



OECD Economic Surveys BELGIUM

FEBRUARY 2015

OVERVIEW



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Executive summary

- *Main findings*
- *Key recommendations*

Main findings

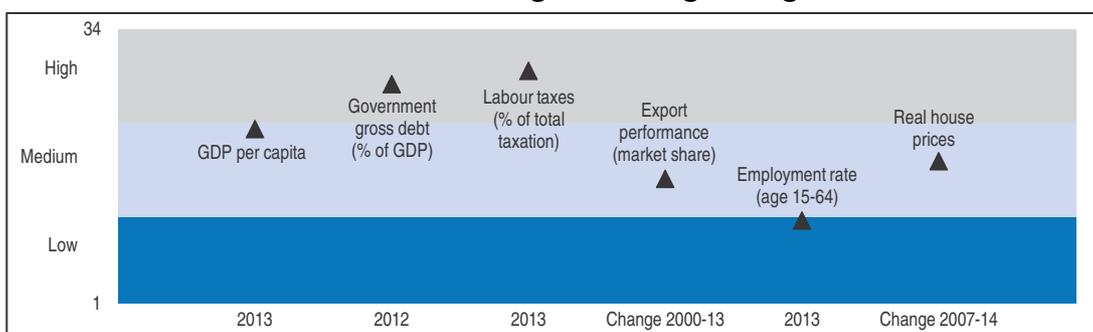
Belgium has returned to growth and halted the deterioration in external competitiveness, while continuing to score well on broader measures of well-being. The authorities have reduced budget deficits and substantially reformed fiscal federalism arrangements. However, the recovery is still fragile, long-term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

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

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

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

Selected economic indicators: Belgian ranking among OECD countries



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

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Key recommendations

Securing fiscal sustainability while promoting employment and competitiveness

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

Improving the labour market integration of immigrants

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

Maintaining an efficient and equitable housing market

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

Assessment and recommendations

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

Challenges facing Belgium

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

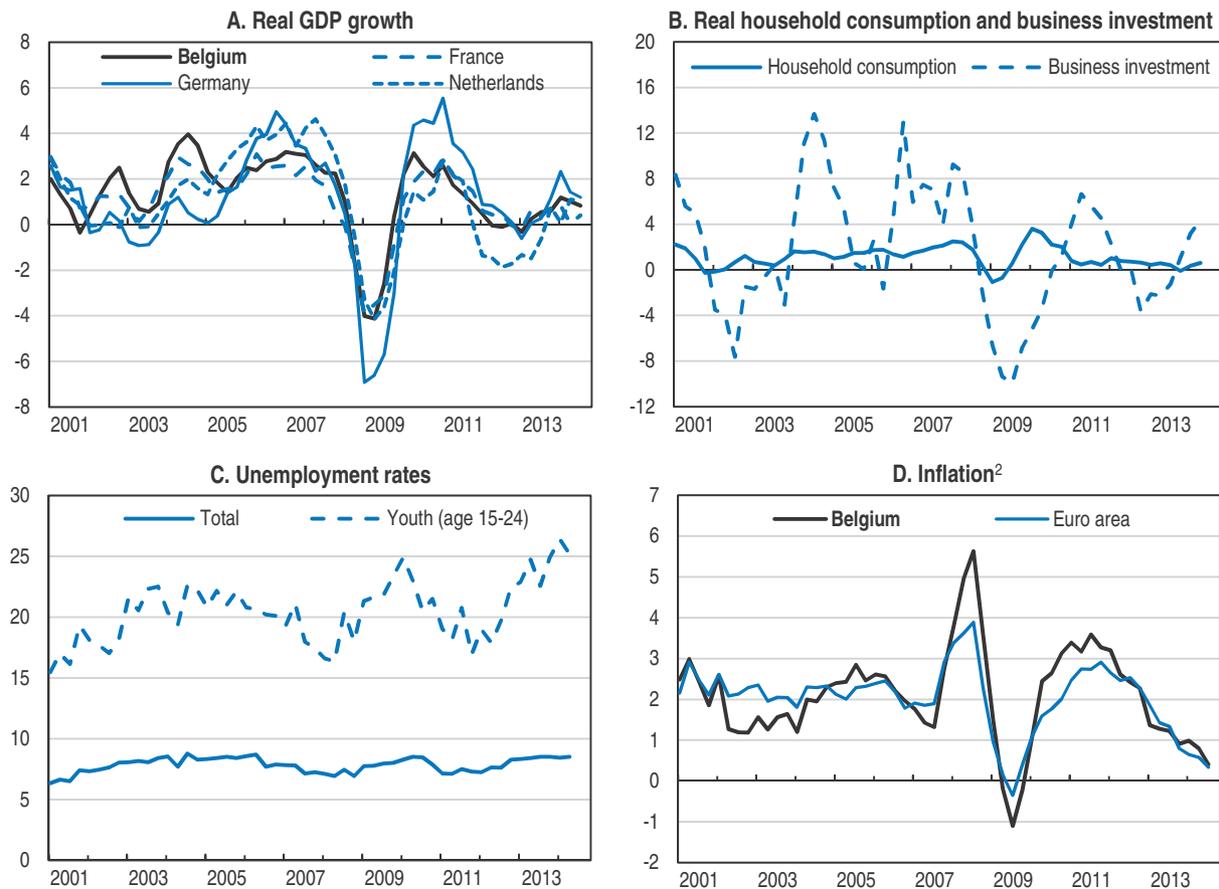
This Survey analyses ways to address these challenges and finds that:

