



# DOES IT MAKE SENSE TO REGIONALIZE LABOUR MARKET INSTITUTIONS ?

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# Introduction

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This E-book addresses one of the most hotly debated questions in the Belgian federation: To what extent should some federal labour market institutions be decentralized? “Labour market institutions” include formal organizations, laws, rules and policies that affect the functioning of the labour market. It starts with the point of view of the ministers Marcourt and Vandembroucke (henceforth, MV) who are in charge of Employment in respectively the Walloon and the Flemish governments. This joint viewpoint appeared in newspapers on December 8, 2008. This viewpoint, briefly summarized in Section 1, establishes a list of institutions that should remain federal and, with a certain degree of precision, others that should be decentralized. The rest of the E-book is made of comments on this viewpoint. These comments are made by academics in economics and sociology and by the Minister Cerexhe who is in charge of employment in Brussels.

## *1. The Marcourt-Vandembroucke (MV) standpoint and a global appreciation of it*

The starting point of MV is that labour regulations, wage policy and the funding of Social Security and all its branches should remain within the competence of the federal authority. Then, the ministers plead for a complete regionalization of a number of training and educational policies that have remained a federal competency up to now. They also propose to investigate whether other policies, such as ALE/PWA, outplacement<sup>1</sup> and temporary work permits shouldn't be regionalized. They call for a further simplification of the federal employment subsidy schemes targeted to specific workers and to gear it better to the specific regional needs.<sup>2</sup> In fact, this point of view seems to be influenced by the general view that the Walloon Region is particularly hit by youth unemployment, whereas the Flemish Region faces the problem of low employment rates among older workers. Finally, MV call for a new funding scheme that would promote “incentives and accountability and take into account the needs and capacities of each government”.

From the various comments found in this E-book, emerges a dominant view that broadly speaking the position paper of MV goes in the right direction. However, “the devil is in the details”. Put another way, an evaluation of these proposals requires that they be formulated in a precise way. Understandably, this is not the case yet, in particular with respect to the new funding scheme. Moreover, there is some disagreement on the opportunity of regionalizing some competencies and Minister Cerexhe argues that improvements are possible and needed within the current structure of competencies. Finally, in our contribution we argue that, even if a well-designed decentralization of labor market policy may improve the functioning of the labor market, it's not the first and most important step. We claim that the current priority is a structural reform of labour market institutions, independently of the issue of decentralization. We briefly explain why and what reform is more urgent, but the reader is referred for details to a companion paper.

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<sup>1</sup> Minister Cerexhe discusses explicitly the regionalization of outplacement.

<sup>2</sup> In particular, this refers to the recently much debated federal scheme of targeted wage subsidies. After the position paper of MV was written, this scheme was sharply reduced by the last inter-professional agreement among the social partners. Since then, this decision has been blocked by the Flemish government. It is also been criticized by Minister Cerexhe in his comment on the MV's position paper. Both argue that such targeted wage subsidies are needed to fight regional-specific problems of non-employment.

## 2. Major arguments and their implications

In arguments for and against regionalization, the notions of “efficiency” and “equity” are key. We briefly clarify these notions for the reader who is not familiar with them. It is often thought that “efficiency” only refers to the utilisation of less resources to attain a given objective. While this “technical efficiency” is required, “efficiency” means more than that. Without entering into technicalities, “efficiency” means that nobody can be made better off without making someone else worse off. Put differently, an allocation of resources is inefficient if a change in this allocation would imply a gain for someone and no loss for others. When the environment presents randomness, in our context when there is a risk of being unemployed, “efficiency” requires that, loosely speaking, an additional euro has the same value in all possible positions occupied by an individual. “Equity” is a very complex notion, too. A basic requirement is “the equal treatment of identical citizens in comparable socio-economic situations, including their equal access to social protection” (Van Rompuy in this E-book). According to the preferred ethical perspective, more can be required: People with different endowments (talents, location of birth...) should be given the same “opportunities” (the precise measurement of it being of course crucial).

This clarification being made, more decentralization should improve the balance between efficiency and equity in Belgium as a whole. It is then often argued that, in the case of the labour market, devolution is motivated by regional long-lasting disparities in unemployment and employment and by the need of creating more coherent packages of instruments to fight the regional-specific unemployment and the ageing problems. Our comment qualifies the importance of these disparities. Moreover, as stressed by several contributors to this E-book, the gain in coherency strongly depends on the details of the implementation.

A common view found in the comments is that social security – from the perspective of efficiency – ought to remain a federal competence. This is also true for the labour market legislation and for the wage-setting institutions. About the latter, while Cantillon considers that “wage costs (...) are uniform throughout the federation”, Plasman *et al* argue that current wage-setting institutions “allow wages to adapt to regional productivity differences”. If more sensitivity of wages with respect to local conditions is needed, they add that current institutions already have regional sub-joint committees and that in addition more importance could be given to collective bargaining at the company level.

Most of the commentators also agree with MV that policies aiming at reintegration of unemployed and of inactive workers in the labour market should be decentralized since they logically are part of a competency that has already been transferred to the Regional level. Such a reform should provide the Regional Public Employment Services (PES) with an enlarged and more coherent set of instruments. So, more efficiency can be expected by such a reform. As some of these policies are currently jointly organised by the federal authorities and the social partners, the role of the latter should be adjusted but the principle of their involvement is not questioned (a standpoint that seems to be shared by MV).

More delicate is whether the Regions should be made responsible for the targeted wage subsidies and for the monitoring and sanctioning of job search, of job acceptance behaviour and of mandatory participation in active labour market policies (ALMP). It is often argued that federal wage subsidies directed to specific target groups should be regionalized, because this allows to accommodate these subsidies to the Regional labour market conditions. Our comment explains why this argument is flawed. Targeted wage subsidies are broadly of two types: Permanent or temporary. The first one, also called “structural”, should remain the competence of the federal level (this is claimed by us and can be deduced from the comment of Van Rompuy and Plasman *et al*). If it makes sense to regionalize any wage subsidy- this is not the view of Minister Cerexhe -, it would be the *temporary* targeted subsidies. The monitoring and the sanctioning of the unemployed should become a responsibility of the regions in the MV position paper, provided that rules remain defined at the federal level. There are good arguments to go in that direction. Still, some important complications should be resolved to gain from such a reform (for further details, see our comment and the critical view of Minister Cerexhe on such a reform).

Policies that affect the duration in unemployment (be it active programme or monitoring and sanctions) touch upon the federal social security scheme. Put differently, regional decisions induce “externalities” at the federal level. Hence, Cantillon calls for “consultation between the competent authorities”. To avoid that the socio-economic outcomes would further diverge between Regions, Cantillon stresses that common objectives should be defined and indicators of fulfilment of these objectives should be monitored, such as in the ‘Open Method of Coordination’ approved by the European Union. Cantillon argues that “the regions should be made fully aware of their financial accountability for federalized policy strategies”, but how remains an open question.

Dewatripont, Van Rompuy and we believe, as MV, that, to bring about convergence in the Regional labour market performance, funding of the Regions on the basis of an explicit incentive scheme is desirable. Incentive contracts are required to resolve problems of conflicting interests. In the case we consider here, the conflicting interest is between the federal authority and the Regions. Essentially, the conflict is that unemployment benefits are paid and wage taxes and contributions are raised at the federal level, while a number of policies, in particular ALMP and education, that affect these expenditures and proceeds are a Regional competence. Since the Regions do not collect the full<sup>3</sup> proceeds of their actions, they tend to under-invest in ALMP and education or do not care enough about their effectiveness. An incentive contract attempts to align the objective of the Regions to that of the federal authority by financially rewarding (or penalizing) Regional actions according to an indicator of performance that reflects the interests of the federal authority. As recognized by the commentators, the details of the design of this scheme are crucial.

1. *The choice of the indicator of performance.* In principle, the indicator of performance could just be the sum of the savings generated by the reduced payments in unemployment benefits and the increased proceeds in terms of wage taxes and contributions generated by each Regions. In practise, it is, however, administratively too costly to measure these savings. This is why the commentators propose to relate incentive pay to indicators that are easier to measure, but that are still related to the generated savings. Two candidates are the Regional long-term unemployment rate<sup>4</sup> (Van Rompuy) and the (full-time equivalent<sup>5</sup>) employment rate. All commentators agree, however, that the employment rate is a better candidate, since the unemployment rate can be “manipulated” by pushing unemployed workers into inactivity.
2. *Limit randomness of the indicator.* Whatever the chosen indicator(s) of performance, one has to be aware that their evolution is not only affected by the regional interventions, but also by many external factors, such as the economic business cycle and policy at the other (federal, European,...) levels of competence. So, a benchmark is needed. Different viewpoints appear here. Principal candidates are a Belgian average, an average in surrounding countries.<sup>6</sup> Even if there is not a clear agreement on the eventual choice of the benchmark, commentators seem to agree the scheme should be ‘win-win’, namely that every entity (federal and federated) actually benefits financially when employment rates improve in any one region. This seems to exclude the first candidate in a pure form.

