



Economic Survey of Belgium, 2000

Summary

Economic performance has been rather good over the past few years. The authorities now face the challenge of moving from a robust cyclical expansion, which has largely closed the output gap, to a strong sustainable non-inflationary expansion. The key to this transition is the combination of wage moderation and a lower tax burden. A “virtuous circle” of improved international competitiveness, high profits, strong investment, rapid job creation and solid consumer confidence could set in. This would enhance fiscal consolidation and create the room for manoeuvre for further tax cuts, thereby boosting disposable income and making wage moderation more acceptable. The planned personal income tax reform is a step in this direction. The likelihood of such a virtuous circle occurring depends crucially on continuing and stepping up other supply side efforts to “activate”, at least in part, the still large pool of working-age benefit recipients not in employment. Progress along these lines can be expected to reduce somewhat the geographical differences in labour market conditions, but more should be done to target labour market measures to specific local conditions, as the authorities have already started to do. Government efforts in various other areas, such as increasing competition and market liberalisation, promoting regulatory reform and administrative simplification, and curbing health care expenditure also need to be pursued. As regards environmentally sustainable growth, this issue is now widely discussed and the federal government has launched a comprehensive plan for sustainable development.

What is driving Belgium's positive growth and labour market performance?

Will this outlook be affected by high oil prices and tightening money supply?

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For further information

This Policy Brief presents the assessment and recommendations of the 2001 OECD Economic Survey of Belgium. The Economic and Development Review Committee, which is made up of the 30 Member countries and the European Commission, reviewed this Survey. The starting point for the Survey is a draft prepared by the Economics Department which is then modified following the Committee's discussions, and issued under the responsibility of the Committee.

Fulfilling international commitments, including EC directives, is the major driving force behind environmental policy. But to date little use has been made of economic instruments, as for instance in reducing CO₂ emissions or groundwater pollution from agriculture. Increasing the public awareness of such issues may allow for a more effective enforcement of environmental targets through the application of economic instruments, like a properly adjusted CO₂ tax. These challenges can be dealt with more easily and more efficiently if the economy is also adaptable and growth is strong. Hence the important progress in structural reform needs to be continued and macro-economic policies must also be geared to providing the right conditions for maintaining the recent period of sustained non-inflationary growth. ■

What is driving Belgium's positive growth and labour market performance?

Since 1997 real GDP growth has been at or above potential with the expansion being broadly based on domestic demand and exports. While there was a temporary slowdown in 1998/99 following the Asian and Russian crises, the Belgian economy quickly regained momentum. The revival of private consumption has continued with improving consumer confidence and a positive outlook for the labour market. For the first time in a number of years growth has been strong enough to bring down unemployment, while the supply side of the economy has been flexible enough to meet the growing demand without overheating pres-

ures. Strong business fixed investment has helped to avoid supply side bottlenecks by shifting the capacity frontiers outward. The current account surplus has remained significantly positive, as it has been for several years. Meanwhile the general government budget deficit has been virtually erased, and while the general government debt remains above 100 per cent of GDP, the downward trend of this ratio has accelerated considerably in recent years.

Unlike earlier business cycles, the wage – price performance has remained free of tensions during this upswing. Real wages have increased less than productivity and unit labour costs have even remained stable due to a decline in social security taxes. More recently consumer price increases have risen due to the oil price shock and the weak euro. However, contrary to events following the last oil price shock in 1989-91, wage demands have not yet reflected a change of behaviour on the side of social partners, who continue to put considerable emphasis on maintaining external competitiveness. A special price index, the so-called “health index” (excluding most energy items, tobacco and alcohol), has been used for indexation since 1994, which, to a large extent, avoids the automatic spillover of terms of trade losses due to higher oil prices into domestic wages. ■

Will this outlook be affected by high oil prices and less accommodating monetary conditions?

The high oil prices and less accommodating monetary conditions in the euro area are likely to lead to a decline of Belgian export market growth, and

this should feed through into somewhat slower overall growth of the Belgian economy. After peaking in 2000 at 3¾ per cent, real growth is projected to ease to 3.1 per cent in 2001 and 2.9 per cent in 2002, which would be a more sustainable rate. Consumer confidence will continue to be boosted by the improving labour market conditions as evidenced by increasing employment and vacancies. Private consumption may, therefore, grow in line with real disposable income, which will continue to be boosted by further tax cuts. Hence, the savings rate is likely to remain at a level which is considerably lower than in 1991-95, but substantially higher than in other EU countries on average. Investors and the business community welcome the renewed political commitment to continue fiscal consolidation and look forward to a series of growth enhancing supply side reforms. Consequently, while decelerating somewhat, business fixed investment is expected to remain relatively dynamic. With economic growth somewhat above the potential growth rate, the output gap would be closed in 2002 with the unemployment rate approaching the estimated structural rate, which may fall to just below 7½ per cent. The major risks and uncertainties concern, first, the spillover of the inflation hike to wage demands in the context of a tightening labour market – especially in the case of a further acceleration of import price increases – and secondly, a stronger than projected decline of export market growth.

