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November 24, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Belgium - Staff Report for the 1992 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1992 Article IV consultation with Belgium, which is proposed to be scheduled for discussion on Wednesday, January 6, 1993.

Mr. Masson (ext. 37483) or Mr. Huybrechts (ext. 34544) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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BELGIUM

Staff Report for the 1992 Article IV Consultation

Prepared by the Staff Representatives for the 1992 Consultation with Belgium

Approved by J. R. Artus and Joaquín Ferrán

November 23, 1992

I. Introduction

A staff team consisting of Messrs. P. Masson, M. Huybrechts, R. Moghadam, and G. O'Callaghan (all EU1), and Mrs. A. Clark (EU1), as assistant, visited Brussels from September 28 to October 7, 1992, to conduct Article IV consultation discussions. 1/ The team met with the Ministers of Finance and of the Budget, the Governor of the National Bank, officials of the National Bank, of the Administration, and of the Banking and Finance Commission, and representatives from the trade unions and the employers' federation. Mr. J. de Groote, Executive Director, and Mr. F. Moss, Assistant to the Executive Director, attended the meetings.

Belgium has accepted the obligations of Article VIII, Sections 2, 3, and 4. 2/ The previous consultation was concluded at the Board on May 31, 1991 (EBM/91/72). At the time, Directors noted the continued good performance of the economy in 1990, owing in part to the adoption of a "strong franc" exchange rate policy, the reduction of the withholding tax on interest income, and sweeping reforms in financial markets. They commended the authorities for the progress in reducing fiscal imbalances, but cautioned against a slackening of the adjustment effort. Directors favored expenditure restraint, including its extension to social transfers, as the main tool of consolidation. Another problem noted by Directors was the persistence of imbalances in the labor market, which could be alleviated by more emphasis on training rather than income support schemes.

1/ The consultation, which should have been completed by May 31, 1992, has been delayed beyond the three-month grace period due to staff shortages, as notified to the Board in the report on Article IV consultation procedures for August 1992.

2/ Belgium requires prior authorization of the Minister of Finance for all payments to or from Iraqi nationals, and to or from residents of Serbia and Montenegro. Restrictions imposed on payments to or from Kuwaiti nationals have been lifted.

II. Background to the Discussions

In the late 1970s and early 1980s, a combination of domestic political developments, attempts to cushion the effects of the oil price shocks, and international recession led to double-digit fiscal deficits (as ratios to GNP) and massive increases in government debt. The general government deficit (excluding net lending) peaked at over 13 percent of GNP in 1981. Despite a steady reduction in the deficit, the debt ratio rose for most of the decade, and general government debt net of short-term financial assets reached 124 percent of GNP in 1988 (Chart 1 and Table 1).

Policy since the mid-1980s has been guided by the goal of first stabilizing and then reducing the public debt ratio. By the end of the decade, the primary (noninterest) balance had improved by 10 percentage points relative to GNP, despite a reduction in the ratio of tax receipts, mainly as a result of expenditure reductions of a structural nature. However, the decline in the deficit in 1988 and 1989 was due solely to faster growth; at the level of general government, there was a positive fiscal impulse in these years. While many expenditure components have decreased in relative terms during the past decade, there has been a disproportionate decline in public investment. In contrast, spending on health care has grown substantially faster than GNP (Table 1). Fiscal adjustment measures and strong economic growth allowed the debt ratio to decline for the first time in 1989. However, after stabilizing in 1990 it rose once again to 124 percent of GNP in 1991 as a result of expenditure slippages especially in social security.

The substantial fiscal adjustment that has occurred has been accompanied by both a rise in the private savings rate and a revival of private investment (Chart 2)--leading to faster growth than in other EC countries. The inflation rate has been among the lowest of the EC, and competitiveness has been maintained, when measured by relative unit labor costs or relative profitability (Chart 3). The current account of the Belgium-Luxembourg Economic Union has been in surplus since the mid-1980s; the present surplus is of the order of 2 percent of GNP. 1/ More recently, wide-ranging reforms have helped to modernize the financial sector and change the orientation and implementation of monetary policy; these have included limiting deviations of the Belgian franc from its deutsche mark central parity to about a 1/2 percent.

Despite a relatively strong output performance, unemployment has remained high (Chart 4) as has the budgetary cost of unemployment compensation and employment support measures. The labor market remains characterized by large regional differences in unemployment rates, high long-term unemployment, high female and youth unemployment, and low

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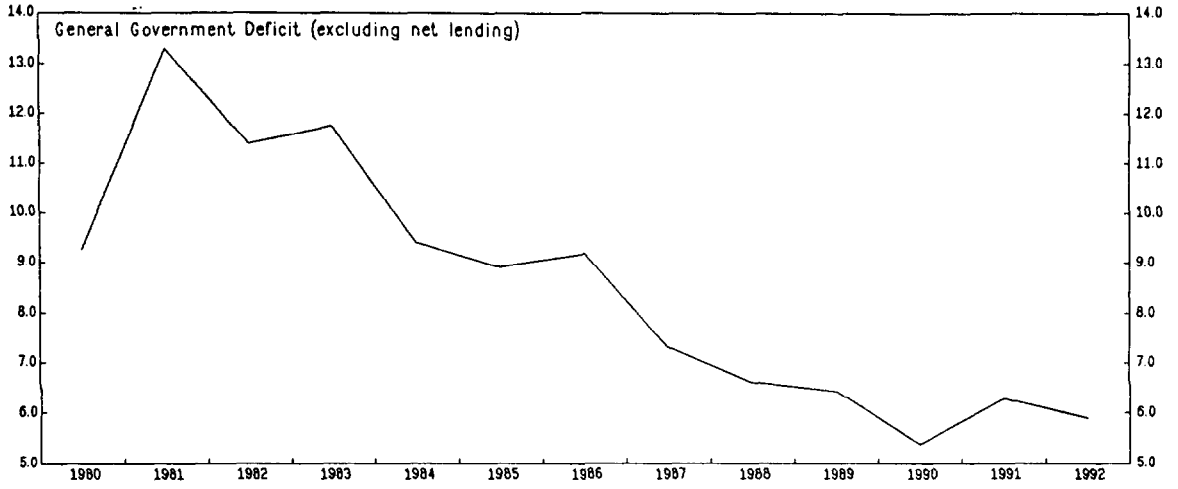
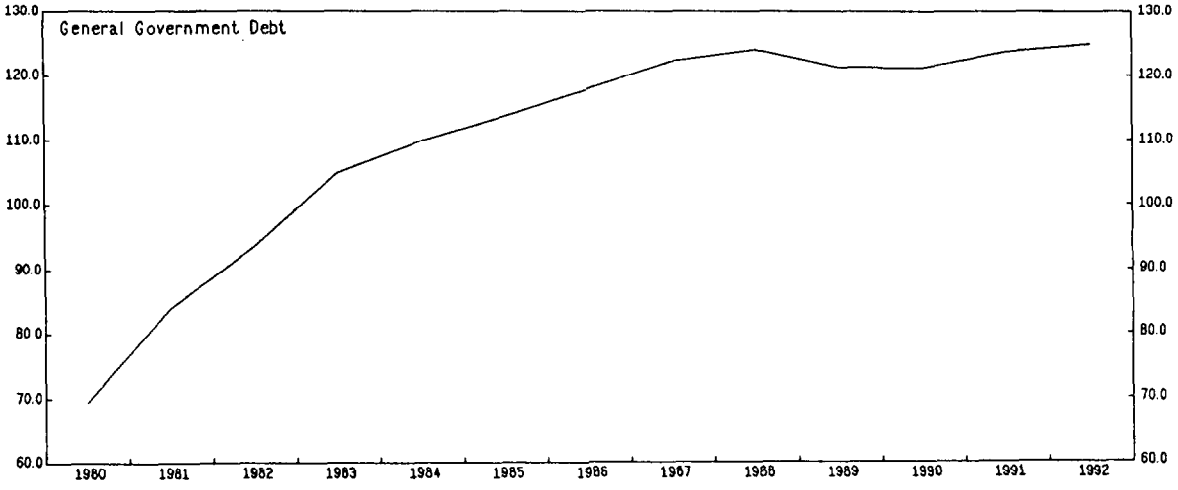
1/ Balance of payments data are not available for Belgium alone, but rough estimates suggest that the Belgian surplus is perhaps one third of the total at present.

