

# Decentralisation and fiscal consolidation: the Belgian case in perspective

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# Introduction and Topics

Actual challenges have to be put in historical and institutional context

- I. Institutional context and structural dimensions
- II. Some measurement and methodological issues relative to structural indicators
- III. 1999-2013: 15 years of fiscal coordination and budgetary policy: an overview
- IV. Future challenges with the new State reform and financing laws (2015)

## I.1.- Some figures about the structure of Belgian PF

### Some reminders

- ✓ 4 levels of government in NA, consolidated in two big Entities (I and II). Entity I. = Federal State (FS) + Social Security (SOS); Entity II = Communities and Regions (C&R) + Local Authorities (LA))
- ✓ Entity I is in charge of nearly 2/3 % of total final primary expenditure (FPE), more than 90% of total Social benefits and interest charges, but only of 32% of other primary FPE.
- ✓ 60% of consolidated financing of Entity II originate from fiscal « automatic » grants (financing laws) and specific budgetary transfers from the FS (even if with some fiscal autonomy). The numbers for the C&R and for the LA are respectively 72% and 50%.

## I.2. – Structure of the Belgian public finances

Relative shares in the Total of Expenditure or Ressources (HCF def.)						
In % of Tot. - Avg. 2010-12	Ent. I	PF	SOS	Entit. II:	C&R	LA
Total final expendit. (incl. Inter.)	67,7%	26,0%	41,7%	32,3%	19,8%	12,5%
Primary final expendit. (PFE)	65,1%	19,3%	45,8%	34,9%	21,4%	13,4%
* Social benefits	93,2%	15,1%	78,1%	6,8%	4,9%	1,9%
* Other PFE	32,1%	24,3%	7,8%	67,9%	40,9%	27,0%
Wages & Salaries	21,8%	17,9%	3,9%	78,2%	43,8%	34,4%
Public employment	19,7%	16,1%	3,6%	80,3%	44,6%	35,6%
Public investment	10,8%	10,0%	0,8%	89,2%	42,2%	47,0%
Own ressources before fiscal transfers	86,3%	56,2%	30,1%	13,7%	7,1%	6,6%
Ressources after fiscal transfers	68,1%	28,8%	39,2%	31,9%	25,2%	6,7%
Ressources after budgetary transf.	65,6%	19,7%	45,9%	34,4%	21,2%	13,3%

### I.3. - Some implications of the actual system

- Fundamental vertical asymmetry from the onset between a very large budgetary autonomy for C&R and a much more limited initial fiscal autonomy.
- Possible debt ceiling only in very exceptional circumstances (never used). No real enforcement mechanisms, but recommendations of HCF.
- Institutional horizontal asymmetry (North/South) – tendency to refinance the whole system from the centre (as in 1992, 2001) once the weakest entity was in financial or budgetary problem (discussion about internal bailouts & consumer federalism)

