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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/9

3:00 p.m., January 18, 1984

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
J. de Groote	
	X. Blandin
	M. Teijeiro
R. D. Erb	
	S. R. Abiad, Temporary
T. Hirao	T. Yamashita
	I. R. Panday, Temporary
	L. Leonard
	H. A. Arias, Temporary
	W. Moerke, Temporary
	C. P. Caranicas
	V. Govindarajan, Temporary
	J. E. Suraisry
J. J. Polak	T. de Vries
	R. Bernardo, Temporary
	O. Kabbaj
F. Sangare	
M. A. Senior	J. L. Feito
	K. A. Hansen, Temporary
	J. Bulloch, Temporary
Zhang Z.	

L. Van Houtven, Secretary
J. A. Kay, Assistant

Also Present

African Department: M. Reichardt. Asian Department: R. H. Nord. European Department: P. Dhonte, A. Leipold, G. A. Mackenzie, V. Marie, M. Xafa. Exchange and Trade Relations Department: R. Pownall. Fiscal Affairs Department: G. Blöndal. Legal Departmen: J. V. Surr. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. El-Khouri, G. E. L. Nguyen, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: M. Camara, L. E. J. Coene, H. Kobayashi, S. Kolb, M. Rasyid, A. A. Scholten, P. Verly, Wang C. Y.

1. BELGIUM - 1983 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/84/8, 1/18/84) their consideration of the staff report for the 1983 Article IV consultation with Belgium (SM/83/255, 12/21/83; and Cor. 1, 1/16/84). They also had before them a report on recent economic developments in Belgium (SM/83/257, 12/29/83; and Cor. 1, 1/16/84).

The staff representative from the European Department, replying to questions raised by Executive Directors during the discussion, recalled that the thrust of the Government's program initiated in February 1982 had been to bring about the necessary adjustments, in particular of the current account, while encouraging a rising trend of output, rather than to approach adjustment by way of deflation. The strategy had been built on a number of medium-term scenarios designed to achieve a certain level of profitability, particularly in the manufacturing sector. In that connection, Executive Directors would recall that in terms of value added, employment, and other measurements, while the manufacturing sector in Belgium represented some 25 percent of gross domestic product, it also represented some 70 percent of the country's exports. It was therefore clear that the prospects for growth in the manufacturing sector would affect the whole growth path for the economy. The target for profitability in the manufacturing sector had been published in the form of a relationship with the average for the years 1970-73. Naturally, there was no one way in which to define such a target. In particular, the choice would depend on the assumptions that were made regarding foreign demand on the one hand and on the growth rate that was considered desirable for the economy as a whole on the other. As there was no one way of defining the target, there was also no one way of assessing the outturn, except by comparison with the target that had originally been set.

Replying to a question by Mr. de Maulde regarding the availability of comparable figures in other countries for returns on manufacturing operations, the staff representative mentioned that the National Bank of Belgium had undertaken a study of relative profitability--meaning profitability in Belgium compared with that in seven major partner countries--and had concluded that in 1983 profitability in Belgium had been restored to the 1970-73 level. Consequently, while it might be concluded that Belgium had not quite achieved the target set in 1982, the deterioration in profitability at the end of 1983 compared with earlier years was no worse than it had been in the partner countries. In itself that was a fairly impressive result. On the other hand, there was clearly no room for complacency; it was for that reason that the staff had insisted that the target set by the Belgian authorities had not been entirely met. In the first place, the external demand prospects were weaker than they had been assumed to be at the time that the forecasts had been made; in the second, the improvement in profitability was not a once-and-for-all achievement that would place the country beyond risk. It could well be reversed.

A number of questions had been raised regarding the indexation mechanism, the staff representative recalled. One Executive Director had inquired why the staff had not asked the authorities to introduce a different form of indexation taking into account terms of trade and other factors. In SM/83/255, the staff had warned of the rigidities associated with any general indexation mechanism, which tended to prevent appropriate adjustment not only to the terms of trade but also to changes in economic performance in the different sectors of the economy. The staff had therefore maintained the position that it had adopted during the previous consultation. However, that particular issue had not been discussed at any great length in Brussels. The authorities knew the staff position on the topic, and the staff had accepted that indexation was being reintroduced. As to whether the new formula would have a different effect on productivity and profitability from the old one, he doubted whether there would be any great change. The differences were that in the new formula the moving average would cover a four-month period instead of a two-month period, thus delaying adjustment at the beginning of the new system, but once and for all. Thereafter, the new averaging process would lead to a smoother path for the transmission of prices into wages, but the fundamental structure of the mechanism had not been greatly altered.

