OECD Economic Surveys

Belgium

OECD PUBLISHING

Volume 2007/3 – March 2007

OECD Economic Surveys

Belgium

2007

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Commission of the European Communities takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

This survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

Also available in French

Table of contents

Boxes

Tables

Figures

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Belgium were reviewed by the Committee on 11 December 2006. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 21 December 2006.

The Secretariat's draft report was prepared for the Committee by Jens Høj, Ekkehard Ernst and Stefaan Ide, under the supervision of Patrick Lenain.

The previous Survey of Belgium was issued in May 2005.

BASIC STATISTICS OF BELGIUM, 2005

THE LAND

Area (1 000 km^2)	30.5
Agricultural area (1 000 km^2)	15.4

Major urban areas (thousand inhabitants), 2006	
Brussels	1 019
Antwerp	955
Liège	591
Ghent	509

THE PEOPLE

Population (thousands)	10 446
Inhabitants per km^2	342
Net increase	49 431
Net migration	31

Total labour force (thousands)	4 642
Total domestic employment (thousands):	4 212
Agriculture	84
Industry and construction	870
Other	3 259

THE PRODUCTION

Gross domestic product (billion euro)	298
Gross domestic product per head (USD)	35 526
Gross fixed investment:	
Per cent of GDP	19.9
Per head (USD)	7 069

Gross domestic product by origin, at market prices (per cent):	
Agriculture	1.0
Industry	17.1
Construction	4.3
Other	77.6

THE GOVERNMENT

General government (per cent of GDP):	
Current expenditure	49.8
Current revenue	49.8
Gross debt	93.3

Composition of the House of Representatives (number of seats):	
Liberals	50
Socialists	48
Christian-democrats	28
Ecologists	4
Others	20
Last election: 18.5.2003	

THE FOREIGN TRADE

Exports of goods and services (per cent of GDP)	86.3
Main exports (per cent of total)	
Chemical products	23.1
Machinery and equipment	12.7
Textile products	4.2
Transport equipment	12.7

Imports of goods and services (per cent of GDP)	83.5
Main imports (per cent of total)	
Chemical products	22.2
Machinery and equipment	14.5
Textile products	3.7
Transport equipment	11.4

THE CURRENCY

Irrevocable conversion rate:	40.3399

Currency units of euro per USD, average of daily figures:	
Year 2006	0.7964
December 2006	0.7568

Executive summary

The Belgian economy is in a strong recovery phase. *The balancing of the budget since the start of the decade has allowed public debt to fall fast relative to GDP, providing a favourable macroeconomic background for the recovery. Moreover, structural reforms, particularly in the labour market, are showing signs of success. Output has accelerated and was by mid-2006 growing at 3% – the fastest pace since 2000. With growth well above potential, some production factors are already under strain. The challenge will be to persist with stability and reform-oriented policies to bolster the economy's trend growth, a challenge made more acute by the impending ageing of the population.*

Maintaining public finances on a sustainable footing in the long term will require additional reforms. *Ageing-related social security spending is projected to increase by some 6 percentage points of GDP by 2050. The current government strategy focuses on securing the system until 2030, pointing to the need for additional measures to secure fiscal sustainability thereafter. A further lowering of marginal tax rates could help to expand labour market participation and thereby also broaden the tax bases, but such cuts could only be sustained if expenditure growth is tightly constrained. Spending restraint is essential, not only at the federal government level, but also at other levels, where spending has been the most dynamic. All government levels need to share the burden of preparing for ageing.*

Labour market policies are aiming to increase participation. *The government has started to close early-retirement routes, make unemployment benefits for prime-age workers conditional on job-search efforts and improve the exchange of information between public employment services. The results are positive so far, but small. Activation policies are in place, but not all unemployed are fully subject to job-search obligations. Moreover, there is no tapering off of unemployment benefits, as practiced in a number of other countries. There is still room to increase employment rates as early exit routes are not entirely closed and wage subsidies are not fully targeted to low-wage workers. Also, the centralised wage bargaining system does not allow wage developments to sufficiently reflect local labour market conditions.*

Tertiary education has been expanded over the past decades, setting Belgium on course towards having a relatively high human capital endowment. *However, there has been no matching increase in funding, which, in the absence of reform, will have a detrimental impact on teaching quality over time. Raising tuition fees would provide tertiary education institutions with independent funding and spur competition further among them. Such a measure encourages students to internalise the cost of their studies and match capabilities and choice of study. The latter should be facilitated by the publication of information concerning study quality and future labour market prospects. Financial barriers to access can be reduced through income-contingent student loans, possibly combined with means-tested grants. As an alternative to increasing tuition fees, other forms of economic incentives may be introduced to encourage students to make efficient use of the tertiary education system.*

The well-functioning financial sector has contributed to growth, but it could work even better. *Cross-selling of retail banking services intended to boost consumer loyalty may have*

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

increased switching barriers and reduced competitive forces. In a similar vein, a number of tax incentives have been introduced to influence household savings behaviour and achieve a variety of policy goals. Their cost effectiveness needs to be assessed against the potential benefits of lower tax rates. There are also various consumer-protection rules that restrict the take-up of credit. In particular, there is little demand among consumers to borrow against their housing wealth, which may partially be related to the lack of adequate mortgage regulation.

ISBN 978-92-64-03186-9
OECD Economic Surveys: Belgium

Assessment and recommendations

The economy is recovering

Belgium's economic recovery is becoming more durable. During 2006, the economy has picked up momentum, reaching an annual rate of 3% year-on-year. The economy has benefited from the EU-wide pick-up in activity, supportive monetary conditions and the beneficial effects of the multi-annual tax and labour market reforms that the government has implemented. Growth has slightly outpaced the euro area average since 2002. The upturn is projected by the OECD to continue at a rate exceeding potential over the next two years, almost closing the output gap by the end of 2008. Nonetheless, there are already signs that some production factors are under strain; capacity utilisation is approaching historic highs and an increasing number of firms report problems finding and hiring qualified workers. Moreover, exporters are losing market share as external competitiveness has deteriorated, partially because of more rapid increases of unit labour costs than among trading partners, but also for structural reasons, such as sectoral and geographic export composition. This indicates that further strengthening of the productive potential and a greater degree of wage flexibility will be essential to bolster long-term growth prospects. The persistence of high unemployment – despite stronger job creation – suggests that labour market reform should continue to be high on the policy agenda.

Key challenges need to be addressed to improve long-term economic prospects

In a broader sense, the Belgian economy exhibits a number of strengths. The cyclical deviation of output from its trend has tended to be small in international comparison, reflecting sound macro-economic policies. This relative stability has perhaps reduced the potential costs of a fairly high degree of nominal rigidity insofar as very large adjustments in product and labour markets have not been needed in recent decades. The level of income per capita has remained high internationally. Belgium has also maintained comfortable current account surpluses, allowing for the continued accumulation of net foreign assets. While productivity growth has not been very dynamic in recent years, the average level of productivity of Belgian workers is among the highest in the world, which may in part reflect the under-representation of low-skill, low productivity jobs. Associated with this, employment levels are low in international comparison, though participation rates are now on a clearly rising trend. Overall, Belgium seems reasonably well placed to reap the benefits of globalisation and to cope with population ageing. But successful adjustment will require policies that in the medium and long term promote continued stronger growth in productivity, while in the short term continue to raise the share of

people in work. The authorities have been aware of the need for reforms and their actions have produced visible outcomes: for instance, the consistent achievements of balanced government budgets have led to a sharp reduction of public debt relative to GDP; likewise, the pick-up in job creation has been accompanied by higher labour market participation rates, especially among older workers. The government intends to stay on the course of economic reforms and has accordingly focused its national reform programme on key priorities to achieve long-term sustainable growth prospects, such as creating a more dynamic labour market, consolidating the budget, securing the future of the welfare system and better protecting the environment. More emphasis on strengthening product market competition in a range of sheltered sectors should likewise be a priority. While the present *Survey* does not encompass all of these priorities, it discusses in detail: *i)* the overall strategy to deal with the sizeable fiscal consequences of ageing; *ii)* the labour market reforms undertaken by the government to boost employment gains; *iii)* the increasing enrolment of new students into tertiary education institutions and related stresses; and *iv)* the contribution of the financial system to long-term prosperity.

The budget is balanced since 2000, but achieving growing surpluses will be challenging

Since 2000, the general government budget has been kept in strict balance, helping to reduce the level of gross debt from about 110% to below 90% of GDP in 2006. However, it will be more difficult to reduce the debt ratio from now on. This is because the primary surplus has been lowered considerably (from 6½ per cent of GDP in 2000 to about 4% in 2006) as the government used some of the savings in interest charges to increase spending. While this expansionary fiscal policy stance has helped the recovery, the dissipating of windfall gains in interest payments has made it more difficult to keep public finances on a sustainable basis in the longer term. The balancing of the budget has been achieved with the help of one-off fiscal measures (such as sale of real estate, special dividends from public companies and securitisation of tax arrears) equivalent to an average of 0.5% of GDP every year, which have helped to postpone the necessary consolidation.

A more ambitious fiscal objective is welcome

The objective for fiscal policy is once again becoming more ambitious. As part of the government's strategy for pre-funding the cost of ageing, the government's long-term plan is to generate a budgetary surplus of 0.3% of GDP in 2007 and then have it growing by 0.2 percentage point of GDP every year until the surplus reaches nearly 1½ per cent of GDP in 2013. The surplus is maintained at this level until 2018, after which surpluses will be gradually reduced to zero by 2030. The surpluses are earmarked to the Ageing Fund – the main pre-funding vehicle – which will be used to finance additional ageing-related spending. The implementation of this plan requires important fiscal consolidation efforts, not only because of the more ambitious targets for fiscal policy, but also because interest charges will decline less rapidly in the future. An additional concern is whether the time horizon of the fiscal strategy is sufficiently long to deal with the bulk of the consequences arising from population ageing. The government's pre-funding strategy aims at financing additional ageing-related costs only until 2030; yet important fiscal burdens of ageing will also materialise in the following decades. *Hence, the government's fiscal targets need to be made*

even more ambitious through a combination of further pre-funding, tax base broadening, expenditure restraint and labour market reform. The necessary amount of additional efforts could be reduced by tightening the pension replacement rates – but they are already internationally low. A more realistic prospect would be to increase the effective retirement age, for example, by linking over time the statutory age of full pension eligibility to developments in life expectancy. Meeting the fiscal challenges of ageing will require enhanced accountability and close coordination across levels of government, in particular because, under current arrangements, most of the additional ageing-related spending growth falls onto the federal level, without appropriately offsetting revenue prospects.

All elements of the budget must play a part

The amount of needed fiscal consolidation suggests that action is required both on the spending and the revenue side. Fiscal consolidation through expenditure restraint cannot be achieved by the federal government alone, as its discretionary spending power is relatively limited. *Thus, all government levels need to participate in the consolidation process by reining in spending. Indeed, the significant extent of fiscal decentralisation means that all levels of government need to generate surpluses in order to participate in the pre-funding effort. To this end, all levels of government might consider working together to establish an expenditure rule that would cap the growth of general government spending. Moreover, attention needs to be paid to surpluses in structural terms, so as to avoid pro-cyclical spending patterns, and defined to exclude the use of one-off measures, which are not sustainable indefinitely. On the revenue side, if the beneficial effects of the government's recent efforts to lower marginal tax rates are to be preserved and extended, the revenues needed to sustain fiscal consolidation can only be realised by directly and indirectly broadening the tax base, such as by phasing out a range of tax expenditures and by expanding labour market participation.*

The labour market is still not functioning effectively

Since 2000, a significant share of new jobs has been created in the public sector, although more recently a welcome development has been the emergence of the private sector as the main source of employment growth. The increase in the level of employment has been accompanied by an expansion of the labour supply and the unemployment rate has therefore hardly changed. Belgium therefore remains characterised by a high level of unemployment, rising but still low participation rates and a significant mismatch between labour demand and labour supply, which is illustrated by large geographical differences in labour market situations. The authorities should therefore continue focussing their efforts on improving labour market outcomes.

Labour market interventions could be improved

The Belgian government has recently taken a series of steps to discourage early exits from the labour market and encourage re-entry of those who have stayed out of activity. These measures have included the closing of some early retirement paths, as stipulated in the Solidarity Pact between the Generations. In addition, activation measures have been enacted, notably in the form of individualised road maps for returning to work, follow-up interviews and possible sanctions in case of insufficient job search activities. Activation,

however, is only applied to unemployed less than 50 years old and with a relatively long unemployment history. Meanwhile, other labour market policies have been kept unchanged, notably the unemployment benefit system. More emphasis has therefore to be placed on interventions to make work pay. *The effectiveness of labour market activation measures could be enhanced by limiting unemployment benefit duration. Alternatively, the government should consider gradually phasing down benefits. This could possibly be combined with a higher initial replacement rate. The monitoring of search effort should be jointly undertaken by the federal and regional public employment services, which would also help to secure consistency of feedback and sanctioning mechanisms. To increase the employment rates of groups with weak labour market attachment, a number of measures should be applied, including further closing of exit routes for early retirement, applying early activation to young school leavers, reducing high effective marginal tax rates for low-income earners and better targeting of wage subsidies to low-skilled earners.*

Wage moderation is important, but more wage differentiation is needed

An important pillar of the authorities' strategy is the emphasis on wage moderation. The centralised wage bargaining system is based on preserving external competitiveness by setting an indicative norm for maximum labour cost increases that keep developments in line with the three main trading partners. There is also a lower bound for wage increases stemming from the system of automatic indexation of wages to price developments. The indexation system is mandatory for all and existing opt-out rules in sectoral wage agreements are rarely applied. These features mean that bargaining can only take place within a narrow range defined by the indexation floor and the wage norm ceiling, which has recently been in the order of only 1 to 2½ per cent over the two year period covered by the wage agreements. As a result, there is in practice little differentiation of wage developments across geographical locations. Thus, the centralised wage bargaining system should be revised to allow wage developments to better reflect local labour market conditions. *As a minimum, this requires facilitating the use of opt-out rules and promoting the use of all-in agreements. In the medium term, it would be advisable that the social partners consider phasing out the wage indexation system, so as to allow greater real wage flexibility.* Inspiration for reforms can also be found in the development of the wage negotiations in some of the Nordic countries, where local conditions are increasingly taken into account in the central bargaining framework.

The expansion of tertiary education is important, but quality and efficiency must be secured

Tertiary education has expanded rapidly over the past several decades, turning the system from having an elite orientation to providing tertiary education to a much larger share of each generation. In the process, the low educational attainment of the population has been increased, setting Belgium on course to having a relatively high human capital endowment. The tertiary system is currently based on the principles of open access, low tuition fees, and the right of students to get a second chance after a first failure in higher education. Some measures have been taken at the community level to further improve the quality of tertiary education, such as adapting the curriculum, introducing a system of

learning accounts, limiting time to graduation, giving greater admission possibilities based on professional experience and enhancing competition between tertiary education institutions. However, there is a concern that the improvement of quality will be difficult to sustain in an environment of rising enrolment without a corresponding increase of funding. Tuition fees are at present too low to provide significant funding to raise quality. The low levels of tuition fees also imply that many students consider tertiary education as a free good. Enrolment rates are therefore high in the first year, where there is limited initial screening, but the failure rate is high at the end of the first year and leads to a frequent change of study fields. *A first measure to enhance the efficiency of the tertiary education system would be to secure a better match between capabilities of the students and the requirements of the studies. This is best done by strengthening screening systems, either at the upper-secondary level or at entry into tertiary education. However, directing students through more extensive counselling could also help.*

Increasing economic incentives in tertiary education, such as tuition fees, with accompanying student loans and grants, would enhance efficiency and improve links to the labour market

Another response to these problems would be to enhance price signals. On the side of the tertiary education institutions, *raising tuition fees to higher cost-recovery levels would provide for an independent revenue source* that would depend on the ability to attract students, thus giving the institutions the financing needed to adapt their supply and quality of teaching. On the student side, higher tuition fees would give an incentive to match capabilities and choice of studies as well as an encouragement to reduce study time. Should tuition fees eventually be raised, financial barriers to access might become an issue. Because capital markets do not accept intangible investments in human capital as collateral, tuition fees cannot be a stand-alone measure and *accessibility should be secured through the introduction of income-contingent student loans, possibly combined with means-tested direct student grants*. Such a combination of measures would also counter the social bias in tertiary education. Moreover, an important contribution of tuition fees would be to further stimulate competition between the tertiary education institutions. However, to alleviate asymmetric information problems and to allow students to make informed choices, recent measures to disseminate relevant information concerning the quality of education should be expanded and combined with career counselling regarding future labour market prospects. As an alternative to increasing tuition fees, the government could consider introducing other forms of economic incentives, so as to encourage students to make an efficient use of the tertiary education system.

The financial sector testifies to Belgium's dynamism, but it could perform even better

The financial sector is sound, dynamic and stable. Banks have shown a capacity for adapting to new market conditions, such as a declining reliance on intermediation of government debt and greater international exposure. They have contributed to economic growth not only by the expansion of their own activities but also, more importantly, by mobilising the large accumulated stock of household savings and intermediating it

effectively to meet financing needs. The fact that no serious banking problems have been experienced for several decades, unlike in a number of other countries, is a testimony to the sector's persistent health.

Greater price transparency of banking services could further promote competition

A defining feature of the Belgian financial system is its concentration in the hands of four large "bancassurance" conglomerates, which offer customers a mix of insurance, banking and financial services. The authorities considered that the emergence of such conglomerates would enhance diversification and contribute to financial stability. These institutions, however, also tend to capture customers by the use of cross-selling strategies, which as such raise switching costs and reduce price transparency, leading to lower competitive pressures. Some steps have been taken by the government to improve price transparency and facilitate switching. The government has also requested an examination of competitive pressure in the savings account market segment, but more needs to be done. *The authorities should reconsider the regulation allowing the tying of a mortgage interest rate reduction and the purchase of certain insurance products. More generally, measures aimed at strengthening competition and contestability in the financial market can be pushed forcefully by the competition authority.*

Relaxing regulation of consumer credit would help

Government intervention in the consumer credit and mortgage loan markets is also more extensive than in a number of countries. The authorities seek to protect consumers notably against over-indebtedness via a variety of administrative measures, including a grid of maximum interest rates. However, this regulation risks stifling innovation in some particular segments of the credit market. Also, the interest rate grid has become the norm for certain credits, notably for credit or store cards. Although the regulation seems effective, it appears to be overly prescriptive. This raises the question as to whether the same results could be achieved in a less prescriptive way, for instance by making the grid indicative. *Empirical research on the various effects of the interest rate grid could contribute to a debate among interested parties and help the government to formulate possible reforms. This should be accompanied by bolstering financial education to enable customers to adapt to the new market-based regulatory environment.*

Easing housing mortgage loan conditions could smooth consumption

Government interventions in the housing and mortgage markets are also extensive. Regulation caps the allowable variability of interest rates on floating-rate mortgage loans. Fees on early repayment of mortgages are also capped at three months of interest payments. High transaction costs on the housing market have reduced the incentive to withdraw equity by trading down to a smaller house or moving to a rental; recent regional decisions to lower transaction costs go in the right direction, but more could be done. Likewise, lengthy foreclosure procedures may add to banks' operating costs, potentially increasing the prices of mortgage loans in certain market segments. Also, mortgages are

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

almost exclusively provided by banks; the near absence of non-bank mortgage institutions may be explained by the lack of mortgage bond legislation and the absence of a mortgage-backed securities market. Mortgage loans can only be reloaded up to the initial value of the loan – reducing the incentive to tap increasing housing equity to smooth consumption. Altogether, there is little use of financial instruments to borrow against housing wealth, such as home equity withdrawal. *So as to modernise the mortgage market, adjustment caps on interest rates should be left to individual decisions, early repayment fees should be cost-based, high real estate transaction costs should be cut and the lengthy foreclosure period should be reduced. Competition in the market for mortgages can be enhanced by introducing mortgage bond legislation. Moreover, consumption smoothing for households should be facilitated by modernising home equity withdrawal and reverse mortgage legislations to make it easier to take out new mortgages on capital gains.*

Tax incentives to savings should be reconsidered

The authorities have also used tax policy to shape financial developments. There are a number of tax incentives favourable to household savings accounts, pension savings plans, life insurance schemes and mortgage payments, with a corresponding tax expenditure of close to 1% of GDP. Such measures do not necessarily increase saving rates and they do not obviously benefit the consumer, but they do influence the allocation of saving. Furthermore, they require higher income tax rates than otherwise. *Thus, the costs and benefits of the various tax incentives favouring specific savings vehicles should be reviewed and, where needed, tax incentives should be reconsidered.*

ISBN 978-92-64-03186-9
OECD Economic Surveys: Belgium

Chapter 1

From stability to sustained growth: challenges for the Belgian economy

The economy of Belgium is currently performing well. The growth of activity has recently gained strength, reaching 3% year-on-year in mid-2006, slightly ahead of the entire euro area. The upturn partly reflects the cyclical trend in neighbouring countries, which has encouraged exports; in addition, residential investment has been encouraged by supportive credit conditions and the multi-year income tax reduction has provided a beneficial support to consumer spending. In a broader sense, the economy exhibits a number of strengths. Steady growth over the past decade has helped maintain living standards at a relatively high level by international comparison, unlike in large euro area countries where the advance of per capita GDP has been more modest. Belgium's income levels reflect for the most part the high productivity of its workers, a testimony to the strong efficiency of its business sector. By contrast, the progress made to involve more of the working-age population into the labour market has been so far modest. Even though participation rates are on a clearly rising trend, the labour market involvement of older workers remains low by international standards, as is the employment rate of the younger generation. The authorities' medium-term reform programme thus attaches a high degree of importance to improving labour market outcomes. This will become increasingly essential with the ageing of the population, which will weigh on the availability of labour resources and on public finances. Ambitious and broad-based reforms to raise labour utilisation, while keeping up the high level of productivity, will be crucial to sustain growth beyond the current cyclical improvement.

The economy has gained in strength

The Belgian economy has recently performed well. Activity has gained momentum since the recovery started, reaching a pace of growth in mid-2006 that is slightly ahead of the average for the euro area. The cyclical upturn has benefited from the firming of demand in trading partners; and the high levels of consumers confidence and business expectations. In a broader sense, the recent improvement corroborates evidence that the economy has gained in strength over the past decade. Activity has been resilient in the face of external influences, as shown by the low degree of variability of the output gap and private sector employment growth (Figure 1.1). This is likely to reflect the effects of stability-oriented economic policies, notably the effects of institutional settings, such as the centralised wage-bargaining system, which has sought to bring wage claims in line with those of neighbouring countries, perhaps at the cost of additional rigidities. Another sign of economic strength is that living standards have remained above OECD average. Even though Belgium has not fully participated in the global acceleration of growth over the past decade, its living standards have not fallen behind as much as they have in the three large euro area countries where the per capita GDP gap with the United States has widened (Figure 1.2). An important area of medium-term improvement has been the fiscal situation, which has strengthened as a result of the consistent achievement of balanced budgets, and led to a steady decline in the debt-to-GDP ratio.

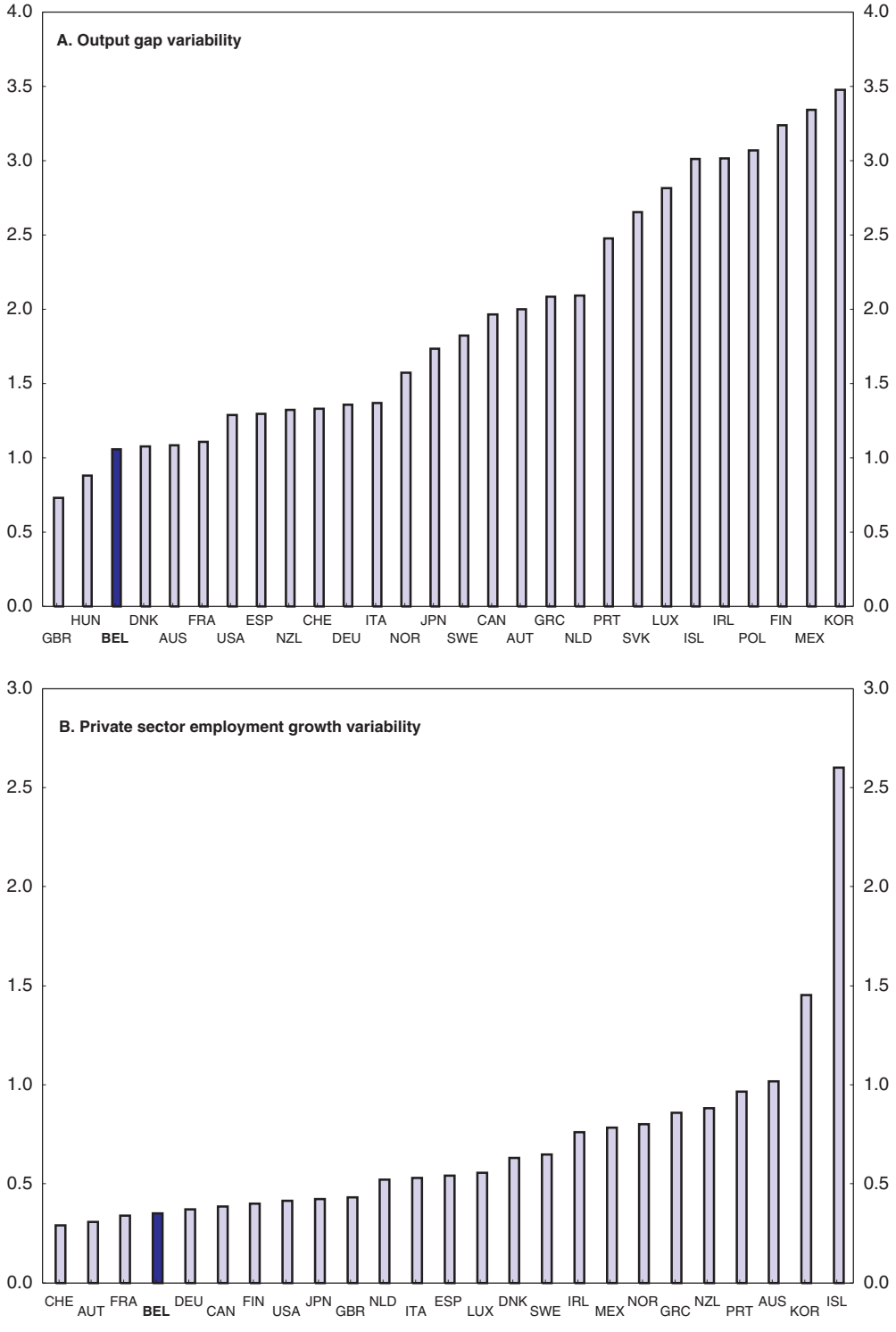
The near-record high level of productivity reflects, to a large extent, the labour market's inability to provide enough jobs to low-skilled workers. Workers with lower education, limited experience or near retirement age remain to a large extent at the margin of the labour market, even though some progress has been made in changing incentives and participation rates are clearly on a rising trend. Employment gains have rebounded at an accelerating rate with the cyclical upturn, but the jobless rate has remained close to 8½ per cent as new inflows increased concomitantly. Employers have nonetheless begun to run into hiring difficulties, notably for certain skills and certain localities, a clear sign of mismatch between labour demand and supply. The authorities are well aware of these difficulties, and the high priority they have given to job creation in the national reform programme reflects their intention to implement further labour market reforms. This will be increasingly important to continue preparing Belgium for the upcoming ageing of the population, which will have important effects on the availability of labour supply and the public finances. Further ambitious reform will go a long way towards helping achieve sustained growth beyond the current cyclical improvement. The present chapter provides the macroeconomic backdrop to these analyses, summarises the key challenges faced by Belgium and briefly introduces those that are discussed in some depth in the present *Survey*.

Recent trends

Real GDP is estimated to have expanded by about 3% in 2006 from the previous year, the most robust pace of growth since the start of the decade. Exports have benefited from

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

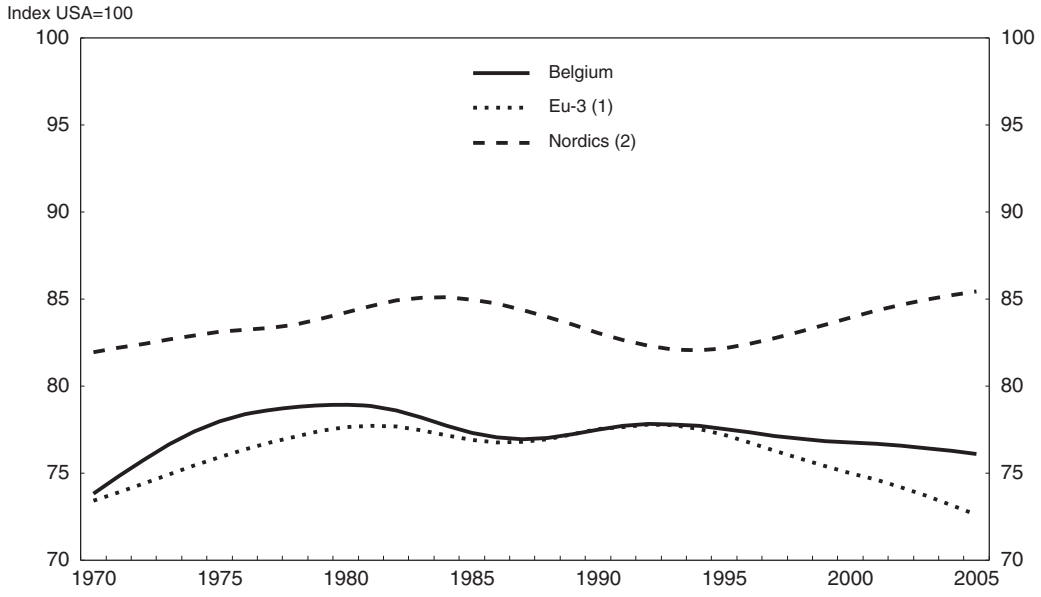
Figure 1.1. **Output gap and employment growth variability**[1]
1995-2005



1. Standard deviation of related series is expressed in per cent.

Source: OECD, Economic Outlook Database and Secretariat's calculations.

Figure 1.2. **GDP per capita 1970-2005**
Relative to USA, in PPP terms, HP filtered



1. France, Germany and Italy.
2. Denmark, Finland, Norway and Sweden.

Source: OECD Analytical Database, Secretariat calculations.

the strong international expansion, even though there have been additional export market share losses (Table 1.1). Real net disposable income has been lifted by the completion of the multi-year programme of personal income tax reduction, helping to support private consumption. Investment has also been dynamic, notably in the residential construction sector where accommodative monetary conditions have eased mortgage loan terms and facilitated accession to home ownership. Business investment also expanded in response to higher capacity utilisation and better business confidence. These trends are expected to remain largely unchanged in 2007, but growth is nonetheless forecast to slow down toward a slightly less rapid pace. This is because public infrastructure investment will be reduced, after having been temporarily boosted ahead of the municipal elections in the autumn of 2006. Likewise, exports are projected to slow, in response to a softening of demand from trading partners. As a result of the losses in export shares, combined with the past deterioration of terms of trade, the current account surplus will fall to below 2% of GDP, down from the average surplus of around 4% at the beginning of the decade.

Output growth currently exceeds the potential rate and, although it is expected to ease slightly in 2007-08, it should nonetheless be sufficient close the output gap by the end of this period. Employment growth has been buoyant and there are already signs that slack is disappearing in some parts of the economy. Capacity utilisation is at its highest level in five years, pushing firms to accelerate investment to meet growing demand. On the labour market, as noted, employers are already signalling hiring difficulties for skilled workers. These tensions have not yet triggered additional cost pressures and core inflation remains below 2%. Nevertheless, the fact that production factors appear to be already under some strain at this relatively early stage of the upswing suggests that there are elements of rigidity hampering the supply response.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Table 1.1. **Short-term outlook**

Percentage change from previous period, at constant prices, unless indicated

	Current prices, euro billion 2003	2004	2005	2006	2007	2008
Private consumption	147	1.6	0.8	2.4	2.0	2.0
Government consumption	63.2	2.1	–0.6	1.6	2.3	2.2
Gross fixed capital formation	51.9	7.0	5.1	3.1	5.2	3.9
Public sector	4.5	3.1	13.5	–9.2	–0.9	2.5
Residential	12.4	9.0	3.5	4.2	5.2	3.5
Business	34.9	6.6	4.8	4.4	5.9	4.2
Stockbuilding[1]		0.1	0.6	0.4	0.0	0.0
Total domestic demand	62.6	3.0	2.0	2.7	2.7	2.4
Exports of goods and services	22.0	5.7	3.3	3.1	4.3	5.0
Imports of goods and service	210.0	6.2	4.1	3.0	4.8	5.4
Foreign balance[1]		–0.1	–0.4	0.1	–0.3	–0.3
Gross domestic product	74.6	2.7	1.5	2.9	2.3	2.1
Memorandum item:						
Consumer price index		2.1	2.8	1.9	1.7	1.8
Unemployment rate		8.4	8.4	8.6	8.3	8.0
Household saving ratio[2]		11.0	10.8	11.5	11.5	11.3
Government financial balance[3]		–0.1	0.0	0.0	–0.2	–0.2
Current account balance[3]		3.5	2.5	2.0	1.9	1.6

1. Contribution to GDP growth.
2. As a percentage of disposable income.
3. As a percentage of GDP.

Source: OECD, *Economic Outlook* No. 80.

Overall, the recent acceleration of growth confirms past evidence of a medium-term strengthening. The Belgian economy has expanded during the past ten years faster than the large three euro area countries. Because of their subdued growth during 1995-2005, these three countries have seen their combined per capita real GDP not only stopped converging towards the US benchmark, but also significantly diverged from it (Figure 1.2). While the Belgian economy has not matched the performance recorded in the Nordic countries, it has performed noticeably better than the three euro area countries, preserving most of the past reduction in the per capita income gap.

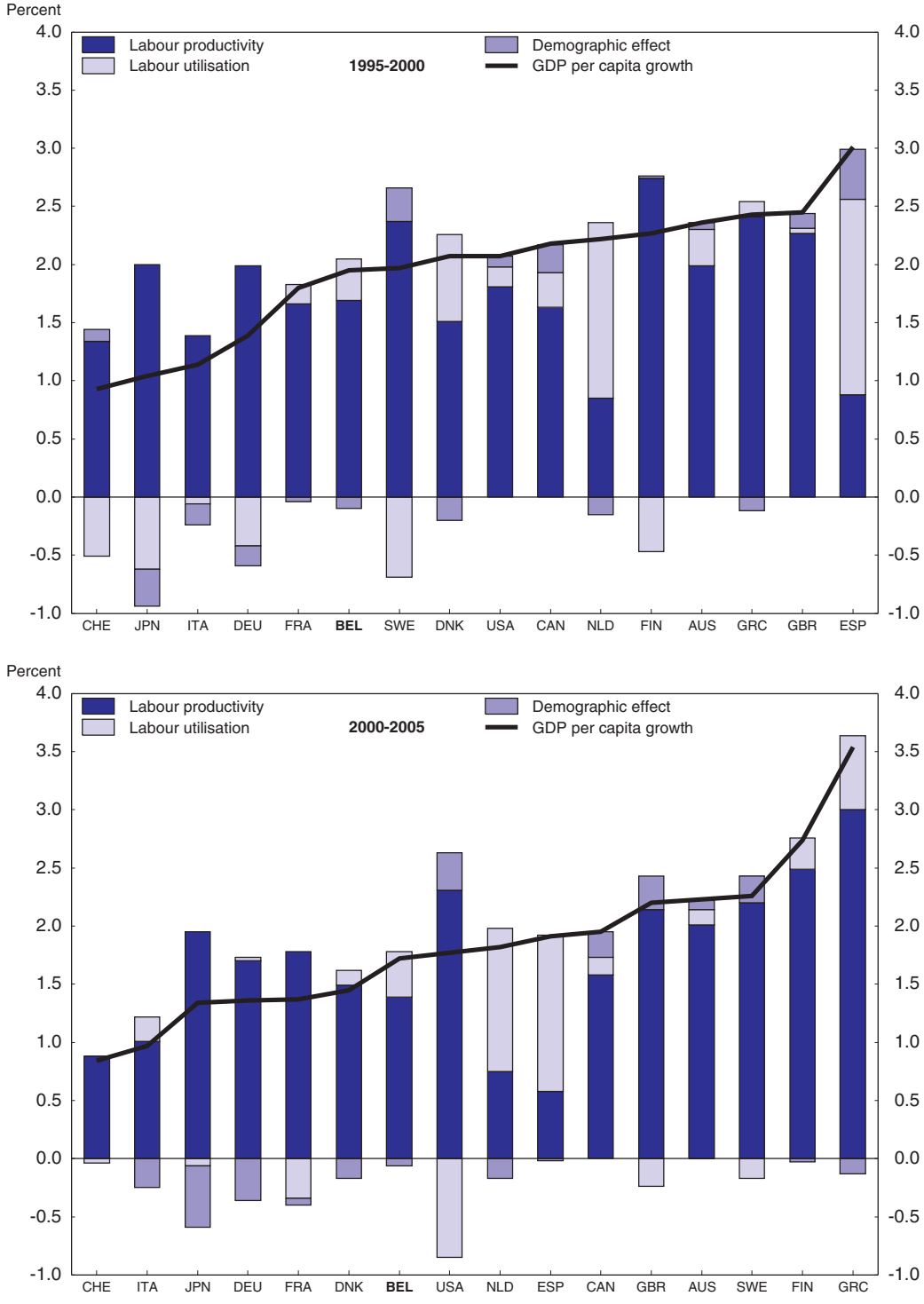
Even though Belgium's growth performance has exhibited some signs of strength relative to the three large euro area countries, it has nonetheless remained below that of many OECD countries, both during the second half of the 1990s and the first half of the present decade (Figure 1.3). This results from a lower contribution of labour productivity in contrast to the revivals observed in countries where the diffusion of new technologies has led to productivity-enhancing changes (*e.g.* United States, United Kingdom and Sweden). Belgium's productivity growth somewhat declined during the first half of the current decade, which might be associated with the improved trend in employment, notably among older workers. This early sign of labour utilisation improvement is, however, of a small magnitude compared to the turnaround observed in countries where labour market outcomes have sharply changed (*e.g.* Italy and Spain).

Labour productivity

Belgian workers are among the most productive in the OECD. In aggregate, their level of hourly labour productivity surpasses that of the United States by about 10%, even

Figure 1.3. **Accounting of GDP per capita**[1]

Average annual growth



1. The figures show the decomposition of average GDP per capita growth over the periods 1995-2000 and 2000-2005 into contributions from labour productivity per hour worked, total hours worked (labour utilisation) and changes in the working age population. All series have been filtered using the HP filter with $\lambda = 40$ applied over the Economic Outlook's medium-term baseline.

Source: OECD, *Going for Growth*, 2007.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

though this result may be somewhat exaggerated by special factors (Box 1.1). This strong performance reflects the high efficiency of almost all of the manufacturing sectors and a specialisation (measured by value-added shares) in capital-intensive industries, such as chemicals and petroleum refining. Belgium has traditionally benefited from large net inflows of foreign direct investment, and therefore from a strong presence of foreign multinational firms. This has led to high intra-firm technology transfers, contributing to a modern capital stock. Indeed, the sectors with the highest share of foreign ownership are also the sectors with the highest productivity growth. These sectors have also been relatively active in outsourcing less productive activities to low-cost countries (Sleuwaegen and De Backer, 2001). The business sector has comforted its traditional strength with a continuous high level of investment; moreover, Belgian firms have begun to close their gap in information and communication technology (ICT) by allocating about 20% of their investments to ICT equipment, a higher share than in most OECD countries; they have also devoted substantial spending to research and development (OECD, 2006a). Thus, Belgian firms have been well prepared to compete in the global environment. The process of de-industrialisation appears to have taken place at a similar pace than in France and the United States, but more slowly than in the United Kingdom, despite the relatively high labour costs (Figure 1.5).

This concentration in highly productive and capital-intensive industries, a natural response to high labour costs, has shaped the specialisation of the Belgian industry, perhaps turning it somewhat to its disadvantage. Belgium has experienced a structural change in the composition of industry away from low-technology industries to medium- and high-technology industries, but to a lesser degree than in other countries. This has

Box 1.1. **Belgium's high productivity level: some qualifiers**

Low share of low-skilled in employment. Belgium has one of the highest levels of labour costs within the OECD, which in a small open economy must be matched by similar levels of productivity. As a result, there has been a substitution of production factors away from labour to capital, explaining that the decline of employment in the manufacturing sector started earlier and has been stronger than in other countries (Robert and Dresse, 2005). Indeed, high labour costs have priced low-skilled workers out of employment, leading to a situation where only about 40% of the low-skilled workers are employed, nearly 12 percentage points lower than the average in the euro area (Figure 1.4). Belgium also has one of the highest unemployment rates for low-skilled workers in the EU.

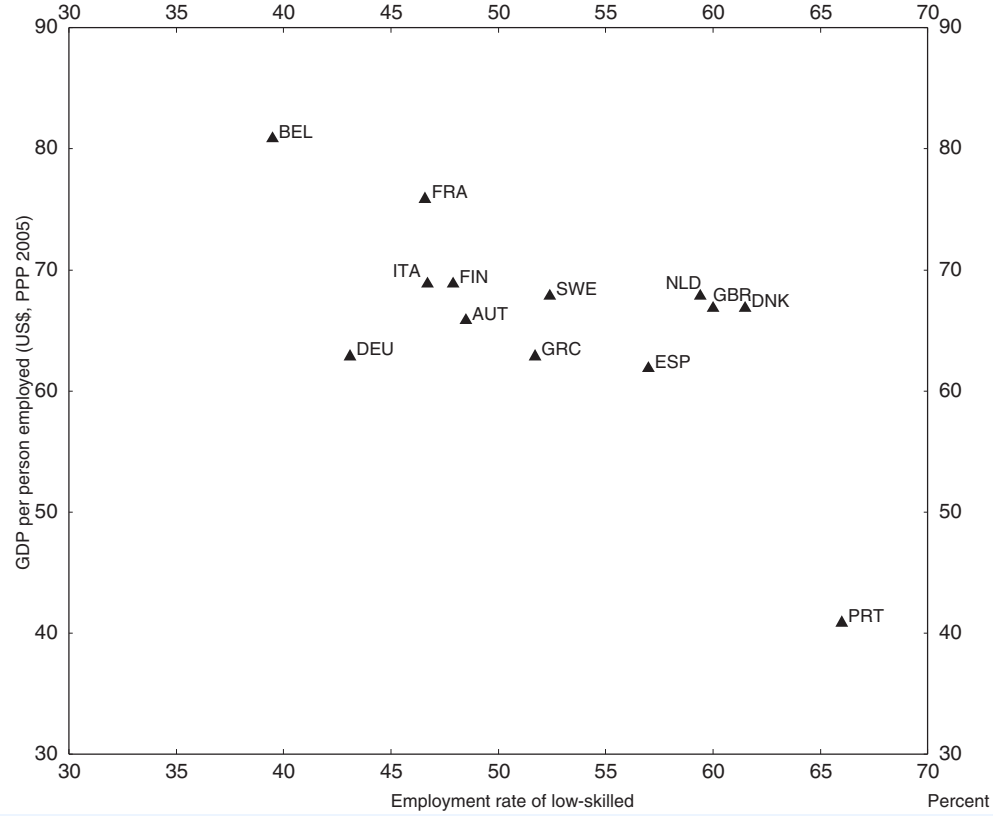
Short working time. Another factor behind the high level of productivity is the short duration of working time, which reduces fatigue effects (Bourles and Cette, 2005).

Taking these two factors into consideration, Cette (2005) shows that if Belgium had the same utilisation of low-skilled workers and same duration of working time as in the United States, then the hourly productivity level expressed in percentage of the US level would be some 13 percentage points lower. An implication is that Belgium appears to be relatively close to the technical efficiency frontier. These findings suggest that the potential for achieving further productivity gains by reaching the technical efficiency frontier are fairly small and that increasing labour utilisation through higher employment of the low-skilled is likely to lead to a transitional reduction in productivity growth without harming its underlying dynamism.

Box 1.1. **Belgium's high productivity level: some qualifiers** *(cont.)*

Figure 1.4. **Employment rates of low-skilled workers and productivity levels**

Selected European countries (2005)

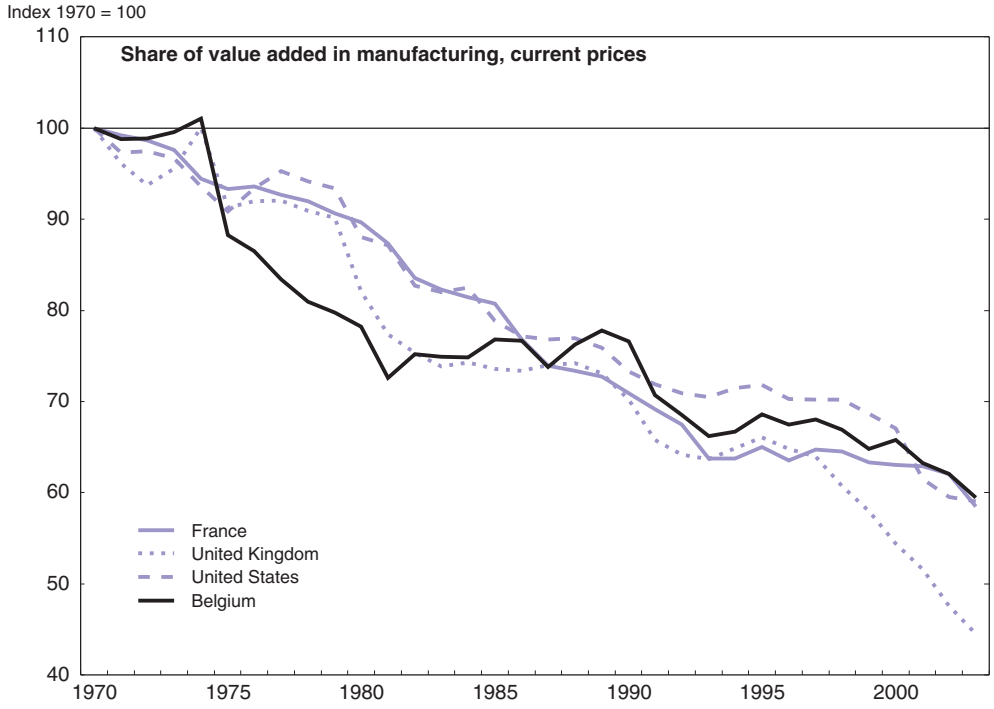


Source: OECD, Productivity Database (2006), Eurostat.

left the economy with a specialisation in relatively less dynamic and mature manufacturing sectors with an orientation towards medium-technology (Table 1.2). The fact that within the same industries Belgian firms tend to perform better than their foreign competitors has not sufficed to raise the relative growth performance. Moreover, their main export markets are typically in the low-growth countries of the euro area (Savage, 2004; ECB 2005). In particular, the economy has a low degree of specialisation in some of the ICT-using services sectors (particularly the telecommunications and distribution sectors) that have been the main drivers of productivity growth in other OECD countries over the past decade (ECB, 2004). In this respect, innovative SMEs play a pivotal role in raising productivity and maintaining competitiveness. As the lack of finance may be a serious barrier to the start-up and expansion of these companies, the Belgian governments have launched a number of support programmes in an attempt to correct for this market failure (see Box 1.2).[1]

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Figure 1.5. **Deindustrialisation in selected countries**



Source: OECD STAN Database.

