



OECD Economics Department Working Papers No. 1009

# Enhancing the Inclusiveness of the Labour Market in Belgium

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<https://dx.doi.org/10.1787/5k4dl080l5d2-en>

**Unclassified**

**ECO/WKP(2013)1**

Organisation de Coopération et de Développement Économiques  
Organisation for Economic Co-operation and Development

**15-Jan-2013**

**English - Or. English**

**ECONOMICS DEPARTMENT**

**ENHANCING THE INCLUSIVENESS OF THE LABOUR MARKET IN BELGIUM**

**ECONOMICS DEPARTMENT WORKING PAPER No. 1009**

**By Jens Høj**

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**JT0333322**

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## ABSTRACT/RÉSUMÉ

### Enhancing the inclusiveness of the labour market in Belgium

The global crisis led to a smaller increase in the unemployment rate than in most other OECD countries as employment has been sustained through intensive use of reduced working time schemes. These schemes have mostly benefited workers with permanent contracts while the higher unemployment mostly affected workers with weaker labour market attachment. A main challenge for policy makers is therefore to avoid that the increase in labour market segmentation between insiders and outsiders that would hurt the most vulnerable. Over the medium term, labour market policies need to respond to the ageing of the labour force, which implies that an increasing number of workers with permanent contracts will retire. Thus, policies must focus on enabling the current labour market outsiders to get a stronger foothold on the labour market as well as to mobilize under-utilised labour resources. The wage determination system has allowed wages to increase faster than the main competitors and faster than productivity, leading to a gradual loss of cost competitiveness. Minimum wages are high by international standards, hampering entry to the labour market for many low-skilled workers. Unemployment benefits are relatively generous, and particularly for long-term unemployed. A complicated tax-benefit system has created high effective marginal tax rates and numerous labour market traps.

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

*JEL Classification:* J2, J11, J31, J65, J64

*Keywords:* Labour supply and demand, ageing of the labour force, wage formation, unemployment benefits, labour market traps

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### Pour un marché du travail plus inclusif en Belgique

La crise mondiale a entraîné une progression du chômage moindre que dans la plupart des autres pays de l'OCDE car l'emploi est resté soutenu du fait du recours intensif à des dispositifs de réduction du temps de travail. Ces dispositifs ont bénéficié essentiellement aux travailleurs titulaires de contrats permanents tandis que la hausse du chômage a principalement touché les travailleurs dont les liens avec le marché du travail étaient plus distendus. L'un des principaux défis pour les responsables des politiques publiques est donc d'éviter que la segmentation accrue du marché du travail entre travailleurs intégrés et travailleurs exclus frappe les plus vulnérables. A moyen terme, les politiques du marché du travail doivent s'adapter au problème du vieillissement de la main d'œuvre qui impliquera le départ à la retraite d'un nombre croissant de travailleurs titulaires de contrats permanents. Les politiques publiques doivent donc s'attacher à permettre aux travailleurs aujourd'hui exclus du marché du travail de s'y implanter plus fermement mais aussi à mobiliser les ressources en main d'œuvre sous-utilisées. Le mécanisme de fixation des salaires leur a permis d'augmenter plus vite que ceux des principaux concurrents et plus vite que la productivité, ce qui a abouti à une perte progressive de compétitivité-coûts. Les salaires minimums sont élevés comparés aux standards internationaux, ce qui est un frein à l'entrée sur le marché du travail d'un grand nombre de travailleurs peu qualifiés. L'indemnisation du chômage est relativement généreuse, en particulier pour les chômeurs de longue durée. Une fiscalité et un régime de prestations complexes ont généré des taux d'imposition effectifs marginaux élevés et de nombreux pièges sur le marché du travail.

Ce Document de travail se rapporte à l'Étude économique de l'OCDE de la Belgique 2011 ([www.oecd.org/eco/etudes/Belgique](http://www.oecd.org/eco/etudes/Belgique)).

*Classification JEL :* J2, J11, J31, J65, J64

*Mots-clés :* L'offre de travail et la demande, le vieillissement de la main-d'œuvre, la formation des salaires, allocations de chômage, les pièges du marché du travail

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## ENHANCING THE INCLUSIVENESS OF THE LABOUR MARKET IN BELGIUM

Jens Høj<sup>1</sup>

### **The labour market performed relatively well during the crisis, but structural problems remain**

The relatively good labour market performance during the crisis reflected widespread labour hoarding, encouraged by intensive use of reduced work time schemes, and the benefits of more intensive activation policies. Workers with permanent contracts were the main beneficiaries of the reduced work time schemes, and unemployment increased mostly in groups with relatively weak labour market attachment. In 2010, employment started to expand again. However, beyond the relatively good conjunctural performance, structural problems remain more widely. The employment rates for males and females are among the lowest in the OECD (Figure 1). Even if population ageing and cohort effects for females may increase participation rates eventually, these demographic changes are unlikely to boost employment rate towards the national employment targets of 73.2% without accompanying structural reforms.

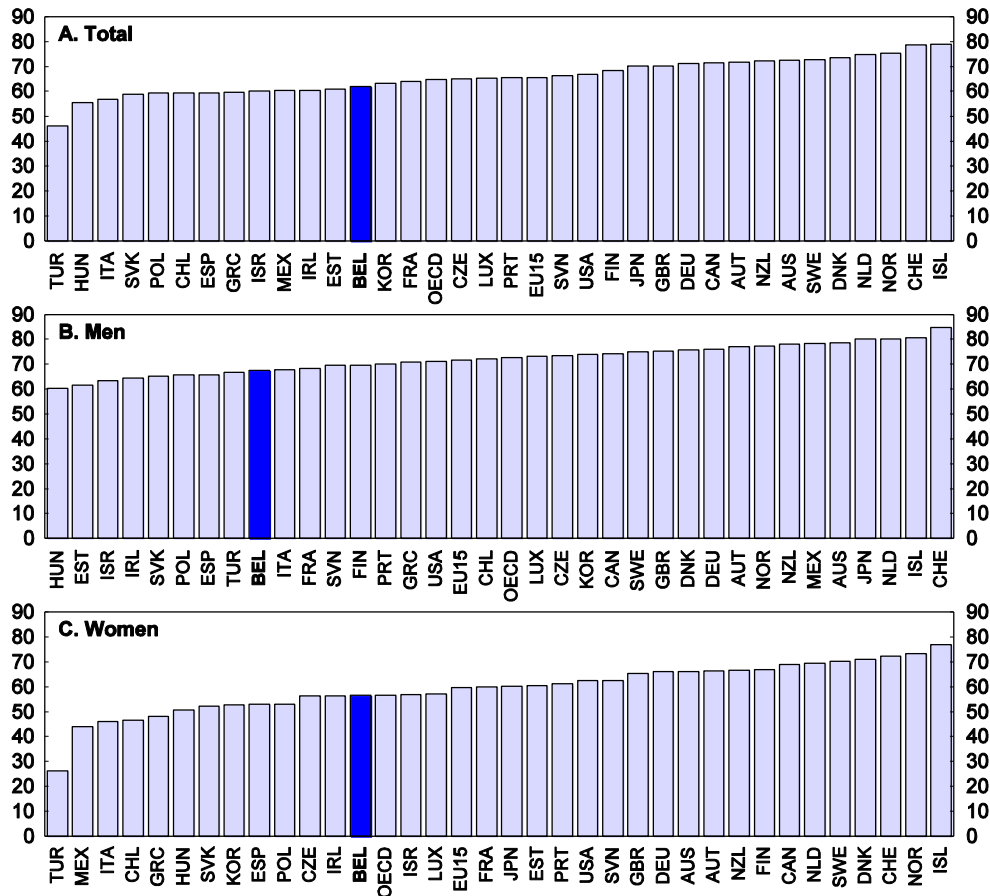
The low employment rates reflect high structural unemployment and a relatively large number of passive income support recipients, such as early retirees and disability beneficiaries. The following section investigates the widening segmentation of the labour market between workers with permanent contracts and those without. Subsequently, an evaluation is made of how crisis measures - despite their positive short-term impact – have contributed to increasing labour market segmentation while carrying a considerable dead-weight. This is followed by looking into how to strengthen the weak labour market attachment of the groups most affected by the crisis – a particularly important issue over the coming years as the ageing of the labour force means that an increasing number of retiring insiders will have to be replaced. The paper concludes with an assessment of how the effects of an ageing labour force can be offset by mobilising other underutilised labour resources.

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1. This Working Paper is based on Chapter 2 of the OECD's 2011 Survey of Belgium which was prepared under the responsibility of the Economic and Development Review Committee. The author is 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 Maartje Michelson for editorial assistance

**Figure 1. Employment rates in OECD countries<sup>1</sup>**

Percent, 2010



1. Population aged 15-64.

Source: OECD, Labour Force Statistics Database.

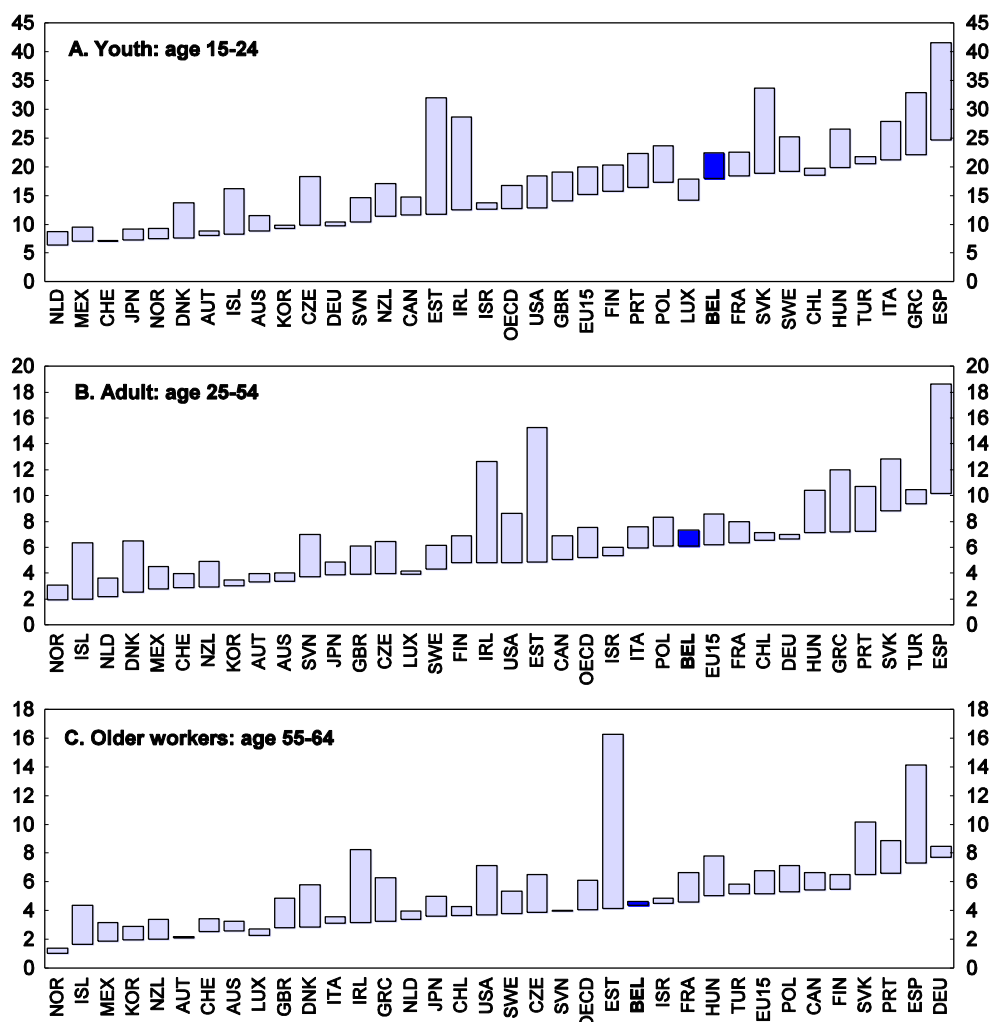
***Unemployment mostly affected workers with a relatively weak labour market attachment***

The unemployment rate of younger workers rose despite a fall in participation that reflected higher education enrolment and longer studies.<sup>2</sup> This has exacerbated the long standing problem of relatively high youth unemployment (Figure 2). Moreover, there is just above 10% of young people who declare that they are neither employed nor in education and training - a share that is slightly higher than the average for the European OECD countries (OECD, 2010b). In addition, duration of unemployment increased further, and the share of long-term unemployed (more than 12 months) edged up to more than half of all unemployed (Figure 3). Since the crisis, unemployment among non-EU immigrants has increased by nearly a quarter, averaging 30.6% in 2010.

