February 2004
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Belgium: 2003 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with Belgium, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 24, 2003,** with the officials of Belgium on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 21, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its February 13, 2004 discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

BELGIUM

Staff Report for the 2003 Article IV Consultation

Prepared by Staff Representatives for the 2003 Consultation with Belgium

Approved by José Fajgenbaum and Michael T. Hadjimichael

January 21, 2004

The discussions took place in Brussels during November 14-24, 2003. The team—Messrs. Everaert (head), Anayiotos, Bell, and Hofman (all EUR)—met with the Prime Minister, the Governor of the central bank and the Minister of Finance and their staffs; the head of the banking commission; the director of Treasury; staffs of the ministries of the Budget, Employment and Pensions, Economics, and Health and Social Affairs; the High Finance Council; the Central Economic Council; the High Labor Council and staff of regional employment organizations; the Planning Bureau; the Health Care Administration; labor unions, business organizations, private sector economists and academics. Mr. Kiekens (Executive Director) and Ms. Dupont (Advisor to Mr. Kiekens) participated in the discussions.

Belgium accepted the obligations under Article VIII and, apart from certain security restrictions, maintains an exchange system free of restrictions (Appendix I).

Belgium subscribes to the Fund's Special Data Dissemination Standard and comprehensive economic data are available on a timely basis (Appendix II).

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Executive Summary

The Belgian economy appears set for moderate growth with low inflation in the near term, while over the long run population aging is the key challenge. Policies have been reducing the burden of public debt steadily and their focus is now shifting to raising potential growth, mainly by promoting job creation. To secure fiscal sustainability, the synergies between consolidation and structural reform will need to be fully exploited and reform accelerated.

There are signs that the economy is recovering from a three-year slump, though growth is likely to remain moderate in the near term. With policy conditions broadly supportive and export markets projected to expand, GDP is expected to grow by 1.8 percent in 2004. Downside risks lie in a stronger-than-envisaged euro, a faltering of the recovery in key trading partners, and high domestic wage increases. Though there is consensus on the need for wage moderation, competitiveness is likely to erode somewhat in the staff's view. The authorities felt that any slippage would be recouped in the next round of wage bargaining. There was agreement that the outlook for inflation was benign.

Fiscal policy remains focused on the medium term, but staff argues that automatic stabilizers should be permitted to operate fully in the course of the 2004 budget execution. The authorities are keen to continue to post a balanced budget and do not intend to allow stabilizers to work on the downside to avoid deficits and preserve fiscal discipline. They explained that achieving balance would rely on sizeable one-off factors, in particular a tax amnesty, and the timing of the booking of exceptional transactions.

Dealing with the pressures of aging requires sustained fiscal surpluses in the long run as well as reforms to boost potential growth. The authorities aim for budget balance or a small surplus through 2007 and rising surpluses subsequently which would lower public debt sufficiently to allow ensuing interest savings to cover the increasing costs of aging. They also plan to phase out recourse to one-off factors and continue to reduce the tax wedge on labor, which will be helpful for growth. To ensure the viability of this approach the staff recommends accelerating fiscal consolidation through a sharper reduction in primary spending growth. This could be achieved by phasing out some transfers, streamlining labor market policies, and civil service reform in the context of the upcoming retirements in the public sector. Health care spending growth will need to be curbed.

Lifting employment rates remains key to improved labor market performance. Recent cuts in the tax wedge on labor and strengthening of work incentives have been helpful. The staff recommends further reforms, in particular the phasing out of early retirement schemes and the promotion of wage flexibility. ***Product market*** functioning is improving but effective competition in network industries should be pursued more resolutely. ***Financial markets have held up well, while supervision is being strengthened*** with the merger of banking and insurance supervisors and increased involvement of the central bank in macroprudential aspects of supervision.

I. Overview

1. **The economy is expected to grow at a moderate pace in the near term, but the long-run challenges of aging appear to have heightened somewhat.** For the past three years, activity has been lackluster, largely reflecting developments in export markets. There are now signs of a recovery taking hold in line with neighboring countries, with downside risks remaining from euro appreciation and domestic wage developments. Against the structural features of high public debt, a high tax burden and low employment rates, demographics pose the main risk to fiscal sustainability. Recent decisions related to social security spending have somewhat amplified this risk.

2. **Policies have made progress in tackling the challenge of aging by delivering balanced budgets and a steady decline in the public debt-to-GDP ratio, while focus is now shifting toward promoting employment.** Even during the recent slump in growth, considerable underlying fiscal adjustment was achieved, though lower interest expenditure and other one-off factors have played an increasing role in attaining budget objectives. Meanwhile, real primary spending growth has been exceeding trend GDP growth by a considerable margin. The government coalition—in office following the May 2003 elections—is emphasizing job creation and anticipates attaining a small budget surplus by 2007. It intends to pursue a strategy of debt reduction, which, if sustained, could generate sufficient interest savings to cover the budgetary costs of aging as officially estimated. Some labor market measures have been announced thus far, but more comprehensive reforms will not be initiated before regional elections in mid-2004.

3. **Over the past several years, fiscal consolidation has been broadly in line with Fund recommendations, but the extent and pace of structural reforms has fallen short.** In recent years, Executive Directors have welcomed the ongoing decline in public debt, though going forward they emphasized that fiscal consolidation needed to continue until a sustainable surplus position had been reached. The authorities have broadly followed this advice: despite low growth, consolidation has proceeded and public debt reduction is being pursued. To combine this objective with a desirable reduction in the tax burden, Directors stressed that real primary spending growth had to be brought well below trend growth for an extended period. While progress on this front has been lacking, the authorities' medium-term budget plans are in line with this advice. As regards structural issues, Directors called for a more vigorous program of labor and product market reform to raise medium-term growth prospects. So far, the authorities have taken only limited measures, reflecting a gradual approach to reform given social preferences for a strong welfare state and the complex political structure of the country.

II. Policy Discussions

4. **Discussions focused on cyclical prospects and policies to bring out the synergies between fiscal consolidation and structural reform.** To benefit fully from the recovery, it was agreed that labor-cost developments needed to remain moderate and that fiscal policy should stay focused on consolidation. The authorities emphasized a sustained decline in the public debt-to-GDP ratio, mainly by keeping the budget at least in balance, and tax and

structural reforms to promote job creation. The staff broadly supported these policies, while calling for early implementation of more comprehensive labor market reforms. Such reforms would contribute to a more ambitious strengthening of the underlying fiscal position, in turn addressing the upward revision in the costs of aging.

A. Economic Performance and Near-Term Outlook and Policies

5. **The economy's recent performance largely mirrored developments in neighboring countries.** Following four years of annual average growth above 3 percent, activity slowed abruptly in 2001, as a result of a sharp deceleration of exports and private consumption and a negative contribution from stockbuilding (Figure 1 and Table 1). With business investment and export growth declining steadily, the economy has since grown at an annual rate of less than 1 percent. The unemployment rate has been rising since 2001 and overall employment started to fall in 2002. With support from tax cuts, private consumption gained strength in 2003, in contrast with neighboring countries, though there was also some offsetting increase in household savings. An improvement in the external environment provided a positive impetus in the third quarter of 2003, with preliminary data showing annualized real GDP growth of more than 2 percent.

6. **Transitory factors kept consumer price inflation below the euro-area average, while wage growth moderated in response to a softening labor market.** The reduction in indirect taxes, in particular the TV and radio license fee, was key to holding twelve-month headline inflation at about 1.5 percent through October 2003 (Figure 2). In November, this rate jumped to 1.9 percent owing to the profile of tax changes and energy price increases. Hourly wage cost growth slowed sharply in 2003, while unit-labor-cost growth started to decline already in 2002.

7. **The macroeconomic policy mix was characterized by supportive monetary conditions set by the ECB and a tight fiscal stance, which, however, turned marginally expansionary in 2003.** ECB interest rate cuts have left monetary conditions well below their historical average, though the recent euro appreciation has led to some tightening (Figure 3). In contrast, the pursuit of nominal deficit targets in the face of a weak economy delivered an appreciable fiscal contraction during 2001-02 (Table 2). In 2003, excluding the transaction involving Belgacom and other one-time factors, the staff estimates the structural deficit to have increased by 0.2 percentage point of GDP.[1]

8. **The authorities and the staff agreed that the near-term outlook was for moderate growth with low inflation.** At the time of the mission, real GDP growth was projected to increase from 1 percent in 2003 to 1.8 percent in 2004, consistent with confidence indicators (Figure 4), monetary conditions that were expected to remain

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[1] The takeover of Belgacom's pension fund and associated obligations by the state yields revenues of 1.9 percent of GDP in 2003, but is budget neutral in the long run.

supportive, and projected growth of export markets.[2] Since the mission, Belgian business confidence—widely accepted as a leading indicator for the euro area—has further strengthened as have business expectations in France, Germany and the Netherlands. Moderate growth, sustained for a few quarters, would trigger a revival of business investment, especially since enterprise balance sheets had held up well and indicators of slack—though still substantial—were much less pronounced than in the 1993 downturn. With the recent euro appreciation, the staff and the authorities projected inflation to average less than 1.5 percent in 2004, despite the waning favorable effect of indirect tax changes.

9. **Main downside risks were seen to consist of a faltering of the recovery in key trading partners, a stronger-than-envisaged euro, and high domestic wage increases.** Another abortive recovery in large euro-area economies would be detrimental to growth. The authorities and the staff concurred that a further marked effective appreciation of the euro could dampen the recovery, though some margin vis-à-vis the dollar remained.[3] With two thirds of exports going to the euro-area and a mere five percent to the U.S., currency movements would impact the economy mostly indirectly through their effect on the euro area. Employers expressed concern about competition from Eastern Europe and Asia. In addition, full implementation of the current guideline for wage increases would lead to a loss of competitiveness, albeit from a comfortable level (Figure 5).[4] Indeed, this guideline covering 2003-04 had been negotiated under the expectation of stronger wage growth in key trading partners (see text table). Even though there was consensus that this norm would not be reached, the staff noted that competitiveness was likely to erode somewhat as productivity increases had not kept pace with key trading partners. The authorities were nonetheless confident that any slippage would be recouped in the 2005-06 round of bargaining.

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[2] The projection includes calendar effects from the leap year and a shift in timing of official holidays, which were estimated to add about 0.2 percentage points to growth.

[3] At the time of the discussions, the dollar was trading at about 1.2 per euro.

[4] Wage bargaining takes place at the national, sectoral, and enterprise level in biennial negotiations. At the national level an indicative norm or guideline for hourly wage increases is agreed upon.

Comparison of Labor Cost Developments
(Annual percentage change)

	1999	2000	2001	2002	2003	2004	2001-04 average
Hourly wages (private sector)							
Belgium	3.4	1.8	3.4	4.7	2.1	2.4-3.4 1/	3.1
Average of three neighbors 2/	1.8	3.2	3.8	3.2	2.8	2.4	2.9
France	2.2	3.6	4.7	4.2	2.5	3.0	3.4
Germany	1.5	2.5	2.8	2.1	2.6	2.0	2.3
Netherlands	2.2	5.8	5.2	5.3	4.5	2.7	4.3
Unit labor costs (economy wide, national accounts based) 2/							
Belgium	2.1	0.8	4.9	3.3	1.4	1.4	2.3
Average of three neighbors	0.9	1.2	2.3	1.8	1.9	1.0	1.5
France	1.2	0.8	2.8	2.3	2.4	1.5	1.8
Germany	0.3	1.0	1.3	0.8	1.3	0.5	0.9
Netherlands	2.8	3.4	5.8	5.0	2.8	1.5	3.5

Sources: OECD, and Central Economic Council, 2003 (CEC); and staff estimates and projections.

1/ The lower estimate is from the CEC based on a limited sample of wage agreements. The higher number assumes full implementation of the wage norm.

2/ Weights computed by the CEC; for 2004: Germany 51 percent, France 38 percent, and the Netherlands 11 percent.

3/ Defined as average income per employee divided by measured average productivity.

10. **The authorities felt that fiscal policy could best contribute to the cyclical recovery by supporting overall confidence.** To this effect, the authorities stressed that a balanced budget would be sought in 2004—which in the staff's view implied a structural tightening of ½ of one percentage point of GDP. Ongoing tax cuts would be complemented by reductions in social security contributions targeted to the low-paid to help create jobs. The authorities explained that achieving balance would rely on sizeable one-off factors, in particular a tax amnesty and the timing of the booking of exceptional transactions. They intended to allow any windfalls to be reflected in a surplus, but would compensate adverse deviations to steer clear of a deficit as this would undermine internal fiscal discipline. The staff supported the general strategy, but argued for allowing automatic stabilizers also to work on the downside, as the authorities' approach of avoiding deficits in all circumstances would likely result in further *ad hoc* measures or erratic fiscal policy. Following the mission, and awaiting a Eurostat decision, the Belgacom proceeds have been booked entirely in 2003, rather than be split between 2003 and 2004. Consequently, some exceptional spending was advanced to 2003 and the authorities have indicated that they will seek further measures to eliminate the projected 2004 deficit of -0.1 percent of GDP. In the staff's view, the economic consequences of these changes are insignificant.

