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The design of unemployment benefits schedules over the unemployment spell: The case of Belgium

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This paper is prepared in the context of the implementation of the OECD Jobs Strategy in member countries, i.e. the process through which the OECD supports countries in their endeavour to promote good economic and labour market performance in a changing world of work by developing country-specific recommendations and action plans. For more information on the implementation of the OECD Jobs Strategy, please visit: http://www.oecd.org/employment/jobs-strategy.

Summary/Abstract

This note focuses on the design of fair and work-oriented unemployment benefits, with a specific focus on Belgium, a country in which the design of the unemployment benefits system has become the subject of an intense policy debate in recent years. After taking stock of the most recent literature and international policy practices, the note describes the main features of the Belgian unemployment benefit system and proposes a number of policy recommendations that can help to make the current unemployment benefit system more work-oriented and fair across all groups of unemployed.

Résumé (in French)

Cette note se concentre sur la conception d'allocations de chômage équitables et axées sur le travail, avec un accent particulier sur la Belgique, un pays dans lequel la conception du système d'allocations de chômage a fait l'objet d'un débat politique intense ces dernières années. Après avoir fait le point sur la littérature la plus récente et les pratiques politiques internationales, la note décrit les principales caractéristiques du système belge d'allocations chômage et propose un certain nombre de recommandations qui peuvent contribuer à rendre le système actuel d'allocations de chômage plus axé sur le travail et plus équitable pour tous les groupes de chômeurs.

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1. Introduction[1]

1. Public income support programmes for the unemployed aim at protecting individuals against the risk of income loss during joblessness, while maintaining incentives for the unemployed to search for work. In addition, unemployment-benefit systems play an important role for redistribution by reducing income inequality and alleviating poverty. The appropriate design of unemployment benefits should reflect these different policy objectives.

2. This note focuses on the design of fair and work-oriented unemployment benefits, with a specific reference to Belgium, a country in which the design of the unemployment benefits system has become the subject of an intense policy debate in recent years. Much of the debate has focused on the question how work incentives can be supported most effectively along the unemployment spell, with a specific emphasis on the time profile of unemployment benefits (Le Soir, 2018[1]; Baert, 2018[2]). In an effort to strengthen work incentives, Belgium implemented a reform in 2012 that made unemployment benefits decline more strongly over the unemployment spell. In 2018, the government made further proposals to make benefits decrease in value more rapidly over an unemployment spell as part of its Jobs Deal (Ministere de l'Emploi, 2018[3]).

3. As a background, Section 2 of this note takes stock of the most recent literature and international policy practices in relation to the design of unemployment benefits, with a specific focus on their time profile over the unemployment benefit spell. To contribute to the ongoing policy discussion, Section 3 focuses on some of the main features of the Belgian unemployment benefit system and develops policy recommendations that can help to make the current unemployment benefit system more work-oriented and fair across all groups of unemployed.

Box 1.1. Policy recommendations for unemployment benefit reform in Belgium

The Belgian unemployment benefit system provides good protection against income losses during joblessness, but has raised concerns about its ability to maintain strong work incentives during unemployment. There is also scope for further enhancing the overall fairness of the system.

Recommendations to strengthen work incentives

- Adjusting the time profile of unemployment benefits could help, but requires a better understanding of its implications for the behaviour of jobseekers. As a result of a recent reform implemented in 2012, the level of income support over the unemployment spell declines more strongly through the introduction of a number of additional steps. The overall decline is now more similar to that on average in the OECD, but this is achieved through a larger number of smaller steps in Belgium than in most other OECD countries. Recent evidence for Hungary indicates that having fewer but larger steps might strengthen work incentives, while maintaining the same level of overall support. Other recent studies

[1] This paper is prepared in the context of the implementation of the OECD Jobs Strategy in member countries, *i.e.* the process through which the OECD supports countries in their endeavour to promote good economic and labour market performance in a changing world of work by developing country-specific recommendations and action plans. For more information on the implementation of the OECD Jobs Strategy, please visit: http://www.oecd.org/employment/jobs-strategy.

have questioned the idea that declining benefits schedules are optimal altogether. An in-depth evaluation of the 2012 reform could help to inform the optimal design of unemployment benefit schedules over the unemployment spell.

- **Make work pay for low earners.** To strengthen work incentives for unemployment benefit recipients with low previous earnings Belgium, could build on the recent "Tax Shift" reforms by : i) extending the possibility of cumulating unemployment benefits and work income to full-time workers with low-earnings; ii) introducing in-work benefits like the *Earned Income Tax Credit* in the US or the *Prime d'activité* in France.

- **Leverage high unemployment benefit coverage more effectively to improve activation.** Over a third of unemployment-benefit recipients in Belgium are not available for work or are discouraged, i.e. have stopped searching actively. Many of these people are likely to face one or several barriers to employment that cannot be overcome simply through higher search intensity. Their existing link with the public employment services through the UB system must be exploited to provide these workers with tailored support, involving the development of individual action plans to overcome the specific barriers they face related to their work availability (e.g. child-care services), work readiness (e.g. training) and the effectiveness of their job search (e.g. job-search assistance).

Recommendations to enhance fairness

- **Improve the fairness of the unemployment benefit system across income levels.** For some family types and certain income levels, the Belgian unemployment-benefit system produces net replacement rates which increase with previous income. This issue can be addressed by adjusting the existing caps on previous earnings and gross benefits, while taking into account their interaction with the overall tax and benefit system. Alternatively, more substantive changes to the way unemployment benefits are computed could be introduced. For example, the policy replacement rates could be explicitly set to decline with the level of previous gross earnings, or unemployment benefits levels could be computed as the sum of a flat amount plus a (small) fraction of total gross income as for example in France. Compared to the existing mechanism involving multiple and varying caps, these alternative solutions would also simplify the administration of the system and enhance its readability for workers.

- **For the very long-term unemployed, ensure that the system is fair across households with different needs.** Belgium is the only OECD country that offers time-unlimited income support for the unemployed which does not become subject to means-testing after a certain period of time. While unemployment benefits gradually lose their link to previous earnings over the unemployment spell, they converge to a long-term level that only varies across three broad family situations. As a result, long-term unemployed in households with potentially different financial needs receive the same level of income support and in some cases, this level falls short of the amount needed to prevent poverty. To ensure that the long-term level of support for the unemployed reflects household needs more closely, Belgium could set a time limit for unemployment benefits, while allowing the unemployed to move to means-tested social assistance benefits - which are a shared responsibility at the federal, regional and local government financed through general taxation. Alternatively, means-testing could be introduced within the current unemployment benefit system. This would have the advantage that the long-term unemployed can continue to benefit from the stronger activation system that comes with unemployment benefits. Persons who lose their income support as a result of means-testing should remain eligible for activation support by the public employment services.

2. The design of unemployment insurance: Insights from the literature and international policy practice

4. Public income support for the unemployed, either in the form of unemployment insurance or assistance programmes, serve two main policy objectives. First, these programmes protect individual workers against the risk of income loss during joblessness, smoothing consumption between unemployment and employment spells. They can also mitigate the risk of wage losses upon re-employment (compared to the situation before job loss) by allowing for workers to spend more time to find a job that matches their skills and attributes. Second, collective unemployment insurance programmes help ensure a fair distribution of income and contain poverty. The design of unemployment insurance systems, including its role for redistribution, depends strongly on the broader features of tax and benefits systems, and notably that of social assistance.

2.1. Protecting workers against the risk of joblessness and wage losses upon re-employment

5. The optimal level of unemployment insurance depends on the value of consumption smoothing and the cost of providing it in terms of higher unemployment (and higher benefit expenses) and lower employment (and lost revenue) (Chetty, 2008[4]).[2] The latter is often referred to as the moral hazard effect of unemployment benefits and refers to the reduction in job-search intensity of jobless persons and their willingness to accept suitable job offers. The optimal degree of unemployment insurance is likely to depend on several factors, including the duration of unemployment, the state of the business cycle and the broader institutional context. This sub-section focuses on the optimal modulation of unemployment benefits over the unemployment spell. For comprehensive reviews on the design of unemployment insurance, see Krueger and Meyer (2002[5]), Tatsimiros and Van Ours (2014[6]), Schmieder and Von Wachter (2016[7]) and OECD (2018[8]).

