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# **OECD Economic Surveys: Belgium 2015**

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## Table of contents

<b>Basic statistics of Belgium, 2013</b> .....	7
<b>Abbreviations and acronyms</b> .....	8
<b>Executive summary</b> .....	9
Main findings .....	10
Key recommendations .....	11
<b>Assessment and recommendations</b> .....	13
Challenges facing Belgium .....	14
Tax reform to promote growth, employment and environmental quality .....	25
<i>Recommendations to secure fiscal sustainability while promoting employment and competitiveness</i> .....	29
Improving the labour market integration of immigrants .....	29
<i>Recommendations to improve the labour market integration of immigrants</i> .....	38
Maintaining an efficient and equitable housing market .....	38
<i>Recommendations to maintain an efficient and equitable housing market</i> .....	45
Bibliography .....	45
<b>Annex. Progress in main structural reforms</b> .....	49

### Thematic chapters

<b>Chapter 1. Improving the labour market integration of immigrants</b> .....	55
Immigration has reached record highs, but integration remains challenging .....	56
Integration and migration policies for better skills and job matching .....	62
General labour market settings often reduce the employment prospects of immigrants .....	67
The educational outcomes of the children of immigrants need improvement. ...	70
<i>Recommendations to improve the labour market integration of immigrants</i> .....	76
Bibliography .....	77
<b>Chapter 2. Maintaining an efficient and equitable housing market</b> .....	79
The affordability and adequacy of the housing market is deteriorating .....	80
Residential mobility is mediocre, leading to various inefficiencies .....	89
Making the most of the Regions' new competences .....	93
Strengthening the rental market through a shift in public support .....	93
Expanding the housing stock and improving its quality .....	97
Increasing efficiency and equity of housing taxation .....	101
<i>Recommendations to maintain an efficient and equitable housing market</i> .....	103
Bibliography .....	104

**Boxes**

1. The 2013 cooperation agreement on fiscal policy . . . . .	25
1.1. The distribution of competences for integration and migration policies . . . . .	67
2.1. Valuation of the housing market . . . . .	82
2.2. Spatial structure of the housing stock . . . . .	88
2.3. Aggregate impact of high homeownership on labour market outcomes . . . . .	92

**Tables**

1. Macroeconomic indicators and projections . . . . .	19
2. Fiscal indicators . . . . .	20
3. Early exits from the labour force for older workers . . . . .	24
2.1. Housing cost overburden is high for lower-income groups . . . . .	85
2.2. Number of households will grow faster than population in the medium term . . . . .	87

**Figures**

1. The recovery is still hesitant . . . . .	15
2. Bank lending to the domestic private sector remains weak . . . . .	16
3. Low competitiveness weighs on export growth . . . . .	16
4. Well-being outcomes are above average . . . . .	18
5. Income distribution is relatively equal . . . . .	18
6. Debt simulations . . . . .	20
7. Expected increases in pension costs . . . . .	21
8. Main components of public expenditure . . . . .	23
9. Spending on passive labour market measures is high . . . . .	24
10. The tax structure is tilted towards labour income . . . . .	26
11. The yield of the value-added tax is relatively low . . . . .	26
12. The labour tax wedge is very high . . . . .	27
13. Greenhouse gas emissions in transport and residential sectors . . . . .	28
14. The employment rate of immigrants is low . . . . .	30
15. Non-EU immigrants have poorer labour market performance . . . . .	31
16. Immigrants have poorer job characteristics . . . . .	31
17. Immigrants are highly concentrated in Brussels . . . . .	32
18. Unemployment and inactivity traps reduce work incentives . . . . .	34
19. Minimum wages are fairly high . . . . .	35
20. Children of immigrants underperform by a wide margin . . . . .	36
21. Children of immigrants are over-represented in disadvantaged schools and lower education tracks . . . . .	37
22. Real house prices have stabilised after a steep increase . . . . .	39
23. Household spending on housing has increased moderately . . . . .	40
24. Tenants are most affected by housing cost . . . . .	41
25. Homeownership is widespread outside Brussels . . . . .	41
26. Housing stock evolved in line with demand . . . . .	43
27. Residential mobility is mediocre . . . . .	44
1.1. Immigration has increased and become more diverse . . . . .	56
1.2. Immigrants are an essential mainstay of the Belgian labour force . . . . .	57
1.3. The employment rate of immigrants is low . . . . .	58
1.4. Non-EU immigrants have poorer labour market performance . . . . .	59
1.5. Immigrants have poorer job characteristics . . . . .	59

1.6. Many immigrants face poverty and social exclusion .....	60
1.7. The share of low-educated immigrants is high .....	61
1.8. Immigrants are highly concentrated in Brussels .....	61
1.9. Immigration for non-labour motives is large .....	62
1.10. Minimum wages are fairly high .....	68
1.11. Unemployment and inactivity traps reduce work incentives .....	69
1.12. Children of immigrants underperform by a wide margin .....	71
1.13. Performance differences between schools are large .....	72
1.14. Children of immigrants are over-represented in disadvantaged schools and lower education tracks .....	72
2.1. Real house prices have significantly increased .....	80
2.2. House and land prices have outpaced construction prices .....	81
2.3. House prices are highest in Brussels .....	81
2.4. Price of cheaper houses has increased most .....	82
2.5. Some indicators point to a large overvaluation of the housing market .....	82
2.6. Debt-service costs are high despite low interest rates .....	83
2.7. Household spending on housing has increased moderately .....	85
2.8. Tenants are most affected by housing cost .....	86
2.9. Homeownership is widespread outside Brussels .....	87
2.10. Residential mobility is mediocre .....	89
2.11. Road traffic congestion is high .....	90
2.12. Nitrogen oxide emissions are above agreed levels .....	91
2.13. Provincial employment and unemployment rates vary widely .....	92
2.14. Rents for social housing are tightly controlled .....	95
2.15. Tenant-landlord regulations in the private rental market appear balanced .....	97
2.16. Housing stock evolved in line with demand .....	98
2.17. Good building plots have become scarcer .....	99
2.18. Taxation of housing is skewed towards non-recurrent taxes .....	101
2.19. Transaction costs are high .....	102

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 24 November 2014. 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 5 December 2014.

The Secretariat's draft report was prepared for the Committee by Álvaro Pina and Sanne Zwart under the supervision of Pierre Beynet. Research assistance was provided by Desney Erb. The survey also benefitted from external consultancy work.

The previous Survey of Belgium was issued in May 2013.

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**Basic statistics of Belgium, 2013**  
(Numbers in parentheses refer to the OECD average)\*

<b>LAND, PEOPLE AND ELECTORAL CYCLE</b>				
Population (million)	11.2		Population density per km <sup>2</sup>	366.7 (34.7)
Under 15 (%)	17.1	(18.2)	Life expectancy (years, 2012)	80.5 (80.2)
Over 65 (%)	17.8	(15.6)	Men	77.8 (77.5)
Foreign-born (% , 2012)	15.2		Women	83.1 (82.9)
Latest 5-year average growth (%)	0.9	(0.6)	Latest general election	May 2014
<b>ECONOMY</b>				
Gross domestic product (GDP)			Value added shares (%)	
In current prices (billion USD)	525		Primary sector	0.8 (2.5)
In current prices (billion EUR)	395		Industry including construction	22.5 (26.8)
Latest 5-year average real growth (%)	0.4	(0.8)	Services	76.7 (70.5)
Per capita (000 USD PPP)	41.9	(37.0)		
<b>GENERAL GOVERNMENT</b>				
Per cent of GDP				
Expenditure	54.4	(42.5)	Gross financial debt	117.6 (110.8)
Revenue	51.5	(36.8)	Net financial debt	90.0 (69.9)
<b>EXTERNAL ACCOUNTS</b>				
Exchange rate (EUR per USD)	0.753		Main exports (% of total merchandise exports)	
PPP exchange rate (USA = 1)	0.847		Chemicals and related products, n.e.s.	28.6
In per cent of GDP			Machinery and transport equipment	20.1
Exports of goods and services	82.8	(53.4)	Manufactured goods	15.4
Imports of goods and services	81.4	(49.4)	Main imports (% of total merchandise imports)	
Current account balance	0.1	(-0.1)	Chemicals and related products, n.e.s.	23.3
Net international investment position	42.9		Machinery and transport equipment	21.8
			Mineral fuels, lubricants and related materials	18.8
<b>LABOUR MARKET, SKILLS AND INNOVATION</b>				
Employment rate for 15-64 year-olds (%)	61.8	(65.2)	Unemployment rate, Labour Force Survey (age 15 and over) (%)	8.4 (7.9)
Men	66.4	(73.1)	Youth (age 15-24, %)	23.7 (16.1)
Women	57.2	(57.4)	Long-term unemployed (1 year and over, %)	3.9 (2.7)
Participation rate for 15-64 year-olds (%)	67.5	(71.1)	Tertiary educational attainment 25-64 year-olds (% , 2012)	35.3 (32.2)
Average hours worked per year	1 570	(1 771)	Gross domestic expenditure on R&D (% of GDP, 2012)	2.2 (2.4)
<b>ENVIRONMENT</b>				
Total primary energy supply per capita (toe)	5.0	(4.2)	CO <sub>2</sub> emissions from fuel combustion per capita (tonnes, 2012)	9.4 (9.7)
Renewables (%)	5.7	(8.8)	Water abstractions per capita (1 000 m <sup>3</sup> , 2009)	0.6
Fine particulate matter concentration (urban, PM10, µg/m <sup>3</sup> , 2011)	28.7	(28.0)	Municipal waste per capita (tonnes, 2012)	0.5 (0.5)
<b>SOCIETY</b>				
Income inequality (Gini coefficient, 2010)	0.264	(0.308)	Education outcomes (PISA score, 2012)	
Relative poverty rate (% , 2010)	9.5	(11.1)	Reading	509 (496)
Median equivalised household income (000 USD PPP, 2010)	24.4	(20.4)	Mathematics	515 (494)
Public and private spending (% of GDP)			Science	505 (501)
Health care (2012)	10.9	(9.2)	Share of women in parliament (% , October 2014)	42.4 (26.7)
Pensions (2011)	10.4	(8.7)	Net official development assistance (% of GNI)	0.45 (0.37)
Education (primary, secondary, post sec. non tertiary, 2011)	4.4	(3.9)		

Better life index: [www.oecdbetterlifeindex.org](http://www.oecdbetterlifeindex.org)

\* Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

Source: Calculations based on data extracted from the databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

## Abbreviations and acronyms

<b>CSF</b>	Conseil supérieur des finances (High Council of Finance)
<b>ECB</b>	European Central Bank
<b>ECEC</b>	Early childhood education and care
<b>EEA</b>	European Economic Area
<b>EPL</b>	Employment protection legislation
<b>ETS</b>	Emissions trading scheme
<b>EU</b>	European Union
<b>EUR</b>	Euro
<b>GDP</b>	Gross domestic product
<b>IMF</b>	International Monetary Fund
<b>LOPs</b>	<i>Lokale overlegplatforms</i> (local negotiating platforms)
<b>NBB</b>	National Bank of Belgium
<b>PES</b>	Public employment service
<b>PISA</b>	Programme for international student assessment
<b>PIT</b>	Personal income tax
<b>PPP</b>	Purchasing power parity
<b>PSO</b>	Public service obligations
<b>VAT</b>	Value-added tax
<b>ULC</b>	Unit labour cost
<b>USD</b>	United States dollar

## Executive summary

- *Main findings*
- *Key recommendations*

## Main findings

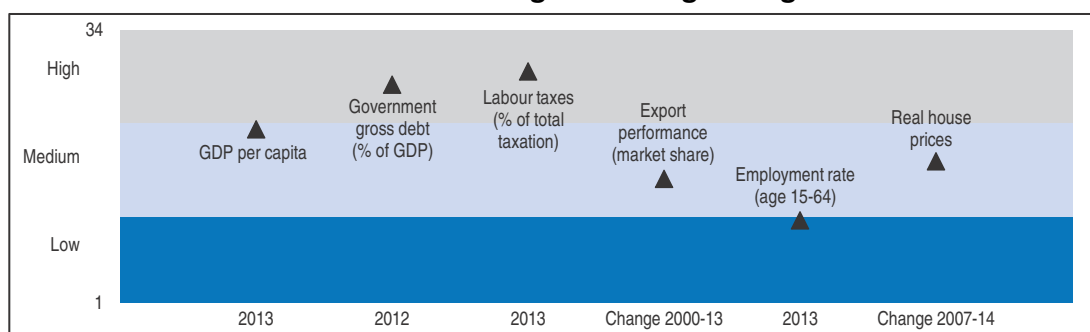
Belgium has returned to growth and halted the deterioration in external competitiveness, while continuing to score well on broader measures of well-being. The authorities have reduced budget deficits and substantially reformed fiscal federalism arrangements. However, the recovery is still fragile, long-term growth is held back by low employment rates and eroded cost competitiveness, and public debt remains uncomfortably high. For vulnerable groups, notably immigrants, labour market integration remains difficult and, for many, housing conditions have deteriorated.

**Securing fiscal sustainability while promoting employment and competitiveness.** Public debt is set to hover around 100% of GDP if no further progress is made in fiscal consolidation. The absence of domestic multi-year expenditure ceilings makes spending-based consolidation and medium-term expenditure reforms more difficult. There is nonetheless considerable scope for these reforms, as public expenditure is high, reflecting public consumption and social transfers, particularly pensions. On the revenue side, taxation relies heavily on social contributions and personal income taxes, in contrast to more employment-friendly tax bases, such as consumption and environmental taxes. Employment and competitiveness have also suffered from a wage setting process with insufficient regard to domestic productivity developments.

**Improving the labour market integration of immigrants.** Immigrants already account for almost a fifth of the working-age population, but their employment rates and wages, especially among those born outside the European Union, remain very low. Immigrants are over-represented in low-skill jobs, under-represented in white-collar jobs and overall badly affected by poor labour market performance. These disadvantages often extend to their offspring. Shortcomings in integration and training policies make it difficult for immigrants to build up human and social capital. Further, their children tend to be concentrated in disadvantaged schools, which often lack experienced teachers. Plans to reduce grade repetition and increase the age at which students are tracked into vocational programmes should help the children of immigrants, and so should more workplace training in those programmes.

**Maintaining an efficient and equitable housing market.** Housing conditions in Belgium are in general good. Homeownership is widespread and benefits from long-standing public support. However, the large increase in house prices of the past decade, fuelled by generous tax conditions, has led to overvaluation. The rental market is small, with long waiting lists for social housing and tenants in the private market spending an increasing share of their income on housing. Reflecting high transactions costs on home sales, residential mobility is mediocre, which may impede labour market flexibility, increases road congestion and raises greenhouse gas emissions from commuting.

### Selected economic indicators: Belgian ranking among OECD countries



Source: OECD (2014), OECD.Stat Database.

StatLink  <http://dx.doi.org/10.1787/888933180740>

## Key recommendations

### ***Securing fiscal sustainability while promoting employment and competitiveness***

- Reform the wage formation process, notably the system of wage indexation, to better reflect domestic productivity developments.
- Broaden tax bases and lower tax rates. Reduce labour taxes on low earners, and increase less growth-distorting taxes such as consumption and environmental taxes. An increase in taxation of capital income should also be considered.
- Make fiscal consolidation expenditure-based through savings in social transfers and public consumption.
- Raise the statutory and effective retirement age to enhance long-run debt sustainability.
- Increase energy taxation for residential use, reduce subsidies to commuting by car and introduce congestion charges in the largest cities.

### ***Improving the labour market integration of immigrants***

- Monitor and, where needed, reform school enrolment to reduce concentration of disadvantaged students in particular schools. Improve teacher training and incentives to attract more qualified and experienced teachers to disadvantaged schools.
- Proceed with reforms to reduce grade repetition and delay tracking in secondary education. Expand workplace-based learning in vocational education.
- As one way to improve labour market outcomes, in particular for the low-skilled, consider reintroducing lower statutory minimum wages for young workers.
- Continue to cooperate with social partners to further expand diversity plans in firms. Expand training offers, including on languages, and skill validation, as well as their articulation with diversity plans.

### ***Maintaining an efficient and equitable housing market***

- Take advantage of the current low interest rates to gradually remove the tax deductibility of interest and capital repayments on mortgage loans. Tilt housing taxation towards recurrent taxes and away from transaction taxes.
- Expand regional rental allowance schemes for low-income tenants renting on the private market. In parallel, increase subsidies for social rental agencies and make publicly-owned plots available for construction of affordable housing, notably by the private sector.
- Increase urban building densities by re-designating land and converting non-residential buildings, further easing restrictions on the construction of denser buildings, and increasing the costs of keeping urban land and buildings unused.



## Assessment and recommendations

- *Challenges facing Belgium*
- *Tax reform to promote growth, employment and environmental quality*
- *Improving the labour market integration of immigrants*
- *Maintaining an efficient and equitable housing market*

## Challenges facing Belgium

Belgium has made progress in reviving growth and halting the deterioration in external competitiveness, while continuing to fare comparatively well on most equity indicators. Budget deficits have been reduced and fiscal governance improved by entrusting enhanced monitoring responsibilities to an independent institution and establishing a budgetary coordination mechanism. Fiscal federalism arrangements have been substantially redesigned with the implementation of the Sixth State Reform. The federal government which took office in October 2014 has announced a multi-year policy programme, broadly in line with OECD recommendations, to achieve a balanced budget and increase employment and competitiveness. Reforms in these areas are needed since the recovery is fragile, long-term growth is held back by low employment rates and eroded cost competitiveness, and public debt sustainability is still not assured. Furthermore, the large foreign-born population suffers from poor employment prospects and poverty, and vulnerable groups have poor housing conditions and could face barriers to residential mobility in response to labour market opportunities.

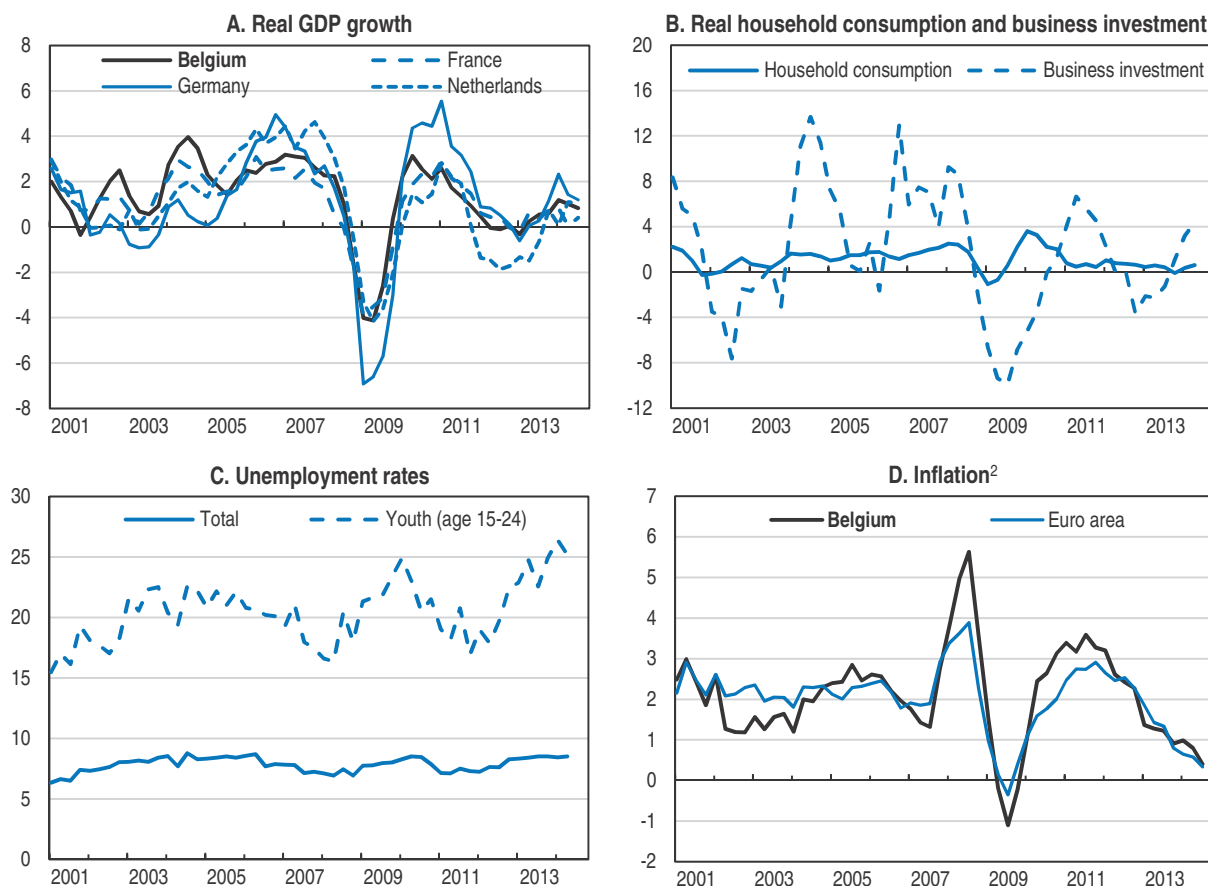
This Survey analyses ways to address these challenges and finds that:

- Pursuing fiscal consolidation is needed at all levels of government, with emphasis on savings in public consumption, in tandem with greater government efficiency, and social transfers. Pension and labour market reforms to enhance employment of older workers are key to ensuring long-run debt sustainability.
- Tax bases should be broadened and rates lowered. The tax burden should be shifted from labour towards less growth-distortive taxes.
- Improving the job prospects of immigrants requires developing their education and skills, in particular through a more equitable education and training system, and supporting both private and public employers to integrate a diverse workforce.
- Rent allowances and support to raise the rental market supply are needed given the many tenants facing high housing costs. The growing demand for housing close to centres of economic activity and related large price increases call for a densification of urban areas.

### ***Economic prospects remain fragile***

The Belgian economy withstood the global financial crisis relatively well and has been growing since early 2013 (Figure 1), but the recovery remains fragile. The pick-up in domestic demand, driven by household consumption and business investment, continues to spur economic activity, with further support coming from the firming of exports. However, weak confidence, low competitiveness, fiscal consolidation and economic slowdown in the euro area all currently weigh on growth prospects. At just above 1% per annum, overall real growth is well below pre-crisis levels.



Figure 1. **The recovery is still hesitant**Per cent<sup>1</sup>

1. Year-on-year percentage change except for Panel C.

2. Measured by the harmonised consumer price index.

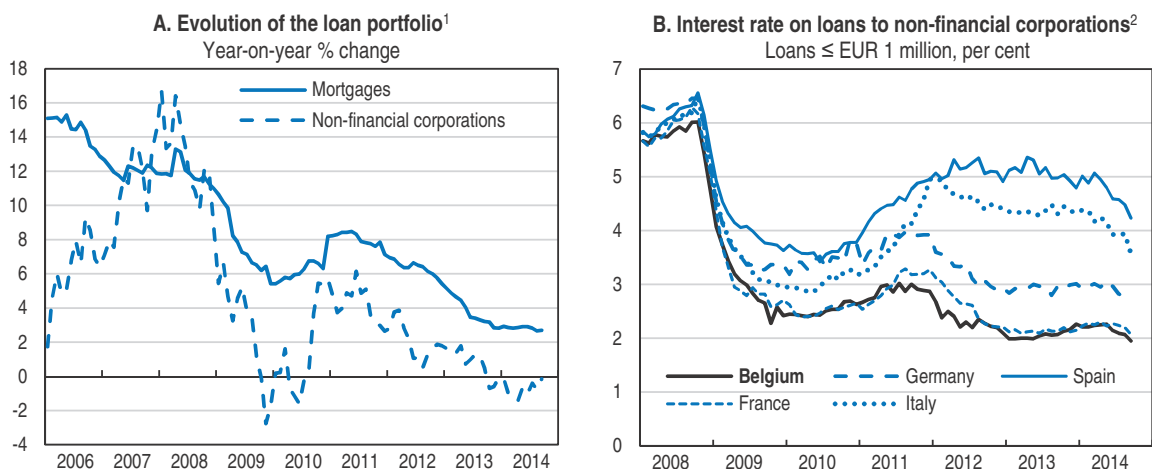
Source: OECD (2014), *OECD Economic Outlook: Statistics and Projections* and *OECD Employment and Labour Market Statistics* (databases), November.

StatLink  <http://dx.doi.org/10.1787/888933180757>

The banking sector has gone through a strong deleveraging process between 2008 and 2013, mainly by reducing trading and foreign activities. Banks' renewed focus on the domestic market supports credit provision to households and non-financial corporations. After lending to the non-financial corporate sector contracted in 2013 due to falling loans to large firms (Figure 2; NBB, 2014a), lending standards have started to ease gradually as risks subsided and competition between banks strengthened. In general, fewer small and medium-sized enterprises consider access to finance as the most pressing problem than in the rest of the euro area (ECB, 2014), which reflects the low interest rates.

Low international competitiveness has long hampered export growth (Figure 3). A relatively large share of exports goes to European Union (EU) countries and only a small fraction to fast-growing developing countries. Earlier increases in unit labour costs created a gap in cost competitiveness vis-à-vis Germany, France and the Netherlands.

Figure 2. **Bank lending to the domestic private sector remains weak**

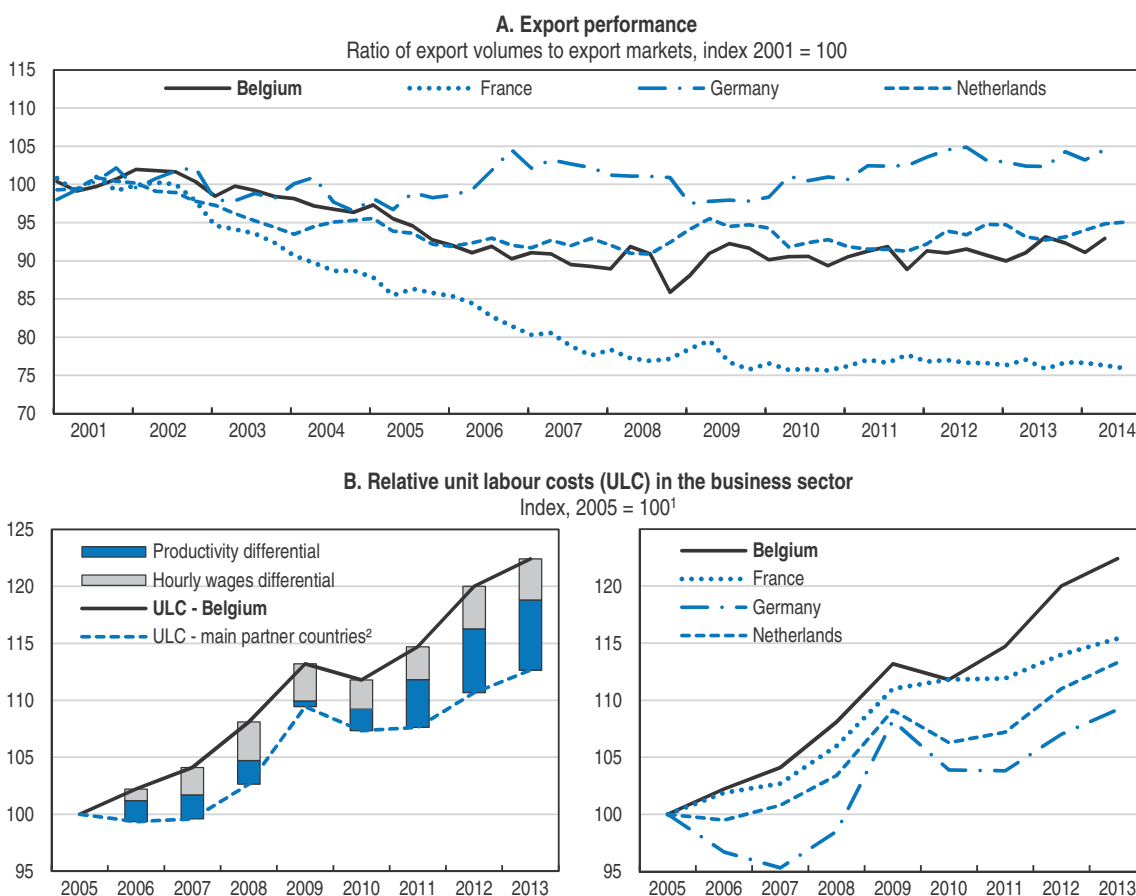


1. Including securitised loans. For non-financial corporations the data covers lending by resident banks to resident corporations.
2. New business loans in euros of up to one year maturity (excluding revolving loans and overdrafts, convenience and extended credit card debt).

Source: ECB (2014), Statistical Data Warehouse (database), European Central Bank, November and National Bank of Belgium.

StatLink <http://dx.doi.org/10.1787/888933180769>

Figure 3. **Low competitiveness weighs on export growth**



1. Non-agriculture business sector excluding real estate. In the left panel, the differentials show the aggregated contribution to the divergence in unit labour costs since 2005.
2. France, Germany and the Netherlands.

Source: OECD (2014), OECD Economic Outlook: Statistics and Projections and OECD Productivity Statistics (databases), December.

StatLink <http://dx.doi.org/10.1787/888933180774>

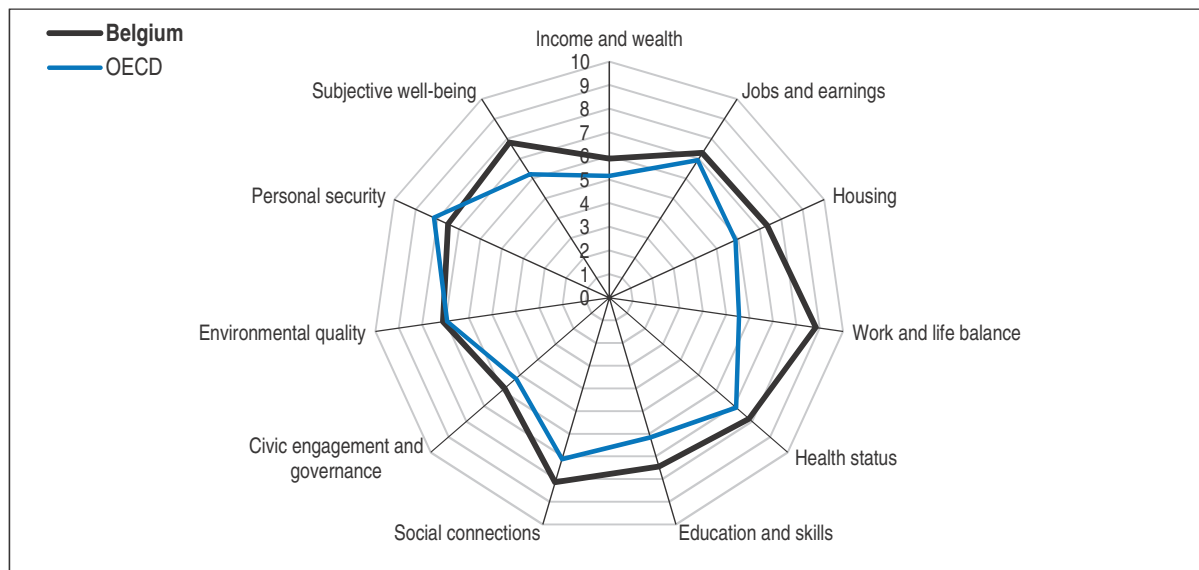
Even though projected wage developments in these countries impose a legal upper bound on real wage increases in Belgium, they tend to be linked to productivity growth, which on average was higher than in Belgium during the last decade. Moreover, Belgian wages increased even faster due to overestimation of wage growth abroad and automatic indexation that prevents wages from falling in real terms. The decision to keep real wages constant in recent years prevented a further deterioration of wage competitiveness, and the loss in export market share came to a halt in 2008. Several measures decided by the authorities, such as the temporary suspension of indexation and the planned cuts in social contributions, will provide further relief. But the wage formation process needs to be reformed to better reflect domestic productivity developments (OECD, 2013a). The adjustments proposed by the new government, most notably an automatic *ex post* correction mechanism to offset for future deviations, are a welcome step in this direction. Some progress has been made in recent years to increase non-cost competitiveness and productivity growth, especially through simplifying regulatory procedures, but the still restrictive regulation of retail distribution and professional services hampers competition, as do the high administrative burdens on start-ups (OECD, 2013b).

Despite the wage increases, households' financial situation has improved only slowly. The labour market has yet to benefit from the economic recovery and the unemployment rate has hovered around 8.5%, a historically high level. New entrants to the labour market are in a particularly difficult situation, as youth unemployment has in some recent quarters risen to 25% of those in the labour force. Inflation is close to the euro area average, and while its low level could support consumption, it may also create risks if it leads to deflationary pressures.

Well-being is high compared to other OECD countries (Figure 4), and Belgium is one of the few countries where, despite rising inequality of market income since the beginning of the crisis, inequality in disposable income has not increased (OECD, 2014a). Due to the step-up in redistributive transfers, which were already among the highest in OECD countries, the after-tax income inequality in Belgium remains low (Figure 5). Relative poverty increased only slightly in recent years, and the share of the population living on less than 50% of the median disposable income stands at 10%, which is below the OECD average of 12%.

Economic growth will remain moderate, reflecting the weak economic activity in the EU and feeble domestic demand, which is in part due to fiscal consolidation (Table 1). External risks are tilted to the downside. The possibility that euro area inflation will stay low and exacerbate weak demand poses a risk to the prospects for the Belgian economy. Geopolitical developments related to Ukraine could weaken European growth as well. Domestic risks stem from the vulnerabilities related to high public debt and historically high house prices. The current stabilisation of the latter could turn into a correction in case of a specific shock. On the other hand, higher than expected growth in the EU and eventually many announced structural reforms, including efforts to bring wages in line with domestic productivity, should raise growth.

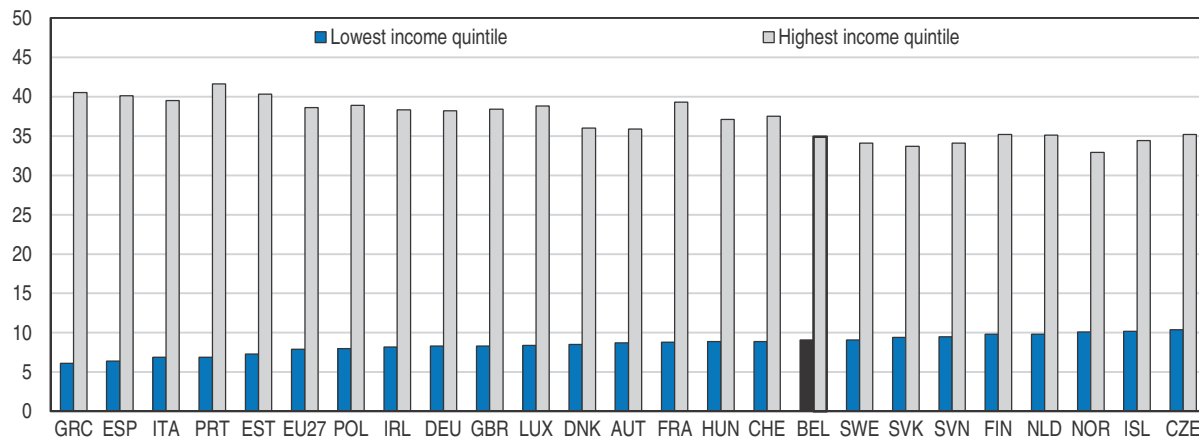
**Figure 4. Well-being outcomes are above average**  
Better life index, 2014<sup>1</sup>



1. Each well-being dimension is measured by one to four indicators from the OECD Better Life Index set. Normalised indicators are averaged with equal weights. Indicators are normalised to range between 10 (best) and 0 according to the following formula: (indicator value - minimum value) / (maximum value - minimum value) x 10.  
Source: OECD (2014), *OECD Better Life Index*, [www.oecdbetterlifeindex.org](http://www.oecdbetterlifeindex.org).

StatLink <http://dx.doi.org/10.1787/888933180780>

**Figure 5. Income distribution is relatively equal**  
Share of national equivalised income, per cent, 2013<sup>1</sup>



1. 2012 for Ireland.

Source: Eurostat (2014), "Income Distribution and Monetary Poverty", *Eurostat Database*, November.

StatLink <http://dx.doi.org/10.1787/888933180791>

**Table 1. Macroeconomic indicators and projections**  
Annual percentage change, volume (2012 prices)

	2011 Current prices (billion EUR)	2012	2013	2014	2015	2016
<b>Gross domestic product (GDP)</b>	<b>380.0</b>	<b>0.1</b>	<b>0.3</b>	<b>1.0</b>	<b>1.4</b>	<b>1.7</b>
Private consumption	195.1	0.8	0.3	0.7	1.1	1.5
Government consumption	90.5	1.4	1.1	0.1	-0.4	0.2
Gross fixed capital formation	87.3	0.0	-2.2	3.1	2.5	2.3
Housing	20.9	-0.5	-3.5	1.0	0.8	1.0
Business	57.8	-0.3	-1.2	4.3	3.5	3.2
Government	8.6	3.4	-5.4	0.6	-0.4	-0.8
Final domestic demand	372.9	0.8	-0.1	1.1	1.1	1.4
Stockbuilding <sup>1</sup>	5.3	-0.9	-0.8	-1.1	0.0	0.0
Total domestic demand	378.1	-0.1	-0.9	0.0	1.1	1.4
Exports of goods and services	309.3	1.9	2.9	3.5	3.9	4.1
Imports of goods and services	307.4	1.8	1.7	2.5	3.7	3.7
Net exports <sup>1</sup>	1.9	0.1	1.0	0.9	0.3	0.4
<b>Other indicators</b> (growth rates, unless specified)						
Potential GDP	..	1.0	1.0	1.2	1.4	1.6
Output gap <sup>2</sup>	..	-0.4	-1.1	-1.3	-1.3	-1.2
Employment	..	0.3	-0.3	0.4	0.6	0.9
Unemployment rate	..	7.7	8.4	8.5	8.4	8.1
GDP deflator	..	2.1	1.5	0.5	0.6	1.2
Consumer price index (harmonised)	..	2.6	1.2	0.6	0.7	1.2
Core consumer prices (harmonised)	..	1.9	1.4	1.5	1.0	1.2
Household saving ratio, net <sup>3</sup>	..	7.5	6.9	6.1	5.9	5.6
Current account balance <sup>4</sup>	..	-0.9	0.1	0.2	0.6	1.0
General government fiscal balance <sup>4</sup>	..	-4.1	-2.9	-2.9	-2.1	-1.3
Underlying general government fiscal balance <sup>2</sup>	..	-2.9	-2.2	-2.0	-1.3	-0.6
Underlying government primary fiscal balance <sup>2</sup>	..	0.3	0.7	0.8	1.3	1.8
General government gross debt (Maastricht) <sup>4</sup>	..	104.0	104.6	106.1	106.4	105.0
General government net debt <sup>4</sup>	..	91.5	90.0	91.6	91.9	90.5
Three-month money market rate, average	..	0.6	0.2	0.2	0.1	0.1
Ten-year government bond yield, average	..	3.0	2.4	1.7	1.2	1.2

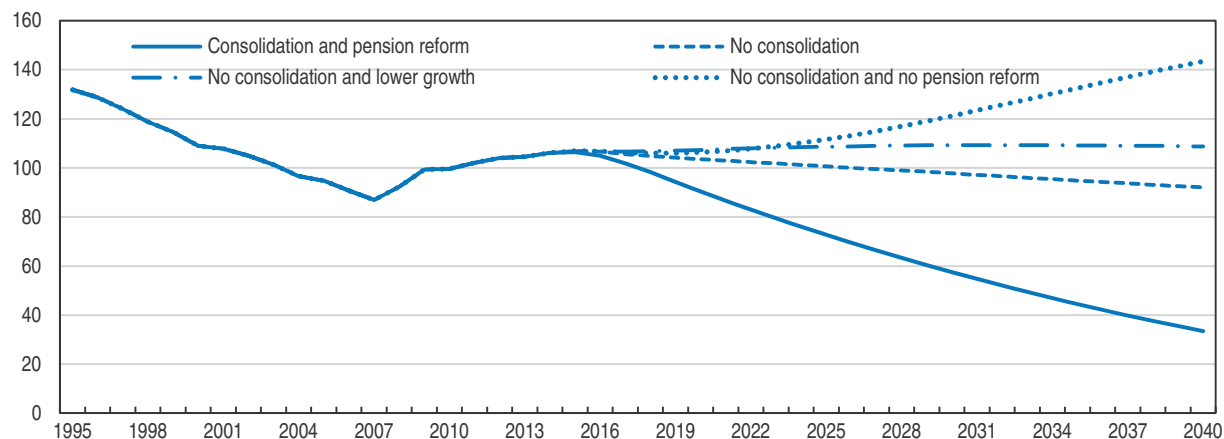
1. Contribution to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of household disposable income.
4. As a percentage of GDP.

