

Fiscal consolidation and economic growth : the case of Belgium



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Short version

DG Ecfm

Workshop Belgium

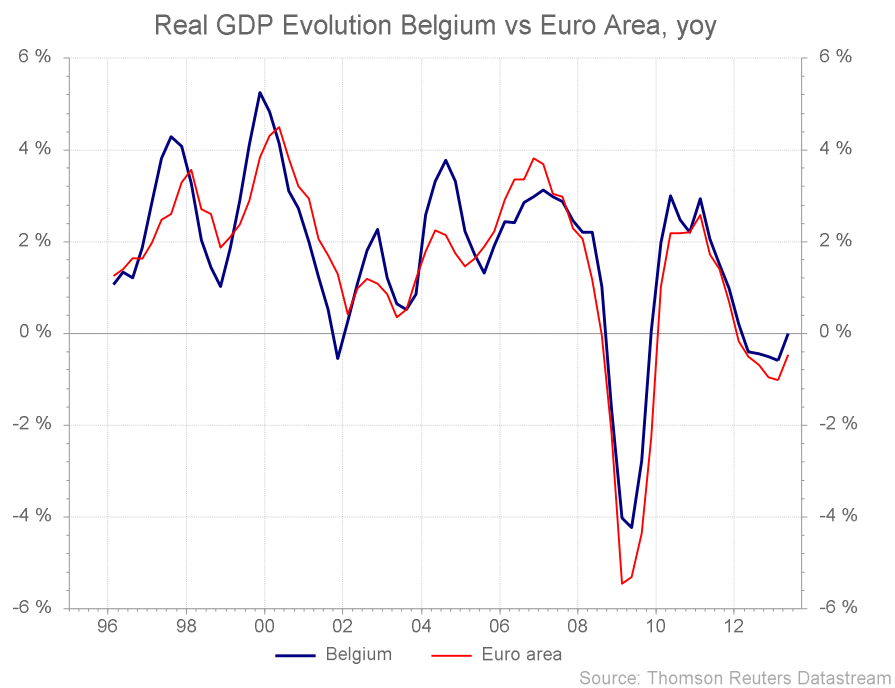
September 25, 2013

Introduction

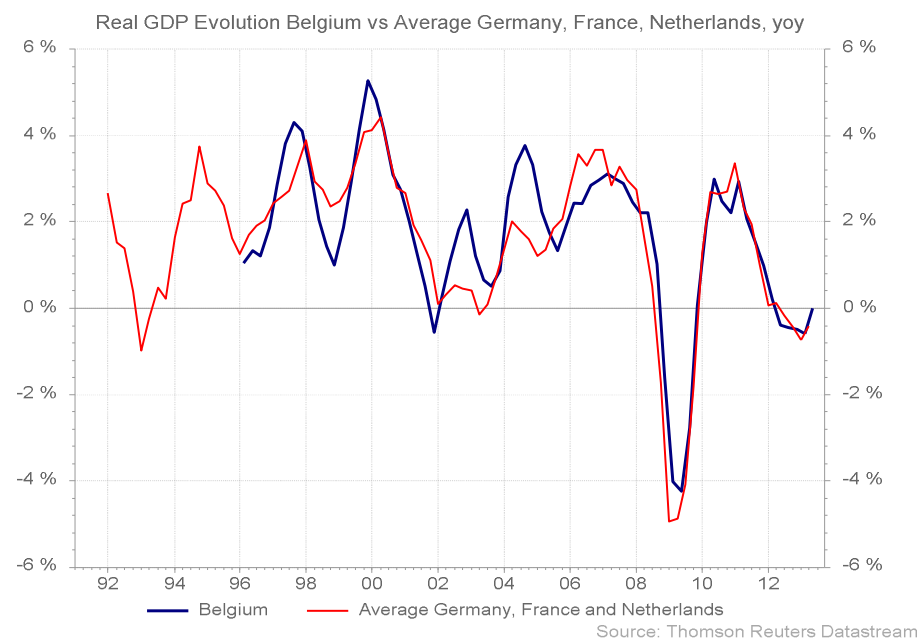


Thanks to Photoshop ? No, to “Brussels Mini-Europe”

Introduction



Correlation of real GDP growth rate between Belgium and unweighted average of Germany, France and the Netherlands is 0.90



Introduction

- Observation : outcome in Belgium = EU average
- Interpretation : local features are irrelevant
- Conclusion : **the seminar is over**

Introduction

- **However ...** it may be interesting to look at
 - Local fabrics
 - Local policy choices

- Here, focus on **fiscal policy** (taxes and expenditures)

- ... with a view about how to boost **low growth** expectations

Potential real GDP growth	2012- 2017	2018- 2030	2031- 2050
Belgium	1.9%	2.2%	1.9%
OECD average	2.0%	2.2%	1.9%

Source : OECD Economic Outlook 2012/1, table 4/1

Content



1. Belgian fabrics – some key features of fiscal relevance

2. Growth-enhancing fiscal consolidation
 - Fiscal stance
 - Tax policy
 - Expenditure policy
 - Governance

1. Belgian fabrics – some key features

Institutional

- Cf. presentation by G. Pagano
- **Unique** structure
 - Regions and language-based Communities
 - Limited number of entities (polarization)
 - Brussels
- Large **devolution** of powers, with overlaps between entities
- Strong **divergences** between Regions (and within Regions ...)
 - Economic performances
 - Political preferences
 - Cultural heritage
- **Fragile co-ordination** set-up
 - no hierarchy
 - ... but federal level hold responsible at EU / EA levels

Demographics & Human Capital

- **More favorable demographic outlook**
 - Fertility : below replacement rate but higher than EU average
 - Migration : large positive inflow but slowing down
 - Life expectations : no outperformance

- **Education : high level of public expenditure ... and average results**

Labor market – overview (1/2)

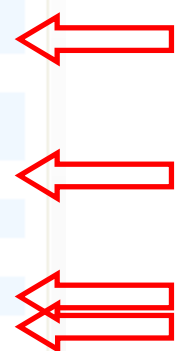
Labour market outcomes

Indicator	Unit	2000	2011	2012	2012
					OECD-Total
Unemployment rate	% of labour force	6.6	7.2	7.6	8.2
Youth unemployment rate	% of youth labour force (15-24)	15.2	18.7	19.8	16.3
Long-term unemployment (12 months and over)	% of total unemployment	56.3	48.3	44.7	34.3
Employment rate	% of working age population	60.9	61.9	61.8	65.1
Employment rate of women	% of female population (15-64)	51.9	56.7	56.8	57.2
Employment rate of older workers	% of population aged 55-64	25.0	38.7	39.5	55.6
Temporary employment	% of dependent employment	9.0	9.0	8.1	11.8
Part-time employment	% of total employment	19.0	18.8	18.7	16.9
Average annual working time	Hours per worker	1 545	1 576	1 574	1 765
Average annual wage	2012 USD PPPs	45 428	47 290	47 487	43 523
Growth of real GDP	% change from previous year	3.7	1.9	-0.3	1.4
Employment growth	% change from previous year	2.0	1.3	0.2	1.0
Wage growth	% change from previous year	1.4	0.3	0.4	-0.1

Last updated: 16 July 2013; disclaimer: <http://oe.cd/disclaimer>

Note: Next update: June 2014, OECD weighted average.

Source: OECD Employment Outlook, for most of the above indicators. For further details, see: [sources](#), [definitions](#) and [related studies](#).



Labor market – overview (2/2)

Labour market policies and institutions

	Unit (earlier, latest years)	Earlier year	Latest year	Latest year OECD- Total
Public expenditure on labour market policies				
Active measures	% of GDP (2000, 2011)	1.1	1.6	0.6
Passive measures	% of GDP (2000, 2011)	2.1	2.1	0.9
Ratio of minimum to median wage	Ratio (2002, 2011)	0.52	0.50	0.48
Employment protection (EP)				
EP strictness – individual and collective dismissals (regular contracts)	Scale 0-6 (2008, 2013)	2.9	2.9	2.3
EP strictness – individual dismissals (regular contracts)	Scale 0-6 (2008, 2013)	2.1	2.1	2.0
EP strictness – temporary contracts	Scale 0-6 (2008, 2013)	2.4	2.4	2.1
EP strictness – collective dismissals (additional restrictions)	Scale 0-6 (2008, 2013)	5.1	5.1	2.9
Labour taxes (for a single person without children)				
At 100% of the average wage	% of labour costs (2001, 2011)	56.7	56.1	35.5
At 67% of the average wage	% of labour costs (2001, 2011)	50.7	50.5	31.8
Unemployment benefits	% of previous earnings (2001, 2011)	34.9	37.2	23.5
Union membership	% of employees (2000, 2011)	49.5	50.4	17.3



Last updated: 16 July 2013; disclaimer: <http://oe.cd/disclaimer>

Note: Next update: June 2014. OECD unweighted average.