The design of unemployment benefits over the unemployment spell has become more controversial as recent empirical evidence has challenged early theoretical insights

6. The OECD has long been concerned about the role of high and long duration unemployment benefits for the work incentives of the unemployed, and particularly those who have been unemployed for a long time (OECD, 1994[9]; OECD, 2006[10]). The OECD Jobs Study of 1994 advocated that unemployment benefits should be temporary, not be overly generous, and declining for longer unemployment durations. Since the Reassessed Jobs Strategy of 2006, the OECD has increasingly emphasised the role of effective activation strategies for preserving good work incentives over the unemployment spell.[3] The Jobs Strategy of 2018 goes further by suggesting not only that effective activation strategies can help overcome any adverse effects of benefit receipt on work incentives, but also that adequate unemployment benefits are needed to ensure that activation policies, based on the threat of benefit sanctions, are credible and effective.

[2] Optimality in the academic literature is based exclusively on risk-aversion (consumption smoothing) and does not take account of inequality aversion even though this does tend to be an important consideration for policy-makers. This issue will therefore be discussed in Section 2.2.

[3] The recommendation of decreasing UB over the spell has been included in the Economic Survey of several countries in recent years, including Portugal (OECD, 2012[25]), The Netherlands (OECD, 2012[26]), Denmark (OECD, 2014[28]) and Finland (OECD, 2018[27]).

7. The rationale for a declining unemployment benefit has traditionally been provided by models that assume that workers are risk-adverse and forward-looking (Hopenhayn and Nicolini, 1997[11]; Cahuc, Carcillo and Zylberberg, 2014[12]). In these models, decreasing unemployment benefits later in the spell has a large impact on flows out of unemployment because it encourages job search among the long-term unemployed as well as among the forward-looking short-term unemployed. In other words, lowering UB for the long-term unemployed brings about a large reduction in the moral hazard cost associated with unemployment benefits. However, lower UBs in the long-term also imply lower income support at a time when workers might value it the most as they progressively deplete any existing assets to smooth consumption. An optimal time profile of the unemployment benefits aims to balance these costs and benefits, while taking into account the effect of any changes on the government budget. Using calibration exercises, these studies generally conclude that unemployment benefits should decline moderately over the spell (Shimer and Werning, 2008[4]). However, these insights have been challenged by a number of recent studies that relax some of the assumptions in these models.

8. A first criticism is that these models assume that the response of the unemployed to changes in UB levels does not vary over the unemployment spell, which may not necessarily be the case in practice. The long-term unemployed might respond differently to incentives than the short-term unemployed because of "duration dependence" and "dynamic selection" (Kolsrud et al., 2018[13]). Duration dependence occurs when the chances of finding employment decline over the unemployment spell either because of skills depreciation or discrimination against the long-term unemployed by employers who take the length of unemployment as a bad signal. Dynamic selection may occur because workers who remain unemployed for longer have lower chances of finding a job irrespective of their search effort. As a result, the elasticity of unemployment duration to changes in UB is likely to decline over the unemployment spell, reducing the moral hazard cost of providing UB to the long-term unemployed. At the same time, the value of unemployment benefit recipiency may increase as unemployed persons deplete their assets as they remain unemployed. Whether these considerations reverse the conclusion that UB should decline over the unemployment spell is an empirical question.

9. Recent evidence for Sweden and Spain suggests that the long-term unemployed are less responsive to financial incentives than their short-term counterparts, weakening the case for declining benefit schedules. In particular, Kolsrud et al. (2018[13]) find that in Sweden the moral-hazard cost of UB decreases sharply along the unemployment spell: the adverse effect of an increase in the overall level of UB on the probability of leaving unemployment is almost entirely concentrated in the first three months of the unemployment spell, while it tends to be small or even negligible for longer durations. Using consumption data, they also find that the value of UB increases over the unemployment spell, as workers deplete resources to support consumption. Overall, these results imply that a switch from the existing flat UB profile to one with increasing UB over the spell would be welfare improving for Sweden. Similarly, Campos, García-Pérez and Reggio (2017[14]) conclude that Spain could improve welfare by making their existing UB profile less declining.

10. A second challenge comes from behavioural economics which suggests that workers behave systematically differently from the way that is assumed in standard models, with potentially important implications for the optimal design of unemployment benefits over the unemployment spell. For example, Spinnewijn (2015[15]) suggests that taking account of the tendency of workers to systematically overestimate their probability of finding a new job ("biased beliefs") provides an argument for less strongly declining or

even *increasing* unemployment benefits over the unemployment spell. This is because workers are less sensitive to future incentives if they do not expect to remain unemployed for long, lowering the moral hazard cost of higher unemployment benefits for the long-term unemployed. However, other behavioural models suggests that the benefits of decreasing UB might be larger than in standard models. This is the case, for example, if workers have "reference-dependent" as opposed to time-invariant preferences, which gradually adjust to changing circumstances (e.g. reduced income and consumption levels). Dell Vigna et al. (2017[16]) argue that in the presence of such preferences, larger declines in UB – even maintaining the overall level of income support over the spell constant – elicit stronger behavioural responses, in terms of job search intensity, resulting in higher outflows from unemployment (see Box 2.1 for further details).

11. In summary, the ongoing debate in the academic literature illustrates that the optimal design of unemployment benefits is ultimately an empirical question. Early theoretical insights point towards a declining profile of unemployment benefits due to the fact that higher long-term benefits discourage job search both among the short-term and the long-term unemployed. However, this view has been challenged by some recent empirical studies which suggest that a richer assessment is needed to characterise the optimal design of unemployment benefit schedules over the unemployment spell. Notably, such an assessment should take account of the possibility that the sensitivity of workers to financial incentives varies over the unemployment spell as well as recent insights from behavioural economics.

Box 2.1. Frontloading unemployment benefits: Evidence from Hungary

In 2005, Hungary implemented a reform that resulted in the frontloading of the unemployment benefits for some workers. In particular, for the affected workers the amount paid over the first 90 days was increased, while that in the subsequent 180 days was reduced and the lower level beyond 270 days left unchanged. The reform therefore resulted in a new step decline at 90 days and a reduced step decline at 270 days.

Evaluations of the reform suggest that the steeper decline in the time profile of unemployment benefits reduced unemployment among the affected workers (DellaVigna et al., 2017[16]) and was revenue neutral despite the initial increase in benefits (Lindner et al., 2016[17]). More specifically, Dell Vigna et al. (2017[16]) find that, following the reform, flows out of unemployment spiked around the 90-day threshold and then converged to their pre-reform levels later in the spell. They further find a reduction in outflows from unemployment after the 270-day threshold. Neither the large spike at the 90-day threshold, nor the decline in the unemployment outflow rate in the period beyond 270 days can be rationalised with standard economic models based on rational agents.

Dell Vigna et al. (2017[16]) explain their findings by pointing at the possibility that workers have "reference-dependent" preferences that adjust over time as circumstances change. In the present context, such preferences imply that workers who become unemployed initially search intensively in an effort to restore income and consumption to the level when working. However, as they get used to the lower level of income and consumption when unemployed, they gradually decrease their job-search intensity. Such preferences can also explain why workers search more intensively immediately before and after the change in UB levels as they try to maintain their consumption constant, but as they grow accustomed

to the new and lower level of income, their search effort decreases again. The same process of habituation can explain the decline in the outflow rate after the 270-day threshold.

All in all, the experience of Hungary suggests that unemployment benefits that decline in larger steps might induce larger flows out of unemployment than a system with more gradually declining unemployment benefits. This does not necessarily imply that the reform was welfare-enhancing since the increase in the outflow rate from unemployment may in part reflect heightened financial distress among the unemployed. The potential benefits of frontloading benefits therefore need to be weighed against the material and psychological cost to workers of larger changes in income.

In practice, almost all countries operate time-limited unemployment benefits, and in several countries, benefits decline before reaching their maximum duration

12. OECD countries have taken very different approaches to the design of unemployment benefit systems, including in terms of the level of income support that is available at different durations of unemployment.

13. In the vast majority of OECD countries initial income support for the unemployed is provided through contributory unemployment insurance systems (UI) in which benefits for eligible job losers are a function of the previous wage. In these systems benefits are typically time-limited, with Belgium being a notable exception (Figure 2.1, Panel A).[4] Two countries, Australia and New Zealand, operate universal unemployment benefits systems that apply from the beginning of the spell providing modest unemployment assistance (UA) benefits to all non-employed persons subject to a means test without any limits to their maximum duration.

