



work in progress

Belgian public finances caught up in a war of attrition

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Introduction

In this text, I am going to retell and attempt to explain the story of Belgium's fiscal woes since the mid-1970s using a formal model that focuses on social conflict in its account of fiscal problems. I hope to demonstrate that it is the inability of different groups in Belgian society to renegotiate the rules governing redistribution that has been at the heart of the deficit problem all through these years. While this finding might not be terribly original, its formal modelling has important implications for both theoretical and policy approaches towards deficits. The model is based on the realization that deficits often arise from a combination of past decisions and exogenous shocks (i.e. a drastic change in the policy environment) rather than from suboptimal policy decisions in the present. Consequently, it puts emphasis on *inaction* – the inability to fix the lack of fit between old policies and new circumstances – and its causes rather than on motives behind socially inadequate active policy decisions. Further, it traces the problem back to fundamental *divisions in society* and assigns less importance to governments and politicians and their motivations.

These two characteristics set this model apart from the rest of the literature on the causes of deficits. The latter attributes responsibility for fiscal problems to policy makers – the government and other politicians influencing the budget – and to their incentives that are incompatible with the aggregate public good (which is taken to mean fiscal prudence). “Political business cycle” models (Nordhaus (1975); Hibbs (1977); Carlsen and Pedersen (1989)) emphasize the motivation of governments to run deficits to engineer a temporary growth in income for their electorate. “Common resource pool” models (Weingast, Shepsle and Johnsen (1981); Hagen and von Harden (1996)) explain the growth of public spending – even beyond available public revenues – by the drive of politicians to squeeze such public expenditure items into the budget that selectively benefit their constituents at the expense of public revenues paid equally by all citizens. The “fiscal institutions” literature (von Hagen (1991); von Hagen and Harden (1996); Alesina and Perotti (1996); Hallerberg and von Hagen (1997); Alesina, Perotti and Tavares (1998); Poterba and von Hagen (1999); Hallerberg (2004); Wyplosz (2005); Milesi-Ferretti (2005); Gyorffy (2007); Lagona-Padovano (2007)) investigates how an institutional framework – a combination of rules, procedural constraints and delegation – can be created to curb the motives and incentives of policy making actors – the government and politicians – to engage in excessive spending. This latter line of research doesn't explicitly investigate where these incentives and motives come from, it just tries to

discover ways of correcting them for the sake of prudent fiscal policy. The common denominator of all of these theories is that they assume deficits to be *created* as policy makers translate particular interests (of their own and of their constituencies) into *policy choices*.

These theories seem to guide policies aimed at improving fiscal decision making. Rules governing spending and borrowing as well as the drafting of the budget adopted in many countries and advocated by the OECD, the IMF and the Commission are very much in line with the recommendations of the “fiscal institutions” school. In fact, the reform of the Stability and Growth Pact – whose declared purpose was to create an improved framework for fiscal policy making in the Member States – also integrates institutional elements shown by the “fiscal institutions” literature to be strongly correlated with fiscal prudence.

The Belgian experience questions the relevance of these theories and policy approaches to the fiscal difficulties of mature welfare states faced with problems of economic adjustment and aging. In the next section, after giving a short overview of Belgian fiscal performance in the past three decades, I am going to show that the source of Belgium’s persistent deficits has been a gap in the financing of the social security system that was created by the shock from the oil crisis which dealt a last blow to Belgium’s (primarily Wallonia’s) outdated industrial structure, thereby increasing unemployment and early retirement expenses. I will also show that it was the inability to close this gap as well as the excess burden of financing caused by the gap that fuelled deficits year after year and not the inability to control discretionary expenditure (i.e. items that are decided on each year by policy makers). In fact, public consumption and investment have continuously been on the decline since the fiscal problems started. In the third section, I will introduce the so called “war of attrition model of fiscal stabilization”, first developed by Alesina and Drazen (1991) which I argue best explains the persistence of the gap in the social security system despite the heavy costs of it in terms of debt accumulation and sacrifices in public consumption and investment and will propose extensions to the original model. In the fourth section, I will map the Belgian experience with attempts to close the financing gap of social security system through reforms of entitlements and funding to the model to show the “goodness of fit” between them. In the last section, I will attempt to draw conclusions about the possible effects of an institutional framework like the SGP on Belgian fiscal performance.

Fiscally troubled Belgium

The two graphs below – showing the development of deficit and debt figures – demonstrate both the severity and the persistence of fiscal problems of Belgium since the mid 1970s.

