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# Wage Indexation and International Competitiveness in Belgium: An Uneasy Coexistence

## Belgium

Andre Geis

SIP/2023/015

***IMF Selected Issues Papers* are prepared by IMF staff as background documentation for periodic consultations with member countries.** It is based on the information available at the time it was completed on February 10, 2023. This paper is also published separately as IMF Country Report No 23/099.

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European Department

**Wage Indexation and International Competitiveness in Belgium: An Uneasy Coexistence**
**Prepared by Andre Geis**

Authorized for distribution by Mark Horton
March 2023

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**ABSTRACT:** *Belgium is one of a small group of euro area countries that maintains indexation of wages to inflation as part of its wage setting framework. With intensified price pressures since late 2020 driving inflation to record levels, the tension between compensating workers for purchasing power losses while maintaining international competitiveness have again been highlighted. To improve the performance and viability of the current setup, several avenues of reform could be envisaged. In particular, the scope for excluding price increases in highly volatile components, like energy and food, from the indexation basis should be explored to less the need to restore competitiveness by prolonged periods of real wage restraint. Moreover, options to widen the flexibility of the indexation regime should be contemplated to alleviate the burden of firms at times of large and multiple shocks, thereby also preserving investment and employment. Finally, productivity trends should also be accounted for to capture deviations of labor costs between Belgium and its key export markets.*

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Author’s E-Mail Address: AGeis@imf.org

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Belgium

INTERNATIONAL MONETARY FUND

# BELGIUM

## SELECTED ISSUES

February 10, 2023


Approved By
**European Department**

Prepared By Andre Geis, Yu Ching Wong (both EUR) and Nate Vernon (FAD).


## CONTENTS

# WAGE INDEXATION AND INTERNATIONAL COMPETITIVENESS IN BELGIUM: AN UNEASY COEXISTENCE[1]

*Belgium is one of a small group of euro area countries that maintains indexation of wages to inflation as part of its wage-setting framework. With intensified price pressures since late 2020 driving inflation to record levels, the tension between compensating workers for purchasing power losses while maintaining international competitiveness have again been highlighted. Against this background, this paper surveys key drivers of the recent surge in inflation and outlines salient features of Belgium's wage-formation process. It then tries to identify some weaknesses and policy recommendations that strive to strike a balance between maintaining benefits of wage indexation while attenuating drawbacks for the economy.*

## A. Introduction

**1. With previous inflationary episodes having faded into the distant past, the recent reemergence of price pressures is of a historical magnitude.** By December 2022, annual headline inflation in Belgium, as measured by the HICP index, reached 10.2 percent, following a peak of 13.1 percent in October. This far surpassed a high of 5.9 percent set in 2008, as the result of a run-up of global commodity prices at that time.[2] Likewise, core inflation, which excludes products with more volatile price fluctuations, such as energy or unprocessed food, accelerated to an annual rate of 7.1 percent, indicating a much broader degree of inflationary pressures than in 2008 and putting to an end a remarkable period of price stability lasting from 2011 to 2021. In a wider euro area context, Belgium is not unique. Since end-2020, its headline inflation rate has risen by 9.9 percentage points, exceeding earlier highs in inflation, like other euro area countries. In addition, the inflation increase in Belgium has been comparable to developments in two of its three main trading partners (France, Germany, and the Netherlands)[3], with price caps maintained in France to contain the impact of the energy crisis on consumers chiefly accountable for the considerably lower rise in inflation there. At the same time, inflation in Belgium has generally stayed below surges in prices in some other small open euro area economies, such as Slovakia, Slovenia, or the Baltic countries.

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[1] Prepared by André Geis (EUR), with helpful comments and suggestions by Mark Horton (EUR) and staff of the National Bank of Belgium and the Federal Planning Bureau.

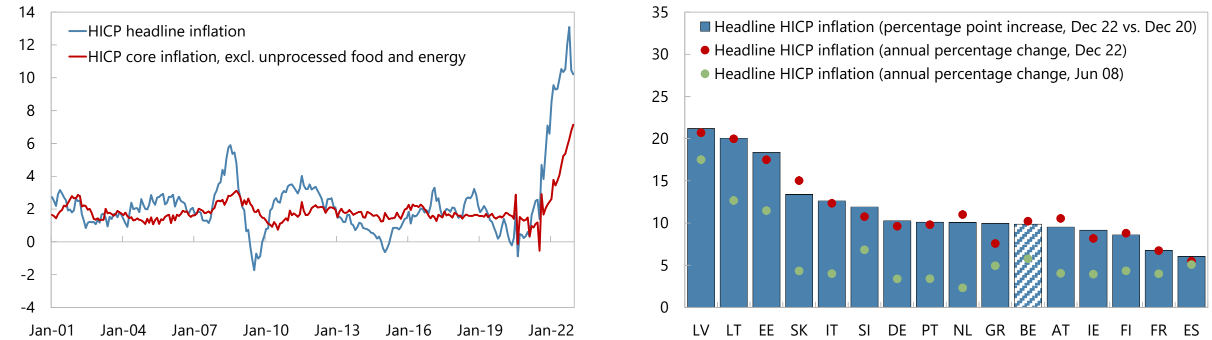
[2] Unless stated otherwise, the subsequent analysis focusses on developments in the harmonized index of consumer prices (HICP), an indicator that has been standardized across the European Union to ensure better comparability of consumer price inflation among countries. Like many other EU economies, Belgium also maintains a national consumer price index (CPI). By and large, the CPI tracks the HICP closely but does not yield identical rates of inflation in each and every month. Particularly during periods of elevated inflation, as at present, gaps can be sizeable, largely reflecting statistical differences, such as the weighting schemes employed to products that enter the consumer baskets underlying the HICP and the CPI.

