

Belgium: Staff Concluding Statement of the 2025 Article IV Mission

February 5, 2025

An IMF team led by Jean-François Dauphin visited Brussels to conduct the 2025 Article IV consultation with Belgium. The mission's discussions (January 22-February 3) took place before the formation of the new government and the present statement, which summarizes the mission's findings and recommendations, does not reflect the new government's policy intentions.

The IMF team thanks the Belgium authorities and other counterparts for the constructive dialogue and productive collaboration. It congratulates the new government on its nomination and looks forward to future engagement.

The Belgian economy has been resilient to a series of shocks, but growth has slowed, and disinflation has faced headwinds. The labor market has been strong but shows signs of cooling. Labor-cost competitiveness has declined with wage growth outpacing sluggish productivity growth. Absent policy change, pressures from an aging population will weigh on Belgium's social model and further increase the fiscal deficit and public debt, heightening vulnerability to changes in market sentiment. The outlook is subject to high uncertainty, amid risks that could push growth down and inflation up, including deepening geoeconomic and trade fragmentation, and adverse energy price developments.

- *Sustained fiscal consolidation is needed to support disinflation, rebuild buffers, lower market vulnerabilities, and address spending pressures from aging and the green transition. All federal and federated entities need to contribute to the adjustment. Rationalizing current spending while preserving (or increasing) public investment in infrastructure, healthcare, and education and enhancing its efficiency is a priority.*
- *To preserve macrofinancial stability, current capital buffer requirements and prudential limits on mortgage loans should be maintained. Recent progress in strengthening systemic risk assessment, supervision, the macroprudential framework, and crisis management and resolution preparedness is welcome and should be sustained.*
- *Reforms are needed to enhance growth potential through higher labor force participation, increased productivity, and a more efficient resource allocation. Priorities include increasing the income gap between work and nonwork through tax and social benefits reforms, reforming the wage-setting mechanism, and upgrading labor skills. Together with efforts with EU partners to deepen the single market, further product market reforms to reduce barriers to entry, foster greater competition, and improve the insolvency regime will improve firm dynamics and the diffusion of innovation. Sustaining the green transition requires strong commitment and enhanced coordination among the federal and regional governments.*

Economic outlook and risks

Growth is expected to be stable in 2025 and inflation to slowly return to target. Output is expected to grow by 1.1 percent in 2025 and slightly increase by 2027 supported by monetary policy easing and a higher contribution from net exports. Inflation is projected to gradually decline as wage growth moderates and the projected drop in international energy prices passes through to retail prices. The external current account is expected to return to small surpluses over the medium term as energy prices ease and external demand increases. Under unchanged policies, pressures from the aging population would further increase the fiscal deficit to about 7 percent and public debt about 125 percent of GDP in 2030, heightening vulnerabilities.

The baseline outlook is subject to sizeable risks, tilted down for growth and up for inflation. Growth could be weaker if the expected recovery in external demand falters amid escalating geoeconomic tensions and trade fragmentation. Inflation could be higher than projected due to adverse energy price developments, or if persistently-high core inflation affects expectations. Fiscal sustainability concerns could arise and lead to a sharp increase in borrowing costs—especially if global risk aversion increases—, necessitating abrupt fiscal consolidation with negative consequences for growth and potentially financial stability.

Rebuilding Fiscal Buffers Despite Pressures

Significant fiscal consolidation is needed to address large structural deficits and rising public debt that were exacerbated by the pandemic and energy crisis. In the short term, consolidation will help further reduce inflation, notwithstanding still-high wage growth and looser monetary policy. This would also help address significant upside risks to inflation. Critically, a sustained reduction in fiscal deficits is needed to reduce vulnerability to changes in market sentiment, rebuild space to address potential future shocks, address long-term spending pressures, and ultimately, preserve the core of Belgium's social model, which places a high premium on solidarity and equity.

Consolidation under the new EU economic governance framework (EGF) would significantly improve fiscal sustainability. Given the magnitude of the needed adjustment, the medium-term fiscal structural plan (MTFSP) under the EGF would benefit from a seven-year rather than a four-year adjustment path, accompanied by credible and front-loaded growth-enhancing reforms. Under such an adjustment, an annual reduction in the structural primary balance of about 0.5 percentage points of GDP until 2031 will be necessary to reach an overall deficit below 3 percent of GDP by 2031 and maintain it until 2041, per the EGF.

Fiscal adjustment should center on rationalizing current spending, while making room for public investment. Rationalizing social benefits and the public wage bill is crucial for achieving budgetary savings. Public investment should be preserved, or ideally, increased to mitigate the growth impact of fiscal consolidation, support green transition, and bolster the economy's productive capacity.

Improving the efficiency of public investment is critical amid competing demands for resources. This includes laying out clear infrastructure investment strategies, strengthening project appraisal, selection, and governance, and improving coordination within and among the federal and federated entities. In healthcare, increasing the focus on preventive care and reforming the organization and role of hospitals would help absorb part of the projected increase in spending due to aging and better prepare the system to the evolving need of an older population. Education reforms can help achieve the same education outcomes at lower costs or improve outcomes without increasing spending.

Pension reforms are essential to address cost pressures from aging. The focus should be on raising the effective retirement age in line with healthy-life expectancy and facilitating longer employment through life-long learning and upskilling. Additionally, reviewing eligibility criteria for specific pension regimes (e.g., disability pensions) and limiting increases in pension benefits by reviewing automatic indexation are necessary steps. A review of special provisions (e.g., arduous jobs) could inform reforms to balance fairness and costs.