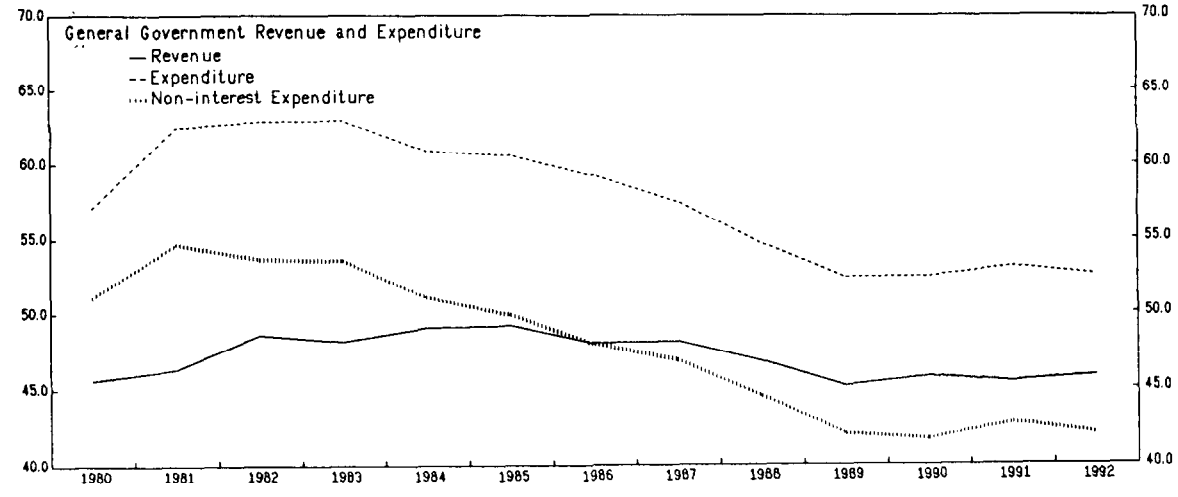
CHART 1
BELGIUM

Fiscal Indicators

(In Percent of GNP)





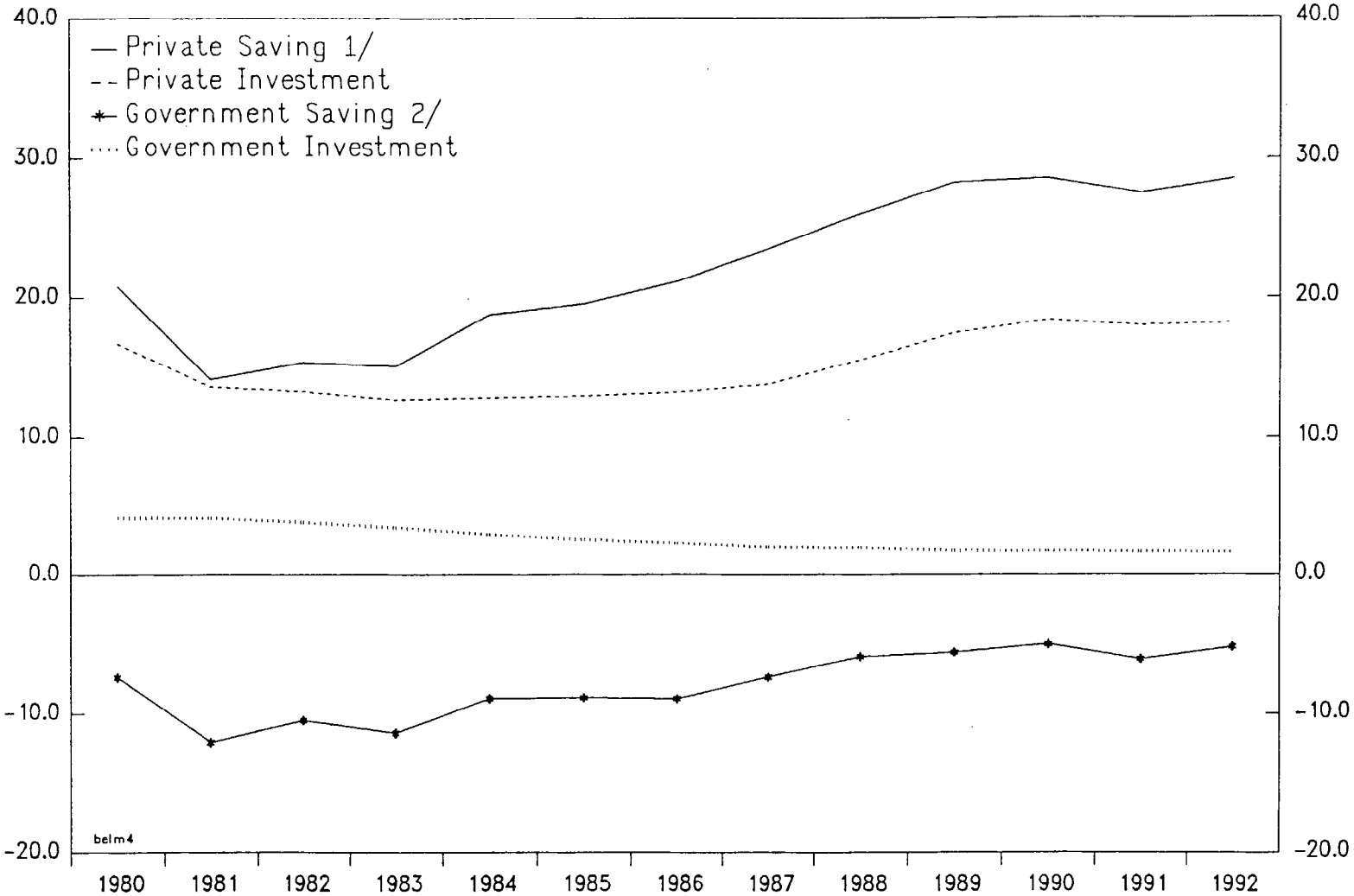


Source: National Bank of Belgium.

CHART 2
BELGIUM

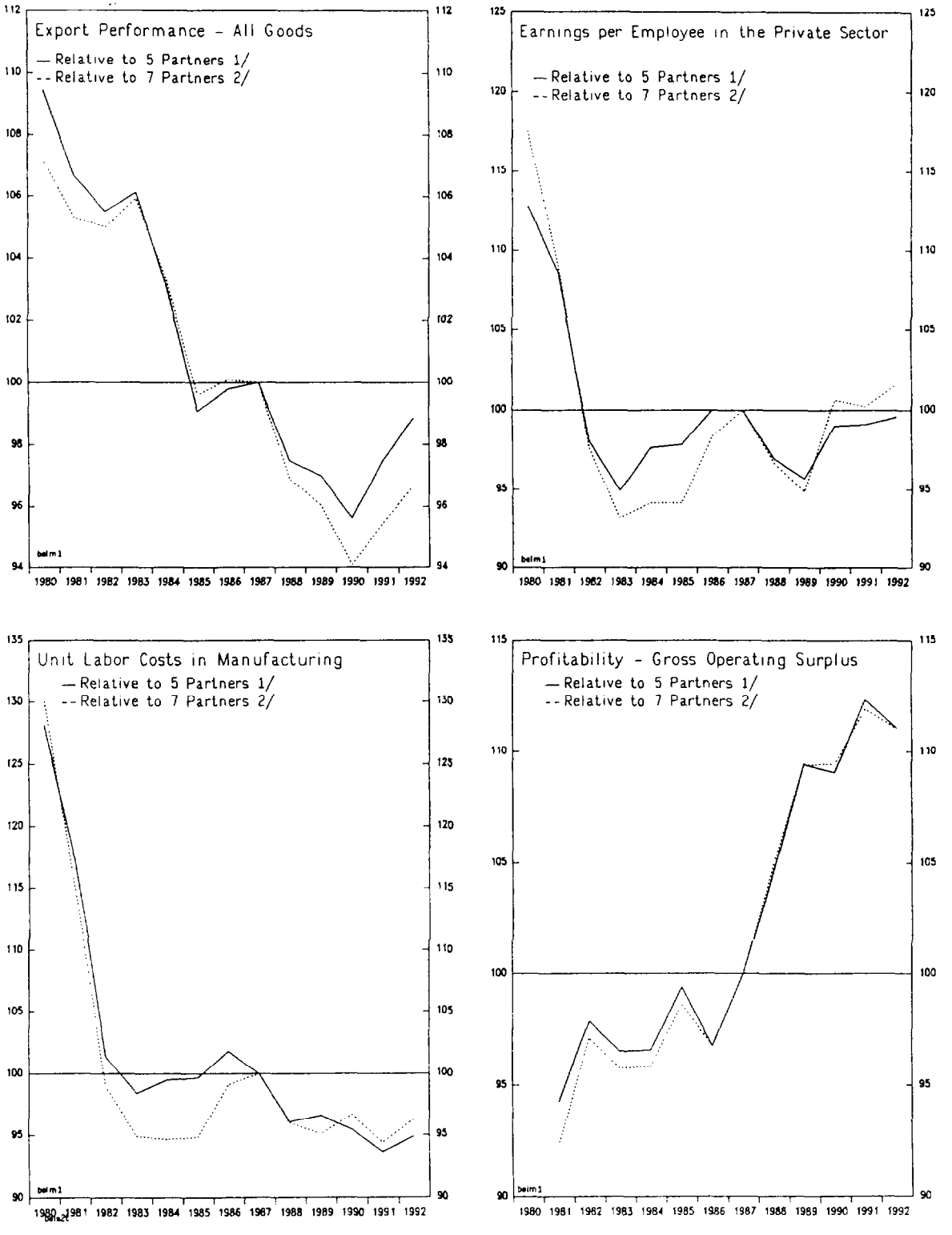
Saving and Investment

(In percent of GNP)



Source: Banque Nationale de Belgique.
1/ GNP minus consumption and government saving.
2/ General government fiscal position plus government investment.