Source: OECD Employment Outlook, for most of the above indicators. For further details, see: [sources](#), [definitions](#) and [related studies](#).

Labor market – unemployment

- Structural unemployment issue
- **Limited increase since 2008 – why ?**
 - Better economic outcome
 - J curve effect on unemployment of wage slippage (automatic indexation)
 - Labor hoarding (severance pay + skill shortages)
 - Measurement issue – hidden unemployment (extension of “Economic unemployment”, increase of number of disability allowances, early retirement)
 - “Titres-services” – legalization of black market
 - Smaller share of workers in tradable, more vulnerable sectors
 - Public sector and non-profit employment (at level of municipalities & health care)
- Progress towards active welfare state but room for more
- Steeper decline of allowances over time but still unlimited

Labor market – employment

- **Low aggregate employment rate :**
 - 25-55 : in line with industrial countries
 - Below 25 : below average
 - **Above 55 : below average**

- Large share of public employment

- Large share of non-profit, subsidized employment

Labor market – working of the market (1/2)

– **Mismatches**

- Shortages of supply, and not only high skills positions
- Number of young adults lacking skills, including soft skills (language, behavior)
- Cultural discrimination against manual work
- Widespread preference for public sector job security
- Unemployment trap
- Limited impact of labor market considerations on choice of studies

– **Rigidities – high level of protection for permanent workers**

Labor market – working of the market (2/2)

– Social climate

- Lack of confidence / heritage from problematic industrial restructuring
- Unions : competition between trade unions, weight of sectors, power (protection of candidates), multiple roles (unemployment benefits), “ratchet” culture
- Fragmentation
 - insiders/outsideers
 - regional immobility
 - professional immobility (seniority related advantages, limited portability of rights)

– Wage determination process

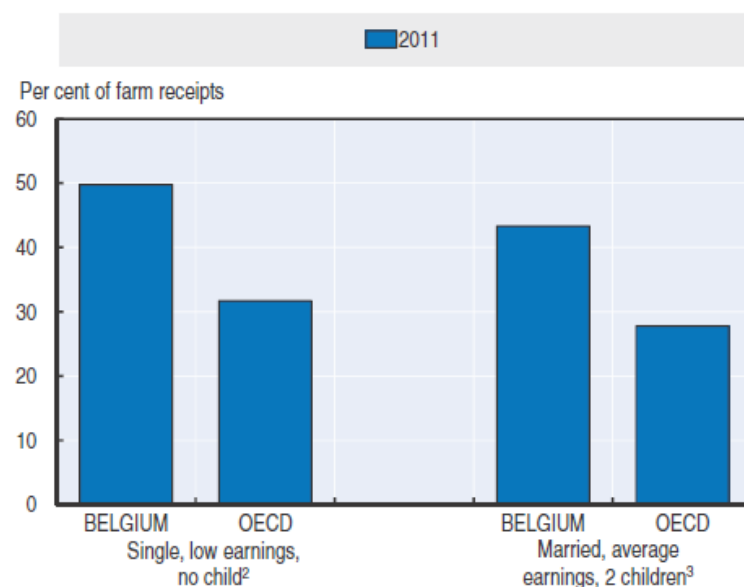
- Automatic wage indexation
- Negotiations at national and at sector level
- No opt-out possibility

Labor market – tax wedge & unemployment trap

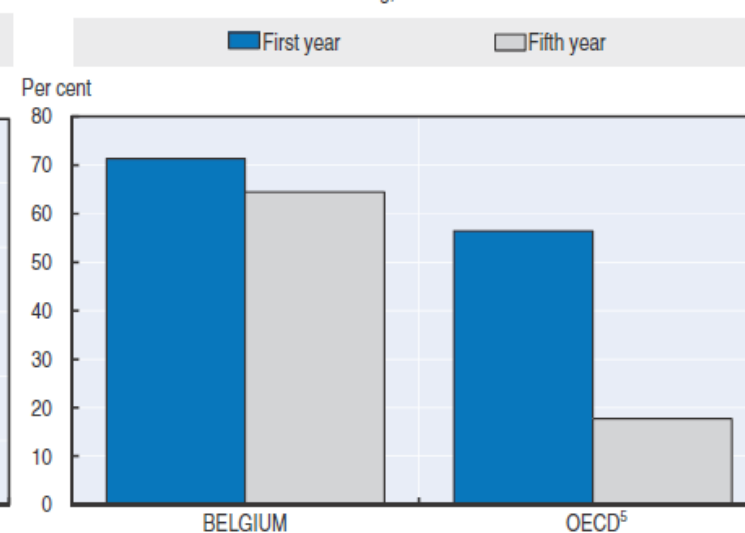
BELGIUM

Policy indicators

A. The labour tax wedge¹ is comparatively high
Percentage of total labour compensation



B. Unemployment benefits are relatively generous
Net income when unemployed as a percentage of net income when working,⁴ 2010



1. Labour taxes include personal income tax and employee plus employer social security contributions and any payroll tax less cash transfers.
2. Low earnings refer to two-thirds of average earnings.
3. At 100% of the average worker earnings for the first earner. Average of three situations regarding the wage of the second earner (0%, 33% and 67% of average earnings).
4. Average of net replacement rates for single, one-earner couple, at 67% and 100% of average wage with and without children.
5. OECD average excludes Chile and Mexico.

Source: OECD, *Labour and Taxing Wages Databases*; *Tax-Benefit Models*.

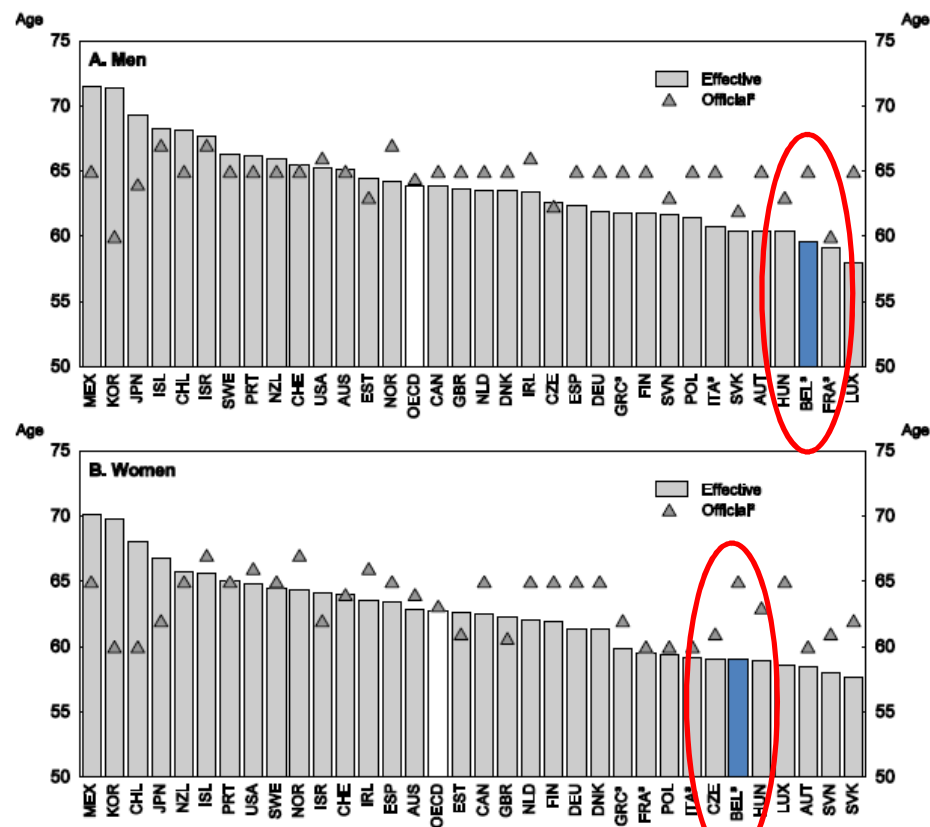
Social security – pensions (1/2)

- **Low effective retirement age**
- First pillar
 - Low replacement rate for private-sector employee with full career
 - “Generosity” towards
 - Civil servants (in general and even more specific schemes (teachers, railways, army, ...)
 - Early retirement schemes / far from actuarial neutrality
 - Assimilated years
- Second pillar (non-mandatory, collective arrangement with tax incentive)
 - Limited scope (and assets)
 - Large tax advantage vs. regular pay
 - Guaranteed interest rate in defined contribution pension schemes (3.75% / 3.25%)
- Third pillar (individual LT savings with tax incentive)
 - Marginal individual amounts
- Forth pillar (not pension-related LT savings, with and without tax privileges)

Social security – pensions (2/2)

Average effective age of retirement versus the official age¹

2006-2011



1. The average effective age of retirement is defined as the average age of exit from the labour force during a 5-year period. Labour force (net) exits are estimated by taking the difference in the participation rate for each 5-year age group (40 and over) at the beginning of the period and the rate for the corresponding age group aged 5-years older at the end of the period. The official age corresponds to the age at which a pension can be received irrespective of whether a worker has a long insurance record of years of contributions.
2. Official retirement age is shown for 2010.
3. For Belgium and France, workers can retire at age 60 with 40 years of contributions; for Greece, at age 58 with 35 years of contributions; and for Italy, at 57 (56 for manual workers) with 35 years of contributions.

