



ISSN 1725-3209

# EUROPEAN ECONOMY

Occasional Papers 99 | July 2012

## Macroeconomic imbalances – Belgium



*Economic and  
Financial Affairs*

**Occasional Papers** are written by the Staff of the Directorate-General for Economic and Financial Affairs, or by experts working in association with them. The “Papers” are intended to increase awareness of the technical work being done by the staff and cover a wide spectrum of subjects. Views expressed do not necessarily reflect the official views of the European Commission. Comments and enquiries should be addressed to:

European Commission  
Directorate-General for Economic and Financial Affairs  
Publications  
B-1049 Brussels  
Belgium  
E-mail: <mailto:Ecfm-Info@ec.europa.eu>

#### Legal notice

Neither the European Commission nor any person acting on its behalf may be held responsible for the use which may be made of the information contained in this publication, or for any errors which, despite careful preparation and checking, may appear.

This paper exists in English only and can be downloaded from the website [ec.europa.eu/economy\\_finance/publications](http://ec.europa.eu/economy_finance/publications)

A great deal of additional information is available on the Internet. It can be accessed through the Europa server ([ec.europa.eu](http://ec.europa.eu))

ISBN 978-92-79-22880-3  
doi: 10/2765/21413

© European Union, 2012  
Reproduction is authorised provided the source is acknowledged.

European Commission  
Directorate-General for Economic and Financial Affairs

## Macroeconomic imbalances – Belgium

## ACKNOWLEDGEMENTS

This report was prepared in the Directorate-General for Economic and Financial Affairs under the direction of Servaas Deroose, Deputy Director-General, Matthias Mors and Anne Bucher, Directors.

The main contributors were Matthias Mors, Johan Baras, Barbara Kauffmann, Javier Yaniz Igal, Jean-Luc Annaert, Fabrizio Melcarne, An Renckens and Henk van Noten.

Other contributors were Maria Demertzis, Ines Drumond, Jonas Fischer, Aurora Mordonu, Fabiana Pierini, Dominique Simonis, Alessandro Turrini and Stefan Zeugner. Laura Fernandez Vilaseca provided statistical assistance.

Comments on the report would be gratefully received and should be addressed to:

Barbara Kauffmann  
European Commission  
BE-1049 Brussels  
[Barbara.Kauffmann@ec.europa.eu](mailto:Barbara.Kauffmann@ec.europa.eu)

The cut-off date for this report was 27 May 2012.

# CONTENTS

Executive summary and conclusions.....	3
1. Introduction .....	5
2. Macroeconomic situation and potential imbalances .....	6
2.1. Macroeconomic scene setter.....	6
2.2. Assessment of the existence of external imbalances .....	6
2.2.1. Description of the evolution of the current account.....	7
2.2.2. Geographical and technological specialization.....	8
2.2.3. Import content of exports.....	9
2.2.4. A closer look to the evolution of market shares .....	10
2.2.5. Cost competitiveness .....	11
2.2.6. Unit labour costs analysis .....	12
2.2.7. Costs of intermediary inputs.....	14
2.2.8. Non-cost competitiveness.....	15
2.2.9. Conclusion on external imbalances .....	18
2.3. Existence of internal imbalances .....	19
2.3.1. Public sector indebtedness.....	19
2.3.2. Private sector indebtedness.....	21
2.3.3. Financial position of households .....	23
2.3.4. The financial sector .....	25
2.3.5. Conclusions .....	26
3. In-depth analysis of selected topics .....	27
3.1. The role of services.....	27
3.2. Impact of the wage setting mechanism on cost competitiveness in Belgium .....	28
4. Policy challenges .....	32



## EXECUTIVE SUMMARY AND CONCLUSIONS

This in-depth review takes a broad view of the Belgian economy with a view to identifying actual or potential imbalances and the possible macroeconomic risks which they may entail. Although the Belgian economy has performed well before the crisis and has shown strong resilience thereafter, it is facing important challenges, related to a loss of external competitiveness and an increasing public debt after a substantial reduction of the latter over the last two decades. Still, Belgium's Net International Investment Position is positive as it reflects past surpluses of the current account.

The main findings of this review are:

- **The Belgian current account, although broadly in balance, represents an emerging risk given its negative trend.** This evolution results mainly from a decline in the goods balance, while the services balance has been improving. It remains unclear whether these developments point to a sustained transition towards a more services-oriented economy. Belgian exports of goods have lost ground not only with respect to the expanding world trade, but also with respect to other euro area countries and the euro area on average. At the same time, unit labour costs have been rising faster in Belgium than in its main trading partners (NL, FR, DE) and the euro area as a whole. Furthermore, the competitiveness of Belgian firms is hampered by higher than EU average costs of intermediary inputs, which mainly reflect relatively weak competitive pressures, especially in the retail sector and in network industries (electricity, gas and telecom). Moreover, the products' technological content (many low-to-medium technology goods) of its exports makes Belgium more sensitive to competition from low-wage countries, while their geographical specialization (neighbours and other euro area countries) implies a slower market growth. The relative weakness of Belgian goods exports can also be attributed to the decline in the number of exporting firms, which decreased by 8% between 2000 and 2007. Furthermore, R&D expenditure, which is crucial for innovation, only reached 2% as compared to the 3% of GDP Europe 2020 target, with most private R&D taking place in foreign-owned firms. Finally, rigidities in the labour market (including through the wage setting system and disincentives to work from the existing tax and benefit system), also play a role.
- **The high level of gross (non-consolidated) private-sector debt does not seem to point to emerging risks in view of the relatively low net (consolidated) level.** The divergence between non-consolidated and consolidated private debt levels is largely explained by the high credit provision among companies, which is partly related to advantageous tax regimes. Nevertheless, the potential impact on the economy of a sudden unwinding of tax policies and the concomitant elimination of intra company loans could be significant. Conversely, household indebtedness is relatively low and mostly related to mortgage debt, while the household savings rate is high.
- **The trend reversal of public debt is a matter of concern.** Given the high and increasing public debt level, and notwithstanding that the economy as a whole is in a net lending position, the Belgian public sector remains vulnerable to market pressure.
- **The strong interplay between the Belgian sovereign and the banking sector poses a risk.** The high levels of state guarantees granted to the financial sector and possible needs for bank recapitalization could have an important impact on public debt. On the other hand, Belgian banks could be negatively impacted by their large holdings of domestic government bonds, which exposes them to a significant sovereign debt.

In this context, **the in-depth review concludes that Belgium is experiencing macroeconomic imbalances, which are not excessive but need to be addressed.** In particular, macroeconomic developments in the areas of external competitiveness of goods and indebtedness, especially concerning the high level of public debt, deserve further attention so as to reduce the risk of adverse effects on the functioning of the economy.

The policy response to strengthen cost-competitiveness could include measures to improve the functioning of the system of wage formation and to enhance competition in the network industries, particularly in energy markets. Possible measures to improve non-cost competitiveness include the

promotion of investment in R&D and in the information and telecom area, ensuring efficient goods and services markets, by strengthening competition and revising regulatory barriers, enhancing the adjustment capacity of the labour market in order to improve labour reallocation and increase labour force utilisation. Finally, decisive implementation of measures to consolidate public finances is needed to put public debt on a steadily decreasing path again and to mitigate pressure in the sovereign debt market. This would also alleviate the risk for banks with large holding of domestic government bonds.

## 1. INTRODUCTION

On 14 February 2012, the European Commission presented its first Alert Mechanism Report (AMR), prepared in accordance with Article 3 of Regulation (EU) No. 1176/2011 on the prevention and correction of macroeconomic imbalances. The AMR serves as an initial screening device helping to identify Member States that warrant further in depth analysis to determine whether imbalances exist or risk emerging. According to Article 5 of Regulation No. 1176/2011, these country-specific “in-depth reviews” should examine the nature, origin and severity of macroeconomic developments in the Member State concerned, which constitute, or could lead to, imbalances. On the basis of this analysis, the Commission will establish whether it considers that an imbalance exists and what type of follow-up in terms it will recommend to the Council.

For Belgium, the AMR suggested the need to look more closely at whether Belgium is exhibiting macroeconomic imbalances of an external and internal nature. On the external side, the AMR highlighted a long record of shrinking current account surplus which coincided with a loss in export market shares in recent years. On the internal side, the high levels of private and public debt were identified as a matter of concern.

Against this background, Section 2 of this review looks more in detail into these developments covering both the external and internal dimensions, followed by a specific focus on the role of services in the current account balance as well as other issues related to competitiveness, in Section 3. Section 4 presents policy considerations.



## 2. MACROECONOMIC SITUATION AND POTENTIAL IMBALANCES

### 2.1. MACROECONOMIC SCENE SETTER

**Between 1999 and 2007, real GDP in Belgium grew by 2¼% per year on average, slightly above the euro area average, but the economy started to lose momentum** in the course of 2007 as export growth slowed down in line with weakening external demand. As a small open economy, the country was strongly affected by the slump in world trade. From the beginning of 2008, domestic demand also gradually softened as a result of the sharp increase in inflation and the labour market deterioration. In the second half of 2008, the global financial crisis hit Belgium hard. Despite showing resilience during the crisis, the Belgian economy did not fully benefit from a rebound in global activity due to the loss of competitiveness in recent years. According to the Commission services' 2012 Spring Forecast, GDP growth is projected to stagnate this year and to rebound to around 1¼% next year.

With respect to public finance developments, public debt has been on a steady downward path between 1993 (134.1% of GDP) and 2007 (84.1% of GDP)<sup>1</sup>. This substantial decline was essentially due to high – albeit decreasing – primary surpluses. The reduction of the debt ratio also benefited from declining interest rates. **Between 2007 and 2011, the public debt increased again, from 84.1% to 98.0% of GDP.** This was partly a result of the operations to stabilize the financial system, which amounted to more than 8% of GDP. Furthermore, in response to the intensification of the crisis and in line with the European Economic Recovery Plan, the government adopted expansionary fiscal measures. Due to these measures - half of which were of permanent nature - and the impact of the automatic stabilizers, the general government headline deficit increased sharply to 5.6% of GDP in 2009, compared to 1.0% of GDP in 2008. The public debt is projected to remain just above 100% of GDP at the end of 2013.

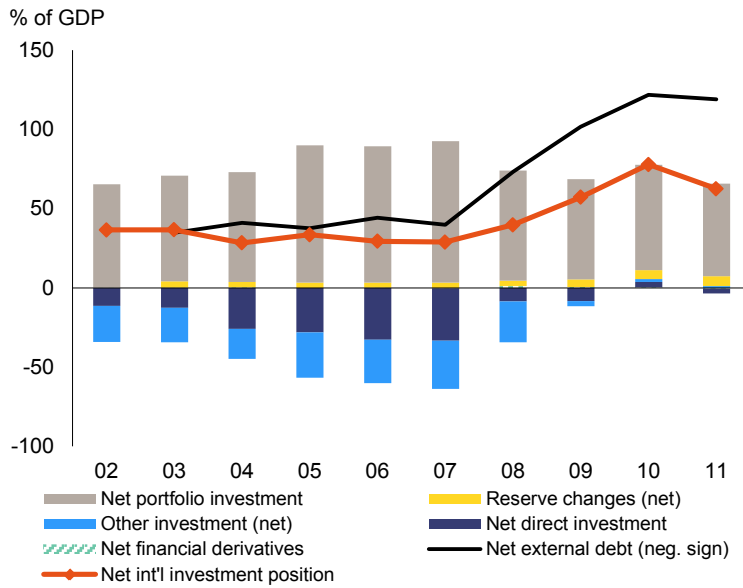
### 2.2. ASSESSMENT OF THE EXISTENCE OF EXTERNAL IMBALANCES

**The current account deteriorated gradually, but steadily, during the last decade.** This evolution results mainly from a decline in the goods balance, while the services balance has been improving. Belgian exports of goods have lost ground with respect to the expanding world trade, and they have grown less than the exports of other euro area countries and the euro area on average. The question is whether these evolutions point to a transition towards a more services-oriented economy. While the productivity level is still high (among the highest in Europe), productivity growth is increasing among the slowest in the EU (although in line with declining productivity growth also observed in the neighbouring countries). Although the indicator on unit labour costs (ULC) is not flashing in the scoreboard, it is very close to the benchmark level. Indeed, Belgium's cost competitiveness has been deteriorating the last decade, as ULCs have been increasing faster than in Belgium's main trading partners (NL, FR, DE) and the euro area on average. Despite these negative developments, the Net International Investment Position (NIIP) of the country is positive and has been on a growing trend since 2007 (see Graph 1).

---

<sup>1</sup> The assumption of the national railway company's debt in 2005 caused a temporary slowdown of the downward trend.