14. The maximum duration of unemployment-insurance benefits varies from less than six months in Hungary and Israel to close to three years in Iceland and Sweden. The time-limited duration of unemployment insurance benefits reflects the notion that unemployment insurance can only provide effective protection against temporary income losses associated with joblessness. Those who exhaust the maximum duration of unemployment insurance benefits and who require continued income support typically can fall back on unemployment assistance or generic social assistance programmes whose primary purpose is to alleviate poverty rather than to smooth consumption (see next sub-section). Only three countries (Italy, Chile and Turkey) do not offer some form of assistance to the long-term unemployed.

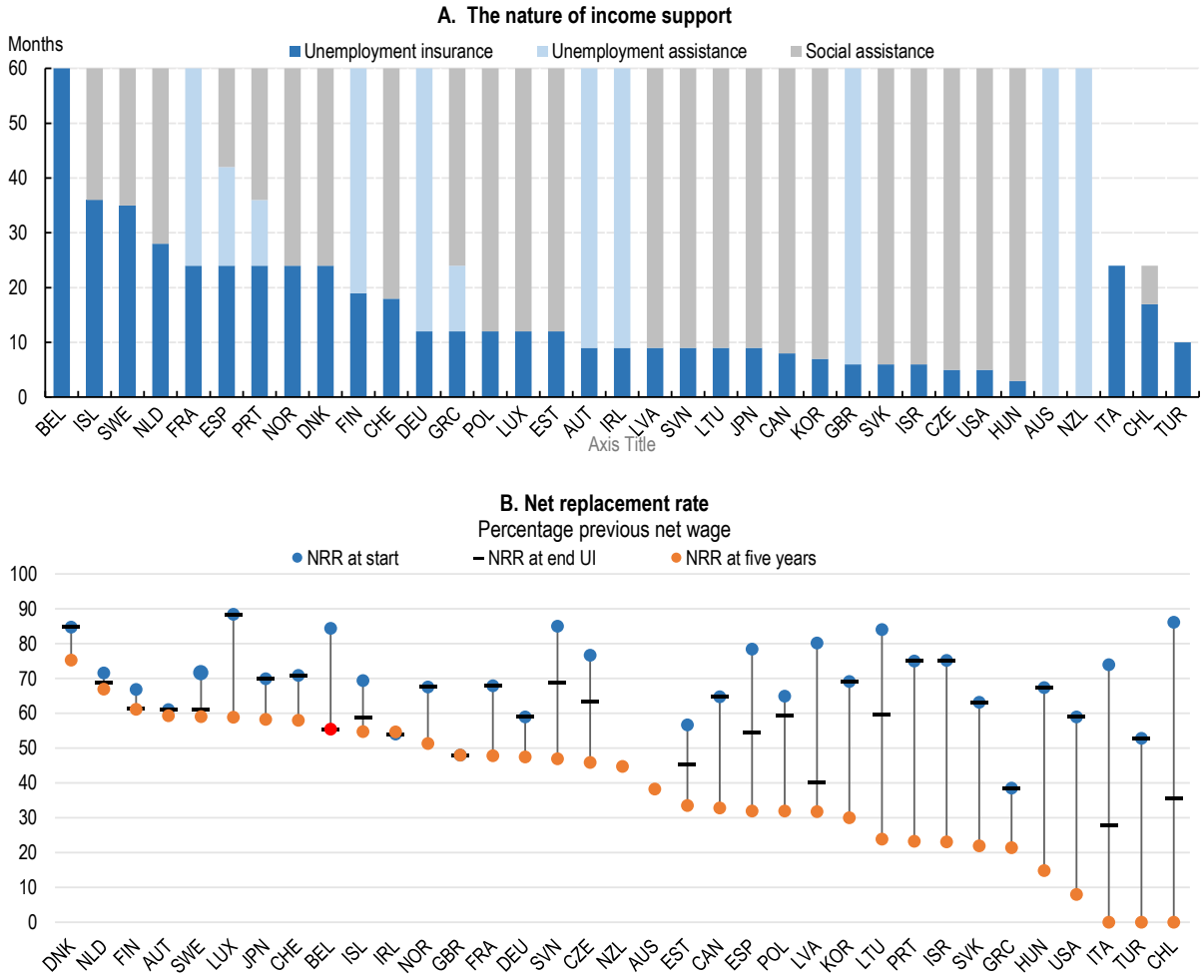
15. In countries with unemployment-insurance systems, unemployment benefits may be constant over the unemployment spell or declining, but never increase (Panel B of Figure 2.1).[5] In almost two-thirds of OECD countries, unemployment-insurance benefits are constant over the unemployment spell (the NRR at start and NRR at end UI is the same). These include several countries with relatively short maximum durations such as Japan,

[4] Throughout the analysis in this note net replacement rates are computed for low-paid individuals (i.e. with previous earnings equal 67% of the average wage), who are generally among the main beneficiaries of unemployment benefits. Sections 2.2 and 3.2 discuss issues regarding the distributional aspects of unemployment benefits and how they vary across income levels.

[5] Some countries have waiting periods before the newly jobless person can claim UB. In those cases, the effective schedule of UB is indeed increasing.

Korea, Slovenia and Hungary.[6] In countries with declining unemployment-insurance benefit schedules, initial net replacement rates[7] are often higher than in most other countries. Among these countries, Belgium, Chile, Latvia, Lithuania, and Slovenia stand out as the ones with the highest initial net replacement rates. In all countries the transition from unemployment insurance to unemployment assistance or social assistance leads to a decline in net replacement rates. Hence, even in countries with constant UI benefits such as Austria, France, Germany and Portugal, the level of support for the unemployed declines over time.

Figure 2.1. Only some countries have declining benefit schedules, but almost all have limited maximum durations



[6] Since Australia and New Zealand rely exclusively on unemployment-assistance benefits, unemployment benefits are constant.

[7] Net replacement rates express the net household income while unemployed as a proportion of the net household income while employed. Crucially, they take into account the role played any part of the tax and benefit system that can complement UB systems in providing support for the jobless. Importantly, this includes any social assistance programmes that countries other than Belgium might rely on to support the long-term unemployed.

Note: For a 40 years-old single with 21 years of contributions history and previous earnings equal to 67% of the average wage. Panel A: Unlimited durations are shown as 60 months.
Source: OECD Tax-Benefits Models, http://www.oecd.org/els/soc/benefits-and-wages/

2.2. Promoting a fairer distribution of income and tackling poverty

16. The discussion above focuses primarily on the trade-off between insurance and moral hazard, but leaves aside considerations related to redistribution for the design of the unemployment insurance system. However, OECD-style public unemployment insurance systems typically entail significant redistribution, as a result of the pooling of risks across individuals, and usually also by design, through the determination of unemployment benefits or contribution requirements (Immervoll and Richardson, 2011[18]). Importantly, given the present focus, equity considerations can also play an important role in shaping the schedule of out-of-work benefits over the unemployment spell.[8]

To some extent, redistribution within UI systems reflects the need for risk pooling

17. Since workers differ in the risk of job loss, collective unemployment insurance systems that pool risk across workers necessarily involve some degree of redistribution from workers with a low risk of unemployment to worker with a high risk. For example, OECD (2015[19]) finds that the risk of unemployment is strongly concentrated among a relatively small group of workers with low life-time earnings. This means that a majority of workers contribute more to the system in the form of social security payments than they get back in terms of unemployment benefits, while a minority receive considerably more in terms of benefits than they contribute. The large majority of OECD countries operate collective unemployment insurance systems that rely to a greater or lesser extent on risk pooling. [9]

18. Some risk pooling is needed to provide workers with effective protection against the risk of joblessness. A system of unemployment insurance without risk pooling would have to be based on mandatory self-insurance, for example individual unemployment savings accounts (IUSAs). However, self-insurance is unlikely to provide adequate protection to vulnerable workers due to frequent or long-lasting spells of unemployment, which quickly exhaust savings and may raise required premiums to unfeasible levels. Chile operates a UI system that combines IUSAs with a small collective UI system to provide income support to job losers who have no or insufficient savings in their individual savings accounts. This helps to mitigate the main limitations of self-insurance, but the level of income protection afforded to the most vulnerable remains often inadequate (OECD, 2019[20]).

