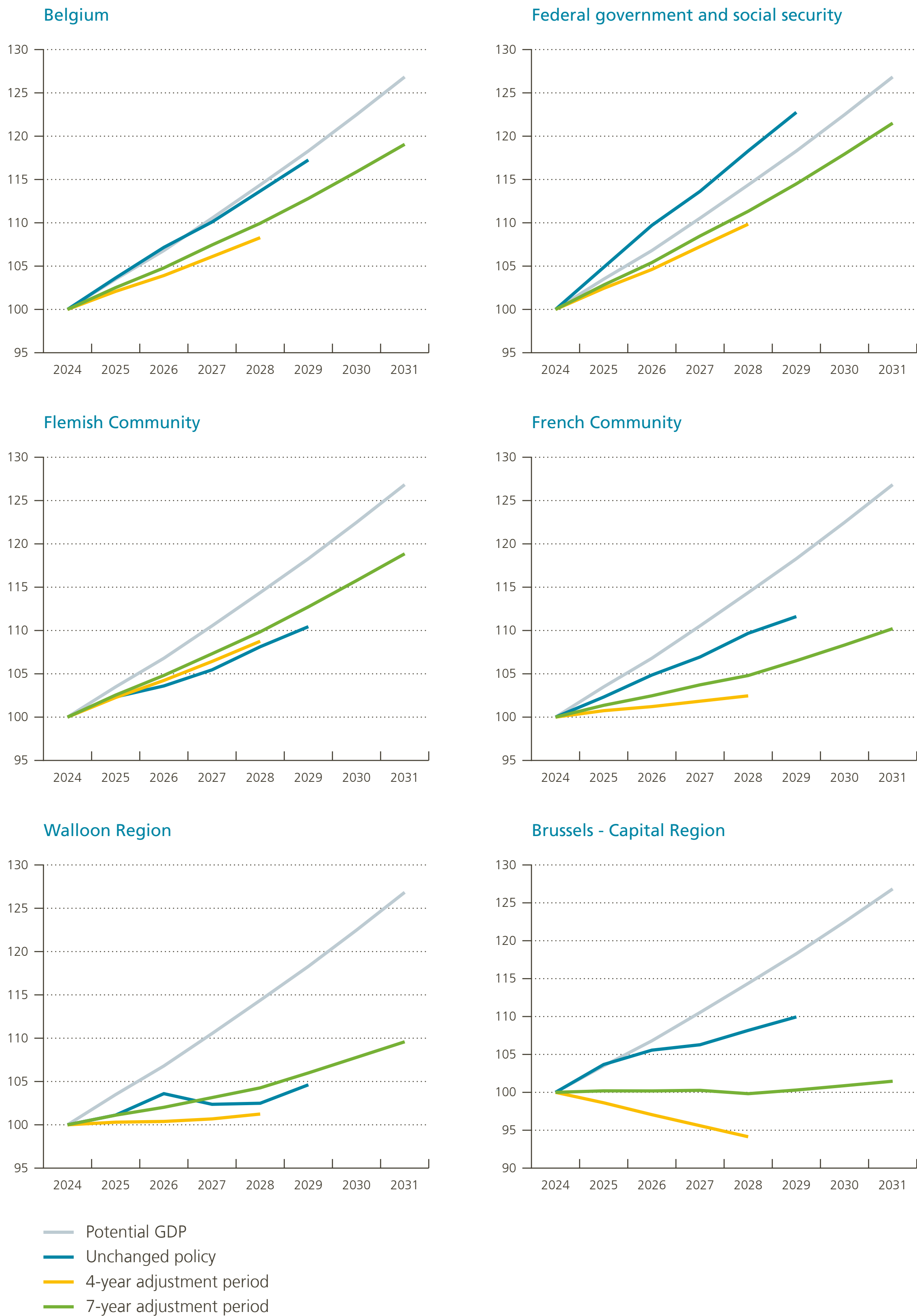
Taken in isolation, the federated entities face challenges of varying scale. Flanders could afford to let its net primary expenditure evolve slightly faster than the FPB's projections under a scenario in which fiscal policy remains unchanged, for both four years and seven years ahead. In Wallonia, this would only be the case if the adjustment were to take place between now and 2031. In the case of an adjustment limited to four years, expenditure should remain close to its current nominal level, one percentage point below the level expected by the FPB in 2028 after the expiry of major expenditure under the recovery plan.

