Reform of the Special Finance Act for the Communities and Regions

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Introduction

On 10 October 2011, eight parties with a special majority in the federal parliament concluded an agreement on the sixth reform of the Belgian State (1). From an economic and budgetary point of view, the two most important aspects of that reform are the transfers of new powers from the federal level to the Communities and Regions, and the revision of the Special Finance Act for the Communities and Regions of 16 January 1989, which has been amended on a number of occasions since that date.

As in previous State reform phases – in 1970, 1980, 1988/89, 1993 and 2001 –, powers are being transferred from the federal level to the federated entities. In the Belgian federal structure, the Walloon, Flemish and Brussels-Capital Regions, which are territorially defined entities, already exercise their powers in spheres such as land use planning, housing, the environment, public works, supervision over local authorities and their general funding, and certain aspects of policy concerning agriculture, energy, transport, employment and the economy. The French, Flemish and German-speaking Communities mainly have powers relating to personal matters, such as education, culture and certain aspects of social support and health policy. In the bilingual Brussels-Capital Region, some community powers are exercised by the French and Flemish Communities, and others by the Joint Community Commission, the French Community Commission and the Flemish Community Commission. In Flanders, the community and regional institutions have been merged.

In most cases, the agreement on the revision of the Finance Act concerns principles and mechanisms. The reference amounts for the transfer of powers and for the variation parameters have not yet been finally set. Since the figures are not fixed, the ones presented in this article should be treated with a degree of caution.

Taking account of the legislative process for the adoption of the texts implementing the sixth State reform, the new Finance Act and the power transfers would probably only come into force in 2014. However, a number of mechanisms should be applied before that date. That should be the case in 2012 for the refinancing of the Brussels institutions and the mechanism giving the federated entities more responsibility for pensions.

The article is structured as follows. Section 1 outlines some key features of the macroeconomic and demographic reference framework, focusing particularly on developments in the three Regions of the country. Section 2 sets out the main mechanisms of the current Finance Act and presents the results of a projection of the main revenues of the Communities and Regions, assuming there is no change of policy. Section 3 reviews the transfers of powers. Section 4 explains the changes which will be made to the Finance Act. The article concludes with some final remarks.

(*) With the assistance of K. Van Cauter.

(1) A special majority is required for the adoption of institutional reform laws. It implies a majority of two-thirds in the Chamber of Representatives and in the Senate, and a simple majority in each language group (French or Dutch).

1. Demographic and macroeconomic prospects per Region

The political negotiations on the reform of the Finance Act were conducted with the technical assistance of the Federal Planning Bureau and the Bank. Simulations of the institutional variants were produced on the basis of a consistent demographic and macroeconomic framework for the three Regions and for the country as a whole up to 2030. They are based on the medium-term economic outlook published by the Federal Planning Bureau in May 2011.

This demographic and macroeconomic framework determines the expected developments concerning the revenues transferred from the federal government to the Communities and Regions under the current Finance Act. It is also a key background element of the institutional negotiations, both for revising the mechanisms of the law dated 16 January 1989 and for organising the funding of transfers of new powers covering such diverse spheres as family allowances, support and health care for the elderly, or employment schemes.

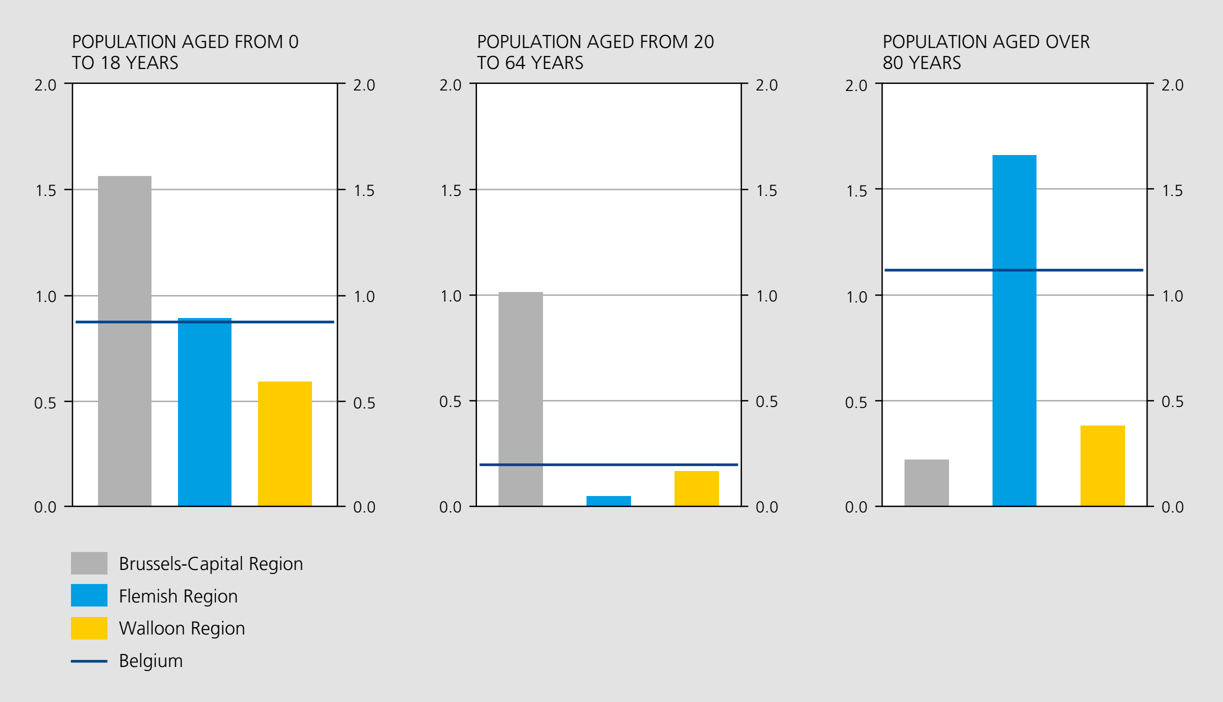
1.1 Population

According to the forecasts, the population of Belgium is expected to rise from 11.1 million in 2012 to 12.1 million in 2025, implying annual average growth of around 0.8 % over the period considered. The population growth is likely to be strongest in the Brussels-Capital Region. It is expected to be a little more pronounced in the Flemish Region than in the Walloon Region.

During the period 2012-2025, the population aged from 0 to 18 years is projected to grow very strongly in the Brussels-Capital Region, around twice as fast as in the Flemish Region and at almost three times the growth rate in the Walloon Region. The main factor behind the strong population growth of the first Region is therefore likely to be the birth rate.

The population aged from 20 to 64 years, which reflects the population of working age, is expected to increase only slightly in the country as a whole, by around 0.2 % per annum throughout the period. Once again, there are divergences between the Regions. The population of working age is set to stagnate in the Flemish Region. In the Walloon Region, it is likely to expand at a slightly

CHART 1 POPULATION FORECASTS
(percentage average annual change over the period 2012-2025)



Source : FPB.

lower rate than this low national average. Conversely, the Brussels-Capital Region will be an exception, with the population of working age growing by around 1 % per annum, on average. That reinforces the image of a young, dynamic population in that Region.

Taking account of the assumptions concerning life expectancy, the number of persons over the age of 80 years is likely to rise considerably in Belgium by 2025. The average growth rate for that age group is estimated at 1.1 %, which is higher than for the other two age groups considered here. That growth is very unevenly distributed between the Regions. It is driven primarily by the Flemish Region, where the number of very elderly persons is expected to increase by an annual average of 1.7 % between now and 2025. In the other two Regions, the rise is put at less than 0.5 %. The stronger growth in the Flemish Region is due both to a higher birth rate in the past and to longer life expectancy.

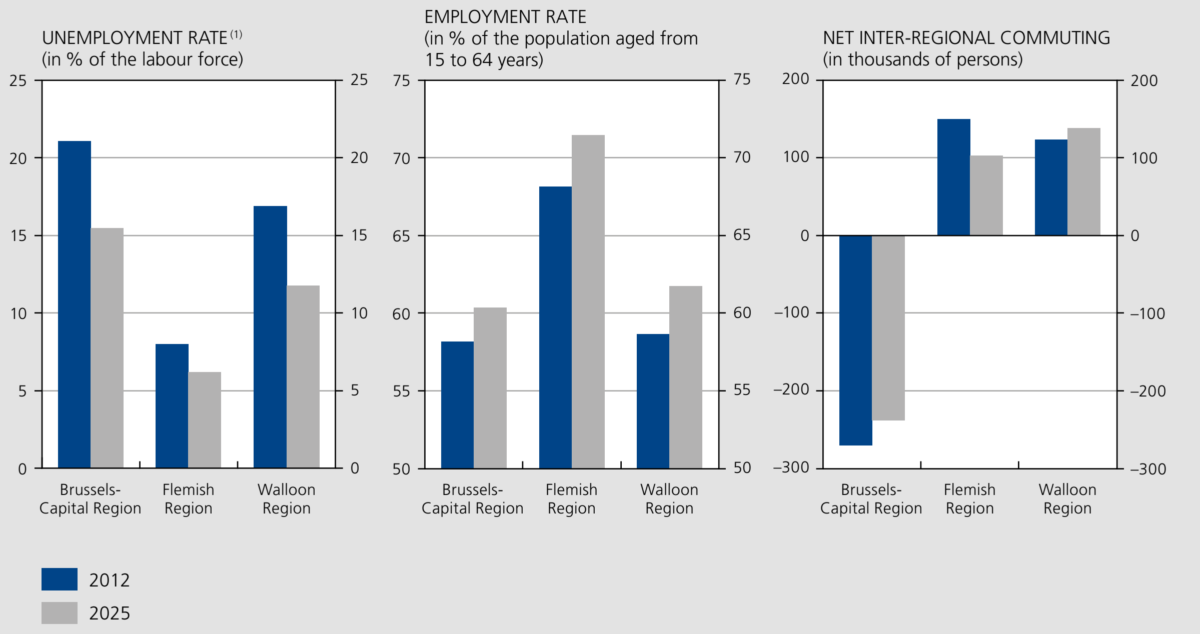
1.2 Labour market

Between 2012 and 2020, the unemployment rate is estimated to fall by just over 2 percentage points in each of the Regions. In the Flemish Region, it should drop to a low point in 2020 of 6.2 % according to the broader definition including older unemployed persons, and will subsequently stay at this low level, considered to be a minimum. In the other two Regions, the unemployment rate should continue falling after 2020. This means that it is likely to fall by much more in the Walloon Region and the Brussels-Capital Region than in the Flemish Region, while remaining at significantly higher levels, respectively representing 11.8 and 15.5 % of the labour force in 2025.