Replying to Mr. Lovato's question about the meaning of the second norm for competitiveness, namely, that Belgian hourly wages should not rise faster than those in competitive countries, the staff representative explained that the authorities feared that following a two-year period during which real wages had declined by about 7 percent, there might be serious attempts to bring about a catch-up. The purpose of the norm was to frustrate such efforts. The rationale for adopting such a norm might be that Belgian manufacturers faced considerable foreign competition and were therefore bound by foreign prices. They were likely to maintain their current level of profitability if their hourly wage costs did not rise faster than those of competitors. At least, in those circumstances, their profitability would not deteriorate faster than that of the competition.

Some speakers had been critical of the staff assertion that the prospects for a resumption of investment were fairly good, the staff representative mentioned. The prospects were considerably better than they had been two years previously, not only for the profitability of enterprises, but also for a fairly steady increase in the rate of capacity utilization in the manufacturing sector. It was difficult to say positively that the sluggishness of investment hitherto had been brought about by insufficient gains in profitability. All that could be said was that the staff did not feel that the lag in the apparently slow response of investors to the increase in profitability was unduly long. A fairly long lag would normally be expected and the adjustment in real wages had been spread over time; indeed, it had only reached its peak in November 1982. In those circumstances, the improvement in profitability had also been gradual. It was in considering how best to improve the prospects for an upturn in investment that the staff had put forward its views on the stance of expenditure policy. Observers talking with entrepreneurs in Belgium obtained the view that profits were currently adequate, and that it was the lack of expectation of any sustained growth in demand that was holding up the formation of new investment plans. The fact that enterprises had accumulated considerable savings, without spending them, in itself exerted a depressing effect on the level of activity.

Commenting on the budget and fiscal policies, the staff representative recalled that a number of Executive Directors had regretted that the staff had not incorporated medium-term projections into its paper. The staff had in fact prepared a considerable number of medium-term projections but, while they helped the staff to focus on the issues, it was not always easy to publish them in an informative manner. One set of projections had been used to help the staff decide on the rate at which, in its view, the level of public expenditure would have to be reduced. It had concluded that the rate of reduction might have to be some 2 percent a year in volume terms, a figure not far from that produced by Mr. Polak. However, all such projections were by nature highly tentative and subject to the accuracy of the assumptions underlying them.

One Executive Director--Mr. Teijeiro--had inquired how large the cyclical component of the government deficit might be, the staff representative noted. Using the Fund's standard adjustment procedures, the staff had concluded that out of an increase in the government deficit of 6.5 percent in the five years ended 1983, some 4.5 percent could be a reflection of cyclical factors. Nevertheless, it might be unwise to infer that a cyclical upturn would automatically improve the situation in Belgium. It would take strong action on expenditures to bring the burden of government outlays under control. For instance, in the early 1970s there had been 39 retirees for every 100 contributors to pension plans. In 1983 there had been 54 retirees per 100 contributors, and it was projected that in 1987 the rate would rise to 68 retirees per 100 contributors. Similarly, the authorities, who had been conducting extensive studies on the prospects for financing the social security system, had come to the conclusion that if the system were to be viable, employment would have to be stabilized. Those two issues were the reflection of major difficulties and, while the authorities were clearly aware of them, it would require strong action to bring about the necessary change. It was clearly rather difficult to start that action at a time when real wages were being sharply reduced.

With regard to monetary changes in Belgium, the staff representative explained that the liquidity ratio had declined gradually, though markedly, over the past two years. It had fallen from 46.8 percent in June 1981 to 44.1 percent in June 1983. Nevertheless, no very great attention was paid in Belgium to the liquidity ratio or to the stance of the authorities on the monetary aggregates. The reason might be that, for instance, in 1981 the shortfall of funds on the domestic market had been equivalent to 8 percent of the gross national product, which had meant that considerable amounts had been financed from abroad, thus bringing about a substantial monetary injection into the economy. In those circumstances, the scope for monetary management was bound to be much more limited than would otherwise be the case. In the past two years, the injection of liquidity through external borrowing had been reduced from 8 percent of gross national product to the equivalent of 3 percent, thus considerably improving the scope for the exercise of monetary control. The authorities took the view that, if there was a shortfall of funds on the domestic market, it would have to be made up either through external borrowing, through a loss of reserves, or through an adjustment in interest rates. The shortfall in funds had been reduced to a point where the authorities could decide how much they wished to borrow abroad, or how much they wished to reduce their reserves, because the reduced shortfall could be controlled effectively by interest rate policy. There had therefore been a major improvement in the situation, although only time would tell whether it would be permanent.