B. Fiscal Consolidation

11. **To address the budgetary implications of aging, the authorities intended to steadily pursue the ongoing reduction of public debt, underpinned by keeping the budget at least in balance.**[5] Since the mid-1990s, public debt had been lowered by 25 percentage points of GDP as primary surpluses were kept well in excess of 6 percent of GDP through 2001. Subsequently, as the effects of reduced interest expenditure and other favorable one-off factors had come into play, the fiscal effort had been relaxed somewhat, as revealed by the decline in the underlying primary surplus adjusted for non-structural measures (see text table). The authorities' latest Stability Program update indicates their intention to reduce public debt by a further 15 percentage points of GDP to 87 percent of GDP in 2007, supported by the achievement of a small surplus. Staff estimates show that the targeted surplus is consistent with the envisaged decline in public debt, but implies no additional fiscal effort during 2004-07, as the structural balance remains broadly unchanged (Table 3).

Primary Balance Adjusted for Cycle and Non-structural Items
(In percent of GDP)

	2001	2002	2003	2004
Headline balance	0.5	0.0	0.3	-0.1
Effect of the cycle (-)	1.1	0.1	-0.7	-0.8
Non-structural measures (-) 1/	0.4	0.2	1.5	0.8
of which Belgacom			1.9	
of which tax amnesty				0.3
Adjusted structural balance	-1.0	-0.3	-0.5	-0.1
Interest payments (+)	6.6	6.1	5.6	5.1
Adjusted Structural Primary Balance	5.6	5.8	5.1	5.0
Memorandum items:				
Real primary expenditure growth 2/	1.3	4.3	3.2	1.5
Public debt 3/	108.7	106.1	100.4	97.6

Source: BNB and staff calculations

1/ Non-structural measures pertain to the sale of land and property, the receipts from the UMTS auctions (2001), the takeover of the Belgacom pension fund (2003), the tax amnesty (2004), timing shifts in the tax collection and the payments to the railways, and various items.

2/ Excluding the effect of the advancement of the 2004 payment to the railways.

3/ These numbers differ from table 1 as they reflect the government's GDP growth assumptions.

12. **In the staff's view there was a need to accelerate fiscal consolidation beyond current plans and phase out recourse to one-off factors**. Some of these measures (e.g., the takeover of Belgacom's pension fund and sale and lease back of real estate) would generate appreciable outlays in the long run. In addition, the implementation of the second pension

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[5] The aging problem and strategies for its resolution were discussed extensively in the 2002 Article IV Consultation (IMF Country Report 03/50).

pillar—while welcome—and some recent decisions on social security spending had raised aging-related cost of pensions and health care above earlier projections. The staff acknowledged that following the 1997 reforms there was limited scope for further savings through pension reform, other than the phasing out of early retirement incentives.[6] Public pension spending in Belgium is not expected to exceed the EU average and its projected increase by 2050 is much less than in the Netherlands, Germany and France. The replacement rate (at about 40 percent) is the lowest in the EU, excluding countries that have flat-rate pension systems complemented by substantial second-pillar pensions.[7] The staff noted, though, that a strategy relying on interest savings would now require a net asset position in the long run (Box 1).[8] To achieve long-term goals in a credible manner, an underlying surplus of about 1 percent of GDP would best be reached already by 2007, about ½ of one percentage point more than envisaged by the authorities. Subsequent further adjustments by ¼ percentage point of GDP per year would be needed through about 2013.

13. **The authorities agreed on the need to run fiscal surpluses in the long run but did not share the staff's sense of urgency.** They noted their exemplary performance under the Stability and Growth Pact, and pointed to high household savings as a sign that private agents had internalized the government's long-term budget constraint, thus mitigating concerns about the implications of aging. The staff concurred that structural reforms could yield sizable long-run budgetary gains, emphasizing that comprehensive reforms would need to be implemented soon and that there were also downside risks, particularly from health care (see ¶ 17). The authorities intended to phase out reliance on one-time factors, which continued to be important in 2004 with the tax amnesty and other measures.[9] They noted that the tax amnesty, if successful, would permanently raise revenues somewhat, as the return on repatriated capital would henceforth be taxed.

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[6] Payments for early retirement schemes are funded by the unemployment budget so that their phasing out will not reduce projected direct budgetary costs of aging.

[7] Economic Policy Committee, "Reform Challenges Facing Public Pension Systems", July 2002.

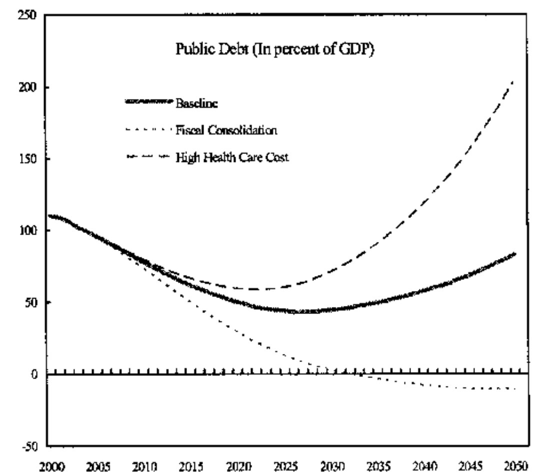
[8] The assessment of debt sustainability according to the standard template—indicating that there were no debt sustainability problems—reported in last year's consultation remains valid (see Country Report No 03/43, February 2003, and "Sustainability Assessments—Review of Application and Methodological Refinements," SM/03/206, 6/11/03). However, demographic issues are not well captured by the standard template. Box 1 accordingly modifies this assessment.

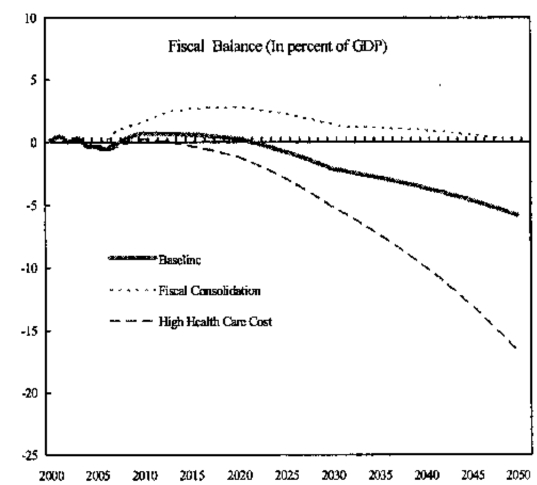
[9] Through end-2004, citizens can repatriate flight capital by paying a tax of 9 percent on its total value, or 6 percent provided that the capital is invested in qualifying assets.

Box 1. Belgium: Fiscal Sustainability and Population Aging

In the coming decades, population aging will threaten fiscal sustainability under unchanged policies. Budgetary outlays on pensions and health care are set to rise by about 7.3 percentage points of GDP between 2000 and 2050 (of which 3.8 percentage points due to pensions). Maintaining general non-aging related primary expenditure in percent of GDP at its 2003 level would lead to a rising general government public-debt-to-GDP ratio after 2030 (figure—Baseline).[1]

One way of dealing with the fiscal pressures of population aging is to run a significant and sustained fiscal surplus. The High Finance Council (HFC) has recommended a strategy of swift debt reduction, especially since there seems to be limited scope for savings from further pension reform as the system is not very generous. Under this scenario, the projected increase in aging-related outlays would be covered by savings on interest payments from lower public debt. With the revised estimate of the cost exceeding the interest bill in 2000 (6.8 percent of GDP), a net asset position would be required. Smooth adjustment suggests that the underlying position be improved by an average of 0.25 percentage point of GDP per year until about 2013 (figure—Fiscal Consolidation). The structural balance would record a surplus of about 1 percent of GDP in 2007 and peak at almost 3 percent of GDP during 2017-2020. Subsequently, as aging costs kick in, it would decline gradually to near balance by 2050.





There are upside and downside risks to this scenario. Population aging will reduce labor supply which could lead to a reduction in unemployment and associated outlays, estimated by the FPB to yield up to 1.6 percentage points of GDP by 2050, thus reducing the need for interest savings. More savings are possible, e.g., from reduced education needs, but all of them will require sustained structural reforms. On the downside, continuing growth in health care expenditure at historic trend rates instead of at FBP projected rates would easily bring public debt onto an explosive trajectory (figure—High Health Care Cost; see also Box 2 for details). The inability to rein in primary spending growth constitutes a further risk and the realization of contingent liabilities (e.g., the planned takeover of the debt of the railways) would require additional adjustment.

[1]This scenario is based on: (1) Draft Winter 2004 WEO projections through 2008, followed by average annual real GDP growth of 1.8 percent over 2009-2050; (2) an implicit real interest rate of 3.4 percent; and (3) pension and health care spending projections by the Federal Planning Bureau (FPB), updated on the basis of the May 2003 Annual Report by the HFC Committee for the Study of Aging. Health care spending projections include a downward adjustment by 0.1 percentage point of GDP to account for the cyclical position in 2002 and real spending growth at 2.7 percent per year during 2008-2050.

14. **Reconciling tax reduction and consolidation objectives requires an appreciable cutback in real primary spending growth.** The staff supported the authorities' plans to reduce the tax wedge on labor while increasing taxation of tobacco and energy products. The net effect of these reforms was modest, however, with the revenue-to-GDP ratio, excluding one-off items, expected to fall by 0.3 percentage point during 2004-07. Nonetheless, with one-off factors waning, to achieve the authorities' consolidation objectives, real primary spending growth would have to average 1½ percent per year during 2005-07.[10] Indeed, continuing spending growth at the recent average of 2½ percent would quickly lead to deficits (Table 3, Unchanged spending scenario). In the staff's normative scenario, real spending growth would need to be curbed to about 1.1 percent per year.

15. **The staff noted that adopting a medium-term expenditure framework would be beneficial to achieve consolidation goals.** While focusing on nominal balance targets had been useful to instill budget discipline, it had necessitated low-quality one-time measures to prevent too procyclical a policy during the downturn. Moreover, most of these measures implied a worsened fiscal position later on and reduced fiscal transparency. In addition, with considerable regional autonomy and the internal stability pact solely focused on balance objectives, there was no guarantee that tax and expenditure decisions at the federal level would not be undone at other levels of government. The authorities recognized the merits of an expenditure-based framework and noted that, for the first time, the coalition agreement had included understandings on a 4-year budget envelope guided by the need to reduce public debt. This had permitted the setting of medium-term spending goals for the federal government and health care. The authorities acknowledged that extending spending control over other parts of social security and other levels of government would be more difficult.

16. **The staff called for comprehensive reform of the civil service and the nexus of social benefits and labor market policies to secure a durable reduction in spending growth.** With a large number of civil servants about to retire, there was room for productivity gains. There was also scope to revamp the broad-based welfare system (Box 2) and labor market policies. In particular, the staff proposed phasing out of early retirement schemes and open-ended unemployment benefits, as this would yield fiscal savings while improving labor market performance (see also ¶ 20).[11] The authorities responded that they would lower spending growth by tightly controlling federal spending, freezing unemployment expenditure in nominal terms as a result of reforms, and abstaining from further *ad hoc* increases in pension benefits. They saw no consensus for more fundamental reform of the social benefit system.

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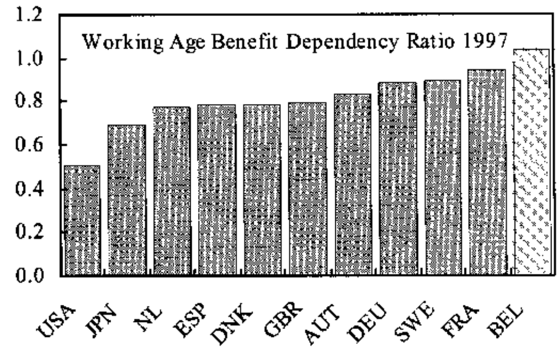
[10] The real primary spending growth rates reported in this paragraph exclude the effects of changes in the timing of exceptional payments between 2003 and 2004.

[11] See accompanying Selected Issues paper.

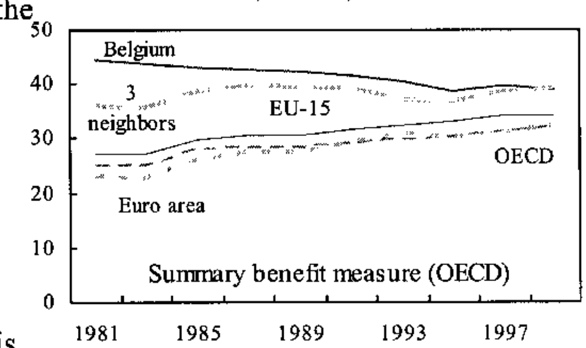
Box 2. Belgium: Social Benefit System

Belgium's social transfer system remains one of the most extensive and expensive by international comparison. It has largely been shielded from the fiscal adjustment of the recent past. Several features stand out:

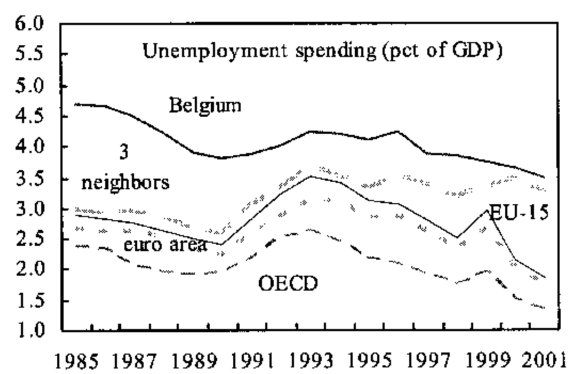
- There is more than one benefit recipient (including old-age pensioners) per working-age adult. This peculiarity reflects the possibility for benefit recipients to accumulate multiple benefits, as well as the wide coverage of such spending.