Box 1.2. **Public support to innovative firms: correcting a market failure?**

Financial systems contribute to long-term economic growth by allocating financing to new firms and therefore stimulating innovation. While market participants might be willing to finance innovative firms when they are ready to commercialise their innovation, rare are the lenders who are willing to do so at the early stage. Providing seed capital is considered to be a high-risk activity because of the uncertainties associated with new and untested technologies – a risk that is often exacerbated by the need for a substantial amount of capital prior to any income streams. It is to correct this perceived market failure that governments intervene in the financing of innovative SMEs (ISME) in many countries. Governments are willing to provide the necessary capital to the ISME because, although they typically only account for a small share of all SMEs, they have the potential to yield disproportionately high externalities upon introducing new technology into the economy. In Belgium, government intervention aimed at solving such market failures takes place at the federal and, more importantly, at the regional government levels.

At the federal level, the Participation Fund offers funding programmes, mostly for SMEs and the self-employed in general. For innovative firms, the Participation Fund mainly provides funding through co-financing under the form of a subordinated loan to projects financed by one or more business angels. At the Flemish level, direct support to innovative firms is mainly concentrated in the Flanders Innovation Fund (Vinnof). Vinnof takes equity stakes in or provides subordinated loans to ISMEs. Vinnof operates as much as possible in partnership with recognised seed capital funds or with the Institute for the promotion of Innovation by Science and Technology in Flanders (IWT) – a public fund jointly operated by

Box 1.2. **Public support to innovative firms: correcting a market failure?** *(cont.)*

the regional government and the universities. A system of co-financing is applied, where the Vinnof matches any funds provided by private partners or provides subordinate loans in the case that the IWT subsidises or supports the project. In some cases innovative SMEs can directly apply to Vinnof, omitting the seed capital fund channel or IWT. The total budget reserved for Vinnof amounts to € 150 million. Another programme is ARKimedes, which is open to all SMEs that need risk capital. ARKimedes doubles the investment capital of a licensed venture capital fund that invests in a Flemish SME. The money is raised through the issuance of shares and bonds. Residents of the Flemish region subscribing to these issuances are entitled to a tax credit. The region of Flanders also gives financial support to BAN Vlaanderen, a platform resulting from a merger of four separately operating Flemish BANs (Business Angels Networks). Whether they receive support depends on a set of criteria like the number of deals, the number of contacts they organise with entrepreneurs, etc.

The approach of the Brussels-Capital Region is comparable to that used by the Flemish Region. The Brussels Regional Investment Company (BRIC) puts the emphasis on the concentration of capital resources in three sectors with innovation potential: ICT, health and environment. The BRIC intervenes from the early stage until the venture capitalists take over. At the Walloon level, a very wide range of programmes has been launched, aimed at providing finance for SMEs and ISMEs. Sowalfin is the overarching government bureau and it coordinates the financing programmes of the sub-regional bureaus – the "Invests". The financing programmes are both based on co-financing under the form of subordinated loans and on loan guarantees and direct equity participation. These programmes are aimed at both SMEs in general and ISMEs. The latter is mainly financed through "spin-off and spin-out" programmes. The "Invests" are mainly creating fund structures that participate in university-linked spin-offs and spin-outs.

A common feature of many of the existing schemes is that government funds are provided in the form of loan guarantees or subordinated loans. The guarantees can reach up to 75% of the total loan, significantly reshaping the risk-taking by banks. Subordinated loans are loans where the public loan has a lower seniority than the funds of private creditors, which in case of a faltering business tend to induce private creditors to seek premature termination of activities. The latter distorts the basic nature of risk capital, which is that entrepreneurs must persuade private investors to accept high risk in the hope of obtaining high return (OECD, 2006c). Thus, the principal role of financial markets can be enhanced by equalising the sharing of risks between private and public funds.

Co-financing is an important measure to engage the private sector in "picking winners". This functioning can be enhanced, in the case where the co-investor is a university fund or another public-supported investment fund, by introducing outcome-based remuneration of board members. For business angels and other private investors in ISMEs, an important source of remuneration is obtained through exit strategies (OECD, 2006d). These rely mainly on selling to a strategic investor as there appears to have been a lack of a vigorous market for initial public offerings (IPO). Recently, measures have been taken to rectify the situation through the creation of two so-called less-regulated markets for SME on Euronext Brussels (Free Market and Alternext), although activity so far has remained relatively low on both markets.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

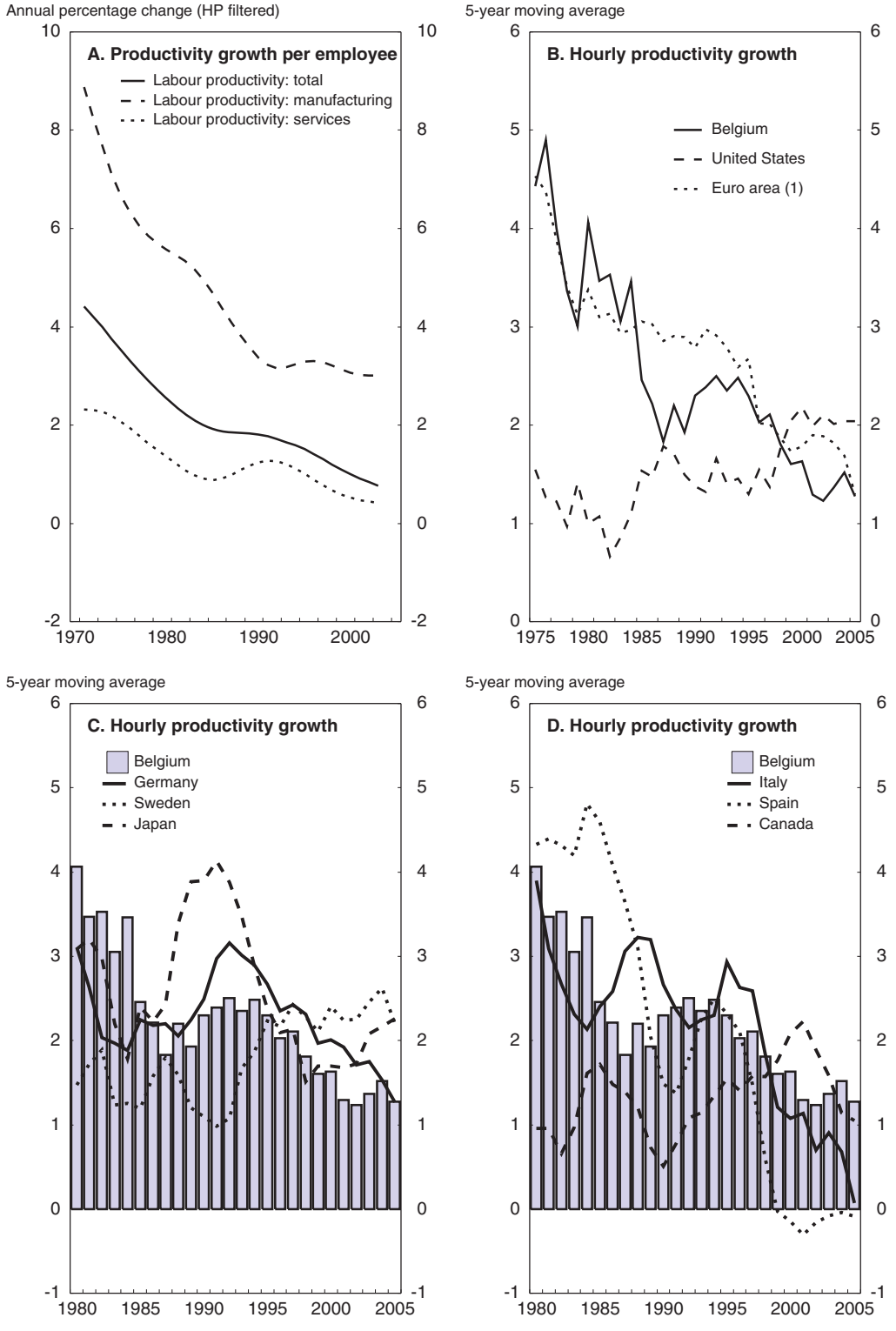
Table 1.2. **Sectoral specialisation and productivity growth in manufacturing**

	Employment shares 1995			Employment shares 2003			Average productivity growth (1995-2003)		
	Low-tech industries	Medium-tech industries	High-tech industries	Low-tech industries	Medium-tech industries	High-tech industries	Low-tech industries	Medium-tech industries	High-tech industries
Austria	43.5	44.7	11.9	39.7	49.0	11.3	4.4	3.6	4.5
Belgium	**40.0**	**51.5**	**8.5**	**38.2**	**53.1**	**8.6**	**3.3**	**3.3**	**5.5**
Canada	50.1	43.2	6.8	48.5	44.9	6.7	3.0	2.2	3.3
Denmark	44.4	46.5	9.2	41.7	47.3	10.9	2.2	2.2	4.7
Germany	30.6	55.4	14.0	28.4	57.6	13.9	0.6	1.4	3.5
Finland	45.4	42.3	12.3	40.3	45.4	14.3	2.8	0.8	14.3
France	40.3	49.0	10.8	39.2	49.7	11.1	1.4	2.8	9.0
Greece	66.4	31.4	2.2	64.7	32.5	2.8	2.8	4.8	4.2
Italy	46.3	44.8	9.0	42.8	47.7	9.5	0.6	–0.2	–0.6
Japan	42.5	40.2	17.4	40.2	42.7	17.0	0.6	1.6	12.0
Korea	37.0	46.4	16.5	32.6	48.4	19.1	5.8	7.4	18.0
Netherlands	49.6	40.8	9.6	48.0	42.3	9.7	1.4	1.8	0.0
Norway	48.0	44.4	7.5	47.0	44.9	8.1	1.7	1.4	0.6
Portugal	68.5	25.5	6.0	66.1	26.2	7.7	1.0	3.0	3.6
Spain	48.5	45.4	6.2	46.1	48.1	5.8	0.5	0.8	0.9
Sweden	37.7	50.1	12.3	34.6	54.2	11.2	3.1	3.3	23.8
Switzerland				31.1	48.3	20.6	3.7	1.8	5.1
United Kingdom	40.4	48.1	11.5	39.6	49.3	11.1	1.4	2.4	4.9
United States	43.1	44.5	12.4	42.7	45.8	11.5	2.5	2.9	24.0
OECD average[1]	45.9	44.1	10.0	42.7	46.2	11.1	1.9	2.4	13.8

Note: The technological classification of sectors into low-tech, medium-tech and high-tech industries is based on the *OECD Science, Technology and Industry Scoreboard 2003*.
1. OECD average based on GDP weights.
Source: OECD STAN and Secretariat's calculations.

Reflecting the under-representation of high-tech industries and Belgium's closeness to the technical efficiency frontier (Box 1.2) productivity growth has been relatively slow. Indeed, the trend of productivity growth has been declining since the 1970s, although more recently there have been signs of improvement. Nevertheless, the trend has still not followed the revival observed in the United States since the mid-1990s (Figures 1.6.A and 1.6.B). Productivity growth in Belgium has also not been as dynamic as in Germany and Japan, where it has been boosted by years of restructuring, nor has it been as dynamic as in the high-tech economies of the Nordic countries, such as Sweden (Figure 1.6.C). By contrast, it has surpassed the sluggish productivity growth of Italy and Spain, but these are countries that have achieved important increases in labour utilisation, in part thanks to labour market reforms (Figure 1.6.D). Overall, there has been a disappointing trend of productivity growth, which has not been fully offset by a strong rebound in employment. This points to the need for an economic strategy combining appropriate framework conditions for the growth of productivity and employment-friendly structural reforms. The underemployment of low-skilled workers is more severe in Belgium than in other countries, and there has been little change in the past fifteen years, in contrast to the improvement observed in other countries (Figure 1.7). Looking forward, it is possible that measures aimed at pricing these workers back into employment and reactivating them would lead to a temporary slowdown of productivity growth. To the extent that this leads to a sharp increase in employment gains, this needs not undermine trend growth and therefore should not be seen as posing a risk for overall economic performance.

Figure 1.6. **Productivity growth**

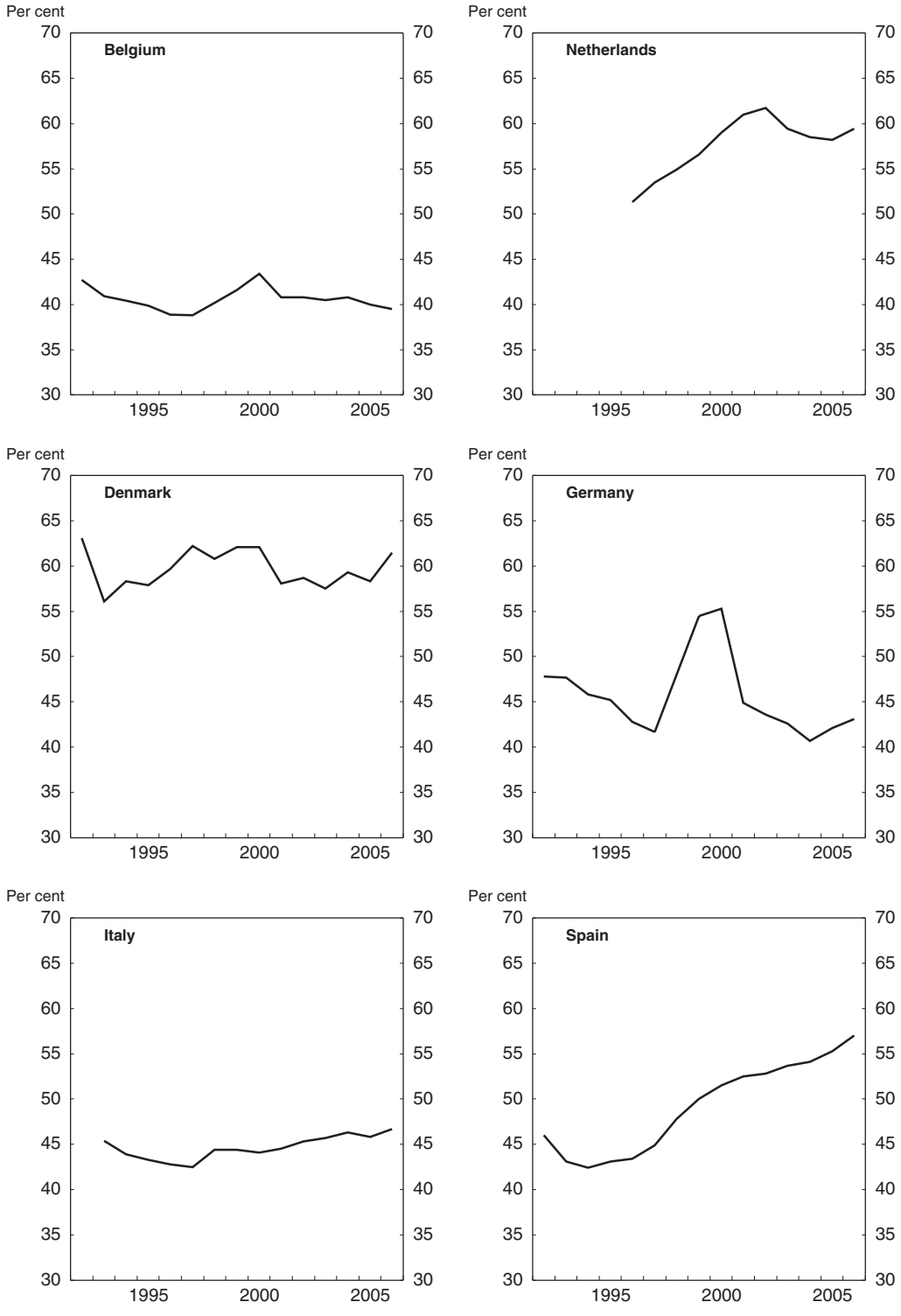


1. Excl. Belgium, Austria and Portugal.

Source: OECD, STAN Database.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Figure 1.7. **The employment rate of low-skilled workers**[1]



1. The employment rate is defined as the employment of low-skilled workers relative to the low-skilled working age population. Low-skilled workers are defined as having no higher than a lower secondary education degree.

Source: Eurostat, Labour Force Survey.

Labour utilisation

Belgium is characterised by an internationally low utilisation of the workforce. As compared to the US benchmark, the level of labour utilisation is about 30 per cent lower. This reflects the combined effects of the short annual working time (1 522 hours, as compared to an OECD average of 1 740 hours), relatively high structural unemployment rate (7.2% of the labour force, compared to an OECD average of 6.4%) and a low labour market participation rate by international comparison (66.4% of the working-age population, compared to an OECD average of 70.3%). While the participation rates of prime-age men and women have been rising and now are high compared to those of other countries, the low level of labour utilisation is for the most part explained by the weak labour market involvement of older workers and the younger generation. There has been an increase in the labour market enrolment of older workers in Belgium since the late 1990s, reflecting cohort effects and structural reforms to close early exit routes and incite later retirement (Figure 1.8); this trend has been important and has helped to narrow the gap between Belgium and other economies. Yet, much remains to be done before achieving a satisfactorily high level of labour market participation of older workers, which currently stands at 33.5% for the age group 55 to 64, compared to an OECD average of 54.2%. Little progress has been made so far to raise the labour market participation rate of the younger generation (age group 15-24), which remains as low as 33.2% by mid-2005 as compared to an OECD average of 49.4%.[2]

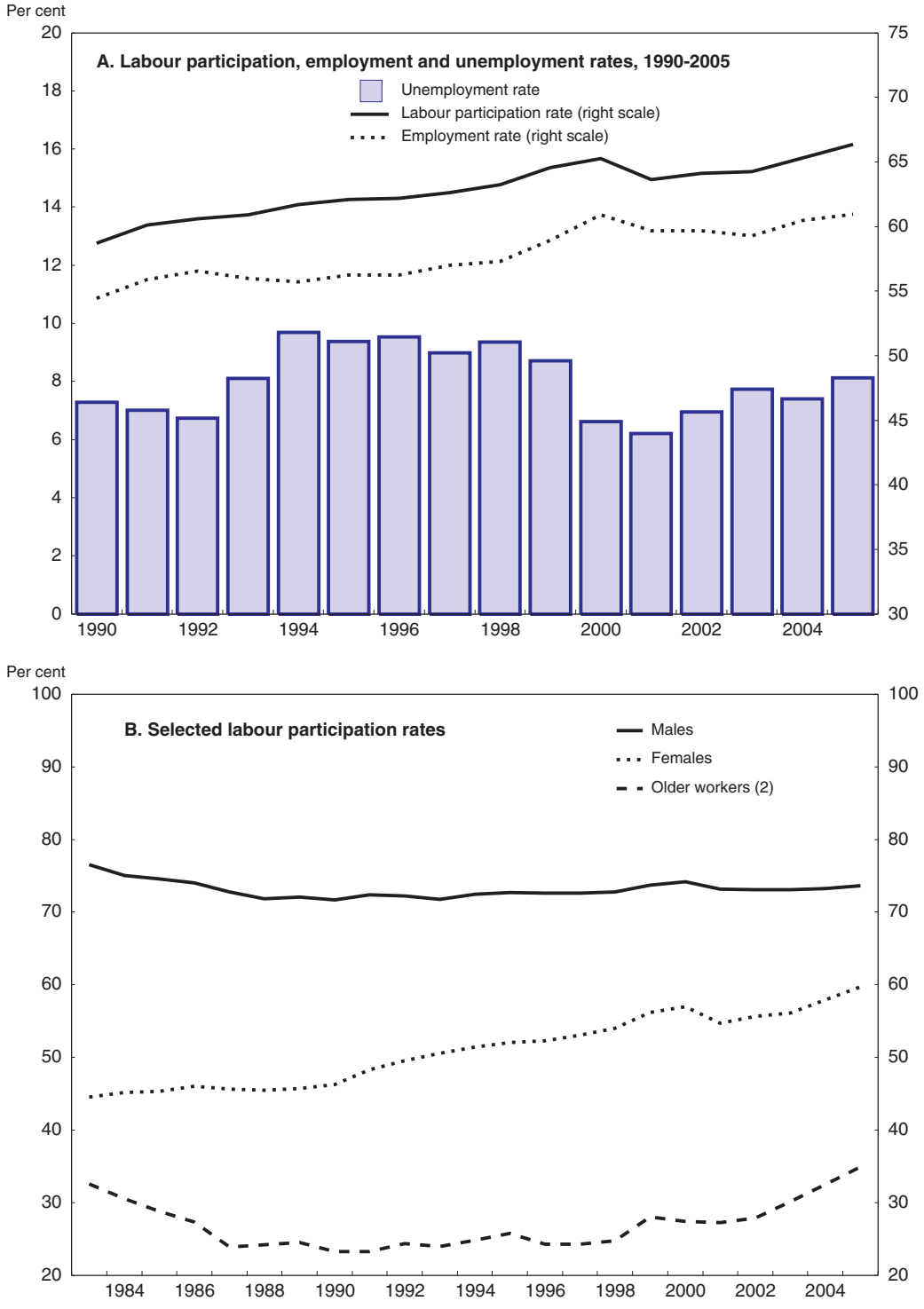
Key challenges remain

This unsatisfactory performance in certain segments of the labour market must not obviate the fact that the Belgian economy exhibits a number of strengths. As noted, growth has been strong lately, and the challenge will be to sustain its upturn. Rising to this challenge will be made all the more important by the upcoming impact of population ageing, which will have a large impact on public finances and on labour market outcomes. The National Reform Programme adopted by the government embraces these various challenges with comprehensive objectives in such various aspects as innovation, entrepreneurship, competition, transport, and communication networks, as well as in improving labour market outcomes (Chancellery of the Prime Minister, 2005). This *Survey* does not encompass all of these important areas; it focuses on the issues of *i)* securing the long-term sustainability of the public finances and coping with the rising cost of ageing (Chapter 2), *ii)* improving the functioning of the labour market so as to achieve a more optimal allocation of available labour resources (Chapter 3); *iii)* ensuring that the recent increase in tertiary education enrolment provides the labour market with the necessary quality and supply of graduates to facilitate the move into higher productivity activities (Chapter 4); and *iv)* obtaining the most of the well-functioning financial markets, by making its financial intermediation function work even better (Chapter 5).

Addressing the long-term fiscal impact of ageing

Fiscal consolidation has progressed since the late 1990s. Past efforts have helped to reduce the public debt-to-GDP from more than 130% of GDP a decade ago to below 90% in 2006, which nonetheless remains high by international comparison (Figure 1.9). The authorities have targeted and repeatedly achieved balanced general government budgets during 2000-06. With a lower debt stock and declining interest rates, there have been welcome windfall gains in the form of a reduced debt service burden. The achievement of balanced budgets at the time when

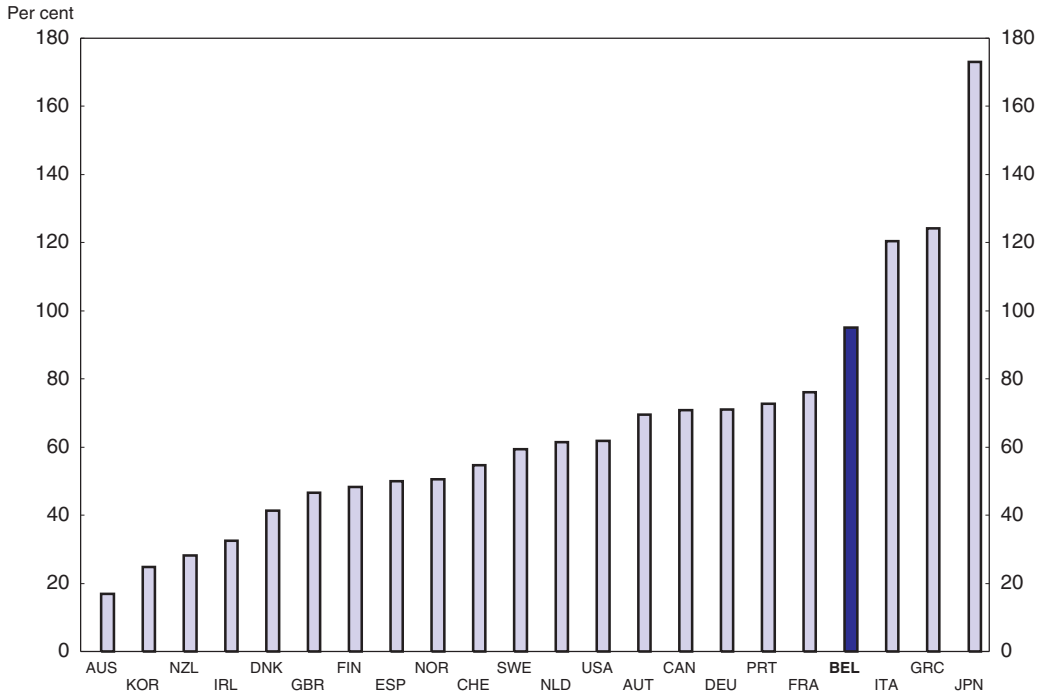
Figure 1.8. **Employment, unemployment and labour participation rates**[1]



1. Labour participation and employment rates are shown in per cent of the working-age population, the unemployment rate is in per cent of the labour force.
2. 55 years and over.

Source: OECD Employment Outlook, 2006.

Figure 1.9. **Gross public debt in the OECD, 2005**
In % of GDP



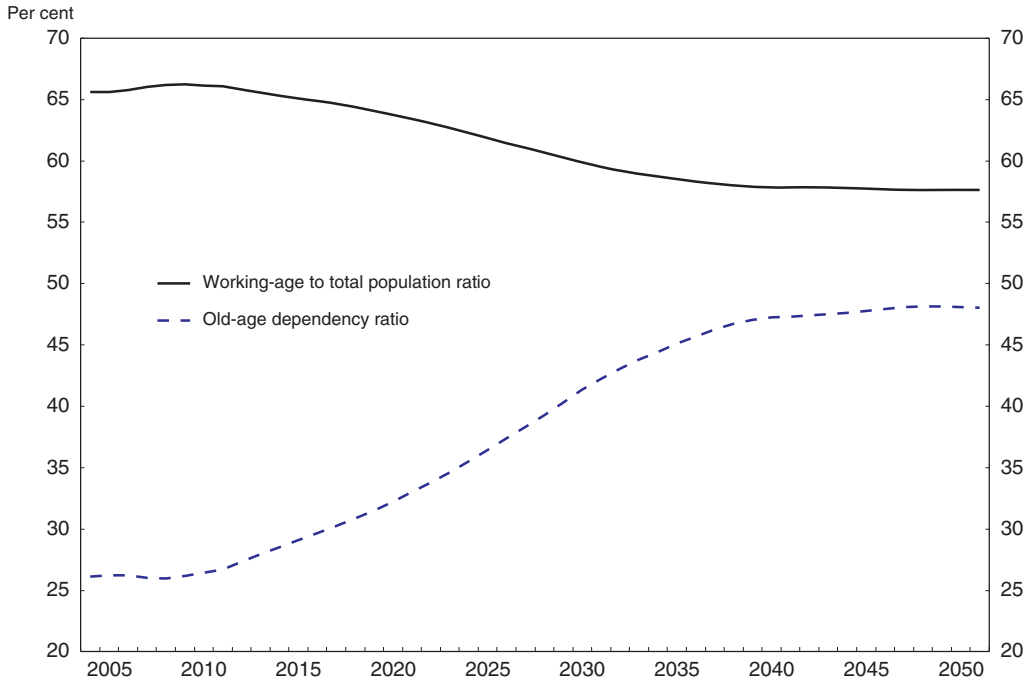
Source: OECD, Economic Outlook Database.

interest payments were falling has meant that the primary surplus declined from 6½ per cent of GDP in 2000 to about 4% in 2006, according to OECD estimates.

The pace of fiscal consolidation has been remarkable; nonetheless, it does not bring public finances in a sufficiently strong position to deal with the long-term fiscal costs of population ageing. The cost of pension liabilities will accelerate from the early 2010s onwards, when the old-age dependency ratio will start to rise and the working age population will start to decline (Figure 1.10). In addition, spending on health and long-term care is also projected to accelerate. Recent measures introduced in the so-called Solidarity Pact between Generations aim at raising the average pension age, and thus reducing future pension costs, although the pact also includes measures that increase future pension spending. While higher labour market participation of older workers will go a long way towards reducing future fiscal gaps, this will not be enough to close them. Replacement rates in the public pension systems could also be reduced, but they are at present not very generous by international comparison and little saving can therefore be expected from lowering them. Hence, the authorities' strategy incorporates an important element of pre-funding of future pension promises. An "Ageing Fund" has already been established; starting in 2007, the authorities intend to generate general government budget surpluses so as to build up its assets. When the debt-to-GDP ratio is below 60%, the fund will begin to finance ageing-related expenditure and will eventually be drained in 2030. While it is an important ingredient of the strategy for securing pensions until 2030, this pre-funding element suffers from a number of shortfalls. Firstly, demographic projections indicate that the fiscal burden of ageing will continue increasing until 2050, pointing to a need for further pre-funding to secure long-term fiscal sustainability (Comité d'Étude sur le Vieillissement,

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Figure 1.10. **Population trends**
In % of total population



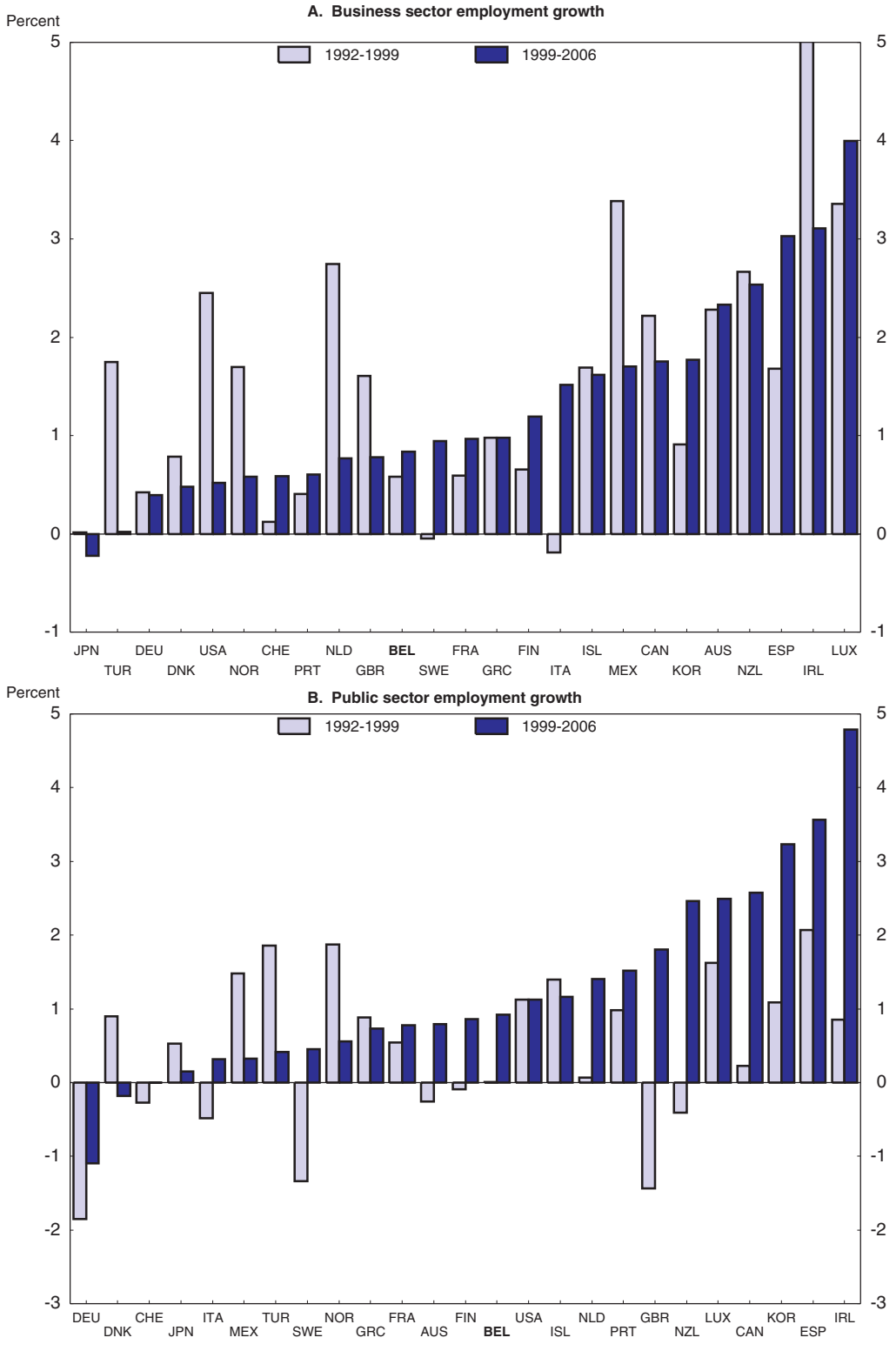
Source: OECD, Eurostat.

2006). Secondly, the current pre-funding strategy appears rather sensitive to small changes in key variables, such as interest rates, which may lead to pre-funding shortfalls in financing additional ageing-related spending. Hence, there is a need to keep the long-term fiscal strategy under review and probably raise its ambitiousness. Larger budget surpluses are likely to be required in order to build up sufficient reserves in the Ageing Fund and meet pension commitments until 2050. The Federal government has, however, decentralised a lot of its spending responsibilities to lower levels of government and has therefore limited flexibility; efforts will therefore be required at all levels of government.

Improving labour market outcomes

As noted, there are several segments of the labour market that function well, while others show weak outcomes by international standards. The acceleration of employment gains since the beginning of the recovery in 2004 is therefore an important development, which will help address the problem of underemployment among certain groups of workers. During the period 1999-2006, average private sector employment growth was somewhat higher than in the previous period, but job creation in the public sector became more important (Figure 1.11). The latter is exclusively due to the sub-national levels of government as employment at the federal level has decreased slightly over the past decade. During the economic downswing in 2001-03, private sector employment contracted by almost 1%, which was nearly offset by higher public sector employment. Since 2004, there has been an acceleration in private sector employment creation and only marginal increases in public sector employment. Employment gains have been most noticeable in the areas of health care and social security. This corresponds to a buoyant

Figure 1.11. **Employment growth**[1]



1. Secretariat estimates for 2006.

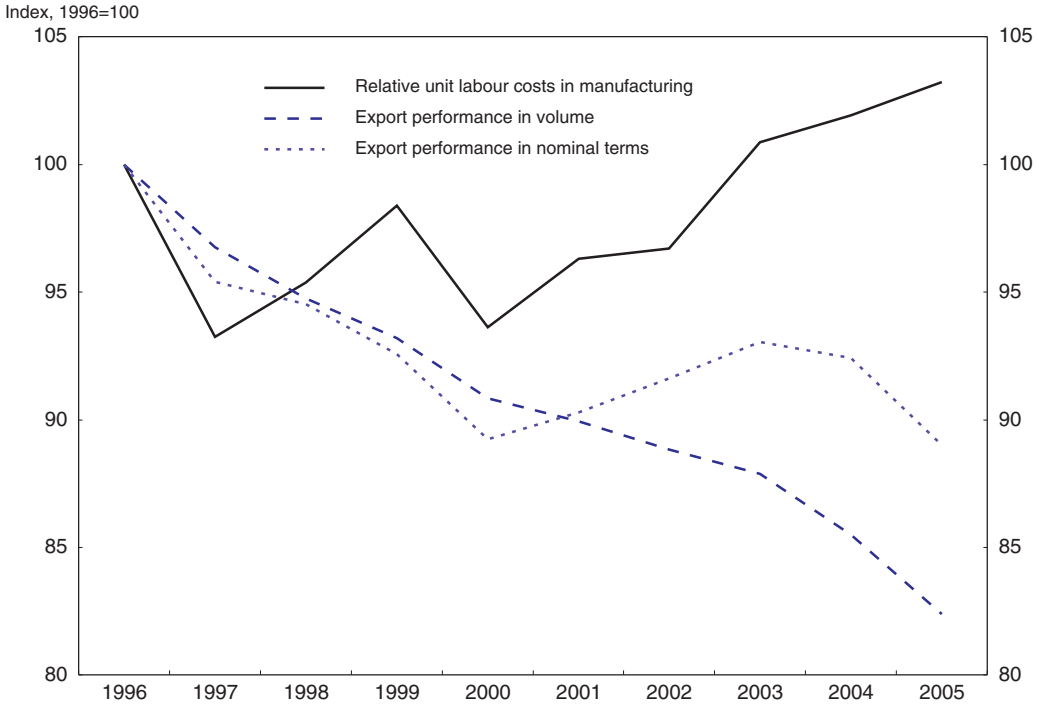
Source: OECD, Economic Database, Secretariat's calculations.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

demand for such services, which is common internationally, but the above noted need for further fiscal consolidation will make it difficult to sustain this pace of job creation in these sectors in the future. Thus, an issue for the formulation of labour market policies is how to further enhance and contain employment growth in the private and public sectors, respectively.

Given the internationally low employment rate of low-skilled workers, an important way of raising employment levels would be to price them back into work, by allowing a high degree of labour cost differentiation. One of the objectives of the wage bargaining system, however, is to safeguard overall external competitiveness. Wage negotiations at the sectoral and enterprise levels include employment objectives. There are few explicit measures in the wage bargaining system that seek greater employment of low-skilled workers, although there are attempts to make allowance for this goal as well. The wage bargaining system fixes an indicative upper limit on wage claims, in line with expected labour cost increases among trading partners, and it sets a lower limit by requiring the indexation of wages to the "health index" (Chapter 3). A finely balanced system between social partners and public authorities has been put in place to guarantee that these agreements are properly applied. However, the system has not achieved the objective of safeguarding external competitiveness. The relative unit labour costs in the manufacturing sector have deteriorated as the result of stronger than expected wage moderation in Germany and an appreciation of the euro, and export market losses have been substantial and larger than in other OECD countries, although the latter is also the result of more structural factors, such as the destination and composition of exports (Figure 1.12). However, developments in export prices do not appear consistent with domestic price and cost

Figure 1.12. **Evolution of relative unit labour costs and export performance**



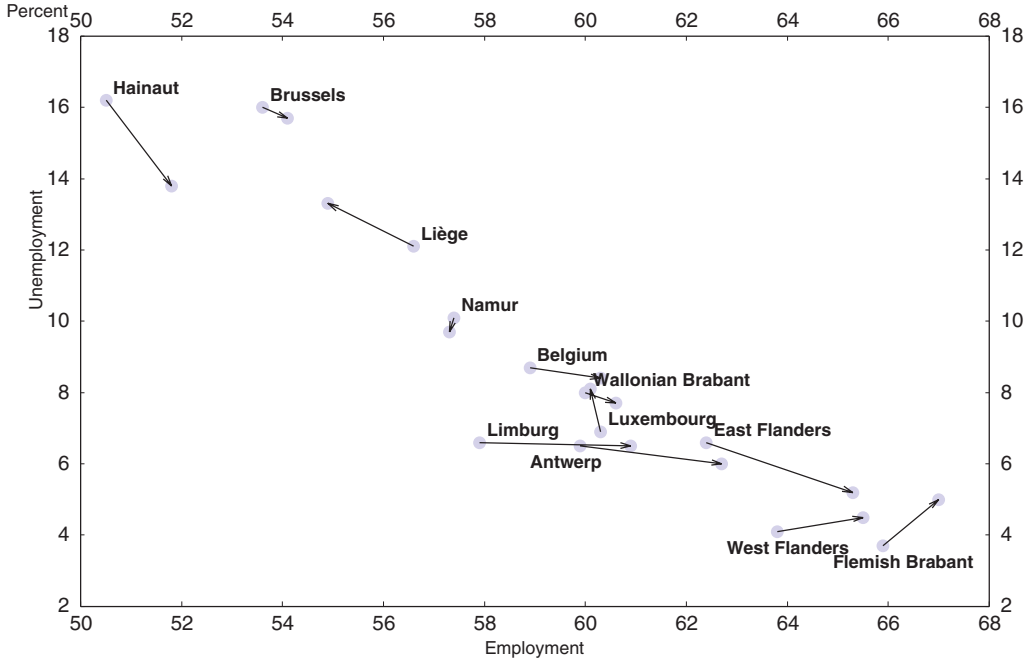
Source: OECD, Economic Outlook Database.

developments. Indeed, when measured in nominal terms export market losses are much less pronounced, perhaps indicating statistical problems in disentangling export prices and export volumes.

The narrow range between the indexation floor and the indicative wage norm ceiling has, in recent years, left little room for wage growth differentiation across geographical locations. Hence, there has been little leeway for wage trends to react to developments in local labour markets. Together with differences in the geographical development of industrial structures, this has contributed to large and widening geographical differences in employment and unemployment rates (Figure 1.13). The lack of wage differentiation has in turn contributed to reducing the scope for labour mobility across regions, a factor that has caused unemployment to drift higher (Figure 1.14). There are other reasons for the low level of mobility, including the generosity of the unemployment benefit system, housing transaction costs (Chapter 5) and other societal aspects. Empirical studies on commuting distances suggest that most of the commuting takes place within a 20 km radius from the employee's residence. Moreover, commuting across regions – except for commuting into Brussels – is a rare exception (Dujardin, 2001). As a result, neighbouring localities can simultaneously have excess demand for labour in one and high unemployment in the other. Thus, one issue for activation policies is how to achieve higher mobility, which could facilitate the transition from inactivity to employment (High Employment Council, 2006). The lack of interaction between local labour markets raises the question of how the current framework for wage negotiations can be revised to serve at the same time the objectives of external competitiveness and employment growth.

Figure 1.13. **Employment and unemployment rates in Belgian provinces**

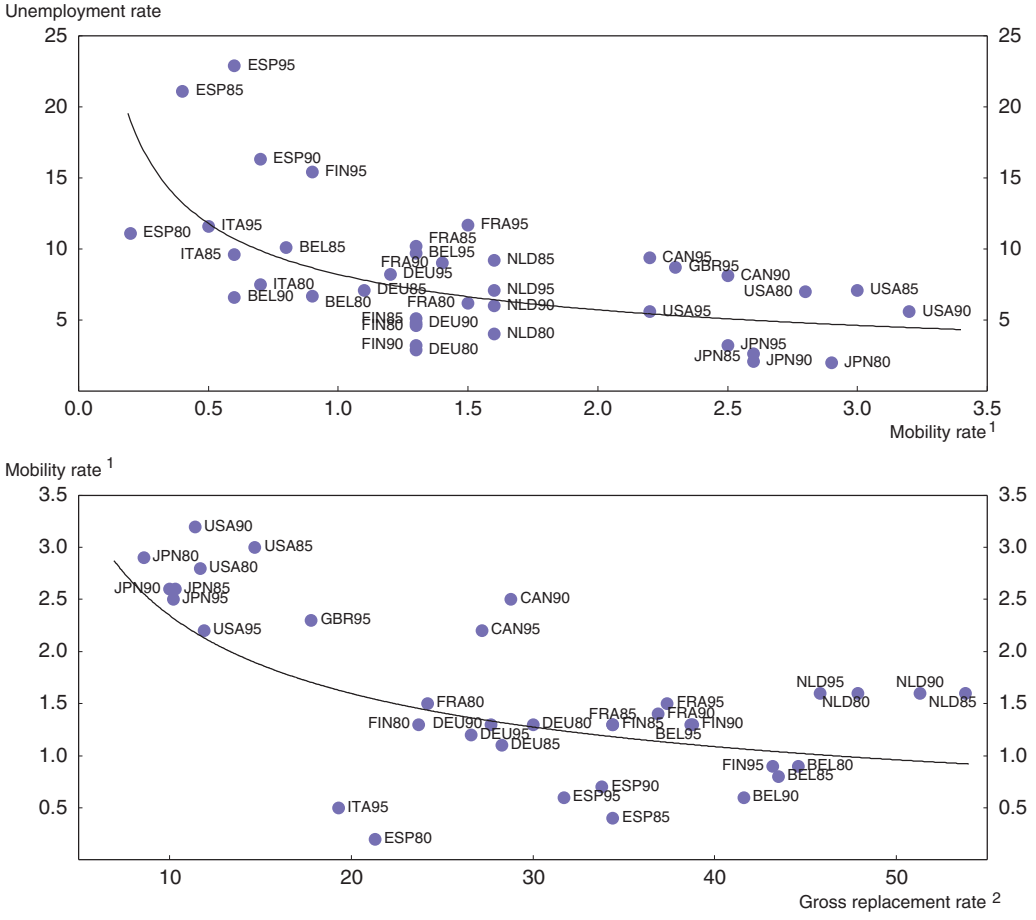
1999-2004



Source: Eurostat.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Figure 1.14. **Geographical mobility, unemployment rates and unemployment insurance**



1. Ratio of the total number of persons who changed region of residence over one year to the total population.
2. Average of gross replacement rates for three family types (single, with dependent spouse, with spouse in work) over a five-year period, with an average of 2/3 APW and 100% APW earning levels in 1999.

Source: OECD (2004), *OECD Economic Surveys: Euro Area*.

Raising efficiency in the tertiary education

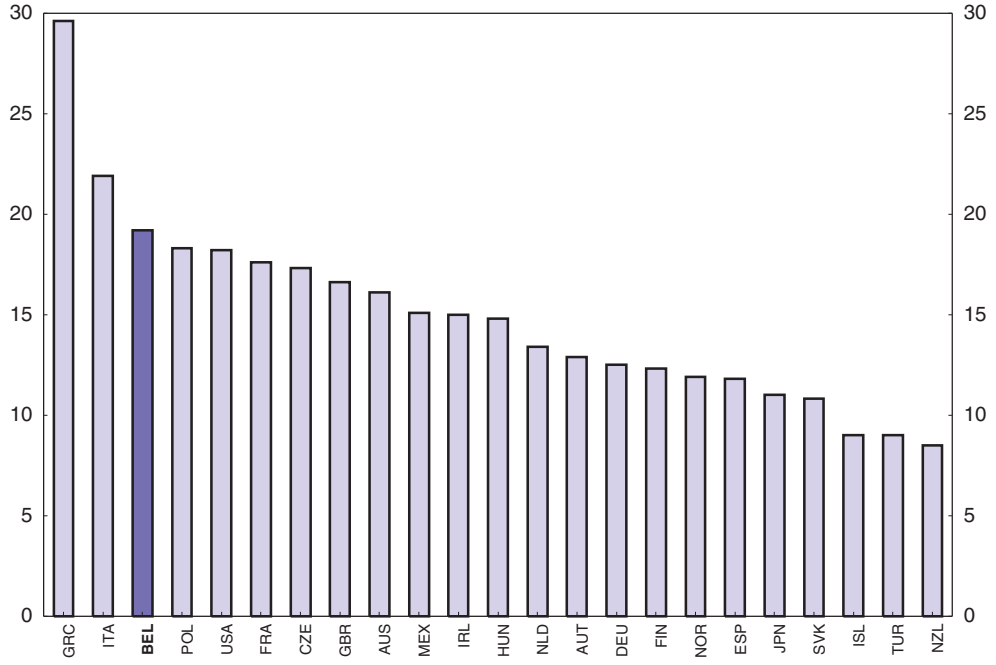
The transition from education to the workplace is made easier when the youth has acquired well-suited skills. Thus, the quality of human capital formation is an essential driver of labour market performance, and hence economic growth. Empirical work indicates that the increasing share of the population with tertiary education was a significant determinant of the increase in US trend productivity growth in the 1990s (Acemoglu, 2002; Beaudry, 2005). An additional effect is that geographical mobility may increase as higher skilled workers are faced with increased opportunity costs of not working. Thus, raising the share of the labour force with tertiary education could contribute to both trend labour productivity growth and the mobilisation of labour resources, adding to long-term potential growth.