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<sup>3</sup> The Regional means already depend of economic indicators that are only partially correlated with the Regional employment level. Moreover, the Federal government already transfers means to finance some Regional labour market policies. It should be added that poor employment performances are detrimental to the image of a Region, with e.g. potential electoral implications.

<sup>4</sup> This is a measure of structural unemployment. As rightly pointed out by Dewatripont, “the relevant concept in this debate is that of ‘structural underemployment and/or unemployment’, not the big cyclical component of unemployment that we are starting to witness right now because of the financial crisis; this latter one has to be dealt with by macroeconomic policy coordinated at EU and even world level.”

<sup>5</sup> We propose this refinement as to avoid that the scheme would be “manipulated” by stimulating the creation of part-time employment.

<sup>6</sup> There is no clear agreement among commentators whether this average should be calculated prospectively (Van Rompuy) or retrospectively.

Even if one reaches agreement over the benchmark, the question remains which Region should be rewarded (or penalized) for employment created (destroyed) in a Region where one does not live. Brussels e.g. attracts 360 000 workers from other Regions and 61 000 inhabitants of Brussels work in the other Regions (Cerexhe, p. 15). Minister Cerexhe argues that, as a consequence, the Brussels Region does not currently receive the funding it's entitled to and that this needs to be resolved before discussing "accountability" in the Regional funding. In our contribution we propose a sharing rule to resolve this problem, but recognize that it's very complicated to assign the appropriate shares in this rule, so that agreement on this point may be key in negotiations regarding the design of an incentive scheme in the funding of the Regions.

3. *The size and form of the bonus-malus.* Since the performance indicator will never perfectly reflect the effort undertaken by the Regions, the transfer to the Region should not be related only to indicators of labour-market performance, but should partly consist of a lump-sum transfer. It is, however, difficult to objectively determine the optimal size of the bonus-malus, which therefore will be subject of intensive political debate (Dewatripont). To avoid 'vicious circles' in case a Region starts losing money as consequence of the incentive scheme, Dewatripont suggests to consider malusses in terms of obligations to intensify labour market policies rather than in terms of reduced financial resources. But this requires an objective measurement of the "intensity" assigned to labour market policies by a third party. Is this feasible?
4. *A neutral initial target.* The employment rates between the different Regions will differ at the moment of the introduction of the scheme. Since the incentive scheme can only affect future actions, we argue that it should take past behaviour as given and normalize each Region's indicator to the level attained at the moment at which the scheme is introduced. This boils down to measuring performance in terms of variation of the employment rate, instead of in absolute terms.

### 3. Conclusion

This collection of brief comments around the MV position paper hopefully paves the way of a more rational debate about decentralization of labour market policies in Belgium. Such a debate is unavoidable. Needless to say, much work remains to be done to help the decision making in this touchy domain.



# Lead Piece

By Jean-Claude Marcourt and Frank Vandenbroucke

# A call for action and dialogue in the interest of economic recovery and social progress<sup>7</sup>

Jean-Claude Marcourt, Employment Minister for the Walloon Region  
Frank Vandembroucke, Employment Minister for the Flemish Region

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In the current economic and financial crisis the authorities should take direct and efficient action at all levels to reestablish the confidence of enterprises and citizens alike and to guarantee their social and financial security. At the European level, the Party of the European Socialists (PES) has just approved a recovery plan. We ask the member states and the European Union to urgently take proactive and coordinated measures through investment programs in order to preserve employment, avoid dismissals and develop a sustainable economy. In Wallonia and Flanders, our regional governments proposed ambitious recovery measures to facilitate the granting of credit to companies, to accelerate and to promote public and private investments in sustainable economic development, and to strengthen our labor market policies, especially for workers hit by restructuring. Together with the federal government we are constructively collaborating to the elaboration of a general short-term anti-crisis plan.

In the same constructive spirit, we also participated in the discussions that occurred within the framework of the inter-community dialogue. A debate on institutional reform is for us neither a fetish nor a taboo. Quite to the contrary, it is a way of guaranteeing in the long run the further development of both the federal state and the federated entities. We believe that, if each authority is given clearly circumscribed competencies, enhancing the federated entities's capacity for action can go hand in hand with enhancing that of the federal authority. Each of the entities can thereby become more efficient, while the whole they form can become more coherent.

We believe that what binds together both the authorities and all the citizens of this country is a strong and therefore sustainably financed Social Security system, i.e. one that guarantees, in particular, sound pensions and health care for all. To achieve this, we must make sure that more people are in work. As a point of departure, we assert that labour law, wage policy, the various branches and funding mechanisms of the Social Security system should remain a federal competence. On the other hand, the federated entities must be enabled to exercise all the competencies that are required in order for them to fulfill their main assignment with regard to employment, namely the active counseling and the following-up of job seekers and workers, including training (alternate work and study schemes, paid educational leave), taking the specificities of their respective labour markets into account. Thus, the general rules regarding suitable employment and exemption from availability for work remain federal, whereas their concrete implementation is performed by the regions, who have to make commitments to the federal authorities within this framework.

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<sup>7</sup> The original version of this text appeared on December 8, 2008, simultaneously in Dutch (in *De Standaard*) and in French (in *Le Soir*). It can be downloaded from [http://www.vlaanderen.be/servlet/Satellite?c=Article\\_C&cid=1227854145950&pagename=minister\\_frank\\_vandembroucke%2FArticle\\_C%2FArticlePageMIN&lang=NL](http://www.vlaanderen.be/servlet/Satellite?c=Article_C&cid=1227854145950&pagename=minister_frank_vandembroucke%2FArticle_C%2FArticlePageMIN&lang=NL) and from [http://www.vlaanderen.be/servlet/Satellite?c=Article\\_C&cid=1227854152573&pagename=minister\\_frank\\_vandembroucke%2FArticle\\_C%2FArticlePageMIN&lang=NL](http://www.vlaanderen.be/servlet/Satellite?c=Article_C&cid=1227854152573&pagename=minister_frank_vandembroucke%2FArticle_C%2FArticlePageMIN&lang=NL)

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In this connection, we would like to investigate whether there may be a point in regionalizing some measures of job matching and of employment, such as the Local Employment Offices (*PWA/ALE*), outplacement, the counseling of employees in the context of restructuring, and temporary work permits. As regards reductions in Social Security contributions and employment plans, we plead for a simplification of the current schemes and for better targeting, tailored to the regional realities. In this domain, however, we await the conclusions of the ongoing negotiations between the trade unions and employer organizations.

In aforementioned reforms one obviously needs to take account of the customs of negotiation between the social partners. Lastly, a strengthening of the competencies of the regions and communities should be coupled with a funding scheme that combines incentives and accountability while taking the needs and capacities of each government into account and yielding a positive return on investment for both the regions as the federal authority.

This is an outline of our position regarding the institutional reform of employment policy. A strengthening of regional labour market policy affords us a greater opportunity to collaborate in order to make our labour market more dynamic. But launching such dynamics requires unblocking the inter-community deadlock and resuming work within the framework of the inter-community dialogue. A new conflict between communities would be unacceptable, indeed irresponsible on the background of the present economic crisis. Finally, we consider that what we can achieve in this area should be achievable in other areas too.

# Comments

# On the regionalization of employment policy

## A response to the joint statement by Ministers Marcourt and Vandenbroucke

Benoît Cerexhe, Employment Minister for the Region of Brussels-Capital

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The regionalisation of employment is one of many topics that were discussed in the framework of institutional negotiations.

I have been asked to respond to the joint statement issued at the end of 2008 by Mr Frank Vandenbroucke and Mr Jean-Claude Marcourt concerning this theme.

I am making the present contribution to the debate in my position as the Regional Minister for Employment, outside of any negotiating context, on the basis of my experience of spending five years at the head of this department.

I feel it necessary to start by mentioning that I have the impression that sometimes people forget that employment has already been regionalised to a large extent in this country.

While the federal authorities are responsible for unemployment insurance and the employment law, and the Communities are responsible for training (this role has been transferred by the French Community to the Walloon Region and to COCOF as regards Brussels), the Regions bear the major responsibility as regards recruitment, return to work programmes for job-seekers who are not engaged in any activity, and the enforcement of standards regarding employment of foreign workers. I would like to emphasise that these are by no means minor matters. We are helping more than 96,000 *Bruxellois* to find work with Actiris, our *Missions Locales* and our local *Werkwinkels*, and our partners and the multiple instruments and tools we have put into place. The Regions therefore have considerable room for manoeuvre.