[3] Based on IMF data, the three countries accounted for 45 percent of Belgium's merchandise exports in 2021, with shares of 19 percent (Germany), 14 percent (France) and 12 percent (the Netherlands).

**Belgium: Inflation Developments**

**HICP Inflation**
(Annual percentage changes)

**HICP Headline Inflation**
(Annual percentage changes, percentage points)




Sources: StatBel and IMF staff calculations.

Sources: Eurostat and IMF staff calculations.

2. **Inflation at record levels is putting the sustainability of Belgium's wage indexation system to the test by weighing on corporate and government finances.** Almost uniquely among euro area countries, the indexation of base pay to price developments is nearly universal in Belgium, applying in equal measure across firms, industries, and the public sector.[4] Wage indexation has its advantages, as it cushions the blow of higher prices on the purchasing power of consumers to a considerable extent, even if some parts of the workforce, most notably the self-employed, do not enjoy its benefits. Moreover, in the present circumstances of an energy price shock draining household demand for other goods and services, the burden of fiscal policy to compensate for the fall in purchasing power should be eased by indexation of wages, opening the door to target government support to the most vulnerable groups, rather than opting for broad-based measures. A terms-of-trade shock like the current climb in commodity prices involves a rise in nominal imports and a loss that needs to be borne by households, corporations, or the government. In Belgium, this loss is disproportionately stemmed by firms and the government in the moment, which ceteris paribus, are bearing the costs of indexed wages.[5] Furthermore, the increase in labor compensation due to indexation is usually a permanent cost factor. Although a passthrough of falling prices to lower wages is possible, in principle, nominal wages rarely adjust downward, even if the worsening of the terms-of-trade should reverse and the additional expenses on employees cannot be passed on to sales prices.

3. **Worsening corporate and government finances due to wage indexation-related cost pressures may have pernicious side effects.** For the government, a corollary of higher expenditures due to public sector wage and social benefit indexation is commonly higher nominal revenues, e.g., from VAT or income tax brackets not being adjusted for inflation. This may soften the budgetary impact. Still, indexation has an opportunity cost as it absorbs revenues that could be directed to other priority areas of government spending. Companies face a more challenging

[4] The other euro area countries that uphold comparable wage indexation arrangements are Cyprus, Luxembourg, and Malta. For on overview of the prevalence of private-sector wage indexation in the euro area, see Grapow and Koester (2021).

[5] In addition, social benefits are also indexed to inflation, creating further pressure on government expenditures.

conundrum. Choosing to keep sales prices stable will cut into profitability, lowering future investment or even threatening solvency, particularly when being confronted with a twin shock of higher labor and other input costs. Passing cost pressures on to consumers may preserve profit margins for products with comparatively inelastic demand but can undermine the competitiveness of exports if international prices for substitutes stay flat or lead imports to become more attractive. Besides, sales price increases in the presence of widespread indexation may propagate a wage-price spiral with the potential to do long-term harm to the economy, specifically for countries that are part of a currency union like Belgium. Finally, raising compensation across income brackets in lockstep with each other at periods of elevated inflation may limit the room for differentiating wages according to productivity developments in the public administration or at the level of industrial sectors and firms, thereby aggravating labor market rigidities. Against this background, the following analysis investigates inflation drivers, also from a cross-country perspective, which may inform the trajectory of future prices in Belgium once the present accumulation of shocks starts to dissipate. Then, it sketches an overview of the key features of Belgium's wage-formation framework before highlighting some of its weaknesses with the aim to suggest recommendations to better balance its benefits with its costs.

## B. A Burst of Inflation Explained: Blaming the Usual Suspects?

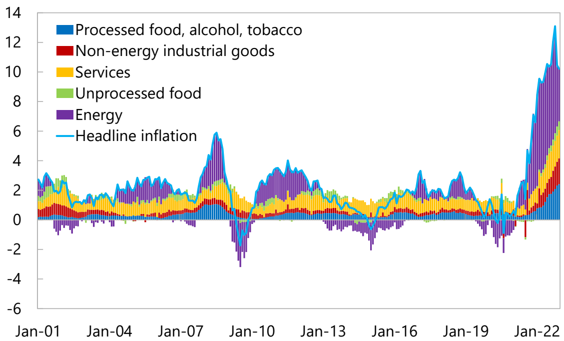
4. **Current price pressures in Belgium show parallels to periods of elevated inflation in recent history yet also involve some important differences.** Specifically, energy prices have again proven to be a key driver of inflation. Not unlike comparable episodes in 2008 and 2010-11, energy prices accounted for around a third of the 10.2 percent rise in Belgian headline inflation in December 2022, but their recent rate of increase far surpasses any antecedents of the 2000s. Likewise, processed food prices contributed 2.4 percentage points to headline inflation in December 2022, roughly the same share as in 2008 with an inflation rate that is about three-fifths higher than at the time. The prices of services and non-energy industrial goods have recently grown at rates not seen in the 2000s to date, adding a respective 1.8 and 1.9 percentage points to headline inflation in December 2022.