Belgium has been characterised over the past decades by growing levels of enrolment into tertiary education, as students have increasingly taken advantage of almost free access. There has, however, been little corresponding increase in funding. As a result, the

efficiency and quality of tertiary education may have come under strain (Figure 1.15). An important issue for the tertiary system is therefore to continue its expansion while, at the same time, providing high-quality education. Moreover, exam failure rates are high and change of subjects frequent. Unemployment among recent graduates tends to be high in some fields, which, together with the signs of skill shortages, raises the issue of how well the labour market signals its demands for qualifications. Another issue is to establish a clear set of signals to allow students to match their capabilities with their choice of study as well as with labour market demands.

Figure 1.15. **Ratio of students to teaching staff in tertiary education**

2003

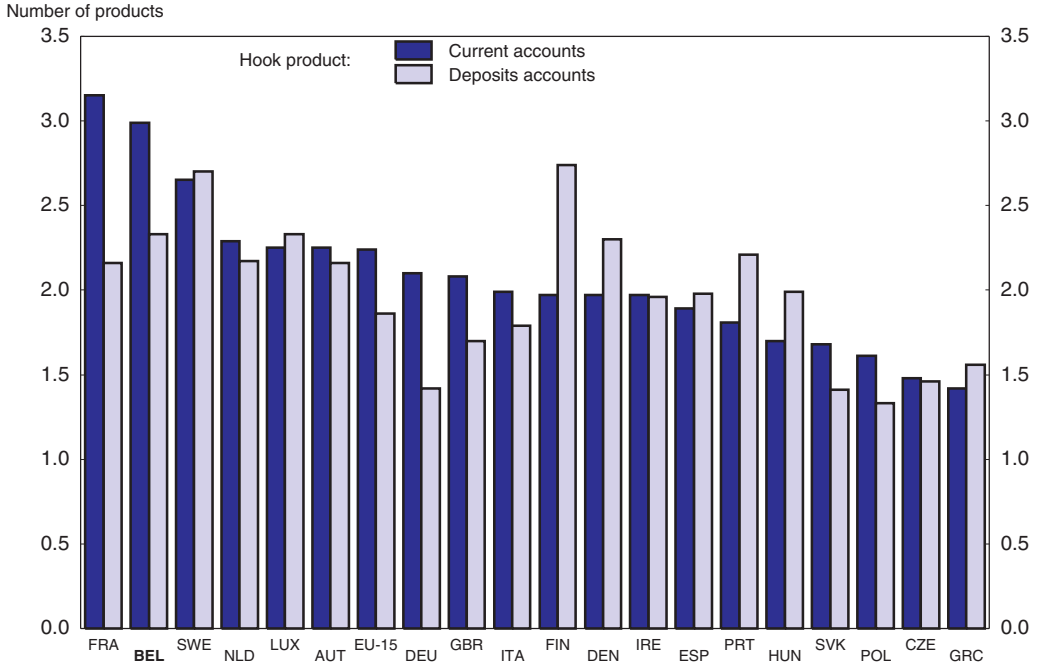


Source: OECD, *Education at a Glance*, 2005.

Enhancing the benefits from financial liberalisation

The Belgian economy is benefiting from a financially stable and steadily growing financial sector. Financial intermediation activity is highly concentrated in the hands of a small number of *bancassurance* conglomerates, which provide a broad range of financial services and products, from traditional retail banking transactions to more elaborate life-insurance investments. The market is also characterised by a high of degree of cross-selling of financial products in Belgium by international comparison (Figure 1.16). The availability of a range of financial services and products supplied by the same institution traditionally fosters the development of "relationship banking" and enhances consumer loyalty. Although this may not be a bad development, there are risks that the institutions use cross-selling strategies to capture customers. Indeed, a too high degree of consumer loyalty may reduce the incentive for consumers to seek alternative providers. In particular, the offer of packages of services at a single price may blur price transparency; as well, the

Figure 1.16. **Cross-selling in banking**[1]



1. Cross-selling is measured as the average number of products that customers purchase from the same bank in addition to so-called "hook products".

Source: European Commission, "Retail Banking Survey", 2005-2006.

provision of complex and interrelated services may erect switching barriers and raise the cost of switching to a competitor. Thus, relationship banking may result less from a deliberate consumer decision than from a marketing strategy. Such practices reduce the probability that consumers will escape to a different bank and make it easier for banks to raise their fees (OECD, forthcoming). Some steps have been taken by the government to improve price transparency and facilitate switching. The government has also requested an examination of competitive pressures in the savings account market segment, but more needs to be done. For example, the allowance of tying of a mortgage interest rate reduction and the purchase of certain insurance products, despite similar practices are explicitly forbidden by the competition authorities in some other OECD countries, raises questions for the prevalence of competitive forces.

An important role of financial markets is to provide financial services that allow households to smooth consumption over the cycle. Such financing is particularly important for consumers who face liquidity constraints and have little choice other than to cut their spending during cyclical downturns in the absence of access to credit. Empirical evidence for Belgium suggests that private consumption is indeed more sensitive to changes in disposable income in Belgium than in other OECD countries, suggesting a smaller degree of consumption smoothing (Pozzi *et al.* 2004). *A priori*, this could be the choice of consumers. However, the observation that home equity withdrawal is almost absent – despite a record level of home ownership – suggests that there might be institutional factors or policy settings that hamper financial innovation. Additional restraint to credit access is found in an overly prescriptive consumer protection regulation,

both in terms of consumer credit and in the area of mortgages. Thus, it appears that the role of financial markets in underpinning economic performance could be further enhanced.

Notes

1. One measure to address this market failure was the 2004 Euronext launch of the Free Market – a stock market segment aimed at attracting SMEs in the growth phase, by minimising the listing requirements – no minimum capital, no obligation to publish interim figures, no need to conform to IAS/IFRS standards, etc.; the only obligation which applies concerns a prospectus approved by the CBFA. This was followed up by the 2006 launch of Alternext which fills the gap between the Euronext Free market and First Market with respect to reporting obligations. Compared to the normal stock market, Alternext is exchange-regulated market with a lighter regulatory framework, offering small and mid-sized companies from any sector a simplified access to the capital markets, while ensuring investor protection and transparency and promoting liquidity. It offers opportunities for private and institutional investors to participate in financing growth.
2. The relatively low labour market participation rate for younger workers is partly related to long mandatory schooling and a relatively high enrolment rate in further education (OECD, 2005).

Bibliography

Acemoglu, D. (2002), "Directed Technical Change", *Review of Economic Studies*, No. 69, pp. 781-810.

Beaudry, P. (2005), "Explorations in Macroeconomics", *Canadian Journal of Economics*, Vol. 38/4, pp. 1136-1159.

Bourles, R. and G. Cette (2005), "A Comparison of Structural Levels of Productivity in the Major Industrialised Countries", *OECD Economic Studies* No. 41, 2005/2.

Cette, G. (2005), "Are Productivity Levels Higher in Some European Countries than in the United States?", *International Productivity Monitor*, No. 10 Spring 2005.

Chancellery of the Prime Minister (2005), *National Reform Programme* 2005-2008, Brussels.

Comité d'Étude sur le Vieillissement (2006), *Rapport annuel*, May, Brussels.

Dujardin, C. (2001), "Effet de frontière et interaction spatiale. Les migrations alternantes et la frontière linguistique en Belgique", *L'espace géographique*, No. 4/01.

ECB (2004), "Sectoral Specialisation in the EU. A Macroeconomic Perspective", *ECB Occasional Paper*, No. 19.

ECB (2005), "Competitiveness and the Export Performance of the Euro Area", *ECB Occasional Paper*, No. 30.

High Employment Council (2006), "Mobility Study", mimeo, Brussels.

OECD (2004), *OECD Economic Survey: Euro Area*, OECD, Paris.

OECD (2005), *Education at a Glance*, Paris.

OECD (2006a), *Information and Technology Outlook*, Paris.

OECD (forthcoming), "Competition and Regulation in Banking", Competition Policy Roundtable.

OECD (2006c), "Risk capital in OECD countries: Past Experience, Current situation and policies for promoting entrepreneurial finance", *Financial Market Trends*, No. 90.

OECD (2006d), *The SME Financing Gap: Theory & Evidence*, Paris.

Pozzi, L., F. Heylen and M. Dossche (2004), "Government Debt and Excess Sensitivity of Private Consumption: Estimates from OECD Countries", *Economic Inquiry*, Vol. 42, No. 4, October.

Robert, B. and L. Dresse (2005), "Industry in Belgium: Past Developments and Challenges for the Future", *NBB Economic Review*, September, Brussels.

Savage, R. (2004), *L'économie belge 1953-2000 : ruptures et mutations*, Presses Universitaires de Louvain.

Sleuwaegen L. and K. De Backer (2001), "Desindustrialisatie in België", *Tijdschrift voor Economie en Management*, Vol. XLVI, 3.

ANNEX 1.A1

Progress in structural reform

This annex reviews actions taken to follow structural policy recommendations made in the *2005 OECD Economic Survey of Belgium*. Recommendations made in this *Survey* are shown in the boxes at the end of each chapter.

Past recommendations	Actions taken and current assessment
A. Public finances	
Put public finances on a sustainable path by increasing the structural budget balance to a surplus of 0.3% of GDP in 2007, and allowing it to rise to 1½ per cent of GDP in 2011.	The budget for the general government should balance in 2006. The following year a surplus of 0.3% of GDP is targeted. A recent amendment to the Law on the Ageing Fund requires the budget surplus to, at least, increase by 0.2 percentage points annually thereafter, until 2012.
Give priority in expenditure restraint when consolidating the budget, avoid non-recurrent measures.	Non-recurrent measures amount to 0.7% of GDP in 2006 and are expected to reach 0.4% of GDP in 2007.
Enhance productivity gains in public administration by increasing mobility, promoting lifelong learning, introducing a new management culture and implementing e-government.	In Flanders, an internal mobility scheme requires the administration to fill vacancies with internal candidates to enhance mobility. Annual wage premia can reach up to 20%. Managers now have yearly individual objectives and are required to prepare management contracts for their agencies to be concluded with the government. E-government services are available in Flanders through a single portal site.
Consider introducing road pricing as soon as it becomes technically feasible. Target fuel taxation on pollution externalities alone and reduce the need for transport subsidies.	A road vignette for car traffic is expected to be put in place from 2008 on.
B. Health care	
Policies affecting the level of aggregate health-care spending	
Step up the frequency and nature of monitoring the enforcement of caps on the global budget for health care expenditure.	Since 2005 quarterly assessments on the total spending take place. This has allowed the government to take timely measures to limit nominal spending increases to 2.5% in 2005. The following year, real growth in health spending is expected to be less than 3%.
Set the reimbursement reference price equal to the cheapest generic drug as long as registered and generic drugs are medically equivalent. Periodically review reimbursement policies in view of medical evidence.	Reference pricing has been partially linked to generic drugs. As a consequence, reference prices show a downward trend. Reimbursement policies on individual drugs are reviewed within an 18 to 36-month period.
Review entry restrictions to medical school to assess whether shortages of the medical profession may materialise in the long run.	The Belgian authorities have requested a study on the long-term needs for medical professions.
Policies improving cost efficiency at the micro level	
Include benchmarks against evidence-based standards for general practitioners. Extend existing benchmarks to other medical professions. Include stakeholders outsider of the medical profession in the development of benchmarks.	Benchmarks and peer review have been introduced for some types of drugs (*e.g.* antibiotics) and some types of medical professions (nurses, physiotherapists). Recommendations (non-binding) of good practice are provided.
Tighten the case-related payment system for frequent surgical interventions.	The cost of treatment will only be fully reimbursed if it does not exceed by 10% (lowered from 20%) the nationwide average cost.

Past recommendations	Actions taken and current assessment
Develop complete and up-to-date electronic medical files for consultation by medical practitioners for all patients.	Some measures have been taken to stimulate the use of electronic medical files, but no automatic exchange between medical practitioners is currently taken place.
Promote the role of general practitioners (GP) as gatekeepers except for emergencies.	Reimbursement is lowered if patients are not referred by their GP.
Lower administrative burden imposed by new regulations in the health care sector.	No action taken.
Policies improving access to health care and its outcomes	
In relation with the implementation of the maximal medical bill, assess the scope for selective increases in co-payments.	No action taken.
Provide GPs technical support in the form of best practice guidelines for the treatment of specific chronic diseases.	A clear division of tasks between the GP and specialists is currently set up for specific chronic diseases (diabetes and kidney disorder).
C. Labour market	
Increase employment of older workers	
Harmonise the age of eligibility for the old-age supplement to the unemployment benefits (UB) with the age for the exemption from job search (currently 58 years) and increase both gradually further.	As an activation measure, old-age unemployed have been allowed to keep the old-age supplement upon entering employment.
Enforce job search requirements for the unemployed aged 50 and over.	No action taken. An evaluation of the current activation system is planned for 2007.
Tax all top-up payments to UB as regular labour earnings. Limit the accumulation of pension rights while receiving unemployment benefits to active job seekers. Make the top-up payment subject to full social security contributions.	A "Solidarity Pact between Generations" (Solidarity Pact) has been decided but not fully implemented and includes provisions to tax top-up payments to unemployment benefits at the normal rate of 32.5%.
Reduce the generosity of the time credit scheme. Ensure that collective arrangements increasing generosity over and above the legal standard are financed by the sector itself.	The Solidarity Pact reduced the time credits for raising children (less than 8 years), caretaking of parents, and training.
Tighten the minimum age and career requirements for pre-pensions. Stop making discretionary use of pre-pensions in collective redundancies.	The Solidarity Pact has increased the minimum age to 60 years and career requirements to 30 years of seniority from 2008 on. From 2012 onwards, the career requirements are increased to 35 years.
Make first-pillar pensions actuarially neutral.	To activate older workers, a bonus of 2 euros per work day has been introduced for workers above the age of 62 and with a career length of 44 years.
Monitor the inflow into the disability scheme to avoid substitution effects as other exit routes are closed down.	The inflow into disability is being monitored and so far no action has been deemed necessary.
Promote a culture of lifelong learning/continuing training, raise awareness with the social partners of the adverse effects of seniority-based pay scales on employment prospects for older workers.	In the Solidarity Pact, social partners are invited to revise their current wage policies to improve labour market chances for older workers by negotiating lower seniority premia. Social partners have also been invited to increase spending on vocational training to 1.9% in 2006. Moreover, by 2010 the goal is that every year half of all employees have access to training.
Reduce structural unemployment	
Make Public Employment Services (PES) insist that jobseekers react to vacancies in a wide area, including at least the commuting area.	Regional PES now exchange information on vacancies, at least for jobs for which employers have difficulties to find workers. The regional and the federal PES exchange information on job search efforts to better target job search assistance and sanctions.
The regions should reduce their reliance on subsidised job creation in the public sector.	No action taken.
Increase the role of (re-)training measures.	The Solidarity Pact emphasises training, particularly in case of enterprise restructuring.
Enhance the efficiency of public expenditure on training by developing a database on jobseekers' trajectories.	Administrative databases are continuously being linked to enable monitoring of career developments.
Strengthen incentives to earn income from work by shifting the calculation of accruing pension rights from the former work income to the actual UB received after some time.	The ceiling on the basis of pensions for unemployed is no longer aligned with the development in the ceiling that applies to employees' pensions..
Combat unemployment and foster employment of youngsters	
Reduce barriers to flexible forms of employment, make working time more flexible.	A new "plus minus conto" account system in the automotive industry allows work up to 10 hours more per week during at most three consecutive years, followed by similar work reductions in the following period. Social security contributions on extra hours worked and for shift workers have been lowered (the latter is reducing wage costs by 5%).

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Past recommendations	Actions taken and current assessment
Consider a more extensive use of internships as part of the regular curriculum in post-secondary and applied tertiary education	No action taken.
Emphasise job-search requirements and closely monitor search efforts for persons without a work record. Give more emphasis to active measures during the school-to-work transition.	A new programme has been enacted to systematically enhance job search activities of long-term unemployed (more than 6 months) by providing them timely assistance in their job search and sanction those who fail to show sufficient search effort.
D. Migration	
Give children of foreign-born parents the amount of language training required for them to successfully participate in a school career that endows them with labour market relevant skills.	No action taken.
Evaluate current measures to tackle discrimination. Strengthen entrepreneurship to mobilise the economic potential that is wasted by discrimination.	No action taken.
Target measures to improve the employability of groups with a low attachment to the labour market specifically at the foreign labour force. Enforce job search requirements and increase in-work benefits.	No action taken.
Enhance efforts to improve the statistical information about foreign-born resident family members and their economic activities.	Since 2006, demographic data contain information regarding the country of birth of the Belgian and foreign resident populations.
E. Secondary education	
Increase instruction time devoted to core subjects.	No action taken.
Improve the quality and attractiveness of technical and vocational branches. Abolish streaming at the beginning of lower secondary education and guarantee the same content of education until the 8th grade.	No action taken.
Pursue efforts to make technical professions more attractive in the French Community.	No action taken.
Make the level of school subsidies dependent on the economic, cultural and social conditions of their students. Give schools autonomy to freely allocate their budget on equipment and teaching time.	The Flemish Community is considering a new funding mechanism that is sensitive to the socio-economic background of students.
Make school's performance in improving the initial conditions of their students a criterion of the budget allocation.	No action taken.
Increase the transparency of admission criteria. Raise awareness among parents from disadvantages milieus of the importance of education and improve counselling on the various pedagogical approaches to offer.	Admission criteria have been changed so individual schools can develop an enrolment policy to secure a broader socio-economic mix among their students.
F. Productivity growth	
Remove barriers to productivity growth in ICT-using service sectors	
Fully implement the Financial Services Action Plan and apply the four-level "Lamfalussy framework"	No action taken.
Monitor the effects of the new law on reducing regulatory barriers for large stores to enter the market. Seek an agreement with social partners on cutting back on strict and complex rules on overtime and on easing regulation of temporary work contracts. Make shop opening hours more flexible.	Rules on the weekly closing day and evening opening hours have been simplified. The number of Sundays on which shops can be open has been increased.
Strengthen product market competition more generally	
Require regulators to assess alternative policy instruments (regulatory and non-regulatory) before adopting a new regulation. Continue to evaluate the need for remaining price controls and abolish them where no longer warranted.	No action taken.
Reduce barriers to entrepreneurship. Introduce a "silent is consent rule".	No action taken.
Increase competition in the electricity sector by auctioning a greater proportion of the incumbent's production capacity, increasing interconnection capacity, facilitating the granting of electricity production operating licences ad by better monitoring of the respective markets in which the vertically integrated incumbent operates.	Following the Suez-Gas de France merger, the government required Suez – the main shareholder of Electrabel – to sell 30% of its transmission capacity to its competitors.

Past recommendations	Actions taken and current assessment
Innovation policies	
Ensure non-discriminatory access to the new wage tax reduction for private companies co-operating with public research institutions. Monitor the effects of the measures in view of the potentially high deadweight loss.	Since January 2006, tax reductions are also granted for researchers in the private sector.
Refocus innovation policies to encourage more investments in organisational change.	No action taken.
Enhance the ICT-using competencies of persons with lower intermediated skills and low education attainment.	No action taken.
Tertiary education	
Increase the share of competitive funding further and make quality indicators as widely accessible as possible in order to stimulate the performance of universities.	No action taken.
Increase the share of private funding, especially for long university studies and give students loans with income-contingent repayments. Give universities more freedom to determine the level of student fees.	No action taken.

ISBN 978-92-64-03186-9
OECD Economic Surveys: Belgium

Chapter 2

Securing the sustainability of fiscal policy in a rule-based system

The achievement of balanced general government budgets has helped to reduce the level of gross debt over the past ten years. Consolidation has been facilitated by non-repeatable factors like falling interest rates and one-off measures. Looking forward, fiscal policy objectives are becoming more ambitious in order to build up surpluses and pre-fund the cost of population ageing. Moreover, the current long-term strategy focuses on securing the system until 2030. However, additional cost of ageing thereafter is not pre-financed, pointing to the need for additional measures to secure the financing of additional ageing-related spending until 2050. Indeed, securing the sustainability of public finances in the long term will require additional reform. Consolidation through spending needs to take place at all levels of government by making each level responsible for generating a surplus formulated in structural terms to avoid pro-cyclical spending patterns and defined to exclude the use of one-off measures. If the beneficial effects of the recent lowering of marginal tax rates are to be preserved and extended, fiscal consolidation through higher revenues can only be achieved by broadening the tax base, such as by phasing out a range of tax expenditures and by expanding labour market participation.

Main issues

The overriding objective of fiscal policy, against the background of high public debt levels and an increasingly decentralised fiscal system, is to cope with the funding gap resulting from the impending ageing of the population. The fiscal cost of supporting the older population is estimated to increase by nearly 4% of GDP by 2030 and by around 6% of GDP by 2050, reflecting higher outlays for pensions and healthcare and lower spending on other items, such as unemployment, education and family benefits (OECD, 2005). The Belgian government's strategy to achieve this objective is centred on pre-funding and increasing labour market participation rates (see Chapter 3). The groundwork for pre-funding has been established over the past half-decade through the balancing of the general government balance and the associated establishment of the Ageing Fund ("the Silver Fund"). Now the difficult challenge is to build up reserves sufficient to finance the additional cost of ageing without resorting to disruptive policy changes, such as markedly higher taxes or drastic cuts in other social programmes.

The remainder of the chapter discusses the progress made in budget consolidation, before addressing the challenges of moving from balanced budgets to growing budgetary surpluses. Next, the chapter considers the room for manoeuvre in the long-term fiscal strategy. The chapter concludes with an assessment and a set of policy recommendations.

Fiscal consolidation has been helped by falling interest rates and one-off measures

Since 2000, the authorities have been successful in balancing the general government budget. This achievement compares favourably with that of many other OECD countries. In addition, Belgium has achieved its balanced budgets in the context of a gradually implemented tax reform (lowering both income taxes and social security contributions). In the process, public debt (Maastricht definition) has declined from 107% of GDP in 2000 to below 90% in 2006.

The progress in budget consolidation has benefited from falling debt service payments as long-term interest rates have been declining and as the public debt-to-GDP ratio declined. In all, interest charges as a share to GDP have fallen by 2 percentage points since 2000 (Table 2.1). Another important element in reaching balanced budget has been the use of – mainly revenue raising – one-off measures, such as sales of buildings and assumption of pension liabilities of (formerly) publicly owned companies (Table 2.2). On average, these measures have contributed about ½ percentage point of GDP per year to achieving the balanced budget. On the other hand, the budget consolidation in terms of improving the structural primary deficit (cyclically-adjusted primary lending) has weakened over the past half decade. Cyclically-adjusted disbursements and receipts measured relative to GDP have been reduced by around 1 percentage point since the early 2000s. Moreover, cyclically adjusted-disbursements excluding interest payments have increased by nearly 1½ per cent of GDP, implying that the windfall gains from lower interest rates have been partially used to finance other spending.

Table 2.1. **General government financial balance**

Percentage of potential/actual GDP

	2001	2002	2003	2004	2005	2006	2007	2008
Current receipts	49.6	49.8	51.1	49.3	49.8	49.0	48.5	48.4
Current disbursements	49.1	49.9	51.1	49.4	49.8	49.0	48.7	48.6
Current receipts cyclically adjusted[1]	49.1	49.3	48.7	48.4	48.9	48.0	47.4	47.3
Current disbursements cyclically adjusted[1]	48.5	48.5	48.6	47.9	47.6	47.4	47.3	47.4
Current disbursements, adjusted and excluding interest charges[1]	42.0	42.8	43.3	43.1	43.3	43.4	43.5	43.8
1) General government balance	0.5	0.0	0.0	–0.1	0.0[2]	0.0	–0.2	–0.2
Net interest charges	6.1	5.5	5.1	4.6	4.2	3.8	3.6	3.5
2) Net primary balance	6.7	5.4	5.1	4.5	4.2	3.8	3.4	3.3
3) Cyclical component	0.3	–0.4	–1.0	–0.8	–1.0	–0.7	–0.4	–0.3
4) Cyclically adjusted net primary balance	6.4	5.9	6.1	5.3	5.2	4.5	3.8	3.6
5) Non-recurrent factors	0.4	0.2	1.2	0.8	0.5	0.7	0.4	–0.1
4)-5) Structural net primary balance, net of one-off measures	5.9	5.6	4.9	4.5	4.7	3.8	3.5	3.7
1)-3)-5) Structural general government balance	–0.2	0.2	–0.2	–0.1	0.6	0.0	–0.1	0.2

1. The cyclical-adjustment separates cyclical influences on the budget balances resulting from the divergence between actual and potential output from those which are non-cyclical.
2. Under the notification of the government deficit and debt data to Eurostat, the Belgian authorities assumed that the FIF – fonds de l'infrastructure ferroviaire – is not part of the government sector. However Eurostat considers that the assumption of the debt of the railway company through the FIF must result in a capital transfer, with an impact on the government deficit of € 7 400 million (2.5% of GDP).

Source: OECD, *Economic Outlook No. 80*.

The multi-annual labour income tax reform was fully implemented by 2006. As a result, the revenues from income tax and social security charges as a share of GDP have declined by some 1½ percentage point since 2001. However, overall government revenues as a share of GDP have remained almost constant as indirect taxes have been increased (higher excise taxes on tobacco, mineral oils and packaging waste). On the other hand, the tax reform has made little inroad into reducing tax expenditures, which amounts to some 3.2% of GDP (Chambre des Représentants, 2006).[1] They are particularly important in the areas of personal income tax (1.4% of GDP), corporate income tax (1% of GDP) and VAT (0.4% of GDP).[2] Removing these tax expenditures could have significant economic effects. For example, the revenue foregone in the 2001 tax reform amounted to about half of the cost of all tax expenditures, and allowed a cut in the average personal income tax rate of 3.1 percentage points that is estimated to raise business sector employment by between 2.4% and 3.5% (Saintrain, 2001; Stockman, 2004). On the expenditure side, health care and security spending have been priority areas; large annual increases in health care spending have allowed to modernise infrastructures and make wages in the sector more competitive.

From a macroeconomic stability point of view, a concern has been that the objective of balancing the budget could have pro-cyclical effects. By not allowing the free play of automatic stabilisers, the government might be forced to increase taxes in economic downswings or might be induced to spend revenue windfall gains in economic upswings. From the outset, such effects were likely to be relatively more important than in many other OECD countries as the Belgian automatic stabilisers (with an estimated semi-elasticity of 0.52, *i.e.* a 1% change in GDP changes the budget balance by 0.52% of GDP) is relatively large in an international context (Girouard and André, 2005). However, the two main contributors – one-off measures and lower interest charges – to achieving the balanced budgets are largely unrelated to the economic cycle, implying that there have been few

Table 2.2. **Temporary effects on the general government balance**[1]

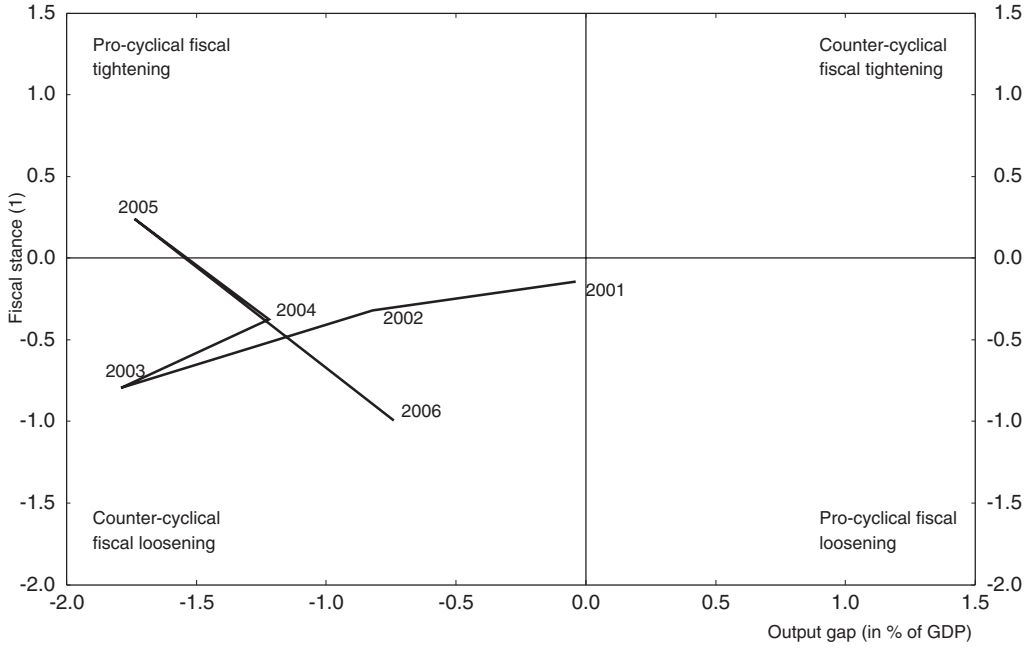
Millions of euros unless indicated otherwise

	2001	2002	2003	2004	2005	2006
A. Revenue	339	239	4 923	833	1 350	1 446
Classical one-offs	–11	–208	440	962	430	987
TGV payments received from the Netherlands						
Reimbursement of Maribel	139	. .	. .	. .	. .	. .
Exceptional Belgacom dividend	. .	125	150	. .	. .	. .
Reimbursement Beaulieu subsidies	. .	39	. .	. .	. .	. .
Personal income tax reduction in Flemish Region	. .	–223	. .	. .	. .	. .
Decreased withholding rates for marriage allowance	–150	–150	30	. .	. .	. .
Increased withholding rates for municipal taxes	. .	. .	260	319	89	. .
Increased withholding rates on replacement incomes	. .	. .	. .	145	116	. .
Tax amnesty	. .	. .	. .	498	. .	150
Aquafin VAT ruling					225	
One-off tax on diamond industry						137
Speeding up of settlements and collection of corporate taxes						700
Self-reversing changes	350	447	–517	–280	439	459
In withholding rates of personal income taxes	350	350	–420	–280	. .	. .
Insufficient indexation in 2001 and 2002	350	350	–420	–280	. .	. .
In settlements with Luxembourg for excises	. .	97	–97	. .	. .	. .
Securitisation of tax arrears	. .	. .	. .	. .	439	459
Assumption of pension liabilities	. .	. .	5 000	151	481	. .
Belgacom	. .	. .	5 000	. .	. .	. .
Biac	. .		. .	151	. .	. .
NMBS/SNCB					267	
Antwerp Port Authority					214	
B. Expenditure	730	383	–1 552	1 481	26	923
Nuclear institute subsidies	. .	. .	. .	48	. .	. .
UMTS auction/license sales	450	. .	. .	. .	. .	. .
Funding NMBS/SNCB	. .	. .	–1 051	1 051	. .	100
Sale of real estate	319	383	195	689	171	920
Guaranteed debt Sabena	–40	. .	. .	. .	. .	. .
Subsidies De Post/La Poste	. .	. .	–199	. .	. .	. .
Reimbursement stock exchange taxes	. .	. .	. .	–130	. .	. .
Reimbursement “animal contributions” (slaughterhouses)			–250			
Debt assumption Antwerp hospitals			–247			
Exceptional pension contribution by local authorities to Ethias				–177		
Energy subsidy	. .	. .	. .	. .	–145	–97
Subsidies to water regional distribution companies in Flanders						–100
C. Overall balance	1 069	622	3 371	2 314	1 376	2 268
% of GDP	(0.4)	(0.2)	(1.2)	(0.8)	0.5	(0.7)
Change in % of GDP	(0.6)	(–0.2)	(1.0)	(–0.4)	–0.3	(0.3)

1. A positive (negative) figure indicates a(n) improvement (worsening) of the budget balance.
Source: National Bank of Belgium.

pro-cyclical effects. In fact, the discretionary fiscal stance has been expansionary in the face of the widening negative output gap since the start of the decade, in the process reducing the surplus on the net primary balance from about 6½ per cent to below 4% of GDP (Figure 2.1). Since the contribution from interest charges is set to decline (see below) and the use of one-off measures must be terminated, there is a risk that pro-cyclical effects may arise in the future. This could be avoided by refocusing the fiscal norm on a measure that is independent of the business cycle.

Figure 2.1. **The fiscal stance has been mainly counter-cyclical**



Note: 2006 based on OECD projections.

1. Fiscal stance is measured by the change in the CAPB (cyclically-adjusted primary balance) excluding one-off measures.

Source: OECD, Analytical Database.

The short-term challenge for public finances is to secure a surplus

The 2007 general government budget is focussed on creating a surplus of 0.3% of GDP after years with balanced budgets. Reaching this target is facilitated by another 0.2 percentage point decline in the interest charges-to-GDP ratio, which is a bit less than the year before as there are only a few high yield bonds left in the public debt portfolio (Box 2.1). Other positive factors include the completion of the multi-year tax reform the year before, and the government's decision to increase environmental taxes. Moreover, the budget position of local governments is expected to improve as local municipalities return to a balanced budget after the election-induced deficit in 2006 (Ministry of the Budget, 2005). However, additional wage subsidies to stimulate employment for workers with weak labour market attachment will be introduced (for young people in 2006 and older workers in 2007 – for details see the "Solidarity Pact between the Generations" in Chapter 3). Furthermore, the objective of a maximum increase in health care spending will be maintained at 4½ per cent in real terms.[3, 4, 5]

On the revenue side, the full implementation of the multi-year tax reform in 2006 implies that revenues, should now grow in line with income. However, a composition effect is expected in 2007 as employment should be mostly in low-income jobs, with a negative effect on tax revenues of about ¼ per cent of GDP. The budgetary effect of this will be partly offset by higher environmentally related taxes, which form part of the government's environmental strategy (Box 2.2). In addition, the government is planning to use one-off measures to the tune of 0.4% of GDP in addition to a small negative effect (about 0.1% of GDP) arising from earlier securitisation of tax arrears.

Box 2.1. **Public debt management**

The management of public debt has been adapted to changing market circumstances. The Belgian Debt Agency was created in 1998 in preparation for the introduction of the euro – an event that changed the government from being a dominant issuer of debt in the national market to a smaller player in a much larger European capital market. Moreover, the balanced budget strategy has changed the role of debt management from a focus on issuing new debt instruments to a focus on refinancing existing debt. The Belgian Debt Agency is still part of the Ministry of Finance, but has been given a certain degree of independence. Other countries (*e.g.* Austria, Germany, Ireland) have moved further in this direction by delegating operational responsibilities for debt management to separate units outside the Ministry of Finance (ECB, 2005). The agency is responsible for the operational management of the federal public debt within the guidelines adopted by the Minister of Finance. The guidelines mainly concern the structure and the acceptable risk level of the debt portfolio.

The agency has a finance strategy of issuing large benchmark bonds in 5-year and 10-year maturities to lower refinancing risks. As a result, there has been a lengthening in the maturity structure of outstanding debt. Since the introduction of the euro, foreign holdings of government debt have increased significantly to around 50 % for long-term debt and to around 70% for short-term debt (Treasury Certificates). On the other hand, the foreign currency risk exposure has been almost eliminated with around 99% of outstanding debt denominated in euros. Government bonds are traded by the market as if they were AAA rated – judging from the almost complete absence of a spread *vis-à-vis* German benchmark bonds – despite only having an AA rating. These favourable financing conditions have contributed to the continuous decline in the implicit interest rate of government debt as older bonds with high nominal interest rates have gradually been refinanced by bonds with lower rates. There are still some high interest rate bonds in the debt portfolio, allowing for some further declines in the implicit interest rate of around 25 basis points until 2009 (Belgian Debt Agency, 2006). Nevertheless, interest charges remain sensitive to changes in market rates as a one percentage point increase in interest rates would boost interest charges by nearly ½ per cent of GDP within four years.

Currently the Belgian debt agency does not issue index-linked bonds. However, these types of bonds may be attractive for institutional investors like pension funds, who could use such bonds to match their long-term inflation-sensitive pension liabilities. Likewise, long-term index-linked bonds would be an appropriate product for the Ageing Fund as the fund is building up assets to finance long-term liabilities, until the fund is emptied by 2030.

OECD projections from autumn 2006 indicate that the net lending position will worsen slightly in 2007. New taxes on packing material and tobacco, and other revenue increasing measures do not suffice to compensate for the substantial use of one-off measures the year before, and the budgetary costs of planned reductions of some social contributions and some small increases in social benefits. Moreover, a number of one-off measures under consideration were insufficiently specified to be included. Furthermore, on current plans it is unlikely that any further budgetary improvement will materialise in 2008 as almost no structural measures have been legislated to replace the 2007 one-off measures. Thus, there will be the need for additional measures to secure continued expenditure restraint and to achieve the further intended increase in the budget surplus.

Box 2.2. **Recent measures to secure environmental sustainability**

Under the EU agreement for the implementation of the Kyoto protocol target, Belgium has agreed to cut its Greenhouse Gas (GHG) emissions by 7.5% by 2008-2012 representing 134.1 million tonnes of CO_2-equivalents. However, under current projections this target is expected to be missed by 8.4% (Federal Planning Bureau, 2006). The federal government and the regions have jointly agreed on a National Climate Plan, which bundles measures that should bring the greenhouse gas (GHG) emissions closer to the targets. The main measures are in the field of transport policy (improving public transport infrastructure, reducing pollution of vehicles through tax incentives) and in supporting energy production from renewable sources.

Taking these measures into account, GHG emissions should remain higher than the level committed to under the Kyoto Protocol (Federal Planning Bureau, 2006). Therefore, the federal government has recently announced a series of fiscal measures to bring down further GHG emissions.[1] These include new taxes on certain types of packaging with estimated revenues of more than € 300 million in 2007 and € 600 million in 2008, tax reductions for housing investment to improve energy efficiency and a VAT reduction for certain types of low-polluting vehicles. Within the framework of the National Climate Plan it is foreseen that the federal and regional governments can purchase emission trading under the Kyoto's flexible project-based instruments: Clean Development Mechanism (CDM) and Joint Implementation (JI). The federal and Flemish governments launched in 2005 the first JI/CDM tender in order to purchase emission reductions from JI and CDM projects. The Walloon and Brussels-Capital Regions have invested in the World Bank's Community Development Carbon Fund, which invest in small-scale CDM projects.

1. Prime Minister's State of the Union (2006), "Les finances belges pour 2007 : de l'équilibre à l'excédent".

The long-term sustainability of public finances

The main long-term challenge of fiscal policy is to finance the cost of ageing resulting from the retirement of baby-boomers and longer life expectancy. For example, the total dependency ratio, calculated as the ratio of non-working-age population (under 20 and over 60) to working age population (20-60), will increase from the current level of 78.5% to a projected 109% in 2050. The associated cost increases are mostly related to higher pensions and health care (particularly long-term care) expenditures (Table 2.3). On the other hand unemployment is expected to decline and the youth cohorts will become smaller, lowering associated spending.

The fiscal strategy is partly based on pre-funding these ageing related cost increases. It is planned to continue with gradual increases in the general government budget surplus to reach 1½ per cent of GDP by 2013. The surplus is maintained at this level until 2018, after which surpluses will be gradually reduced to zero by 2030.[6] The accompanying reduction in the public debt-to-GDP ratio will allow interest charges to be reduced gradually to 1.1 per cent of GDP in 2030, creating the budgetary scope for building up the surpluses.[7] Over the medium term, the planned gradual increases in the budget surpluses can be seen as minimum targets as the government is committed to saving any cyclical windfall gains, which will expressly not be used to finance stimulatory measures.

The surpluses are earmarked until 2012 to build up reserves in the Ageing Fund, which is the principal vehicle for pre-funding future ageing related costs.[8] The size of the fund is projected to peak around 2020 at 16% of GDP before it is gradually emptied by 2030 as the fund is used to absorb expenditure increases in various statutory pension schemes.[9] At

Table 2.3. **Impact of population ageing on the general government budget**

% of GDP	2005	2010	2020	2030	2050
Total expenditure[1]	**50.0**	**49.5**	**48.9**	**50.8**	**53.8**
Social expenditure	**23.1**	**23.4**	**24.4**	**26.8**	**28.8**
Pensions	9.1	8.9	10.0	12.0	13.0
Health care	7.1	7.9	8.6	9.5	10.8
Other social expenditure	6.9	6.6	5.8	5.3	5.0
Interest charges	**4.5**	**3.7**	**2.5**	**1.8**	**2.8**
Other spending	**22.4**	**22.5**	**22.0**	**22.1**	**22.1**
Total revenue	**50.0**	**49.0**	**49.4**	**49.8**	**50.0**
Memorandum items:					
Labour productivity growth	0.9	1.4	1.8	1.8	1.8
Real GDP growth	1.5	2.2	1.8	1.5	1.6
Male participation (20-64)	86.3	86.0	86.5	86.9	86.9
Female participation (20-64)	72.6	74.9	77.5	78.7	78.6
Overall participation (20-64)	79.5	80.5	82.0	82.9	82.8
Unemployment rate[2]	14.3	13.2	9.7	8.0	7.9
Share of population over 65	17.2	17.5	20.4	24.2	26.6

1. The estimate of total expenditure assumes that primary expenditure (other than social spending) falls slightly in terms of GDP. In the case of revenues, the GDP ratio is assumed to be constant after 2009.
2. This refers to unemployment according to the Federal Planning Bureau's definition, which differs in certain respects from the European definition.

Source: Federal Planning Bureau.

present, there are no plans for pre-funding the ageing costs for the period 2030 and 2050, which are substantial (around 2% of GDP), as emphasised in the most recent report from the *Comité d'Étude sur le Vieillissement* (CEV, 2006) (see below). If this period is included in the pre-funding estimates, additional financial needs imply that future budgetary surpluses may need to be raised by as much as ¾-1% of GDP per year from 2010 onwards (Langenus, 2006).

Even in the medium term, there is a need for further fiscal consolidation. The fall in interest charges relies mostly on lower public debt, so the surplus targets can only be reached if the primary surplus stabilises just above 4% of GDP, requiring another improvement by about ¼ per cent of GDP, according to OECD Secretariat estimations. Moreover, the output gap is likely to be closed soon after 2008 and, without further cyclically improvement in the public balance, the required increase in the primary surpluses can only be created through structural measures. An indication of the required improvement can be found in an assessment of fiscal policy from Spring 2006, which indicated that in the absence of one-off or other fiscal measures, policies at that time would only lead to a general government budget surplus by 2012 (Bureau Fédéral du Plan, 2006). Fiscal policies have since been adjusted to bring the budget back to its planned trajectory.

Ageing problems are also materialising in the public sector

Ageing is also affecting the public sector itself. Public sector employees tend be older than private sector employees. This difference has arisen because the welfare state was built up in the 1960s and 1970s, leading to strong growth in public sector employment. As fiscal consolidation became a priority, new hiring was curbed and the average age of public employees began to rise. This has led to a situation where perhaps as many as half of all public employees could retire within the next decade. This coincides with declining youth cohorts entering the labour market. Fully replacing all retiring public employees with new entrants into the labour market would create a crowding-out effect for the private sector.

Alternatively, the government could retain hiring at its historical share of new labour market entrants, in which case public sector productivity would have to increase by 2.1% per year the next decade – a requirement that will soften thereafter – if public services levels are to be maintained (Høj and Toly, 2005). Arguably, these scenarios are both unrealistic, but any development in between will still need to be accompanied by productivity enhancing measures in the public sector to preserve service levels. For example, in certain parts of the primary and secondary education system, empirical research indicates that there is a considerable scope for improving efficiency (Sutherland, 2006). There is also some evidence that this is related to the institutional settings (Gonand, 2006).

The ageing costs are substantial

Aging commences in earnest in 2011. Then the working age population starts to shrink as the number of pensioners increases and smaller cohorts enter the labour market. These factors, together with an expected increase in life expectancy, will nearly double the old-age dependency ratio to almost 50% by 2050, according to Eurostat's baseline population projections. The working-age to total population ratio, however, will decrease less than 10 percentage points as the increase in old-age population is partly offset by smaller youth cohorts (Figure 1.10).

The Ageing Working Group (AWG) of the Economic Policy Committee of the European Union has estimated that the total budgetary burden for Belgium will be 4.5 percentage points of GDP higher in 2030 than in 2004. In 2050, the burden will have increased by another 1.8 percentage points of GDP.[10] The largest part of the increase constitutes higher first-pillar pensions, accounting for a rise of 4.3 and 5.3 percentage points of GDP in 2030 and 2050, respectively. Spending on health and long-term care is estimated to increase by 1.3 and 2.4 percentage points of GDP, respectively. On the other hand, the fiscal burden will be lowered by reduced spending on unemployment benefits and education, amounting to 1.1 and 1.2 percentage points of GDP, respectively (European Commission, 2006).[11]

These projections are based on assumptions about the development in a number of key factors, which can be hard to determine with any precision. For example, the evolution of labour productivity growth is notoriously hard to project as there is no information available about future trends in innovation and multi-factor productivity; but this may have important effects on pension spending as pensions are not fully indexed to wages (and hence productivity growth) and are subject to a set of minimum increases. Assumed increases in labour market participation rates – despite recent measures – may fall short of expectations. Spending pressures may, in some areas, be higher than expected, such as public investment that has been internationally low over the past decades.[12] Higher than expected interest rates may increase interest charges, adding to fiscal pressures. In addition, political pressures may arise to prevent or to limit the implied fall in average pension replacement rates – as pensions are adjusted in line with consumer price developments and with some discretionary adjustment to correct for developments in GDP per capita. This implied fall is lower than in other countries, but the current replacement rate is already very low (OECD, 2005b; European Commission, 2006). The following considers the budgetary consequence of changes in these assumptions:

- The ageing projections rely on future trend labour productivity growth of around 1.8% per year as opposed to a recent trend (over the past five years) of 1.3%. If this acceleration of labour productivity growth fails to materialise, inferring from model simulations indicates that the increase in the budgetary costs would be 0.4% of GDP in 2030 (CEV, 2004).