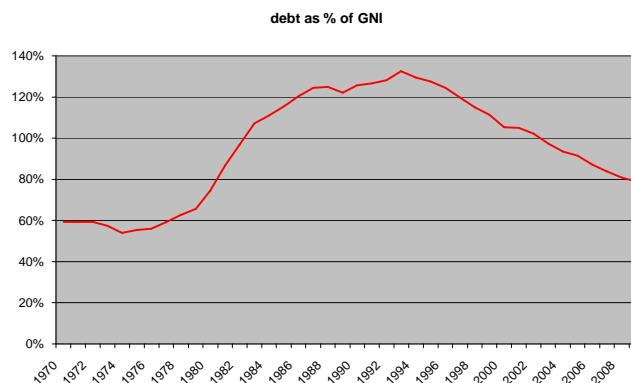


Figure 1. – Debt as a percentage of GNI¹
(source: AMECO)

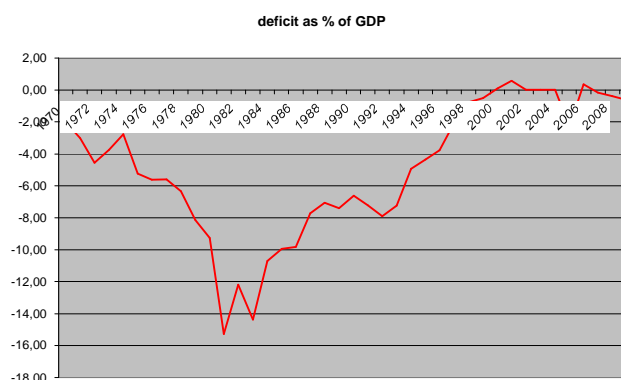


Figure 2. – Deficit as a percentage of GDP
(source: AMECO)

Belgium's fiscal track record until the mid-seventies was not significantly worse than that of other European countries. All through the sixties, the financing requirement of the Belgian state barely ever exceeded 2% of the GDP and in 1974, public debt amounted to 39 per cent of the GDP. After the oil shock, however, deficit exploded and debt started to mount, reaching 56 per cent of the GDP by 1980 and 103% by 1985 (Quaden, p151). At its peak in 1993, the debt amounted to 118 per cent of the GDP (OECD database). After the worst times of the early 1980s, when deficits were as high as 8 to 15 per cent of the GDP, they were somewhat reined in through the second half of the eighties and after 1993, they started to improve rapidly and were finally eliminated by 1993.

¹ This graph is only for illustration purposes, I will try to look for data as a percentage of the GDP instead of the GNI.

The picture painted by the two graphs is misleading. They both suggest that something must have fundamentally changed in fiscal policy in 1993 that allowed deficits to converge to zero and debt to set on a path of consistent decline. The next graph, however, shows that 1993 does not mark a break in policy, as neither primary expenditures (all expenditures excluding interest payments on outstanding debt) nor revenues changed course. It also shows that the break in policy happened as early as 1982.

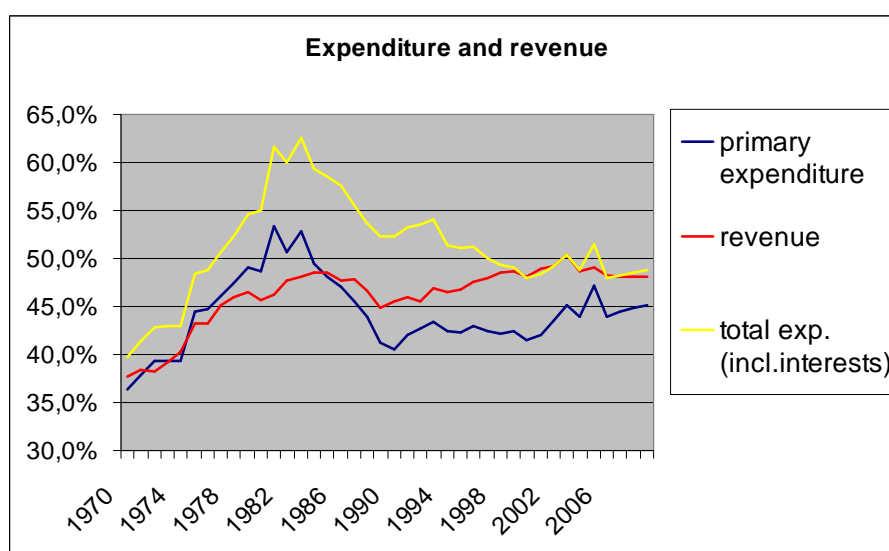
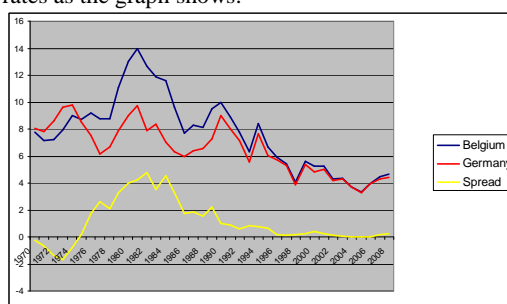


Figure 3. – Total expenditure, total primary expenditure and total revenue
(source: AMECO)

In fact, the dramatic improvement in public finances from 1993 on was the result of an exogenous easing of circumstances due to the decrease of interest rates on outstanding debt that lead to the decline of the debt service burden from around 12 per cent of the GDP to 4 per cent.² As the next graph shows, this allowed the wedge between the primary and total balance to narrow and the total deficit to reach zero by 2000.