Source: OECD (2012), OECD Pensions and Labour Market statistics, December.

Social performance

- Past record :
 - Extensive safety net – an European model
 - Efficient health care system
 - “Unemployment trap” or “welfare trap”
- Evolution
 - **No longer among best performers ... despite faster outlays growth**
 - Progress towards “active welfare state”
 - Fast increase of health care outlays
 - Poverty issues (children, “good health” life expectations)
 - Large regional discrepancies

Labor market – inequity

Large **wage and non-wage discrimination** between :

- Labor status (employees, civil servants, self-employed)
- Statutory civil servants and non-statutory (“contractuels”) civil servants
- Employees of large corporations vs. of SMEs
- Men vs. women
- Elderly workers vs. young workers (close relationship between wage and seniority)
- Local cultural background vs. non-European origins
- Tax treatment of employee vs. management company
- ...

Business environment (1/2)

Mixed picture

- GDP growth in line with peers
- ... but loss of market shares

- Business sector complaining about dramatic loss of competitiveness
- ... but capex and FDI do not point towards acute problems

Business environment (2/2)

- WEF, Global Competitiveness Index
 - Belgium, 2013-2014 : 17 / 148 (8th among EU members)
 - Belgium, 2012-2013 : 17 / 144
 - Belgium, 2011-2012 : 15 / 142

- IMD, World Competitiveness Yearbook
 - Belgium, 2013 : 26 / 60 (10th among EU countries)
 - Belgium, 2012 : 25 / 60

- IESE / E&Y, The Venture Capital and PE Country Attractiveness Index
 - Belgium, 2013 : 16 / 118

- OECD Indicator of Product Market Regulation (PMR) :
 - **Belgium : 11th out of 15 EU** members (2008)

Cost of living

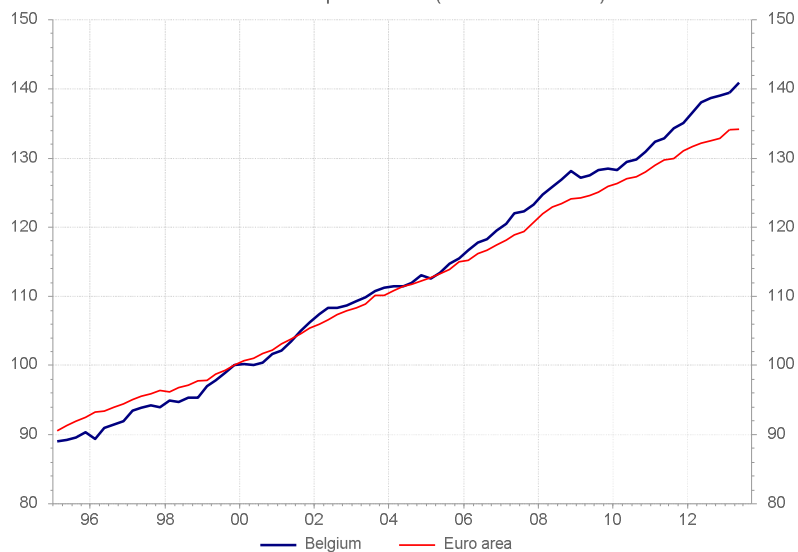
- **Leaving housing aside, cost of living is high – why ?**
 - Higher labor costs
 - Higher VAT
 - **More stringent regulation** (opening hours, overtime regulation, food safety, ...)
 - Higher producer prices
 - Less economies of scale on a small market (+ language related expenses)
 - Less price-consciousness of consumers / higher brand price premium
 - **Less competition**
- In turn impact on wage level and on competitiveness

Inflation

- Used to be lower in Belgium than in the EU
- Over the last years higher in Belgium
 - Economic environment
 - Wage indexation
 - Less G&S deregulation
 - ... despite indirect taxes increases abroad
- **“Back to normal” over the last quarters – why ?**
 - Convergence of economic performance
 - Impact of methodological changes
 - Measures to curb wage increase

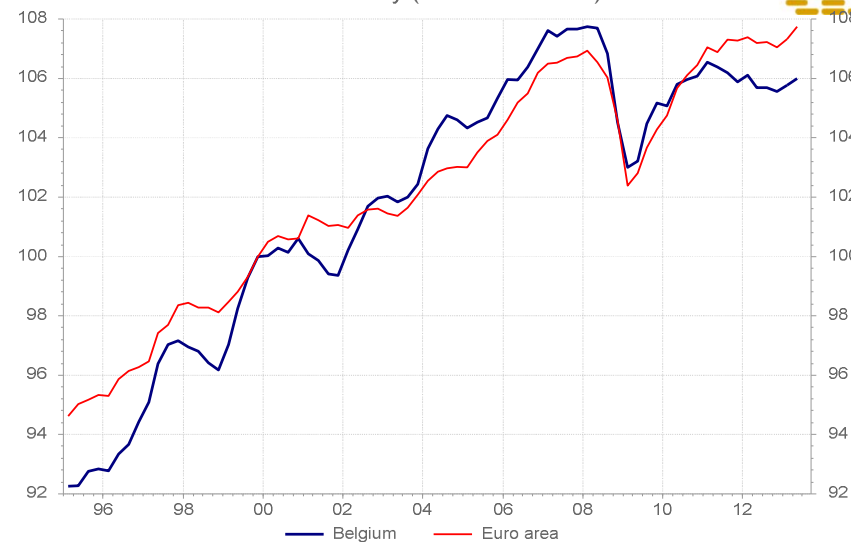
Labor costs

Labour Compensation (31/12/99 = 100)



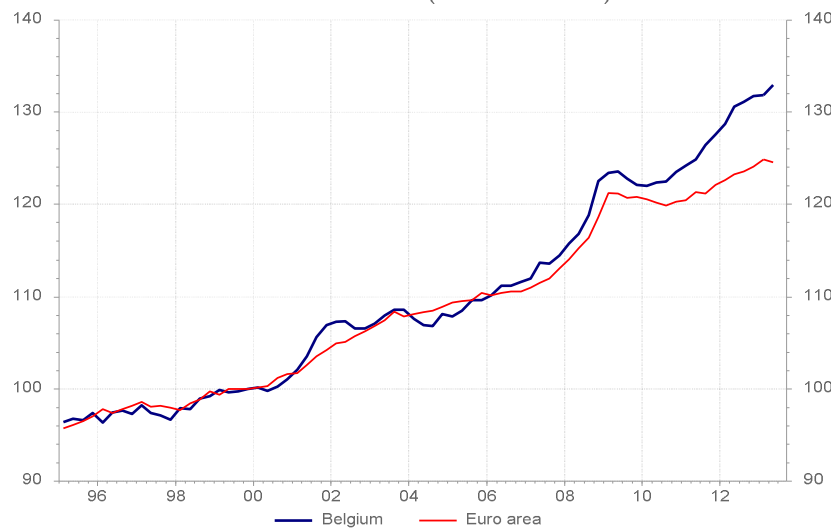
Source: Thomson Reuters Datastream

Productivity (31/12/99 = 100)