- In contrast to developments elsewhere, the system's generosity has been somewhat reined in over the last two decades, importantly through curtailing benefits to recipients with higher income, while protecting base level benefits. Still, the system remains one of the most generous.



- A disproportionate amount of transfers is spent on unemployment-related expenditure, in particular on early-retirement programs and active labor market policies with doubtful efficiency, and both discouraging work.



- Social indicators place Belgium at the top of comparators. Social transfers cut the overall poverty risk by roughly half, to a level of 13 percent, with only 8 percent of the population at risk of persistent poverty. While the favorable picture holds for most of the population—in particular children—income distribution, as measured by the Gini coefficient, is somewhat less equal than in other European countries. In this context, observers have noted some concentration of poverty risk for old pensioners—pensions are not adjusted for real income growth—as well as for the younger unemployed, which have yet to qualify for unemployment benefits.

17. **Healthcare spending could pose serious long-term challenges.** [12] In recent years, budgets had been exceeded by a large margin, mainly reflecting a catch up after earlier restraint, the rapid introduction of new pharmaceutical products, and increasing costs of elderly care. For the next four years, the norm for health spending growth was raised to 4½ percent a year in real terms, somewhat higher than recent history. The staff observed that spending at this rate, or at the average rate of the last decade, would be unsustainable (Box 3). The authorities were confident that they could keep spending within budget. The higher norm was seen as realistic and all-inclusive while allowing for an increase in coverage. Meanwhile, reforms were being implemented to curb spending growth in the long run (e.g., reference prices for hospital procedures, and peer review of prescription behavior). The authorities did not see a larger role for private insurance and attached key importance to ensuring basic coverage for the entire population and avoiding the emergence of waiting lists.

C. Labor and Product Markets

18. **There was agreement that poor labor market performance held back trend growth**. Overall employment rates are very low in Belgium, in particular affecting older workers who often leave the workforce prematurely in the context of early retirement schemes and face limited job search requirements when unemployed. As a result, only 25 percent of those aged 55-64 were employed in 2001, compared to an OECD average of 48 percent (Figure 7). The incidence of long-term unemployment is comparatively high, to a considerable extent because unemployment benefits are open ended and seen as a substitute for welfare benefits. There are also large regional dissimilarities in labor market performance (Figure 8): differences in productivity are interacting with limited wage dispersion and mobility, nationally determined benefits and minimum wages, and features of the wage bargaining system to depress labor demand and distort incentives for job search.

19. **The authorities had made job creation a key policy priority, which they were promoting through targeted cuts in income taxes and social security contributions, tightening of job search requirements, and a variety of other measures.** In consultation with social partners in the context of an "employment conference", several initiatives had been developed. Existing cuts for the low paid and across-the-board reductions in social security contributions were expanded, shift workers added as a target group, and the labor tax wedge for the high skilled lowered. As of mid-2004, the task of checking job search requirements is to be returned to the federal level, which is responsible for payment of unemployment benefits. Other initiatives included subsidies for household service jobs—hitherto largely in the informal economy—increased administrative follow-up of the unemployed, and the promotion of life long learning, research and development, and self employment.

20. **Recognizing that these measures would be beneficial, the staff expressed concern about their budgetary cost and called for more comprehensive reforms as some key problems remained unaddressed**. To raise employment rates appreciably, the staff saw a

[12] See accompanying Selected Issues paper.

Box 3. Belgium: Health Care Spending

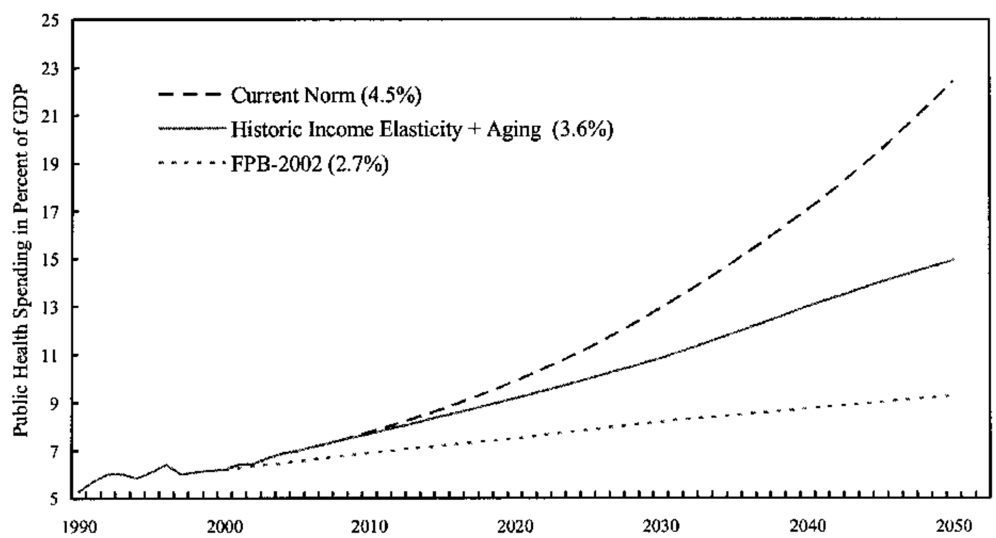
Like other advanced countries, Belgium faces structural upward pressures on health care costs, stemming mainly from increasing demand associated with rising living standards, technological progress, and population aging.

Over the past decade, total health care spending has increased twice as fast as real per capita incomes, causing its ratio to GDP to rise from 7.4 percent in 1990 to 9 percent in 2001. Although current spending is broadly in line with the "expected" level based on per capita income, it is high by international comparison, and above the OECD (8.4 percent) and EU-15 (8.3 percent) averages.

Efforts to curb public spending on health care (about 70 percent of total) through the introduction of a real annual growth norm do not appear to have been effective. In response to considerable overruns, these norms have been raised repeatedly, first from the initial 1½ percent set in 1995, to 2½ percent in 2000, and again to 4½ percent for 2004–07.

These large increases, unless reversed, threaten to jeopardize fiscal sustainability. Indeed, continuing at the new growth rate or the historic average over 1970-2000 would cause the fiscal costs of health care to deviate substantially from the path underlying existing sustainability projections (Federal Planning Bureau FPB-2002).

Public Health Care Spending: Three Scenarios



Source: National Bank of Belgium, Federal Planning Bureau, and staff calculations.

need to phase out early retirement schemes, make the decision to retire actuarially fair, curtail the duration of unemployment benefits, and reduce the breadth of other benefits. The wage bargaining system would have to contribute to wage moderation and greater wage dispersion, while some anomalies such as sectoral minimum wages above the national minimum (and their administrative extension) should be removed. Consequently, owing to an effective increase in labor supply, labor cost growth would slow in the foreseeable future.

21. **The authorities concurred that more effort was required, as noted in the coalition agreement, in particular in tackling pervasive early retirement.** They intended to start discussing this subject in mid-2004, following labor union representative and regional elections, and in the meantime had eliminated some of the tax incentives favoring new early retirement. Labor unions expressed reservations about making the retirement decision fully actuarially fair, however. With respect to benefits, the authorities noted that open-ended unemployment benefits were available only for workers for whom there was no adequate alternative social safety net and that there were no plans for comprehensive benefit reform at this stage. They felt that the wage bargaining system generally had led to a spirit of wage moderation and that it was more flexible than perceived. In any case, recent agreements had been increasingly based on "all-in" wage increases, which mitigated the role of indexation.

22. **In product markets, the authorities' focus was on strengthening competition and reducing the administrative burden but liberalization of key network industries had so far been slow.** The staff strongly supported the intention to put in place an effective competition authority and abolish notification and approval requirements for price increases, which still covered a wide range of products, from bread and water to some types of insurance. Since mid-2003, requirements for business start-ups had become less cumbersome, while streamlining of administrative procedures had been initiated in other areas. On network industries, the authorities conceded that progress had been slow and that consumer benefits remained limited. In the energy sector, competition continued to elude some market segments owing to either legal or *de facto* obstacles. Consumers had not much benefited from price declines as local authorities had raised fees and taxes to replace income lost from distribution monopolies. Rules to implement EU directives for postal services remain to be elaborated and reform of the railways is yet to gather steam.

D. Financial Sector

23. **The staff agreed with the authorities' view that the financial sector had held up well despite the prolonged slump in growth.** Following a difficult year in 2002, banks had improved their profitability appreciably in the first half of 2003 owing to increased revenue from trading, higher realized capital gains, and cost cutting resulting from the ongoing reduction in the number of branches (Table 4). There were no signs of any problematic sectoral or geographical exposures. On the sectoral front, there had been a decline in exposure to the technology, media, and airline sectors. Geographical exposure—while dominated by Western Europe—shifted somewhat toward the U.S. and Central and Eastern Europe and away from other emerging markets and Japan. The staff noted that this could represent a drag on profitability in the short-run owing to weaker credit risk assessments and

legal and institutional frameworks for creditor rights in the region. All in all, solvency had remained strong with the aggregate capital to risk-weighted assets ratio standing at 13 percent at end-June 2003. Despite a small increase, the share of non-performing loans had stayed at a relatively low level (3.4 percent). The insurance sector had performed less well, posting sizeable losses in 2002 due to deteriorating net investment income that overwhelmed the improvement in underwriting results. With the uptick in equity markets its performance is expected to improve in 2003.

24. **Financial supervision continued to be proactive, while the reform of its structure was virtually complete.** In response to difficulties in the insurance sector, the frequency of solvency reporting was increased, some prompt corrective actions were taken, and some smaller institutions were required to raise capital. Oversight over Euroclear—the European settlement system located in Belgium—was being further enhanced by means of memoranda of understanding between interested authorities. Following extension of bank activities in Central and Eastern Europe, cooperation with counterpart supervisors was being intensified. The central bank continued to deepen its macroprudential analysis and publish regular assessments of the overall stability of the financial system. With banking and insurance supervisors merged from January 1, 2004, the staff concurred with the authorities that the structure was in place to further strengthen supervision, in particular on bank-insurance firms, which are important in Belgium. Nonetheless, the authorities acknowledged that the merger of these institutions could pose some operational challenges, given differences in corporate culture and resources. With these changes still to mature, participation in an FSAP had been postponed to 2005.

E. Other Issues

25. Modern legislation to prevent **money-laundering and the financing of terrorism** is being fully implemented, and Belgium's legal system is in compliance with the **OECD anti-bribery convention.**

26. The authorities regretted the failure of the Cancún meeting and continued to strongly support **multilateral trade liberalization,** indicating that they acted within the EU framework, focusing on the reduction of tariffs and non-tariff barriers and the rapid implementation of the agreement on access to generic drugs for developing countries. They intended to step up technical assistance in the area of capacity building and weigh in on reflections within the EU on a different approach to the Singapore issues as regards both strategy and content. Both authorities and employers noted that the domestic adjustment to the imminent elimination of textile quotas was already largely complete. They also observed that EU enlargement would be positive in the long run, with employers remarking that they would be facing heightened competition for investment. In 2002, Belgium spent 0.43 percent of GNI on **official development assistance** (ODA) and it committed to reaching 0.7 percent of GNI by 2010.

27. Economic **statistics** are comprehensive and timely but quarterly data on the general government accounts are not yet available, delays in compiling external capital account data remain considerable, and public availability of financial statistics is limited.

III. Staff Appraisal

28. **Long-term issues continue to dominate the economic policy agenda**. With the economy small and open, there is little room for policies to influence cyclical developments, though moderate unit labor cost growth will be key to preserving competitiveness. Consequently, policies are appropriately focusing on reducing public debt and promoting job creation to deal with the long-term pressures from aging. Successful consolidation will require further progress in reducing primary spending growth and the stepped-up pursuit of synergies between fiscal and labor market reforms.

29. **The economy is expected to grow at a moderate pace in 2004, though there are downside risks.** Policies are broadly supportive: monetary conditions remain historically easy, despite the recent appreciation of the euro; tax cuts are shoring up labor demand; and the fiscal stance is tightening only slightly. With export markets improving and in the absence of noticeable stresses on balance sheets of households, corporations, and financial institutions, the stage is set for enduring growth, albeit at a moderate pace. The inflation outlook is benign. Key downside risks to growth lie in a stronger-than-envisaged euro appreciation, an abortive recovery in key euro-area trading partners, and high domestic wage increases. It will therefore be important to solidify the consensus to keep actual wage increases below the guideline agreed in the latest round of wage bargaining, and ensure that the planned reduction of social security contributions translate into lower labor costs.