² The decline in interest rates faced by Belgium was a result of both a more favourable assessment of Belgium's riskiness as well as a general decline in interest rates as the graph shows:



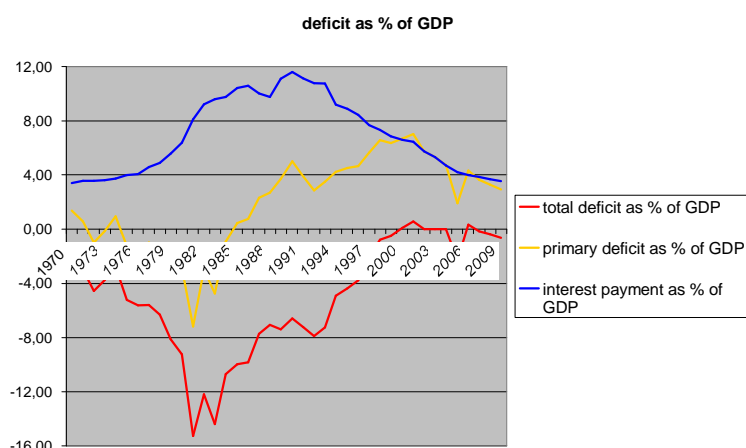


Figure 4. – Composition of deficits
(source: AMECO)

The above graph also shows that the break in policy in 1982 brought the primary balance back to zero as early as 1985, but that corresponded to a total deficit of almost 10 per cent of the GDP because of the high debt service burden. In sum, what we see in Belgium over these three decades is that the primary balance (the balance of revenue and expenditure excluding interest payment on outstanding debt) was approximately zero until 1974, when it started to progressively deteriorate, reaching seven per cent of the GDP in 1981, from where it gradually climbed back to zero by 1985. However, the ten years of negative primary balances as well as an increase in interest rates led to further growth of debt through what is called the “snow-ball effect” (self fuelling debt growth through high debt service expenditures).

The deterioration of the primary balance can be traced back to a swiftly increasing gap in the social security system³. The below diagram⁴ shows the development of social security contributions and expenditures as well as their balance. The explosive growth of expenditures is connected to a rapid deterioration of unemployment. Between 1970 and 1980, the number of unemployed increased more than fourfold (from 72 thousand to 322 thousand), while another 75 thousand opted for early retirement schemes. (European Economy 1993, p37). In the same period, social security spending increased from 13.2 per cent to 19.7 per cent of the GDP and the gap between contributions and expenses grew from 2.8 to 7 per cent of the GDP. In 1981, when the primary balance of the budget was at its lowest of seven per cent, the social

³ “After the first oil shock, overspending in the social security system [...] became the primary cause responsible for debt accumulation.” (European Economy 1993, p57).

⁴ This graph is only for illustration purposes, as the numbers are not comparable with numbers given in % of GDP, but it shows the evolution of the social security gap. I will try to look for data as a percentage of GDP instead of GNI.

security gap was 8.6 per cent of the GDP. After a series of un- and partially successful attempts to close the gap through limits on the growth of expenditure as well as increases in contributions, it was still at five per cent of the GDP in 1990 (European Economy, 1993). Then, in the 1990s, it started to widen again, going up to 9.7 per cent in 1995, then decreasing slightly in the next five years to 7.4 per cent⁵. In 2007 the gap was up to 8.8 per cent of the GDP again (NBB).

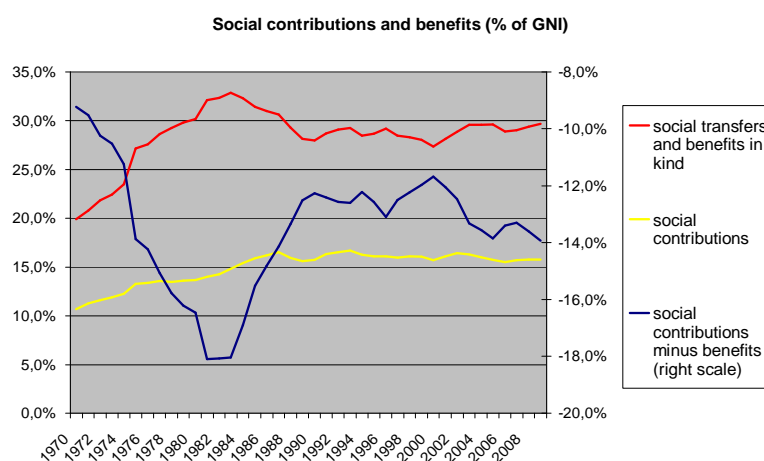


Figure 5. – Social security contributions and expenditures
(source: AMECO)

In order to counterbalance the gap in social security, significant cuts in all other types of expenditure had to be made. Over the course of the eighties, Belgium moved from spending on public consumption and investment on par with countries of similar levels of development⁶ to spending the least on public consumption and by far the least on public investment.

