Assessment and recommendations

The recovery is gathering pace

Belgium has weathered the global crisis relatively well, with a smaller rise in unemployment than the OECD average and an economic recovery that is stronger than in the euro area. At the same time, inflation has accelerated from one of the lowest to one of the highest in the euro area (it stood at around 3½ per cent in early 2011), reflecting a relatively fast and strong pass-through of energy prices. This may create a risk to the recovery as persistent inflation pressures, arising from the automatic indexation of wages (as well as transfers and a number of service prices) and weak competition in energy markets may eventually hurt Belgian cost competitiveness.

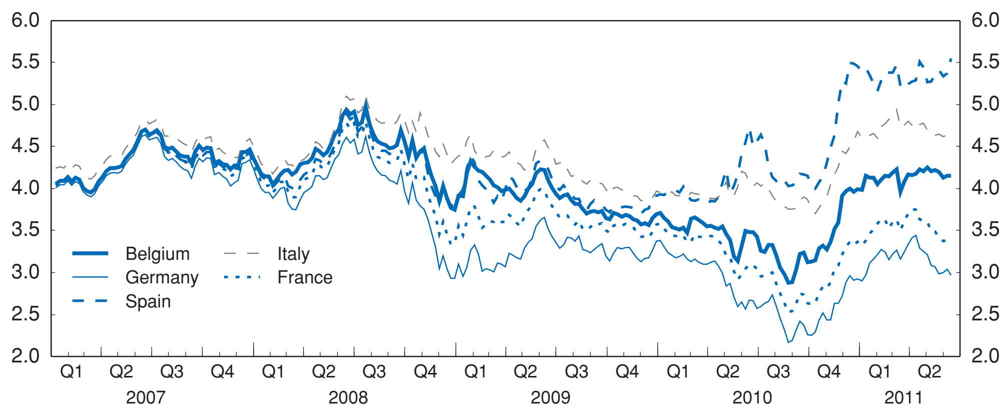
The relatively favourable economic outlook should contribute to secure fiscal sustainability, but will not be sufficient so that renewed efforts should be made, notably in the context of the project to reform fiscal-federal arrangements. An extensive use of the reduced working time schemes meant that unemployment mostly affected workers with weak labour market attachment, potentially increasing labour-market segmentation. Structural reforms are needed to boost employment, particularly in view of the ageing of the working force and to bring excluded groups into the labour market. Lastly, an ongoing policy challenge is to achieve sustainable green growth, notably by adhering to international agreements, such as the European 20/20/20 strategy, which in the absence of cost-efficient policies could be particularly burdensome for the relatively energy-intensive Belgian economy.

The crisis has enhanced the urgency for fiscal consolidation

The authorities' strategy to secure fiscal sustainability has been to prefund ageing-related cost increases through sustained budget surpluses and higher employment rates. To achieve this objective the public debt-to-GDP ratio needs to fall sharply in the coming decades, reducing interest payments to create room for financing ageing-related expenditure increases. The global crisis and the need for saving a number of financial institutions derailed the strategy, which was already off-track prior to the crisis. In 2010, the fiscal deficit was still around 4¼ per cent of GDP and public debt reached almost 97% of GDP – about 12½ percentage points higher than the pre–crisis level and back to the level that prevailed in the early 2000s. As a result, the fiscal sustainability gap is estimated to be more than 5% of GDP – a gap that has to be closed to avoid abrupt changes in public spending or taxation to finance ageing related spending increases.

Financial market concerns about sovereign debt have touched Belgium, increasing the long-term interest rate differential vis-à-vis Germany to 135 basis points in early 2011 (as compared with a virtual zero differential before the crisis), before falling back to around 100 basis points. Combined with higher German rates from early autumn 2010 onwards, this boosted Belgian interest rates some 125 basis points to above 4% in early spring 2011 (Figure 1). There is a risk that contagion effects could widen the spread further, although Belgium has a lower fiscal deficit and a better debt reduction record than many other European countries. If sovereign debt concerns are not reversed, higher interest rates will hurt public finances both through lower economic growth and increased debt-service costs.