Although the ECB has increased its policy interest rates in several steps by 2¼ percentage points, overall monetary conditions in Belgium have been accommodative, because of the considerable real depreciation of the euro since its introduction. Over the projection period

until 2002 the OECD Secretariat assessment is that a further modest increase in policy – controlled interest rates will be required to contain inflation risks in the euro area. Hence, monetary conditions in Belgium are likely to become somewhat less supportive of growth, which would seem appropriate in the circumstance. ■

Where should budget surplus margins be allocated?

The 2001 Budget and the Stability Programme for 2001-05 set targets for the general government budget surplus to rise from 0.2 per cent of GDP in 2001 to 0.7 per cent in 2005, with the debt to GDP ratio falling from 106 per cent in 2001 to less than 90 per cent in 2005. Under pru-

dent macroeconomic assumptions – notably, an average annual rate of growth of real GDP of 2½ per cent – the government estimates that these budget targets can be met, while at the same time providing scope (*marges budgétaires*) for additional policy measures of 0.2 per cent of GDP in 2001, rising to 1.3 per cent by 2005. The small 2001 margin has been used in the 2001 Budget to finance a reduction in the fiscal burden and an increase in health care and other social security spending. A rate of growth of real GDP above the assumed 2½ per cent would, of course, create additional margins, which the government has indicated would be used primarily, but not exclusively, to accelerate the reduction of public debt. It would be advisable that, to the extent that the additional margins are not used for debt reduc-

tion, they should be reserved for the financing of the envisaged tax reform (see below).

As regards the budgetary margins for the 2002-05 period, the government intends to use them for financing an ambitious social and economic programme including an income tax reform. Moreover, a Fund for Population Ageing (*Fonds de vieillissement*) will be created. It will be financed by the proceeds of privatisations (including the sale of UMTS licenses, which is scheduled to take place in early 2001), and, possibly, surpluses in the social security system and part of budget surpluses. To the extent that the Fund will invest and accumulate reserves, it will contribute to an accelerated reduction of the net public debt. The tax reform has been stretched out over a longer

Macroeconomic performance at a glance

	Belgium						EU ¹
	1996	1997	1998	1999	2000 ²	Average 1997-00	Average 1997-00
	Year-on-year percentage changes						
Real final domestic demand	1.1	2.6	3.2	2.9	2.6	2.8	2.9
Real total domestic demand	0.9	2.6	3.9	2.1	2.7	2.8	3.0
Net exports ³	0.3	0.9	-1.2	0.7	1.2	0.4	-0.1
Real GDP	1.2	3.4	2.4	2.7	3.8	3.1	2.8
Inflation ⁴	2.2	1.6	1.0	1.2	2.6	1.6	1.8
Total employment	0.4	0.8	1.2	0.9	1.5	1.1	1.5
	Per cent						
Employment rate ⁵	56.4	56.8	57.5	57.9	58.8	57.7	62.4
Unemployment rate ⁶	9.7	9.4	9.5	9.0	8.5 ⁷	9.0	9.4
General government balance – actual (% of GDP)	-3.8	-1.9	-0.9	-0.7	-0.1	-0.9	-1.1
General government balance – cyclically adjusted (% of potential GDP)	-1.6	-0.5	0.3	0.4	0.3	0.1	-0.7

1. Except for the total employment, weighted average using the method described in the *Economic Outlook*.

2. Estimates, unless otherwise indicated.

3. Contribution to real GDP growth.

4. Private consumption deflator.

5. As a per cent of working age population.

6. Standardised unemployment rate.

7. Actual figure.

Source: OECD.

period (2001-04) than originally intended. As outlined by the government, it will represent a tax cut of BF 135 billion (or a little over 1 per cent of GDP). Its primary aim is to alleviate the tax burden on labour income, especially on lower wage incomes, thereby increasing disposable income with two effects: first, a reduction in replacement rates to encourage some of the many benefit recipients not in employment to join (or rejoin) the active labour force; and second, making continued wage moderation more acceptable. But to avoid an inflationary easing of fiscal policy, it will be necessary to restrain growth in public expenditures, giving the priority to those which increase the supply side elasticity of the economy, even if this may imply difficult choices. With these qualifications, the proposed income tax reform is highly welcome as a way to redress incentives to work and cement the still fragile culture of wage moderation as a result of a free bargaining process between the social partners. ■

How can spending pressures be controlled in the context of the proposed tax reform?