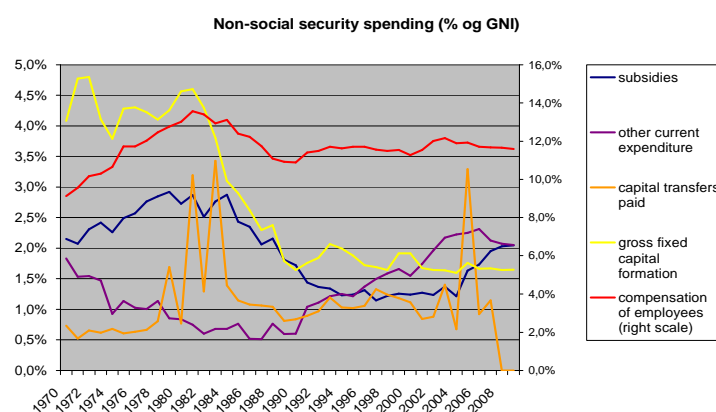


Figure 6. – Non-social security spending
(source: AMECO)⁷

⁵ It will be shown later that this improvement is the result of an „accounting trick” as a percentage of VAT receipts was assigned by law to be directed to the social security funds from 1996 on.

⁶ The IMF’s table of comparison lists Denmark, France, Germany, Italy, the Netherlands, the UK and the US.

⁷ Again, the graph is only to demonstrate trends, the data are not directly comparable with the ones mentioned in the text.

It seems therefore, that governments made serious efforts to contain the problem, but despite significant cuts in public consumption and investment, the snow-ball effect of self-fuelling debts could only be stopped by a favourable exogenous change in interest rates in the 1990s, because until then the gaping hole in social security precluded the use of the funds freed by lower public consumption and investment for the stabilization of the debt situation. The question arises why governments that were able to cut non-social security expenditure by 7.2 per cent of the GDP over the course of the eighties would choose the combination of such sacrifice in spending *and* growing indebtedness instead of tackling the root of the problem by consolidating social security through considerable benefit cuts or contribution increases. The next section will introduce a model, which has the potential to explain this phenomenon.

The war of attrition model

A model based on the standard “war of attrition” (WoA) game provides a tool to formalize and systematically investigate the forces that delay the resolution of fiscal problems caused by exogenous shocks. In the case of Belgium, for example, it is quite obvious that consolidation of the social security system through benefit cuts or increased contributions is prevented by the unwillingness of beneficiaries to give up their entitlements or by the contributors to pay more, but it is difficult to determine under what conditions and for how long each of these actors can keep up their resistance to solutions they dislike in the face of a deteriorating fiscal situation, in which all economic and social actors are likely to suffer heavy losses. The model by Alesina and Drazen based on the WoA game promises to tackle these issues and to predict how long the delay in the resolution of the problem is likely to be.

The standard WoA is an example of a game of timing – i.e. of a game in which payoffs are determined by the timing of action by the players⁸. The warring parties cannot directly defeat each other in battle and therefore try to tire each other out to win the war. However, holding out in a war of attrition until the enemy surrenders is costly and costs are increasing as ammunition gets scarce. Moreover, the country is getting devastated by the war, so the prize for which the war is fought loses some of its value as the war drags on. So each player would

⁸ The best known example of a game of timing is a pistol duel where the duellers start approaching each other from a distance with pistols held at aim and have the possibility to fire a single shot at the other at any time. The distance between them decreases with time and each actor has to make his optimal decision on when to fire his shot by weighing the increasing chance of hitting the other dueller as the distance shrinks against the chance that the other dueller will shoot first and kill him. If one dueller fires his shot too early and misses, the other dueller can come as close as they want to fire theirs. Thus the aim of each dueller is to shoot as late as possible, but still earlier than the other.

like to end the game as early as possible, but still later than the opponent (since winning is defined as holding out longer). Crucial to this game is that players should have limited information about the relative strength of the other. Otherwise, the actor who knows that he is unambiguously weaker and cannot escape surrender, would give up right away to avoid all the costs of trying to hold out, if it is anyway in vain. As time passes and the enemy still persists, each player has to re-evaluate his estimates of his chances of winning and when a player feels that its chance of winning are lower than what could compensate him for the pain of having to wait longer, he surrenders and the war is over.⁹

As Drazen (2000) points out, the war of attrition model can be applied to the analysis of the timing of any policy change with distributive consequences, where a reform that promises to improve welfare for society as a whole is delayed through the inability of the community to decide at whose expense the policy should be changed. In this case the “prize of the war” is being able to enjoy the benefits of reform without having to bear a proportional share of the costs. The costs of the war arise from having to operate in an economy that needs to be reformed and these costs increase with the delay. The relative ability of each social group to endure depends on how much it suffers from suboptimal working of the economy. Furthermore, the longer the delay in the reform is, the more costly it is going to be for society to carry it out and achieve the same level of welfare improvement. (For the winner and the loser, too, they will only differ in the relative share of the burden they have to bear.)