30. **The challenge from aging is becoming more pressing, calling for sustained fiscal consolidation**. Achieving an underlying budget surplus of about 1 percent of GDP by 2007, and proceeding with annual adjustment at a pace of ¼ of one percentage point of GDP through about 2013, would allow sufficient interest savings to accrue in the long run to cover the increasing costs of aging. While structural reforms, especially in the labor market, will facilitate such consolidation, the extent and timing of their impact remains uncertain. Thus, for a strategy based on public debt reduction and tax cuts to be credible, progress with adjustment is required over the next few years. From this perspective, there is a need to strengthen current consolidation plans.

31. **To reach fiscal objectives, primary spending growth will need to be curbed, focusing on areas where the synergies with the promotion of higher trend growth are the largest**. Proceeding with the planned tax cuts will be beneficial for job creation, provided progress with consolidation is not jeopardized, which will require lowering the pace of real primary spending growth well below that of trend GDP. Curtailing spending on transfers and labor market programs and broader benefit reform will contribute directly, but also indirectly by boosting employment rates and potential growth. The intention to hold unemployment spending constant in nominal terms and to abstain from discretionary increases in pension spending is a welcome step. The upcoming large-scale retirements from the civil service offer additional opportunities for savings.

32. **The elaboration of a medium-term fiscal framework based on expenditure growth ceilings rather than nominal balance targets would help underpin the achievement of budget objectives.** While the current framework has served as a valuable

policy communication tool, it has resulted in a growing pursuit of *ad hoc* fiscal policy measures that sometimes trade off a current benefit for a future outlay. By contrast, a system based on primary spending growth ceilings would put a premium on durable fiscal savings measures. When set consistent with medium-term tax cut and consolidation objectives, such a system would preserve interest savings for debt reduction while preventing contractionary impulses in a downturn and structural slippage during upswings. Through a strengthening of the internal stability pact all levels of government could be involved in this process.

33. **The authorities' focus on job creation has triggered helpful initiatives but further, comprehensive labor market reform is needed to raise employment rates appreciably.** Building on the elimination of some of the tax benefits for early retirement, all remaining tax incentives and public spending on early retirement should be phased out and the decision to retire made actuarially fair. The targeted cuts in social security contributions for low-wage earners will promote job opportunities for the low-skilled, but complementary measures will be needed to ensure that budgetary costs remain manageable. To foster wage flexibility, sectoral minimum wages in excess of the national minimum and the administrative extension of contracts should be phased out. Limiting the duration of unemployment benefits and reducing the scope of government transfers would improve work incentives. The proposed expansion of enterprise-based training programs will be helpful, while effective implementation of the initiative envisaging tougher application of job search requirements will be essential.

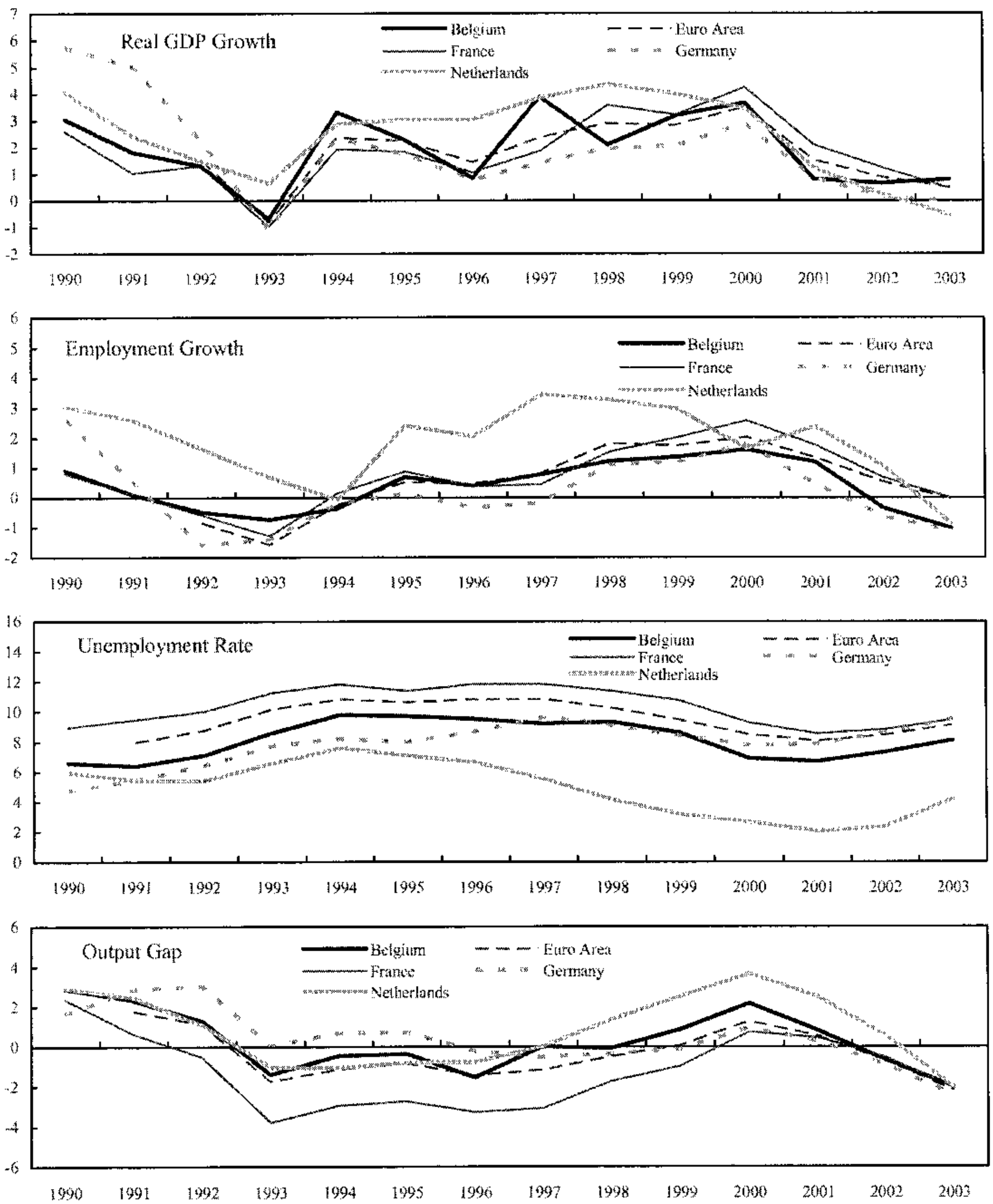
34. **An acceleration of product market reform would provide an impetus to growth.** All segments of the energy markets should be effectively opened to competition, while taking care that measures designed to offset the associated revenue losses of the public sector do not lessen public support for reform. The envisaged strengthening of the competition authority is highly desirable, while further progress in lowering the administrative burden on taxpayers and enterprises, and the adoption of e-government will garner efficiency gains.

35. **While the financial sector has performed well in light of the prolonged slump in activity, the ongoing strengthening of its supervision needs to be pursued**. The merger of banking and insurance supervisors and the closer link between them and the central bank will enhance supervisory capacity. It will be essential to secure a smooth integration of the two institutions and set aside sufficient resources for effective operation of the new agency. The greater involvement of the central bank should be continued as it has boosted the macroprudential dimension of supervision. Supervision of cross-border and bank-insurance firms and the payment system will keep on requiring close attention.

36. Belgium's commitment to raising **ODA** to the U.N. target by 2010 is commendable. In a similar vein, the authorities should use their position in international institutions to help reinvigorate the process of **multilateral trade liberalization**.

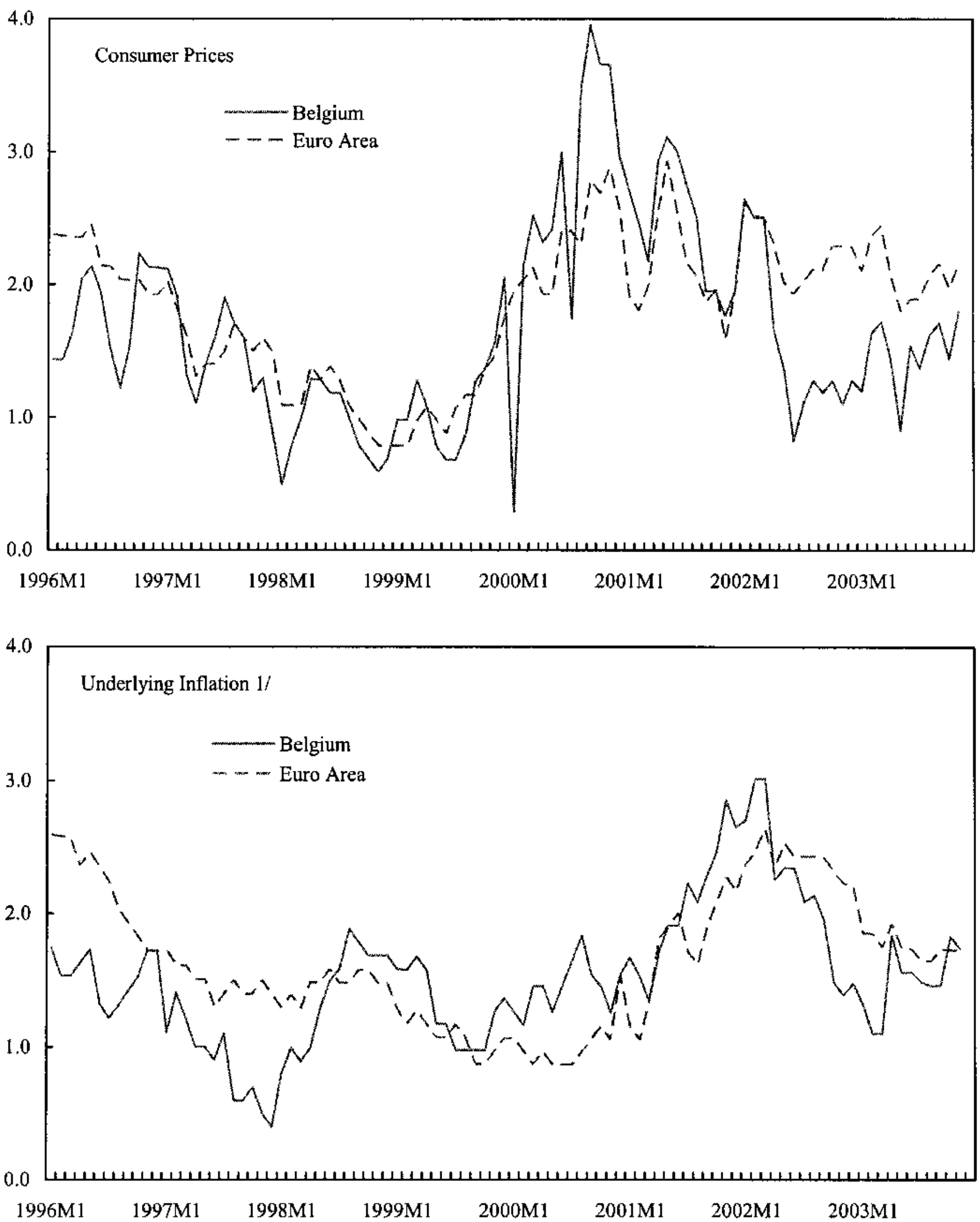
37. It is proposed that the **next Article IV consultation** take place on the standard 12-month cycle.

Figure 1. Belgium: Output and Employment



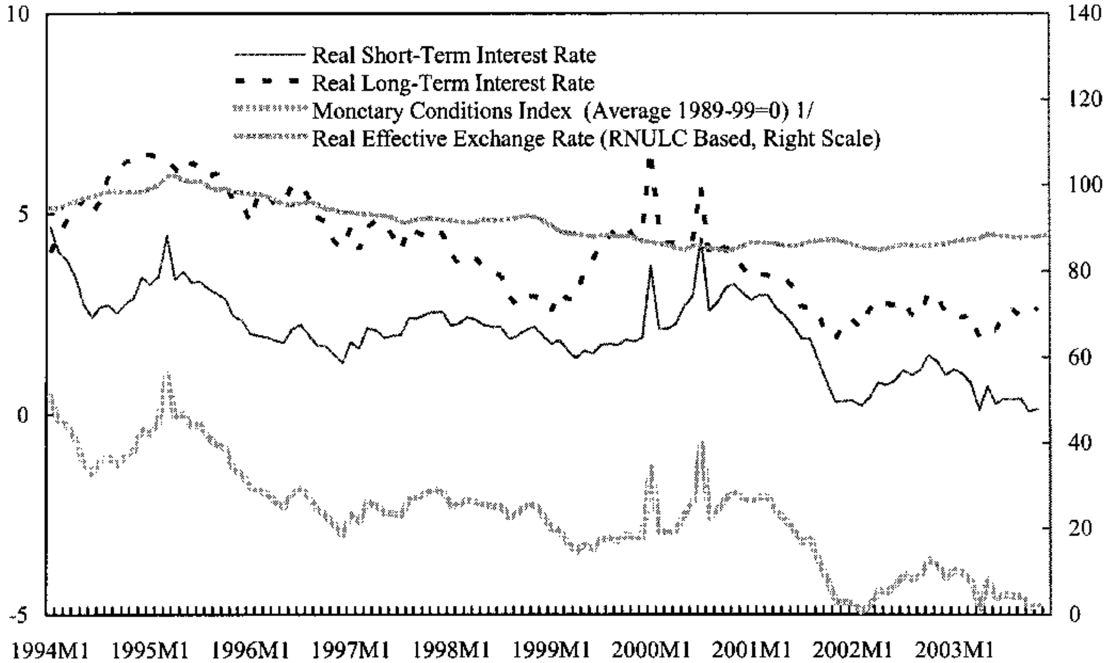
Source: IMF, WEO.