Fiscal consolidation has to go hand in hand with structural changes in government expenditures and revenues, so as to progressively reduce the many distortions of high taxes and expenditures. The share of government expenditures on the federal, regional and local level in Belgium is among the highest in the OECD area. Consequently Belgian tax rates – predominantly on labour income – are also above the average European level. The high tax wedge

both distorts labour supply decisions and introduces a bias against labour (and skill) intensive technologies. If the government intends to continue with its programme of cutting taxes then – in view of increased spending requirements inevitably associated with ageing – it seems clear that general spending programmes will need to be more and more contained through tighter targeting. An example of the difficulties in this area is provided by the renewed increase in public sector health expenditures. The slowdown of health cost expansion in earlier years turned out to be difficult to sustain. Led by strong increases of expenditures for pharmaceuticals, 1999 again saw a major cost overrun of public expenditures on health. It seems that relying on administrative measures and the goodwill of involved groups may not be sufficient. Hence, over the longer term, unless the country is willing to spend a growing proportion of its resources on health care, it will be necessary to consider additional measures to increase efficiency and restrain expenditure. ■

Are labour market policies combating structural unemployment?

The Belgian labour market is still burdened with serious weaknesses inherited from the past. Low employment rates coincide with high tax wedges and benefit replacement rates. The incidence of long term unemployment was above 60 per cent in 1999 and about two-thirds of public spending on labour market measures is accounted for by passive measures, which is relatively high by international comparison. Furthermore significant regional

unemployment rate differentials, both within and among the three regions, are symptomatic of very low labour mobility. While there is some evidence of increased responsiveness of relative wages across different sectors, low geographical mobility and the concentration of unemployment on the low skilled suggest that the degree of wage differentiation across regions and occupations still seems to be insufficient. The recent turnaround on the Belgian labour market – which is primarily cyclical – is supporting the efforts of the authorities to increase labour force participation. The measures include general and targeted reductions of social security taxation and voluntary framework agreements with the social partners. This strategy seems already to be paying off: employers have considerably increased their vocational training efforts for employees in exchange for a general reduction of social security taxes. To further increase wage flexibility at the micro-economic level, the use of “opening clauses” or equivalent arrangements should be encouraged, along with the introduction of bottom sectoral wage scales closer to the statutory minimum wage level, and wider exceptions to the minimum wage level for various target groups. Moreover, a further relaxation of restrictions on temporary work would increase labour market flexibility in general.

The government is relying on a wide variety of active and passive measures in dealing with people out of labour force. To some extent the measures suffer from a complicated institutional split of responsibilities. A prime example is the policy towards unemployed, where the administration of unemployment benefits is under federal control and job seeking assistance is

under regional control. The reluctance on the side of regional authorities to enforce conditions for programme participation, which hit the local population, may have been partly due to the inflexibility of sanctions, which could not be used in a discretionary way. Hence, the recent modifications of the rules so that benefit sanctions correspond better to the nature of non-compliance with entitlement rules are welcome. Higher participation would however include a consistent and credible enforcement of benefit entitlement restrictions, and such enforcement would also tend over time to support increased wage responsiveness and labour mobility, particularly if at the same time there emerged a greater role for individual firm level profitability in wage negotiations. As regards active labour market measures, the recently-introduced “First Job Programme” is welcome since it has a preventive role and it can be adapted to local conditions. However, the “*plan d’accompagnement des chômeurs*” should be extended to persons above 46, thereby meeting a request of the social partners to step up reintegration efforts. Although reducing social security taxes for target groups may be a powerful instrument, in Belgium the very large number of such initiatives and, more generally, of labour market measures may be confusing for both employers and employees, and may hinder their effectiveness. An effort of consolidation and streamlining of these programmes has already started: it should be continued and stepped up.

In order to achieve a more flexible organisation of working time, the government is considering to provide incentives to encourage arrangements agreed by the social partners

to reduce the work week either through a voluntary four-day work week or a general system of career breaks equivalent to a one-fifth reduction in working time. Details on these programmes have not yet been fully spelled out, but there are risks that these measures would not only have a budget cost, but could, if not carefully designed, unduly reduce the effective labour supply. ■

Have competition policy and regulatory reform been sufficiently implemented?