The employment rate is forecast to rise in the three Regions during the period considered, but is likely to increase more strongly in the Flemish Region (+3.3 percentage points) and in the Walloon Region (+3 points) than in the Brussels-Capital Region (+2 points). Consequently, the employment rate will remain much higher in the Flemish Region than in the other two Regions.

Maintaining the dynamism of employment in the Flemish Region requires a significant change in commuter flows with the other Regions. In 2012, the difference between the number of persons going to work in the Brussels-Capital Region while living in the Flemish Region or the Walloon Region and the number of persons living in the Brussels-Capital Region and working in one of the other two Regions of the country is estimated at 271 000

CHART 2 MAIN LABOUR MARKET VARIABLES



Source: FPB.

(1) According to the administrative concept in the broad sense used by the Federal Planning Bureau. That includes all persons registered as job-seekers with the regional employment agencies, and older unemployed persons not seeking work.

persons. In net terms, 149 000 of them are from the Flemish Region and 122 000 from the Walloon Region. In the macroeconomic reference scenario, this net flow of commuters to the Brussels-Capital Region is forecast to decline to 239 000 persons by 2025. That fall is notably attributable to a rise in the number of Brussels commuters finding work in the Flemish Region. Over the same period, increasing numbers of Walloons are also expected to find jobs in the Flemish Region. Consequently, the net total of commuters from the Flemish Region is likely to fall to 102 000.

1.3 GDP by volume

In the macroeconomic reference scenario, the average annual growth of GDP by volume comes to 1.9 % over the period 2012-2025. Compared to the national average, the growth rate during that period is likely to be 0.1 percentage point lower in the Brussels-Capital Region and in the Walloon Region, whereas it should be marginally higher in the Flemish Region. The stronger economic growth in this last Region, more apparent at the end of the period, is due essentially to more sustained employment growth.

1.4 Personal income tax

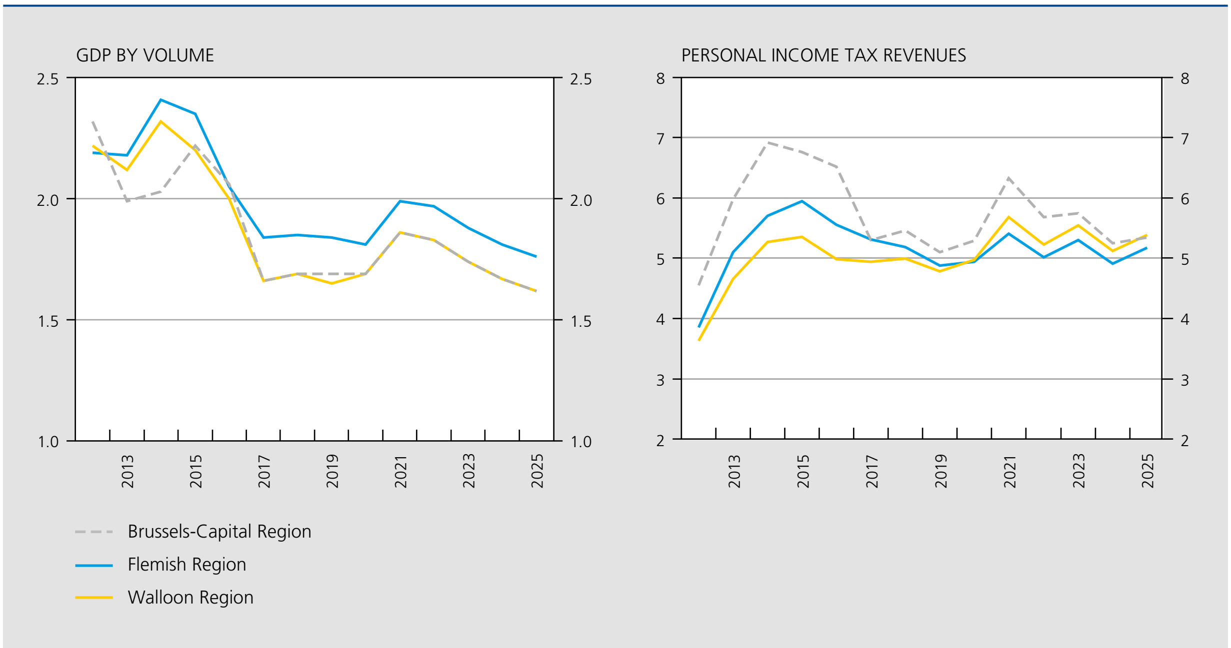
During the period 2012-2025, with no change of policy, and therefore no change in the tax laws, personal income tax revenues tend to rise faster than GDP for two reasons.

First, the personal income tax yield increases faster than the tax base owing to the progressive character of the tax – the tax rates go up at the transition from one tax band to the next – and because some tax relief schemes and the tax-free allowance do not increase as quickly as the tax base.

Second, the tax base expands faster than GDP because, unlike the latter, it includes pension incomes (transfers in the national accounts), and those incomes are rising as a result of population ageing.

The Region with the strongest economic growth, namely the Flemish Region, will not be the one to see the fastest rise in personal income tax revenues. In fact, that Region will actually record the smallest increase in the personal income tax yield between 2020 and 2025, despite having the strongest expansion of activity. This situation is due to substantial changes in commuter flows. GDP is in fact calculated on the basis of the place of production, and therefore the place of work, whereas personal

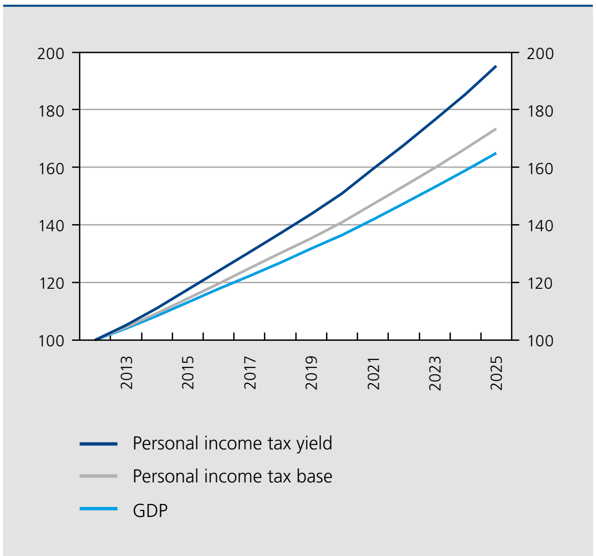
CHART 3 MACROECONOMIC REFERENCE SCENARIO
(percentage changes compared to the previous year)



Source: FPB.

CHART 4 PERSONAL INCOME TAX YIELD AND TAX BASE IN RELATION TO GDP

(projections with no change in the law for Belgium, indices 2012 = 100, in nominal terms)



Sources : FPB, NBB.

income tax revenues are calculated according to the place of residence. The extra number of Walloon and Brussels commuters to the Flemish Region will contribute simultaneously to stronger growth and employment in the Flemish Region and a faster increase in the personal income tax yield in the Walloon Region and the Brussels-Capital Region.

2. Analysis of the current Finance Act

2.1 Principal mechanisms of the Finance Act

The current method of financing the Communities and Regions has been in force since 2002. In fact, the special law of 13 July 2001 on the refinancing of the Communities and extension of the fiscal powers of the Regions, which had implemented the Lambermont Agreement, brought profound changes in the calculation of the budgets available to the federated entities.

The revenues of the Communities and Regions consist mainly of part of the personal income tax and VAT revenues handed over to them by the federal government in accordance with parameters defined in the Finance Act. The Regions can also collect their own tax revenues. Finally, the federated entities receive grants from the federal government, plus the proceeds of the sale of goods and services and miscellaneous other revenues.

PERSONAL INCOME TAX RESOURCES PASSED ON

The revenues derived from personal income tax and attributed to the Communities and Regions are linked to inflation as measured by the national consumer price index, and to the movement in GDP at constant prices. The resulting amount is shared between the entities on the basis of the yield from the personal income tax collected in each territory. Regarding the determination of the allocation key between the Communities, 80 % of the personal income tax collected in the Brussels-Capital Region is allocated to the French Community and 20 % to the Flemish Community.

The amounts paid to the Regions by way of personal income tax are reduced by a "negative term" to compensate for the supplementary regional taxes granted since 2002 under the Lambermont Agreement. The adjustment of this negative term is indexed on prices and 91 % linked to GDP growth, except for the part related to the radio & television licence fees transferred from the Communities to the Regions. This part of the negative term as well as a compensatory grant received by the Communities are only adjusted in line with inflation.