When we speak of 'regionalisation', we are therefore speaking of the transfer of new responsibilities, which are at this moment dealt with at the federal level, to the Regions.

When considering any transfer, whether total or partial, one needs to remember that employment is a sensitive subject, which needs to be handled with a certain degree of caution in my view. In fact, this competence, to the extent that it is linked to work and to social security, includes on the one hand a fundamental element of national and interpersonal solidarity, and is on the other closely linked to a federal model of social consultation. Employment therefore concerns the very foundations of our federal state.

Within a historical context where there has often been a tendency to have multiple institutional reforms without necessarily causing those institutions to function better on every occasion, or to run our politics better, I do not believe that it is possible to transfer new

competences to the Regions unless this actually generates an 'added value'. This would be the case if the transfer were to fulfil the following five criteria:

- not to put at risk interpersonal solidarity, and to allow an acceptable degree of differentiation of policies in the Belgian state;
- do everything first to make our existing tools work better;
- ensure improved effectiveness of the service provided to our population;
- there should be no alternative that more accurately reflects the specific nature of the Regions;
- attach financial or human resources to this transfer, thus allowing the recipients to exercise this competence properly.

### ***1. Not to put at risk interpersonal solidarity, and to allow an acceptable degree of differentiation of policies in the Belgian state***

It appears essential to me that individual and collective employment laws should remain a federal matter. If there is going to be a reform, then it must not undermine interpersonal solidarity and in particular our social security system, or the federal model of social consultation. Apart from that, I leave it to the reader to imagine what the consequences would be of different policies in this area, above and beyond the inevitable complexity they would create! In the first place, such a situation would lead to competition between the Regions. Such a situation would also create complications for businesses that have set up in our country. Finally, this would go against any kind of logic, insofar as the numerous regulations originate from the Directives of the European Union. This means then that there cannot be any question of regionalising family benefits, unemployment benefits, the minimum wage or the reimbursement of medical treatment.

### ***2. Make our existing tools work better***

I am of the view that we are not making full use of the existing cooperation mechanisms. I am going to take two examples of this situation, one of which concerns relations between the Federal government and the Regions at the level of policies for reactivating job-seekers, and the other with regard to relations between the Regions at the level of mobility of job-seekers. Within these two examples, the Regions could benefit from greater autonomy or use their autonomy better, and more effectively, without necessarily transferring new competences to the Regions.

As regards the first example, the Federal government and the Regions settled the arrangements for their collaboration in a cooperation agreement on 30 April 2004 as far as assisting job applicants. The Regions are responsible for assisting and placing job applicants, while the NEO (National Employment Office), a federal organisation, is in particular responsible for checking on the availability of job applicants. The unemployed receive benefits, but they have to be available to the labour market. This means that they cannot refuse a suitable position and that they have to actively look for work. The interpretation of 'suitable employment' has been determined according to a number of criteria that are determined at federal level.

The current regulations mean that the regional employment service (Forem, VDAB, Actiris, Arbeitsamt) takes job-seekers' availability into account when considering whether to send information. This can result, for example, in the NEO being notified if a job-seeker decides not to attend an interview with an employer. It is not up to the regional services to pass judgment on such an action. It is in fact the NEO (the federal agency) that interprets federal legislation with regard to availability, and it is therefore up to the NEO to decide whether an unemployed person is available and whether he or she is actively looking for work. Only NEO can impose a penalty for not being available, which usually happens after it has

notified the regional agency, on administrative grounds. It is also up to the NEO to exempt an unemployed person from having to be available, for example to undertake training or for social or family reasons. There are also (federal) criteria in this regard.

The fact that a federal agency monitors and penalises unemployed persons if they are unavailable is a guarantee that every job-seeker will receive equal treatment as regards their search for work. While labour markets and stratification of unemployment may vary, it is still necessary that monitoring and penalties should be handled at federal level, in the same way as labour legislation.

This is also all the more true given that regionalisation of monitoring and penalties, under the pretext that the labour market within the three regions is not homogeneous, is not likely to solve many problems. Employment catchment areas are not homogeneous within a single region. One cannot compare the area of Vilvoorde with the area of Antwerp in terms of unemployment, in the way that one can compare the Brussel-Halle-Vilvoorde area with Brabant Wallon.

Employment catchment areas draw on potential workers well outside their regional boundaries. Brussels attracts some 360,000 workers from the other regions, while some 61,000 of its inhabitants commute to jobs outside the city. How can one integrate this type of data in a regionalised approach, without then creating a protectionist response from the regions when there is heightened unemployment, which is the case at the moment?

On the other hand, it would be entirely desirable to **reinforce the 2004 agreement regarding policies for activating the unemployed** as suggested by the Federal Ministry for Employment, while leaving greater autonomy for the Regions. A new activation process that grants the Regions greater autonomy (the job-seeker makes a contract with the regional adviser; the adviser is free to define the availability expected from the job-seeker; the NEO performs an evaluation using the database sent by the regional adviser, etc.) could contribute to solving the problem of differing labour markets, without resulting in differences in the treatment of job-seekers. We can make our activities more effective by making our *Contrat de Projet Professionnel* (Professional Project Contract) stricter, while ensuring that the job-seeker is involved to the greatest degree in his or her support project, and shortening time limits for taking action by simplifying the procedures and formalities, but only on condition that additional financial resources are granted to the Region. It is important that the NEO should continue to monitor the uniform application of the regulations throughout Belgium.

It is also important that - within the framework of this new agreement - the Regions should be able to define a suitable path that is either longer or more intensive for job-seekers who are further away from the labour market.

As regards the second example, the Regions have the possibility of arranging how they work together in terms of a cooperation agreement. This hardly even happened until a few years ago. An agreement on the interregional mobility of job-seekers was concluded in 2005. This provides for an exchange of information between regional employment agencies concerning job vacancies relating to key positions and vacant positions that have not been filled for a certain period of time. The Brussels Capital Region recently concluded a specific agreement with the Flemish Region, starting from the principle that the unemployment rate is far lower on the outskirts of Brussels, where there are vacancies that cannot be filled. On the basis of this agreement, we have organised an exchange of vacancies between the two Regions within a certain area and achieved very good results in terms of filling positions. The number of *Bruxellois* who leave our Region to work in the outskirts of the capital has grown by 15% in four years! This is not that complex an initiative, and yet facilitating and encouraging mobility among job-seekers gets more people back into work.

The fact that existing agreements or those to be concluded allow for greater effectiveness without transferring new competences should not stop us from considering whether we should reinforce those agreements or make these forms of cooperation more flexible.

Better coordination of competences has another aspect, namely refraining from pointless competition between Regions, which benefits nobody. It is also within this perspective that I would reject the regionalisation of corporation tax, which could even be damaging to our objectives.

### *3. Improved effectiveness of the service provided*

I am one of those who believe that a policy has no purpose unless it increases the effectiveness of the service provided to the population and more particularly to our job-seekers. It seems to me that this should be our main concern as regards our actions.

If we consider the entire body of competences for which we are responsible, we can see certain aspects here and there where we could achieve the 'added value' that could result from expanded regional competences.

Let me give an example.

At the level of **outplacement**, the Federal state must remain competent for employment law regulations as regards the right to professional reclassification (provisions contained in the collective employment agreement 82bis, rights and obligations of employees and employers, minimum conditions for granting outplacement and actual terms of outplacement, and penalties in the event of failure to comply). Then again, why is it not possible to consider making the Regions responsible for deciding on the **actual terms of outplacement beyond the provisions** set out in collective employment agreement 82bis, so they correspond more to the requirements and needs of our labour market, for issuing a compulsory recommendation with regard to support measures for workers who have been made redundant in the context of restructuring, so that the employer can be recognised as being in a process of restructuring (and so that workers can benefit from a pre-pension at an earlier age), as well as for **allocating funds generated by fines imposed** by the Federal state?

I am keen to emphasise that this 'added value' deriving from greater regional responsibilities is not limited to the elements that would be transferred from the Federal level to the Regions, but also from the Communities to the Regions. Let me cite an example that is specific to Brussels as regards responsibility for **Training**. I am in favour of transferring the competence of the COCOF and the Flemish Community to the Brussels Capital Region. Let me repeat that 65% of job-seekers in Brussels have no more than a lower-secondary qualification and 90% of them are unilingual francophones. Assigning responsibility for training and recruitment to the same institutional authority would make it possible to offer shorter and better targeted training courses. This would be more effective in my view.