In Belgium, product markets and especially the services sectors are areas where reform and increased competition could significantly enhance job creation, thereby facilitating efforts to make the labour market more flexible. Over the past few years, policy efforts in this area have mainly focused on responding to EU guidelines and recommendations. For the period ahead, the federal government and the regional governments have presented a very comprehensive programme aiming at improving the functioning and efficiency of markets through a better regulatory framework, a reform of certain sectors, and measures to facilitate market access for small – and medium – sized enterprises.

Although Belgium has had a strict and comprehensive competition legislation since 1993, its implementation has been hampered by the understaffing of the Competition Council and the Competition Services. The Act on the protection of economic competition was amended in July 1999 to create more positions in these two institutions. In addition, the market share threshold

for notifying mergers has been abolished and only turnover thresholds have been retained. Following this amendment, activities regarding mergers and acquisitions have declined sharply. In the area of anti-competitive practices, most of the cases submitted by the Competition Service to the Council deal primarily with abuses of dominant position. It is to be hoped that the Competition Service and the Competition Council will soon have the necessary staff and resources to allow them to perform their statutory role in the implementation of the Competition Act. This could create a general climate of greater competition and dynamism in the economy with important synergy effects.

The introduction of market forces and market discipline in a number of former public utilities has mainly been driven by EU policies to open these markets for competition, and has generally taken the form of transposing EC directives into Belgian law. The liberalisation process has been quite rapid and has achieved important results in the telecommunication sector and some others, such as air transport and parts of the postal sector, but has lagged in others including rail transport. As regards the very important electricity sector initial reforms have been undertaken, but much remains to be done. Hence, the new government intends to accelerate the liberalisation process in this sector to bring Belgium in line with its main trading partners and to ensure that consumers will benefit from lower prices and a better service. More specifically the government is rightly aiming at creating a clearer distinction between production, transmission, and distribution of electricity, with the regulation of the transmission network in the hand of an independent

regulatory body. Currently Electrabel (a private company with a small participation of the public sector) accounts for the bulk of the production of electricity, and indirectly controls also its transmission and a large share of its distribution. The restructuring of this company remains a challenge. ■

Are co-ordination and co-operation sufficient in the area of environmental policy?

The special chapter on encouraging environmentally sustainable growth illustrates some key issues in environmental policy using examples from the three regions. One important theme running through the discussion is the difficulties caused by the complexity of the institutional structure and the consequent need for a high degree of co-ordination and co-operation. In the past couple of years, both the regions and the federal government have launched initiatives for sustainable development, including long-term considerations of the development of the environment, economy and society and their potential interactions. Many aspects of environmental policy and enforcement are regional responsibilities, while tax issues are primarily a federal responsibility. Policy decisions generally require consensus between the regions and the federal government. During the period when the institutional arrangements were new and unfamiliar, achieving such consensus over problems with a potential conflict of interest between regions, as in the case of Brussels sewage and perhaps also traffic congestion in the capital, may

have lengthened the decision period considerably. The comprehensive set of intergovernmental and inter-ministerial committees designed to mediate these discussions is thought to be working better now, as it faces the task of reconciling the division of responsibilities and powers in implementing recently developed sustainable development plans.

Which factors have impeded positive performance of water policies in the regions?

Two examples that illustrate the implications of the complex institutional structure are discussed in the following paragraphs: bathing water in Wallonia and sewage in Brussels. In both cases, translating EC directives dating from 1975 and 1991 into action has taken a great deal of time and the European Court has recently issued judgements against the Belgian government in both cases. Two further examples that illustrate a second important theme – that of the use of economic instruments – are addressed subsequently: reducing water pollution from agriculture in Flanders and fulfilling international commitments to reduce greenhouse gas emissions.

In Wallonia, while organised bathing zones are closed when the regional government notifies the organisers that norms of the EC directive on water quality have been violated, it seems that this is frequently not the case in other areas. Many local bathing areas are not classified as “organised” and local government administrations (with whom the responsibility for such public health issues lies) find that the costs – either

the direct costs of administration and policing or the indirect costs through reduced tourism and leisure activities – are too great compared with the perceived public health risk. Without a heavy programme of investment in tertiary treatment – which is still relatively rare in most OECD countries, whereas much sewage in Wallonia still does not receive even primary treatment – this aspect of water quality is unlikely to improve rapidly. The Belgian government argued at the European Court that the water directives do not impose any obligation on member states to restrict access to polluted bathing water, an argument confirmed in the Court’s recent judgement. Some explicit assessment of whether the health risks are serious enough to warrant measures to force local government to act more often, perhaps finding a way to give them an incentive to take local action to improve water treatment themselves, would be warranted nevertheless.

