# The new European fiscal framework: implications for fiscal policy in Belgium

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**Based on:** The new European fiscal framework: Implications for fiscal policy in Belgium | nbb.be

1 The new European fiscal framework

2 Implications for fiscal policy in Belgium

3 Breakdown of fiscal targets between entities

4 Conclusion

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1. **The new European fiscal framework**
2. Implications for fiscal policy in Belgium
3. Breakdown of fiscal targets between entities
4. Conclusion

# Key objectives and principles of the new framework according to the European Commission

- **Key objectives:**
  - strengthen debt sustainability
  - promote sustainable and inclusive growth

- **Key principles:**
  - stronger national ownership
  - simpler and more transparent rules
  - more gradual fiscal adjustment in case of structural reforms and more investment
  - better enforcement and common safeguards

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Source: EC.

# Main components of the new EU fiscal governance framework

- New fiscal framework in force since April 30, 2024
- Main elements that will be discussed:
  1. The legal context
  2. The new European fiscal calendar
  3. Fiscal rules for deficit and debt
  4. Net expenditure indicator as the single operational indicator



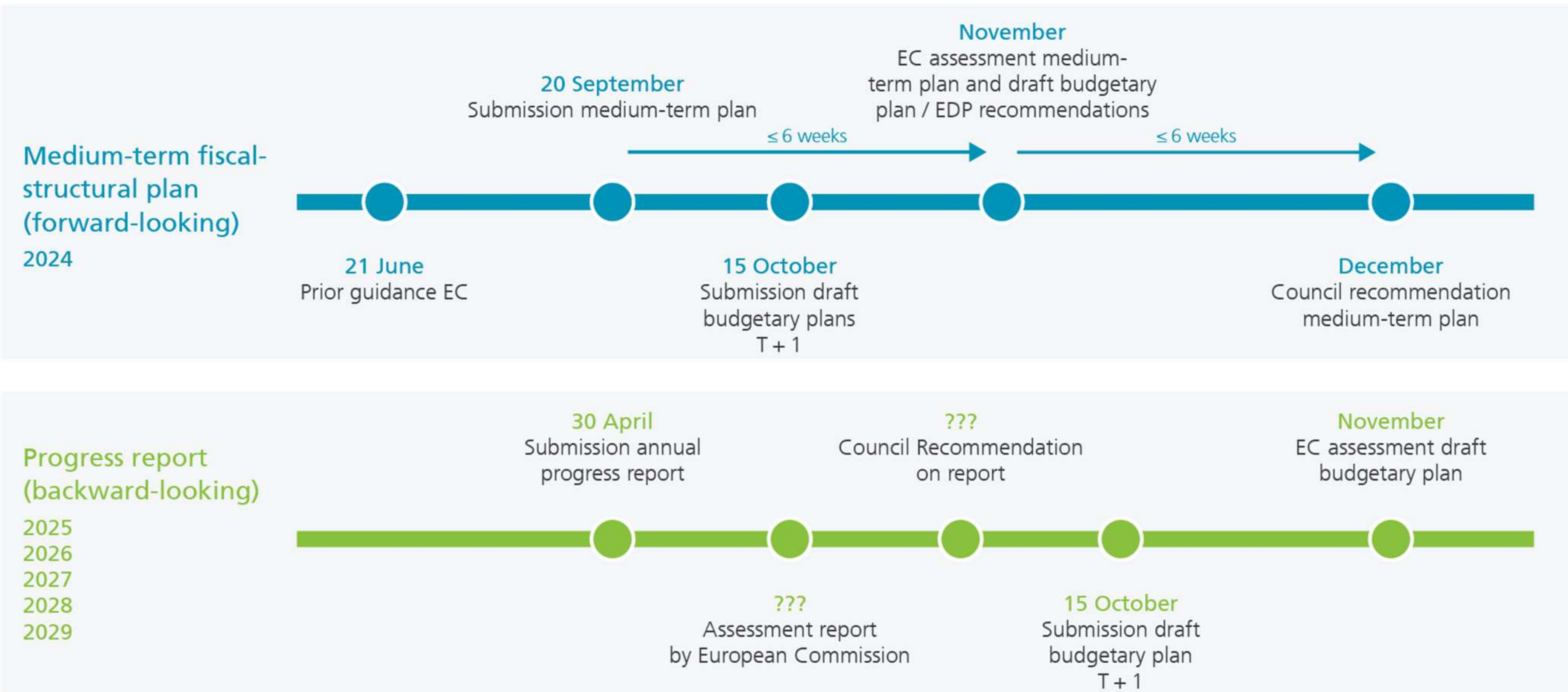
Sources: EC, NBB.