2. The response in youth unemployment to economic cycles has a larger amplitude than adult unemployment both in downturn and upturn, so younger workers should benefit most from an economic upswing (Conseil supérieur de l'emploi, 2009; OECD, 2007).

**Figure 2. Youth unemployment is relatively high<sup>1</sup>**

Percentage points change between 2008 and 2010



1. The lower and the higher limits represent respectively unemployment rates in 2008 and in 2010 except for Chile in panel A, for Germany and Luxembourg in panels A, B and C and for Slovenia in panel C.

Source: OECD, *Labour Force Statistics Database*.

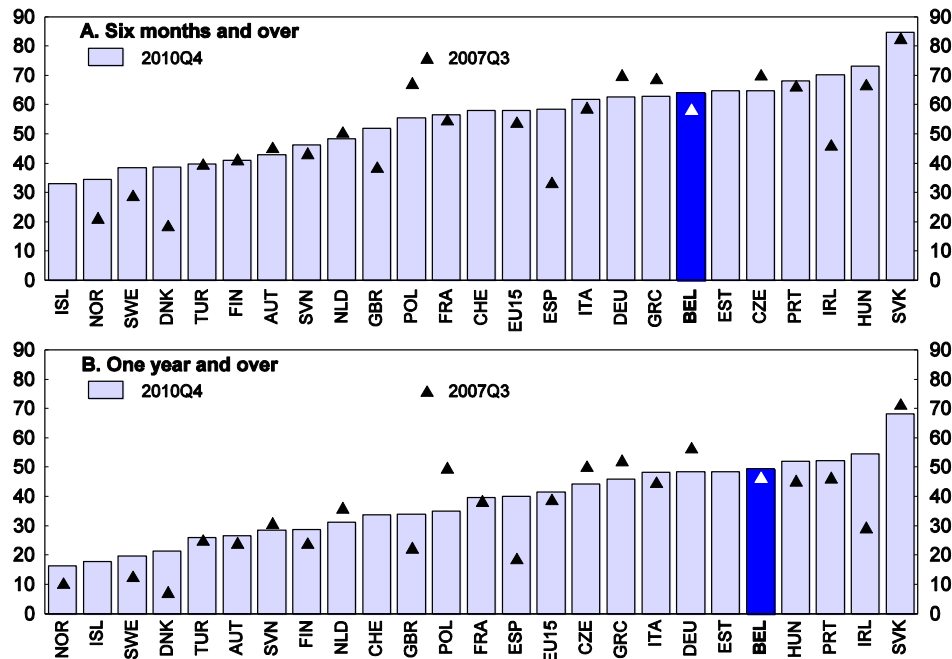
The higher unemployment rate was accompanied by a relatively modest fall in the vacancy rate, reflecting persistent labour market mismatches. During the 2000s, there was an outwards shift of the Beveridge curve. This probably reflects the impact of policies to activate older workers and the long-term unemployed, which made it more likely that these groups would report some job search and therefore be classified as unemployed in labour-force-survey statistics. On the other hand, the persistence of the outward movement of the Beveridge curve (Figure 4) reflects continuing difficulty in achieving effective transitions from the unemployment status into employment, particularly for the older-worker group that has been exempt from activation measures that applies to younger long-term unemployed.<sup>3</sup> Moreover, the intensive use of reduced working time schemes has not reduced mismatch problems, as the schemes have

3. In Flanders, the regional PES (VDAB) has a special support system for those aged 50-52.

allowed firms to keep strong links with their (key) workers, contributing to a low level of unemployment turnover that is pushing up structural unemployment (De Serres *et al.*, 2011). Such mismatch problems needs to be addressed to maintain potential growth in the face of population ageing.

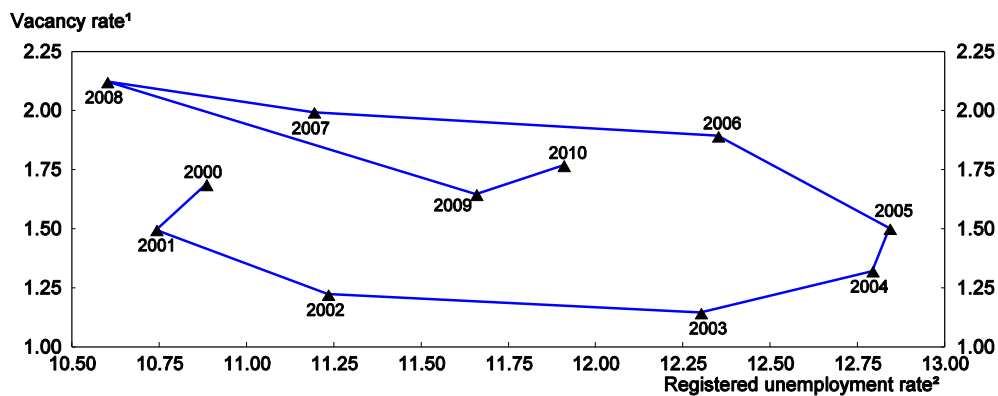
**Figure 3. Unemployment rates by duration**

As a percentage of total unemployed



Source: Eurostat.

**Figure 4. The Beveridge curve has moved out**



1. The number of administrative job vacancies divided by the sum of the number of administrative job vacancies and the number of occupied posts.
2. As a percentage of labour force.

Source: OECD, *Main Economic Indicators* and *Labour Force Statistics Databases*; Belgian Federal Public Service for Employment, Labour and Social Dialogue calculations.

### **The anti-crisis labour measures should be scaled back as the economy recovers**

A number of anti-crisis measures were implemented to support the labour market. Several measures reduced wage costs for certain categories of workers. Demand for younger workers was stimulated via the Win-Win plan from 1 January 2010 (and in place until end-2011) which introduced full or partial exemption from social security contributions for younger workers, where the degree of exemption depends on age, education level, and length of unemployment. The Win-Win plan also targets older unemployed and long-term unemployed. On the other hand, the planned reform to concentrate all reductions in employer's social contributions on low-wage workers by 2009 was not implemented. At the regional level, Flanders has increased wage subsidies for hiring most categories of older unemployed (+50 years) and Wallonia has increased provision of subsidised jobs for youth in SMEs, complementing the existing reduction in employers' social security contributions (for the first three young people hired) that benefits start-up firms.

Measures were also taken to strengthen job search incentives. Firms with more than 20 workers and that engaged in collective dismissals were required to provide counselling for all workers, including those on temporary contracts.<sup>4</sup> Wallonia introduced payments to cover child care and travel costs for low-wage workers. Flanders created work experience possibilities in 2010-11 for young long-term unemployed, and extended search obligations to newly registered unemployed in the age bracket 50-52. In spring 2011, this measure was further extended to the age bracket 53-55 and there are plans for a further extension to 58. Access to training programmes for the unemployed was boosted, particularly for workers in reduced working time schemes, and the training and guidance capacities of the Public Employment Services (PES) were increased. Nonetheless, there has only been limited vocational training of workers enrolled in the reduced working time schemes.<sup>5</sup>

The most important measure to contain the rise in unemployment was a substantial expansion of the existing reduced working time scheme for blue-collar workers, which in mid-2009 was supplemented with schemes for white-collar workers and workers subject to collective reductions (Box 1). The estimated number of jobs saved ranges from ½ per cent of private sector employment to 1¼ per cent of (permanent) employment (Hijzen and Venn, 2011; OECD, 2010). The scheme for blue-collar workers enables firms to temporarily suspend contracts of blue-collar workers when faced with unexpected adverse circumstances outside their control, such as bad weather or adverse economic conditions. Enrolled workers receive unemployment benefits for the non-worked hours and, in most cases, top-ups from their employers. During the crisis, total enrolment in the schemes almost doubled to reach an international high of nearly 6% of all employees (3% in full time equivalents) reflecting an average hours reduction of nearly 40% for those concerned (Figure 5).

The scheme for blue-collar workers saved a considerable number of jobs during the crisis. However, unlike in other countries enrolment is permanently high. Pre-crisis enrolment was actually equal to crisis levels in Germany and Italy (Figure 5). Moreover, about half of the pre-crisis budget was spent on workers who were enrolled for more than 40 working days, which appears long in the context of

- 
4. A problem in this respect is that temporary workers are a very heterogeneous group (often younger and immigrant workers) and they often rapidly change between employment, unemployment, and inactivity, making tracking difficult and hindering the guidance effort by PES.
  5. Designing effective training incentives is difficult. For example, the popular (214 000 requests in 2009) Flemish training cheques with a maximum value of EUR 250 to help workers to gain skills to improve job prospects are mostly used for courses to enhance lifelong learning or personal interests and only 40% for job-related training. In mid-2010, a new requirement for the cheques was that they can only be used for courses that are accredited for paid educational leave. Generally, private firms benefit from providing formal training as the positive net effect on labour productivity is higher than the increase in labour costs and wages, although only about a third of firms actively train their workers (Mahy and Volral, 2010).

unexpected and temporary reductions in activity. Furthermore, the strong seasonality in the use of the scheme harmonises poorly with the stated aim of addressing unexpected adverse developments (Annex A1).<sup>6</sup> The scheme has few checks and balances to minimise dead-weight losses - particularly in terms of avoiding subsidising employment that are not at risk. For employers, the system is very flexible with short notification periods and significant discretion on permissible reductions, ranging from a few hours per week to temporary layoffs. Few other countries have the same degree of flexibility, where often the possibility of temporary layoffs are explicitly ruled out or schemes have to be applied to at least entire production units (Hijzen and Venn, 2011). The scheme helps employers to cope with the relatively strict employment protection legislation for collective dismissals, which requires procedures of an estimated average of 120 days.<sup>7</sup> In early 1990s, Belgium experienced problems with high enrolment in part-time unemployment, when about half of all part-time workers in the economy received benefits for involuntary part-time work. By 1992, the associated fiscal costs eventually led to the introduction of checks and balances (including higher costs for employers and limitation in duration) which reduced the number of beneficiaries by 60% (OECD, 2003).

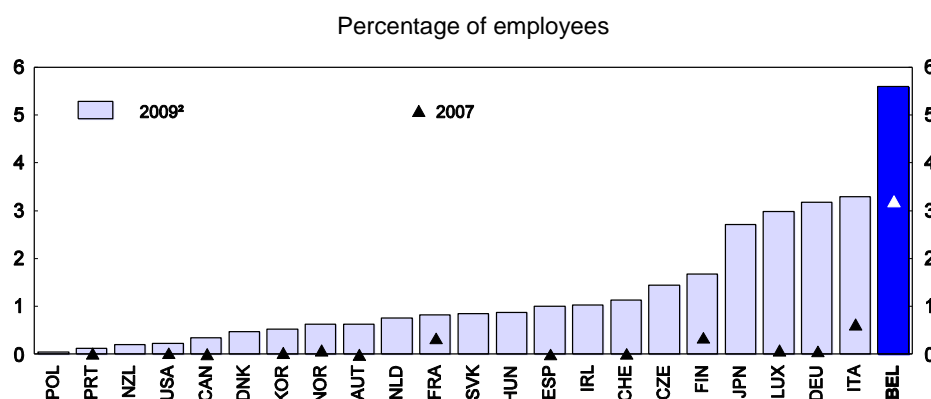
#### **Box.1. The Belgian reduced working time schemes**

Three schemes are in place to reduce working hours during temporary slowdowns in economic activity. Employees may receive benefits up to 75% of their salary and sometimes a top up from the employer:

- The largest (permanent) scheme for blue-collar workers allows employers to suspend (partially or completely) wage contracts, *i.e.* stop remuneration but keep the workers on the pay-roll. The employer can make the decision about whether there is a need to use the scheme and must inform employees 7 days in advance about the degree and duration of the temporary reduced working hours - information that is transmitted to the union (via the "conseil d'entreprise") and the national employment office (ONEM). The ONEM may, if it observes a regular pattern in the use of this scheme by individual firms, decide that structural factors are at play and rule the firm ineligible. Duration ranges from 1 to 12 months, depending on the degree of partial unemployment.
- A second scheme for white-collar workers was introduced in 2009. It is similar to the scheme for blue-collar workers, although there needs to be a formal agreement with the unions at the firm or sector level. To use this measure, the employer needs to demonstrate a significant reduction in economic activity (either a 15% year-on-year decline in turnover, production or orders) or have at least 20% of its blue-collar workers on suspended contracts. The duration ranges from at least one week up to 4-6 months, depending on the degree of partial unemployment.
- A third temporary scheme was introduced in 2009 (and expired in early-2011) to allow employers to reduce working time for all employees within a collective agreement at the firm level - so-called collective reductions. A similar measure can be applied individually (via the so-called "*crédit-temps de crise*"). The employer is broadly subject to the same requirements as in the temporary scheme for white-collar workers. Duration is at least one month.