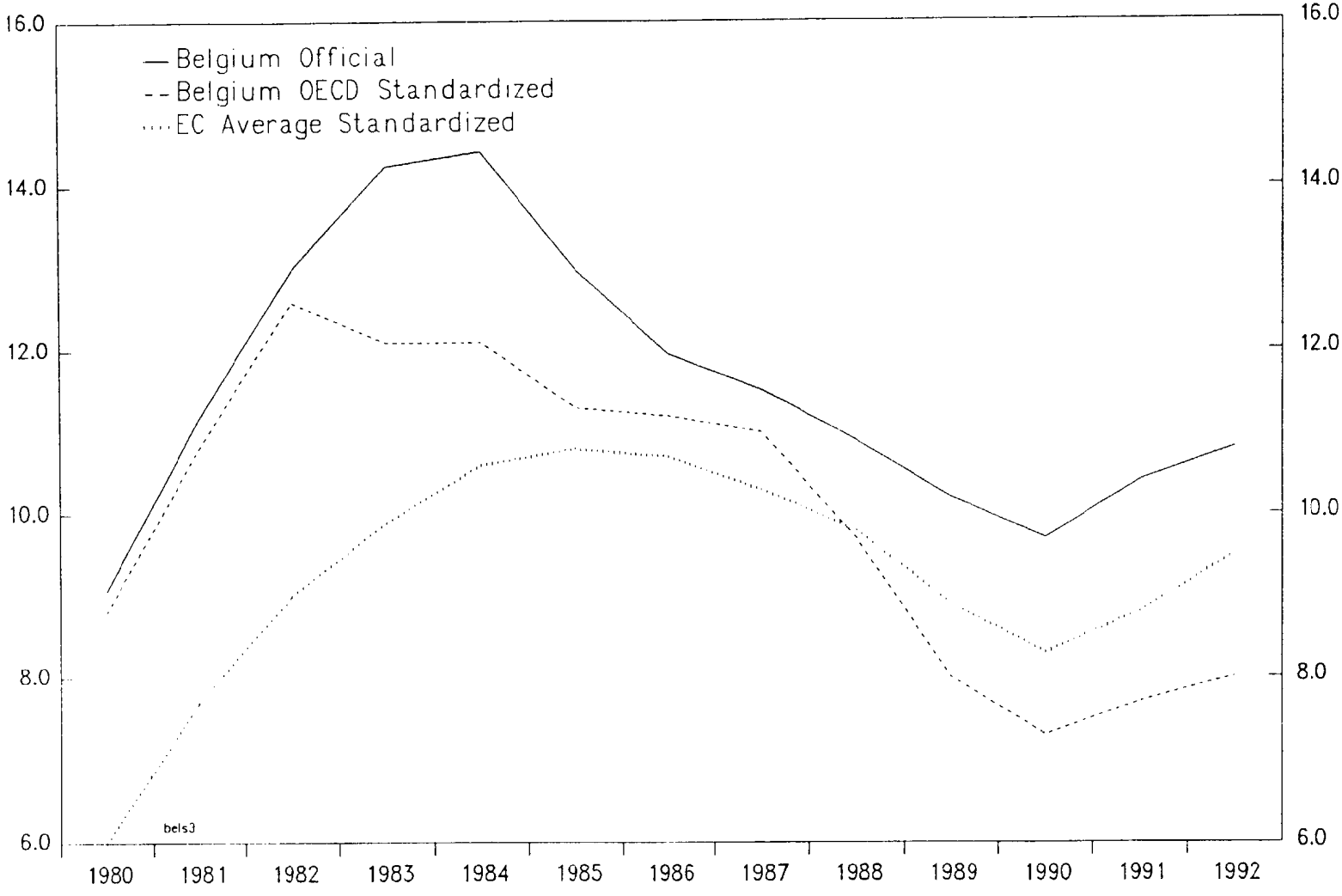
CHART 3
BELGIUM
Indicators of Competitiveness
(Indices, 1987=100)



Source: Conseil Central de l'Economie
1/ Relative to France, Germany, Italy, Netherlands, and U.K.
2/ Relative to France, Germany, Italy, Netherlands, U.K., U.S., and Japan.

CHART 4
BELGIUM

Unemployment Rates



Sources: OECD, Economic Outlook; and data provided by the authorities

Table 1. Belgium: General Government Fiscal Indicators

(In percent of GNP, national accounts basis)

	1981	1982	1985	1988	1989	1990	1991	1992 est.
Revenue	46.4	48.6	49.2	46.8	45.1	45.8	45.4	45.8
Expenditure 1/	59.7	60.0	58.1	53.4	51.6	51.2	51.7	51.7
Of which:								
Interest payments	7.8	9.2	10.7	10.2	10.4	10.8	10.4	10.6
Gross fixed investment	4.1	3.8	2.5	1.9	1.7	1.7	1.6	1.6
Social transfers	23.4	23.4	22.8	21.4	20.7	20.4	21.2	21.2
Of which:								
Central government	2.7	2.6	2.6	2.4	2.4	2.3	2.4	2.4
Local authorities	0.6	0.6	0.5	0.6	0.6	0.6	0.6	0.6
Social security	20.2	20.3	19.7	18.4	17.7	17.5	18.2	18.3
Of which:								
Pensions	7.1	7.1	7.0	6.6	6.4	6.3	6.5	6.6
Health care/ disability	5.9	6.0	6.0	5.8	5.7	5.8	6.2	6.4
Unemployment insurance	3.3	3.4	3.4	3.0	2.8	2.7	2.9	2.8
Family allowances	2.6	2.6	2.2	2.0	1.9	1.8	1.8	1.8
Overall balance 1/	-13.3	-11.4	-8.9	-6.6	-6.4	-5.4	-6.3	-5.9
Of which:								
primary balance 1/	-5.5	-2.2	1.7	3.6	4.0	5.4	4.1	4.7
Memorandum items:								
Net lending	2.8	2.9	2.5	1.2	0.9	1.3	1.4	0.9
Public debt 2/	84.0	93.6	113.6	124.0	121.3	121.2	123.8	124.9

Source: Data provided by the authorities, and staff estimates.

1/ Excluding net lending.
2/ Net of short-term financial assets.

participation rates. Cross-country evidence suggests that the generosity of long-term unemployment benefits helps explain the prevalence of long-term unemployment, and also that high long-term unemployment helps explain low participation rates. 1/ Moreover, there is a large gap in Belgium between the standardized unemployment rate (which counts only those actively looking for work) and the official rate (those drawing unemployment compensation) (Chart 4), indicating that unemployment compensation also has an income support element. This is primarily the result of a complex set of programs that provide unemployment benefits to those who withdraw temporarily from the work force and to those who work part time.

The agreement reached in December 1991 at Maastricht on economic and monetary union (EMU) among EC countries requires countries proceeding to the third stage of EMU to have general government fiscal deficits that do not exceed 3 percent of GDP, unless due to temporary and exceptional circumstances, and general government debt ratios that are at most 60 percent of GDP, or else declining at a satisfactory pace. Meeting these criteria will involve a major policy effort. In June 1992, the Ministry of Finance announced a convergence plan for reaching the 3 percent deficit ratio in 1996, starting from a projected general government deficit of 5.7 percent of GNP 2/ in 1992 (taking into account the measures in the March 1992 budget correction). Primary expenditure relative to GNP is assumed to decline in a linear fashion--by about half a percent per year--such that the deficit and debt ratios reach 3 percent and 117.2 percent, respectively, of GNP in 1996; in 1993, the deficit would be equal to 5.2 percent of GNP (Table 2).

Success in meeting convergence plan objectives will depend critically on outcomes for output, inflation, and interest rates. In 1991, economic activity decelerated sharply in Belgium as in the rest of the EC; real GNP grew at 1.6 percent compared to 3.4 percent in 1990 (Chart 5). Information now available suggests that growth rates assumed for 1992 and 1993 in the convergence plan (Table 2) are too optimistic. Recent official projections are for 1.9 percent GNP growth in 1993, and even these projections are based on export market growth assumptions taken from the October 1992 World Economic Outlook, which are currently being revised downward by substantial amounts. The staff now projects 1.3 percent real GNP growth in 1993, and a 2.9 percent increase in the GNP deflator.

