

Fiscal Consolidation in Belgium: How Much and by What Means?

Yu Ching Wong

SIP/2023/064

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on November 20, 2023. This paper is also published separately as IMF Country Report No 2023/387.

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Prepared by Yu Ching Wong

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ABSTRACT: *Belgium is facing higher structural deficits and rising debt after the pandemic and energy crisis. Fiscal consolidation is needed to lower inflation, rebuild buffers, reduce debt, and preserve Belgium’s social contract. While designing an appropriate fiscal consolidation path involves trade-offs, an ideally front-loaded and significant adjustment to achieve a medium-term structural balance would reduce public debt towards the 60 percent debt threshold, significantly reducing vulnerabilities. Experiences in other countries and in the past in Belgium show that while ambitious, such an adjustment is achievable. Comparisons with peers show that rationalizing and increasing the efficiency of social benefits and the public wage bill would need to be at the core of the consolidation effort. All federal entities should share the burden of the adjustment, in a coordinated manner, with accountability at all levels of government, and within a credible and clear multi-year consolidation plan. Comprehensive spending reviews would help target budgetary saving. To mitigate the growth impact in the near term and boost potential growth, public investment should be preserved, and the adjustment should go together with structural reforms to increase labor force participation and productivity.*

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SELECTED ISSUES PAPERS

Fiscal Consolidation in Belgium: How Much and by What Means?

Belgium

Prepared by Yu Ching Wong



BELGIUM

SELECTED ISSUES

November 20, 2023

Approved By
European Department

Prepared By Yu Ching Wong (EUR)

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FISCAL CONSOLIDATION IN BELGIUM: HOW MUCH AND BY WHAT MEANS?¹

Belgium is facing higher structural deficits and rising debt after the pandemic and energy crisis. Fiscal consolidation is needed to lower inflation, rebuild buffers, reduce debt, and preserve Belgium's social contract. While designing an appropriate fiscal consolidation path involves trade-offs, an ideally front-loaded and significant adjustment to achieve a medium-term structural balance would reduce public debt towards the 60 percent debt threshold, significantly reducing vulnerabilities. Experiences in other countries and in the past in Belgium show that while ambitious, such an adjustment is achievable. Comparisons with peers show that rationalizing and increasing the efficiency of social benefits and the public wage bill would need to be at the core of the consolidation effort. All federal entities should share the burden of the adjustment, in a coordinated manner, with accountability at all levels of government, and within a credible and clear multi-year consolidation plan. Comprehensive spending reviews would help target budgetary saving. To mitigate the growth impact in the near term and boost potential growth, public investment should be preserved, and the adjustment should go together with structural reforms to increase labor force participation and productivity.

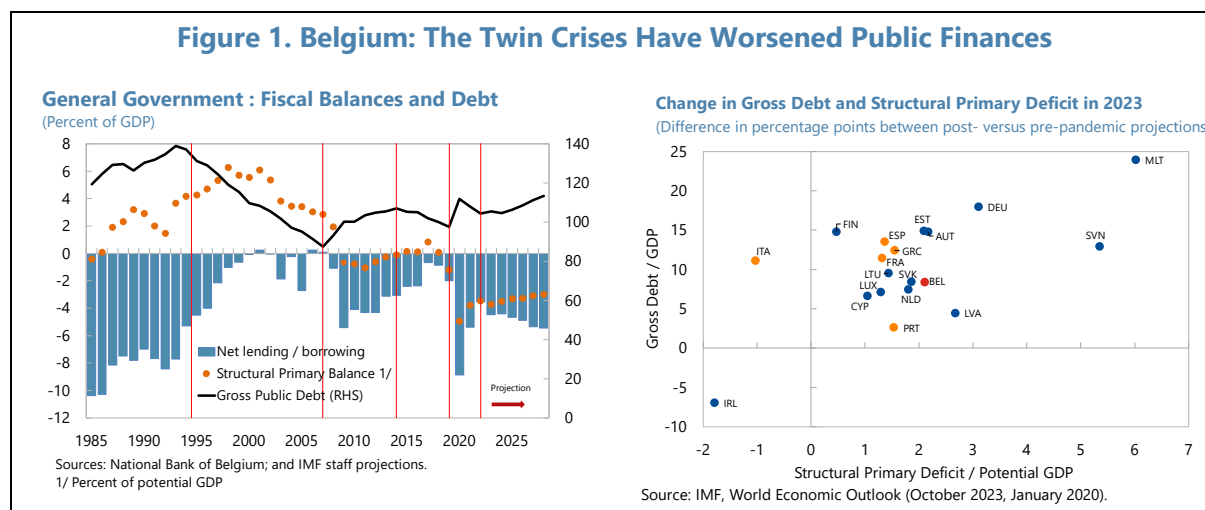
A. Introduction

1. Belgium is left with higher structural deficits and rising debt after the pandemic and energy crisis. When the pandemic hit the economy in early 2020, the debt-to-GDP ratio was on a downward path but still elevated at just below 100 percent in 2019. Timely and forceful fiscal measures mitigated the impact of the pandemic but widened the fiscal deficit and increased public debt significantly in 2020-21. Against limited fiscal buffers, the energy crisis triggered by Russia's war in Ukraine in February 2022 led to a further structural deterioration of public finances. A comparison of current projections for gross debt and structural primary deficits in 2023 with pre-pandemic projections made in January 2020 shows that among high-debt euro area countries (defined as debt-to-GDP ratio above 100 percent, Figure 1, orange dots), Belgium has experienced the largest increase in the structural primary deficit, by about 2 ppts as compared to a pre-pandemic counter-factual.

2. Absent adjustment, the fiscal position is expected to further deteriorate. Under staff's latest baseline projections assuming unchanged policies, the fiscal deficit (net lending/borrowing) is expected to remain elevated over the medium term, rising from 3.5 percent of GDP in 2022 to about 5½ percent of GDP in 2028. Wage and social benefit indexation, aging costs, and higher interest expenses are the key drivers pushing up current expenditure. Public debt will rise to about 115 percent of GDP in 2028, with a high probability that it will continue an upward trajectory beyond the medium term. The high and rising debt trajectory amplifies the impact of high interest rates on

¹ Prepared by Yu Ching Wong (EUR). The chapter benefited from valuable comments by Jean-Francois Dauphin, Mark Horton, Jean-Jacques Hallaert, and Stefan Van Parys and seminar participants at the National Bank of Belgium. The author thanks Xun Li for excellent research assistance.

debt service costs and makes financing requirements more vulnerable to adverse changes in market sentiment.

