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February 2001
IMF Country Report No. 01/44

Belgium: 2000 Article IV Consultation—Staff Report; Staff Supplement; 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 2000 Article IV consultation with Belgium, the following documents have been released and are included in this package:

- the staff report for the 2000 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 27, 2000** 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 February 1, 2001.** 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 staff report supplement based on information available as of **February 16, 2001** updating information on recent economic developments.

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during its February 21, 2001 discussion** of the staff report that concluded the Article IV consultation.

The documents listed below have been separately released.

Mission Concluding Statement
Selected Issues paper

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BELGIUM

Staff Report for the 2000 Article IV Consultation

Prepared by the Staff Representatives for the 2000 Consultation with Belgium

Approved by C. Maxwell Watson and G. Russell Kincaid

February 1, 2001

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I. INTRODUCTION

1. A staff team comprising Mr. Ford (head), Ms. Louppe, and Messrs. Martijn and Estevão (all EU1) visited Brussels from November 17 to 27, 2000 for Article IV discussions. Messrs. Kiekens (Executive Director) or Josz (Assistant to the Executive Director) were also present at the meetings. The last consultation was concluded on February 25, 2000 (SUR/00/19). At that time, Directors welcomed the pickup in economic activity in the context of continued price stability. They commended the authorities for the marked improvement in the fiscal position, while emphasizing that planned tax cuts would require continued strict spending discipline. Citing low employment rates and high unemployment rates, Directors urged comprehensive structural reform—in both labor and product markets—to complement the authorities' policy of reducing nonwage labor costs.

2. The authorities have notified the Managing Director of their intention to publish this Report. Belgium has accepted the obligations of Article VIII, Sections 2, 3, and 4 (Appendix I).

II. BACKGROUND TO THE DISCUSSION

3. **Real GDP grew strongly in 2000, for the fourth consecutive year** (Figure 1, Table 1). Domestic factors, notably substantial increases in employment and high household and business confidence, bolstered final domestic demand growth. The upswing has also been underpinned by monetary conditions in the euro area as a whole, which have remained supportive, even as the European Central Bank increased its financing rate on October 5 and participated in currency-market intervention in late September and again in early November (Figure 2). Net exports also contributed to economic growth, as moderation in labor cost growth and the depreciation of the euro resulted in a favorable competitive position (Figure 3). The current account surplus has remained large, although as a fraction of GDP it narrowed somewhat in 1999 and 2000 due to terms of trade losses.

4. **Headline consumer price inflation on a harmonized basis rose in 2000 due to higher oil prices, though underlying inflation remained moderate**. Belgian inflation pulled ahead of that in neighboring countries, but was falling rapidly at year end, when it stood at 3 percent (Figure 4). Underlying inflation (harmonized basis), which excludes energy, has been broadly unchanged, however, and was 1.6 percent at year end, compared with a euro-area average of 1.5 percent. The so-called health index measure of inflation, which excludes most, but not all, energy products and to which wages are indexed, rose from 1.2 percent in January to 2.3 percent in December 2000.

5. **The situation in labor markets has been improving with the cyclical upswing.** Since the beginning of 1997, employment has increased at an average annual rate of 1.1 percent, reflecting output growth, public sector employment programs, cuts in social security contributions over the course of the 1990s, and greater flexibility in working arrangements (notably, the increase in part-time work). The last two factors may lie behind an apparent increase in the employment intensity of growth: employment growth divided by real GDP growth rose from 0.1 percent in 1994–96 to 0.4 percent in 1997–99. The strong employment performance resulted in a decline in the (harmonized) unemployment rate from

9.4 percent in 1997 to 8.3 percent by end–2000. This gradual but steady tightening of the labor market has been reflected in increasing reports of labor shortages in certain sectors (construction, for example), especially in Flanders.

6. **However, in many respects, labor market performance remains unsatisfactory.** The employment and participation rates are quite low, particularly among older workers (55 to 64 years old), who benefit from generous early retirement provisions (Figure 5). Long-term unemployment is also very high, reflecting to some extent the unlimited duration of unemployment benefits for many people. Moreover, there are serious and persistent geographical disparities in unemployment rates. Labor market conditions are much tighter in Flanders and in some parts of Wallonia than elsewhere (Figure 6). As of 1999, the last available observation, the unemployment rate in Wallonia as a whole had not fallen at all in the current upswing, although more recent reports on the level of unemployment suggest there may have since been some improvement.

7. **The Interprofessional Agreement for 2001-2002, which sets the framework for wage negotiations at the sectoral and enterprise levels, was concluded in early December 2000**. The agreed labor cost increase was between 6.4 and 7 percent over the two years, on average somewhat higher than the 6.4 percent benchmark calculated by the Central Economic Council.[1] To that figure, the social partners agreed to add up to 0.2 percent for commuting costs and additional holidays, to be negotiated at the sectoral level, and, depending on sectoral performance, up to another 0.4 percent. Partly as a result of this last provision, not all the subsequent agreements will incorporate the full 7 percent.[2] According to staff projections, which assume an increase in aggregate labor costs of 6.8 percent over two years, unit labor costs would rise by 0.8 percent a year. Although this would be an increase relative to 1999-2000, when unit labor costs rose only half as fast, it would be consistent with underlying inflation below the European Central Bank ceiling of 2 percent. With respect to international competitiveness, the settlement implies that Belgian labor costs could rise by somewhat less than ¼ of a percentage point a year relative to its three major trading partners.

8. **The fiscal situation has improved greatly in recent years, with the deficit narrowing and the debt-GDP ratio falling.** The general government deficit fell from 8 percent of GDP in 1992 to zero in 2000; and the gross debt-GDP ratio peaked in 1993 at

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[1] The law governing interprofessional agreements encourages international competitiveness by benchmarking increases in labor costs per hour in the business sector to those in Belgium's three major trading partners (Germany, France, and the Netherlands). The 6.4 percent figure is a weighted average of forecast labor cost increases in those three countries. The law also recognizes that an agreement can take domestic employment and training developments into account.

[2] The previous (1999–2000) Agreement stipulated an increase in labor costs over the two years of 5.9 percent and, although there were no sector-specific provisions, preliminary national accounts data suggest that it was actually slightly less than 5 percent.

about 139 percent and fell to about 111 percent in 2000, although this is still very high by international standards (Table 2, Figure 7). In 2000, there was a deterioration in the structural balance (that is, adjusted for cyclical movements) of 0.3 percent of GDP, due essentially to substantial cuts to employers' social security contributions introduced in April. And the high debt-GDP ratio reduced the margin for fiscal maneuver, imposing interest costs of nearly 7 percent of GDP.

9. **The staff projected, based on the WEO assumptions of September 2000, real growth to pick up somewhat from the slow pace of the second half of this year, and headline inflation to ease.**[3] The oil price rise dented confidence and growth around mid-year: business confidence, manufacturing orders, and industrial production growth all fell (Figure 8). The direct terms of trade loss in 2000 is estimated by the staff to be about ½ percentage point of GDP, and the authorities estimated that growth had been depressed by about ¾ of a percent, including through indirect effects on confidence. However, with consumer confidence remaining high, business confidence recovering, and oil prices stabilizing or receding, demand growth is expected to pick up somewhat in 2001, yielding a year-on-year increase in real GDP of 2.9 percent. Headline consumer price inflation, which averaged 2.9 percent in 2000, is projected to fall to 2.2 percent on average in 2001 as the effect of the recent oil price increase wears off.

10. **Since this projection was made, the risks have moved mainly to the downside**. A projection incorporating WEO assumptions as of January 2001 will be provided in a supplement, although the revision to growth will probably amount to, at most, a ¼ percentage point reduction.[4] The main downside risk is an anticipated slowdown in the United States. However, this is expected to have only a small effect on Belgian export market growth. In addition, changes in underlying assumptions from last September (based on forward rates and prices) should, on the whole, exert a somewhat positive effect on activity: a long-term interest rate that is ½ percentage point lower; a short-term interest rate that is a full percentage point lower; oil prices that are $5 a barrel lower; and a euro that is about 2 percent stronger against the U.S. dollar.

III. Policy Discussions

11. **Discussions centered on the fiscal and structural measures needed to ensure strong economic performance in the years ahead**. The authorities and the staff largely agreed on the short-term outlook, and discussions in this respect focused mainly on the possibility of emerging inflationary pressures. Fiscal and structural issues were closely intertwined. The authorities' labor market policy has focused on tax cuts to reduce the wedge

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[3] For 2001, these assumptions (derived from forward prices) are: an average exchange rate of €0.927 to the U.S. dollar; a long-term interest rate of 5¼ percent; a short-term rate of 5¼ percent; and an average oil price of $28 a barrel.

[4] The January Consensus Forecast for 2001 is 2.8 percent real GDP growth and 2.2 percent consumer price inflation.

between firms' costs and take-home pay; in addition, a combination of continued debt reduction and structural reform to increase employment rates will be needed to meet the fiscal obligations of population aging. The mission supported the strategy of tax cuts, and urged greater expenditure restraint to provide room for even greater cuts in the future. But it argued that improving labor market performance would also require more fundamental structural reforms, particularly to benefit programs. The authorities recognized the complementarity of tax cuts and structural reform, but for the near term at least benefit reform was likely to progress slowly.

A. Potential Output and Inflationary Pressures

12. **The sustained upswing in economic activity has reduced margins of slack.** In the light of macroeconomic estimates of capacity, the authorities and the staff agreed that the Belgian economy would be broadly at potential in 2001. Looking forward, the authorities estimated that, at least for the next five years, real GDP growth could be sustained at an annual rate of 2½ percent, which exceeds the longer-term growth rate of about 2¼ percent (although it is below growth in the past four years). This increase was justified by structural improvements and, more speculatively, gains from the "new economy." The authorities also noted that a successful period of fiscal contraction had come to a close, removing a factor that had tended to depress growth. Staff estimates are presented in the Selected Issues paper "The NAIRU and Potential Output in Belgium." The key result at the national level is that potential output growth is estimated to be between 2¼ percent and 2½ percent a year for the next few years, after which it slows because of increasingly adverse demographics.[5] In addition, the staff found significant geographical differences in the NAIRU.

13. **The risks of inflationary pressures have thus increased, although it was agreed that no policy adjustment was needed at this time.** The mission noted that the Belgian business cycle may have moved slightly ahead of that in the euro area as a whole. In addition, headline inflation had moved significantly above that in the euro area; at the time of the mission, underlying inflation had also risen slightly above that in the euro area, although it has since fallen back. The mission therefore wondered if monetary conditions had become slightly too accommodative from the perspective of the Belgian economy. The authorities argued that the cyclical differences were minor; attributed higher headline inflation to a greater weight of energy prices in the Belgian harmonized price index relative to the euro-area average (11.8 percent versus 9 percent); and considered the movements in the underlying inflation rate to be in line with normal historical variation. For all these reasons, they concluded, and the staff concurred, that monetary conditions were still broadly appropriate in the Belgian context.

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[5] By comparison, the European Commission recently published an estimate of 2.9 percent, very close to actual growth in recent years, and the OECD estimate is 2.6 percent.

B. Fiscal Policy

14. **For 2001, the budget projected a surplus of 0.2 percent of GDP, based on a conservative growth assumption of 2.5 percent.** The authorities believed that growth, and therefore the budget outturn, would be better than assumed, and reiterated their commitment to devote all growth-related windfalls in 2001 to deficit reduction (as was done in 2000). They stressed that the achievement of budget balance in 2000 was two years ahead of the schedule they had set only a year ago in their 2000–2003 Stability Program, and that the primary surplus would remain well above the 6 percent floor that had served as the key fiscal guide in recent years. On the basis of higher growth than assumed in the budget, the staff projected a surplus of about ½ percent of GDP (Table 2, Box 1).[6] According to staff calculations, the structural balance would be unchanged in 2001 (and the primary structural balance would deteriorate by 0.4 percent of GDP). As a result, the automatic stabilizers had been allowed full play, although no progress was made toward the medium-term balance objectives discussed below.

15. **Planned increases in primary expenditure were a key factor impeding progress on structural deficit reduction in 2001.** Real primary expenditures are budgeted to rise by 2 percent, only slightly less that the 2.2 percent average of the 10 previous years.[7] The authorities noted that extra spending was needed to reform the police and the judicial system. By far the largest single item, however, was a substantial increase in real health care outlays (which are in the social security budget) of 6.4 percent. This was of particular concern because this sector has long been a source of spending pressure. The authorities explained that the sharp increase reflected a reform package that was to some extent a once-off adjustment intended to help to contain costs in the years ahead. They also pointed to an agreement with pharmaceutical companies to help to restrain increases in the cost of drugs in 2001. The mission argued, however, that some parts of the reform, particularly measures to increase access by limiting out-of-pocket costs and to expand coverage, while justifiable from a social perspective, would tend to aggravate cost pressures in the future.

16. **A specific concern was the significant widening of interest rate differentials (from about 20 basis points to about 40 basis points) on long-term government debt between Belgium and Germany in the course of 2000** (Figure 9). Although not unique to Belgium, this development had the potential to aggravate budget difficulties somewhat given the very large national debt and interest payments. The authorities pointed to a number of technical factors, notably the market perception that German bonds are more liquid.

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[6] Neither projection includes proceeds from the planned 2001 auction of third-generation (UMTS) telephone licenses, which are not known but estimates in the press are on the order of ¼ percent of GDP.

[7] Removing once-off items from both 2000 and 2001—in particular, in both years election-related spending by local governments, in 2000, a subsidy to the railway company for high speed train linked investment, and in 2001 the sale of buildings (a negative expenditure)—would raise real primary expenditure growth to 3 percent.

Box 1. The 2001 Budget

The 2001 budget the budget aims for a fiscal surplus of 0.2 percent of GDP, based on a deliberately cautious real growth assumption of 2.5 percent. The staff projects a surplus of 0.4 percent of GDP, based on 2.9 percent economic growth. The budget would keep the structural balance broadly unchanged; with ongoing cuts in taxes and social security contributions offsetting a further decline in interest expenditure. Primary expenditures would grow at a rate only some ¼ to ½ percent below that of potential GDP.

- On the revenue side, the 2001 budget is affected by earlier decisions on the tax system, in particular the gradual elimination during 2000-2003 of the 3 percentage point crisis surcharge on personal income taxes. A 1 percentage point reduction of this surcharge is scheduled for 2001. In addition, a reduction in social security contributions was introduced in April 2000, and for 2001 as a whole it will reduce revenue by a further 0.1 percent of GDP. Finally, the reinstatement of an annual adjustment of income tax brackets to inflation in 1999 removed a hidden gradual tax increase.

- Real primary expenditure is budgeted to increase by 2.0 percent in 2001, with additional spending on development aid, asylum seekers, social benefits, chairing the EU, information technology and, most importantly, police reform and health care.

The government has used the presentation of the budget for 2001 to unveil its key policy initiatives, most of which will have their main budgetary repercussions after 2001 and even beyond the end of current government period in 2003.

- Income tax reform will have the largest budgetary impact; the revenue loss is projected to rise from 0.1 percent of GDP in 2002, to 0.35 percent of GDP in 2003, and to 1.4 percent of GDP in 2006 (see Box 2).

- The authorities have developed a comprehensive initiative to promote a reduction in working hours and help individuals to combine work and leisure (Box 5). The plan includes conditional subsidies, social benefits, and cuts in social security contributions, with a total budgetary cost that rises from less than 0.02 percent of GDP in 2001 to 0.3 percent of GDP by 2006.

- To combat poverty, a range of pensions and benefits will be increased in 2001 and 2002, when the overall budgetary impact will reach 0.1 percent of GDP. Minimum unemployment benefits and benefits for the disabled will be raised in 2001.Welfare benefits will be raised by 4 percent and pensions increased for older retirees, in 2002.

