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Bringing Belgian Public Finances to a Sustainable Path

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ECONOMICS DEPARTMENT

BRINGING BELGIAN PUBLIC FINANCES TO A SUSTAINABLE PATH

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By
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Abstract/Résumé

Bringing Belgian public finances to a sustainable path

Economic growth is projected to be strengthening from mid-2011 onwards, but will be insufficient to restore the sustainability of public finances. The Belgian strategy to prefund ageing costs by generating fiscal surpluses to bring down public debt was derailed by the global crisis. Restoring the strategy is a priority, especially as spreads on Belgian debt have increased. This will require cuts in public spending, improving efficiency of policies, containing the growth of ageing-related costs and making the tax system more conducive to growth. While past experiences, such as in the 1990s, have shown that successful large consolidations are feasible, the task seems even more difficult this time as potential growth will be muted and interest rates are likely to increase. In this context, a credible fiscal consolidation plan requires the participation of all governments. Its effectiveness can be strengthened by improving the fiscal framework, in particular by introducing multi-year budgets, annual expenditure rules consistent with long-term targets and an enhanced role of an independent fiscal policy watchdog

This Working Paper relates to the 2011 *OECD Economic Survey of Belgium* (www.oecd.org/eco/surveys/Belgium).

JEL Classification: E60, E61, H60, H61, H63, H77.

Keywords: Belgium; fiscal sustainability; public finances; public debt; tax policy; fiscal federalism; fiscal councils; budgetary rules; social security.

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Mettre les finances publiques belges sur la voie de la viabilité

On prévoit un renforcement de la croissance à partir du milieu de 2011, mais il ne suffira pas à rétablir la viabilité des finances publiques. La stratégie suivie par la Belgique, qui consistait à préfinancer le coût du vieillissement en dégageant des excédents budgétaires permettant de diminuer la dette publique, a été compromise par la crise mondiale. En revenir à cette stratégie est une priorité, d'autant plus que la prime de risque sur les taux d'intérêt de la dette belge a augmenté. Cela exigera de faire des économies, d'améliorer l'efficience des politiques publiques, de contenir la hausse des charges liées au vieillissement de la population et de rendre le système fiscal plus favorable à la croissance. Les expériences passées, par exemple celle des années 1990, ont démontré la possibilité d'effectuer un assainissement en profondeur, mais la tâche semble cette fois plus difficile ; en effet, la croissance potentielle sera très modérée et les taux d'intérêt vont probablement augmenter. Dans ces conditions, pour qu'un plan de redressement budgétaire soit crédible, tous les gouvernements doivent y participer. On peut lui donner plus d'efficacité en améliorant le cadre d'action, notamment par l'instauration de budgets pluriannuels et la fixation de règles de dépenses annuelles conformes aux objectifs à long terme ainsi qu'en faisant jouer un rôle accru à une entité indépendante chargée de surveiller la politique budgétaire.

Ce Document de travail se rapporte à l'*Etude économique de l'OCDE de la Belgique 2011* (www.oecd.org/eco/etudes/Belgique).

Classification JEL : E60, E61, H60, H61, H63, H77.

Mots-clés : Belgique ; la viabilité budgétaire ; les finances publiques ; la dette publique ; la politique fiscale ; le fédéralisme fiscal ; conseils fiscaux ; les règles budgétaires ; la sécurité sociale.

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The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Bringing Belgian public finances to a sustainable path

By Tomasz Koźluk, Alain Jousten and Jens Høj[1]

The recovery is gathering pace, but will be insufficient to restore fiscal sustainability

Belgium has weathered the global crisis relatively well with a smaller rise in unemployment than the OECD average and an economic recovery that is somewhat stronger than in the euro area. Over the next years, a relatively dynamic growth in nominal terms should help reduce the fiscal deficit, but will not be sufficient to restore fiscal sustainability. Already in 2010 a general government deficit of just above 4% of GDP was more than ½ percentage point better than expected, thanks to a positive growth surprise and slower growth of some expenditure items (mainly health care). For 2011, the caretaker government's budget stipulates fiscal tightening of about ½ per cent of GDP, reflecting a broad range of small measures. Combined with stronger economic growth, this should reduce the budget deficit to about 3 ½ per cent of GDP in 2011. If similar consolidation efforts are implemented the following years, the budget deficit should fall below 3% in 2012 and the medium-term objective of a small surplus by 2015 should be within reach, marking an important step towards securing fiscal sustainability. However, this can only be achieved through a concerted effort by all governments in the federation.

The remainder of this paper discusses measures to assure sustainable public finances in Belgium. First, the size of the necessary consolidation is assessed, in light of a crisis-related deterioration in public finances and the increasing fiscal costs of ageing. The government's medium-term strategy is reviewed in this context. Next, conditions for a credible strategy are analysed. As the most rapid future increases in spending are to fall on social security, a thorough review of its functioning follows. The paper then turns to discussing improvements in the burden-sharing within fiscal federalism arrangement, the budgeting process and the role of independent institutions in fiscal policy making, which would facilitate reaching and maintaining fiscal sustainability.

High levels of public debt boost the need for fiscal consolidation

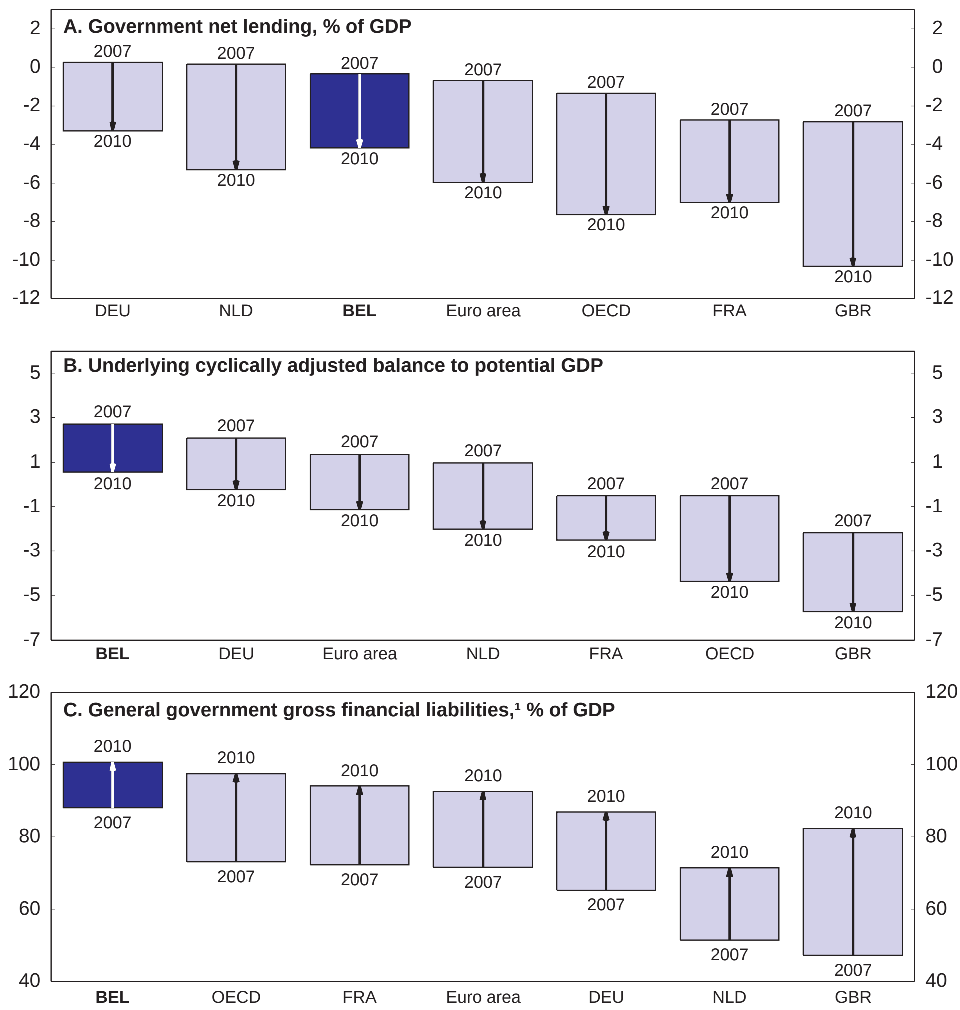
The deterioration in public finances is relatively limited following the global crisis compared to other OECD countries. After a large but mostly cyclical increase in 2009, the 2010 deficit turned out at just above 4% of GDP. Moreover, the sustainability gap of public finances, as measured by the European Commission, remains similar to the EU average. Public debt to GDP increased by some 12½ percentage points between 2007 and 2010 - also less than in the OECD as a whole. Half of the increase was due to direct interventions to save the financial institutions (Figure 1 and Box 1). However, since Belgium had a relatively high debt going into the crisis, public debt reached almost 97% of GDP in 2010. This, and the fact that Belgium has had a caretaker government since April 2010, has contributed to financial markets' concerns regarding fiscal sustainability, raising Belgian sovereign debt spreads. The interest rate differential on long-term Belgian government bonds (*vis-à-vis* Germany) has increased to levels unseen

1. Professor Alain Jousten (HEC - University of Liège) has contributed most of the material and analysis on social security. This Working Paper is based on Chapter 1 of the OECD's 2011 Survey of Belgium which was prepared under the responsibility of the Economic and Development Review Committee. The authors are grateful for the valuable comments received on earlier drafts of this text from Pierre Beynet, Andrew Dean, Robert Ford and other colleagues in the Economics Department. Special thanks for statistical assistance go to Agnes Cavaciuti and to Sylvie Ricordeau for editorial assistance.

since the introduction of the euro, topping 130 basis points on several occasions during 2009 and 2010, and has been at around 100 basis during the first part of 2011.

Figure 1. The effect of the crisis on public finances was lower than in most OECD countries

Change between 2007 and 2010



1. OECD concept based on SNA rules.

Source: OECD, *OECD Economic Outlook Database* No. 89.

Pre-crisis plans to prepare public finances for ageing stipulated running down public debt by generating increasing surpluses over the coming decade or so. This strategy never fully materialised, as planned surpluses were postponed from one year to another (Figure 2). The global crisis has moved the debt-to-GDP ratio further away from the planned consolidation path: public debt was some 20 percentage points of GDP higher in 2010 than according to plans in the last Belgian pre-crisis Stability Programme (Figure 3). This situation calls for a renewed effort to reduce public debt and restore fiscal sustainability, notably in view of the rising ageing-related costs.

Box 1. State interventions in the financial sector and changes to the regulatory environment

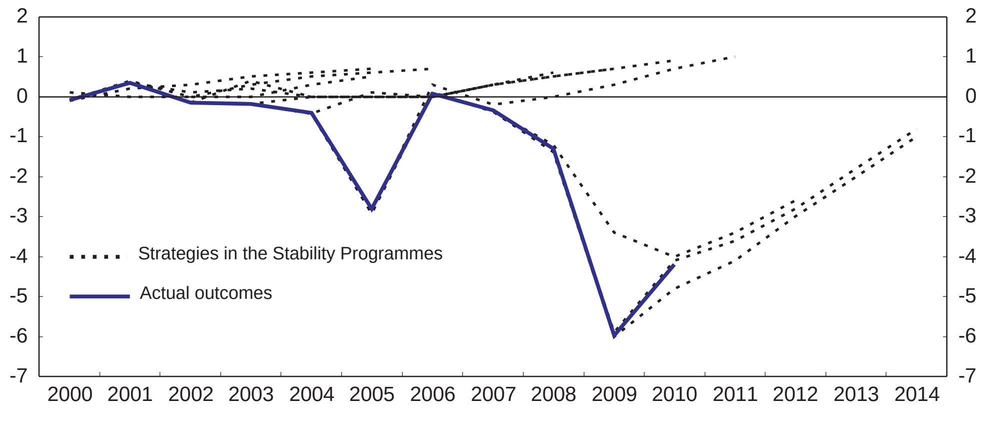
Belgian governments have spent some 6% of GDP in 2008-2009 in the form of capital injections to save the main players in the financial sector (OECD, 2009). As a result, the Belgian state became the largest single shareholder of a large international financial conglomerate BNP Paribas (which acquired most of Belgian Fortis Bank) with almost 11% of shares and 25% of former Fortis Bank Belgium. It acquired almost 6% of Dexia (and a similar amount was jointly held by the three regions). The state and the Flemish region effectively became owners of an 8.5% equity stake in KBC (non-voting) and Belgium, Flanders and Wallonia each became owners of a quarter stake in the insurance company Ethias. In the coming years, the yield on the capital injections is assumed to exceed the interest on government bonds; hence presumed to have a small positive effect on the government budget. The stakes in KBC have explicit exit strategies built in and the loan guarantees will expire automatically. The federal government also issued guarantees on loans and assets amounting to about a fifth of GDP, of which more than half have already expired. The government measures have saved the banking system from collapsing but, contrary to the developments in some OECD countries (such as the Netherlands), no pay back of interventions took place till end 2010. The only exception is the EUR 5.5 billion loan paid back by Fortis already in 2009.

