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DOCUMENT

FEB Position

Evaluation of the Belgian National Reform Programme

Executive Summary

In view of the ambitious objectives of the European initiatives on greater economic governance, Belgium's National Reform Programme is a disappointment. While the objectives pertaining to the Europe 2020 strategy are sufficiently ambitious, the National Reform Programme makes no mention of how to achieve them. Four major weaknesses need to be highlighted:

1. Labour costs are rising too fast. The system of automatic wage indexation needs to be reformed.
2. The labour market is one of Belgium's major weaknesses. Reforms are urgently needed.
3. Public finances are under control in the short term. Major reforms are needed to finance rising ageing costs.
4. Coordination between federal and regional policymaking needs to be reinforced.

To avoid a situation where the European initiatives begin losing momentum right from the outset, the European Commission should be sufficiently stringent in its recommendations. ■

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Like all other Member States, Belgium sent its National Reform Programme to the European Commission in April. Generally speaking, it can be said that **the Belgian objectives linked to the Europe 2020 strategy are sufficiently ambitious, but that there is no clarity at all on how they will be achieved.** Moreover, the fact that we still have a caretaker government and that the dialogue between the federal and regional governments is not always smooth adds to the uncertainty about how we will be able to respond successfully to such challenges as globalisation, the ageing of the population and the fight against climate change.

It is clear that, so far, Belgium does not have a short-term problem. With the economy expected to grow by 2.2% in 2011 and the budget deficit expected to fall to 3.6% of GDP, it is clear that the caretaker government has everything under control for the time being. **Under the surface, however, several challenges are emerging.** If we are not able to respond to these challenges, future economic growth and employment will be hampered. At that point, it will also become very difficult to maintain our way of life in view of the ageing population:

1. Labour costs are rising too fast. The system of automatic wage indexation needs to be reformed.

Under the Belgian Competitiveness Act (1996), Belgian wages cannot increase faster than those of our three neighbouring countries (Germany, France and the Netherlands). This objective was being achieved until 2005, but since then **Belgian wages have started to grow faster.** According to the Federal Planning Bureau, this labour cost difference was 4.1% in 2010.

As a result, representatives of the Belgian social partners signed a moderate wage agreement for 2011-2012. The agreement states that in 2011, Belgian wages can increase only as a result of automatic wage indexation. In 2012, there will be room for real wage increases, but they cannot exceed 0.3%. The agreement also states that a study into automatic wage indexation will be carried out in order to reduce the negative side effects of this measure. Based on the figures available at the time the agreement was concluded, Belgian wages are expected to grow by 4.2% over the next two years (3.9% indexation + 0.3% real wage growth). With such an outcome, it had to be possible to reduce the labour cost difference compared to our three neighbouring countries for the first time in six years.

Unfortunately, two of the three trade unions were unable to accept the wage agreement. As a result, the caretaker government needed to take matters into its own hands. First of all, it confirmed that wages could only increase by 0.3% in real terms in 2012. Secondly, it decided not to commission a study by the Central Bank or the Federal Planning Bureau about how to reform automatic wage indexation.



A few months after the government's decision it is already clear that, due to higher than expected prices for oil and raw materials, automatic wage indexation will have a much bigger impact than the 3.9% mentioned above. According to the Federal Planning Bureau, automatic indexation is now expected to increase Belgian wages over the next two years by 5.5%! As a result, Belgian wages will - for the fourth consecutive wage bargaining round - increase 1% faster than those in our three neighbouring countries.

Obviously, this is not sustainable. Unfortunately, in Belgium's National Reform Programme nothing substantial is said about how Belgian wages can be made to grow in line with those of our main trading partners. Belgium's system of automatic wage indexation is clearly one of the key elements hindering such a development. With this and the competitiveness section of the Euro Plus Pact in mind, **the European Commission should advise Belgium to conduct a study on its system of automatic wage indexation and, on that basis, to make the necessary adjustments** to the system so that Belgium's competitiveness does not deteriorate any further.

2. The labour market is one of Belgium's major weaknesses. Reforms are urgently needed.

In 2010, Belgium's employment rate was 67.6%. The National Reform Programme suggests a target of 73.2% to be achieved by 2020. This is clearly an ambitious target. According to the Federal Planning Bureau, without any new measures Belgium will not even reach 70%, **meaning that an ambitious reform agenda is needed!**

These reforms need to be focused on two areas. Firstly, the percentage of people aged over 55 who are still in work needs to rise. In 2009, it was just 35.3%, giving Belgium the lowest score in the euro zone. The same goes for the effective retirement age: in Belgium it was a low 59.1 in 2010, compared to the European average of 62. The Pact between the Generations (concluded in 2005) needs to be evaluated this year. While the Euro Plus Pact advised limiting early retirement schemes and using targeted incentives to employ older workers, the National Reform Programme is completely silent on this. As a result, **the European Commission should advise Belgium to bolster the current Pact between the Generations.**