In many cases, redistribution reflects explicit policy choices

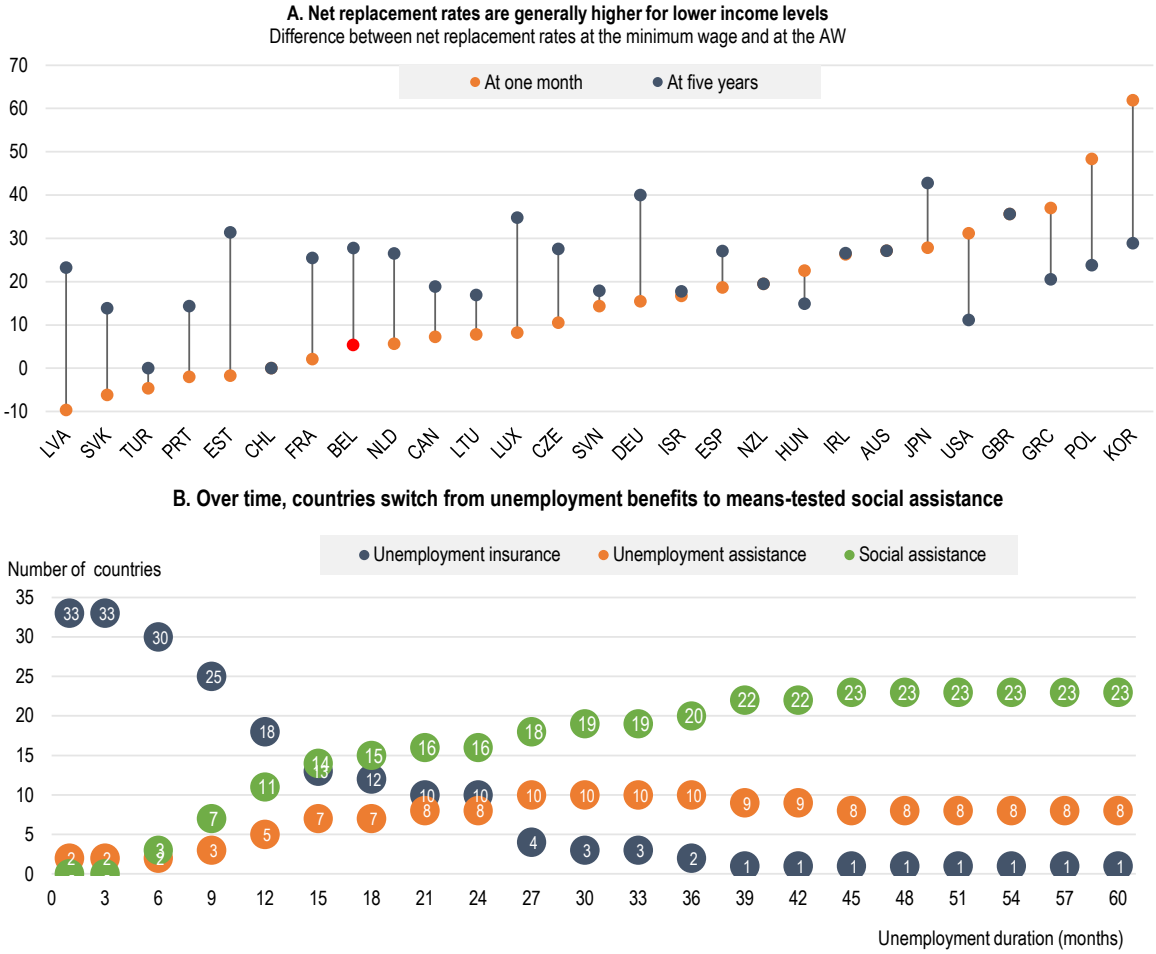
[8] The presence of redistribution, whether as a result of risk pooling or explicit policy choices, explains why public unemployment insurance schemes tend to be mandatory. Redistribution by its nature necessarily implies that net replacement rates differ across individuals and are higher for individuals at limited risk of unemployment. If participation to UI is voluntary, this could induce high-risk workers to self-select into UI and low-risk to opt out, making it financially unsustainable (adverse selection).

[9] Schemes intended for specific subgroups are often voluntary and often run into problems with adverse selection since persons with a higher risk of unemployment are more likely to join (OECD, 2019[20]).

Support for the unemployed is often explicitly targeted towards those with lower earnings. Indeed, in all countries except Latvia, the Slovak Republic, Portugal, and Turkey, initial net replacement rates are higher for workers with previous gross earnings at the minimum wage than for those with previous earnings equal to the average wage (Figure 2.2, panel A). Differences in net replacement rates across income levels can be the result of floors or ceiling on unemployment benefits that exist in many countries and/or the interaction of gross unemployment benefits with other elements of the tax and transfer system (e.g. progressive income taxation, differences in social security contributions, the tax treatment of unemployment benefits). Benefit floors generally guarantee a certain minimum level of income, whereas ceilings can be in place because the value of insurance is considered lower for higher levels of income – in which case both benefits and contributions are capped - or to reduce costs. In most OECD countries, and most notably in Belgium, Estonia, France, Germany and Latvia, the degree of targeting towards workers with low previous earnings grows stronger over the unemployment spell. This generally reflects declining ceilings since floors tend to be constant.

19. Another element that increases the level of targeting towards lower-income workers over the unemployment spell is the shift from unemployment benefits to means-tested assistance programmes that are not linked to previous earnings. In the first six months of the unemployment spell, more than 30 OECD countries offer unemployment insurance linked to previous earnings (Figure 2.2, Panel B). After three years of unemployment, however, only one country – Belgium – continues to offer unemployment insurance, while the others offer some form of means-tested assistance which might be specifically targeted to the unemployed (unemployment assistance) or not (social assistance). Even in Belgium, however, the long-term level of unemployment benefits, while not means-tested, is a fixed amount independent of previous earnings (see Section 3). Hence, over the longer term, all OECD systems become more strongly targeted towards low-income earners, indicating a switch in policy objective from consumption smoothing to poverty alleviation.

Figure 2.2. Most unemployment benefit systems are redistributive by design



Note: For a 40 years-old with a "long" contribution history and previous earnings equal to the average wage. Panel B: In Poland, social assistance after 12 months consists of housing benefits only. Data refer to 2018 except for Chile (2016).
Source: OECD Tax-Benefits Models, http://www.oecd.org/els/soc/benefits-and-wages/

Redistribution not only promotes equity but may also enhance efficiency

20. As discussed in Section 2.1, the optimal design of unemployment benefits depends crucially on the balance of costs and benefits. To the extent that the costs of UI in terms of moral hazard are higher for low-risk high-income individuals and the benefits of consumption smoothing lower, some redistribution beyond just risk-pooling can be efficiency enhancing. Evidence for France indicates that the adverse impact of unemployment benefits on job search tends to be stronger for medium to high skilled workers than for low skilled workers (Dormont, Fougère and Prieto, 2001[21]). This may reflect the possibility that more skilled workers typically have more and better job opportunities and hence more leeway in deciding when to exit unemployment. Similarly, it seems plausible that workers at a lower risk of unemployment or with higher earnings have more wealth or have better access to finance and therefore are better positioned to smooth consumption during spells of unemployment. Consequently, redistribution not only contributes to equity, but may also promote efficiency. [10]

[10] The argument made here is very similar to that by Kolsrud et al. (2018[13]) for the shape of unemployment benefits over the unemployment spell in the presence of dynamic selection.

3. The unemployment benefit system in Belgium: A diagnosis and considerations for reform

21. The Belgian unemployment system is the subject of an intense policy debate. In 2012, the country implemented a reform that made UB generally more declining with the aim of increasing work incentives, consistent with the insights from the early economic literature on the optimal timing of UB and past recommendations by the OECD (see Section 2.1). The last government has made proposals to go further along these lines (Ministere de l'Emploi, 2018[3]). To contribute to the ongoing policy discussion, this section focuses on some of the main features of the Belgian unemployment benefit system and considers potential policy options to boost its ability to activate the unemployed and further enhance the fairness of the system.

3.1. Strengthening work incentives

22. One key concern relates to the potential adverse impact of the unemployment insurance system in Belgium on work incentives, particularly those who have been out of work for a long time. This sub-section discusses a number of key features of the current unemployment benefit system in Belgium that are relevant for the debate on work incentives and puts forward a number of possible avenues for reform that may help to strengthen them, while maintaining strong levels of income support for the unemployed. These include the design of the unemployment benefits schedule over the unemployment spell; a shift in emphasis from out-of-work to in-work benefits; and more effective activation policies.

The level of income support for the unemployed declines more slowly and gradually over the unemployment spell than in other OECD countries

23. Net replacement rates (NRR) for low-paid workers are higher at the start of the unemployment spell in Belgium than on average in the OECD, with the difference growing over the unemployment spell (Figure 3.1).[11] The faster decline of the net replacement rate on average in the OECD reflects to some extent the switch towards lower means-tested benefits after the maximum duration of unemployment-insurance benefits, whereas in Belgium time-unlimited unemployment benefits maintain their dependence on previous earnings for a relatively long time.[12] Compared with neighbouring countries, which also have long-lasting unemployment benefits, the long-term NRR in Belgium do not stand out as particularly high. [13] This result, however, does not hold for all family types. In fact, compared to those in neighbouring countries, long-term NRR in Belgium are higher for

[11] The conclusion that NRR are higher in Belgium than on average across the OECD holds for each of the six family types underlying the average presented in this figure.