The assumption is that a war of attrition only arises in divided communities, where an equal division of costs is unlikely, but also where there is a relative balance of power between actors, because otherwise the stronger actor could push the burden of the reform onto the weaker one¹⁰. Reform becomes difficult because each camp wants to load as much of the

⁹ In more game theoretic parlance, the WoA is an example of a game of timing, where payoffs are a decreasing function of the length of the game. Each actor has the possibility of terminating the game at a cost, so each actor's optimal strategy is the one that best balances the costs incurred by ending the game versus the costs of waiting for someone else to end it. It is a Bayesian game, where each player only knows his own costs (i.e. payoff) exactly and thus the optimal strategy has to be built on assumptions about the other players' costs relative to one's own. As the game proceeds, the players' actions (or rather: inaction) provides information to all other players about the distribution of costs. In other words, if a player has a certain assumption about the probability distribution of all the players' costs, then if others haven't terminated the game until a certain time T, the player can infer from it that he is likely to be the least able to sustain waiting (i.e. most likely to have to incur the cost of terminating the game). As soon as the player has that information, it is in his interest to end the game as soon as possible, to minimize his total costs by minimizing the costs of waiting. Therefore, the dependent variable of the model (the timing of the end of the game) will ultimately be a function of the probability distribution of the costs of waiting, subject to specific parameters determined by the type of problem that the model intends to describe.

¹⁰ Alesina and Drazen (1991), trace the unequal division of the burden of reform to “political polarization”, without defining the term. I take it to mean that a major cleavage in society defines political camps such that coalition formation and reform on the given issue is highly unlikely.

burden as possible on the opposing camp¹¹ – especially since neither of the groups has reliable information about how much the reform is going to benefit the other group, so a credibly “fair” distribution of the costs is not possible.

Alesina and Drazen’s WoA-based model describes a simple case, in which a country needs to eliminate a long term deficit in its public finances by levying a new tax, but social groups are unable to agree upon the distribution of the tax burden. Until the deficit is eliminated, the government has to cover it by issuing debt and printing money. The latter causes accelerating inflation which makes all groups worse off for the time of the delay, but not (not necessarily) to the same degree¹². In the meantime, debt is growing, which means that once the new taxes are imposed, they will have to cover the interest payments on the accumulated debt, too. For each group, the optimal strategy is to wait and refuse to accept the additional tax burden as long as the cost of waiting one more second longer seems smaller than the expected benefit from prolonging resistance a moment longer. The expected benefit depends on each actor assumptions about the likelihood of being able to persist in a high inflation environment longer than the others. This in turn depends on his assumptions about who is suffering more from inflation. Alesina and Drazen show that delay in stabilization depends on the costs of waiting as well as the inequality of the sharing of the tax burden¹³.

They also discuss the possibility that the resolution of the conflict is delayed so long that it becomes infeasible to assign the bulk of the adjustment costs to one player – i.e. the debt grows so large that no group could possibly afford to pay a disproportionate share of the tax burden needed to close the original gap and the interest burden on debt. In such a case, the authors assume, the government can enact an emergency measure to close the gap, but this solution entails a very large loss of utility for all players. If there exists such an exogenous end point of the game, this might motivate players whose optimal surrender time would be beyond this end point to give up just before the emergency measures are enacted, if being the loser is still less costly for them than to bear half of the utility loss caused by these measures.

¹¹ At the same time, if we assume that there is a consensus on the upper and lower limits of socially and politically acceptable levels of redistribution, the distribution of the burden of the solution might not go to the extremes of 0 and 100%.

¹² For example groups on fixed incomes are going to suffer more from inflation than ones that can index their incomes to inflation.

¹³ Stabilization will happen in finite time as long as – at least for one group – the costs of waiting can become higher than cost associated with being the “loser of the game” (i.e. the welfare loss from distortionary taxation is higher than having to bear the bulk of the burden of stabilization). The delay in stabilization is longer, the greater the difference between the share of the burden born by the different groups and the lower the costs of waiting induced by inflation.

On the other hand, this might induce some groups who would have surrendered before the exogenous end point to postpone their surrender until the emergency intervention becomes imminent, in the hope that the other groups have an incentive to surrender early and take on the loser's share of the taxes. If all groups wait until just before the emergency measures and concede at the same time, a coin is flipped, so each group has equal chance of becoming the loser.

My first extension to the model concerns the assumptions that the deficit can only be closed by a permanent tax increase and that as long as the distribution of the tax burden remains contentious and stabilization is delayed, the only way to manage the deficit is to issue debt or print money. These assumptions help to keep the model simple, but also make it less applicable to diverse real life cases. What one needs to notice is that these assumptions are just one specification of a general problem where individuals/groups are unwilling to pay the private cost (a tax in Alesina and Drazen) of solving a public problem (persistent deficit) and in the absence of a solution, the short term management of the problem involves exchanging one public problem (deficit) for other public problems (inflation and debt accumulation)¹⁴. To make the model more generally applicable, I assume that long term deficits can be closed both by increased taxation and by decreased entitlements (as both represent private contributions to solving the public problem) and – more importantly, the short term management of the problem can involve not only debt and inflationary financing but also cuts in public consumption and investments¹⁵. This latter addition needs justification, because it can be argued that if deficit is the problem, cuts in expenditure should be seen as part of the solution, not as exchanging one problem for another. However, if we assume that the functions of the state can be conceptually kept apart, and before the exogenous shock, revenues for and spending on each function reflected a consensus on what kind of and how much public and private consumption should be financed by taxes and contributions, then an imbalance within one function should be corrected by readjusting expenditures and revenues in that sector rather than involving sectors unaffected by the shock. Using the Belgian example, the shock of the change in the international economic environment (compounded by the oil crises) clearly affected the redistributive function of the state and therefore it can be argued that

¹⁴ In this sense, it is the provision of a public good (stabilization) that is at the centre of Alesina and Drazen's war of attrition model, but the question is not only *under what conditions* but also *when* the public good is going to be provided. (Drazen, 2004)

¹⁵ Or even de-investment like selling public property.

lowering public consumption and investment levels to cross-finance the social security gap decreased public welfare.