- To promote the use of information technology, the government intends to improve public infrastructure and provide internet access to all government services by mid-2001. This initiative will be financed through part of the interest savings resulting from the proceeds of the UMTS auction.

- Investment in railways will gradually be increased; the additional costs are projected to reach 0.1 percent of GDP by 2010, and are to be financed by part of the interest savings from the UMTS sale. The investments are part of a wider plan to promote mobility, which also includes limited tax incentives.

- Agreement was reached on a further devolution of responsibilities and financial autonomy to the regions and communities, although it had not been ratified by parliament (see Box 6). Starting in 2002, federal transfers to the communities, for education expenditure, will gradually be increased.

However, although the improved fiscal situation (even relative to Germany) ought to have tended to narrow the differential, the fact that the spread widened more than for France or the Netherlands may indicate that Belgium's fiscal credibility is less firmly established in capital markets.

17. **The 2001 Budget also introduced an innovative five-year fiscal framework for the 2001–05 period.** It assumes real GDP growth of 2.5 percent a year (that is, the authorities' estimate of sustainable growth over this period), sets a baseline for real primary expenditure growth of 1.5 percent a year for the federal government and social security (*Entité I*), and establishes a surplus target of 0.7 percent of GDP in 2005.[8] Based on the authorities' budget figures, the staff calculates that these parameters imply a so-called budgetary margin—the difference between revenues and baseline expenditures, less the surplus target, for the general government—of a cumulative 2.4 percent of GDP during 2001–2005. Most of this margin is earmarked for additional tax cuts, as part of an income tax reform (Box 2). However, the budget also contains expenditures beyond those already in the 1.5 percent baseline path, which are estimated by the staff to raise real primary expenditure growth to 1.9 percent a year on average.

18. **The authorities viewed this framework as ambitious and credible.** They emphasized that their program combined further significant tax reductions with continued increases in the budget surplus. Its feasibility was, in their view, ensured in part by the use of a conservative real growth assumption, which would help to promote fiscal consolidation, as well as by the commitment to place priority on deficit reduction with regard to growth-related windfalls beyond 2001. The authorities also noted that the tax cuts were backloaded—most are scheduled for 2005 and 2006—thereby minimizing the risk of going off track in the event of adverse developments. The mission agreed that this program was feasible, although the slightly lower staff estimate of potential output growth implied a small downside risk over the full five-year period.[9] The mission also welcomed the backloading of the tax cuts, while pointing out that, even in 2006, the tax burden in Belgium would remain relatively high, particularly as regards labor taxes (Box 3). The authorities agreed with this last point, as it illustrated that further cuts would be necessary.

19. **The mission stressed, however, the need for somewhat tighter control of expenditures and the desirability of an accelerated surplus target.** As it has for some time, the staff recommended that real primary spending growth be held to 1.5 percent a year. That is, the baseline path of the authorities' framework should be a target rather than, in

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[8] This target is equivalent to a recommendation of the High Finance Council (an influential government advisory body) of a surplus of 1 percent of GDP in 2005, once adjusted for lower assumed growth in 2001.

[9] Indeed, the staff scenario suggests that the surplus would be higher than target by 2005, because of a lower interest rate assumption than that of the authorities and a better position for the regions and communities (see the second panel of Table 3).

Box 2. The Proposed Income Tax Reforms

In the 2001 Budget, the authorities introduced an income tax reform to stimulate work, promote fiscal neutrality, and streamline the fiscal system. Earlier initiatives of the government to lower the very high tax pressure on labor in Belgium include restoring the indexation of tax brackets to inflation and progressively phasing out the "crisis contribution".

To curtail labor income tax pressure and redress incentives to work, the authorities intend to:

- Introduce a new income tax credit of BEF 20,000 (€496) for workers at the low end of the wage scale, which would lower taxes for those earning less than BEF 500,000 per year (€12,400); and those with a tax liability below BEF 20,000 would receive money (negative tax).

- Reduce the number of tax brackets, which is expected to lower taxes for 83 percent of taxpayers.

- Institute a top marginal income tax rate of 50 percent, after the removal of the top two rates (55 percent and 52½ percent), to help lower the total marginal tax rate for the high-paid (currently estimated at 71 percent) and improve the attractiveness of Belgium to high-skilled labor.

To promote fiscal neutrality between married and unmarried people:

- Tax exemptions, at present higher for unmarried couples, will be identical for married and unmarried couples.

- Tax exemptions for replacement income will be calculated per person, and the tax base will be labor income only (at present it includes other income).

Finally, a streamlining of the fiscal system is to be achieved by grouping the various tax deductions in three main baskets (long-term saving, housing investment, and spending on employment promotion).

The overall fiscal cost of these reforms is estimated at BEF 134.5 billion in 2001, or 1.3 percent of GDP. The tax reform is less ambitious than that in Germany, where the top marginal tax rate is set to fall to 42 percent.

Box 3. Tax Reform in Belgium and Neighboring Countries

The planned 2002–06 tax reform explicitly aims to promote convergence of the tax-GDP ratio relative to neighboring countries. Even after the cuts in social security contributions in 2000, the overall tax burden remains relatively high in Belgium. Moreover, planned tax reform in neighboring countries will significantly lower the pressure over the coming years, potentially intensifying tax competition (see the table below).

General Government Revenue
(In percent of GDP)

	1999	Effect of reform	
Belgium	47.2	-1½	(2006)
Germany	44.6	-2	(2005)
France	50.4	-1¾	(2003)
Netherlands	43.7	-¾	(2001)

- The difference in tax yields is particularly pronounced for labor income, at all income levels (see the table below). Moreover neighboring countries reform efforts are focused on this area, with significant reductions in marginal rates. Belgium follows this trend—lowering income taxes (including social security contributions) by about 2 percent of GDP during 2000-06. The introduction of a workers' income tax credit to address poverty trap problems is also in line with similar initiatives in other countries. However, after the reform, taxes will remain comparatively high in Belgium.

Labor Taxes, 1998
(Including social security contributions; in percent)

	Tax wedge average worker	Marginal rate at 167 percent of minimum wage	Top income tax rate	
			1988	After reform
Belgium	57	70.7	55	50
Germany	53	63.9	53	42
France	48	51.1	54	...
Netherlands	44	50.0	60	52

- At 40 percent (and with generous deductions) profit taxes in Belgium are broadly comparable with those in France (40 percent) and the Netherlands (35 percent). In Germany, tax rates will be reduced from 52 to 25 percent, financed largely through more restrictive deductions. In Belgium, an advisory committee is scheduled to present recommendations for reform by the end of the year.

- In spite of a relatively high standard VAT rate of 21 percent, total indirect taxes (as a share of GDP) are in line with those in neighboring countries. There are no plans for a general reduction of indirect taxes, as priority is given to cuts in direct taxes and indirect taxes are being raised in bordering economies.

effect, a floor for expenditure growth. This expenditure path would provide the room for a somewhat more ambitious target of a structural surplus of 1 percent of GDP, to be achieved in 2003 (Table 3).[10] As was the case last year, when it advocated a modest medium-term budget surplus target, the staff argued for the desirability of an ambitious target by pointing to the need for a rapid reduction of the large debt-GDP ratio, especially in view of population aging, and the desirability of reinforcing the government's commitment to a sound fiscal position. In addition, credibility would be enhanced by setting the date for achieving the target during the current government period, rather than the next one, since it would clearly place responsibility on the current government. A structural deficit target involves well known difficulties regarding definitions, but would allow the automatic stabilizers to operate, thereby helping to avoid procyclical fiscal movements. In the longer run, the simulations in Appendix III illustrate that a sustained surplus of 1 percent of GDP would ensure a rapid reduction in the debt-GDP ratio, while tight expenditure control would create additional room for meaningful reductions in the tax burden.

20. **Expenditure control will be difficult, and increasingly so as the population ages.** The staff acknowledged that the degree of expenditure control it advocated would not be achieved without strong efforts across the board, as evidenced by the pressures felt in the 2001 budget. The authorities regarded restraint beyond that laid out in the five year plan as inconsistent with their policy goals. Health care outlays are likely to remain a chronic source of fiscal pressure, in Belgium as elsewhere. A key source of spending pressure will be population aging, the effects of which may begin as early as 2002, given the low participation rates of older people.[11] The authorities have estimated the additional long-run costs of pensions and health care due to aging at 3½ percent to 4½ percent of GDP. The government's calculation assumes crucially that pension benefits, which are automatically linked to prices but also subject to ad hoc upward adjustments, will continue to rise rather less than wages (although somewhat more than prices). Costs of this magnitude could be met if both the national debt continued to decline steeply and labor force participation rose.

[10] All three scenarios in Table 3 incorporate the authorities' tax cutting program and the staff medium-term projection, including potential output growth in the middle of the 2¼-2½ percent range. The top panel is the staff scenario, with real primary expenditure growing at 1.5 percent a year. The second panel is the budget scenario, including the expenditure initiatives beyond those in the 1.5 percent baseline, but with different economic assumptions than in the budget. For reference, the third panel illustrates the consequences of allowing real primary expenditure to grow at 2.2 percent a year, the average rate of the past 10 years.

[11] The dependency ratio as usually calculated—the number of people over 65 years old divided by the number between 15 and 65—is not expected to begin to rise until 2010. However, given the very low labor force participation of the young and the old, a more relevant measure (especially in the absence of structural reform) may be the number of people over 55 divided by the number between 20 and 54. This ratio will begin to rise in 2002.

Regarding the latter, participation is likely to increase to some extent spontaneously as more women enter the labor force, but structural reforms to increase participation more broadly would also be needed.

21. **To address the pension issue, the government has introduced support for private pension plans and a pension reserve fund.** The establishment of a legal framework for so-called second pillar pensions at the sectoral level was welcomed by the mission. Although it is too early to tell how important such sectoral schemes will prove to be, they can supplement the public pension system and may in the long run reduce political pressures to increase pension benefits (in particular, stemming from those who benefit from second pillar schemes). The recently established pension reserve fund, the "Silver Fund," is expected by the authorities to bolster public support for sustained budget surpluses by making it clear that they were a response to the fiscal consequences of population aging.[12] The mission agreed that this strategy would be helpful in the politically difficult task of defending budgetary surpluses, while noting the risk that the existence of the fund might be mistakenly taken for a solution to the pension problem, undermining support for needed structural reforms.

22. **Another source of budgetary uncertainty stems from the increasing fiscal autonomy of lower levels of government.** Belgium has just completed a ten-year transition to a federal structure and, in the context of the 2001 budget, agreement was reached on further devolution of responsibilities from the federal level (Box 4). In particular, regions will be able to adjust income tax rates to some extent and, in principle, will have increased scope to offset federal fiscal policy. Concerns in this regard are greatly mitigated by limits on the degree of tax autonomy and the strong consultative process between the levels of government, as embodied in formal agreements and coordinating the role of the High Finance Council. In addition, the mission raised the possibility that lower levels of government might be unable to meet their agreed fiscal commitments. However, the authorities at the federal, regional, and community levels underscored that the multi-year budgetary goals were within reach and would continue to be met. They also noted that the fiscal outlook for the lower levels of government was, in their estimate, less differentiated and less challenging than suggested by staff, particularly since the new financing agreement will considerably ease the financial constraints of the communities and the regions.

C. Labor Markets

23. **The authorities and the mission agreed that the key macroeconomic policy challenge now is to improve labor market performance.** Raising the employment rate, which at about 59 percent in 1999 is one of the lowest in the EU, is an important part of the long-run solution raising living standards and meeting pension obligations. Indeed, Belgium

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[12] This fund is an alternative way of accounting for reductions in the national debt. Similar funds have been established in France and the Netherlands.

Box 4. Federal-Regional Fiscal Arrangements

In the context of the 2001 budget, agreement was reached on further devolution of responsibilities from the central government to the regions and communities. There are three regions (Wallonia, Flanders, and Brussels) and three communities (French, Flemish, and German). The French and Flemish communities broadly correspond to the Walloon and Flanders regions, and the Flemish community and Flanders regional governments have been merged. The federal government is responsible for nationwide functions. The regions' responsibilities include economic development and other matters of regional interest. The communities are responsible for education and culture. Regions and communities are governed by their own parliaments and executives, and are not subordinated to the federal government.

The new agreement will enhance the financial autonomy of the regions and communities, which are financed mainly through taxes collected at the central level and then shared between various government levels. The main changes are:

- Responsibility for a number of smaller taxes (amounting to 1.4 percent of GDP), including the traffic tax and the television tax, will shift to the regions. The revenue transfer from the federal government to the regions will be reduced accordingly.

- Regions will be allowed to adjust income tax rates by up to 3.35 percentage points—to be increased to 6.75 percentage points in 2004. Some of this adjustment can be made by introducing tax allowances related to regional responsibilities.

- The revenue transfer to the communities will be increased starting in 2002; the additional transfer will rise to 0.4 percent of GDP by 2006. The basic transfer to the communities is linked to the number of school-age children, which would have tightly constrained nominal expenditure. After 2006 the basic transfer is to be linked essentially to GDP growth.

agreed in Lisbon to the area-wide goal of an employment rate of 70 percent by 2010.[13] There is also an important regional dimension to this issue. For some time, unemployment rates have been much lower in most of Flanders than in many parts of Wallonia, although the difference in participation rates is much smaller. Since a continuation, or an aggravation, of this disparity would increase policy tensions within Belgium, an important challenge is to enhance employment prospects in those areas that are currently lagging.

24. **The centerpiece of labor-market policy has been targeted reductions in taxes and social security contributions.** In April 2000 the government substantially cut employers' social security contributions across the board, with the aim of raising labor demand. As described above, the 2001 budget contains further measures to reduce the tax wedge. The framework for the program of social security contribution cuts was laid out in the 2000 National Action Plan (Box 5). Although it is still too early to evaluate these specific proposals, the Selected Issues paper "The Effect of Tax Changes on Employment" suggests an analytical framework for doing so. The paper concludes that the rise in the tax wedge between labor costs and workers' pay during the 1980s and early 1990s was an important factor reducing employment, even though it was partly offset by other factors, including wage moderation. Taken in isolation, the reductions in employers' social security contributions since 1993 tended to raise employment. However, the overall labor tax wedge, which is the relevant parameter for labor market performance, rose somewhat further during the 1990s as these reductions were more than offset by increases in income taxes.

25. **The government has introduced a number of structural labor market policies, several of which should prove helpful.** The 2000 National Action Plan for Employment emphasized moving unemployment beneficiaries into training and increased cooperation among levels of government to find jobs for the short-term unemployed. These measures should help to contain the serious problem of long-term unemployment. The mission also supported the proposals to require those in the special unemployment insurance regime for older workers to look for and accept suitable employment and for the public employment service to begin offering them jobs.[14] The new employment plan (the First Job Program, or Rosetta plan), which both subsidizes private-sector employment (through reductions in social security contributions for employers who hire low-skilled young workers) and creates public-sector jobs, addressed the significant problem of high youth unemployment. The authorities noted that the plan had succeeded in attracting almost 40,000 participants who, ideally,

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[13] If applied to Belgium this goal would be extremely ambitious, requiring a net increase of some 828,000 jobs. With unchanged policies, and in particular assuming no change in the NAIRU, only about 134,000 jobs, reflecting mainly a trend rise in female participation, are likely to materialize.

[14] Until now, workers over 50 who qualify for unemployment benefits have not been required to look for work. This special regime has become more important in recent years because it has become easier to access.

Box 5. The 2000 National Action Plan for Employment

Four new policy initiatives were introduced in the 2000 National Action Plan for Employment, in response to the EU Council recommendations and after consulting with the social partners. These aim to reduce unemployment, improve incentives in the tax and benefit system, enhance services employment, and strengthen cooperation between the authorities responsible for employment programs.