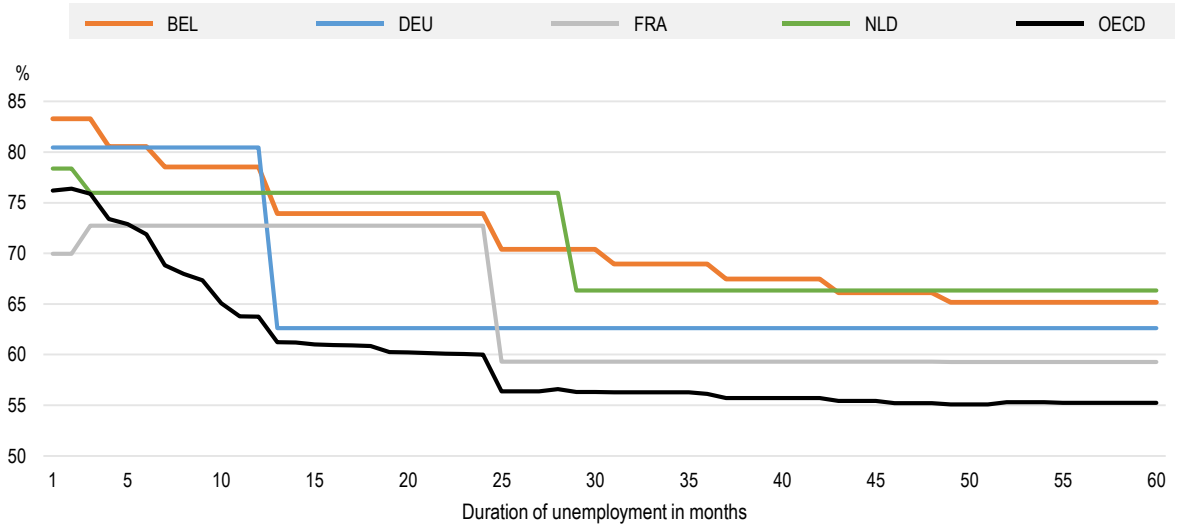
[12] As discussed in Box 3.1**,** the size and number of steps down in Belgium depends on the workers' working history. In the long-term, it converges to a fixed amount, which is independent of previous earnings. For workers with shorter working histories, unemployment benefits converge to the long-term level more quickly.

[13] The relative generosity of the Belgian system in the long-term increases when housing benefits are excluded from the computation of the net replacement rates.

dual-earner couples (with or without children) and for singles with children, but lower for one-earner couples (with or without children) and singles without children.

24. The decline of unemployment benefits over the course of the unemployment spell has long been a feature of the Belgian system, but a reform implemented in 2012 extended the number of workers facing declining UB schedules and made the decline steeper (see Box 3.1). The main objective of the reform was to increase work incentives for the unemployed, based on the rationale that forward-looking agents will search for jobs more intensively when they expect a decline in their UB income in the future (see Section 2.1). Nevertheless, even after the 2012 reform, the level of income support in Belgium declines more slowly and more gradually than in other countries over the unemployment spell (Figure 3.1).

Figure 3.1. Net Replacement Rates in Belgium are higher than the OECD average particularly in the long-term



Note: The indicator is the ratio of net household income during a selected month of the unemployment spell to the net household income before the job loss. Averages over six different family types (single parents, one- and two-earner couples, with and without children), with previous earnings equal to 67% of the average wage. Adults are aged 40. Data refer to 2018. Chile is not included in the OECD unweighted average.
Source: OECD Tax-Benefits Models, http://www.oecd.org/els/soc/benefits-and-wages/

Box 3.1. The 2012 reform

In 2012, Belgium implemented a reform of the UB system that extended the number of workers facing declining UB schedules and made the decline generally steeper. For many workers, this was achieved by increasing the gross replacement rate for the first few months (from 60% to 65% of recent earnings), while decreasing the effective replacement rates later in the spell. The exact speed of decline depends on individual circumstances, namely the family type (i.e., single, in charge of a family, cohabiting), the work history of the unemployed and previous earnings.

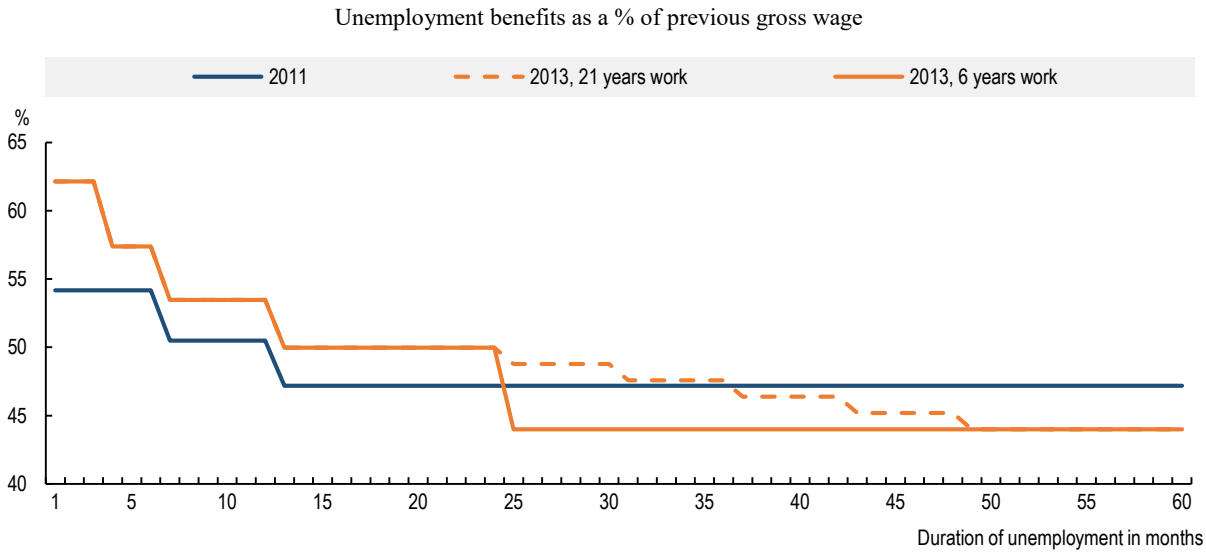
The reform made the long-term level of UB independent of previous earnings, therefore moving towards a system aiming to provide a minimum level of income over the long-term, rather than smoothing income variations per se. This is in line with the practice in many other countries where workers fall back on unemployment-assistance or social-assistance programmes once their entitlement to UB runs out. However, such benefits are generally means-tested, whereas the long-term level of benefits in Belgium is not.

Figure 3.2 illustrates the main implications of the reform using a specific example. The figure shows the evolution of UB levels (as a fraction of previous gross wages) over 60 months (before and after the reform) for a worker on low pay (67% of the year-specific average wage) who is the sole earner of a couple with two children. The Figure considers two work history profiles: a worker with 21 years of contributions and one with 6 years.

Following the reform, the convergence of unemployment benefits to their long-term level is slower the longer the work history of the recipients. Before the reform, regardless of the work history, the UB settled at its long-term level at 12 months. After the reform, both workers receive higher UB in the short term, but they also face more frequent changes (at 3, 6 and 12 months). Eventually, for both work histories, the UB converges to the same level, but the speed of this convergence is faster the shorter the work history. In this example, the worker with 6 years of contributions reaches the long-term rate at 24 months, while that with 21 years does so much later and only after a series of steps.

These examples are illustrative of how the 2012 reform made the time profile of UB steeper, although the magnitude of the changes relative to the situation before the reform varies depending on the workers' characteristics. Proposals put forward by the last government aim to further increase the steepness of the time profile of UB for all workers.

Figure 3.2. The effect of the 2012 reform on the UB schedule over time



Note: For worker on low pay (67% of the year-specific average wage) who is the sole earner of a couple with two children.