Balance sheets of the main Belgian banks have been improving markedly, as reflected in the rebuilding of core capital ratios and some tendency towards concentrating on core business activities, partly due to European Commission's requirements. According to the National Bank of Belgium, Belgian banks' exposure to sovereign risk in the EU periphery (mainly Spain and Portugal) was rather limited – constituting below 3% of GDP or 1% of banks' assets (NBB, 2011). Total exposure to the region (including also claims on banking and private non-banking sector) amounts to some 20% of GDP (Spain, Ireland and Portugal), with similar exposure to Central Europe (Czech Republic, Hungary and Poland). In 2010 the large insurance sector, has halved its total exposure to the euro periphery to about 6% of covering assets (below 4% of GDP). KBC has about 5% of GDP of loan exposure through its Irish subsidiary (8% of total assets under management). On the other hand, indirect exposure to the euro area periphery was somewhat higher as the exposure of non-Belgian subsidiaries of the Dexia group was not covered by the consolidated Belgian financial sector statistics. In early October 2011, Belgian governments agreed nationalising the Belgian retail operations of the Franco-Belgian Dexia Group (for a cost of above 1% of GDP) and providing guarantees for Dexia Group debts of up to 15% of GDP.

In June 2010, the caretaker government passed a law on financial crisis management, which became effective in 2011. The law introduced crisis-resolution mechanisms for systemically important financial institutions, including sketching out the principles for a state takeover. In July another law laid the foundation for the moving and concentrating of supervisory and regulatory tasks in the National Bank, and strengthening the role of the ex-CBFA (Commission for Banking, Finance and Insurance) - now called the FMSA (Financial Services & Markets Authority) in areas of consumer protection, product and market surveillance.

Figure 2. Prefunding strategies of the 2000s failed to materialise

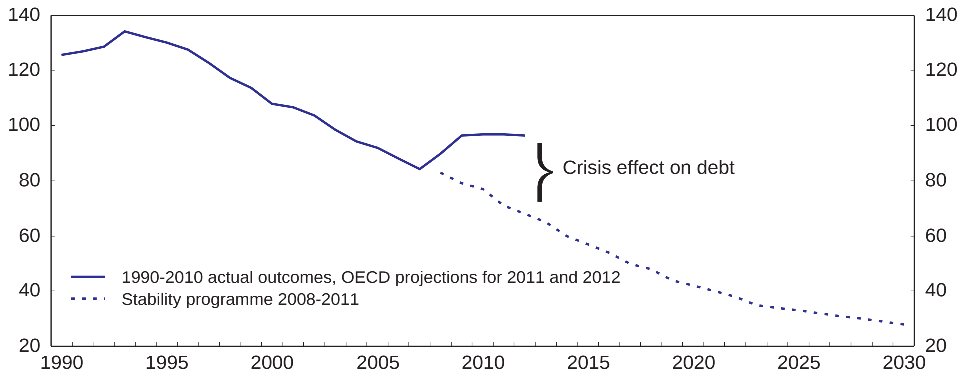
General government net lending, as a percentage of GDP



Source: OECD, *OECD Economic Outlook Database* and European Commission, "Belgian Stability Programmes".

Figure 3. Gross public debt

As a percentage of GDP (Maastricht definition)



Source: OECD, *OECD Economic Outlook Database* No. 89 and Belgian Stability Programme for 2008-11.

The recent medium-term strategy should bring public finances closer to sustainability

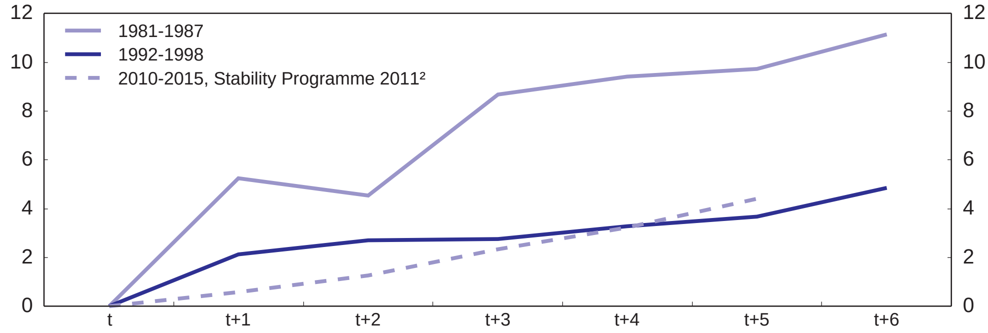
The most recent medium-term consolidation strategy is a step in the right direction. The consolidation strategy presented in the 2011 Stability Programme is an update of the strategy from the previous year, taking into account the High Council of Finance's recently recommended path to reach a small (0.2% of GDP) surplus by 2015. This requires almost 1% of GDP of structural tightening of the ageing-adjusted primary balance per year over 2011-15.[2] As at the same time ageing costs are assumed to grow by around 1 percentage point of GDP, structural measures to curb this growth could slightly reduce the need for measures on the ageing-adjusted primary balance (hence on taxes and expenditures not related to ageing). Significant structural improvements of Belgian public finances of such magnitude are not unprecedented as similar-sized fiscal consolidations were achieved in the 1980s and 1990s – in the shadow of an exchange rate crisis and then in the run-up to the euro introduction, respectively (Figure 4).

Implementing the medium-term strategy would bring public finances closer to a sustainable position, but further efforts are required. Achieving the small surplus in 2015 would bring the sustainability gap - the instantaneous improvement in the primary balance required to would restore the sustainability of public finances in the light of upcoming ageing costs (European Commission's S2 measure) – to around 1% of GDP, down from the current level of around 5% of GDP (and below the pre-crisis levels). Still, to close the gap, consolidation needs to be extended further. OECD simulations show that if the 2015 objective of a surplus of 0.2% of GDP is reached, it should be maintained for two decades to secure fiscal sustainability. In this theoretical scenario, savings resulting from falling interest payments (due to falling debt) cover a significant part of the rise in ageing costs, but further consolidation is still necessary. At the same time, the medium term Stability Programme's path is significantly more ambitious than the minimum debt-to-GDP reduction path implied by the recently proposed ECOFIN amendment to the Stability and Growth Pact. The latter requires high-debt countries to annually reduce their debt-to-GDP ratio by, on average, one-twentieth of the public debt in excess of 60% of GDP. For Belgium this would entail reaching and maintaining a deficit of roughly 1½ per cent of GDP in the medium-term (Annex A1).

2. To achieve the 0.2% of GDP surplus by 2015 (as proposed by HCF, 2011 and endorsed in the Belgian Stability Programme, 2011, for the period 2011-2014) there is a need of improvement in the structural primary balance of 3.6%. Based on a no-policy-change scenario, ageing costs are assumed to grow some 1.1% of GDP over 2009-2015 (HCF, 2010). This is assumed to be evenly distributed over time, requiring an additional consolidation of some 0.9 % of GDP over 2010-2015. Hence overall the consolidation need is 4.5% of GDP over 5 years, which is roughly 0.9% per year.

Figure 4. Fiscal consolidations in Belgium - the past and the future

Changes in primary balance relative to base year t[1]



1. Changes in cyclically adjusted primary balance (ageing adjusted in the projection scenario 2010-2015).
2. Ageing-adjusted cyclically balance improves from 0.9% of GDP in 2010 to 5.3% of GDP in 2015. This is based on Stability Programme (2011) and High Council of Finance (2011) path to reach a 0.2% of GDP surplus by 2015. The assumptions on cyclical adjustment are taken from the SP (2011). The adjustment for increases in ageing-related expenditure is based on the High Council of Finance (2010) where these costs are assumed to increase by 1.1% of GDP between 2009-15. This is assumed to be evenly distributed across 2009-15.

Source: OECD, *OECD Economic Outlook Database*, OECD calculations and High Council of Finance (March 2011), "Évaluation 2010 et trajectoires budgétaires pour le Programme de Stabilité 2011-2015" and *Annual Report* (June 2010), "Comité d'Étude sur le Vieillissement".

To be credible, the consolidation strategy must be backed with well-identified measures

No concrete measures to achieve the Stability Programme objectives beyond 2011 have yet been proposed. The 2010 budget outturn has been better than expected due to favourable cyclical developments, lower-than-expected healthcare expenditures and data revisions. In the first months of 2011, the absence of a federal budget induced some automatic savings as budgeting was done on the basis of previous year's budget, with inflation adjustment. Given the political gridlock, the caretaker government eventually decided to present a 2011 budget proposal in March. The budget targets a 3.6% of GDP deficit, which is likely to stabilise debt to GDP. The expected outcome is partly based on an improved cyclical situation, as the care-taker government did not propose significant structural measures.

Specifying and legislating concrete structural measures to implement the strategy would help calm the sovereign-debt related tensions in financial markets. Overall, the effect on the risk premium is partly offset by the still exceptionally low global interest rates, securing long-term interest rates of just over 4% in early 2011. Nevertheless, while the financing of a large part of the debt that needed to be placed on the market in 2011 (almost 20% of GDP) has already been secured Belgium faces similar needs in 2012 and is hence vulnerable to market sentiment. For example, a 100 basis point premium would be translated into additional annual interest payments of some 0.2% of 2011 GDP over the entire term of the newly issued debt. Some additional costs may come from the fact that about a fifth of the debt stock is financed at variable rates. As global interest rates increase, the costs of servicing debt will follow, unless contained by a lowering of the premium. Hence, proposing and implementing credible measures to achieve fiscal sustainability, together with increasing the credibility of such a commitment by improvements in the fiscal framework, should yield tangible savings and reinforce the consolidation strategy. Moreover, in the context of financial market volatility, the government should consider the planned consolidation path as a minimum requirement. Importantly, such measures should be structural, in particular as some of the saving measures taken over the recent years are not sustainable in the longer term – for example the tax on extending the life of nuclear power plants (yielding about 0.1% of GDP per year) will eventually be exhausted (OECD, 2011a).

Spending cuts and efficiency improvements are necessary

A key consolidation measure should be to improve the cost-efficiency of public service provision. Since 1995, public employment has expanded by an average of 1% per year (Laloy, 2010), faster than in most OECD countries, and maintaining the share of public employment to total employment at just over 18%. Moreover, public employees also enjoyed large wage increases. As a result, public sector wages cost about 13% of GDP, as much as in the early 1980s, when the government was running double-digit deficits. Particularly fast growth of salaries has occurred at the regional and especially local government level where real wage growth has been twice as fast as at the federal level. The fastest growth of employment occurred in the administration of regions, communities and local municipalities (Table 1). Nevertheless, despite that the devolution process has limited federal responsibilities, employment in federal administration grew as fast as in the total economy, partly due to the discretionary policies in the health sector and law and order. Hence, a thorough cost-efficiency review of public administration would aid long-term consolidation efforts. The retirement of about one third of federal civil servants in the coming decade is an opportunity to introduce savings. In this light, the federal administration is already pursuing a programme of selective replacement of retiring civil servants.