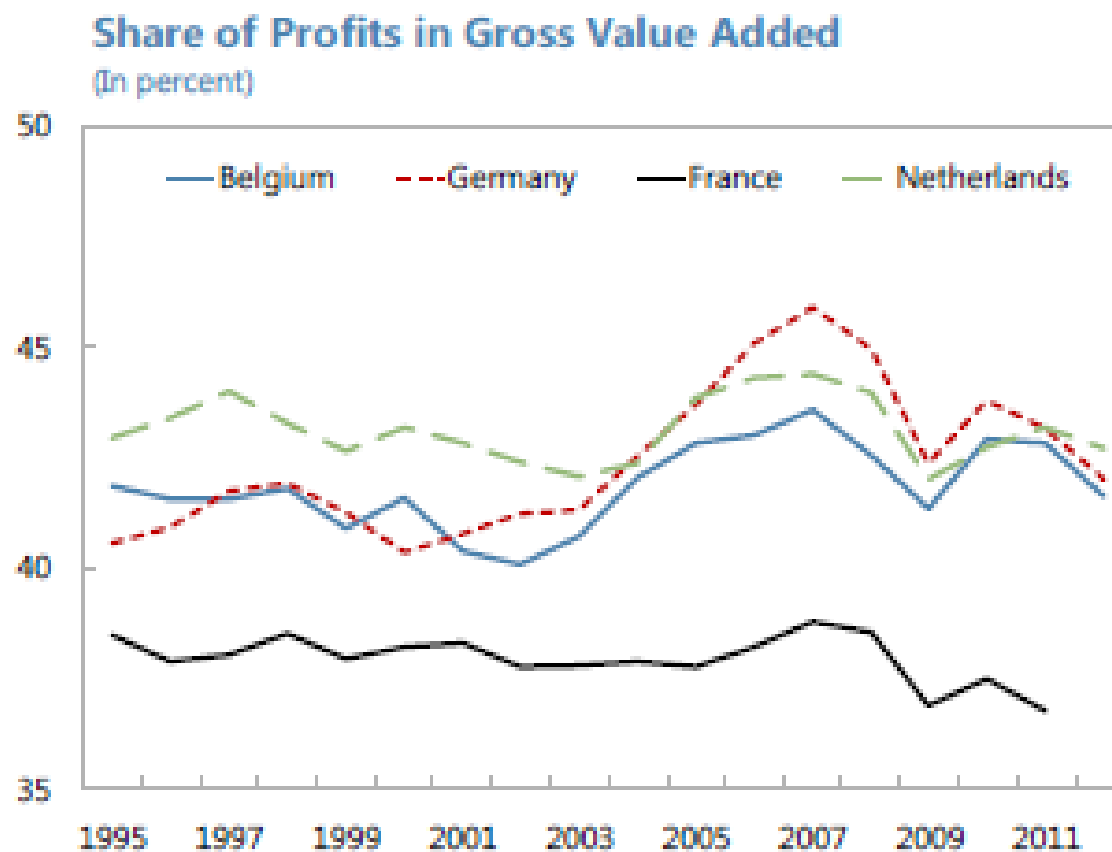
Source: Thomson Reuters Datastream

Unit Labor Costs (31/12/99 = 100)



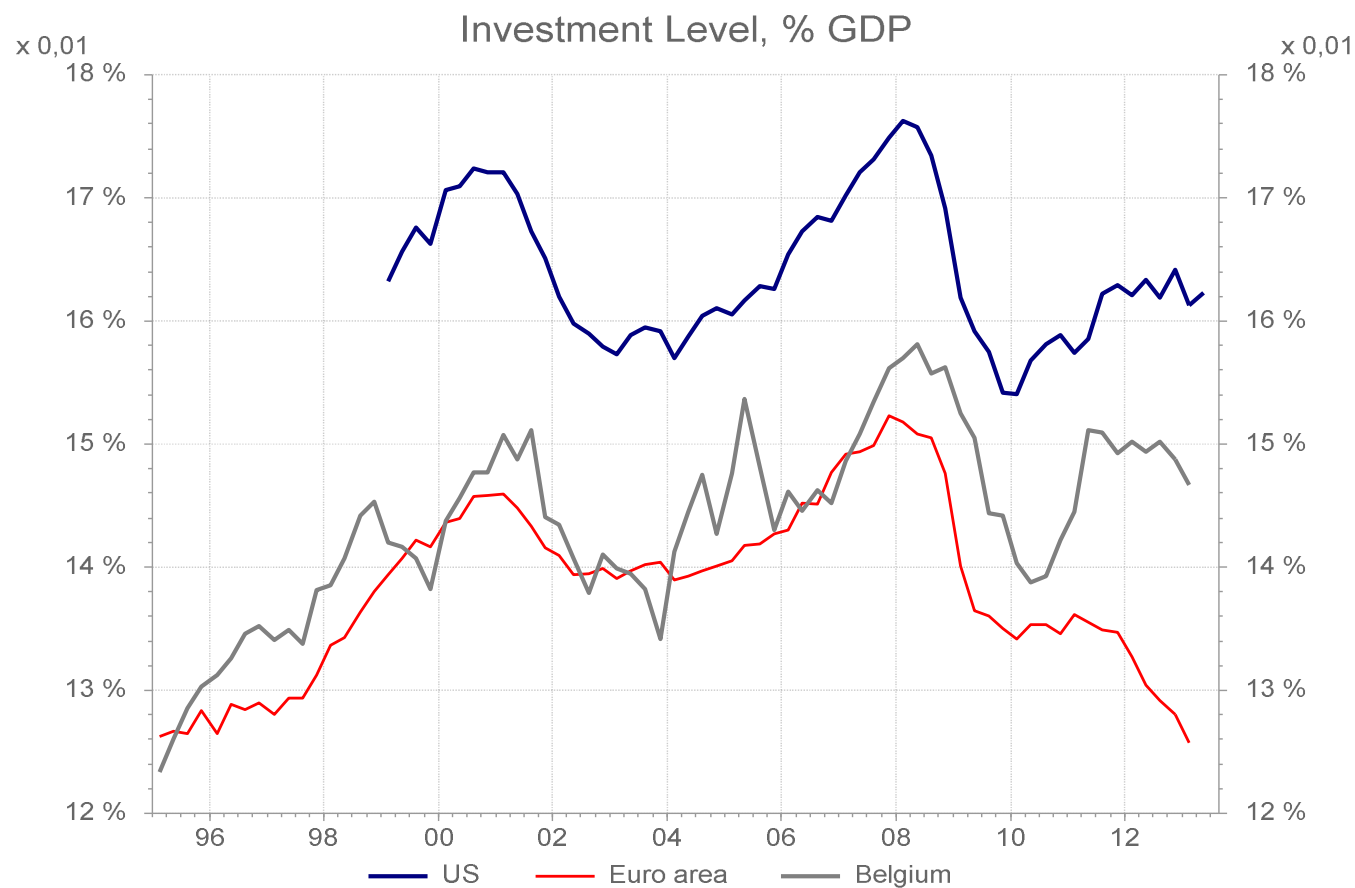
Source: Thomson Reuters Datastream

Profit margins



Source: IMF

Investment

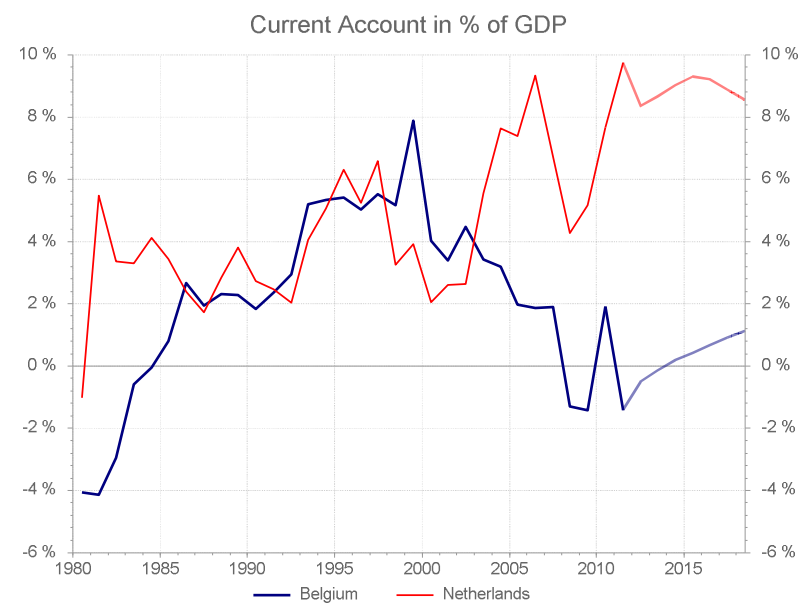
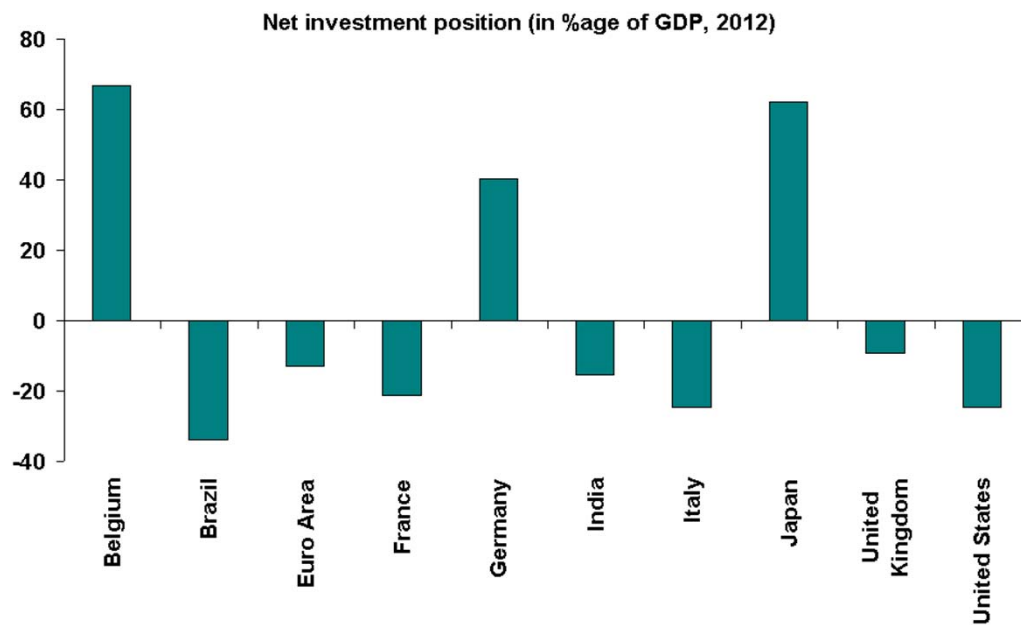