**Graph 1: Decomposition of Net IIP**

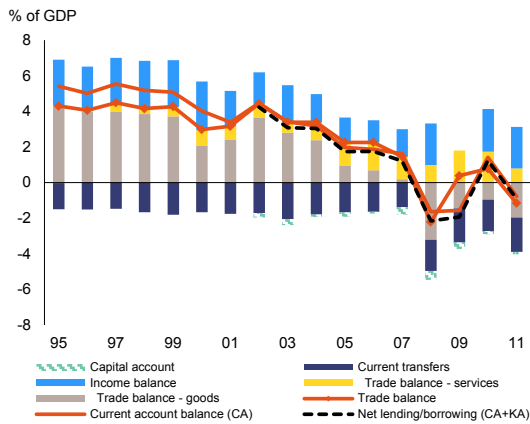


Source: Commission services

**2.2.1. Description of the evolution of the current account**

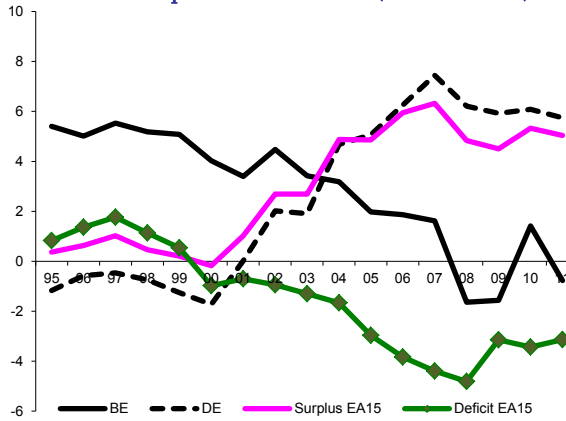
As can be observed in Graph 2, while between 1995 and 1999 the current account generated surpluses of more than 5% of GDP (BoP definition), this positive outcome gradually eroded and the current account even turned negative in 2008 and 2009 (about -1.6% of GDP in both years). It bounced back to into positive territory in 2010 (1.4% of GDP)<sup>2</sup>, but turned negative again in 2011 (-0.8% of GDP). Moreover, although the starting point is around 5pp of GDP higher, the downward evolution (trend) of the Belgian current account is similar to that of the euro-area so-called "deficit" countries<sup>3</sup> (see Graph 3).

**Graph 2: Evolution of the current account balance (BoP definition)**



Source: Commission services

**Graph 3: Evolution current account balance BE versus deficit and surplus Member States (BoP definition)**



Source: Commission services

The bulk of this deterioration can be attributed to the declining surplus in the trade balance for goods, which turned into a deficit in 2008. The decline in the goods balance from a surplus of 4.3% of GDP in 1995 to a deficit of 2.0% of GDP in 2011 was only partly compensated by the gradual improvement of the services balance, which reached a surplus 0.8% in 2011. Moreover, the deficit in current transfers

<sup>2</sup> According to the national accounts definition, the same trend can be observed although the current account remained in surplus even in the crisis years 2008 and 2009. While between 1993 and 2004 the current account according to national accounts definition fluctuated between 4% and 6%, this surplus gradually eroded and fell below the 1% of GDP level, while it is currently fluctuating around 2% of GDP.

<sup>3</sup> IE EL ES FR IT CY MT & PT

(which reflects the transfers from immigrants abroad as well as the fact that Belgium is a net contributor to the EU budget) became somewhat larger since 1995<sup>4</sup> while the positive balance of net primary income has remained almost every year in positive territory, largely explained by the comfortable net international investment position of the country. Projections for the next two years point to a small surplus position.

In sum, rather than the level of the current account, broadly in balance or positive, the main source of concern, is its downward trend over the past years. A related issue is whether the services sector would be able to (partly) offset the negative trend of the goods balance.

### 2.2.2. Geographical and technological specialization

**Belgian exports consist largely of low-to-medium technology goods that are traded with its neighbours or other euro area countries** (see also below: non-cost competitiveness). Table 1 indicates that while the share of high-tech products increased between 2000 and 2011, it remains below 20% of total exports, implying that Belgium continues to be rather specialized in low-to-medium-tech goods. However, the situation does not seem to differ substantially from the performance of the euro area.

**Table 1: Pattern of manufacturing exports by technological content (in %)**

		2000	2011
<b>Belgium</b>	High technology	14.1	18.0
	Medium-high technology	41.2	39.2
	Medium-low technology	19.9	24.2
	Low technology	24.8	18.6
<b>Euro area</b>	High technology	22.5	19.6
	Medium-high technology	39.8	40.4
	Medium-low technology	16.8	21.5
	Low technology	20.9	18.4
<b>Germany</b>	High technology	20.5	18.8
	Medium-high technology	49.9	50.5
	Medium-low technology	15.3	17.4
	Low technology	14.3	13.3
<b>France</b>	High technology	31.5	26.2
	Medium-high technology	35.7	35.8
	Medium-low technology	14.7	18.0
	Low technology	18.1	20.1
<b>The Netherlands</b>	High technology	34.3	27.3
	Medium-high technology	26.2	28.4
	Medium-low technology	18.2	25.1
	Low technology	21.4	19.2

Source: Commission services

Note: Manufacturing exports and imports broken down (%) by tech categories

Technology taxonomy - according to Eurostat and OECD classification

HT = DG244 + DL30 + DL32 + DL33 + DM353

MHT = (DG24 - DG244) + DK29 + DL31 + DM34 + DM352 + DM354 + DM355

MLT = DF23 + DH25 + DI26 + DJ27 + DJ28 + DM351

LT = DA15 + DA16 + DB17 + DB18 + DC19 + DD 20 + DE21 + DE22 + DN36

As to its geographical specialisation, 60% of Belgian exports are oriented to euro area countries (with the largest share – 50% of total exports and 80% of euro area exports – going to the neighbouring countries NL, FR, DE), while exports to more dynamic markets such as the BRIC countries (Brazil, Russia, India, China) remain weak, although the share of trade directed to these countries more than doubled since 2000 (exports to BRIC countries increased from 3.2% to 6.6% of total trade). In comparison, over the same period the share of trade to BRIC countries for the euro area increased from 3.0% to 7.7% in 2011. Therefore, while geographical (euro area oriented, see Table 2) and product specialisation (high share of low to medium technology goods) seem to play a role in explaining the decline in the current account balance, it cannot be seen as the only cause behind the weaker export performance.

<sup>4</sup> According to the national accounts definition the deterioration of the deficit in current transfers was larger, declining from -0.7% of GDP in 1995 to -1.3% in 2010.

Table 2: Belgian exports: main trading partners (in %)

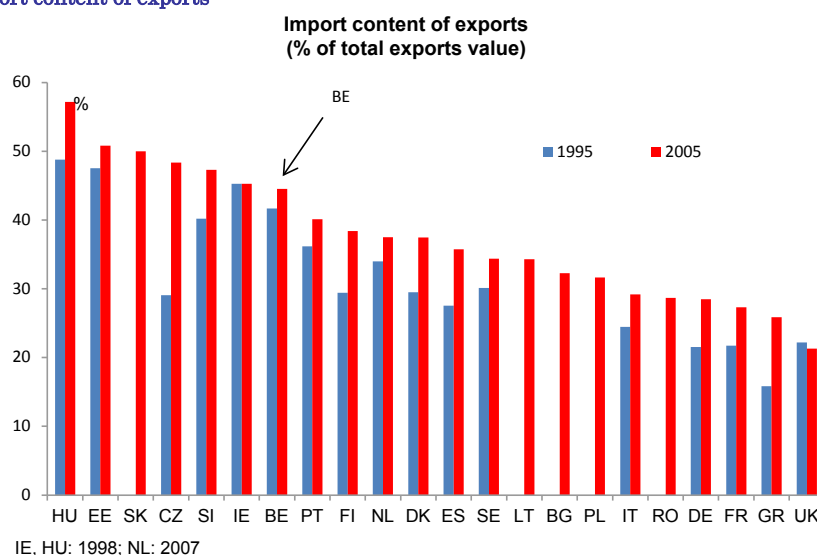
	2000	2010
<b>Total</b>	100	100
<b>EU27_INTRA</b>	79.67	74.22
<b>EU27_EXTRA</b>	20.33	25.78
<b>DE</b>	17.53	19.22
<b>FR</b>	18.30	16.39
<b>NL</b>	12.91	11.37
<b>UK</b>	10.44	7.42
<b>US</b>	5.99	6.20

Source: Commission services

### 2.2.3. Import content of exports

Another interesting element for the analysis of the evolution of the current account is the degree of integration of the Belgian economy in global value chains as part of the internationalisation of production processes<sup>5</sup>.

Graph 4: Import content of exports



Source: Commission services and own calculations

As presented in Graph 4, **compared to other countries, the import content of exports is rather high in Belgium** and has also increased between 1995 and 2005. This is partly related to the small size of the country but also to some features of the domestic production. For example, the automotive sector in Belgium is well known for being a place of assembly of parts coming from various countries.

Specifically, in Belgium **46% of all imports of intermediate inputs are due to the production of the following manufacturing sectors**: food products and beverages; basic metals; motor vehicles, trailers and semi-trailers; coke, refined petroleum products and nuclear fuels; and chemicals, chemical products and man-made fibres. These sectors are particularly intensive in the use of imported intermediate inputs. For example, 62% of the value of gross production of the motor car industry corresponds to the use of imported inputs of production. In the case of basic metals, imported intermediate inputs account for 46% of the value of gross production.

The role of the foreign supply of inputs is apparent in the case of these and other industries; for example, 72% of the intermediate inputs in the motor car industry are of foreign origin. As expected, most (75%) of the import value of intermediate inputs corresponds to goods and the rest, 25%, to services, although this varies across industries. However, this may underestimate the role of services

<sup>5</sup> In this context, the use of input-output tables represents a powerful tool to determine the import content of exports. This approach measures the process of internationalisation of the Belgian economy via the, direct and indirect, purchase of intermediate inputs (both goods and services).

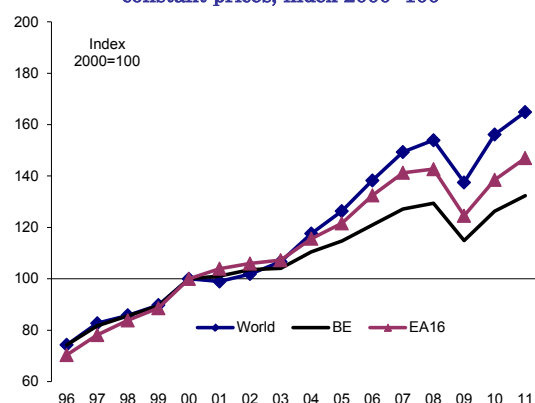
because these contribute also significantly to the production of intermediate goods in the respective countries of origin.

In conclusion, these data suggest that Belgium benefits from international trade by having access to a greater variety of production inputs, but it also implies that the evolution of competitiveness developments cannot be measured by looking only at the export performance, but also has to take into account the volume of imports used in the exporting activities.

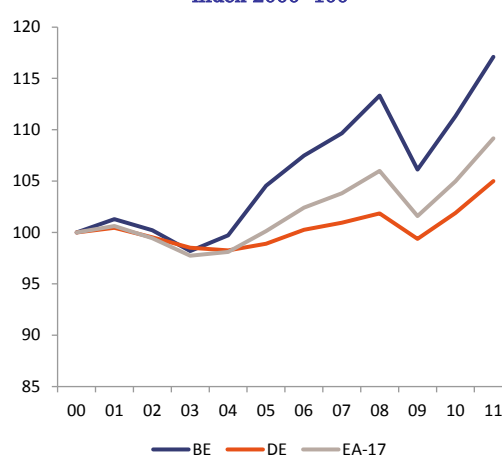
#### 2.2.4. A closer look to the evolution of market shares

Belgian exports have lost ground with respect to the expanding world trade, and they have grown less than the exports of other EA16 countries, especially Germany, without which Belgium would be close to the euro area average (see Graph 5).

**Graph 5: Evolution of exports of goods and services at constant prices, index 2000=100**



**Graph 6: Deflator of export of goods, index 2000=100**



Sources: Euro area and BE: Commission services; IMF: World Economic Outlook Database, April 2012

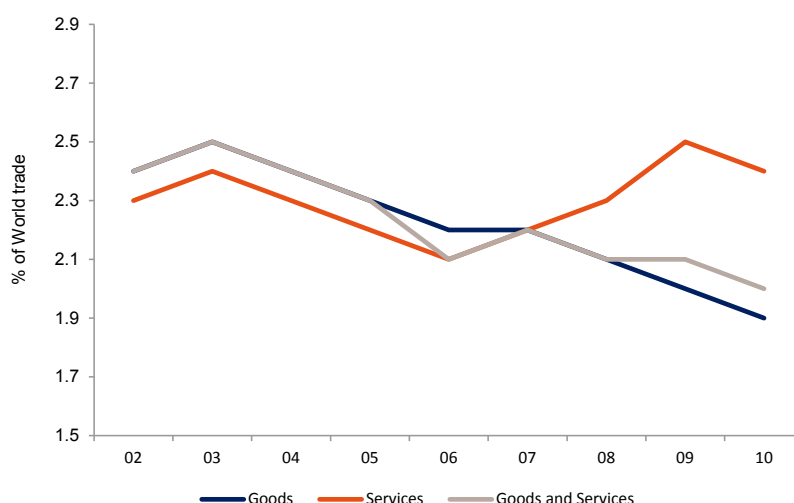
Source: Commission services

Among others factors, higher export prices (see Graph 6) than in the neighbouring countries are often singled out as the culprit for Belgium's worse trade performance compared to the euro area. By improving its cost competitiveness Belgium could thus improve its relative export position in the euro area.

The loss of export market shares is only relevant for goods, with a better performance of services. Indeed, while the 5-year change in export market share for goods and services is -15.4% (in 2010), the loss in export market share for goods is -20.1% while for services there is a gain of +4.5%, starting in 2006 (see Graph 7).

These trends regarding exports of goods and services might indicate a transition towards a more services-oriented economy. Services might be partially replacing goods as the main driver behind growth in Belgian international trade (see in-depth analysis in section 3.1). Even taking into account this positive element, the challenge of increasing the competitiveness of goods remain, given that export of services cannot be expected to fully occupy the space left by goods.

