

Consumer prices in Belgium and its neighbouring countries: Policy issues

October 2012

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Abstract - Food prices in Belgium are higher and rise faster than in its neighbouring countries. This can be verified from Eurostat databases, and has been noticed as part of the European Semesters. During the past few years, the phenomenon of price differentials has been studied at the Belgian and the international level. From these studies can be deduced that the causes are manifold, but that there are also factors that work out favourably in Belgium. Four factors that seem to be outstanding in Belgium: the small economic-geographic scale in combination with the bilingualism, wholesale prices, labour cost and the strategy of certain supermarket chains.

Jel Classification - E31, L11, L41, L81

Keywords - inflation, market structure, market conduct, market regulation, taxation, retail trade

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Executive summary

In Belgium, many goods and services are more expensive than in other countries. In many cases, price increases are also more substantial. As a result, the European Commission decided to address this matter in the recommendations of the European Semester, with an emphasis on retail trade and network industries. In the former, barriers to entry and operational constraints should impede competition. In the latter, liberalization should not yet pay off fully, also resulting in limited competition, which, in its turn, affects pricing. This report assesses the extent of the price disadvantage for retail trade in relation to the neighbouring countries and examines its possible causes. It shows that entry barriers and operational constraints are but two of many factors, and possibly not even the primary ones. They are, however, factors on which government has an important influence. Special attention is given to the food branch.

From data on purchasing power parities it is concluded that, over the period 2005-2010, consumer goods and services prices were nearly 3% higher than the average of the three largest neighbouring countries (France, Germany and the Netherlands). For food, the difference amounted to almost 6%, while in the past (1999-2004) there was an advantage of nearly 2%. These data merely have an indicative value, as purchasing power parities are appropriate for welfare comparisons rather than for price comparisons. For this reason, among others, prices of some tens of thousands of individual products in Belgium and its neighbouring countries were compared in a study requested by the FPS Economy. Although this approach also includes certain disadvantages, about two thirds of the products, bilaterally, proved to be more expensive in Belgium than in the neighbouring country concerned. The average price differential by neighbouring country fluctuates between 7% and 12%. Price increases in Belgium also compare unfavourably with those in the neighbouring countries. Between 2005 and 2011, the HICP rose by 2.4% annually on average in Belgium, compared to 1.8% in the three largest neighbouring countries. For food, the increase amounted to 3.0% and 2.0% respectively.

Several institutions, both at home and abroad, studied the factors which influence pricing of food and other consumer goods. In some cases, they were theoretically derived factors; in others, their relevance was estimated empirically. Certain studies only referred to Belgium, whereas others regarded the euro area, the EU or the OECD. Some factors can be directly influenced by government, while others can only be affected indirectly or not at all. From those studies the following outline has been made.

- The economic-geographic scale, wholesale prices, wage costs and VAT rates are both highly important to pricing and unfavourable in Belgium. From an economic-geographic perspective, the relatively small size of the country, combined with its multilingualism, plays a part. As for wholesale prices, manufacturing industry is suspected to maintain a certain market segmentation between European countries, with Belgium being at a disadvantage. Compared to other countries, Belgian wage costs present handicaps for several reasons. The standard VAT rate is higher than in the neighbouring countries.
- In those areas, policy has but little room to manoeuvre. Geography is an established fact. Wholesale trade is part of free enterprise, though market segmentation requires attention from the European level. Wages can be subject to interference in so far as it remains fair from a welfare

perspective. VAT rates and fiscal as well as parafiscal charges imposed on labour cannot be considered apart from the whole fiscal system.

- On the importance of market regulation, opinions are more divided. Longer shop opening hours can be both favourable and unfavourable to prices. The ban on sales below cost could safeguard competition, but creates the risk of jacked-up wholesale prices. Contrary to the findings of economic studies, the Ikea Law should barely impede entry. The complexity of Belgian legislation, though, could repel entry.
- The reduced VAT rate and labour market regulation are also highly important to pricing, but in this respect Belgium scores averagely compared to its neighbouring countries. As for population density and labour productivity, Belgium even scores reasonably. There is uncertainty on price-cost margins and the significance of the automatic wage indexation. For the former, calculations diverge; for the latter, the common social dialogue in other countries could lead to a similar effect on prices.

As concerns food prices, there are several derogations and specific factors.

- The most important one is the business strategy of supermarket chains. Some chains have reasons not to lower their prices triflingly. This is also part of free enterprise and hard to influence by public authorities. Furthermore, productivity per m² of store surface is relatively low.
- Consumer preferences and central purchasing offices appear to be neutral factors. In spite of the preference for national brands and small-scale stores, discounters have a relatively strong position and consumers visit stores of several chains. Still, price transparency remains a point of interest for policy makers. Central purchasing offices could also be reinforced further.
- Price-cost margins, market dynamics and distributor brands seem to function favourably. Contrary to retail trade as a whole, margins are still low. In the long run, the market shares of supermarket chains did not petrify. Distributor brands hold a strong position, but the extent of their advantage is not (yet) clear.

This outline shows that the European Council's recommendation on retail trade is understandable. However, it also shows that it is not simple to plainly point out one or several decisive elements. There is, indeed, a variety of factors, so each policy initiative requires nuancing.

Synthèse

En Belgique, le prix de nombreux biens et services est plus élevé qu'ailleurs. En outre, les hausses de prix sont dans de nombreux cas plus fortes. La Commission européenne a attiré l'attention sur cette problématique dans les recommandations du Semestre européen. Elle a en outre mis l'accent sur le commerce de détail et les industries de réseau. Dans le premier cas, les barrières à l'entrée et les restrictions d'exploitation sont préjudiciables pour la concurrence. Dans le second cas, la libéralisation du marché n'aurait pas encore porté pleinement ses fruits, limitant ainsi la concurrence. Une concurrence limitée a une incidence négative sur la formation des prix. Le présent rapport vise à évaluer le handicap de prix dans le commerce de détail en Belgique par rapport aux pays voisins et tente d'identifier les facteurs responsables. Il apparaît ainsi que les barrières à l'entrée et les restrictions d'exploitation ne représentent que deux facteurs parmi d'autres, et peut-être pas les plus importants. Toutefois, c'est sur ce type d'éléments que le législateur a une influence notable. Une attention particulière est accordée au commerce de denrées alimentaires.

Il ressort des données des parités de pouvoir d'achat que les prix des biens et services de consommation étaient quasiment 3% plus élevés sur la période 2005-2010 que ceux pratiqués en moyenne dans nos trois plus grands pays voisins (France, Allemagne et Pays-Bas). Quant aux denrées alimentaires, l'écart atteignait presque 6%, alors qu'elles étaient encore près de 2% moins chères sur la période précédente (1999-2004). Ces données sont toutefois purement indicatives, car les parités de pouvoir d'achat sont davantage destinées à comparer des niveaux de bien-être plutôt que des prix. C'est pourquoi, à la demande du SPF Economie, les prix de quelques dizaines de milliers de produits individuels ont été comparés en Belgique et dans les pays voisins. Malgré les inconvénients que présente aussi cette approche, les comparaisons bilatérales ont révélé qu'environ deux tiers des produits sont plus chers en Belgique que dans les pays étudiés. Par pays voisin, l'écart moyen des prix se situait entre 7% et 12%. Les hausses des prix contrastent aussi par rapport aux pays voisins. Sur la période 2005-2011, l'indice des prix à la consommation harmonisé a augmenté en moyenne de 2,4% par an en Belgique, contre 1,8% dans les trois plus gros pays voisins. Pour les denrées alimentaires, la hausse s'élevait respectivement à 3,0% et 2,0%.

Plusieurs instituts belges et étrangers ont mené des études mettant en avant les facteurs exerçant une influence sur la formation des prix des produits alimentaires et d'autres biens de consommation. Dans certains cas, les facteurs ont été déduits théoriquement, dans d'autres cas, leur importance a été évaluée empiriquement. Certaines études portent uniquement sur la Belgique, tandis que d'autres concernent la zone euro, l'UE ou encore l'OCDE. L'influence que peuvent exercer les autorités sur certains facteurs peut être directe, indirecte voire impossible. La synthèse suivante est réalisée à partir de ces études :

- Les éléments influençant la formation des prix et considérés comme défavorables sont en Belgique la taille du pays, les prix de gros, le coût du travail et le taux de TVA. Sur le plan géoéconomique, la superficie relativement petite de la Belgique et son statut multilingue jouent un rôle. En ce qui concerne les prix d'achat, il est probable que l'industrie maintienne une certaine segmentation du marché européen et que la Belgique se retrouve dans une position défavorable. Concernant le coût du travail, il existe pour plusieurs raisons des handicaps par rapport aux pays voisins. Enfin, le taux de TVA de 21% est supérieur à celui des pays voisins.

- Les autorités ont peu d'emprise sur ces domaines. En effet, la géographie est une donnée. Les phénomènes de segmentation de marché pourraient expliquer les écarts de prix de gros alors que ceux-ci devraient, en principe, être faibles dans un marché unique européen. Les coûts salariaux peuvent être revus à condition de rester équitable du point de vue du bien-être. Enfin, la TVA et les charges fiscales et parafiscales sur le travail sont élevées, mais elles doivent être analysées en comparant le régime fiscal tout entier.
- Quant à l'importance d'une réglementation du marché, les opinions divergent. Etendre les heures d'ouverture des magasins peut avoir à la fois un impact positif et négatif sur les prix. Bien qu'elle ne couvre qu'une petite partie du marché, l'interdiction de vendre à perte peut pousser à la hausse les prix pratiqués par les grossistes. La loi Ikea devrait à peine freiner l'implantation de nouveaux magasins, alors que des études scientifiques prévoient l'effet inverse. La complexité de la réglementation belge pourrait toutefois être un élément dissuasif pour l'entrée de nouveaux acteurs.
- Le taux de TVA de 6% et la réglementation du marché du travail influencent aussi sensiblement la formation des prix, mais la Belgique a ici une position neutre par rapport à ses pays voisins. Du point de vue de la densité de population et de la productivité du travail, la Belgique est même bien placée. Pour les marges prix-coûts et l'indexation automatique des salaires, il est encore difficile de déterminer si la position de la Belgique est favorable ou non. En effet, pour les marges prix-coûts, les calculs divergent, tandis que pour l'indexation des salaires, la concertation sociale dans les autres pays pourraient entraîner un effet semblable sur les prix.