- The employment rate is assumed to rise from the current 61% to almost 70% by 2030.[13] Calculations by the OECD Secretariat suggests that for each percentage point that the employment rate is lower than assumed, the fiscal burden would increase by 0.3% of GDP – highlighting the importance of labour market policies for securing sustainable fiscal positions.
- Real long-term interest rates of 3% are assumed over the projection period – in line with the recommendations of the Working Group of Aging. If these rates are 1 percentage point higher, then – only taking into account debt dynamics – the primary surpluses would need to be ½ percentage point higher than projected, or alternatively the debt-to-GDP ratio would be four times higher in 2050, according to OECD Secretariat calculations.[14]
- The budgetary cost of ageing is very sensitive to higher replacement rates. The welfare adjustment to pensions decided in 2005 will gradually increase the average replacement rate by 1½ per cent higher in 2030. Calculations undertaken prior to the implementation of the adjustment indicate that the implied budgetary cost could be around 0.4% of GDP by 2030 (CEV, 2005).

To sum up, the above analysis indicates that the path for sustainable fiscal policies is highly sensitive to a number of parameters, pointing to the need for measures to secure it through a solid fiscal policy framework. Alternatively, sustainability could be secured through more pre-funding of ageing-related costs, requiring more ambitious fiscal policies, or through reforms of the labour market, particularly to increase the effective retirement age and labour market participation (see Chapter 3). More generally, structural reforms have been shown to be strong drivers of improving long-run fiscal positions through their effects on potential growth – results that are underpinned by the experiences of New Zealand and Australia (Hoeller and Giorno, 2006).

Fiscal responsibilities at various level of government

The formulation of fiscal policy reflects the federal structure. From a macroeconomic view, this raises issues of securing coordinated and coherent policies across various levels of government. The Belgian setup for addressing these issue centres on the use of independent institutions.

In the budgetary planning process there are two independent fiscal councils involved: the High Council of Finance (HFC) and the National Accounts Institute. Among the principal tasks of the former are the monitoring of fiscal policy of the sub-national levels of government and the recommendations on an annual basis of a coordinated fiscal plan for the various levels of governments. The "Public sector borrowing requirements" section of the HFC even recommends medium-term financial objectives, providing the basis for the consensus approach to budgetary coordination (Box 2.3). This normative task is based on the concept of fiscal sustainability (Bogaert *et al.*, 2006). The National Accounts Institute is a special purpose vehicle created to coordinate the production of the main national macroeconomic statistics and underlying macroeconomic projections for the federal budget – tasks that are subcontracted to the National Bank of Belgium (statistics) and the Federal Planning Bureau (forecasts and input-output tables) who are jointly responsible for the general government account. Involving several independent institutions in the budget process is contributing to the provision of unbiased projections, particularly by reducing political influences, thereby contributing to a transparent budgetary planning process.

Box 2.3. **Budget coordination between the different levels of government**

The coordination of fiscal policies between different levels of governments is largely based on consensus (EC, 2005). A key role is played by the committee "Public Sector Borrowing requirements" in the High Finance Council (HFC). This committee acts as a monitoring and advisory body with respect to the borrowing requirements of all levels of government. The committee is composed of high-level experts: academics, members of the National Bank of Belgium and representatives of the federal and regional administrations. As part of its normative economics task, the committee analyses at regular intervals the borrowing requirements of each government and formulates recommendations on the medium and long-term budgetary targets in terms of balances for the different levels of government (Bogaert *et al*., 2006). The recommendations are based on a concept of sustainability of public finances. The committee has defined sustainability as government programmes being financed at constant, primary expenditure (excluding the costs of ageing) and revenue-to-GDP ratios and with the public debt-to-GDP ratio stabilizing at a level (as other euro area countries) below 60% of GDP (Conseil Supérieur des Finances, 2002).

The recommendations of the HFC form the basis for the budgetary target agreements between the federal government, the regions and the communities. These agreements typically cover a period of five to six years and are updated regularly to adjust the budgetary targets. In the agreements, the governments of individual regions and communities commit themselves to meeting specific annual budgetary targets in terms of borrowing requirements. Regions and Communities are in principle free to achieve their budgetary targets by adjusting outlays or taxes, although they have little discretionary tax powers. Moreover, the regions are responsible for ensuring that the municipalities adopt public finances that are consistent with the budgetary target set for that sub-sector (NBB, 2005). To achieve this, the municipalities are subject to a golden rule under which deficits are only allowed for investment. In principle, only the federal government is responsible for complying with EU fiscal rules; thus the role of these agreements is to share the commitments for complying with these external constraints among all levels of government, thereby avoiding fiscal policies at other levels of government countering national objectives.

As part of its positive economics tasks, the committee also assesses whether all government entities have met their respective budgetary targets. The federal government, on the recommendation of the High Finance Council, can limit the borrowing capacity of a non-compliant region or community to prevent a structural derailment of the borrowing requirement or if economic stability or external balance would be endangered (Van Rompuy, 2005). So far it has not been considered necessary to use this sanctioning mechanism.

Budget surveillance is well-developed. The "Public sector borrowing requirements" section of the HCF normally publishes two reports per year, although its activities were temporarily suspended 2005-06. The first in the Spring assesses the government's stability programme from the previous year and the second in the summer analyses the borrowing requirements of each government entity and makes recommendations on short- and medium-term fiscal targets. Moreover, the HFC's Study Committee on Ageing publishes an annual report with projections of age-related budgetary expenditures. In addition, the Federal Plan Bureau produces a medium-term economic outlook in the spring, which contains forecasts of public sector accounts and comprehensive analysis of public finances.

Over the years, the sharing of responsibility for securing of the balanced budget has been that the federal government (benefiting from the falling interest charges) has improved its balance and sub-national levels of governments have aimed at balancing their budgets. Nevertheless, sub-national levels of government have been able to increase their

spending (at an annual average of 3.7% in real terms since 2002) considerably faster than the federal government (an annual average of 2.8% in real terms).[15] The high real spending increases at the sub-national levels of governments reflect the fact that the transfers from the federal government are weakly linked to spending requirements and more to economic growth. In fact, there is no direct relationship between the federal government's tax revenues and the subsequent transfers to the regions and communities, as the latter are related to developments in the Consumer Price Index (CPI), population below 18 years, and real economic growth (Box 2.4). Moreover, the de-linking of spending responsibilities and taxing powers at sub-national levels of governments is relatively larger than in other OECD-countries. Around 56% of all government revenues are collected at the federal level against nearly 16% by the regions and communities, while spending at the federal level is only 25% of all government expenditures against 37.5% for the region and communities (Figure 2.2).[16] One way of exposing sub-national levels of governments to the consequences of generating surpluses through spending restraint is to align taxation powers with spending obligations.

Box 2.4. **Fiscal federalism: an evolving institutional context**

Belgium has been transformed into a federal state through five successive revisions in its Constitution (in 1970, 1980, 1988, 1993 and 2001) resulting in an important transfer of responsibilities from the federal authority to sub-national levels of government – the regions and the communities. The latter are responsible for education, culture, languages and person-related matters (such as youth policy, social advancement, leisure, tourism, etc.), while the regions are responsible for territory-related matters (including development planning and the environment) and economic issues, such as employment policy. There are three communities – the Flemish, the French and the German. In the bi-lingual Brussels area, 20% are estimated to speak Dutch and the remainder French – according to which the Brussels area's personal income tax receipt is divided between the Flemish and the French communities. In addition, there are the Flanders, the Walloon and the Brussels-Capital regions. In Flanders, the community and regional institutions have been merged.

To enable the sub-national level of governments to exercise their acquired responsibilities their financial resources have been gradually increased through the Special Finance Act in 1989 and consecutive amendments, of which the so-called Lambermont agreement in 2001 was the latest. The revenues of the sub-national government entities consist of transfers from the federal government, so-called *Finance Act Funds* (72% in 2003), own tax revenues (18%) and some other smaller items (10%) (Claeys *et al.*, 2004). The Finance Act Funds come from federal tax revenues, in particular from personal income taxes (PIT) and the value-added tax (VAT). These taxes are levied uniformly across the country. Subsequently, a share of these tax proceeds is distributed according to a number of criteria (see below). These shares are based on the allocation in 1989 but adjusted annually (see below). Thus, there is no direct relationship between federal tax revenues and subsequent allocation of funds to sub-national levels of government.

The transfers related to the personal income tax proceeds are adjusted every year to the CPI and to real GDP growth. The allocation of the transfers is related to the share of each local government entity in the total proceeds of the personal income taxes (the so-called PIT repartition key).

The VAT related transfers to the communities are adjusted annually to the CPI and a demographic correction factor (population under the age of 18). The allocation of the VAT related transfers is a function of the number of school pupils in each community (VAT repartition key). Between 2007 and 2011 the system will be gradually changed. The annual adjustment will from 2007 onwards include real economic growth. The distribution of this addition will initially be the VAT repartition key, and by 2011 the PIT repartition key.[1]

1. The new system will increase the available funds to sub-national level of governments and will entail a slight redistribution towards the Flemish community.

Box 2.4. **Fiscal federalism: an evolving institutional context** *(cont.)*

The regions have full control over the following indirect taxes: registration fees of housing, inheritance taxes, motor vehicle duty, road fund tax, withholding tax on income from immovable assets, gift tax and some other minor taxes. The regions are also allowed to levy taxes on matters that are not already subject to a federal tax (such as water charges and environmental levies). Finally, the regional entities can levy surcharges or grant reductions on personal income taxes on the conditions that: *a)* the income tax basis is not altered, *b)* the impact is less than 6.75% of the proceeds, *c)* the progression of the tax system is not changed, and *d)* no tax competition is taking place.

The available Finance Act funds have developed differently across sub-national levels of government. Over the period 1990-2004, the combined revenues in the North (defined as the Flanders region and the Flemish community plus 20% of the revenues in the Brussels Capital region) have grown on average 3.6 % per year as compared with 2.2 % per year in the South (Walloon and the French speaking community plus the remainder of revenues in the Brussels Capital region). This difference is mainly related to both a larger share and higher growth of personal income tax proceeds in Flanders and the Flemish speaking community, leading to a higher share in the amount distributed. The higher allocation has allowed this part of the country to reduce own tax revenues (such as transaction taxes as described in Chapter 5). In addition, this part of the country receives a relatively smaller share of the VAT proceeds because of its relatively lower share of young people. In total, the per capita revenue in the Flanders and the Flemish speaking community is 17% lower than in Walloon and the French speaking community (Table 2.4).

Table 2.4. **The financial means of the communities and regions**

2006 initial budget (excluding loans)

In euros per capita[1]	All regional entities	North (Flanders + 20% of Brussels Capital region)	South (French Comm. + Walloon Region + 80% of Brussels Capital region)
Federal grants	140	135	146
Assigned part of revenue from personal income taxes	1 337	1 359	1 305
of which: National solidarity intervention	92	7	219
Assigned part of revenue from VAT	1 131	1 077	1 211
Regional taxes	645	621	682
Other	119	50	223
Total	3 465	3 248	3 787

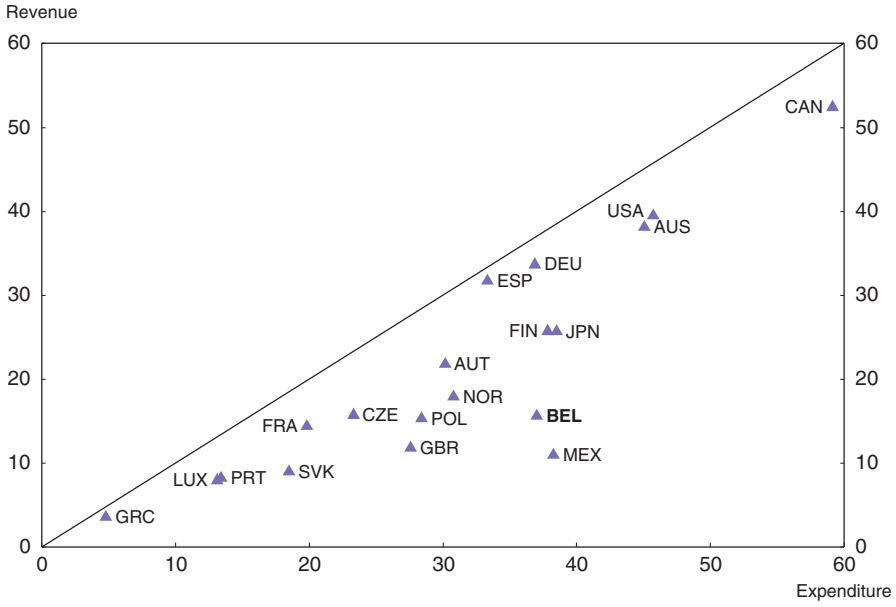
1. To assign the population of Brussels Capital Region to the Flanders and French Communities, the shares in personal income tax are applied. These are respectively 20 pct. and 80 pct.

Source: Federale Overheidsdienst Budget en Beheerscontrole.

The allocation of funds to the sub-national levels of government is set to increase and the fall in interest charges is beginning to level out, suggesting changes in the ability to accommodate fiscal targets at the federal government level. Furthermore, the federal government is responsible for about 60% of all public spending, but about half of these are related to social security over which the federal government has relatively little discretionary power. These arguments point to the need for sub-national levels of government to become responsible for part of the pre-funding of ageing related expenses, which currently mainly falls on the federal government (see Box 2.5). Arguably, such requirements could materialise out of the concept of fiscal sustainability, but the formulation of clearer rules for sharing debt reduction responsibilities would improve the transparency and understanding of the process, thus facilitating the achievement of such surpluses.

Figure 2.2. **Indicators of decentralisation: an international comparison**

Sub-national shares of revenue and expenditure in per cent of total general government, 2003 or 2004[1]



1. 2002 for Mexico. Revenues include direct and indirect taxes as well as non-tax revenues received by regional and local governments. Transfers between government levels are netted out. For Australia the Goods and Services Tax (GST) is considered as a state tax. For Norway data exclude revenues from oil production.

Source: OECD Annual National Accounts Database, May 2006; Belgostat; Statistics Canada; Statistics Norway; US Bureau of Economic Analysis; Australian Bureau of Statistics (2006).

Box 2.5. **A Cost of ageing across different levels of government**

The additional fiscal cost of population ageing (5.8% of GDP between 2005 and 2050) will fall mostly on the federal government and social security, *i.e.* the national level of government (Table 2.5). The federal government is responsible for financing the general pension system as well as for pensions for nearly all government employees, including most of those employed at sub-national level. The bulk of the spending increases is related to higher spending on health and long-term care spending. On the other hand, this level of government is also faced with lower spending on unemployment benefits, family allowances, etc., which off-sets a bit more than a quarter of the ageing related increases. At the sub-national levels of government, the only cost consequences of ageing will be a slight increase in social expenditures, mostly related to assistance to disabled people and social assistance.

Table 2.5. **Net cost of ageing in different levels of government**

Ageing related increases in budgetary costs between 2005-2050, in per cent of GDP

	National		Sub-national	
	Federal government	Social security	Regions and communities	Municipalities
Pensions	1.0	2.8	0.1	0.1
of which: transfers to sub-national level	(0.6)			
Other social expenditures	0.0	1.7	0.1	0.0
Total	1.0	4.5	0.2	0.1

Source: Federal Planning Bureau.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Conclusion

The sustainable path for public finances should be secured – meaning that no disruptive corrections are required in fiscal policies in order to finance future ageing-related costs.[17] Concretely, the definition used in Belgium is that government programmes can be financed at constant revenues-to-GDP shares, and that primary expenditure (excluding the costs of ageing) relative to GDP remains constant, and the public debt-to-GDP ratio stabilises at a level (as other euro area countries) below 60% of GDP. The government's long-term fiscal strategy will allow the financing of ageing-related expenses without large increases in taxes or deep cuts in social programmes until 2030. This means that necessary measures should be implemented to follow the path of gradually increasing surpluses as suggested by the High Finance Council, requiring a combination of further pre-funding, tax base broadening, expenditure restraint and labour market reform. To secure this path a number of measures should be taken as summarised in Box 2.6.

Box 2.6. **Fiscal policy recommendations**

- An even more ambitious fiscal objective is required to secure long-term fiscal sustainability to 2050 by raising available pre-funding resources. The necessary amount of additional pre-funding could be up to a couple of per cent of GDP per year, although this amount could be reduced by lowering the – already internationally low – pension replacement rate and by increasing the effective retirement age. For example, by linking over time the statutory age of full pension eligibility to developments in life expectancy.
- The contribution from falling interest charges to improvements in the budget is set to decline, weakening the federal government's ability to maintain its role as the principal source of fiscal consolidation – which is already relatively small given the federal government's limited discretionary spending power. Moreover, in order to avoid disruptive changes in federally funded programmes, fiscal consolidation needs to take place at all levels of governments.
- Consolidation should be mainly achieved through expenditure restraint, which requires that all levels of government generate surpluses through spending restraint. To this end, all levels of government might consider working together to establish an expenditure rule that would cap the growth of general government spending. Spending restraint should focus particularly on public employment to avoid negative labour market effects and in health care spending to ensure that the high real growth in this area in recent years does not become a norm.
- The current co-ordination framework for fiscal consolidation is based on agreements, which are likely to be tested over the medium term. Meeting the fiscal challenges of ageing will require enhanced accountability and close coordination across all levels of government. This suggests that a more robust framework for coordination of fiscal policy may be needed, implying that each level of government should have a set of clear and binding fiscal objectives with appropriate feed-back mechanisms. Alternatively, taxation powers should be realigned with spending obligations, exposing local governments to the consequences of non-compliance with fiscal objectives.
- Fiscal consolidation through higher revenues can only be achieved through directly and indirectly broadening of the tax base. This can be done by phasing out a range of tax expenditures – such as the tax deductions for mortgage loans, private savings and third-pillar pension schemes – which are costly and create distortions, and by expanding labour market participation, pointing to the need for preserving and extending the beneficial effects of the recently implemented tax reform.
- The fiscal norm should be refocused on a measure that is independent of the business cycle, such as the structural balance for the general government, so as to avoid the risk of running pro-cyclical fiscal policies, and defined as excluding one-off measures.

Notes

1. The estimate for tax expenditures is based on the "revenue foregone" method which *ex post* measures the amount by which tax revenue is reduced because of a particular tax measure. The estimated amount is most likely to be an underestimation as a number of tax expenditures cannot be calculated due to a lack of data and the tax expenditures of the regional entities are not included.
2. Removing all measures leading to tax expenditures would boost tax receipts by more than 12%, with personal income tax revenues increasing by around 13%, corporate income tax revenues by some 34% and VAT tax revenues by around 5.4% (Chambre des Représentants, 2006).
3. The cut in employer's social security contributions for young low-wage workers aged 19-29 years can be converted into a bonus on the employer's total social security contributions if the cut is larger than the social security contribution on the young workers' wages. Other tax cuts to stimulate the economy include a halving of withholding tax on the salaries of researchers in enterprises, which have concluded a co-operation agreement with an approved research centre. This measure will be expanded in scope to a general reduction of 25% in the withholding tax for researchers. In addition, the withholding tax on earned incomes for shift workers will be reduced.
4. The generous funding of health care is to invest in hospital facilities and to improve the relative wages of nursing staff. Otherwise to control health care spending, a February 2005 law included measures to control abuses and to promote good practice (standard profiles for prescriptions, more rational use and distribution of heavy medical equipment; etc.), to enhance the General Practitioner's gatekeeper role, and to control of drug expenditures (extending benchmark reimbursement, greater use of tenders and international cost comparison). In addition, a Health Care Fund has been established to finance future health care costs.
5. The funding base for social security is being expanded to include a packaging levy and 15% of the annual revenue of the withholding tax on capital income, including the revenue generated by the new tax measure on investment funds. Moreover, a part of the tobacco excise revenue will be allocated to health care funding.
6. This process is laid down in the law, following the parliament's approval of the draft law amending the law of 5 September 2001 guaranteeing the continuous reduction in public debt and the creation of the Ageing Fund.
7. The government's current medium term fiscal objectives were laid down in the May 2003 federal government agreement, stipulating the balanced budget path until 2006 and thereafter growing surpluses until 2012. Compared with earlier Stability and Growth programmes (from 2000 to 2003, which covered the period 2001-2005) the fiscal ambitions are lower, as in these earlier programmes the fiscal objective was a budget surplus in order of ½ to ¾ per cent of GDP by 2005.
8. The Ageing Fund is, by law, obliged to invest in government bonds. Thus, there is no change in the government net debt position. On the other hand, the fund has an important role as a beacon for fiscal policy through its role as a commitment mechanism.
9. The Ageing Fund was established in 2001. Its financial resources come from budget surpluses, social security surpluses, non-recurring non-fiscal revenues and investment income. So far the Fund has been financed mainly by non-recurring revenues. For the period 2007-2010, financial resources coming from non-reoccurring funding is limited to euro 250 million, before the limit is expanded to € 500 million in subsequent years. By end 2005, the reserves in the Fund totalled € 13.5 billion – some 4% of GDP.
10. The Conseil Supérieur des Finances publishes a yearly report of the *Comité d'étude sur le vieillissement* (CEV). This report has somewhat different figures for the fiscal burden of ageing, reaching only 3.8 percentage points by 2030 and 5.8 percentage points of GDP by 2050. The report relies, however, on different assumptions and does not allow international comparisons, in contrast to the publications of the AWG.
11. Aging is a burden on fiscal policies through two set of channels. Firstly, there is transitory effect of the baby boomers, which leads to *a)* a higher old-age dependency ratio and *b)* a slowdown of economic growth arising from the decline in the working-age population – the latter may include lower labour productivity growth because of a labour composition effect. As a result ageing-related expenditures increase, but spending pressures on unemployment, social security and education should ease in line with the smaller youth cohorts, and income growth slow. Secondly, there is permanent effect arising from longer life expectancy, which has more lasting increases on ageing-related expenditures, such as healthcare and pension outlays.

12. As pensions are calculated on the basis of past wages, pension replacement rates vary according to the year of retirement. The discretionary adjustment typically applies to pensioners that have seen their pension replacement rates deteriorate relative to "younger" pensioners.

13. As unemployment is expected to fall to its structural level, the labour participation rate would rise from 66% to 78% over the same period. The reason for the current difference between the implied unemployment rate and the actual unemployment rate of 8% is related to the fact that some workers in early retirement are counted as unemployed but are exempt from job search obligations and therefore no longer available for the labour force.

14. Projecting long-term interest rates is fraught with difficulties. One argument for higher long-term interest rates in the future is that long-term simulations on the Ingenue-model suggest that interest rates could be up to 2 percentage points over the long term in reaction to an international saving scarcity arising from similar aging pattern among OECD countries and a slightly delayed aging pattern in some important non-OECD countries (INGENUE, 2001).

15. Until 2011, spending at both levels of government is expected to increase annually by 2.3% in real terms (Bureau Fédéral du Plan, 2006).

16. Social security revenues represent 28.3% of general government revenues and 38.9% of expenditures.

17. For a more detailed discussion of the concept of sustainable fiscal policies, see Langenus (2006).

Bibliography

Australian Bureau of Statistics (2006), *Government Finance Statistics*, 2004-05.

Belgian Debt Agency (2006), "Belgian Government Debt: Presentation to the OECD", mimeo.

Bogaert H., L. Dobbelaere, B. Hertveldt and I. Lebrun (2006), "Fiscal Councils, Independent Forecasts and the Budgetary Process: Lessons from the Belgian Case", *Federal Planning Bureau Working Paper* 4-06, June.

Bureau Fédéral du Plan (2006), *Perspectives Économiques 2006-2011*, Mai 2006.

Chambre des Représentants (2006), "Inventaire 2004 des exonérations, abattements et réductions que influencent les recettes de l'état", annex to *Budget des voies et moyens pour l'année budgétaire 2005*, February.

Claes J., T. Stragier, K. Van Cauter and L. Van Meensel (2004), *The finances of the communities and regions*, *Revue Économique de la Banque Nationale de Belgique*, December.

Conseil Supérieur des Finances (2002), *Rapport annuel*, Section "Besoins de financement des pouvoirs publics", July.

Conseil Supérieur des Finances (2004), *Rapport annuel*, Section Comité d'Études sur le Vieillissement.

Conseil Supérieur des Finances (2005), *Rapport annuel*, Section Comité d'Études sur le Vieillissement.

Conseil Supérieur des Finances (2006), *Rapport annuel*, Section Comité d'Études sur le Vieillissement.

Cour des comptes (2006), La Vente de patrimoine immobilier par la Régie des bâtiments, Bruxelles.

EC (2005), "Federalisation and fiscal consolidation: the Belgian experience", *ECFIN country focus*, Volume 2, Issue 16.

ECB (2005), "Government Debt Management in the Euro Area, Recent Theoretical Developments and Changes in Practices", *Occasional paper* series No. 25, March.

European Commission (2006), "The Impact of Ageing on Public Expenditure: Projections for the EO25 Member States on Pension", Health Care, Long-Run Care, Education and Unemployment Transfers, *European Economy Special Report* No. 1/2006.

Federal Planning Bureau (2006), *Perspectives économiques 2006-2011*, May.

Girouard, N. and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for OECD countries", *OECD Economics Department Working Papers* No. 434.

Gonand, F. (2006), "Public Spending Efficiency in Primary and Secondary Education: Performance Indicators", *OECD Economics Department Working Papers* forthcoming.

Hoeller, P. and C. Giorno (2006), "Nothing Ventured, Nothing Gained: The Long-Run Fiscal Rewards of Structural Reforms", *OECD Economics Department Working Paper* No. 493.

Høj, J. and S. Toly (2005), The Labour Market Impact of Rapid Ageing of Government Employees: Some Illustrative Scenarios, *OECD Economics Department Working Papers* No. 441.

INGENUE (2001), "L'Avenir de nos retraites face à la Globalisation Financière : une exploration du Modèle INGENUE", La lettre du CEPII No. 200.

Langenus, G. (2006), "Fiscal sustainability indicators and policy design in the face of ageing", *Working paper research*, No. 102, October 2006, National Bank of Belgium.

Ministry of the Budget (2005), *Les finances publiques belges pour l'année 2006*.

NBB (2005), "Budgetary Co-ordination in a Federal State – The Case of Belgium", Belgian Prime News No. 29.

OECD (2005a), *Economic Survey: Belgium*.

OECD (2005b), *Pensions at a Glance – Public Policies across OECD Countries*.

Saintrain M. (2001), "La réforme de l'impôt des personnes physiques", Federal Planning Bureau, Working Paper 01-01, January.

Stockman P. (2004), "Personal Income Tax Reform in Belgium: The Short-, Medium- and Long-Run Impact on Wages, Employment and Value Added by LABMOD", Federal Planning Bureau, Working Paper 11-04, April.

Sutherland, D. (2006) "Public Spending Efficiency in Primary and Secondary Education: Performance Indicators", *OECD Economics Department Working Papers,* forthcoming.

Van Rompuy P. (2005), "De coördinatie van het budgettair beleid in België: een evaluatie" Documentatieblad van de FOD Financiën, 1e kwartaal, pp. 299-318, Dutch only.

ISBN 978-92-64-03186-9
OECD Economic Surveys: Belgium

Chapter 3

Labour market reforms to boost employment

Employment growth has picked up since 2004, and so has labour supply, reflecting government policies to encourage participation. Nonetheless, unemployment is persistent and particularly high for certain groups, such as older and younger workers. Moreover, important geographical differences in unemployment rates exist. The authorities have launched a new programme to activate the unemployed. However, the monitoring of search efforts is not yet undertaken jointly by the federal and the regional public employment services, which would help to secure consistency of feedback and sanctioning mechanisms. As for older workers, the government has enacted a series of measures to boost participation by removing incentives to retire early. The centralised wage bargaining system has helped to moderate wage growth, but not to avoid cost competitiveness losses, and in combination with general indexation on prices it has allowed little wage differentiation across geographical locations.

Employment growth has picked up since 2004 in Belgium, after having contracted earlier in the decade. Labour supply has also been expanding, reflecting the increasing participation of older workers and women in addition to the return of some of the discouraged workers to the labour market. The current rate of employment growth is, however, still below the rates experienced over the 1990s when the employment rate came closer to the level observed in other OECD countries. This can be taken as an indication that unresolved structural problems linger on, as shown by the high level of structural unemployment and the large proportion of long-term unemployed. Large geographical differences have widened in recent years, with some local areas being near full employment while others have deep-seated unemployment problems, suggesting a poor functioning of the labour market, notably a lack of mobility and an insufficient reactivity of wages. Incentives remain high to withdraw from the labour market through still generous early-retirement paths and an unlimited duration of unemployment benefits. Finally, the lack and mismatch of human capital – in particular for younger workers – and some of the highest effective marginal tax rates and tax wedges within the OECD continue depressing employment rates.

The rest of the chapter is organised in the following way. First, the chapter considers how the current system of unemployment benefits and job search assistance can be made more activating. Then, the chapter looks into barriers to employment for groups with weak labour market attachment. Finally, the steps that have to be taken to improve the wage formation process are considered from the viewpoint of boosting employment. The chapter concludes with a set of policy recommendations.

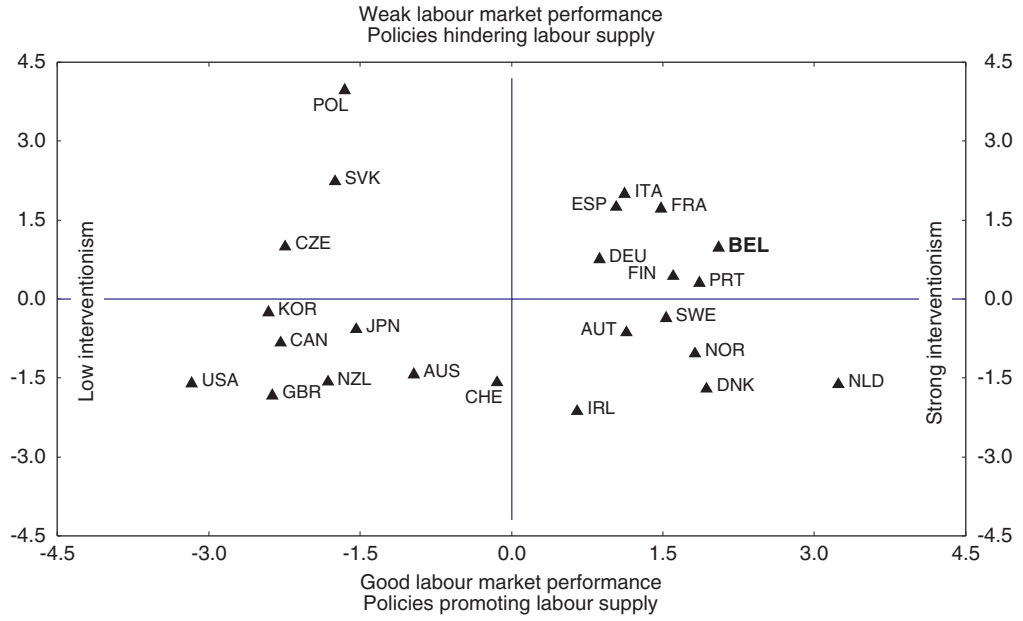
Increasing employment rates through more efficient activation

In the past, Belgium relied on interventions aimed at constraining the supply of labour in an attempt to address its unemployment problems, like a number of other Western European countries. These interventions included measures that ended up discouraging labour market participation (high tax wedges, high tax on continued work for older workers, early retirement and strict EPL on temporary contracts and on collective dismissals). As stressed by the reassessment of the "Jobs Strategy", this has not been successful in bringing the labour market performance closer to that observed in countries relying on interventions to make work pay, incite the return to work and generally encourage labour market participation (see Figure 3.1). The current government has shifted its strategy closer to the latter model, focusing on expanding labour supply by reforming activation, improving incentives for job search and expanding training measures for the low-skilled.

Modifying unemployment insurance to enhance job search activity

Unemployment benefits are of unlimited duration, an exception among OECD countries (see Figure 3.2). Moreover, while (net) replacement rates – taking into account the family situation – are not high at the beginning of an unemployment spell, they barely

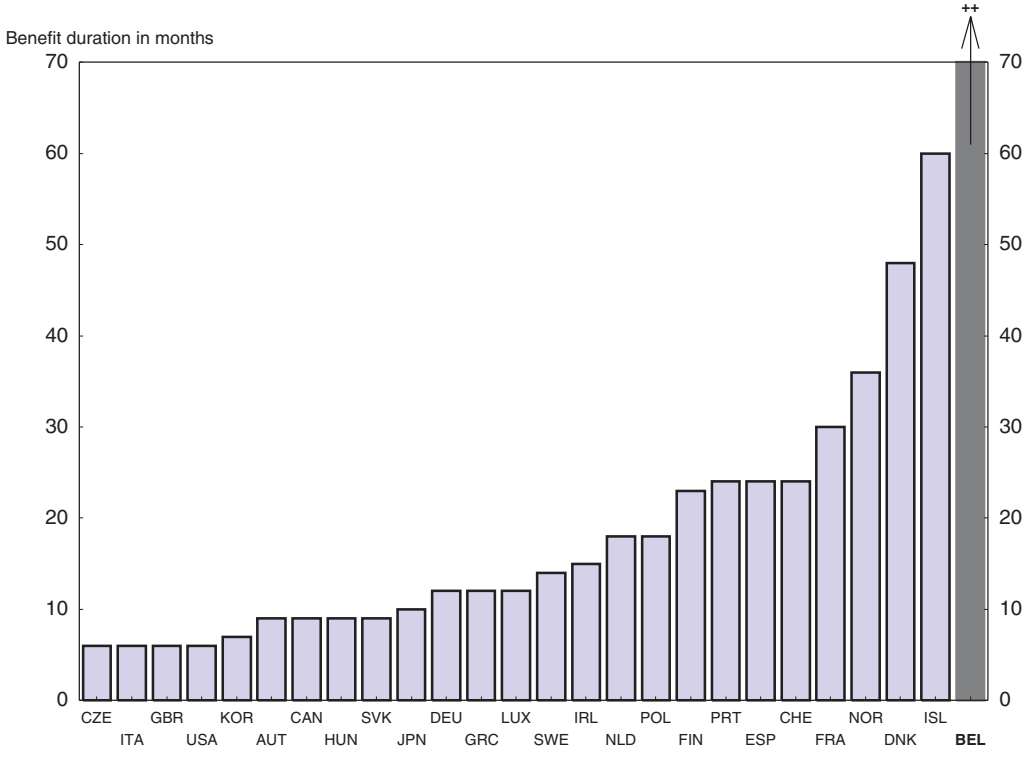
Figure 3.1. **Similarities and differences in policies, institutions and labour market performance**



Note: Labour market interventions are measured by active labour market policies, the degree of wage bargaining coordination, the coverage of wage agreements, employment protection legislation, the tax wedge, product market regulation and unemployment benefit gross replacement rates, all measured on or around 2003. The performance variables cover unemployment and employment rates. The vertical axis shows both labour market performance and the degree to which interventions tend to depress labour supply. The horizontal axis measures the overall stance of interventions.

Source: OECD Employment Outlook, 2006.

Figure 3.2. **Maximum unemployment benefit duration**



Source: OECD, *Benefits and Wages*, 2006.

decrease with unemployment duration, leaving them among the highest in the OECD after 60 months of (continuous) unemployment, at around 77% for married low-wage earners (Tables 3.1 and 3.2). This creates a substantial inactivity trap, causing Belgium to have one of the longest average durations of unemployment among OECD countries, with almost half of all unemployed on benefits for more than a year (Figure 3.3).

Empirical evidence suggests that unemployment benefits should be decreased over time in order to strengthen incentives for unemployed to increase their search efforts. Evidence that unlimited unemployment benefit duration hampers a quick return to work in Belgium comes from the one group of unemployed that until recently could be sanctioned for an excessively long unemployment duration, when they could not prove

Table 3.1. **Out-of-work net income in the initial phase of unemployment (2004)**

	67% of APW			100% of APW		
	Single person, no children	Lone parent, two children	Two-earner married couple, two children	Single person, no children	Lone parent, two children	Two-earner married couple, two children
Australia	45	60	68	31	51	57
Austria	55	74	86	55	70	82
Belgium	**83**	**79**	**85**	**63**	**64**	**74**
Canada	65	70	87	62	75	83
Czech Republic	50	64	79	50	64	74
Denmark	84	90	94	61	76	77
Finland	73	88	86	60	80	79
France	77	90	89	73	77	84
Germany	62	82	93	61	75	91
Greece	71	81	74	48	55	60
Hungary	58	70	81	43	53	70
Iceland	69	82	88	51	67	77
Ireland	42	63	76	30	60	65
Italy	50	54	84	54	60	79
Japan	70	78	87	60	68	79
Korea	54	55	77	51	51	71
Luxembourg	84	90	94	85	89	93
Netherlands	81	85	85	71	80	83
New Zealand	53	78	62	37	63	50
Norway	65	89	86	66	83	83
Poland	75	76	84	52	81	68
Portugal	81	93	91	78	87	88
Slovak Republic	61	59	85	64	62	83
Spain	76	77	89	69	75	87
Sweden	82	92	92	77	88	88
Switzerland	80	82	88	70	81	87
United Kingdom	63	71	77	45	65	65
United States	62	52	84	62	61	80
Euro area average	69	78	86	61	71	80
OECD average	67	76	84	58	70	77

Note: The table presents out-of-work net income available in the initial phase of unemployment following any waiting period. No social assistance "top-ups" are assumed to be available in either the in-work or out-of-work situation. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (*i.e.* monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months. For married couples the percentage of APW relates to one spouse only; the second spouse is assumed to be "inactive" with no earnings in a one-earner couple and to have full-time earnings equal to 67% of APW in a two-earner couple. Children are aged 4 and 6 and neither childcare benefits nor childcare costs are considered.
Source: OECD, *Tax-Benefit Models*.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

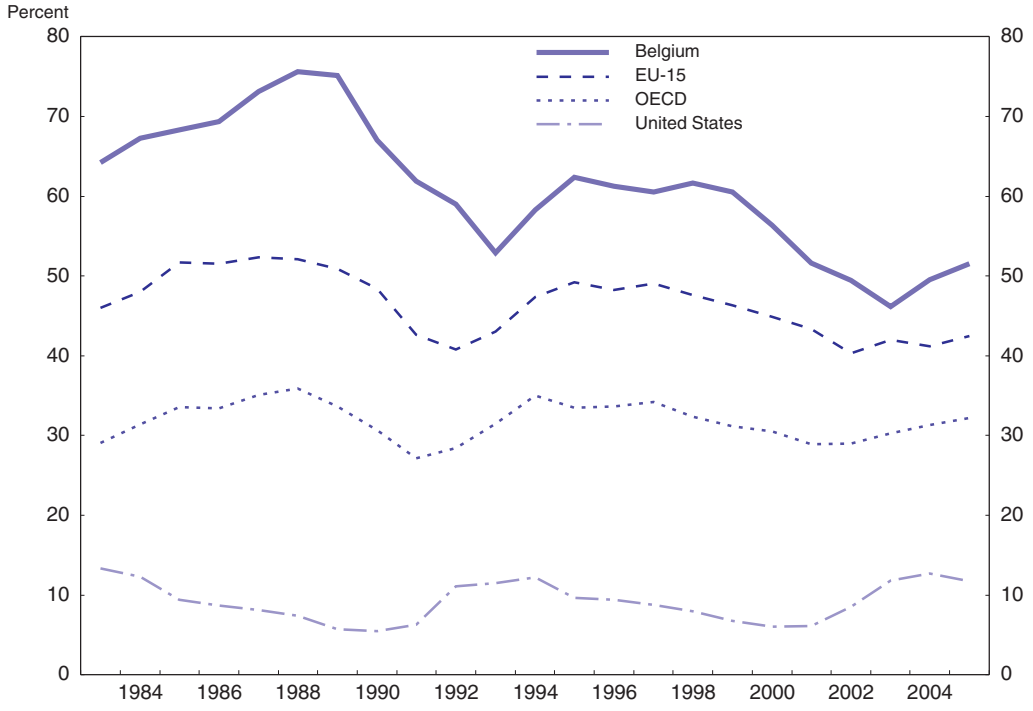
Table 3.2. **Out-of-work net income after 60 months of unemployment (2004)**

	67% of APW			100% of APW		
	Single person, no children	Lone parent, two children	Two-earner married couple, two children	Single person, no children	Lone parent, two children	Two-earner married couple, two children
Australia	45	60	64	31	51	53
Austria	66	82	74	51	66	71
Belgium	**69**	**79**	**77**	**52**	**64**	**68**
Canada	32	55	67	23	48	57
Czech Republic	44	70	65	30	57	55
Denmark	81	84	71	59	71	58
Finland	67	75	74	49	64	63
France	55	80	57	40	61	48
Germany	81	92	66	60	72	58
Greece	0	5	51	0	3	41
Hungary	35	46	55	25	34	47
Iceland	69	82	88	51	67	77
Ireland	71	64	76	51	60	65
Italy	0	0	65	0	0	56
Japan	49	82	62	33	62	51
Korea	23	53	50	16	36	41
Luxembourg	71	85	69	51	61	58
Netherlands	82	79	55	61	67	47
New Zealand	53	78	62	37	63	50
Norway	58	63	56	41	53	47
Poland	44	57	64	30	61	52
Portugal	35	84	71	25	61	59
Slovak Republic	29	49	54	21	36	46
Spain	35	54	53	25	39	44
Sweden	76	68	59	52	58	49
Switzerland	80	95	58	55	68	48
United Kingdom	63	71	73	45	65	62
United States	9	42	65	7	34	54
Euro area average	54	63	65	40	51	56
OECD average	51	66	64	36	53	54

Note: The table presents out-of-work net income after 60 months of continuous benefit receipt. Depending on the country, the net income includes unemployment benefits, social assistance, family and housing benefits. For married couples the per cent of APW relates to one spouse only; the second spouse is assumed to be "inactive" with no earnings in a one-earner couple and to have full-time earnings equal to 67% of APW in a two-earner couple. Children are aged 4 and 6 and neither childcare benefits nor childcare costs are considered.
Source: OECD, *Tax-Benefit Models*.

sufficient search efforts. Empirical evidence on the effect of both the notification of reaching the end of the unemployment benefit pay-out period and of the actual termination of unemployment benefits has shown that the transition probability from unemployment to work doubles at the time of termination and triples a year after benefits have been terminated (Cockx and Ries, 2004). This indicates the need for a gradual decrease of net replacement rates for long-term unemployed towards those prevailing in other countries. In addition, interaction between unemployment benefit replacement rates – even at moderate levels – and employment protection legislation may worsen the unemployment trap (see Annex 3.A1). Overall, this points to a potentially powerful stimulus for labour market activation: benefits should be designed to be bound by a strict duration limit, suggested by international evidence to be no longer than two years, after which other activation measures have to be taken to successfully return the unemployed

Figure 3.3. **Ratio of long-term unemployed (> 1 year) to total unemployed**



Source: OECD Employment Outlook, 2006.

to work. In the Belgian context, this would mean to phase down benefits to the level of social assistance. A consequence of phasing down benefits could be that initial net replacement rates would have to go up in order to provide sufficient margin for such a phase-out.

Benefits can also be used to strengthen job search incentives when sanctions apply to those not willing to take up suitable job offers. In principle, such a mechanism exists; definitions of acceptable work are wide and mobility and commuting requirements are large, but they have not been strictly enforced in the past. In July 2004, a new programme was started to encourage the long-term unemployed to return to work. The federal agency implemented a system of individualised follow-ups for job searchers that has been enacted in co-operation with the regions and communities. The system includes counselling (before 12 months of unemployment) and a series of job interviews (after 21 months of unemployment) to help the unemployed in profiling the job search.[1] The effectiveness of the system has been backed up by sanctions in case of no-show or refusal of a suitable job. Prior to the application of sanctions, a warning of the consequences of insufficient job search efforts is issued to the unemployed after 12 months. Only those under 50 years old are subject to the new procedures. Moreover, young people without an employment record that are on *allocation d'attente* will be counselled before 6 months of unemployment and be interviewed about their search efforts after 15 months of unemployment (including the *stage d'attente*) after they have left school.[2] This activation programme will be evaluated in 2007 to measure its success in bringing the unemployed back into employment. By June 2006, the monitoring of individual job search efforts had led to a temporary or

permanent suspension of benefits for 4.5% of all recipients concerned. Moreover, the amount of sanctions that were applied following information exchanges between the federal PES and the regions and communities (jobs or training refusals, no-show for an interview, etc.) had more than doubled in comparison to 2003. On the other hand, after the introduction of the new system, around 5% of the unemployed are no longer registered. In order to further enhance activation, the government should extend the current measures to all unemployed and activate them as soon as the search effort starts to decline. For younger people this could even take place immediately after entering the *stage d'attente*.

Strengthen the effectiveness of activation measures

Public employment services (PES) need a unified framework for job search assistance and sanctions. Currently, the federal agencies are responsible for collecting social security contributions and distributing unemployment benefits and for implementing sanctions in case of insufficient job search activity, while the regional agencies are responsible for job search assistance. An additional problem in this respect has been that regional agencies lack information on unfilled vacancies in other regions. This problem has been partly resolved by a recent inter-regional information exchange agreement for jobs where employers' demand is particularly pressing. Such limits on information exchange have been deemed necessary to avoid overburdening the job seeker with information. Authorities should, however, consider that job seekers have informational advantages in self-assessment that may not be available to PES when trying to match vacancies to the pool of unemployed. Hence, in order to remove the problem entirely, the information exchange should concern all vacancies.

There is international evidence that outsourcing of job search assistance to the private sector could improve matching. Australia, the Netherlands and New Zealand, among others, have recently started to experiment with introducing more competition in the market for employment services by contracting out job placement services to private providers and increasing competition among existing PES (OECD, 2005a).[3] The latter can be achieved by rating the performance of local employment offices, similar to the Swiss reform implemented in 2000. The publication of these ratings was preceded by detailed research into the determinants of local offices' placement effectiveness. The ratings helped to improve local employment office performance, contributing to lowering the unemployment rate. Competition between public and private providers of job search assistance should be further promoted by providing unemployed vouchers for job search assistance, building on first experience with recent contracting out of job placement services for the long-term unemployed in Flanders.

