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Recommendation for a

COUNCIL RECOMMENDATION

on the 2016 national reform programme of Belgium

and delivering a Council opinion on the 2016 stability programme of Belgium

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the resolutions of the European Parliament[3],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 November 2015, the Commission adopted the Annual Growth Survey[4], marking the start of the 2016 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[5], in which it identified Belgium as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area[6]. This recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016. As a country whose currency is the euro and in view of the close interlinkages between the

1 OJ L 209, 2.8.1997, p. 1.
2 COM(2016) 322 final.
3 P8_TA(2016)0058, P8_TA(2016)0059, and P8_TA(2016)0060.
4 COM(2015) 690 final.
5 COM(2015) 691 final.
6 COM(2015) 692 final.

economies of the economic and monetary union, Belgium should ensure the full and timely implementation of the recommendation.

(2) The 2016 country report for Belgium[7] was published on 26 February 2016. It assessed Belgium's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and included an in-depth review under Article 5 of Regulation (EU) No 1176/2011. On 8 March 2016, the Commission presented the results of the in-depth review.[8] The Commission's analysis leads it to conclude that Belgium is experiencing no macroeconomic imbalances. Weakened external performance combined with high public indebtedness may pose risks in the future. However, recent developments point to an improvement in competitiveness. Corrective measures – comprising wage moderation and reductions in social security contributions – have led to a slowdown in labour cost growth. Public debt is not falling, but short-term risks appear contained.

(3) On 29 April 2016, Belgium submitted its 2016 national reform programme and its 2016 stability programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking effectiveness of the European Structural and Investment Funds to sound economic governance[9].

(5) The 2016 stability programme indicates that the budgetary impact of the exceptional inflow of refugees in 2015 and 2016 and of the exceptional security measures in 2016 is significant, and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure for refugees amounted to 0.03% of GDP in 2015, while the incremental impact in 2016 is estimated at 0.17% of GDP for refugee-related expenditure and at 0.12% of GDP for security measures. The provisions defined in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 allow catering for this additional expenditure, in that the inflow of refugees as well as the severity of the terrorist threat are exceptional events, their impact on Belgium`s public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2015 has been reduced to take into account additional refugee-related costs. Regarding 2016, a final assessment, including on the eligible amounts, will be made in spring 2017 on the basis of observed data as provided by Belgian authorities.

(6) Belgium is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. On 18 May 2016, the Commission issued a report under Article 126(3) of the TFEU, as Belgium did not make sufficient

[7] SWD(2016) 71 final.
[8] COM(2016) 95 final.
[9] COM(2014) 494 final.

progress towards compliance with the debt rule in 2015. The analysis concluded that the debt criterion should be considered as complied with. In its 2016 stability programme, the government plans a gradual improvement of the headline balance from a deficit of 2.6% of GDP in 2015 to -0.2% of GDP in 2019. The revised medium-term budgetary objective, set at a balanced budgetary position in structural terms, is expected to be reached by 2018. However, the recalculated[10] structural balance still points to a structural deficit of 0.4% of GDP in 2018. According to the stability programme, the government debt-to-GDP ratio is expected to peak at 106.2% of GDP in 2016 and to decline to 99.6% by 2019. The macroeconomic scenario underpinning these budgetary projections is plausible. However, the measures needed to support the planned deficit targets from 2017 onwards have not been sufficiently specified. Based on the Commission 2016 spring forecast, there is a risk of a significant deviation from the recommended adjustment in 2016 as well as in 2016 and 2017 taken together, under unchanged policies. In case the budgetary impact of the exceptional inflow of refugees as well as of exceptional security measures was excluded from the assessment, the projected deviation in 2016 is no longer significant. Belgium is not forecast to comply with the transitional debt rule in 2016 and, following the end of the transition period, with the debt reduction benchmark in 2017. Based on its assessment of the stability programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that there is a risk that Belgium will not comply with the provisions of the Stability and Growth Pact. Therefore further measures will be needed to ensure compliance in 2016 and 2017.