The take-up of reduced working time schemes nearly doubled between 2007 and 2009, both in terms of enrollment (reaching 215 000 in 2009) and the total number of hours subsidised. The budgetary costs nearly tripled to reach EUR 1 billion in 2009. The take-up in the schemes for white-collar workers and for collective reduction is more modest, involving about 900 and 4 100 persons in full time equivalents, respectively. Less than 10% of the participants participate in subsidised training as part of the scheme. The reduced working hours schemes have not been assessed.

- 
6. The most important reasons for invoking the reduced working time schemes are adverse economic developments, weather, technical failures, force majeure, closure of the company during annual holidays, and strikes.
  7. The long procedures are also hampering labour reallocation as the PES cannot start accompanying the affected workers until the procedures are completed.

**Figure 5. Average monthly take-up rate of reduced working schemes in selected countries<sup>1</sup>**

1. Take-up is measured by the average stock of participants.

2. Data refer to 2009Q1, 2009Q3 for Austria, Luxembourg, the Netherlands, New Zealand, Portugal, the Slovak Republic and Spain.

Source: Hijzen, A. and D. Venn (2011), "The Role of Short-Time Work Schemes during the 2008-09 Recession", *OECD Social, Employment and Migration Working Papers*, No. 115.

The sum of eligibility and conditionality requirements comes across as weaker than in other countries. Noticeably in term of eligibility requirements, employers only need to notify unions, unlike in many other OECD countries, where employers have to obtain an explicit agreement with the unions (Table 1). Such agreements often function as a screening device, as unions have to balance the temporary fall in income with the probability of maintaining income via an alternative employment, although the effect depends on replacement rates. For example, the German replacement rate of 60% means that the unions must accept a substantial income cut for their members. In comparison, Belgian monthly replacement rates (including employer top-ups) can reach nearly 100%, compared with the replacement rate in the unemployment benefit system of about 60% (Hijzen and Venn, 2011). Individual conditionality criteria tend to be similar to those in other countries, but collectively they come across as weak, implying a risk that the subsidy supports unviable jobs (Table 1). Unlike some other countries, Belgium does not require firms to provide compulsory training and recovery plans. Moreover, Belgian firms are allowed to dismiss enrolled workers without being required to pay-back received subsidies, whereas other countries do not permit dismissals during and immediately after enrolment. In addition, employees are not subject to job search requirements, minimising the risk for firms that their enrolled workers find alternative employment (Table 1). Such requirements help to minimise dead-weight losses, as they reduce displacement effects (such as supporting unviable jobs), upgrade human capital or promote labour mobility. Another benefit for employers of using the system is that they pay no social security contributions for non-worked hours, unlike in many other countries, even though such hours are included in the calculation of pension rights (Figure 6).

Reduced working time schemes entail a trade-off between cost-effectiveness (limiting dead-weight costs) and scale (restricting desirable take-up). The schemes have mostly benefited workers with permanent contracts, pointing to potential deeper labour market segmentation. In addition, by allowing firms to keep their key workers the schemes have probably added to labour market mismatches. Thus, the introduction of appropriate checks and balances could preserve the effectiveness of the system, but at a significantly lower cost, while improving labour resource utilisation and allocation (OECD, 2009a). A starting point should be to align the checks and balances in the system for blue-collar workers with the, more stringent ones embodied in the other schemes, rather than the reverse as stipulated in the 2011-12 wage agreement. Thus, firms should demonstrate a significant temporary drop in activity and enrolment in the scheme should be subject to approval by the labour market authorities. Re-entry into the schemes should be restricted within a given time horizon, such as the following year, to encourage firms to adopt new production planning, processes, and technologies.

**Table 1. Eligibility and conditionality requirements for reduced work time schemes in the OECD<sup>1</sup>**

	Eligibility requirements			Conditionality requirements			
	Firm must provide justification of economic need	Social partner agreement	Participating workers must be eligible for UB	Compulsory training	Recovery plan	No dismissal	Job search requirement for employee
Austria	Yes	Yes	No	No	No	Yes	No
<b>Belgium</b>	<b>Yes</b>	<b>BC: No WC: Yes (or business plan)</b>	<b>No</b>	<b>No</b>	<b>BC: No WC: Yes</b>	<b>No</b>	<b>No</b>
Canada	Yes	Yes	Yes	No	No	No	No
Czech Republic	Yes	Yes	No	Yes	No	No	No
Denmark	No	Yes	No	No	No	No	Yes (when)
Finland	Yes	Consultation	Yes	No	No	No	Yes
France	Yes	Yes	No	No	No	Yes	No
Germany	Yes	Yes	Yes	No	No	No	Yes
Hungary	Yes	No	No	Yes	No	Yes	No
Ireland	No	No	Yes	No	No	No	Yes
		CIGO: No	No	No	Yes	No	No
Italy	Yes	CIGS: Consultation					
Japan	Yes	Yes	Yes	No	No	No	No
Korea	Yes	Consultation	Yes	No	No	No	No
Luxembourg	Yes	Yes	--	No	Yes	No	No
Netherlands	No	Yes	Yes	Yes (or secondment)	No	Yes	No
New Zealand	No	Yes	No	No	No	Yes	No
Norway	Yes	No	Yes	No	No	No	Yes
Poland	Yes	Yes	No	No	Yes	Yes	No
Portugal	--	--	--	Yes	No	No	--
Slovak Republic	Yes	Yes	No	No	No	No	No
Spain	Yes	No	No	No	No	Yes	Yes
Switzerland	Yes	Individual agreement	No	No	No	No	No
Turkey	Yes	No	Yes	No	No	No	No
United States	Yes	Yes	Yes	No	No	No	No

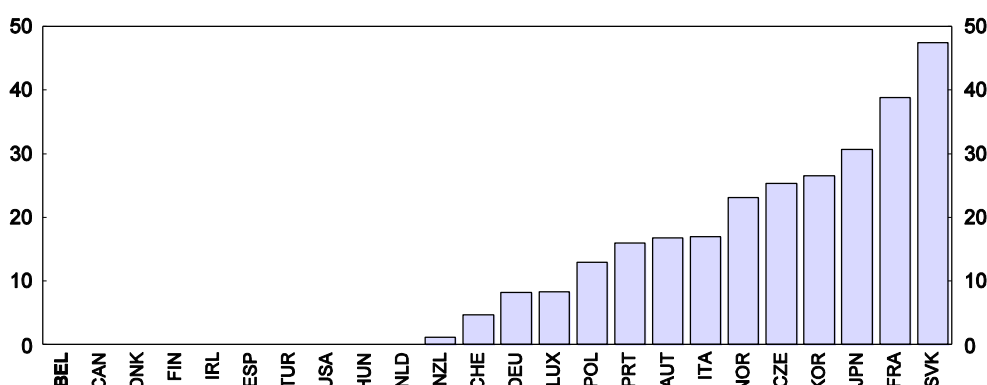
1. BC: blue collar; WC: white collar; CIGO: Cassa Integrazione Guadagni Ordinaria; CIGS: Cassa Integrazione Guadagni Straordinaria; UB: unemployment benefit.

Source: Hijzen, A. and D. Venn (2011), "The Role of Short-Time Work Schemes during the 2008-09 Recession", *OECD Social, Employment and Migration Working Papers*, No. 115.

An important check and balance would be to increase the cost for employers of using the system to secure that only firms exposed to temporary shocks would use the system and to give firms incentives to leave the system as soon as possible. Thus, employers should pay social security contributions for non-worked hours and the benefits for an initial enrolment period. This should be backed with - in line with the Dutch approach (OECD, 2010) - the (partial) repayment of received subsidies if enrolment workers are subsequently fired. To avoid “parking” key workers that may be in demand in other sectors, enrolled workers should – as are other unemployment beneficiaries - be available for hiring in other firms via the PES, who should also monitor and enforce availability. In case of prolonged enrolment, it could be considered to make enrolled workers subject to standard job search requirements. To secure that the system is only used for temporary shocks, there should be a cap on enrolment periods. Currently, employees have little incentives to refuse participation, even if they are aware that the firm is exposed to more structural issues. This could be corrected by having employees sharing a larger part of the costs, for example through reducing benefits over time or the banning of top-ups from the employer. This would increase search incentives for alternative employment and thus facilitating reallocation of labour.<sup>8</sup> In view of the problems of fiscal sustainability problems, closer parliamentary oversight could be secured by making the reduced working time schemes budget dependent. In practise, this would mean that the relevant ministry would have to present a new bill to parliament to secure additional funding, which would at least high-lighten the need for structural reform in case of ballooning fiscal costs.

**Figure 6. Wage cost to employer for hours not worked**

As a percentage of normal total labour cost<sup>1</sup>



1. For a single worker without children who usually earns the average wage.

Source: Hijzen, A. and D. Venn (2011), “The Role of Short-Time Work Schemes during the 2008-09 Recession”, *OECD Social, Employment and Migration Working Papers*, No. 115.

### The government should focus on making the labour market more inclusive

Over the medium-term, the main challenge for labour market policies is to mobilise available labour resources to replace the increasing – due to population ageing – number of retiring permanent contract workers. This requires reforming labour market institutions to strengthen the labour market attachment of outsiders and enhance labour market participation incentives. There has been an increasing focus on earlier activation, but nevertheless available public funds are still focussed on job creation and

8. An additional issue concerns targeting on which no Belgian specific research is available. Recent empirical German studies show that small firms, which are normally more exposed to credit crunches and thus need short-term public support, are significantly less likely to participate in reduced work time schemes than medium – to large sized firms. This probably reflects that small firms have a more limited ability to adjust work processes and to manage flexible working arrangements more generally.

employment incentives, while training and activation resources at the PES play a less important role (Table 2). The focus on job creation and employment incentives may be needed in the context of the high minimum wage, although this is arguably a second-best use of funds.

**Table 2. Public expenditure on labour market programmes**

As a percentage of total expenditure on active measures, 2008

	Belgium	EU15 <sup>1</sup>	EU19 <sup>1</sup>
PES and administration	15.40	27.60	29.40
Training	12.30	26.70	23.50
Employment incentives	35.50	19.50	18.40
Supported employment and rehabilitation	9.60	11.80	13.10
Direct job creation	26.80	11.10	11.10
Start-up incentives	0.30	2.60	4.00
Total expenditure on active measures (% of GDP)	1.28	0.78	1.10

1. The EU15 and EU19 aggregates are unweighted averages and exclude Greece.

Source: OECD, *Labour Market Programmes Database*.

### ***Activation policies, are still applied late in the unemployment spell***

Reforms in the second half of the 2000s have introduced a step-wise activation of unemployment benefit receivers. A first letter about job search obligations is sent out during the 13th month of unemployment (7th month for young unemployed). The first interview occurs about 8 months later (*i.e.* after 21 months of unemployment). If it is unsatisfactory, it leads to an action plan contract with specific steps in the following four months. If these steps have been followed, a next interview will be scheduled for 12 months later; otherwise an additional action plan is offered. Non-compliance with the new action plan leads to sanctions (partial or permanent suspension of benefits). This is complemented by regional guidance and job matching measures, that starts earlier in the unemployment period.

Between 2004 and 2010, nearly 630 000 interviews were conducted and close to 70 000 sanctions (of which nearly 20 500 exclusions) were issued (Table 3). The use of sanctions is supplemented by enhanced regional activation policies, focusing on individual guidance and contracting, job offers, and with special emphasis on young and older workers.<sup>9</sup> The policy has had positive results, as the first notification increases transition rates into employment, by around 6 and 10 percentage points in Wallonia and Flanders, respectively, to 28% and 22% (although often to lower paid and relatively short-term jobs) (Cockx and Dejemeppe, 2010). Nevertheless, the slow pace of intervention reduces the effects of the programme (De Serres *et al.*, 2011) and sanctions are mainly applied to long-term unemployed with low transition into the labour market, implying that most eventually return to the system or transfer to social assistance benefits. Combating long-term unemployment therefore requires that activation be applied much earlier (at the latest after 6 months of unemployment) and be backed up with earlier sanctions, say after 9-12 months of unemployment. The success of such a reform depends on the capacity of regional employment services to provide employment assistance and referrals to job vacancies.