- US : Non residential private investment + Public sector gross investment
- Euro area and Belgium : GFCF – GFCF housing

Corporate landscape

- High level of foreign direct investment
- Few large corporations with local background
- Numerous SMEs, failing to get big
- Limited total market cap of local stock exchange
- Sale of “*bijoux de famille*”
(Fortis, Royale Belge, Petrofina, Electrabel, Glaverbel, ...)
- Absence of economic patriotism / industrial policy

External accounts (1/3)



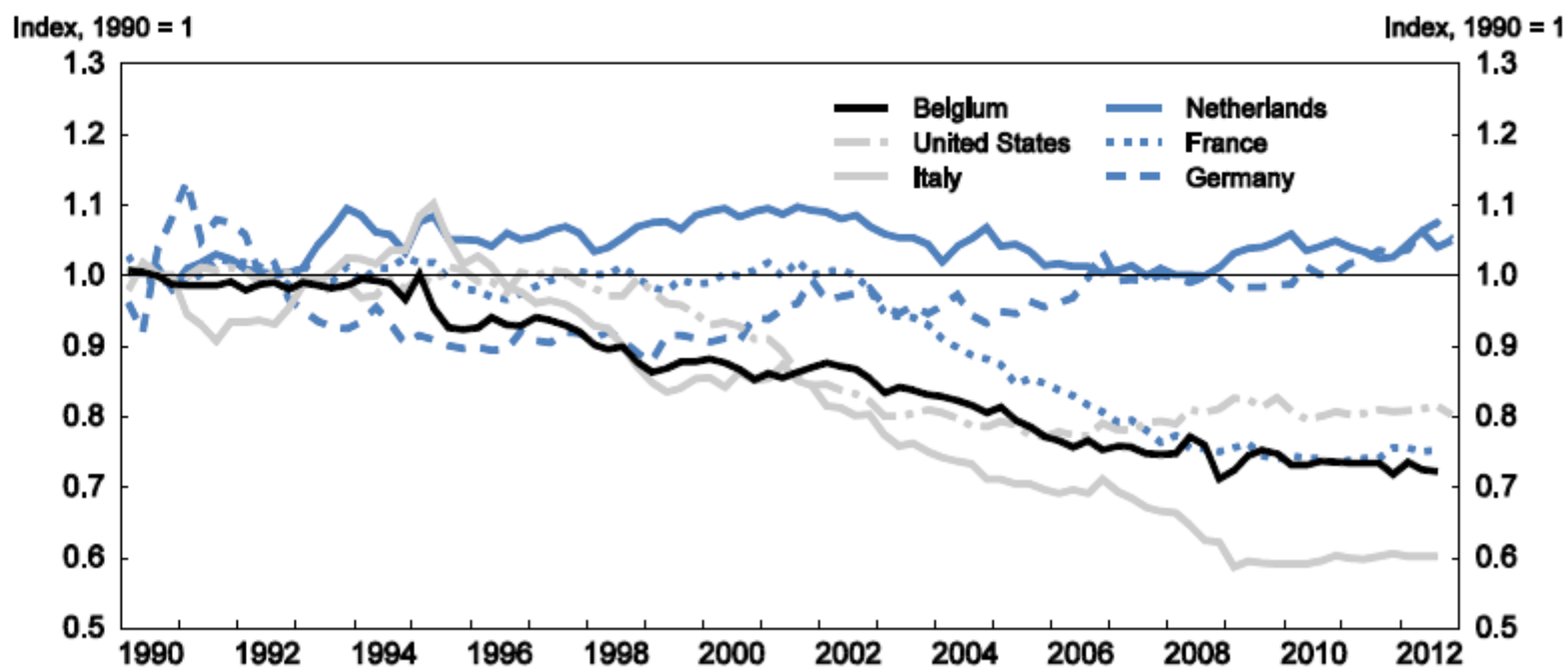
Source: Thomson Reuters Datastream

External accounts (2/3)

- Small, open economy, with focus on neighbouring countries
- **Large net creditor position**
 - Belgium : “Rich country, poor State”
 - Belgians : “Rich individuals, poor citizens”
- **Deterioration of current account and loss of market share – why ?**
 - Wage slippage (impact on exports and on imports)
 - Structural composition of the economy / declining terms of trade
 - Product specialization – half-finished goods, less technology intensive
 - Export specialization (low growth neighbouring countries)
 - Loss of entrepreneurship
 - Other potential elements
 - Public intervention (regulations, ...)
 - R&D volume and efficiency
 - Vocational training
 - ...

External accounts (3/3)

Belgian export market losses have been larger than its competitors



Source: OECD (2012), OECD Economic Outlook: Statistics and Projections database, November.

Financial sector

Key features

- High level of household wealth
- High level of private savings (stable at about 15% of disposable income)
- **Above average impact of financial crisis** (Fortis, Dexia, KBC)
- No big bank anymore in a small country
- Model of “bancassurance”
- Tax privileges on savings products
- High level of bank intermediation

Housing market – structural features

- High home ownership rate
- **Sound financing practices**
 - reasonable LTV
 - amortizing mortgages
 - no equity withdrawal
 - No speculative purchases due to high transaction cost
- Low mobility (“the Belgians do not move, they commute”)
- **Taxation : high at purchase, low on recurrent basis**
 - High one-off registration fee (with portability in Flanders)
 - Low recurrent tax burden
 - Absence of “péréquation cadastrale” means tax bias against new housing, with negative impact on economic activity (break on new housing investment) & energy consumption
 - Home property tax incentive deductibility, that will have to be scaled down

Housing market – valuation

- **Signs of overvaluation** (OECD, August 2013):
 - Price-to-income : 149% of trend valuation (= 33% excess valuation)
 - Price-to-rent : 163% of trend valuation (= 39% excess valuation)
 - Most rapid price increase in Euro Area over the last 40 years
- **Why ?**
 - catch-up effect
 - measurement issue (vanishing undeclared payment, that was not measured)
 - price-to-income biased by parents' transfer
 - increased tax incentive (“woon bonus” in 2005, portability of rights in Flanders)
 - extended mortgage duration (until recently)
 - financial status of “nice return without risk”
 - reinvestment of repatriated assets (following tax amnesty)
 - increased tax pressure on alternative investment (withholding tax, exchange of information)

Budgetary policy framework

- **Small open economy** means :
 - In relative terms, austerity abroad is more painful & domestic austerity less
 - Meaningless to run an expansionary policy on its own
- **Ricardian equivalence** seems to be validated
 - Large fiscal imbalances, large private surpluses (as in Italy)

Tax income – recent evolution (1/2)

	Belgium	OCDE average
Over 2007-2011, change as % of GDP		
▪ Total tax revenue	+ 0.4%	- 1.2%
▪ Taxes on income, profits, K gains	- 0.3%	- 1.2%
▪ Social security contr + payroll taxes	+ 0.6%	+ 0.2%
▪ Taxes on property	+ 0.1%	- 0.1%
▪ Taxes on goods & services	+ 0.1%	0.0%