# Only certain aspects of the European fiscal framework changed

| Amendment procedure | | Key aspects |
|---|---|---|
| | Soft law | Stability and Growth Pact Code of Conduct / Vade Mecum / Commission Communications / Opinions |
| **Council Regulation (2024/1263)**<br>**Council Regulation (2024/1264)**<br>**Council Directive (2024/1265)** | Legislation | **Stability and Growth Pact preventive arm**<br>**Stability and Growth Pact corrective arm**<br>**National budgetary frameworks** |
| **Amend international agreement** | Fiscal Compact | **Budget in balance or surplus, reduction debt 1/20th year**<br>(basis for cooperation agreement of December 2013) |
| **Special amendment procedure** | Protocol No 12 | **Specifies 3% and 60% reference values** |
| **Treaty revision procedure** | Treaty on Functioning of the EU (Article 126) | **Obligation to avoid excessive deficits:**<br>keep below reference values |

Sources: ECB, Nguyen.

# Medium-term fiscal structural plans at centre new fiscal framework




Sources: EC, NBB.

# The main requirements of the new European fiscal rules

| Preventive arm | ⇄ | Corrective arm |
|---|---|---|

a) Deficit > 3% GDP or debt > 60% GDP: **EC reference trajectory:**

| | | | |
|---|---|---|---|
| **Government deficit** | (1) brought below 3% of GDP over the 4-7 year adjustment period and maintained over next 10 years<br>(2) margin of 1.5 ppt GDP in structural terms to 3% of GDP (deficit resilience safeguard) | **Deficit-based** | • deficit > 3% GDP<br>• corrective path = reference trajectory with minimum improvement structural balance of 0.5 ppt of GDP |
| **Government debt ratio** | (3) plausibly downward path by end 4-7 year adjustment period and maintained over next 10 years<br>(4) decrease by minimum annual average of 1 ppt of GDP (if debt >90% GDP) over 4-7 year adjustment period (debt sustainability safeguard) | **Debt-based** | • debt > 60% of GDP AND budgetary position is not close to balance or in surplus AND significant deviation from reference trajectory<br>• corrective path = reference trajectory with correction for deviation from it |

b) Deficit ≤ 3% GDP and debt ≤ 60% GDP: EC technical information provided on request

Sources: EC, NBB.

# Annual expenditure growth norm is the single operational indicator

- Deficit norm T+4(7) ⇨ Required change structural primary balance ⇨ Net primary expenditure growth

$$\text{nominal net primary expenditure growth} =$$

$$\text{nominal potential GDP growth} - \frac{\text{required change structural primary balance}}{\text{net primary expenditure}/\text{GDP}}$$

- Net primary expenditure = total government expenditure minus
  - interest expenditure
  - discretionary revenue measures
  - expenditure on European Union programmes fully matched by European Union funds revenue
  - national expenditure on co-financing of European Union programmes
  - cyclical unemployment expenditure
  - one-offs

  ⇒ Measure of spending under direct control of government

- The nominal expenditure norm is <u>frozen</u> over the adjustment period

  ⇒ Potential <u>economic feedback effects</u> from fiscal consolidation do not affect compliance with rules



Sources: EC, NBB.

# The expenditure benchmark relies on important hypotheses

$$\text{nominal net primary expenditure growth} = \text{nominal potential GDP growth} - \frac{\text{required change structural primary balance}}{\text{net primary expenditure}/\text{GDP}} - \frac{(\text{nominal potential GDP growth} - \text{revenue growth})}{\text{net primary expenditure}/\text{Revenue}} \rightarrow = 0$$

- Nominal potential GDP growth depends on **projections of GDP-deflator growth**

  ⇒ If actual GDP-deflator growth is smaller than projected, the expenditure benchmark will be less strict than the required change in the structural primary balance

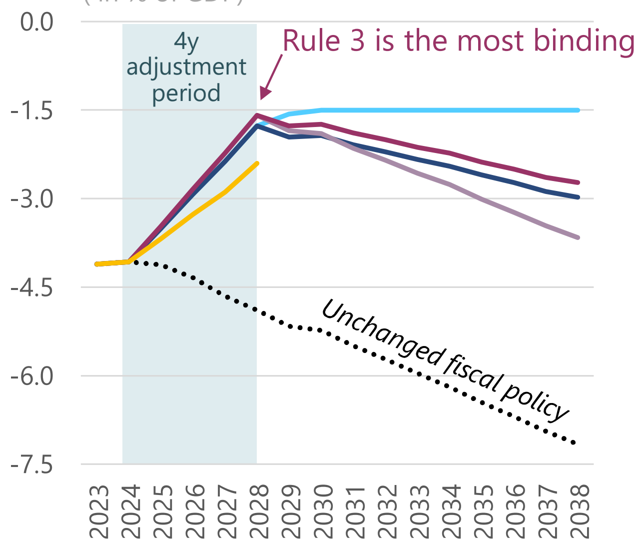
- The formula assumes that structural revenue growth = nominal potential GDP growth

  ⇒ If revenue grows structurally slower than nominal potential GDP, the expenditure benchmark will be less strict than the required change in the structural primary balance

