Difficult budget discussions in Belgium

The successive crises of the last three years have left their mark on Belgian public finances. Fortunately, the situation in the very short term is not as bad as expected. However, efforts will have to be made to avoid a structural deterioration of public finances. In the current political context, this will not be easy

Since last week, the federal government has been discussing its usual budgetary control and preparing its budget for 2024. The exercise is far from easy. Indeed, the federal and regional elections will take place in the first half of 2024. This means that tensions between the political parties forming the current majority will only increase in the coming months. It will then be difficult to decide on major fiscal shifts, let alone more structural reforms. The current exercise is therefore important for public finances in the period 2023-24.

Furthermore, the European Commission has announced that the budgetary rules suspended since 2020 will be reintroduced from 2024 onwards. This implies that Belgium, like the other European countries, will have to inform the Commission in April of its medium-term fiscal trajectory and the efforts it intends to make. Finally, the recent downgrading of the outlook for the Belgian state by the rating agency Fitch shows that the precarious situation of Belgian public finances could hit the confidence of financial markets in the event of an adverse scenario.

It should be pointed out that budgetary efforts do not have to be made entirely by the federal government. The efforts are shared between the different levels of government. The current budgetary control only concerns the federal government (which is also responsible for social security).

First, some good news

To carry out its budgetary control, the government uses the latest available data from the Monitoring Committee of the Ministry of Finance. Fortunately, the latest data are not as bad as previously expected for 2022 and 2023. Indeed, while a deficit of around 5.0% of GDP was expected in 2022, it was finally limited to 4.1% of GDP. This 'improvement' compared to past forecasts is essentially linked to better economic growth than expected last year.

Indeed, caught between the positive effect of the post-Covid reopening of the economy and the negative effects of the war in Ukraine and the energy crisis, the Belgian economy has coped better than expected. It is true that the growth dynamic weakened during the year, but activity never declined. Over the year as a whole, GDP even grew by 3.1%, which is relatively high (the average since 2000 is 1.6%).

This good performance is above all linked to the strong growth of household consumption, which has increased by 4.3% in volume in 2022. It was known that the end of Covid restrictions would allow a return to a normal level of consumption, both of goods and services. Nevertheless, very high inflation, and in particular the sharp increase in household energy bills, risked deteriorating the purchasing power of households and thus their ability to consume. In the end, this was not the case, as consumption coped very well throughout the year, and even grew strongly (+1.1% quarter-on-quarter) in the fourth quarter of the year, which was nevertheless marked by the biggest increase in energy bills.

Three elements have kept household consumption from a disaster scenario:

(1) The labour market has resisted very well with negative shocks to the economy in 2022. Moreover, more than 100,000 jobs were created in 2022, a record high, and this has helped to reduce the unemployment rate, which remains at an all-time low.

(2) The indexation of most incomes (wages, pensions, social benefits) to inflation has made it possible to offset most of the effect of the wave of inflation on purchasing power. Thus, the impact of job creation and indexation has made it possible, according to provisional data from the National Bank (NBB), to increase the disposable income of households by 7.9% in nominal terms and, taking inflation into account, to limit the contraction of real disposable income of households to 0.8% in 2022, which is quite remarkable.

(3) Finally, the important measures taken by governments (federal and regional) to relieve households and businesses have also helped to cushion the energy shock. It should be recalled that VAT on gas and electricity has been reduced to 6%, substantial subsidies have been granted to all households, and more than one million households have been able to benefit from the social energy tariff, a highly reduced and regulated tariff.

For this year, the budgetary outlook has also been revised upwards. While the monitoring committee had expected a deficit of 5.9% of GDP, past improvements and better growth prospects on the back of lower energy prices this year have allowed the projected budget deficit to be reestimated at 4.8% of GDP.

But this is not enough...

It should be noted, however, that despite the downward revision of the deficit, Belgium would, on a no-policy-change basis, see a deterioration in its budget balance this year. Various elements can explain this expected deterioration:

- Nominal GDP growth will be much lower than in 2022, not only because of a falling deflator but also because of much softer growth. This will limit the nominal increase in tax revenues.