5. **The specific mix of supply- and demand-side drivers acting on inflation in the moment is the result of a succession of shocks**. As the economy re-opened after the pandemic, pent-up demand, particularly for services that could not be enjoyed with containment measures in place, met supply chain bottlenecks still related to the pandemic and a labor market that was quickly returning to the tightness witnessed ahead of the disruptions brought about by Covid-19. When some of these effects began to fade, a second shock hit the economy in the form of steeply rising energy and food prices—a consequence of Russia's war in Ukraine—with an ongoing lack of labor supply adding fuel to the fire.

## Belgium: Contributors to HICP Headline Inflation

**HICP Inflation**

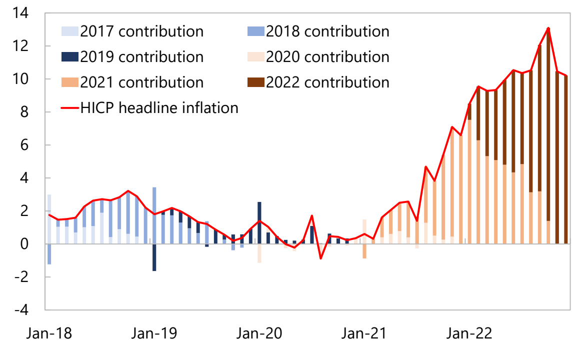
(Annual percentage changes, percentage point contributions)




Sources: StatBel and IMF staff calculations.

**HICP Inflation**

(Annual percentage change, percentage point contributions)




Sources: StatBel and IMF staff calculations.

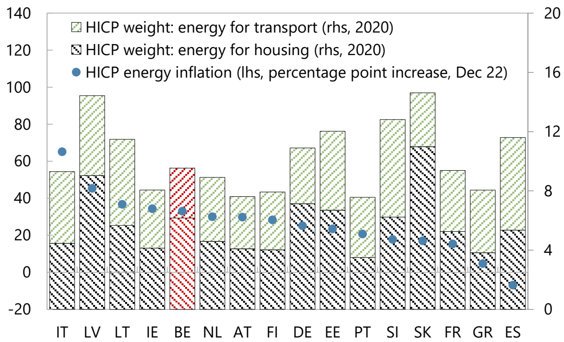
**6. Energy price inflation in Belgium is among the highest in the euro area, in part driven by the relatively low taxation of energy products.** By December 2022, energy prices increased at an annual rate of 33.0 percent, after peaking at a record 69.2 percent in October. Belgium's taxation of energy and natural gas is lower than the euro area average, ensuring a more potent pass-through from wholesale to retail markets. An in-depth examination by the OECD about the use of energy and environmental levies in its member countries indicates that Belgium maintains much more modest excise taxes on diesel and natural gas for the use in buildings than other countries in the European Union.[6] In addition, energy price pressures translate more easily into headline inflation in Belgium than in most other euro area countries, as the weight of energy products in the consumption basket constituting its HICP, particularly of expenses related to the heating and powering of homes, is rather high. Besides, Belgium's energy market is characterized by a comparatively high degree of liberalization without any price controls and variable rate contracts are generally adjusted at intervals that are shorter than in some other EU countries. Lastly, the methodological approach for measuring energy price inflation plays a role. Like statistical institutes elsewhere in the EU, Statbel determines energy inflation on the basis of newly concluded contracts, thereby not reflecting the prices experienced by consumers with existing fixed-price, longer-term arrangements. Especially in periods of rapidly rising energy prices, this method tends to overstate inflation reported by the HICP. For Belgium, however, the effect is likely to be less pronounced than in some other euro area countries as fixed-price contracts typically have a duration of only a year. As a result, most have expired by now and have been renewed at prevailing prices.[7]

[6] See OECD (2019).

[7] For a recent overview, see Jonckheere (2022).

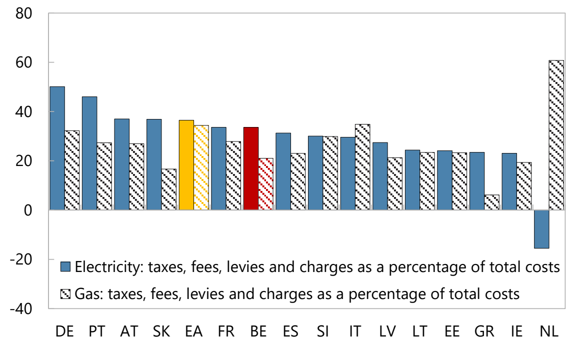
## Belgium: Energy Weights in Consumer Price Baskets and Energy Taxation

**Energy Inflation and Consumer Price Basket Weights**
(Lhs: annual percentage changes, rhs: percentages)




Source: Eurostat.