To reduce unemployment, a new employment program, First Job Program (Rosetta plan), was introduced in April 2000. Both the public and the private sector are to hire young short-term unemployed. Firms with over 50 employees are required to employ a number of young people equal to 3 percent of their workforce (1.5 percent in the case of the public sector). These do not necessarily represent new jobs, and thus the net increase in business sector employment might not amount to 3 percent. In addition, employers hiring low-skilled youth will benefit from additional reductions in social security contributions. And training is to be made available to youth after three months of unemployment. The authorities expect 45,000 jobs to be created.

To redress disincentives in the tax and benefit system, the authorities further reduced employers' social security contributions for the low-paid in April 2000, at an estimated fiscal cost of BEF 49.6 billion (0.5 percent of GDP) in 2000, and implemented additional cuts in employees' contributions for the low-paid. Very little was done to induce older people to work; financial incentives are given to employers to hire older workers but the retirement and early retirement age were not raised. To increase female participation, childcare facilities are to be extended. (Other measures are included in the recent income tax reform proposal; see Box 2).

To increase employment in the service sector, unemployment recipients are to be moved sooner into active labor market programs. Incentives to employers are to be enhanced through indefinite exemption from social contributions and a subsidy between BEF 17,500 and BEF 22,000 per month per worker.

Finally, a cooperation agreement was signed between the central and regional governments to find employment for those who have been unemployed for less than a year (less than six months for youth).

would thus be prevented from falling into long-term unemployment. In the mission's view, market-sector jobs were preferable to public-sector employment, because the latter risked further squeezing a tightening labor market. In addition, the authorities agreed that in the current upswing many participants would have found employment even without the program.

26. **The government has introduced a package to reduce working time, which the mission argued would be counterproductive.** It presented a number of measures to the social partners, along with proposals for corresponding public financial support (Box 6). In the context of the Interprofessional Agreement, a mandatory move from 39 to 38 hours of work a week was agreed, but delayed to 2003; and the mandatory provisions for greater leave time are also to be implemented, although it was agreed that implementation should be flexible in the case of smaller firms. A government proposal to reduce the workweek to 35 hours (which the authorities emphasized was to be voluntary, but supported by fiscal incentives) was not addressed, although it may be discussed again in the future. The authorities argued that these measures were a response to a desire for more flexible employment options and more leisure time, and that they might increase employment if the improved working conditions lured more people into the labor force. The mission responded that they would tend to reduce labor supply, and that the budgetary resources involved (budgeted to rise to 0.3 percent of GDP by 2006) would be better used to encourage work instead.

27. **The mission also argued that more fundamental reforms of benefit programs would be required, suggesting a number of possibilities.** With respect to the early retirement program, proposals included restructuring benefits to avoid the implicit financial penalties for continuing to work (an approach being implemented by the social partners in the Netherlands), raising the early-retirement age, and subjecting benefits to ordinary taxation. The authorities reported they had no plans for such reforms, in part because use of this program was already declining. Regarding unemployment insurance, the mission pointed to the weak enforcement of job-search obligations, and called for it to be strengthened across the board, including for older people. Such efforts should be buttressed by still greater active efforts to move beneficiaries into employment, and by curtailing the unlimited duration of benefits for which many are eligible. The authorities noted that sanctions had recently been made more flexible, in the expectation that they would be more widely used, but otherwise had no plans to reform the unemployment insurance program. The mission also supported the suggestion that the Regional governments, which are responsible for administering unemployment insurance and employment agencies, adopt the ILO recommendation to abolish the monopoly currently enjoyed by the public employment agencies, as competition in this area would improve performance.

28. **The authorities and the staff agreed that addressing geographical economic disparities was a top priority.** It would appear that high labor costs are particularly dissuasive in Wallonia, perhaps because of lower productivity or weaker infrastructure. This observation adds urgency to the authorities' policy of reducing the tax wedge, as well as to the staff's longstanding argument that greater wage differentiation would help to match firm's labor costs with differences in productivity and labor market conditions. A notable

Box 6. Collective and Individual Working Time Reduction

In December 2000, in the context of the two-yearly interprofessional agreement, social partners responded to a government plan for reducing working hours and promoting employment, especially for older workers. The government had announced its proposals in October, inviting social partners to amend them, within the budgetary envelope and without changing the basic objectives. The details of the various arrangements that have now been agreed on in principle, will likely be worked out during 2001. The budgetary cost of this initiative was projected to rise from at BEF 1.7 billion (less than 0.02 percent of GDP) in 2001) to BEF 8 billion (0.1 percent (GDP) in 2002 and to BEF 29 billion (0.3 percent of GDP) by 2006.

A general agreement has been reached on a set of measures to reduce the average workweek:

- Social partners asked the government to reduce the maximum workweek from 39 hours to 38 hours by 2003, and provide additional funding to support the adjustment.
- An existing scheme to facilitate a switch to a four-day workweek will be replaced by a new one that includes a one-time subsidy per worker.

In this connection, the government had proposed a more elaborate scheme of financial incentives, through reduced social security contributions for employers, to promote additional shortening of the workweek, to 35 hours. These proposals were not addressed by social partners, who noted that few budgetary means had been set aside during the two years covered by the agreement.

Other measures, accepted by social partners and to be introduced in 2002, aim to accommodate individual preferences on combining work and leisure:

- Individual workers will get the right to shift to a four-day workweek, during a period of up to five years, and with a proportional wage reduction. The resulting income loss will be compensated by a social security transfer.
- Parental leave schemes for fathers will be extended in 2002, with a compensating social security benefit.
- Each employee is granted up to one year of leave during his career ('career interruption'), to be taken at his own discretion (although within limits, to ensure continuity of the firm), with income replacement through the social security system.

The initiative includes several proposals to support employment of older employees, which have also been accepted by social partners:

- A further cut in social security contributions for firms with employees above 58 years of age will be introduced in 2002, as well as a subsidy for hiring unemployed workers above 45 years of age. Firms will be required to finance outplacement services for workers above 45 years of age that have been laid off.
- Full-time workers above 50 years of age will get the right to opt for half-time employment or a four-day workweek, with compensation through the social security system.
- Unemployed above 50 years of age will again be offered jobs by the employment offices, and be required to accept employment that is suitable given their health, experience, and skills.
- Eligibility for early retirement remains at 58 years of age.

aspect of this problem is very low geographical mobility. While this is in part due to language differences, mobility is low even over relatively short distances and within regions. The staff argued that the generosity of unemployment benefits was unhelpful and that this situation was a specific reflection of the more general problem of blunted work incentives. In addition, greater geographical wage differentiation would reward labor mobility.

29. **In the authorities' view, this was a very difficult issue, although they pointed to signs of wage flexibility**. They noted several disincentives to mobility, including cultural traditions and the large transfer fee on home purchases. They agreed that geographical wage differentials were limited, but argued that the small size of the country constrained firms from differentiating wages on a geographical basis. At the same time, the authorities noted that the most recent *Bilan Social* showed that wage increases had varied substantially across sectors in 1999, although all had been subject to the 1999–2000 Interprofessional Agreement. While this evidence is subject to reservations—it is only one year's data and refers to sectoral rather than geographical differentiation—it does suggest the emergence of more variation than might have been apparent from the centralized nature of the wage bargaining framework.

D. Other Issues

30. **The authorities reported that the health of the banking sector has improved substantially, although challenges related to costs remain.** Before-tax profits rose from about €3.5 billion in the June 1998 – June 1999 period to €4.5 billion in the subsequent 12 months. This pickup reflected higher fee income and reduced provisioning for bad loans, both of which would likely be reversed to some extent in the event of an economic downturn. By contrast, the profitability of traditional lines of banking business were depressed, due to intense competition for market share, and labor and IT costs remained high as institutions continued to digest the recent wave of consolidation. Regulators reported no exposures that might give rise to significant difficulties, and the capital–asset ratio for the sector exceeded 11 percent. The Belgium stock market completed its merger with those of Paris and Amsterdam to form the Euronext exchange; the authorities reported that this had proceeded smoothly.

31. **Regarding financial-sector supervision, the mission perceived an increased degree of cooperation between banking and insurance supervisors**. A cooperation agreement between the two bodies was signed last year, and joint working groups have been established on key issues. Close coordination is important because, in Belgium, the major financial institutions are involved, through holding company arrangements, in both banking and insurance activities.

32. **The government has proposed to strengthen the institutional links between the banking supervisor (the Banking and Finance Commission) and the central bank, while maintaining two separate legal entities**. At the time of the mission, this proposal was not very far advanced. Since then, however, the finance minister has moved rapidly, appointing in December an independent commission to draft legislative proposals. According to the authorities, the proposal is designed to ensure the autonomy of the decision making of the

Banking and Finance Commission, and the central bank's independence in the performance of its functions within the Eurosystem. A key objective is to strengthen overall stability by bringing micro-prudential activities closer to the macro-prudential activities of the central bank. The finance minister has stated that this initiative would help to enhance supervision in the context of increased banking integration in the euro area. In addition, it is envisaged that this structure would allow future adjustments to take into account the increasing desegmentation of banking, investment, and insurance activities, if necessary trough the establishment of a comprehensive supervisory agency.

33. **The authorities are also proceeding with structural reform of the federal government.** The recently introduced Copernicus Plan is to reorganize and streamline the government. In general terms, the aim is to simplify the administration by reorganizing government agencies and making much greater use of new information technologies (such as web pages and electronic or downloadable forms). In addition, the Plan is expected by the authorities to reduce the administrative burden imposed by government from an estimated 2 percent of GDP to 1½ percent by 2003, in line with an effort begun in 1999 to reduce these costs which appears to have fallen behind schedule.

34. **Product market reforms are proceeding, but relatively slowly.** On liberalization of telecoms, gas, and electricity, Belgium is now almost in compliance with EU directives, but unlike some other EU countries is not pushing ahead of them. Telephone rates, which had been among the highest in the EU, have in some cases recently dropped sharply. This development was essentially a unilateral move by Belgacom, the government-controlled service provider, as a response to new competitive pressure. Electricity rates are the highest in the EU for households. They have been recently reduced by the government (rather than directly as a result of liberalization) as a first step in harmonizing electricity prices with those of neighboring countries. One difficulty was that the revenue that municipalities currently receive from electricity transmission would be lost in the liberalization process, and some form of compensation had to be worked out. Regarding competition policy, the authorities reported that the Competition Council had been successfully established. The staff inquired if its institutional arrangements—the staff that prepares cases is not at the Council itself but rather at the Economics Ministry—ensured sufficient resources and independence. The authorities argued that this issue had not proved to be a problem to date, and stressed that it was the Council itself, and not the Economics Ministry, which was responsible for making judgments about competition.

35. **Regarding international trade, the Belgian authorities were in favor of a new global trade round with an increased focus on labor and the environment.** They felt that these latter issues had to be dealt with explicitly to ensure progress in reducing trade barriers. They welcomed the European Commission's position on EU enlargement, which included a clear timetable for entry and the flexibility to go even faster. They mentioned that Belgium was already trading non-agricultural goods freely with the candidate countries. They also favored the Commission's proposal to grant free access to agricultural imports from developing countries. Total development aid was 0.3 percent of GDP in 1999. The overseas development assistance budget, which is only part of development aid, was set to increase as

a fraction of GDP in the years ahead. The evolution of total aid spending would, however, depend to some extent on the governments of the regions, which have been given some responsibility in this area as part of devolution, and the HIPC Initiative.

IV. Staff Appraisal

36. **The current macroeconomic situation provides a favorable setting to intensify expenditure control and structural reform efforts.** Several years of sustained growth have sharply reduced the unemployment rate, while underlying inflation and wage increases have remained moderate, although headline inflation rose last year due to oil price increases. In the short-term, high consumer and business confidence as well as monetary conditions are likely to remain broadly supportive of domestic demand. Against this backdrop, and given the still high debt-GDP ratio, the authorities should build on the strides already made to press ahead with fiscal consolidation as rapidly as possible. This goal is all the more important in the light of the expected fiscal demands on the pension and health care systems stemming from population aging. But the main economic policy challenge is to improve the performance of the labor market, which continues to suffer from structural distortions undermining the incentives to hire and to take a job.

37. **The 2001 budget will be in surplus, though little progress is likely in strengthening the cyclically adjusted balance or reducing expenditure growth.** The surplus—the first in fifty years—is very welcome. Moreover, it may be larger than budgeted due to higher economic growth than assumed, given the government's commitment to devote growth-related windfalls in 2001 to deficit reduction. The cyclically adjusted surplus will be unchanged, however, and excluding interest payments it is projected to deteriorate somewhat. Real primary expenditure growth is projected to be 2 percent for the general government, which represents very little improvement over the preceding 10 years.

38. **The five-year fiscal framework will help to make policy more transparent and predictable, and thus more credible.** The back loading of the planned tax cuts is appropriate, since it will provide room for maneuver in the event of negative budgetary or economic surprises. A high degree of credibility can boost the effectiveness of the tax cuts by allowing enterprises and households to plan ahead with assurance that fiscal policy will not be reversed. Likewise, a credible medium-term surplus target would signal to financial markets the government's determination to continue needed fiscal consolidation.

39. **The medium-term fiscal plan would be enhanced by tighter primary expenditure control and a more ambitious structural deficit target.** Holding real primary expenditure growth of the general government to 1.5 percent a year over the next five years would help to ensure room for the government's tax program, while permitting a structural surplus of 1 percent of GDP to be achieved by end-2003—that is, within the current government period. This surplus target would clearly signal this government's intent to rapidly solidify the public finances, a policy that is needed in view of the size of the public debt and the prospect of population aging. It would also make concrete the call in the 2001–2005 Stability Program for (an unspecified) medium-term structural surplus. Framing the target in structural terms would permit the operation of the automatic stabilizers, although transparency would require

that the method for estimating the structural surplus be made explicit. In the long term, restraining primary expenditure growth would generate substantial room for further tax cuts, thereby enhancing macroeconomic performance more generally. This degree of expenditure containment would, however, require substantial effort, particularly by constraining health care outlays and ensuring continued fiscal coordination among the levels of government.

40. **Population aging underscores the need to both continue the reduction in the national debt and move forward with structural reforms.** The recently announced reserve fund (the Silver Fund) is expected to increase public support for sustained fiscal surpluses. At the same time, however, there is a risk that the fund might be incorrectly seen as an alternative to further structural reforms. To mitigate this risk, the government should press ahead rapidly with measures to increase labor force participation rates and employment rates, especially among older people. The government's decision to further promote second pillar pensions needs to be followed up by measures to develop a significant complement to the public pension system, which would help to ease future pressures to increase spending.

41. **Regarding structural policies, the government's commitment to further tax cuts is commendable.** The reduction in employers' social security contributions last April was welcome, as is the planned introduction of a workers' tax credit. Consideration should be given to expanding the latter in the years ahead, as budgetary circumstances permit. Still, the tax burden remains high in Belgium, especially on labor, and projections imply that this will be true even after the government's five-year program is complete. Tight expenditure control will therefore be needed in the years ahead, since this is ultimately the only way to create the budgetary room for the meaningful further tax reductions to enhance labor market incentives.

42. **To reinforce the positive effects of tax policy, greater focus needs to be placed on the reform of benefit programs, affecting labor force participation of older people.** Correcting the incentives to retire prematurely is a key policy challenge, particularly with a view toward ensuring that the next generation is not also induced into premature retirement. The government's decision to treat older people on unemployment insurance as unemployed—that is, to require job search and to have public employment agencies offer jobs to them—should prove helpful, although the results will also depend on the enforcement of job-search obligations and the effectiveness of the employment agencies. The ultimate goal of this policy should be to end the use of the unemployment regime as an alternative early retirement scheme. In addition, the early retirement system should be reformed to reward continued employment—rather than, as now, penalizing it—by, for example, introducing actuarially fair benefit schedules and raising the age for early retirement.