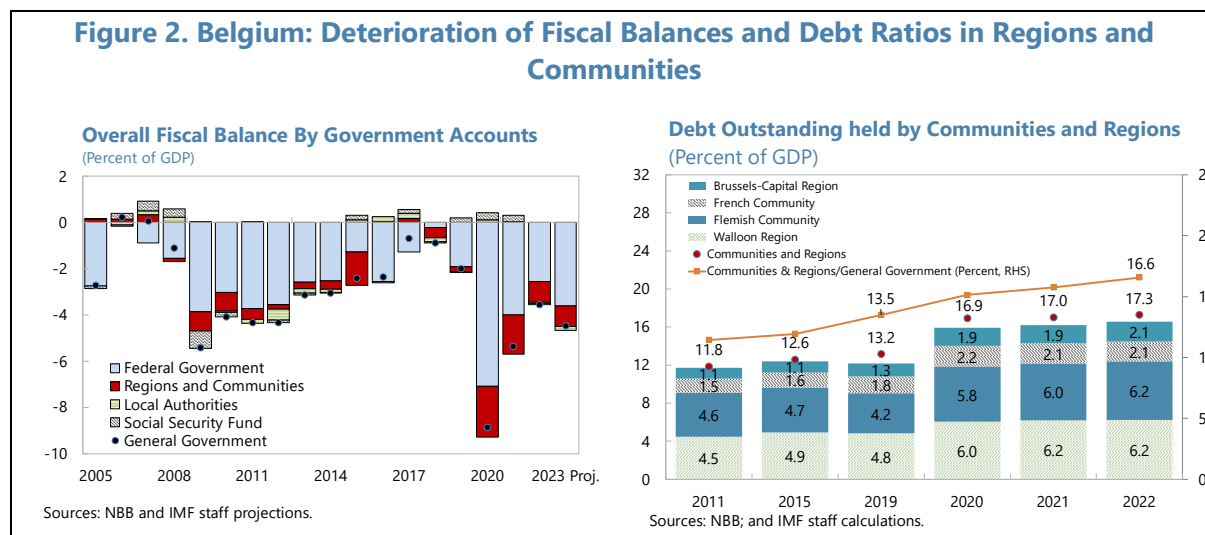


3. All Belgian federal entities face rising debt and deficit levels higher than pre-pandemic. The fiscal deficit of the federal government narrowed to 2.6 percent of GDP in 2022 from 7.1 percent in 2020, but still above 1.9 percent in 2019. As a result, public debt of the federal government moderated to 86 percent of GDP in 2022 from 93 percent of GDP in 2020 but is still 3.7 ppts higher than the pre-pandemic ratio in 2019. Consecutive shocks from the pandemic and hike in energy prices have also worsened the fiscal positions of the regional and community governments. In Wallonia, floods in 2021 and subsequent reconstruction needs presented additional challenges. The overall deficit level of the communities and regions declined to 0.9 percent of GDP in 2022 from 2.2 percent of GDP in 2020 but still above 0.2 percent of GDP in 2019, accounting for one-quarter of general government overall deficits in 2022. Public debt of communities and regions (17.3 percent of GDP or €95.8 billion) which has been rising since the pandemic, rose to 16.6 percent of total public debt (104.3 percent of GDP or €578.1 billion) in 2022. In addition, due to heterogeneity in economic structure and performance among the communities and regions, the debt burden also varies substantially. Measured by the debt-to-total revenue ratio, the debt burden ranged from 50-60 percent in Flanders and French Communities to 205-210 percent in Wallonia and Brussels (Brussels-Capital Region) in 2022.

4. Belgium's federal structure and fiscal decentralization add challenges to improving the fiscal position. Fiscal decentralization progressed substantially in 2015-19, but devolution of expenditure responsibilities outpaced that of revenue authority. In addition, in Belgium's institutional setting, there is no hierarchy in the federal system (i.e., among the federal, regional, and community governments); governments at all levels are equal from a legal perspective, and they are granted specific powers and competencies. A 2013 Cooperative Agreement concluded between the federal and regional and community governments to ensure budgetary coordination was not implemented in practice.² The political and institutional context make budgetary efforts more

² See discussion in Wong (2023).

difficult, and pose additional challenges to implementing fiscal consolidation to improve the fiscal position of Belgium as a whole.



5. Against this background, this paper focuses on key questions regarding implementing fiscal consolidation in Belgium. Section B discusses *the need for fiscal consolidation*; Section C discusses *factors contribute to successful fiscal adjustment* in other countries and Belgium's own experience; Section D examines *how much fiscal adjustment is needed* to restore fiscal space. Section E looks at *where saving could be achieved* by providing an analysis on spending reduction options by comparing Belgium's public expenditure pattern with pre-pandemic projections and with euro area peers. Finally, Section F provides strategic considerations on *principles to follow* to implement the adjustment.

B. Why is Fiscal Consolidation Needed?

6. Fiscal consolidation is needed to lower inflation, rebuild buffers, reduce debt, and preserve Belgium's social contract.

- **Lower inflation.** With euro area inflation still well above the 2 percent target and elevated core inflation remaining persistent, monetary policy should remain tight until inflation is unambiguously on a downward path. In Belgium, headline inflation has declined sharply this year (to 0.7 y/y in September 2023), but core inflation remains high (6.7 percent y/y in September 2023). A more ambitious fiscal consolidation would complement monetary policy in moderating demand, especially given automatic wage and benefits indexation in Belgium, helping avoid a vicious cycle of entrenched inflation requiring more forceful tightening that would push the economy into a recession, possibly leading to the government having to provide fiscal stimulus but with limited fiscal space. A tighter fiscal stance would also help meet the inflation target at lower policy rates, avoiding rising public debt services costs that would crowd out investment and social spending.

- **Rebuild buffers.** Belgium needs to urgently rebuild fiscal buffers that has been eroded by the pandemic and energy crisis, in order to address spending pressures from an aging population and to prepare for future shocks. This is critical in an environment where significant risks exist, including with respect to climate change and geopolitical fragmentation. At the same time, rebuilding fiscal space is increasingly difficult because of already-rising debt service costs (from 1.5 percent of GDP in 2022 to 1.8-2.7 percent of GDP in 2023-28), and aging costs (+0.3 ppt of GDP per year from 2022-70, based on projections by the Federal Planning Bureau (FPB) Study Committee on Aging). There are other rising spending demands, such as defense outlays and capital investment for the green transition.
- **Reduce debt.** A credible deficit and debt reduction strategy would help reduce risks and vulnerabilities from rising costs of debt financing. In a scenario with no policy change, Belgium's public gross financing needs are expected to increase to 21 percent of GDP in 2028 from 16 percent of GDP in 2022. This is driven by weaker fiscal balances and higher interest costs. Belgium's government bonds have one of the longest average residual maturity among euro area countries, 10.9 years in 2022, but as lower-cost debt matures over the medium term, now-favorable debt dynamics will dissipate. Higher borrowing costs will increasingly weigh on debt service, requiring an increasingly larger effort to stabilize debt over the medium term.³
- **Preserve Belgium's social contract.** Securing adequate fiscal space for redistribution and maintaining the social safety net are indispensable, if Belgium is to preserve its social contract of providing a relatively high level of welfare, redistribution, and social protection. Belgium has a comprehensive social protection system and redistributive fiscal policy that deliver a comparatively low level of income and wealth inequality. This involves a high level of social spending channeled through social insurance systems co-governed by employees and employers. However, relatively low labor force participation and an aging population pose increasing challenges to the sustainability of the system; these are compounded by low productivity gains and potential growth. An expansion of spending needs in areas such as employment subsidies and childcare adds further difficulties to containing costs of the welfare system.⁴ Studies have pointed to continuous and incremental reforms of the welfare system over the past decades with mixed outcome.⁵ In this context, preserving and ensuring the sustainability of the current system would still be a pragmatic approach compared to a more drastic and possibly forced overhaul of the system given the complex political environment in

