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**Statement by Mr. Horgan and Mr. Purves on Belgium
(Preliminary)
Executive Board Meeting 09/22
March 4, 2009**

We commend the staff for their thorough report and Messrs. Kiekens and Rottier for their informative Buff.

Countries around the globe face formidable economic and structural challenges, and Belgium is no exception. The crisis has led to a deep recession in the country, similar to the rest of Europe. As a small, open economy we agree with Mr. Kiekens and Mr. Rottier that the path forward for Belgium must contain speedy measures and fundamental reforms, in a framework of close cooperation. We target our comments on fiscal policy, wage policy and productivity, and financial sector reforms.

Fiscal Policy

The staff and authorities seem in broad agreement with the challenges facing Belgium's medium-and long term fiscal outlook. Given the severity of the economic crisis, the government has opted to employ automatic stabilizers to the fullest extent, expecting a fiscal deficit of 3.4 percent of GDP in 2009. This maneuver, on the heels of a volatile period of capital injections into the financial system amounting to 6.3 percent of GDP, has contributed to producing a debt-to-GDP ratio now approaching 90 percent.

Authorities rightly acknowledge that the general deviation from a medium-term path predicated on fiscal sustainability can only be limited and temporary. The authorities' plan is to reduce the structural deficit as of 2011 in line with an adapted medium-term trajectory. The staff's prescription is for the Belgian authorities to firmly commit to a structural adjustment of at least 0.7 percent of GDP per year once the crisis has past, to return as soon as possible to fiscal balance. *We agree with the need for a clear fiscal plan with attainable targets, and that Belgian authorities could benefit from a comprehensive review of spending and revenues. Will this be captured as part of the Belgian High Finance Council's*

recommendations this coming month?

The challenges of an aging population and the impact on Belgium's public finances through anticipated social security obligations present considerable headwinds. This should form the basis of any longer-term fiscal sustainability focus. To this end, we note the Authorities' measures to boost social assistance during this difficult period. To manage these costs, *we support the view that authorities' could benefit from sunset clauses for some of the more expensive social measures contemplated, such as reductions in social contributions and increases in unemployment benefits.*

Wage Policy and Productivity

Policies designed to increase employment levels are key to some of the economy's most difficult longer-run challenges. Belgium's low employment levels stand in contrast to those of its neighbors', and the employment rate remains well below the Lisbon target of 70 percent. *Is there a linkage between low employment levels and the excellent standard of the social security network?*

Certainly the wage bargaining process could stand to provide greater scope for firms to set wages in relation to a worker's output. In the current economic environment, not doing so reduces incentives to hire – delinking wages from productivity - and could also place the economy at a competitive disadvantage. *We support the staff's view that consideration should be given to modifying indexation mechanisms within the centralized bargaining framework. What are the specific suggestions from the staff for recalibrating this formula? In particular, we note the delays inherent in core inflation measures to the indexation formula. From a practical standpoint, wages will continue to climb in 2009 as prices drop. This raises the question – is simply modifying an indexation formula enough?*

The measures outlined above, together with reforms to improve activation policies and increase training opportunities, could lead to improved labour productivity. However, Belgium's productivity growth appears to lag that of its neighbors, and the staff report could have focused more on the context for this. *Can the staff provide some views as to why the Belgian economy has generated less productivity growth than in its larger neighbors?*

Financial Sector

The Belgian authorities should be commended for the action and speed they took in 2008 to both stabilize all three of their bancassurance groups, and to enhance deposit protection on a per beneficiary basis. The overarching objective, as with all countries who have had to respond, has been financial stability. The challenge now is threefold: maintaining stability during a turbulent period; consideration of exit strategies that balances the needs and interests of taxpayers while ensuring stability; and creation of a sustainable supervisory framework

that focuses both on a sound national framework, and reflects the realities of cross-border systemic risks. Belgium is not alone in facing these challenges.

The staff report balances these three challenges well. One cannot deny the risks to the Belgian financial system (as with many others) remains high. There is a shortage of quality collateral everywhere, and while the interbank and repo markets are functioning, it remains on a limited and restrictive basis. Certainly, confidence in a system would be enhanced with the implementation of a more systematic intervention strategy, as suggested by the staff. We support this. However, also important as an effective market signal in this environment is reinforcing that countries will move swiftly and decisively, in a unilateral and co-coordinated manner, to respond to matters of stability.

With these remarks, we wish our colleagues continued success.