Source: OECD (2014), "OECD Economic Outlook No. 96", *OECD Economic Outlook: Statistics and Projections* (database), November.

### **Additional consolidation to secure fiscal sustainability**

High and rising public debt (Figure 6) and heightened market pressure set consolidation efforts in motion once a government was formed in late 2011. In both 2012 and 2013, underlying fiscal adjustment (net of cyclical effects and one-offs) was about 0.7 percentage points of gross domestic product (GDP) enabling Belgium to bring the headline deficit below 3% of GDP and therefore exit the EU excessive deficit procedure (Table 2). Consolidation measures included both tax hikes and substantial spending restraint at all government levels, including only partial replacement of retiring staff and savings in health care, intermediate consumption and public investment (NBB, 2014b). However, rising pension outlays essentially offset these spending-side savings. This prevented a fall in the primary underlying spending ratio and made deficit reduction rely on rising revenues.

Figure 6. **Debt simulations**  
General government gross debt as a percentage of GDP<sup>1</sup>



1. The “consolidation and pension reform” scenario shows projections for the *Economic Outlook No. 96* until 2016, prolonged with the growth scenario used in the 2012 *Fiscal Sustainability Report* (GDP growth in the period 2017-40 averaging 1.6% in real terms and 3.6% in nominal terms). It assumes achieving budget balance in 2018 and a structural surplus of 0.75% of potential GDP in 2019-40. Nominal debt changes by the amount of the budget deficit, thus assuming no asset purchases or privatisations. The “no consolidation” scenario assumes that the budget deficit stabilises over 2015-40 at the level projected for 2014 (2.9% of GDP). The “no consolidation and lower growth” scenario is identical to the previous scenario and assumes that nominal GDP growth is lower by 1 percentage point per year in 2017-40. The “no consolidation and no pension reform” scenario assumes that the budget deficit increases over 2015-40 by the same amount as public pension expenditure (as projected in the 2012 *Fiscal Sustainability Report*).

Source: Calculations based on OECD (2014), *OECD Economic Outlook: Statistics and Projections* (database), November and European Commission (2012), *Fiscal Sustainability Report 2012*, European Economy, No. 8.


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Table 2. **Fiscal indicators**  
General government, as a percentage of GDP or potential GDP<sup>1</sup>

	2005	2009	2010	2011	2012	2013	2014 <sup>2</sup>	2015 <sup>2</sup>	2016 <sup>2</sup>
Fiscal balance	-2.6	-5.5	-4.0	-3.9	-4.1	-2.9	-2.9	-2.1	-1.3
Underlying fiscal balance	-0.6	-4.1	-3.6	-3.6	-2.9	-2.2	-2.0	-1.3	-0.6
Primary fiscal balance	1.4	-2.1	-0.8	-0.8	-0.9	0.0	0.0	0.5	1.1
Underlying primary fiscal balance	3.4	-0.8	-0.4	-0.5	0.3	0.7	0.8	1.3	1.8
Total revenue <sup>3</sup>	48.1	47.5	48.1	49.1	50.4	51.3	51.1	50.7	50.5
Underlying total revenue <sup>3</sup>	47.9	47.4	48.1	49.1	50.2	50.6	50.6	50.3	50.1
Primary spending	46.7	49.6	48.9	49.8	51.4	51.3	51.1	50.2	49.4
Underlying primary spending	44.6	48.3	48.5	49.5	50.0	49.9	49.8	49.0	48.3
Fiscal one-offs	-2.1	-0.5	-0.2	-0.7	-1.1	-0.1	-0.1	-0.1	-0.1
Gross debt (Maastricht)	94.7	99.3	99.6	102.1	104.0	104.6	106.1	106.4	105.0

1. Underlying fiscal variables are net of cyclical effects and one-offs.

2. Projections

3. Excluding gross interest receipts.

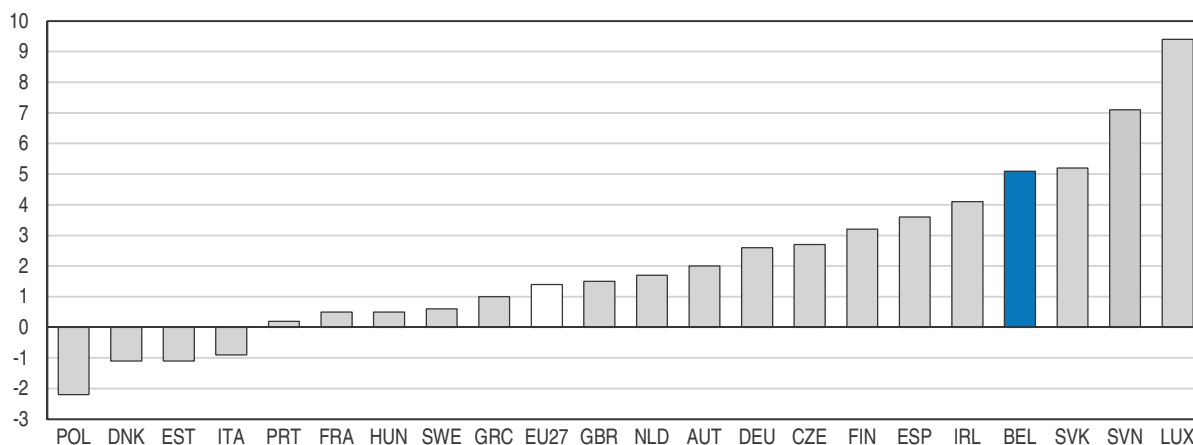
Source: OECD (2014), “OECD Economic Outlook No. 96”, *OECD Economic Outlook: Statistics and Projections* (database), November.

Ensuring debt sustainability requires further consolidation, which slowed down in 2014. Under an average nominal GDP growth of 3.5%, if Belgium attains a 0.75% of GDP structural surplus towards the end of this decade (its current medium-term objective under EU fiscal rules), and then preserves it, debt will decline markedly (Figure 6, “consolidation and pension reform” scenario). In contrast, if the headline deficit stabilises at the 2014 level, the debt ratio will decline only very slowly (“no consolidation” scenario in Figure 6). Strong nominal growth will be critical, as the debt ratio will not fall at all if real

growth or inflation are weaker (“no consolidation and lower growth” in Figure 6). High debt will leave public finances vulnerable to large negative shocks, such as a recession or the materialisation of contingent liabilities (discussed below).

Under legislation up to 2013, the projected long-run rise in pension expenditure is one of the highest in Europe (Figure 7), mainly reflecting a modest increase in the low employment rate among older workers and in the associated low effective retirement age, which worsens the impact of demographic ageing. If the projected increase in pension spending were not offset (by spending cuts elsewhere, or higher taxes) or contained, the deficit would rise over time and debt would be unsustainable (the “no consolidation and no pension reform” scenario in Figure 6). Pension reform is thus key to debt sustainability, and is also crucial to reconcile consolidation with stronger long-term growth.

Figure 7. **Expected increases in pension costs**  
Percentage points of GDP, 2010-60<sup>1</sup>



1. For Belgium, the projections include the effects of the 2012 tightening of early retirement, as well as a first estimate of those of the 2013 reform of pension bonuses, as expected at the time.

Source: European Commission (2012), *Fiscal Sustainability Report 2012*, European Economy, No. 8.

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In 2013, the authorities reformed pension bonuses for continued work after eligibility for early retirement, making them consistent with the 2012 tightening of early retirement rules and somewhat increasing incentives for longer careers (CSF, 2013). Although welcome, these measures are projected to yield savings of only 0.6% of GDP by 2060. The authorities should therefore further increase age and career length requirements for early retirement, as planned, in tandem with a higher statutory retirement age (now 65) indexed to life expectancy. The announced gradual increases in the statutory retirement age (to 67) and in the eligible age for early retirement would be steps in this direction. Increasing the effective retirement age through pension reform and activation policies (see below), possibly combined with enhanced incentives for companies to hire older people, would promote long-term employment and growth with no short-run negative impact on activity (Cournède et al., 2014). However, given that the ensuing budget savings will accrue only gradually, achieving consolidation targets may also require smaller increases of existing pensions in the short and medium run (Commission de réforme des pensions 2020-40, 2014).

Contingent liabilities, such as government guarantees and the debt of public entities classified outside general government, on which information is often limited, pose additional risks to public debt sustainability. Financial sector guarantees fell by almost 4 percentage points during 2013 to 12.1% of GDP, and a further reduction took place during 2014. Nevertheless, linkages between banks and the sovereign remain strong as banks' public exposure is increasingly concentrated on Belgium while further reductions in public support for Dexia, a fragile "bad bank" being wound down, will be more gradual during the years ahead.

Former budget reporting practices, coupled with weak restrictions on borrowing by state-owned enterprises outside the general government perimeter (Fredriksen, 2013), have long prevented a comprehensive view of the Belgian public sector and its liabilities. In 2014, efforts to systematically identify state-owned enterprises led to a substantially enlarged perimeter of the public sector, and of its subset classified as general government. Together with methodological changes, this made general government debt increase by around 8% of GDP, mainly at regional and local levels. This is a significant improvement although the overall indebtedness of the broader public sector is unknown yet. The authorities should continue to improve budget reporting to ensure full coverage of the balance sheets and contingent liabilities of the public sector, and publish that information. The authorities should also introduce limits on borrowing by state-owned enterprises and ensure that any off-budget vehicles maximise value for money when compared to traditional public procurement (Araújo and Sutherland, 2010).

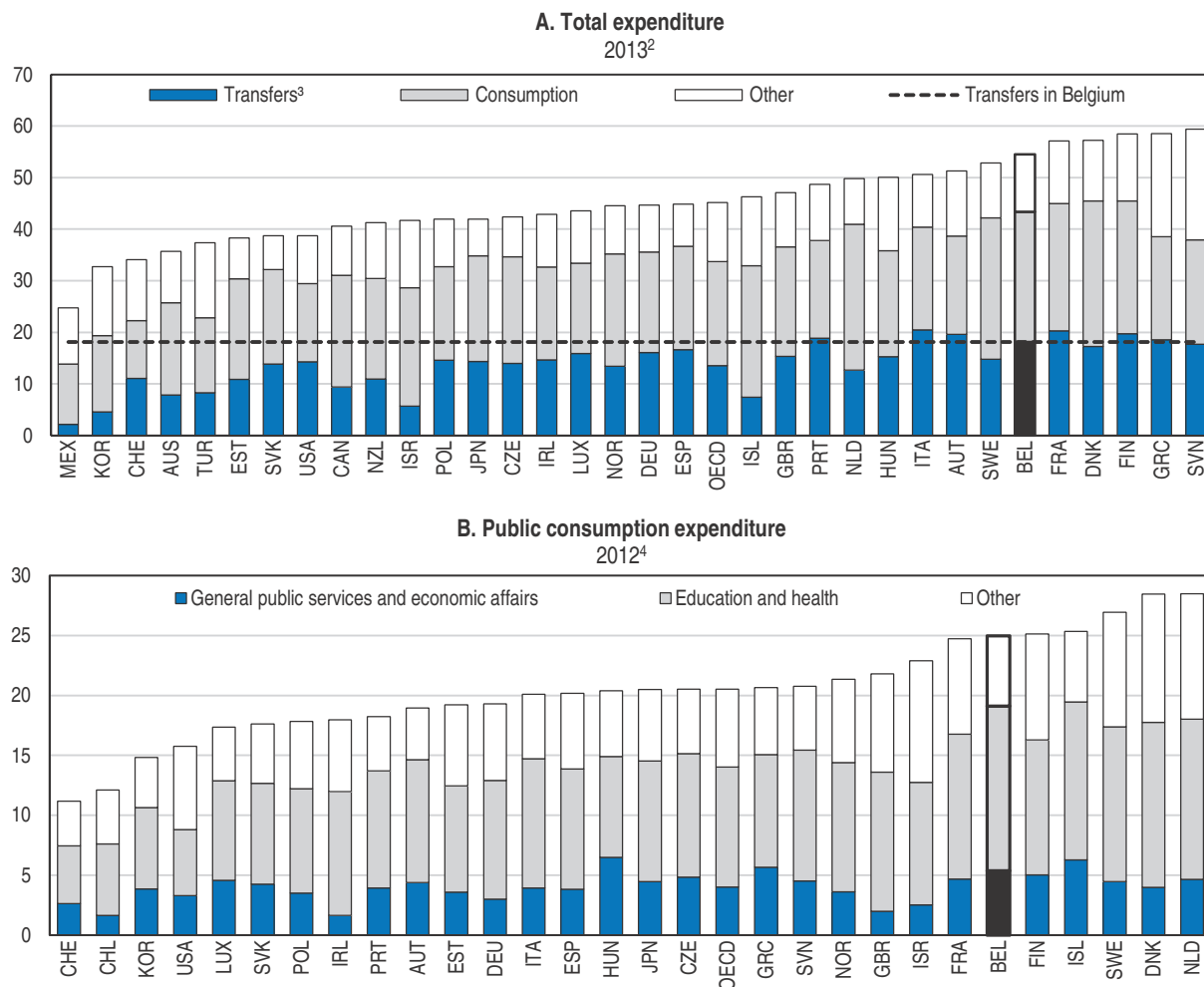
### **Reforms in social transfers and public consumption can reconcile consolidation and growth**

Belgium's high public expenditure offers scope for a larger role of spending restraint in fiscal consolidation, especially as regards social transfers and public consumption (Figure 8). Reforms in social transfers, if properly designed, can yield budget savings while spurring potential growth and preserving wellbeing. In the long run, the positive effects on employment alleviate equity concerns (Cournède et al., 2014). In the coming years, despite a rising contribution from Regions and Communities, the larger part of the total consolidation effort will still fall on the federal government (CSF, 2014a). Its main fiscal levers are taxes and social transfers, the latter accounting for 71% of federal government and social security primary spending in 2013, excluding grants to other levels of government.

In social transfers other than pensions, savings are achievable in the short and medium run by restricting non-pension routes for early labour market exit. Belgium's high spending on unemployment benefits (Figure 9) and fast-rising invalidity outlays largely stem from exits to unemployment with no job search obligations or to invalidity, which, for those aged 50 to 64, are jointly larger than exits to pensions (Table 3). Exit routes to unemployment have been gradually tightened, with the latest reforms in the area adopted in 2012 (OECD, 2013a), but remain substantial. As planned, the authorities should thus further restrict access to unemployment with a company supplement (a top-up to the unemployment benefit) and extend job search obligations up to the pension age, coupled with intensified assistance and monitoring, to all those unemployed. As for invalidity, growing use of this exit route since 2000 suggests a need for stricter gate-keeping and enhanced reintegration. All these measures should be accompanied by increased activation efforts to reinforce the employability of older workers, especially those aged over 55, who account for a low share in hiring and a high share in firing (Saks, 2014). Greater on-the-job training would help on this count.



Figure 8. **Main components of public expenditure**  
General government expenditure as a percentage of GDP<sup>1</sup>



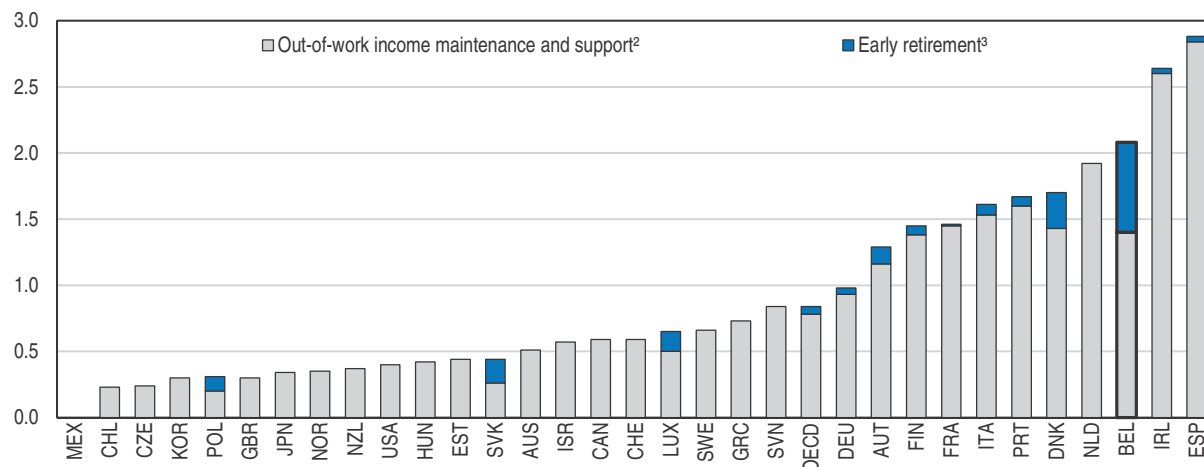
1. Institutional differences across countries (for instance, in the organisation of education, health and pension systems) may affect the accounting of expenditure and therefore international comparability. The OECD aggregate is an unweighted average.
2. 2012 for Australia, Canada, Israel, Japan, Korea, Mexico, New Zealand, Switzerland and the OECD aggregate; 2011 for Turkey.
3. Social benefits other than social transfers in kind, payable.
4. 2011 for Austria.

Source: OECD (2014), "General Government Accounts", OECD National Accounts Statistics (database), October.

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Reducing public consumption will require targeted efforts at all levels of government. In areas other than education (including spending on public research) and health, Belgium has considerable scope for economies, especially by streamlining general public administration (Figure 8, Panel B). All levels of government should step up efforts in this direction. In education and health care, efficiency-enhancing reforms have the potential to reduce spending while preserving service provision (Sutherland and Price, 2007; OECD, 2010). An example in education, building on recent progress, would be to eliminate the possibility that teachers stop working (while retaining most of their salary) before qualifying for early retirement (*mise en disponibilité*). Reforms in health care were extensively discussed in the 2013 OECD Economic Survey of Belgium (OECD, 2013a).

Figure 9. **Spending on passive labour market measures is high**  
Public expenditure as a percentage of GDP, 2012<sup>1</sup>



- 2011 for Australia, Ireland, Israel, Luxembourg, Poland, Spain and United States; 2010 for Greece and United Kingdom. The data shown should not be treated as strictly comparable since data at the level of individual countries in some cases deviate from standard definitions and methods. For details of coverage see notes to Table P in [www.oecd.org/els/emp/employment-outlook-statistical-annex.htm](http://www.oecd.org/els/emp/employment-outlook-statistical-annex.htm).
- Unemployment benefits (full, partial or part time unemployment insurance and assistance), redundancy and bankruptcy compensation.
- For Belgium, early retirement spending consists of unemployment benefits for older unemployed exempt from job search, who in some cases also receive a company supplement.

Source: OECD (2014), "Labour market programmes: expenditure and participants", *OECD Employment and Labour Market Statistics* (database), November.

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Table 3. **Early exits from the labour force for older workers<sup>1</sup>**  
As a percentage of population in corresponding group

	Age 50-54		Age 55-59		Age 60-64		Total, age 50-64	
	2000	2013	2000	2013	2000	2013	2000	2013
Pensions	1.3	1.0	3.8	3.3	41.7	29.0	14.4	10.2
Unemployment with a company supplement, exempt from job search	1.3	0.0	7.2	3.7	13.0	12.3	6.6	4.9
Unemployed exempt from job search	8.1	0.0	11.1	2.5	5.3	8.2	8.2	3.3
Disability	5.7	7.7	7.5	9.6	6.4	8.9	6.5	8.7
Other <sup>2</sup>	0.3	0.1	0.3	0.2	0.0	0.0	0.2	0.1
<b>Total</b>	<b>16.6</b>	<b>8.9</b>	<b>29.8</b>	<b>19.2</b>	<b>66.5</b>	<b>58.4</b>	<b>35.8</b>	<b>27.2</b>

- Estimated totals obtained from a combination of data not necessarily relating to the same period or where the registration time may differ. Pension data for 2000 does not necessarily exclude potential double counting for mixed careers; it was assumed that the share of mixed careers in total pensions was identical to that of 2013. Overall figures thus obtained are therefore only indicative. In addition, they do not necessarily reflect the number of inactive persons according to harmonised labour force surveys, since gainful employment is sometimes allowed in addition to the benefit received.
- Full-time credit and career break.

Source: Y. Saks (2014), "Employees: Too Expensive at Age 50? The Age Component in Wage Setting", *Economic Review*, June, National Bank of Belgium.

### Further improving fiscal rules

Debt sustainability requires fiscal discipline at all levels of government, underpinned by fiscal rules with strong monitoring and enforcement mechanisms. Belgium has long emphasised numerical targets for budget balances, but until 2014 deviations from targets entailed in practice no consequences. In a welcome development, as of 2015 the High Council of Finance (an independent institution) will exercise enhanced monitoring responsibilities, which include, if slippages are detected, taking part in a bilateral correction procedure with the level of government involved. These responsibilities follow from a 2013 cooperation agreement between all levels of government (Box 1).

### Box 1. The 2013 cooperation agreement on fiscal policy

On 13 December 2013, the Belgian authorities adopted a cooperation agreement to implement the EU Fiscal Compact in Belgian legislation. This agreement has been endorsed by all levels of government and is therefore underpinned by a large consensus. It stipulates that the general government sector should reach the medium-term objective as defined in the Stability and Growth Pact and enhances the responsibilities of the High Council of Finance (henceforth “the Council”), a long-standing independent fiscal council.

First, in the context of the preparation of the Stability Programme, the Council is to deliver an Opinion with recommended multi-annual budget targets to promote fiscal sustainability in the medium and long term. These targets are set in nominal and structural terms for each level of government, taking into account a fair burden-sharing of the fiscal consolidation efforts. On the basis of that Opinion, the federal, regional and community governments have to conclude an agreement on the fiscal path and its breakdown.

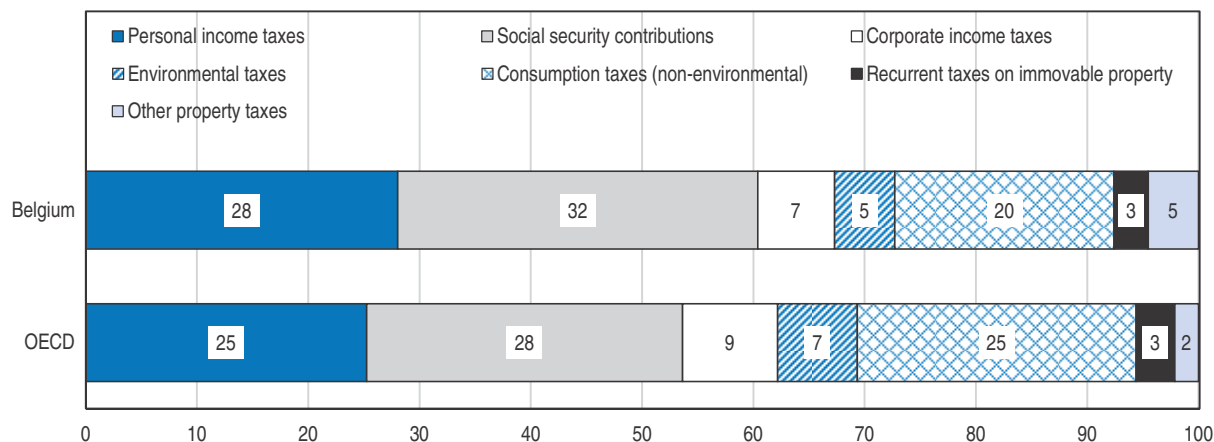
Second, the cooperation agreement also tightens up enforcement of the fiscal rules by strengthening the Council’s monitoring responsibilities. The Council will monitor the different governments’ budget outcomes and, in the event of any significant deviation from targets, will trigger a correction mechanism. In such cases, the government in question will have to implement additional consolidation measures in a limited timeframe to attain its target. The Council will monitor the implementation of these corrective measures.

Expenditure rules setting multi-year ceilings on broad spending aggregates at each level of government would support spending-based consolidation and medium-term expenditure reforms. In the nineties, a ceiling for federal government expenditure, later abandoned, arguably helped to contain the growth of outlays and bring them down as a share of GDP (Van Meensel and Dury, 2008). At present, however, with the exception of a ceiling for health care spending (discussed in OECD, 2013a), no level of government in Belgium is bound by domestic expenditure rules. This contrasts with the growing adoption of such rules across Europe (European Commission, 2013). While each level could have substantial autonomy in setting its spending ceilings, monitoring should be entrusted to the High Council of Finance, as for budget balance targets.

## Tax reform to promote growth, employment and environmental quality

The Belgian tax system presents two broad sets of problems. First, the structure of taxation is heavily tilted towards labour income, which penalises growth and employment (Johansson et al., 2008), not least through higher labour costs and lost competitiveness. In contrast, the less distortive consumption and green taxes are under-exploited (Figure 10). Heavy labour taxation has been only slightly mitigated by the gradual increase in wage subsidies over the past decade (by around 1.2% of GDP). Second, due to numerous tax expenditures, a “narrow base – high rate” approach prevails (Valenduc, 2013), which generally worsens distortions and complexity. Reforms to address these problems, long overdue and now being planned by the authorities, may also play a role in closing consolidation gaps in the near future.

Shifting the tax burden from labour towards consumption can yield both employment and equity gains. For the value-added tax (VAT), extensive reduced rates (6% on basic necessities, most renovation works, and a range of other items and, to a much smaller extent, 12% on some hotel, restaurant, and construction services) imply foregone revenue

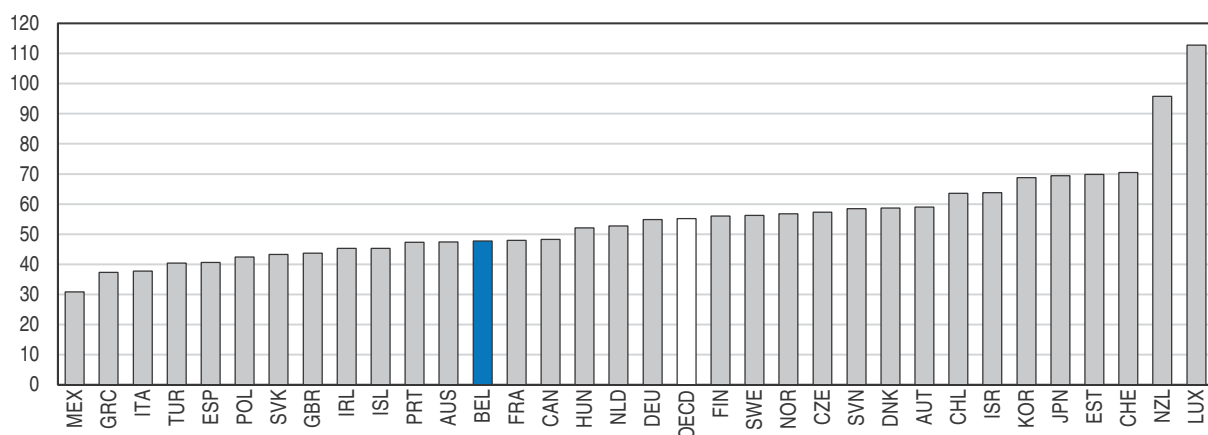
Figure 10. **The tax structure is tilted towards labour income**Tax revenues as a percentage of total tax revenues, 2012<sup>1</sup>

1. The OECD aggregate is an unweighted average excluding Chile and Mexico.

Source: OECD (2014), "Revenue Statistics", OECD Tax Statistics and "Green Growth Indicators", OECD Environment Statistics (databases).

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of over 2% of GDP and are the main factor behind the below-average efficiency in VAT collection (Figure 11). Reduced rates on food and other basic necessities are generally redistributive but poorly targeted, as most benefits accrue, in absolute terms, to the better off. Other reduced rates, such as those on restaurants and hotels, are regressive, as benefits to the rich are larger both in absolute terms and as a proportion of expenditure (OECD, 2014b). The authorities should suppress VAT reduced rates, starting with those goods and services where impacts are regressive.

Figure 11. **The yield of the value-added tax is relatively low**Value-added tax revenue ratio, per cent, 2012<sup>1</sup>

1. The VAT revenue ratio (VRR) is defined as the ratio between the actual value-added tax (VAT) revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. This ratio gives an indication of the efficiency of the VAT regime in a country compared to a standard norm. It is estimated by the following formula:  $VRR = \text{VAT revenue} / ([\text{consumption} - \text{VAT revenue}] \times \text{standard VAT rate})$ . VAT rates used are standard rates applicable as at 1 January of each year. The fact that public consumption is VAT-exempt under EU rules places an upper bound on the attainable VRR, especially in countries with a large public sector, such as Belgium. The OECD aggregate is an unweighted average and data for Canada cover federal VAT only.

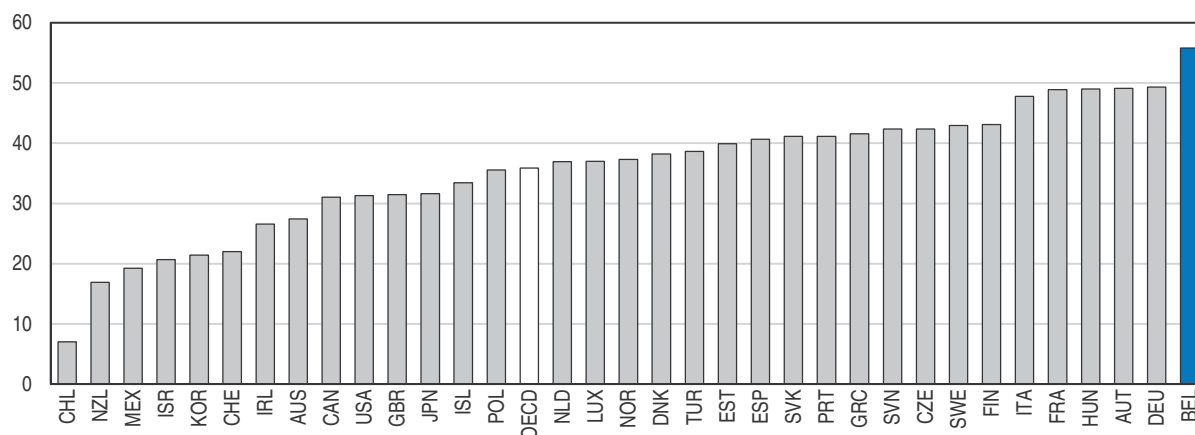
Source: OECD (2014), *Consumption Tax Trends 2014: VAT/GST AND Excise Rates, Trends and Policy Issues*.

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Labour tax wedges are among the highest in the OECD (Figure 12), and deter both labour demand and supply. The wedge reflects onerous social contributions, especially on employers, and heavy personal income tax on wages, where marginal rates quickly reach 50%. Reductions in taxes and contributions targeted on very low wages likely maximise job creation for unskilled workers, but their early phasing out generates high marginal tax wedges at quite modest wage levels. In Belgium, these marginal wedges currently near 80% at less than two-thirds of the average wage (OECD, 2014c), which creates low-wage traps and discourages upskilling. Spikes in marginal tax wedges should be reduced or smoothed, for instance by a more gradual phasing-out of targeted wedge reductions.

Figure 12. **The labour tax wedge is very high**<sup>1</sup>

As a percentage of labour costs, 2013



1. Sum of personal income tax and employee plus employer social security contributions together with any payroll tax less cash transfers. For a single individual without children at the income level of the average worker. For Belgium the labour tax wedge may be slightly overstated, as computations only take account of one category of wage subsidies (representing around one sixth of the total amount of those subsidies).

Source: OECD (2014), "Taxing Wages: Comparative tables", OECD Tax Statistics (database).

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To shift the tax burden away from labour, tax expenditures on capital income should also be tackled, as they induce significant revenue losses and distortions. Broadening the savings tax base can yield higher revenue and better equity, for example by increasing taxation of capital gains, which is very low in Belgium (Harding, 2013; CSF, 2014b). With regard to corporate taxation, an allowance for corporate equity introduced in 2006 reduced the leverage of Belgian firms, which is positive. However, despite the gradual implementation of anti-abuse measures, multinationals have taken advantage of this allowance for aggressive tax planning, such as intra-group transactions which give rise to double deductions (Zangari, 2014). In the framework of coordinated international efforts to fight corporate tax avoidance, the authorities should tighten the rules governing the allowance for corporate equity to avoid that it is used to artificially shift profits within a multinational enterprise group.

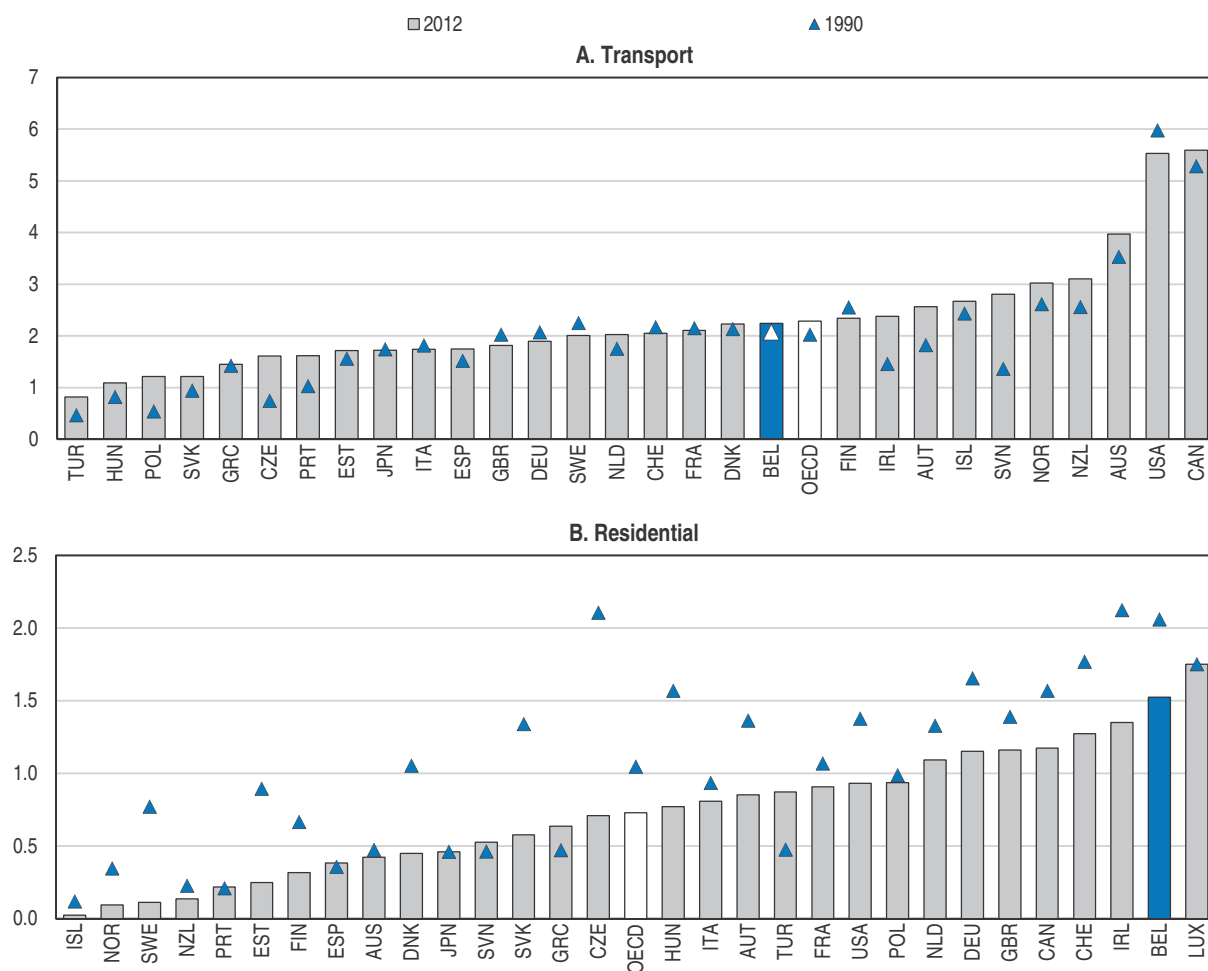
### **Greening the tax system and tackling greenhouse gas emissions**

Belgium has been making progress in reducing greenhouse gas emissions, but meeting its 2020 abatement targets will be challenging, while urban congestion and air pollution continue to weigh on wellbeing. Energy industries and manufacturing have driven the overall decline in emissions since the mid-2000s, mainly due to a shift from

solid to gaseous fuels, growth in electricity generation from renewable sources and the closure of some iron and steel works. Further renewable energy development, backed by efficient and flexible gas generation units, is required to compensate the lost power production stemming from the planned phasing-out of nuclear power by 2025. This will require a stable regulatory framework that promotes cost efficiency. In contrast, insufficient progress has been achieved in the two main non-emissions trading scheme (ETS) sectors: transport, whose emissions increased by 20.5% in 1990-2012 (though with some stabilisation from the mid-2000s); and housing, where emissions decreased, but remain very high in comparison with OECD countries (Figure 13). As a consequence, under existing and currently envisaged policies, Belgium is expected to miss its 2020 target for emissions from non-ETS sectors of a 15% reduction relative to 2005 levels (CNC, 2013). Belgian cities are heavily congested (OECD, 2013a) and air quality is one of the few dimensions of well-being where Belgium does not outperform the OECD average (OECD, 2013c).