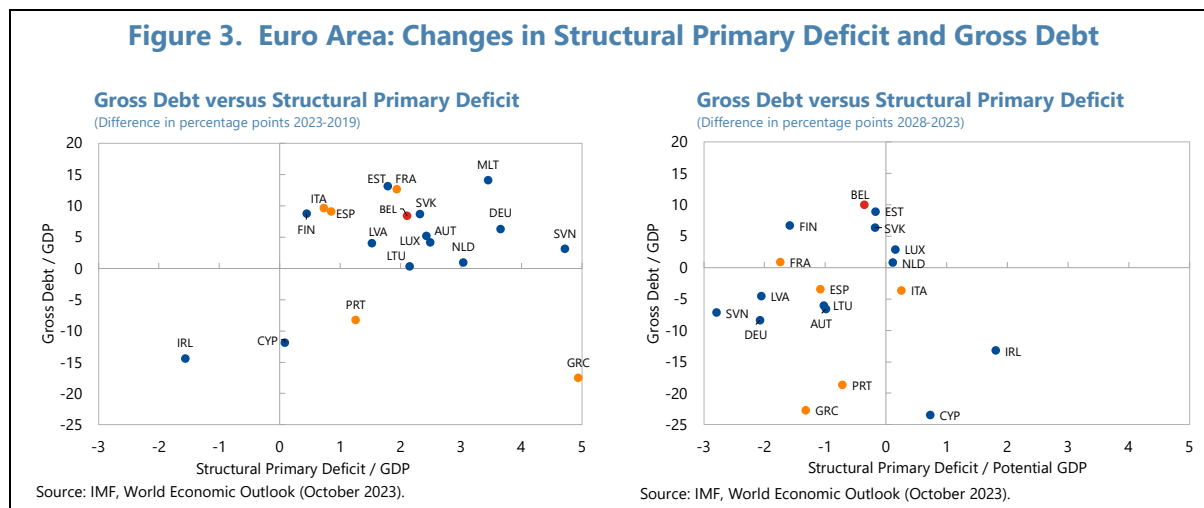
³ In addition, the reduction in net asset purchases of public debt by the ECB, including via active quantitative tightening, will also tighten sources of financing. See also IMF (2023b), Box 4 on medium-term debt stabilization risks in Europe.

⁴ Marx and Van Cant (2019).

⁵ For instance, Deschouwer (2016) and Marx and Van Cant (2019).

Belgium. Changes and reforms are needed to safeguard the core of the current system in the long run.⁶

7. A reduction of the elevated primary deficit is required to put debt on a downward path. Figure 3 (left chart) shows the change in gross debt in relation to the change in the structural primary deficit between 2019–23. Belgium is together with most euro area economies in the north-east quadrant with higher structural primary deficits and higher debt-to-GDP ratios. Compared to the pre-pandemic level in 2019, Belgium’s structural primary deficit widened by 2 percentage points of GDP, contributing to an increase in public debt-to-GDP ratio of about 8 percentage points by 2023. However, WEO baseline projections for 2023–28 in Figure 3 (right chart) show that absent significant policy change, public debt in Belgium is expected to continue rising, due in part to insufficient reduction in the structural primary deficit from—3.1 percent of GDP in 2023 to 2.8 percent of GDP in 2028—over the medium term. In this context, an upward trend in public debt over the medium term against the background of persistently large deficits in comparison to peers exposes Belgium to a higher risk of rating downgrades and higher debt financing costs.



C. What Contributes to Successful Fiscal Adjustment?

8. Based on lessons from other cases of large fiscal consolidation, Belgium appears to have many elements that can contribute to successful adjustment. A survey of consolidation cases by Balasundharam, et. al (2023) highlighted several factors that could increase the probability of success. In terms of underlying conditions, high income levels, a favorable global and domestic environment, a strong track record in fiscal management, and broad-based political support and good communications are important. In terms of the magnitude and duration of adjustment, improving the cyclically-adjusted primary balance by 1-2 percent of GDP per year for 3-4 years appears relatively common. Faster consolidations have been driven by larger and more urgent

⁶ Deschouwer (2016) noted that “this does not mean that changes to welfare policies are impossible, but that they are likely to be slow and that they require from the (political) parties a convincing story about adjustments in the short run being needed to safeguard the system in the longer run. This is easier in times of crisis.”

needs for reform. The authors also noted that a credible medium-term fiscal framework supported by sound institutions helps, and transparency (realistic macro-forecasts and public debate) contributes by improving program design and accountability. On large consolidations, while Balasundharam, et. al (2023) point to generally requiring both revenue and expenditure measures, Blöchliger et al. (2012)'s case studies of large fiscal consolidation episodes suggest that successful consolidations were driven more by spending cuts and to a lesser extent by revenue increases. Lastly, on political economy, Blöchliger et al (2012) found that most consolidation episodes were implemented shortly after an election, more than half of the governments that had started consolidation were re-elected, and some even strengthened consolidation efforts. Overall, Belgium has many elements (e.g., high income level) that would contribute to successful fiscal consolidation—as measured by deficit reduction and debt stabilization or decline. However, it also faces hurdles that need to be overcome, including reaching broad-based political support.

9. Indeed, Belgium successfully achieved large fiscal consolidation in three key past episodes.

According to the NBB (2015), three major fiscal consolidations took place in 1982-87, mainly through cutting primary expenditures; in 1993-98, by raising revenues and reducing the interest burden; and in 2011-17, by cutting expenditure and further reducing interest costs. The 1993-98 consolidation contributed to an impressive debt reduction through 2007. Public debt had peaked at close to 140 percent of GDP in 1993, and thereafter continuously declined over 14 years to 87 percent of GDP in 2007 (Table 1). This large reduction of the debt ratio by 52 ppts of GDP was largely driven by major national fiscal efforts to qualify for euro membership after ratifying the Maastricht Treaty in 1992.⁷ By 1999 when the euro was launched, public debt had been lowered to 115 percent of GDP. The downward trend in debt-to-GDP continued thereafter but was punctuated in 2008 by the onset of the GFC (Box 1).