Replying to Mr. Clark, who had inquired whether Belgium's industrial policy was likely to be effective in promoting exports, the staff representative explained that the purpose of industrial policy in a strict sense in Belgium was to ensure the orderly restoration of those sectors, such as textiles, shipbuilding, or steel, that had been hardest hit by the economic crisis. The broader approach had taken the form of restoring the profitability of enterprises; it was only on that basis that firms in Belgium would be able to discover in which direction to expand.

Finally, the staff representative from the European Department observed that the growth rate of the gross domestic product in Belgium had been 1 percent in 1982 and 0.25 percent in 1983, compared with 0.4 percent in 1982 and 0.5 percent in 1983 in the remainder of the Common Market. Thus, Belgium's performance might be stronger than the average, though not by much. Other indicators also showed that changes in Belgium were roughly comparable to those in partner countries in the European Communities, although the control of inflation had been less successful in Belgium than elsewhere.

Mr. de Groote remarked that it had been accepted by a succession of Belgian Governments of very different political opinions that the Fund staff had an active role to play in determining policy in Belgium, a position that clearly made consultations with the Fund much more than an annual exercise. He wished to pay tribute to the work performed previously by the staff representative from the European Department, who had been involved in the preparation of the present program in difficult circumstances, and to the present staff representative. He hoped that the staff representative would be involved in the future, particularly after the next elections, when the Fund would again be in a position to influence policy-making decisions. It was also particularly noteworthy that the Prime Minister of Belgium had visited Washington to consult with the Managing Director before introducing the measures that the Executive Board had just been discussing, and that the authorities had changed their interest rate policy in November 1983 after the staff visit to Belgium. Thus, the Belgian authorities clearly took the Fund's views into account. The Fund appraisal at the conclusion of the recent consultation mission had been made public by the Prime Minister and the Minister of Finance, and the Government had indicated that it agreed with all aspects of the staff appraisal, including the critical remarks on the public finances.

The points raised by Executive Directors had been admirably dealt with by the staff representative, Mr. de Groote commented. Nevertheless, it was worth recalling that over the past two years, on a transaction basis, almost 75 percent of the current account deficit had been eliminated, a reversal representing more than 3 per cent of the gross domestic product. That was clearly a major adjustment, considerably larger than the one calculated by Mr. Erb, who had perhaps been using a different exchange rate. The current account would certainly be balanced in 1984, and might even show a surplus. The financial surplus of the business sector had increased by 3 percent of gross national product in the two years since the program had been in operation, and the situation could only improve in 1984, when competitiveness had been further restored.

Belgium had noticeably increased its market shares in exports during 1982 and 1983, Mr. de Groote explained, in rather unfavorable international circumstances while Belgian domestic enterprises had also been gaining market shares at home, as could be seen by the fact that imports had decreased more than final domestic demand. In other words, the adjustment had not been exclusively deflationary in nature.

The measures taken on the supply side had also had satisfactory effects in the past two years, Mr. de Groote considered. First, the gross national product in Belgium had increased both in 1982 and in 1983, in contrast to GNP movements in most other European countries; second, industrial production had also recovered, equally in contrast to developments in other countries in the European Communities, where it had fallen further. In consequence, a rather convincing case could be made for the validity of the adjustment policies recommended by the Fund management and staff, and particularly by the Managing Director in his contacts with the spokesmen of the Belgian trade unions and business community. A correct combination of measures intended to reduce internal absorption while increasing the activity of manufacturing industry, and particularly manufacturing for export, had led to remarkable results in terms of a rapid improvement in the employment situation when wage competitiveness had been restored. The increases in unemployment that had been a characteristic of Belgian life for some ten years had come to a halt, and the prospects for employment had greatly improved. Unfilled vacancies were rising, and the increase in unemployment during 1983 had been slightly smaller than the new supply of labor. There were indications that the same favorable situation would prevail through 1984.