# Applying the new rules to Belgian public finances

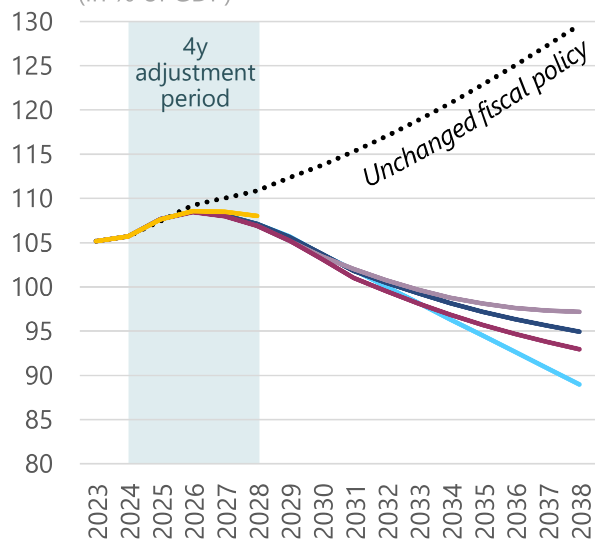
## Structural balance targets according to the 4 rules

( in % of GDP)




## Public debt ratio under the 4 rules

(in % of GDP)




- Rule 1: deficit below 3%
- Rule 2: deficit safeguard of 1.5%
- Rule 3: debt plausibly downward
- Rule 4: debt safeguard (applied when EDP is abrogated)
- Minimum requirement in deficit-based EDP

| | | No fiscal policy change | 1 | 2 | 3 | 4 |
|---|---|---|---|---|---|---|
| ***Structural balance (% of GDP)*** | ***Level in 2028*** | -4.90 | -1.80 | -1.80 | -1.60 | -1.60 |
| 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 (%) | | 3.40 | 2.10 | 2.10 | 2.00 | 2.00 |

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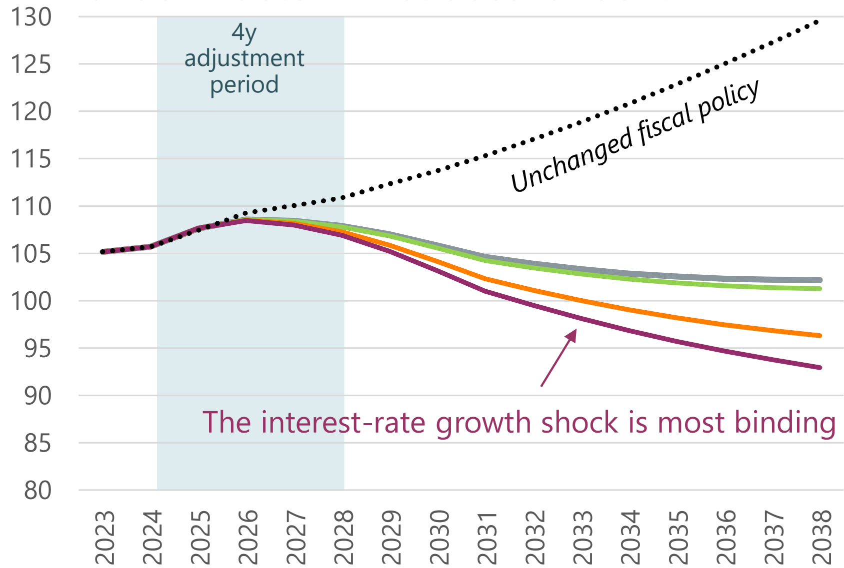
Sources: EC, FPB, NBB.

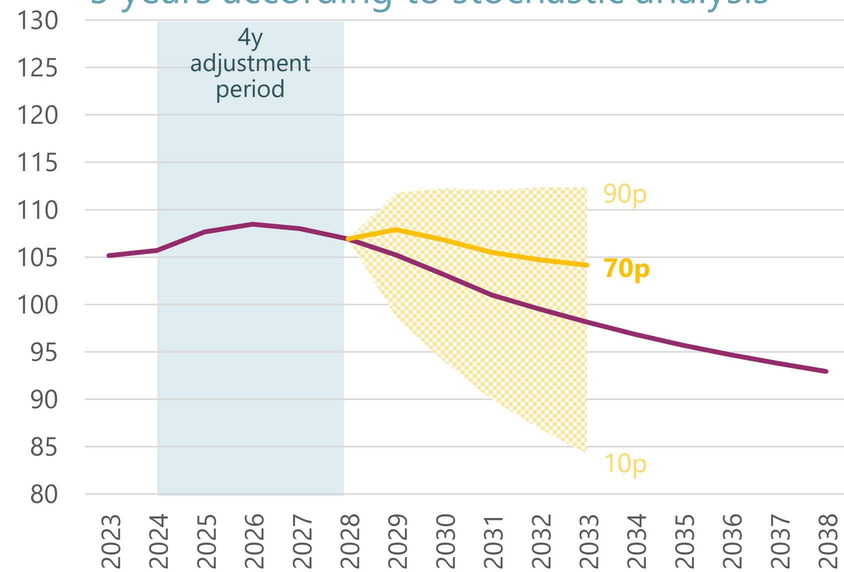
# Rule 3 ‘debt plausibly downward’ is defined by the debt sustainability analysis

