

Outlook for the finances of the Communities and Regions

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Introduction

The sixth State reform, finalised at legislative level at the beginning of the year, continues the reorganisation of Belgium's institutional structure, a process initiated in previous decades. During that period, reforms were implemented in 1970, 1980, 1988-1989, 1993 and 2001. As a result of the reforms, a growing number of powers were devolved from federal level to the Communities and Regions. Provision was also made for the resources needed to fund those powers. In accordance with the sixth phase of the State reform, powers amounting to € 18.7 billion (4.6% of GDP) will be transferred in 2015, the first full year in which the reform applies. The funding of the Communities and Regions is also being modified. In this connection, this government sub-sector is to contribute towards the consolidation of Belgian public finances. The State reform therefore has a significant influence on public finances, and more specifically on the allocation of revenue and expenditure among the various levels of power. This article examines how these changes will affect the finances of the Communities and Regions in the future.

The article is in five chapters. Chapter 1 gives an account of the finances of the Communities and Regions between 1995 and 2013. Chapter 2 goes into more detail on the institutional framework established by the sixth State

reform. Chapter 3 is devoted to the new budgetary framework of the Communities and Regions following the changes resulting from this reform and adjustments to the European governance framework. Chapter 4 contains projections for some of the variables in the budgets of the Communities and Regions, including the budget balance, taking account of the new institutional framework. Chapter 5 gives a broad outline of the government agreements of the four largest Communities and Regions for 2014-2019. The article ends with a number of conclusions.

1. Recent developments in the finances of the Communities and Regions

Chapter 1 of this article gives an account of the finances of the Communities and Regions since 1995⁽¹⁾. In that respect, it deals both with these entities as a whole and with the four largest ones – the Flemish Community, the French Community, the Walloon Region and the Brussels-Capital Region – taken separately. In 2013, these four entities represented 98.4% of the revenue and 98% of the primary expenditure of the Communities and Regions as a whole. We shall proceed to examine the budget balance first, followed by the debt ratio.

1.1 Budget balance

The budget balance of the Communities and Regions as a whole improved during the period 1995-2013, being converted from a deficit of 0.8% of GDP to a more or less balanced budget as a result of real average annual growth

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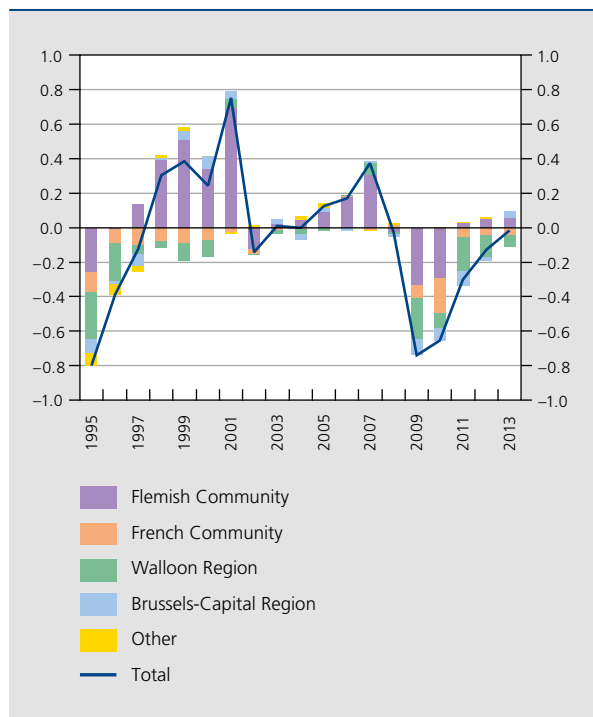
⁽¹⁾ The analysis presented in this article is based mainly on data from the National Accounts Institute relating to the April 2014 government accounts drawn up in accordance with the ESA 95 methodology. There is a break in the statistical series of those data in 2009 owing to an enlargement of the consolidation scope. On 30 September 2014, new government accounts were published in which the figures deviate from those in this article, partly because of methodological changes resulting from the switch to the ESA 2010.

of revenues (2.4 %) exceeding that of primary expenditure (2.1 %) ⁽¹⁾. Both revenues and primary expenditure growth outpaced real GDP growth, on average. The balance fluctuated as there were periods of gradual improvement interspersed with periods when the balance deteriorated sharply.

During the period 1995-2001, the balance improved considerably, changing from a deficit of 0.8 % of GDP into a surplus of 0.8 % of GDP, since the average revenue growth considerably outstripped the rise in primary expenditure (4 %, compared to 1.8 %). That improvement faltered against the background of the sharp cyclical downturn in 2001, and a deficit of 0.1 % of GDP was recorded in 2002. In the ensuing five years, the balance improved again, and a surplus of 0.4 % of GDP was achieved in 2007. However, it deteriorated again thereafter, mainly on account of the financial and economic crisis, and the result was a deficit of 0.7 % of GDP in 2009. Finally, from 2010, it improved again under the impetus of the consolidation programmes of the various regional and

(1) Since the interest charges of the Communities and Regions as a whole are modest, they had no decisive influence on the movement in the budget balance.

CHART 1 BUDGET BALANCE OF THE COMMUNITIES AND REGIONS (in % of GDP)

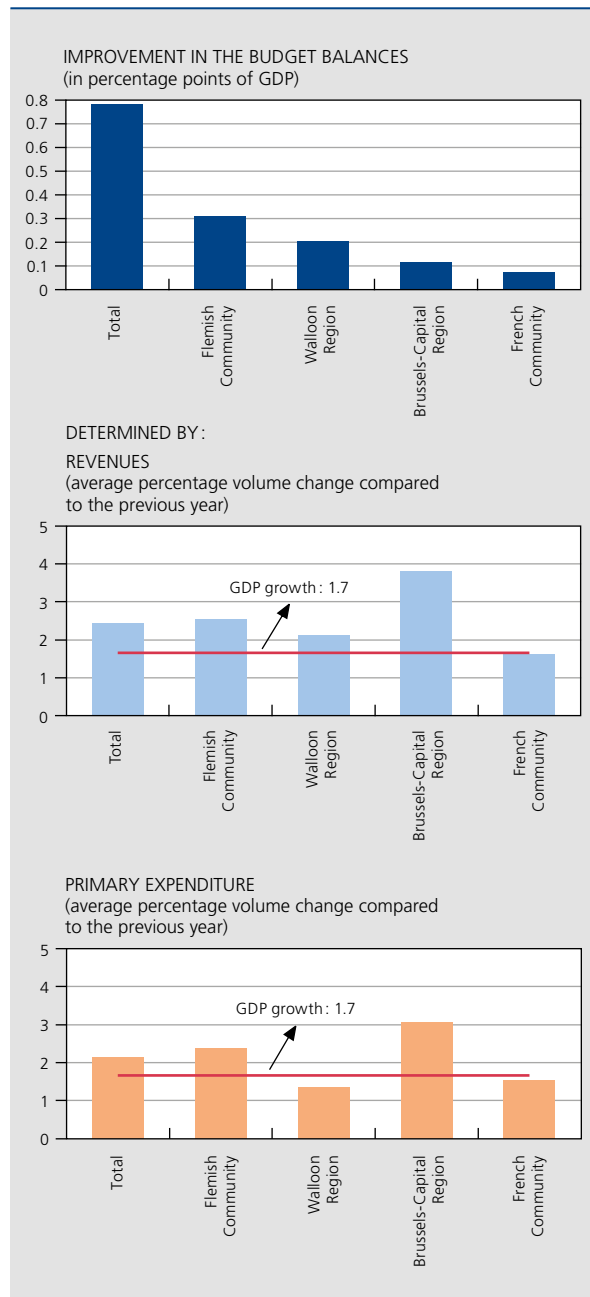


Sources: NAI, NBB.

community governments, so that the budget was more or less in balance in 2013.

