INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/78

BELGIUM

SELECTED ISSUES

March 2016

This Selected issues paper on Belgium was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on February 17, 2016.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BELGIUM

SELECTED ISSUES

February 17, 2016

Approved By
European Department

Prepared By Jean-Jacques Hallaert, Johannes Eugster

CONTENTS

TABLES

FIGURES

BELGIUM—MAKING PUBLIC EXPENDITURE MORE EFFICIENT[1]

1. **Belgium faces fiscal challenges that call for a substantial consolidation over the medium term.** Belgium's long track record of primary surpluses was undone by the global financial crisis and the public debt-to-GDP ratio increased again into triple digits. Recent fiscal consolidation in Belgium has so far been modest and mostly revenue-based (Hallaert and Nowak, 2015; Figure 1). The overall deficit has been hovering around three percent of GDP. The tax-to-GDP ratio is now the third highest in both the OECD and the EU, limiting the scope for further tax hikes. The public expenditure-GDP ratio is also significantly higher than before the crisis and among the highest in the world (more than 10 percentage points of GDP higher than the EU average). Taken together, these developments have created vulnerabilities and squeezed the fiscal buffers that may be needed in the event of future shocks.

2. **The government plans to achieve a structurally balanced budget by 2018, which is ambitious.** The strategy described in the 2015 stability program (European Commission, 2015a) is to reduce significantly the expenditure-to-GDP ratio over 2014–18 and reach balance while reducing the revenue-to-GDP ratio by 0.6 percentage point (Figure 1). Staff estimates that this will require identifying additional savings of almost two percent of GDP, the bulk of which would have to come from the spending side.

3. **The sizable expenditure reduction contemplated by the authorities will be difficult without deeper structural reforms.** Reducing the expenditure-to-GDP ratio by almost four percentage points between 2014 and 2018 would be a substantial effort. In a low inflation environment, it cannot be achieved solely by containment or spending freezes. Moreover, given the potential adverse impact on growth and social protection of across-the-board cuts, it will be important to identify expenditure savings that minimize these effects.

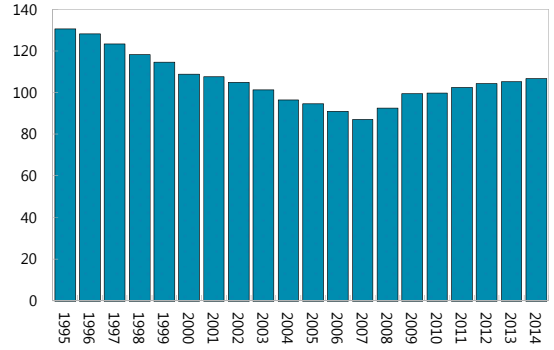
4. **Reforms that improve the efficiency of public spending can help underpin fiscal adjustment while minimizing the drag on growth and protect social cohesion.** The purpose of this paper is to identify areas where there is scope for expenditure efficiency gains. The methodology is based on a double benchmarking, comparing both the *level* and the *outcome* of spending in different categories to other European countries (with a particular focus on three neighboring countries: France, Germany, and the Netherlands). The paper is organized as follows. The first section highlights the sources of expenditure growth and discusses how the structure of public expenditure differs from what is observed in other European countries. The second section benchmarks the level and the efficiency of spending in various sectors. Both sections point to areas where efficiency gains can be achieved.

[1] Prepared by Jean-Jacques Hallaert (EUR). I thank David Coady, Nan Geng, Louis Sears, and Candice Liu for sharing the expenditure database they developed (Coady and Geng, 2015), and Jörg Decressin and Christian Mumssen for their suggestions.

Figure 1. Fiscal Consolidation

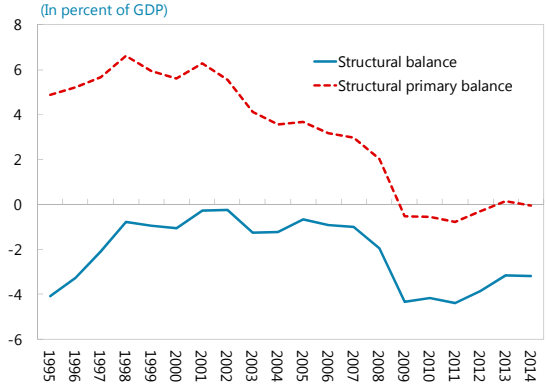
Belgium had an impressive track record of debt consolidation until the crisis,…

General Government Debt
(In percent of GDP)



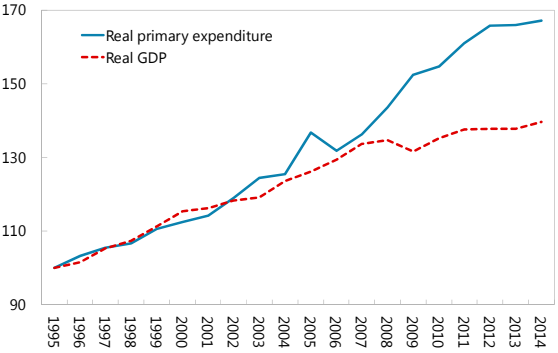
…with sizeable structural primary surpluses.

General Government Structural Balances
(In percent of GDP)



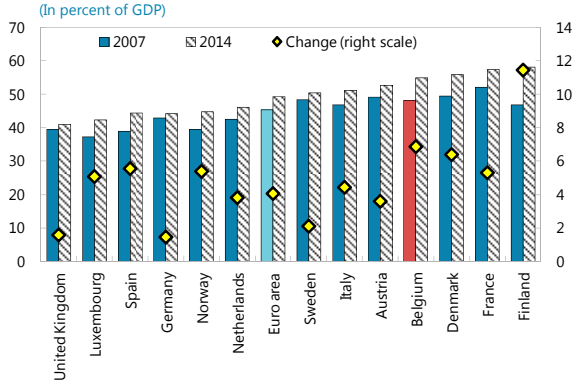
From the onset of the crisis, real primary expenditure started to grow much faster than real GDP.

Real Primary Expenditure and Real GDP
(Index, 1995=100)



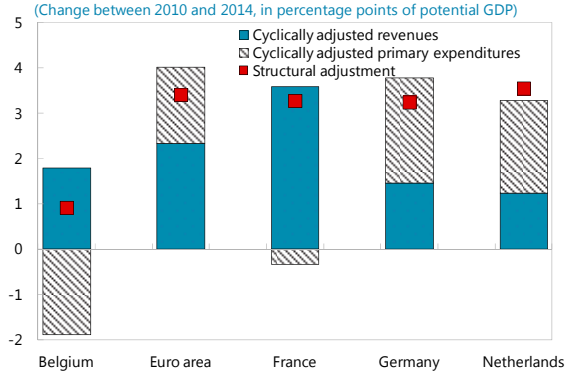
During the crisis years spending growth was larger than in most other Euro Area countries.

General Government Spending
(In percent of GDP)



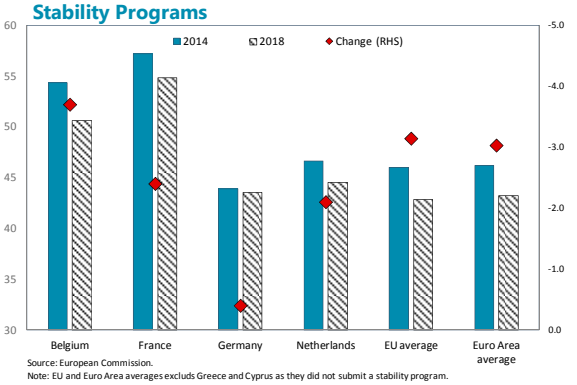
Recent consolidation has been modest as continued spending growth undermined the revenue effort.

Structural Fiscal Adjustment
(Change between 2010 and 2014, in percentage points of potential GDP)



The authorities' objective is now to reach a balanced budget through a significant expenditure reduction

Projected Expenditure-to-GDP ratio in the 2015 Stability Programs

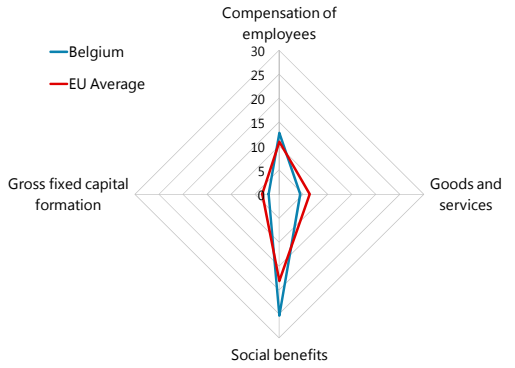


Sources: Haver Analytics, Eurostat, and IMF staff calculations.

A. Sources of Expenditure Growth

5. **At 55 percent of GDP, general government spending is high by EU standards, reflecting in particular sizable social benefits and wage expenditures** (Table 1). Current expenditure has been the driver of recent spending growth. It was 10 percentage points of GDP above the EU average in 2014. This primarily reflects social benefits, on which Belgium spends more than most other countries, but also by the relatively high public wage bill and subsidies. Despite the high debt level, interest payments are currently only slightly above the EU average, thanks to a relatively low interest rates. By contrast, capital spending, notably public investment, was below the EU average.

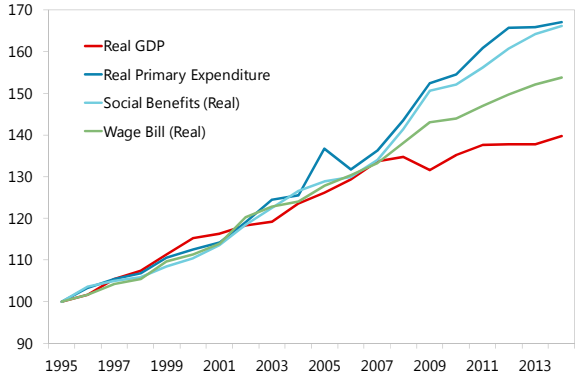
Composition of Public Expenditure in Belgium and in Europe, 2014



Sources: Eurostat.

6. **Unlike in most EU countries, spending continued to grow post crisis.** Despite a decline in debt service (by -0.5 percentage point of GDP), current spending increased by 1.4 percentage points of GDP over 2010–14, with fiscal consolidation relying heavily on revenue raising efforts (Figure 1). Together, social benefits and the wage bill account for 90 percent of the increase in the primary expenditure-to-GDP ratio since 2010. This stands in stark contrast to most EU countries, which reduced spending, including current spending, significantly in recent years (Table 2).

Real Primary Expenditure Growth in Belgium
(In index, 1995=100)



Sources: IMF staff calculations.

7. **Belgium's expenditure policy has been less selective than in most other European countries.** This likely reflects greater reliance on across-the-board containment as opposed to more targeted spending measures. At the same time, the practice of indexation of wages and social transfers (which has been recently suspended) tends to generate a certain underlying spending growth trend across many categories. As a result, as illustrated by a selectivity index (which is equal to 0 when all fiscal categories grow at the same rhythm), Belgium's spending policy has been one of the least selective European countries (Table 2).

Table 1. General Government Expenditure by Economic Classification in Europe

	2008	2009	2010	2011	2012	2013	2014	Difference (2014-2010)	
	(percent of GDP)							(ppts of GDP)	Share of total exp consolidation (%)
Belgium									
Total expenditure	50.3	54.1	53.3	54.4	55.8	55.6	55.1	1.8	100
Current spending	46.8	50.2	49.6	49.9	50.7	51.3	51.0	1.4	78
Compensation of employees	11.8	12.5	12.3	12.3	12.5	12.7	12.7	0.4	22
Goods and services	4.0	4.3	4.2	4.2	4.3	4.3	4.4	0.2	11
Interest payments	4.0	3.8	3.6	3.6	3.6	3.3	3.1	-0.5	-28
Subsidies	2.9	3.1	3.4	3.5	3.4	3.5	3.4	0.0	0
Current transfers	1.8	2.2	2.1	2.1	2.1	2.2	2.1	0.0	0
Social benefits	22.3	24.3	24.0	24.2	24.8	25.3	25.3	1.3	72
Capital spending	3.5	3.8	3.8	4.5	4.9	4.3	4.1	0.3	17
Gross fixed capital formation	2.1	2.3	2.3	2.4	2.5	2.4	2.4	0.1	6
EU average [1/]									
Total expenditure	44.0	48.1	48.0	46.4	46.3	46.7	46.4	-1.6	100.0
Current spending	38.7	42.5	41.9	41.2	41.3	41.4	41.1	-0.8	51.4
Compensation of employees	10.9	11.8	11.4	11.1	11.0	11.0	10.9	-0.5	30.0
Goods and services	6.2	6.6	6.5	6.4	6.3	6.3	6.3	-0.2	12.0
Interest payments	2.1	2.2	2.3	2.5	2.5	2.5	2.4	0.1	-6.1
Subsidies	1.3	1.3	1.3	1.2	1.2	1.2	1.3	-0.1	3.4
Current transfers	2.2	2.4	2.2	2.2	2.2	2.3	2.3	0.0	-1.8
Social benefits	16.1	18.3	18.3	17.9	18.0	18.1	18.1	-0.2	13.9
								0.0	
Capital spending	5.2	5.4	5.9	5.2	4.9	5.2	5.2	-0.8	48.6
Gross fixed capital formation	4.2	4.3	4.0	3.7	3.6	3.4	3.6	-0.4	27.0
France									
Total expenditure	53.0	56.8	56.4	55.9	56.8	57.0	57.5	1.1	100.0
Current spending	47.5	50.7	50.7	50.4	51.1	51.3	52.2	1.5	136.4
Compensation of employees	12.4	13.1	13.0	12.8	12.9	12.9	13.0	0.0	0.0
Goods and services	4.7	5.1	5.1	5.1	5.1	5.2	5.2	0.1	9.1
Interest payments	2.8	2.4	2.4	2.6	2.6	2.3	2.2	-0.2	-18.2
Subsidies	1.5	1.8	1.8	1.7	1.7	1.7	2.2	0.4	36.4
Current transfers	3.1	3.4	3.4	3.3	3.4	3.5	3.4	0.0	0.0
Social benefits	23.0	24.9	25.0	24.9	25.4	25.7	26.2	1.2	109.1
								0.0	
Capital spending	5.1	5.4	5.2	4.9	5.2	5.0	4.8	-0.4	-36.4
Gross fixed capital formation	3.9	4.3	4.1	4.0	4.1	4.0	3.7	-0.4	-36.4
Germany									
Total expenditure	43.6	47.6	47.3	44.7	44.4	44.5	44.3	-3.0	100.0
Current spending	39.9	43.7	42.7	41.1	41.1	41.3	41.0	-1.7	56.7
Compensation of employees	7.4	8.0	7.9	7.7	7.7	7.8	7.7	-0.2	6.7
Goods and services	4.0	4.5	4.6	4.6	4.8	4.8	4.8	0.2	-6.7
Interest payments	2.7	2.6	2.5	2.5	2.3	2.0	1.8	-0.7	23.3
Subsidies	0.9	1.3	1.1	1.0	0.9	0.9	0.9	-0.2	6.7
Current transfers	1.8	1.9	2.0	1.9	2.0	2.2	2.1	0.1	-3.3
Social benefits	23.1	25.4	24.6	23.4	23.4	23.6	23.7	-0.9	30.0
Capital spending	3.7	3.9	4.8	3.6	3.5	3.4	3.4	-1.4	46.7
Gross fixed capital formation	2.1	2.4	2.3	2.3	2.3	2.2	2.2	-0.1	3.3
Netherlands									
Total expenditure	43.6	48.2	48.2	47.0	47.1	46.4	46.2	-2.0	100.0
Current spending	39.4	42.7	43.0	42.6	42.7	42.7	42.2	-0.8	40.0
Compensation of employees	8.7	9.5	9.5	9.3	9.3	9.3	9.2	-0.3	15.0
Goods and services	6.5	7.2	7.0	6.7	6.6	6.4	6.3	-0.7	35.0
Interest payments	2.0	2.0	1.8	1.8	1.6	1.5	1.4	-0.4	20.0
Subsidies	1.3	1.6	1.6	1.5	1.4	1.3	1.2	-0.4	20.0
Current transfers	2.1	1.6	1.9	1.9	1.9	1.8	2.0	0.1	-5.0
Social benefits	18.8	20.8	21.2	21.4	21.9	22.4	22.1	0.9	-45.0
Capital spending	4.5	5.3	5.2	4.6	4.4	4.4	4.1	-1.1	55.0
Gross fixed capital formation	4.0	4.3	4.1	4.0	3.7	3.6	3.5	-0.6	30.0

Sources: Eurostat and IMF staff calculations.
1/ Simple average.

Table 2. Selectivity in Spending Cuts/Increases in Europe

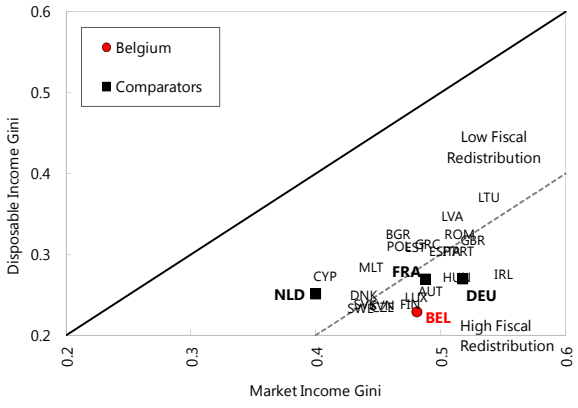
	Pre crisis	Crisis		Number of Cofog categories considered [3/]			Primary spending considered (in percent)		
		"Stimulus"	"Consolidation"						
	2000-07	2007-10	2010-13	2000-07	2007-10	2010-13	2000-07	2007-10	2010-13
Hungary	25.9	17.5	17.6	58	57	59	97.2	97.1	95.5
Portugal	29.5	15.2	17.4	62	61	61	97.8	98.7	99.3
Ireland	45.9	27.8	17.0	58	58	59	98.7	80.3	80.3
Czech Rep.	25.0	17.0	14.8	64	65	65	97.0	97.8	98.1
United Kingdom	27.3	10.6	12.3	62	64	62	98.6	98.6	98.4
Slovenia	21.0	16.8	11.7	63	62	60	98.7	98.3	88.9
Spain [1/]	20.0	11.5	11.0	60	61	61	96.7	96.7	92.8
Japan	n.a.	8.4	10.5	n.a.	56	57	n.a.	93.7	93.9
Slovak Rep.	n.a.	25.3	9.2	n.a.	64	62	n.a.	97.8	98.6
Luxemburg	13.5	11.4	9.2	55	56	56	99.4	99.3	99.3
Netherlands	17.9	8.0	8.9	62	63	62	98.2	97.7	98.5
Italy [2/]	8.6	7.2	7.6	63	63	63	99.1	99.2	99.2
Germany	9.1	8.5	7.5	64	64	64	100.0	96.3	96.4
Norway	n.a.	12.7	7.4	n.a.	63	62	n.a.	98.2	98.3
Denmark	16.7	8.2	6.9	60	59	58	98.1	98.6	98.6
Austria	11.6	6.2	6.5	64	64	64	96.9	96.7	96.3
Belgium [2/]	**11.4**	**6.9**	**5.6**	**62**	**64**	**63**	**95.3**	**94.2**	**93.5**
Sweden [2/]	17.1	8.6	4.6	59	60	59	98.3	98.2	98.0
France	11.7	6.5	3.7	60	61	60	98.4	98.1	98.0

Sources: OECD and IMF staff calculations.
Note: Countries are ranked according to the value of the selectivity indicator in 2010–13. Spending is in national currency deflated by the GDP deflator. The closer to 0 the indicator the more spending change was similar across classifications. For details on the methodology, see Lorach and Sode (2015).
[1]/ For Spain up to 2010–12.
[2]/ For Belgium, Italy, and Sweden: 2001–07.
[3]/ Out of a maximum of 66 COFOG categories as three categories are excluded (0107, 0401, 0407).