(in % of GDP)

The debt ratio declines over 10 years under 4 deterministic scenario’s …



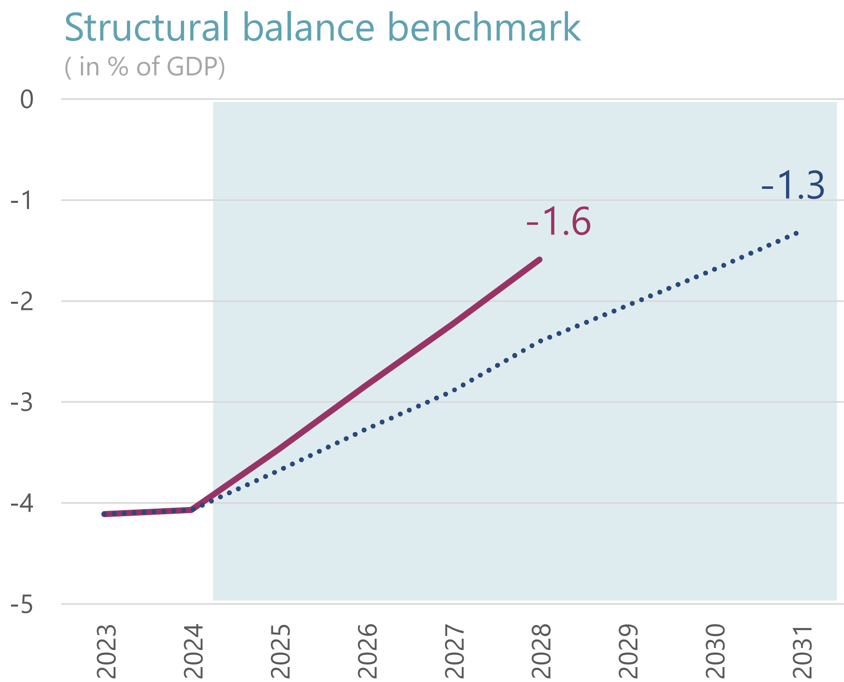

… and stabilizes with 70% probability over 5 years according to stochastic analysis

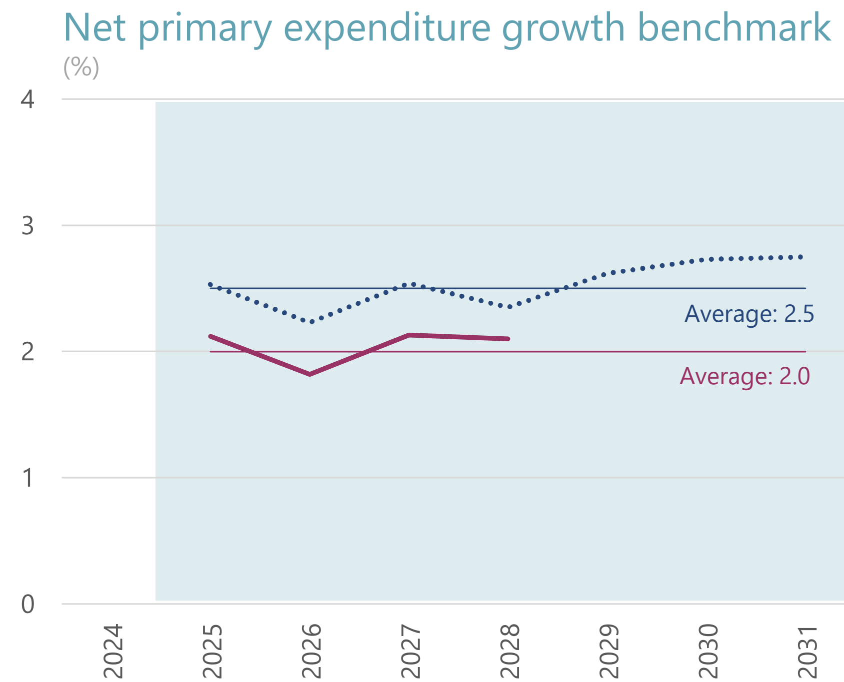



| | Annual average improvement in structural primary balance over adjustment period (in ppt of GDP) |
|---|---|
| Debt declines … | 0.51 |
| … when interest rates + 100 bp + risk premium in 2029 | 0.53 |
| … when structural primary balance deteriorates by 0.5 ppt of GDP over 2029 – 2038 | 0.64 |
| …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

Sources: EC, FPB, NBB.