9. In addition, the increased information exchange between the regional PES has started showing results with for example 7 000 unemployed from the Brussels Capital region finding employment in Flanders. In all, more than 42 000 people from the Brussels Capital Region and about 105 000 people from the Walloon Region worked in Flanders.

**Table 3. The use of sanctions has increased<sup>1</sup>**

	Per cent			
	Flanders	Wallonia	Brussels	Total
2003	1.66	0.08	0.65	0.78
2004	1.64	0.10	0.90	0.83
2005	2.03	0.20	1.42	1.11
2006	3.32	1.36	1.16	2.05
2007	6.92	2.51	2.02	3.92
2008	6.98	3.61	2.23	4.48
2009	4.47	4.66	2.27	4.17
2010	2.57	5.15	3.00	3.81

1. The sanction rate is the number of sanctions relative to the relevant group of unoccupied jobseekers (composed by fully unemployed jobseekers receiving compensations, unoccupied jobseekers who must be registered and unoccupied jobseekers freely registered).

Source: National Employment Office (ONEM).

### ***Young unskilled people have difficulties in finding a foothold on the labour market***

Activation policies are often aimed at young unemployed. Nonetheless, their unemployment rate continued to increase during the 2000s to an internationally high level (Box 2) (Figure 2). This partly reflects an inherent limitation on the ability of the PES to place young workers, as employers consider unsolicited applications and recommendations from other workers as a signal of greater motivation and thus more attractive than referrals from a PES (Bonoli and Hinrichs, 2010). School leavers (particularly those with less than upper secondary education) can expect shorter periods of employment during the first five years after leaving school than in most other OECD countries – reflecting educational attainments that do not match the needs of the labour market with prevailing high minimum wages (see below) – and accentuated by low geographical mobility (Jousten *et al.*, 2008) (Figure 7).

#### **Box 2. Activation policies for young people**

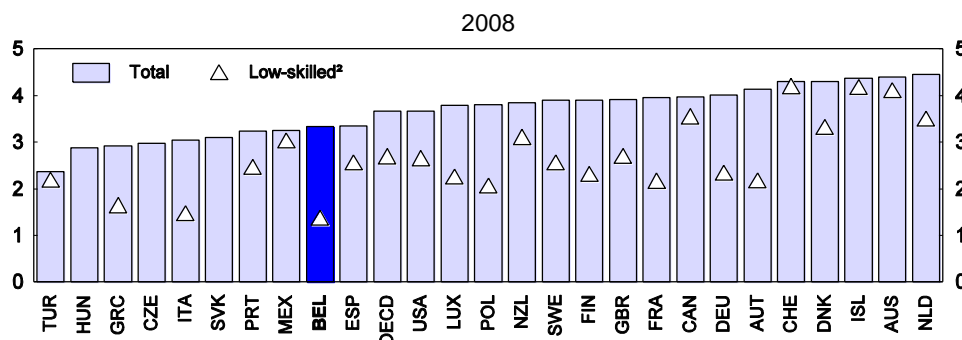
Active labour market policies have gradually become more focused on young job-seekers (OECD, 2010b). Since the mid-2000s, school leavers registered with the PES have to be activated.

In Flanders, early and intensive activation was introduced by the 2004 Youth Work Plan, where all young job seekers (less than 25 years) enrolled with the PES (VDAB) are immediately offered job referrals and guidance through e-instruments as a function of their employability and not (as previously) on their level of education. After one month there is an evaluation and those without job referrals will be contacted by telephone. If necessary they are invited for an interview. After three months, young job seekers have to sign individual action plans, containing job-search assistance, training and re-employment programmes.

In mid-2007, the Walloon PES (FOREM) introduced the Job Tonic programme with intensive tailored-made guidance and counseling for young job-seekers without an upper secondary qualification during the first six months after leaving school. In mid-2008, this programme was extended to include job-seekers with upper secondary qualifications.

In Brussels, school leavers that register with the PES (Actiris) are systematically invited for an interview to elaborate an action plan. Such plans for low-skilled workers are typically signed within one or two weeks.

The success for these programmes hinges on the ability to secure early enrolment, particularly for disconnected youth, in remedial education measures. One way of assuring this is, as in the Netherlands, to make local authorities responsible for work/learn positions that has to be presented before passive income support can be offered. In 2009, legal rights and obligations for local authorities and young people were introduced (OECD, 2010b).

**Figure 7. Expected number of years spent in employment during the five years after school<sup>1</sup>**

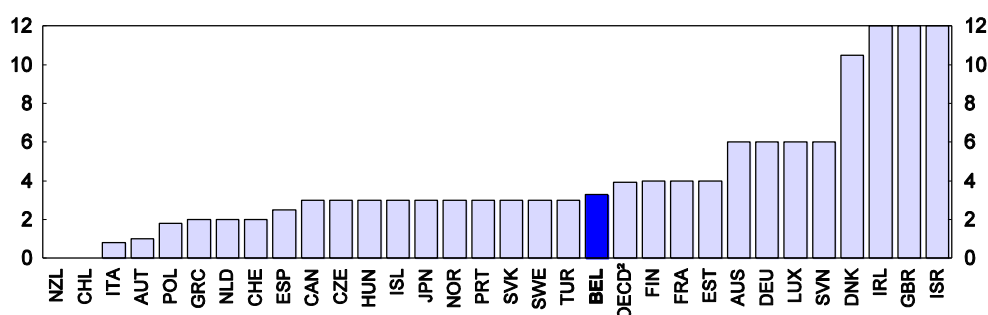
1. In the EULFS, individuals report on the year they obtained their highest degree. The respondent is no longer a student, this information is used to compute the durations underlying the indicator. In HILDA, respondents report on the number of years that have elapsed since they left full-time education. That information is used to compute durations, again conditional on the respondent no longer being a student. A similar methodology is used for Mexico and Canada. For the United States the typical age at which a degree is obtained is used to reconstruct a duration variable. Data refer to 2006 for Australia.
2. Less than upper secondary education.

Source: European Union Labour Force Survey (EULFS); Melbourne Institute, Household, Income and Labour Dynamics in Australia Survey (HILDA), Release 6 for Australia; Labour force survey for Canada; Encuesta Nacional de Ocupación y Empleo for Mexico; Current Population Survey for the United States.

Apprenticeship schemes, internships (or other systems to mix school, training and work) and small hours student jobs are not well developed, implying in most cases an abrupt transition from education to work. Co-ordinating policies to secure a smoother transition is difficult, as the communities are responsible for education, the regions for employment and professional training, and the federal government for labour legislation, collective agreements and social security (OECD, 2007). Young people's employment prospects are also reduced by the widespread use of the LIFO (last-in first-out) firing principle and relatively short average trial periods for new hires (Figure 8). Standard trial periods should be extended to allow employers more time to assess capabilities and skills of new hires with a limited employment record, for example to levels observed in countries with traditionally high employment rates for young people, such as Denmark, Ireland, and the United Kingdom.

High unemployment rates for young people can also be traced to a combination of relatively high statutory minimum wages and relatively generous unemployment benefits (particularly for those still living with their parents) (Figure 9). The high statutory minimum wage drives a wedge between the costs of young low-skilled workers with little previous work experience and their productivity, while generous benefits push up their reservation wages. Statutory minimum wages for younger workers (less than 21 years) is phased in relatively fast (from 70% of the minimum adult wage at age 16 to 94% by the age of 20) to reach an internationally high level (Immervoll and Pearson, 2009; OECD, 2010). It is noticeable that in the Netherlands the phase-in is much slower and youth employment much higher, as the former has contributed to increase the availability of small hours jobs. In some recent wage agreements, these phase-ins were abolished altogether – effectively hampering the hiring of younger low-skilled workers. Moreover, the standard statutory minimum wage concerns only a relatively small part of the employed (1.1%) as everyone else is covered by sectoral minimum wages, which often are about one fifth higher (OECD, 2009a).<sup>10</sup>

10. The split between the statutory and the sectoral minimum wages reflects that the statutory minimum wage has not increased in real terms since 1993, while sectoral agreements typically adjust upwards all wages.

**Figure 8. Trial-period length**Months, 2008<sup>1</sup>

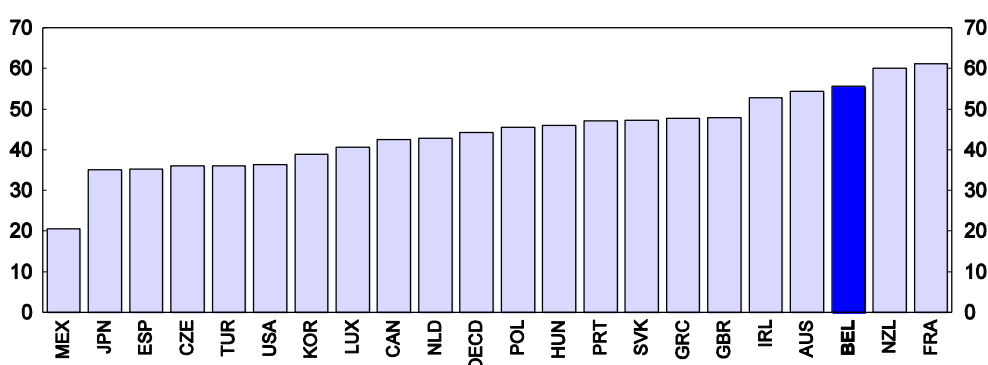
1. For France and Portugal, data refer to 2009.

2. Unweighted average of countries above.

Source: Venn (2009), 'Legislation, Collective Bargaining and Enforcement: Updating the OECD Employment Protection Indicators', OECD Social, Employment and Migration Working Paper, No. 89.

**Figure 9. Statutory minimum wages are relatively high<sup>1</sup>**

As a percentage of median wage, 2008



1. Data refer to the gross wage, which does not take into account potential social contribution exemptions. Data refer to 2007 for Mexico and to 2006 for Turkey.

Source: OECD (2010), *Off to a Good Start? Jobs for Youth*.

Minimum wages need to be brought into line with the productivity levels of low-skilled young job seekers/labour market entrants, requiring that the sectoral minimum wages are aligned with the statutory minimum wage.<sup>11</sup> This would not only enhance the employment chances of low-skilled workers, but the associated increase in the wage differential boost the scope for low-skilled workers to price themselves into the labour market. For workers younger than 21 years, a more gradual phasing in of the minimum wage ensures that their wages and productivity developments are better aligned. Alternatively (sectoral) entry wages should be introduced, applicable to workers (re-) entering employment - a measure that ensures that insiders preserve their wages, while facilitating the transition for workers with weak labour market attachment into employment.

11. An argument for high minimum wages is to combat poverty. However, the minimum wage is a poor instrument to combat poverty, particularly for younger workers still living with their parents.

Despite recent measures to promote internships and apprenticeships, there are still institutional factors hampering school-to-work transition (Box 3). School leavers who register with the regional PES get the right to the so-called waiting allowance, an unemployment benefit (about 50% of the ordinary minimum unemployment benefits) linked to age and the level of studies for an unlimited period after a waiting period of 6-12 months. Thus in the early stages of unemployment school leavers have considerable search incentives, but these are reduced once the waiting allowance kicks in.<sup>12</sup> In most OECD countries school leavers cannot receive unemployment benefits on the basis of their diploma and when they can (Denmark, Greece, Luxembourg and the Czech Republic) there is a well-defined bound on the duration. Search incentives for school leavers would be enhanced by abolishing the waiting allowance, or if it is retained be strictly limited in time, to school leavers (for example making it only available for school leavers younger than 26) and conditional on search activity. This could be combined with early job search assistance, preferably upon registration with the PES. Special measures should be available for school drop-outs, such as non-class remedial support to acquire relevant job market skills, like computer and basis technical qualifications.

### **Box 3. Recent measures to facilitate the school-to-work transition**

Within the Belgian “study first, then work” model, recent measures have focused on promoting internship opportunities rather than encouraging student work.

In the Brussels region, the PES (Actiris) created in 2009 a database of internships and student jobs proposed by firms.