Figure 13. **Greenhouse gas emissions in transport and residential sectors**

Thousand tonnes of carbon dioxide (CO<sub>2</sub>) equivalent emissions per capita<sup>1</sup>



1. Excluding land use, land-use change and forestry. The OECD aggregate is an unweighted average excluding Chile, Israel, Korea and Mexico; in Panel A Luxembourg is also excluded.

Source: UNFCCC (2014), GHG Data, United Nations Framework Convention on Climate Change, July and OECD (2014), *Demography and Population* (database).

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There is extensive scope to make the tax system more environmentally friendly. Environmental excises are internationally low, especially due to low taxation of energy for non-transport uses (OECD, 2013d). A variety of energy subsidies and tax expenditures, such as reduced VAT rates on coal and, more recently, electricity, further weakens incentives to economise on residential energy use. In addition, subsidies to energy-saving investments sometimes favour cost-inefficient technologies, such as solar energy (OECD, 2011). Massive commuting, subsidised through several tax expenditures in personal and corporate income taxes (OECD, 2013a), raises transport emissions and, in urban areas, congestion and air pollution. Similar effects follow from the generous tax treatment of company cars as a fringe benefit for employees (Harding, 2014). As discussed in Chapter 2, the authorities should increase energy taxation for residential use. Further, they should also reduce transport subsidies and make greater use of road pricing, especially location and time-dependent. Introducing congestion charges in the largest cities (OECD 2013a), informed by the lessons from the 2014 road pricing pilot project in the Brussels area, would be a welcome first step. In both energy and transport, accompanying measures to prevent adverse redistributive impacts would be needed.

### **Recommendations to secure fiscal sustainability while promoting employment and competitiveness**

#### **Key recommendations**

- Reform the wage formation process, notably the system of wage indexation, to better reflect domestic productivity developments.
- Broaden tax bases and lower tax rates. Reduce labour taxes on low earners, and increase less growth-distorting taxes such as consumption and environmental taxes. An increase in taxation of capital income should also be considered.
- Make fiscal consolidation expenditure-based through savings in social transfers and public consumption.
- Raise the statutory and effective retirement age to enhance long-run debt sustainability.
- Increase energy taxation for residential use, reduce subsidies to commuting by car and introduce congestion charges in the largest cities.

#### **Additional recommendations**

- Introduce multi-year expenditure rules at all levels of government, with monitoring by the High Council of Finance.
- Further improve budget reporting to ensure full coverage of the balance sheets and contingent liabilities of general government and other entities under public control, and publish these data.
- Tighten rules governing the allowance for corporate equity to avoid its use for artificially shifting profits within a multinational enterprise group.

## **Improving the labour market integration of immigrants**

### ***The immigrant population is large and rising, but poorly integrated***

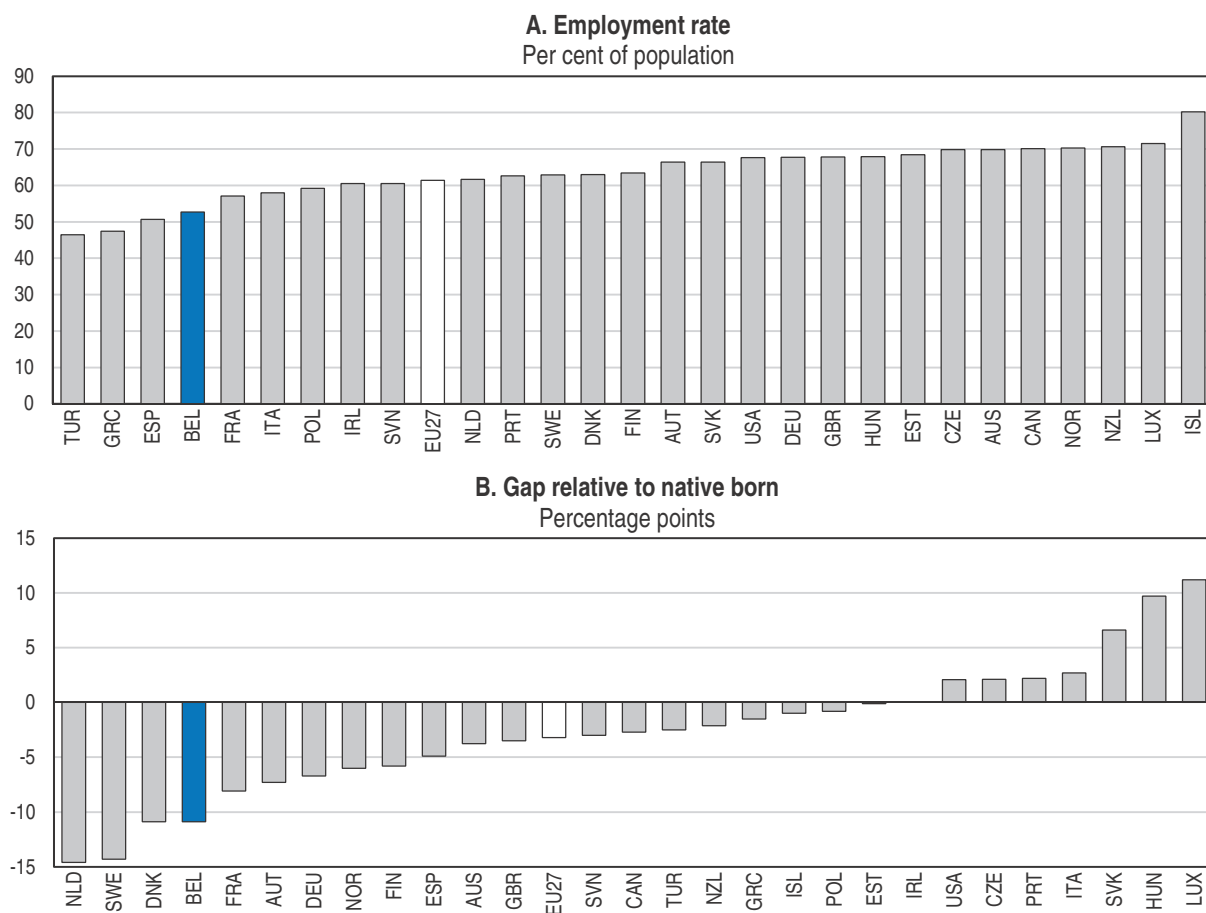
Immigrants, henceforth defined as those born abroad whatever their nationality, account for a high and rising share of the Belgian working age population (19% in 2013). Migration flows have reached record highs since the turn of the century and become more diverse, with a decline in the relative importance of neighbouring countries and Italy, and surging arrivals from the new EU member states, Morocco and the rest of the world.

Successful integration of immigrants can yield important benefits, not least by attenuating the impact of ageing on the labour force. However, the overall employment rate of the foreign-born is very low (Figure 14). Non-EU immigrants, over half of the total, are particularly affected, with high unemployment and, among women, large inactivity as well (Figure 15). In 1996-2008, the employment rate gap to natives of EU-born immigrants fell markedly, while that of non-EU immigrants essentially stagnated (Corluy and Verbist, 2014). In 2008-13, the gap worsened further for non-EU immigrants, particularly men.

Labour market disadvantage extends to several job characteristics and to the native-born children of immigrants (SPF Emploi, Travail et Concertation sociale and Centre pour l'égalité des chances et la lutte contre le racisme, 2013). Compared to native Belgians, immigrants are under-represented in public sector and white-collar private sector jobs, and over-represented in the less well-paid blue-collar and temporary jobs (Figure 16). Again, the gaps to natives are starkest for non-EU immigrants, but still sizeable for those of EU origin. Lower employment, lower wages and households with more children lead to a risk of poverty or social exclusion above 40% among working-age immigrants. These adverse circumstances, coupled with an education system that struggles to improve equity in a context of growing

Figure 14. **The employment rate of immigrants is low**

Age 15-64, 2013<sup>1</sup>



1. 2012 for Australia, Canada, New Zealand, Turkey and United States.

Source: European countries: "Employment and unemployment – Labour Force Survey", Eurostat Database, November; United States: Current Population Surveys; Australia, Canada, New Zealand and Turkey: Labour Force Survey.

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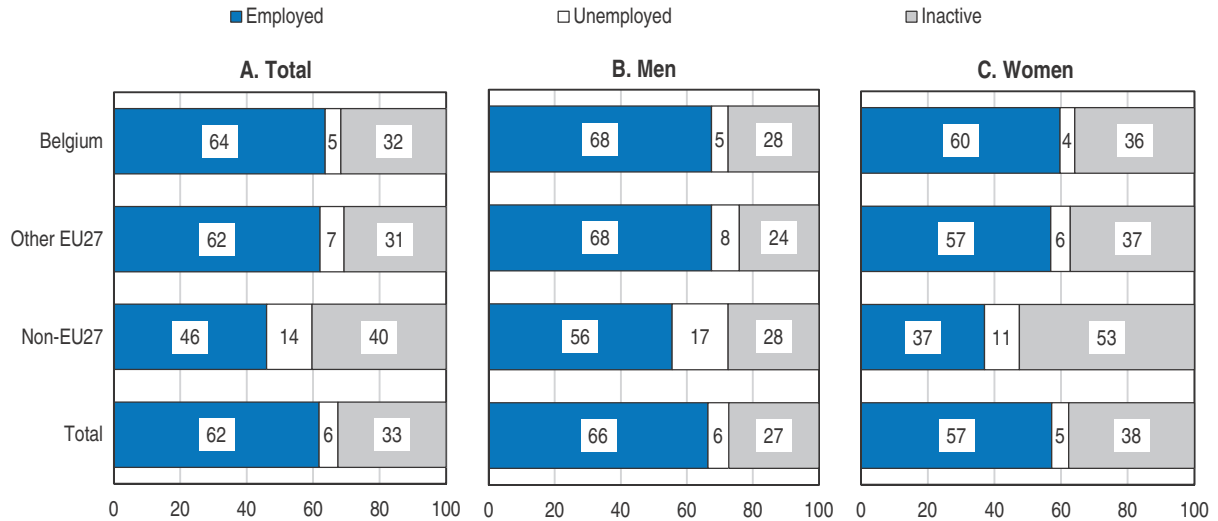


social and cultural diversity among students, help explain why the native-born offspring of immigrants in Belgium also has an internationally low employment rate, especially when both parents (rather than only one) were born abroad (OECD, 2012a; De Keyser et al., 2012).

Multiple factors hamper the labour market integration of immigrants. Immigrants have poorer educational attainment than natives, a gap which has widened over the past two decades for those born outside the EU (Corluy and Verbist, 2014). They are highly concentrated

**Figure 15. Non-EU immigrants have poorer labour market performance**

Employment status by country of origin and gender, age 15-64, per cent, 2013<sup>1</sup>



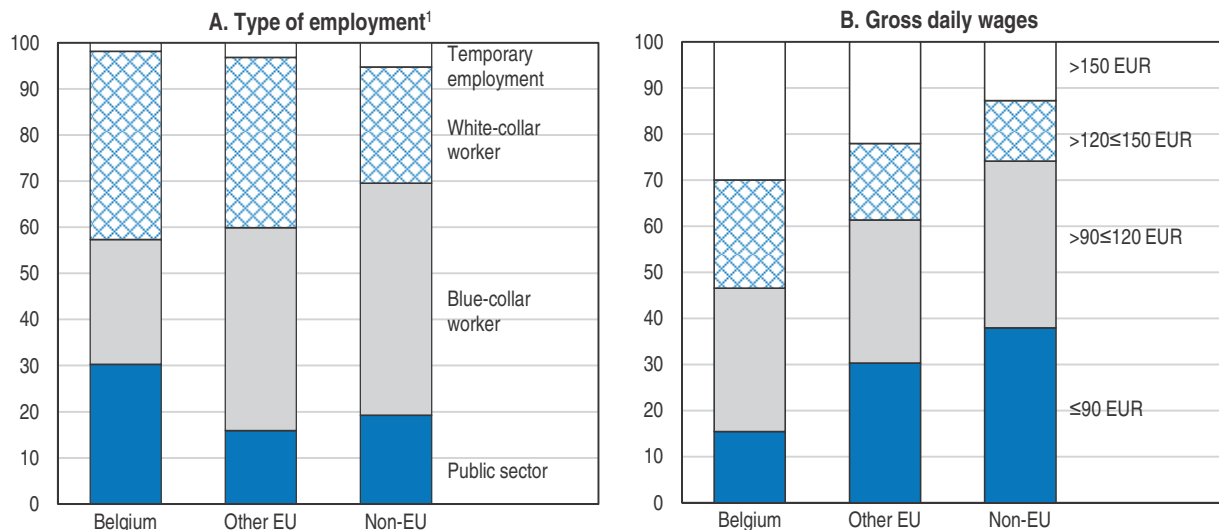
1. Numbers may not add up to 100 due to rounding.

Source: Eurostat (2014), "Employment and Unemployment (Labour Force Survey)", Eurostat Database, November.

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**Figure 16. Immigrants have poorer job characteristics**

Population aged 18-64 by country of origin, per cent, 2012



1. Blue and white-collar categories refer to employees working under a regular blue or white-collar contract of indefinite or limited duration. Temporary work covers interim employment. Self-employment is excluded as are European Union officials.

Source: CBSS (2014), *Datawarehouse marché du travail et protection sociale* (Labour market and social protection database), Crossroads Bank of Social Security.

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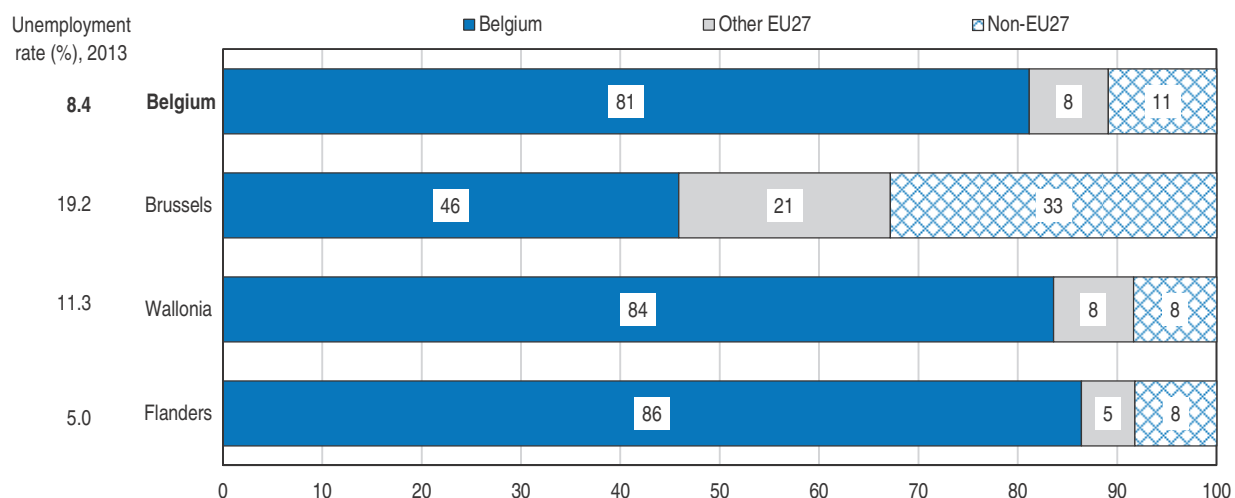
in Brussels (Figure 17), which, despite its high unemployment rate, receives most newcomers due to network effects. Immigrants would be the first to benefit from improved competitiveness and overall better labour market functioning. Being over-represented among low-educated workers, immigrants are highly exposed to the employment-adverse effects of high minimum wages, reduced incentives to take up work at low wage levels and some employment protection legislation provisions. Other handicaps are equally important. Despite extensive legislation to the contrary, discrimination is still an important problem in Belgium (Baert et al., 2013). Lack of host-country-specific human capital, such as language and knowledge about labour market functioning, tends to reduce the productivity and job matching capabilities of immigrants (Causa and Jean, 2007; OECD, 2007). Mismatches with labour market needs also ensue from the large share of immigration for non-labour motives, such as family reunification or asylum.

### **There is scope to improve integration policies**

Immigrants need opportunities to learn the host country language(s), develop social capital and have their education and skills acquired abroad validated and, if needed, reinforced (OECD, 2008). Language courses are offered to newcomers, but their effectiveness for labour market integration would be enhanced by adapting language coaching to workplace needs or combining it with other forms of training, such as internships. Programmes along these lines, currently more developed in Flanders, should be further expanded. With regard to skill validation, professional certificates granting access to specific occupations can be obtained upon successfully passing tests organised by validation centres. This procedure started only in the mid-2000s and remains under-developed, especially in Flanders (only around 100 certificates per year are awarded to immigrants). Skill validation should be expanded, inter alia by providing training in response to weaknesses detected in tests. As with reforms in language courses, this requires coordination between Communities, responsible for education and the integration of foreigners, and Regions, responsible for labour market training. Coordination issues gain particular relevance in Brussels.

**Figure 17. Immigrants are highly concentrated in Brussels**

Population aged 15-64 by Region and country of birth, per cent, 2012



Source: CBSS (2014), *Datawarehouse marché du travail et protection sociale* (Labour market and social protection database), Crossroads Bank of Social Security and Eurostat (2014), "Regional Labour Market Statistics", Eurostat Database, November.

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On the employers' side, improving job prospects for immigrants requires helping firms to address the challenges and exploit the potential benefits of a more diverse workforce. Firm-level diversity plans, supported at regional level, are currently the main tool for this purpose. Participating firms set targets for the employment or professional development of one or more vulnerable groups, such as immigrants, and in return receive free consultancy support and subsidies to co-finance plan-related costs (e.g. language courses). Take-up has gradually increased but remains low: even in Flanders, which pioneered these plans, less than 5% of companies have introduced one (although a greater percentage of workers are covered because participation tends to increase with firm size). The slow nature of organisational change and the post-2008 economic crisis, which has hit immigrants harder than natives, also help explain why the aggregate impact of plans on the employment rates of target groups remains very limited, despite generally successful implementation in participating firms (ULB, 2012; De Coen et al., 2014). While persevering with efforts for further engagement with social partners to expand diversity plans, the authorities should better exploit synergies with other integration and active labour market policies. This is already the case with language training in the workplace, but there is scope for better articulation with other training offers and skill validation.

Overcoming under-representation of immigrants is also needed in the public sector. As in private sector diversity plans, indicative targets, defined relative to total employment or to new hiring, can be a useful tool. Encouraging evidence comes from the Flemish government, which in 2004 set a 4% target, to be attained by 2015, for the share of immigrant employees (using a specific definition based on non-European background). The actual share increased from 1.1% to 3.9% in 2006-14, prompting the authorities to set a new target of 10% for 2019, with an enlarged concept of immigrants. The intention to set a target for immigrant employment also at the federal administration level has been recently announced. Setting these targets requires systematic data collection on the ethnic origin of staff. Collecting similar information, with appropriate privacy safeguards, on public sector job applicants, as some levels of government have started to do, would shed light on the causes of immigrant under-representation (e.g. few candidates or low success in the recruitment process).

Together with an overall low hiring rate in the public sector, citizenship requirements help explain the low share of immigrants in public sector jobs. There are two formal types of public employment, statutory and contractual. Statutory jobs (over half of the total) often require, especially at federal level, citizenship of an European Economic Area country or Switzerland, while in general there are no nationality requirements for contractual workers. In any case, Belgian citizenship is needed for positions involving the exercise of public authority or the safeguard of the general interest. The tightening of naturalisation requirements since 2013 will likely worsen access of immigrants to public employment, especially for those of non-European origin. In this context, the authorities should consider eliminating citizenship requirements for statutory public sector jobs, with only narrowly-defined exceptions.

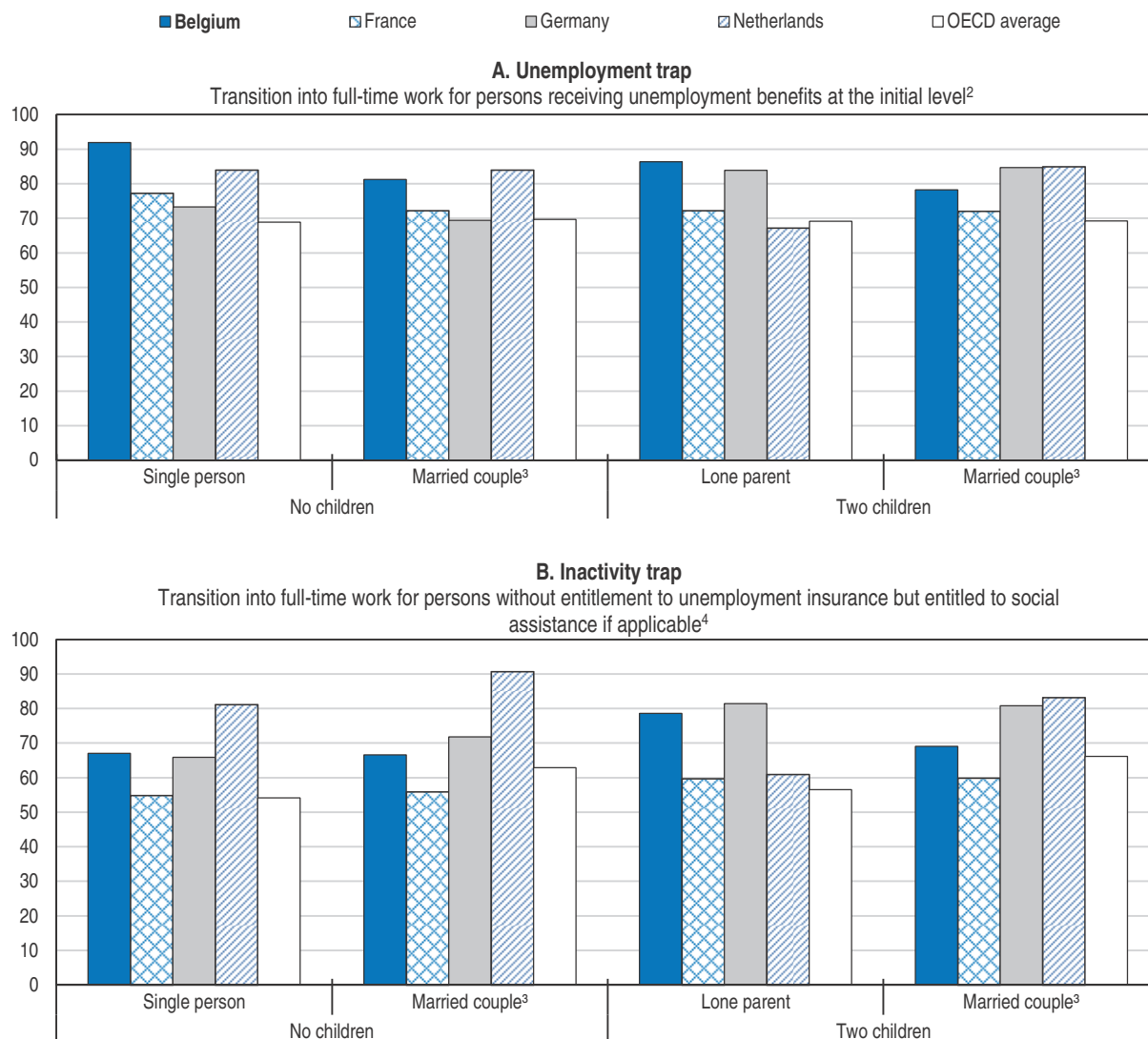
### ***General labour market settings often reduce the employment prospects of immigrants***

Belgian tax and benefit systems are generally unfavourable to the employment of the low-skilled. Their reform would enhance the performance of the Belgian economy and in particular improve the labour market integration of immigrants, who are over-represented among the low-skilled. Reduced employment rates stem from high non-wage labour

costs, which deter demand for low-productivity workers, and small income gains when moving from unemployment or inactivity to a job, which discourage labour supply. At low wage levels, major unemployment and inactivity traps therefore ensue (Figure 18), calling for a reduction of labour taxation, as is being considered by different governments.


**Figure 18. Unemployment and inactivity traps reduce work incentives**

Participation tax rate for earnings equal to 67% of the salary of an average worker (AW), 2012<sup>1</sup>



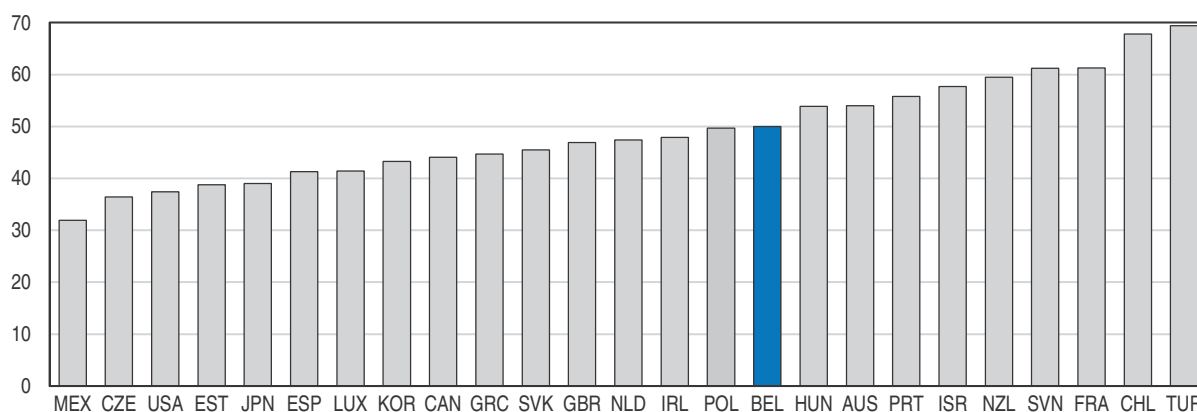
1. Participation tax rates measure the extent to which taxes and benefits reduce the financial gain of moving into work. The percentage of AW relates to the earnings from full-time employment of the individual moving into work. Calculations for families with children assume two children aged 4 and 6.
2. For a person who has just become unemployed and receives unemployment benefits (following any waiting period) based on previous earnings equal to earnings in the new job. No social assistance “top-ups” or cash housing assistance are assumed to be available in either the in-work or out of work situation. Any benefits payable on moving into employment are assumed to be paid. Calculations for families with children do not consider childcare benefits or childcare costs.
3. One-earner married couple, the second spouse is assumed to be inactive with no earnings
4. For a person who is not entitled to unemployment benefits (e.g. because their entitlements have expired). Instead, social assistance and other means-tested benefits are assumed to be available subject to relevant income conditions. Where receipt of such assistance is subject to activity tests (such as active job-search or being “available” for work), these requirements are assumed to be met in the out of work situation. Cash housing benefits are calculated assuming private market rent, plus other charges, amounting to 20% of the full-time wage for all family types.

Source: OECD (2014), *OECD Tax-Benefit Models*, March, [www.oecd.org/els/social/workincentives](http://www.oecd.org/els/social/workincentives).


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Although high minimum wages help prevent in-work poverty, they increase labour costs for low-skilled workers, who may then be priced out of the labour market (Neumark and Wascher, 2006). Groups with additional (real or perceived) productivity handicaps, such as youth or low-skilled immigrants, will likely be among the most affected. The Belgian statutory minimum wage is on the high side in international comparison (Figure 19), and sectoral agreements generally provide for even higher minima. Furthermore, lower youth minimum wages, a common way of mitigating risks of labour market exclusion (adopted by almost half of the OECD countries setting minimum wages), are being phased out in 2013-15. Sectoral agreements will still have the option to set lower wage floors for the young, but these cannot fall below the national statutory minimum wage. In 2012, the overall unemployment rate in Belgium was 7.6% (15-64 age group), rising to 19.8% for youth (aged under 25), and, among these, reaching 29.3% and 27.9% for immigrants and their native-born offspring, respectively. Worryingly, youth unemployment has since risen markedly, reaching 24.9% in the first half of 2014. The authorities and social partners should thus consider reintroducing lower statutory minimum wages for younger workers.

Figure 19. **Minimum wages are fairly high**  
Per cent of median wages, 2013

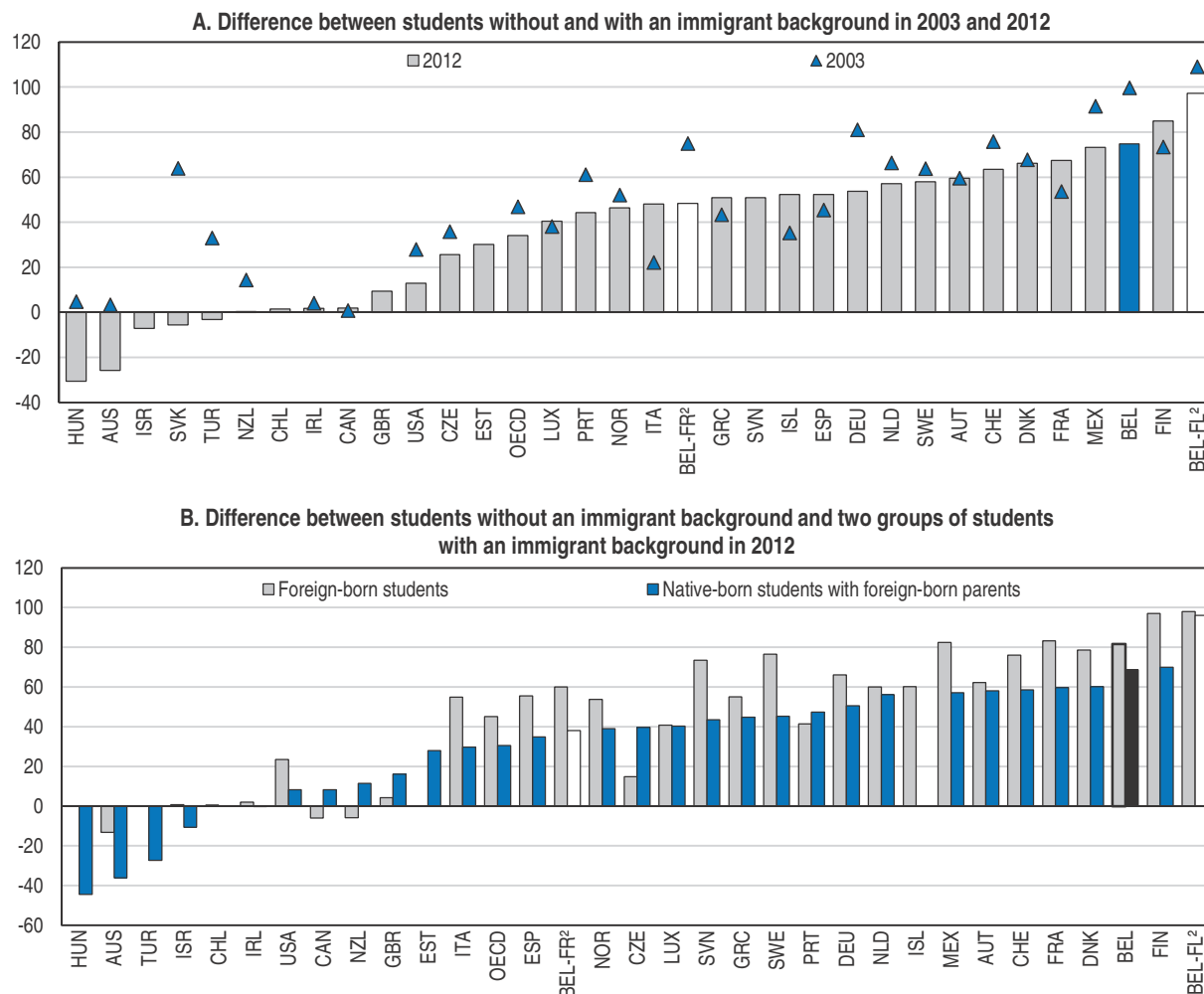


Source: OECD (2014), "Earnings: Minimum wages relative to median wages", *OECD Employment and Labour Market Statistics* (database), November.

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### **The educational outcomes of the children of immigrants need improvement**


To an important degree, the large underperformance of the children of immigrants relative to their colleagues without an immigrant background (Figure 20) stems from lack of equity in education, which harms disadvantaged students in general. A key feature of poor equity is strong school segregation. Disadvantaged students, many of whom are children of immigrants, are highly concentrated in certain schools (Figure 21), which hampers their learning. In both Flemish and French Communities, free choice of schools – not undesirable in itself – has likely contributed to school segregation, which often exceeds residential segregation, especially in Brussels (Musset, 2012; Cantillon, 2013). After several attempts to increase social diversity in schools, which in both Communities had limited effectiveness, the latest Flemish enrolment reform, first applied in 2012-13 and subsequently adjusted, gives priority to certain places in oversubscribed schools to both disadvantaged and non-disadvantaged students in order to reach a better social mix in

Figure 20. **Children of immigrants underperform by a wide margin**Difference in the mean PISA score for mathematics performance relative to immigrant background<sup>1</sup>

1. PISA: Programme for international student assessment. Students with an immigrant background are those whose parents were born in a country/economy other than the country/economy of assessment.

2. BEL-FR: French Community; BEL-FL: Flemish Community.

Source: OECD (2013), *PISA 2012 Results: Excellence Through Equity: Giving Every Student the Chance to Succeed (Volume II)* and national authorities.

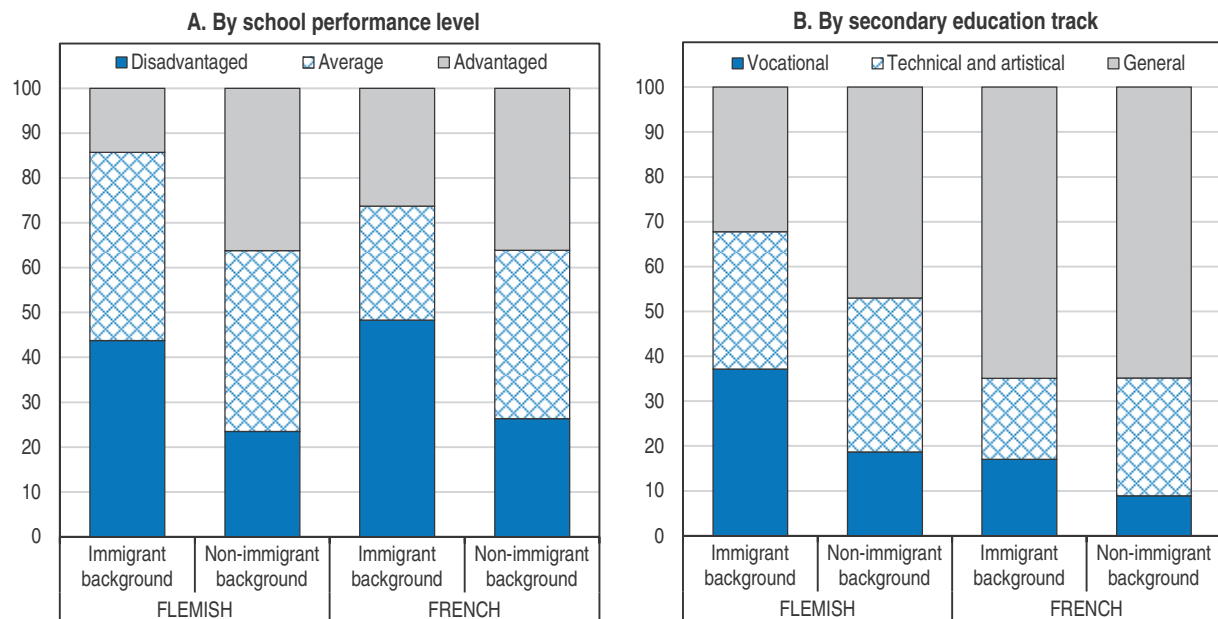
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schools. Preliminary evidence available for Ghent primary schools suggests that this reform has led to less segregation (Verhaeghe and Goetmaeckers, 2013). Reforms along these lines, which strike a balance between free choice and the promotion of social diversity, should be implemented in all main urban areas, while systematically monitoring results at the school level.


In schools with a high proportion of disadvantaged students, steps should be taken to increase performance levels. In both the Flemish and French Communities, financing for schools with disadvantaged populations was reinforced towards the end of the 2000s, making it possible to hire more teachers. This is welcome, as disadvantaged students tend to benefit strongly from smaller classes (OECD, 2005). However, teachers in those schools are often less qualified and experienced (OECD, 2013e), and teacher training to address a multicultural or multilingual classroom is still scarce (OECD, 2014d). The authorities should

Figure 21. **Children of immigrants are over-represented in disadvantaged schools and lower education tracks**

Distribution of students by immigrant status and language Community, per cent, 2012



Source: Calculations based on OECD Programme for International Student Assessment – PISA 2012 Database.

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step up efforts to attract qualified and experienced teachers to disadvantaged schools, inter alia by introducing financial incentives, and train teachers to provide effective tuition to students with different educational needs.

Early tracking and grade repetition are also a source of low equity (OECD, 2012b). Grade repetition is at the high end across the OECD, and even higher among children of immigrants (OECD, 2013f). Tracking starts very early, in practice at age 12, and weaker students – many of whom have an immigrant background – are assigned to low-prestige vocational streams. In Flanders, the authorities should implement the Master Plan for the Reform of Secondary Education (2013), which envisages delaying tracking and moving towards a more comprehensive system. In the French Community, efforts to fight repetition in primary schools are to be expanded, and repetition in the first year of secondary education, with ensuing relegation to a lower stream, is being abolished altogether (2014), with plans for a common curriculum up to age 15 being considered. Reforms should indeed be extended to later years of secondary education, and tracking delayed further.

Besides weaknesses in general skills, largely associated to early tracking, the employment prospects of the young in secondary education vocational studies are hampered by shortcomings in the development of technical skills. A substantial proportion of upper secondary students attend vocational tracks, especially in Flanders, where their share exceeds one quarter (Musset, 2013). Yet workplace training is scarce, leading to abrupt transitions from education to work, and the design of programmes is insufficiently informed by the needs of the labour market. The authorities should expand high-quality workplace training that is attuned to labour market needs. To this end, strong involvement of social partners is essential. Both the Flemish and the French Community have plans to expand dual tracks combining work and study in order to improve the quality of vocational secondary education.

For many children of immigrants, not speaking the language of instruction at home is an important barrier to educational achievement. Addressing language handicaps requires increased participation in early childhood education and care (ECEC), where children of immigrants below the age of three tend to be under-represented (Vande Gaer et al., 2013), and extended provision of remedial language classes, which have very low attendance (OECD, 2012c). Since, on top of availability and affordability concerns, cultural barriers lower ECEC participation below the age of three (in contrast with almost universal participation in free pre-primary education by older children), the authorities should step up efforts at parental and community engagement, for instance by offering language or vocational courses for mothers in ECEC premises. At later ages, systematic screening of language ability should be implemented in all pre-primary, primary and secondary schools, with extra tuition provided when needed. This screening has been introduced in Flanders in the current school year, and its impacts should be carefully monitored.