(7) High public indebtedness is coupled with weak export and competitiveness performance. External performance has deteriorated since 2000, as global market share losses show, and has been aggravated by exports being oriented mainly towards less dynamic markets. While the negative trend in market shares has been halted in recent years, the accumulated losses remain substantial. Specialisation in market segments with a higher exposure to price competition also hampers the country’s export capacity. This is particularly difficult to reconcile with the country’s high labour costs. Unit labour costs have risen fast as a result of low productivity growth and, in particular, fast wage growth. The latter can be attributed to certain features of the wage-setting system. On the one hand, margins for real wage growth were repeatedly set too high. On the other hand, inflation repeatedly exceeded expectations and inflation in neighbouring countries. The structural difference in core inflation rates between Belgium and neighbouring countries is caused mainly by higher price growth for services and a suboptimal functioning of the retail market. This inflation was transmitted to wage growth through the general practice of automatic wage indexation. Together, these factors eroded the effectiveness of the highly coordinated wage-setting system. To halt the decline in competitiveness and its negative impact on export performance and employment, the Belgian authorities have intervened in the wage-setting process in recent years. Wage moderation measures have been imposed, including limits on real wage increases and the suspension of wage indexation schemes. In addition, reductions in social security contributions are being enacted. However, to ensure the durability of the correction, structural reforms of the wage-setting framework are needed in line with the Council recommendations in past years.

[10] The structural balance as recalculated by the Commission based on the information in the stability programme, following the commonly agreed methodology.

Although the government intends to revise the *Loi relative à la promotion de l'emploi et à la sauvegarde préventive de la compétitivité* (the 'Law of 1996'), which provides the basis on which social partners set the 'wage norm' every two years, little progress has been made so far. Ensuring a more formal link between wages and productivity would help lock in recent gains and prevent a recurrence of past problems.

(8) Some progress has been made on the overall functioning of the labour market. Incentives to work have been strengthened by measures to reduce the tax wedge and changes in the unemployment benefit system. However, sizeable employment differentials between specific population groups continue to result in a chronic underutilisation of labour, especially among the low-skilled, young people, older people and people with migrant backgrounds. In addition, marginal tax rates upon entering or re-entering the labour market create inactivity and low wage traps for second income earners and specific household types such as single people and single parents. It is therefore important to fine-tune and implement policies aimed at encouraging moves from inactivity or unemployment to employment. Educational inequalities linked to socio-economic background are amongst the highest in the EU and poor educational outcomes partly explain the observed underperformance of people with a migrant background or low-skilled young people. The education reforms currently being introduced are particularly designed to tackle early school leaving, early childhood care and education. They also seek to improve the quality and relevance of the vocational system. These reforms could facilitate a smoother transition towards a knowledge-intensive and increasingly service-oriented economy and alleviate skills mismatches and persistent labour shortages in certain occupations. In addition, the very low activity and employment rates of older workers call for policies to promote active ageing and to support the labour market demand for older workers. Finally, additional tax measures to facilitate the take-up of work could be warranted.

(9) There is still considerable scope for improving the non-cost dimension of external competitiveness. To safeguard and enhance current welfare levels, more emphasis should be placed on productivity gains and investment in knowledge-based capital. This requires a sustained push towards products and associated services higher up the value chain, on the basis of stronger performance in innovation and utilising the results of R&D. Despite its high-quality public research system, Belgium has relatively few fast-growing firms in innovative sectors. Furthermore, the business climate is hampered by administrative and regulatory burdens, which inhibit the creation and expansion of companies. Shareholding requirements and restrictions on voting rights, legal form and multidisciplinary activities hold back the market dynamism for business services. Operational restrictions and restrictions on where retailers can establish their premises have the same effect in the retail sector. Moreover, there are shortcomings in the efficiency of the justice system, with low penetration of information and communications technology. Together, these factors constitute significant barriers to private investment. Substandard infrastructure and lengthy bottlenecks also undermine productivity growth and investment. The transport network represents the most pressing investment gap. Belgium's geographical location, coupled with the presence of international organisations, has enabled the country to attract many distribution centres, logistics bases and the international headquarters of various companies. However, there is a growing problem of peak-hour traffic congestion, which undermines the country's attractiveness for foreign investors and has major