As a consequence of the addition of cuts in public consumption and investment as a way of managing the structural gap, the costs of living in an economy burdened with high public deficits also have to be rethought. In Alesina and Drazen's model, economic actors only suffer from the deficit, if the government prints money to cover part of it and this causes inflation. In my extended model, lower levels of public consumption and investment also cause welfare loss. Moreover, I assume that debt financing is costly not only because it increases the long term costs of stabilization but also in the short term through the crowding-out effect of higher interest rates. Thus the costs of waiting for the long term consolidation of public finances is a combination of the welfare loss arising from high inflation, high interest rates and low public consumption. At the same time, the short term management also determines how fast the problem escalates – through the accumulation of debt that needs to be serviced and through the deterioration of infrastructure due to the fall in investments.

It needs to be pointed out that since each group's ability to sustain its resistance to footing the bill of consolidation depends on the total costs of waiting they have to bear – on the absolute size of the costs as well as their relative extent compared to other groups – groups are assumed to try to influence the way in which the fiscal situation is managed, in order to minimize their waiting costs. In this sense, the size and the distribution of the waiting costs – in contrast to Alesina and Drazen's model – is not exogenous to the conflict that drives the war of attrition. Explicitly modelling how the battle over the short term management of the deficit is conducted and thus properly endogenizing the cost of waiting would make the model unmanageably complicated. Therefore I introduced another cost element of waging the war of attrition, which I labelled¹⁶ “political costs”. The idea is that by incurring political costs (through lobbying, strikes, demonstrations etc.) each group can influence the choice of short term fiscal management and therefore buy more favourable conditions for itself in the war over long term consolidation. Implicitly, some kind of political cost is also embedded in Alesina and Drazen's model, since resistance to disproportionate tax increases needs to be put up in the political sphere (since taxes are introduced by legislation). Making this idea explicit, I assume that political costs can be expended in the fight over the long term stabilization, too.

¹⁶ By introducing political costs, I was building on Alesina and Drazen's undeveloped idea.

The introduction of political costs allows for the integration of institutional-political considerations into the model. In Alesina and Drazen's model the timing of stabilization depended only on the socio-economic position of the different groups (more concretely on how well each actor could tolerate inflation). Through the introduction of political costs, the chance to prevail in the conflict also depends on the degree of organization of interests, which allows for more effective political action, as well as on the political institutions that determine at what political costs the decisions about short and long term fiscal solutions can be influenced.

In sum, in the model I intend to apply to the Belgian case, an exogenous shock causes a persistent gap in the social security system, which can only be closed by cutting entitlements or increasing contributions. Society is deeply divided over the issue of redistribution, so a compromise is unlikely. Until legislation can be enacted, the gap needs to be financed by printing money, issuing debt or cutting back on public consumption and investment. The two camps can try to influence the mix of these methods of short term fiscal management in order to minimize their share of the costs of the short term fiscal management. This is politically costly, as is resistance to unfavourable proposals for long term consolidation. For the best chance of winning the war of attrition, each camp has to minimize the sum of the costs of waiting and the political costs incurred. Based on their success at this, the final timing – and the chosen method – of the long term consolidation depends on the absolute and relative size of each group's costs. The model predicts that stabilization is expected to happen in finite time only if the total waiting costs (i.e. the costs of high inflation, high interest rates and low public consumption plus political costs) can become higher than the loser's share of the costs of consolidation for at least one group. The time of stabilization is the earlier, the higher the aggregate cost of waiting. If stabilization is delayed so long that the escalation of the problem threatens with consolidation becoming infeasible, emergency measures are taken¹⁷.

In the previous section, I demonstrated that Belgian fiscal problems can be largely traced back to the persistence of a gap in the social security system. In the following section, I am going to describe the division in Belgian society that turned the problem into a drawn-out war of

¹⁷ For a formal treatment see Alesina and Drazen (1991).

attrition, to then go on to describe the “battles in the war” – i.e. the attempts to consolidate social security since the early 1980s.