Graph 7: Balance of goods and services as percentage of world trade (BoP data)



Source: Commission services

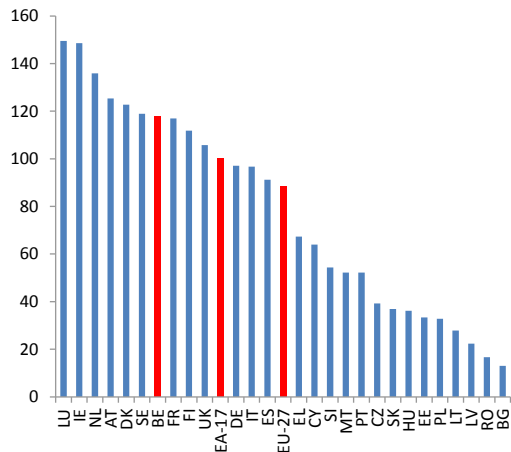
### 2.2.5. Cost competitiveness

The deterioration of the current account and the loss in export market shares in goods might be linked to declining cost competitiveness. Cost competitiveness is an important issue in Belgium for a number of reasons:

- Belgium is still specialized in low- and medium technology goods, for which price competition is higher (so that it is harder to pass on higher input costs to the final customer), in particular from low labour cost countries.
- Belgium is one of the countries with the highest tax wedge worldwide. An exceptionally important part of the wage cost consists of taxes and social security contributions that constitute on average more than 55% of total wage cost. The tax wedge is among the three highest in the EU (with Sweden and Denmark), at 50% for the low wage worker (37% at the EU27 average) and at 56% for the average wage worker (41% at the EU27 average). Also the statutory rate of corporate tax is high in BE compared to other euro area countries, even though tax credit mechanisms and the notional interest rate regime often substantially lower the tax burden for companies.
- Belgium's main trading partner, Germany, did considerable efforts regarding the reduction of labour costs from the mid-90s onwards, resulting in remarkable competitive advantage in international trade for German firms. Belgian companies could compensate for the wage difference through higher productivity growth or better quality or innovative products. However, Belgian productivity growth has been decelerating over the last years, while Germany is investing much more in R&D (3% compared to about 2% for BE).

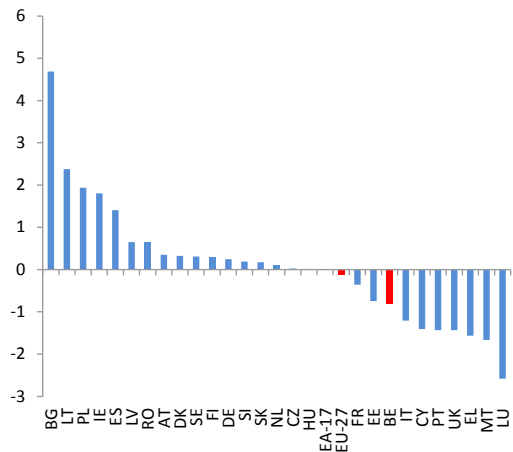
International comparison also shows that, while in terms of productivity levels Belgium belongs to the top EU countries, in terms of productivity growth, it is one of the worst performing countries (see Graph 9). Clearly, since it has become a strong job creation country, Belgium is no longer able to record the high productivity growth experienced in the 1970s and 1980s, which could to some extent warrant rapid wage increases. Although productivity growth is also subdued in Belgium's trading partners, especially in France and the Netherlands and constitutes a general challenge for euro area countries, this does not solve Belgium's competitiveness problem.

**Graph 8: Productivity levels in the EU (2011) – GDP per person employed - EA17=100**



Source: Commission services

**Graph 9: Productivity growth in the EU (2011) - GDP per person employed - EA17=100**

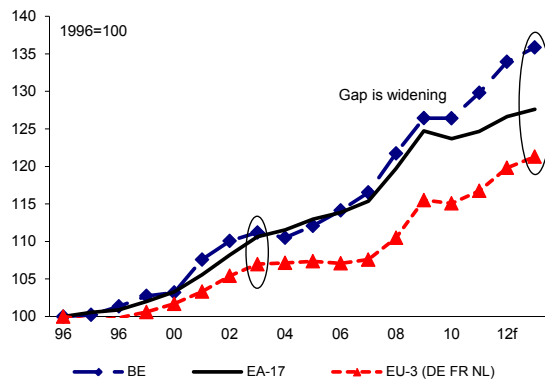


Source: Commission services

### 2.2.6. Unit labour costs analysis

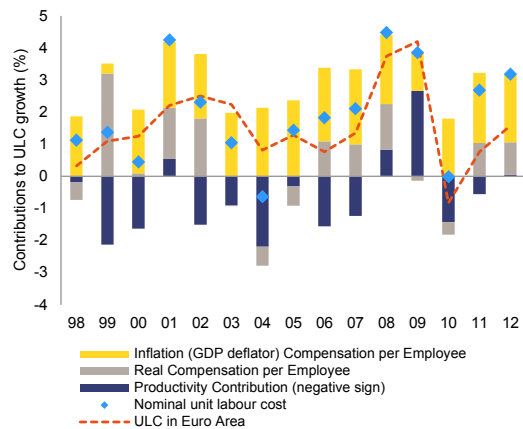
Although the indicator on ULC is not flashing in the scoreboard (8.5%), it is very close to the benchmark level (9%). Indeed, Belgium's cost competitiveness has been deteriorating over the last decade, as nominal ULCs have been increasing faster than in Belgium's main trading partners (NL, FR, DE) and the euro area (see Graph 10), especially since 2005.

**Graph 10: Evolution of nominal unit labour costs in the euro area, Belgium and the weighted average of its main trading partners**



Source: Commission services

**Graph 11: Components of Unit Labour Cost in Belgium**



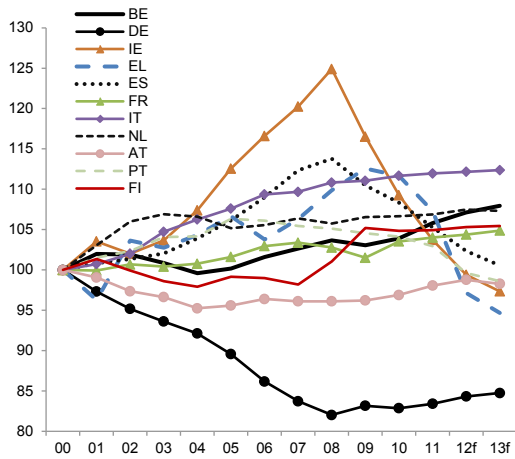
Source: Commission services

Belgium's REER (based on ULC both vis-à-vis the euro area as vis-à-vis a set of 35 IC) increased since the late 1990s (but not more than France's and less than that of the Netherlands), indicating that Belgium is losing cost competitiveness. This assessment needs to be somewhat qualified: when comparing with most other euro area member states, Belgium still shows an average performance (indeed Graph 12 and Graph 13 show that Belgium is broadly in the middle compared to its euro area peers). While Germany is performing significantly better (as well as Austria and Finland), France is behaving similarly as Belgium, while the Netherlands is performing slightly worse. Actually, as clearly shown by Graph 12 and Graph 13, the loss in competitiveness happened chiefly with respect to Germany<sup>6</sup>. Nevertheless, for a small open economy as Belgium it is important to keep pace with evolutions in its main trading partners, including Germany.

<sup>6</sup> In this context it should also be noted that a study performed by Prof. Paul De Grauwe indicates that the loss in Belgian competitiveness is not a structural phenomenon. See, P. De Grauwe (2010).

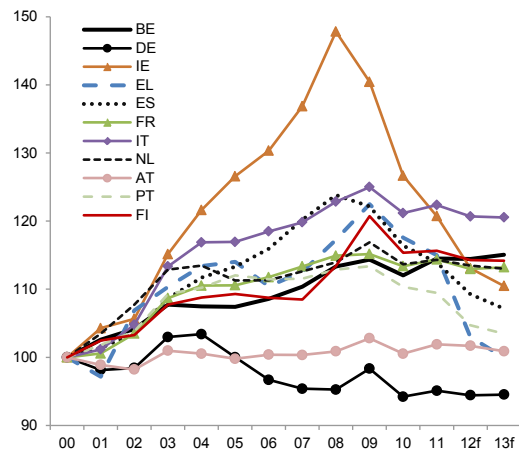


Graph 12: REER vis-à-vis (the rest of) EA17



Source: Commission services

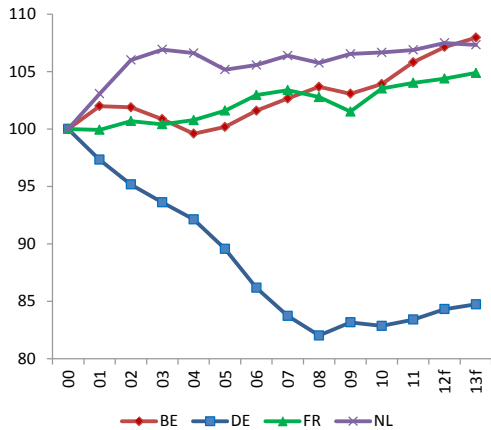
Graph 13: REER vis-à-vis IC35



Source: Commission services

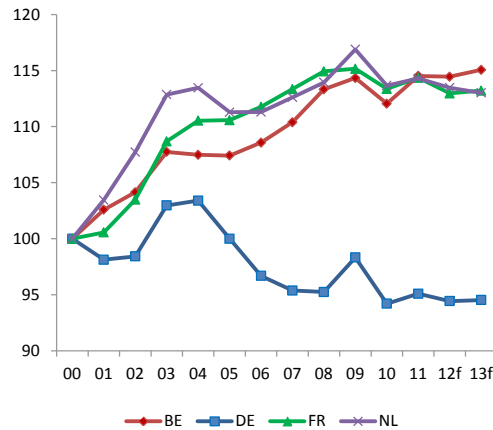
This assessment is confirmed by developments in relative ULCs vis-à-vis the EA3 (Graph 14) and the set of IC35 (Graph 15): Belgium is performing broadly in line with the Netherlands and France, while Germany is performing much better. In the case of Belgium it should be noted, however, that it is particularly since 2005 that ULCs have been increasing faster than in the neighbouring countries and in the euro area on average.

Graph 14: Relative ULC vis-à-vis euro area



Source: Commission services

Graph 15: Relative ULC vis-à-vis IC35



Source: Commission services

Table 3 decomposes (for the period 2000 - 2011) changes in real GDP, employment, productivity, wages, unit labour costs and hours worked in Belgium, its neighbouring countries (EU-3) and the euro area since 2000. The main conclusions that may be drawn from these data are the following:

- Since 2000, nominal wages rose on average around 1.5 times faster in Belgium than in the EU-3, while the difference with the euro area average was less prominent. Compared to Germany they increased more than twice as fast. As can be seen from the Table 3, the fact that wages rose more strongly in Belgium than in the EU-3 is mainly due to the German wage moderation.
- Over the same period, Belgium performed rather well in terms of output growth: the increase in real GDP was about the same as in the Netherlands but slightly stronger than in France, Germany and in the EU-3 as well as the euro area on average.
- As far as employment is concerned, over the period 2000 - 2011, Belgium clearly outperformed its neighbours as well as the average of the euro area. However, it is worth recalling that participation rates remain rather low.

- As a result, the rise in productivity in Belgium (as measured by real GDP per person employed) was lower than in neighbouring countries and even on average one of the lowest in the whole EU<sup>7</sup>. This represents a substantial change with respect to the 1970s and 1980s, when Belgium was typically a high-productivity growth / low job creation country.
- This slower rise in productivity is not a purely negative phenomenon since it mostly reflects a stronger employment growth (both stronger job creation and higher increase in hours worked). Moreover, as already stated, if productivity growth has been slow in recent years, productivity levels are still very high. However, this slower rise in productivity is also the main factor behind the faster rise in ULC from the beginning of this century, with the stronger wage increase reinforcing this development in recent years.

**Table 3: Comparison Belgium vis-à-vis the average of the 3 neighbouring countries and the euro area**

Year 2010 (index 2000=100)	BE	DE	FR	NL	EU-3*	EA-17
1. Nominal compensation per employee	132.8	114.6	133.0	141.8	124.2	129.8
2. Real gross domestic product (2005 market prices)	116.9	113.0	113.7	116.6	113.6	113.8
3. Employment, persons	110.6	104.3	105.7	106.2	105.0	106.6
4. Real gross domestic product per person employed	105.6	108.3	107.1	113.7	108.4	108.9
5. Nominal unit labour costs	125.7	105.8	124.2	124.8	114.6	120.8
6. Hours worked*	100.1	95.7	96.6	96.2	96.2	96.6

Source: Commission services. For BE figures refer to 2009.

\* DE, FR, NL

### 2.2.7. Costs of intermediary inputs

Although the wage bill is an important part of the total cost that companies have to face, cost/price competitiveness is more than only wages. Therefore, for Belgian companies to stay competitive, the price of intermediary inputs should also be kept under control. Nevertheless, the general price level in Belgium is higher than in the neighbouring countries and the euro area. As Belgium is an energy-intensive economy, the cost of energy and the high energy prices also impact on the competitiveness of Belgian companies.

