

Executive summary

Belgium weathered the crisis well with a relatively modest rise in unemployment. Subsequently, the economy has been recovering faster than the euro area and the fiscal deficit is falling rapidly. Nevertheless, Belgium is at a crossroads with public debt at 97% of GDP, and a renewed and sustained effort to pre-fund ageing costs is needed, including revisiting intergovernmental pre-funding agreements. To boost subdued potential growth, measures to substantially increase employment are required while greener growth should be secured through more extensive use of environmental taxation.

- **Fiscal policy should focus on implementing a credible pre-funding strategy.** The 2011 Stability Programme aims at a fiscal consolidation of at least $\frac{3}{4}$ per cent of GDP per year, securing a small surplus by 2015. This is an important step towards securing fiscal sustainability, but achieving it requires well designed plans for spending restraint and better control of ageing-related cost increases (entailing reforms of social security). The political commitment to achieve these goals could be buttressed by a stronger fiscal framework including spending rules, multi-annual budgeting and a larger role for independent analysis and assessments. Importantly, any reform of the fiscal federalism arrangements should also focus on the burden-sharing of fiscal consolidation.
- **The relatively good labour market performance has not resolved deep-rooted structural problems.** Labour hoarding, facilitated by intensive use of reduced working hour schemes, and targeted measures have supported employment. Nonetheless, labour market segmentation has deepened as the increase in unemployment mostly affected workers with weak labour market attachment. Making the labour market more inclusive necessitates broad reforms. Younger people should be able to combine work and studies, and the special youth minimum wage should be increased more gradually. Better integration of immigrants requires better language training and adapting education to their needs, such as later streaming. More generally, employment creation would benefit from linking wage growth to domestic productivity developments. Higher participation can be secured by reducing high effective marginal tax rates and closing exit routes to early retirement to boost the effective retirement age.
- **The economy is energy and emission intensive,** making energy policies the keys to greener growth. Environmental taxation, particularly low in Belgium, should be the main tool to deal with these issues. The EU emission trading scheme addresses emissions in electricity generation and industry, but emissions from transport and housing should be reduced through a well-designed CO₂ tax. In addition, negative transport externalities should be addressed by fuel taxation, road pricing and congestion charges, while measures promoting commuting and company cars should be scaled down. Furthermore, measures to improve thermal efficiency of housing should be refocused on low-income households. In general, there is a need for reviewing the division of environmental responsibilities to reduce the costs of lack of co-ordination and harmonisation of policies. In particular, renewable energy would be better promoted by merging the green certificate markets. Water policies would also be more efficient if organised by river basins and not by regions, and by better internalising pollution costs in water charges.



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