Source : LeBlanc, P., S. Matthews and K. Mellbye (2013), "The Tax Policy Landscape Five Years after the Crisis", *OECD Taxation Working Papers*, No. 17, OECD Publishing. <http://dx.doi.org/10.1787/5k40l4dxk0hk-en>

Tax income – recent evolution (2/2)

Over 2007-2013, change in 34 OECD countries

	Increase	No change	Decrease
▪ Top PIT rate	18	9 (incl. Belgium)	7
▪ Main CIT rate	6	9 (incl. Belgium)	19
▪ Standard VAT rate	18	15 (incl. Belgium)	1

Source : LeBlanc, P., S. Matthews and K. Mellbye (2013), “The Tax Policy Landscape Five Years after the Crisis”, *OECD Taxation Working Papers*, No. 17, OECD Publishing. <http://dx.doi.org/10.1787/5k4014dxk0hk-en>

Top rate	2000	2005	2013
Belgium	60.6%	53.7%	53.7%
EA 17	47.1%	41.9%	44.5%

Source : Eurostat, Taxation trends in the EU, 2013 edition

Tax policy – recent changes

- **Personal income**
 - No change of neither tax rates nor tax brackets
 - Tightening of tax expenses and of “advantages in kind” (company cars, housing)
 - **Focus on capital income**
 - Upwards harmonization of withholding tax (including liquidation bonus)
 - Taxation of mutual funds (non refund of tax on Belgian dividends, ...)
 - Higher rate on stock options and on financial transactions
 - Fight against fraud (transparency assets abroad)
 - Tax amnesty
- **Corporate income**
 - No change of nominal rate
 - Scaling down of notional interest deductibility
 - Alternative minimum tax (called “fairness tax”)
- **Consumption**
 - VAT : no rate increase but extension of scope (notaries, lawyers)
 - Others (excises) : limited increase, but not on oil and gas products

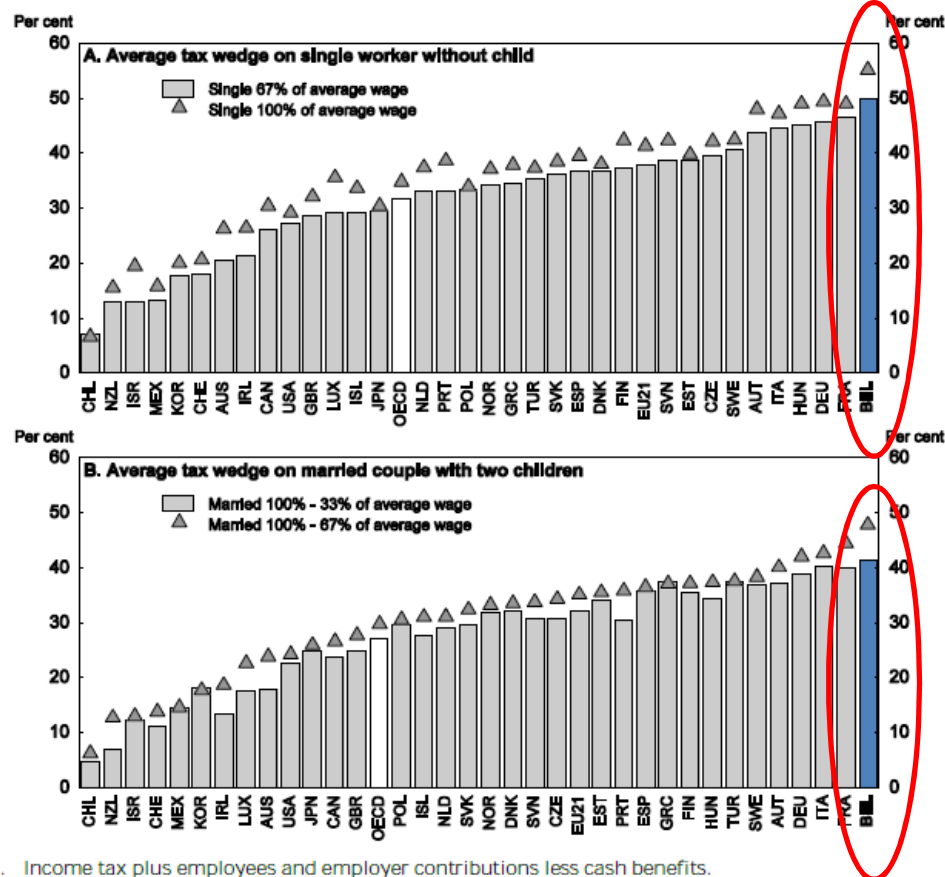
Taxation – personal income (1/2)

- No globalization
- High overall tax wedge on labor income
- Progressive taxation despite not so progressive tax schedule
- Numerous tax expenses
- Intricate (number of inputs on tax enrolment form)
- Compliance issue

Taxation – personal income (2/2)

Tax wedges are high¹

2011², as a share of labour costs



1. Income tax plus employees and employer contributions less cash benefits.
2. 2010 for Greece.

Source: OECD (2012), Taxing wages database, December.

How to read this figure: The tax wedge is labour taxes (income taxes plus employee and employer social security contributions) as a percent of before-tax wage (the so-called gross wage). For example, a single Belgian worker earning 67% of the average wage has a tax wedge of 50%.

Taxation – social security contributions (SSC)

- **Very high SSC contributions** (13% employee + about 35% employer)
- Hidden tax on domestic labor
 - Low differentiation of SS benefits on the basis of contributions due to :
 - Minimal benefits, irrespective of contributions
 - Wage cap for computation of benefits but not of contributions of wage-earners
- Large difference between employees and self-employed
- Numerous, intricate measures to lower SSC

Taxation – corporations

- **Gap nominal vs. effective average rate**
 - High nominal rate (33.99%) (vs. 25.9% EA 17 average)
 - Average effective rate (impact of notional interest deductibility)
- **Notional interest deductibility**
 - Tax neutrality vs. dividends
 - Generalization of former “coordination centres”
 - Harmful tax competition
 - Limited economic impact
- **Incentive towards incorporation**
 - Easy access to status of corporation
 - Large tax differential : lower rate ... and room for optimization (professional expenses)

Source : Eurostat, Taxation trends in the EU, 2013 edition

Taxation – capital income

- No globalization of capital income
- **Low taxation of real estate income**
 - Favorable tax treatment of imputed residential rent income
 - Favorable tax treatment of residential rent income
 - ... but high registration tax on real estate purchase
- **Increased but still low taxation of income on financial assets income**
 - Flat final withholding tax on dividends, interest income, and “liquidation bonus” (25%)
 - No tax on capital gains (no deductibility of losses)
 - No tax on savings account
 - No tax on long-term (at least 8 years) insurance savings

Taxation – consumption & environment

- VAT

- **Normal VAT rate no longer above EU average**

	Belgium	EU27
2000	21%	19.2%
2013	21%	21.3%

- Large scope of consumption not taxed or taxed at reduced rate (6% & 12%)

- Excise duties

- Lower taxes on tobacco products (with cross-border implications)

- **Almost no tax on heating oil & gas**

- Environment : below EA average (2.1% of GDP vs. 2.3%)