In Wallonia, an agreement has been reached to generalise internships and dual training and modularisation in vocational and technical secondary education in 2009-14. Some short cycle tertiary education programmes will have compulsory internships from September 2011 onwards.

In Flanders, internships in vocational and technical secondary education are now strongly recommended. In the Competence Agenda 2010, the social partners have committed themselves to create 75 000 work placements per year for pupils in technical and vocational secondary education and 30 000 work placements over a period of five years for teachers of practical and technology education. Since 2009, new programmes in the short cycle of tertiary education have compulsory internship.

The federal government reduced social security contributions in 2010 by EUR 400 per quarter for employers who have mentors for interns, apprentices or vocational education training teachers.

The OECD general recommendations to improve the effectiveness of vocational education and training (VET) policies include (OECD, 2010b):

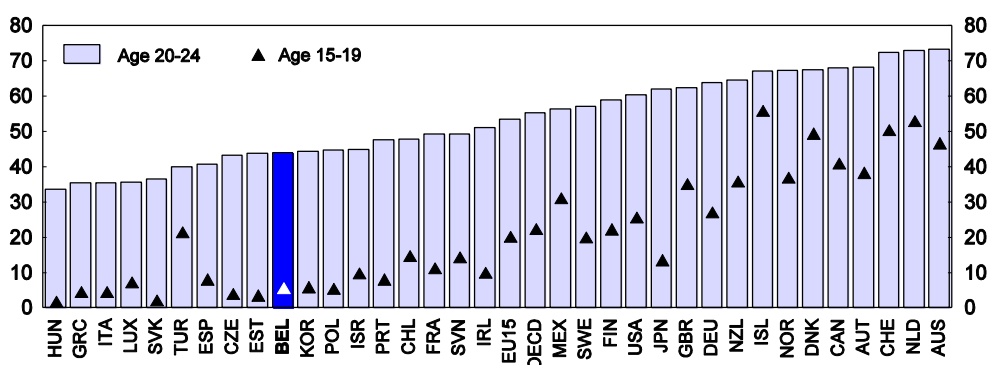
- Provide a mix of VET programmes that reflect student preferences and employer needs through an apprenticeship system based on balancing supply and demand through a market.
- For VET beyond secondary level, share the costs between government, employers and individual students according to benefits obtained.
- Engage employers and unions in curriculum development and ensure that the skills taught correspond to those needed in the modern workplace.
- Provide young people with the generic, transferable skills to support occupational mobility and lifelong learning, and with occupational-specific skills that meet employers’ immediate needs.

12. As with young unemployed receiving unemployment benefits, those on the waiting allowance are subject to the regional guidance and job-matching measures.

The mandatory school leaving age is 18, well above standard age of 15 and 16 in most other OECD countries. In addition, there are few possibilities for younger people to gain workplace experience prior to leaving school. Vocational education (starting at age 16)<sup>13</sup> is poorly developed and mostly for unsuccessful students. Employment during school breaks is encouraged by a holiday-time exemption from social security contributions.<sup>14</sup> In all, both the employment rate for 15-19 (including apprenticeships) and the share of students combining study and work is relatively low – and with a particularly large gap in unemployment and employment rates between low-skilled and other youth (OECD, 2010) (Figure 10).

**Figure 10. Employment rates of youth**

Per cent, 2010



Source: OECD, Labour Force Statistics database.

International evidence indicates that school-to-work programmes boost labour market attachment, skill formation, wages, and earnings (OECD, 2010b and Neumark, 2009). Also Belgian evidence indicates that short-term jobs for long-term unemployed school leavers can act as a stepping stone to more permanent jobs (Cockx and Picchio, 2009). Thus, student jobs, small hours jobs, internships and apprenticeships may help to break the cycle of “no job no experience; no experience no job”. However, there appears to be a scarcity of small-hours jobs as relatively few young people work in service sectors, which have many part-time job opportunities. In addition, working time rules are likely to hinder the supply of small hours jobs, as the minimum length of working time has to be at least 3 consecutive hours and a part-time job must be equal to at least one third of a full time position, although a number of sectoral agreements (particularly in service sectors) include derogations. The availability of small hours jobs could be stimulated by a better alignment of wages and productivity and a removal of restrictions on part-time working time rules. The special holiday exemption seems largely superfluous, as all low-income workers are exempt from social security contribution, and hence it should be abolished. Recent reform in this area abolished the holiday requirement and allows student to work for a maximum of 50 days per year.

### ***High effective marginal tax rates and generous benefits undermine work incentives***

Belgium has some of the highest tax wedges among the OECD countries, calling for deeper reform of the social security and tax systems (Figure 11). Low income workers have particularly high effective marginal tax rates in excess of 80%, arising from employment induced withdrawal of social

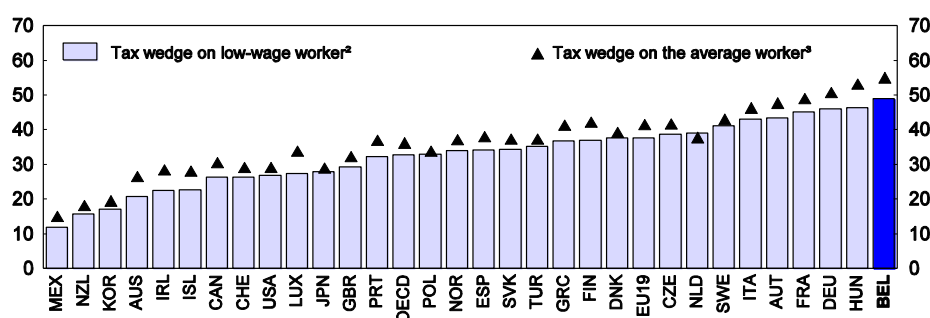
13. Students do not seem to value this type of training as they are perceived to have low status (OECD, 2010). This perception may partly be related to one of the largest discrepancy in performance between vocational and academic students in terms of PISA score in mathematics, reading and science.

14. In spring 2011, the rules were relaxed to allow the exemption to be applicable to an additional 4 days, totalling 50 days, and with no restrictions on timing.

transfers combined with high personal income taxation, greatly undermining work incentives (OECD, 2009a). Reforms to boost labour demand for low-skilled have mostly aimed at reducing labour costs via targeted cuts in employers' social security contributions. As also other categories of workers, such as young, older, low income, R&D, and shift- and night workers, have benefited from similar cuts, the result is a poorly targeted system with considerable dead-weight costs (OECD, 2009a). Plans to simplify the system and focus reductions on low paid workers have not been implemented so far due to the prolonged coalition negotiations. A recent report from the Federal Planning Bureau indicates a lowering of social security charges for low-income workers could boost employment by some 50 000 over the medium term, but at a financial cost in excess of 1% of GDP (Bassilière *et al.*, 2007). Possible reform of the social security contributions to improve tax incentives are discussed in the Economic Survey of Belgium, 2011.

**Figure 11. Tax wedge including employer's social security contributions in OECD countries<sup>1</sup>**

As a percentage of gross income, 2009



1. OECD and EU19 aggregates are unweighted averages.
2. Tax wedge including employer's mandatory social security contributions for a single worker with no children earning 67% of the average wage, excluding social security reduction.
3. Tax wedge including employer's mandatory social security contributions for a single worker with no children earning the average wage, excluding social security reduction.

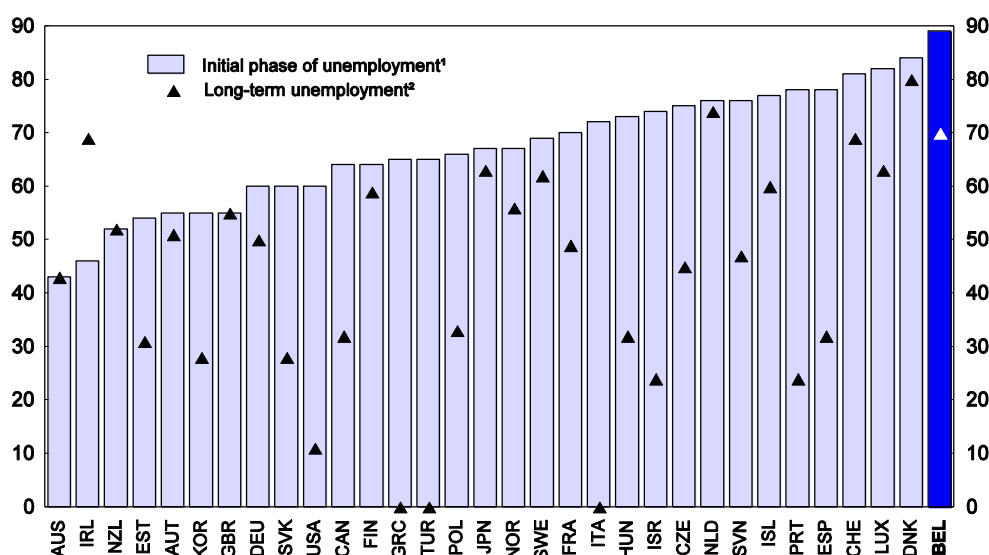
Source: OECD (2010), *Off to a Good Start? Jobs for Youth*.

The combination of high statutory minimum wages and generous unemployment benefits raises long-term unemployment risks and constitutes a particular problem of young low-skilled unemployed with little on-the-job experience. The unlimited duration of unemployment benefits provides few search incentives. Both international evidence<sup>15</sup> and Belgian research indicate that job-search activity increases as benefits are terminated. In Belgium, all categories of unemployed have unlimited duration of unemployment benefits. The only exception (until 2004) was unemployed with abnormally long unemployment spells and with working partners. Notification of benefit termination for this category boosted their employment rates by up to 25 percentage points during the following 14 months (Cockx and Ries, 2004). In addition, the initial replacement rate for low-income workers is among the highest in the OECD. The replacement rate is also relatively high for long-term unemployed (Figure 12). In 2009, first-year benefits were increased, providing for some dynamic search incentives when benefits return to their previous level after one year (OECD, 2008). Income support was further boosted in early 2010 with the introduction of a one-off tax free payment (max EUR 1 666) to laid off blue-collar workers (OECD, 2009a). Nonetheless, job search incentives could be strengthened further by introducing a limit on duration (for example 24 months) and by reducing benefits over that period until they reach the level of social assistance.

15. Increased search activity in connection with exhaustion of benefits has been shown, among others, for Spain (Alba-Ramirez *et al.*, 2006), France (Dormont *et al.*, 2001), Portugal (Portugal and Addison, 2008), and the United States (Jurajda and Tannery, 2003).

**Figure 12. Net replacement rates for a single person without children in OECD countries**

With pre-unemployment earnings at 67% of the average wage, 2009



1. Initial phase of unemployment but following any waiting period. No social assistance 'top-ups' are assumed to be available in either the in-work or out-of-work situation. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (i.e. monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months.
2. After tax and including unemployment benefits, social assistance, family and housing benefits in the 60th month of benefit receipt.

Source: OECD, Tax-Benefit Models.

### *Immigrants have a relatively poor labour market performance*

Workers with immigrant background have not only been relatively hard hit by the crisis, but represent a large underutilised labour resource. In all, more than 12% of the population has an immigrant background (first and second generation) and about a quarter of all teenagers have at least one foreign-born parent – one of the highest shares among the European OECD countries. Furthermore, immigrants from outside the EU (non-nationals) have one of the worst labour market outcome in the EU with a lower employment rate than nationals and an unemployment rate three times higher than for nationals (Tables 4, 5 and Figure 3 in A&R).<sup>16</sup> The high unemployment rate among immigrants is to some degree boosted by Belgian specific characteristics, such as the high youth unemployment rate, as 55% of non-EU immigrants are 15-34 years as compared with 38% of Belgian born citizens. Employment rates for all youth in the age cohort 20-24 are low, but remain low for non-EU immigrants throughout their working lives unlike the situation for Belgian and EU citizens, for whom the employment rate for the next age cohort is already at par with the national level.

16. Nationality acquisition is easy in Belgium (only requiring 7 years of permanent residency and no language or integration tests) benefiting more than 400 000 foreigners in 1990-2002. An implication is that Belgian immigration data represent a narrower group of immigrants than in other countries. Foreigners represent 9% of the population, but at birth almost 13% do not have Belgian nationality (Wets, 2006). Recent immigration relates mostly to family reunification, often implying new arrivals with a longer distance to the labour market.