43. **Equally important will be to restructure other policies, especially unemployment insurance, and to avoid additional disincentives to work.** For many recipients, unemployment benefits are of unlimited duration, a situation that tends to promote long-term unemployment, with adverse consequences for human capital and social inclusion. Limiting duration would help to sharpen work incentives, as would better enforcement of sanctions for those who refuse job offers. To help ensure reintegration into the labor force, a necessary complement to such policies is a more effective system of employment and job-search, and in this regard the introduction of greater competition among employment agencies in

accordance with ILO recommendations would be useful. In addition, closer integration of training and job placement would reduce skills mismatch. At the same time, policies that encourage reductions in work effort should be avoided—decisions on working time should be left to employers and workers. Thus, the measures to reduce working time (including the 38-hour workweek and mandatory leave provisions) move in the wrong direction, as would the implementation of subsidies to induce further reductions in the workweek. The fiscal resources devoted to these initiatives would be better used for measures to stimulate work.

44. **Geographical economic disparities deserve particular policy attention**. Greater wage differentiation according to productivity and labor market conditions would improve the employment prospects of both the low skilled and those in depressed areas. In this regard, it is encouraging that the previous two-year wage agreement appears to have allowed significant differentiation, and it is to be hoped that upcoming sector and enterprise negotiations result in further flexibility. Geographical labor mobility could be enhanced by reform to employment services and the unemployment regime to increase cooperation, offer jobs in other regions, and require beneficiaries to commute longer distances if offered a job in other regions and sub-regions.

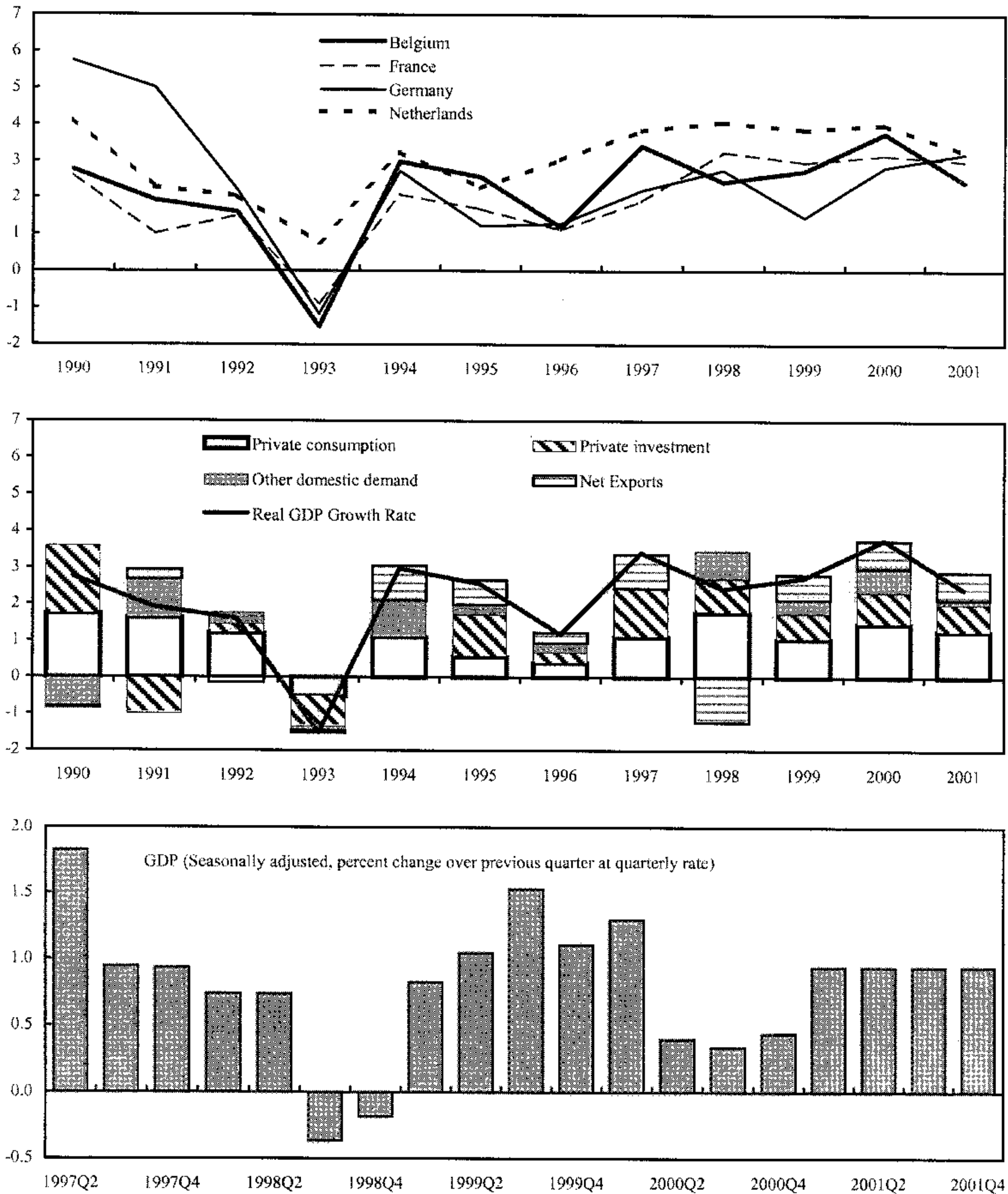
45. **Progress in product market reform continues to be rather slow**. Although Belgium is now proceeding according to the EU timetable to liberalize telecommunications, natural gas, and electricity, it has fallen behind other EU countries that have chosen to accelerate this process and thereby enjoy the benefits earlier. In a deregulated environment, the role of the recently established competition council will take on increased importance, and its resources need to be adequate for the task. The ambitious plan to reduce the administrative burden of government is moving forward, though less rapidly than had been hoped, and the Copernicus program should help to build greater momentum.

46. **The profitability of the banking sector improved last year, though supervisors will need to be alert in the event of an economic downturn**. The major factors behind the improved performance, higher fee income and lower provisioning, may well prove to be cyclical. In view of the structure of the financial sector—the large institutions generally comprise both banking and insurance arms—the increased cooperation between the banking and insurance supervisors is welcome. It will be important to maintain this close contact, in view of the structure of the industry itself, irrespective of how the institutional arrangements for banking supervision evolve.

47. Economic data, which are of high quality, have wide coverage, and are provided on a timely basis, are adequate for surveillance purposes (Appendix II).

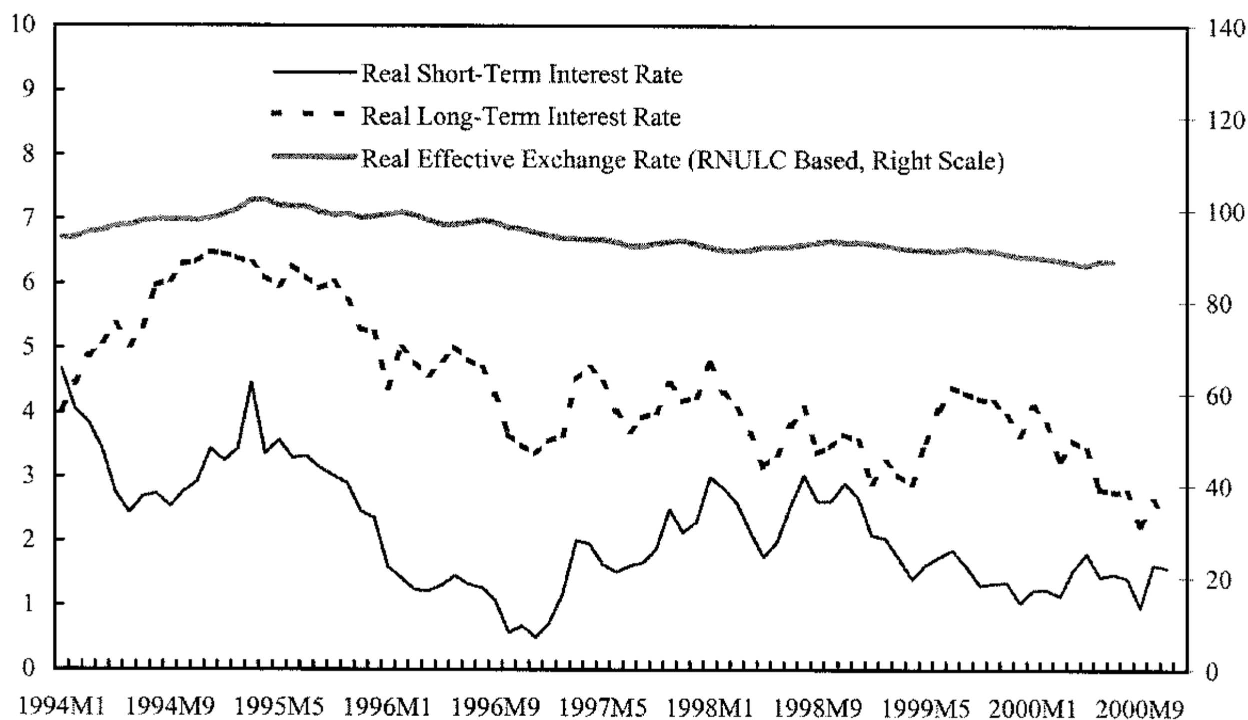
48. It is recommended that the next Article IV consultation take place on the twelve-month cycle.

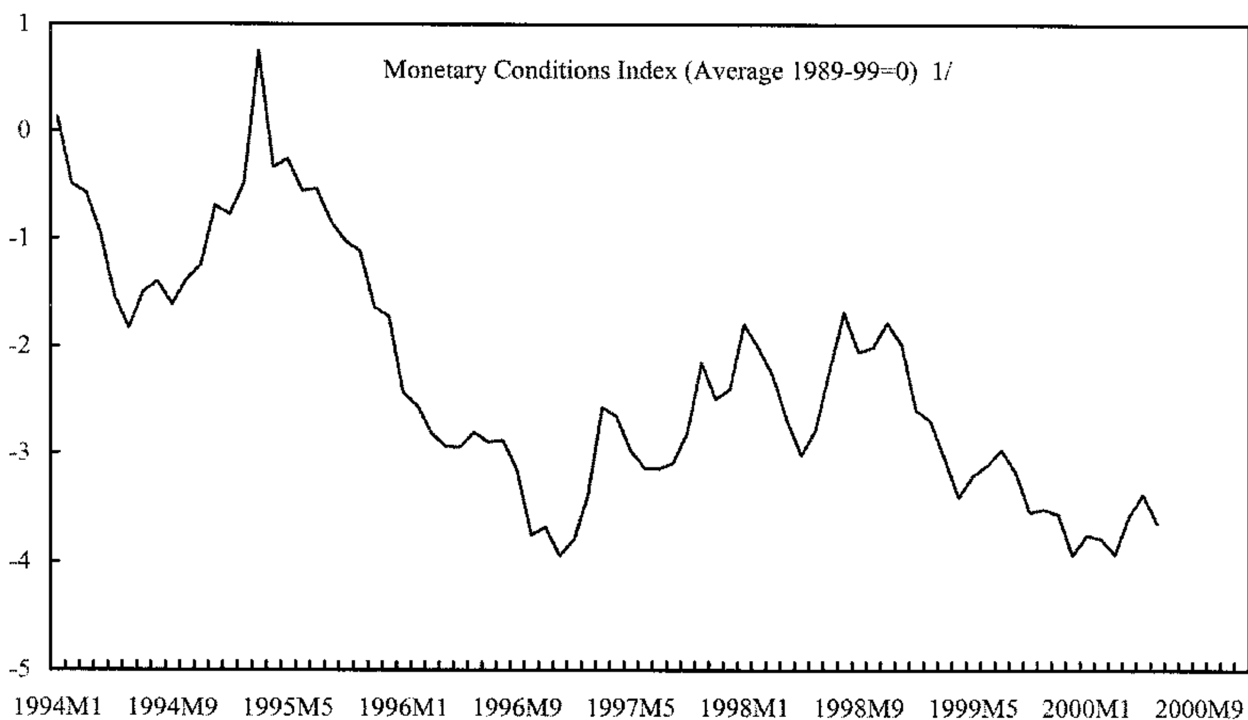
Figure 1. Belgium: Real GDP and Contribution to GDP Growth 1/



Source: IMF, World Economic Outlook; and data provided by the authorities.
1/ Data for third and fourth quarters of 2000 are staff projections.