During the period 1995-2013, the budget balance of the four largest Communities and Regions followed a pattern

CHART 2 DETERMINANTS OF THE MOVEMENT IN THE BUDGET BALANCE OF THE COMMUNITIES AND REGIONS DURING THE PERIOD 1995-2013 ⁽¹⁾



Sources: NAI, NBB.

(1) Two adjustments have been made to the data on revenues and primary expenditure to bring them more into line with the budgetary angle, more particularly as regards imputed social contributions and notional transfers from the federal government to the Communities and Regions for the payment of their staff pensions. The figures at constant prices are calculated by means of the GDP deflator.

fairly comparable to that of the overall balance. Over the period as a whole, all these entities saw an improvement in the balance. The Flemish Community and the Brussels-Capital Region recorded a small surplus in 2013, while the French Community and the Walloon Region ended with a small deficit. At the beginning of the period under review, all four were still in deficit. As in the case of the overall balance, the improvement in the case of the four entities taken separately was due to revenue growth outpacing the growth of primary expenditure. Also, the Flemish Community recorded a modest surplus on average for the entire period, as it had a substantial surplus in some years. Conversely, the other three entities recorded a deficit on average, though it was only small.

The substantial improvement in the budget balance of the Communities and Regions since 2010 is attributable largely to slower growth of primary expenditure, as the annual average increase dropped from 2.5% in the period 1996-2009 to 1% in the period 2010-2013. The consolidation efforts made by the various governments played a key role here. The resulting slower growth of

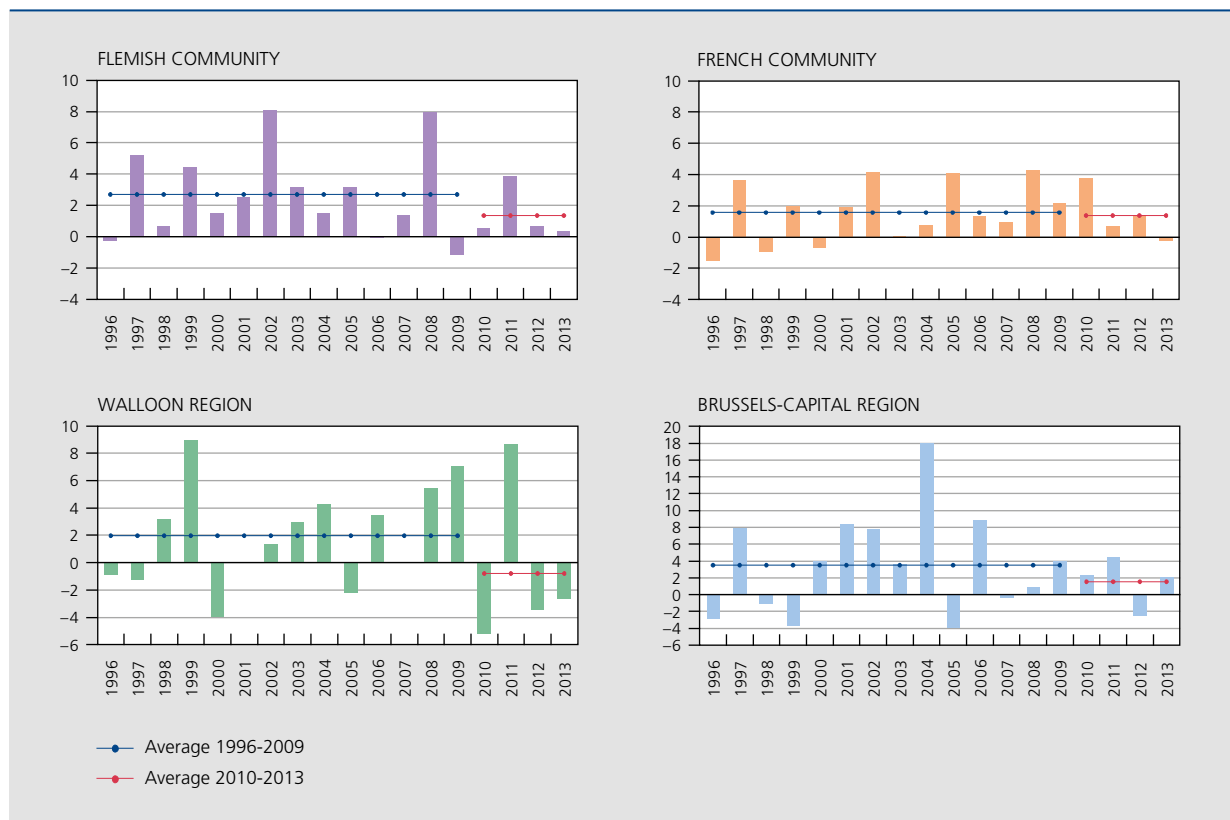
primary expenditure by the Communities and Regions as a whole in the period 2010-2013 could be clearly observed in the four main entities, and especially in the Walloon Region.

1.2 Debt ratio

After 1995, the debt ratio of the Communities and Regions declined almost continuously to reach 3.7% of GDP in 2007. As a result of the budget surpluses accumulated by the Flemish Community, the fall in the debt ratio over that period was much sharper there than in the Walloon Region and the Brussels-Capital Region. In the French Community, the debt was almost stable during this period.

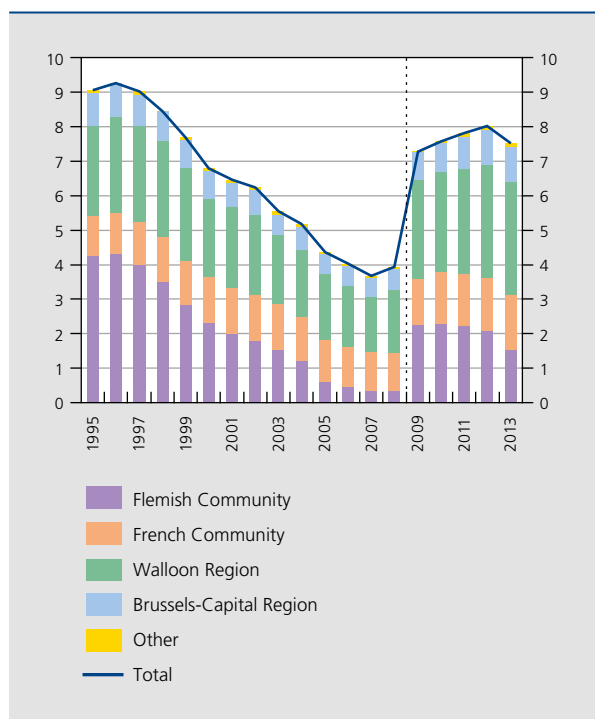
From 2008, the debt ratio of the Communities and Regions increased, reaching 8% of GDP in 2012. That rise was due to cumulative budget deficits, the capital injected into ailing financial corporations (Dexia, Ethias Finance and KBC), and a break in the statistical series in

CHART 3 PRIMARY EXPENDITURE
(percentage changes compared to the previous year, constant prices)



Sources: NAI, NBB.

CHART 4 CONSOLIDATED GROSS DEBT OF THE COMMUNITIES AND REGIONS⁽¹⁾
(in % of GDP)



Sources: NAI, NBB.

(1) In the government accounts published in April 2014, there is a break in the series in 2009 owing to a substantial enlargement of the consolidation scope. That break caused an increase in the debt of the Communities and Regions as a whole amounting to 1.5% of GDP in 2009.

2009 caused by an extension of the consolidation scope. As a result of these three factors, the debt ratio increased more sharply in the Walloon Region and the Flemish Community than in the other two main federated entities.

In 2013, the debt ratio of the Communities and Regions as a whole subsided again, mainly as a result of the repayment by KBC of the first tranche of the capital injection from the Flemish Community.