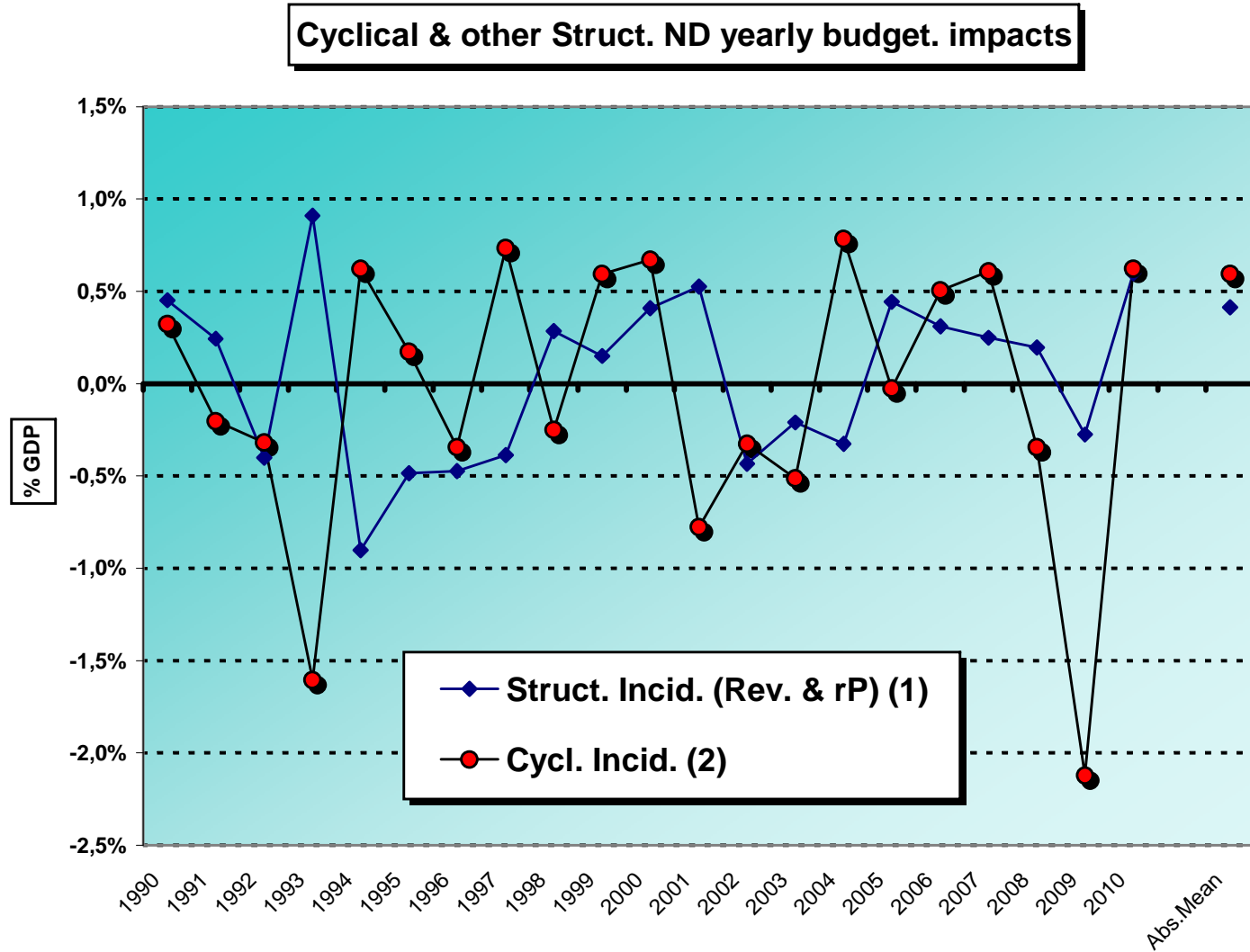
## II.1. – Methodological and measurement issues

- Some semantic confusion between concepts of improving structural balances (ex post), as actually measured, and consolidation structural « efforts ».
- The 2 are the same only if there are no other non-discretionary budgetary impacts than the measured cyclical corrections and the one-shots.
- Probably true in the long term but for Belgian not in the short to medium run. Work done on belgian experience (1990-2010) at the aggregated and Entities levels show this.

## II.2. - Other non-discretionary structural impacts at the global level

1. Compositions dynamics effects on the revenue side by unchanged legislation. In the belgian case: long-term ex ante supra-unity elasticity (1,075) with a positive impact of 3% GDP in 20 years on the revenue ratio (especially since 1995). Large fluctuations.
2. Relative short and long term relative price effects on the expenditure side. Weighted deflator of PE can deviate from the GDP deflator, with an impact on the value of PE to GDP ratio
3. Cyclical investment ratio at the LA level (also global).
4. Structural socio-demographic effects (on the expenditure side), for exemple via ageing costs (mostly at Entity I level).