Table 1. Belgium: General Government: Gross Debt and Key Drivers
(Percent of GDP)

	1993 - 2007	2008 - 2014	2015 - 2019	2021 - 2022	2023p- 2028p
General government debt	↓	↑	↓	↓	↑
Start of period	139	87	107	112	106
End of period	87	107	98	104	113
<i>(Average of period)</i>					
Overall balance	-1.6	-3.6	-1.7	-4.5	-4.9
Primary balance 1/	4.5	-0.5	0.5	-2.8	-2.6
Interest payment	6.5	3.6	2.4	1.6	2.3
Social benefits	21.4	24.3	24.6	25.6	27.0
Real growth of primary expenditure (percent)	2.7 2/	3.2	0.8	0.0	2.0
Real GDP growth (percent)	2.6	0.8	1.8	4.9	1.2

Sources: NBB and IMF staff projections.
1/ Overall balance + net interest payment.
2/ 1996-2007

⁷ The Maastricht convergence criteria include improving public finances, such that the government deficit must not exceed 3 percent of GDP and the public debt must not exceed 60 percent of GDP, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

Box 1. Belgium: Evolution of Public Debt in Belgium

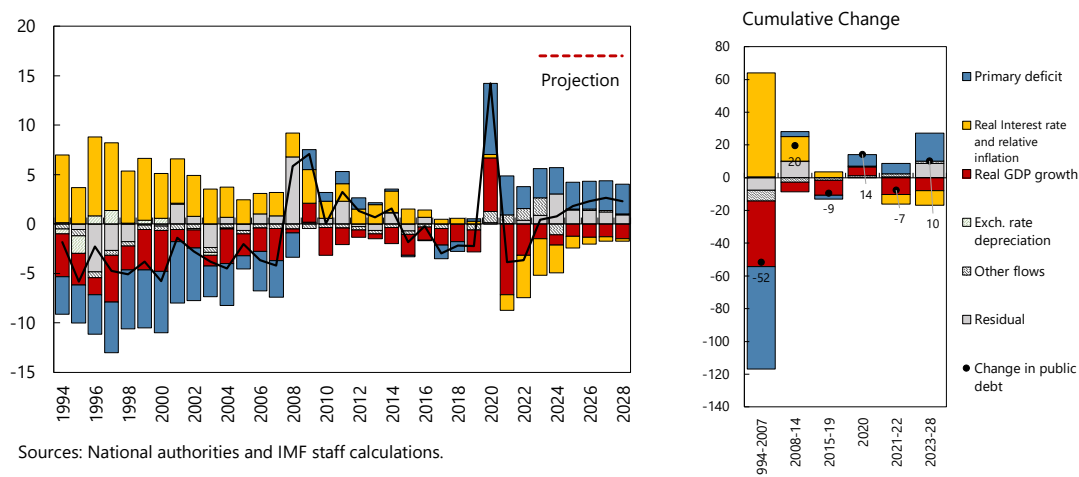
The fiscal consolidation needed over the medium term will take place under challenging conditions of weaker potential growth, tighter financing conditions, and stronger headwinds from spending pressures of population aging.

The drivers for past episodes of reduction in public debt in three previous periods were:

- 1994-2007: the debt GDP ratio declined impressively, with high primary surplus (4.5 percent of GDP) and real GDP growth (2.6 percent) being the key drivers, more than offsetting the impact of high real interest rates (positive r-g).
- 2015-19: the debt-GDP-ratio declined steadily, and real GDP growth (1.8 percent) remained a key driver in lowering debt. The contribution from an improvement in primary balance (0.5 percent of GDP) was much smaller than in the previous episode.
- 2021-22: following the pandemic, the rapid recovery in real GDP growth (4.9 percent) and low real interest rates (negative r-g) more than offset the impact of an elevated primary deficit (-2.8 percent of GDP) in lowering the debt-to-GDP ratio.

Going forward, under unchanged policy settings, the debt-to-GDP ratio is projected to increase in 2023-28, due largely to a high primary deficit (-2.6 percent of GDP). Real GDP growth, projected to slow to its potential of about 1.2 percent over the medium term, is only a minor debt-reducing driver. Stabilizing the debt ratio implies reducing primary deficits to near zero (i.e., the debt stabilizing primary balance is -0.4 percent of GDP in 2028).

Contributions to Change in Public Debt
(Percent of GDP)

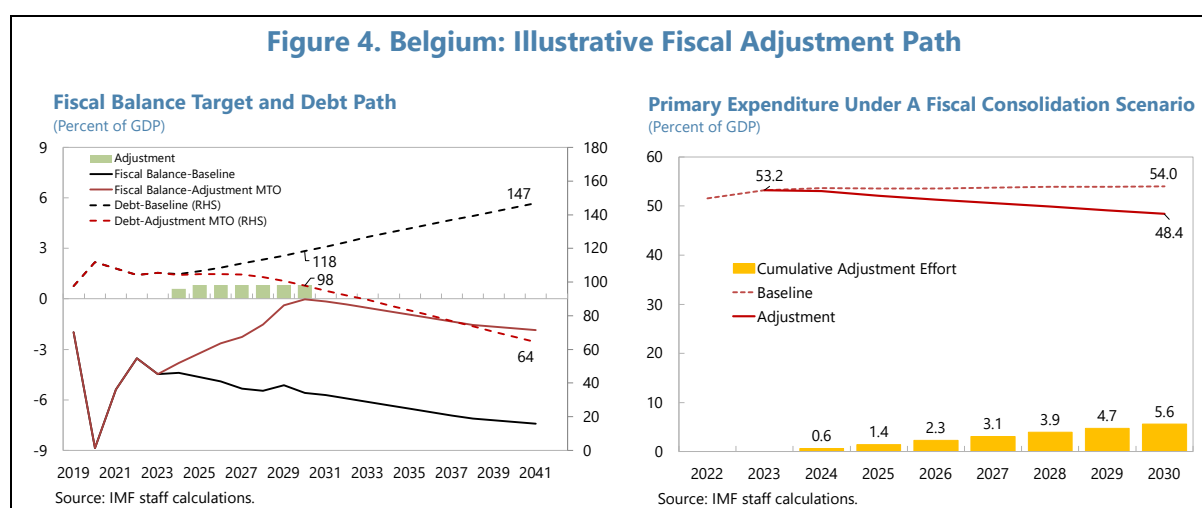


D. By How Much?

10. Designing an appropriate fiscal consolidation path involves trade-offs. As illustrated by the current discussions among EU member countries regarding the reform of the economic governance framework, ensuring fiscal sustainability for high-debt countries is a complex issue that can result in different paths and end targets. For instance, adjustment paths envisaged under the

EC's proposed 4- or 7-year horizons will require, among other criteria the fiscal deficit to remain or to be brought and maintained below 3 percent of GDP and debt at the end of the adjustment period to be lower and continue on a downward path or stay at prudent levels for another 10 years. For a high-debt country like Belgium, the resulting debt path would remain above a 60 percent of GDP threshold. This implies trade-offs. A smaller cumulative fiscal adjustment may have less immediate impacts on growth, but would entail a higher debt level and vulnerabilities to adverse market sentiment for longer, with higher debt-servicing costs that could crowd out investment with a longer-term impact on growth.