2. New institutional framework

From an economic and fiscal point of view, the two most fundamental aspects of the sixth State reform are the transfers of new powers from the federal level to the Communities and Regions and the revision of the

(1) The reform of the Special Finance Act for the Communities and Regions has already been presented in an Economic Review article (see Bisciari P. and L. Van Meensel, 2012).

financing mechanisms of the Communities and Regions. The transfer of federal government and social security powers to the Communities and Regions is governed by the special law of 6 January 2014 on the Sixth State Reform. The budgetary aspects are set out in the special law of 6 January 2014 reforming the financing of the Communities and Regions, extending the fiscal autonomy of the Regions and financing the new powers.

In the spring of 2014, the Law of 19 April 2014 supplemented these two aspects for the German-speaking Community, and decrees transferred certain responsibilities and the associated resources from the French Community to the Walloon Region and the French Community Commission, thus implementing the Sainte-Émilie agreements.

Although these laws and decrees came into force on 1 July 2014, most of the elements relating to financing will not apply until 1 January 2015.

The sections which follow describe the scale of the transfer of powers and outline the new system of funding for the Communities and Regions, focusing on the mechanisms created or modified by the revision of the Finance Act⁽¹⁾.

2.1 Transfer of powers

On the basis of estimates for 2015, i.e. the first full year in which the sixth State reform will be effective, the additional transfer of powers from federal level to the Communities and Regions will amount to around € 18.7 billion, or 4.6% of GDP. In 2016, this will be supplemented by the transfer of funding for hospital infrastructures, on which expenditure is estimated at € 630 million.

Before account is taken of the transfer of powers between federated entities, such as those resulting from the Sainte-Émilie agreements, the most substantial transfers in budgetary terms – amounting to around 2.8% of GDP – will be the transfers to the Communities. This concerns all family allowances and various aspects of health care and social support. In regard to matters concerning the elderly, this mainly concerns such facilities as retirement homes, retirement and care homes, and isolated geriatric hospitals, and support allowances for the elderly. The other health care expenditure transferred comprises aspects of mental health care, preventive medicine and the organisation of front-line care. Most of these powers concern expenditure currently borne by social security. Expenditure relating to other powers, including

TABLE 1 TRANSFER OF POWERS TO THE COMMUNITIES AND REGIONS

(estimates based on needs with no change of policy in 2015⁽¹⁾⁽²⁾)

	Amounts (in € billion)	In % of GDP
Communities	11.1	2.8
of which:		
Family allowances ⁽³⁾	6.4	1.6
Aspects of health care and social support	4.5	1.1
Regions	7.6	1.9
of which:		
Employment policies	4.2	1.0
Miscellaneous tax expenditure	3.0	0.8
Total	18.7	4.6

Sources: federal government, NBB.

(1) This table only concerns transfers scheduled for 2015. It therefore excludes those which have already taken place (Meise botanical garden) and those which will come later (funding of hospital infrastructures in 2016 and inter-university centres in 2018).

(2) Excluding drawing rights and monitoring of the availability of unemployed persons, since the Regions already receive grants for those, while Participation Fund expenditure is not included since the amounts involved are non-recurring.

(3) This figure does not include the family allowances that the Communities and Regions were already paying directly to their workers before the reform.

those concerning justice, is also being transferred to the Communities.

In regard to the Regions, in budgetary terms it is mainly some aspects of employment policy that are being transferred. These transfers originate partly from federal government and partly from social security. Some

of these powers, namely the reductions in certain social security contributions, were previously considered by the National Accounts Institute as reductions in revenue. From 30 September 2014, they are treated as expenditure on subsidies to firms.

The Regions will also acquire significant powers concerning tax expenditure, which counts as reductions in revenue from a statistical point of view. The main tax expenditure concerns the housing bonus. Another substantial budget relates to the use of service vouchers and LEA cheques.

In all, following the sixth State reform, there will be a considerable increase in the share of the Communities and Regions in general government revenues, and even more so in general government expenditure. On the basis of estimated figures for 2015, the additional primary expenditure of this sub-sector, which equals 3.8 percentage points of GDP, will be taken almost entirely from social security expenditure.

TABLE 2 TAX EXPENDITURE TRANSFERRED IN 2015

(in € million)

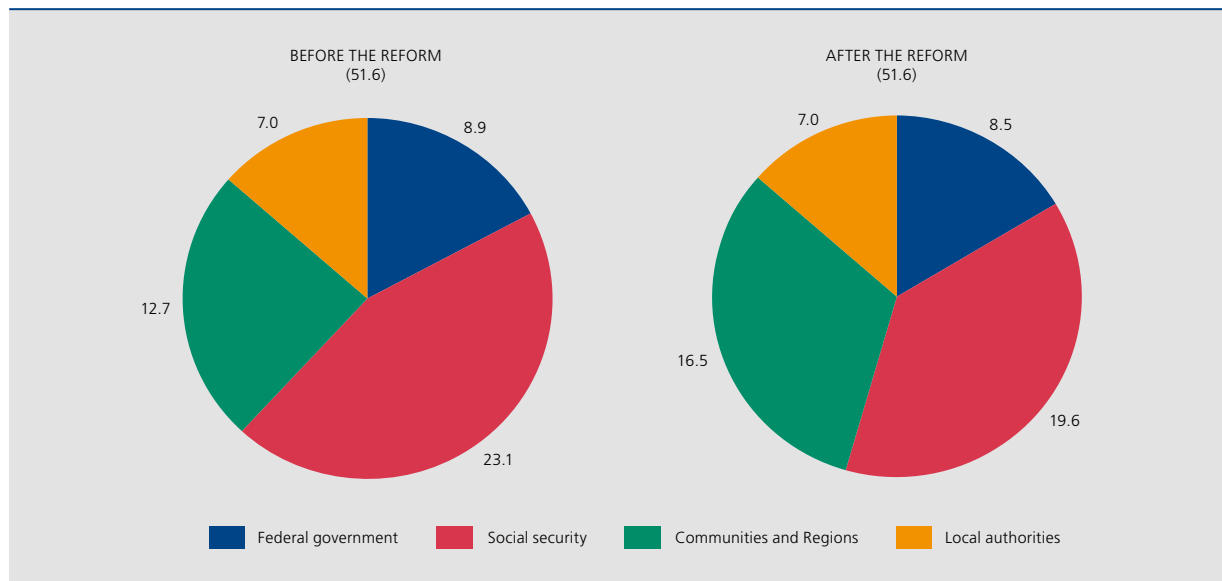
	Flemish Region	Walloon Region	Brussels-Capital Region	Total
Housing ⁽¹⁾	1 714	754	144	2 612
Service vouchers and LEA cheques	219	94	34	347
Energy-saving investment and passive houses	23	8	1	32
Other ⁽²⁾	31	20	6	56
Total	1 986	876	186	3 048

Source: federal government.

(1) Expenditure relating to mortgage loans contracted for own home purchase or maintenance (tax allowance for a single own home, increased tax relief for home savings, additional deduction for mortgage interest and life insurance premiums).

(2) Tax on non-residents and other elements of personal income tax (securing housing against fire and theft, renovation of housing let at modest rents, and housing in an urban positive action zone).

CHART 5 FINAL PRIMARY EXPENDITURE OF THE GOVERNMENT SUB-SECTORS^{(1) (2) (3) (4)}
(in % of GDP, estimates based on 2015 figures)



Sources: federal government, NAI, NBB.

- (1) Excluding transfers between government sub-sectors so that only final expenditure is considered.
- (2) The transferred expenditure is classified on an institutional basis. In the national accounts, some expenditure of the Communities and Regions could be regarded as social security expenditure.
- (3) The reductions in social security contributions transferred to the Regions were reclassified as expenditure in anticipation of the change expected by the NAI on account of the switch to the ESA 2010.
- (4) In contrast to what is done in the rest of the article, imputed social contributions and notional transfers from the federal government to the other sub-sectors for the payment of their staff pensions have not undergone any adjustment, so that they are recorded in the same way as in the government accounts.