In addition, a national solidarity allowance is paid to the Regions whose per capita proceeds from personal income tax is below the figure for the country as a whole. This solidarity allowance constitutes part of the personal income tax transferred by the federal government.

Finally, the resources derived from personal income tax include two smaller transfers effected since the implementation of the Lambermont Agreement, the first in favour of the French and Flemish Community Commissions and the second for the municipalities of the Brussels-Capital Region, channelled via that Region.

VAT RESOURCES PASSED ON

When the Special Finance Act of 16 January 1989 was first introduced, the VAT revenues attributed to the Communities corresponded to budget appropriations for education. Since then, there has no longer been any explicit link between the two, as the Communities have total autonomy over all their revenues. Initially, under the Finance Act, these resources were adjusted only in line with the national consumer price index and with 80 % of the change in the number of persons under the age of 18 years living in the Community where the number of young people had risen the most or fallen the least since

1988. In that connection, 80 % of the number of young people under the age of 18 years in the Brussels-Capital Region is attributed to the French Community and 20 % to the Flemish Community. The Lambermont Agreement considerably increased the VAT revenues passed on by granting flat-rate increases of € 198 million in 2002, € 149 million in 2003 and 2004, € 372 million in 2005, € 124 million in 2006 and € 25 million for the period between 2007 and 2011. In addition, from 2007 the total amount of the VAT grant has been 91 % linked to real growth of GDP at constant prices.

In regard to the sharing of VAT revenues, the Finance Act initially envisaged a progressive transition from the allocation of the education appropriations in force in 1988 to an allocation based on the number of pupils registered in 1987. At the time of the Saint-Éloi Agreement of 1 December 1999, it was decided that, from the year 2000, the revenues would be allocated on the basis of an annual pupil census. However, the Lambermont Agreement ended the sole use of the number of pupils as the basis for allocating the VAT grant, and accorded growing importance to the personal income tax revenues in each Community. In practice, in 2002 the allocation of the additional resources provided for by the Lambermont Agreement – and therefore not the budget originally provided for in the 1989 Finance Act – was based 65 % on the number of pupils and 35 % on the personal income tax revenues. The latter percentage increased gradually to 100 % in 2012.

OWN TAX REVENUES

The resources at the disposal of the Regions are also derived from their fiscal autonomy. The Regions' own tax revenues consist mainly of regional taxes and levies. The regional taxes are taxes which used to be exclusively federal and were then regionalised, in whole or in part, by the Finance Act and its successive revisions. In practice, this concerns inheritance taxes, gift taxes, certain registration fees, road tax, vehicle licence tax, Eurovignette, withholding tax on income from immovable property, radio & television licence fees and three minor taxes, namely the tax on amusement machines, the tax on gambling and betting and the tax on the opening of establishments selling drinks. The regional levies are taxes or levies collected by the Regions on matters within their sphere of responsibility, notably water and waste management.

The Lambermont Agreement also gave the Regions more fiscal autonomy over personal income tax. Since 2004, the Regions have been able to levy additional percentages or grant tax relief of up to 6.75 % of the personal income tax collected in the Region. In practice, no Region has raised any additional resources by this means. Conversely, in the recent part, the Flemish Region has made use of the option of cutting taxes, notably via the tax relief for people in work (*jobkorting*).

The Communities have virtually no tax revenues of their own since they have no exclusive territory and hence no tax-raising powers.

OTHER GRANTS FROM THE FEDERAL STATE

Apart from the VAT and personal income tax revenues handed over, the federal government also funds the Communities and Regions on the basis of various grants with their own specific adjustment rules and allocation keys. The German-speaking Community is funded primarily by a federal grant. The country's other two Communities receive two other federal grants, one to finance foreign students and the other for inter-university cooperation. The three Regions are given drawing rights for the funding of programmes for getting the unemployed back to work. The Brussels-Capital Region receives two additional grants, one by way of mortmain and the other, known as Beliris, for the purpose of public investment. The Joint Community Commission also receives a grant from the federal government.

2.2 Expected trend in the revenues of the Communities and Regions

We begin with a general account of the expected trend in the revenues of the Communities and Regions, assuming there is no change in the institutional framework. Next, we present more detailed comments on two funding mechanisms which, under the agreement on the State reform, see changes to their implementing arrangements. This concerns the transferred VAT revenues and the national solidarity allowance.

2.2.1 Overview

Under the current Finance Act, taking account of the demographic framework and the macroeconomic reference scenario, the main revenues of the federated entities – the three Communities, the three Regions and the three Community Commissions – would increase by around 0.2 percentage point of GDP between 2012 and 2025.

The resources of the Flemish Community would expand steadily as a percentage of GDP. That growth would be due to the Community's share, the main factor being that the VAT resources increase not only with inflation and real economic growth, but also with demographics.

TABLE 1 MAIN REVENUES OF THE COMMUNITIES AND REGIONS (1)

(reference scenario, in % of GDP)

	2012	2015	2020	2025	Change 2012-2025
Flemish Community	6.55	6.62	6.73	6.78	0.23
Community	3.49	3.55	3.65	3.72	0.23
Region	3.06	3.08	3.08	3.06	0.00
French Community	2.33	2.34	2.34	2.35	0.02
Walloon Region	1.68	1.67	1.65	1.63	–0.05
Brussels-Capital Region	0.66	0.66	0.66	0.65	–0.01
German-speaking Community	0.04	0.04	0.04	0.04	0.00
Community Commissions	0.02	0.02	0.02	0.02	0.00
Total	**11.27**	**11.36**	**11.44**	**11.46**	**0.19**

Sources: FPB, NAI, State revenue and resources budgets, NBB.

(1) These are transferred resources derived from personal income tax and VAT (excluding settlement balances), own tax revenues (regional taxes and certain regional levies) and various other federal grants.

The population under the age of 18 years is estimated to expand between now and 2025. Moreover, the additional resources granted under the Lambermont Agreement, allocated on the basis of the personal income tax key which is more favourable to the Flemish Community than the pupil key, will make up a growing share of the resources derived from VAT (cf. Section 2.2.2.). The population factor also has a positive influence on the VAT resources of the French Community, but the latter feels the increasing effect of the personal income tax key, which is less advantageous than the pupil key in this case. Consequently, the resources of the French Community are projected to grow much more slowly than those of the Flemish Community.

As a percentage of GDP, the resources of the Walloon Region are set to diminish steadily, while those of the Flemish and Brussels-Capital Regions are expected to stagnate. There are several factors behind these divergences. First, the three Regions will see their own tax revenues and the federal grants other than transferred personal income tax revenues rise more slowly than GDP owing to Finance Act parameters or underlying assumptions, depending on the case. Conversely, there is the effect of the negative term. Insofar as the initial amount of personal income tax transferred is linked to real GDP growth and inflation, and the negative term – deducted from that initial amount – increases more slowly than GDP, the amount ultimately assigned to the Regions increases faster than GDP. Finally, two other aspects linked to the personal income tax revenues transferred tend to erode the revenues assigned to the Walloon Region to a greater extent than those assigned to the Brussels-Capital Region. First, since the basic amount of the solidarity allowance is only index-linked, the weight of the latter in GDP declines over the years in these two Regions, but the expected fall should be curbed in the Brussels-Capital Region by the strong population growth. Second, the personal income tax key is expected to work against the Walloon Region and in favour, primarily, of the Brussels-Capital Region.

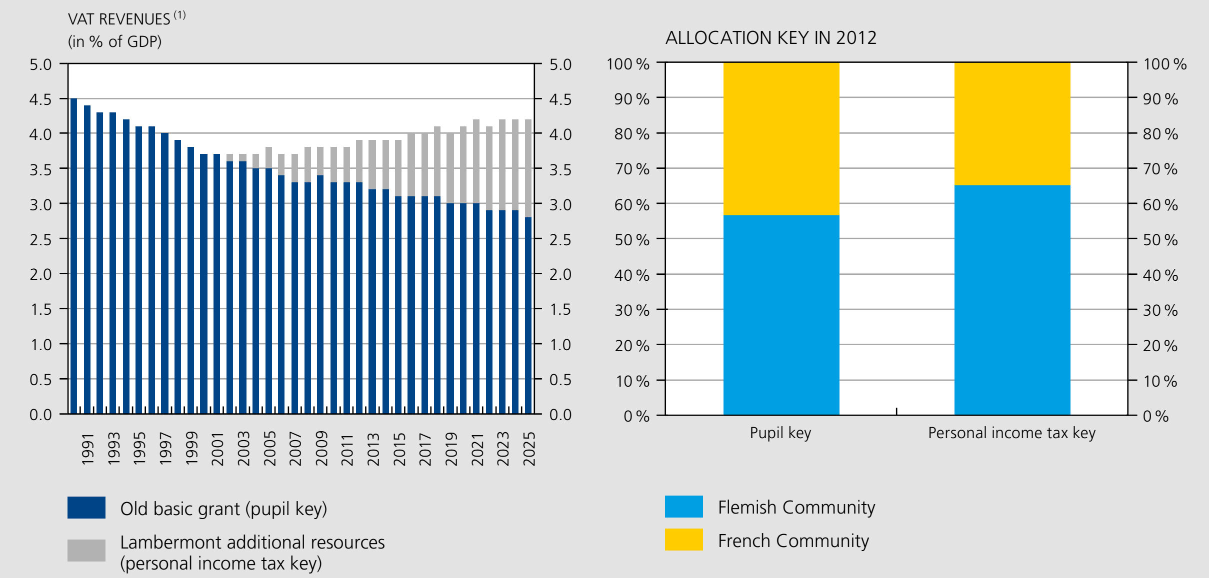
The relatively limited resources granted to the Community Commissions taken as a whole and to the German-speaking Community are likely to keep pace with GDP up to the year 2025.