This higher sensitivity in Belgium of the consumer price index to changes in prices of energetic basic materials can be attributed to a number of factors including (i) higher energy consumption by households (due to relatively big and badly insulated houses and the extensive use of (fiscal-friendly company) cars, (ii) relatively low excise duties on energy products (the excise duties on energy products are only lightly lower for oil in Belgium but much lower for natural gas and mainly for electricity, for which DE and NL charge much more), and (iii) the price setting mechanism for energy products<sup>8</sup>.

The weak export performance can therefore be partly attributed to deteriorating terms of trade, especially in 2008 but also in 2010 and 2011, as the price of basic energy materials (mainly petroleum products) has increased massively in recent years. Belgian producers often fail to pass on these higher input costs in the price of their products, especially when the price competition on the international market to supply the demand for their products is tough.

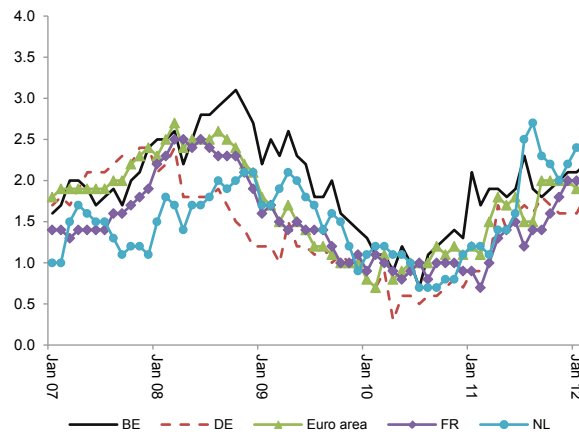
Despite the fact that energy is important (and a main driver of higher inflation in Belgium) it cannot be denied that in recent years Belgium also performs worse than its neighbours and the euro area in terms of core inflation (excluding energy prices and food prices, see Graph 16). Indeed, prices for many other

<sup>7</sup> This was already the case in the second part of the 1990s. See e.g. Federal Planning Bureau, (2010).

<sup>8</sup> According to the federal energy regulator, a reason for rising prices can be found in the monthly indexation of the energy component of electricity and gas bills, which is based on a formula that takes into account the prices of gas, coal and oil. Rising oil prices therefore have an impact on rising electricity and gas bills. The federal regulator believes that the monthly indexation of energy bills based on these parameters is not transparent and does not represent the real costs of supply. The subsequent recommendations advise the government to cap the indexation of the energy component of electricity and gas prices during a certain period of time, in order to be able to develop and implement a number of structural measures.

goods and services are higher in Belgium than in other Member States<sup>9</sup>. For one part this reflects relatively weak competitive pressures, especially in the retail sector, due to competition-restricting regulation, and in network industries (electricity, gas and telecom), due to high entry-barriers and dominant incumbent firms, and a weak supervisory framework. On the other hand, apart from the high weight of energy prices and weak competition, the higher inflation is also partly due to second-round effects induced by characteristics of the wage-setting mechanism in BE, in particular automatic wage indexation.

**Graph 16: Evolution of core inflation in Belgium, France, Germany, the Netherlands and the euro area**



Source: Commission services

### 2.2.8. Non-cost competitiveness

As stated above, there are a number of additional factors that also need to be taken into account when analysing the reasons behind the deterioration of the current account and the loss of market shares<sup>10</sup>. These factors are mostly related to the geographical and product orientations of exports, the ability to innovate and to increase efficiency, as well as the structure of the exporting firms. Labour market institutions and the bargaining structure may also play a role by influencing shifts in specialisation, with the risk of reducing relocation across sectors and twisting factor allocation towards low productivity sectors<sup>11</sup>. In Belgium, both the product composition and the geographical orientation of exports contribute to the explanation of the loss of export market shares.

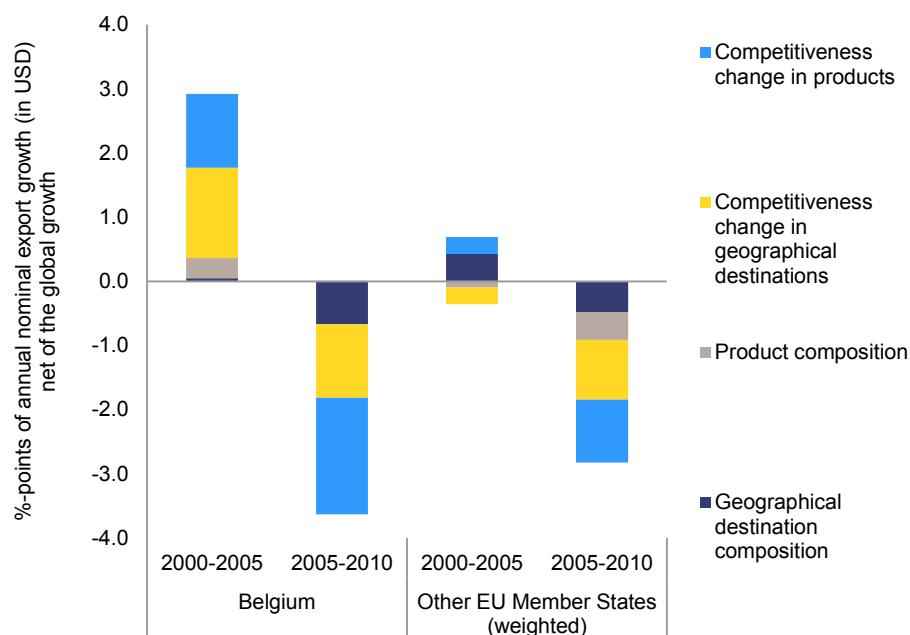
In terms of geographical orientation, there is too little emphasis towards fast-growing export markets - such as the new Member States in Central and Eastern Europe, China and Middle-East - and merely orientation toward less dynamic export markets, such as the neighbouring countries (with Germany, the Netherlands and France counting for about half of total exports) and other countries in the euro area (although it should be recognized that the Belgian exporters benefit indirectly from the new markets through their exports to Germany).

<sup>9</sup> See e.g. the report of the Belgian competition authority comparing prices in Belgian and Dutch supermarkets. This report indicates that products in Belgian supermarkets are about 10% more expensive than the ones sold in the Netherlands. SPF Economie (2012), "Niveau de prix dans les supermarchés". Available at: [http://economie.fgov.be/fr/binaries/etude\\_niveaux\\_prix\\_supermarches\\_tcm326-163021.pdf](http://economie.fgov.be/fr/binaries/etude_niveaux_prix_supermarches_tcm326-163021.pdf).

<sup>10</sup> A joint report by different Belgian institutions deals with the issue of non-cost competitiveness: see National Bank of Belgium, Central Economic Council (CCE) and Federal Planning Bureau (2011).

<sup>11</sup> The use of a shift-share analysis can contribute to the identification of the factors behind long-term declines in export market shares. The product composition and geographical composition effects reflect the impact of the initial export structure. The product composition effect shows whether the country's exports are specialised in sectors characterised by a dynamic world demand. The market composition effect shows whether the country's exports are oriented towards geographical destinations characterised by a dynamic world demand. The dynamic components showing whether the country has increased its market share in all countries and in all sectors show the competitiveness effect reflecting the changes in product composition and in geographical destinations of exports.

**Graph 17: Decomposition of nominal export market growth**

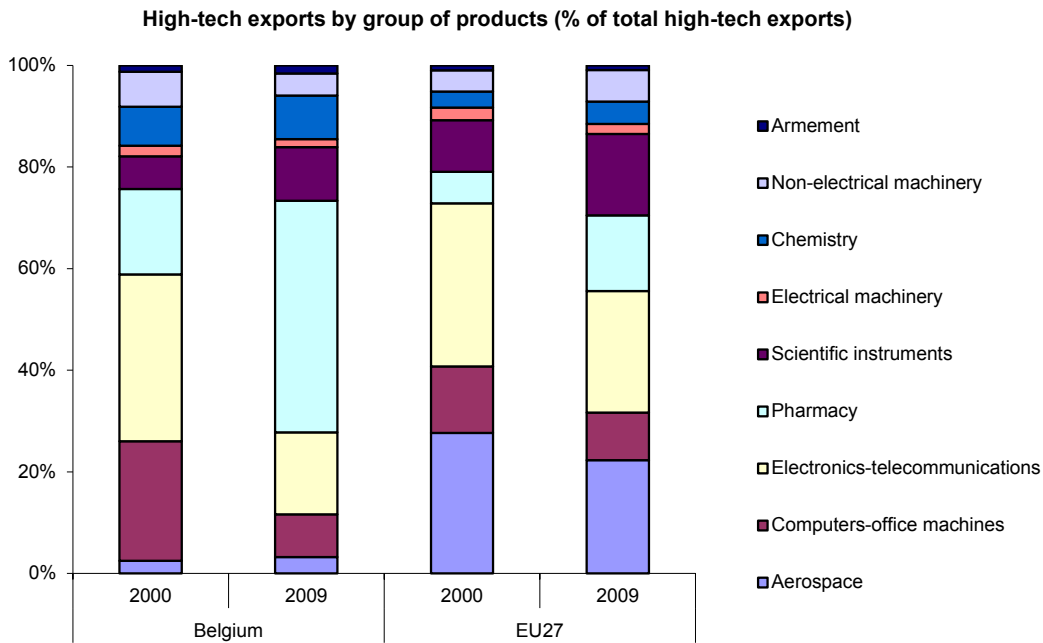


Source: COMTRADE and Commission services' calculations

In terms of product orientation, there is too little orientation towards export of high tech products. For low and mid tech products (such as chemicals, steel and car manufacturing) price competition from e.g. the new EU Member States is higher and therefore it is harder for Belgian exporters to stand firm in these markets. However, although the share of high-tech exports in total exports is lower than the euro area average, it has increased recently from less than 12% in 2000 to more than 18% in 2009, whereas the level in the euro area over the last decade was more or less stable at an average of 18.3%, which implies that Belgium is now very close to that average. Nevertheless, the spectacular rise in the share of high-tech exports in the total Belgian exports, from 14.3% in 2008 to 18.3% in 2009, might be crisis-related, whereby exports of lower-tech products might have decreased relatively more. Therefore, generally speaking Belgium is still lagging behind in terms of exporting high-tech products. Moreover, when looking at the composition of these high-tech exports (see Graph 18), it can be observed that the main rise comes from a boost in the pharmaceutical sector while other important sectors such as ICT and telecom have lost importance.

On the other hand, the relative weakness of Belgian exports for goods in the longer run can be attributed to the decline in the number of exporting firms (decrease of 8% between 2000 and 2007). This factor (extensive margin) is more important than the average value of exports per company (intensive margin). As a consequence, exports are currently concentrated in a limited number of large firms, with a higher capital intensity and productivity than average. This can be attributed to the fact that SMEs, which are very important in Belgium, export less (benefitting less from economies of scale and scope compared to larger firms, they face higher fixed costs) and only few of them have a competitive advantage to successfully compete in international markets. With respect to services, the conclusion is again different. The extensive margin for services has increased, i.e. more companies were involved in the export of services in the period 1995-2005.

Graph 18: Break-down by category of Belgian and EU27 type of exports



Source: Commission services

Labour utilisation and employment trends are also relevant through their contribution to potential GDP growth. As per Belgium:

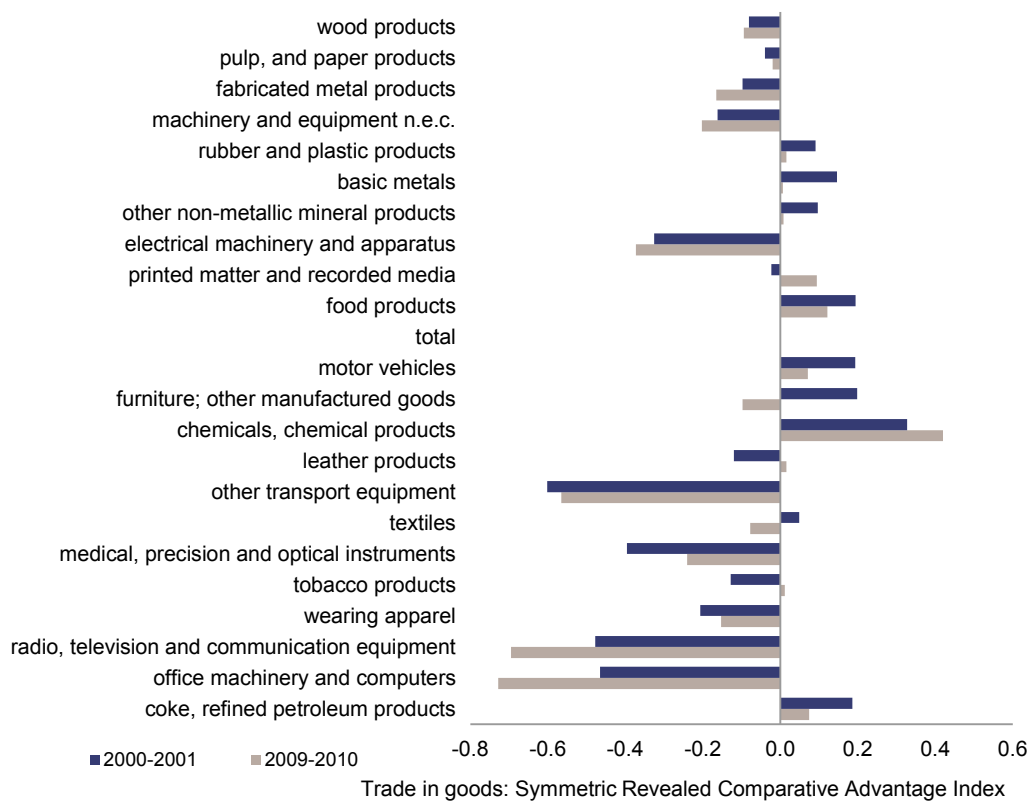
- Despite the fact that employment creation has been accelerating in 2010 (by 0.8%) and in 2011 (by 1.3%), which made the unemployment rate fall from 8.3% in 2010 to 7.2% in 2011, by the end of last year employment growth slowed down again, confirming persisting overall low labour utilisation in Belgium. This includes one of the highest long-term unemployment rates in the EU and particularly low labour market participation rates of older workers and non-EU workers.
- Despite the availability of highly qualified human capital, there appear to be in some sectors structural mismatches between labour demand and supply, resulting in the coexistence of high unemployment and a high number of vacancies, so that companies might lack the necessary human capital they need to reach their full potential.
- Low overall employment rates and high long-term unemployment and structural mismatches between labour demand and labour supply can be explained by the rigidities which characterise the Belgian labour market, including a high degree of real wage rigidities due to the wage setting mechanisms, large financial disincentives to work stemming from the existing tax and benefit system, as well as ineffective activation policies and generous early exit routes for older workers.