2.2 New funding system

This section gives a broad outline of the new funding system, first for the Regions and then for the Communities. Particular attention focuses on the contributions towards the consolidation of public finances and towards the cost of ageing, specified in the law of 6 January 2014; the amounts and mechanisms of those contributions had not yet been decided at the time of the agreement on the State reform dated 10 October 2011. A comparison of the revenue structure of the four main Communities and Regions is also presented by way of illustration.

2.2.1 New funding system for the Regions

The new system of regional funding is based primarily on increased fiscal autonomy for the Regions. This means that they can levy extended additional percentages on personal income tax. This aspect of the reform was implemented by the Law of 8 May 2014 amending the Income Tax Code. In 2015, these additional percentages will correspond to 25.99% of personal income tax revenues, or around € 11.9 billion, which is 3% of GDP. They will finance 40% of the transferred tax expenditure and will replace the basic personal income tax grant and most of

the negative term, the latter compensating the federal State for the loss of revenue resulting from the transfer of certain taxes to the Regions in 2002. With no change of policy, they will keep pace with the proceeds from personal income tax, which will tend to grow faster than GDP for two reasons: the progressive character of the tax and population ageing, as pensions form part of the tax base but are not included in GDP.

The federal government transfers personal income tax revenues to cover the remaining 60% of this tax expenditure and 90% of the new powers relating to employment. These allocated resources are not linked to the growth of personal income tax revenues but are indexed to inflation and, in part, to real GDP growth. They are allocated according to the key for personal income tax which remains at the federal level.

A national solidarity allowance levied on federal personal income tax revenues is retained for Regions where per capita personal income tax revenues are below the national average. However, the detailed arrangements have been changed. Ultimately, 80% of the gap between a Region's share in the population and its share in personal income tax revenues will be adjusted, but the basic

TABLE 3 FUNDING STRUCTURE OF THE REGIONS FOLLOWING THE SIXTH STATE REFORM

Unchanged elements

Regional taxes and levies
Personal income tax resources allocated to the Brussels-Capital Region for the municipalities
Certain federal government grants⁽¹⁾
Transfers received from other federated entities⁽²⁾
Other non-fiscal revenues

New or modified elements

Elements neutralised in 2015 by the transitional amount⁽³⁾

Regional additional percentages on personal income tax
Allocated personal income tax resources

- Resources for new powers (employment and tax expenditure)
- Resources for some residual powers (old and new)
- Revised national solidarity allowance
- Transitional mechanism⁽⁴⁾

Transferred non-fiscal revenues (motoring offence fines)
Transferred fiscal expenditure (negative sign)

Elements not neutralised by the transitional amount

Personal income tax resources allocated

- Contribution to the consolidation of public finances (structural reductions in various transferred resources)
- Contribution to ageing costs (reduction in the link to economic growth for various transferred resources)
- Certain aspects of the refinancing of the Brussels-Capital Region (compensation for commuters and international officials)

Transfers received (grants)

- Climate responsabilisation mechanism (if appropriate)
- Part of the refinancing of the Brussels institutions benefiting the Brussels-Capital Region or channelled through it (grants for mobility, for security and for bilingualism premiums and mortmain)

p.m. New expenditure: pension and, if appropriate, climate, responsabilisation mechanism

Elements resulting from transfers between federated entities

Transfer from the French Community to the Walloon Region (Sainte-Émilie)

(1) Beliris, grants for the collection of certain regional taxes taken over by the Regions, etc.

(2) For example, the grant paid by the French Community to the Walloon Region following the Saint-Quentin agreement.

(3) This amount allows in particular for the restructuring and abolition of old mechanisms for funding the Regions such as the drawing rights for getting unemployed persons back into work.

(4) Account is also taken of an estimate of the needs relating to the new powers transferred to the Regions for calculating the transitional amount. This mechanism captures the difference between the regional distribution of resources and needs in 2015.

amount on which the adjustment is applied now includes resources of the Communities and Regions. In 2015, the amounts transferred in this respect to the Walloon Region

and the Brussels-Capital Region will be reduced, but in the future they will be linked not only to inflation but also to economic growth.

A new residual grant, likewise comprising resources allocated out of federal personal income tax, covers the resources provided for the old powers, namely those transferred in 1993 and 2002, and for various new regional powers.

Taking account of all the changes to the method of financing the Regions, of which only the most important have been mentioned here, some entities will see a reduction or increase in their funding compared to the previous system. A transitional mechanism in the form of an equalisation factor has therefore been provided to ensure that no entity gains or loses at the time of the switch from the old Finance Act to the new one. The amounts of this factor will be fixed in nominal terms for ten years, before being phased out over the ensuing ten years.

There is an exception in the case of some elements, in that they are not offset in the transitional mechanism and therefore have an immediate budgetary impact on relations between the federal government and the Regions. This concerns the refinancing of the Brussels institutions and the two responsabilisation mechanisms, one relating to pensions and the other to climate, and the contributions to the consolidation of public finances and to the cost of ageing (see sub-section 2.2.3. for this last item).

The Brussels institutions – Brussels-Capital Region, municipalities and French and Flemish Community Commissions – will receive additional funding amounting to about 0.1 % of GDP up to 2015, generated via various channels. For instance, given the net inflow of commuters into this Region, with effect from 2014, an adjustment incorporates part of the income of commuters from the other two Regions. This is a horizontal transfer, i.e. a transfer between Regions, which operates via the allocated personal income tax revenues transferred from the federal government. Another mechanism which also applies from 2014 and operates via the transferred personal income tax revenues compensates the Brussels-Capital Region for the revenue which it does not receive on the salaries of officials of international institutions such as the EC and NATO. This compensation only applies in respect of the larger share of these officials in the tax base of the Brussels-Capital Region compared to the other two Regions. Finally, there are grants for specific expenditure such as security, mobility and bilingualism premiums. Part of the refinancing has benefited the Brussels institutions from 2012.

The Regions now pay a contribution to the federal State in respect of the pensions of their civil servants, as a contribution towards the budgetary cost of ageing. Until now, the federal government had borne almost all the cost of these pensions.

Under the climate responsabilisation mechanism, if a Region exceeds the target for reduction in greenhouse gas emissions in residential and tertiary sector buildings, it receives a financial bonus. Conversely, if it fails to meet the target, it has to pay a penalty. In the rest of this article it is assumed that each Region does no more and no less than meet its target.

Finally, under the Sainte-Émilie agreements, the Walloon Region receives a grant from the French Community for the powers which it is taking over in its territory. This mainly concerns family allowances and most of the health care and social support expenditure.

2.2.2 New funding system for the Communities

The method of financing the Communities is based, as before, on resources transferred by the federal government, be it in the form of grants or transferred tax revenues.

Most of the federal transfers are distributed among the Communities according to formulas which reflect the needs for specific powers. Thus, there are demographic criteria for the allocation of resources in respect of the new Community powers: the number of children aged from 0 to 18 years for family allowances, the number of persons over the age of 80 years for health care and elderly people's support, and the total population for other aspects of health care and social support (excluding hospital infrastructures). In addition, the number of pupils attending French-speaking and Dutch-speaking schools is the criterion used for allocating transferred VAT resources. Apart from the old basic VAT transfer – namely the part of the VAT transfer that was already allocated previously according to the number of pupils – the transferred VAT resources now include the “economic growth-related” part of the supplementary Lambermont resources over the period 2010-2015, the compensation for the radio-TV licence fee that was allocated to the Communities on account of the transfer of that fee to the Regions in 2002, and an amount to fund a package of new powers.