**Energy Taxation**
(Percentages)




Source: Eurostat.

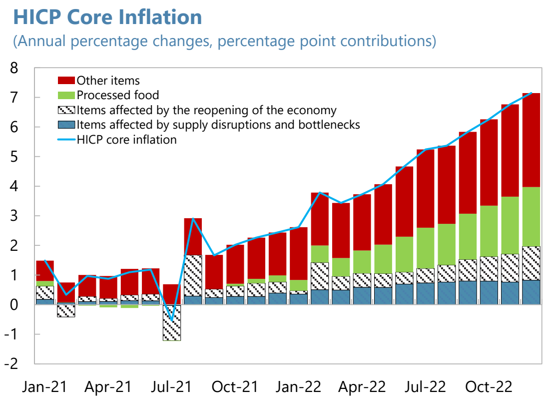
**7. Pandemic- and Ukraine war-related price pressures have increasingly contributed to rising core inflation as corporations have been able to pass cost increases on to consumers.** Since September 2021, the contribution to headline inflation of HICP consumption basket items affected by the re-opening of the economy (15.4 percent of items in 2022) as well as by supply disruptions and bottlenecks (13.9 percent of items in 2022) has climbed from 0.5 to 2.0 percentage points.[8] Similarly, the Ukraine war has amplified the contribution of processed food prices on core inflation from 0.6 percentage points in February to 2.0 percentage points in December, due to its impact on global markets for agricultural commodities. Besides, national accounts data are indicating that, at least on aggregate, the non-financial corporate (NFC) sector seems to have been rather well-placed to transmit higher costs to sales prices. NFC aggregate gross profit margins notably improved between Q4:2020 and Q2:2022, keeping them above levels seen in most other euro area countries and higher than before the pandemic.[9] Still, aggregate figures may conceal substantial heterogeneity across individual firms. Indeed, microeconomic evidence points towards a sizeable share of Belgian companies having experienced a decline in gross profit margins between 2021 and 2022, with the positive development in the aggregate primarily driven by trends in the profitability of a few large corporations.[10]

[8] The classification of HICP consumption basket items into goods and services affected by the re-opening of the economy and by supply disruptions and bottlenecks follows Cuquerella Ricarte et al. (2022).

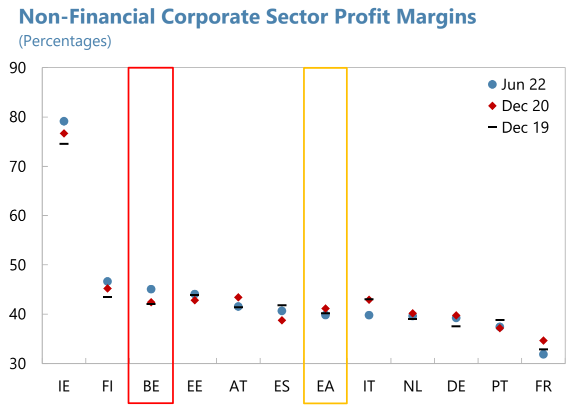
[9] The NFC profit margins shown in the chart were compiled on the basis of national accounts data, expressing the gross operating surplus of the NFC sector as a percentage of its gross value added. A simulation based on microdata by Bijnens and Duprez (2022) showed qualitatively similar results, indicating that energy price and wage pressures appear manageable for the Belgian corporate sector.

[10] See Bijnens and Duprez (2023).

## Belgium: Contributors to HICP Core Inflation and Corporate Profit Margins




Sources: Eurostat and IMF staff calculations.

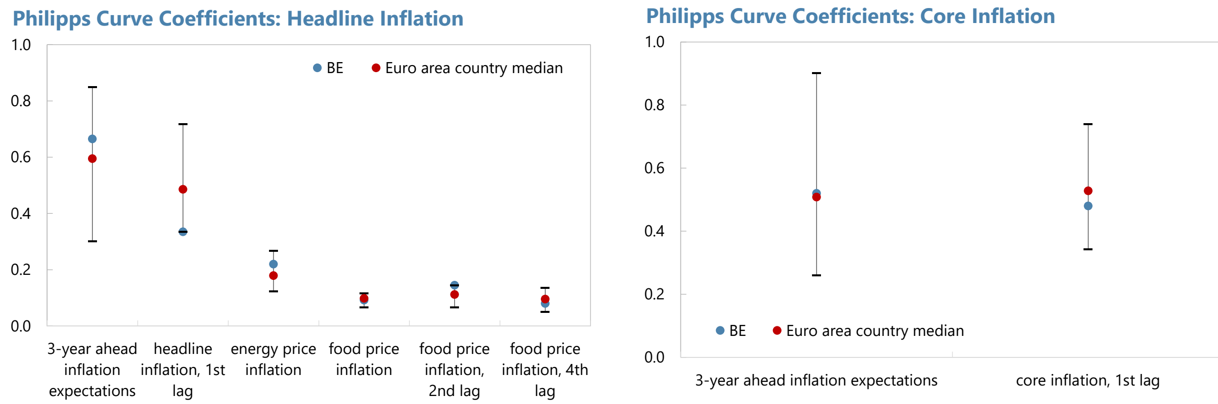



Sources: Eurostat and IMF staff calculations.