2.2.2 Transferred VAT revenues

Until 2001, the VAT revenues assigned to the Communities, allocated according to the pupil key, were adjusted solely in line with inflation and the change in the number of young people under 18 years of age. Consequently, that VAT grant declined steadily in relation to GDP: between 1990 and 2000 it had fallen from 4.5 to 3.7 % of GDP.

From 2002, following the Lambermont Agreement, additional resources derived from VAT were granted to the Communities. These include – since 2007 – a 91 % link between the overall VAT grant (old basic VAT grant plus additional resources) and real GDP change. The main factor which could affect the ratio between that grant and GDP is therefore demography. At the time, taking account

CHART 5 VAT RESOURCES TRANSFERRED TO THE COMMUNITIES



Sources: FPB, State revenue and resources budgets, NBB.
(1) Excluding settlement balances.

of the expectation of a slight fall in the birth rate, the resources transferred to the Communities and Regions were projected to virtually stagnate as a percentage of GDP, as a result of this refinancing. On the basis of the latest population forecasts which imply a relatively high birth rate until 2025, the VAT grant could rise slightly faster than GDP, increasing from around 3.8 to 4.2 % of GDP between 2012 and 2025.

The Lambermont Agreement accorded growing importance to the personal income tax yield in each Community as allocation key. The old basic VAT grant is in fact only adjusted in line with inflation and the population under the age of 18 years, so that it is declining as a percentage of GDP, while the additional resources derived from VAT, allocated according to the personal income tax key, considerably outpace the rise in GDP, hence the name "Lambermont turbo". These divergences have some implications for the sharing of resources between the Communities, as the personal income tax key is much more favourable to the Flemish Community than the pupil key. Thus, in 2012, according to the reference projection, the personal income tax key would assign 65.2 % to the Flemish Community and 34.8 % to the French Community, while the figures according to the pupil key would be 56.6 % for the Flemish Community and 43.4 % for the French Community.

2.2.3 National solidarity allowance

The solidarity allowance is a transfer from the federal government to the Regions where the proceeds from personal income tax per capita are less than the figure for the country as a whole. In 1988, the basic amount of this allowance stood at € 11.60 per head of population and per percentage point difference between the regional figure and the national average for proceeds from personal income tax per capita. That amount is indexed annually.

The Flemish Region has never received any solidarity allowances, since the proceeds of personal income tax per capita have always exceeded the national average there.

Conversely, the Walloon Region has received a solidarity allowance each year. The negative gap in terms of the proceeds of personal income tax per capita in relation to the national average, which was already nearly 10 % in 1990, widened further and fluctuated between 10 and 15 % over the period as a whole. In 2012, it is estimated at around 12 %.

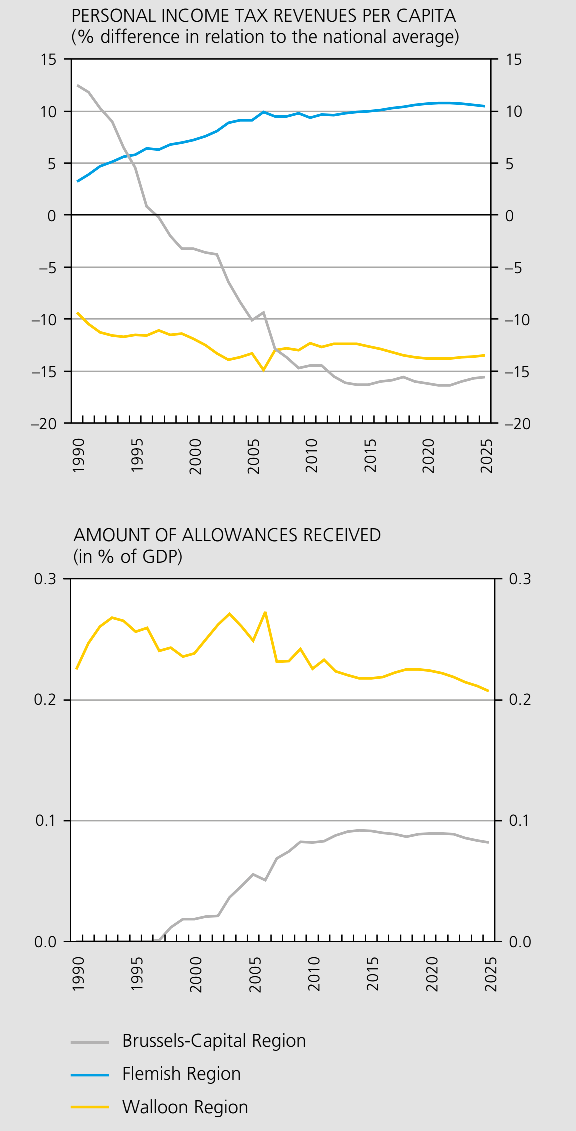
In the Brussels-Capital Region, personal income tax per capita has fallen sharply in relative terms. While the level of personal income tax revenues per capita there was still 12 % above the national average in 1990, that positive gap narrowed steadily and changed to a negative gap. That gap then widened to over 15 % in 2012. The Brussels-Capital Region has therefore qualified for a solidarity allowance since 1997, and the amount of it has risen rapidly, too, on account of the particularly strong population growth in that Region.

The increase in the ratio between the solidarity allowance and GDP is therefore due mainly to the addition of the Brussels-Capital Region as a recipient and the rapid increase in the amount paid to that Region.

In the future, according to the reference scenario, the negative gaps in the personal income tax per capita in relation to the national average could continue to widen slightly, both in the Walloon Region and in the Brussels-Capital Region. However, the solidarity allowances paid to each of those two Regions should decline as a percentage of GDP, since the allowances are not linked to the volume of economic activity.

The solidarity allowance mechanism has attracted criticism, notably from the academic world[1]. It has the perverse effect that an improvement in the relative economic situation in a Region receiving this allowance is liable to lead to a reduction in its revenues. In fact, the loss of revenue by way of the solidarity allowance would be greater for the Region than the positive effects of a better key for the allocation of the personal income tax resources. However, that argument is only valid if these two elements of regional finances are considered on their own, excluding other regional revenues, Community funding – in which part of the grants is also allocated according to the proceeds from personal income tax – and municipal funding which depends very much on the additional percentages charged on personal income tax. Moreover, even if the comparison is confined to regional finances, the perverse effect would eventually weaken over time until it disappeared, since the initial amount of the personal income tax revenues allocated to the Regions moves in line with GDP, whereas the solidarity allowance is only indexed and linked to the population.

CHART 6 SOLIDARITY ALLOWANCE



Sources: FPB, State revenue and resources budgets, NBB.
(1) The proceeds from personal income tax used for the calculations for a year (t) correspond to those recorded for the previous tax year and therefore to the revenue from tax due on income earned in t–2.

2.3 Reasons for revising the Finance Act

The revision of the Finance Act was on the State reform agenda for two main reasons. First, it was necessary to define the mechanisms for funding the new powers devolved to the Communities and Regions. Second, there were calls from various political parties on both sides of the language divide, demanding changes to certain facets of the Finance Act.

The agreement reached on the Finance Act adhered to a number of principles which had been set in the summer of 2010. The aim was to increase the financial autonomy of the federated entities, notably by significantly boosting their own revenues. However, the greater fiscal autonomy desired in regard to personal income tax had to meet three requirements, namely to avoid unfair competition,

(1) Cf. in particular Cattoir and Verdonck (2002), Algoed and Heremans (2008), Chaidron *et al.* (2009), Leibfritz (2009), Verdonck *et al.* (2009) and Heremans *et al.* (2010).

maintain the progressive character of the tax, and maintain the fiscal prerogatives of the federal government regarding the inter-personal redistribution policy. The strengthening of the financial autonomy of the federated entities was also to entail their assumption of increased responsibility in relation to their powers and the policy which they pursue.

Other principles were intended to ensure a balanced agreement. Thus, the issues at stake simultaneously concerned avoiding the structural impoverishment of one or more federated entities, guaranteeing the long-term viability of the federal State, and ensuring the financial stabilisation of the entities. In a deteriorated overall fiscal context, another principle stated that account must be taken of the efforts which all the entities must make in order to consolidate public finances.

Some specific features of the Finance Act also needed revising. The Brussels-Capital Region was to be refinanced with due regard for externalities, such as inter-regional commuter flows, and the sociological reality and specific role of that Region as the capital of Belgium and of the EU. A solidarity mechanism was to be maintained between the entities, but it must be free of any perverse effects. Finally, in the revision of the Finance Act, it was agreed to take account of criteria concerning population and pupils. For example, there is implicit reference to the use of demographic criteria for allocating the resources relating to the new powers devolved to the Communities and the Community Commissions. In addition, greater importance was attached to the pupil criterion for allocating the transferred VAT resources originally intended to fund the principal competence of the Communities, namely education.

TABLE 2 TRANSFER OF POWERS TO THE COMMUNITIES AND REGIONS

	Amounts[1] (in € billion)	In % of GDP
To the Communities and Community Commissions	10.2	2.8
Family allowances	5.9	1.6
Health care and social support	4.2	1.1
of which:		
Accommodation facilities for the elderly	2.5	0.7
Support allowances for elderly persons	0.5	0.1
Other powers	0.1	0.0
To the Regions	6.0	1.6
Labour market	3.8	1.0
of which:		
Reductions in revenues	1.3	0.3
Tax expenditure	1.9	0.5
Other powers	0.2	0.1
Total	**16.2**	**4.4**

Source: Agreement on the State reform, NAI, NBB.