En ce qui concerne les prix des denrées alimentaires, certaines spécificités sont à mentionner :

- Tout d'abord, certaines chaînes de magasins adoptent une stratégie commerciale visant à ne pas baisser trop facilement leurs prix. Ceci relève aussi de la liberté d'entreprise sur laquelle les autorités ont peu d'influence. Par ailleurs, la productivité par m² de superficie commerciale est relativement faible.
- Les préférences des consommateurs et les centrales d'achat semblent jouer un rôle neutre. Bien que les marques nationales et les petits commerçants soient plus appréciés par les consommateurs, les discounters détiennent une part relativement importante du marché et les consommateurs fréquentent les magasins de plusieurs chaînes. La transparence des prix reste cependant une priorité pour le gouvernement. En outre, les centrales d'achat pourraient encore être renforcées.
- Les marges prix-coûts, la dynamique du marché et les marques de distributeurs semblent avoir un effet favorable. Toutefois, contrairement au commerce de détail, les marges sont faibles. Sur une longue période, la part de marché des chaînes de magasins n'a pas stagné. Les marques de distributeurs occupent aussi une position importante, mais il est (encore) difficile d'en déterminer les effets.

Au vu de cette brève analyse, la recommandation du Conseil européen sur le commerce de détail est compréhensible. On comprend aussi aisément qu'il est difficile de déterminer précisément quelle facteur est responsable. Il s'agit plutôt d'une multitude de facteurs, ce qui obligera les autorités à faire preuve de nuance dans leurs initiatives.

Synthese

In België zijn veel goederen en diensten duurder dan in andere landen. Ook de prijsstijgingen zijn in veel gevallen sterker. Voor de Europese Commissie was dat aanleiding om daar in de aanbevelingen van het Europees Semester aandacht aan te besteden. Daarbij lag de nadruk op de detailhandel en de netwerkindustrieën. In de eerste zouden toetredingsbelemmeringen en operationele beperkingen nadelig zijn voor de concurrentie. In de tweede zou de vrijmaking nog niet haar volle vruchten afwerpen, met ook beperkte concurrentie als gevolg. Beperkte concurrentie is nadelig voor de prijsvorming. Dit rapport gaat voor de detailhandel na hoe groot het prijsnadeel ten opzichte van de buurlanden is en welke oorzaken daaraan ten grondslag kunnen liggen. Daaruit blijkt dat toetredingsbelemmeringen en operationele beperkingen maar twee van de vele factoren zijn, en misschien nog niet eens de belangrijkste. Wel zijn het factoren waar de wetgever een belangrijke invloed heeft. Speciale aandacht wordt besteed aan de handel in levensmiddelen.

Uit data van koopkrachtpariteiten is afgeleid dat de prijzen van consumentengoederen en -diensten gedurende 2005-2010 bijna 3% hoger lagen dan gemiddeld in de drie grootste buurlanden (Frankrijk, Duitsland en Nederland). Voor de levensmiddelen was het verschil bijna 6%, terwijl er voorafgaand (1999-2004) nog een voordeel van bijna 2% was. Deze gegevens hebben slechts een indicatieve waarde, omdat koopkrachtpariteiten eerder geschikt zijn voor welvaarts- dan voor prijsvergelijkingen. Mede om die reden zijn op vraag van de FOD Economie de prijzen van enkele tienduizenden individuele producten in België en de buurlanden vergeleken. Hoewel aan die aanpak ook nadelen zitten, bleek op bilaterale basis steeds ongeveer tweederde van de producten duurder te zijn in België dan in het betreffende buurland. Per buurland lag het gemiddelde prijsverschil tussen 7% en 12%. Ook de prijsstijgingen steken ongunstig af tegen die in de buurlanden. Gedurende 2005-2011 nam de HICP in België met gemiddeld 2,4% per jaar toe. In de drie grootste buurlanden was dat 1,8%. Voor de levensmiddelen was het respectievelijk 3,0% en 2,0%.

Door meerdere instituten in binnen- en buitenland zijn studies gedaan waaruit factoren naar voren kwamen die van invloed zijn op de prijsvorming van levensmiddelen en andere consumptiegoederen. In bepaalde gevallen waren het theoretisch afgeleide factoren, in andere gevallen werd empirisch hun belang geschat. Bepaalde studies hadden alleen België als voorwerp, anderen betroffen de Eurozone, EU of OESO. Bepaalde factoren zijn direct door de overheid te beïnvloeden, anderen slechts indirect of helemaal niet. Uit de studies is de volgende synthese gemaakt.

- Van groot belang voor de prijsvorming en ongunstig in België zijn de economisch-geografische schaal, de groothandelsprijzen, de loonkosten en de btw. Economisch-geografisch speelt de relatief kleine omvang van het land in combinatie met de meertaligheid een rol. Bij de inkoop-prijzen bestaat het vermoeden dat de industrie een zekere marktsegmentatie tussen Europese landen in stand houdt, en België daarbij in het nadeel is. Bij de loonkosten zijn er om meerdere redenen handicaps ten opzichte van andere landen. Het hoge btw-tarief ligt boven dat van de buurlanden.
- Het beleid heeft op die gebieden niet veel bewegingsruimte. Geografie is een vaststaand gegeven. Groothandel is een terrein van het vrij ondernemerschap hoewel het fenomeen van markt-

segmentatie wel aandacht van het Europees niveau behoeft. Op lonen kan maar ingegrepen worden zolang het billijk blijft uit het welzijnsoogpunt. De btw en de fiscale en parafiscale lasten op arbeid kunnen niet geïsoleerd van het hele fiscale stelsel gezien worden.

- Over het belang van de marktregulering bestaat minder eensgezindheid. Ruimere winkelopeningstijden kunnen zowel voor- als nadelig zijn voor de prijzen. Het verbod op verkoop met verlies zou de concurrentie vrijwaren, maar geeft wel een risico op het opdrijven van de groothandelsprijzen. De Ikeawet zou nauwelijks de toetreding belemmeren, wat in contrast staat met de bevindingen van wetenschappelijke studies. Wel kan de complexiteit van de Belgische regelgeving een factor zijn die toetreding afstoot.
- Het lage btw-tarief en de arbeidsmarktregulering zijn ook van groot belang voor de prijsvorming, maar België scoort daar neutraal in ten opzichte van de buurlanden. Op bevolkingsdichtheid en arbeidsproductiviteit scoort België zelfs gunstig. Onduidelijkheid is er over de prijs-kostenmarges en het belang van de automatische loonindexering. Van de eerste zijn er uiteenlopende berekeningen, van de tweede zou het gangbare sociaal overleg elders tot eenzelfde effect op de prijzen kunnen leiden.

Wat de prijzen van levensmiddelen betreft gelden enkele afwijkingen en specifieke factoren.

- De belangrijkste daarvan is de zakelijke strategie van winkelketens. Er zijn ketens die redenen hebben om niet te lichtvaardig de prijzen te verlagen. Ook dat hoort bij het vrij ondernemerschap en is moeilijk door de overheid te beïnvloeden. Verder is de productiviteit per m² winkeloppervlakte relatief laag.
- De consumentenvoorkeuren en inkoopcentrales lijken neutraal werkende factoren te zijn. Hoewel er voorkeur is voor nationale merken en kleinschalige winkels, staan toch de prijsvechters relatief sterk en bezoekt de consument winkels van meerdere ketens. Toch blijft prijstransparantie een aandachtspunt voor het beleid. De inkoopcentrales zouden ook nog versterkt kunnen worden.
- De prijs-kostenmarges, marktdynamiek en distributeursmerken lijken gunstig te werken. In tegenstelling tot de hele detailhandel zijn de marges wel laag. Over lange termijn zijn de marktaandelen van de winkelketens niet verstard. De distributeursmerken staan sterk, maar het is (nog) niet duidelijk hoe groot het voordeel daarvan zou zijn.

Uit dit overzicht blijkt dat de aanbeveling van de Europese Raad over de detailhandel te begrijpen is. Het overzicht toont echter ook dat het niet eenvoudig is om één of enkele determinanten aan te duiden die hiervoor verantwoordelijk zijn. Er zijn integendeel een veelheid van factoren, zodat elk beleidsinitiatief genuanceerd zal moeten zijn.