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

Economic prospects remain fragile

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

Figure 1. **The recovery is still hesitant**
Per cent¹



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

2. Measured by the harmonised consumer price index.

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

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

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

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

Recommendations to secure fiscal sustainability while promoting employment and competitiveness

Key recommendations

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

Additional recommendations

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

Improving the labour market integration of immigrants

The immigrant population is large and rising, but poorly integrated

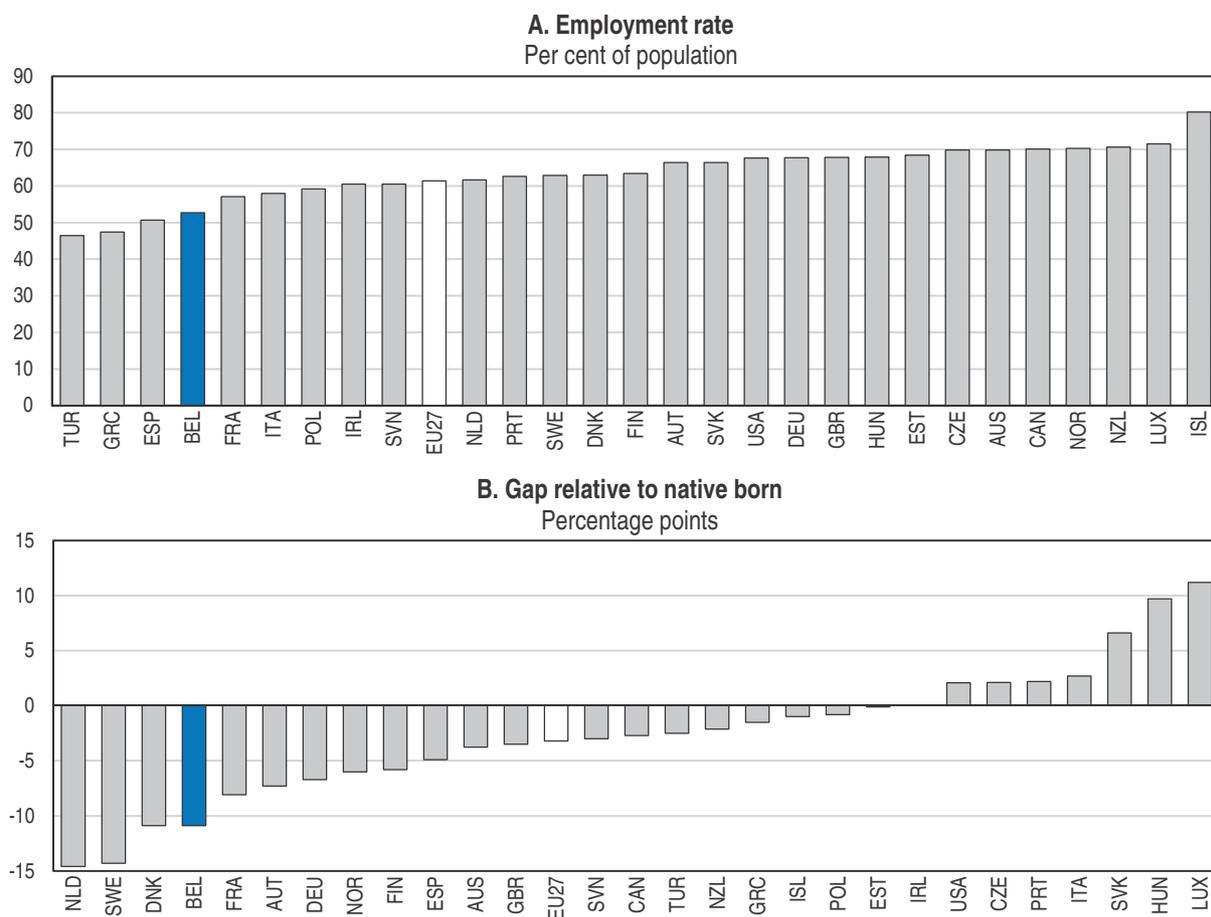
Immigrants, henceforth defined as those born abroad whatever their nationality, account for a high and rising share of the Belgian working age population (19% in 2013). Migration flows have reached record highs since the turn of the century and become more diverse, with a decline in the relative importance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

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

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

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

Age 15-64, 2013¹



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

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

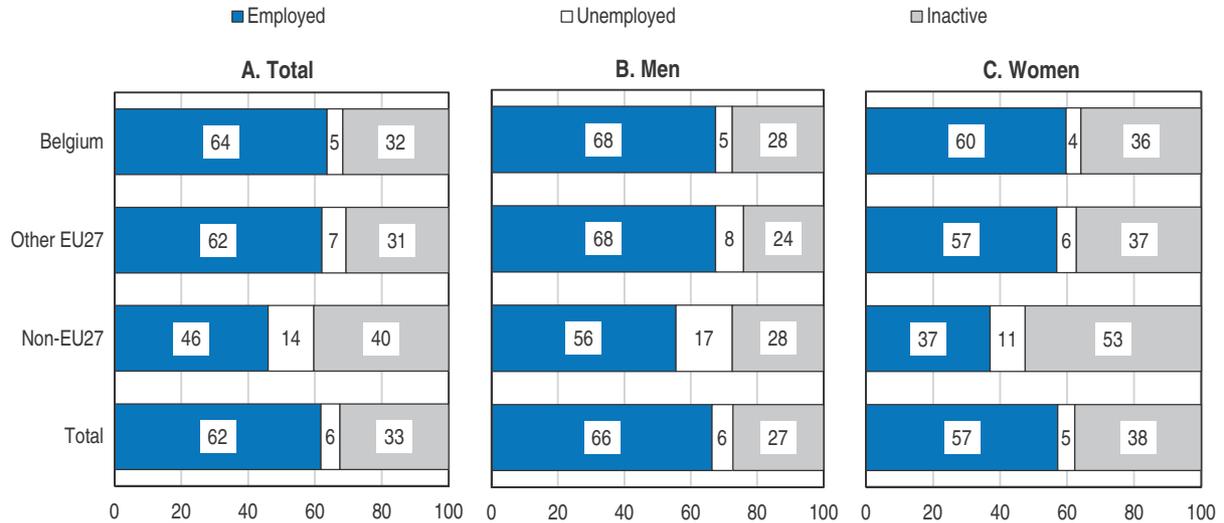
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social and cultural diversity among students, help explain why the native-born offspring of immigrants in Belgium also has an internationally low employment rate, especially when both parents (rather than only one) were born abroad (OECD, 2012a; De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