**8. Compared to the median euro area country, Phillips curve estimates point towards some differences in the inflation-setting process and inflation persistence in Belgium.**[11] In particular, Belgium is among a small group of euro area economies where food prices enter headline inflation at various lags, albeit with coefficients of relatively small magnitude. More commonly, energy prices are a statistically-significant driver of headline inflation but their impact is somewhat higher than in the median euro area economy. The persistence in headline inflation is the lowest among the euro area countries in the sample, while forward-looking inflation expectations play a somewhat more prominent part for the setting of headline inflation than in the median euro area economy. Estimation results for core inflation are qualitatively similar, yet Belgium's distinctiveness in comparison to the euro area median declines and the statistical significance of commodity prices vanishes.

[11] The coefficients in the charts are estimated separately for headline and core inflation on a country-by-country basis with the help of a standard New Keynesian Phillips curve augmented by variables proxying for price developments abroad (lagged by one quarter) as well as for global energy prices (contemporaneous) and food prices (contemporaneous and lagged by up to four quarters). The remaining variables entering the regression are a measure of domestic slack (contemporaneous unemployment gap derived as the deviation from the Hodrick-Prescott-filtered unemployment rate), headline/core inflation lagged by one quarter, three-year ahead Consensus Economics inflation expectations and a set of country fixed effects. For further details about the estimation methodology, see IMF (2022). The charts only present the variables that were statistically significant at a confidence level of at least 10 percent for the case of Belgium. Likewise, the euro area median as well as the range are only taking account of countries where the corresponding variable was statistically significant at a confidence level of at least 10 percent. Apart from Belgium, the euro area countries in the sample include Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

**Belgium: Phillips Curve Coefficients**




Sources: IMF staff calculations.

Sources: IMF staff calculations.

## C. Wage Formation in Belgium: Getting the Best of Both Worlds?

9. **Wage formation in Belgium is characterized by the desire to shield households from purchasing-power losses while protecting the competitiveness of a highly-open economy.** The wage-setting process was codified into law in 1996 by the "Law on the Promotion of Employment and Maintaining Competitiveness" (henceforth the Wage Law).[12] The Wage Law obliged social partners to negotiate salary increases over a two-year period within the bounds of an upper limit set by anticipated hourly wage developments in key export markets (France, Germany, the Netherlands) and a floor determined by expected inflation in Belgium.[13] At the same time, wages in Belgium are indexed to inflation by means of a so-called "health index"[14], opening the door for rises in compensation to exceed the maximum threshold stipulated by the Wage Law if actual inflation outcomes in Belgium surpass both expectations and wage growth in neighboring economies. While the Wage Law was broadly successful in keeping salary developments in line with the three comparator countries over the first decade of its existence[15], a 4 percent gap emerged by 2010, reflecting reluctance to fully enforce the provisions of the Wage Law, but also an episode of prolonged wage restraint in Germany, which contributed to an overestimation of the evolution of compensation in the three peer economies.[16] As a result, the federal government in Belgium made use of its prerogative granted by the Wage Law to set a comparatively moderate benchmark for wage rises for the 2011-12 and 2013-14 negotiation rounds, followed by suspension of indexation

[12] See "Loi relative à la promotion de l'emploi et à la sauvegarde préventive de la compétitivité" (http://www.ejustice.just.fgov.be/cgi_loi/change_lg.pl?language=fr&la=F&cn=1996072632&table_name=loi).

[13] The Wage Law also makes amends for wage drift to account for changes in pay due to, e.g., seniority, promotions or shifts in the employment structure.

[14] The "health index" removes alcoholic beverages, tobacco products and motor fuels (except LPG) from the CPI. Its smoothed version, a 4-month moving average, underpins the indexation of public sector wages, most private sector wages, pensions and social security benefits as well as some prices, such as rents, certain insurance premia or some doctors' fees.

[15] See IMF (2007).

[16] See CCE (2014) and CCE (2017).

between April 2015 to April 2016, which helped close the gap.[17] To minimize the need for such interventions, a wider reform of the Wage Law was implemented in 2017, making the determination of the maximally-permissible wage increase by the Conseil Centrale de l'Economie (CCE) a binding factor in salary negotiations. Moreover, the approach for deriving the ceiling was revised by introducing a correction term for past overshoots of wage developments between Belgium and its three neighbors as well as a safety margin to account for potential forecasting errors. In its current form, the Wage Law effectively puts an upper limit on the real wage rises the social partners can negotiate by considering expected gaps between nominal hourly wage developments in Belgium and abroad over the coming two years while also correcting for past deviations and incorporating a safety margin to address forecasting uncertainties.