1. Introduction

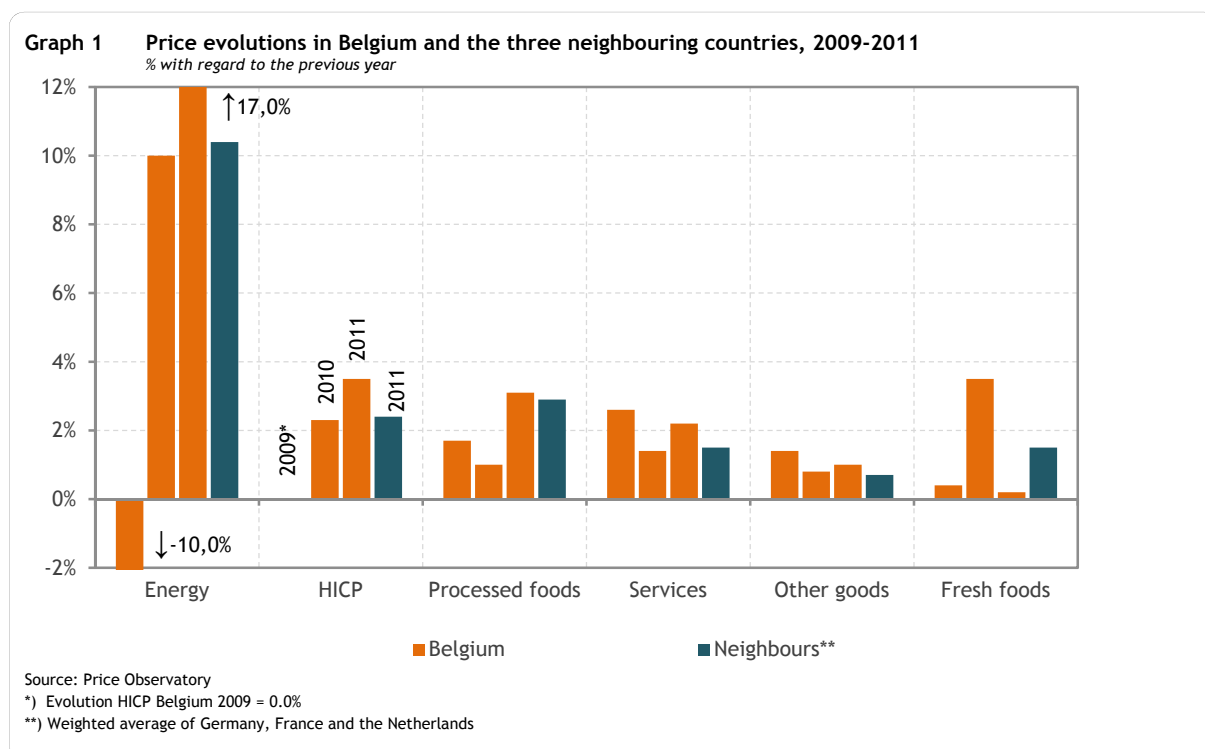
On 30 May 2012 and within the context of the European Semester, the European Commission communicated the recommendation that Belgium should continue to stimulate competition in retail trade. The motivation for this recommendation lies in the observation that many goods and services are more expensive in Belgium than in other countries. As for the causes of this phenomenon, the European Commission identified a number of structural characteristics on the one hand and weak competition on the other. Weak competition should result from entry barriers and operational constraints, among which the Ikea Law and opening hours regulation are mentioned. Structural characteristics include the features of both the country (such as income levels and VAT rates) and the branch (relatively high wage costs, in particular). On 12 July 2011, the Council of the European Union already communicated a similar recommendation in the context of the previous European Semester.

In response to the previously mentioned recommendation, an exploratory study on consumer prices in Belgium was conducted, resulting in this report. Not only price levels, but also price increases were considered. The latter are also higher in Belgium than in other countries, which means that prices will diverge even further rather than converge. Based on data from the Price Observatory and Eurostat, this report shows to which extent prices are indeed higher and increase faster than in other countries, the neighbouring countries in particular (§2). Over the past three years, they have been an important subject of investigation on both the Belgian and the European level. A series of studies has presented several factors affecting consumer prices. This report gives an overview and analyzes the extent to which those factors have played a part in Belgium, with an emphasis on food prices (§3). Finally, it offers points of interest for policy makers which should allow for improved price control (§4). Up to a certain extent, that also bears upon an overview of the studies discussed in this report. Therefore, the added value of this report lies in the brief compilation of existing knowledge rather than in introducing new ideas.

2. Price development in Belgium and its neighbouring countries

2.1. Price increases by consumption category

Prices of consumer goods and services increase more rapidly in Belgium than on average in Germany, France and the Netherlands. Graph 1 shows the main key figures from the Price Observatory's most recent annual report. In 2011, Belgian prices rose nearly one and a half times as fast as in the three neighbouring countries (respectively by 3.5% and by 2.4%). The Price Observatory distinguishes five main categories of goods and services. For four of the five categories, prices increased faster than in the neighbouring countries. Only for the category 'unprocessed food products' ('fresh foods' on the graph) prices grew more rapidly in the neighbouring countries. These prices are subject to strong fluctuations: in 2009 and 2011, they increased by less than 0.5%, compared to 3.5% in 2010. In 2011, prices for energy carriers grew substantially in both Belgium and its neighbouring countries, respectively by 17.0% and by 10.4% on average, and also experienced strong fluctuations.



In its report, the Price Observatory only presents the evolution over the past three years. Table 1 shows the long-term evolution, based on the same source: HICP. On the whole, it confirms the trend of Graph 1. Energy prices have been on the rise for a long time. Over the period 1996-2011, they increased on average by 4.7% in Belgium and 4.3% in the neighbouring countries. In the subperiod 2005-2011, the average increase even exceeded 6% in Belgium, while it only amounted to 4.6% in the other countries. Also for the other categories, prices grew stronger in Belgium than in its neighbouring countries, both over the full period (1996-2011) and the subperiod (2005-2011). This also includes unprocessed food products, the small increases in 2009 and 2011 differing from the long-term trend. Over the full period, the HICP rose 28% faster in Belgium than with its neighbours (2.0% compared to 1.6% on average per year). Between 2005 and 2011, that percentage even amounted to 38%.

The lower section of Table 1 shows the average price increases, broken down by main COICOP category.¹ For nine out of twelve categories, representing on average 92% of private consumption, prices increased stronger in Belgium than in its neighbouring countries. For recreation & culture, comprising a large range of leisure goods and services, the increases were limited. In the neighbouring countries, however, they were nearly zero. In communications (postal services, communication services and communication equipment²) price went down on average: 1.3% per year in Belgium, compared to 2.3% in the neighbouring countries. Over the period 2005-2011, these decreases grew closer towards each other (respectively 1.7% and 1.8%). Of the categories for which prices grew stronger in the neighbouring countries, health care costs (doctors, hospitals, appliances and medication) seem to have been controlled well in Belgium. Ironically, the prices of a number of products which may cause health problems (alcohol & tobacco) have also increased less rapidly than in the neighbouring countries.

¹ The Price Observatory (Graph 1) employs an alternative compilation of basic categories, which is as such also available with Eurostat.

² 90% of the category comprises communication services; the remaining part consists of post and communication equipment.

Table 1 Average annual price increases in Belgium and three neighbouring countries by consumption category

	Budget-share ¹	Period 1996-2011		Period 2005-2011	
		Belgium	Neighb. ²	Belgium	Neighb. ³
Energy carriers	11%	4.7%	4.3%	6.1%	4.6%
Processed food products	12%	2.4%	2.2%	3.4%	2.2%
Services	37%	2.1%	1.8%	2.1%	1.8%
Non-energetic industrial goods	32%	0.9%	0.4%	1.0%	0.6%
Unprocessed food products	8%	2.2%	1.6%	2.2%	2.0%
HICP	100%	2.0%	1.6%	2.4%	1.8%
Foods & non-alcoholic beverages	17%	2.3%	1.5%	3.0%	2.0%
Housing, water, electricity, gas & other fuels	16%	3.4%	2.5%	4.5%	2.8%
Transport	14%	2.8%	2.4%	2.8%	2.6%
Recreation & culture	13%	0.7%	0.0%	1.0%	-0.1%
Restaurants & hotels	9%	2.7%	2.0%	2.8%	2.0%
Furniture, household equipment & maintenance	7%	1.4%	0.8%	1.8%	1.0%
Other goods and services	7%	2.2%	1.8%	2.7%	1.9%
Clothing & footwear	7%	0.5%	0.3%	0.7%	0.6%
Health	4%	0.9%	2.2%	0.2%	1.5%
Alcoholic beverages, tobacco & narcotics	3%	2.6%	3.5%	2.5%	2.6%
Communications	3%	-1.3%	-2.3%	-1.7%	-1.8%
Education ⁴	1%	2.0%	2.9%	2.4%	4.0%

Source: Eurostat (HICP)