### *4. There should be no alternative that more accurately reflects the specific nature of the Regions*

A certain number of measures were passed in the 1980s with a view to reducing the level of employer contributions to reduce employers' wage costs. This led to the creation of different systems, each of which provides for its own particular calculation methods and its own target group. Starting from 2004 a certain number of separate reductions in employer contributions were **harmonised and reorganised into a single reduction in contributions** made up of two types of reductions: a structural reduction and a reduction for 'target groups'. The first reduction applies to all employers. The second only allows for reductions in contributions for employers and/or employees who satisfy certain criteria. This reduction



therefore encourages employers to take on new employees, in particular young persons with few qualifications, first-time job-seekers, etc.

The most recent *Accord InterProfessionnel (AIP)* aims to convert a large part of the financial resources - namely over 70% of the reductions in contributions - for 'target groups' into so-called structural reductions in contributions. By doing so, the category of targeted measures will shrink more and more. It is the case that this category of 'target group' contributions was designed for the unemployment situation in the Brussels Capital Region: i.e. numerous young unemployed (with an unemployment rate exceeding 30% or even 50% in certain districts) with few qualifications. This reform will therefore deprive our Region of important tools that are tailored to its needs.

Naturally, I am not disputing the aims of this reform. The main priority must be to simplify procedures for hiring staff in a generalised and drastic fashion. The objective of this simplification must be to simplify the system for employers, to try to remove the traps that the unemployed fall into, and to strengthen regional employment policies. It is advisable to simplify what are known as 'target group measures' and to provide more custom-made employment in the fight to remove the barriers to employment. Despite the simplification operation of 2004, the numerous employment plans remain a confused tangle of federal and regional measures (federal activation of benefits and reduced social security contributions, and regional grants for recruiting the unemployed). What is more, grants are paid in a piecemeal fashion, which sometimes constitutes a problem on the ground, to the point that in certain situations there is a reverse effect which could actually create an unemployment trap.

Again I wish to emphasise the lack of awareness of specific regional features in this field. Certain people use this example to argue that this matter should be regionalised. I am not one of those people, because here we are talking about reductions in social security contributions, which will have implications for the financing of the social security system. I am in any case convinced that it is possible to be effective and take more account of the specific features of the Regions by involving them in the definition, modification or elimination of target groups, while putting in place compensatory measures using employment activation policy.

##### **5. *Providing additional financial resources***

I would argue that the Brussels Capital Region should have financial means available to it in proportion to the heavy burdens that it takes on for the country as a whole. Our Region contributes 20% of Belgium's gross GDP, represents 10% of the Belgian population, but only receives back 9% of personal income taxes. This is obviously not sufficient to meet the requirements and burdens of a Belgian and international capital city. Is it necessary to repeat that 500,000 people enter and leave our Region every day? It therefore seems to me to be imperative that if we are talking of stimuli and making the Regions more responsible, then we should first concentrate on correcting the structural under-financing of the Region and take into account criteria of distribution of resources that are suited to the specific conditions in Brussels. How can one imagine, for example, giving the Regions a more important role in terms of activation, something that requires a lot of additional staff, without transferring additional financial resources?

**What should our view be of the stance taken by two regional politicians, who are Ministers and participants in their role as negotiators in the institutional dialogue?**

This poses a challenge on several grounds.

As regards the form of their statement, in the first place, their stance only takes very limited account of the Belgian reality since it does not incorporate the Brussels Capital Region,

which is an entirely distinct third Region and, most of all, the main employment catchment area in this country. Do we really need to repeat the highly paradoxical special nature of our Region: an economy that creates riches that represent more than 20% of GDP, a pool of 690,000 official jobs, of which 357,000 are taken up by non-residents, and an unemployment rate approaching 20%... Perhaps this is because the authors have based their position on a deliberately ideological approach, given that they are two socialist leaders, who for that matter refer to the actions of the European Socialist Party.

In addition, this declaration, which has not been the subject of consultation, has arisen within the context of difficult institutional negotiations with identifiable strategies, and has opened the way towards increased regionalisation of employment policies, even if the authors affirm that a number of matters should be retained at the federal level, while at the same time there are those who are fighting to retain the federal nature of this competence. It also opens up a breach in the principle of a financial mechanism that links 'stimulus' and 'responsibility' to a positive financial return for both the Regions and the Federal government on the investments that are made. The whole point is certainly how one defines what one means exactly by such a mechanism, the criteria that are likely to be taken into consideration, the degree of compulsion, and the precise nature of the penalties.

Finally, this declaration, which claims to be one of principles, does not deal with details or special features, as the authors themselves admit, which could create risks within such a complex debate. The nuances are important. I am suspicious of slogans.

At a basic level one has to say that this declaration does not look at all the elements which I have identified.

Even if this declaration tends to support maintaining interpersonal solidarity while confirming that employment law, wages policies and social security (with all its pillars and financial mechanisms) must remain the responsibility of the federal government, it nonetheless opens up new possibilities without really showing how the existing tools could be made to work better, or how a fresh transfer of competences could generate greater efficiency.

The same applies to general rules in the area of suitable employment and granting exemption from availability, which should, according to the two Ministers, remain federal matters, while they would have to be applied concretely at the regional level, with certain undertakings being made towards the federal government.

This also applies in the areas of re-entry and employment measures, such as the *ALEs/PWAs*, outplacement, helping workers who are victims of restructuring, and rules for granting permits for temporary work, where the authors think it would be worth considering the advantages of regionalisation.

The same applies to the rest, even more so when the authors argue in favour of regionalising what is 'necessary' for the Regions to perform their main mission in the employment field, without fixing any kind of reference points or limits.

As regards financing, the authors have opened the way to giving the Regions more responsibility but without making a clear call for resources linked to competences to be transferred.

**In conclusion**, as you will have understood, I am very keen to preserve a strong social security system as the cement that holds our country together, and not to envisage greater autonomy for the Regions, unless this increase in competences is needed to ensure greater effectiveness of the service provided to the population and more particularly to our job-seekers. It seems to me that this should be our main concern as regards our actions. I would

also make a plea for improved coordination of the regional competences we already have available to us, for example through cooperation agreements between the Regions. I would argue that it is necessary to take greater account of the special features of the Brussels Capital Region in the exercise of federal competences. Taking greater account of the special nature of our labour market will not necessarily happen by increasing regionalisation of competences. I am open to a discussion on whether to **reinforce certain existing regional competences with a view to increased consistency and homogeneous policies, as well as greater involvement and therefore responsibilities for the Regions in certain areas**. Finally, as regards **finance**, I would argue that the Brussels Capital Region should be given the financial means in proportion to the heavy burdens that it has to bear for the country as a whole.

# Solidarity and responsibility

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Proponents of devolution of social security cite social transfers as a reason for splitting the social security system: social transfers are seen as an important impediment to economic convergence. Others believe that federalising social security would increase poverty in Wallonia and Brussels. Indeed, simulations demonstrated that halting social transfers from Flanders to Wallonia would dramatically increase the poverty rate in Wallonia in the short term.

The first-order effects of eliminating interregional social transfers between Flanders and Wallonia suggest that social security – from the perspective of social efficiency – ought to remain a federal competence. This also ties in with the theory of fiscal federalism, according to which social redistribution is best organised at the central level of government. The underlying notion is that social redistribution will be pressurised if it is organised at a lower tier of government, because of labour and capital mobility.

However, the logic of fiscal federalism conversely implies that, given that wage costs and social regulations are uniform throughout the federation, possible differences in the economic dynamism between regions will be artificially maintained. In Belgium, the development of comparative advantages and the mobility of labour and capital and – thus an economic convergence of the regions – may be impeded by the prevailing system of universal social protection. The latter argument is heard increasingly often in the debate on the position of social security within Belgian federalism. The question is, however, to what extent federalising the social security system will lead to diverging social safety nets in the regions and a substantial reduction in the cost of labour in Wallonia. Theoretically, a devolved social security system would allow Wallonia to cut taxes and social security contributions (and thus to reduce the cost of labour). As such a measure would inevitably lead to a dramatic increase in poverty, it would appear to be an unlikely political option.

On the other hand, there are good arguments in favour of extended regional competences within a single federal social security system. Principles such as localness (close-knit solidarity), suitability (the fact that regions have different needs and preferences) and efficiency (the fact that accountability will result in cost saving and that a smaller territorial scope creates more room for policy innovation) suggest that federalising social policy further may generate better outcomes. The Belgian case provides some important examples in this respect, Labour market policy is certainly one of them.