# Extending the adjustment period from 4 to 7 years is tempting, but conditional on structural reforms and investment




| | | |
|---|---|---|
| 4y adjustment period | 0.71 | Annual average improvement in structural primary balance over adjustment period (in ppt of GDP) |
| 7y adjustment period | 0.47 | |

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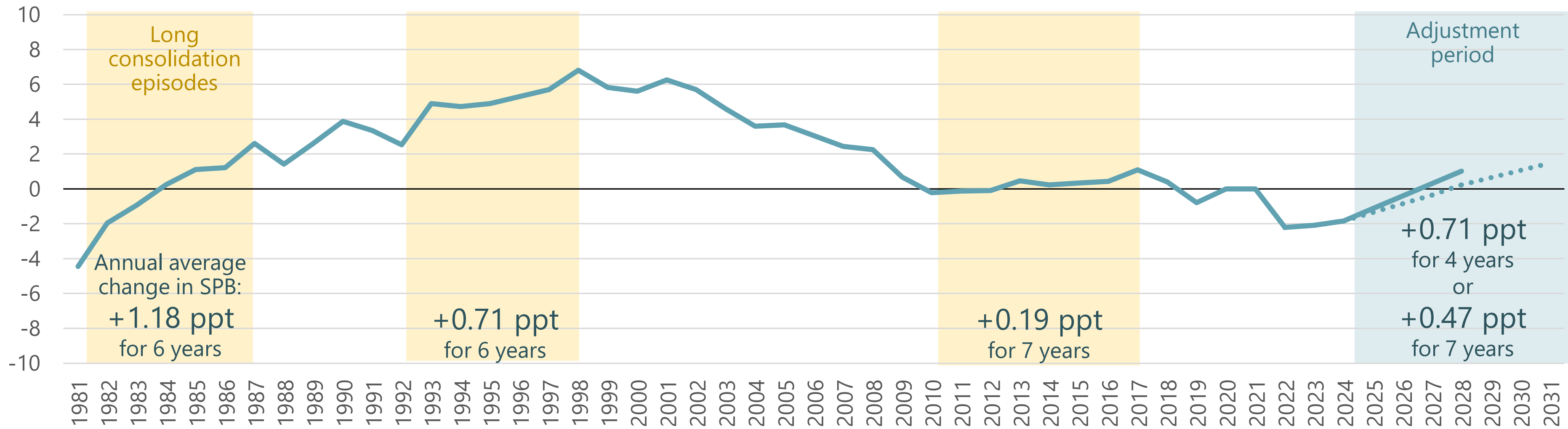
Sources: EC, FPB, NBB.

# The required structural improvement is considerable

Structural primary balance

(% GDP)

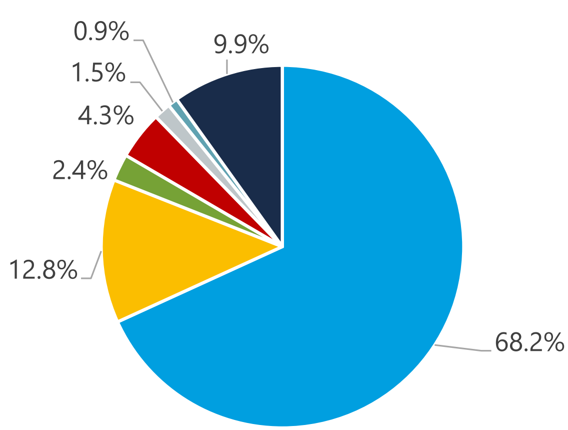



| | 1982-1987 | 1993-1998 | 2011-2017 | 2025-2028/2031 |
|---|---|---|---|---|
| in % of GDP, one year before start of period | | | | |
| **Revenue** | 46.1 | 46.1 ↑ | 49.8 ↑ | 50.8 |
| **Primary expenditure** | 53.2 ↓ | 43.2 | 50.3 ↓ | 53.1 |
| in ppt of GDP, change over period | | | | |
| Ageing costs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

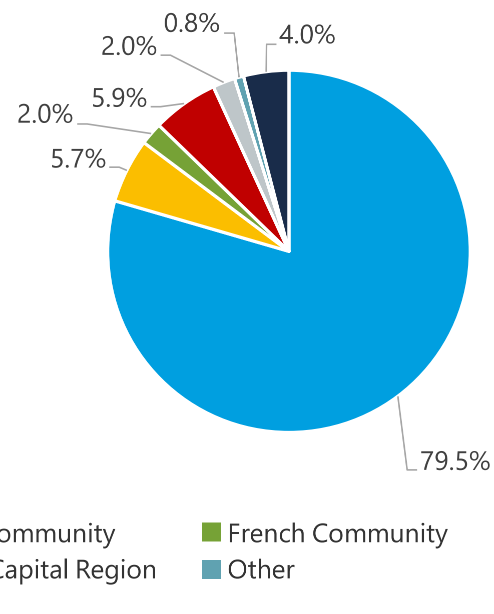
NBB, SCA.