(1) These are the amounts mentioned in the agreement on the State reform, excluding the drawing rights for the funding of programmes for getting the unemployed back to work, since those rights were already the subject of a federal grant to the Regions, while the Participation Fund expenditure is not included since, in the national accounts, that Fund does not come under the general government sector. Most of the estimates concern the year 2011, but – depending on the subject – these amounts may relate to other years. In any case, they precede the implementation of substantial cuts in the federal budget for 2012, particularly regarding the tax deduction for energy-saving investment.

3. Transfer of powers

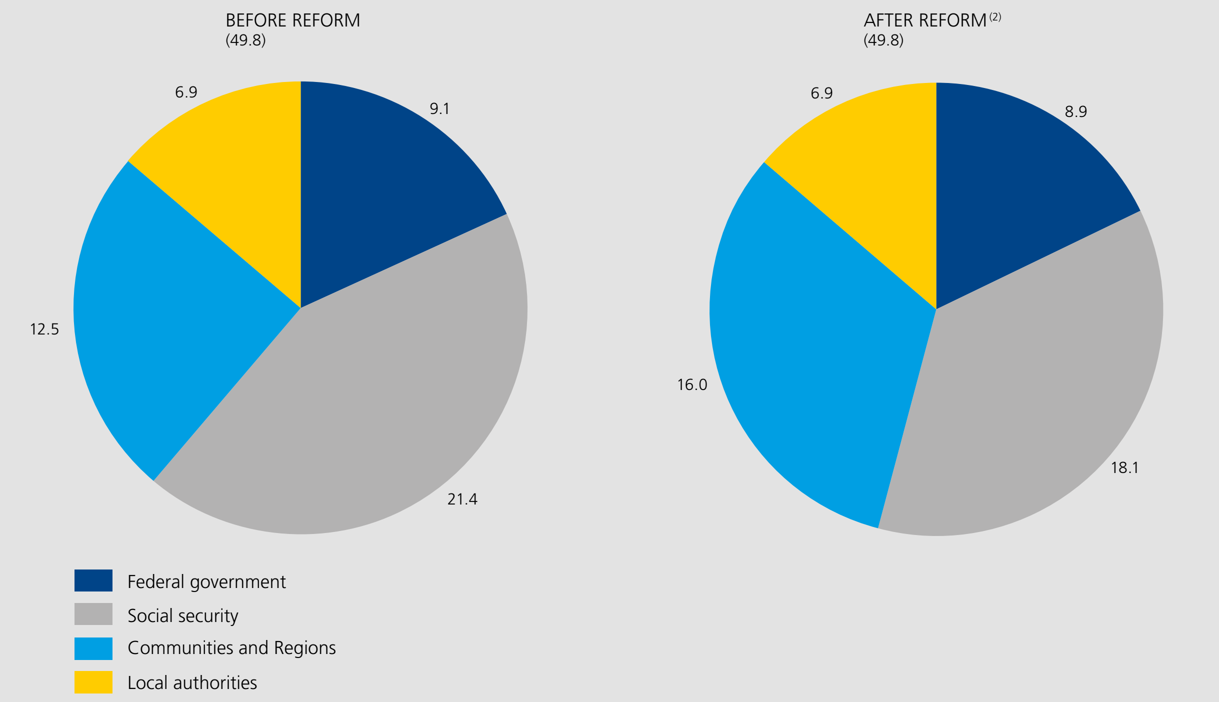
The State reform implies an additional transfer of powers accompanied by budget resources from Entity I, comprising the federal government and social security, to the Communities and Regions. For 2011, the size of this transfer of new powers can be estimated at around € 16.2 billion, or 4.4 % of GDP. More powers were transferred to the Communities – including the Community Commissions in the case of Brussels – than to the Regions.

The majority of the resources transferred to the Communities and the Community Commissions concerns family allowances. A substantial amount is also provided for health care and social support, including the health care provided for the elderly, essentially accommodation facilities such as retirement homes, retirement and care homes, and separate geriatric hospitals, and support allowances for elderly persons. The other expenditure on health care and social support comprises hospital infrastructures, mental health services, preventive medicine and the organisation of front-line health care. Most of these powers concern expenditure which currently comes under social security. Expenditure relating to other powers, notably in the sphere of justice, has also been transferred to the Communities.

In regard to the Regions, the main item transferred – from the point of view of the budget – concerns the labour market. These transfers originate from both the federal government and social security. A significant proportion of these powers relates to revenue rather than expenditure. This primarily concerns reductions in certain social security contributions. Another important power transferred to the Regions concerns tax expenditure, which is effectively a reduction in revenues. The main tax expenditure concerns housing (own-home allowance, tax relief for home savings, and additional deduction for mortgage interest), energy-saving investment and the use of service

GRAPHIQUE 7 FINAL PRIMARY EXPENDITURE OF THE GENERAL GOVERNMENT SUB-SECTORS (1)

(in % of GDP, estimate based on 2011 figures)



Sources : Agreement on the State reform, NAI, NBB.
(1) Not including transfers between general government sub-sectors so that only final expenditure is considered.
(2) Excluding powers transferred on the revenue side (tax expenditure and reductions in social security contributions).

vouchers. Finally, miscellaneous other transfers concern small amounts.

All of these transfers of fiscal powers mean a significant change in the relative weight of the general government sub-sectors. On the basis of the 2011 figures, if the reform had been implemented, the primary expenditure of the Communities and Regions would have risen from 12.5 to 16 % of GDP. The additional 3.5 percentage points would have come almost exclusively from social security expenditure, which would have fallen from 21.4 to 18.1 % of GDP. The federal government's primary expenditure would be down only slightly, from 9.1 to 8.9 % of GDP. This is the first time that such significant powers have been transferred from social security.

4. Revision of the Finance Act

The financial aspects of the agreement on the State reform concerns the mechanisms of the Finance Act, the terms of the fiscal autonomy of the Regions, and the refinancing of the Brussels institutions. Some of the Finance Act variables, such as the reference amounts for the transfers of powers and their variation parameters, have yet to be set following the debate on the consolidation of public finances, which is to restore a balanced budget in Belgium by 2015. The situation of the German-speaking Community requires a specific review.

The ensuing sub-sections will review the new funding mechanisms of the Regions and Communities respectively. Two specific aspects will then be analysed, namely the refinancing of the Brussels institutions and the contribution giving the federated entities more responsibility for the pensions of their permanent staff.

4.1 Revision of regional funding

4.1.1 Overview

For the Regions, one of the main changes resulting from the agreement on the Finance Act concerns their increased fiscal autonomy. Thus, they can levy 'extended' additional percentages on the personal income tax federal revenues. In the future, those additional percentages will constitute the principal revenue of the Regions. They will replace the basic personal income tax grant and the bulk of the negative term, and will provide part of the funding for the transferred tax expenditure.

Most of the transferred tax expenditure and new powers concerning employment attract additional resources shared between the Regions on the basis of a fiscal key.

A national solidarity allowance is retained, but the details are adjusted to eliminate the perverse effects.

Apart from these revenues, a very small number of other grants remain unchanged [1]. Regional taxes and levies are also unchanged.

Taking account of all the changes to the method of regional funding, some entities would receive fewer resources under the new system than under the old one. There is a transitional mechanism to ensure that no entity gains or loses at the time of the switch from the old law to the new one. The amount of the transitional mechanism is held constant in nominal terms for ten years. It is then reduced in a straight line for the following ten years until it disappears.

There is an exception for certain elements, in that the transitional mechanism does not compensate for them, so that they exert an immediate budgetary effect on relations between the federated entities and the federal government. This concerns the refinancing of the Brussels institutions and two specific mechanisms for the transfer of responsibility, the first concerning pensions and the second climate [2]. If a Region exceeds its target for greenhouse gas emissions for buildings, it receives a financial bonus charged to the federal share in the auction of emission quotas. Conversely, if a Region fails to meet its target it must pay a penalty.

4.1.2 Extension of fiscal autonomy

The agreement on the State reform considerably increases the fiscal powers and autonomy of the Regions in regard to personal income tax. We shall begin by examining the degree to which fiscal autonomy has been extended before explaining the detailed arrangements and the limits of the fiscal autonomy. Finally, we shall mention a crucial budgetary issue raised by fiscal autonomy, namely elasticity gains.

4.1.2.1 Scale of the fiscal autonomy

The fiscal autonomy concerns a sum of € 10.7 billion in 2012, or around a quarter of the personal income tax revenues collected in Belgium. That sum corresponds to the old basic personal income tax grant, estimated at € 14.3 billion, reduced by the major part [3] of the negative term (€ 4.3 billion) and increased by 40 % of the transferred tax expenditure. Since the latter amounts to around € 1.9 billion, that 40 % represents roughly € 0.8 billion.

The increased fiscal autonomy in relation to personal income tax is additional to the autonomy already existing as a result of successive institutional reforms. For each Region, the scale of the fiscal autonomy – whether it relates to personal income tax or other taxes – can be measured by the share of the total revenues represented by the Region’s own tax revenues, defined as regional taxes, certain regional levies and the personal income tax additional percentages or reductions. Before the revision of the Finance Act, fiscal autonomy for the year 2012 amounted to 38.5 % in the Walloon Region, 43.5 % in the Flemish Region and 51 % in the Brussels-Capital Region.