Social security, as an instrument of interpersonal redistribution, regions should be made fully aware of their financial accountability for federalised policy strategies. All Community competences touching directly or indirectly upon the federal social security system should be the subject of consultation between the competent authorities. Where appropriate, the regions should be granted competence over certain social security resources (e.g. PWA, outplacement) – to be allocated to the Communities using a well-considered distribution code – so that they could be spent in accordance with local needs. In view of the major socioeconomic differences between the Communities and the growing policy divergences in the fields of labour, care and education, it is necessary to align the various policy levels more closely. Europe's approved 'Open Method of Coordination', whereby common objectives are formulated, indicators defined and policy strategies exchanged, could serve as a useful example in this respect.

# Decentralisation of labour market policy may matter, but other reforms matter more

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Essentially, we agree with the key point of view of ministers Marcourt and Vandenbroucke. If “labour market policy” is restricted to “*active* labour market policies” (ALMP), aiming at the (re)integration of unemployed workers and at the preservation and enhancement of the employability of the active population, further regionalization *can* indeed make policy more coherent and therefore less costly. Nevertheless, even if ALMP should in principle be regionalized, in practise this involves a number of complications, which, if not resolved, could make the regionalization counterproductive. We will point to a number of these problems. More fundamentally, we argue that, before reflecting on the regionalization of labour market policy, we should first step back and reflect on the optimal design of labour market institutions, independently of the issue of decentralization. Labour market institutions include formal organizations, laws, rules and policies that affect the functioning of the labour market. To our opinion, to overcome the huge demographic and economic challenges that we currently face, a comprehensive reform of these institutions matters much more than the decentralization of labour market policy. Within the limits of this paper, we focus on the design of the employment protection legislation (EPL) and of unemployment insurance (UI). We restrict our attention to EPL and UI because the optimal design of these institutions are directly related to that of ALMP, which lends itself to regionalization. *This does not mean, however, that we regard reforms of other labour market institutions, such as the (early) retirement schemes, wage formation, minimum wages and the regulation of migration flows as less important.*

## 1. A fundamental reform of EPL and UI

The current EPL and UI were set up in an economic environment in which relationships between workers and firms were typically long lasting and stable. The increasing globalisation of the economy and the rapid technological and organisational changes require more flexibility of both workers and firms leading to career paths which are much more volatile both within and between firms. Current institutions must be therefore urgently reformed to reconcile this new need of more flexibility with that of security for workers. The call for “flexicurity” is not new, but there is no unanimity on the corresponding institutional model it implies. In a nutshell, we propose the following guidelines for reform, justified in a companion document (Cockx and Van der Linden, 2009).

Transform the bulk of current advance notice payments into a *unique* lay-off contribution, independently of the type of worker (blue or white-collar) and type of contract (temporary or open-ended). A small severance payment is due to cover the “psychic costs” related to dismissal (defined in the companion document). In order to make the employer accountable for the costs he imposes on society, the lay-off contribution should be made proportional to the cumulative past earnings since the moment that the worker was hired in the firm. This contribution would be used not only to finance a supplement to the current unemployment benefits, but also, as to make the worker more accountable, to finance ALMP for the

unemployed. Aside of this scheme, it makes sense to generalise the current scheme of temporary unemployment benefits for blue-collar workers to white-collar workers, but only to the extent that one introduces “experience rating” in the funding, so that again the employers are made accountable for the social costs that they induce by these temporary lay-offs.

To the extent that the Regional authorities are competent with regards ALMP, the additional funding generated by the lay-off tax can partially be used as an additional funding of Regional policy. However, the Regions should not be funded according to the proceeds of the lay-off taxes (nor on the basis of an indicator of Regional unemployment). Rather, in order to provide correct incentives they should receive a lump-sum amount plus a variable part that is positively related to the *increase* in the employment rate realised within the Region, but negatively to the average increase observed in neighbouring countries. We return to this incentive scheme below.

## 2. *Decentralised labour market policy: principles and difficulties*

The starting point of ministers Marcourt and Vandenbroucke is that labour regulations, wage policy and the funding of Social Insurance and all its branches should remain within the competence of the federal authority. This is completely in line with the arguments expressed in Van der Linden (2008) which we both completely subscribe and which we don't repeat here. Remaining federal does not mean that no reforms are needed but discussing all of them is beyond the scope of this paper (some are developed in Van der Linden, 2008).

Moreover, we agree that it makes sense to transfer a number of competences which currently still are at the federal level, but which logically are part of a competency that has been transferred to the Regional level. These concern essentially ALMP that aim at reintegrating unemployed and inactive workers in the labour market. These include the variety of training and counselling programmes, and intermediation services. An optimal allocation of ALMP can only be realized to the extent that the coherent set of policy instruments are grouped within one authority level. Establishing a precise list of the policies that should be regionalized is beyond the scope of the present paper.<sup>8</sup> To avoid counter-productive effects, this can only be done by considering each policy in turn and by looking very carefully at the implications of decentralization. Then, the same exercise should be made for the group of regionalized policies taken together.

### *Targeted wage subsidies*

More delicate is whether the Regions should be made responsible for the targeted wage subsidies<sup>9</sup> and for the monitoring and sanctioning of job search, of job acceptance behaviour and of mandatory participation in ALMP. We now consider these two groups of policies in turn.

One argues that federal wage subsidies directed to specific target groups should be regionalized, because this allows to accommodate these subsidies to the Regional labour market conditions. An example to support this point of view and that is often repeated in public opinion is that Wallonia and Brussels have a problem of youth employment while the employment rate of older workers is too low in Flanders. The problem would be resolved if each Region could target the wage subsidy according to its needs.

This argument is flawed for at least three reasons. First, as documented in Van der Linden (2008), all regions have a problem of low employment of both youth and older workers (if the *Regional* average is the reference). The difference between the Regions is a matter of

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<sup>8</sup> The position paper of the ministers asks for a complete regionalization of training and educational policies that are up to now still federal. They also mention other policies that should be considered for a regionalization: the ALE/PWA, outplacement, temporary work permits... Even though collective bargaining remains federal, one should maintain a role for social partners in case of a regionalization of these instruments.

<sup>9</sup> Contrary to Vandenbroucke (2008), the position paper of the ministers does not ask for such a reform.

relative importance. Second, if the federal legislation entitles both youth and older workers to targeted wage subsidies, then each Region will benefit from these subsidies in proportion to the number of beneficiaries: in Wallonia and Brussels, there will be proportionally more youth who will be subsidised, in Flanders more older workers. Finally and more fundamentally, one may question whether targeted subsidies to youth and older workers are effective policy tools. It is our opinion that the exclusion of these groups from labour market participation is more linked to other reasons (notably, existing forms of labour market protection, seniority rules in wage ladders and the existing early retirement schemes). We believe that a reform of labour market protection along the aforementioned lines (coupled with a much more restrictive use of early retirement schemes) will be much more effective in integrating these target groups into the labour market.

This does not mean that targeted wage subsidies are not useful at all. In previous research (e.g. Cockx *et al.* 2005a, b) we have repeatedly pleaded for an intensification of the *structural* reduction of employer contributions for low wage-workers in which one could accommodate for the increasing relationship between wages and age (Van der Linden 2005). In addition, we have shown that *temporary* wage subsidies for (young) long-term unemployed workers may be effective. As far as we know, this conclusion cannot rigorously be extended to other demographic groups in Belgium.

If it makes sense to regionalise any subsidy, it would be the *temporary* targeted subsidies.<sup>10</sup> The reason is that this form of subsidy could be regarded as a substitute to other ALMP. Since the latter are already a Regional competence, it makes sense that the Region could decide upon the optimal policy mix it provides. Moreover, to the extent that this competence is limited to the *temporary* subsidies there is less risk of engaging in a fiscal competition between the Regions. This also justifies maintaining the competence of all structural labour cost reductions at the federal level. Note that this implies that we oppose the current possibility of Regions to offer a tax exemption to all employees living in a particular Region (the “jobkorting” in Flanders).<sup>11</sup> This opens the door to fiscal competition. If one believes that such measures are useful, they should be decided upon at the federal level.