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

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

Employment status by country of origin and gender, age 15-64, per cent, 2013¹



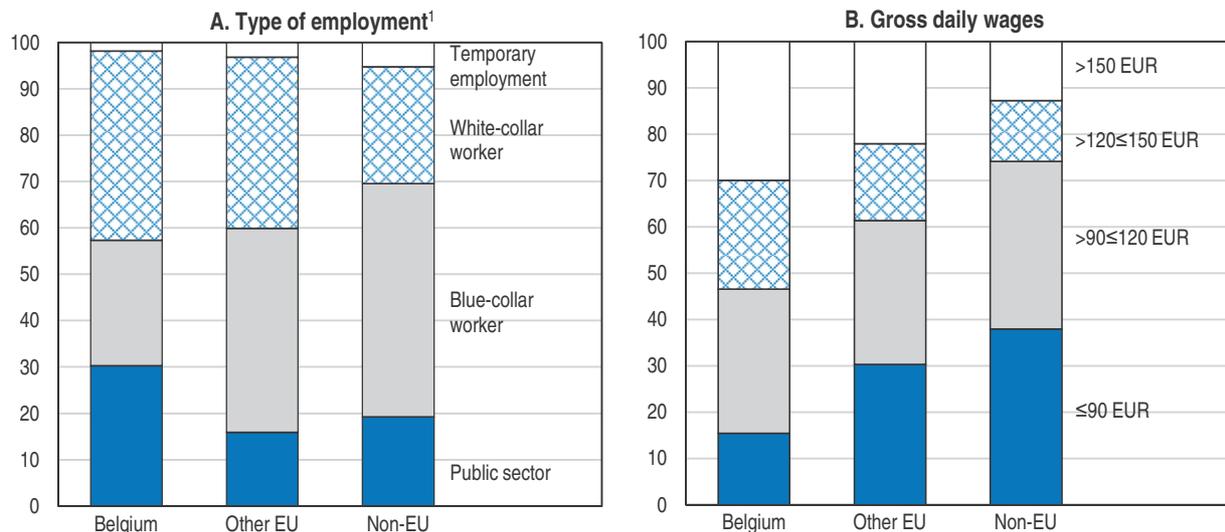
1. Numbers may not add up to 100 due to rounding.

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

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Figure 16. Immigrants have poorer job characteristics

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



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

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

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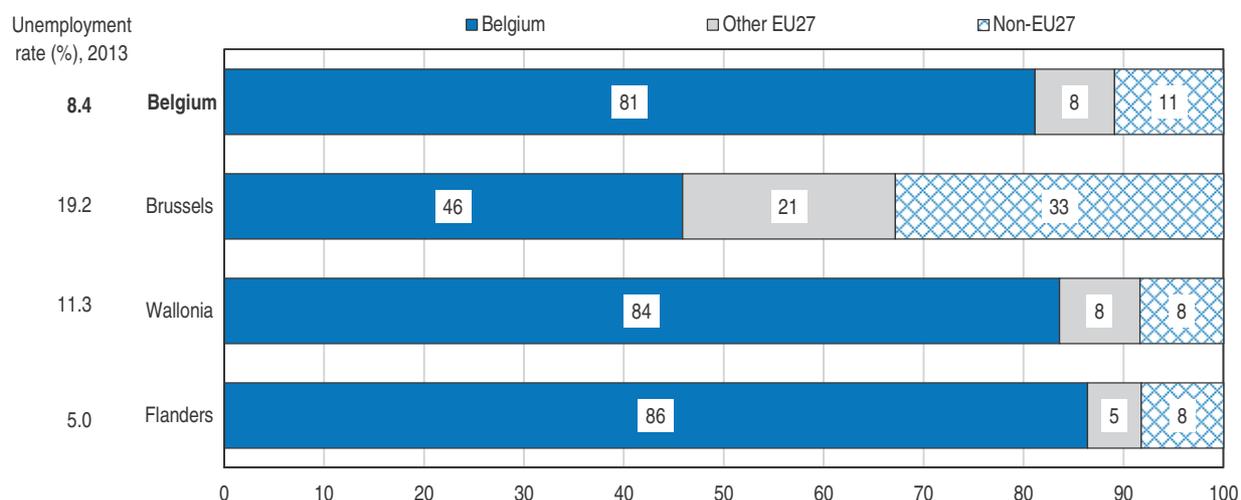
in Brussels (Figure 17), which, despite its high unemployment rate, receives most newcomers due to network effects. Immigrants would be the first to benefit from improved competitiveness and overall better labour market functioning. Being over-represented among low-educated workers, immigrants are highly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

