

# **The current institutional setup of Belgium: bonus or handicap?**

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# Introduction

- Generally empirical research for OECD countries has found beneficial effects of fiscal decentralisation on fiscal management
- But empirical research on the fiscal effects of Belgian fiscal federalism/decentralization is still **scarce**
- The paper is a brave exception, plus it finds “strong indication” in favour of beneficial fiscal effects for Belgium

# Methodology: regression analysis

Too limited to warrant any conclusions?

- Only some 40 observations
- With **time dummy** that is supposed to capture successive rounds of fiscal decentralization
- But:
  - could in fact capture many other variables
  - e.g. the **strengthening of the grip of the EU** on Belgian fiscal policy over time
  - besides not always significant

# Arguments for scepticism...

- Generally empirical research for OECD countries has found *harmful* effects of *grants-based* fiscal decentralisation on fiscal management
- These findings cast doubt on possibly beneficial effects of fiscal decentralisation in Belgium
- Next: a brief literature overview + some anecdotal evidence for Belgium

# 1. Not sure if Belgian fiscal decentralization has **decreased public expenditures / size of government...**

(1)

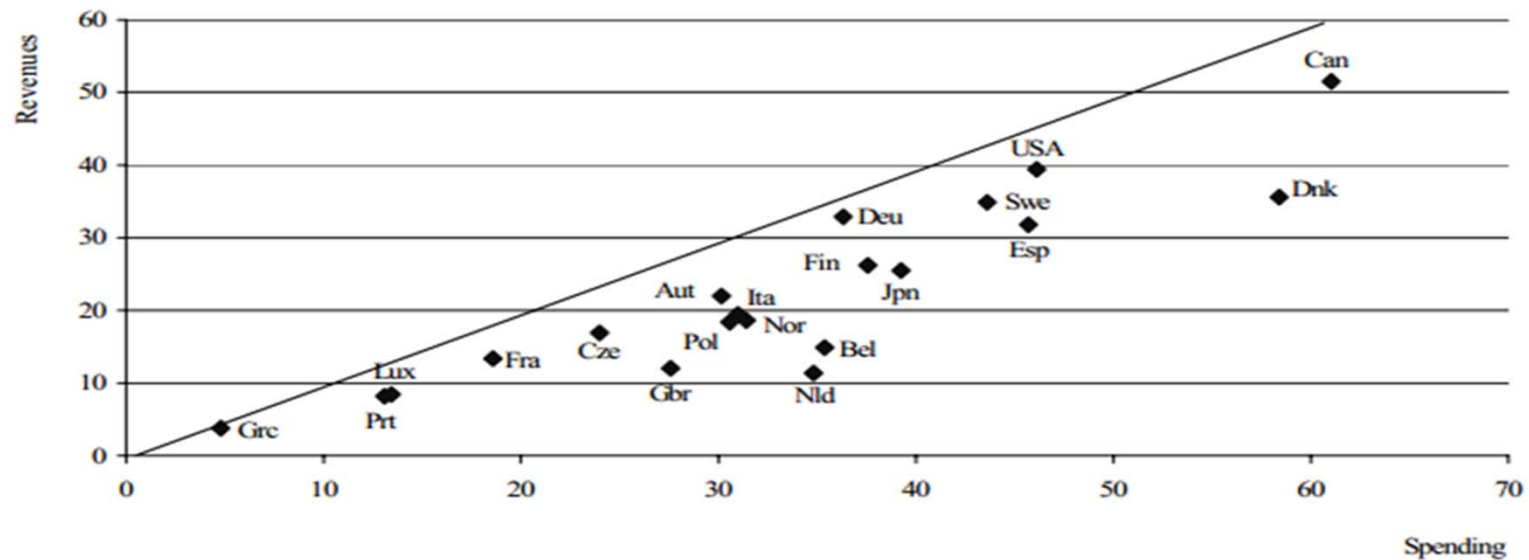
**Vertical fiscal gap** in Belgium is one of the highest in the OECD:

- even after 2001 reform only about 20% of expenditures of Regions and Communities were financed by own taxes (32% after 2013 reform)
- ...

# Vertical fiscal gap in OECD-countries

(Blöchliger and King 2006)

Figure 1. Decentralisation ratios in OECD countries, 2004



Source: National Accounts of OECD countries, 2005

# Share of the “states” in total expenditure and revenue, and resulting VFG (%)

(federal OECD countries + Spain)

	Share in total spending (1)		Share in total revenue (2)		Vertical fiscal gap (1) - (2)	
	1995	2006	1995	2006	1995	2006
Australia						
Austria	13	15	14	15	-1	0
<b>Belgium</b>	<b>21</b>	<b>24</b>	<b>5</b>	<b>9</b>	<b>15</b>	<b>15</b>
Canada	40	45	42	43	-2	2
Germany	19	22	24	24	-5	-2
Spain	22	36	7	24	14	12
Switzerland	31	34	28	28	3	5
United States*	43	45	38	38	5	7
* states + local government						
PM: resp. shares of local govt in Belgium in expenditures and revenue: 12 and 14, and 8 and 7						
Source: Leibfritz 2009						

# 1. Not sure if Belgian fiscal decentralization has **decreased public expenditures / size of government...**

(2)

**Vertical fiscal gap** in Belgium is one of the highest in the OECD:

- even after 2001 reform only about 20% of expenditures of Regions and Communities were financed by own taxes (32% after 2013 reform)
- **flypaper effect**: subcentral expenditures are substantially higher when financed with grants rather than with own taxes (e.g. Inman 2008, Dahlberg 2008, IMF 2013)
- e.g. NBB (2008) found education expenditures by the French Community to be “(very) inefficient”