Table 1. Public administration has been growing at all levels of government

Evolution of employment in Belgium (1995-2009)

Sector	Total employment	
	Level	Average annual growth
	2009 (thousands)	1995-2009 (per cent)
Total economy	4 436	1.0
Public domain (2008)[1]	1 299	1.7
Public sector	828	0.9
	Entity I	
Federal government	139	0.0
of which: Administration	99	1.0
Social security	30	1.2
	Entity II	
Communities and regions	365	0.8
of which:		
Administration	57	1.9
Education	276	0.5
Local governments	294	1.6
of which:		
Administration	205	1.6
Education	68	1.8

1. Public domain includes items like healthcare services provided by the private sector but funded by the state.

Source: Laloy (2010), "*Structure et évolution de l'emploi public belge", FPB Working Paper* 19-10.

Taxation should rely on broader bases and be more conducive to growth

Belgium has one of the highest tax burdens in the OECD and the tax system is highly distortive, particularly with respect to taxation of labour (Høj, 2009). Thus, measures that increase net revenues run a risk of adverse effects on potential growth. Moreover, one effect of the crisis is that the ratio of public expenditure to GDP increased by several percentage points to levels unseen since the early 1990s. Part of the increase is cyclical and will eventually disappear as the economy recovers; nevertheless sizeable cuts are necessary if the ratio is to return to its pre-crisis levels. Moreover, spending cuts are generally regarded as more durable, hence are likely to reinforce the credibility of the retrenchment plans (OECD, 2010).

There is considerable scope for reforming the tax system to make it more supportive for growth and employment. Reforms should focus on base broadening and a shift to less growth-distorting taxes, as discussed in the previous *Survey* (OECD, 2009). Broadening of tax bases would allow for the high marginal rates to be reduced and to make the tax system more neutral. Structural relief and tax expenditures are used on a wide scale to shield particular groups and activities from the high tax rates, but are rather poorly targeted and contribute to higher general tax rates (Høj, 2009). A number of the measures are not very efficient, such as the tax exemption of savings accounts and the crisis-related VAT reduction on hotels and restaurants and some construction activities. These should be withdrawn as soon as possible given that they will have no significant positive long-term effect on economic activity,[3] tend to benefit higher income households, and imply that taxation needs to be higher in other areas.

The overall high taxation of labour and rigid labour market contribute to elevated labour costs and a reduced labour supply (OECD, 2011a). Given the largely distortive nature of labour taxation (OECD, 2008) it would be desirable to shift the burden to other less distortive taxes. OECD research indicates that growth could benefit from a shift towards consumption and property taxes: for instance, value added taxes could be increased. Property taxation revenues are not particularly low by OECD standards but could be increased further, though at the same time the high property sales taxes should come down.[4] Finally, environmental taxes are low by international standards (particularly taxes on energy) and more reliance on such taxes would provide a double dividend of generating revenues and greening the Belgian economy (OECD, 2011a).

Reform of social security is the key to controlling ageing-related cost increases

Most of the spending increases associated with population ageing fall under the responsibility of the social security system. Containing growth in such spending is a major challenge. Public healthcare expenditures are already relatively high compared with a number of European countries (Box 2) despite administrative costs that are comparable with neighbouring countries (Joumard, Andre and Nicq, 2010). The High Council of Finance expects public healthcare costs to grow from 8.1% to 11.7% of GDP by 2060, with particularly high growth in long-term care expenses (HCF, 2010). The expected increase is relatively frontloaded, as a quarter of it will materialise over the next 5 years. In the current set-up, healthcare spending is capped, but the ceiling grows by 4.5% in real terms per year. The cap is hence not binding and does not encourage spending efficiency (Box 2).

Box 2. Spending in the health care sector is rising rapidly

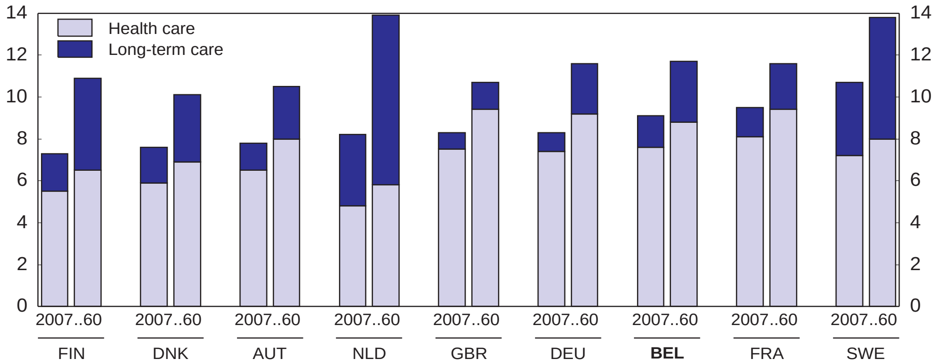
Public healthcare and long term care spending is higher than most EU countries (Figure 5). Total spending on healthcare (not including long-term care) is capped by law – since 2004 the maximum budget grows 4.5% in real terms per year. In the past`, actual spending was not growing as fast as the cap, allowing over the period 2007-09 for a catch-up effect with spending increasing faster than the cap (6% annually in real terms). By 2009, healthcare spending had reached 96% of the maximum budget envelope. The rule permits relatively rapid increases in the cap, which may in itself create spending pressures and at some point in time will have to be lowered. Under the current law the budget ceiling would surpass 25% of GDP in 2060.

3. There are some indications they do not have much of an effect on reducing grey-zone activity (Flanders Today, 2010).

4. OECD Revenue Statistics reveal Belgian property taxation revenues as being below the OECD average. However, separate regional imputed rent taxation (précompte immobilier) is not included in these statistics and yields revenues of another 1.2% of GDP.

Figure 5. Health and long-term care expenditures are high and set to rise further

Public spending, as a percentage of GDP



Source: European Commission, "Sustainability Report 2009".

Significant savings could be achieved in pension payouts. By 2060 the costs of pensions are expected to increase from 9.7% to over 14.4% of GDP (HCF, 2010, EC, 2009). While the gross replacement rate of the Belgian state pensions is low in comparison to other OECD countries, the preferential tax treatment of pension income brings the net replacement rate to around the average (OECD, 2011b). Moreover, pension rights are computed relatively generously, as unemployment spells and a number of other periods of non-work count towards pension rights. On the other hand, the required career length is 45 years. Overall, there may be some room for reducing pension costs. The most promising avenue would be reforms that address work incentives. Encouraging people to extend their working life would increase overall employment thereby raising revenue, and reducing transfers (as the pension system is not actuarially neutral). Low labour utilisation indicates large potential gains, although it is unlikely to improve the budgetary position substantially rapidly. For example, if the consolidation plan 2011-15 was to be realised through savings arising from job creation, it would require creating 150 000 private sector jobs per year, roughly three times the average employment creation of the 2000s.[5] OECD (2011a) proposes reforms aimed at increasing the internationally-low employment and extending the relatively short working life.

Spending control should be improved

Reform of the social security system can yield potentially large savings and help to improve labour market incentives. Currently, the social security system is composed of three regimes: employees, self-employed and civil servants (Annex A2). The system traditionally includes earnings-linked benefits (such as unemployment benefits, pensions, disability, work-place accidents and professional diseases) and universal coverage items such as healthcare. Over time, the system has been shifting from the concept of an insurance system to an increasingly redistributive system without strengthening incentives for spending

5. The number is a simple static estimate derived from the budgetary costs of non-employment, as calculated by the Federal Planning Bureau. The annual cost of a non-employed person, in terms of foregone fiscal revenue was estimated to be around EUR 18 000 in 2002 (Bresselers *et al.,* 2004). The cost of an unemployed, (augmented by the spending on unemployment benefits) was estimated to be above EUR 25 000. Creating jobs for 150 000 people per year for over 5 years would hence yield some EUR 15 billion of structural savings. While the number is enormous relative to past employment growth (largest growth on record is 82 000 in 2000), it would only mean an increase in the employment rate to 74% - the Belgian target for 2020 and below or in line with the levels observed in half of the OECD countries prior to the crisis.

control in individual programmes (Box 3). The link between total benefits and contributions has been weakened by capping benefits and dropping the ceiling on contributions. It was further weakened when the separate contributions to individual funds were replaced with a single contribution – the latter facilitating the smooth transfer from surplus to deficit funds. A pension reform in 1996 introducing a flexible retirement age did not remove the need for ensuring sustainability at the overall level. The system's inability to finance itself has led to increasing transfers from the federal government (part of the transfers reflect universal coverage of some services, such as health care) (Figure 6). By 2010, about a third of the system's revenues come from the general budget in the form of direct subsidies and earmarked revenues (particularly the so-called alternative financing mechanism), amounting to more than 7% of GDP (Budget, 2010 and Figure 7). The federal government determines the parameters in consultations with the social partners. Looking ahead, population ageing means that spending on health and pensions are set to increase, implying higher federal transfers in the absence of reform.

Box 3. Social security – insurance or redistribution?

The Belgian social security system has evolved from a largely insurance-oriented system towards an increasingly redistributive system, predominantly due to the decoupling of benefits and contributions (arising from the capping of benefits and the removal of the ceilings on contributions) and due the dissolution of the link between contributions to individual funds (such as retirement, health, disability, unemployment, workplace accident and professional disease insurance) and the benefit payouts and the inclusion of universal coverage items, such as healthcare, not related to work status nor salaries.

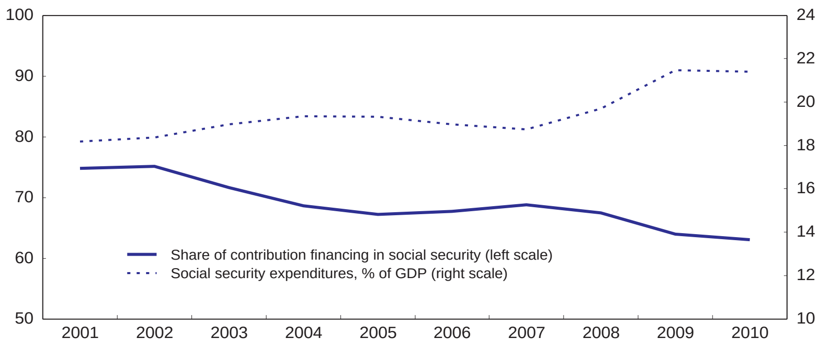
Social protection for wage-earners and self-employed is, in principle, based on a social insurance logic. However, the main social insurance funds share a common financing mechanism with a single unified contribution, implying that *de facto* workers do not pay contributions for individual risks, such as disability and unemployment nor explicit pension contributions. The system is based on two main revenue pools – one for wage-earners and one for self-employed. All revenues enter these common revenue pools, which are subsequently allocated to the various funds depending on the respective spending needs - so-called "global budget management".

As contributions are insufficient to cover spending, they are complemented by budget transfers from the federal government. Since the 1990s, earmarking of (federal) tax revenues plays an increasing role. A more recent development is the increasing use of discretionary *ad hoc* allocations to specific funds, in order to compensate the effect of targeted and general reductions of social insurance contributions for employers (for example the general reductions in the 2009-10 wage agreement cost the federal budget 1% of GDP) or to pay for extensions of benefits to categories of beneficiaries beyond the normal scope of the social insurance system (for instance health insurance coverage to non-contributors). Finally, some transfers simply have overall budget balancing aims.

Social protection of civil servants is predominantly financed via general revenues. Social protection for the needy is entirely general revenue financed – partly through the federal government revenue, and partly through local governments' social assistance budgets.