There is scope to improve integration policies

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

Figure 17. Immigrants are highly concentrated in Brussels

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



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

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

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

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

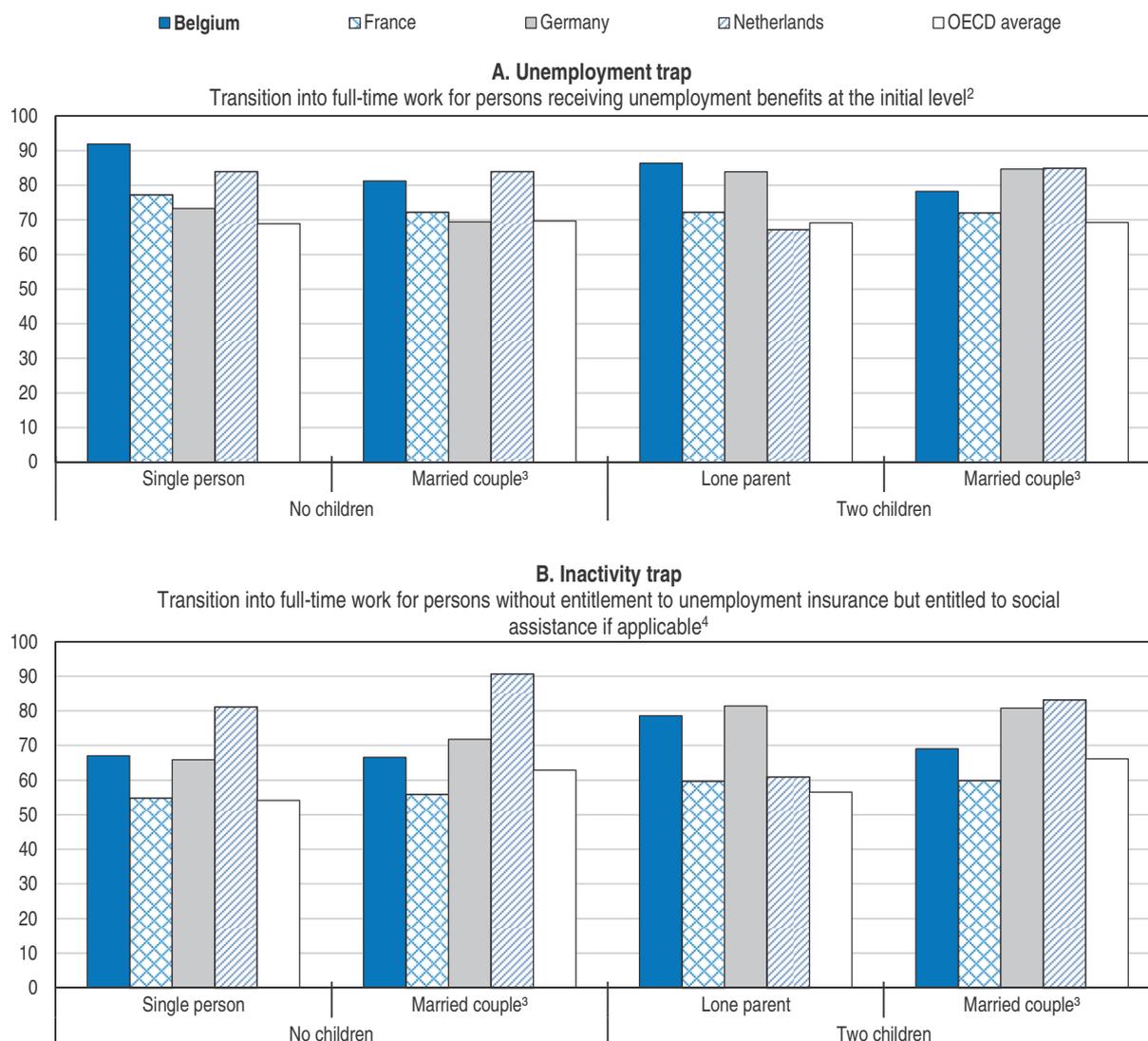
General labour market settings often reduce the employment prospects of immigrants

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

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

Figure 18. Unemployment and inactivity traps reduce work incentives

Participation tax rate for earnings equal to 67% of the salary of an average worker (AW), 2012¹



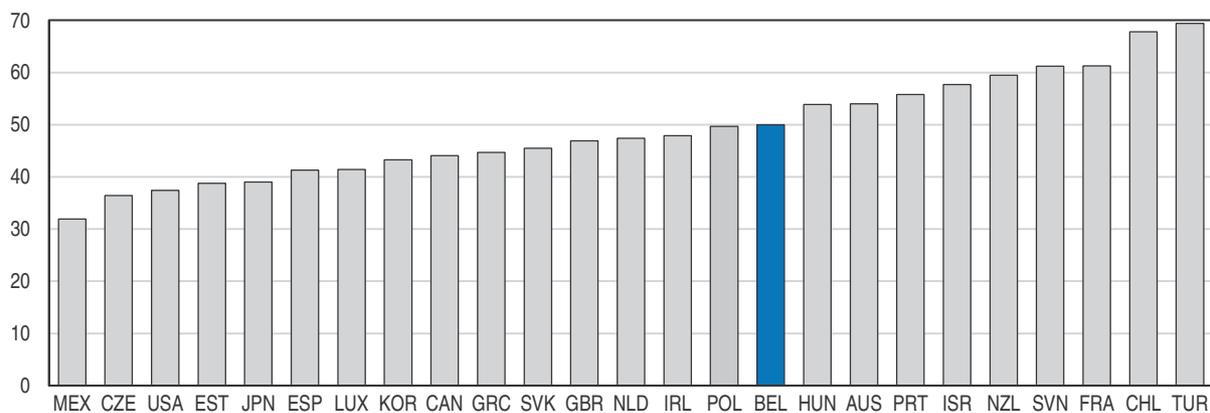
1. Participation tax rates measure the extent to which taxes and benefits reduce the financial gain of moving into work. The percentage of AW relates to the earnings from full-time employment of the individual moving into work. Calculations for families with children assume two children aged 4 and 6.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