The convergence plan assumes that the government will pay an average rate on its outstanding debt equal to 9.2 percent in 1992 and 9.1 percent in 1993. These rates are somewhat high compared to current interest rates (at the middle of November, three-month treasury certificates were yielding

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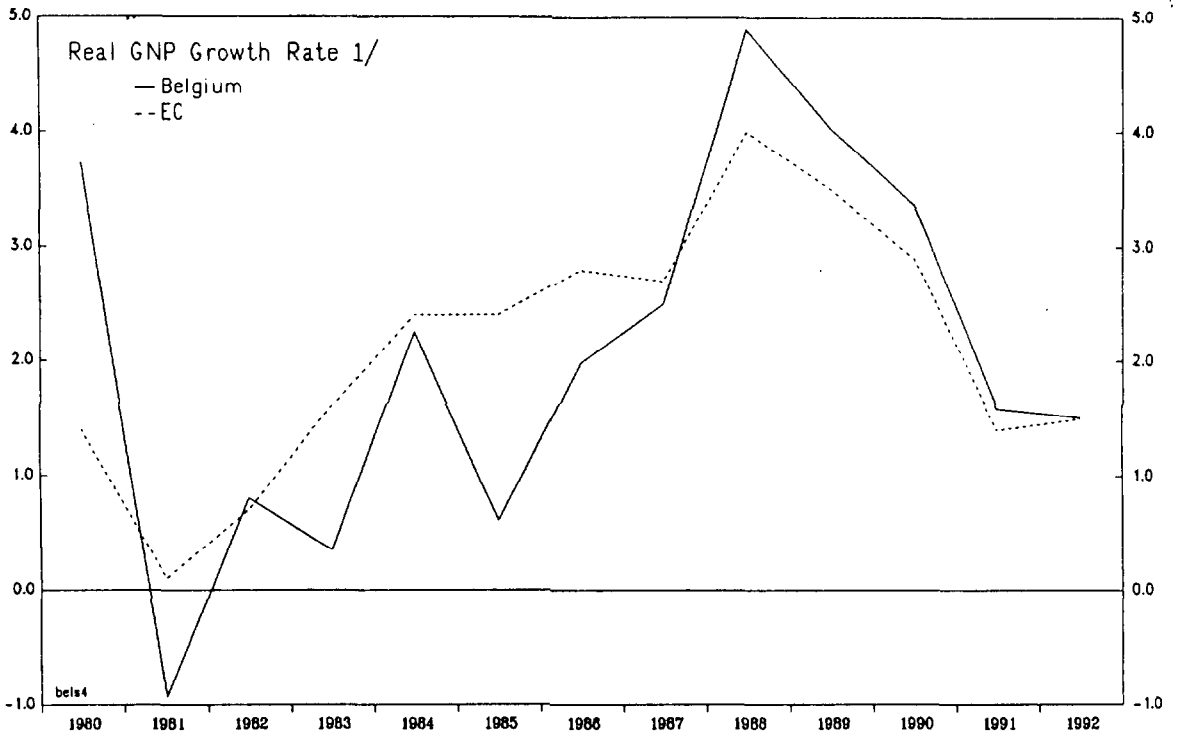
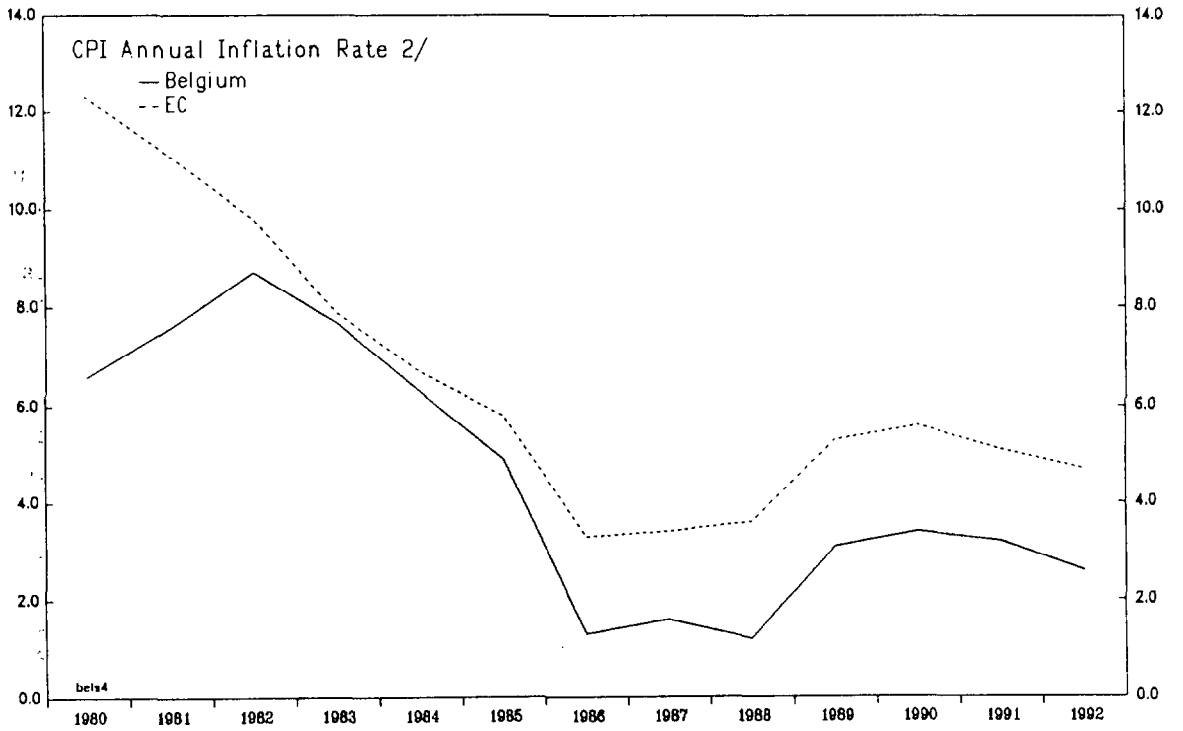
1/ See Appendix I of the Recent Economic Developments paper.

2/ Though the Maastricht Treaty criteria are framed in terms of ratios to GDP, the Belgian convergence plan targets are calculated as ratios to GNP. According to official figures for Belgium, the difference between the two is small.

CHART 5
BELGIUM
Growth and Inflation





Sources: OECD, Economic Outlook; and Banque Nationale de Belgique.
1/ The growth figures for 1992 refer to the lastest projections by BNB for Belgium and by the OECD for EC average.
2/ The inflation figures for 1992 refer to the first nine months.

about 8.5 percent and ten-year bonds, 8 percent), so interest costs in 1993 could well be significantly lower than projected, especially if the current downward trend in interest rates continues.

Table 2. Belgium: EMU Convergence Plan for 1993-96

	1992	1993	1994	1995	1996
		(Changes in percent)			
Macroeconomic assumptions					
CPI	3.2	3.3	3.2	3.2	3.2
Real GNP	1.6	2.3	2.5	2.5	2.5
		(In percent)			
Interest rate (implicit)	9.2	9.1	9.0	8.9	8.8
		(In percent of GNP)			
General Government					
Revenue	46.0	46.0	46.0	46.0	46.0
Primary expenditure 1/	40.9	40.4	40.0	39.5	39.0
Interest burden	10.8	10.7	10.5	10.3	10.0
Deficit 1/	-5.7	-5.2	-4.5	-3.8	-3.0
Net debt	124.1	123.5	122.1	120.0	117.2

Source: Ministry of Finance, Plan de Convergence de la Belgique, June 19, 1992.

1/ Excluding net lending.

III. Policy Discussions

The meetings focused on fiscal issues, notably plans for meeting the Maastricht fiscal criteria, the 1993 budget, and constitutional reform which will, inter alia, transfer some fiscal powers from the national government to the regions and communities. The mission also had extensive discussions of labor market issues and of the recent turbulence in the EMS.

1. Fiscal policy

The convergence plan aims to meet its deficit targets through three "norms": zero real growth of noninterest expenditure by the national government; growth of fiscal receipts in line with GNP; and a requirement of financial balance between social security revenues and expenditures (after taking account of a transfer from the national budget that is frozen in nominal terms at BF 231 billion, or 3.2 percent of 1992 GNP). The authorities are also committed to seeking stability in the debt ratios of the regions and communities by the end of the decade and to prevent any rise in the local authorities' deficit. The goal of zero real growth in non-interest expenditures is to be achieved with the help of a freeze on nominal expenditures in certain areas (national defense, national government's subsidies to social security, and operating subsidies granted to the national railways and to the post office).

The authorities noted that the convergence plan had been approved not only by the national government, but also by the regions and communities. There was thus a wide consensus about the need to achieve the Maastricht threshold. Moreover, the finance section of the Conseil Supérieur des Finances was keeping a close watch on the fiscal position of the regions and communities; if it saw evidence of excessive deficits, it could recommend that the Minister of Finance prohibit them from public borrowing for a two-year period. The mission made clear its concern that expenditures at the regional and community level, such as those for education, should not be allowed to escape budget constraints. Given the importance of achieving the Maastricht criteria, which are defined over the whole government sector, the transfer of powers must not be allowed to produce an overshooting of deficits because the experience of Belgium in the past two decades shows how difficult it is to reverse.

The mission raised the issue of how growth of revenues in line with GNP was to be achieved, given that in the past, the overall elasticity of tax revenues seemed to be around 0.9. The authorities explained that a decision had been made to deindex personal tax brackets for a period of at most four years (1993-96). This measure would increase the elasticity of personal taxes above unity in the intervening period, and from 1994 on, this would compensate for a continuation of the lower corporate tax elasticity.

The mission argued that the emphasis in achieving deficit reduction should be on expenditure reductions, rather than either tax increases (given the already high tax burden on labor income which discouraged employment and investment) or revenues from privatizations. The authorities agreed that a greater proportion of expenditure reductions would be desirable, but this view was not shared by all the social partners. As for privatizations, the mission expressed the view that though they are desirable in many cases on efficiency grounds, they should not be put on the same footing as other budgetary receipts. Privatization receipts have a "one shot" effect on reducing the deficit (and though they lead to lower government debt, they also reduce government assets and future revenue from those assets), and

they should not therefore be seen as a substitute for structural expenditure measures that have a permanent effect on the deficit and on government dissaving.