Social Benefits

8. **At over 25 percent of GDP, social benefits are significantly larger than the EU average, and have increased faster than in most countries.** Over 2007–14, they increased by 4 percentage points of GDP (explaining 58 percent of the increase in total expenditure).

Market and Disposable Income Inequality in Europe, 2013



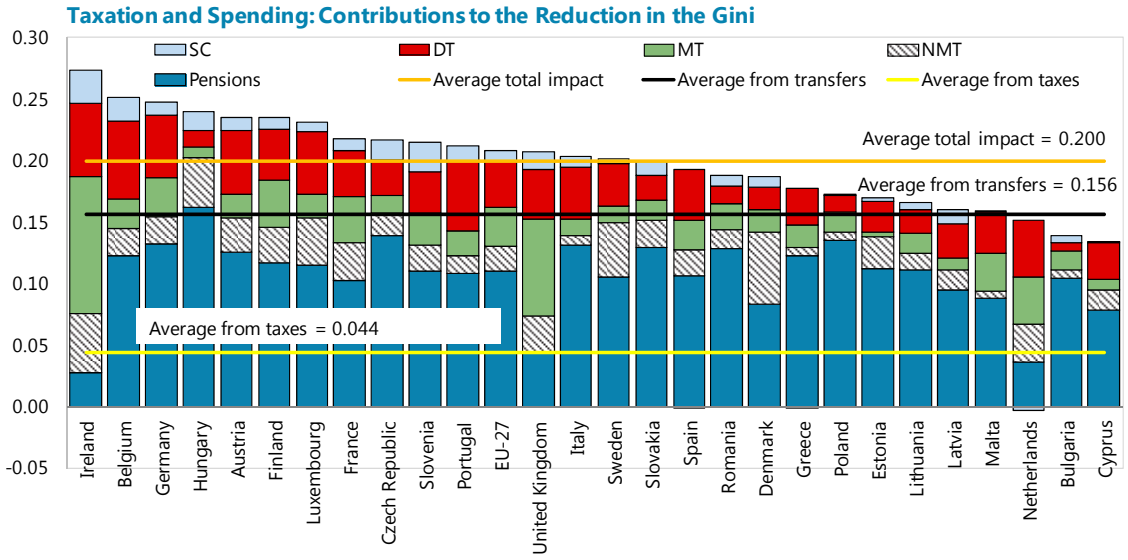
Sources: Eurostat and IMF Staff calculations.

9. **Social transfers and income taxes contribute to a significant reduction in income inequality, more so than in most other EU countries.** Disposable income inequality is the lowest in Europe thanks to the largest redistributive impact of taxes and transfers after Ireland (Figure 2). Fiscal redistribution reduces the Gini index by 0.25 compared to 0.20 on average in the EU and in the three neighboring countries. However,

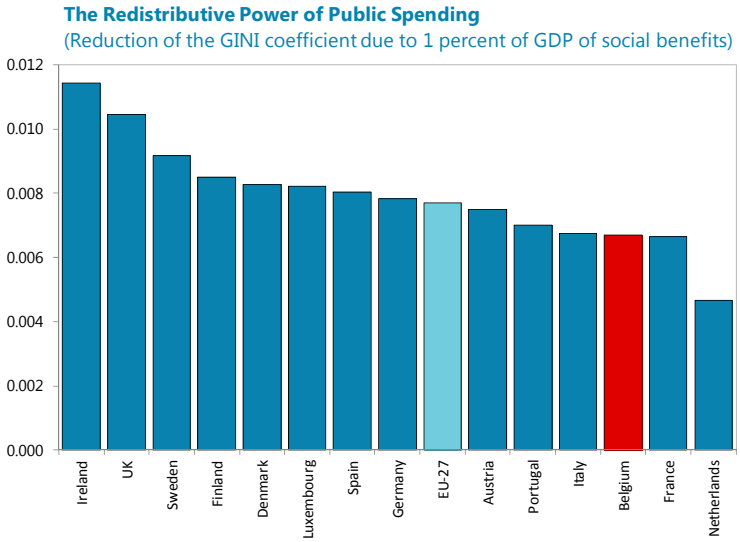
though Belgium has the second largest social spending level in the EU (after France), it ranks only ninth in the reduction in income inequality achieved with transfers. In the EU, on average, transfers contribute to 78 percent of the reduction in income inequalities (75 percent on average in the three neighboring countries). In Belgium, the share is only 67 percent; the lowest in Europe. Therefore, taxes contribute more to the reduction in income inequality than in the rest of Europe. In particular, direct taxes reduce more inequalities than in any other EU country.

Figure 2. Contributions of Fiscal Policy to the Reduction of Income Inequality in Europe, 2013

Belgium achieves the second largest fiscal redistribution in the EU but more than in other countries it is achieved by taxes. Belgium ranks only 8th for the redistribution impact of transfers…



In fact, the redistributive power of spending is one of the lowest in Europe.



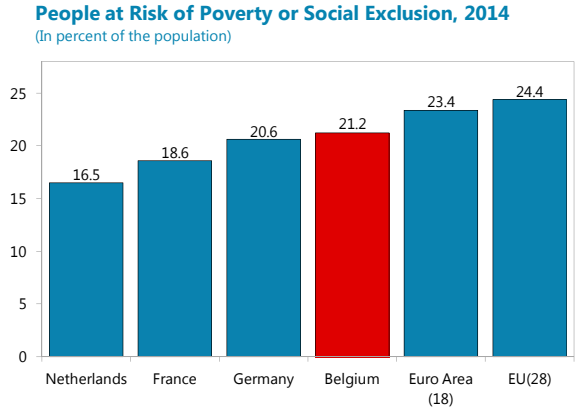
Sources: EUROMOD, Eurostat, and IMF staff calculations.
Note: SC= Social Contributions; DT=Direct Taxes; MT=Means-tested social spending; NMT=Non-means-tested social spending.

10. **The redistributive power of social spending (i.e., the reduction in the Gini coefficient per one percent of GDP in social spending) is low by European standards** (Figure 2). Illustrating the potential for efficiency gains, if Belgium could raise the redistributive power of social spending to the (weighted) EU average, it could achieve the same reduction in inequality with 3¼ points of GDP lower spending.

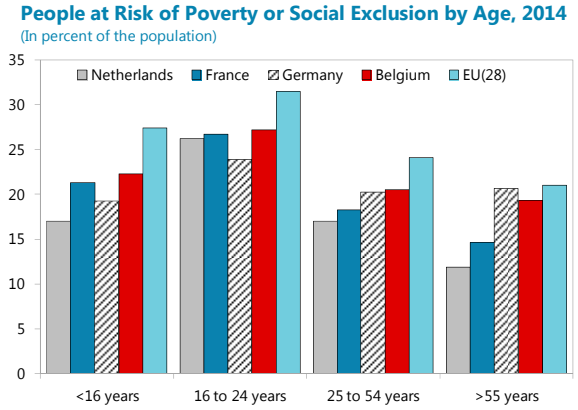
11. **Another sign of potential large efficiency gains is that, despite the substantial income redistribution, poverty remains relatively high in Belgium.** The share of the population at risk of poverty (an indicator for the most vulnerable households at the lower end of the income distribution) is lower than European average but significantly higher than in the three neighboring countries (Figure 3). There are wide differences in the risk-of-poverty ratio by regions that strikingly mirror regional differences in unemployment. In 2011 (latest available data), the risk-of-poverty ratio reached at 15.0 percent in Flanders, 25.4 percent in Wallonia, and 40.4 percent in Brussels.

Figure 3. Poverty in Belgium and in Europe

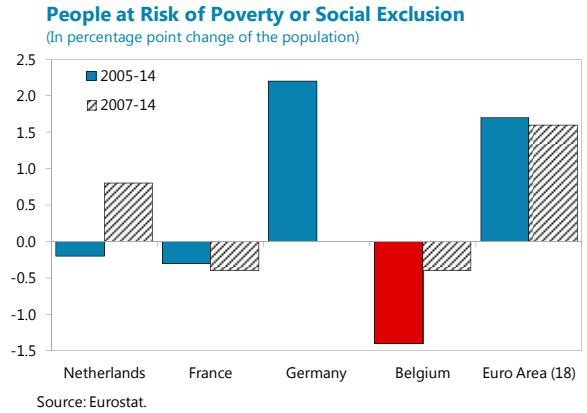
The risk of poverty is higher than in neighboring country…



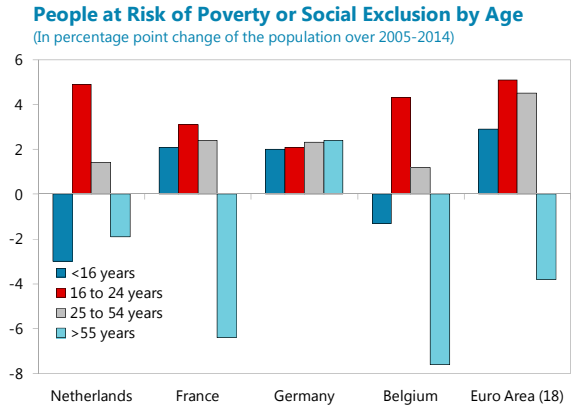
…. for all age groups…



… but has been decreasing…



…. as the drop for seniors and children more than offset the increase for other age groups.

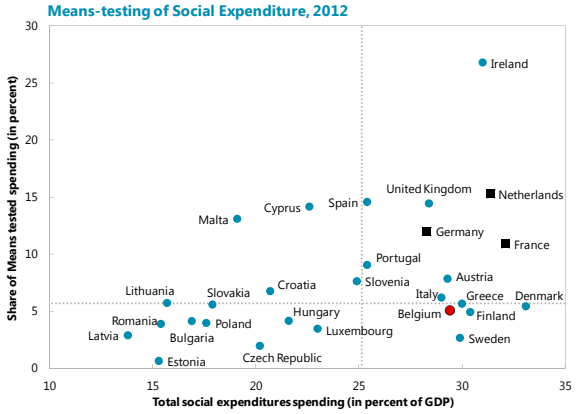


Source: Eurostat.

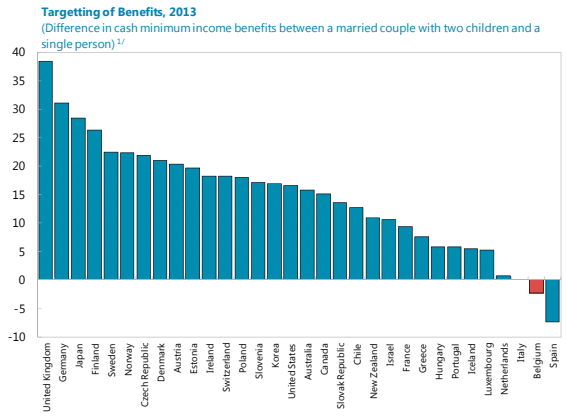
12. **A stronger emphasis on means-testing and better targeting the poor could improve the efficiency of social spending** (Figure 4). Only about 5 percent of social expenditures (in kind and in cash) are means-tested. This is 2½ percentage points less than EU average,[2] and significantly below countries with the same level of spending including the three neighboring countries (11 percent in France, 12 percent in Germany, and 15 percent in the Netherlands). For example, in 2012, family-related spending was not means-tested at all in Belgium while, on average, in the EU and in the three neighboring countries about one quarter of this type of spending was means-tested.

Figure 4. Means-testing of Social Expenditures and Targeting of Safety Nets, 2012
(In percent of social expenditures)

Means-testing is relatively low especially when compared to countries with similar levels of social spending.



There is room to improve the targeting of safety nets.



Sources: Eurostat, OECD, and IMF staff calculations.
Note: Dashed lines represent EU medians.
1/ Difference in the net income value, in percent of median household incomes, of a married couple with two children qualifying for cash housing assistance and a single person that does not qualify for cash housing assistance.

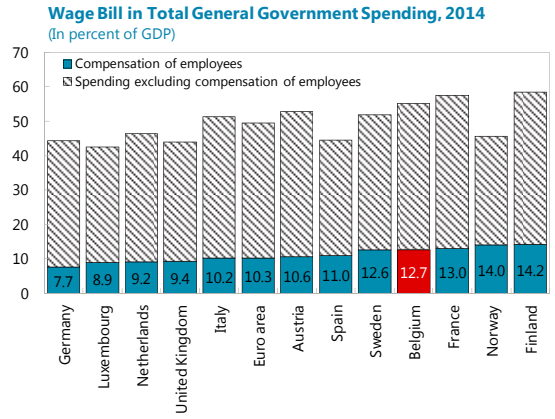
Wage Bill

13. **The wage bill is another reason for large and growing public expenditures.** At 12.7 percent of GDP in 2014, the wage bill is one of the highest in Europe (Figure 5). Moreover, whereas most EU countries cut the wage bill during the recent consolidation period—on average by 0.5 percentage point of GDP over 2010–14—in Belgium, it increased by 0.4 points in the same period (Table 1).

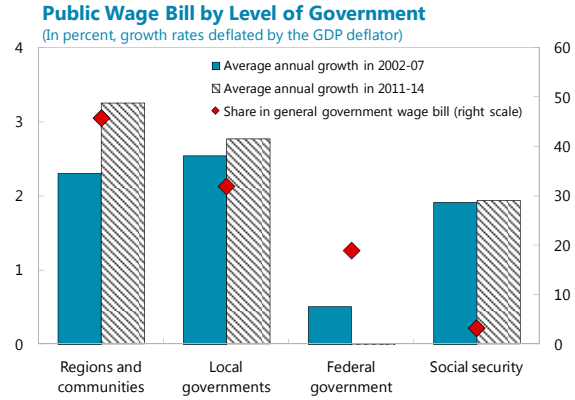
[2] Half a percentage point less than EU median.

Figure 5. Belgium: Public Sector Employment and Wage Level

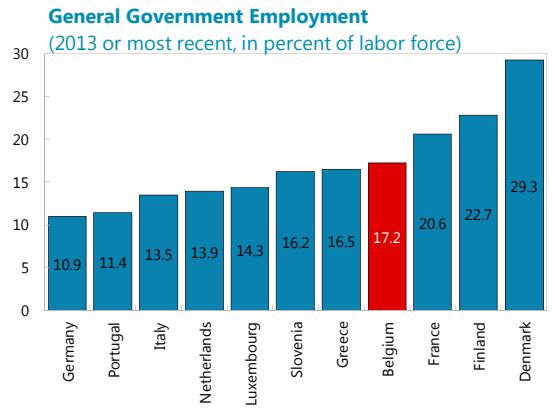
The wage bill is comparatively high in Belgium…



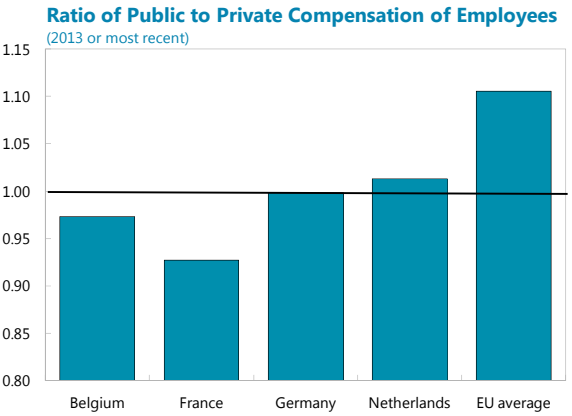
…. and increased due to growth at the sub-national level.



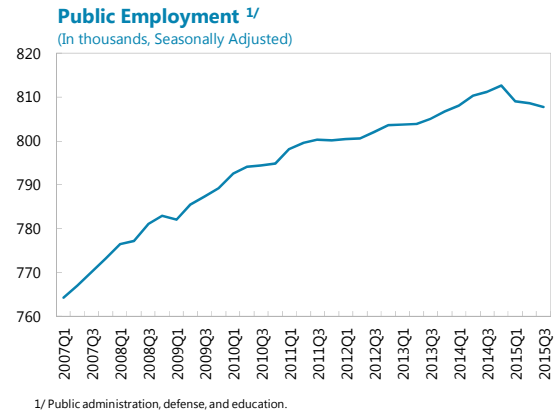
Public employment is high…



… while the public-private wage compensation gap is lower than in other European countries…

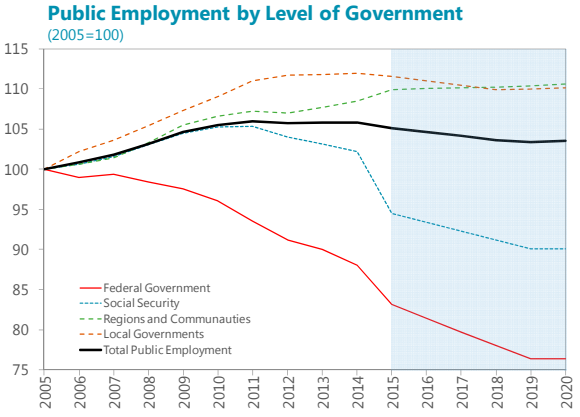


Public employment started to decline in 2015…



1/ Public administration, defense, and education.

… and is projected to decline further until 2019



Sources: Haver Analytics, Eurostat, OECD (2015a), National Bank of Belgium, Federal Planning Bureau (2015a), and IMF staff calculations.

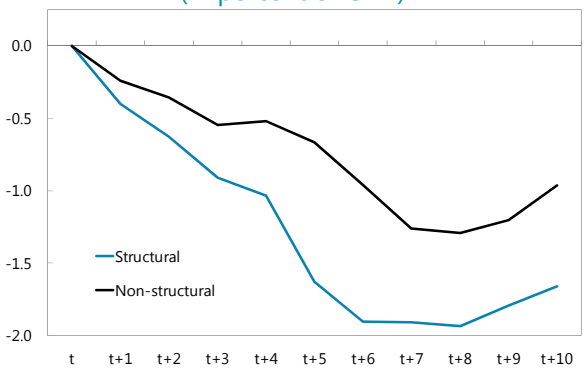
1/ Public administration, defense, and education.

14. **The large wage bill reflects the size of public employment rather than the salary levels.** Driven by an expansion at the sub-national government level (in part due to the decentralization),[3] public employment is among the largest in Europe. However, there is no wage premium for the public sector as evidenced by a lower public-private wage compensation gap than in other European countries (Figure 5). The absence of a wage premium is confirmed by Eugène (2011) and Giordano et al. (2011) who, on the basis of survey data, find that when all sources of differences in the structure of employment (age, employment status, gender, education level, working hours, and managerial duties) between public and private sectors are taken into account, wages in the public sector were only 1.7 percent higher than in the private sector in 2004–07. This gap is smaller than in France and Germany (between 10 and 15 percent).

15. **Structural measures have a more durable impact in reducing the public wage bill**. An analysis of recent consolidation episodes in advanced economies concludes that the reduction of the government wage bill has been larger and more durable when the adjustment included structural measures (Figure 6 and IMF, 2014). Structural reforms include rationalizing the size and structure of government, outsourcing non-core functions, and improving the efficiency of the wage formation and hiring processes. Short-term measures such as wage or hiring freezes have generally expired within a few years, and generated less durable reductions in the wage bill.

Figure 6. Cumulative Change in the Public Wage Bill Ten Years after the First Year of Measures

(In percent of GDP)



Source: IMF (2014).

Note: t indicates the year of introduction of the wage bill measure. Episodes with structural measures are: Austria (1996–97), Belgium (1982), Canada (1991–92), Italy (1993), Portugal (2005–07), the United Kingdom (1994). Those without are: Belgium (1992, 1994), Denmark (1983–84), Germany (1983–84), Germany (1995, 1997, 2000), Ireland (1982), Ireland (1987–88), the Netherlands (1984–86), the Netherlands (2005), Portugal (2000, 2003), Spain (1997).