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

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

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



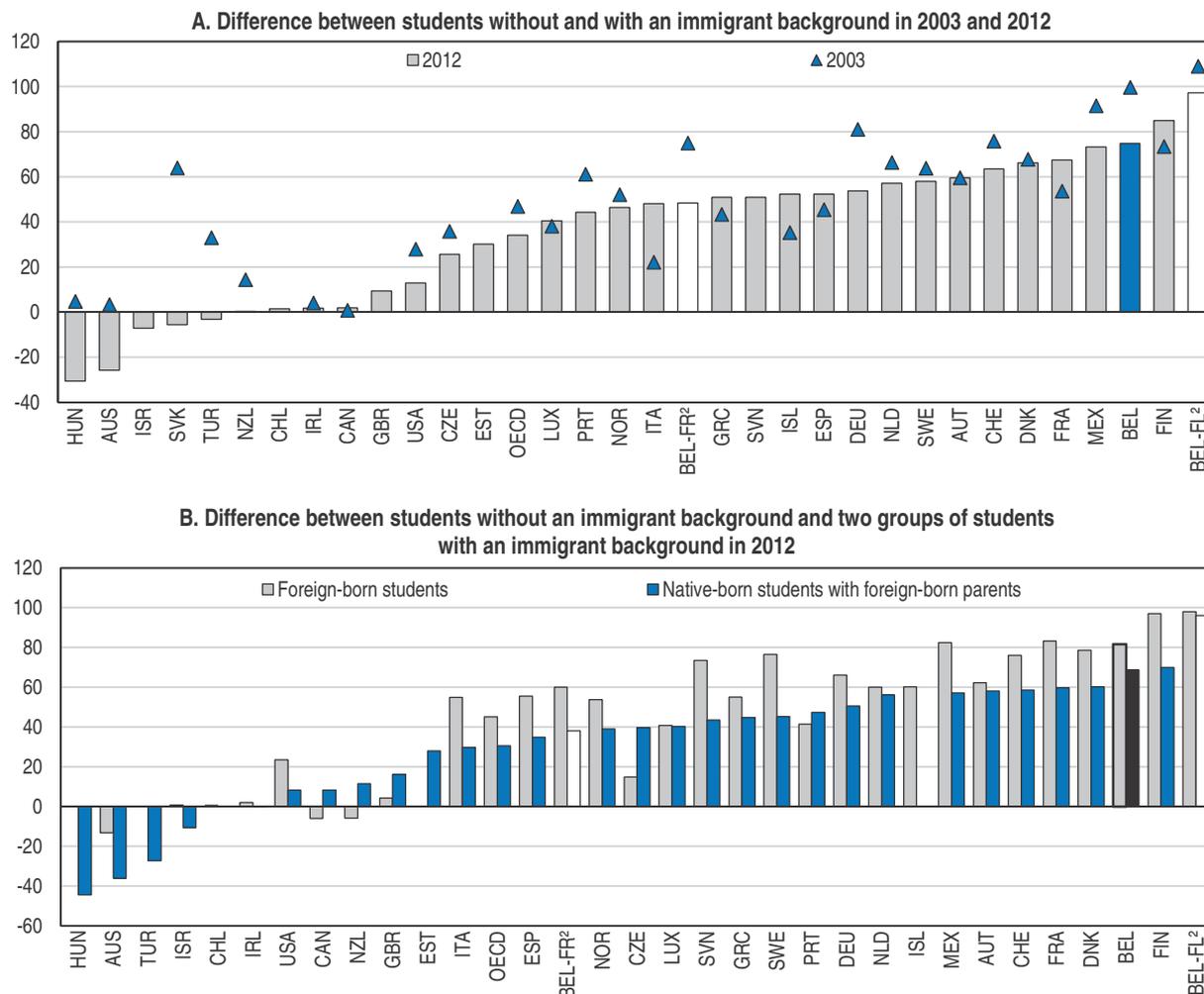
Source: OECD (2014), "Earnings: Minimum wages relative to median wages", *OECD Employment and Labour Market Statistics* (database), November.

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The educational outcomes of the children of immigrants need improvement

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

Figure 20. **Children of immigrants underperform by a wide margin**
Difference in the mean PISA score for mathematics performance relative to immigrant background¹



1. PISA: Programme for international student assessment. Students with an immigrant background are those whose parents were born in a country/economy other than the country/economy of assessment.
 2. BEL-FR: French Community; BEL-FL: Flemish Community.
- Source: OECD (2013), *PISA 2012 Results: Excellence Through Equity: Giving Every Student the Chance to Succeed (Volume II)* and national authorities.