11. Consolidation targeting a reduction of debt-to-GDP towards 60 percent would significantly reduce vulnerabilities and rebuild buffers. Such an ambitious approach would require an adjustment of 0.6 percent of GDP in 2024 and 0.8 percent of GDP (or more) annually from 2025, to reach structural balance in 2030—Belgium's previous EU medium-term objective or MTO.⁸ The adjustment would translate into a cumulative reduction in the structural balance of about 5½ ppts of GDP in 2024-30. For simplicity, assuming no policy changes that lead to greater revenue mobilization, this would require a cumulative permanent primary expenditure reduction of 5½ ppts of GDP. This could be achieved by limiting nominal spending growth to an average of 1.3 percent annually in 2025-2030 (Figure 4).



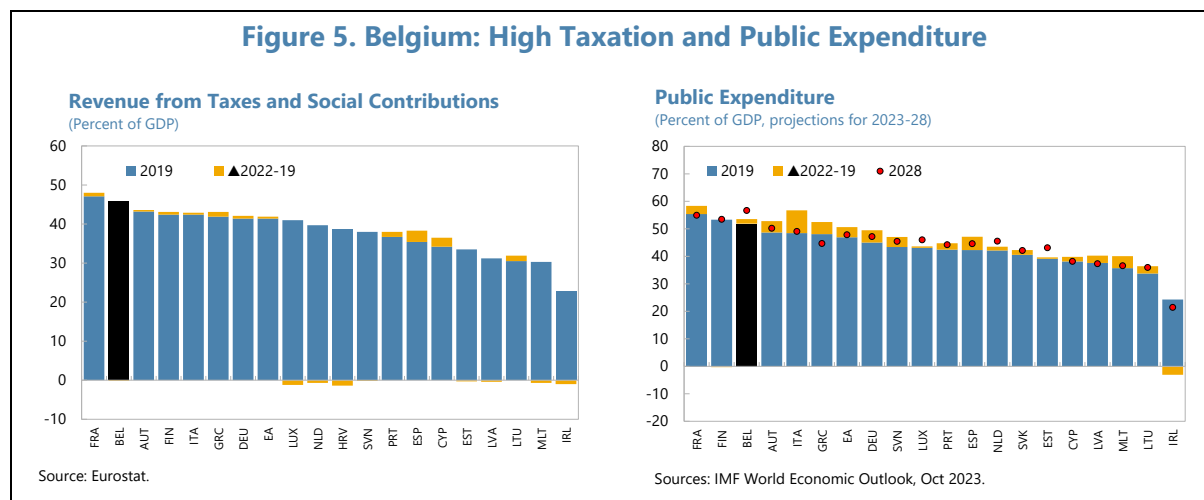
12. This approach is broadly consistent with the three-year adjustment path for 2024-26 as outlined in Belgium's 2023-26 Stability Program, with additional adjustment to reach structurally balance in 2030. The cumulative adjustment would be more than offsetting the estimated increase in aging outlays of 4 ppts of GDP (2022-41), with the debt-to-GDP ratio declining steadily towards 60 percent of GDP by the early 2040s. Additional savings would continue to be needed to facilitate higher investment spending to boost medium-term growth. This ambitious and upfront fiscal adjustment has the benefit of reducing the structural deficit and stabilizing the debt

⁸ Defined as the deviation of the change of the structural balance from its change under the baseline. See FPB (2023) for further discussion of the MTO.

path. Growth would be lower—about 0.2 ppt lower than in the baseline for a small open economy with relatively large automatic stabilizers—absent reforms to increase productivity.

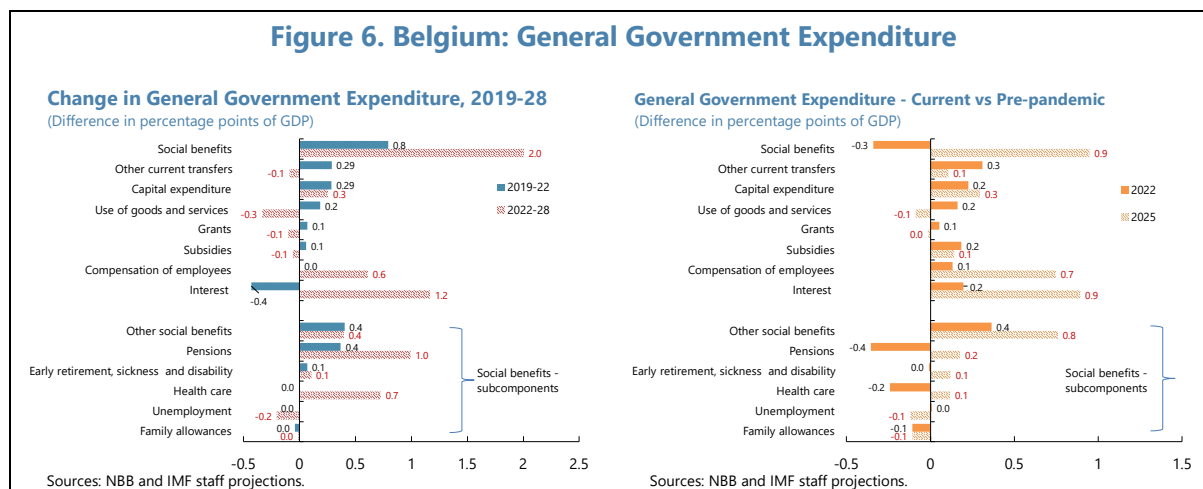
E. Where Can Savings Be Achieved?

13. The adjustment will need to rely mostly on reducing spending rather increasing revenues. Given the high level of taxation, room for mobilizing additional tax revenue appears limited, although efficiency-enhancing tax reforms should proceed. Conversely, the high level of spending offers opportunities for savings and increases in efficiency (Figure 5).