The fiscal effort required would be much more pronounced for the French Community and the Brussels-Capital Region. In the strictest scenario (a four-year adjustment period), the Brussels-Capital Region would even have to reduce its final primary expenditure by 6 % in nominal terms. In the case of a seven-year adjustment, the region's expenditure should remain unchanged by 2029, i.e. 10 percentage points below its expected growth.

In order to comply with the sub-national rules, all entities should closely monitor their budgetary policy via monitoring committees, which should be able to quantify revenue and expenditure over the course of the year

Figure 10

Trajectory of net primary expenditure over the adjustment period



Sources: EC, FPB, HCF, NBB.

and draw up reliable multi-year estimates for future years. In doing so, budgetary figures should be presented in accordance with the definitions of the European System of Accounts (ESA) and include variables that allow the evolution of net primary expenditure to be estimated, so that the degree of compliance with the path imposed by the EU can be assessed in a uniform manner.

4. Conclusion

Below we first assess the European fiscal framework against the objectives put forward by the EC and then consider the main implications for Belgium's fiscal policy and framework.

4.1 Assessment of the new European fiscal framework

The main objective of the new European fiscal framework is to strengthen the sustainability of Member States' finances. As the rules are based (in part) on the EC's debt sustainability analysis, they are stricter for countries with higher sustainability risks. Use of debt sustainability analysis to determine the stringency of fiscal targets is a welcome development. Nevertheless, the resulting calculation of the permissible budget deficit is somewhat arbitrary. For instance, the fiscal target is determined by macroeconomic and budgetary estimates for the next 14 to 17 years, which rely heavily on assumptions. One of the rules provides that the expected increase in ageing-related costs and interest charges in the ten years following the four- or seven-year adjustment period must be pre-financed, which is an exacting requirement. A second rule stipulates that the debt ratio must fall even in the case of adverse scenarios, which are inevitably arbitrary. While such scenarios are undeniably helpful for assessing sustainability risks, it is questionable whether they should directly be used to determine the level of the fiscal target. That being said, these analyses allow for a certain margin with regard to the deficit target of 3 % of GDP and the debt reduction target, which is most definitely advisable in normal economic times.

The complexity of the new fiscal rules does not contribute to the stated objective of achieving a simpler and more transparent fiscal framework. On top of the two rules mentioned above, two further "safeguards" apply. These were put in place at the request of some Member States, including Germany, that wanted additional safeguards to ensure a sufficiently swift reduction in the debt ratio. One feature that does simplify the framework is that the European Commission will henceforth use a single operational indicator: progress towards the fiscal target will be measured solely by compliance with an expenditure growth benchmark. This is easier for policymakers to monitor than changes in the structural balance because it does not take into account the more volatile evolution of revenue caused by cyclical fluctuations. Nevertheless, it is not easy to explain how the structural balance target is converted into an expenditure target and the assumptions underlying this conversion. This is all the more true when the expenditure target has to be allocated across several entities within a country, as is the case in Belgium.

In the *ex post* assessment of the expenditure target, it remains to be seen how the EC will deal with differences between actual inflation and the level estimated *ex ante* (at the time the nominal expenditure target is frozen). If the EC includes only positive revisions to inflation, this could imply a partial hollowing out of the sustainability rules. Lastly, the review of the expenditure target will also consider discretionary revenue measures, which are difficult to identify and quantify. Possible revenue growth below expected nominal potential GDP growth, not caused by discretionary revenue measures, will be tolerated by the EC.

The new fiscal framework also aims to increase Member States' ownership and sense of responsibility. By making the rules more country-specific and better aligned with sustainability risks, it is expected that countries will be more willing to accept them. In addition, a country's commitments are now fixed in a medium-term fiscal-structural plan (MTFSP) spanning its entire legislative term. This is a major improvement on the annual

stability programmes under the previous framework, in which fiscal targets could be pushed forward year after year. From now on, if Belgium overshoots the expenditure target, it must make up for it in subsequent years. Deviations will no longer be tolerated (or, at least, not to the same extent).