Technological competitiveness driven by the capacity to innovate as well as to increase efficiency and reduce costs is another important element influencing export performance. In this respect, R&D investment (not only by private firms but also supported by the government), human capital investment, innovative projects and entrepreneurship are important elements.

- According to the EU2020 strategy, 3% of GDP should be allocated to R&D investment. Belgium only reached 1.96% in 2009 and 1.99% in 2010. Moreover, 1% should be invested by the public sector (0.67% in 2010) and 2% by the private sector (1.32% in 2010). Most of the private R&D takes place in foreign-owned firms. Three sectors alone are responsible for 50 % of R&D expenditure (chemicals including pharma, telecoms equipment, and machinery and equipment) and only 10 companies are responsible for 40 % of business R&D expenditure.

- While the level of **education** is rather high in Belgium, there seems to be often a mismatch with the labour market and there is currently a lack of scientific and technically schooled workers. This could become a major barrier in terms of further improving the innovation performance of the Belgian economy.
- **Innovation** is mostly focused on process innovation in Belgium (in order to reduce production costs). To compete on the international markets it is however necessary to be also active in product innovation. Other areas of innovation that might be useful in the current economic environment are innovation towards durable products, client services and organizational innovation.
- Despite its importance, **entrepreneurship** is rather weak in Belgium, mainly caused by poor demand perspectives, problems to hire qualified personnel and fierce competition (especially on the international markets for low to mid tech goods).
- In 2010, **the public sector** in Belgium only spent 0.67% of GDP in R&D (compared to 1% objective), which is similar to the average of the euro area but less than the neighbouring countries. Nevertheless, when taking into account not only direct government funding but also indirect government support through R&D tax credits, BE is ranked 6th of all OECD countries.

**Graph 19: Comparative advantages**



Source: COMTRADE and Commission services' calculation

Over the period 2000-2010, Belgium appears to have increased its comparative advantage in chemicals and pharmaceuticals, but has reduced its comparative advantage in motor vehicles, food products, and petroleum products (see Graph 19).

**2.2.9. Conclusion on external imbalances**

Belgium has been suffering losses in export market shares for goods in recent years. Although the evolution of the balance of services is positive, Belgium cannot count exclusively on future

developments in exports of services as the way to compensate for the deterioration of export market shares of goods.

Therefore, restoring the performance of goods exports is required and could benefit from action with respect to both cost and non-cost competitiveness factors. Regarding the former, the wage setting mechanism might be reviewed for wages to develop more in line with productivity developments. Additionally, companies would benefit from a better functioning of the energy market, avoiding unnecessarily high energy costs. Regarding non-cost competitiveness, an impulse towards higher differentiation in the production and export of high-technology goods seems warranted. This means, among others, investing more in R&D and in the information and telecom area as well as improving the geographical location of exports. Finally, improving the functioning of the labour market could also increase the contribution of labour to growth and productivity and enhance the quality of export products.

### **2.3. EXISTENCE OF INTERNAL IMBALANCES**

#### **2.3.1. Public sector indebtedness**

One of the most important challenges facing Belgium is to ensure the long-term sustainability of its public finances, in the light of its very high level of public debt: at 98% of GDP at the end of 2011, the Belgian public debt ratio is currently the 5<sup>th</sup> highest in the EU, after Greece, Ireland, Portugal and Italy. In 2010, around 44% of Belgian government debt was held by Belgian residents, mainly by financial corporations. This figure is increasing steadily since 2008.

This high debt level can fuel market concerns over the government's creditworthiness and result in an increase in interest rates. This makes Belgium particularly vulnerable to tensions in financial markets as debt levels further increase. This was already the case a few times in previous months: for instance, the spread on Belgian 10-year bonds (with respect to the German Bund) rose to more than 360 basis points at the end of November 2011, while, at the same moment, the spreads on French and Dutch bonds reached about 190 and 60 basis points, respectively. Moreover, there has also been since the beginning of the financial crisis a substantial increase in contingent liabilities resulting from support operations and guarantees to the financial sector and amounting at the moment to about 15½% of GDP (7½% from the latest support to Dexia and another 8% from previous guarantees to KBC, Fortis and Dexia).

Furthermore, population ageing will cause an above EU-average rise in public expenditure on pensions, healthcare and long-term care. The effective retirement age and the employment rate of older workers are particularly low in Belgium. Increasing the employment rate of older workers and limiting retirement before the statutory age would have the double beneficial effect to increase the number of contributors to the pension system and to slow down the increase in the number of pensioners.

In this vein, it is worth underlining that the high public debt is not an isolated phenomenon, but may have an impact on many economic areas, which in turn, can impact on public finances. While high public debt levels can exert pressure on the financial sector via the sovereign risk, the above-mentioned guarantees on the financial sector also represent a risk for fiscal stability. Additionally, there are also important links between public finances and the labour market given that an important part of public revenues stem from labour taxes, as well as a non-negligible amount of public expenditure such as unemployment benefits. Finally, increasing interest rates for public bonds would put upward pressure for interest rates in the economy as a whole, including households and SMEs. In sum, the high public debt, the financial sector, high taxes and low level of employment are all interlinked

Additionally, the public sector can be an actor helping the country to regain external competitiveness. Measures such as shifting taxes from labour towards consumption and environmentally friendly areas could be beneficial for public finances and would improve the overall competitiveness of the country.

Belgium belongs to the group of EU countries with the highest tax levels, alongside the Nordic countries and Austria. At 46.2% of GDP, the Belgium total tax-to-GDP ratio was the second highest in the EU in 2010 (EU average 39.6%), while taxes on labour accounted for 23.7% in 2009 (EU average: 17.5%). The high burden on labour mirrors primarily high taxation of personal income. The top personal income tax rate of 53.7% (EU: 37.5%) is the second highest in the EU.

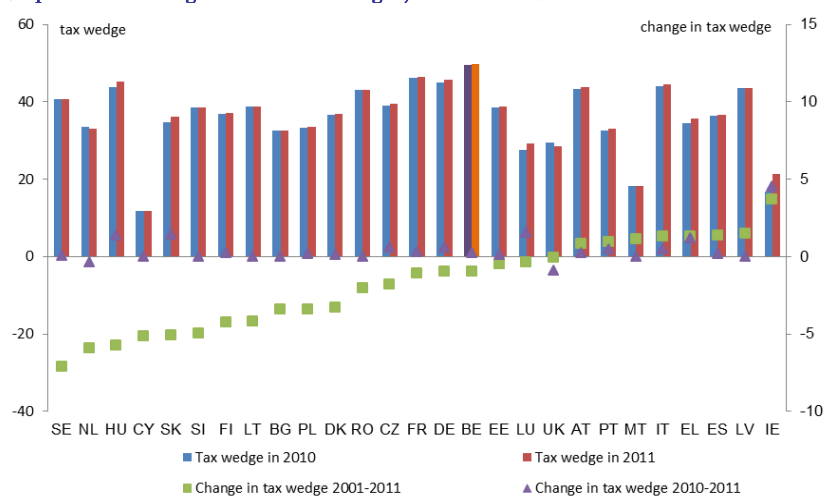


The tax wedge on labour income is among the highest in the EU, at 50% for the low wage person (37% at the EU27 average) and at 56% for the average wage person (41% at the EU27 average). For most categories of taxpayers, Belgium ranks together with Sweden and Denmark among the three highest tax wedges in the EU.

In addition, marginal effective tax rates on labour are in general significantly above the EU average. The unemployment trap (i.e. the incentives to work resulting from the interaction between the withdrawal of unemployment benefits when taking up work and labour taxation, as measured by the marginal effective tax rates) has widened over the past ten years, with financial gain when moving from unemployment to work in some cases below 20% (corresponding to marginal effective tax rates above 80%). This applies in particular for unemployed and inactive persons taking up low-paid jobs. Financial disincentives to move from inactivity to work are also relatively high for the second spouse in a household with two children and one earning spouse, which depresses the participation rate of women.

Companies are subject to a fixed tax rate of 33.99 % regardless of the origin and the destination of the profits<sup>12</sup>. This rate is the third highest in the EU (after Malta and France). However, while the corporate tax rate is high in Belgium, the tax base is subject to important allowances and reductions, leaving taxable profits considerably below accounting profits. The importance of tax allowances and reductions in Belgium is also evidenced by the Paying Taxes 2011 report, which calculates the actual tax rate on corporate income of a typical medium-size company at around 5%, thus much lower than the statutory rate of 33.99% (for the EU an actual tax rate of below 12% compares to an average statutory rate of above 23%). In particular, an allowance for corporate equity (ACE), referred to as '*notional interest on corporate capital*', was introduced in 2006 to stimulate the self-financing capability of companies. The introduction of this system made the Belgium corporate tax system more neutral vis-à-vis various types of funding sources, partly removing the incentives for debt financing found in most other OECD countries, but has also contributed to the high debt levels in gross terms of the Belgian companies.

**Graph 20: Tax wedge and recent changes, low income workers**



Source: Commission services

Note: Data for non-OECD EU countries (LT, LV, MT, BG, RO are only available for 2010, CY only for 2007)

Another issue refers to the performance of the labour market. Belgium has a high share of long-term unemployed (+12 months) on total unemployment, at 48.8% in 2010, against 39.9% EU average. The employment rate of young and older workers is particularly low, respectively at 25.2% (34% EU average) and 50.9% (56.7% EU average) in 2010. Moreover, the employment rate of non-EU citizens is also low, comparing decisively bad to EU average, with 38.2% in BE against 55.2% at EU level in 2010.

<sup>12</sup> Under certain conditions, a special scheme applies to SMEs having an assessed income lower than € 322 500: a tax rate of 24.98 % is applied on the part from € 0 to € 25 000, 31.93 % on the part of € 25 000 to € 90 000 and 35.54 % on the remaining part up to € 322 500.

### 2.3.2. Private sector indebtedness

The scoreboard indicator on the private sector debt level (232.8% of GDP) is well above the scoreboard threshold of 160%. However, the private sector indebtedness based on the consolidated accounts of non-financial corporations - thus eliminating the credit transactions between different branches of companies - stands at 131% of GDP, lower than the 158.3% of GDP average of the euro area. Credit provision among companies in Belgium is high and related to the previously advantageous fiscal regime of the coordination centres (coordinating the financial and fiscal activities of multinationals, see Box 1) and non-financial holdings (operating as intermediary in the financing of companies). After European legislation prohibited this advantageous fiscal regime for "coordination centres", the "notional interests" regime was introduced as a standard corporate tax feature and Belgium remained an attractive place to invest. Multinationals already present in Belgium have therefore stayed and seem to have continued the financial intermediary transactions, which are recorded as intra-company loans. More generally, the corporate tax rate is high and the provisions for deduction of interests are generous in Belgium by European standards and might explain why Belgium might rely more heavily on intra-company loans than other Member States. Additionally, household indebtedness is relatively low and mostly related to mortgage debt, while the household savings rate is high.

#### **Box 1: COORDINATION CENTRES AND NOTIONAL INTERESTS**

The origin of the Coordination Centres can be traced back to 1982, when a Decree set out the favourable conditions, especially concerning tax issues, for multinational groups. The adoption of the European Code of Conduct for business taxation in 1997 raised the question of the incompatibility of the Coordination Centres with European competition law. The principle behind was that they distorted the decision-making process for the location of an activity within the EU and could be considered as a state-aid incompatible with EU law. After a long legal process, the system was changed into the current Notional Interest Deduction.

Coordination Centres have been subject to the corporate tax as any other firm in Belgium. However, the tax base is not the profit but a rather complicated notional base which includes concepts such as the addition of a mark-up of 8% to reflect activity profits. All in all, the result is that the effective tax rate is close to zero. On top of that, dividends have been excluded from withholding in Belgium.