### **Monitoring of job search**

We agree with ministers Marcourt and Vandenbroucke that it makes sense to regionalize the monitoring and sanctioning of job search, of job acceptance behaviour and of mandatory participation in ALMP's: (i) the Regional unemployment agencies ("UA's") enter in direct contact with the unemployed and are therefore better informed than the federal UA on the effort is exerted to escape unemployment; (ii) it isn't cost effective, as currently, that these tasks are divided between the two agencies. By the way, Regional UA's can already automatically induce a sanction if the information transmitted to the Federal UI agency is a withdrawal from the register of insured unemployed. Nevertheless, if one assigns the complete responsibility of monitoring to the Regional UA's, then two complications must be resolved. First, there is a risk that the function of counselling and intermediation conflicts with that of monitoring and sanctioning if they have to be realized within the same organization (Van der Linden, 2009). We need not forget that the separation in 1978 of the federal UA into two services resulted from the difficulty of integrating intermediation and monitoring within one service (Palsterman 2003). Second, the Regional UA's will underinvest in both the monitoring and the services they provide to unemployed if they are not financially rewarded for the savings they generate in terms of reduced unemployment benefit payments by the federal UA. This brings us to the proposal of ministers Marcourt and Vandenbroucke to design an appropriate funding scheme that internalises the external benefits of its actions to the federal UA.

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<sup>10</sup> To a small extent, Regions have already implemented their own temporary wage subsidies. Currently, federal temporary targeted subsidies mainly are the so-called activation of unemployment benefits and the temporary reductions in social security contributions (whose importance has been much reduced by the inter-sectoral collective agreement 2009-10).

<sup>11</sup> Recall that for economists it does not matter which side of the market is taxed. Cuts in income taxation can eventually be translated into reductions in the wage cost.

## *Incentive funding*

To the extent that the Regional monitoring activity and their ALMP improve the matching between job seekers and job vacancies and so eventually increases employment, the Regional UA's generate a positive externality on the federal budget. Outlays on unemployment benefits are so reduced and tax receipts increased.<sup>12</sup> It makes therefore sense to reward the Regions for this positive externality. A simple way of realising this objective is to introduce a transfer from the federal authorities to the Regions that is positively related to both the average savings per *full-time equivalent* employed worker and the Regional *full-time equivalent* employment rate. It makes more sense to relate it to the employment rate than to an indicator of the unemployment rate, since this avoids the adverse incentive of rewarding the Regions by pushing unemployed workers into inactivity.

We should refine the incentive pay scheme such that it rewards only changes in the employment rate that are a consequence of the actions undertaken by the Region.<sup>13</sup> Van der Linden (2008) discusses at length the complications of identifying an outcome indicator that correctly reflects the savings generated by the Regional employment policy rather than other factors. Here we follow a more constructive and pragmatic approach by defining a refinement of the above-mentioned indicator that is far from perfect, but that remains relatively simple, while taking a number of essential complications into account.

First, the employment rate is probably more affected by the business cycle than by the Regional policy actions. For instance, without any correction for the current worldwide economic crisis, the incentive pay would sanction all the Regions, even if they were not responsible for the fall in the employment rate. We therefore propose to relate the reward to the difference between the Regional and the average employment rate in the neighbouring countries.<sup>14</sup> Second, the scheme should reward and sanction current and not past policy as to avoid that the scheme would sanction the Regions who did not perform well in the past. Therefore, it's important to normalise the transfer at some negotiated starting date. This implies that for a given employment rate the Walloon Region could receive a higher transfer than the Flemish Region if Wallonia realizes higher employment growth than in Flanders. The scheme could nevertheless take into account that it's more difficult to increase the employment rate by one percentage point if the initial level is higher in one Region than in the other. Finally, some workers living in one Region will find employment in another Region. This raises a complicated question of which Region is responsible for the employment realized in another Region. Is it the sending Region, e.g. by providing appropriate training or search incentives to its unemployed workers? Or is the employment the consequence of the Regional provision of adequate infrastructure and other favourable conditions for employment creation by firms? Since it is difficult to assign a correct weighting for each of the factors, we propose to use an adjusted employment rate in the incentive pay scheme. In the adjusted employment rate the transfer would be calculated such that a worker living in one region and working in the other would contribute for 50% to the employment rate where she lives and for the other 50% to the employment rate of the Region where she works. Obviously, this is a first proposal that may require more reflection before it's implemented.

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<sup>12</sup> The increase in tax receipts currently only affect the Regional receipts to a limited extent.

<sup>13</sup> Note that this incentive pay scheme could be partially financed by the lay-off contribution of the reform mentioned in Section 1. A deep revision of the "trekkingsrechten/droits de triage" is also recommended (Van der Linden, 2008).

<sup>14</sup> An alternative would be to relate it the employment rate of the country. By doing so, the incentive scheme would, however, become a zero-sum game in which the best performing Region(s) would be always be rewarded and the worst performing Regions would be sanctioned. One could imagine, however, that all Regions perform well, in that their policy results in a growing employment rate, even if one region may relatively perform better than the other. Relating the employment norm to the neighbouring countries avoids a zero-sum game, which makes sense in this context, because it's absolute and not relative performance that matters. Note, any aggregate benchmark can suffer from imperfections due to differences in compositions (according to, say, sector of activity or demographic characteristics). Ideally, one should try to correct for these differences.



### 3. Conclusion

To face the challenges induced by the economic and demographic crisis we currently need an ambitious reform of labour market institutions and, in particular, of the employment protection legislation (EPL) for which we provide some guidelines in a companion document (Cockx and Van der Linden, 2009). The reform of EPL is much more important than the decentralisation of labour market policy. This does not mean that decentralization, if properly designed, cannot bring efficiency gains. In this perspective, the joint proposal of ministers Marcourt and Vandenbroucke goes in the right direction. Still, we argued that a number of these gains are uncertain and crucially depend on their precise implementation.

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# A comment on Marcourt and Vandenbroucke's call for action in the interest of economic recovery and social progress

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In my view, this Marcourt-Vandenbroucke (hereafter MV) text is more than welcome. In fact, when I read it in the newspaper in December 2008, I thought it was a real source of hope, after such a long period of immobility in the political debates about institutional reforms that started right after the 2007 elections. The really disappointing news is that things do not seem to have progressed on this front while we are already at the end of March and everybody gets focused on the upcoming regional elections. I fear that the failure to move on the basis of this text constitutes a missed opportunity for all those who would want to convince voters that this country has not become unmanageable. My hope is that political parties will be able to make progress along the lines of the MV text after June 2009.

In terms of substance, I agree with the basic assumptions and main objectives of the MV text, and I also agree with its main proposal.<sup>16</sup> As such, the MV text is understandably short on details in some dimensions, and I will elaborate a bit on these at the end of my comment.

As far as assumptions are concerned, the MV text takes as given the need for institutional reforms in this country, to promote efficiency while maintaining solidarity. I agree with this view, because: (i) there is wide consensus within Flanders about the need for reforms, and this cannot be negated forever if one wants to keep this country together; (ii) of course, in order to obtain an agreement, one also needs to reassure French-speaking Belgium about the maintenance of interpersonal solidarity; and (iii) in turn, this requires credible mechanisms to ensure that federated entities manage to gradually “converge” so that solidarity is not forever unidirectional as far as cross-regional flows are concerned.

The MV text stresses the labour market as first priority. This is quite right, because the main reason for the economic imbalance between our federated entities concerns employment and unemployment rates. If Brussels and Wallonia had the same employment rates as Flanders,<sup>17</sup> there would be no significant “financial transfer” between them any more.<sup>18</sup> Moreover, given that regional labour markets have very different outcomes, it makes sense to think about decentralizing some labour market policies.

Which policies should be decentralized? The MV text argues for keeping labour law, wage setting and welfare state provisions federal, and for decentralizing active labour market

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<sup>15</sup> I thank Antonio Estache for useful comments.

<sup>16</sup> In fact, it is very consistent with proposals put forward in January 2008 by 120 academic economists from all over Belgium: “Reforming the Belgian institutions: Combining flexibility and coordination”; the French version of this text will be republished in a special issue of *Reflète et Perspectives de la Vie Economique* entitled “Wallonie et Bruxelles – Analyses et Enjeux” to appear in April 2009.

<sup>17</sup> Instead of the current rates of around 65% in Flanders versus 55-56% in Brussels and Wallonia.

<sup>18</sup> I leave aside here the issue of whether transfers should be computed on the basis of GNP or GDP, which is crucial to consider the relative “contributions” of Brussels and Flanders.

policies and training. Conceptually, this seems a reasonable balance between efficiency and equity, even if the devil can be in the details here, and labour market experts should be brought in to comment on the fine-tuning of the system.

One question these proposals beg concerns their real expected impact: how much convergence can we hope to obtain if we follow them? This will in fact depend on the resulting actual labour market policies chosen by public authorities. And here the MV text suggests coupling decentralization with an incentive scheme conducive to Governmental “responsibility” so that to insure a “positive return for the regions as well as the federal state”.