Figure 1. **Interest rate differentials *vis-à-vis* Germany remain high**[1]



1. Interest rates on 10-year government bonds.

Source: Datastream.

StatLink http://dx.doi.org/10.1787/888932459033

Post-crisis fiscal policy should restore sustainability through spending restraint

Reflecting broad political support for fiscal consolidation, the caretaker government adopted a 2011 budget that is expected to lower the deficit by ½ per cent of GDP. In the medium term, the 2011 Stability Programme foresees a small budget surplus in 2015, implying fiscal consolidation of around ¾ per cent of GDP each year, which is comparable to the effort made in the run-up to the euro introduction. Such a substantial structural improvement would be an important step towards putting the prefunding strategy back on track. *To secure fiscal sustainability and to address financial market concerns, an urgent task is to implement the consolidation path through well-specified structural measures to achieve consolidation of at least ¾ per cent of GDP per year until 2015. In the context of financial market volatility, the government should consider the planned consolidation path as a minimum requirement.* After 2015, fiscal efforts should focus on securing the necessary surpluses to prefund ageing related spending increases. To avoid hurting long-term growth prospects, the focus should be on reducing spending at all levels of government and broadening tax bases by removing tax expenditures. The devolution of powers to regions and communities has substantially increased public sector wage costs, calling for increased co-ordination, notably to reduce overlapping responsibilities. *Thus, a thorough cost efficiency review of public administration at all levels of governments would help longer-term consolidation efforts.*

Social security needs to be modernised

Starting in 1994, the social security system was progressively reformed by replacing individual contributions to social security funds (such as health, unemployment insurance, and pensions) with a single contribution. Pooling the funding allows the smooth transfer from surplus funds to deficit funds, but the reform did not strengthen incentives for spending control in individual programmes. Nevertheless, an important pension reform was decided in 1996. As a consequence of the social security reform sustainability needs to be assured at the overall level. Currently, the federal government is responsible for a large share of financing: the federal government transfers more than 7% of GDP, or about a third of all social security spending, to other bodies. The government determines the parameters in the system in consultations with the social partners. Only limited reforms have been implemented in the administration and tasks of the funds, which remain complex with for example large differences in pension regimes and multiple administrative levels in the unemployment insurance. Thus, the institutional landscape should be evaluated to identify possible improvements and strengthen incentives and budget constraints.

The tax system can be made more growth conducive by shifting taxation from labour to less distortive taxes. This can be achieved by moving further towards tax-financing social security (*i.e.* reducing the reliance on social security contributions). A first candidate to be financed via general taxation could be health care, reflecting its universal provisions and its complex governance, which means that most parametric reforms have originated from the federal government. If a more gradual and piecemeal approach is chosen, then stronger feedback mechanisms should be introduced in the non tax-financed programmes to secure endogenous responses to increased spending pressures. For example, reductions in contributions for specific groups should be fully financed via offsetting revenue increases from other contributors.

Fiscal federalism reform should also focus on securing sustainability of public finance

The strategy to secure fiscal sustainability at different levels of governments has relied on inter-governmental agreements, most of which have been anchored in recommendations from the High Council of Finance. In recent years, the strategy stipulated that regions and communities should balance their budgets, and the federal government and social security system generate the planned surpluses. However, the federal level has had the slowest growing revenue – partly reflecting tax reform – while it is responsible for most of the ageing-related cost increases and interest payments, which are set to pick up significantly. This combination makes the current arrangement increasingly untenable without providing additional resources to the federal level or implementing some form of burden sharing with the regions and communities. The regions and communities, on the other hand, have benefited from dynamic revenues, reducing their incentives to control expenditure growth.