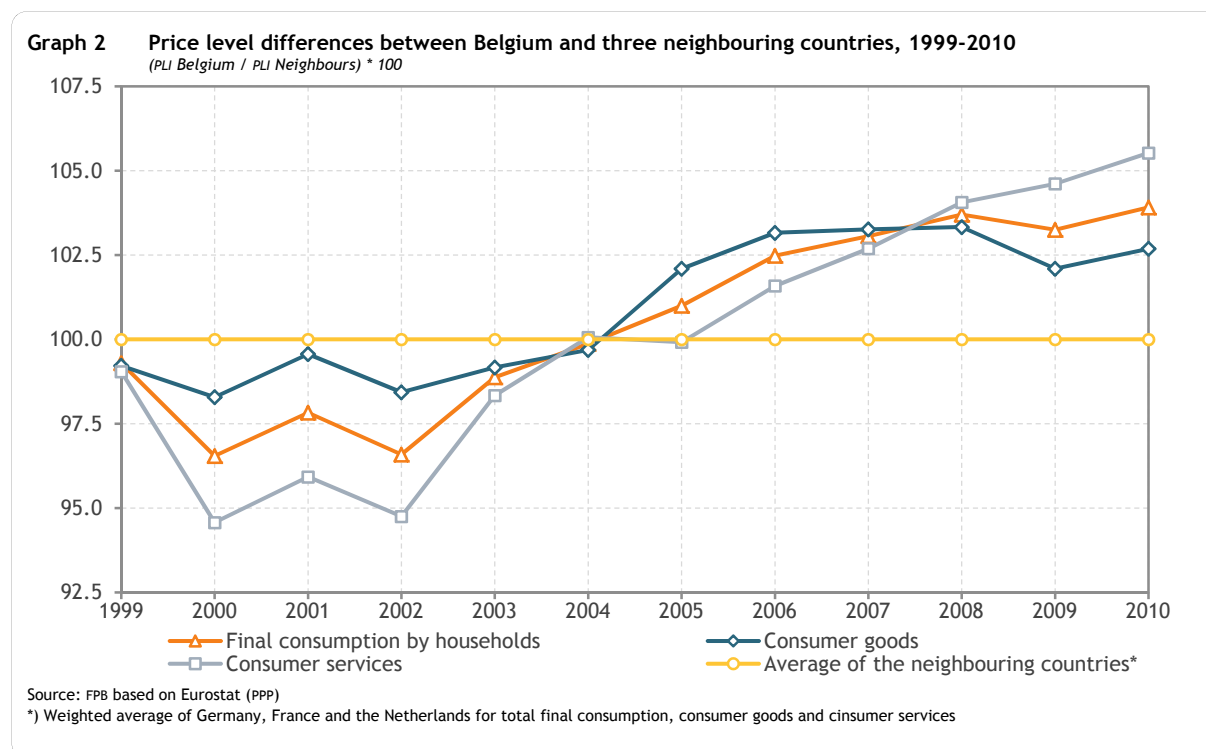
¹) Average share in Belgian private consumption over the period 1999-2011^{2,3}) Weighted average of Germany, France and the Netherlands⁴) Belgium: 2000-2011 instead of 1996-2011

2.2. Relative price level by consumption category

From a methodological perspective, data on relative price levels are harder to obtain than data on price increases. The Eurostat Price Level Indices (PLI) database is the most comprehensive source. PLI are purchasing power parities multiplied by the exchange rate. Within the euro area, the later, obviously, equals one and the PLI equal purchasing power parities. One of the disadvantages of PLI is that they are based on national consumption patterns, thus providing an heterogeneous weighting. That results from, among other things, the fact that the statistic is actually not intended for price comparisons but for welfare comparisons. Hence, it only provides an indication of price differences. This is further marked by the fact that the derived price increases are inconsistent with the HICP and sometimes even point in the opposite direction. The annex shows this for the twelve main COICOP categories.

Taking into account these remarks, Graph 2 shows for Belgium that high prices are a recent phenomenon. Up to 2004, prices were on average 3% lower than in the neighbouring countries. Subsequently, the difference mounted to +3.9% for private consumption as a whole. Graph 3 shows the price level differences by main COICOP category. It gives the average variation of the Belgian PLI from the PLI of the neighbouring countries over the period 1999-2004 and the period 2005-2010. During the latter period, prices for nine of the twelve categories were on average higher in Belgium than in the other countries. They represent approximately 70% of household expenditures. The most important price differences

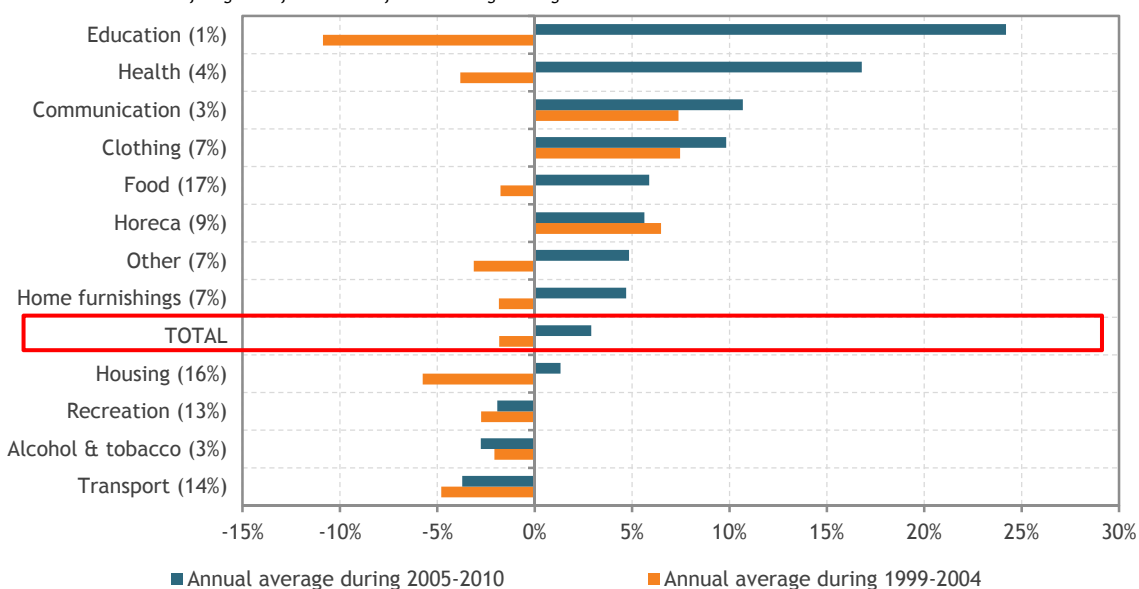
are found in a few categories with a relatively small share. For six categories - comprising half of expenditures - price differences are between 4% and 11%. Three categories were less expensive, including alcohol & tobacco and transport. Of the first category, especially tobacco was cheaper than in the neighbouring countries, on average 10% over the full period 1999-2010, whereas alcohol was nearly 6% more expensive. In transport, both means of transport and transport services were somewhat cheaper in Belgium. The database holds no distinct data on transport fuels.



Three categories were more expensive than in the neighbouring countries over both the period 1999-2004 and the period 2005-2010: communication, clothing and horeca, which constitute on average 19% of expenditures. The database provides no further breakdown of the category of communication, but communication services hold a share of approximately 90%. Clothing is broken down into clothing and footwear, the price differences in which were roughly identical. Although it does not explicitly show on the graph, housing is a remarkable category. Over the period 2005-2010, prices were on average 1.3% higher than in the neighbouring countries. Within that category, energy constitutes an important component (share $\pm 40\%$). It was more expensive in Belgium than in the neighbouring countries for only three of the twelve years (2000, 2001 and 2008). Over the entire period, the average price advantage in Belgium amounted to 5%. In 2010 it was 7.5%. This is, to a certain extent, in contrast with the CREG's (2012) recent findings, according to which the electricity and gas bill of Belgian households is on average 5.7% higher than in the neighbouring countries. The CREG findings are, however, based on merely one household type (the average household) and do not consider fuel oil prices. It should, therefore, be examined whether that accounts for the 13.2 percentage point difference.

Graph 3 Price level differences between Belgium and three neighbouring countries by consumption category, 1999-2010*

Variation of Belgian PLI from the PLI of the main neighbouring countries**



Source: FPB based on Eurostat (PPP)

*) Between brackets: the share of each category in Belgian private consumption, average over the period 1999-2011. See Table 1 for the comprehensive nomenclature of COICOP categories

**) Weighted average of Germany, France and the Netherlands

2.3. Focus on food products

Approximately 20% of household expenditure goes to food products. It can be inferred from Table 1 that 8% is reserved for unprocessed food products, 3% for alcohol & tobacco and the remaining 9% for processed food products. It can also be inferred that over the period 1996-2011, food prices annually increased by 2.3% on average, compared to 1.9% in the neighbouring countries,³ implying that prices in Belgium grew 24% faster than in the neighbouring countries. They also grew more rapidly than the general price level (HICP), amounting to roughly 15% in both Belgium and its neighbouring countries.⁴ During the last part of the period (2005-2011), prices picked up in Belgium and the other countries, but at a higher pace in Belgium. On average, food prices increased by 2.9% annually, compared to 2.1% in the neighbouring countries, which means Belgian prices grew as much as 37% faster. Compared to the general price level, food prices in both Belgium and the other countries rose approximately 20% more rapidly.

Not only the price increases but also the price levels of food products are higher than in the neighbouring countries. Graph 3 already showed, using purchasing power parities (PPP), that Belgian prices have outgrown prices in the neighbouring countries. Over the period 1999-2004, the price level of food products in Belgium was on average 1.8% higher than in the other countries, as it was for total private consumption as well. Subsequently, Belgian prices rose above the average of the other countries. Over the period 2005-2010, the difference amounted to 5.9% for food products and 2.9% for all private con-

³ Weighted average of price increases mentioned for processed food products and unprocessed food products.

⁴ For Belgium: the mentioned 2.3% increase with regard to the average 2.0% HICP increase from Table 1; for the neighbouring countries: the mentioned 1.9% increase with regard to the 1.6% from Table 1.

sumption.⁵ However, as mentioned before, the PPP contain a certain inaccuracy because of non-homogeneous consumption baskets.

To respond to that disadvantage, business consultant A.C. Nielsen, by order of the FPS Economy, compared the prices of well over 23 000 identical food products in Belgium and its main neighbouring countries. This is the only method - using identical EAN codes - to allow for a pure comparison. A downside to this approach is the fact that the majority of the compared products are branded products. Less expensive distributor products and first price products are often only traded in the mother country and, therefore, do not allow for a comparison with other countries. Moreover, the data were only gathered in supermarkets (surface > 400m²); stores of hard discounters were not considered in the comparison. To come to average price differences, a simple weighting procedure was applied which considers the fact that certain products hold a bigger share in private consumption than others.⁶ The main results are listed in Table 2. It shows that, on average, food product prices in Belgium are approximately 10% higher than in the neighbouring countries. About two thirds of the compared products are more expensive in Belgium.