This idea makes a lot of sense: all levels of Government should have incentives to tackle much more vigorously our labour market problems.<sup>19</sup> Of course, this is a politically hot issue, and it is maybe not surprising that the MV text is really short on details on this topic. My feeling is that this question should be addressed explicitly, namely with well-defined targets and bonus-malus components in case of deviations with respect to these targets.

Once again, the devils will be in the details. Work needs to be done to make investigate “sustainable scenarios”. Let me just offer here a few remarks:<sup>20</sup>

1. First, on French-speaking side, where concerns exist with respect to such bonus-malus mechanisms, one should consider their benefits in terms of ‘commitment devices’, which will build momentum to focus policies on raising employment rates (just like the Maastricht criteria helped improve the state of Belgian public finances).
2. Second, one should define ‘neutral’ initial employment rate targets,<sup>21</sup> maintaining current solidarity levels, as well as ‘reasonable’ objectives in terms of speed of convergence. These objectives will be the subject of intense political debates, and the same will be true for the size of the bonus-malus in case of deviations from this path.
3. Note that I assume objectives in terms of labour market outcomes, not in terms of policies, since the idea is to decentralize policies. However, one should avoid ‘vicious circles’ in case a region fails to meet its objectives and starts losing money as a result, which may hamper its ability to undertake adequate labour market policies. One may therefore want to consider malusses in terms of obligations to intensify labour market policies rather than in terms of reduced financial resources.
4. Finally, one should limit the randomness of such mechanisms for the regional public finances. This means filtering out as much as possible risks that are beyond the control of policymakers, for example, the current deterioration of employment rates due to the international financial crisis. Since such events typically affect all Belgian regions at the same time, going for some form of ‘relative performance evaluation’ is the natural solution. One should make sure however that the system remains ‘win-win’, namely that every entity (federal and federated) actually benefits financially when employment rates improve in any one region.

Putting together a system which decentralizes active labour market policies and training and incentivizes federated entities is a good way to introduce a commitment device to improve employment rates and thereby make interregional solidarity sustainable. It will moreover also focus political energy on improving education systems, another key issue for employability, especially in Brussels and Wallonia. Designing such an incentive system is not technically

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<sup>19</sup> Of course, the relevant concept in this debate is that of ‘structural underemployment and/or unemployment’, not the big cyclical component of unemployment that we are starting to witness right now because of the financial crisis; this latter one has to be dealt with by macroeconomic policy coordinated at EU and even world level.

<sup>20</sup> These remarks are further developed in an article entitled “Gouvernance francophone « responsable », condition d’une politique socio-économique efficace et solidaire en Belgique?”, to be published in a special issue of *Reflets et Perspectives de la Vie Économique* entitled “Wallonie et Bruxelles – Analyses et Enjeux” in April 2009.

<sup>21</sup> Employment targets are attractive because they are more comprehensive and less ‘manipulable’ than unemployment targets or, worse, long-term unemployment targets.

trivial, but it can be done in a way which is truly “win-win”. It would be politically very desirable if one wants to preserve Belgian solidarity while favouring efficiency.

# Should the setting of wages in Belgium be regionalized?

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Within the debate over the relationship between the structure of wage bargaining and economic performances in Europe, the issue of regional dimension returns in a recurring way. The discussion often relates to the capacity of wage-setting systems to take into account the important economic disparities between regions. Pench *et al.* (1999) support for example that a uniform fixation of wages across regions would not be adapted to local job markets. According to Davies and Hallet (2001), the important regional differences in unemployment observed in numerous European countries are due to the incapacity of the wage-setting systems to take into account the levels of productivity of the least productive regions.<sup>23</sup> The predominance of national industry bargaining, in a large number of European countries, could explain this phenomenon. Accordingly, two types of answers are generally proposed in order to take into account the local environment in the establishment of wages. The first, supported by the European Commission (Davies and Hallet, 2001) and the OECD (OECD, 2006), consists of decentralizing wage bargaining towards the company level. The second, which is at the heart of current negotiations relative to a de-federalization of employment policy in Belgium, consists of regionalizing wage bargaining.

In their joint “call for action and dialogue for economic recovery and social progress”, Ministers Frank Vandenbroucke and Jean-Claude Marcourt clearly indicate that the Belgian wage policy should remain a federal competence. This is an important statement as it implies that wage setting in Belgium should not be regionalized. In what follows, we explain why we share their point of view and suggest alternative ways to increase the sensitivity of wages in Belgium to local (and in particular regional) conditions if it turned out to be necessary.

Partisans for the regionalization of wage bargaining argue that the actual wage-setting system in Belgium (inter-professional agreement, followed by industry agreements, and eventually followed by firm-level agreements) is not flexible enough to take into account the regional differences in productivity. They also indicate that negotiations at the Walloon level would be more sensitive to unemployment and would thus involve lower wages for this region.

To assess whether the setting of wages in Belgium should be regionalized, it is interesting to focus first on other countries’ experience. Within European countries, only Spain and Germany present a regionalized formation of wages. In Spain, Simón *et al.* (2006) note important variations in wages between regions as well as in wages agreed at the industry level as in actual paid wages. They deduce from this that the regional character of industry bargaining allows for a differentiation of wages between regions. However, these wage differences do not seem to fully reflect local conditions because of the phenomenon of inter-regional imitation within one same industry (Bande *et al.*, 2008). In the case of Germany, the regional differences in industry agreed wages are rather weak although wage bargaining is

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<sup>22</sup> The views expressed in this paper are those of the author and do not necessarily represent those of the Central Economic Council.

<sup>23</sup> Other factors such as differences in economic development, labour qualification and the lack of geographic mobility can also cause differences in unemployment between regions. (Davies et Hallet, 2001)

held at the Landers level. The strongly coordinated character of wage bargaining between trade-union confederations and employer associations could explain this situation (Schnabel, 1999). The idea that the level of regional wage differentials depends on the degree of centralisation/coordination of wage bargaining is also supported by Vamvakidis (2008). The latter analyzes the relation between the degree of centralisation/coordination of wage bargaining<sup>24</sup> and the regional wage differentials in 10 European countries between 1980 and 2000. He finds a negative relation between the degree of centralisation/coordination of wage bargaining and the level of regional wage differentials. To sum up, empirical evidence suggests that regionalization of wage bargaining is neither a necessary nor a sufficient condition for generating high levels of regional wage differences. It seems in fact, in this debate, that the regional character of the wage-setting systems brings less than the degree of centralisation/coordination of wage bargaining.

Another way to evaluate the pertinence of the regionalization of wages is to examine potential consequences for Belgium highlighted in recent studies. According to Bogaert (2008), a regionalization of wages would remove the moderating influence of “francophone” unemployment on Flemish wages. This would increase wages in Flanders and, through demonstration, generate similar wage increases in Wallonia. The final result would be a higher increase of wages than in the current federal system. This phenomenon seems to be occurring in Spain where bargaining is already regionalized (Bande *et al.*, 2008). Deschamps (2003) suggests that a regionalization of wage bargaining would also increase the complexity of the system and lead to administrative costs for firms that have production sites in more than one region. Moreover, he argues that a regionalization of wages would pave the way to the regionalization of social security. It would seem incoherent to restrict regionalization solely to wages, and not to total labour costs. Therefore, the contributions to social security, which represent a large part of the total labour costs, would also be regionalized. This could, finally, affect the level of social security spending in the different regions.

Several recent studies have examined whether the current system of wage formation in Belgium is capable of taking into account the regional levels of productivity (Dejemeppe and Van der Linden, 2006; Plasman *et al.*, 2007; Joskin *et al.*, 2008). Their results indicate that the average labour productivity is lower in Wallonia and that regional wage differentials are smaller than regional differences in productivity. Yet, Plasman *et al.* (2008) show that regional wage differentials and regional productivity differences are positively correlated within joint committees<sup>25</sup>. Moreover, their results indicate that this correlation is stronger in decentralized joint committees (whereby company-specific agreements have a significant impact on the wage setting) and in joint committees already sub-divided along a local line (i.e., subdivided in regional sub-joint committees). These results thus suggest that it is the possibility to negotiate wages at the company level and the existence of regional sub-joint committees that allow wages to adapt to regional productivity differences.

Overall, more research is needed on whether wages in Belgium are sufficiently sensitive to local (and in particular regional) specificities (Du Caju *et al.*, 2008; Rusinek and Rycx, 2008). Yet, if it turned out that this is not the case, we would recommend to increase the possibility of negotiating wages at the company level and to facilitate the creation of regional sub-joint committees. This solution would have the advantage of avoiding increasing administrative complexities in joint committees where a more important wage differential is not necessary. Moreover, the decision to increase the weight of company-specific agreements or to subdivide joint committees would be taken by the national joint committees, composed of members close to the reality on the field. In addition, these mechanisms would not only allow to take into account differences between regions but equally differences between provinces, labour pools or companies. Lastly, it is important to keep in mind that

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<sup>24</sup> Measured by the OECD index taking into account the prevailing bargaining level and the formal or informal coordination between trade unions and employers.