Figure 2. Belgium: Monetary Conditions

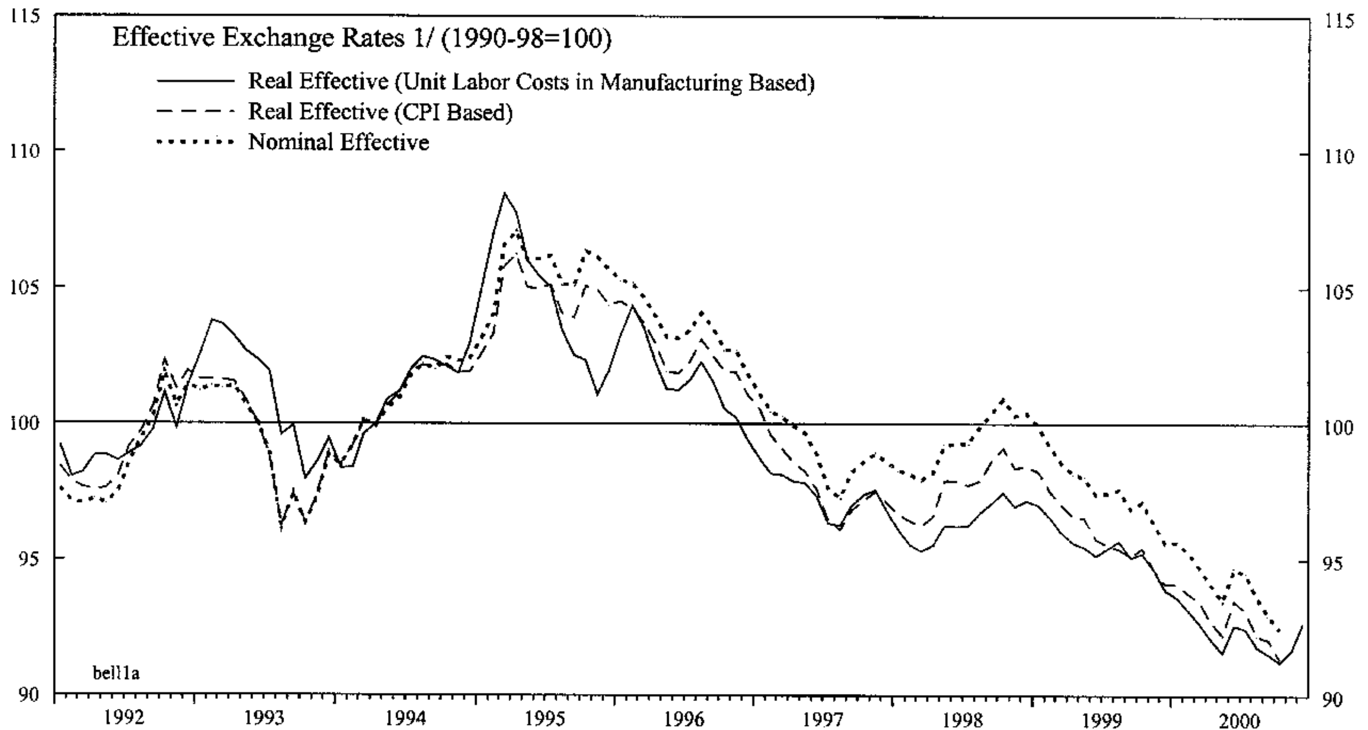


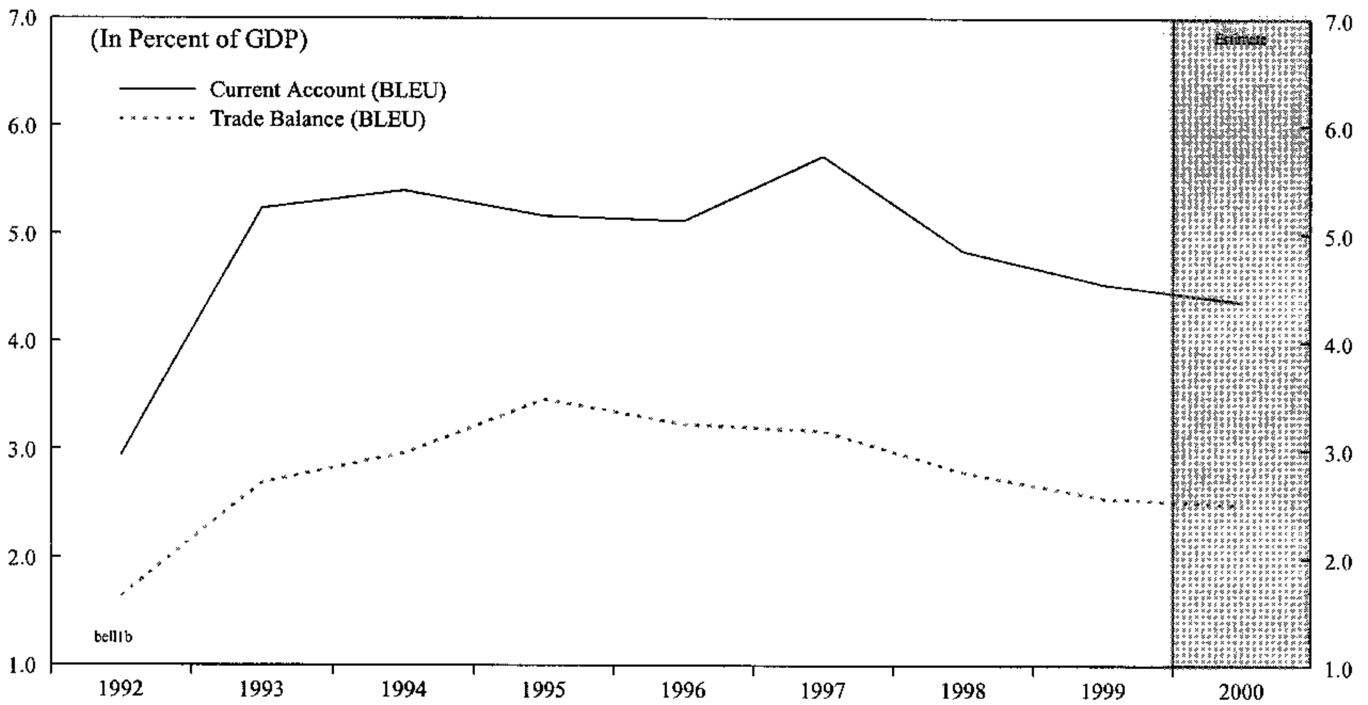


Source: Source: IMF, IFS.

1/ The monetary conditions index is a weighted average of the real effective exchange rate and the short-term real interest rate, with weights 1 and 2.5 respectively.

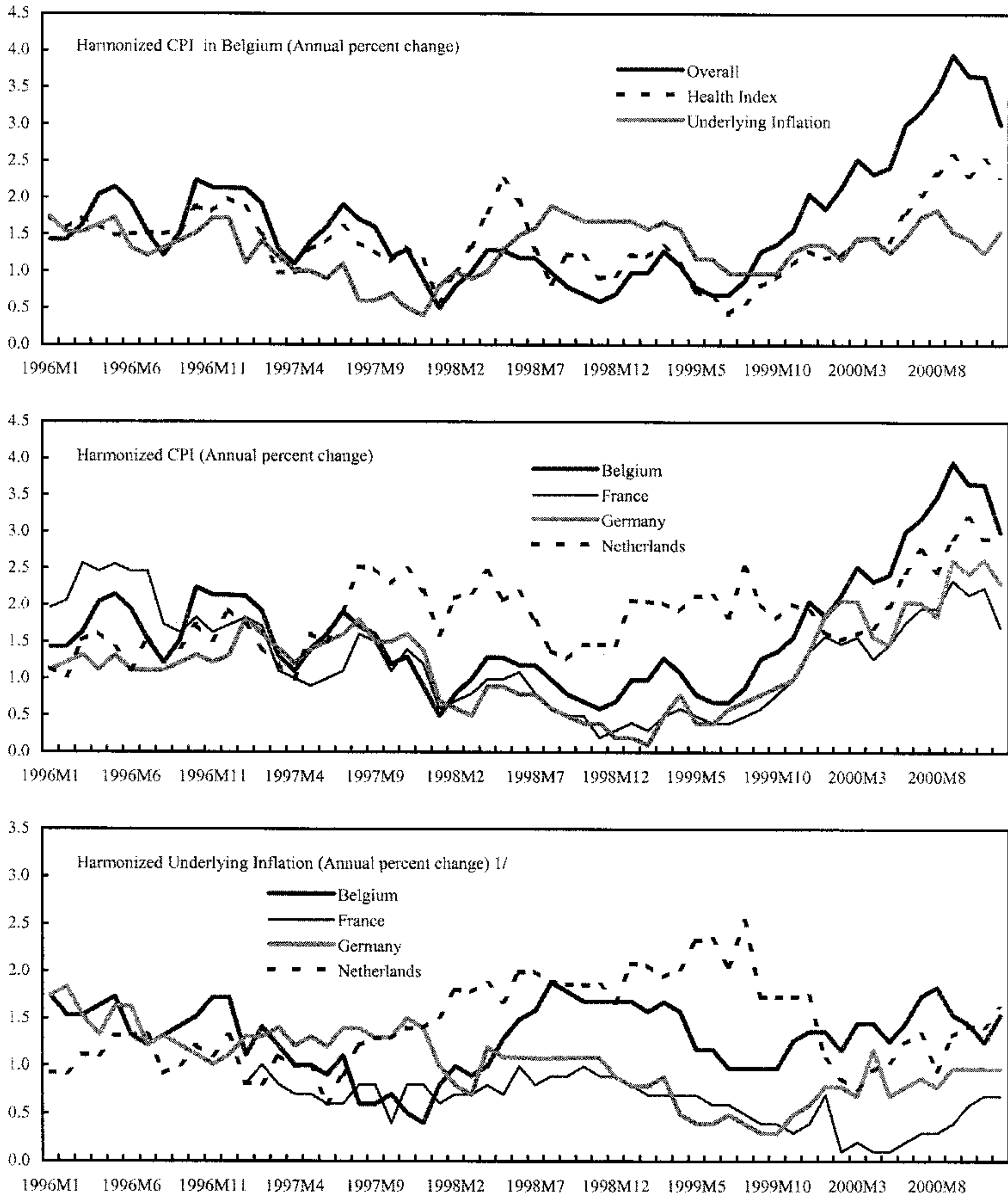
Figure 3. Belgium: External Indicators





Sources: IMF, International Financial Statistics; and Eurostat.
1/ An increase indicates an appreciation.

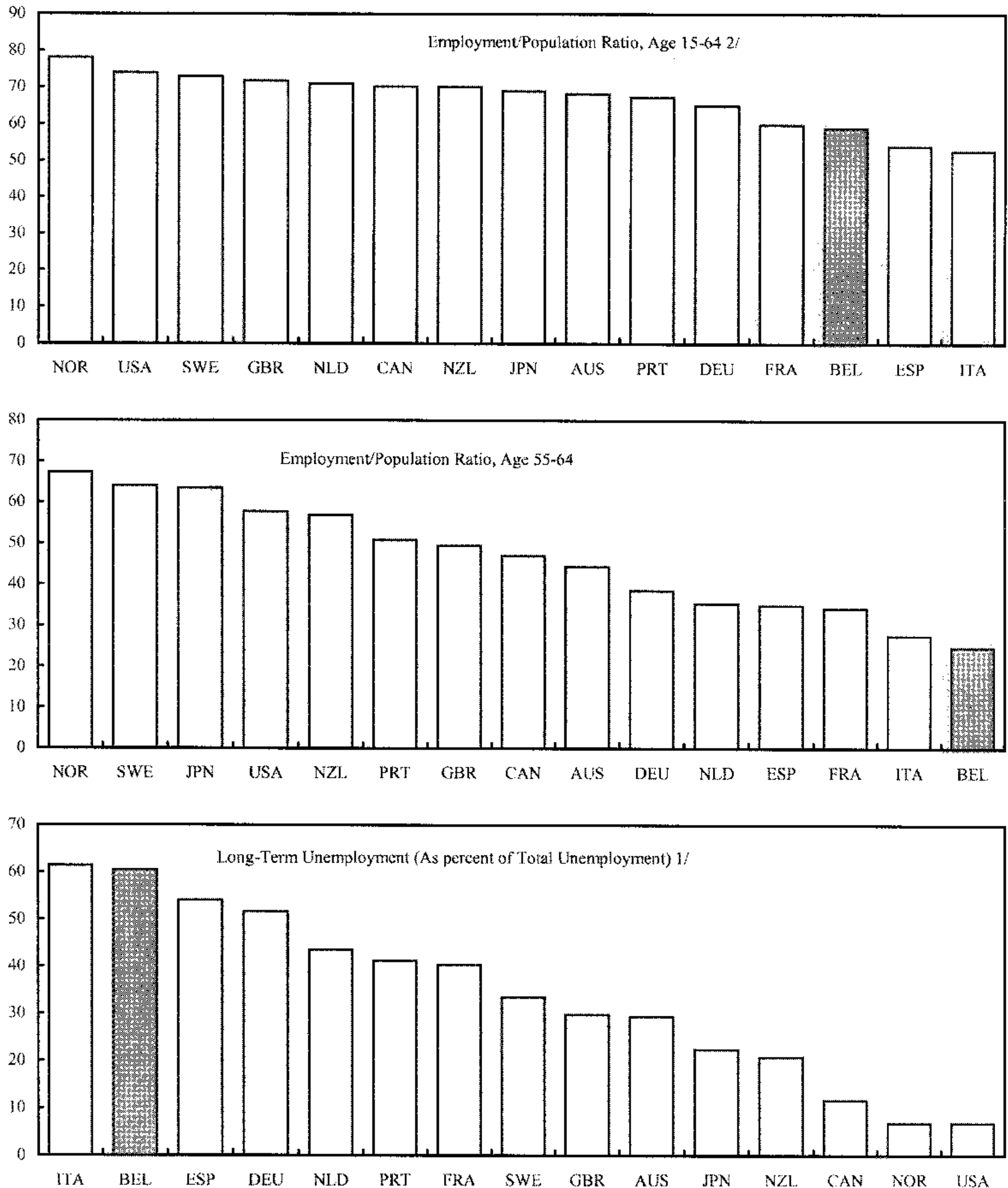
Figure 4. Belgium: Price Developments



Source: IMF, IFS; and Cronos database.

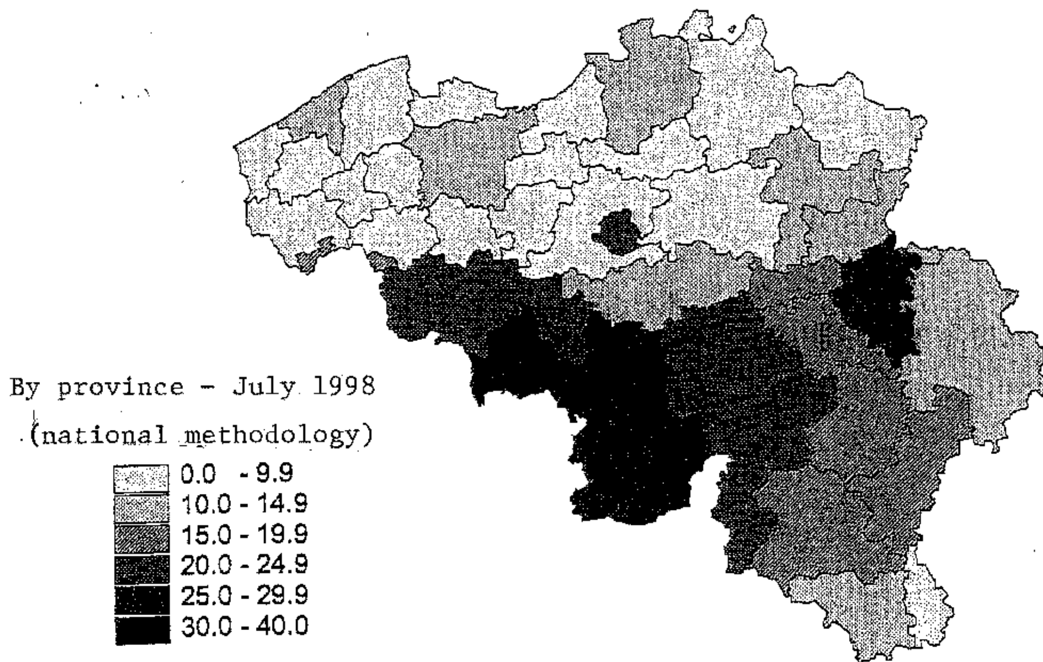
1/ Overall harmonized index excluding energy, food, alcohol and tobacco.

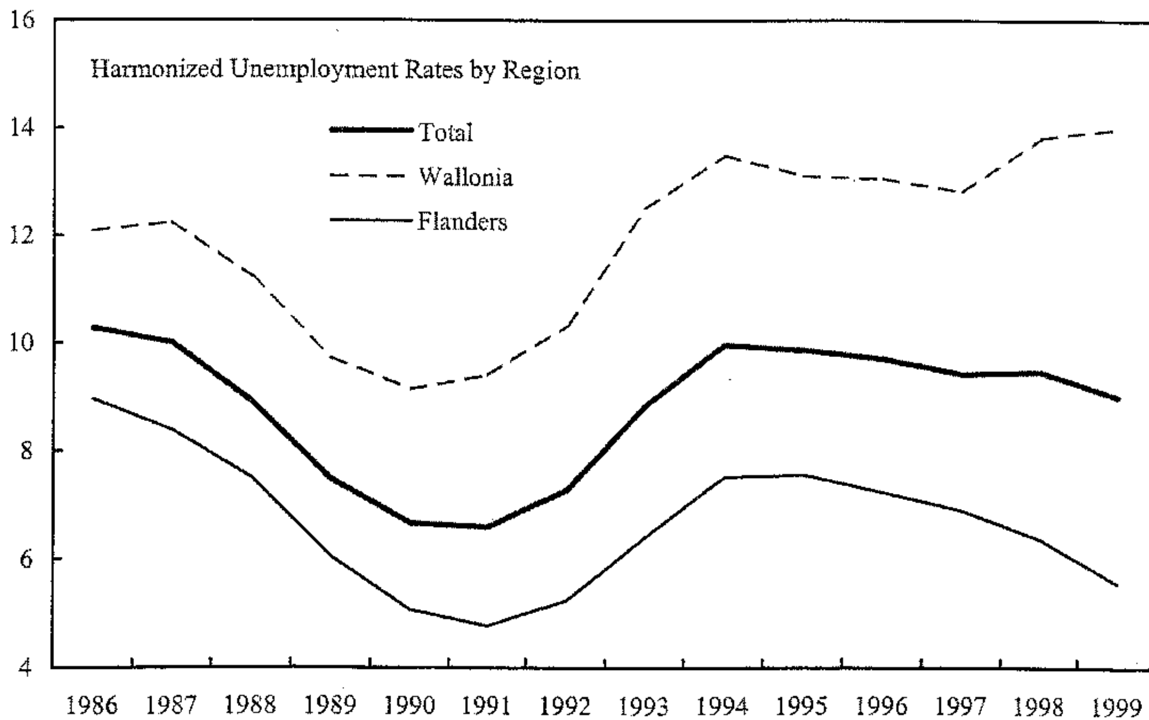
Figure 5. Belgium: Labor Market Indicators in Selected Countries 1/



Source: OECD, Employment Outlook, June 2000.
1/ Data are for 1999 except panel 3 data for 1998. (ESP, SWE)
2/ Refers to persons aged 16 to 64. (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.