### **Recommendations to improve the labour market integration of immigrants**

#### **Key recommendations**

- Monitor and, where needed, reform school enrolment to reduce concentration of disadvantaged students in particular schools. Improve teacher training and incentives to attract more qualified and experienced teachers to disadvantaged schools.
- Proceed with reforms to reduce grade repetition and delay tracking in secondary education. Expand workplace-based learning in vocational education.
- As one way to improve labour market outcomes, in particular for the low-skilled, consider reintroducing lower statutory minimum wages for young workers.
- Continue to cooperate with social partners to further expand diversity plans in firms. Expand training offers, including on languages, and skill validation, as well as their articulation with diversity plans.

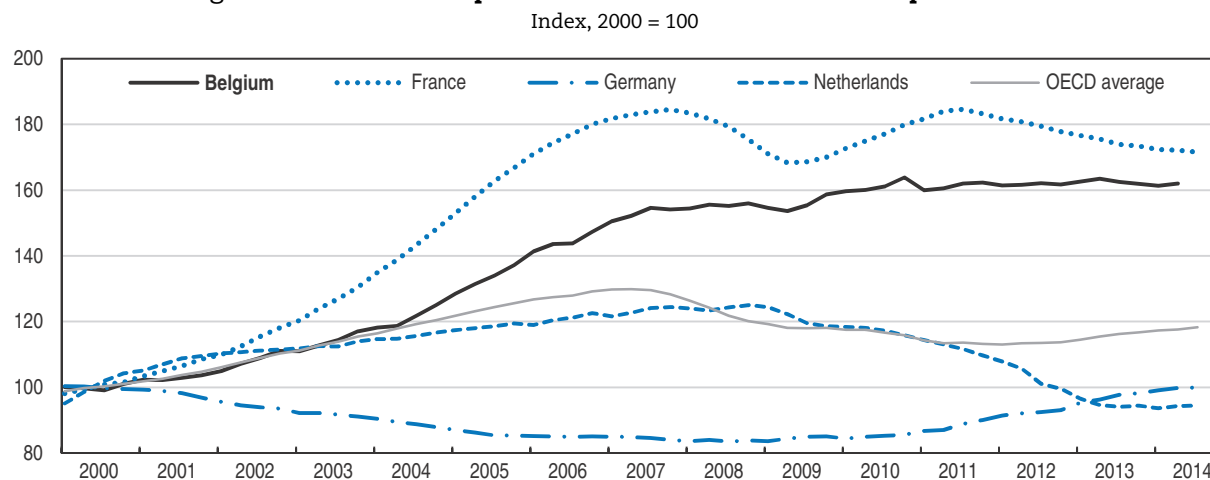
#### **Additional recommendations**

- Address language handicaps of the children of immigrants by promoting participation in child care below age three and by systematically assessing language proficiency in primary and secondary schools, offering remedial classes when needed.
- Set indicative targets for the share of immigrants in employment or new hiring at all levels of government. Consider narrowing the scope of public jobs subject to citizenship requirements.


## **Maintaining an efficient and equitable housing market**

Housing conditions in Belgium are among the best in the OECD according to the Better Life Index (OECD, 2013c), as dwellings are of high quality and large, while housing costs are average. However, the steep increase in house prices before the crisis and some increase afterwards (Figure 22) put market access for first-time buyers under pressure. Housing affordability is also deteriorating for the poor, as demand for social housing is not met by supply and even the cheaper segment of the private rental market has become overpriced. Another challenge is the high level of greenhouse gas emissions, which is due to the old age of the housing stock. Finally, residential mobility is mediocre, which harms labour market functioning and contributes to congestion and air pollution.



Figure 22. **Real house prices have stabilised after a steep increase**

Source: OECD (2014), *Housing Prices Database*, Economics Department, November.

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Under the Sixth State Reform, competences for housing taxation and private rental legislation were transferred to the Regions in July 2014. The new allocation of responsibilities reduces the areas where authorities from different levels have overlapping responsibilities and allows regional governments to develop a more coherent housing policy. At the same time, Regions set their own priorities on housing-related issues, as is shown by the different plans regarding the fiscal treatment of mortgage loans and a more strategic use of recurrent housing taxation by the Brussels-Capital Region.

### ***The housing market is overvalued, but related risks seem low***

After the long period of price increases, traditional indicators suggest that the Belgian market is overpriced: the price-to-income ratio is 47% above its long-term average and the price-to-rent ratio is 58% higher. However, lower interest rates on mortgage loans, longer maturities and the widened tax deductibility of interest and capital repayments since 2005 all support higher house prices. In addition, demand for housing will continue to increase as the number of households is expected to grow by 11% between 2013 and 2030 (FPB, 2014). Hence, the actual overvaluation, while difficult to assess, falls to 28% when accounting for the current low interest rates and to 5-15% when also assuming a continuation of the other relatively lenient financing conditions (IMF, 2014).

The risk of a significant fall in house prices does not appear immediate as considerable changes in underlying determinants seem remote. However, prices warrant close monitoring given that some estimates of the size of the overvaluation are large and a fall triggered by a change of expectations cannot be ruled out. Although wealth effects are limited in Belgium (Eugène et al., 2003), more than 15% of outstanding mortgage loans at end-2013 had a loan-to-value ratio of more than 90% while for a large share of borrowers debt-service costs accounted for more than 50% of their disposable income (NBB, 2014a). To avoid further growth of these borrower segments with high levels of risk, the authorities should impose maximum limits for new mortgage loans on loan-to-value and debt-service-to-income ratios when appropriate in view of housing market dynamics.

### Housing affordability is deteriorating, especially for vulnerable groups

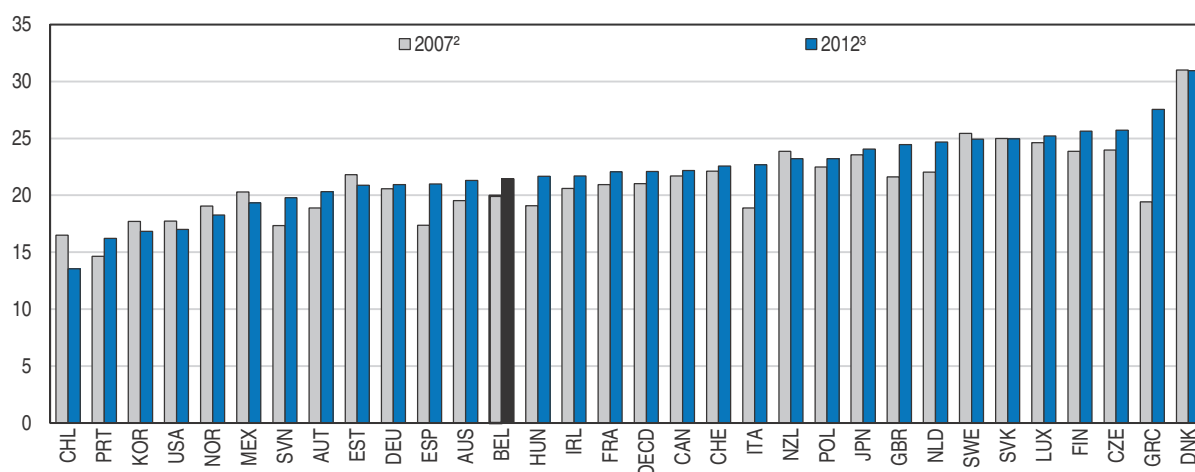
Between 2007 and 2012, household spending on housing rose from 20% of disposable income to 21.4% (Figure 23), which is just below the OECD average. Nevertheless, around 11% of the population live in a household that spends more than 40% of its disposable income on housing. During recent years, affordability deteriorated considerably for renters, who are already much more frequently overburdened, although fewer homeowners faced excessive housing costs (Figure 24). In Brussels, one out of five households face high housing costs (Winters and Heylen, 2013) due to more expensive accommodation and a larger share of the population at risk of poverty than in the other Regions. Problems related to housing quality are also more widespread in Brussels, indicating that good and affordable housing at the bottom-end of the market is in short supply.

Waiting lists for social housing lead to high demand at the bottom end of the private rental market and contribute to affordability problems among lower-income tenants. The social rental market amounts to 6% of the dwelling stock, which is small compared to other OECD countries (Andrews et al., 2011) and insufficient to meet all demand. The number of tenants on the private rental market who, based on their income, would qualify for social housing is rising. Social rental contracts for an indefinite period were abolished in Brussels and Wallonia, but many dwellings are still occupied by households which, although they do no longer qualify for their current social rental on the basis of income or household size, cannot be easily relocated. Shrinking families who stay in too large houses can be penalised in some cases, but often prefer to pay the small fine rather than moving to a smaller place. There are few incentives to voluntarily leave social rental housing as rents are on average 40% lower than in the private sector. Regions have ambitious plans for the construction of social housing, but it will take many years before these will lead to a significant reduction of the waiting lists.

The small and falling share of homeowners experiencing affordability problems hides the growing challenges for first-time buyers to buy a house. Homeownership is widespread, in particular outside Brussels (Figure 25), as it is perceived to provide the

Figure 23. Household spending on housing has increased moderately<sup>1</sup>

As a percentage of net disposable income



1. Housing, water, electricity, gas and other fuels. The OECD aggregate is an unweighted average of data shown.

2. 2008 for Chile.

3. 2011 for Greece, New Zealand and Switzerland.

Source: OECD (2014), "Detailed National Accounts", OECD National Accounts Statistics (database), October.


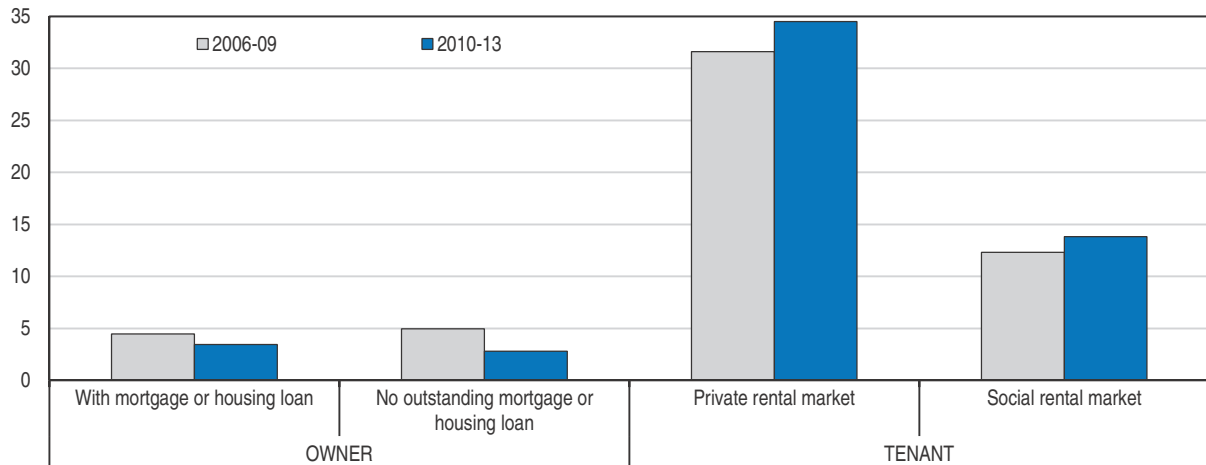
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Figure 24. **Tenants are most affected by housing cost**  
Housing cost overburden, per cent of relevant population<sup>1</sup>

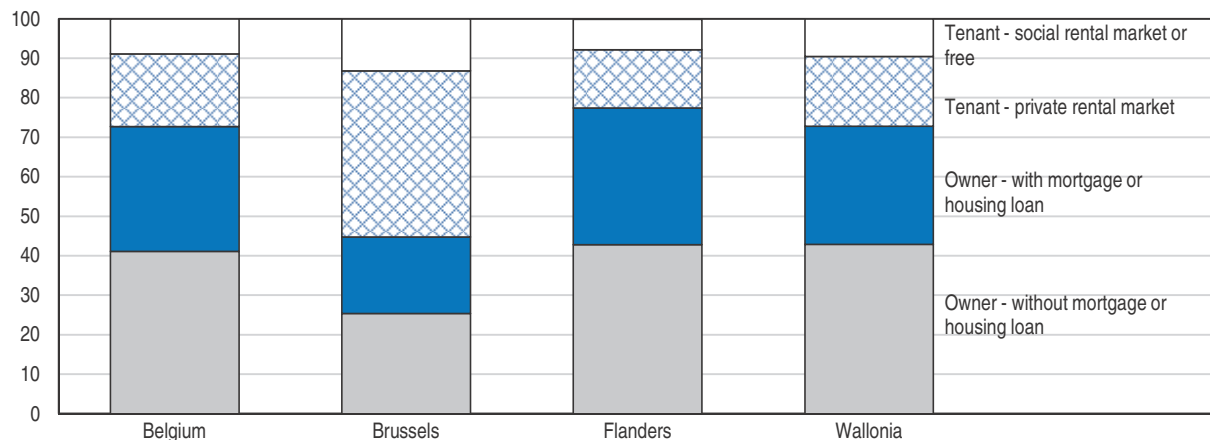


1. Share of people living in a household that spends over 40% of disposable income on housing.

Source: Eurostat (2014), "Income and Living Conditions – Housing Cost Burden", Eurostat Database, November.

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Figure 25. **Homeownership is widespread outside Brussels**  
Per cent of population, 2009



Source: S. Winters and K. Heylen (2013), "How Housing Outcomes Vary Between the Belgian Regions", *Journal of Housing and the Built Environment*, July.

StatLink <http://dx.doi.org/10.1787/888933180994>

highest degree of housing security and privacy and to reduce housing costs after retirement. But the traditional housing model is coming under pressure (Meeus et al., 2013) as conditions for prospective buyers are deteriorating. The average downpayment increased rapidly from around EUR 20 000 in 2004 to some EUR 50 000 in recent years (Albrecht and Van Hoofstat, 2011). When including the substantial transactions costs, such as transfer taxes, real estate agent fees and notary fees, a buyer needs on average around EUR 75 000 in cash, which is around a third of the house price, to acquire a house. In addition, debt-servicing costs of young households are often high relative to income (Du Caju et al., 2014). Without financial support from parents, many first-time buyers can no longer afford housing of the same quality and quantity as a decade ago (Heylen and Winters, 2011) and more and more young people resort to the private rental market in anticipation of acquiring a home later (Le Roy and Vandekerckhove, 2011).

### **Strengthening the rental market requires a shift in public support**

Public support is skewed towards homeownership. When taking into account both federal and regional subsidies, the average homeowner in Flanders receives 4.3 times more housing benefits than the average tenant (Heylen and Winters, 2012). Moreover, the tax deductibility of interest and capital repayments on mortgage loans disproportionately benefits the better-off. In Flanders, 47% of total housing subsidies are received by the top 40% incomes, a group for whom housing problems, in terms of affordability and quality, are almost negligible. To a large extent the tax deductibility has translated into higher house prices, and by some estimates dwellings in 2012 are valued 29% (EUR 54 000 on average) higher than in the absence of fiscal support (Damen et al., 2014; Vastmans et al., 2014).

A more neutral tax treatment of owner-occupied housing, both relative to renting and to alternative investments, would lower economic distortions. Foremost, this would mean taxing imputed rental income for homeowners or reducing the tax deductibility of mortgage loans. In practice, the latter reform is easier to implement as it is more understandable and accepted by citizens than taxing imputed rents. The current low mortgage interest rates facilitate such a reform, and the Sixth State Reform has created momentum as housing taxation has become a regional competence while the transferred financial means fall short of costs. Already, Flanders has implemented initial reforms to limit the tax deductibility and Wallonia has decided to slightly reduce the rate of deductibility for new mortgages. Given the large effect on prices, changes should be introduced gradually and uncertainty about future measures should be minimised.

Regions should direct a larger share of their housing budgets towards the private rental sector, which receives the least support of all tenures. Existing regional rental allowance schemes have a very limited scope and should be extended to cover all tenants in the private market who qualify for social housing, while avoiding a capitalisation of the subsidy into rents through, for example, linking the allowance to the local median rent (De Boer and Bitetti, 2014).

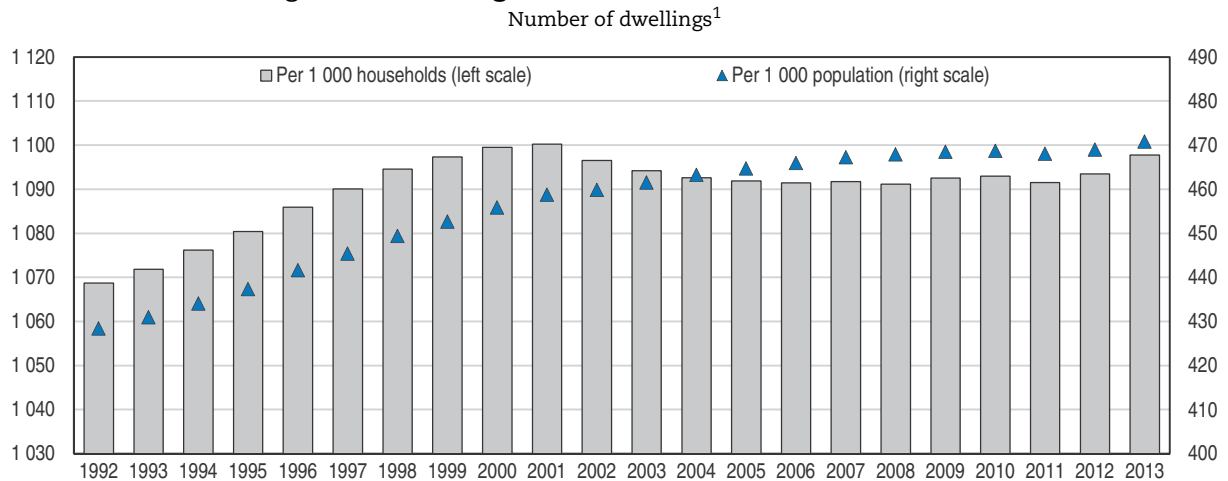
The shift in public support towards the rental market should be complemented by increased efforts to raise the supply of private rental housing, especially at the lower end of the market. Broadening the allowance scheme would already raise the supply of rental housing, as many potential landlords are currently deterred by the combination of high quality requirements and weak financial positions of low-income tenants. In this respect, the role of social rental agencies, which rent dwellings on the private rental market and let these to households according to housing needs, could also be expanded. With increased financial means, these agencies could strengthen their real estate management without compromising their welfare services. Private-sector development could be stimulated by making publicly owned plots available for the construction of affordable rental dwellings.

### **The housing stock needs densification and greening**

There are few signs of an overall housing shortage in Belgium (Figure 26), but there are mismatches in the availability of building plots and demand. The lack of good plots has led to a quadrupling of real land prices during 1992-2013, while real house prices only doubled. To meet the increasing demand for new housing in the neighbourhood of economic centres, densification of urban areas should be promoted so as to simultaneously reduce


energy consumption and commuting time. In this respect, the Regional Spatial Development Perspective for Wallonia adopted in November 2013 makes several proposals, which should be explored further and incorporated into municipal development plans. In Flanders, the share of new houses to be built in urban areas, 60% as prescribed by the spatial development plan, is perhaps too low. In Brussels, current efforts for identifying new housing possibilities, through re-designating land, converting non-residential buildings and further facilitating the construction of denser buildings, should be stepped-up while taking into account the environmental and social impact.

Figure 26. **Housing stock evolved in line with demand**



1. Number of households for latest years is estimated.

Source: Statistics Belgium (2014), "Statistique cadastrale du parc de batiments", *be.STAT Database*, July and ADSEI (2014), "Huishoudens per gewest", *Algemene Directie Statistiek en Economische Informatie*, available at <http://data.gov.be>.

StatLink  <http://dx.doi.org/10.1787/888933181005>

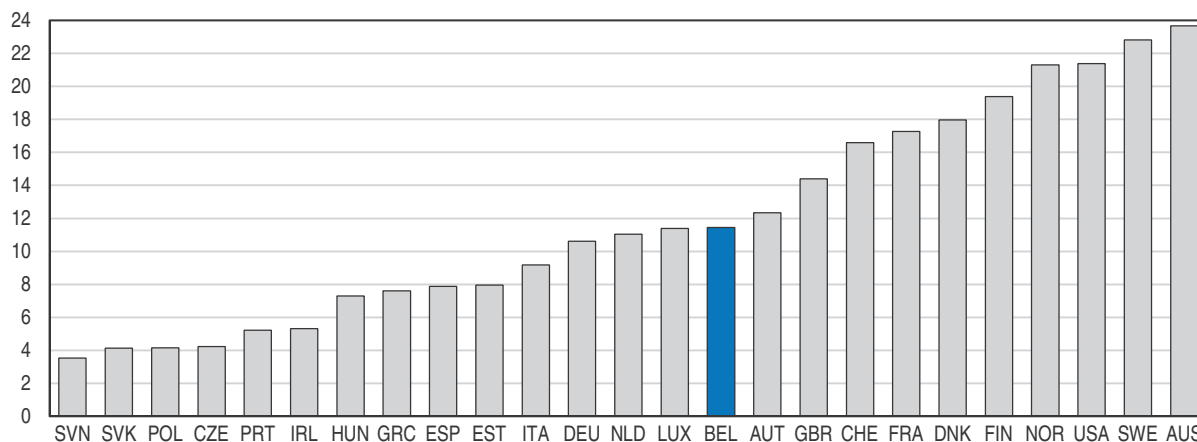
Dwellings in Belgium are relatively old (Andrews et al., 2011) and many are detached, and as a result the residential sector remains energy intensive despite recent improvements (Cassilde, 2014). Federal support for energy efficiency improvements has been streamlined by phasing out all measures except for a tax reduction for roof-top insulation, which is one of the most efficient ways to reduce residential energy consumption. At the regional and municipal levels, several subsidies exist, in particular for low-income households. However, uncertainty whether energy-efficiency improvements would lead to an increase in the cadastral income and related taxes, calls for a clearer specification of the criteria. Landlords are further deterred from implementing energy saving investments by rental legislation that limits rent increases during an ongoing contractual period. Following the Sixth State Reform, Regions can remove this barrier to energy-efficiency improvements in rental housing.

The overall support for energy efficiency is commendable, but low energy taxation and high subsidies provide the wrong incentives. The widespread use of social energy policies contributes to the high residential emissions (OECD, 2011). The lower tariffs discourage energy savings and should be replaced by income subsidies for low-income households. Similarly, the reduction of VAT on electricity introduced last April should be reversed.


### **The allocation of housing can be improved**

Residential mobility is mediocre, with only 12% of households changing residence during a two-year period (Figure 27). Homeowners, the largest tenure group by far, are much less likely to move residence than tenants who rent in the private market (Isebaert, 2013; Andrews et al., 2011). Social tenants are also less frequently changing residence as they risk losing their subsidised housing, especially given the scarcity of social housing.

Figure 27. **Residential mobility is mediocre**  
Percentage of households that changed residence within the last two years, 2007



Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", OECD Economics Department Working Papers, No. 836.

StatLink  <http://dx.doi.org/10.1787/888933181011>

Low residential mobility contributes to congestion and sub-optimal labour market outcomes (OECD, 2013a). As discussed in detail in the 2013 OECD *Economic Survey of Belgium*, transport infrastructure is well developed, but congestion is among the highest of OECD countries for which data is available. Labour market inefficiencies arise when jobseekers who cannot find suitable jobs in their neighbourhood prefer to remain unemployed, or even withdraw from the active labour market, instead of moving to places with higher labour demand. Low residential mobility thus contributes to the large geographical variations in labour market outcomes. Higher residential mobility will have a stronger effect on the regional than on the national level, as labour mobility between the two largest Regions accounts for just 13% of all inter-regional commuting given the different languages and similarities in qualification and skill mismatches (Zimmer, 2012).

Residential mobility can be increased by tilting housing taxation towards recurrent taxes. Real estate transactions are now discouraged by transfer taxes that are among the highest in the OECD, while recurrent taxes account for a relatively low share of property tax revenues. Notwithstanding regional deductions, the high transaction taxes curb the liquidity of housing markets and lead to an inefficient allocation of housing. As a reduction of transaction taxes would stimulate house prices, it could mitigate negative price pressures resulting from lower tax relief for homeowners. Lower transaction taxes can be offset by higher recurrent taxes through an increase in rates. In addition, the federal cadastre should be updated, since values mostly stem from 1975 and the subsequent indexation does neither reflect actual rent increases nor changes in the standings of neighbourhoods. This would require a cost-sharing agreement with the Regions.

Alternatively, regional cadastres can be set-up, as the Brussels-Capital Region is considering. Self-assessment of values by owners can be used in case of insufficient administrative capacity.

People from lower socioeconomic groups have limited choice when they want to change residence as the supply of rental housing is small and concentrated in neighbourhoods with high unemployment rates, often above 20% (Le Roy and Vandekerckhove, 2011). Residential social, economic and ethnic segregation tends to exacerbate unemployment further (Dujardin et al., 2008). Widening the housing choice for lower socioeconomic groups by expanding the rental market, introducing portable rental allowances and avoiding clustering in the construction of new social housing, would thus have a positive effect on their labour market outcomes.

### **Recommendations to maintain an efficient and equitable housing market**

#### **Key recommendations**

- Take advantage of the current low interest rates to gradually remove the tax deductibility of interest and capital repayments on mortgage loans. Tilt housing taxation towards recurrent taxes and away from transaction taxes.
- Expand regional rental allowance schemes for low-income tenants renting on the private market. In parallel, increase subsidies for social rental agencies and make publicly-owned plots available for construction of affordable housing, notably by the private sector.
- Increase urban building densities by re-designating land and converting non-residential buildings, further easing restrictions on the construction of denser buildings, and increasing the costs of keeping urban land and buildings unused.

#### **Additional recommendations**

- Impose maximum limits on loan-to-value and debt-service-to-income ratios for new mortgage lending when appropriate in view of housing market dynamics.
- Update the federal cadastre or set up regional cadastres.
- Stimulate higher occupation turnover of social rental housing by a stronger enforcement of contractual eligibility requirements and the abolition of open-ended contracts.
- Allow rent increases during a contractual period when justified by energy-efficiency improvements.

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## ANNEX

# Progress in main structural reforms

*This annex reviews action taken on recommendations from previous Surveys. Recommendations that are new in this Survey are listed in the relevant chapter.*

## Fiscal sustainability

Recommendations from previous Surveys	Actions taken since the previous Survey (2013)
Secure sustained debt reduction by moving to an underlying fiscal balance through structural fiscal reforms. Let the automatic stabilisers operate if growth deviates from expectations. Introduce a robust framework for fiscal consolidation burden sharing, which should contain, for all levels of government, clear and transparent multi-year rules for spending and budget balances.	The underlying fiscal deficit was reduced in 2013-14 by around 1 percentage point of GDP. The 2015 Budget contains new structural consolidation measures, mainly on the expenditure side. In the context of the Sixth State Reform, the contribution of Regions and Communities to fiscal consolidation will gradually rise over 2014-17 to 0.7% of GDP. A cooperation agreement between different levels of government (December 2013) gave the High Council of Finance enhanced budget monitoring responsibilities. No action taken as regards domestic spending rules.
Create stronger links between working careers and pensions in the early retirement system and subject all older unemployed to standard search monitoring and activation conditions.	The authorities reformed pension bonuses for continued work after eligibility for early retirement, somewhat increasing incentives for longer careers.

## Labour market

Recommendations from previous Surveys	Actions taken since the previous Survey (2013)
Reduce sectoral minimum wages to the legal level and have a more gradual phase-in of the youth minimum wage. Concentrate cuts in social security benefit contributions on low-wage workers.	No action on reducing sectoral minimum wages, while lower youth minimum wages are instead phased out in 2013-15. A third of the cuts in social contributions announced in late 2013 are for low-wage workers.
The government and social partners should consider a new wage formation process. As part of such reform, social partners should be encouraged to phase out the automatic wage indexation mechanism to avoid that the effects of negative external shocks become permanent.	No action taken regarding the wage formation process, but the calculation of the health index was revised in early 2014 to follow consumption patterns more closely.
Bolster employment creation and preservation of external cost competitiveness by linking wage growth more closely to domestic productivity developments.	Indexation will be temporarily suspended in 2015 to correct for built-up losses in external cost competitiveness.

## Health care

Recommendations from previous Surveys	Actions taken since the previous Survey (2013)
Give sickness funds a more active role to promote cost-efficient care, by allowing them to benchmark the performance of suppliers and to experiment on a limited scale with selective contracting.	Since 2014, the Common Sickness Funds Agency, of which all sickness funds are a member, publishes benchmark analyses on individual hospitals, e.g. the number of performed complex procedures.
Enhance providers' incentives and information flows by greater centralisation and co-ordination of data management on a single platform, completing the shift to pathology-based hospital budgets, and relying more on capitation-based remuneration of doctors.	Information from the single data warehouse of the sickness funds is increasingly used for publishing overall statistics and indicators. No action taken on financing of care providers, but ambitious plans are under consideration.
Tackle high drug spending by reinforcing procedures to stimulate rational prescription and to stop excessive prescription, regularly revising reimbursement rules and liberalising the pharmacist market.	Criteria and procedures for reimbursement of drug spending have been adapted, with increasing cost-efficiency as one of the aims. For elderly patients, reimbursements will be linked with a rationalised dosing in early 2015.
Once adequate incentives to control costs are in place, enable a more flexible health supply by phasing out overly prescriptive regulation on hospital supply.	No action taken.
Grant long-term care patients autonomy to organise their care at home. Qualify care needs on a unified geriatric assessment and introduce dissuasive sanctions to deter overstatement of care needs.	The introduction of BELRai, a tool to evaluate the health of elderly people, has increased the efficiency of public spending. A regulation was introduced to reduce overstated needs in the home nursing sector (July 2014).
Give Communities (or Regions) a stake in federal health care spending in their Community to avoid cost shifting.	Various competences related to long-term care have been transferred to the Communities, which are currently assessing the scope for new policies.

## Infrastructure

Recommendations from previous <i>Surveys</i>	Actions taken since the previous <i>Survey</i> (2013)
Develop an integrated long-term infrastructure plan supported by Regions and the federal government covering all types of transport and make cost-benefit analysis a standard tool for evaluating the economic value of individual projects.	Debates and studies on multimodal mobility involving federal and regional authorities have been launched to work out a coordinated action plan. In railway infrastructure, a federal competence, the new 2013-25 investment plan is incorporating priority projects of the Regions.
Make the costs of public service obligations (PSO) explicit and compensate service providers for the provision of these PSOs.	No action taken.
Abolish the favourable taxation of company cars and the tax advantages of diesel cars and of diesel as a transport fuel.	No action taken.
Introduce a road pricing system and differentiated public transport fares to reduce congestion. For road pricing, start with congestion pricing in the largest cities before envisaging a national scheme. These measures should be carefully calibrated to avoid unintended shifts to other transport modes.	A road pricing pilot project in the Brussels area was carried out in 2014.



# Thematic chapters





## Chapter 1

# Improving the labour market integration of immigrants

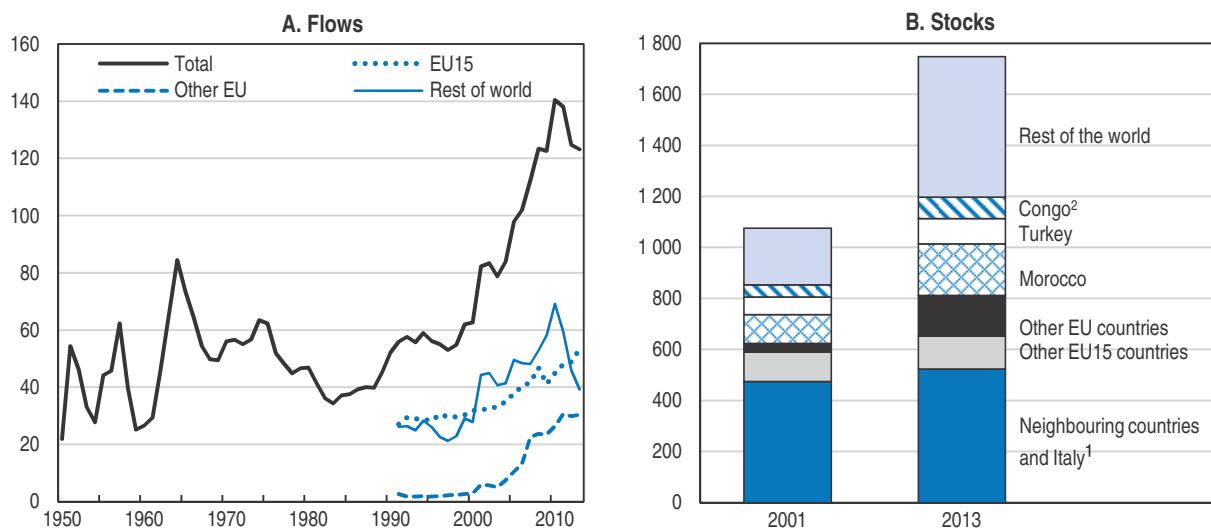
*Immigrants make up one fifth of the Belgian working age population, but their labour market integration is poor. Employment rates of non-EU immigrants, in particular, are very low, and the problem extends to their native-born offspring. Further, with more precarious jobs and lower wages, immigrants are heavily exposed to poverty. This is explained by low educational attainment and correspondingly high vulnerability to disincentives to work and relatively high minimum wages, but also by more diffuse handicaps, like discrimination and imperfect knowledge of the languages of Belgium.*

*Improving the labour market performance of immigrants requires a two-fold strategy. First, policies specific to migrants need to be enhanced. To improve job matching, immigrants need more support to develop and validate their human capital, and employers, both public and private, need stronger incentives to hire a more diverse workforce. Second, general reforms to improve the functioning of the economy, desirable in any case, could also have a significant positive impact on immigrants. There is vast scope to reduce labour costs and increase work incentives for low-skilled workers. Also, the education system needs to become more equitable and responsive to the needs of the children of immigrants.*

## Immigration has reached record highs, but integration remains challenging

Immigrants, henceforth defined as those born abroad whatever their nationality, account for a high and rising share of the Belgian population (16% in 2013). Long substantial, immigration has risen to unprecedented levels since the turn of the century (Figure 1.1). Inflows have also become more diverse, with a decline in the relative importance of neighbouring countries and Italy, and surging arrivals from the new EU member states, Morocco and the rest of the world. Indeed, immigration has accounted for the bulk of population growth in Belgium since the 1990s and can play an important role in counterbalancing the negative effects of ageing on the labour force, if immigrants can be socially and economically integrated (OECD/European Union, 2014). As their age structure differs from natives', with relatively more people aged 20 to 55, immigrants already account for almost one fifth of the working age population (Figure 1.2). Successful integration of immigrants may also bring benefits in other areas, such as sizeable fiscal gains from higher employment (OECD, 2013a) and new export opportunities for Belgian firms through networking and better knowledge of the tastes and needs of foreign consumers.

Figure 1.1. **Immigration has increased and become more diverse**  
Thousand persons, by origin



1. France, Germany, Netherlands and Luxembourg.

2. Democratic Republic of the Congo.

Source: Federal Planning Bureau and Eurostat (2014), "Population by citizenship and country of birth", Eurostat Database, November.


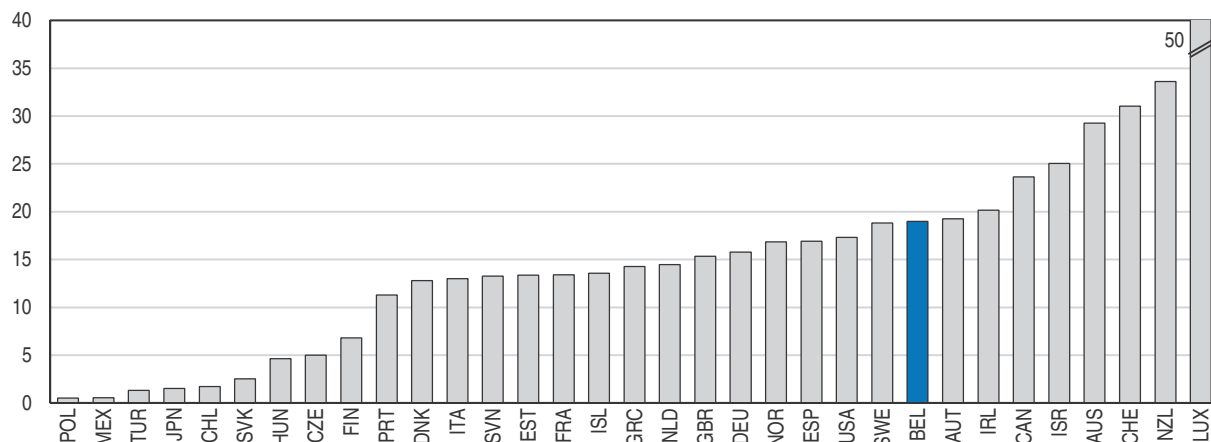
StatLink  <http://dx.doi.org/10.1787/888933181029>

Figure 1.2. **Immigrants are an essential mainstay of the Belgian labour force**Foreign-born population as a percentage of total population, age 15-64, 2011-13<sup>1</sup>

1. 2013 for European Union member countries, Iceland, Norway and Switzerland; 2011-12 for other countries.

Source: Eurostat (2014), "Population by citizenship and country of birth", Eurostat Database, November and OECD International Migration Statistics (database).