In the past, the PES have been reluctant to use benefits to activate the unemployed as unemployment benefits have been seen as a substitute for social assistance (SA). The latter takes the form of the *revenu d'insertion* (previously known as *minimex – minimum d'existence*). In practice, this system has been considered inapt to effectively activate people with weak labour market attachment. This need not necessarily be the case, as the recent reform of the Dutch Social Assistance has shown (see Box 3.1). The authorities should therefore consider strengthening incentives for municipalities – where social assistance is paid out – to bring their activation effort in line with that of the PES. At the same time, unemployment benefits should no longer be considered a substitute to social assistance, making the case for limited benefit duration even stronger.[4]

Box 3.1. **The Dutch social assistance reform**

Most social assistance laws in OECD countries stipulate some form of activation measures in order to avoid assistance recipients relying permanently on transfers. A few systems have also strengthened incentives for the responsible administration to actually use these activation measures and bring recipients back to work rapidly. The Netherlands introduced in 2004 a new system that goes in that direction by giving full financial responsibility for the social benefit budget to the municipal administration (Work and Social Assistance Act). The law also stipulates that it has to tender out at least 70% of the separate activation budget received from central government to private reintegration service providers and must pay back unspent money from this budget. As a result, municipalities are encouraged to reintegrate beneficiaries rather than confining themselves to paying social benefits. While municipalities remain free as to how they spend the remaining 30% of the activation budget (*e.g.* whether to subsidise municipal jobs or to give small wage subsidies to regular employment) the central government wants to reduce the high number of subsidised municipal jobs as beneficiaries' chances of re-entering the regular job market were found to be small. During 2003 a temporary subsidy of € 17 000 per worker was granted for turning subsidised jobs into regular employment.

Fostering continuous education to reduce skill mismatches

Besides geographical differences in unemployment rates, there is also evidence of severe skill mismatch. This appears to partly stem from the lack of training centres in sufficient quantity to respond to changes in demand for certain skills. For medium-skilled workers, there seems to be an inadequacy between the skills received at these training centres and the available jobs (CCE, 2006a). Financial effort devoted by firms to training is low, with regional variations (Table 3.3) which are partly explained by geographical differences in firm-size distribution (Heuse and Delhez, 2003).

Table 3.3. **Vocational training in firms: breakdown by region (2002)**

	Single-region firms			Multi-region firms			Total
	Brussels	Flanders	Wallonia	Brussels	Flanders	Wallonia	
Number of trainees (in % of employment)	31.3	29.7	19.9	54.9	56.5	53.1	35.1
Hours of training (in % of number of hours worked)	0.62	0.57	0.38	1.36	1.62	0.95	0.79
Training costs (in % of labour costs)	0.87	0.84	0.52	2.49	2.43	1.27	1.26
Firms reporting training activities (in % of the total number firms)	7.1	7.3	4.8	45.7	49.7	46.6	7.3

Source: National Bank of Belgium, 2004.

To counter such problems, the social partners have regularly stipulated in their inter-professional agreements (AIP) that employers should spend a certain percentage of the wage bill for continuous education and training (CCE, 2006b). Nevertheless, private training efforts have slightly decreased over recent years (1.13% of the wage bill was spent on training in 1997, 1.34% in 2000, 1.09% in 2004 and is estimated to be 1.02% in 2005). Moreover, training has been concentrated on high-skilled and younger workers. In reaction to these developments, social partners have added a new target to the financial objective

for 2004 (defined in 1998 as 1.9% of the wage bill to be earmarked for training purposes): in 2010, 50% of all workers should participate in training activities each year (CCE, 2006b). The government has introduced a sanction mechanism should the financial target not be respected and which will be applied to sectors with insufficient training efforts. Moreover, training vouchers to stimulate demand for training have not been met by adequate supply of skill-relevant training from either public or private centres, as witnessed by the fall in the average length of training leave that firms are willing to agree for their employees (CCE, 2006b). Moreover, training courses are criticised for being outdated and training infrastructure of poor quality. Mechanisms for ensuring the appropriate supply of training should be put in place to maximise the benefits expected from the tax subsidies. This includes regular updating of training contents and increased investment, in particular regarding public training centres.

Lack and mismatch of skills also prevent those out of work from returning quickly to gainful employment. In this regard, the current training efforts do not seem to be targeted at improving the job prospects of the weakest groups on the labour market, as only 5.9% of all unemployed and inactive people received training courses in 2004 (CCE, 2006a), well below the European average of 8%. In addition to the pure quantitative aspect, the way through which training is provided matters. In particular, the fact that the PES are organising the training measures themselves may lead to training contents not corresponding to labour market needs.[5] Training of the unemployed should rather be part of a unified training framework where the unemployed can have access to training infrastructure used by the private sector, as is done in the *centre de compétence*. Moreover, the unemployed should be better profiled in order to select appropriate training programmes to improve their chances of a quick return to employment.

Improving employment prospects of groups with weak labour market attachment

Making taxation and public spending more employment-friendly for low-wage earners

To improve low employment and participation rates for selected labour market groups (Table 3.4), the government has regularly lowered social security contributions for both employers and employees in the past (see Box 3.2). Recent reductions have been concentrated on employees' social security contributions. However, even when including the most recent reduction, effective marginal tax rates still remain high, independently from the income/wage level. For low-income workers (67% APW), both marginal personal income tax and social security contributions are at the top end among OECD countries (Table 3.5). High marginal tax rates impact doubly on equilibrium employment rates, by reducing both labour supply through inactivity and poverty traps and demand through higher reservation wages (Daveri and Tabellini, 2000; Everaert and Heylen, 2002; Nickell, Nunziata and Ochel, 2005). In countries where wages are predominantly fixed at the sectoral level, as in Belgium, trade unions tend to be powerful enough to shift at least part of the tax burden onto higher wages but do not completely internalise associated negative external effects, which may explain why Belgians have to face high marginal tax rates as well as persistent unemployment.

High effective marginal tax rates – in particular at low income levels – are driven to a large extent by personal income taxation (around 60%, see OECD, 2006a). Reducing income taxes – targeted at low-wage earners – would help to substantially reduce marginal tax

Table 3.4. **Employment and labour participation rates for selected groups**

	Labour force participation					
	By age			By skill level		
	25-54	55-59	60-64	Low	Medium	High
Belgium	**84.4**	**45.2**	**17.8**	**55.4**	**77.7**	**86.9**
France	87.2	61.0	17.5	67.8	81.5	87.1
Germany	86.4	73.3	31.7	61.1	78.2	87.5
Italy	77.4	44.5	18.7	56.0	77.7	86.5
Luxembourg	83.9	47.7	12.9	62.4	71.2	85.7
Netherlands	84.6	63.6	24.4	62.6	80.8	88.1
United Kingdom	84.1	70.6	43.0	56.8	82.4	89.6
United States	82.8	71.4	51.6	63.1	77.2	84.7
EU15	83.9	62.4	30.0	63.1	79.8	88.1
OECD	80.6	65.2	41.1	62.5	79.0	87.2
	Employment rate					
	By age			By skill level		
	25-54	55-59	60-64	Low	Medium	High
Belgium	**78.3**	**43.3**	**17.0**	**49.4**	**73.1**	**84.1**
France	79.6	56.7	16.6	59.6	75.4	81.7
Germany	77.4	63.4	28.2	48.6	69.5	82.7
Italy	72.2	43.1	18.0	51.6	73.5	82.3
Luxembourg	80.6	46.8	12.6	59.3	68.5	93.2
Netherlands	80.9	60.8	23.2	59.0	77.7	95.6
United Kingdom	81.1	68.5	42.0	53.0	79.4	88.8
United States	79.3	69.0	50.0	56.5	72.8	82.0
EU15	77.7	58.1	28.2	57.5	74.9	84.4
OECD	75.8	62.1	39.3	56.6	74.2	83.9

Note: Labour participation and employment rates by age refer to 2005, those by skill level refer to 2004.
Source: OECD, 2005a.

rates. A lowering of employees' social security contributions has already been enacted, and a work bonus replacing the previous tax credit scheme has been introduced in 2005 for low-wage earners. Further measures could be taken in this respect. In addition to a favourable impact on labour supply, this would set incentives for social partners to lower wage pressure for this group, raising their labour market prospects. Moreover, social security reductions should become more targeted. The current system in Belgium applies both unconditional ("structural reductions" assimilated to a wage subsidy) and conditional (hiring subsidy) measures, with the former being the more important one. All employees benefit from an unconditional fixed lump-sum reduction of € 133.3 per month. This is topped up by a variable reduction to reach a total maximum reduction of € 257.3 per month at the minimum wage and then decreases again to the lump-sum reduction at 1.5 times the minimum wage. The experience with these measures has been mixed. In several cases, the reductions ended up fuelling steeper wage growth. Around 50% of past reductions are said to have been passed on to employees in the form of higher net wages (Ooghe *et al.*, 2000). In order to reduce associated deadweight costs (foregone revenues due to social security reductions have reached 1.7% of GDP in 2005, up from 0.5% of GDP ten years earlier) the existing measures could be strengthened by phasing out the unconditional

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Table 3.5. **Marginal rate of income tax plus employee contributions less cash benefits, by family-type and wage level**[1]

Per cent of gross wage earnings, 2005

Family-type :	Single no ch	Single no ch	Single no ch	Single 2 ch	Married 2 ch	Married 2 ch	Married 2 ch	Married no ch
Wage level (% of average wage):	67	100	167	67	100-0	100-33[2]	100-67[2]	100-33[2]
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Australia	31.5	31.5	48.5	66.4	51.5	31.5	31.5	31.5
Austria	44.9	44.9	37.5	44.9	44.9	44.9	44.9	44.9
Belgium	**61.3**	**54.8**	**59.3**	**61.3**	**54.8**	**54.8**	**54.8**	**54.8**
Canada	26.5	35.1	33.0	51.9	52.9	39.1	39.1	35.1
Czech Republic	25.6	30.0	34.4	46.6	42.3	25.6	30.0	30.0
Denmark	42.9	49.2	63.0	42.9	43.7	43.7	43.7	43.7
Finland	38.9	44.1	49.8	38.9	44.1	44.1	44.1	44.1
France	32.6	36.8	42.2	21.4	30.6	26.0	31.3	31.3
Germany	51.3	57.8	44.3	49.1	46.9	51.2	54.4	51.3
Greece	16.0	41.2	49.6	16.0	41.2	41.2	41.2	41.2
Hungary	36.5	69.5	51.5	36.5	69.5	69.5	69.5	69.5
Iceland	36.2	36.2	40.2	42.9	42.9	42.9	42.9	36.2
Ireland	26.0	48.0	44.4	62.4	26.0	26.0	26.0	26.0
Italy	37.1	37.1	45.6	38.7	39.5	38.7	37.1	37.1
Japan	19.0	23.1	27.0	19.0	20.2	20.2	20.2	23.1
Korea	10.3	17.6	19.9	10.3	12.1	17.6	17.6	17.6
Luxembourg	33.7	46.1	47.9	14.0	14.1	30.1	37.2	30.1
Mexico	14.9	14.9	26.1	14.9	14.9	14.9	14.9	14.9
Netherlands	49.6	45.4	52.0	45.3	45.4	45.4	45.4	45.4
New Zealand	21.0	33.0	39.0	39.0	63.0	33.0	33.0	33.0
Norway	35.8	35.8	47.8	35.8	35.8	35.8	35.8	35.8
Poland	34.8	34.8	43.7	34.8	34.8	34.8	34.8	34.8
Portugal	24.0	34.5	45.0	24.0	24.0	24.0	34.5	24.0
Slovak Republic	29.9	29.9	28.7	29.0	29.0	29.0	29.0	29.9
Spain	34.0	28.8	37.0	23.6	28.8	28.8	28.8	28.8
Sweden	35.4	32.2	56.6	35.4	32.2	32.2	32.2	32.2
Switzerland	26.7	28.9	37.1	21.2	24.2	25.9	30.7	27.9
Turkey	32.6	32.6	36.8	32.6	32.6	32.6	32.6	32.6
United Kingdom	33.0	33.0	41.0	70.0	33.0	33.0	33.0	33.0
United States	28.9	28.9	38.9	20.0	45.0	28.9	28.9	28.9
Unweighted average:								
OECD	32.4	37.2	42.3	36.3	37.3	34.8	36.0	35.0
EU15	37.4	42.3	47.7	39.2	36.6	37.6	39.2	37.9
EU19	36.2	42.0	46.0	38.7	38.1	38.1	39.6	38.5

Note: ch = children.

1. Assumes a rise in gross earnings of the principal earner in the household. The outcome may differ if the wage of the spouse goes up, especially if partners are taxed individually.
2. Two-earner family.

Source: OECD, *Taxing Wages*, 2006.

lump-sum wage subsidy. At the same time, the variable reduction could be raised more steeply to benefit low-wage earners. In particular, the system should aim at a further reduction of social security contributions for those at the minimum wage.

Box 3.2. **Programmes to reduce social security contributions**

There is a long tradition in reductions of social security contributions both for employers and employees. In order to curb unemployment, a first cut to employers' contributions had been enacted as early as 1981 (Cockx *et al.*, 2003). These unconditional ("structural") reductions are assimilated to wage subsidies and amounted to € 3.3 billion in 2004 (roughly 1.3% of GDP). Further targeted measures have been concentrated on low-wage earners in 1993 and in 2000 a reduction of low-wage employees' social security contributions has been introduced. In addition, several types of hiring subsidies exist for targeted groups of unemployed. Particular measures exist to encourage the hiring of younger and older workers as well as for certain occupations (scientific researchers, occupations in the non-profit sector, and shift workers). Finally, enterprises may benefit from reductions to social security contributions in periods of restructuring. Some of these measures are said to have induced important substitution effects, such as when older workers are hired instead of younger workers, with no net increase in employment (Cockx *et al.*, 2005). The sum of these measures amounts to some 15.5% of total social security contributions (see Table 3.6 for a breakdown of the costs).

Table 3.6. **Reductions in social security contributions 2004-2006**

In thousand euros

	2004	2005[1]	2006[1]
(1) Total reduction of employer's social security contributions	**3 869 966**	**4 361 224**	**4 471 600**
Structural reductions	3 343 773	3 572 992	3 598 727
Targeted reductions	274 503	524 142	608 833
For older workers	*72 410*	*93 153*	*92 541*
For restructuring enterprises	*11 993*	*25 880*	*27 500*
Specific reductions	251 690	264 090	264 040
For scientific personnel	*68 890*	*60 340*	*61 600*
(2) Reductions for the non-profit sector	**396 000**	**420 000**	**468 000**
(3) Reductions for employee's social security contributions	**157 220**	**238 813**	**516 764**
Total reductions (1) + (2) + (3)	**4 423 186**	**5 020 037**	**5 456 364**
In % of GDP	***1.5***	***1.7***	***1.7***

1. As provided in the budget.

Source: Office National de Sécurité Sociale, 2006.

Shutting down exit routes for older workers and improving their employability

Reducing the use of early retirement systems more drastically

Employment rates for older workers are low and decrease sharply after age 50. Labour force participation of Belgian workers aged 60 and over is one of the lowest in the OECD. Various exit routes have made it easy in the past for older workers to leave the labour market. Job search requirements for workers above age 50 were absent until 2002 and benefits were topped up by companies or through sectoral funds. In addition, early retirement could be taken at age 58 or even younger in the case of enterprise restructuring. Moreover, there is a decline in employability due to steep seniority pay and low incidence of training even at younger ages that would help to maintain and extend the human capital base. In the light of the demographic ageing that will reduce the working-age population

starting in 2011, older workers seem therefore to constitute an important group for increasing labour supply.

Recently, measures to limit early retirement were introduced in the "Solidarity Pact between Generations", which is being progressively put into legislation (see Box 3.3). Conditions for the use of early retirement benefits have been tightened in line with an increase in job search requirements up to age 58. On the other hand, activation programmes are still not extended to the age cohort of 50 years and over. Unemployment benefit top-ups from firms to individually negotiated redundancies are now subjected to a tax rate of 32.5% – paid by the employer – to limit its use. In addition, redundancies following enterprise restructuring will be taken care of through special PES structures (*tewerkstellingscel/cellule de reconversion*), and older workers will no longer be granted automatic access to pre-pensions. As a consequence of the pension reform of 1996, the entry age for first-pillar pensions is gradually being increased to 65 for females to align it with that of males, making pre-pensions more expensive for employers as they have to pay pre-pension top-ups for a longer period.

Box 3.3. **The Solidarity Pact between Generations**

To restrict access to certain early retirement systems and to offer provisions to encourage labour demand for older workers, the government has adopted a new reform plan in early 2006, called the "Solidarity Pact between Generations". The main elements of this pact include:

- Imposing a 32.5% tax on unemployment benefit top-ups that companies have been using in the past to foster voluntary redundancies ("Canada-dry arrangements").
- Raising the ordinary early-retirement age from currently 58 years at 25 years seniority to 60 years in 2008 (30 years of seniority) and increasing the required seniority to 35 years of services by 2012. Some exceptions continue to hold, such as for workers in occupations that are considered to be arduous.
- Setting up special PES structures (*tewerkstellingscel/cellule de reconversion*) responsible for a close follow-up of mass redundancies in the event of enterprise restructuring.
- Introducing financial incentives to continued work, including new cuts in employers' contributions for firms employing or recruiting older workers, greater scope for combining a pension with an earned income, a new bonus system granting a pension supplement for persons continuing to work after the age of 62 years, and more generous tax treatment of second pillar incomes under pension systems in the case of persons resuming work or remaining in employment up to the statutory retirement age.

In addition to these legal provisions, social partners have been asked to consider a reform of the pay scales that link pay increases to age or seniority, in order to limit the pressure caused by pay differentials between young and old workers.

The generation pact has reduced the number of exit routes for older workers. However, there still exist alternative routes, which might be increasingly used in coming years. In particular, the 32.5% surtax on top-ups on unemployment benefits only applies to sectoral agreements signed after 1 August 2005; employers who entered agreements earlier continue to be free to offer such schemes to their employees without paying this tax. At a minimum, and in order to avoid asymmetric treatment of employees in different sectors,

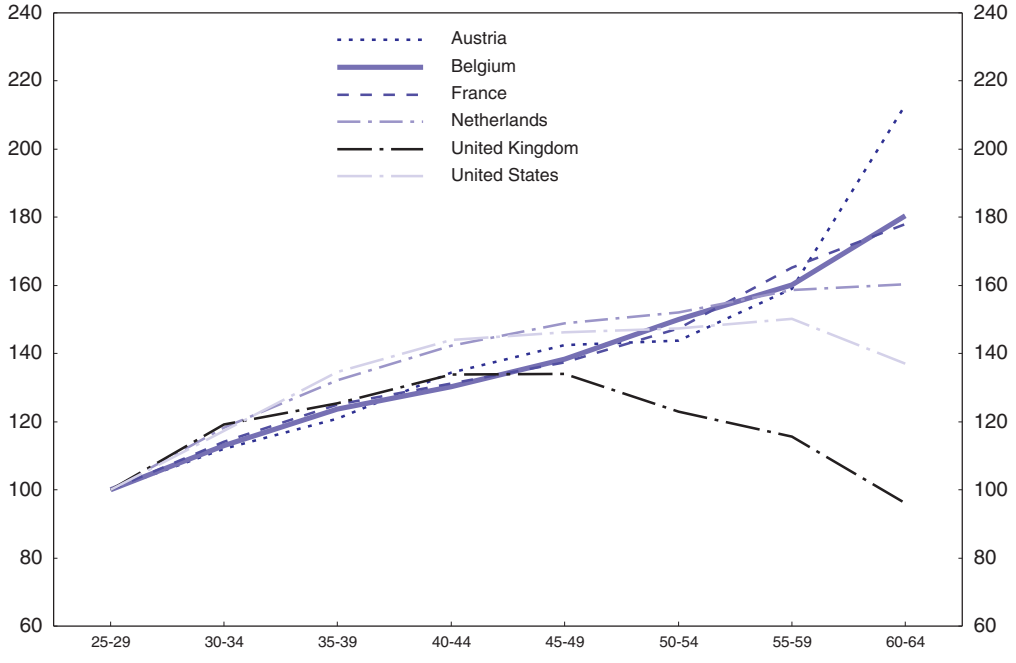
these sectoral agreements should be treated independently of the date when they were signed and top-ups on unemployment benefit should be systematically taxed. In addition, any exemption from the pact's provisions – such as those related to particular occupations – should be phased out. Similarly, search requirements for older unemployed workers should not decline with age. Over the medium term, the authorities should consider adjusting the legal retirement age with increases in life expectancy.

Lowering seniority premia to improve the employability of older workers

Employability of older workers is suffering from steep seniority pay increases, which need to be reduced if employment for older workers is to be encouraged. For male employees older than 60, wages are almost 180% of their level at age 25-29 years. Such a profile is very different from those in the United Kingdom and the United States – where lower productivity at a more advanced age is reflected in a reduction in the average wage beyond a certain age – but close to the wage profile for French employees (see Figure 3.4). Employment protection provisions that are tightening with increasing seniority are likely to have strengthened the insider position for the remaining older workers, contributing to the high seniority premia. Moreover, wage subsidies for older workers have created substitution effects in labour demand (van der Linden, 1997), which may have fuelled wage growth for those with long seniority. Reforms to increase the employability of older workers should therefore aim at reducing the seniority premia by removing provisions that strengthen employment protection with tenure. Moreover, such reforms should include a change in the focus of wage subsidies by targeting them on low-wage workers rather than on older employees.

Figure 3.4. **Seniority premia for men in OECD countries**

Salaries of 25-29 years old = 100



Source: OECD, *Live Longer, Work Longer*, 2006.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Increasing the sensitivity of wages to local considerations

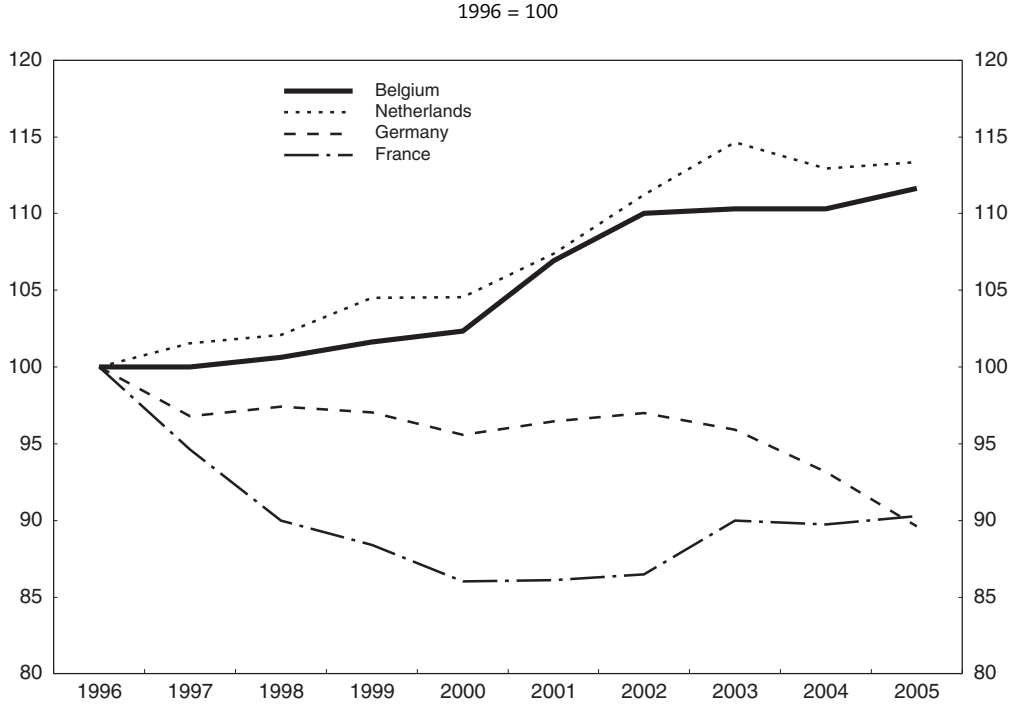
The Belgian wage negotiation system has two dominant features: the wage norm (see Box 3.4) and wage indexation, which effectively constitute an (indicative) upper and lower bound to wage growth. Belgium is one of the last OECD countries (apart from Luxembourg, where it has recently been temporarily suspended) to use such automatic wage indexation to adjust wage increases to the cost of living. The indexation is an effective lower bound as it draws in a floor for negotiated wage increases. The indexation mechanism hampers real wage adjustments to supply shocks, which have become increasingly important, adding to a high degree of real wage rigidity. In order to introduce more leeway, the wage indexation was modified in 1994 and is now based on an adjusted core inflation measure known as the health index; this excludes the prices of tobacco, alcohol and fuel energy (but not heating energy), which makes up around 7.5% of the overall HICP.[6]

Box 3.4. **The wage norm**

The upper bound of wage growth is fixed by an (indicative) national norm. The norm is fixed by the social partners (or by the government in case of non-agreement) on the basis of biannual calculations by the Conseil Central de l'Économie (CCE) on the basis of expected nominal average hourly labour cost developments in three neighbouring countries (Germany, France, and the Netherlands). By law (*Loi sur la compétitivité de 1996*) social partners are constrained to negotiate agreements that, as a maximum, increase the labour costs (*coût salarial*) by the rate set in the norm and, as a minimum, increase them by the contribution of the rate of inflation and step increases (*augmentations barémiques*). The wage norm is formally published in an inter-professional agreement (*accord inter-professionnel*, AIP) which constitutes the basis of sectoral and firm-level negotiations conducted subsequently to the AIP. In principle, agreements on lower bargaining levels cannot go below what has been centrally determined. In exceptional circumstances, such as firm restructuring, opt-out rules exist that allow an enterprise to temporarily deviate from the sectoral agreement after approval by a sectoral joint committee; the procedure is only sparingly used.

The current set-up of the wage bargaining process has failed to maintain price competitiveness since the law was enacted (see Figure 3.5). Partly, this is related to the two-year forecast horizon that is involved in calculating the wage norm, which has proven inappropriate in periods of volatile price and wage developments in either Belgium or its neighbouring countries. Moreover, the framework itself does not always seem to deliver expected results: for the last agreement the government had to step in to enforce moderate wage growth in the absence of social partners' willingness to agree on the wage norm. The social partners have sought to diminish the risk that high wage growth poses for competitiveness by concluding so-called all-in-agreements that stipulate that in case of higher than expected increases in the health index (and hence the wage increases induced by indexation), the sectoral and firm-level agreements have to be reduced by the same amount, so as to guarantee that actual wage increases never exceed the wage norm (CCE, 2005). However, the wage indexation still applies to these all-in-agreements, providing for a lower bound for wage increases. To increase the effectiveness of all-in-agreements, they should become all encompassing, and social partners should consider phasing out the wage indexation system in the medium term to increase real wage flexibility. Moreover, the

Figure 3.5. **Unit labour cost in manufacturing in comparison with the three neighbouring countries**



Source: OECD, Economic Outlook Database, 2006.

use of all-in-agreements should become more widespread; for the moment, only 20% of all private sector employees are covered by this new type of wage agreements. Finally, to help enterprises to cope with adverse shocks, the use of existing opt-out rules in sectoral wage agreements should only depend on the approval of the firm and its employees and approval of opt-out agreements by the sectoral joint committee should no longer be required.

Allowing wages to react to geographical differences in unemployment

The combination of wage indexation and the wage norm fixes a substantial part of the annual wage growth at the national level, leaving very little room to negotiate differences in wage growth at other levels.[7] Such a system does not provide enough flexibility to react to economic differences at the firm or local levels. In addition, the spread between wage indexation and the indicative wage norm has narrowed in the recent past, leaving only around 1.2% for negotiation at lower level bargaining units over a two-year period. As a result, with few exceptions wage rates follow broadly similar trends across sectors and localities. Across sectors, the (nominal) hourly labour costs have risen on average by 2.6% annually between 1998 and 2004, with a minimum of 0.5% in agriculture and a maximum of 3.2% in some service sectors. Regarding wage trends at the local level, a recent assessment shows that wage increases have been broadly similar between 1998 and 2002 in Brussels (17%), Flanders (16%) and Wallonia (13%) (Heuse and Delhez, 2004). Hence, differences in local labour markets do not translate into differences in the wage dynamics, preventing unemployment rates from equalising across the country.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

In addition to the centralised nature of the wage bargaining system, a high statutory minimum wage of € 1 234 (which corresponds to one of the highest hourly labour costs in the OECD, although slightly below the levels observed in neighbouring countries) constitutes a major obstacle for low-skilled workers to price themselves back into employment. No differentiation exists between regions or occupations. The statutory minimum wage is automatically adjusted in line with the health index. In addition, sectoral agreements include wage floors that lie above the statutory level. These sectoral minimum wages are not covered by any existing all-in clauses, even if their growth rate exceeds the wage norm (CCE, 2006a). This further contributes to a decline in competitiveness and difficulties for certain groups in the labour market to find a job. All in all, this system of setting wages has contributed to large and widening differences in employment and unemployment rates (Table 3.7).

Table 3.7. **Employment and unemployment rates in Belgian provinces 2000-2005**

In per cent

	2000	2001	2002	2003	2004	2005	2000	2001	2002	2003	2004	2005
Brussels	55.0	53.9	54.5	53.2	54.1	54.8	13.9	12.9	14.5	15.6	15.7	16.3
Flanders	63.9	63.4	63.5	62.9	64.3	64.9	4.3	4.0	4.9	5.7	5.4	5.2
Antwerp	61.7	61.8	61.6	61.0	62.7	63.5	4.8	4.3	5.6	6.4	6.0	6.2
Limburg	60.0	60.3	61.1	59.4	60.9	60.5	4.9	4.3	5.3	6.8	6.5	7.1
East Flanders	64.9	64.8	64.3	64.4	65.3	66.7	4.5	3.8	5.5	5.5	5.2	4.9
West Flanders	65.9	63.6	64.5	64.2	65.5	67.5	3.6	3.6	3.8	4.2	4.5	4.4
Flemish Brabant	67.1	66.5	66.5	65.6	67.0	65.7	3.6	3.7	4.0	5.6	5.0	4.7
Wallonia	56.0	55.4	54.9	55.4	55.0	56.0	10.2	9.9	10.5	10.8	12.0	12.0
Wallonian Brabant	61.2	60.9	59.5	60.2	60.6	60.0	6.9	5.9	7.0	7.9	7.7	9.0
Hainaut	53.6	52.2	52.1	52.6	51.8	52.9	12.0	11.9	12.6	12.6	13.8	14.0
Liège	54.9	55.3	54.7	55.6	54.9	56.1	10.2	10.4	10.8	11.2	13.3	11.9
Luxembourg	62.1	61.5	60.5	59.4	60.1	61.1	6.8	6.3	6.5	6.7	8.1	7.9
Namur	57.6	56.9	56.5	57.1	57.3	59.1	10.3	8.9	9.4	9.5	9.7	10.4
Belgium	**60.5**	**59.9**	**59.9**	**59.6**	**60.3**	**61.1**	**7.0**	**6.6**	**7.5**	**8.2**	**8.4**	**8.4**

Source: Eurostat.

Labour demand for young workers is also depressed by high entry wages. Partly, this can be related to relatively high minimum wages at an already young age. The *revenu minimum mensuel moyen garanti* (RMMMG) is set through a collective bargaining agreement at the national level between the social partners under the auspices of the *Conseil national du travail*. A collective convention concluded in 1991, and still in place, defines minimum wages for workers younger than 21 years old. In this convention, the RMMMG is set at 94% of the current minimum wage for 20-year-olds, gradually decreasing to 70% of the minimum wage for 16-year-olds and younger workers. The actually observed minimum wages across sectors are above these levels (OECD, 2007). Given productivity differentials arising from learning-by-doing and other experience-related factors, these entry wages come across as too high, in particular when considering that they only represent the legal minimum and that sectoral agreements usually stipulate higher entry wages.

The government and social partners consider that the current wage bargaining framework gives enough room for differentiation and have been very reluctant to consider further decentralisation of wage negotiations as a possible answer to the labour market problems. They point to the risk that high wage agreements in the North would spill over to the South in case of regional wage agreements, which can be taken as an indication that

even at a local level, wages react only sluggishly to changes in unemployment rates. The top-down determination of wages, whereby the national wage norm is followed by agreements at the sectoral levels and then by firm-level agreements is seen as leading to sufficient margin of negotiations (Deschamps, 2003). Critiques of a decentralised wage bargaining process also point to large differences in sectoral employment between the two major regions – in particular with respect to the public employment share – which means that decentralisation of wage negotiations would run the risk of magnifying any current geographical employment differences.

While these concerns are well taken, it nevertheless seems that some of the risks would turn out to be of minor importance, once the system allows more geographical differentiation in wage developments. Evidence from other countries with similar regional disparities – such as Germany – shows that once opt-out clauses and local wage agreements become widespread, the local bargaining units will use them to adjust the outcome of their negotiations to their local conditions rather than to import high wage growth from economically more advanced regions. It would, however, require that wages and particularly minimum wages are set at a decentralised level as well and that unemployment benefits leave enough room for wages to differentiate across the country. As regards the differences in sectoral specialisation, these should be considered endogenous and part of the reason why some industries no longer exist in the southern part of the country is related to the fact that high wage growth has driven them out of business.

The large variety of unemployment across provinces suggest that the current framework of wage bargaining and the existence of different wage floors – statutory and sectoral – leaves too little room for the unemployed to price themselves back into employment. This calls for a substantial reform of the centralised approach to wage bargaining, which can be inspired by recent changes in some of the Nordic countries (see Box 3.5). In particular, the social partners should revise the current system of putting a floor

Box 3.5. **Recent reforms to centralised wage bargaining systems in Nordic countries**

The Nordic countries (Denmark, Finland, Norway and Sweden) have had historically high degrees of centralisation in their wage negotiation system. Some of these countries have, however, over time introduced elements of flexibility to account for local labour market circumstances. Sweden has long since moved towards a more sectoral approach of wage negotiation, with some agreements covering only indications to wage increases at firm levels. In Denmark, framework condition negotiations take place at the sectoral level. These negotiations include holidays and pension contributions as well as the increases in each sector's wage floor. The latter is considerably below the average wage in each industry. The outcome of sector negotiations then provides the framework for the wage negotiations at the firm (or factory) level. For the individual worker the outcome of these local negotiations can vary from a uniform wage increase for all employees to a negotiated average wage increase for the firm, giving the employers considerable room for aligning individual wage increases with performance. As an implication of this system, employees within the same firm are not guaranteed the same wage increase nor do firms within the same industry have similar wage increases. This is also showing up in greater variation of wage growth. Finally, firm-level agreements are only signed after final consent by the confederation of trade unions and the employers' association.

to negotiations through wage indexation – preferably abolishing it – so that local differences can be better reflected in wage dynamics. As a short-term measure, a gradual approach could be to further adjust the current calculation of the health index. One possibility in this regard would be to remove items that have shown very strong increases in the past, subject to a ceiling. Such a modified indicator would constitute a reduced lower bound, increasing the scope for wage negotiations while safeguarding some of the employees' purchasing power. Notwithstanding revisions to the use of wage indexation, all-in-agreements should become more generally applied and the use of opt-out-clauses should be facilitated.

Conclusion

The gap in employment rates between Belgium and the average of OECD countries has narrowed. However, employment growth needs to gain further momentum to allow a further decrease in unemployment rates amidst rising participation rates. This requires that the recent programme to activate the unemployed should become a core objective of the PES, helping to reduce the high stock of long-term unemployed. Labour market measures, such as training and social security reductions, should be more focused on low-wage, low-skilled earners where labour market attachment is weak and the transition to employment particularly difficult. Moreover, wages should better reflect differences in local labour market conditions. Besides these general recommendations, a set of detailed recommendations are provided in Box 3.6.

Box 3.6. **Summary of labour market policy recommendations**

Improve activation measures

- The unemployment benefits should be phased out with unemployment duration so as to increase incentives for those out of work to enhance their job search activities and should be bound by a strict time limit. Initial net replacement rates may have to go up in order to provide a sufficient margin for such a phase-out.
- Activation measures should be applied generally. This would include extending the new federal activation programme to workers older than 50 years and monitoring the search efforts of young school leavers receiving the *allocation d'attente* earlier.
- The activities of the public employment services should be better coordinated to strengthen the effectiveness of activation measures. Job search assistance, training requests and eventual sanctions should be better coordinated between regional and federal services.
- Continuous education should be encouraged to reduce skill mismatches. Training and continuous education needs to be supported further, in particular through enhancing the supply conditions for vocational training.

Improve employment rates of groups with weak labour market attachment

- Effective marginal effective tax rates are high, in particular for low income earners, and should be reduced to increase labour supply and lower structural wage pressure for this group.
- All wage subsidies and reductions of social security contributions should be targeted to low-wage earners to avoid substitution effects between different support schemes. Other reductions of social security contributions should be phased out.

Box 3.6. **Summary of labour market policy recommendations** *(cont.)*

- Early retirement schemes should be phased out more rapidly and the still existing exit routes should be closed. This includes extending the surtax on top-ups on unemployment benefits to all wage agreements and phasing out occupational exemptions.
- Over the medium term, the authorities should consider adjusting the legal retirement age with increases in life expectancy.

Increase sensitivity of wages to local considerations

The centralised wage bargaining system should be revised to allow wage developments to reflect local labour market conditions. As a minimum this requires abolishing wage indexation, as has been done in other countries. Moreover, wage increases should only be subject to negotiations on the firm level. In addition, the use of opt-out rules should be facilitated.

Notes

1. For unemployed younger than 25 years old, the counselling begins before 6 months and the job interviews after 15 months.
2. The unemployment insurance does not cover young school leavers without an employment record. With at a minimum a secondary school degree, those unable to find a job have to wait between 155 and 310 days (depending on age) before they are eligible to enter a complementary insurance system, called the *allocation d'attente* and which is paid out over an unlimited period. For a more detailed description of this system see OECD (forthcoming).
3. Such a strategy is not without risk, as cream-skimming (*i.e.*, selection by service providers of which clients to serve) has to be prevented, a proper evaluation of the services provided must be available (*i.e.*, private placement services must be prevented from manipulating published outcomes) and individual entitlement to benefits has to be protected against possible abuses of service providers to report excessive refusals to participate in the labour market programme.
4. At the same time, incentives for social assistance need to be strengthened to return benefit recipients to work. Currently, the system sets incentives to pass SA recipients to the unemployment benefit scheme instead of into employment.
5. There is also evidence that making training measures obligatory for the unemployed renders them inefficient as people try to avoid these measures, considering them as not helpful and a waste of time (Geerdsen, 2006).
6. As a result of this set-up of the health index, inflation of indexed wages was lower than consumer price inflation since 2003 and is projected to remain lower for 2007 (BFP, 2006). The shortfall of the wage index relative to the consumer price index could only be compensated, were the health index to increase at a more rapid pace until 2011.
7. Wages *levels* do differ – sometimes substantially – between sectors and locations, taking into account differences in human and physical capital equipment and sectoral rents to be shared.

Bibliography

Bassanini, A. and R. Duval (2006), "Employment Patterns in OECD Countries: Reassessing the Role of Policies and Institutions", OECD Social, Employment and Migration Working Paper, No. 35, and *OECD Economics Department Working Paper*, No. 486, Paris.

Cockx, B. and J. Ries (2004), "The Exhaustion of Unemployment Benefits in Belgium. Does it Enhance the Probability of Employment?", *IZA Discussion Paper*, No. 1177.

Cockx, B., H. Sneessens, and B. Van der Linden (2003), "Allégements de charges sociales : Une mesure à promouvoir mais à réformer", *Regards Économiques*, No. 15.

Cockx, B., H. Sneessens, and B. Van der Linden (2005), "Allégements des cotisations patronales à la sécurité sociale : Pourquoi, pour qui et comment ?", *Revue Belge de Sécurité Sociale*, pp. 583-598.

Conseil Central de l'Économie (2005), Rapport technique du secrétariat sur les marges maximales disponibles pour l'évolution du coût salarial.

Conseil Central de l'Économie (2006a), *Lettre mensuelle socio-économique*, No. 113.

Conseil Central de l'Économie (2006b), *Lettre mensuelle socio-économique*, No. 115.

Conseil Central de l'Économie (2006c), *Lettre mensuelle socio-économique*, No. 112.

Daveri, F. and G. Tabellini (2000), "Unemployment and Taxes. Do Taxes Affect the Rate of Unemployment?", *Economic Policy*, Vol. 30, pp. 48-104.

Debuisson, M., F. Docquier, A. Noury and M. Nantcho (2004), "Immigration and Ageing in the Belgian Regions", *Brussels Economic Review*, Vol. 47/1, pp. 139-157.

Deschamps, R. (2003), "Faut-il régionaliser la négociation salariale ?", *Reflets et Perspectives de la Vie Économique,* XLII/4, pp. 71-80.

Everaert, G. and F. Heylen (2002), "Labour Taxes and Unemployment in the OECD. A Nonstationary Panel Data Analysis", SHERPA, Discussion Paper.

Geerdsen, L.P. (2006), "Is There a Threat Effect of Labour Market Programmes? A Study of ALMP in the Danish UI system", *Economic Journal*, 116, pp. 738-750.

Heuse, P. and P. Delhez (2004), "Le bilan social 2003", Banque Nationale de Belgique. Revue Économique, Vol. 4-2004, pp. 95-133.

High Employment Council (2006), "La mobilité du facteur travail", mimeo, Brussels

Nickell, S., L. Nunziata and W. Ochel (2005), "Unemployment in the OECD Since the 1960s. What Do We Know?", *Economic Journal*, Vol. 115, pp. 1-27.

OECD (2005a), *Employment Outlook*, Paris.

OECD (2005b), *Education at a Glance*, Paris.

OECD (2006a), *Taxing Wages*. 2005 Edition, Paris.

OECD (2006b), *Economic Surveys: Luxembourg*, Vol. 2006/9, Paris.

OECD (2006c), *Employment Outlook,* Paris.

OECD (2007), *Des emplois pour les jeunes* : *Belgique*, Paris.

Ooghe, E., E. Schokkaert and J. Flechet (2000), "The Incidence of Social Security Contributions: An Empirical Analysis", Discussion paper DPS 00.23, *Center for Economic Studies*, KUL.

Van der Linden, B. (1997), "Effets des formations professionnelles et des aides à l'embauche : exploitation d'une enquête auprès d'employeurs", Économie et Prévision, Vol. 130, pp. 113-130.

Wibaut, Q. (2001), "Centralisation de la formation des salaries en économie ouverte et politique monétaire", *Reflets et Perspectives de la Vie Économique*, XL/1-2, pp. 103-115.

ANNEX 3.A1

Interactions between EPL and unemployment benefits

Labour market policies are often found to reinforce each other in their effect on employment and wage dynamics (OECD, 2006c). In the case of Belgium, this seems to be particularly relevant regarding the interaction between the wage bargaining system, unionisation and unemployment benefits, on the one hand, and employment protection legislation (EPL), on the other. Employment protection reinforces the position of insiders in the firm, thereby changing the balance in wage bargaining negotiations away from job creation, making unemployment more persistent. In addition, negative employment effects from sectoral wage bargaining will be magnified through high replacement rates that lower opportunity costs for being laid-off.

Interaction of wage indexation with employment protection legislation

Employment protection for individual dismissals is on an average level in Belgium (see Table 3.A1.1), but the provisions that govern collective dismissals are one of the strictest among OECD countries, concerning mainly additional notification requirements involving substantial delays. Such regulation reinforces the position of insiders and easing them may be necessary in order for social partners to internalise the costs of their wage bargaining and to bring down the upward pressures on wage agreements. Moreover, the effects of strict EPL are magnified by wage indexation. EPL can indeed be priced into wages, allowing employees to trade-in lower wage income for more employment protection. This requires, however, that wages are downwardly flexible, which is exactly what wage indexation prevents from happening.

Interaction of unemployment benefits with unionisation and employment protection legislation

The recent reassessment of the "Jobs Strategy" found that an important interaction between unionisation and unemployment benefits exists, both raising the bargaining power of workers and thereby increasing wages and depressing employment. As suggested by the results in Bassanini and Duval (2006), a reform of unemployment insurance and a reduction in union density that each would independently lower the unemployment rate by 1 percentage point has a combined effect of an additional 0.36 percentage points decrease in unemployment when occurring simultaneously. This represents 15% of the total effect of the reform package.