The warring parties

The deep social cleavage complicating Belgian political life has been a fascinating topic for political scientists for quite a while. Class and ideological divisions are only reinforced by ethnic-linguistic-regional opposition between the Flemish and Walloon. This has been especially true since the late 1960s, when national political families split into regional parties and Flanders became a (conservative) Christian Democratic stronghold, Wallonia came to be dominated (until the very latest election) by the Socialists, while mixed Brussels opted Liberal. This “linguicisation” of ideological cleavages is also reflected in the difference between parties of nominally the same ideological colour on both sides of the Flemish-Walloon divide. The Catholic party has a much more labour-friendly outlook in Wallonia than its “big sister” in Flanders, while Flemish Socialists take a much more conservative stance on many issues than the French speaking Socialists¹⁸. (Fitzmaurice)

In the early 1980s, the three political families’ (and thus the regions’) position on redistribution were – and became even more strongly – opposed to each other as the Flemish Christian Democrats moved to a pronouncedly anti-statist, less redistributive stance, the Liberals adopted a Thatcherite attitude towards economic policy, while the Walloon Socialists retained their interventionist and labour-friendly position, (Fitzmaurice). Flemish Christians professed the need to restore the Belgian economy’s competitiveness through lower labour costs as well as increased emphasis on self-reliance and the better incentives it provided. At the same time, Walloon Socialists emphasized the need to cushion workers from the full effect of the economic crisis. The ideological polarization was further reinforced by the differential effect of the downturn on the two parts of the country: Flanders was weathering it relatively better due to its more modern industrial structure, while there was little hope left for the obsolete industry in Wallonia. Therefore, it made sense for politicians of the former to think in terms of competitiveness-enhancing measures and for representatives of the latter to seek to alleviate the effects of what seemed inevitable decline. Naturally, the increased awareness of the fact that redistribution between individuals within the social security system

¹⁸ Most of these parties have changed names several times since the 1970s, so I will keep to refer to them by their ethnicity and political label.

entails a redistribution across regions (from Flanders towards Wallonia) further contributed to the consolidation of the anti- and the pro-redistribution camps (Anderson et al.)

The ideological-linguistic division of the country is also represented in the landscape of interest groups outside the Parliament. Flemish Christian trade unions, Flemish farmers' and "Middenstand" organizations have been closely associated with the Flemish Christian Democrats. Notably, the Flemish trade unions have a relatively Conservative outlook, they have had a tendency to avoid industrial conflict and to seek cooperative solutions with employers' organizations. Formal and informal employers' organizations were historically also close to the Christian Democrats, but they have increasingly allied themselves with Liberals of both linguistic communities. Walloon Socialists are associated with francophone Socialist trade unions (traditionally representing a more radical and conflictual line in relations with employers) as well as youth and women's organizations. (Fitzmaurice, Kuipers)

While Flanders is almost twice as populous as Wallonia and therefore the Flemish Christian Democrats have always had a much larger constituency than Walloon Socialist, there are laws in place that safeguard the balance of influence between the linguistic communities. Therefore, numerical dominance have not enabled the anti-redistribution camp to prevail. For most of the period under consideration (except for seven years between 1981 and 1988), governments included both Walloon Socialists and Flemish Christian Democrats, because only in this way could both Parliamentary majority and the balance between the two linguistic communities dictated by the law be ensured. This obviously makes enacting significant reforms of the social security system – either the increasing of contributions or the cut of benefits – very difficult. At the same time, forging agreement within the government – either by excluding the Walloon Socialists or by reaching a compromise – has not necessarily been a guarantee of success, since extra-parliamentary interest groups can – and as will be shown in the description of the individual reform attempts often have – put up such resistance to legislative proposals that they had to be repealed.

These circumstances create the ideal setting for a war of attrition over stabilization in which each player is determined to make the other pay for the reform, but is unable to realize this ambition as long as the other player resists. The next section describes how the struggle over consolidating the social security budget unfolded.

The following section is only an outline, not a full explanation of the last part of the argument¹⁹

Battles and strategy in war

The period since the 1970s saw nine attempts to comprehensively reform the social security system (and several proposals that never made it to the decision making fora) to eliminate the structural gap in its financing. The earliest one was proposed in 1981, the latest in 2005. Out of these nine attempts, only two had any impact on the financing of the social security system, the other seven were either abandoned in the face of protests or were enacted in such watered-down versions that they ended up completely ineffectual.

The two that did have some impact (the reforms under the “Special Powers Act” of 1981 and the St. Anna Plan of 1986) happened relatively early on and although they led to cuts in benefits and some increase in the level of contributions, they were unable to close the gap completely. I argue that the relative success of these two early attempts were possible under the “emergency measures” scenario of the war of attrition²⁰. Until the early eighties, practically all of the deficit created within the social security system was debt financed. By 1981, the accumulation of the debt threatened with explosive growth through the snow-ball effect, where interest payments themselves feed ever accelerating debt growth. This created such a crisis sentiment that the Christian Democrats proposed a “Disaster Plan” to avert the risk of an uncontrollable debt explosion. As the Socialist coalition partners opposed the plan because of the proposed social security cuts, the government fell and in the new elections, the Liberals made such large gains that the Christian Democrats were able to form a government with them excluding the Socialists for the first time in decades. Although the new government had a relatively small majority (53% in the House and 55% in the Senate), in the general atmosphere of crisis, they could obtain special powers to rule by decrees – without having to obtain Parliamentary endorsement – in the interest of achieving the broadly formulated

¹⁹ A fuller version will include a detailed description of each reform proposal and an analysis of the composition of cuts in public consumption and investment to establish their effect on the warring parties and explain why the effect was not severe enough to make further reforms possible.