The restructuring of the resources available to the Communities to finance their previous powers has also affected the transferred personal income tax revenues. As before, they are shared between the Communities according to the proceeds of this tax. These revenues now consist of the old basic personal income tax transfer plus the supplementary VAT resources relating to the Lambermont agreement other than the part reflecting the “link to economic growth” 2010-2015, which is shifted to the reformed VAT transfer.

TABLE 4 FUNDING STRUCTURE OF THE COMMUNITIES AND COMMUNITY COMMISSIONS FOLLOWING THE SIXTH STATE REFORM

Unchanged elements

- Certain federal government grants⁽¹⁾
- Transfers received from other federated entities⁽²⁾
- Other non-fiscal revenues

New or modified elements

Elements neutralised in 2015 by the transitional amount

- VAT resources allocated (revised mechanism⁽³⁾)
- Personal income tax resources allocated
 - Restructured personal income tax resources
 - Transitional mechanism⁽⁴⁾
- Resources allocated to the Joint Community Commission and the German-speaking Community⁽⁵⁾
- Federal grants for most of the new powers⁽⁶⁾

Elements not neutralised by the transitional amount

- Personal income tax resources allocated
 - Contribution to the consolidation of public finances (structural reductions in various transferred resources)
 - Contribution to ageing costs (reduction in the link to economic growth for various transferred resources)
 - Shares of the refinancing of the Brussels institutions allocated to the French Community Commission and the Flemish Community Commission

p.m. New expenditure: pension responsabilisation mechanism

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- (1) University payroll tax, funding for foreign students, cooperation between universities, national lottery, Institute of Tropical Medicine, Meise botanical garden, etc.
- (2) This mainly concerns transfers received by the Community Commissions from the French Community (Saint-Quentin grant for the French Community Commission), the Flemish Community or the Brussels-Capital Region. They also include grants by the Walloon Region to the German-speaking Community, in particular following the transfer of certain powers.
- (3) The revision of the mechanism also affects the composition of the VAT resources allocated. They will also include the old compensatory grant for the radio-TV licence fee that the Communities have received since 2002 on account of the transfer of this fee to the Regions.
- (4) Account is also taken of an estimate of the needs relating to the new powers transferred to the Regions for calculating the transitional amount. In particular, this mechanism captures the differential between the regional distribution of resources and needs in 2015.
- (5) From 2015 onwards, the old general grants paid by the federal government to the German-speaking Community and to the Joint Community Commission will be converted into transferred tax revenues. The drawing rights for getting unemployed persons back into work in the German-speaking Community will be incorporated into the general funding of that Community via transferred tax revenues.
- (6) Family allowances, care for the elderly, other health care and social support, hospital infrastructures, justice and inter-university centres.
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As in the case of the Regions, there is a transitional mechanism to ensure that no entity loses or gains resources at the time of the switch to the new Finance Act. However, some elements apply after implementation of the transitional mechanism in order to trigger an immediate budgetary effect favourable to the federal government. This concerns the contributions towards the consolidation of public finances and to the ageing costs, and pension responsabilisation. The impact of this last item on the budget will be greater for the Communities than for the Regions, since the former employ more workers than the latter, primarily teaching staff.

2.2.3 Contributions from the Communities and Regions to the consolidation of public finances and to the ageing costs

The Finance Act now specifies a number of contributions from the Communities and Regions towards the consolidation of public finances. In 2014, a one-off reduction of € 250 million will be applied to the personal income tax resources allocated to them under the old Finance Act. Lump sums are fixed for each Community and Region.

From 2015, the Finance Act will arrange structural levies in the form of cuts in the transferred tax revenues so

that, including the induced effect on the revised national solidarity contribution, the Communities and Regions together should make a contribution of € 1.25 billion, which will be increased to around € 2.5 billion from 2016. The transferred tax revenues in question are the personal income tax resources levied to fund the new employment policies for the Regions and those destined for the Communities and the Joint Community Commission.

Furthermore, from 2017, the federated entities will be asked to make an additional effort rising to 0.2 % of GDP in 2030, by means of reductions in the link to economic growth for certain grants or transferred tax revenues. In the case of the Regions, this concerns the personal income tax revenues transferred to cover the new employment powers and tax expenditure, for which the link to growth will decline from 75 % to 55 %, and the new residual grant for which the link will be cut from 100 % to 55 %. For the Communities, the link to economic growth will drop from 82.5 % to 65 % for grants relating to health care and to support for the elderly, and from 75 % to 55 % for personal income tax resources. There will also be a reduction in the link to growth – from 82.5 % to 65 % – in the case of resources transferred to the Joint Community Commission.

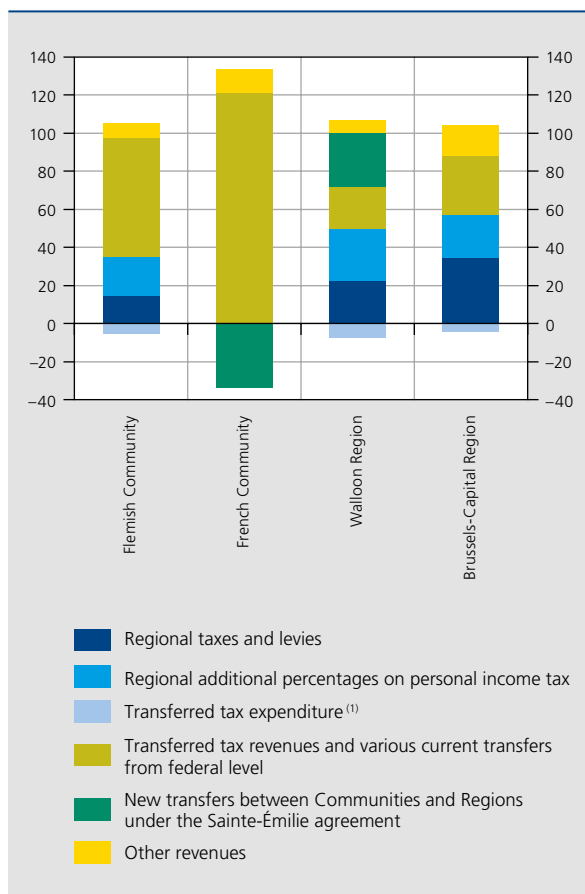
2.2.4 Structure of the revenues of the main Communities and Regions

Taking account of all the changes made by the special law of 6 January 2014 and by the decrees implementing the Sainte-Émilie agreements, the structure of the revenues of the Communities and Regions will be considerably different from 2015 onwards. In addition, that structure will vary greatly from one entity to another. The breakdown of the revenues of the four main federated entities set out in this sub-section assumes no change of policy in 2015.

The revenue breakdown for the French Community is the most atypical in that this Community is financed solely by transfers from the federal government under the Finance Act and by various revenues (such as higher education tuition fees). In addition, this entity transfers around one-third of its revenues to the Walloon Region and the French Community Commission under the Sainte-Émilie agreements.

This “Sainte-Émilie” transfer from the French Community represents 28 % of the Walloon Region’s revenues. Transfers from the federal government under the Finance Act, mainly transferred tax revenues, now only make up 22 % of the Region’s revenues. Half of its revenues are own tax revenues, be it new additional percentages on personal income tax (28 %) or old regional taxes and levies (22 %).

CHART 6 REVENUE BREAKDOWN IN 2015
(share of total revenues of each entity, in %)



Sources: federal government, NAI, NBB.

(1) Transferred tax expenditure amounts to a reduction in revenues. The impact of this transfer of powers is offset under other headings (partly in the regional additional percentages on personal income tax and partly in tax revenues transferred by the federal government to the Regions).

These old taxes and levies, which include property registration fees and inheritance duties, are still the primary source of funding for the Brussels-Capital Region, accounting for around 35 %. The additional percentages on personal income tax add around 15 % to the Region’s own tax revenues. Transfers under the Finance Act, mainly personal income tax revenues, generate 31 % of this Region’s revenues.