Source : Eurostat, Taxation trends in the EU, 2013 edition

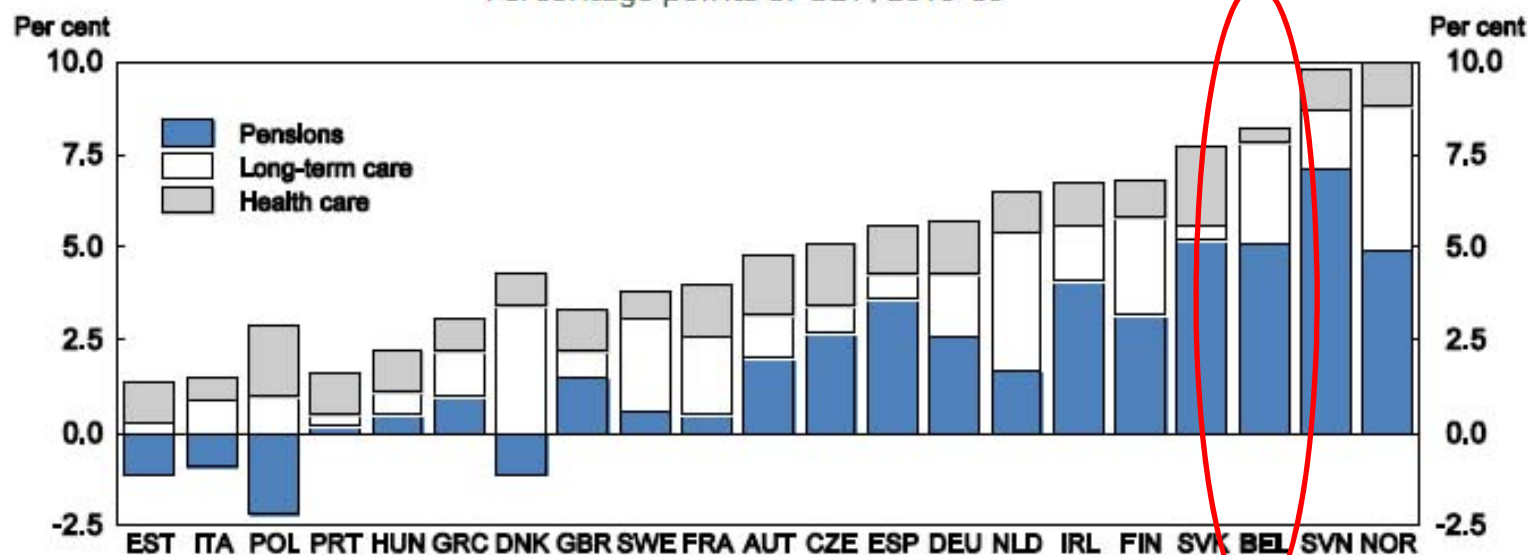
Public expenditure – investment

- Shortage of public investment
Mobility issue, even if not properly measured
- **Far from 3% EU historical average (and implicit norm) for decades**
- Impact of infrastructure on competitiveness

Public expenditure – ageing

Expected increases of ageing costs are relatively high¹

Percentage points of GDP, 2010-60

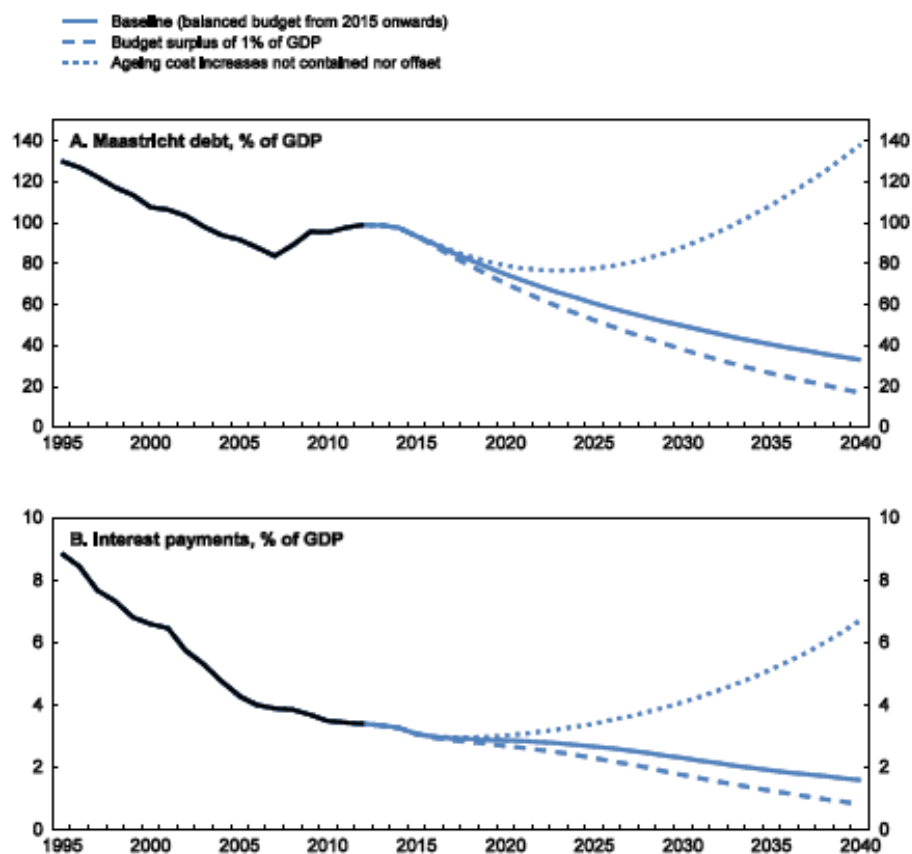


- Each bar is the sum of three components of ageing-related spending under the assumptions of unchanged policy. In Belgium, population ageing is projected to induce an increase in public spending on pensions, health care and long-term care, as a share of GDP, by respectively 5.1, 2.7, 0.4 percentage points between 2010 and 2060. For Estonia, Italy, Poland and Denmark, pension spending is projected to fall relative to GDP.

Source: European Commission (2012), Fiscal Sustainability Report 2012, European Economy 8.

Public expenditure – debt path

Illustrative public debt paths¹



1. This figure presents the path of public debt and interest payments in three scenarios. In the baseline, the general government budget is assumed to be in balance from 2015 onwards, implying that ageing-related spending increases (notably on pensions and health) are either contained or offset by reducing other spending. The "budget surplus" scenario assumes a budget surplus of 1% of GDP after 2016 with the same implication for ageing-related spending. The third assumes that rising ageing-related spending increases are neither contained nor offset, but debt financed. It is not meant to be realistic, as the debt path is unsustainable, but it is one illustration of the magnitude of the challenge posed by population ageing. GDP growth and interest rate projections are from the OECD Long-Term Database. Ageing costs estimates are from the European Commission 2012 Ageing Report.

Public accounting

■ Impact of accounting on policy

- Focus on nominal fiscal balance
 - No adjustment for the cycle
 - No adjustment for investment
 - No adjustment for fluctuating implicit interest rate
 - Window dressing (PPP, “de-budgetization” and other artefacts, ...)
- Focus on gross debt ...
 - With no eye for future liabilities (ageing)
 - With no eye for public sector financial assets (limited in the case of Belgium)
- Revenue vs. expenditure (child policy / social security contribution rebates / ...)

■ Quality of the data

cf. Ph. Defeyt, *L'état des statistiques en Belgique*, Juillet 2013

2. Growth-enhancing fiscal consolidation

2.1. What are the problems ? (1/2)

■ **Out-performance of Belgium since 2008 – why ?**

- Despite absence of reforms
- Despite political turmoil
- Despite high exposure to financial crisis

Key intuitive factors

- Exposure towards Germany
- EA average driven down by periphery
- Absence of short-term loss associated with structural reforms
- Wage evolution (wage indexation)
- Confidence (wage indexation)
- Budgetary policy : limited improvement, subsidized local employment more than countercyclical measures that would have supported imports

2.1. What are the problems ? (2/2)

- EC Recommendations (June 19, 2013) :
 - Sustainable public finances
 - Social security for the elderly
 - Cost competitiveness and wage setting
 - Competition in network industries and services
 - Shifting taxes from labour
 - Labour markets
 - Greenhouse gas emissions

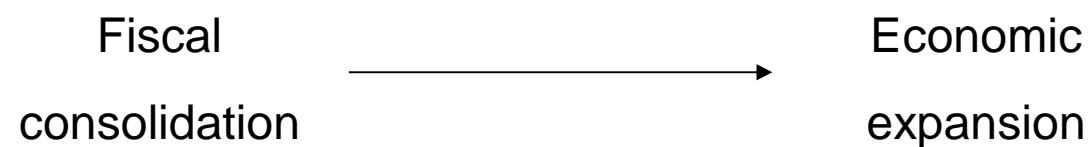
<http://register.consilium.europa.eu/pdf/en/13/st10/st10623-re01.en13.pdf>

2.2. Fiscal stance (1/3)

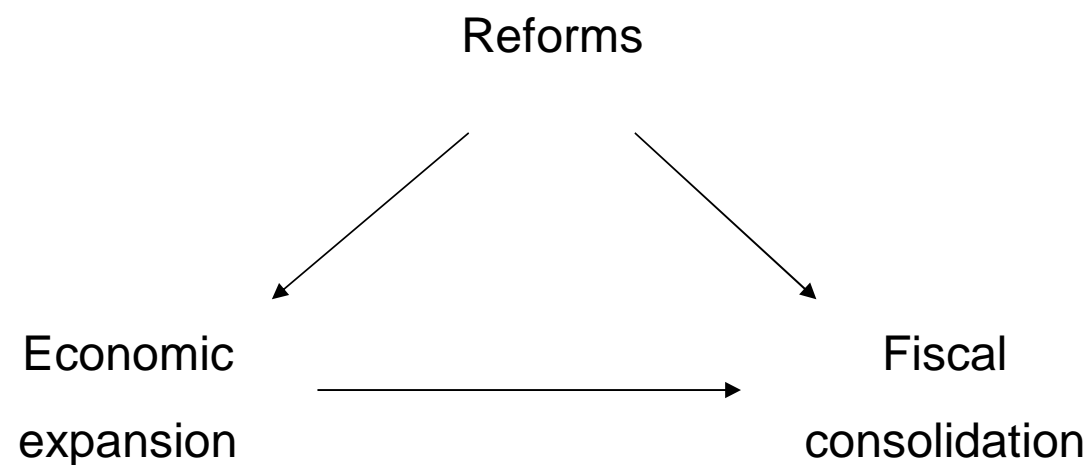
- **Expansionary consolidation = oxymora**
- Consolidation → short-term brake on economic activity
- Cf. Blanchard / IMF
- The second death of Ricardo

2.2. Fiscal stance (2/3)

FROM “Goldilocks” ...