**Table 4. Employment rates for nationals and immigrants**

As a percentage of corresponding working age population, 2009

	Brussels	Flanders	Wallonia	Belgium	EU27
Nationals	55.4	66.3	57.2	62.5	65.0
EU citizens	63.1	64.8	52.8	59.6	68.0
Non-EU citizens	38.8	44.5	28.9	38.8	55.7

Source: EC, Directorate-General for Statistics and Economic Information (DGSEI).

**Table 5. Unemployment rates for nationals and immigrants**

As a percentage of corresponding active population, 2009

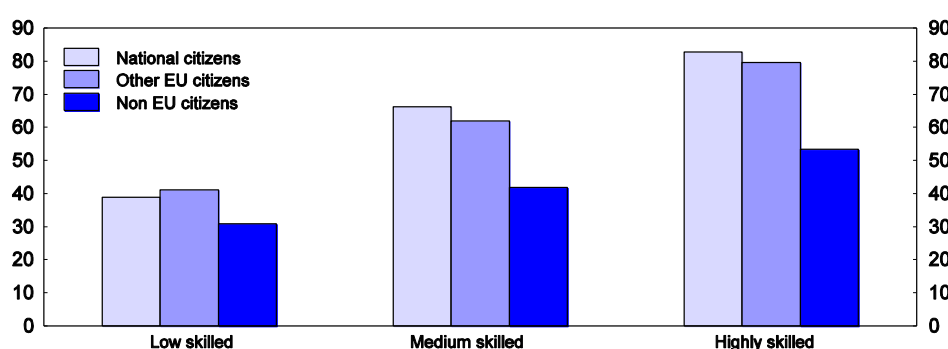
	Brussels	Flanders	Wallonia	Belgium	EU27
Nationals	15.1	4.5	10.5	7.1	8.4
EU citizens	10.3	8.6	13.8	11.1	11.6
Non-EU citizens	33.0	21.6	38.9	29.4	19.4

Source: EC, Directorate-General for Statistics and Economic Information (DGSEI).

Immigrants have relatively low educational attainment; about half of them are low-skilled, compared with less than one-third of natives. The OECD PISA study shows that the educational disadvantage of second generation immigrants is larger than elsewhere. Moreover, the educational qualifications of immigrants are often discounted in the labour market, and the employment rates for medium and highly skilled workers are much lower than for Belgian natives with similar education background (Figure 13). An additional problem for well educated immigrants is that many highly qualified civil servant jobs in the public sector are restricted to EU citizens.

**Figure 13. Employment rates by nationality and educational attainment<sup>1</sup>**

As a percentage of working age population, 2009



1. Low skilled refer to pre-primary, primary and lower secondary education, medium skilled refer to upper secondary education and post-secondary non-tertiary education and highly skilled refer to tertiary education.

Source: Directorate-General for Statistics and Economic Information (DGSEI), "Labour Force Survey 2009".

The educational achievement of Belgian pupils is in the top 10 in the most recent PISA study (OECD, 2010c). The performance gap of pupils with immigration background (and controlling for socioeconomic factors) *vis-à-vis* other pupils has narrowed over the past decade, but remains larger than the OECD average. Pupils with immigration background are twice as likely as other pupils to be in the bottom quarter of students, even though Belgium is relatively good at allocating additional teaching resources to socioeconomically disadvantaged schools. However, these additional resources are not sufficiently targeting immigrant areas. Principals for schools in high immigrant areas report more frequently than in most other countries that insufficient educational resources hinder learning (OECD, 2010c). Targeting more resources to students with immigrant backgrounds could narrow disparities in educational attainment and help to better integrate such students in society.

A main problem is often a lack of language proficiency. Participation in pre-primary education strengthens immigrant children's language ability, leading to improved educational performance and employment probabilities (OECD, 2010d). In this respect, the new legislation mandating pre-school education of immigrant children is a welcome measure – an area that was previously poorly developed (OECD, 2008). For new arrivals who enrol in the school system, there are special “welcome classes”, lasting for less than a year and targeting pupils less than 18 years, although language courses are mandatory only in Flanders. Arriving adults often receive language courses only a year after arrival. Early language education should become mandatory, and for new arrivals language courses should be offered upon arrival and be available for a sufficient long time to secure adequate language skills.

The Belgian education system is characterised by early streaming of pupils into an “upper” academic stream aimed at students that are expected to pursue further studies and a “lower” vocational and technical stream. The first streaming at age 12 tends to steer pupils with immigrant background into the lower vocational stream. The next streaming at age 14 tends to steer them into a technical orientation with few subsequent possibilities to move upstream. Students tend to see the vocational track as a dead-end with relatively little value in the labour market (OECD, 2009a). Remedies in this area should include improving the quality of the vocational track, facilitating later streaming, and improving the possibilities for moving to a higher track at a later stage.

The successful integration of immigrants is complicated by immigration policy being a federal responsibility, labour market integration a regional responsibility, and integration and education policies community responsibilities. There is little interaction among key actors, both within but especially between government levels, and policies are seldom targeted specifically at immigration. Such general measures may help immigrants as witnessed by the service vouchers (aimed at boosting demand for household services) that have boosted employment of immigrants by individual households. Regular national integration reports to identify good and bad practices could help to improve transparency and co-ordination and help to develop a coherent economic immigration policy (OECD, 2008). More generally, the main problem for many workers with immigrant background is to find a first job as they have to overcome prejudices and discrimination – less important factors once immigrants have had the opportunity to demonstrate ability (Bisin *et al.*, 2011). This suggests that reforms that aim at making the labour market more flexible are particularly beneficial for the labour market integration of workers with immigration background (OECD, 2009a and 2010).<sup>17</sup> Similarly, low-skilled immigrants can be expected to benefit from better targeting of demand-side barriers, such as wage subsidies and targeted reductions of social security contributions to low-wage workers.

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17. A striking comparison can be made with Austria, which has an employment rate for Turks that is comparable or higher than for natives and much higher than for Turks in Belgium. The main difference between the two countries is that in Austria an extended period of unemployment can cost immigrants the legal base of their stay, while in Belgium the ease of obtaining nationality provides the right to unlimited duration of unemployment benefits, creating large unemployment traps (Wets, 2006).

***The wage determination process has not preserved international cost competitiveness***

The wage determination process aims at preserving international competitiveness and protecting workers' purchasing power. Nonetheless, wages have increased faster than in neighbouring countries and real wages have outpaced domestic productivity. Wages are determined in a highly co-ordinated wage negotiation system with a wage norm for maximal wage increases (with the upper limit determined by the expected wage developments in Germany, France, and the Netherlands) and a lower bound of expected price developments. Agreed wage increases are subsequently implemented in sectoral wage agreements (covering more than 90% of all employees). A result is rigid real wages, which forces firms to adjust labour costs via labour inputs, explaining the high take up of reduced working time schemes and the encouragement of older workers to leave (on early retirement) so they can be replaced by cheaper (because of the strong seniority element in wages) younger workers (Babecky *et al.*, 2009). *Ex ante*, the setup should secure wage developments that are in line with trading partners. *Ex post* this is not the case, as the automatic indexation of wages to the health index (the consumer price index less transport fuels, tobacco and alcohol items) have ensured that unexpected inflation has been translated into higher wages. Since 1996, an accumulated hourly wage gap of about 4% *vis-à-vis* the main trading partners has opened up (Conseil Central de l'Économie, 2010). Over the same period, an even larger hourly productivity gap of 5½% has opened up, leading to accumulated competitive losses in terms of unit labour costs of nearly 10%. For the business sector ¾ of the accumulated loss in competitiveness is due to relative weak productivity developments (NBB, 2011).

The wage agreement for 2011-12 stipulates a real wage increase of zero in 2011 and only 0.3% in 2012. As accumulated expected price increases were 3.9 percentage points higher, accumulated expected nominal wage growth is correspondingly higher. Subsequently, the health index projections have been revised up to 5% over 2011-12, implying that total accumulated nominal wage increases are expected to reach 5.3% under the assumption of zero wage drift. Not all social partners accepted the agreement and the government subsequently passed it into law with some modification, including the introduction of a (in-) working bonus of EUR 10 net per month for the lowest income workers. During the negotiations, the social partners initially agreed to study the effects of wage indexation (an idea that was subsequently abandoned), reflecting increasing concerns about possible negative effects of the system, particularly as a number of service prices are indexed to general price developments. The government has decided to change the indexation formula (lower frequency of tariff changes) for gas and electricity contracts to assure less volatile energy prices and has requested the energy regulator to increase market surveillance. Nevertheless, the current high oil and raw material prices may yet again be (partly) absorbed in relatively higher wages, threatening further erosion of external competitiveness.

The agreement also gradually (only for new hires) harmonises dismissal notification periods for blue- and white-collar workers (aiming at a general rule of one month pay for each year worked) implying shorter periods for white-collar workers and longer for blue-collar workers. More importantly, the alignment of reduced working time schemes may lead to a structural increase in enrolment, which has to be financed by the federal government. Also the previous wage agreement contained measures that increased federal financing (Box 4) (OECD, 2009a). The one-day wait for receiving sickness benefits for blue-collar workers was also suppressed in the agreement.

The wage norm law stipulates that past overshooting of wage developments should be recovered in the subsequent wage period. The scope for negotiations in the 2011-12 agreement was limited to 1% by the system's upper bound on expected wage developments in France, Germany, and the Netherlands and its lower bound on expected domestic price increases - not taking into account past overshooting. The agreement implies – in the absence of inflation surprises – that Belgium wages should grow an accumulated ¾ per cent less than in the neighbouring countries - a relatively minor improvement in relative wages considering the accumulated loss in cost competitiveness. Indeed, even no change in real wages would restore lost international competitiveness only over a very long period. On the other hand, the employment gains of recuperating the lost external wage competitiveness would be considerable. Closing the wage gap could generate an additional 48-83 000 jobs (Bureau du Plan, 2010; Abraham and Konings, 2010).

#### Box 4. Reductions in employers' social security contributions in 2009-10

To offset the impact on labour costs of the negotiated wage increases, the rebate on the withholding tax on wages was increased in 2009-10. These rebates do not affect wage earners' personal income tax liability. Thus, the rebate acts as a wage subsidy.

- The general rebate granted to all firms was increased from 0.25% of gross wages to 0.75% in July 2009 and to 1% in January 2010.
- The rebate for night and shift work was raised from 10.7% to 15.6%.
- The rebate for researchers was raised from 65% to 75%.
- The number of overtime hours that qualify for a rebate in charges was increased from 65 to 100 hours in 2009 and again to 135 hours in 2010.

At the end of 2009, reductions in labour costs amounted to EUR 1.7 billion or 1.2% of the private sector wage bill (Table 6). According to the national account definitions as drawn up in the ESA95 rules, these are not treated as direct reductions in labour costs, but as subsidies. Thus from a statistical viewpoint, these measures do not reduce labour costs despite their effect in real life. If these cost reductions had been taken into account in calculating the increases in labour costs per hour worked, then the increase would have been 0.4 percentage point lower in 2009 and with a similar impact in 2010.

**Table 6. Wage subsidies granted by increasing the rebate on the withholding tax on wages**

Millions of euros

	2004	2005	2006	2007	2008	2009
Total reductions <i>of which:</i>	25	110	455	834	1 223	1 687
General reductions	0	0	0	53	208	470
Shift and night work	25	95	343	606	697	756
Researchers	0	4	63	90	193	340
Overtime	0	11	24	33	37	24
Share of private sector wage bill	0	0.1	0.4	0.6	0.9	1.2
Impact on private sector labour costs per hour	0	-0.1	-0.3	-0.3	-0.3	-0.4

Source: National Bank of Belgium.