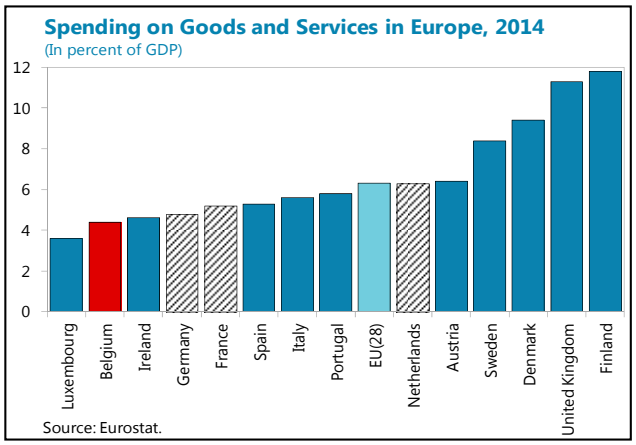
16. **This suggests that wage bill containment would be best achieved through targeted rationalization and greater efficiency of public employment.** This would complement the policy of wage moderation pursued in recent years, including the temporary suspension of the wage indexation. Already, measures are taken at various levels of government to reduce the number of civil servants.[4] As a result, after reaching a peak at the end of 2014, public employment started to decline in 2015 (Figure 5), although at a still relatively modest pace.

[3] The Federal Planning Bureau estimates that the sixth reform of the state led to a transfer of 4,700 civil servants from Entity I (federal government and social security) to communities and regions. No transfer is foreseen after 2015.

[4] As illustrated in Figure 5, the reduction in public employment was in the past mostly achieved at the federal level. Regions and communities have recently taken initiatives. For example, the Flemish community took measures to limit the number of teachers and the Walloon will not replace 1 out of five retirees until 2017.

Spending on Goods and Services and Public Investment

17. **In contrast to social and wage spending, Belgium's public sector spends comparatively little on goods and services.** At 4.4 percent of GDP, spending on intermediate consumption is significantly lower than the EU average and in the three neighboring countries (Table 1), suggesting that the scope for savings is more limited in this category.



18. **Public investment is also lower than in most European countries.** At about 2½ percent of GDP, public investment is well below EU average and median of 3¾ percent of GDP and in the three neighbors except Germany. As a result, the public capital stock is among the lowest in Europe (Figure 7). In almost every functional category, public investment is lower than 80 percent the EU average. There is one notable exception: investment in "general public services."[5] In this category, which accounts for 36 percent of total public investment, Belgium spends 60 percent more than the EU average or the three neighbors' average.[6]

Public Expenditure by Functional Categories, 2013
(In percent of GDP)

	Current expenditure	Grossed fixed capital formation
Total expenditure	50.3	2.2
General public services	7.6	0.8
Defence	0.8	0.1
Public order and safety	1.7	0.1
Economic affairs	5.3	0.6
Environment protection	0.6	0.1
Housing and community amenities	0.1	0.1
Health	7.7	0.0
Recreation, culture and religion	1.2	0.1
Education	6.1	0.3
Social protection	19.3	0.1

Source: Eurostat and IMF staff calculations.
Note: In red are areas where Belgium's spending exceeds EU average by 20 percent or more; in green are areas where spending is at least 20 percent below EU average.

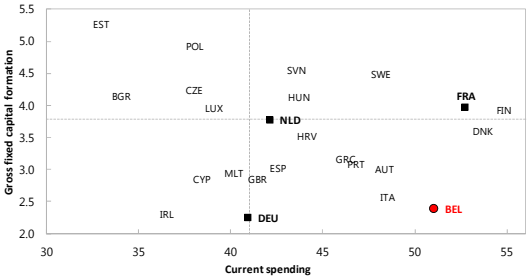
19. **There may be scope for redirecting resources to more productive investment projects.** While capital spending on general public services is relatively high, investment in "economic affairs", at only 0.6 percent of GDP, is about half the EU average.[7] In particular, transport infrastructure is perceived to be of lower quality than in the three neighboring countries. The perceived quality of both road and rail infrastructure have declined in recent years, and traffic congestion is a serious problem. Within transport infrastructure, the priority appears to be maintenance rather than expanding the size of the networks[8] (Figure 7).

[5] Differences for "public order and safety" and "social protection" are marginal as there is traditionally little investment.
[6] Belgium started to diverge from EU average in 2008.
[7] As in other countries, public investment also takes place through investment subsidies to and State owned enterprises and private entities (for example the railway company; see below section on subsidies). However, comparable data are not available. For details see Hallaert and Queyranne (2016).
[8] Belgium has the highest road density in Europe at 504.5 km of roads per 100 square kilometer of land area. Rail density at 11.8 kilometers per 100 square kilometers of land area is the second largest in the EU (after the Czech Republic) and is more than twice the EU average (5.7).

Figure 7. Public Investment, Capital Stock, and Infrastructure Quality

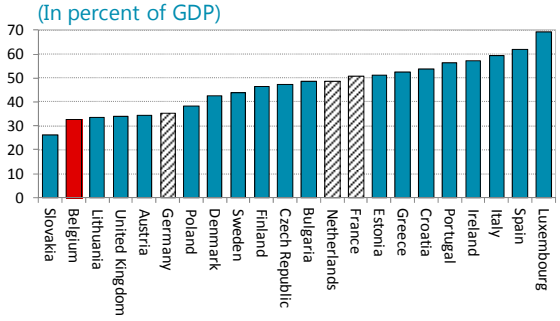
By European standards, public investment is low…

Current Spending vs. Gross fixed capital formation, 2014
(In percent of GDP)



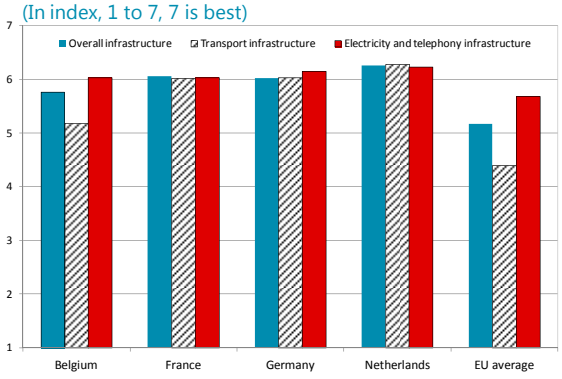
…. as is the public capital stock.

Public Capital Stock, 2012
(In percent of GDP)



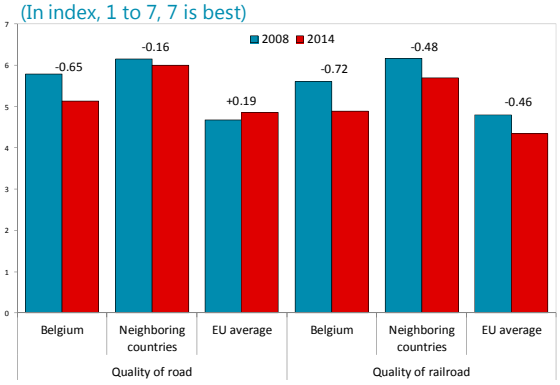
The perceived quality of infrastructure is lower than in the neighboring countries, in large part because of transport infrastructure.

Perceived Quality of Infrastructure, 2014
(In index, 1 to 7, 7 is best)



Transport infrastructure is deteriorating faster in Belgium than in the rest of Europe.

Evolution of Perceived Quality of Infrastructure
(In index, 1 to 7, 7 is best)



Source: Eurostat, World Economic Forum, and IMF estimates.
Note: Dashed lines indicate medians.

B. Public Expenditure by Sector

20. **High public spending is reflected across most functional categories, especially for social protection and health** (Table 3). Belgium spends less on defense, environment protection, and housing and community amenities than EU average and neighboring countries. However, spending is substantially above the EU average on education (by 1.1 percentage points of GDP), economic affairs (by 1.3 percentage points of GDP), health (by 1.5 percentage points of GDP), and social protection (by 2.6 percentage points of GDP). To some extent, this reflects the broader issues identified above: (i) social spending is not always well targeted; (ii) the wage bill is driven by high public employment; (iii) investment is low and insufficiently oriented toward productive activities. However, to identify specific efficiency gains, it is necessary to examine individual functional spending in more depth.

Table 3. General Government Expenditure by Functional Classification in Europe [1/]

	2008	2009	2010	2011	2012	2013	Difference (2013-2010)	
	(percent of GDP)						(ppts of GDP)	e of total exp consolidation
				Belgium				
Total expenditure	49.4	53.2	52.3	53.2	54.8	54.4	2.1	100
General public services	8.6	9.1	8.5	8.5	8.6	8.5	0.0	0
Defence	1.1	1.0	1.0	0.9	0.9	0.9	-0.1	-5
Public order and safety	1.7	1.8	1.8	1.8	1.8	1.8	0.0	0
Economic affairs	5.9	6.4	6.6	7.0	7.5	6.6	0.0	0
Environment protection	0.6	0.6	0.7	0.9	0.9	1.0	0.3	14
Housing and community amenities	0.3	0.3	0.4	0.4	0.4	0.3	-0.1	-5
Health	7.1	7.7	7.6	7.7	7.9	7.9	0.3	14
Recreation, culture and religion	1.2	1.1	1.2	1.2	1.3	1.3	0.1	5
Education	5.7	6.0	6.1	6.3	6.3	6.4	0.3	14
Social protection	17.2	19.0	18.5	18.5	19.2	19.7	1.2	57
				EU average [2/]				
Total expenditure	44.0	48.1	48.0	46.4	46.2	46.6	-1.3	100.0
General public services	6.3	6.8	6.6	6.9	7.0	6.9	0.2	-16.2
Defence	1.4	1.4	1.4	1.3	1.2	1.2	-0.2	15.6
Public order and safety	1.8	1.9	1.9	1.9	1.8	1.9	0.0	3.8
Economic affairs	5.2	5.4	5.9	5.0	4.8	5.3	-0.6	46.4
Environment protection	0.8	0.8	0.8	0.7	0.8	0.8	0.0	0.5
Housing and community amenities	0.9	0.9	0.8	0.8	0.7	0.7	-0.1	9.2
Health	6.1	6.6	6.5	6.4	6.4	6.4	-0.1	8.6
Recreation, culture and religion	1.2	1.3	1.3	1.2	1.2	1.2	-0.1	5.4
Education	5.3	5.7	5.6	5.5	5.3	5.3	-0.2	17.5
Social protection	15.2	17.3	17.2	16.8	17.0	17.1	-0.1	7.8
				France				
Total expenditure	53.0	56.8	56.4	55.9	56.7	57.1	0.7	100.0
General public services	7.2	7.2	6.8	6.8	6.8	6.8	0.0	0.0
Defence	1.7	1.9	1.9	1.8	1.8	1.8	-0.1	-14.3
Public order and safety	1.5	1.7	1.7	1.6	1.6	1.6	-0.1	-14.3
Economic affairs	4.5	4.9	5.1	4.8	5.0	4.9	-0.2	-28.6
Environment protection	0.9	1.0	1.0	1.0	1.0	1.0	0.0	0.0
Housing and community amenities	1.2	1.5	1.4	1.4	1.4	1.4	0.0	0.0
Health	7.4	7.9	7.9	7.9	8.0	8.1	0.2	28.6
Recreation, culture and religion	1.3	1.4	1.4	1.4	1.4	1.5	0.1	14.3
Education	5.4	5.7	5.6	5.5	5.5	5.5	-0.1	-14.3
Social protection	21.8	23.7	23.6	23.7	24.1	24.5	0.9	128.6
				Germany				
Total expenditure	43.5	47.4	47.2	44.6	44.2	44.3	-2.9	100.0
General public services	6.4	6.6	6.5	6.6	6.4	6.4	-0.1	3.4
Defence	1.0	1.1	1.1	1.1	1.1	1.1	0.0	0.0
Public order and safety	1.5	1.6	1.6	1.6	1.5	1.6	0.0	0.0
Economic affairs	3.5	3.9	4.7	3.4	3.4	3.3	-1.4	48.3
Environment protection	0.5	0.7	0.6	0.6	0.6	0.6	0.0	0.0
Housing and community amenities	0.7	0.7	0.6	0.5	0.4	0.4	-0.2	6.9
Health	6.4	7.1	7.0	6.8	6.8	7.0	0.0	0.0
Recreation, culture and religion	0.8	0.8	0.8	0.8	0.8	0.8	0.0	0.0
Education	3.9	4.3	4.4	4.3	4.3	4.3	-0.1	3.4
Social protection	18.7	20.6	19.9	18.9	18.8	18.9	-1.0	34.5
				Netherlands				
Total expenditure	43.8	48.2	48.2	47.0	47.5	46.8	-1.4	100.0
General public services	5.7	5.5	5.7	5.3	5.2	5.1	-0.6	42.9
Defence	1.3	1.4	1.3	1.3	1.2	1.2	-0.1	7.1
Public order and safety	1.9	2.0	1.9	1.9	1.9	2.0	0.1	-7.1
Economic affairs	4.4	5.4	5.2	4.8	4.5	3.9	-1.3	92.9
Environment protection	1.6	1.7	1.6	1.6	1.6	1.5	-0.1	7.1
Housing and community amenities	0.5	0.7	0.6	0.5	0.5	0.5	-0.1	7.1
Health	6.9	7.8	7.8	7.9	8.4	8.3	0.5	-35.7
Recreation, culture and religion	1.7	1.8	1.8	1.7	1.7	1.6	-0.2	14.3
Education	5.3	5.7	5.7	5.6	5.6	5.5	-0.2	14.3
Social protection	14.7	16.3	16.6	16.5	16.9	17.2	0.6	-42.9

Sources: Eurostat and IMF staff calculations.

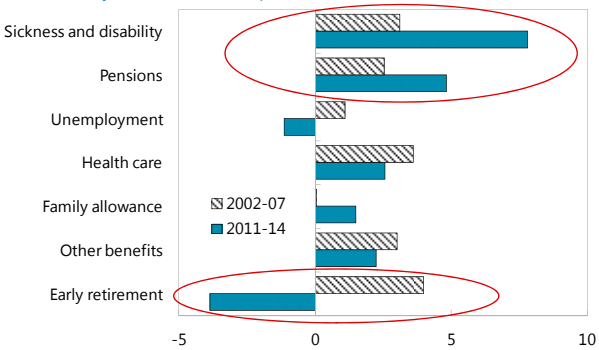
[1/] When this study was undertaken, data by functional classification are not yet available for 2014.

[2/] Simple average.

21. **Social spending is high and has grown substantially over the past decade.** Social spending is among the highest in the OECD (Figure 8). Over the last decade, it increased by over 5 percentage points of GDP.[9] This is more than twice the OECD average and the third largest increase in the OECD. A large share of this increase took place in the recent past: during 2010–14, social spending increased by almost 2 percentage points while it declined on average by 0.1 percentage point in the OECD. Only Finland experienced stronger growth.

22. **Recent reforms have contained social spending growth.** Pre-crisis, real spending on early retirement had been growing at 4 percent per year, second only to health care spending. As a result of recent reforms (focused on tightening the generous early retirement schemes and encouraging longer employment), spending on early retirement is now declining. However, spending on pensions continued to increase rapidly, as in other European countries. The reform of the unemployment benefits reduced slightly the growth of unemployment spending despite the impact of the crisis, but the parallel increase in the demand for sickness and disability allowances suggests the presence of substitution effects across benefits. Structural reforms are continuing (Table 4). In the long term, the impact of the pension reform adopted in August 2015 will have the largest impact but the short-term fiscal saving is expected from measures to contain the growth of the health care spending.

Real Annual Growth in Social Spending[1]
(Deflated by the GDP deflator, in percent)



Sources: Haver Analytics, WEO database, and IMF staff calculations.
1/ Unemployment benefits are adjusted for cyclical developments.

Table 4. Estimated Fiscal Savings from Recent Measures[1/]
(Cumulative, in million of Euros unless otherwise specified)

	2016	2017	2018
2015 measures (compared to trend)			
Health	616	1256	2,132
Pensions	56	276	601
Unemployment	292	519	692
Sickness and disability	149	199	250
Adjustment to welfare	109	169	310
Sub Total	**1,222**	**2,419**	**3,985**
In percent of GDP	*0.3*	*0.6*	*0.9*
2016 budget measures (budget estimates)			
Pension [2/]	33	n.a.	n.a.
Unemployment [3/]	57	n.a.	n.a.
Social correction of the tax shift [4/]	-50	n.a.	n.a.
Other savings [5/]	100	350	700
Sub Total	**140**	**>350**	**>700**
In percent of GDP	*0.0*	*>0.1*	*>0.2*

Sources: Federal Planning Bureau and IMF staff calculation.
[1/] The impact of some measure such has the saving on social expenditure from the temporary suspension of the wage indexation, and the indirect effects on employment and unemployment are not taken into account.
[2/] Second pillar available only at the new legal retirement age.
[3/] Faster digressivity.
[4/] Subsistence minimum, guaranteed income for elderly and the lowest pensions.
[5/] Sickness, disabilities, pensions.

[9] OECD data are available for total social spending but the breakdown is available only until 2011.

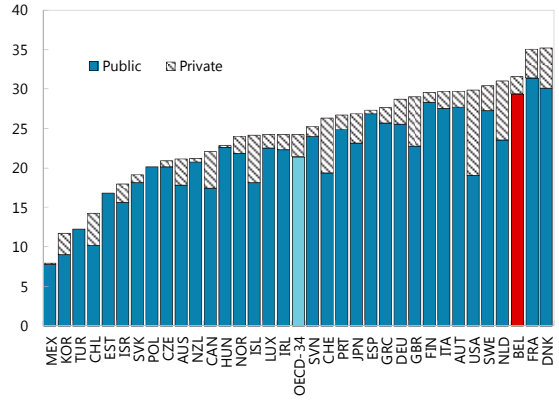
Pensions

23. **As in other European countries, pensions are the largest social spending category accounting for over a third of the total.** Spending on pensions is broadly in line with other European countries (Figure 8). At 10 percent of GDP in 2011 (i.e., before reforms started to be implemented), it was above the OECD average of 7.6 percent and the average of other EU countries member OECD of 9.4 percent but below France's and Germany's level. However, this comparison is somewhat misleading as part of unemployment benefits (the so-called "unemployment with employer top-up") act as a *de facto* early retirement scheme. Unemployment benefits "for early retirement for labor market reasons" represented a spending of 0.7 percent of GDP in 2011, by far the largest amount in OECD and well above the EU average (0.1 percent).

Figure 8. Social Expenditure in the OECD, 2011 [1/ 2/]

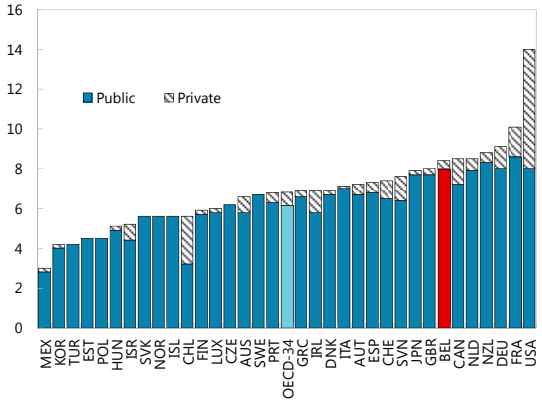
Public social expenditure in Belgium is among the largest in the OECD…

Total Public and Private Social Expenditure
(In percent of GDP)



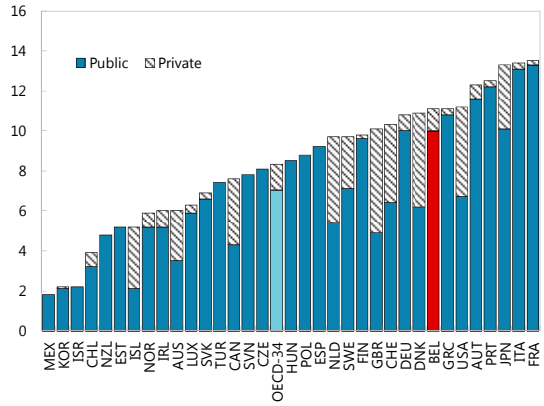
… due to the third largest public spending on health …

Public and Private Social Expenditure on Health
(In percent of GDP)



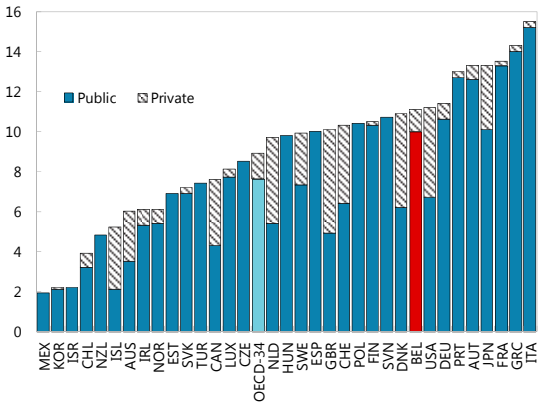
… while public spending on pensions, though higher than the OECD average, appears comparable to spending in France and Germany….