## 2. Not sure if Belgian fiscal decentralization has **improved budget balance...**

- **Soft budget constraint** = moral hazard = when expectation of extra grants increases the budget deficit:
  - grants-based federalism leads to higher subcentral (or overall) budget deficits (OECD: Asatryan e.a. 2012; EU: DG Ecfm 2012; Germany: Baskaran 2012; Spain: Sorribas-Navarro 2011)
- Revisions of the major Belgian fiscal federalism law (SFA) have included:
  - 1993 and 2001: **extra grants** in view of education expenditures of the French Community
  - 2001 and 2013: **extra grants** for the Brussels Region
  - Bordignon and Turati (2009): **bail-outs may well happen ex ante**, instead of ex post
  - Inman (2003): bail-out can be subsidy either for previous or for **current** period spending
- Boadway (2009 handbook of fiscal federalism): overall fiscal discipline in Canada by means of:
  - high subcentral **tax autonomy**
  - **no periodic increases of transfers** to subcentral governments

### 3. Not sure if Belgian fiscal decentralization has **increased economic growth...**

#### **Moral hazard + common pool problem :**

- much of economic policy is subcentral (education, infrastructure, ...)
- but social security is federal
- hence, if subcentral growth policies fail, federal govt pays
- Algoed & Persyn (2009): interregional fiscal transfers –in EU mostly through social security- are bad for economic convergence

# Conclusion

- Fiscal decentralization in Belgium has to be understood with a political logic
- **Major** aims do **not** seem to have been economic growth, expenditure efficiency, or budget balance
- International literature tends to agree that fiscal decentralization is generally beneficial to fiscal management **if sufficiently tax-based**
- Answer for Belgium may be: not **less** but **different** fiscal decentralisation

# References

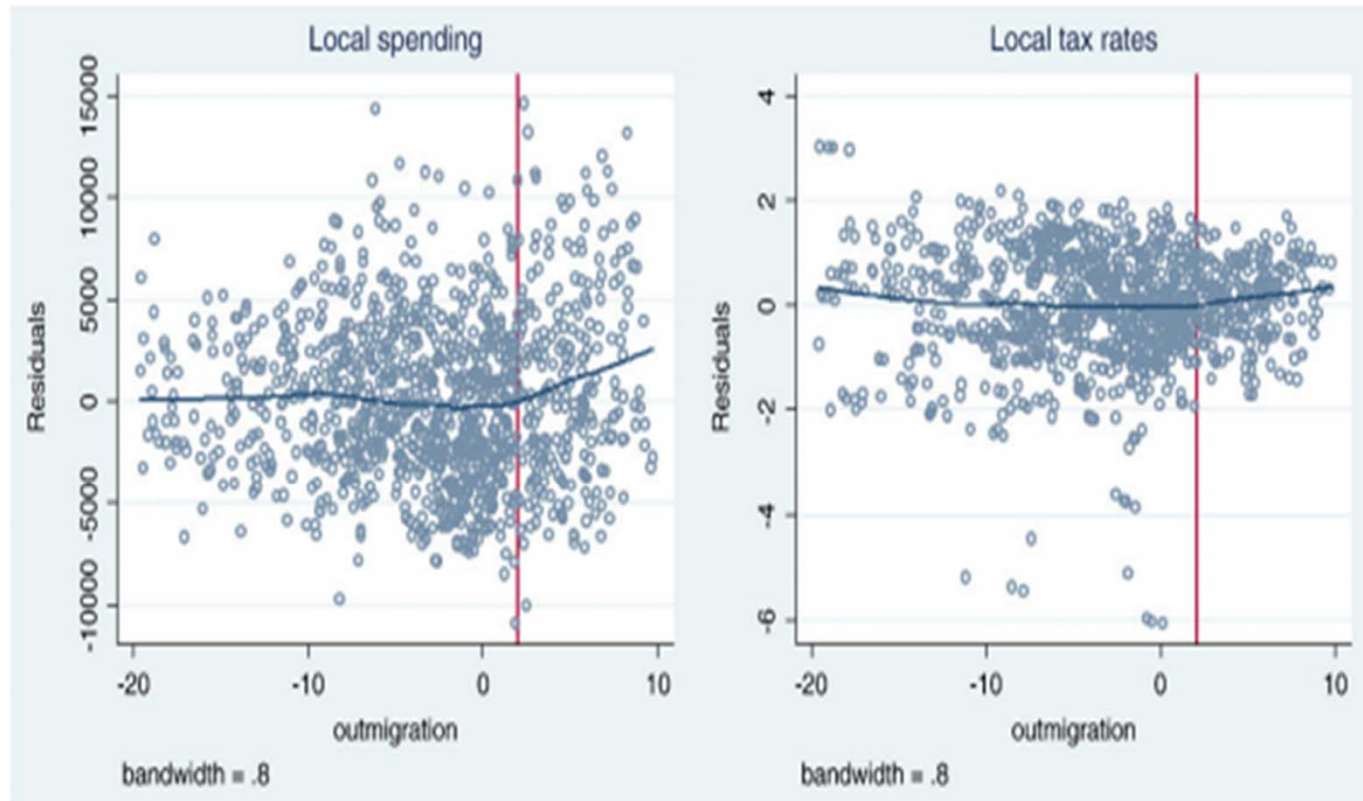
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# The flypaper effect

(Swedish outmigration grants are fully spent)

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# Budget balances of Belgian Regions and Communities (euros per capita, 1996-2011)