Figure 6. Spending of social security has been growing, while self-financing has been falling

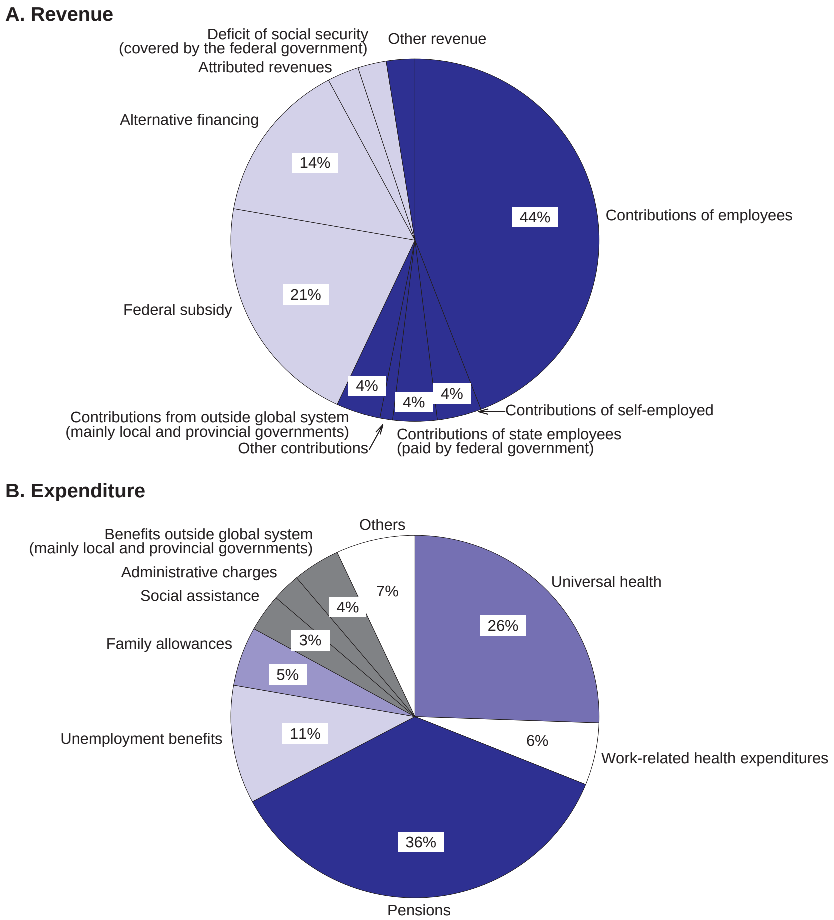
Per cent



Source: Statistical Bulletin of the National Bank of Belgium (2011).

Figure 7. The breakdown of revenue and expenditure in social security

Per cent, 2009



Source: Preliminary 2009 data from Budget 2010.

There is a need for a thorough evaluation of the effectiveness and efficiency of operations

A key strength of the system is that social protection has a wide reach with few people falling through the social protection net. This is reinforced by the operational importance of players such as mutual health insurance organisations, trade unions and local council social assistance centre with a strong presence at the local level – guaranteeing easy access to the system. However, the multi-layer and multi-pillar structure comes with relatively high administrative and management costs.[6] The strong involvement of social partners in the management and organisation of the system may also have contributed to a lack of focus on efficiency enhancing reforms. A notable example is the organisation of labour market activation. A central unemployment insurance fund (RVA-ONEM) is responsible for unemployment benefits, while regional public employment services are responsible for training and job placement, implying that if the latter is successful, then the financial benefits are accrued by the central fund. Moreover, most unemployed have to sign up with both their trade union and their regional employment office, as the regional employment office is in charge of job placement and the unions are the paying agents for the federal unemployment benefit from RVA-ONEM. Such a structure may have had advantages in terms of proximity, but is likely to lack in effectiveness and cost-efficiency.

Dynamic embedded incentives to pursue cost efficiency are not well-developed as the paying agencies operate on a not-for-profit basis and the payments for their services do not depend on the efficiency of operations. As a result of the unified contribution, there are no automatic feedback mechanisms to assure sustainability in the system. Specifically, no one is fully in charge of surveillance or policy-making with respect to the budgetary balance of the system, implying a lack of systematic alignment between benefits and contributions in response to changes in the socio-economic environment. The National Social Insurance Office (RSZ-ONSS), which is the central revenue collection and budget management agency, has no direct control over benefit levels and thus no direct means of influencing spending patterns in individual funds. The funds, in turn, are essentially specialised spending agencies with no responsibilities in terms of the revenue base or for long-term sustainability. They are simply in charge of benefit delivery – a fact further reinforced by the segmentation of social insurance into different regimes. This calls for a need to evaluate the institutional landscape to identify areas, where the present setup is less than optimal and to ensure that funds are faced with a coherent set of economic incentives and budget constraints.

Social security should not discourage working

The design of the system encourages early retirement and discourages mobility, inhibiting optimal resource allocation. Large numbers of workers retire from the labour market through other programmes than the pension schemes – such as unemployment insurance, conventional early retirement and possibly disability insurance. The parametric design of pension schemes encourages such earlier withdrawal – for example, all periods spent on programmes such as unemployment or early-retirement are credited to the individual's earnings record as if he had continued to work at a wage corresponding to his last wage (in constant real terms) without being coupled with a (pension) contribution payment. In addition, particularly for higher income workers, the pension cap combined with uncapped contributions on earnings mean that early retirement induces a pension entitlement loss below the actuarially neutral level. Belgium used to display the highest penalty to continued work across 12 OECD countries studied in Gruber and Wise (2004) for workers in the private sector. The introduction of a pension bonus for people working after 62 gave greater incentives for extending working life, in particular for lower income workers given that the bonus is independent of the earnings level. On the other hand, civil servants enjoy relatively generous pension entitlements (reflecting that their pensions are calculated on the basis of the last five

6. For example, the total administrative cost of the unemployment compensation system is 4.6 % of total benefits in 2010, of which about half is accounted for by the services of these paying agents.

years of salary rather than as a career average) and the cap on contributions of the self-employed may distort labour mobility further.

The tax system can be made more growth conducive by shifting taxation from labour to less distortive taxes. This can be achieved by moving further towards tax-financing social security (*i.e.* reducing the reliance on social security contributions. Indeed, social security premiums contribute to high effective marginal tax rates, creating numerous labour market traps as described in the previous *Survey*. A first candidate to be financed via general taxation could be health care, reflecting its universal provisions and its complex governance, which means that most parametric reforms have originated from the federal government.

Universal services should be financed with general revenue

Health insurance with its universal coverage has an intrinsically weak link between contributions and benefits. Moreover, some of the complex governance issues in the health sector strengthen the case for direct tax financing (and hence spending control) by the federal government. The idea of general revenue financing is *de jure* partially recognised in the current social insurance system as a substantial share of the alternative financing of social insurance is earmarked to health insurance. *De facto*, the situation is less clear cut. A large share of these earmarked revenues is allocated to health insurance through a formula apportionment system – meaning that mechanical rather than system-specific needs drive the magnitude and trends of these transfers. Moreover, health insurance is part of the overall global budgetary management of the two revenue pools for wage earners and self-employed – meaning that any form of earmarked revenues for health insurance can and will easily be undone through lower transfers from the common revenue pools.[7]

The system's sustainability should be strengthened by encouraging endogenous reforms

As a big-bang approach of abolishing contributions and move to full tax-financing could prove politically difficult, a more piecemeal approach should be adopted. In which case, feedback mechanisms should be introduced in the area of earnings-linked benefits, such as pensions, disability, unemployment, professional disease and workplace accident insurance. In such programmes, explicitly and credibly linking contributions to benefits ensures that contributions become and are perceived as an insurance premium for the coverage against a risk rather than a tax. Such a reform would help to internalise the benefits of the associated programme and thus reduce the (tax) distortion of labour choices. Moreover, system dynamics and constraints become more apparent for members and employers. For example, in the face of shrinking working-age populations, an explicit link implies that social choices of pension generosity (and hence intra- and intergenerational transfers) become clearer. A pension fund's budget constraint ensures that any financing shortfall will be identified, projected and potentially absorbed by adequate policy measures on the benefit (pension cuts) or the contribution side (contribution hikes) or both (for instance increasing the retirement age), in the process enhancing the transparency as well as the fiscal and social sustainability of the system. Examples of such automatic feedback mechanisms in pension systems can be found in Germany and Sweden, among others.

7. Another issue is the restriction of the contribution base. In general, non-work income is subject to favourable (or even zero) contribution rates. Pension income (above a minimum threshold) is subject to a reduced social security contribution of 3.55%, intended to cover healthcare costs. In practice however, the level of the minimum threshold means the contribution is not applicable, for instance, to most pensioners on public pensions. Higher pensions are subject to an additional "solidarity" contribution of 0.5-2%. According to the budgetary accounting rules, a worker's contribution for medical care is also 3.55% of gross wage, but the additional employer contribution is 3.80%, leading to a total contribution rate of 7.35%.

Funds should also be granted an active role in managing the overall balance relating to their activities, subject to an explicit and binding budget constraint. In particular, there should be no scope for systematic or *ad hoc* expansions of revenues to meet additional spending needs. Ring-fencing the budget of funds thus works as a disciplining devices for politicians and fund managers (thus also the social partners), as they make costs and benefits of any policy measure explicit. For example, any reduction in revenues affecting a given fund, because of a discretionary policy measure (such as a targeted reduction for a specific group), would need to be explicitly and fully compensated across time by an associated benefit reduction or via offsetting revenue increases from other contributors. Such explicit mechanisms also give funds incentives to prepare for the future by building up reserves to meet future commitments as the short and long run cost of policy measures become measurable and predictable. Particularly in the case of a more piecemeal approach, one way to make such feedback mechanisms more automatic (for contribution financed funds) is to increase the degree of self-financing of social security, reducing federal transfers. At the same time, government goals of improving labour market prospects of groups such as low-income workers can be pursued with targeted in-work subsidies.

Fiscal federalism reform should facilitate consolidation

The result of discussions on how Belgian federalism should be organised will ultimately affect the distribution of consolidation efforts across the governments in the federation. Since the June 2010 general election, the main issues in the coalition negotiations have been reform of the federal arrangement, focussing on the division of fiscal powers (giving sub-federal levels more responsibilities from the federal government and/or more autonomy, in particular in the area of taxation) and the organisation of the Brussels-Capital region and surroundings (financing and constituency issues). Any decisions taken on these points will inevitably, directly or indirectly, feed into how the organisation of fiscal federalism should contribute to securing fiscal sustainability.

Up until the crisis, the pre-funding strategy has had two pillars with different roles for the federal and sub-federal levels. The latter agreed to keep a balanced budget, while the federal level, responsible for most of the increase in ageing costs (mainly via social security), was to make room for (future) ageing costs by running down public debt. As a result of the crisis, the sustainability gap of public finances has grown to a magnitude which makes such a plan untenable in the absence of substantial tax increases. The ongoing decentralisation of powers and the relatively slow-growing federal revenue streams have reduced the ability of the federal government to cope the consolidation targets (Box 4), arguing for more consolidation in social security (see above) and at the sub-federal level.

As agreed in 2010, the burden of fiscal consolidation in 2010-12 is to be shared between the federal level (responsible for two thirds of the planned adjustment) and the sub-federal levels (the rest). The sub-federal governments are to gradually reach budget balances. The latter is likely to be achieved in 2011 in the Flanders (region and language community), and by 2014 in the Walloon region and the French community as a whole. The Brussels-Capital region has declared it will not be able to adhere to the agreement without additional funding (according to the 2011 Stability Programme, it should reach a balance by 2016). If the burden sharing agreement of two-thirds of consolidation at the federal level, one third at the sub-federal, was to be prolonged to the medium term, achieving the 2015 targets would require a more significant effort from the sub-federal level. On current fiscal federalism arrangements achieving the planned small surplus would need an overall sub-federal surplus of 1% of GDP by 2015 (HCF, 2011).

Box 4. Federal government has limited discretion to consolidate

The federal government collects the majority of taxes, including some of the regional taxation. However, most of revenues are earmarked. Some 60% of tax revenues are attributed to other government bodies: the regions, communities, social security; and the EU. Another 15% of revenues are used for interest payments on public debt. As a consequence, the federal government's discretionary power is limited. Deducting attributed revenues and interest payments on debt from the 2010 budget leaves some 6½ per cent of GDP of revenues (Table 2). Adjusting for the cyclical effect may increase federal revenues another 1 to 1½ percentage point of GDP. In principle, the federal government can boost its revenues by simply increasing income or consumption taxes (or other taxation). This is due to the shared-revenue principle whereby the revenues transferred to the regions and communities are indexed with GDP growth (and some small demographic element in case of VAT), irrespective of the actual revenue collected. In practice however, this would be difficult given Belgium's high tax burden and complicated political situation. The federal government is also responsible for most tax expenditures, which are relatively widespread in Belgium..