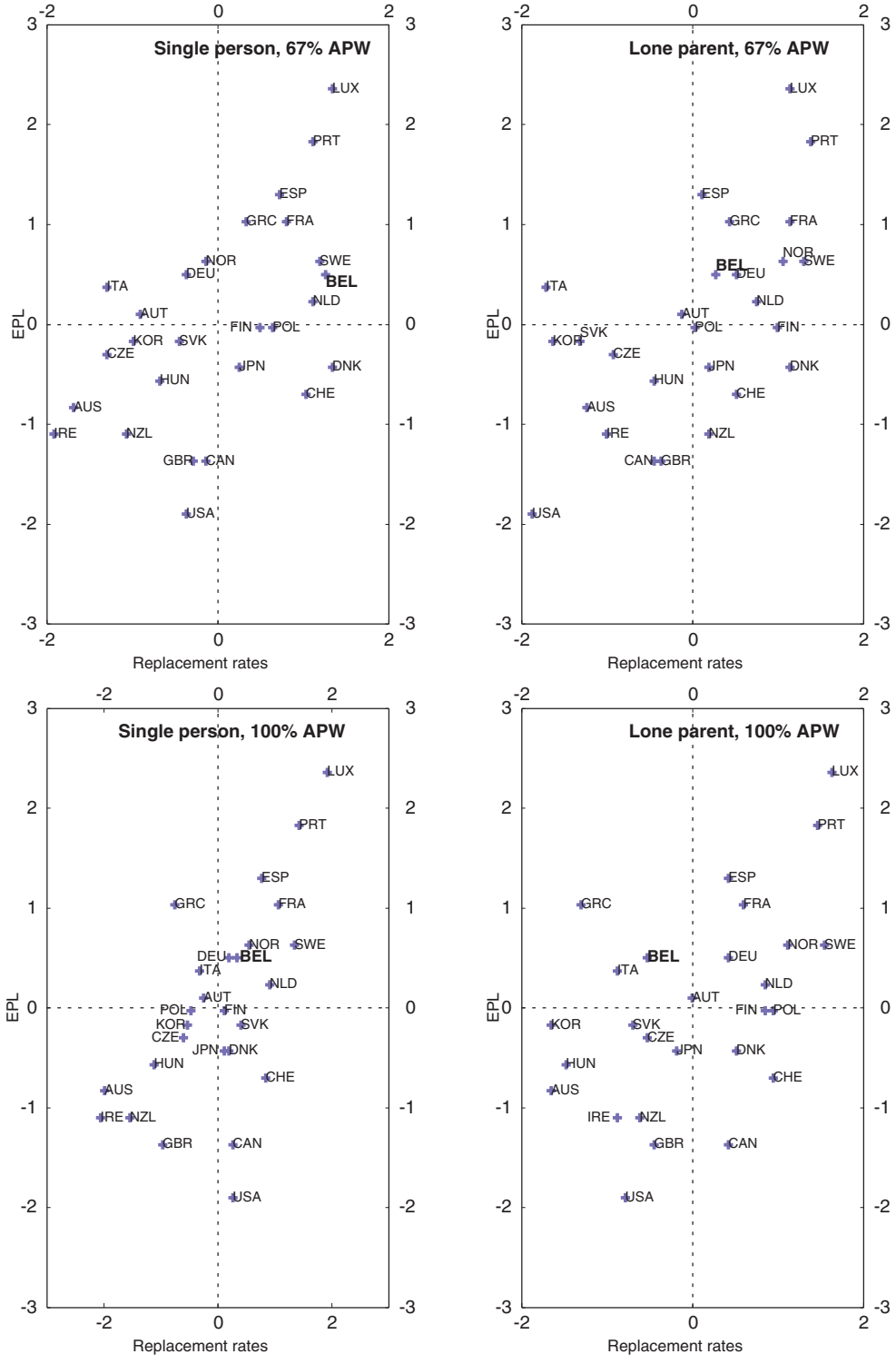
Table 3.A1.1. **Employment protection legislation details in OECD countries (2003)**

	Regular procedural inconveniences	Notice and severance pay for no-fault individual dismissals	Difficulty of dismissal	Fixed-term contracts	Temporary work agency employment	Collective dismissals	EPLR	EPLT	Summary indicator
Australia	1.5	1.0	2.0	1.3	0.5	2.9	1.5	0.9	1.5
Austria	2.5	0.9	3.8	1.8	1.3	3.3	2.4	1.5	2.2
Belgium	**1.0**	**2.4**	**1.8**	**1.5**	**3.8**	**4.1**	**1.7**	**2.6**	**2.5**
Canada	1.0	1.0	2.0	0.0	0.5	2.9	1.3	0.3	1.1
Czech Republic	3.5	2.7	3.8	0.5	0.5	2.1	3.3	0.5	1.9
Denmark	1.0	1.9	1.5	2.3	0.5	3.9	1.5	1.4	1.8
Finland	2.8	1.0	2.8	3.3	0.5	2.6	2.2	1.9	2.1
France	2.5	1.9	3.0	4.0	3.3	2.1	2.5	3.6	2.9
Germany	3.5	1.3	3.3	1.8	1.8	3.8	2.7	1.8	2.5
Greece	2.0	2.2	3.0	4.5	2.0	3.3	2.4	3.3	2.9
Hungary	1.5	1.8	2.5	1.8	0.5	2.9	1.9	1.1	1.7
Ireland	2.0	0.8	2.0	0.8	0.5	2.4	1.6	0.6	1.3
Italy	1.5	0.6	3.3	2.5	1.8	4.9	1.8	2.1	2.4
Japan	2.0	1.8	3.5	0.5	2.0	1.5	2.4	1.3	1.8
Korea	3.3	0.9	3.0	0.8	2.6	1.9	2.4	1.7	2.0
Luxembourg	2.5	2.0	3.3	5.3	4.3	5.0	2.6	4.8	3.9
Mexico	1.0	2.1	3.7	2.5	5.5	3.8	2.3	4.0	3.2
Netherlands	4.0	1.9	3.3	0.8	1.6	3.0	3.1	1.2	2.3
New Zealand	2.0	0.4	2.7	1.5	1.0	0.4	1.7	1.3	1.3
Norway	2.0	1.0	3.8	3.3	2.5	2.9	2.3	2.9	2.6
Poland	3.0	1.4	2.3	0.0	2.5	4.1	2.2	1.3	2.1
Portugal	3.5	5.0	4.0	1.8	3.8	3.6	4.2	2.8	3.5
Slovak Republic	5.0	2.7	2.8	0.3	0.5	2.5	3.5	0.4	2.0
Spain	2.0	2.6	3.3	3.0	4.0	3.1	2.6	3.5	3.1
Sweden	3.0	1.6	4.0	1.8	1.5	4.5	2.9	1.6	2.6
Switzerland	0.5	1.5	1.5	1.3	1.0	3.9	1.2	1.1	1.6
Turkey	2.0	3.4	2.3	4.3	5.5	2.4	2.6	4.9	3.5
United Kingdom	1.0	1.1	1.3	0.3	0.5	2.9	1.1	0.4	1.1
United States	0.0	0.0	0.5	0.0	0.5	2.9	0.2	0.3	0.7
Min.	0.0	0.0	0.5	0.0	0.5	0.4	0.2	0.3	0.7
Max.	5.0	5.0	4.0	5.3	5.5	5.0	4.2	4.9	3.9
OECD average	2.2	1.7	2.8	1.8	2.0	3.1	2.2	1.9	2.2
EU average	2.3	1.8	2.9	2.4	2.1	3.5	2.4	2.2	2.5

Note: The summary EPL indicator is a weighted average of EPLR, EPLT and the strictness of collective dismissals, with weights 5/12, 5/12 and 2/12.
Source: OECD, *OECD Employment Outlook* 2004; OECD, *OECD Economic Survey of Luxembourg*, 2006.

In addition, strict EPL increases the average unemployment spell for those who happen to be laid off. These dynamic effects of employment protection are magnified with the length of unemployment benefit duration and the high tax level on low wages. This interaction effect sets in already at moderate levels of both employment protection and replacement rates, in particular when wages are predominantly bargained at the sectoral level (Nickell, Nunziata and Ochel, 2005). Among OECD countries, both EPL and unemployment benefits seem to be highly correlated, independently from the particular family status of the benefit recipient (see Figure 3.A1.1). The figure highlights that Belgium occupies a position in the north-east quadrant of the diagram that stands for more restrictive policies both regarding employment protection and net replacement rates, for

Figure 3.A1.1. **EPL against net replacement rates**[1]



1. The figure plots the percentage level of net replacement rates after 6 months against the strictness of employment protection as measured by the 2003 level of the EPL indicator. Four different figures are presented, corresponding to differences in the wage level and the family situation. Dots in the north-east direction indicate more restriction on labour market responsiveness. Values for EPL and net replacement rates are mean-centred across the OECD.

Source: OECD, *Benefits and Wages*, 2005; *OECD Employment Outlook*, 2004, Secretariat's calculations.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

all four categories of workers. Independently of various child and family allowances, Belgian households therefore face an interaction between net replacement rates and employment protection that lies in the highest quartile of OECD countries. Policies should therefore be reoriented to avoid the combination of two factors that dampen the responsiveness of the labour market. In particular, policies should ease EPL, in particular for collective lay-offs, while at the same time strengthen active labour market measures, as suggested in this chapter, to help the unemployed to return to work quickly.

ISBN 978-92-64-03186-9
OECD Economic Surveys: Belgium

Chapter 4

Improving incentives in tertiary education

The tertiary education system has been transformed from an elite-oriented system to a system providing tertiary education to a much larger share of each new generation. This re-orientation has contributed to raising education attainment in Belgium. However, in many respects the organisation of the tertiary education systems has not been changed fundamentally and economic incentives are only to a minor extent in place for securing the supply and quality of tertiary education. The system has come under strain, as revealed in the high failure rate among first-year students and the high incidence of subject change. There is thus a need for the system to adapt to be able to continue to support the improvement in educational attainment.

Investment in human capital plays a key role in sustaining and enhancing growth. This role is likely to become even more important in the future as the ongoing globalisation process necessitates further moving up the value-added chain and as ageing puts downwards pressure on overall growth. Belgium has responded to this challenge by boosting tertiary education over the past couple of decades. Notwithstanding some recent changes, funding continues to be mostly input-based and there is only limited competition between tertiary education institutions. Despite the generally good quality of tertiary education and the substantial increase of investment in human capital, there has been no corresponding improvement in labour productivity and hence the economy's performance (see Chapter 1), raising questions about the efficiency of this investment.[1] The chapter discusses the policy challenges in the tertiary education system. After a brief overview of recent developments, it addresses issues concerning the organisation of tertiary education institutions and student support. This is followed by a discussion of a range of measures that, if introduced, could contribute to a more cost-efficient and higher quality tertiary education system.

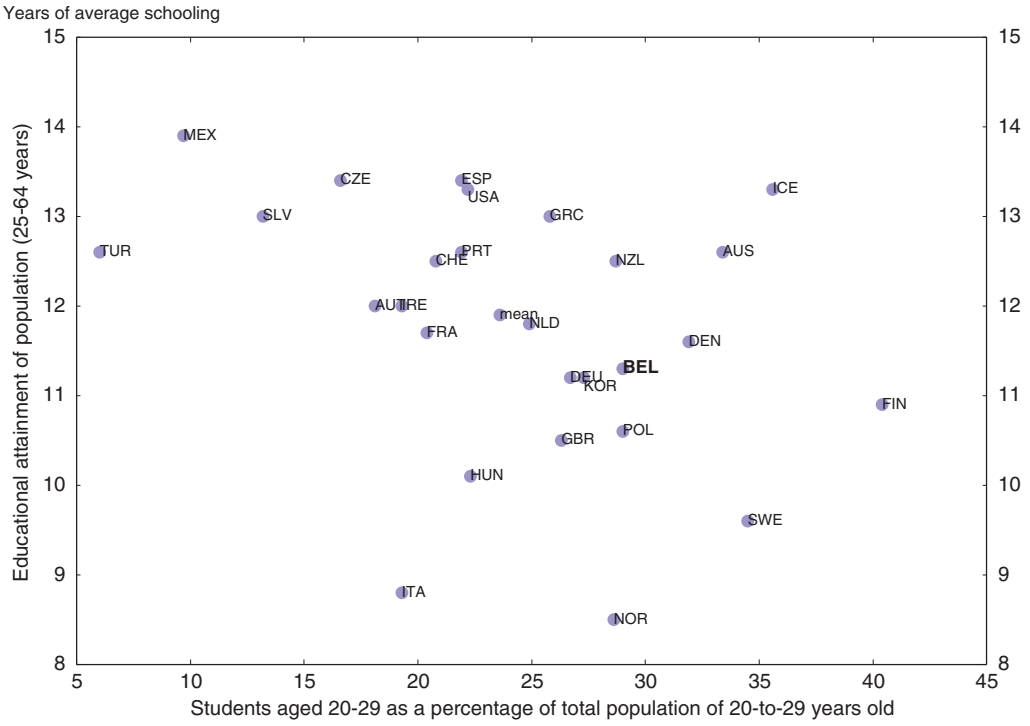
Belgian tertiary education in an international context

Educational attainment is relatively low, but enrolment in tertiary education is high

The average educational attainment of the working age population in Belgium is lower than in most other OECD countries (OECD, 2006). This reflects the fact that historically only a relatively small part of the population attained upper secondary education. On the other hand, tertiary education attainment has historically been relatively high. Moreover, tertiary education has been expanded over the past decades, leading to a significant improvement in the educational attainment of younger generations, with 41% of the age cohort 25-34 years having a tertiary degree. This is among the highest rates of tertiary education attainment among younger people in the OECD and twice as high as the Belgian age cohort of 55-64 years.[2] For the total population, about 30% of people hold a tertiary education degree, which is (abstracting from the Nordic countries) among the highest in Europe and set to increase further with the high enrolment rate into tertiary education (Figure 4.1).[3]

Tertiary institutions include universities – providing longer academic degrees – and non-university institutions, which typically provide shorter professional degrees (in some cases, though, study time at the non-university institutions may be as long as at the universities) and account for about two-thirds of enrolment in tertiary education. The expansion of tertiary education has mostly taken place in non-university institutions (Figure 4.2). However, there has not been a similar expansion of teaching resources, leading to an increase in the student-to-teaching staff ratio over the past 10 years, and leaving Belgium with one of the highest overall student/teacher ratios in the OECD area (Figure 1.15).[4]

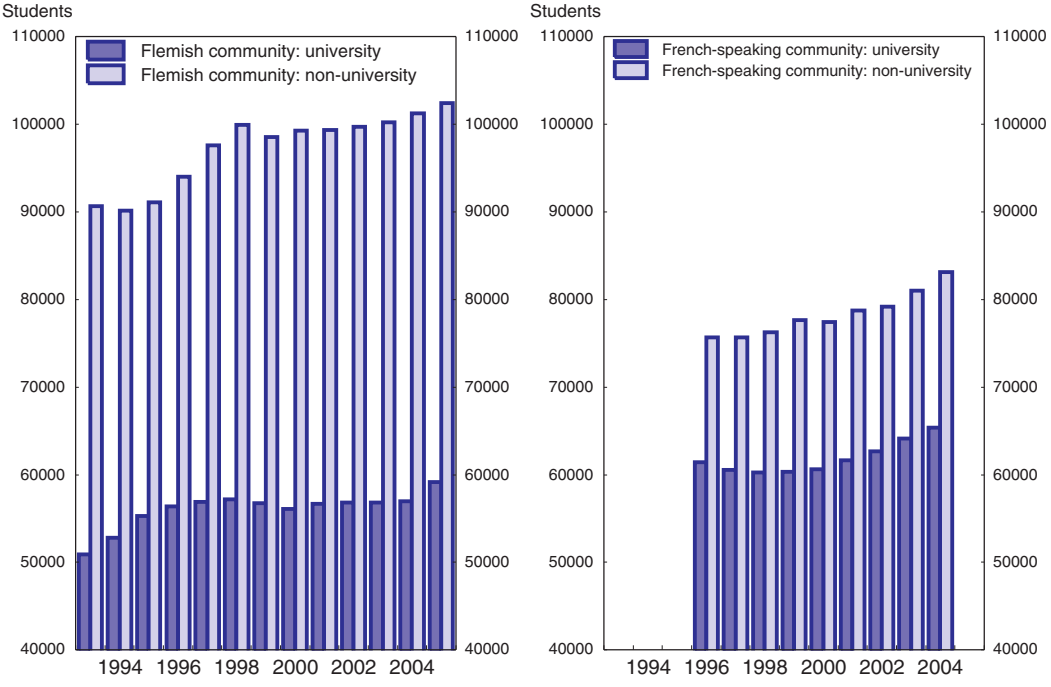
Figure 4.1. **Educational attainment and enrolment in tertiary education, 2003**



Source: OECD, *Education at a Glance*, 2006.

Figure 4.2. **Enrolment in tertiary education**

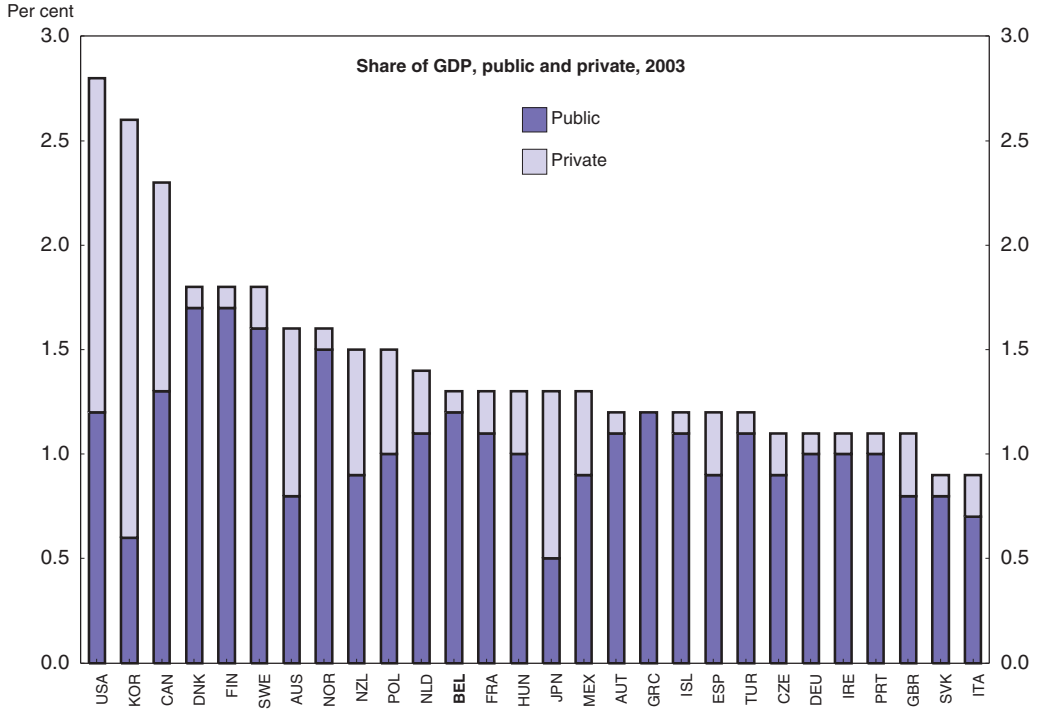
1993-2005



Source: Ministries of Education.

Despite the apparent lack of teaching resources, total spending in tertiary education as a share of GDP is nevertheless relatively high by international standards (Figure 4.3). In response to the budgetary pressure arising from the larger enrolment, there has been a drive in the French-speaking community to seek economies of scale and scope by merging non-university institutions – although this does not seem to have reduced overhead costs so far.

Figure 4.3. **Expenditure on tertiary education**



Source: OECD, *Education at a Glance*, 2006.

Signs of strains in the tertiary education system have emerged. In the university institutions, there is a dropout rate of nearly 40 per cent – higher than in most other OECD countries – and about half of the drop-outs continue in non-university institutions (Jacobs and van der Ploeg, 2006). In addition, more than half of all first-year university students fail their first annual exam (Vandamme *et al.*, 2006). Average study time (excluding the effects of students prematurely leaving the institutions) is nearly 20% longer than the nominal period of study, suggesting few incentives for students to rapidly complete their studies (Ministry of Education and Training, 2006). A number of measures have been adopted to address these issues (see below).

The organisation of tertiary education is decentralised

Tertiary education is the responsibility of the communities. The financing of educational institutions is provided at a lower level of government than in most other OECD countries, an arrangement that is similar to that of several other federal countries, such as Germany, Spain and the United States (European Commission, 2004). The federal

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

government has retained the important role of providing child benefits and granting tax credits to parents with a child in tertiary education. Overall education spending accounts for the bulk (nearly half of the combined budget for the Flemish region and community and about three-quarters in the French community) of the Communities' budgets, of which about one-fifth goes to tertiary education. The tertiary education institutions have traditionally been financed through an input-based system, *i.e.* a funding based on the number of students enrolled.[5] For universities, close to three-fourths of the overall funding (which is indexed to the health index) is distributed among the universities according to their number of students (Deschamps and Schmitz, 2006). In addition, the distribution of funds between universities and non-university tertiary education institutions has been fixed since 1995. A relatively small share of spending is allocated to income support of students in the form of scholarships and grants (see below).

The Flemish community is introducing a new output-based budgeting system, planned to be in place by the beginning of 2008. In the new system, besides a lump sum, the budget for first-year students will continue to be based on the number of enrolled students, while the budget for other students will be based on the number of students who pass the end-of-year exams.[6] The effective overall spending limit on tertiary education (set by the overall budget requirements) implies that the new system will lead to a re-allocation of available resources towards the more efficient institutions. As input-based funding provides few incentives for matching teaching capacity and quality with student intake, the move towards an output-based budgeting system is an improvement, although the risk of grade inflation must be countered by having a system of external examiners or, less effectively, a peer review system.[7] Moreover, it is regrettable that the new system was not extended to include first-year students, where the problems are most visible: failed exams; widespread changes of study field; or dropping out of the system altogether.[8]

There has been a divergence in tertiary education real spending between the Flemish and French speaking communities. In the Flemish community, real spending per student in universities and non-universities has increased since 1991 by nearly 7½% and 13%, respectively, as opposed to decreasing by 17% and 12%, respectively, in the French speaking communities. By 2005, the spending per university student was 70% higher in Flanders than in Wallonia, while spending for non-university students was 30% higher (Table 4.1). The budgets of the communities are mainly financed by federal transfers, as discussed in Chapter 2. These transfers are based on VAT revenues and distributed between the communities according to the share of the population below 18 years, securing a relative solid link between the number of pupils and the associated education expenditures. As the distribution criteria will be gradually changed to reflect growth in real GDP, this link will be somewhat weakened.

Table 4.1. **Spending per student, in euros, on tertiary education in the French and Flemish Communities 2003-2004**

	French Community	Flemish Community
University	7 761	13 241
Non-university	4 772	6 219
Total spending in millions of euros	894	1 409

Source: Ministries of Education.

Access to tertiary education is almost free

Entering tertiary education is easy. There is almost no pre-screening of students in terms of ability and capacity to pursue tertiary education programmes. The only entry requirement for most tertiary studies is an upper secondary diploma and only a few much sought-after studies like dentistry, medicine, and veterinary science have restricted intake through entry tests.[9] Moreover, tuition fees are low – covering on average about 7% of the universities' costs – and similar across studies. The nearly free access to tertiary education is often defended on equity grounds by facilitating access for students from low-income families. However, in reality the tertiary education system is not promoting social mobility (Box 4.1). Easy access contributes to the high failure rate among students, reflecting poor matching between individuals' selection of studies and their capabilities, as well as insufficient preparation for further studies at lower levels of education (OECD, 2005a).[10] Thus, the free access leads mostly to a misallocation of resources as tertiary education institutions have to provide teaching to large number of students who fail their exams and/or leave the institutions. In response to these problems, Flanders is replacing the system of year exams with a credit system for completed academic course work. In addition, a learning account system is being implemented. Upon entry students are allocated a fixed amount of credit points in the learning account. At the start of each academic year, students are debited from this account a number of credit points that is equivalent to the required academic course work. Upon successful completion of the latter, the credit points are added back to the learning point. In principle, once students have exhausted their allocation they cannot continue their studies, thus creating incentives for timely study completion, although the initial allocation of credits allows for at least a year of extra study time to complete studies.[11] However, in the absence of a reward for timely completion of studies, such a system risks becoming a norm-setting system, *i.e.* it signals that completion time should include (parts of) the extra study time. Moreover, it is unclear how the problem of denying students that are approaching graduation access to further studies will be

Box 4.1. **Social mobility and the tertiary education system**

In most OECD countries there is a correlation between family income and tertiary education attendance/completion. Such correlations are normally explained as arising from short-run liquidity constraints (*i.e.* a lack of public or private funding prevents poor students from entering higher education) or as arising from family background (influencing both cognitive and non-cognitive ability as well as forming education expectations). Empirical tests of these hypotheses for Belgium suggest that there is little evidence of short-term liquidity constraints and that nearly all variations can be explained by family background and secondary school achievement (Vandenberghe, 2006a). This suggests that financial aid to families is unlikely to affect tertiary education attendance and that increasing the current low tuition fees is unlikely to affect the distribution of enrolment across socio-economic groups. The result also indicates that the investment in tertiary education has significant regressive elements in terms of income distribution (particularly when including lifetime income, which for the average taxpayer is lower than that of the average graduate). Thus, it would appear that improving the access to tertiary education for socially disadvantaged groups depends on improving secondary education (Vandenberghe, 2006b). Indeed, Jakobs and van der Ploeg (2006) present some evidence that there is a correlation between PISA outcomes in science (where Belgium has a relatively low average score) and drop-out rates.

addressed. In the French community, a number of measures to lower the high failure rate among first-year students have been introduced, including easier access to mid-term exams, opening up of gateways to other degrees, and granting admission on the basis of professional experiences. Moreover, universities are obliged to devote a greater share of their budgets and will receive special grants to promote the success of first-year students.

The free access to tertiary education is extended to nationals from other EU countries, which may contribute to explaining the relatively high share of foreigners enrolled in Belgian tertiary education institutions.[12] Most of these are enrolled in the French-speaking universities, also indicating a language choice.[13] In addition to the resource allocation problems, this creates a fiscal issue as foreign students neither contribute directly to the cost of provision through cost-recovery tuition fees nor indirectly through future increases in tax revenues.[14] To reduce the problem of Belgian students being crowded out by foreign students, the French community has introduced a regulation system for selected (particularly for veterinary) studies, which restricts the number of foreign students to 30%. Another solution to the fiscal issue would be to introduce cost-recovery tuition fees combined with the introduction of education vouchers or study grants for Belgian students (Gérard, 2006).[15] Additional advantages of such a system would be the introduction of a price signal on which universities can compete and of incentives for students to minimise study time.

Financial aid to students is mostly based on indirect measures. There is no system of student loans and *direct* support is only given in the form of means-tested grants to students from low-income families – a system that is relatively limited in scope.[16] *Indirect* student support is given in the forms of child benefits (granted to about 90 per cent of families) and tax credits to students' parents for each child in tertiary education – a method that is relatively rare in other countries (Vossensteyn, 1999). The federal government is financing this support, amounting to an estimated cost of some € 700 million, according to calculations by the OECD Secretariat.[17] Moreover, unlike a number of other European countries (such as Denmark, Germany, the Netherlands and Sweden) there is no strong link between the (indirect) financial support to the student and his/her academic progress, thus providing for few incentives to minimise study time. Moreover, because financial aid is provided to the family, many students continue to live in their parental home and choose tertiary educational institutions that are within commuting distance.

The development of direct student aid would help to stimulate competition among tertiary education institutions, as such a measure would allow students to move to the institutions that offer the best programmes (Jacobs and van der Ploeg, 2006). Empirical research suggests that students tend to study in institutions that are close to their parents' home, implying that travel and accommodation costs have a strong impact on the choice of institutions (Kelchermans and Verboven, 2006). This is likely to lower competition between universities. Enhancing competition among tertiary education institutions would require that students can access information about the quality of education and future labour market prospects. Flanders has started to release information about each university (including information about student-to-staff ratios, ICT and laboratory use, research achievements, peer and students reviews), while similar information in Wallonia tends to be confidential. Obviously, the provision of such information is a minimum requirement for students to make informed choices. Moreover, tertiary education is an investment in human capital and in order to evaluate and compare rates of returns of such investment across studies and universities, students should also be provided with career counselling regarding future labour market prospects.

Rates of return to investment in tertiary education are low

The rates of return on human capital investments can be calculated from the perspective of the individual undertaking the education, capturing how much higher expected future earnings are relative to the private costs of education (the so-called private rate of return); or from the perspective of the provider of education, capturing whether higher future tax revenues are larger than the cost of provision (fiscal rate of return). (For a detailed discussion of various rates of return on human capital investment, see De La Fuente and Jimeno, 2005). The private rate of return takes into account foregone earnings during the studies, private costs of education, expected higher future incomes, unemployment risks, retirement patterns and other relevant variables. Differences between calculated rates of returns reflect a host of factors (including relative skill premia in the labour market, marginal tax rates, and wage bargaining systems) that are all beyond the influence of the tertiary education system. Nevertheless, such earning differentials provide strong economic incentives for individuals to enter further education (OECD, 2005b).

Comparing rates of return over time is a hazardous undertaking as changes in methodology and data sources can have impacts on results that overshadow underlying developments. Nonetheless, there are some indications that private rates of return to tertiary education have declined over the past decade. Nonneman and Cortens (1997) present estimated private rates of return from the early 1990s that are some 20% higher than those from early 2000s presented in Table 4.2. Furthermore, the private rates of return in Belgium are presently among the lowest in the Europe.[18]

Decomposing the private rates of return into their various components helps to understand the relatively low results for Belgium. Return in terms of the expected increase in future income stream (net of foregone earnings) is slightly below the EU14 average. This reflects the compressed wage distribution, both between different education levels and across tertiary degrees. The relatively low private returns also reflect the fact that the value of educational subsidies is lower than in other countries. Interestingly, the tax system has little effect on Belgian private rates of return, unlike the lowering seen in most other

Table 4.2. **Net internal private rates of return to tertiary education**

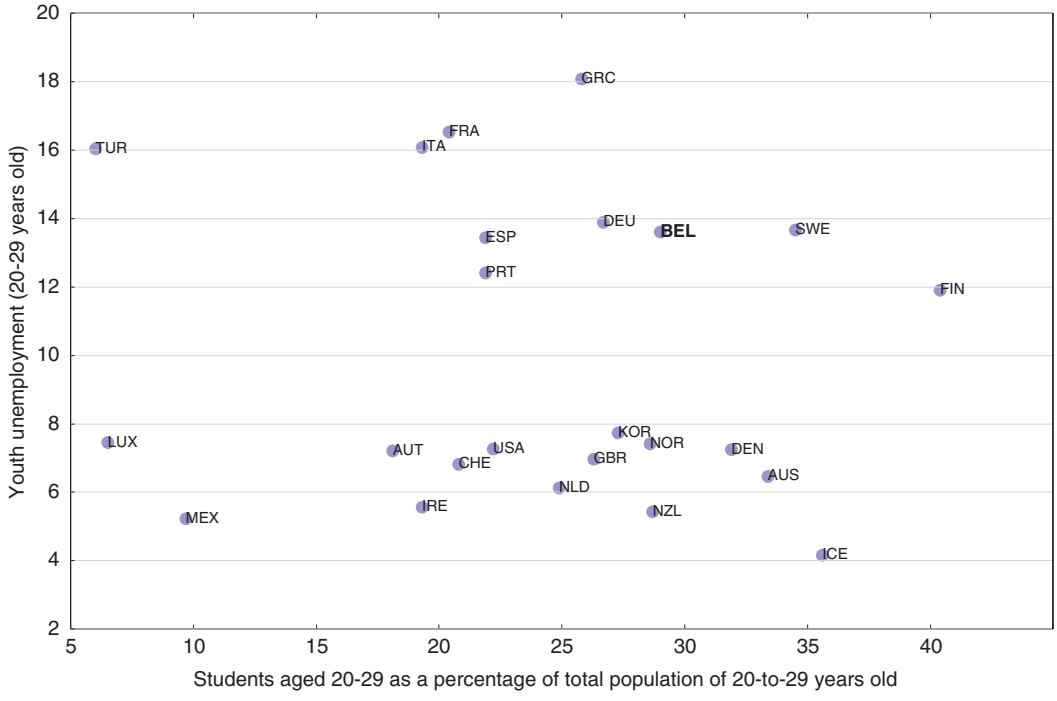
In per cent

	Raw returns (*i.e.* no government transfers)	+ Educational subsidies	+ Taxes	+ Housing and unemployment benefits
Austria	6.22	10.35	8.96	**8.52**
Belgium	**7.20**	**9.91**	**9.88**	**7.47**
Denmark	5.08	7.87	9.16	**7.99**
Finland	9.19	13.31	12.15	**9.98**
France	7.25	11.00	10.59	**8.63**
Germany	8.32	11.32	9.97	**9.13**
Greece	8.28	11.16	10.22	**9.18**
Ireland	10.98	15.82	12.40	**11.03**
Italy	7.31	10.46	10.08	**8.44**
Netherlands	6.11	8.73	7.98	**6.95**
Portugal	6.87	11.44	10.82	**10.30**
Spain	8.91	12.24	11.59	**7.50**
Sweden	3.21	6.48	7.18	**4.28**
United Kingdom	9.94	13.07	13.16	**12.25**
Avg. EU14	7.56	11.05	10.43	**8.78**

Source: De La Fuente, A. and J. F. Jimeno, 2005.

countries, presumably reflecting the limited progression in the personal income tax system. Further adding the unemployment risk and housing subsidies leaves Belgian private rates of return notably lower than the average in EU countries. The implication is that the economic incentives for undertaking tertiary education in Belgium are relatively low. Instead, the high enrolment rate in tertiary education may be related to an attempt to avoid unemployment (see also Chapter 3) (Figure 4.4).

Figure 4.4. **Youth unemployment and enrolment in tertiary education**



Source: OECD, *Education at a Glance*, 2005, *Labour Force Statistics*.

The incentives for the governments to provide tertiary education are relatively high, as shown by the large fiscal rate of return. The additional tax revenues resulting from raising educational attainment exceed the cost of provision (Table 4.3). This results from the high average rates of personal income taxes and social security contributions and the low cost of provision, both in terms of direct spending on tertiary education and spending on income support for students – an area where Belgium spends relatively little, although this does not include indirect student support through tax reduction and child benefits to the parents.

The rates of return to tertiary education vary across study fields. In general, graduates in humanities (such as in politics, social science, psychology, history and philosophy) are encountering above-average unemployment problems (EIU, 2005). In Flanders, the average unemployment rate among recent graduates was about 11.6% in 2004, but there was considerable variation across fields of study (Ministry of Education and Training – Flemish Community, 2006).[19] The high enrolment in study fields with limited employment prospects can probably be explained by the high level of youth unemployment, which

Table 4.3. **Fiscal rates of return to investment in tertiary education**

In per cent

	+ Personal taxes	+ Consumption taxes	+ Employer social security contributions
Austria	0.68	1.17	**2.11**
Belgium	**3.03**	**3.15**	**3.91**
Denmark	0.82	1.19	**1.18**
Finland	3.77	4.10	**4.92**
France	1.52	2.11	**3.66**
Germany	3.97	4.13	**4.70**
Greece	1.79	2.54	**3.70**
Ireland	5.34	5.67	**6.17**
Italy	1.81	2.21	**3.39**
Netherlands	2.25	2.52	**2.82**
Portugal	0.09	1.18	**2.42**
Spain	2.98	3.37	**4.74**
Sweden	–1.42	–1.25	**–0.52**
United Kingdom	3.19	3.80	**4.53**
Avg. EU14	2.35	2.74	**3.58**

Source: De la Fuente and Jimeno, 2005.

induces young people to seek graduate diplomas in order to signal ability. The latter has also been important for young workers to benefit from the general shift in labour demand towards more highly qualified workers (Box 4.2).

Box 4.2. **The relative shift in labour demand**

Along with the increase in number of graduates there has been a shift in labour demand towards higher qualified workers. Since the end of the 1990s, there has been a decline in the share of lower qualified workers (defined as having at most lower secondary education) of about 6¼ percentage points. By contrast, the share of workers with short and long tertiary education has increased by about 4 percentage points. The largest increases in the share of workers with tertiary education have been seen in the sectors of public administration and private services, particularly the business services sector. This shift in labour demand has been met by an increase in the share of young people with a graduate education. Contrary to other countries, few adults have entered tertiary education. The lack of adult students is likely to reflect a lack of both flexible educational options (such as distance learning and e-learning) and financial incentives (an absence of financial aid and high tax on continued work on older workers).

Economic incentives

A range of economic instruments can improve the efficiency of tertiary education. Among them, charging tuition fees is an instrument that might come with two main benefits: *first*, it provides additional funding to tertiary institutions and encourages them to compete for students; *second*, it encourages graduate students to internalise the social costs of education, select fields of study with high rates of return and minimise the length of studies and associated costs. See Box 4.3 for a more detailed discussion of the benefits of tuition fees. Empirical research indicates that the introduction of uniform cost-based tuition fees achieve most of the above welfare gains, *i.e.* such tuition fees will have little

overall effect on the demand for higher education (Kelchtermans and Verboven, 2006). However, the compressed wage structure is preventing the labour markets from sending clearer signals about the relative demand for skills. Thus, in areas where the private rate of return is particularly high, there is a case for having higher tuition fees without risking large relative shifts in the demand for education. Other economic instruments than tuition fees can be used to introduce competition between institutions. For example, the current education subsidies to the tertiary education institutions can be used to create individual (preferably nominal study time limited) education vouchers that students can use to purchase education services from accredited domestic and foreign institutions.[20]

Tuition fees, however, cannot be a stand-alone instrument. If students are faced with a liquidity constraint due to a lack of income or capital market failure, such fees are inefficient and inequitable as high ability/low income students are deterred from entering tertiary education (generating an efficiency as well as a social loss). Problems of lack of income or capital market failure can be addressed through student aid in the form of either grants or loans.

Box 4.3. **The benefits of tuition fees**

The introduction of (partial) cost-recovery tuition fees has a number of effects that may benefit the tertiary education system:

- The budgetary constraints on the governments are likely to remain in place over the foreseeable future, making governments unwilling or unable to provide sufficient funds to maintain the appropriate quality and quantity of tertiary education. Fees levied on the direct beneficiaries of education will provide tertiary education institutions with an independent revenue source.
- Tuition fees will increase the responsiveness of tertiary education institutions to the needs and demands of students, which make such fees an important driver for continued improvements of efficiency and quality, including that of the teaching staff.
- Fees give incentives for students to both entering studies that match their capabilities and to reducing their average duration of studies – both factors releasing resources for the provision of tertiary education. The design of such fees can include negative fees. For example, the Dutch "achievement-related grant" is initially provided as a loan, but is converted into a grant if the student graduates within 6 years in a study programme with a planned four year horizon (Vossensteyn, 1999).
- Fees are a dynamic progressive fiscal instrument as graduates tend to come from high income families and that they will earn higher than average incomes. Naturally, equity goals can be pursued through a progressive income tax system, but imposing fees on those that have benefited directly provides for better targeting.
- Cost-recovery tuition fees prevent the cross-subsidisation of foreign students (Vandenberghe and Debande, 2006).
- Fees are unlikely to lead to a substantial reduction in incentives to study as empirical evaluations indicate that the introduction of a cumulative € 20 000 tuition fees will at most reduce private rates of return on tertiary education by a maximum ¾ percentage point (Vandenberghe and Debande, 2006).
- International evidence suggest that when fees are combined with measures to secure accessibility (student loans, means tested grants, etc.) there are no significant adverse effects on participation and have in some cases reduced social bias (OECD, 2004).

General grants tend to be regressive as the lifetime incomes of graduates are higher than those of the average taxpayer. Moreover, means-tested grants that are based on the income of students tend to become universal as students usually have relatively little labour income. On the other hand, means-tested grants that are based on the parental income do not directly address the problem of capital market failures. The latter can be addressed through (subsidised) student public loans. Moreover, if repayments are made contingent on future income, then efficiency will be enhanced (as neither students nor lender are deterred by excessive risks) and equity concerns are addressed (as repayments are tailored to *ex post* ability to pay).[21, 22] Such income contingent student loans should, nevertheless, probably be combined with targeted grants (scholarships) to students from low-income households to alleviate asymmetric information problems.

Designing optimal income-contingent student loans can be difficult. They carry an associated risk premium insofar as higher graduate incomes fail to materialise, which in the Belgium case has been estimated to be around 13% for tertiary education (Vandenberghe and Debande, 2004). This risk can either be shifted to the taxpayers or pooled in a scheme. The choice between the two solutions is a balancing of the fiscal costs and the implicit rise in public debt against the increasing cost of pooling if there is a high risk of adverse selection (as potential high earners opt out). The latter can partly be addressed by pooling students according to their risk profiles. An alternative solution, although probably difficult to implement, is to make participation mandatory (Vandenberghe and Debande, 2006). An additional concern is that such loans may deter labour market participation as they may raise marginal effective tax rates (METRs) during the repayment period. This is a particularly important consideration given the low private rates of return on tertiary education in Belgium, suggesting that the subsidy element should be relatively important.[23]

Tuition fees should not be the only entry regulating mechanism in tertiary education. Screening tests are important to align the ability of students with the requirements of their chosen studies and thus enhance the efficiency of the tertiary education system. This is a particular issue in Belgium where there are no regional or national exit tests at the upper secondary level, and thus there is no mechanism for ensuring homogenous standards across students. As an implication, students may not even have a realistic assessment of their own abilities and better directing of students through more extensive counselling could be helpful. The current system has an ability test in the form of the first-year exams, but with more than half of the students failing the tests, this type of screening is very costly. Two types of ability screening can be identified within the OECD countries. In countries with nation-wide exams (and external examiners) at the upper-secondary level, the grades obtained are often used as an access criteria for tertiary education. In other countries, systems of entry exams can be found, either at the general level or in selected institutions. At times, though, such entry exams tend to have a risk of social bias as higher income families are better placed to economically support applicants through the often extended periods of entry exam preparation.

Conclusion

Despite recent changes, tertiary education institutions still have incentives to accept as many first-year students as possible. At the same time students are faced with few incentives to match their capabilities and studies. The introduction of economic instruments can ensure that the supply of tertiary education reflects demands for quantity

and quality and that students adjust their demand to reflect their capabilities and have incentives to minimise study time. Detailed recommendations to reorient tertiary education can be found in Box 4.4.

Box 4.4. **Recommendations for improving incentives in tertiary education**

- Introduce tuition fees that are high enough (*i.e.* to partial cost-recovery levels) to become an important source of financing for tertiary education institutions. Such fees give the institutions incentives to supply adequate quantities and qualities of studies in response to demand for tertiary education. At the same time, the fees provide students with incentives to match their capabilities with their choice of study.
- Higher tuition fees, however, cannot be a stand-alone measure. Accessibility should be secured through the introduction of income-contingent student loans. Given the low private rates of return, the design of such loans could include a subsidy element, either through a below-market interest rate or as a premium for timely conclusion of studies. In addition, social bias concerns could be addressed through the introduction of targeted grants (scholarships) to students from low-income households.
- The introduction of a screening system would contribute to matching students' capabilities with the demands for tertiary education and thus lower the current high failure rate among first-year students as well as the high number of changes of study fields. Such a system can also function as a feedback mechanism for secondary education. Another helpful measure to direct students would be to expand recent measures to disseminate relevant information concerning the quality of education and which should be combined with more extensive career counselling regarding future labour market prospects.
- An important aspect of tuition fees is that they stimulate competition between tertiary education institutions for attracting students. However, to alleviate information asymmetries and allow students to make informed choices, all institutions should be obliged to publish relevant information concerning the provided quality of education and future labour market prospects.

Notes

1. The quality of tertiary education institutions is confirmed in rankings published by the Times newspaper.
2. On the other hand, the graduation rate for advanced research programmes is relatively low in an international comparison.
3. Of those enrolling into tertiary education, the majority is enrolled in non-university institutions. The share enrolled into university level tertiary education is actually among the lowest in the OECD area (OECD, 2006).
4. At the same time there has been an increase in the number PhD enrolled (reflecting to a large degree both regional and EU efforts to expand such numbers). With increased demands on professors to teach and support PhDs, concerns have been raised about whether professors have sufficient time to do their own research. Moreover, some of the funding problems are set to be rectified as both the Flemish and French communities are budgeting with real increases in the funding of tertiary education.
5. Input based financing systems provide for an element of competition among tertiary education institutions as each institution has incentives to attract as many students as possible. However, such systems embody few incentives for improving graduation rates.

6. In addition, extra funding will be provided for students from under-represented socio-economic groups, students in strategically important subjects (mathematics, science and technology), and for students in joint study programmes.

7. In Flanders, the quality of tertiary education is secured through a peer review system (an academic accreditation programme) particularly *vis-à-vis* Dutch tertiary educations. Such systems aim at objective evaluations, although the incentive structure may hinder damaging critics. The use of external examiners would provide a more direct evaluation system, both of students' individual performance, but also of the overall performance of the institutions.

8. The new funding model will have an impact on first year students as acquired study credits can be transferred to other study programmes.

9. Similar access systems are in place in Denmark, Germany, and the Netherlands. However, in Denmark access is regulated through the grades obtained at the secondary level. In contrast, the United Kingdom, Sweden and the *grandes écoles* in France operate with strict entrance criteria (Jacobs and van der Ploeg, 2006).

10. An additional factor might be the system of annual exams involving all subjects studied, which may constitute a considerable hurdle for inexperienced first-year students, although this exam form is likely to contribute to the high pass-through rate in subsequent years as exams in individual subjects cannot be redone.

11. Another incentive for timely study completion is the opportunity for enrolling in another study programme.

12. The highest number of foreigners is enrolled in the French community. The number approaches 10 per cent when including non-Belgians and members of the Flemish community attending university in Brussels (Vandenberghe, 2006b).

13. Only a limited number of tertiary education courses are offered in English. More than a quarter of all foreign students are from France and about half of all foreign students come from other EU countries (OECD, 2006).

14. This problem tends to be concentrated at short and medium tertiary programmes as tuition fees for Advanced Master Studies programmes are generally considerably higher.

15. In this context, it should be noted that EU member states are obliged to charge the same tuition fees for all citizens of the EU, but may have a higher tuition fee for non-EU citizens. This differs from the practise in the United States, where tuition fees for resident students are considerably lower than for out-of-state students (Gérard, 2006).

16. For example in Flanders, students from low-income families that qualify for the full student grant and are campus residents are entitled to € 3069 per year. For qualifying students staying with the family the annual grant is € 1 842.

17. The estimates are based on the assumption that the 303 427 students come from 202 285 households (assuming that half of the tertiary students have a sibling also in tertiary education). For each of these households the average value of the associated tax credit is € 988 per year and they will receive an average child allowance of €2 437 per year.

18. The estimates presented in Table 2 are best interpreted as the rate of return of an additional year of education. Similar estimates but for whole tertiary education cycle (Blöndal *et al*., 2002) tend to confirm the presented ranking, although some point estimates vary considerable between the two studies. However, the Blöndal *et al.* (2002) study does not include Belgium.

19. The unemployment rate about graduates with degree in visual and audio-visual arts is 37%, in architecture 22%, in music and dramatic art 22%, in political and social sciences 20%, in history 23%, in archaeology and art sciences 26%, and in philosophy and moral sciences 26% (Ministry of Education and Training, 2006).

20. Such a strengthening of the demand side is likely to induce a supply response, which may entail changes in the organisation of the provision of tertiary education.

21. The arguments in favour of deferred payments include the notion of unequally distributed liquidity constraints, the time lag between the investment decisions and the materialisation of the actual benefits, and the information problem concerning the student's future income. The latter means that deferred payments could become an income-contingent scheme, thereby aligning tuition fees with the student's ability to pay (Vandenberghe and Debande, 2006).

22. Jacobs and van der Ploeg (2006) provide some empirical support for the proposition that if students borrow more and pay more for their studies, then the overall educational performance improves.

23. An additional concern is that it can be difficult to secure a sufficiently high income after graduation (job search, seniority based wages, etc.) so loans should probably have relatively long time horizons.

Bibliography

Blöndal, S., S. Field and N. Girouard (2002), "Investment in Human Capital Through Post-Compulsory education and Training: Selected Efficiency and Equity Aspects", *Economics Department Working Paper* No. 333.

Brunello, G. and R. Winter-Ebmer (2003), "Why do Students Expect to Stay Longer in College? Evidence from Europe", *Economics Letters* No. 80.

De La Fuente, A. and J.F. Jimeno (2005), "The Private and Fiscal Returns to Schooling and The Effect of Public Policies on Private Incentives to Invest in Education: A General Framework and Some Results fro the EU", *CESifo Working Paper* No. 1392.

Deschamps, R. and V. Schmiz (2006), "Le financement de l'enseignement supérieur et le contexte budgétaire de la Communauté française de Belgique", *Reflects et Perpsectives*, XLV, 2006/2.

Economist Intelligence Unit (EIU) (2005), *Belgium – Country Profile 2005*.

European Commission (2004), Projects in "Economics of Education" – study on "The Financing of Higher Education in Europe".

Jacobs, B. and F. van der Ploeg (2006), "How to Reform Higher Education in Europe", *Economic Policy*, July 2006.

Gérard, M. (2006), "Enseignement superior et mobilité, l'interpellation du passager clandestin", *Reflets et Perspectives*, XLV, 2006/2.

Keltchtermans, S. and F. Verboven (2006), "Participation and Schooling in a Public System of Higher Education", *CEPR Discussion Paper*, No. 5690.

OECD (2004), *Economic Survey of the United Kingdom*, Paris

OECD (2005), *Economic Survey of Belgium*, Paris.

OECD (2005), *Education at a Glance* – OECD Indicators.

OECD (2006), *Education at a Glance* – OECD Indicators.

Ministry of Education and Training (Flemish Community – Belgium), *Country Background Report – Flanders – OECD Thematic Review of Tertiary Education*, Brussels, June 2006.

Nonneman, W. and I. Cortens (1997), "A Note on the Rate of Return to Investment in Education in Belgium", *Applied Economics Letters*, 1997, No. 4.