... TO “Efforts do eventually pay off” ...



2.2. Fiscal stance (3/3)

... **BUT with a price**

- Initial impact :
 - Increased uncertainty
 - Less jobs (J curve effect of labor market liberalization)
 - Less consumption with higher indirect taxes
 - Less investment in ex-protected sectors
 - Political risk
- No offset of negative initial impact
 - Fiscal policy under constraint
 - No much monetary room left
 - Credit tightening after a financial crisis
- Conclusion : there is an initial trade-off – **reforms will first be painful**

2.3. Tax policy – introductory considerations

General recommendations

- Simplicity
- Predictability
- Pragmatism (competition for mobile tax bases)

Warning

What follows is focused on growth, at the expense of equity / fairness considerations and with no account of social acceptability

2.3. Tax policy – growth & social contributions (1)

Potential reforms

- **Tax shift : lower social security contributions**
- Across the board vs. targeting :
 - If focus is on growth, no targeting seems better to benefit producers of tradables (usually not the ones with lowest wages)
 - Alternatively, targeted on labor supply issues (older workers)
- With control over wage evolution
- Timing : spread over several years
- Budgetary compensation :
 - less expenditures
 - higher alternative taxes (on non labor personal income, consumption & pollution)

2.3. Tax policy – growth & social contributions (2)

Potential reforms

- Shift of current targeted lowering of social contributions
- Currently favorable treatment for
 - Shift work (largely in declining sectors)
 - Very small corporations (up to 3 employees, 5 for cafés)
 - Non-profit sector
 - Convenience services (“titres-services”)
 - Low wages
 - + Research and disabled people
- **Focus could shift towards**
 - growing corporations (“creative destruction”)
 - tradable sectors (... but seen as discriminatory)
 - widened focus on researchers (broader definition – anybody with scientific education ?)
 - older workers

See Groupe d’experts “Compétitivité et emploi”, Rapport au Gouvernement, July 2013,
http://www.plan.be/admin/uploaded/201307190919210.GECE_EGCW_201301.pdf

2.3. Tax policy – growth & personal income tax (1)

Potential reforms

■ **Work vs. unemployment**

- **Lower taxes on low income** (against unemployment trap)
 - Lower rate at bottom of tax schedule
 - Larger bracket at bottom of tax schedule
 - Larger notional professional expenses deductibility
- ... financed through elimination of tax expenses not focused on growth
 - ex.: deductibility of maintenance allowances (*“rentes alimentaires”*)
 - ex.: deductibility of mortgages
- ... and elimination of the marital quotient (*“quotient conjugal”*) and possibly of the assistant spouse deduction (*“déduction pour conjoint aidant”*)

■ **Work vs. retirement**

- **Elimination of tax advantage for replacement income**
- **Private pension scheme : tax advantage only if paid as annuities**

2.3. Tax policy – growth & personal income tax (2)

Potential reforms

- **Lower labor cost**

Lower PIT rates / larger tax schedule brackets are unlikely to translate into lower labor costs

- **Added value & productivity**

- Tax deductibility of education expenses, with carry forward
- Favorable tax treatment of bonuses (?)

- **Intensity of work**

Through lower tax rate on overtime or lower tax rate on higher income

But labor supply elasticity for those who are concerned is likely to be low

- **Compliance / fight against black market**, still widespread, as de facto does largely benefit non-tradable, low growth sectors (independent professionals, construction, “Horeca”, ...)

2.3. Tax policy – growth & corporate income tax

Potential reforms

- **To convert notional interest deductibility** into
 - Investment-related incentives
 - Employment-promoting measures
 - Lower nominal tax rate
- **To restrict access to corporate tax status** (to exclude “independent professional” (“*professions libérales*”), or very small businesses)

To promote entrepreneurship ≠ to lower effective tax rate for Belgian dentists
- To be more selective in terms of **deductibility of professional expenditures** (rents, cars, restaurant, ...)
- **To scale down/eliminate other specific regimes** (reduced rate for SMEs, tax shelter for film industry, ...)

2.3. Tax policy – growth & consumption taxes (2)

Potential reforms

- **VAT**
 - Higher VAT rates (normal, basic, and/or intermediary)
 - Widened VAT scope
 - Limitation of goods subject to reduced rates

- **Excise duties**
 - Higher duties on tobacco
 - Higher duties on heating oil and gas (no risk to cross-border transactions)

- **More of “polluter pays” principle**

PS1 : Beware the impact on wage if **automatic indexation** maintained

PS2 : Has to go with social corrective measures

2.3. Tax policy – growth & capital income taxes (1)

Rationale

■ **Financial assets income**

- Capital income taxes remain much lower than labor income taxes
- Taxation of capital gains on equity may not deter investment if associated with tax deductibility of capital losses (in addition, acts as automatic stabilizer)
- Current tax distortion in favor of savings accounts, at the expense of **risky investments** that could boost activity (but equity funds privileged vs. fixed income funds)

■ **Real estate income**

- Taxation of real estate is relatively low, while it has no direct adverse impact on activity and competitiveness
- No revision of tax basis for more than 30 years benefits renovation at the expense of new housing
- High transaction tax is a brake on mobility (but also a brake against housing bubbles)

2.3. Tax policy – growth & capital income taxes (2)

Potential reforms

■ **Financial assets income**

- Taxation of capital gains and deductibility of capital losses
- Elimination of the tax exemption for savings accounts

■ **Real estate income**

- Lower registration taxes on real estate (and generalized portability)
- Revision of cadastral income
- Upward revision of taxation of owners' equivalent rent, in particular for leisure housing
- Taxation of rental income based on effective rents instead of cadastral income
- ... with deductibility official maintenance expenses (against black market)

2.4. Expenditure policy – pensions

Potential reforms

- **Actuarial neutrality** / notional accounts
- Less generous **public sector** pensions
- **Portability** of pension rights (to promote mobility)
- Less generous treatment of “**assimilated years**”
- Lowered guaranteed rate of returns on private pension contributions (as excess vs. market-conform interest rate is paid by employers)

2.4. Expenditure policy – unemployment

Potential reforms

- **More “activation”** (cf. “active welfare state”) vs. passive benefits payment
- **Limited duration** of benefits or, alternatively, faster decline of benefits over time
- Stricter definition of **“suitable job”** (“*emploi convenable*”)
 - longer home to work distance
 - no study-related consideration (in order to promote labor market consciousness at time of study choice)
- **“Economic unemployment”** : upon condition (exclusion of declining sectors)
- Lowering, activation and mutualization of severance payments
- **“Experience rating”** – financial responsibility of employers whose former employees stay longer out of job

2.4. Expenditure policy – policy choice

- To do better – improving public management
- To do less
- To charge higher prices / more of “beneficiary pays” principle
 - Ex.: events’ organizers (soccer, f.i.) pay for police service
 - Ex.: higher tuition fees for higher education (currently at about EUR 800/year)
- To focus on research & innovation
 - Financing of universities
 - ...
- To improve the infrastructure
 - Mobility
 - High-tech

2.5. Governance

- Transparency
 - Efficiency control
 - Access to public data (cf. the USA about open data – default option for government information is open and machine-readable)
- Institutions
 - Usefulness of some institutions (provinces)
 - Competition distortions
 - Coordination and consistency issues across authorities
 - Overextended role of “cabinets” of politicians vs. public administration
- Conflict of interest
 - f.i. : trade unions and payment of unemployment benefits
 - f.i. : mutual insurance cies both on the supply and the demand sides (cf. Jan De Maeseneer, Le Soir, 6 Sept 2013)

Conclusion

Conclusion

- Fate largely beyond national control ... but right policies may help
- Poor reform track-record but resilience during the crisis
- Misleading performance indicators
- Long term challenges
- Need for external pressure
- Room for improvement

All opinions expressed in this document constitute the judgment of the author, without involving Bank Degroof

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