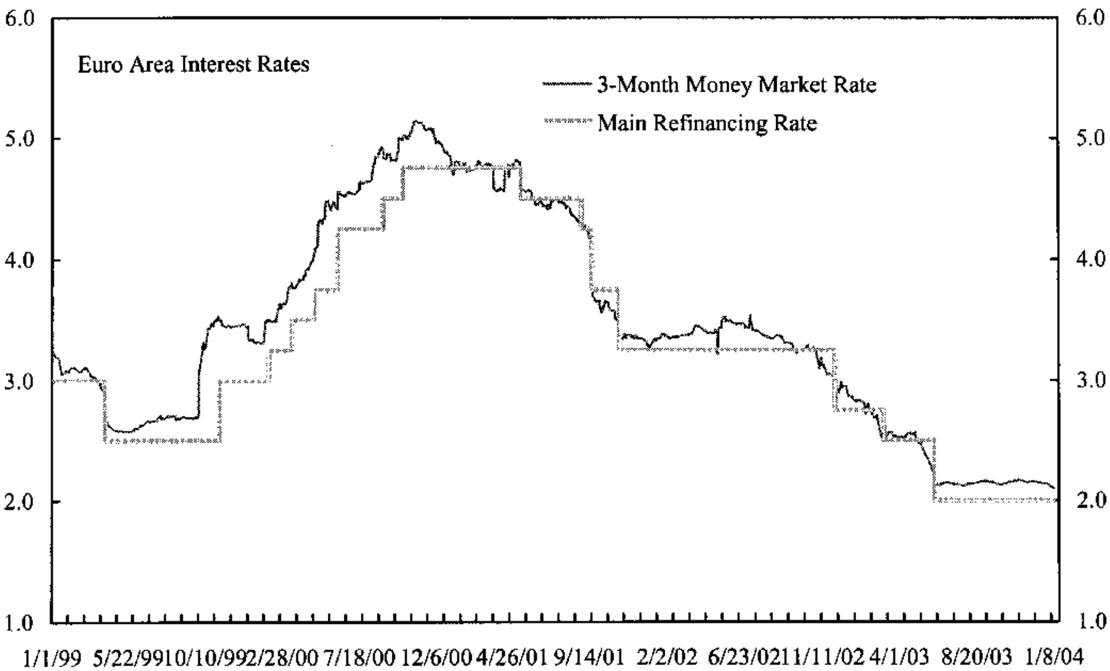
Figure 2. Belgium: Price Developments
(12-Month Growth Rate; Harmonized CPI)



Sources: IMF, IFS; and Cronos database.
1/ Overall harmonized index excluding energy, food, alcohol and tobacco.

Figure 3. Belgium: Monetary Conditions

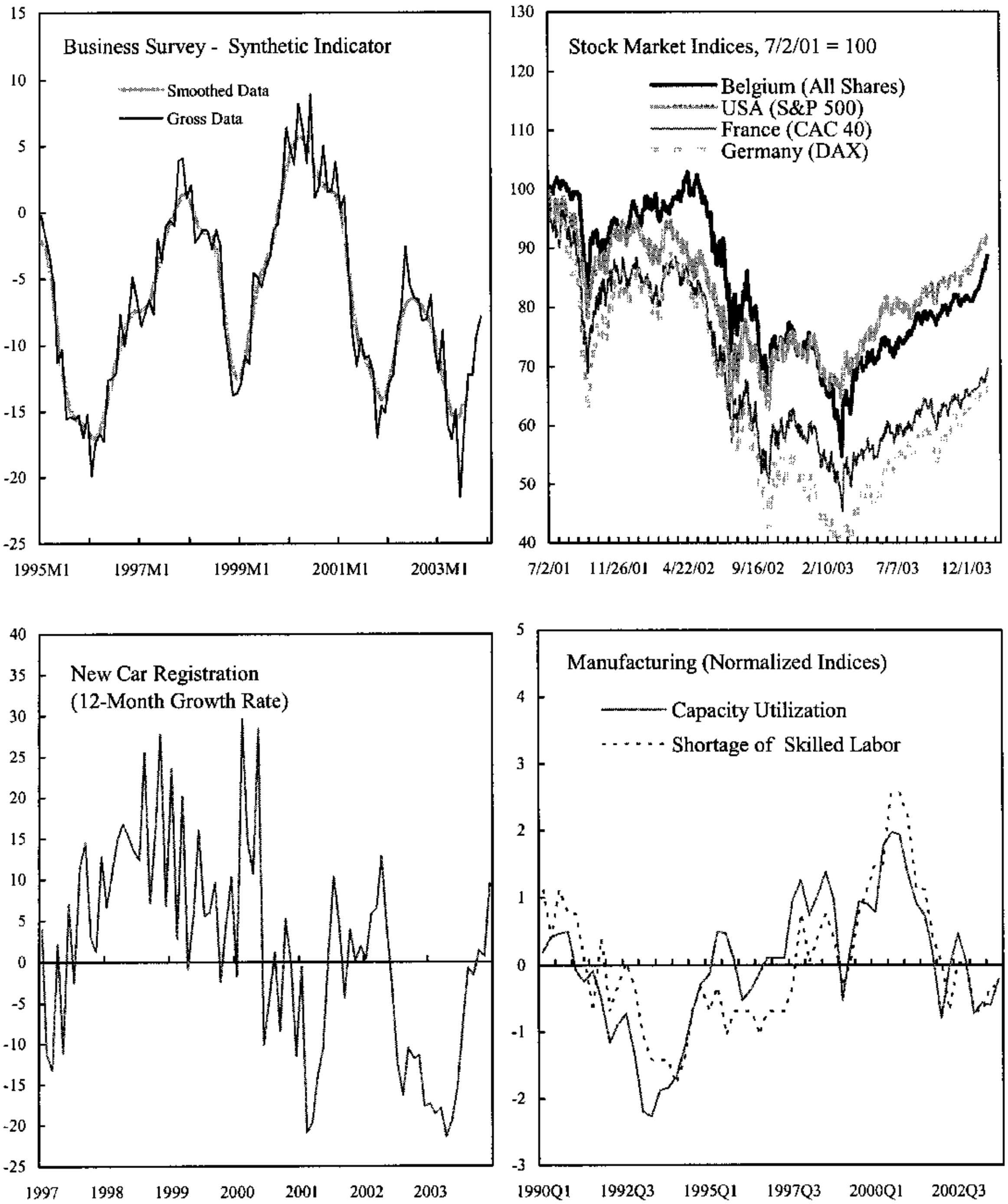




Sources: IMF, IFS; and European Central Bank.

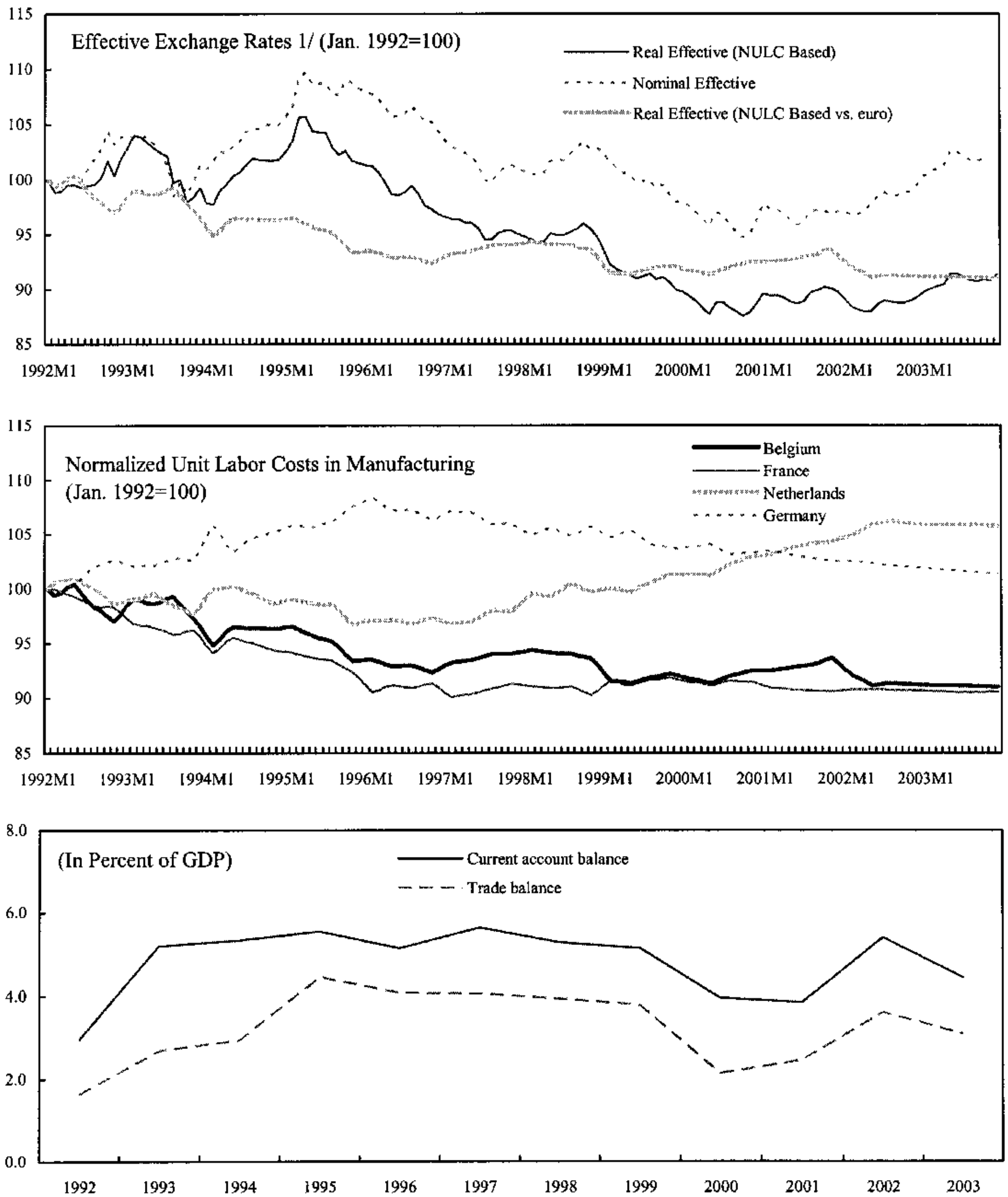
1/ The monetary conditions index is a weighted average of the real effective exchange rate (weight=0.1) and the short-term real interest rate (weight=0.9).

Figure 4. Belgium: Cyclical Indicators



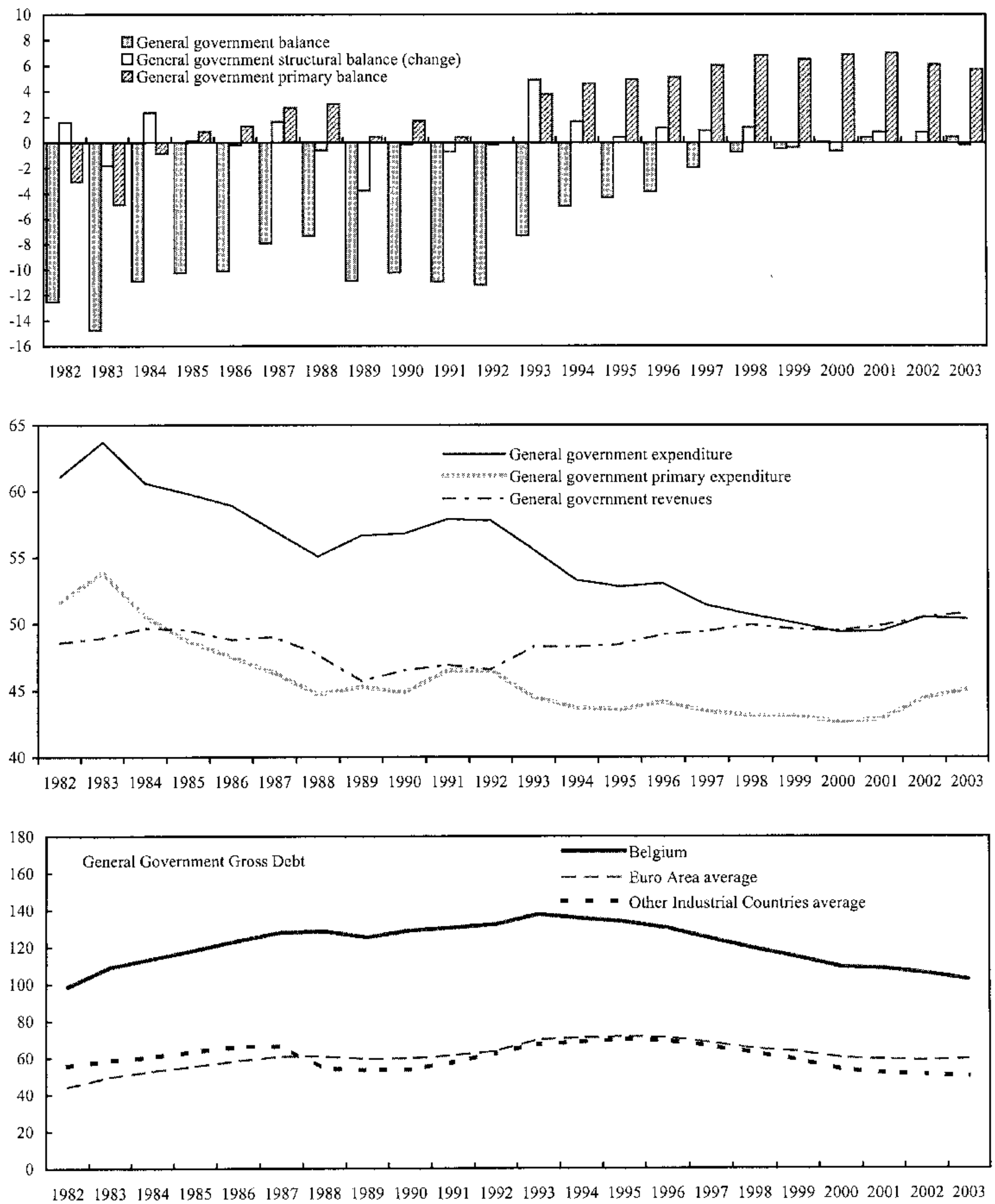
Sources: WEFA Intline Database; and NBB.