25. Indeed, in comparison with its neighbours, Belgium stands out as the only country where net replacement rates decline in a series of small successive steps. During the first year, the policy replacement rate shows a series of small downward steps at 3, 6 and 12 months. Beyond the first year, the number and size of downward steps depend on the work history of the person. Table 3.1 shows that among all OECD countries, Belgium is the country with the largest number of changes in the net replacement rate (between 3 and 60 months) and one of the countries with the smallest average size of these changes.[14]

[14] The table refers to a worker with 6 years of work experience, but, as discussed in Box 3.1 workers with a longer work history face an even larger number of smaller steps in Belgium.

Table 3.1. Maximum and minimum replacements rates

	Replacement rate at 3 months	Replacement rate at 60 months (minimum)	Time when the minimum is reached	Number of changes	Change in p.p.	Average change in p.p.
Australia	58.2	58.2	1	0	0.0	-
Austria	78.7	61.0	8	1	17.8	17.8
Belgium	**83.3**	**65.2**	**49**	**5**	**18.1**	**3.6**
Canada	75.9	56.3	9	1	19.6	19.6
Czech Republic	71.8	59.0	7	3	12.9	4.3
Denmark	89.3	63.0	25	1	26.3	26.3
Estonia	67.8	52.6	10	2	15.2	7.6
Finland	79.8	71.9	22	2	7.9	3.9
France	72.7	59.3	49	2	13.4	6.7
Germany	80.4	62.6	13	1	17.8	17.8
Greece	59.0	38.2	25	2	20.8	10.4
Hungary	76.3	31.1	4	1	45.2	45.2
Iceland	84.1	66.8	37	4	17.3	4.3
Ireland	70.5	64.9	10	1	5.6	5.6
Israel	63.8	46.6	4	1	17.2	17.2
Japan	82.2	70.8	5	1	11.4	11.4
Korea	77.3	52.5	6	1	24.8	24.8
Latvia	74.1	50.2	10	3	23.9	8.0
Lithuania	87.7	51.5	10	3	36.2	12.1
Luxembourg	91.0	67.4	13	1	23.5	23.5
Netherlands	76.0	66.3	6	2	9.7	4.8
New Zealand	60.7	60.7	1	0	0.0	-
Norway	83.9	65.7	25	1	18.2	18.2
Poland	66.8	59.7	13	2	7.1	3.5
Portugal	80.6	46.0	19	4	34.6	8.6
Slovak Republic	70.5	41.1	7	1	29.4	29.4
Slovenia	81.0	68.7	7	2	12.3	6.1
Spain	79.7	45.4	39	3	34.3	11.4
Sweden	80.7	63.4	43	3	17.3	5.8
Switzerland	79.5	67.2	19	1	12.3	12.3
Turkey	60.3	17.0	11	1	43.3	43.3
United Kingdom	60.8	58.3	10	2	2.5	1.3
United States	65.4	28.5	49	3	36.8	12.3

Note: 25 year-old adults, average across family types: single parents, one- and two-earner couples, with and without children.
Source: OECD Tax-Benefits Models, http://www.oecd.org/els/soc/benefits-and-wages/

26. Recent evidence (see Section 2.1) suggests that in systems with declining UB over the unemployment spell, having fewer but larger steps (even while maintaining the long-term level of UB unchanged) might increase job-search intensity and reduce unemployment (DellaVigna et al., 2017[16]).[15] Other recent studies, however, have questioned the idea that declining benefits schedules are optimal altogether. These studies highlight in particular

[15] See Box 2.1 for a summary of this and related literature.

the need to understand how individuals respond to variations in income and work incentives at different points of the unemployment spell for evaluating the social desirability of potential reforms in the time profile of benefits.

27. The implementation of the 2012 reform in Belgium could provide a fruitful case study to gain fresh insights in the optimal design of unemployment benefits over the unemployment spell and provide an important input for the policy debate in Belgium and other countries with long-lasting benefits such as France, the Netherlands and Sweden.

A shift in emphasis from out-of-work to in-work benefits could help to strike a better balance between income adequacy and work incentives

28. Relative to other OECD countries, Belgium features high levels of income adequacy, i.e. high level of net household income as a share of the corresponding median income, after accounting for differences in household needs resulting from differences in household composition, but also potentially weak work incentives Figure 3.3. Unemployment benefits in Belgium usually prevent the jobless and their families from becoming poor by ensuring that net household incomes remain well above half of median income at all unemployment durations and for most family types.[16]

29. The flipside of relatively generous income support for the jobless (for most family types) is that work incentives tend to be relatively weak. As of January 2018, the participation tax rate, the share of additional earnings from work that is lost due to reduced benefits and increased taxes for workers with low wage (in previous and new job), was 82% after 3 months and 66% after 4 years of unemployment, higher than the OECD averages of 70% and 48%, respectively. These figures refer to a typical worker who lost a low-paid job and obtains another low-wage job with the same salary after having been unemployed for some time. They do not take account of the possibility that re-employment wages tend to be lower.[17] Neither do they take account of the 2016-2019 "Tax Shift" reforms that were implemented after January 2018.

30. The comparison with neighbouring countries suggests that there might be scope for Belgium to reduce work disincentives while maintaining or even increasing the current level of income support.[18] For example, 48 months into the unemployment spell, the Netherlands offers approximately the same level of income support as Belgium, but with lower participation tax rates. Germany, on the other hand, has broadly similar participation tax rates, but a higher level of income support.

31. Building on the 2016-2019 "Tax shift" reforms, Belgium could consider a number of additional measures to strengthen work incentives further. One option is to extend to full-time workers with low earnings the possibility to cumulate unemployment benefits and income from work, building on the existing scheme for part-time workers (*Allocation de*

[16] As discussed in Section 3.2, there are some notable exceptions.

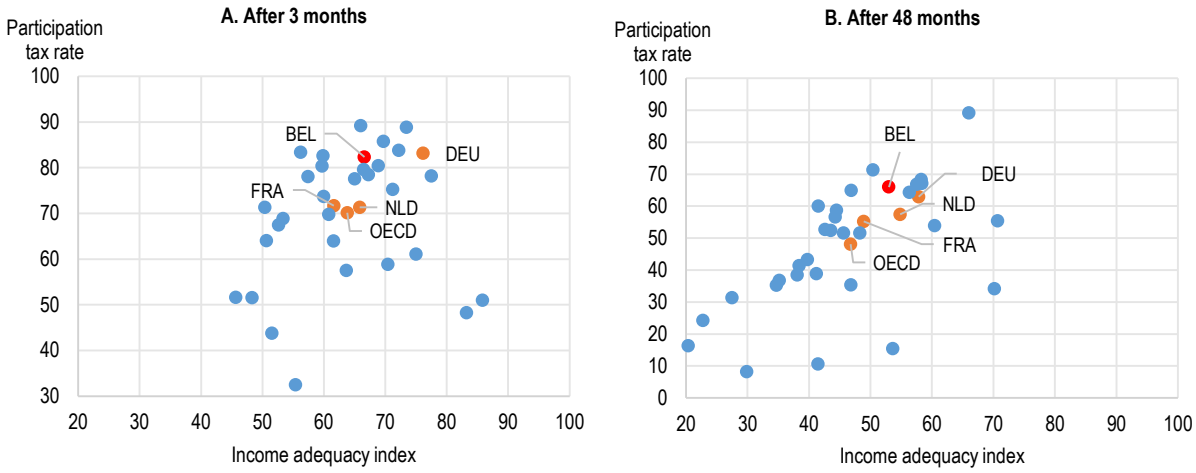
[17] There is considerable empirical evidence that re-employment wages tend to be considerably lower after job loss and that the wage losses upon re-employment tend to be larger for workers experiencing longer spells of unemployment (Jacobsen and Sullivan, 1993; OECD, 2013). Wage losses upon re-employment may reflect the role of skills depreciation over the unemployment spell, employer discrimination against the long-term unemployed as well as the economic context more generally.

[18] Apart from differences in the tax and benefits system, the position of countries may also reflect differences in market income inequality (i.e. before taxes and benefits).

Garantie de Revenus, AGR, or *Inkomensgrantieuitkering*, IGU). Alternatively, Belgium could consider the introduction of in-work benefits, like the long-standing *Earned Income Tax Credit* in the US or the *Prime d'activité* in France (Carcillo et al., 2019[22]). In each of these cases, it is important to make sure that these measures are sufficiently well targeted at low-wage workers, both to limit their fiscal costs and to reduce the risk that employers capture some of these benefits. To the extent that wage floors – whether in the form of the statutory minimum wage or collectively agreed sectoral wage floors – are binding for low-wage workers the risk that firms capture the benefits of well-targeted make-work-pay measures through bargaining is limited in Belgium. The shift in emphasis from out of work income support towards supporting those in work – initiated by the recent Tax Shift reforms - is consistent with the recent trend that is taken place across the OECD (Causa and Hermansen, 2017[23]).