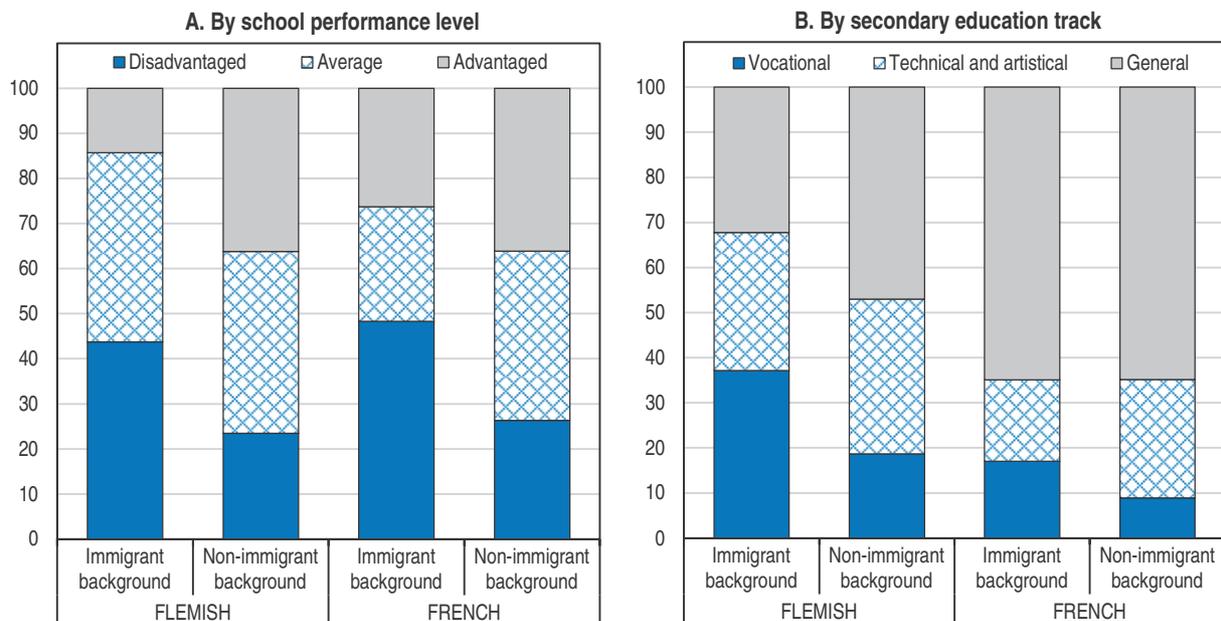
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schools. Preliminary evidence available for Ghent primary schools suggests that this reform has led to less segregation (Verhaeghe and Goetmaeckers, 2013). Reforms along these lines, which strike a balance between free choice and the promotion of social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

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

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

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



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

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

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

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

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

Recommendations to improve the labour market integration of immigrants

Key recommendations

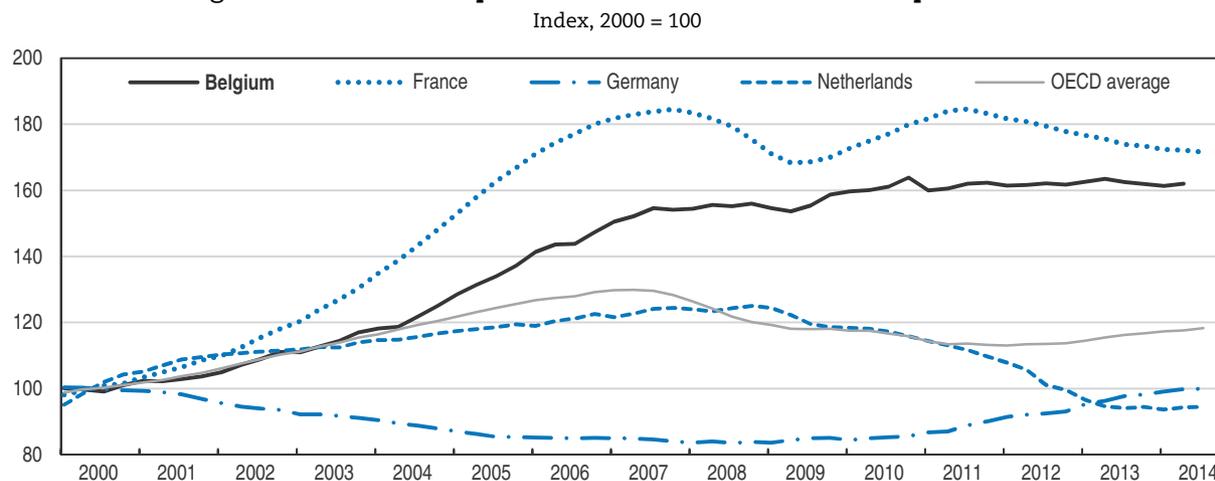
- Monitor and, where needed, reform school enrolment to reduce concentration of disadvantaged students in particular schools. Improve teacher training and incentives to attract more qualified and experienced teachers to disadvantaged schools.
- Proceed with reforms to reduce grade repetition and delay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