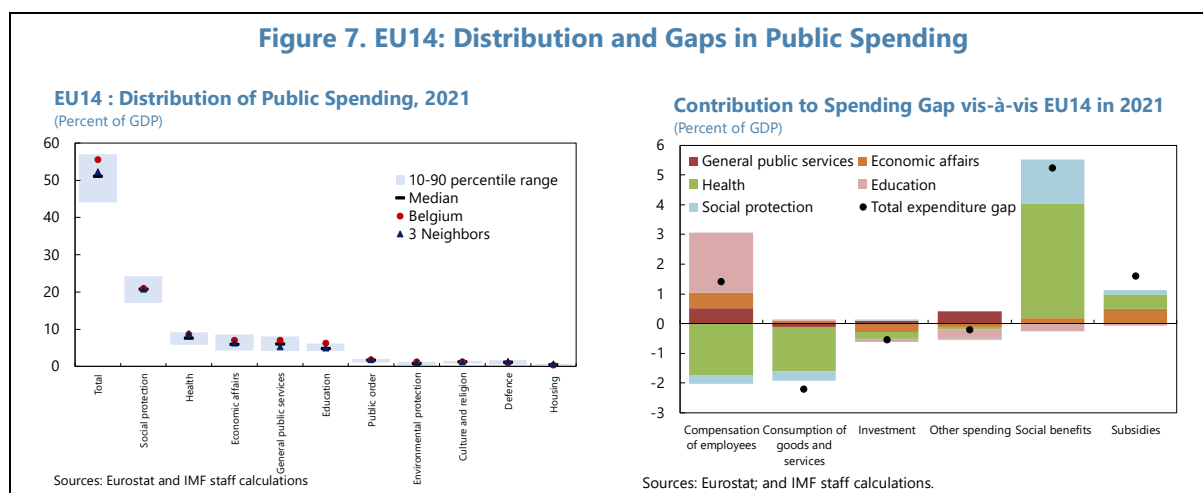


14. Consolidation would need to rein in the rise in general government expenditure above the pre-pandemic trend. General government spending is elevated—53 percent of GDP in 2022, particularly social outlays (25 percent of GDP), the wage bill (12 percent of GDP), and subsidies (4 percent of GDP). While most of the temporary measures introduced during the pandemic and the energy crisis have lapsed, primary expenditure in 2022 was higher by 1.7 percentage points of GDP compared to 2019, reflecting the impact on high inflation indexation on social benefits and public wages and permanent measures taken during COVID-19 (e.g., increases in health-sector public wages).⁹ With no policy changes, primary expenditure is expected to increase by another 2.3 ppt in 2023-28. Spending on social benefits is the largest driver, having increased by 0.8 ppt of GDP in 2019-22 and likely to increase by another 2.0 ppt in 2023-28 via increases in pensions and health spending (Figure 6, left chart). Compared to pre-pandemic projection (January 2020 WEO forecast), primary expenditure is about 1 ppt higher in 2022 and 2 ppt higher in 2025 (Figure 6, right chart). A large part of the increase in 2025 is coming from social benefits at 0.9 ppt higher than pre-pandemic projection.

⁹ Analysis by the NBB (2023) indicates that the inflation surge structurally increases fiscal deficits by about 1.4 percent of GDP by 2025. Notably, about one half of primary expenditure items are automatically linked to the rise in the health index following CPI increase, which has risen more than the GDP deflator.



15. Belgium spends more than EU advanced economies on average on social benefits, compensation of employees, and subsidies. A comparison of spending patterns and developments with euro area peers offers indications of possible avenues for saving. Based on Eurostat expenditure-by-function data (available up to 2021), Belgium consistently spent more than the average of its EU-14 peers since 1996.¹⁰ Comparing with the average of Belgium’s three neighbors (France, Germany, The Netherlands) yields broadly similar results, although the spending gap with France has been negative. In 2021, Belgium’s expenditures in the largest 5 functions—social protection, health, economic affairs, general public services, and education—were all higher than the EU-14 median and its neighbors (except for health) (Figure 7, left chart). By spending type, Belgium spent more than peers in social benefits (driven notably by health and social protection), wages (largely on general public services), and subsidies, representing three key areas where saving could be sought (Figure 7, right chart). Further, the heatmap in Figure 8 illustrates that Belgium’s social benefits spending was 5.2 ppt of GDP higher in 2021 than the average of EU advanced economies; this positive gap is equivalent to one-fifth of Belgium’s current social benefits outlays (26 percent of GDP).



¹⁰ The EU-14 are those countries who were members of the EU prior to 2004: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Republic of Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and Sweden.

Figure 8. Belgium: Gap in Major Spending Categories Between Belgium and EU Peers (2021)

	Total Expenditure	General public services				Economic affairs			Health			Education			Social protection								
		General public services	Exec. & Legis. Organs, Fiscal, Financial & External affairs	Basic research	Public debt transactions	Economic affairs	General econ. affairs	Transport	Health	Medical products and equipment	Outpatient services	Hospital services	Education	Pre-primary and primary education	Secondary education	Tertiary education	Social protection	Sickness and disability	Old age	Survivors	Family and children	Social exclusion n.e.c.	Unemployment
Total General Government Expenditure	5.3	0.9	0.4	0.4	0.5	0.9	1.1	0.5	0.8	(0.3)	0.8	0.6	1.3	0.2	0.6	0.0	1.0	0.9	(1.0)	0.3	0.1	0.2	0.5
Compensation of Employees	1.4	0.5	0.3	0.2		0.5	0.2	0.4	(1.7)		(0.4)	(1.3)	2.0	0.6	0.9	0.2	(0.3)	(0.2)	(0.1)		(0.1)	0.2	0.0
Consumption of goods and services	(2.2)	(0.1)	0.0	0.0	0.1	0.1	0.1	0.1	(1.5)				0.0	(0.0)	0.0	(0.0)	(0.3)						0.1
Investment	(0.5)	0.1	0.0	0.3		(0.3)	0.0	0.2	(0.2)				(0.1)			0.0	0.1						
Other Spending	(0.2)	0.4	0.1		0.4	(0.1)	(0.1)	(0.2)	(0.1)		(0.1)						(0.0)	(0.0)	(0.1)		(0.1)	0.1	
Social Benefits	5.2					0.2	0.2		3.9	(0.2)	1.6	2.5	(0.3)				1.5	1.2	(0.7)	0.3	0.5	(0.0)	0.5
Subsidies	1.6					0.5	0.8	(0.0)	0.5			0.5					0.2						

Higher (+) or lower (-) than EU14 peers average in percent of Belgium expenditure category

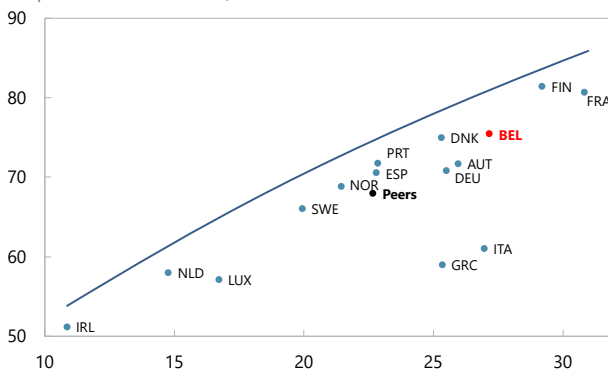
■ Higher by more than 25 percent
 ■ Higher by 15-25 percent
 ■ Higher by 5-15 percent
 ■ Higher by 0-5 percent
 ■ Lower by 0-5 percent
 ■ Lower by 5-25 percent
 ■ Lower by more than 25 percent

Sources: Eurostat and IMF staff calculations.
 Note: EU14 is previously EU15 excluding the U.K.

16. Efficiency assessments further point to opportunities for savings in social spending. Figure 9 shows the relationship between social protection efficiency scores and social protection spending and illustrates that there is scope for efficiency gains for Belgium by moving to the efficiency frontier with lower social spending.¹¹ Belgium spent more than most European peers, with social protection spending of 27 percent of GDP and a social protection efficiency score that is slightly above the peer average. This suggests that Belgium could reduce spending to about 24 percent of GDP while maintaining its current efficiency score.

