



DG ECFIN WORKSHOP : “Medium-term challenges for the Belgian economy”

The Current Institutional Setup of Belgium : Bonus or Handicap for the Economy ?

By Prof. Giuseppe PAGANO

Introduction

Three questions

conomic growth and efficiency

Size of government and fiscal consolidation

Solidarity and convergence

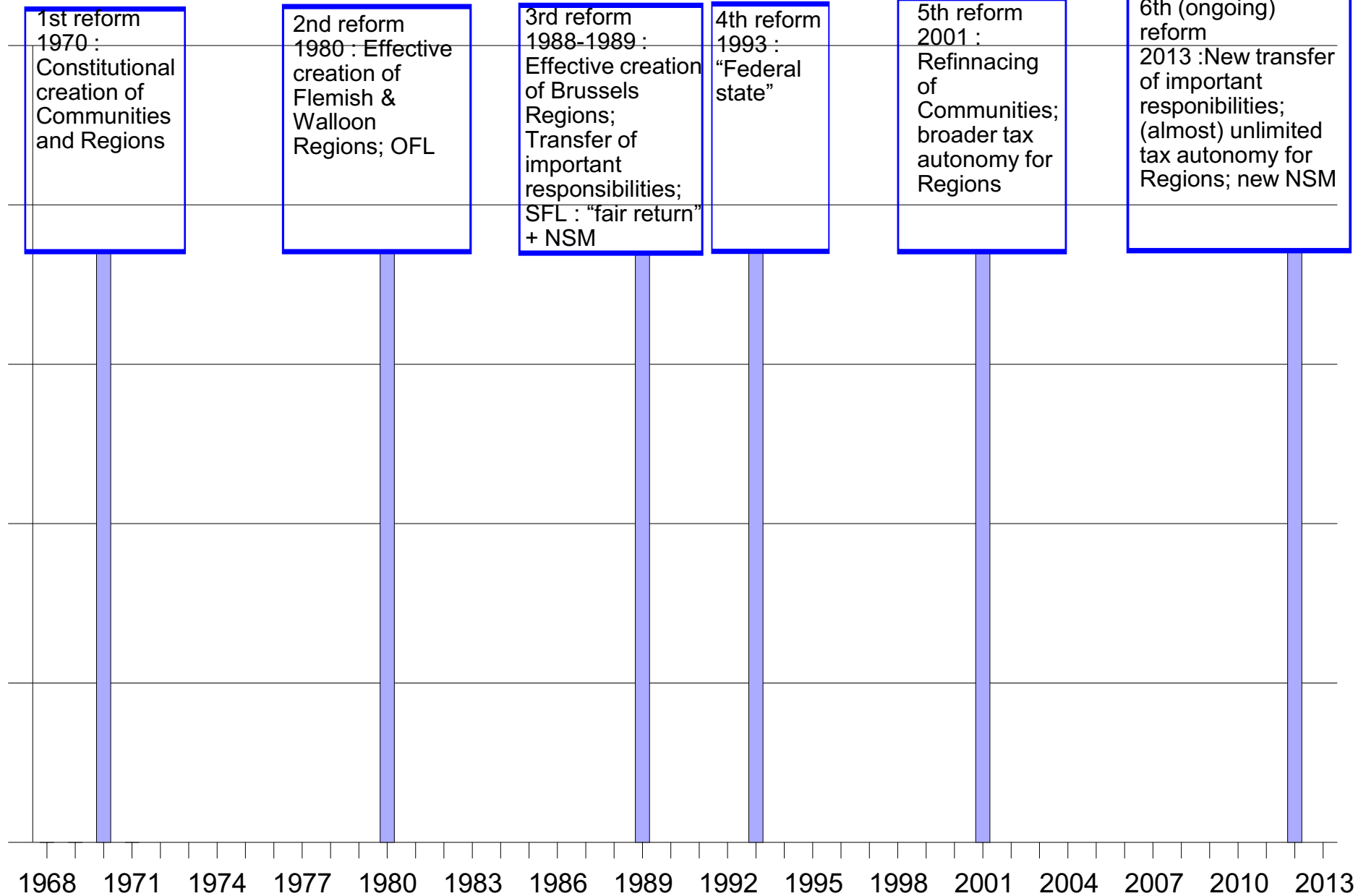
Conclusion

Introduction

Const. Art. 1 : *Belgium is a federal state composed of Communities and Regions* (1993)