Additional recommendations

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

Maintaining an efficient and equitable housing market

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

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

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

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

The housing market is overvalued, but related risks seem low

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

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

Housing affordability is deteriorating, especially for vulnerable groups

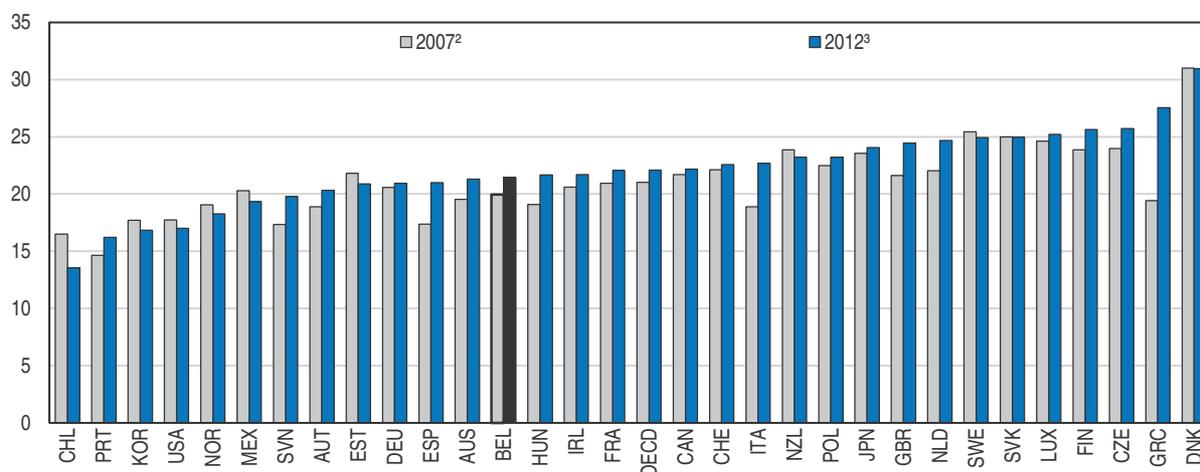
Between 2007 and 2012, household spending on housing rose from 20% of disposable income to 21.4% (Figure 23), which is just below the OECD average. Nevertheless, around 11% of the population live in a household that spends more than 40% of its disposable income on housing. During recent years, affordability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

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

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

Figure 23. **Household spending on housing has increased moderately¹**

As a percentage of net disposable income



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

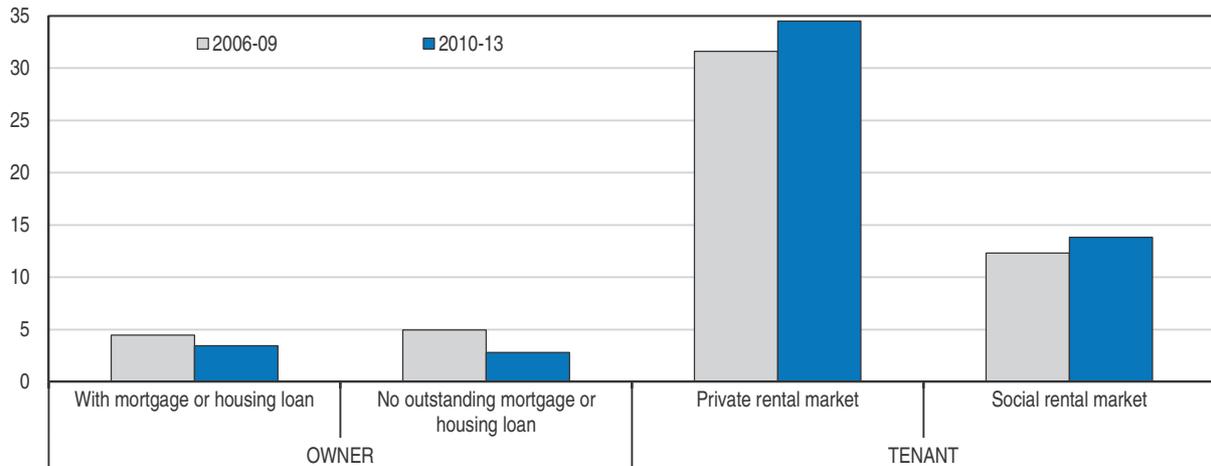
2. 2008 for Chile.

3. 2011 for Greece, New Zealand and Switzerland.

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

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Figure 24. **Tenants are most affected by housing cost**
Housing cost overburden, per cent of relevant population¹