Figure 9. Belgium: Efficiency Frontier of Social Protection

(Social protection index 2017-19 vs public social protection expenditure in percent of GDP 2015-17)



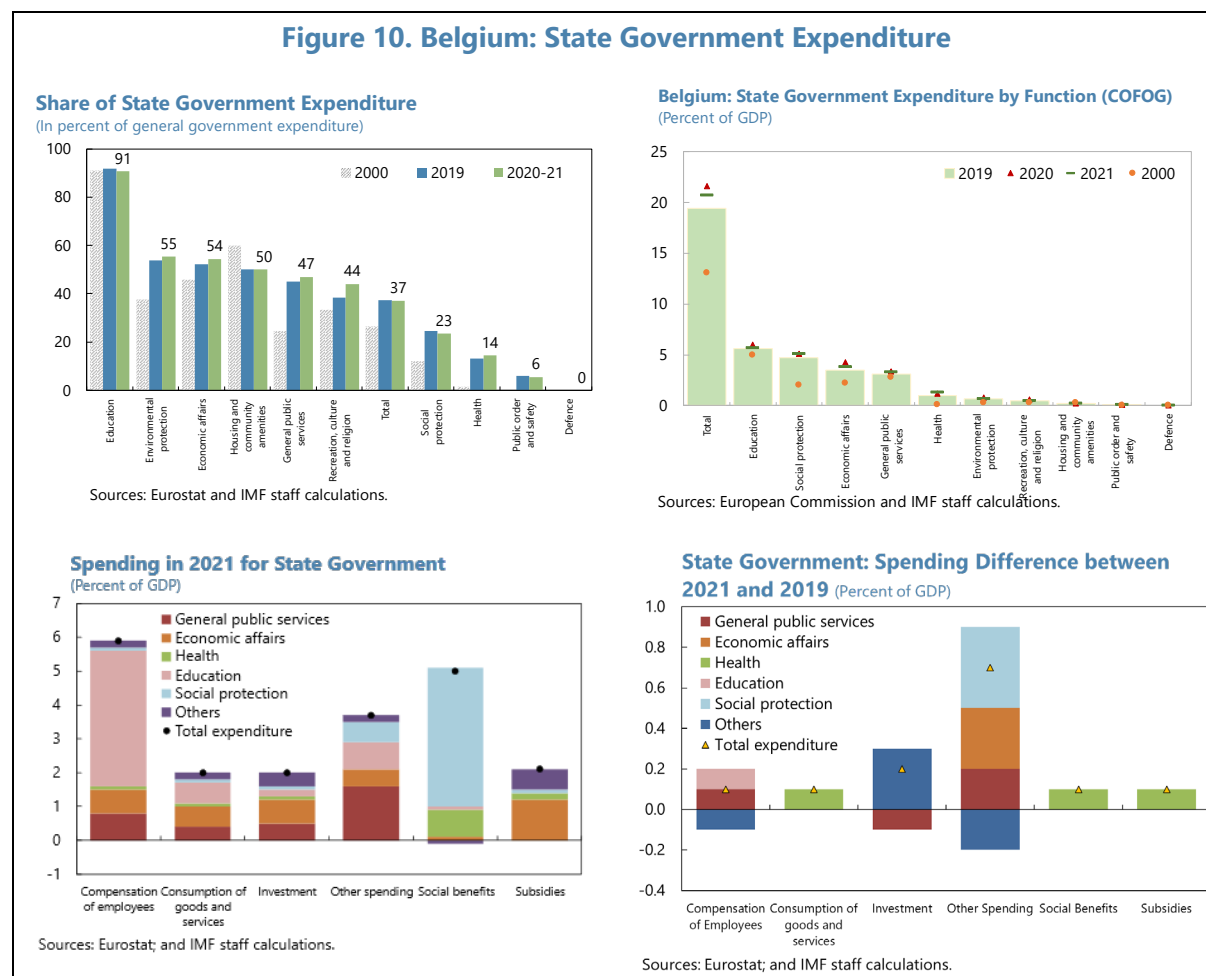
Sources: OECD; Eurostat; and IMF staff estimates.

17. Fiscal consolidation should seek savings mainly from social benefits and the public wage bill. The continuous expansion in social benefit spending suggests that the wide-reaching social-benefit system—notably, unemployment benefits of unlimited duration and generous disability support—should be made more efficient. For instance, the share of disability benefits recipients increased rapidly to about 5½ percent of the population in 2018 from slightly above

¹¹ See IMF (2023a) for estimates of spending efficiency.

3 percent in 10 years.¹² More targeted social spending to protect the most vulnerable segment of the population could be achieved through increased use of mean-tested programs. The share of total social protection spending that is means-tested was 16.7 percent in Belgium as of 2017, among the lowest in countries in Europe. This compares with the U.K. at 64.4 percent, Ireland at 62.5 percent, and the Netherlands at 59.5 percent. Many high-spending countries have increased their use of means testing over recent decades.¹³ Saving on the public wage bill, including through a review of automatic wage indexation, functional reviews, comparisons of the number of public employees to other countries and to the private sector on wages, should also be considered.

Figure 10. Belgium: State Government Expenditure



¹² OECD (2022). See also Selected Issues Paper on the fiscal cost of aging – pensions and healthcare.

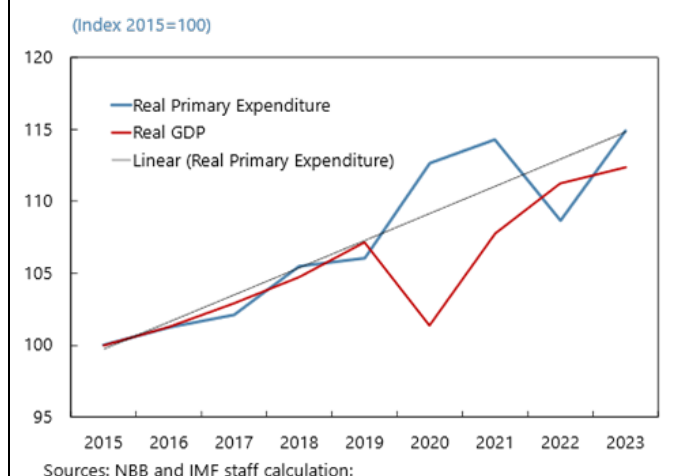
¹³ Coady et al. (2021).

18. Fiscal consolidation should also focus on controlling increases in wage and social benefit outlays at the regional level and on reducing federal-regional duplication.