The convergence plan provided the background for the discussion of short-term fiscal developments. The authorities noted that, while the fall of the government in October 1991 had delayed needed measures, the new government (formed in March 1992) immediately took a series of adjustment measures which were aimed at keeping the general government deficit to no more than 5.7 percent of GNP for 1992. These measures included increasing excises and social security taxes, modification of VAT classes in the context of EC tax harmonization discussions, changes to corporate taxation to prevent incorporation solely for tax avoidance, sales of public assets, cuts in defence spending, and measures to reduce social security spending in the areas of health costs and of unemployment insurance. 1/ Similarly, the 1993 budget, which includes measures decided in early August 1992 as well as supplementary measures announced early in October, aims to reduce the general government deficit to the 5.2 percent ratio targeted by the convergence plan. The measures include the deindexation of personal income tax brackets (mentioned above), measures to raise corporate tax collections, reduction in tax subsidies to employers in labor-intensive tradable goods sectors, further excise tax increases, restrictions on personal direct tax deductions, social security expenditure cuts, privatization receipts, and miscellaneous spending reductions and receipts from tax arrears and the tightening of fiscal loopholes.

However, in the view of the staff, further weakness in economic activity has put in doubt whether the objective of keeping the general government deficit to no more than 5.7 percent of GNP in 1992 will be achieved; indeed, published budgetary figures through September suggest a substantial slippage in the position of the national government. The outcome for 1992 will, in turn, influence the deficit path in the 1993-96 convergence plan. The staff is also not convinced that the 1993 deficit target of the authorities is achievable on the basis of currently planned measures. The new measures agreed in October 1992 fail to correct for the combined effects of the budgetary overshoot in 1992 and the expected weakness of economic activity in 1993, both of which are likely to be greater than forecast even a few months ago. Achieving the Government's 1996 fiscal target of 3 percent is also by no means assured, as difficult political decisions remain to be taken, even if interest rates were to decline significantly. The authorities admitted that it was not yet fully clear whether or how the three norms would be achieved, and the budget for 1993 had noted that further unspecified measures were needed to hit the 1996 deficit target. Uncertainty related especially to the objective of balancing social security. 2/ Some officials projected a widening

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1/ See discussion of labor market policies in section III.3a below.

2/ Trends and prospects for social security are discussed in Appendix II of the Recent Economic Developments paper.

deficit, while others assumed that balance would be achieved in part by further increases in contribution rates. Table 3 gives three scenarios, all of which assume that the government's revenue goal as well as the expenditure norm for the national government will be achieved: (1) the original convergence plan; (2) a baseline projection including recent budgetary measures and assuming interest rates unchanged at current levels; and (3) a similar scenario, but with a gradual decline in rates permitting achievement of a 3 percent fiscal deficit in 1996. In the latter scenario, long-term interest rates need to decline by roughly 0.5 percentage points from current levels by 1996, and short-term rates by 1 percentage point. 1/

2. Monetary, exchange rate, and financial sector policies

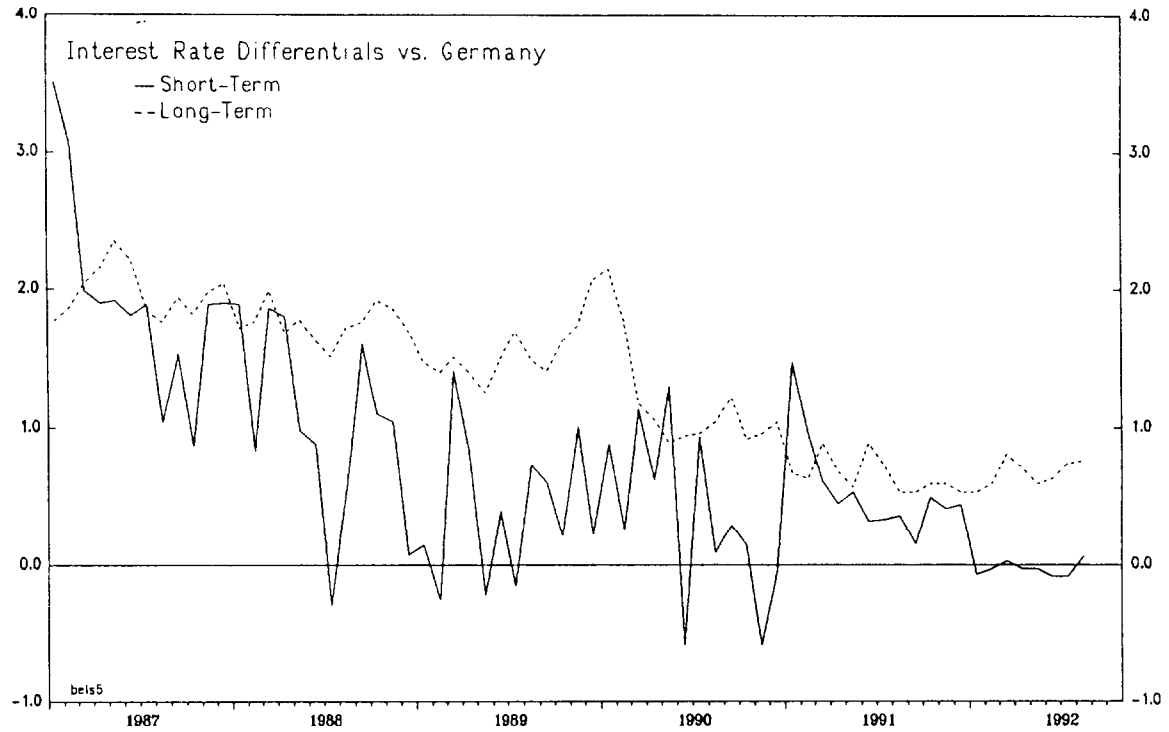
The staff reiterated its support for the strong franc policy. Enhanced confidence in monetary policy, availability of new financial instruments, and a reduction in the incentives for moving capital abroad (through a cut in the withholding tax on interest income) had combined to produce a favorable situation in which the franc had strengthened within the EMS, interest rates had declined relative to Germany (to levels below German rates at the short end--see Chart 6), and the efficiency of financial markets had increased.

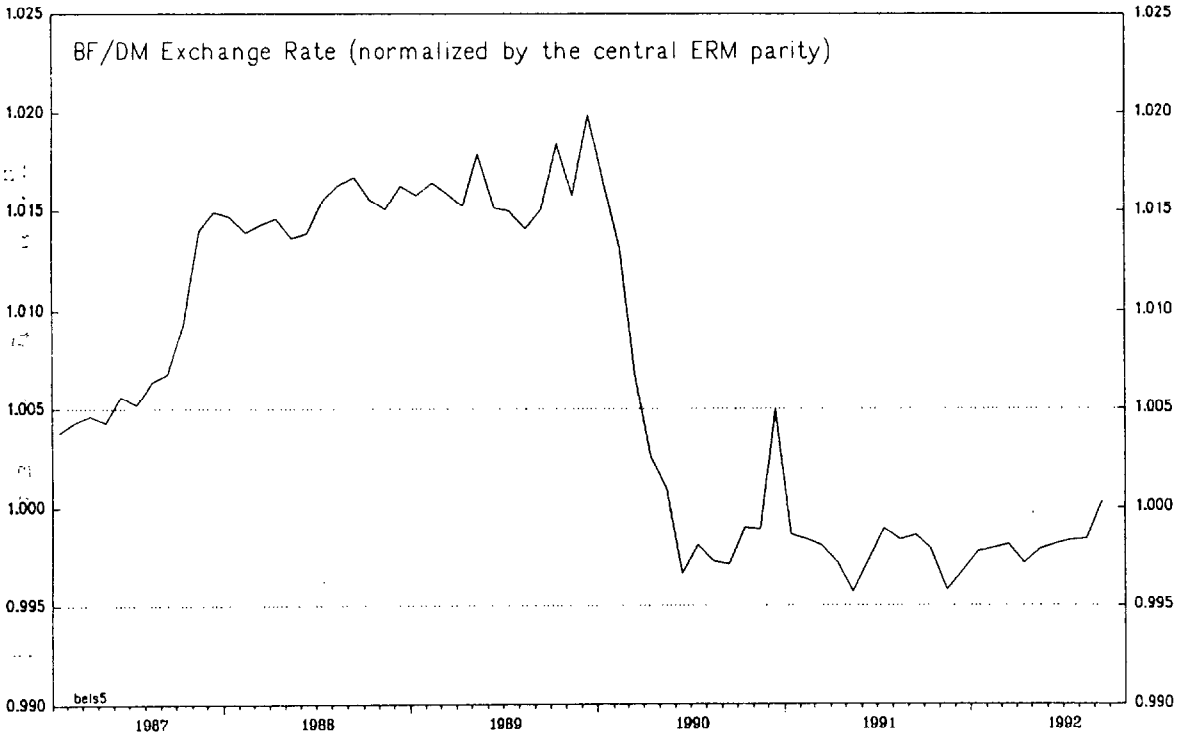
The authorities were very satisfied with the behavior of the Belgian franc and the instruments for carrying out monetary policy during the September 1992 EMS crisis. The franc had remained at or near the top of the band, along with the deutsche mark and the guilder. On only one day, the Thursday (September 17) before the French referendum, was there any evidence of downward pressure on the Belgian franc; the Belgian National Bank (BNB) promptly raised short-term rates (Chart 7). The pressure subsided quickly, so that rates were allowed to decline. By the beginning of October short-term rates were once again at German levels. The BNB intervened on numerous occasions to support weaker currencies and acquired several billion dollars of foreign exchange reserves. It had been able to sterilize the domestic monetary effects of intervention; however, by early October, when the crisis subsided, the BNB was reaching the point at which it had fewer domestic assets on its balance sheet than was desirable in order to carry out its money market operations. The authorities thought that the strength of the Belgian franc was linked to the strong basic balance position of the Belgium-Luxembourg Economic Union and their willingness to move interest rates promptly in response to exchange market pressures. They were determined not to be complacent, however; given the magnitude of Belgium's public debt, the EMS crisis was a strong reminder of the need to proceed with a convincing fiscal adjustment.