“Double layer” or “twofold” system

Decentralization process : 6 stages



Introduction

Responsibilities of Communities	Regions
Education Culture (broadcasting) Preventive side of health care Personal matters	Economy Research Infrastructures Transport Local authorities Employment (training) Airports Town planning Environment Water & energy Agriculture

Introduction

Three questions

Three questions

Economic growth & efficiency

Size of government and fiscal consolidation

Solidarity and convergence

Introduction

Three questions

conomic growth and efficiency

Economic growth and efficiency

Why decentralization fosters efficiency and economic growth

Reduces cost of information

Makes choice possible (Tiebout)

Makes benchmarking possible

Makes tailored policies possible when preferences differ (Oates - 1972)

Economic growth and efficiency

Why decentralization curb efficiency and economic growth

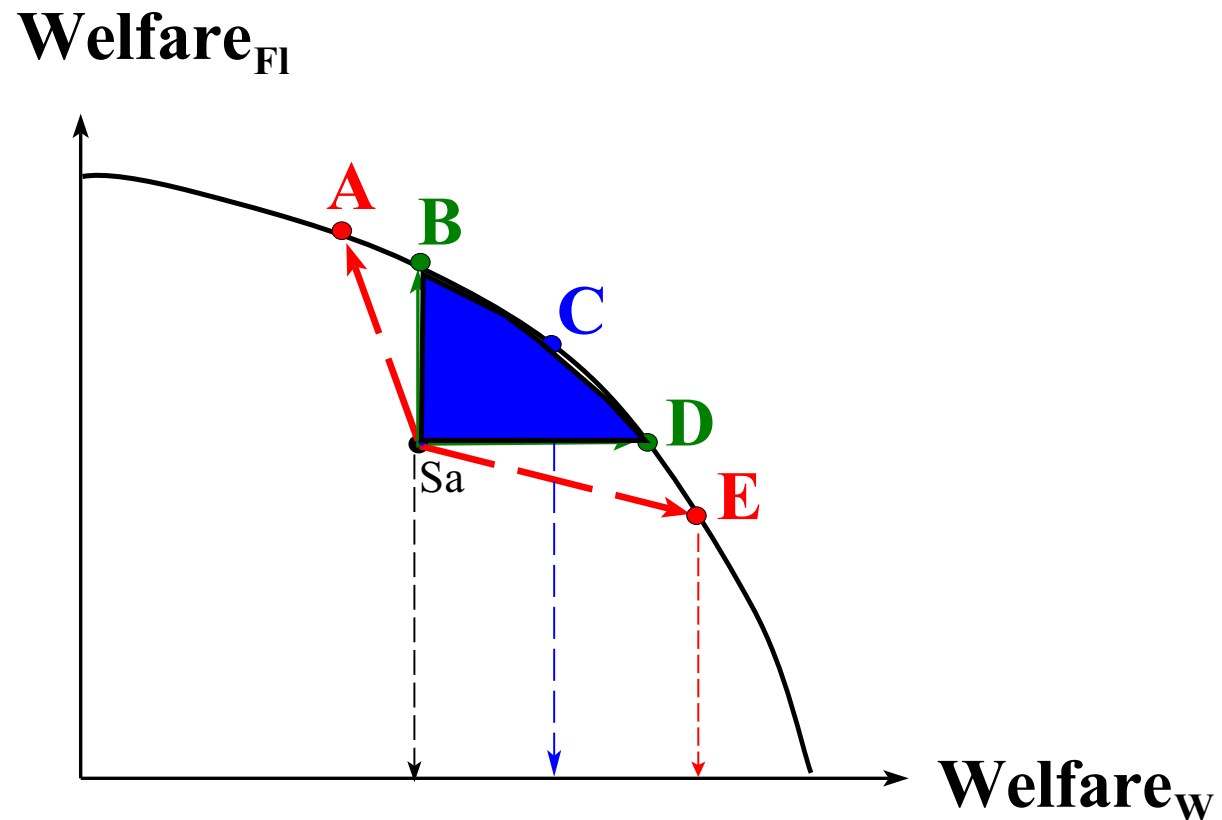
Economies of scale or (increasing returns)