Table 2. Federal government primary spending[1]

Based on 2010 budget, as a percentage of GDP

Revenue sources	Revenues	Attributed to				Sum of attributed
		Regions	Language-co mmunities	Social Security	Others (inc. EU)	
Personal income tax	10	2.8	1.9		0.4	5.1
Value added and related taxes	7.5		3.7	3.5	0.2	7.4
Corporate income tax	2.7					
Duties	0.5				0.5	0.5
Excise taxes	2			0.3		0.3
Regional taxes collected at the federal level	2	2				2
Withholding tax on capital income	0.7			0.1		0.1
Others	0.3					
Total	**25.7**	**4.8**	**5.6**	**4.1**	**1.1**	**15.6**
Debt servicing						3.3
Revenues less attributed expenditures and interest payments				**6.8**		
Expenditures less attributed expenditures and interest payments				**10.3**		

1. Numbers may not add up due to rounding errors. Attributions do not include items such as transfers to the national rail.

Source: Budget Memorandum 2010.

There are several ways of reorganising fiscal federalism in light of fiscal sustainability. The two main options are either to provide the federal level with sufficient resources to finance ageing costs or to share the costs of ageing among different levels of government. Leaving more resources at the federal level can be done by reducing transfers (or their growth) from the federal level, or transferring spending responsibilities without the associated budgetary resources. Regarding the latter, the responsibility for financing pensions of the regional and community government employees, currently at the federal level, would be a possible candidate. Other solutions could entail splitting the costs of public debt interest payments - which would also have the benefit of making sub-federal levels more directly responsible for the costs of fiscal laxity or market sentiment. A number of policies may entail large scale economies or national equity considerations which may make them more attractive to be run at the federal level. Hence, in some cases, such as for instance public debt, it may be preferable to devolve financing (interest payments) while not the policy instrument itself (debt issuance). Such arrangements, in turn, may raise governance issues. Overall, whichever solution is eventually chosen, a number of principles for the devolution of powers should be taken into account, as described in the previous *Survey*:

- Strengthen the financial position of the federal level to provide room for servicing the upcoming costs of ageing (for instance by improving its revenues base), and/or shift some of the ageing burden costs to the regional level.
- Transfers between government levels should better reflect services provided – for instance by redesigning transfers between different governments (a workplace element of income taxes to compensate Brussels for the services it provides to other regions).[8]
- Improve the coherency of policies. In areas which are better dealt with at the regional level, the regions should be given the appropriate powers to execute them (such as taxing powers in the relevant areas) and should rely more on developing their own tax bases. In areas of national interest – where better results can be achieved at lower costs if policies are common or well co-ordinated across the country consider either moving powers to the federal level or, at the minimum, developing efficient co-ordination and co-operation mechanisms. In this light there should be an institutionalised periodic assessment of the efficiency and effectiveness of the division of powers.

An internal stability pact would improve the burden-sharing of fiscal targets

Changes in fiscal federalism and the fiscal framework should be accompanied by an internal stability pact among the governments. The pact should replace the set of *ad-hoc* agreements on consolidation efforts. It should outline in detail the pre-funding responsibilities, including pre-agreed automatic sanctioning mechanisms for governments that do not adhere to their commitments, but also stipulate recovery paths in case of slippage. Such issues will become even more important if EU reforms lead to direct sanctions for fiscal underperformance. The pact should be made operational in the budgeting process by establishing consistent paths for each government within a medium-term target and spending rules. Any deviation from the stability pact rules (such as the non-application of sanctions due to extraordinary circumstances) should only arise due to exceptional developments and require the explicit consent of all the government bodies. To reinforce the pact and its implementation into federal and sub-federal budgets, there is a need for strengthening the role of independent fiscal councils in Belgian fiscal policy making (see below).

A stronger fiscal framework requires spending rules, longer budget horizons...

Over recent years, fiscal rules have been given increasing attention across the OECD, with the aim of making fiscal policies more sustainable and less pro-cyclical. The Belgian experience so far has proven mixed. Several domestic fiscal rules (apart from the EU stability pact) have been in place over the past decades, in particular during the successful run up to the euro adoption (Table 3). During the 2000s, up until 2007, rules were relatively well respected (Van Meensel and Dury, 2008), contributing to the overall balance in public finances. However, one-off measures were used to achieve the balanced budget objective, implying that part of the achievement was unsustainable and the rules did not prevent

8. The current transfers of tax revenues from the federal to the regional level are based on historical budgets. When competencies were transferred to the regions (as in the early 1990s and in the 2000s), the budgets associated with them were also transferred (through the shared income and value-added tax revenues). The transfers where then (basically) indexed to GDP (with the exception of a consolidation effort preceding euro adoption, when the governments agreed to have price indexation only), regardless of whether certain areas have become more/less important.

unexpected improvements (such as in interest payments) from increasing primary spending above what had been planned in budgets. Moreover fiscal policy was not tight enough to guarantee consistency with the High Council of Finance's recommendations on medium-term fiscal sustainability targets (which required general government surpluses).

In order to better anchor annual budget to the concept of fiscal sustainability, fiscal policymaking should focus on a medium-term structural budget target, derived from a strategy to assure long-term sustainability of public finances. Such medium-term targets, proposed in the previous *Survey*, should be made operational, for instance by translating them into multi-year budgets with annual expenditure ceilings. Ceilings could be imposed on specific spending areas, with overspending compensated within the given area. There may be a case for exempting from ceilings some very cyclical items (such as unemployment benefits), or items outside the direct control of the government (such as interest payments). Specific rules would be required for windfall gains, and for tax expenditures. The latter should remain, as currently, published annually, but could be attached as an annex to the budget. Multiannual budgets would put annual plans into a medium-term perspective and help to correct incidental slippages. This need was recognised in the Stability Programme of 2010, but the budget for 2010 constituted only a small step in the direction by outlining the main 2011 budget plans. Moreover, multi-annual budgets would encourage upfront presentation of policies to achieve targets, improving transparency and potentially discouraging the use of one-offs. Overall, such a set-up should allow automatic stabilisers to work on the revenue side and perhaps on selected spending items.

Table 3. Several domestic numerical fiscal rules have been in place since the 1990s

Type of rules	Body subject to rule	Details	Sanctions/enforcement
Expenditure			
1993-1998	Federal government	Zero real growth limit on primary expenditures	In the coalition agreement. No sanctions foreseen
Since 1995	Social Security	Rule on the real growth of the expenditure ceiling for health spending (since 2004, 4.5% per year)	In law. Automatic compensation mechanism
Balanced budget			
Since 1990[1]	Local governments	Annual nominal budget balance[2]	In law. Regions, as supervisory authorities are responsible for monitoring the implementation
1992-2008	Social security	Nominal budget balance	In the coalition agreement. No sanctions foreseen.
1990 (1995)-2008	Regional governments	Nominal balance (or surplus) by 2010	Political agreement. Potential sanction – federal level can impose borrowing limits
2010-2015	Regional governments	Nominal balance (or surplus) by 2015	Political agreement. Potential sanction – federal level can impose borrowing limits
Revenue			
1995-1999	Federal government	Growth of revenues must follow nominal GDP growth	In the coalition agreement. No sanctions foreseen

1. In the early 1990s, the rule implemented was to stabilise debt to revenues, afterwards replaced by a balanced budget rule.
2. The local government nominal balance is not based on ESA 95 rules and for instance does not include capital expenditures and revenues.

Source: European Commission, Belgian government.

Given that all levels of government have to contribute to securing fiscal sustainability, such rules should be made operational both on the federal and the regional and language-community levels. The exact design and implementation of rules for sub-federal government is likely to depend on the outcomes of devolution negotiations, in particular in the area of tax autonomy and transfers. For instance, if shared-tax transfers from the federal level to the regions and communities remain, as now, indexed to GDP growth, surplus-generating expenditure rules would require additional rules on what is to happen to the surplus. On the other hand, if in a new federalism arrangement the (net) transfers would be falling fast enough relative to GDP, a balanced budget rule on the sub-federal levels could suffice, in particular as it has the virtue of being easier to understand. In general, the multi-year approach should concern all levels of government requiring increased co-ordination and streamlining of the budget process. In this context, publishing budgets at all government levels in a standardised format would improve their transparency and public understanding. Further improvements should entail the full adoption of ESA 95 accounting standards by local governments, currently under discussion. On the other hand, a clear obstacle is different electoral cycles among the different constituencies.

... and a stronger role of independent assessments and analyses

A strong fiscal council would increase “the political costs of ‘bad’ fiscal behaviour” (Coene and Langenus, 2010) and improve transparency of fiscal policy making. Fiscal councils have been operational in some OECD countries, although their exact role differs from one to another (Box 5). In this respect the current Belgian framework has a number of virtues, as several functions of a fiscal council are already performed by existing institutions:

- The High Council of Finance (HCF) is generally responsible for longer-term analysis of fiscal policy. The Council provides annual estimates of consequences of ageing for future budgets, evaluation of Belgian Stability Programmes, their implementation and compliance with budgetary targets (as well as reasons for non-compliance) at different levels of the government. The taxation section of the Council is responsible for tax policy analysis. The work includes medium and long-term recommendations on the budget and taxes with the aim of improving co-ordination and fiscal discipline in the federal structure.
- The National Accounts Institute (consisting of the Federal Planning Bureau, the National Bank and the federal Ministry of Economy) has a more technical role, providing forecasts of key macroeconomic variables for the budget, including the parameters used for the calculation of transfers between different government bodies. While there is no legal obligation for the government to base budget assumptions on these forecasts, in practice they are taken into account. On several occasions more conservative forecasts have been used, the fact being explicitly acknowledged (Bogaert *et al.*, 2006).
- The Federal Planning Bureau (FPB) and (similar) regional institutions have some tasks of the evaluating the policies on the relevant level. Some national economic issues are occasionally researched jointly by the National Bank and FPB.

The HCF and the FPB contributed notably to the improvements of public finances in the 1990s in terms of analysing the requirements of fiscal policy in the run-up to the introduction of the euro and reducing the forecast bias in budget preparation (Van Meensel and Dury, 2008, Lebrun, 2006). However, the weaker role of these fiscal institutions after euro adoption (in particular of the HCF, Coene and Langenus, 2010) shows that their contributions have been more useful in the presence of a strong political consensus. One of the factors behind the weaker role was a political gridlock in the mid-2000s, which had caused problems replacing some of the members of the HCF and hence with issuing recommendations. This problem has been (partly) addressed by a reform in 2006 to resolve recurrent political gridlock problems, though most of the members of the HCF are directly selected by the governments. At the same time, the FPB, which performs high-quality analysis in various specific policy fields, has competencies largely limited to federal issues.

Box 5. The role of fiscal councils

A fiscal council can be defined as a body providing "independent analysis and projections relating to the budget and macroeconomy and possibly normative assessment of fiscal policy in the light of governments' own stated objectives" (Debrun *et al.*, 2006). In principle, it has no mandate or authority over policy or its targets, but may raise the political costs of fiscal irresponsibility through improved transparency of fiscal policy (Coene and Langenus, 2010) by correcting the alleged deficit-bias of fiscal policy due to the role of short-term political considerations in a democratic society. In practice, the role of a "pure' fiscal council is likely to be twofold – assessing the government's budgetary objectives with respect to fiscal sustainability and subsequently the evaluation of adherence to the stated objectives. While many institutions which perform many of the roles of fiscal councils exist across the OECD, they differ widely on mandates, tasks and degree of independence (both legal and perceived) from policy makers. For instance, the one of the institutions often cited as a successful example of a fiscal council (but not only), the Dutch Central Planning Bureau, is legally (and budget-wise) a part of the Ministry of Economy, yet its *de facto* independence is widely recognised.

In most OECD countries with a body that can be regarded as a fiscal council the latter would be charged with providing independent macroeconomic forecasts as an input for the budget preparations – with the aim of reducing the forecast bias, arising from a tendency for governments to use overoptimistic assumptions (Hagemann, 2010). Still, in most of these countries it will be a commonly accepted principle rather than a legal obligation, where the political costs of not adhering could turn out high (*e.g.* the Netherlands, Belgium, and Austria). On the other hand, relatively few fiscal watchdogs will go beyond that task and project the evolution of individual fiscal spending aggregates, evaluate budgets with respect to sustainability, their execution or the individual policy measures, their implementation and economic effects. Most of these tasks are performed by independent research bodies (often Economic Councils) in Denmark, Sweden, the United Kingdom and the Netherlands. On the other hand, normative assessments of budget targets or policy plans are a less common mandate, but for example in Austria, Belgium, Denmark, Sweden and Germany such bodies are to a varying degree explicitly responsible for assessment of compliance with fiscal rules or proposing alternative measures in case of slippage (Hagemann, 2010).