economic and environmental costs. Belgium is also expected to fall short of its 2020 greenhouse gas emission reduction target and suffers from serious air pollution problems. Given the high concentration of economic activity around the capital and the ports, the most urgent challenges are upgrading basic rail and road transport infrastructure and eliminating missing links between the main economic hubs. At the same time, it is important to tackle peak hour congestion by improving public transport services, optimising traffic management and eliminating market distortions and adverse tax incentives, such as favourable treatment for company cars.

(10) Another challenge relates to the adequacy of domestic power generation and the security of supply in general. Hampered by repeated interruptions, Belgium's ageing nuclear installations have become unreliable sources, while the repeatedly revised timetable for phasing out the nuclear park has created a climate that is not conducive to long-term investment decisions. This is reflected in higher imports and increasingly impaired security of supply. Although short-term supply risks have abated, longer-term investment needs are still considerable. In addition to substantial new domestic production capacity and a further increase in interconnections, smart grids are needed to develop demand-side management. Given the considerable lead time for large projects in the energy sector and the high need for replacement capacity over the next decade, swift action will be required, in particular in the form of a suitable legal framework that promotes the increase in generation capacity.

(11) Belgium has made some progress in reforming the tax system, notably by shifting taxes from labour to other tax bases, which will gradually reduce the tax wedge on labour. Reductions in personal income taxation and employers' social security contributions will also help narrow the gap. Nevertheless, the tax system remains complex, with tax bases eroded by specific exemptions, deductions and reduced rates. Some of these involve revenue losses, economic distortions, and a heavy administrative burden. In addition, the tax shift does not seem to be neutral from a budgetary point of view. There is still considerable scope for improving the design of the tax system by further broadening tax bases, allowing for both lower statutory rates and fewer distortions. There is also considerable potential for a 'green' tax shift which stems from, among other things, the favourable tax treatment of company cars and fuel cards, which contribute to pollution, congestion and greenhouse gas emissions.

(12) In recent years, Belgium has made important progress in reforming its pension system. The law of 10 August 2015 on the rise in pensionable age, the conditions for early pensions and the minimum age for survivors' pensions establishes a new minimum age and career length criteria for ordinary pensions. However, even after the recent reforms, the projected increase in the pension expenditure ratio remains substantial. An automatic link to changes in life expectancy, as recommended in the past, would reduce medium and long term sustainability risks. In this respect, the governement has announced its intention to introduce a credit-based pension system, which could allow for automatic adjustment mechanisms in response to demographic developments. These issues will continue to be monitored closely under the European Semester.

(13) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Belgium's economic policy and published it in the 2016 country report. It has also assessed the stability programme and the national

reform programme and the follow-up given to the recommendations addressed to Belgium in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Belgium but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance of by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations 1 to 3 below.

(14) In the light of this assessment, the Council has examined the stability programme, and its opinion[11] is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that Belgium take action in 2016 and 2017 to:

1. Achieve an annual fiscal adjustment of at least 0.6% of GDP towards the medium-term budgetary objective in 2016 and in 2017. Use windfall gains to accelerate the reduction of the general government debt ratio. Agree on an enforceable distribution of fiscal targets among all government levels. Simplify the tax system and remove distortive tax expenditures.

2. Carry out the intended review of the 'Law of 1996' on competitiveness and employment in consultation with the social partners. Ensure that wages can evolve in line with productivity. Ensure the effectiveness of labour market activation policies. Move forward with education and vocational training reforms and provide training support, notably for people from a migrant background.

3. Boost the capacity to innovate, notably by fostering investment in knowledge-based capital. Increase competition in the business services sector and the retail sector by removing unwarranted operational and establishment restrictions. Address shortfalls in investment in transport infrastructure and energy generation capacity.

Done at Brussels,

For the Council
The President

[11] Under Article 5(2) of Council Regulation (EC) No 1466/97.