Makes structure more complicated

Spillover & tax export

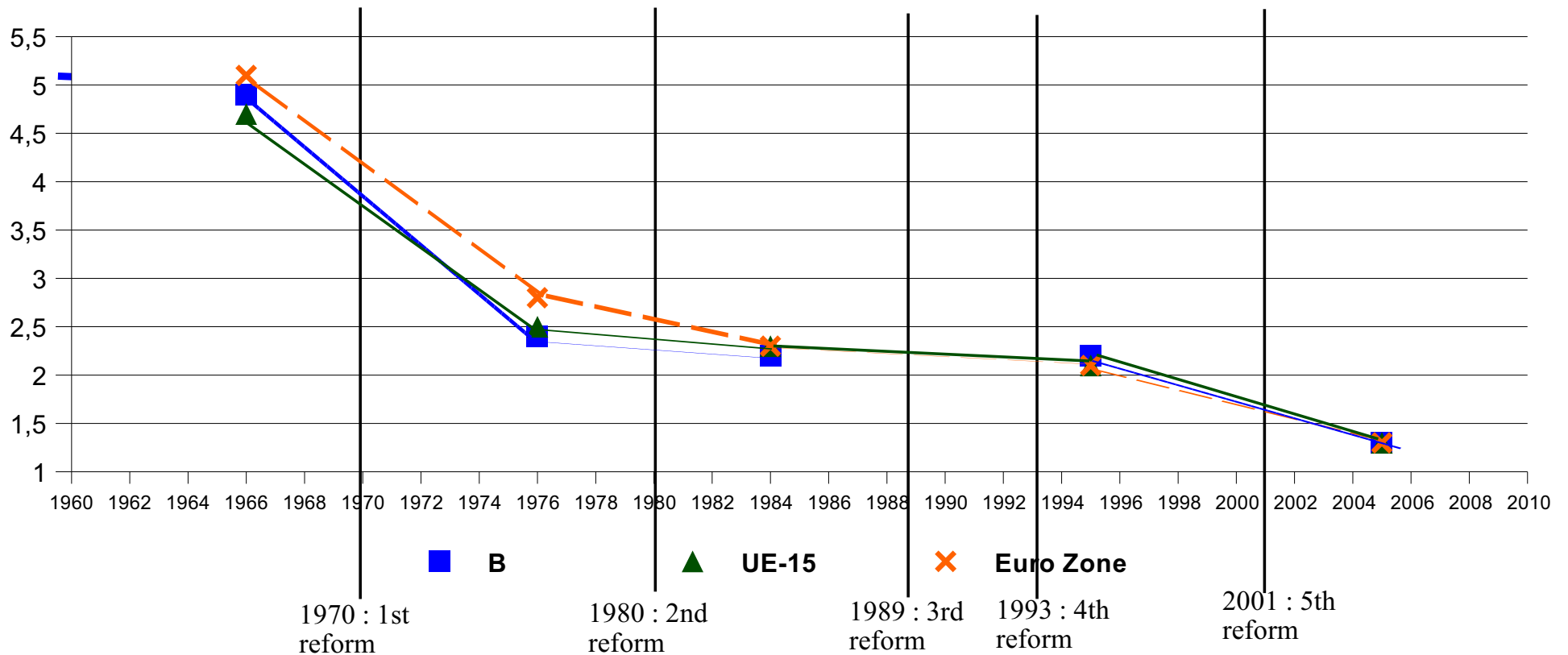
Economic growth and efficiency

Citizens' welfare can be improved by implementing the optimal level of centralization / decentralization



Economic growth and efficiency

Did decentralization in Belgium have an impact on growth ?



Did decentralization in Belgium have an impact on growth ?

Test : $G_B = f(G_{UE} + \text{Decentralization})$

Linear regressions								
Indep. Var.	β	Sig	Indep. Var.	β	Sig	Indep. Var.	β	Sig
OECD	0.745	0.000	UE	0.858	0.000	EZ	0.095	0.000
							7	
Period	0.006	0.961	Period	-0.040	0.634	Period	0.048	0.542

Did decentralization in Belgium have an impact on growth ?

Decentralization in Belgium seems to have had little influence on overall economic growth. Between 1960 and 2010, Belgium has followed the global trend of OECD and EU towards reduced growth rates and there is no indication in data analysis that the reduction of the growth rates could have been in Belgium more or less significant than it has been elsewhere.