<sup>25</sup> Joint committees are permanent bodies at the industry level in which employers' associations and trade unions are represented. Their main task is to oversee the conclusion of industry collective agreements by the organizations represented.

regionalization of wage bargaining could create a higher increase in wages than in the current national system, and could open the path to the regionalization of the social security. In conclusion, it appears that the current system already contains the mechanisms that allow for regional differences in productivity to be reflected in wages. It is therefore not certain that a regionalization of the wage setting system is necessary.

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# Regional Labour Market Policies: Scope and Limits in a Federal State

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## *1. Introductory Remarks*

It goes without saying that labour markets are, much more than any other market, intimately embedded in the overall national institutional framework. This holds in particular for the European continental labour markets, characterized by a relatively high degree of social protection. This fact implies that decentralization or a “regionalization” of labour market policies in a federal setting, motivated by economic efficiency grounds needs to be evaluated by equity considerations. The latter refer to, i.e. the equal treatment of identical citizens in comparable socio-economic situations, including their equal access to social protection. This constraint on the devolution of federal policies inspired the shaping of the federal system in Belgium and in other European post-war federal states.

The close connection between working conditions ( hours, retirement age ... ) , social rights acquired during involuntary inactive spells of time and the entitlement to legal pensions , unemployment benefits and replacement income during periods of illness, necessarily imply a uniform federal legal framework, that is at the heart of the social security system.

Because of the low degree of interregional labour mobility and of the striking and persistent differences between regional unemployment rates, one can hardly perceive the Belgian labour market as one, integrated market in contrast to e.g. the more homogeneous labour market in the Netherlands. This feature inspires the idea to regionalize some aspects of labour market policies in order to deal with the specific regional hard core problems in a more efficient way. Some of these aspects that are actually debated on the political forum will be briefly discussed in the sequel.

## *2. Unemployment Benefits*

### *2.1 Efficiency and Redistributive Aspects.*

Negative shocks hitting all or some regions and resulting in an increase of the unemployment rate(s), can be distinguished according to their transitory or permanent nature. A business cycle downturn hits all regions and represents a transitory negative shock, although its unemployment effect may differ regionally. The specific industrial pattern of a region, e.g. the importance of the car assembly sector and of related suppliers in Flanders, may as a result of a worldwide restructuring, either lead to a transitory period of higher unemployment or to a prolonged distressed regional labour market. The flexibility of the regional labour market, the performance of the regional intermediation agencies and the emergence of new economic activities will make the difference.

It is, from an insurance point of view, efficient to pool social risks due to transitory negative shocks that hit all regions or that are specific for some regions. “*Pooling*” social risks implies a federal insurance system, financed basically by employee and employers’ contributions. On the other hand, permanent negative shocks that cover several business cycles and lead to persistent (or “structural”) high levels of unemployment in some regions cannot be efficiently insured. They therefore call on an interregional redistributive mechanism, organized at the

federal level and sustained by federal subsidies. The redistributive dimension of the unemployment benefit system is deeply embedded in our social security system, although its relative weight in total social expenditure could be reduced by a more efficient organization of labour market policies.

The pure insurance as well as the redistributive dimension of the unemployment benefit system is subject to the well known moral hazard problem at the level of the insured. But due to the specific Belgian situation, created by the 1980 constitutional reform, an additional moral hazard problem arises. Since then, the financing, regulation and sanctioning functions have been maintained at the federal level (with the RVA –ONEM), whereas labour market intermediation, monitoring and training functions have been transferred to the regional Employment Agencies (EA). Because it is not evident that the latter do take the federal insurer's budget constraint into account, an incentive problem may arise at the regional level. Several proposals to increase the accountability of the regional EPs have been put forward in the recent past.

## 2.2 *Incentive Schemes for the Regions*

2.2.1 If the principle of equal access to social protection for the insured in identical situations applies, irrespective of their region of residence or of work place, unemployment benefits should be maintained uniformly across all regions. In addition, the strict adherence to the “*level playing field*” principle for firms implies uniform employers' contribution rates as well.

The difference between the unemployment impact of negative transitory shocks and of permanent ones is to a large extent reflected in the time span of uninterrupted average spells of unemployment. In addition to the impact of these negative demand shocks, regional labour supply characteristics as well as relatively high labour costs- as compared to labour productivity of the job seekers- result in regionally specific pockets of long term unemployed. Young, low skilled unemployed and older (50 +) job seekers fall into this category. But as shown by Van der Linden (e.g. 2008), the unfavourable gap between their acquired skills and their labour costs appears to be more important than their age profile. The common feature of these two groups is their long spell of unemployment, i.e. more than one year. The probability of finding a suitable job drops dramatically to zero after this initial uninterrupted spell of unemployment. Hence, unemployment benefits for these categories are more of a redistributive nature, as compared to the pure insurance dimension of the system.

In view of their large share of the Belgian unemployed population, i.e. 50.4 % in 2007, which substantially exceeds the EU-15 average of 40.5 % for the same year (*Eurostat data*), it is clear that a high priority should be given to them in the active labour market policies (LMP). The striking regional differences (2007 data) of their respective share in total unemployment, reaching about 57 % in the Brussels Capital Region and in Wallonia, as compared to Flanders ( 37,5 %), suggest a regional specific policy mix.

2.2.2 *The most simple incentive scheme* for the long term unemployed could be based on their regional (average) number during a reference period, agreed on by all regions. The economies in terms of benefit expenditure at the federal level would flow to the region in which the yearly average number of long term unemployed decreases on condition that the period of continuous employment exceeds  $x$  months. The transfer in favour of the region should preferably be earmarked, i.e. only used for active labour market policies. If the employment is situated in a region, different from the region of residence, the “*bonus*” could be subject to a sharing rule. Although the derived fiscal gains of an increased regional employment rate exceed the economies in terms of reduced unemployment benefits, the former should remain at the federal level in order to finance its rising ageing costs and the burden of its debt.

Symmetrical to the bonus, a penalty or “*malus*” is conceivable if the regional number of long term unemployed increases substantially in a given year. However, the practical implementation of a penalty system is hindered by the occurrence of unforeseen, regionally specific negative shocks that can be evaluated only *ex post* and that could be subject to divergent interpretations, drawing the incentive scheme into endless discussions.

2.2.3 A preferable and more realistic incentive scheme should be based on *regional overall employment rate targets*, defined over a medium term time span. In this way, the incentive scheme fits into the federal employment policy, aiming at substantially increasing the employment rate in order to cope with the forthcoming ageing issue. The employment rate targets should be conditioned on national growth forecasts translated into regional growth forecasts and their derived employment elasticity. For each year of the forecast period, the federal forecasted economies in terms of unemployment benefits could be allocated to the regions and corrected for *ex post* in a positive or negative sense. The use of employment rate targets over unemployment rate goals, also avoids classification issues of the unemployed decided on by the regional *EA* (e.g. according to their appreciation of suitable job opportunities). Clearly, such an incentive schema should be part of a cooperation agreement between the regions and the federal government and evaluated periodically. In addition, it does not exclude periodical audits of the regional *EA* by the federal insurer (RVA-ONEM) of their performance.

2.2.4. Since the characteristics of the long term unemployed *differ substantially between regions*, regionally specific employment incentives (for the unemployed as well as for the employers) should be allowed for in the framework of the federal budget for *LMP*. But in order to prevent interregional competition between firms for workers in times of labour scarcity, the conditions for granting these incentives, including maximum levels or rates, should be part of an overall federal legal framework. Moreover, it is conceivable to transfer the total budget for *LMP measures* in a reference year, (i.e. exclusive of the federally financed unemployment benefit component and the costs of the *EA*'s services), which amounted to about .89 % of GDP in 2006, (*Eurostat data, categories 2 to 7*) to the regions and make them financially accountable for future increases. In this way, the regions can apply the appropriate active labour market policy mix, within the limits of the cooperation agreement.

2.2.5 A final remark bears on the close link between regional incentives for target groups, e.g. older workers, and the *federal early retirement scheme*. The latter, although overhauled in the so called “*generation pact*”, still invites employers to shed older workers ( 55+ ), which conflicts with incentive schemes designed for this group. An adjustment of the early retirement scheme in view of the ageing challenge would therefore render federal and regional employment policies more efficient and reduce the burden of the redistributive aspects of the unemployment insurance system.

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