# The allocation key to distribute the structural balance target must safeguard debt sustainability of each individual entity

## Allocation key High Council of Finance: share in final expenditure + own revenue
(2016)



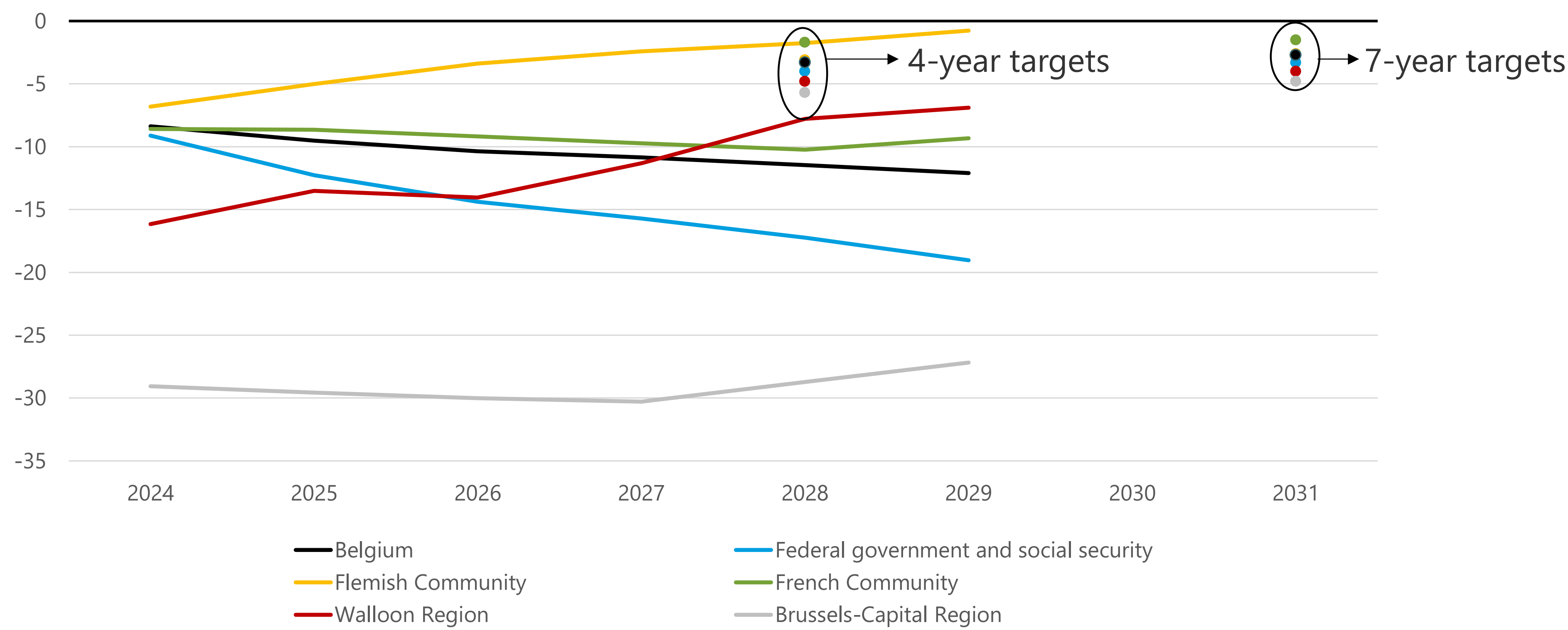

## p.m. Actual debt allocation
(2023)




Sources: HCF, NAI, NBB.

# Substantial efforts are needed to reach the 4- or 7-year targets

(structural balance[1], in % of disposable revenue[2])