In this context, any reform of fiscal federalism needs to observe a number of principles to secure sustainable consolidation efforts, as discussed in the previous *Survey*. A first guiding principle should be ensuring sustainable burden-sharing of consolidation responsibilities. This means that, under the current prefunding strategy with consolidation efforts taking place at the federal level, *the federal level of government should be provided with revenues sufficient to meet the cost of population ageing and public debt service*. An implication would be fewer resources allocated to sub-federal levels of government. This would entail a greater need for ensuring that intergovernmental transfers reflect services provided, for instance implying the introduction of a workplace element in the sharing of income taxes. Also, transfer arrangements should be sustainable over the medium- to long-term. *For example the implicit pension transfer from the federal level to sub-federal level of governments should be removed by making each level of government responsible for the pensions of their employees*. Another guiding principle should be an efficient spending and taxation structure, which necessitates a better alignment of expenditure and revenue responsibilities at the sub-federal level of government. An implication is that *the regions and communities should develop their own tax bases. There is also a need for greater coherence of policies in areas of national interest to improve cost-efficiency of public services via better and less costly co-ordination or changes in the federal division of powers*.

The alternative to allocating more financial resources to the federal government is for the regions and communities to take greater responsibility for securing the increasing surpluses necessary for the prefunding strategy. Either way, there is a need for implementing *an internal stability pact to share pre-funding responsibilities and stipulate pre-agreed automatic sanction mechanisms and recovery paths in case of non-compliance with commitments – particularly important issues if EU reforms lead to direct sanctions for fiscal underperformance*. Determining how the prefunding burden should be shared among different levels of governments is a complex task, not least because the fiscal capacity of governments depends on the size of implicit transfers in the revenue sharing mechanism.

A stronger fiscal framework would facilitate consolidation

In the 2000s, following the euro adoption, it proved more difficult to generate sufficient political support for securing the surpluses needed to implement the pre-funding strategy, pointing to the need for a reform of the fiscal framework. *To avoid spending of windfall gains or excessively rapid tightening, fiscal policy should be governed by a medium-term budget surplus consistent with the prefunding strategy. The rule should be made operational by adopting expenditure ceilings for all levels of governments and for individual spending departments. To facilitate assessments and comparisons, a common format for budget presentation should be adopted at all levels of government*.

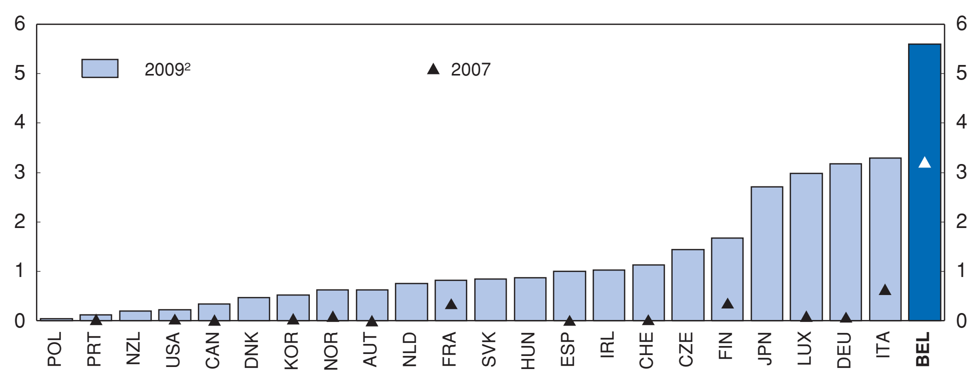
Political commitment would be buttressed by more integrated oversight and evaluation of fiscal policy. The High Council of Finance (HCF) provides regular assessments of long-term spending pressures, recommendations on budget targets for different levels of governments, and evaluations of Stability Programmes. To complete this oversight of fiscal policy, *the HCF's tasks should be extended to include evaluation of expenditures at all levels of government. To secure equal treatment, the HCF's ex-ante and ex-post in-depth evaluations should cover all governments and should include evaluation of the adherence to fiscal rules and the internal stability pact. At the same time, the National Account Institute (which provides technical expertise, such as projections of key macroeconomic variables) should evaluate the economic and fiscal consequences of main policy measures at both the federal and sub-federal levels of government. This could include assessments of current subsidiarity principles in terms of which level of government can provide individual public services most efficiently, as this is currently not analysed on a* *systematic basis*. The National Account Institute's input to the budgetary process could include projections of public finances under unchanged policy assumptions to facilitate assessments of the fiscal stance.