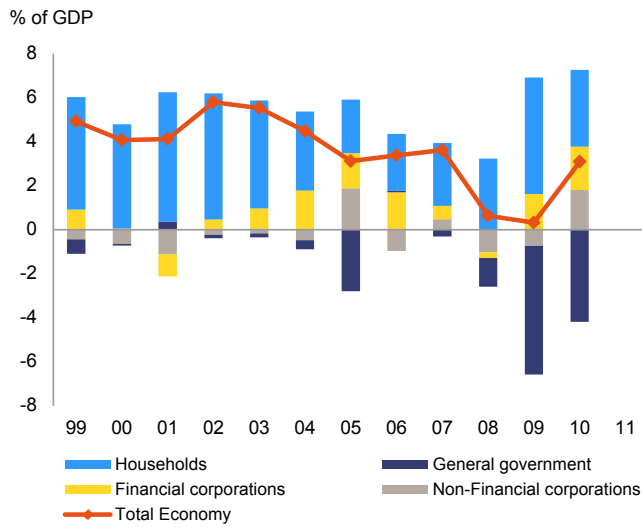
Fearing that Belgium would become a less attractive place to invest, the Notional Interest concept was introduced in 2005. This system is in line with competition state-aid rules, and is applicable to all companies. The principle behind it is that there is a different tax treatment for investments according to their financing source. In case funding stems from banks or credit institutions, in most countries companies are granted deductions for the interests they must pay. However, self-financed investment or even private equity funding does not enjoy such fiscal advantages. Therefore, the Notional Interest Deduction aims precisely to simulate the equivalent interest payments associated to self investment and then grant a concomitant fiscal deduction.

This system intended to give a continuation of the Coordination Centres philosophy of attracting multinational groups to Belgium, or encouraging them to stay, but also responded to the needs of Small and Medium companies, which must often rely on private equity to launch investment projects.

The Notional Interest Rate was based on the 10-year Belgian bond (OLO). The rate cannot change by more than 1pp each year (with a maximum of 6.5%) to give some predictability to the system. Small and Medium companies receive a premium of 0.5pp on the basis of the higher risk associated to investing in rather small companies, which moreover, have more limited access to standard financing. Lately, the rate has been fixed by the government. The rate in 2011 was around 3¾% and declined to 3% in 2012, making the system less attractive, but also less costly for public finances.

Graph 21 and Table 4 show that the high government debt level contrasts with the rather healthy position of the Belgian private sector, in particular households.

**Graph 21: Net lending (+)/borrowing (-) as a percentage of GDP**



Source: Commission Services

In consolidated accounts, financial transactions between different branches of the same company are not considered, so that positive and negative financial streams might cancel out each other. While non-consolidated data are particularly interesting to check the financing structure of individual companies, consolidated data could tell more with respect to financial health. The system of Notional Interest Deduction might be creating incentives for inter-company loans. Indeed, a company could borrow from a credit institution, deduct the interests paid for its corporate tax declaration and still lend part of the loan to another company of the group, which could also deduct the notional interests associated to it. High intra-sector loans also reflect to some extent an issue of financial accounts classifications, i.e. the fact that some corporations are classified as non-financial rather than financial. While this does not change non-consolidated figures, it implies that consolidated debt is lower than would have been otherwise. The new financial accountancy standards to enter into force in 2014 are likely to reclassify part of the currently non-financial under financial corporations. As a result, consolidated debt figures would appear to be higher.

In contrast, it can be assumed that there are no significant financial transactions among households, so that for them the national financial accounts are similar either in consolidated form or in non-consolidated figures. Differences can however be observed for non-financial corporations, as these companies may include financing corporations outside the financial sector, which is the case for multinationals.

The difference between consolidated and non-consolidated figures therefore depends on the financial structure of the country. Belgium is the country with the most prominent difference between gross (non-consolidated) and net (consolidated) figures, i.e. 100% of GDP in 2010. Indeed, in some countries, consolidated and non-consolidated figures are in line with each other (e.g. Germany: 127% of GDP non-consolidated versus 111% of GDP consolidated) or even exactly the same (e.g. Denmark: 245% of GDP, both in consolidated or non-consolidated terms).

**Table 4: Overview of net lending/borrowing position, indebtedness and net financial assets in Belgium per sector**

YEAR 2010		Net Lending (+) /Borrowing (-)		Indebtedness (*)		Net financial assets	
		bn €	% of GDP	bn €	% of GDP	bn €	% of GDP
<b>BE</b>	<b>Total economy</b>	10.9	3.1	468.4	132.2	72.0	20.3
	<b>Households</b>	12.4	3.5	191.0	53.9	725.5	204.7
	<b>Corporations</b>	13.4	3.8	493.3	139.2	-369.2	-104.2
	<i>Financial corporations</i>	7.0	2.0	200.4	56.5	-4.9	-1.4
	<i>Non-Financial corporations</i>	6.4	1.8	292.9	82.7	-364.3	-102.8
	<b>Government</b>	-14.8	-4.2	353.0	99.6	-284.4	-80.2
<b>euro area (**)</b>	<b>Total economy</b>	-42.8	-0.5	22,612.8	246.8	-934.3	-10.2
	<b>Households</b>	395.4	4.3	6,179.7	67.5	11,966.7	130.6
	<b>Corporations</b>	131.7	1.4	16,294.3	177.9	-7,689.2	-83.9
	<i>Financial corporations</i>	130.4	1.4	7,971.4	87.0	1,025.2	11.2
	<i>Non-Financial corporations</i>	1.4	0.0	8,323.0	90.8	-8,714.5	-95.1
	<b>Government</b>	-570.0	-6.2	7,971.4	87.0	-5,211.7	-56.9

Source: Commission services.

(\*) Figures on indebtedness include the sum of 'Securities other than shares', 'Loans' and 'Other accounts receivable/payable' from the Balance sheets accounts (Consolidated figures).

(\*\*) Figures for the euro area do not include data on Cyprus, Malta, Ireland and Luxembourg.

Still the question arises on whether this particular financial structure of companies represents a risk as a potential source of imbalances. Indeed, it cannot be ignored that when financial transactions are taking place with a view to optimising the fiscal position of a company, some distortion is being introduced in the individual behaviour of the subsidiaries of the group. Therefore, whether this represents a risk or potential source of imbalances has to be evaluated against a situation, in which these fiscal incentives will disappear. A sudden unwinding of fiscal policies, i.e. the drastic elimination of the notional interest deduction, will reposition the financial architecture of company groups by diminishing their amount of inter-company loans. Another potential risk in the system linked to the large share of intra-sector loans stems from complex inter-linkages which may risk a domino effect in the case of bankruptcy.

### 2.3.3. Financial position of households

Although the economic crisis had a severe impact on the wealth of Belgian households (net financial wealth dropped from EUR 706 billion mid-2007 to EUR 616 billion end-2008), the net financial wealth of individuals is again higher than before the crisis (standing at EUR 736 billion mid-2011)<sup>13</sup>. This is due to the important saving efforts of Belgian households, which is among the highest in Europe (see Table 5).

**Table 5: Household saving rate (2008-2012)**

	Household saving rate (% of Gross disposable income)				
	2009	2010	2011	2012f	2013f
Belgium	18.4	16.2	16.6	16.2	16.1
Euro area (*)	15.3	13.9	n.a.	n.a.	n.a.

Source: Commission services' spring 2012 forecast

Moreover, the net financial assets of Belgian households amount to about 200% of GDP, which is higher than in other euro area Member States (see Table 6). The wealth of Belgian households is therefore higher than the sum of the public sector debt and the debt of the non-financial corporations.

<sup>13</sup> See <http://www.nbb.be/belgostat/PresentationLinker?TableId=347000044&Lang=E>.

**Table 6: Households' Net Financial Assets (2006-2010)**

	Net Financial Assets (% of Gross Domestic Product)				
	2006	2007	2008	2009	2010
Belgium	220.4	208.7	182.3	202.2	204.9
Euro area (*)	139.0	134.6	119.3	131.2	n.a.

Source: Commission services

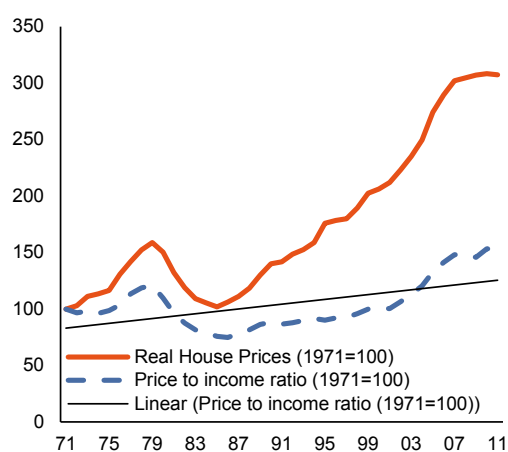
While the financial situation of households is reassuring, some risks associated with the housing market deserve further consideration. Mortgage markets showed an acceleration of mortgage growth during the years prior to the crisis, encouraged by favourable loan to value ratios (sometimes above 100%). The interest rate structure, dominated by fixed interest rates ensures somewhat protection for households to interest rate hikes risks. The lack of Mortgage Equity Withdrawal contributed to containing credit developments though.

Real housing prices have been on the rise since their trough reached in 1986 (see Graph 22), basically tripling in the last 30 years. The evolution over the last 3 years shows some deceleration and a first hint of correction in 2011. This smoothing behaviour represents a striking difference with respect to the last cycle in Belgian house prices, which peaked in 1979 (see Graph 23) and then saw a sharp correction until the mid-80s. The sustainability of the prolonged upswing together with house price future dynamics stands indeed as an important issue for analysis in Belgium.

The evolution of the housing market and the main determinants behind price growth can help gauge the risks for a house price correction and its ensuing pressures on the financial sector. In Belgium, almost no housing price correction took place so far. Depending on the evolution of interest rates, unemployment or credit conditions a certain correction cannot be discarded. This, in turn, would affect the size of non-performing loans, putting pressure on the financial sector.

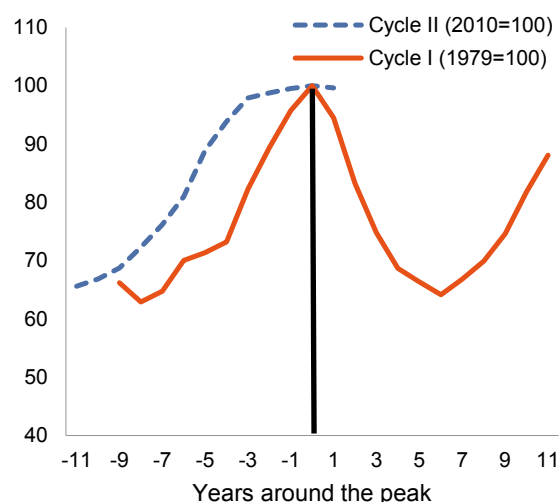
Estimates of fundamental house prices, based on its main determinants, may yield different results depending on the assumptions made and methods used. Using a broad set of approaches, the National Bank of Belgium finds that, for Belgium on average, in the third and fourth quarters of 2010, house prices were overvalued by between 15 and 66 % compared to their long-term value<sup>14</sup>.

**Graph 22: Real house prices and Price to Income ratio, 2005=100**



Source: Commission service, ECB, OECD

**Graph 23: Belgian real house price dynamics over the last cycles**



Source: Commission services, ECB, OECD

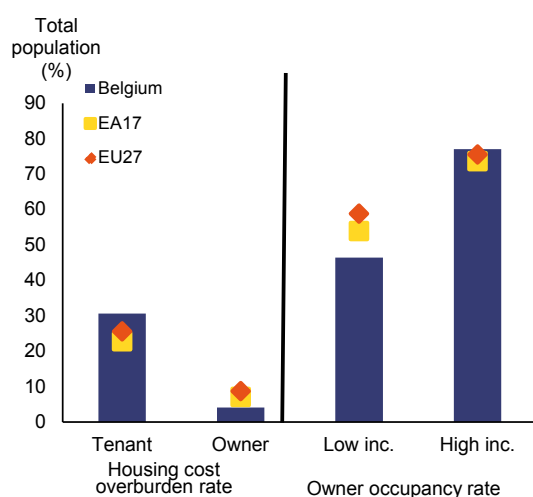
Amongst the various competing views on how to assess the existence of untenable pressures in housing prices, affordability [Price-to-income] and dividend [Price-to-rent] ratios have the advantage of being simpler and easier to interpret than econometric estimations. Although their findings have to be considered with caution due to their simplifying assumptions and their crude approach, they provide a

<sup>14</sup> See National Bank of Belgium (2011).

useful alternative. As can be seen from Graph 22, the price-to-income ratio yields some signs of increasing pressures as it has trended upwards in the last 30 years, reaching levels above its linear trend since 2003. This picture is confirmed by looking at the price-to-rent ratio. Indeed, housing prices can also be assessed against alternative investment decisions, like renting a house. The price-to-rent ratio shows a significant increase in the cost of owning versus the cost of renting in the last 30 years (see Graph 25).

The increase in house prices over the last decades might also have adverse effects in distributional terms. As can be seen in Graph 24, the owner occupancy rate of the low income population is relatively low in Belgium. Low income households are constrained to stay in the rental market and thus the overburden rate for tenants (% of households where the total housing costs represent more than 40 % of their disposable income) in Belgium stands out when compared with other Member States.