Public and Private Social Expenditure on Pensions [3/]
(In percent of GDP)



… even when early retirement schemes are taken into account.

Public and Private Social Expenditure on Pensions and Early Retirement Schemes [3/]
(In percent of GDP)



Source: OECD.
[1/] Total public social expenditure reached 31.9 percent of GDP in 2014. The breakdown by categories is only available up to 2011.
[2/] Social expenditure are defined as social transfers in cash. Services spending, and spending on active labor market policies.
[3/] Pensions are defined as in cash spending for old age and survivors. Private expenditure includes both mandatory and voluntary schemes.

24. **The pension system is a key contributor to the reduction in inequality through fiscal redistribution** (Figure 2). Pensions explain 73 percent of the income reduction achieved through transfers. This is higher than the EU average (68 percent) or any of the three neighboring countries (34 percent in the Netherlands, 60 percent in France, and 71 percent in Germany).

25. **The fiscal cost of early retirement is partly offset by a slightly less generous system than in other countries.** With one of the lowest effective retirement ages in the OECD,[10] Belgium has the second largest life expectancy after pensionable age after France: 25.8 years for men and 21.2 years for women (OECD, 2015b).[11] The fiscal cost of this demographic is partly offset by a relatively lower replacement rate. This suggests that pension reforms should target the retirement age rather than the level of benefits.

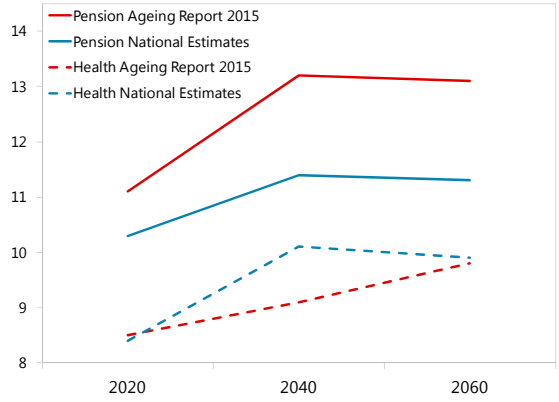
Pension Replacement Rate, 2014
(in Percent of pre-retirement earning)

	Gross	Net
Belgium	46.6	60.9
France	55.4	67.7
Germany	37.5	50.0
Netherlands	90.5	95.7
EU28 [1/]	52.7 / 52.3	63.0 / 62.6
OECD average [1/]	59.0 / 58.8	70.9 / 70.7

Source: OECD.
1/ When the replacement rate differs for men and women, the table reports both as follows men/women.

26. **In light of the relatively rapid ageing of population, reforms of the pension system are necessary to maintain the financial sustainability of the system.** According to the EC's 2015 *Ageing Report,* produced before the 2015 pension reform, spending on public pensions would increase by 3.4 percentage points of GDP between 2013 and 2035 and would remain broadly stable afterwards. National estimates that include the impact of the 2015 reform project a more limited increase in the fiscal cost of pensions, which remains substantial (Figure 9).[12]

Figure 9. Fiscal Cost of Ageing
(In percent of GDP)



Source: EC (2015b) and Study Committee of Ageing.

27. **In this context, the 2015 reform is a major step toward maintaining fiscal sustainability in the long term.** The main elements of the pension reform adopted in August 2015 involve (i) gradually increasing the legal retirement age from 65 to 66 in 2025 and 67 in 2030;

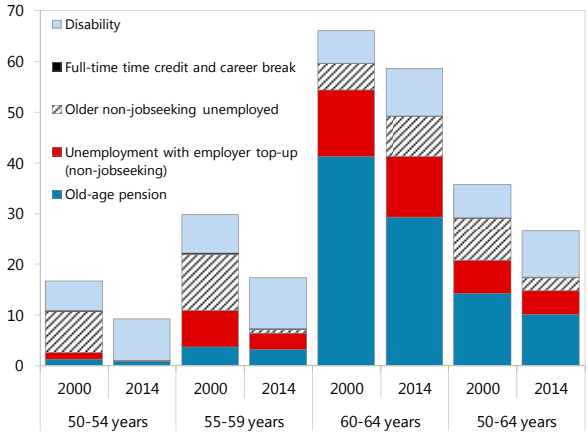
[10] In 2014, the average effective age of labor-market exit was at 59.6 years, a level similar to France but below Germany (62.7), the Netherlands (62.4), and the average for the other EU members of the OECD (62.1).

[11] The OECD average was respectively 22.3 and 17.6.

[12] For details including differences between National and EC estimates, see Federal Planning Bureau (2015b).

(ii) raising the minimum age and career length required for early retirement in 2017; and (iii) boosting the minimum age for survivor's pension. This reform, combined with earlier efforts to tighten early retirement schemes,[13] addresses the main reason for the cost of pensions described above: the early effective retirement age. The authorities expect that it will halve the annual growth in pension costs from the current 4–5 percent per year, reducing significantly a major element of the fiscal cost of ageing. In addition, the authorities plan to further reform the pension system in 2016 by focusing on civil servant pensions and the second pillar (notably by disallowing benefitting from the supplementary pension before the legal age of retirement). This would again provide incentives to increase the effective retirement age. In the same spirit and, given their fiscal cost, further reforms could tighten the regime of unemployment with employer top-up, which still accounts for a large share of labor market exits among seniors.

Labor Market Exits among 50 to 64 Year Olds [1/]
(In percent of the corresponding population)

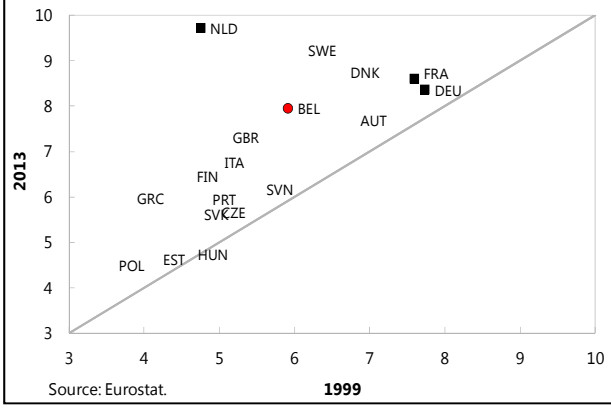


Sources: NBB calculations based on DGS-FPB, PDOS-SdPSP, NIHDI, NEO, NPO.
1/ Estimated totals, obtained by combining data that don't necessarily reflect the same period. For the year 2000, for which insufficient data are available, it was assumed that the share of mixed careers in the total number of pensions was the same as in 2014 (to avoid double counting in the case of mixed public/private careers).

Health

28. **Health spending is under pressure.** At almost 8 percent of GDP, health spending is high by international standards. It is well above EU or OECD averages though slightly lower than the spending level in the three neighbors (Figure 8 and Table 3). Moreover, health spending is increasing rapidly. Between 2007 and 2013, it increased by 1.2 percentage point of GDP, much more than EU average of 0.6 percentage point, and more rapidly than in France and Germany (both at 0.7 percentage point), but less than in the Netherlands (1.5 percentage point). Due to medical progress and the ageing of the population there will be longer-term cost pressure. Both the EC and national estimates project that health spending would increase to reach about 10 percent of GDP by 2060 (Figure 9).

Increase in Public Health Spending in Europe, 1999-2013
(In percent of GDP)



Source: Eurostat.

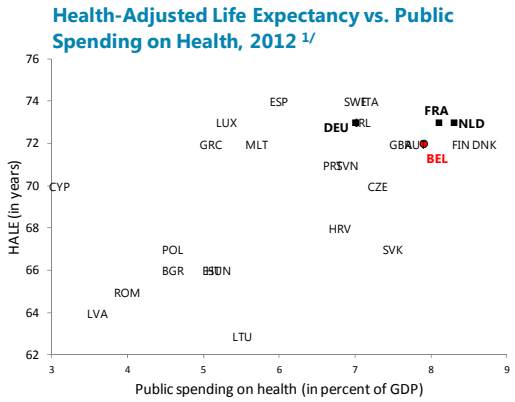
[13] See the Staff Report's appendix on Labor Market and Pension Reform Measures and De Vil et al. (2015).

29. **The government has taken measures to contain health spending growth** (Table 4)**.** The Federal Planning Bureau (2015a) projects a trend growth in public health spending of 2.1 percent per year in real terms over 2016–20. However, the Belgian government has set a growth ceiling of 1.5 percent annually for the current legislature (2015–19). To limit spending growth, the government has announced various containment measures such as price cuts on pharmaceuticals, a reform of the calculation of the sickness and disability allowance, and a reduction in the length of stay in maternity wards. In the long run, structural measures will need to be taken in coordination with the regions and communities: in 2015 regions and communities became responsible for elderly care (0.9 percent of GDP) and in 2016 they will be responsible for hospital investment (0.15 percent of GDP).

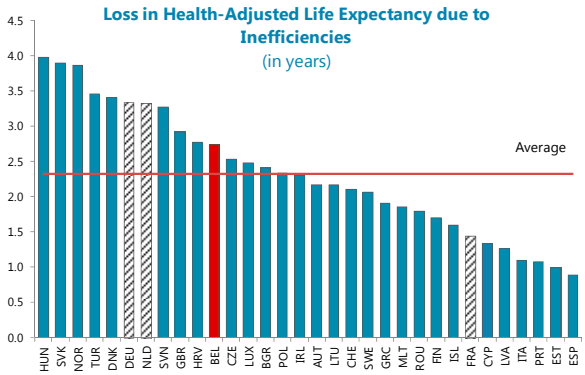
30. **The efficiency of public health spending could be increased**. Belgium achieves a good overall health outcome, but at a higher fiscal cost than in peer countries (Figure 10). The Health-Adjusted Life Expectancy at birth is high but in many countries is achieved at a lower cost. Most health indicators are significantly better than EU average but tend to be lower than in neighboring countries that, as mentioned above, have similar level of spending.

Figure 10. Health Outcomes [1/]

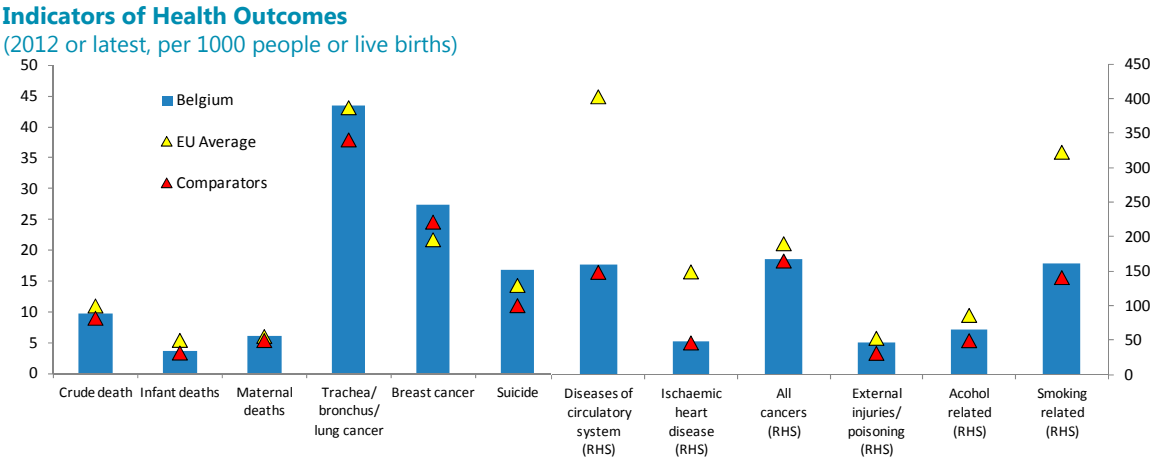
Health outcome are less favorable than those in countries with similar health spending.



There is scope to increase the efficiency of health spending.



Health outcomes are generally better than EU average but lower than in the neighboring countries.

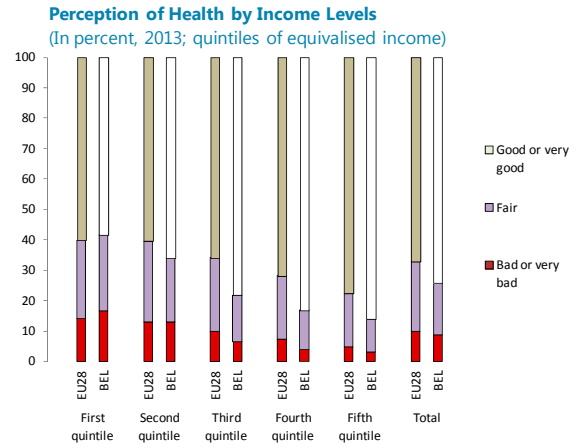


Sources: Eurostat, WHO, and IMF staff calculations.

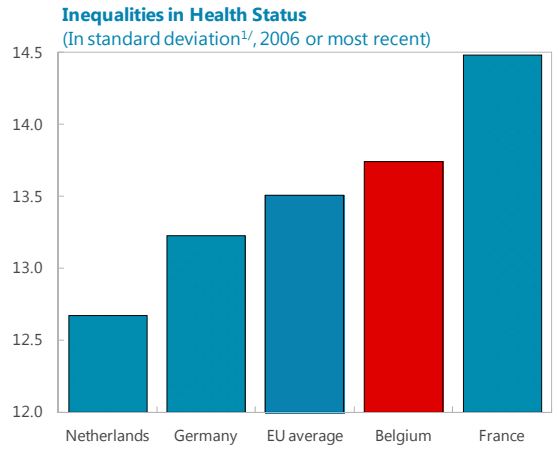
[1/] Health-Adjusted Life Expectancy at birth is the average number of years a person can expect to live in good health or free of disease and injury.

Figure 11. Social Outcomes of Health Spending

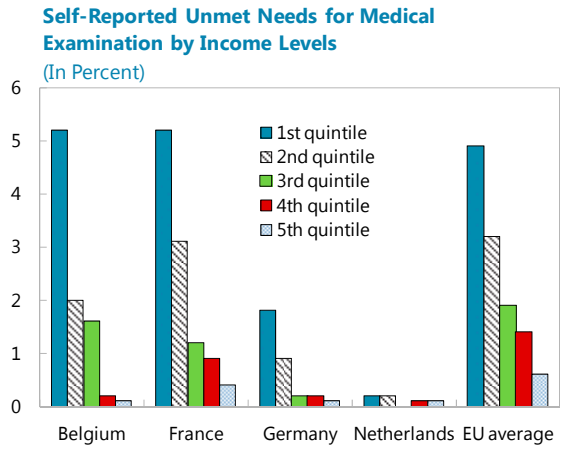
The self-perceived level of good health exceeds EU average except for the lowest income.



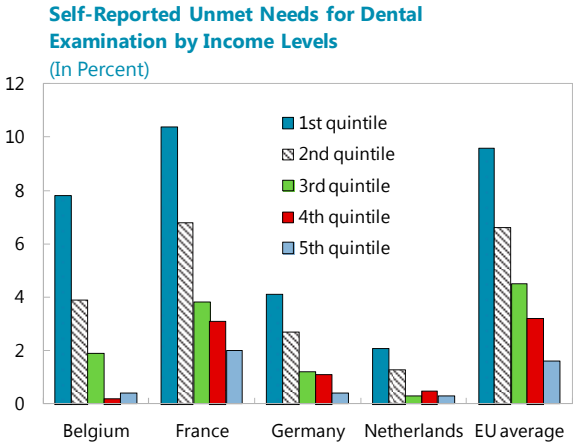
Health inequalities are higher than EU average.



Access to medical care is slightly worse than EU average but worse than in Germany and the Netherlands…



Access to dental care is better than EU average and France but again worse than in Germany and the Netherlands.



Sources: Eurostat, OECD, and IMF estimates.
1/ Standard deviation in mortality for population older than 10. EU average for OECD members only (excluding Greece).

31. **However, the health outcomes are not evenly distributed within the Belgian population.** The self-perceived level of good health exceeds EU average except for the poorest (first quintile) and other comparative data suggest that health inequalities, though lower than in France, are higher in Belgium than on average in the EU, in Germany, and in the Netherlands, (Figure 11). Access to dental and medical examination is worse than in Germany and the Netherlands.[14] It is important to consider self-reported unmet healthcare needs in conjunction with other indicators of potential barriers to access, such as the extent of health insurance coverage and the amount of out-of-pocket payments. In Belgium, while public health insurance covers almost all inhabitants (99 percent), households out-of-pocket expenditure reached 18 percent of total health

[14] For more details on inequalities in the access to healthcare, see Devaux and de Looper (2012).

expenditure in 2013 a level similar to the average for the EU members of the OECD of 19 percent but significantly higher than in the three neighbors: 5 percent in the Netherlands, 7 percent in France, and 13 percent in Germany (OECD, 2015c).

32. **Beyond the ongoing efforts to contain health spending growth, deeper structural reforms would help mitigate longer-term health-spending pressures.** While budget caps and other macro-levels controls can reduce spending in the short term, they usually do not directly address the underlying causes of spending and are thus unlikely to be sustainable in the longer term. Going forward, Belgium could strengthen micro-level reforms to increase the efficiency of spending. Some advanced countries have undertaken reforms that could inform Belgium on how to contain health spending (IMF, 2012). In particular, reforms could:

- Be based on cost-effectiveness evaluations to determine what health services should be financed by public funds (as in Australia, Finland, the Netherlands, Sweden, and the United Kingdom). Reforms in this area include delisting ineffective drugs (as in Germany) and treatments (as in the Netherlands).

- Make generics prescription compulsory, impose electronic prescribing, and further develop clinical guidelines to cover a large share of drug prescribing, as in Portugal (OECD, 2015d). This would require progress in unifying patients' health electronic records, and in ensuring a full integration of electronic systems on personal health records. In 2013, generics account only for 31½ percent of the volume of pharmaceuticals consumed in Belgium. This is well below EU average of about 60 percent or the three neighbors' average of 44 percent (OECD, 2015c).

- Rationalize the organization of the health system by giving sickness funds a more active role as promoters of cost-efficiency and focusing on medium-term budgeting (OECD, 2013).

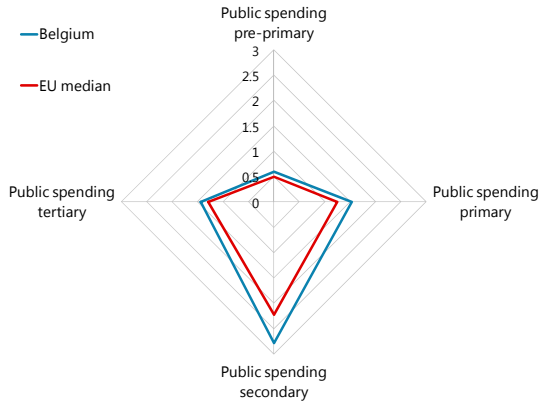
- Review the sickness and disabilities system. Spending on sickness and disabilities has grown more rapidly than in any European country except Ireland (by 2.1 percentage points of GDP during 2002–13). This increase is in part related to the reforms of early retirement schemes which led to an increase in the use of the sickness and disabilities scheme by older workers. Reforming the eligibility criteria would thus seem appropriate, possibly together with some means-testing. The government has reduced the allowance by reforming the calculation formula leading to some saving (Table 4) and announced that it will strengthen the control mechanism and promote re-activation policies to reduce the period of inactivity due to disability leave.