## II.3. – Ann. Cyclic. & Other ND budget. Impacts





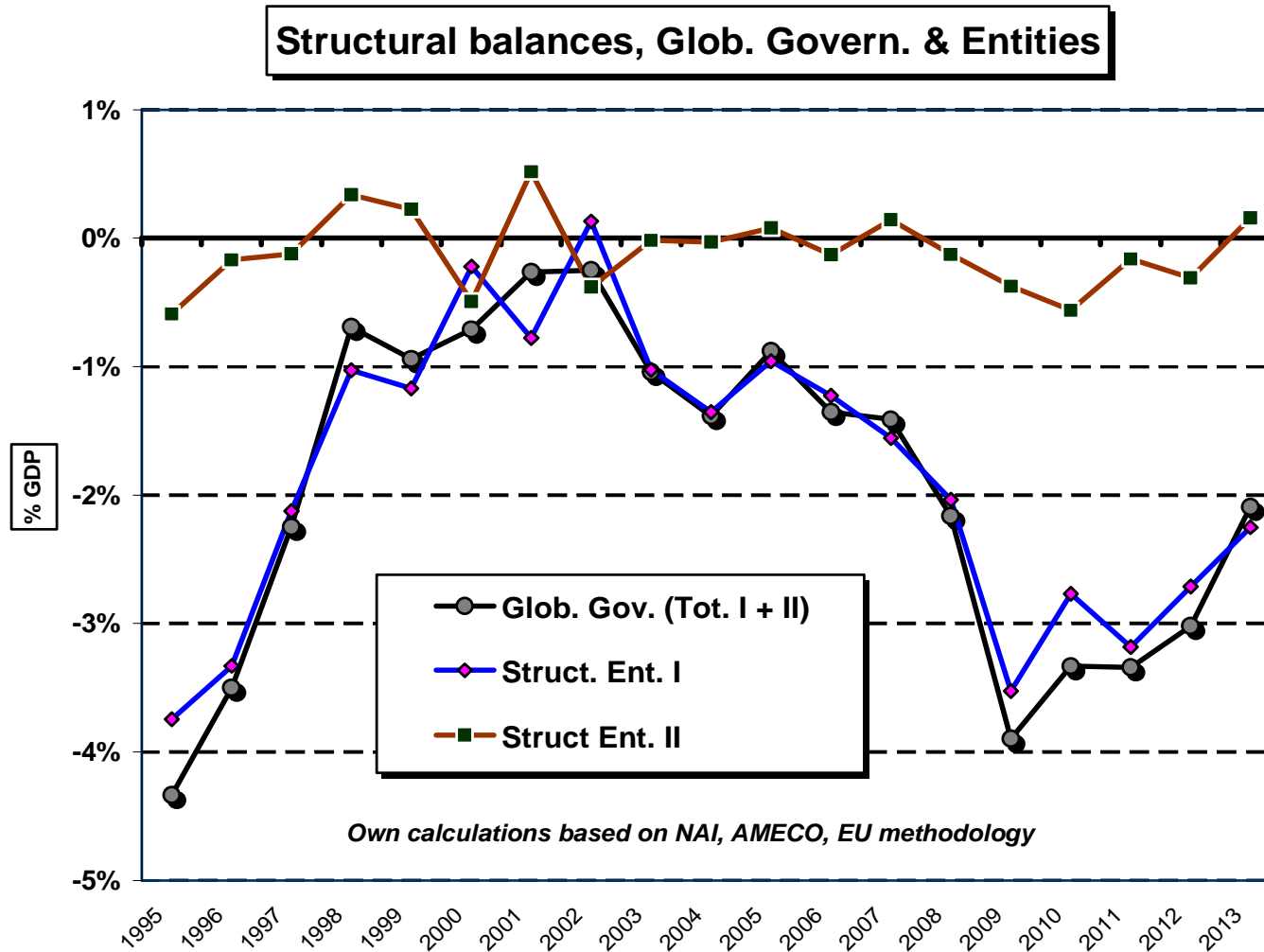
## II.4. – Comments on previous graph

- Yearly budgetary impacts of cyclical variations (EU methodology) and the 2 other most significant non-discretionary effects merged (revenue composition and relative prices).
- No correlation between the two and for Belgium the avg. absolute mean of the second impact is 0,4% GDP, more than 70% of the (avg.) absolute mean of the cyclical impact (around 0,55% GDP).

### III – Analysis of the last 15 years by Entity

1. Analysis based on standard EU methodology
2. Other non-discretionary specific impacts at the disaggregated levels
3. Consolidation and coordination policy in the post-Maastricht area (1999-2010)
4. The Transitory 2010-2014 phase

### III.1.1. – Structural balance by main Entities – EU methodology



### III.1.2. – Structural evolutions -Some comments

- On an Entity basis (EU methodology), up to 2009, two major structural trend reversals at the global and Entity I level, with Entity II remaining in a position of smooth structural fiscal balance (whole period 1996-2008).
- In the 2001-2007 period, the share of Entity II in the global structural deterioration was 1/3 (in line with its share in total FPE)
- Since 2007, on that same (uncorrected) methodological base, the whole deterioration could be attributed to Entity I (-0,7% GDP in 2007-13).