Figure 5. Belgium: External Developments



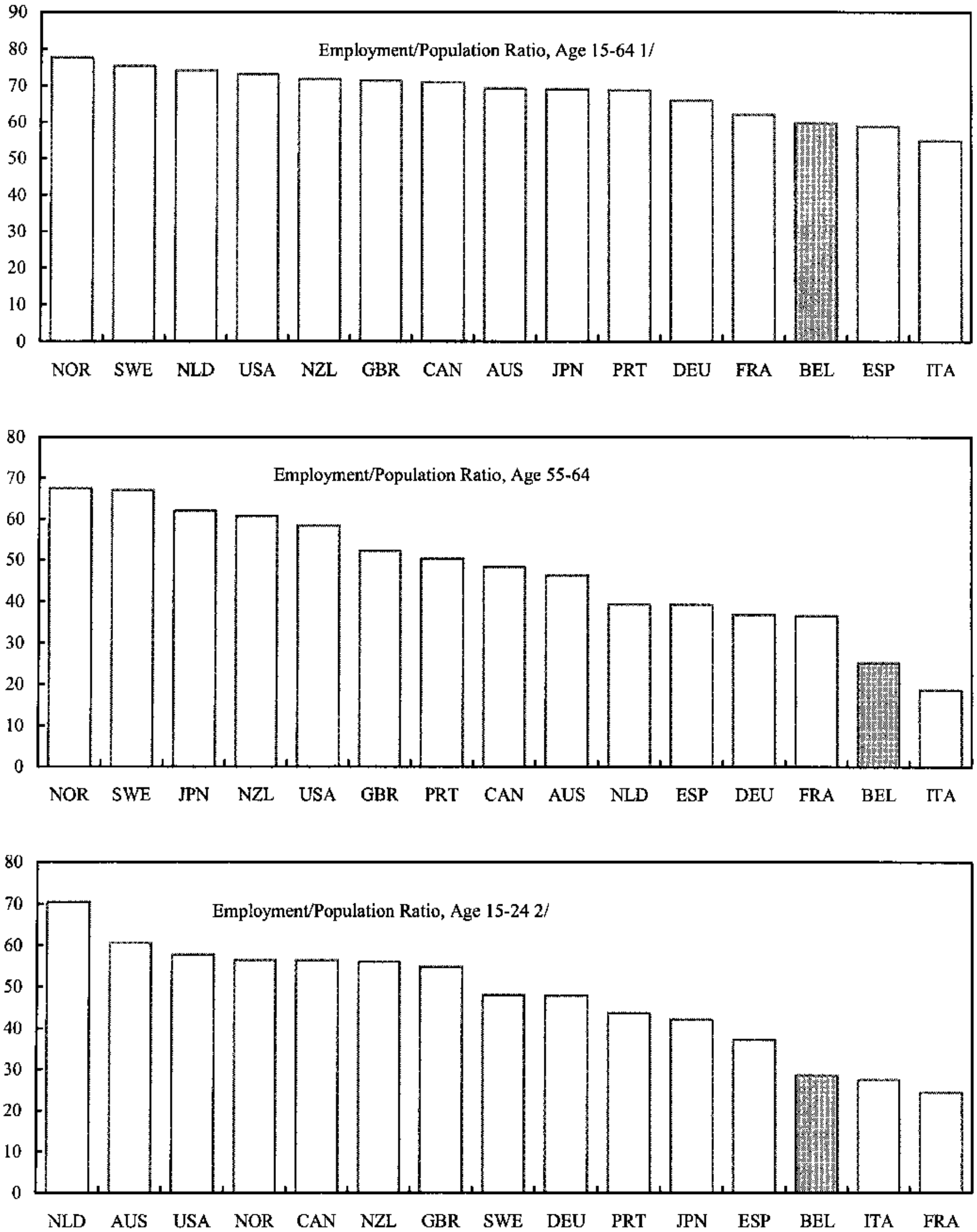
Sources: IMF, IFS and WEO.
1/ An increase indicates an appreciation.

Figure 6. Belgium: Fiscal Developments
(In Percent of GDP)



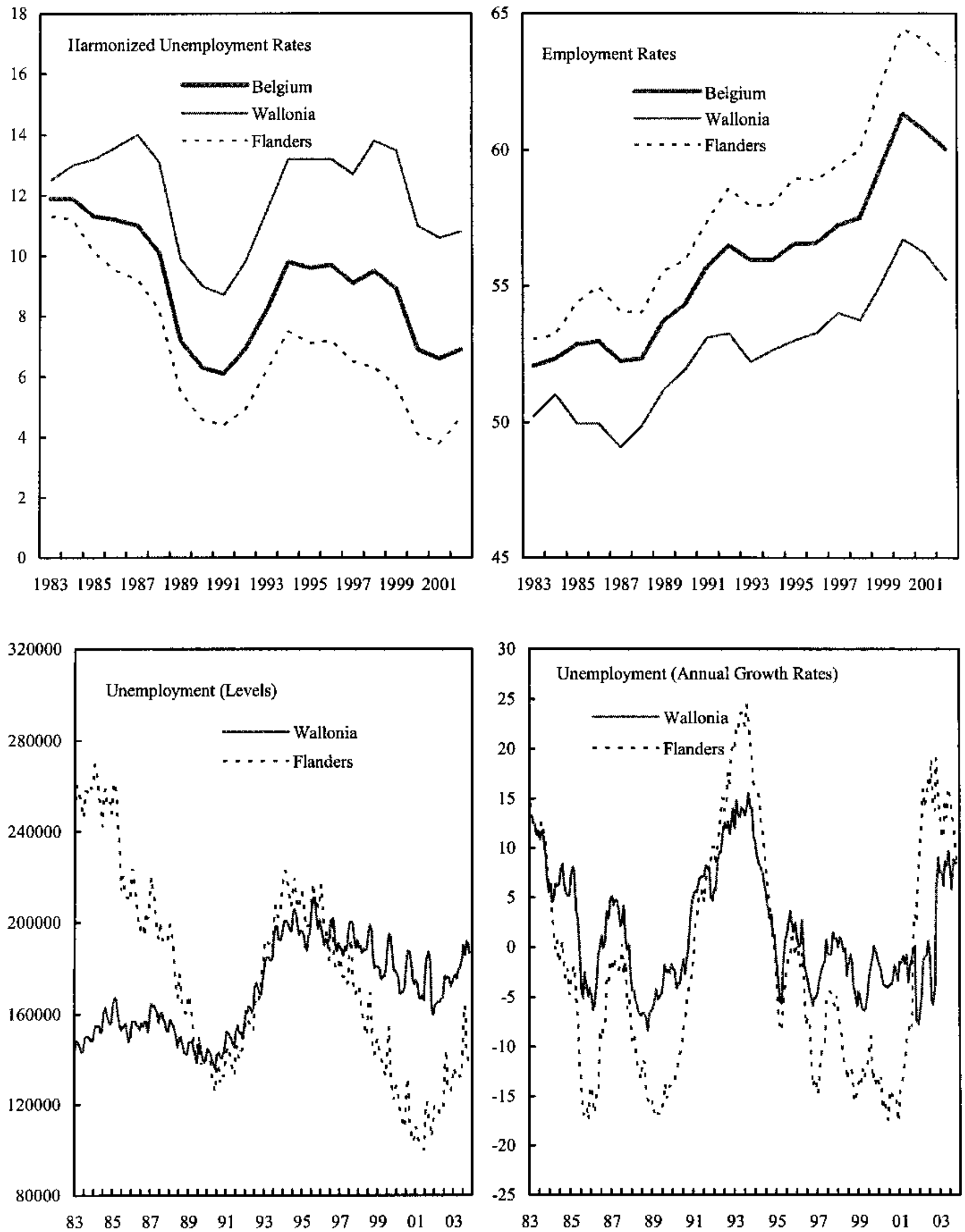
Source: IMF, WEO.

Figure 7. Belgium: Labor Market Indicators in Selected Countries (2001)



Source: OECD, Employment Outlook, July 2002.
1/ Refers to persons aged 16 to 64. (ESP, GBR, NOR, SWE, USA)
2/ Refers to persons aged 16 to 24. (ESP, GBR, NOR, SWE, USA)
Countries are: AUS=Australia, BEL=Belgium, CAN=Canada, FRA=France, DEU=Germany, ITA=Italy, JPN=Japan, NLD=Netherlands, NZL=New Zealand, NOR=Norway, PRT=Portugal, ESP=Spain, SWE=Sweden, GBR=United Kingdom, USA=United States.

Figure 8. Belgium: Labor Market Developments



Sources: Data provided by the Belgian authorities; Cronos Database; and staff calculations; staff estimates for employment and unemployment rates in 2002.

Table 1. Basic Data

Demographic and other data:

Population (mid-2002)	10.3 million
GNI per capita (1999)	US$ 22,499
Social indicators (1993-2000)	
Life expectancy at birth	
Male	75
Female	81
Infant mortality rate	5 per 1,000 live births
Population per physician (1995)	437
Population per sq. km. (1995)	335

	1990		2002	
	Billions of euro	Percent of GDP	Billions of euro	Percent of GDP
Private consumption	90.5	55.4	141.5	54.5
Public consumption	33.2	20.3	58.1	22.3
Gross capital formation	36.5	22.3	50.6	19.5
Exports of goods and services	116.1	71.1	218.1	83.9
Imports of goods and services	112.8	69.1	208.3	80.1
GDP	163.4	100.0	259.9	100.0

	1999	2000	2001	2002	2003 Est.	2004 Proj.	2005 Proj.
			(Changes in percent)				
National Accounts							
Demand and output (volume)							
Private consumption	2.3	3.4	0.9	0.4	1.7	1.7	2.2
Public consumption	3.5	2.7	2.5	1.9	1.8	1.8	1.9
Gross fixed investment	4.6	3.5	0.5	-2.1	1.7	2.2	4.1
Of which:							
Enterprise investment	2.5	4.6	2.5	-2.7	1.3	3.5	4.8
Stockbuilding 1/	-0.6	0.2	-0.7	0.8	0.5	-0.8	-0.1
Total domestic demand	2.4	3.5	0.5	1.0	2.2	1.0	2.4
Exports of goods and nonfactor services	5.4	8.6	1.3	0.8	1.6	4.3	5.5
Imports of goods and nonfactor servises	4.5	8.4	1.1	1.1	3.1	3.5	5.4
Foreign balance 1/	0.8	0.4	0.2	-0.3	-1.2	0.8	0.3
GDP	3.2	3.7	0.7	0.7	1.0	1.8	2.7
Output gap (in percent of potential GDP)	1.0	2.6	1.2	-0.1	-1.1	-1.3	-0.8
Manufacturing production	1.1	4.9	-0.4	1.3	-0.7	2.9	2.9

Table 1. Belgium: Basic Data (continued)