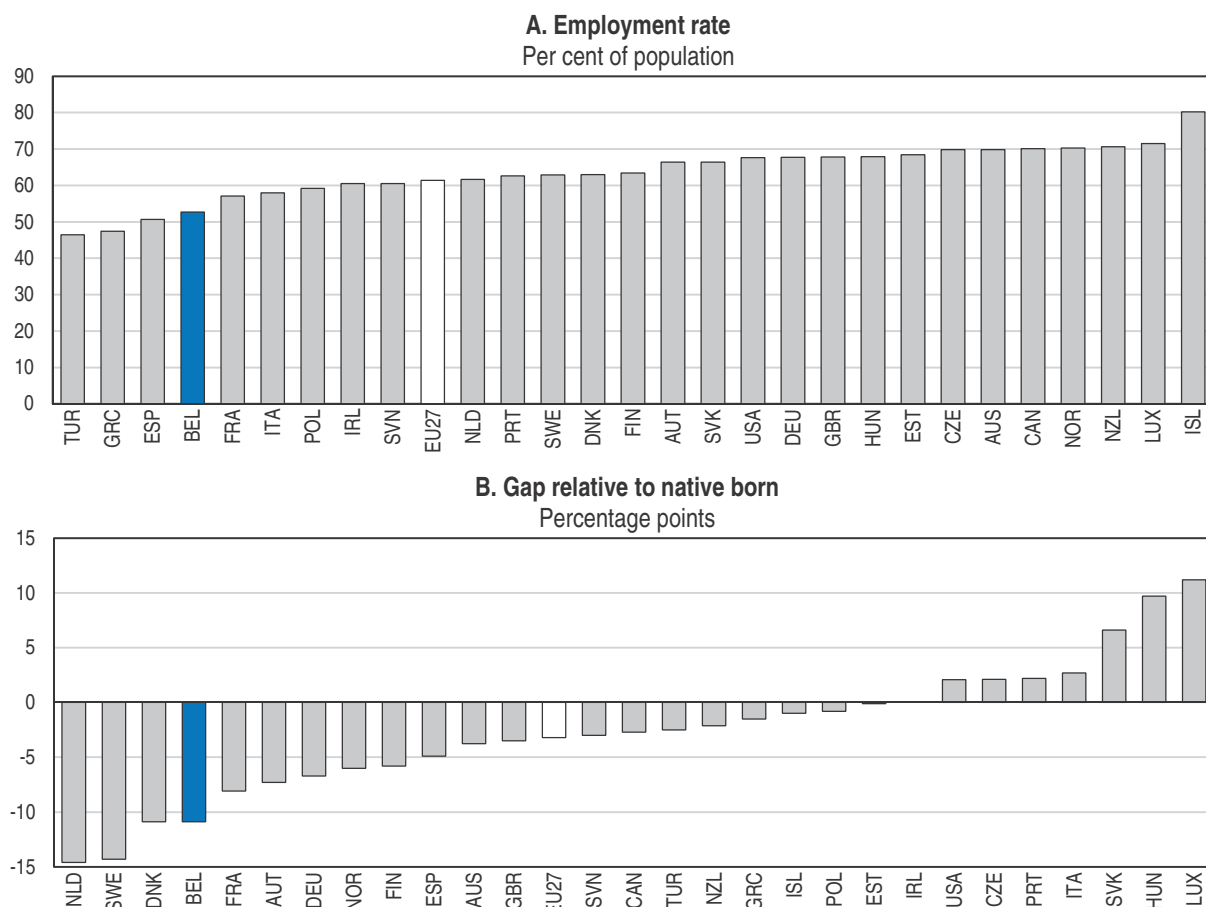
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### **The labour market integration of immigrants remains weak**

However, the labour market integration of immigrants is poor. In international comparison, the employment rate of immigrants in Belgium is among the lowest, lagging the native-born by one of the widest gaps (Figure 1.3). Among immigrants, important heterogeneity exists. The employment status of immigrants from EU origin is broadly comparable with that of natives, with men more exposed to unemployment but less to inactivity (Figure 1.4). In contrast, the labour market performance of non-EU immigrants is much worse, with high unemployment and, among women, large inactivity as well. In 1996-2008, the employment rate gap to natives of EU-born immigrants fell markedly, while that of non-EU immigrants essentially stagnated (Corluy and Verbist, 2014). Since 2008, non-EU immigrants have been hit hardest by the crisis, with a further worsening of their employment rate gap, making integration problems even more pressing.

Weak labour market integration extends to the native-born children of immigrants. Not immigrants themselves, they might be expected to reap the benefits of greater familiarity with Belgian culture and institutions. However, like their parents, they have a low employment rate (OECD, 2012a). Labour market disadvantage is greatest when both parents (rather than only one) were born abroad (De Keyser et al., 2012) and for the children of non-EU immigrants. Despite some progress in 2008-12, outcomes for the native-born offspring of immigrants stress the persistent nature of integration problems.

Besides lower employment rates, immigrants also tend to face less favourable job characteristics. Compared to natives, immigrants are under-represented in public sector and white-collar private sector jobs, and over-represented in the less well-paid blue-collar and temporary employment (Figure 1.5). Again, disadvantage is largest for non-EU immigrants, but there are also important gaps in average job characteristics between EU immigrants and natives.

Figure 1.3. **The employment rate of immigrants is low**Age 15-64, 2013<sup>1</sup>

1. 2012 for Australia, Canada, New Zealand, Turkey and United States.

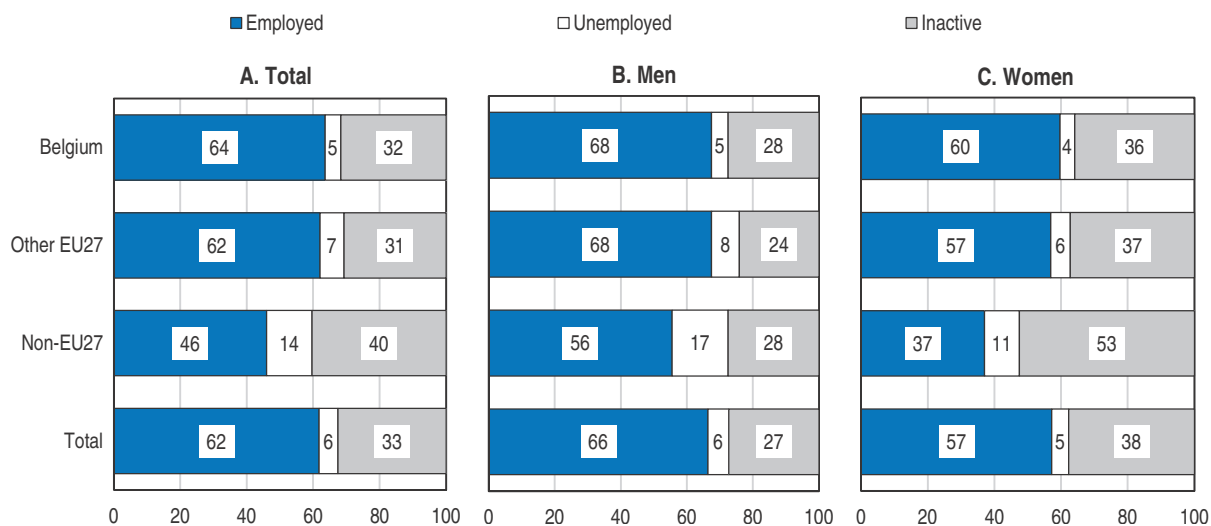
Source: European countries: "Employment and unemployment – Labour Force Survey", Eurostat Database, November; United States: Current Population Surveys; Australia, Canada, New Zealand and Turkey: Labour Force Survey.

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Lower employment and lower wages fuel poverty and social exclusion, where Belgium displays, together with Greece, the largest gap in the EU between immigrants and natives (Figure 1.6). While among natives couples are three times less likely than singles to live in a poor household, they are as or more likely among non-EU immigrants. This results from lower wages, higher unemployment and a different household composition, with widespread female inactivity and more children.

### **Both immigrant-specific and general policies need reform**

Poorer educational attainment goes some way to explain the weak labour market integration of immigrants. Belgium has an internationally high share of low-educated non-EU immigrants (Figure 1.7). Unlike their EU-born peers, immigrants born outside the EU have not accompanied the general upward trend in education levels in Belgium over the past two decades, and their comparative disadvantage has therefore increased (Corluy and Verbist, 2014). Taking adult skill proficiency instead of educational qualifications yields a similar picture, with an internationally low performance of immigrants to Flanders in

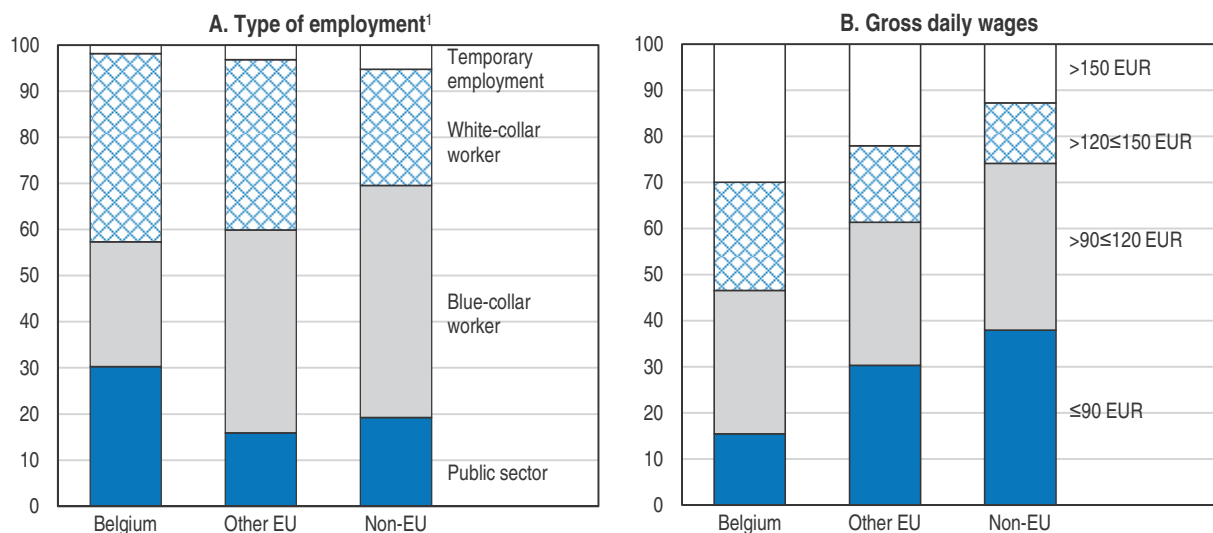
**Figure 1.4. Non-EU immigrants have poorer labour market performance**Employment status by country of origin and gender, age 15-64, per cent, 2013<sup>1</sup>

1. Numbers may not add up to 100 due to rounding.

Source: Eurostat (2014), "Employment and Unemployment (Labour Force Survey)", Eurostat Database, November.

StatLink <http://dx.doi.org/10.1787/888933180898>**Figure 1.5. Immigrants have poorer job characteristics**

Population aged 18-64 by country of origin, per cent, 2012

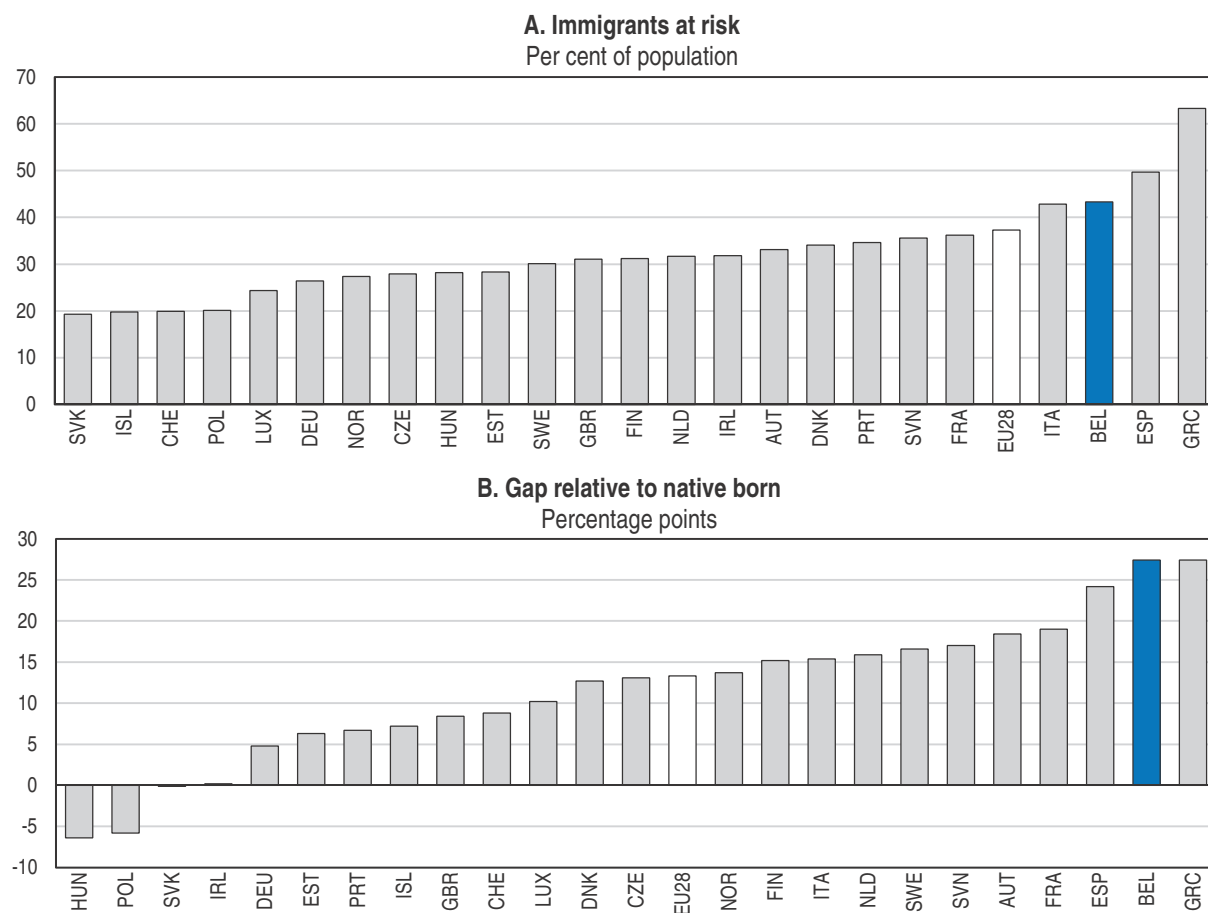


1. Blue and white-collar categories refer to employees working under a regular blue or white-collar contract of indefinite or limited duration. Temporary work covers interim employment. Self-employment is excluded as are European Union officials.

Source: CBSS (2014), *Datawarehouse marché du travail et protection sociale* (Labour market and social protection database), Crossroads Bank of Social Security.StatLink <http://dx.doi.org/10.1787/888933180902>


literacy and problem-solving skills (OECD, 2013b). Nonetheless, education accounts for only a limited part (less than 20%) of the large employment rate differences between natives and non-EU immigrants, and even controlling for other socio-demographic factors (such as Region of residence, discussed below) a large unexplained gap remains – often called the ethnic gap or penalty (Corluy and Verbist, 2014).

Figure 1.6. **Many immigrants face poverty and social exclusion**  
 Risk of poverty or social exclusion by country of birth, age 18-64, 2013<sup>1</sup>



1. 2012 for Ireland and Switzerland. People at risk of poverty or social exclusion corresponds to the sum of persons who are: at risk of poverty, severely materially deprived or living in households with very low work intensity. At risk-of-poverty are persons with an equivalised disposable income below 60% of the national median (after social transfers). Severely materially deprived persons are constrained by a lack of resources experiencing at least 4 out of 9 deprivation items such as being unable to pay rent or utility bills, buy a telephone or a washing machine. People living in households with very low work intensity are those living in households where the adults worked less than 20% of their total work potential during the past year.

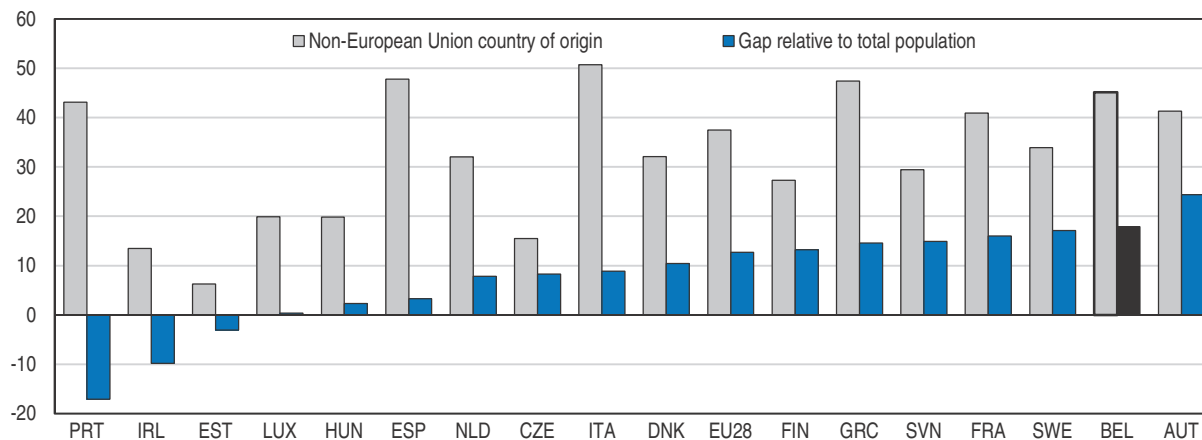
Source: Eurostat (2014), "Living conditions and welfare: People at risk of poverty or social exclusion (Europe 2020 strategy)", Eurostat Database, November.

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Patterns of regional settlement and some general labour market settings also help explain lower employment rates among immigrants. The foreign-born, and especially newcomers among them, are highly concentrated in Brussels, where unemployment is highest, and relatively less numerous in Flanders, where unemployment is lowest (Figure 1.8). Each Region broadly displays the same gaps in employment status between immigrants and natives observed for Belgium as a whole, with non-EU immigrants, and especially women among them, lagging behind. Brussels is the starkest example of a more general pattern of strong concentration of immigrants in the largest cities, which gives rise to problems of residential and school segregation. Network effects from settled communities help explain that pattern, further reinforced by low residential mobility and language barriers. Certain labour market, taxation and welfare policies are also likely to

**Figure 1.7. The share of low-educated immigrants is high**

Per cent of population aged 25-64 with lower secondary education or less as highest level of education, 2013



Source: Eurostat (2014), "Education and Training: Distribution of the population by educational attainment level", Eurostat Database, November.

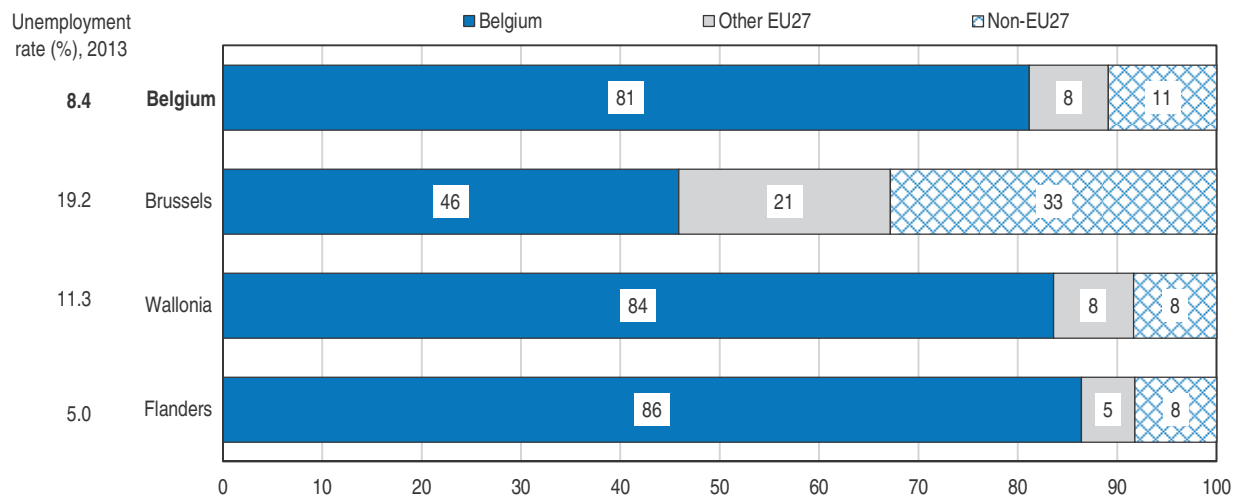
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penalise immigrants disproportionately, due to their over-representation among low-skilled workers. Examples are the high costs of low-productivity labour and small income gains when moving from unemployment or inactivity to a job.

A host of other factors, often hard to quantify, can also underpin labour market disadvantage. Despite extensive legislation to the contrary, discrimination is still an important barrier to labour market access, although it becomes less of a problem when immigrants apply for jobs in high demand (Centre pour l'égalité des chances et la lutte contre le racisme, 2012; Baert et al., 2013). Notwithstanding efforts by integration policies,

**Figure 1.8. Immigrants are highly concentrated in Brussels**

Population aged 15-64 by Region and country of birth, per cent, 2012



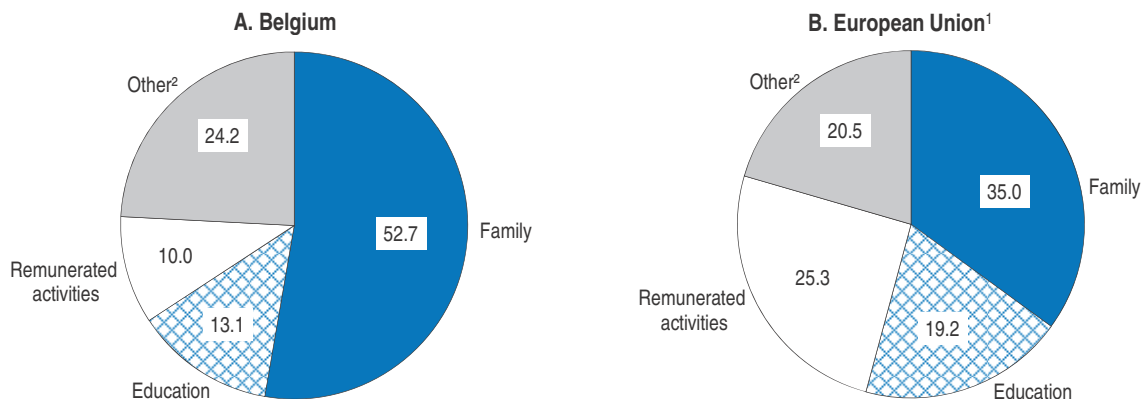
Source: CBSS (2014), *Datawarehouse marché du travail et protection sociale* (Labour market and social protection database), Crossroads Bank of Social Security and Eurostat (2014), "Regional Labour Market Statistics", Eurostat Database, November.

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not least in language training, poorer knowledge of the language and labour market of the host country, which hampers effective networking and job search, also plays against immigrants. Furthermore, the composition of the migration inflows, with a large share of immigration from outside the EU for non-labour motives, such as family reunification or asylum (Figure 1.9), also adds to mismatches with labour market needs (OECD, 2008).

Figure 1.9. **Immigration for non-labour motives is large**

Residence permit issued to a person for the first time, average 2012-13



1. EU27 unweighted average.

2. Includes asylum, subsidiary protection and humanitarian reasons.

Source: Eurostat (2014), "International migration and asylum", Eurostat Database, November.

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This chapter proposes a two-pillar approach to improve the labour market performance of immigrants by enhancing policies directly targeted at migrants on the one hand while improving more generally the functioning of the labour market and the education system on the other hand. *First*, better integration and migration policies are needed to address the challenges summarised in the paragraph above. *Second*, reforms in labour market and education settings, mostly of a general, non-immigrant-specific nature, have potentially a large payoff for immigrant employment while at the same time yielding gains for the economy as whole. Reforms in the housing market, which would conceptually also belong to the second pillar, are discussed in Chapter 2. Although presented separately, these two strands of action are arguably intertwined and mutually reinforcing. For instance, policies designed to help firms integrate and manage a more diverse workforce will likely have greater effectiveness if educational attainment among immigrants rises. Conversely, progress in fighting discrimination and promoting diversity will improve labour market opportunities for immigrants and hence may increase their incentives to invest in education.

### Integration and migration policies for better skills and job matching

Integration policies are needed to help immigrants adapt to the host country and its labour market. In their early years in a new country, immigrants may have lower productivity than natives with similar levels of education, due inter alia to lack of host-country-specific human capital and poorer worker-to-job matching capabilities (Causa and Jean, 2007; OECD, 2007). Furthermore, discrimination often makes the perceived productivity gap exceed the real one. Migration policies which fail to attract



immigrants well-matched to labour market needs compound these difficulties. Anti-discrimination legislation, well-developed in Belgium, is important but not enough. Immigrants need opportunities to learn the host country language(s), develop social capital and see the education and skills acquired in country of origin validated and, if needed, reinforced. In turn, employers need to be prepared to deal with the challenges and opportunities posed by a more diverse workforce. The economy-wide implications of immigrant integration also mean that policies need to be developed and implemented in cooperation with social partners.

### **Reinforcing human capital**

Language training is essential for social and economic integration, and should be provided in a way that maximises the acquisition of social capital and labour market skills. Language courses are part of the integration programmes offered to newcomers by both the Dutch and French-speaking Communities. Mostly optional, courses are organised flexibly so that those employed can follow them, but more systematic evidence on their quality and impact on employment rates would be welcome. Effectiveness for labour market integration will likely be enhanced by adapting language training to workplace needs or combining it with other forms of training, such as internships. Existing programmes along these lines should thus be expanded. For this purpose, the Flemish government plans to increase cooperation with social partners and non-government organisations, and to develop datasets to better monitor the socio-economic trajectories of immigrants. Implementing integration programmes linked to labour market training is one of several examples which illustrate the need for coordination between different levels of government.

Knowledge of both Dutch and French would enhance the employability of immigrants, especially in the bilingual Region of Brussels, where immigrant concentration and unemployment are highest. Appropriately, the Brussels public employment service (PES), Actiris, has a scheme of language cheques, which, following a diagnostic test, offers an amount of free tuition in a second language to job seekers or those recently hired. Launched in 2002 and open to both Belgian and foreign citizens, eligibility conditions have been gradually expanded, and overall take-up increased more than ten-fold in 2006-12. The share of non-EU citizens has also progressed. Language cheques have been found to increase the probability of exiting unemployment, though gains are smaller for foreign citizens and tend to fade in the long run (Observatoire bruxellois de l'Emploi, 2013a). Given that in areas close to the Brussels Region the share of commuters to the capital sometimes exceeds 25% of the workforce (OECD, 2013c), eligibility for language cheques could be extended to those seeking a job in Brussels but residing in other Regions, as is already the case for those recently hired by a Brussels employer.

Timely recognition of academic degrees and professional skills acquired abroad would also improve the job prospects of immigrants. Its absence can induce delays in taking up employment, mismatches and over-qualification, all with risks of human capital depreciation. As regards skill validation, professional certificates granting access to specific occupations can be obtained upon successfully passing tests organised by recognised validation centres. This procedure started in the mid-2000s and applies to high, medium and low-skilled occupations. However, it remains under-developed, with few certificates awarded, especially in Flanders (only around 100 certificates per year are awarded to immigrants). Skill validation should be expanded, *inter alia* by providing

training in response to weaknesses detected in tests. The required coordination between Communities, responsible for skill validation, and Regions, responsible for labour market training, has particular importance in Brussels, as the relevant authorities are aware.

Despite some improvement, the recognition of foreign diplomas in Belgium (a Community competence) remains burdensome, which discourages many immigrants from even attempting it (De Keyser et al., 2012). For instance, in a sample of newly-arrived immigrant jobseekers registered at the Brussels public employment service, over 90% held a non-recognised foreign education degree, and lack of recognition helped explain why unemployment exit rates were broadly similar for low and highly-educated jobseekers (Observatoire bruxellois de l'Emploi, 2013b). Flanders shortened the average duration of the recognition procedure for higher education degrees from 211 days in 2011 to 127 in 2013, but some backlog remains. In the French Community, tertiary education recognition for professional purposes (rather than for further studies) takes on average around 100 days. However, this statistic does not include the numerous requests (more than half of the total in 2013) on which a decision is postponed, due to incomplete applications or other reasons. Further, the share of negative decisions on tertiary education requests is high in both Communities (in 2013, over 40% in Flanders and around two thirds in the French Community, though this latter figure mostly includes cases where equivalence to a lower degree was awarded). The authorities should continue to reduce delays in degree recognition and ensure that decisions are well-informed. Support to more contacts between Belgian universities, which advise on degree recognition, and their foreign counterparts, especially from outside the EU, could help on both counts.

### ***Fostering diversity in the private sector***

Promoting equality of opportunities and fighting discrimination also requires helping firms to address the challenges and exploit the benefits of a more diverse workforce. Diversity plans, pioneered by Flanders and later adopted by the other Regions, are the main instrument for this purpose (OECD, 2008). Firms which choose to implement a diversity plan must set targets for the recruitment, internal mobility, training or retention of immigrants or some other vulnerable group, like unqualified youth or disabled people. To achieve targets, firms receive free consultancy support (e.g. on skill development and the management of diversity) and subsidies to co-finance plan-related costs (e.g. language courses). In Flanders, firm-level plans may also benefit from broader-level schemes set up in cooperation with social partners, such as support in recruitment from target groups (Jobkanaal).

Diversity plans have much scope for expansion and for better links with other policy initiatives. Take-up has gradually increased but remains low: even in Flanders, still less than 5% of all companies have introduced a diversity plan, though the participation share increases with firm size, reaching 30% among those with 200 or more employees. Unsurprisingly, despite generally successful implementation in participating firms, the aggregate impact of plans on the employment rates of target groups remains very limited (ULB, 2012; De Coen et al., 2014). The slow nature of cultural and organisational change may help explain this, as does the post-2008 economic crisis, which has hit immigrants harder than natives. While persevering with efforts for further engagement with social partners to expand diversity plans, the authorities should better exploit synergies with other strands of integration policies. This is already the case with language training in the workplace, but there is scope for better articulation with PES training offers and skill validation.

### **Overcoming under-representation in public employment**

There is large scope for the Belgian public sector to support further the economic and social integration of immigrants. A large employer itself (over a quarter of total dependent employment), by hiring immigrants the public sector may also act as a role model for private firms, increase the visibility of immigrants in everyday life and better address their needs as users of public services (OECD, 2008; foreign-born teachers illustrate these points). Over the past decade, diversity plans have been launched at several levels of government, and recruitment processes increasingly reviewed for potentially discriminatory features. These initiatives, however, have often had little impact. On top of their overall low employment rate, comparatively few immigrants hold a public sector job (recall Figure 1.5).

Together with an overall low hiring rate in the public sector, citizenship requirements help explain the low share of immigrants in public sector jobs. There are two types of public employment, statutory and contractual. Statutory jobs (over half of the total) often require, especially at federal level, citizenship of an European Economic Area (EEA) country or Switzerland, while there are in general no nationality requirements for contractual workers. In any case, Belgian citizenship is needed for positions involving the exercise of public authority or the safeguard of the general interest. Unsurprisingly, both for those of EU and non-EU origin, naturalised immigrants are more likely to work in the public sector than those who remain foreign nationals (Corluy et al., 2011). The tightening of naturalisation requirements since 2013 (longer residence periods and need for proof of social and economic integration) will likely worsen immigrant access to public employment, especially for those of non-European origin. In this context, the authorities should consider eliminating citizenship requirements for statutory public sector jobs, with only narrowly-defined exceptions.

As in firm-level diversity plans, indicative targets for immigrant employment or recruitment can be used to promote diversity in the public sector workforce. Encouraging evidence comes from the Flemish government, which in 2004 set a 4% target, to be attained by 2015, for the share of immigrant employees (using a specific definition based on non-European background). The actual share increased from 1.1% to 3.9% in 2006-14. Despite major data limitations (discussed below), this progression has likely been above-average: in the Belgian public sector as whole, the share of the foreign-born increased by only 0.7 percentage points in 2008-12. The Flemish authorities have recently set a new target of 10% for 2019, with an enlarged and more comparable concept of immigrants (based on non-Belgian background). The federal government has also announced the intention to set a target for immigrant employment in the federal administration. Targets of this nature, defined relative to total employment or to new hiring, should be set at all levels of government, their indicative character ensuring that recruitment remains competence-based.

Knowing the ethnic origin of staff is needed to implement targets for immigrant employment and, more generally, to better understand their under-representation. However, at the level of individual layers of government, there remain major data gaps. In most cases, information on the origin of employees is still available only on the basis of citizenship. Exceptions using a broader definition of migration background include a survey in the Brussels Region in 2012 and an anonymous monitoring system implemented by the Flemish government. Systematic monitoring of the ethnic origin of staff, on an anonymised basis and with appropriate data privacy safeguards, should be implemented

at all levels of government and based on a common definition of immigrants. Further, monitoring should also be extended to public sector job applicants, thus shedding light on the causes of immigrant under-representation (e.g. few candidates or low success in the recruitment process). Since 2013, the federal and Flemish recruitment agencies have taken a first step in this direction by giving candidates the option to indicate their origin on a voluntary basis.

### ***Migration policies for better matching with labour market needs***

Belgian migration policies do not generally push newcomers into periods of forced inactivity, but the matching of inflows to labour market needs could be improved. EU citizens have free access to the Belgian labour market, with transitional restrictions for Croatians only. Immigrants from the rest of the world who still do not have a permanent right of residence generally need a work permit, which can limit career prospects (see below) but seldom impedes access to employment (De Keyser et al., 2012). However, shortcomings in migration policies leave opportunities for addressing labour market needs unexploited.

Some policy shortcomings are likely to be especially detrimental for the attraction of highly-qualified labour immigrants. Despite efficient administrative procedures for high-skilled newcomers (Deloitte, 2013), Belgium issues initial work permits (type B) valid for only one year, though with the possibility of renewal. This short horizon likely weighs on work and career prospects, one of the areas that make Belgium unattractive for high-skilled immigrants when compared to neighbouring countries (Berkhout et al., 2010). For instance, Germany and the Netherlands issue EU Blue Cards (a combined work and residence permit for high-skilled non-EU citizens) valid for four years, against 13 months in Belgium, and France and the Netherlands grant to other (i.e. non-Blue Card) high-skilled immigrants a three and five-year work and residence permit, respectively. At least for high-skilled labour immigrants, the authorities should significantly extend the current one-year permit duration. In these cases, granting the immigrant's spouse a permit of similarly extended duration may also enhance Belgium's attractiveness. To further reduce administrative burdens, the authorities should finalise ongoing preparations for a single work and residence permit, as in many EU countries. Coordination among different levels of government is essential to implement reforms and avoid undesirable competition between Regions (Box 1.1).

Better use of the simplified work permit procedure to fill bottleneck positions will improve labour market matching for medium-skilled immigrants. This procedure was introduced in 2006 to manage inflows from the new EU member states and has accounted for the majority of work permits issued in recent years. However, the full opening of the Belgian labour market, in 2009, to citizens of countries having joined the EU five years earlier, extended at end-2013 to Bulgarian and Romanian nationals, left the procedure only applicable to Croatians and to non-EU citizens who are long-term residents in a EU country. Furthermore, the list of occupations covered has remained unchanged since the outset, despite the fact that regional PES produce yearly updates of shortage-list occupations, on which technical professions and health care positions feature prominently. The bottleneck procedure should be extended to non-EU newcomers, and its list of occupations regularly updated. Preparatory work towards a dynamic and fine-tuned list is being carried out by the Flemish PES.

**Box 1.1. The distribution of competences for integration and migration policies**

Integration and migration policies aptly illustrate the complex distribution of competences across levels of government and the ensuing need for strong coordination mechanisms.

Responsibility for the several dimensions of integration policies discussed above lies mostly with Communities and Regions. Communities are responsible for the integration of foreigners, and hence organise integration programmes for newcomers. Within their broader responsibility for education, recognition of academic degrees and professional skills also fall within the remit of Communities. Many of these areas have the potential for synergies with labour market training, for which Regions are responsible. The ensuing need for coordination is strongest in Brussels, a Region where the two main language Communities are present. Regions are also in charge of promoting diversity in the private sector. As employers, all levels of government can influence the participation of immigrants in the public sector workforce.

Responsibility for migration policies is essentially divided between the federal government, in charge of residence permits, and the Regions, competent for those work permits pertaining to labour-motivated migration (type B, valid for one year, and type A, permanent and granted only after two to four years of work under a type B permit). Work permits granted to foreigners with a limited or precarious right of residence, such as asylum-seekers (type C), are issued by the federal authorities. The Sixth State Reform transferred the regulation of labour migration from the federal level to the Regions, previously only responsible for policy execution in this area. Some forms of competition among Regions in the rules for work permits could have negative effects, such as distorting company location decisions. As acknowledged by the authorities, coordination among different levels of government, already substantial before the Sixth State Reform, will thus need to be increased further.

There is scope to improve labour market access for asylum seekers, who are barred from working during the first stage of their application procedure. In a welcome step, this period of inactivity, which could formerly be very long, has been reduced to a maximum of six months, already shorter than in some neighbouring countries. Still, as forced inactivity may erode human capital and thus make a return to work more difficult, the authorities could consider giving immediate permission to work in those cases where it can be determined that the asylum application is not obviously unfounded.

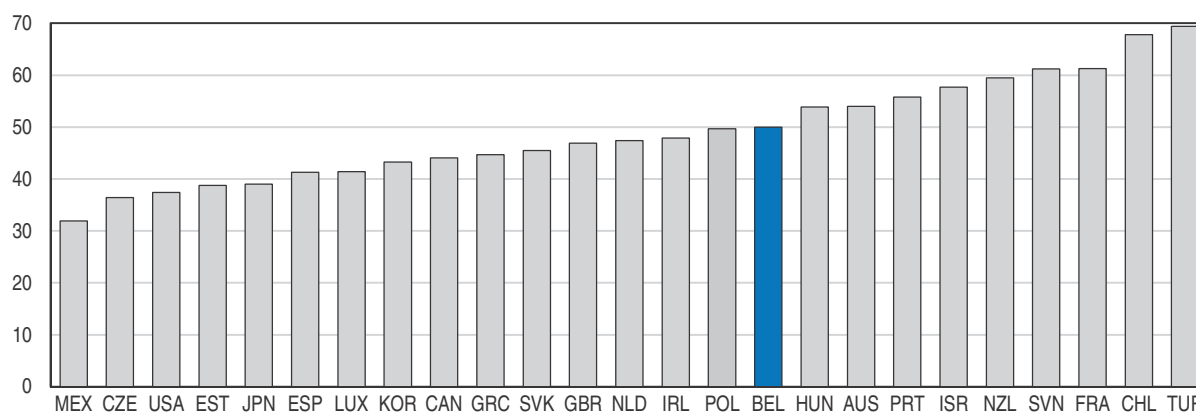
### **General labour market settings often reduce the employment prospects of immigrants**

Belgian labour market settings are generally unfavourable to the employment outcomes of low-skilled workers. Reduced employment rates stem from high labour costs, which deter demand for low-productivity workers, and small income gains when moving from unemployment or inactivity to a job, which discourage labour supply (OECD, 2011; OECD, 2014a). Furthermore, labour market segmentation and rigidity weigh on the wages and progression prospects of outsiders. With immigrants over-represented among low-wage, vulnerable workers, labour market settings likely hurt the foreign-born disproportionately. The possibility of differential effects of given settings on immigrants and natives, on which limited evidence exists for Belgium, is an important area for future analysis (SPF Emploi, Travail et Concertation sociale and Centre pour l'égalité des chances et la lutte contre le racisme, 2013).

### Reducing costs and taxes to stimulate labour demand and supply

Minimum wages can create a barrier to employment of low-skilled immigrants, especially for youth. As a proportion of the median wage, the Belgian statutory minimum wage is on the high side in international comparison (Figure 1.10), and sectoral agreements generally provide for even higher minima. This helps to prevent in-work poverty (which in 2012 only affected 3.6% of those with a full-time job, against 7.6% across the EU), but risks pricing low-skilled workers out of the labour market (Neumark and Wascher, 2006). Groups with further real or perceived productivity handicaps, such as youth or immigrants, will be among the most affected. In 2012, the overall unemployment rate in Belgium was 7.6% (15-64 age group), rising to 19.8% for those in the labour force aged under 25, and, among these, reaching 29.3% and 27.9% for immigrants and their native-born offspring, respectively.