The Belgian experience, Mr. de Groote went on, could be used as an illustration of one of the Chairman's recent speeches regarding Fund adjustment policies. Moderation in labor costs had exercised a positive influence on the demand for labor in Belgium by leading to increased profitability. Moreover, an appropriate adjustment of the exchange rate combined with measures aimed at a rapid transfer of resources from households to manufacturing, and particularly to the export sector, had restored the external balance while improving national income, because the effect on the balance of the current account had been larger than the effect of the deflationary action that had made it possible. Belgium's experience demonstrated that a major adjustment with obvious deflationary effects and a reduction of internal absorption had not led to a fall in national income. The adjustments had taken place much faster than had been envisaged, and the outcome had not been expected by many Executive Directors on the occasion of the previous consultation with Belgium (EBM/82/133 and EBM/82/134, 10/8/82). What the Chairman had told the leaders of trade unions and the business community before the program's inception had turned out as he had forecast. The adjustment had been unequivocably favorable for labor and for the national income, and it had taken place very rapidly.

Commenting on an observation by Mr. Polak that different policies in Belgium and the Netherlands had led to an identical situation in the two countries, Mr. de Groote remarked that, if industrial production in Belgium were compared with that in the Netherlands, it would be seen that in Belgium there was no increase in 1982 and that there would be an increase of some 3.5 percent in 1983; while in the Netherlands, industrial production had fallen by some 4 percent in 1982 and would remain stagnant in 1983. The effects in terms of employment were also quite different. The employment situation in the Netherlands had deteriorated markedly compared with that in Belgium, since at present the proportion of unemployment was similar in the Netherlands and Belgium, while in 1980 the rate had been some 3.5 percent lower in the Netherlands.

Taking up the question of whether the adjustment in Belgium should have gone still further, Mr. de Groote stated that he would certainly admit that the results in terms of the public finances were unsatisfactory. The Government's current expenditure represented 65 percent of the gross national product, and some 10 percent was taken up by interest payments. Such a situation was certainly bound to re-create the problems that the program was intended to correct. Nevertheless, the deterioration in the public finances had been halted and some improvement was taking place.

In addition, Mr. de Groote observed, there had been a small reduction in the public sector borrowing requirement as a proportion of gross domestic product in 1983, a point that prevented him from agreeing entirely with the view put forward by Mr. Polak and Mr. Teijeiro regarding the public finances in Belgium. They had commented that the Belgian authorities appeared to be relying on growth in the gross domestic product without introducing further structural changes, and to take the view that little more could be done. His own intention had been to say that not much more could be done in connection with fiscal incomes and government expenditure. Where action could be taken was in the field of social security transfers, an area in which the authorities had already taken notable measures. The public sector deficit had represented some 15 percent of the gross domestic product in 1983. Some 12 percent of gross domestic product had been financed by domestic savings, and major improvements had been made in the maturity of the debt. Looked at differently, external borrowing had been more than halved in one year. The Government's position was that if measures were taken as expected in connection with transfers and if at the same time some economic recovery did take place, the increase in domestic savings would be more than sufficient to finance the increase in investment, while the public sector deficit--which was expected to fall to 8 percent of gross domestic product in due course--would also be financed by domestic savings, as had traditionally been the case. Naturally, the maintenance of a free foreign exchange market was an important element for sustaining the confidence of savers in general.

Executive Directors would be interested to know, Mr. de Groote remarked, that for the first time in 1983 his Belgian authorities had introduced a procedure whereby the budget would be revised in February each year. Thus, slippages could be eliminated sufficiently early in the budget year by revising the assumptions that had been adopted in July of the previous year. In 1983 the exercise had led to substantial reductions in expenditure, and his authorities expected to maintain the procedure in the future.

A fall in interest rates would also help the adjustment since each reduction of 1 percentage point in interest rates reduced the charges on the government budget by about 0.5 percent of gross domestic product, Mr. de Groote said. Finally, the transfers of resources from households to the manufacturing sector had represented more than 7 percent of gross domestic product in two years, a massive adjustment in terms of internal absorption.

He could agree with those speakers who felt that new measures were still needed, Mr. de Groote continued. A transfer of resources was needed from households to the public sector in the form of a reduction of transfers to consumers. For that purpose, a new social and political contract would have to be devised and the Government was trying to formulate such a contract. In the meantime, his authorities would try to keep the situation as it was, with marginal improvements, in the hope that the new phase of adjustment would be carried out by the Government voted into power by the forthcoming election. Representatives of every party currently in the Government had stated that they would not promise that everything would be rosy after the election; on the contrary, they wished the public to know that in 1985 and 1986 there would have to be still further changes, in the form of transfers away from households to the Government.

