Mr. President
Mr. European Commissioners

Dear Mr. Juncker
Dear Mr. Moscovici,
Dear Mr. Dombrovskis

Friday, 21th November 2014

It is no exaggeration to say that the ongoing economic recovery is timid and tentative. But we agreed long ago at the European level that we have to look beyond the short term and give priority to laying the foundations for sustained economic growth. This is the rationale behind the introduction of the European semester a couple of years ago. The economic part of the Semester is built on two main pillars: sound public finances and structural reforms.

The strategy of the new Belgian government is to achieve both, since in the medium term they are mutually reinforcing and the only credible way towards a sustained reduction of unemployment and sustainability of our welfare.

The new federal government is acutely aware that budgetary efforts without strong structural reforms provoke a very real risk that at the end of the day no new sustained economic growth will emerge on the horizon, while at the same time endangering the budgetary consolidation.

It is for this reason that the new government, while respecting sound public finances, has decided to strongly intensify structural reforms. As the Commission is well aware, the main reference point of these economic reforms are the ones contained in the specific country recommendations which are adopted within the framework of the European Semester. The most recent ones were adopted in the spring of this year.

The Belgian government is in a position to inform you that as part of the so called "government policy agreement" and the recent draft budget, the federal government has laid out in sufficient detail the content, scope and time frame for the implementation of these economic reforms tied to the European Semester recommendations.

It would not be feasible to enumerate all the decisions. Therefore the government confines itself to a concise enumeration of the main relevant country specific recommendations to Belgium in the framework of the European Semester and the main measures and decisions of the Belgian authorities to implement them.

The first relevant recommendation invites the Belgian authorities to "improve the balance and fairness of the overall tax system and prepare a comprehensive tax reform that will allow shifting taxes away from labour towards more growth friendly bases". The federal government has already taken measures "to make work pay", contained in the 2015 budget. In this respect the so called lump sum allowance for professional expenses has been raised considerably. The federal government will take consistent measures in order to finance the funds needed to lower the taxes on labor. For example, a whole series of tax deductabilities will not be adjusted for inflation during the present governing period. Furthermore, loopholes are being closed, such as making the corporate income tax applicable to intermunicipal entities. We apply new rules like more restrictive VAT regimes to certain activities such as certain medical services, building renovations and electronic services and a tax on off-shore constructions to broaden the taxable base of the VAT and withholding tax. The government will in this legislature assess how a further tax shift can be engineered.

The second relevant recommendation invites the Belgian government to "contain future public expenditure growth related to ageing, in particular from pensions and long-term care…". The government policy agreement mentioned above foresees several concrete measures in this respect. The legal retirement age will be raised from 65 to 67 years, early retirement is being made considerably more difficult, the minimum age for several pension categories (such as surviving spouse pensions) is being raised. Especially for public pensions certain equivalence periods and pension bonuses are being curtailed. Even more strategically, it has been decided that the general pension system will evolve towards a system that is more explicitly tied to life expectancy.

The third relevant recommendation invites the Belgian authorities to "increase labour market participation, notably by reducing financial disincentives to work, increasing labour market access for disadvantaged groups such as the young and the people with a migrant background, improving professional mobility and addressing skills and shortages and mismatches as well as early school leaving". One should remark that in this area that the measures mentioned above "to make work pay" are the main contribution (and probably the most powerful one) to increase labour market participation. But in addition to this, the Regions and Communities have recently taken important steps to strengthen active labour market possibilities and improve general education and skills, especially for specific groups. In this context long term employed will provide two half days per week community services, to be framed in the context of a reintegration path into the labour market.

The fourth relevant recommendation invites Belgium foremost to "restore competitiveness by continuing to reform the wage-setting system, including wage indexation…". In this respect it has been decided that the normal inflation adjustment of wages, foreseen in 2015, will be cancelled. To protect and increase the purchasing power without raising labour costs, the government raised the lump sum allowance for professional expenses with a focus on low and middle-high wage. The above mentioned government policy agreement document foresees that wages will be moderated in 2016 as well until competitiveness (mainly vis à vis our three main trading partners) is restored. In this respect the Competitiveness Law will be adapted to give it more bite and make it more *operational to claw back temporary competitiveness losses. Also the government will further reduce employers social contribution to reach a target of 25% before the end of the legislature.*

The European semester recommendation also provides "strengthening competition in retail sectors, removing excessive restrictions in services and addressing the risk of further rises of energy distribution costs". The fact of the matter is that competition in the retail sector is already strengthening considerably by new entrants and the restructuring of existing chains. The Ministry of the Economy and the Competition council are monitoring the implementation of the European services directives. In some sectors and subsectors, this has already led to a fierce increase of competition from non-Belgian firms. As far as energy distribution costs are concerned: one has to admit that the risk of higher costs is indeed very real. These distribution costs have in the meantime largely become a regional competence and the regions are well aware of the impact. However this has to be seen in the broader perspective of environmental and energy security objectives.

The recommendation also mentions "promoting innovation through streamlined incentive schemes and reduced administrative barriers". These innovation schemes are now mainly pursued by the Regions, which means that overlapping with the federal level has been sharply reduced. At the same time the government policy agreement foresees a considerable reduction of administrative charges for the corporate sector, especially SMEs. At the same time there will be more regulatory stability, a simplification of tax and social security regulation and making electronic invoicing the norm.

As we mentioned above, the aim of this letter is to demonstrate that structural reforms in accordance with the country specific recommendations are not loose ideas but decisions that are as yet concrete enough to give their follow-up maximum plausibility. Action is already very much reflected in the 2015 draft budget. The government will continue to pursue the essential elements of its reforms. It is as yet not possible to attach a detailed time table to each of the measures, because they are very numerous and because the new government has had up till now to focus on the 2015 budget.

All this being said about structural reforms, Belgium confirms that it also wants to respect the Stability and Growth Pact, which is to be considered the second economic pillar of the European Semester. Our country wants to achieve a balanced structural budget by 2018, while at the same time frontloading the fiscal efforts. Our budget is based on a reduction of the structural deficit by 0,7 % of GDP in 2015 (with decisions detailed) and a further reduction by 0,6 % by 2016. It is important to know that more than 2/3th of these efforts are achieved on the expenditure side, thereby improving the quality of fiscal adjustment. If we, based on the Autumn Forecast, compare the improvement of the structural deficit in 2015 vis-à-vis our European partners, it shows we are among the best performing countries. This clearly demonstrates the engagement of the new federal government to cope decisively with the problem of the structural budget deficit and to make public finances healthy.

It has to be recognized that all this is being pursued during a period of very low nominal and real GDP-growth, not only in Belgium but throughout the whole euro area. This creates considerable headwinds for fiscal adjustment (especially for respecting the debt criterion).This even apart from unforeseeable methodological statistical revisions which have emerged at a moment when budgets are drafted, making in the process the whole exercise even more onerous and making retro-active adjustment realistically speaking impossible and in our eyes undesirable. Moreover we all know from experience, it is not excluded that structural reforms can have costs in the short term. We shall provide you with an overall assessment of the impact of the reforms on the main budgetary parameters by the end of next January 2015.

At the end of the day we trust that the Commission in its overall judgment will accept that our policy is, in the given circumstances, a sensible and sound mix of structural adjustment and fiscal consolidation. The Belgian government is fully committed to putting its fiscal and structural reform strategy into practice. We hope that the Commission will allow us the necessary serenity to be able to focus entirely on the implementation of its strategy.

Yours sincerely

Charles Michel, Prime Minister

Johan van Overtveldt, Minister of Finance

Hervé Jamar, Minister of Budget