Figure 1.10. **Minimum wages are fairly high**  
Per cent of median wages, 2013

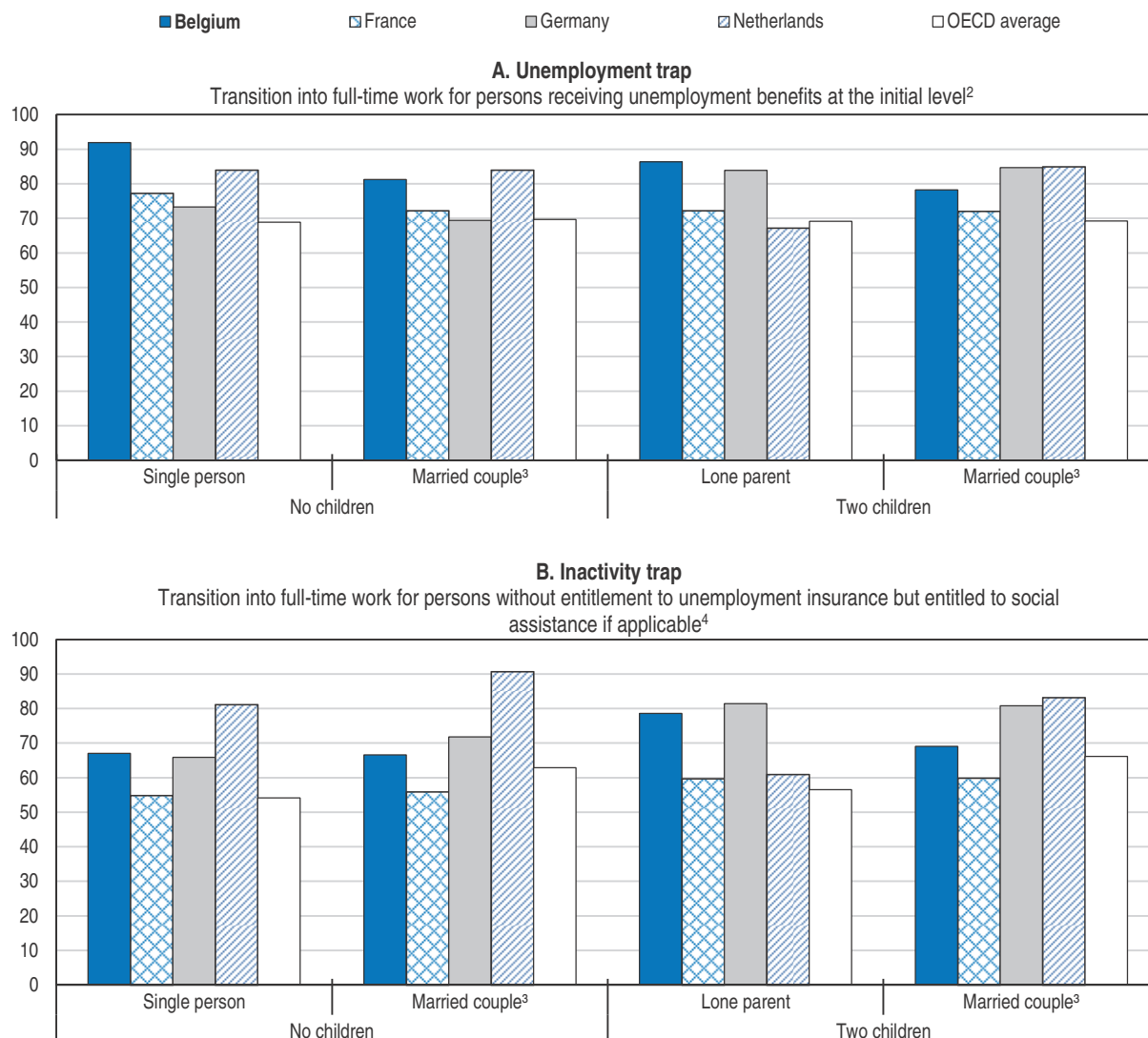


Source: OECD (2014), "Earnings: Minimum wages relative to median wages", *OECD Employment and Labour Market Statistics* (database), November.


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Lower youth minimum wages may mitigate risks of labour market exclusion. In 2012, 12 OECD countries applied reduced statutory minima to youth (out of 25 countries setting minimum wages at all). Belgium was one of them, with lower minima in the 16-20 age range (a 6% reduction for each year below 21), where in-work poverty risks are often alleviated by family support. However, this age differentiation is being phased out in 2013-15. Sectoral agreements will still have the option to include lower youth minimum wages, but these cannot fall below the national statutory minimum. Worryingly, since 2012 youth unemployment has risen markedly (reaching 24.9% in the first half of 2014 for 15-24 year-olds in the labour force), and the youth employment rate has fallen, unlike that of prime-age workers. The authorities and social partners could consider reintroducing lower statutory minimum wages for young workers.

The Belgian tax and benefit systems also reduce employment rates, especially among the low-skilled. Labour tax wedges are among the very highest across the OECD. Work incentives are reduced by the combination of relatively generous out-of-work income support, above-average employee social contributions and high personal income tax (PIT) on wages, with marginal rates quickly reaching 50%. At low wage levels, major unemployment and inactivity traps therefore ensue (Figure 1.11). In one-earner couples, which are much more prevalent among immigrants than among natives, work disincentives

**Figure 1.11. Unemployment and inactivity traps reduce work incentives**Participation tax rate for earnings equal to 67% of the salary of an average worker (AW), 2012<sup>1</sup>

1. Participation tax rates measure the extent to which taxes and benefits reduce the financial gain of moving into work. The percentage of AW relates to the earnings from full-time employment of the individual moving into work. Calculations for families with children assume two children aged 4 and 6.
2. For a person who has just become unemployed and receives unemployment benefits (following any waiting period) based on previous earnings equal to earnings in the new job. No social assistance “top-ups” or cash housing assistance are assumed to be available in either the in-work or out of work situation. Any benefits payable on moving into employment are assumed to be paid. Calculations for families with children do not consider childcare benefits or childcare costs.
3. One-earner married couple, the second spouse is assumed to be inactive with no earnings
4. For a person who is not entitled to unemployment benefits (e.g. because their entitlements have expired). Instead, social assistance and other means-tested benefits are assumed to be available subject to relevant income conditions. Where receipt of such assistance is subject to activity tests (such as active job-search or being “available” for work), these requirements are assumed to be met in the out of work situation. Cash housing benefits are calculated assuming private market rent, plus other charges, amounting to 20% of the full-time wage for all family types.

Source: OECD (2014), *OECD Tax-Benefit Models*, March, [www.oecd.org/els/social/workincentives](http://www.oecd.org/els/social/workincentives).StatLink  <http://dx.doi.org/10.1787/888933180921>

also stem from the *quotient conjugal*, a PIT provision which allocates 30% of income to the non-earning spouse: if this spouse enters employment, part or all of the ensuing income will be taxed at the higher tax rate of the other spouse. To reinforce labour demand and work incentives for low-skilled people, labour tax wedges should be reduced, as is being considered by different governments. Care should be taken not to target reductions on very low wages alone, as this would risk increasing already high marginal tax wedges at still modest wage levels, with ensuing low-wage traps and disincentives to upskill. In Belgium, marginal tax wedges currently near 80% at less than two-thirds of the average wage (OECD, 2014a).

### **Avoiding relegating immigrants to precarious contracts**

Policies that aggravate labour market dualism tend to harm immigrants. In Belgium, the foreign-born are often relegated to the lower tier of the labour market, with lower wages, higher turnover and fewer chances for human capital accumulation (Causa and Jean, 2007; SPF Emploi, Travail et Concertation sociale and Centre pour l'égalité des chances et la lutte contre le racisme, 2013). Employment protection legislation (EPL), which has important implications for dualism, has been recently reformed in Belgium (2014), with the unification of rules for blue and white-collar regular workers as regards trial periods (which were abolished for both groups) and periods of notice before dismissal, among other previous differences. One form of dualism has thus been reduced, which is welcome. However, since the unified rules have increased employment protection for the blue-collar segment, where immigrants are over-represented, there is for this segment a risk of rising dualism between regular and temporary contracts, with immigrants and other vulnerable groups increasingly hired under the latter. If this risk materialises, the authorities should make the unified rules less protective, namely by reintroducing trial periods and shortening periods of notice before dismissal.

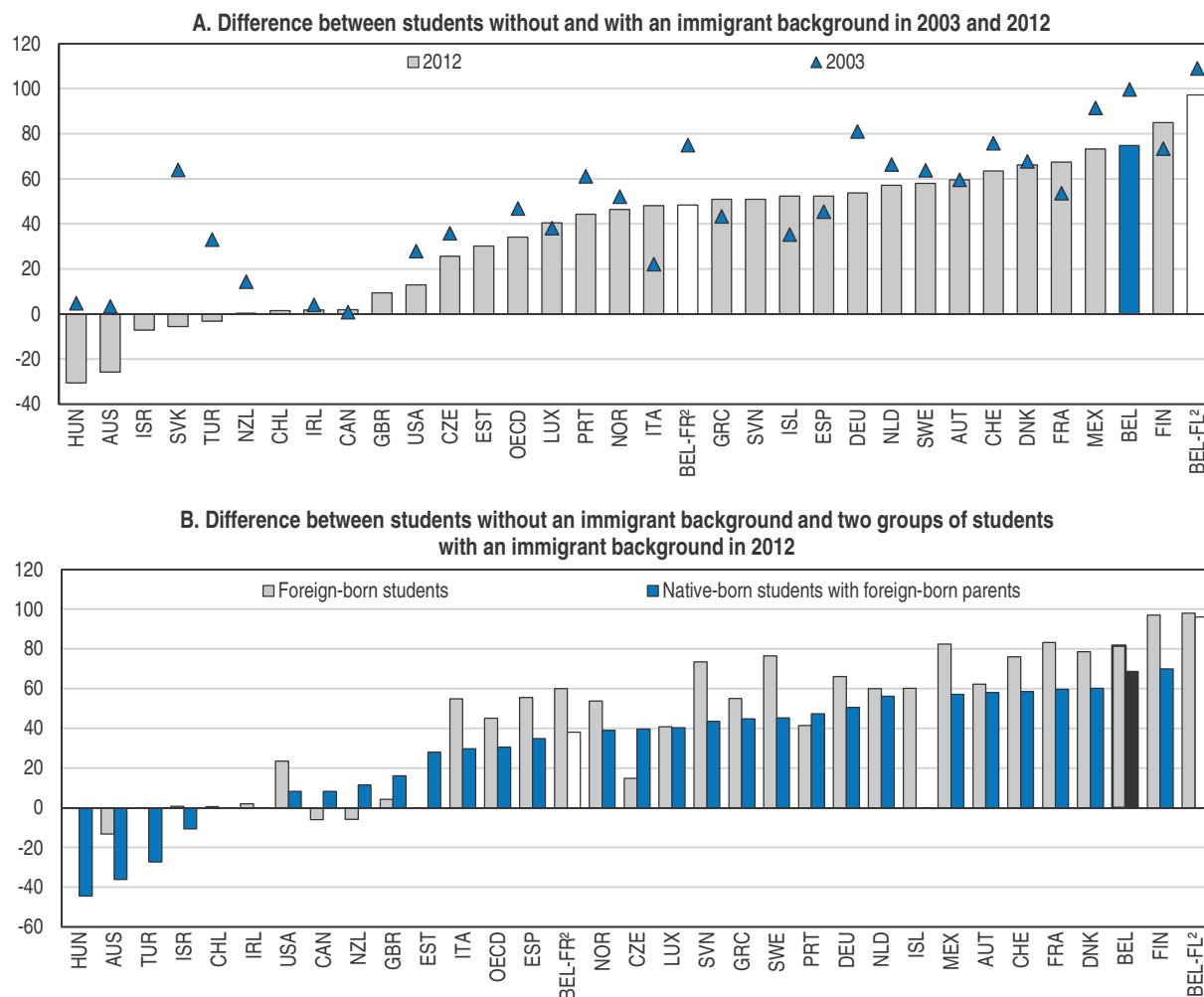
## **The educational outcomes of the children of immigrants need improvement**

Compared to their peers without a migration background, the children of immigrants tend to underperform by a wide margin, and by more than in many other countries. Poorer school achievement, a major determinant of the lower educational attainment of the population with an immigrant background, is mirrored in the PISA results (Liebig and Widmaier, 2010): despite some improvement over the past decade, 2012 performance gaps in Belgium remain very high in international comparison (Figure 1.12). Gaps are largest in the Flemish Community, but also a cause for concern among French speakers. Progress from foreign-born students to native-born students with foreign-born parents is limited.

To an important degree, the weaker performance of the children of immigrants stems from low equity in Belgian education, which harms disadvantaged students in general. Socioeconomic family status has an internationally high impact on student performance, and that impact has only modestly waned in 2003-12 (OECD, 2013d). Controlling for socioeconomic status both at the student level and at the school level (which averages the status of students attending it, and thus captures a high concentration of disadvantaged students in certain schools), the PISA 2012 performance gap between students without and with an immigrant background is nearly halved (from 75 to 39 score points, one of the largest reductions across the OECD). Besides equity issues, immigrant-specific factors, like a different language spoken at home, help explain the performance gap and thus also call for policy action.




Figure 1.12. **Children of immigrants underperform by a wide margin**  
Difference in the mean PISA score for mathematics performance relative  
to immigrant background<sup>1</sup>



1. PISA: Programme for international student assessment. Students with an immigrant background are those whose parents were born in a country/economy other than the country/economy of assessment.

2. BEL-FR: French Community; BEL-FL: Flemish Community.

Source: OECD (2013), PISA 2012 Results: Excellence Through Equity: Giving Every Student the Chance to Succeed (Volume II) and national authorities.

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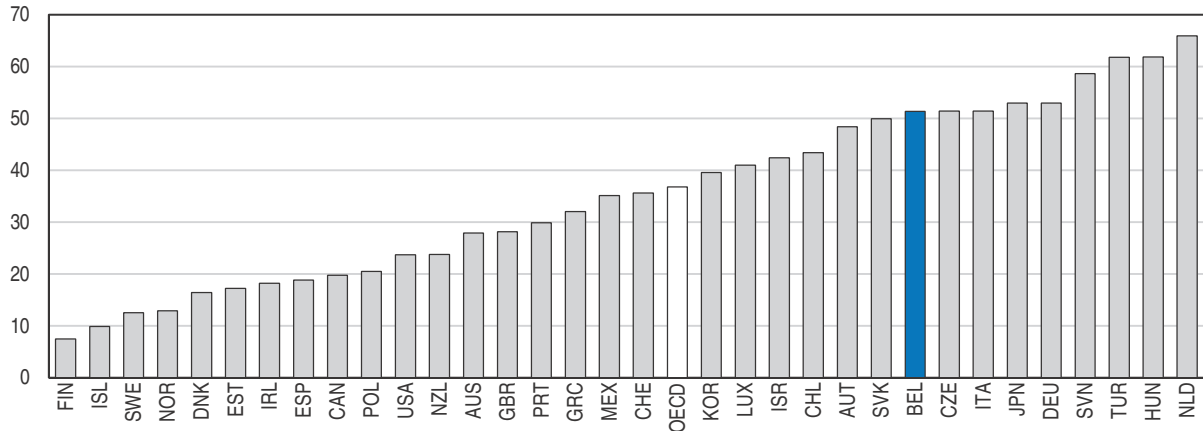
### Promoting social diversity in schools

School segregation in Belgium is high, helping to explain large performance differences across schools (Figure 1.13) and calling for reforms in enrolment procedures. Disadvantaged students tend to be highly concentrated, which hampers their learning without clear benefits for their better-off peers (Karsten, 2010). The children of immigrants are hit hard, both because they are over-represented in disadvantaged schools (Figure 1.14) and because the effect of school disadvantage on learning outcomes tends to be larger than for students with no immigrant background (OECD, 2012b). In both the Flemish and French Communities, free choice of primary and secondary schools, with enrolment largely unregulated until the past decade, has likely contributed to school segregation, which often

exceeds residential segregation, especially in Brussels (Musset, 2012; Cantillon, 2013). In welcome steps, the authorities have introduced controlled choice schemes, which supplement free choice with allocation mechanisms to increase social diversity in schools. These schemes, however, need to be further refined and expanded.

**Figure 1.13. Performance differences between schools are large**

Variation in mathematics performance between schools as a percentage of variation between+within schools, PISA 2012<sup>1</sup>



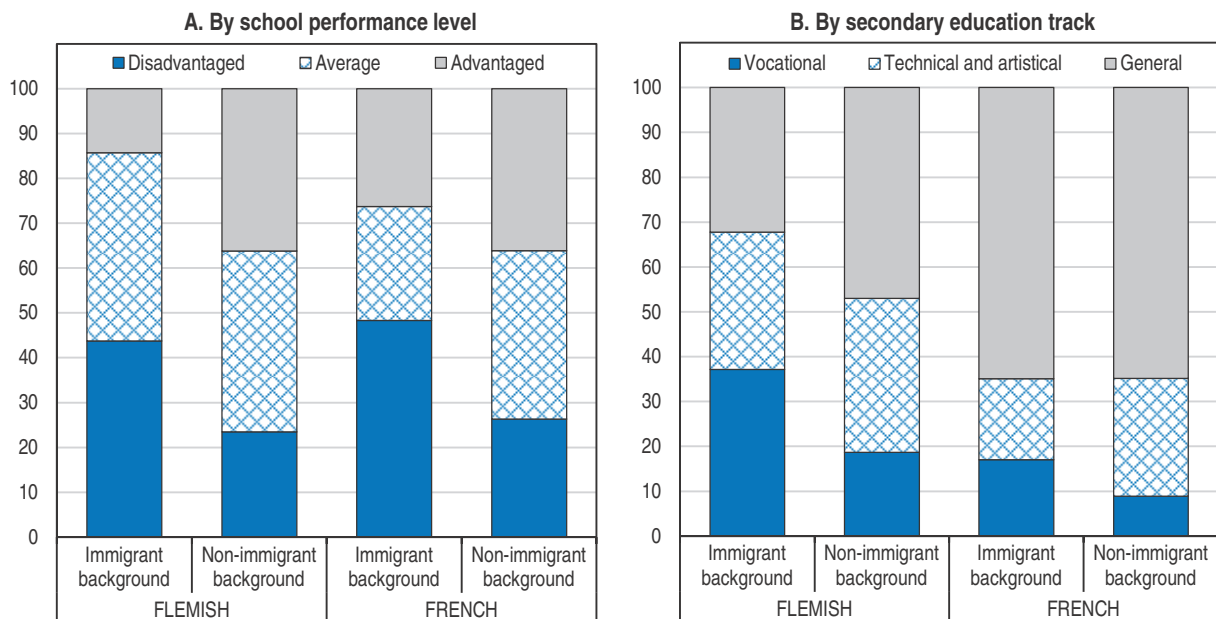
1. PISA: Programme for international student assessment. In some countries, sub-units within schools were sampled instead of schools; this may affect the estimation of between-school variation components (see Annex A3 of source publication). Due to the unbalanced clustered nature of the data, the sum of the between and within-school variation components, as an estimate from a sample, does not necessarily add up to the total variance.

Source: OECD (2013), PISA 2012 Results: Excellence Through Equity: Giving Every Student the Chance to Succeed (Volume II).

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**Figure 1.14. Children of immigrants are over-represented in disadvantaged schools and lower education tracks**

Distribution of students by immigrant background and language Community, per cent, 2012



Source: Calculations based on OECD Programme for International Student Assessment – PISA 2012 Database.

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Flanders pioneered attempts to ensure equal opportunities in school enrolment in 2003, with several adjustments in subsequent years, but these early efforts had limited effectiveness, as school segregation likely increased in 2001-11 (Wouters and Groenez, 2013). Drawing on the lessons learned, a 2011 decree, first applied in 2012-13 (and subsequently adjusted) for admissions in all pre-primary, primary and secondary schools, gives priority to certain places in oversubscribed schools to both disadvantaged and non-disadvantaged students, in proportion to the socioeconomic composition of each school's neighbourhood. Implementation (e.g. neighbourhood definition) is decentralised to local negotiating platforms (*lokale overlegplatforms*, LOPs), which helps to reduce local resistance to the new rules. Preliminary evidence on the impact of this reform already available for Ghent primary schools points to an overall decrease in segregation (Verhaeghe and Goetmaeckers, 2013).

In the French Community, school choice reforms started in 2007 and enrolment in the first year of secondary education has been subject to a uniform 20% quota for disadvantaged students in every school since the 2010-11 academic year. However, the identification of disadvantaged students can be improved (it relies on the average socioeconomic status of the pupils of the primary school of origin, in turn defined on the basis of residence areas) and there is no scope for adjustments at the local level, which may help explain strong resistance by schools and other stakeholders (Cantillon, 2013). To avoid school segregation exceeding residential segregation, the authorities should align priority rules for school enrolment with the socioeconomic composition of each neighbourhood. They should also better identify disadvantaged students, give local actors some degrees of freedom in implementation and extend similar reforms to pre-primary and primary schools, where enrolment remains largely unregulated. In both Communities there is a need to systematically monitor enrolment outcomes at the school level, and to reduce residential segregation through improved housing affordability and residential mobility (as discussed in Chapter 2).

### ***Improving the performance of disadvantaged students and schools***

Efforts to tackle segregation should be accompanied by steps to improve student performance in disadvantaged schools. As a result of funding reforms in 2008-09, schools in both main language Communities receive extra financing for disadvantaged pupils, making it possible to hire more teachers and have smaller class sizes. This is welcome, as disadvantaged students tend to benefit strongly from smaller classes (OECD, 2005; Piketty and Valdenaire, 2006). However, teachers in disadvantaged schools tend to be less-qualified (OECD, 2013d), which decreases or even undoes the benefit of a lower student-teacher ratio. They also tend to be less experienced and have high turnover, as disadvantaged schools rely more than others on novice teachers, who soon move elsewhere or quit the profession altogether (Fourny, 2014). The authorities should step up efforts to attract more qualified and experienced teachers to less-favoured schools, inter alia by introducing financial incentives. Greater support for novice teachers from their more senior peers would also enhance teaching quality in schools with disadvantaged populations.

### ***Tackling early tracking and grade repetition***

Early tracking is also a source of low equity. In both main language Communities, four different streams of secondary education start at age 14: general (academic-oriented), vocational (emphasising specific professional skills, and considered the least prestigious),

technical (also professionally-oriented, but stronger in general skills) and arts (of negligible size). However, pupils are *de facto* first selected at the outset of secondary education – when they are 12, an internationally low age (OECD, 2012c) – and those perceived as weaker are assigned to a lower, pre-vocational stream. Early selection generally harms students in lower tracks, and in Belgium also reinforces school segregation, since schools often offer just one track. Unsurprisingly, children of immigrants are over-represented in vocational streams, especially in Flanders (Figure 1.14).

Moreover, Belgium stands out for widespread retention practices: 36% of 15-year-olds taking part in PISA 2012 reported to have already repeated a grade, the highest proportion in the OECD (OECD, 2013e). In the case of students with an immigrant background, the share rises to 53%. Grade repetition is often ineffective in improving educational outcomes, widens inequities and has major budgetary costs (OECD, 2012c). It also reinforces tracking, with downgrading to lower streams often a consequence of grade repetition in higher ones (Cockx, 2013).

The authorities have started to tackle these problems. In Flanders, 2014 legislation gives students more possibilities of appeal against grade repetition decisions. Furthermore, the Master Plan for the Reform of Secondary Education (2013) envisages delaying tracking and moving towards a more comprehensive system. The new government stemming from the 2014 elections should proceed with implementing the Plan along these lines. In the French Community, where repetition is highest, the authorities are planning to expand the *Décolâge!* project, currently adopted by one sixth of primary schools, which develops pedagogical tools to reduce repetition. As regards the two initial years of secondary education, a recent reform (2014) abolishes repetition in the first year and reinforces remediation support for students in difficulty. As repetition in that year was associated with relegation to a lower stream, the reform also commendably delays tracking. Furthermore, plans for a common curriculum up to age 15 are being considered. Reforms should indeed be extended to later years of secondary education, since tracking at 14 is still early in international comparison.

### **Upgrading vocational studies**

Besides weaknesses in general skills, largely associated to early tracking, the employment prospects of youth in secondary education vocational studies are also hampered by shortcomings in the development of technical skills. Workplace training is scarce, leading to abrupt transitions from education to work, and the design of programmes insufficiently informed by the needs of the labour market (Musset, 2013). This creates a vicious circle of low quality and prestige of vocational programmes and employer reluctance to train apprentices. Vocational studies should be reformed by expanding high-quality workplace training well attuned to labour market needs. To this end, strong involvement of social partners and an improvement in the general skills of the prospective apprentices are essential. Both the Flemish and the French Community plan to expand dual-track vocational education combining work and study, which may also help to reduce early school leaving.

### **Addressing the educational needs of the children of immigrants**

To teach multicultural classrooms effectively, schools need to strengthen professional development and evaluation practices. Results from TALIS (OECD, 2014b), a survey focussing on lower secondary education in 34 countries and sub-national entities, show

that Flanders has the fourth lowest percentage of teachers (8%) with recent training for teaching in a multicultural or multilingual setting (the French Community did not participate). Moreover, this dimension of teacher performance is usually reported as a low-importance item in teacher appraisal and feedback. The authorities should mainstream this dimension in teachers' professional development and assessment. Giving more emphasis to effective teaching of children of immigrants requires as a pre-condition better data collection on the school population. In both main language Communities, education statistics identify nationality, but not migration background.

For many students with an immigrant background, not speaking the language of instruction at home is an important barrier to educational achievement. Belgium stands out as one of the few countries where this barrier affects native-born students with foreign-born parents almost as much as foreign-born students, which underlines the importance of extending the provision of language support beyond newcomers. This should ideally be done through increased participation of children of immigrants under age three in childcare (see below), but also through remedial language classes, which in Belgium are attended by an internationally very low share of students with an immigrant background (OECD, 2012b). In a welcome step, recently implemented (September 2014), the Dutch language knowledge of all new pupils in primary and secondary Flemish schools is to be assessed, with extra tuition when needed. The impact of these efforts should be carefully monitored, and systematic screening of language ability should also be implemented in the French Community. In 2012, this Community commendably reformed access criteria to remedial language courses in secondary schools, broadening eligibility beyond newcomers.

High-quality early childhood education and care (ECEC) tends to pave the way for successful school attainment at later ages (OECD, 2012d). Attendance from an early age by children of immigrants will be particularly beneficial, given their often poorer home learning environment and language handicaps. In Belgium, participation in pre-primary education from the age of three is almost universal (OECD, 2013f). However, enrolment by younger children in ECEC is lower and widely perceived as unequal. Amidst major data limitations, a recent Flemish survey shows that only 34% of mothers with foreign citizenship are regular users of those services, against 73% of Belgian mothers. Though use by both groups has increased since 2002, the gap between them has remained essentially unchanged (Vande Gaer et al., 2013).

High labour inactivity of female immigrants likely is both a cause and a consequence of keeping young children at home. On top of childcare availability and affordability concerns, which tend to be more pressing in urban areas, evidence suggests that cultural factors play an important role. Among non-EU immigrants, marriage decreases the employment probability of women, and motherhood decreases it further (Corluy and Verbist, 2014). In Flanders, poverty decreases child care use among Belgian mothers, but has a much smaller impact on use among their non-Belgian peers (Vande Gaer et al., 2013). To address cultural barriers, the authorities should step up efforts at parental and community engagement, an important lever for higher and more effective ECEC participation (OECD, 2012d). Offering language or vocational courses for mothers in ECEC premises can be a promising way forward, while helping to compensate the under-representation of immigrant women in some introduction programmes to newcomers.

## **Recommendations to improve the labour market integration of immigrants**

### **Improving integration and migration policies**

- Continue to cooperate with social partners to further expand diversity plans in firms. Expand training offers and skill validation, as well as their articulation with diversity plans.
- Evaluate the effectiveness of language courses to immigrants and link them further to workplace needs and labour market training.
- Further reduce delays in the recognition of foreign academic degrees and ensure that decisions on recognition requests are well-informed.
- Set indicative targets for the share of immigrants in employment or new hiring at all levels of government. Consider narrowing the scope of public jobs subject to citizenship requirements.
- Collect systematic, anonymised data on the country of origin of applicants for public sector jobs.
- At least for high-skilled labour immigrants, significantly extend the current one-year duration of initial work permits. Introduce a single work and residence permit, as planned.
- Extend the simplified work permit procedure to fill bottleneck positions to non-EU newcomers, and regularly update its list of occupations.

### **Reforming general labour market settings**

- As one way to improve labour market outcomes, in particular for the low-skilled, consider reintroducing lower statutory minimum wages for young workers.
- Monitor hiring patterns in the wake of the unification of labour statutes for blue and white-collar workers. If temporary contracts grow at the expense of regular ones, make the unified rules less protective, namely by reintroducing trial periods and shortening periods of notice before dismissal.

### **Promoting better educational outcomes for the children of immigrants**

- Monitor and, where needed, reform school enrolment to reduce concentration of disadvantaged students in particular schools. Ensure accurate identification of disadvantaged students.
- Improve incentives to attract more qualified and experienced teachers to disadvantaged schools.
- Proceed with reforms to reduce grade repetition and delay tracking in secondary education. Expand workplace-based learning in vocational education.
- Train teachers to provide effective tuition to students with different educational needs, as is the case in multicultural classrooms.
- At the beginning of the school year, systematically assess proficiency in the language of instruction in primary and secondary schools, and offer remedial classes when needed.
- Promote participation of children of immigrants in child care below age three through stronger engagement with parents and communities. For this purpose, consider offering language or vocational courses for mothers in child care premises.

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## Chapter 2

# Maintaining an efficient and equitable housing market

*Housing conditions in Belgium are among the best in OECD countries according to the Better Life Index, as dwellings are of high quality and large, and housing costs are average. However, the steep increase in house prices since 2003 has put market access for first-time buyers under pressure. Housing affordability is also deteriorating for the poor, as demand for social housing has not been met while the private rental market has become expensive. As a result, access to housing is at risk of becoming less equitable if the young and poorer people are priced out. Affordability for poorer people could be improved by expanding the regional rental allowance schemes. In parallel, scaling down the disproportional support for homeownership would free up public resources and reduce the bias towards homeownership. Other challenges to the efficiency of the housing market are posed by the high level of greenhouse gas emissions due to the old age of the housing stock and the low residential mobility, which harms the labour market and contributes to congestion and air pollution. To maintain an efficient housing market, policies should aim at increasing building densities in residential areas. Tilting taxation from transaction to recurrent taxes would lower barriers for residential mobility and contribute to labour market flexibility.*

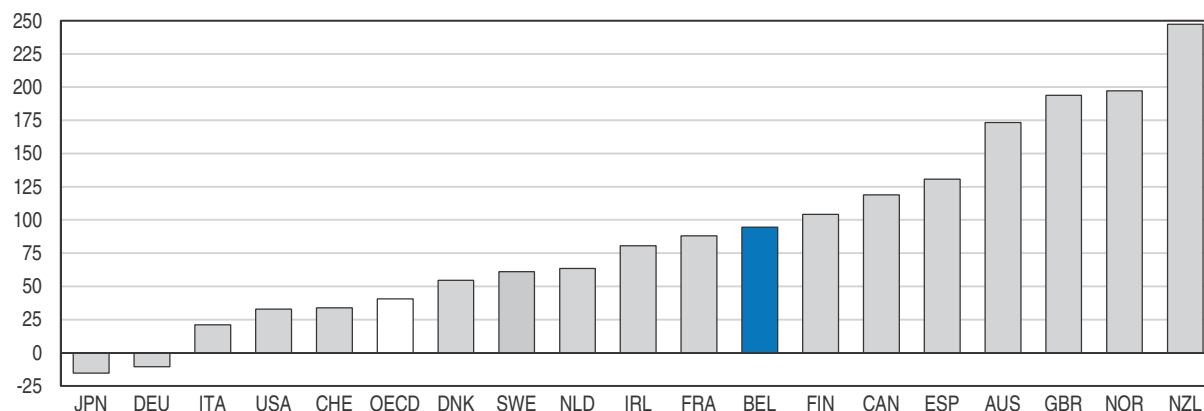
## The affordability and adequacy of the housing market is deteriorating

### **After a steep increase, house prices remain at an elevated level**

Belgium experienced a steep increase in property prices; real prices in 2013 were almost twice as high as in 1980 (Figure 2.1). In contrast with many other European countries, the recent crisis had a small effect on the housing market as prices continued to rise, albeit at a slower pace. The comparable increase in the value of land points to a growing scarcity of building opportunities at good locations (Figure 2.2). Construction costs did not contribute to the fast rise in house prices as they increased broadly in line with inflation.

Figure 2.1. **Real house prices have significantly increased<sup>1</sup>**

Per cent, 1980-2013



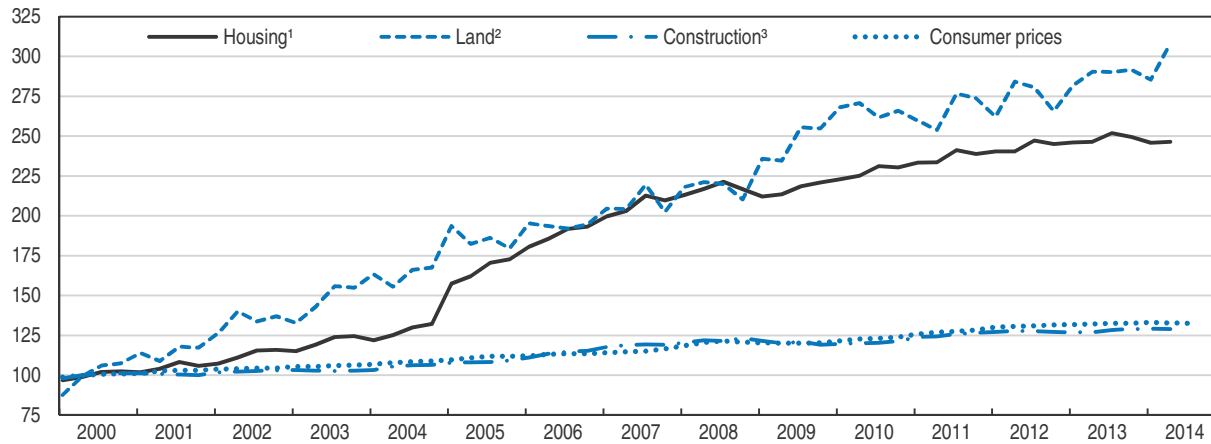
1. Based on annual averages of quarterly house price indices. Nominal prices deflated by the private consumption deflator.  
Source: OECD (2014), *OECD Housing Prices Database*, Economics Department, November.

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Property values in the Brussels-Capital Region are considerably higher than in the other Regions due to a more limited housing supply, and the difference continues to widen (Figure 2.3). Relative price developments in all Regions are comparable though. In all price segments values are above their pre-crisis levels, but the cheapest housing saw the largest relative increases (Figure 2.4). The most expensive properties, often villas in semi-rural areas, have recently started to decline in value as their high price and maintenance costs started to weigh on demand. This shift in demand towards cheaper housing can be observed in all Regions, but is strongest in Brussels.

Figure 2.2. **House and land prices have outpaced construction prices**

Index, 2000 = 100



1. Average price of a single family house (*maison d'habitation ordinaire*).
2. Price of building plots.
3. Construction cost for new residential buildings (excluding community residences).

Source: Statistics Belgium (2014), *Tableaux téléchargeables*; Eurostat (2014), *Eurostat Database* and OECD (2014), *Main Economic Indicators* (database), November.


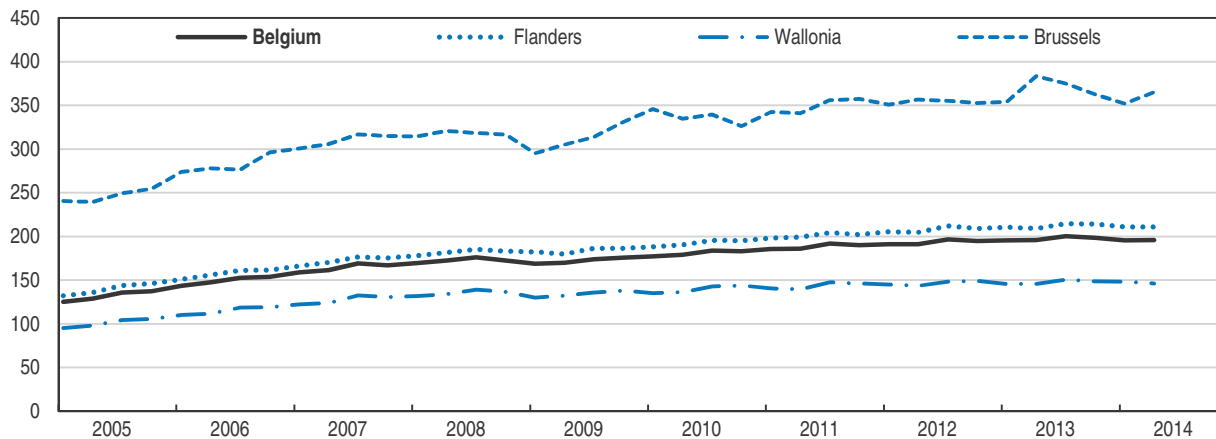

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Figure 2.3. **House prices are highest in Brussels**Single-family houses by region, thousand EUR<sup>1</sup>

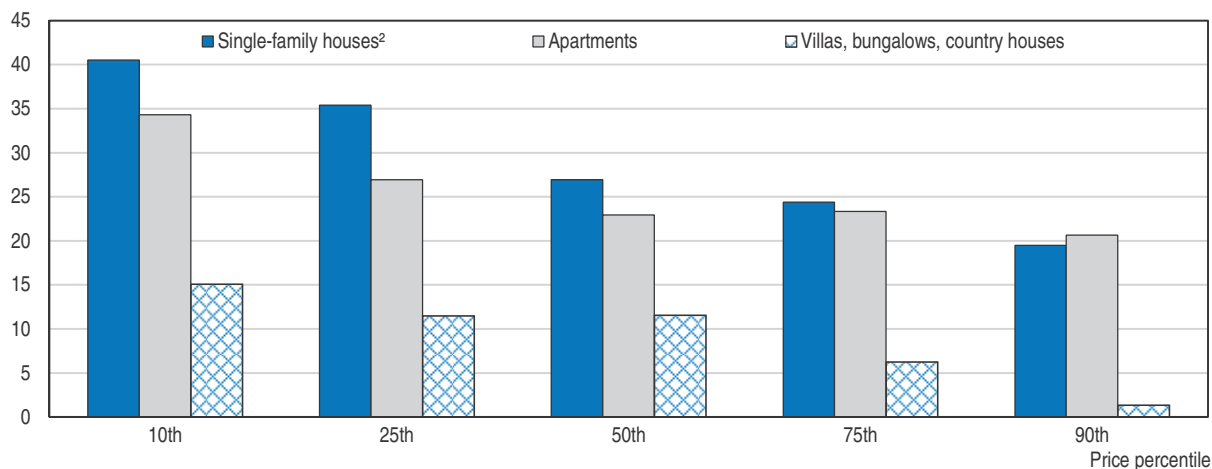
1. *Maisons d'habitation ordinaires*. Nominal prices deflated by the private consumption deflator.