Encouraging the role of independent input in fiscal policymaking may help gather and sustain the political consensus necessary for public finance sustainability. The institutional framework can be strengthened by improving the current system. In this case, the powers and competencies of the existing institutions should be strengthened:

- To complete its role, the HCF, which already has working groups on long-term sustainability, ageing and taxation, should also include a study group on spending issues. This group should look into the evolution, efficiency and effectiveness of public spending at all levels of government, and issue relevant recommendations.
- To increase its analytical input into the debate on how targets can be implemented, when analysing a specific issue (such as taxation, spending, or budget paths) the HCF could also provide a set of policy proposals on how to address the problem (together with projected economic effects). To some extent, this is already done for taxes, but should be done also for the expenditure side and for combinations of measures from the expenditure and revenue side.
- The HCF should continue its *ex ante* and *ex post* analysis of public finance sustainability but also have a mandate to assess budgets (and their execution) at all levels of the government. This should allow the HCF to give a relatively early assessment on whether budgets are on a track consistent with sustainability and to identify the origins of any slippage or over-performance.
- Given the good track record, the National Accounts Institute should continue to provide input macroeconomic forecasts to be used when calculating budget plans. This role could be enhanced

by publishing the simulated evolution of public finances with unchanged policies in order to provide a baseline scenario and facilitate the assessment of new proposals.

- To improve the oversight over the increasingly important regional and community policies and assess them against comparable benchmarks, the FPB or the National Accounts Institute should have freedom to initiate research into sub-federal policy areas, assessing economic and fiscal consequences of any existing or proposed significant policy measures. In practice this can be done in co-operation with the regional institutes.

The main role of the fiscal councils would be advisory, with an overall aim of improving the transparency of fiscal policy making and increasing the public understanding of the need for fiscal consolidation. This means that governments should not be obliged to adopt the recommendations, but importantly, if a government should decide not to follow the recommendation it should obliged to publicly state their reasons for doing so (*e.g.* before the parliament), thereby increasing accountability on both sides and providing a ground for debate. In case of the sub-federal governments, the increased mandate of the fiscal institutions would also assure that they are subject to similar surveillance standards as the federal government – which is currently under the scrutiny of international institutions (EU, IMF, OECD) – a particularly important consideration given the sub-federal level's increasing responsibilities. The fiscal institutions should have sufficient independence to be considered as a neutral provider of assessment and recommendations, which requires assuring adequate resources, with participation from all levels of government.

Box 6. The main recommendations for securing fiscal sustainability in the federation

Design and implement a credible fiscal consolidation plan, focusing on public expenditures

- Establish a credible consolidation path with well specified structural measures to achieve at least ¾ per cent of GDP consolidation per year until 2015 as planned. Treat the path as a minimum requirement.
- Focus consolidation on reducing spending at all levels of government and broadening tax bases by removing tax expenditures. Review cost efficiency of all public administration, particularly of wage costs.

Modernise social security

- Reduce and remove spikes in effective marginal tax rates by tax-financing social security and control expenditures via strict spending ceilings. A first candidate to be financed via general taxation could be health care, reflecting its universal provisions and where its complex governance means that most parametric reform has originated from the federal government. In a more gradual approach, feedback mechanisms should be introduced in the non tax financed programmes to secure system credibility.

Fiscal federalism reform should also address fiscal sustainability

- Secure sufficient revenues for the federal level of government to meet the cost of population ageing and public debt service. This would include ensuring that intergovernmental transfers reflect services provided, for instance implying the introduction of a workplace element in the sharing of income taxes. Make such transfers sustainable by removing the implicit pension transfer from the federal level to sub-federal level of governments. Alternatively, the regions and communities could generate the necessary surpluses.
- Better align expenditure and revenue responsibilities at the sub-federal level of government by requiring that the regions and communities develop their own tax bases. Improve cost-efficiency of public services via better and less costly co-ordination or changes in the federal division of powers.
- Introduce an internal stability pact to share pre-funding responsibilities and stipulate pre-agreed automatic sanction mechanisms and recovery paths in case of non-compliance with commitments – particularly important issues if EU reforms lead to direct sanctions for fiscal underperformance.

Strengthen the fiscal framework

- Govern fiscal policy by a medium-term surplus objective that is consistent with the prefunding strategy. Make this operational by adopting expenditure ceilings for all levels of governments and spending departments.
- Extend the tasks of the High Council of Finance to include evaluation of expenditures at all levels of government. Extend also the budgetary oversight to include *ex post* analysis at all levels of government to provide early fiscal sustainability assessments. This would also allow for evaluation of the adherence to the fiscal rules and internal stability pact.
- Expand the tasks of the National Account Institute or the Federal Planning Bureau to include evaluation of the economic and fiscal consequences of individual policy measures at both the federal and sub-federal levels of government to improve oversight. This could include assessments of current subsidiarity principles in terms of which level of government can provide individual public services most efficiently. To facilitate assessments of the fiscal stance, the Institute should also project public finances under an unchanged policy assumption.

Tighter fiscal rules at all levels of government

- Make budgetary targets operational in multi-annual budgets with strict annual expenditure ceilings at all levels of government. Within each government, consider making spending departments responsible for adhering to the expenditure ceiling, while the final responsibility should lie on the relevant government body. The budgetary process should be streamlined and better co-ordinated. In particular, a common and straightforward standard for budget proposals should be introduced across all governments.

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Annex 1

Scenarios for public finances

Simulations were performed for the evolution of public debt by 2060, based on the assumptions:

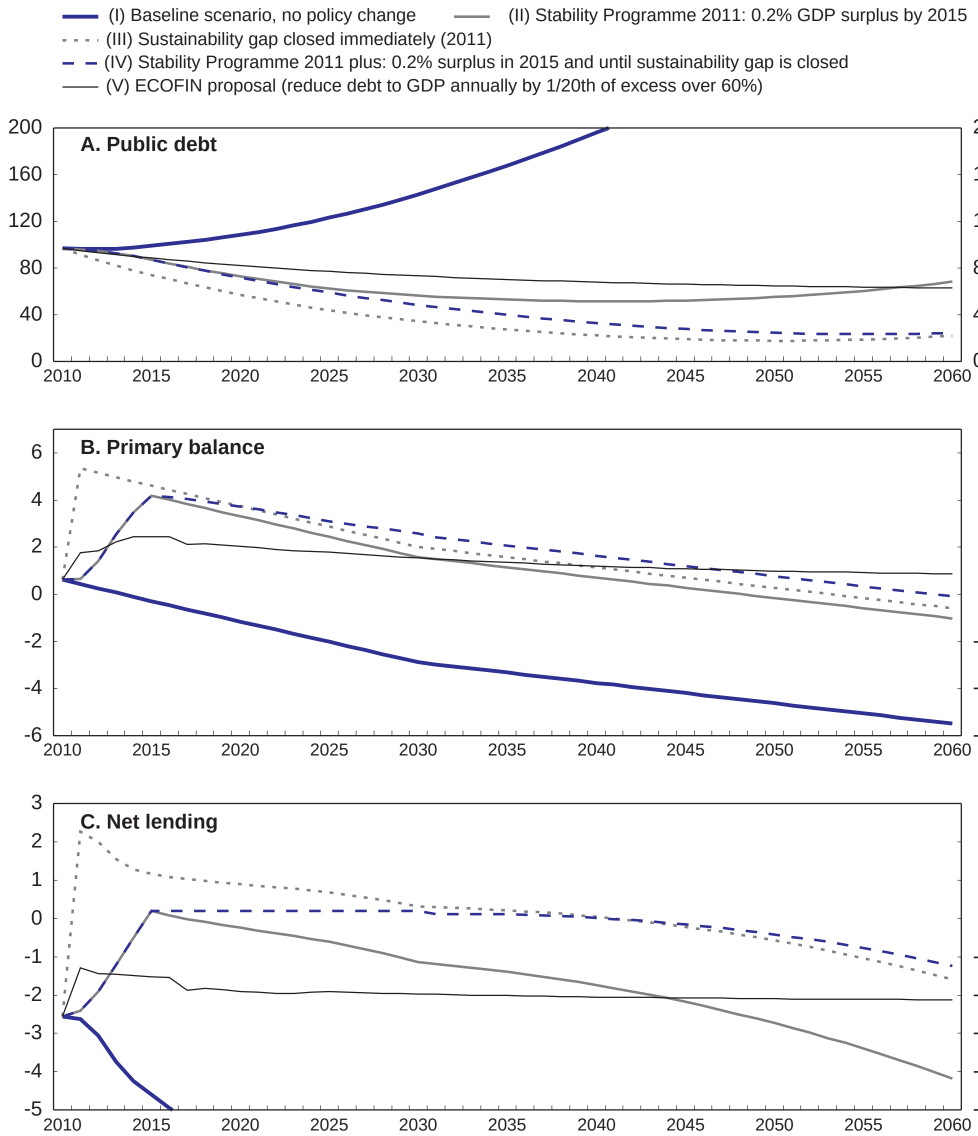
- GDP growth (nominal) is taken from the *OECD MTB Database*. For the data 2026-60 the values are kept constant 2025 levels (3.6% per year). In this simple, long-term model no feedback from fiscal policies to GDP growth is assumed.
- The estimates for the costs of ageing are from the High Council of Finance (2010). This means an increase from the current 25.7% of GDP to 31.8% by 2060. They are interpolated linearly for the years where estimates are not available.
- The nominal interest rate (effective) on government bonds is fixed as 5% in 2020 (roughly in line with the EC assumption of a 3% real interest rate in its public finance sustainability scenarios). This interest is phased in from the current rate by 2020 (due to gradual debt rollover).
- Vulnerability tests with different assumptions on the interest rates, growth rates and ageing costs reveal that the overall conclusions are relatively stable.

The scenarios employed are the following:

- **Scenario I – no-policy-change baseline: no consolidation is taken in 2011.** Rising ageing costs reduce the primary balance throughout the period, increasing the deficits. The scenario leads to explosive developments in the public debt to GDP (Figure A2.1).
- **Scenario II – 0.2% of GDP surplus by 2015, no policy changes thereafter.** Strategy is based on the Stability Programme of 2011. Consolidation efforts until 2015 are helped by falling interest payments (due to the reduction of debt to GDP), which is partly offset by rising ageing cost. After 2015, rising ageing costs have a negative effect on the primary balance. Public debt falls until the 2030s, but starts increasing rapidly thereafter as ageing-cost increases dominate.
- **Scenario III (fiscally sustainable) – sustainability gap closed in 2011.** Assumes that in 2011 the sustainability gap (defined as the European Commission's S2 measure – an immediate increase in the primary balance that ensures the public finance sustainability in light of upcoming increases in ageing costs, EC, 2010) is closed in a single effort. This means a one-off shift in the primary balance by about 5 per cent of GDP and leads a fall in the debt-to-GDP, until 2040s, and a small increase thereafter. Ageing cost increases reduce the primary balance starting 2012.
- **Scenario IV (fiscally sustainable) –0.2% of GDP surplus by 2015 and thereafter, until fiscal sustainability is achieved.** To close the sustainability gap, a surplus is necessarily maintained into the 2040s, meaning that rising ageing costs are offset only partly by falling interest payments, partly by alternative measures in the budget. Thereafter increasing ageing costs reduce the primary balance.
- **Scenario V (fiscally sustainable) – gradual convergence to 60% debt-to-GDP ratio.** The debt-to-GDP ratio follows the rule proposed in 2011 by ECOFIN – one-twentieth of the excess over 60% is reduced per year. In this case debt-to-GDP converges to 60% in the long run, meaning that consolidation is effectively back loaded (large increases in ageing costs have to be compensated with budget cuts, and hardly benefit from falling interest payments).

Figure A1.1. Simulated developments in public finances to 2060

Different scenarios, as a percentage of GDP



Source: OECD calculations based on *OECD Economic Outlook 88 Database*.