**10. Despite successfully maintaining wage competitiveness in recent years, the current run-up in inflation is prone to put the wage setting framework under additional strain.** Against the background of manageable wage discrepancies with the three comparator economies, the reformed Wage Law allowed for two-year real wage improvements of 1.1 percent in 2017-18 and 0.8 percent in 2019-20, respectively.[18] However, for the period 2021-22, the available scope for real wage hikes was identified at 0.4 percent[19], drawing the ire of labor unions. Agreement could not be reached among the social partners, necessitating government mediation at non-negligible fiscal costs.[20] Since the end of 2020, the pace and degree of wage indexation has accelerated with rising inflationary pressures. Each cumulative 2 percent increase in the smoothed health index implies an equivalent, near-immediate rise in nearly half of private sector salaries and in public sector wages as well as in pension and social security outlays.[21] For the large remainder of private sector pay (close to two-fifths) indexation takes place in January of each subsequent year, which implied an approximately 10 percent rise at the start of 2023. Since wage developments in the three neighboring countries have not kept pace with Belgium to date, CCE estimates point to the opening of a wage gap of 2.9 percentage points by the end of 2022. This gap is anticipated to widen to 5.7 percent by the end of 2024.[22] In the spirit of the Wage Law, the extent of this overshoot suggested no space for real wage growth in 2022-24, requiring another costly round of intervention by the government to secure a deal between social partners.[23]

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[17] The suspension of indexation was performed by a so-called "index jump". In April 2015, the smoothed health index was lowered by 2 percent from its March 2015 value and indexation only resumed once the index had caught up with its March 2015 level which was the case in April 2016.

[18] See CCE (2017) and CCE (2019).

[19] See CCE (2021).

[20] To preserve social peace, the government made concessions on early retirement provisions, exempting some overtime arrangements from tax and social security payments, and providing employers with some form of compensation for raising the minimum wage.

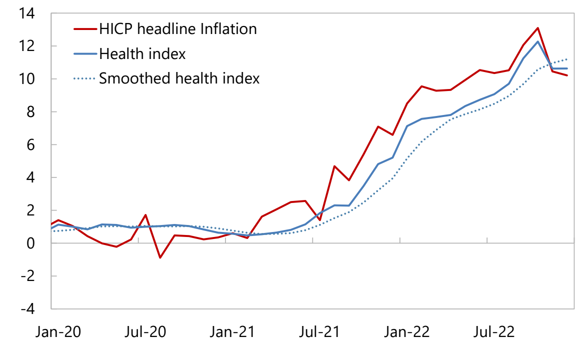
[21] Social benefits and public sector wages are indexed a respective one month and two months after a 2 percent increase in the smoothed health index.

[22] See CCE (2022).

[23] For firms that were (exceptionally) profitable in 2022 companies, the government proposed a €500 (€750) bonus payment for 2023 in the form of consumption vouchers that are fully tax-deductible for companies and tax-free for employees.

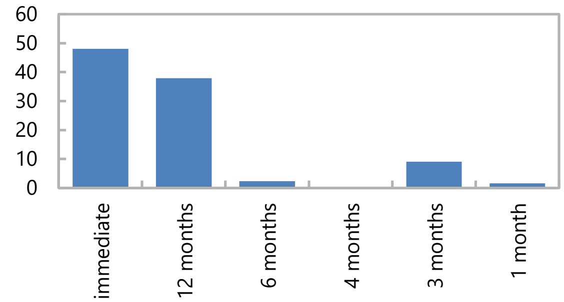
**Belgium: Health Index Inflation and Mechanisms for Private Sector Wage Indexation**

**HICP Headline Inflation and CPI Health Index Inflation**
(Annual percentage changes)




Sources: StatBel, Eurostat and IMF staff calculations.

**Mechanisms for Private Sector Wage Indexation, 2021**
(Percentages)




Source: NBB.
Note: The chart shows the share of employees benefitting from wages indexation immediately after a 2 percent health index increase or at n month intervals.

## D. Systemic Weaknesses of Wage Formation and Policy Recommendations

**11. To enjoy the benefits of indexation, maintaining a mechanism such as the Wage Law to align domestic with foreign wages is essential to preserve external competitiveness.** Belgium can be characterized as a highly-integrated small open economy facing substantial competition in international markets. The technology-intensity of its merchandise exports is comparatively high with medium- and high-tech manufactures accounting for more than half of the total exports of goods, somewhat above the euro area median, suggesting at least some pricing power from a differentiated product mix with high value-added.[24] However, more standardized goods, such as commodities and natural resource-based manufactures are also prominent, with a 35 percent share. In addition, Belgium does not occupy a dominant supply position in its three main foreign markets for the vast majority of its manufactures, including for products that constitute the largest share of its exports, implying the existence of substitutes and the need to sustain price competitiveness.[25]

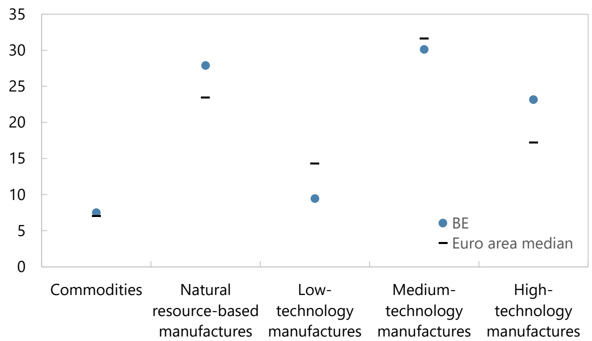
[24] The classification of merchandise exports into commodities, natural resource-based manufactures as well as low-, medium- and high-technology manufactures is based on the Standard International Trade Classification (SITC) and follows Lall (2000).