Tax reforms should aim to shift part of the tax burden from labor to capital, without revenue loss, and to reduce tax exemptions. Belgium has the highest labor-tax wedge in the OECD. Reducing labor taxation will help increase the employment rate. All revenue from capital (e.g., interests, dividends, and capital gains) should be taxed in the same way to ensure neutrality in investment decisions, ideally by incorporating these

revenues into the overall taxable income subject to personal income tax. Reducing preferential regimes and treatments in the tax system, a significant source of foregone revenue, also needs to be part of the reform package. Tax reforms should be coordinated among the federal and federated entities for their revenue and distributional impacts.

The new EGF provides an opportunity to strengthen Belgium's fiscal framework through a revitalized fiscal council and greater accountability among federated entities. The implementation of the 2013 federal-regional coordination agreement has proved challenging, given the complexities of Belgium's fiscal federalism. The new EGF provides a renewed opportunity to introduce binding rules for burden sharing the fiscal adjustment, with clear accountability for the federal and all federated entities. A strengthened fiscal council (e.g., with enhanced staffing and direct reporting to parliaments) would help ensure that the federal and each federated entity's fiscal behavior is consistent with Belgium's European commitments.

Preserving Macrofinancial Stability

Overall systemic risks in the financial sector remain moderate but are evolving due to changing macroeconomic and market conditions. While the economy is slowing and real estate markets cooling, interest rates are now decreasing. Household indebtedness has stabilized, and corporate indebtedness has declined due to substantial investments being largely cash financed. Corporate bankruptcies have been increasing but remain aligned with pre-pandemic trends. Risks from residential real estate have moderated, but commercial real estate market activity has dropped sharply, and vacancies have risen, reflecting low demand for office space. Overall, exposures to real estate remain broadly stable.

With the level of financial stability risks expected to remain unchanged, capital buffers and prudential limits on residential mortgages should be maintained. Since last year, macroprudential policies have tightened, with capital buffers significantly raised. The NBB also appropriately encouraged banks to lengthen new mortgage maturities to ease the debt servicing burden of households and pre-empt borrower distress. Progress has been made in implementing the 2023 Financial Stability Assessment Program (FSAP) recommendations and this effort should be accelerated now that a new government is in place and the required legislative changes can be pushed forward.

Strengthening Labor Markets

Labor market fragmentation and rigidity in Belgium are impeding growth potential. The coexistence of local or sectoral pockets of high vacancies and pockets of high unemployment highlights inefficiencies in labor allocation that hinder potential growth. Employment gaps for low-skilled workers, older workers, women, and individuals with an immigration background or disabilities remain high. Fostering a more inclusive labor market will enhance overall economic performance and mitigate fiscal pressures.

Enhancing labor market incentives is essential. Labor market, tax, and social benefit reforms should consistently aim to increase the income gap between work and nonwork and reduce the cost of hiring and dismissal. Reducing the duration of unemployment benefits and linking social benefits to income levels would incentivize re-entry into the labor force. Policy efforts should also focus on facilitating re-integration of workers from long-term sick leave.

Reforming the wage-setting mechanism will help increase labor market efficiency, improve competitiveness, and reduce fiscal costs. Automatic wage and social benefit indexation protected household purchasing power during the inflation shock. However, it also increased structural fiscal deficits and led to labor-cost increases exceeding those of major trading partners when accounting for productivity differential, weighing on competitiveness. Consideration should be given to abolishing the automatic indexation and the 1996 wage law which, together, define a floor and a ceiling for wage growth, that do not

allow for an optimal allocation of labor and increased employment. At a minimum, the labor market would already benefit from reforms including adjusting the basis for indexation to exclude volatile prices, broadening the group of comparator countries in the wage law, using productivity-adjusted wage growth as the basis for comparison, and allowing firms to partially index wages considering specific local and sectoral labor market conditions.

Reforms in education and life-long training are necessary to upskill the labor force, enhance employment rates, and promote growth. While educational outcomes in Belgium are comparable to peers, they are achieved at a higher cost. Addressing teacher shortages, reducing grade repetition rates, and achieving greater equality of educational outcomes irrespective of backgrounds will require a comprehensive reform of the educational system. Actions should seek to align education with the needs of Belgian companies, better leverage teachers' time, and strengthen support provided to students who face difficulties. These reforms would help increase employment, productivity, and the creation and diffusion of innovation.

Boosting Productivity

Boosting productivity will require further product market reforms to improve firm dynamics and the diffusion of innovation. Despite significant investment in innovation, Belgium's long-term productivity slowdown is worse than peers, suggesting room to improve the transmission of innovation to productivity gains. Lagging productivity is linked to insufficient firm dynamics—the entry, growth, and exit of firms—with Belgium experiencing some of the lowest firm entry and exit rates in the EU. To enhance productivity and dynamics, further product market reforms are necessary to reduce regulatory and administrative barriers and improve the insolvency regime.

Deepening the European single market and advancing the capital market union would benefit firms in Belgium. Removing remaining barriers to trade within the EU and harmonizing regulations and bankruptcy frameworks would enhance Belgian firms' access to a much larger customer base, improve competition and firm dynamics, and provide buffers against risks from geo-fragmentation. Moreover, developing venture capital within an EU-wide push toward capital market union would help widen Belgian firms' options to finance growth.

Sustaining the Green Transition

Despite progress, much effort remains needed to achieve climate objectives. The expansion of the EU emissions trading system should be complemented by timely implementation of carbon taxation and phasing out fossil fuel subsidies, while ensuring support for vulnerable population. The consolidation of federal and regional climate efforts into a coherent and cohesive national strategy is essential. Improved coordination and accountability among the federal and regional governments will facilitate the design, execution, and evaluation of climate policies. Adequate investments in the green transition are necessary to ensure Belgium meets its climate goals and contributes to the European Green Deal.

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