- Pay specific attention to health inequalities, which may be warranted to improve outcomes for low-income population groups.

Education

33. **At 6.4 percent of GDP, public spending on education is higher than the EU average and in the three neighbors** (Table 3). This remains true even when controlling for lower private spending in Belgium than in other EU countries or for income level (Figure 12). Between 2010 and 2013, education spending has grown by 0.3 percentage point of GDP while it declined on average in the EU (-0.2 percentage point), in France (-0.1 percentage point), and in Germany (-0.1 percentage point), and in the Netherlands (-0.2 percentage point). Public spending on education is higher than EU average at all level of study, most notably at the secondary level.

Public Spending on Education by Level of Study, 2012
(In percent of GDP)

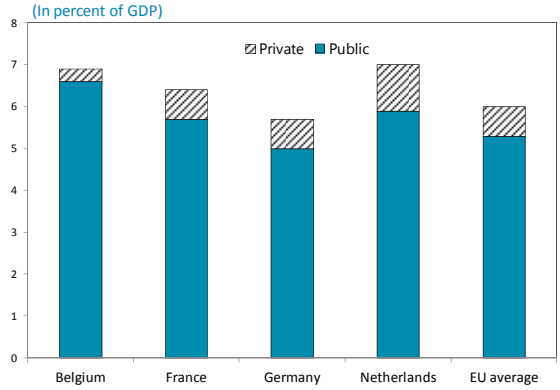


Source: World Bank.

Figure 12. Educational Inputs

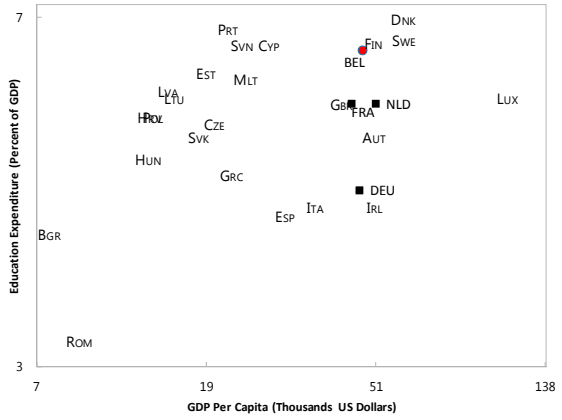
Education spending are high even when relatively low private spending are considered

Total Education Spending, 2011
(In percent of GDP)



...or when differences in income levels are taken into account

Public Education Spending Controlling for Income, 2013

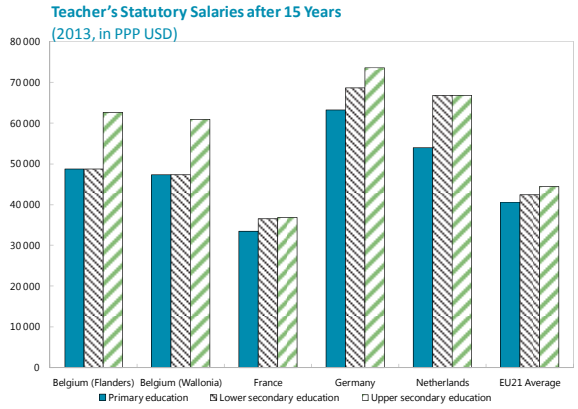


Sources: Eurostat, and IMF staff calculations.

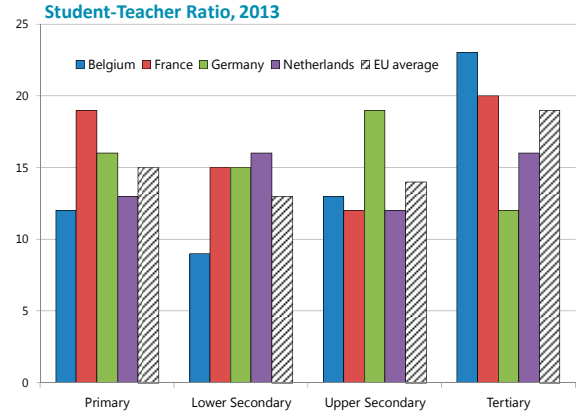
34. **Public spending on education reflects a large wage bill.** At 5.1 percent of GDP, the public wage bill accounts for 95 percent of total public spending on education. This is much more than EU average of 60 percent or the three neighbors' average of 90 percent. As for the general government as a whole, the wage bill is large because of employment rather than salary levels (Figure 13). The recent decision of the Flemish community to limit the increase in the number of teachers should be seen against the backdrop of this broader staffing issue.

Figure 13. Compensation of Employee in the Education Sector

Teachers' salaries are in an intermediate position in Europe…



…but employment is large as reflected by the low student-teacher Ratio



Sources: OECD and EC (2015b).

35. **The high level of education spending is not reflected in improved student test scores, pointing to the scope for efficiency-oriented reforms** (Figure 14). Student test scores are close to the three neighbor's average, but have deteriorated in mathematics and science. In 2012, overall PISA scores were higher than EU average but slightly below neighboring average. The PISA score in math and sciences declined from 2003 to 2012, while they increased in Germany and the Netherlands. Student performance appears mediocre relative to the three neighbors when controlling for a significantly higher spending-per-student, reflecting the low student-to-teacher ratio (Figure 13). Moreover, though Belgium is the European country where education spending increased the most between 2003 and 2012, it is also one of the countries that experienced the largest decline in student performance.[15]

36. **In addition, educational inequalities are more pronounced in Belgium than in most European countries** (Figure 15). The 2012 PISA finds that the link between students' socio-economic status and student performance is much stronger in Belgium than in most OECD and EU countries, notably Germany and the Netherlands. However, while Belgium performance scores in mathematics deteriorated between 2003 and 2012, equity improved.

Evolution of the Student Population, 2013–60
(In percent)

	Belgium	France	Germany	Netherlands	EU(28)
Total	37.3	8.3	-18.3	-10.7	-1.4
Primary	40.1	6.7	-9.7	-10.5	1.6
Lower Secondary	40.9	6.6	-16.6	-12.5	-0.3
Upper Secondary	38.2	10.1	-21.6	-10.4	-0.1
Tertiary	28.8	11.5	-26.9	-9.6	-8.6

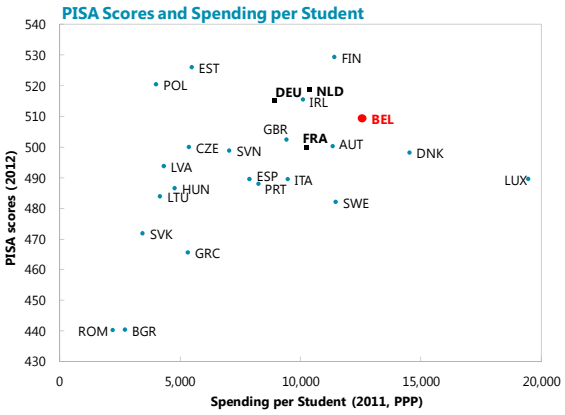
Sources: EC (2015b).

[15] In addition, the education system does not address enough an important skill mismatch. For details, see the staff report for the 2016 Article IV consultation and the chapter *The Belgian Labor Market: Segmentations and distortions*.

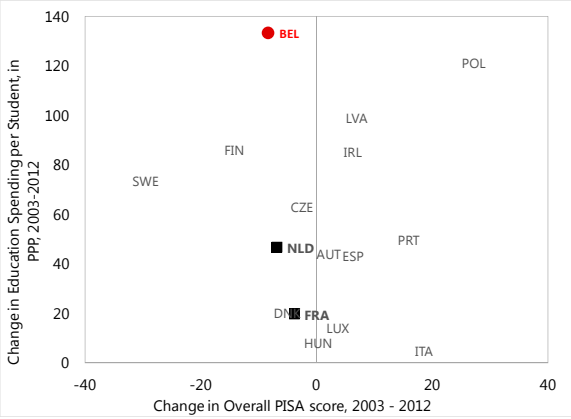
37. **Given long-term cost pressures, reforms of the education system should thus include efforts to make better use of resources.** According to the EC's *2015 Ageing report*, in contrast to other European countries, the student population will increase substantially in Belgium through 2060. The increase is particularly sizable at the primary and lower secondary levels, where the student-teacher ratio is the lowest (Figure 13). The EC estimates that the projected increase in the student population would imply an increase in the number of teachers of 38 percent and an additional fiscal cost of 0.3 to 0.4 percent of GDP (most of it by 2030). Reforms could focus on organizational efficiencies, possibly through a rationalization of the school network (class and school merger) and an increase in the versatility of teachers.

Figure 14. Educational Spending and Outcomes

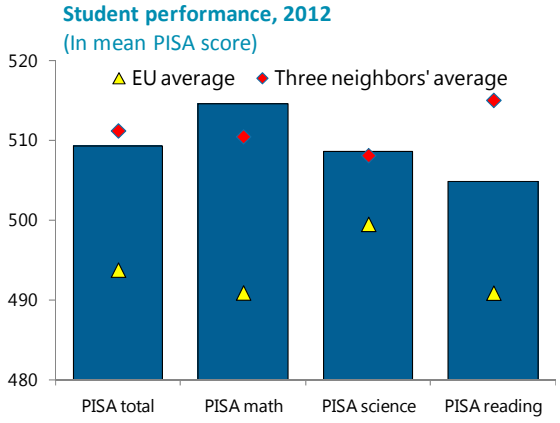
Higher spending per student than in neighboring countries does not translate into higher student performance.



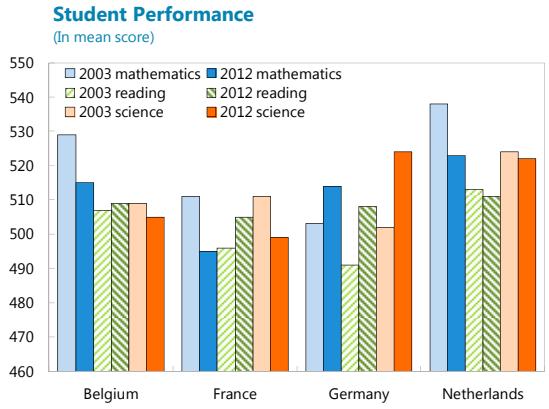
Belgium experienced one of the largest decline in student performance despite the largest increase in spending.



Student performance is close to the neighboring countries' average.



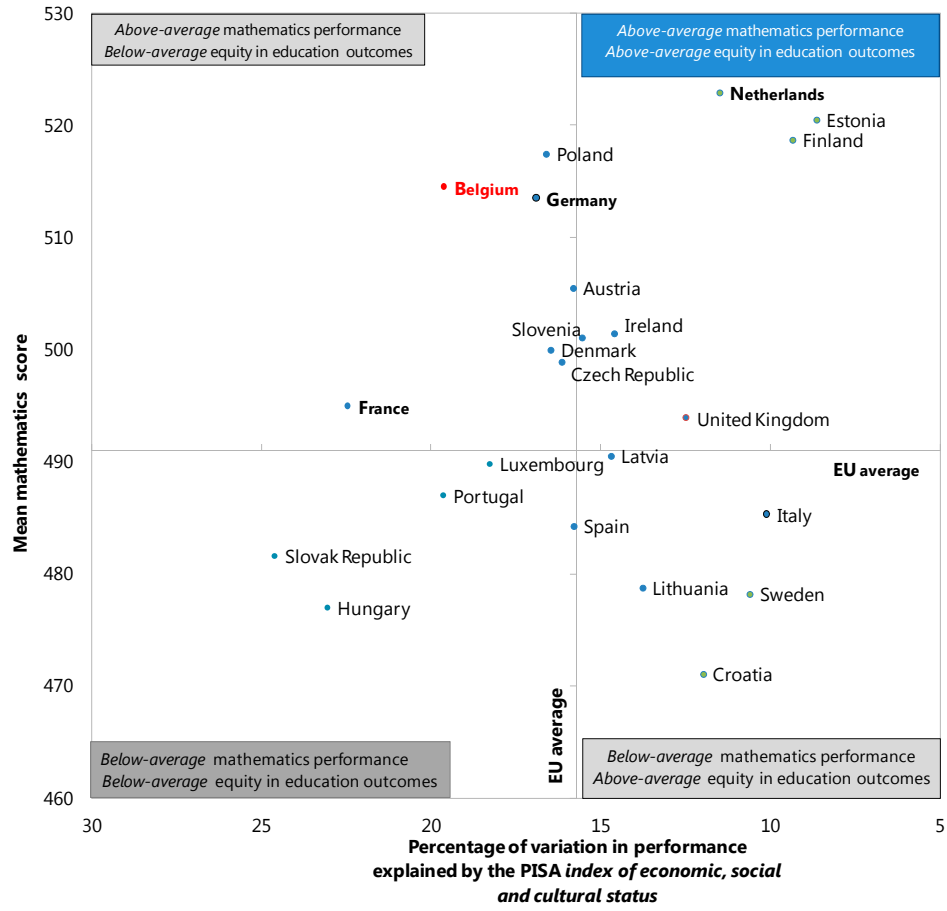
Performance in mathematics and science declined and scores are below those of Germany and the Netherlands.



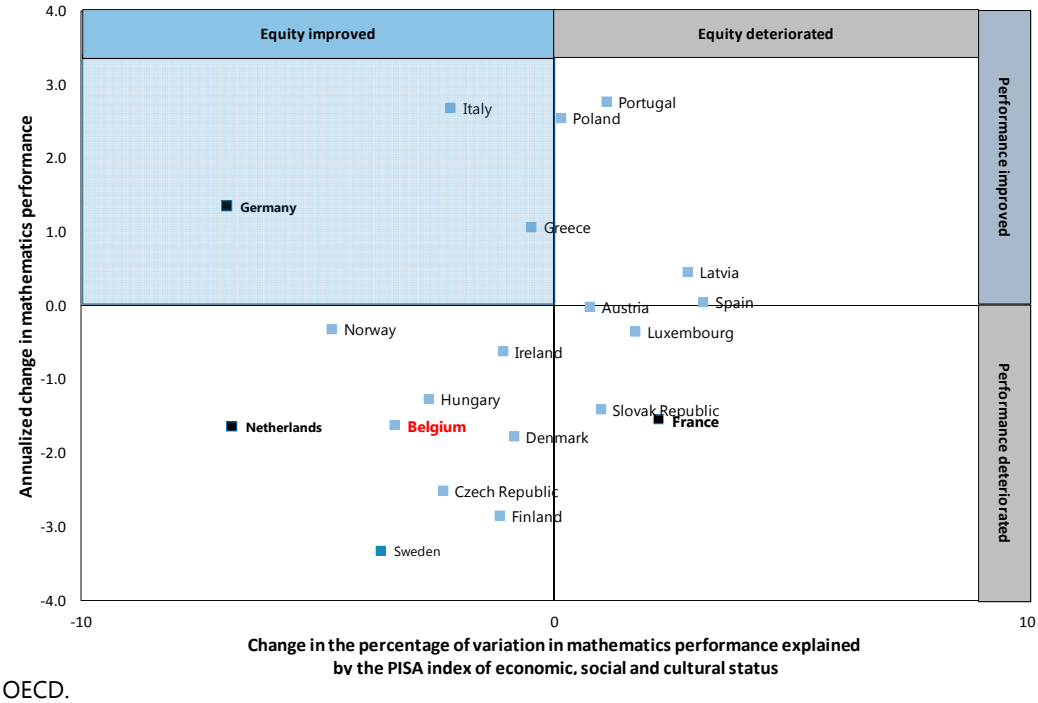
Sources: OECD, and IMF staff calculations.

Figure 15. Student Performance and Equity

Student Performance and Equity, 2012



Change in Performance and Equity, 2003–12



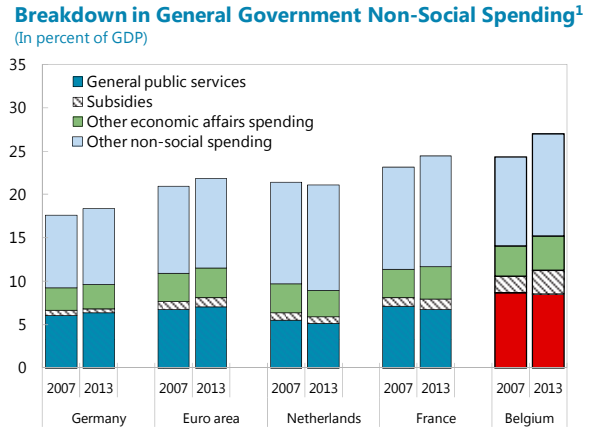
Source OECD.

Subsidies

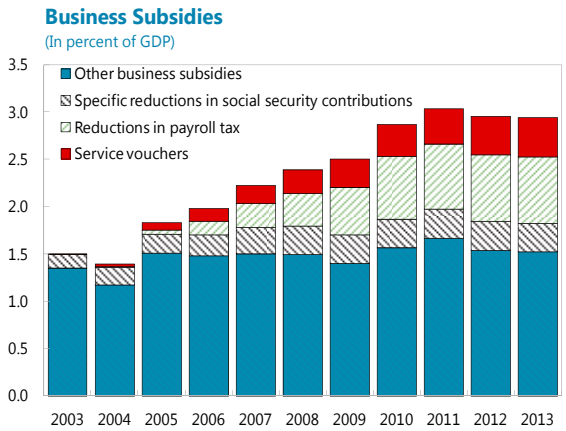
38. **Belgium spends more on subsidies than other countries and planned reductions are limited.** Subsidies partly explain the larger spending on economic affairs in Belgium than in the rest of the EU and in any of the three neighboring countries. At 2.3 percent of GDP, subsidies are about three times larger in Belgium than on average in the three neighbors or in the euro area (0.8 percent of GDP in both cases). Moreover, subsidies increased by 0.8 percent of GDP between 2007 and 2012, while they remained broadly constant in other European countries (Table 3 and Figure 16).

Figure 16. Fiscal Cost of Business Subsidies, 1995–2013

General public spending and economic affairs expenditure—especially business subsidies—are large.



The cost of business subsidies rose steadily due to higher spending on wage subsidies.



Sources: Eurostat, Groupe d'experts "Compétitivité et Emploi," and IMF staff calculations.

39. **A significant share of subsidies is intended to reduce labor costs.** Some of these subsidies, such as the services vouchers, act as in-work-benefits aimed at providing jobs to the low-skilled (Figure 15). Others, which represent a larger share, aim at boosting competitiveness by reducing the labor costs or reducing the cost of innovation (9 percent of labor subsidies are directed to R&D jobs) and are planned to be further increased.

40. **The government plans to reduce business subsidies**. Over 2015–18, the planned reduction of EUR 600 million (0.1 percent of GDP) focuses on the subsidies to the railway company and leave untouched other subsidies.

C. Conclusion

41. **The above double benchmarking exercise demonstrates that there is significant scope for increasing the efficiency of public expenditure in Belgium.** This could play a key role in underpinning the authorities' ambitious fiscal adjustment objectives by limiting potential adverse social and economic outcomes. It would also lay the foundations for placing Belgium's high level of public debt on a more sustainable downward trajectory, supported by additional measures to address the fiscal cost of aging. A strategic approach to spending adjustment would be most effective because the expected impact differs across spending categories.

42. **This paper identifies a range of policy options:**

Impact of Public Expenditure Reforms by Areas

Expenditure reform → for… / of… ↓	Fiscal saving	Improving outcome	Addressing long-term pressure
Social benefits	√	√	√
Civil service employment	√		
Health	√	√	√
Education		√	√
Subsidies	√		
Public investment		√	√

Social spending is a key factor explaining Belgium's comparatively high level of public expenditure. While social spending is the major tool for reducing inequality, it does so less efficiently than in most other European countries. If Belgium could raise the redistributive power of social spending to the EU average, it could achieve the same reduction in inequality with 3¼ percent points of GDP lower spending. Such efficiency would require deep reforms in a number of programs, notably by (i) expanding means-testing of social benefits and (ii) continuing to implement measures to increase the effective retirement age notably by further tightening the benefits that act *de facto* as early retirement scheme, such as the unemployment benefit with employer top-up.