The crisis has increased segmentation in the labour market

The relatively good labour market performance relied to an important extent on a doubling of enrolment in reduced-working hours schemes (Figure 2), which are intended to help firms to retain strong ties with their key workers during temporary downturns in activity. By 2009, the enrolment reached 6% of all employees (3% on a full-time basis), implying that Belgium relied twice as much on such schemes as the second most intensive users of such schemes (Germany and Italy). Even though temporary and interim workers were included in the schemes during the crisis, the schemes mostly included workers with permanent contracts, while other workers were faced with higher unemployment, increasing segmentation in the labour market.

Figure 2. **Average monthly take-up rate of reduced working schemes in selected countries**[1]

Percentage of employees



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.

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The main scheme for blue-collar workers has few checks and balances to limit deadweight costs. Eligibility criteria are also relatively weak as no explicit agreements with unions are required and there are no conditionality requirements, such as provision of training, presentation of recovery plans, restrictions on firing, or job search requirements for enrolled workers. As a result, the use of the scheme during even normal economic circumstances is as large as in Germany during the crisis. *To limit the use of the schemes to firms in temporary difficulty, firms should be required to demonstrate a significant drop in activity and their participation should be approved by the relevant labour market authority.* The scheme for blue-collar workers has a higher degree of flexibility for employers than in most other countries, as firms can fully determine the amount of reduction and only need to notify shortly in advance. *To avoid systematic usage, re-entry into the scheme should be restricted, which would also encourage firms to adopt new production planning, processes and technologies. Alternatively, employers should be responsible for financing the initial period of enrolment.* In this context, the government has asked the social partners to propose measures in this area by end-2012.

Employers do not have to pay social security contributions for non-worked hours and, including top-ups from the employers, participating employees can maintain up to 100% of their income. The government has recently legislated that employers are obliged to provide a top-up of a minimum EUR 2 per day. *Parking of key workers in the system should be avoided by requiring employers to (partially) re-pay subsidies if workers are fired after enrolment and by making enrolled workers available for hiring by other firms.* Such features are, for example, incorporated in the Dutch scheme. *Indeed, incentives for employees to seek alternative employment should be enhanced by reducing benefits over time, banning top-ups from employers, and introducing a fixed upper limit on days of enrolment per year.*

Improving young people's labour market transition

Young people have a difficult transition into the labour market, suffering from low employment rates and high unemployment rates. A problem in this respect is the strict Belgian "study-first-work-later" model, which leads to many young people entering the labour market relatively late without being prepared for the realities of the labour market. Small hours jobs are restricted by the requirement that they be at least one third of a full time job in terms of hours worked. *To boost the supply of small hours jobs and thus facilitate school leavers' transition into the labour market, such minimum restrictions should be abolished.* There is a special holiday exemption for social security charges, which is mostly superfluous as low-income workers are already exempt, and it could be abolished.