Table 2 Price level differences for food products between Belgium and three neighbouring countries

	Number of products	Average price difference	Share of more expensive products
Belgium compared to Germany	4,824	+7%	63%
Belgium compared to France	15,277	+9%	67%
Belgium compared to the Netherlands	7,774	+12%	72%

Source: Price Observatory

The next two chapters, based on a literature review, sum up factors that may lie at the bottom of the differences and provide an assessment of which of those factors are more or less relevant and the extent to which they relate to food products. They also offer potential policy action to improve the situation.

⁵ Including alcohol & tobacco, the price level over the period 1999-2004 should also have been 1.8% lower. Over the period 2005-2010, it should have been 4.5% higher.

⁶ The applied weighting method (citation translated into English): "To products from the first quartile of the best selling products (the 25% of all products that have the highest turnover in Belgium), the coefficient 4 is applied; to second quartile products the coefficient 3, to third quartile products the coefficient 2 and to the 25% of all products that have the lowest turnover in Belgium, the coefficient 1 is applied. The results are confirmed by several robustness tests. The results are indeed very stable with regard to the applied weighting to aggregate the price differences for individual products. (FOD Economie, 2012, p 23).

3. Driving factors for price evolutions

There is an abundance of demand and supply factors which may influence consumer prices. The enumeration in this chapter is based on recent studies by Belgian and European institutions. Although the weight and the significance of the factors are difficult to assess, this chapter will still mark, based on those studies, which factors are to be considered as important and which as less important, especially for food prices. Another difficulty lies in the fact that the effect is not always univocal. For certain factors, there are reasons to assume that they have a favourable effect on prices, as well as reasons to assume that their effect is unfavourable. In practise, the question is which effect has the upper hand. Also in literature, opinions on the effect sometimes differ.

In spite of ambiguity and differing opinions at times, it was attempted to determine the extent to which each factor is present in Belgium, favourably or unfavourably. Also in this case, ambiguity and differing opinions apply. Still, it seems that the majority of factors have an unfavourable impact and there is a role for policy to bring improvement.

The factors are grouped in four categories: competition & business strategy, market-exogenous conditions, market regulation and operating costs. The distinction between the categories is not clear-cut, but was only drawn to structure this discussion.

3.1. Competition & business strategy

Market concentration

The traditional explanation for the continuum between the atomistic market and the monopoly states that the higher the market concentration, the less competition and the higher the prices and economic rent in favour of the producers. However, opinions differ on that explanation. High concentration may also imply the existence of a limited number of efficient units. They can fully exploit their economies of scale and have great mutual rivalry. Low concentration, then, implies an impediment to that rivalry. In retail trade, the concept is relevant on both the national and the local level. On the national level, it concerns the concentration of large store chains, each having its with own strategy; on the local level, it concerns the branches of these chains and independent retailers. Also on the latter level, high concentration may involve branches of large and efficient store chains. A pure monopoly seems, at any rate, unfavourable, since it allows the local monopolist a large degree of freedom in price setting (EC, 2010b).

Belgian market concentration does not appear excessively high or low, although opinions on that matter differ. According to some studies, it is moderate in the food branch *on the national level*, but still lower than in other West-European countries (Cornille & Langohr, 2011; ECB, 2011). Other studies claim it to be higher than in the neighbouring countries (Baugnet et al., 2009). Opinions on the evolutions differ as well. According to Van der Linden (2010, 2011), respectively based on his own calculations and the EUKLEMS database, the concentration of the entire Belgian retail trade reached a peak in the first years of the previous decade and declined afterwards. The CRB (2010), however, one-sidedly claims that market concentration is inclined to increase. Compared to other countries, market concentration *on the*

local level is low, both in food products (Baugnet et al., 2009) and retail trade as a whole (Cornille & Langohr, 2011; ECB, 2011; FOD Economie, 2012).

Market structure in itself does not seem to lead to inefficiency and high prices. In the category food products, it is determined by three major supermarket chains with a joint market share of approximately 70% and four small chains jointly representing about 25%. On the local level – especially in the densely populated areas of the country – there seem to be no pure monopolies. From the perspective of competition, the causes of unfavourable price evolutions should rather be sought in market conduct.

Market stability

Rivalry between producers may cause turbulence within the market: many entries and exits and changing strength among producers. A stable market may, therefore, point out a lack of competition. Turbulence can be measured by the number of entries and exits and changing market shares, but literature also uses the measure of profit elasticity. Its basic assumption is that, with sufficient rivalry, a producer can easily improve its market position after a cost reduction, while with insufficient rivalry, that cost reduction offers little or no market position improvement.

In Belgian retail trade, both market share turbulence and profit elasticity over the period 1997-2005 were moderate compared to other countries, but have slightly increased (Van der Linden, 2010, 2011). Eurostat data on the year 2006 show that the level of entry and exit was very low with regard to the other member states, but Van der Linden (2011) recorded it to have been slightly on the rise since 2003. Although there was less rather than more turbulence compared to other countries, there seems to be a slightly upward trend. More specifically in the food branch and over ± 30 years, three supermarket chains have seen their market share increase gradually and two historically large chains have lost market share (FOD Economie, 2012). That is clearly not indicative of stable market structure.

Business strategy

Market structure and changes in market structure determine market conduct, which in its turn determines prices. Although market structure and turbulence in Belgium, up to a certain level, form a good basis for a favourable price level, the FOD Economie (2012) suspects that certain market players are responsible for continuously high prices. The profitability of one chain is so low that there remains little room for lowering prices. Another chain manifests itself as a price follower to such an extent that competition will benefit little from price reductions. Evidently, the strategy of those players is not beneficial to a competition based on sharp prices.

Price transparency

The probability that a consumer will buy cheaper products seems higher when he/she is better informed on prices. Greater price transparency may support low prices (EC, 2010), all the more since, in that case, producers are given an additional incentive to price competition. It is unknown to which extent price transparency is higher in Belgium than in other countries. It is, however, very probable that electronic commerce advances price transparency. Electronic commerce is known to be less de-

veloped in Belgium than in other countries (2.6% of GDP according to recent newspaper reports⁷; see also Cornille & Langohr, 2011). Still, that cannot be a significant cause of price differences. Firstly, e-commerce, in any case, is not yet a widespread practise. In other countries as well, it does not represent more than a few per cent of GDP. Secondly, e-commerce, as a rule, does not comprise food products (Cornille & Langohr, 2011) but rather electronics, home and garden items, clothing, leisure and information technology.⁸

Sales methods

The aforementioned e-commerce is a new sales method with a potential important effect on prices. The sales method relates to outlet type and size. Together with the selection of products, they constitute the main marketing instrument in retail trade (CRB, 2010). According to the CRB (2010), there is little innovation in sales methods in Belgium, as a result of which no price lowering effect is to be expected from that sphere. Koźluk (2009) claims that this is prevented, among other things, by market regulation.

Upstream market structure and conduct

Up to this point, competition has been considered among retailers as consumer goods suppliers. The interaction between retailers and their suppliers is also important. Also in this case, the market is not atomistic and pricing depends on the power relations between the demand and supply side (EC, 2010; ECB, 2011). When suppliers hold a relatively strong position (i.e. wholesale trade, import and industry), prices will rather be high. When retailers are in a strong position, they will rather be low.

The situation in Belgium shows a mixed picture. Two factors play a significant role: purchasing offices and distributor brands. As is the case in other countries, traders succeeded in positioning themselves favourably in the negotiations by cooperating within central purchasing offices. The CRB (2010) considers that to be a strong point. The concentration of those offices in Belgium compared to other euro countries should be rather moderate (ECB, 2011). As for food products, the FOD Economie (2012) observes a higher upstream market concentration in the Netherlands. That is believed to explain approximately one percentage point of the price difference with Belgium. Trading distributor brands offers food store chains a certain position of market power, as they thereby compete with their own suppliers. Since those brands hold a relatively strong position in Belgium, the CRB considers that to a strong point of Belgian retail trade. In a far-reaching form, the position of distributor brands may turn against competing supermarket chains, but that does not seem to take place in reality (FOD Economie, 2012).

Price-cost margins

The beginning of this chapter mentioned that a lack of competition may lead to the occurrence of an economic rent for producers. That is the margin between the price and production cost, the latter including the normal allowance for capital and entrepreneurship. Even in the event of differences in efficiency, with efficient producers achieving better results than inefficient producers at given prices, a lack of competition is possible. In that case, it seems as though the efficient producers do not benefit

⁷ De Standaard, 28 March 2012.

⁸ De Standaard, 28 March 2012.

from their efficiency because they do not price inefficient producers out of the market. In practise, prices are higher as price-cost margins are higher. The ECB (2011) considers that correlation to be positive significant.

Opinions differ on the height of price-costs margins in Belgian retail trade. According to Comeos, they are among the lowest of the euro area (ADL, 2012). According to Cornille & Langohr (2011), they are lower than in the neighbouring countries and according to Baugnet et al. (2009), they are in between. Van der Linden (2010, 2011) claimed that they are higher than in the neighbouring countries. He even found increases. For food products, they seem rather low (Cornille & Langohr, 2011; ADL, 2012). Still, the FOD Economie (2012) considers them to be about equal to the Dutch price-cost margins. It is, therefore, not clear whether the high Belgian price levels are also caused by price-cost margins. For food products, that is more likely not the case.