Wage Bill spending is high and there is scope for saving across all levels of government. As the level of the wage bill is primarily the result of high public employment, as opposed to generous salaries, the most promising approach would be to amplify the reduction in public sector employment initiated in 2015 –while ensuring that it is well targeted and oriented at the efficient functioning of both central and local governments—rather than extending the wage freeze currently applied to the whole economy.

Reforms should also aim at coping with longer-term fiscal pressures. The relatively rapid aging of the population will have a significant fiscal impact in the medium- to long-run for three important expenditure categories: pensions, health, and education.

- ***Pensions***. The 2015 pension reform increases the legal retirement. Focusing reforms on the retirement age rather than on the benefits is adequate given that the effective retirement age is low while the replacement rate tends to be less generous than in other European countries. These reforms could be complemented by measures to avoid a substitution toward other benefits. Partly as a result of the recent reforms tightening the early retirement, request for sickness and disability allowances have increased. In this context, it is important to review the eligibility criteria for and increasing the control of sickness and disabilities payments. Similarly it is important to tighten schemes that, *de facto,* act as an early retirement scheme.

- ***Health.*** The efficiency of public health spending could be increased. Belgium achieves a good overall health outcome, but at a higher fiscal cost than in neighboring countries. Beyond the ongoing efforts to contain health spending growth, deeper structural reforms would help mitigate long-term spending pressures. Possible measures include (i) strengthening the cost-benefit analysis in order to limit the range of non-essential healthcare covered by the public

insurance; (ii) increasing further the use of generics, including by making their prescription compulsory; (iii) rationalizing the organization of the health system by giving sickness funds a more active role as promoters of cost-efficiency and focusing on medium-term budgeting. A specific attention to health inequalities would also be warranted to improve health outcomes for low-income populations.

- ***Education***. Public spending on education is higher than EU average and in each of the three neighbors, mostly owing to high employment levels resulting in a low student-per-teacher ratio. Despite the high and fast growing level of spending, test scores are deteriorating, the efficiency in reducing inequalities is more limited than in most European countries, and many young people are not adequately prepared for the job market. The causes of these adverse trends should be carefully studied, and scope for efficiency gains should be seized to mitigate the spending pressures arising from a fast growing student population.

Public investment. Part of the fiscal saving achieved through reforms could be used to increase public investment in areas that can boost the country's potential growth. There appears to be scope to redirecting public investment to more productive projects, notably in transport infrastructure, where quality and efficiency could be improved significantly.

Subsidies. Subsidies are much larger in Belgium than in other countries. There is scope to go beyond the planned reductions in business subsidies. As the tax shift is implemented, some of the business subsidies, aiming at offsetting the impact of high taxes could be phased out.

References

Coady, David and Nan Geng (2015), *From Expenditure Consolidation to Expenditure Efficiency: Addressing Public Expenditure Pressures in Lithuania*, Washington, D.C.: International Monetary Fund, Working Paper WP/15/278, 33 p., http://www.imf.org/external/pubs/cat/longres.aspx?sk=43496.0.

Devaux, Marion and Michael de Looper (2012), *Income-Related Inequalities in Health Service Utilisation in 19 OECD Countries, 2008–2009*, Paris: OECD, Health Working Papers No. 58, 57 p., http://dx.doi.org/10.1787/5k95xd6stnxt-en.

De Vil, Greet, Nicole Fasquelle, Christophe Joyeux, Bertrand Scholtus, and Saskia Weemaes (2015), *Analyse des effets de la réforme des pensions et du chômage avec complément d'entreprise*, Brussels : Federal Planning Bureau, 42 p., http://www.plan.be/admin/uploaded/201601151147370.CEP1_11080_06102015.pdf.

Eugène, Bruno (2011), "Public Sector Wages," *Economic Review,* Brussels: National Bank of Belgium. pp. 21–33, https://www.nbb.be/doc/ts/publications/EconomicReview/2011/ecorevIII2011_H2.pdf.

European Commission (2015a), *Assessment of the 2015 Stability Programme for Belgium,* Brussels: European Commission, 22 p., http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2015/01_be_scp_en.pdf.

_____ (2015b), "The 2015 Ageing Report - Economic and budgetary projections for the 28 EU Member States (2013-2060)", *European Economy* 3/2015, 397 p., europa.eu/epc/pdf/ageing_report_2015_en.pdf.

Federal Planning Bureau (2015), *Perspectives économiques 2015-2020,* Brussels: Federal Planning Bureau, 84 p., http://www.plan.be/press/communique-1479-fr-perspectives+economiques+regionales+2015+2020.

_____ (2015b), *Economic Policy Committee's Ageing Working Group; Belgium: Country Fiche 2015 (Updated version including the Belgian 2015 pension reform),* Brussels: Federal Planning Bureau, 61 p., http://www.plan.be/admin/uploaded/201511271708080.Country_fiche_Belgium_20151126.pdf.

Giordano, Raffaela, Domenico Depalo, Manuel Coutinho Pereira, Bruno Eugène, Evangelia Papapetrou, Javier J. Perez, Lukas Reis, and Mojca Roter (2011), *The Public Sector Pay Gap in a Selection of Euro Area Countries,* Frankfurt: ECB, Working paper 1406, 40 p., http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1406.pdf.

Hallaert, Jean-Jacques and Maximilien Queyranne (2016), *From Containment to Rationalization: Increasing Public Expenditure Efficiency in France*, Washington, D.C.: International Monetary Fund, Working Paper WP/16/7, 65 p., http://www.imf.org/external/pubs/ft/wp/2016/wp1607.pdf.

_____ and Sylwia Nowak (2015), *Toward a Growth-Friendly Fiscal Consolidation in Belgium,* Washington, D.C.: International Monetary Fund, Country Report No. 15/71, pp.15–41, http://www.imf.org/external/pubs/cat/longres.aspx?sk=42780.0.

International Monetary Fund (2012), *The Economics of Health Care Reform in Advanced and Emerging Economies*, Washington D.C.: IMF, 370 p., https://www.imf.org/external/pubs/cat/longres.aspx?sk=25336.0.

_____ (2014), *Public Expenditure Reform: making Difficult Choices,* Washington, D.C.: IMF, Fiscal Monitor, 90 p., http://www.imf.org/external/pubs/ft/fm/2014/01/pdf/fm1401.pdf.

Lorach, Nicolas and Arthur Sode (2015), *Quelle sélectivité dans la réduction des dépenses publiques*, Paris: France Stratégie, Note d'analyse 28, 7 p., http://www.strategie.gouv.fr/sites/strategie.gouv.fr/files/atoms/files/note-28-selectivite-reduction-depenses-publiques.pdf.

OECD (2013), *Economic Surveys: Belgium 2013,* Paris: OECD, 104 p., http://www.oecd-ilibrary.org/economics/oecd-economic-surveys-belgium-2013_eco_surveys-bel-2013-en.

_____ (2015a), *Education at a Glance 2015 – OECD Indicators*, Paris: OECD, 563 p., http://www.oecd-ilibrary.org/education/education-at-a-glance-2015_eag-2015-en.

_____ (2015b), *Pensions at a Glance: OECD and G20 Indicators*, Paris: OECD, 374 p., www.oecd-ilibrary.org/pensions-at-a-glance-2015_5jrtpt44c0f3.pdf.

_____ (2015c), *Health at a Glance: OECD Indicators*, Paris: OECD, 216 p., http://www.oecd-ilibrary.org/social-issues-migration-health/health-at-a-glance-2015_health_glance-2015-en.

—— (2015d), *Portugal – Raising Standards*, Paris: OECD, Reviews of Health Care Quality, 2015, 38 p., http://www.oecd.org/health/health-systems/Review-of-Health-Care-Quality-Portugal-Executive-Summary.pdf.

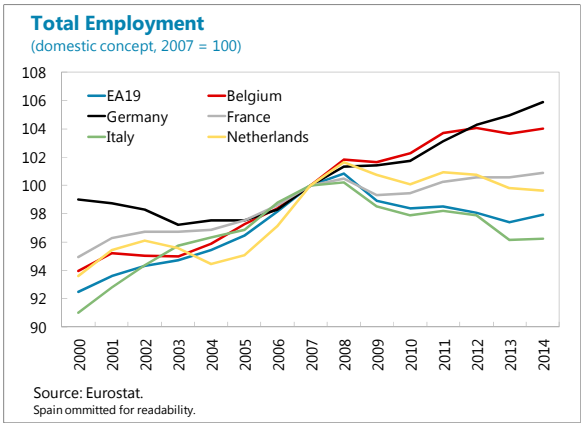
THE BELGIAN LABOR MARKET—SEGMENTATIONS AND DISTORTIONS[1]

1. **The Belgian labor market suffers from rigidities and fragmentation**. While the headline unemployment rate is somewhat below the EU average, labor market outcomes differ dramatically across Belgium's regions, and are poor among the young, the low-skilled, and non-EU immigrants. This segmentation points to underlying rigidities and distortions that create significant fiscal costs, while holding back potential output and undermining social cohesion.

2. **The design of policies to increase employment rates among these vulnerable labor market segments requires a thorough reflection of symptoms and underlying causes.** To this end, our analysis starts by reviewing recent employment trends, highlighting the role of direct and indirect public support, but also identifying signs of rigidities. The second section looks at the large differences across ages, skill levels, gender, locations, and country of origin. The last section examines some of the underlying causes, including barriers to geographic mobility, skill inadequacy, policies discriminating against the young, distortions of incentives, reduced flexibility in contracts and wage-setting, and barriers to the labor market integration of non-EU immigrants.

A. Apparent Resilience but Signs of Rigidities

3. **Employment was less affected by the crisis, and recovered faster, than in other euro area countries.** After rapid growth in the run-up to the crisis, total employment declined by a very moderate 0.2 percent in 2008, and rebounded in the following three years. This compares to a euro area-wide employment contraction of almost 2 percent in 2008 alone and an additional 1½ percent over the three following years. The more recent slowdown in 2013 does not fundamentally change this apparently positive picture.

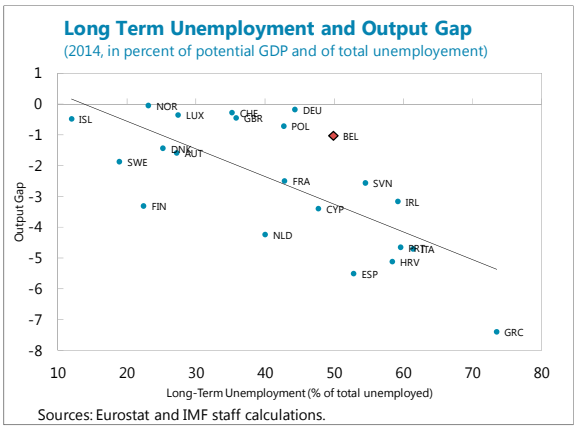


4. **Direct and indirect public support was an important driver of employment in recent years.** As in many other European economies, market-based employment[2] has not yet recovered to its pre-crisis level, whereas employment has continued to grow in sectors providing public services,

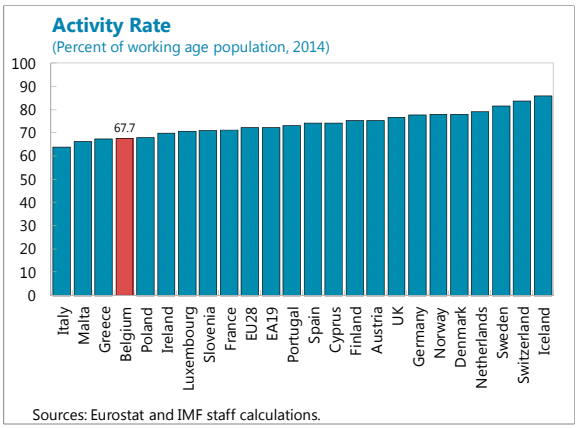
[1] Prepared by Johannes Eugster (EUR).

[2] Market-based employment is defined here as total employment excluding public administration, defense, social security, education, human health and social work activities. Source: Eurostat, *Employment by Sex, Age and Economic Activity*.

particularly human health and social work. Other sectors have benefitted from labor subsidies, including service vouchers, whose growth accelerated dramatically already before the crisis and has continued until recently. Additionally, emergency policies during the crisis[3] have allowed companies to temporarily cut labor costs without firing staff. This has contained the increase in unemployment (and the knock-on effects on domestic demand), and has allowed companies to maintain production capacity and institutional memory.

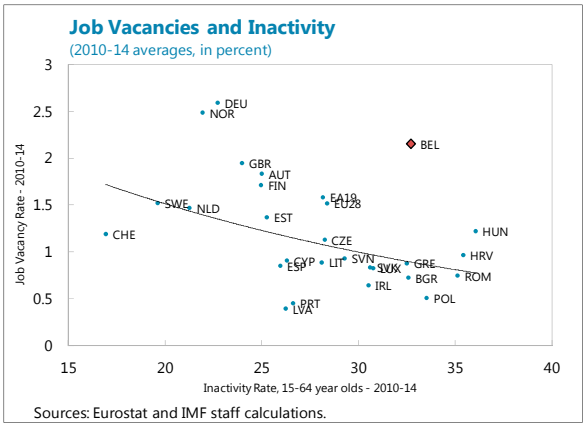


Sources: Eurostat and IMF staff calculations.



Sources: Eurostat and IMF staff calculations.

5. **Long-term unemployment is substantial and inactivity widespread.** At 8½ percent in 2014, the unemployment rate was moderate by euro area standards, and only 1.5 percent above the 2008 peak. However, once out of work, getting back to being employed appears more difficult in Belgium than many other countries. In 2014, half of all unemployed were in this status for more than a year. This share is just below Spain's, which has an output gap that is 4½ percentage points larger than Belgium's. Moreover, a third of Belgium's working age population is inactive, i.e. neither employed nor looking for a job. This share is the third largest in the Euro area and far above most countries in a similar economic situation.



Sources: Eurostat and IMF staff calculations.

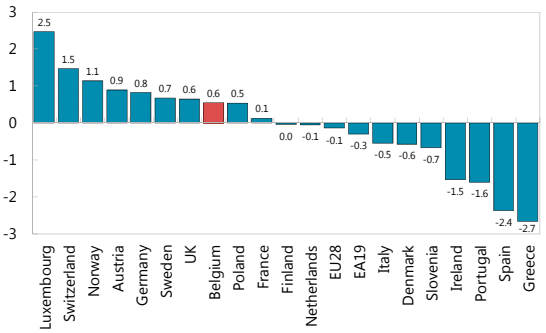
6. **Structurally high job vacancy rates suggest skill mismatches.** Belgium has the second highest job vacancy rate in the Euro area and the fourth highest in the EU, despite elevated unemployment and inactivity rates. The unemployment rate in Belgium is 2½ percentage points above the UK and 5 percentage points above Norway, countries with almost identical vacancy rates. These facts suggest the presence of considerable aggregate mismatches between labor demand and supply, partly reflecting deficiencies in education and training.

[3] Under the *chômage temporaire pour raisons économiques* unemployment benefits can be a complement to the standard salary for employees whose working hours have to be reduced due to overcapacity.

Figure 1. Resilience and Signs of Frictions

Employment fell less during the crisis and has grown more rapidly since than in many other countries.

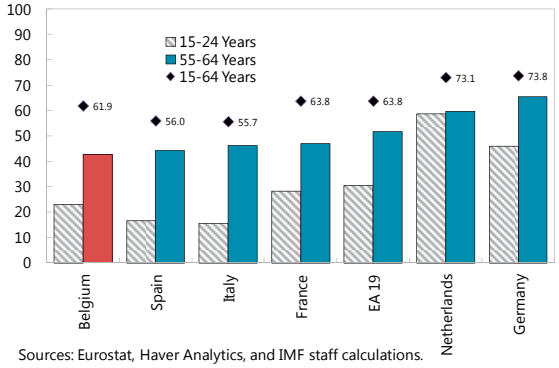
Employment Growth since the Crisis
(in percent, total employment domestic concept, 2008-14 average)



Source: Eurostat.

Employment rates are still low, however, especially for the young and older workers.

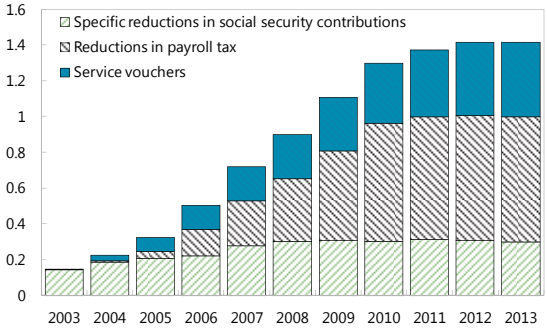
Employment Rates by Age Group
(in percent of labor force, 2014 average)



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

Employment growth benefitted from ballooning labor subsidies…

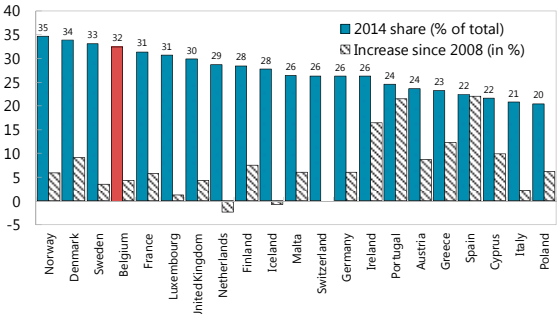
Labor Subsidies
(in percent of GDP)



Sources: NBB

… and a growing share of employment dedicated to the provision of public services.

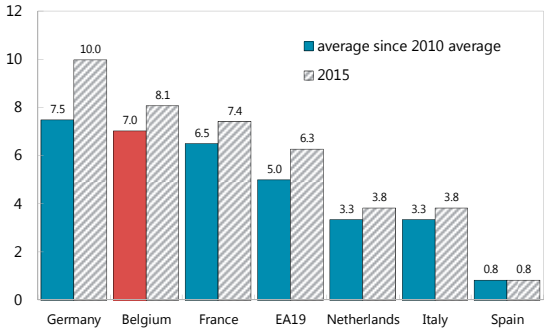
Public Service Employment
(Share of total, in percent, includes public administration and defence, compulsory social security, education, human health and social work activities)



Sources: Eurostat and IMF staff calculations.

Despite the low employment rate, labor supply is increasingly perceived as constraining production …

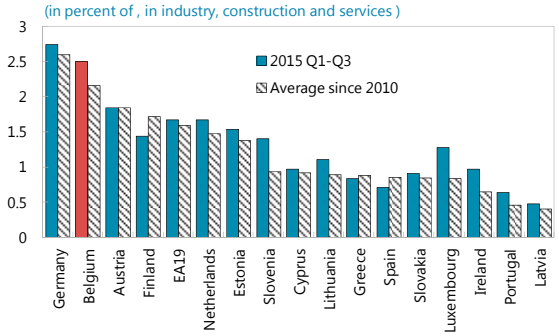
Factors Limiting Production - Labor
(in percent of managers reporting labor constraints as a limiting factor)



Sources: Haver / European Commission

… which, together with high job vacancy rates, points to mismatches between supply and demand.

Job Vacancy Rates
(in percent of , in industry, construction and services)



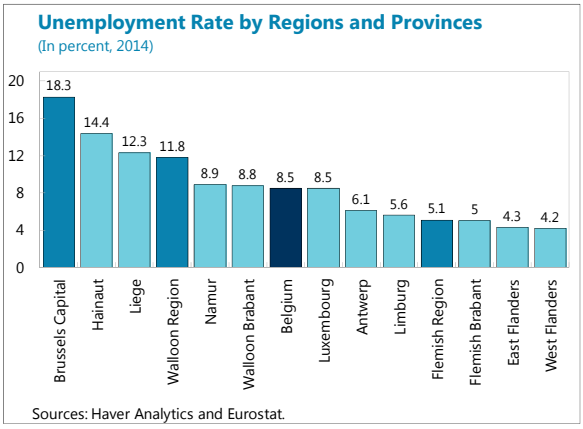
Sources: Eurostat and IMF staff calculations.
Data for France, Italy and Malta not availible.
Excludes activities of households as employers and extra-territorial organisations and bodies.