Small open country (export = 80 % of GDP), sensitive to the economic cycle of its partner's

Belgian decentralization process also pursued non economic goals :

**culture and language diversity,
political stability**

successfully

Introduction

Three questions

Economic growth and efficiency

Size of government and fiscal consolidation

(1) Size of government

Size of government and budget consolidation

Why decentralization can increase the size of government

Multiplication of administrative bodies (two layer system)

Diseconomies of scale

Size of government and budget consolidation

Why decentralization can reduce the size of government

Competition among federate entities

Avoid “*Waffle-iron policy*”

Size of government and budget consolidation



Automatically produces two waffles even when only one is needed or wanted

Size of government and budget consolidation

Did decentralization rather increase or reduce the size of government in Belgium ?

Test : $PE_B = f(PE_{UE} + \text{Decentralizat.})$

Linear regressions

Indep. Var.	β	Sig	Indep. Var.	β	Sig	Indep. Var.	β	Sig
OECD	1.971	0.000	UE	1.506	0.000	EZ	0.767	0.000
Period	-1.890	0.000	Period	-1.222	0.000	Period	-0.728	0.000

Size of government and budget consolidation

Did decentralization rather increase or reduce the size of government in Belgium ?

There is a strong indication that decentralization in Belgium at least did not hamper the reduction of the size of overall government, or even may have fostered it.

Introduction

Three questions

Economic growth and efficiency

Size of government and fiscal consolidation

(1) Size of government

(2) Deficit

Size of government and budget consolidation

Reducing the size of government generally implies reducing the deficit; What in Belgium ?

Test : $BB_B = f(BB_{UE} + \text{Decentralizat.})$

Linear regressions								
Indep. Var.	β	Sig	Indep. Var.	β	Sig	Indep. Var.	β	Sig
OECD	1.972	0.000	UE	1.237	0.000	EZ	0.954	0.000
Period	2.091	0.000	Period	1.638	0.000	Period	1.680	0.000

Size of government and budget consolidation

Did decentralization play a positive role in the reduction of the deficit ?

There is a strong indication that decentralization in Belgium at least did not hamper the reduction of the deficit, or even may have fostered it. This conclusion is coherent with the the preceding one.

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Introduction

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Economic growth and efficiency

Size of government and fiscal consolidation

(1) Size of government

(2) Deficit

(3) Public Debt

Size of government and budget consolidation

The impact of decentralization on the level of public debt is probably of indirect nature : through deficit

Size of government and budget consolidation

Did decentralization in Belgium play a positive role in the reduction of the debt ratio ?

Test : $PD_B = f(PD_{UE} + \text{Decentralizat.})$

Linear regressions

Indep. Var.	β	Sig	Indep. Var.	β	Sig	Indep. Var.	β	Sig
USA ¹	0.518	0.119	UE	0.419	0.051	EZ	0.405	0.109
Period	3.346	0.342	Period	-22.063	0.000	Period	-24.806	0.000

Size of government and budget consolidation

Did decentralization play a positive role in the reduction of the debt ratio ?

Globally, there remains a strong indication that decentralization in Belgium at least did not hamper the reduction of the public debt, or even may have fostered it. This conclusion is coherent with the one of the preceding sections.