### III.1.3. - Structural evolutions by Entity (EU methodology)

Structural balances evolutions by subperiod & Entity								
Evol. % GDP	1995-01	2001-07	2007-13	2001-04	2004-07	2007-10	2010-13	2001-13
Total (GG)	4,1%	-1,1%	-0,7%	-1,1%	0,0%	-1,9%	1,2%	-1,8%
* Entity I	3,0%	-0,8%	-0,7%	-0,6%	-0,2%	-1,2%	0,5%	-1,5%
* Entity II	1,1%	-0,4%	0,0%	-0,5%	0,2%	-0,7%	0,7%	-0,4%
Relat. Share Ent. I	72,8%	67,6%	102,0%	51,3%	--	63,2%	42,2%	80,4%

Own calculations based on NA and AMECO

- But the period 2007-13 is not homogeneous and must be divided in two very different sub-periods
- 1) 2007-2010: proportional structural *deterioration of I & II.*
- 2) 2010-13: less than proportional *improvement* by Entity I
- And this is not the whole story (other non-discretionary factors)

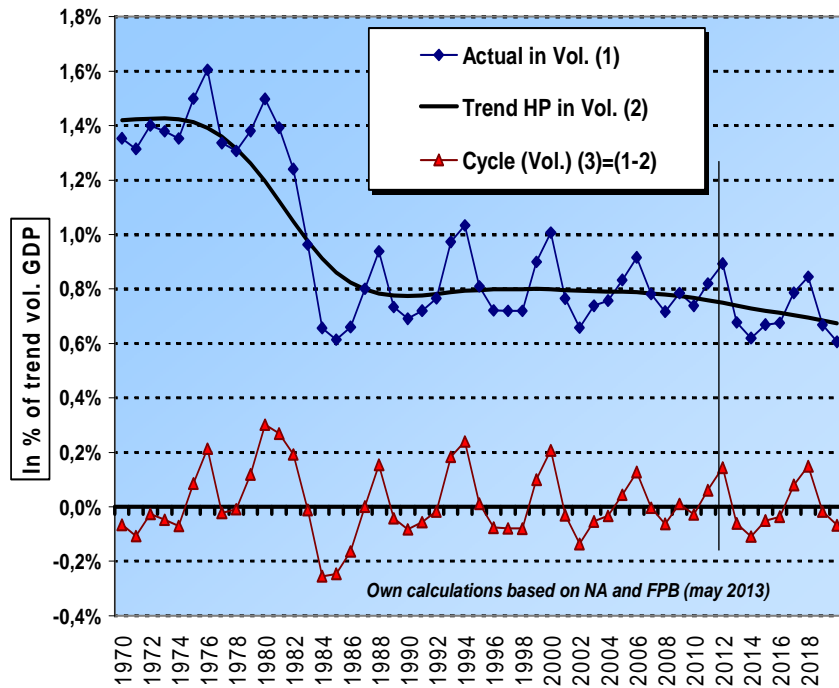
### III.2.1. – Non-discretionary impacts at lower levels

- Investment « political » cyclus at the LA level, with 3 yearly pic to peaks impacts of 0,3% GDP on the balance of Entity II
- Lags and administrative « cycles » in the total (fiscal and budgetary) transfers of the FS to Entity II, which can amount up to 0,3 to 0,5% GDP in 1 or 2 years (2008-10)
- Strong volatility in the last years in NA terms of the PIT received by the LA, because of varying tax collection rythms at the FS level, with sometimes yoy impacts of 0,1 to 0,3% of GDP.