Sources: Eurostat, Haver Analytics, National Bank of Belgium, European Commission

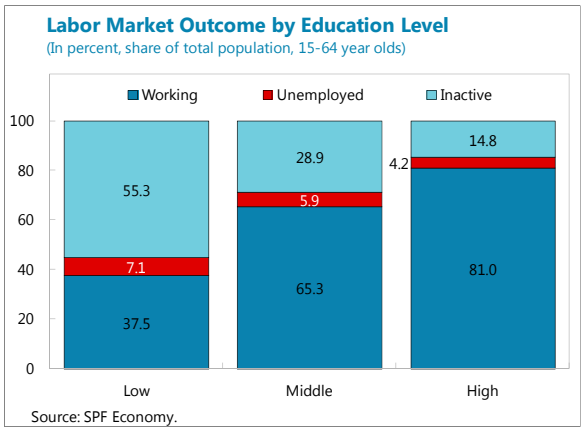
B. Severe Fragmentation

7. **Belgium's labor market is severely segmented across various dimensions.** Signs of poor labor market functioning are become more abundant when focusing on regional differences and specific groups. Below the aggregated level, important segmentations become apparent when the population is separated according to educational attainment, age, gender, regions or country of birth. For many—though not all—vulnerable groups, Belgium stands out either with employment and activity rates that are lower than in similar countries or with higher differences from the average.

8. **Regional differences.** Geographic differences across the three regions are striking: unemployment is more than twice as high in Wallonia (12 percent) than in Flanders (5 percent); and almost 3½ times in the Brussels capital region (18 percent)—the highest regional unemployment differences in the EU. While legacies of structural change can explain some of these longstanding differences, there are few signs of convergence.[4] Despite the big differences in labor market outcomes, job vacancies are quite comparable in the three regions; though not necessarily in the same professions.[5]



9. **Low-skilled.** More so than in many other countries, Belgian labor market outcomes are substantially worse for people with lower educational attainment. In Belgium, the employment rate of the low-skilled[6] is below 40 percent, one of the lowest in the euro area and less than half the rate for high-skilled. More than 55 percent of low-skilled persons are inactive.

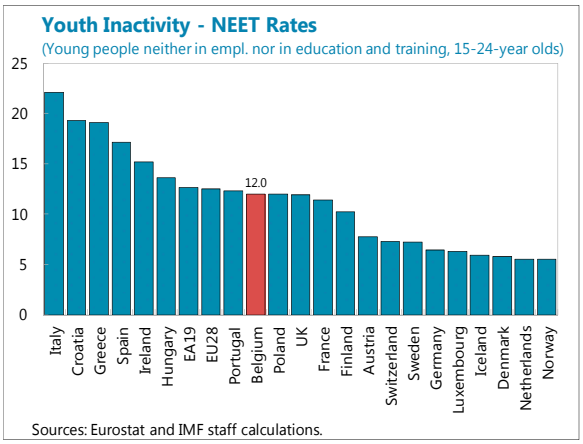


[4] In fact, the simple differences in unemployment rate relative to the Flemish region have actually increased between the 2000–04 and 2010–14 periods; going from an average of 5.2 to 6.0 in the case of Wallonia and from 10.1 to 13.0 in the case of Brussels.

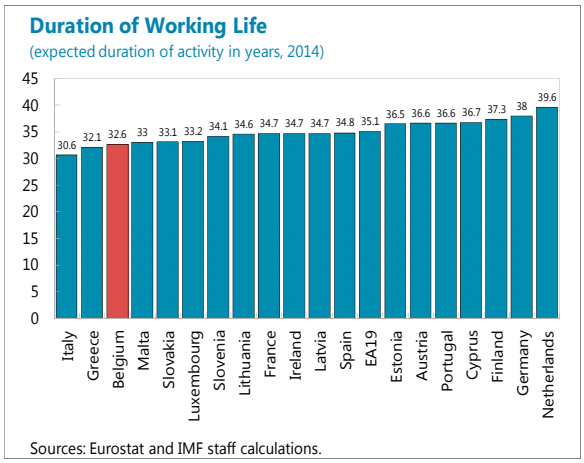
[5] The most thought after employees were for commercial functions in Flanders, technical positions in Wallonia and it teaching personnel in Brussels. See *Annual Report 2015, Conseil Superieur de l'Emploi*.

[6] Levels 0 to 2 by ISCED11 classification, meaning people with less than primary, primary or lower secondary education.

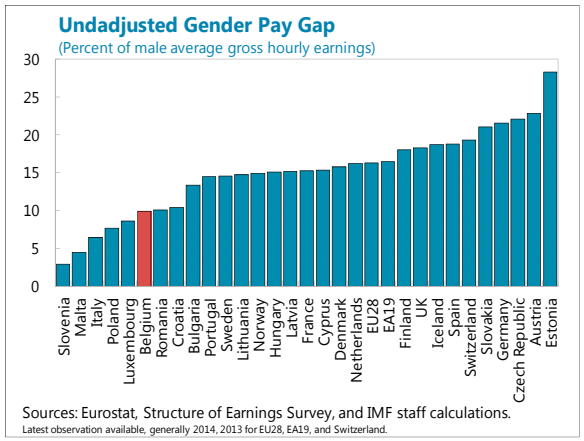
10. **Young.** While the youth unemployment rate is relatively low, this is partly due to a weak labor force participation rate of the young. The low activity rates among the 15-to-24 year olds can be partly explained by an increasing tendency to pursue tertiary education and a less developed vocational training system. However, schooling is unlikely to explain the full difference, as the share of young persons who are neither in employment nor in education and training (NEET) is higher than in many neighboring countries.



11. **Ages 55 and above.** At 43 percent, the employment rate for 55-to-64 year-olds is the fifth lowest in the Euro area, just after Greece, Slovenia, Malta and Luxembourg. In terms of average expected working life, only Italians and Greek have shorter careers. While the current situation still compares favorably to the early 2000s, when the same employment rate was under 30 percent, this improvement was less pronounced in Belgium than elsewhere in the euro area. Recent policy initiatives that discourage early exit from the labor force provide the prospect that participation of older workers will continue to increase.



12. **Women.** While the female employment rate is below the euro area average, this is due to generally higher inactivity rates, rather than unemployment or indicators of discrimination. The employment rate for women, at 58 percent, is 8 percentage points lower than for men, a gap that is below the euro area average. Unemployment is actually less prevalent among women than men, and the gender pay gap is substantially below the European average.

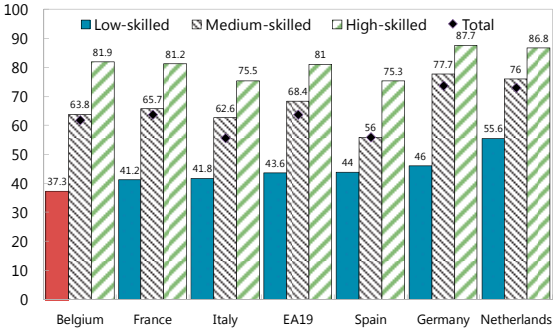


13. **Migrants.** Immigrants born outside the EU are much less integrated in the local labor market than in other EU countries. Non-EU immigrants have the highest inactivity rate and the biggest unemployment gap relative to natives in the EU. Overall, only about half of non-EU immigrants aged 25–54 are employed, compared to over 80 percent for Belgian-born residents. This employment gap cuts across all education levels. Given the recent surge in asylum applications, which could add up to one percent to the Belgian population by 2017, improving the labor market integration of migrants will be both urgent and challenging.

Figure 2. Symptoms of a Severe Segmentation

Belgian labor market outcomes are comparatively poor for persons with lower educational attainment.

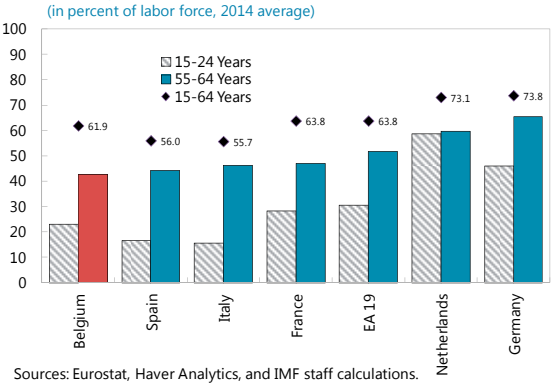
Employment Rate by Educational Attainment
(Share, in percent, 15-64)



Sources: Eurostat and IMF staff calculations.

Employment rates of younger and older persons are low by international standards.

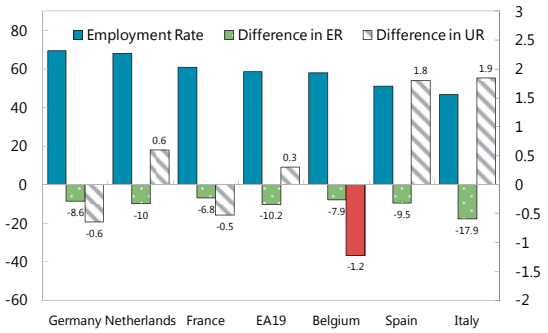
Employment Rates by Age Group
(in percent of labor force, 2014 average)



Sources: Eurostat, Haver Analytics, and IMF staff calculations.

Comparatively greater gender equality is a positive aspect of the Belgian labor market.

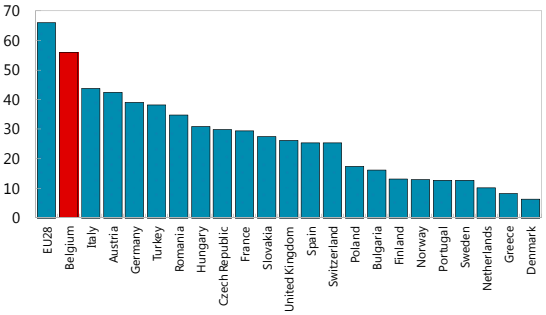
Gender Differences in Employment
(rates in percent, differences relative to men)



Sources: Eurostat and IMF staff calculations.

Within-country regional differences in unemployment rates are the largest in Europe; just behind the EU as a whole.

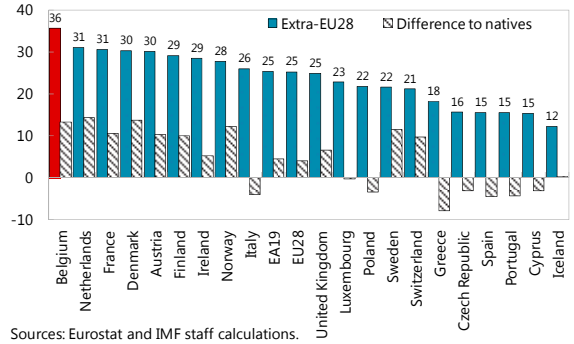
Regional Unemployment Rate Dispersion
(Dispersion of regional unemployment rates by NUTS2 area, in percent, coefficient of variation of employment rates of the age group 15-64)



Sources: Eurostat and IMF staff calculations.

The inactivity rate of non-EU immigrants is the highest in the EU …

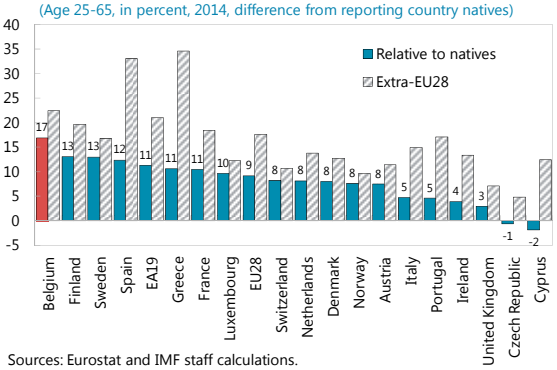
Inactivity Rates Among Extra-EU28 Migrant
(Population 25-65, in percent, difference from reporting country natives)



Sources: Eurostat and IMF staff calculations.
Data for Germany not available.

… as is the unemployment gap relative to natives.

Unemployment Among Extra-European Migrants
(Age 25-65, in percent, 2014, difference from reporting country natives)



Sources: Eurostat and IMF staff calculations.
Data for Germany not available.

Sources: Eurostat, Haver Analytics, and IMF staff calculations.

14. **Vulnerabilities across these groups often overlap.** For example:

- Non-EU migrants are geographically concentrated in the Brussels capital region, where they make up one third of the population and where unemployment is far higher than in the rest of the country. However, the relative size of the non-EU population notwithstanding, the employment gap between non-EU immigrants and natives is similar in all three provinces. The lower average levels of educational attainment among immigrants born outside of the EU can explain part of the employment gap relative to average Belgian-born resident. However, relative to natives of the same skill level, the employment gap actually tends to increase with educational attainment, suggesting that other factors are at play as well.

- Low levels of educational attainment overlap with the segmentation across age groups and regions. More than 40 percent of working age persons below 25 and above 54 are low-skilled, compared to less than 25 percent among 25-to-54 year olds. While the demographic patterns across regions are comparable, the educational breakdown varies; with proportionally more low-skilled living in Brussels and Wallonia than in Flanders.[7]

C. Underlying Distortions and Policy Issues

15. **Recent policy efforts should help, but may not fully address the deep-rooted causes of labor market fragmentation.** Recent efforts have included wage moderation, labor subsidies, reductions in the labor tax wedge, pension reforms, and tighter unemployment benefits. These policies have contributed to a relatively benign overall unemployment picture, and should bear fruit also for some of the vulnerable groups and regions. However, the causes of labor market fragmentation appear to be deep, and will likely require a broad approach that further addresses obstacles for the young, for non-EU immigrants, and for the low-skilled across all regions. This would require close policy coordination across all levels of government and different institutions.

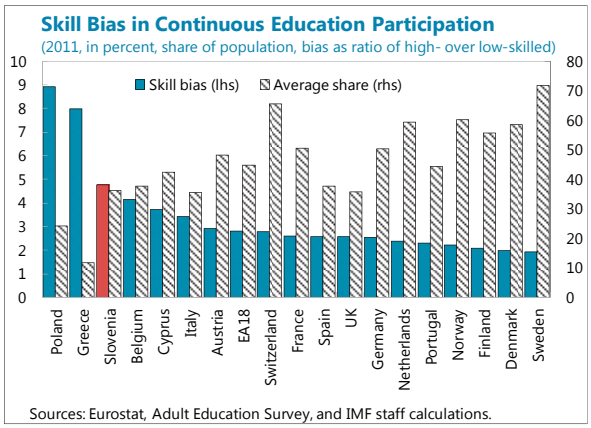
16. **Structural rigidities appear to play an important role.** While vulnerabilities cut across several groups and outcomes differ across regions, the underlying issues are often common. They involve barriers to mobility that impair the matching process, an insufficiently qualified labor supply, ill-aligned incentives, and wage- and contract rigidities that constrain the demand.

- **Geographical mobility and impaired matching process.** The persistent geographic differences in labor outcomes are sustained by language barriers, poor integration of labor market institutions, infrastructure bottlenecks, and fiscal incentives that reduce mobility. Following the sixth reform of the state, most responsibilities related to guidance and placement of the unemployed have been delegated to sub-national authorities. With still limited cooperation between the regional public employment services and their often poor links with

[7] Brussels has a particular education profile as its population is predominantly low- and highly educated. On the other hand, the share of the population with a medium education—an upper secondary or a post-secondary non-tertiary degree—is more than 10 percent below the national average.

companies from other regions, they may not be fully equipped for facilitating job search in another region. Moving is discouraged by fiscal disincentives (e.g. housing transaction cost), and commuting—the prevalent choice for many—is time-intensive and sometimes impossible due to congestion and insufficient public transport links (e.g., between the city of Brussels and its airport, situated in Flanders). Low-income earners, who cannot rely on a car for everyday use, are particularly geographically constrained. Removing infrastructure bottlenecks, assuring that public transportation fits the needs of the population, and reducing congestions by adjusting incentives away from using a personal car may make the labor force more mobile, contribute to a more unified labor market, and promote employment for vulnerable groups.

- **Skill and qualification adequacy.** Rough indicators and more refined—but somewhat dated—analyses point to skill and qualification mismatches that are more prevalent in Belgium than in many other European economies.[8] This suggests that the education system cannot deliver the expertise that the economy requires. Basic education often appears misaligned with the local labor market, both in terms of their curriculum—with an insufficient focus on the skills that are most useful for the job search—and in effectively facilitating the transition into working life. The share of adults who report no knowledge of foreign languages is higher in Belgium than in most European countries, which is particularly problematic in a country where three languages (French, Flemish, and English) are widely used, and a fourth (German) is an official language in a smaller community.[9] Foreign language teaching starts comparatively late in Belgium,[10] which particularly affects the opportunities and mobility of the low-skilled, who leave the school system earlier. This may be due to the community based approach to education; a system that may divert the focus away from the fact that Belgium is a tri-lingual country, resulting in higher language requirements than in many other countries. Additionally, continuous education is often badly targeted and underused. The share of the population benefitting from training is below euro area average and its use is tilted toward high-skilled employees. In 2011, only 15 percent of



Sources: Eurostat, Adult Education Survey, and IMF staff calculations.

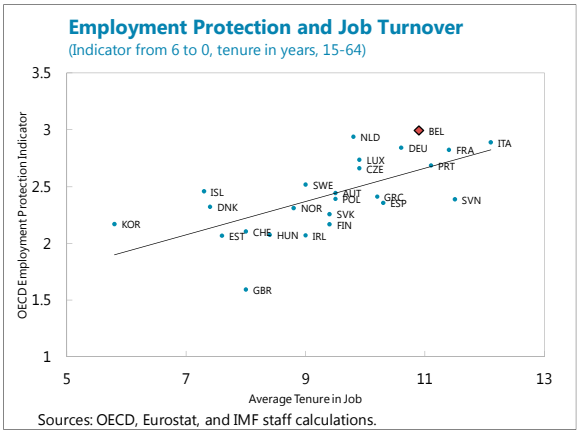
[8] See Commission Staff Working Document, Employment and Social Developments in Europe 2012, Volume VIII/IX, Chapter 6: "*The Skill Mismatch Challenge in Europe*"

[9] Source: Eurostat, Number of foreign languages known (self-reported) by educational attainment level of education.

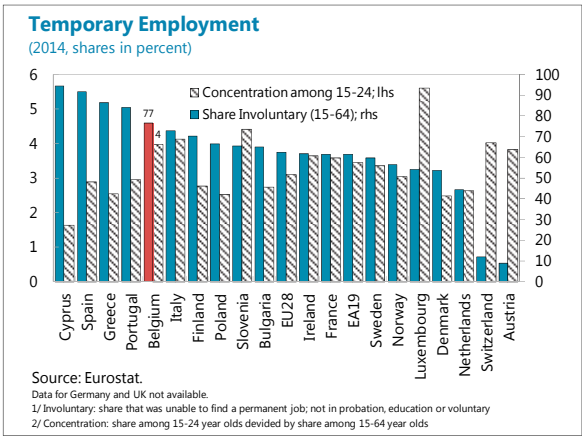
[10] At the level of primary school, the Belgian pupils knows 0.4 foreign languages, among the lowest in the EU. At the level of upper secondary education, this number is to 1.7 for Belgium as a whole and even 2.1 for the Flemish region; comparing favorably to a 1.3 EU average. Source: Eurostat, Average number of foreign languages studied per pupil by education level.

low-skilled adults received any sort of training; this is about half the average share in France, Germany, and the Netherlands.[11]

- **Policies disadvantaging the young may induce labor market duality[12].** Belgium has very stringent employment protection compared to other OECD countries,[13] particularly due to the specific requirements against collective dismissal. High barriers against laying off employees tends to reduce job turnover, may impair the efficient allocation of resources and thus productivity growth,[14] but also diminishes opportunities for the young. Particularly in times of uncertainty, employers often hesitate to offer permanent contracts to workers with little experience and reputation; they offer temporary contracts instead.[15] While overall not very common in Belgium, temporary contracts are more often involuntary and more concentrated among the young than in similar countries. Barriers for the young to durably enter into the labor market have both long-term and macro-relevant consequences, as poor early labor market outcomes will have effects during the entire career and can hence persistently reduce labor productivity.