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Three questions

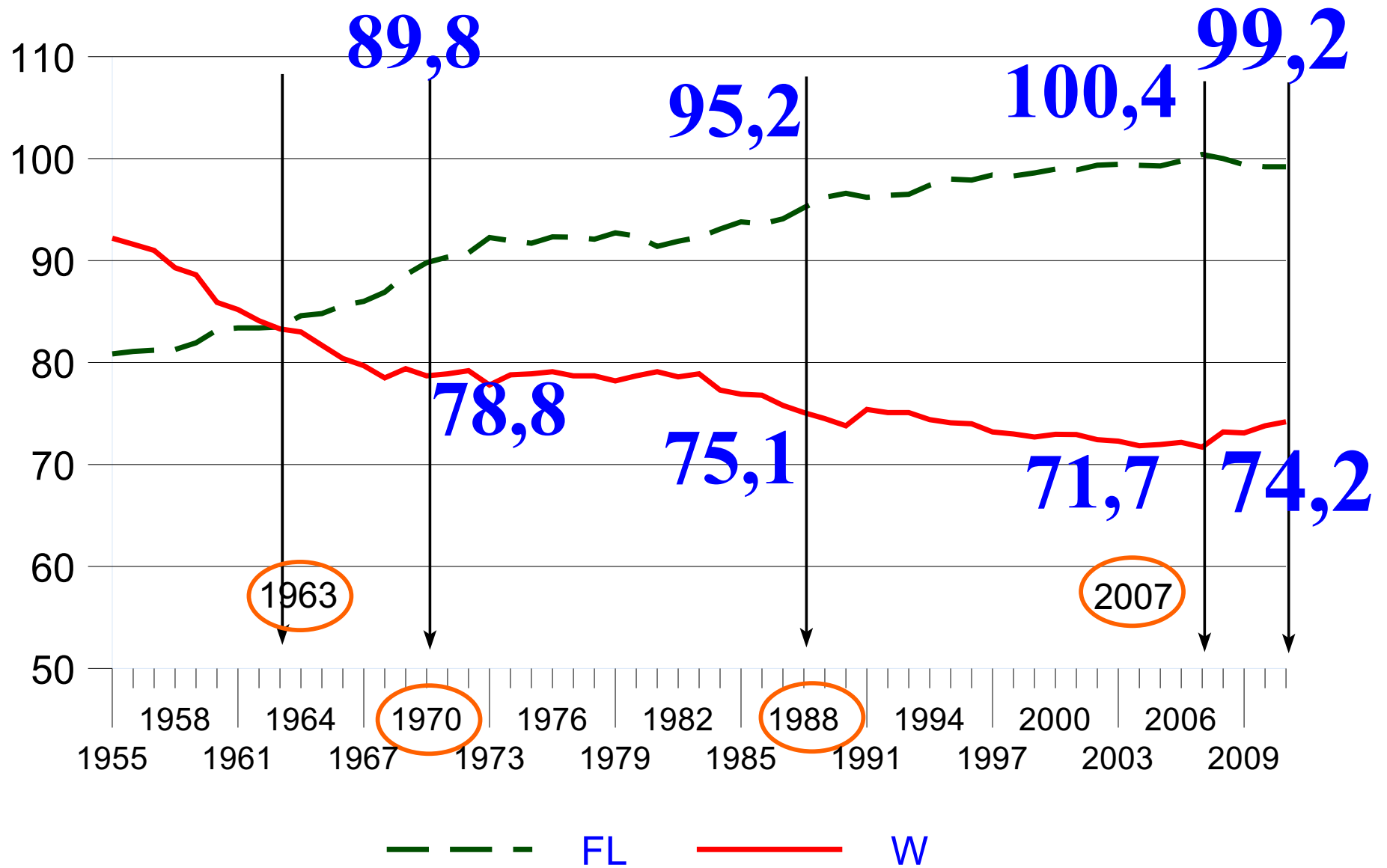
Economic growth and efficiency

Size of government and fiscal consolidation

Solidarity and convergence

(1) Solidarity

GDP per capita; indices : Belgium = 100



Impact of “*fair return*” (Milliard Bef of 1989 or %)

eg	Cost of Resp.	IT share (%)	“F R”	Diff.
FI	121.1	58.57	137.5	+16.3
W	87.3	30.07	70.6	-16.7
Brus	26.3	11.36	26.7	+ 0.4
Tot	234.7	100.0	234.7	0.0