	1999	2000	2001	2002	2003 Est.	2004 Proj.	2005 Proj.
				(Changes in percent)			
Labor market							
Labor force (national definition)	0.4	0.9	1.2	0.3	0.3	0.4	0.4
Employment (national definition)	1.2	1.9	1.6	-0.1	-0.8	-0.1	0.7
EU harmonized unemployment rate /2	8.6	6.9	6.7	7.3	7.9	8.3	8.1
NAIRU	9.0	8.5	8.3	7.9	7.9	7.9	7.9
Prices, wages and incomes							
GDP deflator	1.4	1.2	1.8	1.7	2.0	1.8	1.7
Terms of trade (goods)	-0.6	-1.3	-1.0	2.2	1.1	0.5	0.2
Consumer price index 3/	1.1	2.7	2.4	1.6	1.5	1.4	1.4
Compensation per employee 4/	3.7	2.0	2.8	3.7	1.9	3.4	3.5
Labor productivity 4/	1.6	1.2	-2.1	0.4	0.4	1.9	2.0
Unit labor costs 4/	2.1	0.8	4.9	3.3	1.5	1.4	1.4
Real disposable income	2.2	2.1	1.8	1.5	2.5	1.2	2.2
				(In percent)			
Interest rates							
Money market rate 5/	3.0	4.4	4.3	3.3	...	...	...
Government bond yield	4.7	5.6	5.1	5.0	...	...	...
				(In percent of GDP)			
Saving and investment							
Private saving	25.6	24.6	23.7	24.1	23.3	23.8	23.9
Of which:							
Household saving as percent of disposable household income	11.1	10.2	11.2	12.3	12.9	12.4	12.3
Private investment	19.2	19.3	19.3	18.3	18.2	18.4	18.6
Private saving surplus	6.4	5.2	4.4	5.8	5.1	5.3	5.3
Government saving surplus	-1.6	-1.4	-1.3	-1.4	-1.4	-1.4	-1.3
National saving surplus	4.8	3.9	3.1	4.4	3.7	4.0	4.0
Public finances, general government							
Revenue	49.6	49.5	50.0	50.5	51.7	50.2	49.9
Expenditure	50.1	49.4	49.5	50.5	51.4	50.4	49.8
Of which:							
Interest on public debt	7.0	6.8	6.6	6.1	5.6	5.1	4.8
Fiscal balance 6/	-0.4	0.1	0.5	0.0	0.3	-0.1	0.1
Primary balance 6/	6.5	6.9	7.1	6.1	5.9	5.0	4.9
Structural balance 7/	-1.1	-1.7	-0.8	-0.1	-0.9	0.7	0.6
Structural primary balance 7/	6.0	5.3	5.9	6.0	4.6	5.7	5.4
Gross public debt	114.8	109.5	108.7	106.1	100.3	97.5	93.6

Table 1. Belgium: Basic Data (continued)

	1999	2000	2001	2002	2003 Est.	2004 Proj.	2005 Proj.
	(In billions of euros)						
Balance of payments							
Current account balance	12.1	9.8	9.7	14.0	11.9	12.5	13.5
(In percent of GDP)	5.1	3.9	3.8	5.4	4.4	4.5	4.7
Trade balance	8.9	5.3	6.2	9.3	8.2	9.3	10.7
(In percent of GDP)	3.8	2.1	2.5	3.6	3.1	3.4	3.7
Official reserves (US$ billion) 8/	10.9	10.0	11.3	11.9	...	...	...
Reserve cover (months of imports of GNFS)	0.7	0.6	0.7	0.7	...	...	...
Exchange rates							
Euro per U.S. dollar (January 20, 2004) 9/						0.7930	
Nominal effective rate (1995=100)	92.8	90.1	90.5	91.2	93.9	...	...
Real effective rate (1995=100) 10/	88.4	85.6	86.5	85.7	87.8	...	...

Sources: data provided by the authorities; and Fund staff estimates and projections.

1/ Contribution to growth.
2/ Percent of the labor force
3/ Harmonized consumer price index.
4/ Economy wide.
5/ Since 1999, Euro rate.
6/ Includes UMTS license revenue of 0.2 percent of GDP in 2001; and projected proceeds from the transfer of Belgacom's pension fund of 1.9 percent of GDP in 2003.
7/ Excludes UMTS license revenue of 0.2 percent of GDP in 2001; and projected proceeds from the transfer of Belgacom's pension fund of 1.9 percent of GDP in 2003.
8/ Excluding gold. Since January 1999, Eurosystem's definition.
9/ Belgium entered the final stage of EMU on January 1, 1999 at a rate of 40.3399 Belgian francs to the euro.
10/ Based on relative normalized unit labor costs in manufacturing.

Table 2. Belgium: Operations of the General Government, 1996 - 2002
(In percent of GDP)

	1996	1997	1998	1999	2000	2001	2002
Revenue	49.2	49.5	50.0	49.6	49.5	50.0	50.5
Tax revenue	44.5	44.8	45.4	45.1	45.0	45.2	45.7
Direct taxes	16.7	17.1	17.6	17.1	17.3	17.6	17.6
Personal income tax	13.8	14.0	14.0	13.6	13.8	14.2	14.3
Company income tax	2.8	3.0	3.6	3.4	3.4	3.3	3.2
Other direct taxes	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Indirect taxes	12.7	12.9	12.9	13.2	13.1	12.7	13.0
Social contributions	14.7	14.5	14.5	14.4	14.1	14.4	14.7
Other taxes	0.4	0.4	0.4	0.4	0.5	0.5	0.5
Nontax revenue	4.7	4.7	4.6	4.6	4.5	4.8	4.8
Expenditure	53.0	51.4	50.7	50.1	49.4	49.5	50.5
Primary expenditure	44.2	43.4	43.1	43.1	42.6	42.9	44.4
Current expenditure	41.4	40.4	40.2	39.9	39.5	40.4	41.8
Wages	11.9	11.7	11.6	11.6	11.4	11.6	12.0
Operations and maintenance	2.9	2.9	3.0	3.0	3.1	3.2	3.4
Social transfers	23.0	22.3	22.1	21.7	21.5	22.1	22.8
Old age	8.8	8.7	8.6	8.4	8.3	8.4	8.6
Health	5.8	5.4	5.5	5.6	5.6	5.9	5.9
Unemployment	2.1	2.1	2.0	1.9	1.8	1.8	2.0
Other social transfer	6.3	6.1	5.9	5.8	5.8	5.9	6.2
Subsidies to enterprises	1.6	1.4	1.5	1.5	1.5	1.6	1.6
Other transfers	2.1	2.1	2.1	2.1	2.0	2.0	2.0
Capital expenditure	2.7	3.0	2.9	3.2	3.1	2.4	2.6
Interest	8.9	8.0	7.6	7.0	6.8	6.6	6.1
Overall balance	-3.8	-2.0	-0.7	-0.4	0.1	0.5	0.0
Primary balance	5.1	6.0	6.8	6.5	6.9	7.1	6.1
Memorandum items:							
Structural balance	-2.9	-1.9	-0.7	-1.1	-1.7	-0.8	-0.1
Central government balance	-3.4	-2.5	-1.6	-1.6	-0.5	-0.9	-0.3
Gross public debt (Maastricht definition)	130.5	124.8	119.5	114.8	109.5	108.7	106.1

Sources: Data provided by the Belgian authorities, and Fund staff projections.

Table 3. Fiscal Scenarios, 2001-2007
(In percent of GDP)

	2001	2002	2003	2004	2005	2006	2007
Government Scenario							
Revenue	50.0	50.5	51.7	50.3	49.9	49.4	49.5
Expenditure	49.5	50.5	51.4	50.4	49.9	49.4	49.1
Primary expenditure	42.9	44.4	45.8	45.3	45.1	44.7	44.5
Interest payments	6.6	6.1	5.6	5.1	4.8	4.7	4.6
Balance	0.5	0.0	0.3	-0.1	0.0	0.0	0.3
Structural balance 1/	-0.8	-0.1	-0.9	0.7	0.4	0.2	0.6
Primary balance	7.1	6.1	5.9	5.0	4.8	4.7	4.9
Structural primary balance 1/	5.9	6.0	4.7	5.8	5.2	4.9	5.2
Debt	108.7	106.1	100.4	97.6	93.6	90.1	87.0
Memorandum items (in percent):							
Real primary expenditure growth 2/	1.3	4.3	3.2	1.5	1.4	1.5	1.8
Interest rate	6.2	5.6	5.2	5.0	5.1	5.2	5.2
GDP growth	0.7	0.7	0.9	1.8	2.8	2.5	2.1
Unchanged spending policies (average 2000-2003)							
Revenue	50.0	50.5	51.7	50.2	49.9	49.4	49.5
Expenditure	49.5	50.5	51.4	50.4	50.4	50.3	50.3
Primary expenditure	42.9	44.4	45.8	45.3	45.6	45.6	45.6
Interest payments	6.6	6.1	5.6	5.1	4.8	4.7	4.7
Balance	0.5	0.0	0.3	-0.1	-0.5	-0.9	-0.8
Structural balance 1/	-0.8	-0.1	-0.9	0.7	0.0	-0.6	-0.6
Primary balance	7.1	6.1	5.9	5.0	4.3	3.8	3.9
Structural primary balance 1/	5.9	6.0	4.6	5.7	4.8	4.1	4.1
Debt	108.7	106.1	100.3	97.5	94.2	91.7	89.3
Memorandum items (in percent):							
Real primary expenditure growth 2/	1.3	4.3	3.2	1.5	2.5	2.5	2.5
Interest rate	6.2	5.6	5.2	5.0	5.1	5.2	5.2
GDP growth	0.7	0.7	1.0	1.8	2.7	2.5	2.5
Staff Scenario							
Revenue	50.0	50.5	51.7	50.2	49.9	49.4	49.4
Expenditure	49.5	50.5	51.4	50.4	49.8	49.1	48.4
Primary expenditure	42.9	44.4	45.8	45.3	45.0	44.4	43.8
Interest payments	6.6	6.1	5.6	5.1	4.8	4.7	4.6
Balance	0.5	0.0	0.3	-0.1	0.1	0.3	1.0
Structural Balance 1/	-0.8	-0.1	-0.9	0.7	0.6	0.5	1.0
Primary balance	7.1	6.1	5.9	5.0	4.9	5.0	5.6
Structural primary balance 1/	5.9	6.0	4.6	5.7	5.4	5.2	5.7
Debt	108.7	106.1	100.3	97.5	93.6	89.9	85.8
Memorandum items (in percent):							
Real primary expenditure growth 2/	1.3	4.3	3.2	1.5	1.1	1.1	1.1
Interest rate	6.2	5.6	5.2	5.0	5.1	5.2	5.2
GDP growth	0.7	0.7	1.0	1.8	2.7	2.5	2.5

Sources: Data provided by the authorities and Fund staff projections.

1/ Excluding the effects of the UMTS auctions and the capital transfer resulting from the Belgacom pension fund takeover. Other non-structural items and one-off factors have not been excluded in line with the WEO convention.

2/ Excluding the shift in the timing of the 2004 payment to the railways.

Table 4. Belgium: Indicators of External and Financial Vulnerability 1/
(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000	2001	2002	2003 III
External Indicators								
Exports (annual percentage change, in U.S. dollars)	1.7	-0.7	3.5	-0.2	2.9	-0.4	5.6	...
Imports (annual percentage change, in U.S. dollars)	2.2	-1.0	4.0	-0.3	5.2	-0.6	4.0	...
Terms of trade (annual percentage change)	2.4	-2.2	-0.2	-0.6	-1.3	-1.0	2.2	...
Current account balance	5.1	5.6	5.3	5.1	3.9	3.8	5.4	...
Inward portfolio investment (debt securities etc.) 2/	13.5	22.2	23.6	53.8	57.4	64.7	...	...
Inward foreign direct investment	6.2	8.2	13.2	54.6	108.5	24.1	24.1	...
Official Reserves (in billions of U.S. dollars, end-of-period) 3/	17.0	16.2	18.3	10.9	10.0	11.3	11.9	10.7
Official reserves in months of imports	1.2	1.1	1.2	0.7	0.6	0.7	0.7	...
Exchange rate per U.S. dollar (period average) 4/	31.0	35.8	36.3	0.937	1.083	1.116	1.1	0.9
Financial Markets Indicators								
10-year Government bond rate	6.5	5.8	4.7	4.7	5.6	5.1	5.0	4.1
Government bond yield (real)	4.7	4.3	3.8	3.6	2.9	2.7	3.4	2.7
Stock martket index (period average)	120.6	161.2	223.6	231.1	208.5	195.8	174.5	138.2
Spread of 10-year government bond rate with Germany	0.29	0.09	0.19	0.23	0.30	0.31	0.19	0.11
Number of credit institutions	141	134	120	119	119	113	111	110.0
Off-balance-sheet operations of credit institutions (in billions of euro)	1,534	2,107	2,116	2,507	2,611	3,237	4,297	4,449.7
interest rates	906	1,393	1,376	2,006	2,071	2,640	3,627	3,776.0
foreign exchange	603	682	626	402	358	368	432	447.0
other	25	32	114	99	182	229	238	225.0
Financial Sector Risk Indicators								
Risk-based capital asset ratio 5/ 6/	11.7	11.4	11.3	11.9	11.9	12.9	13.2	13.0
Profits of the banking sector (in billions of euros)	2.0	2.1	2.6	3.7	5.5	3.8	3.2	2.4
Rate of return on average equity								
banking sector 6/	11.5	12.0	11.0	17.1	20.4	13.7	11.8	...
insurance sector	13.4	20.1	34.2	26.9	21.5	12.1	-10.4	...
Loan /deposit ratio	63.7	66.0	68.4	71.8	77.8	76.4	78.7	78.5
Non-performing loans/total loans	3.5	3.0	2.7	2.7	2.7	2.9	2.9	3.4
Provisions + write-offs/non-performing loans	53.0	57.0	61.0	58.0	57.0	57.0	51.8	46.3
Foreign assets of the banking sector (in billions of U.S. dollars, end-of-period) 7/	267.8	262.5	...	112.0	108.2	127.0	164.3	170.2
Foreign liabilities of the banking sector (in billions of U.S. dollars, end-of-period)	293.7	280.0	...	181.8	163.9	176.3	199.0	200.7
Cost-income ratio of the banking system	68.8	69.2	65.8	69.9	72.2	74.1	74.7	70.6
Insurance sector coverage ratio 8/	296.0	312.0	319.0	267.0	265.0	276.0	253.0	...