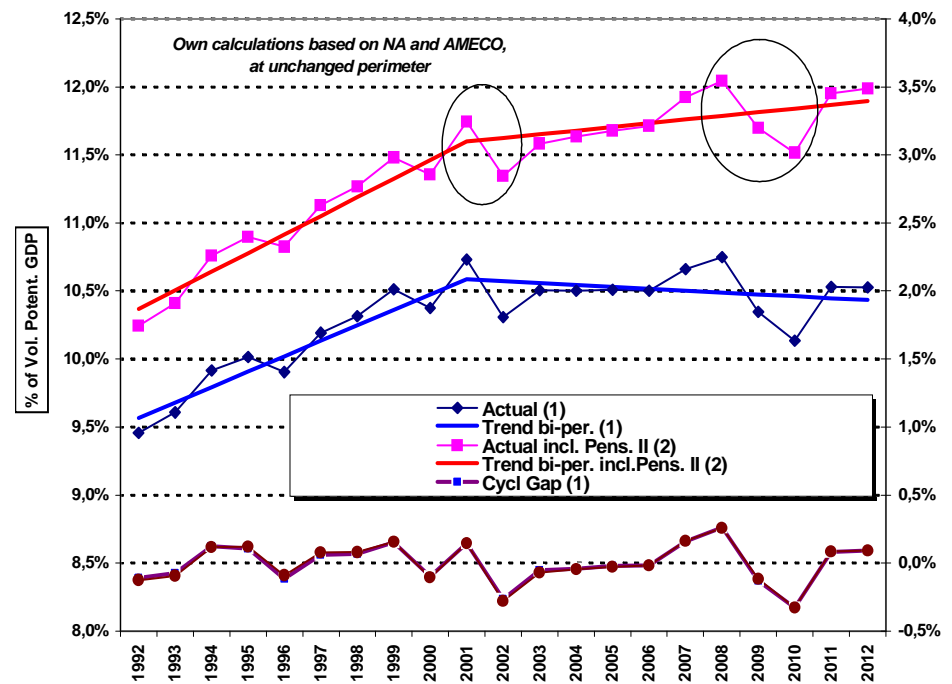
At the end, relevance of taking account of those factors, but also to be prudent when interpreting in the sort term the structural underlying developments.

## III.2.2. - Other more specific or internal ND impacts

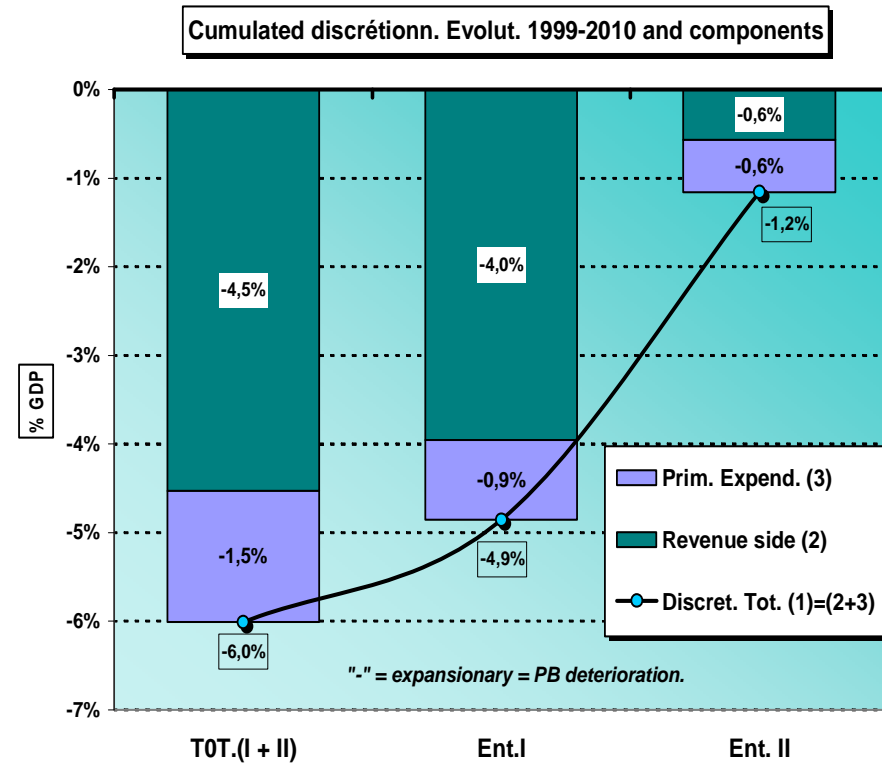
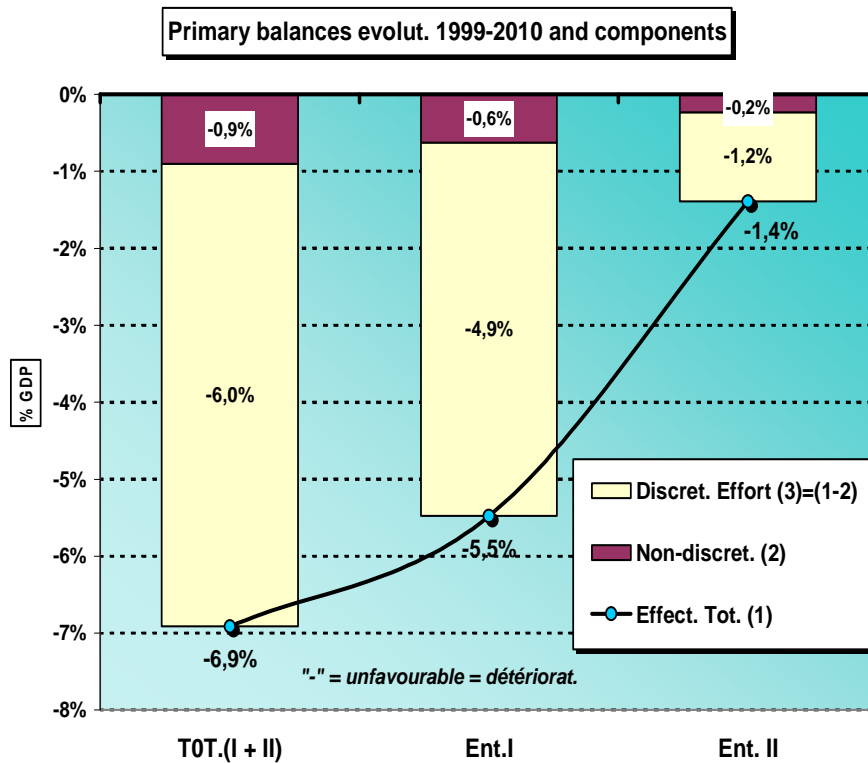
Invest. cycle of the Local authorities (LA)