Ownership should also be enhanced as countries will, in principle, be able to co-determine their fiscal path in the MTFSP, although the margin for deviation from the reference trajectory proposed by the EC is minimal. Member States can opt for a stricter four-year adjustment period or a slightly less strict seven-year period provided sufficient structural reforms are agreed and investment is increased. This, in turn, gives the EC leverage to encourage the realisation of its usually well-founded country-specific recommendations.

Finally, the aim is to ensure stricter implementation or enforcement of the rules. Strengthening the corrective arm increases the credibility of the framework. Henceforth, an excessive deficit procedure will be opened against high-debt countries that do not follow the fiscal trajectory agreed with the EC. However, there is still a major question mark over the extent to which the rules will be applied in practice. Only stricter application than in the past will ensure that countries build up buffers in good times to weather the bad times. Such countercyclical policies are essential to ensuring the sustainability of public finances and the ability to cope with the next crisis.

4.2 Implications for Belgium's fiscal policy and framework

The new European fiscal framework tightens Belgium's fiscal policy targets. This is vital given that the country's deficit is well above 3 % of GDP and will increase in the coming years. Consequently, the already high public debt ratio will also continue to rise. Under the new fiscal framework, Belgium should aim for a structural deficit of no more than 1.6 % of GDP by 2028, or 1.3 % of GDP by 2031 assuming adequate structural reforms and investments are agreed. Expressed in terms of the expenditure benchmark, nominal net primary expenditure is allowed to grow by no more than 2.0 % or 2.5 % per year on average, under the four-year and seven-year adjustment periods respectively.

The binding deficit target ensures that debt will fall even if the interest rate-growth differential (i.e. the difference between the implicit interest rate on outstanding debt and nominal GDP growth) were to deteriorate by 100 basis points compared with baseline expectations. If the deficit target is achieved, the deficit should remain below 3 % of GDP in the ten years thereafter, despite increasing ageing-related costs and interest expenses.

Substantial fiscal consolidation is needed to meet the deficit target. Indeed, assuming no change in policy, the Federal Planning Bureau estimates that the structural deficit will reach 5.5 % of GDP by 2028 and 5.8 % of GDP by 2029 (the final year of the projection period). Nominal expenditure is set to increase on average by 3.2 % per year. The EC will assess Belgium solely on compliance with the expenditure growth benchmark. Any potential (negative or positive) feedback effects stemming from fiscal consolidation measures or reforms will not affect the net primary expenditure growth rate or compliance with it.

The expenditure growth target should be allocated across the various levels of government in Belgium. In the absence of an established hierarchy, a negotiated agreement will be required. The Public Sector Borrowing Requirements Section of the High Council of Finance made a proposal for allocation of the expenditure target in an opinion issued in July. If we compare the proposed expenditure growth target per entity in the seven-year adjustment period with that projected by the FPB under a scenario in which fiscal policy remains unchanged, the Brussels-Capital Region will have to reduce expenditure growth by ten percentage points over the next five years, and the federal government by 8 percentage points. The French Community will also have to make a significant reduction of five percentage points. For the Walloon Region and the Flemish Community, the realisation, by the end of the legislative term, of savings already agreed upon would be sufficient (according to the FPB's estimates).

Finally, we fully endorse the High Council of Finance's view that "the new European fiscal framework offers an excellent opportunity to thoroughly revise the Belgian fiscal framework and make it more binding. Belgium needs an internal Stability and Growth Pact with a clear statutory framework, binding fiscal rules for all entities, multi-year budgets at all levels of government, close monitoring of fiscal policy, *ex post* assessment of policy coupled with the possibility to impose sanctions, and a strong, independent fiscal institution. Throughout this process, the sustainability of the finances of each individual entity should always be kept in mind" (see HCF (2024), section 4, for the full position statement).

Annex

The DSA methodology in the new fiscal framework

The new fiscal framework uses the EC's well-established debt sustainability analysis (DSA) methodology, with minor adjustments, to evaluate EU Member States' deficit and debt dynamics over the medium term. This assessment underpins the fiscal adjustment path set for each country under the new rules (the reference trajectory). The DSA methodology is described in detail in the EC's 2023 Debt Sustainability Monitor. Below we provide a brief overview, focusing on the first application of the new fiscal framework which sets the fiscal adjustment path over the period 2025-2028/31.