His view of the immediate future was more optimistic than that of the staff, Mr. de Groote maintained. In the first place, investment in manufacturing industry was expected to rise by 10 percent in 1984, and investment in the domestic economy, including residential construction, by 3 percent. Such an increase in investment might well be the basis for sustained growth. Second, the competitiveness of Belgian industry had probably been restored more effectively than the figures indicated. After all, the comparison for purposes of competitiveness had been made with the years 1970-73, a period during which some observers felt that Belgium had been overcompetitive. Indeed, various groups had suggested that at that time a revaluation would have avoided the later wage increases that had caused so much difficulty. If in fact Belgian industry had been overcompetitive at the time used as the baseline for the staff's measurement, it would be incorrect to insist that competitiveness should return to that level. Naturally, the country had to earn a surplus on foreign trade to be able to pay off foreign debt as it fell due; but he was by no means certain that it was necessary to return to the 1970-73 situation before concluding that Belgian industry was fully competitive once again.

Another factor that would influence developments in 1984, Mr. de Groote considered, was that despite the reintroduction of indexation, relative labor costs would not deteriorate during the year. The Government would certainly introduce measures to maintain competitiveness in relation to the seven trading partners if competitiveness seemed to be threatened. The authorities fully intended to ensure that their decision would be carried out at all times. In that respect it was quite striking that in 1983, unit labor costs had risen by 6.0 percent in Belgium and by 10.7 percent in the seven trading partners. He agreed with Mr. Suraisry and Mr. Zhang that the restoration of some kind of indexation was probably an important element in maintaining the social consensus. He also agreed with Mr. Lovato, Mr. Laske, and others, who had suggested that the indexation mechanism could perhaps be improved still further by eliminating indirect taxes and terms of trade effects. In general, the situation seemed rather more favorable than the staff had appeared to think.

Another factor that was more favorable than had been recognized by Executive Directors, Mr. de Groote considered, was the recovery in residential construction. Some years previously there had been an excess of homes because it had been expected that the demand would increase more than it had actually done when the staff of the North Atlantic Treaty Organization and the European Communities (EC) had first come to Belgium. There had been a substantial reduction in residential building for the past four or five years, but currently a new demand for homes was emerging. Taken in combination with the present policies, the change in outlook probably meant that in 1984, unlike 1983, there would be no decline in household income. Nor did he believe that the maintenance of household income would lead to a deterioration in the current account balance because domestic enterprises were increasing their domestic market shares and pushing out imports very rapidly. Another favorable factor was that there was a high degree of social consensus on the measures adopted by the Government. Recently, the members of the coalition Government had announced that they intended to continue with the same policies throughout 1984 and to extend them even further if they were re-elected toward the end of the year.

One problem that had not been mentioned by Executive Directors, and that he considered important, Mr. de Groote mentioned, was the difference in reaction between the exposed and nonexposed sectors in the economy. There had been substantial increases in manufacturing output in Belgium both in 1982 and in 1983, the increase in Belgium being greater than that in other EC countries. However, inflation in Belgium had also been high, probably because inflation in the nonexposed sectors had permeated the whole economy and driven up costs. The usual explanation of increases in wage costs or in the prices of imports did not appear to apply. It might also be that the noncompetitive elements in the protected sectors had been dominant in determining costs; if so, the authorities would certainly need to take action.

Commenting on industrial policy in Belgium, Mr. de Groote said that he agreed with several speakers that the policy was probably too defensive and that too few incentives were offered for new enterprises. Nevertheless, there had been recent improvements in incentive legislation. To answer Mr. Hirao's question, the Belgian authorities hoped that the introduction of incentives as part of the policy for restoring market mechanisms and increasing the profitability of enterprises would in due course lead to the emergence of new and profitable industries.

Taking up the topic of the social security system, Mr. de Groote noted that several speakers had shown interest in the proposals by the Minister of Social Affairs for basing social security contributions on the value-added tax. The project was still only in the study stage. However, the Belgian authorities would not introduce such a system in Belgium unless a similar approach were at least considered in other European countries; to introduce it alone would bring about too great a distortion in competitive conditions. Nevertheless, the approach was an interesting one, if only because it would at least do away with the system by which employers paid social security contributions in proportion to the number of people to whom they had given work. The new idea was that social security was one of the elements in the economic system and that employers would contribute to it according to the profits that they made. As Mr. de Maulde had observed, such an arrangement would at least give an incentive to small firms that at present resisted the burden of taking on extra workers because of the increased cost. The arrangement would of course penalize to some extent capital-intensive industries, a point that had been discussed in Belgium. In any event, resources had to be found to cover the government deficit, and there was probably no way of doing so except to act on social transfers and the social security system.