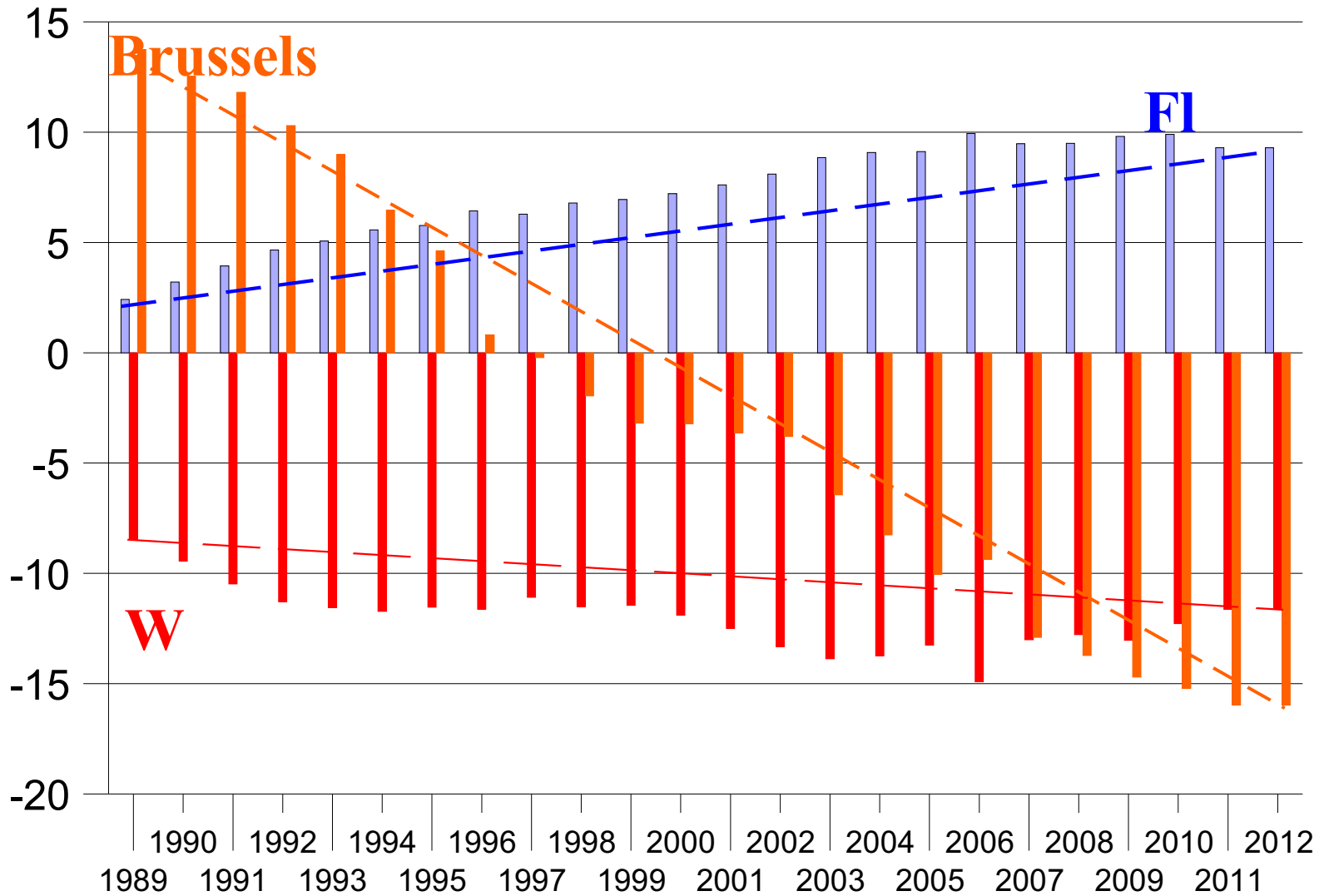
Solidarity and convergence

The SFL of 1989 is based on the principle of “fair return” but also sets out a NSM

$$468 \text{ Bef indexed } \times \text{Pop}_R \times \left(\frac{\frac{IT_B}{\text{Pop}_B} - \frac{IT_R}{\text{Pop}_R}}{\frac{IT_B}{\text{Pop}_B}} \right) \times 100$$