1/ More details are given in Appendix III of the Recent Economic Developments paper.

CHART 6
BELGIUM

Recent Evolution of Interest and Exchange Rates

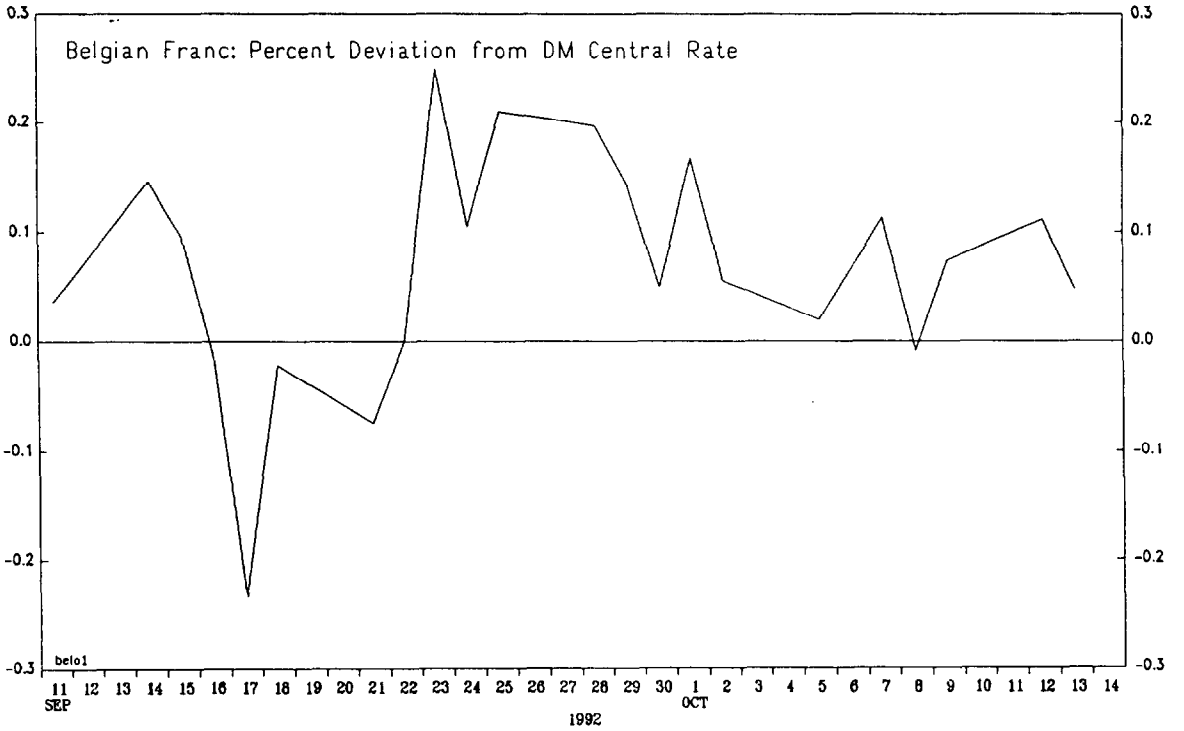


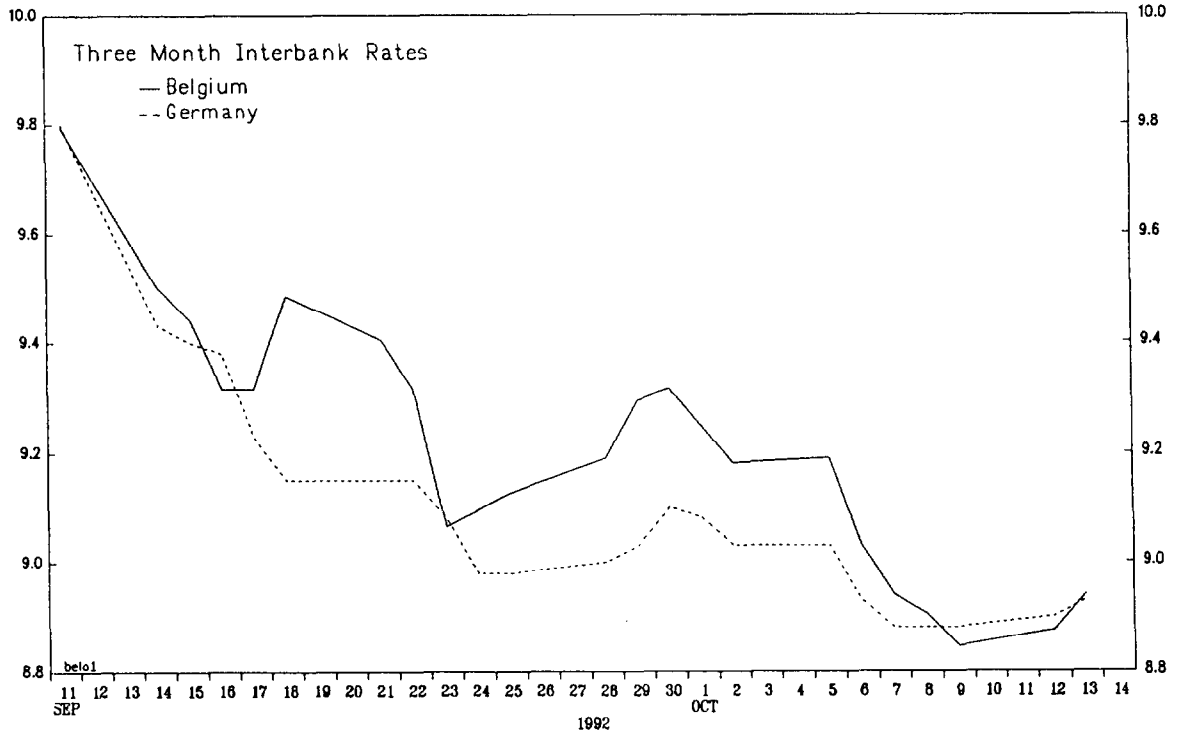


Sources: Data provided by the authorities; IMF, International Financial Statistics.

CHART 7
BELGIUM

Interest and Exchange Rates





Sources: IMF, Treasurer's Department and Banque Nationale de Belgique

Table 3. Belgium: Fiscal Convergence Scenarios

(in percent of GNP; national accounts basis)

	1992	1993	1994	1995	1996
Convergence Plan 1/					
Net financing requirement 2/	-5.7	-5.2	-4.5	-3.8	-3.0
Interest Expenditure	10.8	10.7	10.5	10.3	10.0
Primary balance	5.1	5.5	6.0	6.5	7.0
Primary Expenditure 2/	40.9	40.5	40.0	39.5	39.0
Revenue	46.0	46.0	46.0	46.0	46.0
Net Debt	124.1	123.5	122.1	120.0	117.2
Baseline Scenario (with Stable Interest Rates) 3/					
Net financing requirement 2/	-5.9	-5.5	-5.3	-4.4	-3.6
Interest Expenditure	10.6	10.5	10.4	10.0	9.7
Primary balance	4.7	5.0	5.2	5.7	6.1
Primary Expenditure 2/	41.2	41.0	40.7	40.2	39.7
Revenue	45.8	46.0	45.9	45.9	45.9
Net Debt	124.9	126.2	125.9	124.3	122.0
Baseline Scenario with Further Interest Rate Reductions 4/					
Net financing requirement 2/	-5.9	-5.3	-5.0	-4.0	-3.0
Interest Expenditure	10.6	10.3	10.2	9.6	9.2
Primary balance	4.7	5.0	5.2	5.6	6.1
Primary Expenditure 2/	41.2	41.0	40.7	40.2	39.7
Revenue	45.8	46.0	45.9	45.9	45.9
Net Debt	124.9	126.0	125.5	123.5	120.6

Sources: Data provided by the authorities and staff projections.

1/ Based on June 1992 assumptions.
2/ Excluding net lending.
3/ Based on revised projections for growth and inflation; interest rates are assumed to stabilize at end-October 1992 levels; incorporates supplementary measures agreed in October 1992; and includes expected expenditure overshooting in 1992.
4/ Average interest rates are lower than in the baseline scenario by 0.2 percentage points in 1993 and 1994, 0.3 percentage points in 1995, and 0.4 percentage points in 1996.