Source: Statistics Belgium (2014), "Ventes de Biens immobiliers (1990-2014)", *Tableaux téléchargeables* and OECD (2014), *OECD Economic Outlook: Statistics and Projections* (database), November.

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Traditional measures suggest that overvaluation in the Belgian market is second highest among OECD countries, with prices about 50% above their long-term average relative to income and rents (Figure 2.5). However, these indicators do not provide the full picture as the cost of a house for a household does not depend only on its price, but also on other factors which can make it easier for the household to purchase a house, such as the level of allowed indebtedness and associated interest rates. Hence, the actual overvaluation falls to 28% when accounting for the current low interest rates and to 5-15% when also assuming a continuation of the other relatively lenient financing conditions, although changes in these factors could dramatically alter the assessment (Box 2.1).

**Figure 2.4. Price of cheaper houses has increased most**  
Real prices by type of dwelling and price segment, percentage change 2005-13<sup>1</sup>



1. Average prices deflated by the private consumption deflator.

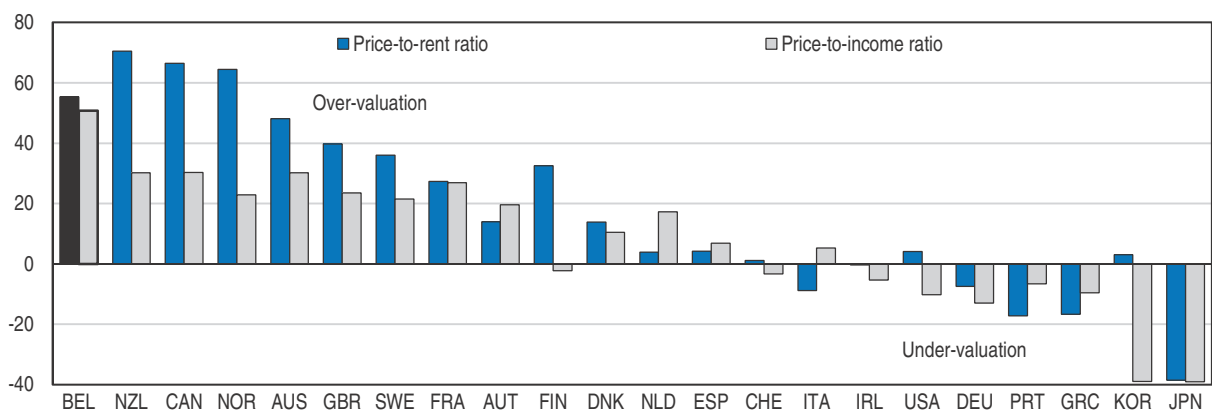
2. *Maisons d'habitation ordinaires*.

Source: Statistics Belgium (2014), "Ventes de Biens immobiliers (1990-2014)", *Tableaux téléchargeables* and OECD (2014), *OECD Economic Outlook: Statistics and Projections* (database), November.

**How to read this figure:** This figure shows the price evolution for selected price percentiles for three categories of dwellings; for example, the 50th percentile represents the evolution of the price of a median house (i.e. a house for which 50% of other houses are cheaper and 50% are more expensive). For median houses, the cumulated price increase since 2005 was about 25% for a single-family house. For more expensive houses (75th and 90th percentiles), the cumulated price increase has been lower while for cheaper categories (10th and 25th percentiles) it has been much higher.

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**Figure 2.5. Some indicators point to a large overvaluation of the housing market**  
Per cent of over or under-valuation relative to long-term averages, second quarter of 2014<sup>1</sup>



1. Countries are ranked by the average of the two indicators, from highest to lowest. The long-term average covers the period from 1980 (or earliest available date) to the latest available quarter.

Source: OECD (2014), *OECD Housing Prices Database*, Economics Department, November.

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**Box 2.1. Valuation of the housing market**

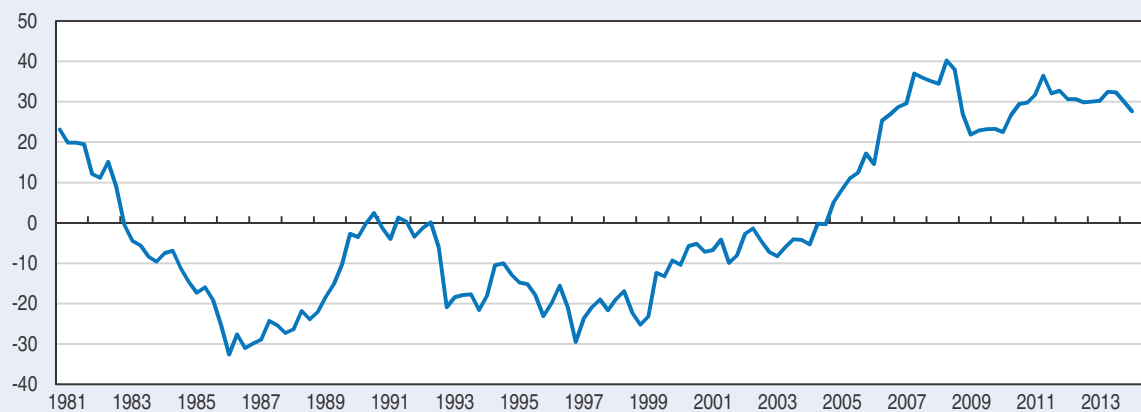
Traditional indicators suggest that Belgian real estate is strongly overpriced, but when house prices are translated into effective housing costs, the overvaluation appears much smaller. Housing costs depend on house prices, but also on other factors, most notably the interest rate to be paid on mortgage loans, the duration of the mortgage loan and the maximum amount that can be borrowed relative to the house price.

### Box 2.1. Valuation of the housing market (cont.)

The effect of the interest rate is particularly large, and the overvaluation based on an interest-adjusted index of housing costs drops to 28% from about 50% for loan-to-income or loan-to-rent ratios (Figure 2.6). Housing costs also benefited from a gradual increase in the repayment period of mortgage loans. First-time buyers now obtain mortgage loans with an average maturity over 25 years, which is seven years longer than in 1996. The reform of housing taxation in 2005, with a widened tax deductibility of interest and capital repayments, provided additional incentives to borrow. This is one of the main reasons that house prices in Belgium increased more than in any other OECD country during 2005-08 (Vastmans et al., 2014). Hence, accounting for these developments in the financing of housing lowers the scope for overvaluation, provided of course that these underlying factors do not change.


Figure 2.6. **Debt-service costs are high despite low interest rates**

Deviation relative to long-term average of the ratio between debt service and disposable income per household, % points<sup>1</sup>



1. Debt with a fixed maturity of 20 years, all dwellings. This indicator is based on an interest-adjusted-affordability index discussed in National Bank of Belgium, *Report 2013: Economic and Financial Developments and Financial Stability Review 2014*.

Source: National Bank of Belgium and OECD calculations.

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Econometric models also point at a more moderate overvaluation. The European Central Bank (ECB) regularly performs a cross-country econometric analysis to explain changes in house prices by changes in affordability. It also derives a measure of imbalances from a model that assumes equal costs of owning and renting in the long-run. These model-based approaches indicate that the housing market is fairly balanced (ECB, 2013). The International Monetary Fund (IMF) arrives at an overvaluation of 5-15% based on an interest-adjusted affordability regression analysis (IMF, 2014). The latter finding is consistent with anecdotal evidence of limited speculation based on the belief of further increases in house prices.

Perhaps as important as an estimate of the overvaluation is the awareness that changes in financing conditions or the fiscal treatment of housing may have important effects on the level of house prices. Assuming unaltered conditions, a price correction might occur, most likely through a stabilisation or a modest decrease in real house prices. However, some segments of the market and parts of the country might experience more pronounced declines. Prices for villas in semi-rural locations have already been falling for some time, while prices for the upper segment in general came to a standstill. High demand and limited supply will continue to support housing prices in the lower segments and more so in Brussels than in the other Regions.

#### References:

ECB (2013), *Financial Stability Review*, November, European Central Bank.

IMF (2014), "Article IV Consultation – Staff Report", *Country Reports*, No. 14/76, International Monetary Fund.

Vastmans, F. et al. (2014), *Woningprijzen: woningprijzen-mechanisme en marktevenwichten. De logica, nood en valkuilen van betaalbaarheid als woningprijzen determinant* (Housing prices: housing prices mechanism and market disequilibria. The logic, need and pitfalls of affordability as housing price determinant), Steunpunt Wonen (Policy Research Centre Housing).

Risks for the economy related to residential properties will depend first on the likelihood of a price correction, second on the ability of borrowers to withstand a fall in price, and third on the capacity of banks to absorb potential losses on mortgage loans. The first risk (a significant fall in prices) does not appear immediate as the possibility of considerable changes in underlying determinants seems remote. However, house prices warrant close monitoring given that some estimates point at a large overvaluation and a fall triggered by a change of expectations cannot be ruled out. Such a change could originate, for example, from the necessary reform of the mortgage tax relief, which emphasises that adjustments should be made gradually.

In case of a fall in house prices, the impact on the economy will then depend on households' reaction to it. Wealth effects are limited in Belgium (Eugène et al., 2003), so the impact should not be major on consumption. However, consumption could be hurt if a significant share of households becomes "underwater" (i.e. the value of the house becomes lower than the loan they subscribed to purchase their property), which could force them to raise their precautionary savings to protect themselves from a loss in the event they need to sell the house. This risk is not negligible as one third of the new mortgage volume in 2013, and 15% of the outstanding mortgage loan stock, had a loan-to-value ratio of more than 90% (NBB, 2014). Together with the often high debt-service ratios this could lead to problems in case of a sizable correction in house prices. A normalisation of interest rates could put pressure on house prices as smaller new mortgage loans would reduce support for the current price level, but the direct effect on household spending seems limited as almost 60% of outstanding mortgage loans have fixed interest rates while adjustments to variable-rate mortgage loans are capped.

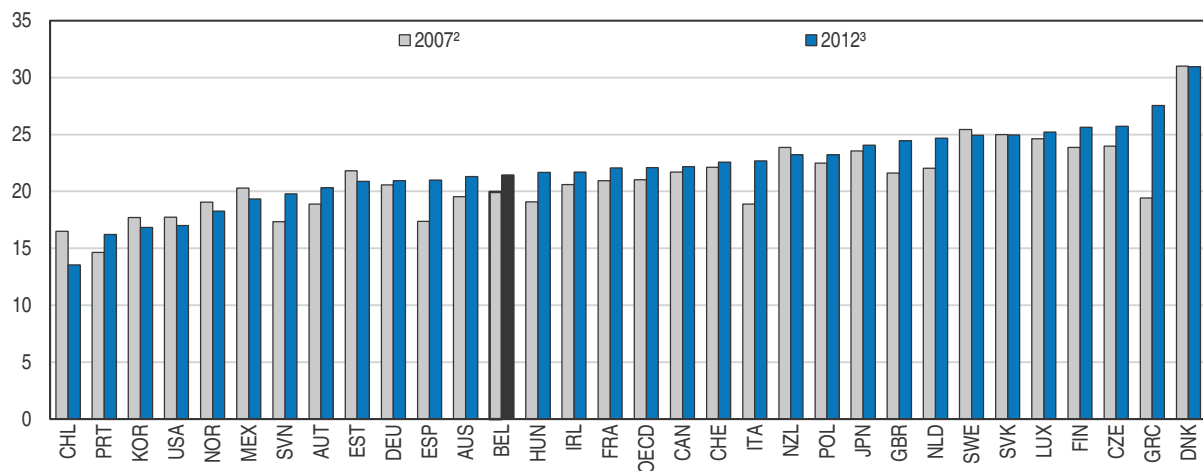
The third main risk is how banks could weather households' payment difficulties. Default rates on mortgage loans are very low, even for recent vintages, and capital buffers of the main banks are sufficient to absorb a moderate increase in defaults according to the stress test recently conducted by the European Central Bank. However, the share of domestic mortgage loans on the balance sheet of Belgian credit institutions is large, which prompted the National Bank of Belgium at the end of 2013 to take several prudential measures to strengthen banks' resilience, most notably an increase in banks' risk weightings for Belgian mortgage loans. Further growth of borrower segments with very high levels of risk should be avoided by imposing maximum limits for new mortgage loans on loan-to-value and debt-service-to-income ratios when appropriate in view of housing market dynamics.

### ***Housing affordability varies widely across tenures and Regions***

Despite the steep increases in property prices, average affordability of housing only decreased slightly (Figure 2.7), as rising house prices did not affect existing owners while for first-time buyers the impact was cushioned by falling interest rates and longer repayment periods. A cross-country comparison of housing costs, although hampered by the lack of a uniform calculation method, shows that Belgium belongs to the middle bracket of OECD countries.

Around 10% of the population lives in a household that spends more than 40% of its disposable income on housing, which is slightly below the EU average (Table 2.1). Housing cost overburden is higher than some years ago, but the small increase understates the growing problems related to affordability. The situation deteriorated considerably for renters, who are already much more frequently overburdened, while on the other hand

Figure 2.7. **Household spending on housing has increased moderately**<sup>1</sup>  
As a percentage of net disposable income



1. Housing, water, electricity, gas and other fuels. The OECD aggregate is an unweighted average of data shown.

2. 2008 for Chile.

3. 2011 for Greece, New Zealand and Switzerland.

Source: OECD (2014), "Detailed National Accounts", OECD National Accounts Statistics (database), October.


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Table 2.1. **Housing cost overburden is high for lower-income groups**<sup>1</sup>

2010-13

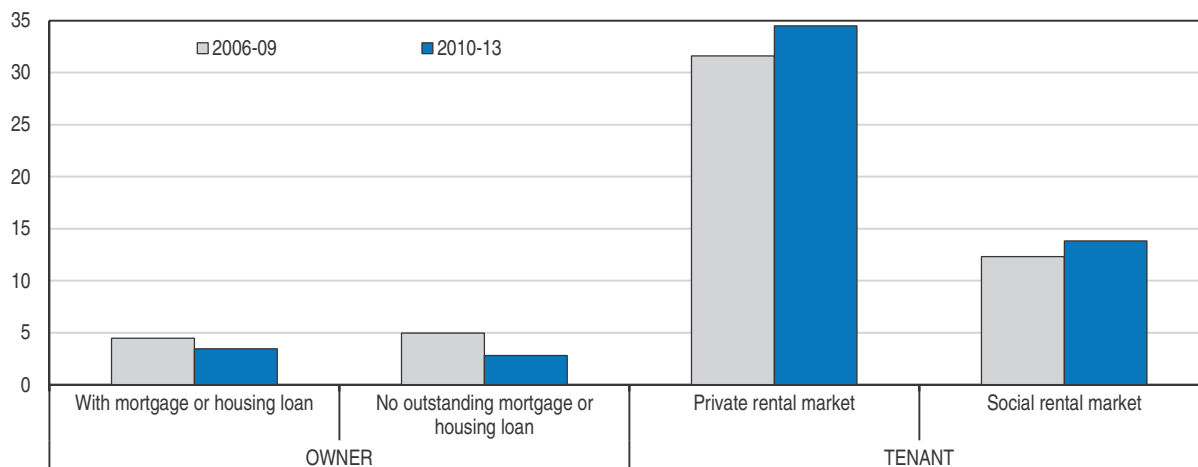
Income quintile	First (bottom 20%)	Second	Third	Fourth	Fifth (top 20%)
<b>Belgium</b>	<b>35.4</b>	<b>10.2</b>	<b>3.3</b>	<b>1.0</b>	<b>0.4</b>
European Union (28 countries)	34.9	11.5	5.4	2.9	1.6
France	17.8	4.9	1.9	0.9	0.2
Germany	43.0	16.6	9.3	6.5	4.2
Netherlands	34.2	16.1	10.4	7.2	5.5

1. Percentage of the population living in a household where the total housing costs (net of housing allowances) represent more than 40% of the total disposable household income (net of housing allowances). For example, in Belgium 35% of persons earning the lowest 20% of income pay over 40% of this income on housing.

Source: Eurostat (2014), "Income and Living Conditions – Housing Cost Burden", Eurostat Database, November.


fewer homeowners were facing excessive housing costs (Figure 2.8). Around one out of seven social renters are now overburdened by housing costs and for private tenants, most of whom do not benefit from rental support, it is even one out of three.

After a long period of rising rents and weakening income profiles of tenants, the affordability of housing has become a structural problem for large groups of the population. In Flanders, the share of disposable income spent on housing increased more rapidly for tenants than for homeowners during at least 20 years (Heylen et al., 2007). Income differences became more pronounced as those who could afford a house saw their real earnings rise while tenants experienced a decline between 1992 and 2005. This decline is partly explained by better-off tenants becoming homeowners, which confirms the increasingly residual character of the private rental market. In Flanders, the divergence in incomes came to a halt recently (Heylen and Winters, 2014), probably due to deteriorating overall labour market conditions.

Figure 2.8. **Tenants are most affected by housing cost**Housing cost overburden, per cent of relevant population<sup>1</sup>

1. Share of people living in a household that spends over 40% of disposable income on housing.

Source: Eurostat (2014), "Income and Living Conditions – Housing Cost Burden", Eurostat Database, November.

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Shortages in the provision of social housing contributed to a deterioration of the price-quality ratio at the lower end of the private rental market. The social rental market amounts to 6% of the dwelling stock, which is low compared to other OECD countries (Andrews et al., 2011), but also relative to demand. In Brussels, more households are on the waiting list than living in social rental housing. In Flanders, demand is 70% higher than supply, and in Wallonia 40%. Many people who would qualify for social housing based on their financial means have to resort to the private rental market, and the higher rents weigh heavily on their budgets. Affordability problems are most severe in Brussels, where the share of households with housing cost overburden is above 21%, compared to around 10% in Wallonia and 6% in Flanders (Winters and Heylen, 2013). The difference between the capital and the other Regions reflects both the higher cost of accommodation and the much higher share of the population at risk of poverty.

The small and falling share of homeowners experiencing affordability problems hides the growing challenges for first-time buyers to buy a house. The recent low interest rates have a tempering effect on mortgage costs, but their decline over a longer period has merely led to higher prices. The average downpayment has increased rapidly from around EUR 20 000 in 2004 to some EUR 50 000 in recent years (Albrecht and Van Hoofstat, 2011). When including the substantial transactions costs, a buyer needs on average around EUR 75 000 in cash, which is around a third of the house price, to acquire a house. The surge in required own funds makes it increasingly difficult for first-time buyers to follow the traditional model where young people, soon after starting to work, acquire a house with the intention of staying there for the rest of their life (Meeus et al., 2013). In addition, debt-service costs of young households are often very high relative to income (Du Caju et al., 2014). Without financial support from parents, many first-time buyers can no longer afford housing of the same quality and quantity as a decade ago (Heylen and Winters, 2011). The growing financial challenges of first-time buyers are one of the reasons for the recent modest fall in homeownership rates (Heylen and Winters, 2014), which bucks a long-standing trend.

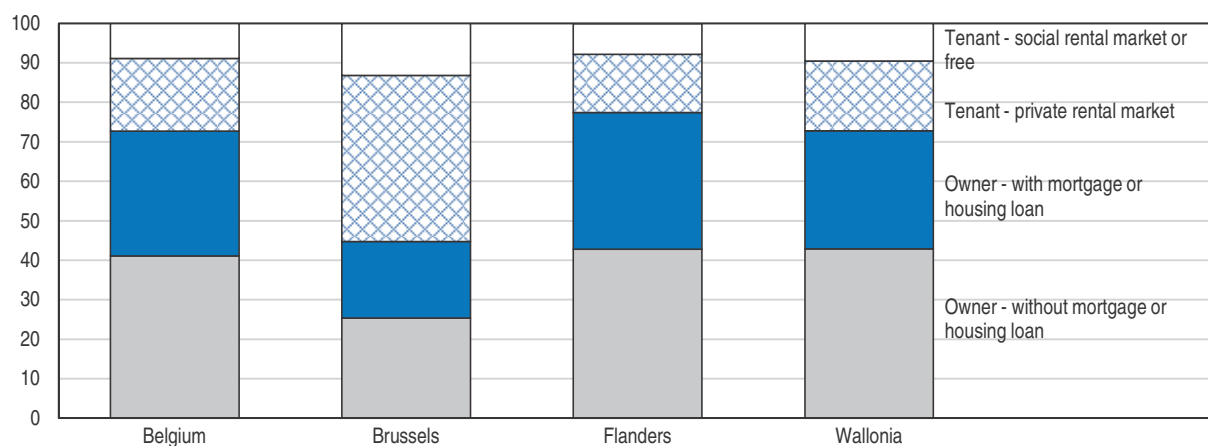


### **Adequacy of the housing supply is challenged by rising and changing demand**

After an extended period of increases, over 70% of the population lives in owner-occupied housing (Figure 2.9), which is among the highest observed in OECD countries (Andrews et al., 2011). The high share of owners reflects that homeownership is traditionally viewed as the ideal housing tenure as it is perceived to provide the highest degree of housing security, privacy and self-determination and to reduce housing costs after retirement. Tax deductions provide further financial incentives, especially after the tax reform of 2005 (Winters, 2013). Increasing house prices and the growing difference with rents slowed down acquisition by especially lower income groups, and since 1976 only the two richest income quintiles in Flanders have been contributing to the overall growth in homeownership.

**Figure 2.9. Homeownership is widespread outside Brussels**

Per cent of population, 2009



Source: S. Winters and K. Heylen (2013), "How Housing Outcomes Vary Between the Belgian Regions", *Journal of Housing and the Built Environment*, July.

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Between 2013 and 2030, the number of households is expected to increase by 540 000, or 11% (Table 2.2). Two-thirds of the growth is caused by an increase in population, the remainder by a decrease in household size due to aging and more single-parent families. In Brussels, though, the number of households is increasing in line with the population as the already low average household size is not expected to decline further. The overall shift in housing demand extends a long trend: nowadays 65% of households consist of one or two people, up from 58% in 1990. As a result, construction of apartments has surpassed that of new single family houses. The increasing demand for smaller housing provides opportunities for spatial planning as it allows for a greater densification of residential areas.

**Table 2.2. Number of households will grow faster than population in the medium term**

Change 2013-30

	Belgium	Brussels	Flanders	Wallonia
Population (% growth)	7	10	6	8
Households (% growth)	11	9	11	13
Households (thousand)	540	50	284	206

Source: Federal Planning Bureau and Statistics Belgium (2014), *Perspectives démographiques 2013-60 : Population, ménages et quotients de mortalité prospectifs* (Demographic projections 2013-60 : Population, households and prospective mortality quotients), April.

Despite the overall good conditions of the housing stock, a substantial share is of poor quality and energy-efficiency is in general low. The quality of housing is most problematic in cities, and damp problems, for example, are much more widespread in Brussels than in the other Regions (Box 2.2). The relatively old age of the dwelling stock (Andrews et al., 2011) and the many free-standing houses, make Belgian residential greenhouse gas emissions per capita the second highest among OECD countries despite recent improvements (Cassilde, 2014). The large and detached houses in semi-rural areas that once catered for the needs of their owners have become expensive in their maintenance and energy consumption. Ageing owners who now want to move to the city centre in order to be closer to facilities and services often struggle to find buyers due to the high costs of renovation.

### Box 2.2. Spatial structure of the housing stock

The housing stock in urban agglomerations is older than in the rest of the country and 36% of the dwellings date from before 1946. Regional differences are stark, with 45% of houses in Wallonia built before the end of the Second World War compared to just 24% in Flanders. This difference is a result of Wallonia's intensive industrialisation and high population growth during the nineteenth and the beginning of the twentieth century, combined with a higher tendency towards renovation instead of demolition. The recent catch-up of Brussels and Flanders regarding renovation activities reflects a growing scarcity of building plots at good locations and the related increase in land prices. When considering the share of dwellings in a bad physical state, there is a clear north-south contrast, but in absolute numbers most of the houses in poor conditions are found in cities.

The spatial structure of the Belgian housing stock is closely linked to the concentration of socioeconomic problems in certain neighbourhoods. In the larger cities, unemployment is high in the areas with nineteenth century working-class houses, as the residents, mostly older Belgian workers and migrants, often have a low level of education (Vandermotten et al., 2011). Former areas with mines or heavy industry, mostly located in Wallonia, are characterised by similar problems. Clusters of social housing can be found in city centres and in more suburban areas and have led to a concentration of weaker households.

The detached home, preferably situated on the edge of the city or in the green, is still the most popular ownership choice (Halleux and Strée, 2013). The share of apartments is low by international standards, both in the country as a whole and in cities such as Brussels. However, the share of apartments in most cities and many suburban communes is growing to cater for an ageing population and younger couples. Social housing is concentrated in urban areas, but is still below 15% of the dwelling stock.

Opposing the long-standing trend of suburbanisation is the gentrification that occurs in several core city quarters. Young people, often single and well-educated, move to certain older parts of the city centre to be in the proximity of cultural life. Their presence revitalises the neighbourhood as they often undertake badly-needed renovations of their houses.

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- Halleux, J-M. and J. Strée (2013), "Production de l'habitat et enjeux territoriaux. Partie 2 : Les modes d'habiter" (Production of housing and land issues. Part 2: Ways of living), *Intermediary Report*, Conférence Permanente du Développement Territorial, Liège University.
- Vandermotten, C. et al. (2011), "Dynamic Analysis of Deprived Neighborhoods in the Belgian Urban Regions", POD Maatschappelijke integratie (Federal Public Service for Social Integration).

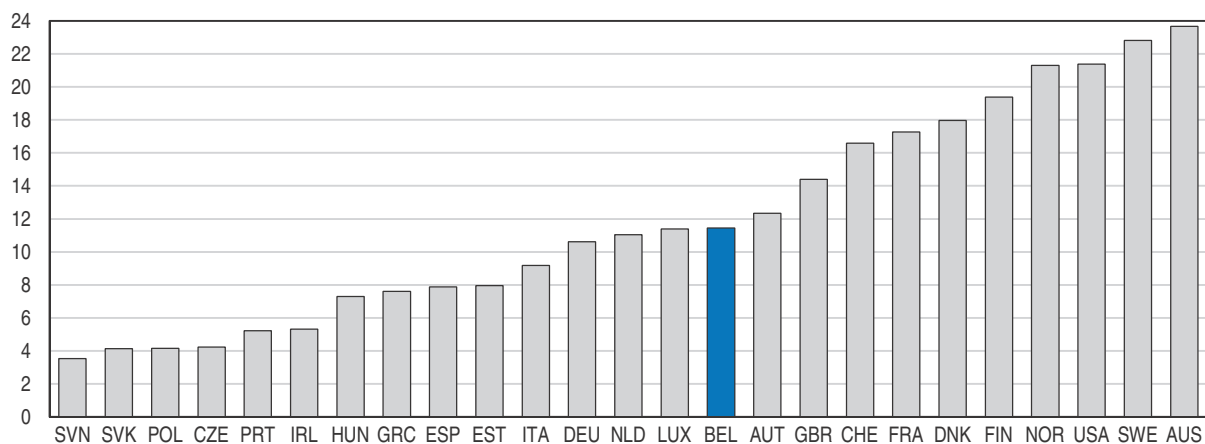
The physical state of private rental housing remains lower than in the social housing and owner-occupied segments (Heylen et al., 2007). Many rental apartments are owned by older people who are often cash-constrained and put off by the efforts needed to undertake investments. The overall lower standards of rental housing reflect that the majority of dwellings are located in urban neighbourhoods with older houses. Nevertheless, demand for private rental housing is high and leads to a deteriorating price-quality ratio at the lower end of the market. However, landlords often find it difficult to find appropriate tenants, given the long period of weakening income profiles among renters. In Flanders, about a third of the private rental market now concerns socioeconomic vulnerable households in low-quality dwellings (Le Roy et al., 2008; Le Roy and Vandekerckhove, 2011). Better rentals are in general occupied either by young highly educated starters or by older tenants.

## Residential mobility is mediocre, leading to various inefficiencies


### High homeownership weighs on residential mobility

Residential mobility is mediocre, with around 12% of households changing residence during a two-year period (Andrews et al., 2011). Even though the relatively small size of Belgium and its linguistically homogenous zones may explain a less acute need for residential mobility, some similar countries, for example Denmark, have a higher residential mobility (Figure 2.10). The propensity to move differs between tenure types, with private tenants having the highest mobility. Social tenants are less frequently changing residence as they risk losing their subsidised housing. Homeowners are least mobile, but empirical studies for Belgium are inconclusive on the role of mortgage loans (Andrews et al., 2011; Isebaert, 2013). On the one hand, mortgagors can be locked-in by negative equity effects due to the high housing transaction costs, on the other hand they may be more willing to accept jobs that require a change of residence to remain able to meet mortgage repayments. Nevertheless, as homeowners are up to 23% less likely to move residence than tenants, the counterpart of widespread ownership is depressed residential mobility.

Figure 2.10. **Residential mobility is mediocre**  
Percentage of households that changed residence within the last two years, 2007



Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", OECD Economics Department Working Papers, No. 836.

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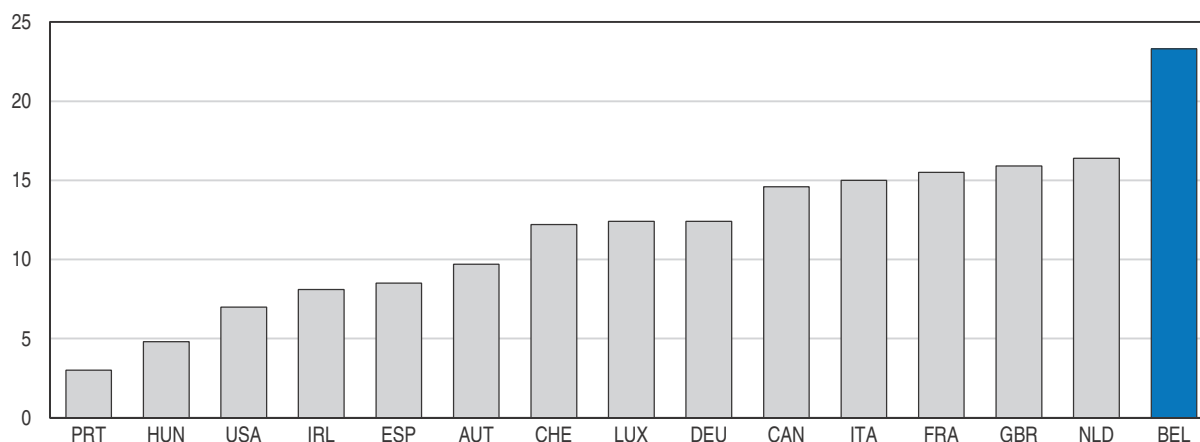
Long-distance relocations are relatively rare as the vast majority of moves are local. Preliminary research by Roel Helgers shows that in 2013 half of the buyers in Flanders moved to a location less than 4.5 kilometres away from their old home and the median distance in Wallonia was 9.1 kilometres (ERA, 2014). For the majority of relocations, moving to a specific area is not an important objective. In particular, only 7% of households that moved mentioned work as the main reason, while 69% indicated dissatisfaction with the current dwelling and 24% pointed at personal reasons (Winters and Heylen, 2013). Large differences in house prices, especially between Wallonia and Brussels, can be an obstacle for people to relocate over longer distances.

People from lower socioeconomic groups have limited choice when they want to change residence as the supply of rental housing is small and concentrated (Box 2.2; Le Roy and Vandekerckhove, 2011). In Brussels, massive suburbanisation of high and middle-income households towards the periphery accelerated the degradation of central zones. The cheap, but often old and poor-quality, rental housing in these neighbourhoods led to a high concentration of disadvantaged communities, including many unskilled workers and ethnic minorities. These areas also have the highest unemployment rates, often above 20%, reflecting their residents' lower education levels and a skill mismatch between labour supply and demand. In addition, residential social, economic and ethnic segregation exacerbates unemployment (Dujardin et al., 2008).

### **Mediocre residential mobility contributes to congestion, greenhouse gas emissions and labour market inefficiencies**


As people relocate relatively infrequently, home-work distances and hence commuting times are considerable. Over 18% of the population lives further than half an hour away from their workplace, which is one of the highest shares in the EU (Eurofound, 2011). Despite the well-developed transport system, congestion in Belgium is among the highest of OECD countries for which data is available (Figure 2.11).

Figure 2.11. **Road traffic congestion is high**  
INRIX index, percentage point increase over free-flow, 2013<sup>1</sup>



1. Index representing the barometer of congestion intensity. For a road segment with no congestion, the index would be zero. Each additional point in the index represents a percentage point increase in the average travel time of a commute above free-flow conditions during peak hours.

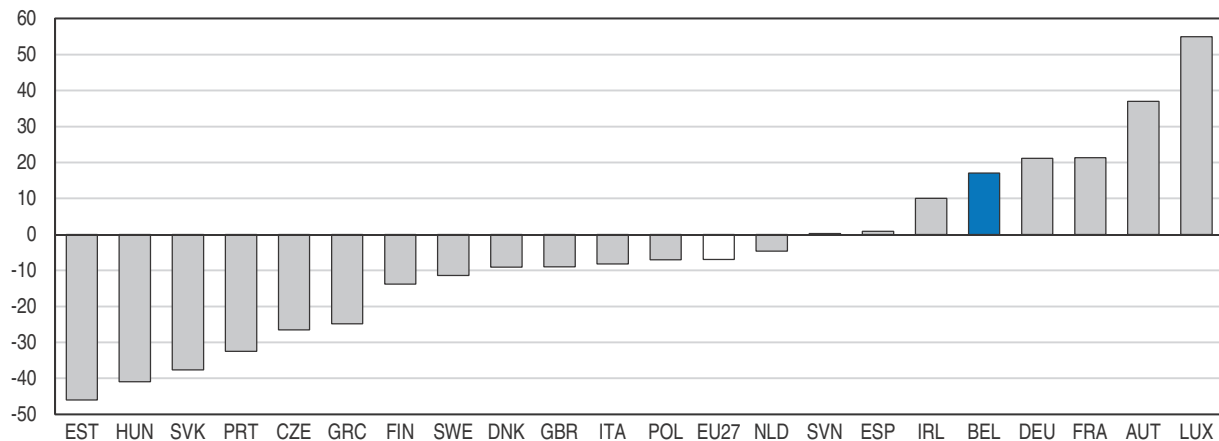
Source: INRIX Inc. (2014), *INRIX Traffic Scorecard*, <http://scorecard.inrix.com>.

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Commuting is supported through substantive subsidies for home-work related travel and, by some measures, the most generous tax treatment of company cars among OECD countries (Harding, 2014), but contributes to the high and increasing share of the transport sector in Belgium's greenhouse gas emissions (OECD, 2013). In addition, the role of diesel is higher than in any other OECD country, which results to a large extent from the lower taxation. Although the difference has been reduced, diesel still has 30% lower excises per litre than gasoline. The higher emissions of pollutants such as nitrogen oxide and particulate matter aggravate air pollution, especially in Brussels and Antwerp, and are one of the reasons why emissions are persistently above internationally agreed levels (Figure 2.12).


Figure 2.12. **Nitrogen oxide emissions are above agreed levels**

Distance from ceiling, per cent, 2012<sup>1</sup>



1. Under the National Emission Ceilings (NEC) Directive, EU Member States have individual emission limits, known as “ceilings”, that were to be achieved by 2010 for four different pollutants. The reported national totals of Austria, Belgium, Ireland, Luxembourg, Netherlands and United Kingdom are based on fuel used, all other Member States reported a national total based on fuel sold. The aggregated EU27 emission total is based on data for fuel used and for fuel sold.

Source: EEA (2014), “NEC Directive Status Report 2013”, Technical Report, No. 10, European Environment Agency.

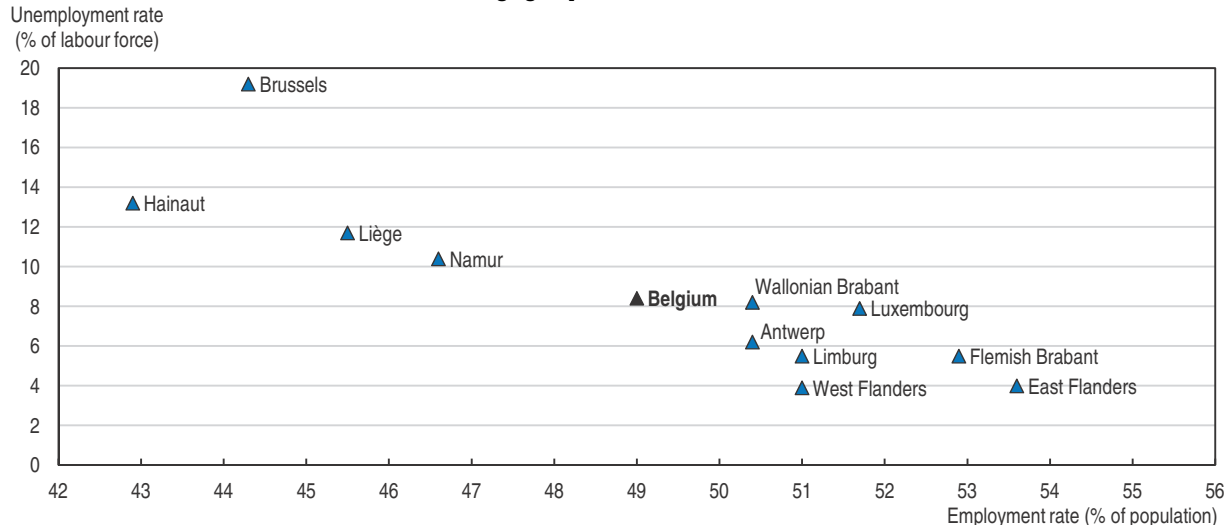
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Low residential mobility causes labour-market inefficiencies. If people prefer to work closer to home, they might have to take jobs below their level of education and experience, which is a suboptimal use of human capital. Although this phenomenon has not been quantified, it is likely to be relevant for the same reasons as why many recent graduates are overeducated, namely that the likelihood of finding more adequate work is small and that unemployment is financially and psychologically less attractive (Baert et al., 2013).