The Flemish Community, which combines the powers of Communities and Regions, is in an intermediate position between the extremes of the French Community and the other two Regions. Transfers under the Finance Act, be it personal income tax or VAT revenues or federal grants, bring in almost 63 % of this entity’s resources. The new additional percentages on personal income tax represent just over one-fifth of the revenues of the Flemish Community, while the old regional taxes and levies bring in 15 %.

3. New budgetary framework

Recent years have seen considerable changes in the fiscal policy framework of the various Belgian public authorities, owing to the significant adjustments to the European rules and following the sixth State reform. This section will begin by discussing those changes. Against that backdrop, it will then deal with the proposed normative path.

3.1 Significant recent changes

In a federal State such as Belgium, each entity contributes towards the attainment of the budget targets applicable at the level of general government. To ensure the necessary coordination of policy between the various governments, the “Public Sector Borrowing Requirement” Section was established within the High Council of Finance (HCF) by the Special Finance Act of 16 January 1989. In its opinions, this Section makes recommendations on budget balances, both for the general government and for each of the Communities and Regions separately; these opinions generally form the basis of the cooperation agreements on fiscal targets concluded by the Consultative Committee of the federal government and the governments of the Communities and Regions. These agreements are the cornerstone of the coordination of fiscal policy in Belgium.

The fiscal policy of the Belgian public authorities has long been largely determined by European rules. In recent years, owing to the sovereign debt crisis, the European budget guidelines have been tightened up by the introduction of the “Six Pack”, the “Two Pack” and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, and especially its section on the budget, better known as the “Fiscal Compact”. This compact was implemented by the cooperation agreement of 13 December 2013 between the federal State, the Communities and Regions and the Community Commissions.

A key aspect of this cooperation agreement is the transposition into Belgian law of the “golden rule” of the Fiscal Compact. This stipulates that the general government budget must be in balance or in surplus. This rule is deemed to be respected if the annual structural balance of general government corresponds to the medium-term objective (MTO) specific to the country, or if it conforms to the required convergence path tending towards that objective.

In addition, the cooperation agreement formalises the existing coordination arrangements by creating a legal

basis for the recommendation and assessment functions of the “Public Sector Borrowing Requirement” Section. Moreover, the Section’s responsibilities have been extended. For instance, it has to issue an opinion on the allocation of the annual general government budget target among the various levels of power, in both nominal and structural terms. It is also designated as the independent body responsible among other things for monitoring these decisions and more generally for assessing compliance with the commitments given by the governments. In addition, it is asked to issue an opinion on the scale of any adjustment to be made, and to supervise the implementation of the measures. It also has a new task of proposing how any financial penalty imposed by the Council of the European Union should be shared between the various levels of government, in proportion to the slippages identified.

The cooperation agreement also specifies that the overall budget target of general government is first to be discussed by the Consultative Committee and that the latter must approve the allocation of the targets between the various levels of power.

Another recent major change affecting the fiscal framework and the setting of the budget targets in particular for each entity concerns the introduction of a series of mechanisms from 2014 onwards under the new Finance Act (see section 2.2.). This concerns contributions from the Communities and Regions for their staff pensions, towards the consolidation of public finances and to the cost of ageing.

3.2 Normative budget path of the Communities and Regions

In 2009, the “Public Sector Borrowing Requirement” Section of the HCF began to make proposals for the consolidation of public finances, which was essential after the public deficit had swollen in the wake of the financial and economic crisis. In formulating these proposals, it was necessary not only to set overall budget targets, particularly a balanced budget by no later than 2015, but also to move towards a clear, balanced sharing of the effort across the various government sub-sectors. Another vital criterion concerned ensuring the fiscal sustainability of each level of power.

In 2009, the Section proposed four possible schemes for sharing the consolidation efforts between Entity I, comprising the federal government and social security, and Entity II, comprising the Communities and Regions and local authorities. At the end of 2009, the Consultative

Committee decided to base the allocation up to 2012 on the share of final primary expenditure⁽¹⁾. That criterion has the advantage of taking account of the relative positions in regard to government intervention, and is justified by the fact that fiscal sustainability is based more particularly on long-term control of the range of public sector activity. According to simulations produced by the Section, since Entity II initially had a smaller deficit, application of this formula would lead to a divergence in the normative budget paths with an estimated surplus of around 1 % of GDP for Entity II in 2015 and a comparable deficit for Entity I. However, that does not correspond to fiscal sustainability at each level of power, and could cause problems for certain components of Entity II, presumed to continue accumulating surpluses. Indeed, such surpluses are not justified for Entity II which has a relatively small debt burden and does not face the issue of pre-financing ageing-related expenditure under the allocation of powers.

In its opinions between September 2009 and March 2011, the Section therefore recommended an institutional reform to permit convergence of the budgetary prospects and trajectories for the various entities. In March 2012, in view of the October 2011 agreement on the State reform, the Section based the sharing of the budget targets on a return to nominal balance in 2015 for each level of power, including each Community and each Region, making this new path conditional upon a transfer of costs from Entity I to Entity II. For Entity II, it was important to specify the arrangements for the participation of the federated entities in the consolidation of public finances referred to in the agreement on the State reform. In its March 2013 opinion, the Section reiterated this principle and examined two potential scenarios for the contribution of Entity II towards the fiscal consolidation effort.

In July 2013, a final political agreement was concluded on the sixth State reform, leading to a transfer of fiscal burdens from Entity I to Entity II. In its March 2014 opinion, the Section took note of this political agreement and this transfer of burdens which it estimated at 0.7 % of GDP for the year 2017, and in consequence retained the principle of a balanced budget for Entity II and its components during the period 2014-2017, leaving Entity I to make the remaining effort⁽²⁾. During 2014-2017, the Communities and Regions as a whole and each federated entity considered separately would have to aim at a nominal balance every year. These targets were included

under the form of an indicative path in Belgium's April 2014 stability programme.

4. Projections incorporating the new institutional framework

Two projection exercises were conducted for the various Communities and Regions, one outlining the budget balances under the assumption of no change of policy up to 2030, and the other calculating the growth rates of primary expenditure (other than expenditure linked to the reform of the Finance Act) compatible with a return to a balanced budget from 2015. Section 4.1 sets out the main elements of the method and assumptions underlying these projections.

4.1 Assumptions and method

These projections are based, for 2013, on the April 2014 government accounts drawn up by the NAI in accordance with the ESA 95.

For 2014, the methodology is similar to that for the forecasts published by the Bank last June. The primary expenditure growth rates are inferred from an analysis of the initial budgets of the main entities. From 2014, revenues are estimated according to the Finance Act on the basis of a macroeconomic framework corresponding to that of the Bank's June forecasts up to 2016, and subsequently to that of the annual report of the Study Committee on Ageing, published in July. The demographic framework is based on the population forecasts for 2013-2060 published in April.

The effects of the switch to the new Finance Act and of the decrees implementing the Sainte-Émilie agreements have been taken into account. On the basis of an unchanged policy, it is assumed that the federated entities take over the powers from the federal government and social security exactly as those sub-sectors would have applied them in the absence of the State reform. They therefore do not exercise their decision-making autonomy on these subjects. It is similarly assumed that the Regions do not use their fiscal autonomy.

Apart from a few exceptions, the other revenues are assumed to track nominal GDP. In the case of regional taxes and levies, as in the Bank's June forecasts account is taken of the measures adopted and of the impact of certain temporary factors, such as the tax regularisation and the one-month reduction in the time limits for submitting inheritance duty declarations. Another temporary factor

(1) Entity I was therefore to assume 65 % of the efforts over the period as a whole, and Entity II was to take on 35 %. These percentages were derived from the allocation of expenditure between these entities over the period 2006-2008, according to figures available in the summer of 2009.