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Annex 2

The Belgian social security system

A basic guide to the Belgian social protection system

The following presentation summarises the main features of the Belgian social protection landscape in terms of the essentials for the understanding of the system's design and working. Like in other OECD countries, the social protection system is based on both social insurance and social assistance principles. By international standards, Belgian social protection has a broad coverage in terms of risks and a distinguishing feature of the system is that it grants social partners and their collective bargaining agreements a key role in the design and operations of the system. The result is a complex system of social protection institutions and programmes, reflecting several factors. As in most countries, social protection has evolved in terms of its objectives, its composition and its scope to reflect changing economic constraints and social needs, leading to a progressive shift of focus and resources between the different programs and institutions. Moreover, social partners play an important role in social insurance, but the overall social protection landscape is also heavily affected by government intervention in the form of social assistance programmes as well as in the generosity, and financing of various social insurance schemes. Lastly, the changes in the federal structures have increased complexity of the system.

In light of this complexity, the various programmes can be classified into three broad regimes for wage-earners, self-employed and civil servants. Participation in the system is compulsory for all labour market participants, with coverage extended to dependents. The regimes are completed the extension of some types of social insurance coverage to non-workers and a needs-based social assistance component. The remainder of this annex uses this classification to outline programmes and the associated role of the public and private institutions involved in the operations of the system. First, the main systems for private sector wage-earners are described. This is followed by a similar treatment of the system for the self-employed, before turning the attention to the case of the public sector. The annex is completed with a description of the social insurance and assistance-based extensions to the system.

The contractual wage-earner regime

The contractual wage-earner regime is the largest in terms of membership, covering all blue and white collar wage-earners in the private sector as well as contract workers in the public sector. Workers are entitled to 6 main categories of benefits: medical care, sickness and invalidity; pensions; unemployment; family allowances; work accidents; and professional diseases. For blue collar workers, the system is extended to include annual leave benefits.[1] All benefits are provided under federal legislation, with federal institutions having a predominant role in implementation – both on the benefit and financing side.

1. Contrary to white collar workers whose annual vacation is directly covered by their employer, employers of blue collar workers pay extra social insurance contributions to finance payments by a dedicated social insurance institution: RJV-ONVA.

Benefits provision in the institutional setting of insurance funds

Public health insurance is organised and co-ordinated at the federal level by the health insurance fund (RIZIV-INAMI).[2] Health coverage includes two main categories of risks: medical care insurance and invalidity benefits for people who are unable to pursue their work because of accidents or conditions linked to the private life of the insured.[3] Medical care benefits are payable under the form of partial cost reimbursements – with higher reimbursements available for low-income workers and their families. Sickness and invalidity benefits are payable under the form of a real annuity that is a function of (capped) past wages, with different benefit formula applying to primary incapacity (up to 1 year) and to secondary incapacity (beyond 1 year). At an operational level, the health insurance fund relies on a series of accredited mutual health insurance providers that act as the interface between the health insurance system and the insured – with financial balancing mechanisms in place for compensating inherently different risk pools between providers. The role of the mutual insurance providers in the public health insurance is rather wide. Beyond their role as a paying agent on behalf of the health insurance fund, they also play an active gatekeeper role in the access to sickness and invalidity benefits. In addition, mutual insurance bodies offer supplementary health insurance policies to complete the coverage by the basic regime.

The pension system for the contractual wage-earners is organised and run by the Pension fund (RVP-ONP), which is in charge of pension benefit payments to retirees, their entitled dependents and survivors. Benefits are computed on the basis of 45 best years of earnings. The legal retirement age is 65, but early retirement is possible as of the age of 60, after a career of 35 years. Fictive earnings are imputed into the earnings record for any period of time that the individual was in receipt of other social insurance benefits – without any contributions due on behalf of the paying institutions. Social security benefits are indexed to the cost of living and on an occasional and purely discretionary basis to the growth rate of the economy. *De facto*, the pension system has progressively shifted away from its originally predominantly Bismarckian logic with protection against longevity risks being provided proportionately to contributions. Over time, three factors have interacted and lead to a substantially weakened link between benefits and contributions (*i.e.* a Beveridgean system). *First*, maximum annual pension benefits have not grown in line with average wages, leading to an increasing share of individuals hitting the maximum, but with their social contributions still due on full earnings. *Second*, minimum pensions have progressively been increased more strongly than average pensions – as most recently illustrated in the recent 2011 budget bill. *Third*, fundamental change on the financing side substantially altered the link between benefit accrual and contributions – particularly as of 1994 (see below).

The payment of unemployment benefits is organised by the Unemployment insurance fund (RVA-ONEM). Benefits are computed based on capped past earnings. Several features render the system different from its counterparts in other countries. *First*, eligibility is not entirely based on a contributory history, as high school graduates can enter the unemployment rolls without ever having contributed to the system. *Second*, benefits are payable indefinitely. *Third*, job search and availability conditions are widely required, but not universally applicable to all beneficiaries. This is particularly the case of the so-called old-age unemployed, *i.e.* older unemployed who are exempted from such requirements.[4] Beyond paying for unemployed, the unemployment insurance system also covers the bulk of costs relating to the Belgian

2. Compulsory health insurance is an exclusive federal competency, while public health and health care provision are a shared competency with communities and regions.

3. Workplace-related loss or reduction of earnings ability is protected through the accidents at work and occupational disease schemes we further detail below.

4. For a discussion on the changes of eligibility over time and their effect on labour force and system participation, see A. Jousten, M. Lefebvre, and S. Perelman, "Disability in Belgium: There is More than Meets the Eye", in D. Wise, eds., "Social security and retirement around the world: historical trend in DI provisions and participation and health" (forthcoming), University of Chicago Press and NBER.

system of conventional early retirement. Under conventional early retirement, workers can leave the labour force by claiming a basic compensation that is slightly more generous than regular unemployment benefits. In addition, workers often obtain a complement from their former employer. Upon reaching the legal retirement age, individuals transfer into the regular pension system. Conventional early retirement has played an important role in the Belgian retirement landscape, and combined with the old-age unemployment system *de facto* represents an important additional retirement system, as unemployed older than 58 is exempt from job-search requirements and those older than 50 are exempt from the follow-up procedures, implying that job search requirements are not enforced.[5] The unemployment insurance system also contains uncommon administrative arrangements. Job placement and training services are fully devolved to the regional level, requiring an important need for co-ordination between levels of government. In addition, trade unions play an important operational role as official paying agents with beneficiaries of unemployment and early retirement benefits having to register with trade unions to receive benefits as well as the informational points of contact for the unemployed with respect to their entitlements.[6]

Family benefits are organised by the Child allowance fund (RKW-ONAFTS). Lump-sum benefits are payable upon birth and adoption, and a real tax-free annuity is payable to dependent children. The monthly benefit amount is a function of the number of children in the household and is increased in case of special needs, the latter being a function of the child's characteristics (disability, *e.g.*) and/or the parents' (social benefit receipt of the parents, *e.g.*). As for other branches of the social insurance system, a large part of the operations is effectively outsourced to separate accredited family allowance registers that employers are affiliated with. Each one of these registers effectively manages and pays the child allowances for the employees of the affiliated employers.[7]

Work accidents and professional diseases are the two remaining big categories of risks covered by social insurance. The insurance of professional diseases is completely managed and operated by the Professional diseases fund (FBZ-FMP), while the situation is quite different for work accident insurance, where the largest part of the insurance coverage is provided by specialised accredited private work accident insurers, reflecting the mandatory purchases from private insurers. Insurers provide civil liability insurance as well as coverage against loss of earnings ability. A public institution, the Work accidents insurance fund (FAO-FAT) acts as the market regulator (medical and insurance) and provides complementary insurance coverage to some categories of victims.

Financing in the institutional setting

There are two major sources of financing for the 6 categories of benefits. The first is tax-deductible contributions of workers and employers on earnings, which include all forms of compensation, such as wages, fringe benefits, and other emoluments. The institution in charge of collecting these contributions is the RSZ-ONSS, with the employers acting as withholding agents,[8] collecting social contributions according to the schedule illustrated in Table A3.1 the 6 main categories of benefits. Extra contributions for employers cover a wide array of special purposes, such as vocational training leave (0.05%), child care

5. For an empirical estimation of retirement incentives in Belgium see A. Dellis, R. Desmet, A. Jousten and S. Perelman "Micro-modeling of retirement incentives in Belgium", in J. Gruber and D. Wise, eds., "Social Security Programs and Retirement around the World: Micro Estimation", (2004), University of Chicago Press and NBER.

6. A separate public institution is put in place to act as paying agent for non-unionised unemployed.

7. The RKW-ONAFTS is the provider of last resort for those not affiliated with a family allowance register.

8. In practice, accredited private social secretariat companies sometimes collect the contributions from employers and transfer them on to the RSZ-ONSS.

(0.05%), a contribution to protect workers of failed companies (between 0.09 and 0.14%), the asbestos fund (0.01%), etc. In addition, some categories of employers (typically larger companies) have additional surcharges on unemployment insurance, annual leave and workplace accident insurance. Further, an effective extra 7.48% of gross wages is due as a wage moderation contribution by employers. Finally, employers are required to purchase separate workplace accident insurance coverage with recognised private insurers. All revenues are centralised by the RSZ-ONSS in one common resource pool – the global financial management before being distributed to the various funds according to their revenue needs.[9]

In spite of this general contributions schedule, there are numerous cases where contributions are either not due or reduced. There are two broad scenarios of contribution reductions – both sharing the common aim of increasing employment. *First*, there are targeted measures that grant reductions or waivers for employers that hire their first workers, recruit a long-term unemployed person, employ young workers, low-wage workers, etc. *Second*, there are general measures that apply to all categories of workers. One general measure is the special contributions regime for employers in the non-profit sector. Another one is a per-worker lump-sum reduction in social contributions that is granted to almost all employers in Belgium. These general measures in turn contain a series of target-group specific complements – and in some cases benefits under targeted and general measures can be cumulated.

Table A2.1. Contributions for contractual wage-earners[1]

Categories	Employee contribution (%)	Employer's contribution (%)	Total (%)
1. Health and invalidity			
Medical care	3.55	3.80	7.35
Sickness and invalidity	1.15	2.35	3.50
2. Pensions	7.50	8.86	16.36
3. Unemployment	0.87	1.46	2.33
4. Family benefits	0.00	7.00	7.00
5. Accidents at work	0.00	0.30	0.30
6. Occupational diseases	0.00	1.00	1.00
Total (= "global contribution")	13.07	24.77	37.84

1. Contributions for blue-collar vacation pay is not contained in this table. Similarly, some earmarked supplementary contributions are not detailed.

Source: RSZ-ONSS.

The second major source of financing is transfers from the federal government – more specifically to the RSZ-ONSS as the financing agent of the contractual wage-earner scheme.[10] The transfers are partly discretionary and partly earmarked. The federal government subsidy to the RSZ-ONSS to support the social insurance of contractual wage-earners is the clearest example of a discretionary transfer of budgetary resources. Earmarks, on the other hand, pre-commit specific government revenues to an explicit expenditure item. Among earmarked transfers, the most important one is the so-called alternative financing, *i.e.* a pre-commitment of a substantial share of VAT revenues to the RSZ-ONSS. More than 40% of total VAT revenues transit in this way to the RSZ-ONSS. The specific amounts contain both

9. Contrary to the general principle, some specific tasks of these institutions are excluded from the global financial management (*e.g.*, asbestos fund and vocational training leave).

10. In addition to regular transfers, there exists a special earmarked social insurance contribution collected by the federal tax administration with the personal income tax.

mechanical and discretionary components – as the initially purely proportional revenue earmark has progressively been adjusted upwards to cover discretionary or mechanical spending needs and revenue shortfalls (*e.g.* financing of health insurance and subsidised household services). Additional earmarked financing for RSZ-ONSS comes from a variety of other sources such as exc ise duties, the stock-options tax, withholding tax on capital income, the personal income tax and the corporate income tax.