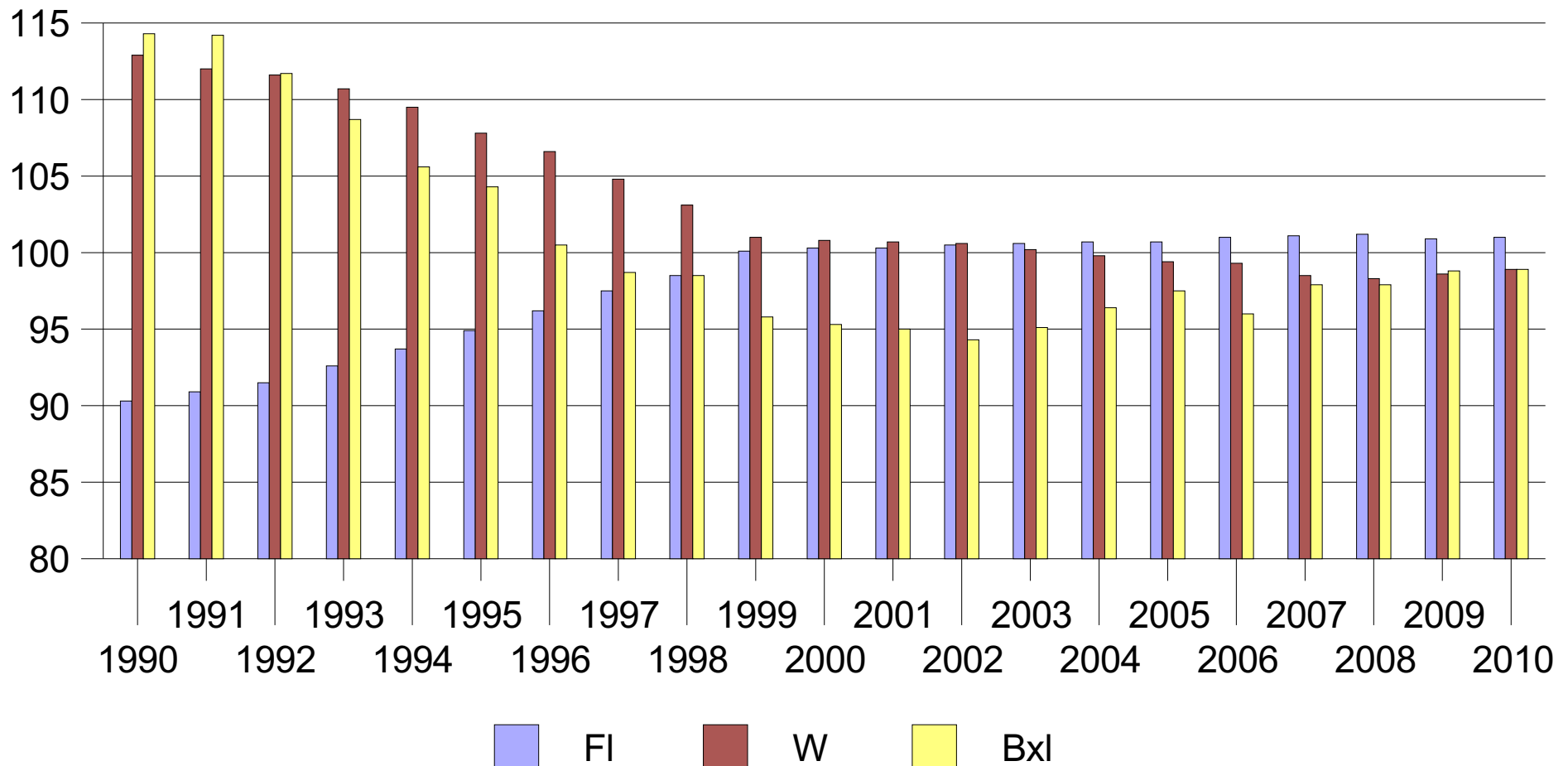
Solidarity and convergence

Fiscal capacity



Solidarity and convergence

Equalization and paradox of revenue



Solidarity and convergence

Poverty trap

Fair return and NSM have opposite effects; which one is strongest ?

Solidarity and convergence

Poverty trap

	Walloon Region	Flemish Region	Brussels Region	Federal state
		Increase of Walloon IT		
NSM	- 41,3	0	4,8	
Fair return	27	- 23,9	- 3,2	
Total	- 14,2	- 23,9	1,7	136,5
		Increase of Flemish IT		
NSM	16,2	0	4,8	
Fair return	- 10,6	13,8	- 3,2	
Total	5,6	13,8	1,7	79
		Increase of Brussels IT		
NSM	16,1	0	- 52,6	
Fair return	- 10,6	- 23,9	34,5	
Total	5,5	- 23,9	- 18,2	136,5

Source : Pagano G. et Vandermoot J. (2010).