Sources: OECD, Eurostat, and IMF staff calculations.



Source: Eurostat.
Data for Germany and UK not available.
1/ Involuntary: share that was unable to find a permanent job; not in probation, education or voluntary
2/ Concentration: share among 15-24 year olds devided by share among 15-64 year olds

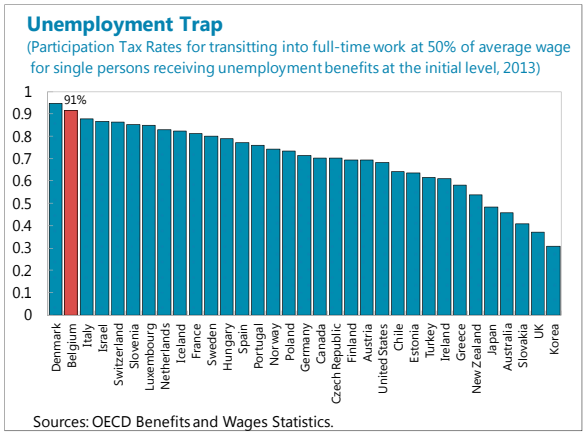
[11] Source: Eurostat, Adult Education Survey, Participation rate in education and training by people with pre-primary, primary and lower secondary education.

[12] See IMF Staff Discussion Note (2013) "*Labor Market Policies and IMF Advice in Advanced Economies During the Great Recession*" for a more detailed discussion of the link between employment protection and larbor market duality.

[13] Source: OECD Indicators of Employment Protection, Protection of permanent workers against individual and collective dismissals, 2013.

[14] Employment protection (e.g. in form of unemployment insurance) can be useful for companies to internalize the societal cost of lay-offs, but can affect productivity in different ways. Productivity growth relies heavily on an efficient allocation of resources, but may also benefit from stable employment relationships, by allowing the accumulation of specific human capital and reducing the costs related to job search. The design of the employment protection regime should strike a balance between the various costs and benefits.

[15] The government's decision to abolish trial periods creates an additional hurdle for the young to get a permanent contract.



- **Incentives.** Ill-aligned incentives may contribute to long-term unemployment and low activity, particularly among the young and low-skilled. While good insurance against unemployment and poverty is part of Belgium's social contract, unemployment benefits are often badly targeted and may distort incentives[16]. The effective income gain for an unemployed single person when moving into poorly-paid full-time employment is the second-lowest in the OECD, with an implicit tax rate of 90 percent (i.e., the additional taxes and social contributions on the wage income plus the loss of unemployment-related benefits). Moving into employment could be made more beneficial, not necessarily by reducing unemployment-related benefits, but by building on the targeted measures already implemented or announced[17] to reduce the effective tax wedge in favor of employment. Further strengthening incentives to front-load job search efforts may help avoid long-term unemployment. The degressivity of unemployment benefits has been reinforced in 2012, but according to the OECD, net replacement rates still fall only very slowly; the convergence to the social minima takes up to 4 years depending on career length and family situation. In addition, lax search requirements, lenient enforcement, and loose guidance may weaken incentives of jobseekers. While conditions related to availability and active job search have been tightened somewhat, more frequent meetings between unemployed and counselor—the *facilitateur*[18]—would allow closer guidance and continuous feedback, which could help make the job search more effective. Poor incentives for the young may be amplified by the "*allocations d'insertion*",[19] an unemployment insurance for school leavers without working experience who are unable to find a job during 310 days. Remaining idle for a long period puts recipients at a disadvantage relative to more recent graduates and may contribute to an early degradation of their just acquired human capital.

[16] By international standards, net replacement incomes are generous particularly at the lower end of the income distribution. See *Belgium—Making Public Expenditure More Efficient* (above) for a more general discussion of poor benefit targeting and its fiscal impact.

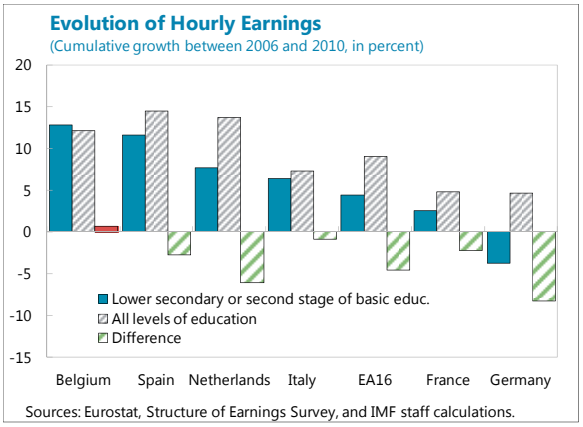
[17] In 2014, the government decided against inflation-adjusting the tax deductability for unemployment benefits. Additionally, the government announced various measures that will reduce the effective personal income tax rate, particularly at the lower end.

[18] Whether the job search was sufficient is evaluated for the first time during a meeting no sooner than 21 months after unemployment registration (15 months if younger than 25). Subsequent meetings are at a 12-months interval if conditions are met; and four months otherwise.

[19] The *allocation d'insertion* is an unemployment insurance for school leavers of 25 years or younger, for a maximum duration of 3 years and starting at the earliest 310 days after the initial registration. During this period the applicant must demonstrate job search efforts.

Reinforced job placement services and other active labor market policies may be a more efficient use of resources to facilitating a successful transition into the labor market.

- **Wage setting.** The wage setting process appears to leave relatively little room for individual productivity-related adjustments. This could have aggravated labor market problems, especially for certain groups. For example, between 2006 and 2010,[20] earnings of workers with a relatively low educational attainment (lower secondary degree) grew faster than for the average population in Belgium—in contrast to the euro area where they grew 4½ percent more slowly—while over the same period, unemployment increased by 1½ percent for the low-skilled and remained broadly stable for others. Another example is that seniority pay in Belgium continues to increase more rapidly for older workers than in other countries, making them less mobile and potentially disadvantaged in the job search and layoffs.[21] Finally, the automatic indexation and collective bargaining within a *wage norm*[22] can limit flexibility for individual companies: while employers can give wage increases beyond the negotiated limits to a certain degree, they have little room to raise wages by less than the norm even if this would be warranted by the economic situation or productivity developments. In the absence of a built-in correction mechanism at the aggregate level, wages can outpace the ones of Belgium's neighbors and require *ad hoc* measures to protect competitiveness.[23]



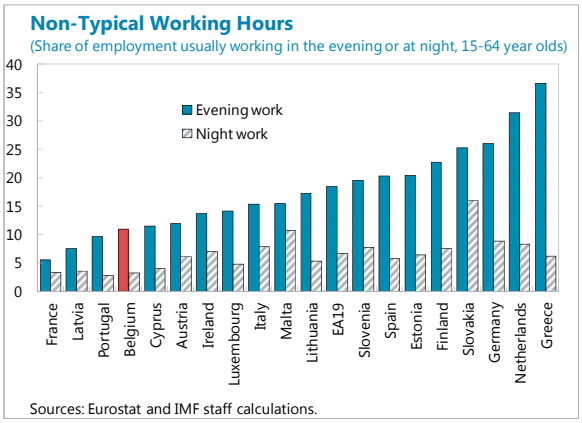
[20] The results of the more recent survey (2014) are yet to be published, leaving this comparison a little bit dated. Source: European *Structure of Earnings Survey*, Hourly Earnings.

[21] See NBB Economic Review June 2014, "*Employees : too expensive at 50? The age component in wage-setting*" for a discussion of the importance of age in the wage formation process.

[22] The "norme salariale" is a government imposed upper limit to the private sector wage growth, defined every two years and thus creates a framework for collective wage bargaining among social partners. For the 2013–14 period, as well as for 2015, the wage norm was 0.0; for 2016 it was defined as 0.5 percent in gross plus an additional 0.3 percent in net terms. As the wage norm limits the average labor costs at the company level and not the individual salary, some very moderate lee-way existed for individual wage increases, if high earning employer left the organization (e.g. due to retirement).

[23] After Belgian labor costs far outgrew the weighted average of its neighbors, the current and previous governments have taken measures to reign in the ballooning wages and labor costs (e.g. a much reduced wage norm, a temporary suspension of wage indexation, a gradual reduction of the employers' social security contribution). This should bring average wages back into line with neighboring countries, possibly already by the end of 2016.

- **Contract flexibility.** More flexible working relations could support job creation in certain sectors and help increase employment rates among the young and older workers—just as expansion of part-time opportunities has particularly benefited women. For above 95 percent of all jobs, collective agreements at the sectoral level build on national regulations, creating a vast network of rules. Legal possibilities to depart from the collectively negotiated contracts exist, but often imply financial and administrative costs. For example, given the regulations related to non-typical working hours, evening- and night work is much less common than in other countries. In a time when much business is done "just in time" and consumers become more demanding, this can put Belgium at a disadvantage in attracting new industries.[24] Reducing limits to evening and night work could create opportunities for the young, who are often less constrained. More flexibility in setting working time arrangements during the day—an area where Belgium also lagged behind some Northern European peers[25]—could also benefit older workers and adults with family obligations.



- **Employment opportunities for migrants.** Creating labor market opportunities is essential to facilitating integration of immigrants. Various aspects of labor market rigidities described above can be particularly important for immigrants from outside the EU. Skill mismatches are more prevalent,[26] and the education and training systems may not be delivering the needed support pupils with a migration background.[27] Language barriers and more limited knowledge of local labor market conditions make effective guidance for job search even more important. In light of the ongoing refugee surge in Europe, recent research by the IMF[28] suggests that appropriate labor market policies—possibly involving a combination of training, wage subsidies, further

[24] Night work has been much discussed as a factor limiting the development of e-commerce in Belgium. While the transport and logistics sectors had been excepted from a legal ban on night work, this was not the case for electronic shops. Fearful of permanently losing these companies—and the related services—to some neighboring countries with more relaxed regulation, social partners agreed in late December 2015 to allow these sectors to negotiate night work at company level.

[25] The 2004 Labor Force Survey focused working time arrangements. Belgians had on average less flexibility than the German, Dutch and most Northern and Central Europeans bar the French (see Eurostat, LFS ad-hoc module 2004). The more recent 2010 European Working Conditions Survey transmits a relatively similar message.

[26] See Economic Review, December 2012: "Labour market integration of the population of foreign origin" (2012).

[27] A recent NBB working illustrates that very small progress in education outcomes between the first and the second generation of non-EU immigrants tends to sustain poor labor market outcomes of families with a migration background. See NBB Working Paper N° 285: "The labour market position of second generation immigrants in Belgium" (2015).

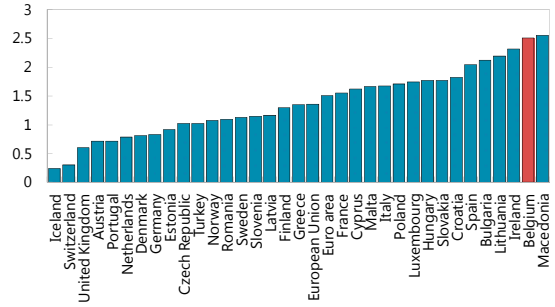
[28] IMF Staff Discussion Note: *The Refugee Surge in Europe: Economic Challenges* (2016).

Figure 3. Policies and Underlying Distortions

Certain measures of labor market outcomes suggest the presence of wide-spread skill mismatches.

Skill Mismatch

(2014 average, squared difference in proportions between population and employed, by level of education)

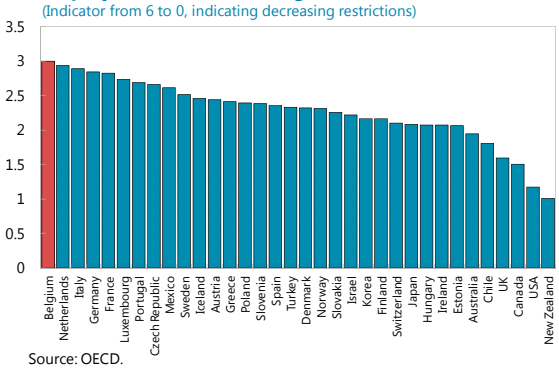


Source : Eurostat, IMF staff calculations

Employment protection, in particular limits on collective dismissals, is higher than among peers, …

Employment Protection Legislation

(Indicator from 6 to 0, indicating decreasing restrictions)



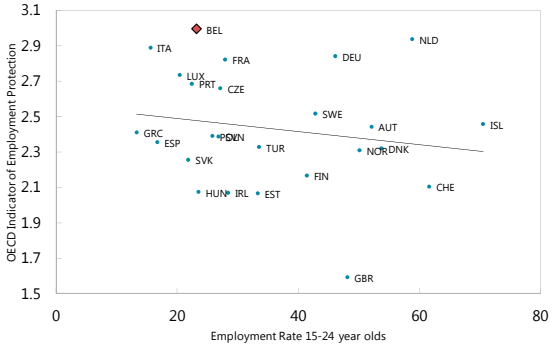
Source: OECD.

2013 or 2014 depending on latest year available.

… contributing to longer job tenure and lower turnover.

Employment Protection and Youth Employment

(indicator from 6 to 0, 2014 employment rate in percent)

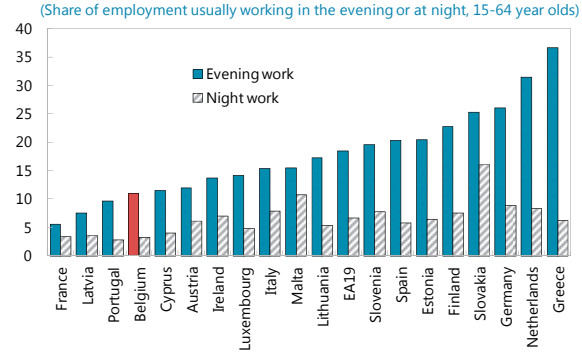


Sources: OECD, Eurostat, IMF staff calculations

Non-typical working hours are comparatively uncommon.

Non-Typical Working Hours

(Share of employment usually working in the evening or at night, 15-64 year olds)

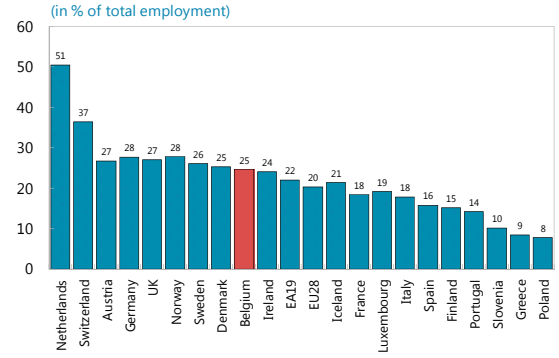


Sources: Eurostat and IMF staff calculations.

However, above-average availability of part-time work is supporting labor force participation of women…

Part-Time Work

(in % of total employment)

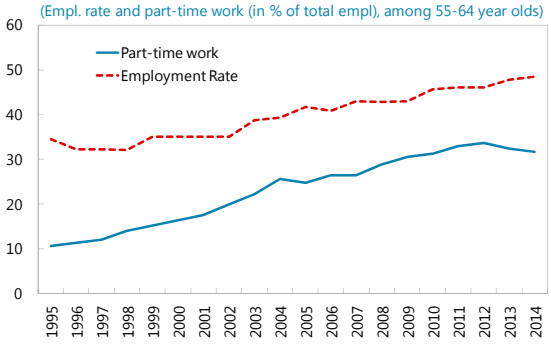


Sources: Eurostat and IMF staff calculations.

… and of older workers.

Part-Time and Employement Among Elderly

(Empl. rate and part-time work (in % of total empl), among 55-64 year olds)



Sources: Eurostat and IMF staff calculations.

Part-time work data for years 1999 and 2000 missing. Linear interpollation.

Sources: Eurostat, OECD, IMF staff calculations

targeted reductions of taxes and social security contributions, and access to temporary employment agencies—may be important for facilitating the labor market integration of migrants. Moreover, minimizing restrictions to taking up work during the asylum application and facilitating self-employment and skill-recognition would help. The government's decision to shorten the waiting period from six to four months for a refugee to get a work permit is an important step in this direction. Reducing barriers to entry in some sectors and the administrative burdens for start-ups would open further opportunities.

D. Conclusion

17. **The severe fragmentation of the labor market carries significant social and economic costs, and creates a high level of entrenched unemployment and inactivity.** This paper has aimed to shed light on a web of interconnected mismatches and segmentations of the Belgian labor market, which particularly affect the young, the low-skilled, and immigrants from outside the EU. Addressing these will be essential to reduce the fiscal cost of unemployment and inactivity, promote long run growth, and support social cohesion.

18. **The deep roots of labor market segmentation suggest the need for a comprehensive and coordinated jobs strategy across levels of government and different institutions.** Recent policy efforts, including wage moderation and labor tax wedge reductions, are important steps forward. They are, however, unlikely to be sufficient for resolving the significant regional disparities and the low employment rates among vulnerable groups, in particular the young, the low-skilled, and immigrants from outside the EU. A broader approach would ideally involve coordinated strategies for addressing not only wage setting but also qualification mismatches, entry barriers for the young, education and training gaps, ill-aligned incentives, and barriers to mobility. Number of policy options could be explored in parallel:

- To lock in the benefits from recent wage moderation, the wage formation process could be reformed to account not only for price developments but also broader labor market and economic conditions.

- Education and training could be improved to better meet languages and technical skill requirements. This could be supported by aligning curricula closer to local labor market needs and by intensifying the cooperation between schools and employers, including under apprenticeship programs (which are a successful tradition in the German-speaking community). Promoting and improving the targeting of continuous education could support the labor force's flexibility and quality, for example to allow for greater movement between economic sectors.

- Work incentives for the unemployed could be further strengthened, e.g. by making benefits still more degressive and enforcing strengthened job search requirements. In the meantime, the job search could benefit from more effective support by unemployment agencies, and individualized training offers. Additional targeted reductions in the labor tax wedge could further promote job creation for the low-skilled.

- Geographic segmentation could be addressed by reducing barriers to mobility and improving collaboration between local governments. Addressing the severe traffic congestion in some large urban centers, improving public transport, and reducing disincentives to buy/sell a house would make the labor force more mobile. Collaboration between regional entities could be further encouraged to improve the flow of information, harmonize administrative procedures, and share opportunities more effectively.

References

Shekhar Aiyar, Bergljot Barkbu, Nicoletta Batini, Helge Berger, Enrica Detragiache, Allan Dizioli, Christian Ebeke, Huidan Huidan Lin, Linda Kaltani, Sebastian Sosa, Antonio Spilimbergo and Petia Topalova; IMF Staff Discussion Note: "*The Refugee Surge in Europe: Economic Challenges*" (2016)

Vincent Corluy, Joost Haemels, Ive Marx and Gerlinde Verbist; NBB Working Paper N° 285: "*The labour market position of second generation immigrants in Belgium*" (2015)

Tomas De Keyser, Philippe Delhez, Hélène. Zimmer; NBB Economic Review, December 2012: "*Labour market integration of the population of foreign origin*" (2012).

Yves Saks, NBB Economic Review June 2014, "*Employees : too expensive at 50? The age component in wage-setting*"

Commission Staff Working Document, Employment and Social Developments in Europe 2012, Volume VIII/IX, Chapter 6: "*The Skill Mismatch Challenge in Europe*"

Conseil Superieur de l'Emploi, Annual Report 2015

Olivier Blanchard, Florence Jaumotte and Prakash Loungani, IMF Staff Discussion Note (2013) "*Labor Market Policies and IMF Advice in Advanced Economies During the Great Recession*"