External competitiveness could be better preserved if wage developments reflect productivity developments at the firm level. This is currently possible through the seldom used opt-out clauses, but their implementation is restricted by the requirement of approval from inter-industrial committees. The clauses cannot be used to reduce wages and are bound by the statutory (sectoral) minimum wage (Keune, 2011). The use of opt-out clauses would be facilitated by making them only subject to approval by the involved workers and firms. Their usefulness would be enhanced if they were not bound by sectoral agreements on statutory minimum wages and the automatic wage indexation. Another possibility is the rarely used all-in agreements, which stipulate nominal wage growth thus removing any effect of inflation surprises. These should be promoted along with opt-out clauses. Within the current wage agreement's focus on real wage increases, the all-in agreements would have to use the expected nominal wage increases as a benchmark. In the context of an overall review of all indexation mechanisms, the automatic wage indexation should be reformed. A first step in this direction could be to redefine the health index to exclude all energy components in the consumer price index so as to remove the most common terms-of-trade shocks. Also all effects of higher indirect taxation could be excluded. In parallel, there is a need for improving the price and tariff mechanisms in the energy markets. However, such a first step would not remove inflation effects of euro depreciations. In the medium term, it would be advisable that the social partners consider phasing out

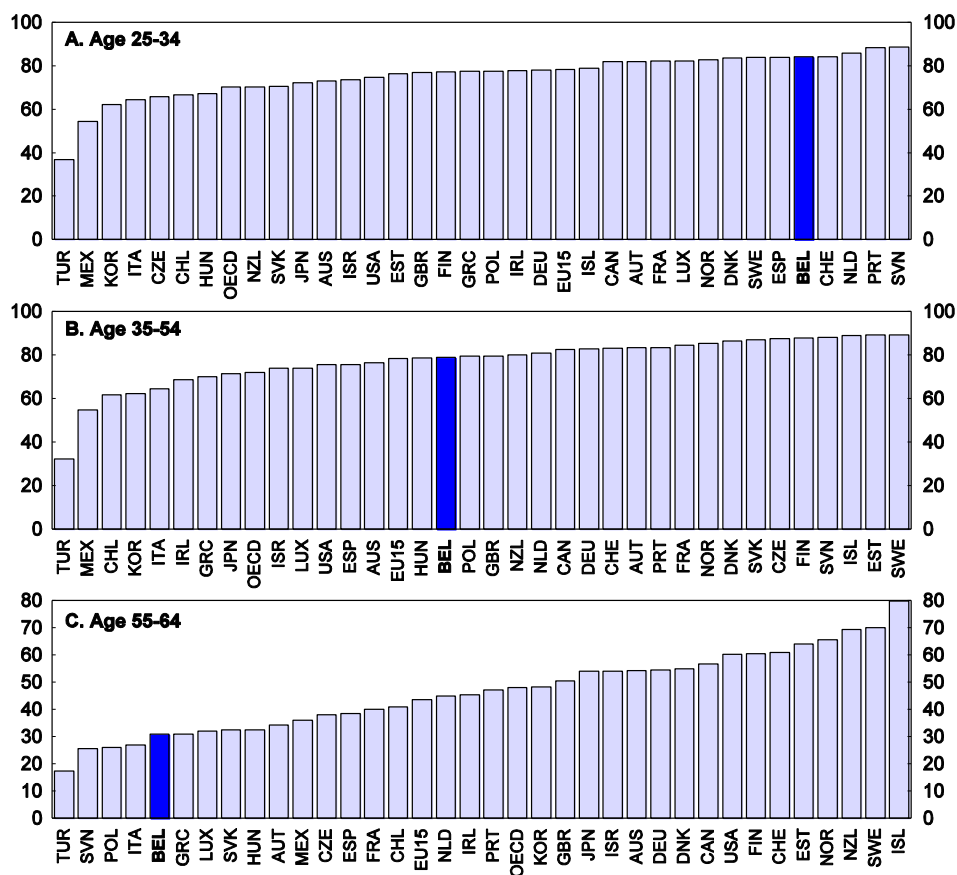
the wage indexation system, so as to allow greater real wage flexibility. Over the longer term, the losses in competitiveness can be prevented by having wage developments based on domestic (firm-level) productivity developments.

### There are still large underutilised sources of labour

The labour force could be expanded substantially by increasing the low female employment rate. It is low largely because of the low employment rate for low-skilled women, but also a strong cohort effect (Figure 14). The cohort effect, together with the continued expansion of service sectors, means that the female employment rate will increase over time. On the other hand, boosting employment of low skilled women requires marked reductions in the internationally high effective marginal tax rates, which creates inactivity and unemployment traps that hit low income spouses particularly hard. While further reforms in this area are needed, such measures should be combined with an expansion of earned income tax credits (EITC) to reduce the effective marginal tax rates for low-income families. Such a measure should be combined with the completion of the full tax separation of spouses as recommended in the last *Survey* (OECD, 2008).

**Figure 14. Female labour participation exhibits a strong cohort effect**

Percent, 2010

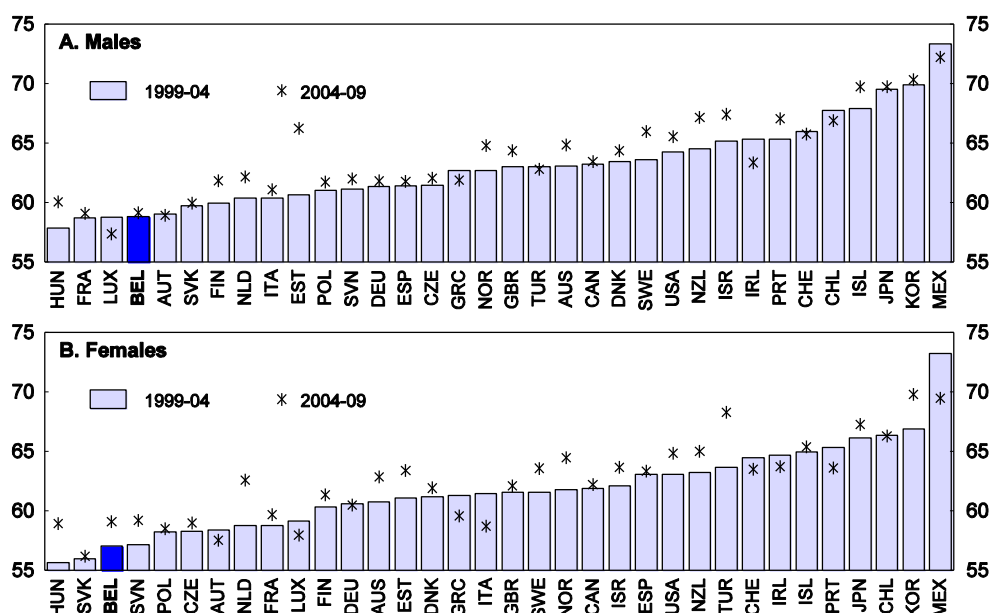


Source: OECD, Labour Force Statistics database.

### *The effective retirement age is among the lowest in the OECD*

Since mid-2000, there has been a minor increase in the effective retirement age for males and a two year increase for females, largely reflecting the gradual increase, completed in 2009, in the legal retirement age for women to 65 to align it with that of men. Despite these positive developments, the age for both males and females remains among the lowest in the OECD (Figure 15). The 2005 Intergenerational Solidarity Pact aimed at increasing working lives by reforming early retirement systems (Box 5). The Pact tightened access to the conventional early retirement scheme by restricting eligibility before the age of 58 to workers with long working careers and in physically demanding jobs (Jousten *et al.*, 2008).<sup>18</sup> Moreover, the Pact stipulates that in 2012 the career length for men and women should increase from 37 and 33 years, respectively, to 40 years, if the employment rate for +50 years has not increased 1½ time faster than the EU average. If that is the case, the career length is to be increased to 38 years as from 2014. The implementation of these measures is to be discussed in the autumn of 2011.

Figure 15. Effective retirement ages in the OECD<sup>1</sup>



1. The average effective age of retirement is calculated as a weighted average of (net) withdrawals from the labour market at different ages over a 5-year period for workers initially aged 40 and over. In order to abstract from compositional effects in the age structure of the population, labour force withdrawals are estimated based on changes in labour force participation rates rather than labour force levels. These changes are calculated for each (synthetic) cohort divided into 5-year age groups.

Source: OECD estimates based on the results of national labour force surveys, the European Union Labour Force Survey and, for earlier years in some countries, national censuses.

18. Similar exceptions are in place for some workers in the construction sector and some shift workers. Earlier retirement is possible (at 52 or even 50 years) under special circumstances, if the company is in economic difficulties. Legally, it is possible to activate early retirees, but this is rarely done.

### Box 5. Present and past early retirement systems in Belgium

The 1967 merger of several existing pension systems laid the basis for the current pension system. The Pay-As-You-Go (PAYG) system originally had a normal retirement age of 65 for men and 60 for women. In that system, earlier retirement was possible within 5 years before the normal retirement age by accepting a 5% reduction of benefits per year before the normal retirement age. Full pension benefits were calculated on the basis of a 45 year working career for men and 40 years for women. Since 2009, male and female legal retirement ages have been aligned to 65 and they have the same 45 years working career condition. Some categories of workers, such as veterans, resistance fighters, deported people, coal miners and sailors are allowed to retire up to five years earlier without reductions in benefits. One of the arguments for increasing the scope for early retirement was to create employment possibilities for younger workers, but the lack of an empirical link between retiring cohorts and youth unemployment shows this to be a lump-of-labour fallacy (Jousten *et al.*, 2008).

An early retirement scheme was introduced in 1983, allowing workers to retire up to five years before the normal retirement age if the employer replaced the worker with an unemployed person. This scheme was terminated in 1991, when the present system came into force, effectively reducing the early retirement possibilities for females to the age of 60 rather than 55. Between 1997 and 2009, the female retirement age was gradually aligned with the male one.

In 1973, a parallel system of complementary benefits for early retirement was introduced for fired older workers (+60 years), who would be entitled to an employer paid top-up equal to half of the difference between the net wage and the unemployment benefit. In addition, older workers would be exempt from job search and the unemployment spell would be fully credited in the calculation of the working career – such credits are also made for a range of other non-work periods, including for sickness, maternity leave, partial work, vacation, strikes, lock-outs, among others (Conference Pensions, 2011). The initial age limit of 60 years was since lowered through collective sectoral bargaining agreements to 58 years. Numerous exceptions are in place. For example, the general rule stipulates that the retiree must be replaced, unless the company is in economic difficulties, restructuring or unable to find a suitable replacement. If the company is in economic difficulties, the standard minimum age of 58 can be lowered to 52 or even 50 in special circumstances. Some sectors and professions enjoy lower minimum access ages (55, 56, or 57) such as the steel, glass, textiles, construction sectors and some shift workers, etc depending on more stringent career conditions.

Granting early retirement to workers from larger firms in economic difficulties has been used repeatedly, including Renault Vilvorde (1997), Sabena (2002), Belgacom (2001), Siemens Belgique (2001), Philips Hasselt (2002), Fortis (2002), Ford Genk (2003), VW Forest (2007), BASF Feluy (2009), GSK (2009), and Carrefour (2010). More recently, an exceptional lowering of the legal early retirement age from 52 to 50 years was granted to nearly 650 fired Opel workers (Antwerp) as nearly half of these were in the age bracket 50-52 years.

The employment rate for older workers (age 55-64) is about 41% higher than in the beginning of the 2000s, partly reflecting that the possibility for older workers to receive unemployment benefit without being available to the labour market was in 2004 restricted to workers older than 57 and stricter access to conventional early retirement in 2008 (Jousten *et al.*, 2008). Since 2007, a financial reward – a pension supplement of 2 EUR per day worked – has been offered to workers who remain in the labour market after the age of 61 or prolong their career beyond 43 years. Nonetheless, the employment rate for older workers in 2009 (age cohort 55-64) was only around 35%, some 11 percentage points lower than the EU average. On the other hand, the measures implemented have helped during the crisis to contain the increase in early retirement to be less than in other recessions. Nevertheless, many (high-skilled) workers are still retiring from the labour market well before reaching the official retirement age of 65, adding to the labour market mismatch problems, and further measures are needed to boost the effective retirement age.<sup>19</sup>

19. There are examples of key workers entering early retirement. When the large metallurgist Arcelor Mittal began to restart steel production after the crisis on a temporary basis in 16 of its 25 European furnaces, none of the Belgian ones were restarted, reportedly because of a lack of replacements for former skilled employees that have entered early retirement.

There remain a number of routes to leave the labour market before the legal pension age of 65. Firstly, workers in the age bracket 60-64 can retire through the standard pension system after a career of 35 years. In addition, the unemployment benefit system provides for four main paths for the age bracket 55-59 (Cremer *et al.*, 2009):

- Unemployed older than 57 are not subject to search requirements and can thus use the unemployment benefit as their pension income.
- Unemployment benefits may, in some instances (typically in case of collective dismissals), be topped up by the former employer with the consent of the government, the so-called pre-pension.
- Firms persuade their workers to take unemployment and provide a compensation to make up for (some of) the difference between their earlier salary and unemployment benefits. This system is often referred to as “Canada Dry” pre-pension.<sup>20</sup>
- Firms allow workers to take a part-time career break (“time credit”) and compensate them for the non-worked time. Schemes that are based on social benefits other than unemployment benefits and employer top-ups are often referred to as pseudo pre-pensions.