While Belgium has undergone extensive reforms and liberalization of the domestic financial system, a few restrictions on interest rates and constraints on competition among financial institutions remain. The authorities characterized these as anomalies that had survived from the earlier, controlled financial system. In particular, financial institutions offering one to five year time deposits have been sheltered from competition from the Treasury (which has not issued bonds in that maturity range) in return for a gentlemen's agreement whereby interest rates on these deposits would be kept at least 50 basis points below the rate on Treasury bonds issued to the public. This arrangement, originally intended to minimize the government's borrowing costs, was increasingly difficult to maintain since some foreign banks were disregarding the gentlemen's agreement and offering higher rates. Another restriction was the ceiling on interest rates paid on savings deposits which are free of withholding tax.

The mission argued that arbitrage between foreign bonds and domestic debt was likely to determine the government's borrowing costs, making the interest rate ceilings unnecessary. The authorities agreed that such arbitrage was more and more important. Nevertheless, they thought that there was some evidence of market inefficiency; for instance, though the pricing of newly introduced subordinated savings deposits did not fully take into account their riskiness, the public seemed willing to acquire these deposits.

3. Structural policies

a. Labor market policies

As discussed above, the labor market has features that suggest a lack of flexibility and policy-induced distortions. The views of the authorities, however, reflected a new appreciation of the seriousness of the problem and a widespread desire to modify labor market policies in order to strengthen incentives for obtaining employment and to limit budgetary costs, in part due to numerous criticisms from international organizations that unemployment assistance in Belgium was not focused on training, that the duration of benefits was unlimited and that the system was used for long-term income support. As a result, major new initiatives were undertaken in 1992, in particular the plan d'accompagnement and stricter enforcement of regulations requiring those who draw unemployment benefits to be seeking work.

The plan d'accompagnement, which was approved by the national government and the regions and communities in September 1992, is a program for monitoring and training unemployed persons below age 46 who enter their 10th month of unemployment. This program will provide individual action plans, including counseling and training, as appropriate, with the objective of finding employment for those participating. It will also provide for monitoring to ensure that the unemployed person is fully cooperating and intent on obtaining employment. The assistance of the regions and communities (as well as local authorities) is necessary since unemployment

insurance, while a national program, is administered locally and training is provided by the regions. The program is to be financed by a tax on the wage bill of 0.10 percent, payable by the employer. Regions will also reserve a proportion of their job creation programs for those unemployed who are enrolled in the plan d'accompagnement.

The mission expressed its support for the objectives of the plan but questioned its effectiveness, since it required coordination among various levels of government and did not address some of the fundamental dis-incentives in the labor market (large tax wedges, generosity of long-term unemployment benefits, and compensation for part-time unemployment). The authorities conceded that it was not yet clear exactly how the program would be implemented. The fact that the regions were signatories to the agreement, despite earlier reservations (in particular, in Wallonia), was a positive sign. As for reducing the budgetary costs of unemployment compensation, this would depend on how many were permanently removed from the rolls: in any case, the authorities indicated that further measures were possible, after the initial results had been evaluated.

Several changes have also been made to enhance the administration of unemployment benefits. Under existing regulations, unemployment compensation can be cut off when a person's spell of unemployment is more than twice the region's average if the person is less than 50 years old and unable to prove active attempts to look for work. A new program, decided at the time of the March 1992 budget control exercise, consisted of reducing the scope for an unemployed person to delay the cut-off of benefits through appeal. A second measure was the doubling of the maximum suspension period from unemployment benefits for the unemployed who without a valid reason have quit work or have refused an offer of employment. A third measure consisted in reducing the benefits which are paid to those who temporarily "withdraw from unemployment," i.e., from the labor force, for social or family reasons.

b. Competition policy and wage and price determination

A new competition law is to come into effect on April 1, 1993, bringing Belgian legislation into line with that in other EC countries and creating a Competition Council to administer it. As for remaining price controls, the authorities stressed that those in effect were at present restricted to only a few areas, though there were a number of sectors where the Ministry of Economic Affairs had to be notified of price changes. Price controls are primarily imposed in the areas of water distribution, drugs (controlled because of the budgetary costs of social security reimbursement), old age home care, gasoline, and rents. In consultation with social partners (i.e., trade unions and employers' federations), the authorities intended to limit further the application of controls and notification requirements.

Wages in Belgium are fully indexed to changes in the cost of living, with adjustments occurring after a threshold has been reached. Real

increases are negotiated every two years at an economy-wide level between employers' federations and trade unions. These interprofessional negotiations, though not binding, then serve as a guide to sectoral negotiations. The current interprofessional agreement expires at the end of 1992, and some concern was expressed about the chances of reaching agreement for 1993-94; employers do not see much scope for real wage increases. This view is supported by a recent report of the Central Economic Council, which found, with some reservations, that the competitive position was generally satisfactory. It now seems likely that an agreement with moderate wage increases may be reached.

c. Trade and other policies

Several trade policy issues were raised with the authorities. The mission was given detailed information concerning passage of "Single Market" measures in conformity with EC directives. The authorities explained that, as of the end of August, 108 of the 168 directives had been incorporated into Belgian law. Belgium was well behind its European partners in this respect, mainly because of institutional problems with the regions, which have jurisdiction in several of the areas concerned. These problems were being addressed, and twelve laws would be submitted to Parliament before the end of the year. The elimination of customs controls also required new administrative arrangements for implementing control functions in the areas of agricultural products and public health.

The authorities stressed their full support for the June 1992 reform of the CAP. Belgium was not very much affected as a producer, given the limited size of its agricultural sector, but should benefit as a consumer. As regards nontariff barriers, the authorities said that they were not significant in the case of Belgium and that state aid to industry had been declining in importance, in conformity with EC rules. The authorities saw serious problems, however, in freeing cross-border competition in energy products, as advocated by the EC Commission. In particular, since the cost structure of foreign companies in electricity and gas distribution (mostly publicly owned) was hard to assess, there was the potential for "dumping" in the Belgian market. In this context, energy security was a concern. The mission concurred with the view of the authorities that liberalization would have to await a comprehensive European competition policy on energy.

The authorities stressed their full commitment to a speedy resolution of the Uruguay Round; they fully supported the mandate given to the Commission to reach an agreement. The Government has resisted calls for sectoral protection, and generally favors greater competition, including foreign competition. As for ODA, it had declined to 0.42 percent of GNP in 1991, from 0.46 percent the year before and from an average of 0.58 percent in 1981-85, partly reflecting political problems in some African countries. The mission emphasized the importance of increasing aid to the agreed target ratio of 0.70 percent of GDP.

IV. Staff Appraisal

Belgium has made major and commendable efforts in the 1982-90 period in reducing the deficit of the public sector. However, in 1991, the fiscal deficit widened and the reduction of the public debt/GNP ratio was reversed; the debt ratio is likely to rise again in 1992 despite further measures. Reinforcing fiscal consolidation in order to achieve a declining debt ratio is the main macroeconomic issue facing the Belgian authorities. The government's convergence plan, which targets a deficit of 3 percent of GNP in 1996, is appropriate in the context of the Maastricht deficit criterion, but an even more ambitious target would be highly desirable in order to support a convincing decline of the debt ratio toward the Maastricht threshold of 60 percent. Unless there is clear evidence of a substantial and sustained reduction of the debt ratio, confidence in macroeconomic policies will remain fragile. There is, in the view of the staff, evidence *that the very high level of debt contributes to the long-term interest rate* differential with Germany remaining above the differential of short-term rates. Lower debt, by reducing the interest burden, should eventually allow a durable reduction in the level of taxation, which is still substantially higher than the average for the EC. A lower debt stock would also create some room for maneuver to provide for increased pensions and medical payments associated with an aging population.

The staff also consider that, in cutting the deficit, it would be desirable to rely considerably more than is presently envisaged on expenditure reductions rather than tax increases. The high level of taxation on labor income tends to depress labor market participation and employment. Other possible sources of tax revenue are limited: higher taxation of income from capital is difficult in the absence of agreement with EC and other countries, while further indirect tax increases are similarly constrained.

Social security is clearly an area in which major fiscal adjustment is needed. The danger exists that, if expenditure containment is not successful, adjustment will be achieved through increases in social security contributions, which would add to the already high tax burden and have negative effects on employment. Social security transfers are high by EC standards, and there is scope for expenditure reductions in several areas. Medical costs have been rising extremely rapidly, and their containment should receive priority. Pension benefits and family allowances could provide some savings, as would unemployment benefits.

Looking beyond social security, in the staff's view, budgetary savings from reducing government employment and limiting the generosity of public pensions should be carefully considered. The resulting budgetary room for maneuver could be used, to some extent, to increase the salaries of a smaller work force in the public sector and to increase public investment. Transfer of powers from the national government to the regions and communities should be accompanied by rationalization of public employment at the various levels.

The wide-ranging financial reforms that have helped to modernize the financial system and change the orientation and implementation of monetary policy have been remarkably successful, as have the reduction of the withholding tax and the adoption of the strong franc policy. These policies have contributed to the strong external balance of the Belgium-Luxembourg Economic Union and allowed the Belgian franc to emerge unscathed from the turbulence affecting other currencies in recent weeks. However, determined fiscal adjustment has become all the more important in the light of those events. There is, however, a need in Belgium to complete the transition to a market-oriented financial system, especially since remaining market segmentation measures are hard to maintain in the new deregulated financial environment.