Figure 3.3. Belgium has high levels of income support and high participation tax rates, particularly later in the employment spell

Averages across six family types, 2018



Note: Averages over six different family types: single parents, one- and two-earner couples, with and without children. Data refer to 2018. Chile is not included in the OECD unweighted average.
Source: OECD Tax-Benefits Models, http://www.oecd.org/els/soc/benefits-and-wages/.

Leverage high unemployment benefit coverage to reach out to benefit recipients and tackle employment barriers

32. Unemployment benefit coverage in Belgium is high by OECD standards (Panel A of Figure 3.4). UB coverage among the unemployed was over 60% in 2017, the third highest in the EU after Finland and Germany and more than double the EU average. UB coverage is high for all durations of unemployment, including the long-term unemployed (Panel E of Figure 3.4).[19] While the time-unlimited duration of unemployment benefits

[19] Coverage among the unemployed for less than 6 months is 50% in Belgium vs 32% in the EU, for those with duration between 6 and 12 is 60% versus 37% and for the long-term unemployed is 70% versus 27%. Germany and Finland have higher or very similar coverage rates to Belgium for all unemployment durations.

certainly plays a role in explaining the overall high coverage, the fact that coverage is relatively high at all durations suggests that other factors play a role as well.[20]

33. Relatively lenient job-search requirements, particularly in terms of availability to work, [21] most likely play an important role in explaining the high coverage level (OECD, 2018[24]), especially among the inactive.[22] In fact, in Belgium, 11% of the inactive receive unemployment benefits versus 4% on average in the EU (Figure 3.4, Panel A). Over 70% of inactive UB recipients, about a quarter of all UB recipients in Belgium, are not readily available for work Figure 3.4, Panel D). The other 30% are "discouraged" workers who are available to work but are not actively searching. These discouraged workers are likely to have experienced disappointing rewards from previous search efforts. Both groups of inactive benefit recipients are likely to require tailored support, involving the development of individual action plans and the regular monitoring of efforts undertaken to regain employment, to overcome barriers to employment to increase their work availability (e.g. child-care services), work readiness (e.g. training) and the effectiveness of their job search (e.g. job-search assistance).

34. Finally, coverage is also high among the employed, with 4.3% receiving UB versus 0.8 % on average in the EU. This largely reflects part-time workers who can in some cases combine partial unemployment benefits (*Allocation de Garantie de Revenus, AGR,* or *Inkomensgrantieuitkering, IGU*) and work. These benefits ensure that working part-time yields a net income that is equal or higher than full unemployment benefits.

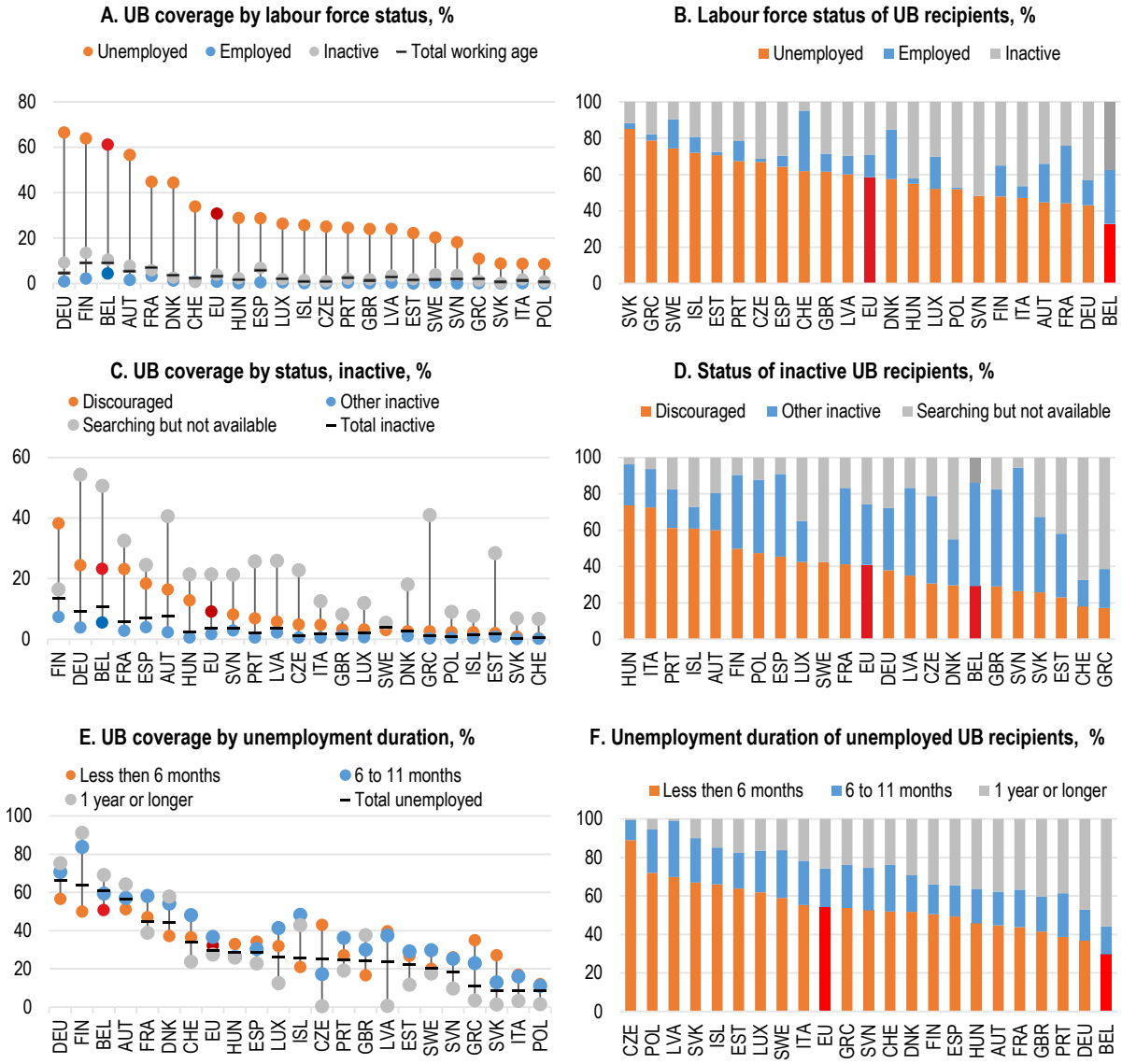
[20] Since minimum contribution requirements are relatively high by OECD standards, this also does not account for high coverage (OECD, 2018[24]).

[21] Belgium (alongside the United States) appears to have the most lenient availability requirements among OECD countries according to Immervoll and Knotz (2018[29]). These criteria determine under which circumstances claimants can restrict their availability to work without losing their right to benefits. The availability indicator is combined with two others ("Job search and monitoring", and "sanctions") to obtain an overall indicator of the strictness of job search requirements. For this overall indicator, Belgium has the 13th lowest score among the 39 countries considered in Immervoll and Knotz (2018[29]).

[22] Inactive people are those who are not working at all and are not available or looking for work either.

Figure 3.4. Belgium has high unemployment benefit coverage

Unemployment benefit coverage by labour force status and unemployment duration, 2017



Source: European labour force survey (EU-LFS).