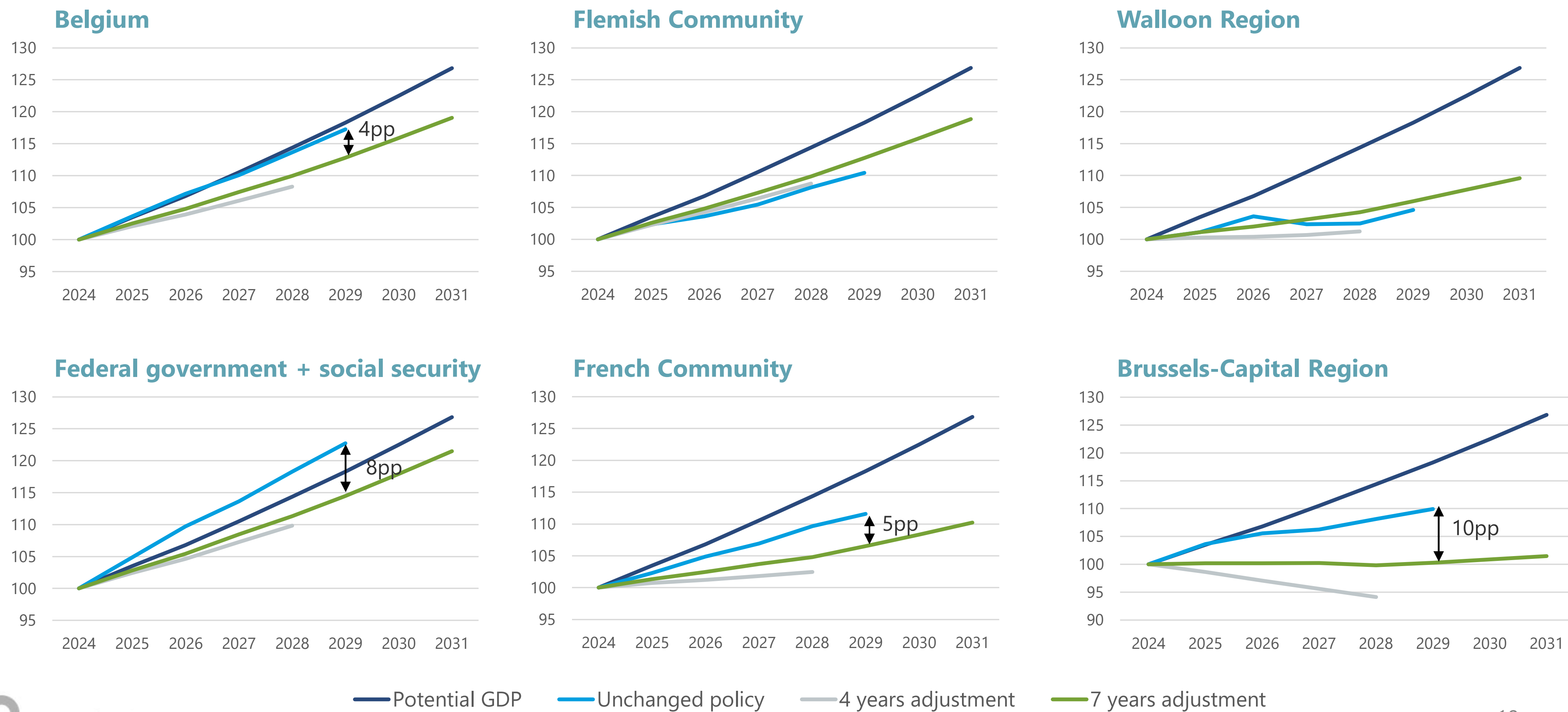

Sources: EC, FPB, HCF, NBB.

[1] The lines represent trajectories with unchanged policy. Note that the structural deficit theoretically 'allocated' to the local authorities is added to that allocated to their respective supervisory authorities (i.e. the three regions and the German-speaking Community).

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

# Expenditures must grow much slower to meet the benchmark

(level final primary expenditure, index 2024=100)




Sources: EC, FPB, HCF, NBB.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# Conclusion (1)

- **New European budgetary framework:**
  - Strengthen debt sustainability? → Yes: there is again a budgetary framework
  - Stronger national ownership?
    - Yes: country-specific trajectory ~ DSA + countries submit own Medium Term Fiscal Structural Plan
    - No: safeguards
  - Simpler and more transparent rules?
    - No: rules extremely complex + DSA based on uncertain and sometimes arbitrary hypotheses + how to deal with inflation revisions?
    - Yes: the single operational indicator (expenditure growth norm) is under control of governments
  - More gradual fiscal adjustment in case of structural reforms and more investment?
    - Yes: extension from 4 to 7 years in case of reforms and investment
    - ?: risk of arbitrariness and discretion
  - Stricter implementation?
    - Yes: debt based EDP depends on compliance with reference trajectory ~ control account
    - Yes: multiannual plans fixed for legislative term-> 'bygones' are no longer 'bygones'
    - ???: regarding implementation, 'the proof of the pudding is in the eating'

# Conclusion (2)

- **Implications for Belgium as a whole:**
  - A priori, the new framework is not more demanding than the previous one (MTO=0, $\Delta$SB=0,6), although the challenges remain huge for a long time
  - But implementation probably stricter: fixed 'medium-term fiscal structural plan', control account,…
  - Belgium's trajectory determined by:
    - Pre-financing of ageing costs and interest payments, according to EC projections
    - (arbitrary) Choice of deterministic scenario's in DSA

- **Distribution of consolidation effort within Belgium:**
  - The distribution of the effort shows the enormous challenges at all government levels
  - Belgium needs an internal Stability and Growth Pact with:
    - Binding budgetary rules, enforced by an independent body
    - Multiannual budgets with frozen targets over the legislation period
    - Spending rules at the level of each individual entity
    - A stronger Independent Fiscal Institution

# Appendix

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# Ex post evaluation plan by the EC under the new framework

- Each year assessment annual **progress report** with focus on implementation net expenditure path, reforms and investments

- **Control account** to keep track of deviations from the endorsed net expenditure path:
  - debit when actual net expenditure is above the net expenditure path set by the Council
  - credit when actual net expenditure is below the net expenditure path set by the Council
  - cumulated balance control account is sum of yearly debits and credits expressed in % GDP
  - information in the control account used to start debt-based excessive deficit procedure
    - maximum tolerated deviation from net expenditure path set by Council:
      - annual threshold: 0.3 ppt of GDP
      - cumulative threshold: 0.6 ppt of GDP
  - reset after endorsement of new plan

- **Possible sanctions** under EDP: maximum 0.05% of GDP per six months period

Sources: EC, NBB.