3.2. Market-exogenous conditions

Geography

Two factors play a role: scale and population density. The larger the economic size of a country is and the higher its prosperity, the easier producers and store chains can take advantage of economies of scale and keep their purchasing prices and operating costs at a low level. Moreover, there is room for more competitors to reach the minimum efficient scale. The more densely populated a country is, the easier advantage can be gained with regard to logistic costs. Furthermore, it is less probable that there will be many local monopolies. The ECB (2011) found a negative significant relationship between population density and prices. In Belgium, both forces oppose each other. Population density is very high, but Belgium is small compared to other countries. Moreover, the linguistic diversity forms a handicap (Baugnet et al., 2009; CRB, 2010, ADL, 2012; FOD Economie, 2012; INR, 2012). ADL (2012) and the FOD Economie (2012) add that strict labelling regulations bring about a further upward pressure on prices. The FOD Economie (2012) judges that the lower purchasing volume could explain approximately one percentage point of the difference in food prices with the Netherlands.

Prosperity

Price levels are positively correlated to GDP per capita. As a result, high GDP per capita correlates more than proportionally to purchasing power. The ECB (2012) found a significant relationship and Van der Linden (2011) revealed a clear bivariate correlation. Still, it is of no importance to the price level of Belgium compared to the neighbouring countries, since there are hardly any differences in welfare between those countries.

Consumer preferences

Irrational as it may seem, specific consumer preferences may effectuate that certain products are purchased at a price that is higher than necessary if cheaper products of similar quality were also available on the market. That also keeps the average price level high. According to some studies, that also applies to the Belgian food branch (Cornille & Langohr, 2011; Steenbergen & Walckiers, 2011). Thus, the Belgian consumer has a relatively strong preference for national brands, good service and specialized

stores. Local taste patterns could also lead to relatively high prices. Still, compared to other countries, discount stores represent a relatively large market share (Cornille & Langohr, 2011; FOD Economie, 2012) and the FOD Economie (2012) found that many consumers visit more than one supermarket chain. Consumer preferences may, therefore, be an important factor to relatively high prices, though certain nuances should be taken into account.

Indirect taxes

It is evident that there is a close connection between prices and indirect taxes. The most common indirect tax is VAT. The ECB (2011) concluded that at the EU level, VAT has a positive significant impact. The standard rate in Belgium is higher than in the neighbouring countries: 21% compared to a weighted average of 19.2%.⁹ That has an unfavourable effect on certain prices. However, one should not forget the fact that many food products are taxed according to the reduced VAT rate, which lies in between the low rates of the neighbouring countries. The excise duties do also not differ substantially between Belgium and its neighbouring countries (ADL, 2012). In any case, they only have a very small effect on the general price level, since there are but few excisable products (FOD Economie, 2012). Belgian packaging levies may also affect the price difference (ADL, 2012; FOD Economie, 2012). ADL (2012) further discusses the disadvantages emanating from other environmental taxes and duties connected to publicity and food safety. It can be inferred from their data that the disadvantage with regard to the neighbouring countries should amount to about 1%, both for food and other products. The FOD Economie (2012) even estimates that higher Belgian taxes may explain approximately two percentage points of the price difference for food with the Netherlands.

3.3. Market regulation

Market regulation is often pointed to as a factor which restricts competition and affects prices and productivity. Although several studies found a positive significant correlation (e.g. Koźluk, 2009), there is no absolute consensus on the matter.

Price regulation

It seems almost tautological that regulated prices have a direct effect on the price level. The more prices are regulated, the stronger the effect is. In Belgium, prices are only regulated on few markets, the number of which has but decreased over the past decades. For the time being, though, the tide seems to have been turned as a result of the temporary energy price freeze. Rather, concerns are expressed about the ban on below-cost selling (Koźluk, 2009; Steenbergen & Walckiers, 2011; FOD Economie, 2012). This may jack up prices, since it keeps retailers from carrying through certain price reductions and since possibly jacked-up wholesale prices should tacitly count as minimum price. The former effect will probably only affect a small share of sales volumes. The second effect has been proven for France, where the equivalent Loi Galland is believed to have had an unfavourable effect on inflation (FOD Economie, 2012). ADL (2012) argues that a too restrictive ban may indeed cause those effects, but allowing them unconditionally may end up impeding competition, which is also the initial motivation

⁹ Weighted average of the elevated rates of Germany, France and the Netherlands. After the Dutch VAT increase of 1 October, the weighted average will rise to 19.5%.

behind the ban. That makes them content with the Belgian legislation. Though it has not been proven for Belgium in particular, based on the French study, an upward pressure on prices should be well taken into account.

Entry and exit barriers

Due to urban planning reasons, large branch-stores cannot be planted offhand. This process can be steered in the right direction using efficient outlet regulation. Although it serves other social purposes, it can be harmful to prices. The ECB (2011) and the OECD (see Koźluk, 2009) found a positive significant correlation between the price level and the OECD PMR index of entry barriers, which rises as barriers are stronger. An unfavourable effect would also have been proven for the Loi Royer in France (FOD Economie, 2012).

In Belgium, outlet regulation has long since been used to protect small retailers from competition of large branches of store chains, though the Services Directive has brought change in that area. As mentioned before, that may hinder efficiency and the occurrence of relatively low prices. Nevertheless, ADL (2012) and the FOD Economie (2012) argue that outlet regulation has not impeded entry in Belgium and ADL (2012) and Steenbergen & Walckiers (2011) add that there probably has not been a strong effect on costs and prices respectively.

Rather, a risk is considered in impeding exit. Inefficient retailers remain active in the market if restructuring and/or exit costs are higher than the costs of staying in the market, which has an unfavourable effect on the price level. The FOD Economie (2012) mentions two factors that may, indeed, induce strong exit barriers in Belgium. One relates to social law and the relations between employers and employees (see also §3.4). The other lies in the contractual relationship store chains can impose on their independent franchisees. The latter, at any rate, applies to the food product sector. The scope of the price disadvantage could not yet be assessed.

Opening hours

The effect of opening-hours regulation is ambiguous. Deregulation can consist in extending opening hours. Stores which go along with that may have to deal with higher cost without realizing proportionally higher turnover (Baugnet et al., 2009; Steenbergen & Walckiers, 2012; FOD Economie, 2012). However, it is also believed that extended opening hours advance innovation in sales methods (Koźluk, 2009), which, in the end, may lead to lower prices. According to Baugnet et al. (2009), they may end up promoting price competition. Compared to the neighbouring countries, opening-hours regulation in Belgium is stringent (ADL, 2012). In any case, opening-hours regulation is rather stringent in the old EU15 compared to some new member states (EC, 2010b). According to an index developed by Cornille & Langohr (2011), they are, in fact, very strict in Belgium. In practise, opening hours are often shorter than legally permitted (ECB, 2011). That is mainly due to labour legislation, as a result of which night and weekend work is not financially attractive to employers (Baugnet et al., 2009; Cornille & Langohr, 2011; ADL, 2012).

Complexity of regulation

From the information mentioned above it can be inferred that the influence of market regulation on prices is possibly rather small in Belgium. The weight of legislation should, therefore, imply no great danger. Cornille & Langohr (2011) and ADL (2012) claim that regulation complexity, which should be relatively high in Belgium, could rather pose a risk. According to Baugnet et al. (2009), the perception of the weight of legislation could also imply a risk. Both may discourage entry. Nonetheless, the ECB (2006) found no significant correlation between relative price levels and the OECD PMR index in the euro area.

3.4. Operating costs

Many of the discussed factors have an influence on operating costs. After all, the distinction between the four categories of this chapter is not clear-cut. This section discusses some factors which are less directly connected to business strategy, exogenous conditions and market regulation. That does, however, not mean that these factors are less important. They include productivity and labour costs.

Productivity

High production factor productivity may lead to relatively low average costs, which is beneficial to the price level. For Belgium, the picture is balanced. On the one hand, labour productivity is still relatively high. On the other hand, labour productivity growth has long since been stagnating compared to other countries (see, among others, Van der Linden, 2010). As for capital productivity, the FOD Economie (2012) recorded that, in the food branch, turnover per m² of store surface in Belgium is lower than in the Netherlands. Total factor productivity (TFP) grows rather slow with regard to other countries, though ADL (2012) is not displeased with the Belgian innovation climate.

Wage costs

There is a direct relationship between the wage bill a retailer must pay and the prices he can or should ask. The ECB (2006) found a positive significant correlation between prices and unit labour cost (ULC). In Belgium, the wage bill seems relatively high compared to value added. The CRB (2010), Cornille & Langohr (2011), ADL (2012), FOD Economie (2012) and INR (2012) point out several causes. There is a relatively high number of permanent staff and a relatively low number of staff for which the work only provides an additional income. Both staff age and the degree of unionization are relatively high. Wage indexation is said to give no impetus to keep prices at a low level. Staff competency level rose faster than in Germany and the Netherlands. The FOD Economie (2012) states that the higher wage bill could explain approximately two percentage points of the price difference for food products with the Netherlands. ADL (2012) even calculated the difference at almost 3% and for the other countries at respectively 1% (France) and well over 2% (Germany).¹⁰ In addition, social legislation is rather inflexible in Belgium. In that respect, the ECB (2011) found no significant relationship between prices and the OECD employment protection legislation index (EPL).

¹⁰ ADL (2012) does not use prices but turnover excl. VAT as the reference, which is equivalent to prices.