Following the reform, taking account of the resources transferred to cover the new powers, the share of own tax revenues – including fiscal autonomy relating to personal income tax – in the total revenues considered increases to 66.1 % in the Walloon Region, 68.1 % in the Brussels-Capital Region and 78.4 % in the Flemish Region.

4.1.2.2 Detailed rules on fiscal autonomy

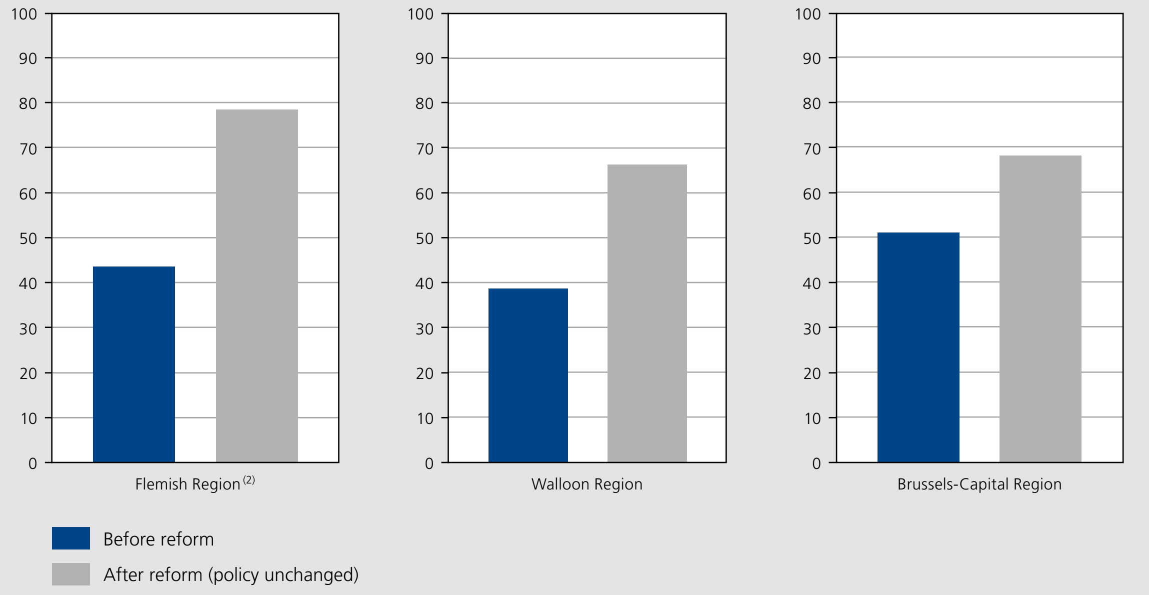
In practice, the increased fiscal autonomy is granted in the form of ‘extended’ regional additional percentages on personal income tax revenues. Those additional percentages are levied on the tax retained at federal level, after deduction of the amount covered by fiscal autonomy. Box 1 gives a broad outline of this new system.

The regional additional percentages apply to the tax according to the tax scales, after taking account of the tax-free allowance – including the supplementary allowance for dependants – and tax relief on replacement incomes and incomes of foreign origin. Applying the additional percentages at a fairly low level in the calculation of the tax means that the yields between Regions are similar to

(1) These grants concern additional resources made available under previous revisions of the Finance Act (1993 for agriculture and 2002 for a series of powers having a minor budgetary impact) and certain grants specific to Brussels, created by the Lambermont Agreement (such as the one for the municipalities with at least one Dutch speaker on the municipal board and the one for the single-language Community Commissions).
(2) The details of this mechanism have yet to be devised and will be defined by an ordinary law, to be adopted at the same time as the Finance Act.
(3) A small part is not subtracted in determining the amount for which fiscal autonomy applies. It forms the residue of the negative term. These amounts are no longer included separately and therefore come under the transitional mechanism.

CHART 8 SHARE OF OWN TAX REVENUES IN THE TOTAL RESOURCES OF THE REGIONS (1)

(on the basis of estimated figures for 2012, in %)



Sources: FPB, State revenue and resources budgets, NBB.

(1) The resources considered in the analysis include the own tax revenues, the transferred resources derived from personal income tax and VAT, and other federal grants. The new resources to be transferred following the sixth phase of the State reform are also taken into account.

(2) In the case of the Flemish Community (taking the Region and the Community together), the share of own tax revenues will rise from 20.3 to 34.4 %.

those obtained on the basis of the key for the proceeds of personal income tax. Compared to the key for the personal income tax base, this key allocates almost 2 % more to the Flemish Region and around 2 % less to the Walloon Region. This difference is due to various factors. First, since the average income is higher in the Flemish Region, the tax collected in that Region is greater owing to the progressive character of the tax. Next, the tax relief on replacement incomes affects the Walloon Region more than the Flemish Region, particularly in view of the higher unemployment rate. Finally, proportionately more residents of the Walloon Region than the Flemish Region receive incomes of foreign origin, particularly incomes from transfrontier work.

TABLE 3 REGIONAL ALLOCATION KEYS FOR VARIABLES RELATING TO PERSONAL INCOME TAX

(estimated amounts with no change of policy for the 2012 income year, in %)

	Flemish Region	Walloon Region	Brussels-Capital Region
Extended regional additional percentages	63.3	28.2	8.5
Personal income tax proceeds (1)	63.2	28.1	8.7
Personal income tax base	61.4	30.2	8.4

Sources: FPB, NBB.

(1) Excluding municipal additional percentages.

The agreement puts down some markers defining fiscal autonomy. The federal government retains exclusive competence to determine the tax base and the payroll tax, and to collect the tax. It is also free to set the tax rates. The federal government exercises all these rights without the Regions being able to invoke any conflict of interests. To preserve the strictly federal character of the tax base, the transferred tax expenditure is – or will become – a set of instruments affecting the tax due, and not the tax base. Therefore, for example, the own-home allowance is to be converted to tax relief in the same way as that for home savings. The aim is thus to avoid any interference between regional policies and federal policy.

For their part, the Regions will in future be able to levy proportional general additional percentages, and grant fixed-rate or proportional general reductions – without

Box 1 – Practical arrangements concerning the extended additional percentages on personal income tax revenues

The operation of the new system is illustrated by the simplified example of a single person with no dependants, with a taxable income of € 30 000 in 2011, not qualifying for any tax relief or special tax deductions.

On the basis of the tax rates and taxable income bands in the 2012 tax year, under the current system the person would have to pay € 9 350 in tax, taking account of basic tax of € 10 992 and a tax-free allowance of € 1 643, i.e. 25 % of total tax-free income (€ 6 570).

To illustrate the new system, the formula for allocation between the federal government and the Regions is taken as 75 %-25 %. In that case, to maintain the tax burden and tax revenues unchanged overall, an additional 33.3 % would need to be levied on the federal tax cut by a quarter.

Under the new system, each of the tax bands is cut by a quarter. The basic federal tax in the example comes to € 8 244, i.e. three-quarters of the tax levied by the federal government under the current system. The reform allows the Regions to subdivide this basic federal tax into bands as they wish, and for each of those bands the Regions are free to decide the additional percentage to be levied, but the basic federal tax – cut by a quarter – remains unchanged.

Next, federal tax relief is calculated, corresponding to the tax-free allowance, the extra tax-free allowance for dependants, and the tax relief on replacement incomes. The amount of this federal tax relief is subtracted from the basic federal tax calculated according to the taxable income, beginning with the lowest tax bands. In the example

CALCULATION OF THE PERSONAL INCOME TAX BEFORE AND AFTER REGIONALISATION FOR A SINGLE PERSON WITH A TAXABLE INCOME OF € 30 000

(tax year 2012 ; in € unless otherwise stated)

Taxable income bands	Marginal rate (in %)	Tax accruing to the federal government			Tax accruing to the Regions	Total tax
		Basic tax	Tax-free allowance	Federal tax excluding allowance		
Current system (before regionalisation)						
0 – 8 070	25	2 018	1 643	375		375
8 070 – 11 480	30	1 023	0	1 023		1 023
11 480 – 19 130	40	3 060	0	3 060		3 060
19 130 – 35 060	45	4 892	0	4 492		4 492
Total		**10 992**	**1 643**	**9 350**		**9 350**
New system (after regionalisation, with no change of policy, with application of uniform 33.3 % regional additional percentages)						
0 – 8 070	25	1 513	1 232	281	94	375
8 070 – 11 480	30	767	0	767	256	1 023
11 480 – 19 130	40	2 295	0	2 295	765	3 060
19 130 – 35 060	45	3 669	0	3 669	1 223	4 892
Total		**8 244**	**1 232**	**7 012**	**2 338**	**9 350**

given here, only the tax-free allowance is taken into account. That allowance, also cut by a quarter, is subtracted from the lowest tax band. It is thus equivalent to € 1 232, or likewise 25 % less than the relief calculated under the current system.

Overall, the single person considered would therefore have to pay tax of € 7 012 in favour of the federal government, or 25 % less than under the current system.

If the Region where the single person in the fictitious example lives levies an additional 33.3 % on the federal tax in each of the tax bands, the single person will have to pay € 2 338 in favour of the Region, so that the total payable in tax, taking all levels of power together, will be € 9 350, as under the current system. If there is no change of policy, the new system is therefore neutral for taxpayers.