(2) The years 2014 and 2015 form an exception in that a surplus of 0.1 % of GDP is prescribed for Entity II on account of a temporary surplus stipulated for the local authorities, in view of their investment cycle.

taken on board is the 2013 transfer from the federal government of part of the proceeds of the sale of the mobile telephony licences. KBC is not expected to pay any dividends in 2014 or in 2016. As agreed with the EC, between now and 2020, this bank is to repay to the Flemish Community the capital which it injected.

The analysis of primary expenditure for 2014 takes account, among other things, of the downward revision of inflation following the cut in VAT on electricity. In particular, this delays until 2015 the indexation of the wages of employees of the community and regional authorities. In the case of the Flemish Community, the *Scholen van Morgen* public-private partnership (PPP) is included in the expenditure. In 2015, primary expenditure is also adjusted for the temporary impact of the sale of buildings and land in the previous year.

No account was taken of the measures announced in the regional and community policy statements issued in July. The projections therefore show the budgetary context in which those measures were decided.

4.2 Expected movement in budget balances with no change of policy

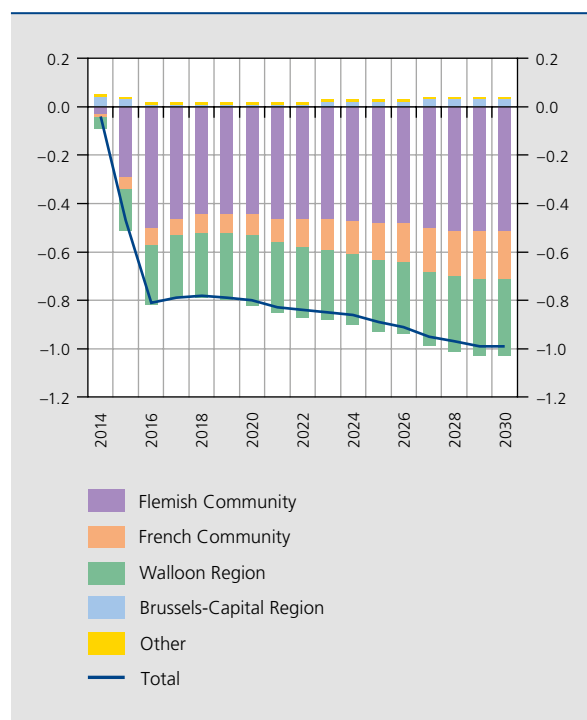
The budget balance projection exercise assuming no change of policy is based on the additional assumption that, from 2015, primary expenditure other than that related to the revision of the Finance Act will increase in line with nominal GDP, except for the adjustments mentioned at the end of the previous section.

In the case of the Communities and Regions as a whole, the expected deficit – which is small in 2014 – is likely to increase in 2015 and 2016, stabilising at around 0.8% of GDP until 2021, then rising again up to 2030. The profile is fairly similar for the Flemish Community, the French Community and the Walloon Region. In the Brussels-Capital Region, the 2014 surplus will diminish in future years, becoming virtually zero in 2017. This Region's surplus will subsequently increase again slightly.

The movements in the primary balance account for much of the changes in the budget balance. The increase in the interest burden, which is modest at the start of the period, will subsequently accelerate owing to the debt dynamics.

Factors relating to the Finance Act account for much of the movement in the primary balance compared to 2014 in the Flemish Community, the French Community and the Walloon Region. More particularly, the contribution towards the consolidation of public finances, which

CHART 7 BUDGET BALANCES IF PRIMARY EXPENDITURE OTHER THAN THAT RELATED TO THE REVISION OF THE FINANCE ACT⁽¹⁾ INCREASES IN LINE WITH NOMINAL GDP FROM 2015
(in % of GDP)



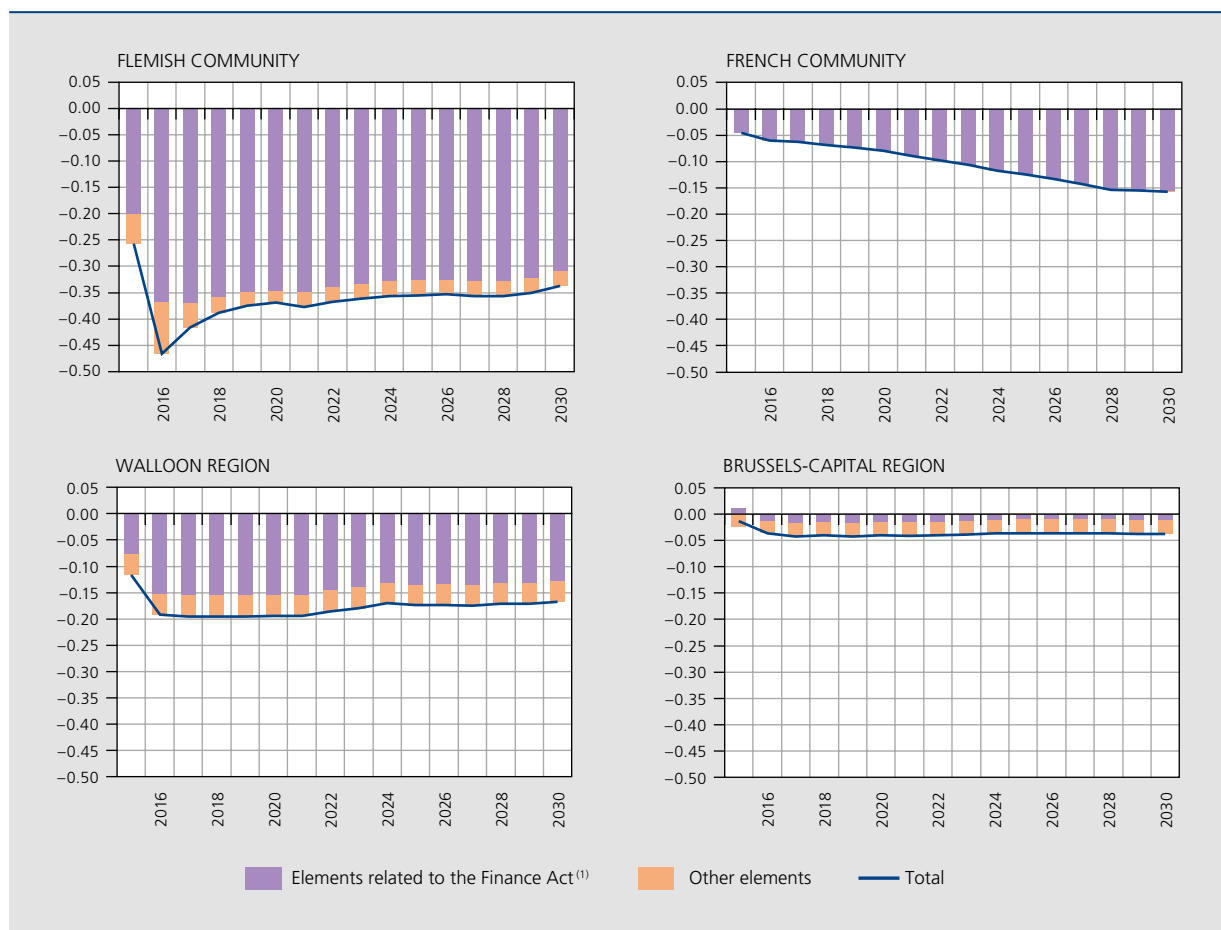
Sources: FPB, Study Committee on Ageing, federal government, NAI, NBB.
(1) The expenditure relating to the revision of the Finance Act is primary expenditure concerning the powers transferred under the sixth State reform, the pension responsabilisation contribution and the transfers under the Sainte-Émilie agreements.

increases from € 250 million in 2014 to € 1.25 billion in 2015 and then to € 2.5 billion in 2016, will be a burden on the finances of each of the federated entities. The finances of the Communities will also have to bear pension responsabilisation contributions, the cost of which will rise until 2028.