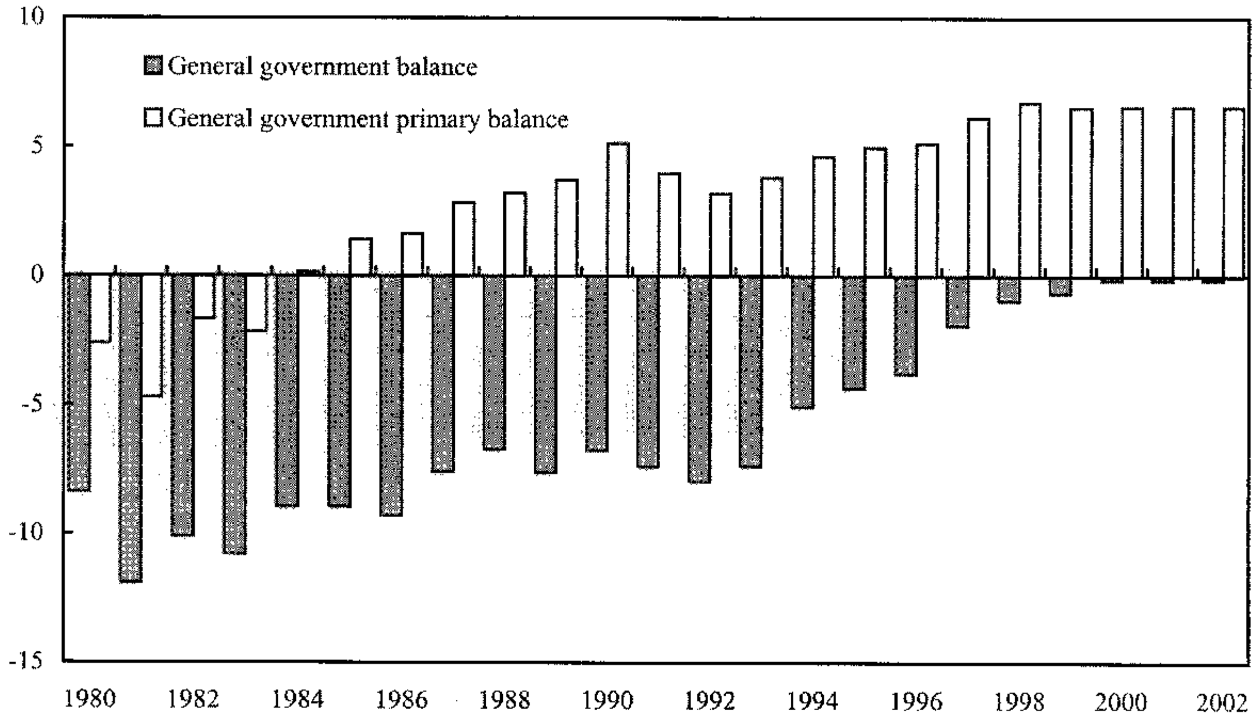
Figure 6. Belgium: Regional and Sub-regional Unemployment Rates

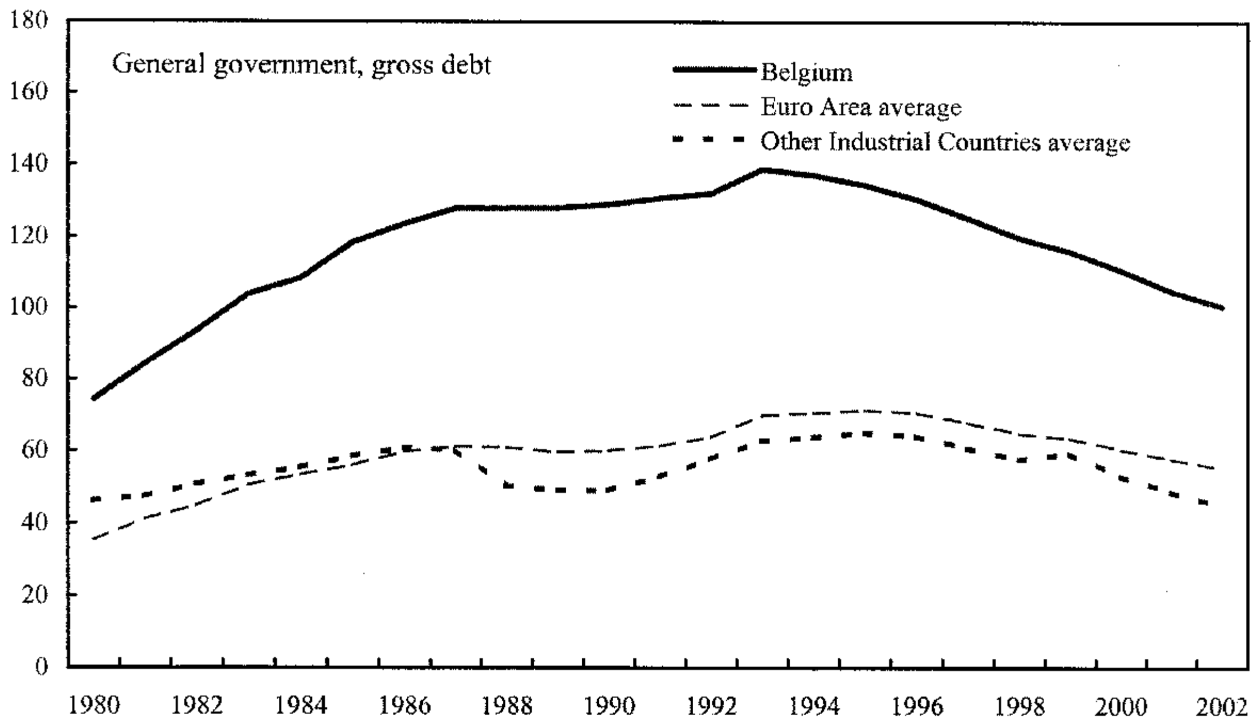




Source: Data provided by the Belgian authorities.

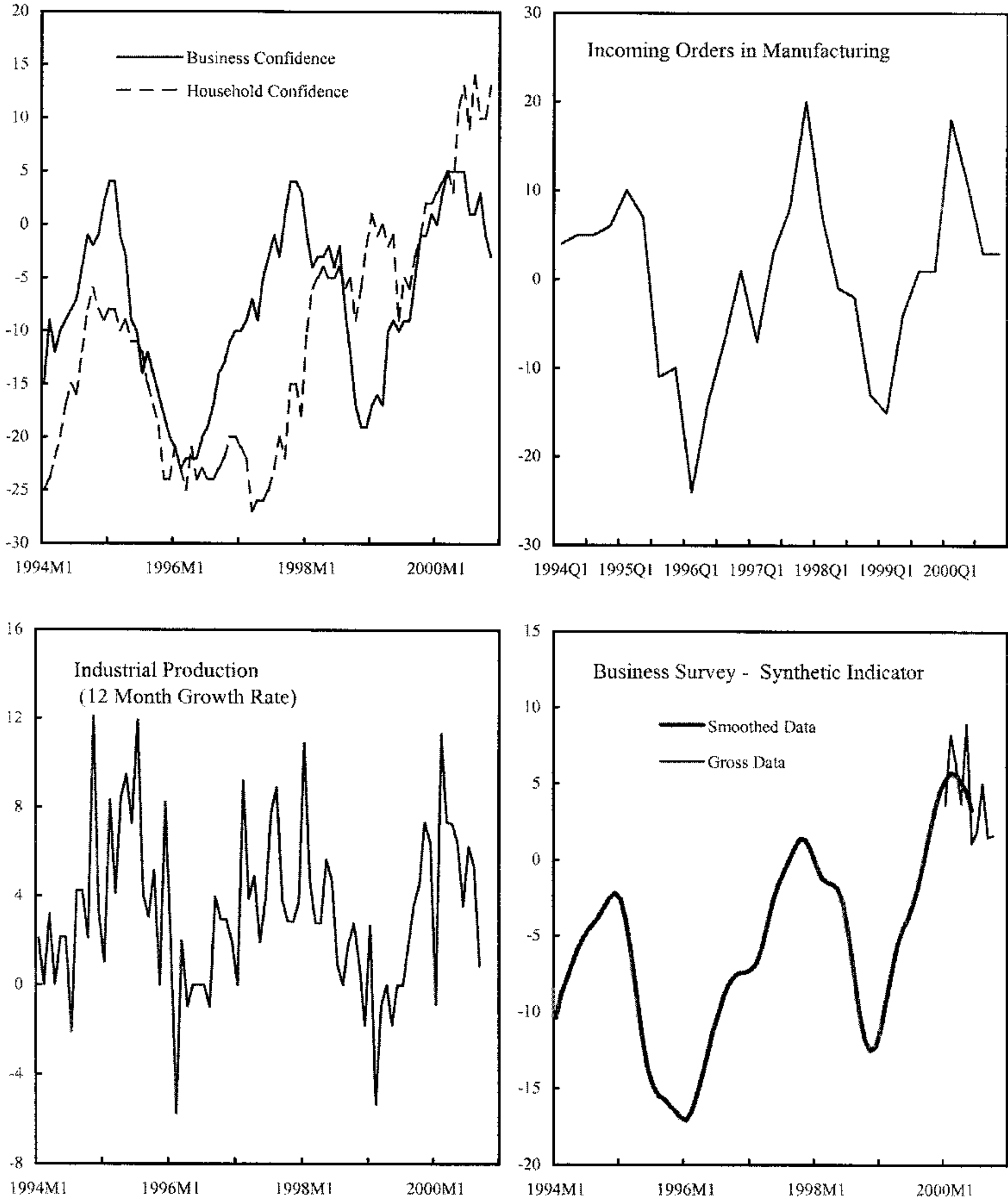
Figure 7. Belgium: Fiscal Indicators
(In percent of GDP)





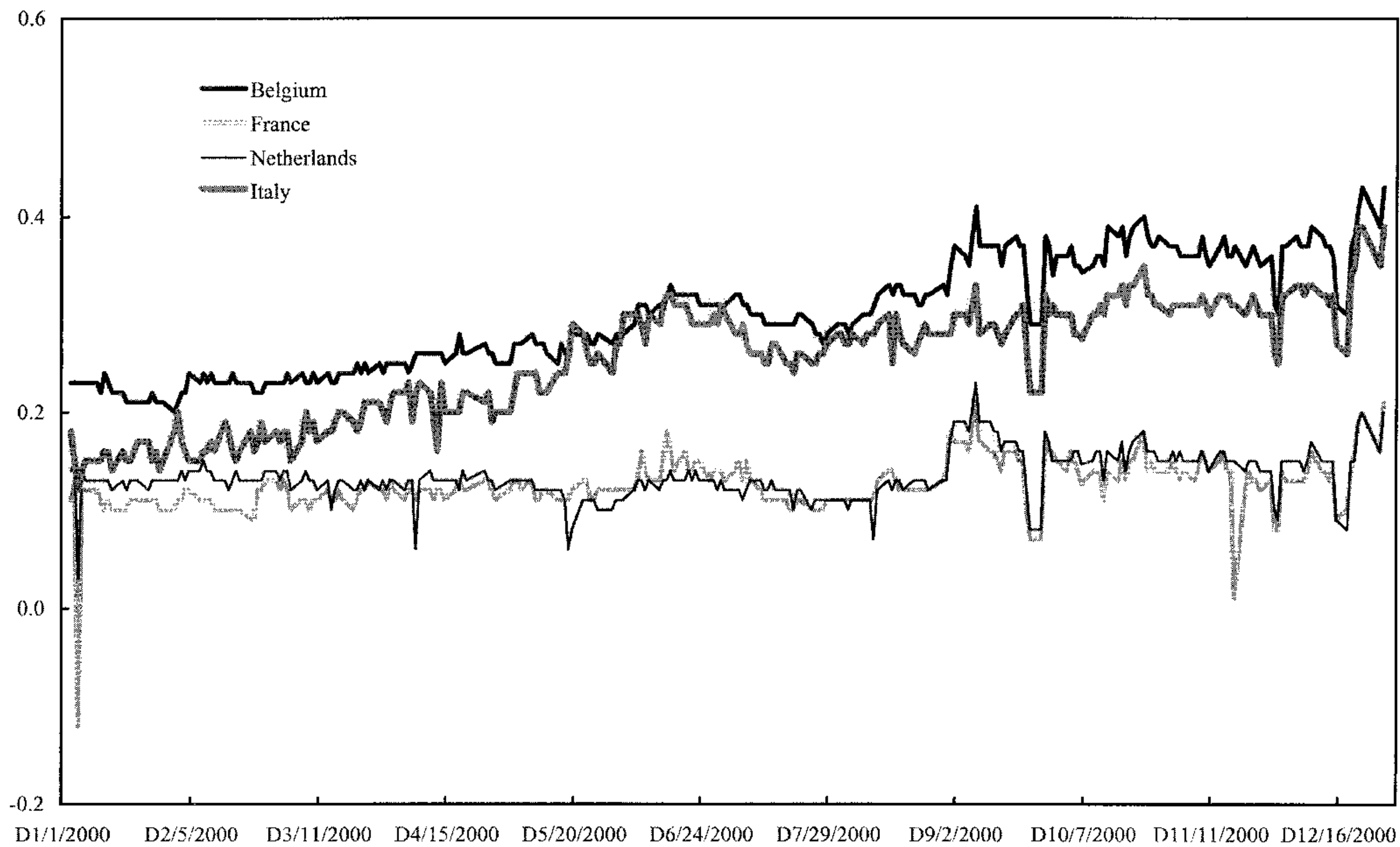
Source: IMF, WEO.

Figure 8. Belgium: Cyclical Indicators



Sources: WEFA Intline Database; and NBB.

Figure 9. Belgium: Ten-year Government Bond Rate Differential against Germany
(In Percent)



Source: IMF, Research Department.