# Principles for allocating the structural balance within Belgium

Distributing debt norm ➡ Distributing balance norm ➡ Distributing expenditure norm

- Determining/distributing a balance norm is equivalent to determining/distributing a debt benchmark at infinity:
  - $balance \approx -\, debt_{\infty} \,.\, nom\_gdp\_growth$
  - e.g. -1.8 % GDP ≈ -60 % GDP . 3%

➔ **the determination of the key for distributing the balance depends on the desired distribution of the debt ratio among the various sub-entities!**

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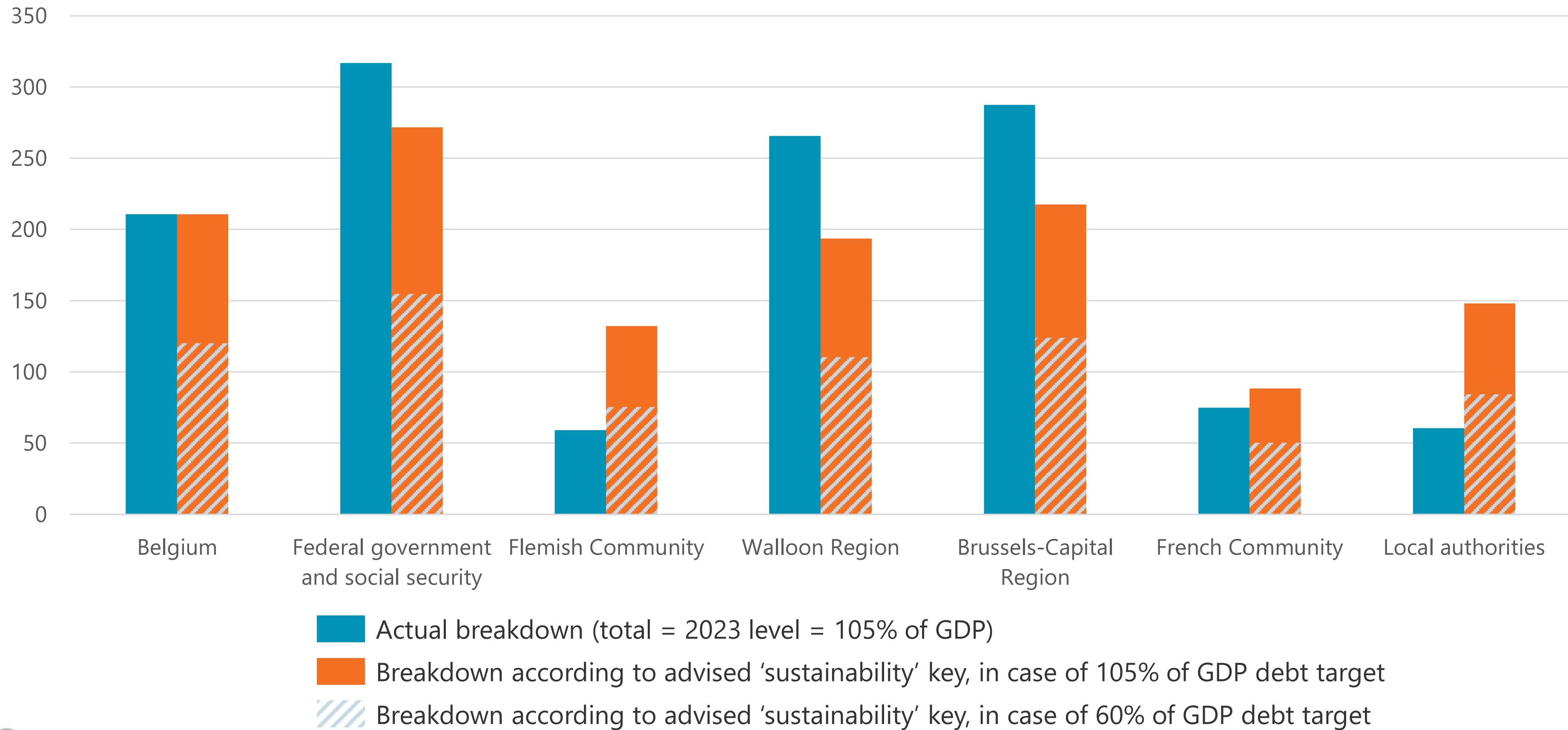
# Actual and proposed breakdown of gross public debt

(gross public debt, as a % of disposable revenue[1] of each entity)




Sources: HCF, NAI, NBB.

[1] Disposable revenue is total revenue corrected for transfers paid to other government entities (i.e. revenue available to implement policies).

# Deficit targets at 4 / 7 years compared to unchanged policy

(€ billion)

| | Starting point 2024 | Target (4-year) 2028 | *No policy change 2028* | Target (7-year) 2029 | *No policy change 2029* | Target (7-year) 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.