Explicit & Tot. Transf. (fisc.+ budg.) to Ent. II from the Fed. State



### III.3.1.- Structural (corrected) PB evolut. globally and by Entity – Look at the 1999-2010 pertiod.





### III.3.2. - The period 1999-2010 - Comments

- Very expansionary fiscal and budgetary policy (-6% GDP), specially at Entity I level (80% of the total), and on the revenue side (incl. revenue or tax reliefs recorded in NA as wage subsidies)
- The expansionary policy at Entity II level (1,2% GDP) was partially made possible by the refinancing laws of 2001-2002.
- Deficit crept from 1% GDP in 2008 to 5,6% in 2009 and stayed above 3,5% GDP in 2010-11. The policy failure to get to structural surplusses and so to prefinance partially the coming ageing costs was not a problem of coordination but of a global too expansionary fiscal stance.

### III.4.1. The consolidation phase 2010-2013.

- So, given the deficit of 2009 and high debt ratio, there was an EDP procedure opened end 2009 with the recommendation to bring the deficit under the 3% ceiling in 2012, with structural yearly improvements of 0,75% GDP per year, and then to respect the MTO.
- The difficult political question was then about vertical burden-sharing for the next phase (post-2010), in a context of much lower expected potential growth, rapidly soaring ageing costs, and some competitiveness problems.
- The objectives were not attained in 2012 in effective and structural terms but should be met in 2013 on actual informations.

### III.4.2. - The difficult transitory phase – The context

- *Mehodology of the HCF* – Normative deficit targets for each big Entity (balance on the cycle for LA) on basis of *primary effort allocation with a « 65% / 35% » PE key*.
- Then concertation in Interministerial Conference and Concertation Committee to attribute specific budget balances targets to each federated entity or Community and Region. Internal Cooperation agreements.
- No explicit PE growth norms (budgetary autonomy of each C&R or federated entity)