[25] Using the Standard International Trade Classification (SITC) at the third-highest level of detail, the chart shows Belgium's share in the total imports by France, Germany and the Netherlands of each of the 260 SITC level 3 product groups (blue bars) as well as the share of each of the 260 product groups in Belgium's exports (red dots).

## Belgium: Export Structure and Export Market Shares

### Technology Intensity of Merchandise Exports

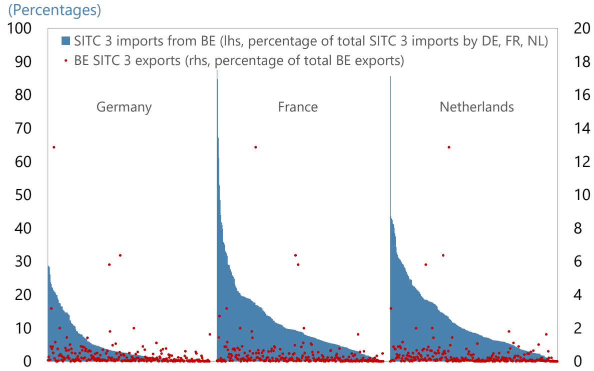
(Percentages of total exports)




Sources: UN Comtrade and IMF staff calculations.

### Market Dominance of Belgian Exports by SITC 3 Category

(Percentages)



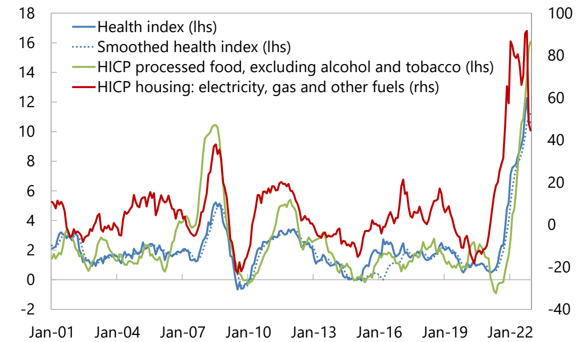

Sources: UN Comtrade and IMF staff calculations.

**12. The present episode of record high inflation is putting some of the weaknesses of the wage indexation framework and its corrective arm, the Wage Law, into sharper relief.** Most notably, global or idiosyncratic price shocks get rapidly transmitted to Belgian wages, as the smoothed health index is not well insulated from fluctuations in the most volatile components of the HICP, such as energy or food prices. Moreover, the provisions of the Wage Law mandate prolonged periods of low or no improvements of real compensation if salaries abroad do not fully catch up with near universal wage indexation in Belgium. As a consequence, the bargaining space for labor unions becomes unduly constrained while employers lose leeway to adjust real base pay for existing employees with productivity developments at the firm or sectoral level, further aggravating the rigidity of a labor market that is already characterized by relatively low job-to-job transition rates.[26] Finally, the tension between compensating workers for purchasing-power losses and maintaining external competitiveness fosters a confrontational stance between employees and employers at times of elevated inflation, weakening social cohesion. It also leads to frequent government intervention in collective bargaining, such as the freeze in indexation administered in 2015-16 or the brokering of a compromise in 2021 and 2022, at additional budgetary costs, likely a sub-optimal outcome for a process that should ultimately be driven by the private sector.

[26] However, Coppens and Saks (2022) show that, despite the rigid wage formation process, salaries in Belgium largely reflect productivity differences, at least at the sectoral level. At the same time, they also find evidence for more notable divergence at the firm level or between educational attainments.

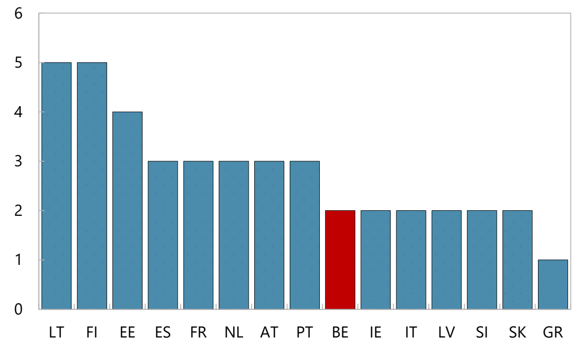
**Belgium: Health Index Inflation Drivers and Job-to-Job Transition Probabilities**

**Health Index and Selected HICP Sub-Components**
(Annual percentage changes)




Sources: StatBel, Eurostat and IMF staff calculations.

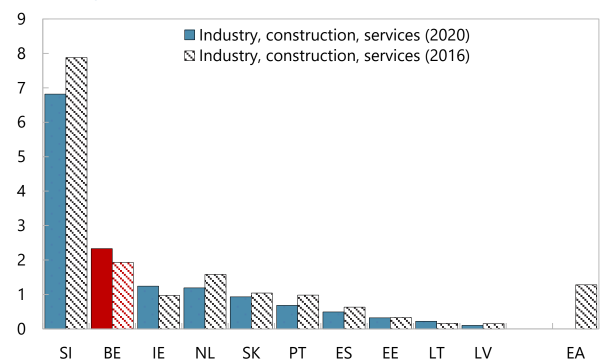
**Estimated Job-to-Job Transition Probabilities, Ages 15-74**
(Percentages)




Source: Eurostat.