Vandamme, J.P., N. Meskens, and J.F. Superby (2006), "Évaluation du risque d'échec des étudiants de première année universitaire selon leur profil", in *Reflets et Perspectives*, XLV, 2006/2.

Vandenberghe, V. (2006a), "Attending Tertiary Education – Does Parental Money Matter? An empirical Assessment Using Belgian Household Data", Mimeo, Economics Department, IRES, Université Catholique de Louvain.

Vandenberghe, V. (2006b), "Au-delà de Bologne, la question du 'comment' financer l'enseignement supérieur européen persiste", *Reflets et Perspectives*, XLV, 2006/2.

Vandenberghe, V. and O. Debande (2004), "Financing Higher Education with Student Loans, The Crucial Role of Income contingency and Risk Pooling", *IRES – ECON DP*, No. 2004-36, IRES, UCL.

Vandenberghe, V. and O. Debande (2006), "Refinancing Europe's Higher Education with Deferred and Income-Contingent Fees: An Empirical Assessment Using Belgian, German, and UK data", forthcoming in *Education Economics*.

Vossensteyn, J.J. (1999), Where in Europe Would People Like to Study? The Affordability of Higher Education in Nine Western European Countries. *Higher Education*, No. 37.

ISBN 978-92-64-03186-9
OECD Economic Surveys: Belgium

Chapter 5

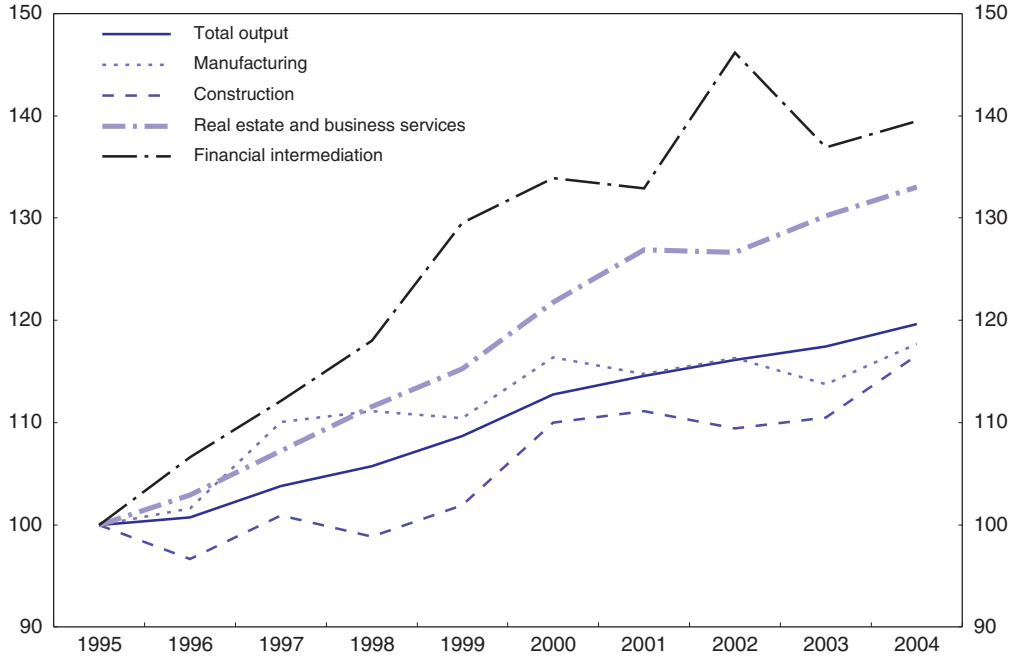
Enhancing the benefits of financial liberalisation

The Belgian financial landscape has been transformed over the past two decades and now consists of a relatively large, well-functioning and internationally integrated financial sector contributing directly and indirectly, through its intermediary function, to long-term economic growth. One of the financial system's key characteristics is the concentration of activity among a small number of financial conglomerates that offer a combination of banking and insurance services. Although this mix of activities may contribute to financial stability, it has led to a widespread commercial practice of cross-selling, possibly dampening competitive pressures. Competition may also be hindered by regulatory policies in the markets of mortgage loans and consumer credit; although these policies aim at protecting consumers against the risk of over-indebtedness, they risk having the unintended consequence of increasing entry costs for new providers, thus hindering competition and innovation and hurting consumer interests. Besides regulatory policy, tax policy has also been used to shape the development of the financial system. Tax credits are granted to influence investment and borrowing decisions, notably to stimulate home ownership, encourage saving and stimulate private pension accounts. International experience suggests that such tax expenditures, while influencing the allocation of saving, have no obvious impact on the overall level of saving. However they result in significant tax expenditure and necessitate higher tax rates elsewhere. Reforms recommended in this chapter would help to make a well-functioning system perform even better.

The financial sector is stable and generally well-functioning

The Belgian economy enjoys the benefits of having a relatively large, well-functioning and internationally integrated financial sector. The sector comprises four large conglomerates offering banking and insurance activities, the Euronext Brussels stock market and a variety of other important private entities. The financial landscape has been transformed over the past two decades by reforms to liberalise international flows, privatise banks and deregulate financial and insurance activities. An additional factor behind this transformation is the ongoing integration of financial markets in Europe. Although measurements of the financial sector's output are subject to large margins of errors, the difference between the growth of the financial intermediation sector's value-added in real terms during the past ten years (3.8% per year) and that of the overall economy (2%) leaves no doubt as to its underlying dynamism (Figure 5.1). Other activity indicators confirm this dynamism.[1] The financial stability of the sector over the past twenty years – it has avoided the type of large bank crises observed in some other countries – has also been an important contributor to overall prosperity.

Figure 5.1. **Real value-added by sector**
1995 = 100



Source: National Bank of Belgium, Belgostat.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

While the system's direct contribution to output is notable, its *indirect* contribution is all the more important. As suggested by recent empirical studies, a well-functioning financial system contributes to long-term growth through various channels (Leahy *et al.*, 2001; de Serres *et al.*, 2006). This includes mobilising large volumes of domestic and international savings, allocating them adequately, spreading risks across the economy and monitoring the users of external funds. In addition, a well-functioning financial system can enhance economic resilience by helping consumers borrow their way through downturns to stabilise spending and thereby economic activity. The evidence presented in this chapter suggests that Belgium's financial sector generally fulfils these functions adequately, but that there is room for improvement. Key features that risk hindering overall economic performance are the high concentration of activity among a small number of institutions, the relatively strict stance of credit regulations, particularly for mortgage and consumer credit, and the large-scale use of tax incentives to influence financial decisions. The chapter addresses these issues and recommends various further reform measures that could help to spur long-term growth.

The financial system is highly concentrated

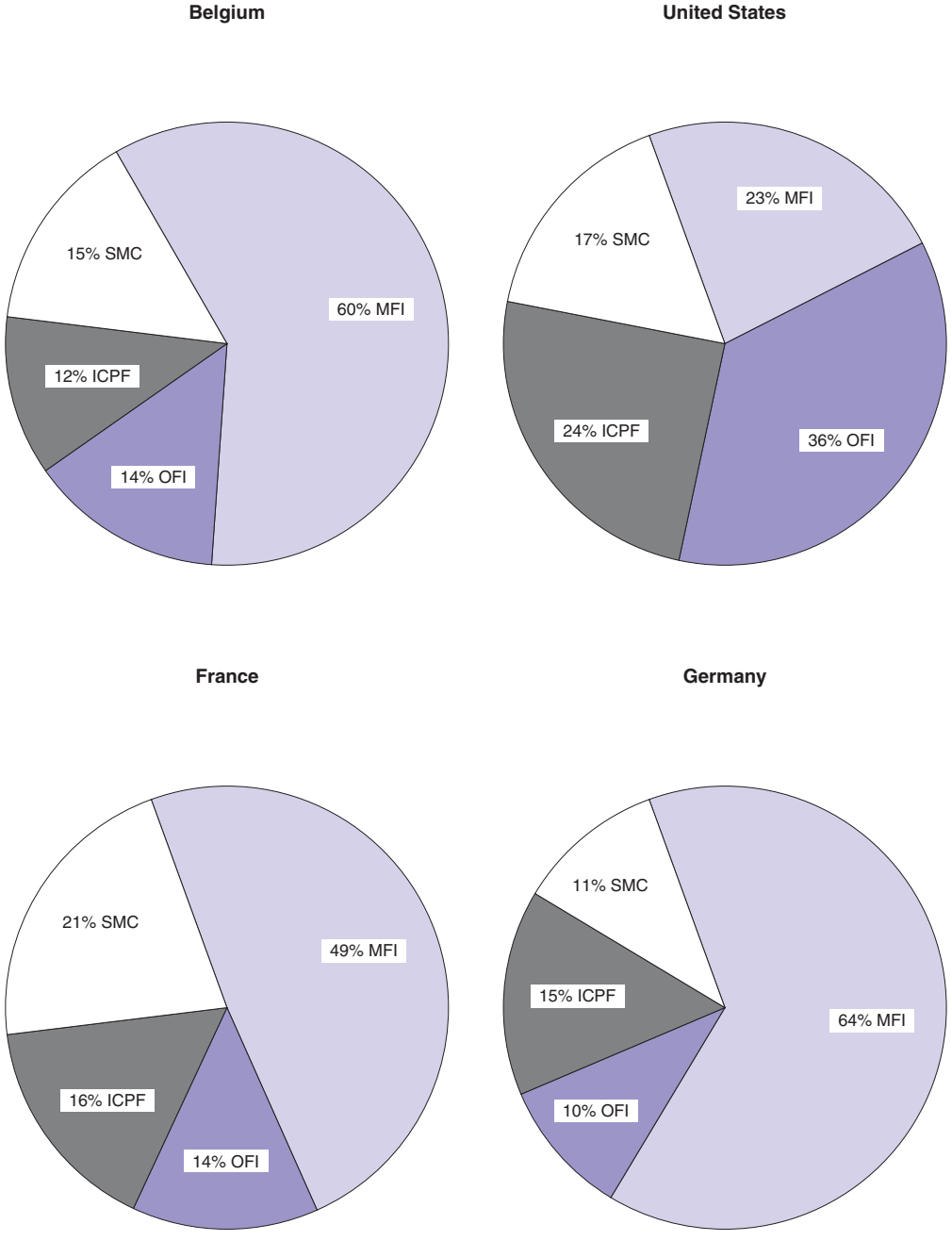
As measured by the distribution of assets, Belgium's financial sector appears dominated by banking institutions (Figure 5.2). The banking system itself is highly concentrated among a small number of entities, which offer both banking and insurance services and therefore have been qualified as "bancassurance conglomerates". Past mergers and acquisitions have left the sector largely in the hands of four such institutions, which offer a wide range of retail financial services, providing personal clients with the equivalent of a one-stop financial service centre.[2] The four conglomerates hold about 80% of the country's banking assets, as compared to an average of 45% for the largest five banks in the EU15, which makes the Belgian sector a highly concentrated one (Allen *et al.*, 2005). This assessment needs to be qualified to take into account the size of the country, because there is less room for banks to operate with sufficient economies of scale in small countries. Indeed, the degree of banking concentration in Belgium is comparable to that of the Netherlands and Finland (Figure 5.3). Nonetheless, there are small countries (Austria, Denmark, Ireland and Greece) where less concentrated banks appear to operate profitably.

While the banks have transformed themselves since the early 1990s, data from the financial accounts suggest that the composition of their funding has remained stable and that banks rely heavily on the household sector to fund their activities (Figure 5.4). However, these data do not include interbank market transactions and, being on a territorial basis, cover only branches and subsidiaries operating in Belgium. Hence, the data potentially overestimate the importance of the household sector. Nevertheless, such resources are stable and less costly to mobilise than other external funds, while at the same time exploiting the extensive existing retail branch networks. Thus, safeguarding this source of financing is an important aspect of the banks' business model and an essential factor of their profitability.

The fact that households bring such large resources to the financial system is not entirely surprising. The Belgian household sector is characterised by a high savings ratio and, consequently, by a large level of accumulated net worth by international standards, with gross financial assets of more than 400% of gross disposable income compared to financial liabilities of less than 80% (Figure 5.5). In addition, the household sector owns housing wealth of also approximately 400% of gross disposable income, which makes aggregate net wealth very large

Figure 5.2. **Assets of financial intermediaries**

As per cent of total financial assets, 2004

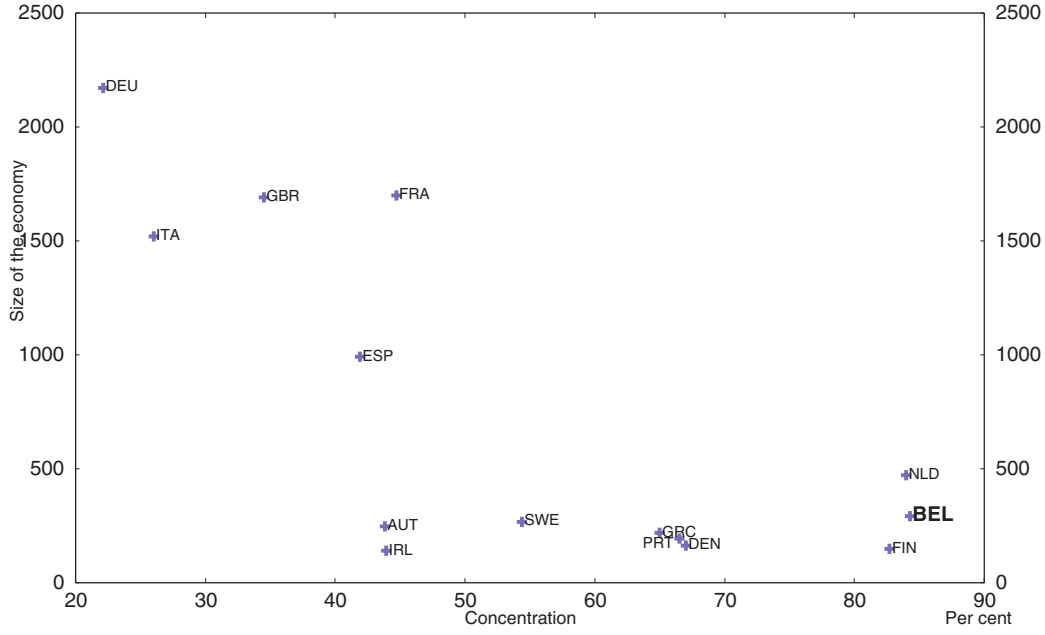


Note:
MFI: Monetary financial institutions.
OFI: Other financial intermediaries.
ICPF: Insurance corporation and pension funds.
SMC: Stock market capitalisation.

Source: OECD, Financial Accounts, Euronext, Allen *et al.* (2005).

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Figure 5.3. **Concentration in the banking sector and size of the economy**[1]

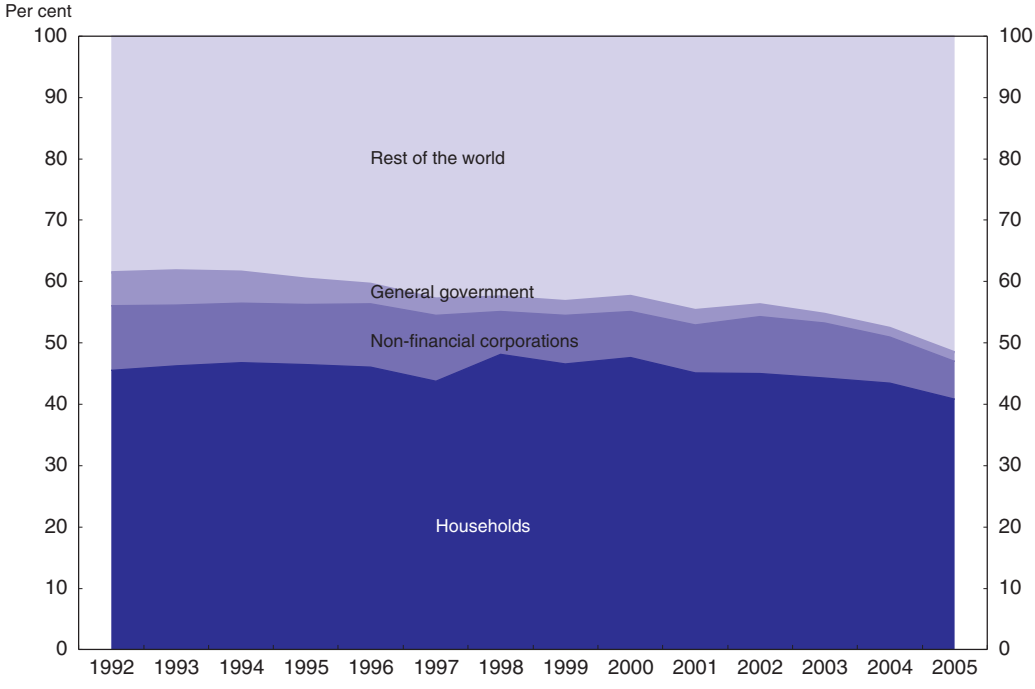


1. Concentration ratio refers to the five largest institutions' share of total bank assets, 2004. The concentration ratio of the three largest banks of some major non-European countries is 30% (USA), 39% (JPN) and 53% (CAN). Size of the economy is measured by GDP volume at PPP, billions of USD, 2005.

Source: OECD, Allen *et al.*, 2005.

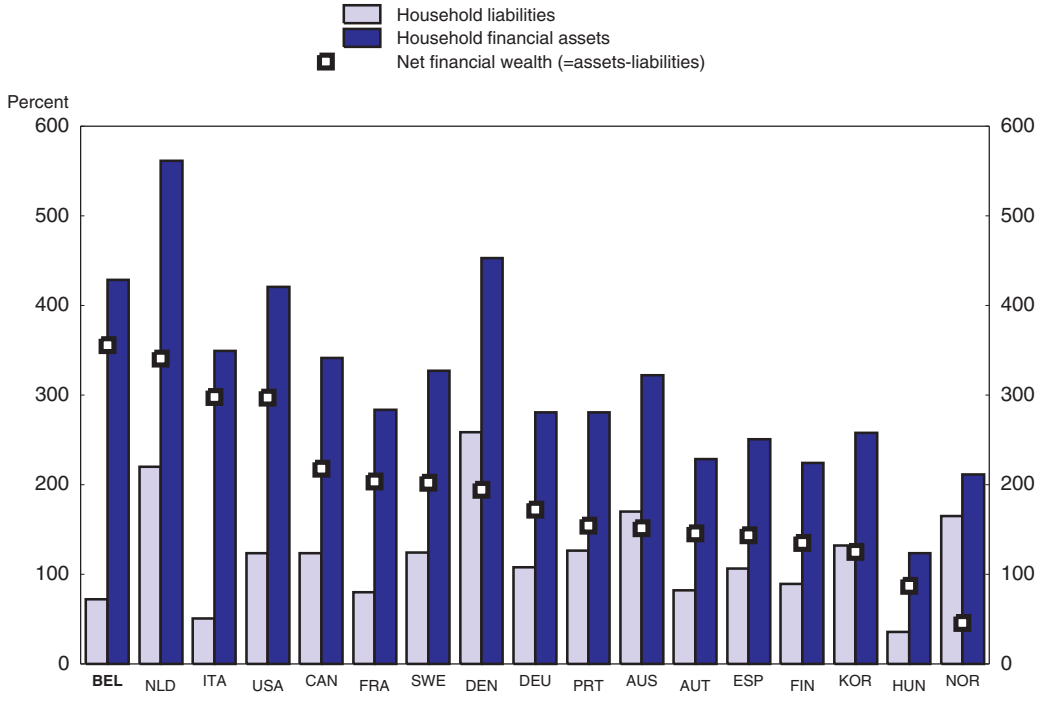
Figure 5.4. **Decomposition of banks' liabilities by type of claimant**

In per cent



Source: Financial Accounts of Belgium, Belgostat.

Figure 5.5. **Household financial balance sheet**
As a per cent of disposable income



Source: OECD, Financial Accounts.

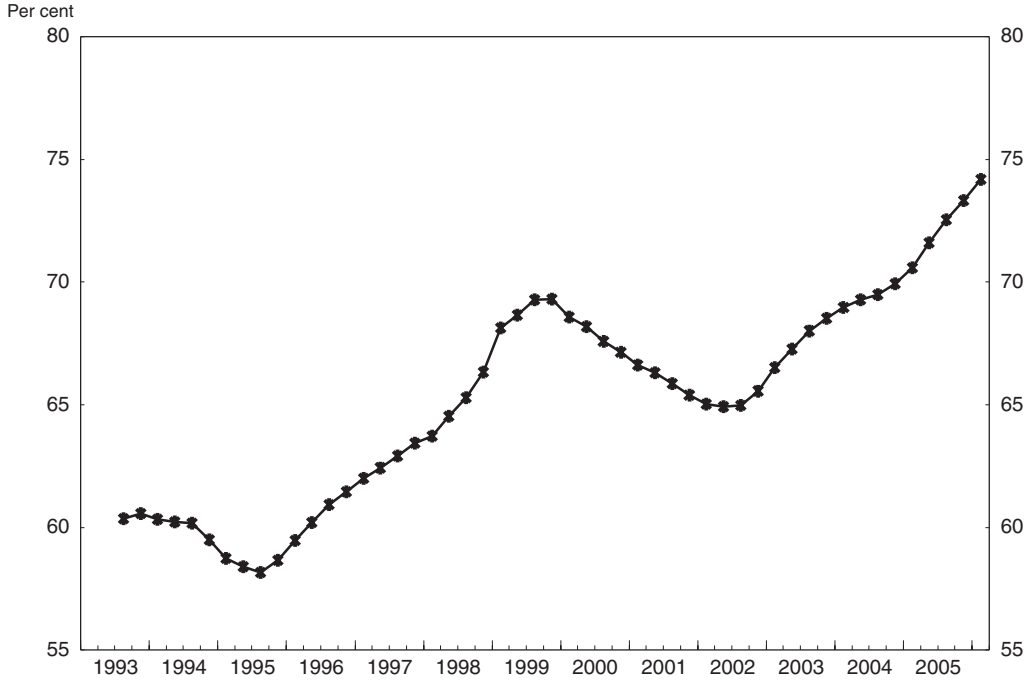
in comparison to other countries. The accumulation of wealth partly reflects the persistently high volume of household saving, which may have been a reaction to the ongoing accumulation of large public debts (IMF, 2006). However, the household savings ratio has declined from over 20% in 1995 to below 14% in recent years, partially reflecting the balancing of the budget over the past half decade. The fact that households tend to accumulate large amounts of saving may also be linked to the low replacement rates provided by the first-pillar pension scheme, which may have encouraged households to invest in second and third-pillar schemes (such as life-insurance products) as well as by the persistent high degree of unemployment, which may encourage a high level of precautionary saving.

Like in other countries, the household sector has sharply increased its borrowing during the first half of the decade (Figure 5.6). Activity in the mortgage market has been particularly buoyant as households took the opportunity of low mortgage rates to increase their borrowing, while the take-up of other forms of debt (such as consumer loans and term loans) showed a more moderate increase. As a result, the household debt-to-income ratio has reached the record level of 75% in early-2006 and the share of mortgage debt in total household indebtedness rose to an unprecedented level of 72%. The net financial wealth of the aggregate household sector nevertheless remains extremely high and the recent sharp increase in house prices implies that total wealth is rising fast.

In contrast to the household sector, the *corporate sector* has further reduced its borrowing from the domestic banking sector. The importance of bank credit to Belgian firms as a share of GDP has declined in the past five years and stands well below the corresponding ratio for firms located in the euro area. Medium- and large-sized firms have access to the

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Figure 5.6. **Household debt**
In per cent of gross disposable income



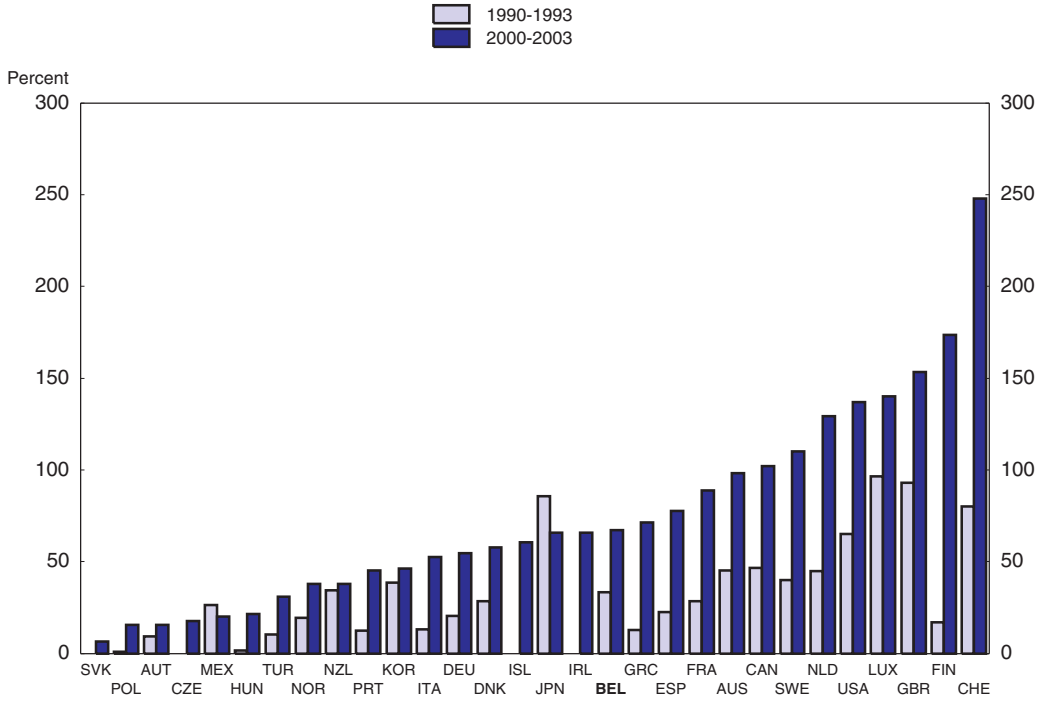
Source: OECD Analytical Database.

international credit market and make a limited recourse to the domestic banking system. Similarly, the corporate sector resorts only to a limited extent to the domestic stock market. Indeed, the Belgian stock market capitalisation is relatively small by international standards (Figure 5.7) and at the same time liquidity (measured by shares turnover ratio of stock traded) is on the low side (Allen *et al.*, 2005).[3] Factors that limit the number of quoted shares are the high number of smaller companies with a family shareholder structure and the issuance of unquoted shares in connection with inward foreign direct investment and venture capital funds (Baugnet and Wuyts, 2006). The combination of these factors is behind the limited free float (*i.e.* the shares that available for trading) on the Belgian subsidiary of Euronext.[4]

All of this suggests that domestic financial market activities (such as equity issuance or bond floatation) play a less important role as a long-term growth driver than bank credit; this appears to be confirmed by an empirical assessment comparing the roles of intermediated and dis-intermediated financing in Belgium and the United States (Ernst and Compton, 2007).

The financial stability of banks is underpinned by a number of Belgium-specific features, such as the system's large (though diminishing) holdings of government securities, banks' stable sources of funding *inter alia* from household accounts and a traditionally cautious attitude towards risk (NBB, 2006a). The overall soundness of the financial intermediaries has been confirmed by the results of stress tests (simulating large shocks to the system) run by the main financial institutions, the National Bank, and the financial supervisor, in coordination with the IMF. A contributing factor has been the ongoing reform of financial supervision (see Box 5.1).

Figure 5.7. **Stock market capitalisation in OECD countries**
Per cent of GDP



Source: World Bank financial structure database.

Box 5.1. **Financial supervision**

In 2004, financial sector supervision of banking, finance and insurance was merged into a single supervisor (the Banking, Finance, and Insurance Commission, CBFA), to further strengthening the supervision of the increasingly complex and continuously evolving strategies of the *bancassurance* groups and of the trend towards greater cross-border activities. The creation of a single supervisor should increase the quality of supervision as well as improve consistency of supervision across sectors (Cihak and Podpiera, 2006). Moreover, the Financial Stability Committee (FSC) was created, bringing together all the board members from the CBFA and the National Bank of Belgium, in order to complement micro-prudential surveillance and macro-prudential analysis. This includes the global stability of the financial system, crisis management co-ordination and co-ordination of the supervision of financial conglomerates.

The *bancassurance* business model may impede competition

A particular feature of the Belgian financial system is that the four major institutions offer a combination of banking and insurance services. Bank customers can therefore combine traditional banking operations with insurance transactions (notably investments in life-insurance schemes). Banks typically offer a package of services to their clients within an overall pricing strategy, thus cross-selling their services and products. This business model has many virtues, notably because it contributes to reducing operating costs for the banks and makes it possible to build large databases on the main

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

characteristics of each client, thus helping to develop specific products and better satisfy the customer's needs. The marketing literature also points to cross-selling as being a key tool for forging stronger relationships with customers and reducing customer "churn" (Kamakura *et al.*, 2003). This is because the selling of additional products by the vendors increases the switching costs for the customer and therefore reduces the probability that the customer will switch to a rival institution in response to a more competitive offer.

The authorities view the business model of *bancassurance* as a risk diversification measure, which contributes to strengthening the robustness of the system (NBB, 2006a). The cycles in the banking and insurance markets tend to move in different directions due to differences in duration of assets and liabilities in banking and insurance. Thus, the cross-selling of banking and insurance services adds to financial stability. Even though insurance activities are less important than banking activities for the four main conglomerates, they nevertheless constitute an important source of asset diversification and corporate earnings (Table 5.1). The widespread practice of cross-selling, however, risks dampening competitive pressures because it blurs price transparency and strengthens consumer loyalty. In the market segment for large corporate borrowers, the high concentration in the banking sector has not come at the cost of restraining competition because large corporations are able to access international financial markets. For households, however, there is little choice other than dealing with domestic banks, which, particularly the largest ones, tend to follow similar business models.[5]

Table 5.1. **Relative importance of banking and insurance activities**

Percentages

	Market share in Belgium[1]		Contribution to group profit[2, 3]		Share of total assets[3]	
	Banking	Insurance	Banking	Insurance	Banking	Insurance
Dexia	14.7	6.4	81.1	18.9	93.1	6.9
Fortis	31.9	17.8	66.5	33.5	85.7	14.3
ING Belgium	14.0	6.7	84.4	15.6	93.3	6.7
KBC	21.4	13.4	80.7	19.3	91.2	8.8
Total	*82.0*	*44.3*	–	–	–	–

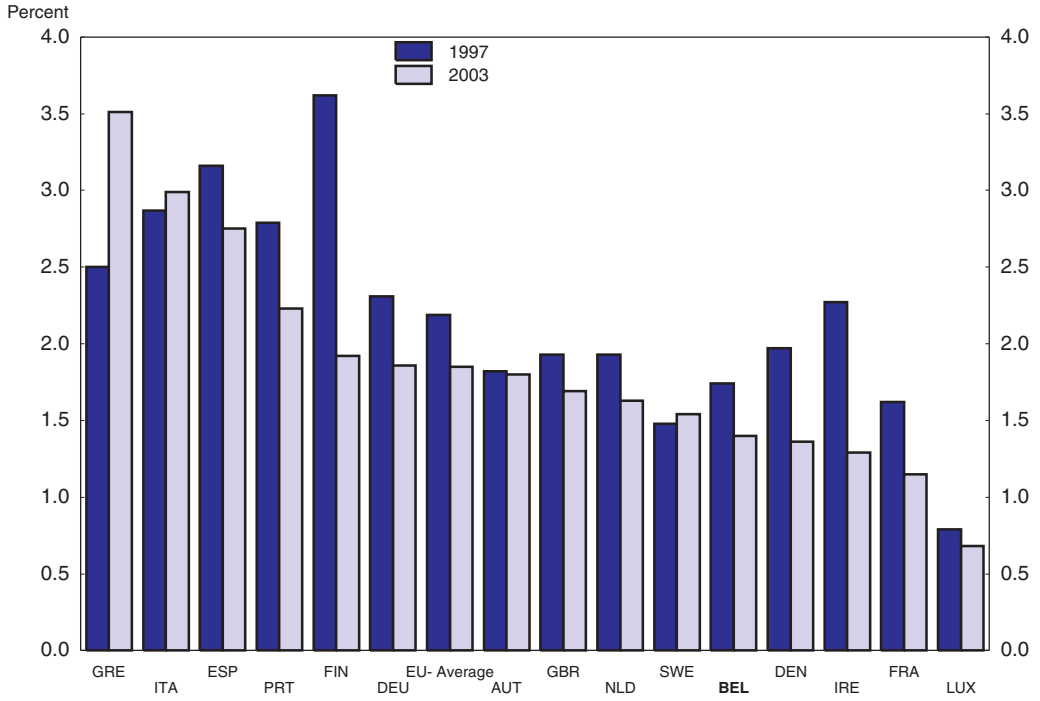
1. On the basis of deposits by Belgian residents for banking and collected premiums for insurance.
2. Percentages of the group's net operating profit.
3. Data for 2005.

Source: NBB (2006a).

In principle, the number of banks is large enough to support competition and, as judged for instance by the very low level of net interest margins, the market for retail banking appears to be competitive (Figure 5.8). However, such low margins could reflect a strategy of generating income through banking fees rather than covering management and transaction costs through interest margins. Indeed, credit institutions' net income is equally divided between net interest income and non-interest income (NBB, 2006a). This may reflect the fact that bank customers are offered low-interest credit products (such as mortgage loans) and interest-earning savings accounts cross-sold with fee-based services (such as life-insurance and mutual fund investments) (Figures 1.15 and 5.9).[6] As noted above, the strategic marketing goal of cross-selling products is to increase the switching costs for customers, thus reducing the probability of their escape toward more competitive rivals. Such cross-selling may include aggressive pricing on mortgage loans or savings accounts, which are cross-sold with other products. Thus, financial services providers tend

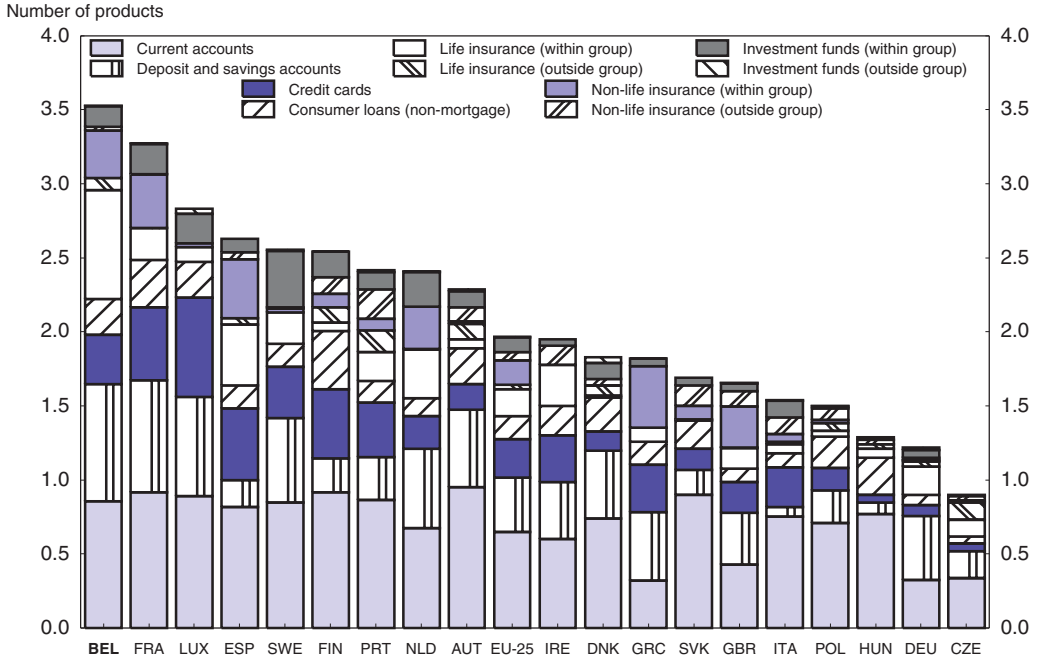
Figure 5.8. **Net interest margins**

In per cent of total banking assets



Source: BankScope (taken from Allen, Bartiloro, Kowalewski, 2005).

Figure 5.9. **Mortgage cross-selling**[1]



1. Cross-selling is measured as the average of products that customers purchasing a mortgage are purchasing from the same financial institution.

Source: European Commission, "Retail Banking Survey", 2005-06.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

to compensate their low net interest margins with income from cross-sold banking and insurance products. An additional concern is that customers may be offered an overall package of products – comprising new credits, savings accounts, insurance coverage, investment products – at conditions that reflect the outcome of negotiations with the customer, thus reducing the transparency of the prices of individual products for the client (though not for the service provider). So although there may be economies of scope from cross-selling, it is unclear – in the absence of price transparency – that such efficiency gains are actually passed on to the customers. While such practices are not confined to Belgium, they are reinforced by the specific nature of the *bancassurance* business model.

While cross-selling may be a rational strategy for both banks and customers, tying of financial products is potentially harmful for competition (European Commission, 2006). Although in general tying of financial products is explicitly forbidden in Belgium, there is one exception in the mortgage credit law: mortgage loan providers are allowed to grant a conditional interest rate reduction if a life insurance ("*l'assurance de solde restant dû*") and/or a home insurance is bought from the same financial institution.[7] As a result, the closure of a mortgage contract is a bargaining process, with reduced transparency, which is likely to be at the detriment of consumers as they end up with tied products and high switching costs if they want to escape to a rival at a later stage. It is for the purpose of discouraging anti-competitive cross-selling practices that the authorities should reconsider the regulation of authorising mortgage interest rate reduction conditional on the joint purchase of insurance products.

In February 2004, the Belgian authorities concluded a "gentleman's agreement" with the Banking Association that includes a commitment to improve price transparency and make comparisons easier. Despite this agreement, it appeared that more was needed to spur competition. Thus, in June 2006 the Council of Ministers adopted a draft law – anticipating European regulation – that allows depositors to close a bank account or a saving account without incurring fees and be reimbursed for any banking fee paid in advance for future services. Such measures aimed at reducing switching costs go in the right direction and should be complemented by the forceful implementation of the competition law in the financial markets by the competition authority. An important step in this direction is the request from the government to the competition authorities to examine competitive pressures on the market for savings account.

It has often been argued that stronger competition in financial markets could conceivably have adverse implications for the stability of financial institutions and hence economic stability. However, there is no evidence that OECD countries with vibrant competition are more prone to instability then countries with more muted market forces (De Serres *et al.*, 2006). Indeed, Beck *et al.* (2004) find that fewer regulatory restrictions – lower barriers to bank entry and fewer restrictions on bank activities – lead to less banking fragility, suggesting that regulatory restrictions are not beneficial in the stability dimension. Moreover, Degryse and Ongena (forthcoming) argue that supervisory authorities have increased their ability to support stability through prudential/capital regulation (Basle I and Basle II). Moreover, the competition authorities are engaged in applying a common set of competition principles across the economy, thus securing an even-handed approach.

Policies to regulate household borrowing may hamper consumption smoothing

Another type of regulation that has shaped the development of the financial system is consumer protection policy – *i.e.* protecting borrowers against the risk of over-indebtedness – notably in the areas of mortgage loans and consumer credit.

Mortgage debt regulation

Housing wealth is the most important component of most households' assets and mortgage debt represents a correspondingly large share of their liabilities. In many countries, financial innovation has helped households tap their housing equity to compensate for temporary fluctuations in income. In downturns, consumers can maintain their spending in a variety of ways using housing finance (such as contracting a mortgage loan to renovate a house, taking a second mortgage loan, reloading an existing mortgage loan, taking home equity credit lines, trading down to a smaller house, moving to a rental, etc.). This requires an efficient mortgage market, a well-functioning real estate market and a relatively flexible regulatory environment. This is particularly important for liquidity-constrained households, who are not able to draw down short-term assets (such as bank accounts or savings deposits). In Belgium, however, the combination of banking practices and government policies appear to prevent this from happening, with the risk of hindering consumption smoothing (Box 5.2).

In Belgium, banks do not offer equity withdrawal loans, although there is no regulation prohibiting them from doing so (Table 5.3). Almost all mortgage loans offered are of the "mortgage credit opening" type. This type of mortgage loan allows a reloading of new credit up to a maximum of the original loan amount. This lets people obtain fresh resources, but only after years of repayment of the principal and excludes the possibility of taking advantage of capital gains in owner-occupied housing. As a result, the possibilities for smoothing consumption through equity withdrawal are limited. Equity withdrawal in the form of reverse mortgage can also be used by older people to cash in on their housing wealth and obtain a stream of revenue supplementing their pension income.[8] This could be of particular interest in Belgium, where second- and third-pillar pension funds are not very well developed and where the replacement rate of the first-pillar pension system is among the lowest in the OECD.

Another way to draw down housing equity is to sell one's house – so as to trade down to a smaller house or temporarily use rental accommodation. However, high transaction costs are likely to act as an impediment. Such costs amount to approximately 18% of the purchase value (reflecting both relatively high registration taxes and relatively high notary fees) making them among the highest in the OECD (Figure 5.10). These costs contribute to the low number of transactions (Figure 5.11) and hence fewer market opportunities are available. Indeed, many homeowners purchase only one house in their lifetime, implying that there is little adaptation of housing to variation in family size. The high transaction costs also contribute to explaining the very low geographical labour mobility (see Chapter 3). To address such problems Flanders recently introduced a system of portability of transaction costs within the Flemish region (Box 5.3).[9] Further lowering of real estate transaction costs would stimulate the housing market and thus the market for mortgages – in the process creating opportunities for entry of new mortgage providers.

Box 5.2. **Consumption smoothing**

Economic theory and empirical studies suggest that people like to spend in accordance with their expected lifetime income. In aggregate, people do not fully adjust their spending to changes in their income: they save more when their income is temporarily high and they save less and/or borrow more when their income is temporarily low. There is some controversy as to whether rich and poor people act differently, but there is agreement that consumption smoothing is a goal sought by people in aggregate. For consumers to keep their spending unchanged in the face of income changes, the financial system has to function efficiently, especially for liquidity-constrained people. An efficient financial sector can therefore make an important contribution to the reduction of output volatility and to the resilience of economies in the face of economic shocks. There is evidence that financial innovation has lowered output volatility by making it easier for consumers to tap the credit market and borrow their way during economic downturns (Dynan *et al.*, 2006). To find empirical evidence on the behaviour of consumers, empirical studies estimate the sensitivity of private consumption to changes in real income. A high marginal propensity to consume (so-called "excess sensitivity") may indicate, on the supply side, that the financial system does not provide efficient services to people seeking to smooth their consumption or, on the demand side, a conservative attitude towards borrowing for consumption. By contrast, a low sensitivity to changes in real income suggests that people can and will use the financial system efficiently to maintain their spending when their income fluctuates. According to existing empirical studies, Belgian households show a relatively high excess sensitivity (Table 5.2). As opposed to the low sensitivity of spending in the United States, the United Kingdom and northern Europe, there is some degree of excess sensitivity in western Europe, and particularly in Belgium.

Table 5.2. **Estimated excess sensitivity of consumption to disposable income**[1]

	1990	1999
Belgium	0.92	0.85
Italy	0.80	0.84
Canada	0.44	0.48
Austria	0.50	0.53
Denmark	0.47	0.41
Netherlands	0.48	0.57
Spain	0.40	0.39
United States	0.39	0.16
Finland	0.06	0.06
France	0.33	0.45
Germany	0.40	0.53
Japan	0.31	0.28
Sweden	0.27	0.26
United Kingdom	0.26	0.24

1. Excess sensitivity (λt) was estimated by the linear specification $\Delta c_{jt} = \alpha_j + \lambda_{jt}\Delta y_{jt} + \varepsilon_{jt}$ and $\lambda_{jt} = \beta_0 + \beta_1 b_{jt} + \beta_2 FL_{jt}$. With c private consumption, y household disposable income, b ratio of government debt to GDP and FL per capita number of credit cards.

Source: Pozzi *et al.*, 2004.

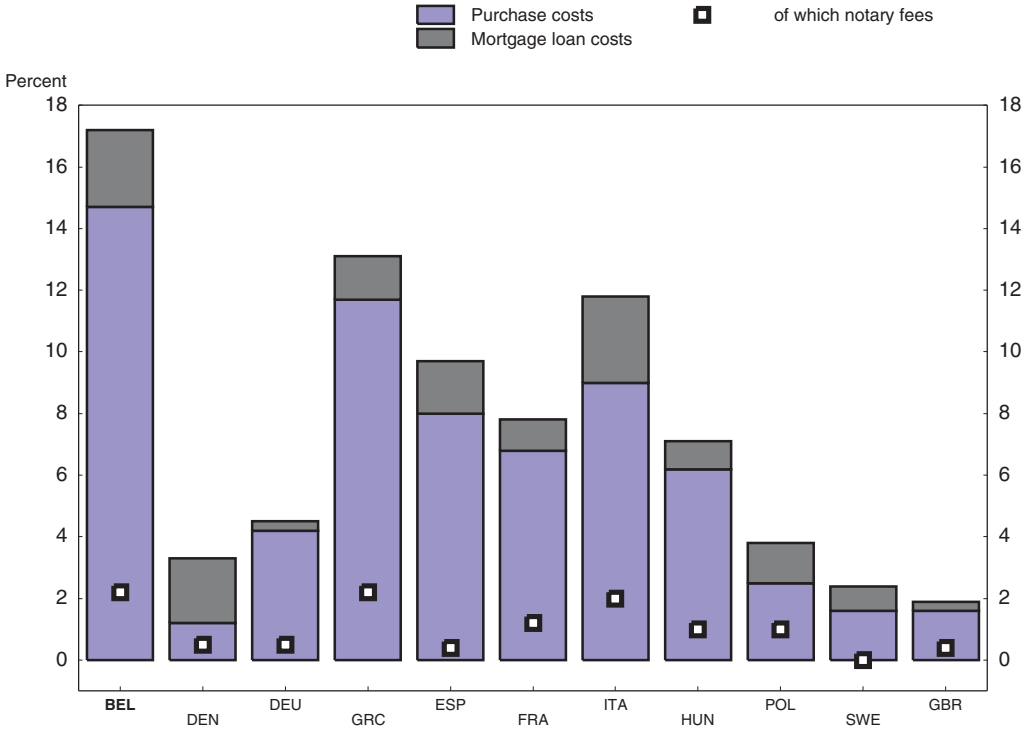
Table 5.3. **Mortgage markets: general characteristics**

	Typical rate structure	Recent/peak LTV ratios (per cent)[1]	Typical term (years)	Prepayment fees	Equity release products	Tax regime[2]	Owner occupation (per cent)
Belgium	Fixed	80/115	20	Capped at 3-months interest	Not used	Ded, IT	68
Denmark	Fixed	80	30	Administration fee only	Used	Partial Ded; WT; IT	51
France	Fixed	67/100	15	Limited to 3% of repaid principal	Not used	WT; IT	56
Germany	Fixed	67/80	25	Lender entitled to compensation for lost income[3]	Not used	IT	43
Japan	Fixed	85/100	25	Lender entitled to compensation for lost income	Limited use	Limited term Ded; WT; IT	n.a.
Netherlands	Fixed	90/115	10	No fees up to 10% of capital prepaid each year	Used	Ded; IT	55
United Kingdom	Floating	69/110	25	Usually no fees	Used	IT	69
United States	Fixed/Floating	80/100	30	Usually no fees	Used	Ded; IT	68
Canada	Fixed/Floating	75/100	25	Penalty fees. No charges on portable mortgages.	Not used	No taxes, no deductibility	n.a.