### III.4.3. – Somme assessment of FPE real growth

<b>Structural Prim. Expendit.</b> % average real growth	2001-07 a	2007-10 b	2010-13 c	Diff. d=b-c	2005-09 e	2009-13 f	Diff g=f-e
Total Publ. Administr.	2,7%	2,8%	1,3%	-1,5%	2,7%	1,4%	-1,2%
* Social benefits	2,5%	3,1%	2,1%	-1,0%	2,9%	2,0%	-0,9%
* Other (non-ageing)	2,9%	2,5%	0,3%	-2,2%	2,4%	0,8%	-1,7%
+ Current	3,2%	2,6%	0,4%	-2,2%	2,5%	1,0%	-1,5%
+ Capital, adj.	1,3%	2,2%	0,0%	-2,2%	2,3%	-0,7%	-3,0%
Entity I - final	2,8%	3,1%	1,5%	-1,6%	3,0%	1,6%	-1,3%
* Social benefits	2,5%	3,1%	2,0%	-1,1%	2,9%	2,1%	-0,8%
* Other	3,8%	3,0%	-0,2%	-3,2%	3,5%	0,3%	-3,2%
pm. Netto budget. Transf. >. II.	6,6%	3,5%	3,2%	-0,3%	1,6%	3,4%	1,9%
pm. Total prim. Expendit. Entity I	2,9%	3,1%	1,6%	-1,6%	2,9%	1,7%	-1,2%
Entity II - final	2,5%	2,2%	0,8%	-1,4%	2,2%	1,1%	-1,1%
* Wages & interm. Cons.	2,3%	1,9%	1,1%	-0,8%	2,2%	1,2%	-1,0%
* Social benefits, transf. etc.	4,5%	3,5%	1,0%	-2,5%	3,6%	1,9%	-1,7%
* Capital, adj	0,7%	1,9%	-1,3%	-3,2%	-0,1%	-0,8%	-0,7%
* C&R (final)	2,9%	2,3%	0,4%	-2,0%	2,3%	0,7%	-1,5%
* Local Author. - Final	2,0%	2,1%	1,4%	-0,6%	1,9%	1,7%	-0,2%
pm. Real GDP	2,1%	0,1%	0,6%	0,5%	0,9%	1,0%	0,1%
pm. Real, Potential GDP	1,8%	1,3%	0,9%	-0,4%	1,5%	1,0%	-0,6%
pm. Real PE - Pot. GDP Growth	0,9%	1,5%	0,4%	-1,2%	1,2%	0,5%	-0,7%

### III.4.4. - Consolidation paths & PE evolutions

- A look at recent FPE evolutions in 2010-13 versus 2007-10: sharp slowing down of real growth (-1,5%), especially in non-ageing PE (-2%). Rather evenly divided between the two Entities (-1,6% & -1,4%), to a lesser extent inside Entity II in the LA (slowing of 0,6%, compared with 2% for the C&R). Sharpest slowdown for non-ageing expenditure at Entity I level (-3,2%), with a real annual reduction of 0,2%.
- But also slowing down of estimated average potential growth, so the PE real growth differential, even if reduced in 2010-2013, was still positive (+0,4%).
- So the real structural PE ratio was still rising, but at a much slower pace. And not any more during the last two years (2012-13).

## IV.1. - New challenges in the context of the european budgetary governance and the new State reform

Analysis of the HCF in 2010-2011 (before the state reform):

- Arising conflict between two competing criteria:
- 1) vertical « fair » (proportional) burden-sharing and
- 2) individual or sub-level sustainability (horizontal)
- First criteria (65% / 35% repartition key) leads to diverging budgetary goals and debt or assets accumulation between the 2 Entities & inside Entity II. Not compatible with disaggregated sustainability criteria.
- Second criteria (LT sustainability), with balanced budgets for Entity II and each sublevel, and structural surpluses for Entity I, led to uneven burden sharing, and possibly uneconomic and inefficient or growth unfriendly policy choices.

## IV.2. - Consolidation criteria - Next

- So, given the opportunity of the incoming State reform and new financing laws, the recommendation of the HCF was to underfund the devolution of the new budgetary competences and so to provide a consolidation contribution by the C&R of up to maximum 1% GDP
- The FPB recently estimated that a netto burden transfer to the C&R of about 0,6 of GDP was integrated in the new financing system. With the new state reform and financing mechanisms, the two criteria could hopefully be partially reconciled.

## IV.3 - New challenges in the context of the coming State reform

- The institutional framework is being reinforced (HCF, Concertation Committee of Ministers of Budget and Finance, new internal Cooperation agreement of dec. 2013, etc.)
- Focus this year on the LA where there has been slippage and could be problems in the pipeline
- Dangers also at the Entity I level for the year 2015 & later, with a huge consolidation effort still to be made (very probably more than proportional, because of ageing costs).
- Implementation of budget targeting in structural and nominal terms at the sub-government level. New normative framework from 2015 on in being prepared by the HCF.