

**FOR
AGENDA**

SM/02/37
Correction 2

CONTAINS CONFIDENTIAL
INFORMATION

February 28, 2002

To: Members of the Executive Board
From: The Secretary
Subject: **Belgium—Staff Report for the 2001 Article IV Consultation**

The attached correction to SM/02/37 (2/6/02) has been provided by the staff:

Page 9, footnote 10, line 4: for “Beginning in 2001,” read “Beginning in 1999,”

Questions may be referred to Mr. R. Ford (ext. 34411) and Mr. G. Bell (ext. 37672).

Att: (1)

Other Distribution:
Department Heads

14. **Social security spending has been an important source of spending growth for some years.** The staff projects real social security expenditures to increase by 4.3 percent in 2002, including an overrun in health-care expenditure relative to the budget, in line with past experience. The health care system has been under severe budgetary pressure for several years, in Belgium as elsewhere. The government recently imposed new control measures, notably a mechanism to claw back overruns from suppliers (such as pharmaceutical companies), but it was widely recognized that these had proven insufficient. The staff argued that justified increases in health spending, which is not excessive by international standards,⁹ had to be offset by savings elsewhere if overall expenditure control was to be preserved.

15. **Finally, budgets at both the federal and lower levels contained significant tax measures.** The reform of personal income taxes, to be implemented in 2002, involves lowering the top marginal tax rate, reducing the number of tax brackets, a tax credit for low-income earners, greater neutrality of tax treatment between married and unmarried couples, and streamlining the system of tax deductions. In 2001, the federal government announced reforms complementary to the corporate income tax. Rates are to fall from 39 percent to 33 percent (for small and medium-sized enterprises, the rate would fall from 28 percent to 24¼ percent, and re-invested profit would no longer be taxable).¹⁰ The authorities assured the mission that the corporate tax reform would be revenue neutral, as measures to broaden the tax base would offset the revenue loss from the rate cuts. In addition, firms will be able to get advance rulings on their tax liability before implementing business decisions (investments, for example), in order to reduce uncertainty. The staff welcomed both reforms. The Flemish government plans to eliminate the annual television tax and to reform the property transfer tax, both of which imply a significant revenue loss. The mission supported the latter measure in particular, as this tax is a significant impediment to mobility.

C. Labor, Product, and Financial Markets

16. **There was wide agreement on the need to boost labor-market performance.** While the unemployment rate is not particularly high by European standards, Belgium is near the bottom of the scale in the EU on several criteria (Figure 8). The authorities stressed the problem of low employment rates, especially among older people (those between 50 and 65 years old), and the need to raise them in order to better manage the costs associated with

⁹ According to OECD estimates, in 1999 public sector health care expenditure was 6.3 percent of GDP in Belgium, which is slightly above that in the Netherlands (6.0 percent) but well below those in Germany (7.8 percent in 1998) and France (7.3 percent).

¹⁰ These figures do not include the crisis contribution, which is a surtax of 3 percent levied on the tax liability (a tax on the tax). Thus, the full rate paid by corporations has been 39 percent plus a 1.17 percent crisis contribution, for a total of 40.17 percent; the tax reform will reduce this to 33 percent plus a 0.99 percent crisis contribution. Beginning in 1999, the crisis contribution is being phased out on personal but not corporate taxes.

population aging. In this regard, making substantial progress toward the objectives laid out at the Lisbon summit has become an important point of reference for policymakers.¹¹

17. **However, the momentum for reform appears to be flagging.** The authorities noted that the economic downturn had made reform more difficult, but also reiterated their intention to press forward with tax cuts in the years ahead, and pointed to recent structural initiatives (Box 2). Clearly, the measures aimed at older workers were in the right direction (the “activation” of unemployment benefits and elimination of the pension penalty). However, it was agreed that these and the other recent measures would probably not result in sufficient movement toward the Lisbon objectives. The mission also argued that some initiatives had drawbacks. Thus, although high enrolment in the youth employment program is a sign of success, such positions often do not lead to permanent employment, may crowd out private-sector employment, and are costly to the budget. Likewise, measures to reduce working hours risk raising labor costs, although it was agreed that the voluntary nature of these programs—they are subject to negotiations by the social partners, rather than imposed by law—would mitigate such problems.

18. **In particular, there has been little progress on fundamental reform of the benefits system.** The ratio of beneficiaries to workers has risen significantly in the past two decades, and is large by comparison with other countries (see Table).¹² The duration of unemployment benefits remains effectively unlimited for many claimants. Eligibility

¹¹ For Belgium, achieving these objectives—to raise the employment rate to 70 percent and the female employment rate to 60 percent by 2010—would be very ambitious, requiring an increase in each of 1 percentage point a year.

¹² The figures in the Table include old-age pensioners. The study from which it is drawn also estimated dependency ratios excluding this group, which of course are much lower, but that in Belgium is still the highest of the countries examined. The study also reveals that Belgium has a relatively high dependency rate in programs designed for the unemployed (which include, but are not restricted to, unemployment insurance).