The debt ratio is first projected over the medium term under a scenario in which fiscal policy remains unchanged, based on the following assumptions:

- Fiscal policy. Assuming no new fiscal measures, as of 2025 the structural primary balance (in % of GDP) is kept constant at its 2024 level (as projected in the EC's 2024 Spring Forecast). Only changes in the costs related to population ageing are added on top. The cyclical component is calculated as the product of the output gap and country-specific budget balance semi-elasticities. For the period 2024-2025, projections of one-offs, other temporary measures and stock-flow adjustments are from the EC's 2024 Spring Forecast; thereafter they are set to zero.

- GDP growth. For the period 2024-2025, real GDP growth projections are from the EC's 2024 Spring Forecast, but the 2025 growth rate is adjusted for the feedback effect of fiscal adjustment on GDP growth via a standard fiscal multiplier of 0.75. Beyond that, actual GDP growth is derived from potential growth with the assumption that the output gap closes in 2028. Potential growth estimates up to 2033 are based on the commonly agreed EU methodology within the Output Gap Working Group of the Economic Policy Committee and thereafter they are from the 2024 Ageing Report.

- Inflation (as measured by the GDP deflator). For the period 2024-2025, GDP deflator growth projections are from the EC's 2024 Spring Forecast. Thereafter they converge in a linear fashion to market-based euro inflation expectations by 2033, and then further, by 2053, to the ECB's 2 % inflation target.

- Market interest rates. Short- and long-term interest rates on new and rolled-over debt converge in a linear fashion from country-specific current values to country-specific market-based forward nominal rates by 2033. Beyond that, nominal long-term rates converge to 4 % by 2053 and nominal short-term rates to 2 % by 2053, assuming a yield curve coefficient of 0.5.

The new fiscal framework requires the debt ratio to decline under four deterministic scenarios: (1) an adjustment scenario that makes use of the macro-economic and financial developments of the no-fiscal-policy-change scenario, (2) a financial shock scenario, (3) a fiscal shock scenario and (4) an interest-growth shock scenario. The four scenarios start with a four- or seven-year adjustment period followed by a ten-year no-fiscal-policy-change period. Compared to the scenario in which fiscal policy remains unchanged, the following assumptions are modified:

- Fiscal policy. The necessary fiscal adjustment over the adjustment period (2025-2028/31) is computed in terms of the structural primary balance. No assumption is made on whether the adjustment comes from changes in primary expenditure or discretionary revenue measures. Beyond the adjustment period, the assumption of no changes to fiscal policy applies again, with primary expenditure being modified only by changes in ageing-related costs.

- GDP growth. Real GDP growth is adjusted for fiscal adjustments via the fiscal multiplier. The output gap closes three years after the end of the adjustment period.

- Three shock scenarios. They capture more adverse assumptions for the drivers of debt compared to the no-fiscal policy-change scenario. The main text describes their set-up in detail; the shocks are applied at the end of the adjustment period.

The new fiscal framework also builds on a stochastic analysis to account for wide-ranging uncertainty. Stochastic debt simulations (starting at the end of the adjustment period and covering a period of five years) are applied around the adjustment scenario. They illustrate the numerous ways in which shocks to governments' budgetary positions, economic growth, interest rates and exchange rates can affect debt dynamics. These shocks are generated based on the past volatility in the variables mentioned and the correlation between them.

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Conventional signs

bp	basis point
ppt	percentage point
%	per cent
etc.	*et cetera*
et al.	et alia (and other)
i.e.	*id est* (that is)
e.g.	*exempli gratia* (for example)

List of abbreviations

Countries or regions

EU	European Union

Abbreviations

COVID-19	Coronavirus disease 2019
DSA	Debt sustainability analysis
EC	European Commission
ECB	European Central Bank
EDP	Excessive deficit procedure
ESA	European System of Accounts
FPB	Federal Planning Bureau
GDP	Gross domestic product
HCF	High Council of Finance
MTFSP	Medium-term fiscal-structural plan
NBB	National Bank of Belgium
SCA	Study Committee on Ageing
SGP	Stability and Growth Pact
TFEU	Treaty on the Functioning of the European Union
TSCG	Treaty on Stability, Coordination and Governance
VAT	Value added tax

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