The unemployment benefits system also needs to be reformed. Belgium's structural unemployment rate remains very high, with the long-term unemployed continuing to account for a significant proportion. The measures set out in the National Reform



Programme are clearly not enough to change this, which is why the European Commission should repeat the recommendations it made in its Annual Growth Survey to get the unemployed back to work. More specifically, **Belgium should design benefits so that the unemployed are rewarded for returning to work, for instance by implementing time-limited support and linking benefits more closely to training and efforts to find a job.**

3. Public finances are under control in the short term. Major reforms are needed to finance rising ageing costs.

Belgium's public finances are clearly in a much better shape today than would have been expected one year ago. It is very likely that this year the budget deficit will be reduced to 3.6% of GDP compared to 4.1% in the previous Stability Programme. Next year, the goal is to cut the deficit to less than 3% of GDP in order to once again achieve a balanced budget by 2015. Consequently, it should be possible to keep Belgium's public debt rate below the symbolic threshold of 100% of GDP.

According to the Federal Planning Bureau, Belgium has to find an additional €17 billion in order to balance its budget. Given the fact that Belgium's tax burden is already one of the highest in the world and that over the past three years much expenditure (health care, pensions, public administration, etc.) has outpaced the average growth rate of the economy, it is clear that most of the budgetary effort will need to be made on the expenditure side. Studies by the IMF, OECD, European Commission and European Central Bank have clearly demonstrated that spending cuts have a less negative impact on economic growth and job creation than tax increases. As a result, **the European Commission should advise Belgium to find at least 80% of its €17 billion effort on the expenditure side.**

For years, Belgium has not implemented any reforms to prepare for the ageing of the population. Last year it started a National Conference on Pensions which collected all the relevant information needed to make the appropriate political decisions. Unfortunately, with the ongoing negotiations on forming a new federal government, the National Conference on Pensions is currently on hold. Nor does Belgium's National Reform Programme clarify how the pension system will be put on a more sustainable footing. Consequently, **the European Commission should, in line with the Euro Plus Pact, advise Belgium to restart the National Conference and to align the pension system with the national demographic situation, for instance by aligning the effective retirement age with life expectancy.** The growth rate of health care expenditure (on average by 3.7% per year in real terms over the past ten years) represents another key challenge in the context of the ageing of the population. In this respect, **the European Commission should recommend that the legal growth rate of 4.5% per year on top of inflation be abandoned and**



that the expansion of health care expenditure be brought back in line with what the economy can bear.

Finally, Belgium's public administration is much less efficient than in neighbouring countries. For instance, Belgium employs 4 civil servants for every 100 inhabitants, compared to 3.6 in France, 3.2 in Germany and 3 in the Netherlands. Furthermore, while our neighbouring countries have seen this ratio drop over the past 15 years, in Belgium it has continued to rise. Since many of its public servants will retire in the next ten years, **Belgium has a tremendous opportunity to improve the efficiency of its public administration and to bring the relative number of public servants more in line with the levels seen in other countries.** As a result, the European Commission should advise Belgium to implement as fast as possible a multiannual, multilevel (i.e., covering the federal, regional and local governments) plan to achieve this objective.

With these reforms it should be possible to reduce the gap between the current public debt ratio and the target of 60% of GDP by one-twentieth every year. It will also ensure that the debt ratio remains below this level subsequently, and despite the ageing of the population.

4. Coordination between federal and regional policymaking needs to be reinforced.

The European Commission's aim was for the Member States to develop a short but coherent National Reform Programme (approximately 20 pages) describing how the national targets pertaining to the Europe 2020 strategy would be achieved, how public finances would be put on a sustainable footing and how any macroeconomic imbalances would be corrected.

The difference between this objective and the Belgian National Reform Programme could not be any greater. The lack of concrete proposals concerning how to foster competitiveness, promote employment and contribute further to the sustainability of public finances has already been mentioned above. This paragraph highlights the lack of coordination between federal and regional policymaking. This can be clearly seen in the National Reform Programme: the parts of the federal and regional governments are presented separately instead of being integrated in a common medium-term strategy. The reason for this is clear: in Belgium, there is no medium-term strategy, shared by the federal and regional governments, on how to tackle the many challenges we face. And as there is no common strategy, it is also completely unclear whether federal and regional policymaking reinforce or hinder each other. As a result, **the European Commission should advise Belgium to improve**



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coordination between federal and regional policymaking so that the next National Reform Programme includes a common medium-term strategy.