Solidarity and convergence

Poverty trap

Is real but has to be tempered :

- does not exist if Communities are included,
- is slowly diminishing
- disappears with the 6th reform

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(1) Solidarity

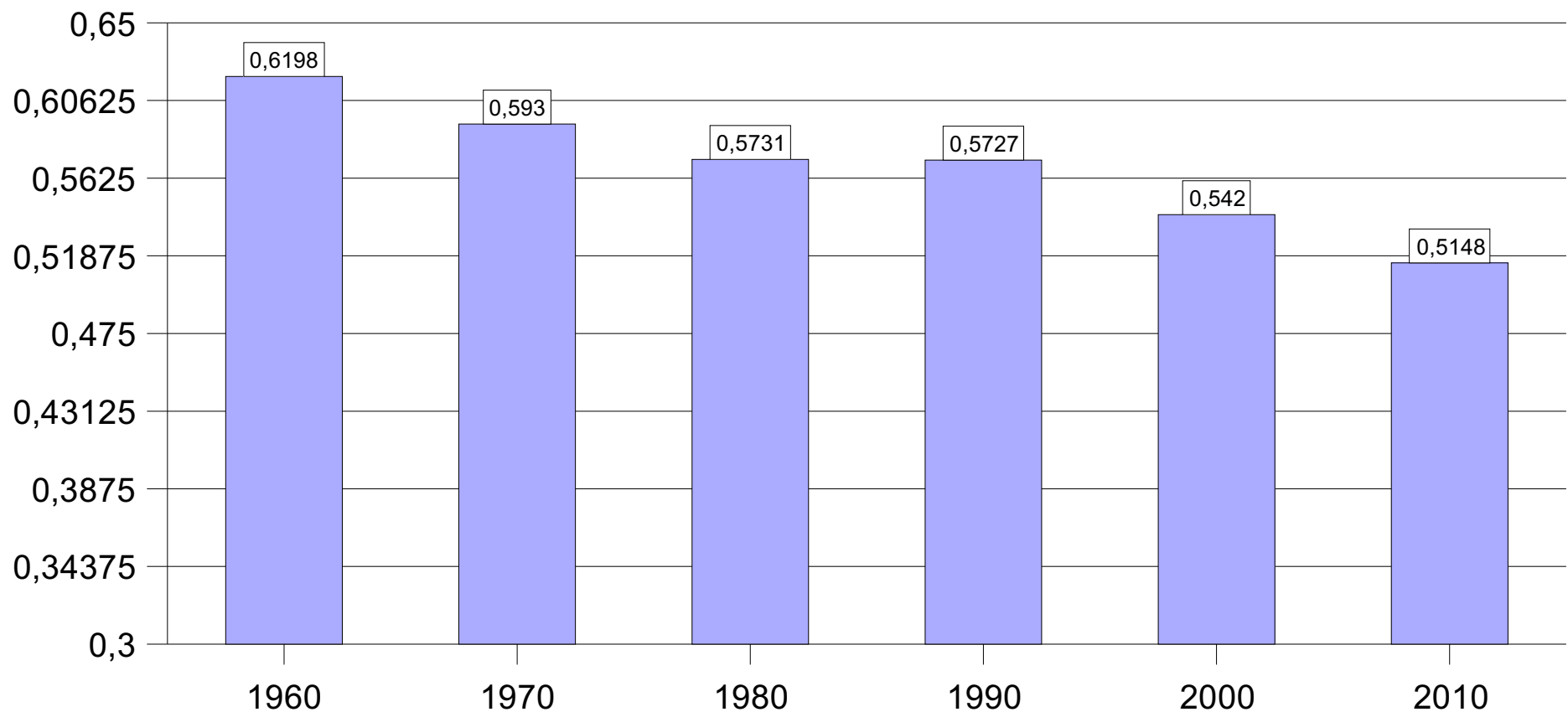
(2) Convergence

Solidarity and convergence

Did the Regions of Belgium rather convergence or diverge through the decentralization process ?

Solidarity and convergence

Standard deviations (/ means) of GDP per capita



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Solidarity and convergence

Conclusion

Conclusion

Decentralization in Belgium ...

1. Has probably not had any noticeable impact on growth
2. Has been efficient in preserving culture and language diversity and in preserving (to some extent) political stability (at least, at this stage; for the future, see your crystal ball...

Conclusion

Decentralization in Belgium ...

3. Has probably had a positive impact on reducing the size of government, the deficit and the debt

4. Had been associated with a strong solidarity mechanism bringing about to large equalization of revenue per capita

Conclusion

Decentralization in Belgium ...

5. Has been associated with a rather convergent evolution of GDP per capita

Thus... globally rather bonus than handicap for the Belgian society.



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Thank you very much...