**13. Absent abolition of salary indexation and the Wage Law, several avenues of reform could improve the performance and viability of the current wage-setting framework.** Possible measures may target the wage formation process itself, but could be usefully complemented by policy efforts in other areas. In particular:

**Wages and Salaries in Kind**
(Percentages of total labor costs)

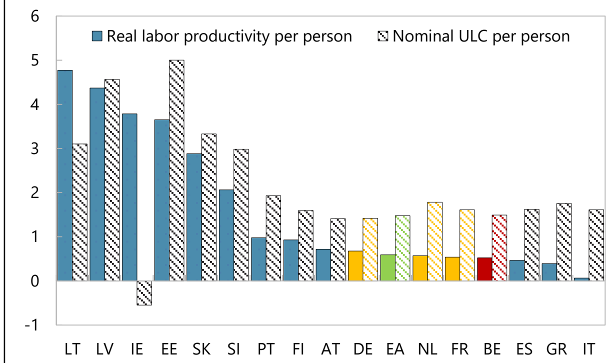



Source: Eurostat.

- **The basis for indexation, the smoothed health index, should be reviewed**. At present, shocks from highly volatile components of the consumer price basket, like energy or food prices, feed quickly into wages, shifting the burden of adjustment from households to other sectors of the economy. Therefore, the scope for excluding such items from the smoothed health index should be fully explored, as this would distribute losses more evenly, particularly in the event of a terms of trade shock. In addition, it would contribute to a more predictable development of salaries—and wage costs—over time, replacing the present alternation of episodes of briskly rising compensation with periods of prolonged moderation mandated by the provisions of the Wage Law. If a fuller compensation of households for purchasing power losses is desired, it could be achieved by well-targeted fiscal support for vulnerable groups, a strategy made easier by indexation already cushioning part of the impact of higher prices on household budgets, thereby obviating the need for much more broad-based measures. Likewise, loosening the rigidities imposed by the Wage Law by re-defining the health index may give more frequent opportunities to social partners to negotiate on (real) salary increases differentiated across sectors or firms. This may contribute to a more optimal allocation of economic resources and reduce the necessity to rely on second-best alternatives, such as government intervention in the wage bargaining process or workers and their employers resorting to less transparent in-kind benefits to achieve a differentiated compensation structure.

- **Productivity trends should be accounted for to capture deviations of labor costs between Belgium and its key export markets in a more appropriate manner**. Although labor productivity and nominal unit labor costs per person in Belgium have largely developed in line with its three-country benchmark and the euro area average over the past 25 years, potential deviations should be taken into consideration. Such an approach would also have the advantage that improvements in productivity above comparator economies could be reflected in higher wages. Slower-than-comparator productivity gains could be reflected in lower wages, rather than by increasing capital intensity or moving production abroad. Furthermore, widening the group of countries against which salaries and productivity are assessed might be advisable. France, Germany and the Netherlands constitute less than half of Belgian merchandise exports, potentially hiding losses in external competitiveness against other important trading partners.

**Real Labor Productivity and Nominal ULC, 1997Q1-2022Q3**
(Average annual percentage changes)




Sources: Eurostat and IMF staff calculations.

- **Options to at least temporarily widen the flexibility of the indexation regime should be contemplated**. While private sector wage indexation is guaranteed by the Wage Law, opening avenues for a well-considered relaxation of strict indexation rules in cases where the going concern of a viable firm is at risk should be reflected upon. In the recent past, parts of the corporate sector have been confronted with a multiplicity of shocks, ranging from the pandemic to supply chain disruptions and surging input costs, warranting the creation of opportunities for particularly affected companies to pause or limit wage indexation to preserve investment and employment.[27] In the long-term, possibilities for reviving contracts with all-in clauses should be assessed. Their compensation for expected rather than actual inflation could have benefits similar to the re-casting of the health index and would also fit the comparatively forward-looking inflation formation process suggested by Philipps curve estimates.

- **A stronger reliance on excise duties to tax energy products, specifically for housing-related purposes, should be considered**. In an international context, taxation of energy supplies for the heating and powering of buildings is low. In pondering the use of taxes to achieve ambitious emissions reduction and climate goals, preference should be given to excise rather than ad valorem taxes. By being charged on a per-unit basis, excises would dampen the

[27] Some sectors, such as banks and insurances, are indeed capping wage indexation at a maximum threshold at times of high inflation.

pass-through of energy price fluctuations from wholesale to retail markets and on to consumer price inflation and wages.

- **Product market reform should be accelerated.** Across euro area countries, the profit margins of Belgian corporations appear elevated, possibly pointing towards some lack of competitive pressures. Even though margins are anticipated to sharply contract in the coming quarters[28], they are likely to remain above the euro area average. Weakening the ability of firms to transmit higher input costs to sales prices by encouraging competition via product market reforms would contribute to containing the risks of a wage-price spiral while also fostering a more dynamic economy.

[28] See again CCE (2022).

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