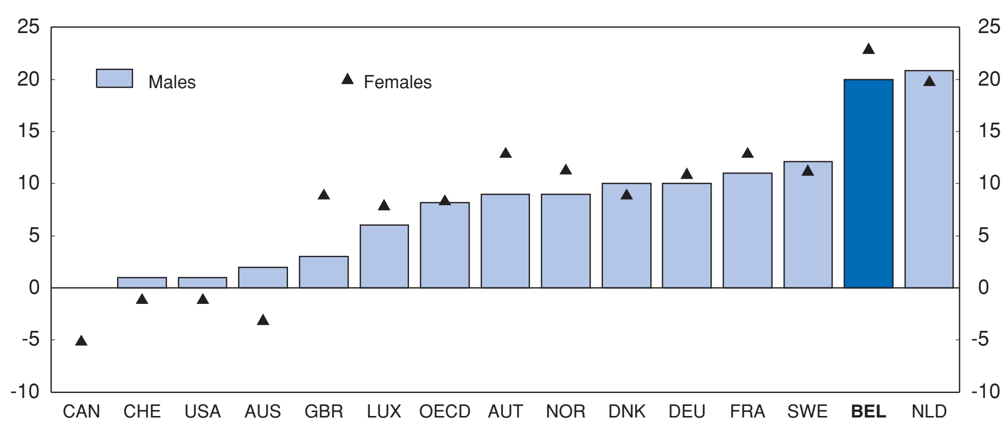
Labour market entry for early school leavers and those not pursuing further studies is also hampered by high minimum wages, which reduce demand for low-skilled workers. The statutory minimum wage as a per cent of the median wage is among the highest in the OECD and sectoral minimum wages are usually 20-30% higher. For younger people (below 21 years) there is a phase-in, allowing some alignment with their lower productivity, but an increasing number of sector wage agreements have abolished phase-ins. In addition, the phase-in is relatively steep. The implication is that young labour market entrants need to have a high level of productivity from day one – which is difficult given the few possibilities for combining studies and small hour jobs. *To better align young people's wages with their productivity, sectoral minimum wages should be reduced to the legal minimum wage and, there should be a more gradual phase-out of the youth minimum wage. Alternatively (sectoral) entry wages should be introduced, which should only be applicable to workers (re-)entering employment.* Such a reform should be combined with measures to strengthen search incentives in the system of special unemployment benefit for young school leavers (the so-called "waiting allowance"), which is available for an indefinite period. Such *benefits for school leavers should be restricted to those younger than 26 years* – a measure that would allow the least qualified relatively more time to solve their more difficult labour market integration. The government's recent introduction of a (in-)working bonus of EUR 10 net per month for low-skilled workers aims at increasing work incentives.

Special measures are required to address the unfavourable labour market outcomes for immigrants

Immigrants and their descendants have much lower employment and much higher unemployment rates than in other European countries, notably compared to native-born children (Figure 3). This may reflect discrimination, although there is little evidence that this is more pronounced in Belgium than in other OECD countries. The outcome can also partly be ascribed to relatively low educational attainment, particularly in terms of languages as immigrants are faced with two official languages: an example is Brussels, where immigrants usually learn French, but job possibilities are often in the surrounding Flanders. In this respect, making pre-school public child care mandatory is a step in the right direction. *Language teaching should be extended further to other age groups, particularly early language training of new arrivals, and be available for a sufficiently long time to secure adequate language skills.*

Figure 3. **Gaps in employment rates between the native-born children of immigrants and natives**

20-29 years old and not in education, latest available year



Source: OECD (2010), *Equal Opportunities?: The Labour Market Integration of the Children of Immigrants.*

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The poor educational attainment reflects immigrants' educational profile upon arrival and that their descendants in the Belgian early steering process end up in non-academic vocational studies, which are often not well regarded on the labour market and from which it is difficult to pursue additional studies. For the descendants of low-skilled immigrants, the situation is compounded by insufficient additional educational resources to schools with large immigrant populations. *Thus, streaming should be postponed as far as possible and the possibilities for returning to a higher track should be improved. Moreover, the allocation mechanism of additional educational resources to correct for socio-economic backgrounds should include a more significant element reflecting student's immigration backgrounds. More generally, there is a need to improve vocational training to better reflect labour market demands.* Because of the low qualifications of many immigrants and their descendants, this group of labour market outsiders will benefit in particular from more flexible labour markets generally, making all other recommendations to enhance the inclusion of outsiders particularly pertinent for immigrants (especially those related to minimum wages).