Merchandise

Aside from price effects which may result from the aforementioned upstream market concentration, the FOD Economie (2012) suggests that the food product industry is maintaining a certain degree of market segmentation between European countries, allowing for price differentiation between member states. ADL (2012) mentions several reasons why that could be to the disadvantage of Belgium. The difference with the neighbouring countries is calculated at well over 3% in terms of turnover, both for food products and certain industrial consumer goods. Moreover, the INR (2011, 2012) found that the food product industry and retail trade readily follow the increases of raw material prices, but are less eager to adapt prices when raw material prices drop. As this exercise was only carried out for Belgian prices, the extent to which that practise also occurs in the neighbouring countries cannot be ascertained.

Other operating costs

Compared with the Netherlands and the United Kingdom, there are many small enterprises and outlets in Belgium and store density is high (EC, 2010). The ECB (2011) implicitly regards that as a barrier to the introduction of distributor brands. As mentioned before, that does not seem to have been an impediment in Belgium, as distributor brands hold a relatively strong position. ADL (2012) sees a cost advantage of more than 0.5% in the rent of commercial space, but a disadvantage in publicity cost, which are high for several reasons. Store security should also be more expensive than in the neighbouring countries, but only represents a relatively small percentage of turnover. According to ADL (2012), costs relating to logistics, financing, utilities, banking transactions and information systems should have a neutral effect. The CRB (2012) also mentions the sensible compromise between internalization and externalization as a major strength of Belgian retail trade. Although its effect is probably rather small, it is part of successful cost control.

4. Towards improved price control in Belgium

The previous chapter listed factors which may affect price levels and changes. Based on a number of recent studies, it reported factors that are expected to have an important effect and factors that are expected to have a less important effect. A number of those factors work out favourably on prices in Belgium compared to the neighbouring countries. A number works out unfavourably. Finally, it aimed to distinguish between retail trade as a whole and retail trade of food products. This chapter offers an assessment of those factors and suggests possible policy actions to reduce the unfavourable effects.

4.1. Driving factors in Belgium: an assessment

For the purpose of this assessment, the factors have been divided into four categories: (1) factors with an unfavourable influence on prices in Belgium; (2) factors with a neutral influence; (3) factors with a favourable influence; (4) factors for which the influence on prices in Belgium is not or not yet known. Within those four categories, the factors can be subdivided based on their level of importance to prices (great, moderate, little). For some, however, the importance is not known, possibly because their importance has only been deduced theoretically, but not been examined empirically. It is also possible that there is no consensus on their importance. The categories and factors for retail trade as a whole are listed in Table 3. Table 4 shows the specific case of the food branch.

For a good understanding of the possible effects of those factors, a distinction should be made between factors affecting price *levels* and factors affecting price *changes*. Nevertheless, a high level of overlap is trivial. Many factors have an influence on price levels for as long as they do not change. If, however, they do, they bring about price changes. Still, some factors may effect price changes when they are in status quo. In Table 3 those are shown in italics. Whether or not the government can influence the factors and, thus, contribute to the control of prices and price increases, constitutes another important distinction. Factors generally subject to government influence are underlined. Yet, that distinction is not clear-cut. Therefore, the table presumes that government does not intervene in the domains of free enterprise and the empowered consumer, for example market structure and consumer preferences.

It is clear that the factors of category (1), as far as they have a substantial influence on prices, are of prior importance, since they can actually contribute to improved price control. Those factors are listed at the top left of the table. Factors of moderate importance also have an influence, though to a smaller extent. It is also evident that for many factors, the measure of significance for price control is still to be examined and that for some cases, the position of Belgium compared to its neighbours is not (yet) clear. Moreover, the demarcation between the categories and the degree of importance is not clear-cut.

Table 3 Categorization of driving factors of prices in Belgian retail trade*

	Unfavourable in Belgium	Neutral in Belgium	Favourable in Belgium	Belgian position unclear
Factors of great importance to prices	Geographic scale <u>VAT</u> <u>Wage bill</u> Wholesale prices	Prosperity <u>Ikea Law</u>	Population density Labour productivity	<i>Business strategy</i> Price-cost margins Consumer preferences <u>Price regulation</u> <u>Wage indexation</u>
Factors of moderate importance to prices	<u>Various taxes</u> <u>Marketing cost</u>		Market concentration Rent of store space	<u>Price transparency</u>
Factors of weak importance to prices	<u>Electronic commerce</u> <u>Heaviness of regulation</u> Security cost	<u>Excise duties</u> <u>Labour regulation</u> Operational cost		Outsourcing
Factors for which the influence in Belgium has not been determined.	Entry and exit Sales methods <u>Ban on sales below cost</u> <u>Barriers to exit</u> <u>Shop opening hours</u> <u>Regulatory complexity</u> <u>TFP growth</u>	Market turbulence Profit elasticity Centralized purchasing		Capital productivity

Source: FPB

*) Italics: factors which are of particular importance to price changes when they are in status quo;

Underlined: factors wholly or partly subject to government influence

An unfavourable influence

The economic-geographic scale, wholesale prices, wage costs and VAT rates are factors that almost certainly and to an important extent have contributed to the unfavourable situation in Belgium. From an economic-geographic perspective, the relatively small size of the country, combined with its multilingualism, may play an important part. As for wholesale prices, it has been emphasized that the industry is suspected to maintain a certain market segmentation between European countries, with Belgium being at a disadvantage. Compared to other countries, Belgian wage costs were said to present handicaps for several reasons. The standard VAT rate is 1.8 percentage point higher than the average of the neighbouring countries.

Other indirect taxes play a certain though less important role. Each individual tax seems to have but little effect on prices. The sum of all taxes, however, should have caused a clear price difference with the neighbouring countries. Likewise, marketing costs should have a limited but clear effect. Compared to other countries, electronic commerce is less common and store security costs are high. Yet, these factors comprise only a small part of total trade and operational costs, respectively. Market regulation as a whole is heavy but should, in the end, have no significant effect on prices.

There also is a number of factors on which Belgium scores unfavourably but for which it is not clear whether or not they have an important impact on prices. Entry and exit rates are low, which may partly be due to exit barriers. There is little innovation in sales methods and probably also in other areas. The latter appears from the slow growth of total factor productivity (TFP). From a theoretical perspective, these factors should have an unfavourable effect on prices, although this was not empirically investigated in the studies discussed. On the influence of certain market regulations, opinions are divided.

Longer shop opening hours can be both favourable and unfavourable to prices. The ban on sales below cost would safeguard competition for independent shop-keepers. Nevertheless, it has been shown that this advantage can be eliminated where the ban also makes wholesale prices being jacked-up. It was also mentioned that it is the complexity of Belgian market regulation that repels entry.

A probably neutral influence

The level of welfare directly affects price levels. On that issue, Belgium barely differs from its neighbouring countries. The regulation on shop location is heavy and has, according to certain studies, a significant effect on prices. Nevertheless, only few applications have been rejected under the Ikea Law. Relatively few products are excised and the Belgian excise duties diverge little from those in the neighbouring countries. Employment protection regulation has proven to be insignificant to prices. Other operational costs constitute only a relatively small part of the price. For these two last factors, Belgium differs little from its neighbouring countries, as does it for market share dynamics and profit elasticity, although their relationship with prices has not been shown yet. It is unknown whether central purchasing offices are significant to prices in branches other than food (see below).

A favourable influence

Population density in Belgium is extremely high and both positively and significantly correlated with prices. The country is renowned for its labour productivity, although its lead on other countries is diminishing. Rental prices of commercial space and the market structure also seem advantageous. However, market conduct shows that the favourable market structure seems to be utilized insufficiently.

Influence unclear

Price-cost margins, price regulation and wage indexation are directly connected with prices. The Belgian position compared to its neighbouring countries, however, is not clear. As for price-cost margins, different studies offer different calculations, making it impossible to determine unmistakably whether they are relatively high or low in Belgium. Currently, there is hardly any price regulation. It could also be investigated to which extent that also applies to other countries. Automatic wage indexation occurs in no other country, but the common social dialogue could lead to a similar effect. Transparent prices allow consumers to choose the best value for money. There is no information available on this matter, so it is not known whether prices are more or less transparent abroad. An intelligent outsourcing policy can grant an entrepreneur a certain cost advantage. This is assessed as proper in Belgium, without it being compared to other countries. Business strategy, consumer preferences and capital productivity have been identified as factors in the food industry. Their measure of significance in other retail trade is unknown.

Driving factors in the food branch

The categorization used for retail trade as a whole also applies to many factors in the food branch. Yet, there are also differences, as shown in Table 4. Obviously, VAT rates do not belong to the most critical factors now. The reduced VAT rate applies to most foods and does not differ much to the neighbouring

countries. Business strategy, on the other hand, plays an important part. The studies show that certain supermarket chains in Belgium have reasons not to lower their prices triflingly. There is hardly or no electronic commerce of food. The influence of the regulation's heaviness is examined on the level of retail trade as a whole, not on the level of food trade. It is, therefore, not yet known whether it is of importance there. The discussed studies did show a possibly low productivity per m² of store surface, without the extent of its significance to prices being clear.

Table 4 Categorization of driving factors of food prices in Belgium*

	Unfavourable in Belgium	Neutral in Belgium	Favourable in Belgium	Belgian position unclear
Factors of great importance to prices	<i>Business strategy</i> Geographic scale <u>Wage bill</u> Wholesale prices	Central purchasing Prosperity Consumer preference <u>VAT</u> <u>Ikea Law</u>	Price-cost margins Population density Labour productivity	<u>Price regulation</u> <u>Wage indexation</u>
Factors of moderate importance to prices	<u>Various taxes</u> <u>Marketing cost</u>		Market concentration Rent of store space	<u>Price transparency</u>
Factors of little importance to prices	Security cost	<u>Excise duties</u> <u>Labour regulation</u> Operational cost		Outsourcing
Factors for which the influence in Belgium has not been determined.	<u>Ban on sales below cost</u> <u>Barriers to exit</u> <u>Shop opening hours</u> <u>Heaviness of regulation</u> <u>regulatory complexity</u> Capital productivity		Market turbulence Distributor brands	Profit elasticity Entry and exit Sales methods <u>TFP growth</u>

Source: FPB.