Sources: Data provided by the authorities, IMF, *International Financial Statistics*, and IMF Research department.

1/ The interpretation of some of the indicators is affected by the launch of the EMU in 1999.

2/ Capital account data cover the definition of the Belgium-Luxembourg Economic Union (BLEU).

3/ Reserves and foreign liabilities refer to the Belgian central bank, both before and after EMU. Official reserves exclude reserves in gold.

4/ Belgian francs (BEF) per dollar until 1998, euro per dollar, thereafter. The fixed BEF/euro conversion rate is 40.3399.

5/ On a consolidated basis and after distribution of profits.

6/ Excludes foreign branches in Belgium.

7/ Banking institutions.

8/ Available solvency ratio over required solvency ratio.

Belgium: Fund Relations
(As of October 31, 2003)

I. **Membership Status**: Joined 12/27/45; Article VIII

II. **General Resources Account**:	**SDR Million**	**% Quota**
Quota	4,605.20	100.00
Fund holdings of currency	2,711.44	58.88
Reserve position in Fund	1,893.77	41.12
Operational budget transfers (net)		

III. **SDR Department**:	**SDR Million**	**% Allocation**
Net cumulative allocation	485.25	100.00
Holdings	427.86	88.17
[Designation plan]		

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund** (SDR Million; based on existing use of resources and present holdings of SDRs): None

VII. **Exchange Rate Arrangement**:

Until December 31, 1998, Belgium formed a monetary union with Luxembourg in which the Belgian and Luxembourg franc were at par, while also participating in the exchange rate mechanism of the European Monetary System. Belgium entered the final stage of European Economic and Monetary Union on January 1, 1999 at a rate of 40.3399 Belgian francs to the euro.

VIII. **Article IV Consultations**:

Belgium is on the 12-month cycle; the last consultation was completed on February 21, 2003 (EBM/03/14).

IX. Belgium retains restrictions vis-à-vis Iraq, the Socialist Peoples Libyan Arab Jamahiriya, and the Federal Republic of Yugoslavia (Serbia and Montenegro) pursuant to U.N. Security Council resolutions 661, 883, and 757, respectively. These restrictions have been notified to the Fund. The residual restrictions vis-à-vis the Federal Republic of Yugoslavia (Serbia and Montenegro) relate solely to balances of the former National Bank of Yugoslavia that remain frozen, since they are subject to unresolved legal claims.

Belgium: Core Statistical Indicators

As of January 5, 2004[1]

	Exchange Rates	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP
Date of Latest Observation	1/5/04	1/5/04	11/03	9/03	9/03	2002	Q3/03
Date Received	1/5/04	11/5/04	1/2/04	1/2/04	1/2/04	5/30/03	12/10/03
Frequency of Data	Daily	Daily	Monthly	Monthly	Quarterly	Annually	Quarterly
Frequency of Reporting	Daily	Daily	Monthly	Monthly	Quarterly	Annually	Quarterly
Source of Update	Reuters	Reuters	Eurostat	NBB 2/	NBB 2/	NBB 2/	NBB 2/
Mode of Reporting	Electronic	Electronic	Electronic	NBB Website	NBB Website	NBB website	NBB Website
Confidentiality	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Daily	Daily	Monthly	Monthly	Monthly	Annually	Quarterly

1/ Important data may be found on the internet site http://www.nbb.be/belgostat/ and www.statbel.fgov.be. Flemish data may be found at http.//aps.vlanderen.be/statistiek/cijfers/stat_cijfer_economic.htm#conjunctuur
2/ National Bank of Belgium.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
February 27, 2004

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with Belgium

On February, 13, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Belgium.[1]

The Belgian economy is beginning to emerge from a prolonged period of slow growth. Since 2001, average annual growth has been below one percent, owing to falling business investment and subdued export growth. With support from tax cuts, private consumption gained strength in 2003, though some of the increase in disposable income was saved. An improvement in the external environment provided a positive impetus in the third quarter of 2003, with preliminary data showing annualized real GDP growth of more than 2 percent. The unemployment rate has been rising since 2001 and overall employment started to fall in 2002, with the harmonized unemployment rate averaging 7.9 percent in 2003.

Consumer price inflation has eased more than in the euro area, reflecting transitory factors, notably reductions in the television and radio license fee, which were key to holding monthly average inflation to about 1.5 percent through October 2003. With these transitory effects waning, inflation has more recently posted a similar pace as the euro area average. Hourly wage growth slowed sharply in 2003 to 2.1 percent, while unit-labor-cost growth started to decline already in 2002. Nevertheless, in recent years the increases in unit labor costs have exceeded the average of Belgium's three main trading partners (Germany, France and the Netherlands).

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The staff projects moderate growth and low inflation for the near term. Accordingly, real GDP growth is expected to average 1.8 percent in 2004, consistent with confidence indicators, monetary conditions that are expected to remain supportive, and the projected growth of export markets. Moderate growth, sustained for a few quarters, is expected to trigger a revival of business investment. With the recent euro appreciation, inflation is projected to average less than 1.5 percent in 2004. The main downside risks to the growth projection lie in a stronger-than-envisaged euro, a faltering of the recovery in key trading partners, and domestic wage increases, though there appears to be a consensus among social partners to keep wage developments below the guidelines of the 2003-04 Interprofessional Agreement.

Macroeconomic policies have recently been supportive, but fiscal tightening is expected to resume in 2004, in line with medium-term requirements. Monetary conditions have been historically easy, and following the appreciable structural contraction in 2001-02, the primary surplus declined in 2003, beyond the full play of automatic stabilizers. Nevertheless, with sizeable one-off measures, notably related to the transfer of the Belgacom pension fund to the state, the 2003 budget outturn is expected to record a small surplus following 2 years of balance. For 2004, the budget targets balance, relying on one-off factors, including a tax amnesty. The staff estimates the 2004 budget to imply a structural consolidation of one-half of one percentage point of GDP.

To deal with the consequences of aging, the authorities are implementing a strategy of debt reduction so that interest savings can be applied to increased budgetary outlays on pensions and health care with stable debt dynamics, and structural reforms to promote growth, in particular by boosting comparatively low employment rates. To achieve the latter, the authorities have recently embarked on labor market reforms in the context of an employment conference involving social partners. In addition to various other measures, existing cuts for the low paid and across-the-board reductions in social security contributions were expanded and marginal tax rates for the high skilled lowered. As of mid-2004, job search requirements for unemployment benefit recipients are to be made more effective and reforms seeking to redress the high incidence of early retirement are to be launched. In product markets, the focus has been on reducing the administrative and regulatory burden and the strengthening of the competition authority, while in financial markets the supervisory agencies of the insurance and banking sectors have been merged, effective January 1, 2004.

Executive Board Assessment

Executive Directors considered that Belgium's economic fundamentals remain basically sound, given the low inflation, strong underlying primary fiscal balance, sizable external current account surplus, and adequate national savings rate. Directors commended the authorities on the considerable fiscal retrenchment achieved so far, even during the recent slump in growth, but noted that, going forward, successful fiscal consolidation will require further progress in reducing primary expenditure growth and stepped-up pursuit of synergies between fiscal and labor market reforms. They endorsed the authorities' focus on reducing public debt and promoting employment growth to deal with the long-term pressures from population aging.

Directors expected the economy to grow moderately during 2004, on the basis of a recovery in export markets and broadly supportive macroeconomic policies. However, they also noted downside risks, in particular from a stronger-than-envisaged euro appreciation, an abortive recovery in key euro-area trading partners, and high domestic wage increases. Against this background, most Directors supported the authorities' strategy of maintaining the budget at least in balance in 2004. These Directors considered that the short-run positive confidence effect of a balanced budget and lower public debt outweighs the negative impact on aggregate demand of a slight tightening of the fiscal stance. Some Directors, however, supported the full operation of automatic stabilizers in view of the risks to growth. Directors also considered it important to avoid wage increases in excess of those in neighboring countries in order to maintain Belgium's competitiveness, and stressed the need to ensure that the ongoing cuts in social security contributions lead to lower labor costs.

Looking forward, Directors recommended a steady increase in the underlying budget surplus for the foreseeable future, and many Directors viewed a surplus of about 1 percent of GDP by 2007 as an appropriate intermediate target. However, they strongly cautioned against the continued use of ad hoc fiscal measures to achieve this objective, noting that such measures often trade off a current benefit for a future outlay. In this regard, in addition to targeting a primary surplus, most Directors saw merit in focusing the medium-term fiscal framework on primary expenditure growth ceilings. They considered that such a framework would promote durable fiscal consolidation, avoid imparting a procyclical bias to fiscal policy, and, when set consistent with medium-term tax policy and consolidation objectives, preserve interest savings for debt reduction. Directors also noted that such a framework would need to involve all levels of government.

Directors noted the high ratio of revenue to GDP—one of the highest in the European Union—and endorsed the authorities' planned tax cuts as desirable for job creation. Therefore, to achieve the fiscal objectives, they considered it essential to curb primary spending growth and keep it well below trend-GDP growth. Directors suggested that spending cuts be focused on transfers and labor market programs, noting that this would boost employment rates and potential output. In this context, they welcomed the authorities' intention to implement reforms that would hold unemployment spending constant in nominal terms and to abstain from discretionary increases in pension spending. Directors noted that the upcoming large-scale retirements in the civil service offered a good opportunity for fiscal savings. They also saw a need to put in place mechanisms that would restrain health care spending growth in the long run.

While commending recent initiatives to boost employment, such as the targeted cuts in social security contributions, the enterprise-based training programs, and the stricter enforcement of job search requirements, Directors viewed more vigorous labor market reform as essential to raising Belgium's low employment rate and its potential output growth. They recommended that all remaining measures inducing early withdrawals from the labor force be phased out and that the decision to retire be made actuarially fair. Directors observed that limiting the duration of unemployment benefits would sharpen work incentives. In addition, against the background of substantial differences in regional productivity and employment rates, Directors called for greater labor mobility and wage differentiation. In this context, they saw a need to remove some impediments to greater wage flexibility by modifying aspects of the wage bargaining system.

Directors urged the authorities to accelerate the pace of product market reform to provide an impetus for growth. While welcoming recent progress, they pressed the authorities to achieve complete opening of the energy and telecommunications industries to competition, while ensuring that benefits accrue to consumers. Directors supported the intentions to strengthen the competition authority and lower the administrative burden on taxpayers and enterprises.

Directors agreed that the financial sector has performed generally well in light of the prolonged slump in economic activity, and stressed the need to pursue the ongoing strengthening of supervision, particularly in the insurance sector. In this context, they endorsed the merger of banking and insurance supervision, and welcomed the central bank's involvement in macroprudential supervision. Directors considered that the supervision of important cross-border and bank-insurance firms should remain a priority task. They also commended the authorities' decision to participate in the Financial Sector Assessment Program.

Directors urged the authorities to continue supporting multilateral trade liberalization and to use their position in international institutions to promote a successful outcome of the Doha Round. Directors welcomed the authorities' commitment to raise official development assistance to the UN target of 0.7 percent of GNP by 2010.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with Belgium is also available.

Belgium: Selected Economic Indicators

	2001	2002	2003	2004	2005
Real economy (change in percent)					
Real GDP	0.7	0.7	1.0	1.8	2.8
Domestic demand	0.5	1.0	2.2	1.0	2.4
CPI	2.4	1.6	1.5	1.4	1.4
Unemployment rate (in percent)	6.7	7.3	7.9	8.3	8.1
Public finance (percent of GDP)					
General government balance	0.5	0.0	0.3	-0.1	0.1
Structural balance	-0.8	-0.1	-0.9	0.7	0.6
Primary balance	7.1	6.1	5.9	5.0	4.9
General government debt	108.7	106.1	100.3	97.5	93.6
Interest rates (percent)					
Money market rate	4.3	3.3			
Government bond yield	5.1	5.0			
Balance of payments (percent of GDP)					
Trade balance	2.5	3.6	3.1	3.4	3.7
Current account	3.8	5.4	4.4	4.5	4.7
Official reserves (US$ billion)[1]	11.3	11.9			
Reserve cover (months of imports of GNFS)	0.7	0.7			
Exchange rate					
Exchange rate regime					
Euro per U.S. dollar (January 20, 2004)			0.7930		
Nominal effective rate (1995=100)[2]	90.5	91.2	93.9		
Real effective rate (1995=100)[2, 3]	86.5	85.7	87.8		

Sources: Data provided by the Belgian authorities, and IMF staff projections.

[1] Excluding gold; Eurosystem's definition.
[2] For 2003, average through end-November.
[3] Based on relative normalized unit labor costs in manufacturing.