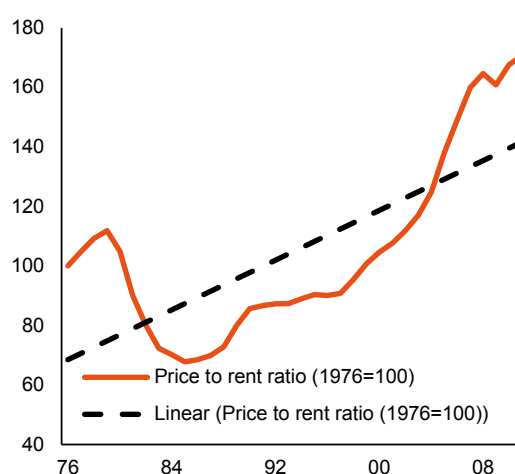
**Graph 24: Structural features of the housing market**



Source: Commission services

Note: Housing cost overburden rate is the % of the population living in households where the total housing costs represent more than 40 % of disposable income, 'net' of housing allowances. The owner occupancy rate represents the percentage of low (below the 6<sup>th</sup> decile) and high income population owning a house.

**Graph 25: Price to Rent ratio, 1976=100**



Source: OECD

#### 2.3.4. The financial sector

The crisis and its aftermath have led to a credit quality deterioration, which remained moderate by international standards. Non-performing loans increased to 3.3% of gross loans on average in 2011 from 1.5% in 2007. The deleveraging process depressed the business outlook, but banks remained profitable in 2011, with return on equity deteriorating from 10.5% in 2010 to 0.7%. Looking at the liquidity of the Belgian banking sector, the loan to deposit ratio remained below 100% with traditionally stable domestic deposits, which nevertheless came under pressure during the financial crisis.

The difficult access to the wholesale funding market is reflected in higher demand for Eurosystem loans. Overall, year-on-year deposit growth rates considerably slowed down and credit activity as well, while remaining in positive territory. Belgian banks have increased their borrowing from the ECB to EUR 50.2 billion (4.5% of liabilities) by end-February, accessing the ECB's Long Term Refinancing Operation (LTRO), which may support lending activity in the future. Overall loans to the private sector remained sustained albeit at lower rates than in 2008, but credit statistics are difficult to interpret because of ongoing securitisation.

While the indebtedness of domestic households and firms remained contained, Belgian banks needed considerable government support because of a rapid international expansion, which turned out badly. Following the Lehmann Brothers collapse in October 2008 and the continuing malaise in financial markets, the Belgian banks were cut from the wholesale market on which they financed their international expansion and the state had to step in to support all major banks (Fortis, Dexia and KBC).

In total about EUR 25 billion (6.7% of GDP) of public capital was provided to the banks, reflected in higher solvency ratios (CAR) in 2008 (see Table 7). Furthermore, the state has about EUR 100 billion (25% of GDP) in guarantees outstanding towards the Belgian banks, covering bad assets. The average solvency ratio further increased in 2010, as banks returned to profitability, while it deteriorated again in 2011, mainly due to impairments on investments abroad (Greece, Ireland and Hungary).

**Table 7: Banking sector key indicators**

	2007	2008	2009	2010	2011
in %					
Regulatory capital to risk-weighted assets (CAR)	11.2	16.2	17.3	19.3	18.5
Regulatory Tier 1 capital to risk-weighted assets	12.1	11.3	13.2	15.5	15.1
Return on assets (RoA)	0.4	-1.3	-0.1	0.5	0
Return on equity (RoE)	13.3	-37.8	-2.6	10.5	0.7
Loans to deposits (LtD)	93	82	87	93.5	91.9
Non-performing loans to total gross loans (NPL)	1.5	2	2.9	2.8	3.3
Bank provisions to NPLs (Coverage ratio)	32.3	41.1	43	42.8	41.5

*Source: National Bank of Belgium*

### 2.3.5. Conclusions

Even though the private sector is facing important challenges concerning its financial position, the main source of internal imbalances remains the high and increasing government debt, which make the public sector vulnerable to market pressure. Moreover, the high level of state guarantees granted to the financial sector and possible needs for bank recapitalization could have an important impact on public debt.

The aggregated financial situation of households is reassuring and, although the increase in house prices over the past decade has been substantial, sector-specific risks seem to be contained. However, there is a strong interplay between the the public and the financial sector.

Finally, there are also relevant links with the labour market given that an important part of public revenues stem from labour taxes, as well as a non-negligible amount of expenditure such as unemployment benefits.



### 3. IN-DEPTH ANALYSIS OF SELECTED TOPICS

#### 3.1. THE ROLE OF SERVICES

Services constitute an increasing share and have an increasing importance in the economy of industrialized countries. On the one hand, demand factors play a role, such as the increase in household income and socio-demographic evolutions (ageing population, higher labour market participation of women, and higher share of leisure time). On the other hand, supply factors and globalization of the economy play a role. First, technological developments lead to higher productivity gains in the industry (also stimulated by higher international competition), so that a higher share of the labour force became available to work in the area of services. Second, due to the decrease in transportation costs and the development of information and communication technologies, a fragmentation of the production process became possible, so that several steps of the supply chain of a product can be performed on different locations, leading to a higher degree of outsourcing and off-shoring<sup>15</sup>. Off-shoring has an impact on the economy as well as it puts downward pressure on wages in industrial sectors in advanced economies.

Services account for a dominant share of the Belgian economy: in 2008, services had a share in value added and employment of the country of 76% and 73% respectively (close to the euro area averages of 72% and 67%)<sup>16</sup>. However, while services are important within the national economy, they only play a minor role in international trade<sup>17</sup>. Although the export of services has tripled between 1995 and 2010 in Belgium the share of services in international trade has roughly remained the same (about 15% in BE and Europe), so that trade of goods still remains the most important component of international trade.

Nevertheless, since 2007 net export of services (in % of GDP) became the main component to the positive balance of the current account. More specifically, the export of services that are closely related to the export of goods and to the role of Belgium as central location for several companies and organisations has increased significantly. Graph 27 shows the breakdown in type of service and from this it can be seen that mainly transport and business services have been expanding most (while the importance of services related to travel decreased). According to Duprez (2011) two subcategories in the area of business services are dominating the services balance: merchanting and services to affiliated enterprises.

- *International merchanting* occurs when there are two consecutive transfers of ownership of a good, from a non-resident to a resident and vice-versa. The balance consists of the difference between the value of the good acquired and paid by the resident and the value at the time of the resale abroad, and so this difference forms the remuneration for the resident merchanting firm. In fact, this service is very much related to the international trade in goods.

- *Services between affiliated enterprises* cover the general administrative and operating expenses of the parent companies, subsidiaries, branches and agencies if the payments are total amounts which cannot be allocated in more detail. Belgium's central position and attractiveness for multinationals (coordination of their European activities) contribute to the positive balance of these services.

In sum, the service-related activities have expanded mainly thanks to the central location of Belgium in Europe and the presence of multinational companies and the EU institutions. On the other hand, given that the share of high-tech goods (in particular ICT and telecom) in trade is rather weak, services related to more high-tech products have not gained higher importance.

The healthy state of Belgium's service exports can also be seen from its export market share. The share of Belgium's service exports in world trade in services (in current prices) remained constant during the period 1995-2010 (about 2.3%). During this period, Germany's share remained stable around 6.5%,

---

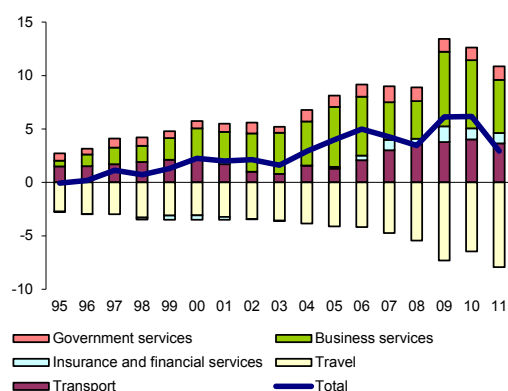
<sup>15</sup> In contrast to outsourcing, off-shoring always occurs to companies in foreign countries. This strategy is most often used for routine tasks of which the quality can be more easily verified from a distance.

<sup>16</sup> See Duprez, C. (2011).

<sup>17</sup> Reasons for this may be the need for physical proximity between consumer and supplier in the case of services, and the statistical difficulties related to separating goods and services.

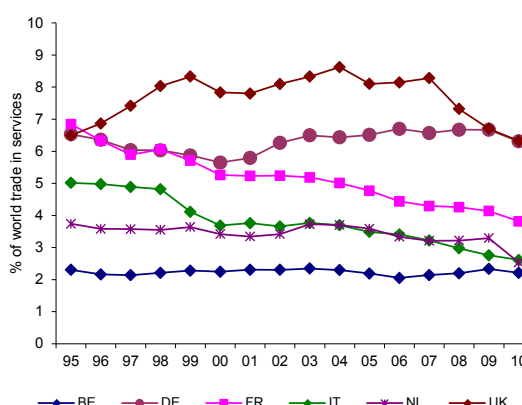
while the shares of both the Netherlands and France declined from 3.7% to 2.5% and from 6.8% to 3.8% respectively (see Graph 27).

**Graph 26: Breakdown of Belgian balance of services (bn EUR)**



Source: Belgostat

**Graph 27: Share of services in world trade in services**



Source: Unctad

The gains in market share were merely concentrated on the period 2007-2010. It should however be noted that the high increase in export market share for services in 2007 (which forms a break in the trend) coincides with the introduction of a new data collection method for the BoP. Therefore, the change of the system might have affected the statistics<sup>18</sup>.

Despite the healthy export performance of services, there are also some impediments and limits to trade in services. According to the NBB report (cf. supra) various factors contribute to the relatively low level of trade in services, despite their importance in the economy. First, there are *statistical difficulties*, contributing to the low level of trade in services. In contrast to trade in goods (whereby a physical crossing of frontiers is involved), trade in services takes the form of flows which are more difficult to be measured. Moreover, the distinction between goods and services became vaguer recently as the sale of goods is often linked to services that are offered together with the product. This might also contribute to an underestimation of trade in services. Second, many services cannot be stored so that the service provider needs to be located close to the customer. Despite the development in information and communication technology, the *proximity requirement* is still a natural barrier to trade in services. Third, another factor that might hamper trade in services are *administrative barriers*. According to the market regulation indices of the OECD, barriers in trade decreased between 1998 and 2007, although they are still higher than for goods. Based on the 2007 OECD indicators, Belgium has an intermediate position regarding regulation in most service branches, apart from telecommunications and rail transport where regulation is stricter in Belgium. This might indicate that administrative barriers might exist on the service market in Belgium.

### 3.2. IMPACT OF THE WAGE SETTING MECHANISM ON COST COMPETITIVENESS IN BELGIUM

According to the Global Competitiveness Index 2011-2012, Belgium is ranked 126<sup>th</sup> (out of 142) concerning "flexibility of wage determination" and 131<sup>st</sup> regarding "hiring and firing practices", while "restrictive labour regulations" are counted as the most problematic factor for doing business in Belgium. Indeed, the Belgian labour market is rather rigid with a highly structured wage bargaining system, relatively high minimum wages and long-time lags and termination fees when being dismissed. Belgium is also one of the few countries in Europe that makes use of an automatic indexation system to safeguard purchasing power whereby not only wages, but also rent prices, insurance policies and several public services (e.g. transport) are adjusted to the evolution of prices (as reflected in the "health index"<sup>19</sup>).

<sup>18</sup> See Duprez, C. (2011).

<sup>19</sup> In Belgium there are two indices: the general *Consumer Price Index* (CPI) and the *Health Index*. The health index uses the same basket of goods/products as the CPI, with the exception of products which could be detrimental to health, such

The wage bargaining system is structured at three levels: the national cross-sector level covering the entire economy; an important intermediate sectoral level; and a company level as a complement or substitute for the sector-level bargaining. In principle, lower level agreements can only improve what has been negotiated at higher level. In exceptional circumstances, such as firm restructuring, opt-out rules exist that allow an enterprise to temporarily deviate from the sectoral agreement after approval by a sectoral joint committee; yet the procedure is only sparingly used. Negotiations take place every two years with three key components: the Inter-professional Agreement (IPA) followed by sectoral negotiations; administrative extension of sectoral wage agreements; and indexation of wages to prices during the contract. The IPA defines an indicative "wage norm", which is meant to keep developments in line with expected labour costs increases in the three main trading partners, and a national minimum wage. Taken together, the two serve as the upper and lower limits for the subsequent negotiations at lower level.

The "wage norm" was introduced in 1996 (*Loi sur la compétitivité*) to promote employment and preserve external competitiveness vis-à-vis France, Germany and the Netherlands, its three major trading partners. Specifically, the 1996 Law requires that the growth of nominal hourly labour costs for enterprises in a period of two years should not exceed a "wage norm", i.e. a weighted average of the projected increases in nominal average hourly labour costs in the three above neighbouring countries, according to projections published by the OECD's Economic Outlook and corrected for average hours worked. The law stipulates that overruns of the wage norm should be corrected in the subsequent wage agreements. By law, the social partners are constrained to negotiate agreements that, as a maximum, increase the labour costs (*coût salarial*) by the rate set in the norm and, as a minimum, increase them by the contribution of the rate of inflation and step increases (*augmentations barémiques*). The wage norm is formally published in an inter-professional agreement (*accord interprofessionnel*, AIP) which constitutes the basis of sectoral and firm-level negotiations conducted subsequently to the AIP.

This top-down determination of wages, with a prominent role of the wage norm and the automatic wage indexation mechanism, has had two main effects on wage dynamics: (i) it has helped to moderate wage growth - but not enough to avoid cost competitiveness losses over time; (ii) it has allowed for little wage differentiation at lower levels, thus limiting the response of wages to productivity and local labour market developments.