Labour market inefficiencies also arise when jobseekers who cannot find suitable jobs in their neighbourhood prefer to remain unemployed, or even withdraw from the labour market, instead of moving to places with higher labour demand. Low residential mobility, which cannot be fully offset by commuting, thus contributes to the large geographical variations in labour market outcomes (Figure 2.13). Indeed, at the district (arrondissement) level a 1 percentage point rise of homeownership, the tenure type with the lowest residential mobility, implies a reduction in the fraction of people at working age with a job of 0.35 percentage points (Isebaert et al., 2013). More importantly, high homeownership leads to a weaker aggregate labour market performance through various externalities, as for example companies may leave when congestion becomes problematic, although for Belgium the relative importance of the different channels has yet to be studied in detail (Box 2.3).

Figure 2.13. **Provincial employment and unemployment rates vary widely**

Age group 15 and over, 2013



Source: Eurostat (2014), "Regional Labour Market Statistics", Eurostat Database, November.

StatLink  <http://dx.doi.org/10.1787/888933181167>**Box 2.3. Aggregate impact of high homeownership on labour market outcomes**

Macro studies between or within countries suggest that high homeownership is associated with low residential mobility and high unemployment as suggested by the Oswald hypothesis (Oswald, 1996 and 1997). Micro-data, on the other hand, tend to indicate that owning a home makes people more likely to be employed than when renting, thereby pointing at a positive effect at the individual level. Recent research highlights the role of negative externalities in explaining these contradicting findings (Isebaert et al., 2014; Laamanen, 2013), but further research is needed to identify the channels and their relative importance. The following factors might play a role in explaining how high homeownership rates can lead to higher aggregate unemployment:

- **Traffic congestion:** Employment may fall as businesses faced with productivity losses related to the increased duration and unreliability of transportation relocate to other areas. For example, part of the growth in commuting distances between 1981 and 2001 is caused by a loss in spatial proximity between housing and jobs, indicating that there is a growing divergence between the location of jobs and labourers (Boussauw et al., 2011).
- **Not-in-my-backyard behaviour:** Homeowners might try to prevent businesses from locating in their neighbourhood.
- **Rental market tightness:** The small rental market might limit worker reallocation, thereby reducing the labour market outcomes of people who would otherwise have been willing to change residence.
- **Reductions in consumption:** Mortgage loans are associated with increased housing expenditures. Obligatory monthly capital repayments on mortgage loans reduce self-control problems related to saving, while policies supporting homeownership provide additional incentives to spend a larger share of the budget on housing.

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Increasing residential mobility will have positive impacts on the labour market (Estevão, 2002). The effect is likely to be stronger on the regional than on the national level, as labour mobility between the two largest Regions accounts for just 13% of all inter-regional commuting. Clearly, the different languages cause a high degree of labour market fragmentation, but similarities in qualification and skill mismatches play a role as well (Zimmer, 2012). The large lack of high-skilled labourers in Brussels is partially addressed by a high inflow of commuters from Flanders and Wallonia, but these Regions have shortages as well. Measures aimed at increasing mobility should thus be accompanied by labour market policies in order to address geographical differences.

### **Making the most of the Regions' new competences**

Under the Sixth State Reform, competences for housing taxation and rental legislation were transferred to the Regions in July 2014. The new allocation of responsibilities reduces the areas where authorities from different levels have overlapping responsibilities, which led to legal problems and uncertainties. For example, safety, health and habitability norms for rental housing set by the federal authorities were not fully aligned with norms at the regional level regarding the quality of dwellings (Hubeau and Vermeir, 2013 and 2014). With more homogenous responsibilities, regional governments can develop a coherent housing policy that better addresses the specificities in their part of the country.

Regions are now responsible for most, but not all, housing-related matters, although they will increasingly have to take policies in other parts of the country into account. Several aspects remain a federal competency, most notably the tax treatment of non-owner occupied housing, the value-added tax (VAT) rates on construction and renovation, the taxation of rental income, the registration of rental contracts, procedural law and the collection of taxes. In some of these areas, for example regarding the registration of rental contracts, the scope for conflicting legislation has increased, as there is a federal (tax) dimension and an increasingly important regional (security of housing) dimension. At the same time, the transfer of competences allows Regions to set priorities on housing-related issues, as is shown by the different plans regarding the fiscal treatment of mortgage loans and a more strategic use of recurrent housing taxes under consideration in Brussels.

The transfer of housing competences offers Regions a unique opportunity to revise current policies, and the remainder of this chapter discusses three areas where reforms can contribute to a more efficient and equitable housing market. Firstly, the rental market requires additional support to address the long waiting lists for social housing and strengthen the private rental segment. Secondly, expansion, modernisation and greening of the building stock are needed in view of the growing and changing demand for housing. Finally, apart from making the tax treatment of housing tenures more neutral, taxation reforms have considerable scope to increase efficiency and remove barriers to residential mobility.

### **Strengthening the rental market through a shift in public support**

#### ***Moving towards fiscal neutrality***

Housing policy is focused on increasing homeownership, with the rental market, and especially the private segment, receiving relatively little support. For example in 2012, 61% of the Flemish housing budget was spent on the owner-occupied sector, 34% on the social rental sector and only 5% on the private rental market (Haffner et al., 2014). When also including federal subsidies, most notably mortgage tax relief, the average homeowner in Flanders receives 4.3 times more housing benefits than the average tenant (Heylen and

Winters, 2012). Increasing homeownership is a policy objective in many countries, motivated by the perception that it generates positive neighbourhood effects and raises social capital. However, the evidence for such effects is weak (OECD, 2011a). In addition, such support tends to be regressive, with 47% of Flemish housing subsidies going to the top 40% of earners, a group for whom housing problems, in terms of affordability and quality, are almost negligible. The regionalising of housing taxation provides an opportunity for a budgetary shift towards the rental sector, which would improve the allocation of housing support.

The total mortgage tax relief for homeowners, a federal competency until mid-2014, is larger than the rest of the housing budget. Tax relief on debt-financing is close to the OECD average (Andrews et al., 2011), although Belgium is the only country where besides interest also capital repayments are tax deductible (albeit with an overall cap). Apart from influencing tenure choice, tax favouring of homeownership can lead to an excessive amount of capital allocated to housing at the expense of more productive investments. Indeed, to a large extent the increased tax deductibility of debt financing costs since 2005 has translated into higher house prices, and by some estimates dwellings in 2012 are valued 29% (EUR 54 000 on average) higher than in the absence of fiscal support (Damen et al., 2014; Vastmans et al., 2014). For first-time buyers, the direct benefits of mortgage tax relief are thus to a large extent offset by higher prices, while people who already owned a house in 2005 are benefiting from both effects.

The tax relief for homeowners with mortgage loans should be reformed – not least because its costs are set to grow to a level that is unaffordable for the regional governments (Vlaamse Woonraad, 2012). The current low mortgage interest rates facilitate such a reform. Authorities should remove the tax deductibility of capital repayments. In addition, they can decide to subject imputed rental income to personal income taxation or to reduce the tax deductibility of interest payments of mortgage loans. In practice, the latter reform is easier to implement as it is more understandable and accepted by citizens than taxing imputed rents. The recently implemented reforms in Flanders to limit the tax deductibility are a first step in this direction, as is the decision by Wallonia to slightly reduce the rate of deductibility for new mortgages. Given the likely large effect on prices, changes should be introduced gradually and uncertainty about future measures should be minimised.

### ***Broadening rental allowance schemes to support the weakest renters***

Public support for poor tenants in the private rental market is limited as rental allowances target specific groups. All Regions have an allowance for households with low incomes, but on the condition that previous housing was not meeting quality standards. Specific allowances exist for people waiting for social housing, but only if they are on the waiting list for over four years (Flanders) or belong to a priority group (Brussels). Reciprocity of these allowances is low, with for example less than 0.5% of private renters in Flanders receiving any of these allowances (Winters and Vermeir, 2013), while 40% qualify for social housing (Heylen et al., 2007).

Regions should expand the existing rental allowance schemes to cover all tenants in the private market who qualify for social housing. In many European countries, allowances are becoming more important (Griggs and Kemp, 2012) as they allow rents to be decided by the market, thus contributing to market efficiency, while keeping housing affordable for vulnerable groups. Moreover, more secure yields may also help to raise the supply of rental housing. When allowances can be taken along when changing municipalities, they tend to hinder residential and labour mobility less than the direct provision of social housing. Such



a rental allowance would also remove eligibility requirements for social housing based on “existing local ties” (for example already living or working in the neighbourhood), which are used by municipalities in Flanders and Wallonia and can lead to indirect discrimination (CGKR, 2014).

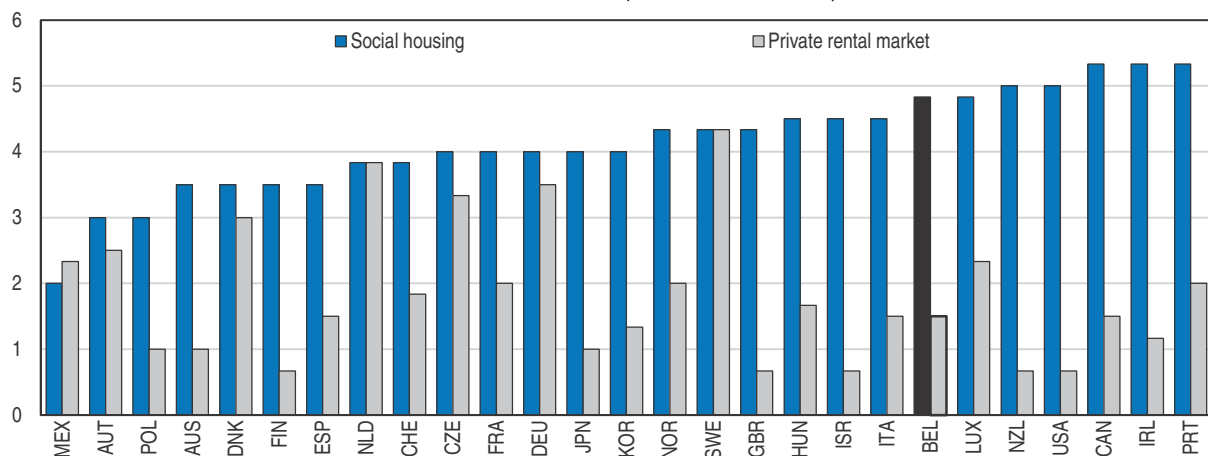
Several potential disadvantages of allowances can be mitigated through good design. As rent levels vary across the country, a uniform allowance risks being either too generous or insufficient. Instead, income and rent ceilings could be set at a sub-regional level, as is the case in for example Finland and Germany (De Boer and Bitetti, 2014). Allowances depending on the actual rent risk to drive up prices, as they provide incentives for tenants to choose housing with rents just within eligibility limits while landlords may raise rents to this level, as happened in the Netherlands. Linking the allowance to the local median rent, for example in the municipality, would limit its capitalisation into rents. Furthermore, low allowance withdrawal rates reduce the effective marginal income tax rate and thereby minimise negative incentives for finding a (better-paid) job.

### **Raising the supply of rental housing at the lower end of the market**

The long waiting lists for social housing and the sharp rent increases at the lower segment of the private rental market point at a shortage of cheaper housing. The problem is partly caused by the low turn-over of social rental housing. Contracts for an indefinite period were abolished in Brussels and Wallonia, but many dwellings are still occupied by households which, although they no longer qualify for their current social rental on the basis of income or household size, cannot be easily relocated. For example, around 8% of social tenants have earnings above the eligibility limits for new candidates as a result of raising incomes. There are few incentives to voluntarily leave social rental housing as, due to the high rent control (Figure 2.14), rents are well below those in the private sector. Shrinking families who stay in too large houses can be penalised in some cases, but often prefer to pay the low fine instead of moving to a smaller place. A stronger enforcement of contractual eligibility requirements and, in Flanders, abolishing unlimited rental contracts would make social housing available to those who need it most.

**Figure 2.14. Rents for social housing are tightly controlled**

Indicator with a scale of 0 to 6 (least to most control), 2009<sup>1</sup>



1. Composite indicator of the extent of controls of rents, how increases in rents are determined and the permitted cost pass-through onto rents in each country.

Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), “Housing Markets and Structural Policies in OECD Countries”, OECD Economics Department Working Papers, No. 836.

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Better utilisation of existing social housing and the planned new construction would bring supply closer to demand, but are unlikely to fully close the gap. Social housing is mostly provided through associations, which are private organisations in which municipalities are often the main shareholder. Some social housing associations lack personnel and, more importantly, many dwellings are undergoing, or waiting for, renovation works. As a result, 6% of the social housing stock is unoccupied, compared to for example 3.5% in the Netherlands (CBS, 2014). All Regions have ambitious plans for the construction of new social housing. Brussels, for example, aims to expand its stock at twice the current pace. However, targets are unlikely to be met unless progress is closely monitored: four years after the Flemish government set targets for municipalities, half of the local authorities were behind schedule and had no action plan in place to catch up. In general, clustering of social housing should be avoided when constructing new units to minimise segregation effects. Moreover, the construction of social housing should only be directed at the rental sector, as selling dwellings at reduced prices would provide a lifelong benefit independent from income developments to a small minority.

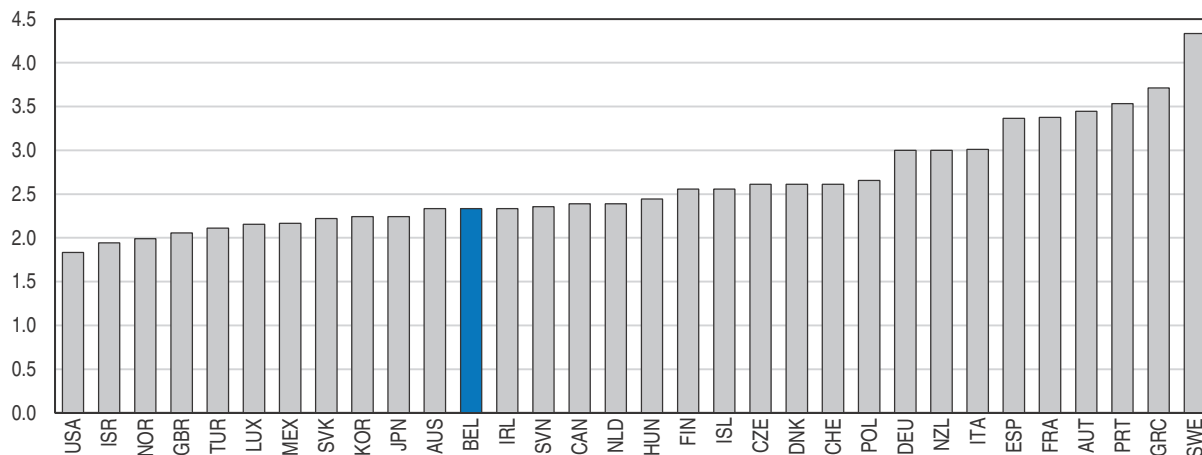
Efforts to raise the supply of private rental housing, especially at the lower end of the market, should be increased. Bringing existing housing, or converted offices if allowed by the local development plan, to the rental market is relatively easy as the dwelling should meet minimum criteria regarding health and safety, but no rental permit is required. However, the combination of minimum quality standards and maximum rents reduces returns on social housing. Making publicly-owned plots available at reduced prices on the condition that it is used for the construction of affordable housing would raise the returns for private investors. The role of social rental agencies, which rent dwellings on the private rental market and let these to households according to housing needs on the basis of priority rules, could also be supported more. Crucially, these agencies assure timely payments to landlords and adequate maintenance of the dwelling (De Decker et al., 2009). However, the agencies are often small, with less than 100 dwellings on average, account for a small part of the rental housing stock (around 1.5% in Flanders) and do not have full geographical coverage (De Decker, 2009 and 2014). With increased financial means, these agencies could strengthen their real estate management without compromising their welfare services.

### ***Making renting on the private market a more attractive tenure***

Discrimination in the private rental market is widespread. Over 40% of the real estate agents are willing to honour a request by the landlord to not consider foreign tenants, and 60% have no objections in ignoring unemployed tenants (CGKR, 2014). When directly contacting the landlord, women on social welfare, Turkish and Moroccan men and to a lesser extent disabled people and single mothers tend to be discriminated against. Candidates from foreign origin often have to provide additional references and documents, and higher guarantees – sometimes even in cash. Given the scale of the problem, authorities should increase pressure on real estate agents to adopt a binding code that bans discrimination, step-up random checks to avoid that discrimination moves to later stages of the rental process and analyse whether the housing inspection can be involved in the investigation of reported incidents, akin to social inspection agencies that have the competences to investigate both safety and discrimination at the work place.


Tenant-landlord relations seem broadly balanced as shown by the average extent of regulations (Figure 2.15), but several aspects of the current rental legislation could reduce the attractiveness of the private rental market. Many potential landlords are reportedly deterred from renting their property due to the perceived strong legal protection of renters. Relatedly, the standard legal rental period is nine years, but in practice more than half of the rental contracts are concluded for a period of three years or less. Rent controls ensure that during a contractual period the rent changes in accordance with the cost of living, but they could discourage tenants from relocating if the indexation falls short of market-based increases. More research is needed, for example on rent changes between subsequent contracts and the determinants of the rental period, to understand whether the private rental market has the right balance between flexibility and security, both for the tenant and the landlord, and thus fulfils its role as a tenure complementary to homeownership.

Figure 2.15. **Tenant-landlord regulations in the private rental market appear balanced**  
Indicator with a scale of 0 to 6 (least to most protection for tenants), 2009<sup>1</sup>



1. This indicator increases with the extent of tenant-landlord regulation within a tenancy. It accounts for the ease of evicting a tenant, degree of tenure security and deposit requirements.

Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", OECD Economics Department Working Papers, No. 836.

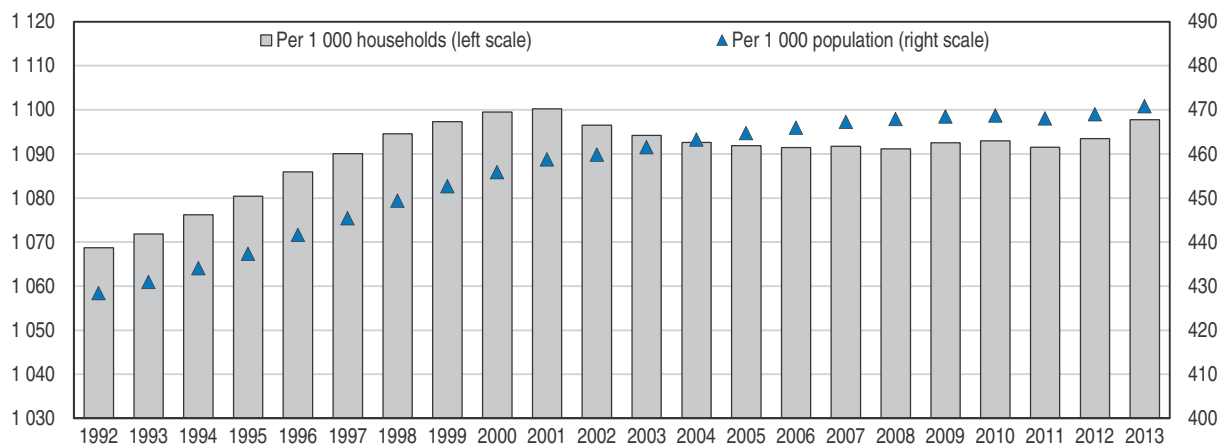
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## Expanding the housing stock and improving its quality

### Meeting rising housing demand through densification

Rigidities in housing supply can lead to price increases when construction fails to keep up with growing demand, but there are, nonetheless, few signs of a housing shortage in Belgium as a whole. The number of houses per thousand inhabitants has continued to increase, while compared to the number of households it has been broadly stable during the last decade (Figure 2.16). The steady growth of new houses has thus been able to meet the increased demand, at least to a large extent, which confirms that the past increase in house prices is more related to demand factors than to a structural undersupply of housing.

Figure 2.16. **Housing stock evolved in line with demand**  
Number of dwellings<sup>1</sup>



1. Number of households for latest years is estimated.

Source: Statistics Belgium (2014), "Statistique cadastrale du parc de bâtiments", *be.STAT Database* and ADSEI (2014), "Huishoudens per gewest", *Algemene Directie Statistiek en Economische Informatie*, available at <http://data.gov.be>.

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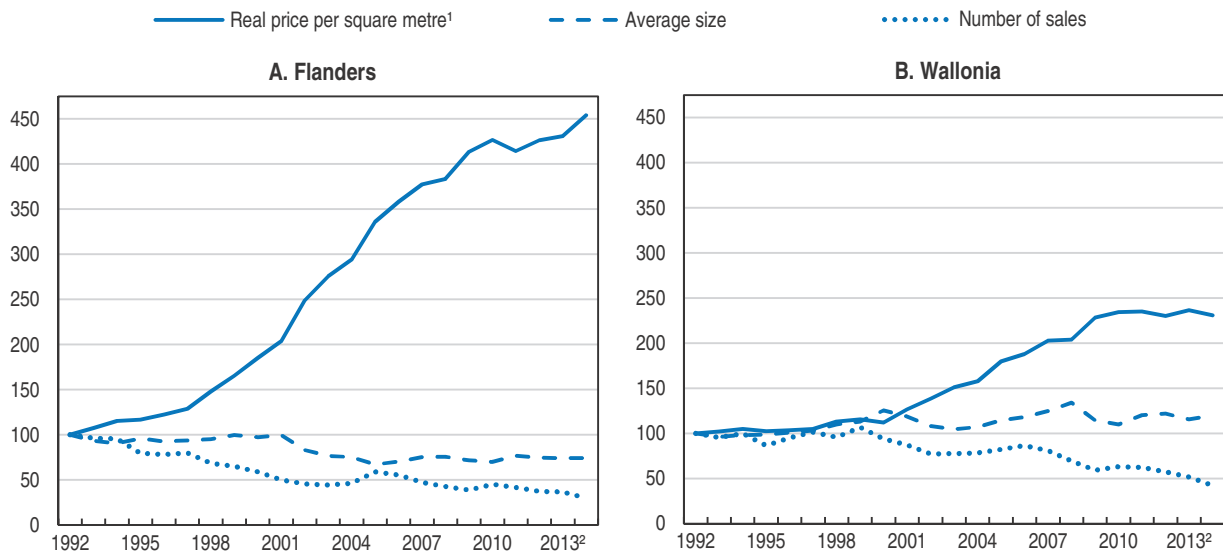
However, it will be challenging to expand the dwelling stock at a pace commensurate to the increasing number of households. After a long period with a high level of building activities, it will become increasingly difficult to find available sites, especially close to economic centres. There are already housing shortages in the main cities, and increasingly land designated to non-residential activities is being reclassified as mixed purpose. In Brussels, office buildings in the European quarter are now being converted to houses, reversing a long-standing trend. In addition, more and more high-rises are allowed.

The relatively low urban density of Brussels suggests there is scope for densification. Efforts for identifying new housing possibilities, through re-designating land, converting non-residential buildings and further facilitating the construction of denser buildings, should be stepped-up, while taking into account the environmental and social impact. Municipal authorities can consider using "density bonusing" to facilitate community acceptance of densification, as is practice in several US and Canadian cities: developers are allowed to build above a zone's density or height norms in exchange for cash contributions for social amenities, such as a community centre or a childcare facility (OECD, 2014).

In the two largest Regions there are major mismatches in the availability of building plots and demand. In Flanders, for example, there are still more than 300 000 parcels freely eligible for development, but relatively few are in the neighbourhood of the main cities. In addition, ownership is highly fragmented with 84% of the plots owned by individuals (Loris, 2009). As the majority of owners only possess a single lot, it is often difficult to realise larger housing projects. The scarcity of good plots has led to a quadrupling of real land prices in Flanders during 1992-2013 (Figure 2.17), while real house prices only doubled. Scarcity of land is also becoming an issue in Wallonia, although not at the same scale as in Flanders.

Figure 2.17. **Good building plots have become scarcer**


Index based on transactions, 1992 = 100



1. Deflated by the consumer price index.

2. Data for 2014 covers the first semester where the number of sales is an estimate based on double the sales of the first semester.

Source: Statistics Belgium (2014), "Immobilier et utilisation du sol: Statistiques des ventes de terrain à bâtir", *be.STAT Database*, November.

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To meet the high demand for new housing, construction close to centres of economic activity should be stimulated so as to simultaneously reduce energy consumption and commuting time. In this respect, the Regional Spatial Development Perspective for Wallonia, adopted in November 2013, outlines several measures for a densification of villages and towns. Proposals to construct additional housing on underdeveloped parcels should be further explored and incorporated in municipal development plans. The envisioned minimum building densities for new construction projects and for large renovations will also lead to more compact urban centres and should be made operational. Adding floors to existing buildings could be promoted by streamlining the involved procedures.

The spatial development plan for Flanders stipulates that 60% of new houses are built in urban areas and 40% in rural areas. These ratios reflect the distribution of the housing stock in 1991 and were introduced in 1997, when construction increasingly took place in rural areas, to avoid further urbanisation. Targets for provinces and municipalities have ensured that the overall ratio has been respected. Raising the bar by setting a more ambitious target would reinforce efforts of authorities at all three levels to facilitate the development of new housing close to areas with high economic activity.

### **Activating vacant plots and buildings**

In general, unused plots, especially in urban areas, could be activated by lowering the profitability of unused land. Regional policies exist to encourage owners to build on their land, while municipalities can impose activation charges and taxes. However, only a minority of municipalities is taxing unused plots and the amounts involved are often small compared to the steadily increasing plot values. Overall, the inventory of empty plots needs to be updated and its coverage extended to all municipalities in Belgium.

Vacant dwellings are also a potential source for additional housing. In Flanders, there are some 15 000 unoccupied houses, 15 000-30 000 in Brussels and at least a similar number in Wallonia for which the last reliable estimate dates from the 1990s. Many of these houses will need major renovations, but others can be used without substantial costs. Municipalities can tax uninhabited houses and buildings, but in practice few do so. This prompted Brussels-Capital Region to introduce a regional charge in 2012. In addition, federal housing taxation provides the wrong incentive by giving a deduction for dwellings unoccupied for over 90 days.

### ***Modernising and greening the housing stock***

A wide range of measures is in place to stimulate the renovation of existing housing, especially regarding energy efficiency improvements. Ordinary renovations benefit from the low VAT rate of 6%, as opposed to new constructions for which a rate of 21% applies. Federal support for energy efficiency improvements has been streamlined by phasing out all measures, except for a tax-reduction on roof-top insulation, which is one of the most efficient ways to reduce residential energy consumption. Additional subsidies exist at the regional and local level, the exact amount depending on various criteria, including income and the nature of the work. However, several supporting measures are inefficient, most notably the subsidies for solar panels in Wallonia (OECD, 2011b).

Potentially disproportionate increases in property taxes discourage owners to carry out investments. Substantial renovations should be reported to the cadastre, which subsequently re-estimates the potential value for which the dwelling can be rented (the cadastral income) and on which property taxes are based. Given that the last general update of the cadastre took place in 1975, the re-estimation can lead to a considerable increase in the cadastral income and the related taxes, and hence only rarely renovations are reported spontaneously (Rekenhof, 2013). In addition, the administrative procedure to levy fines is so complex that no sanction has been issued since 2006. However, the procedure is currently being streamlined, which makes non-reporting less attractive in the future. It is therefore increasingly important to address disincentives for renovations related to property taxes, for example by updating the cadastre (discussed in detail below).

Aside from adjustments to the cost of living, landlords can increase the rent during contractual periods only if renovations increased the rental value by 10% or more. Following the Sixth State Reform, Regions are now responsible for rental legislation, which provides an opportunity to stimulate the renovation of rental housing and in particular energy-efficiency improvements. Offering targeted loans to cash-constrained landlords, often older people, would encourage investments in rental dwellings as they could spread the costs over time. Tenants at the lower end of the rental market whose housing conditions are improved should be shielded from too large rent increases through specific subsidies.

Prospective renters should be given more information about the energy consumption of dwellings. Easily observable energy-saving features are valued by tenants. For example, in Wallonia rents of properties with double or triple glazing are some 10% higher than those with single glazing (Kryvobokov and Pradella, 2014). However, other energy-efficiency measures, such as good insulation, can be assessed less easily, which makes renters reluctant to pay the higher rents. In Brussels the cost of occupancy, which includes both mortgage costs or rents and energy expenses, has to be included in acquisition and operating contracts for public buildings from July 2015 onwards, and the

authorities are assessing whether this requirement can be extended to the residential sector. Notwithstanding challenges related to the practical implementation, using the cost of occupancy seems a promising way to raise attention to a dwelling's energy costs and its use should be considered by the other Regions.

Despite the overall support for energy efficiency, energy subsidies are providing the wrong incentives. The widespread use of social energy policies contributes to the high residential emissions (OECD, 2011b). The lower tariffs discourage energy savings and should be replaced by social policies such as lump-sum income subsidies for low-income households to prevent energy poverty. Similarly, the reduction of the VAT on electricity introduced in April 2014 should be reverted. The progressive energy pricing in Brussels and Wallonia, to be implemented in January 2015, will increase incentives for lower energy consumption and raise awareness.

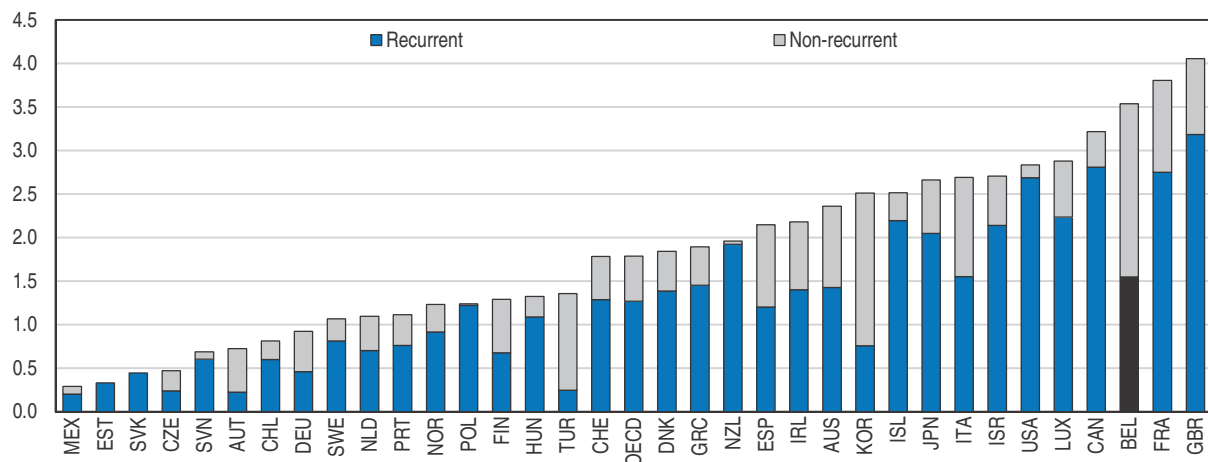
## Increasing efficiency and equity of housing taxation

### Tilting housing taxation towards recurrent taxes to increase efficiency and mobility

Revenues from property taxes are high in Belgium compared to other OECD countries (Figure 2.18). They are an important source of income at the local level, accounting for around half of all tax receipts. About two-thirds of property tax revenues come from housing. A high share of total revenues comes from non-recurrent taxation, mainly taxes on inherited dwellings and property transactions. Indeed, transfer taxes are high in Belgium, pushing up the transaction costs for buyers (Figure 2.19). As in many other countries, tax breaks exist. All Regions have abatements to reduce the taxes, with the higher abatements in Brussels and Wallonia off-setting higher tax rates. In Flanders, previously paid taxes can qualify for discounts when purchasing a new house in the Region – a cumbersome administrative process that is carried out by the federal authorities. Notwithstanding these complex ways of mitigating the high transaction tax rates, Belgium is often mentioned as a country where lowering transfer taxes on property would lead to significant welfare gains (Van Ewijk and Van Leuvensteijn, 2009).

Figure 2.18. **Taxation of housing is skewed towards non-recurrent taxes**

Revenues as a percentage of GDP, 2013<sup>1</sup>



1. 2012 for Australia, Estonia, Greece, Mexico, Netherlands, Poland and the OECD average.

Source: OECD (2014), "Revenue Statistics: Comparative tables", OECD Tax Statistics (database).


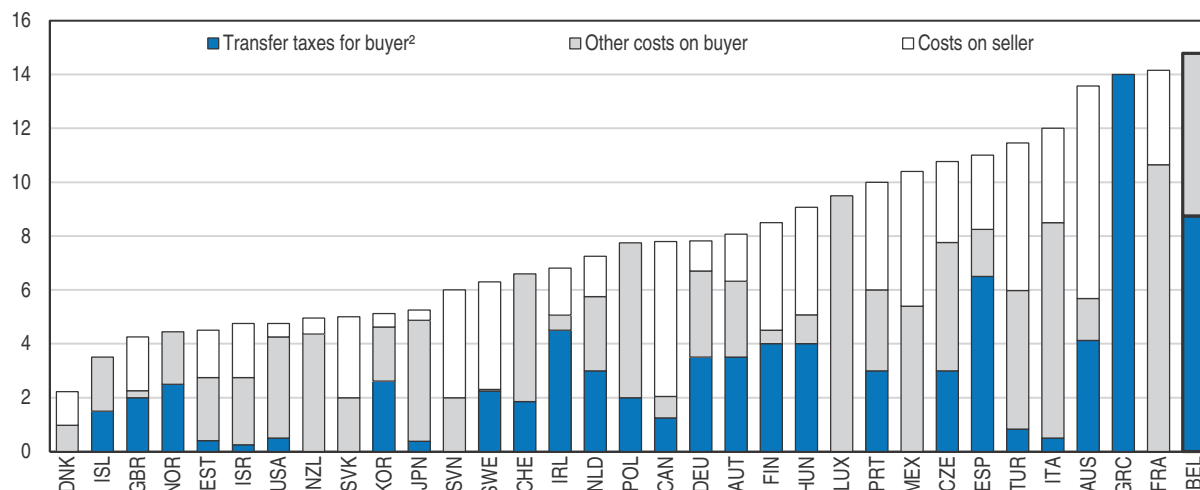
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Figure 2.19. **Transaction costs are high**  
Average costs in per cent of property value, 2009<sup>1</sup>



1. The estimates do not take into account the various tax breaks for certain dwellings implying that the estimated cost may overestimate the actual cost in some countries, in particular in Italy, where such tax breaks are frequent.

2. Stamp duty for example.

Source: D. Andrews, A. Caldera Sánchez and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries", OECD Economics Department Working Papers, No. 836.

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Comparing the origins of property tax revenues of Belgium and OECD countries (Figure 2.18) indicates that there is scope to tilt taxation towards recurrent taxes. Such a reform would make it less costly to relocate and would take away a barrier to labour mobility (Isebaert et al., 2014). In addition, it would increase tax efficiency as transaction taxes are highly distorting, and the same tax revenue could in principle be obtained at a lower economic cost by a recurrent tax on immovable property (Johansson et al., 2008). As a reduction of transaction taxes would stimulate house prices, it could mitigate negative price pressures resulting from lower tax relief for homeowners. A phase-in mechanism could cushion the impact of the increased tax burden for current homeowners (Slack and Bird, 2014), but may involve transitional fiscal costs.

### Updating rateable values

The cadastral income, an estimate of the potential net rental income of a dwelling, forms the base for many housing-related taxes, including the withholding tax on real estate, a levy on inhabitable buildings and income taxes on non-owner occupied housing. It also serves to determine eligibility for lower transaction taxes. The valuation date of the cadastral income is 1 January 1975, but since 1990 values have been indexed to the consumer price index and increased by 40% to determine the taxable amount. However, this revision method has led to a significant underestimation of rental values. For example, in Wallonia revenues based on the cadastre increased by 74% during 1982-2013 while other revenues more than doubled. An additional problem is the large variation between selling prices of specific properties and their cadastral incomes as standings of areas have changed over time. In general, properties with comparable selling prices have higher cadastral incomes in the main cities.



In setting recurrent taxes, the Regions have full competences except undertaking an update of the cadastral values which remains a federal competence. As the costs of an update are borne by the federal authorities while the benefits accrue to the Regions, a cost-sharing agreement has to be sought. An alternative is to change the base of taxation, a possibility since 2001, by setting up a regional cadastre, as is discussed in Brussels. Either way, the cadastral income should be derived on a good proxy of a property's market value. If administrative capacity is limited, self-assessment of property values by owners, the method recently used in Ireland, might be an option (Slack and Bird, 2014).

An update of cadastral income would raise the taxable rental income on non-owner occupied housing. Although this would merely be a correction of implicit benefits that accrued over the years, the lower after-tax returns on renting could lower the supply or drive up rents. Moving towards a taxation of real actual rental incomes, at least for the rented dwellings, would address this problem, but in analogy of other investments would call for deductions related to the maintenance of the property and, in case of debt financing, interest payments as well as a tax on realised capital gains (CSF, 2014). A full assessment is further complicated by the frequent use of corporations that are specifically set-up by the landlord for tax purposes. For second residences, the higher taxation would be in line with a reduction in mortgage tax relief for owner-occupied housing.

### **Recommendations to maintain an efficient and equitable housing market**

#### **Policies to limit risks posed by the overvalued housing market**

- Take advantage of the current low interest rates to gradually remove the tax deductibility of interest and capital repayments on mortgage loans.
- Impose maximum limits on loan-to-value and debt-service-to-income ratios for new mortgage lending when appropriate in view of housing market dynamics.

#### **Policies to improve the functioning of the rental market**

- Expand regional rental allowance schemes for low-income tenants renting on the private market. Make the allowance portable and dependent on local median rents.
- Increase subsidies for social rental agencies and make publicly-owned plots available for construction of affordable housing, notably by the private sector.
- Focus on rental housing instead of selling newly constructed social housing at discounted prices.
- Stimulate higher occupation turnover of social rental housing by a stronger enforcement of contractual eligibility requirements and the abolition of open-ended contracts.

#### **Policies to meet the rising demand for housing and improve the housing stock**

- Increase urban building densities by re-designating land and converting non-residential buildings, further easing restrictions on the construction of denser buildings, and increasing the costs of keeping urban land and buildings unused.
- Address disincentives for renovations related to the disproportionate increase in property taxes – in particular for energy-efficiency improvements.
- Allow rent increases during a contractual period when justified by energy-efficiency improvements.
- Offer targeted loans for renovations to cash-constrained landlords, possibly guaranteed by the dwelling.

### **Recommendations to maintain an efficient and equitable housing market (cont.)**

#### **Policies to make the housing market more dynamic and the private rental market more attractive**

- Tilt housing taxation towards recurrent taxes and away from transaction taxes. Reduce transaction taxes through lower rates instead of increasing abatements and expanding portability of previously-paid taxes.
- Update the federal cadastre, financed through a cost-sharing agreement between government levels, or set up regional cadastres.
- Review taxation of rental income to avoid negative effects on the supply of rental housing from an update of the federal cadastre.
- Increase pressure on real estate agents to adopt a binding code that bans discrimination and step up random checks to avoid that discrimination moves to later stages of the rental process.

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