The wage determination system has delivered too high wage increases

Over the past 15 years, wages have increased faster than in the main trading partners and faster than domestic productivity, leading to a gradual erosion of external competitiveness. Since the mid-1990s, wages have been governed *ex ante* by a wage norm that shadows expected nominal hourly wage developments in France, Germany and the Netherlands. *Ex post,* the automatic wage indexation passes higher-than-expected inflation into nominal wages. Such a system has the benefits of maintaining the purchasing power of employees. However, the system has not been able to prevent relatively high wage increases during periods of inflation spikes nor to preserve competitiveness by importing low wage inflation. There are increasing concerns about possible negative effects of wage indexation, particularly as a considerable part of the consumer price index (mostly services) is itself subject to automatic indexation. The government has already decided to change the indexation formula for gas and electricity contracts to assure less volatile energy prices. *However, 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 to remove the most common terms-of-trade shocks. Also all effects of increases in 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 the social partners consider phasing out the wage indexation system, so as to allow greater real wage flexibility.* By linking Belgian wage developments *ex ante* to those in the neighbouring countries, wages are to a large extent linked to foreign productivity developments. As domestic productivity developments have been weaker, this accounts for nearly half of the loss in external competitiveness. *Such losses could be prevented by basing wage developments on Belgian productivity developments*.

The highly co-ordinated wage determination system has also contributed to a compact wage structure, limiting the scope for outsiders to price themselves into employment. Currently, firms can diverge from the sectoral wage agreement through opt-out clauses, which are subject to industry committee approvals, and rarely used all-in agreements that include (expected) price inflation. *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.*

Other large pockets of under-utilised labour resources should be mobilised to counter the ageing of the labour force

Efforts are required to boost the low employment rate. A general problem in this respect is the high effective marginal tax rates which, as discussed in the previous *Survey,* can only be addressed through broad reform to the tax and benefit system. Also more flexible wage setting would certainly be an important contributor to boosting employment rates, but special attention is required to mobilise other rather large pockets of under-utilised labour resources. The relatively low female participation rate is set to increase over the coming decades due to a strong cohort effect. Nevertheless, *the high effective marginal tax rates faced by low-income females can be reduced by completing the tax separation of spouses* as discussed in the previous *Survey*. Most of the increase in the effective retirement age can be explained by females staying longer on the labour market. Nevertheless, the effective retirement age remains among the lowest in the OECD, which means that, together with the gains in life expectancy, the currently retiring generations have the longest non-working life in Belgian history.

Increasing the effective retirement age is a priority and requires a broad-based approach. As stressed in the 2007 *Survey*, remaining exit routes to early retirement should be closed. Measures in this respect should focus on *increasing the enrolment age in such early retirement programmes and replace sectoral exemptions, such as allowing earlier entry for workers in the steel and construction sectors, with individual assessments of work capacity*. Furthermore, it should become economically more beneficial to remain in the labour market, *pointing to a need for increasing the taxation of pensions to the same level as is applied to similar income from other sources*. In addition, alternative exit routes should be eliminated. *Older workers on unemployment benefit should be subject to the standard search obligations applicable to other unemployed without exemptions and all employer-provided top-ups should be taxed similarly to other work-related income. In addition, a differential in the accumulation of pension entitlements between unemployed and employed should be introduced.* The 2005 Intergenerational Solidarity Pact contains provisions for longer careers to secure a full pension as the increase in the effective retirement age falls short of expectations. The effectiveness of this strategy will depend on introducing measures to improve labour demand for older workers, such as ensuring that their wages and productivity are aligned. Also a relatively large share of the working age population is receiving disability benefits, which in part functions as an open-ended passive income support system as enrolled recipients are rarely re-tested. *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*. Finally, pension reform could include an increase in *the legal retirement age, as is happening in many other OECD countries, to reflect past gains in life expectancy, and thereafter link it to further gains in longevity*. Such a measure is likely to further increase the effective retirement age as it raises the private costs of early retirement.