While the norm has helped to frame the wage negotiations over time, it did not prevent slippages in wage trends to occur, especially since 2006 when Belgian hourly unit labour costs started to grow relatively faster than in the three neighbouring countries. This was mainly due to one or more of the following factors: downward corrections in the evolution of relative unit labour cost in these countries linked to productivity differentials; higher than agreed negotiated sectoral gross wages in Belgium; higher inflation in Belgium (feeding into wages through indexation); and increased weight of employer's social security contributions on labour costs over the reference period.

One of the main limits of the 1996 Law is related to the fact that it only foresees alignment with respect to wage growth, while **differences in productivity growth are not taken into account**. While this was not problematic at the time the law was drafted (productivity growth in Belgium during the eighties and nineties was high, so a focus on wage growth alone was considered to be appropriate) this has become more problematic in recent years as productivity growth in Belgium has been lower than in the neighbouring countries, and among the lowest in the EU, while wages have been growing as fast or even faster compared to the average of the neighbours and the euro area. As mentioned earlier, the higher wage and lower productivity growth have resulted in a faster increase in ULCs in Belgium than in its main trading partners, hereby eroding price competitiveness.

Moreover, the increase in nominal average hourly costs in the three neighbouring countries, which is the base of the wage norm, turned out to be often overestimated, which resulted in an excessive level of allowed wage growth. To correct for these estimation errors, **ex post corrections** in years where the wage norm has been excessive are possible on principle, but were never applied in practice.

A second element of the wage setting system with potential effects on the capacity for wages to adjust to shocks is the wage indexation system. The system of automatic wage indexation (whereby wages are

---

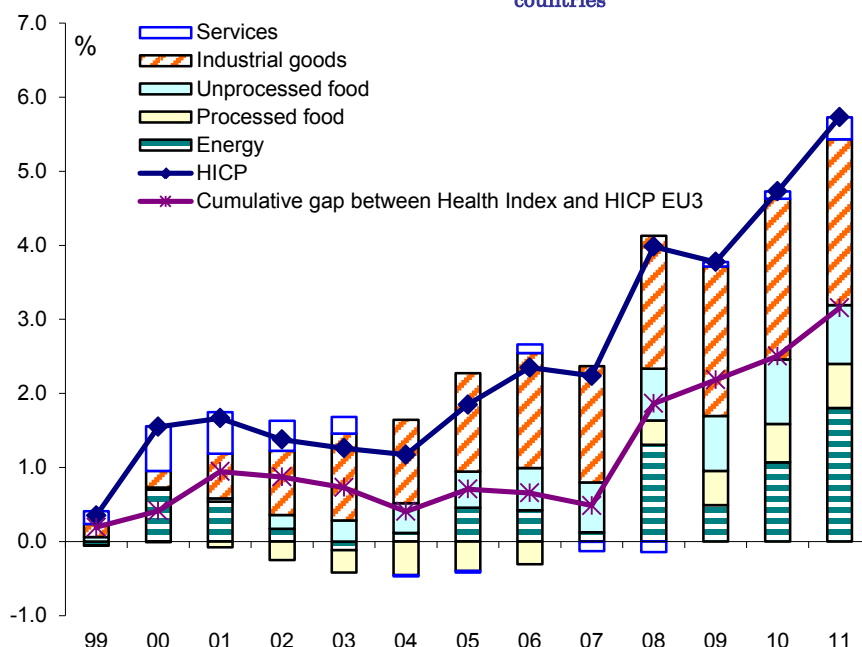
as alcohol, cigarettes and gasoline. However, the prices of oil, electricity and gas (together counting for about 60% of all energy carriers) are included in the Health Index.

automatically adjusted in line with the evolution of inflation, measured by the "health index") makes adjustments in real wages (notably to reflect changes in productivity, terms of trade shocks or the need to absorb unemployment) more difficult. Applying the health index instead of the domestic CPI helps for the adjustments to terms of trade shocks (notably, energy prices), but the effect is limited by the effect that the health index includes only 60% of all energy products.

Moreover, when inflation in Belgium is protractedly high and higher than in neighbouring countries, the system of automatic indexation implies competitiveness losses accumulating over time. In this respect, the use of "all-in clauses", allowing the temporary suspension of indexation in periods where inflation is above the wage increase allowed by the wage norm, would be useful.

Finally, despite sector and regional productivity differentials, the real wage growth target applies to all sectors and regions in Belgium. As bargaining can actually only take place within the narrow range defined by the indexation floor and the wage norm ceiling, there is in practice little differentiation of wage developments across geographical locations and productivity performance. Together with differences in the development of industrial structures, this has contributed to large and widening geographical differences in employment and unemployment rates, as well as to reducing the scope for labour reallocation across sectors and regions, towards dynamic firms and sectors.

**Graph 28: HICP and Health index cumulative gap between Belgium and the average of the 3 neighbouring countries**



Source: Commission services' calculations (EU3 is computed as a weighted average)

The question arises on whether the advantages or the disadvantages of the wage indexation system dominate. The main argument supporting the mechanism of automatic wage indexation is that it helps to preserve the population's purchasing power and hence to support domestic demand, while opponents to the system emphasize its role in the deterioration in cost-competitiveness, hereby reducing exports, increasing imports or directly causing some productions to migrate abroad.

## **Box 2: INTERPLAY BETWEEN WAGE INCREASE AND OUTPUT AND EMPLOYMENT**

In the theoretical case of a fully closed economy, which produces everything it consumes and invests, the effect of wage increases on output and employment are expected to be positive. Even much stronger wage increases than abroad do not affect negatively demand and output, except maybe through their effect on inflation. Conversely, in the opposite case of a fully open economy that sells abroad everything it produces and imports everything it consumes and invests, the support wage increases provides to domestic demand is of no effect on domestic output, which is exclusively determined by foreign demand, while domestic demand only affects imports. Wage increases have a negative effect on output and employment.

In Belgium, being one of the most open economies in the EU, the negative effect will tend to dominate. This hypothetical assessment is confirmed among others by a recent study of the University of Leuven<sup>20</sup>. Using econometric estimates, they conclude that an increase by 1% in the "health index" leads to a 0.7% rise in wages spread over five quarters. Similarly, a 2% increase in wages leads to an increase by 0.3 percentage point in the unemployment rate. The negative impact of wage increases on employment is reinforced by the fact that their effect on consumption is not unambiguously positive: indeed, if it results in a loss of competitiveness, it will translate into rising unemployment, which may lead to additional precautionary saving and decreasing confidence stemming from the deterioration in public finances (in a high public debt country like Belgium).

In the same vein, according to the study, the effect of a "saut d'index" on employment (i.e. the non-application of a 2% indexation as it happened in 1982-1983, when Belgium was facing a similar loss of competitiveness) would always be positive and would amount to between 14,000 and 41,000 additional jobs (between 0.3% and 0.9% of the actual level of total employment), depending on the consumption behaviour of households (the lowest figure corresponding to the assumption of a marginal propensity to consume of 1, the lowest to a propensity of 0.4%).

The automatic wage indexation system can also more directly affect employment in the case of multinational companies that have an important leeway in choosing their production locations, which seems to be a rather accurate picture of the Belgian industrial sector. Some multinational firms decide on a certain budget for wage increases to their subsidiaries in different countries that allows them for instance to grant a 2% wage increase, independent of what type of wage bargaining system the country uses. The subsidiaries can then freely allocate this amount over their employees. However, in countries where a system of (automatic) wage indexation (or mandatory wage increases) exists, the extra budget is often fully eaten by the effect of indexation, whereby all employees (performing good or bad, earning a lot or less) receive the same percentage of wage increase. This mechanism prevents companies to reward better performing employees, and it might even negatively affect employment in a negative way when inflation and therefore indexation are substantially higher than allowed by the budget.

---

<sup>20</sup> Konings, Joep Bas van Aarle and Marieke Vandeweyer, (2012).

## 4. POLICY CHALLENGES

The preceding analysis has shown that Belgium is experiencing macroeconomic imbalances, which are not excessive but need to be addressed. In particular, macroeconomic developments in the areas of external competitiveness of goods and indebtedness, especially concerning the high level of public debt, deserve further attention so as to reduce the risk of adverse effects on the functioning of the economy.

Belgium has already put in place policies aiming at tackling the inflationary pressure resulting from surges in the prices of energy and commodities in order to address the loss of cost competitiveness of the Belgian economy. A price observatory has been granted extra powers and retail prices for energy have been frozen from April 2012 onwards until the end of the year. The government has also announced a number of structural measures in the energy market to be implemented in the coming months<sup>21</sup>, although the majority of those do not focus on fostering competition, but rather on directly reducing the end consumer's final energy bill<sup>22</sup>. In order to increase R&D intensity of the economy, the federal government is allowing a 75 % payroll tax exemption for researchers, and regions and communities have developed strategic innovation approaches covering major aspects of a successful innovation strategy.

With a view to preventing price/cost competitiveness losses, Belgium could:

- **make sure that the 'wage norm' is applied correctly** by making better use of the possibility to implement ex post corrections;
- initiate a **reform of the wage indexation system**, including the promotion of "all-in" agreements, thereby ensuring that wage growth better reflects developments in labour productivity and competitiveness. Reducing the weight of energy products in the index would temper the effect of the automatic indexation system in times of high imported inflation in order to leave more scope to adjust wage growth in line with productivity and competitiveness. Belgium could also facilitate the use of opt-out clauses from sectoral collective contracts to ensure that wage growth better reflects labour productivity developments at local and sectoral level. This would improve the adjustment capacity of the labour market and smooth labour reallocation towards most dynamic firms and sectors;
- take measures to assure a **better functioning of energy markets**, with more competition and closer supervision of the energy sector, which would put downward pressure on energy prices and hence improve cost competitiveness. There is room to improve the coordination between the competition authority and the sectoral regulators as a way of improving the enforcement of competition rules in the energy market. **Improving energy efficiency** of the economy would also temper the impact of oil price increases on competitiveness and inflation.
- strengthen **competition in the retail sector** by lowering barriers to entry and reducing operational restrictions and in **other network industries** (telecom, postal services and transport), by revising regulatory barriers and reinforcing the institutional set up for an effective enforcement of state aid rules;
- **shift the tax burden from labour to other sources of revenue, which** could have positive effects on the cost competitiveness of the Belgian economy.

Regarding non-cost competitiveness, Belgium would benefit from a further transition towards higher technology exports in which input costs play a smaller role. A further stimulation of **investment in R&D and ICT** would both increase the technology content of products as well as increase

---

<sup>21</sup> In particular, the federal government decided to oblige GDF Suez to divest part of its production capacity (of amortised nuclear plants) and sell it on the market. Other initiatives such as on-line price comparability tools for electricity and gas (provided by the regulators of the three regions) can also increase transparency of energy prices for customers.

<sup>22</sup> They refer to the elimination of switching fees, support for renewable energy, suspension during 9 months of the transfer of money to the Kyoto fund, encouraging regions to work on reducing distribution tariffs, revision of the social tariff system and freezing of distribution tariffs until 2014.

productivity. Research and innovation policy could become more demand driven, and it could be ensured that better coordination and overall coherence among the various R&D policies undertaken at federal, community and regional levels are fully exploited. There is also a need to attract more young talent into science and engineering studies in order to avoid skills shortages which may deter future private R&D investments. Moreover, **entrepreneurial attitudes** and innovation skills need to be fostered across the whole education system. In order to better **match skills with labour market demand**, the coherence could be strengthened between regional education, training and employment policies while continuing to invest in cooperation between regional authorities to boost interregional labour force mobility. Labour market reforms, for example by making work more attractive and increasing the effective retirement age, would lead to a better utilisation of the full potential of the available labour force.

Concerning public debt, the economy as a whole would benefit from a decisive implementation of measures aiming to **consolidate public finances** in a sustainable way, putting the public debt on a declining path. This would not only reduce the risk associated to sovereign debt, but also will give the authorities more room for manoeuvre to implement a fiscal policy aiming at improving the cost competitiveness of the country, as well as to face unexpected developments in other economic sectors such as financial markets. With a longer term perspective, curbing the expenditure associated to ageing would also be beneficial to prevent a further increase of the debt level.



## REFERENCES

De Grauwe, P. (2010), "De competitiviteit van België: een lange termijn analyse", *Leuvens economische standpunten* 2010/132.

Duprez, C. (2011), "International Trade in Services – A growing contribution to Belgium's current balance", NBB, Economic Review December 2011, pp. 53-67. Available at:

[http://www.nbb.be/doc/TS/Publications/EconomicReview/2011/ecorevIII2011\\_H4.pdf](http://www.nbb.be/doc/TS/Publications/EconomicReview/2011/ecorevIII2011_H4.pdf).

Federal Planning Bureau (2010), "*Comparaison des composantes de la croissance de la productivité: Belgique, Allemagne, France et Pays-Bas, 1996-2007*", Working Paper 18-10, 2010.

Konings J., B. van Aarle and M. Vandeweyer, (2012), "De impact van de automatische loonindexering op de koopkracht en werkgelegenheid", Catholic University of Leuven, Vlaams Instituut voor Economie en Samenleving (VIVES) and Vlaams netwerk van Ondernemingen (VOKA), February.

National Bank of Belgium (2011), "End of the crisis in the housing markets? An international survey", Economic Review, Issue 1 (53-41).

National Bank of Belgium, Central Economic Council (CCE) and Federal Planning Bureau (2011), "De uitdagingen voor het concurrentievermogen in België", 20 September 2011.