1. Maximum LTV for eligibility to Realkreditobligationer in Denmark. Obligations Foncières in France and Pfandbriefe in Germany are 80%, 60% and 60%, respectively.
2. Interest Deductibility (Ded); Wealth Tax on housing (WT); Inheritance Tax on housing (IT). In most countries, capital gains are taxable. However, owner-occupiers also benefit from various degrees of tax exemptions after a number of years of occupation.
3. In the first ten years of the loan.

Sources: MOW, 2003; European Mortgage Federation, 2005; IMF staff estimates.

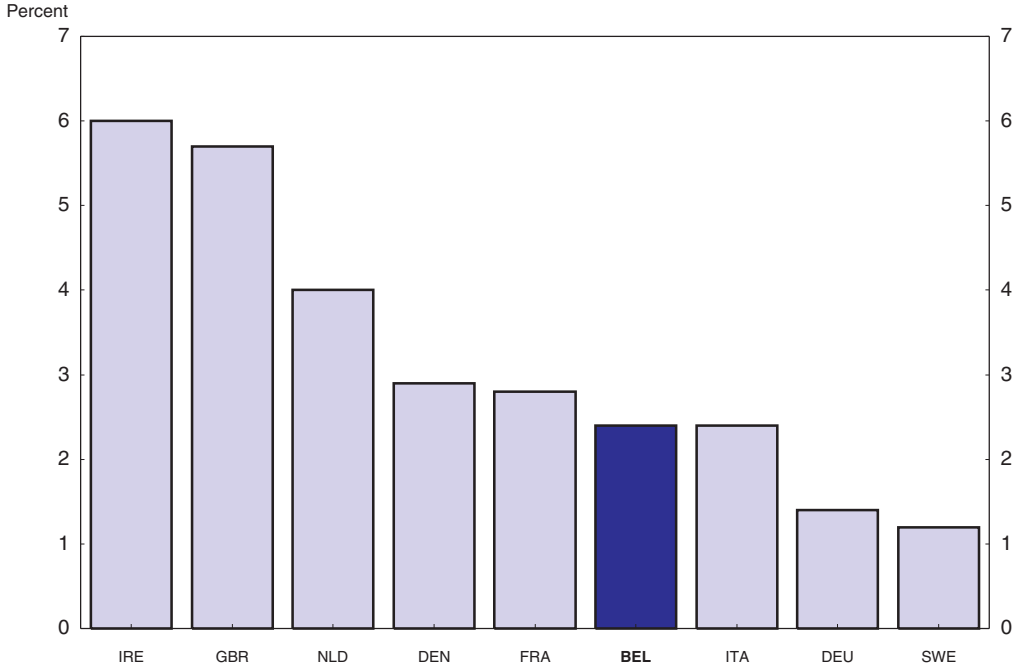
Figure 5.10. **Total transaction costs as per cent of total house purchase costs**



Source: European Mortgage Federation, 2006a.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Figure 5.11. **Average annual turnover of housing stock**[1]



1. The average annual turnover of housing stock has been calculated by dividing the simple average of the number of transactions during the last ten years (1995-2004) by the simple average of the total dwelling stock during the last ten years.

Source: European Mortgage Federation, 2004.

Box 5.3. **Transaction costs in Belgium**

The 18% transaction cost consists of the following elements: a 12.5% registration tax, a 2.5% notary fee and a 3% real estate broker fee. In some cases, the cost may be lower, as not all real estate transactions are brokered by real estate agents and registration tax is lowered to 6% for modest houses, *i.e.* houses with imputed rentals of less than € 750.[1] In 2002, the region of Flanders reduced registration taxes to 10% (5% for modest houses) and introduced the portability of transaction taxes, meaning that transaction taxes paid for a previous house are deducted from the transaction taxes for the next house, but only up to a maximum of € 12 500. This portability is, however, not transferable when moving outside Flanders. In the Brussels region, a tax exemption on the first € 45 000 (the amount is increased to € 60 000 in socially disadvantaged areas) of the acquisition price was introduced in 2003. These amounts were increased in 2006 to € 60 000 and € 75 000, respectively.

1. Imputed rentals or cadastral income is deemed to represent the net annual income (not indexed) from the premises.

The role of financial markets for funding mortgage lending (via mortgage-backed securities and covered bonds) remains very limited, contrary to developments in a number of countries (BIS, 2006). The market for mortgage-backed securities, which in Belgium come in the form of undertaking for collective investment in debt securities, is rather inactive and there is no legislation on covered or mortgage bonds (see below). In Belgium,

mortgage lenders rely mainly on savings from private individuals for the funding of the mortgage loans. These saving flows have been quite stable as a financing source due to the tax exemption on the savings deposits (see below). The beneficial effects of using secondary market instruments are to allow access to a wider range of investor capital, increasing the ability of lenders to manage their capital and so potentially reducing the cost of mortgages, which should eventually be reflected in lower rates for the borrowers.[10]

Belgium is one of the few countries in the European Union that does not have a mortgage bond legislation.[11] This prevents mortgage credit institutions from funding loans through the issuance of bonds. Naturally, such issuance can take place in other countries, but that is likely to hamper the emergence of Belgian mortgage credit institutions and adds an exchange risk for foreign entrants from outside the euro area. It should be noted that one of the major advantages of mortgage credit institutions is that the interest rates for mortgages are quoted in the bond market, which increases price transparency. The emergence of specialized mortgage credit institutions would address some of the asymmetric information problems in the current bargaining process for mortgages. This would lead to borrowers paying similar interest rates regardless of income, which would provide low-income families with cheaper finance for owner-occupied housing (OECD, 2006). Thus, the introduction of mortgage bond legislation is likely to make the mortgage market more contestable and therefore an appropriate legislation on mortgage bonds (covered bond legislation) should be introduced.

Another regulatory cost that may hinder the supply of mortgage credit – in particular to sub-prime borrowers – is the lengthy enforcement procedure in case of default (foreclosure costs). The usual time required for the distribution of the proceeds to creditors in Belgium is 18 months (Table 5.4). In comparison, the time required in countries with well-developed bond markets, such as Denmark, the Netherlands and the United Kingdom, is less than a year. The speed of foreclosure translates into higher costs for lenders which tend to be passed on to consumers (Mercer Oliver Wyman, 2003). Hence, high enforcement costs due to the lengthy procedure would force mortgage institutions to charge higher interest rates irrespective of their customers' risk profile, which in comparison with the well-informed banks would tend to blunt the competitiveness of mortgage institutions. This would indicate that reducing the time of mortgage enforcement procedures would level the playing field between different financial institutions.

Table 5.4. **Mortgage enforcement costs**

	Usual time required[1] (months)
Austria	6
Belgium	18
Denmark	6
Finland	3
France	15-25
Netherlands	6
Sweden	5
United Kingdom	8-12
United States	8

1. Total time from right of execution (in countries where the mortgage must be given executory power by a court) to the distribution of proceeds to creditors).

Source: OECD Economic Outlook 75; *The Economist*; Ahearne *et al.*, 2005.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

Regulation prescribes that mortgage contracts with variable interest rates must include caps and floors that limit the extent to which mortgage interest rates can vary. Such regulation may be found in other countries, but Belgium has some of the strongest legal requirements on such matters (EMF, 2006b). Rates cannot be adjusted more than once a year and consumer protection legislation requires that variable interest rates do not increase by more than 1 percentage point during the second year and by more than 2 percentage points during the third year of the contract. While such regulation protects borrowers from large shifts in interest rates, it makes the funding of mortgages more costly. Moreover, there is a cap on early repayment fees of three months' interest on the remaining amount (Table 5.3). This is unlikely to cover the associated refinancing cost, which is the standard (either through explicit fees or embodied in the interest rates on offer) in other European countries. An additional concern is that such specific regulation increases the cost of entry and may exacerbate structural and economic differences between markets, making integration of European financial markets more difficult (MOW, 2003). Therefore, the regulation on adjustment caps on interest rates should be phased out and caps on early repayment fees should be cost-based to allow creditors to charge an objective fee to compensate for associated losses.

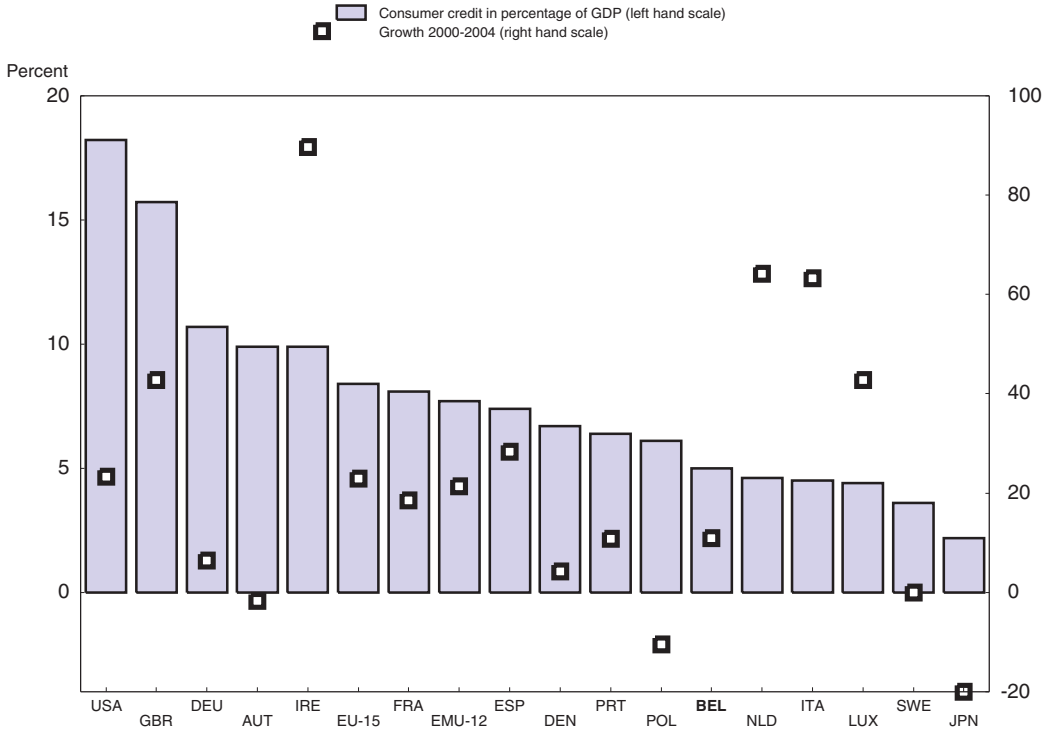
Consumer credit regulation

Consumer credit is another category of financing available to people wishing to smooth their consumption through temporary economic slowdowns, in particular cash-constrained people. It is typically offered to consumers directly in stores and is therefore immediately available to the consumer to finance purchases. In Belgium, however, suppliers of consumer credit, including credit card issuers, are subject to strict regulation meant to protecting consumers against over-indebtedness. Credit regulation is generally meant to correct market failures arising from the asymmetry of information between lenders and borrowers. Lenders may not have enough information to price the credit in accordance to the borrower's risk profile and therefore may be inclined to err on the side of overcharging. Similarly, borrowers may not have enough information on the terms of the credit to compare different offers and fully understand the financial consequences of their decision. Most countries require full disclosure of information and retraction periods so as to level the playing field and fully inform the consumers. Belgium has a well-developed regulation for this purpose. For instance, lenders must make their offer according to certain rules that enable consumers to compare across providers, so contracts must include all credit costs and, to facilitate comparisons, these costs have to be presented in a comprehensive interest rate measure – the "Taux Annuel Effectif Global" (TAEG) – which includes the cost of the interest rate, administrative costs, commissions, etc. In the same vein, all credits must be registered in a national database (see below) that lenders need to consult to obtain information about the borrowers' indebtedness.

Existing regulation, however, goes beyond remedying the asymmetry of information and intervenes directly in contractual terms through the use of maximum interest rates. There exists a "grid" of maximum allowed interest rates (defined in terms of annualised percentage rate of charge, including fixed costs) which vary with the form of credit, the amount borrowed and, until the 31 January 2007, the duration of the contract. For a number of credit types (particularly for credit cards) the grid has become a norm as observed interest rates are very close to the maximum interest rates (Test Aankoop, 2006). This implies that most consumer credit institutions operating in these segments of the market

have little incentive to engage in individual risk profiling, which again suggests that some of the existing borrowers pay higher than warranted rates.[12] Moreover, maximum interest rates that are set below market-clearing levels create supply shortage for credit, where the consequent rationing among borrowers reallocates credit toward those with higher incomes. Villegas (1989) finds clear evidence that in the United States low-income households residing in states with strict usury ceilings obtain significantly less consumer credit compared to low income households in states which had abolished usury ceilings. Thus, one unintended effect of the grid of maximum interest rates may be a reduction of credit available to low-income borrowers. Indeed, consumer credit in Belgium is at a relatively low level and is expanding at a more modest pace than in other countries (Figure 5.12). Several other countries, such as the Netherlands, Poland, Italy and France also apply a system of maximum interest rates. Except for France, all these countries are characterised by a low level of consumer credit outstanding.

Figure 5.12. **Consumer credit in selected OECD countries**



Source: European Credit Research Institute, statistical package.

As the system of maximum interest rates has become the norm for some types of credit, competition is limited among consumer credit providers in certain segments of the market. Moreover, the overall market for consumer credit is dominated by the major banks. Indeed, the importance of consumer credit specialists, although increasing, remains limited.[13] In addition, the strictness of consumer credit regulation enhances the role of overdraft facilities and other short-term bank credit instruments for financing consumption. As well, non-financial institutions like supermarkets and mail-order companies must have recourse to a financial institution/intermediary to offer credit.

OECD ECONOMIC SURVEYS: BELGIUM – ISBN 978-92-64-03186-9 – © OECD 2007

In July 2006 the authorities adopted a new and more restrictive grid of maximum interest rates, which in the future the grid will vary with developments in market rates. As the grid was already norm-setting for certain types of credit, the cost to consumers of the regulation associated with protecting consumers against over-indebtedness is set to increase. This raises the question whether an alternative and more flexible model for consumer protection in this area could be to make the grid indicative of what is considered non-usury rates and to encourage lenders to become more prudent. Empirical research on the various effects of the interest rate grid could contribute to a debate among interested parties and help the government to formulate possible reforms. In France, for example, the authorities are investigating the possible reasons for the low level of consumer credit and this has resulted in a quantification of the number of people that are currently deprived from consumer credit under the current legislation (including usury rates), (Babeau, 2006). Obviously, a first step would be to obtain micro-level data on the financial situation of the households, comparable with, for example, the Federal Reserve Survey of Consumer Surveys.

Consumer protection is also a concern at the European level and such legislation is being harmonised within the European Union. However, current EU directives stipulate an approach of minimum harmonisation, which has allowed the Belgian authorities to maintain and introduce national legislation on top of EU requirements. This has resulted in consumer protection legislation that comes across as one of the strongest in the EU, notably with regard to counter the problem of over-indebtedness.

The policy objective of avoiding over-indebtedness arises from social concerns. However, the concept is difficult to measure. No consensus exists in the literature on how to measure over-indebtedness and the Belgian authorities often refer to the default rates registered by the Central Individual Credit Registry (CICR).[14] According to this definition in 2005 about 4.2% of the Belgians had a least one contract on which they had defaulted with an average amount of around € 4305 (NBB, 2006b).[15] Both numbers have decreased since 2002. Moreover, these numbers are likely to be an overestimation as they include unsolved commercial disputes and as credit providers have few incentives to seek compromises given the near-absence of personal bankruptcies.

Some of the responsibility for ensuring a competitive marketplace must be placed on the borrowers themselves, since knowledgeable, informed borrowers help foster competition in credit markets (Federal Reserve, 2006). An additional helpful tool is financial education, complementing basic consumer legislation or as a temporary measure towards a broader and deeper consumer credit market. In several OECD countries, financial education programmes have been established. For example, in the United Kingdom there is a free telephone helpline/consumer hotline service targeted to underserved and financially illiterate consumers (OECD 2005); other examples are informative websites in the United States and public education campaigns organised by the financial supervisor in Korea.

Tax concessions have shaped the financial development

Another government intervention that has influenced the financial system is the tax treatment of financial transactions. There are three main tax concessions affecting household financial decisions: the tax exemption of interest earned on saving accounts; the tax credit for contribution to second- and third-pillar pension schemes; and the tax deductibility of mortgage loan repayments (see Table 5.5).[16] International evidence has

Table 5.5. **Main tax concessions on households' financial transactions**

	Type of tax concession	Maximum amount exempted per year (euro)	
Saving account	Exemption from withholding tax	1 600 of interest earned, annually (3 200)[1]	
Third-pillar pension accounts[2]			
Individual life insurance	Personal income tax reduction at adjusted average rate for contributions	1 920 (3 840)[1]	
Individual pension-saving funds		800 (1 600)[1]	
Mortgage loan repayments	Personal income tax reduction at marginal rate for all repayments combined[3]	First ten years	Afterwards
		2 560 (5 120)[1]	1 920[4] (3 840)[1]

1. Amounts for co-habiting households.
2. If the time of withdrawal is stipulated as in the contract, the funds are taxed at 10%. for contributions or premiums paid after 1993. A rate for 16.5% is applied for contributions or premiums paid before 1993. In case of earlier withdrawal, contributions made before 1993 are taxed at the progressive rate; contributions made after 1993 are taxed at 33%.
3. These include interest payments, capital repayments and life insurance (*assurance du solde*) premiums.
4. Concessions for individual life insurance and mortgage loan repayments cannot be combined.

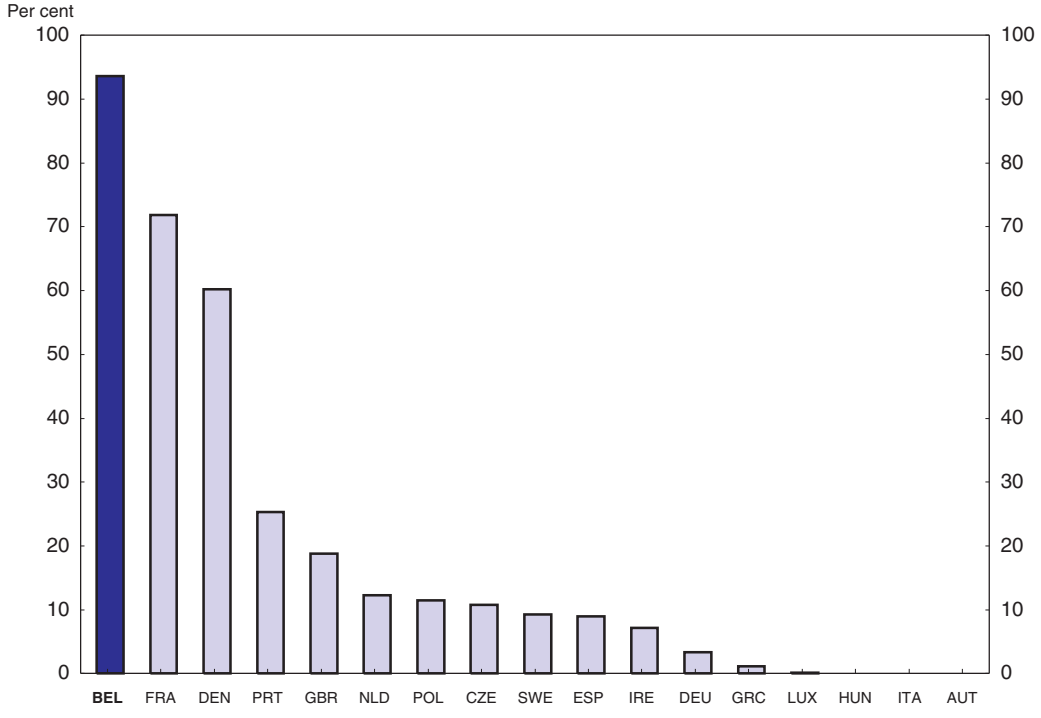
Source: Ministry of Finance, Fiscal Memento.

shown that relatively small fractions of the funds going into tax-advantaged savings vehicles can be considered to be "new" saving. As such, the best interpretation of the evidence is that such policies are expensive ways of encouraging savings (Attanasio *et al.*, 2004). According to the most recent data available fiscal expenditure related to favourable tax treatment of household financial transactions in Belgium were estimated to be around € 2.1 billion in 2002 (equivalent to 0.8% of GDP).[17] This is estimated to reduce personal income tax annual receipts by about 6%, thus resulting in higher tax rates than otherwise. To the extent that marginal effective tax rates are increased by the generosity of the tax incentives, this may weaken overall economic performance.

The tax concession on interest income earned in savings accounts is a long-established tradition. Savings accounts held by residents are exempt from withholding tax and from income tax up to a limit of earned interest of € 1 600 interest per year.[18] The tax concession appears to be very popular as can be gauged by the high number of saving accounts (around 17 million), which largely exceeds the Belgian population (10.4 million). This suggests a widespread practice of having multiple accounts, perhaps reflecting active consumers. On the other hand, account holders can evade withholding taxes by opening savings accounts in several banks. Currently more than € 160 billion (equivalent to about 54% of GDP) have been put into saving accounts. Preferential tax treatment of deposits and savings accounts does exist in other EU countries, but the importance of such accounts is much higher in Belgium than in other countries (Figure 5.13).

The tax concession on the savings accounts does not appear to have an obvious policy objective. Nevertheless, it is often cited that the tax concession was introduced out of social concerns as these accounts are supposed to be the main savings instrument of the less well-off households. However, the savings accounts provide a tax-free income proportional to the deposited amounts and therefore run the risk of benefiting well-off households and hampering the income distribution ambition of the tax system. In any case the tax concession has facilitated mobilising a large volume of household savings in order to finance the public sector's past heavy borrowing requirements as well as the demands of other borrowers. Covering these heavy borrowing needs at affordable interest rates was more demanding before the creation of the euro area, as foreign investors were

Figure 5.13. **Savings accounts with tax preferences**
Share of saving accounts with fiscal advantages in per cent of total, 2005

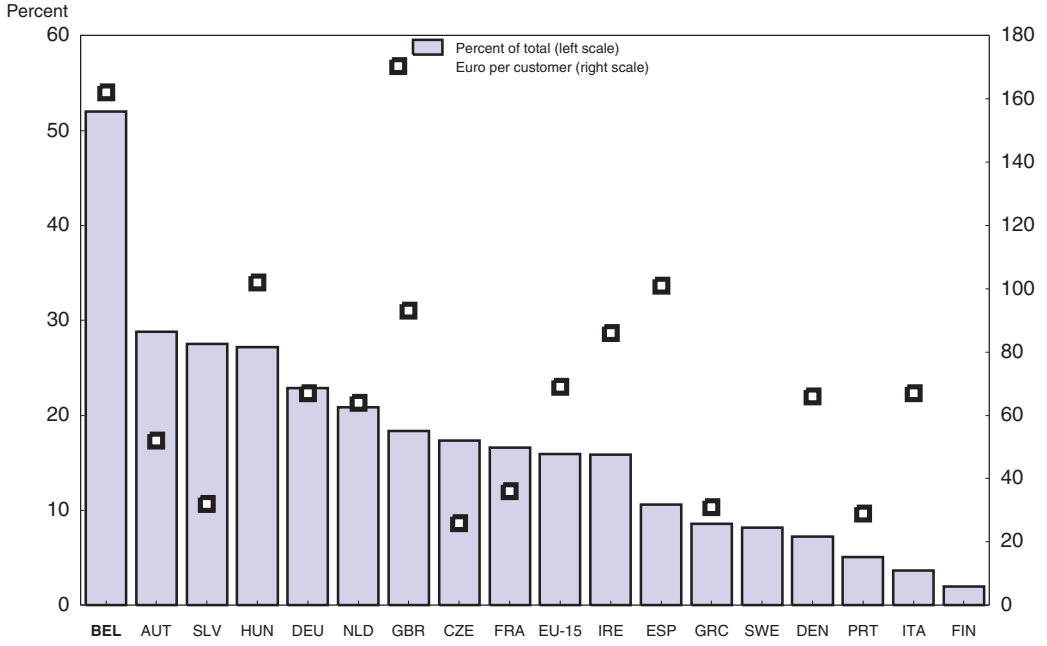


Source: European Commission, "Retail Banking Survey", 2005-2006.

expecting a premium over benchmark bonds to cover the exchange rate risk.[19] The small depth of the domestic capital market also made it difficult to cover financing needs via market-based issuances.

In addition, there is evidence that the benefits of the tax exemption have not been entirely captured by the savers; according to Valenduc (2003), the (net) rate of return on taxable deposits has been higher than that on tax-free savings accounts with a similar investment horizon.[20] The author also calculates effective tax rates for both products and finds that the (quasi-)effective tax rate on savings accounts is even at times higher than the effective tax rate on the non-exempted deposit, implying that the withholding tax exemption does not benefit the saver. On this evidence, the tax exemption appears to have worked, at least partially as a tax subsidy to the banking sector. It is therefore not surprising that the savings accounts have become a major source of income for the banks, as they represent half of the gross income from retail banking activity and are in terms of income per customer among the highest in the European Union (Figure 5.14).[21, 22] A contributing factor to the latter finding is that saving deposit interest rates are rather sticky compared to changes in market rates in an asymmetric manner, with deposit rates reacting sluggishly towards higher market rates, but rapidly to lower market rates (Maes and Timmermans, 2005). At the same time, the authors find that holdings in savings accounts have limited sensitivity to rate changes in alternative instruments or to higher interest rates on saving accounts offered by niche-players. This limited sensitivity may be related to relationship banking, reinforcing the impression of major banks having a degree of market power.

Figure 5.14. **Gross income from retail banking activity for deposits and savings**[1]



1. Retail banking activity includes current accounts, deposits and savings, consumer loans, mortgages and credit cards. The variable gross income captures all revenue that banks make on a specific retail banking activity, covering interest and non-interest sources.

Source: European Commission, "Retail Banking Survey", 2005-2006.

In 2002 (the last year for which official data is available), the associated tax expenditures were only about € 0.4 billion, reflecting current low interest rates. Given the poor targeting of this measure and that resistance to abolishing the measure is likely to be relatively limited at current rates, this would seem to be an opportune moment to reconsider this tax concession. A removal of the incentives to invest in the savings accounts could in the short-run have consequences for banks and potentially the overall financial stability (the share of savings deposits represents over 15% of banks' liabilites). However, there is currently a mismatch between the maturity of the banks' assets and liabilities as short-term demand deposits are financing long-term loans, including mortgages. Thus, the present system is already posing challenges for the banks' risk management (Dewachter, Lyrio, Maes, 2006). An additional measure is that the authorities should take steps towards establishing information gathering to ensure that the holding of multiple accounts does not lead to tax evasion.

Another tax incentive has been offered to encourage individual investment in second- and third-pillar pension schemes, so as to complement the low replacement rate in the first-pillar pension scheme. In response to ageing, households are increasingly focusing on longer term savings through individual and group life insurance and pension-saving funds, but this trend has been reinforced by the favourable tax treatment of pension products. In the case of pension-savings funds, the investment is deductible from households' taxable income up to a certain ceiling. Although it is not generous, by international comparison this tax concession nonetheless distorts the composition of household saving (Yoo and de Serres, 2004). The taxation of savings should become more neutral not only *vis-à-vis*

products within the same area, but also across product areas. A guiding principle in this area might be the EU rule for withholding tax on cross-border deposits. This could be applied to domestic savings accounts and introduce the same rate to all financial instruments.

The third tax provision that shapes households' financial decisions is the deductibility of mortgage loan repayments. This tax provision was introduced to support home ownership and improve the quality of housing. Even though these goals appear to have been achieved – as judged by the high level of home ownership by international standards – the maximum permissible amount of tax deduction was nevertheless increased in 2005, unlike the trend observed in other countries (Box 5.4). Under the new fiscal regime, tax deductibility is applied to all mortgage expenses, which include interest payments, capital repayments and life insurance premiums. The new legislation introduces a fixed amount (indexed to price developments) of what can be deducted from the borrower's taxable income at his or her marginal tax rate.[23] Moreover, these amounts are doubled for co-habiting households. Empirical studies suggest that the tax deductibility may have been internalised, at least partially, into higher house prices, although the complexity of the various tax incentives make such results subject to caution (IMF, 2006). The optimal taxation of housing is based on the neutrality criterion. This implies that housing should be taxed the same way as alternative investments (Van den Noord & Heady, 2001). As it is the case for taxation for investments, tax issues for housing arise at three

Box 5.4. **Tax subsidies for households with mortgage loans**

In the following countries a reduction in tax deductibility of mortgage loan repayments has been implemented:

- Sweden reduced the tax deductibility of mortgage interest payments over a period of time (1985-1991). The maximum deductible rate declined from 50% in 1985 to 30% in 1991.
- The United Kingdom fully phased out the tax deductibility of mortgage interest payments over the course of 25 years (1974-1999). First, a nominal ceiling was introduced on the size of mortgages eligible for interest deductibility. Second, the tax rate at which interest on debt below the ceiling could be deducted was gradually lowered to zero.
- In Denmark, the tax value of interest deductibility was reduced in several steps during the 1980s and 1990s. As the marginal tax rates for capital income were reduced from 46% to 33%, this reduces the tax value of deductible interest payments.
- In the Netherlands several steps have been taken to limit mortgage interest deductibility when owner-occupiers withdraw housing equity: since 1997, they have not been permitted to claim interest deductions on equity withdrawals from their existing residence except for home improvements; since 2001, the period during which mortgage interest payments could be deducted from personal income has been limited to 30 years and, more importantly, a cut in tax rates has effectively lowered tax subsidies for high income earners by about 20%; and, from the beginning of 2004, owner occupiers can only deduct interest on that part of the mortgage that is equal to the home's value minus the equity withdrawal from the former home (OECD, 2004).
- In France, the tax credit equal to 25% of mortgage interest payments, conditional on being the principal residence and only for the first five years after the purchase, was abolished in 1997.

levels: the acquisition of the house (which is equivalent to a financial investment), the imputed rent and capital gains (equivalent to the return on investment) and the liquidation of the invested capital when the house is sold. Tax neutrality is reached when the three levels are treated in a symmetric manner. This is the case when either a taxed-taxed-exempt (TTE) or an exempt-taxed-taxed (ETT) scheme is applied to the three levels and comparable tax rates are used. Currently, imputed rentals are below comparable private market values and realised capital gains are not taxed after a holding period of five years (Carey, 2003). This implies that Belgium is close to applying a TEE tax schedule. In such circumstances, an additional favourable tax treatment on mortgage loans favours the allocation of capital towards owner-occupied housing at the expense of possibly more productive uses. Against the background of the already high degree of owner-occupied housing and the possible distorting effects of the tax provision on deductibility of mortgage loan repayments, the tax subsidy scheme should be reduced in scope and, at the least, be restricted to the interest component.

Conclusion

The Belgian financial system is generally sound and has been supportive of economic activity. Indeed, the sector does not appear to be in need of major reforms. Nevertheless, it would appear that the interaction of a highly concentrated retail banking sector, tax policies and consumer protection legislation have reduced competition. To rectify the situation, there is a need to make tax policies more neutral across financial instruments and rebalance consumer protection legislation towards enhancing competition. Moreover, the current dominance of the four largest banks suggests that additional competitive pressures are most likely to arise from further market entry. To facilitate the latter, the authorities should limit national regulation and support the implementation of EU directives on the creation of a single internal financial market. In addition to these broad recommendations, the set of detailed policy recommendations is summarised in Box 5.5.

Box 5.5. **Policy recommendations to enhance the benefits from financial liberalisation**

Measures favouring the cross-selling of products by *bancassurance* conglomerates

- The explicit regulation allowing tying of a mortgage interest rate reduction and the purchase of certain insurance products should be abolished to stimulate price transparency and thus increasing competitive pressures.
- More generally, to further strengthening competition and contestability in the financial market, the competition authorities should assess if current cross-selling practices are in line with the common set. of competition principles across the economy.

Measures to facilitate households' access to credit

- Modernise home equity withdrawal legislation to allow consumption smoothing for households, facilitate pension financing and enable intergenerational transfers of capital gains.
- Further reduce the real estate transactions costs to stimulate the market for mortgages.
- To deepen mortgage loan markets, appropriate legislation on mortgage bonds (covered bond legislation) should be introduced.
- The lengthy foreclosure period of non-performing loans should be lowered to comparable levels in other countries.
- Caps on early repayment fees should be cost-based to allow creditors to charge a fair and objective fee to compensate the loss.
- Regulation of adjustment caps on interest rates should be phased out and left to individual decisions.
- Stimulate thorough empirical research on the various effect of the interest rate grid on consumer credit, including evaluations of such measures as making the grid of maximum interest rates indicative of what is considered non-usury rates, to contribute to a debate among interested parties and to help the government to formulate possible reforms.
- Enhance competition by promoting the principle of "full harmonisation" of the EU consumer credit directive with a minimum of national legislation on top of EU requirements.
- The authorities should focus more on consumer information and financial literacy through financial education programmes as knowledgeable informed borrowers help to foster competition, in particular in transition to a broader and deeper financial market.

Tax treatment of households' financial transactions

- Tax rules should be more neutral to decrease distortions in the allocation of savings. In particular, given the poor targeting of the tax exemption on savings accounts, this measure should be reconsidered. It would be preferable to introduce the same tax rate for domestic savings accounts as those applied to intra-EU cross-border deposits.
- Tax deductibility granted to mortgage loans should be re-evaluated against its original goal of home ownership and should at least be restricted to the interest component.

Notes

1. Loans granted to households have increased by 35% since 1999 and loans to small firms by 56% over the same time period. In the insurance sector, per capita life insurance premiums have increased by 166% between 1996 and 2003.
2. *Fortis* is a large Belgo-Dutch institution.. The Dutch group *ING* has a strong presence in Belgium, via its subsidiaries ING Bank Belgium and ING insurance Belgium. *Dexia* is a Belgo-French Group. The Belgian-owned *KBC* has a strong presence in the financial markets in Central and Eastern Europe.
3. The limited availability of quoted shares is partly the result of the historical prevalence of industrial conglomerates (so-called *holdings*). These holdings typically organise their portfolio to keep controlling equity stakes in a number of companies from different sectors and diversify their risk exposure. As a consequence, these substantial amounts of shares are unavailable for day-to-day trading. However, the importance of holdings is diminishing.
4. Over the period 1995-2005, quoted shares accounted only for 5% of the cumulative new liabilities of non-financial corporations.
5. A high number of foreign (specialised) financial institutions are operating on the Belgian market, evidence of the high degree of internationalisation of the Belgian economy (revealed by, among other things, the substantial inward FDI-flows and the large number of foreign workers). Nevertheless the market share of the four largest for the major *bancassurance* conglomerates in the major retail segments (saving deposits, sight deposits, mortgages) remain high and relatively stable.
6. The data for Figures 9, 10 and 13 were taken from the European Commission Retail Banking Survey which was published in the interim report II "Current accounts and related services". The latter document was published within the framework of the European Commission's inquiry into competition in financial services, pursuant to Article 17 of Regulation (EC) No. 1/2003. The financial services sector enquiry focuses on three areas: payments cards, core retail banking and business insurance. The Retail Banking Survey was based on a sample of around 250 banks that covered each of the 25 Member States.
7. This insurance serves to finance outstanding housing debt in case the borrower's decease prior to full repayment.
8. The introduction of reverse mortgages on the Belgian financial market is currently under consideration.
9. The European Commission is concerned that this may lead to tax discrimination as citizens who move from another EU-Member State to Flanders and buy a house there cannot get a credit for the registration tax that they had paid on the purchase of a house in their Member State of origin. In early 2007, the European Commission decided to refer Belgium to the European Court of Justice.
10. Funding through the financial markets mostly takes the form of covered mortgage bonds and mortgage-backed securities. Both are based on trading the rights to the borrower's agreed stream of payments. Mortgage-backed securities is a funding and risk transfer technique where the bank or finance company originator of mortgage loans sells and/or transfers these loans to an independent special purpose company or vehicle in return for cash payment. A covered mortgage bond is typically a mortgage securitisation where the bank of finance company keeps the loans on its balance sheet, and the legal rights as well as the underlying loans satisfy conditions set out in a law regulating the issuance of covered bonds. As one of the few remaining countries in Europe without this kind of legislation, Belgium does not allow mortgage institutions to operate.
11. In the context of establishing a market for mortgage-backed securities, the financial institutions were asked whether the development of such a market would benefit from mortgage bond legislation. However, the institutions showed little interest as they use the special purpose vehicle of undertaking collective investment in debt securities mentioned above for securitising their outstanding mortgage loans.
12. Unlike in other European countries, lenders in Belgium may directly access part of the borrower's earnings without a court order.
13. According to data from the Credit Registry at the National Bank of Belgium the market share of the banks (monetary financial institutions) for consumer credit excluding mortgages is around 70%. They dominate the market for instalment loans, the largest market segment, and they have market share of around 55% for credit openings (including credit cards). The consumer credit specialists have the largest market share for instalment sales.
14. The CICR records all information relating to all consumer credits and mortgage loans by national persons as well as any payment defaults resulting from these loans.

15. This amount is less than one-third of net income after taxes of a single average production worker with no children earning 67% of average wage. Debt is recorded as in default on the criteria; that payments are more than three months overdue; or that three instalments have not been paid; or non-payment after one month in the case that a formal notice has been served.

16. In addition, investment decisions are also affected by the general absence of capital gain taxation.

17. This number includes fiscal expenditures related to savings accounts (€ 406 million), life insurance premium and mortgage capital repayments (€ 230 million), pension savings (€ 246 million), group life insurance (€ 86 million), mortgage interest payments (€ 325 million), other mortgage related expenses (€ 846 million). Source: Chambre des représentants de Belgique (2006). These estimates are calculated using the "revenue foregone" method, which is a static *ex post* calculation that is widely used because of the relative ease of computation.

18. The exemption is conditional on the requirement of a tiered remuneration structure, consisting of a base rate and premia, whereby the limits for the base rate and the various premia are set at 4% and 2%, respectively. The non-cumulative premia consist of an accrual premium and a loyalty premium, the former applying to new inflows into savings books that remain on the account for at least 12 months, and the latter applying to outstanding savings account balances that remain on the account for at least 12 months.

19. The spread paid by Belgian government bonds above German government bonds was about 80 basis points during 1991-94.

20. Valenduc (2003) compares the rate of return and the effective taxation rate of tax-preferred saving accounts and a one-year bank deposit (subject to tax). The tax exemption does not mean that effective taxation is zero. The author computes a quasi-taxation that results from the regulation of interest rates. While the funds are readily available to the investor wishing to withdraw them, the choice of the one-year bank deposit as an alternative investment is justified given the "dormant" character of most saving accounts. Although there might be a bias in these calculations as a one-year bank deposit does not provide the holder with the same liquidity as a tax-preferred saving account.

21. The highest income per customer for deposit and saving accounts is actually reported for Luxembourg and Cyprus, but for confidentiality reasons the figures for these countries could not be given (EC, 2006).

22. The variable gross income captures all revenue that banks make on banking activity, covering interest and non-interest sources. Clearly not all gross income is paid directly from consumers to banks. A saver earning a rate of interest may receive interest payments from their bank while the bank uses the saver's capital to earn higher returns elsewhere (EC, 2006).

23. The European Commission has sent Belgium a formal request to amend its legislation concerning tax relief for owner-occupied houses. A person resident in another Member State and owning a dwelling with a mortgage there and obtaining his income entirely or almost exclusively from work performed in Belgium will thus not be able to benefit from the tax relief related to his mortgage loan in the same way as a person resident in Belgium. According to the European Commission, this constitutes an infringement of the free movement of workers.

Bibliography

Ahearne A.G. *et al.* (2005), "Housing prices and Monetary Policy: A Cross-Country study", *International Finance Discussion Papers No. 841*, Board of Governors of the Federal Reserve System.

Allen F., L. Bartiloro and Kowalewski (2005), "The Financial System of the EU25".

Attanasio O., J. Banks and M. Wakefield (2004), "Effectiveness of Tax Incentives to Boost (Retirement) Savings: Theoretical Motivation and Empirical Evidence", *in OECD Economic Studies* No. 39, 2004/2.

Baugnet, V. and G. Wuyts (2006), "Le rôle des actions dans le financement des sociétés en Belgique", *Revue Économique de la Banque Nationale de Belgique*, September.

Babeau A. (2006), "La demande des ménages en matière de crédit à la consommation et les ajustements nécessaires pour y répondre", report by the BIPE for the CSSF, January.

Beck, T., A. Demirguc-Kunt, and R. Levine, "Bank Concentrations and Crises". World Bank, mimeo.

BIS (2006), "Housing Finance in the Global Financial Market", *Committee on the Global Financial System Papers* No. 26.

Carey, D. (2003), "Tax Reform in Belgium", *OECD Economics Department Working Papers* No. 354.

Cihak and Podpiera (2006), "Is One Watchdog Better Than Three? International Evidence with Integrated Financial Sector Supervision.", *IMF Working paper* WP/06/57.

Degryse, H. and S. Ongena (forthcoming), "Competition and Regulation in Retail Banking", *OECD Competition Policy Roundtable*, OECD, Paris, forthcoming.

De Serres, A., S. Kobayakawa, T. Sløk and L. Vartia (2006), "Regulation Of Financial Systems And Economic Growth", *OECD Economics Department Working Paper* No. 506.

Dewachter, H., M. Lyrio and K. Maes (2006), "A Multi-Factor Model For The Valuation And Risk Management Of Demand Deposits", *NBB Working Paper Research No.* 83, May.

Dynan K., D.W. Elmendorf and D.E. Sichel, (2006), "Can Financial Innovation Help to Explain the Reduced Volatility of Economic Activity?" *Journal of Monetary Economics*, Vol. 53.

European Commission (2006), "Interim Report II Current Accounts And Related Services", Sector inquiry under Article 17 Regulation 1/2003 on retail banking, July.

EMF (2004), "Study On The Cost Of Housing", *www.hypo.org*.

EMF (2005), "Hypostat 2004 – A Review of Europe's Mortgage and Housing Markets", *www.hypo.org*.

EMF (2006a), "Study On The Cost Of Housing In Europe", Brussels.

EMF (2006b), "Study On Interest Rate Variability In Europe", Brussels.

Ernst, E. and R.A. Compton (2007), "An Examination of the Changing Transmission from Banking to Growth: Evidence from the OECD", *OECD Economics Department Working Paper*, forthcoming.

Federal Reserve (2006), "Controlling Interest: Are Ceilings on Interest Rates a Good Idea?", *www.chicagofed.org/consumer_information/controlling_interest.cfm*.

Hypostat (2003) *European Housing Finance Review* (2004).

IMF (2006), "Belgium's Financial System – Stability Assessment", *IMF Country Report* No. 06/75.

Kamakura, W., M. Wedel, F. de Rosa and J.A. Mazzon (2003), "Cross-Selling through Database Marketing: A Mixed Data Factor Analyzer for Data Augmentation and Prediction", *International Journal of Research in Marketing*, 20 (2003) 45-65.

Leahy, M., S. Schich, G. Wehinger, F. Pelgrin and T. Thorgeirsson (2001), "Contributions of Financial Systems To Growth in OECD Countries", *OECD Economics Department Working Paper* No. 280.

Maes, K. and T. Timmermans (2005), "Measuring the Interest Rate Risk of Belgian Regulated Savings Deposits", in *NBB Financial Stability review* pp. 136-151.

Mercer Oliver Wyman (2003), "Study on the Financial Integration of European Mortgage Markets", European Mortgage Federation, Brussels, October.

NBB (2006a), *Financial Stability review*, Brussels.

NBB (2006b), "Statistieken, Centrale voor kredieten aan particulieren", June.

OECD (2004), *Economic Survey of the Netherlands*, OECD, Paris.

OECD (2005), "Improving Financial Literacy, Analysis of Issues and Policies", OECD, Paris.

OECD (2006), *Economic Survey of Denmark*, OECD, Paris.

Pozzi, L., F. Heylen and M. Dossche (2004), "Government Debt and Excess Sensitivity of Private Consumption: Estimates from OECD Countries", *Economic Inquiry*, Vol. 42, No. 4, October.

Valenduc (2003), "Effective Taxation of Household Savings in Belgium", Paper presented at the 59th Congress of the International Institute for public finance "Public Finance and Financial Markets".

Van den Noord, P. and C. Heady (2001), "Surveillance of Tax Polices: A Synthesis of Findings in Economic Surveys", *OECD Economics Department Working Paper* No. 303.

Villegas (1989), "The impact of Usury Ceilings on Consumer Credit", *Southern Economic Journal* 56, pp. 126-141, July.

Test Aankoop (2006), "Beste koop gratis en voor niets", in *Budget en Recht* No. 185, March/April.

Yoo, K.Y. and A. de Serres (2004), "Tax Treatment of Private Pension Savings in OECD Countries and the Net Tax Cost Per Unit of Contribution to Tax-Favoured Schemes", *OECD Economics Department Working Paper* No. 406.

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(10 2007 03 1 P) ISBN 978-92-64-03186-9 – No. 55463 2007

Belgium

Special Feature: Financial Markets and Economic Performance

Economic Surveys
Most recent editions
Australia, July 2006
Austria, July 2005
Belgium, March 2007
Canada, June 2006
Czech Republic, June 2006
Denmark, May 2006
Euro area, January 2007
Finland, May 2006
France, September 2005
Germany, May 2006
Greece, September 2005
Hungary, July 2005
Iceland, August 2006
Ireland, March 2006
Italy, November 2005
Japan, July 2006
Korea, November 2005
Luxembourg, July 2006
Mexico, November 2005
Netherlands, December 2005
New Zealand, September 2005
Norway, January 2007
Poland, June 2006
Portugal, April 2006
Slovak Republic, September 2005
Spain, January 2007
Sweden, February 2007
Switzerland, January 2006
Turkey, October 2006
United Kingdom, November 2005
United States, December 2005

Non-Member Economies
Most recent editions
Baltic States, February 2000
Brazil, November 2006
Bulgaria, April 1999
Chile, November 2005
China, September 2005
Romania, October 2002
Russian Federation, November 2006
Slovenia, May 1997
Federal Republic of Yugoslavia, January 2003

www.oecd.org

ISSN 0376-6438
2007 SUBSCRIPTION
(18 ISSUES)

OECD
OECDPUBLISHING

Volume 2007/3 – March 2007

ISBN 978-92-64-03186-9
10 2007 03 1 P

9 789264 031869