Environmental policies and measures need to be better co-ordinated

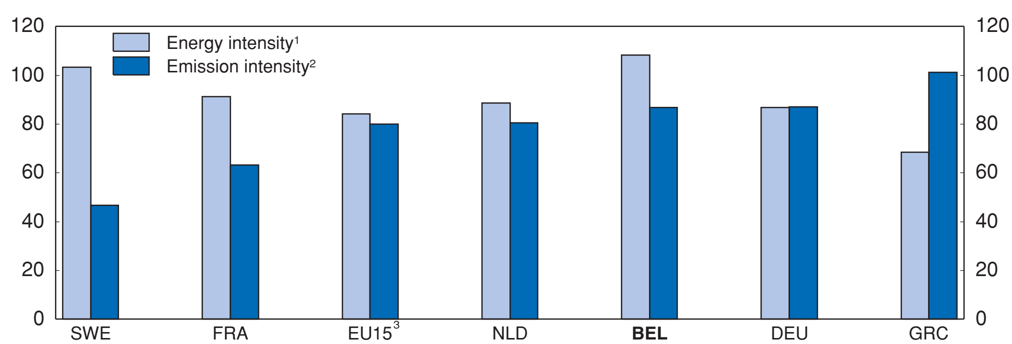
Belgian environmental policy has the complex division of powers and responsibilities. The three regions have major responsibilities for environmental policy and related areas, such as transport, agriculture and energy. But the federal government has the main responsibility for tax policies, often one of the most effective measures to pursue environmental objectives, for example by securing that polluters pay for the marginal external damage of their pollution. The dispersion of responsibilities has led to the creation of a large number of co-ordination and consultation bodies. This imposes a higher overall cost of environmental measures on the economy, as illustrated by different abatement costs across regions. *The economic rationale in environmental policy formulation should be strengthened by evaluating the costs of the current set-up in terms of lack of co-ordination and harmonisation of policies, and the cost-efficiency of policy boundaries and measures in place.* This recommendation applies particularly to policies devoted to green house gas emission and water management, as outlined below.

Additional measures are required to further improve environmental outcomes

Environmental outcomes have improved over the past decade. Belgium is likely to meet its Kyoto objectives, partly because of the recession, and progress in water quality is visible. Nevertheless, there is still considerable room and need to implement cost-efficient environmental policies, particularly as environmental objectives are becoming stricter, as in the European 20/20/20 strategy. In addition, Belgium is an energy intensive economy, partly reflecting a relatively high share of energy-intensive industries, but also because the energy use in transport and heating of residential and non-residential buildings is higher than in many other OECD countries (Figure 4). The outcome is related to an internationally low reliance on environmentally related taxes. Moreover, emission intensity is set to increase with the planned phasing out of nuclear energy, which currently accounts for about a half of all electricity generation. The increase in emissions will need to be offset by reductions elsewhere in the EU, as electricity generation is covered by the EU's cap-and-trade Emission Trading Scheme (ETS).

Figure 4. **The economy is energy and emission intensive in a European perspective**

OECD = 100, average of levels between 2003 and 2008



1. Total primary energy supply expressed in tons of CO_2 equivalent divided by GDP in 2000 USD using PPPs.
2. GHG emissions (excluding land-use, land-use change and forestry) in thousand tons of CO_2 equivalent divided by GDP in 2000 USD using PPPs.
3. Unweighted average of 2003-2008 levels.

Source: *OECD World Energy Balances Database* and *United Framework Convention on Climate Change Database*.

StatLink http://dx.doi.org/10.1787/888932459090

A carbon tax is an effective low-cost measure to curb emissions

A two-tier approach is necessary to curb emissions. The EU emission trading scheme is the main instrument to curb emissions in energy generation and industry, ensuring that the cost of emissions is equalised across the participating countries. Another approach is needed to curb emissions from activities outside the EU emission trading scheme, such as transport, small industry, heating of housing and non-residential buildings. Current measures in these sectors reflect the (regional) division of powers in energy and environmental policies and are at times internally conflicting. Consequently, the implicit price of CO_2 emissions differs between various measures (and from that in the EU emission trading scheme). A more efficient approach is to *introduce a uniform CO_2 tax for the non-ETS sectors (primarily transport and housing)*. Such a measure could adversely affect income distribution, which might then be addressed in the tax benefit system. The combination of specific measures in housing and transport does not lead to cost-efficient policies. Energy saving measures in housing have not reduced emissions as federal and regional subsidies to improve thermal efficiency of buildings have low take-up due to conflicting incentives, poor awareness and low prices of energy. *Thermal efficiency measures should be streamlined and geared to low-income households, which otherwise may not be able to react to the price signals embodied in a uniform CO_2 tax*. In addition, a significant number of households are entitled to low energy prices ("social tariffs"), shielding them from energy-saving incentives. *Such social energy tariffs should be replaced by income support.*