As concerns labor market policies, it is the view of the staff that it would be advisable to separate completely the cyclical, short-term, function of unemployment insurance from its permanent and redistributive income support function. Such a separation would be desirable because income support is means-tested, while unemployment compensation is not. The combination in one program of two separate functions--compensating for short-term cyclical unemployment and providing long-run income support--makes it more difficult to channel benefits to those for whom they are intended. Independently of budgetary savings, separating the two functions should increase labor market flexibility and hence employment. The liberal provisions for the part-time unemployed also make it too easy to use the program as an income supplement; these provisions should be re-examined. As for the current wage negotiations, it is important that wage increases be moderate, in order to maintain Belgium's relatively favorable competitive position.

In conclusion, Belgium is benefiting from the policy measures that have been put in place over the past decade and that have received widespread support, but more remains to be done to reduce government deficits and to promote labor market flexibility. While the international environment is now difficult, it is important to continue the fiscal adjustment effort, notably by reducing expenditures on social security and government wage and pension costs, so as to reduce the fiscal deficit to or below 3 percent and to achieve a major reduction in the debt ratio over the medium term. Rationalization of labor market measures should help both to produce budgetary savings and to stimulate employment. Achieving these targets would provide a strong foundation for meeting the challenges of the future.

It is recommended that the next consultation with Belgium be held on the standard 12-month cycle.

Belgium - Basic Data

Population 1/ (mid-1990):	10.0 million
GNP per capita 1/ (1990):	US$15,540

	1965	1990
Social indicators 1/		
Life expectancy at birth		
Male	68	73
Female	74	80
Infant mortality rate	24	8
Population per physician	700	330
Higher education (in percent)	15	34
Daily calorie per capita	...	3,679

	1975		1991 2/	
	Billions of BF	Percent of GNP	Billions of BF	Percent of GNP
Private consumption	1,421.1	61.1	4,317.0	63.2
Public consumption	388.3	16.7	1,153.0	16.9
Gross capital formation	511.9	22.0	1,338.0	19.6
Exports of goods and services	1,156.5	49.7	4,839.0	70.8
Imports of goods and services	1,139.7	49.0	4,656.0	68.1
GNP	2,325.8	100.0	6,834.0	100.0

	1987	1988	1989	1990	1991	1992 est.
	(Changes in percent)					
GNP and main categories of expenditure at 1985 prices 3/						
Private consumption	2.9	3.2	3.2	3.5	1.7	2.2
Public expenditure	-0.5	...	-1.1	1.1	0.9	--
Gross fixed capital formation	5.6	15.1	14.3	8.3	-0.2	2.9
Stockbuilding 4/	0.7	...	0.2	0.1	--	--
Total domestic demand	3.6	4.5	4.8	4.1	1.2	2.0
Exports of goods and services	7.3	9.3	7.9	5.0	4.0	1.5
Imports of goods and services	9.6	8.7	9.3	4.6	3.7	2.3
Net exports of goods and services 4/	-1.7	0.4	-1.2	0.3	0.2	-0.7
GNP	2.5	4.9	4.0	3.4	1.6	1.5
Industrial production 5/	2.5	6.0	3.4	3.6	-2.3	1.9

	1987	1988	1989	1990	1991	1992 est.
			(Changes in percent)			
Employment and unemployment						
Labor force 6/	0.2	0.3	0.4	0.8	0.4	0.1
Employment 7/	0.5	1.5	1.6	1.4	-0.3	-0.3
Unemployment (official definition) 6/	-3.1	-8.3	-8.7	-4.9	7.1	10.0
Prices, wages and incomes						
GNP deflator 5/	2.0	1.3	4.5	3.0	3.1	3.4
Consumer price index 5/	1.6	1.2	3.1	3.5	3.2	2.5
Terms of trade 8/	0.7	0.2	0.5	-0.6	-0.3	...
Hourly compensation 10/ (manufacturing)	2.2	1.7	5.7	4.5	5.2	...
Unit labor costs 8/	-1.9	-3.0	1.7	3.7	2.8	...
Real disposable income (households) 10/	1.6	4.4	6.1	2.0	3.7	...
Personal savings ratio (level) 10/	14.7	14.8	17.2	16.0	17.7	...
Monetary aggregates						
Monetary base	2.3	1.3	2.9	-2.6	0.9	...
Money (M1)	3.7	6.5	8.6	1.5	0.3	...
Money plus quasi-money (M2)	10.2	7.7	13.1	4.5	5.4	...
Domestic credit	7.7	7.7	9.3	5.6	4.3	...
Private	8.6	13.4	16.5	7.6	8.0	...
Government	7.0	3.6	3.5	3.8	0.8	...
			(In percent; period averages)			
Unemployment rate 11/ (official definition, level)	11.5	10.9	10.2	9.7	10.4	10.8
OECD standardized unemployment rate (level) 7/	11.0	9.7	8.0	7.3	7.7	8.0
Interest rates						
Three-month money market rate	5.7	5.0	7.0	8.3	9.4	9.6
Government bond yield	7.8	7.9	8.6	10.1	9.3	8.9
Real (CPI deflated)	6.2	6.7	5.5	6.5	6.1	6.2
			(In percent of GNP)			
Public finances						
General government						
Expenditure 12/	55.4	53.4	51.5	51.2	51.7	51.7
Revenue	48.1	46.8	45.1	45.8	45.4	45.8
Financial balance 12/	-7.3	-6.6	-6.4	-5.4	-6.3	-5.9
Interest on public debt	10.6	10.2	10.4	10.8	10.4	10.6
Transfers to households	22.3	21.4	20.7	20.4	21.2	21.2
Transfers to enterprises 13/	5.4	4.9	4.2	4.4	4.4	3.8
Debt 14/	122.2	124.0	121.3	121.2	123.8	124.9

	1987	1988	1989	1990	1991	1992 est.
	(In billions of Belgian francs)					
Balance of payments 15/						
Trade balance	-6.5	51.4	33.0	18.8	0.9	-25.0 16/
Services balance	166.5	140.7	190.5	205.0	217.1	131.0 16/
Transfer balance	-56.0	-70.1	-76.5	-71.5	-65.1	-43.0 16/
Current account balance	104.0	122.0	147.0	152.3	152.9	63.0 16/
(In percent of GNP)	(2.0)	(2.2)	(2.4)	(2.3)	(2.2)	...
Capital account balance	-18.4	-95.5	-108.0	-80.3	-122.4	-69.0 16/
Change in net reserves of BNB	80.7	25.2	12.3	16.6	17.5	-2.0 16/
	(Changes in percent)					
Exchange rates and competitiveness 17/						
U.S. dollar rate (US$ per BF)	19.3	1.6	-6.8	18.1	-2.0	4.8
Nominal effective rate	3.5	-1.2	-0.7	4.6	-0.1	0.4
Real effective rate	1.0	-3.4	-1.3	4.0	-1.7	0.5

1/ World Development Report 1992.
2/ BNB, Report 1991, page 108.
3/ BNB, Report 1991, page 106.
4/ Contribution to growth.
5/ BNB, Indicateurs Economiques Pour la Belgique.
6/ OECD, Employment Outlook, pages 274, 277.
7/ OECD, Economic Outlook, pages 191-193.
8/ BNB, Report 1991, pages 42, 45.
9/ OECD, Main Economic Indicators, July 1992.
10/ BNB, Report 1991, page 111.
11/ Bulletin de Statistique.
12/ Excluding net lending.
13/ Including net lending.
14/ Gross debt minus domestic financial assets.
15/ Belgium-Luxembourg Economic Union (BLEU) on a payments basis.
16/ First seven months.
17/ Year average.

Belgium: Fund Relations
(As of October 31, 1992)

I. Membership Status: Joined 12/25/45; Article VIII

II. General Resources Account:

	SDR Million	% Quota
Quota	2,080.40	100.0
Fund holdings of currency	1,732.99	83.3
Reserve position in Fund	347.53	16.7
Operational budget transfers (net)	21.80	

III. SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	485.25	100.0
Holdings	394.85	81.4
Designation plan amount	15.50	3.2

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund (SDR Million; Based on Existing Use of Resources Only):

	Overdue	Forthcoming				
	10/31/92	1992	1993	1994	1995	1996
Charges/interest		1.3	5.4	5.4	5.4	5.4
Total		1.3	5.4	5.4	5.4	5.4

VII. Exchange Rate Arrangement:

Belgium forms a monetary union with Luxembourg in which the Belgian and the Luxembourg franc are at par. A maximum margin of 2.25 percent is maintained between the Belgian and Luxembourg francs and the currencies of other countries participating in the exchange rate mechanism of the European Monetary System (EMS), with the exception of the Portuguese escudo and the Spanish peseta, for which the margins are 6 percent.

VIII. Article IV Consultations:

Belgium is on the 12-month cycle; the last consultation was completed May 31, 1991 (EBM/91/72). The three-month grace period was exceeded due to staff shortages.