Table 1. Basic Data

Demographic and other data:

Population (end-1997)	10.2 million
GNP per capita (1997)	US$ 23,640
Social indicators (1993)	
Life expectancy at birth	
Male	74
Female	81
Infant mortality rate	6 per 1,000 live births
Population per physician (1995)	437
Population per sq. km. (1995)	335

	1989		1999	
	Billions of BF	Percent of GDP	Billions of BF	Percent of GDP
Private consumption	3446.0	55.3	5054.0	53.6
Public consumption	1277.0	20.5	2016.0	21.4
Gross capital formation	1360.0	21.8	1995.0	21.2
Exports of goods and services	4573.0	73.4	7213.0	76.5
Imports of goods and services	4425.0	71.0	6856.0	72.8
GDP	6231.0	100.0	9423.0	100.0

	1996	1997	1998	1999	2000 Est.	2001 Proj.
	(Changes in percent)					
National Accounts						
Demand and output (volume)						
Private consumption	0.7	2.1	3.3	1.9	2.8	2.4
Public consumption	2.5	0.1	1.5	3.4	1.6	1.5
Gross fixed investment	0.9	6.7	4.6	4.8	4.8	2.6
Of which:						
Enterprise investment	3.9	7.8	6.0	4.8	5.1	4.3
Stockbuilding 1/	-0.2	0.0	0.6	-0.7	0.1	0.0
Total domestic demand	0.9	2.6	3.9	2.1	3.1	2.2
Exports of goods and nonfactor services	1.2	6.7	4.4	5.2	7.5	6.5
Imports of goods and nonfactor servises	0.8	5.7	6.5	4.4	6.9	5.9
Foreign balance 1/	0.3	0.9	-1.2	0.7	0.8	0.8
GDP	1.2	3.4	2.4	2.7	3.8	2.9
Output gap (in percent of potential GDP)	-3.3	-2.0	-1.9	-1.5	0.0	0.4
Manufacturing production	0.0	4.6	2.4	2.7	3.8	2.9

	1996	1997	1998	1999	2000 Est.	2001 Proj.
			(Changes in percent)			
Labor market						
Labor force (national definition)	0.2	0.3	0.4	0.3	0.6	0.5
Employment (national definition)	0.4	0.8	1.2	1.3	1.5	1.4
Unemployment rate (national definition) 2/	13.4	12.4	11.6	10.9	10.7	9.9
EU harmonized unemployment rate /2	9.7	9.4	9.5	9.1	8.5	7.9
NAIRU	8.4	8.3	8.3	8.3	8.2	8.1
Prices, wages and incomes						
GDP deflator	1.2	1.3	1.6	1.0	2.1	2.2
Terms of trade (goods)	-0.4	-0.6	1.2	-0.7	-1.5	0.2
Consumer price index 3/	1.8	1.5	0.9	1.1	2.9	2.2
Compensation 4/	1.8	3.1	2.1	2.5	2.8	3.7
Labor productivity 4/	0.9	3.4	1.4	1.7	2.8	2.0
Unit labor costs 4/	0.9	-0.2	0.7	0.7	0.0	1.7
Real disposable income	0.1	0.5	2.7	1.7	1.7	2.7
			(In percent)			
Interest rates						
Money market rate 5/	3.2	3.5	3.6	3.0	4.4	...
Government bond yield	6.3	5.7	4.7	4.5	5.6	...
			(In percent of GDP)			
Saving and investment						
Private saving	26.0	24.4	23.2	22.6	22.6	22.8
Of which:						
Household saving as percent of disposable household income	18.9	17.5	16.7	16.4	15.8	15.4
Private investment 6/	18.3	18.8	19.1	19.3	19.8	19.7
Private saving surplus	7.7	5.6	4.1	3.3	2.8	3.1
Government saving surplus	-3.1	-1.1	-0.1	0.1	0.8	1.6
National saving surplus 7/	4.6	4.5	4.0	3.4	3.6	4.6
Public finances, general government						
Revenue	49.3	49.7	50.0	50.0	49.6	49.2
Expenditure	53.0	51.6	50.9	50.7	49.6	48.8
Of which:						
Interest on public debt	8.9	8.0	7.7	7.2	6.9	6.5
Fiscal balance	-3.8	-1.9	-0.9	-0.7	0.0	0.4
Primary balance	5.1	6.1	6.7	6.5	6.9	6.8
Structural balance	-1.6	-0.5	0.3	0.3	0.1	0.1
Structural primary balance	7.0	7.3	7.8	7.4	7.0	6.6
Gross public debt	128.1	123.0	119.7	116.4	110.5	104.8

	1996	1997	1998	1999	2000 Est.	2001 Proj.
	(In billions of Belgian francs)					
Balance of payments 8/						
Current account balance	426.1	498.9	439.3	426.7	435.8	532.4
(In percent of GDP of Belgium)	5.1	5.7	4.8	4.5	4.4	5.1
Trade balance	269.1	276.4	253.2	240.3	248.4	305.0
(In percent of GDP of Belgium)	3.2	3.2	2.8	2.6	2.5	2.9
Official reserves (US$ billion) 9/	17.0	16.2	18.3	10.9	9.9	...
Reserve cover (months of imports of GNFS)	1.1	1.0	1.2	0.7	0.7	...
Exchange rates						
Euro per U.S. dollar (January 25, 2001) 10/					0.92	
Nominal effective rate (1990=100) 11/	97.9	93.9	93.9	92.8	90.6	...
Real effective rate (1990=100) 11/ 12/	97.3	93.2	92.1	91.4	88.9	...

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/ Manufacturing, full-time equivalent.
5/ Since 1999, Euro rate.
6/ Incl. Stockbuilding
7/ Including capital transfers.
8/ Belgium-Luxembourg Economic Union (BLEU) on a transactions basis.
9/ For 2000, November; excluding gold; since January 1999, Eurosystem's definition.
10/ Belgium entered the final stage of EMU on January 1, 1999 at a rate of 40.3399 Belgian francs to the euro.
11/ For 2000, average of the first seven months.
12/ Based on relative normalized unit labor costs in manufacturing.

Table 2. Public Finances, 1994-2001

(In percent of GDP)

	1994	1995	1996	1997	1998	1999	2000 Est.	2001 Proj. 1/
Revenue	48.8	48.6	49.3	49.7	50.0	50.0	49.6	49.2
Expenditure	53.9	53.0	53.0	51.6	50.9	50.7	49.6	48.8
Primary expenditure 2/	44.2	43.7	44.1	43.6	43.2	43.5	42.7	42.3
Federal	8.8	8.5	8.6	8.7	8.5	8.6	8.4	8.2
Social security	18.8	18.8	19.1	18.4	18.3	18.2	17.7	17.8
Local government	6.4	6.1	6.1	6.0	6.0	6.2	6.2	6.0
Regions and communities	10.2	10.3	10.3	10.4	10.4	10.5	10.4	10.4
Interest payments	9.7	9.3	8.9	8.0	7.7	7.2	6.9	6.5
Balance	-5.0	-4.3	-3.8	-1.9	-0.9	-0.7	0.0	0.4
Federal	-4.6	-3.8	-3.4	-2.4	-1.7	-1.7	-0.6	-0.2
Social security	0.5	0.0	-0.2	0.5	0.4	0.7	0.2	0.2
Local government	-0.1	0.3	0.2	0.2	0.1	0.1	0.1	0.1
Regions and communities	-0.9	-0.8	-0.4	-0.1	0.2	0.3	0.3	0.3
Memorandum items:								
Primary balance	4.6	5.0	5.1	6.1	6.7	6.5	6.9	6.8
Structural balance	-3.1	-2.7	-1.6	-0.5	0.3	0.3	0.1	0.1
Structural primary balance	6.3	6.4	7.0	7.3	7.8	7.4	7.0	6.6
Output gap	-2.7	-2.3	-3.3	-2.0	-1.9	-1.5	0.0	0.4
Gross debt (Maastricht)	137.2	134.4	130.5	125.2	119.7	116.4	110.5	104.8
Net debt	123.9	123.0	120.5	115.9	110.7	107.4	101.3	95.6
				(Real growth rate, in percent) 3/				
Total expenditure	-0.8	0.8	1.3	0.7	1.0	2.3	1.5	1.3
Primary expenditure	1.6	1.4	2.2	2.2	1.6	3.4	1.8	2.0
Federal government	-0.2	-0.9	2.0	5.0	0.0	3.9	1.5	-0.2
Social security	0.6	2.2	2.6	-0.2	1.8	2.3	1.0	3.2
Local government	4.1	-1.8	1.9	1.9	2.1	6.1	3.4	-0.9
Regions and communities	3.8	3.7	1.9	4.3	2.2	3.4	2.5	3.5

Sources: Data provided by the authorities; OECD, Economic Outlook; and Fund staff projections.

1/ The projection does not include the proceeds from the planned UMTS auction.

2/ Primary expenditure by government entity excludes transfers to other levels of government.

3/ Deflated using the GDP deflator.

Table 3. Belgium: Three Fiscal Scenarios, 1998-2006
(In percent of GDP)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Baseline scenario (1.5 percent real expenditure growth)									
Revenue 1/	50.0	50.0	49.6	49.2	48.8	48.5	48.3	48.0	47.4
Expenditure	50.9	50.7	49.6	48.8	48.2	47.6	47.0	46.4	45.8
Primary expenditure	43.2	43.5	42.7	42.3	42.0	41.6	41.3	41.1	40.8
Interest payments	7.7	7.2	6.9	6.5	6.3	5.9	5.6	5.3	5.1
Balance	-0.9	-0.7	0.0	0.4	0.6	0.9	1.3	1.6	1.6
Structural balance	0.3	0.3	0.1	0.1	0.3	0.7	1.2	1.6	1.6
Primary balance	6.7	6.5	6.9	6.8	6.8	6.8	7.0	6.9	6.6
Debt	119.7	116.4	110.5	104.8	100.3	95.9	91.3	86.7	82.1
Memorandum items (in percent):									
Primary expenditure growth	1.6	3.4	1.8	2.0	1.5	1.5	1.5	1.5	1.5
GDP growth	2.4	2.7	3.8	2.9	2.4	2.3	2.2	2.2	2.2
Scenario (including new policy initiatives)									
Revenue 1/	50.0	50.0	49.6	49.2	48.8	48.5	48.3	48.0	47.4
Expenditure	50.9	50.7	49.6	48.8	48.4	47.9	47.4	47.0	46.5
Primary expenditure 2/	43.2	43.5	42.7	42.3	42.2	42.0	41.7	41.6	41.4
of which: Social security	18.3	18.2	17.7	17.8	17.6	17.5	17.4	17.2	17.1
Interest payments	7.7	7.2	6.9	6.5	6.3	5.9	5.7	5.4	5.1
Balance	-0.9	-0.7	0.0	0.4	0.4	0.6	0.9	1.0	0.9
Structural balance	0.3	0.3	0.1	0.1	0.1	0.3	0.8	1.0	0.9
Primary balance	6.7	6.5	6.9	6.8	6.6	6.5	6.6	6.3	6.0
Debt	119.7	116.4	110.5	104.8	100.5	96.4	92.2	88.2	84.3
Memorandum items (in percent):									
Primary expenditure growth	1.6	3.4	1.8	2.0	2.0	1.8	1.7	1.9	1.7
GDP growth	2.4	2.7	3.8	2.9	2.4	2.3	2.2	2.2	2.2
Higher real expenditure growth (2.2 percent)									
Revenue 1/	50.0	50.0	49.6	49.2	48.8	48.5	48.3	48.0	47.4
Expenditure	50.9	50.7	49.6	48.8	48.5	48.2	47.9	47.6	47.4
Primary expenditure	43.2	43.5	42.7	42.3	42.3	42.2	42.2	42.2	42.2
of which: Social security	18.3	18.2	17.7	17.8	17.7	17.7	17.7	17.7	17.7
Interest payments	7.7	7.2	6.9	6.5	6.3	5.9	5.7	5.4	5.2
Balance	-0.9	-0.7	0.0	0.4	0.3	0.3	0.4	0.3	0.0
Structural balance	0.3	0.3	0.1	0.1	0.0	0.1	0.3	0.3	0.0
Primary balance	6.7	6.5	6.9	6.8	6.5	6.3	6.1	5.8	5.2
Debt	119.7	116.4	110.5	104.8	100.6	96.8	93.0	89.6	86.5
Memorandum items (in percent):									
Primary expenditure growth	1.6	3.4	1.8	2.0	2.2	2.2	2.2	2.2	2.2
GDP growth	2.4	2.7	3.8	2.9	2.4	2.3	2.2	2.2	2.2

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

1/ Including the plans tax for tax cuts announced by the central and Flanders governments.

2/ Based on the staff's interpretation of the policy initiatives put forward in the context of the 2001 Budget.

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

	1995	1996	1997	1998	1999	2000
External indicators						
Exports (annual percent change, in US dollars)	16.8	-0.7	-2.3	3.6	1.3	-1.7
Imports (annual percent change, in US dollars)	17.3	-0.4	-2.6	4.3	1.4	-1.3
Terms of trade (annual percent change)	1.8	1.3	-0.8	-1.1	-0.4	-0.6
Current account balance	2.9	5.2	5.4	5.2	5.1	5.7
Inward portfolio investment	1.9	13.6	16.6	17.3	38.8	...
Inward foreign direct investment	3.8	5.0	4.7	8.7	6.0	...
Official reserves (in US dollars, billions) 2/	24.1	22.9	21.3	21.1	13.3	10.0
Official reserves in months of imports	1.6	1.5	1.5	1.4	0.9	0.7
Exchange rate (per U.S. dollar, period average)	29.48	30.96	35.77	36.30	37.86	43.78
Financial Market Indicators						
Public sector debt (Maastricht definition)	134.4	130.5	125.2	119.7	116.4	110.5
Government bond yield	7.4	6.5	5.7	4.7	4.8	5.6
Government bond yield (real)	6.0	4.4	4.1	3.8	3.7	3.0
Stock market index 3/	100.0	120.6	161.2	223.6	231.1	206.6
Spread of government bond yield with Germany	0.67	0.28	0.09	0.19	0.23	0.30
Financial Sector Risk Indicators						
Risk based capital-asset ratio 4/	11.9	11.7	11.4	11.3	11.9	11.9
Rate of return on equity (after tax) 5/	8.4	10.4	10.9	9.6	11.4	15.1
Foreign assets of the banking sector 6/	273.1	267.8	262.5	...	113.3	102.8
Foreign liabilities of the banking sector 6/	302.9	293.7	280.0	...	183.1	158.5

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

1/ The interpretation of some indicators is affected by the launch of monetary union in 1999.
2/ Reserves and foreign liabilities refer to the Belgian central bank, both before and after EMU. End-of-period.
3/ For 2000, average for period up to September.
4/ For 2000: June.
5/ For 2000: First half.
6/ Foreign assets and liabilities of banking institutions, end-of-period (in US dollars, billions). Series break in 1999. For 2000: November data.

Belgium: Fund Relations
(As of December 31, 2000)

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

II. **General Resources Account**:	**SDR Million**	**% Quota**
Quota	4,605.20	100.0
Fund holdings of currency	3,301.36	71.7
Reserve position in Fund	1,303.84	28.3
Operational budget transfers (net)	-7.00	

III. **SDR Department**:	**SDR Million**	**% Allocation**
Net cumulative allocation	485.25	100.0
Holdings	235.81	48.6
[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 25, 2000 (EBM/00/18).

IX. Belgium retains restrictions vis-à-vis Iraq, the Socialist People's 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 pursuant to Decision No. 144-(52/51) in EBD/90/251 (8/17/90), EBD/94/187 (11/29/94), and EBD/92/139 (7/7/92). 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 25, 2001

	Exchange Rates	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP
Date of Latest Observation	1/25/01	1/25/01	11/00	10/00	9/00	1999	Q3/00
Date Received	1/25/01	1/25/01	1/5/01	1/12/01	1/12/01	11/3/00	11/12/01
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	NBB 1/	NBB 1/	NBB 1/	NAI 2/	NBB 1/
Mode of Reporting	Electronic	Electronic	NBB Website	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/ National Bank of Belgium.
2/ National Accounts Institute.

Three Long-Term Scenarios for the Public Finances

This appendix presents three scenarios for the public finances, illustrating the rewards from expenditure restraint and the scope for accelerating tax cuts. In each scenario, the general government balance moves into surplus in 2001, in accordance with the Budget. An actual and structural surplus of 1.0 percent of GDP is maintained from 2006 to 2020—before that, it results from expenditure growth and the current government's plans for tax cuts. In the longer term, the development the revenue share broadly corresponds to the growth of primary expenditure (relative to GDP) and the gradual decline in interest costs. The scenarios show that primary spending restraint, together with the resulting fall in debt and interest costs, would provide room for significant tax cuts in the years ahead.

The calculations indicate that the fiscal repercussions of population aging can be absorbed if expenditure restraint is preserved. After 2005, aging is projected to imply slightly higher growth of social security spending—in particular on pensions and health care—and after 2010 an anticipated decline in the working-age population would dampen growth. The interest savings from debt reduction could help offset the resulting squeeze of the public finances.