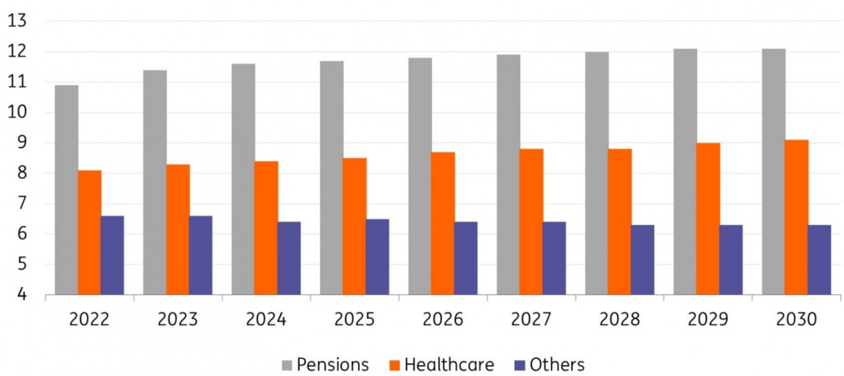
- A range of expenditures will continue to rise rapidly: these include pension expenditure, due to a large flow of people reaching pension age. Healthcare expenditure is also expected to grow faster than nominal activity growth.

- Finally, over the last decade, the interest burden on the debt has been falling steadily, despite the increase in the debt, thanks to the extreme fall in interest rates. The interest burden has thus fallen from €13.4 billion in 2012 (3.5% of GDP) to €8.4 billion in 2022 (1.5% of GDP). That said, we know that the downward movement in interest rates has come to an end in 2022. Therefore, given a rapidly increasing debt due to the public deficit and the higher interest rates on new debt issues, the interest burden should start to increase again this year.

Thereafter, still, with an unchanged policy, the deficit will continue to deteriorate. It should be noted that Entity I (comprising the federal government and social security) accounts for the largest share of this deterioration. Indeed, as the vast majority of Belgian public debt is at the federal level, the latter bears the interest burden and therefore the impact of the increase in rates.

But above all, the ageing of the population will lead to increasing pressure on social security expenditure (including pension payments). Since 2013, pension payments have increased by more than 47% while nominal GDP has only increased by 40%. Due to the ageing population, this trend will only increase. According to the latest projections, pension benefits will represent 1.2 percentage points of GDP more in 2030 than in 2022. Similarly, health care will increase by 1.0 percentage point of GDP (Graph 1).

Gr. 1: Cost of public spending impacted by the population ageing (in % of GDP)



Source: Study committee on ageing

What efforts?

In this context, budgetary negotiations will take place on two levels: on the one hand, should efforts be decided now? Opinions on this subject are divergent in the majority. The Governor of the National Bank has recommended the government an effort of 0.4pp in the 2024 budget (including 0.3pp at the level of entity I). But not all political parties agree with this, with the biggest party in government, the French-speaking socialists, not very keen on austerity measures at this juncture. Some would even prefer to spend more. There is therefore no consensus to date on the need to enter into discussions to make efforts. On the other hand, if efforts are to be made, will they be on the expenditure side or on the revenue side? Here too, a consensus is lacking.

Deeper reforms

Beyond budgetary control, two reforms that the current government has committed to carry out remain under discussion. One is the pension reform. Some small adjustments have already been made and new decisions could still be taken. But we should not expect a major reform. As it stands, the current reform is unlikely to contribute to a structural improvement of public finances. That said, the fundamentals of the current pension system and its calculation are not and probably will not be called into question during this legislature.

On the other hand, the government had committed itself to a tax reform that would reduce the tax burden on labour. The Minister of Finance, Vincent Van Peteghem, has submitted an initial proposal for discussion with the majority of partners. The objective would be to reduce taxation on labour by around €6 billion, compensating this with an increase in taxation on wealth and consumption (for a total of around €4.5 billion). The balance would have to be covered by the dynamic effects of the measures taken (in particular a greater attractiveness of work, and therefore a higher employment rate), so as to balance the cost and financing of the reform.

Important discussions will take place in the coming weeks on these issues. However, these reforms should not be expected to improve the state of public finances in the short or medium term either.

To conclude...

The federal government is entering a crucial period. Two of the reforms announced at the beginning of the legislature should find their epilogue in the next few weeks: the pension reform and the tax reform. But we should not expect any major revolutions, but rather adjustments. Nor will these reforms fundamentally alter the budgetary trajectory of the coming years.

The budgetary control itself is uncertain. It must be said that since the estimated figures for 2022 and 2023 turned out to be better than expected, and since external pressures, both from creditors and from Europe, are fairly moderate at the moment, the temptation could be great to postpone difficult issues until later. With general elections in 2024, consolidation efforts might have to wait until 2025. But, beyond the risk that this represents for the budgetary trajectory itself (and potential nervousness on financial markets), there is also the risk of not being able to free up the means to carry out the major infrastructure investments necessary to combat climate change and particularly to implement the energy transition. At this stage, there is no room to improve this type of investment spending, which is nevertheless essential.

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