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PRESS RELEASE

Outlook for the finances of the Communities and Regions
(Article for the September 2014 Economic Review)

The sixth State reform completed at legislative level at the beginning of this year transfers powers from the federal government to the Communities and Regions. The financing of the Communities and Regions is also being adjusted. The State reform therefore has a significant influence on public finances. This article examines the impact of these changes on the future financial position of the Communities and Regions.

According to the data from the National Accounts Institute concerning the April 2014 general government accounts, the budget balance of the Communities and Regions as a whole improved from a deficit of 0.8% of GDP to a more or less balanced position between 1995 and 2013. The Flemish Community and the Brussels Capital Region recorded a small surplus in 2013, while the French Community and the Walloon Region showed a small deficit[1].

For 2015, i.e. the first full year in which the sixth State reform will apply, the additional transfer of powers from federal level to the Communities and Regions will amount to roughly € 18.7 billion, or 4.6% of GDP. That includes the whole of the child allowance and various aspects of health care and personal care, as well as some aspects of employment policy. Power over some fiscal expenditure will also be transferred to the Regions, the main item being the housing bonus.

The new system of funding the Communities and Regions is based partly on greater fiscal autonomy for the Regions. Thus, they will levy additional percentages on personal income tax revenues. The various mechanisms under the law on the financing of the Communities and Regions will also undergo thorough reform. To ensure that no individual entity receives more or less funding under the new system than under the old one, a transitional mechanism was devised in the form of an equalisation factor. The amounts of that factor will be fixed in nominal terms for a ten-year period; during the following ten years they will be gradually phased out. Some elements are an exception to that because they are not offset by the transitional mechanism and therefore have an immediate budgetary impact on relations between the federal government and the Communities and Regions. This concerns the refinancing of the Brussels institutions for a total of around 0.1% of GDP by 2015, and two responsibility mechanisms – one concerning pensions and another relating to climate – as well as contributions from the Communities and Regions towards the consolidation of public finances. Thus, the new Finance Act for 2014 provides for a one-off deduction of € 250 million in 2014and structural deductions from 2015 onwards in the form of cuts in the tax revenues allocated, so that the Communities and Regions together will make a contribution of € 1.25 billion, increasing to € 2.5 billion from 2016. In addition, from 2017 the Communities and Regions will be required to make a contribution to ageing costs, in that a number of appropriations or tax revenue allocations will be linked less closely to economic growth.

The results of two projection exercises based on the new institutional framework created by the sixth State reform are also presented. One exercise outlines the budget balance position up to 2030 with no change of policy. The other calculates the growth of primary expenditure that would be compatible with the restoration of a balanced budget from 2015. That balanced budget objective was recommended in March 2014 by the "Public Sector Borrowing Requirements" section of the High Council of Finance, and was adopted as part of the indicative path presented in the Belgian Stability Programme of April 2014.

1 On 30 September 2014 the National Accounts Institute will publish new public accounts with figures which differ from those used here, partly because of methodological changes caused by the switch from the ESA 1995 to the ESA 2010.

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With no change of policy, i.e. before the implementation of the measures adopted in the government agreements concluded this summer, the projections indicate a total deficit of around 0.8% of GDP from 2016. The increase in the deficit in 2015 and 2016 is due mainly to the contributions towards the consolidation of public finances. During the ensuing decade the deficit is expected to rise to around 1% of GDP. With the exception of the Brussels Capital Region, which would maintain a small surplus throughout the period, the other main Communities and Regions, namely the Flemish Community, the French Community and the Walloon Region, are projected to record substantial deficits throughout the period.

Owing to the contributions towards the consolidation of public finances, the main Communities and Regions other than the Brussels Capital Region are required to make a considerable fiscal consolidation effort in order to achieve the target of a balanced budget. The government agreements concluded for 2014-2019 for the Communities and Regions clearly reflect the fiscal context described above.

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