Revenue needs of the various funds are debited to the global financial management of RSZ-ONSS based on the net amount of individual fund's expenditures – *i.e.* net of funds' own revenues. The latter include returns on investments or proceeds from contracted loans as well as earmarked revenues, such as the Health insurance fund's (RIZIV-INAMI) special contribution from pharmaceutical companies on their sales of reimbursable drugs. Another increasingly important financing source is fund-specific alternative financing by the federal government in the form of a direct transfer of VAT and excise tax revenues, in the process by-passing the central financing body of the system. The aim of these mechanisms is to compensate for the impact of discretionary policy measures affecting only specific funds – such as for example the introduction of vocational training leave – or to offset long-term trends affecting some sectors – such as the strongly increasing expenditures in the health care sector.

The self-employed regime

Social insurance for the self-employed is the smallest and least generous of the three social insurance regimes. The system is organised and regulated by the Social insurance fund for the self-employed (RSVZ-INASTI). Contrary to the situation for contractual wage-earners, the same institution is in charge of organising the income and expenditure side of the system. Self-employed are insured against a smaller set of risks as compared to wage-earners. In addition to medical, sickness and invalidity insurance, they only benefit from old-age insurance and family allowances.

Benefits provision in the institutional setting of insurance funds

As a result of explicit policy choices over the last 15 years, benefits are increasingly similar in terms of generosity to those available to wage-earners for the covered risks – while historically insurance coverage was much less complete. Medical care coverage is the prime example of this trend, with coverage progressively aligned on that of wage-earners. Sickness and invalidity payments remain significantly less generous than in the wage-earner scheme, with benefits corresponding to a rather low lump-sum amount. The alignment of the self-employed on the wage-earner system is further by the fact that health insurance provision for both is provided by the same institution - the RIZIV-INAMI. As for wage-earners, pension coverage is also based on an insurance logic. The system has many similarities with the wage-earner scheme in terms of the benefit structure.

The benefit formula for pensions is comparable to the one for wage-earners – though less generous. Benefits are computed in a defined benefit logic based on the 45 best years of earnings – with old-age, survivor and family benefits available. The legal retirement age is 65, and early retirement is possible at the age of 60. While early retirement from the labour market is possible, it is much less common than in the wage-earner scheme, as there are no early exit routes available outside of the pension scheme. Social security benefits are indexed to the cost of living and on occasional purely discretionary measures lead to increases in benefit generosity. While the system officially is a contributions-linked system, its effective payouts are largely determined by the minimum contribution to the system (see below), as many self-employed declare very low earnings. Benefit calculations are done by the RSVZ-INASTI, while the Pension fund (RVP-ONP) acts as a paying agent for the system.

Self-employed also enjoy family benefits with slightly different conditions and benefit levels as compared to the wage-earner scheme. Benefit levels are determined by the Health insurance fund, but operations are outsourced to private social insurance registers that verify eligibility and make payments to their affiliates and with a separate public insurance register for those not affiliated with a private entity. These registers play a key operational role in the system, being the point of contact of individuals for family allowances as well as having a crucial role in the collection of social insurance contributions (see below).

Financing in the institutional setting

In line with the situation of the wage-earner scheme, there are two main categories of financing: social contributions by affiliates and general government transfers. Contributions of the self-employed obey a significantly different logic from the one for wage-earners. *First*, contributions are not due on a monthly but on a quarterly basis. *Second*, they are not calculated on current earnings but on the indexed taxable earnings over the past three calendar years. *Third*, two separate contributions schedules exist, distinguishing full and part-time self-employed. For full-time self-employed, the contributions schedule is displayed in Table A2.2. For part-time workers, contributions are calculated according to a more favourable schedule for earnings below the first threshold of the system of EUR 12 129.76 with the contributions for full-time earnings applicable for earnings above this threshold.

The most striking difference of the contributions structure with respect to the wage-earner scheme is that contributions have a regressive rate structure and display a maximum amount of taxable wages. This cap effectively has the effect of significantly limiting the effective marginal tax rate on self-employment income as compared to wage-earner income. Finally, contributions are not directly payable to RSVZ-INASTI, but rather to an accredited private social insurance register, which *de facto* act as the sole interface between the RSVZ-INASTI and the insured contributor. Only upon retirement, will the insured get into a direct contact with the self-employed fund. The registers transfer periodically the collected social insurance contribution to RSZV-INASTI, which centralise all revenues (including transfers from the federal budget) in one common resource pool – the global financial management, which then distributed to the various funds according to their revenue needs.

Table A2.2. Contributions for full-time self-employed[1]

Earnings in 2008, EUR	Indexed earnings, EUR	Marginal contribution rate
Up to 11 510.56	Up to 12 129.76	Absolute minimum of 650.34 EUR
Between 11 510.56 and 49 704.72	Between 12 129.76 and 52 378.55	22% of net earnings
Between 49 704.72 and 73 249.02	Between 52 378.55 and 77 189.00	14.16% of net earnings
More than 73 249.02	More than 77 189.40	0% of net earnings

1. Contributions in 2011 based on earnings in 2008.

Source: RCVZ-INASTI.

The second main source of financing of the system again comes from government transfers. These government transfers again take the form of both earmarked and non-earmarked government revenues. Historically, the longest standing form of general government financing has been a sustained lump-sum transfer to the system, which has been adjusted upwards over time, partially to compensate for the effect of price inflation, but also partially to offset the budgetary effect of discretionary coverage expansions. In addition to these mechanical components, annual *ad hoc* transfers are made to the system to bring the deficit of the system to the desired level. As for the wage-earner scheme, the so-called alternative financing by means of earmarked tax revenues also plays an increasing role as a tool for general government financing of the RSVZ-INASTI. As in wage-earner scheme a major component is a share of VAT revenues based on a mechanical component based on a formula that is progressively adjusted upwards in line with coverage expansion and financial shortfalls of the system. Additional revenues stem from various other revenues, such as excise duties, the stock-options tax, the withholding tax on capital income, the personal income tax, the corporate income tax, and the tax on insurance policies. Self-employed also benefit from the specific alternative financing that is independent of the job status of the affiliate and purely driven by revenue needs – such as improved financing of hospital care for all insured. Over the period 2006-10, the share of general government financing has increased from 34% to 45%.

Public sector regimes

The social protection for the public sector is the most heterogeneous. Several major kinds of systems can be distinguished – though a full listing would be beyond the scope of this presentation. *First*, there is the regime of the civil servants at the federal, regional and community level. *Second*, there are the contractual workers at the federal, regional and community level – who are fully subject to the contractual wage-earner scheme discussed above. *Third*, there is a separate regime for civil servants of the provincial and local level and, fourth, another separate regime for contractual workers at the provincial and local level. Finally, there are a series of special civil-servant pension regimes for public entities and enterprises, such as the national railway company. All of these categories enjoy very different degrees of social protection, with associated large differences in institutional settings. In what follows below, the focus is on the civil servants of the federal, regional and community administrations, and the civil servants of the provincial and local authorities.[11] As compared to wage-earners, the social insurance coverage of civil servants encompasses a smaller group of risks, which can partly be explained by the absence of an unemployment risk and partly by the direct employer provision of some benefits.

Medical care is the only common social insurance program between these two groups. In fact, civil servants are fully integrated on the benefit and financing side in the regime for contractual wage-earners. The Health fund (RIZIV-INAMI) plays the role of co-ordinator, and mutual health insurance bodies are the operators. For federal, regional and community civil servants, the employee contributions are 3.55% and for employers 3.86% of gross wages, payable to RSZ-ONSS. For provincial and local civil servants they are 3.55% and 3.80% respectively, payable to RSZPPO-ONSSAPL (a specialised social insurance institution). In the latter case, the health insurance contributions are passed on to the RSZ-ONSS, ensuring that all civil servant medical contributions and benefits are subjected to the system of global management of RSZ-ONSS.

Pensions are the main point of differentiation both with respect to wage-earners and self-employed, as within the group of civil servants. Pensions of federal, regional and community employee are largely payable without any contributions on the employee or employer side.[12] In contrast to the private sector, retirement is mandatory at the latest at age 65. However, there exists a variety of scenarios under which people can retire earlier – be it under the form of an early retirement pension, invalidity benefits, or waivers from active service. Pensions are more generous than in the other regimes, reflecting that benefits are computed on the average earnings of the last 5 years of service and are indexed on the evolution of wage scales – often a more favourable indexing series than is the case in the other systems. Pensions are computed by the Pension service of the public sector (PDOS-SDPSP) and are paid by the central pension

11. Contractual employees of provincial and local authorities enjoy a special status both in terms of benefits and institutional affiliation follows closely the one in the private sector – with lower significantly lower employer contributions. Finally, civil servants in public entities and enterprises have regimes that are comparable in structure to the one of the federal, regional and community civil servants – with variations in terms of generosity.

12. Only a 7.5% employee contribution is due on all earnings to finance survivor benefits.

payment service of the federal finance ministry. Effectively, the absence of contributions and the payment by the federal finance ministry means that the latter absorbs the aggregate pension cost of federal, regional and community administrations without cost sharing. Pensions of provincial and local administrations are significantly more heterogeneous across provinces and localities, with three broad types of pension arrangements in existence. *First*, there are pay-as-you-go defined benefit pension plans operated by some provincial/local authorities in a fully autonomous way. *Second*, there are private pension arrangements with an external pension fund, with operations based on the capitalisation of employer contributions. *Third*, there are a number of pension pools operated by the RSZPPO-ONSSAPL that are characterised by varying degrees of generosity and a membership that is largely determined by historical evolutions.[13] The three types of local administration pension systems have in common that all contributions and charges are entirely borne by the employer.

All remaining benefits for federal, regional and community civil servants are directly managed by the employer, without any contributions to a separate social insurance fund. As such, sickness and invalidity benefits, professional disease and work accident coverage are the responsibility of the employer. Similarly, family allowances, though similar in amount and principle to the ones for wage-earners, are paid out by specific family allowance registers for the public sector entities. The situation is slightly different for civil servants of provincial and local governments, where employers have to explicitly contribute 5.25% for family allowances and 0.17% for professional diseases to the RSZPPO-ONSSAPL, who uses these funds to finance benefits for employees in these two areas along rules largely comparable to those in place for private sector wage-earners.

Extensions to the system

Two broad categories of extensions of the system exist, social assistance and social insurance extensions beyond workers and their dependents. Social assistance is the most important extension and includes four main categories of benefits:

- Means-tested social assistance for working-age people.
- Means-tested social assistance for the population above 65 years of age.
- Means-tested benefits for disabled people.
- Guaranteed family allowances.

The right to means-tested social assistance for the working age populations is based on a federal regulation. Its implementation is based on local government's social assistance offices implementing the system in practice and paying out benefits to needy residents. Finally, the community government is in charge of the administrative oversight of the local social assistance offices on its territory. Benefits paid out under the social assistance regime for the elderly are more generous than for younger recipients. The benefits also obey a different logic in terms of fiscal federalism as it is the federal level that pays out the benefits – with the Pension fund (RVP-ONP) acting as a paying agent. Similarly, the federal government is in charge of the payment of needs-based social assistance to the disabled – through the Federal Public Service Social Security.

Guaranteed family allowances are the only one of these four components that is not means-tested. Eligibility for this benefit is based on the beneficiary's ineligibility for insurance-based family allowances

13. At an operational level, the pensions accrued in the pools of RSZPPO-ONSSAPL are computed by the PDOS-SDPSP as for federal employees with corresponding financial transfers from the RSZPPO-ONSSAPL.

in Belgium or abroad. Hence, it is a residual system, trying to ensure that all families enjoy financial support in raising their children. Beyond these cash benefits per se, all beneficiaries of social assistance are also automatically eligible for medical care coverage under the Health insurance fund (RIZIV-INAMI) social insurance programme, with more favourable reimbursement rates than for average workers.

Finally, there are social insurance extensions available to some specific categories of people. In the field of medical care insurance, students with low or no income and individuals without a social assistance or a work status have the right to contribute to the RIZIV-INAMI by paying age- and status-dependent lump-sum contributions, with any shortfall of contributions again financed by the global managements and alternative financing. Similarly, workers who are working outside of the European Economic Area and are working for a Belgian company or are European citizens have the right to contribute to a special Belgian social protection regime, organised by a specialised public institution, the Social insurance office for people working abroad (DOSZ-OSSOM).

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