A sizable share of public spending is implemented at the regional level. With further decentralization since 2015, spending by communities and regions now accounts for close to 40 percent of general government expenditure. Based on the devolution of competencies, 90 percent of spending in education and more than half of spending in environmental protection, economic affairs, and housing and

communities, respectively, are implemented at the level of communities, regions, and local authorities. By expenditure size, four functions—education, social protection, economic affairs, and general public services—made up close to 90 percent of spending by state (i.e., regional and community) governments (Figure 10).¹⁴ Spending is largely in public wages (mainly education), social benefits (mainly social protection), and other spending based on breakdown by COFOG function. During the pandemic, spending increased by 1.3 percent of GDP in 2019-21, of which 0.7 percent of GDP was in the other spending category (Figure 10). Overall, real primary expenditure grew by 1.7 percent during 2015-23, exceeding real GDP growth of 1.5 percent (Figure 11).

Figure 11. Belgium: Communities and Regions: Real Primary Expenditure



F. What Principles?

19. Deficit reduction plans should be underpinned by concrete adjustment efforts by all federal entities. The federal government's 2024 draft budget seeks to reduce the overall deficit to 4.2 percent of GDP for 2024. Belgium's 2023-26 stability program aims to reduce the deficit further to 3.3 percent and 2.9 percent of GDP in 2025 and 2026, respectively. However, the 2024 combined budget of regions and communities will deviate from the stability program with a planned deficit that is 0.4 ppt of GDP larger than the target of -1.1 percent of GDP (Table 2).

¹⁴ Note that spending on social protection accounts for one-third of general government expenditure, of which old age and sickness and disability accounted for one-half. The rapid increase in public expenditure during 2019-20 was largely in health and social protection, functions borne by the federal government and federal social security funds.

Table 2. Belgium: Summary of Fiscal Positions by Federal Entities

	(Percent of GDP)							
	2019	2020	2021	2022	2023	2024	2023	2024
					SP	SP	DBP	DBP
General government								
Revenue	49.9	49.9	49.5	49.6	51.1	51.2	50.5	51.8
Expenditure	51.9	58.8	54.8	53.2	56.2	55.4	55.7	56.4
o/w Interest	2.0	1.9	1.7	1.5	1.7	2.0	1.9	2.1
Net Lending(+)/Borrowing (-)	-2.0	-8.9	-5.4	-3.5	-5.1	-4.2	-5.2	-4.6
<i>Entity I</i>								
<i>Federal government</i>	-1.7	-6.8	-3.7	-2.6	-3.5	-3.0	-3.5	-2.9
<i>Social Security Funds</i>	-1.9	-7.1	-4.0	-2.6	-3.4	-3.0	-3.6	-3.0
<i>Social Security Funds</i>	0.2	0.3	0.3	0.0	-0.1	0.0	0.1	0.0
<i>Entity II</i>								
<i>Regions and Communities</i>	-0.3	-2.1	-1.7	-0.9	-1.5	-1.2	-1.6	-1.6
<i>Local government</i>	-0.2	-2.2	-1.7	-0.9	-1.4	-1.1	-1.5	-1.5
<i>Local government</i>	0.0	0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.2
Structural balance	-2.9	-6.4	-5.2	-4.1	-4.6	-3.8	-4.8	-4.1
Consolidated Gross Debt	97.6	111.8	108.0	104.3	106.7	107.1	108.3	108.1

Sources: NBB; Stability Program (SP) 2023-26; Draft Budgetary Plan (DBP) 2024 and IMF staff calculations.

20. Coordination, burden sharing, and accountability for all federal entities should be strengthened. For consolidation to be successful, a pragmatic approach that holds all levels of government accountable for the fiscal adjustment path outlined in the stability program or in the new EU fiscal framework will be required. Regions and communities should implement spending limits consistent with their deficits. While regional governments are targeting a return to balanced-budget positions over the medium term, this should be accompanied by concrete adjustment plans and a binding timeframe with obligations to make up adjustment slippages in subsequent years. Improving federal and regional coordination and burden sharing will require political agreement to work within the institutional setting of no hierarchy among the federal government, regions, and communities. This could involve reinvigoration and implementation of the 2013 Cooperative Agreement.

21. Adopting a credible, multi-year consolidation plan will be critical. This would help to avoid *ad hoc* adjustments year-by-year, which increase uncertainty, and to limit risks of adopting reduction measures that could be more costly over the long run. The difficulties in reaching agreement within the coalition government on adjustment efforts during the budget process in recent years also point to limitations, risks, and inefficiencies of a non-structured approach. Given the large size and long duration of the proposed fiscal adjustment, a carefully-designed and committed multi-year plan would provide a clear, transparent and accountable roadmap, helping secure buy-in of the population and markets. While Belgium responded well to external pressures during past fiscal adjustment episodes, an abrupt, disorderly expenditure-cutting response—possibly triggered by sharply-widening spreads—would be costly and should be avoided.

22. Comprehensive spending reviews can help target budgetary saving. Spending reviews have been rolled out since 2019 at the federal and regional government levels. In this pilot phase,

reviews have been limited to 2-3 selected areas per year and narrow in scope.¹⁵ Building on these experiences, moving to comprehensive spending reviews covering a larger share of government spending would be beneficial at a time when urgency, focus, and resource limits need to be taken into consideration. Reviews should be designed to meet multiple objectives, including fiscal consolidation, by identifying savings measures that reduce the rate of growth or the level of public expenditure. Other objectives are the creation of fiscal space to accommodate new policy priorities or to address emerging fiscal pressures and identifying areas of inefficient or redundant spending for better value for money or free up resources for higher priorities.¹⁶

23. Public investment should be preserved, and better yet, scaled up to mitigate the growth impact of consolidation, boost potential growth, and facilitate the green transition.

There is scope to enhance public investment—mostly a regional government competence—as it remains relatively low at 2.7 percent of GDP in 2022, despite some increases in recent years. This limits gains in productivity and potential growth. A wide gap remains with the authorities' investment-spending target of 4 percent of GDP by 2030, notwithstanding Next Generation EU (NGEU) grants.

24. Similarly, fiscal consolidation needs to be complemented with structural reforms.

Belgium needs to intensify structural reform efforts to sustain the fiscal consolidation. Further reforms in social benefits, pensions, and health are indispensable for containing the rise of aging costs and for improving benefits targeting, an integral part of the consolidation.¹⁷ Advancing proposed tax reforms that would reduce the tax burden on labor and address work disincentives via changes to tax rates and brackets and better alignment with social benefits, along with labor market reform measures, would help lift the labor force participation rate. This is needed to reduce cost pressures from social benefits. Product-market reforms would also help increase productivity and boost potential growth, thereby increasing tax revenues and job opportunities.

¹⁵ Spending reviews were introduced in the federal budget process at end 2020. The pilot reviews conducted at the federal government in 2021 are the impact of generalized teleworking on the organization and expenditure of the federal government; the exemption from payment of withholding tax; and effective care. In 2022, the nuclear passive and BELSPO, and in 2023 court costs, and asylum and migration.

¹⁶ Doherty and Sayegh (2022).

¹⁷ See Selected Issues Paper on the fiscal cost of aging – pensions and healthcare.

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