*) Italics: factors which are of particular importance to price changes in status quo;
Underlined: factors wholly or partly subject to government influence

Belgian consumer preferences seem to reveal opposing forces at work. The preference for national brands, chains with relatively high price levels and small-scale stores is pointed out explicitly. Still, considerable interest for distributor brands and discount stores is observed. A similar situation applies to upstream market concentration, which should be relatively low. Central purchasing offices, in which merchants unite, and distributor brands, which offer merchants a competitive advantage on their suppliers, also exert an influence.

Price-cost margins appear to be favourable still. Although the studies do not agree on the margins in retail trade as a whole, they seem to be rather low in the food branch. The market share dynamics have not been compared to those abroad. Still, it cannot be concluded that they have fossilized in Belgium, considering the gradual shifts in relative strength among the seven largest chains. Distributor brands have a relatively strong position, which is regarded as an advantage. The scope of that advantage is, however, not clear. Finally, for few factors it was already unknown whether they are of importance to prices in retail trade as a whole. In the food branch, it even has not been studied to what extent Belgium scores favourably. Those factors are profit elasticity, entry and exit, sales methods and TFP growth.

4.2. Possibilities for improved price control

A clearly unfavourable influence...

To bring about improved price control, government should primarily target factors with a clearly unfavourable effect. That is not a simple task, since those factors are not or difficult to influence by government, serve other societal purposes or affect the fundamental role of government. Geography should be considered as a fact. The country remains bound to the market's relatively small scale, but does benefit from high population density.

Basically, the business strategy of store chains should also be considered as a fact. That pertains to the field of free enterprise. Moreover, the Belgian market is by no means fossilized and there actually is rivalry between the chains. For instance, the strategy of two players in the food branch, which should not be beneficial to low prices, has not prevented a third player from permanently charging low prices. Also in that branch, market shares have been shifting for a long time and the market offers a wide range of distributor and first-price brands. An effective enforcement of competition law is important. That has indeed improved over the past two decades, but would remain moderate compared to other countries. It should continue to respond properly to certain market trends. Rumours about price agreements, for instance, require attention of the competition authority. The FOD Economie (2012) also mentions other examples. Another aspect of business strategy relates to the strategy in upstream markets. If, indeed, it shows that the position with regard to suppliers is not strong enough, a stimulus might be given to further continue the assembly in central purchasing offices. Combined with the necessary attention at the European level, that should help to further counterweigh the suggested price differentiation between countries.

The labour market is a sensitive subject. On the one hand, increased flexibility can yield important advantages, leading to more favourable conditions of employment, employee statuses and staff structures. On the other hand, it also includes an important social dimension, as it relates to people's welfare. This is, in fact, a matter of fairness. Conditions of employment and statuses can be altered, as long as they are fair to employees and offer sufficient protection. The crucial question is, then, which employment conditions and which level of social protection are 'fair'. Automatic wage indexation is also a sensitive subject, since it should be an important cause of jacked-up prices. However, it could also be possible that the - non automatic - indexation in other countries has a similar impact. It is said that retailers benefit from the automatic indexation, as price increases should affect employees less since the indexation leads to a wage increase anyway. Therefore, it is not clear whether an eventual abolition is expected to have an important effect. Finally, the degree of unionization and the employees' skills play a part. Obviously, unionization cannot be altered, as it is every employee's free choice. There are two sides to the level of skills. A high level implies relatively high wage costs, but also sufficient skills to handle technological innovation. The latter is important to the next price-determining factor: productivity.

An easy way to improve price control is to alter certain indirect taxes. That cannot be dissociated from budgetary policy as a whole. In order to maintain a certain level of collective expenditure, fiscal relief in one area should be accompanied by fiscal tightening elsewhere. Still, the FOD Economie (2012) judged that tackling the tax burden is expected to have an important effect.

As mentioned before, Belgian labour productivity is relatively high but has virtually stopped growing. Total factor productivity - a measure for technological and organizational innovation - even showed negative growth. Although the innovation climate has been evaluated as being relatively favourable and it is not clear whether an important effect on prices is to be expected, pro-innovation measures would certainly play a role. The relatively low turnover per m² of supermarket space can imply two things. Either stores are too large, so market pressure should bring about the rationalization of that size. Or there are too many stores. In that case, their number could be reduced by spatial planning, without triggering off anticompetitive market concentration.

Therefore, there seem to be only limited possibilities for policy makers to influence those factors which probably have a clearly unfavourable effect on prices. Geography is an established fact. Basically, the strategy of store chains is too. Wage costs can only be cut back as long as the result remains fair, but that should allow to somewhat reduce the gap with the neighbouring countries. Remaining are attention for the upstream market position of store chains, proper enforcement of competition law, pro-innovation measures and, possibly, spatial planning measures to bring about an efficient use of store surface.

A supposedly modest influence...

As mentioned before, a number of factors have an unfavourable but supposedly small influence on Belgian price levels. They include, among other things, the still insufficiently developed electronic commerce, the lack of other innovative sales methods and - according to certain studies - the specific regulation for retail trade. As for the latter, the OECD often finds a significant relationship when its PMR index is used as explanatory variable. Still, some studies argue that deregulation probably cannot have a big influence on Belgian prices. Although regulation of shop location (Ikea Law and preceding) is able to maintain an inefficiently low local market concentration, in reality it seems to have little effect on prices. Deregulation of opening hours has either no effect if retailers remain within the legal time frame, or a short-term cost-increasing effect. As for the ban on sales below cost, it can be examined whether it has also lead to jacked-up wholesale prices in Belgium.

A limited effect does not apply to direct price interventions, which, of course, effectively allow for price control but usually are controversial. They upset market equilibrium, which by definition leads to inefficient prices. However, it is also open to question whether the 'market equilibrium' itself is efficient. In that case, the price policy may imply a - possibly imperfect - correction of the inefficient equilibrium.

Measures to support innovative sales methods (including e-commerce) and a critical evaluation of regulation are undoubtedly advisable, but are not to be expected to have a substantial effect on price levels. It is important, though, that regulation is not too complex.

The influence is not (yet) clear...

Self-evidently, the factors of which the impact is not or not yet clear should also be considered. After all, important results can also be achieved on such factors. Before taking measures, however, it should be examined which factors indeed have an unfavourable effect on prices.

Consumer preferences, like business strategy, should in principle be respected, since they also pertain to the willingness to pay and the utility derived from certain services. Still, consumers can be made aware of the fact that the same quality and, possibly, the same utility can be obtained at a lower price. According to the FOD Economie (2012), improved transparency of price and quality is expected to have an effect. By making a number of rather divergent recommendations on that matter, the FOD aims to alert consumers to the fact that the same quality is often available at a lower price. The scope of that effect could still be verified. Many consumers already visit several chains, and cheap products and discount stores already hold relatively strong positions in Belgium.

The FOD Economie (2012) also emphasizes exit barriers, which should feature prominently in Belgian retail trade, although not quantified yet. Tackling those could lead to improved price control. Hence, in this case as well, it should be verified whether an important effect is to be expected. Potentially, adjusting consumer preferences, shifting the tax burden and tackling exit barriers could yield results. It should, however, first be examined whether the resulting effect is sufficient and, from a broader societal perspective, advisable.

4.3. Points of interest for policy makers

By way of summary, the points of interest derived in the previous section are grouped in areas in which an important effect is to be expected, areas in which that is not or not yet clear and areas in which no important effect is to be expected.

In the following fields, an important effect is to be expected.

- Price and quality transparency: this has been suggested by the FOD Economie (2012) and translated into a number of recommendations. They are not specifically aimed at electronic commerce, but rather at affecting consumer preferences.
- Conditions of employment, employee statutes and staff structure: it should be noted that the result of a possible increase in flexibility should be fair to the employee.
- Direct and indirect taxes and social security: it should be noted that they cannot be dissociated from the fiscal system as a whole.
- Price ceilings: as mentioned before, price ceilings are not beneficial to an efficient market balance, but can correct inefficiencies that are more severe.

In the following areas, it is not or not yet clear whether an important effect is to be expected.

- Competition law with regard to market behaviour: enforcement has improved, but it remains unclear what further improvement may yield.
- Ikea Law: although OECD studies frequently point out its harmful effects, other institutions argue that it should have little effect on prices in Belgium.
- Promoting electronic commerce and innovative sales methods: these were cited as relevant factors which, however, cover no significant parts of market.

- Ban on sales below cost: although it directly safeguards competition for independent shop keepers, it could have jacked up wholesale prices indirectly.
- Complexity of regulation: the question is how significantly its effect actually is.
- Barriers to exit: it is important to know the extent to which they affect prices.
- Innovation and skills: it is not clear how many productivity gains they can yield.
- Wage indexation: although this may increase cost, it cannot be ruled out that the same thing actually occurs abroad, but as a result of periodical negotiations between social partners.

Finally, some policy fields are expected not to have an important effect.

- Competition law with regard to market structure: market concentration in Belgium does not seem problematically high or low.
- Shop opening hours: opening hours are often shorter than the legal maximum.

Annex

Graph 4 Price change differences between Belgium and three neighbouring countries, calculated from two alternative sources

Average annual price changes in Belgium compared to the largest neighbouring countries, 2000-2010*



Source: FPB based on Eurostat
 *) Weighted average of Germany, France and the Netherlands

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