The simplified example takes no account of certain incomes or certain tax relief. Under the new system, the tax relief on incomes of foreign origin will be imputed proportionately. The regional additional percentages will also apply to certain incomes which are taxable separately, except for income from movable property and some miscellaneous incomes such as taxable capital gains, which remain within the exclusive competence of the federal government. Furthermore, for these incomes there will be a uniform, single additional percentage rate, in that there will be no differentiation between bands and a single rate will apply whatever the federal tax rate on that income.

any limits – and refundable tax credits in their sphere of competence. They are also free to decide their tax bands and the rate of the additional percentage per band without constraints where it is a matter of making the system more progressive, but with two restrictions if the system is being made more regressive. First, the regional surcharge on a tax band cannot be less than 90 % of the highest surcharge on the lower tax bands. Second, the concession per taxpayer cannot exceed an indexed figure of € 1 000 per annum.

4.1.2.3 Elasticity gains

As already explained in Section 1.4, if the tax laws remain unchanged, personal income tax revenues will rise faster than GDP. The resulting revenue differential is often referred to as "personal income tax elasticity gains". Under the current Finance Act, the federal government benefits from these gains. In fact, the resources derived from personal income tax which it transfers to the Regions are linked only to the change in GDP. In future, the Regions will benefit from these gains to the extent of the amount of the personal income tax revenues covered by fiscal autonomy. To compensate for the resulting loss of revenues for the federal government, the new regional grant – essentially covering the resources for employment and transferred tax expenditure – will only be 70 % linked to real GDP growth.

No one can be sure about the net effect resulting from the interplay between, on the one hand, this incomplete link between the new regional grant and economic growth, and on the other hand, the elasticity gains for the Regions amounting to the extent of their fiscal autonomy. It is in fact difficult to predict accurately the extent to which personal income tax revenues will grow faster than GDP. Moreover, the elasticity gains are based on the assumption that there is no change in the law, and that implies an increase in the tax pressure. Yet the tax laws could be changed between now and 2025, and that might affect the outcome *ex post*.

4.1.3 Funding the new regional powers

Since 40 % of the resources necessary to cover the tax expenditure are included in the regional fiscal autonomy relating to personal income tax, the remaining 60 %, like the 90 % of the resources needed to exercise the powers relating to employment, are provided for the Regions in the form of a new grant for the transferred powers. In the case of employment, the amount in question (€5.3 billion in 2012) also includes the drawing rights which were already transferred to the Regions in the form of a special grant (€0.5 billion). The transitional mechanism covers the other 10 %.

The new grant will be adjusted in line with inflation and 70 % of real GDP growth. This grant is allocated according to the key concerning the personal income tax retained at federal level, i.e. the personal income tax collected by the federal government from which is deducted the part over which the Regions have fiscal autonomy. That deduction is intended to ensure that a Region's resources are not affected by the fiscal policies chosen by the other Regions, more specifically by the exercise of their fiscal autonomy. In 2012, the key concerning the personal income tax retained at federal level would allocate 63.5 % of the resources to the Flemish Region, 28 % to the Walloon Region and 8.5 % to the Brussels-Capital Region.

In regard to the other powers, which have less impact on the budget, the institutional agreement is still relatively vague. It is a question of one or more specific grants. The adjustments to those grants have yet to be determined. The grants will be allocated according to "usage" keys and hence according to need.

4.1.4 Revision of the solidarity allowance

A national solidarity allowance has been retained. As before, this concerns a vertical transfer in the form of a grant from the federal government to the Regions where the personal income tax per capita is below the national average.

However, the details concerning the allowance have been revised. The amount due to the recipient Regions under the new mechanism is determined by the following formula : 80 % x (db – dpb) x V. In this formula, db represents the Region's share in the population of Belgium, and dpb is the Region's share in the personal income tax retained at federal level. V is the basic amount taken into account for calculating the solidarity allowance. That basic amount is equal to the whole amount covered by fiscal autonomy and all or part of the regional and community grants allocated according to a fiscal key. In 2012, that would correspond to € 20.1 billion, or the € 10.7 billion covered by regional fiscal autonomy relating to personal income tax, € 5.3 billion of the new regional grant shared according to a fiscal key (labour market and tax expenditure), and 50 % of the € 8.2 billion grant paid to the Communities and allocated according to a fiscal key.

Consequently, the allowance now only compensates for 80 % of the gap between a Region's share in the population and its share in the personal income tax retained at federal level, but the basic amount now includes both regional and community resources. In 2012, the new mechanism leads to a solidarity allowance which is lower than the old one. Conversely, the basic amount will increase not only with inflation, as under the old system, but also with real economic growth.

4.2 Revision of the funding of the Communities

4.2.1 General

In order to exercise their new powers, the Communities are being allocated additional resources in the form of grants. These grants are allocated on the basis of demographic keys depending on the nature of the power in question (cf. 4.2.2.).

The resources available to the Communities for their old powers are restructured. They comprise a grant allocated according to the number of pupils attending French-language and Dutch-language schools, plus a grant allocated according to a fiscal key (cf. 4.2.3.).

The other federal grants are unchanged. They concern funding for foreign students and inter-university cooperation.

As in the case of the Regions, a transitional mechanism is provided to ensure that no entity loses resources at the time of the switch to the new Finance Act, and the mechanism giving the Communities more responsibility for pensions is strengthened.

4.2.2 Financing the new powers

The basic amounts for the three main new powers transferred to the Communities, namely family allowances, various matters relating to elderly persons, and other powers transferred in regard to health care and social support, are determined on the basis of the resources granted by the federal government. For 2012, the total amount concerned is estimated at € 10.6 billion.

The basic amounts are then shared among the entities on the basis of demographic keys. Once these resources have been shared out, they follow their own dynamics within each entity. The entities concerned vary slightly according to the subject. The Flemish and French Communities are always involved, but in the case of the Brussels-Capital Region, the transfer always takes place via the Joint Community Commission, the French and Flemish Community Commissions also share competence for matters concerning the elderly. The German-speaking Community is mentioned in the agreement on the State reform in regard to the transfer of family allowances.

The resources for family allowances are allocated according to the population aged from 0 to 18 years in each entity. Those concerning the elderly are allocated on the basis of the population over the age of 80 years. The resources to cover the other aspects of health care and social support are allocated between the entities in proportion to the total population.

Apart from inflation, the criteria for adjusting the resources to cover the new Community powers vary from case to case. The finance for family allowances only tracks the movement in the population aged from 0 to 18 years in the various entities, but part of the "welfare" budget may also permit an adjustment in real terms for resources devoted to this type of social benefit. The funding of responsibilities relating to the elderly is adjusted both according to the change in the population aged over 80 years in each entity and 82.5 % of real GDP growth per capita at national level. The resources allocated to other health care and social support are adjusted in line with 82.5 % of real GDP growth. The agreement on the State reform presents the restriction of the link to growth to 82.5 % as a form of contribution by the federated entities to the cost of ageing.

Finally, in the case of the other powers transferred to the Communities, notably those concerning justice, the resources will be allocated on the basis of "usage" keys. The criteria for adjusting these resources are yet to be determined.

4.2.3 Funding of the old powers

The old powers – the main one in terms of budgetary importance being education – are funded essentially by a new grant allocated according to the number of pupils aged between 6 and 17 years, attending French-language and Dutch-language schools. That criterion was used to share out the resources of the old basic VAT grant, i.e. the part of these revenues allocated which existed before the Lambermont Agreement. That allocation criterion now applies to this new grant which includes two other elements, as well as the old basic VAT grant. The first element is the "link to economic growth" element of the additional resources over the period 2010-2012 under the Lambermont Agreement. The second is the compensatory grant for the radio & television licence fee which used to form part of the allocated personal income tax revenues.

The new grant is estimated at around € 13.8 billion in 2012. While the old basic VAT grant was not linked to economic growth, the new grant, allocated according to the number of pupils, is linked to growth. As used to be the case for the VAT grant as a whole, the new grant is indexed and linked to 91 % of real GDP growth. The link to population is still limited to 80 % and based on the Community with the fastest expanding population under the age of 18 years since 1988.

Alongside the grants based on demographic keys, there is still a grant allocated according to a fiscal key. The allocation key here is again the proceeds from personal income tax retained at federal level. In regard to the proceeds from personal income tax collected in the Brussels-Capital Region, the institutional formula used previously is unchanged. It allocates 80 % of those proceeds to the French Community and 20 % to the Flemish Community. That grant comprises not only the resources derived from personal income tax but also the additional resources derived from VAT, granted under the Lambermont Agreement, except for the element now included in the grant allocated according to the pupil key. In other words, the additional resources derived from VAT and transferred to the grant allocated according to a fiscal key are the flat-rate annual increases and the share of the link to economic growth over the period 2007-2010. The grant allocated according to a fiscal key, estimated at € 8.2 billion in 2012, will be adjusted according to inflation and 82.5 % of real GDP growth.

One of the innovations concerning the funding of the old Community powers therefore consists in the termination of the "Lambermont turbo". From now on, the old basic VAT grant and the additional resources essentially form part of two separate grants largely linked to economic growth, the first allocated according to the pupil key and the second according to the key concerning the personal income tax retained at federal level.

4.3 Refinancing of the Brussels institutions

There is provision for refinancing the Brussels institutions to the tune of € 461 million by 2015. Several mechanisms have been introduced, concerning either the Brussels-Capital Region, or the Community Commissions or the municipalities in the Brussels-Capital Region. Each mechanism has its own rationale and its own dynamics, but the agreement concerns the figures for 2015, rather than the mechanisms.

By 2015, the Brussels-Capital Region, the municipalities in that Region and the French and Flemish Community Commissions will receive refinancing amounting respectively to € 363, € 58 and € 40 million. In addition, as was assumed in the projection with no change of policy, the amounts currently allocated to Beliris (€125 million) are confirmed.