²⁰ This scenario – as described above – assumes that the government is able to enact emergency measures if further delay would risk losing control over the problem and stabilization would become infeasible in the sense that its costs would suddenly grow so much that neither of the groups would be able to pay it. In the Belgian case, the threat of infeasibility arose in the early 1980s from the snow-ball like accumulation of the debt. The sudden explosion of debt and the jump in interest payments threatened with creating an unacceptable burden for social groups.

objectives of economic recovery and restoring the financial balance in the social security system. Socialist trade unions protested fiercely against the enacted pension indexation freeze and cuts in other parts of the social security system, but Catholic unions decided to side with the government arguing that they were convinced that the measures were necessary for economic recovery (Anderson et al.). The St. Anna Plan of 1986 was enacted under similar circumstances (through decrees, by a Christian Democratic-Liberal coalition in government, in response to the unabated rate of debt accumulation and with passive support of the Catholic trade unions).²¹

I also argue that the significant cutback on public consumption and investment – which was carried out in the early eighties in the face of the spectre of uncontrollable debt growth and the inability of the government to fully close the social security gap — was the factor that doomed to failure the later efforts to fix social security²², as opting for less debt-heavy ways of short-term deficit management and the ensuing slowing of debt growth postponed the “emergency scenario”. It is difficult to say whether the slower (but still positive) rate of debt accumulation could have eventually lead to another crisis (since the snow-ball effect was not eliminated, just mitigated) and to another successful reform attempt, had it not been for the windfall gains from the fall in the interest rates in the 1990s that exogenously did away with the snow-ball problem. In any case, the crisis sentiment seems to have passed for the rest of the eighties, Socialists came back into government coalitions permanently and public consumption and investments never recovered from the cuts they suffered in the eighties. Further research is needed into the composition of these cuts and how they affected each camp to be able to explain why the pressure (waiting costs) they imposed on the warring parties did not trigger a concession to any of the new reform proposals. It is noteworthy, that by the end of the eighties the Flemish and Walloon communities have agreed to separate their budgets on almost all items of public consumption and investment (with the exception of areas like defence). In the new system, which was phased in during the nineties, each community has a predefined share of the centrally collected taxes, which it allocates

²¹ Interestingly enough, there was another failed attempt between these two partly successful attempts (the Mainil Reform of 1984). I explain the failure of this effort with the fact that in this reform the government took on the public service employees, who formed a much more united front in their opposition and strike activities than the workers trade unions in 1981 and 1986. (Anderson et al., Kuipers)

²² The Wilcox reform attempts in 1992-1993, the “Global Plan” of 1993, the Colla reform of 1996, the “Silver Fund” initiative in 2001 and the “Solidarity Pact” of 2005. Of these, only the Colla reform managed to cause an improvement in the balance of social security funds. However, this improvement is only cosmetic, as it rested on the official assignment of a share of VAT revenues to social security funds and in this sense it only made it explicit that social security is financed at the expense of public consumption, from non-social contribution revenues of the government.

independently between functions and spending objectives. I am inclined to say that this federalization of all non-defence, non-social security expenses is a part of the war of attrition over redistribution between the two camps (i.e. it is a settlement of the struggle over the ways of the short term management of the long term gap) and it is part of the reason each camp finds the waiting costs bearable in the longer term, but I will need to do more research to substantiate this claim.

I will also need more data to confirm the hypothesis, that the deficit ceiling imposed by the Maastricht Criteria and the Stability and Growth Pact reshuffled the balance of power within the war of attrition (i.e. changed the parameters of the model) such that they contributed to the failure of reform attempts after 1993. The hypothesis states that by eliminating the possibility of issuing debt to cover the structural gap, the imposed fiscal rules further encouraged reliance on public consumption and investment cuts, ruling out the possibility of an emergency scenario²³. Another element of the hypothesis is that because it is likely to be more important for the anti-redistributive camp to comply with the rules, the SGP would improve the bargaining position of the pro-redistribution camp²⁴ thus strengthening the weaker camp's ability to persist.

Conclusion

This text attempted to demonstrate on the example of Belgium that in the case of deficits caused by exogenous shocks, governments' determination to deal with the problem and reinstitute fiscal prudence might have little importance if it is impossible to forge consensus within society over how to share the costs of adjustment and it is also unviable to impose a solution on part of society by force. This makes the institution of rules on fiscal policy making – in the form of deficit ceilings, procedural rules, commitment to medium term objectives – logically questionable. Although further research needs to be done to prove this point, my argument is that such constraints on the governments room of manoeuvre in fiscal policy making might in fact make long term consolidation even more difficult.

²³ At the same time, it will obviously need to be investigated if there's a minimum level of public consumption and expenditure under which the emergency scenario becomes relevant again – i.e. the social security gap needs to be tackled if the country is to remain functional *and* adhere to the deficit rule at the same time.

²⁴ The above mentioned Colla Reform – i.e. the acquiescence of the anti-redistribution camp to permanently redirect a non-social security related government revenue to cover social security expenditure – might provide support for this argument.

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