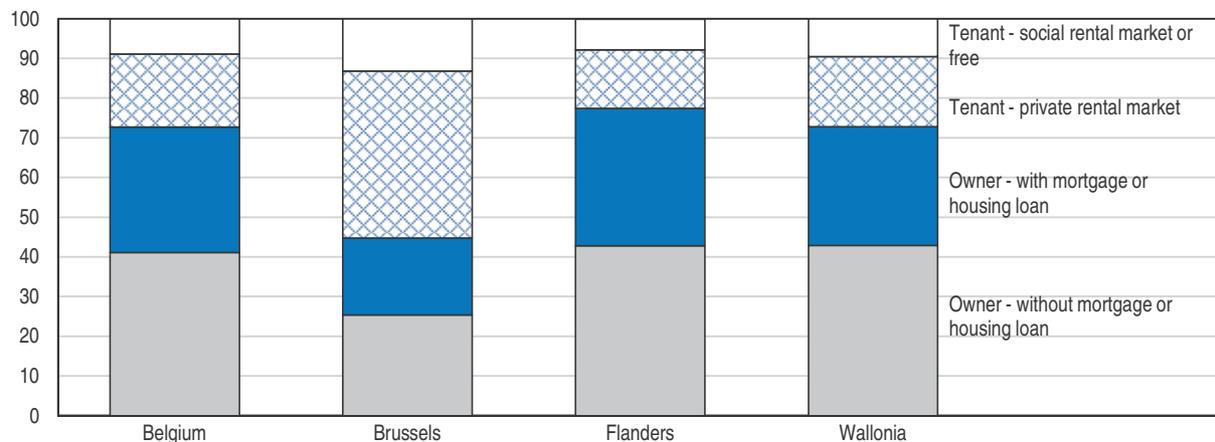


1. Share of people living in a household that spends over 40% of disposable income on housing.

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

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



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

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

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

Strengthening the rental market requires a shift in public support

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

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

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

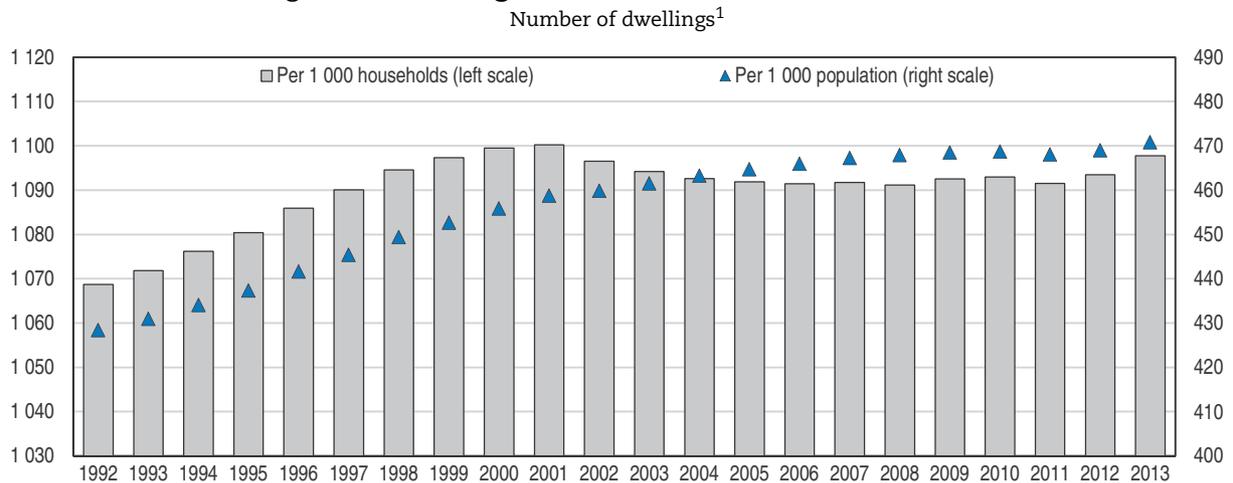
The shift in public support towards the rental market should be complemented by increased efforts to raise the supply of private rental housing, especially at the lower end of the market. Broadening the allowance scheme would already raise the supply of rental housing, as many potential landlords are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

The housing stock needs densification and greening

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

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

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



1. Number of households for latest years is estimated.

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

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

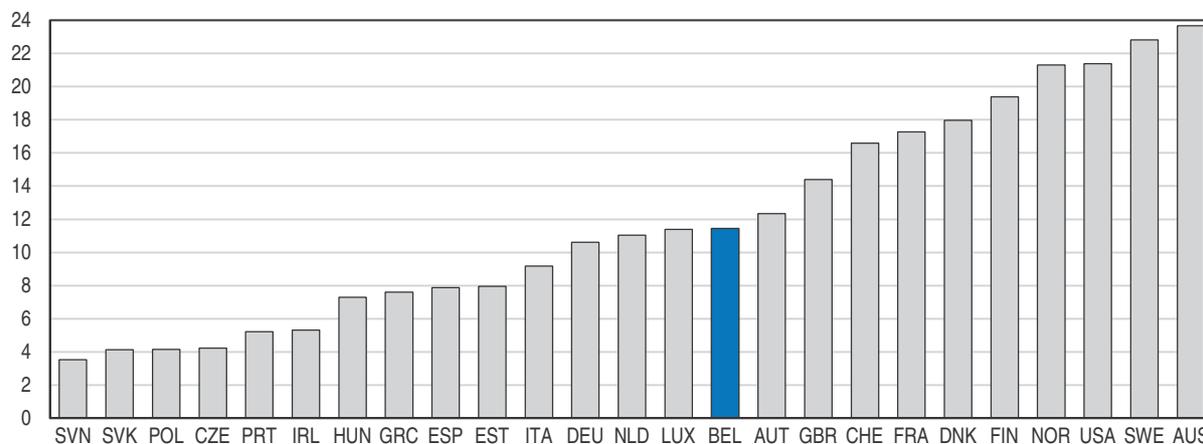
Dwellings in Belgium are relatively old (Andrews et al., 2011) and many are detached, and as a result the residential sector remains energy intensive despite recent improvements (Cassilde, 2014). Federal support for energy efficiency improvements has been streamlined by phasing out all measures except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

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

The allocation of housing can be improved

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

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



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

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

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

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

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

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

Recommendations to maintain an efficient and equitable housing market

Key recommendations

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

Additional recommendations

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

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ANNEX

Progress in main structural reforms

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

Fiscal sustainability

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

Labour market

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

Health care

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

Infrastructure

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

Chapter Summaries

Chapter 1

Improving the labour market integration of immigrants

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

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

Chapter 2

Maintaining an efficient and equitable housing market

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

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

The economic situation and policies of Belgium were reviewed by the Committee on 24 November 2014. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 5 December 2014.

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

The previous Survey of Belgium was issued in May 2013.

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