In the case of Brussels sewage, action has now been taken that should bring the city into line with legal requirements by 2005, with one water treatment works only about to come into operation and the result of tenders for another soon to be announced. Part of the explanation for the delay seems to have been that constitutional change and fiscal adjustment reduced the importance attached to this issue, but inadequate co-operation between the regional government of Brussels-capital, generating the pollution, and that of Flanders, receiving it, may also have been a factor. Given the magnitude of the problem – few people would imagine that a city of the size and importance of Brussels could be entirely without sewage treatment – it is also surprising that no domestic legal action occurred. Pressure from the

EU, which eventually took action at the European Court, may have accelerated the process. ■

What about economic instruments?

Surface and, increasingly, groundwater in Flanders is seriously affected by nutrient discharges (particularly of nitrates) due to heavy manure production from intensive livestock rearing. The authorities face a difficult trade-off: introducing and enforcing legislation compatible with water quality norms implies imposing costs on polluting activities, and possibly reducing their extent. A tax on wastewater from industry has reduced discharges from this source as enterprises have been induced to treat their wastewater; livestock farmers have had insufficient incentive to reduce their discharges. Reliance on codes of good farming practices, even though backed up by stiff fines supporting an EC directive, seems to have been insufficient. The extreme range in the new tax rates on the application of nutrients (both in animal feed and in fertiliser) in sensitive areas, could be narrowed to give more consistent incentives to reduce overall nutrient discharges,

possibly using farm-by-farm nutrient flow accounts to bring the tax base closer to actual discharges. Tax credits based on a proportion of historical applications or discharges could mitigate abrupt financial shocks, while still maintaining the incentive to avoid pollution at the margin. A tradable discharge permit system with similar “grandfathering” of permit allocations would be an alternative that might meet quantitative targets more reliably.

As in most OECD countries, emissions of CO₂ have been rising even as governments have been agreeing to relatively ambitious targets for reducing emissions by 2008-12; little has been done so far in Belgium to meet this target. However, the recent Federal Plan for Sustainable Development envisages an energy/CO₂ tax introduced through the EU – the authorities intend to pursue this during the Belgian presidency in the second half of 2001, planning domestic action in the absence of agreement on this. Whether or not such a tax is introduced through the EU, the emphasis in the Plan on avoiding competitiveness effects and social costs should not allow the measure to be diluted, as it has been in a number of countries introducing a tax unilaterally.

According to the OECD Secretariat, all emissions should face the same tax, perhaps with compensation for heavy emitters through a form of tax credits based on past emissions, leaving a uniform tax rate on marginal emissions without too great a financial burden on heavy emitters. A cap and trade system, with “grandfathered” emission permit allocations, would achieve a similar effect, as well as being better adapted to the quantitative nature of the Kyoto target and capable of allowing an easy link to international permit trading. In either case, the compensation schemes should be phased out over a number of years in order not to become a system of support for “incumbents”. What is welcome, however, is that the authorities are considering an approach which uses economic instruments. The way in which these are implemented needs great care to ensure that they are introduced in an effective and efficient way. ■

For further information

More information about the Survey can be obtained from Bixio Barenco (Email: bixio.barenco@oecd.org, tel.: (33-1) 45 24 87 84). ■

For further reading

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- **Economic Outlook No. 68,** December 2000. A preliminary edition is published on the OECD Web site approximately one month prior to the publication of the book: www.oecd.org/eco/out/Eo.htm.

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Where to contact us?

FRANCE

OECD Headquarters
2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: 33 (0) 1 45 24 81 81
Fax: 33 (0) 1 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD BERLIN Centre
Albrechtstrasse 9/10
D-10117 BERLIN
Tel.: (49-30) 2888353
Fax: (49-30) 28883545
E-mail:
berlin.contact@oecd.org
Internet:[www.oecd.org/
deutschland](http://www.oecd.org/deutschland)

JAPAN

OECD TOKYO Centre
Landic Akasaka Bldg
2-3-4 Akasaka, Minato-Ku
TOKYO 107
Tel.: (81-3) 3586 2016
Fax: (81-3) 3584 7929
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD MEXICO Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560
Mexico, D.F.
Tel.: (00.52.5) 281 3810
Fax: (00.52.5) 280 0480
E-mail:
mexico.contact@oecd.org
Internet: www.rtn.net.mx/ocde

UNITED STATES

OECD WASHINGTON Center
2001 L Street N.W.,
Suite 650
WASHINGTON D.C. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
Toll free: (1-800) 456 6323

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