The two latter paths (with employer-provided compensation) are made more attractive by the fact that the top-up payments are taxed at a preferential rate and not subject to social security charges. The 2005 Intergenerational Solidarity Pact subjected employer-provided compensation outside the provisions of sectoral collective agreements to special social security charges to discourage the use of these alternative early retirement schemes. The benefit for firms of providing top-ups is that this allows for relatively cheap downwards adjustment of labour inputs and avoids a negative gap between productivity and experience-based wages. Indeed, the steep earning-age gradient in Belgian wages may hamper the ability of older workers to remain in employment. Furthermore, all three paths allow the accumulation of pension rights based on the previous salary (as is the case with other job seekers) unlike the situation in most other OECD countries with a pay-as-you-go pension system (OECD, 2009b). Moreover, the top-ups and the continued accumulation of pension rights mean that workers are often financially better off using the unemployment benefit system as a pathway into early retirement than actually taking early retirement, which would mean a significantly lower replacement rate (Whitehouse *et al.*, 2010).

Increasing the effective retirement age is one of the most effective measures to meet the fiscal challenge of population ageing (OECD, 2011) and has been pursued across the OECD countries by closing down paths into early retirement and by giving economic incentives for workers to remain in the labour market. The 2005 Intergenerational Solidarity Pact contains provisions for longer careers before entering early retirement to secure a full pension as the increase in the effective retirement age falls short of expectations. Nevertheless, additional measures are needed. A first step would be to increase the age at which early retirement programmes can be accessed and make entry conditional on individual assessments of work capacity. It should also become more economically beneficial to remain on the labour market. Currently, workers choosing the exit route can maintain almost all of their previous income without losing pension rights. This can be addressed by taxing all employer-provided top-ups in line with other labour income instead of being declining with the age of the worker and exempted for top-ups under sectoral collective agreements. This should be combined with the introduction of a differential in the accumulation

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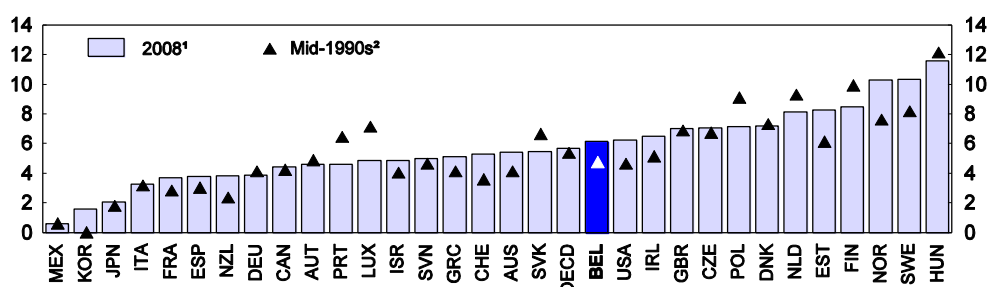
20. The term originates from an old European commercial stating that: “Canada Dry Ginger Ale looks like beer, has the colour of beer, but is not beer” and where the word “beer” is replaced by “unemployment”.

in pension rights between unemployed and active workers, for example by crediting the unemployment period in the calculation of the working career, but only with the value of the received benefit rather than the previous salary. In addition, taxing of pensions should be increased to the same level as is applied to similar income from other sources. To encourage those that nevertheless chose this route to seek employment, the standard job search requirements should be extended to all unemployed irrespective of age. Such measures could be combined with enhancing incentives to remain in work by increasing the accumulation of pension rights, for example by raising the pension supplement for workers continuing working after the age of 61. Increasing the legal retirement age and the required career length to obtain a full pension for women contributed significantly to push up their effective retirement age. This measure could be used again by increasing the official retirement age to, for example, 67 years to partly reflect past gains in life expectancy and thereafter link it to further changes in longevity. The effectiveness of such a reform would depend on introducing measures to improve labour demand for older workers, such as ensuring that their wages and productivity are aligned. Moreover, an increase in the legal pension age could be accompanied by special retirement arrangements for workers that via individual assessments are found to have reduced work ability.

***A relatively high share of the potential labour force is parked in disability benefit system***

In 2008, the number of recipients of disability benefits was above 6% of the working age population (equivalent to nearly 9% of the labour force) and spending stood at about 2% of GDP (Figure 16), following a couple of years with doubled digit spending growth (NBB, 2008; Jousten *et al.*, 2010). There is some concern that disability is being used as a route to early retirement as twice as many of an older cohort collect disability benefits than of middle age cohort (Milligan and Wise, 2011; Jousten *et al.*, 2010). Moreover, spending on disability has increased as labour market policies became stricter, suggesting possible substitution. In other European countries disability reforms have been high on the agenda, particularly to restrict access and introducing retesting procedures of claimants (OECD, 2010). The 2011 Budget contains some measures to encourage disabled to voluntary return to work, in terms of making it financially more attractive and to provide support and counselling. Testing or retesting that can distinguish between disabled and healthy, but retirement-prone, workers may prevent the use of disability as a route into early retirement (OECD, 2010e; Cremer *et al.*, 2004). In Belgium, the eligibility criteria in disability include a loss of earnings capacity of 66% over a period of at least 12 months and the recipient must also satisfy a minimum contribution requirement of 120 days (Jousten *et al.*, 2010). The level of benefit is dependent on the household situation and paid free of taxes with replacement rates that are similar or lower than those in the unemployment benefit system. Incentives to return to work are limited as recipients are initially classified as fully disabled and thus without work capacity. Subsequently, recipients may return to (part-time) work if their work capacity is reduced by at least 50%, but benefits are reduced in line with rising wage income, entailing a high effective marginal tax rate.

**Figure 16. Disability benefit recipients**  
As a percentage of the population aged 20-64



1. 2005 for Luxembourg, 2007 for Austria, Canada, France, Israel, Italy, Poland, the Slovak Republic, Spain and the United Kingdom. Data for Hungary include three different non-contributory allowances.
2. 1996 for Belgium and Canada, 1999 for the Netherlands, 2000 for Hungary, Italy and the Slovak Republic, 2001 for Ireland, 2003 for Japan and Mexico, 2004 for Poland.

Source: OECD (2010), 'Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries'.

1. 2005 for Luxembourg, 2007 for Austria, Canada, France, Israel, Italy, Poland, the Slovak Republic, Spain and the United Kingdom. Data for Hungary include three different non-contributory allowances.
2. 1996 for Belgium and Canada, 1999 for the Netherlands, 2000 for Hungary, Italy and the Slovak Republic, 2001 for Ireland, 2003 for Japan and Mexico, 2004 for Poland.
3. 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.

Source: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries*.

Reform of the disability system could follow initiatives in taken in other countries, notably in the Netherlands. Stricter entry requirements could improve sorting and assess remaining work capacity. For those enrolled in the programme, work capacity should be assessed on a regular basis (rather than the degree of disability). To ensure that it always pays to work for the partially disabled, the work capacity assessments should be used to determine the hypothetical earnings capacity of the benefit recipients. Disabled that return to the labour market should have benefits that (partially) cover the income loss implied by the difference between the received wage and the hypothetical wage.

**Box 6. Summary of recommendations to make the labour market more inclusive**

**Introduce checks and balances to reduce deadweight costs of the reduced working time schemes**

- Access should be restricted to firms that can demonstrate a significant drop in activity and approved by the relevant labour market authority. Restrict re-entry into the schemes to reduce systematic use. Alternatively, employers should finance the initial period of enrolment. Control overall costs by making schemes budget dependent, requiring parliamentary approval for continuation.
- Avoid parking of key workers by requiring employers to (partially) re-pay subsidies if workers are fired after enrolment. Make enrolled workers available for hiring by other firms. In case of prolonged enrolment, considered making enrolled workers subject to standard job search requirements. Enhance job-search incentives by reducing benefits over time, banning benefit top-ups from employers, and limiting days of enrolment per year.

**Improve young people's labour market transition**

- Facilitate school leavers' transition into the labour market by abolishing minimum hour restrictions on small hours jobs to secure a more flexible supply of such jobs.
- Better align young people's wages with their productivity by reducing sectoral minimum wages to the statutory minimum wage, combined with a more gradual phase-in of the youth minimum wage. Alternatively (sectoral) entry wages should be introduced, applicable to workers (re-)entering employment.
- Strengthen job search incentives in the system of special unemployment benefits for young school leavers (the so-called "waiting allowance") by restricting such benefits to those younger than 26 years.

**Enhance the labour market performance of immigrants**

- Extend sufficient language teaching to all age groups, particularly early language training of new arrivals. Postpone streaming in the education system as long as possible and improve the possibilities for returning to a higher track. Include a more significant immigration element in the allocation mechanism of additional educational resources to correct for socio-economic backgrounds. More generally, there is a need to improve vocational training to better reflect labour market demands.

**Refocus the wage determination system on preserving and improving external competitiveness**

- The possibilities for aligning wage developments with local labour market conditions should be enhanced by making opt-out clauses and all-in agreements only subject to approval by employers and employees of the involved firm. Wage determination should be based on domestic productivity developments.
- In the context of an overall review of all indexation mechanisms, the automatic wage indexation system should be reformed. A first step could be to redefine the health index to exclude all energy components from the health index. Also all effects of higher indirect taxation could be excluded. In parallel, there is a need for improving the price and tariff mechanisms in the energy markets, including stronger competition enforcement. In the medium term, it would be advisable that, so as to allow greater real wage flexibility. In the long term, external competitiveness losses could be prevented by basing wage developments on Belgian productivity developments.

**Activate other resources of under-utilised workers**

- Boost work incentives for low-income spouses by reducing their effective marginal tax rates by completing the tax separation of spouses.
- Increase the effective retirement age by raising the minimum enrolment age in early retirement programmes and replace sectoral exemptions with individual assessments of work capacity. Enhance incentives to remain in the labour market by taxing pensions similarly as income from other sources. Increase the legal retirement age to reflect past gains in life expectancy, and thereafter link it to further gains in longevity.
- Subject older workers on unemployment benefit to standard search obligations. Tax all employer-provided top-ups similarly to other work-related income. In addition, a differential in the accumulation of pension entitlements between unemployed and employed should be introduced.
- Restrict access to the disability system to prevent it being used as a route into early retirement – particularly if other routes are being closed.
- Reform of the disability system should focus on assessing partial disability with a link to benefits that ensures that work pays for the partially disabled.

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## Annex

## The seasonal pattern in the reduced working time programme

There is a strong seasonality in the use of the reduced working time programme for blue-collar workers with a particularly strong pick-up in usage during the poor weather season in the autumn and winter. This indicates that the programme is not really targeting special adverse economic situations, but rather has become an integral part of the functioning of the labour market. This is likely to have adverse effects on wage formation and labour allocation, as firms that park their employees in the programme are willing to offer a higher wage to ensure that workers return to their company after the unemployment spell, reducing reallocation of labour. In addition, there is a risk that firms do not adopt new production planning, processes and methods to counter adverse seasonal developments.

The seasonality is tested for by estimating the variable on its lagged value and a dummy for each of the four quarters.

**Table A1. Estimation results<sup>1</sup>**

Dependent Variable: EMECSAPT  
Method: Least Squares  
Sample (adjusted): 1988Q2 2011Q1  
Included observations: 92 after adjustments

Variable	Coefficient	Std. error	t-Statistic	Prob.
EMECSAPT (-1)	0.63	0.08	7.69	0.00
Q1	40 689.660	3 622.67	11.23	0.00
Q2	-2980.52	5 670.34	-0.53	0.60
Q3	4150.62	3 583.26	1.16	0.25
Q4	21080.76	2 940.36	7.17	0.00
R-squared	0.764901	Mean dependent var	42 417.33	
Adjusted R-squared	0.754092	S.D. dependent var	17 603.25	
S.E. of regression	8 729.294	Akaike info criterion	21.04	
Sum squared residuals	6.63E + 09	Schwarz criterion	21.18	
Log likelihood	-962.8203	Hannan-Quinn criter.	21.10	
Durbin-Watson statistic	1.882682			

1. EMECSAPT is the number of persons on part-time employment for economic reasons.

Source: OECD, *Main Economic Indicators Database*.

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