Taking up less fundamental points, Mr. de Groote stated that he agreed with Mr. Clark and Mr. Jaafar that a description of trade policies would be appropriate in consultation reports. The Belgian authorities would certainly be happy to help the Fund staff by providing the necessary information. He also agreed with Mr. Sangare about the effects of devaluation. Mr. Sangare's observation explained a number of general questions that Executive Directors had had in mind in discussing such problems. Like Mr. Polak he believed that during the past few months the conduct of monetary and exchange rate policy had not been particularly helpful in Belgium. The authorities were reviewing monetary policy and were giving consideration to approaches that would be more in harmony with the success achieved in reducing internal absorption, readjusting the balance of payments, and restoring competitiveness. It was rather paradoxical that in those areas where change could have been introduced with the least social harm and with comparatively little public reaction, little had been done, while in other areas extremely unpopular measures had been taken, such as the suspension of indexation and the reduction of real income. The only explanation was the workings of the internal tensions between institutions in Belgium. He could agree with a number of speakers that a more active monetary policy was probably desirable.

Speaking personally, Mr. de Groote observed that the Belgian authorities felt that they were pursuing the correct exchange rate policy; they would be happy to have the support of speakers who had said that they should continue to defend a stable exchange rate within the existing arrangements. It was a particular pleasure to the Belgian authorities to know that the Managing Director would be visiting them in a few weeks.

The Chairman made the following summing up:

Executive Directors commended the Belgian authorities for the successful implementation of a broadly based adjustment program. They noted that major progress had been recorded in the correction of two major imbalances in the economy, the declining profitability of enterprises and the widening external current account deficit. They thought that Belgium was therefore in a much better position than previously to take advantage of the expected recovery in the world economy.

Directors observed however that major imbalances remained in other respects, particularly as regards the high rate of unemployment, the condition of the public finances, and the persistence of a high rate of inflation. Several Directors stressed that, in present circumstances, greater emphasis should be placed on the reduction of these imbalances than on the maintenance of aggregate demand. Otherwise, there was a real danger that competitiveness might weaken again and that the much needed revival of private productive investment would be thwarted. A number of Directors stressed the dangers of the reintroduction of wage indexation. They warned that wage cost developments must not be allowed to reverse the progress made in restoring the financial condition of enterprises. They emphasized that current conditions did not provide any leeway for a catch-up in real wages, which had been significantly reduced in the course of the adjustment process, as such a catch-up would, of course, burden enterprises and undermine the prospects for a pickup in activity. In this regard, the maintenance of a "competitiveness norm" was regarded as an important feature of the present mechanism.

Directors viewed with great concern the very high public sector expenditures and deficits, which, they stressed, were in their view unsustainable. They supported the Government's policy of sharply reducing foreign borrowing--which, otherwise, might well become a problem by itself. They further observed that the tax burden and financing requirements associated with the present level of public spending had a bearing on the competitiveness of Belgian industry, and for that reason must also be reduced. Directors emphasized that a lasting easing of unemployment conditions must rest on a revival of activity in the private sector. They observed that a lower public deficit, made possible by reduced expenditure, would allow more room for a recovery of investment. They regarded it therefore as extremely important for the authorities to give the highest priority to a steady reduction in the public sector deficit in a medium-term framework. All agreed that in view of the high level of taxation and the burden of interest payments, the emphasis of restraint in real spending would have to lie on current social transfers. Unless strong action was taken to reduce public expenditure, there was a real danger of slipping back into the vicious circle of inflation, high interest rates, higher taxes, and lower growth.

In the area of industrial policy, several Directors emphasized the need for Belgium to stress investment in new export-oriented industries and to reduce financing of declining branches of industrial activity. Directors expressed strong support for the policy of using interest rates to influence private sector capital flows and to safeguard the net foreign asset position of the National Bank. They noted that interest rate action in this context would be most effective if taken early. Several Directors believed that monetary policy was probably too accommodating, particularly vis-à-vis the public sector.

The Belgian authorities were commended for their performance with regard to official development assistance, in spite of the budget constraints.

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

APPROVED: June 1, 1984

LEO VAN HOUTVEN
Secretary