If annual real primary expenditure growth remained at 1½ percent, a sustainable reduction in the revenue share, by more than 4 percent of GDP, could be achieved by 2010. In the baseline scenario, which is presented in the top panel of the Table, primary spending growth is kept at 1½ percent until 2010. Subsequently, primary spending increases slightly faster, reflecting the aging-induced rise in social security spending. This path leaves room for a cut in the revenue-GDP ratio from 49.6 percent in 2000 to 45.3 percent in 2010, while the debt ratio declines to 69.5 percent of GDP. After 2010, the gains from an ongoing decrease in interest costs broadly offset the effects of population aging on expenditure and growth.

The critical role of expenditure restraint is illustrated in the second and third scenarios, both of which feature higher spending growth. The second scenario incorporates the budgetary plans announced by the current government, and keeps primary expenditure growth rate at 1.8 percent after 2005 (before the extra costs due to population aging). Following a reduction in the revenue ratio by 2010, this ratio would almost return to its current high level by 2030. The third scenario illustrates the detrimental implications of maintaining primary expenditure growth rate at 2.2 percent (again, before the extra costs due to population aging), the average recorded during 1995–99. In this case, the revenue ratio would broadly stabilize up to 2020, and rise steeply in the following decade.

Table 5. Belgium: Three Long-term Fiscal Scenarios, 1998-2030
(In percent of GDP)

	1998	1999	2000	2001	2002	2005	2010	2015	2020	2030
Baseline scenario (1.5 percent real expenditure growth)										
Revenue	50.0	50.0	49.6	49.2	48.8	47.4	45.3	44.6	44.5	44.7
Expenditure	50.9	50.7	49.6	48.8	48.2	46.4	44.3	43.6	43.5	44.7
Primary expenditure	43.2	43.5	42.7	42.3	42.0	41.1	40.0	40.2	40.8	42.8
Interest payments	7.7	7.2	6.9	6.5	6.3	5.3	4.2	3.4	2.7	1.9
Balance	-0.9	-0.7	0.0	0.4	0.6	1.0	1.0	1.0	1.0	0.0
Structural balance	0.3	0.3	0.1	0.1	0.3	1.0	1.0	1.0	1.0	0.0
Primary balance	6.7	6.5	6.9	6.8	6.8	6.3	5.2	4.4	3.7	1.9
Debt	119.7	116.4	110.5	104.8	100.3	87.4	69.4	55.4	43.7	30.8
Memorandum items (in percent):										
Primary expenditure growth	1.6	3.4	1.8	2.0	1.5	1.5	1.7	1.7	1.7	1.7
GDP growth	2.4	2.7	3.8	2.9	2.4	2.2	2.0	1.6	1.5	1.2
Scenario (including new policy initiatives)										
Revenue	50.0	50.0	49.6	49.2	48.8	48.0	46.4	46.4	46.8	48.5
Expenditure	50.9	50.7	49.6	48.8	48.4	47.0	45.4	45.4	45.8	48.5
Primary expenditure	43.2	43.5	42.7	42.3	42.2	41.6	41.1	41.9	43.1	46.6
of which: Social security	18.3	18.2	17.7	17.8	17.6	17.2	16.8	17.2	17.6	19.1
Interest payments	7.7	7.2	6.9	6.5	6.3	5.4	4.3	3.4	2.7	1.9
Balance	-0.9	-0.7	0.0	0.4	0.4	1.0	1.0	1.0	1.0	0.0
Structural balance	0.3	0.3	0.1	0.1	0.1	1.0	1.0	1.0	1.0	0.0
Primary balance	6.7	6.5	6.9	6.8	6.6	6.3	5.3	4.4	3.7	1.9
Debt	119.7	116.4	110.5	104.8	100.5	88.2	70.1	56.1	44.2	31.2
Memorandum items (in percent):										
Primary expenditure growth	1.6	3.4	1.8	2.0	2.0	1.9	2.0	2.0	2.0	2.0
GDP growth	2.4	2.7	3.8	2.9	2.4	2.2	2.0	1.6	1.5	1.2
Higher real expenditure growth (2.2 percent)										
Revenue	50.0	50.0	49.6	49.2	48.8	48.0	47.9	48.8	50.2	54.1
Expenditure	50.9	50.7	49.6	48.8	48.5	47.6	46.9	47.8	49.2	54.1
Primary expenditure	43.2	43.5	42.7	42.3	42.3	42.2	42.5	44.2	46.4	52.1
of which: Social security	18.3	18.2	17.7	17.8	17.7	17.7	17.9	18.9	20.1	23.2
Interest payments	7.7	7.2	6.9	6.5	6.3	5.4	4.4	3.5	2.8	2.0
Balance	-0.9	-0.7	0.0	0.4	0.3	0.3	1.0	1.0	1.0	0.0
Structural balance	0.3	0.3	0.1	0.1	0.0	0.3	1.0	1.0	1.0	0.0
Primary balance	6.7	6.5	6.9	6.8	6.5	5.8	5.4	4.5	3.8	2.0
Debt	119.7	116.4	110.5	104.8	100.6	89.6	72.1	57.8	45.7	32.4
Memorandum items (in percent):										
Primary expenditure growth	1.6	3.4	1.8	2.0	2.2	2.2	2.4	2.4	2.4	2.4
GDP growth	2.4	2.7	3.8	2.9	2.4	2.2	2.0	1.6	1.5	1.2

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

INTERNATIONAL MONETARY FUND

BELGIUM

Staff Report for the 2000 Article IV consultation
Supplementary Information

Prepared by the European I Department

(In consultation with other Departments)

Approved by C.M. Watson and G. Russell Kincaid

February 16, 2001

1. This supplement is based on information concerning economic and financial developments relating to Belgium since the issuance of the staff report (SM/01/28) on February 2, 2001. In particular, projections for 2001 have been updated in line with WEO assumptions as of the date of preparation of this supplement. This additional information does not alter the thrust of the staff appraisal.

2. A less favorable external environment is reflected in a downward revision of economic growth for 2001 to 2.6 percent, from 2.9 percent in the staff report (Table 1).[1] The adjustment mainly reflects the adverse effect on export demand of the slowdown in the United States, both directly and indirectly through other partner countries. Belgian export growth has been revised down from 6.5 percent to 6.2 percent. Indicators of consumer confidence have remained strong. Nevertheless, a small negative repercussion on domestic demand seems likely, in part through less buoyant employment growth. Accordingly, projected domestic demand growth has been revised down by 0.1 percentage point, to 2.1 percent.

3. As a result of this revision, the general government surplus is now projected to amount to 0.2 percent instead of 0.4 percent of GDP, for an unchanged structural balance.

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[1] The February 2001 Consensus Forecast for 2001 is 2.7 percent real GDP growth and 2.0 percent consumer price inflation.

Table 1. Belgium: Main Economic Indicators

	1996	1997	1998	1999	2000 Est.	2001 Proj.
Real economy (change, in percent)						
Private consumption	0.7	2.1	3.3	1.9	2.8	2.3
Public consumption	2.5	0.1	1.5	3.4	1.6	1.5
Gross fixed investment	0.9	6.7	4.6	4.8	4.8	2.6
Total domestic demand	0.9	2.6	3.9	2.1	3.1	2.1
Exports of goods and nonfactor services	1.2	6.7	4.4	5.2	7.5	6.2
Imports of goods and nonfactor services	0.8	5.7	6.5	4.4	6.9	5.8
Foreign balance 1/	0.3	0.9	-1.2	0.7	0.8	0.6
Real GDP	1.2	3.4	2.4	2.7	3.8	2.6
Cyclical indicators (in percent)						
Output gap	-3.3	-2.0	-1.9	-1.5	0.0	0.1
Unemployment rate	9.7	9.4	9.5	9.1	8.5	8.1
Saving and investment (in percent of GDP)						
Gross national saving	23.6	24.7	24.7	24.6	25.0	25.4
Gross domestic investment	20.1	20.6	20.9	21.3	21.9	21.6
Prices (change, in percent)						
GDP deflator	1.2	1.3	1.6	1.0	2.1	2.0
CPI (year average) 2/	1.8	1.5	0.9	1.1	2.9	2.2
Public finance (in percent of GDP)						
General government balance	-3.8	-1.9	-0.9	-0.7	0.0	0.2
Structural balance	-1.6	-0.5	0.3	0.3	0.1	0.1
Primary balance	5.1	6.1	6.7	6.5	6.9	6.7
General government debt	130.5	125.2	119.7	116.4	110.5	105.5
Balance of payments (in percent of GDP) 3/						
Trade balance	3.2	3.2	2.8	2.6	2.5	2.7
Current account	5.1	5.7	4.8	4.5	4.4	4.8

1/ Contribution to growth.

2/ Harmonized consumer price index.

3/ Belgium-Luxembourg Economic Union (BLEU) on a transactions basis.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/18
FOR IMMEDIATE RELEASE
March 7, 2001

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

IMF Concludes Article IV Consultation with Belgium

On February 21, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Belgium.[1]

Background

Real GDP growth is expected to slow to 2.6 percent in 2001, following four consecutive years of strong economic growth. During this upswing, employment rose substantially and the unemployment rate declined to 8.3 percent in December 2000 from an average of 9.1 percent in 1999. Strong domestic demand and a good competitive position—reflecting both sustained wage moderation and the depreciation of the euro—have underpinned growth.

The upswing is resulting in shortages in some labor markets, particularly in Flanders. Nevertheless, the Interprofessional Agreement governing wages for 2001-02 (concluded in November of last year) implied moderate labor-cost increases, both in relation to those in other countries and with respect to pressure on underlying inflation. Headline inflation rose sharply through 2000 due to oil price increases, but recently fell again; underlying inflation remained low.

The fiscal position continues to improve. The budget was in balance in 2000 and is expected to move to a small surplus position this year. The debt-GDP ratio, while still high at 110.6 percent of GDP, has been declining steadily for some time. This performance is directly attributable to the effects of the upswing: adjusted for the cycle, the deficit is projected to

[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. This PIN summarizes the views of the Executive Board as expressed during the February 21, 2001 Executive Board discussion based on the staff report.

change little in 2001. There continue to be pressures on the spending side in 2001 especially in the health care sector.

The government's medium-term fiscal plan calls for a steady improvement in the deficit, to 0.7 percent of GDP in 2005, and significant back-loaded income tax cuts designed in part to enhance labor market performance. A number of structural labor market measures have also been introduced, including an employment program for youth, reforms to encourage employment among older people, and measures to reduce working time.

Executive Board Assessment

Executive Directors noted with satisfaction the continued robust growth of the Belgian economy, which had resulted in declining unemployment in the context of underlying price stability. They agreed that the outlook for 2001 is for more moderate economic growth. While external demand is slowing, domestic demand continues to benefit from strong employment growth, high consumer confidence, and appropriately supportive monetary conditions. Although headline inflation had risen as a result of oil price increases, Directors felt that more moderate growth, lower energy prices, and responsibly negotiated wage increases would help preserve price stability.

Directors commended the Belgian authorities for the sustained and successful effort to improve the fiscal position, noting in particular that the budget was balanced in 2000 for the first time in fifty years, and well ahead of the authorities' schedule. Directors supported the authorities' program of ambitious tax cuts in the medium term, especially as they saw reductions in the tax burden as an important policy for improving labor market performance. They also agreed that, over the medium term, some further increase in the structural surplus would be needed in light of Belgium's still high level of public debt and the expected spending pressures associated with the aging of the population. They supported the authorities' policy to allocate all growth-related windfalls in 2001 to debt reduction and encouraged them to continue this approach in subsequent years.

Directors emphasized that continued tight control over spending growth would be the key to combining tax cuts with a strong fiscal position. They recommended that the authorities reduce the growth of real primary spending to a rate significantly below the recent historical average. In this context, they welcomed the establishment of an explicit medium-term fiscal framework, and agreed that this approach would help support the authorities' fiscal objectives. A number of Directors saw merit in setting a more demanding medium-term consolidation target to clearly signal the authorities' commitment in this regard.

Directors agreed that the main economic policy challenge now is to improve labor market performance, in particular to raise employment and reduce regional disparities. They welcomed the authorities' policy of tax reductions and stressed that further cuts would be critical to retain competitiveness, given recent tax reductions in neighboring countries. Directors welcomed the planned tax reform to increase incentives to work, particularly for people at the low end of the wage scale.

Directors encouraged the authorities to reinforce the beneficial employment effects of tax reductions by accelerating and deepening structural reforms. Noting Belgium's still considerable level of unemployment, they suggested stronger enforcement of job-search requirements for benefit recipients, introducing competition in the area of employment agencies, and closer integration of training and job placement in order to reduce skill mismatches. Directors saw merit in limiting the duration of unemployment benefits, in order to sharpen work incentives.

Directors underscored the importance of raising the very low participation rate of people above the age of 50. They commended the authorities for their decision to require people in this age group on unemployment insurance to search for suitable employment and to have jobs offered to this category of the unemployed. As a next step, they urged the authorities to reform the early retirement system, with the aim of rewarding continued employment rather than premature retirement. Directors viewed such measures as being particularly important to ensure the continued participation in the workforce of the next generation of older workers, and to reduce the burden on the public pension system. In this regard, Directors noted with interest the authorities' plan regarding the financing of the Silver Fund.

Directors noted that, while the system of centralized wage bargaining had contributed to wage moderation, geographical economic disparities called for greater wage differentiation. In this context, they noted that some degree of flexibility had already been achieved under the previous wage agreement, and urged that its scope be expanded in the future. They also encouraged the authorities to promote labor mobility across regions—which, so far, had been limited—by ensuring cooperation of employment services and sharpening benefit recipients' incentives to accept jobs in other regions.

Directors urged the authorities to move forward with the remaining agenda for product market reforms, including the deregulation of utilities. They welcomed the authorities' ambitious plan for reducing the administrative burden on enterprises.

Given the high degree of integration of banking and insurance activities, Directors welcomed the improved cooperation between banking and insurance supervisors. Directors welcomed the authorities' intention to strengthen coordination between the prudential activities of banking supervision and the macro prudential activities of the central bank through prospective new institutional arrangements.

Directors commended the authorities for the increase in development assistance included in the authorities' medium-term budgetary program. They also welcomed the authorities' support for the EU Commission's proposal to grant free access to agricultural imports from developing countries.

It is expected that the next Article IV consultation with Belgium will be held on the standard 12-month cycle.

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.

Belgium: Selected Economic Indicators

	1997	1998	1999	2000	2001 1/
Real economy (change in percent)					
Real GDP	3.4	2.4	2.7	3.8	2.6
Domestic demand	2.5	3.6	2.2	3.1	2.1
CPI (year average)	1.5	0.9	1.1	2.9	2.2
Unemployment rate (in percent)	9.4	9.5	9.1	8.5	8.1
Public finance (percent of GDP)					
General government balance	-1.9	-0.9	-0.7	0.0	0.2
Structural balance	-0.5	0.3	0.3	0.1	0.1
Primary balance	6.1	6.7	6.5	6.9	6.7
General government debt	125.2	119.7	116.4	110.5	105.5
Interest rates (percent)					
Money market rate 2/	3.5	3.6	3.0	4.4	...
Government bond yield	5.7	4.7	4.5	5.6	...
Balance of payments (percent of GDP) 3/					
Trade balance	3.2	2.8	2.6	2.5	2.7
Current account	5.7	4.8	4.5	4.4	4.8
Official reserves (US$ billion) 4/	16.2	18.3	10.9	9.9	
Reserve cover (months of imports of GNFS)	1.0	1.2	0.7	0.7	
Exchange rate					
Exchange rate regime			Member of euro area		
Euro per U.S. dollar (December , 2000)					
Nominal effective rate (1995=100) 5/	93.9	93.9	92.8	90.6	
Real effective rate (1995=100) 5/ 6/	93.2	92.2	91.4	88.9	

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

1/ Staff projections.

2/ Since 1999, Euro rate

3/ BLEU on a transaction basis.

4/ Excluding gold; since January 1999, Eurosystem's definition.

5/ For 2000, average of the first seven months.

5/ Based on relative normalized unit labor costs in manufacturing.