TABLE 4 REFINANCING OF THE BRUSSELS INSTITUTIONS
(in € million)

	2012	2013	2014	2015
Part applicable from 2012	134	175	217	258
Amounts allocated	110	151	192	233
of which:				
Security (municipalities)	30	30	30	30
Language premiums (municipalities)	25	26	27	28
Mobility	45	75	105	135
Community Commissions	10	20	30	40
Amount not allocated (mortmain)	24	24	25	25
Finance Act part (1) (amounts not allocated)	0	61	129	203
Compensation for commuters (2)	0	13	28	44
Compensation for employees of international institutions	0	48	101	159
Total	**134**	**236**	**346**	**461**
of which:				
Amounts allocated	110	151	192	233
Amounts not allocated	24	85	154	228

Source: Agreement on the State reform.
(1) Assuming the Finance Act enters into force in 2012, this part applies from 2013 to prevent the effects of refinancing being negated by the transitional mechanism.
(2) Since this compensation is horizontal, it is not charged to the federal government but to the other Regions.

The refinancing of the Brussels institutions is in two parts. The first should enter into force in 2012 pursuant to a special law which will also modify various aspects of the organisation of the Brussels-Capital Region and its periphery. The 2012 budgets of the federal government and the Brussels-Capital Region take account of this refinancing. The second part would come into force with the new Finance Act.

4.3.1 Part applicable from 2012

For the first part, the only refinancing mechanism in which the amount is not allocated to a specific need is the increase in the compensation for the "mortmain". This concerns the exemption from withholding tax on income from immovable property, applicable to certain buildings belonging to public legal entities. The resulting shortfall for the municipalities is compensated by the federal government. This particularly affects the municipalities of the Brussels-Capital Region owing to its status as a capital city and the high concentration of national and international organisations in its territory. In the 1989 Finance Act, for these municipalities, the mortmain compensation has been transferred to the Region. Under the revision of the Finance Act, the refinancing in relation to mortmain consists in increasing the compensation from 72 to 100 % and extending it.

Four other mechanisms for the refinancing of the Brussels institutions consist in granting amounts earmarked for a predetermined expenditure item. The only mechanism benefiting the Brussels-Capital Region is a new mobility policy grant paid directly by the federal government, intended particularly for public transport. Another mechanism aims to boost the resources of the single-language Community Commissions. The special grant which has existed since the Lambermont Agreement is increased in a linear fashion over four years from 2012. That grant is still allocated on the basis of 80 % for the French Community Commission and 20 % for the Flemish Community Commission. The last two mechanisms benefit the municipalities. This respectively concerns a "language premium" grant and a supplementary appropriation granted to the Fund for the financing of expenditure relating to security, resulting from the organisation of European summits.

4.3.2 Part implemented by the new Finance Act

The second part enters into force in the year following the introduction of the new law, so that the effects of this refinancing are not negated by the transitional mechanism guaranteeing that, in the first year, no entity is a winner or loser.

This part first consists of an adjustment for commuters. The idea is that many commuters living in the Flemish Region or the Walloon Region use public services in Brussels without the Brussels-Capital Region receiving any financial support so far, since personal income tax is calculated on the basis of the household's place of residence, not the place of work. In future, the Brussels-Capital Region will therefore receive a grant which will make up for part of this shortfall. Since the compensation for commuters is a horizontal mechanism, the revenues accruing to the Brussels-Capital Region will come from the other Regions rather than from the federal government. The total cost of the refinancing of the Brussels institutions borne by the federal government is therefore the total minus the compensation for commuters.

This second part also comprises a mechanism to compensate for the fact that regional taxes have not been collected from employees of international institutions such as the EU or NATO. There are proportionately greater numbers of those workers in the Brussels-Capital Region than in the other two Regions of the country. Their wage bill represents 15.4 % of the tax base of the Brussels-Capital Region, compared to barely 0.7 % in the Flemish Region or the Walloon Region. The grant will apply only to the higher proportion of international officials in the tax base of the Brussels-Capital Region than in the other two Regions.

After 2015, the agreement on the State reform provides for the refinancing to be capped at 0.1 % of GDP but only in the case of the Brussels-Capital Region, i.e. excluding the municipalities and the Community Commissions. In order to respect that constraint, the agreement comprises a number of brakes on the growth of the mechanisms described above. Thus, the resources allocated to the two mechanisms of the part relating to the Finance Act, i.e. those compensating for the effect of commuters and employees of international institutions, will be frozen in nominal terms, the "mobility" grant will be linked to inflation and only 50 % of real GDP growth, and – as in the reference scenario with an unchanged institutional framework – the mortmain grant will continue to be indexed only.

4.4 Contribution of the federated entities to the budgetary cost of ageing

The institutional debates took place against the backdrop of a Belgian general government deficit that was deemed excessive according to the European rules. In 2011, the deficit was located primarily at federal level, while the Communities and Regions as a whole recorded only a slightly negative balance. Moreover, since the bulk of the budgetary costs of population ageing are still in the future and will mainly affect the federal government and social security, the State reform agreement provides for two mechanisms whereby the federated entities will share in the effort to consolidate general government finances. The agreement targets the two sectors coming under the federated entities which are most directly affected by the lengthening life expectancy, namely the powers transferred under the institutional reform and relating to elderly persons, and the pensions for their civil servants.

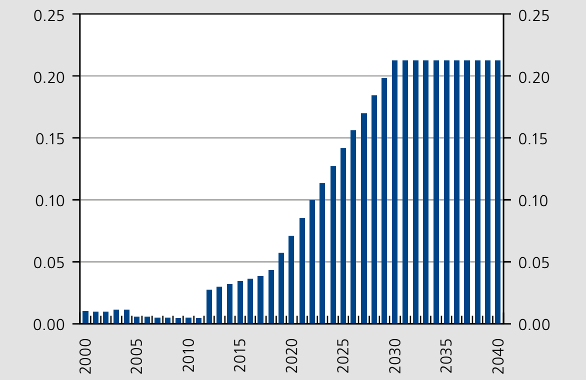
Regarding support and health care for the elderly, the participation of the Communities – or the Community Commissions in the case of Brussels – results from the application of a partial link between the corresponding grant and economic growth. The grant is adjusted according to the number of persons over the age of 80 years in each entity, inflation and 82.5 % of real GDP growth per capita. The same applies to the other transferred powers relating to health care and social support, for which the resources are linked to inflation and 82.5 % of real GDP growth.

The pension costs of Communities' and Regions' civil servants are borne by the federal State. Since 1994, there has been a mechanism for sharing responsibility, to ensure that the federated entities contribute to the cost of these pensions. However, the federated entities' contribution to the payment of pensions for their permanent staff was particularly small. The special law of 5 May 2003 introducing a new method of calculating the responsibility contribution due from certain public sector employers provided for increasing that contribution, but the new mechanisms were never applied. Under the State reform agreement, the mechanisms will enter into force in 2012. The 2012 federal budget includes the corresponding amounts. The State reform agreement also introduces a new mechanism from 2016, whereby the federated entities pay the federal government a contribution towards the salaries of their permanent staff : by 2030, that will match the rate applicable to contract workers, currently 8.86 %. From 2016, the contribution collected will be the higher of the two : the one resulting from application of the special law of 5 May 2003 or the one under the new mechanism. The new mechanism should supersede the old one fairly quickly.

The contribution of the federated entities concerning responsibility for pensions is set to increase steadily and accelerate from 2019. Up to 2018, it would be less than 0.05 % of GDP. In 2030, it would reach 0.21 % of GDP. The biggest contributions would always come from the Communities rather than the Regions, owing to their relatively larger wage bill due primarily to the presence of teaching staff.

CHART 9 CONTRIBUTION OF THE FEDERATED ENTITIES CONCERNING RESPONSIBILITY FOR PENSIONS (1)

(in % of GDP)



Sources: FPB, NAI, NBB.

(1) After 2030, the civil servants' wage bill is assumed to grow in line with GDP, and the contribution rate is held at 8.86 %.

It should be remembered that, since the mechanism concerning responsibility for pensions is separate from the transitional mechanism, it represents a transfer from the federated entities to the federal government from 2012.

5. Final remarks

The State reform agreement comprises the transfer of powers amounting to around 4.4 % of GDP. The transferred powers mostly come under social security rather than the federal government. This is the first time that substantial social security powers have been shifted. Moreover, the powers are transferred largely to the Communities and Community Commissions – institutions with no fiscal powers of their own – rather than to the Regions.

In view of the main aims and principles defined before the revision of the Finance Act, the fiscal autonomy of the Regions is increased in relation to personal income tax, but with certain limits, and if there is no change in the legislation, the federated entities should not be any poorer, thanks to the personal income tax elasticity gains. For their part, the Brussels institutions are refinanced. A solidarity allowance is maintained but it is adjusted. There is also provision for a transitional mechanism to neutralise the effects of the reform when it enters into force, and to limit the scale of its effects during the first decade.

As it stands, the agreement on State reform does not solve the issue of the various entities' participation in the necessary consolidation of Belgian public finances. Although the agreement includes an increased contribution from the federated entities towards the budgetary cost of ageing, the federal government and social security still bear most of the expenses associated with this demographic phenomenon. It is therefore important to determine the sharing of the consolidation efforts needed to restore a balanced budget in Belgium by 2015, to specify the arrangements for the participation by the federated entities and, in that connection – as stipulated by the agreement – to finally set certain Finance Act variables, such as the reference amounts for the transfer of powers and their variation parameters.

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