BUFF/ED/92/87

December 28, 1992

Statement by Mr. de Groote on Belgium
Executive Board Meeting 92/157
December 30, 1992

It has been a little more than a decade now since Belgium initiated a policy of economic rehabilitation against the background of a fundamental process of federalization. In 1992, another important step forward could be made towards attainment of the twin goals of consolidating the favorable economic performance achieved during the last 10 years and establishing a truly federal political system. The government has recently agreed on constitutional reforms which will institutionalize the federal structure of Belgium. At the same time, a multi-year framework has been adopted to guide the economy towards full convergence with its European partners in an Economic and Monetary Union. In their preliminary reactions to the staff documents, some of my colleagues wondered why the agenda remains unfinished after such a long adjustment period and whether a shock therapy would not have been preferable. These valid questions elicit a straightforward answer: in Belgium, gradualism has been the preferred strategy because it leaves open more options at the outset and thus provides time to build a broad consensus on the policy stance. With such a consensus, public support for the government's policies and confidence in their outcome have been sustained. Economic policies have thus been constantly debated and at times re-adjusted as a result.

Policy objectives have basically centered on three issues: safeguarding the competitiveness of the Belgian economy, and adhering to a strategy of low inflation and low budget deficits. The medium-term strategy in pursuit of these three objectives has, over the course of the years, obviously been accompanied by minor shifts in emphasis on the relative importance of each of them. The restoration of external competitiveness has been in the focus in the earlier part of the 1980s. The reaction of the Belgian economy to the adjustment measures, and in particular to the February 1982 exchange rate devaluation of the franc by 8.5 percent, has proven swift and sizable: the current account of the BLEU balance of payments moved from a deficit of 4.1 percent in terms of GNP in 1981 to a surplus of 2.6 percent in 1986; the surplus has remained above the 2 percent level ever since. In the latter part of the previous decade, the emphasis shifted to a gradual strengthening of the exchange rate policy in order to make the counter-inflationary stance of monetary policy more credible: after having devalued by 2 percent vis-a-vis the deutsche mark in the 1986 EMS realignment and by 1 percent in the 1987 realignment, the central rate of the franc was declared fixed relative to the German currency in mid-1990. On a day-to-day basis, my authorities committed themselves to deliberately constrain the fluctuation margin between the two currencies. Fiscal policy consolidation has continuously received the attention of my authorities: the general government deficit has declined by a full 7 percentage points in terms of GNP, from 13.3 to 6.3 percent, over the course of the 1981-91 period. The improvement in the general government's primary balance has been even more impressive, amounting to some 10 percentage points in terms of GNP during the same period. Stabilizing the debt to GNP ratio has been an important intermediate objective, in order to contain the growth of interest payments on public debt in the budget. When, in 1988, that ratio stopped increasing, a reduction in the fiscal pressure, especially on households, was introduced to let them share in the benefits of the earlier adjustments. The resulting slowdown in the pace of fiscal retrenchment was compounded by the impact of a sharp deceleration in economic growth from 1991 onwards. Cognizant of the fragility of the fiscal consolidation and committed to meeting the convergence criteria of the Maastricht Treaty, the government is now giving prime attention to a reduction in the general government deficit to 3 percent of GNP in 1996 and to the concomitant decline in the public debt ratio, in order to have Belgium among the first group of EC countries to enter the Economic and Monetary Union.

The fiscal convergence plan presented by Belgium to its European partners is founded on three norms: zero real growth of noninterest expenditure by the national government; growth of fiscal receipts in line with GNP; and financial balance in the social security sector, after incorporation of a nominally fixed transfer from the national budget. My authorities are fully committed to respecting these norms in order to meet the 3 percent of GDP fiscal deficit criterion set out in the Maastricht Treaty. They are aware that reaching that target is by no means fully assured, especially in view of the recent weakening of economic activity. They are thus determined to take, in due time, whatever measures needed to bring the process of fiscal consolidation in line with its targeted outcome. The October 1992 supplementary measures to keep the 1993 budget on track offered an example in this respect: it is the first time a government has taken additional steps to keep the budget on track before the traditional budget control exercise in February/March. The February 1993 budget control will provide the next occasion to take stock of fiscal and economic developments. It is perfectly clear to my authorities, moreover, that the fiscal effort cannot be halted after 1996. A substantial decline in Belgium's public debt to GDP ratio will come about only after the turn of the century and must involve continued fiscal restraint. It is intended therefore not to let the primary budget surplus slip after 1996, so as to create ample room for a virtuous circle of diminishing interest payments and declining debt stock.

Bringing the fiscal adjustment to a successful conclusion will buttress the credibility of the strong franc policy which was put to the test during the recent EMS turmoil. The absence of speculative downward pressure on the Belgian franc indicates that this policy, adopted in May 1990, had already acquired credibility when the EMS crisis erupted in September 1992. Two main underlying causes help explain the satisfactory behavior of the franc which is also evident from the declining interest rate differential between Belgian franc and deutsche mark denominated assets. First, confidence in the National Bank's independent monetary policy stance has grown: the termination, in 1991, of the government's ability to satisfy part of its financing needs through the central bank, and the bank's willingness to move interest rates promptly in response to exchange market pressures have clearly left a favorable impression on financial markets. Second, investor interest in Belgium's financial markets has risen, and the sizable surplus in the balance of payments' basic balance since 1990 bears testimony to this fact: aside from return considerations, residents have been repatriating capital following the cut in the withholding tax on interest income, whereas non-residents have imported capital in response to the greater product availability and increased efficiency of the Belgian financial markets. The upcoming decision to make the National Bank legally independent from the government and the continued broadening of the range of financial products denominated in Belgian francs can be expected to strengthen further financial markets' favorable perception of the Belgian situation.

In sum, my authorities want to keep the Belgian economy well-positioned in the European Economic Area and well-prepared for the EC's monetary union later on. This preoccupation leads them to accord increasing importance to structural policy issues. The recently announced measures to address problems in the labor market underscore their concern. As in other policy areas, the approach adopted is founded on thorough mutual consultation between policy makers at the federal, community and regional levels alike, as well as between the so-called social partners, the employers' and trade union organizations. The approval of the Maastricht Treaty and of the Belgian convergence plan by all levels of government is also a sign that the transfer of political authority from the center will not entail a weakening in fiscal responsibilities which would ultimately endanger the well-being of Belgium's aging population. On the contrary, the federalization of the country has increased the perception of fiscal responsibility in the different regions and communities. With the benefits of the hard currency option in mind, all policy makers seem ready now to confront the challenge of Maastricht with optimism. Likewise, the recent conclusion of an interprofessional agreement containing guidelines for very moderate real wage increases in 1993-94 exemplifies the importance attached by employers and trade unions alike to the safeguarding of external competitiveness. Awareness of this issue has been the underlying force of the successes achieved since 1982, illustrating clearly the advantages that can be obtained from an informal incomes policy that is actively implemented by all parties under the guidance of the government. This concern for the maintenance of competitiveness by all parties to the economic decision-making process in Belgium is fully in line with the Articles of Agreement of this institution when they stress the advantages of expanding international trade in terms of employment and real income. It can come as little surprise therefore that my authorities have always been highly appreciative of the policy advice given by the staff and of the Article IV consultation discussions in this Board.

* * *