Emissions from the transport sector have been increasing. The effects of measures to promote less polluting vehicles, such as tax rebates for purchasing low-emission vehicles, have been offset by low fuel taxation and tax measures to promote company cars and commuting. In addition, the relatively low taxation of diesel has led to a diesel-heavy fuel mix, aggravating air quality problems in larger cities – particularly in Brussels. In this regard, the government's 2010 decisions to increase excise tax on diesel and relate the fiscal deduction of company car costs to emissions are welcome. Nevertheless, more substantial measures will be necessary to contain the negative externalities from transport. *Fuel taxation, particularly of diesel, should be increased further to better reflect negative externalities. Moreover, the recent agreement among regions to introduce road pricing for freight should be extended first to company cars and later to all cars, while charges should be set to reflect the negative externalities of transport. Congestion charges should be introduced to improve air quality in larger cities. Commuting allowances, particularly for road transport, should focus on low-income workers that otherwise would be at risk of dropping out of the labour market. Emissions associated with commuting can be reduced by introducing measures to increase the attractiveness and demand-responsiveness of public transport by introducing more competitive forces, such as more use of competitive public tendering.*

Renewable energy policies should exploit economies of scale and scope

Important pillars of Belgium's climate change strategy are to boost renewables from just over 4% of energy sources to 13% in 2020 and to increase energy efficiency. Renewables are promoted through numerous measures at various levels of governments: subsidies to windmills, photovoltaic and biomass (mainly imported from overseas), guaranteed prices, and complex systems of green certificates. There are five separate and incompatible green certificate markets (a federal and four regional ones, as there are two in Flanders) although there has recently been harmonisation efforts to combine markets in Brussels and Wallonia. Consequently, each government sets its own objectives and chooses different tools to attain them, often with the aim of picking a winning technology. This means that CO_2 abatement costs differ between regions and among technologies, implying that renewable energy policies are not exploiting economies of scale and scope, thereby increasing the overall costs of achieving renewable energy targets. *To equalise and lower abatement costs, recent market harmonisation efforts should be expanded to create as large and deep market as possible. Ideally, renewable energy policies should be based on a single country-wide green certificate market, which with the additional incentives coming from carbon taxes and the European emission trading scheme, would make the numerous subsidies and guaranteed prices superfluous.*

Water quality is still below European standards

A decade ago, water quality was among the poorest in the European Union, but it has since improved significantly due to extensive investment in water treatment plants, particularly in Brussels. Nonetheless, a considerable number of agglomerations continue to have insufficient water treatment in place and Belgium was yet again found to be in breach of the EU urban wastewater treatment directive in 2010. The unsatisfactory situation reflects the problems of co-ordinating definitions, monitoring and measures among the regions and the fact that the two main river basins do not follow regional borders. *Water policies could be better integrated by establishing water authorities at either the river-basin or the national level*. Further complications arise from water provision and sanitation being the responsibility of the municipalities. As a result, numerous different pricing schemes are in place and they often neither cover costs nor have prices related to pollution intensity. To provide incentives for private investors to address the persistent treatment problems, *water users should be charged according to the marginal externality they impose. New entry should be encouraged via public tendering of contracts*. A particular problem is the preferential treatment of the intensive agriculture sector which is the source of pollution from animal husbandry, pesticides and synthetic fertilisers. The impact on water pollution should be curbed *through taxation or by merging the regional manure management systems into a national system with tradable manure rights. This could take the form of a farm-level balancing scheme for nutrient content, which would limit the damage from manure spreading and limit the use of synthetic fertiliser. Pollution from pesticides should be limited through a pesticide tax based on the pollution content and tighter regulatory measures limiting their use*.

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