3.2. Enhancing the fairness of the unemployment insurance in Belgium

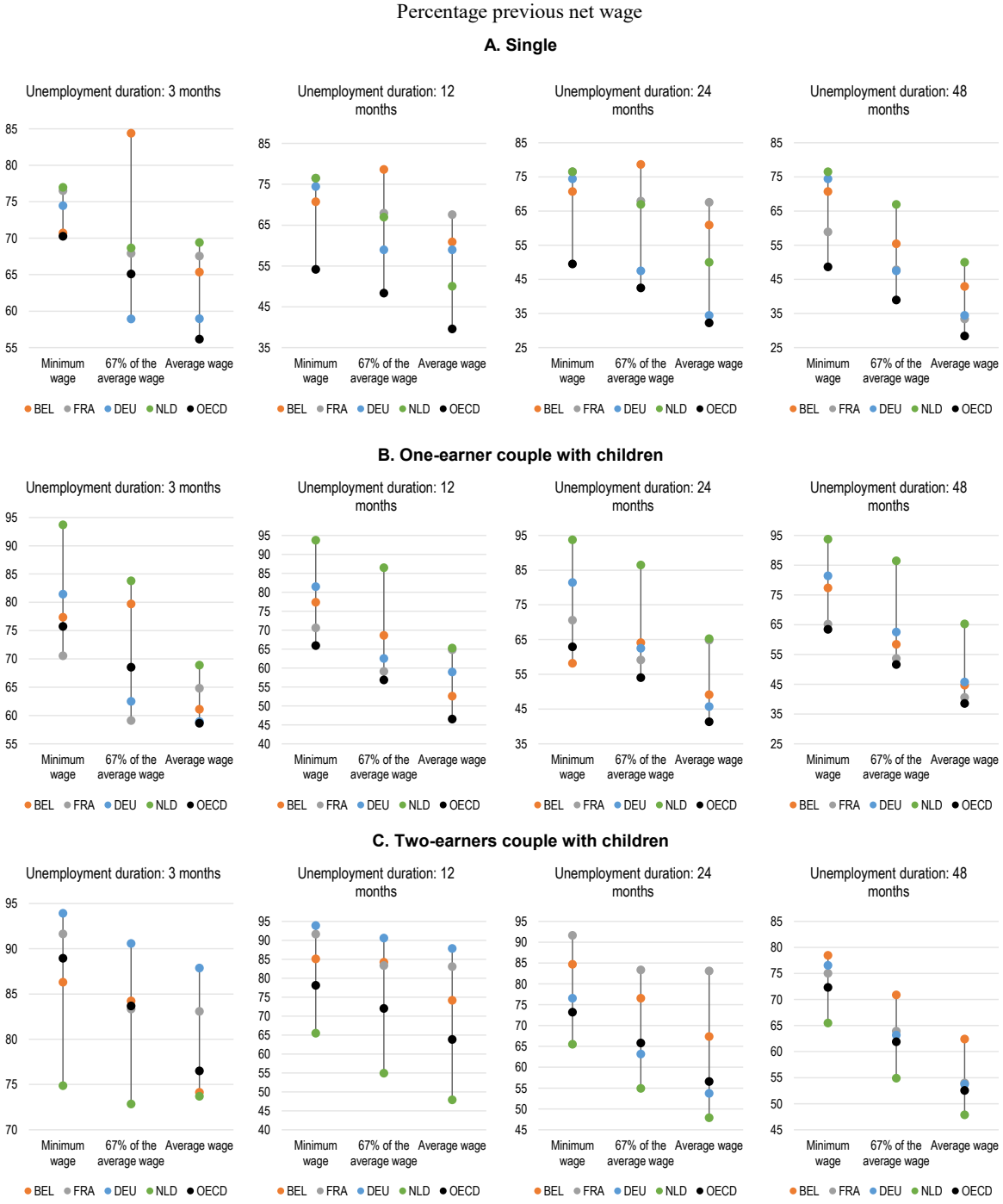
35. As discussed in Section 2.2, in all OECD countries unemployment benefit systems have an important redistributive component, and as such, play a potentially important role for containing excessive inequality and alleviating poverty. This is also the case of Belgium. Nevertheless, there are some aspects in which the fairness of the system could be improved further. This sub-section focuses on fairness across previous earnings levels as well as household types.

Improve the fairness of the unemployment benefit system across previous income levels

36. In Belgium, unemployment benefits are generally progressive across previous earnings levels, and more so at longer durations of unemployment (Figure 2.2), but not for all family types or not to the same extent (Figure 3.5). For example, the NRR for a single person with previous earnings equal to the minimum wage is lower than that of a single person with previous earnings equal to 67% of the average wage (Panel A). An analysis by the Belgian Federal Ministry of Labour suggests this is an issue more broadly as NRR appear to increase with income over a wider range of income levels than considered here for several household types (Ministere de l'Emploi, 2018[3]).

37. This sort of regressivity in NRR in Belgium is not due to the design of gross policy replacement rates, but rather their interaction with other elements of the tax and benefits system. One way of addressing this - without changing those other aspects of the tax and benefit system– is to adjust the existing caps on unemployment benefits or the level of previous earnings for the calculation of benefits. Alternative ways of ensuring relatively more generous NRR for household with lower previous incomes include (a) explicitly setting higher replacement rates for lower previous earnings and (b) computing unemployment benefits as the sum of a flat amount plus a (small) fraction of total gross income. A system similar to the latter is already in place in France. The Belgium Ministere de l'Emploi (2018[3]) argues in favour of a similar design as it would not only enhance fairness but also enhance the readability of the system for workers and simplify the administration of the system , by overcoming the current mechanism of caps on earnings and benefits.

Figure 3.5. NRR rates in Belgium do not fall monotonically with previous income for some family types



Note: Data refer to 2018. OECD unweighted average for all countries except Chile at 67% and 100% of the average wage, and for all countries with a minimum wage at the MW level (26 countries).
Source: OECD Tax-Benefits Models, http://www.oecd.org/els/soc/benefits-and-wages/.

For the very long-term unemployed, ensure that the system is fair across households with different needs

38. As described in Box 3.1, the level of income support provided to the long-term unemployed in Belgium is a flat amount that only varies across three broad family situations. The absence of any means-testing implies that long-term unemployed persons in households with potentially very different financial needs receive the same level of income support. For some households, it is insufficient to lift them out of poverty (with the poverty line defined as half median household income). This is the case, for example, for a low-paid person with a dependent partner with or without children.

39. To ensure that the level of support for the long-term unemployed reflects household needs more closely, most OECD countries limit the maximum duration of the unemployment-insurance benefits, while allowing the unemployed to move to either means-tested unemployment-assistance or social-assistance programmes after their expiration. This suggests there are two main options for introducing means-testing in the determination of benefits for the long-term unemployed in Belgium. It could extend its current social-assistance programme to the long-term unemployed or it could replace the flat rate for the long-term unemployed by means-tested benefits in its current system of unemployment insurance. Extending social-assistance would involve treating all persons living in poor households – whether long-term unemployed or inactive - in the same way and treating income support for the long-term unemployed in poor households as a social policy issue that is financed through general taxation (and is a shared responsibility at the federal, regional and local level) rather than social security contributions (which are managed at the federal level). The main advantage of introducing means-testing within the current UB system for the long-term unemployed is that they can continue to benefit from the stronger activation system that comes with UB.

40. Irrespective of the way means-testing is introduced, it is important to note that this would inevitably cause some UB recipients to lose income support. This is likely to be the case for the unemployed who are in households with other sources of income, such as those with a working partner, or those who have assets or savings, such as some older workers with long work histories. It is important, however, that persons who lose their income support as a result of means-testing remain eligible for activation support by the public employment services. The associated cost savings could be used to strengthen work incentives through the introduction of in-work benefits or additional investments in activation support.

4. Concluding remarks

41. The Belgian unemployment benefit system provides good protection against income losses during joblessness, thanks to a combination of high coverage and generous unemployment benefits relative to other OECD countries. However, it has raised concerns about its ability to maintain strong work incentives during unemployment and to provide a fair degree of income support to all groups of unemployed. This note discusses a series of policy options that can help achieve a fairer and more strongly work-oriented unemployment benefit system.

42. To make the unemployment benefit system more strongly work-oriented, this note suggests reconsidering the time profile of the unemployment benefits, the effectiveness of its activation policies and the balance between in and out of work benefits. Given the ongoing debate in Belgium most emphasis is given to the design of unemployment benefit schedules over the unemployment spell. Early theoretical contributions suggest that front-loading unemployment benefits can be an effective way of preserving work incentives and promoting active job search along the unemployment spell. However, more recent empirical contributions for other countries provide a more mixed picture and highlight the need of empirical work on the optimal design on unemployment benefits for Belgium, including an in-depth evaluation of the 2012 reform that reinforced the declining time profile of unemployment benefits over the unemployment spell.

43. While the unemployment benefit system in Belgium provides adequate income support to most groups of unemployed, income support is not always sufficiently targeted to those who need it the most. For example, the interaction of the unemployment benefit system with other parts of the tax and benefits systems in a number of instances produces regressive net replacement rates, i.e. higher rates for households with higher incomes. One way of ensuring higher net replacement rates for low-income households, while simplifying the current system based on multiple caps on earnings and benefits, may be to compute unemployment benefits as the sum of a flat rate plus a fraction of previous gross earnings, as is currently done in France. Moreover, due to the absence of means-testing, the current system does not take sufficient account of differences in household needs across different groups of long-term unemployed. The introduction of some form of means-testing for the long-term unemployed, as commonly done across the OECD, should help to address this issue.

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