In the Flemish Community, factors relating to the Finance Act will cause a marked deterioration in the primary balance in 2015 and 2016, mainly because of the structural contribution towards the consolidation of public finances. In 2015, revenues will no longer be supported by the favourable temporary effect in 2014 due to the tax regularisation, while expenditure will feel the repercussions of the sale of buildings and land in 2014 and the effects of the *Scholen van Morgen* PPP. The maximum impact of factors other than those relating to the Finance Act will be felt in 2016, partly on account of this PPP and the absence of any KBC dividends in that year.

In the French Community, the deterioration in the primary balance will be due entirely to factors relating to the

CHART 8 BREAKDOWN OF THE CHANGE IN THE PRIMARY BALANCE
(in percentage points of GDP compared to 2014)



Sources: FPB, Study Committee on Ageing, federal government, NAI, NBB.

(1) Mainly transferred tax revenues, most of the federal grants, fiscal autonomy, the transfer of powers over revenue and expenditure, transfers resulting from the Sainte-Émilie agreements and pension responsabilisation

Finance Act. Up to 2016, the effect of the contribution towards the consolidation of public finances will predominate, but in the long term it is the pension responsabilisation contribution that will entail the biggest cost.

In the Walloon Region, most of the deterioration in the primary balance in 2015 and 2016 will be due to the contribution towards the consolidation of public finances. From 2015 onwards, the Region will also feel the repercussions of the one-off measures adopted in 2014, such as the sale of the Sofico fibre optic network and the temporary effects concerning inheritance duties following the tax regularisation.

From 2015, the primary balance of the Brussels-Capital Region will deteriorate but, in contrast to the other federated entities, that will be due solely to factors other than those relating to the Finance Act, such as the

repercussions of one-off measures adopted in 2014 (sale of buildings and land) and temporary effects concerning inheritance duty (tax regularisation). In 2015, this Region will still benefit from the final phase of the refinancing obtained under the sixth State reform. That effect will outweigh the impact of the contribution towards the consolidation of public finances.

4.3 Efforts required to restore a balanced budget in 2015

Another simulation exercise involves assessing any scope available to the entities in terms of admissible real growth of primary expenditure other than spending relating to the revision of the Finance Act in order to achieve the target of a balanced budget in 2015 and maintain it thereafter as recommended by the "Public Sector Borrowing

TABLE 5 ADMISSIBLE REAL GROWTH OF PRIMARY EXPENDITURE OTHER THAN THAT RELATING TO THE REVISION OF THE FINANCE ACT TO ACHIEVE A BALANCED BUDGET IN 2015 AND MAINTAIN THAT BALANCE

(percentage changes compared to the previous year, data deflated by the GDP deflator)

	2014 ⁽¹⁾	2015	2016	Average 2017-2019
Flemish Community	1.0	-1.7	-1.3	1.8
French Community	-0.2	-0.3	1.2	1.4
Walloon Region	0.5	-6.7	-2.7	1.6
Brussels-Capital Region	5.7	6.2	-0.8	1.4
Total	1.0	-1.5	-1.0	1.6

Sources: FPB, Study Committee on Ageing, federal government, NAI, NBB.

(1) Expenditure growth compatible with the estimate based on the Bank's June 2014 forecasts.

Requirement" Section of the HCF. For this exercise, the starting point for 2014 is the same as for the projection with no change of policy. The profile of primary expenditure relating to the revision of the Finance Act and of revenues is the same as in the scenario with no change of policy.

For the Communities and Regions as a whole, following modest real growth of primary expenditure estimated at 1 % in 2014, the restoration of a balanced budget would require a 1.5 % reduction in primary expenditure in 2015 and a further 1 % cut in 2016. These efforts are due not only to the need to restore a balanced budget but also, and above all, to the additional constraint imposed by the contribution towards the consolidation of public finances. Furthermore, primary expenditure could rise thereafter by an annual average of around 1.6 % over the last three years of the regional legislature due to end in 2019.

Among the main federated entities, the Walloon Region is the one subject to the tightest constraint in terms of the admissible rate of real growth of primary expenditure other than spending relating to the revision of the Finance Act, that is to say if the budgetary effort did not concern either revenues or expenditure transferred following the sixth State reform. That other primary expenditure needs to be cut by 6.7 % in 2015 and by a further 2.7 % in 2016. This constraint is more severe than for the other entities owing to a budget position estimated to be less favourable in 2014, as the Walloon Region is in fact the entity with the biggest deficit in that year.

Conversely, the Brussels-Capital Region will benefit from a surplus in 2014 and from the last tranche of refinancing for the Brussels institutions in 2015. It could maintain a balanced budget while recording strong growth of

its primary expenditure other than that relating to the revision of the Finance Act. However, in 2016, it would have to cut that expenditure by 0.8 %, as the consolidation contribution will outweigh the refinancing, and the Region's starting point in 2015 is a balanced budget.

The French and Flemish Communities are in an intermediate position: in the scenario outlined, they need to cut their primary expenditure (other than that relating to the revision of the Finance Act) in real terms in 2015, but to a lesser degree than the Walloon Region.

The simulation illustrates the difficulty of achieving the consolidation efforts in the main federated entities other than the Brussels-Capital Region solely on the basis of the old expenditure. Given the scale of the adjustment required, it is also conceivable that measures might have to be taken in regard to the new spending powers and on the revenue side.

5. Government agreements of the Communities and Regions

The government agreements concluded in the various federated entities during July 2014 reflect the budget position as described in the preceding sections.

The governments of the Brussels-Capital Region and the Flemish Community aim to maintain a balanced budget throughout the legislature ending in 2019, while the governments of the French Community and the Walloon Region aim to achieve a balanced budget by 2018.

To meet these targets, all the entities are expecting to maintain strict control over their spending growth. A

number of specific measures have been devised with that aim in view; their effects will be felt mainly at the start of the legislature. Similarly, some entities intend to make substantial cuts in recruitment numbers.

In addition, the Regions will exercise their new tax-raising powers. The Brussels-Capital Region aims to reduce the tax burden on labour to some extent, transferring it to property. The housing bonus could be modified for that purpose. The Flemish Region decided to keep the housing bonus but to end its indexation under existing contracts; moreover, the tax advantage for new contracts is to be restricted. The Walloon Region will make reductions in the tax advantage of service vouchers and is considering a reform of the housing bonus.

Conclusions

According to the government accounts published in April 2014, the accounts of the Communities and Regions as a whole were more or less in balance in 2013. The Flemish Community and the Brussels-Capital Region recorded a small surplus while the French Community and the Walloon Region showed a small deficit.

In addition to a substantial transfer of powers to the Communities and Regions and increased fiscal autonomy for the Regions, the revision of the Finance Act implies a transfer of costs from the federal government to the Communities and Regions. In 2015 and 2016, that transfer will take the form of contributions towards the

consolidation of public finances. After that, it will mainly concern contributions towards the cost of ageing. The sixth State reform has also made provision for the refinancing of the Brussels institutions from 2012.

With no change of policy, i.e. before the implementation of the measures mentioned in the government agreements concluded this summer, the projections for 2030 set out in the article 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 again to around 1% of GDP, mainly on account of the contributions towards the cost of ageing. With the exception of the Brussels-Capital Region, which will 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 predicted to record substantial deficits throughout the period.

Taking account of the contributions towards the consolidation of public finances, the maintenance or achievement of the balanced budget target advocated in March 2014 by the "Public Sector Borrowing Requirement" Section of the HCF, and included under the form of an indicative path in Belgium's April 2014 stability programme, implies substantial fiscal consolidation for the main Communities and Regions other than the Brussels-Capital Region. The recent government agreements for the legislature ending in 2019 take account of this budgetary context.

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